



OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

FROM: DEBORAH A. BUTLER
ASSISTANT CHIEF COUNSEL (FIELD SERVICE)
CC:DOM:FS:PROC

SUBJECT: Assessment and Collection of a Deficiency While on Appeal to the
United States Court of Appeals and After the Court of Appeals
has Remanded the Case to the Tax Court

This Field Service Advice responds to your memorandum dated November 17, 1998.
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.

LEGEND:

X	=
A	=
N	=
Tax Year 1	=
Tax Year 2	=
Tax Year 3	=
Year 1	=
Year 2	=
Year 3	=
Date 1	=

Date 2 =
 Date 3 =
 Date 4 =

ISSUES:

1. Whether the Service is required to abate the assessments and refund the overpayments to the partners of X for Tax Year 2 and Tax Year 3, when the assessments and collections were made after the partner-s appeal to the United States Court of Appeals for A in Year 1, and A reversed and remanded the case to the Tax Court for a further determination.
2. Whether the Service is required to refund the overpayments made by the partners of X for Tax Year 1 pursuant to the Service-s authority to abate the assessment, or may the Service apply the overpayments to other tax liabilities of the partners of X, including the liabilities for Tax Year 2 and Tax Year 3 assessments.

CONCLUSION:

1. The Service is not required to abate the assessments and refund the overpayments for Tax Year 2 and Tax Year 3. The finality rule in accordance with I.R.C. ' ' 6213 and 6225, prohibits the Service from assessing and collecting a deficiency amount once a proceeding in Tax Court has begun until the decision of the Tax Court becomes final. However, the Service may assess and collect a deficiency under section 7485(a) if the taxpayer has appealed the decision of the Tax Court and has not filed an appeal bond.
2. The Service is required to abate the assessment for Tax Year 1 and refund the overpayment because the Service concedes that the period of limitations to assess a deficiency has expired if the extension agreements were invalid for that tax year. The government may, pursuant to I.R.C. ' 6402, credit the amount of the overpayment from the abatement of the assessment for Tax Year 1 to the liability in respect of any internal revenue tax on the part of the person who made the payment. However, the government is prohibited at this point of time from any further attempts to collect the deficiency owed for Tax Year 2 and Tax Year 3 pursuant to sections 6225 and 6213. This includes crediting to Tax Year 2 and Tax Year 3 the amounts collected for the deficiency for Tax Year 1, which have now resulted in overpayments for Tax Year 1.

FACTS:

X consists of more than N partnerships. The partners of X timely filed their Forms 1065, Partnership Return of Income, for the tax years at issue. On Date 1, the Service issued to the partners of X notices of final partnership administrative adjustment (FPAA). The

partners of X filed a petition to the Tax Court in Year 2. The partners of X filed a Motion for Summary Judgment, arguing that the limitations period for assessing the partners had expired as the Service issued the FPAA later than three years after the partners' income tax returns were filed for all three tax years. The partners of X also argued that the three year limitations period had not been validly extended. The Tax Court denied the partners of X's motion. A decision was entered by the Tax Court on Date 2.

The Service and the participating partners of X entered into a stipulation to be bound, whereby the parties agreed that several test cases from the partners of X would be chosen to be appealed to the United States Court of Appeals for a determination on the issue of whether the limitations period was validly extended. The partnerships that were not chosen to be test cases remained pending in Tax Court, but they agreed to be bound by the outcome of the test cases in the appellate court. In other words, a decision in the non-test cases would be submitted when a decision in the test case becomes final under I.R.C. ' 7481. The partners of the partnerships that were not chosen to be a test case also agreed to the assessment and collection of the deficiencies notwithstanding the restrictions under I.R.C. ' 6225.

