

Office of Chief Counsel
Internal Revenue Service
memorandum

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to: Associate Area Counsel, Salt Lake City

from: Robert M. Brown
Associate Chief Counsel
(Income Tax & Accounting)

subject: **Form 8752**

This responds to your memorandum requesting our views on three issues involving § 7519 of the Internal Revenue Code.

ISSUES

1. If in Year 1 a taxpayer fails to make a required payment and in Year 2 the taxpayer terminates its § 444 election, must the taxpayer make the required payment for Year 1 and then seek a refund, or may the Internal Revenue Service abate the assessment of the required payment for Year 1 under § 6404(a)?
2. Should the Internal Revenue Service's (IRS) computer program be changed to ensure that, in the situation described below, the payment is never credited earlier than the date the original required payment was made?
3. Can the IRS roll a timely credit forward and make a refund from that timely credit in a later year without first requiring the taxpayer to file a return for the prior year?

CONCLUSIONS

1. The Year 1 required payment need not be made in Year 2. Under § 7519(c)(2), the entity's liability for the required payment is extinguished as of the date the election is terminated. On that same date, the assessment for the required payment becomes excessive in amount under § 6404(a). Accordingly, the required payment amount may be abated under § 6404(a) as of the date the entity terminates its § 444 election.

2. We recommend that the IRS's computer program be revised to require that the rolled-forward amount be credited no earlier than the date the original required payment was made.

3. In order to obtain a refund of the excess required payment balance, if any, a partnership or S corporation is required to file all delinquent Forms 8752. This will ensure that the taxpayer's liability for underpayment interest and penalties for the year in question are established.

FACTS

For all issues, assume that the taxpayer is either a partnership or an S corporation, that the entity was in existence for at least 1 year prior to making a § 444 election, and that "Year 1" refers to the first applicable election year. Assume also that, apart from any § 7519 questions, the § 444 election was valid. Additional facts pertinent to particular issues are specified below.

Issue 1: In Year 1, the taxpayer timely filed Form 8752, Required Payment or Refund Under Section 7519. Although the taxpayer reported the proper amount of the required payment, it did not make the required payment. Using Transaction Code (TC) 150, the Internal Revenue Service assessed the required payment, plus interest attributable to the underpayment, plus the 10 percent failure to pay penalty. In Year 2, the taxpayer terminated its § 444 election. Therefore, no required payment is due for Year 2.

Issue 2: The taxpayer did not make the payments required under § 7519 for Years 1 through 6. The due date for each such required payment was May 15th of the following calendar year, per § 1.7519-2T(a)(4)(ii) of the Income Tax Regulations. The IRS assessed the taxpayer, for each of Years 1 through 6, for the required payment, the interest attributable to the required payment, and the 10 percent failure to pay penalty. On September 30, Year 6, the taxpayer paid the required payment, interest, and penalty for Year 1.

Using its current computer program, the IRS credited the required payment for Year 1 on the date it was paid. Pursuant to § 7519(b), the amount of the Year 1 required payment rolled forward into Year 2. Per the computer programming, the amount rolled forward from Year 1 was credited to Year 2 as of May 15, Year 3, which was the due date of the required payment for Year 2. Subsequently, the amount of the required payment rolled forward to Years 3 through 6, being credited in each instance as of the date the required payments for Years 3 through 6 were due (i.e., on May 15 of Years 4 through 7).

Issue 3: The taxpayer filed a Form 8752 and made a required payment for Year 1. Once applied to Year 1, the amount of the required payment rolled over to Year 2. The taxpayer did not file a Form 8752 for Year 2, but did file the form for Years 3, 4, and 5. The Form 8752 for Year 5 shows that no required payment is due from the taxpayer.

LAW AND ANALYSIS

This case involves § 7519, which requires S corporations and partnerships to make deposits to the Treasury if those entities have elected to use § 444. The purpose of § 7519, as explained below, is to lessen or eliminate the benefit of tax deferral that partners or shareholders could otherwise obtain through a § 444 election.

