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Office of Chief Counsel
Internal Revenue Service

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memorandum

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to: Associate District Counsel, Salt Lake City, CC:WR:RMD:SLA

from: Assistant Chief Counsel, CC:DOM:IT&A

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subject: Significant Service Center Advice

This responds to your request for Significant Advice dated, March 7, 1997, in connection with questions posed by the Ogden Service Center.

Disclosure Statement

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ISSUES

You asked for advice on two issues:

1) If a Service Center receives an amended return with little time remaining in the period of limitation for assessment, and the amended return contains items that would increase income, may the Service Center assess the resulting tax if the amended return contains other items that would offset the increased income?

2) Can Service Centers make assessments based on amended returns received after the assessment limitation period has run, but mailed on or before the expiration date?

In addition, we have considered the following issue, which is relevant to these situations:

3) If a Service Center receives an amended return containing items that would increase income, but offset by items that decrease income, is the assessment limitation period extended for up to 60 days under § 6501(c)(7)?

CONCLUSIONS

1) Service Centers cannot assess tax based on tax-increasing adjustments from an amended return, to the extent the amended return shows offsetting items. In appropriate cases, the Service Center should consider issuing a notice of deficiency.

2) Service Centers cannot make assessments based on amended returns received after the period of limitation has run, even if the amended return was mailed on or before the expiration date.

3) An amended return that does not report a net increase in tax does not trigger an extension of the assessment period.

ISSUE 1
Facts

Service Centers often receive amended returns with little time remaining in the period of limitation for assessment. This causes difficulties, as illustrated by the following example.

The Service audited the taxpayer's returns for 1991 and 1992. The Service disallowed a bad debt deduction in the amount of $3,000,000 claimed on the 1991 return concluding that the debt had not become worthless in that year. The Service issued a 30-day letter and the taxpayer filed a timely protest.

The Appeals Office settled the issue by allowing the taxpayer to deduct 50 percent of the bad debt in 1991. The Appeals Office concluded that the taxpayer could claim the remaining $1,500,000 bad debt deduction in a later year when the taxpayer could demonstrate that the debt had become totally worthless and otherwise met the criteria of § 166 of the Code.

After Appeals closed its case the taxpayer filed an amended return for 1993 with a Service Center. The amended return reported a reduction of a previously claimed net operating loss carryover from 1991 in the amount of $1,500,000, due to the settlement of the bad debt issue with Appeals. The amended return also claimed a deduction of $1,500,000 for the remaining bad debt. The reduction of the net operating loss carryover (a positive adjustment) was offset by the claim of the bad debt deduction (a negative adjustment) and produced no tax liability.

The taxpayer filed the amended return with the Service Center on April 19, 1997. The period of limitation for 1993 would have expired October 15, 1997. When processing the amended return, the Service Center determined that it could not allow the bad debt deduction because the Examination function needed to examine it.

Discussion

Generally, the Supreme Court has described assessment as follows:

> The "assessment," essentially a bookkeeping notation, is made when the Secretary or his delegate establishes an account against the taxpayer on the tax rolls. 26 U.S.C. § 6203. . . .

Laing v. United States, 423 U.S. 161, 170 n. 13 (1976). The authority of the Internal Revenue Service to make an assessment relies on several different statutes. The following list includes some of the items the Service can assess:

1. taxes shown on returns, § 6201(a)(1);

2. supplemental assessments, whenever it is ascertained that any assessment is imperfect or incomplete in any material respect, § 6204;

3. deficiencies in tax -- but only after compliance with deficiency procedures, § 6213(a);

4. taxes arising on account of a mathematical or clerical error appearing on a return, § 6213(b)(1);

5. amounts paid as a tax or in respect of a tax, § 6213(b)(4);

6. amounts as to which the taxpayer has waived the deficiency procedures, § 6213(d).

The Service Center has inquired whether it may make an assessment based on the information from the amended return. We believe that this is not allowed under any of these provisions.

Section 6201(a)(1): Tax Shown on Return

Section 6201(a)(1) provides that the Secretary shall assess all taxes determined by the taxpayer.

Section 301.6211-1(a) of the Regulations on Procedure and Administration provides, in part, that any amount shown as additional tax on an "amended return," so-called (other than amounts of additional tax which such return clearly indicates the taxpayer is protesting rather than admitting) filed after the due date of the return, shall be treated as an amount shown by the taxpayer "upon his return" for purposes of computing the amount of a deficiency.

The Service has the authority to assess, without following deficiency procedures, taxes determined by the taxpayer; it has interpreted this authority to permit a supplemental assessment of additional tax reported on an amended return, unless the taxpayer is protesting the additional amount. However, these provisions refer only to the "tax" reported by the taxpayer -- not to a different amount computed by the Service based solely on the positive adjustments in a taxpayer's return.