The Service became concerned that this appeal agreement may be invalid for those partnerships not chosen to be test cases. Therefore, the Service abated the assessments that were based on the potentially invalid appeal agreement. The Service then obtained individual consents to waive the restrictions on assessment and collection in accordance with section 6224(b) from the partners whose assessments had been abated. The consents stated that the partners wished to be bound to the previous stipulation entered by the parties. The consents also waived the restrictions on the assessment and collection by the Service of any computational adjustment attributable to partnership items. The Service began making assessments after the appeal was filed in Year 3.

The test cases were appealed to the United States Court of Appeals for A. A determined that the tax matters partners (TMP) for the partnerships had a conflict of interest with the limited partners because the TMPs were under criminal investigation by the Service when they signed the statute extension on behalf of the partnerships, and the TMPs were trying to ingratiate themselves with the Service. The appellate court reversed the decision of the Tax Court regarding the validity of the limitations extension and remanded the test cases to the Tax Court for a determination on whether the six year statute of limitations applies to the partnerships pursuant to section 6229(c).

The partners of X are now requesting that the Service abate the liabilities for all three tax years and refund the amounts that were collected pursuant to the assessments.

LAW AND ANALYSIS

Issue 1:

Pursuant to I.R.C. ' 6225, the Service is prohibited from assessing a deficiency attributable to any partnership item until the decision of the Tax Court has become final. Section 6213 also prohibits the Service from making an assessment of a deficiency and from collecting the deficiency until the decision of the Tax Court has become final.¹ An exception to these rules can be found in section 7485, which states that an appellate review under section 7483 does not operate as a stay of assessment or collection of any portion of the amount of the deficiency determined by the Tax Court unless a notice of appeal is filed by the taxpayer, and the taxpayer timely files an appeal bond with the Tax Court. I.R.C. ' 7486 further states that:

In cases where assessment or collection has not been stayed by the filing of a bond, then if the amount of the deficiency determined by the Tax Court is disallowed in whole or in part by the court of review, the amount so disallowed shall be credited or refunded to the taxpayer, without the making of claim therefor, or, if collection has not been made, shall be abated.

The issue of the effect of the taxpayer's failure to file an appeal bond when appealing a Tax Court decision was addressed by the case of United States v. Bolt, 375 F.2d 725 (6th Cir. 1967). In Bolt, the court held that where a taxpayer fails to stay the assessment and collection of taxes and penalties by filing a bond pursuant to section 7485, the decision of the Court of Appeals reversing the Tax Court does not vitiate the assessment, and the taxpayers are entitled only to an abatement in the assessment for the amount the Court of Appeals determined was overassessed. Id. at 726. The facts in the case Denison v. Barlow, 563 F.Supp. 263 (E.D.Ark. 1983), are similar to the case at issue. In Denison, the taxpayer appealed the Tax Court decision and failed to post bond on appeal. The Service assessed the tax deficiency which was upheld by the Tax Court and filed a lien and a levy against the taxpayer. The Service collected \$100.12 from the levy, which was applied to the taxpayer's liability. The Court of Appeals reversed the Tax Court in Denison, and remanded the case for further proceedings. The taxpayers filed a motion asking the court

¹Section 6213 and section 6225 are henceforth referred to as the finality rules.

to enjoin the Service from any further collection activities and to remove the tax lien. In the Denison case, the court determined that:

The assessment and collection efforts challenged by plaintiff began during the pendency of the appeal before the Eighth Circuit and presumably are continuing. These efforts are precisely the type of actions which may only be stayed by the posting of the bond unless disallowance is made by the court of appeals. 26 U.S.C. ' ' 7485(a)(1), 7486. The Afinality@provision contained in section 6213 is not controlling and no disallowance was made by the Court of Appeals.

Id. at 264.

These cases hold that section 7486 only requires the Service to credit or refund collected deficiency amounts if the court of review has disallowed that deficiency determination. A Court of Appeals decision to remand the case for further hearing is not a disallowance of the claim. Denison v. Barlow, 563 F.Supp. 263, 264 (E.D.Ark. 1983). The Denison case even allowed the Service to continue collection procedures while the case was on remand to the Tax Court because the court held that the finality provision in accordance with section 6213 was not controlling.

