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

MEMORANDUM FOR

FROM: Curtis G. Wilson  
Assistant Chief Counsel (Procedure and Administration) CC:PA

SUBJECT: Statute of Limitations on Assessment

This Field Service Advice responds to your memorandum dated July 31, 2000. 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.

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LEGEND

Taxpayer =

Year 1 =

Year 2 =

ISSUES

(1) Whether the statute of limitations bars assessment of a tax deficiency for a year in which the taxpayer fraudulently failed to file a return, but subsequently filed a nonfraudulent return.

(2) Whether the statute of limitations bars assessment of the fraudulent failure to file penalty imposed under section 6651(f) more than three years after the taxpayer files a nonfraudulent return for the same tax year.

CONCLUSIONS

(1) The tax deficiency cannot be assessed at any time under section 6501(c), but must be assessed within the three-year period of limitations provided in section 6501(a). Thus, since it is now over three years from the date the delinquent return was filed, assessment of the tax is barred.

(2) The section 6651(f) fraudulent failure to file penalty is subject to the three-year period of limitations under section 6501(a). Thus, since it is now over three years from the date the delinquent return was filed, assessment of the fraudulent failure to file penalty is barred.

FACTS

Taxpayer fraudulently failed to timely file tax returns for Year 1 through Year 2. However, he did file delinquent nonfraudulent returns for those tax years. The IRS assessed the amount of tax shown on the delinquent returns and assessed penalties for failure to file a return pursuant to section 6651(a), but did not assess penalties for fraudulent failure to file pursuant to section 6651(f). The IRS also determined deficiencies, as well as section 6651(f) penalties based on the deficiencies, with respect to those tax years. There was no 25 percent omission of income; thus, the six year statute of limitations of section 6501(e) is not applicable.

Further, taxpayer never extended the statute of limitations on assessment. Thus, it would appear that the three-year assessment statute will apply to bar assessment of the deficiencies and the fraudulent failure to file penalty, unless the three-year statute does not apply.

### LAW AND ANALYSIS

Section 6501(a) provides, in part, that except as otherwise provided in this section, 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).

Section 6501(c)(1) provides that in the case of a false or fraudulent return with the intent to evade tax, the tax may be assessed at any time.

Section 6501(c)(2) provides that in case of a willful attempt in any manner to defeat or evade tax imposed by this title (other than tax imposed by subtitle A or B), the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

Section 6501(c)(3) provides that in the case of failure to file a return, the tax may be assessed at any time.

Section 6665(a) provides (1) that the additions to the tax 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; and (2) any reference in this title to "tax" shall be deemed also to refer to the additions to tax and penalties provided by this chapter.

For returns due prior to January 1, 1987, section 6653(b) provided an addition to tax of 50 percent of the amount of the underpayment of tax if any part of the underpayment is due to fraud. As a result of the Tax Reform Act of 1986, which is effective for returns due after December 31, 1986, the section 6653(b) penalty rate was increased from 50 percent to 75 percent and made applicable only to the amount of the underpayment attributable to fraud.

The Revenue Reconciliation Act of 1989, which is effective for returns due after December 31, 1989, repealed section 6653(b) and replaced it with new sections 6663 and 6651(f). The section 6663 fraud penalty applies only to filed returns and the 6651(f) fraudulent failure to file penalty governs the fraudulent failure to file.

Rev. Rul. 79-178, 1979-1 C.B. 435, holds that if a taxpayer does not timely file an income tax return in a willful attempt to evade income tax but files a delinquent, correct return after a Service investigation has begun, the tax cannot be assessed at any time under section 6501(c), but must be assessed within the three-year period of limitations provided in section 6501(a). Rev. Rul. 79-178 states that imposing the civil fraud penalty under section 6653(b) does not necessarily indicate that the tax can be assessed at any time under section 6501(c). The ruling concludes that because the delinquent return was not false or fraudulent, section 6501(c)(1) does not apply. Section 6501(c)(2) does not apply because the income tax is imposed by subtitle A. Finally, since a return was filed, section 6501(c)(3) also does not apply.

