Omitted Subpart F and GILTI Income May Be a Statute of Limitations Trap for the Unwary

By Andrew R. Roberson and Kevin Spencer

Taxpayers large and small desire closure with respect to tax reporting positions. This can occur in several ways, one of which is the closing of the limitations period for assessing additional tax. In a prior article, we discussed limitations periods in the tax generally, with an emphasis on provisions aimed at international tax reporting.[1] In this article, we discuss recent Internal Revenue Service (IRS) guidance relating to the limitations period for omitted Subpart F income.

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Background

Code Sec. 6501(a) provides the general rule that the IRS has three years after a tax return is filed to assess additional tax. There are, however, several exceptions to this rule. One exception is contained in Code Sec. 6501(e)(1)(C), which provides that the limitations period is extended to six years if the taxpayer fails to include in gross income its Subpart F income or Code Sec. 956 investments in U.S. property. This six-year statute also applies to omissions from global intangible low-tax income (GILTI).[2]

One issue is whether a single dollar of Subpart F or GILTI omitted from a return extends the standard three-year limitations period to six years for all items on the tax return (not just the omitted items). A related question is whether the time period for filing refund claims is extended to six years if the assessment period is extended after the expiration of the normal three-year period.

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Recent IRS Guidance

In recent IRS internal guidance, the IRS concluded that the omission of a single dollar of Subpart F income extends the limitations period on assessment to a six-year period, but that a refund claim filed after the expiration of the general three-year assessment period but before the expiration of the six-year period is untimely.[3]

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The Chief Counsel Advice (CCA) was issued in response to a request for advice from IRS field counsel to the IRS's Procedure & Administration group based on issues arising during the examination of a corporate taxpayer. The factual basis for the CCA is as follows. The taxpayer timely filed Form 1120, *U.S. Corporation Income Tax Return*. It subsequently filed an amended return claiming a refund based on adjustments to previously claimed credits (apparently before the expiration of the limitations period for filing a refund claim under Code Sec. 6511), and that refund was paid. The taxpayer thereafter filed a second amended return after the normal three-year limitations periods for assessment but before the expiration of the six-year period in Code Sec. 6501(e)(1)(C). In the second amended return, the taxpayer reported an omission of Subpart F income and claimed additional credits and credit adjustments.[4]

At some point, the IRS commenced an examination of the taxpayer. The parties agreed that the omitted Subpart F income triggered the six-year limitations period in Code Sec. 6501(e)(1)(C). Before the expiration of the six-year period, the taxpayer and the IRS executed Form 872*, Consent to Extend the Time to Assess Tax*, extending the limitations period for assessing tax.[5] As part of the examination, the IRS proposed to adjust other items unrelated to the omitted Subpart F income.

IRS field counsel sought advice from the IRS National Office on two issues: (1) whether the six-year limitations period in Code Sec. 6501(e)(1)(C) applies to the entire return or just the items related to omitted Subpart F income; and (2) whether an agreement under Code Sec. 6501(c)(4) to extend the assessment limitations period also extends the refund limitations period for filing a refund claim when the agreement was entered into before the extended six-year period had expired but after the normal three-year period for claiming a refund under Code Sec. 6511(a).

With respect to the first question, the CCA interpreted the prefatory language in Code Sec. 6501(c)(1) that "the tax may be assessed … at any time" to mean that the extended period applied to all items on the return and not just the omitted Subpart F items. It cited the decision in *Rhone-Poulenc*[6] as support. It also referenced *Colestock*,[7] where the Tax Court held that an extended limitations period for substantial omissions from gross income applied to the entire return and not just the item giving rise to the substantial omission. Both of these cases involved exceptions to the general three-year limitations period in situations where the statutory language referred to "the tax." The CCA contrasted these exceptions with the exception in Code Sec. 6501(h), which involves the extension of the assessment period for a "deficiency" related to a specific item. Accordingly, the CCA concluded that "the six-year limitations period under section 6501(e)(1)(C) applies to the entire tax liability for a particular tax year and is not limited to the specific Subpart F items constituting the omission from gross income."

