

**Office of Chief Counsel
Internal Revenue Service
Memorandum**

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to: Senior Team Coordinator
Group Manager

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subject: Taxpayer Year3 Amended Return

This memorandum responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

Taxpayer =
Partnership =
Year1 =
Year2 =
Year3 =
Year4 =
Year5 =
Year6 =
Year7 =
Year8 =
Amount1 =
Amount2 =
Amount3 =
Amount4 =
Amount5 =
Amount6 =
Amount7 =
Amount8 =
Amount9 =

Amount10 =
Amount11 =
Amount12 =
Amount13 =
Amount14 =
Amount15 =
Date1 =
Date2 =
Date3 =
Date4 =
Date5 =

ISSUES

1. Whether the R&E credit portion of the taxpayer's Year3 Form 1120X can be processed as a timely-filed claim.
2. Whether the Year3 amended partnership return can be treated as a timely-filed AAR, and whether the adjustments can flow to the partners, given the circumstances of the previously signed Form 870-PT.
3. Whether the Year3 tax increase which follows from the foreign tax credit (FTC) carryover impact of allowing the taxpayer's Year1 claim can be assessed pursuant to mitigation.
4. Whether the additional R&E credits claimed on the Year3 Form 1120X can be allowed as an offset to the additional FTC-related tax to be assessed pursuant to mitigation.

CONCLUSIONS

1. No, the R&E credit portion of the Year3 Form 1120X cannot be treated as a timely-filed claim. A tax-decreasing entry on an amended return that does not exceed a tax-increasing entry does not constitute a refund claim under § 6402. The Service cannot "unbundle" the offsetting adjustments in an amended return and issue a refund based solely on the tax-decreasing entry when there is no overall overpayment for the year. Moreover, the taxpayer cannot convert the Year3 Form 1120X into a claim for credit or refund by including a request for credit of payments attributable to subsequent tax years.
2. Pursuant to the TEFRA provisions, a refund or credit related to a partnership item may be allowed without the filing of a claim.
3. Allowance of the taxpayer's Year1 claim results in a double allowance of a credit. Therefore, the Year3 tax increase which follows from the foreign tax credit (FTC) carryover impact of allowing the taxpayer's Year1 claim can be assessed pursuant to mitigation.
4. The additional R&E credits claimed on the Year3 Form 1120X cannot be allowed as an offset to the additional FTC-related tax to be assessed

pursuant to mitigation, because the R&E credit adjustment is not the same item that was the subject of the Year1 adjustment.

FACTS

Partnership ("Partnership") is a partnership wholly owned by two C corporations who are members of the TAXPAYER ("Taxpayer") consolidated group. Partnership elected into TEFRA. The research credit was a partnership item of Partnership for each of the tax years Year1, Year2, and Year3.

870-PT

At the conclusion of the audit of Taxpayer's Year1, Year2, and Year3 years, which included an examination of Partnership, Taxpayer executed a Form 870-PT (rev. 6-2008) covering the partnership tax years at issue (Year1, Year2, and Year3) on Date3, Year6. The 870-PT included partnership-level adjustments for the research credit in each year. No FPAA was issued to Partnership.

On Date3, Year6, the same date the 870-PT was signed, the taxpayer also signed a Form 5701 Notice of Proposed Adjustment containing certain research credit adjustments. Exam had issued this 5701 to the taxpayer on Date2, Year6. The 5701 proposed an increase to the research credit for Year1, and decreases to the research credit for Year2 and Year3. The Form 886A detailed explanation attached to the Form 5701 stated:

Taxpayer's Position:

On [Date1], [Year6], the taxpayer was notified by the IRS Examination that the adjustments shown in this 5701 were final. The taxpayer was asked to consider these adjustments and determine whether they agreed or not. As of [Date2], [Year6], the taxpayer notified the IRS they would be willing to agree to the IRS 09-14-[Year6] research credit proposal to close out the current examination. However, they wanted to inform the IRS Exam Team they would be filing a claim for [Year1], [Year2] and [Year3] in the near future to change the hours that were charged by employees for departmental meetings, etc. originally classified as nonqualified hours to qualified hours.

