Office of Chief Counsel
Internal Revenue Service
memorandum

Number: **201545016**
Release Date: 11/6/2015

CC:PA:01:HMarch
POSTF-112882-15

UILC: 6501.04-00, 6664.01-00, 6212.03-00, 6663.00-00, 6651.22-00

date: July 17, 2015

to: Ardney J. Boland, III
Senior Attorney (New Orleans)
(Small Business/Self-Employed)

from: Adrienne Griffin
Senior Technician Reviewer
(Procedure & Administration)

---

subject: Civil Tax Issues Relating to Taxpayer's Filing of False, Fictitious, or Fraudulent Claims and Guilty Plea Under 18 U.S.C. § 287

This Chief Counsel Advice responds to your request for assistance dated May 8, 2015. This advice may not be used or cited as precedent.

ISSUES

1. Are the taxpayer's returns valid?

2. Should the Service abate the assessments of the or tax liabilities? Are the assessment periods of limitations open? And can the Service assess or reassess the tax and any penalties or additions to tax without following deficiency procedures?

3. If the Service imposes a fraud penalty for tax year , how should the penalty be calculated?

4. For tax years and , can the Service assess the tax and additions to tax for failure to file under section 6651 without following deficiency procedures? And how do the purported returns affect the period of limitations?

5. Does the taxpayer's guilty plea under 18 U.S.C. § 287 collaterally estop the taxpayer from litigating section 6651(f) fraudulent failure to file additions to tax or the section 6663 fraud penalty?

6. Is either way of treating the tax returns – as valid or invalid – more consistent with the positions taken in the criminal prosecution than the other?

CONCLUSIONS

1. The taxpayer's returns are invalid. The taxpayer's return is valid.

2. The Service can abate the assessment. The Service can also abate the excessive portion of the assessment. The period of limitations for tax year is open. The period of limitations for tax year is only open if the Service can establish that the return was false or fraudulent with the intent to evade tax. The Service cannot assess or reassess the tax and any penalties or additions to tax without following deficiency procedures.

3. The underpayment for purposes of the fraud penalty should be calculated as described below.

4. The Service cannot assess the tax and any penalties or additions to tax without following deficiency procedures. The period of limitations is open for tax years and .

5. No, the taxpayer's guilty plea under 18 U.S.C. § 287 does not collaterally estop the taxpayer from litigating section 6651(f) fraudulent failure to file additions to tax or the section 6663 fraud penalty for any of the tax years at issue.

6. Neither treating the returns as valid nor treating them as invalid is inconsistent with the criminal prosecution.

FACTS

As described in more detail below, the taxpayer filed purported tax returns for tax years , which reported false original issue discount (OID) income and false withholdings. The taxpayer attached Forms 1099-OID, Original Issue Discount, to the returns, reflecting the false OID income and false withholdings. The taxpayer falsely claimed that he received the Forms 1099-OID from various financial institutions. For each of the tax years , the taxpayer was charged with one count of filing a false, fictitious, or fraudulent claim under 18 U.S.C. § 287. The taxpayer pled guilty to the charge for tax year and was sentenced to in prison. The government dropped the charges for tax years .

On , the Service received the taxpayer's purported paper return for , which reported false income and false withholdings and claimed an overpayment of $. The "under penalties of perjury" portion of the jurat had been struck through. The Service assessed tax based on the purported return. The amount assessed was grossly overstated because of the false income. The Service also

assessed additions to tax for failure to file and interest. The Service gave the taxpayer no credit for the withholdings and did not issue a refund of the claimed overpayment. The Service then issued CDP lien and levy notices, from which the taxpayer did not request CDP hearings, and the time to do so has now expired.

On , the Service received the taxpayer's purported paper return for , which reported false income and false withholdings. The "under penalties of perjury" portion of the jurat had been struck through. The Service did not process the return.

On , the Service received the taxpayer's purported paper return for , which reported false income and false withholdings. The "under penalties of perjury" portion of the jurat had been struck through. The Service did not process the return.

