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Tax Controversy Services

IRS Insights

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IRS Memorandum Addresses the SB/SE Division's Use of the New IDR Enforcement Process in Employment Tax Examinations

On September 2, 2014, the IRS issued an internal memorandum for its employment tax managers and specialists. The memorandum advised SB/SE employment tax examiners are to utilize the LB&I process for issuing Information Document Requests ("IDRs") and its three-step IDR enforcement process. The mandatory Enforcement Process has three graduated steps: (1) Delinquency Notice; (2) Pre-Summons Letter; and (3) Summons. If an employment tax examiner is issuing a Pre-Summons Letter or Summons under the process, the examiner must contact the examiner's local TE/GE Counsel for support.

Details on the LB&I IDR issuance and enforcement processes can be found on the IRS website in the "Large Business and International Directive on Information Document Requests Enforcement Process" memorandum, dated February 28, 2014.

IRS Analyzes Whether Third-Party Employment Tax Returns Were Sufficient to Start Assessment Statute of Limitations

Section 6501(a) generally prohibits the assessment of any internal revenue tax beyond a three-year period after the date a return is filed. If the IRS fails to assess the tax within three years, then it is prohibited from collecting the tax, as well as interest, additions to tax, additional amounts, and penalties that are collected as part of the tax. The critical act to commence the statute of limitations on assessment is the filing of a "return," and the term "return" is defined in section 6501(a) to mean "the return required to be filed by the taxpayer (and does not include a return of any person from whom the taxpayer has received an item of income, gain, loss, deduction, or credit)." Consequently, when a document is filed with the IRS, the characterization of the document as a return can control the assessment statute of limitations and the validity of any subsequent assessment.

Recently, the IRS issued a memorandum ("Memorandum"), available at 2014 TNT 183-26, in which it analyzed, under four scenarios, whether an employment tax return prepared and filed by a third party on behalf of an employer was sufficient to commence the period of limitations on assessment under section 6501 for the employer.

Third Party Arrangements

Employers generally are required to deduct and withhold federal income tax and Federal Insurance Contributions Act (FICA) taxes from wages paid to their employees under sections 3402(a) and 3102, and are separately liable for the employer's share of FICA taxes under section 3111 (collectively referred to as employment taxes). For various reasons, an employer may choose to enter into an agreement with a third party to ensure that the employer's withholding, reporting, and payment obligations are satisfied.

One common third-party arrangement is the IRS's authorization of an agent, at the employer's request, under section 3504, to perform acts required of the employer, including the filing of employment tax returns under the agent's employer identification number. Revenue Procedure 2013-39, 2013-52 I.R.B. 830, describes the procedure for requesting the IRS authorize a person to act as agent under section 3504. Another common third-party arrangement involves an employer who enters into an agreement with a third party to perform the employment tax obligations of the employer, which includes the filing of employment tax returns under the third-party payor's employer identification number ("EIN") without receiving authorization from the IRS to do so. In these cases, the IRS may designate certain third-party payors under Treas. Reg. § 31.3504-2 to perform the acts required of an employer with respect to wages or compensation paid by the third-party payor to any individual performing services for any employer. In both cases, the third party becomes the agent of the employer and both parties assume responsibility for filing and payment.

Return Requirements

The statute of limitations on assessment in section 6501(a) begins to run with the filing of a return. But not all filings qualify as a "return" under that section.

Congress has granted the Secretary broad authority to determine what information should be submitted with a tax return, and how that information should be submitted. Section 6011 states:

> When required by regulations prescribed by the Secretary any person made liable for any tax imposed by this title, or with respect to the collection thereof, shall make a return or statement according to the forms and regulations prescribed by the Secretary. Every person required to make a return or statement shall include therein the information required by such forms or regulations.

The IRS's broad authority to prescribe the manner of filing has been recognized by the Supreme Court. In *Commissioner v. Lane-Wells Co.*, the Court stated:

> Congress has given discretion to the Commissioner to prescribe by regulation forms of returns and has made it the duty of the taxpayer to comply. It thus implements the system of self-assessment which is so largely the basis of our American scheme of income taxation. The purpose is not alone to get tax information in some form but also to get it with such uniformity, completeness, and arrangement that the physical task of handling and verifying returns may be readily accomplished. *Lane-Wells Co.*, 321 U.S. 219, 223 (1994).

