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# Loss Carryovers and Carrybacks When Only Part of a Consolidated Group is Bankrupt: The Garbled Message of PT-1 Communications

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Tax professionals are sometimes distressed by the liberties that bankruptcy courts take with the Code.[1] A recent decision of the Bankruptcy Court for the Eastern District of New York, *In re PT-1 Communications, Inc.*, 103 AFTR 2d 2009-1577, 403 BR 250 (Bkrptcy. DC N.Y., 2009), illustrates the tension between the need for an even-handed and technically correct application of the tax law, on the one hand, and the bankruptcy courts' understandable desire to facilitate the rehabilitation of debtors and the administration of cases under their jurisdiction, on the other.

In *PT-1*, the bankruptcy court played fast and loose both with Section 7421 (the "Anti-Injunction Act"), which prohibits suits "for the purpose of restraining the assessment and collection of any tax," and the consolidated return Regulations. The result that a bankrupt debtor became entitled to a substantial federal income tax refund. Ironically, the court could likely have reached the same result under an unobjectionable analysis, if only the parties had presented the court with that alternative.

## The Saga of PT-1

Prior to February 4, 1999, PT-1 Communications, Inc. had been the common parent of an affiliated group that filed consolidated returns (the "PT Group"). The taxable year of the PT Group ended on June 30. On its consolidated federal income tax return for the taxable year ended June 30, 1998, the PT Group reported taxable income and paid federal income tax of $2,178,891.

On February 4, 1999, STAR Telecommunications acquired all of the stock of PT.[2] PT and its subsidiaries thereby became members of the affiliated group filing consolidated returns of which STAR was the common parent (the "STAR Group"). The STAR Group used the calendar year as its taxable year. When the former members of the PT Group became members of the STAR Group, the PT Group terminated and the taxable year of the PT Group, which had commenced on July 1, 1998, ended.[3] The PT Group filed a final consolidated federal income tax return for its short year ended February 3, 1999.

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STAR was indebted to WorldCom Communications Corp, and STAR pledged its shares in PT-1 to WorldCom to secure STAR's obligations. In connection with the pledge, STAR also granted to WorldCom the right to vote STAR's PT-1 shares in the event that STAR defaulted on its obligations to WorldCom. At some point prior to March 2001 STAR defaulted on those obligations, and WorldCom on March 9, 2001, exercised its right to vote STAR's PT-1 shares to elect a new board of directors for PT-1. Nevertheless, title to the PT-1 shares was never transferred from STAR to WorldCom. The income (or loss) of the members of the STAR Group for the periods that PT-1 and its subsidiaries were included in the STAR Group, to the extent that they can be extracted from the bankruptcy court's opinion, can be summarized thus:

| Calendar Year | PT-1 and Subsidiaries | Other Members of STAR Group |
|---|---|---|
| 1999 | ($6,299,032) (February 4, 1999, through December 31, 1999, only) | Overall loss |
| 2000 | ($7,423,329) | Unsubstantiated overall loss |
| 2001 | ($6,993,074) ("2001 Stub Period" of January 1, 2001, through March 8, 2001, only) | Apparently an overall loss |

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*See note 9, infra, and the accompanying text.

Immediately after the election of new PT-1 directors on March 9, 2001, PT-1 filed a voluntary petition for reorganization under Chapter 11 of Title 11. Later in 2001, STAR filed its own petition in bankruptcy and was liquidated, and the STAR Group did not file any federal income tax return for the period commencing January 1, 2001.[4]

WorldCom took the position that PT-1 and its subsidiaries never became members of the WorldCom consolidated group (since WorldCom never took title to the stock of PT-1), and the taxable income of PT-1 and its subsidiaries, for the period commencing March 9, 2001, was not reported on WorldCom's consolidated returns. PT-1 accordingly filed consolidated federal income tax returns for itself and its subsidiaries, for the period commencing March 9, 2001, and ending December 31, 2001 (the "2001 short period"), and the IRS appears to have conceded that this treatment was proper.[5] The 2001 Short Period return of PT-1 and its subsidiaries reflected $19,160,492 of taxable income, determined without regard to NOL carryovers from prior periods, on which PT-1 paid $6,706,172 in federal income taxes.

