

Office of Chief Counsel
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Memorandum

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to: Associate Area Counsel (Salt Lake City)
(CC:SB:5:SLC)

from: Associate Chief Counsel (Income Tax & Accounting)
(CC:ITA)

subject: Refunds of Required Payments under § 7519

This Chief Counsel Advice responds to your memorandum requesting advice on the applicable statute of limitations for refunds of required payments under § 7519 of the Internal Revenue Code. This advice may not be used or cited as precedent. T

ISSUES

1. Whether a claim for refund of a required payment made under § 7519 is subject to the period of limitations in § 6511.¹
2. Whether the IRS should make refunds under § 7519(c) to taxpayers who have not filed Forms 8752 to calculate their annual required payments.

CONCLUSIONS

1. A required payment under § 7519 is a payment in the nature of a deposit rather than a tax. Accordingly, a claim for refund of a required payment is a non-tax claim against the government that is subject to the general six-year period of limitations in 28 U.S.C. §§ 2401 and 2501.

¹ All statutory references in this memorandum are to the Internal Revenue Code (26 U.S.C.) unless expressly indicated otherwise.

2. The IRS should not make refunds of required payments until the entity has filed Forms 8752, Required Payment or Refund Under Section 7519, for each tax year that precedes the year for which the refund is requested. Because the deposit required by § 7519 varies from year to year, the IRS cannot compute the amount of the deposit to be refunded until it has received and evaluated the entity's calculation (on Form 8752) of the amount of deposit that is required for each year.

FACTS

The Ogden Campus Accounts Management Division has observed that a number of entities subject to the requirements of § 7519 are delinquent in filing Forms 8752.

LAW AND ANALYSIS

Taxable years and deferral

Section 441(a) requires each taxpayer to compute taxable income on the basis of the taxpayer's taxable year, which for most taxpayers, is the calendar year. To avoid the deferral of income to shareholders, a pass-through entity such as an S corporation must generally use a calendar year unless it can demonstrate a business purpose for using a fiscal year other than a calendar year. Section 1378(b). Similarly, in the absence of a business purpose, a partnership ordinarily must use the same taxable year as its partners. Section 706(b)(1).²

Even if a partnership or an S corporation does not have a business purpose for using a fiscal year, § 444(a) nevertheless permits the entity to elect a taxable year that differs from its otherwise required taxable year. An entity may make the § 444(a) election only if the deferral period is no longer than three months (i.e., the entity's fiscal year may end on September 30, October 31, or November 30 if the shareholders or partners are calendar year taxpayers) and the entity makes the payments required by § 7519. Section 444(b) and (c)(1).

Absent statutory limitations on what constitutes a permissible taxable year, owners of pass-through entities could achieve significant tax deferral by the simple expedient of having the entity's taxable year end at a time different than theirs. The deferral is possible because §§ 706(a) and 1366(a)(1) provide that the income of a partnership or S corporation is included in the returns of its partners or shareholders for the taxable year of the partners or shareholders that includes the last day of the entity's taxable year. For example, a business that earned most of its income from October through December could defer the taxation of that income until the next calendar year if the

² The mechanism for electing a different taxable year upon a showing of a business purpose is found in Treas. Reg. § 1.442-1(b) and Rev. Proc. 2002-39, 2002-1 C.B. 1046, as modified by Notice 2002-72, 2002-2 C.B. 843.

business operated as a partnership with a fiscal year ending September 30. The partners would not report the income from the first year until the end of the second year.

Required payments under § 7519

As further explained below, § 7519 compensates the government for the lost time value of money when taxes are deferred under § 444. To maintain a valid § 444 election, a partnership or an S corporation is obligated to make the required payments imposed by § 7519. The entity must both file a Form 8752, Required Payment or Refund Under Section 7519, showing the required payment (even if the amount of such payment is zero) and pay the full amount of the required payment as reported *for each year* in which the § 444 election is in effect. Section 7519(e)(2)(B), Treas. Reg. § 1.7519-2T(a). The Form 8752 and the payment are due not later than May 15th of the calendar year following the calendar year in which the entity's applicable election year begins. Treas. Reg. § 1.7519-2T(a)(4)(ii).

The amount of the "required payment" an entity must make under § 7519(b) for any applicable election year is the excess of ---

(1) the applicable percentage of the adjusted highest section 1 rate multiplied by the net base year income of the partnership or the S corporation [the "(b)(1)" amount] over

(2) the net required payment balance [the "(b)(2)" balance].

Section 7519(e)(4); Treas. Reg. § 1.7519-1T(a)(3)(ii), (a)(4) ex. 1-3.