On , the Service received the taxpayer's electronically filed return for , which reported false income and false withholdings and claimed an overpayment of $. Nothing on the face of the return indicated that it was overtly fraudulent or noncompliant. Specifically, the taxpayer reported a $ tax liability on his return and claimed $ in tax withholdings. The taxpayer actually had $ in tax withholdings but had, however, made $ in estimated payments, which his return omitted. The "under penalties of perjury" portion of the jurat was not struck through, as the return was filed electronically. The Service assessed tax and credited withholdings based on the amounts shown on the return, applied $ of the purported $ overpayment to his tax liability, and froze the remainder. The Service later determined that the correct tax liability for is $.

LAW AND ANALYSIS

You have asked a number of questions, which raise the following issues.

1. Are the taxpayer's returns valid?

For tax years through , the taxpayer struck out the "under penalties of perjury" portion of the jurat. Therefore, these purported returns are not valid returns because they were not executed under penalties of perjury. Section 6061 states that "[e]xcept as otherwise provided … any return, statement, or other document required to be made under any provision of the internal revenue laws or regulations shall be signed in accordance with forms or regulations prescribed by the Secretary."). Section 6065 states that "[e]xcept as otherwise provided by the Secretary, any return, declaration, statement, or other document required to be made under any provision of the internal revenue laws or regulations shall contain or be verified by a written declaration that it is made under penalties of perjury." Courts have repeatedly found that in order for a return to be valid, it must be signed under penalties of perjury. See, .e.g., Beard v. Commissioner, 82 T.C. 766, 777 (1984), aff'd 793 F.2d 139 (6th Cir. 1986) (stating that

in order to constitute a valid return "the taxpayer must execute the return under penalties of perjury"); Mosher v. Internal Revenue Service, 775 F.2d 1292, 1294 (5th Cir. 1985) (holding that where taxpayer had struck out "under penalties of perjury" jurat, the income tax return was invalid, and the Service could not process the return and therefore could not judge the substantial correctness of the self-assessment for purposes of the section 6702 penalty); United States v. Moore, 627 F.2d 830, 833-34 (7th Cir. 1980) (holding that defendant did not file returns for the purposes of the crime of willful failure to file a return under section 7203 where defendant scratched out the verification by his signature); Cupp v. Commissioner, 65 T.C. 68, 78-79 (1976), aff'd 559 F.2d 1207 (3rd Cir. 1977) (sustaining the additions to tax for failure to file returns where the words "under penalties of perjury" were deleted because "in order for a Form 1040 to constitute a valid income tax return it must be signed by the taxpayer under penalties of perjury").

For tax year , the taxpayer did not strike the "under penalties of perjury" portion of the jurat. Courts have identified a four-part test for determining whether a defective or incomplete document is a valid return: "First, there must be sufficient data to calculate tax liability; second, the document must purport to be a return; third, there must be an honest and reasonable attempt to satisfy the requirements of the tax law; and fourth, the taxpayer must execute the return under penalties of perjury." Beard, 82 T.C. at 777. This generally accepted formulation of the criteria for determining a valid return, known as the Beard formulation or the "substantial compliance" standard, derives from a venerable line of Supreme Court cases. Badaracco v. Commissioner, 464 U.S. 386 (1984); Zellerbach Paper Co. v. Helvering, 293 U.S. 172, 180 (1934); Florsheim Bros. Drygoods Co. v. United States, 280 U.S. 453 (1930). In this case, the taxpayer's return satisfies the four-part test and should be treated as valid. The data reported by the taxpayer on the return was incorrect, but as long as the return "on its face plausibly purports to be in compliance," the fact that it is incorrect or even fraudulent does not prevent it from being a valid return. See Badaracco, 464 U.S. at 396-97.

2. Should the Service abate the assessments of the or tax liabilities? Are the assessment periods of limitations open? And can the Service assess or reassess the tax and any penalties or additions to tax without following deficiency procedures?