Before the bankruptcy court, PT-1 sought tax refunds for the PT-1 Group's 2001 short period (the "2001 tax refund"), on the grounds that the former members of the PT Group were entitled to carry their NOL for the 2001 stub period (*i.e.*, the period from January 1 through March 8), incurred while they were members of the STAR Group, to the 2001 short period.[6] PT-1 also sought to carry to the 2001 short period NOLs from the 2000 consolidated return of the STAR Group that were apportioned to PT-1 and its subsidiaries, as well as NOLs from the consolidated return filed by PT-1 and its subsidiaries for 2002.

The Service asserted that, in order for PT-1 to carry the NOLs from the 2001 stub period to the 2001 short period, the STAR Group was required to file a tax return for the 2001 stub period apportioning those losses to PT-1 and its subsidiaries. Since STAR had already been liquidated and could no longer act on behalf of the STAR Group, PT-1 requested, on April 13, 2007, that the IRS designate PT-1 as the "agent" of PT-1 and its subsidiaries (the only remaining members of the STAR Group), for the purpose of filing a return for the 2001 stub period.[7] PT-1's request was not granted by the IRS.

The rules under the consolidated return Regulations regarding when and to what extent a member (such as PT-1) of a consolidated group (in this case, the STAR Group) is permitted to carry a portion of the group's NOL to a tax year in which that corporation is a member of a different consolidated group (the post-March 8, 2001, group of PT-1 and its subsidiaries) are detailed and complex.[8] Nevertheless, the IRS apparently conceded the amount of NOLs that would be apportioned to PT-1 and its subsidiaries for the 2001 stub period. The bankruptcy court accepted the Service's concession, finding that, since the other members of the STAR Group, taken in the aggregate, did not have positive income for the 2001 stub period, PT-1 and its subsidiaries were entitled to be apportioned the full amount of the NOLs that they incurred during that period.[9]

The STAR Group had also reported "significant" losses on its consolidated federal income tax return for 1999, and the IRS conceded that $6,299,032 of the STAR Group's NOLs for that year were properly apportioned to PT-1 and its subsidiaries. PT-1 sought to carry these apportioned losses back to the PT Group's year ended June 30, 1998, and timely filed a claim for a refund of the $2,178,891 in federal income taxes that the PT Group had paid for that tax year (the "1998 tax refund").[10] The IRS denied the 1998 tax refund, because it asserted the right to set off, against the 1998 tax refund, any potential additional tax due from either the STAR Group or the PT Group for the 2001 stub period, a period for which no return had been filed by the STAR Group or the PT Group.

At this point, both refunds sought by PT-1 were, in effect, being blocked by the STAR Group's failure to file a return for its tax year that included the 2001 stub period.[11] PT-1 sought a judgment from the bankruptcy court under section 505 of the Bankruptcy Code[12] directing the IRS to "accept" a tax return for the 2001 stub period (January 1 through March 8, 2001) prepared by PT-1 and reflecting the losses of PT-1 and its subsidiaries for that period.[13] PT-1 sought, as a consequence of this mandated "acceptance" of the 2001 stub period return by the IRS, to recover the 1998 Tax Refund from the Service, since the 2001 stub period tax return prepared by PT-1 showed no additional tax due in 2001 that could offset the refund. PT-1 also sought to recover all the federal income taxes that PT-1 and its subsidiaries had paid for the 2001 short period, since the 2001 short period's taxable income would be reduced to zero by losses shown on the return for 2001 stub period that PT-1 proposed to file, by losses apportioned to PT-1 and its subsidiaries from the STAR Group's taxable year 2000, and by losses carried back by PT-1 and its subsidiaries from their 2002 taxable year.

The bankruptcy court held that it was empowered to direct the IRS to "accept" the 2001 stub period return prepared by PT-1 for itself and its subsidiaries, because the IRS had offered no reasonable reason why PT-1 could not file such return, with the effect that the Service's refusal to accept the return was arbitrary and capricious.[14] Based on that return, the substantive correctness of which was not challenged by the IRS, and based on the court's finding that the rest of the STAR Group did not have positive income during the 2001 short period, the court found it "apparent" that neither the PT Group nor the STAR Group owed additional tax for 2001, and that the IRS could thus not assert any right of setoff to block the 1998 Tax Refund.[15] Nevertheless, the PT Group was not entitled to summary judgment on its claim for the 2001 tax refund, because PT-1 could not sufficiently substantiate its claimed NOLs incurred during 2000 and 2002. Accordingly, the Court scheduled the 2001 tax refund issue for an evidentiary hearing.

