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COLLECTION, BANKRUPTCY AND SUMMONSES BULLETIN

Department of the Treasury | Office of Chief Counsel | Internal Revenue Service

SUMMONSED IN

Interview Standards Not Required for Summonses

In an unpublished decision, the Sixth Circuit affirmed that the Service is not required when issuing summonses to follow the taxpayer interview safeguards established by I.R.C. § 7521(b). In **Cypress Funds, Inc. v. United States, 2000 U.S. App. LEXIS 27048 (6th Cir. Oct. 20, 2000) (*unpublished*)**, the Sixth Circuit affirmed the enforcement of the Service's summons against the taxpayer's Motion to Quash. The Service issued a summons under section 7602 to the taxpayer's bank, seeking documents and information about the taxpayer. The taxpayer responded, seeking to quash the summons. The taxpayer claimed that the Service failed to satisfy the fourth element of United States v. Powell, 379 U.S. 48 (1964) by not following the administrative steps required by the I.R.C. (specifically, those in section 7521(b)(1)(B)) and because the Service acted in bad faith by relying on a paid informant.

The appellate court initially found that the Service, by affidavit, made a prima facie case under Powell. Addressing the first of the taxpayer's arguments, the Sixth Circuit found that nothing in section 7602 dictates that the Government must satisfy section 7521(b)(1(B); the plain language of section 7521(b)(1)(B) does not apply to the enforcement of summonses; and case law does not support such a finding.

The court also disagreed with the taxpayer's argument that once allegations of bad faith were raised, the Government had an affirmative duty to deny bad faith. The Sixth Circuit held that once the Government, by affidavit, establishes a prima facie case for enforcement, the burden shifts to the taxpayer. The taxpayer in this case did not meet that burden because it failed to set forth specific facts or evidence to support a showing of bad faith. The court specifically denied the taxpayer's reliance on the criminal law "fruit of the poisonous tree" doctrine, finding the taxpayer's conclusory allegations of illegal surveillance and use of paid informants insufficient.

SUMMONSES: Defenses to Compliance: Improper Purpose

DIVIDED ON SUBDIVISION

"Replacement" Valuation Applied to Real Estate

In **United States v. Donato, 253 B.R. 151 (M.D. Pa. 2000)**, the district court denied the Service's request to subdivide and sell the debtor's property, instead ruling that the proper valuation of the land was its replacement cost. This lowered valuation stripped the Service's lien from the property.

The Service filed a secured proof of claim for over $100,000 in the debtors' Chapter 13 bankruptcy case. The debtors' primary asset was a 14-acre tract of rural real estate, which the debtors intended to use as a horse farm. In their plan of reorganization, the debtors proposed to subdivide and sell a portion of this land to pay off their secured creditors, a bank and an individual creditor. The United States was not listed, and did not object to the plan, which was confirmed. The debtors then filed a complaint to determine the secured status of the Service's proof of claim. The Service's expert valued the property at $926,000 if subdivided. The bankruptcy court, finding the debtors did not intend to subdivide the property except to the extent necessary to fund the plan, accepted the debtors' valuation of $186,000. This effectively eliminated the Service's secured claim, which was inferior to the bank's mortgage.

On appeal, the district court reviewed the valuation as a finding of fact, subject to a clearly erroneous standard. The court accepted, except to the limited extent provided by the plan, that the debtors did not intend to subdivide the property. The Service argued that, for that reason, the plan could not be confirmed under B.C. § 1322(a)(3), because by subdividing for one secured creditor, the debtors improperly classified the Service as a separate secured creditor. The court disagreed, finding that as the Service's lien had been stripped by the valuation, the Service no longer was a secured creditor to whom section 1322(a)(3) applied.

As to the valuation issue, the court applied the rationale of Associates Commercial Corp. v. Rash, 520 U.S. 953 (1997). Under Rash's view of B.C. § 506(a), where a debtor seeks to retain and use the creditor's collateral in a Chapter 13 bankruptcy, the collateral is to be valued at its replacement value, that is, the amount the debtor would have to pay for comparable property. Although Rash dealt with personal property, the court felt the decision was equally applicable to real estate. Since the debtors in this case intended to use the property as a homestead and farm, rather than subdivide it, their valuation was accepted.

BANKRUPTCY CODE CASES: Determination of Secured Status: Valuation of Estate

CASES

1. **BANKRUPTCY CODE CASES: Assessment**
   PARTNERSHIPS: Collection of Individual Liability
   In re Briguglio, 2000 Bankr. LEXIS 1148 (Bankr. C.D. Ca. Sept. 11, 2000) - Partners filed individual Chapter 13 bankruptcies, in which the Service filed proofs of claim for taxes assessed against the partnership. The court held that as the partners had not been assessed individually by the Service under I.R.C. § 6203, they had no tax liability. Because the three-year statute of limitations for assessment under section 6501(a) had expired, the court disallowed the Service's claim. The companion case is In re Galletti.

2. **BANKRUPTCY CODE CASES: Chapter 11: Effect of Confirmation (§ 1141): Provisions of Plan**
   In re Bartleson, 253 B.R. 75 (B.A.P. 9th Cir. 2000) - In this non-tax case, a Ninth Circuit bankruptcy appellate panel held that a confirmed Chapter 11 plan does not preclude creditors from collecting nondischargeable debts outside of bankruptcy. Because the debtors neither included an injunction against such collection in their plan, nor requested one, the creditors may collect against non-plan assets.

3. **BANKRUPTCY CODE CASES: Chapter 13: Secured Taxes**
   In re Kressler, 253 B.R. 632 (Bankr. E.D. Pa. 2000) - Chapter 13 debtors may not use the plan confirmation process to cramdown or avoid a lien without first taking an affirmative step such as filing an adversary complaint or an objection to the secured claim, the court ruled in a non-tax case. In addition, the court ruled that a secured creditor who filed an untimely proof of claim still has standing to object to the confirmation of a plan which attempts to avoid the creditor's lien.

