

Office of Chief Counsel
Internal Revenue Service

Released 6/18/98
SCA 1998-016

memorandum

CC:DOM:IT&A:3
CAProhofsky - TL-N-4798-97

date: NOV 17 1997

to: Associate District Counsel, Salt Lake City
CC:WR:RMD:SLC

from: Assistant Chief Counsel (Income Tax & Accounting)
CC:DOM:IT&A

subject: Significant Service Center Advice
Issues Arising from 1996 Legislation

Disclosure Statement

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This responds to your request for Significant Advice dated August 14, 1997. The questions addressed in this memorandum were received by your office from personnel at the Ogden Service Center in connection with their viewing of the National CLE on Service Center Issues. The questions concern the interpretation of legislation enacted in 1996; the Small Business Job Protection Act, P.L. 104-188 (Small Business Act), and the Personal Responsibility and Work Opportunity Reconciliation Act, P.L. 104-193 (Personal Responsibility Act) (referred to collectively as "the 1996 legislation").

I. ALLOWANCE OF INTEREST

Issue

Is a return that omits certain taxpayer identification numbers (TINs) relating to the earned income credit or the dependency exemption filed in processible form for the purposes of § 6611(h) of the Code? Specifically, if a return does not contain TINs for either the taxpayer, the taxpayer's spouse, the taxpayer's qualifying child, or the taxpayer's dependent is the return filed in processible form under § 6611(h)?

Conclusion

A return that omits the TIN of a qualifying child or a dependent, but is otherwise complete, is filed in processible form. However, a joint return that omits the TIN of either spouse is not filed in processible form.

Discussion

In pertinent part, § 6611(h) states that a return is filed in processible form if it is filed on a permitted form and the return contains (1) the taxpayer's name, address, and identifying number, and the required signature, and (2) sufficient required information (whether on the return or on required attachments) to permit the mathematical verification of tax liability shown on the return. A return that omits the identification number of a qualifying child or a dependent, but is otherwise complete, is filed in processible form. The qualifying child or dependent is not the taxpayer for the return and the tax liability on the return can be mathematically verified without the identification number of the dependent or qualifying child. The same is true for the identification number of a spouse on a return that is not a joint return under § 6013.

However, a return that does not contain the TIN of the taxpayer is not filed in processible form under § 6611(h). For a joint return, the taxpayer is both the husband and the wife. Accordingly, a joint return that omits the identification number of either spouse is not filed in processible form.

II. APPLICATION TO PRIOR YEARSIssue

Does the Service's authority to treat as a math error the omission of a correct TIN, when the taxpayer is claiming the EIC, apply to situations in which:

- 1) a taxpayer files a 1995 or prior year return in 1997, or
- 2) a taxpayer previously (before 1997) filed a 1995 or prior year return and the Service has not yet released the earned income credit?

Conclusion

No, calendar-year 1995 returns are not affected by the new math error authority, even if the returns' due dates were extended. Likewise, delinquent returns from earlier years are not affected; nor are amended returns for earlier years.

Discussion

Section 6213(b) of the Internal Revenue Code provides that the Service may summarily assess additional tax due as a result of a mathematical or clerical error without sending the taxpayer a notice of deficiency and without giving the taxpayer an opportunity to petition the Tax Court. The assessment must be abated at the taxpayer's request.

The term "mathematical or clerical error" is defined in § 6213(g). The 1996 legislation added several items to the definition of a math error. The definition of a math error now includes an omission of a correct TIN required under § 21 (relating to expenses for household and dependent care services necessary for gainful employment) or § 151 (relating to allowance of deductions for personal exemptions). § 6213(g)(2)(H); Small Business Act § 1615. "Math error" also includes an omission of a correct TIN required under § 32 (relating to the earned income credit). § 6213(g)(2)(F); Personal Responsibility Act § 451.

Section 1615 of the Small Business Act and § 451 of the Personal Responsibility Act contain the same language regarding effective dates. They provide:

The amendments made by this section shall apply with respect to returns the due date for which (without regard to extensions) is on or after the 30th day after the date of the enactment of this Act.

The Small Business Act was enacted August 20, 1996. The Personal Responsibility Act was enacted August 22, 1996.

This means that the omission of a correct TIN required for personal exemptions or the dependent care credit is a math error only for returns that were originally due on or after September 19, 1996. Extensions are not considered. For calendar-year taxpayers, 1996 tax returns will be the first returns due on or after September 19, 1996. Thus, the omission of TINs required by § 21 or 151 from returns for taxable years before 1996 will not be a math error.

If a return from a pre-1996 year is filed late or is amended in 1997 or later, the new math error authority still does not apply. The effective date is written with regard to the original due date of the return, not with regard to when the return is actually filed or amended.