Tax Year

The Service can abate the assessment for tax year . Section 6404(a) authorizes the Service to voluntarily abate the unpaid portion of an assessment of any tax if the assessment was excessive, made after the assessment period expired, or erroneous or illegal. Treasury Regulation § 301.6404-1(a) states that "the district director or the director of the regional service center may abate any assessment, or unpaid portion thereof, if the assessment is in excess of the correct tax liability." Based on the facts

provided, that the taxpayer claimed false OID income based on false Forms 1099-OID, the assessment for tax year was in excess of the correct tax liability.

Note that because the Service cannot reassess an abated liability unless it does so within the applicable period of limitations, the Service should give careful consideration to period of limitations issues before deciding to abate any assessment. See Gray v. Commissioner, 104 F.3d 1226, 1228 (10th Cir. 1997). Because the return for tax year was invalid, however, no return has been filed for that year. See, e.g., Beard, 82 T.C. at 777. Because no return has been filed, the period of limitations on assessment has not begun to run. See I.R.C. § 6501(c)(3).

The Service cannot assess the tax liability, however, without first issuing a notice of deficiency pursuant to section 6212. As a general rule, the Service may not assess or collect a taxpayer's deficiency unless it sends out the requisite notice of deficiency pursuant to section 6212. See McCarty v. United States, 929 F.2d 1085 (5th Cir. 1991). As defined by section 6211, a "deficiency" is "the amount by which the tax imposed …exceeds … the amount shown as the tax by the taxpayer on his return …." Because the purported returns were invalid, the taxpayer has not shown any tax on his return, and the Service must follow deficiency procedures in order to assess any deficiency against non-filers. See Spurlock v. Commissioner, 118 T.C. 155 (2002).

Similarly, the Service cannot assess any section 6651(a)(1) addition to tax for failure to file without following deficiency procedures. Section 6665(b) provides that deficiency procedures apply to the portion of the addition to tax that is "attributable to a deficiency." Because the taxpayer never filed a valid return, the entire amount of the failure to file addition to tax is "attributable to a deficiency."

Tax Year

Based on the facts provided, that the taxpayer claimed false OID income based on false Forms 1099-OID, the assessment for tax year was also in excess of the correct tax liability. Because the tax return was valid, the Service was authorized to assess the tax shown on the taxpayer's return under section 6201(a)(1). But the Service can voluntarily abate the excessive portion of the assessment for tax year under section 6404(a).

Again, because the Service cannot reassess an abated liability unless it does so within the applicable period of limitations, the Service should give careful consideration to period of limitations issues before deciding to abate any portion of the assessment. See Gray, 104 F.3d at 1228. Because the return was deemed filed on under section 6501(b)(1), the normal 3-year period of limitations under section 6501(a) has expired. Because the return for tax year was valid, the section 6501(c)(3) exception to the period of limitations does not apply. The period of limitations on assessment may be open, however, if the Service can establish that the return was false or fraudulent with the intent to evade tax. In that case, the Service can assess the

tax liability at any time under section 6501(c)(1). Based on the facts provided, there do not appear to be any other relevant exceptions to the period of limitations on assessment. The Service would therefore not be able to reassess any abated portion of the tax liability unless it could establish that the return was false or fraudulent with the intent to evade tax. See Gray, 104 F.3d at 1228.

Additionally, the Service cannot assess any section 6663 fraud penalty without following deficiency procedures. If the Service can establish the taxpayer's liability for the fraud penalty, it will also be able to establish that the period of limitations on assessing the fraud penalty is open under the section 6501(c)(1) exception for false or fraudulent returns as the definition of fraud for purposes of section 6501(c)(1) is the same as the definition of fraud for purposes of section 6663. See Neely v. Commissioner, 116 T.C. 79, 85 (2001).

