



OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224
October 22, 1999

Number: **200004021**
Release Date: 1/28/2000
UILC: 6404.01-03
7405.00-00

WTA-N-117227-99
CC:DOM:FS:PROC

INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR ASSOCIATE DISTRICT COUNSEL, ROCKY MOUNTAIN
ASSOCIATE DISTRICT, CC:WR:RMD:SLC

FROM: ASSISTANT CHIEF COUNSEL (FIELD SERVICE) CC:DOM:FS

SUBJECT: Reversal of Erroneous Abatement

This Field Service Advice responds to your memorandum dated September 1, 1998.
Field Service Advice is not binding on Examination or Appeals and is not a final
case determination. This document is not to be cited as precedent.

LEGEND

Taxpayers	=	
Year 1	=	
Year 2	=	
Year 3	=	
Year 4	=	
Year 5	=	
Year 6	=	
Year 7	=	
Year 8	=	
Day 1	=	=
Day 2	=	
Day 3	=	
Day 4	=	
Day 5	=	
Day 6	=	
Day 7	=	=
Day 8	=	=
Date X	=	
Month 1	=	
Month 2	=	

\$v =
 \$w =
 \$x =
 \$y =
 \$z =

ISSUE

Can the Service recover the erroneous refund issued to the taxpayer as a result of an “erroneous” abatement following a Chapter 7 discharge.

CONCLUSION

No. The Service can no longer recover the erroneous refund at issue.

FACTS

The taxpayers filed their Year 1 joint income tax return on Day 3 of Year 2, showing an overpayment of \$v. On Day 5 of Year 3, the taxpayer husband filed a Chapter 7 bankruptcy. In Month 1 of Year 4, the taxpayers filed an amended Year 1 return with Form 2119 to report the sale of their home. The amended return, Form 1040X, showed a liability of \$w. The taxpayers provided no payment with their amended return.

On Day 1 of Year 4, the Service assessed the self-reported liability against the taxpayers. On Day 5 of Year 4, the Service received a payment of \$x, in full satisfaction of the assessed taxes plus interest and penalties.

The taxpayer husband received a Chapter 7 discharge on Day 5 of Year 4. He informed the Service of the discharge and advised the Service that the discharge order discharged the Year 1 liability. As a result, on Day 7 of Year 4, the Service abated the Year 1 liability resulting from the amended return based on a redetermination of the taxpayers’ liability.

The Service began to process the refund of \$y but stopped it in Month 2 of Year 5. The Service learned that the bankruptcy discharge did not, in fact, discharge taxpayers’ Year 1 tax liability, despite taxpayer husband’s assertions to the contrary. On Day 2 of Year 6, the Service reversed the earlier abatement as erroneous. Nonetheless, on Day 4 of Year 6, a manual refund of \$z was issued to the taxpayers.

The Service attempted to “collect” the erroneous refund by relying on the original Year 4 assessment. The taxpayer executed a Form 900, Tax Collection Waiver, extending the collection period for collection of the Year 1 tax liability until Day 6 of Year 8.

LAW AND ANALYSIS

The courts are in agreement that when a taxpayer tenders a payment on a tax assessment, the assessment is extinguished to the extent of the taxpayer's payment and, that an erroneous refund - whether rebate or nonrebate - does not revive a previously paid assessment. See Bilzerian v. United States, 86 F.3d 1067, 1069 (11th Cir. 1996), remanded sub nom., Steffan v. United States, 952 F. Supp. 779 (M.D. Fl. 1997), acq. in result only, 1998 AOD LEXIS 8; Clark v. United States, 63 F.3d 83, (1st Cir. 1995); O'Bryant v. United States, 49 F.3d 340 (7th Cir. 1995); United States v. Wilkes, 946 F.2d 1143, 1150 (5th Cir. 1991). Also Rodriguez v. United States, 629 F. Supp. 333 (N.D. Ill. 1986); United States v. Young, 79-2 USTC ¶ 9609 (D. Del. 1979). The Service, thus, may not take administrative collection action on a previously paid tax assessment, even if the Service inadvertently refunds a portion of the taxpayer's payment back to the taxpayer. Stanley v. United States, 35 Fed. Cl. 493 (1996); Rodriguez, supra.