## Analysis

The bankruptcy court erred in concluding that it was not barred by Section 7421 from ordering the IRS to "accept" a tax return. Even if the bankruptcy court had the power to make such an order, it was incorrect to allow PT-1 to file a "consolidated return" for the 2001 stub period on behalf of only PT-1 and its subsidiaries, since those corporations had continued to be members of the STAR Group during that period. The court could have avoided these errors and still reached the same bottom-line conclusions by focusing only on the proper filing of the tax returns (and claims for refund) of PT-1 and its subsidiaries for 1998 and for the 2001 short period, periods during which they were not members of the STAR Group.[16]

## Directing IRS to 'Accept' a Tax Return

Section 7421(a) states: "Except as provided in [a series of exceptions, none of which is pertinent here[17]], no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed."[18] The purpose of this statute is to protect the government's need "to assess and collect taxes alleged to be due, without judicial intervention, and to require that the right to the disputed sums be determined in a suit for refund."[19] The taxpayer's remedy is to bring "a suit at law to recover any part of sums unlawfully collected by the United States."[20]

The bankruptcy court held that section 7421(a) did not bar it from ordering the IRS to accept PT-1's proposed return for the 2001 stub period because there were no tax assessment or collection activities hindered by the relief sought by PT-1, as PT-1 and its subsidiaries owed no taxes for the 2001 stub period and were seeking only to obtain refunds of taxes already paid. The court adopted an unduly narrow view of Section 7421(a), however; the statute applies to bar any suit that would "restrain" the IRS in its assessment or collection of tax, including by rescission of a completed tax collection.

If section 7421(a) did not apply to suits filed after a tax had been collected, then, once the Service had finished collection activities, a taxpayer could file suit seeking injunctive relief against the IRS to recover those amounts, instead of pursuing the proper remedy at law of a refund suit. Section 7421(a) has in fact been used to bar suits by taxpayers seeking to recover properties seized or levied by the IRS.[21] Section 7421(a) has also been used to bar injunctive relief on behalf of taxpayers who had no outstanding tax liability.

For example, in *Johnson*, 76 AFTR 2d 95-7202, 70 F3d 115 (CA-6, 1995), the IRS had seized $50,800 from the taxpayer for delinquent taxes and penalties, and the taxpayer had petitioned the Tax Court to redetermine his deficiency. While the Tax Court case was still pending, the taxpayer filed a complaint in federal district court seeking injunctive relief. The Sixth Circuit held that the refund suit was prohibited by Section 7421(a), as it would prevent the assessment or collection of a tax, even though the tax had already been collected.

In *Falck v. United States,* 96 AFTR 2d 2005-6668 (DC Ohio, 2005), Section 7421(a) barred the taxpayers from seeking an injunction ordering the IRS to return $29,001 that it had seized from the taxpayers' bank accounts. Even though the taxpayers asserted that they "are not seeking to restrain the lawful assessment or collection of any internal revenue tax, but dispute the unlawful seizure of their personal property," the court stated that "the fact that the [taxpayers] dispute any existing obligation to pay taxes is exactly the kind of conflict which this court cannot resolve .... [A]ny attempt to sue the government for a refund of taxes improperly collected cannot proceed."

And in *Gasparutti,* 77 AFTR 2d 96-1508 (DC Calif., 1996), the taxpayer's motion seeking an order directing the government "to return his confiscated wages" was barred by Section 7421(a), as it "prevents district courts from compelling the IRS to return monies collected as taxes." Section 7421(a) has also been held to bar a taxpayer's writ of mandamus requiring the government to repay the taxes it had collected.[22]

In *PT-1,* the bankruptcy court did not cite any authority holding, contrary to these cases, that Section 7421(a) did not apply if the IRS had already collected all taxes in full from the taxpayer.[23] While the mere filing of an amended return may have no effect on the IRS assessment and collection process, a bankruptcy court injunction forcing the IRS to "accept" the PT Group's 2001 stub period tax return should be barred by Section 7421(a), since acceptance of that return would result in tax refunds and thereby reduce the amount of taxes collected by the IRS.[24]

## Wrong Return, Wrong Taxpayer, Wrong Period

The bankruptcy court directed the IRS to accept the 2001 stub period return showing the NOLs incurred only by PT-1 and its subsidiaries, but not the income or loss of other members of the STAR Group. Even if the bankruptcy court were, in the abstract, empowered to order the IRS to accept tax returns and even if PT-1 were authorized to file tax returns on behalf of the STAR Group, the court should still not have ordered the filing of a return that "consolidated" the operations only of PT-1 and its subsidiaries.

The bankruptcy court's decision creates the novel construct of the filing by a "subgroup" within an existing consolidated group of a return only for the subgroup's members. This construct does not fit within the framework of the consolidated return Regulations, which do not recognize computations of the tax liability of subgroups within consolidated groups. In reaching its conclusion, the bankruptcy court appears to have conflated two separate questions: (1) which corporations should be *included* in the consolidated return, and (2) which corporation should *file* the return (or on behalf of which corporation it should be filed).

The first question is addressed by rules such as Reg. 1.1502-2(a), providing that the tax liability of a group is determined by computing the tax imposed by Section 11 on the "*consolidated* taxable income" for the year, and Reg. 1.1502-6(a), providing that the *common* *parent corporation and each subsidiary* that was a member of the group during any part of the year "shall be severally liable for the tax for such year."

The second question is addressed by Reg. 1.1502-77,[25] providing that the common parent is generally the "agent" for the group, but that the IRS may, in some circumstances, deal directly with another member.[26]

As PT-1 and its subsidiaries were members of the STAR Group during the 2001 stub period, any return that was filed by PT-1 should have been a return for the entire STAR Group. And, as the 2001 taxable year of the STAR Group did not end at the end of the 2001 stub period (when PT-1 and its subsidiaries left the STAR Group),[27] any return that was filed for the STAR Group – whether filed by STAR, by PT-1, or by or on behalf of any other corporation – should have included the operations of the STAR Group's remaining members for the rest of the 2001 taxable year.

When a similar situation was presented in FSA 200051002 (Sep. 15, 2000), the IRS allowed a subsidiary to file an income tax return, after the common parent's officers refused to file a consolidated return, but required that the subsidiary "file a consolidated return for all of the items of income and expense of the group even though such return will only be a filing of the consolidated return by this one subsidiary and not [the common parent or other group members]. See Treas. Reg. sections 1.1502-6 and 1.1502-77(a). The filing of the consolidated return by [the subsidiary] will constitute a consolidated return filed only by that subsidiary" but will include "all of the group's income and expenses." Thus the subsidiary could file a consolidated return acting only for itself, but it had to be a return which would show the subsidiary's several liability for the taxes of the entire group.

Although the IRS is permitted to deal directly with a member of a consolidated group,[28] the IRS must do so with respect to that member's tax liability, *i.e.*, that member's several liability for the tax of the entire consolidated group,[29] and not a tax liability computed by reference to the operations of just that member or of a "subgroup" within the consolidated group.[30]

The bankruptcy court's holding that PT-1 and its subsidiaries could file a return showing only their own operations during the 2001 stub period, a period during which those corporations were members of the STAR Group, improperly allowed a "subgroup" within a consolidated group to file its own return, and improperly allowed the filing of a return for a period that did not constitute a taxable year.

## How to Arrive at the Correct Result

It was not necessary for any 2001 stub period tax return to be filed in order for the bankruptcy court to determine PT-1 was entitled to the 1998 tax refund and the 2001 tax refund. The amount of the STAR Group's NOL for the 2001 stub period properly apportioned to PT-1 and its subsidiaries was merely a fact relevant to the determination of the tax liability of PT-1 and its subsidiaries for the 2001 short period.[31]

But, it was *not necessary*, in order for PT-1 and its subsidiaries to be entitled to claim a NOL deduction under Section 172 on their return for the 2001 short period for losses arising during the 2001 stub period, that any return have been filed for the 2001 stub period.[32] Thus, in *Rodriguez-Torres,* TC Memo 1970-76, PH TCM ¶70076,[33] the taxpayer sustained certain business losses in 1961 after fleeing Cuba, and he sought to carry the losses forward as an NOL to his 1964 tax return. Even though the taxpayer did not file a return in 1961, the court allowed some of the claimed NOL after finding sufficient evidence for the original losses.

