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

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OFFICE OF
CHIEF COUNSEL

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MEMORANDUM FOR ASSOCIATE AREA COUNSEL, SMALL BUSINESS/SELF-EMPLOYED, AREA 1, BROOKLYN CC:SB:1:BRK
ATTN: PAREIEGGER

FROM: ROBERT A. MILLER, ACTING CHIEF, BRANCH 3
COLLECTION, BANKRUPTCY & SUMMONSES

SUBJECT: ABILITY OF IRS TO RETAIN ERRONEOUS REFUNDS REPAID MORE THAN TWO YEARS AFTER ERRONEOUS REFUNDS MADE Your ref: CC:SB:1:BRK:TL-5479-00

This is in response to your memorandum dated October 23, 2000, in which you requested Significant Service Center Advice under CCDM 35.2.13.3(4), et. seq.. The memorandum deals with two scenarios in which the Service made erroneous refunds for which, more than two years after the refunds were made, it requested and received repayment. The primary concern of the Service Center is whether it is permissible for the Service to keep the repayments. Because of the refund aspects of your inquiry, this office coordinated with Administrative Provisions and Judicial Practice (APJP). After discussions with your office and APJP, because of the uncertainty of the facts in the inquiry, which facts probably were not discoverable, we reclassified this case from a Significant Service Center Advice to a Chief Counsel Advisory.

ISSUES

Scenario 1.

(1) Do the facts, as developed or could reasonably be developed within a short time frame, sufficiently support bringing an erroneous refund suit against an individual more than two years after such refund was made, where the individual submitted a check noted with a partnership EIN, which resulted in the check being posted to a partnership account and the amount thereof refunded to the partnership, but for which, upon his request, he was credit with a payment in the amount of the check, with the portion exceeding his outstanding liabilities refunded to him with interest?

(2) Do the facts, as developed or could reasonably be developed within a short time frame, sufficiently support the position that the Service is not required to repay funds to a third party, where the funds were received from the third party in response to a

request for repayment of an erroneous refund made to a partnership and where the Service's request for repayment and the repayment were made more than two years after the erroneous refund was made?

(3) Where the erroneous refund repayment requested of the partnership was apparently made by a third party without interest, do the facts, as developed or could reasonably be developed within a short time frame, sufficiently support seeking recovery of the interest by an erroneous refund suit against the third party?

Scenario 2.

Do the facts, as developed or could reasonably be developed within a short time frame, sufficiently support the position that the Service is required to repay funds received in response to a request for repayment of an erroneous refund made to an individual, where the request for repayment and the repayment were made more than two years but less than five years after the erroneous refund was made?

CONCLUSIONS

Scenario 1.

(1) The facts, as developed or could reasonably be developed within a short time frame, do not appear to sufficiently support bringing an erroneous refund action against the individual.

(2) The facts, as developed or could reasonably be developed within a short time frame, do not appear to sufficiently support the position that the Service is required to return the funds.

(3) The facts, as developed or could reasonably be developed within a short time frame, do not appear to sufficiently support bringing an erroneous refund action against the third party to recover interest.

Scenario 2.

The amount received in response to a request for repayment of an erroneous refund is an overpayment, where the request and repayment were made more than two years but less than five years after the erroneous refund was made and the facts do not suggest that the five year period is applicable; thus, since the period for taxpayer to claim a refund has not expired, the Service should either notify the taxpayer of the overpayment and request instructions as to disposition, or the Service could on its own initiative refund the overpayment with interest.

FACTS

Scenario 1.

A remittance in the form of a check from an individual was received by a service center. On the check was noted the Employee Identification Number (EIN) of a TEFRA partnership. The remittance was posted to a tax year of the partnership that was undergoing a TEFRA audit. The posting was made using a TC640 code to show a remittance in the nature of a cash bond. At the conclusion of the TEFRA partnership case, a TC300 (subsequent assessment by examination) for ".00" was input to that partnership account, indicating that the case had been concluded at the partnership level. The TC300 released the freeze holding the remittance in the tax account and a refund of the deposit was issued to the partnership without interest. One week later, another service center, at the request of the individual, transferred the remittance to the individual's account for the same year as that of the partnership. The service center treated the remittance as a payment, as of the date received by the Service, which satisfied the individual's outstanding liability and resulted in a refund for the difference plus interest.

