



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

March 4, 1999

CC:DOM:FS:IT&A

Number: **199924071**

Release Date: 6/18/1999
UILC: 172.07-00

INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR:

FROM: ASSISTANT CHIEF COUNSEL (FIELD SERVICE) CC:DOM:FS

SUBJECT:

This Field Service Advice responds to your request dated December 2, 1998. It is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND:

Taxpayer	=
Year 1	= 1
Year 2	= 1
Year 3	= 1
Year 4	= 1
Year 5	= 1
Year 6	= 1

ISSUE:

Whether certain state taxes and interest on taxes are specified liability losses within the meaning of section 172(f)(1) and, therefore, eligible for a ten-year net operating loss carryback period rather than the generally applicable three-year period in effect for the years at issue.

CONCLUSION:

The taxes and interest expenses in issue do not qualify for the ten-year carryback for specified liability losses under section 172(f).

FACTS:

The following factual summary is adopted from your incoming request memorandum. We only recite herein the matters which are pertinent to the taxes and interest issues upon which we are rendering advice. See fn. 1, infra.

For the taxable years in issue, Year 1 through Year 6, Taxpayer was the parent company of a consolidated group of corporations filing its returns on the accrual basis. As your request memorandum states, specific facts have not been developed regarding the separate income and deductions items for each of the subsidiaries. Taxpayer filed Forms 1120X claims for refund for the taxable years in issue. Eventually, however, Taxpayer withdrew its claims for Years 4, 5, and 6; but, taxpayer noted its intent to refile those claims.

Taxpayer claimed deductions for the payment of both uncontested and contested state tax liabilities as well as interest on deficiencies. The contested deficiencies were ultimately agreed to and paid by Taxpayer. Those payments occurred—apparently in each instance—more than three years after the actual tax liability arose. In addition, Taxpayer also claimed deduction for interest paid to the Service on a federal income tax deficiency for a taxable year that was at least three years prior to the one of the years in issue, i.e., Year 3.

LAW AND ANALYSIS:

Section 172(f) presents a more narrow exception to the general carryback rule than has been asserted by this taxpayer. The specified liability loss exception is much more severely limited than that which would be extant under a supposed “plain meaning” reading of the section’s elements. That correct narrower reading is based upon our interpretation of the scant legislative history as well as the statutory and practical context within which this relief provision was first adopted by Congress. Given that backdrop, at least prospectively, Congress recently clarified the scope of the section. See Tax and Trade Relief Extension Act of 1998, § 3004, reprinted in CONG. REC. H11287 (daily ed. Oct. 19, 1998). Yet, the new statute is only effective for tax years ending after enactment; thus, we are still confronted by the problem of application in any earlier years under examination. Nevertheless, our position with respect to the eligibility of the state taxes and interest issues presented in this case would not be affected by that clarifying

amendment. Under either the former or new provision, these deductions are still outside the scope of specified liability losses.

As you are aware, the only Tax Court opinion to address the relevant portions of section 172(f) to date is Sealy Corp. v. Commissioner, 107 T.C. 177 (1996), appeal docketed, No. 98-70369, et seq. (9th Cir. March 31, 1998). Sealy set out a very narrow reading of the section; nevertheless, the opinion did not address all aspects of numerous current arguments in this area. The case does, however, provide a Service-favorable starting point for any discussion of the litigation risks involved in this area.

A recent Tax Court case, Internet Corp. v. Commissioner, 111 T.C. No. 16 (filed December 8, 1998), presented the issue of whether state taxes and interest on state and federal taxes qualify as specified liability losses. We argued therein that those expenditures are ineligible for the ten-year carryback under section 172(f). Unfortunately, the court's opinion did not reach this issue; rather, the case was resolved in favor of the Commissioner upon what the court saw as the dispositive threshold matter of whether there was a net operating loss under section 172 and the consolidated return regulations (i.e., the "netting" issue). See Treas. Regs. §§ 1.1502-12, 1.1502-21A(f).

That portion of section 172 that provides for a ten-year carryback for deferred statutory or tort liability losses was added to the Code in 1984, when the economic performance rules under section 461(h) were enacted. Deficit Reduction Act of 1984, Pub. L. 98-369, § 91(d). The statutory context, as well as the limited legislative history, indicate that Congress intended the ten-year carryback to apply to only a narrow class of liabilities.

The distinguishing feature of those liabilities within the eligible narrow class is an element of delay in the timing of the deduction that is inherent in the nature of the deduction itself. For example, arguably, land used for mining purposes cannot be reclaimed environmentally during the time which it is actually being mined. Accordingly, there is an inherent delay of the deduction for reclamation expenses to later years.

Taxpayer claims specified liability loss treatment for contested state tax payments. The contested v. uncontested aspect of the payments is of no moment in our determination, merely delaying payment--whether through contesting the liability or other "extraneous" means--is inadequate to support section 172(f) applicability. In Internet, supra, we argued that the state tax liabilities at issue do not have that inherent delay nature; consequently, taxes are not within that narrow class of expenses that are eligible for the ten-year carryback. As stated in our Internet briefs, Congress did not intend the special carryback rule to apply to all liabilities for which a deduction is delayed by the economic performance rules. If merely routine costs--which surely includes state income taxes and interest--were

within the eligible class, then simply nonpayment of current liabilities for more than three years would qualify a taxpayer for a ten-year carryback upon the payment of those costs. On the facts presented, that is what appears to have happened here.

CASE DEVELOPMENT, HAZARDS, AND OTHER CONSIDERATIONS:

[REDACTED]

1 [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

In sum, on the basis of the foregoing, as to the state taxes and interest expenses in issue, we conclude that these are not qualified specified liability losses. [REDACTED]

DEBORAH A. BUTLER

By: _____
CLIFFORD M. HARBOURT
Senior Technician Reviewer
Income Tax & Accounting Branch
Field Service Division