In the instant case, the Service received a payment in full satisfaction of the taxpayers' Year 1 assessment.¹ At that point, the taxpayers' tax liability with respect to the Year 1 assessment was extinguished. When the Service erroneously refunded the payment to the taxpayers, the tax assessment was not revived. Instead, the erroneous refund created a new liability. This liability, however, cannot be collected in reliance on the original tax assessment. Bilzerian, 86 F.3d at 1069; Stanley, 35 Fed. Cl. at 500.

In order to recover the erroneous refund issued to the taxpayers, the Service should have followed proper erroneous refund procedures and initiated a suit to recover the erroneous refund within the two-year period of limitations set forth in I.R.C. § 6532(b). See IRM 5.4. As this period has expired, the Service can no longer recover the erroneous refund issued to the taxpayers as a result of the "erroneous" abatement.²

¹ We agree with your determination that the assessment against the taxpayer husband violated section 362(b) of the Bankruptcy Code. We also concur with your conclusion that in the instant case the Service did not have the legal authority to reverse the abatement and, furthermore, that the reversal did not constitute a new assessment under I.R.C. §§ 6201 and 6202. Nonetheless, even if the Service had not committed these errors, the Service could not collect the erroneous refund in reliance on the original, previously paid, assessment.

² The Form 900, Tax Collection Waiver, signed by the taxpayer husband does not extend the statute of limitations for recovery of the erroneous refund under I.R.C. § 6532(b). The facts do not indicate that the refund at issue was either induced by fraud or a misrepresentation of a material fact and, thus, that the five-year period would apply.

Once money is erroneously refunded, the government's only recourse is to sue under I.R.C.

§ 7405 for the recovery of the erroneous refund or to assert a new deficiency based on a new underpayment. Bilzerian, supra; O'Bryant v. United States, 49 F.3d 340, 347 (7th Cir. 1995); and Purcella v. Commissioner, 92-1 U.S.T.C. ¶ 50,083 (D. Colo. 1992). In the case of a rebate refund, the Service must issue a new notice of deficiency and assess within the 3-year period of limitations, as suspended by applicable Code provisions. In this case, I.R.C.

§ 1034(j) extended the assessment period of limitations by three years, to Month 1 of Year 7. In addition, I.R.C. § 6503(h) also comes into play because of the bankruptcy stay. In any case, the statute of limitations on assessments would have run by Date X so as to preclude a reassessment or supplemental assessment.

Rebate refunds occur where the service has made a redetermination of liability which reduces the amount of the original assessment. Nonrebate refunds occur where the Service returns to the taxpayer an amount assessed for a reason not based on a redetermination of liability. In this case, the amount refunded was based on a redetermination of liability, namely a determination that bankruptcy had discharged the liability. As a consequence, the refund was a rebate refund. In order to recover a rebate refund, the Service must issue a notice of deficiency and assess within the 3-year period of limitations for assessment. In this case, the period of assessment has expired. Accordingly, the Service has no recourse for recovering the erroneous refund in this case.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

The Service should take immediate steps to ensure that no further collection actions are taken with respect to the Year 1 tax assessment. In addition, we share your concern regarding the Service's practice of routinely reversing previously posted abatements. Accordingly, we embrace your recommendation that the Internal Revenue Manual be revised to provide more specific guidance to the service centers.

If you have any questions concerning the above, please call.

DEBORAH A. BUTLER
Assistant Chief Counsel
(Field Service)

By: _____

BLAISE M. DUSENBERRY
Assistant to the Branch Chief
Procedural Branch
Field Service Division

cc: Regional Counsel, CC:WR
Assistant Regional Counsel (TL), CC:WR