Although the IRS has broad authority to determine what information should be submitted with a tax return, and how that information should be submitted, the issue of what constitutes a valid return to commence the assessment statute of limitations has been frequently litigated. The current test used by courts for determining whether a return is valid for assessment period of limitations purposes under section 6501 is outlined in *Beard v. Commissioner*, 82 T.C. 766, 777 (1984). For a document filed with the IRS to be considered a valid return sufficient to begin the limitations period of section 6501, it must:

1. Have sufficient data to calculate the tax liability;
2. Purport to be a return;
3. Be an honest and reasonable attempt to satisfy the requirements of the tax law; and
4. Be executed under penalties of perjury.

Four Factual Scenarios

In the Memorandum, the IRS set forth the following four arrangements between an employer and a third-party to address if the third-party's filing with the IRS was sufficient to commence the period of limitations on assessment for the employer.

Scenario 1

Facts – An employer has authorized an agent to act on its behalf with Form 2678, *Employer/Payer Appointment of Agent*. The Form 2678 is signed by both the employer and agent. The form is approved by the IRS, making both parties responsible for fulfilling the employer's employment tax filing and payment obligations. The agent files an aggregate Form 941 with its own EIN and attached Schedule R (Form 941), *Allocation Schedule for Aggregate Form 941 Filers*, on which it allocates the amount shown on Form 941 among all the employers it represents.

Conclusion – Because the employer had an approved Form 2678 on file with the IRS, the agent was authorized to file a return on behalf of the employer, thereby meeting the *Beard* requirement that a filing purport to be a return. In addition, because the filing included both Form 941 and Schedule R (Form 941), the IRS had all the necessary information in order to determine the employer's liability, thereby meeting the data sufficiency requirement of *Beard*. As a result, the IRS concluded the filing described in Scenario 1 would be sufficient to start the limitations period described in section 6501.

Scenario 2

Facts – An employer has authorized an agent to act on its behalf with an approved Form 2678. The agent files an aggregate Form 941 with its own EIN but does not attach Schedule R (Form 941).

Conclusion – Unlike in Scenario 1, no Schedule R (Form 941) was filed by the third party agent. As a result, the IRS was provided with the gross amount paid by the third party but had no way of determining to which employer(s) the payments should be allocated. Because of this omission, the IRS concluded that the data sufficiency requirement of *Beard* had not been satisfied and the filing did not constitute a return. As a result, the IRS concluded that the filing described in Scenario 2 would not be sufficient to begin the limitations period in section 6501 for the employer.

Scenario 3

Facts – An employer does not have an approved Form 2678 in place with respect to a third-party payor. However, the IRS has designated, pursuant to Treas. Reg. § 31.3054-2, the third-party payor to perform the acts required by the employer. The payor files an aggregate Form 941 with its own EIN but does not attach Schedule R (Form 941). The employer does not file its own Form 941.

Conclusion – As in Scenario 2, the IRS concluded that because only aggregate data was provided, the filing had insufficient information to constitute a return and, therefore, would not begin the period of limitations in section 6501. In Scenario 3 the IRS would have even less data than in Scenario 2, where although the IRS didn't have details on the payments it could at least determine which employer(s) the filings related based upon the previously filed Forms 2678. The IRS concluded that the filing described in Scenario 3 would not be sufficient to begin the limitations period in section 6501 for the employer.

Scenario 4

Facts – An employer does not have an approved Form 2678 in place with respect to a third-party payor. The third-party payor does not qualify under Treas. Reg. § 31.3054-2 for a designation by the IRS to perform the acts required by the employer. The employer does not file its own Form 941.

Conclusion – Under this scenario the IRS did not analyze the sufficiency of the data provided in the filing. Because the third party had no authorization to file on behalf of the employer (and as a result, had no liability for the employer's taxes), the IRS concluded that third party was not authorized to sign the return and, as a result, the return was insufficient to start the assessment statute of limitation for the employer.

Summary

Because the IRS has broad authority under section 6011 to dictate the form of filing for returns, taxpayers should take care to ensure that their filings are sufficient to meet IRS standards. IRS acceptance of a filing as a "return" is crucial because a valid return is necessary for the period of limitations under section 6501 to commence.

The fact that the IRS has three years to assess taxes is a well-known rule, but the complexities of that rule are not equally well known. As a result, taxpayers can be unpleasantly surprised to discover, years later, that the IRS still considers the assessment statute open for a year the taxpayer had thought to be closed. As illustrated by the IRS's Memorandum, this problem is compounded when third-party filers are involved, because unseen missteps by the third parties can have far-reaching impact on the taxpayers.