The face of the Form 5701 also included the following language:

Taxpayer's Comments:

Taxpayer is agreeing to the adjustments proposed by the Service solely to facilitate the Service's desire to close the audit within an accelerated timeframe. Taxpayer will be filing amended returns for tax years [Year1], [Year2] and [Year3] to claim the proper amount of Sec. 41 research credit as mentioned on page 12 of the Notice of Proposed Adjustment under "Taxpayer's Position". Taxpayer does not agree with the reason stated by the Service as to why a claim would be filed. The Service states that taxpayer "would be filing a claim for [Year1], [Year2] and [Year3] in the near future to change the hours that were charged by employees for departmental meetings, etc. originally classified as nonqualified hours to qualified hours." Taxpayer explained to the Service that during the calculation of the Sec. 41 research credit for tax year [Year5] which was ongoing during the audit of tax years [Year1], [Year2] and [Year3], the taxpayer discovered that employees did not understand the meaning behind the numerous function codes required to be

utilized when inputting their time into the project accounting system. Understanding the function codes is critical to computing the proper amount of the credit as the function codes are used to calculate the amount of qualified hours eligible for the Sec. 41 credit. The taxpayer believes this misunderstanding has unfairly led the taxpayer to claim fewer qualified hours than it is eligible to Claim under Sec. 41 . The taxpayer needs additional time to investigate and document its findings and, therefore, will file amended returns for [Year1], [Year2] and [Year3] subsequent to the close of the Service's audit for these years.

At the bottom of the Form 5701, the taxpayer checked the box "Agreed in Part" with the handwritten entry "see comments above."

The 870-PT was signed by the Service in May, Year7. The 870-PT signed by the service included a different copy of the research credit Form 5701 which was not signed by the taxpayer and did not contain the above language. The tax due from the 870-PT adjustments was paid and assessed.

Amended Returns

On Date2, Year7, Partnership submitted amended Forms 1065 for the partnership tax years Year1, Year2, and Year3 claiming additional research credits. No Form 8082 was attached. The taxpayer attached the research credit Forms 5701 and 886A to their amended return, and also attached a statement which included the following: "As stated on the NOPA, the taxpayer agreed to the adjustments with the understanding a claim for refund would be filed." Some of the claimed expenses were previously adjusted in the research credit Form 5701 and associated 870-PT. The amended 1065 for the Year3 year claimed an additional \$Amount1 in research credits in addition to what was claimed on the original return, and \$Amount2 in excess of the research credit allowed pursuant to the 870-PT.

Taxpayer ("Taxpayer") filed a Form 1120X for the Year3 year (the "Year3 Amendment"). The return was received by the Ogden Service Center ("Ogden") in January Year8, with a postmark date of Date5, Year7. Taxpayer had previously executed a Form 872 (rev. 6-2008) to extend the assessment period for its Year3 year through Date5, Year7. The Year3 Amendment showed a tax increase of \$Amount3. Because it was received after expiration of the assessment period and showed a tax increase, the Year3 Amendment was rejected by the Service Center as untimely and the \$Amount3 tax was not assessed.

On Date4, Year7, the taxpayer also mailed two other amended returns (Forms 1120X) for the tax years ended Year1 ("Year1 Claim") and Year2 ("Year2 Claim") respectively. These amended returns were also received by Ogden in early January, Year8. The Year1 and Year2 Amendments requested refunds of \$Amount4 and \$Amount5 respectively, and were processed as timely-filed claims based on their postmark date.

The Year1 Amendment showed an increase to taxable income in the amount of \$Amount6, which represented the effect of reclassifying \$Amount7 from a dividend

eligible for the 80% dividend-received deduction to a foreign dividend gross-up. As a result of this change, the taxpayer's foreign tax credit (FTC) limitation was increased for the Year1 year, which resulted in the Taxpayer utilizing \$Amount8 of additional FTC for Year1.

