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Internal Revenue Service
Memorandum

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subject:
ASFR Questions involving Subsequently Filed Delinquent
Original Returns

This Chief Counsel Advice responds to your request for assistance dated December 13, 2004.

ISSUES

1. Is the preparation of an automated substitute for return (ASFR) made under the

authority of section 6020(b) considered an examination within the meaning of section 7602?

2. Does the ASFR unit have the authority to adjust its proposed or actual assessments based upon the delinquent original return that is voluntarily submitted by the taxpayer?

3. Whether the Service should process a delinquent original return submitted by a taxpayer or ignore the information contained in that return?

4. Currently, when an assessment based on an ASFR has been made against a taxpayer, and the taxpayer and spouse thereafter file a joint return, the original assessment is abated and a new assessment is made with a collection statute expiration date (CSED) date based upon the new assessment. The IRS Master File does not allow dual CSEDs on a joint return. Is this practice correct?

CONCLUSIONS

1. The preparation of a section 6020(b) return is not considered an examination within the meaning of section 7602. Further, any limited contact with a taxpayer to verify items on a taxpayer's delinquent original return that does not extend to requesting and subsequently inspecting the taxpayer's books and records is not an examination.

2. The ASFR unit has the authority to adjust proposed or actual assessments based upon a return that is voluntarily submitted by the taxpayer.

3. The Service should process a delinquent original return submitted by a taxpayer. Further, the Service should not ignore any information contained in the taxpayer's return, and where appropriate, the Service may assess additional amounts of tax or abate if the original assessment is erroneous.

4. The Service should not effectively extend the CSED by abating and then reassessing the same tax if a taxpayer files a delinquent original joint return.

BACKGROUND

The ASFR Program prepares automated substitutes for returns for individuals who fail to file or fail to adequately explain why they are not required to file after having been notified. The ASFR Program uses information from the Information Reporting Program

(IRP) and the Information Return Master File (IRMF), combined with other internally available information, to calculate taxable income. IRM 5.1.11.6.5; IRM 5.18.2.

After the computer system generates an ASFR, the Service sends a 30-Day letter to the taxpayer informing the taxpayer of the calculated tax and proposed penalties. The taxpayer may then agree to the liability (with or without payment) by signing the report enclosed with the letter, file the delinquent return, request an appeals conference, pay the balance due and file a refund claim, or simply do nothing. If the taxpayer does nothing, then after 30 days, the Service will issue a statutory notice of deficiency, and, if the taxpayer continues to take no action, the Service will assess the deficiency after 90 days.

ASFR audit reconsideration is the process the IRS uses when the taxpayer contests an ASFR determination by filing an original delinquent return. I.R.M. 4.13.1.2. The I.R.M. currently instructs that Exam determines and performs ASFR audit reconsideration.

I.R.M. 5.18.1.9.154. This office has previously advised that whether the ASFR Reconsideration campus tax examiner can audit an ASFR in lieu of Exam is not a legal issue, but rather a business decision to be made by the Service.

When a taxpayer files a delinquent original, processable return in response to the 30day letter, the statutory notice of deficiency, or even post assessment, the current ASFR practice is to process the return as is. This means to post the return to the Master File and set the assessment statute expiration date (ASED), regardless of the amount of income reported. Under prevailing procedures, an ASFR examiner may not change a return without the taxpayer's agreement except for math error corrections below a certain dollar mark. IRM 5.18.1.9.154. Before processing the return, if the reported income is less than the ASFR income, the assigned ASFR tax examiner may contact the taxpayer (or, rarely, a third party) to inquire about the difference and try to verify the amount on the return or obtain the taxpayer's agreement to the higher figure. Assuming the variance is not resolved, the return is nevertheless processed as is. Once the return is formally processed, it is classified for examination purposes, and a minority of returns over a certain threshold are referred for examination.

If the delinquent original return is filed pre-assessment, unless it is referred for examination, it is processed for assessment (if a balance-due return) or refund; if the delinquent original return shows neither an underpayment nor overpayment, the case is closed. If the delinquent original return is filed post-assessment (a "reconsideration"

return) and shows a balance due, the examiner recalculates the tax and assessment amount, and if the deficiency is below a set amount, it is allowed without more; if above the set amount, the recalculation must be supported by Form W-2, W-2G, or 1099. IRM 5.18.1.9.137. The AFSR tax examiner abates the prior assessment and issues a recalculated notice of deficiency. De minimis outstanding balances are simply written off and the associated cases closed.

The ASFR units are interested in preserving the income item and other items on the ASFR in the face of taxpayers' delinquent original returns that omit or underreport income. Thus, where a taxpayer files a delinquent original return between the 30 day letter and a notice of deficiency, rather than either accepting the income amount as reported or forwarding the return for examination, the ASFR units are considering issuing a notice of deficiency for the unreported or underreported income. The deficiency would be determined using IRP information for income, while deductions and filing status would come from the delinquent original return./1/ Similarly, for a taxpayer who files a delinquent original return during the 90 days after the notice of deficiency yet does not timely petition the Tax Court, the ASFR units would like to be able to assess the original deficiency, as opposed to recalculating the deficiency on account of the taxpayer's delinquent original return.