4. **BANKRUPTCY CODE CASES: Exceptions to Discharge (§ 523): No, Late or Fraudulent Returns**
   In the Matter of Haesloop, 2000 Bankr. LEXIS 1104 (Bankr. E.D.N.Y. Aug. 30, 2000) - Debtor, a successful attorney, untimely filed 1990-92 income tax returns in 1993, and made only partial payments towards the resulting tax liability. Instead, he paid other creditors and expenses, including mortgage on country home and private college tuition for his daughter. Despite a yearly income of $275,000, he filed a Chapter 7 no-asset bankruptcy in 1997, seeking discharge of his tax debt. The bankruptcy court found the debtor (1) had a duty to pay the tax; (2) knew of that duty; and (3) voluntarily and intentionally violated that duty. Although mere nonpayment standing alone will not support a finding of nondischargeability, the court held that the debtor's culpable omissions in failing to timely file returns and his choosing to pay substantial lifestyle expenses instead of his taxes led to a finding of nondischargeability under B.C. § 523(a)(1)(C).

5. **BANKRUPTCY CODE CASES: Jurisdiction of the Bankruptcy Court**
United States v. Zellers, Trustee (In re CNS, Inc.) No. 4:99CV1589 (N.D. Ohio Sept. 18, 2000) - Trustee for a Chapter 7 no-asset business bankruptcy filed objection to Service's proof of claim. The Service, which also assessed a Trust Fund Recovery Penalty against the Trustee for unpaid employment taxes, claimed the Trustee only sought to determine whether he was personally liable for the taxes. The bankruptcy court held that it had jurisdiction because the Trustee's liability was intertwined with the business' bankruptcy. The district court disagreed, holding that an assessment under I.R.C. § 6672 is not "related to" a corporate bankruptcy case as required by 28 U.S.C. § 1334(b). As the United States did not otherwise consent to be sued, sovereign immunity and the Anti-Injunction Act, I.R.C. § 7421, prohibit the Trustee from using an Objection to Claim to determine his personal tax liability.

6. **BANKRUPTCY CODE CASES: Preferences**
United States v. Natale, Trustee (In re TCB Carpet Services, Inc.), 2000 U.S. Dist. LEXIS 15334 (N.D. Ill. Oct. 6, 2000) - Service levied on bank account to recover employment taxes. After the debtor was placed in an involuntary Chapter 7 bankruptcy, the trustee moved for return of the levied funds as a preference under B.C. § 547. The Service argued that so long as the debtor has funds available at the time of levy, an involuntary transfer of funds satisfies the nexus requirement of Begier v. I.R.S., 496 U.S. 53 (1990). The court disagreed that levying on the accounts receivables which flowed from the work for which the trust fund wages were paid provided a sufficient nexus to the withheld taxes. Because the debtor used an unsegregated account to pay both wages and business expenses, where the daily account balances were well below the amount of tax liability, the court found insufficient evidence that the levied funds were trust funds.

7. **BANKRUPTCY CODE CASES: Proofs of Claim: Informal**
In re M.J. Waterman & Assoc., Inc., 2000 U.S. App. LEXIS 23276 (6th Cir. Sept. 15, 2000) - In this non-tax bankruptcy case, the Sixth Circuit adopted the following five elements to determine if a filing may be considered an informal proof of claim:
(1) the informal claim must be in writing
(2) the writing must contain a demand by the creditor on the debtor's estate
(3) the writing must express an interest to hold the debtor liable for the debt
(4) the writing must be filed with the bankruptcy court
(5) allowance of the informal claim must be equitable under the circumstances.
In this case, the court of appeals upheld the finding by the bankruptcy court that the creditor's pre-bar date motions did not constitute an informal proof of claim.

8. **BANKRUPTCY CODE CASES: Refunds: Bankruptcy Court Determination**
United States v. Henderson (In re Guardian Trust Co.), 2000 U.S. Dist. LEXIS 15436 (S.D. Miss. Sept. 26, 2000) - The court ruled that if a request for a

refund arises from an offset or counterclaim, then there is no need for the debtor to file an administrative claim with the Service in order to confer jurisdiction on the bankruptcy court under B.C. § 505. Once the Service commits to expending resources to resolve the taxpayer's liability for the year in question by filing a proof of claim, the court found, no additional burden exists if the bankruptcy court orders a refund.

9. COLLECTION DUE PROCESS

Anderson v. Commissioner, T.C. Memo 2000-311 (T.C. Oct. 2, 2000) - Taxpayer, a fisherman, argued that his employer was responsible for payment of FICA taxes. He requested a Collection Due Process hearing, was denied relief, and was sent a Notice of Determination which provided, in part, that if the taxpayer wanted to dispute the determination he needed to file with the Tax Court within 30 days. Taxpayer timely filed, but the Tax Court ruled that it lacked jurisdiction. Under I.R.C. § 6330(d)(1), the Tax Court determined that it cannot extend its jurisdiction beyond the type of taxes it normally considers (taxes subject to deficiency notice), which excludes FICA taxes.

10. COLLECTION DUE PROCESS

Katz v. Commissioner, 115 T.C. 26 (T.C. Oct. 13, 2000) - Taxpayer demanded an appeals hearing in West Palm Beach, Florida, where he lived, under I.R.C. § 6320(b). The Service offered a hearing in Sunrise, Florida, or a hearing by telephone. The taxpayer did discuss the merits of the case with the hearing officer by phone, but also repeated his request for a hearing in West Palm Beach for the purpose of having witnesses attend. The Tax Court found that the taxpayer had been offered the opportunity for an appeals hearing as required by section 6320(b). The court went on to hold that, for purposes of reviewing a notice of determination, the phrase "underying tax liability" in I.R.C. § 6330(d)(1) includes the tax deficiency, additions to tax, and statutory interest. Since the taxpayer previously stipulated to the amount of tax owed, he was precluded from relitigating his liability.

11. COLLECTION DUE PROCESS

MacElvain v. Commissioner, T.C. Memo 2000-320 (T.C. Oct. 13, 2000) - Taxpayer challenged several years of tax deficiencies, but the amounts were determined either by stipulation or court decision. After the Service issued a Notice of Intent to Levy, the taxpayer took advantage of his Collection Due Process rights, and then appealed the Notice of Determination to the Tax Court. The Tax Court held that I.R.C. § 6330(c)(2)(B) precludes a taxpayer from relitigating the existence or amount of previously-determined tax liabilities before either Appeals or the courts. (The court reached the same result in Howard v. Commissioner, T.C. Memo 2000-319, also decided Oct. 13).