With respect to the second issue, the CCA interpreted Code Sec. 6501(c)(4)'s extension by agreement exception as extending the date for claiming a refund under Code Sec. 6511 only where the agreement is executed before the general rule that a refund claim must be made within the later of three years from the date the return was filed or two years from the time the tax was paid. Although the CCA acknowledged that Congress generally intended the assessment and refund limitations period to run concurrently, Code Sec. 6511 did not contain an extended refund claim period when the six-year assessment period under Code Sec. 6501(e)(1) is extended by agreement under Code Sec. 6501(c)(4). In so concluding, the CCA treated the extension agreement as valid only with respect to the assessment of tax (*i.e.*, because such agreement was executed before the extended period for Subpart F omissions) but not valid for purposes of timely claiming a refund (*i.e.*, because such agreement was executed after the general period for claiming a refund).

The CCA relied heavily on language used by the Ninth Circuit in *Chism Est.* to support its position.[8] In that case, a Form 872 was executed more than three years after the return due date but before the expiration of the assessment period for a substantial omission from gross income. After the expiration of the three-year period but before expiration of the period agreed to in the Form 872, the IRS issued a notice of deficiency relating to omitted income and, in response to the taxpayer's argument that the assessment limitations period had expired, asserted that the extended limitations period applied due to a substantial omission from gross income. The taxpayer disputed the IRS's determinations, and alternatively argued that it was entitled to a refund for all taxes paid.

The Ninth Circuit reviewed the limitations periods for assessments and refunds. It held that there was an omission from gross income that triggered the extended limitations period for assessment (which was subsequently extended by agreement of the parties). Parsing substantially the same refund limitations period language in existence at the time, the court found that the extension executed after the normal three-year period for filing a claim for refund did not extend such period even though the assessment limitations period remained open by virtue of the substantial omission from gross income exception.

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Accordingly, it concluded based on the plain language of the relevant statutes that "in situations in which the [extended limitations period for assessment in situations involving substantial omissions from gross income] is applicable, agreements to extend the assessment period can be made at any time before [the extended limitations period statute] has run. But refunds are authorized only if the claim has been filed within the three years after the return was filed, or within a period as extended by an agreement made within that three-year period."[9]

Observations

Although the CCA addressed only an omission of Subpart F income, its reasoning would seem to apply equally to Code Sec. 956 investments and GILTI omissions. And, while not binding precedent,[10] the CCA does reflect the views of the IRS Office of Chief Counsel and CCA's setting forth legal positions are typically be followed by IRS personnel.

An important point to note is the interplay of the burden of proof rules. Normally, the IRS's determinations in a notice of deficiency are presumed correct and the taxpayer has the burden of demonstrating that the determinations are incorrect. However, when the notice of deficiency is issued after expiration of the general three-year period and the taxpayer affirmatively alleges that such notice is untimely, the IRS has the burden of proving that there was an omission that would trigger an extended limitations period.[11]

In *Fazi*, the taxpayers pled in their Tax Court petition that the notice of deficiency was untimely (which meant that no assessment could be made in the future) because the notice was issued more than three years after the tax return was filed. The IRS alleged that a six-year limitations period applied in its answer to the petition. However, the court held that the IRS failed to meet its burden of producing evidence showing that the bar of the three-year limitations period was not applicable because, even though the parties agreed there was an omission, the IRS did not show by a preponderance of the evidence that the omission was properly includable in the taxpayers' gross income.

Thus, if the IRS issues a notice of deficiency to a taxpayer more than three years after the commencement of the statute of limitations on assessment, then once the taxpayer asserts that the notice of deficiency is untimely the IRS would have to prove as a substantive matter that there was an omission of Subpart F income, Code Sec. 956 investments in U.S. property, or GILTI that was properly includible therein for the six-year limitations period discussed above to apply. If the IRS cannot meet its burden, the notice of deficiency would be held invalid, the Tax Court would lack jurisdiction over the case, and the IRS would be barred from assessing any additional tax.

