



OFFICE OF
CHIEF COUNSEL

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

MEMORANDUM FOR ASSOCIATE AREA COUNSEL, AREA 5, SALT LAKE CITY
CC:SB:5:SLC

FROM: Assistant Chief Counsel (Administrative Provisions and
Judicial Practice)
CC:PA:APJP

SUBJECT: Significant Service Center Advice

This responds to your request for Significant Advice dated November 6, 2000, in connection with questions posed by the Frivolous Return Group in the Ogden Service Center and the Underreporter (Document Matching) Program in the Ogden Compliance Service Center.

ISSUES

1. Does suspension of interest under I.R.C. § 6404(g) apply to a document which qualifies as a frivolous return under I.R.C. § 6702 if the IRS treats the document as a valid return for purposes of the statute of limitations?
2. Must the notice sent to the taxpayer pursuant to I.R.C. § 6404(g) contain a computation of interest that takes into account periods of interest suspension mandated by I.R.C. § 6404(g)?

CONCLUSIONS

1. Once an otherwise frivolous return is treated as valid, it is a valid return for all tax purposes. As such, I.R.C. § 6404(g) applies to those frivolous returns treated

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as valid, suspending interest and certain penalties where the Service has failed to properly notify the taxpayer of his or her liability and the basis for the liability within the 12 or 18-month period prescribed by the statute.

2. I.R.C. § 6404(g) does not require the notice to contain an interest computation which reflects any period of interest suspension resulting from compliance with I.R.C. § 6404(g).

FACTS

1. The IRS frequently treats frivolous returns as valid for purposes of the statute of limitations. The Frivolous Return Group questions whether, under I.R.C. § 6404(g), the IRS must also suspend the imposition of any interest on tax liabilities the IRS determines are owed by the taxpayers unless the IRS issues a notice of the tax liabilities within the 12 or 18-month period as specified in the statute. You conclude that even though a document meets the standards of I.R.C. § 6702 for imposition of a frivolous return penalty, if the document is treated as a valid return, it is subject to I.R.C. § 6404(g) unless one of the exceptions under I.R.C. § 6404(g)(2) applies.

2. The Service Center treats the CP2000 notice as satisfying the notice requirements of I.R.C. § 6404(g), serving the function of the “30-day letter” in a regular audit and providing a summary of each adjustment, the proposed tax increase, and the interest which the taxpayer would owe on the proposed deficiency. Currently, the computer programs of the Service Center do not allow for a suspension of interest calculation for purposes of the CP2000 notice. Such a computation can be performed at the time of the assessment of the deficiency. The Underreporter Group asks whether CP 2000 satisfies the requirements of I.R.C. § 6404(g) if it does not compute the exact amount of interest due. The Service Center suggests adding some language to the CP2000 notice to indicate that the IRS will adjust the interest amount at the time of assessment to reflect any period of suspension under I.R.C. § 6404(g).

LAW AND ANALYSIS

I. I.R.C. § 6404(g) APPLIES TO ALL VALID RETURNS AND ALL RETURNS TREATED AS VALID.

§ 3305 of the Internal Revenue Service Restructuring and Reform Act of 1998 amended I.R.C. § 6404(g) to suspend the running of interest when the IRS does not give the taxpayer proper notice of certain liabilities within a statutorily defined period. As amended, I.R.C. § 6404(g) requires that, where a taxpayer files a federal income tax return on or before the due date, including extensions, and the

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Service fails to provide a notice to the taxpayer stating the taxpayer's liability and the basis for that liability within a statutorily defined period, the Service must suspend the "interest, penalty, addition to tax, or additional amount with respect to any failure relating to the return which is computed by reference to the period of time the failure continues to exist and which is properly allocable to the suspension period." I.R.C. § 6404(g)(1)(A). The suspension does not apply to any penalty under I.R.C. § 6651, any interest, penalty, addition to tax, or additional amount in a fraud case or with respect to any tax liability shown on the return, or any criminal penalty.

As stated above, a prerequisite to I.R.C. § 6404(g) treatment is the filing of a timely federal income tax return. The Tax Court in Beard v. Commissioner, 82 T.C. 766, 777 (1984), set out the Supreme Court's test for a return considered valid for tax purposes as follows:

The Supreme Court test to determine whether a document is sufficient for statute of limitations purposes has several elements: First, there must be sufficient data to calculate tax liability; second, the document must purport to be a return; third, there must be an honest and reasonable attempt to satisfy the requirements of the tax law; and fourth, the taxpayer must execute the return under penalties of perjury.

I.R.C. § 6702 states that if the taxpayer files "what purports to be" a federal income tax return which does not contain sufficient information for determining the correctness of the self-assessment or contains information which indicates on its face that the self-assessment is substantially incorrect, and the position of the taxpayer is frivolous or exhibits a desire to delay or impede the administration of the tax laws, then a penalty is imposed. If a return is a "frivolous return", generally it does not constitute a valid return for tax purposes under the Supreme Court's test set out in Beard and the § 6702 penalty may be assessed at any time.
I.R.M. § 120.1.10.9.0.

However, under certain circumstances, the Service treats some documents, which would otherwise be considered frivolous, as valid. For example, the Ninth Circuit Court of Appeals held in United States v. Long, 618 F.2d 74 (9th Cir. 1980), that a return containing zeros on most of the lines and signed by the taxpayer without modifications, additions, or deletions to the attestation statement would be sufficient to calculate tax liability, and, therefore, constitute a valid return.

Once the document is treated by the Service as a valid return, it is deemed to have satisfied the Beard test, and, therefore, should be considered a return for all tax

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purposes. Since it is valid for all tax purposes, the notice and interest suspension provisions of I.R.C. § 6404(g) apply.

- II. I.R.C. § 6404(g) DOES NOT REQUIRE AN INTEREST COMPUTATION WHICH REFLECTS ANY PERIODS OF INTEREST SUSPENSION UNDER I.R.C. § 6404(g).

For purposes of I.R.C. § 6404(g), the notice to the taxpayer of the tax liability must be sent to the taxpayer's last known address and must include the amount of the liability, the basis for that liability, and sufficient information or explanation regarding the adjustment to enable the taxpayer to challenge the adjustment. Office of Chief Counsel Notice N(35)000-172 (March 22, 2000). The interest computation is not necessary to explain the liability or necessary to challenge the adjustment and is not required to be added to a notice pursuant to I.R.C. § 6404(g).¹

Please call if you have any further questions.

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By: JOHN MCGREEVY
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CC:PA:APJP:B3

¹If a notice includes an amount of interest required to be paid then I.R.C. § 6631 applies.