12. LIENS: Removal: Suit to Compel

Ibraham v. United States, 2000 U.S. Dist. LEXIS 14397 (S.D. Ohio Aug. 22, 2000) - Plaintiff purchased house from taxpayers on July 23. On August 14 the Service filed a tax lien against the property. The plaintiff requested a release of the lien, and sued when the Service refused. The court held that as the plaintiff was not the person against whom the Service was trying to collect, under I.R.C. § 7432 the plaintiff is not a "taxpayer" and so lacks standing to bring suit.

13. REFUNDS: Payment of

Estate of Algerine Allen Smith v. Commissioner, 115 T.C. 27 (T.C. Oct. 18, 2000) - Estate appealed deficiency determination, and the court of appeals reversed, vacated and remanded for further proceedings, without establishing an amount of tax due. The Service then assessed the deficiency, and the estate brought a motion to stay collection and for a refund under I.R.C. § 7486. Where a court of appeals reverses and remands without indicating any ascertainable amount of the previously determined deficiency has been precluded, the court ruled, the court of appeals has not "disallowed in whole or in part" the amount of deficiency, and so the taxpayer is not entitled to a refund under section 7486.

The following material was released previously under I.R.C. § 6110. Portions may be redacted from the original advice.

CHIEF COUNSEL ADVICE

Offers in Compromise; Noncompliance by Related Entity

June 19, 2000

CC:EL:GL:Br2
GL-602150-00
UILC: 17.00.00-00

MEMORANDUM FOR DISTRICT COUNSEL,
NORTH-SOUTH CAROLINA DISTRICT

FROM: Kathryn A. Zuba
Chief, Branch 2 (General Litigation)

SUBJECT: Applicability of Compliance Requirements to an Individual Taxpayer Submitting an Offer in Compromise

This memorandum responds to your request for advice dated March 17, 2000. This document may not be cited as precedent by taxpayers.

ISSUE:

Whether a taxpayer's offer in compromise is considered "not processable" because a corporation he currently owns and operates is not current in its obligations to file returns and make Federal tax deposits.

CONCLUSION:

Under the policies and procedures of the Service, a taxpayer's offer in compromise is processable notwithstanding non-compliance by the corporation he owns and operates. However, the district has the discretion to accept or reject the offer as it deems appropriate under the circumstances.

BACKGROUND:

The taxpayer has submitted an offer to compromise trust fund recovery penalties assessed against him pursuant to section 6672 of the Internal Revenue Code as a responsible officer of Company A. The penalties relate to unpaid employment taxes for all four quarters of Year 1 and the first and third quarters of Year 2. That corporation was placed in receivership and we understand that it has since ceased operations.

As of the date of your request, the taxpayer had failed to file his personal income tax return for Year 3. A threshold requirement for consideration of a taxpayer's offer in compromise is that all required returns have been filed. See IRM 5.8, Offer in Compromise Handbook, Section 3.3(4). The offer unit has given the taxpayer additional time to file his return before concluding that his offer is "not processable" due to the unfiled return.

During the offer investigation, the district discovered that the taxpayer formed a second corporation, Company B, in June of Year 1. That corporation is engaged in substantially the same business as was Company A. The taxpayer owns ninety-seven percent of Company B, the other three percent being held by an individual who was also part owner of Company A. Company B is not current on its Federal tax deposit and employment tax return obligations. FICA taxes for the second, third, and fourth quarters of Year 2, the fourth quarter of Year 3, and the first quarter of Year 4 remain unpaid. Returns for the third and fourth quarters of Year 4 have not been filed, and it appears that deposits from those two quarters will be insufficient to cover the anticipated liability.

The Offer in Compromise Handbook, IRM 5.8, Section 3.3(4), states that an offer in compromise is not processable if the taxpayer has not met certain compliance criteria. Individual taxpayers must have filed all required tax returns. In-business taxpayers must have demonstrated current compliance by timely filing returns and making Federal tax deposits during the preceding two quarters.

The district has asked how the processability requirements of the handbook would apply in this situation. Specifically, they ask whether the continued non-compliance of Company B would affect the processability of the taxpayer's offer, notwithstanding the fact that the corporation is a separate entity under the law.

DISCUSSION:

The Secretary's authority to compromise tax cases is contained in section 7122 of the Code, which states: "The Secretary may compromise any civil or criminal case arising under the internal revenue laws prior to reference to the Department of Justice for prosecution or defense." I.R.C. § 7122(a) (emphasis added). Treasury regulations issued pursuant to that section likewise state: "The Secretary may exercise his discretion to compromise an civil or criminal liability arising under the

internal revenue laws . . . ." Treas. Reg. § 301.7122-1T(a)(1). The Secretary's authority to compromise is, thus, discretionary.

The Secretary is empowered to set the threshold requirements for consideration of a proposed compromise. All offers to compromise must be submitted according to procedures prescribed by the Secretary. See Treas. Reg. § 301.7122-1T(c)(1). An offer is considered "pending" when the Secretary accepts an offer for processing, and the Secretary may return an offer which is deemed "nonprocessable." See id. at (c)(2). The Service's policy with regard to the processability of offers is contained in Chapter 3 of the Offer in Compromise Handbook, IRM 5.8. As is noted above, individuals must have filed all outstanding returns, and businesses must have successfully met their Federal tax obligations for two consecutive quarters. See IRM 5.8.3.3(4).

In this case, the taxpayer is an individual attempting to compromise his own tax obligations. Under the provisions cited above, his offer is considered processable provided: (1) he is not in bankruptcy, and (2) all tax returns have been filed. The taxpayer has not yet filed his Year 3 income tax return. Thus, his offer in compromise is not considered processable. Once the Year 3 return has been submitted, the district can consider the offer. Because the taxpayer is not an in-business taxpayer liable for employment taxes, the compliance provisions related to employment taxes do not apply. The district may not deviate from the processability criteria of the handbook without prior written approval from the National Office. IRM 5.8.3.3.1(1). Absent such approval, we would understand Collection's current policy to deem this offer in compromise processable.[1]

The district is concerned, however, that consideration of the offer while the taxpayer's corporation fails to comply is allowing the taxpayer to circumvent the spirit of the IRM's compliance requirements. Further, the suggestion has been made that an individual taxpayer wishing to compromise employment taxes arising from a sole proprietorship could form a corporation to continue his business. He could then have his individual offer considered even as the corporation failed to comply with the tax laws.[2]

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[1] Lack of local flexibility in making the processability determination is evidence of the Service's recent commitment to work with taxpayers to perfect offers. Prior to 1998, there were at least eight identified processability requirements, any one of which was grounds for returning the offer without further consideration. See Form 656, Offer in Compromise (Rev. 1-97), Instructions at 2. The Service now considers offers with missing information or other defects to be "unperfected," and will assist taxpayers in developing an offer that can be considered on its merits. See IRM 5.8.3.1(2).

