Number: 200139029
Release Date: 9/28/2001
UIL: 9999.98-00

August 9, 2001
CC:PA:CBS:B2
GL-134599-01

JULY 2001 *BULLETIN NO. 490*

COLLECTION, BANKRUPTCY AND SUMMONSES BULLETIN

Department of the Treasury **Office of Chief Counsel** Internal Revenue Service

Discharged Tax May Be Setoff Against Pre-petition Overpayment

The Fifth Circuit, deciding **<u>In re Luongo</u>, 2001 U.S. App. LEXIS 15986 (5th Cir. Jul. 18, 2001)**, held that a bankruptcy court had jurisdiction to resolve the debtor's right to a prepetition tax refund. The court also held that the Service permissibly set off the debtor's prepetition tax overpayment against her discharged prepetition debt, and that the debtor could not defeat setoff by exempting the overpayment under B.C. § 522.

Following the debtor's discharge from a Chapter 7 bankruptcy, the Service set off her 1997 income tax overpayment against a 1993 tax liability, which had been discharged in the bankruptcy. The debtor moved to reopen her case and amend her schedules to list the overpayment as an exempt asset under B.C. § 522. The Service did not object, and the schedules were amended. The debtor then brought an action to recover the overpayment. The bankruptcy court held that the language of section 522, which says that exempt property is not liable for any prepetition debt, took precedence over the Service's setoff rights found in B.C. § 553(a). The district court reversed, holding that the Service's right of setoff was unaffected by the exemption of the overpayment.

On appeal, the Service first argued that the bankruptcy court lacked jurisdiction to consider the matter, since the claim for refund was for the debtor personally, not for the benefit of the estate. The Fifth Circuit disagreed. Under B.C. § 505, a bankruptcy court has broad discretion to determine the amount or legality of any tax. Absent express limitations found in section 505(a)(2)(A) & (B), the bankruptcy court has jurisdiction to consider tax issues brought by the debtor, limited only by the court's discretion to abstain. In deciding whether to abstain, the Fifth Circuit ruled that a court should consider the impact of the abstention not only on the administration of the estate, but also on the debtor. Just because a matter involves tax law, the court found, is not a reason to automatically abstain. Rather, where bankruptcy issues predominate, and the Bankruptcy Code's objectives would potentially be impaired, a bankruptcy court generally should exercise jurisdiction.

Next, the appellate court considered the Service's right of setoff. The court first held that a debtor's discharge in bankruptcy does not bar a creditor from asserting a right of setoff,

finding the "clear language" of section 553 overcomes the discharge bar of section 524(a)(2). The court held that because the prior unpaid tax liability exceeded the amount of the overpayment, the debtor was not entitled to a refund and so the tax refund did not become property of the estate and thus could not be exempted. The Fifth Circuit thus declined to decide whether the exemption statute, section 522, controls over the setoff statute, section 553.

In a lengthy dissent, Judge Garza argued that a bankruptcy court's jurisdiction extends only to refund claims which benefit the bankruptcy estate. He found that the plain language and legislative history of section 505(a)(2)(B) compelled such a reading, and that the section did not abrogate the Government's sovereign immunity to the debtor's refund claim.

BANKRUPTCY CODE CASES: Setoff: Taxes

CASES

1. BANKRUPTCY CODE CASES: Allowance of Claims

In re FM Transmix Corporation, 2001 U.S. Dist. LEXIS 8789 (E.D.N.Y. May 31, 2001) - Service filed claim for dyed diesel fuel penalty under I.R.C. § 6715(a) against debtor in Chapter 11 bankruptcy. The district court, upholding the decision of the bankruptcy court, first determined that, under Raleigh v. Illinois Dept. of Revenue, 530 U.S. 15 (2000), the debtor retained the burden in bankruptcy to prove it did not know it was using dyed fuel, and so avoid the penalty. The court then found that under the facts of this case, the debtor did not know or have reason to know that the fuel it was using for an improper purpose was dyed, and so imposition of the penalty was inappropriate.

2. BANKRUPTCY CODE CASES: Chapter 13: Discharge

In re Parffrey, 2001 Bankr. LEXIS 840 (Bankr. S.D. Tex. May 28, 2001) - The United States moved to dismiss the debtor's Chapter 13 bankruptcy case as the debtor had not filed post-petition tax returns, nor paid any post-petition taxes, since the bankruptcy began three years previously. However, the debtor had nearly completed his payments under the plan, and upon notice of the Service's motion, prepaid the remaining amount due. Although the court was troubled by the debtor's conduct, it found the statute clear - when the debtor completes payments under the plan, he is entitled to a discharge, and the Service's motion to dismiss then is moot. The court noted the Service could have filed its motion to dismiss earlier, and also that the court now has a standing order which requires debtors to file and pay post-petition taxes (the order was not in place when this case was filed).

3. BANKRUPTCY CODE CASES: Exceptions to Discharge

United States v. Gardner, 88 AFTR2d ¶ 2001-5050 (Bankr. W.D. Ky. May 22, 2001) - The court found the debtor’s taxes nondischargeable in bankruptcy under B.C. § 523(a)(1)(C), as the debtor wilfully attempted to evade or defeat his tax liability. The court held that the Government met its burden of showing that the debtor knowingly and deliberately failed to pay his taxes by a preponderance of the evidence. Specifically, the Service established that the debtor lived lavishly during the period of time the Service attempted to collect the tax liability; that the debtor used nominee bank accounts to conceal large deposits of income not reflected on collection information statements provided to the Service, and that the debtor had the ability to pay the taxes but failed to voluntarily turn over large sums of income received during the collection period.

4. BANKRUPTCY CODE CASES: Exceptions to Discharge
TRANSFEREES AND FRAUDULENT CONVEYANCES

In re McKowen, 263 B.R. 618 (D. Colo. 2001) - Service assessed debtor under I.R.C. § 6901(a) for transferee liability due to unpaid corporate taxes. The bankruptcy court, relying on the Government's contention that the transfer of assets

from the corporation to the debtor was fraudulent, found under state law that the transferee liability was not a tax. (*See February 2001 Bulletin*) The district court reversed, finding that section 6901(a) is meaningless if it is considered to be a non-tax debt. Based on the legislative history of the statute, the court concluded that the transferee liability was a tax and therefore nondischargeable.

5. BANKRUPTCY CODE CASES: Interest: After Confirmation: Setoff

In re Matunas, 2001 Bankr. LEXIS 847 (Bankr. D.N.J. Jul. 12, 2001) - After confirmation of their Chapter 11 plan, debtors entered into a payment stipulation with the Service. With the payments under the stipulation and application of a tax refund, the debtors paid more than the stipulated amount, and the Service agreed the debtors were due a refund. The Service discovered that it had not included all of the taxes due in the stipulation, but the court refused to allow the Service to amend the stipulation under the doctrine of judicial estoppel. (*See May 2001 Bulletin*) The Service then requested that the court classify the refund as an overpayment in order to offset interest accrued from the date of the petition through the date of confirmation. The court found that post-petition, pre-confirmation interest on an unpaid tax debt remains a personal obligation of the debtors and, although it cannot be claimed in bankruptcy, is not discharged. The court found the stipulation agreement did not bar the Service from offsetting this interest liability of the debtors.

6. BANKRUPTCY CODE CASES: Liens
LIENS: Priority Over State and Local Liens: Taxes

WPG, Inc. v. I.R.S., 2001 Bankr. LEXIS 882 (Bankr. D.C. Jul. 13, 2001) - Service and District of Columbia both claimed priority to limited funds available for payout in bankruptcy. Although the federal tax liens arose prior to the District's sales tax liens, under D.C. Code § 47-2012 the sales tax liens have an absolute priority in bankruptcy or insolvency situations. The court found that since the District's law is federal law, the I.R.C. does not automatically control. Because section 2012 is a specific statute which applies to a specific type of tax, the court held that it controls the priority of payment over general principles of choateness, which is the doctrine upon which the unfiled federal tax liens base their priority. Thus, the later D.C. lien had priority over the earlier federal tax lien.

7. BANKRUPTCY CODE CASES: Proofs of Claim

In re Carney, 2001 U.S. App. LEXIS 15953 (5th Cir. Jul. 16, 2001) - The Fifth Circuit affirmed the Government's motion for summary judgment on the debtor's challenge to the Service's tax deficiency claims, holding that the debtor attorney's failure to respond to the Government's request for admissions concerning the validity of the Government's proof of claim conclusively established the validity of the claim. The case involved tax shelter partnerships that were found to lack legal substance. The debtor and the Government engaged in discovery, both sides petitioning the court for redress. The debtor attempted to withdraw his deemed admission, but he was denied by the district court. The debtor did not attempt to set

aside the default, and so the court granted summary judgment on behalf of the United States, making the taxes nondischargeable under B.C. § 523(a)(1)(A).

