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From:
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To:
Cc:
Subject: RE: The question we talked about

Section 6501(a) provides that an assessment of tax must be made within 3 years after the return was filed.

Section 6501(e)(1)(A) provides that if a taxpayer omits from gross income an amount properly includible and that omission is in excess of 25 percent of the amount of gross income stated in the tax return, the tax may be assessed, or a proceeding in court for the collection of such tax may begin without assessment, at any time within 6 years after the return was filed.

For purposes of a trade or business, section 6501(e)(1)(B) specifies that gross income is the "total amounts received or accrued from the sale of goods or services (if such amounts are required to be shown on the return) prior to the diminution by the costs of such sales or services." Under section 6501(e)(1)(B), an amount is not considered to be omitted from gross income, however, if the amount is disclosed on the return in a manner adequate to apprise the IRS of the nature and amount of the item.

In your case, the taxpayer omitted over 25% of gross income on a timely filed original tax return. Subsequently, but within the three year period under section 6501(a), the taxpayer filed an amended return showing additional gross income. Your question is whether the amended return reporting the additional income is a disclosure of income that would prevent the amount omitted on the original from being considered to be "omitted" for purposes of applying the six-year period under section 6501(e).

The filing of an amended return showing additional income will not operate to preclude the application of section 6501(e). The original return governs for purposes of determining whether the taxpayer has omitted from gross income an amount that is over 25% of the amount stated on the return. Houston v. Commissioner, 38 T.C. 486 (1962) (amended return's inclusion of salary omitted on original return did not prevent section 275(c) of the 1939 Code (predecessor to section 6501(e)) from applying); Chin v. Commissioner T.C. Memo. 1994-54 ("…we ignore the amended return when applying section 6501(e)"). Further, the Supreme Court in Badaracco v. Commissioner, 464 U.S. 386, 395-96 (1984) held that the filing of an amended return subsequent to a taxpayer's filing of a fraudulent return does not affect the unlimited limitations period under section 6501(c)(1). In reaching it's decision that the taxpayer could not use an amended return to prevent the application of section 6501(c)(1), the Court recognized that a taxpayer who non-fraudulently omits 25% of gross income "cannot benefit by filing an amended return; instead he must live with the six-year period specified in § 6501(e)(1)(A)." The Court concluded that Congress did not intend for taxpayers who file fraudulent returns to be better off than taxpayers who understand their income without fraud. This analysis is consistent with our conclusion that the amended return showing additional gross income is not a disclosure of income that would prevent section 6501(e) from applying when there has been a substantial omission with respect to the original return.

We note that the Service should act within the three-year period of section 6501(a) whenever possible. To the extent that additional tax may be assessed and/or notices of deficiencies issued in your case within the three-year period, the Service should take that action even if it is determined that section 6501(e) applies.