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

OFFICE OF
CHIEF COUNSEL

CC:NTA
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September 3, 1999

MEMORANDUM FOR W. VAL OVESON
NATIONAL TAXPAYER ADVOCATE
Attn: Senate Finance Committee Project Team

FROM: Arlene A. Blume
Office of Counsel to the National Taxpayer Advocate

SUBJECT: Correspondence from [redacted]

This memorandum responds to your request for legal assistance in responding to a Senate Finance Committee inquiry concerning [redacted] In a letter dated May 5, 1999 to the National Taxpayer Advocate, [redacted] identifies two ongoing problems he is having with the Internal Revenue Service. On April 30, 1999, Bill Nixon of the Senate Finance Committee staff requested priority handling of [redacted] case based on representations made to him by [redacted] In response to your request for legal advice, we sought assistance from the Associate Chief Counsel (EBEO) and from District Counsel, North Central District, in St. Paul, Minnesota. This memorandum incorporates the assistance they provided.

FACTS:

[redacted] a [redacted] businessman in his [redacted], has sought Congressional assistance in resolving two separate tax issues with the Service. First, he claims that the Service erroneously charged him with income on the premature distribution of funds from his company's profit sharing plan because his bank erred in using annuity contracts belonging to the profit sharing plan to secure a personal loan to himself and the Resolution Trust Corporation (RTC), which took over the bank, then wrongfully used the annuity contracts to collect the defaulted loan payments. Second, he claims that the Service should be prohibited from collecting interest on a reported, but unpaid tax liability, because he understood an agreement explaining a tax deficiency for the same period as also covering the initial reported (and assessed) liability. Service agents who have dealt with [redacted] report that they have each tried to aid [redacted] to the extent possible within the law (by

abating penalties and making adjustments), but that [redacted] takes more aggressive as positions as he deals with them and will create new scenarios to justify his position as new contradictory facts are learned by the agents.

1. ISSUE 1: The [redacted] or [redacted] distribution from the [redacted]

In [redacted], [redacted] the [redacted] percent owner of [redacted], negotiated a personal loan of approximately $[redacted] with [redacted]. We understand that [redacted] required that the loan be secured by life insurance policies, and that [redacted] intended to secure the loan with insurance policies that he already owned. [redacted] agent was then supposed to take the agreements to [redacted] to obtain [redacted] personal life insurance policies to secure the loan. An affidavit, dated November 9, 1998, from [redacted], supports these facts.

We understand that [redacted] had done considerable business with [redacted] over prior years, and that [redacted] financial statements at the time the loan was made reflect that his net worth substantially exceeded the amount of his loan. The financial statements included among [redacted] records shows that he owned [redacted] life insurance policies when the loan was made; their aggregate value was less than $[redacted]

On [redacted], [redacted] obtained [redacted] annuity policies with an aggregate cash value of $[redacted] that were held in the name of the [redacted] and used the information regarding such policies to complete the terms of the [redacted]. [redacted] Secretary/Treasurer and [redacted] witnessed the [redacted] which identified the [redacted] policies as collateral for [redacted] personal loan from [redacted], [redacted] apparently forwarded the [redacted] to [redacted], the issuer of the [redacted] annuity policies, on [redacted].

At some time after [redacted] apparently requested a corporate authorization from him relating to the assignment of the [redacted] policies. He signed the form, but claims that he also called [redacted] to clarify that his personal life insurance policies, not the [redacted] policies, were supposed to have been used as collateral on the personal loan. [redacted] claims that he requested the return of the policies and related documents. The policies were not returned, but [redacted] claims that [redacted] assured him not to worry because the assignment was ineffective absent written corporate approval.

He also claims that [redacted] indicated that they would treat the loan as unsecured. The [redacted] affidavit from [redacted] verifies that a corporate authorization was later requested but not provided, that [redacted] does not remember what happened after that request, but that [redacted] likely would have considered the loan as unsecured based on the strong personal financial statement and good past payment history that [redacted] then had with [redacted] apparently took no further action to obtain the return of the [redacted] policies from [redacted], because [redacted] continued to hold the policies. Under the Loan Agreement, the loan was due to be repaid on [redacted] failed to repay the loan on that date.

