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memorandum

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date: May 21, 1999

to: District Counsel, South Texas District, Austin CC:MSR:STX:AUS
Attn: Jerry Hamilton

from: Assistant Chief Counsel (Income Tax & Accounting) CC:DOM:IT&A

subject: Significant Service Center Advice Request, Erroneous Abatements

This responds to your request for Significant Advice, dated January 27, 1999, in connection with a question posed by the Austin Service Center.

Disclosure Statement

Unless specifically marked "Acknowledged Significant Advice, May be Disseminated" above, this memorandum is not to be circulated or disseminated except as provided in CCDM (35)2(13)3:(4)(d) and (35)2(13)4:(1)(e). This document may contain confidential information subject to the attorney-client and deliberative process privileges. Therefore, this document shall not be disclosed beyond the office or individual(s) who originated the question discussed herein and are working the matter with the requisite "need to know." In no event shall it be disclosed to taxpayers or their representatives.

Issue

Whether a taxpayer has made a timely refund claim where the refund claim was filed more than three years after the taxpayer's return was filed and the Service applied the taxpayer's partial, undesignated payments made within two years of the refund claim to penalties and interest. If the refund claim is untimely, what are the remedies available to the Service for recovery of an erroneous abatement based on the untimely refund claim.

Conclusion

A refund claim filed more than three years after the taxpayer's return was filed but within two years of the payment of penalties and interest, which are treated as payments of tax, is timely, although the amount that can be refunded or credited is limited

to the amount of tax, including penalties and interest, paid in that two-year period. Therefore, the abatement was not erroneous to the extent of amounts paid within two years of the filing of the refund claim. With respect to the amount abated in excess of the amount paid within two years of the filing of the refund claim, the Service's remedies generally are limited to requesting voluntary repayment or filing an erroneous refund suit under § 7405.

Facts

The issues are shown in the following hypothetical statement of facts:

The taxpayer filed his 1991 return on October 1, 1994, reporting a liability of \$100,000, withholding credits of \$10,000, and a balance due of \$90,000. The taxpayer began submitting partial payments that were undesignated as to whether the taxpayer intended the payments to be applied to tax, penalties, or interest. Revenue Ruling 73-305, 1973-2 C.B. 43, states that the Service will apply partial, undesignated payments to tax, penalty, and interest, in that order, starting with the earliest period. Pursuant to Rev. Rul. 73-305, the Service applied the payments to the taxpayer's tax, penalties, and interest, in that order. Applying the taxpayer's payments in that manner, the taxpayer's 1991 tax liability was fully paid on July 1, 1996. The Service applied the \$8,000 of payments that the taxpayer made from September 1, 1996, through November 1, 1997, first to penalties, then to interest.

On August 1, 1998, the taxpayer filed an amended return for 1991, claiming that his tax liability should be decreased by \$9,000. Later in 1998, the Service redetermined and abated the taxpayer's 1991 tax liability in the amount of \$9,000, \$3,000 of which was applied to the taxpayer's 1992 tax liability and \$6,000 of which was refunded to the taxpayer.

In 1999, the Austin Service Center determined that the taxpayer had made an untimely refund claim and, consequently, the previous abatement was erroneous. Also in 1999, the Austin Service Center reassessed the \$9,000 of tax previously abated.

Discussion

The Austin Service Center determined that the abatement was erroneous because the refund claim was untimely. Accordingly, we first address whether the taxpayer's claim for refund was timely, then whether the abatement and corresponding refund and credit were erroneous and how any erroneous refund can be recovered.

A. Timeliness of Refund Claim

Section 6511(a) provides that claim for credit or refund of an overpayment of any internal revenue tax for which the taxpayer is required to file a return must be filed within three years from the time the return was filed or two years from the time the tax was paid, whichever is later.

