

Department
of the
Treasury

Internal
Revenue
Service

Office of
Chief Counsel

N o t i c e

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November 16, 1999

Application of Failure to Pay
Addition to Tax to Returns
Subject: Prepared Under I.R.C. § 6020(b)

Upon Incorporation
Into the CCDM
Cancel Date:

The purpose of this Notice is to advise District Counsel attorneys of the following issues resulting from the recent enactment of section 6651(g) providing for the application of the section 6651(a)(2) failure to pay addition to tax to returns prepared pursuant to section 6020(b): first, what constitutes a return prepared for or executed by the Secretary under section 6020(b); second, whether the addition to tax imposed under section 6651(a)(2), in the context of a section 6020(b) return, is subject to deficiency procedures; third, whether the Tax Court has jurisdiction over the section 6651(a)(2) addition to tax imposed pursuant to section 6020(b) returns; and fourth, how is the amount of the addition to tax to be expressed on the notice of deficiency, answer and decision document. We are just beginning to see cases in which the failure to pay addition to tax has been determined against non-filers, and many questions have arisen regarding how to handle this issue.

1. What constitutes a return prepared for or executed by the Secretary under section 6020(b)?

As discussed more fully below, a return prepared pursuant to the Automated Substitute for Return [hereinafter "ASFR"] procedures and accompanied by a signed thirty day letter or revenue agent's report generally constitutes a valid section 6020(b) return. Section 6020(b)(1) authorizes the Secretary to make a return upon either a taxpayer's failure to file a return or upon a taxpayer's filing of a fraudulent return. Section 6020(b)(2) provides that this return, which is also known as a substitute for return, will be considered as prima facie valid for all legal purposes. Currently, the majority of substitutes for return are prepared pursuant to the Service's ASFR procedures, which allow the Service to generate

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substitutes for return via computer for non-filers. An ASFR, which is prepared by the Service through information gathered from past filings and/or third parties, generally contains the taxpayer's name, address, social security number, filing status and categories and amounts of taxable income.¹

A substitute for return prepared for a taxpayer pursuant to section 6020(b) 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.² See Millsap v. Commissioner, 91 T.C. 926, 930 (1988). A section 6020(b) return is not necessarily contained in a single document, but may consist of several documents which, together, satisfy these requirements. Thus, for example, an ASFR and a thirty day letter or revenue agent's report will suffice to constitute a valid section 6020(b) return. A statutory notice of deficiency does not constitute a valid section 6020(b) return.

A return merely containing taxpayer identifying information, but no data which could be used to establish tax liability, commonly referred to as a "dummy return," does not *per se* constitute a valid section 6020(b) return. See Phillips v. Commissioner, 86 T.C. 433, 437, 438 (1986), aff'd in part and rev'd in part, 851 F.2d 1492 (D.C. Cir. 1988). See also Britt v. Commissioner, T.C. Memo. 1988-419 (front page of Form 1040 listing taxpayer's name, address, identification number, dependency exemptions and filing status is not a valid 6020(b) return, as it was unsigned and contained insufficient data to compute tax liability). A dummy return is generated to open up an account for the taxpayer on the master file, and normally consists of a first page of a Form 1040 which contains a taxpayer's name, address and social security number. If, however, a dummy return is accompanied by

¹ As part of the ASFR procedure, the Service simultaneously prepares and mails a thirty day letter to the taxpayer, and attaches an explanation of proposed adjustments (which contains the same information as is contained in the ASFR), as well as a tax calculation summary report. If the taxpayer fails to respond to the thirty day letter, the Service sends a statutory notice of deficiency to the taxpayer by certified mail with the same attachment.

² I.R.C. § 6020(b)(2). See also Hartman v. Commissioner, 65 T.C. 542, 545, 546 (1975), holding that section 6020(b)(2) requires that the return be subscribed, but need not be signed under oath. Section 7701(a)(11) defines the Secretary as the Secretary of the Treasury or his delegate. A delegate includes any officer, employee or agency of the Department of the Treasury authorized by the Secretary of the Treasury to perform functions described in the context. I.R.C. § 7701(a)(12)(A)(i). The Regulations under section 6020(b) provide that such a return may be executed by the district director or other authorized internal revenue officer or employee. Treas. Reg. § 301.6020-1(b)(1). The Internal Revenue Manual provides that Service employees, such as revenue agents and tax auditors, as well as revenue officers and collection office function managers who are at least at the GS-9 level, may execute a section 6020(b) return. I.R.M., Handbook No. 1229, Handbook of Delegation Orders, Order No. 182. See also I.R.M. 5290-5293.3.

other documents which satisfy the three requirements listed above, then the dummy return and those documents will, together, constitute a valid section 6020(b) return.

