

Office of Chief Counsel
Internal Revenue Service
Memorandum

Number: **20050201F**
Release Date: 1/14/2005
CC:SB:4:CLE:POSTS-120107-04
UIL: 9999.98-00
MMLippert

date: August 13, 2004

to:
Group Manager, Area 6
, Ohio

Attn. _____,
Revenue Agent

from: Associate Area Counsel, Cleveland
(Small Business/Self-Employed)

subject: **Advisory Opinion on Collection of Taxes**

Taxpayer:
SSN:
Tax Years: through
S/L: None

This memorandum is in response to your memorandum dated March 22, 2004 and received by this office on March 23, 2004, wherein you request advice on a case involving collection of the taxes of _____, a case recently returned to you from Criminal Investigation.

ISSUES

1. Is the Service's collection of the tax liabilities of _____ (hereafter referred to as the taxpayer) barred by the expiration of the statute of limitations?
2. How should the Service proceed to assess the tax liabilities at issue?

CONCLUSION

For the reasons set forth below, collection of the

taxpayer's liabilities is not barred by expiration of the statute of limitations. We recommend that you proceed with collection of the liabilities and that you assess the taxes under the math error procedures set forth under I.R.C. § 6213(b).

FACTS

The following factual discussion is based upon your written summary of the facts and the documents included with your referral.

filed joint federal income tax returns with his wife for tax years through and he filed individual returns in tax years and . An audit of all of those years was undertaken and resulted in the Service determining over-assessments due to the taxpayer's substantial overstatement of income for each of the tax years. The audit process was initiated based upon a review of the taxpayer's returns for the and tax years, which was initiated on or about August 25, 1999. Audit of the through tax years was begun on August 7, 2003.

After its examination, the Service determined that as part of what appears to have been a scheme to generate extra income, the taxpayer was preparing erroneous W-2s for two

wherein he reported fictitious income and claimed withholding in excess of that to which he was entitled. Specifically, the taxpayer overstated his withholding and received erroneous refunds as follow:

TAX YEAR	OVERSTATED WITHHOLDING	FALSE REFUND
	\$	\$
	\$	\$
	\$	\$
	\$	\$
	\$	\$
	\$	\$

Based upon what was later found to be false information in the returns, the Service issued refunds to the taxpayer in excess of those to which he was entitled.

An administrative criminal investigation was undertaken with respect to tax years and . In both of those tax years, the

subject federal tax returns were signed and mailed to the Service under penalties of perjury. In , the return was submitted reporting wages of \$, with withholding of \$, when the wages in fact earned were \$ and the taxes withheld were actually \$. To support the information submitted on the return, two W-2s were attached to the return for each of two , one named and the other named . For each , one W-2 reported the actual wages paid out by the , while the second W-2 was a fictitious document which reported additional wages and additional withholding. Using this same method for the tax year, the taxpayer's return was submitted reporting wages of \$, with withholding of \$, when the wages in fact earned were \$ and the tax withheld was \$.

As a result of the administrative criminal investigation with respect to tax years and , the taxpayer pled guilty to a violation of I.R.C. §7206(1) for tax year in exchange for the government's agreeing to waive taking criminal action against him with respect to all of the previous tax years. On , a Plea Agreement was signed by the taxpayer, by his attorney, , and by Assistant U.S. Attorney , on behalf of United States Attorney. In the plea agreement, the defendant admits the additional tax owing for the years through , as a result of the false refund scheme. The Plea Agreement contains a paragraph , stating that "The Court may order Defendant to pay restitution as a condition of probation and/or supervised release."

Pursuant to the remaining provisions of the Plea Agreement, the taxpayer was sentenced to fifteen months in prison and one year of supervised release, and a \$100.00 fine was imposed against him. Although the judgment is ambiguous as to whether the Court ordered restitution, according to assistant U.S. Attorney , the Court did not order restitution of the erroneous refunds.

There is an entry of note shown on the account for the taxpayer's tax year, that being an action code evidencing a refund check inquiry. We are uncertain of the exact nature of the inquiry, but are in process of seeing whether we will be able to obtain any documentation to provide clarification of the underlying transaction. Based upon discussion with a Service representative, it is quite possible that the code was an entry made by the Service as it undertook inquiry as to the erroneous

refund situation. Although there may be no additional information forthcoming, this fact was added for your information only.