The authority to assess taxes shown on returns found in § 6201(a)(1) depends on the concept of agreement by the taxpayer to an amount shown in the return. In the case of Penn Mutual Indemnity Co. v. Comm'r, 32 T.C. 646, 668 (1959) (concurring opinion), aff'd, 60-1 USTC ¶ 9389 (3d Cir. 1960), the Tax Court discussed the legal basis for assessing tax shown on a return and said:

> Although the question of jurisdiction was decided correctly by an order of Judge Train, who heard this case, and is the subject of a footnote only in the majority opinion, nevertheless, since it is dealt with at great length in a dissent, it may be well to discuss this issue briefly. "The amount shown as the tax by the taxpayer upon his return" in section 271(a) must be read in the light of the rest of the Code in order to determine the intention of Congress and when so read it seems reasonably clear the Congress meant the tax shown to be due by the taxpayer upon his return. John Moir, 3 B.T.A. 21. It is generally recognized that Congress intended the return to be a method whereby the taxpayer would make a self-assessment of the amount of tax which he agrees or concedes is due and which he intends to pay without any action by the tax-collecting Commissioner. Here, the taxpayer does not agree or concede that any amount of tax is due but, on the contrary, states in a letter accompanying the return that no tax is lawfully due and it will not pay as tax the contested amount shown in the calculation on the return. ... The taxpayer was not self-assessing any tax and it was thus proper for the Commissioner to determine a deficiency in the contested amount so that

> he could eventually assess and collect the amount as a tax.

32 T.C. at 667-68.

While Penn Mutual dealt with a different fact pattern, the same result should apply here. The Service can assess taxes shown due on the return. However, just as the Service cannot "unbundle" a taxpayer's original return, and assess tax without regard to tax-reducing items, the Service cannot base an assessment on only the tax-increasing items in an amended return. [1] The taxpayer in filing the amended return does not agree to have the Service accept part and reject the rest.

Splitting an amended return into its components in this fashion would also be inconsistent with Service position in other areas. For example, in Consolidated Edison Co. of N.Y. v. United States, 941 F. Supp. 398 (S.D.N.Y. 1996), the court concluded that a credit had to involve an offset between different kinds of taxes or tax years. See 941 F. Supp. at 402-03. The court rejected the taxpayer's argument that -- for purposes of meeting the 2-year-from-payment refund limitation in § 6511 -- the taxpayer made a "payment," through a credit, when there were upward and downward adjustments in the same year:

> Nor did the denial of the ... tax credits create an outstanding income tax liability, which was "paid" when offset against an overpayment of income taxes for the same year. An assessment of tax liability or overpayment resulting from an audit "involves not the offsetting of an overassessment against an existing deficiency, but the offsetting of an upward adjustment against a downward adjustment to a single tax liability ... for a single tax year." Kingston Products Corp. v. United States, 368 F.2d 281, 287 ([Ct. Cl.] 1966).

Id. at 401. See also Republic Petroleum Corp. v. United States, 613 F.2d 518, 525 (5th Cir. 1980); Babcock & Wilcox Co. v. Pedrick, 212 F.2d 645, 648 (2d Cir. 1954), cert. denied, 348 U.S. 936 (1955). Similarly, in the present situation the upward and

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[1] As opposed to an original return, there is some authority to the effect that acceptance of an amended return is discretionary on the part of the Service. See Badaracco v. Comm'r, 464 U.S. 386 (1984). However, for the reasons discussed in the text, we do not believe the Service has discretion to accept part and reject part.

downward adjustments are only components of a single tax liability. [2]

Section 6211: Deficiency

Another way of stating that an increase in tax, based only on positive adjustments in such situations, is not assessable as "tax shown on a return," is that it does meet the definition of a "deficiency."

Section 6212 authorizes the Secretary to send a notice of deficiency to a taxpayer when the Secretary has determined that there is a deficiency in tax. Section 6211 defines a deficiency as the amount by which the tax imposed by subtitle A or B, or chapter 41, 42, 43, or 44, exceeds the excess of --

(1) the sum of
(A) the amount shown as the tax by the taxpayer upon his return, if a return was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus
(B) the amounts previously assessed (or collected without assessment) as a deficiency, over--
(2) the amount of rebates, as defined in subsection (b)(2), made.

As discussed above, Reg. § 301.6211-1(a) provides that in certain circumstances any amount shown as additional tax on an amended return may be treated as an amount shown by the taxpayer "upon his return" for purposes of computing the amount of a deficiency. However, as also discussed, this only applies to "additional tax," not just positive adjustments, and not to amounts that the taxpayer is protesting. Thus, any tax increase calculated solely on the basis of the positive adjustments in an amended return would be a "deficiency," subject to the deficiency procedures unless an exception to those procedures applies.

