

**CALIFORNIA DEPARTMENT OF CHILD SUPPORT SERVICES**

P.O. Box 419064, Rancho Cordova, CA 95741-9064



July 5, 2006

CSS LETTER: 06-25

ALL IV-D DIRECTORS  
 ALL COUNTY ADMINISTRATIVE OFFICERS  
 ALL BOARDS OF SUPERVISORS

<u>Reason for this Transmittal</u>
<input type="checkbox"/> State Law or Regulation Change
<input type="checkbox"/> Federal Law or Regulation Change
<input type="checkbox"/> Court Order or Settlement Change
<input type="checkbox"/> Clarification requested by One or More Counties
<input checked="" type="checkbox"/> Initiated by DCSS

SUBJECT: IRS JOINT RETURN INTERCEPT PROCESSING, INCLUDING  
 IRS NEGATIVE ADJUSTMENTS

## REFERENCE:

- CSS Letter 04-13 – Federal Income Tax Refunds and Injured Spouse Claims, dated June 24, 2004 (Rescinded)
- CSS Letter 04-17 – Federal Income Tax Refunds and Injured Spouse Claims, dated July 20, 2004

The purpose of this letter is to establish a consistent statewide process and procedures among local child support agencies (LCSAs) for the retention, release, and disbursement of eligible funds in consideration of possible negative adjustments against Internal Revenue Service (IRS) tax offset collections.

This letter also serves as follow-up to: CSS Letter 04-17 (issued July 20, 2004), by defining the IRS negative adjustment process; and CSS Letter 04-13 (issued June 24, 2004), by establishing criteria for holding IRS offset collections. The IRS offset and payment collection adjustment processes detailed in this letter are specific to CCSAS Version 1, Implementation 1.3 (V1.3).

**IRS Tax Offset**

The IRS offset process, as provided in the Code of Federal Regulations (CFR) 303.72, enables the State to collect delinquent child support obligations by intercepting and redirecting federal income tax refunds. Non-custodial parents (NCPs) owing past due child support who are eligible for federal tax refunds, may be subject to the redirection of their tax refunds towards the reduction and/or elimination of their child support arrears. Qualified child support cases meeting established federal criteria received by the federal Office of Child Support Enforcement (OCSE) are forwarded to the Federal Management Service (FMS) for offset collection. FMS flags and monitors the respective NCP's IRS account for the occurrence of tax refunds.

The fee charged by FMS for processing tax offsets is absorbed by the Department of Child Support Services (DCSS). DCSS passes the whole offset collection payment to LCSAs for posting to the respective NCP arrears. The LCSA is required to disburse the offset collection amount the respective CP is entitled to receive (based on status of the IRS tax return filed) within two business days of the date of receipt by the State Disbursement Unit (SDU).

### **IRS Tax Offset Against a Jointly Filed Return**

The IRS makes a provision for injured spouse claims (ISC) in situations where an IRS tax refund offset has occurred against a jointly filed return between the NCP and non-obligated spouse. The IRS permits injured spouses to file claims up to six (6) years retroactively from the filing date of the joint tax return, allowing injured spouses to recover a portion of the tax refund offset. Following the processing and approval of an ISC (IRS form #8379), the IRS retroactively takes back 100% of the tax refund offset and then disburses the adjusted amount at a later date. The IRS notifies FMS, who in turn notifies OCSE of the take back. OCSE then subtracts the amount of the negative adjustment from the next funds transfer to DCSS.

### **Holding Disbursements of IRS Offset Collections (CCSAS V1.3)**

In an attempt to avoid situations where tax refunds belonging to an injured spouse are disbursed to CPs, OCSE established the provision within federal regulations (45 CFR 303.72), permitting the State to hold IRS offset collections resulting from joint tax returns from distribution. In cases where OCSE notifies the State that an IRS joint return refund offset has been made to satisfy non-TANF arrears and there is no ISC information provided, distribution of the collection may be delayed for a period not to exceed six (6) months from offset notification, or until the State receives injured spouse claim information, whichever is earlier.

LCSAs are required to review the "Injured Spouse" indicator for all child support cases receiving IRS offset collections where CCSAS V1.3 passes offset information regarding jointly filed IRS tax returns. The ISC indicator will be set for all joint returns. The indicator appears on the County Collections and Adjustment Record. In addition, the collection Detail Record on the Current Year Query Screen within the CCSAS application will contain a new code in the first position of the text fields that will combine the information from the ISC with that of the Joint Return Indicator. The first position of the text field will now contain either: 0 – no joint return was filed; 2 – a joint return was filed, but no ISC information is available; or 3 – an ISC has been processed for a joint return. If the joint return indicator is "0" or "3", LCSAs must issue disbursement instructions within two days. If the joint return indicator is a "2", LCSAs must issue disbursement instructions in accordance with the following Six Month Hold Process.

### **IRS Offset Collection – Six Month Hold Process:**

- On non-TANF cases indicating a joint return was filed where the Collection and Adjustments Record contains status information that the ISC indicator equals “Y”, LCSAs are to issue disbursement instructions for the IRS collection(s) within two (2) business days.

Note: If the ISC equals “Y”, an ISC has been processed against the tax return that is being processed.

