DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

July 9, 2002

Number: **200235025**
Release Date: 8/30/2002

CC:PA:CBS:Br2
GL-120227-02
UILC: 6871.00-00

MEMORANDUM FOR JILLENA WARNER, ASSOCIATE AREA COUNSEL (SB/SE)
AREA 4, LOUISVILLE

FROM: Lawrence Schattner, Chief, Branch 2
(Collection, Bankruptcy & Summonses)

SUBJECT: Advisory Opinion–Return for Dischargeability Purposes

This memorandum responds to your request for advice dated April 9, 2002, in determining whether a Form 1040 filed after a substitute for return (SFR) is completed by the Service under I.R.C. § 6020(b) and an assessment has been made constitutes a return for purposes of dischargeability under B.C. § 523(a)(1)(B)(i). In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent. This writing may contain privileged information.

BACKGROUND

The Sixth Circuit in In re Hindenlang,164 F.3d 1029, 1034 (6th Cir. 1999), cert. denied, 528 U.S. 810 (1999), held that a Form 1040 after the Service based on an SFR, the serves no tax purpose and therefore does not constitute a return under the Internal Revenue Code nor a return for purposes of dischargeability under B.C.§ 523(a)(1)(B)(i). The return filed in Hindenlang contained the same information and reported substantially the same liability as in the SFR prepared by the Service. In support of its conclusion that such Form 1040 serves no tax purpose, the Sixth Circuit that the return would have had no effect on the running of the statute of limitations for assessment under section 6501(a), and would not affect liability for civil and criminal penalties for failure to file a timely return if the Service chose to assert such liabilities. Some courts have declined to adopt the Hindenlang rationale and prefer to review the factual circumstances of each case to determine whether a purported income tax return has any tax effect and represents an honest and genuine attempt to comply with the tax laws. This memorandum provides guidance on whether the Service should follow the Hindenlang approach.

returns for dischargeability purposes where the Forms 1040, unlike the Hindenlang facts, report tax liabilities that are either greater or less than the amount by the Service on the SFR.

ISSUES

1. Should the Service follow the Hindenlang conclusion that a Form 1040 filed after Service has made a deficiency assessment based on an SFR prepared under section 6020(b) serves no tax purpose, and thus is not a return for purposes of the exception to discharge under B.C. § 523(a)(1)(B)(i) rather than reviewing the facts of each case to determine whether the taxpayer has made an honest endeavor to comply with the tax laws?

2. When a taxpayer files a Form 1040 listing a liability greater than that determined by the SFR, and files the document after a statutory notice of deficiency has been mailed and an assessment has been made, does the Form 1040 constitute a return for dischargeability purposes?

3. When a taxpayer files a Form 1040 listing a liability less than the amount determined by the Service via the SFR and assessed after a defaulted deficiency notice, does it constitute a return for dischargeability purposes where the Service accepts the information on the Form 1040 and abates a portion of the assessment in excess of the amount reported on the Form 1040?

CONCLUSIONS

1. The exact parameters of the Hindenlang decision are unclear. On the one hand, Hindenlang taxpayer

While this conclusion seems to establish a bright line rule that Forms 1040 filed after a deficiency assessment is made are not returns, the Sixth Circuit also noted that if a taxpayer could establish a tax purpose for filing a Form 1040 after the Service has made an assessment, the Government could still produce evidence showing that filing such document was not an honest and reasonable attempt to comply with the tax laws. This statement seems to indicate that a tax purpose could exist for Forms 1040 filed after the Service has made a deficiency assessment in which case the facts and circumstances of each case would determine whether the Form 1040 met the fourth prong of the test. While the Sixth Circuit did not explain clearly what it meant by "tax purpose" or "effect," it is our view that a Form 1040 does not have a tax purpose or effect unless it satisfies a purpose for filing returns. Once the Service makes an assessment amount determined by the Service, as reported on an SFR after the taxpayer defaults a statutory notice of deficiency, the purpose and function of a return as an integral part of the tax determination process cease. While the Service is authorized to reconsider liabilities that have been assessed and to abate assessments that it considers are excessive in amount, these reconsideration and abatement procedures are discretionary and beyond the scope of the return filing requirements. Thus, we generally believe that a Form 1040 filed after a deficiency assessment is made

does not possess a purpose for filing returns and would therefore fail to satisfy the fourth prong of the test.