Section 6213(b): Math Error or Amount Paid

Neither of these exceptions to the deficiency procedures permits assessment here. The types of situations in which tax may be summarily assessed as a "mathematical or clerical error" are carefully set out in § 6213(g), and none of the definitions apply. Since the taxpayer is not declaring any net increase in

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[2] Even if, arguendo, a tax liability can be split into its components to produce an additional tax, the taxpayer could be considered to be protesting this amount rather than admitting it, within the meaning of § 301.6211-1(a).

tax, presumably none is paid, and the exception in § 6213(b)(2) is inapplicable.

Section 6213(d): Waiver

Section 6213(d) provides that a taxpayer at any time has the right, by a signed notice in writing filed with the Secretary, to waive the § 6213(a) restrictions on the assessment and collection of a deficiency.

We have considered the possibility that the Service could assert such a deficiency and then treat the amended return as a waiver of restrictions on assessment and collection of the asserted deficiency and immediately assess it, without issuing a deficiency notice. For the following reasons, we conclude that there is no authority for such a procedure. First, there is no language of waiver as to the positive adjustments on the amended return. Second, even if we were to regard the return as such a waiver, it would seem clearly conditional on the Service accepting the negative adjustments as well as the positive. Cf. Powerstein v. Comm'r, 99 T.C. 466 (1990) (where taxpayers filed several amended returns in attempt to generate a net refund, the Service could not reject some, and assess amounts from others). Third, a taxpayer cannot be deemed to waive restrictions on the assessment and collection of a deficiency of which the taxpayer has no notice. As in the case of assessment under § 6201, basic consent is lacking. Cf. Penn Mutual.

We conclude that the Service cannot assess positive adjustments on an amended return while ignoring negative adjustments. Thus, the only alternative open to the Service is to determine a deficiency and issue a deficiency notice, if time permits.

Issue 2

The Service Center also asked how to handle those amended tax returns mailed on or before the expiration of the period of limitation, but received after the period has expired. The Service Center currently does not make assessments based on amended returns received after the expiration date, even if the taxpayer mailed it before the expiration date.

Section 6501 provides that tax generally shall be assessed within three years after the return was filed. Section 6501(c)(7) provides an exception to this general limitation on assessments for certain amended returns. Where, within the 60-day period ending on the day on which the period of limitation on assessment would otherwise expire, the Secretary receives a written document signed by the taxpayer showing that the taxpayer

owes an additional amount of tax, the period for the assessment of such additional amount shall not expire before the day 60 days after the day on which the Secretary receives such document.

The plain language of § 6501(c)(7) requires that the Service receives the return within the last 60 days of the period of limitation. If the Service does not receive the return before the expiration, but shortly thereafter, this prerequisite for application of § 6501(c)(7) is not satisfied. Thus, § 6501(c)(7) will not apply when an amended return has been mailed but not received within the limitation period.

The Service Center asked whether § 7502 applies to § 6501(c)(7), expanding its application to those returns received after the expiration of the period of limitation. Section 7502 provides that if any return, claim, statement, or other document "required to be filed" within a prescribed period is delivered after such period by United States mail to the agency with which the return is "required to be filed," the date of the postmark will be deemed the date of delivery. This section applies only if the postmark date falls within the prescribed period for the filing of the return.

Section 7502 applies only to returns "required to be filed." The treatment of a timely mailed return as timely filed does not apply to timely mailed amended returns that show additional tax due because these returns are not "required to be filed" by any internal revenue law. [3] See Est. of Lewis v. Comm'r, T.C. Memo. 1988-36; Myers v. Comm'r, T.C. Memo. 1988-306. But see Jacobson v. Comm'r, 73 T.C. 610 (1979) (unclear whether return at issue was an "amended" joint return; also appears as though return did not show additional tax due). For this reason, the Service may not treat a timely mailed amended return that is received after the limitation period, and that shows additional tax due, as received within the limitation period so as to extend that period under § 6501(c)(7).

Issue 3

Although this question was not specifically asked, it may be useful to provide a specific answer.

As discussed under Issue 2, § 6501(c)(7) provides an extension of the assessment limitation period of up to 60 days when certain documents are received within 60 days from the end

[3] Section 7502 would apply, however, to an amended return that entails a claim for refund because taxpayers are required to file such returns in order to retrieve overpayments of tax.

of the assessment period. To trigger this extension, it must be a written document signed by the taxpayer showing that the taxpayer owes an additional amount of tax.

An amended return on which tax-increasing adjustments were offset by tax-decreasing adjustments would not show "an additional amount of tax" and would not trigger the extension under § 6501(c)(7).

If you have any comments or further questions, please call Cathy Prohofsky at (202) 622-4930.

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by /s/
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