In [redacted] the Resolution Trust Corporation (RTC) took over [redacted] claims that he tried to obtain the annuity policies from the RTC, but that the RTC told him that the [redacted] policies had never been assigned to [redacted]. By letter dated [redacted], the RTC notified [redacted] that his loan was [redacted] months past due and demanded immediate repayment. Another letter, dated [redacted] presumably from the RTC to [redacted] notified [redacted] of RTC's intention to make a withdrawal from the [redacted] annuity policies. However, the authenticity of that letter is in issue since it is not on RTC letterhead and it is unsigned. [redacted] claims that he never received the [redacted] letter and that it was falsely created after the fact to satisfy a 20-day notice requirement imposed on the RTC by [redacted]. On [redacted], [redacted] issued a check to the RTC in the amount of $[redacted] in payment of the loan. [redacted] claims that he first discovered that the RTC had made the withdrawal from the policies in [redacted] when he contacted the RTC to obtain a payoff balance on his personal loan. In [redacted], [redacted] issued a Form 1099-R to [redacted] for the amount distributed from the policies in [redacted].

The Internal Revenue Service initiated an audit based upon [redacted] failure to report the income from the Form 1099-R. On September 15, 1994, the Service issued a 30-day letter to [redacted] for additional income taxes due for tax years [redacted] and [redacted]. On October 14, 1994, [redacted] responded to the 30-day letter by generally indicating that he protested the asserted taxes and wanted to take the issue to Appeals. By letter dated October 27, 1994, [redacted] requested additional time to prepare to have his case heard by Appeals. Although we understand that the Service granted [redacted] request for additional time, he failed to submit the additional materials required to take the case before Appeals. [redacted] failed to attend scheduled meetings with the agents that were working on his case; repeated attempts by the Service over the next six months to contact him were unsuccessful. On April 26, 1995, the Service issued a second 30-day letter to [redacted] for the additional income taxes due for tax years [redacted] and 1991. The explanation of items attached to the 30-day letter states that the cash surrender value of the [redacted] policies assigned to [redacted] on

[redacted] was includable in [redacted] income in [redacted] as a deemed distribution, and that the difference between the amount of the [redacted] deemed distribution and the amount actually distributed by [redacted] in [redacted] was included in [redacted] income in [redacted]. On August 21, 1995, the Service issued a statutory notice of deficiency for tax years [redacted] and [redacted] relating to the additional income taxes. [redacted] failed to respond to the notice of deficiency and did not petition the Tax Court to contest the Service's asserted tax liabilities for [redacted] and [redacted]. Sometime in [redacted], [redacted] contacted Congressman Bryan Dorgan and, subsequently, Senator William Roth. On April 30, 1999, William Nixon of Senator Roth's staff contacted the National Taxpayer Advocate on [redacted] behalf. [redacted] and [redacted] his legal representative, argue that the assignment of the policies was illegal and invalid because it was done without his knowledge or consent, and that the Service's assessment should be abated.

Counsel for the North Central District has advised the Service to reject [redacted] request that the taxes be abated, so [redacted] could correct the transaction without penalty by repaying the FDIC, who in turn would repay [redacted], which would restore the [redacted] annuities. We understand that [redacted] directly contacted the FDIC regarding restoration of the [redacted] annuities with [redacted] sometime in [redacted]. By letter dated [redacted], the FDIC advised [redacted] that it would participate in such a transaction only if the Service approved of the proposed transaction and would represent in writing that it would not pursue [redacted], the RTC or the FDIC for any action taken by any of these entities from [redacted] to the present.

ISSUE 2: [redacted] tax liability for [redacted]

[redacted] was incorporated in [redacted] and was engaged in the business of owning and leasing property during [redacted] [redacted] owned [redacted] percent of the common stock. [redacted] operated on a fiscal year ending December 31.

Pursuant to a timely filed extension, [redacted] filed it's [redacted] corporate federal income tax return, Form 1120, on [redacted] [redacted] reported a total tax due of $[redacted] consisting of $[redacted] in tax and an estimated tax penalty of $[redacted]. No remittance was submitted with the return. The Form 1120 was signed by [redacted] Secretary-Treasurer for the corporation, and reflects that it was prepared by a paid tax professional.

The tax and penalties reported on [redacted] Form 1120 are the subject of collection actions, and are subject to statutory interest under Code section 6601. The final

notice for payment issued by the Automated Collection Unit was issued February 3, 1997.