Similarly, the omission of a correct TIN required for the earned income credit is a math error only for returns that were originally due on or after September 21, 1996, such as calendar-year 1996 returns.

You also forwarded instructions that the Service Center received on how to process returns with TIN problems. They state that if a return was filed before 1997 without a valid TIN, and the taxpayer now corresponds submitting a valid SSN or ITIN, the taxpayer is entitled to the prior year refund (even if the earned income credit was claimed). We agree with this conclusion. We note that this is also accurate for 1996 or later year returns. If the taxpayer did not have a valid TIN at the time the 1996 return was filed, but the taxpayer later receives a TIN, the taxpayer can submit the TIN and receive the earned income credit. The taxpayer can correct or supplement the information at any time that a claim for refund would otherwise be timely.

III. CALCULATION OF THE EARNED INCOME CREDIT

Issue

Is the calculation of the earned income tax credit (EITC) in the CLE materials correct?

Conclusion

No, the calculation of the EITC in the materials is not correct.

Discussion

The CLE materials contained the following example intended to demonstrate the application of the mathematical error provisions of § 6213(g) as enacted by the 1996 legislation:

A taxpayer with two qualifying children reports \$9,000 self-employment income on his return. No other income is reported, and the taxable income is zero.

EITC on the return was computed on \$9,000 earned income, and amounted to \$3,556.

SE tax on \$9,000 is $\$9,000 \times .9235 \times .153 = 1,272$. According to limit (A), EITC may be reduced by only \$1,272, the amount of the unreported SE tax. (According to the CLE materials, the action to be taken by the Service is to allow the \$3,556 EITC amount, and assess \$1,272 SE tax, resulting in a net decrease in the taxpayer's refund of \$1,272.)

Section 32(a) of the Internal Revenue Code allows a credit against tax in an amount equal to the credit percentage of the taxpayer's earned income. Earned income is defined by § 32(c)(2)(A)(ii) to include net earnings from self-employment within the meaning of § 1402(a) and "determined with regard to

the deduction allowed to the taxpayer by § 164(f)." Net earnings from self employment is defined by § 1402(a) as gross income derived by an individual from any trade or business carried on by that individual, less certain trade or business expenses, and various other exclusions described in § 1402(a). Among those exclusions, § 1402(a)(12) requires a deduction, in lieu of the deduction allowed by § 164(f), equal to the product of net earnings from self employment (determined without regard to § 1402(a)(12)) and one half of the rates imposed by sections 1401(a) and (b). (As described by § 1401, self-employment tax consists of old-age, survivors, and disability insurance tax imposed under § 1401(a) equal to 12.4 percent, and hospital insurance tax imposed under § 1401(b) of 2.9 percent.) A deduction is allowed by § 164(f) in the amount of one half of the self-employment tax for the taxable year.

There are two omissions in the example included in the CLE materials. Specifically, the example does not compute earned income on the basis of net earnings from self employment, and it does not take into account the deduction for one half of the self-employment tax. Therefore, the example incorrectly describes the EITC computation for taxpayers with income from self-employment. Consequently, the EITC is incorrect. This affects the calculation designed to illustrate the mathematical error provisions of § 6213(g)(2)(G), because the EITC is a smaller amount resulting in a reduced amount remaining after the reduction of the EITC by the unpaid self-employment tax.

The following is a description of how the EITC should have been calculated in the example. The taxpayer has \$9,000 of self-employment income. First, the taxpayer's earned income for EITC purposes must be calculated. To determine the amount of earned income, the taxpayer's net earnings from self employment must be computed. Net earnings from self employment are \$9,000, reduced by $\$9,000 \times .0765$ (this is one half of 12.40 percent and 2.90 percent under § 1402(a)(12)), or \$688.50. Thus, \$9,000 less \$688.50 is \$8,311.50, which is the taxpayer's net earnings from self employment. Pursuant to § 32(c)(2)(A)(ii) this amount is then reduced by one half of the self-employment tax. The self-employment tax described by § 1401 is 15.3 percent. Thus, $\$8,311.50 \times 15.3$ percent is \$1,272, and one half of this amount is \$636. Therefore, earned income in this example is \$8,311.50 less \$636, or \$7,675.50. The EITC is then computed based on earned income of \$7,675.50. The EITC for an individual with earned income of \$7,675.50 and two qualifying children is \$3,070.

The incorrect description of the EITC computation in the CLE materials was an oversight, and the EITC should have been computed in the above-described manner to take into account the correct computation of net earnings from self employment and the deduction allowed by § 164(f). If computed in this manner, there