8. COLLECTION DUE PROCESS

McMahan v. Commissioner, T.C. Memo 2001-191 (Jul. 25, 2001) - Taxpayers requested CDP hearing, claiming the Service had not produced a valid summary record of assessment, but they did not appear at the CDP hearing, nor reschedule it. The court found it was not an abuse of discretion for the appeals officer to rely on a Form 4340 in complying with I.R.C. § 6330(c)(1), and consequently the administrative determination that the Service's proposed collection action was sustained was not an abuse of discretion.

9. COLLECTION DUE PROCESS

Service Engineering Trust v. Commissioner, T.C. Memo 2001-181 (Jul. 20, 2001) - Taxpayers' representative provided interrogatories to the Service in advance of a CDP hearing. When the Service did not respond to his request, taxpayers did not participate in the scheduled teleconference. The court found that, as the taxpayers admitted they were provided the opportunity for a hearing, and did not challenge the adequacy of the hearing, no further inquiry into the requirements of I.R.C. § 6320(b) was required by the court.

10. INJUNCTIONS

SUITS: By the U.S.

United States v. Lopez, 88 AFTR2d ¶ 2001-5053 (S.D. Cal. Jun. 25, 2001) - In this decision, the court approved a stipulated order granting the Government's request for a mandatory injunction. In its Complaint, the Government alleged that the taxpayers repeatedly failed to make tax deposits or otherwise pay employment tax liabilities, even while in bankruptcy. The taxpayers did pay other vendors, however. The order requires the debtor to

Timely make all future federal tax deposits

Mail an affidavit of compliance with the above requirement monthly to the Service

Follow these two requirements for a period of five years.

If the taxpayers fail to comply with these terms, the court will enter an order forbidding the taxpayer to disburse any funds and will consider any other equitable relief the Service proposes.

11. LIENS: State Law, Effect of

Larrew v. United States, 2001 U.S. Dist. LEXIS 8905 (N.D. Tex. Jun. 11, 2001) - Service filed NFTL in county where taxpayer owned property. The taxpayer responded by bringing suit in state court, claiming the lien was procedurally defective. The Service countered by removing the case to federal court, where the taxpayer objected, claiming removal was improper because tax liens must be filed according to state law. The court disagreed, finding that federal law controls the filing of federal tax liens. The court further found that the tax liens did not require

an independent state certification to be valid, and so denied the taxpayer's motion to remand the case to state court.

12. LIENS: Priority Over Mortgages

<u>First Security Bank of Bozeman v. United States</u>, 88 AFTR2d ¶ 2001-5027 (D. Mont. Apr. 4, 2001) - On July 15, taxpayer assigned all proceeds from the sale of a parcel of real estate to the Service, to be applied to back taxes. On that date, the parcel was for sale but not under contract. The assignment was recorded the same date. On August 28, the taxpayer executed a deed of trust in favor of the bank, which was recorded on September 4. The taxpayer entered into a contract for sale two years later. Both the bank and the Service claimed priority to the sale proceeds (the Service had filed NFTLs, but had released them, and so relied solely on the assignment for priority). The court found the assignment did not create a security interest in the sale proceeds, because under the Uniform Commercial Code the taxpayer had no rights in the sale proceeds until the property was under contract. Since the assignment could not have been perfected until the sale contract was signed, the Service acquired its rights after the bank had perfected its own interest, and so the bank had a priority right to the proceeds.

13. PROPERTY SUBJECT TO COLLECTION: Community Property

<u>Hegg v. I.R.S.</u>, No. 26734 (Id. June 22, 2001) - Debtor and her husband owned their home as community property, subject to a filed federal tax lien based on the husband's fraud penalty. After the debtor obtained innocent spouse relief under I.R.C. § 6013(e), and so no longer had personal liability for the debt, she filed for Chapter 13 bankruptcy, seeking to have the tax lien removed. On a question certified by the federal court, the Supreme Court of Idaho held that community assets may be reached to satisfy a debt incurred by one spouse's fraud committed during marriage even if the other spouse is completely innocent of the fraud and has no personal liability.

14. SUITS: Against the U.S.: Interpleaders

<u>Luxton v. State Farm Life Ins. Co.</u>, 2001 U.S. Dist. LEXIS 9682 (D. Minn. Apr. 4, 2001) - In a breach of contract action, the Service brought an interpleader claim against insurance proceeds. The beneficiaries requested injunctive relief, and demanded a jury trial. The court disagreed with the Service that the beneficiaries failed to make a timely demand for a jury trial, finding under Fed. R. Civ. P. 81(c) that there is no requirement that a party make a jury demand following removal until instructed by the court. The court then found that the beneficiaries had the burden to show a waiver of the Government's sovereign immunity. Absent a constitutional basis, any right to jury trial in suit against the United States must be specifically found in statute. The court found there was no waiver of immunity permitting jury trial either in the federal interpleader statutes, 28 U.S.C. § 1335 and § 2361, nor in the third party statute, section 2410(a)(5). The court held there is no right to a jury trial against the United States in an interpleader action.

15. TRANSFEREES AND FRAUDULENT CONVEYANCES

United States v. Subklew, 2001 U.S. Dist. LEXIS 9518 (S.D. Fla. Jan. 5, 2001) - The United States brought an action to recover unpaid estate taxes from an alleged transferee, who was the co-owner of a bank account in the Cayman Islands with the decedent. The court found that the transferee was not subject to the court's long-arm jurisdiction because of his limited contacts with the state. The court found it unreasonable to consider the transferee's contacts with the state over a thirteen-year period predating the suit, especially when the transferee had not had any contact with the state whatsoever in the past six years.

16. TRANSFEREES AND FRAUDULENT CONVEYANCES: Nominee

United States v. Olsen, 2001 U.S. Dist. LEXIS 10098 (N.D. Ill. Jul. 18, 2001) - United States filed tax liens against property owned by trust, of which the taxpayer held the sole beneficial interest. After the taxpayer filed for bankruptcy, his wife purchased the property from the bankruptcy estate "free and clear of all liens and encumbrances." The United States did not object to the sale, but when it sought to foreclose on the property (under nominee and fraudulent conveyance theories), the district court granted summary judgment to the wife. On a motion for reconsideration, the court reversed itself, finding that although the Government did not present either nominee or fraudulent conveyance arguments to the bankruptcy court, that failure was not a waiver of the arguments. Because the husband's tax debt was nondischargeable and because the wife allegedly used funds provided by her husband to purchase the property, the United States could not have brought a nominee or fraudulent conveyance argument until after the bankruptcy court confirmed the sale.

The following material was released previously under I.R.C. § 6110.
Portions may be redacted from the original advice.

CHIEF COUNSEL ADVICE

OFFER-IN-COMPROMISE; BASIS FOR; OPINION OF COUNSEL

May 29, 2001

CC:PA:CBS:Br2
GL-114537-01
UILC: 17.16.00-00

MEMORANDUM FOR ASSOCIATE AREA COUNSEL (SB/SE), AREA 1
LONG ISLAND

FROM: Joseph W. Clark
Senior Technician Reviewer, Branch 2
(Collection, Bankruptcy & Summonses)

SUBJECT: Delegation Order No. 11

This Chief Counsel Advice responds to your request dated March 1, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

ISSUES:

1. Can the Compliance Area Director accept an offer in compromise notwithstanding an opinion by the Associate Area Counsel (SB/SE) opposing acceptance of the offer?

2. Can the Compliance Area Director accept an offer in compromise if no grounds for compromise under section 301.7122-1T of the Treasury Regulations have been established?

CONCLUSIONS:

1. Yes. Although section 7122(b) of the Internal Revenue Code requires that an opinion of Counsel be placed on file whenever a compromise is made, Counsel's opinion need not favor compromise in order for the Service to accept an offer.

2. No. Although section 7122(a) grants the Secretary broad authority to compromise,

Treasury Regulations issued pursuant to that section establish that compromise can only be made on specific grounds. No compromise may be made unless one of the bases for compromise recognized by the regulations has been established.

