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INTERNAL REVENUE SERVICE NATIONAL OFFICE
SIGNIFICANT SERVICE CENTER ADVICE

MEMORANDUM FOR [REDACTED]

FROM: W. E. Williams, Senior Technical Reviewer
CC:INTL:BR1

SUBJECT: Virgin Islands Tax Questions

This Significant Service Center Advice responds to your memorandum dated July 28, 1999. Service Center Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

Issues

1. Does the Statute Of Limitations ("SOL") under 26 U.S.C. §6511 apply to a request from the Bureau of Internal Revenue of the Virgin Islands that the IRS cover over taxes withheld and paid to the United States on payments made to a bonafide resident of the Virgin Islands ("VI")?
2. Does the Statute Of Limitations under 26 U.S.C. §6511 preclude the IRS from transferring funds to the VI that were erroneously paid into the United States by a foreign corporation that only had VI sourced income?

Conclusions

1. The cover over of funds into the Treasury of the VI is not a "refund". Accordingly, the SOL under §6511 does not apply to a request from the Bureau of Internal Revenue of the Virgin Islands that the IRS cover over taxes withheld and paid to the United States on payments made to a bonafide resident of the VI. Additionally, there is no statute of limitations on the requirement in section 7654 that the IRS cover over certain taxes to the Bureau of Internal Revenue of the Virgin Islands.

2. The IRS may not transfer the erroneously paid-in funds to the VI. The transfer cannot be characterized as a refund because the proposed payment would be issued to the VI, not to the taxpayer that made the overpayment. Additionally, the SOL bars any refund to the taxpayer. Further, even if double taxation arises and the competent authority proceedings are invoked, the SOL on refunds applies. Finally, the cover over process does not apply to non-individual taxpayers, and therefore may not be utilized in this case.

Background

Section 6402

Section 6402(a) of the Code states in relevant part:

In the case of any overpayment, the Secretary, within the applicable period of limitations, may credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment and shall, . . . , refund any balance to such person. [emphasis added]

Section 6501

Section 6501(a) of the Code states in relevant part:

Except as otherwise provided . . . , the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) . . . and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

Section 6511

Section 6511(a) of the Code states in relevant part:

Claim for credit or refund of an overpayment of any tax imposed by this title in respect of which tax the taxpayer is required to file a return shall be filed by the taxpayer within 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever of such periods expires the later, or if no return was filed by the taxpayer, within 2 years from the time the tax was paid. . . . [emphasis added]

Section 7654

Sub-Sections 7654(a) and (b)(1) of the Code state:

(a) General rule.--The net collection of taxes imposed by chapter 1 for each taxable year with respect to an individual to whom section 931 or 932(c) applies shall be covered into the Treasury of the specified possession of which such individual is a bona fide resident.

(b) Definition and special rule.--For purposes of this section--

(1) Net collections.--In determining net collections for a taxable year, an appropriate adjustment shall be made for credits allowed against the tax liability and refunds made of income taxes for the taxable year. [emphasis added]

Discussion

Issue 1

A cover over under section 7654(a) is not a refund under section 6402(a), and therefore, the SOL under sec. 6511 does not apply to the cover over process. Case law has distinguished the cover over process from a refund. United States v. Johnston, 124 U.S. 236, 252 (1888), holds that the phrase “covered into the treasury,” as used in acts of Congress and the practice of the United States Treasury Department, means that money has actually been paid into the treasury in the regular manner, as distinguished from merely depositing it with the treasurer.

The Johnston Court cites Rice, Assignee v. United States, 21 C. Cl. 413 (1886), as the source for the definition of “cover into”. While considering the effects of a certain Congressional Resolution, the Rice court stated the definition of the term “cover into” as:

That resolution required all moneys . . . to be paid into the Treasury of the United States, and they were thereupon “covered into the Treasury” and mingled with other public money [emphasis added].

Consequently, “cover over” means that funds are actually transferred to a governmental body (i.e., a treasury) for use by that body in its public functions. This is distinguishable from a refund. A “refund” is a remittance of overpaid taxes to the taxpayer. R.A. Westin, Shepard’s Tax Dictionary 535 (1995-1996). This definition is in consonance with the statutory framework. Section 6402(a) provides that overpayments of taxes will be credited against any unpaid internal revenue tax liability and amounts in excess of such credit will be refunded only to “the person who made the overpayment.” Therefore, since the VI Treasury is not the “person who made overpayment”, in this instance, the cover over process is not a refund. Accordingly, the strictures of the SOL under sec. 6511 do not apply to the cover over process under section 7654.