Prior to the Service's initiation of enforced collection action, [redacted] submitted an amended [redacted] corporate federal tax return, Form 1120X. In a claim filed on [redacted] asserted that its corrected tax liability should be $[redacted] less than originally reported. [redacted] submitted a payment of $[redacted] with the Form 1120X (that amount equaling the difference between the tax per the Form 1120 (exclusive of failure to pay penalties) of $[redacted] and the claim amount). [redacted] executed the Form 1120X as President of [redacted]

Exam initiated an audit, ultimately assigned to Revenue Agent [redacted] to consider the claim and the tax return as originally filed. [redacted] issued her report of income tax examination changes to [redacted] on August 14, 1998. She determined: (a) that the changes to income and tax reported on [redacted] Form 1120X were not being allowed and (b) that additional adjustments to the original Form 1120 resulted in a proposed deficiency of $[redacted]. The report contains a computation showing the corrected tax liability of $[redacted], consisting of the $[redacted] reported on the original return and a deficiency of $[redacted] [redacted] also included a computation of interest on the deficiency amount only, to September 13, 1998, of $[redacted]

[redacted] met with [redacted] on August 14, 1998, to discuss the report and explain his appeal rights (including providing a copy of Publication 5). They also had two subsequent conversations concerning the report. [redacted] called [redacted] on August 25, 1998, and the two held a face-to face meeting on August 27, 1998.

[redacted] executed two agreements and submitted a $[redacted] payment at the August 27 meeting. According to [redacted], [redacted] expressed his agreement with the report of income tax changes. Accordingly, [redacted] executed the Consent to Assessment and Collection, Form 4549, for the deficiency of $[redacted], and a Waiver of Statutory Notification of Claim Disallowance, Form 2297, in connection with the Form 1120X. These documents had been included with the items contained in the August 14 report. [redacted] signed both documents as President of [redacted] [redacted] also asked [redacted] to provide him with a final payoff figure. According to [redacted] she understood this request to mean the unpaid portion of the tax per the original Form 1120 as well as the tax deficiency and interest on the deficiency as reflected in her audit report. This amount came to $[redacted] ($[redacted] plus $[redacted] plus $[redacted]. [redacted] did not include interest or penalties accrued on the initial tax liability reported by YFI. She summarizes what followed:

I provided [redacted] with a printout of the calculation of the interest on the additional tax. He asked me to sign it and I did so. He also asked me to make a notation on his check register slip regarding the payment. I made a statement that the check was "payment in full for [redacted] taxes, interest (no penalty)". This statement was made because we had discussed interest and penalties on the additional tax. I made the statement because he had full paid the additional tax and interest on that tax. We had no discussion regarding if there was any interest or penalties on the amount of the claim disallowed. He asked me if I could provide a letter stating he had full paid. After he left I wrote him a letter [dated August 27, 1998] stating that he agreed to the claim disallowance and additional tax. Also that he had "fully paid the amount of the claim disallowed of $[redacted]" and "fully paid the deficiency of $[redacted] and interest of $[redacted]". I made no mention of any interest or penalties on the claim disallowed.

[redacted] has further stated that she did not discuss the ongoing "taxpayer delinquent account" investigation of [redacted] with [redacted]

[redacted] submitted a payment on August 27, 1998, for the amount of $[redacted] Because [redacted] August payment did not provide for the satisfaction of the assessed interest and failure to pay estimated tax penalties on [redacted] original Form 1120, the Service has pursued collection of those amounts.

In a letter dated February 5, 1999, [redacted] representative, attorney [redacted] asserted that the August 27 payment constituted in full payment of **all** [redacted] tax liabilities. According to [redacted] applying general contract principles of accord and satisfaction, [redacted] arrangement constituted a binding settlement between [redacted] and the Service. [redacted] suggests that [redacted] will file a wrongful levy action and seek damages should the Service continue in an effort to collect the unpaid balance.

ISSUES:

1) Whether the Service currently has the authority to retroactively reverse the tax effects of [redacted] pledge of assets of a corporate profit sharing plan to secure a personal loan in [redacted] and the RTC's use of that security in [redacted] to pay the loan on which [redacted] defaulted.

2) Whether a statement signed by a revenue agent in [redacted] with respect to the income tax liability of [redacted] concerning the payment of such liability prohibits the collection of statutory interest and penalties on the liability.

We have also considered a third issue:

3) Whether the Service should solicit an offer in compromise from [redacted] based upon doubt as to liability, doubt as to collectibility, or promoting effective tax administration in resolution of the foregoing issues.

