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State of South Carolina  
**Department of Revenue**  
301 Gervais Street, P. O. Box 125, Columbia, South Carolina 29214

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SC REVENUE PROCEDURE #95-5 (TAX)

- SUBJECT:** Claims for Refund and Correction of Errors in Tax Years  
Barred by the Statute of Limitations
- EFFECTIVE DATE:** Applies to all periods open under the statute. Except  
Commission Decision #93-1 is not superseded for claims filed  
prior to the amendment of Code Section 12-47-440 on June 29,  
1994.
- SUPERSEDES:** SC Revenue Procedure #89-1  
SC Revenue Ruling #89-9  
SC Revenue Ruling #91-10  
Commission Decision #93-1  
Commission Decision #92-75  
Commission Decision #91-33  
Commission Decision #90-17  
Commission Decision #88-257  
All other previous documents and any oral directives in  
conflict herewith.
- REFERENCES:** S. C. Code Section 12-60-470 (1995)  
S. C. Code Section 12-60-2150 (1995)  
S. C. Code Section 12-54-85 (1995)
- AUTHORITY:** SC Code Section 12-4-320 (Supp. 1994)  
SC Revenue Procedure #94-1
- SCOPE:** A Revenue Procedure is a statement which provides information of a  
procedural nature. It is valid and remains in effect until superseded or  
modified by a change in the statute or regulations or a subsequent  
court decision, Revenue Procedure or Revenue Ruling.

## **INTRODUCTION**

The South Carolina Code of Laws sets forth time limits within which the Department of Revenue must assess and collect taxes and within which taxpayers must file claims for refunds. In some instances, the taxpayer may benefit where the Department of Revenue does not act within the required time and in other instances, the taxpayer may be disadvantaged where he does not take action within the required time.

Although the statute of limitations is arbitrary and can cause hardships, its application is designed to be neutral. As noted by the Supreme Court in Rothensies v. Electric Storage Battery Co., 329 U.S. 296 (1946), the "statute of limitation is an almost indispensable element of fairness as well as of practical administration of income tax policy."

The purpose of this document is twofold. First, this document sets forth the Department of Revenue's authority for granting refunds. Second, this document briefly describes the remedies available to taxpayers and the Department of Revenue, where appropriate, that allow correction of errors that are barred by the statute of limitations.

The principles outlined in this document are intended to replace the principles in effect under Code Section 12-47-440 (the general statutory rule for filing a claim for refund prior to the repeal of Chapter 47 in 1995), Code Section 12-54-30 (repealed in 1995), SC Revenue Procedure #89-1, SC Revenue Ruling #89-9, SC Revenue Ruling #91-10, Commission Decisions #93-1, #92-75, #91-33, #90-17, #88-257, and all other previous documents and any oral directives in conflict herewith.

## **GENERAL RULE FOR CLAIM FOR REFUND - CODE SECTION 12-54-85**

Code Section 12-60-470 contains the general rule applicable to claims for refunds of taxes, other than property taxes. The section provides, in part:

(A) A taxpayer may seek a refund of any state tax by filing a written claim for refund with the department. A claim for refund is timely filed if filed within the period specified in Section 12-54-85 even though the time for filing a protest under Section 12-60-450 has expired and no protest was filed.

Code Section 12-60-2150 contains the general rule applicable to claims for refunds of property taxes administered by the Department. The section provides, in part:

(A) Subject to the time limitations in Section 12-60-1750<sup>1</sup>, and within the time limitation of Section 12-54-85(F), a property taxpayer may seek a refund of property taxes paid and assessed by the department by filing a claim for refund with the department if it originally assessed the property or the taxpayer believes the property is exempt, other than from the homestead exemption, from property taxes.

Code Section 12-54-85, the general statutory rule for filing a claim for refund for all fees and all taxes administered and collected by the Department of Revenue, provides for the time periods within which to timely file a claim for refund. The section provides, in part:

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<sup>1</sup> Notwithstanding any other provision of law, Code Section 12-60-1750 provides that no refund of property taxes must be given: (1) for a property tax exemption requiring an application, unless the application was timely filed; or (2) for errors in valuation, unless the assessment was appealed in accordance with Section 12-60-2110, 12-60-2510, or 12-60-2910, as appropriate. For purposes of this item, the taxation of exempt property is not an error in valuation.

(F)(1) Except as provided in subsection (D)<sup>2</sup> above, claims for credit or refund must be filed within three years of the time the return was filed, or two years from the date of payment, whichever is later. If no return was filed, a claim for refund must be filed within two years from the date of payment.