[2] The facts you have relayed indicate a such a close relationship between the taxpayer and the corporation that they could be considered as one. However, there could be many variations on this fact pattern. It is possible that an individual could own

We would agree that such machinations do not seem in keeping with the spirit of the compromise program's dual objectives of resolving past delinquencies and allowing taxpayers a "fresh start" toward compliance with the tax laws. See Policy Statement P-5-100. However, we do not agree with the implicit assumption that a procedure calling for consideration of this offer lessens the degree of discretion afforded the district in making the eventual decision to accept or reject the offer.

Although the Service's general policy is to accept offers which reasonably reflect what the Service could expect to collect by other means, the "ultimate goal" of the compromise program is reaching agreements which are "in the best interest of both the taxpayer and the Service." Policy Statement P-5-100. Thus, acceptance of such an offer still requires a judgment that compromise is the best resolution of the case and will advance the overall goals of the compromise program. The Commissioner's policy goes on to make clear that realizing the reasonable collection potential in specific cases is just one of the objectives to be achieved by an effective offer in compromise program: "Acceptance 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.

Once a taxpayer's offer has been accepted for processing, the Service's procedures do not establish a presumption that an offer will be accepted, nor do they assume rejection as the likely result. Rather, each proposed compromise should be evaluated and considered on its own merits. In this case the district has the discretion to decide whether to accept or reject the offer. Provided the district exercises sound judgment and discretion when exercising its authority to compromise, we do not believe processing this offer undercuts the Commissioner's overall compromise policy and objectives.

Termination of Installment Agreement; Collection Statute of Limitations

June 20, 2000
GL-501228-00
UILC: 61.03.00-00

MEMORANDUM FOR DISTRICT COUNSEL, MANHATTAN DISTRICT, NEW YORK

FROM: Joseph W. Clark
Senior Technician Reviewer, Branch 2 (General Litigation)
CC:EL:GL:Br2

SUBJECT: , Installment Agreement

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the vast majority of the stock in a corporation and still be found to bear no responsibility for that company's tax delinquency. Such cases illustrate the difficulty of adopting the processability criteria the district seems to be advocating.

This responds to your memorandum dated March 28, 2000. This document is not to be cited as precedent.

ISSUES

(1) May the Internal Revenue Service ("Service") terminate the installment agreement at issue in this case on the grounds that the payments provided for under the agreement will not fully pay the tax liability prior to the expiration of the statute of limitations?

(2) May the Service require the taxpayers to supply updated financial information even though the taxpayers remain in compliance with the installment agreement?

CONCLUSIONS

(1) No, the Service may not terminate the installment agreement at issue in this case because the payments provided for under the agreement will not pay the tax liability in full prior to the expiration of the statute of limitations.

(2) Yes, the Service may require the taxpayers to supply updated financial information even though the taxpayers remain in compliance with the installment agreement.

FACTS

Taxpayers entered into an installment agreement with the Service on Date A to pay their Year A income tax liability in Amount A monthly payments.[3] Taxpayers have remained in compliance with that agreement. The payments provided for under the installment agreement will not result in full payment of the tax liability prior to the expiration of the collection statute of limitations.

Another installment agreement providing for Amount A payments for tax years Year B, Year A, and Year C was approved on Date B.[4] A letter of acceptance was sent

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[3] The Service has not been able to locate the installment agreement, but it is indicated in the Service's records.

[4] You state that the reason for the Month A "reinstatement" of the installment agreement was the misapplication of a Date C payment resulting from a Date D deficiency assessment of the taxpayers' Year B tax liability. The taxpayer paid the deficiency in two payments; one on Date E, and the balance on Date C. The Date C payment was misapplied by the Service to tax year Year D, and was not corrected until Month B. It does not appear possible that this misapplication was the cause of the Month A agreement, because the agreement was accepted prior to the misapplication. The reason for the Month A agreement is not clear, but we note that the taxpayers signed a power of attorney Form 2848 for years Year B through Year A with their

to the taxpayers on Date G, though the letter only referenced the Year A liability. The case was then reassigned to a new Revenue Officer, who noticed that the collection statute was not protected and recommended rejection of the agreement.[5] On Date I, a letter was sent to the taxpayers regarding the Year A and Year B tax liabilities scheduling a meeting on Date J. The letter stated that the Service has no record of receiving tax returns for these years. Attached to the letter were handwritten instructions by the Revenue Officer advising the taxpayers to bring specified financial information.

On Date J, the taxpayers, through their attorney, sent copies of the Month A installment agreement, and copies of the checks that paid the Year B deficiency. They also contend that the requested financial information was not available at that time, but that such information was not necessary in light of the installment agreement. On Date K, the Service sent the taxpayers a letter informing them that the request for a part payment agreement had been turned down because, (1) they did not respond to the Date I, request for information, and (2) because the Month A proposal would not full pay the outstanding liabilities before the collection statute of limitations expires. The letter notified that taxpayers of their right to an appeal of the rejection determination. Taxpayers continue to contend that the installment agreement is still effective and therefore cannot be denied.

ANALYSIS

In your memorandum, you ask whether the Service can terminate the installment agreement in this case, and whether the Service can require updated financial information from the taxpayers. You conclude that the expiration of the collection statute of limitations is not a basis for termination of an installment agreement. You also conclude that because the taxpayers did not provide the requested financial information, the installment agreement could be terminated. However, you recommend that the installment agreement not be terminated in this case because the real basis for the termination was the fact that the liability will not full pay before the expiration of the collection statute of limitations, and that it seems improper to reject the agreement for that reason when the Service did not do so in Year E or Year F. Even so, you also conclude that the taxpayers are required to provide updated information, and that if the CIS shows that the taxpayers circumstances have changed, the Service can modify or terminate the agreement.

