



OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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MEMORANDUM FOR AREA COUNSEL (SB/SE), AREA 1, MANHATTAN

FROM: Kathryn A. Zuba
Chief, Branch 2 (Collection, Bankruptcy and Summonses)

SUBJECT:

This memorandum responds to your memorandum dated November 14, 2000. This document is not to be cited as precedent.

ISSUE

Whether the bankruptcy court's final decree closing the Chapter 11 bankruptcy case concluded or terminated the bankruptcy proceeding so that the Internal Revenue Service ("Service") may process an offer in compromise of prepetition claims.

CONCLUSION

There is no legal bar to processing the offer. Whether the Service should process the offer in compromise of taxpayer's prepetition claims after the confirmation of taxpayer's Chapter 11 plan is a question of policy.

FACTS

Debtor filed a voluntary Chapter 11 bankruptcy petition, and the Service filed a timely proof of claim reflecting both secured and priority claims. The Service also filed an administrative claim for taxes incurred by the debtor after the petition date, but prior to confirmation of the Chapter 11 plan. The confirmed Chapter 11 plan provided for the secured and priority claims to be paid in installments commencing one month after the effective date of the plan. Approximately a year after confirmation the court entered a final decree closing the bankruptcy case.

In the three years following the confirmation of the plan the debtor made no payments on the Service's secured or priority claims. The debtor states that it has paid all creditors under the plan other than the Service. The debtor did pay the Service's administrative claim in full. The debtor is current with its post-confirmation tax obligations.

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The debtor recently submitted an offer in compromise of the defaulted secured and priority claims. The offered amount is far less than the amount of the secured and priority claims provided for in the plan. The Service returned the offer as nonprocessable pursuant to I.R.M. 5.8.3.3, which states that the Service will not consider an offer in compromise from a taxpayer in bankruptcy until the bankruptcy proceeding is "concluded or terminated." The debtor then filed an adversary proceeding in bankruptcy court seeking to compel the Service to consider the offer. You state that you have been informed by the Assistant United States Attorney handling the adversary proceeding that the bankruptcy judge was critical of the Service's policy and advised the debtor's attorney to file a dispositive motion.

DISCUSSION

In your memorandum you state that the Service's policy not to process an offer in compromise submitted by a taxpayer who is the subject of a bankruptcy proceeding until the proceeding is "concluded or terminated" requires us to consider the question of when a Chapter 11 bankruptcy proceeding is considered legally "concluded or terminated." You conclude, based upon your understanding of applicable legal authority applied to the facts of this case, that the entry of a final decree following the confirmation of the Chapter 11 plan closed the bankruptcy case, and the bankruptcy case was therefore "concluded or terminated" at that time. You reasoned that after the debtor received a discharge and the automatic stay no longer applied, there was no longer any legal impediment to processing the offer.

While there may be administrative, policy, and legal concerns regarding the consideration of an offer in compromise while a taxpayer is under the protection of the bankruptcy laws, there is no *per se* legal impediment to consideration of such an offer. However, the Service has determined that the Bankruptcy Code provides a means for balancing the interests of the taxpayer and the Service as does an offer in compromise, and too many administrative and legal problems would be created if a tax liability was simultaneously the subject of a bankruptcy case and an offer in compromise process. Thus, the general policy of the Service as stated in the Internal Revenue Manual is not to consider an offer in compromise until the bankruptcy proceeding is "concluded or terminated." We do not disagree with your legal conclusion that a Chapter 11 bankruptcy proceeding is generally "concluded or terminated" after confirmation of the plan and closure of the case. However, we do not view this as a strictly legal determination, but a policy determination to be made by the Service as to whether a compromise should be considered with respect to tax liabilities which are the subject of a defaulted Chapter 11 plan. The policy nature of the issue is especially apparent in this case. In contravention of its own plan, the taxpayer failed to make any payments on the prepetition secured and priority claims it seeks to compromise, and instead paid lower priority creditors. However, the Service has not pursued collection action since default over three years ago, so an offer in compromise may be the Service's best collection option.

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You were also concerned about the possibility of adverse precedent if the court were to follow the analysis of the court in In re Mills, 240 B.R. 689 (Bankr. S.D. W.V. 1999), and In re Chapman, 1999 Bankr. LEXIS 1091 (S.D. W.V. June 23, 1999) (holding that while the decision whether or not to accept an offer in compromise is a matter within the discretion of the Service, the Service must consider an offer from a taxpayer in bankruptcy). As you are aware, it is the Service's position that Mills and Chapman are incorrect, and that it is solely within the Service's discretion whether or not to consider an offer in compromise from taxpayers who have availed themselves to the relief offered under the Bankruptcy Code.

In conclusion, although the issue presents litigating hazards, it is our position that the Service may decline to consider offers in compromise after Chapter 11 confirmation. Whether or not to consider an offer in this particular case is a matter of policy. This decision should be made by the Service based on policy concerns, including the appropriateness of considering an offer in this case, and the legal options and related risks, including the viability of administrative or judicial collection action.

If you have any questions, contact the attorney assigned to this matter at (202) 622-3620.