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INTERNAL REVENUE SERVICE
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OFFICE OF
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INTERNAL REVENUE SERVICE NATIONAL OFFICE
SIGNIFICANT SERVICE CENTER ADVICE

MEMORANDUM FOR MARY C. GORMAN
TEC/CAS SUPPORT MANAGER DIVISION COUNSEL
(SMALL BUSINESS/SELF EMPLOYED)

FROM: Heather C. Maloy
Associate Chief Counsel
(Income Tax & Accounting)

SUBJECT: Request for Significant Service Center Advice
Child Tax Credit

This Significant Service Center Advice responds to your memorandum dated January 29, 2002. In accordance with § 6110(k)(3) of the Internal Revenue Code, this Significant Service Center Advice should not be cited as precedent.

ISSUE

How should disallowed refundable child tax credit be reflected on notices of deficiency?

CONCLUSION

Disallowed refundable child tax credit should be reflected on notices of deficiency as "negative tax."

LAW AND ANALYSIS

Section 24 allows a "child tax credit." The credit first became effective in 1998. For 1998, the credit was \$400 per qualifying child, with a phase-out depending on the taxpayer's income. For 1999 and 2000, the credit was raised to \$500 per qualifying child (also with a phase-out). The credit was generally "nonrefundable," in that the credit could not exceed the amount of the taxpayer's tax, as reduced by certain other credits. An exception to nonrefundability was provided by § 24(d), under

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which the credit was refundable for taxpayers with three or more qualifying children. For such taxpayers, the credit was refundable to the extent that the social security taxes (FICA or RRTA) paid by the taxpayer exceeded the amount of the taxpayer's earned income credit.

Starting in 2001, the credit will be increased over time, with a maximum per child amount of \$1,000 in 2010 and thereafter, subject to an income-related phase-out. The maximum credit in 2001 was \$600. The refundability aspect has also been changed. For taxpayers with less than three qualifying children the credit is now refundable to the extent of 10 percent of the taxpayer's earned income in excess of \$10,000 (indexed for inflation beginning in 2002). The percentage is increased to 15 percent for calendar years 2005 and thereafter. For taxpayers with three or more qualifying children the credit remains refundable up to the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income credit (if that amount is greater than the refundable credit based on the taxpayer's earned income in excess of \$10,000.)

The distinction between nonrefundable and refundable credits can be administratively significant. Nonrefundable credits may be applied to reduce tax, and certain excess nonrefundable credits may be carried to other years. However, unlike excess refundable credits, they may not be "refunded" to taxpayers in the year they arise. Nonrefundable personal credits are listed in subpart A of part IV, subchapter A, chapter 1, of the income tax subtitle ("subpart A"). Refundable credits are listed in subpart C of the same part ("subpart C").

In a Significant Service Center Advice (Chief Counsel Advice 19948027), we concluded that, while an overstatement of the nonrefundable portion of the child tax credit results in a deficiency under § 24(a) and can be assessed and collected under the deficiency procedures, overstatement of the refundable portion could not be so assessed and collected. The reason for the latter conclusion was that when § 24 was enacted, Congress did not amend § 6211 or otherwise provide for assessment of the refundable portion of the child tax credit. Since Congress had provided for such treatment for other refundable credits, its silence as to such treatment for the refundable portion of the child tax credit was construed to preclude its assessment. As a result, a refund based on the refundable portion could only be recovered through voluntary repayment or through the erroneous refund procedures of § 7405.

The Community Renewal Tax Relief Act (CRTRA) of 2000, Pub. L. No. 106-554, Appendix G, 114 Stat. 2763A-587 (2000), section 314(a), amended § 6211(b)(4) by adding § 24(d) to the list of tax credits that may be taken into account as "negative tax" in computing a statutory deficiency under § 6211(a). The amendment was retroactive to the enactment of § 24(d). See Notice CC-2001-020 (3/30/01). § 6211(b)(4) now states:

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(4) for purposes of subsection (a) -

(A) any excess of the sum of the credits allowable under sections 24(d), 32, and 34 over the tax imposed by subtitle A (determined without regard to such credits), and

. . . .

shall be taken into account as negative amounts of tax.

The amendment is effective as if included in the provision of the Taxpayer Relief Act of 1997 (Pub. L. No. 105-34) to which it relates (effective for tax years beginning after December 31, 1997).

Section 6211(b)(4), as amended by section 314 of the Act, addresses a deficiency¹ created by overstatement of refundable child credit. It treats the refundable portion of the child credit under section 24(d) as part of a "deficiency." Thus, the usual assessment procedures applicable to income taxes will apply to both the nonrefundable and the refundable portions of the child credit. Conference Agreement at p.1025-26.

The practical consequence is that the tax credit that previously had to be recovered through voluntary repayment or civil suit under § 7405 now can be recovered through assessment. Therefore, rather than the Service being required to file a suit for an erroneous refund, it may now issue a notice of deficiency through normal deficiency assessment procedures.

This reverses the conclusion reached in Chief Counsel Advice 199948027. We recommend that the Wage & Investment Division procedures be modified to reflect this.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

Please call 202-622-4920 if you have any further questions.

¹ Deficiency = tax imposed (correct tax) - [tax reported as shown on return + prior assessments - rebates]