

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **201548006**
Release Date: 11/27/2015
Index Number: 39.00-00, 38.00-00

Third Party Communication: None
Date of Communication: Not Applicable

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Refer Reply To:
CC:PSI:B05
PLR-106854-15
Date:
August 24, 2015

LEGEND:

Taxpayer =

Dear :

This is in response to a request for a ruling dated January 28, 2015, submitted by your authorized representatives. The request involves section 39 of the Internal Revenue Code, which provides rules for the carryback and carryforward of unused general business credits under section 38.

Taxpayer is a non-passive owner of various flow-through entities (both partnerships and S corporations). The flow-through entities are in the trade or business of operating restaurants. During 1998-2012, the flow-through entities generated credits under section 45B for employer social security and Medicare taxes paid on certain employee tips. In general, the section 45B credit is taken in lieu of deducting social security and Medicare taxes. This credit is a separately stated item on Schedule K and is claimed by the partners/S corporation shareholders on Form 8846, "Credit for Employer Social Security and Medicare Taxes Paid on Certain Employee Tips," and Form 3800, "General Business Credits."

Taxpayer represents that it has been determined that the flow-through entities did not properly compute the amount of allowable credits under section 45B of the Code for years closed under the statute of limitations. This error resulted in an understatement of the allowable credits, with a correlative understatement of ordinary

income, due to the requirement that the amount of any credits generated be removed as an allowable deduction. At the time the error was discovered, the statute of limitations had expired for tax years prior to 2010. Tax returns for 2010-2012 have been amended to reflect the corrected amount of section 45B credits, with the 2013 year filed accurately based on the corrected computation.

Taxpayer represents that if the section 45B credits had been calculated correctly in the closed tax years, the individual partners/S corporation shareholders would have been able to claim more credit than claimed per their originally filed returns. Furthermore, after utilization of the maximum allowable credits in those years, including taking into account increased taxable income for those years due to reduced deductions; additional credits would have been carried forward to future years. This would result in a larger credit carryforward to the 2014 tax year than is otherwise reflected on the taxpayers' returns. Taxpayer represents that it will change the general business credit carryforward to 2014 from \$ (all from 2013) to \$ (\$ from 2012 and \$ from 2013).

Taxpayer requests a ruling that he can adjust the section 45B credit carryforwards to the 2014 tax year where computational errors existed in the year or years from which the credits originated that are closed under the statute of limitations.

Section 45B(a) of the Code provides that, for purposes of section 38, the employer social security credit determined under section 45B for the taxable year is an amount equal to the excess employer social security tax paid or incurred by the taxpayer during the taxable year.

Section 45B(b)(1) of the Code defines the term "excess employer social security tax" as any tax paid by an employer under section 3111 with respect to tips received by an employee during any month, to the extent such tips (A) are deemed to have been paid by the employer to the employee pursuant to section 3121(q) (without regard to whether such tips are reported under section 6053), and (B) exceed the amount by which the wages (excluding tips) paid by the employer to the employee during such month are less than the total amount which would be payable (with respect to such employment) at the minimum wage rate applicable to such individual under section 6(a)(1) of the Fair Labor Standards Act of 1938 (as in effect on January 1, 2007, and determined without regard to section 3(m) of such Act). Section 45B(b)(2) provides that, in applying section 45B(b)(1), there shall be taken into account only tips received from customers in connection with the providing, delivering, or serving of food or beverages for consumption if the tipping of employees delivering or serving food or beverages by customers is customary.

Section 45B(c) of the Code provides that no deduction shall be allowed under Chapter 1 for any amount taken into account in determining the credit under section

45B. Section 45B(d) provides that section 45B shall not apply to a taxpayer for any taxable year if such taxpayer elects to have this section not apply for such taxable year.

Section 38(a) of the Code provides that there shall be allowed as a credit against the tax imposed by Chapter 1 for the taxable year an amount equal to the sum of (1) the business credit carryforwards carried to such taxable year, (2) the amount of the current year business credit, plus (3) the business credit carrybacks carried to such taxable year.” Section 38(b)(11) provides that the amount of the current year business credit includes the employer social security credit determined under section 45B(a).

Section 38(c) of the Code provides that the credit allowed under section 38(a) for any taxable year shall not exceed the excess (if any) of the taxpayer’s net income tax over the greater of (A) the tentative minimum tax for the taxable year, or (B) 25 percent of so much of the taxpayer’s net regular tax liability as exceeds \$25,000. For purposes of the preceding sentence, the term “net income tax” means the sum of the regular tax liability and the tax imposed by section 55, reduced by the credits allowable under subparts A and B of Part IV, and the term “net regular tax liability” means the regular tax liability reduced by the sum of the credits allowable under subparts A and B of Part IV.