CONCLUSIONS:

1) The facts concerning [redacted] use of annuity contracts owned by the profit sharing plan to secure a personal loan in [redacted] and the RTC's subsequent use of those contracts to complete the payment of the loan on which [redacted] had defaulted in [redacted] do not support Mr. Armstrong's claim that the transactions should be "undone" for tax purposes. Further, even if the actions were to be undone in [redacted] the [redacted] transaction would not alter the previously determined tax liabilities for [redacted] and [redacted]

2) While there is some doubt about the equity of assessing and collecting statutory interest and penalties on [redacted] reported income tax liability for [redacted], the agent who provided a statement to [redacted] saying that [redacted] income tax was being fully paid for the [redacted] tax year did not have the authority to waive the payment of statutory interest and penalties in a closing agreement or an offer in compromise. District Counsel has advised the Service to disregard a Consent to Assessment and Collection (Form 4549) and a Waiver of Statutory Notification of Claim Disallowance (Form 2297) that [redacted] signed on August 27,1998, and to contact [redacted] concerning the disposition of the payment [redacted] made in apparent reliance on the agent's statement.

3) Based upon advice from counsel, there is no significant doubt as to [redacted] liability for the [redacted] and [redacted] personal income taxes or for [redacted] liability for corporate income tax for [redacted]. Likewise, [redacted] appears to have significant assets. [redacted] has previously declined requests that he submit an offer in compromise based upon collectibility because he is unwilling to fully disclose the assets he owns under penalty of perjury. Finally, any consideration of [redacted] ability to qualify for the new "tax administration" offer in compromise should take into account his history of transactions with the Service.

LEGAL ANALYSIS:

ISSUE 1: The [redacted] distribution from the [redacted]

1) The assignment of assets of a pension plan gives rise to a deemed distribution that is taxable when the assignment is made.

In general, benefits under a qualified plan are rarely assigned because, except under limited exceptions, the assignment would violate the anti-alienation rule of I.R.C. § 401(a)(13). However, if benefits are assigned, a plan's administrator would generally facilitate the assignment at the request of a participant or beneficiary in accordance with the plan's terms. In a case such as this one in which the corporation is closely held and the participant is the corporate president and the plan trustee, it often becomes difficult to determine whether the formalities of plan administration have been observed.

Nonetheless, under I.R.C. §72(p)(1)(B), if qualified plan assets are assigned or the participant agrees to assign them, the assignment or agreement to assign is treated as a plan loan in the year in which it occurs. Under I.R.C. §72(p)(1)(A), a plan loan generally is treated as a deemed distribution from the plan.[1] A distribution or deemed distribution is includable in income in the year received under I.R.C. §402(a). Therefore, the assignment of (or the agreement to assign) the annuity contracts in [redacted] with [redacted] personal participation and knowledge would constitute a deemed distribution under I.R.C. §72(p)(1)(B), the amount of which ([redacted]) would be includable in [redacted] income for [redacted] under I.R.C. §402(a). In addition, in accordance with I.R.C. §§402(a) and 72, the amount includable in [redacted] gross income would be the amount distributed by [redacted], reduced by [redacted] "investment in the contract" (i.e., basis) in the plan's policies (including any basis received for amounts previously included in income as a "deemed distribution" in [redacted]). Alternatively, if [redacted] did not assign or agree to assign the policies in [redacted], the [redacted] distribution from the policies ([redacted]) would constitute an actual distribution of plan assets which would be includable in [redacted] income for [redacted] under I.R.C. §402(a) in accordance with I.R.C. §72. The amount which would be includable in [redacted] income, as described above, would

[1] I.R.C. §72(p)(2) provides an exception for plan loans that satisfy certain requirements. However, the requirements of I.R.C. §72(p)(2) do not apply to an assignment which is treated as a plan loan.

be reduced by any basis [redacted] had in the plan's policies in [redacted][2]

2) Although an assignment made without the knowledge of the plan participant is not taxable, the known facts indicate that [redacted] either assigned the annuity contracts or tacitly agreed to their assignment.

As stated above, under I.R.C. §72(p)(1)(B), an assignment of (or agreement to assign) plan assets by a participant or beneficiary is treated as a plan loan which is generally treated as a deemed distribution of plan assets. If, in fact, the annuity contracts were assigned without [redacted] participation or knowledge, the assignment, if any, was not an assignment or an agreement to assign under I.R.C. §72(p)(1)(B). However, in this case, whether [redacted] participated in the assignment or whether he agreed to the assignment of the [redacted] annuities, as a participant or trustee, is primarily a question of fact and witness credibility.

