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IRS Insights
A closer look.
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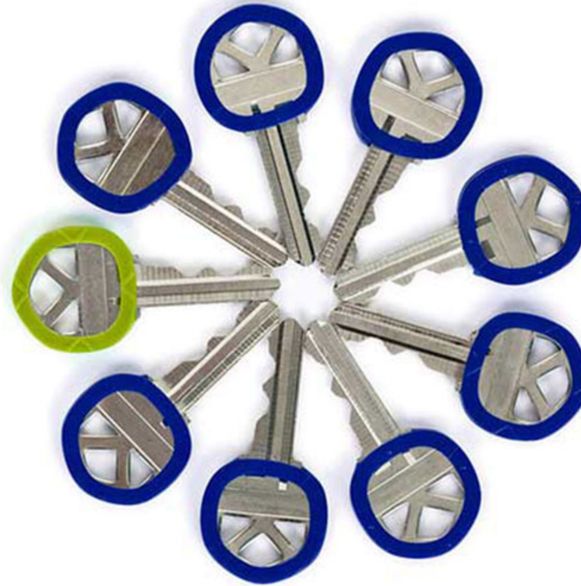

In this issue:

IRS issues Rev. Proc. 2020-23 to allow BBA partnerships to utilize relief provisions provided in the CARES Act........... 1

Treasury and the IRS are reconsidering whether Section 6511(d)(3)(A) applies to refund claims resulting from an FTC carryback caused by an NOL carryback 2

Supreme Court rejects federal common law test for deciding how distribute Tax Refund 3

The Tax Court addresses the application of the substantial omission of gross income exception to the ordinary three-year period of limitations on assessment 5

IRS issues Rev. Proc. 2020-23 to allow BBA partnerships to utilize relief provisions provided in the CARES Act

On April 8, 2020, as part of the effort to provide relief to taxpayers in the midst of the COVID-19 pandemic, the IRS issued Revenue Procedure 2020-23 that allows eligible BBA partnerships, for tax years beginning in 2018 and 2019, to file an amended partnership return and to issue mended Schedules K-1 to partners as an alternative to filing an Administrative Adjustment Request.

On April 8, 2020, as part of the effort to provide relief to taxpayers in the midst of the COVID-19 pandemic, the IRS issued Revenue Procedure 2020-23 that allows eligible BBA partnership, for tax years beginning in 2018 and 2019, to file an amended partnership return and to issue amended Schedules K-1 to partners as an alternative to filing an Administrative Adjustment Request ("AAR").

The Bipartisan Budget Act of 2015 ("BBA") created a new federal partnership audit regime that applies generally to certain partnerships for taxable years beginning on or after January 1, 2018. Under the BBA, partnership audits take

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place at the partnership level.[1] Under the BBA rules, a partnership is generally prohibited from issuing amended Schedules K-1 to its partners after the due date of the partnership tax return.[2] Partners in a BBA partnership must generally file their tax returns reporting any "partnership-related item" in a manner that is consistent with the treatment of such item on the partnership return and the information as reported on their Schedule K-1.[3] Under the BBA rules, a partnership can file an AAR, and a partner may file an AAR if the adjustment in the AAR would not result in an imputed underpayment.[4] However, as a general matter, partners would be limited to claim the benefit of the AAR in the year in which the partnership makes the request. For many partnerships, this could mean that those benefits could not be claimed until 2021. Moreover, any benefit would be capped by the partner's tax liability.

The IRS determined that, without providing relief, BBA partnerships that already filed their Forms 1065 for 2018 or 2019 generally would be unable to take advantage of the relief provided in the CARES Act.[5] To this end, the IRS issued Rev. Proc. 2020-23, which allows eligible BBA partnerships to file an amended Form 1065 and issue amended Schedules K-1 for tax years beginning in 2018 and 2019. A partnership is considered eligible if it is subject to BBA rules, and filed Form 1065 and furnished all required Schedules K-1 for a tax year beginning in 2018 and 2019 prior to the issuance of Rev. Proc. 2020-23.

