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INSIGHT: OMB's Recent Policy Change May Have Created an Opportunity to Recover Previously Sequestered Amounts of AMT Refunds



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On Jan. 14, 2019, the Internal Revenue Service announced that refunds resulting from alternative minimum tax credits (MTCs) paid pursuant to [Section 53\(e\)](#), passed by the Tax Cuts and Jobs Act of 2017 (TCJA), will not be subject to sequestration under the Balanced Budget Act of 1985, as amended by the Budget Control Act of 2011, and budget agreements in 2013 and 2015 (BBA). See *Effect of Sequestration on the Alternative Minimum Tax Credit for Corporations* (fiscal year 2019), <https://www.irs.gov/newsroom/effect-of-sequestration-on-the-alternative-minimum-tax-credit-for-corporations-fiscal-year-2019>.

The IRS announcement was a result of the Office of Management and Budget (OMB) reversing its original position, announced by the IRS in early 2018, that Section 53(e) refundable MTCs would be subject to sequestration by the BBA. While the OMB did not explain its reasoning for reversing its sequestration position, the OMB must have ultimately concluded that refunding Section 53(e) MTCs is not direct government spending and, as a result, could not be subject to sequestration under the BBA.

The Jan. 14, 2019, the IRS announcement made clear that sequestration will still apply to refunds of MTCs for taxpayers who made a Section 168(k)(4) election to forgo bonus depreciation in return for refundable MTCs. Taxpayers whose refunds were sequestered because of a [Section 168\(k\)\(4\)](#) election should consider whether the OMB's reversal of its sequestration position for Section 53(e) refundable MTCs creates an opportunity to challenge the OMB's sequestration position on previously sequestered Section 168(k)(4) refunds.

This article will discuss the Section 168(k)(4) election and why sequestration should not apply to Section 168(k)(4) refunds of MTCs.

Operation of Section 168(k)(4) to Increase Available MTC Credits

Prior to the repeal of Section 168(k)(4) by the TCJA, a taxpayer could elect to forgo bonus depreciation on qualified property in return for a credit or refund of a portion of the taxpayer's MTC balance that resulted from the payment of the alternative minimum tax (AMT) in an earlier tax year.

The Housing Assistance Tax Act of 2008 (Public Law 110-289) enacted Section 168(k)(4), which gave taxpayers the option to forgo bonus depreciation allowances (originally provided for in the Job Creation and Worker Assistance Act of 2002 (Pub. L. 107-147)) in exchange for a refundable amount of the taxpayer's MTCs. Although a taxpayer may have made a Section 168(k)(4) election for a variety of reasons, a taxpayer in a net operating loss position would typically find it more beneficial to make a Section 168(k)(4) election to receive an immediate cash refund as opposed to allowing the bonus depreciation allowance to increase the size of the taxpayer's net operating loss. Through the election, a currently unprofitable taxpayer, who paid AMT in the past, would essentially receive a substantially similar net tax benefit (through refundable MTCs) as a profitable taxpayer who receives a tax benefit by reducing its taxable income through bonus depreciation deductions. Congress clearly intended to incentivize unprofitable taxpayers to invest in qualified property, and leveling the playing field with profitable taxpayers, by providing

a mechanism, through the Section 168(k)(4) election, to receive an immediate tax benefit (i.e., refundable MTCs).

Since 2008, when Section 168(k)(4) was originally enacted, until it was repealed by the TCJA, Congress amended and extended Section 168(k)(4) several times with the latest amendment being in December 2015, when Congress passed the Protecting Americans from Tax Hikes Act of 2015 (PATH Act, P.L. 114-113). The amendments passed by the PATH Act apply to taxpayers who made Section 168(k)(4) elections in 2016 and 2017, and allowed an electing taxpayer to recover a portion of its pre-2016 MTC balance rather than only a portion of their pre-2006 MTC balance.