BACKGROUND:

On July 19, 1999, temporary regulations were issued which expanded the Secretary's authority to compromise tax liabilities under section 7122 of the Code. See T.D. 8829, Compromises, 64 Fed. Reg. 39020 (July 21, 1999). In additional to the traditional compromise grounds of doubt as to liability and doubt as to collectibility, the temporary regulations authorize the Secretary to compromise when compromise will promote effective tax administration. Specifically, where there is no doubt as to either liability or collectibility, the Service may now compromise on the basis that: 1) collection of the full tax liability would create economic hardship, or 2) regardless of the taxpayer's financial condition, exceptional circumstances exist such that collection of the full liability would be detrimental to voluntary compliance by taxpayers. See Treas. Reg. § 301.7122-1T(b)(4).

You have asked our advice regarding several issues revolving around this expanded compromise authority. Specifically, you have asked whether and under what circumstances the Area Director can compromise a case notwithstanding an opinion by Counsel which opposes acceptance of a taxpayer's offer when the offer is based on a purported finding that collection in full would cause the taxpayer economic hardship. First, you have asked that we address a situation in which the offer group has established that collection in full would result in economic hardship, but Counsel issues an opinion stating that the amount proposed for acceptance is nevertheless too low under the circumstances of the case. Second, you have asked our opinion of a case in which it has not been established that collection in full would result in economic hardship.

DISCUSSION:

Section 7122(a) of the Internal Revenue Code grants the Secretary the authority to compromise civil or criminal liabilities arising under the internal revenue laws. Ever since that authority was granted in 1868, the Code has also required that an opinion of Counsel be placed on file in certain cases. The current statement of this requirement provides:

> Record.–Whenever a compromise is made by the Secretary in any case, there shall be placed on file in the office of the Secretary the opinion of the General Counsel for the Department of the Treasury or his delegate,[1] with his reasons therefor, with a statement of—
>
> (1) The amount of tax assessed,

---

[1] The General Counsel for the Treasury has delegated the functions relative to the review of offers in compromise to the Chief Counsel of the Internal Revenue Service. See General Counsel Order No. 4. (Rev. January 19, 2001).

> (2) The amount of interest, additional amount, addition to the tax, or assessable penalty, imposed by law on the person against whom the tax is assessed, and
>
> (3) The amount actually paid in accordance with the terms of the compromise.
>
> Notwithstanding the foregoing provisions of this subsection, no such opinion shall be required with respect to the compromise of any civil case in which the unpaid amount of tax assessed (including any interest, additional amount, addition to the tax, or assessable penalty) is less than $50,000. However, such compromise shall be subject to continuing quality review by the Secretary.

I.R.C. § 7122(b).

The system for obtaining review of offers recommended for acceptance is contained in the Service's IRM Handbook 5.8, Offers in Compromise, Chapter 8, and in the Chief Counsel Directives Manual, Part 34, Chapter 5 (CCDM 34.5). The opinion of Counsel is sought after a recommendation of acceptance has been made but prior to formal acceptance of the offer by the official with delegated authority to accept. IRM 5.8.8.4.3. The offer itself (Form 656), along with the Form 7249, Offer Acceptance Report, and supporting documentation, are sent to the appropriate Associate Area Counsel (SB/SE) office for review. The Service expects that Counsel's opinion will assess both whether the legal requirements for compromise are met and whether the offer conforms to the Service's policies and procedures. IRM 5.8.8.2(2).

The CCDM states that the "primary role" of Counsel "is to determine whether there is a bonafide doubt as to liability or doubt as to collectibility." CCDM 34.5.2.1(3)a. At the time this manual section was promulgated, doubt as to collectibility and doubt as to liability were the only authorized bases for compromise under then governing Treasury regulations. See Treas. Reg. § 301.7122-1(a) (1960). Although the permissible bases for compromise have since been expanded in the regulations to include the promotion of effective tax administration, Counsel's role has not changed, and verifying that a basis for compromise is present continues to be the most important part of Counsel's role in reviewing proposed acceptances.

Although verifying that there is a legal basis for compromise is the principal role of Counsel, most of the manual is dedicated to Counsel's examination of the "adequacy" of the amount proposed for acceptance, a matter which is undoubtedly a question of policy. See T.D. 8829, 64 Fed. Reg. at 39023 ("[T]he amount to be paid, future compliance or other conditions precedent to satisfaction of a liability for less than the full amount due are matters left to the discretion of the Secretary."). Thus, both the offer in compromise handbook and the CCDM recognize that the role of Counsel is to review both legal and policy issues.

Asking that Counsel review policy matters does not grant a veto power or establish that Counsel has final say over whether an offer will be accepted. The procedures explicitly recognize that Counsel's concurrence in the decision to compromise is not required. See IRM 5.8.8.2(2); CCDM 34.5.2.1(3)a.5. Thus, if Counsel issues an opinion that the compromise of the case is not in keeping with the Service's acceptance policy, either because the amount offered is too low or for any other reason, the Service may nevertheless compromise the case. Because the Counsel opinion is sought prior to the issuance of an acceptance letter, the official with final authority to accept will have an opportunity to consider Counsel's concerns before the decision to accept is made final.

Your question assumes that the basis for compromise is the promotion of effective tax administration, specifically economic hardship. The Internal Revenue Manual gives the following guidance with respect to determining an acceptable offer based on considerations of economic hardship:

> In offers based on economic hardship, an acceptable offer amount should be determined based on the facts and circumstances of the taxpayer's situation and the financial information analysis. For example, the taxpayer has $100,000 liability and assets and income of $125,000. To avoid economic hardship, it is determined that the taxpayer will need $75,000. The remaining $50,000 should be considered in determining an acceptable offer amount.

IRM 5.8.11.2.1(4). The standard articulated in this manual provision appears very similar to the "reasonable collection potential" standard used for doubt as to collectibility offers, see Policy Statement P-5-100, in that the Service expects a taxpayer to offer an amount equal to that which could be collected after the economic hardship has been accounted for. Counsel's disagreement with the amount determined to be acceptable pursuant to the foregoing guidance will not barr compromise of the case. As with all advice issued by Counsel, it is appropriate and proper for you to render your opinion as to whether a proposed action is in keeping with the Service's stated policies. The ultimate decision, however, remains with the Area Director or other delegated official.

A more serious issue is presented if Counsel concludes that no basis for compromise is present. Treasury regulations enacted by the Secretary in accordance with required procedures have the force and effect of law. They are mandatory, not directory, and must be followed. See Boulez v. Commissioner, 810 F.2d 209, 215 (D.C. Cir. 1987) (specifically discussing compromise regulations under section 7122).[2] In fact, the Supreme Court has

[2] In Boulez, the court was considering the requirement, contained in the regulations but not in the statute, that all compromises be in writing. We find the court's analysis even more persuasive when the issue is one of substantive authority as opposed to mere procedural safeguards. In the words of the court: "Indeed, when a compromise of tax liability is at issue, the need for rigorous compliance with pertinent

recognized that it "must defer to Treasury Regulations that implement the congressional mandate in some reasonable manner." Commissioner v. Portland Cement Co., 450 U.S. 156, 169 (1981) (citations and internal quotation marks omitted). The Commissioner's delegation of authority to compromise necessarily carries with it the implicit assumption that it will be exercised in accordance with applicable law and regulations. See Boulez, 810 F.2d at 215 (stating that it "defies common sense" to infer that Secretary's delegates may waive requirements stated in regulations). Thus, no Service official may compromise a case unless it has been established that a basis for compromise, as established by Temp. Treas. Reg. § 301.7122-1T, is present in the case.[3]

Confusion on this point may in part stem from language in prior versions of Delegation Order No. 11, which grants certain officials the authority to compromise. Prior to revision in November 1999, the delegation of authority vested in certain officials the authority to compromise "in the event Counsel renders a negative legal opinion." Delegation Order No. 11 (Rev. 25) (September 29, 1997). In spite of internal guidance to the contrary, many within the Service mistakenly believed that this language authorized compromise even where there was no doubt as to either liability or collectibility. In reality, this delegation was intended to authorize certain officials to accept less than reasonable collection potential once doubt as to collectibility had been established. See Delegation Order No. 11 (Rev. 24) (June 21, 1994) (stating that authority to accept notwithstanding negative Counsel opinion "applies only to offers in compromise - Doubt as to Collectibility").

The more recent delegation of compromise authority, partially in an effort to alleviate any confusion, has removed language making reference to the opinion of Counsel in favor of positive grants of authority to certain officials. The authority to accept less than could otherwise be collected in a doubt as to collectibility case, now referred to as compromise based on "special circumstances," is specifically delegated to certain officials. See Delegation Order No. 11 (Rev. 27) (November 1, 1999) (delegating authority to accept offers based on special circumstance criteria as well as authority to accept offers based on the promotion of effective tax administration); IRM 5.8.8.3 (explaining special circumstances criteria and acceptance authority).