The Year3 Amendment had three components. First, it claimed additional research credits of \$Amount2 flowing through from Partnership. Second, it reduced foreign tax credits claimed for Year3 by \$Amount8. On the originally filed return for Year3, Taxpayer had utilized \$Amount8 of FTC carried forward from Year1; these credits were no longer available as a result of the Year1 amendment. Thus, the net increase in tax shown on the Year3 Amendment was \$Amount3. Third, the Year3 Amendment requested that a \$Amount9 overpayment from the Year5 year be credited against the \$Amount3 net tax liability for Year3.¹

Taxpayer's originally filed Year3 return reflected an overpayment of \$Amount11. The Year4 return was the Taxpayer's consolidated group's final return; the "final return" box was checked on page 1 of the Year4 Form 1120. The Year4 return reported a tax liability of \$Amount12, and an overpayment of \$Amount9, which included the \$Amount11 applied forward from the Year3 year, and additional net payments of \$Amount13 (\$Amount14 estimates paid for Year4, less \$Amount15 refunded via Form 4466, less Year4 tax liability of \$Amount12).

LAW AND ANALYSIS

A claim for refund of an overpayment must generally be filed within three years of the date the return was filed, or two years from the date of payment, whichever is later. I.R.C. § 6511(a). If the period for assessment is extended by agreement, the period for filing claim for credit or refund shall not expire prior to 6 months after the expiration of the period within which an assessment may be made pursuant to such extension. § 6511(c)(1). The period for assessment expired on Date5, Year7. Thus, Taxpayer had until June 30, Year8 to file a claim with respect to the Year3 year.

Year3 Amendment was untimely

A tax return is generally considered "filed" when it is received by the appropriate Service office. See Winnett v. Commissioner, 96 T.C. 802 (1991); Dingman v. Commissioner, T.C. Memo. 2011-116. The "mailbox rule" of Section 7502 provides an exception to this general rule where a return required to be filed by a certain date is postmarked prior to the deadline. A refund claim qualifies for the mailbox rule, but the rule does not apply to an amended return showing additional tax due, because such an amendment is not a

¹ Taxpayer requested that the remaining \$Amount10 be applied towards an anticipated deficiency from the ongoing audit of the Year4 year.

"document required to be filed within a prescribed period" as required by the statute. See Treas. Reg. § 301.7502-1(a). The Year3 Amendment was postmarked prior to the expiration of the assessment period, but was received after expiration. Thus it is timely filed only if it can be considered a claim for refund.

At first glance, the Year3 Amendment might appear to be a claim, because it shows an overpayment on line 11 of Form 1120X, and "Refund – Research Credit" is written across the top. However, the return shows a net increase in the Year3 tax liability on line 4. The Year3 Amendment derives an "overpayment" by treating its Year5 overpayment as a payment for Year3. Because the attachment to the 1120X states that the "overpayment" actually represents a Year4 overpayment which was credited to the Year5 year's estimated taxes, we do not believe that the Year3 Amendment represents a claim for refund or credit with respect to the Year3 year. The excess payments applied against the underpayment shown on the Year3 Amendment were actually excess payments for Year5. As a result, the Year3 Amendment did not constitute a claim for refund of tax paid for the Year3 year in excess of the amount that was properly due for that year.

A refund of Taxpayer's Year5 payments cannot be validly requested pursuant to an amended return filed for Year3. An election to apply an overpayment to a subsequent year's estimated taxes is irrevocable. Martin Marietta Corp. v. U.S., 572 F.2d 839, 842 (Ct. Cl. 1978), Starr v. Commissioner, 267 F.2d 148, 151 (7th Cir. 1959). Section 6513(d) provides that once a taxpayer claims an overpayment as a credit against estimated taxes for the succeeding year, that amount is treated as a payment of income tax for the succeeding year (whether or not actually claimed as a credit in the return) and no claim for credit or refund of such overpayment shall be allowed for the taxable year in which the overpayment arises. A taxpayer cannot file an amended return to obtain a refund of an overpayment previously credited to the succeeding year's taxes. Georges v. U.S., 916 F.2d 1520 (11th Cir. 1990). Taxpayer originally credited its Year3 overpayment to its Year4 estimated taxes, and then further applied that overpayment to Year5 estimated taxes. Thus, having originally elected to apply its Year3 overpayment to Year4 (and its Year4 overpayment to Year5), the taxpayer cannot file a claim for refund of this amount with respect to the Year3 year. Moreover, the taxpayer cannot merge overpayments for multiple tax years into a single claim. Separate claims must be made for each taxable year. Treas. Reg. §301.6402-2(d). For all the above reasons, the Year3 Amendment cannot be processed as a timely claim.

