

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

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to: Troy N. Stemen
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from: Joseph W. Clark
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(Procedure & Administration)

subject: Use of the common law right of offset to recover erroneous refunds and restitution amounts

This memorandum responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUE

Whether the Service may use a common law right of offset to recover Category D erroneous refunds and unpaid amounts of restitution.

CONCLUSION

The Service may not use its administrative offset powers to credit an overpayment to an unassessable order of restitution, but the Service may use its administrative offset powers to credit an overpayment to Category D erroneous refunds provided it does so within the applicable two or five year period of limitations set forth in I.R.C. § 6532(b). The Service may use the Treasury Offset Program to credit an overpayment to an order of restitution.

BACKGROUND

In its recent audit, the Treasury Inspector General for Tax Administration (TIGTA) recommended that the Service discontinue using its administrative offset power to fully or partially satisfy existing criminal restitution order liabilities because the procedure was

used inconsistently and may be a violation of the Internal Revenue Code.¹ The TIGTA report cites to program manager technical advice (PMTA) dated April 26, 2010, and issued by the Office of Chief Counsel with respect to the use of the Treasury Offset Program (TOP) to satisfy unpaid and unassessed restitution orders (the TOP PMTA)². TIGTA interprets the TOP PMTA as requiring that the Service must use TOP in order to use its refund offset powers with respect to existing restitution liabilities.

Before we discuss the Service's use of offsets, it is important to briefly address the two liabilities that are explicitly and indirectly referred to in the TIGTA report: amounts ordered as restitution and erroneous refunds.

As addressed in the TOP PMTA, restitution orders arise under Title 18, specifically 18 U.S.C. § 3556, regardless of whether that restitution is based on a criminal offense under Title 18 or any other title of the U.S. Code. Amounts ordered as restitution are not a tax, although the recently passed the Firearms Excise Tax Improvement Act of 2010 ("the FETI Act"), Pub. L. No. 111-237, § 3 now provides the Service with the authority to assess an amount ordered as restitution as a tax under I.R.C. § 6201(a)(4).

Erroneous refunds, on the other hand, do arise under Title 26 because they originate from the taxpayer's tax liability or a mistake regarding that liability. Generally speaking, an erroneous refund is the receipt of any money from the Service to which the recipient is not entitled. The Service identifies five categories of erroneous refund: Category A1 occurs when the tax liability has been understated due to an error of the assessment or an adjustment of the tax liability; Category A2 involve errors on refundable or non refundable credits subject to deficiency procedures; Category B occurs when the taxpayer overstates his or her Federal income tax withholding credits or estimated income tax payments on a return or claim for refund; Category C involves errors by the taxpayer or Service on Business Master File accounts; and Category D includes all erroneous refunds not included in the other four categories as well as any Category A1, A2, B, or C erroneous refunds for which the assessment period of limitations (I.R.C. § 6501) has expired but the erroneous refund period of limitations (I.R.C. § 6532(b)) has not yet expired. IRM 21.4.5.4. It is our understanding that the types of erroneous refunds handled by the Ogden campus specifically investigated by TIGTA arise from fraudulent filings by the taxpayer. Accordingly, the majority – if not all – of the erroneous refunds tracked by Ogden are of the Category D variety.

LAW AND ANALYSIS

The Service's refund offset powers arise under I.R.C. § 6402(a), which requires the Service to credit a taxpayer's overpayment to "any liability in respect of an internal revenue tax on the part of the person who made the overpayment," as well as certain

¹ The TIGTA report does not identify which section or sections of Title 26 are violated by the use of the Service's administrative offset power.

² This TOP PMTA was sent from the Office of Chief Counsel to the Office of Collection Policy. It is not found in Westlaw or Lexis.

specified non-tax debt, before the overpayment is credited to the taxpayer's future estimated taxes or refunded.³ Although the phrase "any liability in respect of an internal revenue tax" is not defined in the statute, it has long been the Service's position that a tax liability which could be enforced through normal assessment and collection procedures – i.e., a tax liability which has been assessed, is assessable, or for which a statutory notice of deficiency has been issued – is a prerequisite for making an offset under section 6402. See Treas. Reg. § 301.6402-1. Accordingly, unless the Service can assess the amount erroneously refunded, the Service may not use its section 6402(a) statutory right of offset.

