



OFFICE OF
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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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MEMORANDUM FOR AREA COUNSEL

SMALL BUSINESS/SELF-EMPLOYED: AREA 6

CC:SB:6;HOU:1:GL

Attn: Marilyn S. Ames, Associate Area Counsel (SB/SE: Area 6)

FROM: John J. McGreevy
Assistant to the Branch Chief
Administrative Provisions & Judicial Practice Division
CC:PA:APJP:1

SUBJECT: Significant Service Center Advice
Offset Bypass Procedures and Nonrebate Erroneous Refunds

In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

This responds to your request for Significant Service Center advice in connection with the question posed by the Taxpayer Advocate Service. We have restated the issue as follows:

ISSUE

Whether the Internal Revenue Service ("Service") is prohibited from issuing a refund under the offset bypass procedures when the liability to which the overpayment would otherwise be applied is a nonrebate erroneous refund.

CONCLUSION

The Service is not prohibited from issuing a refund under the offset bypass procedures when the liability to which the overpayment would otherwise be applied is a nonrebate erroneous refund.

FACTS

Taxpayer requested a manual refund for tax year 1996, which was issued by the Taxpayer Advocate Service in Houston, Texas on February 18, 2000. Due to an error in processing, a second erroneous refund for 1996 was systematically generated on

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March 6, 2000. Taxpayer received both refunds, and no amount has been repaid on the erroneous refund. Taxpayer filed his tax year 2000 return, showing an overpayment, and requested that the refund be directly deposited. Because of the erroneous refund for the 1996 taxable year, the direct deposit request was denied. Taxpayer then contacted the Taxpayer Advocate Service in Houston and requested his refund on the basis of hardship. The National Taxpayer Advocate's Office agreed that a hardship existed, and a request for a manual refund was made by the Taxpayer Advocate in Houston through a Taxpayer Assistance Order. The Field Director, Submission Processing, in the Austin Service Center raised the issue of whether the offset bypass refund procedures, which allow for the issuance of a refund rather than having the overpayment offset against liabilities owed by a taxpayer, apply in the case of a nonrebate erroneous refund. The Taxpayer Assistance Order was rescinded by the Area Taxpayer Advocate, with the concurrence of the National Taxpayer Advocate's Office.

LAW AND ANALYSIS

There are two categories of erroneous refunds, rebate and nonrebate. A rebate erroneous refund occurs when a taxpayer's tax liability is incorrectly reduced or abated by the Service, as the recomputed tax liability is determined to be less than the amount reported and paid by the taxpayer. See, I.R.C. § 6211(b)(2); Singleton v. United States, 128 F.3d 833,836 n. 11 (4th Cir. 1997); O'Bryant v. United States, 49 F.3d 340, 342 (7th Cir. 1995). A nonrebate erroneous refund is one which is created by the Service in connection with the performance of some function other than the recomputation of tax liability. A non-rebate erroneous refund may be due to an erroneous determination of credits for estimated tax payments or withheld tax, or the issuance of a refund check by the Service in the wrong amount or to the wrong taxpayer.

Further, a rebate erroneous refund is recoverable through the well-established procedure of issuing a notice of deficiency, assessing the liability and employing administrative collection. A nonrebate erroneous refund can be recovered in two ways only. First, it can be recovered under § 7405 of the Internal Revenue Code ("Code"), which provides for suits if any portion of a tax imposed by the Code is erroneously refunded. Second, it can be recovered through the offset of an amount payable to the taxpayer for another year under the principle that the government has the same common law rights as any other creditor to apply funds owed to its debtor against the debt owed. See, United States v. Munsey Trust Co. of Washington, 332 U.S. 234, 239 (1947); In re Chateaugay Corp., 94 F.3d 772, 778-779 (2d Cir. 1996).

Section 6402(a) of the Code states that the Secretary may credit the amount of any overpayment against any liability "in respect of an internal revenue tax on the part of

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the person who made the overpayment.” While 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 or for which a statutory notice of deficiency has been issued), is a prerequisite to making an offset under section 6402. See, Treas. Reg. § 301.6402-1. Accordingly, unless the Service can assess the amount erroneously refunded (as in the case of a rebate refund), the Service may not use its statutory right of offset under section 6402 to recover the erroneous refund. Due to the Code’s permissive use of the word “may”, the Commissioner has the authority to choose not to offset the overpayment against an outstanding tax liability, rather he may refund it to the taxpayer instead. In a situation involving a nonrebate erroneous refund, however, the amount owed by the taxpayer cannot be recovered through normal assessment and collection procedures. As a result, § 6402(a) of the Code is inapplicable as to the nonrebate erroneous refund.

There is no express authority in the Code addressing whether the Commissioner has the discretion to exercise the common law right of offset. If an ordinary creditor was involved, there is no question that the creditor could choose not to exercise the right to offset, but could instead refund the funds being held to the debtor. Therefore, the Service is not prohibited from issuing a refund under the offset bypass procedures when the liability to which the overpayment would otherwise be applied is subject to a common law offset.

The issue has been raised as to whether 31 U.S.C. § 3711(a) prohibits the Service from bypassing an offset against a nonrebate erroneous refund. Pursuant to 31 U.S.C. § 3711(a)(1), “the head of an executive, judicial, or legislative agency - shall try to collect a claim of the United States Government for money or property arising out of the activities of, or referred to, the agency.” The use of the word “shall” in § 3711(a) dictates a mandatory action.

Section 3711(d) provides that the head of an executive, judicial, or legislative agency acts under the regulations prescribed by the head of that agency, and under the standards that the Attorney General and the Secretary of the Treasury may prescribe. The standards issued pursuant to 31 U.S.C. § 3711(d) are contained in 31 C.F.R. Parts 900-904. 31 C.F.R. 901.12(a) provides that:

The preceding sections of this part, to the extent they reflect remedies or procedures prescribed by the Debt Collection Act of 1982 and the Debt Collection Improvement Act of 1996, such as administrative offset, use of credit bureaus, contracting for collection agencies, and interest and related charges, do not apply to debts arising under, or payments made under, the Internal Revenue Code of 1986.

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Irrespective of whether a nonrebate erroneous refund (i.e., a “non-tax debt”) can be characterized as a claim arising out of the activities of the Service within the meaning of § 3711(a), the standards prescribed for applying this rule specifically exempt debts arising under, or payments made under, the Code. We think it is inconsistent to argue that the nonrebate erroneous refund is a claim for money or property arising out of the activities of the Service for purposes of § 3711(a), but not a debt or payment arising under the Code for purposes of the exemption. Accordingly, the mandatory language of 31 U.S.C. § 3711(a) does not prohibit the Service from issuing a refund bypass order in situations involving nonrebate erroneous refunds.

If you have any questions, please contact Rob Desilets, Jr. at (202) 622-7179.