

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

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date: December 10, 2014

to:

(Large Business & International)

from: Elizabeth Chirich
Branch Chief
(Procedure & Administration)

subject: Section 6511(d)(1) Bad-debt Deduction

This Chief Counsel Advice responds to your request for assistance dated October 14, 2014. This advice may not be used or cited as precedent.

ISSUE

A group of partnerships kept its internal accounting records under the accrual method but used cash-basis reporting for tax purposes. From to , the partnerships inadvertently reported as income running balances of accounts receivable from their internal accounting records, thus overstating income allocated to the partners. In , Taxpayer, the partnerships' then-only partner, filed a formal claim for refund for his individual tax year to correct his outside basis in the partnerships due to the accounting errors the partnership made in and . Does this claim for refund fall within the seven-year limitations period of § 6511(d)(1) for a § 166 "bad debt?"¹

¹ This analysis disregards any issues related to (1) the taxpayer and partnerships' failure to file a request for administrative adjustment under section 6227(e), which may bind the taxpayer to the partnerships' returns; and (2) the taxpayer's failure to file formal claims for refund for and , which may prevent refund unless the formal claim adequately apprised the IRS that the taxpayer was seeking refunds for and .

CONCLUSION

The seven-year limitations period of § 6511(d)(1) does not apply because the refund claim—whether it was to correct , , or — did not relate to bad-debt deductions under § 166.

FACTS

Taxpayer was a majority owner of partnerships that erroneously overstated income on their partnership tax returns. The errors began in in connection with converting the partnerships' internal accrual-basis accounting records to cash-basis reporting for their tax returns. From through , the partnerships inadvertently reported as income amounts from accounts receivable² that they had not yet received and thus, under the cash method of tax reporting, should have been excluded from income. We assume the overstated reported partnership income was allocated to the partners, pursuant to Subchapter K of the Internal Revenue Code, thus overstating the partners' outside basis in the partnerships. Taxpayer purchased the remaining interests of the partnerships in , and on , he amended his individual income tax return to claim a refund due to an adjusted outside basis in his partnership interests—the result of correcting the partnerships' inclusion of not-yet collected income in partnership income in and .³ You have asked whether the seven-year limitations period under § 6511(d)(1) applies to Taxpayer's refund claim.

LAW AND ANALYSIS

Section 6511(d)(1) provides for a seven-year period of limitations if, essentially, “the claim for credit or refund relates to an overpayment of tax imposed by subtitle A,” and the overpayment is “on account of the deductibility by the taxpayer, under [§] 166 . . . , of a debt as a debt which became worthless.” I.R.C. § 6511(d)(1). For section 6511(d)(1) to apply to bad-debt deductions, a debt must exist for tax purposes under the taxpayer's method of tax reporting. See *W.L. Moody Cotton Co. v. Commissioner*, 143 F.2d 712, 713–15 (5th Cir. 1944).

Unlike an accrual-basis taxpayer who maintains an accounts-receivable account for income it has accrued under the all-events test but has not yet received, a cash-basis taxpayer does not maintain accounts receivable because cash-basis taxpayers recognize gross income when the income is actually or constructively received. See Treas. Reg. § 1.446-1(c)(1)(i). Thus, a cash-basis taxpayer should not be reporting uncollected income or maintaining an accounts-receivable account on its tax books for which a bad-debt deduction under § 166 would subsequently be allowable. A taxpayer

² Money that is owed to a company by a customer for products and services provided on credit.

³ Taxpayer did not amend his and individual returns and did not file requests for administrative adjustment under section 6227(e).

must consistently apply the method of accounting for income and deductions that the taxpayer is following and cannot benefit from mistakenly employing another method of accounting for a particular tax item. *W.L. Moody Cotton Co.*, 143 F.2d at 713–15.

Thus, under the facts you presented, the partnerships could not have bad debts to deduct; there was, therefore, no bad debt for tax purposes and no basis for the partnerships, or the Taxpayer in this case, to come within the seven-year limitations period of § 6511(d)(1) for a § 166 “bad debt.” The partnerships’ book treatment is not relevant or applicable for section 6511(d)(1).

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Please call (202) 317-5425 if you have any further questions.