Although Denison provides some authority for allowing the Service to continue with collection procedures after the case is remanded to the Tax Court, there is another Code section which suggests that the finality rules under section 6213 and section 6225 should control once the case is remanded to the Tax Court. I.R.C. section 7481(a)(4) states that Aif the case is remanded by the United States Court of Appeals to the Tax Court for a rehearing... then the decision of the Tax Court rendered upon such rehearing shall become final in the same manner as though no prior decision of the Tax Court has been made.@² Section 7481(a)(4) suggests that the finality rules under section 6213 and section 6225, which prohibit against further assessment and collection pending a final decision in the Tax Court, are in effect once the case is remanded to Tax Court, and the Service should be prohibited from any further collection proceedings on the assessment until the Tax Court decision becomes final.

²The Chief Counsel Directives Manual also states in section (35)(13)14 that Aif the court of appeals remands a case to the Tax Court for a rehearing,... the decision entered as a result of the rehearing will become final in the regular manner as if there had been no prior proceeding.@ (A rehearing encompasses any Tax Court proceeding beyond the mere entry of a decision. CCDM (35)(13)14.)

In the case at issue, an appeal was filed in the test cases for the X partnerships in Year 3. The Service did not begin to assess or collect the deficiency for these test cases until the appeal was filed. The partners of X failed to file appeal bonds for the test cases pursuant to section 7485(a). Therefore, the Service properly began the assessment and collection of the deficiencies for the test cases. Pursuant to section 7486, the Service is not required to abate the assessment and refund the overpayment unless the court of appeals reversed the decision of the Tax Court and disallowed the deficiency. The Court of Appeals did not reverse the Tax Court and disallow the deficiency as required in section 7486. Instead, the Court of Appeals reversed a portion of the Tax Court decision regarding the issue of the extension of the limitation period and remanded for the Tax Court to determine if the six year limitation period applied. Thus, the Service is not required to abate the assessment for Tax Year 2 and Tax Year 3, and the Service is not required to refund any overpayments for those tax years.

However, the finality rules of sections 6225 and 6213 do prohibit the Service from assessing and collecting a deficiency once a case is proceeding in Tax Court until the Tax Court case becomes final. Once the test cases were remanded to Tax Court for a rehearing, the cases proceed in Tax Court as if there was not a prior decision pursuant to section 7481. Therefore, the finality rules apply, and the Service is prohibited from making any further assessment or collection of the deficiency.

The Service is not required to abate the assessment and refund the overpayments to the cases where the partners agreed to be bound to the test cases for Tax Year 2 and Tax Year 3. The parties entered into a stipulation to be bound, and the individual partners in the non-test cases signed a consent form which waived the restrictions to assessment and collection and agreed that the partners in the non-test cases would also be bound by the stipulation agreement. The stipulation agreement states that the only unresolved issue in the case is whether or not the statute of limitations is a bar to the assessment and collection of the deficiencies attributable to the partnership items at issue. The agreement provides that if the test cases were appealed, the partners in the non-test piggyback cases would consent to the assessment and collection of the deficiencies, notwithstanding the restrictions under section 6225. The stipulation agreement also provided that the piggyback cases would be resolved as if they were the same as the partnership in the controlling test cases.

Section 6213(d) provides that a taxpayer may sign a notice to the Service waiving the restrictions to assessment and collections while the case is pending before the Tax Court pursuant to section 6213(a). The Parties may also enter into settlement stipulations before a case is appealed. See Fisher v. Commissioner, T.C. Memo. 1994-434. A settlement stipulation is a contract. Smith v. Commissioner, T.C. Memo. 1991-412; Robbins Tire and Rubber Co. v. Commissioner, 52 T.C. 420 (1969). General principles of contract law are applied in construing a settlement agreement. United States

v. ITT Continental Baking Co., 420 U.S. 223, 238 (1975). A Contract law principles generally direct that we look within the "four corners" of the agreement, unless it is ambiguous as to essential terms. @ Rink v. Commissioner, 100 T.C. 319, 325 (1993).