3. If the Service imposes a fraud penalty for tax year , how should the penalty be calculated?

The section 6663 fraud penalty is 75% of the underpayment, unless the taxpayer can establish that some portion of the underpayment is not attributable to fraud. See I.R.C. § 6663(a) and (b). The underpayment is calculated as follows. See Treas. Reg. § 1.6664-2(c)(1); Feller v. Commissioner, 135 T.C. 497 (2010) (upholding the validity of the regulation).

Underpayment = W – (X + Y – Z), where
W = the amount of income tax imposed;
X = the amount shown as the tax by the taxpayer on his return;
Y = amounts not so shown previously assessed (or collected without assessment); and
Z = the amount of rebates made

See Treas. Reg. § 1.6664-2(a)(2).

In this case, the amount of income tax imposed (W) is $.[1]

The amount shown as the tax by the taxpayer on his return (X) is the tax liability shown by the taxpayer on his return, determined without regard to estimated tax payments or withholding credits, except that it is reduced by the excess of the amounts shown by the taxpayer on his return as credits for tax withheld, as estimated tax payments, or any other payments made by the taxpayer for that year before filing the return over the amounts actually withheld, actually paid as estimated tax, or actually paid before filing the return. Treas. Reg. § 1.6664-2(c)(1). In this case, the taxpayer showed a $

[1] This is the amount of tax liability calculated by the Service based on amounts reported by the taxpayer on his return that were not related to the false 1099-OID income.

tax liability on his return, and claimed $ in tax withholdings, but actually had $ in tax withholdings. However, he did have $ in unreported estimated tax payments. This results in an amount shown as tax by the taxpayer on his return of -$, which is calculated by reducing the $ tax liability shown on the return by the $ in claimed withholdings over the $ in actual estimated tax payments.

The amount collected without assessment (Y) is the amount by which the total of the estimated tax payments and other payments made before the return is filed exceed the tax shown on the return (provided that the excess has not been refunded or allowed as a credit to the taxpayer). See Treas. Reg. § 1.6664-2(d). The total of the estimated tax payments, withholdings, etc., $, exceeds the $ tax shown on the return by $ ($ – $ = $). The Service credited $ of the claimed overpayment to the taxpayer's tax liability, and froze the remainder. This means that $ of the excess of the estimated tax payments over the tax shown on the return was not refunded or allowed as a credit to the taxpayer ($ – $ = $). Therefore, there is an amount collected without assessment of $.

The amount of rebates made (Z) is any abatement, credit, refund, or other repayment made on the ground that the tax imposed was less than the excess of the sum of the amount shown as the tax by the taxpayer on his return plus amounts not so shown previously assessed or collected without assessment over rebates previously made. See I.R.C. § 1.6664-2(e). The crediting of a portion of the claimed overpayment to the taxpayer's tax year is the result of an error in determining the proper credit for withheld tax; the amount was not credited on the ground that the tax imposed is less than the amount shown as tax by the taxpayer on the return. In this case, there are no rebates for .

Based on the above, the underpayment = $ – ($ + $ – $) = $.

You have indicated that you are concerned that the section 6663 fraud penalty would be much larger than the section 6651(f) fraudulent failure to file addition to tax because the fraud penalty is based on the underpayment, which is increased by the amount of the overstated withholdings, but the failure to file addition to tax is based only on the "amount required to be shown as tax." See I.R.C. § 6651(a)(1). You have indicated that you are concerned about treating the tax years differently on the sole basis that the taxpayer struck out the jurats in certain years but not in another. As shown above, however, the amount of the section 6663 fraud penalty for is similar to the amount that a section 6651(f) addition to tax would be because the Service froze the refund of the vast majority of the claimed overpayment. This greatly reduced the amount of the underpayment, and it is in fact similar to the "amount required to be shown as tax." We note, however, that the section 6663 fraud penalty is calculated differently than the section 6651(f) fraudulent failure to file penalty, and in some cases the amounts of the

