

When Does a Telephone Excise Tax Refund Accrue?

To the Editor:

Since 2006, the IRS has refunded billions of dollars in unlawfully collected federal excise tax on communications (“FET” or “telephone excise tax”) through the refund procedures set forth in IRS Notice 2006-50, and IRS Notice 2007-11.¹ In brief, telephone excise tax refunds are claimed on Form 8913, which is filed as an attachment to a taxpayer’s original or amended 2006 tax return. And in a somewhat unusual procedural maneuver, the Service held the filing window for these claims open from March 15, 2007 (the due date for 2006 corporate tax returns) through July 27, 2012.²

This unusually long filing window highlights the necessity of ensuring that the IRS uses the correct accrual date for an FET refund. Assume, for example, that a taxpayer filed an amended 2006 tax return and refund claim in July 2010, and the claim was examined and partially allowed in July 2012. If the Service assigned a 2006 accrual date to the refund because the claim was made on a 2006 tax return, by the time 2012 rolled around the refund would have been substantially eroded by interest charges on the “underpayment” of tax due on the refund under section 6621 of the code.³

In other words, if the IRS deemed the refund to have accrued in 2006, the taxpayer will be assessed underpayment interest on the tax due on the refund for 2006 through 2011, even though the taxpayer was unaware of whether the refund would be allowed and in what amount, until 2012. Believe it or not, some revenue agents have attempted to do just that.

The taxpayer’s pushback, either at the examination level or appeals, should be that a claim cannot accrue until “all the events have occurred that fix the right to receive the income and the amount

thereof can be determined with reasonable accuracy.”⁴ There is a lot of authority for this proposition.

First, the Instructions for Form 8913 state that taxpayers “must include in gross income in the year received or accrued” both the amount of tax refund claimed and the interest thereon. Second, based on the “all events test” and Revenue Ruling 2003-3, a refund does not accrue as income until the year in which the claim survives an IRS audit and is either fully or partially allowed. In particular, Revenue Ruling 2003-3 held that approval by state authorities of state income and franchise tax refund claims is not ministerial but involves substantive review. Accordingly, the taxpayer accrues the refund of its New York State corporate franchise taxes attributable to a 2001 net operating loss carryback in 2003, the year the taxpayer receives notice that the N.Y. Department has approved the refund claim.

Similarly, ILM 201231011 (June 22, 2012) relies on Revenue Ruling 2003-3 for the proposition that “A business entity that uses an accrual method of accounting generally should report income from a telephone excise tax refund when it receives payment or notice that the request for refund has been approved, whichever is earlier.”

While the window for filing telephone excise tax refunds has closed, this discussion remains of practical importance to taxpayers that have refund claims currently under examination. Moreover, even after an examination has closed, a taxpayer that was victimized by the use of an inappropriately early accrual date can seek redress by filing a Form 843 (Claim for Refund and Request for Abatement) to correct the Service’s error. Finally, the teachings of Revenue Ruling 2003-3 and Counsel Advice Memoranda 201231011 are applicable to fixing the appropriate accrual date for any refund claim that must be examined by the Service.

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May 6, 2013

¹ Notice 2006-50, 2006-25 IRB 1141 (2006); Notice 2007-11, 2007-5 IRB 405 (2007).

² IRS Announcement 2012-16.

³ Internal Revenue Code of 1986, as amended, section 6621.

⁴ Revenue Ruling 2003-3, 2003-2 IRB 252 (2003) (quoting reg. section 1.451-1(a)).