

SC REVENUE PROCEDURAL BULLETIN #00-3

- SUBJECT:** Claims for Refund and Correction of Errors in Tax Years Barred by Time Limitations
- EFFECTIVE DATE:** Applies to all periods open under the statute.
- SUPERSEDES:** SC Revenue Procedure #95-5  
Commission Decision #93-1  
All other previous documents and any oral directives in conflict herewith.
- REFERENCES:** S. C. Code Section 12-60-470 (2000)  
S. C. Code Section 12-60-2150 (2000)  
S. C. Code Section 12-54-85 (As Amended August 2000)  
S. C. Code Section 12-60-40 (2000)
- AUTHORITY:** S. C. Code Ann. Section 12-4-320 (2000)  
S. C. Code Ann. Section 1-23-10(4) (Supp. 1999)  
SC Revenue Procedure #99-4
- SCOPE:** The purpose of a Revenue Procedural Bulletin is to provide procedural guidance to the public and Department personnel. It is a written statement issued to assist in the administration of laws and regulations by providing guidance that may be followed in order to comply with the law. **A Revenue Procedural Bulletin does not have the force or effect of law, and is not binding on the public.** It is, however, binding on agency personnel until superseded or modified by a change in statute, regulation, court decision, or advisory opinion.

## 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. The United States Supreme Court in Rothensies v. Electric Storage Battery Co., 329 U.S. 296 (1946) noted that 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 advisory opinion is to set forth the Department’s authority for granting refunds and briefly describe the remedies provided by law which may be available to taxpayers and the Department, where appropriate, that allow correction of errors that would otherwise be barred by time limitations.

### **GENERAL RULE FOR CLAIM FOR REFUND - CODE SECTIONS 12-60-470, 12-60-2150, and 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.

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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.

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, provides for the time periods within which to timely file a claim for refund. The section provides, in part:

(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 timely filed return, including extensions, 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 item (2) or (3), as the case may be, as if a claim were filed on the date the credit or refund is allowed.

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<sup>2</sup> Notwithstanding any restrictions on filing a claim for refund provided in subsection (F), subsection (D)(3) allows a person to file a claim for refund resulting from an overpayment due to changes in taxable income made by the Internal Revenue Service within one hundred and eighty days after the date a final determination of tax adjustment (i.e. the federal assessment date) is made by the Internal Revenue Service. The refund described in this subsection applies only to the overpayment of taxes resulting from adjustments of the Internal Revenue Service.

## **SUSPENSION OF TIME LIMITATIONS FOR CLAIM FOR REFUND OR CREDIT - CODE SECTION 12-60-40**

As stated above, Code Section 12-60-470 grants the Department the authority to issue refunds provided such claims are submitted within the time limitations of Code Section 12-54-85. These time limitations, however, may be extended or suspended as authorized by Code Section 12-60-40 which provides:

(A) A taxpayer may waive his rights under this chapter [Chapter 60 - The South Carolina Revenue Procedures Act], providing the waiver is in writing and is signed by the taxpayer or his representative. The department may extend any time limitations provided by this title and for any other taxes. 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 Procedures] of this chapter.

(B) Time limitations provided under this chapter [Chapter 60 - The South Carolina Revenue Procedures Act] and Chapter 54 [Uniform Method of Collection and Enforcement of Taxes Levied and Assessed by the Department] are suspended during a stay ordered by the Taxpayers Rights Advocate.

See also Code Section 12-54-85(G) which provides for a suspension of the time limitations provided in subsections 12-54-85 (A), (B), (C), (D), and (E) in certain situations, such as for 90 days after the date of a proposed assessment, or during the pendency of a stay ordered by the Taxpayers' Rights Advocate.

### **CLARIFICATION TO THE GENERAL RULE FOR CLAIM FOR REFUND**

As discussed above, Code Section 12-60-470 grants the Department authority to issue a credit or refund for taxes, other than property taxes, provided such claims are submitted within the time limitations provided in Code Section 12-54-85.

Consistent with its longstanding administrative position, the Department will continue to interpret the time limitations in Code Section 12-54-85 consistent with the following rules:

1. If the taxpayer agrees to the Department's request that a waiver of the time 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 Department will also consider the time within which a taxpayer may file a claim for refund to 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 position only applies to effective extensions agreed to in writing with the Department.
2. A taxpayer must file a claim for refund within the time limitations and state the reasons for that request. Code Section 12-60-470(B)(5) requires a claim for refund to state the amount claimed, but, if 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, but only if the adjustment is based upon issues raised in the timely filed claim for refund. No additional refund is allowed for new issues raised after the time limitations has expired.
3. 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.

In the Department's opinion it does **not** otherwise have the authority to allow correction of errors that are barred by the time limitations for any reason, including situations where:

1. A mistake is made calculating the expiration date of the time 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. A taxpayer in a situation where it is undetermined which state is due the tax should file a protective claim with the Department within the time limitations. See item 2 above.

Code Section 12-60-470(G) 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.

Code Section 12-60-2150(G) similarly provides that:

Even if a taxpayer has not filed a claim for refund, where no question of fact or law is involved, and it appears from the record that money has been erroneously or illegally collected from a taxpayer or other person under a mistake of fact or law, the department may, subject to the limitations in Section 12-60-1750, within the period specified in Section 12-54-85 and upon making a record in writing of its reasons, order a refund to the taxpayer or other person.

The Department uses Code Section 12-60-470(G)<sup>3</sup> and 12-60-2150(G) when it audits a taxpayer and determines that the taxpayer is entitled to a refund. It has been and is the Department's longstanding administrative opinion that its right to grant a refund to a taxpayer pursuant to this section is limited by time limitations, *i.e.*, that it cannot grant a refund unless at the time the Department grants the refund, the taxpayer could have filed a timely claim for refund. In 1995, the General Assembly enacted Code Section 12-54-85(F)(4) which is consistent with this opinion. In the opinion of the Department, if it refuses to grant a refund pursuant to this section a taxpayer is not entitled to a hearing, and the taxpayer is not entitled to appeal the Department's decision. However, if the taxpayer files a claim for refund before the expiration of the time limitation, the taxpayer is entitled to a hearing and an appeal of the Department's decision.

## **SUMMARY OF SETOFF, DOCTRINE OF EQUITABLE RECOUPMENT, AND MITIGATION PROVISIONS**

**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.

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<sup>3</sup>This provision was previously contained in Code Section 12-54-30 which was repealed and replaced by Code Sections 12-60-470(G) and 12-60-2150(G) in 1995. 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..."

Setoff may be used by the Department 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 time limitations on assessments is closed, the Department 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 time limitation on assessments under Code Section 12-54-85(C)(1), (2), or (3). The taxpayer discovers an error, the correction of which would result in a refund, for the period under audit. Since the time 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 time 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 time 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 time limitations was closed with respect to the beneficiary. The trustee paid the tax and sued for a refund. The Court ruled that the trustees 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 time 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 time 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 time 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 12-60-470, 12-54-85, and 12-60-40, and, as provided in this advisory opinion.

Be advised that this advisory opinion 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

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Columbia, South Carolina