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INTERNAL REVENUE SERVICE
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WDBrackett

MEMORANDUM FOR ASSOCIATE AREA COUNSEL, SB/SE AREA 5, SALT LAKE
CITY, ATTN: MARK H. HOWARD CC:SB:5:SLC

/S/

FROM: ROBERT A. MILLER, SENIOR TECHNICIAN REVIEWER
BRANCH 3 (COLLECTION, BANKRUPTCY & SUMMONSES)

SUBJECT: SIGNIFICANT SERVICE CENTER ADVICE

This responds to your request for Significant Service Center Advice dated April 4, 2001, in connection with a question from the Frivolous Return Unit in the Ogden Compliance Center.

ISSUE

With respect to a frivolous refund claim based on a claim of entitlement to an invalid, nonexistent credit (such as for Black reparations), you ask can the Service, and if so by what procedures or remedies, refuse to post the credit to the account, reverse a frivolous credit posted to the account, stop FMS from processing a refund voucher (whether for a check or an electronic fund transfer, EFT), intercept a mailed check or EFT, recover the check from the hands of the taxpayer or the bank prior to final processing of the check, recover deposited Treasury check or EFT proceeds before or after the proceeds become available for withdrawal, or recover Treasury check proceeds withdrawn from the bank account by the taxpayer?

CONCLUSIONS

If the frivolous claimed credit is discovered:

(1) during processing and prior to posting the credit to the Master File (MF) account, and action is taken to deny the credit as not existing, do not post the credit to the account;

(2) after posting the credit to the MF account but before an electronic refund voucher is sent to Financial Management Services (FMS), reverse the credit on the MF account for the reason that it does not exist;

(3) immediately after an electronic refund voucher has been processed to FMS but before the voucher has been processed by FMS, reverse the credit on the MF account and send an electronic order to FMS directing that FMS stop processing the voucher and, as applicable, restore funds to the IRS' Treasury account;

(4) immediately after a voucher has been processed by FMS, and before the check or EFT has gone out (that is, before the check is put in the hands of the United States Postal Service, USPS, or before the EFT is transmitted to a correspondent bank), reverse the credit on the MF account and request that, as applicable, FMS secure and cancel the check, or cancel the EFT, and in either case restore the funds to the IRS' Treasury account;

(5) shortly after a check is put in the hands of USPS, reverse the credit on the MF account and submit an expedited request, to the local and regional USPS offices which have initial jurisdiction over the refund checks issued by FMS, asking for return to the IRS (as sender) of the envelope containing the Treasury check;

(6) shortly after an electronic funds transfer has been sent by FMS to a correspondent bank, reverse the credit on the MF account and ask that a stop payment be electronically issued by FMS;

(7) while a check is being held by the taxpayer, revenue officers should converse with the taxpayer, face to face, inform the taxpayer that the check was obtained by misrepresentation of a material fact, request that the taxpayer turnover the check to the IRS, and inform the taxpayer that assessment and collection action will be taken if the request is not honored;

(8) after taxpayer presents the check for negotiation to a depository bank but while the check is still in the possession of the bank and before the bank makes funds available for withdrawal, the bank can be requested to withhold processing of the check under 12 C.F.R. 229.13(b),(f),(h) (In that circumstance one or more revenue officers should converse with the taxpayer, face to face, inform the taxpayer that the check was obtained by misrepresentation of a material fact, request that the taxpayer consent to the bank turning the check over to the IRS, and inform the taxpayer that assessment and collection action will be taken if the request is not honored.);

(9) after the depository bank has deposited proceeds of the check in the taxpayer's account but before the funds are available for withdrawal:

(a) one or more revenue officers should converse with the taxpayer, face to face, inform the taxpayer that the check was obtained by misrepresentation of a material fact, request that the taxpayer voluntarily return the amount of the erroneous refund, and inform the taxpayer that failure to do so will result in assessment and collection action;

(b) If the taxpayer will not voluntarily turn over the funds to the IRS, after meeting with one or more revenue officers, the IRS should make an I.R.C. § 6201(a)(3) assessment;

(10) after the funds have been withdrawn from the bank account by the taxpayer, the IRS should make a section 6201(a)(3) assessment.

FACTS

A number of taxpayers have filed claims for refund based on a claim of entitlement to an invalid, nonexistent credit (such as for Black reparations). The IRS has centralized in the Ogden Compliance Center the processing of frivolous return claims under I.R.C. § 6702, Frivolous return Penalty, and particularly the Black reparations claims for the entire United States. It was discovered that some offices of the IRS have erroneously processed returns and allowed some Black reparations claims to proceed to an approved refund status. However, the IRS has often discovered this error either before the check is mailed to the taxpayer or before the check has cleared the banking process.