In reviewing proposed acceptances, Counsel should defer to the offer group on factual determinations such as valuation of assets, allowable expenses, and the existence of

---

regulations may be at its greatest, for not only the integrity of the public fisc but also public faith in the equitable enforcement of the tax laws hangs in the balance." 810 F.2d at 218.

[3] See also Rev. Proc. 80-6, 1980-1 C.B. 586. In explaining the various delegations of compromise authority, the revenue procedure stated: "The above delegations are 'limited' to the extent that the delegated authority must be exercised in accordance with the limitations prescribed by section 301.7122-1 of the Regulations on Procedure and Administration and with procedures established by the National Office."

circumstances which warrant acceptance of less than could otherwise be collected.[4] If, having done so, Counsel is unable to verify that a basis for compromise as authorized under the regulations is present, that determination is more than a policy disagreement. Under such circumstances, the seriousness of the decision to compromise warrants opening up a dialogue with the Area Director to attempt to reach consensus. If no consensus can be reached, it is appropriate to elevate the question to higher levels of management just as would be done in any other type of case. Nevertheless, because both Compliance and Counsel are working toward the same goals, disputes of this nature should be rare.

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

OFFER IN COMPROMISE; BANKRUPTCY, PREPETITION CLAIM

February 5, 2001

GL-506883-00
UILC: 17.00.00-00

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

[4] At the outset, the CCDM states clearly that the factual determinations of the Service are not to be reexamined unless "patently erroneous" and that asset valuations in particular are "largely matters of administrative discretion and judgment and should rarely be questioned by Counsel." CCDM 34.5.2.1(3)a.1.

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.

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.

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.

COLLECTION DUE PROCESS; POWER OF ATTORNEY

CC:PA:CBS:Br1
TL-N-1200-01
UIL 6330.00.00-00

June 4, 2001

MEMORANDUM FOR JAMES E. CANNON, ASSOCIATE AREA COUNSEL,
KANSAS CITY CC:SB:5:KCY
Attn: Charles M. Berlau

FROM: Alan C. Levine
Chief, Branch1 Collection, Bankruptcy & Summonses
CC:PA:CBS:Br1

SUBJECT: Power of Attorney–Request for a Collection Due Process Hearing

You requested our views on the reliance upon a self-styled "General Power of Attorney and Appointment of Attorney-in-Fact" (the General Power of Attorney) in connection with a request for a collection due process hearing. Specifically, you asked what is the legal effect of the General Power of Attorney, which does not meet all of the Service's requirements for powers of attorney. You also noted that Appeals believes that there may be similar powers of attorney at the service center submitted in connection with other collection due process cases.

In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

ISSUE

With respect to a request for a collection due process hearing, what is the legal effect of a power of attorney submitted by or on behalf of a taxpayer that does not meet all of the Service's requirements for powers of attorney.

CONCLUSION

The taxpayer should be given a collection due process hearing because the request substantially complies with the requirements for requesting a hearing. While the taxpayer should be given the opportunity to sign the request and have a hearing, because the General Power of Attorney presented here is not valid, it cannot be relied upon for representation purposes. While the taxpayer's signing the request will entitle her to a hearing, it does not cure the defects in the General Power of Attorney. If the taxpayer wishes to authorize a representative to act on her behalf, she must do so in accordance with the Service's procedures for granting an individual (or individuals) power of attorney.

FACTS

The facts as we understand them can be summarized as follows: the taxpayer and the purported representative signed the General Power of Attorney on May 19, 2000 and May 23, 2000, respectively. They did not use Form 2848 (Rev. 12/97), Power of Attorney and Declaration of Representative. Rather, they used a self-styled General Power of Attorney. The document submitted identifies a business entity as the representative and does not contain a declaration of representative. Thereafter, the purported representative submitted a self-styled Request for a Collection Due Process Hearing on behalf of the taxpayer.

DISCUSSION

For the reasons articulated in your memorandum, as well as the memoranda of the Appeals team manager and the Director of Practice, we believe that the General Power of Attorney is not sufficient to authorize the purported representative to act on behalf of the taxpayer. In sum, although the Instructions for Form 2848 provide that only individuals may be named as representatives, [5]the document submitted does not do so. In addition, the document does not contain the Declaration of Representative contained in Part II of Form 2848. While it is not necessary to always use Form 2848, a non-Service power of attorney must attach a signed and dated Declaration of Representative which contains all of the information contained in Part II of Form 2848. See Publication 947, p. 7. Finally, it appears from the information you provided that the purported representative is not recognized to practice before the IRS.

We agree with your analysis of Carstenson v. Commissioner, 57 T.C. 542 (1972), but do not believe that the case is dispositive here. As you noted, this case is distinguishable because the purported representative was not at the time authorized to practice before the Service. [6]In Carstenson, the Tax Court found that the amended petition filed by the petitioners related back to the date of the original petition filed by the petitioners' agent which was timely, but defective. It reasoned that the petitioners ratified the defective petition that was timely filed by their authorized agent. While ratification may have been sufficient to satisfy the Tax Court that the agent acted with "the knowledge, consent, and approval" of the petitioners, knowledge, consent, and approval are not all that is required for a valid power of attorney for the purpose of representing taxpayers before the Service. We note that Publication 947 addresses what should be done where a non-Service power of attorney does not meet the Service's requirements: the taxpayer can submit a Form 2848 or a new non-Service power of attorney that contains all the necessary information; or, under certain circumstances, the non-Service power of attorney may submit a Form 2848 on behalf of the taxpayer.

The Temporary Treasury Regulations on collection due process provide:

> The taxpayer must make a request in writing for a CDP hearing. A written request in any form which requests a CDP hearing will be acceptable. The request must include the taxpayer's name, address, and daytime telephone number, and must be signed by the taxpayer or the taxpayer's authorized representative and dated.

---

[5] Publication 947 (Rev. January 1999), Practice Before the IRS and Power of Attorney, also provides that individuals can be appointed representatives.

[6] In addition, we understand from your office that the purported representative has recently been convicted of numerous charges against him.

Treas. Reg. § 301.6330-1T(c), Q&A C1 (emphasis added). The regulations do not address the effect of a defect in a request, generally, or, more specifically, a defect with respect to the authority to represent the taxpayer. However, it is clear that the right to a collection due process hearing is dependent on a timely written request. It is our position that a request, although deficient, that substantially complies with the requirements for making a request is timely and, therefore, sufficient to afford the taxpayer the opportunity for a collection due process hearing. What the instant case presents is, in effect, an unsigned or improperly signed request. [7] In such cases, the Service affords the taxpayer(s) the opportunity to correct an error in the request: the Internal Revenue Manual provides that "[i]If the appropriate signatures are not present on the CDP hearing request, give the taxpayer a reasonable time to provide the necessary signatures." IRM 5.1.9.3.6. The only distinction here is that signing the request will provide the taxpayer the opportunity to have a collection due process hearing, but will not cure the defects in the power of attorney.

BANKRUPTCY; REFUNDS; OFFER IN COMPROMISE; DEPOSITS

CC:PA:CBS:BR2
GL-115666-01
U.I.L. 17.18.00-00
June 14, 2001

MEMORANDUM FOR ASSOCIATE AREA COUNSEL (SB/SE), LAGUNA NIGUEL

FROM: JOSEPH W. CLARK, Senior Technician Reviewer, Branch 2 (Collection, Bankruptcy, Summonses)

SUBJECT: Advisory Opinion–Refund of Offer Deposits in Bankruptcy

This memorandum responds to a request for advice received from your office on April 6, 2001. You have asked us to consider whether the Service must refund a deposit it received in connection with a taxpayer's offer in compromise when the taxpayer files Chapter 7 bankruptcy before the Service has acted upon the offer. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent. This writing may contain privileged information.

ISSUE

When a taxpayer with a pending offer in compromise files Chapter 7 bankruptcy, must the Service return the deposit it received in connection with the offer?

---

[7]Although we do not have all of the documents related to this matter, it appears from the information you provided us that improper power of attorney is the only defect.

CONCLUSION

When the taxpayer files Chapter 7 bankruptcy, the offer becomes nonprocessable; unless the taxpayer has signed Form 3040 authorizing the Service to apply the deposit to tax liabilities, the Service must refund the deposit to the taxpayer upon the bankruptcy filing.

DISCUSSION

As a rule, once a taxpayer files a bankruptcy petition, any related and pending offer to compromise becomes unprocessable. See I.R.M. 5.8.3.1(1), 5.8.3.3(2), 5.8.10.2.1.