The Tax Court has held that various combinations of documents meeting the above requirements constituted valid returns under section 6020(b). In Millsap v. Commissioner, the court held that a dummy return consisting of taxpayer's name, address and social security number, and a signed revenue agent's report containing an explanation of taxpayer's income, exemptions, deductions, and filing status represented a valid section 6020(b) return. Millsap v. Commissioner, 91 T.C. 926, 928 (1988). The Tax Court similarly found that a Form 1902E, Explanation of Adjustments, containing information on taxpayer's income, deductions, and exemptions, as well as a dummy return, consisting of taxpayer's name, address and social security number, satisfied the requirements of section 6020(b). Conovitz v. Commissioner, T.C. Memo. 1980-022, 39 T.C.M. 929, 930. See also Smallbridge v. Commissioner, 804 F.2d 125, 128, n.3 (10th Cir. 1986) (document signed by examiner containing taxpayer's name, address, social security number, wage and exemption information and filing status was valid under section 6020(b)).³

2. Are section 6651(a)(2) additions to tax imposed in the context of section 6020(b) returns subject to deficiency procedures?

Yes. In the context of section 6020(b) returns relating to subtitle A taxes, section 6651(a)(2) additions to tax are subject to deficiency procedures set forth in sections 6212 and 6213. Section 6651(a)(2) authorizes the imposition of an addition to tax where, without reasonable cause, a taxpayer has failed to pay the amount shown as tax on his or her return on or before the payment due date plus extensions. In addressing the application of the section 6651(a)(2) addition to tax to returns prepared under section 6020(b), section 6651(g)(2) states that a section 6020(b) return will be treated as a return filed by the taxpayer for purposes of determining the section 6651(a)(2) addition to tax. Section 6651(g) applies to returns due (without regard to extensions) after July 30, 1996. See Taxpayer Bill of Rights 2, Pub. L. 104-168, § 1301(a), 110 Stat. 1452 (July 30, 1996). Section 6665 provides that penalties and additions to tax will be assessed, collected and paid in the same manner as taxes, except for, *inter alia*, an addition to tax under section 6651 which is not attributable to a deficiency. I.R.C. § 6665(a)(1), (b)(1).

When the Service prepares a section 6020(b) return for a taxpayer, the return is considered a return filed by the taxpayer under section 6651(g)(2) only for purposes of calculating the section 6651(a)(2) addition to tax. For purposes of determining what constitutes a deficiency, however, a section 6020(b) return is not considered to be the return of the taxpayer. A "deficiency," as defined in section 6211(a), includes the difference between the correct amount of income tax and the amount shown as tax by the taxpayer on his or her return, if such a return was made. Thus, because the taxpayer did

³ Although the Tax Court indicated in Millsap v. Commissioner that it would not follow the Smallbridge case outside of the 10th Circuit in reference to its analysis of section 6103, the court did not reject the portion of the opinion addressing the validity of the section 6020(b) return. See Millsap v. Commissioner, 91 T.C. 926, 935-37 (1988).

not make a return, a deficiency would include the correct amount of tax, unreduced by the amount reflected on the section 6020(b) return. Because the underlying tax constitutes a deficiency, the addition to tax under section 6651(a)(2) is attributable to a deficiency, and thus will also be subject to deficiency procedures pursuant to section 6665(b)(1). This conclusion is supported by the legislative history of section 6651(g), which provides that for purposes of the section 6020(b) return, the tax on which the section 6651(a)(2) addition to tax is measured is considered to be a deficiency. H.R. Rep. No. 104-506, 104th Cong., 2nd Sess. 53 (1996), 1996-3 C.B. 101. See also Millsap v. Commissioner, 91 T.C. 926, 938 (1988), acq. in result in part, 1991-2 C.B. 1 (Service's preparation of section 6020(b) return does not foreclose taxpayer's right to deficiency procedures). Thus, in the context of section 6020(b) returns relating to income taxes, section 6651(a)(2) additions to tax would be subject to deficiency procedures.

3. Does the Tax Court have jurisdiction over section 6651(a)(2) additions to tax?

The Tax Court has jurisdiction over the section 6651(a)(2) addition to tax for failure to pay, as long as the court has jurisdiction to redetermine the underlying tax deficiency.

Sections 6213(a) and 6214(a) confer jurisdiction on the Tax Court to redetermine deficiencies relating to income, estate, gift and certain excise taxes, increases in deficiencies and additions to tax. Section 6665(a)(2) states that deficiency procedures applicable to income, estate, gift and certain excise taxes also pertain to additions to tax. Section 6651(b)(1) contains an exception to this rule for an addition to tax under section 6651 which is not attributable to a deficiency.

