

**Office of Chief Counsel
Internal Revenue Service
Memorandum**

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to: Internal Revenue Service
(Ogden Campus)
1973 N. Rulon White Blvd
Ogden, UT 84404

Attn: Jacqueline T. Mobley, MS 4160

from: Mark H. Howard
Senior Counsel (Salt Lake City)
(Small Business/Self-Employed)

subject: Amended return with tax increase and NOL carryback

This memorandum responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUES

1. Does the IRS have any guidance available on the proper processing of a claim which contains both a general adjustment increasing income and then an adjustment to another year because the general adjustment reduces the net operating loss available for carryback?

2. Can the Service make the assessment on a year in which the taxpayer claimed a prior net operating loss carryback, when an amended return filed by the taxpayer for another year reduces the amount of the net operating loss available for carryback?

3. Can the Service process an amended return and assess tax based on a general adjustment increasing taxable income without allowing the net operating loss carryback claimed in the amended return which would reduce the taxable income?

CONCLUSIONS

1. We could not find any direct guidance for the IRS on the proper processing of a claim which contains both a general adjustment increasing income and then an adjustment to another year because the general adjustment reduces the net operating loss available for carryback. We have provided some references to Internal Revenue Manual provisions we think you may find helpful.

2. The Service cannot make the assessment on a year in which the taxpayer claimed a prior net operating loss carryback, when an amended return filed by the taxpayer for another year reduces the amount of the net operating loss available for carryback. The Service has several avenues available including obtaining the consent of the taxpayer to the assessment in the carryback year or issuing a notice of deficiency for the carryback year.

3. The Service cannot unbundle an amended return and assess tax based on a general adjustment increasing taxable income without allowing the net operating loss carryback claimed in the amended return which would reduce the taxable income. The taxpayer's agreement to assessment based on a return relates to the entire return and not to its unbundled parts.

FACTS

Service personnel at the Ogden Campus have seen two recent claims, where the taxpayer reported tax increases and net operating loss (NOL) carrybacks in the return/claim and accounts management assessed the general adjustments without allowing the NOL. Personnel in Ogden have identified two similar cases and have asked for counsel's guidance on the proper handling of the cases.

First case

In the first case, the taxpayer originally filed a Form 1120 return in which it reported a loss for 2002 and carried the 2002 NOL back to 1997. Later, the taxpayer filed an amended return for 2002. This return reported two new items:

1. an increase to taxable income due to a dividend from a foreign controlled corporation, not reported on the original return; and,
2. an NOL from 2004.

The taxpayer did not file a Form 1120X return for the 1997 year to remove the original 2002 NOL which no longer existed. In the amended return for 2002, the taxpayer mentioned the previous 2002 NOL deduction it had carried back to 1997.

After receiving the amended 2002 return, Accounts Management took the following action:

1. reversed the NOL deduction on the 1997 tax¹ period;
2. increased the 2002 taxable income by the amount of the reported foreign dividend;
3. did not apply the NOL from the 2004 year claimed on the amended return for 2002;
4. forwarded the claim to Exam to make a determination.

Jacqueline Mobley received the claim for classification in the Compliance Service Center. She requested that the 1997 adjustment be reversed. She directed the Tax Examiner to:

1. request that the taxpayer file an amended return for the carryback to 1997;
2. monitor for the receipt of that amended return;
3. if the IRS receives the return, then ask Accounts Management to make the adjustment to the 1997 tax year account;
4. if the Service does not receive the amended return within 45 days, then send the claim to Exam for the adjustment to be made by sending the taxpayer a notice of deficiency.

Ms. Mobley requested that this action all occur prior to September of 2006 when the assessment statute of limitations expires.

Under normal selection criteria, the Service would not send this amended return for examination. Instead, Accounts Management would normally just process the return. Only the NOL carryback from 2002 to 1997 changes that process in this case. Accounts Management took the action it did for fear that the IRS would end up with a delay in process which could bar the assessment of taxes. Ms. Mobley believes that the foreign dividend income causes a three-year extension of the assessment statute pursuant to I.R.C. § 6501(c)(8).

In connection with this first fact pattern, Ms. Mobley has the following questions:

1. Does the IRS have any guidance available on the proper processing of a claim which contains both a general adjustment and then an adjustment to another year because the general adjustment affects a carryback?
2. Can the Service make the assessment on the 1997 tax return where the taxpayer had not filed an 1120X or must the Service issue a notice of deficiency before making the adjustment?

¹ The assessment statute and refund statute expiration dates for 2002 expire in September of 2006.

3. Can the Service process the return which contains the general adjustment without allowing the NOL carryback from 2004 and then send the return for examination to determine whether to allow the NOL carryback from 2004?

Second case

In the second case, the taxpayer filed an amended return which makes a general adjustment increasing the reported income from the original return. This return also asserts a claim for a net operating loss deduction from a loss year currently under audit by the Service. Accounts Management processed the return and allowed the general adjustment to income but did not allow the net operating loss deduction. The assessment statute expiration date in this case is November of 2006.

