



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

DATE: February 10, 1999

MEMORANDUM FOR:

FROM: Elizabeth G. Beck
Senior Technician Reviewer, CC:INTL:6

SUBJECT:

This Field Service Advice responds to your memorandum dated October 15, 1998. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be used or cited as precedent.

LEGEND:

USCorp.	=
FSC1	=
a	=
Date A	=
Date B	=
Date C	=
Date D	=
Date E	=
Year 1	=
Year 2	=
Year 3	=

ISSUES:

1. Whether the Service may assess additional tax voluntarily tendered by a foreign sales corporation (FSC) based on amended returns that indicated additional commission receipts by the FSC, notwithstanding that the statute of limitations for assessment of the FSC under I.R.C. § 6501 expired prior to the filing of the amended returns.
2. Whether, for the U.S. related supplier's taxable years corresponding to the FSC years at issue in Issue 1 above, the Service may grant refunds of tax based on amended returns that showed additional deductions for FSC commission expenses, where the statutes of limitations for assessment and refund were open with respect to the U.S. related supplier when the amended returns were filed.

CONCLUSIONS:

1. Because the statute of limitations for assessment with respect to the FSC had already expired under I.R.C. § 6501 when the amended returns were filed, the Service has no authority to assess additional tax indicated on the amended FSC returns.
2. Because the Service may not assess additional tax with respect to the FSC, the redetermination with respect to the FSC and its related supplier failed the condition precedent in Temp. Treas. Reg. § 1.925(a)-1T(e)(4), that it "shall affect" both the FSC and the related supplier. Thus, the Service may not grant the U.S. related supplier's refund claims, based on additional FSC commission deductions reflected on the amended returns.

FACTS:

USCorp. is a domestic corporation. During Years 1-3, USCorp. exported merchandise through its wholly-owned subsidiary, FSC1, a qualified foreign sales corporation within the meaning of I.R.C. § 922(a). Both USCorp. and FSC1 file income tax returns based on a calendar year.

During the examinations of US Corp. and FSC1 for Years 1-3, FSC1 and the Service timely executed Forms 872, extending the period of limitations for assessment for Years 1-3 with respect to FSC1 through Date A. In addition, USCorp. and the Service timely executed Forms 872, extending the period of limitations for assessment with respect to USCorp. through Date B, a date three years after Date A.

On Date C, approximately six months after Date A, FSC1 filed amended Forms 1120FSC for Years 1-3, claiming additional sales and additional commission income arising from a change in transfer pricing methods. The amended Forms 1120FSC showed additional tax due in the amount of \$a and included the additional tax. The statute of limitations for assessment with respect to FSC1 had expired on Date A. To date, the Service has not assessed the additional tax paid by FSC1.

Approximately three months after date C, on Date D, USCorp. filed amended Forms 1120 with respect to Years 1-3, claiming additional deductions for the FSC commissions reported on the amended Forms 1120FSC filed by FSC1. The statute of limitations for refunds with respect to FSC1 expired on Date E, which is six months after Date A.

LAW AND ANALYSIS:

Section 6501(a) states the general rule that the Service must assess tax due within three years of the date of filing of the return. Section 6501(c)(4) provides that the Service and the taxpayer may enter into written agreements extending the period of limitations for assessment, provided that the agreement is executed before the end of the period of limitations specified by section 6501(a), or the period as previously extended pursuant to section 6501(c)(4).

Section 6501(e)(1)(A) provides that, if the taxpayer makes an omission of more than 25% from gross income, the Service may assess tax within six years of the date of filing of the original return. Section 6501(e)(1)(A)(i) defines “gross income” in the case of a trade or business as “the total of the amounts received or accrued from the sale of goods and services (if such amounts are required to be shown on the return) prior to diminution by the cost of such sales or services.”

Section 6511(c)(1) provides that if the Service and the taxpayer executed an agreement to extend the period for assessment (Form 872, Consent to Extend the Time to Assess Tax), the period for filing a claim for refund does not expire prior to six months after the expiration of the period during which assessment could be made pursuant to the agreement or any extension thereof under section 6501(c)(4).

The rules governing redeterminations of FSC commissions for tax years beginning before January 1, 1998, are contained in Temp. Treas. Reg. § 1.925(a)-1T(e)(4), which states:

(4) *Subsequent determination of transfer price, rental income or commission.*
The FSC and its related supplier would ordinarily determine under section 925 and this section the transfer price or rental payment payable by the FSC or the commission payable to the FSC for a transaction before the FSC files its return for the taxable year of the transaction. After the FSC has filed its

return, a redetermination of those amounts by the Commissioner may only be made if specifically permitted by a Code provision or regulations under the Code. Such a redetermination would include a redetermination by reason of an adjustment under section 482 and the regulations under that section or section 861 and § 1.861-8 which affects the amounts which entered into the determination. In addition, a redetermination may be made by the FSC and related supplier if their taxable years are still open under the statute of limitations for making claims for refund under section 6511 if they determine that a different transfer pricing method or grouping of transactions may be more beneficial. Also, the FSC and related supplier may redetermine the amount of foreign trading gross receipts and the amount of the costs and expenses that are used to determine the FSC's and related supplier's profits under the transfer pricing methods. Any redetermination shall affect both the FSC and the related supplier. The FSC and the related supplier may not redetermine that the FSC was operating as a commission FSC rather than a buy-sell FSC, and vice versa.