Whether the alleged assignment in this case was an innocent mistake, or whether [redacted] consented thereto, or had sufficient knowledge thereof such that he can be said to have pledged or assigned, or to have agreed to pledge or assign the [redacted] policies within the meaning of I.R.C. §72(p)(2)(B) is a difficult determination. However, based on the above-described facts, we believe that the evidence strongly supports a conclusion that [redacted] either assigned or, at least tacitly, agreed to assign the policies as collateral for his personal loan in [redacted]. Despite the claim that the assignment at issue was unauthorized, [redacted], in his capacity as the trustee of the [redacted] related trust, would have had the authority to assign the [redacted] policies. Also, even if the policies can not be said to have been assigned as a matter of law, [redacted], as a participant, can be said to have agreed to assign the policies, even without appropriate [redacted] authorization. In addition, despite [redacted] sworn statement that he realized after the loan that a corporate authorization was necessary, [redacted] took no action to retrieve the [redacted] that was previously sent to [redacted], the issuer of the policies. More importantly, [redacted] took no verifiable steps that a reasonable person would take to insure the return of the policies to him.

[redacted] self-serving assertions that the assignment was unauthorized and therefore should not constitute an "assignment" or "agreement to assign" for purposes of I.R.C. §72(p)(1)(B) are not particularly credible or persuasive under the circumstances. We note the following facts in support of this conclusion:

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[2] We do not know whether [redacted] made any participant contributions to the plan that might be included treated as basis.

[redacted] executed the documents that were then used to obtain the [redacted] policies; [redacted] personal life insurance policies at the time the loan was taken were clearly inadequate to secure the approximately $[redacted] personal loan; officers of [redacted] assisted in making the assignment; and, as stated above, [redacted] failed to retrieve the policies from [redacted] after he supposedly discovered the erroneous assignment. In addition, [redacted] statements that he had other resources with which to repay his personal loan is inconsistent with the reality that he defaulted on the loan on [redacted], and that, as of [redacted] (i.e., the date on which the RTC received the policies proceeds to repay the defaulted loan), [redacted] had failed to repay the loan to the RTC. Moreover, since that time, [redacted] consistently failed to utilize the administrative procedures available to him through Appeals, and failed to timely petition the Tax Court. The fact that, in [redacted], [redacted] may not have realized that his actions would have adverse tax consequences or that proceeds from the policies would ever actually be distributed is irrelevant to a determination under I.R.C. §72(p)(1)(B). Accordingly, we believe that the Service's assertion of the 1989 income tax deficiency in this case is adequately supported by I.R.C. §72(p)(1)(B). The distribution of $[redacted] to the RTC in [redacted] gave [redacted] additional taxable income of $[redacted] in that year.

A. The tax liability for [redacted] and [redacted] based upon the assignment and distribution would not change even if the Service were to approve the proposal to "undo" the [redacted] transaction in [redacted]

If the Service were to agree that the apparent assignment of the annuity contracts in [redacted] did not give rise to taxable income in [redacted], the distribution of assets under the contracts in [redacted] to RTC would have given rise to $[redacted] of income in that year. Under I.R.C. § 402(a), amounts distributed from a qualified plan are includable in income in the year distributed in accordance with I.R.C. § 72 (except to the extent such amount represents a return of "investment in the contract (i.e., basis)). Accordingly, if the [redacted] policies were not assigned in [redacted] we believe that it would also be appropriate for the Service to assert an alternative position that the annuity proceeds distributed to the RTC in satisfaction of [redacted] outstanding loan in [redacted] ([redacted]) were includable in their entirety at the time they were distributed in [redacted]. Although [redacted] claims that total abatement is appropriate, I.R.C. §402(a) requires that the distribution be includable in gross income no later than [redacted]

[redacted] proposal that the Service condone the FDIC's agreement to "undo" the [redacted] distribution and return the distributed funds to the annuity accounts does not alter the facts that a taxable distribution was made no later than in [redacted]. Under the proposal, the funds that were removed in [redacted] would be replaced in [redacted], or later. The Service has no legal authority to ignore the [redacted] distribution

and pretend that it did not happen. First, the proposal ignores the economic effect of the distribution over time, including the time value of money, inasmuch as the FDIC would be compensating the annuity accounts in [redacted] or later, with [redacted] dollars and [redacted] would likewise be reimbursing the FDIC with money that he has held (and presumably invested) for at least [redacted] years. The proposal to retroactively undo the transactions would result in the transfer of the income on $[redacted] from the annuity accounts to [redacted] for [redacted] years, thereby enriching [redacted] at the expense of the annuity accounts.

