



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

OFFICE OF
CHIEF COUNSEL

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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?

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 the amount so accepted shall be withdrawn" from the deposit account and deposited into the Treasury as collections.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.

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