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INTERNAL REVENUE SERVICE
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MEMORANDUM FOR ASSOCIATE AREA COUNSEL BROOKLYN CC:SB:1:BRK
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SUBJECT: IRM Procedural Update 00230

This provides further guidance on IRM Procedural Update 00230, which we initially addressed in our memorandum dated July 20, 2001. In accordance with I.R.C. § 6110(k)(3), it should not be cited as precedent.

The prior service center advice concluded that the execution of a return under I.R.C. § 6020(b) does not start the period of limitations for assessment and collection, as provided under I.R.C. § 6501(b)(3). The service center advice also stated that the 10-year collection statute under I.R.C. § 6502 does not affect the clear rule in section 6501(b)(3). Because field offices subsequently raised several additional assessment issues relating to the first advice, we coordinated these questions with Branch 2 of the Administrative Provisions and Judicial Practice Division ("APJP"), which has jurisdiction in this area, and incorporated their answers in the following discussion.

Issues

1. Whether a substitute for return (SFR) relating to an income tax liability is a return under section 6020(b)?
2. Whether section 6501(b)(3) prohibits the Service from making an assessment after the taxpayer defaults on a statutory notice of deficiency related to a 6020(b) return?
3. When a taxpayer files a return showing a lower tax liability than the liability assessed from a SFR, whether the Service may reduce the SFR assessment to

make it equal to the amount of tax shown on taxpayer's return or abate the entire SFR assessment and reassess the lower liability from taxpayer's return?
Whether section 6501(b)(3) affects the collection statute under section 6502?

5. Given that the Service has already assessed the taxpayer's liability under the deficiency procedures and that the Service does not abate such an assessment and make a new assessment when it reduces the tax liability pursuant to a late-filed return, is IRM Procedural Update 00230 correct in requiring that the collection statute expiration date ("CSED") be adjusted so that the 10-year collection period runs from the adjustment input date of the taxpayer's late filed return?

Conclusions

1. An SFR meets the requirements of a section 6020(b) return.
2. Section 6501(b)(3) does not prohibit the Service from making an assessment of the amount of tax owed on a section 6020(b) return. Execution of a section 6020(b) return, however, does not allow the Service to avoid following deficiency procedures to assess income tax.
3. The Service currently reduces the amount of the SFR assessment to make it equal to the amount of tax shown on taxpayer's return. The Service does not abate the assessment and make a new assessment.
4. Section 6501(b)(3) does not affect the collection statute under section 6502; section 6501(b)(3) relates only to the statute of limitations within section 6501.
5. IRM Procedural Update 00230 is incorrect in requiring that the CSED be adjusted so that the 10-year collection period runs from the adjustment input date of the taxpayer's late filed return. Section 6502 requires that the 10-year collection period run from the assessment date. The only assessment date in this situation relates to the deficiency assessment; the Service did not make an assessment when the taxpayer late filed his return. Accordingly, the CSED calculated from the deficiency assessment should not be changed.

Background

The problem arises in the following situation. After the taxpayer fails to file a timely income tax return, the Service executes a section 6020(b) return and issues the taxpayer a notice of deficiency. When the taxpayer defaults, the Service then makes a deficiency assessment. Subsequently, the taxpayer files a late return showing a liability smaller than the assessed liability. The Service then reduces the assessed deficiency to the amount shown on the late return. When the Service reduces the taxpayer's liability, IRM Procedural Update 00230 instructs employees to input a TC 550 extending

the CSED, i.e., the TC 550 will reset the 10-year collection period to begin from the time the taxpayer filed his late return. (As discussed below, the Service does not abate the deficiency assessment and make a new assessment based on the taxpayer's late return.)

Discussion

Substitute for Return and 6020(b) Return

Section 6020(b)(1) of the Code 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. Section 6020(b)(2) of the Code provides that a return prepared under the authority of section 6020(b) is prima facie valid for all legal purposes.

Under the authority of section 6020(b), the Service prepares income tax returns for individuals who fail to file returns or who file fraudulent returns. The Service prepares these returns using manual procedures and automated procedures referred to as substitute for return (SFR) procedures. Under SFR procedures, the Service establishes a taxpayer account on a computer system with the use of dummy return, enters a Transaction Code (TC) of 150, and prepares and mails a thirty-day letter to the taxpayer. Attached to the thirty-day letter is an explanation of proposed adjustments, as well as a tax calculation summary report. The information used to compute the tax is gathered from past filings and/or third party information returns. The thirty-day letter is signed by an employee with the proper delegated authority. If the taxpayer fails to respond to the thirty-day letter, the Service mails a statutory notice of deficiency to the taxpayer with the same explanation of adjustments and tax calculation summary report that was attached to the thirty-day letter.