Section 7519 effectively requires every partnership or S corporation with a § 444 election to maintain a running deposit account with the IRS. The "(b)(1)" amount that an entity must keep on deposit during a given year is intended to approximate the maximum tax the partners or shareholders could defer through the entity's use of a different tax year.³ The "(b)(2)" balance is the net deposit that is left in the account from the prior year. Section 7519(b) obliges the entity to make a "required payment" equal to the amount by which the "(b)(1)" amount required to be on deposit for that year exceeds the "(b)(2)" balance that is already on deposit from the prior year. The entity adjusts the account balance annually when it files Form 8752, either by making an additional "required payment" under § 7519 (if a higher deposit is required) or by claiming a refund under § 7519(c) (if the required balance is less than the balance in the account).

Refunds from the net required payment balance

If the entity claims on a Form 8752 that the "(b)(1)" amount required to be kept on deposit for a year is less the existing "(b)(2)" account balance from the prior year, the

³ The relevant calculation, set forth in section 7519(d) and (e), is not germane to this discussion.

entity is entitled to a refund of the excess amount in the (b)(2) account. Section 7519(c)(1). The rationale underlying § 7519(c)(1) is straightforward: the IRS may not keep any part of the “(b)(2)” account balance from one year into the next year that exceeds the “(b)(1)” amount to be kept on deposit for the next year. Excessive amounts in the “(b)(2)” account would be refunded, for example: 1) if the entity’s income has declined from one year to the next; or 2) if the maximum tax rate dropped from one year to the next. An entity is entitled to a refund of the entire “(b)(2)” account balance when the entity revokes its § 444(a) election or goes out of existence. Section 7519(c)(2). Upon liquidation or termination, an entity’s “(b)(1)” required deposit becomes zero.

Assessment and collection of required payments

For collection and assessment purposes, a § 7519 required payment is treated like an employment tax. If the entity does not timely make a “required payment”, the amount due can be assessed and collected “as if it were a tax” under Subtitle C. Section 7519(f)(1). The required payments may be assessed under §§ 6201 through 6207 and collected under §§ 6301 through 6306. The deficiency procedures for income taxes in §§ 6211 through 6216, however, do not apply.

A § 7519 required payment is also treated “as a tax” for purposes of determining interest and some penalties. Section 7519(f)(3) provides that any amount of the “required payment” not paid on or before the last date prescribed for payment accrues interest on the unpaid amount for the period from the prescribed date to the date the required payment is paid. Likewise, § 7519(f)(4)(A) allows a 10 percent late payment penalty to be imposed if the “required payment” is not made timely; § 7519(f)(4)(B) allows additional penalties for negligence and fraud.⁴

However, a required payment is not treated “like a tax” for other purposes. Once a required payment is assessed and collected, it becomes part of the amount required to be kept on deposit for the deferral year. The deposits rolled over from the prior year and any required payments serve as a security deposit for the entity’s right to use a taxable year other than a required tax year. The government may invest the deposited amount and collect interest, but must refund the deposits when the entity liquidates or terminates its § 444 election. Section 7519(f)(3) treats a required payment as a deposit rather than a tax by explicitly providing that “no interest shall be allowed with respect to any refund of a payment made under this section.”⁵

⁴ The ultimate penalty for an entity’s willful failure to make any required payment under § 7519 is the termination of the § 444 election.

⁵ See Semmes, Bowen & Semmes v. United States, 30 Fed.Cl.134 (1993); aff’d without opinion, 34 F.3d 1080 (Fed. Cir. 1994).

For a comparison of deposits with tax payments, see Rev. Proc. 2005-18; 2005-13 IRB 798, superseding Rev. Proc. 1984-58, 1984-2 C.B. 501, which provides the current instructions on using designated cash

Statute of limitations on refunds

Section 7519 does not provide a limitation period for claiming the refund of required payments, either when the existing “(b)(2)” account balance exceeds the “(b)(1)” amounts to be kept on deposit for a year or when the § 444 election terminates.

Refunds of tax overpayments are authorized under § 6402(a). The regulations under § 6402 provide that “refunds of overpayments may not be allowed or made after the expiration of the statutory period of limitations properly applicable unless, before the expiration of such period, a claim therefore has been filed by the taxpayer.” Treas. Reg. § 301.6402-2(a)(1). Section 6511(a) provides the statutory period of limitations for refunding tax overpayments:

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 later, or if no return was filed by the taxpayer, within 2 years from the time the tax was paid.

Section 6511(b)(1) provides that no credit or refund shall be allowed or made after the expiration of the period of limitations prescribed in § 6511(a), unless a claim for credit or refund is filed by the taxpayer within such period.