An electing taxpayer computes the Section 168(k)(4) refundable MTCs on the Form 8827, Credit for Prior Year Minimum Tax – Corporations, and reports the refundable amount on Schedule J of the Form 1120, U.S. Corporation Income Tax Return. Once a Section 168(k)(4) election is in place, it cannot be revoked without IRS consent. The Section 168(k)(4) election has the effect of increasing the Section 53(c) limitation on MTCs by a portion of the amount of forgone bonus depreciation. See Section 168(k)(4)(A)(iii). The aggregate Section 168(k)(4) increase to the Section 53(c) MTC limitation is treated as a refundable credit allowed under subpart C of Part IV of Chapter 1 of Subtitle 1 of the tax code. See Sections 168(k)(4)(C) and 6401(b). The refundable MTCs created by the election could either be applied against a taxpayer's regular tax liability for the current tax year, or if the taxpayer had no regular tax liability in that tax year, the amount of the refundable MTCs would be paid to the taxpayer as an overpayment for the tax year for which the increase was allowed. See Sections 37, 53(c), 168(k)(4)(C) and 6401(b). In both cases, according to the OMB and the IRS, the refundable MTCs are subject to sequestration under the BBA. See <https://www.irs.gov/businesses/effect-of-sequestration-on-the-alternative-minimum-tax-credit-for-corporations>.

Arguments That Show Why Section 168(k)(4) Refunds Are Not Subject to Sequestration

On September 4, 2018, we published an article entitled "Refundable AMT Credits Should Not be Subject to Sequestration." Our article focused on several arguments against the OMB's sequestration position for Section 53(e) refundable MTCs. Many of the same arguments discussed in our article show that Section 168(k)(4) refundable MTCs also should not be subject to sequestration.

In our previous article, we explained that the Section 53(e) refundable MTCs are defined as "overpayments" in the Internal Revenue Code of 1986, as amended. Section 53(e)(3) provides that the MTCs allowed under Section 53(e) shall be treated as a credit allowed under subpart C of part IV of subchapter A of chapter 1, which defines the Section 53(e) MTCs as an "overpayment" pursuant to Sections 37 and 6401(b)(1). Subpart C of part IV of subchapter A of chapter 1 includes eight different "refundable credits," including Section 37, which addresses overpayments. By operation of Section 6402(a), the Secretary of the Treasury is required to issue a full refund of the balance of an overpayment to a

taxpayer after the overpayment is applied to the taxpayer's liability. Section 168(k)(4)(C) provides the exact same provision as Section 53(e)(3), bringing the Section 168(k)(4) refundable MTCs within subpart C of part IV of subchapter A of chapter 1 and making the credit refundable. Therefore, Section 168(k)(4) refundable MTCs credits require the same treatment as Section 53(e) refundable MTCs, meaning both require a full refund pursuant to Section 6402(a).

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, the 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.

The BBA requires sequestration of government outlays or refunds that are direct spending, but the sequestration authority does not extend to refunds that are reductions of government 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 so they are subject to sequestration by the OMB pursuant to the BBA. 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 the OMB sequestration powers under the BBA, not because of a specific statutory exemption, but rather because they are not outlays for budgetary purposes.

A refund of MTCs, either through Section 53(e) or 168(k)(4), clearly falls within the BBA's reduction of government receipts category of "refundable tax credits," since a refund of MTCs reflects a return of previously paid AMT rather than direct government spending where a tax credit exceeds the tax paid. In fact, AMT paid by a taxpayer is effectively a loan to the government that should be repaid by the government in full. It is not possible for a credit or refund of MTCs to ever exceed the amount of tax paid by a taxpayer, thus it could never qualify as direct government spending. This position is supported by the Joint Committee on Taxation's historical view of the AMT regime. In its 1985 report titled, "Tax Reform Proposals: Tax Shelters and Minimum Tax," the Joint Committee on Taxation 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)).

