

INTERNAL REVENUE SERVICE

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MEMORANDUM FOR ASSOCIATE DISTRICT COUNSEL
KANSAS-MISSOURI DISTRICT, KANSAS CITY

FROM: Joseph W. Clark /s/ *Joseph W. Clark*
Acting Chief, Branch 2 (General Litigation)

SUBJECT: Trust Fund Recovery Penalty - Erroneous Refund

This responds to your request for Significant Service Center Advice dated January 21, 2000. This advice is not binding and is not to be cited as precedent.

ISSUE

Whether an erroneous refund of the Trust Fund Recovery Penalty (TFRP) caused by the Service's error in cross-referencing a payment made by another responsible person can be recovered through administrative means.

CONCLUSION

No. The Service must rely on erroneous refund procedures to recover any erroneous refund issued to one responsible person as a result of an error in cross-referencing a payment made by another responsible person.

BACKGROUND

The hypothetical situation you asked us to address can be summarized as follows. A Trust Fund Recovery Penalty (TFRP or penalty) was assessed against two or more responsible persons for the same underlying employment tax liability.¹ Although all responsible persons are liable for the full amount of the assessed penalty under the law, it is the Service's policy to collect the liability only once. Policy Statement P-5-60. When one responsible person makes a payment of the TFRP (or when a payment for the trust fund portion of the employment tax liability is received from the corporation), that payment is cross-referenced against the liability of all other responsible persons.

¹ I.R.C. § 6672(a) makes "any person" having the responsibility to collect and pay over the employment taxes liable for the penalty. Transaction Code 240 is used to record the TFRP assessment.

See IRM 5.7.7.4; IRM 21.9.7.4.1.14. The payment is posted to the paying responsible person's account with a Transaction Code (TC) 670. The payment is cross-referenced against the other responsible persons' assessments with a Transaction Code 241, reference number 699 (TC 241 RN 699).²

When the amount collected from all responsible persons exceeds the amount of the assessed TFRP, including accruals, it is the Service's procedure to refund the excess to the responsible person whose payment caused the overpayment. See IRM 21.9.7.4.1.20. If the amount due from the other responsible person(s) is less than the payment received from the paying responsible person, the Service employee is instructed to input TC 241 RN 699 for the full amount of the payment and then to adjust the module by reversing the excess credit with TC 240 RN 699. IRM 5.7.7.4; IRM 21.9.7.4.1.14. In order to ensure that the excess credit is not erroneously refunded to the other responsible person(s), the module must be monitored until the excess credits are reversed and the module shows a zero balance.

This process can be illustrated by the following example. On April 15, 1998, the Service assesses TFRP against two responsible persons, A & B, in the amount of \$9,000 and \$10,000, respectively. On June 20, 1999, responsible person A makes a payment of \$8,000. A few days later, on July 2, 1999, responsible person B pays \$4,000. The payments are properly cross-referenced to the other responsible person's account. A proper refund of \$2,000 is issued to responsible person B on August 16, 1999. See Example 1 below.

Example 1:

<u>Responsible Person A</u>		<u>Responsible Person B</u>	
TC 240 (4/15/98)	9,000	TC 240 (4/15/98)	10,000
TC 670 (6/20/99)	8,000 -	TC 241 RN 699 (6/20/99)	8,000 -
TC 241 RN 699 (7/2/99)	4,000 -	TC 670 (7/2/99)	4,000 -
TC 240 RN 699 (7/2/99)	3,000		
		TC 846 (8/16/99)	2,000

² Although in the incoming memorandum you refer to this transaction as an abatement, TC 241 RN 699 is actually an adjustment code. See IRM 21.9.1.7.4.3. The reversal of the TC 241 RN 699, therefore, does not constitute a new assessment nor is it subject to the statute of limitation on assessments.

On occasion, however, the Service fails to timely adjust the other responsible person's account and the excess credits are erroneously refunded to that responsible person before the account is adjusted to reflect a zero balance. For example, let us assume that in the above described situation the Service did not timely adjust responsible person A's account to reflect a zero balance. As a result, in addition to issuing a \$2,000 refund to responsible person B, the Service also issues a \$3,000 erroneous refund to responsible person A. See Example 2 below. The question posed by the service center is whether the Service can collect the \$3,000 refund administratively or whether it must follow erroneous refund procedures.