Section 3.02 of Rev. Proc. 2020-23 authorizes eligible BBA partnerships to amend Forms 1065 and Schedules K-1 for a tax year beginning in 2018 or 2019 to take into account tax changes brought about by the CARES Act as well as any other tax attributes to which the partnership is entitled by law. "Tax attribute" is defined in the regulations as anything that can affect the amount or timing of a partnership-related-item or that can affect the amount of tax due in any taxable year.[6] Thus, it appears that the relief provided by Rev. Proc. 2020-23 is broadly applicable and not limited solely to the changes related to the CARES Act.

To amend a return, a BBA partnership must follow the procedures in Rev. Proc. 2020-23, which include filing a Form 1065 and furnishing the associated Schedules K-1 to its partners. The amended return must indicate at the top of the return "FILED PURSUANT TO REV PROC 2020-23". Each Schedule K-1 sent to the partners must also have a statement attached to it including this same notation. Rev. Proc. 2020-23 provides that a partnership may file an amended return pursuant to the Revenue Procedure by either mail or electronically, however it notes that filing electronically may allow for faster processing of the amended return. A BBA partnership under examination by the IRS may file an amended return so long as it sends a notice in writing to the revenue agent coordinating its examination that explains that it seeks to file an amended return. Such notice must be provided to the revenue agent contemporaneous or prior to the filing of the amended return. In addition, a copy of the amended return must also be sent to the revenue agent.

Treasury and the IRS are reconsidering whether Section 6511(d)(3)(A) applies to refund claims resulting from an FTC carryback caused by an NOL carryback

On April 17, 2020, the IRS issued Revenue Ruling 2020-8. Revenue Ruling 2020-8 suspends a prior revenue ruling pending reconsideration of whether the ten-year limitations period under section 6511(d)(3)(A) should apply to claims for refund or credit of an overpayment resulting from a foreign tax credit ("FTC") carryback arising as a result of a net operating loss ("NOL") carryback from a subsequent year. In particular, the IRS is considering whether the three-year limitations period under section 6511(d)(2)(A) applies instead of the ten-year limitations period under section 6511(d)(3)(A) in that specific context.

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[1] *See generally* IRC sections 6221 through 6241
[2] IRC section 6031(b)
[3] IRC section 6222
[4] IRC section 6227
[5] The Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"), P.L. 116-136
[6] Treas. Reg. 301.6241-1(a)(10)

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Background

Section 6511(a) provides that a claim for credit or refund of tax paid must be filed within three years from the time the return was filed or within two years from the time the tax was paid. If a claim for refund or credit is not filed during this period, no credit or refund is allowed.

Section 6511(d)(2)(A) and section 6511(d)(3)(A) provide exceptions to the ordinary three-year limitations period under section 6511(a). Section 6511(d)(2)(A) provides that when "the claim for credit or refund relates to an overpayment attributable to a net operating loss carryback or a capital loss carryback," the limitations period is three years from the due date of the return for the year of the net operating loss or net capital loss that results in such carryback. Section 6511(d)(3)(A) provides that when "the claim for credit or refund relates to an overpayment attributable to any taxes paid or accrued to any foreign country," the limitations period is ten years from the due date of the return for the year in which the foreign taxes were paid or accrued.

Rev. Rul. 71-533

In Revenue Ruling 71-533, the taxpayer incurred an NOL in 1969 that it carried back to 1966, eliminating the taxpayer's taxable income for 1966. On its original 1966 return, the taxpayer had claimed an FTC for the foreign taxes it had paid that year. When the NOL carryback eliminated the taxpayer's taxable income for 1966, the entire amount of taxes it paid to foreign countries for that year exceeded the amount allowable as an FTC for 1966. Consequently, the taxpayer carried the excess FTC back from 1966 to 1964, which generated an overpayment in that year for which the taxpayer filed a claim for refund. The ruling held that the refund claim was subject to the ten-year limitations period provided by section 6511(d)(3)(A) without considering the applicability of the three-year limitations period provided by section 6511(d)(2)(A).

