



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

OFFICE OF  
CHIEF COUNSEL

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MEMORANDUM FOR DISTRICT COUNSEL  
BROOKLYN DISTRICT

FROM: Pamela W. Fuller  
Acting Chief, Branch 1 (Administrative Provisions & Judicial  
Practice) CC:PA:APJP:1

SUBJECT: Significant Service Center Advice: Offset of Erroneous Refunds

This responds to your request for Significant Service Center advice in connection with questions posed by the Brookhaven Customer Service Center. We have restated the issues as follows:

**ISSUES**

1. Where the Service seeks to recover an erroneous refund by offsetting it against an overpayment of tax from a later tax year, may the offset be deemed to have occurred prior to the date the taxpayer files the return showing the overpayment?
2. Under the circumstances described below, may the Service reverse a valid offset made pursuant to sections 6402(c) or 6402(d) of the Internal Revenue Code?

**CONCLUSIONS**

1. Based on the facts you describe, the Service may not deem an offset to have occurred prior to the date the taxpayer filed the return showing an overpayment of tax.
2. The Service may not reverse an offset properly made pursuant to sections 6402(c) or 6402(d) of the Code under the circumstances you describe.

**FACTS**

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You present two independent scenarios:

1. On May 26, 1998, the Service made a nonrebate erroneous refund to a taxpayer for the taxpayer's 1997 taxable year. You note that the statute of limitations for recovering the erroneous refund expired on May 26, 2000.<sup>1</sup> The Service took no action prior to May 26, 2000, to recover the erroneous refund. The taxpayer filed his 1999 income tax return in August 2000, pursuant to a valid extension of time for filing. The taxpayer's 1999 return reflected estimated tax payments and a credit from 1998 in excess of tax liability, resulting in an overpayment of tax. You indicate that when the Service processed the taxpayer's 1999 return, the taxpayer's overpayment "posted as of April 15, 2000." Because April 15, 2000 is prior to the expiration of the statute of limitations on the erroneous refund, you ask whether the Service may offset the erroneous refund against the 1999 overpayment "as of" April 15, 2000.

2. On May 26, 1998, the Service made a nonrebate erroneous refund to a taxpayer for the taxpayer's 1997 taxable year. You note that the statute of limitations for recovering the erroneous refund expired on May 26, 2000. The taxpayer filed his 1999 income tax return on April 15, 2000, and requested a refund. Prior to May 26, 2000, the Service took no action to offset the erroneous refund against the overpayment shown on the taxpayer's 1999 return. Instead, pursuant to sections 6402(c) and 6402(d), the entire amount of the claimed overpayment was offset to one or more federal or state agencies to whom the taxpayer was indebted.<sup>2</sup> The Service now asks whether it can reverse the offsets made pursuant to sections 6402(c) and 6402(d), and if so, whether it may offset the erroneous refund against the overpayment shown on the taxpayer's 1999 return.

## **LAW & ANALYSIS**

### **Issue 1**

The Service's authority to credit overpayments of tax against outstanding tax liabilities is contained in section 6402(a) of the Code. Section 6402 is not an appropriate means of recovering an erroneous refund unless the Service can assess the amount erroneously

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<sup>1</sup> Under section 6532(b) of the Code, absent fraud or misrepresentation of a material fact, the statute of limitations for recovering an erroneous refund expires two years after the date the erroneous refund was made.

<sup>2</sup> A refund offset to an outstanding child support or Federal agency debt made before 1999 is referred to as a debtor masterfile (DMF) offset. Refund offsets made after 1998 are referred to as Treasury Offset Program (TOP) offsets.

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refunded (as in the case of a rebate refund).<sup>3</sup> However, the Service may recover a nonrebate erroneous refund pursuant to the common law right of offset.

Under the facts you present, the Service seeks to use the common law right of offset to credit the taxpayer's overpayment for the 1999 tax year against the nonrebate erroneous refund attributable to the 1997 tax year. Pursuant to the statute of limitations for recovering an erroneous refund, the Service must have made the offset on or before May 26, 2000.

Generally, an overpayment is treated as arising on the date on which the tax payments first exceed the correct tax liability for the year. Section 301.6611-1(b) of the Regulations on Procedure and Administration provides:

Except as provided in section 6401(a), relating to assessment and collection after the expiration of the applicable period of limitation, there can be no overpayment of tax until the entire tax liability has been satisfied. Therefore, the dates of overpayment of any tax are the date of payment of the first amount which (when added to previous payments) is in excess of the tax liability. . . and the dates of payment of all amounts subsequently paid with respect to such tax liability. . .

For purposes of applying this regulation, section 301.6611-1(d) provides that the provisions of section 6513(b) (treating wage withholding and estimated tax payments during a taxable year as a "tax payment" on April 15<sup>th</sup> of the following year) shall apply in determining the date of an overpayment.