Example 2:

<u>Responsible Person A</u>		<u>Responsible Person B</u>	
TC 240 (4/15/98)	9,000	TC 240 (4/15/98)	10,000
TC 670 (6/20/99)	8,000 -	TC 241 RN 699 (6/20/99)	8,000 -
TC 241 RN 699 (7/2/99)	4,000 -	TC 670 (7/2/99)	4,000 -
TC 846 (8/7/99)	3,000	TC 846 (8/16/99)	2,000

LAW & ANALYSIS

While the Service could take a position that a TFRP assessment is satisfied only to the extent of payments made by a taxpayer against whom the penalty was assessed, and not by payments made by other responsible persons, this position would contravene the Service's established policy and procedures. Accordingly, we are of the opinion that when the Service issues an erroneous refund to a responsible person it must pursue recovery of the refund by following proper erroneous refund procedures.

Section 6672 of the Internal Revenue Code imposes personal liability in the amount of the unpaid trust fund taxes upon any person who is required to collect, account for, and pay over such taxes and who willfully fails to do so. I.R.C. § 6672(a). More than one person may be a "responsible person" under section 6672. Slodov v. United States, 436 U.S. 238, 246-50 (1978). Moreover, each person found liable under section 6672 can be held responsible for the total amount of withholdings not paid. There is nothing in the statute that prevents the Government from collecting and retaining from each responsible person the full amount of the penalty. USLife Title Insurance Company of Dallas v. Harbison, 784 F.2d 1238, 1243 (5th Cir. 1986).

While the Service is legally entitled to collect the full amount of the penalty from each responsible person, it has long been the Service's policy to collect the delinquent taxes only once. Policy Statement P-5-60. In accordance with this policy, any amount recovered from one of the assessed responsible persons is cross-referenced to reduce the amount due from the other responsible persons. IRM 21.9.1.7.4.3. See also Kelly

v. Lethert, 362 F.2d 629 (8th Cir. 1966). To the extent that the Service collects more than 100% of the assessed penalty, its policy is to refund the excess to the appropriate responsible person. Policy Statement P-5-60; IRM 21.9.7.4.1.20.

With the Service’s administrative policy in mind, the courts have been reluctant to allow the Service to recover more than the total amount of withholdings not paid. McCray v. United States, 910 F.2d 1289 (5th Cir. 1990); Brown v. United States, 591 F.2d 1136, 1143 (5th Cir. 1979) (“double recovery by the government is not necessary to fulfill section’s 6672 primary purpose – protection of government revenue”). Although in one recent case a court allowed the Service to collect interest and penalties from one responsible person where the Service previously issued an erroneous refund to another responsible person, see Chene v. Chene, 236 B.R. 69 (M.D. Fla. 1999), the weight of the case law and the Service’s policy and procedure support a contrary conclusion.

One issue on which courts are in agreement is that once a taxpayer tenders a payment on a tax assessment, the assessment is satisfied to the extent of the payment and an erroneous refund - whether rebate or nonrebate - does not revive a previously paid assessment. See Bilzerian v. United States, 86 F.3d 1067 (11th Cir. 1996); 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 (5th Cir. 1991). Although generally a taxpayer is not entitled to a credit for another taxpayer’s payment, it is the Service’s policy and practice to credit one responsible person’s account with another responsible person’s payment. As such, one responsible person’s payment may extinguish another responsible person’s liability for the TFRP. See, e.g., McCray v. United States, 910 F.2d 1289 (5th Cir. 1990).

This proposition is more evident when we consider the following example. Let us assume that in addition to the two responsible persons in Example 1 above, the Service also makes an assessment for the same underlying employment tax liability against a third responsible person (C) in the amount of \$10,000. Furthermore, let us assume that the erroneous refund is issued to responsible person C rather than to responsible person B, as in Example 2. Thus, the situation before the Service is as follows.

Example 3:

Responsible Person A

TC 240 (4/15/98)	9,000
TC 670 (6/20/99)	8,000 -
TC 241 RN 699 (7/2/99)	4,000 -
TC 240 RN 699 (7/2/99)	3,000

Responsible Person B

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TC 240 (4/15/98)	10,000
TC 241 RN 699 (6/20/99)	8,000 -
TC 670 (7/2/99)	4,000 -
TC 846 (8/16/99)	2,000

Responsible Person C

TC 240 (4/15/98)	10,000
TC 241 RN 699 (6/20/99)	8,000 -
TC 241 RN 699 (7/2/99)	4,000 -
TC 846 (8/7/99)	2,000 (erroneous refund)