2. A Form 1040 reporting a liability greater than the amount reported on an SFR prepared by the Service and already assessed is a return under the Internal Revenue Code because the additional assessment would be based on the amount reported on the Form 1040, thus fulfilling the purpose of a return of requiring the taxpayer to supply income information on which to compute a liability and make assessments. Form 1040 would trigger the statute of limitations for assessing the additional amount under section 6501(a). The previous assessment based on the SFR does not affect the Service's ability to make further determinations of liability and assessments. Under these circumstances, the Form 1040 constitutes a return for the additional liability reported thereon for purposes of determining dischargeablility under B.C. § 523.

3. A Form 1040 reporting a liability less than the amount reported on an SFR prepared by the Service under section 6020(b), and filed after the taxpayer defaulted on a statutory notice of deficiency and the taxes were assessed, a return under the Internal Revenue Code and thus not a return for purposes of determining dischargeability under B.C. § 523. even if the Service later agrees with the amount reported on the Form 1040 and decides to abate a portion of the assessment in excess of that amount. The Service already has determined the amount of liability on its own and made the assessment, thus the Form 1040 fails to fulfill the purpose of a return to supply income information on which to base an assessment. The fact that the Service decides to abate a portion of the assessment, based on information contained in the Form 1040, does not make that document a return when the Form 1040 was filed after the Service had made its determination without the benefit of a return and after the taxpayer had the opportunity to contest the merits of his liability in the Tax Court. The Form 1040 has no effect on the statute of limitations for assessment nor mitigate any civil or criminal penalties for failure to file a timely return. A Form 1040 submitted after assessment that does not report any additional income and liabilities is not an honest endeavor to comply with the tax laws, because it fails to fulfill the self-assessment function of a return, but is usually a mere attempt to prevent the Service from collecting the assessed liabilities from the taxpayer.

DISCUSSION

Issue 1

Where a taxpayer fails to file a return, I.R.C. section 6020 authorizes the Service to prepare a substitute for return ("SFR") in order to assess the tax. The Code allows for two types of SFRs. Under section 6020(a), the Service prepares an SFR based on the taxpayer's "consent to disclose all information necessary for the preparation thereof" and the taxpayer signs it. Under section 6020(b), the Service may prepare an SFR without the input, or even knowledge of the taxpayer.

Bankruptcy Code section 523(a)(1)(B)(i) excepts from discharge taxes "with respect to which a return . . . was not filed." The policy behind this subsection is that a debtor should not be permitted to discharge a tax liability based upon a required tax return that he never filed. In re Jackson, 184 F.3d 1046, 1052 (9th Cir. 1999). Because the term "return" as used in B.C. § 523(a)(1)(B) is not defined in the Bankruptcy Code, and nothing in the legislative history of B.C. § 523 indicates whether Congress had in mind a specific definition of what constitutes a return for purposes of section 523, courts have construed it to mean "those documents which would qualify as returns under the Internal Revenue Code." See In re Hindenlang, 164 F.3d 1029, 1035 (6th Cir. 1999). Generally, if the debtor has filed a return under the tax laws, then he has filed a return for discharge purposes. See, e.g., In re Villalon, 253 B.R. 837 (Bankr. N.D. Ohio 2000); In re Wright, 244 B.R. 451 (Bankr. N.D. Cal. 2000); In re Beard, 181 B.R. 653 (Bankr. M.D. Fla. 1995).

In In re Hindenlang, the Sixth Circuit considered the situation in which a debtor filed returns calculating his taxes substantially the same as SFRs previously prepared by the Service. In re Hindenlang, 164 F.3d 1029, 1031 (6th Cir. 1999), cert. denied, 528 U.S. 810 (1999). The court utilized prior Supreme Court precedent and derived a four-part test to determine whether a document filed with the Service constitutes a return under section 523(a)(1)(B). In re Hindenlang, 164 F.3d at 1033 (6th Cir.), (citing Germantown Trust Co. v. Commissioner, 309 U.S. 304 (1940); Zellerbach Paper Co. v. Helvering, 293 U.S. 172 (1934). In order to qualify as a return:

(1) it must purport to be a return; (2) it must be executed under penalty of perjury; (3) it must contain sufficient data to allow calculation of tax; and (4) it must represent an honest and reasonable attempt to satisfy the requirements of the tax law.

