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

OFFICE OF
CHIEF COUNSEL

December 28, 1999

MEMORANDUM FOR JACK HOLSTEIN
DIRECTOR, INNOCENT SPOUSE PROGRAM

FROM: Daniel J. Wiles
Deputy Associate Chief Counsel (Domestic)

SUBJECT: Offsets after Filing of Innocent Spouse Claims

You requested advice whether it was permissible to modify and correct the taxpayer's account so as to provide a refund with respect to an overpaid year when an innocent spouse claim with respect to an underpaid year was pending administrative consideration. After due consideration, we believe such action is permissible under the doctrine of correction of a clerical error. However, since the concept of clerical error is not well defined, and some courts have not permitted an assessment to be administratively adjusted so as to be "unpaid" when it could have been considered as previously paid and satisfied, we recommend a procedure for processing these cases so as to avoid future legal challenges.

FACTS

At the time a taxpayer elects the relief provisions of I.R.C. § 6015 (b) or (c), certain collection actions are prohibited with respect to the liability as to which the election is filed. I.R.C. § 6015(e)(1)(B)(i). These prohibited collection actions do not include offsetting overpayments from other tax years, and such credits may legally be applied to the unpaid liability as to which the election is filed [hereafter referred to as "unpaid" or "election" year]. Nevertheless, such offsets are discretionary with the Service, I.R.C. § 6402(a), and [redacted]] DP

[1] [redacted] 7(E)

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DISCUSSION

Most legally permissible actions of the Service Centers have legal ramifications from the moment the action occurs, and generally those legal effects cannot be avoided by simply "undoing" the action; that is, the Service may lack the authority to change its original action. Thus, for example, while it is within the Service's discretion whether to make an assessment of tax, once that assessment is properly made, it can be abated only under the conditions provided in I.R.C. § 6404. While

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[redacted] See § 6015(e)(3)(A) and Notice 98-61.

[2] This code also prevents offsets of refunds that are generated by overpayments of the nonrequesting spouse. However, those refunds are nevertheless frozen and later applied to the outstanding liability once the innocent spouse issue is determined.

the Service may decide that it does not desire to file a tax lien against a taxpayer's property, once the lien is filed, it may be released or withdrawn only under the conditions provided in § 6323(j).[3] A nonstatutory "common law" exception to these prohibitions of correcting or changing legal actions of the Service has emerged under the case law and is referred to as the "clerical error" exception. Succinctly stated, whenever an action occurs because of mistake of fact or bookkeeping error, that mistake can be corrected, so long as this does not prejudice the taxpayer, Crompton-Richmond Co. v. United States, 311 F.Supp. 1184 (S.D.N.Y. 1970). Stated otherwise,

> ... [T]he government was not bound by some action by one of its officers resulting from a mistake of fact, which when such action was corrected, left the whole matter in such a situation that the party complaining had received no injury and had been done no injustice.

Kroyer v. United States, 55 F.2d 495 (Ct. Cls. 1932). At least one other court has come to the same result by deeming the mistaken action as not being what it purported to be (in that case an abated assessment), which essentially permitted the correction to occur. Matter of Bugge, 99 F.3d 740 (5th Cir. 1996).

The Service, under some circumstances, has adopted the rationale of clerical error corrections. There are, however, limitations and risks to following this line of reasoning. First, the parameters of "clerical errors" are not well defined. The case law does distinguish between an action which was taken pursuant to a judgment as to the substantive tax liability (not a clerical error) and mechanical or ministerial (i.e, nondiscretionary) errors; however, it cannot be stated with confidence when an error, not involving a substantive determination of liability, can be said to be wholly "clerical" in nature.

Second, the case law has arisen from cases significantly different from the issue here. In earlier cases, the mistake caused an erroneous abatement of a liability which was desired to be "unabated" by the Service but not the taxpayer. The question in these cases was whether the Service could return the assessment liability to where it had been before the error. Here, the error causes no changes to an assessment, but only to application of funds to that assessment. No assessment is abated.

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[3] It is to be noted that the circumstances under which a lien may be withdrawn were expanded at the Service's request precisely because it was felt that the prior law did not permit withdrawal of liens when the original filing was legal but unwise under the circumstances. Pub. Law 104-168, § 501(a).

Third, those cases dealt with situations where the erroneous action was clearly contrary to law. The correction brought the situation back into compliance with the law. In the instant situation, the offset is discretionary with the Commissioner; either offsetting or nonoffsetting would be perfectly legal. Thus, the correction here is not of a legally improper action.

Whether the clerical error doctrine applies depends on the specific facts of a situation; nevertheless, we are confident that in the case at hand, the reversal of the errors of application of the overpayment under the specific facts present here is within the parameters of the clerical error doctrine. We therefore conclude that reversing the offset by transferring the overpaid amount back to the overpayment year account is within the parameters and may be legally accomplished as the correction of a clerical error.

While the situation here is distinguishable from the fact situations of the case law, perhaps a stronger argument could be made here for correcting the clerical error. In the earlier cases, the taxpayer did not seek the correction of the error; rather the taxpayer opposed the correction. Nevertheless, the courts found that the correction could be made in that it did not prejudice the taxpayer (the result was as it would have been but for the clerical error). Here, the taxpayer will desire and request that the error be corrected. Thus, there is even less argument here that the taxpayer might be prejudiced.[4] Finally, while we recognize that the error we are correcting did not amount to an illegal act, it is one that is plainly contrary to clear nonjudgmental administrative procedures of the Service. Thus, we believe it logically may fall within the clerical error correction process.

We conclude therefore that reversing the offset by transferring the overpaid amount back to the overpayment year account is within the parameters and may be legally accomplished as the correction of a clerical error. It may then be refunded to the taxpayer or otherwise credited as permitted by § 6402.

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[4] [redacted]

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RECOMMENDATION

As noted above, this conclusion is not without risk, and that risk is not limited to a finding that this is or is not a clerical error correction. Apart from the clerical error issue, the courts are in agreement that a taxpayer's payment tendered in satisfaction of a tax assessment extinguishes the assessment to the extent of the payment. See generally Bilzerian v. United States, 86 F.3d 1067 (11th Cir. 1996), acq. in result, 1998 AOD LEXIS 8; Clark v. United States, 63 F.3d 83 (1st Cir. 1995); O'Bryant v. United States, 49 F.3d 340 (7th Cir. 1995). The Service, thus, may not take administrative collection action on a previously paid tax assessment, even if the Service inadvertently refunds a portion of the taxpayer's payment back to the taxpayer. Stanley v. United States, 35 Fed. Cl. 493 (1996); Rodriguez v. United States, 629 F. Supp. 333 (N.D. Ill. 1986). While the Service has now accepted the result of these cases, see Bilzerian AOD, the issue as to whether erroneous applications of funds will extinguish the assessment temporarily applied against is not yet clear.[5]

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cc: Counsel to National Taxpayer Advocate
Deputy Assistant Chief Counsel (IT&A)
Assistant Chief Counsel (General Litigation)
Associate Chief Counsel (Domestic)

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[5] Service position remains that not every credit to the taxpayer's account constitutes a payment in satisfaction of the original assessment. A payment and/or credit satisfies only the tax to which it is properly applied. Clark, 63 F.3d at 89 (an assessment is not extinguished by the Service's error in applying the payment to the incorrect tax period). Thus, where, as here, neither the Service nor the taxpayer intends the overpayment to be offset to the election year, we would contend that no "satisfaction" or "extinguishment" can occur and the taxpayer continues to be liable for the unpaid tax.