DISCUSSION

With respect to a frivolous refund claim based on a claim of entitlement to an invalid, nonexistent credit (such as for Black reparations), you ask can the Service, and if so by what procedures or remedies, refuse to post the credit to the account, reverse a frivolous credit posted to the account, stop FMS from processing a refund voucher (whether for a check or an EFT), intercept a mailed check or EFT, recover the check from the hands of the taxpayer or the bank prior to final processing of the check, recover funds after the check or EFT has been deposited in the taxpayer's bank account and before or after the funds became available for withdrawal, or recover Treasury check proceeds withdrawn from the bank account by the taxpayer? Generally, we conclude that if the Service acts quickly enough, there are pre-assessment administrative procedures for recovery at each step of the process a check or EFT follows, and if those are unavailing, there are assessment, collection, and erroneous refund remedies. Our positions, explained in more detail below, is drawn from a number of prior advisories and other authorities, which we take this opportunity to collect and update.

(1) If the frivolous claimed credit is discovered during processing, and action is taken to deny the credit as not existing prior to posting the credit to the Master File (MF) account, do not post the credit to the account. Our position is implied from our prior Significant Service Center Advice, 200034028, WTA-N-110702-00, dated July 21, 2000, which concludes that a frivolous claim to an invalid, nonexistent credit (Black reparations credit in that instance) can be reversed.

(2) If the frivolous invalid, nonexistent credit is discovered after posting the credit to the MF account but before an electronic refund voucher is sent to Financial Management Services (FMS), reverse the credit for the reason that it does not exist. See our prior Significant Service Center Advice, 200034028, WTA-N-110702-00, dated July 21, 2000, which concludes that a frivolous claim of an invalid, nonexistent credit (Black reparations credit in that instance) can be reversed.

(3) If the frivolous claimed credit is discovered immediately after an electronic refund voucher has been processed to FMS but before the voucher has been processed by FMS, send an electronic order to FMS directing that FMS stop processing of the voucher and, as applicable, restore funds to the IRS' Treasury account. See our prior Significant Service Center Advice, SCA 1998-017, TL-N-5968-97, dated December 12, 1997. We note in this regard that we have been advised by FMS that their processing time for a check is ten days and their processing time for an EFT is three days, both measured from the date that FMS receives the electronic voucher

(4) If the frivolous claimed credit is discovered immediately after a voucher has been processed by FMS, and before the check or EFT has gone out (that is, before the check is put in the hands of the USPS, or before the EFT is transmitted to a correspondent bank), request that, as applicable, FMS secure and cancel the check, or cancel the EFT, and in either case restore the funds to the IRS' Treasury account. FMS has informally acknowledged that FMS is able to do this. We note in this regard that we have been advised by FMS that their processing time for a check is ten days and their processing time for an EFT is three days, both measured from the date that FMS receives the electronic voucher.

(5) If the frivolous claimed credit is discovered shortly after a check is put in the hands of USPS, immediately submit an expedited request to any USPS post office identifying the mailpiece and the Treasury Department (IRS) as the sender. This procedure is provided in USPS Domestic Mail Manual (Issue 56 plus Postal Bulletin changes through PB22047, 4-5-01) D030 1.2, which states: "[a] federal agency may recall any mailpiece sent as official mail by submitting to any post office a Mailgram or an Express Mail letter identifying the piece." The USPS treats the IRS as the sender of all IRS refund checks.

(6) If the frivolous claimed credit is discovered shortly after an electronic funds transfer has been sent by FMS to a bank, ask that a stop payment be issued by FMS electronically to the correspondent bank and the depository bank. We mention the correspondent bank because EFTs, while designed to be a transmittal that occurs quickly, sometimes incur delay between receipt and retransmittal by a correspondent bank.

The regulations providing for funds availability as the result of clearance of EFTs, and providing procedures for the issuer of the funds to stop the clearance, are contained in

12 C.F.R. 229. An EFT is cleared (received) when the receiving bank has received the payment in “actually and finally collected funds” and information on the account to be credited. See section 229.10(b)(2). Thus, normally, a Treasury EFT would be made available for withdrawal the business day after the banking day on which the EFT is finally received by the depository bank. See section 229(b). However, if the IRS acts quickly enough and if the bank is still in possession of the funds (including if they are in the taxpayer’s bank account), it may still be possible for the EFT transaction to be reversed.

