

Office of Chief Counsel
Internal Revenue Service
memorandum

CC:PA:CBS:Br2:WFCConroy
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to: Michael P. McDermitt
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subject: CDP Consideration of Terminated Offers in Compromise

Question Presented

In conducting a collection due process (CDP) hearing, what actions should an appeals officer take if the taxpayer contends that the Service's termination of an offer in compromise (OIC) was not legally authorized because there was no default by the taxpayer or because the taxpayer did not "materially breach" the OIC under Robinette v. Commissioner, 123 T.C. 85 (2004), appeal docketed, No. 04-3600 (8th Cir. Oct. 13, 2004)?

Conclusions

1. Robinette has been appealed by the Government. While our legal position may be revisited based on the outcome of the appeal, our current legal position is that the terms and conditions of OICs must be strictly complied with. In particular, the taxpayer must strictly comply with his or her agreement under the OIC to file returns and pay taxes during the 5-year period after the offer is accepted. The Service is legally authorized to terminate the OIC and reinstate the original tax liability if there has been a default by the taxpayer. Under the strict compliance test, the only relevant inquiry is whether there has been a default. Whether the taxpayer has "materially breached" the OIC or has "substantially complied" with the OIC is irrelevant.

2. If the appeals officer determines that there was a default, the termination of the OIC was legally authorized and neither the National Office nor the Office of Appeals can "reinstate" the OIC despite the suggestion in Robinette that a terminated OIC may be reinstated.

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3. Although the appeals officer cannot reinstate a terminated OIC when there was a default by the taxpayer, the appeals officer must consider, pursuant to section 6330(c)(2)(a)(iii), any new OIC proposed by the taxpayer as a collection alternative. If the taxpayer declines to raise a collection alternative and the appeals officer determines that the collection action is otherwise appropriate, the appeals officer should include in the notice of determination a statement listing the act or acts of default that preceded the termination of the OIC by the Service. The notice of determination must set forth findings and decisions that explain how the requirements of section 6330(c)(3) were met.

4. If the appeals officer determines that there was no default by the taxpayer and the termination of the OIC was therefore not legally authorized, the purported termination by the Service had no legal effect. In such a case, the OIC does not need to be "reinstated" because the OIC never ceased to be in effect as a legal matter. The appeals officer should issue a notice of determination stating that the Service will not proceed with collection.

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Applicable Law

1. OIC Requirements

Under section 7122, the Service is authorized to compromise tax liabilities owed by a taxpayer. The Service will consider offers under section 7122 on one or more of the following grounds: doubt as to liability, doubt as to collectibility, or the promotion of effective tax administration. An offer by a taxpayer to compromise a liability under section 7122 must be submitted according to the procedures, and in the manner and form, required by the Service. Treas. Reg. § 301.7122-1(d)(1).

Acceptance by the Service of the taxpayer's compromise offer conclusively settles the liability. Neither the Service nor the taxpayer is allowed to reopen the case except where (i) false information or documents were supplied in connection with the offer; (ii) ability to pay or assets of the taxpayer were concealed; or (iii) there was a mutual mistake of material fact sufficient to cause the offer to be set aside or reformed. Treas. Reg. § 301.7122-1(e)(5).

A taxpayer must agree to the terms set forth in the OIC and the compromised amount remains a tax liability until the taxpayer meets all the terms and conditions of the OIC. See Form 656, Offer In Compromise, Item 8(k). With respect to OICs entered into

because of doubt as to collectibility or the promotion of effective tax administration, the taxpayer must agree to comply with the filing and paying obligations under the Internal Revenue Code for a 5-year period after the offer is accepted by the Service. See Form 656, Item 8(d). If a taxpayer fails to meet any of the terms of an OIC and the offer is terminated, the Service has the right to reinstate the compromised liability and pursue collection action against the taxpayer. See Form 656, Item 8(n). This is supported by court decisions.¹ When the Service determines that an OIC should be terminated, it first sends the taxpayer a default letter. Before the OIC is terminated, the taxpayer is allowed a total "grace period" of 60 days (30 days for the default letter with a 15 day grace, plus 15 more days after the default letter). I.R.M. 5.19.7.3.23(4). A taxpayer may not protest the termination of an OIC to the Office of Appeals.²

2. CDP Requirements

Section 6330(c)(1) requires that an appeals officer conducting a CDP hearing obtain verification that the requirements of any applicable law or administrative procedure have been met. Section 6330(c)(2)(A) provides that a taxpayer may raise any relevant issue at a CDP hearing relating to the unpaid tax or proposed levy, including offers of collection alternatives such as the posting of a bond, an installment agreement, or an offer in compromise.