Moreover, the tax-decreasing adjustment in the Year3 Amendment (research credit) cannot be unbundled from the tax-increasing adjustment (foreign tax credit) for processing. The Year3 Amendment resulted in an overall increased tax liability, even though it included a tax-decreasing adjustment for the research credit. When a taxpayer submits an amended return that includes both favorable and unfavorable adjustments, the Service cannot accept only some of the taxpayer's self-reported adjustments because each of the adjustments are only components of a single tax liability. See Penn Mutual Indemnity Co. v. Commissioner, 32 T.C. 653, 668 (1959);

Kingston Prod. Corp. v. U.S., 368 F.2d 281, 287 (Ct. Cl. 1966). The Service cannot accept the research credit adjustment as a timely claim while rejecting the foreign tax credit adjustment as an untimely self-assessment. The Year3 Amendment as a whole must be rejected as untimely.

Research Credit AARs

The research credit was originally a partnership item of Partnership for each of the years at issue. In the normal case, the 870-PT executed by the each of the partners for the Year1, Year2, and Year3 years would remove those partners from TEFRA proceedings with respect to Partnership for those partnership years. All partnership items would be converted to nonpartnership items with respect to the signing partners. The 870-PT contains closing agreement language, which prohibits the partners from filing claims for any items of that partnership. The partnership can still file an AAR, but no adjustments would flow through to the partners because they both previously settled.



The remainder of this analysis assumes the research credits will continue to be treated as partnership items of Partnership, without regard to the previously signed 870-PT. Subchapter B of chapter 66 (I.R.C. sections 6511 – 6515) does not apply to any credit or refund of an overpayment attributable to a partnership item. § 6230(d)(6), See also § 6511(g) ("the provisions of section 6227 and subsections (c) and (d) of section 6230 shall apply in lieu of the provisions of this subchapter").

I.R.C. § 6230(d)(1) provides generally that no credit or refund of an overpayment attributable to a partnership item (or an affected item) for a partnership taxable year shall be allowed or made to any partner after the expiration of the period of limitation prescribed in I.R.C. § 6229 with respect to such partner for assessment of any tax

attributable to such item. However, if a request for administrative adjustment ("AAR") under Sec. 6227 is timely filed with respect to a partnership item, credit or refund of any overpayment attributable to such partnership item (or an affected item) may be allowed or made at any time before the expiration of the two-year period prescribed in section 6228 for bringing suit with respect to such request. § 6230(d)(2).

An AAR must be filed within three years after the date the partnership return is filed. § 6227(a)(1). In the case of an extension of the limitations period under § 6229, the period prescribed by § 6227(a)(1) for filing an AAR is extended for the period within which an assessment may be made pursuant to an agreement under § 6229(b), and for 6 months thereafter. § 6227(b). Courts are split on whether an amended return constitutes an AAR. See Wall v. United States, 133 F.3d 1188 (9th Cir.) (amended partner's income tax return qualified as an AAR); Rigas v. United States, 2011 WL 1655579 (S.D. Tex. 2011) (amended partner's return qualified as AAR); Samueli v. Commissioner, 132 T.C. 336 (2009) (amended partner return did not constitute an AAR); Phillips v. Commissioner, 106 T.C. 176 (1995) (amended return by partner did not qualify as AAR because the amended return was not accompanying Form 8082). The test for whether an amended return qualifies as an AAR depends on whether the return substantially conforms to the applicable AAR statutory requirements. Samueli v. Commissioner, supra.

The Year3 Amendment arguably constitutes a request for an adjustment of partnership items if it is deemed to substantially comply with the AAR filing requirements. The partnership's 6229(b) statute was extended via Form 872P to Date5, Year7, so (without regard to the 870-PT) an AAR could be filed within 6 months after that date. Thus, Partnership's purported amended return for Year3 was timely filed. The period during which a credit or refund may be allowed is two years after the date of the AAR, or January of 2014. See I.R.C. § 6228(a)(2).