In Bennett v. Commissioner, 30 T.C. 114 (1958), acq. 1958-2 C.B. 3, the Tax Court held that filing a delinquent nonfraudulent return after a fraudulent failure to timely file a return will begin the running of the period of limitations. The Tax Court stated: “For, once a nonfraudulent return is filed, putting the Commissioner on notice of a taxpayer’s receipts and deductions, there can be no policy in favor of permitting assessment thereafter at any time without limitation. We think that the statute of limitations begins to run with the filing of such returns.” 30 T.C. at 123-24. The court went on to hold that the filing of a delinquent nonfraudulent return will not erase or diminish the additions to tax provided by the fraud penalty, but will begin the running of the limitations period within which the Service must assess and collect the penalty.

In Badaracco v. Commissioner, 464 U.S. 386 (1984), the taxpayers filed fraudulent returns for tax years 1965-1969. In August 1971, the taxpayers filed nonfraudulent amended returns for those years and paid the additional taxes shown thereon. In November 1977, the Commissioner asserted the fraud penalty under section 6653(b). The Supreme Court stated that the case was controlled by the clear language of section 6501(c)(1), and that fraudulent returns are not nullities for statute of limitations purposes. After citing E.I DuPont de Nemours & Co. v. Davis, 264 U.S. 456, 462 (1924), for the principle that statutes of limitations barring assessment and collection of federal taxes are strictly construed in favor of the government, the Supreme Court found that section 6501(c)(1) was clear on its face. The Court went on to conclude that once the taxpayer filed a fraudulent return, the tax could be assessed “at any time.” 464 U.S. at 391-93.

The Supreme Court also concluded that the language employed in sections 6501(c)(1) and (c)(3) indicates that Congress intended different limitations to apply. Thus, despite its holding that the three year statute did not apply once a fraudulent return was filed, the Supreme Court specifically noted that section 6501(c)(3) “ceases to apply once a return has been filed for a particular year, regardless of

whether that return is filed late and even though the failure to file a timely return in the first instance was due to fraud. [citations omitted ]” 464 U.S. at 401.

In the instant case, the returns filed were not false or fraudulent; therefore, section 6501(c)(1) does not apply. Section 6501(c)(2) does not apply because income tax is imposed under Subtitle A. Since a return was filed, albeit delinquent, section 6501(c)(3) also does not apply. Therefore, based on Bennett, Badaracco, and the language of section 6501, the tax deficiency cannot be assessed at any time under section 6501(c), but must be assessed within the three-year period of limitations provided in section 6501(a).

Similarly, the section 6651(f) fraudulent failure to file penalty is also subject to the three-year period of limitations under section 6501(a) because section 6665(a)(1) requires that penalties be assessed and collected in the same manner as taxes. In conclusion, since it is now over three years from the date the delinquent return was filed, the assessments of both the tax deficiencies and the section 6651(f) fraudulent failure to file penalty are barred by operation of the period of limitations under section 6501(a).

#### CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

Examination should be reminded that when a delinquent return is filed, the Service must assess the delinquency penalty (section 6651(a)) or the section 6651(f) fraudulent failure to file penalty based upon the tax shown on the return. Thus, where the Commissioner determines that taxpayer's failure to file is attributable to fraud and the taxpayer later files a return reflecting a tax liability, the section 6651(f) penalty related to the tax reflected on the return should be assessed immediately under the law in the same manner as the usual delinquency penalty (since not calculated upon a deficiency). I.R.C. § 6665(b)(1) (deficiency procedures do not apply to section 6651 except as applied to deficiencies).

For example, assume that a taxpayer delinquently files an income tax return and reports \$100 on the return. The Commissioner determines that the failure to file is attributable to fraud, so that the section 6651(f) penalty applies. Upon examination, the Commissioner determines that the correct tax liability is \$150, thus there is a deficiency in the amount of \$50. On this example, the \$100 of tax reported on the return could be assessed immediately. Also, the section 6651(f) penalty which is calculated based on the \$100 of tax reported on the return could be assessed immediately. However, the \$50 deficiency and the section 6651(f) penalty which is calculated based on the \$50 deficiency would be subject to the normal deficiency procedures under sections 6211 through 6216.

[REDACTED]

[REDACTED]

Section 6503, which ordinarily protects the Service when issuing a notice of deficiency, only applies "in respect to any deficiency as defined in section 6211 . . ." Since the fraudulent failure to file penalty amount based upon the tax shown on a return cannot constitute a deficiency, as noted, assessment of the penalty could be barred if not made timely. See Notice N(35)000-74, November 14, 1990. See also CCDM (35)2.3(10) (05-05-2000).

Please call if you have any further questions.

By: \_\_\_\_\_  
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