Tax Court Analyzes Assessment Statute of Limitations for Excise Tax under Section 4979A

Recently, in the *Law Office of John H. Eggertsen P.C. v. Comm'r*, 143 T.C. No. 13 (Oct. 1, 2014) ("*Eggertsen II*"), the Tax Court analyzed the period of limitations for assessing an excise tax under Internal Revenue Code ("IRC") section 4979A where the Taxpayer did not file a Form 5330, *Return of Excise Taxes Related to Employee Benefit Plans*.

As background, in February of 2014, the Tax Court had concluded that the Law Office of John H. Eggertsen P.C. ("Taxpayer") was subject to a 50-percent excise tax for 2005, applying IRC § 4979A. See *Law Office of John H. Eggertsen P.C. v. Comm'r*, 142 T.C. No. 4 (Feb. 12, 2014) ("*Eggertsen I*"). In *Eggertsen I*, the Internal Revenue Service ("IRS") took the position, and the Tax Court agreed, that the period of limitations set forth in IRC § 4979A(e)(2)(D), and not IRC § 6501 (a general statute applicable to all taxes imposed by the IRC), was controlling. In addition, the Tax Court in *Eggertsen I* further determined that the statute of limitations under IRC § 4979A(e)(2)(D) for assessing excise tax had expired, and concluded that the IRS's notice of deficiency was untimely.

Subsequently, the IRS filed a motion for reconsideration of findings with the Tax Court. In its motion, the IRS argued that the assessment statute of limitations in IRC § 4979A(e)(2)(D) supplements, but does not replace, the general assessment statute of limitation in IRC § 6501.

In *Eggertsen II*, the Tax Court found that it had made a substantial error in its earlier ruling, *Eggertsen I*, in concluding that the period of limitations had expired and that the IRS could not collect the excise tax from Taxpayer. Specifically, the Tax Court concluded that IRC § 4979A(e)(2)(D) could extend the IRC § 6501 limitations period, but not abbreviate it.

The Tax Court then analyzed whether the assessment statute of limitation of IRC § 6501 had expired. In this case, the Tax Court concluded that the Taxpayer had not filed Form 5330, or another document that could qualify as a return for IRC § 4979A(a) excise tax purposes within the meaning of IRC § 6501. Because the Taxpayer had not filed a return to start the assessment statute of limitation, under IRC § 6501(c)(3), the IRS could assess the IRC § 4979A excise taxes.

The Tax Court's decision and rationale in *Eggertsen II* is reminiscent of its discussion and resolution of the statute of limitations dispute in *Rhone-Poulenc Surfactants & Specialties, L.P. v. Comm'r*, 114 T.C. 533 (T.C. 2000), in the context of TEFRA partnerships. In *Rhone-Poulenc*, the Tax Court addressed the interaction of the TEFRA partnership returns limitations period in IRC § 6229(a) and the individual partner limitations period in IRC § 6501. The Tax Court determined that the IRS has the longer of the period from the filing of the partner's return (IRC § 6501) or the filing of the partnership return (IRC § 6229) within which to assess tax with respect to partnership items and affected items. The Court held that IRC § 6229(a) includes an alternative, minimum period of limitations and does not preclude the applicability to specific partners a longer period of limitations, such as the six-year period in IRC § 6501(e)(1)(A).

In cases where there is a statutory provision that provides an alternative limitations period to the general assessment period of limitations in IRC § 6501, one can expect that the IRS is likely to contend that it has the longer of the two periods within which to assess tax.

Federal Court of Claims, Applying the Relation Back Doctrine, Dismisses Foreign Tax Credit Refund Claims as Untimely

In *Albemarle Corp. & Subs. v. United States*, 2014 U.S. Claims LEXIS 1143 (Fed. Cl. Sept. 19, 2014), Albemarle Corporation & Subsidiaries ("Taxpayer") requested a refund for taxes paid in the 1997 and 1998 tax years, arguing that the Internal Revenue Service ("IRS") had incorrectly disallowed its refund claims for foreign tax credits related to its Belgian subsidiary, for the 1997 and 1998 tax years.

