

Office of Chief Counsel
Internal Revenue Service
Memorandum

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Via Email & Hand Delivery

date: March 23, 2018

to: Pamela Cardwell
TCO & Exam Fraud Coordinator

from: Maria Cerina De Ramos
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(Small Business/Self-Employed)

subject: Review of Proposed Notice of Deficiency

Taxpayer:
SSN:
Tax Year:
ASED:

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ISSUES

1. Whether the Service may impose the penalty on erroneous claims for refund or credit pursuant to I.R.C. § 6676 when (‘‘taxpayer’’) filed a return claiming a refund of \$ that the Service subsequently froze.
2. Whether and to what extent the Service’s imposition of the section 6676 penalty is subject to deficiency procedures under the circumstances of this case.
3. Whether the Service may impose the 10-year Earned Income Credit (EIC) ban pursuant to I.R.C. § 32(k)(1)(B)(i).

SHORT ANSWERS

1. [REDACTED]
2. [REDACTED]
3. [REDACTED]

FACTS

Taxpayer timely filed her tax return on April 15, , reporting wages of \$, a Schedule C business loss of \$, and federal income tax withholding of \$. Taxpayer also claimed an EIC of \$, additional child tax credit (ACTC) of \$, the American Opportunity Credit (AOC) of \$, and a refund totaling \$. The Service “froze” this refund, so the amount has not been refunded or credited to the taxpayer.

The following summarizes the credits taxpayer claimed on her return and the Service’s disposition of such credits

Amount Claimed on Return	Amount Allowed by IRS	Excessive Amount
Withholding (§ 31) \$	\$	\$
EIC (§ 32) \$	\$	\$
ACTC (§ 24(d)) \$	\$	\$
AOC (§ 25A) \$	\$	\$
Total: \$	\$	\$

During , taxpayer was employed by . reported to the Service that it paid wages of \$ and withheld federal income tax of \$ for taxpayer for . When the Service asked taxpayer to substantiate her wages, she provided a letter signed by her mother, , stating that taxpayer is an event planner/coordinator at the who received wages of \$ and withheld federal tax of \$ while working for .¹ during . After receiving an inquiry from the Service,

¹ The . is a family-owned business, which operates the

explained that her assistant mistakenly used the letterhead instead of the letterhead.

also provided taxpayer's monthly pay statements. The monthly pay statements, however, appear to have been altered. The same typographical and computational errors appear on the statements for , and , and only the and statements reflect federal and state income tax withholding and Social Security withholding. After the reviewing the documents from , the Service sent another request to the . requesting documents, such as direct deposits or cancelled checks, substantiating the payments to taxpayer. The Service's request was returned as "unclaimed/unable to forward" and the . did not provide additional documents or information.

ANALYSIS & RECOMMENDATIONS

Applicable Penalties

The facts of this case implicate the section 6662 accuracy-related penalty, the amendment to section 6664(a) (defining "underpayment") by section 209(a) of the PATH Act, the penalty imposed by section 6676 on excessive claims for refund or credit, and the Service's treatment of frozen refunds in administering the accuracy-related and civil fraud penalties.

In Rand v. Commissioner, 141 T.C. 376 (2013), the Service argued that disallowed refundable credits claimed by the taxpayers should be taken into account when determining the tax shown on the return and that the resulting tax shown on the return could be a negative amount. The court agreed that disallowed refundable credits must be taken into account when determining the tax shown on the return, but held that disallowed refundable credits cannot reduce the tax shown on the return below zero. This resulted in only a limited accuracy-related penalty when a taxpayer's inaccurate return consisted of an overstated refundable tax credit and claim for refund.

Section 209(a) of the PATH Act amended section 6664(a) of the Code to provide that "a rule similar to the rule of section 6211(b)(4) shall apply for purposes of this subsection."² Under section 6664 as amended, disallowed refundable credits must be taken into account when determining the tax shown on the return and can reduce the tax shown on the return below zero for purposes of calculating the underpayment subject to penalty under section 6662 or 6663. Section 209(d)(1) of the PATH Act

² Section 6211(b)(4) provides that certain refundable and partially refundable tax credits, including the AOC, EIC, and ACTC, are included as negative tax in a deficiency calculation when claimed in excess of tax shown on the taxpayer's return.

provides that the amendment is effective for all returns filed after December 18, 2015, and all returns filed on or before December 18, 2015, for which the period of limitations under section 6501 had not expired as of that date.