Rev. Rul. 2020-8

In Revenue Ruling 2020-8, Treasury and the IRS announced that they are reconsidering whether the ten-year limitations period provided by section 6511(d)(3)(A) applies to the refund claim at issue in Revenue Ruling 71-533. Specifically, under the facts of Revenue Ruling 71-533, there would not have been any excess FTC available to be carried back from 1966 to generate an overpayment in 1964 if the taxpayer had not carried the NOL back to 1966. The 1964 overpayment resulted from the interaction of the NOL carryback from 1969 and FTC carryback from 1966, but Revenue Ruling 71-533 does not consider whether the three-year limitations period provided by section 6511(d)(2)(A) should apply to the refund instead. Under the facts of Revenue Ruling 71-533, if the taxpayer had filed its 1964 claim for refund in 1972 and the IRS concludes that section 6511(d)(2)(A) applied, this would still produce a taxpayer favorable result because the claim for refund was filed within three years from the due date of the return for the year in which the NOL arose.

Because Treasury and the IRS are reconsidering the holding of Revenue Ruling 71-533, Revenue Ruling 2020-8 suspends Revenue Ruling 71-533. In addition, because Revenue Ruling 71-533 relies on Revenue Ruling 68-150, Revenue Ruling 2020-8 also suspends Revenue Ruling 68-150 in part. Finally, Revenue Ruling 2020-8 provides that the suspension of Revenue Ruling 71-533, and partial suspension of Revenue Ruling 68-150, will not be applied adversely to a taxpayer during the pendency of Treasury and the IRS's reconsideration of these revenue rulings.

Supreme Court rejects federal common law test for deciding how distribute Tax Refund

In *Rodriquez v. Federal Deposit Insurance Corporation*,[7] the Supreme Court addressed the validity of the federal common law rule known as the *Bob Richards*[8] rule that, absent a tax allocation agreement between members of a consolidated group of corporations, governs how a tax refund is distributed among members of the consolidated

[7] *Rodriquez v. Federal Deposit Insurance Corporation*, 589 US _ (2020)
[8] *In re Bob Richards Chrysler-Plymouth Corp.*, 473 F. 2d 262 (9th Cir. 1973)

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group. The Supreme Court unanimously held that the *Bob Richards* rule is not a legitimate exercise of federal common lawmaking.

The case arose out of a dispute over a four-million-dollar tax refund between the trustee of a bankrupt bank parent corporation and the FDIC, who was appointed the receiver of the parent bank's subsidiary after it too filed for bankruptcy. The corporations were part of a corporate consolidated group that filed a consolidated return. Justice Gorsuch, writing for a unanimous Court, observed that while the regulations under section §1502 are very precise in prescribing the reporting requirements for an affiliated group of corporations; the regulations are less clear about how refunds are distributed among corporate group members.[9] To that end, many affiliated corporations draft tax allocation agreements that specify what share of the refund each member is entitled to receive. The question before the Court in *Rodriquez v. FDIC* was, in the absence of such an agreement, whether federal courts should rely on state law or apply a federal common law rule to decide a dispute.

For almost fifty years, the federal courts have crafted a federal common law rule, the eponymous *Bob Richards* rule, named after the Ninth Circuit Court of Appeals case, *In re Bob Richards Chrysler-Plymouth Corp*.[10] Originally, the *Bob Richards* rule provided that the refund belongs to the group member who generated the losses that led to it. Over time, the application of the *Bob Richards* rule shifted from a stopgap measure to the default rule that some federal courts applied, unless a tax allocation agreement between the members of the consolidated group specified otherwise. Some circuit courts, however, rejected the *Bob Richards* rule as an inappropriate exercise of the federal common lawmaking making the issue ripe for resolution by the Supreme Court.[11] In the current case, the Tenth Circuit Court of Appeals decided to apply the *Bob Richards* rule and held that the FDIC owned the refund. The trustee for the parent bank objected to the Tenth Circuit's adoption of the *Bob Richards* analytical framework.