Albemarle S.A., a Belgian subsidiary of Taxpayer, issued registered debentures to Taxpayer, providing for semi-annual interest payments. During 1997 through 2001, Albemarle S.A. did not pay withholding tax in connection with interest payments made on debentures. Albemarle S.A. took the position that the payments were exempt from Belgian tax, and the Belgian tax authorities issued a notice of adjustment asserting that the debenture interest payments were subject to Belgian withholding tax at a rate of 25%. In January of 2002, Albemarle S.A. and the Belgian tax authorities reached an agreement; in accordance with the agreement, Albemarle S.A. would pay the withholding tax at a rate of 15% for all applicable years. During 2002, Albemarle paid the Belgian tax authorities in excess of $1.4 million, and the payments were allocated as follows: $412,923 for 1997; $412,923 for 1998; and the remainder for 1999-2001.

In May of 2009 (*i.e.*, seven years after Albemarle S.A. paid the Belgian withholding taxes to the Belgian tax authorities), Taxpayer filed an administrative refund claim for the 2002 year, using Form 1120-X, *Amended U.S. Corporation Income Tax Return*. Taxpayer did not file a protective refund claim for any of the years in issue. Taxpayer claimed a foreign tax credit in the amount of $412,923 for 1997 and $412,923 for 1998, attributable to the withholding taxes that it paid in 2002, but related to the taxes owed for 1997 and 1998. The IRS disallowed the 1997 and 1998 refund claims because they were not filed within the period for filing a claim seeking a refund based on a foreign tax credit, as set forth in Internal Revenue Code ("IRC") § 6511(d)(3)(A).

IRC § 6511(d)(3)(A) provides a special period of limitations for foreign taxes paid or accrued, and states that the period of limitations "shall be 10 years from the date prescribed by law for filing the return for the year in which such taxes were actually paid or accrued." The question before the Court of Claims ("Court") was, for 1998, whether the ten-year limitations period in IRC § 6511(d)(3)(A) should be calculated from the date that Taxpayer incurred the Belgian tax liability and the year for which the Taxpayer claimed the refund (*i.e.*, 1998) or from the date that Taxpayer actually paid the contested liability (*i.e.*, 2002). Taxpayer argued that the Belgian tax accrued once in 1998 in order to trigger its ability to claim the foreign tax credit, and then actually accrued in 2002 when the contested liability was resolved and paid. The IRS argued that the claims for the foreign tax credit, although resolved and paid to the foreign government in 2002, related back to the year for which Taxpayer claimed the refund (*i.e.*, 1998).

The Court ultimately concluded that the period of limitations in IRC § 6511(d)(3)(A) was triggered by the 1998 date, and that the $412,923 of foreign taxes paid by Taxpayer in 2002 (withholding taxes owed in connection interest payments made in 1998) related back to the 1998 year. The Court determined that the Taxpayer's claim, filed in May of 2009, was untimely and precluded jurisdiction in the Court of Claims for the 1998 tax year.

For the 1997 year, there was a dispute among the parties as to which version of IRC § 6511 applied. The Court decided that the pre-amendment IRC § 6511 provisions were applicable. However, the Court found that, regardless of which version of IRC § 6511 applied, the ten-year period of limitations started to run on March 15, 1998 for the 1997 tax year. Accordingly, the Taxpayer's May 2009 claim for a refund relating back to 1997 was untimely, and the Court likewise determined that it lacked jurisdiction to consider Taxpayer's 1997 refund claim.

IRS Issues Memorandum for Estate and Gift Tax Employees Announcing New Timeframes for Estate and Gift Tax Cases Subject to Appeals Jurisdiction

On September 3, 2014, the Director of Specialty Tax for the Internal Revenue Service ("IRS") Small Business/Self-Employed Division issued interim guidance, in a Memorandum for Estate and Gift Tax Employees, Control Number SBSE-04-0914-0064 ("Memo"), reflecting changes to the required number of days that must be remaining on the statute of limitations for estate and gift cases going to and coming from the IRS Office of Appeals as part of the Appeals Judicial Approach and

Culture ("AJAC") project. As discussed in the September edition of *IRS Insights*, the AJAC project is intended to reinforce Appeals' quasi-judicial approach to the way that it handles cases. The AJAC project is also designed with the goal of enhancing internal and external customer perceptions of a fair, impartial and independent Office of Appeals. The updated Estate and Gift Tax examination timeframes, provided in the Memo, are reflected in the chart below.
URL: http://newsletters.usdbriefs.com/2014/Tax/IRSI/140908_1.html

Situation	Days Required to be Remaining on Assessment Statute of Limitations
Gift or Fiduciary Income Tax case initially received by Appeals	365
Estate Tax case received by Appeals	270
Case received in Examination, where Appeals released jurisdiction of the case to Examination for consideration of new information or new issues raised by the taxpayer	210
Case received in Appeals, where Appeals released jurisdiction of the case and returned it to Examination for additional analysis and/or determination	180

In addition, the Memo indicates that, in cases where Appeals retains jurisdiction, the examiner should complete the review of new information or new issues raised by the taxpayer within 30 days of receipt from Estate and Gift Tax Planning and Special Programs ("PSP").

