



October 18, 2018

S Corporation Inconsistent Reporting Issues: *'Rubin v. United States'*

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In general, the owner of an equity interest in a pass-through entity, such as a partnership or an S corporation, must treat items of income, gain, loss, deduction, and credit attributable to the entity on the owner's tax return in a manner that is consistent with the treatment of those items on the entity's return (IRC §§ 6222(a), 6037(a)). If the owner takes an inconsistent position, the IRS may make an adjustment to the owner's tax liability to conform to the treatment by the entity, and the IRS may assess tax attributable to that adjustment immediately, rather than through the issuance of a notice of deficiency (*see* IRC § 6213). The issuance of a notice of deficiency provides a taxpayer with rights to contest the proposed deficiency without payment of the tax that do not apply where, as in this case, no notice of deficiency is required.

If, however, the owner of the equity interest provides appropriate notification to the IRS that an inconsistent position is being taken by the owner, the rule permitting a conforming adjustment to tax to be made without the issuance of a notice of deficiency does not apply.

In the partnership context, final and proposed regulations (as well as cases cited in the decisions discussed below) address how the notice of inconsistent treatment is to be provided and the con-

sequences of such notice. Those regulations could benefit from further clarification, as has been noted in comments to the IRS on the new so-called "Centralized Partnership Audit Regime" (*see, e.g.,* Document ID IRS-2018-0020-0002, submitted by Elliot Pisem and posted on www.regulations.gov on August 28, 2018).

There are no regulations that address how a notice of inconsistent treatment is to be provided in the context of an S corporation. *See generally* Pisem and Binder, *Lack of Consistency in S Corporation Reporting—How Onerous Are the Results?*, 113 *Journal of Taxation* 354 (2010).

Form 8082, titled "Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR)," has been issued by the IRS for use (i) in respect of a partnership or S corporation, to provide notice of inconsistent treatment and (ii) in respect of a partnership only, to file an "administrative adjustment request." Use of that form appears to be mandatory under regulations applicable to partnerships (*see, e.g.,* Proposed Reg. § 301.6222-1(c)(1)). Whether that form is also required to be used to provide notice of inconsistent treatment in respect of an S corporation was one of the issues addressed by the trial court in *Rubin v. United States* (118 AFTR 2d 2016-6235 (D. Ct. Cal.), reversed on other grounds by the Ninth Circuit (122 AFTR 2d 2018-5979)), discussed below.

Facts in *Rubin*

Thomas Rubin ("Rubin") was the sole shareholder of Focus Media, Inc. ("Focus"), an S corporation that engaged in advertisement placement. Focus was ultimately forced into bankruptcy by its creditors in the year 2000, at a time when Focus had large but essentially uncollectible receivables. The trustee in bankruptcy filed the Focus tax return for 2000 in a manner that did not, in Rubin's view, properly report cancellation of indebtedness income of Focus, and that did not claim bad debt deductions of \$23 million that could have been claimed by reason of the uncollectible receivables.

Rubin's original personal tax return for the year 2000 was consistent with the Focus return filed by the trustee and the related Schedule K-1 sent to Rubin. In October 2004, Rubin filed an amended personal income tax return for 2000 and amended returns for two preceding years, in a package sent to the IRS under a single cover letter to facilitate joint review of the returns. Those amended returns were accompanied by a statement that stated his disagreement with the 2000 tax return filed by the trustee for Focus.

Included with the amended individual returns for 1998-2000 was a pro forma amended return for Focus that reflected additional cancellation of indebtedness income and bad debt expense (attributable to the receivables), and a pro forma Schedule K-1 showing the amounts that Rubin thought should have

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been allocated to him by Focus. The amended personal income tax returns claimed a refund for 2000, and refunds for 1998 and 1999 on the basis of a carryback of the losses to those years.

Apparently, no Form 8082 was filed with Rubin's original or amended tax returns for 1998-2000. That may have been consistent with the instructions to the form. Page 2 of the instructions to the form, as revised in 2000, provides, under the heading "How and When to File," that, when the form is filed as a notice of inconsistent treatment, it is to be attached to the partner or shareholder's tax return and filed "when you file your original return"—obviously not feasible when the inconsistent position is first set forth on an amended return.