Section 7809(b) of the Internal Revenue Code establishes a "deposit fund account" to hold "sums offered in compromise," and provides that "upon acceptance of such offer in compromise, . . . the amount so accepted shall be withdrawn" from the deposit account and deposited into the Treasury as collections. Upon rejection, I.R.C.§ 7809(b) requires the Service to refund the deposit to the "maker" of the offer.

Treas. Reg. § 301.7122-1T(g) provides that "[s]ums submitted with an offer to compromise . . . are considered deposits and will not be applied to the liability until the offer is accepted unless the taxpayer provides written authorization for application of the payments. If an offer to compromise . . . is determined to be nonprocessable. . . any amount tendered with the offer . . . will be refunded without interest." The regulation further allows that refund is not required "if the taxpayer has agreed in writing that amounts tendered pursuant to the offer may be applied to the liability for which the offer was submitted." Accordingly, item 8(c) of Form 656 notifies the taxpayer that "[i]f the IRS rejects or returns the offer, . . . the IRS will return any amount paid with the offer. If I/we agree in writing, IRS will apply the amount paid with the offer to the amount owed." By signing Form 3040, the taxpayer may authorize the Service to apply an offer in compromise deposit to outstanding tax liability.

The Internal Revenue Manual also requires return of the deposit in such situations. I.R.M. 5.8.7.7(2) states that the Service should request the taxpayer to sign Form 3040, authorizing application of the deposit to outstanding liabilities in the event the offer is not accepted; however, "[i]f the taxpayer does not authorize application of the deposit, the deposit **must** be refunded to the taxpayer" (emphasis in original). Further, I.R.M. 5.8.2.5, relating to the disposition of deposits received with unprocessable offers in compromise, provides "[d]eposits received with offers that are not processable must be returned to the taxpayer," and that the employee making the determination is "responsible for sending the deposit back to the taxpayer."

In light of language in the Code, the regulations, and the I.R.M., the Service has made a policy decision to return any funds submitted with an offer when it becomes nonprocessable. Thus, unless the taxpayer has signed a Form 3040 authorizing application of the deposit to tax liabilities, the Service should refund the deposit when a taxpayer has filed bankruptcy rendering the offer nonprocessable.

BANKRUPTCY; AUTOMATIC STAY; NOTICE OF TAXES DUE

CC:PA:CBS:Br2
GL-106360-01
UILC: 09.08.00-00
May 22, 2001

MEMORANDUM FOR ASSOCIATE AREA COUNSEL (SB/SE)

FROM: Joseph W. Clark, Senior Technician Reviewer
Branch 2 (Collection, Bankruptcy & Summonses)

SUBJECT: Advisory Opinion–Claims in Escrow / Violation of Stay

This memorandum responds to a request for advice received from your office on February 22, 2001. You have asked us to consider whether the Service violates the automatic stay when it issues a Form 10492 Notice of Federal Taxes Due to an escrow company involved with a taxpayer's refinancing of non-estate property during a Chapter 13 bankruptcy. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent. This writing may contain privileged information.

ISSUE

In a Chapter 13 case, does the Service violate the debtor's automatic stay when it issues a Form 10492 Notice of Federal Taxes Due to an escrow company refinancing the debtor's non-estate property?

CONCLUSION

No. Because Form 10492 is informational, rather than coercive or threatening, and the debtor initiated the communication from the Service in order to refinance non-estate property, the Service does not violate the stay when it provides Form 10492.

BACKGROUND

You state that this issue frequently arises in the context of a Chapter 13 debtor operating under a confirmed plan. The debtor wishes to refinance property (which is not a part of the bankruptcy estate), usually in order to obtain funds to complete the plan early or to secure a more favorable interest rate. In cases where the debtor intends to use the refinancing proceeds to buy out future plan obligations, both the Chapter 13 Trustee and the debtor's counsel usually know about the transaction. In other cases, however, the debtor's counsel may not be involved.

The escrow company performing the transaction requests a lien payoff amount from the

Service, and the Service responds by providing a Form 10492 Notice of Federal Taxes Due. Form 10492 is informational in nature. It contains the identity of the taxpayer and the sums due for taxes secured by lien on the property, and it includes calculations for interest and penalties. Form 10492 further states that the Service will file a certificate of release of Federal Tax Lien upon payment of the amount due. Because the property being refinanced is legally vested in the debtor, not the Bankruptcy estate, court approval has not been requested.

DISCUSSION

Bankruptcy Code § 362(a)(5) provides that the automatic stay arises immediately upon filing of the bankruptcy petition, prohibiting "any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien arose before the commencement of the case . . . ." Section 362(a)(6) further prohibits "any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case. . . ." The stay extends to property of the estate until it is no longer property of the estate, and with respect to other acts, it continues until the case is closed or dismissed, or a discharge is granted or denied. B.C. § 362(c). When a Chapter 13 plan is confirmed, B.C. § 1327 (b) states that all estate property vests in the debtor, unless the plan or confirmation order provides otherwise.

The automatic stay has three dimensions: it protects the debtor, it protects the debtor's property, and it protects the property of the bankruptcy estate. In re Chugach Forest Products, 23 F.3d 241, 246 (9th Cir. 1994). The purposes of the automatic stay are to facilitate the debtor's rehabilitation by protecting the debtor from collection and other harassing actions by creditors, and to provide for orderly liquidation of the debtor's assets in order to assure that all creditors are treated equally. Morgan Guaranty Trust Co. v. American Savings & Loan Ass'n, 804 F.2d 1487, 1491 (9th Cir. 1986), cert. denied 482 U.S. 929 (1987). Although the language "any act" is broad, courts limit the scope of the stay in reference to its purposes. See Checkers Drive-in Restaurants v. Commissioner, 51 F.3d 1078, 1082 (D.C. Cir.), cert. denied, 516 U.S. 866 (1995); Chugach, 23 F.3d 241, 245 (9th Cir. 1994)("Thus, while seemingly broad in scope, the automatic stay provisions should be construed no more expansively than is necessary to effectuate legislative purpose."). In Rett White Motor Sales Co. v. Wells Fargo Bank, 99 B.R. 12, 15 (N.D. Cal. 1989), the court found "simply no language in Section 362(a) designed to stay actions initiated by the debtor."

Courts have further allowed creditors to send letters offering to continue conducting business with the debtors if they reaffirm their debt. See In re Brown, 851 F.2d 81 (3d Cir. 1988); In re Duke, 79 F.3d 43 (7th Cir. 1996). In these cases, the courts have determined such communications do not violate the stay, provided they are not threatening or coercive. As the court described in Brown, "[t]he respite is not from communication with creditors, but from the threat of immediate action by creditors, such as foreclosure or a lawsuit." Brown, 851 F.2d at 86. See also, In re Spaulding, 116 B.R. 567, 570-71 (S.D. Ohio 1990) ("Letters that are isolated and informational are less

likely to result in violations of the automatic stay. . . . ").

In Morgan Guaranty, 804 F.2d at 1491, the court considered whether presentation of a note to the debtor's bank violated the automatic stay. After considering the legislative purpose for the stay, the court concluded:

> The mere act of presentment does not interfere with orderly administration of the estate, the debtor's "breathing spell," or the status quo. Presentment cannot be characterized as harassment, particularly where the creditor presents its notes to the payor bank, rather than to the debtor . . . . We conclude that the language and purposes of section 362(a) do not bar mere requests for payment unless some element of coercion or harassment is involved.

Thus, case law clearly indicates that communications from creditors do not violate the stay in the absence of threats or coercion. Therefore, responding to an escrow company's request for a lien payoff amount with a Form 10492, consisting merely of a factual statement of the amount the debtor owes the Service, the method to calculate interest, and the property to which the lien has attached, does not violate the stay.

OFFER IN COMPROMISE; DEFAULT

July 30, 2001
CC:PA:CBS:Br2
GL-125574-01
UIL: 7122-03-00

MEMORANDUM FOR JOEL GOVERMAN, DIRECTOR, FILING AND PAYMENT COMPLIANCE

FROM: Lawrence H. Schattner
Chief, Branch 2 (Collection, Bankruptcy & Summonses)

SUBJECT: Related Bankruptcy During a Pending Offer in Compromise Investigation

This responds to your memorandum dated May 4, 2001.

ISSUES

1) Whether an offer in compromise ("OIC") from a partnership entity seeking to compromise employment tax liabilities can be returned as unprocessable because one or more partners have filed for personal bankruptcy.

