Davis William R

From: Davis William R

Sent: Tuesday, August 21, 2001 2:37 PM

To: Politzer Joni L

Cc: Mungo David J

Subject: 52-53 week tax year

Tracking:

Recipient	Delivery	Read
Politzer Joni L	Delivered: 8/21/01 2:39 PM	Read: 8/21/01 3:34 PM
Mungo David J	Delivered: 8/21/01 2:37 PM	Read: 8/21/01 4:53 PM

This is to follow-up to the advice that I provided you concerning the validity of the consent for a taxpayer using a 52-53 week tax year. The taxpayer concerning which the advice was rendered had previously executed a consent that identified the tax year for which it was effective as "tax year ended December 31, 19XX." Our advice said to use the same format for subsequent consents for that tax year, and for other tax years for which consents were being sought at the same time.

While the reviewers agreed with the advice **for these circumstances**, they did say that, if faced with the question of the proper identification of the tax period for a taxpayer using a 52-53 week tax year where no prior consents had been obtained, they would identify the tax period differently. Such identification would depend upon whether the election related to (1) the date such same day of the week last occurred in whichever calendar month to which it pertained, or (2) the date such same day of the week fell which was nearest to the last day of the calendar month to which it pertained.

This message should not be read as a modification to the prior advice, but as supplemental information that may be relevant to you for a taxpayer using a 52-53 week tax year for which you may need consents in the future.

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Office of Chief Counsel
Internal Revenue Service

memorandum

CC:LM:NR:DEN:TL-N-2907-01
WRDavis

date: JUN 25 2001

to: Team Manager, LMSB, Team 1294
Attn: Revenue Agent Joni Politzer MS 4294 SO

from: Area Counsel
(Natural Resources:Houston)

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subject: **Request for LMSB Division Counsel Assistance:**
[redacted] -
A. Restrictive Language for Consent - Form 872
B. Validity of Prior Consents
C. Proper "tax period ended date" to be used on Form 872

We respond to your request for assistance by reviewing the proposed language restricting the issues for which the taxpayer, [redacted], will consent to extend the statute of limitations for [redacted] taxable years. We further opine as to both the proper "tax period ended date" to be used for these taxable years, and the validity of prior consents received for two of these tax years. Our recitation of the facts as we know them, analysis, and recommendation follow. This memorandum should not be cited as precedent.

DISCLOSURE STATEMENT

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse affect on privileges, such as the attorney-client privilege. If disclosure becomes necessary, please contact this office for our views.

ISSUES

1. Should the Service enter into an agreement with [redacted] ("new [redacted]"), under which its consent to extend the statute of limitations on assessment for [redacted] ("old [redacted]" or "taxpayer"), is restricted to a particular issue for the [redacted] taxable year, in respect to which a claim for refund or credit subject to review by the Joint Committee on Taxation has been filed, and where the

Service does not anticipate auditing any issues other than the ones arising from the refund claim?

2. Should the Service enter into an agreement with new [redacted] under which its consent to extend the statute of limitations on assessment for old [redacted] is restricted to the research credit issue for the [redacted] taxable year and the short taxable year ending [redacted], using the language suggested by new [redacted]?

3. What is the proper date to use in the space identifying the "period(s) ended" date on a consent extending the assessment statute for a tax year during which old [redacted] filed its return using a 52-53 week tax period that ended on a date other than December 31?

4. Are the previously-obtained consents that purported to extend the period of limitations on assessment of tax for the taxable year for which old [redacted] filed a return reflecting the taxable period as ending on December 29, [redacted], valid where the consents identify the tax period as having ended December 31, [redacted]?

CONCLUSIONS

1. Absent a specific significant reason to restrict the extension of the assessment statute to particular issues, we recommend against entering into any agreement with restrictive language, no matter how drafted, for the taxable year [redacted]. We recommend resoliciting an unrestricted agreement extending the assessment statute from new [redacted].

