

**Office of Chief Counsel
Internal Revenue Service**
memorandum

date: December 16, 2010

to: Thomas S. Ryan
Director
Service Wide Interest Program
(SBSE)

from: Blaise G. Dusenberry
Senior Technical Reviewer, Branch 1
(Procedure & Administration)

subject: Section 6603 remittances

This office issued a memo on June 30, 2010, relating to section 6603 remittances. On September 29, 2010, and October 19, 2010, you asked clarifying questions pertaining to matters discussed in the memo and raised additional issues. This memorandum is in response to those questions.

Questions

- (1) Can the Service credit an excess section 6603 deposit to an “outstanding liability” under section 6402(a)?
- (2) What authority does the Service have to offset section 6603 deposit interest to pay outstanding balance(s) before refunding any excess credits back to the taxpayer?
- (3) Whether certain portions of the Internal Revenue Manual are consistent with Service treatment of section 6603 deposits?

Conclusions

- (1) The Service cannot unilaterally credit an excess section 6603 deposit to an “outstanding liability” under section 6402(a).
- (2) The Service does not have the authority to offset excess section 6603 deposits to pay other outstanding balances.
- (3) Portions of the Internal Revenue Manual are inconsistent with Chief Counsel’s positions on the Service’s lack of offset authority.

Law**Section 6603 Deposits.**

By adding section 6603 to the Internal Revenue Code via The American Jobs Creation Act of 2004, P.L. 108-357, 118 Stat. 1418, Congress provided a way for taxpayers to make designated deposits to suspend the running of interest on potential underpayments of tax. Under section 6603(a), a taxpayer may make a deposit, *instead of a payment of tax*, to the Service that may later be used by the Service to pay any tax imposed on the taxpayer under the Code. See I.R.C. § 6603(a).

Although Congress empowered the Secretary to promulgate regulations to implement section 6603, the Secretary has not done so; instead, guidance for the administration of section 6603 is provided by Rev. Proc. 2005-18, 2005-1 C.B. 798. Under section 4.01(1) of Rev. Proc. 2005-18, for a remittance to qualify as a 6603 deposit, the taxpayer must remit a check or money order accompanied by a written statement designating the remittance as a deposit. Further, the written statement must set forth (a) the type of tax; (b) the tax years for which the deposit is being made; and (c) identify the amount and basis for the disputable tax. Any other remittance is treated as an “undesigned remittance” and may or may not be treated as a 6603 deposit. See Rev. Proc. 2005-18, 2005-1 C.B. at 800.

To the extent a section 6603 deposit is used to pay a tax, the tax will be treated as paid on the date the deposit is made for purposes of determining underpayment interest under I.R.C. § 6601. In the event that the amount deposited exceeds the eventual tax liability, the taxpayer is entitled to interest at the Federal short-term rate to the extent the deposit was attributable to a “disputable tax.”¹ I.R.C. § 6603(d).

Deposits and Payments.

Any portion of a section 6603 deposit up to the amount of the ultimately assessed underpayment of tax will be posted to the taxpayer’s account as a *payment of tax*. See Rev. Proc. 2005-18, 2005-1 C.B. at 799. A section 6603 deposit thus retains its character as a deposit until the Service has properly assessed the tax and given the taxpayer the statutorily required time to file a petition with the Tax Court. Once these requirements are met, the deposit amount is “converted” to a *payment of tax*, but only to the extent of the amount of assessed tax. *Id.* at 800.

Relevant to applying section 6603 deposits to liabilities other than the taxpayer designated “disputable tax,” section 4.02(3) of Revenue Procedure 2005-18 provides that “a *taxpayer* may elect to have a deposit that exceeds the amount of tax ultimately determined to be due applied against another assessed or unassessed liability.”

¹ A “disputable tax” is the amount of tax specified at the time of deposit as the taxpayer’s “reasonable estimate of the maximum amount of tax attributable to disputable items.” I.R.C. § 6603(d)(2).

Crediting an Overpayment under section 6402.

Pursuant to section 6402 of the Internal Revenue Code, the Secretary may credit the amount of any *overpayment*, including interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment. See I.R.C. § 6402(a)(emphasis added). Section 6402(a) defines “overpayment” as “the part of the amount of the payment of any internal revenue tax which is assessed or collected after the expiration of the period of limitation properly applicable thereto.” I.R.C. § 6402(a). Under the corresponding regulations, any credit from an overpayment may be made against any outstanding liability. Treas. Reg. § 301.6402-1. Going even further, an overpayment may be credited towards an unassessed liability that has been determined in a statutory notice of deficiency. See Rev. Rul. 2007-51.

