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Memorandum

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date: February 16, 2005

to: Director, Area 15

Attn: Joni Troncoso, Program Manager (SBSE)

from: Deputy Associate Chief Counsel (International)

subject: IRC § 932(c) and the statute of limitations on assessment

This responds to your request for our views on an issue involving I.R.C. §§ 932(c) and 6501.

ISSUE

Whether the statute of limitations under I.R.C. § 6501(a) is open with respect to a taxpayer who is a U.S. citizen, who timely files an income tax return with the U.S. Virgin Islands ("USVI"), but who fails to meet a requirement of section 932(c)(4)?

CONCLUSION

Section 932(c) imposes a dual filing regime on a U.S. citizen. If such individual claims to be a bona fide resident of the USVI but fails to meet a condition in section 932(c)(4), he or she must file a Form 1040 with the IRS. A taxpayer who is required to file a federal income tax return is subject to the generally applicable rules of the Code and regulations regarding the filing of returns and payment of tax, and the statute of limitations on assessment in section 6501(a) does not begin to run until a return is filed with the IRS.

FACTS

The taxpayer is a U.S. citizen who claims to be a bona fide resident of the USVI for the relevant taxable year. Taxpayer files a USVI income tax return for that year but does not meet one or more of the requirements in section 932(c)(4).

DISCUSSION

With certain exceptions, every individual having gross income for the taxable year that equals or exceeds the exemption amount is required to file a federal income tax return with the IRS. I.R.C. §§ 6011 and 6012(a). Section 1.6012-1(a)(1) of the Treasury Regulations provides that the term “individual” encompasses all residents or citizens of the United States. If such individual files the required return, under the general rule of Section 6501(a), any tax imposed with respect to that return is required to be assessed within 3 years after the return was filed. If a U.S. federal income tax return is required and not filed, an exception under section 6501(c)(3) applies, and the tax may be assessed at any time. For purposes of this chapter, the term “return” means the return required to be filed by the taxpayer rather than any party reporting on payments to the taxpayer. I.R.C. § 6501(a). Unless specifically excluded by Subtitle A of the Code, gross income means income from whatever source derived. I.R.C. § 61(a). Accordingly, absent proof that he satisfies any specific exceptions from these general rules, a US citizen or resident must file a US federal income tax return. The limitations period of section 6501 will not begin to run until such a return is filed.

For US citizens or residents claiming a bona fide residence in the USVI, section 932 provides an additional filing requirement as well as an exclusion from gross income resulting in an exception to the general filing requirements. Section 932(c)(4) provides such exclusion from gross income:

- (4) RESIDENTS OF THE VIRGIN ISLANDS.- In the case of an individual-
 - (A) who is a bona fide resident of the Virgin Islands at the close of the taxable year,
 - (B) who, on his return of income tax to the Virgin Islands, reports income from all sources and identifies the source of each item shown on such return, and
 - (C) who fully pays his tax liability referred to in section 934(a) to the Virgin Islands with respect to such income,for purposes of calculating income tax liability to the United States, gross income shall not include any amount included in gross income on such return, and allocable deductions and credits shall not be taken into account.

An individual described in section 932(c)(4) may exclude the income described in that section from his or her U.S. gross income and may thereby be relieved of his obligation under section 6012 to file a U.S. federal income tax return.

However, if a taxpayer fails any of the requirements, he or she must file a U.S. federal income tax return; and prior to filing such return, the statute of limitations on assessment in section 6501(a) does not begin to run. For example, if an individual is not a bona fide resident of the USVI and is otherwise required to file a U.S. federal income tax return, that person must file a U.S. federal income tax return under the generally applicable filing requirements of the Code and regulations to begin the statute of limitations on assessment. Similarly, a bona fide resident of the USVI who fails to pay his or her full tax liability to the USVI as required by section 932(c)(4)(C) is not relieved of the requirement to file a U.S. federal income tax return, and must file to start the statute of limitations on assessment.

This interpretation is supported by a clarifying amendment to section 932(c)(2) in the Technical and Miscellaneous Revenue Act of 1988, P.L. 100-647, § 1012(w)(3), effective as if included in the Tax Reform Act of 1986, P.L. 99-514 (Oct. 22, 1986). Prior to this amendment, section 932(c)(2) was as follows:

FILING REQUIREMENT.- Each individual to whom this subsection applies for the taxable year shall file his income tax return for the taxable year with the Virgin Islands. [Underlining added.]

After the amendment made by P.L. 100-647, section 932(c)(2) is as follows:

FILING REQUIREMENT.- Each individual to whom this subsection applies for the taxable year shall file an income tax return for the taxable year with the Virgin Islands. [Underlining added.]

The legislative history of this amendment states that the change

makes it clear that such an individual [a bona fide resident of the USVI] is to file “an” income tax return with the Virgin Islands, rather than filing “his” return with the Virgin Islands, to make it clear that individuals who do not comply with all requirements for U.S. tax exemption will have to file a U.S. return.

See H.R. Rep. No. 100-795, 100th Cong., 2d Sess. 299 (July 26, 1988). See also S. Rep. No. 100-445, 100th Cong., 2d Sess. 315 (Aug. 3, 1988). Thus, the statutory change clarifies that an individual taxpayer who does not meet the prerequisites of section 932(c)(4) is required to file a U.S. federal income tax return.

There are no cases that interpret the filing requirements of section 932. Condor International, Inc. v. Commissioner, 78 F.3d 1355 (9th Cir. 1996), aff’g in part and rev’g in part 98 T.C. 203 (1992), however, involves a collection effort by the United States, and the year in issue is one to which the amendments made by the Tax Reform Act of 1986 do apply. In Condor, the court stated that the effect of the 1986 Act was to require the taxpayer to file a return with the United States, and that the filing of a return with the USVI did not start the statute of limitations for U.S. federal income tax purposes.

Condor, 78 F.3d at 1358. Accordingly, the court held that a return filed with the USVI on August 14, 1984, did not make an IRS notice of deficiency dated September 8, 1987, untimely. Id. at 1359. Because section 932(c)(4) requires a taxpayer to file a U.S. federal income tax return unless certain requirements are met (just as the 1986 Act obligated the taxpayer in Condor to file a U.S. federal income tax return), the principles of Condor apply and the filing of a return with the USVI does not start the statute of limitations for U.S. federal income tax purposes.

It is our view that the issues with respect to the statute of limitations on assessment in Danbury, Inc. v. Anthony Olive, Director, BIR, 820 F.2d 618 (3d Cir. 1987), cert. denied 484 U.S. 964 (1987), and Bizcap v. Olive, 892 F.2d 1163 (3d Cir. 1989), cert denied 496 U.S. 905 (1990), are distinguishable from the issue under discussion. Both Danbury, Inc. and Bizcap involve collection efforts by the USVI and years to which the amendments made by the Tax Reform Act of 1986 do not apply.

In summary, it is our view that section 932(c) imposes a dual filing requirement on individual taxpayers who do not meet all of the conditions of section 932(c)(4). If a taxpayer has an obligation to file a federal income tax return the taxpayer is subject to the generally applicable rules of the Code and regulations regarding the filing of returns and payment of tax, and the statute of limitations on assessment in section 6501(a) does not begin to run until a return is filed with the IRS.

BENEDETTA A. KISSEL
Deputy Associate Chief Counsel
(Strategic Programs)