Section 6511 does not define, or otherwise identify, what constitutes a “tax imposed by this title.” However, in analyzing the § 6511 limitation period, courts generally have recognized that the tax laws are technical and the statutes of limitation are to be interpreted accordingly. Ewing v. United States, 914 F.2d 499, 501 (4th Cir. 1990). Section 6511 applies only to “tax” paid by taxpayers, and not to deposits or other payments that do not constitute payments of tax.⁶

If a payment claimed from the IRS is not a tax subject to § 6402 and § 6511, claimants generally have six years after the right of action accrues to file suit against the government in a district court or in the Court of Federal Claims for recovery of such

deposits under § 6603, rather than tax payments, to stop the accrual of interest on potential underpayments of tax. Effective for deposits made after October 22, 2004, § 6603 provides for the payment of interest on the return of a “designated deposit.” See § 6603(d)(1). Prior to the enactment of § 6603, a payment in the nature of a cash bond under Rev. Proc. 1984-58 was not a payment of tax, was not subject to a claim for credit or refund, and, if returned to the taxpayer, did not bear interest.

⁶ For example, the payment of overpayment interest under § 6611 is not a refund of tax and is not subject to the limitations period in § 6511. General Instruments Corp. v. United States, 33 Fed. Cl. 4, 8 (1995). Likewise, section 6603 and Rev. Proc. 2005-18, supra, note 4, do not take into account a limitation period for the return designated deposits made by taxpayers to stop the running of interest.

payment. 28 U.S.C. §§ 2401(a) and 2501. Based on common law rules, the six-year period starts when all the events which fix the government's alleged liability have occurred and the taxpayer was or should have been aware of their existence. Hapland Band of Pomo Indians v. United States, 855 F.2d 1573, 1577 (Fed. Cir. 1988).

Section 7519 required payments are deposits, not taxes

The key issue, then, for this analysis is whether the amount to be refunded from the § 7519 required payments are taxes subject to section 6511. This office and the one court that has considered the issue have previously concluded that the required payment is a tax. A September 2000 memorandum to District Counsel, Los Angeles District, discussed the essence of what constitutes a tax:

A tax has been defined as an enforced contribution, exacted pursuant to legislative authority in the exercise of the taxing power, and imposed and collected for the purpose of raising revenue to be used for public or governmental purposes. Whether a particular charge falls into the category of a tax depends upon its real nature. If it is in the nature of a tax, it is not material that it is called by a different name.

The memorandum concluded that the required payments, being enforced contributions exacted pursuant to legislative authority, were taxes. CCA 200050014 (Dec. 15, 2000), 2000 IRS CCA LEXIS 139. The IRS took the same position in Voss Industries, Inc. v. United States, 2003-1 U.S.T.C. (CCH) par. 50,248 (N.D. Ohio 2003). The district court held that the section 7519 required payments were taxes and that the time for filing a refund had expired before the entity's claim was filed.

Upon further consideration, we are reversing our earlier administrative and litigating position for the following reasons.

First and foremost, the legislative history and the statutory construction of § 7519 indicate that the required payments are not a legislative attempt to collect revenue through enforced contributions, but are refundable deposits. Section 7519 is intended to compensate the government for the lost "time value of money" when the taxpayer-owners of an S corporation or partnership defer income earned through an entity that has made a § 444 election. In lieu of collecting an enhanced estimated tax from the taxpayer-owners, Congress required the entity to keep a required balance on deposit with the IRS for the period over which the taxpayer-owners deferred the income. See Omnibus Budget Reconciliation Act of 1987, P.L.100-203 § 10206, H.R.Conf. Rep. 100-495 (Dec 21, 1987).⁷

⁷ The initial House bill would have required the partners in an electing partnership and shareholders in an electing S corporation to pay "enhanced" estimated tax payments in advance of the year for which the taxes would be due. The conference agreement modified the House bill by requiring the electing entity to make "additional payments." Although the report called the entities' payments "taxes," the revised bill described in the report contemplated that the entity level payments would serve as advance deposits of

Section 7519(b)(1) defines the amount that must be kept on deposit for each year. The payment required by § 7519 is the amount the entity must pay if the existing deposit, defined by § 7519(b)(2), is less than the required deposit for the current year. Rather than providing for a new deposit to be made and refunded each year, § 7519 envisions an ongoing deposit account for each entity, for which the entity annually makes up or down adjustments. After making an initial required payment to establish the balance in a deposit account for the first year of the deferral, the entity would need to report the adjustments for each year. Depending upon whether the § 7519(b) formula increased or decreased the amount required to be kept in the account each year, the entity would either make an additional required payment or get a refund from the existing account when it filed its Form 8752.

In essence, § 7519 creates continuing accounts to earn interest to compensate the government for the interest that the government loses on the shareholders' and partners' deferred taxes. The government, after collecting the required payment from the entity, may invest and collect interest upon the entity's deposit for the year until the partners or shareholders pay the tax that has been deferred under the § 444 election. In the words of Notice 89-41, 1989-1 C.B. 681, 682, "[r]equired payments are intended to represent the value of the tax deferral obtained by the owners of those [passthrough] entities through the use of a taxable year different from the required taxable year."