As discussed in our June 30, 2010 memo and evidenced by Rev. Rul. 2007-51 and Rev. Proc. 2005-18, there is a difference in the treatment of remittances characterized as overpayments and those characterized as section 6603 deposits. The rules regarding crediting overpayments to other liabilities established in Rev. Rul. 2007-51 are wholly inapplicable to an excess section 6603 deposits *because an excess section 6603 deposit is not an overpayment*. Also noteworthy is the existence of distinct refund procedures for overpayments and section 6603 deposits. See Ford Motor Company v. U.S., 2010 U.S. Dist. LEXIS 54987; Rev. Proc. 2005-18 (refund procedures for Section 6603 deposits); Rev. Rul. 2007-51 (procedures for crediting an overpayment against unassessed liabilities).

Right of Setoff.

Generally speaking, setoff is the discharge or reduction of one demand by an opposite one. See Fisher v. U.S., 80 F.3d 1576 (Fed. Cir. 1996); Lewis v. Reynolds, 284 U.S. 281 (1932); Dysart v. U.S., 340 F.2d 624 (Ct. Cl. 1965). The Service is afforded the right of setoff in a variety of contexts. The most common use of setoff is in the Bankruptcy Code, as codified in 11 U.S.C. § 533. Generally, under section 533 setoff may be used when both the credit and the debt occur before the filing of the bankruptcy petition.² I.R.C. § 6402 is a codified version of setoff authority preserved for the Service. As mentioned above, section 6402 operates in the context of an overpayment and is inapplicable to excess section 6603 deposits.

Outside of any statutory grant of offset authority, there is a common law right to offset. Particularly, the authority has arisen in the tax context when periods of limitations to assess has run in tax refund suits. In Lewis v. Reynolds, the Supreme Court held that the government can offset any additional amounts the taxpayer owed if the deficiency is for the same year as the year refund is requested, even if the time for assessment has expired for that tax year. 283 U.S. 281 (1932); See also Dysart v. U.S., 340 F.2d 624

² Once a bankruptcy petition has been filed, generally all such activity is stayed. However, it appears that the Service has the right to *retain* refunds to protect its right of setoff even if the refund arises post-petition; it is still barred from actually setting off with the retained refund.

(1965)(“[T]he essential principle [is] that a taxpayer suing for a refund of a tax for particular year must show that, in actuality, he overpaid that tax.”); Patterson v. Belcher, 302 F.2d 289 (5th Cir. 1962)(“The Director is entitled to set off any monies still owing to the Government against the amounts claimed for refund.”). Even if the Service is barred from making a new assessment for a particular tax year, it is not prevented from retaining amounts already received for that year that do not exceed what might have been properly assessed. See Bachner v. Comm’r, 81 F.3d 1274 (3d Cir. 1996).

Analysis

Crediting of a remittance under section 6402 requires the remittance to be an overpayment; a 6603 deposit is not an overpayment.

The language of section 6603, section 6402 and Rev. Proc. 2005-18 makes clear there is a distinction between a *deposit* and a *payment* or *overpayment*. Any excess section 6603 deposit remaining after application of section 6603 deposit to a determined tax liability is considered to retain its character as a section 6603 deposit. On the other hand, any payment of tax in excess of determined tax is characterized as an overpayment.

The distinction is evident in the different rules that apply to section 6603 deposits and to overpayments. With respect to overpayments, the following rules are applicable: section 6611, establishing the rules for payment of interest on overpayments; section 6402, allowing the Secretary to credit the amount of any *overpayment*, including interest allowed thereon, against any liability in respect of an internal revenue tax; Rev. Rul. 2007-51, providing for the procedures for crediting an overpayment against other tax liabilities.

Section 6603 deposits have their own set of rules where a section 6603 deposit exceeds the ultimate tax liability. As discussed above, a 6603 deposit retains its character as a deposit and, generally, may not be applied to any unassessed tax or tax other than the “disputable tax” to which the deposit was designated. The only contemplated instance in which a 6603 deposit may be applied to an “unassessed tax” or a tax other than the designated “disputable tax” is when the taxpayer requests it.³

Further, I.R.C. § 6603(c) and Section 6 of Rev. Proc. 2005-18 provides that the Secretary “shall return to the taxpayer any amount of the deposit (to the extent not used for a payment of tax) which the taxpayer requests in writing.” I.R.C. § 6603(c). Section 6.01 of Rev. Proc. 2005-18 clarifies that a deposit is not an overpayment, asserting that “a deposit . . . is not subject to a claim for credit or refund as *an overpayment until the deposit is applied by the Service as payment of an assessed tax.*” See also CC Notice 2010-002 (“[C]onverting the character of the entire deposit to that of payment would render section 6603 moot and would be inconsistent with the legislative intent of

³ “[A] taxpayer under examination for several different years may request that a deposit made for one type of tax in one year be applied to another type of tax in another year.” Rev. Proc. 2005-18, 2005-1 C.B. at 799-800.

sections 6603 and 6611.”).

The prerequisite of crediting a remittance to another liability under Section 6402, its accompanying regulations and Rev. Rul. 2007-51 is that the remittance be an overpayment. As discussed above, an excess section 6603 deposit is not an overpayment. Therefore the crediting mechanisms of section 6402 are inapplicable to section 6603 deposits.

