



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224
October 5, 2000

OFFICE OF
CHIEF COUNSEL

Number: **200046037**
Release Date: 11//17/2000
UIL:6402.02-00

CC:PA:APJP:B1:JJMcGreevy
TL-N-3516-00

MEMORANDUM FOR DISTRICT COUNSEL, SOUTH TEXAS DISTRICT

FROM: Pamela W. Fuller
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(Administrative Provisions and Judicial Practice)

SUBJECT: Significant Service Center Advice - Injured Spouse Allocation

This is in response to your request for Significant Service Center Advice dated June 19, 2000, in connection with a question posed by the Taxpayer Relations Branch of the Austin Customer Service Center.

Issue

What is the proper way to compute an injured spouse's refund in a community property state (Texas) when the other spouse owes both a tax and a non-tax debt.

Conclusion

The Service first computes the amount of the joint overpayment subject to offset under § 6402(a) to satisfy the liable spouse's tax liability. Next the Service computes the amount of the joint overpayment subject to offset under §§ 6402(c), (d), or (e) to satisfy the liable spouse's non-tax debts subject to offset under those sections. The Service is required to refund to the injured spouse the amount of the injured spouse's share of the joint overpayment that remains after the liable spouse's tax and non-tax debts are offset.

Facts

Example 1.

		Injured spouse	Liable spouse
Total income	\$12,939.00	\$5,117.12	\$7,820.88
Total W/H	\$1,013.00	\$311.31	\$701.86
Total EIC	\$2,238.00	\$961.89	\$1,276.11

The example states that the total overpayment is \$3,251.00 of which \$1,831.91 was applied to the liable spouse's separate premarital tax debt and \$1,419.09 was applied to the liable spouse's non-tax debt. The service center computed the injured spouse's refund as follows:

Total amount owned by the injured spouse	\$1,468.39 (50% of the W/H plus the injured spouse's portion of the EIC)
LESS 75% of the tax debt of the liable spouse	\$1,373.94
Injured spouse's refund	\$94.45

According to the service center, because there was both a tax and a non-tax debt, the injured spouse receives only \$94.45.

Example 2.

		Injured spouse	Liable spouse
Total income	\$75,998.00	\$28,576.00	\$47,422.00
Total W/H	\$13,066.00	\$2,906.00	\$10,160.00

The total overpayment is \$7,373.00 of which \$5,806.00 was applied to the liable spouse's separate premarital tax debt and \$1,566.50 was applied to the liable spouse's non-tax debt. The service center computes the injured spouse's refund as follows:

Total amount owned by the injured spouse	\$3,686.50 (50% of the overpayment)
LESS 75% of the tax debt of the liable spouse	\$4,354.88
Injured spouse's refund	-0-

According to the service center, because there was both a tax and a non-tax debt, the injured spouse receives nothing.

Example 3.

Both taxpayers are employed and had income tax withheld from their wages. The total joint overpayment is \$2,042.00, of which \$1,002.46 was applied to the liable spouse's separate premarital tax debt and \$269.15 was applied to the liable spouse's separate non-tax debt. The service center computes the injured spouse's portion of the overpayment as follows:

Total amount owned by the injured spouse	\$1,041.00 (50% of the overpayment)
LESS 75% of the tax debt of the liable spouse	\$751.85
Injured spouse's refund	\$269.15

According to the service center, because there was both a tax and a non-tax debt, the injured spouse receives \$269.15.

The request for advice states that current IRM procedures used by the Customer Service function dictate the results described in the above three examples.

IRM 21.4.6.4.10.1(2)a states "In Texas, the IRS may offset 50%, 75%, or 100% of the joint overpayment to the tax debt of one spouse or the other."

IRM 21.4.6.10.1(2)c states with respect to Texas "Deduct any TC 820/826/896/898 offsets that were applied to a liability of the injured spouse and any TC 840/846 refunds from the amount determined below."

IRM 21.4.6.10.2(3)e states that any remaining outstanding tax liability for the injured spouse is to be deducted from the injured spouse's overpayment.

According to Customer Service, these references mean that since the injured spouse can be held responsible for 50%, 75%, or 100% of the liable spouse's separate tax debt, then the 50%, 75%, or 100% should be deducted from the injured spouse's portion of the overpayment.

Discussion

I. Application of joint overpayment to separate unpaid tax liability¹.

A. General.

Section 6402(a) provides that 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, subject to subsections (c), (d), and (e), refund any balance to such person.

