

INTERNAL REVENUE SERVICE

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MEMORANDUM FOR DISTRICT COUNSEL, SOUTH TEXAS DISTRICT

FROM: Joseph W. Clark
Acting Branch Chief
Branch 2 (General Litigation)

SUBJECT: Significant Service Center Advice: Erroneous Refunds

This responds to your request for Significant Service Center Advice dated July 1, 1999, in connection with questions posed by the Austin Service Center.

ISSUES:

1. Does "misrepresentation of a material fact" under I.R.C. § 6532(b) have to be deliberate, willful, or intentional?
2. Can the Service establish general case criteria to determine when a refund was induced by "misrepresentation of a material fact" or must such a determination be made on a case-by-case basis?

CONCLUSIONS:

1. No. Misrepresentation of a material fact need not be deliberate, willful, or intentional.
2. Yes. With the assistance of local counsel, the Service may establish criteria to be used to determine the applicability of the five-year period under I.R.C. § 6532(b).

FACTS:

The Austin Service Center has requested your assistance in establishing and implementing procedures to comply with the changes to Internal Revenue Manual sections 3.17.79.16 and 21.4.5. These provisions contain the new procedures governing the discovery and recovery of the many erroneous refunds the Service issues each year. In relevant part, section 3.17.79.16.5.1(4)b and section 21.4.5.5.1(1) require the Service to coordinate with the local counsel every erroneous refund case where the Service intends to rely on the five-year statute of limitations under I.R.C. § 6532(b).

According to your memorandum, the Austin Service Center has approximately 77 cases

where the erroneous refund resulted from payment of a refund check over cancellation after the taxpayer claimed that the original refund check was lost, stolen, or destroyed.

In these cases, the taxpayer generally files with the Service a Form 3911, *Taxpayer Statement Regarding Refund*, claiming that the original refund check was either lost, stolen, or destroyed, and requests a replacement check. See IRM 21.4.1.3.1.3.¹ If the Service determines that the taxpayer's claim is valid, it issues a replacement refund check to the taxpayer. Although the original refund check is canceled, often the taxpayer is able to cash both refund checks. This results in a nonrebate erroneous refund to the taxpayer.

When this happens, the Department of Treasury Financial Management Service (FMS) provides the Service with the photocopy of the original cashed check. The Service then send the taxpayer a Form FMS 1133, *Claim Against the United States for the Proceeds of a Government Check*, along with the photocopy of the refund check, requesting that the taxpayer complete and return the form to the Service. If the taxpayer denies having endorsed the original refund check, the signature on the check is analyzed to determine whether it belongs to the taxpayer.

You propose that when the taxpayer admits that he has endorsed and cashed both refund checks or where FMS determines that the signature on the check belongs to the taxpayer, the Service may rely on the five-year statute of limitations under I.R.C. § 6532(b) without additional opinion from Counsel. You state that the Service should not rely on the five-year statute without Counsel's approval in cases where taxpayer denies having cashed both checks and FMS either agrees with the taxpayer's claim or is unable to conclusively determine whether the signature belongs to the taxpayer.

LAW & ANALYSIS:

With the exception of the right of offset pursuant to Lewis v. Reynolds, 248 U.S. 281 (1932), the Service's remedies to recover a nonrebate or nonassessable erroneous refund are subject to the time limitations set forth in I.R.C. § 6532(b). This section provides as follows:

Recovery of an erroneous refund under section 7405 shall be allowed only if such suit is begun within 2 years after the making of such refund, except that such suit may be brought at any time within 5 years from the making of

¹ The form provides in relevant part as follows:

Under penalties of perjury, I declare that I have examined this form, and to the best of my knowledge and belief, the information is true, correct, and complete. I request that you send a replacement refund, and if I receive two refunds I will return one.

the refund if it appears that any part of the refund was induced by fraud or misrepresentation of a material fact.

I.R.C. § 6532(b).

You ask under what circumstances may the Service rely on the five-year rather than the two-year period when recovering an erroneous refund. Specifically, you would like to know whether the Service may rely on the five-year period under the factual circumstances described above.

As stated, section 6532(b) provides that the Service may recover an erroneous refund within five years if “it appears that any part of the refund was induced by fraud or misrepresentation of a material fact.” I.R.C. § 6532(b). Neither section 6532 or 7405, nor the regulations thereunder, define the terms “fraud” or “misrepresentation of a material fact.” See Treas. Reg. § 301.6532-3. “Fraud” is, however, commonly thought of as “an intentional misrepresentation, concealment or nondisclosure for purpose of inducing another ... to part with some valuable thing; a false representation of a matter of fact by words or conduct.” Webster’s Third New International Dictionary (Third Ed. 1986). In order to show that an erroneous refund was induced by fraud, therefore, the Service will have to show that the taxpayer either made false representations or concealed or failed to disclose important facts with the intent of obtaining funds to which he or she was not entitled. Thus, intent is an integral part of “fraud.”

The Government’s burden of proof with respect to the “misrepresentation of a material fact” is somewhat lower than in cases of fraud. “Misrepresentation” is defined as “an untrue, incorrect, or misleading representation.” Webster’s Third New International Dictionary (Third Ed. 1986). The representation can be in a form of a statement, assertion, or a failure to disclose relevant information. The representation need not be willful or intentional. It must, however, be with regard to a fact that is material or essential to the Service’s decision to issue the erroneous refund.

In United States v. Indianapolis Athletic Club, Inc., 785 F. Supp. 1336 (S.D. Ind. 1991), the court followed a three-part analysis proposed by the Government to determine whether the refund was induced by misrepresentation of a material fact.² We believe that this three-part test should be used by the Service and Counsel when determining whether an erroneous refund may be recovered within the five-year, rather than the two-year, limitations period. Therefore, before the Service may rely on the five-year statute, it must establish three things. First, it must establish that a misrepresentation of fact (as opposed to a conclusion of law) was, in fact, made. Second, the Service

² While the court accepted the Government’s proposed test, it held that the refund at issue was not caused by the misrepresentation of a material fact but rather by a conclusion of law. Thus, the five-year period did not apply in that case.

must show that the fact was material. Third, it must show that the decision to issue the erroneous refund was induced by the misrepresentation. Id. at 1337-38.

When a taxpayer requests a duplicate or a replacement refund, he makes two representations to the Service. Both of these are made under the penalties of perjury. First, the taxpayer represents that the original refund check was either lost, stolen, or destroyed, and that, as such, the taxpayer did not benefit from the first check. Second, the taxpayer represents that he or she will not negotiate both refund checks if he happens to receive two.

The Service relies on both of these representations in determining whether to issue a replacement refund to the taxpayer. Thus, to the extent that these representations of a fact are untrue, incorrect, or misleading, they constitute “misrepresentation[s] of a material fact” for purposes of I.R.C. § 6532(b). Thus, the Service should be able to pursue these cases within the five-year period without obtaining prior approval from Counsel.

HAZARDS & OTHER CONSIDERATIONS

In addition to the erroneous refund liability, a taxpayer who submits a claim for a replacement check but fails to return the replacement refund after receiving two may also be subject to criminal liability. By endorsing and negotiating for payment the replacement refund check, the taxpayer could face criminal liability for conversion of government property to one’s own use, in violation of 18 U.S.C. § 641 or possibly for filing a false claim against the United States in violation of 18 U.S.C. § 287. It may be advisable to explore the possibility of a criminal prosecution in appropriate cases.

As always, we appreciate the opportunity to assist you and hope that the advice provided herein is helpful. If you have any comments or questions regarding the above, please contact the attorney assigned to this matter at 202-622-3620.