2. Similarly, the consents for [redacted] and [redacted] should not be restricted. I you choose to proceed with a restricted consent, the proposed consent language does not adequately protect the government's interests. Since there are issues which may give rise to a deficiency in each year, we suggest that you modify the first paragraph of the language identifying the restriction as follows:

> The amount of any deficiency assessment is to be limited to the following items:
>
> > (1) the tax effect resulting from any adjustment with respect to the credit for increasing research activities under Section 41 of the Internal Revenue Code;

(2) the tax effect resulting from any adjustment with respect to any business credit carried forward or carried back to such taxable year;

and includes any amount resulting from statutory computations, recomputations or consequential changes to other items based on such adjustment including, but not limited to, the application of Section 280C of the Internal Revenue Code to prohibit the deduction of expenses for which credits are allowable, and the effect of any adjustments to the tentative minimum tax computation under Section 55(b) of the Internal Revenue Code on the amount of any business credit that may be applied to the tax liability for that taxable year, regardless of whether the taxpayer is liable for any alternative minimum tax under Section 55 of the Internal Revenue Code for that year.

3. Whenever a taxpayer, such as old [redacted], files a return reflecting the use of a 52-53 week taxable year and such date is determined with respect to the end of the month of December, the "period ended" date on any agreement to extend the assessment statute for such taxable year should use December 31 as the last day of that tax year. In the instant case, any Forms 872 extending the [redacted] and [redacted] tax years of old [redacted] should show [redacted], and [redacted], as the last day of those tax years, respectively.

4. The previously-obtained consents obtained for the [redacted] and [redacted] tax years are valid.

FACTS

Consolidated corporate income tax returns were filed for the taxpayer, [redacted] ("old [redacted]"), for its [redacted] and [redacted] taxable years, and for the short taxable year ending [redacted] ("[redacted] tax year"). On that date, old [redacted] was merged into a [redacted], a subsidiary of [redacted]. Thereafter, [redacted], changed its name to [redacted] ("new [redacted]").[1]

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[1] We note that, in checking the web site for the Colorado Secretary of State's office (http://www.sos.state.co.us), we discovered a filing noting a name change from [redacted], to [redacted] taking place on [redacted] (see attached copies). If this name

(continued...)

Old [redacted] filed its Form 1120, U.S. Corporation Income Tax Return, for the consolidated group using a 52-53 week tax year, identifying that period as beginning December 31, [redacted] and ending December 29, [redacted] ("[redacted] tax year"). However, the Form 1120 filed for the subsequent tax year did not similarly reflect the 52-53 week tax year, leaving the alternate date line at the top of the [redacted] return ("[redacted] tax year") blank. Had this return reflected a 52-53 week tax year, the tax year would have begun on December 30, [redacted], and ended on either December 27, [redacted], or January 3, [redacted], depending on whether old [redacted]'s election to use a 52-53 week tax year was made pursuant to I.R.C. § 441(f)(1)(A) or (f)(1)(B), respectively. Each of the returns identified old [redacted] as a "personal service corporation," as defined in Temp. Treas. Reg. § 1.441-4T.

One of the proposed Forms 872 shows [redacted], as the "period ended" date. From this, we assume that a consolidated return for the affiliated group of corporations for which old [redacted] was the common parent was filed for the short taxable year ended that date. We further assume that this date corresponds with the merger of old [redacted] into [redacted], with [redacted] surviving that merger, thus terminating the taxable year for old [redacted] under Treas. Reg. § 1.1502-76(b)(1)(ii)(A).

The Service and new [redacted], as successor in interest to old [redacted], and as alternative agent for the old [redacted] consolidated group, entered into agreements to extend the periods for assessment for the [redacted] and [redacted] tax years to [redacted], pursuant to section 6501(c)(4). An officer of new [redacted] executed the Forms 872 as the successor/agent for old [redacted]. Each of the Forms 872 identified the taxable period being extended as the period ended December 31 of the respective tax year. The period for assessment with respect to old [redacted]'s [redacted] tax year expires on [redacted], as well, [redacted] years after the return was filed.

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[1](...continued)
change concerns the successor to the common parent of the consolidated group with respect to which your request for assistance pertains, you should <u>first</u> confirm the current name of the successor corporation (i.e., survivor of a merger) and, if the name has changed, modify the line identifying the name of the corporation consenting to any extension to reflect the corporation's current name and any intermediate names that the corporation has had since the former common parent was merged into it.