We agree that the installment agreement in this case may not be terminated on the basis that it does not provide for the full payment of the tax liabilities before the expiration of the collection statute of limitations. Section 6159 of the Internal Revenue Code authorizes the Service to enter into written agreements with

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present attorney on Date F.

[5] The Month A installment agreement indicates that the earliest collection statute expiration date in Date H.

taxpayers under which taxpayers can satisfy tax liabilities in installment payments if doing so would facilitate the collection of the liabilities. I.R.C. § 6159(a). Both the statute and the corresponding regulation contemplate that an installment agreement shall provide for full payment of the tax liability covered by the agreement. Id., Treas. Reg. § 301.6159-1(a). However, nothing in the statute, the regulation, or the legislative history, suggests that the failure of the Service to obtain an adequate extension of the statute of limitations on collection to guarantee full payment of the tax liability under the installment agreement renders the installment agreement void, or that the Service would be permitted to terminate an installment agreement because it does not provide for full payment of the tax liability.[6]

Rather, Internal Revenue Code section 6159(b) provides that an installment agreement remains in effect for its term unless: (1) information which the taxpayer provided to the Service prior to the date the agreement was entered into was inaccurate or incomplete; (2) collection of the tax is in jeopardy; (3) the financial condition of the taxpayer has significantly changed; or (4) the taxpayer fails to pay an installment, to pay any other tax liability when due, or provide financial information requested by the Service. I.R.C. § 6159(b). See also Treas. Reg. § 301.6159-1(c), I.R.M. 5.14.8.3.

The installment agreement in this case was accepted in Year E and again in Year F.[7] The agreement cannot be terminated on the basis that it did not provide for the full payment of the tax liability before the collection statute expired. The Service's statement in the Date K letter that the "request for a part payment agreement has been turned down" on this basis was therefore incorrect and ineffective to terminate the agreement.

We also agree with your conclusion that the Service may request updated financial information to protect its interests even if the taxpayer has not defaulted under the installment agreement. The treasury regulation under section 6159 provides:

> Except as otherwise provided in the installment agreement, during the term of the agreement the director may take actions to protect the

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[6] A Senate report accompanying a bill containing the subsequently enacted version of section 6159 states, as the sole reason for the enactment of this provision, that "the Code should provide standards relating to the termination of installment agreements executed by the IRS." S. Rep. No. 309, 100th Cong., 2d Sess. 8 (Report of the Committee on Finance to accompany S. 2223) (March 29, 1988). Similarly, the Conference Report accompanying the legislation notes that the "IRS is granted statutory authority to enter into a written installment payment agreement if the IRS determines that an agreement will facilitate collection of the tax owed." H.R. Conf. Rep. No. 100-1104, at 220, 100th Cong., 2d Sess. 8 (1988).

[7] An installment agreement becomes effective on the date it is signed by the Service. Treas. Reg. 301-6159-1(b)(3).

> interest of the government with regard to the unpaid balance of the tax liability to which the installment agreement applies (other than actions pursuant to subchapter D of chapter 64 of subtitle F of the Internal Revenue Code [Seizure of Property for Collection of Taxes] against a person that is a party to the agreement), including actions enumerated in the agreement. The actions include, for example . . . <u>requesting updated financial information from any party to the agreement</u>[.]

Treas. Reg. § 301.6159-1(d) (emphasis added). There is no limitation that the request for financial information be made only when the taxpayer is in noncompliance with the agreement. Failure to provide an update of financial condition when requested is grounds for termination of the agreement. I.R.C. § 6159(b)(4)(C).[8]

However, we also agree with your conclusion that the best course of action in this case would not be to terminate the installment agreement based upon the failure to respond to the Date I letter. The letter is unclear and contains misstatements. The letter speaks of the non-receipt of tax returns for periods listed at the end of the letter, Year B and Year A, though failure to file tax returns is not indicated in the facts of this case. Further, the request for information in this case was made in handwritten instructions by that Revenue Officer that accompanied the letter, and did not mention the installment agreement.[9]

We therefore recommend that the installment agreement in this case not be terminated on the basis that the taxpayers failed to respond to the Date I request for undated financial information. The Service could, in its discretion, again request updated financial information, making clear that the failure to provide the requested information will result in termination of the installment agreement. If the taxpayers

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[8] Such termination must nevertheless be made within statutory and regulatory guidelines. Unless collection of the tax is in jeopardy, termination or modification can only take place after 30 days notice to the taxpayer. I.R.C. § 6159(b)(5). <u>See</u> <u>also</u> IRM 5.14.8.4 and 5. The notice must in writing and briefly describe the reason for the intended alteration, modification, or termination, and upon receiving notice, the taxpayer may provide information showing that the reason for the intended alteration, modification, or termination is incorrect. Treas. Reg. § 301.6159-1(c)(4). The Service must provide for an independent administrative review of terminations of installment agreements for those taxpayers who request such a review. I.R.C. § 6159(d). <u>See</u> <u>also</u> I.R.M. 5.14.8.7.

[9] We also note that the Date K letter, which notified the taxpayers that they have 30 days to appeal the rejection of the agreement, implies that the taxpayers only recourse is to appeal the determination to reject the offer. Service procedures provide that upon receiving a default notice, taxpayers will have 30 days to comply with the terms of the agreement before the agreement is terminated. IRM 5.14.8.4.

again fail to provide the requested information, the 30 day notice of the proposed termination should be then sent. IRM 5.14.8.4.

Levy; Surplus Proceeds; Application of Payments

July 13, 2000

CC:PA:CBS:B01
GL-801188-00
UILC: 50.20.03-00
58.00.00-00

MEMORANDUM FOR PACIFIC NORTHWEST DISTRICT COUNSEL

FROM: Gary D. Gray
Assistant Chief Counsel (Collection, Bankruptcy and Summonses) CC:PA:CBS

SUBJECT: Application of Surplus Levy Proceeds to Unlevied Periods

This advice pertains to your memorandum concerning the above subject. We have reconsidered our position taken in our April 21, 2000, memorandum, CCA 200023048, and are now of the view that the surplus proceeds can be offset since a Collection Due Process notice is not required under I.R.C. § 6330(a)(1).

ISSUE:

Whether the Internal Revenue Service ("Service") may apply surplus levy proceeds to a tax period not included on the levy where such tax period is a period in which the taxpayer has not received a Collection Due Process Hearing Notice ("CDP notice"), or whether the Service must refund the surplus proceeds to the taxpayer.