Hindenlang, 164 F.3d at 1033. See also, In re Pierchoski, 243 B.R. 639, 642 (Bankr. W.D. Pa. 1999); In re Billman, 221 B.R. 281, 282 (Bankr. S.D. Fla. 1998); In re McGrath, 217 B.R. 389, 392 (Bankr. N.D.N.Y. 1997). The focus in most cases is on the fourth prong of the test, i.e., whether it constitutes an honest and reasonable attempt to comply with the tax law. As the court stated in Hindenlang, a return filed too late to have any effect at all under the Internal Revenue Code cannot constitute an honest and reasonable attempt to satisfy the requirements of the tax law, and accordingly, a Form 1040 is not a return if it no longer serves any tax purpose or has any effect under the Internal Revenue Code. Hindenlang, 164 F.3d at 1034.

Applying the four part test to the type of situation you present, there would generally be no dispute that the late filed Forms 1040 purport to be returns and further pass the second and third prongs of the test, provided the debtor signed the Forms 1040 and they contained the information needed to calculate the debtor's tax liability. The final issue, however, would be whether the particular documents, filed after the Service has created SFRs and made a formal assessment represent an honest and reasonable attempt to satisfy the requirements of the tax law.

In In re Hindenlang, 164 F.3d 1029, 1034 (6th Cir. 1999), the court stated that, "as a matter of law ... a Form 1040 is not a return if it no longer serves any tax purpose or has any effect under the Internal Revenue Code. A purported return filed too late to have an effect at all under the Internal Revenue Code cannot constitute 'an honest and reasonable attempt to satisfy the requirements of the tax law.' Once the government shows that a Form 1040 submitted after an assessment can serve no purpose under the tax law, the government has met its burden." See also In re Hetzler, 262 B.R. 47 (Bankr. D. N.J. 2001) (relying upon In re Hatton, 220 F.3d 1057 (9th Cir.2000) and Hindenlang, court holds that as a matter of law, the Service met its burden to establish that the 1040 forms filed by the debtor did not represent an honest and reasonable attempt to comply with the tax laws where the forms were filed three years after the Service issued assessments for the years in question, and substantially mirrored the information in the assessments); In re Shrenker, 258 B.R. 82 (E.D.N.Y. 2001).

The statement above indicates that the Government has the burden of showing that a Form 1040 filed after an assessment does not have a tax purpose, implying that such late filed document might have a tax purpose. See also Id. at fn. 7. However, the Sixth Circuit also concludes as follows: "...when the debtor has failed to respond to both the thirty-day and the ninety-day deficiency letters sent by the IRS, and the government has assessed the deficiency, then the Forms 1040 serve no tax purpose, and the government thereby has met its burden of showing that the debtor's actions were not an honest and reasonable effort to satisfy the tax laws. " Id. at 1034. While this conclusion would seem to establish a bright line rule that Forms 1040 filed after a deficiency assessment serve no tax purpose, other statements in the Hindenlang mentioned above indicate that such documents could serve a tax purpose, thus requiring the government to prove in each case that the facts and circumstances support a finding that filing a Form 1040 was not an honest and reasonable attempt to comply with the tax laws.

Other courts seem to find that a Form 1040 filed after an assessment could have a tax purpose and inquire on a case by case basis as to whether the debtor's late submissions are reasonable attempts to comply with the tax law. See, e.g., In re Nunez, 232 B.R. 778 (9th Cir. BAP 1998) (holding that a Form 1040 meets the honest and reasonable requirement if, on its face, it appears to be an honest and genuine endeavor to satisfy the law, and the debtor submitted it with the subjective intent to comply with his tax obligations); In re Rushing, 273 B.R. 223 (Bankr. D. Ariz. 2001) (holding tax returns submitted with offers in compromise based upon doubt as to collectability did not constitute an honest and reasonable attempt to comply with the federal tax laws); In re Crawley, 244 B.R. 121 (Bankr. N.D. Ill. 2000) (declining to follow the reasoning of Hindenlang, and finding that late filed returns were a belated honest attempt to comply with the tax law filing requirement).

We believe that a Form 1040 does not have a tax purpose or effect unless it satisfies the purpose for filing a return. A Form 1040 filed after the taxpayer failed to pursue his remedies in the Tax Court and after the Service makes an

assessment should have no legal effect because filing such document after the Service has made its own determination of liability is inconsistent with the basic principle of self-assessment in our tax system that taxpayers are required to report their income information on a return and make their own determination of liability on which an assessment can be made under section 6201(a). Once the Service makes an assessment of liability under its authority of section 6201(a), the determination process is over and the Service may pursue the full panoply of administrative and judicial remedies to collect the assessed liability. While during these administrative and judicial proceedings the taxpayer may request the Service to reconsider its determination of the assessed liability and may submit information to support its request for reconsideration, the form in which that information is submitted is not provided by the Code. Thus, the fact that the taxpayer submits his income information on a Form 1040 after assessment to ask for reconsideration should have no greater legal effect than if that information was submitted in a letter or given to the Service by telephone. In each case, the Service has the discretionary authority whether to accept or reject the information supplied by the taxpayer, but since the assessment has already been made, there is no legal requirement that the information be placed on a Form 1040 and signed under penalties of perjury - the time for doing that in the form prescribed by the Service was before the assessment was made so that the Service would not have to make its own determination under the authority of section 6020(b). Thus, the fact that the information is on a return form does not make it a reasonable attempt to comply with the taxpayer's return filing obligations.