The legislative history of the 1986 amendment to section 6214(a) contains a section clarifying the issue of whether the Tax Court has jurisdiction over the failure to pay addition to tax.⁴ The House and Senate Reports state that the Tax Court has jurisdiction over the addition to tax for failure to pay under section 6651(a)(2) where the court has jurisdiction to redetermine the tax deficiency on which the addition to tax is based. H.R. Conf. Rep. No. 99-841, at II-804 (1986), 1986-3 C.B. (Vol. 4) 804; S. Rep. No. 99-313, at 200 (1986), 1986-3 C.B. (Vol. 3) 200. The Senate Report notes that it is appropriate for the Tax Court to have jurisdiction over the addition to tax for failure to pay, as long as the court already has jurisdiction over the tax on the return. S. Rep. 99-313, at 200 (1986), 1986-3 C.B. (Vol. 3) 200. This statement overrides the Tax Court's opinion in Young v. Commissioner, 81 T.C. 879 (1983), which held that the court did not have jurisdiction over the addition to tax for failure to pay, even though it held that it had jurisdiction to redetermine the underlying tax deficiency. The Tax Court has since acknowledged that it has jurisdiction over the redetermination of this addition to tax. See Nemerov v. Commissioner, T.C. Memo. 1998-186, 75 T.C.M. 2344, 2346 (1998) (citing H.R. Conf. Rep. No. 99-841, at II-841 (1986), 1986-3 C.B. (Vol. 4) 804; S. Rep. No. 99-313, at 200 (1986), 1986-3 C.B. (Vol. 3) 200).

⁴ The 1986 amendment to section 6214(a) changed "an addition to the tax" to "any addition to the tax", with respect to the Tax Court's jurisdiction. The amendment applies to Tax Court proceedings in which a decision had not yet become final as of October 22, 1986.

4. How is the section 6651(a)(2) addition to tax imposed pursuant to a section 6020(b) return to be expressed on a notice of deficiency, answer and decision document?

a. Notices of Deficiency

Section 6651(a)(2) imposes an addition to tax for non-payment of “the amount shown as tax on any return . . . on or before the date prescribed for payment of such tax (determined with regard to any extension of time for payment), unless it is shown that such failure is due to reasonable cause and not due to willful neglect” The addition to tax is “0.5 percent of the amount of such tax if the failure is not for more than 1 month, with an additional 0.5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate” I.R.C. § 6651(a)(2). Thus, the addition to tax for failure to pay may accrue for a period of up to fifty months.

Since a section 6020(b) return is considered to be a return filed by the taxpayer for purposes of section 6651(a)(2), under section 6651(g), the section 6651(a)(2) addition to tax will be imposed from the original due date of the tax return. If a notice of deficiency is issued during this fifty month period, the Service will not be able to determine the full amount of the addition to tax since it will continue to accrue until the amount is paid.

Thus, the notice of deficiency should state that the Service has imposed the section 6651(a)(2) addition to tax for failure to pay as of the due date of the return, and that taxpayer has not shown that his or her failure to pay is due to reasonable cause. Assuming that the notice of deficiency is sent to the taxpayer within the fifty month period during which the addition to tax accrues, the notice should state that the amount of the addition to tax cannot be determined at this time, but that an addition to tax of 0.5 percent will be imposed for each month, or fraction thereof, of nonpayment, up to 25 percent, based upon the liability shown on the section 6020(b) return, or the final determined liability, if less.

b. Answers

If you receive a petition contesting the applicability of the section 6651(a)(2) addition to tax, you should first determine whether the years at issue are after the effective date of section 6651(g). If they are not, and the statutory notice nonetheless determines that the addition to tax is applicable, even though no return was filed by the taxpayer, the addition to tax should be conceded on answer.

Second, you should review the administrative file to determine if it contains a valid section 6020(b) return under the standards described above. If you determine that a section 6020(b) return has not been prepared, you should admit in the answer that the taxpayer is not liable for the addition to tax.

Where the notice of deficiency was issued pursuant to a valid section 6020(b) return which contains a specific amount for the section 6651(a)(2) addition to tax, then you must

determine whether the notice of deficiency was issued prior to the expiration of the fifty month period, at which time the addition to tax would have accrued to 25 percent. If the notice of deficiency was issued after the expiration of this period, then the notice of deficiency should reflect the full amount of the addition to tax actually owed by the taxpayer. If the notice of deficiency was issued prior to the expiration of this period (and the tax has not yet been paid) then you should allege in the answer that the Service is entitled to additional amounts for the section 6651(a)(2) addition to tax, as the full amount of the addition to tax has not accrued as of the date of issuance of the notice of deficiency. You should also explain in the answer how the addition to tax accrues, and state that the addition to tax will continue to accrue for fifty months after the due date of the return, or the date on which the tax is paid.