Additionally, the OMB should find the legislative history of Section 168(k)(4) persuasive authority for not sequestering MTCs. By introducing bonus depreciation allowances, Congress clearly intended to motivate profitable taxpayers to invest in qualified property by providing accelerated tax benefits. Enacting Section 168(k)(4) provided motivation to unprofitable taxpayers to invest in qualified property as well. Consider the discussion of the House Committee on Ways and Means regarding Section 168(k)(4) when the House of Representatives proposed H.R. 2510 titled, “Amending the Internal Revenue Code of 1986 to Modify and Make Permanent Bonus Depreciation,” which included an expansion of the Section 168(k)(4) election that was ultimately passed as part of the PATH Act. The House Committee on Ways and Means, in its Oct. 25, 2015, report on H.R. 2510, praised the proposed expansion of the Section 168(k)(4) election for “increasing the ability of businesses to access trapped AMT credits, H.R. 2510 provides vital cash for investments in business operations and growth, as well as much-needed job creation and increased wages.” H.R. Rep. No. 114-317 at 10 (*emphasis added*). This is an express indication of Congress that investments by unprofitable taxpayers would give them access to previously paid taxes, by credit or refund, to use for growing businesses and jobs. The Section 168(k)(4) election simply accelerates access to AMT previously paid by providing access to “trapped” MTCs.

Sequestering Section 168(k)(4) MTCs should also present a tax policy concern for the OMB because taxpayers accelerating the use of MTCs via the election are receiving different tax results than those taxpayers who reduced taxable income by deducting the bonus depreciation allowances. For example, if Taxpayer A deducted the bonus depreciation allowance provided by Section 168(k) in 2017, Taxpayer A would receive the full benefit of the deduction to reduce 2017 taxable income. Taxpayer B, who elected Section 168(k)(4) in 2017, could credit the refundable MTCs against 2017 regular tax, but Taxpayer B’s credit would be sequestered. In theory, good tax policy should drive identical tax result for Taxpayers A and B under this scenario by not allowing sequestration of Taxpayer B’s credit.

The timing of the reversal of the OMB’s sequestration position for Section 53(e) MTCs in late 2018, and announced by the IRS in 2019, makes the difference highlighted above even more unfair to Taxpayer B. At the time Taxpayer B’s 2017 tax return was due on March 15, 2018, the IRS had announced that all refunds involving AMT would be sequestered. However, the OMB reversed its sequestration position on Section 53(e) MTCs in late 2018 after the 2017 tax return deadline had passed and the Section 168(k)(4) election could not be reversed without IRS consent. If Taxpayer B had known that Section 53(e) MTCs were not subject to sequestration when Taxpayer B filed its 2017 tax return in March 2018, Taxpayer B could have not made the Section 168(k)(4) election, which would have preserved the otherwise sequestered MTCs, and Taxpayer B would have

started receiving a full refund of the Section 53(e) MTCs in 2019, one year later when the 2018 tax return was filed.

Taxpayers Should Consider Challenging OMB’s Sequestration Position

Taxpayers whose Section 168(k)(4) refunds have been sequestered should consider bringing a refund suit to recover the sequestered portion of the credit or refund. Conveniently, an electing taxpayer’s original Form 1120 with a Section 168(k)(4) election acts as the taxpayer’s claim for refund, so a taxpayer need not file an additional claim for refund in order for a court to have jurisdiction over the refund suit. Treasury Regulation 301.6402-3(a)(5). A court hearing a refund suit would be required to determine whether the OMB properly classified the refunds of Section 168(k)(4) MTCs as direct government spending rather than a reduction of government receipts under the BBA. In addition, a court would consider the application and Congressional intent behind the Sections 37, 53, 168, 6401, and 6402 and other tax statutes under Title 26 in determining whether the sequestration of Section 168(k)(4) refunds is prohibited.

As we discussed more thoroughly in our September 2018 article, when multiple federal statutes may be applicable to determining an issue, courts consistently have held that specific statutes control over general statutes. See *Bulova Watch Co. v. United States*. A court applying that test in this case would likely find that taxpayers electing Section 168(k)(4) are entitled to a full refund of Section 168(k)(4) MTCs, because the application and Congressional intent behind the Sections 37, 53, 168, 6401, and 6402 and other tax statutes under Title 26 are more specific than the BBA. In addition, if a refundable tax credit must exceed tax paid to be classified as direct spending under the BBA, any credit or refund of MTCs could never meet that classification because MTCs represent a taxpayer’s prepayment of tax through the AMT regime. Accordingly, the government has no power to sequester MTCs and owes taxpayers a refund of Section 168(k)(4) MTCs in the full amount like in the case of refunds of Section 53(e) MTCs.

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