2) Whether an OIC from a corporate entity seeking to compromise employment tax liabilities can be returned as unprocessable because a responsible individual has filed

for personal bankruptcy.

3) What effect does the bankruptcy have on the Service's ability to include the debtor's assets and future ability to pay in its determination of reasonable collection potential for the partnership or corporate entity?

4) If the OIC is processed, can the Internal Revenue Service ("Service") request full disclosure and verification of all financial information from the debtor in bankruptcy without violating the automatic stay of collection?

CONCLUSIONS

1) No. An OIC from a partnership entity should not be returned as unprocessable when one or more partners have filed for personal bankruptcy. Rather, this is a factor that should be taken into account when deciding whether to accept or reject the OIC.

2) No. An OIC from a corporate entity should not be returned as unprocessable when a responsible individual has filed for personal bankruptcy. Rather, this is a factor that should be taken into account when deciding whether to accept or reject the OIC.

3) When determining the reasonable collection potential for the partnership or corporate entity the Service should take into account a variety of factors such as, the type of bankruptcy filed, what if anything the Service will be collecting from the partner or responsible individual through bankruptcy, and what if anything the Service can collect outside of bankruptcy, including exempt assets and future ability to pay.

4) No. The automatic stay does not bar the collection and verification of the partner's or responsible individual's financial information.

LAW & ANALYSIS

Processability

An OIC will fall into one of three categories: processable, not processable or unperfected. IRM 5.8.3.3(2). An offer is considered not processable if (1) the taxpayer is in bankruptcy or (2) if the taxpayer fails to comply with filing requirements. IRM 5.8.3.3(4). Whether or not to process an OIC is a matter of policy within the Service's discretion, however, the current provisions of the Manual seem to favor the processing of OIC's. As noted above, the Manual lists only two criteria for a finding of not processable.[8] IRM 5.8.3.3(4). Deviation from these criteria "may not be made without

---

[8]We have seen a trend toward a decrease in the number of criteria that make an offer not processable. For example, it used to be that the Service would not processes forms with missing information or other mistakes. See, Form 656 (Rev. 1-97)

written authorization from the National Office." IRM 5.8.3.3.1(1). Strict adherence to these criteria is necessary because a finding of not processable denies the taxpayer its appeal rights, thus "all processable offers must be investigated and the taxpayer must be provided an opportunity to appeal any rejection of the offer." IRM 5.8.3.3.1(2).

The receipt of an OIC from a taxpayer in bankruptcy has been the source of much debate within the Service. However, as the current Manual clearly reflects, it is the Service's policy not to accept such offers. The rationale behind this policy is that both the OIC process and the Bankruptcy Code work to protect the taxpayer's and the government's interests in similar ways. IRM 5.9.4.7. Thus, a taxpayer who has elected to resolve his/her financial difficulties through the bankruptcy process is adequately protected by Code provisions and Service procedures. Trying to consider an OIC during this process will only add needless administrative and legal difficulties.

This rationale applies to cases where the taxpayer is in bankruptcy. In the scenarios you have presented the taxpayer is the partnership or corporate entity and the debtor in bankruptcy is a general partner or a responsible individual. Therefore, we need to determine whether the same policy considerations apply.

In the case of a partnership, the Internal Revenue Code creates a single employment tax liability for which the partnership is liable. State law making general partners liable for partnership debts allow the Service to collect from the general partners without the need for a separate assessment against them. IRM 5.12.1.18.3(1). Notwithstanding the general partners' derivative liabilities, the Service's policy has been to compromise employment taxes at the partnership level only. See IRM 5.8.1.12(1). A rule preventing the processing of a non-debtor partnership's OIC because a general partner has filed for personal bankruptcy would leave the partnership with no recourse to settle its outstanding liabilities. Further, given the Service's policy to compromise outstanding employment taxes with the partnership only, rather than with the individual partners, any non-debtor partners would similarly be left without recourse to compromise their liabilities. Thus, the above rationale for returning OICs from taxpayers in bankruptcy does not fit this situation. Ultimately, however, whether or not to process an OIC is a matter of policy in the Service's discretion.

In the case of a corporate entity, responsible individuals are not liable for corporate debts. Instead, a separate assessment of the Trust Fund Recovery Penalty ("TFRP") under IRC section 6672 must be made. When a corporate entity submits an OIC it is seeking to compromise its own tax liabilities, not the separate liabilities of a responsible individual in bankruptcy. In such a case, because the taxpayer is the corporation we can longer say that the Bankruptcy Code is working to protect the taxpayer. Thus, as in the case of a partnership, the rationale of returning OICs from taxpayers in bankruptcy

---

Instructions p.2. Now these defects merely make an offer unperfected and the taxpayer is allowed the opportunity to cure the mistakes. IRM 5.8.3.3(6).

does not fit.

As you are well aware, the processing of an OIC does not mean that it will be ultimately accepted and as you have pointed out there are a variety of factors that will impact upon that determination. To be acceptable, an OIC from a partnership or corporate entity must include any amount that could be collected from the general partners or responsible individuals. IRM 5.8.1.12(1); 5.8.4.11(1). Thus, the Service must consider what will be collected from the general partner or responsible individual in bankruptcy (e.g., under a confirmed plan), as well as what could be collected outside of bankruptcy (e.g., from exempt assets and future earnings).

Automatic Stay

You have also raised the issue of the automatic stay. The purpose of the automatic stay provisions of the Bankruptcy Code 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 the situation you presented, the Service is not seeking to collect from the debtor, rather it is trying to facilitate the collection from someone else. In fact, a compromise agreement with a partnership or corporation may help to shield the debtor from collection activity. For example, with regard to a corporation's trust fund tax liabilities, "if an offer is accepted from a corporation to compromise trust fund taxes, there is no basis for collection of any related TFRP assessments." IRM 5.8.4.11(1). This is based on "the Service's policy to collect the unpaid trust fund taxed only once." 5.17.7.1.11(1). Therefore, the automatic stay is not implicated.

BANKRUPTCY; POST-PETITION REFUNDS; SETOFF

June 27, 2001
CC:PA:CBS:Br2
GL-125039-01
UILC: 09.39.00-00

INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR ASSOCIATE AREA COUNSEL, OMAHA

FROM: Lawrence H. Schattner
Chief, Branch 2 (Collection, Bankruptcy & Summonses)

SUBJECT: Setoff of Postpetition Refunds

This Chief Counsel Advice responds to your memorandum dated May 29, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

You asked us to review your proposed memorandum discussing whether the Internal Revenue Service ("Service") must turn over to the Chapter 7 trustee a refund for a tax period ending after a Chapter 13 bankruptcy petition was filed but before the case was converted to Chapter 7 and whether the Service may setoff a post-petition refund against a pre-petition tax liability.

We agree with your conclusion that an asset acquired after the Chapter 13 petition was filed but before the case was converted to Chapter 7 is not property of the Chapter 7 estate. 11 U.S.C § 348(f)(1)(A) (2001); In re Stramm, 222 F.3d 216 (5th Cir. 2000); Farmer v. Taco Bell, 242 B.R. 435 (Bankr. W.D. Tenn 1999). We therefore agree with your conclusion that the refund should not be turned over to the Chapter 7 trustee. We further agree with your conclusion that the language of Bankruptcy Code section 553(a) does not bar the Service from setting off the post-petition refund against the pre-petition tax liability under I.R.C. section 6402(a), because the debts are mutual and the pre-petition claim is not dischargable.

Because several courts have disallowed the setoff of post-petition debts against pre-petition claims due to a lack of mutuality, you may want to incorporate an explicit statement into paragraph nine of your Motion for Relief that the Service's and the Debtors' claims are mutual. As you correctly concluded, the 2000 tax refund is owed directly to the Debtors and not to the Chapter 7 estate. Thus, even though the refund is post-petition the Service's and the Debtors' claims are mutual. See, In re Schons, 54 B.R. 665, 666-67 (Bankr. W.D. Wash. 1985) (setoff of creditor's post-petition liability to debtor allowed against debtor's pre-petition liability to creditor since mutuality is present); Contra, In re Apex Int'l Mgt. Serv., 155 B.R. 591, 594 (Bankr. M.D. Fla. 1993) ("Because the pre-petition debtor acts in a different capacity than does the post-petition debtor, debts that arose at different times, one pre-petition and one post-petition, lack mutuality and set-off may not be had under § 553"); Cf., In re Braniff, 42 B.R. 443 (Bankr. N.D. Tex 1984) (finding mutuality lacking because creditor owed liability to debtor-in-possession rather than debtor itself).

