



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

OFFICE OF
CHIEF COUNSEL

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MEMORANDUM FOR ASSOCIATE AREA COUNSEL (SB/SE), AREA 7,
PORTLAND

FROM: Michael L. Gompertz
Senior Technician Reviewer, Branch 2
(Collection, Bankruptcy and Summonses)

SUBJECT: Section 6402 Offsets and the Automatic Stay

This Chief Counsel Advice responds to your memorandum dated October 4, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

ISSUE

Whether the Service is immune from suit when offsets performed pursuant to section 6402(c), (d) or (e) violate the automatic stay.

CONCLUSION

The Service is immune from suit under section 6402(f) of the Internal Revenue Code. It is the requesting federal or state agency's responsibility to ensure that the automatic stay is not violated.

FACTS

You were asked by the Portland Insolvency Unit to give advice concerning a request on behalf of the State of California to offset a Chapter 13 debtor's refund against outstanding child support liabilities. The offset was to be performed under section 6402(c) of the Internal Revenue Code and the Treasury Offset Program (TOP). If the offset were performed it would have violated the automatic stay in bankruptcy. B.C. § 362. Based in part on conversations with our office, you concluded that given the language of section 6402(c) the Internal Revenue Service ("Service") was required to perform the offset and section 6402(f) would provide the Service with immunity from suit to review the offset. You further concluded that in

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light of the Service's immunity, the State of California had the sole responsibility to ensure that the stay was not violated.

After your memorandum was issued, you were asked if the same conclusion applied to offsets performed on behalf of federal agencies under section 6402(d). Given the importance of this matter to the Service, you have asked us for our advice regarding the Service's role in TOP offsets pursuant to section 6402.

LAW AND ANALYSIS

Background on the Treasury Offset Program

In order to improve the ability of the federal government to collect debt payments, and in order to increase the amount of child support payments collected by state agencies, Congress enacted two companion statutes, section 6402 of the Internal Revenue Code and 31 U.S.C. section 3720A. Together, these statutes give the Service the authority to offset any tax refunds against eligible non-tax debts a taxpayer owes to other federal or state agencies. I.R.C. § 6402(c), (d), (e); 31 U.S.C. § 3720A(c).

For collection of non-tax debts owed to other federal agencies, section 6402(d) of the Internal Revenue Code provides, in relevant part:

Upon receiving notice from any Federal agency that a named person owes a past-due legally enforceable debt . . . the Secretary shall:

- (A) reduce the amount of any overpayment payable to such person by the amount of such debt;
- (B) pay the amount by which such overpayment is reduced under subparagraph (A) to such agency; and
- (C) notify the person making such overpayment that such overpayment has been reduced by an amount necessary to satisfy such debt.

(emphasis added).¹ Likewise, 31 U.S.C. section 3270A(c) says:

¹Compare the language in section §6402(a):

In the case of any overpayment, the Secretary, within the applicable period of limitations, may credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment and shall, subject to subsections (c), (d), and (e) refund any balance to such person.

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Upon receiving notice from any Federal agency that a named person owes to such agency a past-due legally enforceable debt, the Secretary of the Treasury shall determine whether any amounts, as refunds of Federal taxes paid, are payable to such person. If the Secretary of the Treasury finds that any such amount is payable, he shall reduce such refunds by an amount equal to the amount of such debt, pay the amount of such reduction to such agency, and notify such agency of the individual's home address.

(emphasis added).

In accordance with section 3720A(d), the Secretary of Treasury has promulgated regulations governing the offset procedures. See Treas. Reg. § 301.6402-6; 31 C.F.R. pt. 285.2. These regulations also provide that the Service shall reduce refunds owed to a taxpayer by amounts owed to federal agencies for legally enforceable debts.

For the collection of certain non-tax debts owed to state agencies, section 6402(c) provides that overpayments:

shall be reduced by the amount of any past-due support (as defined in section 464(c) of the Social Security Act) owed by that person of which the Secretary has been notified by a State in accordance with section 464 of the Social Security Act. The Secretary shall remit the amount by which the overpayment is so reduced to the State collecting such support and notify the person making the overpayment that so much of the overpayment as necessary to satisfy his obligation for past-due support has been paid to the State.

