



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

OFFICE OF
CHIEF COUNSEL

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November 10, 1998

MEMORANDUM FOR DISTRICT COUNSEL

ATT:
CC:

FROM: ASSISTANT CHIEF COUNSEL (FIELD SERVICE)
CC:DOM:FS

SUBJECT: INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD
SERVICE ADVICE

This Field Service Advice responds to the materials you forwarded by facsimile transmission on August 11, 1998. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND:

A =
\$B =
Tax Year 1 =
Tax Year 2 =

ISSUE(S):

May the Service retain an amount the Tax Court determined to be an overpayment for one tax year to cover an asserted deficiency in taxes of the same taxpayer for a separate tax year which is at issue in a separate, ongoing Tax Court case?

CONCLUSION:

Under I.R.C. § 6402(a) the Service may credit a taxpayer's overpayment against a deficiency asserted with respect to him, even though that deficiency has not yet been assessed and the taxpayer's account will not be balanced until after his pending Tax Court case is finally decided.

FACTS:

In accord with a stipulation between A and the Internal Revenue Service (Service), the Tax Court entered a decision finding an overpayment of income tax for the Tax Year 1 in the amount of \$B. In a separate case, A has petitioned the Tax Court for the redetermination of a deficiency that the Service has determined with respect to Tax Year 2. Pending the outcome of the case with respect to Tax Year 2, the Service has retained the overpayment that the Tax Court determined with respect to Tax Year 1. A's attorney has requested immediate refund of the overpayment for Tax Year 1.

LAW AND ANALYSIS:

I.R.C. § 6512(b)(1) provides that if the Tax Court finds that a taxpayer has made an overpayment of income tax for the same year to which the taxpayer's petition relates, then the Tax Court has jurisdiction to determine the amount of the overpayment and "such amount shall, when the decision of the Tax Court has become final, be credited or refunded to the taxpayer." Here, the Service has not refunded an overpayment determined by the Tax Court under § 6512(b)(1), but is holding it to cover an asserted deficiency that is at issue in a separate, pending Tax Court case and that has not yet been assessed. See I.R.C. § 6213(a). I.R.C. § 6402(a) authorizes the Service to credit any overpayment "against any liability in respect of an internal revenue tax on the part of the person who made the overpayment and shall . . . refund the balance to such person." Thus, the Service's actions in retaining the adjudicated overpayment are appropriate if the Service's actions fall within the parameters of § 6402(a).

The legislative history and regulations under § 6402(a) state that the Service may credit any overpayment of tax against any "outstanding liability." S. Rep. No. 1622, 83d Cong., 2d Sess. A412 (1954); Treas. Reg. § 301.6402-1. Neither the legislative history nor the regulations under § 6402(a) give any further definition of what constitutes a "liability in respect of an internal revenue tax" for purposes of § 6402(a). A few older cases, however, interpreted predecessor statutes to § 6402(a) with respect to whether the Service could credit an overpayment against an alleged deficiency for a different tax year even though the deficiency was not yet assessed but was being contested before the Board of Tax Appeals at the time the credit was made. These cases included McCarl v. United States ex rel. Leland, 42 F.2d 346 (D.C. Cir.), cert. denied, 282 U.S. 839 (1930); United States ex rel. Cole v. Helvering, 73 F.2d 852 (D.C. Cir. 1934); United States ex rel. New River Co. v. Morgenthau, 105 F.2d 50 (D.C. Cir. 1939). In each of these cases the court determined that it was proper for the Service to credit the overpayment against the contested deficiency.

These cases interpreted the language of § 284(a) of the Revenue Act of 1926, which provided that if a taxpayer had made an overpayment of tax, “the amount of such overpayment shall . . . be credited against any income, or war-profits, or excess-profits tax or installment thereof then due from the taxpayer, and any balance of such excess shall be refunded immediately to the taxpayer,” or of virtually identical language of § 322 of the Revenue Act of 1928.

The reasoning of these cases was that, at the time the Commissioner made a deficiency determination, the amount of the deficiency was “then due” even though the taxpayer’s account could not be finally balanced until the Board of Tax Appeals determined the disputed deficiency.

The language of § 322(a) of the Revenue Act of 1928 remained in the Code substantially unchanged until the enactment of § 6402(a) in 1954, at which time the phrase “tax . . . then due” was deleted. Instead, the Service was granted the authority to credit the amount of an overpayment against “any liability in respect of an internal revenue tax.” There is no indication in the legislative history that the change in the language was meant to be any more restrictive of the authority of the Commissioner to credit overpayments than that authority had been under prior case law. In fact, on the basis of the more liberal language in § 6402, it would appear that the intended change was one of liberalization of the Commissioner’s authority, rather than restriction.

So far as our research has revealed, ever since the early cases construing the predecessors to § 6402, the Service has consistently taken the position that a judicially-determined overpayment for one tax year may be retained to cover an asserted deficiency for another tax year pending the final determination of that deficiency in separate litigation.