A. Background

Section 441(a) requires taxpayers to compute their taxable income on the basis of the taxpayer's taxable year. Were there no statutory limitations on what constitutes a permissible taxable year, owners of passthrough entities could achieve substantial deferral by the simple expedient of having the entity's taxable year end later than theirs. Sections 706(a) and 1366(a)(1) provide that the income of a partnership or S corporation is included in the returns of its partners or shareholders for the taxable year of the partners or shareholders that includes the last day of the entity's taxable year. For example, suppose an S corporation used a year ending on January 31, but the S corporation's shareholder used the calendar year. In this situation, the income earned by the S corporation from February 1, 2001, through January 31, 2002, would not be included in the shareholder's income until 2002, even though 11 months of the S corporation's 12-month taxable year occurred in 2001.

Over the years, Congress has made it increasingly difficult for taxpayers to achieve deferral. Thus, as a general rule and in the absence of a business purpose, S corporations are now required to use the calendar year. Section 1378. Similarly, in the absence of a business purpose, a partnership ordinarily must use the same taxable year as its partners. Section 706(b)(1).

However, a partnership or S corporation may elect a taxable year other than the ones described above upon a showing of a business purpose. See generally 1.442-1(b); Rev. Proc. 2002-30, 2002-1 C.B. 1184. Such an election, which is subject to various conditions and limitations, is made under § 444(a). In particular, a partnership or S corporation making a § 444 election must make the payments required by § 7519. Section 444(c)(1).

B. Operation of § 7519

Section 7519 applies to any taxable year in which a partnership or S corporation has a § 444 election in effect and the "required payment" for such taxable year (or any preceding taxable year) exceeds \$500. For any year in which the election is in effect ("applicable taxable year"), the entity must file a return showing the required payment (even if the amount of such payment is zero) and pay any required amount prescribed. Section 7519(e)(2)(B), § 1.7519-2T(a)(1), -2T(a)(2)(i). Form 8752, Required Payment

or Refund Under Section 7519, must be filed not later than May 15th of the calendar year following the calendar year in which the applicable election year begins. Section 1.7519-2T(a)(4)(ii).

C. The required payment

Section 7519(b) provides that the amount of the required payment for any applicable election year is the excess of (1) the applicable percentage of the adjusted highest section 1 rate, multiplied by the net base year income of the partnership or the S corporation,¹ of the partnership or the S corporation, over (2) the net required payment balance. The net required payment balance is the excess (if any) of the aggregate of required payments for all preceding applicable election years over the aggregate amount allowable as a refund to the entity over all such years. Section 7519(e)(4). Stated differently, the cumulative amount of required payments actually made for all preceding applicable election years, reduced by the cumulative amount refundable for those years, is taken into account in determining the amount of payment required for the current election year. Section 1.7519-1T(a)(3)(ii).

Thus, the general effect of § 7519 is to require a partnership or S corporation that has elected a taxable year other than a required taxable year to maintain a deferred payment balance with the Internal Revenue Service.² The entity adjusts the balance annually, either by making an additional payment (if a higher balance is required) or by claiming a refund under § 7519(c) (if the required balance for the year is lower than the actual balance in the account). As stated in a leading tax treatise:

The aggregate amount on deposit is intended to approximate the taxes deferred by the partners or S corporation shareholders for the deferral period of the taxable year of the entity that is currently in progress. The current payment thus is limited to the amount needed to bring the aggregate up to this amount.

¹ The terms “applicable percentage” and “adjusted highest section 1 rate” are defined in § 7519(d)(4) and (b), respectively. A “base year” is the taxable year of the partnership or S corporation immediately preceding an applicable election year. Section 7519(e)(2)(A). “Net base year income” is computed under § 7519(d)(1) and (2).

² There are a few circumstances under which a payment is not required. For example, a de minimus rule provides that a payment is not required if the amount of the required payment for an applicable election year does not exceed \$500 and the entity was not required to make a required payment for a prior year. Section 7519 (a)(2); § 1.7519-1T(a)(2). The de minimus rule is illustrated in § 1.7519-1T(4).