(emphasis added). In addition, section 6402(e) requires the Secretary to offset overpayments against legally enforceable state income tax obligations. The regulations governing offsets to state agencies can be found in Treas. Reg. § 301.6402-5 and 31 C.F.R. pt. 285.1.

As a part of the Debt Collection Improvement Act of 1996, Pub. L. No. 104-134, 110 Stat. 1321, Congress required the administrative offset of all non-tax debts that have been delinquent for 180 days or more. See 31 U.S.C. § 3716(c)(6). In order to carry out these administrative offsets the Treasury Offset Program was created. The program works by maintaining a Government-wide database of delinquent debtors owing qualified non-tax debts, known as the Debtor Master File (DMF). Whenever a payment to be made by the Department of Treasury matches a name

(emphasis added).

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in the DMF, the funds are diverted to pay the debt. Prior to 1999, the Service helped to maintain the DMF and thus could prevent offsets that would violate the automatic stay. However, in 1999 TOP was merged with another offset program and is now managed solely by Financial Management Service (FMS), the Government's central debt collection agency. As a result, the Service has lost the ability to input freeze codes on offsets for debtors in bankruptcy and offsets may occur without the Service's knowledge. This has increased the possibility that TOP offsets will be done in violation of the automatic stay.

Judicial Review of the Treasury Offset Program

Section 6402 and the regulations thereunder provide the Service with immunity against suits to review offsets done on behalf of another federal or state agency. Specifically, section 6402(f) provides:

No Court of the United States shall have jurisdiction to hear any action, whether legal or equitable, brought to restrain or review a reduction authorized by subsection (c), (d), or (e). No such reduction shall be subject to review by the Secretary in an administrative proceeding. No action brought against the United States to recover the amount of any such reduction shall be considered to be a suit for refund of tax. This subsection does not preclude any legal, equitable, or administrative action against the Federal agency or States to which the amount of such reduction was paid or any such action against the Commissioner of Social Security which is otherwise available with respect to recoveries of overpayments of benefits under section 204 of the Social Security Act.

See also Treas. Reg. § 301.6402-6(l); 31 CFR pt. 285.2(j). Thus, suits to review TOP offsets must be brought against the requesting agency, not the Service.

The Service's Role in Offsets Done on Behalf of Federal Agencies

Outside of bankruptcy, courts have generally found that the above statutory and regulatory provisions impose a legal requirement on the Service to perform offsets on behalf of other federal agencies. As long as the request complies with statutory and regulatory requirements, case law indicates that the Service must apply a taxpayer's overpayments to legally enforceable non-tax debts. See e.g., Quansah v. United States, 1995 U.S. Dist. LEXIS 8049 (N.D. Cal. 1995) ("26 U.S.C. § 6402(d)(1) requires the IRS to reduce a taxpayer's refund by the amount of any past due debt owed by the taxpayer to the federal agency."); Jones v. Cavazos, 889 F.2d 1043, 1048 (11th Cir. 1989) ("This regulation was promulgated pursuant to the power granted to the Internal Revenue Service under . . . companion statutes . . . which impose a duty on the Secretary of Treasury to comply with the offset

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requests properly submitted by other federal agencies.”); Roberts v. Bennett, 709 F. Supp. 222, 223 (N.D. Ga. 1989) (These companion statutes . . . imposes [sic] a duty upon the Secretary of Treasury to honor requests from other Federal agencies for these offsets.”).

Further, courts have refused to hold the Service liable for offsets done on behalf of other federal agencies. Thus, “[w]hat this means in practice is that taxpayers . . . who object to the setoff of their tax overpayments may only sue the agency that requested the setoff, not the IRS.” Bianco v. Internal Revenue Service, 1994 U.S. Dist. LEXIS 14067 (S.D.N.Y. 1994).

Things become more complicated once a bankruptcy petition is filed because an automatic stay of collection goes into effect and is applicable to all entities. B.C. § 362. The purpose of the automatic stay is to prohibit attempts to compel a debtor to pay pre-petition debts outside of the bankruptcy process. H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 340, 342 (1977). In fact, it is “one of the fundamental debtor protections provided by the bankruptcy laws.” In re Stucka, 77 B.R. 777 (Bankr. C.D. Cal. 1987).

