



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

FROM: W. EDWARD WILLIAMS
SENIOR TECHNICAL REVIEWER CC:INTL:BR.1

SUBJECT:

This Field Service Advice refers to your memorandum dated October 9, 1998. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be used or cited as precedent.

LEGEND:

A =

Year B =

ISSUE:

Whether the statute of limitations under Code section 6501(a) is open with respect to a taxpayer who is a U.S. citizen and also a bona fide resident of the United States Virgin Islands ("USVI") and who timely filed a USVI tax return for Year B but failed to report on that return income from U.S. sources.

CONCLUSION:

Since more than three years have passed since the taxpayer filed a USVI return for Year B, as required by Code section 932(c)(2), the IRS may not assess additional tax, despite that he failed to report on that return gross income from U.S. sources, as required by Code section 932(c)(4). Therefore, the limitations period imposed by Code section 6501(a) has expired, unless an exception applies.

FACTS:

The taxpayer is a U.S. citizen who was also a bona fide resident of the USVI for the relevant taxable year, Year B. He filed a USVI income tax return for that year but failed to report on that return gross income from U.S. sources, specifically, a dividend from a U.S. corporation.

LAW AND ANALYSIS

Code section 932(c) applies to “an individual for a taxable year if – (A) such individual is a bona fide resident of the Virgin Islands at the close of the taxable year, or (B) such individual files a joint return for the taxable year with an individual described in subparagraph (A).” Taxpayer meets the requirement of subsection 932(c)(1)(A).

Code section 932(c)(2) provides that “[e]ach individual to whom this subsection applies for the taxable year shall file an income tax return for the taxable year with the Virgin Islands.”

Code section 932(c)(4) provides that “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.”

The Tax Reform Act of 1986, P.L. 99-514, § 1274(a) (Oct. 22, 1986) (“TRA ‘86”) enacted Code section 932. According to the Senate Finance Committee report, pursuant to this provision, “an individual qualifying as a bona fide Virgin Islands resident as of the last day of the taxable year will pay tax to the Virgin Islands under the mirror system on his or her worldwide income. He or she will have no final tax liability for such year to the United States, as long as he or she reports all income from all sources and identifies the source of each item of income on the

return filed with the Virgin Islands.” S. REP. NO. 99-313, 99th Cong., 2d Sess. 482 (1985).

The Technical and Miscellaneous Revenue Act of 1988, P.L. 100-647, § 1012(w)(2)(Nov. 10, 1988)(“TAMRA”), amended Code section 932(c)(4), adding to the bona fide resident requirement and the reporting requirement a third requirement for exclusion of items reported on the tax return of a qualifying resident of the USVI. The third requirement is that the individual seeking the exclusion from federal gross income fully pay his or her tax liability, as provided by Code section 934(a), to the USVI with respect to income from all sources.

According to the Senate Finance Committee report, the addition of this requirement clarified that in applying Code section 932, the Federal laws described in Code section 934(a), regarding tax liability incurred to the USVI, are not applicable for purposes of determining income tax liability incurred to the USVI. S. REP. NO. 100-445, 100th Cong., 2d Sess. 315 (1988). That is, for USVI tax purposes, Code section 932 applies for determining the taxable income of USVI residents but it, itself, is not part of the “mirror” tax code of the USVI that was established by the Naval Appropriations Act of 1921 (48 U.S.C. section 1397)(West 1997). Id.

TAMRA also amended Code section 932(c)(4), effective for tax years beginning after December 31, 1986, by substituting the phrase “*an income tax return*,” for the phrase “*his income tax return*” in Subsection 932(c)(4)(B) (emphasis added). The Senate Finance Committee report explains that this change clarified that an individual who does not comply with all requirements for exemption from U.S. taxation will be required to file a U.S. return. S. REP. No. 100-445, 314-5.

Code section 6501 restricts the IRS’ ability to assess and collect taxes by limiting the time for assessment and collection. Code section 6501(a) provides that “the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed)...and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period. For purposes of this chapter, the term “return” means the return required to be filed by the taxpayer...” Code section 6501(a). See also Treas. Reg. section 301.6501(a)-1. In other words, unless an exception in Code section 6501 applies, if more than three years have passed since the date a return for a particular year was filed, then no further assessment and collection of tax can be made for that year. Other subsections of Code sections 6501 give the IRS more time to assess and collect tax. For example, in cases of fraud or willful attempts to avoid tax, the IRS may act “at any time.” Code section 6501(c). Further, if a taxpayer omits from gross income an amount which exceeds more than twenty-five percent of the gross income reported on the return, the IRS has six years after a return is filed in which to proceed. Code section 6501(e). For purposes of this memorandum, because the application of

Code sections 6501(c) and (e) is unlikely, analysis is made solely under Code section 6501(a).

