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## AMT

### INSIGHT: Refundable AMT Credits Should Not Be Subject to Sequestration



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The Tax Cuts and Jobs Act of 2017 (TCJA) (Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, 131 Stat. 2054 (2017)) repealed the corporate alternative minimum tax (AMT) and provided for a full refund of a taxpayer's alternative minimum tax credits (MTCs). The TCJA amended tax code Section 53 to return the MTCs to taxpayers in the form of a refundable credit, which is defined as an "overpayment" of tax. Additionally, the refunding formula contained in amended Section 53 provides for a return of 100 percent of the MTCs by 2021, and the legislative history behind the amendments to Section 53 emphasizes that "the **full amount** of the minimum tax credit will be allowed in taxable years beginning before 2022." (H.R. Rep. No. 115-466 at 322-23 (2017) (Conf. Rep.)) (*emphasis added*).

On March 28, 2018, the IRS stated that "[c]orporations claiming refundable credits under Section 168(k) or 53 will be notified that a portion of their requested refund was sequestered." Internal Revenue Service, "Effect of Sequestration on the Alternative Minimum Tax Credit for Corporations" (March 28, 2018). This article presents the argument that sequestering the MTCs is contrary to the statutory framework of Section 53 and the congressional intent behind the changes made to Section 53 by the TCJA. We begin by explaining the changes made to Section 53 by the TCJA, briefly outlining the history of sequestration, and

finally describing why it would be improper for the MTCs to be subject to sequestration pursuant to the Budget Control Act of 2011 (BCA) and how taxpayers can sue to have any sequestered funds returned. (Budget Control Act of 2011, Pub. L. No. 112-25, 125 Stat. 239 (2011)).

#### I. SECTION 53 AS AMENDED BY THE TCJA

SEC. 12002(a) of the TCJA added the following subsection to Section 53:

Subpart C (of Part IV of Subchapter A of Chapter 1), as referenced by Section 53(e)(3), contains a list of the following "Refundable Credits" sections:

- Section 31 - Tax Withheld on Wages
- Section 32 - Earned Income
- Section 33 - Tax Withheld at Source on Nonresident Aliens and Foreign Corporations
- Section 34 - Certain Uses of Gasoline and Special Fuels
- Section 35 - Health Insurance Costs of Eligible Individuals
- Section 36 - First-Time Homebuyer Credit
- Section 36B - Refundable Credit for Coverage Under a Qualified Health Plan
- Section 37 - Overpayments of Tax

We have not located any evidence which indicates that refunds resulting from the application of these sections'

refundable credits have ever been subject to sequestration.

## The MTCs are Defined as Overpayments in the Code

The MTCs described in Section 53(e) are defined as “overpayments” in the tax code by operation of Sections 37 and 6401, and therefore the direct application by the Treasury Secretary of Section 6402 results in a refund of the MTCs.

Section 37, OVERPAYMENTS OF TAX, (*within Subpart C of Part IV of Subchapter A of Chapter 1*) states: “[f]or credit against the tax imposed by this subtitle for overpayments of tax, see section 6401.”

Section 6401(b)(1), AMOUNTS TREATED AS OVERPAYMENTS, Excessive Credits, states:

Section 6402, AUTHORITY TO MAKE CREDITS OR REFUNDS:

Accordingly, pursuant to Section 6402, the Treasury Secretary is required to treat the MTCs as an overpayment of tax and issue a full refund to the taxpayer in the amount of that overpayment.

## II. HISTORY OF SEQUESTRATION

Sequestration was originally introduced as part of the Balanced Budget and Emergency Deficit Control Act of 1985, Pub. L. No. 99-117, 99 Stat. 1037 (1985) (1985 Budget Act), but expired in 2002. The BCA renewed and amended sequestration as it existed in the 1985 Budget Act. The BCA requires the Office of Management and Budget (OMB) to reduce certain categories of direct spending. Refundable tax credits can take two forms, direct spending or reduction of receipts. Tax credits that are deemed direct spending are credits which provide taxpayers with payments in excess of the amount of income tax they have paid. Those credits resemble government spending and are treated as outlays for budget purposes. Refundable tax credits, which only credit taxpayers for taxes previously paid by, or for the account of, a taxpayer, are considered reductions of receipts rather than outlays for budget purposes because there is no equivalency to direct spending. Such refundable credits are exempt from sequestration, not because of a specific statutory exemption, but rather because they are not outlays for budgetary purposes.

Sequestration, as described in the BCA, officially began on March 1, 2013, and is still in effect. (American Tax Payer Relief Act of 2012, Pub. L. No. 112-240, 126 Stat. 2313 (2013)). In 2012, prior to the beginning of sequestration, OMB issued a report pursuant to the Sequestration Transparency Act of 2012, in which it listed those payments that it believed would be exempt from sequestration. (Office of Mgmt. & Budget, Exec. Office of the President, Report Pursuant to the Sequestration Transparency Act of 2012, Pub. L. 112-115, 125 Stat. 1210 (2012)). Notably, that report lists “Payment Where Alternative Minimum Tax Credit Exceeds Liability for Tax” as exempt from sequestration due to its nature as a refundable credit that was not also an outlay for budget purposes.