CONCLUSION:

The Service may apply surplus levy proceeds to a tax period not included on the levy where such tax period is a period in which the taxpayer has not received a CDP Notice.

FACTS:

In a hypothetical factual situation, a levy served on intangibles lists a specific amount of tax liability for a specific tax period. Between the time of the levy and the receipt of the levy proceeds, a payment is posted to the tax period listed on the levy. The levy proceeds are received thereafter in an amount equal to that shown on the levy. The levy proceeds are posted to the tax period shown on the levy, and because of the intervening payment a credit now exists for the tax period. The taxpayer has another tax liability for a tax period not included on the levy in which the taxpayer has not received a CDP notice.

LAW AND ANALYSIS:

This advice concerns your advisory opinion dated February 29, 2000, addressed to the Pacific Northwest District Director, Special Procedures function, regarding the application of surplus proceeds pertaining to the upcoming Alaska Permanent Fund Dividend Levy Program. Based on the facts described above, you concluded that pursuant to I.R.C. § 6402(a) the Service is authorized to apply the credit to the unpaid tax liability for the period not included on the levy.[10] After further analysis, we now agree with your conclusion.

Initially, in a memorandum to your office dated April 21, 2000, we disagreed with your conclusion. In our memorandum we concluded that pursuant to section 6330(a)(1) the Service could not apply the surplus levy proceeds to the tax period not included on the levy. We stated that the Service was in effect levying the taxpayer's property to satisfy a tax liability for a tax period in which the taxpayer had not received a pre-levy CDP notice. After reconsidering the requirements of sections 6330 and 6402, we now believe that section 6330 does not apply to the application of surplus proceeds in this case because such application is not a levy. Pursuant to section 6342(b), surplus levy proceeds constitute an overpayment. Section 6402(a) provides that the Secretary may credit "any overpayment . . . against any liability . . . ." In the hypothetical case scenario, the requirements for a CDP notice in section 6330(a)(1) were satisfied for the liabilities listed on the levy. Applying the surplus levy proceeds to a tax and tax period not included on the levy does not constitute an additional levy, but rather, an offset. Accordingly, the advice given in the April 21, 2000, memorandum, IRS CCA 200023048, 2000 IRS LEXIS 39 (April 21, 2000), is rescinded.

We note that the Service has procedures in place to minimize the occurrence of situations such as the one described here. <u>See</u> <u>generally</u> IRM 5.11.2.2.1, 21.9.4.4.1.11-13, 21.9.4.4.1.16 (provide conditions for releasing levies and issuing multiple simultaneous levies). For example, IRM section 21.9.4.4.1.12 provides that a partial levy release should be issued to avoid potential over collection in situations where payments or adjustments will reduce, but not fully pay, a liability for a tax period on which a levy is outstanding. In addition, this section provides the procedures for issuing partial levy releases in situations where multiple

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[10] Section 6402(a) provides as follows:

> (a) General Rule. – In the case of any overpayment, the Secretary, within the applicable period of limitations, may credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment and shall, subject to subsections (c), (d), and (e) refund any balance to such person.

simultaneous levies were used. Another example is IRM section 21.9.4.4.1.16 which provides the limitations and controls for issuing multiple simultaneous levies. This section provides that Customer Service Field Operations must approve all Automated Collection System ("ACS") plans governing the use of multiple simultaneous levies to ensure that the ACS support function implements and adheres to procedural safeguards that minimize instances of over collection. Moreover, this section provides that all instances of over collection resulting from multiple simultaneous levies must be reported to management in order to determine if procedural improvements are necessary.

Offer in Compromise; Partnership

July 11, 2000

CC:PA:CBS:Br2
GL-702312-00
UILC: 17.00.00-00

MEMORANDUM FOR DISTRICT COUNSEL, NORTH TEXAS DISTRICT

FROM: Kathryn A. Zuba
Chief, Branch 2 (General Litigation)

SUBJECT: Offer in Compromise -

This memorandum responds to your request for advice dated April 13, 2000. This document may not be cited as precedent by taxpayers.

ISSUE:

Whether the Service can compromise with a general partner for his individual, derivative share of the employment tax obligations of a partnership.

CONCLUSION:

The employment tax obligations of a partnership represent a single liability assessed against the partnership entity. Although the federal tax lien allows the Service to collect from general partners, there remains one tax liability subject to compromise, that of the partnership.

BACKGROUND:

The taxpayer is liable for unpaid income tax liabilities for the years Year 2, Year 4, Year 5, and Year 8. He also owes a trust fund recovery penalty assessed against him for Year 3. Two partnerships of which the taxpayer was a general partner are liable for unpaid employment taxes. Partnership A owes FICA taxes for the first and fourth quarters of Year 1 and the first and second quarters of Year 2, as well as FUTA taxes for both of those years. Partnership B owes FICA taxes for the second

quarter of Year 1 and FUTA taxes for both Year 1 and Year 2. On Date A, the taxpayer submitted an offer in compromise intended to cover both his personal income tax liabilities and his portion of the partnerships' liabilities.

The Offer in Compromise Handbook, IRM 5.8, contains no guidance on compromising a derivative portion of a partnership's employment tax liabilities. With regard to compromising the liabilities of a partnership, the handbook provides:

> The amount that must be offered to compromise a partnership tax liability must include the maximum collection potential for the partnership and all general partners. Secure Collection Information Statements from the partnership and all partners before beginning your analysis.

IRM 5.8.1.12(1).

The case history indicates that the revenue officer assigned to process the offer initially inquired as to the status of the partnership and the existence or location of other partners, and requested documentation regarding the potential for collection from partnership assets or the assets of other general partners. The taxpayer's representative responded that the taxpayer was proposing to compromise only his personal share of the liabilities of the two partnerships, not the liability of the partnership or the other partner(s). On this theory, the revenue officer investigated only the collection potential of the taxpayer. Therefore, the file contains no information on the partnerships or any other partners. The revenue officer appears to have proceeded on the assumption that the partnerships are now defunct.