The refund claims were rejected by the IRS, on the merits of the claims (not otherwise discussed in the *Rubin* opinions) and without any assertion that Rubin had either failed to adequately identify the inconsistencies between his returns and the returns of Focus or that the IRS was uncertain as to the nature of Rubin's claims.

Rubin also amended his return for 2001 and enclosed a Form 8082 with the 2001 amendment, without actually seeking any refund for that year. (Neither opinion in *Rubin* provides any indication as to why the 2001 amendment was filed; conceivably, it was protective in nature.)

Rubin filed a complaint in 2016 in a U.S. District Court to pursue the tax refunds. The government, after filing an answer, made a motion to dismiss the complaint without leave to amend, on the grounds that the amended returns were not consistent with the return of Focus and that Rubin had not filed a "statement identifying the inconsistency" as required by Section 6037(c)(2)(A). More specifically, the government argued that the failure to include a Form 8082 with the amended individual tax returns that claimed the refunds was fatal to Rubin's claims.

The district court concluded that it was not clear that the case law concerning consequences of a failure to file Form 8082 in a partnership context was applicable in respect of an S corporation

shareholder, and declined to decide whether the filing of a Form 8082 by an S corporation shareholder was necessary to meet the requirement under Section 6037(c)(2)(A) that inconsistencies with the corporate return be identified to the IRS. Instead, and without significant analysis in the opinion, the court concluded that the amended returns did not include any "concise document" that satisfied this identification requirement.

Upon appeal by Rubin, the Court of Appeals reversed the judgement of the district court on this issue and remanded the case for further proceedings.

Footnote 4 in the Court of Appeals decision states that the government did not argue, in its brief or in oral argument before the Court of Appeals, that Rubin's claims should be rejected because he failed to file the Form 8082; accordingly, the Court of Appeals did not consider that argument. Rather, the government argued on appeal that the statement included with the amended returns for 1998-2000 was deficient because it did not specifically identify how Rubin's amended tax return for 2000 was different from the return of Focus itself for 2000; and that it would be unduly burdensome for the government to have to review the 20+ page pro forma amended return for Focus (included with Rubin's amended returns) to identify the inconsistencies.

The Court of Appeals noted, however, that the government's arguments were undercut by the Form 8082 itself. That form requires the S corporation shareholder to list the treatment of items (i) as disclosed on the Schedule K-1 issued by the S corporation to the shareholder and (ii) as being reported by the shareholder. There was no guidance in the Form 8082 instructions or otherwise that supported the government's argument to the court that the shareholder was required to identify inconsistencies from the pages of the corporation's return (exclusive of the Schedules K-1 issued to shareholders).

Indeed, a non-management shareholder not involved with the preparation or execution of the corporate return would not normally have a copy of the corporate return, although conceivably a

copy of the corporate return could be obtained by the shareholder from the IRS, likely after some delay, by request pursuant to IRC Section 6103(e).

The Court of Appeals further concluded that Rubin had made adequate disclosure by including a pro forma Schedule K-1 in the amended returns and a statement describing the relevant inconsistencies. Accordingly, Rubin had complied with the requirement of Section 6037 relating to identification of inconsistencies.

Observations

Based on the circumstances described in the opinions of the district court and the Court of Appeals in *Rubin*, the effort by the government to avoid consideration of the substance of refund claims by the S corporation shareholder, on the basis of the alleged failure to adequately identify the inconsistency with the corporation's reporting treatment, seems to have lacked substantial support—especially in light of the absence of any regulation under Section 6037 supporting the government's reading of the disclosure requirement.

Administration of, and compliance with the requirements of Section 6037(c) might well be simplified through the issuance of appropriate regulations. Pending the issuance of such regulations, however, any S corporation shareholder considering positions inconsistent with the Schedule K-1 that he or she received is forewarned to make the disclosure of the inconsistency as clear as possible, and to give serious consideration to including a Form 8082 in the original or amended personal tax return setting forth the inconsistent position, even if that form is not clearly required.

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