Further, to ensure full candor with the court, you may want to note in the Motion for Relief that In re Firestone, 179 B.R. 148 (Bankr. D. Neb. 1995), persuasive authority in your jurisdiction, states that the Service may only exercise a setoff under section 6402(a) of the Internal Revenue Code when the requirements of section 553 are met. Id. at 149. This language can be distinguished as dicta because the Firestone court was only considering pre-petition debts and did not directly confront a post-petition claim.

Although we agree with your analysis and conclusions, you might consider noting adverse authority in your memo to ensure that the Insolvency Group is aware of potential litigation hazards. See, In re Willardo, 67 B.R. 1014 (Bankr. W.D. Mich. 1986) (striking down local court rules because, among other things, they would allow impermissible setoffs of post-petition claims against pre-petition debts); In re Internal Revenue Tax Liabilities & Refunds in Chapter 13 Proceedings, 30 B.R. 811 (Bankr.

M.D. Tenn. 1983) (striking down an agreed upon order between the Chapter 13 trustee and the Service because, among other things, it would allow impermissible setoffs of post-petition claims against pre-petition debts); In re Hammett, 21 B.R. 923 (Bankr. E.D. Penn. 1982) (holding that the Service has no right to setoff post-petition refunds against pre-petition liabilities and thus no right to relief from the stay). In our view, the above cases do not properly consider the issue of mutuality.

We note on page eight of your memo and in paragraph six of the Motion for Relief you state that the Service can hold the refund until Debtors receive their discharge.[9] This is true, however, the Service can only retain the amount eligible for setoff. See CCDM 34.10.2.6(2)c. The Service must refund any amount in excess of the pre-petition tax liability or risk violating the stay. In re Holden, 217 B.R. 161, 166 (D. Vt. 1997).

We also note that in paragraph twelve of your Motion for Relief you discuss the setoff's benefit for the creditors. You may want add a discussion about the benefit to the debtors. Since post-petition interest continues to accrue on non-dischargeable tax liability in Chapter 7 proceedings, it is in the debtors' best interest to allow the Service to setoff the refund against the pre-petition liabilities as soon as possible to stop the accrual of interest. Bruning v. United States, 376 U.S. 358 (1964); In re Hanna, 872 F.2d 829 (8th Cir. 1989).

To review, we agree with the analysis and conclusions in your memo. We recommend that you make minor changes to your memo and Motion for Relief as discussed above.

OFFER IN COMPROMISE; REJECTION; INFORMATION FROM NON-LIABLE SPOUSE

CC:PA:CBS:Br2
GL-131535-00
UILC: 17.12.04-00

MEMORANDUM FOR ASSOCIATE AREA COUNSEL (SBSE)

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

---

[9]However, long-term or indefinite freezes may in fact violate the automatic stay. See, Citizens Bank v. Strumpf, 516 U.S. 16 (1995); In re Orr, 234 B.R. 249, 255 (Bankr. N.D. N.Y. 1999); In re Wicks, 215 B.R. 316 (E.D. N.Y. 1997). However, as we discussed, in this jurisdiction discharge in a no asset case usually occurs within three to four months. If the Service is going to hold the refund for longer than that amount of time, we should seek relief from the stay. IRM 5.9.4.3.1.

SUBJECT: Advisory Opinion–Rejection of Offers in Compromise

This memorandum responds to a request for advice from your office received by email on December 27, 2000. You have asked us for our assistance in addressing a request by a taxpayer's representative concerning whether the Service may reject an offer in compromise when a taxpayer's non-liable spouse with whom he shares living expenses refuses to provide her personal financial information. This document is not to be cited as precedent.

ISSUE

Whether the Service may consider in rejecting a taxpayer's offer in compromise that the taxpayer's non-liable spouse with whom he shares living expenses has submitted an affidavit stating that the taxpayer's entire income is used for their housing and utilities and that she pays the remainder, but has refused to provide her financial information.

CONCLUSION

The decision to compromise a case under section 7122 of the Internal Revenue Code is discretionary on the part of the Commissioner. Rejecting a taxpayer's offer in compromise, in part because the taxpayer's non-liable spouse refuses to supply financial information which the Service has determined may be needed to evaluate the expenses claimed by the taxpayer, is a permissible exercise of that discretion.

BACKGROUND

The taxpayer at issue has submitted an offer to compromise taxes assessed against him. The taxpayer is currently unemployed, but receives a small payment from his work with the Air Force Reserves. The taxpayer is married and lives with his spouse, but she is not liable for any of the taxes at issue. Pursuant to IRM 5.8.5.6(3), the Service requested financial information from the taxpayer and the non-liable spouse.

The taxpayer submitted a collection information statement which contained information on his current income and living expenses, but the spouse refused to do so. Instead, she submitted a document entitled "certification," which she has signed under penalty of perjury. In this document she states that whenever the taxpayer is employed, he pays his entire income to her for use toward their household expenses. She further states that the taxpayer's income is not sufficient to provide their housing and utility expenses, so she contributes the remainder from her income. She has also provided a handwritten letter stating that she had no part in her husband's tax difficulties, they maintain separate bank accounts, and she does not "feel . . . responsibility" to help him pay his tax liabilities. The Service has rejected the taxpayer's offer, and it is currently pending before Appeals.

The Service has received a letter from the taxpayer's counsel setting forth his belief that because the Service cannot collect from the non-liable spouse's assets, and because she has provided a statement under penalty of perjury that all of the taxpayer's income is put toward their living expenses, the Service may not reject his offer on the basis of her refusal to provide personal financial information.

DISCUSSION

The Secretary's authority to compromise tax cases comes from section 7122 of the Internal Revenue Code, which states: "The Secretary may compromise any civil or criminal case arising under the internal revenue laws prior to reference to the Department of Justice for prosecution or defense." I.R.C. § 7122(a) (emphasis added). Treasury regulations pertaining to that section likewise state: "The Secretary may exercise his discretion to compromise any civil or criminal liability arising under the internal revenue laws . . . ." Treas. Reg. § 301.7122-1T(a)(1). Thus, the Secretary's authority to compromise is discretionary.

The Secretary has delegated this authority to the Commissioner, who has then delegated it to various officials throughout the Service. See Delegation Order No. 11. Implicit with this delegation of authority is the responsibility to exercise sound judgment and discretion when determining whether the Service should accept a taxpayer's proposed offer in compromise. Although the Service's general policy is to accept offers which reasonably reflect what the Service could expect to collect by other means, the "ultimate goal" of the compromise program is to reach agreements which are "in the best interest of both the taxpayer and the Service." Policy Statement P-5-100. Thus, acceptance of such an offer still requires a judgment that compromise is the best resolution of the case and will advance the overall goals of the compromise program. The Commissioner's policy goes on to make clear that realizing the reasonable collection potential in specific cases is just one of the objectives to be achieved by an effective offer in compromise program: "Acceptance of an adequate offer will also result in creating for the taxpayer an expectation of and a fresh start toward compliance with all future filing and payment requirements." Id. Policy Statement P-5-100 further states that the Service will accept an offer when it is unlikely that the tax liability can be collected in full, and the amount offered "reasonably reflects collection potential."

Consistent with these goals, the Service follows a procedure set forth in IRM 5.8.5.6 requesting financial information from non-liable individuals with whom the taxpayer shares living expenses. IRM 5.8.5.6(3) instructs the Service to request the non-liable person's financial information in order to determine the actual household income and expenses, verify the percentage of the taxpayer's portion of the shared expenses, and allocate the expenses to the taxpayer based upon his percentage of income.

In this case, the taxpayer supplied a collection information statement listing his living expenses and his income from past employment. Although his spouse has stated under penalty of perjury that they share expenses and that she essentially pays all their

current expenses due to his unemployment, without her financial information, the Service may encounter difficulty verifying the percentage of the taxpayer's portion of their shared expenses and allocating the expenses between them.

You are correct that current procedures do not clearly state that rejection is permissible for this reason. However, neither is acceptance of an offer mandatory where a non-liable spouse refuses to submit any specific financial information and the Service makes the determination that this information is necessary to evaluate the adequacy of the expenses claimed by the taxpayer. Although the Service has made a concerted effort to achieve a degree of uniformity in evaluating offers, as reflected in the IRM, the acceptance decision remains discretionary. The Service's procedure of requesting the non-liable spouse's financial information is not inconsistent with the regulations, and such information may be necessary in order to exercise that discretion. The Service's offer in compromise procedures do not create a presumption that all offers will be accepted, nor do they presume rejection. Rather, each offer in compromise should be evaluated and considered on its own merits, and accepted or rejected as dictated by the facts and circumstances present in the case. Thus, after considering the financial information provided by the taxpayer and the sworn statement provided by the non-liable spouse, the facts and circumstances may lead the Service to conclude that the offer is not in the best interest of the Service, and thus, it may exercise its discretion to reject the offer.