B. Community Property.

¹For purposes of this discussion, "tax liability" refers to the taxes imposed by title 26.

Rev. Rul. 85-70, 1985-1 C.B. 361, amplified by Rev. Rul. 87-52, provides a two-part process for determining the amount of a joint overpayment that the Service may offset against the separate tax liability of one of the spouses. In a community property state, each spouse is considered to be the recipient of one-half of the aggregate wages. Each spouse is also entitled to a credit for one-half of the taxes that are withheld from such wages. Pursuant to Rev. Rul. 85-70, if an overpayment results from wages and withholding of tax thereon, each spouse has a one-half interest in the refund.

In the second step described in Rev. Rul. 85-70, the rights of creditors under state law are considered. If permitted by State law, the Service may exercise a common law right of offset against the amount of the overpayment otherwise payable to the nonliable spouse. Texas law is an example of community property law according to which the property subject to one spouse's sole management, control, and disposition is not subject to any liabilities incurred by the other spouse before marriage. Tex. Fam. Code Ann. § 5.61(b)(1) (West 1993).

Rev. Rul. 87-52, 1987-1 C.B. 347, describes the formula for allocating the earned income credit shown on a joint return in determining the amount of a joint overpayment that can be applied against the unpaid tax liability of one spouse pursuant to § 6402(a). The ruling states that the formula applies to taxpayers in both community property states and noncommunity property states because the earned income is computed without regard to community property laws. However, Rev. Rul. 87-52 also notes that the Service may have additional set off rights in applying overpayments of taxpayers residing in certain community property states. See Rev. Rul. 85-70.

In general, under § 6402(a) the Service can offset 50% of a joint refund in a community property state because each spouse has a 50% community property interest in the refund. This leaves the injured spouse only entitled to 50% of the refund. In cases involving Texas community property law, the Service can take 75% of a joint refund if both spouse's had wages and withholding, and 100% of a joint refund if the liable spouse was the sole wage earner and the refund was entirely the liable spouse's sole management community property.² This is the rule reflected in IRM 21.4.6.4.10.1(2)a. The Service can offset the liable spouse's entire portion of the joint overpayment allocated to the Earned Income Tax Credit. The tax debt, if any, remaining after the maximum offset under these rules cannot be satisfied from the injured spouse's share

²See Medaris v. United States, 884 F. 2d 832, 833-34 (5th Cir. 1989), in which the court concluded that in Texas the Service could levy on 100% of a liable spouse's income and on 50% of a nonliable spouse's income. Although the injured spouse cannot use the exemption under state law to request 100% of the refund, the Service is still only entitled to the liable spouse's 50% community property interest in the refund and must return the injured spouse's 50% interest.

of the joint overpayment.³ Therefore, the remaining joint overpayment, if any, must be refunded to the injured spouse.

II. Application of joint overpayments to separate unpaid nontax liabilities⁴.

Section 6402(c) provides that the amount of any overpayment to be refunded to the person making the overpayment shall be reduced by the amount of any past-due support (as defined in § 464(c) of the Social Security Act) owed by that person of which the Secretary has been notified by a State in accordance with § 464 of the Social Security Act.

Section 6402(d) provides that upon receiving notice from any federal agency that a named person owes a past-due legally enforceable debt (other than past-due support subject to § 6402(c)), the Secretary shall reduce the amount of any overpayment payable to such person by the amount of such debt, pay the amount by which the overpayment is reduced to the agency, and notify the person making the overpayment that the overpayment has been reduced by an amount necessary to satisfy the debt.

Section 6402(e) provides that upon receiving notice from any state that a named person owes a past-due legally enforceable state income tax obligation to such state, the Secretary shall reduce the amount of any overpayment payable to such person by the amount of such state income tax obligation, pay the amount by which the overpayment is reduced to the state, and notify the person making the overpayment that the overpayment has been reduced by an amount necessary to satisfy the state income tax obligation.

Under §§ 6402(c), (d), and (e) if a person filing a joint return with the person liable for the debt takes appropriate action to secure his or her proper share of a refund from which an offset was made, the Service is required to pay the person (the "injured spouse") his or her share of the refund. See 31 CFR § 285.2(g), offsets to collect past-due, legally enforceable nontax debt; 31 CFR § 285.3(f), offsets to collect past-due support; and 31 CFR § 285.8(f), offsets to collect state income tax obligations.