(7) If the frivolous claimed credit is discovered while a check is being held by the taxpayer, one or more revenue officers should converse with the taxpayer, face to face, inform the taxpayer that the check was obtained by misrepresentation of a material fact, request that the taxpayer turnover the check to the IRS, and inform the taxpayer that failure to do so will result in assessment and collection action.

(8) If the frivolous claimed credit is discovered after taxpayer has presented the check to a depository bank but before the financial institution has given funds to the taxpayer or released deposited funds for withdrawal, the bank can be requested to withhold processing of the check. Section 229.10(c)(1),(i) provides, in the case of funds derived from a Treasury check deposited in an account of the payee of the check, that a depository bank shall make the deposited funds available for withdrawal not later than the business day after the banking day on which the funds are deposited (next day availability). However, two exceptions, are provided in section 229.13. The first exception, section 229.13(b), provides that section 229.10(c) does not apply to deposits in excess of \$5,000 on any one banking day. The second exception, section 229.13(f), provides that section 229.10(c) does not apply to funds deposited by check in a depository bank in the case of an emergency condition beyond the control of the depository bank. For purposes of both exceptions, section 229.13(h) provides that the depository bank may extend the next day availability time period established by section 229.10(c) by a reasonable period. Section 229.13(h)(4) defines reasonable period as, normally, an extension of up to six business days for checks described in section 229.10(c)(1); however, that provision notes that a longer period may be reasonable but the bank bears the burden of so establishing. In our view, one or more revenue officers should converse with the taxpayer, face to face, inform the taxpayer that the check was obtained by misrepresentation of a material fact, request that the taxpayer consent to the bank turning the check over to the IRS, and inform the taxpayer that failure to do so will result in assessment, imposition of interest and collection action.

(9) If the frivolous claimed credit is discovered after the proceeds of the check have been deposited by the depository bank to the taxpayer’s account and the funds have been made available for withdrawal:

(a) one or more revenue officers should converse with the taxpayer, face to face, inform the taxpayer that the check was obtained by misrepresentation of a material fact,

request that the taxpayer voluntarily return the amount of the erroneous refund, and inform the taxpayer that failure to do so will result in assessment, imposition of interest and collection action;

(b) if the taxpayer will not voluntarily turn over the funds to the IRS, after meeting with one or more revenue officers, the IRS should make a section 6201(a)(3) assessment.

(10) If the frivolous claimed credit is discovered after the check has been negotiated and funds have been withdrawn from the bank account by the taxpayer, the IRS should make a section 6201(a)(3) assessment.

OTHER CONSIDERATIONS

If the IRS makes a section 6201(a)(3) assessment, the IRS then has available the full range of administrative and judicial collection authority. In this regard, the IRS generally has ten years from the date of the assessment to administratively collect, including by levy. If use of the levy authority cannot recover some part of the refund, a collection suit to reduce the assessment to judgement can be brought at any time within the ten year period.

Alternatively, as you mention, an erroneous refund suit under I.R.C. § 7405 is an available remedy for obtaining a judgement. The period for bringing an erroneous suit in respect of a refund premised on an invalid, nonexistent credit is the I.R.C. § 6532(b) five year period that applies to misrepresentations of material fact. See our Chief Counsel Advice, CT-104674-99, dated March 17, 1999.

Jeopardy levy may be an appropriate remedy in many of these instances. See Chief Counsel Advice, CT-104674-99, dated March 17, 1999. In determining whether jeopardy exists, local counsel will review the jeopardy proposal and determine whether jeopardy levy is appropriate in the circumstances. In this regard, we refer you to the discussion of jeopardy in our prior Chief Counsel Advice CT-104674-99. We suggest that, among other factors, local counsel consider: whether the relative level of the taxpayer's reported income is low in respect to the size of the erroneous refund (here, \$40,000 or \$80,000), thereby suggesting a likelihood that if withdrawn a significant amount may not be recovered; and whether, upon being contacted by one or more revenue officers in a face to face conversation as described above, the taxpayer refused to voluntarily return or to consent to the bank's return of the check or funds.

If the refund of the frivolous credit cannot be recovered, the refund constitutes income to the taxpayer in the year in which the taxpayer received the refund. See Chief Counsel Advice (Field Service Advice) TL-N-8392-93, 1999 TNT 55-49, dated August 26, 1993. The normal deficiency procedures are used to impose income tax in respect of this income.

You posed an additional question relating to the holding in Neece v IRS, 922 F.2d 573 (10th Cir 1990), but informally indicated that few of the taxpayers involved with the invalid, nonexistent credits are located within the Tenth Circuit. Because of the limited application of the question to the facts you present, and because the Neece question has been addressed in prior advisories, there is no need for us to address it here.

If you have any questions, contact 202-622-3630.