

UNITED STATES BANKRUPTCY COURT  
MIDDLE DISTRICT OF NORTH CAROLINA  
DURHAM DIVISION

IN RE: )  
 )  
Donald James Frank, ) Case No. 01-83748C-11D  
 )  
Debtor. )

MEMORANDUM OPINION

Before the court is a motion filed by William P. Miller (Docket Item #205) seeking instructions from the court as to the disbursement of funds held by him as Examiner and Disbursing Agent in this case ("Motion"). The claimants to these funds are the Internal Revenue Service who has appeared through its attorney, Scott L. Little, and the Debtor who is appearing pro se.

JURISDICTION

The court has jurisdiction over the subject matter of this proceeding pursuant to 28 U.S.C. §§ 151, 157, and 1334, and the General Order of Reference entered by the United States District Court for the Middle District of North Carolina on August 15, 1984. The proceeding initiated by the Motion is a core proceeding within the meaning of 28 U.S.C. § 157(b) which this court may hear and determine.

FACTS

Pursuant to the confirmed plan in this case, certain funds were paid to Mr. Miller to be distributed by him in accordance with the provisions of the plan. All of the funds received by Mr. Miller have been distributed except for \$25,205.02 which is still

held by Mr. Miller. Under the plan, these funds are payable to the Internal Revenue Service ("IRS") to the extent such funds are needed in order to satisfy the IRS's claim in this case. The Debtor contends that nothing is owed on the claim of the IRS. If the Debtor is correct, then the funds held by Mr. Miller are payable to the Debtor. The resolution of the Motion thus turns on whether the claim of the IRS has been satisfied as contended by the Debtor. The pertinent facts in determining whether the IRS claim has been satisfied are undisputed and include the facts discussed in the following analysis.

#### ANALYSIS

Early in this case, the IRS filed a proof of claim (Claim #14) for \$213,476.93 in Trust Fund Recovery Penalties and interest assessed against the Debtor, as the responsible party for the failure of Continental Textile Corporation to timely remit its trust fund tax obligations (the "tax liability"). The Debtor objected to the claim on various grounds. Following a hearing, this court issued a memorandum opinion in February of 2005 in which the court sustained the Debtor's objections to the extent of \$116,108.68, found that the Debtor was entitled to credits totaling \$60,432.31 and reduced the IRS's claim to \$29,958.75 as of the petition date, plus appropriate pre-petition interest on the reduced amount of the claim. The memorandum opinion explained the basis for giving the Debtor the \$60,432.31 credit as follows:

The Debtor asserts and the IRS concedes that he is entitled to a credit for: 1) \$3,071.83 for the fourth quarter of 1998 based on a previous overpayment; 2) \$10,000.00 which was misapplied by the IRS, and 3) \$47,361.01 for the Debtor's personal income tax overpayments which were seized by the IRS pursuant to a setoff. The claim of the IRS therefore should be reduced by these additional amounts.

Following this ruling, the IRS gave notice of appeal but subsequently withdrew the notice of appeal and initiated steps to collect the reduced amount due under the memorandum opinion. In approximately August of 2008, the IRS, apparently based on the mistaken assumption that the Debtor still was entitled to receive \$47,361.00 of overpayments, credited a portion of the \$47,361.01 amount in satisfaction of Debtor's tax liability as adjudged in the memorandum opinion and sent the Debtor a refund check in the amount of \$15,876.00 for the remaining balance of the overpayment amount. In doing so, the IRS representatives involved in the transaction were unaware of or overlooked the fact that the Debtor already had received credit for the \$47,361.01 of overpayments in the calculation of tax liability contained in the memorandum opinion. The result is that the Debtor received credit for the \$47,361.01 of overpayments twice as a result of a mistake on the part of the IRS. The issue presented is whether the IRS is entitled to reverse the erroneous credit, treat the \$29,958.75 tax liability as unpaid and claim the \$25,205.05 being held by the Examiner for application to such tax liability. For the reasons that follow, the court

concludes that this issue should be answered in favor of the IRS and that the IRS is entitled to receive the funds held by the Examiner.

As to whether the IRS may correct the error that occurred when the IRS gave the Debtor credit the second time for overpayments that already had been applied against the Debtor's tax liability, the court is satisfied that the IRS is entitled to correct the error that occurred when the Debtor was given credit for the overpayments the second time. In granting such credit, the IRS was acting pursuant to 26 U.S.C. § 6402. Under that section of the Internal Revenue Code, the IRS "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), (e), and (f), refund any balance to such person." When the IRS has acted under section 6402, "[t]he Commissioner may reverse a credit under Section 6402(a) allowed erroneously."

3 Laurence F. Casey, Casey Federal Tax Practice § 10:22 (2010) (citing Comm'r v. Newport Indus., Inc., 121 F.2d 655 (7th Cir. 1941)). In Newport, the court held that the action of the IRS in allowing a credit, if erroneous, was not binding on the IRS and could be corrected by reversing the credit and reinstating the deficiency that existed before the credit was applied. 121 F.2d at 658. In so holding, the court stated:

Our thought in the matter is that the Commissioner has the power in a tax case to undo what he has done in order to eliminate error, and that in the instant case he exercised the power of correction properly and timely. We think this conclusion squares with the case law on the subject. It is the general rule that within the period of limitations the Commissioner may reopen his own administrative rulings and findings.

Id.