The amended definition of the section 6664 “underpayment” under section 209(a) of the PATH act applies here because the section 6501 limitations period on assessment for the taxpayer’s return had not expired as of December 18, 2015. Consequently, the portion of the taxpayer’s disallowed refund claim based on the EIC and ACTC constitutes an underpayment that could be subject to a penalty under section 6662. Overstated withholding tax is provided for in section 1.6664-2(c)(1)(i) and (ii) and reduces the “amount shown as the tax by the taxpayer on his return”. Such overstated withholding tax increases an underpayment and may be subjected to an accuracy-related penalty or civil fraud penalty. Snow v. Commissioner, 141 T.C. No. 6 (2013); Feller v. Commissioner, 135 T.C. 497 (2010).

The Service has adopted the practice of treating the amount of a frozen refund as a sum collected without assessment for purposes of calculating a section 6664 underpayment, with the result, in many cases, that there is no underpayment and therefore no penalty under section 6662 or 6663. See. Treas. Reg. § 1.6664-2(d) (amounts not shown previously assessed and amounts collected without assessment); and IRM 20.1.5.16(7). In this case, while the taxpayer overstated refundable credits on her return, under the Service’s practice in the treatment of frozen refunds no accuracy-related or civil fraud penalty applies because the Service never paid a refund. However, the excessive amount of the refund claim may be subject to penalty under section 6676.

Section 6676 imposes a penalty on any claim for refund or credit of income tax (other than a claim for a refund or credit relating to the earned income credit under section 32) that is excessive in amount and lacks a reasonable basis for the claim.³ The penalty is equal to 20 percent of the excessive amount of the claim, and section 6676(b) provides that the excessive amount is the disallowable portion of the claim for refund or credit.

The section 6676 penalty does not apply to any portion of a claim to which the accuracy-related penalty on underpayments under section 6662 or the fraud penalty under section 6663 applies. I.R.C. § 6676(d). [REDACTED]

³ For claims filed before December 18, 2015, the section 6676 penalty may not be imposed on the excessive portion of claim for refund or credit relating to the EIC. For claims filed after December 18, 2015, the section 6676 penalty can be imposed on the excessive portion of the claim for refund or credit relating to the EIC. In addition, a “reasonable basis” standard applies to claims filed before December 18, 2015. For claims filed after December 18, 2015, a “reasonable cause” standard applies. See PATH Act, Pub. L. 114-113 Div. Q, section 209 (2015).



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Assessment Procedure for section 6676 Penalty


The rules of application for assessable penalties under subchapter B of Chapter 68, which includes the penalty for excessive refund claims under section 6676, reads in part that “[t]he penalties and liabilities provided by this subchapter shall be paid upon notice and demand by the Secretary and shall be assessed and collected in the same manner as taxes.” I.R.C. § 6671(a) (emphasis added). In Smith v. Commissioner, 133 T.C. 424, 428-29 (2009), the Tax Court opined on the Court’s jurisdiction to review the assessable penalty for failure to report involvement in a listed transaction as follows:

. . . . We concluded that section 6707A penalties are not included in the statutory definition of “deficiency.” See secs. 6671, 6211. Section 6707A penalties do not depend upon a deficiency. They may be assessed even if there is an overpayment.

Smith, 133 T.C. at 429.

Our office interprets section 6671 and Smith to mean, generally, that when a penalty is dependent upon an underlying deficiency determination, such penalty must be assessed under the deficiency procedures. By contrast, section 6676 penalties are generally assessable without deficiency procedures when an excessive amount of a claim for credit or refund arises from an item or transaction other than an erroneous refundable credit. I.R.M. § 20.1.5.16.5(2).

An overstatement of tax withheld at the source falls outside of the deficiency definition and may be immediately assessed pursuant to section 6201(a)(3).⁵ 



⁴ Taxpayer is entitled to claim the AOC of \$.

⁵ The Tax Court has no jurisdiction over an assessment of an overstatement of withheld taxes. Samuel & Bernice Boone Trust v. Commissioner, T.C. Memo. 2000-350.

[REDACTED] I.R.M.

§ 20.1.5.16(8); see I.R.M § 20.1.5.16.5(2).

10-Year EIC Ban

If a taxpayer fraudulently claimed the EIC in prior years, then the Service can disallow the credit for a period of 10 taxable years after the most recent taxable year for which there was a final determination that the taxpayer's claim for the EIC was due to fraud. I.R.C. § 32(k)(1)(B)(i).

[REDACTED]

[REDACTED]

Please call Maria De Ramos at (512) 499-5440 if you have any further questions.

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By: _____
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Enclosure (1)
Administrative File