Office of Chief Counsel
Internal Revenue Service

memorandum

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date: JUN 12 2002

to: Taxpayer Advocate Service
Don Kurihara-Nakasu
Revenue Agent Technical Advisor

from: Associate Area Counsel (SB/SE)
David Lau, Attorney Honolulu

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subject: **Request for Advisory Opinion**
Refund of Erroneously Cashed Check

This responds to your request for advice in the above-mentioned matter. You asked the following question:

ISSUE

Whether the taxpayers are entitled to a refund of their payment that was misapplied by the Internal Revenue Service and offset against their outstanding federal income tax liability and Treasury Offset Program?

CONCLUSION

The taxpayers are entitled to a refund of the amount of the check made payable to the Department of Social Services, State of California, which the Internal Revenue Service improperly altered and negotiated.

FACTS

The facts provided were as follows:

The taxpayers, a married couple, were on a $[redacted] per month installment agreement to pay off a prior year joint Federal income tax liability.

One spouse obtained two cashier's checks - one made payable to the Internal Revenue Service, in the amount of $[redacted], and one made payable to the Department of Social Services, State of California, in the amount of $[redacted]. However, the check to the Internal Revenue Service was inadvertently mailed to the Department of Social Services, and the check to the Department of Social Services was inadvertently mailed to the Internal Revenue Service.

The Internal Revenue Service stamped "US Treasury" over the "Department of Social Services State of California". The Internal Revenue Service then posted the $[redacted] to the taxpayers' account and full paid the taxpayers' prior year joint Federal income tax liability.

The remaining amount, about $[redacted], was offset to a Treasury Offset Program agency. It appears that the $[redacted] went to the Department of Social Services, State of California.

The Department of Social Services, State of California, returned the check made out to the Internal Revenue Service to the taxpayer.

The taxpayers contacted the Taxpayer Advocate (TAS) because they needed the money to pay for their basic living expenses.

TAS concluded that the taxpayers were entitled to a refund based on the facts presented and submitted a manual refund request to the Ogden Service Center Manual Refund Unit.

The Ogden Service Center denied the manual refund request and provided a counsel opinion as the basis for the denial. That opinion addresses IRM 21.4.6.4.8.2(1)(d), which states that a reversal of a DMF or TOP offset may not be done to refund or credit a tax account because the offset resulted from an over-collected or erroneously collected levy, unless the IRS levied another taxpayer's account. The opinion concludes that the manual provision is correct because the offset of an overpayment, under I.R.C. § 6402(a) is mandatory.

DISCUSSION

You have asked for advice in a case where the Internal Revenue Service stamped over the third-party's name on the payee line of the check and cashed check the check.

A cashiers' check is a negotiable instrument. It may be made payable to order or to bearer. A check made payable to a particular payee is made to order, and it will generally be effective only if paid to the named payee. "Obviously, a change in the payee's name by obliterating the payee's name and substituting the name of someone else as payee, if done without authorization, would be a material alteration." Brady on Bank Checks, Revised Ed., ¶ 27.02 [2002 Update No. 1] A change of the payee's name and indorsement by the substitute payee may be both an alteration and forgery. Brady on Bank Checks, Revised Ed., ¶ 27.02 [2002 Update No. 1]; Abraham & Co. v. Dollar Savings Bank, 48 AD2d 807, 370 NYS 2d 1, 17 UCC Rep. 824 (1975). In this case, by stamping the words "U.S. Treasury" over the name of the

payee, the Internal Revenue Service altered the check without authorization. The Internal Revenue Service then negotiated the check and applied the proceeds to the taxpayer's tax liabilities and his child support debt. This action was improper.

The Internal Revenue Manual states as follows:

> f. If the payee is not U.S. Treasury or another government agency, examine the reverse side of the check for an endorsement by the payee. If not endorsed, return check to the taxpayer or responsible employee (as appropriate) per (3) or (4) below.

IRM 5.4.1.11(2)f [Review of Non-Cash Remittances (05-31-2000)].[1] In this case, the payee was the State of California, and the check was not endorsed by the payee. The Internal Revenue Service should have returned the check made payable to the Department of Social Services, State of California, to the taxpayers.[2] In this case, the IRS failed to follow its own procedures. Instead, it altered the payee line and negotiated the check. (b)(5)(AC), (b)(5)(AWP)

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[1] Similarly, IRM 3.8.45.4.3 Remittance Not Payable to United States Treasury (01-01-2002) states that:

(1) If remittance is not made payable to the United States Treasury or one of the acceptable payees listed in return the remittance to the taxpayer with PLS Letter 11370 Return of Payments to Taxpayer,

a. If remittance is not intended as payment for accompanying return/document, process return/document as non-remittance. Return remittance to taxpayer with an explanation of Unacceptable Payment.

b. If remittance and return/document are not for Internal Revenue Service, forward to intended receiver.

c. If the remittance is made payable to Social Security Administration and received with SSA Form 4511, over stamp with Internal Revenue Service and deposit where received.

[2] The IRM contains procedures regarding "altered and/or stolen taxpayer payments" (IRM 21.5.7.4.7.8.). Altered or stolen payments (taxpayer tax payments), refer to negotiable instruments either:

- Endorsed or made payable to someone other than IRS, (e.g. Payee name line changed, employee embezzlement, also see IRM 3.0.167.4.12, Losses and Shortages.) or
- With the amount changed

We do not believe that these procedures apply in this case. It appears that these procedures apply here. In this case, the IRS made a check payable to the IRS and endorsed it.

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If you have any questions regarding this memorandum, please call me at (808) 539-2876.

David Lau
DAVID LAU
Attorney (SBSE)

cc: Pamela Fuller
Senior Technician Reviewer (CC:PA:APJP:BR1)