Offset is not available to apply excess section 6603 deposits to outstanding liabilities.

As indicated above, the statutory rights of offset granted to the Service are inapplicable in the context of excess section 6603 deposits. The statutory right of offset under section 533 of the Bankruptcy Code involves situations where a bankruptcy petition has been filed. The statutory right of offset implied in I.R.C. § 6402 is inapplicable to excess section 6603 deposits. As mentioned above, section 6402 operates in the context of an overpayment and is inapplicable to excess section 6603 deposits.

The common law right of offset has been applied in the tax context when the Service is subject to a refund suit for a tax year in which the assessment period has run. The rule put forth in Lewis v. Reynolds and its progeny suggest that setoff is allowed *for the tax year in question*, and up to the amount that could have been originally assessed. The purpose of the rule is to prohibit the taxpayer from claiming and obtaining a refund for the very same tax year in which they had an underpayment of tax. In the inquiry presented, the issue is whether the Service can apply an excess section 6603 deposit to offset a liability from another tax year. The statutory rights of offset are inapplicable, as discussed above, and the common law right in the context of tax administration has not operated to allow for the use of offset in the manner requested here.

Certain I.R.M. provisions are inaccurate in light of the positions taken above.

I.R.M. 20.2.4.8.2.1(3)

The relevant portion of I.R.M. 20.2.4.8.2.1(3) reads:

Any amount of a 6603 deposit that is not posted as a “payment of tax” because it exceeds the liability as ultimately determined, will continue to be considered a 6603 deposit and, provided no other liabilities exist, will be returned to the taxpayer **with** interest . . . If another liability does exist, the deposit will not convert to a “payment of tax” until the assessment date of the liability the deposit is applied.

I.R.M. 20.2.4.8.2.1(3). The last sentence referenced above is an incorrect reading of section 6603 and Rev. Proc. 2005-18. Any amount of section 6603 deposit that is not posted as a payment of tax because it exceeds the liability as determined should be (1)

returned to the taxpayer with 6603 interest (assuming the 6603 deposit was posted towards a “disputable tax”) or (2) *upon the written request of the taxpayer*, applied as an excess section 6603 deposit against another liability. See Section 4.02(3) of Rev. Proc. 2005-18. Thus, the section 6603 deposit cannot, via the Service’s unilateral action, be applied to another liability; the taxpayer must make such a designation in writing.

Some confusion may be caused by the language of Section 4.05(3): “[t]his excess amount will be treated as a deposit until sufficient information is obtained by the Service to apply the remittance to an outstanding liability or to determine that the amount of the remittance should be returned to the taxpayer.” However, a contextual analysis of this provision makes clear that this language applies only in the context of the submission of an *undesignated remittance* by the taxpayer.

The example following the section is also rendered incorrect as a result of the incorrect I.R.M. section. In the example, taxpayer submits a section 6603 deposit of \$6,000 (satisfies disputable tax requirement) and is assessed a liability of \$4,500. The Service transfers the remaining \$1,500 section 6603 deposit to an unpaid tax deficiency for another year. The example specifically says: “The transferred 6603 deposit is available to reduce deficiency interest on tax year 200512, as of its availability date of June 12, 2008.” This application of section 6603 deposits is incorrect. The Service does not have the authority to unilaterally apply an excess 6603 deposit to another tax year—it must either return any excess section 6603 deposit to the taxpayer or apply it to another tax year only *upon the written request* of the taxpayer.

I.R.M. 20.2.4.8.2.1(4)

The entire section reads:

If, as of the date of a deficiency assessment, a 6603 deposit is posted to a taxpayer’s account as a “payment of tax,” any subsequent full or partial abatement of the deficiency that results in an overpayment will accrue interest (to the extent the deposit is attributable to a disputable tax), from the date of the deposit to the date of refund or offset.

I.R.M. 20.2.4.8.2.1(4). A subsequent full or partial abatement of a deficiency that was previously satisfied using a section 6603 deposit does not result in an overpayment. Instead, the result of a full or partial abatement results in an excess 6603 deposit and any interest that accrues will be section 6603 interest (at the Federal short-term rate).

The example immediately following the above-cited language, consequently, is also incorrect. In the example, a taxpayer submits a 6603 deposit for \$100,000 (amount of disputable tax) for an assessment for tax year 200612, which is later determined to be \$80,000. According to the example, the Service “offsets” \$15,000 of the “overpayment to a liability on tax year 200812 . . . The remaining overpayment of \$5,000 is refunded.” The \$20,000 excess that results from the abatement is not an overpayment, but rather an excess section 6603 deposit. As discussed above, the excess 6603 deposit should

either be returned to the taxpayer or applied as a section 6603 deposit towards the tax liability of another tax year *if* the taxpayer directs in writing that it be applied in such manner.

Please call 202-622-4910 if you have further questions.