The Service cannot offset more than 50% of a joint overpayment to make an offset authorized by §§ 6402(c), (d), and (e) because the Service is not the creditor with respect to the non-tax debts specified in those sections. In the case of offsets under §§ 6402(c), (d), and (e), the Service is required to pay the injured spouse 50% the joint

³ If 100% of the joint overpayment is used to satisfy the liable spouse's unpaid federal tax debt then, of course, nothing would remain available for refund to the injured spouse.

⁴For purposes of this discussion, "non-tax debts" refers to the liabilities subject to offset under §§ 6402(c), (d), and (e).

overpayment irrespective of whether a portion of the injured spouse's overpayment is the sole management and control property of the liable spouse.

III. Application of joint overpayments to tax and non-tax debts.

Section 6402 provides specific rules for determining the order in which an overpayment can be offset to satisfy unpaid liabilities. The amount of the overpayment is applied to satisfy tax liabilities pursuant to § 6402(a) according to the rules discussed above. Any remaining overpayment will be reduced in the following order. First, by the amount of past-due support assigned to a state which is offset pursuant to § 6402(c). Second, by the amount of any past-due, legally enforceable federal debt which is offset pursuant to § 6402(d). Third, by the amount of past-due support not assigned to a state which is subject to offset pursuant to § 6402(c). Fourth, by the amount of past-due state income tax obligations subject to offset under § 6402(e). The amount of the overpayment, if any, remaining after the offsets are made pursuant to §§ 6402(c), (d), and (e) may be credited at the taxpayer's request to the succeeding year's estimated taxes pursuant to § 6402(b) or refunded. See 31 CFR § 285.3(d).

As discussed above, in Texas, the Service can offset 50%, 75%, or 100% of the joint overpayment attributable to wages and withholding, plus the liable spouse's EITC, to satisfy the tax liability pursuant to § 6402(a). However, in Texas, the Service is limited to offsetting 50% of the joint overpayment to satisfy non-tax debts pursuant to §§ 6402(c), (d), and (e).

When a tax debt and a non-tax debt are owed by the same spouse the Service first applies 50%, 75%, or 100% of the joint overpayment to the tax liability under § 6402(a). The Service next applies the joint overpayment to the liable spouse's non-tax debt. However, if the tax liability exceeds 50% of the joint overpayment the Service will not be entitled to make any offset under §§ 6402(c), (d), or (e) because the Service will already have taken the maximum amount (50%) of the liable spouse's joint overpayment available to make the §§ 6402(c), (d), or (e) offset. Assuming the Service did not take 100% of the joint overpayment, the amount of the joint overpayment in excess of the 50% or 75% used to satisfy the liable spouse's separate tax liability must be refunded to the injured spouse.

If the tax debt is less than 50% of the joint overpayment then the Service can offset the full amount of the tax debt. In addition, the Service can offset the liable spouse's non-tax debt by the difference between the tax offset and 50% of the joint overpayment available to make the §§ 6402(c), (d), or (e) offset. In this case the remaining 50% of the joint overpayment must be refunded to the injured spouse.

These principles can be illustrated using the examples provided in the Facts.

Example 1. In this example, the injured spouse and the liable spouse both had income and withholding. The total overpayment is \$3,251.00 of which \$1,013.00 is attributable

to combined income tax withholding and \$2,238.00 is attributable to EITC . The EITC is allocated \$961.89 to the injured spouse and \$1,276.11 to the liable spouse. The liable spouse's tax liability is \$1,831.91 and the liable spouse's non-tax debt is \$1,419.09.

First in priority is the offset of the overpayment to the tax liability pursuant to § 6402(a). The Service, as creditor, can offset up to \$2,035.86 of the joint overpayment to satisfy the tax liability of the liable spouse. The total available is the sum of \$759.75 (75% of the \$1,013.00 overpayment attributable to withholding) plus \$1,276.11 (the liable spouse's share of EITC). In this example, the Service can make a § 6402(a) offset equal to the liable spouse's entire tax liability of \$1,831.91.

