Office of Chief Counsel
Internal Revenue Service

memorandum

CC:SB:8:LA:3:~~TL-N~~-156173-01
GMSlavett POSTF-

date: 3/8/02

to: Laurie Keleman, Taxpayer Advocate, Los Angeles
Attn: Bob Casaburi, Tech. Advisor

from: GARY M. SLAVETT
Attorney (SBSE)

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subject: [redacted], Inc.
[redacted]

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. This memorandum may be disclosed to IRS employees who need the information to carry out their official tax administration responsibilities. If disclosure to others becomes necessary, please contact this office for our views.

Your office has requested advice with respect to the above-referenced taxpayer. This memorandum should not be cited as precedent.

ISSUE

Whether a failure to pay, or the late payment of, an installment payment due under I.R.C. § 1363(d) causes the remaining unpaid annual installments to accelerate and become due and payable immediately.

SHORT ANSWER

The failure to pay, or late payment of, an installment payment due under I.R.C. § 1363(d) does not cause the remaining unpaid annual installments to accelerate and become due and payable immediately.

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FACTS

[redacted], Inc. ("[redacted]") was incorporated as a C corporation on or about [redacted]. [redacted] used the LIFO method of accounting for its inventory. [redacted] elected S status and was approved for the tax year beginning January 1, [redacted]. As a result of the S election, and pursuant to I.R.C. § 1363(d), [redacted] must include in income the "LIFO recapture amount."

The tax attributable the to LIFO recaptured amount "shall" be payable in four equal installment, the first of which is payable by the due date of the C corporation's last tax return. I.R.C. § 1363(d)(2)(A), (B). The three remaining installments are due by the respective due dates of the corporation's returns for the three succeeding years. I.R.C. § 1363(d)(2)(B).

[redacted] final C corporation return is for the [redacted] tax year, which was due on March 15, [redacted]. The [redacted] C corporation tax return was filed on or about April 24, [redacted]. This return did not include the LIFO recapture amount. On [redacted], [redacted] filed an amended return to include the LIFO recapture amount. The tax attributable to the LIFO recapture amount, as reported by [redacted] in its amended return, is $[redacted]. The first installment, which was due on March 15, [redacted], in the amount $[redacted], was paid with the amended return on [redacted], [redacted]. The second payment, which was due on March 15, [redacted], was not paid until [redacted].

The Fresno Service treated the failure to make a timely first payment as a default installment agreement and started regular collection procedures, including the assessment of interest, on the entire amount of LIFO recapture tax.

LAW

Section 1363(d) provides that a C corporation that maintains its inventory using the last-in, first-out (LIFO) method for its last tax year before an S corporation election becomes effective must include in gross income a LIFO recapture amount when it converts to S corporation status.[1]

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[1] Section 1363(d) was enacted as the result of Congress' concern that a corporation maintaining its inventory under

The tax attributable to the inclusion in income of any LIFO recapture amount "shall" be payable by the corporation in four equal installments. I.R.C. § 1363(d)(2)(A). The first payment is due on or before the due date of the corporate tax return for the electing corporation's last tax year as a C corporation. I.R.C. § 1363(d)(2)(B). The three subsequent installments are due on or before the respective due dates of the S corporation's returns for the three succeeding tax years. I.R.C. § 1363(d)(2)(A).

No interest is payable on the installments if they are paid by the respective due dates. I.R.C. § 1363(d)(2)(C); H.R. Rep. No. 495 (Conf.), 100th Cong., 1st Sess. 975 (1987). Section 6601(a) provides that interest on unpaid taxes begins to accrue on the last date prescribed for payment by the Code. With respect to the LIFO recapture tax, the last date prescribed for payment of each installment is the due date of that installment. I.R.C. § 1363(d)(2)(C). Thus, interest only begins to accrue if an installment is not paid by the due date of the installment, and then, only with respect to that individual installment.

ANALYSIS

The Service Center appears to be treating the installment payments under I.R.C. § 1363(d) in the same manner as an installment agreements entered into under the provisions of I.R.C. § 6159. Thus, the Service Center treats the taxpayer's failure to make a timely payment of a LIFO recapture tax installment as a defaulted installment agreement and causes the remaining unpaid annual installments to accelerate and become due and payable immediately. This treatment is not consistent with the Code.

Unlike an installment agreement under I.R.C. § 6159 where the Service and taxpayer voluntarily enter into the installment agreement, the installment provision of I.R.C. § 1363(d) are mandatory. Section 1363(d)(2)(A) states that a

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LIFO might circumvent the built-in gain rules of I.R.C. § 1374 to the extent the corporation did not liquidate its LIFO layers during the 10 years following its conversion from a C corporation to an S corporation.

taxpayer "shall" pay in four equal installments. The Service does not have discretion to allow or disallow the payment of the LIFO recapture tax in installments and does not have the authority to terminate the installment payment provisions of I.R.C. § 1363(d)(2) if the taxpayer does not timely pay an installment.[2] Each installment is to be treated independently.

The interest provisions of I.R.C. § 1363(d)(2)(C) also provide the statutory underpinning for the proposition that each installment is to be treated independently. Section 1363(d)(2)(C) provides that for purposes of the accrual of interest, the last date prescribed for payment of each installment is the due date of that installment. Thus, the LIFO recapture tax only becomes due as each installment date passes. To accelerate payment of the entire amount of LIFO recapture tax because of failure to timely make an installment payment is contrary to the Code.

To clarify, interest begins to run from the due date of each individual installment. In this case, [redacted]'s final C corporation return was due on March 15, [redacted]. Thus, the first installment of the LIFO recapture tax was due on March 15, [redacted]. See I.R.C. § 1363(d)(2). Since [redacted] did not make payment on the first installment until [redacted], interest accrues from March 15, [redacted] to [redacted] on the first installment amount only. The remaining installment payments are not accelerated and retain their original due dates.

CONCLUSION

The failure to pay, or late payment of, a LIFO recapture tax installment does not cause the acceleration of all future installments to become due and payable immediately.

If you have any questions or comments, please contact Attorney Gary M. Slavett at 213-894-3027, ext. 185.

JAMES A. NELSON
Area Counsel, SB/SE

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[2] In contrast, the Service does have the authority in certain situations to termination an installment agreement entered into under I.R.C. § 6159. I.R.C. § 6159(b)(4).

By:_____
GARY M. SLAVETT
Attorney