The taxpayer's offer in compromise has been recommended for acceptance by the revenue officer because the amount offered is consistent with the taxpayer's ability to pay, and has been submitted to your office for review so that you can issue the required opinion of Counsel. See I.R.C. § 7122(b). In your proposed response to the district, you agree that the offer is adequate in amount, but suggest several changes intended to insure that the Service adequately protects its rights to proceed against any assets of the partnership or other partners. Most significantly, you suggested that a collateral agreement be secured which clearly states the intent of the parties to compromise only the liabilities of the taxpayer and retains the right to proceed against other partners.

DISCUSSION:

The Internal Revenue Code requires employers to deduct and withhold income and Federal Insurance Contributions Act (FICA) taxes from their employees' wages. See I.R.C. §§ 3402(a) and 3102(a). The Code imposes additional FICA taxes on employers themselves, as well as Federal Unemployment Tax Act (FUTA) taxes. See I.R.C. §§ 3111 and 3301. These taxes are generally referred to collectively as "employment taxes." The Code provides that the "employer" is the entity liable for payment of employment taxes. See I.R.C. § 3403 (employer liable for withheld

income taxes); I.R.C. § 3102(b) (employer liable for withheld FICA tax); I.R.C. § 3111 (employer liable for employer's share of FICA tax); I.R.C. § 3301 (employer liable for FUTA tax).

For purposes of income tax withholding, "employer" is defined as the person for whom an individual performs any service as the employee of such person. I.R.C. § 3401(d). The term "person" includes an individual, trust, estate, partnership, association, company, or corporation. I.R.C. § 7701(a)(1). Although the Code gives no comparable definition of employer for purposes of determining liability for FICA and FUTA taxes, courts have held that "employer" for purposes of the FICA and FUTA provisions should be defined the same as the section 3401(d) definition. See Otte v. United States, 419 U.S. 43, 51 (1974); In re Armadillo Corp., 410 F. Supp. 407 (D. Colo. 1976), aff'd, 561 F.2d 1382 (10th Cir. 1977).

In the case of employees who work for a partnership, the Service takes the position that the partnership is the employer for purposes of employment tax obligations. However, because under state law the general partners are liable for the debts of the partnership, the general partners are derivatively liable for the partnership's employment tax obligations. Thus, one assessment is made against the partnership, and this one assessment is sufficient to make the general partners liable for the assessed employment taxes. The Service also takes the position that a notice and demand on the partnership is sufficient to create a tax lien on the property of the general partners for the partnership debts. See IRM 5.12.1.18.3. The theory behind these procedures is as follows:

> In a situation in which the partnership as an entity is made liable under federal law for a specific tax, as is true, e.g., with reference to withholding requirements, social security, and certain excise taxes, the added effect of state law, making the partners individually liable for the partnership debts, serves to bring a lien to bear on the properties of both–the partnership and the general partners.

Plumb, Federal Tax Liens 31 (3d ed. 1972).

The courts have generally agreed that where the partnership, as taxpayer, is liable for employment or excise taxes, general partners are also liable pursuant to state law statutes making general partners liable for partnership debts. See Remington v. United States, 210 F.3d 281, 283 (5th Cir. 2000) ("The partnership is the primary obligor and its partners are jointly and severally liable on its debts."); Ballard v. United States, 17 F.3d 116, 119 (5th Cir. 1994); United States v. Hays, 877 F.2d 843, 844 n.3 (10th Cir. 1989); Calvey v. United States, 448 F.2d 177, 180 (6th Cir. 1971); United States v. Underwood, 118 F.2d 760, 761 (5th Cir. 1941). Our longstanding position has been that, although the Code creates a single employment tax liability for which the partnership entity is liable, the application of state law allows the Service to collect the unpaid liability from individual general partners. Texas partnership law, as does the law in most jurisdictions, states that

general partners are jointly and severally liable for the debts and obligations of the partnership. See Tex. Civ. Stat. Ann. art. 6132b-3.04.

Relying on the principle that general partners are jointly and severally liable for the unpaid debts of the partnership, the district has proposed acceptance of an offer by Taxpayer which is intended to compromise only his individual, derivative liability as a partner in the two partnerships. The district is apparently treating the joint and several liability of partners as similar to the liability of a husband and wife who elect to file a joint return. See I.R.C. § 6013(d)(3) (if joint return is made, liability for tax shall be joint and several). When spouses are jointly and severally liable for tax, the Offer in Compromise Handbook provides procedures whereby one spouse may reach a compromise with the Service, but the Service preserves its rights to proceed against the spouse who is not party to the compromise. See IRM 5.8.6.2. The compromising spouse must execute a collateral agreement making clear that the offer relates to the offeror's personal liability only, and that the Government may still collect from other co-obligors. See Pattern Letters P-229 and P-230 (Rev. 6-90). The district reasons that the joint and several liability of a general partner can be compromised in the same way and that the Service can later collect from other partners.

The liability of a partnership is fundamentally different than that of a husband and wife who file a joint return. As is explained above, the partnership liability is a single liability, assessed once against the partnership and owed by the partnership itself. The Service's ability to collect from general partners is created not by operation of the Code, but from state law liability for the debts of a partnership, liability which can be enforced through means of the federal tax lien whether or not the Service has obtained a judgment against an individual general partner.[11] This ability to collect does not alter the nature of the liability itself–it remains a singular debt for which the partnership entity is primarily liable.[12]

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[11] Assessment gives the Government the ability to proceed against a taxpayer without reducing a claim to judgment. See Bull v. United States, 295 U.S. 247, 260 (1935). It is said to work a "reversal" of the normal collection process, in that "payment precedes defense." Id. Collection from general partners based on the partnership assessment is a logical extension of this principle, in that a private creditor could no doubt execute against a general partner if it obtained a judgment against the partnership.

[12] Note that the Service cannot collect from partners or shareholders where they are not liable for the debts of the business under state law, such as in a corporation, limited partnership, or limited liability company. Each form of business association has advantages and disadvantages which must be weighed before choosing the form a business will take. Treatment of the entity for federal income and employment taxes should be one of these considerations.

The joint and several liability of a husband and wife, on the other hand, is provided for by the Code. Section 6013(a) permits a husband and wife to file a single, joint return for income taxes. Section 6013(d)(1) states that if a joint return is made, liability with respect to the tax will be joint and several. This differs from the partnership liability in that the Code imposes the joint and several nature of the debt.