(2) If the claim was filed by the taxpayer during the three-year period prescribed in item (1), the amount of the credit or refund may not exceed the portion of the tax paid within the period, immediately preceding the filing of the claim, equal to three years plus the period of any extension of time for filing the return.

(3) If the claim was not filed within the three-year period, the amount of the credit or refund may not exceed the portion of the tax paid during the two years immediately preceding the filing of the claim.

(4) If no claim was filed, the credit or refund may not exceed the amount which would be allowable under items (2) or (3), as the case may be, as if a claim were filed on the date the credit or refund is allowed.

## **ADDITIONAL AUTHORITY FOR CLAIM FOR REFUND OR CREDIT OF TAXES OTHER THAN PROPERTY TAXES**

### **1. CODE SECTION 12-60-40(A)**

Code Section 12-60-40(A) provides for the extension of the statute of limitations and reads:

The department and a taxpayer may agree to extend any time limitations or waive any requirements provided in Article 5 [State Revenue Appeals Procedure] or Article 9 [Property Tax Protest, Appeal, and Refund Procedure] of this chapter.

### **2. CODE SECTION 12-60-40(B)**

Code Section 12-60-40(B) provides for time limitations to be suspended and reads:

Time limitations provided under this chapter [Chapter 60 - The South Carolina Revenue Procedures Act] and Chapter 54 are suspended during a stay ordered by the Taxpayers Rights Advocate.

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<sup>2</sup> Notwithstanding any restrictions on filing a claim for refund provided in subsection (F), subsection (D) allows a corporation to file a claim for refund resulting from an overpayment due to changes in taxable income made by the Internal Revenue Service within thirty days from the date the Internal Revenue Service changes the taxable income.

### **3. CODE SECTION 12-60-470(G)**

In addition to Code Sections 12-54-85 and 12-60-40, Code Section 12-60-470(G) also provides for a refund or credit of taxes, other than property taxes, administered by the Department of Revenue. The statute provides that:

Even if a taxpayer has not filed a claim for refund, if the department determines that money has been erroneously or illegally collected from a taxpayer or other person, the department, in its discretion, may, upon making a record in writing of its reasons, grant a refund to the taxpayer or other person.

This statute gives the Department the authority to grant a refund of any taxes, other than property taxes, it believes to have been paid in excess of what was due.

This provision was previously contained in Code Section 12-54-30 which was repealed in 1995. Under Code Section 12-54-30, a taxpayer was not entitled to a hearing; there was no appeal granted from an adverse decision; nor was there any reference to a statute of limitations. See Argent Lumber Co. v. Query, 178 SC 1, 182 S.E. 2d 93 (1935) where, in a similarly worded statute, the court determined that "under the terms of this act the tax commission is clothed with the power and authority to make such refunds for valid reasons, but no corresponding right is conferred upon the taxpayer to compel by suit the exercise of this authority; so that if such legislation enacted subsequent to the time of the payment of the taxes now sought to be recovered, should be held applicable, the petitioner has no legal right of redress under the specific terms of this section, for the recovery of taxes paid...."

Therefore, a taxpayer filing a request for refund under Code Section 12-60-470(G), rather than under Code Section 12-54-85, should be aware that (1) he is not entitled to a hearing; (2) there is no appeal granted from an adverse decision; and, (3) there is no reference to a statute of limitations.

### **PRINCIPLES REPLACED**

This revenue procedure replaces the principles set forth in SC Revenue Procedure #89-1, SC Revenue Ruling #89-9, SC Revenue Ruling #91-10, Commission Decisions #93-1, #92-75, #91-33, #90-17, #88-257, and all other previous documents and any oral directives in conflict herewith.

### **EXCEPTIONS TO GENERAL RULE FOR CLAIM FOR REFUND FOR TAXES OTHER THAN PROPERTY TAXES**

Refunds will be granted in accordance with Code Section 12-54-85. For taxes, other than property taxes, the Department will allow under Code Section 12-60-470(G) correction of errors that may otherwise be barred by the statute of limitations in the following circumstances:

