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

OFFICE OF
CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE CHIEF COUNSEL ADVICE

MEMORANDUM FOR ASSOCIATE AREA COUNSEL (LMSB),
Attn:

FROM: Curtis G. Wilson
Assistant Chief Counsel (Administrative Provisions and Judicial Practice) CC:PA:APJP

SUBJECT: Change of Accounting Period and Statute of Limitations

This Chief Counsel Advice responds to your memorandum dated May 8, 2001. Chief Counsel Advice is not binding on Examination or Appeals and is not a final case determination. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

The issue presented concerns the expiration of the period for assessing tax for certain subsidiaries of the taxpayer. The subsidiaries changed their annual accounting period from a calendar year to a fiscal year effective September 30, 1993. Your office and the National Office have determined that the change was unauthorized. The only issue remaining is the expiration of the period for assessing tax assuming the Service requires use of the calendar year or, alternatively, accepts the unauthorized fiscal year filings.

LEGEND

taxpayer (parent) =

subsidiaries =

ISSUES

1. If the Service requires the use of the calendar year as the taxable year, has the period of limitations expired for calendar years 1993, 1994, and 1995?

2. If the Service accepts the use of the years ended September 30, 1993, September 30, 1994, and September 30, 1995, has the period of limitations for assessing tax for those years expired?

CONCLUSIONS

1. If the Service requires use of the calendar year, the period of limitations for the year ended December 31, 1993, has expired and no tax for calendar year 1993 may be assessed. For the year ended December 31, 1994, the three-year assessment period expired on December 15, 1998, and the six-year period (if there was a substantial understatement of gross income) will expire on December 15, 2001. Finally, the period of limitations has not expired for the year ended December 31, 1995.

2. If the Service allows use of the fiscal year, then the periods of limitation for the years ended September 30, 1993, and September 30, 1995, have not expired as these periods have been extended by the consent of the parties. However, the period of limitations for the year ended September 30, 1994, has expired.

FACTS

The taxpayer has several wholly-owned subsidiaries that elected to be taxed under section 936 of the Code. Section 936 provides substantial tax credits for companies receiving income from the active conduct of a trade or business in Puerto Rico.

Prior to 1993, the subsidiaries and the parent all used the calendar year as the taxable year. In 1993, the subsidiaries filed applications to change their annual accounting period. The applications (Form 1128) requested a change to a taxable year ended September 30, effective September 30, 1993. The applications were filed in order to avoid the impact of an amendment to section 936 reducing the available tax credit for tax years beginning after December 31, 1993. The intent in filing the applications was to obtain the benefit of the larger credit for nine months longer than if the subsidiaries had remained on the calendar year.

The applications for a change in the accounting period were approved by the Service pursuant to Rev. Proc. 92-13, 1992-1 C.B. 665. However, Rev. Proc. 94-12, 1994-1 C.B. 565, modified Rev. Proc. 92-13 so that section 936 corporations could no longer change their annual accounting period under Rev. Proc. 92-13 if the application was filed on or after August 10, 1993. You have determined that the applications were subject to Rev. Proc. 94-12 and that the Service has the right to revoke its prior approval of the change to a fiscal year. However, the Service is not required to revoke its approval. Thus, the Service may disapprove of the change and require filing on the calendar year basis or it may accept the fiscal year returns.

The subsidiaries filed tax returns for the nine-month year commencing on January 1, 1993 and ending on September 30, 1993, and for the three subsequent twelve-month years ending on September 30, 1994, September 30, 1995, and September 30, 1996. The parent (taxpayer) filed returns for its years ended December 31, 1993, December 31, 1994, and December 31, 1995. The Service is currently examining the parent and the subsidiaries for all of the above periods.

For the years ended September 30, 1993, September 30, 1995, and September 30, 1996, extensions of the period of limitation on assessment (Forms 872) were executed and the period remains open for assessment for each year of each subsidiary. However, for the subsidiaries' years ended September 30, 1994, no extensions were requested or executed.

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. If a federal income tax return is filed prior to its due date, the period of limitations begins to run from the due date. I.R.C. § 6501(b)(1).

Section 6501(e)(1)(A) provides that, if the taxpayer makes an omission of more than 25 percent from gross income, the Service may assess tax within six years of the date of filing of the original return.

Section 6501(c)(4) provides that the Service and the taxpayer may enter into a written agreement (Form 872, Consent to Extend the Time to Assess Tax) 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).

A return can start the running of the § 6501(a) three-year period even if it is defective or incomplete in certain respects. However, tax returns that lack the data necessary for the computation and assessment of deficiencies generally should not be regarded as triggering the period of assessment. Bufferd v. Commissioner, 506 U.S. 523, 528 (1993).