Some court have found the Service liable for violations of the automatic stay in section 6402 offsets. These cases, however, do not cite or discuss the impact of section 6402(f). See In re Lafanette, 208 B.R. 394 (Bankr. W.D. La. 1996); In re Herron, 177 B.R. 866 (Bankr. N.D. Ohio 1995); In re Stucka, 77 B.R. 777 (Bankr. C.D. Cal. 1987). However, other recent cases that do consider section 6402(f), or its predecessor section 6402(e), have found the Service immune from suit. In In re Hankerson, 133 B.R. 711 (Bankr. E.D. Pa. 1991) rev'd on other grounds, 138 B.R. 473 (E.D. Pa. 1992) the Service performed an offset at the request of the Department of Education. The debtor argued that the offset should be reversed under section 553(b) of the Bankruptcy Code. While ultimately finding the Department of Education liable for the improper offset, the bankruptcy court noted that complaints about offset should only be brought against the agency receiving the offset and dismissed the Service as a party. Most recently, in In re Bourne, 2001 U.S. Dist. LEXIS 11449 (E.D. Tenn. 2001) the district court concluded that the Service was properly dismissed from a case where the Service's offset at the request of the Department of Housing and Urban Development was found to have violated the automatic stay. See also In re Blake, 235 B.R. 568 (Bankr. D. Md. 1998) (finding that the Department of Education, not the Service, was liable for violating the automatic stay since it was the agency that caused the setoff).

Given the Service's statutory immunity, the Service is likewise protected from civil damages under section 7433(e) of the Internal Revenue Code for TOP offsets that violate the automatic stay in bankruptcy. It is the requesting federal agency's responsibility to ensure that TOP offsets do not violate the automatic stay.

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The Service's Role in Offsets Done on Behalf of State Agencies

As is the case with offsets done on behalf of federal agencies, courts have found that section 6402 offsets done on behalf of state agencies are mandatory and not discretionary. See e.g., In re Conley, 54 B.R. 363, 366 (Bankr. S.D. Ohio 1985) (“The diversion of the tax overpayments by the Internal Revenue Service is completely controlled by statute and neither the Secretary of Health and Human Services nor the Secretary of Treasury has any statutory discretion in remitting the funds to the states.”); In re Wilkerson, 22 B.R. 728, 731 (Bankr. E.D. Wis. 1982) (“Section 6402(c), on the other hand, mandates payment of the debtor’s tax refund to a third party.”). In fact, courts have found that section 6402 creates a statutory lien in favor of state agencies. In re Biddle, 31 B.R. 449 (Bankr. N.D. Iowa 1983).

Recognizing that the Service “does not have the information and resources needed to adjudicate the validity” of a State’s request for an offset, “Congress has expressly declined to waive sovereign immunity of the United States with respect to” claims challenging such offsets. Harrison v. United States, 1990 U.S. Dist. LEXIS 16393 (D. Idaho 1990). As explained in a recent unpublished opinion, the Service’s role in a 6402 offset is simply ministerial and the Service “does no more than retain and transfer an amount certified by the State agency.” Swartz v. Internal Revenue Service, 98-2 U.S.T.C. ¶ 50,773 (1st Cir. 1998) (unpublished), citing, Larsen v. Larsen, 671 F. Supp. 718, 720 (D. Utah 1987); but see Oatman v. Dept. of Treas., 34 F.3d 787 (9th Cir. 1994).² The Service’s immunity extends to bankruptcy cases. In In re Williams, 2000-1 U.S.T.C. ¶ 50,277 (Bankr. W.D. Pa. 2000) the court concluded it had no jurisdiction to review an offset performed by the Service on behalf of the Ohio Child Enforcement Agency. To the extent the debtors sought a review of the reduction in their refund, the court had no jurisdiction over the Service pursuant to section 6402(f).³

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

²At first glance, Oatman seems to provide an exception to the Service’s immunity under section 6402(f) whenever a joint refund is setoff to satisfy one spouse’s separate liability. However, when a joint refund is setoff, the non-liable spouse can file an injured spouse claim with the Service to recover the portion of the refund attributable to him or her. If the Service denies that claim, the non-liable spouse can appeal the administrative determination, which is different from the offset under section 6402.

³As with offsets for federal agencies, the Service is not liable for civil damages under I.R.C. section 7433(e).

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If you have any further questions please call the attorney assigned to this matter at (202) 622-3620.