ACKNOWLEDGED SIGNIFICANT ADVICE, MAY BE DISSEMINATED

Office of Chief Counsel
Internal Revenue Service

Acknowledged 9-10-97
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memorandum

CC:DOM:IT&A:1
JJMcGreevy

date: June 5, 1997

to: District Counsel, South Texas District, Austin

from: Assistant Chief Counsel (Income Tax and Accounting)
CC:DOM:IT&A

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subject: Significant Service Center Advice

This responds to your request for Significant Advice dated March 12, 1997, in connection with a question posed by the Austin Service Center.

Disclosure Statement

Unless specifically marked "Acknowledged Significant Advice, May Be Disseminated" above, this memorandum is not to be circulated or disseminated except as provided in Paragraphs III.D.4. and IV.A.5 of Notice N(35)000-143. This document may contain confidential information subject to the attorney-client and deliberative process privileges. Therefore, this document shall not be disclosed beyond the office or individual(s) who originated the question discussed herein and are working the matter with the requisite "need to know." In no event shall it be disclosed to taxpayers or their representatives.

ISSUES

1. Is an overpayment shown on the joint return of H and W community property?

2. If the overpayment is community property of H and W, is it subject to the sole management and control of W or is it subject to the joint management and control of H and W?

3. If the overpayment is subject to the sole management and control of W, is it exempt under state law from liability for H's debt to the United States Department of Education (DOE)?

4. If the overpayment is exempt from liability under state law, does § 6402(d) preempt the state law exemption, affording the Service the same collection rights under § 6402(d) as it has under § 6402(a)?

5. Are there applicable provisions of federal law other than § 6402 which preempt the state law exempting W's sole management property from contractual debts incurred by her husband before marriage?

CONCLUSIONS

Based on the facts submitted we conclude:

1. The claimed overpayment is the community property of H and W.

2. The overpayment is the sole management property of W.

3. H's one-half property interest in the joint overpayment is not exempt under state law from liability for H's debt to the DOE.

4. The Service is not afforded the same collection rights under § 6402(d) for debts owed to the DOE as it has under § 6402(a) for tax debts.

5. We are not aware of any provision of federal law that would preempt the state law exempting W's sole management property (the joint overpayment) from offset.

FACTS

Taxpayers H and W are husband and wife who live in a community property state (Texas). In 1994, H received no income and W received income from wages in the amount of $55,000. W had federal income tax withholding of $8,000. This resulted in an overpayment of tax in the amount of $6,000, which the taxpayers claimed on their joint 1994 federal income tax return. H is in default on a federal student loan in the amount of $5,000, incurred before his marriage to W. The DOE properly notified the Service of the debt.

The Service properly notified H and W and offset the 1994 federal income tax refund claimed on their joint income tax return against the outstanding student loan. W filed a Form 8379, Injured Spouse Claim and Allocation, requesting all of the claimed overpayment be refunded to her. The Service allowed one-half of the refund and requested your office's advice on how much, if any, of the remaining overpayment should be refunded.

DISCUSSION

Section 6402(a) provides that in the case of any overpayment, the Secretary, within the applicable period of

limitations, may credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment and shall, subject to subsections (c), (d), and (e) refund any balance to such person.

Section 6402(d) provides that upon receiving notice from any federal agency that a named person owes a past-due legally enforceable debt (other than past-due support subject to § 6402(c)), the Secretary shall reduce the amount of any overpayment payable to such person by the amount of such debt, pay the amount by which the overpayment is reduced to the agency, and notify the person making the overpayment that the overpayment has been reduced by an amount necessary to satisfy the debt.

Section 6402(d)(3)(B)(ii) provides that, in the case of OASDI overpayments, if the other person filing a joint return with the person owing the OASDI overpayment takes appropriate action to secure his or her proper share of the refund subject to reduction under § 6402(d), the Secretary shall pay such share to such other person.

Section 301.6402-6(i) of the Procedure and Administration Regulations provides that, in the case of past-due, legally enforceable federal debts, if the person filing the joint return with the taxpayer owing the past-due, legally enforceable debt takes appropriate action to secure his or her proper share of a refund from which an offset was made, the Service shall pay the person his or her share of the refund and shall deduct that amount from amounts payable to the agency.