In addition, in the case of any overpayment by a partner which is attributable to a partnership item (or an affected item) and which may be refunded under this subchapter, to the extent practicable credit or refund of such overpayment shall be allowed or made without any requirement that the partner file a claim therefor. § 6230(d)(5).

Year3 Mitigation Assessment

The three-year period for assessment under Section 6501, as extended by consent, had already expired when the Year3 Amendment was received by Ogden. As a result, the net tax increase shown on the Year3 Amendment was not assessed. This barred assessment will bestow a double benefit on the taxpayer if the Year1 claim is allowed, as the same FTC will be claimed in both years.

The mitigation provisions were designed to prevent a party from asserting the statute of limitations as a defense with respect to a closed year, where that party has taken an

inconsistent position in an open year. See Bradford v. Commissioner, 34 T.C. 1051, 1054 (1960). For an adjustment to be authorized under the mitigation provisions, four conditions must be met: there must be (1) a determination for an open tax year; (2) an error in a closed year that cannot otherwise be corrected; (3) a circumstance authorized in § 1312; and (4) the determination must adopt a position that is inconsistent with the error in the closed year.

First, there must be a "determination" for an open tax year. A "determination" is a final disposition by the Secretary of a claim for refund. I.R.C. § 1313(a)(3). A claim for refund shall be deemed "finally disposed" when, for example, the refund or credit is allowed. I.R.C. § 1313(a)(3)(A). A timely claim for refund for the Year1 tax year was filed, and the disposition of this claim could provide a determination for mitigation purposes.

Second, an error must have occurred in a closed tax year that cannot otherwise be corrected by operation of law. See I.R.C. § 1311(a). The Year3 tax year is currently closed for assessment. The error resulting from the Year1 "determination" is the improper allowance of a Year1-generated FTC carryforward in Year3, when the FTC has now been utilized in Year1.

Third, the determination must result in a circumstance under which an adjustment is authorized by Sec. 1312. There are seven circumstances under which an adjustment is authorized. Sec. 1312(2) of the Code defines one of the circumstances of adjustment as follows:

(2) Double allowance of a deduction or credit. The determination allows a deduction or credit which was erroneously allowed to the taxpayer for another taxable year or to a related taxpayer.

As a result of the allowance of the Year1 claim, \$Amount8 of FTC will be utilized in Year1 rather than being carried forward to Year3. The allowance of the \$Amount8 FTC in Year1 is inconsistent with the allowance of the same FTC amount in Year3. If the Year1 claim is allowed, the "error" is that the taxpayer receives a double benefit by claiming the same FTC in Year1 and Year3.

Fourth, except for determinations described in § 1312(3)(B) and in § 1312(4), the determination must adopt a position maintained by a party that is inconsistent with the error that has occurred. See IRC § 1311(b). If Taxpayer's foreign tax credit adjustment is accepted, the determination (the allowance of Taxpayer's claim for refund) will adopt the Taxpayer's 1120X position with respect to the Year1 year, which is inconsistent with its previously claimed Year3 FTC.

Because the statutory conditions will be satisfied, mitigation will support the closed-year assessment for Year3 in this case. The Service will have one year from the date of the determination to assess the tax. IRC § 1314(b).

Mitigation assessment amount

The amount to be assessed pursuant to mitigation is limited, and cannot be adjusted for items other than the adjustment subject to mitigation. See Treas. Reg. § 1.1314(a)-1(c) ("No change shall be made in the treatment given any item upon which the tax previously determined was based other than in the correction of the item or items with respect to which the error was made.") In this case, the correction which is subject to mitigation is the double allowance of the \$Amount8 foreign tax credit. The research credit is a separate item from the foreign tax credit duplication. Therefore, the \$Amount8 FTC-related mitigation assessment cannot be adjusted to reflect the research credit allowance. The research credit must be separately allowed, if at all, through TEFRA procedures as discussed above.

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Please call (313) 628-3113 if you have any further questions.

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