ACKNOWLEDGED SIGNIFICANT ADVICE, MAY BE DISSEMINATED

Office of Chief Counsel
Internal Revenue Service

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memorandum

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CAProhofsky TL-N-3530-97

date: SEP 5 1997

to: District Counsel, Georgia, CC:SER:GEO:ATL

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, May 30, 1997, in connection with questions posed by the Atlanta Service Center.

Disclosure Statement

Unless specifically marked "Acknowledged Significant Advice, May Be Disseminated" above, this memorandum is not to be circulated or disseminated except as provided in the CCDM. This document may contain confidential information subject to the attorney-client and deliberative process privileges. Therefore, this document shall not be disclosed beyond the office or individual(s) who originated the question discussed herein and are working the matter with the requisite "need to know." In no event shall it be disclosed to taxpayers or their representatives.

ISSUES

You asked for advice on two factual situations:

1) A taxpayer files an amended return, which the Service Center receives on April 14, with a Schedule C reporting $10,000 nonemployee compensation income and $20,000 in expenses resulting in a net loss of $10,000. The return previously had no Schedule C. The period of limitation on assessment will expire on April 15. If the Service disagrees with the expenses, does the Service have 60 days from receipt of the document to assess the tax on the $10,000 nonemployee compensation or must the Service disallow the claim?

2) A taxpayer files an amended return, which the Service Center receives on April 14, with a Schedule C reporting an increase to income from nonemployee compensation, but failing to compute self-employment tax. Does the Service have 60 days from the receipt of the document to assess self-employment tax?

CONCLUSIONS

1) Assessment of an additional amount of tax, based on tax-increasing adjustments from an amended return that shows offsetting tax-decreasing items, is not permissible. Further, in this situation, the period of limitations will not be extended by § 6501(c)(7).

2) The receipt of an amended return showing an increase in income tax does not extend the time to assess self-employment tax that is not shown on the amended return.

DISCUSSION
ISSUE 1

Your question assumes that assessment of an additional amount, without following deficiency procedures, would be permissible in this situation if the amended return were received with adequate time left on the assessment statute to process it -- that is, even without recourse to the 60-day extension in § 6501(c)(7). We do not agree with this assumption.

Generally, the Supreme Court has described assessment as "essentially a bookkeeping notation ... made when the Secretary or his delegate establishes an account against the taxpayer on the tax rolls." 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).

We believe that in this situation an assessment 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. The legal basis for assessing tax shown on a return has been described as follows:

> 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.

Penn Mutual Indemnity Co. v. Comm'r, 32 T.C. 646, 667-68 (1959) (Murdock, J., concurring), aff'd, 60-1 USTC ¶ 9389 (3d Cir. 1960).

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 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

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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.

[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 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 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 way for the Service to assess additional tax is to determine a deficiency and issue a deficiency notice, if time permits. Of course, even if the Service does not assess additional tax, it may reject the claimed refund.

In this situation, the Service may not have time to determine a deficiency and issue a deficiency notice because the period of limitations will expire one day after the receipt of the amended return. Section 6501(c)(7) provides an exception to the general period of limitations for certain amended returns. Where, within the 60-day period ending on the day on which the period of limitations 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 receive a document showing that the taxpayer owes an additional amount of tax. In this situation, the amended return does not show that the taxpayer owes additional tax; rather, the return shows a net loss. Because the amended return does not show additional tax owed, § 6501(c)(7) does not apply to extend the period of limitations on assessment. Any notice of deficiency must be sent before the period expires on April 15.

ISSUE 2

In the second situation you raise, a taxpayer files an amended return with a Schedule C reporting an increase to income from nonemployee compensation, but failing to compute self-employment tax. You asked whether the Service has 60 days from the receipt of the amended return to assess self-employment tax.

As discussed above, § 6501(c)(7) extends the period of limitations on assessment for amended returns received within the last 60 days of the period that show the taxpayer owes an additional amount of tax.

In the situation you posed, should the Service Center receive, within the 60-day period prior to the expiration of the period of limitations on assessment, an amended return showing additional income tax from that shown on the original return due to the increase to income from nonemployee compensation, then, the Service would have 60 days from the receipt of the amended return to assess the additional income tax shown.

However, the amended return does not show that the taxpayer owes an additional amount of self-employment tax. As discussed above, assessment without prior notice of deficiency is proper where the taxpayer has made a "self-assessment." This is based upon the taxpayer's consent to the assessment of tax. Section 6501(c)(7) merely provides the Service with additional time in which to assess the "self-assessed" tax. In this situation, the taxpayer has not admitted liability for self-employment tax. Thus, we conclude that the period of limitations on assessing self-employment tax is not extended by the receipt of an amended return that does not show an increase in self-employment tax.[3]

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

Assistant Chief Counsel
(Income Tax & Accounting)

by /s/
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cc: EOSCO, T:E
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[3] It could be argued that the return in the fact pattern falls within the scope of § 6501(c)(7) because, although the return does not actually report any self-employment tax, the return "shows" a liability by including the nonemployee compensation. However, the legislative history to § 6501(c)(7) draws no distinction between "showing" and "reporting" additional tax: "This [provision] will assure that additional tax due as reported by a taxpayer on an amended return may be assessed and collected." Staff of Senate Comm. on Finance, 98th Cong., 2d Sess., Deficit Reduction Act of 1984 (Vol. 1) 792 (emphasis added).