Further, section 7654(a) utilizes the term “shall” which renders the statute mandatory as opposed to discretionary. See 2A N. Singer, Sutherland Stat Const, sec. 25.04. This indicates an absolute instruction from which the IRS may not deviate. The statutory construction of the term “shall” has been interpreted in several tax cases. United States v. Chavez, 627 F.2d 953, 955 (9th Cir. 1980), holds that in construing the use of the term “shall” in IRC sec. 7203:

The plain meaning of the statute is clear. The grammatical structure of the statute and the use of the word “shall” compel the conclusion that the provision is mandatory. “The use of the word ‘shall’ in the statute, although not entirely controlling, is of significant importance, and, indicates an intention that the statute should be construed as mandatory.” [citation omitted]

Other tax cases have adopted the statutory construction of the term “shall” as mandatory (as opposed to discretionary). See, e.g., United States v. Jungels, 910 F.2d 1501 (7th Cir. 1990) and United States v. Mckenna, 791 F.Supp. 1101 (E.D.LA 1992) (Interpreting use of word “shall” as mandatory in sections 7201 and 7206); Cook v. United States, 104 F.3d 886 (6th Cir. 1997) (Interpreting use of the term “shall” as mandatory in section 7609(a)(1)). Utilizing this statutory construction of the term “shall” renders section 7654 as an absolute mandate from which the United States may not depart.

Moreover, section 7654(a) states: “The net collection of taxes imposed . . . shall be covered into the Treasury of the specified possession. . . .” The term “net collections” is defined in section 7654(b)(1) as:

for a taxable year, an appropriate adjustment shall be made for credits allowed against the tax liability and refunds made of income taxes for the taxable year.” [emphasis added]

Accordingly, the statute contemplates the cover over of “net collections”, that is, moneys after refunds have been issued. The plain reading of the statute demonstrates that refunds are a separate act, occurring before the “cover over” process. Consequently, refunds are distinct from the cover over process, and therefore, cover overs are outside the SOL of section 6511.

Issue 2

In this issue, a foreign corporation with only VI source income made tax payments to the IRS. While the corporation filed claims with the IRS for refund of the tax, the claims were denied on the ground that they were not filed within the statute of limitations under section 6511(a). The Bureau of Internal Revenue of the VI

assessed income tax against the corporation on its VI source income within the statute of limitations under section 6501 as mirrored in the local law of the VI.

There is no authority for the IRS to transfer the funds to the government of the VI. The IRS may not do so in the form of a refund because a refund is a payment that returns an overpayment to the taxpayer, and is therefore, issued to the taxpayer and not to a foreign government to whom the tax may be owed. See section 6402. In this case, the taxpayer allowed the statute of limitations to expire before filing a claim for refund with the IRS. Moreover, even where double taxation may arise and the competent authority proceedings are invoked under the Tax Implementation Agreement between the United States of America and the Virgin Islands (signed February 24, 1987), any refund is subject to the applicable SOL under section 6511. See Revenue Procedure 89-8, section 3.03, 1989-1 C.B. 778, 779, which provides the following:

When, in conjunction with a request for assistance under this revenue procedure, a taxpayer seeks relief in the form of a credit or refund of tax due to either a possession or the United States, the allowance of such relief is subject to the applicable tax and procedural rules of the possession and the United States. [Emphasis added]

See also Rev. Proc. 96-13, section 9.01, 1996-1 C.B. 616, 624, which provides procedures for requesting competent authority assistance under U.S. treaties:

In any matter subject to this revenue procedure, the taxpayer must take (or, if necessary, advise a related person to take) such protective measures as may be necessary with the U.S. and foreign tax authorities so that the implementation of any agreement reached by the competent authorities is not barred by administrative, legal or procedural barriers. . . . Protective measures include, but are not limited to: (a) filing amended returns or protective claims for refund or credit; (b) staying the expiration of any period of limitations on the making of a refund or other tax adjustment. . . . [emphasis added]

Further, there is no authority to “cover over” to the VI under section 7654 taxes of a person who is not an individual and a bonafide resident of a possession. The authority to cover over funds to the VI that is granted by section 7654 relates to individuals that meet the requirements of section 932(c). See section 7654(a). Consequently, taxpayers which are not individuals are excluded from the cover over process. As a final matter, we know of no theory on which the U.S. may rely in order to transfer the funds in question to the VI.

If you have any further questions concerning this matter, please call [REDACTED]
[REDACTED]