Second, "undoing" the [redacted] distribution by letting [redacted] put the amount of the original distribution back into the annuity accounts now would not affect the tax liability on the distribution in [redacted], or earlier, when it was made. Income taxes are determined on an annual basis, and transactions that are completed in one year are taxed in that year regardless of whether corrective actions reversing such transactions are taken in a later year. See Burnet v. Sanford & Brooks Co., 282 U.S. 359, 51 S.Ct. 150, 75 L.Ed. 383 (1931); Estate of Levy v. Commissioner, 17 T.C. 728, 731 (1951). To allow any other accounting with respect to reporting a transaction, would, in effect, keep the transaction open indefinitely. The distribution in [redacted] remains subject to tax, and the tax effect, if any, of replacing the funds in [redacted], or later, would be determined under the law in effect for that year. Without the desired tax benefit in [redacted], [redacted] could accomplish the same tax and economic results he seeks in undoing the [redacted] transaction by contributing the amount he now seeks to repay directly to the profit sharing annuity accounts rather than through the FDIC.

B. The Service lacks authority to abate the properly assessed taxes.

Under I.R.C. §6404, the Service can abate excessive, barred, or erroneous or illegal assessments. As discussed above, we do not believe that the assessment in this case was excessive or erroneous, and [redacted] does not allege (nor do we have any basis to conclude) that the assessment was barred or illegal. The Service gave [redacted] ample opportunity to administratively and judicially contest the liability before the assessment was made. Accordingly, we do not believe that there is any basis to support the abatement of the taxes at issue.

C. [redacted] can still contest the tax liability (to the extent it remains unpaid) by paying the tax and filing a claim for refund.

As stated above, we understand that [redacted] failed to use timely the administrative procedures available to him with Appeals when the Service previously issued its 30-day letters to him in September 15, 1994, and April 26,1995. Thereafter, [redacted] defaulted on the statutory notice of deficiency issued on August 21,1995, and failed to timely petition the Tax Court. Accordingly,

he forfeited his opportunity to have these matters considered by Appeals or by a Court prior to paying the tax. Nonetheless, the Service has effectively provided a administrative reconsideration in response to this request.

[redacted] further options for relief at this time are limited to: (1) paying the assessed tax deficiency, submitting a request for refund with the Service, and (once that claim is denied or unanswered for six months) filing a suit for refund of tax in the appropriate district court under Code section 7422; or (2) requesting administrative relief by submitting an offer in compromise.

ISSUE 2: [redacted] tax liability for [redacted]

I.R.C. §§ 7121 and 7122 provide for the agreement or compromise of liabilities in tax cases. Section 7121 allows the Service to enter into a final and binding agreement in writing with any person relating to the liability of such person with respect to any internal revenue tax for any period. Likewise, section 7122 grants to the Secretary the authority to enter into agreements to compromise tax liabilities arising under the Internal Revenue Code.

Because it can finally and conclusively resolve a tax liability, a closing agreement pursuant to section 7121 must be prepared in writing on a form approved by the Service, must be executed by an official with the delegated authority to act for the Service, and must specifically state the terms of the agreement. Treas. Reg. § 301.7121-1; Del. Order No. 97 (Rev. 31), 1992-2 C.B. 357. Generally, the United States is not bound by a statement made by an agent or by a notation on a check submitted by the taxpayer if the statement or notation does not meet these formal requirements. See Dorl v. Commissioner, 507 F.2d 406 (2d Cir. 1974)(letter from revenue officer that account would be "paid if full" if the deficiency was paid does not preclude further assessments); Estate of Rackett v. Commissioner, T.C. Memo. 1976-117, 35 TCM (CCH) 530 (acceptance of check with notation that is was made "as satisfaction in full for any and all claims" was not binding on the Service).

By regulation, compromise agreements under section 7122 must also be in writing and otherwise comply with requirements for form. Treas. Reg. § 301.7122-1. These sections establish the sole mechanism by which tax cases may be compromised. Accord Brooks v. United States, 833 F.2d 1136, 1145 (4th Cir. 1987). The courts have strictly construed the regulatory provisions for entering compromise agreements. Id. at 1146; Boulez v. Commissioner of Internal Revenue, 810 F.2d 209 (D.C. Cir 1987). Additionally, Del. Order 11 (Rev. 24), 1994-1 C.B. 324, identifies those Service officials authorized to enter into such agreements. This authority was not delegated to the field agent level during 1998.

