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

OFFICE OF
CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR JODY TANCER
ASSOCIATE AREA COUNSEL
(Large and Mid-Size Business)

FROM: Associate Chief Counsel (Passthroughs & Special Industries)
CC:PSI

SUBJECT:

This Chief Counsel Advice responds to your memorandum dated June 25, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

LEGEND

Grantor Trust =

X =

D1 =

Year 1 =

Year 2 =

Year 3 =

ISSUE

Whether the statute of limitations under § 6501(a) is started by the filing of the tax return of the grantor or by the tax return of Grantor Trust.

CONCLUSION

The statute of limitations under § 6501(a) is started by the filing of the tax return of the grantor, not the tax return of Grantor Trust. Therefore, the statute of limitations will run for 3 years from the filing of the return of the grantor of Grantor Trust.

FACTS

X's Year 1 initial public offering is being examined. Grantor Trust may be a party to the public offering. Grantor Trust is a grantor trust as set forth in § 671 et. seq.

Grantor Trust was created on D1. Grantor Trust filed Forms 1041, U.S. Income Tax Return for Estates and Trusts for Year 1, Year 2 and Year 3. The Grantor Trust returns contain no information relating to the trust's tax liability. The return contains the statement:

> Under the terms of the trust instrument this is a grantor trust and all income is taxable to the grantor as set forth under 1986 I.R.C. sections 671-678.

A "Grantor Tax Information Letter" is attached, which sets forth information regarding income, deductions, tax credits and preference items, and miscellaneous information.

The statute of limitations for the personal liabilities of all related individuals have been protected. The relevant individuals filed Forms 1040 with respect to their income tax liabilities.

LAW AND ANALYSIS

Section 6501(a) of the Internal Revenue Code provides that, except as otherwise provided, tax must be assessed within 3 years after the return was filed, whether or not such return was filed on or after the date prescribed.

Section 671 provides that where it is specified in subpart E that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under chapter 1 in computing taxable income or credits against the tax of an individual. Any remaining portion of the trust shall be subject to subpart A through D. No items of a trust shall be included in computing the taxable income and credits of the grantor or of any other person solely on the grounds of his dominion and control over the trust under § 61 (relating to definition of gross income) or any other provision of this title, except as specified in subpart E.

Section 1.671-4(a) of the Income Tax Regulations provides that except as otherwise provided in § 1.671-4(b), items of income, deduction, and credit attributable to any portion of a trust which, under the provisions of subpart E (§ 671 and following), part I, subchapter J, chapter 1 of the Internal Revenue Code, is treated as owned by the grantor or another person are not reported by the trust on Form 1041, but are shown on a separate statement to be attached to that form.

Therefore, because a grantor trust is not a taxable entity, a grantor trust only files a blank return with a statement that shows the items of income, deduction, and credit of the trust for the taxable year that are attributable to the grantor.

The Second Circuit Court of Appeals held in Rothstein v. U.S., 735 F.2d 704 (2d Cir. 1984), that although the grantor must include items of income, deduction, and credit attributable to the trust in computing the grantor's taxable income and credits, the trust must continue to be viewed as a separate taxpayer for purposes of sales transactions. In response to the Rothstein opinion, the Service issued Rev. Rul. 85-13, 1985-1 C.B. 184, that stated that the Service would not follow Rothstein insofar as it holds that a trust owned by a grantor must be regarded as a separate taxpayer capable of engaging in sales transactions with the grantor.

The grantor trust cases involving this issue have been litigated at the Tax Court level. In Lardas v. Commissioner, 99 T.C. 490 (1992), the Tax Court held that the return for determining when the statue of limitations is triggered is the return of the grantor not the grantor trust. The same conclusion was reached in Olson v. Commissioner, T.C. Memo. 1992-711, and in Bartol v. Commissioner, T.C. Memo. 1992-141.

The case law suggests strongly that the "return" of a passthrough entity, such as a grantor trust or a partnership, does not start the statute of limitations because the statute of limitations should apply to the person who pays the tax. In Siben v. Commissioner, 930 F.2d 1034 (2d Cir.), the Second Circuit found in a partnership case that "it appears to us that the 'return' that starts the running of the limitations period at issue is that of the taxpayer (emphasis added) whose liability is being assessed and not that of an ... entity whose return might also report the transaction that gives rise to the liability." The Ninth Circuit in another partnership case, Charlton v. Commissioner, 990 F.2d 1161 (1993), agreed with Siben stating that because the partnership itself is not liable for tax, the partnership return is only an informational return. It stated that "[t]he return, then, which triggers the 3 year period must refer to the return that actually reports the tax obligation – that of the liable partner." The Supreme Court addressed this general issue in Bufferd v. Commissioner, 113 S. Ct. 927 (1993), aff'g 952 F.2d 675 (2d Cir. 1992). This case involved an S corporation. S corporations may in some cases pay tax, but, generally, are passthrough entities. In Bufferd, the Supreme Court held that the statute of limitations is started by the return of the S corporation shareholder not the return of the S corporation itself. (In doing so, it overturned Kelley v. Commissioner, 877 F.2d 756 (9th Cir. 1989), which held that, in certain circumstances, the return of the S corporation triggered the statute of limitations, not the return of the respective shareholder.)

The Eighth Circuit Court of Appeal has held in Fendell v. Commissioner, 906 F.2d 362 (8th Cir. 1990) rev'g and remanding 92 T.C. 708 (1989), that the beneficiaries' statute of limitations does not begin running with the filing of the complex trust return because the beneficiaries and the complex trust are separate taxpayers. Complex trusts are separate taxable entities under § 641. However, the Fendell opinion insofar as it relies on Kelley, was impacted by the Bufferd opinion which overturned Kelley.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

The Fendell opinion has never been specifically rejected. A judge could potentially read the case to hold that all trusts, whether complex or grantor trusts, are separate taxable entities for purposes of § 6501. However, that does not appear likely.

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.

Please call if you have any further questions.

Paul F. Kugler
Associate Chief Counsel
(Passthroughs & Special Industries)
By: J. THOMAS HINES
Branch Chief
CC:PSI:2