DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

FROM: Peter K. Reilly
Special Counsel, Branch 3, Office of Assistant Chief Counsel
(Administrative Provisions and Judicial Practice)
CC:PA:APJP:B3

SUBJECT: Application of I.R.C. section 6213(b)(3)

This Chief Counsel Advice responds to your memorandum dated May 31, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

LEGEND

$a =	Year 1 =	Date 1 =
$b =	Year 2 =	Date 2 =
$c =	Year 3 =	Date 3 =
	Year 4 =	
	Year 5 =	
	Year 6 =	

ISSUES

1. Whether it is appropriate under the circumstances described herein to make an immediate assessment pursuant to I.R.C. § 6213(b)(3) of a possible deficiency arising from a section 6411 tentative carryback adjustment.

2. If immediate assessment under section 6213(b)(3) is not appropriate, should the Internal Revenue Service ("Service") remove the freeze placed on the taxpayer's account with respect to the tentative refund.

CONCLUSIONS

1. We do not think that the summary assessment procedure provided by section 6213(b)(3) is appropriate under these circumstances.

2. The Service should remove the refund freeze from the taxpayer's account.

FACTS

During all years, up to and including Year 4, the taxpayer (a corporation) was engaged in a rental business. The taxpayer is currently engaged in a minimal amount of business activity, but remains a viable entity under state law. The sole shareholder of the taxpayer has indicated that corporate business activities will be increased to prior levels.

The taxpayer reported a net operating loss ("NOL") of $a on its Year 4 income tax return (Form 1120) which was filed on Date 1, Year 5. Subsequently, on Date 2, Year 5, the taxpayer filed a Corporate Application for Tentative Refund (Form 1139) in which it requested to apply a portion of the Year 4 NOL to Year 2 and a portion of the Year 4 NOL to Year 3. On Date 3, Year 6, the Service notified the taxpayer that it had an overpayment for Year 2 of which approximately one-third would be applied to an outstanding liability for Year 1 with the remainder being refunded to the taxpayer.[1]

The taxpayer contacted a local Taxpayer's Advocate's office shortly after receiving the notice from the Service to inquire as to when it would receive the refund. The Taxpayer's Advocate's representative learned that the taxpayer's Year 4 income tax return was under examination. At that point, the taxpayer's accounts for Year 2 and Year 3 were frozen, effectively preventing the issuance of a refund check for the remainder of the allowed tentative refund. The decision to freeze the refund was based on the revenue agent's preliminary proposal that the Year 4 NOL be disallowed. The taxpayer's accounts remain frozen at the present time, which is more than ninety days from the date the taxpayer filed its Form 1139.

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[1] The portion of the Year 4 NOL applied to Year 3 did not result in a refund for that year because the taxpayer based its Year 3 taxable income on an amended return, which was substantially less than the taxable income reported on the original return. The Service used the higher amount of taxable income from the original return in processing the Form 1139 because it did not accept the amended return, thus the taxpayer did not have an overpayment for Year 3.

The revenue agent has completed his examination of the taxpayer's Year 4 income tax return and has proposed to disallow a substantial portion ($b) of a bad debt deduction claimed in the amount of $c. The proposed disallowance would eliminate most of the NOL for Year 4 which would, in turn, reduce the amount of the tentative refund significantly. The taxpayer filed a protest and the case is currently under consideration by Appeals.

LAW AND ANALYSIS

Issue 1: Appropriateness of Summary Assessment Procedures

Section 6411(a) provides, in part, that a taxpayer may file an application for a tentative carryback adjustment of the tax for a prior taxable year affected by a net operating loss carryback as provided for in section 172(b), a business credit carryback as provided for in section 39, a research credit carryback as provided for in section 30(g)(2), or by a capital loss carryback as provided for in section 1212(a)(1), from any taxable year. The application must contain specific information and must be filed within twelve months from the end of the tax year in which the loss or credit was sustained (but not before the return for that year has been filed). An application for a tentative carryback adjustment shall not constitute a claim for credit or refund.

Under section 6411(b), the Service is to make, to the extent deemed practical, a limited examination of an application for a tentative carryback adjustment to discover material omissions and errors of computation and to determine the amount of the decrease in tax attributable to the carryback. Within ninety days from the date on which the application is filed, or from the last day of the month in which falls the last date prescribed by law (including extensions) for filing the return for the taxable year of the net operating loss, whichever is the later, the examination must be completed. Section 6411(b) also provides that the Service may disallow, without further action, any application that contains either errors of computation that cannot be corrected within the 90-day period or material omissions.

The Service need not satisfy itself of the merits of the applications for tentative carryback adjustments in order to approve refunds under section 6411(b). Section 6411(b) creates a presumption in favor of prompt refunds for corporations in years in which they suffer operating losses. All that is required for a Form 1139 is that certain minimum information be furnished regarding the taxpayer and the tax impact of the asserted loss. Because this information must be "mathematically verifiable," the Service is instructed to do a "limited examination." It is not required to examine the documents previously filed on which the Form 1139 summary calculations are based or attempt to reconcile the form with the transcript of account before making a tentative refund. The only relevant attachment required by the form itself is a calculation of the credit carryback. See e.g., Columbia Gas System, Inc. v. United States, 32 Fed. Cl. 318, 328 (1994), aff'd 70 F.3d 1244 (Fed. Cir. 1995).