Based on the facts provided, an overpayment for the 1999 taxable year arose on April 15, 2000. As of that date, the taxpayer's estimated tax payments were deemed "tax payments" by virtue of section 6513(b)(2), and such payments exceeded the taxpayer's correct tax liability for the year. In cases where tax payments are deemed paid on April 15<sup>th</sup> pursuant to section 6513(b), it is our understanding that the Service's computers properly reflect the fact that an overpayment of tax exists on April 15<sup>th</sup>.

Although an overpayment existed on April 15, 2000, it is incorrect to hold that the Service can offset the erroneous refund at that date. The courts and the Code have long provided that a liability is considered paid by a credit on the date the credit is allowed. U.S. v. Swift & Co., 282 U.S. 468 (1930); Rahr Malting Co. v. U.S., 260 F.2d 309 (7<sup>th</sup> Cir. 1958); § 7422(d).

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<sup>3</sup> See Memorandum from Acting Deputy Assistant Chief Counsel (General Litigation) dated February 7, 2000.

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Typically, the Service allows a credit of an overpayment against an outstanding liability only after it receives and processes the taxpayer's return for the year of the overpayment, verifies that the taxpayer is claiming an overpayment of tax, and decides to apply the overpayment against the outstanding liability. Except for certain non-tax offsets, the Service has the discretion whether to apply an overpayment to an outstanding liability, and may choose not to credit an overpayment against an outstanding liability.

Based on the facts provided, we conclude that an offset of the overpayment for the 1999 taxable year may not be deemed to have occurred prior to the date the Service accepted and processed the taxpayer's 1999 return, despite the fact that the Service's computers post the overpayment as of April 15, 2000.

## Issue 2

Sections 6402(c) and (d) of the Code require that certain debts that a taxpayer owes to federal or state government agencies be offset against any tax overpayments of the taxpayer. These offsets are mandatory. Under the facts you present, the Service issued an erroneous refund to the taxpayer for the 1997 year. On April 15, 2000, the taxpayer filed his 1999 tax return, claiming an overpayment of tax. The overpayment shown on the 1999 return was offset to satisfy a non-tax debt. After the expiration of the statute of limitations for recovering the erroneous refund, the Service discovered that it could have applied the 1999 tax overpayment against the erroneous refund for 1997. The Service now seeks to reverse the offsets and apply the overpayment against the erroneous refund, based on the rationale that it had the authority to apply the overpayment against the erroneous refund as of April 15, 2000, but did not do so.

Neither section 6402 nor the regulations thereunder specifically address the Service's authority to reverse an offset after the funds have been paid to the state or federal agency. In general, specific statutory authority is required for the Service to reverse a completed transaction. Thus, for example, while it is within the Service's discretion whether to make an assessment of tax, once that assessment is properly made, it can be abated only under the conditions provided in section 6404 of the Code. Similarly, while the Service may decide that it does not desire to file a tax lien against a taxpayer's property, once the lien is filed, it may be released or withdrawn only under the conditions provided in section 6323(j).

A nonstatutory "common law" exception to these prohibitions on reversing a completed transaction is referred to as the "clerical error" exception. Succinctly stated, whenever an action occurs because of mistake of fact or bookkeeping error, that mistake can be

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corrected, so long as this does not prejudice the taxpayer.<sup>4</sup> In the past, the Service has chosen to apply the clerical exception in clear cases of clerical error, and has been reluctant to apply the doctrine where the decision made by the Service was discretionary.<sup>5</sup>

In our opinion, the Service may not apply the clerical exception to the facts you present. The case law regarding clerical exception has arisen from cases significantly different from the situation you present. These cases dealt with abatements of tax assessments where the abatement was erroneous and clearly contrary to law. The courts held that the accidental abatement was not effective.

In contrast, the situation you present involves the legally correct application of the taxpayer's overpayment to past due federal or state agency debts. Under the facts you present, the taxpayer's past due support or federal agency debts were properly offset against the tax overpayment. Because the offset was legally proper, the correction the Service seeks is not a correction of a legally improper action on the part of the Service based on mistake of fact or clerical error. For this reason, it is our conclusion that the Service may not legally reverse the offset under the facts you describe.

Furthermore, reversing the offset in this circumstance would merely reinstate the overpayment on the taxpayer's account. Because the statute of limitations for offsetting the erroneous refund has expired, the Service would be unable to credit the overpayment against the erroneous refund. As indicated in Issue 1 above, it is our opinion that the Service may not make the offset after the expiration of the statute of limitations and deem it to have occurred prior to such expiration.

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<sup>4</sup> See, e.g., Matter of Bugge, 99 F.3d 740 (5<sup>th</sup> Cir. 1996) (unauthorized and accidental abatement of assessment may be corrected); Crompton-Richmond Co. v. United States, 311 F.Supp. 1184 (S.D.N.Y. 1970) (when tax is abated due to mistake of fact or bookkeeping error, the assessment may be reinstated).

<sup>5</sup> See Memorandum from Senior Technician Reviewer, Branch 2 (General Litigation) dated February 2, 1999 (where the Service chose to credit a taxpayer's overpayment against an outstanding tax liability, the Service lacked the authority to reverse the transaction for purposes of issuing a hardship refund to the taxpayer).