



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

OFFICE OF
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MEMORANDUM FOR PERRY T. FOSTER
ASSISTANT REGIONAL COUNSEL (GL)
WESTERN REGION CC:WR

FROM: Lawrence H. Schattner
Chief, Branch 3 CC:EL:GL:BR3

SUBJECT: Treasury Reclamation Branch

This is in response to your memorandum dated May 3, 1999. This document is not to be cited as precedent.

ISSUE:

What efforts can be made to prevent Financial Management Service (FMS) from reclaiming tax refund amounts from a Chapter 13 trustee's bank account.

CONCLUSIONS:

Special Procedures should make certain that refund checks are made payable to the taxpayer/debtor, and the trustee should always obtain the debtor's endorsement before depositing the check. Additionally, there should be improved communication between Special Procedures and the Service Center. In no case should the Service Center refer a refund inquiry to FMS without investigating a taxpayer's bankruptcy history and consulting with the office that originated the refund. Finally, if the trustee cannot resolve the matter with FMS, he may want to consider his rights against his bank.

FACTS:

Your memorandum presents a problem faced by a Chapter 13 trustee in one of the districts in your region. Although the problem has come up in at least three different cases, due to the similarity of all the relevant facts, we will treat them as arising out of one case.

The Special Procedures Insolvency Unit prepared a request for a manual refund to be made out to the taxpayer/debtor in care of the Chapter 13 trustee. The refund check was so issued by the Service Center and deposited by the trustee into his trust account. The trustee deposited the check with his stamp; he did not have the taxpayer endorse the check. Subsequently, the Service Center received a claim for refund from the debtor. Apparently, the Service Center then referred the matter to FMS for investigation. At some point, the debtor filled out a FMS Form 1133, Claim Against The United States For The Proceeds Of A Government Check. Subsequently, FMS issued a Form 6536, a reclamation request, to the trustee's bank. The reclamation requested that the bank remit the amount of the refund to the appropriate Federal Reserve or Depository Bank. The reason given was "unauthorized negotiation/claim submitted by payee." The bank complied with the request by taking the money out of the trustee's account apparently without first notifying the trustee. As the trustee had already distributed the amount of the refund to the debtor's creditors, the money withdrawn by the bank actually belonged to the estates of other debtors. Essentially, this leaves the trustee personally liable to those other estates. The trustee has written to the Reclamation Branch of FMS attempting to resolve the matter.

LAW AND ANALYSIS:

One of the first questions raised by these facts is whether Special Procedures and the Service Center properly handled the refund. Internal Revenue Manual section 57(13)3.13 sets forth the duties of Special Procedures regarding the issuance of refunds in bankruptcy cases. Relevant here, the Manual provides that where it is determined that the trustee is to receive the refund, Special Procedures is to cause the issuance of a check made payable to the taxpayer, but mailed to the trustee. IRM § 57(13)3.13(1)(c). The issuance of a check will be requested by preparing Form 5792, Request For IDRS Generated Refund, to be mailed to the Service Center. The notation "issue letter 1444(C)" must be entered in the Remarks section of the form. The letter 1444(C) notifies the taxpayer that the refund is being sent to the trustee. When Special Procedures receives the refund check, it should send the check to the trustee. *Id.* Where it is determined that the taxpayer is entitled to the refund, Special Procedure is to cause the issuance of a refund check made payable to the taxpayer and mailed directly to the taxpayer by mailing a Form 5792 to the Service Center. Such refund checks are not routed through Special Procedures. IRM § 57(13)3.13(1)(d).

According to the supporting documents attached to your memorandum, the Service Center did not issue a Letter 1444C. Special Procedures management is now attempting to correct that problem with the Service Center, which we agree would be helpful. The honest debtor/taxpayer generally will not seek a refund from the Service if he is aware that it was issued to the trustee.

Another matter that Special Procedures should consider is that its request in the instant case that the refund be made payable to the taxpayer "in care of" the trustee is not completely consistent with the Manual. The Manual provides that the check is to be made payable to the taxpayer. IRM § 57(13)3.13(1)(c). We strongly suggest that the "in care of" language be omitted from refund checks in this type of situation. Although it is quite questionable whether the bank properly honored the check without the debtor's endorsement even with the "in care of" language, if the Service had simply made the check payable to the taxpayer/debtor, the trustee's problem may have been avoided. The estate is not a separate entity in a Chapter 13, and the trustee should be required to obtain the debtor's endorsement before depositing the refund check. Special Procedures may want to advise trustees about proper endorsements. If the debtor refuses to endorse a check, the matter may always be brought before the bankruptcy court.

The Service Center also played an important role here. Before it referred the debtor's refund inquiry to FMS, it should have consulted with the office that originated the refund and/or investigated the debtor's bankruptcy history. Better communication between the Service Center and Special Procedures in this regard may avoid this problem in the future. Accordingly, Special Procedures should contact the Service Center to make sure that this does not happen again. Formal procedures of coordination could be established to the extent they do not already exist.

As indicated above, the Service can certainly take steps to avoid improper reclamations by FMS. However, it appears that the trustee may well have a legitimate complaint against his bank. FMS is authorized to reclaim the amount of a check that has been paid over a forged or unauthorized endorsement from the presenting bank or other endorser that breached its guarantee of endorsement. 31 C.F.R. § 240.01, et seq. (Copy attached.) Here, the FMS Form 6536, the reclamation, which was issued to the bank, requested that the bank remit the refund amount to the appropriate Federal Reserve or Depository Bank. It did not require the bank to take the amount of the refund from the trustee's account. It appears, that the bank satisfied FMS's request by taking the money out of the trustee's account without first notifying the trustee. The bank did not follow the procedures set up for protesting a reclamation by FMS in 31 C.F.R. § 240.07. Had it done so or at least notified the trustee, FMS probably would have withdrawn its reclamation request.

We spoke informally with an employee in the Financial Processing Division of FMS. She informed us that if the trustee filed a protest in the form of a letter, it would be processed. She further stated, however, that matters may be processed more quickly when the protest is filed by the bank. She suggested that the trustee should have presented evidence to the bank showing that the refund check was property of the debtor's bankruptcy estate, and then the bank should have protested the

reclamation. Of course, the trustee was not in a position to challenge the reclamation until he had notice of it.

It is our understanding that the trustee now has been refunded the amount of the refund in at least one of the cases. We assume that this is FMS's response to his inquiries and that the other refunds may be forthcoming. The Service may want to consider whether an erroneous refund suit against the debtor would be appropriate. Our suggestion is that because the amount at issue is de minimus, taking the measures explained above to prevent the problem from arising in future cases may be the better action.

HAZARDS AND OTHER CONSIDERATIONS:

We do not see any significant risks with the position taken herein. The trustee has made his inquiries to FMS and, although the process may be slow, it seems that that agency is responding to the matter.¹ However, for its part, the Service should take steps to ensure that refunds are properly processed in bankruptcy situations, or it may be exposed to such risks as violating the automatic stay and issuing two refunds checks.

If you have any further questions, please call us at (202) 622-3630.

Attachment:
As stated.

cc: Assistant Regional Counsel (GL), Western Region

¹ We note that the address to which the trustee sent his inquiry letters to FMS is slightly different than that provided in 31 C.F.R. § 240.7. That may be one reason why it has taken FMS so long to respond to his inquiries.