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Subject: FW: abatement of unpaid 706 or 709 tax (setoff issue)

we agree with the RA's that the unassessed portion of a delinquency penalty may be taken into account before determining the amount of an estate tax overpayment even though the period of limitations for assessment of the penalty has expired.

The RA cites to Fisher v. U.S., 80 F.3d 1576, 1581 (Fed. Cir. 1996), where the taxpayer claimed a refund based on an income tax adjustment and the Service applied a time barred interest adjustment to determine if the taxpayer had in fact overpaid income tax for the year at issue. The Federal Circuit held for the government. The court noted that while it found no reported case allowing the government to offset a tax liability with interest, the offset principal in Lewis v. Reynolds, 284 U.S. 281, 283 (1932) does not simply offset like item against like item (i.e., tax against tax, penalty against penalty, and interest against interest) but allows a redetermination of the entire tax liability for the year at issue. Fisher recites a statement from Allen v. U.S., 51 F.3d 1012, 1015 (11th Cir. 1995) that "Lewis sweeps broadly to permit redetermination of the entire tax liability by retaining any tax payment 'which might have been properly assessed and demanded.' Lewis, 284 U.S. at 283." And Fisher shows that tax liability includes underpayment interest by referencing IRC 6601(e)(1) ("Interest prescribed under this section on any tax shall be paid upon notice and demand, and shall be assessed, collected, and paid in the same manner as taxes.")

A case submitted by the confirms the application of Fisher to a penalty case; one involving the failure to timely pay an additional assessment. Brown v. U.S., 217 F.3d 858 ((Table) Fed.Cir. 1999) aff'ing 43 Fed.Cl. 463 (Fed.Cl., 1999). The Federal Circuit reasoned that IRC 6601(e)(1) corresponds to IRC 6665(a)(1) regarding penalties ("[T]he additions to the tax, additional amounts, and penalties provided by this chapter shall be paid upon notice and demand and shall be assessed, collected, and paid in the same manner as taxes."). The Federal Circuit's reliance on Fisher seems a bit lukewarm: "Although Mr. Brown challenges Fisher as not well reasoned, it is binding on this court." (And the lower court is similarly lukewarm; 43 Fed.Cl. at 468.) But we have no doubts that Brown and Fisher are correct. While there may not be many cases on the application of Lewis to interest and penalties, the Service's practice is longstanding. See Rev. Rul. 56-492 (Interest and penalties for the taxable year barred by the statute from assessment should be taken into account in determining the amount of overpayment allowable to a taxpayer on the basis of a timely filed claim for refund for the same taxable year and the same type of tax.) See also Bachner v. Commissioner, 109 T.C. 125, 132 (1997), aff'd 172 F.3d 859 ((Table) 3rd Cir. 1998) (the taxpayer claim for a refund based on overwithholdings was determined taking into account a time-barred negligence penalty) which references Allen, Fisher, and Loffin & Woodard, Inc. v. U.S., 577 F.2d 1206 1245-47 (5th Cir. 1978) (the taxpayer claimed a refund based on a carryback loss and the court upheld the Service's application of a time barred delinquency penalty to determine the overpayment carryback year).