Temp. Treas. Reg. § 1.925(a)-1T(e)(4) (emphasis added).

This regulation establishes, as a condition precedent to a taxpayer-initiated redetermination of FSC commissions, that the statute of limitations for refunds under I.R.C. § 6511 be open with respect to both the FSC and the related supplier. Temp. Treas. Reg. § 1.925(a)-1T(e)(4); Union Carbide Corp. v. Commissioner, 110 T.C. 375 (1998). In addition, the regulation requires that the redetermination "shall affect" both the FSC and the related supplier. That is, the Service must be able to assess additional tax due with respect to the taxpayer (in this case the FSC) which is in a deficiency position as a result of the redetermination.

When FSC1 filed amended Forms 1120FSC on Date C reporting additional tax, the statute of limitations for refund purposes under section 6511 was open. Because FSC1 and the Service had executed agreements to extend the statute of limitations for assessment to Date A, the limitation period for refunds was open for six months after that date, or until Date E, pursuant to section 6511(c)(1). The statute of limitations for assessment, however, had already expired. The statutes of limitations for both assessment and refund were open with respect to USCorp. as of Date C, pursuant to a valid Form 872 executed by USCorp. and the Service.

The specific issue presented in this case is whether the redetermination by the FSC and the related supplier satisfies the regulation's additional requirement that it "shall affect" both the FSC and the U.S. related supplier. The statute of limitations for assessment, as extended, had already expired with respect to FSC1 prior to Date C, on Date A. Thus, the general three-year statute of limitations of section 6501(a), as extended under section 6501(c)(4), barred assessment of additional tax with respect to FSC1 as of the date the

amended Forms 1120FSC were filed. Unless some other exception to the three-year statute of limitations is applicable, the redetermination for FSC1 and USCorp. fails the second requirement contained in the regulation that "any redetermination shall affect both the FSC and the related supplier."

Because the redeterminations in this case are based in part on additional foreign trading gross receipts and foreign trade income attributable to such receipts, the six-year statute of limitations of section 6501(e)(1) is potentially applicable. I.R.C. §§ 923(b), 927(b)(2), 6501(e)(1)(A)(i); Temp. Treas. Reg. §§ 1.923-1T(a), 1.927(b)-1T(e). However, for none of Years 1-3 does the additional total income reported on the amended Forms 1120FSC reach, or even approach, the threshold level of a 25% omission of gross income. Thus, these redeterminations do not call for application of the six-year limitation period of section 6501(e)(1)(A).

Moreover, the tender of additional tax by FSC1 with the amended Forms 1120FSC does not affect the Service's assessment authority under section 6501. If a taxpayer voluntarily pays tax after the period of limitations for assessment has expired, and the Service has failed to make a timely assessment of that tax, the taxpayer is entitled to a refund. Ewing v. United States, 914 F.2d 499, 505 (4th Cir. 1990), cert. denied, 500 U.S. 905 (1991); Diamond Gardner Corp. v. Commissioner, 38 T.C. 875, 881 (1962); Rev. Rul. 74-580, 1974-2 C.B. 400. Stated differently, a taxpayer is entitled to refund of all "overpayments" of tax, which I.R.C. § 6401(a) defines as "that part of the amount of the payment which is assessed or collected after the expiration of the period of limitations properly applicable thereto." In this case, the Service may retain the additional tax tendered by FSC1 only so long as no claim for refund is made. See I.R.M. § 403(26).1 (the Service may accept "voluntary" payments of tax after expiration of statute, but may not assess with respect to such payments, and must inform the taxpayer of his right to obtain a refund of these amounts). If FSC1 files a refund claim, the Service must grant it.

The mitigation provisions of I.R.C. §§ 1311-14, which under certain circumstances may ameliorate the impact of the statute of limitations, are also inapplicable. Because FSC1 elected to be a FSC pursuant to section 922(a), it cannot be a member of the same consolidated group as USCorp., and therefore cannot be a "related taxpayer" within the meaning of section 1313(c)(7). Furthermore, even if FSC1 were a related taxpayer, the conditions of section 1312 are not satisfied where one corporation claims a deduction and its counterpart claims an increase in income with respect to the same item. E.g., Schwartz v. United States, 67 F.3d 838 (9th Cir. 1995) (capital gain income in one year, denial of claimed straddle losses in another year).

In summary, when FSC1 filed amended Forms 1120FSC for Years 1-3 reporting additional tax, the statute of limitations for assessment had already expired, and the Service had no authority under section 6501 to assess additional tax. In this context, the tender of additional tax by FSC1 constituted a non-assessable advance payment of tax, and the

amounts tendered were therefore subject to refund upon demand. Because the Service had no authority to assess additional tax with respect to FSC1 for Years 1-3, the proposed redetermination fails the requirement in Temp. Treas. Reg. § 1.925(a)-1T(e)(4) that it "shall affect" both FSC1 and US Corp. We recommend that the Service inform FSC1 that it is entitled to refund of the additional tax tendered with the amended Forms 1120FSC. In addition, we recommend that the Service disallow the claims submitted by USCorp. on amended Forms 1120 for Years 1-3, for additional FSC commission deductions.

If you have any questions, please call Branch 6 at (202) 874-1490.

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