Since filing its return for the [redacted], new [redacted] has filed a claim for refund arising from old [redacted]'s claimed research credits under section 41. From a conversation with Revenue Agent Joni Politzer, we understand that the amount of refund claimed in the [redacted] tax year exceeds $[redacted]. Additionally, new [redacted] filed a Form 1120X, Amended U.S. Corporation Income Tax Return, for old [redacted]'s [redacted] tax year. This amended return reflects a balance due of $[redacted], but also includes a research credit claim under section 41 of $[redacted], the use of which is limited in the [redacted] tax year.

A recent transmittal reflects your view that the credit limitations under section 38(c)(1) have been erroneously computed for [redacted]. Specifically, you indicate that the tentative minimum tax under section 55(b)(1)(B) was erroneously computed on Form 4626, Alternative Minimum Tax - Corporations, by decreasing the wage expense by the amount of the current year section 41 credit. When this wage expense is left undisturbed, the tentative minimum tax limits the credit by more than the amount reported on Form 3800, line 15, resulting in a deficiency exceeding the additional tax due reflected on line 10 of Form 1120X for [redacted] by in excess of $[redacted].

The taxpayer's original return for the [redacted] tax year claimed a credit under section 41 for increasing research expenditures on its [redacted] tax return.

The taxpayer has proposed restricting the consents to extend the assessment statute through the use of the following language:

> *This consent is restricted to the tax effect resulting from any adjustment with respect to the research and experimental credit under Section 41 of the Internal Revenue Code and includes any amount resulting from statutory computations, recomputations or consequential changes to other items based on such adjustment.*
>
> *The provisions of Section 6511(c) of the Internal Revenue Code are limited to any refund or credit resulting from adjustment for which the period of assessment is extended under this agreement.*

We further understand that, based upon the scope of the refund claims, it is unlikely that issues unrelated to the examination of the claimed research credits will be audited.

ANALYSIS

1. The refund claim for the [redacted] tax year, if approved, will subject it to the review of the Joint Committee on Taxation, pursuant to section 6405(a). Because of its magnitude, this review would apply despite the increase in the minimum amount for such review - $2 million - made by the Community Renewal Tax Relief Act of 2000, Pub. L. No. 106-554, 114 Stat. 2763, 2763A-634.

It is well established that a Form 872 consent to extend the statute of limitations is essentially a unilateral waiver of a defense by the taxpayer, and not a contract in the true sense. Stange v. United States, 282 U.S. 270 (1931); United States v. Gayne, 137 F.2d 522 (2d Cir. 1943); Tallal v. Commissioner, 77 T.C. 1291 (1981). Since section 6501(c)(4) requires that the parties reach a written agreement, the courts have applied contract principles to determine the existence of and scope of that agreement. Kronish v. Commissioner, 90 T.C. 684, 693 (1988); Southern v. Commissioner, 87 T.C. 49 (1986); Piarulle v. Commissioner, 80 T.C. 1035, 1042 (1983). It is with this in mind that we provide our analysis and recommendations.

The Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685 ("RRA98"), modified, inter alia, section 6501(c)(4), the Code provision concerning extension by agreement of the statute of limitations on assessment. Specifically, it added section 6501(c)(4)(B), "Notice to taxpayer of right to refuse or limit extension," which states as follows:

> The Secretary shall notify the taxpayer of the taxpayer's right to refuse to extend the period of limitations, or to limit such extension to particular issues or to a particular period of time, on each occasion when the taxpayer is requested to provide such consent.

RRA98 § 3461(b)(2), 112 Stat. 764.

The legislative history explains that the intent of this provision was to "require[] that, on each occasion on which the taxpayer is requested by the IRS to extend the statute of limitations on assessment, the IRS must notify the taxpayer of the taxpayer's right to refuse to extend the statute of limitations or to limit the extension to particular issues." S. Rep. No. 174, 105th Cong., 2d Sess., at 88. The reason given for the change was that:

> taxpayers should be fully informed of their rights with respect to the statute of limitations on assessment. The Committee is concerned that in some cases taxpayer [sic] have not been fully aware of their rights to refuse to extend the statute of limitations and have felt that they had no choice but to agree to extend the statute of limitations upon the request of the IRS.

Id., at 87. This provision became effective on January 1, 2000.

A taxpayer has a right to request a restricted consent, but the Service is not bound to grant the taxpayer's request. As stated above, the statute of limitations on assessment is extended under section 6501(c)(4) where "the Secretary and the taxpayer have consented in writing" to such extension. The 1998 changes to this section do not require the Service to agree to any restrictions proposed by the taxpayer.

Absent a specific significant reason to restrict the extension of the assessment statute to particular issues, we recommend against entering into such an agreement. We note the following I.R.M. provisions that echo this sentiment.

I.R.M. 4.3.5, Joint Committee Handbook, states that "[i]t is Service practice to keep the statutory period of limitations open on all returns involved in a Joint Committee case, including returns recommended for survey action . . . until the Committee's consideration is complete." § 3.4.(1). Additionally, the portion of the I.R.M. dealing with Appeals' handling of Joint Committee cases echoes this sentiment. There, it states:

> Consents are ordinarily obtained where the period of limitations expires in less than six months from date of submission of a report to the JC. Do not use restricted consents in JC cases. In cases where there is no reasonable prospect of a deficiency, a statutory notice is not arbitrarily issued.

Section 8.9.1.3.1(1) (emphasis added).

In accord with the manual, and in recognition of the possibility of the Joint Committee raising unforeseen issues, see, e.g., United Dominion Indus. v. United States, 2001 U.S.LEXIS 4124, *13 (June 4, 2001), we recommend against entering into any agreement with restrictive language, no matter how drafted, for the taxable year [redacted]. Rather, we suggest that you solicit an unrestricted agreement extending the assessment statute from new [redacted].

2. The [redacted] tax year involves an amended return (refund claim) on which the taxpayer first claims a credit under section 41. Because of adjustments mandated by section 280C(c), the credit claim on this amended return results in an increase in taxable income, and a corresponding increase in the income tax before application of this claimed credit. Further, because of the limitation imposed by section 38(c) relating to the tentative minimum tax for that year, the amount of the credit applied against the [redacted] tax liability is far less than the additional tax attributable to the section 280C(c) adjustments, resulting in a "balance due" amended return.

Unlike the other two tax years to which your inquiry pertains, the [redacted] tax year does not involve the filing of an amended return. Rather, the original return contains the taxpayer's claim for research credit under section 41. The magnitude of any refund claimed does not, to our knowledge, require review by the Joint Committee on Taxation.

As previously discussed, a taxpayer has a right to request a restricted consent, but the Service is not bound to grant each such request. For the [redacted] tax year, the Service needs additional time to complete an audit of the research credit issue - one that, if a sufficient amount of the credit is found not to be allowable, will result in a deficiency. We believe that the Service should seek additional extension of the assessment statute, with some modification of the terms restricting the matters for which the assessment statute will be extended.

First Paragraph. We note that, from the portions of the amended [redacted] return included in your subsequent transmission, $[redacted] of the tentative general business credit claimed thereon arises from the carry forward of general business credits to that tax year from prior years. Likewise, inasmuch as the taxpayer is unable to use the combined amount of the section 41 credit arising in [redacted] ($[redacted]) and the credit carried forward to [redacted] from prior years in [redacted], the credit first applied in this year, as well as some portion of the credit applied in [redacted] will arise from the business credits carried forward into [redacted]. Section 39.

We further note that, for [redacted], it appears that, to the extent that the [redacted] research credit is allowable <u>and</u> <u>used in</u> <u>that</u> <u>tax</u> <u>year</u> (i.e., if the credits carried forward to [redacted] are not allowed), a deficiency may arise from the increase in taxable income attributable to application of section 280C to the expenses forming the basis of the claimed section 41 credit. Beyond that, the resultant effect of an adjustment to the tentative minimum tax computation under section 55(b) on the

allowable amount of any business credit appears to be in dispute, regardless of whether the taxpayer is liable for any alternative minimum tax under section 55 for that year.