Similarly, in *Coulter*, TC Memo 1987-121, PH TCM ¶87121, *aff'd* 853 F2d 924 (CA-5, 1988), the taxpayers did not file any income tax returns for the years 1976-1980. On audit, the Service determined that they had income for 1979 and 1980 and a loss for 1978. The 1978 NOL was allowed to be carried to the other years, despite the lack of a return for 1978.[34]

Thus, in *PT-1* the bankruptcy court simply could have found that the taxpayer and its subsidiaries sustained losses in the 2001 stub period, and then taken those losses into account in computing the 2001 tax refund, which related to a period as to which PT-1 was the common parent of its own group and for which PT-1 properly filed a return.[35] Similarly, the bankruptcy court simply could have found as a fact that the STAR Group had no unpaid liability for its 2001 taxable year, with the effect that there was no liability that could be offset against the 1998 tax refund.

PT-1 was the proper party to seek refunds for the 1998 and 2001 short period tax years. PT-1 was the common parent of its group for those periods. The consolidated return Regulations, providing that the common parent is the sole agent for the group in all matters relating to the tax liability for the consolidated return year, continue that agency designation even if the group is merged into another group.[36] After STAR's acquisition of PT-1, PT-1 still retained its status as agent of the PT Group for the group's 1998 taxable year, and it could seek the 1998 tax refund independently of STAR. Since the IRS apparently conceded that the PT Group could file its own consolidated return for the 2001 short period, PT-1 was the proper agent to seek a refund for that year as well.

## Conclusion

*PT-1 Communications* demonstrates how courts can struggle to integrate complex areas of tax law with other disciplines. In this case, the court erred in its interpretation of Section 7421(a) and also in its recognition of a separate and distinct subgroup (within an existing consolidated group) that could file its own consolidated tax returns, errors the court might not have made had it been aware that no corporation had to file a tax return for the 2001 stub period in order for the NOLs from that period to be carried to other years. A court more familiar with sophisticated income tax concepts could have achieved the same outcome in a much more straightforward and legally correct fashion.

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[1] One of the more heavily criticized cases is In re Prudential Lines, Inc., 114 BR 27 (Bkrptcy. DC N.Y., 1989), *aff'd,* 119 BR 430 (DC N.Y., 1990), *aff'd,* 67 AFTR 2d 91-972, 928 F2d 565 (CA-2, 1991), *cert. den*. See, e.g., Sheppard, "When Bankruptcy Courts Take Tax Law into Their Own Hands," 51 TAX NOTES 158 (1991); Pisem and Glicklich, "Was the Bankruptcy Court Lost at Sea? Prudential Lines Collides with the Internal Revenue Code," 48 TAX NOTES 1553 (1990); Morris, "Imposition of Transfer Limitations on Claims and Equity Interests During Corporate Debtor's Chapter 11 Case to Preserve the Debtor's Net Operating Loss Carryforward:

Examining the Emerging Trend," 77 AM. BANKR. L.J. 285 (2003) (criticism by bankruptcy practitioner). The Sheppard article also criticized In re Holywell Corp., 85 BR 898, 71A AFTR2d 93-3062 (Bkrptcy. DC Fla., 1988), *aff'd* 66 AFTR 2d 90-5625, 911 F2d 1539 (CA-11, 1990), which held that a liquidating trustee is not liable for tax on gain from sale of all of the debtor's assets, a decision that was unanimously reversed by the Supreme Court, 69 AFTR 2d 92-682, 503 US 47, 117 L Ed 2d 196 (1992). See also Phelan and Jernigan, "The 'LTV Risk': Bankruptcy Court Disallows *'OLD'* [sic] Created in Exchange Offer*,"* REAL ESTATE LAW & PRACTICE COURSE HANDBOOK SERIES 51 (PLI No. N4-4549, Jan.-Mar., 1991) (criticizing In re Chateaugay Corp*.*, 109 BR 51 (Bkrptcy. DC N.Y., 1990), *aff'd,* 130 BR 403 (DC N.Y., 1991), which held that a face value exchange of debt obligations in a consensual workout generates new OID, a holding that was reversed by the Second Circuit, 961 F2d 378 (CA-2, 1992)).