The stipulation agreement and the consent forms to the stipulation agreement show that the parties waived the restrictions to assessment and collection. The stipulation agreement and the consent forms also show that the parties did not intend to submit a decision in the piggyback cases until a final decision was entered in the controlling case. The agreement does not contain any language requiring the Service to abate the assessment and refund the deficiency prior to the final decision in the controlling case. The decision in the controlling case is not a final decision at this point because the United States Court of Appeals remanded the cases to the Tax Court for a further hearing. Therefore the Service did properly assess and collect the deficiency from the piggyback partners for Tax Year 2 and Tax Year 3, and the Service is not required to abate and refund this assessment until the decision becomes final in the controlling case.

Issue 2:

Section 6402(a) states that in the case of any overpayment, the Secretary, within the applicable period of limitations, may credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment and shall, subject to subsections (c), (d), and (e) refund any balance to such person. Section 6402 permits the Service to credit an overpayment of tax to any other tax then due to the United States. Daugherty v. United States, 1 Cl. Ct. 216, 218 (1983). The Service may also credit any overpayment of tax to an outstanding liability even when the overpayment results from a judicial determination. Heinrich v. United States, 340 F.Supp. 283 (N.D. Ill. 1971).

In the case at issue, the Service collected the assessed deficiency amount for Tax Year 1 while the case was pending on appeal. The United States Court of Appeals ruled that the extension agreements for Tax Year 1, Tax Year 2, and Tax Year 3 were invalid because of the conflict of interest of the TMPs. The Court of Appeals remanded the case to the Tax Court to determine if the six year limitation period would apply to the tax years at issue. However, the partnership income tax return for Tax Year 1 was filed in Date 4, and the FPAAs for all three tax years were not issued until Date 1, which is over six years later. Thus, the Service has conceded that the remand issue does not apply to Tax Year 1, and the Service's assessment was untimely for that tax year and should be abated. Because the assessment was untimely, the collection of the deficiency amount was improper and has resulted in an overpayment for Tax Year 1. This overpayment may be credited to any other internal revenue tax liability of the partners of X pursuant to section 6402(a) before the Service refunds the balance to the partners.

As stated previously, Section 6213 prohibits the Service from assessing or collecting a deficiency amount until the decision in Tax Court becomes final. This would include prohibiting the Service from crediting an overpayment to a deficiency amount that is still pending in Tax Court. The liability determination for Tax Year 2 and Tax Year 3 are still pending a final decision in Tax Court, thus the liability amount is not yet due to the Service. I.R.C. ' 6225. Therefore, the Service is prohibited from continuing to collect the deficiency amount for those tax years, and the Service may not credit the overpayment amount from Tax Year 1 to the deficiency amount for Tax Year 2 and Tax Year 3. See Snyder v. United States, 630 F.Supp. 182, 184 (D.Md. 1986).

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

We recognize that the taxpayers may argue based on equity against the position that Tax Year 2 and Tax Year 3 liabilities should not be abated. In making the stipulation agreement, the parties did not anticipate a remand of these cases. Instead, the taxpayers will argue, the parties only provided for the provision that the Service would refund the collected assessments if the Service did not win on appeal. The taxpayers may argue that they are entitled to a refund of the collected assessment because the Service did not win on appeal. In addition, the taxpayers may argue that the remand involves a new issue, the six year statute of limitations.

However, the stipulation agreement states that the only unresolved issue is whether the statute of limitations is a bar to assessment and collection of the deficiencies. It does not specify the available limitation period. [REDACTED]

[REDACTED] Therefore, this is not a completely new issue now being raised to the taxpayers.

Please call if you have any further questions.

By: _____
 Nancy B. Romano
 Senior Technician Reviewer
 Procedural Branch