In his unanimous opinion, Justice Gorsuch explained that the principle of separation of powers relegates federal common lawmaking to a minor role as Article I of the Constitution grants Congress the legislative power. The opinion notes that the view that federal common lawmaking was inconsistent with the separation of powers was vindicated in *Erie Railroad Co. v. Tompkins*,[12] which upended the practice of federal common lawmaking inaugurated by the Court's holding in *Swift v. Tyson*.[13] After *Erie*, federal common lawmaking has been confined to limited areas such as admiralty and certain disputes between the states.[14] The Court identified one of the most essential factors for determining if federal common lawmaking is appropriate is whether such lawmaking is necessary to protect uniquely federal interests.[15]

As to the question of what unique interest the federal government has in the distribution of a tax refund, the Court held that there is none. The Court concludes that corporations, as creatures of state law, are best governed by state rules of decision. If there are special exceptions to this general principle, the Court held that the distribution of a tax refund is not one of them. Justice Gorsuch concludes the opinion for the Court by condemning the *Bob Richards* rule as a violation of the narrow parameters of federal common lawmaking and remanding the case to be decided under the applicable state law.

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[9] 26 *USC*. §1502
[10] *In re Bob Richards Chrysler-Plymouth Corp., supra*
[11] *See, e.g., FDIC v. AmFin Financial Corp.*, 757 F. 3d 530, 535 (6th Cir. 2014)
[12] *See* Erie Railroad Co. v. Tompkins, 304 US 64 (1938)
[13] *See Swift v. Tyson*, 41 US (16 Pet.) 1 (1842)
[14] *See Sosa v. Alvarez-Machain*, 542 U. S. 692, 729 (2004)
[15] *See Texas Industries, Inc. v. Radcliff Materials, Inc.*, 451 U. S. 630, 640 (1981)

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The Tax Court addresses the application of the substantial omission of gross income exception to the ordinary three-year period of limitations on assessment

In *ACQIS Technology, Inc. and Consolidated Subsidiaries v. Commissioner*,[16] the Tax Court addressed whether the substantial omission of gross income exception to the ordinary three-year period of limitations on assessment applied where the taxpayer reported patent liability settlement payments as if they were the proceeds of sales of stock. The court held that, if the government's view of the transactions were to be sustained, the disclosures were inadequate. However, the court concluded that it could not determine that the substantial omission of gross income exception applied because the court first needed to decide whether the transactions were properly reported on the relevant returns.

Background

In 2009, ACQIS Technology, Inc. ("Taxpayer") filed patent infringement lawsuits against eleven companies.[17] Eight of the defendants entered into settlement agreements that provided for a release of claims and a license of the patents at issue. Taxpayer reported the settlement amounts that it received with respect to these defendants as ordinary income.[18]

Taxpayer also entered into settlement agreements with the other three defendants, but these settlements were structured and reported differently. In those cases, the defendants agreed to purchase stock in Taxpayer as part of the settlement agreement.[19] Taxpayer received the settlement payment amounts in these cases in 2010, 2011, and 2012. However, Taxpayer did not report the settlement payment amounts as income in 2010, 2011, and 2012.[20] Instead, Taxpayer reported as "other costs" on Schedule A, *Cost of Goods Sold*, of $12.1 million, $10.4 million, and $12.7 million on its 2010, 2011, and 2012 returns, respectively.[21] Taxpayer also reported an increase in common stock on Schedule L, *Balance Sheet Per Books*, of $30 million, $8 million, and $33.8 million on its 2010, 2011, and 2012 returns, respectively.[22]

The IRS subsequently determined that the settlement payment amounts should be treated as payments made to settle the patent litigation or, alternatively, that the purported stock purchases lacked economic substance and issued notices of deficiency for the three years.[23] The IRS issued the notices of deficiency more than three years, but less than six years, after the filing of Taxpayer's 2010, 2011, and 2012 returns.[24]

The substantial omission of gross income omission exception to the three-year period of limitations on assessment

Subject to various exceptions, the IRS is required to assess the tax due, or issue a notice of deficiency to the taxpayer, within three years of the date that a return is deemed filed.[25] Section 6501(e)(1)(A) provides an exception to the general rule if the gross income omitted from the return exceeds 25% of the amount of gross income reported on the return (a "substantial omission of gross income"). If there is a substantial omission of gross income on the return, the IRS may issue a notice of deficiency within six years of the date that a return is deemed filed (the "substantial omission of gross income exception").[26] However, the substantial omission of gross income exception does

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[16] T.C. Memo. 2020-38.
[17] *See id.*, Slip Op. at *3.
[18] *See id.*
[19] *See id.*, Slip Op. at *4 – *5.
[20] *See id.*, Slip Op. at *5 – *9.
[21] *See id.*
[22] *See id.*
[23] *See id.*, Slip Op. at *9, *17 n.9.
[24] *See id.*
[25] *See* IRC § 6501(a).
[26] *See* IRC § 6501(e)(1)(A).