Section 6330(c)(3) explains the basis for the determination made by the appeals officer. First, the appeals officer must verify that the requirements of applicable law and administrative procedures have been met. Second, the appeals officer must consider relevant issues raised by the taxpayer relating to the unpaid tax or the proposed collection action. Third, the appeals officer must consider whether the proposed collection action balances the need for efficient collection of taxes with the legitimate concerns of the taxpayer that the collection be no more intrusive than necessary. The notice of determination issued by the appeals officer must set forth findings and decisions that explain how these requirements were met. See Treas. Reg. § 301.6330-1(e)(3), A-E8(i). In particular, the notice of determination must respond to any offers by the taxpayer for collection alternatives. Q&A-E6 of Treas. Reg. § 301.6330-1(e)(3) describes collection alternatives that may be available to the taxpayer. They include a proposal to withhold collection action in circumstances that would facilitate the collection of the tax liability; an installment agreement; an offer-in-compromise; the posting of a bond; or the substitution of other assets.

¹See, e.g., United States v. Lane, 303 F.2d 1, 3 (5th Cir. 1962) (Service properly terminated agreement because of taxpayer's failure to provide sworn statements of annual income); United States v. Feinberg, 372 F.2d 352, 355 (3d Cir. 1965) (Service terminated OIC because taxpayer failed to make installment payments in the required amounts); Roberts v. United States, 225 F. Supp. 2d 1138, 1145 (E.D. Mo. 2001) (Service terminated OIC because taxpayer failed to comply with future compliance provision by not paying tax on time).

²I.R.M. 5.19.7.3.22(3) states that "taxpayers who default an accepted offer do not have appeal rights." In contrast, section 7122(d)(2) requires that a taxpayer be allowed to appeal any rejection of a proposed OIC to the Office of Appeals.

Analysis

Upon termination of an OIC, the taxpayer is liable for the unpaid amount of the original tax liability. The Service may file a notice of federal tax lien and provide notice and opportunity for a CDP hearing under section 6320 or may provide notice and opportunity for a CDP hearing before levy under section 6330. The taxpayer may contend in the CDP hearing that there was no default by the taxpayer or that the termination of the OIC was not legally authorized because the taxpayer did not "materially breach" the OIC under Robinette. Upon the appeals officer's issuance of an adverse notice of determination, the taxpayer may challenge the notice of determination in the Tax Court or a federal district court and argue before the court that the termination was not legally authorized.

In Robinette the Tax Court held that the appeals officer abused his discretion in determining to proceed with collection of the petitioner's tax liability because the taxpayer did not "materially breach" the OIC (the taxpayer's breach consisted of a failure to timely file one tax return during the 5-year compliance period after acceptance of the OIC). In addition, the court stated that the appeals officer "did not have an open mind regarding reinstatement" of the OIC. 123 T.C. at 112. The court also noted that the appeals officer "believed only the National Office could reinstate the offer-in-compromise. Neither the Internal Revenue Code nor the Internal Revenue Manual, however, states that he could not reinstate the offer-in-compromise." Id. The Tax Court's opinion thus raises the issue of whether an appeals officer or the National Office is legally entitled to "reinstate" a terminated OIC.

We disagree with the conclusions reached by the Tax Court in Robinette and the Government has appealed the case. The Service was well within its rights in terminating the OIC because, among other reasons, a material breach of an OIC is not required for the termination of an OIC. We believe that the terms and conditions of an OIC must be strictly complied with. In Robinette, the taxpayer failed to timely file the 1999 income tax return, and this failure provided the Service with legal authorization to terminate the OIC in view of the taxpayer's agreement to comply with all the filing and payment provisions of the Code during the 5-year compliance period. Also, we disagree with the Tax Court's suggestion that a legally terminated OIC may be reinstated. Neither the Office of Appeals nor the National Office may reinstate a terminated OIC as explained below.

1. Cases in which the Service Terminated the OIC after Default

The termination of an OIC by the Service after a taxpayer's default ends the compromise under the agreement and authorizes the Service to collect the entire unpaid amount of the original liability.³ There is no legal basis on which to reinstate a

³See Item 8(n) of Form 656, which provides that if the offer defaults, the Service may: (1) immediately file suit to collect the unpaid balance of the offer; (2) immediately file suit to collect an amount equal to the original tax liability as liquidated damages (minus payments already received), (3) disregard the amount

legally terminated OIC. In order to enter into an OIC, there must be doubt as to either liability or collectibility or the OIC must promote effective tax administration. Although one of these grounds must have originally existed in order for the Service to agree to the OIC, the Service can no longer continue to rely on these grounds once the OIC has been legally terminated. A new OIC would have to be entered into in order to provide the Service with a legal basis for compromising the liability.

An additional reason why reinstatement of a legally terminated OIC is not permitted is that reinstatement of the OIC would constitute a compromise of the taxpayer's liability and a forbearance from collection action simply because the taxpayer has come back into compliance with his or her tax filing and payment obligations or has agreed to come back into compliance. Such compliance is, however, required of all taxpayers by the Internal Revenue Code. Thus, reinstating a legally terminated OIC would be akin to a unilateral abatement of the liability by the Service. Such a unilateral abatement would be contrary to the principle that an OIC requires mutual obligations on the part of the taxpayer and the Service.⁴

If a taxpayer contends in a CDP hearing either that there was no default by the taxpayer or that there was a default but the termination was nonetheless not legally authorized because the taxpayer's breach was not "material" under Robinette, the appeals officer should determine whether there was a default by the taxpayer. If there was a default, the Service was legally authorized to terminate the OIC. Because taxpayers do not have a right to administratively appeal the termination of an OIC, we recommend that

of the offer and apply all amounts already paid under the offer to the original tax liability; or (4) file suit or levy to collect the original amount of the tax liability.