The interim guidance is effective as of September 3, 2014, and will be incorporated into IRM 4.25.10 by September 1, 2015.

New IRS Guidance Highlights the Authority That Can Be Granted to Employees Pursuant to an LB&I Examination Plan

Recently, the IRS Office of Professional Responsibility issued Alert Issue Number 2014-12 ("Alert"), in which it described the limitations on Form 4764 and described when Form 2848, *Power of Attorney and Declaration of Representative*, was necessary instead.

At the beginning of an IRS examination, many corporate taxpayers are asked to sign an LB&I examination plan (Form 4764). Form 4764, among other functions, includes a Communications Agreement as section 1(b). There, taxpayers are able to authorize employees, in their interactions with the IRS, to: (1) discuss tax matters; (2) provide and receive information; and (3) receive and discuss adjustments.

The Alert notes that if corporations would like employees to take actions beyond those basic tasks, they cannot do so with Form 4764 authorizations. Any additional actions – such as advocating or negotiating – require an executed Form 2848. The Alert provides two additional warnings with respect to Form 2848. First, the form must be signed by a duly elected officer of the corporation. The Alert warns that so-called "vanity-titled" officers are not authorized to sign Forms 2848. Second, the IRS considers Form 2848 to be evidence of practice before the IRS that subjects the employees listed on Form 2848 to the regulations concerning practice before the IRS set forth in Circular 230.

IRS Releases Additional Guidance on the Codified Economic Substance Doctrine

The Internal Revenue Service ("IRS") released Notice 2014-58 ("Notice") to provide taxpayers with additional guidance on the economic substance doctrine, which has been codified in IRC §7701(o). The new guidance updates two IRS positions: how "transactions" subject to the doctrine are identified; and how to determine what a "similar rule of law" is for purposes of the accuracy-related penalty.

Economic Substance Codification

The Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, ("Act") contained several related provisions to codify the judicial doctrine of economic substance. The primary component of the codification was the addition of section 7701(o), which contains the basic elements of the economic substance doctrine: a transaction must change a taxpayer's non-tax economic position in a meaningful way; and a taxpayer must have a substantial, non-tax purpose for entering into a transaction. Subparagraph (5)(D) notes that the term "transaction" includes a series of transactions.

The Act also incorporated the economic substance doctrine into the section 6662 accuracy-related penalty. Section 6662(b)(6) was added to expand the scope of transactions subject to a 20% penalty; now included are transactions lacking in economic substance or a transactions "failing to meet the requirements of any similar rule of law."

Notice 2014-58

The Notice provides the IRS position on two issues: the definition of a "transaction" in section 7701(o)(5)(D) and the meaning of "similar rule of law" in section 6662(b)(6).

"Transaction"

The Notice describes two alternative procedures to determine what the "transaction" is that will be subject to analysis: aggregation and disaggregation. Aggregation is the process by which several different steps are combined into a single "transaction." Disaggregation is the process by which the IRS breaks a series of steps apart and analyzes them separately. The aggregation approach is codified in section 7701(o)(5)(D) and disaggregation was added administratively by the IRS.

"Similar Rule of Law"

The accuracy-related penalty under section 6662(b)(6) applies to a transaction lacking in economic substance or that is disallowed based on a "similar rule of law." The Notice details the IRS position on what a similar rule of law is: any doctrine, regardless of label, that uses the same factors as the economic substance doctrine: a transaction must change a taxpayer's non-tax economic position in a meaningful way or a taxpayer must have a substantial, non-tax purpose for entering into a transaction.

It is not clear from the Notice whether a "similar rule of law" requires both factors, or if a single factor is sufficient. The Notice states that the "similar rule of law" analysis must be the same as the economic substance analysis; however, in the Notice, the IRS uses the disjunctive "or," whereas, in the statute, Congress used the conjunctive "and." Future guidance may be needed.

Have a question?
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