At some point, one of the service centers realized that the Service had twice applied funds in connection with the same remittance. That service center determined that the partnership, rather than the individual, was erroneously returned the deposit. More than two years after return of the deposit to the payee partnership, the service center sent a request for repayment to the partnership at the address on its final return and indicated that interest would be waived if repayment was made within a stated period. Somewhat later than the stated period, repayment was made in the amount of the returned deposit by another partnership, which requested that interest be waived.

The continuing (winding up) status under state law of the partnership, which was the payee on the refund check, is unclear. The partnership filed its final return prior to the erroneous return of the deposit. The individual, who is now deceased and whose date of death can be ascertained from state records, was a partner. The refund check was negotiated by a stamp of the name of the partnership without the signature of a signatory; however, the account to which it was deposited, particularly whether it was an account of someone other than the payee partnership, can be ascertained.

Scenario 2

A payment check was received by a service center. On the check was noted the tax year, Form 1040, and an SSAN (which contained a misstatement in the SSAN). The service center posted the payment to the individual income tax account for the tax year of the taxpayer whose SSAN was noted on the check.

Shortly thereafter, a check was received from the taxpayer, to whose account the first check was misapplied, in full payment of the liability reported on his return. Upon posting of the second check to the taxpayer's account, a refund was generated in the

amount of the first check plus interest. Thereafter, the Service received notice that the first check was dishonored.

The service center determined that the first check was sent by a third party and that the SSAN noted on the first check contained an error; the first check should not have been deposited to the account of the taxpayer to whom the noted SSAN belongs. Therefore, the service center transferred the entries regarding posting of the check, and the dishonoring of the check, out of the account of the taxpayer to which it was misapplied and over to the tax account of the person who wrote the check.

More than two years but less than five years after making the erroneous refund, the service center billed the taxpayer, to whose account the check had been misapplied, for a tax in the amount of the erroneous refund. The taxpayer paid the bill within the five year erroneous refund period.

DISCUSSION

Scenario 1

(1) The issue is whether the facts sufficiently support bringing an erroneous refund suit against an individual more than two years after such refund was made. The individual submitted a check noted with a partnership EIN, which resulted in the check being posted to a partnership account. However, upon his request, he was credit with a payment in the amount of the check as of the date of the Service's receipt of the check, with the portion exceeding his outstanding liabilities refunded to him with interest?

Because the individual wrote the check on a personal account, the Service accepted as correct the individual's claim that the remittance was made as a payment of his individual tax liability. The individual is now deceased, and it appears that no facts can be developed to contradict his claim that the remittance was made in connection with his own liability. Accordingly, the facts, as developed or could reasonably be developed within a short time frame, do not appear to sufficiently support bringing an erroneous refund action against the individual.

(2) The issue is whether the facts sufficiently support a position that the Service is required to repay funds to a third party. An amount received from an individual, but noted with the EIN of the payee partnership, was posted to an account of the payee partnership as a deposit. The partnership did not pay the money in and did not have any right to the deposit. Thus, the funds were never more than a deposit and were not received, nor treatable as received, from the partnership as a collection of tax. Following posting of a TC 300 code to the account, the deposit was released and a check in the amount of the deposit (without interest) was issued to the payee partnership.

Funds in repayment were received from a third party partnership in response to a request for repayment made to the payee partnership. The Service's request for repayment and the repayment were made more than two years after the deposit was refunded.

If a period longer than two years is applicable to the Service's recovery of the deposit, the repayment by the third party was timely received and the Service is not required to return the repayment to the third party. We conclude that a sufficiently long period is available to the government. **1/**

What was paid by the Treasury check was the return of a deposit. A deposit is not a payment of tax. Rosenman v United States, 323 US 658 (1945). Thus, the recovery of an erroneous return of a deposit would not be subject to the remedies and limitations of the Internal Revenue Code.

In comparison, we point out that in recovering a deposit, a taxpayer it is not subject to Internal Revenue Code procedures, such as regarding refunds and the statute of limitations applicable to recovery of refunds. The taxpayer's action is in the form of an action on an implied contract, and is in the nature of an action for unjust enrichment.

1/ Several periods appear available. A six year period is provided by 28 U.S.C. §2415(a) for recovery on an implied contract if the exception of section 2415(h) does not apply; that exception provides that section 2415 does not "apply to actions brought under the Internal Revenue Code or incidental to the collection of taxes." The Supreme Court, in Rosenman, supra, held that a deposit is not subject to the Internal Revenue Code procedures; thus, recovery of an erroneous return of a deposit would also be outside the Internal Revenue Code.