A leading tax treatise explains the rationale for computing the deposit that the entity must have on deposit each year:

Net base year income is multiplied by a percentage that is one point higher than the highest marginal tax rate for individuals....The product of this multiplication is intended as a surrogate for the taxes the partners or shareholders would have paid on the deferred income and is the sum the entity must keep **on deposit** with the Treasury. The entity's payment for the year is usually this amount, less the 'net required payment balance,' which is the excess of the sum of the required payments for prior years over the portions of these payments that have been refunded to the entity. The aggregate amount **on deposit** is meant to approximate the taxes deferred by the partners or shareholders for the deferral period of the taxable year of the entity that is currently in progress. The current payment is thus limited to the amount needed to bring the aggregate up to this amount.

Bittker & Lokken, Federal Taxation of Income, Estates and Gifts, par. 105.2.3, pages S105-20 - S105-21 (2005 Cum. Supp. No. 2). (Emphasis added; footnotes omitted.)

The second crucial distinction between the § 7519 required payment and a tax is that the entity is entitled to a refund of the entire account balance upon termination of the election or liquidation of the entity, and to excess aggregate payments during the entity's life. As stated in Bittker & Lokken, supra at S105-21 (emphasis added; footnotes omitted):

If the computation formula yields a negative number, the partnership or S corporation is entitled to a refund of that amount. A negative number represents an excess of prior payments over the tax presently being deferred, an excess of the existing deposit over the amount intended to be covered by the deposit. **The refund is thus essential to the function of the payments as a deposit rather than a tax.**

The computation will always yield a negative number for the year in which the entity liquidates or terminates its § 444 election. Because the liquidation or termination will end the deferral of income by the entity's partners or shareholders, the entity will no longer need to maintain a deposit with the IRS. Any amount remaining in the "(b)(2)" account will then be refundable to the entity. This full refund of all the required payments is inconsistent with the characterization of the required payment as a tax.

Third, under § 7519(f)(3), the required payments function as deposits. Each year, the government holds the amounts specified in 7519(b)(1) so that it may earn interest on an amount approximately equal to income that was deferred as a direct result of the entity's § 444 election. It is consistent with that purpose to require entities to pay interest and penalties on late payments because an entity with delinquent payments is depriving the government of the opportunity to invest the required balance. Likewise, the government is excused from paying interest on any refund because the government, not the entity, was intended to benefit from the use of the required payments over the deferral period.

Finally, § 7519 payments are not definite, fixed liabilities like taxes. Required payments, once made, are rolled forward from one year to the next throughout the life of a § 444 election. The payments are kept on deposit over the life of the § 444 election, with the balance being adjusted from year to year to maintain the deposits required by § 7519(b)(1). The required payments will seldom be refunded within 3 years of assessment or 2 years of payment. Section 6511 contemplates payments and refunds for a single tax period, not requests for the refund of amounts held in a rolling account over several tax years.

Making refunds under § 7519(c)

Required payments, even if assessed like taxes, are not taxes once they become part of a required payment account. Thus neither § 6402 nor § 6511 apply to refunds from a required payments account under § 7519(c).

In the absence of a specific limitation period for claiming the refund of § 7519 required payments, the general limitation period in 28 U.S.C. §§ 2401(a) and 2501 will apply. An entity has six years to file suit against the government for recovery of a required payment from the date on which all the events which fix the government's alleged liability have occurred and the entity was or should have been aware of their existence. The entity may file an administrative refund claim within that six year period. The six year period for filing suit should start as of the due date of the Form 8752 on which the refund of a required payment should have been claimed. The entity's right to a refund of any excess payment becomes fixed (albeit unknown to the government) as of the due date for the Form 8752 and the entity, being responsible for filing the required Form 8752, should be aware that the events establishing the liability had occurred.

Likewise, all the events which fix the government's alleged liability for refunding the balance of the § 7519(b)(2) accounts would occur if the entity liquidated or terminated its § 444 election. The entity would have up to six years from the liquidation or termination of the § 444 election to file suit to recover any excess § 7519 deposits.

The government should not make any refund of a required payment to an entity for any year until the entity has filed Forms 8752 for each preceding year that the entity's § 444 election was in effect. The § 7519 statutory scheme for required payments mandates the annual computation of any required payment or refundable amount for each successive year. The balance to be kept in a required payment account could increase, decrease, or stay the same from any one year to the next. If an entity does not file the required Form 8752 for each year, the government can not determine whether the entity failed to make required payments (and to pay interest and penalties) for the intermediate years or if the taxpayer failed to make a timely claim for refund of excess required payments for those years.

Please call (202) 622-4920 if you have any further questions.