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 M.K. MORTENSEN
CC:WR:RMD:SLC, ASSOCIATE DISTRICT COUNSEL

FROM: SARA M. COE
Chief, CC:PA:APJP:BO3

SUBJECT: Request for Significant Service Center Advice,
Reversal of erroneous abatement

This Significant Service Center Advice responds to your memorandum dated August 9, 2000 in which you make a supplemental request with regard to the reversal of erroneous abatements.

ISSUE:
Under what circumstances can errors to a taxpayer's account be reversed after the expiration of the applicable period of limitations for assessment?

CONCLUSION:
An erroneous abatement as the result of a data entry error or mistake of fact which does not prejudice the taxpayer or an invalid abatement can be corrected or reversed at any time. However, a supplemental assessment can only be made during the applicable period of limitations.

FACTS:
The original Significant Service Center Advice was issued October 22, 1999. The original Advice states that section 3.17.46.2.8(1) of the IRM (Revised 1-1-99) is based on the holding of Crompton-Richmond Co. v. United States, 311 F. Supp. 1184 (S.D.N.Y. 1970). However, concern was expressed as to whether erroneous abatement procedures should be made based on the Fifth Circuit's opinion in Bugge v. United States, 99 F.3d 740 (5th Cir. 1996). The original Advice declined to advise a revision of the manual based on Bugge. Continuing to rely on Crompton-Richard, the original Advice concluded that a clerical error cannot be reversed if based on a substantive redetermination of the tax liability, that is, the abatement cannot be reversed outside the statute of limitations if it was deliberate and intentional.

The following examples were provided in the undated memorandum:
1) The IRS abates an assessment on an account for the purpose of reprocessing the return (Form 3893) to another tax period, taxpayer identification number (TIN), etc., but

the posting of the assessment for the correct period or TIN occurs after the statute of limitations has expired. The correct procedure would be to do an account transfer which will keep the assessment date intact, i.e., the abatement is reversed and the account transferred to the correct tax period or TIN.

2) The IRS abates an assessment based on a joint statutory notice of deficiency where one spouse files a petition with the Tax Court but the other does not. The IRS should move the assessment on the non-petitioning spouse to non-master file (NMF) for billing purposes. Often, district offices will erroneously abate the tax so the petitioning spouse will not be billed.

3) The IRS abates the tax on the wrong taxpayer's account due to a transposition of the TIN or tax period. For example, the amended return reported social security number (SSN) 000-00-001 but the IRS input the adjustment on SSN 000-00-0002; or, the taxpayer filed the amended return for the 1998 year but the IRS input the adjustment on the taxpayer's 1995 account.

4) The IRS abates the incorrect amount of tax due to a clerical or typographical error. For example, the IRS should have input an abatement for $1,500 but due to an error in data entry, the IRS input the abatement on IDRS as $15,000.00.

5) The IRS abates the assessment based on an unallowable issue, i.e., the tax examiner made a mistake on the issue and should not have allowed the adjustment. In most cases, the amended return should have gone to the Examination Branch prior to adjusting the account but the tax examiner fails to send the case to Examination Branch to review the issue.

LAW AND ANALYSIS:
The Fifth Circuit in Bugge reached the same conclusion as the district court in Crompton-Richmond, although based on a different analysis. In Bugge and in Crompton-Richmond, a Service employee erroneously abated an assessment because of a mistake of fact. In Crompton-Richmond, the district court found that an abatement as the result of a mistake of fact or clerical error can be reinstated after the expiration of the limitations period so long as the taxpayer is not prejudiced. See also, United States v. Cooper, 83-1 USTC ¶ 9266 (D.D.C. 1983); Freres Lumber Co., Inc. v. Commissioner, T.C. Memo. 1995-589.

In contrast, the Fifth Circuit in Bugge refused to recognize an exception to the limitations period based on an error by the Service. The Fifth Circuit, instead reasoned that the abatement was void because the Service employee who made the mistake acted outside the Service's authority to abate found in I.R.C. § 6404. Because the erroneous abatement was invalid and ineffective, the original assessment was never extinguished.