There are numerous cases striking down "apparent" agreements between taxpayers and Service employees that did not satisfy the formal requirements of the Code and regulations. Eg. Botany Worsted Mills v. United States, 278 U.S. 282 (1929) (gentleman's agreement with subordinate officials not binding); Dorl v. Commissioner, 507 F.2d 406(2d Cir. 1974) (Revenue Officer's letter of assurance not a valid compromise agreement); Country Gas Service, Inc., v. United States, 405 F.2d 147 (1st Cir. 1969) (no agreement where agent was not authorized).

Applying the above principles, it is clear that Revenue Agent [redacted] could not compromise or finally resolve the [redacted] corporate tax liabilities. Her representations, including the notations she added to [redacted] checking account documents and her August 27, 1998, letter, did not satisfy the requirements of sections 7121 or 7122.

A somewhat more complex question is presented by the waivers executed by [redacted] on August 27. I.R.C. §§ 6211, et. seq., requires the issuance of a notice of deficiency, and the suspension of assessment for any tax liabilities related thereto, for an audit determination. Section 6213(d) permits a taxpayer to waive the deficiency procedures and consent to an immediate assessment. A taxpayer may also waive the limitations period on refund claims. I.R.C. § 6532(a)(3) provides for the waiver of the issuance of a notice of claim disallowance resulting in the commencement of the two year statutory period.

Waiver agreements of the types described above are considered statutory arrangements by the courts. As such, the general defenses of contract law (such as accord and satisfaction) do not apply. Tallal v. Commissioner, 77 T.C. 1291 (1981). But, as an agreement, the courts will still require some evidence of mutual assent. Schulman v. Commissioner, 93 T.C. 623 (1989); Kronish v. Commissioner, 90 T.C. 684 (1988). The question of proper intent is analyzed under an objective, rather than subjective, test. Id. A unilateral mistake of fact is not sufficient to negate an objective manifestation of an intent to execute the underlying waivers. See, Quigley v. Internal Revenue Service, 289 F.2d 878 (D.C. Cir. 1960); Stamm International Corp. v. Commissioner, 90 T.C. 315 (1988).

The circumstances of the instant case strongly suggest that [redacted] executed the two waivers with the intention to enter into the agreements. [redacted] explained the audit proposals on August 14, 1998. At that time, [redacted] was also provided with an explanation of his appeal rights. On August 25, [redacted] called [redacted] and was provided responses to questions he had concerning the report. When [redacted] arrived at the meeting with [redacted] on August 27, she again went over the audit report. [redacted] expressed his agreement and, on that date, executed the two

waivers. These observable facts demonstrate an intent to enter into the agreements.

[redacted] indicates his belief, however, that his execution of the agreements was interconnected to his understanding that the August 27 payment would fully satisfy [redacted] tax liabilities. Therefore, [redacted] signed the consents conditioned upon, and subject to, the belief that the [redacted] account for [redacted] was fully paid. In contrast, [redacted] believes that the only "full payment" items she referred to during the August 27 meeting were the unpaid tax per the original [redacted] Form 1120 (as reflected on the claim, Form 1120X) and the tax, interest, and penalties (of which there were no penalties) from her audit determinations, without more.

There is strong case support that a statutory consent will not be negated even where a taxpayer may have *intended* something, but not expressed it. As observed by the Tax Court in Kronish v. Commissioner, supra. at 693:

> It is the objective manifestation of mutual assent as evidenced by the parties' overt acts, not the parties' secret intentions, that determines whether the parties have made an agreement. In the instant case, petitioner intentionally signed the first consent form, and thereby manifested her assent to terms contained in that form.

Like the taxpayer in Kronish, [redacted] acts appear to have demonstrated his intention to execute the two waivers. However, a misunderstanding of whether the [redacted] income tax liability (including accrued interest and penalty) for [redacted] was, in fact, fully paid may have affected [redacted] comprehension of the terms of the agreements.

On May 5, 1999, Revenue Officer Beth Coons and District Counsel for the North Central District contacted [redacted] to discuss the issues raised by [redacted] [redacted] contended that [redacted] representations constituted an accord and satisfaction. The Service representatives rejected his assertion, summarizing the legal authorities cited above. In acknowledging the apparent misunderstanding, they discussed the outlines of a proposed settlement that would result in a treatment of the two agreements as invalid, thereby providing [redacted] with its full appeal rights. Counsel explained, however, that there was absolutely no basis on which to forgo collection on the tax, penalties, and interest on the [redacted] Form 1120. They proposed that the Revenue Officer satisfy the unpaid balance on the TDA by either executing the prior issued levy or applying the August 27, 1998, payment. [redacted] responded that he would contact his client and advise of his decisions.