Next is the offset of the overpayment to satisfy the liable spouse's non-tax debt. The amount of the joint overpayment that is subject to offset for non-tax debts is limited to \$1,782.61 (50 percent of the \$1,013.00 plus the liable spouse's \$1,276.11 EITC). Because the tax offset (\$1,831.91) exceeds the liable spouse's \$1,782.61 interest in the joint overpayment, no additional amount of the joint overpayment can be offset to satisfy the non-tax debt. The amount of the joint overpayment that must be refunded to the injured spouse is \$1,419.09 (\$3,251.00 less the \$1,831.91 overpayment used to satisfy the tax liability).⁵

Example 2. In this example, the injured spouse and the liable spouse both had income and withholding. The total overpayment is \$7,373.00. The liable spouse's tax liability is \$5,806.00, and the liable spouse's non-tax debt is \$1,566.50.

First in priority is the offset of the overpayment to the tax liability pursuant to § 6402(a). The Service, as creditor, can offset up to \$5,529.75 of the joint overpayment to satisfy the tax liability of the liable spouse. The total available is equal to 75% of the \$7,373.00 joint overpayment. In this example, the Service can satisfy up to \$5,529.75 of the liable spouse's tax liability.

Next is the offset of the overpayment to satisfy the liable spouse's non-tax debt. The amount of the joint overpayment that is subject to offset for non-tax debts is limited to \$3,686.50 (50% of the joint overpayment). Because the tax liability offset (\$5,529.75) exceeds the liable spouse's \$3,686.50 interest in the joint overpayment, no additional amount of the joint overpayment can be offset to satisfy the liable spouse's non-tax debt. The amount of the joint overpayment that must be refunded to the injured spouse is \$1,843.25 (\$7,373.00 less the \$5,529.75 overpayment used to satisfy the tax liability).

⁵ The injured spouse's actual interest in the overpayment is \$1,468.39 (50 percent of the \$1,013.00 plus the injured spouse's \$961.89 EITC). However, the Service, as creditor is entitled to take a portion of this amount to satisfy the liable spouse's tax liability.

Example 3. In this example, the injured spouse and the liable spouse both had income and withholding. The total joint overpayment is \$2,042.00. The liable spouse's tax liability is \$1,002.46 and the liable spouse's non-tax debt is \$269.15.

First in priority is the offset of the overpayment to the tax liability pursuant to § 6402(a). The Service, as creditor, can offset up to \$1,531.50 of the joint overpayment to satisfy the tax liability of the liable spouse. The total available is equal to 75% of the \$2,042.00 joint overpayment. In this example, the Service can satisfy the liable spouse's entire tax liability of \$1,002.46.

Next is the offset of the overpayment to satisfy the liable spouse's non-tax debt. The amount of the joint overpayment that is subject to offset for non-tax debts is limited to \$1,021.00 (50% of the joint overpayment). Because the tax liability offset (\$1,002.46) is less than the liable spouse's \$1,021.00 interest in the joint overpayment, the difference (\$18.54) can be offset to satisfy the liable spouse's non-tax debt. The amount of the joint overpayment that must be refunded to the injured spouse is \$1,021.00 (\$2,042.00 less the \$1,002.46 and \$18.54 of the non-tax debt).

IV. Service Center procedures.

The Service Center states that in situations involving Texas community property law the current procedures require that the injured spouse's allocable portion of the joint overpayment be reduced by 75% of the tax liability of the liable spouse. This methodology is supposedly supported by IRM 21.4.6.4.10.1(2)c, which states, in part, that in Texas the Service should "Deduct any TC 820/826/896/898 offsets that were applied to a liability of the injured spouse...." The request for advice states that this IRM reference means that 50-100% of the tax liability must be deducted from the injured spouse's portion of the overpayment.

We find no support in the current IRM for the methodology suggested in the request for Service Center Advice.⁶ IRM 21.4.6.4.10.1(2)c merely requires that the Service Center personnel take into account prior refunds made to the injured spouse to insure that only a net refund is issued. It is clearly improper to reduce the injured spouse's share of the joint overpayment by the liable spouse's tax or non-tax offset because to do so would result in the Service making two offsets with respect to the same tax liability or non-tax debt.

⁶ The request for assistance cites IRM 21.4.6.4.10.2(3)e, which states that "any remaining outstanding tax liability for the injured spouse" is to be deducted from the injured spouse's portion, as additional support for the methodology used in the service center. However, in the examples provided, the injured spouse was not separately liable for a tax liability subject to § 6402(a).

If you have any questions regarding this memorandum, please call John McGreevy at (202) 622-4910.