Section 39(a) of the Code provides that if the sum of the business credit carryforwards to the taxable year plus the amount of the current year business credit for the taxable year exceeds the amount of the limitation imposed by section 38(c) for such taxable year (hereinafter in this section referred to as the “unused credit year”), such excess (to the extent attributable to the amount of the current year business credit) shall be (A) a business credit carryback to the taxable year preceding the unused credit year, and (B) a business credit carryforward to each of the 20 taxable years following the unused credit year, and, subject to the limitations imposed by section 38(b) and (c), shall be taken into account under the provisions of section 38(a) in the manner provided in section 38(a).

Section 6511(a) of the Code provides that claim for credit or refund of an overpayment of any tax imposed by this title in respect of which tax the taxpayer is required to file a return shall be filed by the taxpayer within 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever of such periods expires the later, or if no return was filed by the taxpayer, within 2 years from the time the tax was paid. Claim for credit or refund of an overpayment of any tax imposed by Title 26 which is required to be paid by means of a stamp shall be filed by the taxpayer within 3 years from the time the tax was paid.

Section 7602(a)(1) of the Code provides that, for purposes of ascertaining the correctness of any return, making a return where none has been made, determining liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting

any such liability, the Secretary is authorized to examine any books, papers, records, or other data which may be relevant or material to such inquiry.

Mennuto v. Commissioner, 56 TC 910 (1971), involved the carryforward of recomputed investment credit from a closed tax year. The Court affirmed the Service's right to recompute the incorrect credit carryforward originating from a closed year. The court's position was supported by Rev. Rul. 69-543, 1969-2 C.B. 1, which held that assessment and collection of deficiencies resulting from the disallowance of investment credit carryovers can be made even though the year in which the investment credit was incorrectly claimed is barred by section 6501(a) of the Code.

In Hill v. Commissioner, 95 TC 437 (1990), the petitioner attempted to distinguish Mennuto and, by implication, those cases in the area of net operating losses holding that it is proper to recalculate the amount of net operating loss carryover from a closed year. The Court held that the critical element is that the deficiency being determined is for a year on which the period of limitations has not run. Accordingly, the Court affirmed the Service's right to recompute the incorrect credit carryforward originating from a closed year.

Rev. Rul. 82-49, 1982-1 C.B. 5, addresses a question relating to the recomputation and carryforward of investment credit similar to the question raised by Taxpayer with respect to the recomputation and carryforward of the section 45B credit. Rev. Rul. 82-49 holds that the investment credit on qualified section 38 property need not have been claimed on an income tax return, or in a timely claim for refund for the year the property was placed in service, before the investment credit can be carried over under former section 46(b) of the Code to an open taxable year.

Under Rev. Rul. 82-49, the failure to claim investment credit on qualified section 38 property placed in service in a taxable year for which the period of limitations for filing a claim for credit or refund has expired under section 6511 of the Code does not prevent a taxpayer from carrying forward any unused credit from the closed taxable year to an open taxable year. The investment credit and employer social security credit determined under section 45B(a) are current year business credits under section 38, and are both subject to the same section 39(a) carryforward rules.

In conclusion, it is clear that a general business credit originating from closed years and being carried into open years in arriving at tax due can be adjusted to correct errors under the applicable provisions of the law by both the Service and Taxpayer. Although none of the precedents cited above specifically involve partnerships, S corporations, or section 45B credits, it is reasonable to apply the same analysis in Rev. Rul. 82-49 to recalculating the section 38 general business credits and the section 39 carryforward of unused section 45B credits that Taxpayer failed to claim on his original returns from the flow-through entities. For this purpose the Service should treat the carryforward of the investment credit and the section 45B credit the same. Even though

Taxpayer's tax years before 2010 are closed, the Service may examine the correctness of the partnership's and S corporation's recomputation of the section 45B credit. In determining the proper amount of the carryforward for the 2014 tax year Taxpayer needs to apply the provisions of Rev. Rul. 82-49. Meaning, that to the extent the additional credits would have been used to reduce Taxpayer's liability in a closed year, including taking into account increased taxable income for those years due to reduced deductions, Taxpayer would not be entitled to a claim of refund, but would rather be entitled to determine the amount of the carryforward in the open year by an amount equal to the excess of the corrected credit over the amount that would have been allowed as a credit in the closed years including any carrybacks.

No opinion is expressed or implied regarding the application of any other provision in the Code or regulations. Nor is an opinion is expressed or implied regarding the amount of Taxpayer's carryforward of unused section 45B credits. This ruling is subject to application of section 6222 of the Code. We are not opining with respect to application of section 6230(d).

This ruling is directed only to the taxpayer that requested it. Under section 6110(k)(3) of the Code it may not be used or cited as precedent. In accordance with a power of attorney filed with the request, a copy of the ruling is being sent to your authorized representatives.

Sincerely yours,

Paul F. Handleman
Chief, Branch 5
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

cc: