

Department
of the
Treasury

Internal
Revenue
Service
**Office of
Chief Counsel**

Notice

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December 26, 2001

Subject: Black Reparations Claims

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Purpose

The purpose of this Notice is to provide direction regarding assessment procedures in processing returns which claim a refund resulting, in whole or in part, from a claim for a "Black Reparations Tax Credit."

In General

Questions have arisen about the proper procedure for processing returns claiming "Black Reparations Tax Credits." These returns typically claim a large refund resulting, in whole or in part, from a credit for tax purportedly paid with respect to undistributed long term capital gain from a regulated investment company (RIC) or a real estate investment trust (REIT). Taxpayers who make such claims generally attach to the return a version of Form 2439, *Notice to Shareholder of Undistributed Long-Term Capital Gain*. The Form 2439 reports that a RIC or REIT allegedly paid a tax pursuant to section 852(b)(3)(D)(ii) or section 857(b)(3)(D)(ii) for which the taxpayer may claim a credit. The words "Black Reparations Tax Credit," "Black Investment Taxes" or similar terms frequently appear on the Form 2439. In reality, no such RIC or REIT exists and the claim for refund is a frivolous claim with no legal foundation.

Claims for refund based on the Black Reparations Tax Credit have become widespread across the country. When the Service timely identifies such frivolous claims, it seeks to avoid paying refunds. There have been instances, however, in which refunds based on the frivolous claims have been issued.

The Service has, in many cases, followed summary assessment procedures under

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section 6201(a)(3) to recover these erroneous refunds. Section 6201(a)(3) permits the Service to summarily assess overstated credits for income tax withheld at the source or for amounts paid as estimated income tax. Although sections 852(b)(3)(D)(ii) and 857(b)(3)(D)(ii) allow taxpayers to claim a credit for taxes owed and paid by a RIC or a REIT, payments under those provisions do not constitute either income tax withheld at the source or estimated income tax. Consequently, the summary assessment procedures of section 6201(a)(3) applicable to overstatements of credit for income tax withheld at the source or for estimated tax payments do not apply to overstated credits under sections 852(b)(3)(D)(ii) and 857(b)(3)(D)(ii) and such assessments are invalid.

For claims for refunds based on a Black Reparations credit, the Service should follow the assessment procedures prescribed by section 6213(b)(1) for mathematical or clerical errors appearing on returns or other alternative assessment procedures where applicable, e.g., jeopardy assessment under section 6861, to obtain valid assessments of these erroneous refunds. The Service will also need to take corrective action in those cases where it already summarily assessed the tax. In some of those cases, the Service may have determined that the section 6331(a) jeopardy levy procedures were applicable, and may have followed the summary assessment with a jeopardy levy on the taxpayer's bank account or other assets in attempting to recover the refund. The procedures described below describe the corrective actions necessary in each of several different situations.

Cases in which the Service has not issued a refund

A taxpayer's original return showing an overpayment attributable to an overstated RIC or REIT credit constitutes a claim for refund of the overpayment. While the Service has authority under section 6402 to issue a refund of an overpayment, the Service does not have to do so where it determines that no overpayment exists. A claim for a refund based on a Black Reparations Tax Credit has no legal foundation, whether the taxpayer claims the credit under the RIC or REIT provisions or pursuant to any other provision. Therefore, no overpayment attributable to a Black Reparations Tax can exist under current law and the Service has no obligation to issue a refund in such cases. Initial processing of these returns often results in a credit being entered on the account, typically using Transaction Code 766. When the Service identifies returns claiming Black Reparations Tax Credits, the Service should reverse the credit (typically by entering Transaction Code 767 on the taxpayer's account).

When the Service enters a credit and a reversal on the account, and the Service does not wish to adjust the return for issues other than the frivolous credit, the Service may issue a Letter 569 (SC), *Letter of Claim Disallowance*, with regard to the taxpayer's claimed refund of the frivolous credit. The Letter 569 (SC) should be accompanied by a copy of Form 3363 (Acceptance of Proposed Disallowance of Claim for Refund or Credit). The Service should also send Form 2297 (Waiver of Statutory Notification of Claim Disallowance) and Publication 1 with the Letter 569 (SC). If the taxpayer contests the proposed disallowance within 30 days, the Service should send Letter 105 (SC/SP), *Taxpayer Disallowance of Claim Letter*, or its functional equivalent to the taxpayer. If the Service simply disregarded the credit claimed on the return and entered

nothing on the account regarding the credit, the same claim disallowance procedures may be followed.

The Service has the discretion to choose whether to follow the procedures described above or to simply freeze the refund. By following notice of claim disallowance procedures, the Service will start the two year period of limitations on filing suits for refund. If the Service elects not to issue a notice of claim disallowance, but simply freezes the refund, the taxpayer would have an indefinite period to bring a suit for refund. Section 6532(a).

If the Service has already made a summary assessment, but has successfully frozen the refund, the Service should abate the assessment and reverse the credit. In order to start the period of limitations running, the Service should follow the claim disallowance procedures discussed above.

Cases in which the Service has already issued a refund

If the Service has already issued a refund, the Service should follow math error procedures. In doing so, the Service should consider the potential applicability of jeopardy assessment and collection procedures under sections 6861 and 7429. We understand that the promotional information surrounding the Black Reparations Tax Credit scheme usually encourages taxpayers who receive refunds based on the credit to cash the check promptly and spend the funds rapidly. Consequently, depending on the facts and circumstances, assessment and collection of the deficiency through the usual procedures may often be jeopardized by delay.

Section 6213(b) provides a limited exception for mathematical or clerical errors to the usual deficiency procedures required under sections 6211, 6212 and 6213. Section 6213(g)(2) defines the term "mathematical or clerical error" to include:

- (C) an entry on a return of an item which is inconsistent with another entry of the same or another item on such return.
- (D) an omission of information which is required to be supplied on the return to substantiate an entry on the return.

Where there is a mathematical or clerical error, the Service should send out a math error notice and immediately assess the additional tax resulting from the error. If the taxpayer requests an abatement of the assessment within 60 days of the notice, the Service will abate the assessment and follow normal deficiency procedures.

Here, the entry of an amount for a RIC or REIT credit (Line 64 of the 2000 Form 1040) is inconsistent with a zero entry for capital gain income (Line 13 of the 2000 Form 1040), in the absence of a Schedule D showing capital losses that would offset the capital gain income from the RIC or REIT that was necessary to generate the credit.

If the Service has issued and then summarily assessed a refund, the Service must reverse the summary assessment and, in order to collect the tax, institute math error

procedures. Because the summary assessment is invalid, there is no prohibition on the Service following math error procedures, see Mitchell v. Commissioner, 51 T.C. 641, 650 (1969).

Where the Service determines that assessment and collection of the amount of the refund would be jeopardized by delay, the Service should consider jeopardy assessment and levy procedures as an alternative to the math error procedures. For example, if a bank or other financial institution has all or most of the proceeds of the refund, a jeopardy assessment and levy may be appropriate to collect the refund before it can be dissipated. Counsel should work with the Service to ensure that the jeopardy assessment and levy procedures are followed and that the necessary approvals, as required by delegation orders, have been obtained.

Erroneous refunds returned to Service

If the Service issued a refund based on the frivolous credit, summarily assessed under section 6201(a)(3), and took levy or other action which resulted in the return of the funds to the Service, then the funds should be applied to the taxpayer's account. The Service should abate the summary assessment, issue a math error notice identifying the frivolous credit claimed on the return, make a new assessment based on the math error notice and then apply the payment to the new assessment. If the taxpayer then requests an abatement of the math error assessment, the Service should abate the second assessment, as required by section 6213(b)(2)(A), and then issue a statutory notice of deficiency. The Service should take appropriate action to prevent issuance of a second erroneous refund by freezing the credit. Section 6402.

Finally, in those situations where the Service simply contacted the taxpayer and obtained the return/payment of the erroneous refund without the need for a summary assessment, the Service should follow the procedures above for cases where the erroneous refund was not issued in the first place.

For further information regarding this notice, contact Kerry Bryan or Blaise G. Dusenberry at (202) 622-7940.

/s/
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