- On non-TANF cases indicating a joint return was filed where the ISC indicator equals “N”, no ISC has been filed or the ISC information is not available. LCSAs are to suspend 100% of the disbursement associated to the IRS collection(s) for a period not to exceed six (6) months, or until a negative adjustment is received.

Note: If the ISC indicator equals “N” there may be no ISC filed, or an incomplete ISC that has not yet been processed. Once an ISC form has been completed, submitted, and processed, the IRS retroactively takes back 100% of the tax refund and disburses the adjusted amount at a later date.

### **Refunds of IRS Offsets**

Federal regulations 45 CFR 303.72 (f-g) require a mechanism be established for prompt refund of erroneous/over collection of offset money that may result from participation in the federal and State intercept process. Current DCSS policy defines a prompt refund as occurring within 15 business days from the date the county receives the County Funds Transfer Report (MPP 12-713.2). Previously, some LCSAs provided advance refunds to NCPs prior to the intercepted funds being received by the county due to the length of time it took for offset collections to arrive. Transition to the SDU has shortened the time IRS intercept collections are received and processed by LCSAs to the point that offset funds will be ready for refund disbursement within the 15 day timeframe set forth in current regulations.

CCSAS V1.3 will offset/intercept all payments within the 15 day timeframe as required by current regulations and all payments will be processed within the same timeframe LCSAs currently process “advances”. LCSAs are advised to process IRS/FMS Offset/Intercept refunds upon receipt of the funds from IRS/FMS, which will be within 15 business days of receipt of the Funds Transfer File. In accordance with federal directives LCSAs should fully research situations surrounding any refund of an IRS offset collection prior to issuing disbursement instructions to ensure the offset should **not** be held and reported to FMS for correction and adjustment (reference OCSE AT-99-14, situations 2, and 3).

In addition, LCSA research should include contact with OCSE/FMS to insure there are no duplicate pending IRS refunds involving the same offset collection. Upon issuing disbursement instructions for an offset refund, the LCSA should immediately notify OCSE/FMS of the refund to the taxpayer.

### **IRS Negative Adjustments**

The following negative adjustment process detailed in this letter will be used by LCSAs during the operation of CCSAS V1.3. Collection adjustments will continue to be part of the financial management function performed by LCSAs during the operation of CCSAS V1.3. IRS negative adjustment functionality will be implemented at the statewide level as LCSAs transition to CCSAS V2. A follow-up CSS letter will address specific details concerning IRS negative adjustment policy and procedures closer to implementation of CCSAS V2.

IRS negative adjustment information is recorded in CCSAS V1.3 records and then forwarded to the appropriate LCSA for processing. Negative adjustments received by the LCSA represent reductions in the amounts of previous IRS collections credited to IV-D cases.

In order to maintain an accurate audit trail the IRS collection credits associated with the negative adjustment "process year" (the year the original payment was posted) must be backed out. Completion of the negative adjustment process results in a reversal of the original IRS collection transaction(s) posted in the case financial history. Since CCSAS V1.3 does not contain payment distribution and disbursement case information, negative adjustments must be processed in the appropriate LCSA through the Automated Child Support Enforcement System Replacement System (ARS) and California Automated Support Enforcement System (CASES) child support applications.

#### **IRS Offset Collection – Negative Adjustment Process:**

- DCSS Integrated Database (IDB) receives collection files, which also contain IRS negative adjustments from OCSE via the Department of Technology Data Center.
- DCSS IDB transmits the LCSA collection and adjustment files which include negative adjustment information obtained from OCSE to the SDU.
- The State Treasury receives the Funds Transfer File wired from the United States Treasury's FMS minus the funds associated to the negative adjustment. DCSS Accounting then verifies that intercept offset funds received from FMS are equal to the IRS intercept offset collections (minus adjustments and fees).
- DCSS Accounting posts IRS Tax Intercept funds to the Child Support Payment Trust Fund, compensating for collection fees withheld (covering the shortfall) in order to make the LCSA collection whole.

- Upon receipt of the actual IRS negative collection, LCSAs will identify the corresponding IRS collection credits associated with the identified process year and key negative adjustments into the ARS/CASES legacy systems.
  - Negative adjustments are processed by a reversing entry to IRS collection(s) received within the same process year. Negative adjustments are to be “backed out” of the system in the order the IRS collections were originally received. The negative adjustments will begin with the first payment received, continuing forward through the IRS collections (rolling over any remaining negative adjustment balance) until the negative adjustment amount is completely backed out of the case.
  - Interest is to be assessed, with an effective date, back to the first IRS collection following the reversal of the original credit entries.
- For those IRS negative adjustments resulting from injured spouse claims (funds withheld by the IRS), LCSAs will be required to contact the CP (recipient of the initial IRS offset disbursement) and determine if the IRS offset funds are immediately recoverable.
  - For IRS offset collection distributions resulting in negative adjustments that are not immediately recoverable, the LCSA establishes a receivable within ARS or CASES (as appropriate for the LCSA) to collect funds from an overpaid CP.

If you have any questions or concerns regarding this matter please contact Trish Salveson, Financial Policy Management Unit, at (916) 464-5055.

Sincerely,  
/os/

KAREN ECHEVERRIA  
Deputy Director  
Child Support Services