The Fifth Circuit's analysis is correct to the extent that an abatement is invalid if a Service employee makes the abatement with the intent to act outside the scope of his authority, thus violating I.R.C. § 6404. See generally, Boulez v. Commissioner, 810 F. 2d 209 (D.C. Cir.), cert. denied, 484 U.S. 896 (1987) (affirming Tax Court decision which found offer in compromise ineffective on the ground that Service employee lacked authority to enter into it).

Other courts, however, have found that an act by a government agency based on a mistake of fact or clerical error is not ultra vires provided it does not prejudice the parties. See In Re Chene, 82 AFTR 2d 98-6754 (Bankr. Fl. 1998) (stating that IRS was not bound by non-prejudicial error of employee who used incorrect date in posting payment); Kroyer v. United States, 55 F.2d 495 (Ct. Cl. 1932). See also, Frieling v. Commissioner, 81 T.C. 42 (1983); Wilson v. Commissioner, T.C. Memo. 1997-515 (finding that inconsequential errors do not void statutory notice of deficiency if taxpayer is not prejudiced). But see, Range v. United States, 245 B.R. 266 (Bankr. S.D. Tex. 1999) (following Fifth Circuit precedent in stating that a clerical error is not an exception to the statute of limitations under I.R.C. § 6501(c)).

Finding otherwise would allow an original assessment to remain intact, regardless of whether the taxpayer is prejudiced by a Service error. This reasoning has been rejected in the guise of an erroneous refund by several circuit courts including the Fifth.[1] See Bilzerian v. United States, 86 F.3d 1067 (11th Cir. 1996); Clark v. United States, 63 F.3d 83 (1st Cir. 1995); O'Bryant v. United States, 49 F.3d 340 (7th Cir. 1995); United States v. Wilkes, 946 F.2d 1143 (5th Cir. 1991).

Consider the case in which a Service employee, mistakenly abates an assessment for twice the correct amount, resulting in an erroneous refund. Under the Fifth Circuit's reasoning in Bugge, the abatement is void ab initio because it is unauthorized. Therefore, the Service can collect the erroneous refund as an underpayment based on the original assessment.

The Seventh Circuit found otherwise in O'Bryant, 49 F.3d 340. The court held that the original assessment was extinguished because it was actually paid by the taxpayer. Furthermore, the IRS error did not revive the assessment. In fact, the Seventh Circuit reasoned that the IRS error was not associated with the original assessment at all. Id. (stating that the "money the O'Bryants have now is not the money that the IRS' original

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[1]A non-rebate refund occurs as a result of a mistake by the Service in some function other than a determination of the taxpayer's liability. See CCA 200014033 (April 7, 2000). The Service previously argued that in the case of a non-rebate refund, there was no abatement of the original liability, so no need existed for the tax to be reassessed and the usual post-assessment tax collection procedures could be used to collect the erroneous refund. The Service has since abandoned this position.

assessment contemplated"). Therefore, the erroneous refund could only be collected through the erroneous refund recovery statute or by a supplemental assessment within the applicable statute of limitations.

This same conclusion was reached by the Fifth Circuit itself in Wilkes, 946 F.2d 1143, an action to reduce a tax liability to judgment. The Fifth Circuit did not characterize the IRS error in misapplying a payment as a void, unauthorized act. Instead, the Fifth Circuit noted that an IRS error cannot create a debit in a taxpayer's account. See also, Clark v. United States, 63 F.3d 83 (1st Cir. 1995) (noting that an IRS error cannot extinguish an assessment).

In effect, the Seventh Circuit in O'Bryant and the Fifth Circuit in Wilkes are simply reaching the same conclusion as did the district court in Crompton-Richards. The Seventh and the Fifth Circuits found that an IRS error has no effect on a taxpayer's account, so long as that taxpayer is not prejudiced by the action by receipt of an erroneous refund. To characterize an IRS error as void ab initio opens the door to a result that prejudices the taxpayer.

For the above reasons, we advise, as was stated in the original Service Center Advice, that Crompton-Richard remain the authority with regard to this issue. Abatements may be reinstated if based on a clerical error or mistake of fact and if the reinstatement does not prejudice the taxpayer.