**2** See "STAR Telecom Completes Acquisition of PT-1 Communications Creating the Nation's Seventh Largest Long Distance Carrier," BUSINESS WIRE (Feb. 4, 1999), *available at* http://findarticles.com/p/articles/mi_m0EIN/is_1999_Feb_4/ai_53702992/ (last visited May 12, 2009).

**3** See Reg. 1.1502-76(b).

**4** The bankruptcy court stated that STAR "refused" to include the post-March 9, 2001, operations of PT-1 and its subsidiaries in the STAR Group consolidated return for 2001, on the grounds that WorldCom controlled PT-1 from and after that date. While STAR may have indicated its intent to exclude those operations of PT-1 and its subsidiaries from the STAR Group consolidated return for 2001 if such a return was filed, it is difficult to make too much of this "refusal" when no return of any kind was, in fact, filed for the STAR Group for 2001.

**5** It is arguable that PT-1 and its subsidiaries did remain members of the STAR Group until that group's termination at the time of STAR's liquidation sometime later in 2001, and thus that it was improper for PT-1 and its subsidiaries to file their own return that included any period prior to STAR's liquidation. Conversely, it is also arguable that PT-1 and its subsidiaries were properly included in the WorldCom group from and after March 9, 2001. There are some inconsistencies in the case law and rulings regarding when, for purposes of determining consolidation under Section 1504, stock will be considered "voting stock" and by whom stock will be considered to be held in the case of pledges and similar arrangements. See, e.g., INI, Inc., T.C. Memo 1995-112, RIA TC Memo ¶95112; SEE GENERALLY Hennessey, Yates, Banks, and Pellervo, *The Consolidated Tax Return,* Sixth Edition (Thomson Reuters/WG&L, 2008, and 2009 Cum. Supp. No.1), ¶2.03[3], and Yates, "The Effect of the Lack of Stock Voting Rights on Beneficial Ownership Under Section 1502(a)," 18 J. Corp. Tax'n 3 (1991). Given the Service's apparent concession of these unsettled questions and the absence of any meaningful discussion of them in the bankruptcy court's opinion, we merely note their existence.

**6** PT-1 never filed a claim for refund with the IRS with respect to the 2001 Tax Refund. The Service, however, had filed various proofs of claim in the PT-1 bankruptcy, and the bankruptcy court held, consistently with the legislative history of Bankruptcy Code § 505(a)(2)(B) and prior case law, that PT-1 could seek its refund by means of a counterclaim to the Service's proofs of claim, notwithstanding PT-1's noncompliance with Section 7422(a), which provides that no suit for recovery of a tax refund can be maintained prior to the filing of a claim with the IRS.

**7** Reg. 1.1502-77A(d).

**8** Reg. 1.1502-21. Other restrictions, such as those under Section 382, also may apply. No issue was raised in the opinion regarding these other restrictions.

**9** The bankruptcy court's analysis apparently does not take into account any income that other, non-PT Group members of the STAR Group may have realized from March 9 through December 31, 2001, a period that was included in the same taxable year of the STAR Group as the 2001 stub period, even though such income would have reduced the losses that could be apportioned to PT-1 and its subsidiaries. (The court did state that "STAR did not receive a discharge of indebtedness," but did not consider other potential sources of income.) Indeed, if only *some* of the non-PT Group members of the STAR Group had positive taxable income, but the non-PT Group members of the STAR Group, in the aggregate, had an overall loss, the loss apportioned to PT-1 and its subsidiaries could still be reduced, even if one focuses only on the 2001 stub period; see Reg. 1.1502-21. Nevertheless, the IRS apparently conceded "that PT-1 is not attempting to obtain the benefit of NOLs for the [2001] stub period ... that would not otherwise be allocable to it," so we assume that the calculations of the losses apportioned to PT-1 and its subsidiaries were done correctly.