The IRS has procedures in place that require it to obtain an extension of the general three-year limitations period months before the period expires. Thus, the IRS in most situations likely will not rely on the conclusion in the CCA except in rare situations where a consent to extend the limitations period cannot be obtained before the expiration of the general three-year period or a potential omission for a year is discovered in a subsequent audit before the six-year period has expired.

Taxpayers sometimes file amended returns or make disclosures at the beginning of an examination that might include an additional amount of Subpart F or GILTI income. Importantly, the disclosure could be considered an admission or concession that the extended six-year limitations periods apply. Thus, taxpayers that find themselves in this situation may need to assume that the six-year limitations period applies even in the absence of an agreement to extend the normal three-year limitations period, or choose not to disclose the omission.[12]

As noted above, taxpayers want finality with respect to their tax reporting positions. The expiration of the limitations period can play an important role in situations where a taxpayer has reported a position on Schedule UTP, Uncertain Tax Position Statement. Taxpayers may need to consider how the above limitations periods rules apply to situations where they have reported a Subpart F or GILTI position on Schedule UTP.

Parting Thoughts

The IRS's conclusion in the CCA solidifies its position on the two above points, and it reminds taxpayers to carefully monitor their statutes of limitations on both the assessment of tax and for seeking any claim for refund or credit. A refund claim should be submitted before the expiration of the general three-year statute of limitations on assessment unless an agreement to extend the statute of limitations for making a refund or credit has been extended before that period expires. The silver lining in the CCA may be that the IRS, consistent with case law and the plain language of the Code, has acknowledged that an agreement to extend that statute of limitations on assessment that is executed after that period has expired cannot revive the closed statute.

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ENDNOTES

[1] Andrew R. Roberson and Elizabeth Chao, *Seeking Closure on Tax Positions: A Look at Tax Statutes of Limitation*, INT'L TAX J, Jan.-Feb. 2018.

[2] Code Sec. 951A(f)(1)(A).

[3] CCA 202142009 (Oct. 22, 2021) (available online at *www.irs.gov/pub/irs-wd/202142009.pdf*).

[4] The facts in the CCA indicate that a similar practice was followed for two other tax years. For convenience, this article discusses the context of the CCA with reference to a single tax year.

[5] Under Code Sec. 6501(c)(4)(A), the IRS and a taxpayer can agree to consent to the extension of the period of time to assess tax under the Code (except for estate tax) at any time prior to the expiration of the period agreed upon.

[6] *Rhone-Poulenc Surfactants and Specialties, L.P.*, 114 TC 533, Dec. 53,929 (2000).

[7] *Colestock*, 102 TC 380, Dec. 49,703 (1994).

[8] *Chism Est.*, CA-9, 63-2 USTC ¶9640, 322 F2d 956.

[9] *Id.*, at 963 (citations omitted).

[10] Under Code Sec. 6110(k)(3), CCAs may not be used or cited as precedent unless otherwise provided by the IRS in regulations.

[11] *Fazi*, 105 TC 436, 447, Dec. 51,060 (1995); *see also CNT Investors, LLC*, 114 TC 161, 188 (2015) ("The statute of limitations is an affirmative defense to be pleaded and ultimately proven by petitioner; but because response asserts that the six-year statute of limitations in section 6501(e)(1)(A) applies, respondent bears the burden of going forward with the evidence regarding the alleged omission of income.").

[12] As a general matter, amended returns are a creature of administrative origin and grace and a taxpayer that discovers an error after the filing of an original Federal tax return is not legally obligated to file an amended return correcting that error. *Badaracco*, SCt, 84-1 USTC ¶9150, 464 US 386, 393, 104 SCt 756; *see also Adams Challenge (UK) Limited*, 156 TC 9, 20 n. 10 (2021); *Broadhead*, 70 TCM 120, Dec. 50,766(M), TC Memo. 1995-328. However, because an amended return is filed under penalties or perjury, if a taxpayer does decide to file an amended return, it must correct any errors on the return for which it is aware.

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