Having received no response to the May 5 conversation, Counsel contacted [redacted] on July 12, 1999. A detailed message was left with [redacted] office. To date, no response has been provided.

District Counsel recommended the following actions by the Collection and Examination functions in memoranda dated July 21, 1999:

A. (To Collection)

Take all appropriate action to collect the payment of the tax liabilities of [redacted] as reflected by its [redacted] corporate tax return, Form 1120. Attempt further contact with [redacted] to determine [redacted] desires concerning the August 27, 1998, payment before making any applications of that amount.

- (to Examination)

1. Disregard the Consent to Assessment and Collection, Form 4549, dated August 27, 1998, and abate the assessment of $[redacted] of tax and $[redacted] related thereto.

2. Disregard the Waiver of Statutory Notification of Claim Disallowance, Form 2297, dated August 27, 1998, and issue a notice of claim disallowance to [redacted].

3. Issue a notice of deficiency reflecting the audit determinations contained in the RAR dated August 14, 1998, to [redacted] before the statute of limitations on assessing the deficiency for [redacted] taxable year expires on [redacted]

4. Work with Collection to have the remaining portion of the taxpayer's August 27, 1998, payment (approximately $[redacted] applied in a manner consistent with the taxpayer's directions.

In a conference on August 3, 1999, we concurred that those recommendations were appropriate. To the extent that [redacted] disagrees with the legal determination concerning the effect of [redacted] statement, [redacted] has two options: (1) filing a claim for refund of the assessed tax, and (once that claim is denied or unanswered for six months) filing a suit for refund of tax in the appropriate district court under *Code section 7422*; or (2) requesting administrative relief by submitting an offer in compromise.

ISSUE 3: Using an offer in compromise

In Code section 7122, Congress has authorized the Service to compromise any civil case pursuant to guidelines prescribed by the Secretary. In temporary and proposed regulations promulgated on July 19, 1999, the Service has added a new criteria for offers when collection of the entire tax liability would create economic hardship or if exceptional circumstances exist in which collection of the entire tax liability would be detrimental to voluntary compliance. Temp Treas. Reg. 301.7122-1T(b), effective July 21, 1999, T.D. 8829, now provides three grounds for offers in compromise: doubt as to liability, doubt as to collectibility, or to "promote effective tax administration.

Under this newest standard, if there are no grounds for compromise under the other standards, a compromise may be entered into to promote effective tax administration when ---

> (i) Collection of the full liability will create economic hardship within the meaning of section 301.6343-1; or
>
> (ii) Regardless of the taxpayer's financial circumstances, exceptional circumstances exist such that collection of the full liability will be detrimental to voluntary compliance by taxpayers; and
>
> (iii) Compromise of the liability will not undermine compliance by taxpayers with the tax laws.

The temporary regulation provides special rules for evaluating offers to promote effective tax administration and determining economic hardship. Any determination must be "based upon consideration of all the facts and circumstances, including the taxpayer's record of overall compliance with the tax laws." Economic hardship is determined after considering the taxpayer's ability to earn a living, the ability to meet basic living expenses, and the ability to borrow against the equity in assets.

Although [redacted] continues to dispute the tax, there does not appear to be any significant doubt concerning [redacted] and [redacted] liability for the tax, penalty and interest as determined by the Service with respect to the [redacted] profit sharing's annuity accounts or [redacted] tax liability. District Counsel (North Central District) has provided advice concerning the strong merits of the Service's position on both issues. In response to our request, the Associate Chief Counsel (EBEO) reviewed the first issue and concurs with the District Counsel conclusion.

Revenue Officer Beth Coons has previously solicited an offer in compromise from [redacted] on the grounds of collectibility, with success. [redacted] has

told Ms. Coons that he is unwilling to provide the fundamental criteria for such an offer by submitting a statement under perjury in which he lists his assets. [redacted] must be willing to comply with the regulatory criteria before the Service can consider such an offer.

The Service might consider an offer based upon the grounds of promoting tax administration, if [redacted] submits such an offer, based upon verification of the information provided in such offer. The consideration of such an offer should include an analysis of whether compromise of the liability would undermine compliance with the tax laws based upon all the facts and circumstances, including [redacted] and [redacted] overall compliance with tax laws.

RECOMMENDATIONS:

[redacted]

DP

[redacted]

If you have further questions, call Arlene Blume at 202-927-0320.