**10** It is unclear how the PT Group's entire federal income tax liability for the year ended June 30, 1998, could have been completely eliminated by the carryback, since NOL deductions for alternative minimum tax purposes are generally allowable only to the extent of 90% of alternative minimum taxable income. See Sections 56(a)(4) and 56(d).

[11] The 2001 tax refund was denied because a return that included the 2001 stub period, the period during which the net operating losses being carried to the 2001 short period arose, had not been filed. The 1998 tax refund, which was not attributable to any carryback from the 2001 stub period, was nevertheless denied because of the possibility that it might be subject to offset against the liability of the STAR Group for 2001, for which PT-1 and its subsidiaries, as members of the STAR Group for a portion of the year, were liable under Reg. 1.1502-6(a).

[12] Providing generally that the bankruptcy court "may determine the amount or legality of any tax, any fine or penalty relating to a tax, or any addition to tax, whether or not previously assessed, whether or not paid, and whether or not contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction." See generally Jacobs**, "**The Bankruptcy Court's Emergence as Tax Dispute Arbiter of Choice," 45 TAX LAW. 971 (1992).

[13] PT-1 was acting through a "liquidating trustee" when it sought the declaratory judgment. The IRS challenged the ability of a "liquidating trustee," as distinguished from a bankruptcy trustee, to seek relief under section 505 of the Bankruptcy Code, but the Court rejected that argument.

[14] The Administrative Procedures Act allows a reviewing court to "hold unlawful and set aside agency actions, findings, and conclusions found to be ... arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." See 5 U.S.C. section 706.

[15] As discussed in footnote 9, *supra*, the court apparently did not consider the possibility that the non-PT Group members of the STAR Group had positive income during the portion of 2001 following the 2001 stub period, with the effect that the STAR Group could have had a tax liability for the 2001 taxable year.

[16] Such a focus, however, might have drawn attention to some of the bankruptcy court's questionable computational conclusions discussed at note 9, *supra*, and the accompanying text (and to the questionable IRS concessions that enabled those conclusions to be reached).

[17] There also are judicially created exceptions, under which the bar of Section 7421(a) does not apply if a taxpayer has no alternative legal way to seek relief, (see South Carolina v. Regan,53 AFTR 2d 84-731, 465 US 367, 79 L Ed 2d 372 (1984)), or if a taxpayer can show that the government cannot ultimately prevail under any circumstances and that collection will cause irreparable harm to the taxpayer, (see Enochs v. Williams Packing & Navigation Co., 9 AFTR 2d 1594, 370 US 1, 8 L Ed 2d 292, 1962-2 CB 349 (1962)). The bankruptcy court did not appear to argue that section 505 of the Bankruptcy Code, which authorized it to "determine the amount or legality of any tax," provided an independent legal basis for carving out an exception to the application of Section 7421(a).

[18] See generally 4A Boris I. Bittker & Lawrence Lokken, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS, Second Edition (Thomson Reuters/WG&L, 1992 and 2009 Cum. Supp. No. 1), ¶¶1115.9.2, 115.9.3 (describing a broad class of cases in which Section 7421(a) has been applied). The Declaratory Judgment Act, 28 U.S.C. section 2201, which prohibits granting declaratory judgments "with respect to Federal taxes," has a specific exception for actions under section 505 of the Bankruptcy Code, but Section 7421(a) does not have such an exception.

[19] Enochs, *supra* note 17.

[20] William B. Scaife & Sons Co. v. Driscoll, 20 AFTR 978, 94 F2d 664 (CA-3, 1937), *aff'g* 19 AFTR 48, 18 F Supp 748 (DC Pa., 1937).

[21] See, e.g., Rosenblum, 39 AFTR 2d 77-766, 549 F2d 1140 (CA-8, 1977).

[22] Moshier v. Owyand, 78 AFTR 2d 96-6681 (DC Ariz., 1996).

[23] The court cited only In re Macher, 92 AFTR 2d 2003-7427, 303 BR 798 (DC Va., 2003), which held that Section 7421(a) does not bar injunctive relief ordering the IRS to process and consider a bankrupt debtor's offer in compromise on the same basis as offers from non-bankrupt debtors. The court in Macher reasoned that the automatic stay provisions of the Bankruptcy Code already enjoin the IRS from collecting taxes from bankrupt debtors, so that the injunction could not possibly interfere with any tax collection.