The Treasury Regulations implementing section 6411(b) limit the type of review to which applications for tentative carryback adjustments are subject. For example, under section 1.6411-3(b) of the regulations, the Service in determining decreases in tax attributable to a carryback, will not change an amount claimed on the return as a deduction for depreciation because the Service believes that the taxpayer has claimed an excessive amount. Likewise, the Service will not include in gross income any amount not so included by the taxpayer on the return even though the Service believes that the amount is subject to tax and properly should be included in gross income.

This limited review is consistent with Rev. Rul. 78-369, 1978-2 C.B. 324, amplified by, Rev. Rul. 84-175, 1984-2 C.B. 296, where the Service determined that, despite strong evidence indicating that the corporation ultimately would not be entitled to the claimed tentative refund and would likely be liable for a deficiency for the loss year, the Service was nevertheless required to refund the decrease in tax shown on the application. That ruling stated that in determining decreases in tax attributable to a carryback, the Service will not change an amount claimed on the return, because it determined that the taxpayer had claimed an excessive amount. This is in spite of the fact that the taxpayer's carryback year was under criminal investigation.

In Rev. Rul. 84-175, 1984-2 C.B. 296, the Service authorized the use of a procedure whereby the Service simultaneously made an assessment to offset or to recover a scheduled refund resulting from a decrease in tax shown on Form 1045, Application for Tentative Refund, but only in certain specific, narrowly defined circumstances. The Service held that where the Commissioner has made the determination that it is highly likely there was a gross valuation overstatement, or a false or fraudulent statement had been made with respect to a tax shelter promotion or partnership interest in a tax shelter promotion that would be subject to a penalty under section 6700 of the Code, the Service is entitled to schedule the refund claimed on the Form 1045, make an assessment under section 6213(b)(3) of the Code and offset the assessment against the refund within the 90-day period provided in section 6411(b). This is the only published guidance concerning when the Service will authorize the use of such a procedure.

The legislative history of section 6213(b) is instructive in ascertaining when the summary assessment procedures under section 6213(b)(3) are appropriate. Sections 6411 and 6213(b)(3) were originally enacted as part of section 3780 of I.R.C. section 1939, by section 4(a), Tax Adjustment Act of 1945, Pub. L. No. 170, 59 Stat. 521-523 ("Act"). The committee report accompanying section 3780 states that the Act provides for prompt payment of refunds attributable to carrybacks of net operating losses in order to encourage a vigorous post-war business expansion. H. Rep. No. 849, 79th Cong., 1st Sess. (1945), 1945 C.B. 566, 569. The committee report then states, in pertinent part:

> In recognition of the fact that, due to the short period of time allowed, the Commissioner necessarily will act upon an application for a tentative carryback adjustment only after a very limited examination, subsection (c) of section 3780 provides a summary procedure whereby the Commissioner and the taxpayer each may be restored to the same position occupied prior to the approval of such application. ...
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> It is to be noted that the method provided in subsection (c) of section 3780 [the predecessor of section 6213(b)(3)] to recover any amounts applied, credited, or refunded under section 3780 which the Commissioner determines should not have been so applied, credited, or refunded is not an exclusive method. It is contemplated that the Commissioner will usually proceed by way of a deficiency notice in the ordinary manner, and the taxpayer may litigate any disputed issues before the Tax Court. The Commissioner may also proceed by way of suit to recover an erroneous refund.

H. Rep. No. 849, supra, 1945 C.B. at 583 (emphasis added).

As a policy matter, we do not think that you should use the section 6213(b)(3) procedure under the facts of this case. The legislative history reflects the congressional preference for issuing statutory notices of deficiency to recover refunds made pursuant to section 6411. Essentially, you propose to use the procedure similar to that set out in Rev. Rul. 84-175, where the Service would simultaneously make an assessment to offset or to recover a scheduled refund. We have advised in the past that the section 6213(b)(3) procedure would be available if the Service implements nationwide procedures like those in place to detect abusive tax shelters. The Service simply has not set up a program to cover the factual situation described herein. Additionally, this case is now under the jurisdiction of Appeals. It may be that Appeals will agree or at least partially agree with the taxpayer's position based on a hazards of litigation analysis. This erodes the certainty of the determination made by the revenue agent concerning the disallowance of the bad debt deduction. Furthermore, although not actionable, the Service has failed to meet the time requirements under section 6411(b) for processing the refund.

We would also note that corporations claiming losses are not likely to be in the best financial shape. To systemically disallow refunds based on doubt as to collectibility would result in undermining the assistance provided by section 6411 to the corporations that need it most.

Various options remain available to the Service in this situation. After Appeals reviews the case, a notice of deficiency could be issued. If the taxpayer becomes insolvent due to distributions to the sole shareholder, a notice of transferee liability

could be issued to the sole shareholder. The government can also bring suit to recover the erroneous refund.

Issue 2: Removal of Refund Freeze

Freezing the refund is tantamount to the Service taking no action at all on the tentative refund claim and forcing the taxpayer to file refund claims in the normal course. We do not view this as a viable approach. We interpret section 6411 as requiring the Service to act on the refund request (by allowing or disallowing it) within ninety days. Moreover, Congress created a presumption in section 6411 in favor of prompt refunds to corporations for years in which they suffered operating losses. Thus, the only grounds justifying disallowance, as enumerated in section 6411(b), are material omissions or errors of computation which the Service determines cannot be corrected within the ninety-day period. We read this as mandating that any processible applications for tentative carryback adjustments (i.e., those having no material omissions or non-correctable errors of computation) must be allowed within ninety days. See Columbia Gas System, Inc. v. United States, 32 Fed. Cl. 318 (1994), aff'd, 70 F.3d 1244 (Fed. Cir. 1995).

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Please call if you have any further questions.