Issue 2

In Hindenlang, the Government posed a hypothetical situation where the taxpayer files a Form 1040 after an assessment is made and reports a liability in excess of the assessed amount. See Hindenlang, 164 F.3d at 1033, n.5. The Government argued that the Form 1040 would constitute a return for dischargeability purposes to the extent it resulted in a higher tax obligation than the assessment, under the theory that the taxpayer made a good faith attempt to comply with the tax laws in reporting the additional amount. The Government made this argument in In re Hetzler, 262 B.R. 47 (Bankr. N.J. 2001). The debtor in Hetzler, after the Service had made an assessment based on an SFR, filed a return which resulted in an additional $237 of tax liability. The debtor argued that the additional liability rendered the tax year dischargeable. The Service agreed that the additional amount, was "the product of a self-assessment process that may be discharged by the debtor. . . [b]ut the remainder of the assessment . . . restated by the debtor three years later, does not qualify as an honest and reasonable attempt by the debtor to comply." Id. at 54.

We concur in the Government's view that a Form 1040 filed after an assessment is made based on an SFR prepared by the Service under section 6020(b) and reporting a liability in excess of the assessed amount is a return under the Internal Revenue Code, but only to the extent of the additional liability. The Form 1040 is not a return with respect to the liabilities already assessed based on the SFR. An

assessment for a particular taxable period based on an SFR does not preclude the Service from making additional assessments for the same taxable period. . Since the SFR prepared under the authority of section 6020(b) is not a return and does not trigger the statute of limitations for assessment under section 6501(a), the Form 1040 reporting an additional liability would constitute the original return for the additional amount not already determined in the SFR and would trigger the running of the statute of limitations for assessing that additional amount. Thus, the Form 1040 has a tax purpose or effect under the Code and the filing of this document reporting income information and calculating the tax liability before the Service itself has determined the additional income and liability and made an assessment is consistent entirely with the basic structure of the Code.

Issue 3

A Form 1040 reporting a liability less than the amount reported on an SFR prepared by the Service under section 6020(b) and filed after the taxpayer defaulted on a statutory notice of deficiency and the taxes were assessed, is not a return for purposes of determining dischargeability under B.C. § 523. As Hindenlang points out, a Form 1040 filed after assessment has no tax purpose or effect under the Internal Revenue Code because it fails to satisfy a purpose for filing a return. In addition, such document neither affects the running of the statute of limitations for assessment nor the taxpayer's civil or criminal liability for failure to file a timely return. Moreover, a Form 1040 filed after an assessment that does not report any liabilities in excess of such assessment is inconsistent with the basic principle of self-assessment under which the Code operates that requires taxpayers to report their income information on forms prescribed by the Service that serves as a basis on which assessments are made under section 6201(a).