[24] In Scaife, *supra*, note 20, where the statute provided that the tax in one year was dependent on the value of stock reported on the return for a prior year, whether or not that reported value was correct, the filing of an amended return for the prior year would have reduced the taxpayer's liability for the later year, and the Third Circuit held that the predecessor of Section 7421(a) precluded ordering the IRS to accept such an amended return.

[25] And, in the case of tax years beginning before June 28, 2002, Reg. 1.1502-77A.

[26] The question of whether a court could order the IRS to designate a particular subsidiary corporation as agent for the *entire* group is beyond the scope of this article.

[27] Regs. 1.1502-75(d)(1) and 1.1502-76.

[28] Reg. 1.1502-77A(a) (tax years beginning before June 28, 2002) and Reg. 1.1502-77(a)(6) (tax years beginning after June 28, 2002). Under certain circumstances, another corporation may be appointed agent for the group; see Reg. 1.1502-77A(d) (tax years beginning before June 28, 2002) and Reg. 1.1502-77(d) (tax years beginning after June 28, 2002).

[29] Reg. 1.1502-6.

[30] Regs. 1.1502-77A and 1.1502-77. Thus, although the IRS might have consented to PT-1's designation as "agent" for the entire STAR Group, the filing of a 2001 stub period return for just PT-1 and its subsidiaries was improper. See Browning Ferris Industries, Inc., 99 AFTR 2d 2007-1312, 75 Fed Cl 591 (Fed. Cl. Ct., 2007) ("For tax years prior to June 28, 2002, when the common parent of a consolidated group has terminated without designating a substitute agent for the group, the only options are (1) for the remaining members to designate one of its members as agent for the [entire] group, or (2) for the IRS 'to deal separately with each remaining member for any purpose not covered by 1.1502-77T,' e.g., filing a refund claim."), *rev'd on other issues,* 101 AFTR 2d 2008-1770, 274 Fed Appx 904 (CA-F.C., 2008).

[31] Compare Section 6214(b) (the Tax Court may consider facts relating to years not before the court and over which it lacks jurisdiction in determining deficiency or overpayment for year over which it does have jurisdiction).

[32] A return for the loss year is also not *sufficient* evidence of the existence of the loss reported thereon. See, e.g., Wicker, TC Memo 1993-431, RIA TC Memo ¶93431 (a tax return "is merely a statement of a taxpayer's position" and does not establish the losses claimed on the return as correct), *aff'd per cur.* 75 AFTR 2d 95-1701, 50 F3d 12 (CA-8, 1995).

[33] Acquiescence recommended in AOD, 1/14/71 WL 29044.

[34] In contrast to the rules governing NOLs, the Code does specifically make the filing of a tax return a prerequisite to the allowance of deductions in other contexts, such as Section 874(a) (nonresident alien must file a true and accurate return in order to get the benefit of deductions and credits), Section 882(c)(2) (same for foreign corporations), and Section 63(e) (individual taxpayer must make an election on its return in order to be allowed itemized deductions).

[35] See note 5, *supra.*

[36] Reg. 1.1502-77A(a). The regulation was ambiguous as to whether the common parent's agency designation survived subsequent events, but cases interpreted the agency relationship of the consolidated return year to survive the group's merger into another consolidated group. See Interlake Corp., 112 T.C. 103 (1999) ("for any given year in which a consolidated return is filed, the entity that is the common parent for that particular year continues as the sole agent with respect to any procedural matters that may arise in connection with the group's tax liability for that year"); Union Oil Company of California, 101 T.C. 130 (1993). A later version of the Regulation clarified that the common parent of a consolidated group continues to be the "sole agent" of the group "with respect to that year" as long as that common parent continues to exist, regardless of whether the common parent becomes the subsidiary of another group or the group has a new common parent in a later year. See Reg. 1.1502-77(a)(4) and the Preamble to REG-103805-00, 9/26/00, the proposed version later finalized by TD 9002, 6/27/02 (the new Regulations were intended "to reduce uncertainty for both taxpayers and the IRS" by following the Interlake and Union Oil cases).