Office of Chief Counsel
Internal Revenue Service
memorandum

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from: Peter K. Reilly
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subject: **Disallowance of Puerto Rico Filers' Claims for Refund of Additional Child Tax Credit**

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

ISSUE

What is the proper procedure for disallowing the additional child tax credit under section 24(d) of the Internal Revenue Code when the Internal Revenue Service (Service) has issued a refund or when the Service has frozen the refund?

CONCLUSION

Deficiency procedures should be followed when disallowing the additional child tax credit under section 24(d) in either event

FACTS

Your memorandum offers two different scenarios whereby a taxpayer, a resident of Puerto Rico, files a Form 1040 claiming that his/her income is exempt from tax under section 933, but that he/she is entitled to the refundable additional child tax credit. We have been advised that the procedures for denying the additional child tax credit are the same for Puerto Rican taxpayers as it is for U.S. taxpayers. We are providing this advice based on this assumption.

In the first scenario, the Service issues the refund but later reviews the Form 1040 and determines that the taxpayer has not established that he/she is entitled to the credit. The Service then asks for more information but the taxpayer fails to provide it. In the

second scenario, the Service reviews the Form 1040 prior to issuing the refund and requests more information but does not receive a response from the taxpayer. The Service then places a hold on the refund.

Currently, the Service is issuing notices of deficiency to claimants in Scenario 1 and notice of disallowance letters to claimants in Scenario 2.

LAW AND ANALYSIS

Section 24(d) provides for the refundability of the child tax credit for a "qualifying child." Congress provided a mechanism so that the overstatement of the additional child tax credit would be taken into account for tax deficiency purposes. When initially enacted, deficiency procedures only applied to the nonrefundable portion of the credit.

The amendment of section 6211(b)(4)(A)[1] by the Community Renewal Tax Relief Act (CRTRA) of 2000, Pub. L. No. 106-554, Appendix G, Section 314(a), specifically addresses the treatment of the refundable portion of the child credit as a deficiency. It provides that any excess of the sum of such credits as shown by the taxpayer on the return over the amounts shown as tax by the taxpayer on the return (determined without regard to such credits) is taken into account as a negative amount of tax in computing a deficiency.

The legislative history of CRTRA section 314(a) is sparse, merely stating that the amendment to section 6211:

> [T]reats the refundable portion of the child credit under section 24(d) as part of a "deficiency." Thus, the usual assessment procedures applicable to income taxes will apply to both the nonrefundable and the refundable portions of the child credit.

H.R. Conf. Rep. No. 106-1033 at 1025 (2000).

If the Service determines that the taxpayer is not entitled to the credit, a notice of deficiency should be issued and the disallowed amount is reflected as a "negative tax." I.R.C. § 6211(b)(4). A notice of deficiency should be issued when the tax shown on a return is less than the actual tax liability, regardless of whether the taxpayer claims a refund on the return.

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[1] Section 6211(b)(4) as amended, states the following:

> (4) For purposes of subsection (a) –
>
> > (A) any excess of the sum of the credits allowable under sections **24(d)**, 32 and 34 over the tax imposed by subtitle A (determined without regard to such credits), . . .
>
> shall be taken into account as negative amounts of tax. (Emphasis added).

Congress amended section 6211(b)(4)(A) to subject disallowance of the credit to deficiency procedures and allow taxpayers to contest such determinations in the Tax Court when the credit is refundable. The change simplifies matters for the both the Service and the taxpayer. For the Service, the change obviates the need to file suit for an erroneous refund under section 7405. For the taxpayer, the change allows the taxpayer to contest denial of the credit in the United States Tax Court by filing a petition in response to the notice of deficiency, rather than by initiating a refund suit under section 7422.

With respect to situations in which the refund has not been made, we recognize that the Service has authority to refuse to allow a refund or credit, even without assessment, of any amount collected within the period of limitations on assessment, on the ground that there is no "overpayment" as required by section 6402. See Lewis v. Reynolds, 284 U.S. 281 (1932); Rev. Rul. 85-67, 1985-1 C.B. 364. This authority has been used, for example, to retain funds when, for some reason, a timely assessment of tax has not been or cannot be made. See, e.g., Ewing v. Commissioner, 914 F.2d 499 (4th Cir. 1990).

The Service has not generally used this authority to substitute claim disallowance procedures for normal deficiency procedures with respect to refunds or credits claimed on original returns since to do so would deprive taxpayers of their right to contest deficiencies in Tax Court. There is no requirement in the Internal Revenue Code that a notice of claim disallowance be issued. Claim disallowance procedures do not provide taxpayers with the prepayment opportunity to litigate which is provided by deficiency assessment procedures.

Given the Service's general practice of following deficiency assessment procedures even in refund hold cases, Congress' actions subjecting the credit adjustments to deficiency procedures, and the general obligation of the Service to treat similarly-situated taxpayers consistently, we see no justification for not following deficiency procedures here.

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 at if you have any further questions.