1. If the taxpayer agrees to the Department of Revenue's request that a waiver of the period of statute of limitations on assessments be extended, then the time the Department may mail a notice of assessment pursuant to Code Section 12-54-85 will be extended. In so doing, the time within which a taxpayer may file a claim for refund will also be extended until the agreed upon date, however, if the Department's extension is limited in any way, such as to a particular issue, then the extension for a refund by a taxpayer will be limited in the same way. This exception only applies to effective extensions agreed to in writing by the Department.
2. For sales and use tax purposes, if a retailer: (1) erroneously pays sales or use tax to the person from whom he purchases property, (2) subsequently sells the property to others, (3) erroneously fails to collect sales tax and, (4) is found liable for sales tax on his sales of the property when audited by the Department of Revenue, then the retailer will be allowed to use the sales or use tax he paid to the person from whom he purchased the property as a credit against the sales tax determined to be due upon audit. This exception will allow the Department to offset the sales or use tax paid up to the amount of the assessment; it will **not** result in a refund to the retailer. In applying this exception, the retailer must: (1) provide verification that taxes were paid, and (2) obtain a written assignment of rights to a refund of sales tax from the seller from whom the property was purchased for the entire examination period.
3. A corporation must file a claim for refund with the Department of Revenue within 30 days after a final determination is received from the Internal Revenue Service. For tax years beginning after 1990, the adjustment of income by the Internal Revenue Service upon audit extends the time the taxpayer, other than a corporation, may file a claim for refund with the Department of Revenue to 180 days after the date a final determination of adjustment is received from the Internal Revenue Service. These extensions apply only when it results from an audit by the Internal Revenue Service; they do not apply to refunds of overpayments reported on the taxpayer's original return, or when the taxpayer's refund was the result of a claim for refund filed with the Internal Revenue Service. (See Code Sections 12-54-85 and 12-54-140.)
4. After filing a timely claim for refund, the taxpayer discovers that a refund greater than the amount originally requested is due. The Department will consider such claims only if the adjustment is based upon issues raised in the timely filed claim for refund. No additional refund will be allowed if a taxpayer raises new issues after the statute of limitations has expired.
5. Setoff, the doctrine of equitable recoupment, or the mitigation provisions provided in Internal Revenue Code Sections 1311 - 1314 apply to the situation, as briefly described below.

NOTE: The Department will not allow correction of errors that are otherwise barred by the statute of limitations for any other reasons including the following:

1. A mistake is made calculating the expiration date of the statute of limitations.

2. A taxpayer failed to file a timely claim for refund when another state assessed a tax on the same income taxed in South Carolina. Taxpayers in situations where it is undetermined which state is due the tax should file a protective claim with the South Carolina Department of Revenue while the statute of limitations is open. The protective claim should include the time period and issues involved, even if specific dollar amounts are not known.

## **SETOFF**

In general, setoff permits all items involving the same tax and the same taxable period to be considered for adjustment in determining whether there has been an overpayment or underpayment of tax. Setoff does not permit recovery of an underpayment or overpayment in and of itself, instead it operates to decrease the recovery claimed by the other party.

Setoff may be used by the Department of Revenue to reduce or eliminate a refund claimed by a taxpayer. For example, a taxpayer files a claim for refund for erroneously paid tax. Although the statute of limitations on assessments is closed, the Department of Revenue is permitted to review the return for other errors. Setoff allows the Department to reduce the amount of the taxpayer's claim for refund by the amount of any error, the correction of which would result in additional tax being due. The refund may be reduced to zero; however, the Department may not make an additional assessment.

Setoff is also available as a remedy to taxpayers. For example, a taxpayer under audit is subject to a longer statute of limitations on assessments under Code Section 12-54-85(C). The taxpayer discovers an error, the correction of which would result in a refund, for the period under audit. Since the statute of limitations on claims for refund has expired, the taxpayer cannot obtain a refund. Setoff may be used by the taxpayer to setoff the potential refund amount against the amount of an assessment by the Department. The assessment may be reduced to zero; however, the taxpayer may not receive a refund.

For an interpretation of setoff by the courts see, Lewis v. Reynolds, 284 U.S. 281 (1932).

The following general principles are applicable to the doctrine of setoff:

1. The claim arises from the same tax.
2. The claim arises from the same taxpayer.
3. The claim arises from the same taxable period.

## **THE DOCTRINE OF EQUITABLE RECOUPMENT**

In general, the doctrine of equitable recoupment permits a taxpayer or a taxing authority to make up for a mistake in the tax treatment of a transaction in a closed tax period by adjusting an amount involving the same transaction in an open tax period. The doctrine, however, may only

be raised in conjunction with a tax dispute that is not barred by the statute of limitations. Like setoff, the doctrine of equitable recoupment permits a refund claimed by a taxpayer or an assessment made by the Department to be reduced to zero, and does not permit the taxpayer to receive a refund or allow the Department to make an additional assessment.

