



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

OFFICE OF  
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MEMORANDUM FOR DISTRICT COUNSEL, ROCKY MOUNTAIN DISTRICT

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

SUBJECT: Choice of Law in Offers in Compromise

This memorandum responds to your request for advice dated April 24, 2000. This document may not be cited as precedent.

ISSUE:

When the Service compromises with one party to a joint and several tax liability, which state's law governs for purposes of determining the effect of such compromise on the liability of the other joint obligor.

CONCLUSION:

The effect of a compromise on the obligations of other parties who are jointly and severally liable for the taxes compromised is governed by the law of the state of residence of the compromising taxpayer.

BACKGROUND:

The Internal Revenue Code permits married individuals to elect to file a joint return for income taxes. See I.R.C. § 6013(a). If a married couple elects to do so, liability for the tax liabilities of the year covered by the return is joint and several. See I.R.C. § 6013(d)(3). As a joint as several debt, the Service may collect the entire debt from either spouse, or may choose to reach a compromise with one spouse or the other. You have asked what law governs for purposes of determining how compromise with one spouse will affect the liability of the non-compromising spouse.

The Internal Revenue Manual instructs offer specialists to take the steps necessary, where appropriate, to preserve the Government's right to collect from other individuals liable for the tax liability that is the subject of the compromise agreement. See IRM 5.8.6.2(1). To determine what effect compromise with one spouse will have on the liability of the other spouse, the manual relies on the law of the state in which the offer proponent resides. See IRM 5.8.6.2(2). Based upon the rule followed in the particular jurisdiction, the manual provides collateral agreements which are to be secured as

additional consideration for the compromise. In states which follow the common law rule which releases co-obligors from liability upon compromise with one liable party, Pattern Letter P-229 is to be secured. See IRM Exhibit 5.8.6-1. In states where the express reservation of the right to proceed against the taxpayer who is not a party to the compromise will protect the Government, Pattern Letter P-230 is to be secured. See IRM Exhibit 5.8.6-2. In states where neither collateral agreement will effectively preserve the Government's ability to collect from the non-compromising party, the collection potential of both spouses must be considered in determining the adequacy of a particular offer. See IRM 5.8.6.2(2).

Your memorandum of April 24th raises the possibility that some law other than that of the offer proponent's state of residence may govern for purposes of determining the effect of a compromise on the liability of a taxpayer who is jointly and severally liable for the same taxes. For instance, you cite the rule that the place of contract formation, regardless of the residency of the parties, may govern for this purpose. Under this rule, the contract is formed where the last act is done which is necessary to form the contract and bind the parties. Alternatively, you cite the rule that the law of the place of performance governs. In a contract for the payment of money, this rule would hold that the place of payment is considered the place of performance.

#### LAW & ANALYSIS:

Agreements to compromise federal tax liabilities have generally been interpreted by the courts 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). When it becomes necessary for courts to settle a dispute between the Service and a taxpayer regarding the interpretation or effect of a compromise, those courts have often relied upon state law contract principles for the rule of decision. See, e.g., United States v. Ross, 176 F. Supp. 932 (D. Neb. 1959). Generally, courts have applied the law of the state where the taxpayer resides. Id. It does not appear that this assumption as to which law applies has been subject to any serious challenge when it has been necessary for such disputes to be submitted to the courts.

Your memorandum questions this assumption, particularly in light of the fact that the compromise process will now frequently involve acts in several different states. As your memorandum points out, an offer may now be submitted in one state, accepted in another, and provide that payments must be sent to a third. Both of the rules you have cited—place of formation and place of performance—would likely have yielded the same result when the Service's functions were more localized. Now, however, application of either of those rules may yield a different result than the "place of residence" rule which the Internal Revenue Manual assumes will govern.

Both of the rules you have cited have ample support in both commentaries and case law. See 16 Am.Jur.2d Conflicts of Laws §§ 94 & 104 and cases cited therein. However, the uncertainties you have pointed out when contracts involve formation or performance across state lines have led most courts to favor the "significant

relationship” rule. See Restatement (Second) Conflict of Laws § 188; 16 Am.Jur.2d Conflicts of Laws § 86. Under this rule, the law of the forum which has the most significant contacts with the subject matter of the contract is held to govern. Id. Facts such as where the contract was formed or where performance is required are but two of the relevant considerations, and may be resorted to if the significant relationship rule does not yield a definitive answer. See NL Industries, Inc. v. Commercial Union Ins. Co., 65 F.3d 314 (3d Cir. 1995) (law of place of making controls unless another state had dominant relationship with parties and issues); 16 Am.Jur.2d Conflicts of Laws § 104 (contract to repay money lent governed by place of payment unless another state has more significant relationship to contract).

In the case of compromise of federal tax liabilities, the Service’s assumption that the law of the taxpayer-proponent’s state of residence will govern is reasonable in light of this rule. The Service generally will accept an offer to compromise when the amount offered reasonably reflects what could be collected by other means. See Policy Statement P-5-100. To determine what could be collected through other means, the Service must first rely on state law to determine the nature of a taxpayer’s interest in property. See Aquilino v. United States, 363 U.S. 509, 513 (1960). Having done so, the Service can then determine whether that interest is subject to the federal tax lien, and, thus, subject to levy by the Service. See I.R.C. §§ 6321, 6331.

State law plays a particularly important role in many of the states of your district, as a determination of what could be collected and applied to the tax debt will often require consideration of state community property laws. We believe that these factors, together with the fact of the taxpayer’s domicile, weigh heavily in favor of the rule the Service has assumed will govern in the event it is necessary to later determine how compromise has effected the status of other parties liable for the taxes at issue.

#### CONCLUSION:

We conclude that, for purposes of determining the effect of compromise on the liabilities of other parties who are jointly and severally liable for the taxes at issue, the law of the state with the most significant relationship to the contract will govern. We agree with the offer in compromise handbook’s conclusion that this will generally be the state of residence of the proponent of the offer.

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

cc. Assistant Regional Counsel (GL), Western Region