A return prepared by the Service pursuant to section 6020(b) of the Code must meet three requirements. First, the return must contain taxpayer identifying information, including the taxpayer's name, address, and social security number. Second, the return must contain sufficient data to compute the taxpayer's liability. Third, the Secretary or his delegate must sign the return. See Millsap v. Commissioner, 91 T.C. 926 (1988), acq. in result in part, 1991-2 C.B. 1. In Millsap, the court concluded that an SFR, i.e., the dummy return along with the revenue agent report (which is generally attached to the thirty-day letter), meets the requirements of a return prepared by the Service under section 6020(b). First, the taxpayer's name, address, and social security number appear on the dummy return, 30-day letter, and revenue agent report. Second, the 30-day letter along with the revenue agent report or other attachments, contain sufficient information to compute the taxpayer's liability. Third, the proper Service employee authorizes the execution and signs the SFR documents. We agree with the court's conclusion.

Assessment of 6020(b) Return

In general, where a taxpayer has not filed its own return, the Service must follow deficiency procedures to assess income tax, while assessment of employment tax does not require deficiency procedures. I.R.C. §§ 6511 and 6512 provide for the deficiency procedures. As previously stated, the SFR process includes producing a 6020(b) return and then completing the deficiency procedures for income tax returns.

Section 6501(b)(3) provides that the execution of a section 6020(b) return will not start the running of the period of limitations on assessment and collection. We see nothing in section 6501(b)(3) that prohibits assessment when the Service prepares an SFR. Thus, the Service is correctly assessing income tax shown on a section 6020(b) return after completing the deficiency procedures.

Taxpayer's Return After 6020(b) Return Assessment

When a taxpayer files a return after the Service has made an assessment on a section 6020(b) return and the Service determines that taxpayer's return is correct, the Service abates a portion of the 6020(b) deficiency assessment to make it equal to the amount of tax shown on taxpayer's return; a new assessment is not made. See IRM 4.3.6, Audit Reconsideration Handbook and IRM 4.13.5, Audit Reconsideration for Automated Substitute for Return.

Section 6501(b)(3)'s Effect on Collection Statute of Limitations Under Section 6502

We do not believe that section 6501(b)(3) has an effect on the collection statute of limitations set forth in section 6502. As previously stated, section 6501(b)(3) provides that the execution of a section 6020(b) return shall not start the running of the period of limitations on assessment and collection. We believe that the term "collection" in section 6501 refers to a proceeding in court for the collection of tax without assessment. Without the provision of section 6501(b)(3), section 6501(a) would require that any collection via a proceeding in court without assessment begin within three years after the filing of a 6020(b) return. The execution of a section 6020(b) return does not affect the running of the limitations period after assessment, however, because the running of that period is not tied to the execution of any return. Instead, the trigger for the running of the limitations period under section 6502 is the assessment of tax. Because the execution or filing of a return is not the equivalent of assessment, there is no reason why the execution or filing of a section 6020(b) return should affect the running of the limitations period under section 6502.

United States v. Updike, 281 U.S. 489 (1930), clarifies that section 6501(b)(3) does not affect the collection statute in section 6502. The Court in Updike, ruled that once the Service assessed a liability against a taxpayer, where the taxpayer did not file a return, the six-year (now ten-year) statute of limitations on collection began. The Court stated, "[w]here, in a 'no return' case, an assessment, which under paragraph (a), may be made at any time, has in fact been made, proceeding to collect must be begun within six years thereafter; but where there has been no assessment, the proceeding may be begun at any time." Thus, the exception listed in section 6501(b)(3), in reference to

collection, applies only to the statute of limitations as provided in section 6501(a) for the collection of tax before an assessment is made. The collection statute in section 6502 is ten years from the date of any assessment; it does not matter that the assessment is related to a section 6020(b) return.

Section 6502

Section 6502(a) provides that the CSED is calculated from the assessment of the tax. See generally 15 Mertens Law of Federal Income Tax § 57:77 (2001). Apparently, IRM Procedural Update 00230 incorrectly assumed that the Service made an assessment based on the taxpayer's late return, which reduced the amount previously assessed. As discussed above, the Service does not make an assessment in this situation. Consequently, in this situation, a new CSED should not be calculated based on the taxpayer's late return showing a reduced tax liability.

If you have any questions or concerns regarding the assessment issues (issues one through four), please contact Branch 2 of APJP at 202-622-4940. If you have any questions or concerns regarding the period for collection (issue five), please contact Walter Ryan at 202-622-3610.