Regarding this fact pattern, Ms. Mobley asks whether Accounts Management may process a return in this manner and allow a general adjustment but not the net operating loss carryback prior to sending the case to be associated to a field exam?

LAW AND ANALYSIS

Issue 1

You asked whether the Service has any direct guidance for dealing with the type of situation you describe where the taxpayer files an amended return which eliminates or reduces an NOL which the taxpayer previously claimed as a carryback to another year. I have done a number of searches. I found some IRM provisions which have some relevance to the situation you have identified. Those provisions include: IRM 3.11.6.2.1 Carryback/Carryforward (01-01-2006); IRM 4.4.4.5.2 Carryback Claim (excess investment credit, net operating loss, etc.) (02-01-1999); IRM 25.6.6.7 (Claims for Credit or Refund – Special Items of Income, Deduction, Loss or Credit (05-17-2004); IRM 25.6.6.7.1 Net Operating Loss (NOL) Carryback or Capital Loss Carryback (05-17-2004); IRM 21.5.9 (Carrybacks) (10-01-2006); IRM 21.5.9.5 (Carryback Processing) (10-01-2005). None of these manual provisions precisely address the fact pattern you posed, but they do give some direction I think you will find helpful. I also searched for prior Chief Counsel opinions on this subject matter. While I found some, none seemed close enough to your fact pattern to merit bringing them to your attention.

Issue 2

An adjustment to a tax year can result in a reduction or elimination of a net operating loss. If the taxpayer has carried that loss to another year, the Service may not automatically make an assessment of the increased tax in the carryback year. The IRS has several options available, but would normally issue a notice of deficiency to the

taxpayer for the carryback year. The situation you describe does not give the Service the right to make a summary assessment on the carryback year even though the taxpayer has filed an amended return for the net operating loss year admitting the reduction or elimination of the net operating loss. During the audit process, the taxpayer could agree to the assessment for the carryback year. In your case, you have asked the taxpayer to demonstrate this agreement by filing an amended return for the carryback year. If the taxpayer agrees to the assessment, then the IRS can make the assessment without issuing a notice of deficiency.

Issue 3

A number of years ago, the Ogden Service Center asked for guidance on processing of amended returns and posed a question regarding whether it could accept the tax increasing adjustments while ignoring or failing to allow the tax decreasing adjustments. You have posed a similar question about the processing of an amended return and whether the Service can assess a general adjustment increasing tax while not allowing the net operating loss carryback claimed on the return to reduce tax.

Generally, the Supreme Court has described assessment as follows:

The "assessment," essentially a bookkeeping notation, is made when the Secretary or his delegate establishes an account against the taxpayer on the tax rolls. 26 U.S.C. § 6203. . . .

Laing v. United States, 423 U.S. 161, 170 n. 13 (1976). The authority of the Internal Revenue Service to make an assessment relies on several different statutes. The following list includes some of the items the Service can assess:

1. taxes shown on returns, I.R.C. § 6201(a)(1);
2. supplemental assessments, whenever it is ascertained that any assessment is imperfect or incomplete in any material respect, I.R.C. § 6204;
3. deficiencies in tax -- but only after compliance with deficiency procedures, I.R.C. § 6213(a);
4. taxes arising on account of a mathematical or clerical error appearing on a return, I.R.C. § 6213(b)(1);
5. amounts paid as a tax or in respect of a tax, I.R.C. § 6213(b)(4);
6. amounts as to which the taxpayer has waived the deficiency procedures, I.R.C. § 6213(d).

The Service cannot base an assessment on only a part of the information in an amended return. No statutory provision permits it. The most clearly applicable authority comes from I.R.C. § 6201(a)(1) which permits the Secretary to assess all taxes determined by the taxpayer. The Service has the authority to assess, without following deficiency procedures, taxes determined by the taxpayer; it has interpreted this authority to permit a supplemental assessment of additional tax reported on an amended return, unless the taxpayer is protesting the additional amount. However, these provisions refer only to the "tax" reported by the taxpayer -- not to a different amount computed by the Service based solely on the positive adjustments in a taxpayer's return. See also, Treas. Reg. § 301.6211-1(a). The authority to assess taxes shown on returns found in I.R.C. § 6201(a)(1) depends on the concept of agreement by the taxpayer to an amount shown in the return. In the case of Penn Mutual Indemnity Co. v. Commissioner, 32 T.C. 653 (1959) (concurring opinion), aff'd, 277 F.2d 16 (3d Cir. 1960), the Tax Court discussed the legal basis for assessing tax shown on a return and said:

Although the question of jurisdiction was decided correctly by an order of Judge Train, who heard this case, and is the subject of a footnote only in the majority opinion, nevertheless, since it is dealt with at great length in a dissent, it may be well to discuss this issue briefly. "The amount shown as the tax by the taxpayer upon his return" in section 271(a) must be read in the light of the rest of the Code in order to determine the intention of Congress and when so read it seems reasonably clear the Congress meant the tax shown to be due by the taxpayer upon his return. John Moir, 3 B.T.A. 21. It is generally recognized that Congress intended the return to be a method whereby the taxpayer would make a self-assessment of the amount of tax which he agrees or concedes is due and which he intends to pay without any action by the tax-collecting Commissioner. Here, the taxpayer does not agree or concede that any amount of tax is due but, on the contrary, states in a letter accompanying the return that no tax is lawfully due and it will not pay as tax the contested amount shown in the calculation on the return. ... The taxpayer was not self-assessing any tax and it was thus proper for the Commissioner to determine a deficiency in the contested amount so that he could eventually assess and collect the amount as a tax.

