



OFFICE OF  
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
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MEMORANDUM FOR ASSISTANT REGIONAL COUNSELS (GENERAL LITIGATION)

FROM: Gary D. Gray  
Assistant Chief Counsel (General Litigation)

SUBJECT: Offers in Compromise and Bankruptcy

The purpose of this memorandum is to advise you of the decision of the National Director, Collection Field Operations ("Collection"), regarding the treatment of offers in compromise received prior to January 1, 2000, from taxpayers who have filed bankruptcy petitions, and to provide guidance to Counsel in processing these offers. The Memorandum For Regional Chief Compliance Officers Assistant Commissioner (International), dated December 10, 1999, is attached.

Earlier this year Collection allowed the processing of offers in compromise from taxpayers in bankruptcy.<sup>1</sup> That position was reflected in Form 656A, which was made available to the public in September 1999. The form stated that taxpayers in bankruptcy could submit offers in compromise if documentation were supplied to the Internal Revenue Service ("Service") showing that the bankruptcy court lifted the automatic stay to allow the Service to research the offer.

As you are aware, Collection has rescinded its allowance of offers in compromise from taxpayers in bankruptcy. After January 1, 2000, when Form 656A becomes obsolete, the Service will no longer consider such offers. Until that time offers will be considered if the taxpayer has the automatic stay lifted for that purpose.

Collection's memorandum states the grounds for consideration of offers received pursuant to the obsolete Form 656A prior to January 1, 2000. First, it provides that if the offer involves a post-bankruptcy collection issue, the case will be worked based on the merits of collectibility assuming the discharge would be granted. The primary purpose of this directive is to allow the Service to consider offers from taxpayers in

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<sup>1</sup> This decision primarily related to offers involving doubt as to collectibility, and did not relate to doubt as to liability offers based on litigating hazards. Doubt as to liability offers have always been considered by the Service during taxpayers' bankruptcy cases, prior to objection to the proof of claim. See IRM 34.10.1.6(6).

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Chapter 7 cases who wish to compromise nondischargeable liabilities before the discharge has been granted and the automatic stay is terminated. These offers should normally not be referred to Counsel for review unless the total amount of the liability is \$50,000 or more. I.R.C. § 7122(b).

Collection's memorandum also directs that if the offer "pertains to or is relevant to the bankruptcy proceeding," the minimum amount to be considered acceptable is the amount that is required to be provided under the Bankruptcy Code. However, if it appears that the offered amount is the best alternative, a recommendation to accept the offer can be made, but only with District Counsel concurrence, and provided that other creditors do not benefit from the Service receiving lesser treatment.

The primary purpose of this directive is to provide for the treatment of offers from taxpayers in Chapter 11, 12, and 13 cases. This directive indicates that the Service should not compromise its claim to the extent that the compromise allows taxpayers to make payments to lower priority creditors or increased payments to creditors of equal priority (e.g., state tax authorities). Our understanding of the policy behind this position is (1) that the Service does not generally allow for the payment of such creditors when it considers offers in compromise outside of bankruptcy, and should not do so for taxpayers in bankruptcy, and (2) that if the taxpayer has elected to use the bankruptcy process to handle the taxpayer's obligations, the taxpayer should abide by the bankruptcy priority scheme.

We make the following recommendations as to the role of Counsel in reviewing offers in Chapter 11, 12 or 13 cases. First, review the offer under normal criteria, e.g., whether the offer meets the standard of doubt as to collectibility. Second, review the Service's determination as to the amount it is entitled to receive under the Bankruptcy Code, e.g., the amounts it would be entitled to receive on its secured, priority, and general unsecured claims in the Chapter 11, 12, or 13 case. Third, review the Service's determination that the amount offered, though less than the amount the Service is entitled to under the Bankruptcy Code, is the best alternative. There are many factors that could affect whether the amount offered is the Service's best alternative. Such factors include the effect that conversion or dismissal would have on the Service's claim, and whether accepting the offer would result in an abuse of the Bankruptcy Code. Fourth, Counsel should review the Service's determination that compromising the Service's claim will not enhance the return to creditors of junior or equal priority. Fifth, Counsel should ensure that the offer is properly reflected in the terms of any Chapter 11, 12, or 13 plan.

Please contact us with any questions you may have. We are interested in feedback as to how this works to assist us in giving Collection advice for future cases.

Attachment (1)