This position is further bolstered by the more recent decision in Smith v. Director of Internal Revenue, 77-2 USTC ¶ 9599 (S.D. Fl. 1977), wherein the taxpayer filed suit for a refund of 1975 income tax. The Service had credited the 1975 overpayment against 1973 and 1974 self-employment and income tax deficiencies, and those deficiencies were before the Tax Court. The district judge dismissed the suit as premature, stating in its order:

Where there is an overpayment of any internal revenue tax, Section 6402(a) of the 1954 Code provides that such overpayment, including any interest allowed thereon, may be credited against “any liability in respect of an internal revenue tax on the part of the person who made the overpayment.” 26 U.S.C. § 6402(a); 10 Mertens on the Law of Federal Income Taxation § 58.38 (1976). The Internal Revenue Service has applied the 1975 overpayment against plaintiff’s tax deficiencies for 1973 and 1974, pursuant to its authority. Since the overpayment of plaintiff’s 1975 income tax return was fully allowed as

a credit on plaintiff's 1974 and 1974 tax liabilities, the plaintiff has not stated a claim for a refund.

Id. The apparent concern with retaining an overpayment pending a final determination of liability in a separate lawsuit appears to arise from the usual requirement that an assessment precede collection and application of funds against a deficiency. In fact, we are aware of an isolated case in which the court stated that liability for taxes arises upon its administrative assessment by the Commissioner. Belloff v. Commissioner, 996 F.2d 607, 614, 616 (2d Cir. 1993). That opinion in that case, however, did not consider the issue presented by the present facts. Moreover, the weight of authority is that liability for taxes exists independently of an assessment. See Goldstein v. United States, 104 F.3d 1198, 1199-1200 (10th Cir. 1997) (held that a valid assessment of tax liability is not prerequisite to subsequent claim for taxes due); Davis v. Columbia Construction Co., 936 F.2d 771, 774 (4th Cir. 1991) ("An assessment of tax is not a prerequisite to imposition of tax liability"); United States v. Craddock, 184 B.R. 974, 978 (D. Colo. 1995). The assessment does not create the liability, but merely acts as a judgment for taxes determined to be due. Bull v. United States, 295 U.S. 247, 259 (1935). The liability derives from the statutory obligation to account for, collect, or pay a tax. Goldstein v. United States, 104 F.3d at 1200. A taxpayer may be liable for, and make a payment of, tax even though the tax has not been assessed. See I.R.C. § 6213(b)(4) and Teas. Reg. § 3301.6213-1(b)(3). Thus, I.R.C. § 6402(a) authorizes the Service to credit A's overpayment in the present case to another tax year.¹

Furthermore, we do not believe that the changes made to I.R.C. § 6512(b)(2) and Tax Court Rules affect the foregoing conclusion. The current § 6512(b)(2), which was enacted in 1988 as part of the Technical and Miscellaneous Revenue Act of 1988, provides the Tax Court with jurisdiction to order a refund of an overpayment if the Service has not refunded the overpayment within 120 days after the Tax Court's decision. Rule 260 sets forth procedural requirements for invoking this jurisdiction.² Although § 6512(b)(2) was enacted long after the McCarl, Cole, and

¹ Because I.R.C. § 6402(a) requires crediting or refund of an overpayment, the overpayment should not merely be retained or "frozen." Instead, it should be credited against the asserted deficiency for Tax Year 2, even though the Tax Court has not finally determined the liability for that year.

² It appears that the taxpayer's attorney may be acting preliminarily to filing a motion to enforce overpayment jurisdiction as a supplemental proceeding under T.C.R. 260 and I.R.C. 6512(b)(2). A's counsel has made written demand for refund of the overpayment determined by the Tax Court. We note, however, that T.C.R. 260(b)(4) (continued...)

New River were decided, it was not intended to change the ability of the Service to retain an overpayment for application of the overpayment to another tax year. Instead, § 6512(b)(2) merely broadened jurisdiction of the Tax Court so that taxpayers would no longer have to file separate actions in other court to enforce the overpayment determination made by the Tax Court. H.R. Rep. No. 1104, 100th Cong., 2d Sess. at 231 (Oct. 21, 1988). In at least one action brought under the jurisdictional authority of § 6512(b)(2), the Tax Court has recognized the authority of the Service to apply adjudicated overpayments to other tax years. See Dover Corp. v. Commissioner, T.C. Memo. 1997-340, aff'd, 148 F.3d 70 (2d Cir. 1998). Accordingly, we believe that the Service may appropriately credit A's overpayment pending the conclusion of the Tax Court case respecting Tax Year 2.

If you have any further questions, please call the branch telephone number, 202-622-7940.

DEBORAH A. BUTLER
Assistant Chief Counsel
(Field Service)

By: _____
SARA M. COE
Chief, Procedural Branch

²(...continued)

directs the demand to be made upon the Commissioner through the Commissioner's last counsel of record in the action in which the Court determined the overpayment which the taxpayer seeks to enforce. A's counsel has not complied with this rule in that he directed his demand to an employee in Special Procedures.