



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
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MEMORANDUM FOR DAVID A. BREEN  
SENIOR ATTORNEY  
CC:SB:2:PHI:1

FROM: Heather C. Maloy  
Associate Chief Counsel  
(Income Tax & Accounting)

SUBJECT:

LEGEND:

X =

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f =

This Chief Counsel Advice responds to your request for assistance dated February 7, 2001, raising questions regarding the tax treatment of payments made to individuals pursuant to the subject settlement. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

**Questions 1, 2a, and 2b:** Questions 1, 2a, and 2b pertain to allocation of the settlement between joint or multiple claimants. The tax payment allocation is based on each person's proper underlying ownership interest in the settlement. Thus, any allocation is ultimately based on the facts and circumstances of each situation. The taxpayer has the burden to show that the allocation is reasonable and proper.

**Question 3:** Question 3 involves a claimant who, claiming insolvency, excludes from income loans forgiven as part of the settlement and is credited with a tax payment equal to c percent of the settlement amount (\$d plus forgiven loans). This generated a large overpayment because the tax payment credited to the claimant's account was based on the assumption that the full amount of debt forgiven would be taxable. You

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ask whether such a claimant (1) is entitled to the full tax payment credited to his account, and (2) is entitled to a refund of the overpayment.<sup>1</sup> Absent any finding that the tax payment violates a settlement agreement between the claimant and the government, the claimant is entitled to the full payment.

Whether the claimant is entitled to the full tax payment credited to his account is not merely a tax matter. If the settlement agreement was intended to allow tax payments to claimants only to the extent their settlement awards were taxable, X may be justified in seeking a partial return of this claimant's tax payment. This would be a matter of interpreting the settlement agreement, as opposed to a tax issue.

The issue raised was whether the claimant is entitled to a refund of any overpayment of tax generated by the tax payment. If a taxpayer makes an overpayment of tax for a given year and files a timely claim, he or she may receive a refund of that amount, absent any tax or non-tax debts the government may offset against that overpayment. See §§ 6402 and 6511 of the Internal Revenue Code. The claimant may have already received the overpayment, by filing his 1999 return and stating that the overpayment reflected on that return should be paid to him (and not applied toward estimated tax for 2000).

Section 6402(a), by its terms, only allows an overpayment to be refunded to the "person who makes the overpayment". A number of cases address this issue of who has made an overpayment of tax. In one, an employer agreed to pay certain employment taxes on behalf of another a party, a Mr. Scanlon. See *Scanlon v. United States*, 330 F.Supp. 269 (E.D. Mich. 1971). Mr. Scanlon subsequently sought a refund of these taxes. The Court held as follows in concluding that his refund claim should be denied:

The language of § 6402(a) is specific in limiting the refund of overpayments to the 'person who made the overpayment'... . Exhibit 15 ... expressly recites that [the employer] assumes the responsibility for the tax and all of the evidence in the case indicates that it paid it. Both the agreement and Mr. Scanlon's testimony cause the Court to conclude that Mr. Scanlon did not pay the tax.

*Id.* at 270-271.

In another case, an attorney who advised his client to invest in a tax shelter paid a tax deficiency for the client when the Service challenged the shelter. See *Bruce v. United States*, 759 F.2d 755 (9<sup>th</sup> Cir. 1985). The Court concluded that because the attorney

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<sup>1</sup> This question raises an issue of whether the taxes that X pays on behalf of claimants take on the character of the indebtedness itself. They do not. The taxes paid by a claimant who excludes the forgiveness of indebtedness from income, claiming insolvency, are not excludable from income.

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had assumed full responsibility for payment of the tax, the client had “no financial interest” in seeking a refund of that tax.

These cases are arguably distinguishable from the present case. Both *Scanlon* and *Bruce* involved agreements to pay in full certain taxes the taxpayers owed. Here, we understand that the claimant’s income reflected the payment of liabilities by X. In this situation, it may be easier for a taxpayer to argue that it did in fact “make an overpayment”.

X may conclude that under the terms of the settlement agreement, the claimant should not have received any tax payment with respect to the forgiveness of debt, since that item proved to be nontaxable. If X proves that the claimant owes it a partial refund of the tax payment, it appears that such a debt could be recovered from future overpayments. Section 6402(d) provides generally that upon proper notice, the Service will withhold from overpayment refunds any past-due debts owed to a federal agency.

**Question 4:** Question 4 involves whether the Service may issue a tax refund to a bankruptcy trustee. In the scenario you presented, the claimant filed a Chapter 7 bankruptcy petition before receiving the award. The bankruptcy trustee included the settlement in income and credited the payment to the Service against the resulting tax on the Form 1041 filed on behalf of the bankruptcy estate.

In this scenario, the taxpayer is the bankruptcy estate. The trustee, who is the representative of the estate, is the appropriate party to whom the refund should be paid. Therefore, the Service may issue a resulting refund to the trustee.

**Question 5a and 5b:** Questions 5a and 5b involve the account transfer of a tax payment credit, and how the credit should be allocated. The facts and circumstances, not the Form 1099, determine who owns the income. If the corporation or partnership owns the income, the payments should be recredited to the proper taxpayer’s account.

**Question 6:** Question 6 involves how the tax payment is allocated among heirs, and whether heirs who did not report the award in income would still be entitled to a percentage of the tax payment. The settlement amount and the \$f are considered to be income in respect of decedents. Therefore, the Service Center should process this claim in the same manner as any claim filed by a beneficiary regarding the benefit on an amount withheld on an item characterized as income in respect of decedents for tax purposes. Each case must be evaluated on its own merits.

**Question 7:** Question 7 involves a situation in which the Forms 1099 are issued to deceased claimants “in care of” other individuals. You ask whether Service personnel may discuss the status of the deceased claimant’s cases with these “in care of” individuals without power of attorney or other authorization.

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According to §§ 6103(e)(1)(E) and 6103(e)(7), the administrator, executor or trustee of an estate may have access to the returns and return information of the decedent. Similarly, according to the same Code sections, any heir at law, next of kin, beneficiary under the will, or recipient of the decedent's property may also have access to the decedent's returns or return information, but only if such person has a material interest which will be affected by the return or return information. Generally, state law should be consulted in determining who is an heir at law.

Before disclosure, the "in care of" person must furnish satisfactory evidence that he or she falls into one of the authorized categories of recipients. This includes a showing of material interest if the "in care of" person is an heir at law, next of kin, beneficiary under the will, or recipient of the decedent's property.<sup>2</sup>

We hope this memorandum is helpful. If you have any further questions, please contact \_\_\_\_\_ at \_\_\_\_\_

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<sup>2</sup> No opinion is expressed whether the Form 1099s have been properly issued.