The application of the doctrine of equitable recoupment to tax law was analyzed in the following four U. S. Supreme Court decisions: Bull v. United States, 295 U.S. 247 (1935); Stone v. White, 310 U.S. 269 (1937); Rothensies v. Electric Storage Battery, 320 U.S. 296 (1946); and McEachern v. Rose, 302 U.S. 56 (1937).

Bull describes how recoupment applies to a situation involving double taxation (income tax and estate tax) of a single item of income. An estate received income from a partnership following the death of a partner. Estate tax was erroneously paid on the income. After the statute of limitations on filing a claim for refund for estate taxes had run, the Internal Revenue Service determined that the partnership income was subject to federal income tax. Since the statute was open on the income tax issue, the executor paid the tax, but sued to recoup the barred overpayment of estate taxes. The court ruled that the estate should have been entitled to credit the estate tax overpayment against the income tax deficiency.

In Stone, the Internal Revenue Service used the doctrine of equitable recoupment to recoup a barred deficiency from a refund due to a related person. The trustee paid income tax on trust income. The beneficiary erroneously excluded the trust income from her individual income tax. The IRS erroneously assessed an income tax deficiency against the trust, after the statute of limitations was closed with respect to the beneficiary. The trustee paid the tax and sued for a refund. The Court ruled that the trustee and the sole beneficiary must be considered as one and allowed the Internal Revenue Service to recoup the deficiency of the beneficiary against the overpayment of the trust.

The following general principles are applicable to the doctrine of equitable recoupment:

1. The taxable event claimed upon and the one considered in recoupment arise from a single item or transaction occurring in different years.
2. The single transaction must be subject to two taxes based upon inconsistent legal theories.
3. The amount claimed in recoupment must be barred by the statute of limitations while the disputed amount must be timely.
4. If more than one taxpayer is involved, there is an identity of interest between the taxpayers.
5. It applies in situations not covered by the mitigation provisions.

## **THE MITIGATION PROVISIONS**

The mitigation provisions are set forth in Internal Revenue Code Sections 1311 - 1314. South Carolina has adopted these Internal Revenue Code provisions, and the Department will apply them to determinations made under South Carolina income tax laws only, where applicable.

In general, the mitigation provisions permit an error to be corrected even though correction of the error in a closed year is prevented by some provision or rule of law. Unlike setoff and the doctrine of equitable recoupment, the taxpayer may receive a refund under the mitigation provisions, and the Department may make an additional assessment.

Many factors must be present in order for the mitigation provisions to be used to correct an error in a year closed under the statute of limitations. Some of the factors include:

1. A "determination" for an open period must establish that the same item has been treated erroneously in a prior, closed year. "Determination" is defined in Internal Revenue Code Section 1313 and generally includes a court decision or administrative action.
2. On the date of the determination, the correction of the error in the closed period must be barred by the operation of law, such as the statute of limitations, or rule of law, such as estoppel or res judicata. Operation of law, however, does not include the mitigation provisions or offers-in-compromise.
3. The determination creates a "circumstance of adjustment" that includes one of the following conditions defined in Internal Revenue Code Section 1312:
  - a. Double inclusion of item of gross income,
  - b. Double allowance of deduction or credit,
  - c. Double exclusion of item of gross income,
  - d. Double disallowance of deduction or credit,
  - e. Correlative deductions or inclusions for trusts or estates or for legatees, beneficiaries, or heirs,
  - f. Correlative deductions and credits for related corporations, or
  - g. Basis of property after erroneous treatment of prior transaction in certain circumstances.

If all of the required conditions are met, then the mitigation provisions apply and the error period is reopened for a limited period of time. The adjustment may be made to correct errors that relate to a single item or to an affected item. No other items are reopened. Internal Revenue Code Section 1314 sets forth the rules concerning the amount and method of adjustment.

## **CONCLUSION**

It is the Department's policy to allow claims for refund as provided in Code Sections 12-54-85, 12-60-40, and 12-60-470(G), as provided in this document.



Be advised that this revenue procedure is intended to provide only a brief overview of setoff, the doctrine of equitable recoupment and the mitigation provisions. There are numerous court cases and articles available that discuss these three remedies in detail. Questions concerning the specific applicability of setoff, the doctrine of equitable recoupment and the mitigation provisions should be directed to your tax advisor.

South Carolina Department of Revenue

s/Burnet R. Maybank III  
Burnet R. Maybank, III, Director

Columbia, South Carolina  
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