The courts have held that the period of limitations may begin to run if the taxpayer mistakenly files returns for improper periods. Paso Robles Mercantile Co. v. Commissioner, 12 B.T.A. 750, 753 (1928), affd. 33 F.2d 653, 654 (9th Cir. 1929). The rationale is that the improperly filed returns will, if pieced together, provide the

Commissioner with sufficient information to determine the tax liability for the period for which the return should have been filed. See also Atlas Oil & Refining Corp. v. Commissioner, 22 T.C. 552, 557 (1954), nonacq., 1955-2 C.B. 10; Century Data Systems, Inc. v. Commissioner, 86 T.C. 157, 171 n.10 (1986). The Tax Court has explained this rationale as follows:

> The rationale followed in Atlas Oil, Paso Robles, and Mabel Elevator, is that when the Commissioner is given information by a taxpayer in properly executed form, i.e., on duly executed tax forms, covering all of a taxable period in issue, the period of limitations applicable to the period in issue begins to run, even though the taxpayer may have filed returns for improper periods. In other words, if a tax return filed by a taxpayer for an incorrect period, when considered with other returns filed by the same taxpayer, provides the Commissioner with the information necessary to determine the true tax liability of the taxpayer for the taxable period in dispute, the period of limitations for the period in dispute begins to run, even though the return is not for the period required by the Code. Atlas Oil & Refining Corp. v. Commissioner, 22 T.C. 552, 559 (1954).

Estate of Simpson v. Commissioner, T.C. Memo. 1994-207 (1994). Thus, if a taxpayer is required to file returns on the basis of the calendar year, but improperly files returns on the basis of a fiscal year, the fiscal year returns may be pieced together to provide sufficient information necessary to determine the tax liability for the calendar year. As explained previously, the subsidiaries did not obtain valid approval of the change to a fiscal year. As a result, the Service may require use of the calendar year (Option 1) or may accept the returns filed on the basis of the unauthorized fiscal year (Option 2).

Calendar Year Analysis (Option 1)

Under the first option requiring use of the calendar year our analysis is as follows for 1993, 1994, and 1995.

1. Calendar Year 1993

The first nine months of 1993 were reported on the return for the nine-month year ended September 30, 1993. The period of limitations for those nine months was extended by Form 872. The last three months of calendar year 1993 were reported on the return for the year ended September 30, 1994. A Form 872 based on a fiscal year will, by its plain language, extend the period of limitations only for the fiscal year. Generally, although a Form 872 is not a contract, contract principles apply to its interpretation. Piarulle v. Commissioner, 80 T.C. 1035 (1983); Kronish v. Commissioner, 90 T.C. 684 (1988). We do not think the subsidiaries can be said to have assented to an extension for the calendar year as this period is not specified by the Form 872. Therefore, none of calendar year 1993 is open because consents are not outstanding for the entire year.

You raise the issue whether adjustments may be made for the first nine months of calendar year 1993 because this period is covered by the Form 872. This issue implicitly arose in Atlas Oil & Refining Corp., supra. In that case, the taxpayer filed tax returns on the basis of fiscal years ending November 30. In a prior decision, the Tax Court held that deficiencies had been improperly determined on the fiscal year basis as the taxpayer kept its books using the calendar year. Subsequently, the Commissioner sent notices of deficiency for calendar years 1942 and 1943. The consents with respect to fiscal years 1942 and 1943 had expired prior to the mailing of the deficiency notices. The only unexpired consent outstanding at the time of the mailing related to fiscal year 1944. That consent left one month (December) of calendar year 1943 open at the time the notices of deficiency were mailed. The Tax Court held that the statute of limitations barred the assessment of deficiencies for 1942 and 1943. Implicit in the holding was the concept that calendar year 1943 was indivisible. Because the period of limitations was not open as to all of 1943, it could not be viewed as open with respect to the one month (December 1943) covered by the unexpired consent. Thus, the court did not view the notice of deficiency as timely with respect to this month. Similarly, in this case there is an outstanding consent covering the first nine months of 1993. No tax may be assessed for 1993 because the consent covers only a portion of 1993.

2. Calendar Year 1994

Income for the first nine months of 1994 was reported on the return for the year ended September 30, 1994; income for the last three months of this calendar year was reported on the return filed for the year ended September 30, 1995. The two fiscal year returns may be pieced together "to determine the true tax liability of the taxpayer for the taxable period in dispute" upon filing of the return for the year ended September 30, 1995. That return was due on December 15, 1995, and was timely filed. The period of limitations for this calendar year thus began to run on December 15, 1995. Three years thereafter was December 15, 1998. Six years thereafter will be December 15, 2001. The general three-year period of limitations has therefore expired for 1994 as there is no outstanding consent covering all twelve months in 1994. However, if a substantial understatement of gross income (as defined in I.R.C. § 6501(e)) is determined, then a notice of deficiency for this calendar year may be mailed as late as December 15, 2001.

3. Calendar Year 1995

Income for the first nine months of 1995 was reported on the return filed for the year ended September 30, 1995; income for the last three months was reported on the return for the year ended September 30, 1996. The two fiscal year returns may be pieced together to determine the tax liability for calendar year 1995. There are unexpired consents for the years ended September 30, 1995, and September 30, 1996. Therefore, the period for assessing tax has not expired for the year ended December 31, 1995.

Fiscal Year Analysis (0ption 2)

Under the second option, the Service will permit the use of the fiscal year ended September 30 for the returns already filed. The period for assessing tax was extended by Forms 872 for the years ended September 30, 1993, and September 30, 1995. These taxable years remain open. For the year ended September 30, 1994, the three-year period expired on December 15, 1997 and the six-year period expired on December 15, 2000. Therefore, the Service would not be able to collect taxes for the fiscal year ended September 30, 1994.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

If you have any further questions, please contact Lisa Neuder at (202) 622-4940

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