Section 6402(a), nonetheless, does not preclude the Service's use of other means to offset an overpayment as long as an independent authority exists for that offset. Isbrandtsen Co. v. Johnson, 343 U.S. 779, 783 (1952) ("Statutes which invade the common law. . . are to be read with a presumption favoring the retention of long established and familiar principles, except when statutory purpose to the contrary is evident.") It is a long established principle that the Government has the same common law right belonging to every creditor to set off monies owed by it to debts due it by the same debtor. United States v. Munsey Trust Co., 332 U.S. 234 (1947); Cherry Cotton Mills, Inc. v. United States, 325 U.S. 234 (1947); Crocker First Nat'l Bank v. United States, 137 F. Supp. 573 (N.D. Cal. 1955). Accordingly, this common law right still exists notwithstanding section 6402(a). Unlike the statutory right of offset under section 6402(a), however, the Service has taken the position that the common law right of offset is limited to the two or five year period of limitations set forth in section 6523(b).⁴

For the purposes of this memo, we will identify the Service's ability to offset under section 6402(a) as its "administrative statutory offset power," and the Service's ability to offset under the common law as its "administrative common law offset power." Collectively, we will refer to these as the Service's "administrative offset powers."⁵

As described above and unlike erroneous refunds from the Service, amounts ordered as criminal restitution by a Federal court do not arise under Title 26. When a federal district court orders restitution, it does so pursuant to 18 U.S.C. § 3556. Criminal restitution serves to compensate a victim for the loss caused by that defendant. In some criminal cases the Service may be identified as a victim, therefore a court may order a defendant to pay restitution to the Service for a tax-related loss. Restitution is ordered pursuant to 18 U.S.C. § 3556, and the enforcement of that order is retained by

³ This specified non-tax debt is identified as non-tax child support, Federal agency non-tax debt, State income tax obligations, and unemployment compensation debts. I.R.C. § 6402(c), (d), (e), and (f).

⁴ A taxpayer may voluntarily and knowingly waive this period, see United States v. Nat'l Steel Corp., 75 F.3d 1146 (7th Cir. 1996), but the Service should not solicit such waivers for the sole purpose of offsetting the taxpayer's refunds to the erroneous refund liability.

⁵ We are identifying the Service's administrative offset powers in this manner in order to avoid confusion. Although the Treasury Offset Program is indirectly referred to – for example – in section 6402(d) for the satisfaction of nontax debts, this is inherently different from the Service's statutory and common law offset power to satisfy unpaid tax liabilities.

the United States under Title 18, including 18 U.S.C. § 3664. Although the Service can accept payments of restitution as the victim, neither Title 18 nor Title 26 provides the Service with the power to administratively collect on a restitution order without a tax-related assessment. As a nontax debt, however, TOP is a method by which the government may collect an unpaid restitution liability.

Unlike the Service's administrative statutory offset power under section 6402(a) and its administrative common law offset power, TOP is a centralized offset program for nontax debts administered by the Financial Management Service. See 31 U.S.C. § 3716; 31 C.F.R. § 285.2(b)(3)("[TOP] does not apply to any debt or claim arising under the Internal Revenue Code."). TOP is used to collect a variety of debts owed to Federal and state agencies, including restitution liabilities. See, e.g., Rason v. Nicholson, 562 F. Supp. 2d 153 (D.D.C. 2008) (TOP used to offset VA liability); In re Huff, 343 B.R. 136 (W.D. Pa. 2006) (TOP used to offset USDA mortgage liability); United States v. Mayer, 2010 WL 4916561 (D.N.H. Dec. 3, 2010) (TOP used to offset criminal restitution order). In our research we have verified that the government has successfully used TOP to satisfy unpaid restitution liabilities in at least one criminal tax case. United States v. Harrison, 2007 WL 2332662 (N.D. Tex. Aug. 16, 2007).⁶

Amounts ordered as restitution and the existence of an erroneous refund are not necessarily exclusive. For example, a court may order that a criminal defendant pay restitution under 18 U.S.C. § 3556 for filing a false return and inducing the Service to issue an erroneous refund. Although the amount of restitution itself is not a tax, the amount of funds erroneously refunded by the Service for the same tax period at issue in the criminal case does arise under Title 26. Because the amount ordered as restitution and the erroneous refund itself arise under Titles 18 and 26 respectively, they are collected differently as well. This does **not** mean, however, that the government can collect both amounts in full. Instead, the Service must ensure that any amount of the erroneous refund recovered using administrative offset procedures is reported to the appropriate U.S. Attorney's Office and its Financial Litigation Unit (FLU) so that it may be administratively credited towards the unpaid restitution amount, and vice-versa. Cf. United States v. Helmsley, 941 F.2d 71, 102 (2d Cir. 1991) ("[W]e believe it is self-evident that any amount paid as restitution for taxes owed must be deducted from any judgment entered for unpaid taxes in . . . a civil proceeding.").

In summary, the Service may use its administrative offset powers to recover an erroneous refund, whereas TOP would be inapplicable because erroneous refunds arise from Title 26. On the other hand, the Service may use TOP, but not its administrative offset powers, to satisfy nontax liabilities such as an amount ordered as restitution. Finally, if an amount is ordered as restitution and that amount is based upon an erroneous refund for the same tax period, the Service may use TOP to satisfy the restitution amount and its administrative offset powers to satisfy the erroneous refund, provided that either method is cross-accounted in order to avoid double collection.

⁶ The TOP PMTA lists numerous other examples of cases in which the government successfully used TOP to collect unpaid restitution liabilities, although only the case cited above was a criminal tax case.

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