

Office of Chief Counsel  
Internal Revenue Service  
**Memorandum**

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CC:PA:CBS:B03:WDBrackett

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date: July 05, 2005

to: Associate Area Counsel - Greensboro  
(Small Business/Self Employed)  
CC:SB:2:GBO

from: Senior Technician Reviewer, Branch 3  
(Collection, Bankruptcy and Summonses)  
CC:PA:CBS:3

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subject: Interest on Erroneous Refunds

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

**ISSUES**

- (1) Whether the refunds were erroneous.
- (2) Whether I.R.C. § 6602 interest is assessable.
- (3) Whether the IRS has discretion to abate section 6602 interest on refunds in excess of \$50,000.

**CONCLUSIONS**

- (1) The refunds were erroneous.
- (2) Section 6602 interest is assessable.

(3) The IRS has discretion to abate section 6602 interest on refunds in excess of \$50,000.

## **FACTS**

Employees were shifted among corporations that were members of a consolidated group. The corporations filed employment tax returns which for the group in total agreed with the total of Forms W-2 issued within the group, but there were discrepancies between Forms 941 of individual corporations and the Forms W-2 issued by those corporations. The common parent on behalf of the member corporations sought by amended employment tax returns to correct the discrepancies by rearranging the liabilities and reapplying payments, producing reductions in liabilities for some of the corporations that were to be abated, and increases for other corporations that were to be assessed. The common parent submitted all of the amended returns as one package with the direction that they be processed together. The common parent directed the IRS to move the payments from the corporations whose liabilities were abated to the corporations whose liabilities were increased. The IRS, however, did not do so, instead refunding the payments freed-up by the abatements. The refund checks were cashed but shortly thereafter, in response to bills for the assessments, the refunds were fully repaid. Two of the refunds each exceeded \$50,000.

## **LAW AND ANALYSIS**

(1) **Erroneous Refunds.** The refunds were contrary to the common parent's direction to apply the funds freed-up by the abatements to the assessments of increased liabilities. The direction was clear, made by an authorized person (common parent), and in regard to a designation of a credit originally received as a voluntary payment. The IRS should not have disregarded the direction. [Note: this response does not address the effective date to be given the application of each payment to the entity with the assessed liability.] For these reasons, the refunds were erroneous.

The method of correction is to enter the funds on the accounts as the parent company directed; that is, move the funds from the account where they became an overpayment to the account with the assessments. This will leave an erroneous refund on each account from which refunds originated (the origination account will bear a transfer to the designated account and an erroneous refund, both in the same amount).

(2) **Section 6602 Interest Assessable.** Section 6201 (Assessment Authority), in section 6201(a), defines taxes which the Secretary is required to assess to include interest. Also, 6602 is in the same subchapter (Underpayment Interest) as 6601, and uses the same rates determined in 6621. Consistent with these provisions, section 6404(e)(2) states "The Secretary shall abate the assessment of all interest on any erroneous refund under section 6602 ... ." Based on the foregoing, section 6201(a) makes 6602 interest assessable like a tax; the period for the assessment of section 6602 interest is limited by the erroneous refund suit period of section 6532(b). Section 6602 interest is collectable during the erroneous refund suit period by suit, voluntary

repayment or offset. In this context, the function of the assessment is to put the liability for the interest on the Service's books to provide a liability to hold postings of payments in the account.

**(3) Discretion to Abate Section 6602 Interest on Refunds Exceeding \$50,000.**

Congress enacted section 6404(e) to provide the Service with flexibility in abating interest that accrued because of the Service's own errors or delays. H.R. Rep. No. 426, 99<sup>th</sup> Cong., 2d Sess. 844 (1985); S. Rep. No. 313, 99<sup>th</sup> Cong., 2d Sess. 208 (1986). Under section 6404(e)(2), interest under 6602 shall be abated until the demand for repayment is made "unless ... the erroneous refund exceeds \$50,000." That mandatory abatement provision does not explicitly address discretion to abate interest on erroneous refunds that exceed \$50,000. The legislative history cited above, however, states "[t]he bill gives the IRS authority to abate interest but does not mandate that it do so (except that the IRS must do so in cases of certain erroneous refunds of less than [now \$50,000])." See also, H.R. Rep. No. 426, id., at 845; S. Rep. No. 313, id., at 209; Conf. Rep. No. 841, 99<sup>th</sup> Cong., 2d Sess., II-810, II-811 (1986).

On balance, the limitations in section 6404(e)(2) only limit the erroneous refunds subject to the mandatory interest abatement rule. The legislative history of section 6404(e) evidences a desire to afford the Service authority to abate interest accrued because of Service errors or delays. It would be inconsistent with the purposes underlying section 6404(e) to read the limitations in section 6404(e)(2) as precluding the exercise of discretionary abatement where the amount of the erroneous refund exceeds \$50,000.

The parameters of the Service's discretion are not defined in section 6404(e). Some facts and circumstances relevant to determining whether abatement would be consistent with the legislative intent are: whether taxpayer failed to return the erroneous refund for a significant period of time after discovery of the error, or after taxpayer reasonably should have discovered the error; whether taxpayer returned the erroneous refund before the Service notified the taxpayer of the error; whether the taxpayer is sophisticated in tax or business matters; and whether the taxpayer contributed to the error or delay.

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Please call if you have any further questions.