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From: [REDACTED]

Sent: Friday, February 06, 2015 9:49:45 AM

To: [REDACTED]

Cc: [REDACTED]

Bcc:

Subject: RE: Question involving 6 year statute: I.R.C. § 6501(e)(1) and Treas. Reg. § 1.1366-1(c)(2).

Regarding your first question, the overstated COGS on the Form 1120S does not result in “unreported flow-through income,” because the amount of pass-through entity income that constitutes “omitted income” for the purpose of § 6501(e)(1)(A) is the amount of gross receipts omitted on Form 1120S, rather than the understatement of ordinary business income (overstatement of loss) on line 21. *See* § 6501(e)(1)(B)(ii); *see also*, e.g., *United States v. Home Concrete & Supply, LLC*, 132 S. Ct. 1836 (2012); *The Colony, Inc. v. Commissioner*, 357 U.S. 28 (1958).

Regarding your second question, “a shareholder’s gross income includes the shareholder’s pro rata share of S corporation gross income (as described in section 6501(e)(1)(A)(i)).” Treas. Reg. § 1.1366-1(c)(2)(i) (T.D. 8852, Dec. 21, 1999). When Treasury Regulation § 1.1366-1 was published in 1999, § 6501(e)(1)(A)(i) read: “In the case of a trade or business, the term “gross income” means the total of the amounts received or accrued from the sale of goods or services (if such amounts are required to be shown on the return) prior to diminution by the cost of such sales or services” “*The amount of S corporation gross income used in deriving the shareholder's pro rata share of any item of S corporation income, loss, deduction, or credit (as included or disclosed in the shareholder's return) is considered as an amount of gross income stated in the shareholder's return for purposes of section 6501(e).*” Treas. Reg. § 1.1366-1(c)(2)(i) (emphasis added).

Because the overstated COGS on the Form 1120S is not “omitted income,” the calculation of the amount omitted on the Form 1040 per Treasury Regulation § 1.1366-1(c)(2)(ii) is as follows when using your estimated numbers:

S-Corporation Gross Receipts: \$ (reported as \$ on Form 1120S)

Taxpayer's required amount to report as 100% shareholder: $-\$ \quad (-\$ \quad + \$ \quad)$
 (presuming the \$ underreported as the S-Corp gross receipts translated directly to a \$ difference in ordinary business income, which may not have been the case)

Reported Share of S-Corporation Gross Receipts: *If the share of gross receipts is multiplied directly by gross income, as the example in § 1.1366-1(c)(2)(ii) might otherwise indicate, the result where a shareholder, as here, overstates the loss from an S-Corp would be an overstatement of income. Because such result would be nonsense that could effectively negate the effect of other income omitted on the Form 1040, I construe "the amount of S corporation gross income used" to be a maximum of 100% of the shareholder's pro-rata share of S-Corp's gross receipts, with any additional loss claimed being unrelated to the S corporation gross income. Thus, rather than using a ratio of 105.94% ($-\$ \quad / -\$ \quad$), which would result in an amount of \$ $(105.94\% * \quad)$ being stated in the shareholder's return, I merely use $100\% * \$ \quad$.*

Taxpayer's reported Gross Income from S-Corp: \$

Taxpayer's total gross income, as you calculated, is \$ $(\$ \quad + \quad + \$ \quad)$. But there is no omission from gross income for the purpose of § 6501(e)—100% was reported.

Please let me know if you have any questions or wish to discuss further.