⁴Section 6404 provides legal authority for unilateral abatements. In particular, section 6404 provides that an abatement is authorized when a liability is erroneously or illegally assessed, assessed after the period of limitations, or assessed in an excessive amount. Once an OIC has been entered into and there has been a default by the taxpayer, a section 6404 abatement is not permitted in our view. This is true even if an abatement would otherwise have been permitted had the taxpayer not entered into the OIC. Our conclusion is based on the rule that an OIC "conclusively settles the liability" except in the very narrow circumstances specified in Treas. Reg. § 301.7122-1(e)(5) (these circumstances differ from those in which a section 6404 abatement is authorized). U.S. v. Feinberg, 372 F.2d 352, 359-365 (1967) (decision on rehearing en banc) supports our conclusion that a section 6404 abatement is not authorized after a default and termination of the OIC. In Feinberg the court held that the government could sue to collect the full amount of the original tax liability upon a default in installment payments even though the tax had been assessed after the expiration of the 3-year period of limitations (see section 6501(a)) and the taxpayer's waiver of the assessment period was executed after the 3-year period, contrary to section 6501(c)(4). The fact that the tax was assessed after the expiration of the 3-year period would ordinarily provide a basis for an abatement under section 6404(a)(2). The court, without discussing section 6404, stated that section 7122 "has no relationship to, or dependency upon" section 6501 and concluded, "If a taxpayer employing the statute of limitations defense could defeat a suit for the full amount of the precommitment liability when there is a default in the installments, the taxpayer's obligations would be hollow ones, and mutuality would be absent from the contractual relationship." Id. at 360-61. See also Waller v. U.S., 767 F. Supp. 1042, 1044-45 (E.D. Cal. 1991) (although the liability was assessed after the expiration of the 3-year assessment period, there was no legal basis to set aside the OIC under the regulations and the taxpayer could not recover the amounts paid under the OIC).



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Even though an appeals officer in a CDP hearing cannot reinstate a terminated OIC, the appeals officer must consider any new OIC or other collection alternative proposed by the taxpayer. Section 6330(c)(2)(A) allows a taxpayer to raise "any relevant issue" at a CDP hearing and specifically permits a taxpayer to propose an OIC as a collection alternative. Further, under section 6330(c)(3) the appeals officer must consider whether the proposed collection action balances the need for efficient collection of taxes with the legitimate concerns of the taxpayer that the collection be no more intrusive than necessary. Thus, the appeals officer must give careful attention to any new OIC proposed by the taxpayer and must exercise sound judgment and discretion in determining whether to accept the proposed OIC. Although the Service's general policy is to accept offers which reasonably reflect the collection potential in a given case, 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, realizing the reasonable collection potential in specific cases is not the only objective to be achieved by the offer in compromise program. The appeals officer should also take into account the fact that "[a]cceptance 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.

2. Cases in which the Service Terminated the OIC but there was no Default

From time to time, the Service may terminate an OIC because the taxpayer appeared to be in default based on the information available to the Service at the time, even though no default had actually occurred. If there has not been a default by the taxpayer, the Service does not have the legal right to take collection action under Item 8(n) of the OIC. In such a situation the purported "termination" of the OIC was not permitted under the law and has no legal effect. Also, absent an actual default by the taxpayer under the OIC, section 7122 prevents collection of the original liability, since under Treas. Reg. § 301.7122-1(e) the acceptance of an OIC conclusively settles the liability and neither the taxpayer nor the Service is permitted to reopen the case absent one of the grounds provided in that regulation.

There may be a variety of reasons, including clerical error, why an OIC is terminated without an actual default by the taxpayer. For instance, the Service may terminate the OIC on the ground that the taxpayer failed to satisfy the future compliance provision in the OIC by incurring a tax liability during the 5-year compliance period, but the taxpayer



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may later establish that no such liability exists. Also, the Service may terminate the OIC on the ground that the taxpayer failed to timely file a tax return during the compliance period, but the taxpayer may subsequently provide a certified mail receipt verifying that the return was timely filed. Under these and similar circumstances, although the Service may have acted reasonably based on the information available to it at the time of termination, the Service was not legally authorized to terminate the OIC and the purported termination had no legal effect.

If the Service terminates an OIC without an actual default by the taxpayer, the OIC does not need to be "reinstated" because the OIC never ceased to be in effect as a legal matter. Therefore, an appeals officer who determines in the course of a CDP hearing that the Service terminated an OIC without an actual default should issue a notice of determination stating that the Service will not proceed with collection.

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If you have any questions regarding this memorandum, please contact William Conroy at (202) 622-3620.

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