LAW AND ANALYSIS

Sections 6020(b) and 6013

Section 6020(b)(1) provides that the Service may execute a return for a taxpayer who fails to make any return required by any internal revenue law or regulation at the time prescribed, or who makes, willfully or otherwise, a false or fraudulent return. Preparing a section 6020(b) return, however, does not allow the Service to assess without deficiency procedures if the tax is a type subject to deficiency procedures. See Spurlock v. Commissioner, 118 T.C. 155, 161 (2002).

The execution of a section 6020(b) return will not start the running of the period of limitations on assessment and collection without assessment. I.R.C. section 6501(b)(3). Accordingly, until the taxpayer files his own return, there will be no deadline by which the Service must assess the tax or file a suit to collect without assessment. Once the Service chooses to assess the tax, however, a 10-year period of limitations on collection begins. I.R.C. section 6502(a)(1).

Section 6013 provides that persons who are married at the end of a taxable year may choose to file either separate or joint federal income tax returns for that year. Section 6013(b)(1) permits married taxpayers, who have previously reported their income for any particular year on separate returns, thereafter to take advantage of the joint filing rates by simply filing a joint return for that year so long as they do so within the time limits specified in section 6013(b)(2). Under section 6013(b)(2)(A), no subsequent joint return can be filed more than three years after the date the return for a particular year would normally be due. See IRM 5.18.1.9.154.1(4). The Tax Court has held that section 6020(b) returns filed separately on behalf of married taxpayers are not returns taxpayers file within the meaning of section 6013(b)(1) and, therefore, the Service making a section 6020(b) return does not foreclose taxpayers from electing joint filing status at any subsequent time. See Millsap v. Commissioner, 91 T.C. 926 (1988), acq. in result 1991-2 C.B. 1; see also Phillips v. Commissioner, 851 F.2d 1492 (D.C. Cir. 1988), aff'g in part and rev'g in part, 86 T.C. 433 (1986).

Examinations Under Section 7602

Section 7602(a) empowers the Service to examine "any books, papers, records, or other data" which may be relevant for four specific purposes, one of them being the making of a return where none has been made. Section 7605(a) authorizes the Service to set the time and place of examination, and section 7605(b) prohibits "unnecessary examination[s]" and more than one inspection of a taxpayer's books of account for the same taxable period unless necessary.

Although the Code does not define "examination" (or "audit," for that matter), nor are we aware of any meaningful official agency/2/ or judicial definition, we believe it necessarily involves the Service examining a taxpayer's "books, papers, records, or other data." The Service's determination of a liability made without examining books and records (or the like) is not an examination. Our interpretation is consistent with the Service's de facto approach to what qualifies as an examination. See, e.g., Publication 3114, Compliance Check, Audit, Examination, or Review? (informing taxpayers that "[a]n examination is an inspection of an individual's or entity's books and records"). Because the ASFR Program as currently in force or as it may be changed does not and would not involve an examination of a taxpayer's books and records other than potentially a very limited review of supporting records that a taxpayer voluntarily submits in response to a discrepancy or similar inquiry, operation of the program is not an examination for purposes of sections 7602(a) and 7605(b). As indicated, even a review of records in these circumstances — assuming it's a relatively simple review — does not rise to the

level of an examination./3/ See Rev. Proc. 94-68, 1994 C.B. 803, section 4.02(2) ("A contact with a taxpayer to verify or adjust a discrepancy between the taxpayer's income tax return and an information return is not an examination, inspection [of the taxpayer's books of account], or reopening [of a closed case]."); Policy Statement P-4-3, IRM 1.2.1.4.1(2)./4/

Delinquent Original Return Filed Subsequent to the 30 Day Letter, but Before the Issuance of the Notice of Deficiency

Section 6201(a)(1) states that "the Secretary shall assess all taxes determined by the taxpayer or by the Secretary as to which returns or lists are made under this title." If a taxpayer files a valid delinquent original return after the 30 day letter is issued, but before the notice of deficiency is issued, that return should be processed and assessed. The criteria for a valid return includes: 1) there must be sufficient data to calculate tax liability; 2) the document(s) must purport to be a return; 3) there must be an honest and reasonable attempt to satisfy the requirements of the tax law; and 4) the taxpayer must execute the return under penalties of perjury. See Beard v. Commissioner, 82 T.C. 766, 777 (1984), aff'd per curiam, 793 F.2d 139 (6th Cir. 1986).

Generally, a deficiency is the amount by which the tax imposed exceeds the amount shown as the tax by the taxpayer on his return. I.R.C. section 6211. If the excluded income items to which you refer result in a deficiency, then the Service must issue a notice of deficiency to that taxpayer in order to assess that deficiency. Therefore, if there are omissions from the taxpayer's return resulting in a deficiency to the taxpayer, the Service will need to issue a notice of deficiency to take into account the adjustments derived from the omissions.