penalties may be drastically different. Whether the document is signed under penalties of perjury is a necessary requirement of a valid return. See I.R.C. §§ 6061, 6065; Beard, 82 T.C. at 777. And the case law is clear that a taxpayer who files an invalid return has not filed a return for penalty purposes. See Beard, 82 T.C. at 774-80. The taxpayer's conduct in filing the return is similar to the taxpayer's conduct in Feller, in which the taxpayer attached fictitious Forms W-2, Wage and Tax Statement, to his income tax returns reporting fictitious income and fictitious withholdings and seeking a refund of the overpayment that he claimed resulted from these and other falsifications. See Feller, 135 T.C. 497. The Tax Court upheld the section 6663 fraud penalty in Feller; therefore, imposing the fraud penalty for would be consistent with both the regulations and Feller even if the underpayment was not greatly reduced by the Service's freezing of the refund.

4. For tax years and , can the Service assess the tax and additions to tax for failure to file under section 6651 without following deficiency procedures? And how do the purported returns affect the period of limitations?

As with tax year , the Service cannot assess the or tax liability or section 6651 failure to file addition to tax without first issuing notices of deficiency pursuant to section 6212.

As with tax year , because the returns for tax years and were invalid, no return has been filed for either year. See, e.g., Beard, 82 T.C. at 777. Because no return has been filed, the period of limitations on assessment has not begun to run. See I.R.C. § 6501(c)(3).

5. Does the taxpayer's guilty plea under 18 U.S.C. § 287 collaterally estop the taxpayer from litigating section 6651(f) fraudulent failure to file additions to tax or the section 6663 fraud penalty?

Generally, collateral estoppel precludes the litigation of any issue of fact or law that was actually litigated and necessarily determined by a valid and final judgment. Montalbano v. Commissioner, T.C. Memo. 2007-349. Moreover, for the purposes of applying collateral estoppel, it is immaterial that a petitioner's conviction resulted from a plea of guilty to a set of criminal charges as opposed to a trial on the merits. McCarthy v. United States, 394 U.S. 459, 466 (1969). In the context of criminal tax evasion under section 7201, a final criminal judgment estops re-litigation of the issue of fraudulent intent in a subsequent proceeding concerning the civil fraud penalty under section 6663. See Montalbano v. Commissioner, T.C. Memo. 2007-349. In order to establish fraud, the Government must prove that the taxpayer intended to evade a tax believed to be owing. See Wright v. Commissioner, 84 T.C. 636, 639 (1985). The issue here, therefore, is whether the intent to evade tax is a necessary element to both 18 U.S.C. § 287.

Section 287 of Title 18 provides that whoever makes or presents to any person or officer in the civil, military, or naval service of the United States, or to any department or agency thereof, any claim upon or against the United States, or any department or agency thereof, knowing such claim to be false, fictitious, or fraudulent, shall be imprisoned not more than five years and shall be subject to a fine in the amount provided in this title.

The intent to evade tax does not appear to be a necessary element to 18 U.S.C. § 287. Therefore, although the taxpayer's guilty plea may be relevant to the issue of fraud, it does not preclude the taxpayer from litigating the issue.

6. Is either way of treating the tax returns – as valid or invalid – more consistent with the positions taken in the criminal prosecution than the other?

Whether or not any given purported return is valid is what determines how we treat that return – whether we assess summarily and consider the section 6663 fraud penalty or follow deficiency procedures and consider the section 6651(f) fraudulent failure to file addition to tax. Neither is inconsistent with the criminal prosecution. The crime to which the taxpayer pled guilty consists of knowingly making a false or fraudulent claim against any department or agency of the United States. Regardless of whether the taxpayer struck out the "under penalties of perjury" portion of the jurat, the taxpayer has still presumably presented a "claim" to the Government for purposes of 18 U.S.C. § 287. Therefore, whether the purported returns were valid or invalid is not relevant to the criminal prosecution. Neither treating the returns as valid nor treating them as invalid is inconsistent with the criminal prosecution.

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 (202) 317-6845 if you have any further questions.