In order to recover the \$2,000 erroneous refund administratively, the Service must establish that the TFRP remains unpaid despite the full payment received from responsible persons A and B. In order to do so, the Service can argue that the TFRP assessment made against C was not satisfied to the extent of the erroneous refund. The courts are not likely to find this argument persuasive, however. See, e.g., O'Bryant v. United States, 49 F.3d 340, 347 (7th Cir. 1995) (erroneous refunds and tax liabilities are simply not of the same ilk; an unsolicited erroneous refund must be handled on its own terms, not under the rubric of an assessed liability). The Service may also argue that since C has not made any payments against the TFRP assessed against him, the Service may collect the entire \$10,000, plus accruals, from C. This position, however, is contrary to the Service's administrative policy to collect the TFRP only once. Under current procedures, any payments made or collected from responsible person C would be cross-referenced against the liabilities, if any, of A and B. This application could result in additional erroneous refunds being issued. Furthermore, the only reason the Service would argue that responsible person C in the example above is not entitled to receive a full or partial credit for the payments made by persons A & B is that the Service issued him an unsolicited erroneous refund. Again, this position contravenes the Service's policy and the case law regarding erroneous refunds.

Finally, the Service can argue that no responsible person is entitled to a credit for another responsible person's payment until the Service's right to retain the amount collected is established. See Policy Statement P-5-60. Pursuant to this argument, the Service arguably could collect \$1,000 from responsible person A (\$9,000 - \$8,000),

\$6,000 from responsible person B (\$10,000 - \$4,000), and \$10,000 from responsible person C.³ Again, while legally sound, this position contravenes the Service's administrative policy and procedure. Moreover, however, it is not entirely clear whether the Service could apply any of the amounts collected to the liability resulting from the erroneous refund or whether such amounts would constitute overpayments under I.R.C. § 6401.

In conclusion, while the Service could craft an argument that a TFRP assessment is not satisfied for the purpose of collecting an erroneous refund by payments made by other responsible persons, this position would be contrary to the Service's current policy and procedures regarding collection of the TFRP. Accordingly, the Service must rely on erroneous refund procedures to recover any erroneous refund issued to one responsible person as a result of an error in cross-referencing a payment made by another responsible person. See IRM 21.4.5, *Erroneous Refunds*.⁴

HAZARDS & OTHER CONSIDERATION

In your incoming memorandum, you discuss the possibility of collection on the ground that the entry of the TC 241 RN 699 for the full amount of the payment constituted a clerical error which the Service can reverse at any time pursuant to the court's reasoning in Crompton-Richmond Co. v. United States, 311 F. Supp. 1184 (S.D.N.Y. 1970). We do not believe the doctrine of clerical error is applicable to the facts of this case for the following reasons.

First and foremost, the entry of the TC 241 RN 699 in the full amount of the payment was neither erroneous nor clerical in nature. As stated above, it is the Service's policy and procedure to cross-reference the payment by entering a TC 241 RN 699 for the full amount of the payment and then adjust the account as appropriate to prevent the

³ In In re Chene, 82 AFTR.2d 6754 (Bank. M.D. Fla. 1988), *rev'd & remanded*, Chene v. Chene, 236 B.R. 69 (M.D. Fla. 1999), the Government took the position that an erroneous refund of the TFRP to the other responsible person did not affect the debtor's liability for the TFRP assessed against her. Thus, since the debtor did not full pay the assessment, including accruals, the Service argued and the district court agreed, the debtor continued to be liable for the any accrued interest and penalty. It is not clear whether the Service also attempted to collect the unpaid portion of the TFRP from the responsible person who received the erroneous refund.

⁴ Please note that this conclusion does not alter our position that the TC 241 RN 699 credits are conditioned upon the Service's right to retain the payment. I.R.C. § 6511; Policy Statement P-5-60. Thus, when the Service issues a refund to a person determined not to be responsible, the Service may reverse the corresponding TC 241 RN 699 entries and continue to collect the TFRP against the remaining responsible person(s).

excess from refunding to the incorrect responsible person. The only error committed by the Service was its failure to reverse the TC 241 RN 699 in the appropriate amount to zero out the account. While this error may be considered 'clerical,' the Service may correct its errors only as long as the correction does not prejudice the taxpayer. Crompton-Richmond, supra. In the case at hand, the correction of the error would prejudice the taxpayer because, but for the Service's error, the TFRP assessed against the taxpayer would have been considered paid. While the taxpayer continues to be liable, the liability is one for an erroneous refund and not for a TFRP. Accordingly, it is our opinion that the Service cannot rely on the clerical error doctrine to collect the amount erroneously refunded as a tax in reliance on the TFRP assessment.

As always, we hope the advice provide herein is helpful. If you have questions regarding this matter, please contact the attorney assigned to this matter at 202/622-3620.

cc: All Assistant Regional Counsel (General Litigation)