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not apply to the extent that the taxpayer discloses the omitted gross income "in the return, or in a statement attached to the return, in a manner adequate to appraise the Secretary of the nature and amount of such item."[27]

Under the Tax Court's precedents, a disclosure is adequate if the disclosure is sufficiently detailed to alert the IRS of the nature of the transaction so that the IRS's decision as to whether to select the return for examination is a reasonably informed decision.[28] Conversely, disclosure is inadequate if the IRS needs to thoroughly scrutinize the return to ascertain whether gross income was omitted.[29]

In this case, the parties agreed that that the notices of deficiency were issued more than three years, but less than six years, after the filing of the respective returns. Thus, the issue before the court was whether the Taxpayer adequately disclosed the nature and amount of the omitted income on its tax return for purposes of avoiding the substantial omission of gross income exception to the three-year period of limitations on assessment.

Taxpayer's motion for summary judgment

Taxpayer, in its motion for summary judgment, argued that it adequately disclosed the amount and nature of the settlement payment amounts. Taxpayer further argued that its disclosure was similar to the disclosure of the taxpayer in *University Country Club, Inc v, Commissioner*,[30] where a taxpayer sold country club memberships and reported the membership payment amounts as stock purchases. In that case, the Tax Court held that the taxpayer's disclosure was adequate and, therefore, the six-year period of limitations did not apply.[31]

The Tax Court, however, disagreed with Taxpayer's characterization of the sufficiency of its disclosure and, therefore, denied Taxpayer's motion for summary judgment. The court noted that, if either of the IRS's theories is correct – *i.e.*, that the settlement payment amounts were payments made to settle the patent litigation or that the stock purchases lacked economic substance – Taxpayer's disclosure would not have alerted the IRS as to the nature and amount of the omitted gross income.[32] The court distinguished the disclosure in this case from the disclosure in *University Country Club* because taxpayer in that case attached a statement to its return that included an itemized schedule that reconciled the capital surplus account and disclosed crucial, itemized information about the memberships sold. This detailed information alerted the IRS that the payments may be licenses. By contrast, here, Taxpayer did not attach an itemized statement that disclosed the nature and amount of the settlement payment amounts.[33]

The IRS's motion for summary judgment

The IRS, in its motion for partial summary judgment, argued that the disclosure was plainly inadequate because the disclosure failed to alert the IRS of the true nature and amount of the settlement payments.[34] The court, however, rejected this argument because the adequacy of the disclosure depends on whether the court agreed with the Taxpayer or the IRS regarding the true nature of the transactions. As the underlying characterization of the transactions was not currently before the court, the court concluded that it would be premature for it to issue summary judgment to the IRS on whether the disclosure was adequate to exclude the settlement payment amounts from gross income for purposes of excluding those amounts from the substantial omission of gross income exception computation.[35]

Conclusion

This case highlights the need for taxpayers to consider whether their return positions are adequately disclosed for purposes of avoiding the substantial omission of gross income exception to the three-year period of limitations on

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[27] IRC § 6501(e)(1)(B)(iii).
[28] *See ACQIS Tech.*, T.C. Memo. 2020-38, Slip Op. at *13 (citing *Estate of Fry v. Comm'r*, 88 T.C. 1020, 1023 (1987)).
[29] *See id.*, Slip Op. at *13 (citing *CNT Inv'rs v. Comm'r*, 144 T.C. 161, 214 (2015)).
[30] 64 T.C. 460 (1975).
[31] *See ACQIS Tech.*, T.C. Memo. 2020-38, Slip Op. at *18 (citing *Univ. Country Club*, 64 T.C. at 469, 471)).
[32] *See id.*, Slip Op. at *17 n.9.
[33] *See id.*, Slip Op. at *19.
[34] *See id.*, Slip Op. at *17.
[35] *See id.*

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assessment. Inadequately describing the nature of a transaction can result in a court finding that the disclosure was inadequate and that, therefore, the substantial omission of gross income exception applies.

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