Delinquent Original Return Filed Subsequent to the Issuance of the Notice of Deficiency, but Prior to the Expiration of the 90 Day Period for Filing a Petition with the Tax Court.

If the taxpayer does not petition the Tax Court from the notice of deficiency, the Service is entitled to assess the amount determined in the notice of deficiency. I.R.C. section 6213(c). Pursuant to section 6201(a)(1), the Service is also required to assess all taxes determined by the taxpayer on a valid return. Therefore, the Service should first assess the amount shown on the taxpayer's return. If the tax shown on this return is less then the correct tax set forth in the notice of deficiency, the Service may generally assess the difference between the correct tax as reflected in the notice and the tax shown on the

return. The Service may only make this incremental deficiency assessment based on the adjustments in the notice of deficiency.

To the extent you are requesting our views concerning a taxpayer's right to go to the Office of Appeals, the procedural rules with respect to appeals are merely directory and confer no substantive rights. Houlberg v. Commissioner, T.C. Memo. 1985- 497. We recommend that you contact the Office of Appeals for their views concerning how these matters should be handled. The taxpayer does have the right to petition the Tax Court within 90 days from the issuance of the notice of deficiency.

If the return at issue is a joint return and one of the taxpayers on the joint return has not been sent a notice of deficiency for the year at issue, the Service may assess the taxpayer who was not sent a notice of deficiency for the amount listed on the return without issuing a notice of deficiency. I.R.C. section 6201(a)(1). If the Service, however, determines that the non-receiving taxpayer's correct tax exceeds the tax shown on the return, then the Service must issue a notice of deficiency prior to assessing the difference between the correct tax and the tax shown on the return.

Delinquent Original Return Filed After the Assessment has Been Made

Section 6404(a) states that the Secretary is authorized to abate the unpaid portion of the assessment of any tax or any liability in respect thereof, which is excessive in amount. If the items claimed on the return are valid and would reduce the correct tax, then ASFR may abate the assessment to reflect the correct tax since the default assessment is excessive in amount. As far as appeal rights are concerned, see our previous discussion above.

If the return at issue is a joint return and one of the taxpayers on the joint return has not received a notice of deficiency for the year at issue and an assessment has not been made for that taxpayer, the Service may assess the taxpayer who has not received a notice of deficiency for the amount shown on the return without issuing a notice of deficiency. I.R.C. section 6201(a)(1). If the Service, however, determines that the taxpayer who has not received a notice of deficiency owes an amount that exceeds the amount shown on the return, then the Service has determined a deficiency as to that taxpayer and must issue a notice of deficiency for the deficiency amount prior to assessing the full amount determined by the Service.

Extending the Collection Statute Expiration Date

As discussed previously, the Service making a section 6020(b) return for a married taxpayer does not necessarily foreclose taxpayers from later electing joint filing status. Therefore, a husband and wife may file a delinquent joint original return reflecting their total liability where neither spouse has previously filed a return for a taxable year. If only the wife had been assessed under the ASFR program, the husband will become jointly liable for all tax reported on the joint return, including any amount for which the wife was previously assessed, and the Service should assess the tax against him. As to the husband's account, the CSED for the entire liability runs from the date of the assessment against him. If the return reflects any amounts in excess of the wife's original assessment, the Service should also assess that excess amount against her, and a new CSED as to the additional amount will begin to run.

As you have indicated in the incoming request for advice, current Service practice does not allow dual CSEDs on accounts. The Service should not effectively extend the CSED by abating the original amount of tax assessed under section 6404(a) and then reassessing the full amount of tax. We agree with the suggestion that the Service could separate the account and track the spouses separately on the Non-Master File. Therefore, the Service should be able to use dual CSEDs, one based on the original assessment date for the taxpayer assessed under the ASFR program and another CSED based on the later assessment date of the jointly filed return. This is a programming issue that must be resolved. We would be happy to assist in working with your office to resolve this issue.

Please call Tracey Leibowitz at (202) 622-4940 if you have any further questions.

FOOTNOTES

/1/The incoming memorandum suggests that the ASFR units might be inclined to disregard or disallow a taxpayer's reported return items other than income.

/2/ Although the Service has defined when an "examination" occurs in different contexts and for varying purposes, the definitions are not conclusive and not generally instructive outside of their contexts.

/3/We reach our conclusion notwithstanding the Manual's use of examination nomenclature in the ASFR Program context, e.g., IRM 5.18.1.9.72.4(2), which explains that the "[30-day] letter notifies taxpayer that SFR action is beginning and taxpayer has 30 days to respond to proposed Examination report."

/4/No bright line exists beyond which a records review becomes an examination, but at some point as the number of items at issue grows and correspondingly the volume of records produced, the ASFR examiner’s actions will effectively become a campus examination. In that case, our conclusions would alter accordingly, at a minimum we would need to reconsider them.