OFFER IN COMPROMISE; BANKRUPTCY; EXEMPT/ABANDONED PROPERTY

CC:PA:CBS:BR2
June 27, 2001 GL-119911-01
UIL 09.17.00-00

MEMORANDUM FOR T. KEITH FOGG
ASSOCIATE AREA COUNSEL/RICHMOND (CC:SB:2:RCH)

FROM: Joseph W. Clark
Senior Technician Reviewer, Branch 2 (CBS)

SUBJECT: Offers in Compromise for Exempt and Abandoned Property

This Chief Counsel Advice responds to your memorandum dated April 16, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

ISSUE:

Do the provisions of I.R.C. § 7122 apply when the Service consents to release its lien for a discharged tax period upon payment of less than the full value of its interest in

property subject to the lien?

CONCLUSION:

Amounts discharged in bankruptcy are accounted for by abatement under I.R.C. § 6404(c) rather than compromise under I.R.C. § 7122.

FACTS:

A task force under the Insolvency Manager for Area 4 is developing uniform, area-wide procedures for collection from exempt, abandoned or excluded property where a notice of federal tax lien was filed and where the underlying tax liability is discharged in bankruptcy. As explained in Notice CC-2001-014, abatements made pursuant to I.R.C. § 6404(c) to account for bankruptcy discharges do not invalidate otherwise proper assessments nor extinguish otherwise proper liabilities. When a tax liability is discharged in bankruptcy, the Service still may enforce a surviving tax lien against property which is exempt, abandoned or excluded from the bankruptcy estate. In some cases, you note, the Service may wish to accept less than the full value of its interest in the property, because levy or seizure is impractical or may result in severe financial hardship. You ask if the Service releases its tax lien in such cases, whether that action is subject to the Offer in Compromise provisions of I.R.C. § 7122?

LAW AND ANALYSIS:

A discharge order in bankruptcy discharges the debtor from a personal obligation to pay and creates an injunction barring creditors from attempting to collect discharged debts from the debtor personally. B.C. § 524(a)(1), (2). The discharge does not destroy the pre-petition liability, however. Johnson v. Home State Bank, 501 U.S. 78, 84, 111 S. Ct. 2150 (1991) ("a bankruptcy discharge extinguishes only one mode of enforcing a claim -- namely, an action against the debtor in personam"); see also In re Conston, 181 B.R. 769, 773 (D. Del. 1995) (collecting cases).

When the Service learns of a taxpayer's discharge from bankruptcy, the Insolvency function Tax Examiner or Bankruptcy Specialist evaluates the taxpayer's various tax liabilities to decide which have been discharged by the bankruptcy. See generally IRM 5.9.12.5 (describing procedures for evaluating and processing discharge). If the Insolvency employee decides that the costs of working the case do not warrant collection of the amounts involved, then the Insolvency employee must bring the balance due in each discharged tax liability module to zero by inputting adjusting credit Transaction Codes (TCs) to offset whatever debit TCs were used to account for the liabilities. Because the Service's accounting system is designed so that a prior transaction is never erased or extinguished or eliminated from the record, the abatement always takes the form of a credit transaction entered to bring the balance

due to zero.[10]

Adjustments made to account for bankruptcy discharges are abatements made pursuant to section 6404(c). A section 6404(c) adjustment is caused by the Service's decision that, despite section 6301's direction to collect taxes, it is not in the public interest to collect a particular liability because of the costs involved. Section 6404(c) authorizes the Service to abate the unpaid portion of any assessment when the Service decides "under uniform rules prescribed by the Secretary that the administration and collection costs involved would not warrant collection of the amount due." This abatement has nothing to do with a judgment about whether the assessment reflects the taxpayer's true liability; it only represents the Service's judgment that collecting the account is not cost-effective.[11] In effect the Service excuses its collector's obligation to account for the tax liability, but does not excuse the taxpayer's liability. See Crompton-Richmond v. U.S., 311 F. Supp. 1184, 1186 (S.D.N.Y. 1970) (Service can revive an assessment abated under section 6404(c) because the abatement of an uncollectible tax does not cancel the tax). See also Carlin v. U.S., 100 F. Supp. 451, 454-55 (Ct. Cl. 1951) (IRS cannot relieve a taxpayer of tax liability merely because it is uncollectible, but can only abate it as a bookkeeping entry); Sugar Run Coal Mining v. U.S., 21 F. Supp. 10, 12 (E.D. Pa. 1937) (an abatement made because of a collectibility determination does not extinguish the liability).

Such abatements do not extinguish an otherwise valid tax liability, regardless of the reason for the abatement. Because the section 6404(c) abatement is made on the basis of collectibility and not because the liability was improperly assessed, money may still later be collected, so long as the collection limitations period is open. While the bankruptcy discharge affects the Service's ability to collect the discharged liability, it does not extinguish either the underlying liability or those tax liens which have otherwise survived the bankruptcy. Since the underlying tax liability exists after bankruptcy discharge, it also exists after the assessments for the discharged taxes are abated. To account for the later collection, the section 6404(c) abatement may be reversed.

---

[10] Although the Insolvency employee does make a collectibility determination, the freeze code TC 530 cannot be used because (1) that would shut down collection on every tax module of the entire account and (2) the eventual reversal of the TC 530 would cause collection to commence against all of the taxpayer's property. Only by abating specific tax assessments (the ones for discharged taxes) can the Insolvency employee continue to collect the nondischarged taxes and, if the opportunity arises, collect the discharged taxes out of the property to which the lien for those taxes still attaches.

[11] Treas. Reg. 301.6404-1(d) delegates to the Commissioner the authority to prescribe the uniform rules for making a section 6404(c) determination. The Service has embodied the procedures for bankruptcy discharge determinations in the Bankruptcy Handbook, IRM 5.9.

Bankruptcy Code section 522(c)(2)(B) provides that exempt property is generally not liable for a prepetition debt, except where such debt is secured by a properly filed tax lien. Accordingly, where a Notice of Federal Tax Lien is on file before the petition is filed, it may be possible to collect the dischargeable tax liabilities from prepetition assets that were exempted or abandoned in the bankruptcy. See In re Isom, 901 F.2d 744 (9th Cir. 1990). Although the NFTL may be released pursuant to IRM 5.9.12.12(2) once the section 6404(c) abatement is posted, the Service can reinstate the NFTL under I.R.C. § 6325(f)(2) once the abatement is reversed. Adjustments such as these, because they do not affect tax liability, are not the same as a compromise of the debtor's taxes.

The Service has the authority under I.R.C. § 7122 to compromise tax liabilities. Agreements to compromise federal tax liabilities have generally been interpreted by applying contract principles. See United States v. Feinberg, 372 F.2d 352 (3d Cir. 1967); United States v. Lane, 303 F.2d 1 (5th Cir. 1962); Robbins Tire & Rubber Co., Inc. v. Commissioner, 52 T.C. 420 (1969). Contract formation requires mutual assent among the contracting parties: one party makes an "offer" of a contract and the other party accepts that offer. Some form of consideration also is necessary. See Restatement (Second) of Contracts § 22. The Service's determination of collectibility following a section 6404(c) abatement is a unilateral act by the Service which does not incorporate the required contractual elements of offer, acceptance, or consideration.

To enforce the debtor's *in rem* liability, Insolvency makes a non-contractual determination as to the amount that can effectively be collected out of the property to which the lien for those taxes still attaches. See IRM 5.9.12.5.1. That determination is based on myriad factors, including the relative financial condition of the debtor, the net worth of the exempt, abandoned or excluded property, and the total amount of taxes owed. Such a unilateral collectibility determination is not a compromise bargained for with the taxpayer under I.R.C. § 7122.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

The discharge injunction of B.C. § 524(a)(2) prohibits the commencement or continuation of any act to collect, recover or offset any discharged debt. While the bankruptcy discharge affects the Service's ability to collect the discharged liability from the debtor personally, it does not extinguish either the underlying liability or those tax liens which have otherwise survived the bankruptcy. I.R.C. § 6404(c) permits the Service to abate a tax assessment to reflect an administrative determination that collection of a tax is economically unfeasible due to a bankruptcy discharge. Should collection become feasible within the statutory collection period, a section 6404(c) abatement may be reversed without effecting an offer in compromise with the taxpayer under section 7122.