Application of Code sections 932(c)(4) and 6501(a) to the facts of this case requires a careful look. In this case, the taxpayer, a U.S. citizen who is also a bona fide resident of the USVI for Year B, timely filed an income tax return with the USVI. However, he failed to report on that return gross income from a U.S. source, specifically, a dividend received from a domestic corporation. This contravenes the requirement that “income from all sources” be reported on his tax return filed with the USVI in order for the taxpayer to be exempt from the requirement of filing with the United States. See Code section 932(c)(4). However, if the income tax return that A filed with the Bureau of Internal Revenue of the Virgin Islands started the statute of limitations for federal tax purposes, the limitations period under Code section 6501(a) would preclude assessment and collection of tax for the year at issue, Year B, as more than 3 years have passed since the Year B return was filed¹. As such, we look to case law for guidance.

The precise issue in this case, but involving corporate taxpayers, has been before federal courts. See Danbury v. Olive, 820 F.2d 618 (3d Cir. 1987), cert. denied, 484 U.S. 964 (1987); Condor Int’l v. Commissioner, 78 F.3d 1355 (9th Cir. 1996); Business Ventures Int’l v. Olive, 893 F.2d 641 (3d Cir. 1990); Bizcap, Inc. v. Olive, 892 F.2d 1163 (3d Cir. 1989). Danbury concerned pre-TRA ‘86 tax years and the application of transitional rules under TRA ‘86 to a domestic corporation considered an “inhabitant” of the USVI under the Revised Organic Act of the Virgin Islands, 48 U.S.C. section 1642 (“ROA”). The income tax provisions of the ROA were superseded by Title 26 through an amendment made to Code section 7651(5)(B) in TRA ‘86, § 1275(b).² The court found that “[the taxpayer’s] returns to the Virgin Islands satisfied its filing obligations under the [Code] for the purpose of considering time bars.” Danbury, 820 F.2d at 627. Thus, the IRS had three years from the filing of each of the taxpayer’s USVI returns in which to assess a

¹ As noted above, the possibilities of fraud or a willful attempt to avoid tax are not dealt with herein (Code section 6501(c) would allow the IRS to assess and proceed to collect tax at any time in such case), nor is the possibility that the taxpayer omitted from gross income an amount which exceeds more than twenty-five percent of the gross income reported on the return (if proved, the IRS would have six years from the time the subject return was filed in which to assess tax or initiate a proceeding to collect tax from the taxpayer pursuant to Code section 6501(e)).

²Code section 7651(5)(B) states that section 28(a) of the ROA is treated as having been enacted prior to Title 26. See Danbury, 820 F.2d at 625. Specifically, the amendment to Code section 7651(5)(B) applies to taxable years beginning after December 31, 1986 and to “any pre-1987 open year.” The court interpreted “pre-1987 open year” as a year for which the IRS could make an assessment on October 22, 1986.

deficiency under Code section 6501(a). Since more than three years had passed since each of the filings, the court ruled that the IRS was precluded from assessing deficiencies for those tax years pursuant to Code section 6501(a)³. The limitations period under Code section 6501(a) with respect to each tax year was found to have begun on the date that the taxpayer filed a USVI return, even though no return was filed with the IRS, because the law then in effect required the taxpayer to file his return with the USVI. Code section 932(c)(2). Other decisions have followed this precedent. See Condor, 78 F.3d 1355; Business Ventures, 893 F.2d 641; Bizcap, 892 F.2d 1163.

We think that this analysis also applies to individual taxpayers. Thus, the starting point for analysis is the filing requirements applicable to A. Code section 932(c)(2) requires bona fide USVI residents to file an annual return with the USVI. Since A filed a USVI tax return for Year B, he met the requirements of Code section 932(c)(2). However, on account of his failure to report dividend income from a domestic corporation, A did not satisfy Code section 932(c)(4)(B), which required that he report on his USVI return income from all sources and to identify the source of each item shown on such return, nor Code section 932(c)(4)(C), which required that he pay income tax to the USVI on his worldwide income.

Code section 6501(a) gives the IRS a period of up to three years from the date of the filing of a return to assess taxes due by the taxpayer. Since more than three years have passed since the taxpayer filed the tax return required by Code section 932(c)(2), the IRS may not assess and collect additional tax unless other exceptions apply. Code section 6501(a).

³Danbury was remanded to district court for consideration of whether the taxpayer had filed a false or fraudulent return, in which case the IRS can assess a deficiency at any time. See Code section 6501(c).

If you have any further questions, please call Allison Wielobob at (202) 622-3880.

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