OFFICE OF
CHIEF COUNSEL

**DEPARTMENT OF THE TREASURY**
**INTERNAL REVENUE SERVICE**
**WASHINGTON, D.C. 20224**
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR DISTRICT COUNSEL, DELAWARE-MARYLAND DISTRICT,
CC:SER:DEM:WAS

FROM: ASSISTANT CHIEF COUNSEL (FIELD SERVICE)
CC:DOM:FS

SUBJECT: Tax Court Jurisdiction Over Erroneous Refund of EIC

This Field Service Advice responds to your memorandum dated April 13, 2000. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

## DISCLOSURE STATEMENT

Field Service Advice is Chief Counsel Advice and is open to public inspection pursuant to the provisions of section 6110(i). The provisions of section 6110 require the Service to remove taxpayer identifying information and provide the taxpayer with notice of intention to disclose before it is made available for public inspection. Sec. 6110(c) and (i). Section 6110(i)(3)(B) also authorizes the Service to delete information from Field Service Advice that is protected from disclosure under 5 U.S.C. § 552 (b) and (c) before the document is provided to the taxpayer with notice of intention to disclose. Only the National Office function issuing the Field Service Advice is authorized to make such deletions and to make the redacted document available for public inspection. **Accordingly, the Examination, Appeals, or Counsel recipient of this document may not provide a copy of this unredacted document to the taxpayer or their representative**. The recipient of this document may share this unredacted document only with those persons whose official tax administration duties with respect to the case and the issues discussed in the document require inspection or disclosure of the Field Service Advice.

LEGEND

Taxpayer =

Year 1 =
$x =

$y =
$z =

ISSUE

If a taxpayer obtains a refund based on an erroneous earned income credit claim, but it is determined that the document, upon which the refund was based, was not a return, can the Service still recover the refund as a deficiency?

CONCLUSION

Even though no return was filed, the refund can properly be characterized as a "rebate," resulting in a deficiency. This is because the refund is made on the ground that the correct tax (which is a negative number in the case of a refundable earned income credit) is less than the tax shown on the return. In a case where no return is filed, the tax shown on the return is deemed to be zero.

FACTS

In Year 1, Taxpayer's husband filed a timely, separate return on her behalf. That return reflected Taxpayer's entitlement to a refund of $z resulting from (1) an earned income credit (EIC) of $y and (2) withholding credits of $x. Taxpayer deposited the refund check of $z upon receipt. However, now that the Service is attempting to recapture the EIC, Taxpayer seeks to disavow the return on the basis that her husband "forged" her signature. Taxpayer acknowledges that her husband normally "took care" of their taxes and that she gave him her Form W-2 so that he could have the return prepared. However, she argues that she thought that he was going to have a joint return prepared, but that he tricked her and had a separate return prepared for each of them. Therefore, according to Taxpayer, the return is invalid.

LAW AND ANALYSIS

You intend to make the primary argument that Taxpayer, having remained silent and having cashed the refund check, is now estopped from disavowing the return. You want to make an alternative argument that, even if the return is invalid, there is still a deficiency. This memorandum addresses the alternative argument.

The term "deficiency" is defined in I.R.C. § 6211(a) as the amount by which:

> the tax imposed [that is, the correct tax] exceeds the excess of–
>
> (1) the sum of
> (A) the amount shown as the tax by the taxpayer upon the return, plus
> (B) the amounts previously assessed (or collected without assessment) as a deficiency, over—
> (2) the amount of rebates made.

This definition has often been summarized using the following formula:

> Deficiency = correct tax - (tax on return + prior assessments - rebates); or
> Deficiency = correct tax - tax on return - prior assessments + rebates.[1]

In determining a deficiency, prepayment credits are ignored. I.R.C. § 6211(b)(1).

A "rebate" is defined in I.R.C. § 6211(b)(2) as "so much of an abatement, credit, refund, or other repayment," as was made on the ground that the tax imposed was less than the excess of the amount specified in I.R.C. § 6211(a)(1) over the rebates previously made. In other words, a rebate results whenever a refund was made on the ground that the correct tax was less than the tax as reported by the taxpayer (adjusted for previous assessments and rebates).

The refundable portion of the earned income credit allowed by I.R.C. § 32 is made subject to the deficiency procedures through the concept of "negative tax." Section 6211(b)(4) provides that for purposes of defining a deficiency, the excess of the EIC over the correct tax (determined without regard to the EIC), and the excess of the EIC over the amount shown by the taxpayer on the return (again determined without regard to the EIC), shall both be taken into account as negative amounts of tax.

The Case Where a Return is Filed

Thus, for example, if your primary argument prevails, and the return is deemed to be valid, then applying the formula for a deficiency, the correct tax is zero, and the tax shown on the return is negative $y (the $x withholding credit is ignored). Therefore the deficiency is calculated as follows:

| | |
|---|---|
| Correct tax | $ 0 |
| Less tax on return | -(-y) |
| Plus rebates | 0 |
| Less prior assessments | 0 |
| Deficiency | $ y |

Subtracting a negative amount results in a positive deficiency, in the amount of the erroneous EIC. Note that in this scenario, the refund is not a "rebate," since the refund was not made on the ground that the correct tax was less than the tax reported on the return; rather, it was made on the ground that the correct tax was the (negative) tax reported on the return.[2]

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[1] See S-K Liquidating v. Commissioner, 64 T.C. 713, 715 (1975); Miller v. Commissioner, 23 T.C. 565, 568 (1954), aff'd 231 F. 2d 8 (5th Cir. 1956); and Kurtzon v. Commissioner, 17 T.C. 1542, 1548 (1952).

[2] Similarly, the refund of $x in withholding was not a rebate.