Once the erroneous credit is removed as the IRS has elected to do in this case, it follows that the IRS is entitled to proceed with obtaining payment of the \$29,958.75 of tax liability that was upheld in the court's memorandum opinion. Under section 6502 of the Internal Revenue Code, once the IRS makes an assessment, it has ten years to collect the assessment amount. 26 U.S.C. § 6502(a)(1).<sup>1</sup> The proof of claim filed by the IRS reflects that the tax liability was assessed by the IRS at the earliest on April 30, 2001.<sup>2</sup> Because less than ten years have passed since the assessment of the taxes in this case, the IRS is not barred by the ten-year statute of limitations from pursuing post-assessment remedies to collect the taxes. Moreover, the assessments underlying the IRS claim in this were not extinguished as a result

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<sup>1</sup>Section 6502(a)(1) provides that "[w]here the assessment of any tax imposed by the title has been made within the period of limitations properly applicable thereto, such tax may be collected by levy or by a proceeding begun . . . within ten years after the assessment of the tax. . . ."

<sup>2</sup>The \$213,476.93 included in the IRS proof of claim was the aggregate amount of five separate assessments, four of which occurred on April 30, 2001, with the fifth assessment occurring on October 14, 2002.

of the IRS erroneously applying a credit against the assessed tax liability. As noted in the Newport case the IRS is entitled to reverse an erroneous credit and, unlike the situation where taxes are actually paid by the taxpayer, "assessments may only be extinguished by payment tendered by the taxpayer, and not by an IRS error." Clark v. U.S., 63 F.3d 83, 89 (1st Cir. 1995). See also U.S. v. Wilkes, 946 F.2d 1143, 1152 (5th Cir. 1991) (allowing the IRS to recover the portion of an assessment that had received an erroneous credit as a result of an IRS misapplication but not the portion that had been paid by the taxpayer). The assessment of the unpaid tax liability of the Debtor thus remains in effect. Collection of taxes pursuant to an assessment may be pursued by administrative methods such as tax liens, summonses and levies, or by judicial methods such as suits to foreclose liens or reduce assessments to judgment. 26 U.S.C. §§ 6321-6326, 7403. These available methods are broad enough to include the action taken by the IRS in this case when it asserted its claim against the funds held by the Examiner.<sup>3</sup>

The fact that the IRS released certain previously filed tax liens following the granting of the erroneous credit does not preclude the IRS's claim as asserted by the Debtor. The Debtor is

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<sup>3</sup>The matter before the court does not involve the status of the \$15,876.00 refund that the Debtor received in August of 2008 when the erroneous credit was applied by the IRS, and the court therefore has not addressed any issues that may exist regarding the status of the refund.

correct that in April of 2008, the IRS filed notices of federal tax liens in Moore County with respect to tax liability included in the proof of claim filed by the IRS and that subsequently the IRS filed a Certificate of Release of Federal Tax Lien with respect to such tax liens. Such release, however, did not have the effect of extinguishing the Debtor's tax liability. A certificate of release, while conclusive that the lien is extinguished, does not establish that the underlying tax liability has been paid or is not owed. See Comm'r v. Angier Corp., 50 F.2d 887, 892 (1st Cir. 1931), cert. denied, 284 U.S. 673 (1931). See also Miller v. Comm'r, 231 F.2d 8 (5th Cir. 1956) (release of tax lien not a basis for estoppel against IRS).

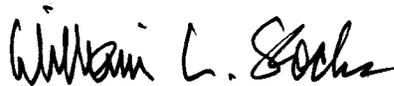
Nor is there any evidence that would support a finding that the credit was extended pursuant to a closing agreement that the parties entered into pursuant to section 7121 of the Internal Revenue Code, as contended by the Debtor. The Debtor argues that various acts of the IRS such as the involvement of four IRS offices, extending the credit, releasing the tax liens and issuing the refund "in their totality constitute an agreement that falls under 26 USC 7121(b) (1) and (2) and should not be reopened or set aside regardless of whether clerical errors occurred." In effect, the Debtor argues that the acts of the IRS should be deemed a contract. That is not what is contemplated under the statute. Section 7121 requires an actual "agreement in writing" between the

IRS and the taxpayer. Anything less, does not constitute a closing agreement that is final and conclusive under section 7121. See Knapp-Morarch Co. v. Comm'r, 139 F.2d 863, 864 (8th Cir. 1944). The erroneous credit was not extended pursuant to a written closing agreement. The erroneous credit instead was a case of the IRS exercising the authority granted pursuant to section 6402 of the Internal Revenue Code. A lack of effective communication among various IRS employees and offices did allow the error to occur. While this resulted in considerable confusion, it did not prejudice the Debtor in a manner that would constitute grounds for nonpayment of taxes legitimately owed.

#### CONCLUSION

Based upon the foregoing findings and conclusions, the court concludes that the \$25,205.02 held by the Examiner should be paid to the Internal Revenue Service for application to the unpaid portion of its claim in this case. An order so providing is being entered contemporaneously with the filing of this memorandum opinion.

This 9th day of March, 2011.



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WILLIAM L. STOCKS  
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT  
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ORDER

In accordance with the memorandum opinion which is being filed contemporaneously herewith, it ORDERED that the \$25,205.02, plus any accrued interest, held by the Examiner in this case be paid to the Internal Revenue Service for application to the unpaid portion of the claim of the Internal Revenue Service in this case.

This 9th day of March, 2011.

  
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WILLIAM L. STOCKS  
United States Bankruptcy Judge