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MEMORANDUM FOR JOSEPH G. KEHOE SBSE
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FROM: Stuart Spielman CC:PA:APJP:B3
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SUBJECT: Suspension of Interest After Reconsiderations

This Significant Service Center Advice responds to your memorandum dated October 2, 2002, in connection with questions posed by the Brookhaven IRS Campus. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

ISSUES

1. The Service has encountered situations where a taxpayer will report self-employment income and related income and self-employment tax liabilities, even though the taxpayer did not actually have any self-employment income. Taxpayers have reported this self-employment income in order to support an unjustified claim for earned income tax credit (EITC) under I.R.C. § 32 in excess of the reported tax liabilities. In such cases, the Service will often issue a notice of deficiency that disallows the EITC. The Service bases its determination of a deficiency on a lack of

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substantiation that the taxpayer actually had self-employment income sufficient to support the claim for EITC. After the taxpayer fails to timely petition the notice of deficiency, the taxpayer will sometimes ask the Service to reconsider its claim for EITC. To support its request, the taxpayer provides substantiation that the taxpayer did, in fact, have self-employment income that gives rise to income and self-employment tax liabilities. The Service, however, determines that despite the substantiated self-employment income, the taxpayer still does not qualify for the EITC because the taxpayer fails some other EITC eligibility criterion. The Service then issues a second notice of deficiency for the tax attributable to the now substantiated self-employment income. You have asked whether section 6404(g) requires the Service to suspend the application of underpayment interest to this later determination of deficiency.

2. Does the answer to the first question change if the taxpayer waives the restrictions on making a second assessment?
3. Does the answer to the first question change if the Service determines that the taxpayer's income exceeded what he reported on his income tax return?

CONCLUSIONS

1. Section 6404(g) applies with respect to the tax liability as reported on the original return. If a new item or adjustment ties specifically to the original return, notice must be issued within the applicable statutory period or interest with respect to the item or adjustment must be suspended. In the cases described above, the initial notice timely advised the taxpayer, for purposes of section 6404(g), of the outstanding liability and the basis therefore (i.e., no qualifying earned income for purposes of EITC), given the information available to the Service and provided that the Service has attempted to get information from all applicable sources. The Service is not required to issue a second notice under these circumstances. However, a second notice should be issued disclosing the adjusted liability and basis provided that the first notice was not petitioned.
2. The timing of the assessment of the liability is irrelevant for purposes of section 6404(g) notice requirements. As such, the waiver of restrictions thereon would not affect the necessity for notice within the statutory period.
3. Any alteration of the amount of liability listed in the first notice of deficiency requires the issuance of a second notice of deficiency within the statutory period to avoid the suspension of related penalties and interest.

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LAW AND ANALYSIS

Issue 1:

Congress instituted section 6404(g) to address concerns that taxpayers were incurring large amounts of penalties and interest in circumstances where they had not received notice of any underpayment. H.R. Conf. Rep. No. 599, 105th Cong., 2d Sess. 259 (1998), 1998-3 C.B. 1013; S. Rep. No. 174, 105th Cong., 2d Sess. 64 (1998), 1998-3 C.B. 600. Section 6404(g) references the original return only, using the filing date of the original return as the trigger date for the notice timeline. Of course, it is important that a taxpayer be continually apprised of changes to his or her liability and the basis thereof in successive notices within the statutory period. However, there is no continuing notice obligation beyond items tied to the original return.

It is assumed that, in the given fact pattern, the examination was thorough, that information was sought by the Service from all relevant sources, and that the taxpayer did not provide information within his control. There are minimum examination requirements set out within the IRM, e.g., sections 4.10.4.3, 4.10.4.3.2, and 4.10.4.4.2, which, if complied with, help guarantee that the Service has met its notice requirements under section 6404(g) with the initial notice, as well as supporting the contention that such determinations are not arbitrary or capricious.

As such, once a proper notice has been issued with regard to the original return appraising the taxpayer of his or her liability, Congress' policy goals will have been met. If the Service erred in failing to uncover a new item or adjustment by failing to meet its examination requirements,¹ that information should be treated as having been disclosed on the original return, and the relevant interest should be suspended. However, if the new item or adjustment is not the result of incomplete research by the Service during the original examination, could not have been otherwise discovered by the Service, and arises only after the 6404(g) notice deadline, such issue is treated similarly to an amendment to the original return, and is treated separately for purposes of 6404(g) suspension.

Issue 2:

Congress has not provided for an exception to the notice requirement where the taxpayer signs a waiver of the restrictions on assessment. The notice requirement of section 6404(g) and the resultant suspension of interest and penalties apply without regard to assessment and are primarily applicable prior to the time assessment is

¹Per I.R.C. § 6404(g)(1)(b), the suspension applies "separately with respect to each item or adjustment."

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contemplated. A waiver of the restrictions would also not qualify as a “self-assessment” for purposes of the exception under section 6404(g)(2)(C).

Issue 3:

Any items specifically shown on the return as provided by the taxpayer are exempt from the suspension and notice requirements. See I.R.C. § 6404(g)(2)(C). However, if the Service redetermines those values provided by the taxpayer, the Service must issue notice within the statutory period for the altered value. For example, if the taxpayer reports \$100 of income but the Service determines the income amount to be \$120, the Service must provide notice to the taxpayer regarding the additional \$20 of income and the corresponding tax liability within the statutory period or interest and penalties on the additional amount will be suspended. Section 6404(g) is “applied separately with regard to each item or adjustment.” I.R.C. § 6404(g)(1)(B).

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Please call if you have any further questions.