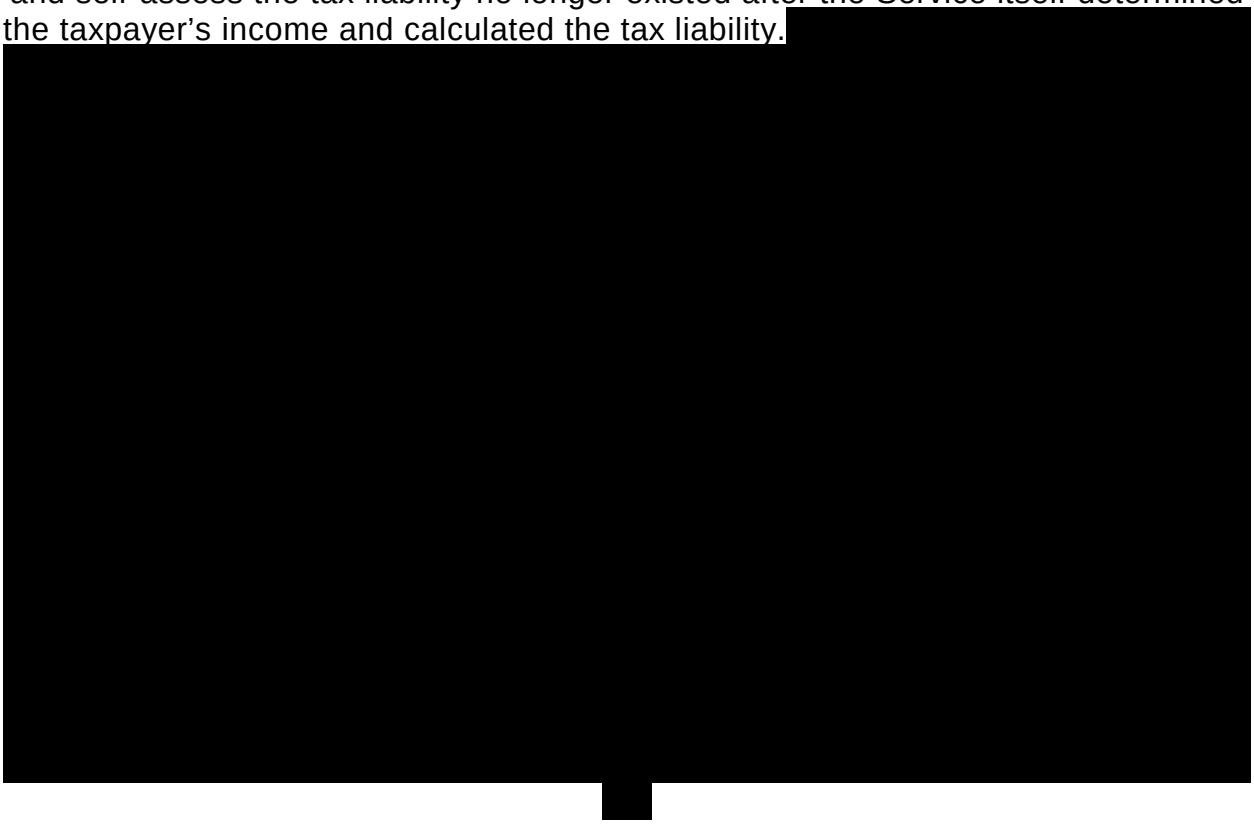
One might argue that if the Service accepts the information on the Form 1040 and consequently abates a portion of the assessment under its authority of section 6404(a), filing the Form 1040 had a tax purpose in persuading the Service to abate the assessment of the taxpayer's liability, or in persuading the Service to allow the overpayment, and thus should constitute a return even under Hindenlang. We disagree. First, a Form 1040 filed after an assessment and which reports less liability than the assessed liability but does not claim an overpayment is in essence a request to abate an assessment under section 6404(a). However, section 6404(b) specifically prohibits taxpayers from filing claims for abatement. The Service's decision to abate an assessment under section 6404(a) is discretionary and while the Service may consider information provided by the taxpayer in deciding whether to abate a liability, the fact that this information is on a Form 1040 rather than in some other communication format is irrelevant under the Code. Thus, construing this document as a claim for abatement of an assessment that has a tax purpose because the Service did in fact abate a portion of the assessment certainly does not make the document a return where the Code specifically prohibits taxpayers from filing claims for abatement and clearly does not

require that information supporting an abatement be given in any prescribed form as in the case of a return.

Second, even if we accept the argument that a Form 1040 filed after assessment has a tax purpose, we believe that such Form 1040 is not an honest endeavor to comply with the tax laws because it fails to fulfill the self-assessment function of a return. The taxpayer had an opportunity to aid the Service in determining the correct tax liability through the statutory notice and Tax Court procedures but failed to exhaust these procedures. Rather than trying to comply with the tax laws by agreeing to a tax liability against which the Service could assess, the purpose of filing a Form 1040 after assessment and notice and demand simply is to prevent the Service from exercising its collection mechanisms against assessed liabilities.

LITIGATION HAZARDS AND OTHER CONCERNS

It is our view that the requirement imposed by the Sixth Circuit in Hindenlang that a Form 1040 have a tax purpose or effect in order to constitute an honest and reasonable attempt to comply with the tax laws should be construed to mean that filing such document contains a purpose for filing returns. Thus, filing a Form 1040 after the Service has made a deficiency assessment based on an SFR and requesting the Service to abate a portion of the assessed liabilities does not have a tax purpose because the purpose for filing a return to report income information and self-assess the tax liability no longer existed after the Service itself determined the taxpayer's income and calculated the tax liability.



If you have any further questions, please contact the attorney assigned to this matter at (202) 622-3620.