In order to clarify the matters in dispute and which affect the computation of a deficiency, we recommend that you modify the first paragraph restricting the consents you obtain for the [redacted] and [redacted] tax years as follows:

> **The amount of any deficiency assessment is to be limited to the following items:**
>
> > **(1)** the tax effect resulting from any adjustment with respect to the **credit for increasing** research **activities** under Section 41 of the Internal Revenue Code;
> >
> > **(2) the tax effect resulting from any adjustment with respect to any business credit carried forward or carried back to such taxable year;**
>
> and includes any amount resulting from statutory computations, recomputations or consequential changes to other items based on such adjustment **including, but not limited to, the application of Section 280C of the Internal Revenue Code to prohibit the deduction of expenses for which credits are allowable, and the effect of any adjustments to the tentative minimum tax computation under Section 55(b) of the Internal Revenue Code on the amount of any business credit that may be applied to the tax liability for that taxable year, regardless of whether the taxpayer is liable for any alternative minimum tax under Section 55 of the Internal Revenue Code for that year.**

(modified language in **bold**)

Please be sure to use the indentations shown here so that it is clear that the flush language (beginning "and includes") applies to both subparagraphs.

Second Paragraph. This paragraph purports to limit the rules under section 6511(c) concerning the time for filing claims and limiting the amount of claims filed after the agreement, to any "refund or credit resulting from the adjustment for which the period of assessment is extended under the agreement." We first note that section 6511(c) appears to us to be an attempt to set forth an agreement concerning the statute of limitations on credit or refund, something that the Code permits only in

connection with an extension of the period for assessment in accordance with section 6501(c)(4). To the extent that such language is effective, we believe that it is superfluous and should not be included in any consent form.

3. and 4. Section 441 sets forth the period for computation of taxable income. Therein, section 441(f) generally permits taxpayers who, in keeping their books, regularly compute income on the basis of an annual period which varies from 52 to 53 weeks and ends always on the same day of the week which is either such day last occurring in a calendar month, or such day falling closest to the last day of the calendar month, to elect to compute taxable income on the basis of that annual period.

Section 441(i) sets out the general rule establishing the calendar year as the taxable year of any personal service corporation. Old [redacted] identified itself as a personal service corporation on its returns for the [redacted] and [redacted] tax years. The Code permits, by regulation, use of the 52-53 week taxable periods by, among other entity forms, personal service corporations.

Nonetheless, Temp. Treas. Reg. § 1.441-4T make clear that, in the case of old [redacted], the last day of the [redacted] and [redacted] taxable years shall be treated as December 31. Temp. Treas. Reg. § 1.441-4T spells out that, for purposes of defining a personal service corporation's taxable year, "a 52-53 week taxable year of a personal service corporation ending with reference to the month of December shall be treated as <u>the calendar year</u>." Temp. Treas. Reg. § 1.441-4T(b)(2)(ii) (emphasis added). Promulgated pursuant to section 441(f)(3), this regulation is a "legislative regulation," to be treated as "controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute." <u>Chevron U.S.A. Inc. v. Natural Resources Defense Council</u>, 467 U.S. 837, 844 (1984).

In summary, for a personal service company, the end of a taxable year where a 52-53 week tax year which references the month of December should be treated asa calendar year. Here, the previously-obtained consents correctly identified the periods as having ended December 31 and are valid consents for the [redacted] and [redacted] tax years. Should you obtain further consents for those tax years, the same tax period ended dates (i.e., December 31, [redacted] and December 31, [redacted]) should be used. For [redacted], the short year ending [redacted] should be identified as the "period ending" on the [redacted] consent.

Please do not hesitate to contact Bill Davis if you need further assistance concerning this matter, at (303) 844-2214, ext. 259.

BERNARD B. NELSON
Area Counsel
(Natural Resources:Houston)

By: David J. Mungo
DAVID J. MUNGO
Associate Area Counsel (LMSB)

Attachment

copy to:
Patrick Pientka, Technical Coordinator
Denver, QMS, Technical Territory West