

cc: MGRS

Internal Revenue Service
memorandum

DEC 16 1988

DISTRICT DIRECTOR

date: DEC 12 1988 1988 DEC 16 PM 2:04 5480
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to: District Directors
Western Region SACRAMENTO DISTRICT
(Simultaneous copies to Chiefs, Collection Division)

from: Assistant Regional Commissioner (Collection) C
Western Region *[Signature]*

subject: Substitute for Return Program

The attached National Office memorandum on the above subject, dated October 24, 1988, is forwarded for your information.

If there are any questions, please have a member of your staff contact Rick Bazick on FTS 461-6806 or SAM 202-0027.

Attachment

COLLECTION DIVISION *[Signature]*

	RESP	ACTION	CORD	INFO
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CHIEF, FB II				
CHIEF, FB III				
CHIEF, SPF				
CHIEF, I & S				
STAFF ASST.				
MGMT. ANAL.				
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COI-89-0205

Internal Revenue Service
memorandum

date: **OCT 24 1988**

to: Assistant Regional Commissioners (Examination and Collection)
Assistant Commissioner (International) IN
Attn: Director, Office of Management, Planning and Research IN:M
(Information Copies to Service Center Directors)
from: Assistant Commissioner (Examination) EX *Robert Johnson*
Assistant Commissioner (Collection) CO *John T. Oler*

subject: Substitute for Return Program

This memorandum serves as a follow-up to our joint memorandum on the Substitute for Return Program (SFR) issued on March 1, 1988. In that memorandum, we stated our intention to clarify the issue of joint filing status on SFR cases by requesting an interpretation from Chief Counsel, while temporary procedures were provided in the interim. This memorandum incorporates the opinion of Chief Counsel on the issue, as well as the recent decision of the U.S. Court of Appeals for the District of Columbia in Phillips, #87-1398.

Prior to the appellate decision in Phillips, the position of Chief Counsel has been that the statutory provisions of IRC 6013(b) do not prevent the allowance of joint filing status to qualifying taxpayers after the Notice of Deficiency has been issued (or separate return filed), as long as the following three conditions are all met:

- 1) the joint return is filed within 3 years of the original due date of the return (not including extended due dates),
- 2) the taxpayers must not file a petition with the U.S. Tax Court for the year in question, and
- 3) the taxpayers must pay the tax reflected on the joint return at or before the time of filing the joint return.

The Service chose not to pursue the IRC 6020(b) issue (regarding what constitutes a valid substitute for return) in the Phillips case, and only appealed the joint filing status issue of IRC 6013(b) to the circuit court. The only evidence of a substitute for return submitted to the Tax Court in Phillips was an incomplete Form 1040 with only entity information on it, the so called "dummy return." Since the Tax Court found that the "dummy return" submitted alone did not constitute a substitute for return, no prior separate return had been filed by the taxpayer, and nothing in the case prevented the application of joint rates. As a result, the Court of Appeals found for the taxpayer.



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Assistant Regional Commissioners (Examination and Collection)
Assistant Commissioner (International) IN
Attn: Director, Office of Management, Planning and Research IN:M

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We believe that a properly prepared SFR case file, including a Form 1040 with only entity information, a complete examination report, and a Notice of Deficiency, is supportable in court. Therefore, the issuance of a Notice of Deficiency on a thoroughly prepared SFR case file constitutes a separate filing, and the limitations on joint filing as itemized in the second paragraph of this memorandum would be applicable. Other recent court decisions have supported this position (see Smallbridge, 86-2 USTC 9764, in which the Tenth Circuit Court of Appeals upheld a Tax Court decision for the Service; and Conovitz, 39 TCM 929). Therefore, we will follow the guidelines above in all our future preparations of SFR cases.

We acknowledge that in some circumstances it will be administratively difficult to resolve joint filing issues, especially when the return or request arrives toward the end of the 90-day period or when the return raises other issues not previously addressed in the Notice of Deficiency. Ideally, we would like to have enough time to be able to review all of the taxpayer's information, determine what additional information might be needed, and prepare a detailed response with enough remaining time for the taxpayer to petition the Tax Court. However, in many cases we do not have this luxury.

To the extent possible, we should expedite a response to the taxpayer during the 90-day period, including all related joint filing status issues (spousal income, joint tax rates, exemptions) and other allowable items, and inform the taxpayer that the statutory period for filing a petition with the Tax Court has not been, and cannot be, extended by either party. Reasons for disallowance of unallowable or unsubstantiated items should be included in our response. If a phone number is available and there is little time left for the taxpayer to file a petition, we should call the taxpayer to inform him/her of our decision and follow it up with a written response.

If the taxpayer agrees with our examination report and the only outstanding issue is full payment, Collection personnel should contact the taxpayer immediately (by telephone, if possible), advising him/her of the amount and deadline for submitting payment.

Assistant Regional Commissioner (Examination and Collection)
Assistant Commissioner (International) IN
Attn: Director, Office of Management, Planning and Research IN:M

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We will continue to allow unrestricted joint filing status prior to issuance of the Notice of Deficiency or the filing of a separate return. All returns filed under the SFR Program, whether before or after issuance of the Notice, should be screened by Examination for audit potential before processing and assessment. The procedures provided in the previous memorandum for handling returns filed during the 90-day period should still be followed.

Returns filed during the 90-day period require a signed examination report or waiver of restrictions to be considered agreed and allow for assessment of tax and penalties. Therefore, supplemental reports should be used to secure agreements to reduced tax liabilities in Notice of Deficiency cases. Where Collection personnel work taxpayer responses, they can use Examination's supplemental report procedures.

We would like to emphasize the importance of training in the examination of SFR cases because of the multitude of tax issues that may arise during our contacts with taxpayers in this program. Since any number of unusual and complex issues can be raised on returns filed under the SFR Program, we need to ensure that front-line personnel are provided with broad tax law awareness modules so as to be able to recognize potential examination issues and identify such other compliance problems as tax fraud.



Discussions with the field and other functions have shown that there are inconsistencies in the handling of the statute of limitations in Substitute for Return cases. We would like to call your attention to the fact that, under IRC 6501(b)(3), the preparation and filing of an SFR return by the Service does not begin the tolling of the statute of limitations. The normal "3 years from filing/2 years from payment" limitations on assessment do not begin until the taxpayer voluntarily files a return or signs an agreement to a tax assessment proposed by the Service.



If you have any questions, please have a member of your staff contact Duke Lokka in Examination at FTS 566-6474 or Lois Barley in Collection at FTS 343-9673.