Where the notice of deficiency is issued pursuant to a valid section 6020(b) return, but does not contain an amount for the section 6651(a)(2) addition to tax, you should allege in the answer that the failure to pay addition to tax is applicable and explain how the addition to tax accrues.

c. Decision Documents

Attached to this Notice are sample decision document paragraphs addressing various scenarios involving the section 6651(a)(2) addition to tax.

If you have any questions regarding this notice, please call (202) 622-7900.

/s/ Daniel J. Wiles

for

JUDITH C. DUNN
Associate Chief Counsel
(Domestic)

A. The following language should be used when preparing decision documents in which the notice of deficiency determines an amount due under I.R.C. § 6651(a)(2) for years prior to the enactment of section 6651(g) and the taxpayer has not filed a return:

**NO ADDITION UNDER I.R.C. § 6651(a)(2)
6020(b) RETURN**

That there is no addition to tax due from the petitioner for the taxable year 1995, under the provisions of I.R.C. § 6651(a)(2).

[This paragraph can be used to dispose of the addition where it has been erroneously placed in a statutory notice for 1995 and earlier years.]

B. The following language should be used when preparing decision documents in which it is determined that the addition under I.R.C. § 6651(a)(2) applies.

**ADDITION UNDER I.R.C. § 6651(a)(2)
6020(b) RETURN**

(1) ADDITION DETERMINED 50 MONTHS HAS ALREADY TRANSPIRED

That there is an addition to tax due from the petitioner for the taxable year _____, under the provisions of I.R.C. § 6651(a)(2), in the amount of \$_____.

(2) ADDITION ACCRUING MONTHLY LESS THAN 50 MONTHS ELAPSED

(A) CASE CONCEDED IN FULL BY TAXPAYER

That there is an addition to tax due from the petitioner for the taxable year _____ under the provisions of I.R.C. § 6651(a)(2) of 0.5% of the amount of [insert amount] commencing on the due date of the petitioner's return and accruing for each month or fraction thereof during which the petitioner fails to pay, not exceeding 25% in the aggregate.

(B) CASE SETTLED FOR REDUCED DEFICIENCY

That there is an addition to tax due from the petitioner for the taxable year _____ under the provisions of I.R.C. § 6651(a)(2) of 0.5% of the amount of the income tax **required to be shown*** on the return, [insert amount] commencing on the due date of the petitioner's return and accruing for each month or fraction thereof during which the petitioner fails to pay, not exceeding 25% in the aggregate.

(*I.R.C. § 6651(c)(2) provides that if the amount required to be shown as tax on a return is less than the amount shown as tax on such return, subsections (a)(2) and (b)(2) shall be applied by substituting such lower amount.)

(C) DELINQUENT RETURN FILED BY TAXPAYER

That there is an addition to tax due from the petitioner for the taxable year _____ under the provisions of I.R.C. § 6651(a)(2) of 0.5% of the amount of the income tax shown on the return, [insert amount] commencing on the due date of the petitioner's return and accruing for each month or fraction thereof during which the petitioner fails to pay, not exceeding 25% in the aggregate.

(3) NOTICE SETS FORTH THE ADDITION TO TAX IN A SUM CERTAIN

The following language should be used if the addition under section 6651(a)(2) is in the notice in a sum certain from the due date of the return to the date of the notice, and the amount of the ultimate addition to tax is greater than the amount in the notice. If the ultimate addition to tax is greater than the amount in the notice, we will have to move for an increase in addition to tax. The increased addition to tax language should be in the stipulation paragraph (below the judge's signature).

It is further stipulated that the respondent claims an increased addition to tax under the provisions of I.R.C. § 6651(a)(2), for the taxable year _____ of 0.5% of the amount of the income tax shown on the return, commencing on the due date of the petitioner's return and accruing for each month or fraction thereof during which the petitioner fails to pay, not exceeding 25% in the aggregate, pursuant to the provisions of I.R.C. § 6214(a).

(This paragraph should be modified if we know either the exact amount of the addition or we are using the required to be shown language in the addition paragraph.)

(4) SECTION 6651(a)(2) ADDITION IS NOT APPLICABLE; SECTION 6651(a)(1) ADDITION UNDERSTATED

Where it is determined that section 6651(a)(2) is not applicable, the section 6651(a)(1) addition will have been understated by 0.5% for five months and you will need to move for an increased 6651(a)(1) addition to tax. Since this addition only runs for five months, we will be able to determine an exact amount. We recommend the following increased addition to tax paragraph.

It is further stipulated that the respondent claims an increased addition to tax under the provisions of I.R.C. § 6651(a)(1), for the taxable year _____, in the amount of \$_____.