The Case Where No Return is Filed

If, on the other hand, the document filed by the taxpayer's husband is not deemed to be a valid return, then the computation above does not apply because the "tax shown on the return" is not a negative $y. However, in our view there is still a deficiency, under an alternative computation.

The key to this conclusion is the principle embodied in Treas. Reg. § 301.6211-1(a), which states:

> If no return is made ... for the purpose of the definition [of a deficiency] the amount shown as the tax by the taxpayer upon his return shall be considered as zero. Accordingly, in any such case, if no deficiencies with respect to the tax have been assessed, or collected without assessment, and no rebates with respect to the tax have been made, the deficiency is the amount of [the correct tax imposed].

This rule, which prevents taxpayers from avoiding the deficiency and assessment procedures by the simple expedient of not filing a return, has been upheld by the courts. See, e.g., Hartman v. Commissioner, 65 T.C. 542, 545-46 (1975); Roat v. Commissioner, 847 F.2d 1379, 1381-82 (9th Cir. 1988). Cf. Mirike v. Commissioner, T.C. Memo. 1994-348.[3]

If, in the present case, we assume that the document filed by the taxpayer's husband was not a return, then the application of Treas. Reg. § 301.6211-1(a) has two consequences.

First, the amount shown on the return is deemed to be zero. If this were the only change, however, then there would be no deficiency: the excess of the correct tax (zero), over the tax shown on the return (zero), would produce a deficiency of zero.

However, in our view, application of Treas. Reg. § 301.6211-1(a) has a second consequence, which we believe to be a reasonable and consistent reading of the statute and regulations. It turns the refund into a rebate refund, in the amount of $y. This is because, in applying the definition of a rebate under I.R.C. § 6211(b)(2), the tax imposed (namely a negative $y under I.R.C. § 6211(b)(4)) is less than the I.R.C. § 6211(a)(1) amount (namely the amount which is deemed to have been shown on the return, i.e. zero, under Treas. Reg. § 301.6211-1(a)). In short, in applying the definition of "rebate," we have a refund that was made on the basis that the tax imposed, namely a negative $y, was less than zero.[4] This results in the following computation:

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[3] Our argument can also be supported by a line of cases which extend the "no return = zero tax" concept into the context of the substantial understatement penalty. See, e.g., Hesselink v. Commissioner, 97 T.C. 94 (1991).

[4] As before, pursuant to I.R.C. § 6211(b)(1), the $x is ignored.

| | |
|---|---|
| Correct tax | $ 0 |
| Less tax on return | 0 |
| Plus rebates | y |
| Less prior assessments | 0 |
| Deficiency | $ y |

In our view, this is a logical extension of the principle reflected in Treas. Reg. § 301.6211-1(a), as applied in the context of a "negative tax," such as the earned income credit. As in the case of normal, "positive tax" adjustments, it prevents a taxpayer, who has managed to obtain a refund, from avoiding the deficiency procedure by disavowing or refusing to file a return. Otherwise, the Service would be left with the more cumbersome and limited alternative of recovering the refund by suit under I.R.C. § 7405.

This interpretation also produces correct results in situations that involve the more normal, "positive" tax. Suppose, for example, that a taxpayer whose correct tax was $1000 was able to get a refund of $1000 in withholding credits by filing a document that was later deemed not to qualify as a return. In such a case, there would be a deficiency of $1000, calculated as follows:

| | |
|---|---|
| Correct tax | $1000 |
| Less tax on return (under § 301.6211-1(a)) | 0 |
| Plus rebates | 0 |
| Less prior assessments | 0 |
| Deficiency | $1000 |

In this situation, the refund would not be a rebate refund (which would result in an incorrect deficiency of $2000), because the refund is not made on the ground that the correct tax is less than the (deemed) tax on the return: $1000 is greater, not less than, zero.[5]

In Lesinski v. Commissioner, T.C. Memo 1997-234, the taxpayer, through a combination of prepayment credits and other payments, paid a total of $58,000 for the tax year 1991.[6] The Service asserted a deficiency of $80,000. The taxpayer then filed a return showing a liability of approximately $48,000 and an overpayment of $10,000, which the Service refunded. The Service accepted the return as filed, but asserted a deficiency in the amount of the $10,000 refund, on the ground that the refund was time-barred under the amount limitations in I.R.C. §§ 6512(b)(3) and 6511(b)(2), and was therefore erroneous. The court held that it lacked jurisdiction, because there was no deficiency. According to the court, the deficiency was zero because the Service

[5] Thus, there is no conflict with the statement in Treas Reg. § 301.6211-1(a), quoted above, to the effect that when a return is not filed, the deficiency is generally the taxpayer's correct tax liability.

[6] All amounts are approximate.

agreed with the liability on the return. Because, therefore, the refund was not made because the correct tax was less than the tax shown on the return, the refund was not a rebate.[7]

In our view, because Lesinski is distinguishable from the present case, the holding of Lesinski does not mandate a different result here. In Lesinski, although the taxpayer initially filed no return, at the time of the disputed refund a return had been filed, and the Service eventually accepted the amount of tax as reported on the delinquent return. The reason the Service sought to recover the $10,000 refund was because it was barred by the statute of limitations and not because, in the absence of the limitations barrier, there was a dispute as to the correct amount of tax. In the present case, by contrast, the Service does not agree that the taxpayer is entitled to the EIC. As discussed above in connection with your primary position, if the document filed by Taxpayer's husband is deemed to be Taxpayer's return, there would still be a deficiency.

If you have any questions concerning the above, please call the branch number.

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cc: Regional Counsel, CC:SER
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[7] The government subsequently brought a civil action to recover the erroneous refund under I.R.C. § 7405. See United States v. Lesinski and McGrath, 85 AFTR 2d 1289 (Feb. 23, 2000). The issues raised in that litigation are not relevant here.