Government officials shared two considerations said to be taken into account when deciding to exempt a credit from sequestration: (1) the credit is paid to an individual, and (2) the entire payment of the tax and

credit is reconciled in the same tax year. If these two considerations determine, either in whole or in part, the decision of whether to subject a tax credit to sequestration, then these determinations have been inconsistently applied historically. As noted above, refundable credits provided in Sections 32 through 36 have not been subject to sequestration. Refunds resulting from these credits are not solely paid to individuals. For example, Section 33 applies to nonresident aliens **and** foreign corporations. Further, to our knowledge, no credit or refund amounts paid to taxpayers, whether individuals or corporations, as a result of an amended tax return processed in a subsequent tax year, or as a result of the carrying back of a net operating loss, has been subject to sequestration.

Moreover, using the two above considerations as an analytical framework is inconsistent with Congressional intent in the 1985 Budget Act. At the time the 1985 Budget Act was passed, the only refundable credit was the Earned Income Tax Credit (EIC), which is an outlay for budget purposes. Thus, Congress created the explicit statutory exception for refundable credits. The proper interpretation of the statutory language in the 1985 Budget Act is the intent of Congress to avoid the sequestration of a particular type of outlay—the outlay portion of the EIC. The legislative intent to exempt the outlay portion of the EIC should not be read broadly to subject refunds defined as overpayments (not budget outlays) to sequestration.

In addition, as stated above, the statutory language of amended Section 53 and the legislative history indicate an intent to refund all of the MTCs. The refunding formula used in Section 53(e)(2) indicates that Congress intended to apply a percentage of the MTCs over a four year period with 100 percent of Section 53(e) MTCs paid out by 2021. Similarly, the legislative history states that the full amount of the MTC will be allowed before 2022.

## III. SECTION 53(e) MTCs ARE EXEMPT FROM SEQUESTRATION

The payment of refundable credits pursuant to Section 53(e) is not direct spending or an outlay by the government. Rather, it is a repayment of a loan to the government from the taxpayer. As a result, those payments should not be subject to a reduction by sequestration. The Joint Committee on Taxation, in its 1985 report “Tax Reform Proposals: Tax Shelters and Minimum Tax”, stated, “[t]o the extent that the minimum tax is a timing device limiting deferral, it is not meant to increase the total liability of taxpayers who are subject to it . . . Thus, the minimum tax can be seen as requiring an adjustment device, whereby taxpayers receive in subsequent years the benefit of deferral preferences that have resulted in minimum tax liability.” (Staff of J. Comm. on Taxation, 99th Cong., Tax Reform Proposals: Tax Shelters and Minimum Tax (Comm. Print 1985)). The TCJA’s repeal of the corporate AMT regime makes it necessary to return all of the accumulated MTCs. This is consistent with Section 6401(b) treatment of the MTCs as overpayments, which Section 6402 requires the Secretary of the Treasury to pay in full.

While the Section 53(e) MTCs should be exempt from sequestration as a technical matter, tax policy and the intent of the TCJA also mandate such exemption. The

quantum of MTCs used to offset taxable income is not subject to sequestration, while the amount refunded (under OMB's current view) would be sequestered. As a result, two corporate taxpayers with identical MTC balances but differing levels of taxable income over the four-year period may see very different results. One taxpayer with greater taxable income may have fewer (or no) MTCs sequestered, thus potentially realizing the full benefit of the taxpayer's MTCs. The other taxpayer, by comparison, would not realize the full benefit of its MTCs, even though the taxpayer prepaid the same amount of tax into the tax system. Such a result seems in direct conflict with the intent of Section 53(e).

#### **IV. PURSUING THE SEQUESTRATION AMOUNT IN LITIGATION**

If the Treasury Secretary sequesters the Section 53 MTCs (i.e., not paying them in full), taxpayers will have jurisdiction to sue for refund of the sequestered amounts in either a U.S. Federal district court or the U.S. Court of Federal Claims. A court hearing this refund case will be required to resolve the apparent conflict between the application of the BCA and the TCJA. In resolving such statutory conflicts, a court would rely on judicial precedent which consistently holds that later expressions of legislative intent are considered to be

binding on laws enacted earlier, and specific statutes control over general statutes. See *Kane County v. United States*, *Yankee Atomic Elec. Co v. United States*, and *Bulova Watch Co. v. United States*. Under either of these judicial tests, a court will likely find that a full refund of the MTCs provided by the TCJA will control over the BCA's sequestration of the refund. The TCJA is a more recent statute than the BCA, so its legislative intent is binding on the BCA. Further, the TCJA specifically provides a mechanism to refund 100 percent of the MTCs, whereas, the BCA's description of how sequestration should apply is much more general. We recommend that corporations whose MTC refunds are sequestered carefully consider pursuing a refund suit.

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