On March 22, 2004, the Revenue Agent submitted a request to this office, seeking technical advice. Her request advises us that the taxpayer's attorney is asserting that because this case is not a "deficiency" case, but is instead an erroneous refund case, pursuant to I.R.C. §§ 7405 and 6532 the statute of limitations has expired on assessment and collection of taxes owed for all of the years at issue. The Revenue Agent requests advice on how she should proceed with her collection efforts. She additionally questions how we can pursue the assessment of this liability.

DISCUSSION AND ANALYSIS

I.R.C. § 7405 contains provisions authorizing an action for recovery of erroneous refunds. According to those provisions, any portion of a tax, refund of which is erroneously made within the purview of section 6514 (regarding refunds after the period of limitations), may be recovered by civil action brought in the name of the United States. I.R.C. § 7405(a). Section 7405(b) provides that any portion of the tax which has been erroneously refunded, if such refund would not be considered as erroneous under I.R.C. § 6514, may be similarly recovered. Pursuant to I.R.C. § 7405(d), statutory periods of limitations for actions authorized under that section are set forth in I.R.C. § 6532(b).

Under I.R.C. §6532(b), suits for recovery of erroneous refunds are allowed only if they are begun within two years after the making of such refund, "except that such suit may be brought at any time within 5 years from the making of the refund if it appears that any part of the refund was induced by fraud or misrepresentation of a material fact."

The general rule on assessment and collection of taxes which is set forth in I.R.C. §6501 provides that "the amount of any tax imposed by this title shall be assessed within three years after the return was filed . . . and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period." Exceptions to this general rule are contained in I.R.C. § 6501(c), with one such exception being in the situation of a false or fraudulent return with the intent to evade tax, in which case "the tax may be assessed, or a

proceeding in court for collection of such tax may be begun without assessment, at any time." I.R.C. §6501(c)(1).

A review of applicable case law shows that in circumstances similar to those presented by the present case, and based upon a finding of an intent to cheat and deceive the government, it has been held that, with the requisite showing of intent on the part of the taxpayer, the Service is entitled to the unlimited tolling provision of I.R.C. § 6501(c)(1). In Brister v. United States, 35 Fed. Cl. 214 (1996), the taxpayer claimed withholding credits which he knew were not made. In that case, the Court defined the term fraud as it pertains to I.R.C. §6501, as the demonstration of "an intent to cheat or deceive the government." With respect to the definition of a false statement, as the term is used in I.R.C. § 6501, the Court stated that a statement is false if it is untrue when made, and was known to be untrue by the person making it. Applying the Brister facts, the Court further found that the taxpayer's scheme involved more than mere over-withholding. The Court held that the taxpayer's fraudulently claiming the withholding credits was committed with intent to evade tax and the refunds fraudulently obtained constituted a tax liability. As such, the unlimited statute of limitations provided for in section 6501(c)(1) is applicable. In an analogous situation, the Tax Court in Corbett v. Comm., 41 T.C. 96 (1963) held that a taxpayer's fraudulently claiming an estimated tax credit established that the taxpayer's return was false and fraudulent with the intent to evade tax and, thus, section 6501(c)(1) was applicable.

Statutory exceptions to restrictions on assessment are specifically authorized in I.R.C. §6213(b), which relates to assessments arising out of mathematical or clerical errors. Pursuant to I.R.C. § 6201(a)(3), an overstatement of withholding credit may be treated as a mathematical error and assessed in the same manner. Section 6201(a)(3)'s treatment of an overstatement of a withholding credit as a tax assessment is further support that this is a tax liability adjustment subject to the tolling provisions of §6501(c)(1).

In light of the above case law, we recommend that you do proceed with collection of the tax liabilities in this case. We recommend that you first proceed by making math error assessments and that you thereafter proceed to collect the tax.

This memorandum may contain privileged information. Any unauthorized disclosure of this memorandum may have an adverse

effect on privileges, such as the attorney-client privilege. If disclosure becomes necessary, please contact this office for our views.

If you have any questions or wish to discuss this matter, please feel free to contact the undersigned at

DENNIS G. DRISCOLL
Associate Area Counsel
(Small Business/Self-Employed)

By: _____
MICHELLE M. LIPPERT
General Attorney
(Small Business/Self-Employed)