The erroneous refund check was negotiated after the payee partnership filed its final return, and negotiation was by use of a name stamp of the payee partnership without an authorized signatory's signature. It can likely be determined whose account the refund was deposited to, whether anyone retained signatory authority over the payee partnership's account, and who had signatory authority over the account to which the check was deposited. A six year period is provided by the False Claims Act, 31 U.S.C. §3729, et seq, to recover damages for presentation of a false claim, which includes negotiation of a government check, if the exception of section 3729(e) does not apply; that exception provides that section 3729 "does not apply to claims, records or statements under the Internal Revenue Code." The recovery of the proceeds of a Treasury check from someone other than the payee does not relate to a claim record or statement under the Internal Revenue Code by the person who wrongly negotiated the check. Alternatively, the section 1396(a)(2) cause of action could be brought within the section 2401 period.

A voluntary repayment can be made to the Service within any of these periods.

See Rosenman, supra (note that the action was brought within six years of the notice of application). Jurisdiction is given to the district courts and the Court of Federal Claims by 28 U.S.C. 1396(a)(2). The six year period of 28 U.S.C. 2401 applies to an action on an implied contract, and begins upon the accrual of the cause of action.

We also point out that taxpayers recover overpayment interest by use of an action under section 1396(a)(2), that is subject to the six year period of section 2401, rather than subject to the refund procedures and limitations. See, Alexander Proudfoot Co. v. United States, 454 F2d 1379 (Ct. Cl. 1972); Barnes v. United States, 137 F.Supp. 716 (Ct. Cl. 1956); Murphy v. United States, 78 F.Supp. 236 (SD CA 1948); Colgate-Palmolive-Peet Co. v. United States, 58 F2d 499 (Ct. Cl. 1932); Rev. Rul. 56-506, 1956-2 CB 959; Rev. Rul. 56-574, 1956-2 CB 959; Rev. Rul. 57-242, 1957-1 CB 452; Rev. Proc. 99-19, 1999-1 CB 842; Rev. Proc. 99-43, 1999-2 CB 579; Rev. Proc. 2000-26, 2000-1 CB 1257.

We further point out that the government has been allowed to use periods outside the Internal Revenue Code in regard to recovery on collateral. See, Golub v. United States, 204 Ct. Cl. 935 (1974).

In view of the foregoing, we conclude that recovery of an erroneously returned deposit is not a tax, and is not governed by a remedy and a limitations period outside the Internal Revenue Code. We further conclude that the period had not expired when the Service received the repayment. Accordingly, the facts, as developed or could reasonably be developed within a short time frame, do not sufficiently support the position that the Service is required to return the funds.

(3) Where the repayment requested of the payee partnership was made without interest by a third party partnership, do the facts, as developed or could reasonably be developed within a short time frame, sufficiently support seeking recovery of interest, for the period of time that the funds were outside of the government's possession, by an erroneous refund suit against the third party?

The letter sent to the payee partnership specifically indicates that, if repayment is made, no interest would be charged. The repayment was made by the third party partnership with reference to the interest term of the letter and a stated request that the interest be abated. The Service received the repayment and has not returned the repayment.

The above facts provide, at least, an appealing equitable argument that the Service's acceptance of the repayment was acceptance of the Service's offer. Thus, the facts, as developed or could reasonably be developed within a short time frame, do not appear to sufficiently support bringing an erroneous refund action against the third party to recover interest.

Scenario 2

Do the facts, as developed or could reasonably be developed within a short time frame, sufficiently support the position that the Service is required to repay funds received in response to a request for repayment of an erroneous refund made to an individual, where the request for repayment and the repayment were made more than two years but less than five years after the erroneous refund was made?

The refund was not in any way induced by the individual. Thus, the five year period of section 6532(b) does not apply.

Under I.R.C. §6401, "[t]he term overpayment includes that part of the amount of the payment of any internal revenue tax which is assessed or collected after the expiration of the period of limitation properly applicable thereto." Since the facts do not suggest that the five year period is applicable, the amount received more than two years after the erroneous refund was made is an overpayment.

Accordingly, the facts, as developed or could reasonably be developed within a short time frame, sufficiently support the position that, since the period for taxpayer to claim a refund has not expired, the Service should either notify the taxpayer of the overpayment and request instructions as to disposition, or the Service should on its own initiative refund the overpayment with interest.