



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

OFFICE OF
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MEMORANDUM FOR DISTRICT COUNSEL,
NORTH-SOUTH CAROLINA DISTRICT

FROM: Kathryn A. Zuba
Chief, Branch 2 (General Litigation)

SUBJECT: Applicability of Compliance Requirements to an Individual
Taxpayer Submitting an Offer in Compromise

This memorandum responds to your request for advice dated March 17, 2000. This document may not be cited as precedent by taxpayers.

LEGEND:

Company A
Company B
Year 1
Year 2
Year 3
Year 4

ISSUE:

Whether a taxpayer's offer in compromise is considered "not processable" because a corporation he currently owns and operates is not current in its obligations to file returns and make Federal tax deposits.

CONCLUSION:

Under the policies and procedures of the Service, a taxpayer's offer in compromise is processable notwithstanding non-compliance by the corporation he owns and operates. However, the district has the discretion to accept or reject the offer as it deems appropriate under the circumstances.

BACKGROUND:

The taxpayer has submitted an offer to compromise trust fund recovery penalties assessed against him pursuant to section 6672 of the Internal Revenue Code as a responsible officer of Company A. The penalties relate to unpaid employment taxes for all four quarters of Year 1 and the first and third quarters of Year 2. That corporation was placed in receivership and we understand that it has since ceased operations.

As of the date of your request, the taxpayer had failed to file his personal income tax return for Year 3. A threshold requirement for consideration of a taxpayer's offer in compromise is that all required returns have been filed. See IRM 5.8, Offer in Compromise Handbook, Section 3.3(4). The offer unit has given the taxpayer additional time to file his return before concluding that his offer is "not processable" due to the unfiled return.

During the offer investigation, the district discovered that the taxpayer formed a second corporation, Company B, in June of Year 1. That corporation is engaged in substantially the same business as was Company A. The taxpayer owns ninety-seven percent of Company B, the other three percent being held by an individual who was also part owner of Company A. Company B is not current on its Federal tax deposit and employment tax return obligations. FICA taxes for the second, third, and fourth quarters of Year 2, the fourth quarter of Year 3, and the first quarter of Year 4 remain unpaid. Returns for the third and fourth quarters of Year 4 have not been filed, and it appears that deposits from those two quarters will be insufficient to cover the anticipated liability.

The Offer in Compromise Handbook, IRM 5.8, Section 3.3(4), states that an offer in compromise is not processable if the taxpayer has not met certain compliance criteria. Individual taxpayers must have filed all required tax returns. In-business taxpayers must have demonstrated current compliance by timely filing returns and making Federal tax deposits during the preceding two quarters.

The district has asked how the processability requirements of the handbook would apply in this situation. Specifically, they ask whether the continued non-compliance of Company B would affect the processability of the taxpayer's offer, notwithstanding the fact that the corporation is a separate entity under the law.

DISCUSSION:

The Secretary's authority to compromise tax cases is contained in section 7122 of the 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 issued pursuant to that section likewise state: "The Secretary may exercise his discretion to compromise an civil or criminal liability arising under the

internal revenue laws” Treas. Reg. § 301.7122-1T(a)(1). The Secretary’s authority to compromise is, thus, discretionary.

The Secretary is empowered to set the threshold requirements for consideration of a proposed compromise. All offers to compromise must be submitted according to procedures prescribed by the Secretary. See Treas. Reg. § 301.7122-1T(c)(1). An offer is considered “pending” when the Secretary accepts an offer for processing, and the Secretary may return an offer which is deemed “nonprocessable.” See id. at (c)(2). The Service’s policy with regard to the processability of offers is contained in Chapter 3 of the Offer in Compromise Handbook, IRM 5.8. As is noted above, individuals must have filed all outstanding returns, and businesses must have successfully met their Federal tax obligations for two consecutive quarters. See IRM 5.8.3.3(4).

In this case, the taxpayer is an individual attempting to compromise his own tax obligations. Under the provisions cited above, his offer is considered processable provided: (1) he is not in bankruptcy, and (2) all tax returns have been filed. The taxpayer has not yet filed his Year 3 income tax return. Thus, his offer in compromise is not considered processable. Once the Year 3 return has been submitted, the district can consider the offer. Because the taxpayer is not an in-business taxpayer liable for employment taxes, the compliance provisions related to employment taxes do not apply. The district may not deviate from the processability criteria of the handbook without prior written approval from the National Office. IRM 5.8.3.3.1(1). Absent such approval, we would understand Collection’s current policy to deem this offer in compromise processable.¹

The district is concerned, however, that consideration of the offer while the taxpayer’s corporation fails to comply is allowing the taxpayer to circumvent the spirit of the IRM’s compliance requirements. Further, the suggestion has been made that an individual taxpayer wishing to compromise employment taxes arising from a sole proprietorship could form a corporation to continue his business. He could then have his individual offer considered even as the corporation failed to comply with the tax laws.²

¹ Lack of local flexibility in making the processability determination is evidence of the Service’s recent commitment to work with taxpayers to perfect offers. Prior to 1998, there were at least eight identified processability requirements, any one of which was grounds for returning the offer without further consideration. See Form 656, Offer in Compromise (Rev. 1-97), Instructions at 2. The Service now considers offers with missing information or other defects to be “unperfected,” and will assist taxpayers in developing an offer that can be considered on its merits. See IRM 5.8.3.1(2).

² The facts you have relayed indicate a such a close relationship between the taxpayer and the corporation that they could be considered as one. However, there

We would agree that such machinations do not seem in keeping with the spirit of the compromise program's dual objectives of resolving past delinquencies and allowing taxpayers a "fresh start" toward compliance with the tax laws. See Policy Statement P-5-100. However, we do not agree with the implicit assumption that a procedure calling for consideration of this offer lessens the degree of discretion afforded the district in making the eventual decision to accept or reject the offer.

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 reaching 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.

Once a taxpayer's offer has been accepted for processing, the Service's procedures do not establish a presumption that an offer will be accepted, nor do they assume rejection as the likely result. Rather, each proposed compromise should be evaluated and considered on its own merits. In this case the district has the discretion to decide whether to accept or reject the offer. Provided the district exercises sound judgment and discretion when exercising its authority to compromise, we do not believe processing this offer undercuts the Commissioner's overall compromise policy and objectives.

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

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could be many variations on this fact pattern. It is possible that an individual could own the vast majority of the stock in a corporation and still be found to bear no responsibility for that company's tax delinquency. Such cases illustrate the difficulty of adopting the processability criteria the district seems to be advocating.