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date: Assistant Regional Commissioners (Collection)  
to: Assistant Regional Commissioners (Examination)  
Assistant Commissioner (International) IN  
Attn: Director, Office of Management, Planning and Research IN:M  
(Information Copies to Service Center Directors)  
from: Director, Office of Field Operations CO:O:SC *Grant A Newman*  
Director, Office of Examination Program EX:E *Dianna Brant*  
National Office

OFFICE OF ARC (COLLECTION)  
WESTERN REGION

subject: Substitute for Return Program

When Collection assumed responsibility for working Substitute for Return (SFR) referrals in October 1986, the scope of the program was expanded dramatically. Now that the Service Center Collection Branches (SCCBs) are beginning to make assessments on large numbers of cases, several issues have come up that require clarification. The issues are discussed in detail in Attachment I. Please ensure that all field personnel, specifically ACS, Cff, and appropriate SCCB employees receive a copy of this memorandum, including the attachment.

Another major issue that requires clarification is a taxpayer electing joint filing status when a Notice of Deficiency (90-day Statutory Notice) has been issued or when a separate return has already been filed.

✓ Once a Notice of Deficiency has been issued IRC 6013(b) specifically states that a taxpayer cannot elect joint filing status, if a petition is then filed with the U.S. Tax Court. This restriction applies on an independent basis in all cases; there are no extenuating circumstances or exceptions to the rule.

The Service has historically interpreted this provision to bar joint filing entirely during the 90-day period, with no exception for whether or not a petition was filed with the U.S. Tax Court. The recent Tax Court decision in the Phillips case (86 TC433), which is currently on appeal to the U.S. Court of Appeals, has caused some doubt as to the proper handling of both substitute for returns and joint filing status issues. To clarify this situation, and because Examination receives the unagreed fallout from this program, National Office Examination is expediting a written opinion from the Office of Chief Counsel. In the meantime, joint filing status should not be allowed once the 90-day Statutory Notice has been issued, for any reason, and Examination should continue to select these returns during the screening process.

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✓ In addition to the above restriction, when a separate return has already been filed, two other statutory restrictions prevent joint filing status under any circumstances:

(1) The first applies when a joint return is submitted when three years have passed since the original due date of the return (without regard to extensions).

(2) The second restriction applies if the taxpayer fails to pay the tax shown on the joint return in full at the time of filing.

✓ In other words, if a separate return has previously been filed, a taxpayer can elect to file jointly if three years have not passed since the original due date of the return, the joint tax is paid in full, and a Notice of Deficiency has not been issued.

It should be noted that joint returns submitted prior to issuance of the Notice of Deficiency can be accepted as original filings if no prior returns have been filed by the taxpayers, since the three restrictions noted above will not apply.

In accordance with IRM 5480, all returns received from taxpayers under the SFR Program must be screened by Examination. Prior to issuance of the Notice of Deficiency, a taxpayer can elect joint filing status, Examination can select the return during the screening process, and the normal processing actions can be taken by Collection. However, once the Notice of Deficiency has been issued, the Notice itself serves as an original filing under IRC 6020(b), and any subsequent taxpayer filing constitutes an amended return. Therefore, a TC 290 posting is not appropriate after the Notice of Deficiency has been issued since it serves to restrict the Service's position if the case is petitioned with Tax Court. Instead, if Examination selects a return filed during the 90-day period, input TC 595 cc 88 and process the return with a TC 977. The relevant portions of section 860 of IRM 5480 pertaining to the processing of returns filed during the 90-day period will be revised.



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Section 850 of IRM 5480 mentions revising the 90-day Statutory Notice. Based on the above clarification, this phrase will be eliminated. If a 90-day Statutory Notice should be revised based on information and/or a return submitted by the taxpayer, Examination will issue a supplemental report.

There are proposed Revenue Procedures dealing with the Rescission of Statutory Notice of Deficiency as provided in Section 1502(a) of the Tax Reform Act of 1986. The current approach to this provision is conservative and is not intended for Collection's use during SFR processing. However, Collection is coordinating with Chief Counsel on a broader interpretation of this authority to address the potential customer relations problem when returns and/or correspondence are received after the Statutory Notice of Deficiency has been issued. This change would relieve taxpayers of the burden of paying taxes they may not owe and having to subsequently file for a refund of those taxes. The rescission would be consistent with the Commissioner's goal of providing taxpayer service, fairness, reducing problems, and warding off unfavorable publicity. We will keep you advised of our progress.

If there are any questions, please have your regional staff contact Jennifer Morrison on FTS 343-9672, or Jan Rocks on FTS 566-8600.

Attachment

Adjustments

Recently, a Manual Supplement was issued, 5G-337, which contains guidelines for requesting adjustments on SFR assessments. As stated in this document, the only time an SFR assessment can be adjusted is if one or more of the following criteria are met: the taxpayer never received the statutory notice; the taxpayer was mentally incapable of understanding the notice; or the taxpayer, due to unusual circumstances, was not able to gather the information necessary to file his own return. This last category is to be used only in unique situations and with caution.

There has been a great deal of misunderstanding about what can or cannot be done with an SFR assessment, and what is an acceptable excuse for processing an adjustment. These cases are treated the same as any other audit adjustment, since technically an SFR case is the result of a correspondence audit. As mentioned above, the circumstances which justify an adjustment are very limited. An SFR assessment is different from a BMF 6020(b) assessment. A legal statutory notice of deficiency is issued, and the taxpayer has the right to go to U.S. Tax Court. Once the assessment is made, the taxpayer loses the right to make several elections that could have been taken if he/she had voluntarily filed a return. In effect, the IRS makes the election for him/her and the assessment becomes a legal debt. Unless one of the above three conditions exists, we cannot take any action to adjust the balance due until the assessment has been full paid. At that time the taxpayer may file a claim.

Undelivered Mail

There have been some questions and concerns with the volume of undelivered mail processing in SFR. If research does not obtain a new address we are discontinuing SFR processing on these cases to avoid inflating our inventory and increasing the risk of invalid assessments. In this situation input TC 593 CC 88. IRM 5480, texts 720 and 833, will be revised accordingly. To enhance our processing, Fresno's SCCB is testing tape-to-tape address research with a credit bureau for SFR/ASFR. We will keep you advised of its progress and make it available as soon as possible.

Credit Balances

One additional item that should be addressed is credit balance conditions. If a TDI period undergoing SFR processing is closed TC 590 or 591, it is important that special care be taken to resolve any credit balance remaining on that module. Follow the procedures found in IRM 5422.7 when this situation is encountered.