

## **ACTION ON DECISION**

**SUBJECT:** Pacific Gas and Electric Company v. United States, 417 F.3d 1375 (Fed. Cir. 2005), rev'g 55 Fed. Cl. 271 (2003)

### **Issue:**

Whether the statute of limitations barred the Service from recovering erroneously paid overpayment interest by offsetting against a subsequent refund of tax and interest determined to be due to the taxpayer for the same taxable year.

### **Discussion:**

In 1988, after reviewing an amended return filed by the taxpayer, the Service made several adjustments to the taxpayer's 1982 taxable year and ultimately determined that the taxpayer had an overpayment of tax for 1982. The Service then refunded the 1982 overpayment, with overpayment interest, to the taxpayer.

In 1992, the taxpayer filed an additional claim for refund for the 1982 taxable year. While reviewing the taxpayer's subsequent refund claim for 1982, the Service discovered that it had erred in computing the overpayment interest paid to the taxpayer in 1988. The Service allowed the additional claim, determining an overpayment of tax for 1982 on which statutory interest could accrue. As a result, in computing the taxpayer's subsequent refund, the Service offset the overpayment interest erroneously paid to the taxpayer in 1988 against the refund of tax and overpayment interest due to the taxpayer for the subsequently determined 1982 overpayment.

The taxpayer filed suit in the Court of Federal Claims for additional overpayment interest, arguing that the period of limitation, under section 6532(b) barred the offset. The court determined that sections 6532(b) and 7405 did not prevent the administrative remedy chosen by the Service. The court further held that, as this case involved the same taxpayer, the same tax, and the same tax year, the government, without application of a period of limitation, may offset against a tax refund any additional amounts the taxpayer owes with respect to the tax shown on the return. On appeal, the Court of Appeals for the Federal Circuit reversed and held that the Service's ability to offset erroneously paid overpayment interest against a taxpayer's refund for the same tax year is subject to the same statute of limitation that applies to a suit by the

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government to recover an erroneous refund of tax under sections 7405 and 6532.

It is a long-standing principle that “the government has ‘the same right which belongs to every creditor, to apply the unappropriated moneys of his debtor, in his hands, in the extinguishment of debts due him.’” United States v. Munsey Trust Co., 332 U.S. 234, 239 (1947) (quoting Gratiot v. United States, 15 Pet. 336, 370, 10 Led. 759). Under the doctrine of common-law recoupment, a claim that involves “the setting off against asserted liability of a counterclaim arising out of the same transaction,” is “generally not barred by a statute of limitations so long as the main action is timely.” Reiter v. Cooper, 507 U.S. 258, 264 (1993). Furthermore, pursuant to the tax-specific holding in Lewis v. Reynolds, 284 U.S. 281 (1932), the Service has the right to recompute amounts owed by a taxpayer without a period of limitation, when considering a taxpayer’s refund claim so long as the recomputation involves the same taxpayer, the same tax, and the same tax year as the refund claim. See also, Fisher v. United States, 80 F.3d 1576 (Fed. Cir. 1996); Dysart v. United States, 340 F.2d 624 (Ct. Cl. 1965).

The right of common-law recoupment and the rationale of Lewis v. Reynolds apply equally in the context of payments of overpayment interest, and are separate and distinct from the Service’s statutory authority under section 7405 to bring a suit to recover any portion of a tax which has been erroneously refunded. Regardless of any cause of action that may be available to the government, and regardless of the statute of limitations that may apply to such a cause of action, Congress has not imposed any statute of limitations on the recovery of overpayment interest by means of offset against a taxpayer’s refund claim. See United States v. Nashville, C. & St. L. Ry Co., 118 U.S. 120, 125 (1886) (the sovereign is “not bound by any statute of limitations unless Congress has clearly manifested its intention that they should be so bound.”)

The Federal Circuit’s decision is erroneous. The taxpayer’s right to receive overpayment interest is derived from a determination of the taxpayer’s tax liability in comparison to its payments of tax. Accordingly, overpayment interest is directly related to a taxpayer’s tax liability. The Service’s common law right to offset erroneous overpayment interest against a taxpayer’s refund for the same taxable year is not subject to the statute of limitation that applies to suits by the Service to recover an erroneous refund of tax under sections 7405 and 6532(b), or any period of limitation. Finally, the court erred by disregarding the overpayment interest already received by the taxpayer and incorrectly requiring the Service to pay the same amount a second time.

The Service will continue to offset erroneously paid overpayment interest against subsequent refunds for the same taxable year, even if the period for filing suit under

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sections 7405 and 6532(b) has elapsed, and will continue to litigate this position, even in cases that would be appealable to the Federal Circuit.

**Recommendation:**

Nonacquiescence

**Reviewers:**

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Timothy Sheppard  
Attorney, Procedure and Administration  
(Administrative Practice and Judicial  
Procedure Division)

Approved:

Donald L. Korb  
Chief Counsel

By: \_\_\_\_\_  
Deborah A. Butler  
Associate Chief Counsel  
(Procedure and Administration)