Section 6511(b)(2)(A) provides that if the claim was filed within the three-year period prescribed in § 6511(a), the amount of the credit or refund may not exceed the portion of the tax paid during the period immediately preceding the filing of the claim equal to three years plus the period of any extension of time to file the return. Section 6511(b)(2)(B) provides that if the claim is not filed within the three-year period, the amount of the credit or refund may not exceed the portion of the tax paid during the two years immediately preceding the filing of the claim.

Section 6601(e)(1) provides that interest prescribed under § 6601 on any tax shall be paid upon notice and demand and shall be assessed, collected, and paid in the same manner as taxes. That section further provides that any reference in the Code (except for provisions relating to assessment of deficiencies) to any tax imposed by the Code is deemed also to refer to interest imposed under § 6601 on that tax.

Section 6665(a) provides that, except as otherwise provided: (1) the additions to the tax, additional amounts, and penalties provided by chapter 68 of the Code shall be paid upon notice and demand and shall be assessed, collected, and paid in the same manner as taxes, and (2) any reference in the Code to "tax" imposed by the Code shall be deemed also to refer to the additions to the tax, additional amounts, and penalties provided by chapter 68.

In the instant case, the refund claim was filed more than three years after the return was filed, making inapplicable the three-year limitations period of § 6511(a). Therefore, the taxpayer's claim is timely under § 6511(a) if the claim was filed within two years from the time the tax was paid. Because §§ 6601(e)(1) and 6665(a) require that payments of interest and penalties be treated as payments of tax, the taxpayer in this case made tax payments within two years of having filed his refund claim. See, e.g., Allstate v. United States, 550 F.2d 629 (Ct. Cl. 1977) (tax deficiency plus interest paid was considered tax paid within the two-year period of § 6511(b)(2)(B)). Further, it does not matter that the issue with respect to which the taxpayer claims a refund, his tax liability, was paid outside of that two-year period. Id. Therefore, the taxpayer's refund claim was timely under § 6511(a).

Section 6511(b)(2)(B), however, limits the amount that can be credited or refunded to the portion of the tax paid during the two years immediately preceding the filing of the refund claim. Therefore, in the instant case, the amount that could be credited or refunded is the amount paid in the two years prior to August 1, 1998, which is \$8,000. The amount abated, however, was \$9,000.

B. Erroneous Credit and Refund

An erroneous refund includes any receipt of money from the Service to which the recipient is not entitled, regardless of whether the recipient is the taxpayer or a third party. As explained above, the amount credited and refunded, \$9,000, in 1998 exceeded the limitation in § 6511(b)(2)(B) of the amount of tax, \$8,000, paid in the previous two years. Since under § 6402(a) the purported overpayment was first applied, \$3,000, to taxpayer's 1992 tax liability, we think that \$1,000 of the \$6,000 refund paid to the taxpayer was erroneous.

However, the reason that the \$1,000 refund is erroneous is not because the taxpayer's 1991 income tax liability is greater than the \$91,000 (\$100,000-\$9,000) assessed tax liability remaining after the Service Center's 1998 recomputation of tax liability based on taxpayer's 1991 amended tax return and refund claim. Thus, there is no tax deficiency for 1991 and no amount that could be properly assessed for 1991. Even if the statute of limitations on assessment under § 6501(a) had not already run by 1999, there is no tax that could have been properly assessed for 1991. See §§ 6201(a) and 6501(a) which concern a deficiency of tax and assessment of tax, respectively. Consequently, the Austin Service Center's 1999 reassessment of the erroneous refund amount was not in accord with the Code and must be reversed.

The Service's remedies in recovering the erroneous refund in this example are basically limited to bringing suit for recovery under § 7405, subject to the time limitations of § 6532(b), and seeking a voluntary repayment from the taxpayer. Although by its terms § 6532(b) does not apply to voluntary repayments, once the Service is precluded from bringing suit for recovery of erroneous refunds outside of the time limitations imposed by § 6432(b), the Service is likewise precluded from soliciting voluntary repayments outside those time limitations.

If you have any questions or comments regarding this matter, please call Amy Pfalzgraf at (202) 622-4930.

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By: _____

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