Additionally, § 1.7519-1T(a)(4) provides that (i) if an applicable election year is the entity’s first year in existence, the required payment for such applicable election year is zero [because such an entity does not have a “base year”], and (ii) no required payment is due if the applicable election year ends before the last day of the required tax year [because in this circumstance, use of the applicable election year results in less deferral than would result from use of the required year]. However, as noted earlier, § 1.7519-1T mandates that the entity file a return for each applicable election year, whether or not a required payment is due.

Bittker & Lokken, Federal Taxation of Income, Estates and Gifts, par. 105.2.3, pages 105-38 - 105-39 (2d ed. 1992).

If the entity does not timely make the required payment, the amount due can be assessed and collected as if it were a tax. Section 7519(f)(1). Section 7519(f)(3) provides that for purposes of determining interest, any payment required by this section shall be treated as a tax; except that no interest shall be allowed with respect to any refund of a payment made under this section. Section 6601(a) provides that if any amount of tax imposed by this title is not paid on or before the last date prescribed for payment, interest on such amount at the underpayment rate established under § 6621 shall be paid for the period from such last date to the date paid.

A 10 percent late payment penalty may be imposed if the required payment is not made timely (§ 7519(f)(4)(A)), and negligence and fraud penalties may also be applicable (§ 7519(f)(4)(B)). An entity's willful failure to comply with § 7519 will result in termination of the § 444 election (§ 7519(f)(4)(C)).

D. Refund of a required payment

Section 7519(c)(1) provides that if the required payment computation results in a negative number -- that is, if the net required payment balance for an applicable election year exceeds the required payment for that same year -- the entity is entitled to a refund of the excess amount. The rationale underlying § 7519(c) is straightforward: a negative number occurs only if there is an excess of the existing deposit (i.e., of prior payments) over the tax presently being deferred (i.e., of the amount intended to be covered by the current deposit). Refunds typically occur if the entity's income has declined. Generally, refunds are payable on the later of (1) April 15th of the year following the calendar year in which the applicable election year began, or (2) the date a claim for refund is filed. Section 7519(c)(3)(A)(i), (B).

The entity also is entitled to a refund of the net required payment balance if either the entity's § 444 election is terminated or the entity is liquidated. Section 7519(c)(2). In these circumstances, the refund is payable on the later of April 15 of the calendar year following the year during which the termination or liquidation occurs or 90 days after a claim for refund is filed. Section 7519(c)(3)(A)(ii), (B).

As noted earlier, no interest is payable on any refund. Section 7519(f)(3).

E. Analysis as to Issue 1.

Under the facts of Issue 1, a taxpayer makes a § 444 election in applicable election Year 1 but does not make the required payment. The IRS then assesses both the required payment, interest, and a 10 percent penalty on the underpayment. In Year 2 the taxpayer terminates the election. These facts raise the question whether the IRS may abate the assessment of the required payment under § 6404(a), or whether the

IRS instead must first require the taxpayer to make full payment of the required payment amount, and then refund that required payment amount to the taxpayer.

Section 6404(a) authorizes the IRS to abate the unpaid portion of the assessment of any tax or any liability in respect thereof, which is (1) excessive in amount, (2) assessed after the expiration of the applicable assessment period, or (3) erroneously or illegally assessed.

Section 7519(c)(2) provides that if an election under § 444 is terminated with respect to any year the entity shall be entitled to a refund of the net required payment balance. We read § 7519(c)(2) as extinguishing the entity's assessed liability for the required payment as of the date the election is terminated even if the entity has not paid the assessed required payment. On the same date the entity's liability for the required payment is extinguished under § 7519(c)(2), the assessment for that required payment for Year 1 becomes excessive in amount. Thus, § 6404(a) permits the abatement of the required payment amount as of the date the entity terminates its § 444 election. Note, however, that abating the required payment amount does not relieve the entity of its liability for interest and penalties. The interest and penalties are calculated on the required payment for the period between the required payment's assessment and abatement, and the amount so calculated continues to accrue interest until paid.