State law governs in determining the extent of a taxpayer's interest in a joint refund. See Aquilino v. United States, 363 U.S. 509 (1960). Once a taxpayer's interest has been defined by state law, federal law determines the consequences for federal tax collection purposes. United States v. Bess, 357 U.S. 51 (1958). The relevant state law in the instant case is Texas law.

Under Texas law, "community property" is defined as any property other than separate property acquired by either spouse during marriage. Tex. Fam. Code Ann. § 5.01(b) (West 1993). Personal earnings are generally classified as community property subject to the earning spouse's "sole management, control, and disposition." Tex. Fam. Code Ann. § 5.22(a)(1) (West 1993).

The overpayment shown on the joint return filed by H and W in the situation described is community property of H and W in which H has a one-half property interest. The entire overpayment is subject to the sole management, control and disposition of W.

Under Texas law, community property subject to one spouse's

sole management, control, and disposition is not subject to any liabilities incurred by the other spouse before marriage. Tex. Fam. Code Ann. § 5.61(b)(1) (West 1993). However, the Service is not subject to state law exemption in collecting federal income tax debts. See Medaris v. United States, 884 F. 2d 832, 833-34 (5th Cir. 1989). Similarly, the Texas exemption would not prevent the Service from paying H's one-half interest in the overpayment to the DOE pursuant to § 6402(d). See Bosarge v. United States Dept. of Education, 5 F.3d 1414 (11th Cir. 1993, cert. denied, 114 S. Ct. 2720 (1994), in which the court held that state law exemptions did not prevent the interception of a tax refund pursuant to § 6402(d).

In Emily Oatman v. Department of Treasury, 34 F.3d 787 (9th Cir. 1994), the court concluded that the Treasury must return to a joint filing spouse her share of the refund if she claims it by proper and timely application. 42 U.S.C. § 664(a)(3)(C) provides that if the other person filing a joint return with the individual owing the past-due support takes the appropriate action to secure his or her proper share of the refund from which a withholding was made, the Secretary of the Treasury shall pay such share to the other person. The Court of Appeals concluded that the rule applicable in some states whereby one spouse's share of community property can be reached for payment of the other spouse's separate debts relates only to creditors' rights. In the case of past-due child support, only the state agency, as creditor, may proceed against the nondebtor's community property if permitted by state law.

Generally, a federal agency, as creditor, can assert a right to the nondebtor spouse's share of the joint refund in those states where the community property can be reached for payment of the debts of one spouse. However, § 301.6402-6(i) (in the case of past-due, legally enforceable debts) and Code section 6402(d)(3)(B)(ii) (in the case of OASDI overpayments), like 42 U.S.C. § 664 (in the case of past-due child support), require the Service to pay the nondebtor spouse his or her portion of the refund. The requirement to repay the nondebtor spouse his or her share of the joint refund applies irrespective of any right the federal agency may have to pursue collection of the debt against the nondebtor spouse's share of the refund.[1]

Based on the facts submitted, the Service was correct to allow only half of W's claimed refund on Form 8379. A state law

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[1] Offsets made pursuant to sections 6402(d) are distinguishable from the offsets authorized by § 6402(a) against past-due taxes since in the tax debt situation the Service is the creditor. See, Rev. Rul. 85-70, 1985-1 C.B. 361.

that exempts sole management property from the separate debts of one spouse incurred before marriage is ineffective against the federal government. However, in the case of the tax refund offset program, federal law permits the Service to offset only the debtor spouse's one-half property interest in a joint overpayment. The Service is required to refund the nondebtor spouse's share of a joint overpayment if that spouse takes appropriate action to secure that share (i.e., files Form 8379).

Injured spouse claims filed by current or former residents of California, Louisiana, Idaho, and Texas claiming all or a portion of a joint overpayment that was used to offset the spouse's pre-marital tax debt can be denied because community property in these states is available to satisfy pre-marital tax debts of either spouse. See IRM 3(15)(129)7.88(3) (1-1-97)

However, as a result of the Oatman decision the Service will honor Form 8379, filed by current or former residents of the states of California, Idaho, Louisiana, and Texas, against all Debtor Master File (DMF) offsets (i.e., offset made pursuant to section 6402(c) and (d)). See IRM 3(15)(129)7.88(2) (1-1-97).

If you have any questions regarding this memorandum, please contact John McGreevy at 622-7506.

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By: _____
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