32 T.C. at 667-68.

While Penn Mutual dealt with a different fact pattern, the same result should apply here. The Service can assess taxes shown due on the return. However, just as the Service cannot "unbundle" a taxpayer's original return, and assess tax without regard to tax-reducing items, the Service cannot base an assessment on only the tax-increasing items in an amended return. The taxpayer in filing the amended return does not agree to have the Service accept part and reject the rest.

Splitting an amended return into its components in this fashion would also be inconsistent with Service position in other areas. For example, in Consolidated Edison

Co. of N.Y. v. United States, 941 F. Supp. 398 (S.D.N.Y. 1996), the court concluded that a credit had to involve an offset between different kinds of taxes or tax years. See 941 F. Supp. at 402-03. The court rejected the taxpayer's argument that -- for purposes of meeting the 2-year-from-payment refund limitation in section 6511 -- the taxpayer made a "payment," through a credit, when there were upward and downward adjustments in the same year:

Nor did the denial of the ... tax credits create an outstanding income tax liability, which was "paid" when offset against an overpayment of income taxes for the same year. An assessment of tax liability or overpayment resulting from an audit "involves not the offsetting of an overassessment against an existing deficiency, but the offsetting of an upward adjustment against a downward adjustment to a single tax liability ... for a single tax year." Kingston Products Corp. v. United States, 177 Ct. Cl. 471, 368 F.2d 281, 287 (1966).

Id. at 401. See also Republic Petroleum Corp. v. United States, 613 F.2d 518, 525 (5th Cir. 1980). Similarly, in the present situation the upward and downward adjustments are only components of a single tax liability.

Another way of stating that an increase in tax, based only on positive adjustments in such situations, is not assessable as "tax shown on a return," is that it does meet the definition of a "deficiency." Section 6212 authorizes the Secretary to send a notice of deficiency to a taxpayer when the Secretary has determined that there is a deficiency in tax. Section 6211 defines a deficiency as the amount by which the tax imposed by subtitle A or B, or chapter 41, 42, 43, or 44, exceeds the excess of --

- (1) the sum of
 - (A) the amount shown as the tax by the taxpayer upon his return, if a return was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus
 - (B) the amounts previously assessed (or collected without assessment) as a deficiency, over--
- (2) the amount of rebates, as defined in subsection (b)(2), made.

Treas. Reg. § 301.6211-1(a) provides that in certain circumstances any amount shown as additional tax on an amended return may be treated as an amount shown by the taxpayer "upon his return" for purposes of computing the amount of a deficiency. However, as also discussed, this only applies to "additional tax," not just positive adjustments, and not to amounts that the taxpayer is protesting. Thus, any tax increase calculated solely on the basis of the positive adjustments in an amended return would be a "deficiency," subject to the deficiency procedures unless an exception to those procedures applies.

We have also considered whether the Service could rely on an argument of waiver under I.R.C. § 6213(d). Section 6213(d) provides that a taxpayer at any time

has the right, by a signed notice in writing filed with the Secretary, to waive the section 6213(a) restrictions on the assessment and collection of a deficiency. Some might argue that the Service could assert such a deficiency based on the revenue increasing adjustments in the amended return and then treat the amended return as a waiver of restrictions on assessment and collection of the asserted deficiency and immediately assess it, without issuing a deficiency notice. For the following reasons, we conclude that there is no authority for such a procedure. First, there is no language of waiver as to the positive adjustments on the amended return. Second, even if we were to regard the return as such a waiver, it would seem clearly conditional on the Service accepting the negative adjustments as well as the positive. Cf., Powerstein v. Commissioner, 99 T.C. 466 (1990) (where taxpayers filed several amended returns in attempt to generate a net refund, the Service could not reject some, and assess amounts from others). Third, a taxpayer cannot be deemed to waive restrictions on the assessment and collection of a deficiency of which the taxpayer has no notice. As in the case of assessment under section 6201, basic consent is lacking. Cf., Penn Mutual Indemnity Co. v. Commissioner, 32 T.C. 653 (1959) (concurring opinion), aff'd, 277 F.2d 16 (3d Cir. 1960).

We conclude that the Service cannot assess positive adjustments on an amended return while ignoring negative adjustments. Thus, the only alternative open to the Service is to determine a deficiency and issue a deficiency notice, if time permits.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call me at telephone number (801) 799-6620 if you have any further questions.

/s/ Mark H. Howard _____
Mark H. Howard
Senior Counsel (Salt Lake City)
(Small Business/Self-Employed)