F. Analysis as to Issue 2.

Section 7519(f)(3) provides that, for purposes of determining interest, any payment required by this section shall be treated as a tax. Section 6601(a) provides that if any amount of tax is not paid on or before the last date prescribed for payment, interest on such amount shall be paid from such last date to the date paid, with the interest calculated at the underpayment rate found in § 6621.

For Years 1 through 6, the taxpayer did not make the required payments by the last day for payment (May 15th of the following calendar year). On September 30, Year 6, the taxpayer paid the required payment for Year 1. Pursuant to § 7519(b), the Year 1 required payment rolled forward to Years 2 through 6. Thus, pursuant to §§ 7519(f)(3) and 6601(a), interest should accrue on the Years 1 through 6 underpayments from the due date of each year's required payment to the date the taxpayer made the required payment for Year 1.

Under the IRS's computer program, the required payment was credited to Year 1's liability as of the payment date. As a result, interest accrued on the Year 1 underpayment from the due date of the required payment for Year 1 – that is, from May 15, Year 2 -- to the date in Year 6 (September 30) on which the taxpayer actually made the Year 1 required payment. Accordingly, the IRS's procedures, as they relate to Year 1, are consistent with §§ 7519(f)(3) and 6601(a).

For the subsequent years, however, the IRS's current computer program is incorrect. Under the current rules, once the September 30, Year 6, payment was credited to the required payment for Year 1, the amount of that required payment automatically rolled forward to Years 2 through 6. The problem here is not that the required-payment amount was rolled forward, but that the rolled-forward amount was credited in each year as of the date (May 15) that the required payments for Years 2 through 6 were due, rather than on the date (September 30, Year 6) that the required payment for Year 1 was actually paid.

The effect of using the due date rather than the date of actual payment for Years 2 through 6 is to reduce or eliminate, improperly, the interest and penalty on the Years 2 through 6 underpayments. For example, interest on the Year 2 required payment properly should run between May 15, Year 3 (the date the Year 2 required payment was due) and September 30, Year 6, the date the actual payment of the Year 1 required payment amount was made. Instead, under the current IRS computer programming, no interest is shown for the May 15, Year 3, through September 30, Year 6, period, because the programming (inaccurately) reflects that the Year 2 required payment was made in a timely fashion (i.e., on May 15, Year 3).

The current IRS computer program, as it relates to Years 2 through 6, are in conflict with §§ 7519(f)(3) and 6601(a). Accordingly, we recommend that the IRS's computer programming be revised to require that the rolled-forward amount be credited no earlier than the date the original required payment was made (e.g., on September 30, Year 6).

G. Analysis as to Issue 3.

Issue 3 raises the question whether the IRS can refund an excess required payment balance (if any) in a later year, through the rolling forward of a timely credit, if the entity has been delinquent in filing Form 8752 in a prior year. Under the facts of Issue 3, the taxpayer filed a Form 8752 and made a required payment for applicable election Year 1. Once applied to Year 1, the amount of the required payment rolled over to Year 2. The taxpayer did not file a Form 8752 for Year 2, but did file the form for Years 3, 4, and 5. The Form 8752 for Year 5 shows that no required payment is due from the taxpayer.

As noted earlier, for any year in which a partnership or S corporation has a § 444 election in effect, the entity must file a return showing the required payment (even if the amount of such payment is zero) and pay any required amount prescribed. Section 7519(e)(2)(B), § 1.7519-2T(a)(1), -2T(a)(2)(i). If the entity does not timely make the required payment, the amount due can be assessed and collected as if it were a tax. Section 7519(f)(1). Section 7519(f)(3) and (f)(4)(A) provide, respectively, that interest is charged and a 10 percent late payment penalty can be imposed if the required payment is not made timely.

In order to comply with the overall purpose of § 7519, the IRS should not make a refund of any excess payment balance from a rolled-forward timely credit until it has first

required the entity to file all delinquent Forms 8752. Requiring the entity to file a previously unfiled Form 8752 for a prior year will ensure that the taxpayer's liability for underpayment interest and penalties for the year in question are established.

If we may be of further assistance, please telephone CC:ITA:4 at .