There is no statutory definition or definitive guidance with regard to what qualifies as a clerical error. Prejudice to the taxpayer is also a question of fact. See McKay v. Commissioner, 89 T.C. 1063, 1068 (1987), aff'd, 886 F.2d 1237 (9th Cir. 1989); United States v. Cooper, 83-1 USTC ¶ 9266 (D.D.C. 1983) (allowing abatement to be reinstated when the taxpayer did not allege prejudice).

However, the following conclusions may be made based on the Service's statutory authority to abate found in I.R.C. § 6404 and case law regarding clerical errors.

ERROR VS. DETERMINATION:

1) Data input errors are considered clerical errors and may be reversed if the taxpayer is not prejudiced.

2) An abatement based on a mistake of fact is also a clerical error if it does not involve a determination. In deciding whether a determination was made by the Service it is helpful to use I.R.C. § 6404 as a guide.

If the abatement was originally made in order to correct an erroneous, illegal, or excessive abatement or an assessment made outside the statute of limitations, then no mistake was made. The decision to abate was, in fact, a determination. If it is later

decided that the original determination was incorrect, it cannot be reversed outside the applicable statute of limitations. Instead, the Service must rely on a supplemental assessment. In contrast, if the original abatement was not made to correct an erroneous, illegal, or excessive assessment or an assessment made outside the statute of limitations, then a determination was *not* made.

For example, suppose the Service believes that a taxpayer, John Doe, is entitled to an abatement. In reality, taxpayer, Jack Doe, is entitled to the abatement. The abatement was made to the wrong taxpayer's account not because of a determination but because of a mistake of fact. The erroneous abatement based on a mistake of fact may be reversed provided John Doe, the taxpayer whose account was erroneously abated, is not prejudiced.

In contrast, suppose an amended return is examined and a decision is made to abate the taxpayer's account by a certain amount. The abatement is made. Upon reconsideration, it is determined that the original determination was incorrect and the abatement should not have been made. This is not a clerical error. A determination was made and it cannot be reversed. A supplemental assessment must be made within the applicable statute of limitations.

EXAMPLES:

Based on the foregoing, the following conclusions may be made regarding the examples provided:

1. Posting an abatement to the incorrect TIN is a clerical error because the action does not abate an assessment that was excessive, illegal, erroneous, or made outside the statute of limitations. The abatement may be reversed so long as the taxpayer is not prejudiced.

However, assessment of the liability to the correct taxpayer's account is not associated with the reversal of the erroneous abatement. It is a supplemental assessment that must be made within the applicable period of limitations.

Alternatively, not posting the original assessment to the correct taxpayer's account may be seen as an error that prejudices the taxpayer. Whichever analysis is adopted, the correction cannot be made outside the applicable statute of limitations.

2. This abatement was done with the intent to exceed the authority of I.R.C. § 6404 because its purpose was not to abate an assessment that was excessive, illegal, erroneous, or made outside the statute of limitations. The abatement is void and ineffective, and may therefore be reversed. However, this practice should be discontinued because it is an action outside the authority granted by Congress to the Service.

3. This is a clerical error because its purpose was not to abate an assessment that was excessive, illegal, erroneous, or made outside the statute of limitations. The abatement may be reversed so long as the taxpayer is not prejudiced.

4. This is a clerical error because its purpose was not to abate an assessment that was excessive, illegal, erroneous, or made outside the statute of limitations. The abatement may be reversed so long as the taxpayer is not prejudiced.

5. This is not a clerical error. The abatement was made to correct an excessive or erroneous assessment. Therefore, a determination was made to abate. The abatement may not be reversed outside the statute of limitations.

PREJUDICE TO TAXPAYER -

You asked whether a different answer would result in the above examples if the IRS discovers that it made an erroneous abatement after the abatement occurred but before the IRS sends notices and/or refunds to the taxpayer. The answer is no. The responses remain the same for the examples provided.

However, notices and/or refunds to the taxpayer are factors to consider in determining whether the taxpayer is prejudiced. While, inconsequential errors do not prejudice taxpayers, see, Frieling v. Commissioner, 81 T.C. 42 (1983); Wilson v. Commissioner, T.C. Memo. 1997-515, litigation is more likely if the taxpayer is contacted by the Service. Furthermore, it is more likely that a court will find prejudice if the taxpayer receives an IRS notice or erroneous refund.