Compromise of this liability will also necessarily have a different effect. The Secretary has the authority to compromise any "case arising under the internal revenue laws." I.R.C. § 7122(a). Regulations giving effect to that section consider a "case" to be a "civil or criminal liability." See Temp. Treas. Reg. § 301.7122-1T(a)(1). The liability at issue in this case is that of the partnership. , as a general partner, can bind the partnership to a compromise. See Tex. Civ. Stat. Ann. art. 6132b-3.04. The compromise would be binding on the partnership, the Government, and all the partners. See Temp. Treas. Reg. § 301.7122-1T(5).

The Offer in Compromise Handbook's instruction to consider the reasonable collection potential of the partnership and all general partners is a recognition that the unpaid employment taxes of a partnership represent one liability which can be collected from several sources.

Because the Code does not provide that the employment tax liabilities are joint and several, there is no individual liability for Taxpayer to compromise. In contrast, the Code recognizes the tax liability of spouses filing a joint return to be joint and several. As with any joint and several co-obligors, one party to that assessment can reach an accord with the Service without necessarily affecting the Service's right to proceed against the other party.

Furthermore, reliance on the joint and several liability of partners under state law would subject the Service to the vagaries of state partnership law when determining whether the Service could still collect from other partners. In United States v. Ross, 176 F. Supp. 932 (D. Neb. 1959), a general partner, Ross, challenged the Service's collection efforts against him after a compromise had been reached between the Service and another partner, Kornfeind. The compromise agreement contained a clause which read as follows:

> This offer is submitted in lieu of my liability to pay balance of said tax, penalty, and interest, remaining after deducting from assessment the amount hereby tendered, collection of which balance shall not be enforced against me by suit or any other proceedings; it is being understood that this undertaking shall not release any other person from liability under said assessment.

176 F. Supp at 934 (emphasis added).

Notwithstanding this clause in the agreement, the court found that the Service's compromise with one partner released the other partner. Because upon dissolution of the partnership the partners had agreed that Kornfeind would be liable for the debts of the partnership, and the Service had knowledge of that arrangement, reaching a compromise with Kornfeind which "materially altered" the nature or time of payment for the tax obligation had the effect of releasing his partner. Id. at 935 (applying the Illinois version of section 36 of the Uniform Partnership Act).

The same section was the law in Texas prior to 1994, so it may directly govern the relationship between the partners in this case. The Texas Revised Partnership Act contains a similar, but broader, provision:

> Material Alteration of Obligation Without Consent Discharges Withdrawn Partner. If a creditor of a partnership has notice of a partner's withdrawal and without the consent of the withdrawn partner agrees to a material alteration in the nature or time of payment of an obligation of the partnership incurred before the withdrawal, the withdrawn partner is discharged from the obligation.

Tex. Civ. Stat. Ann. art 6132b-7.03(d). In this case, it is not known if there were other general partners, the circumstances surrounding the dissolution of the partnership (if there was a dissolution), or whether upon dissolution there was an agreement allocating responsibility for the partnership's debts.

Further, an agreement to discharge a partner can be implied from a creditor's course of dealings with a remaining partner. Section 36 of the Uniform Partnership Act states, in part:

> A partner is discharged from any existing liability upon dissolution of the partnership by an agreement to that effect between himself, the partnership creditor and the person or partnership continuing the business, and such agreement may be inferred from the course of dealing between the creditor having knowledge of the dissolution and the person or partnership continuing the business.

This principle was applied in Texas in Victoria Air Conditioning, Inc. v. Southwest Texas Mechanical Insulation Co., 850 S.W.2d 720 (Tex. App. 1993). Notably, the creditor's failure to pursue collection against the other partner and failure to insist that he be made a party to the agreement were seen as evidence from which the jury could have inferred an agreement to discharge the non-contracting partner. Id. at 725.

One potential concern about the current procedures for compromising partnership liabilities is that they may prevent one or more partners from compromising with the Service if another general partner is uncooperative. However, that inability to compromise is owing more to the nature of a partnership than anything else. Partnerships have obvious income tax and business flexibility advantages, but carry with them the risks that partners will deadlock over a chosen course of action or that individuals will be held liable for actions of the other partners.

Furthermore, an offer in compromise is a discretionary collection tool which should be used when the Service has judged it to be the appropriate resolution of a particular case. The "ultimate goal" of the compromise program is to reach agreements that are "in the best interest of both the taxpayer and the Service." Policy Statement P-5-100. In any situation where the Commissioner does not believe that a compromise can be constructed so as to adequately protect the interests of the Government, it is within his discretion to exercise other collection methods.

This does not present the only situation in which the nature of the liabilities prevent the Service from compromising despite the apparent willingness of an individual taxpayer to do so. For instance, an uncooperative responsible officer will prevent the Service from determining the reasonable collection potential of a corporation so as to evaluate a proposed compromise of employment taxes. See IRM 5.8.4.10. Also, the Service cannot compromise with one spouse if state law provides no way to preserve the ability to proceed against the non-compromising spouse. See IRM 5.8.6.2(2).

CONCLUSION:

Although the employment tax liabilities of a partnership can be collected from individual general partners, the liability itself is not joint and several under the Internal Revenue Code. For that reason, the Service's procedures allow for compromise of the entire partnership liability and not the derivative liability of individual general partners.

Liens; Third Party Remedy; Refund Suit

CC:P&A:CBS:Br1
GL-106119-99

July 26, 2000

UILC: 50.30.00-00
69.06.00-00
74.03.08-00

MEMORANDUM FOR HOUSTON DISTRICT COUNSEL
Attn: C. Reeves

FROM: Michael R. Arner, Senior Technician Reviewer, Collection, Bankruptcy, and Summonses CC:PA:CBS:Br1

SUBJECT: RRA Section 3106; I.R.C. § 6325(b)(4), Williams case

This responds to your EMAIL request for assistance on the above referenced matter.

ISSUE

Whether a person who is not personally liable for a tax but who is challenging a lien on such person's property can bring a refund suit pursuant to United States v. Williams, 514 U.S. 527 (1995), in light of the Restructuring and Reform Act of 1998 ("RRA 98") § 3106 amendment to I.R.C. § § 6325 and 7426 giving persons not liable for the tax a new administrative and judicial remedy to contest the validity of tax liens on their property?

CONCLUSION

In cases filed after July 22, 1998, (the effective date of RRA 98) section 7426(a)(4) is the exclusive remedy.

FACTS

The typical facts would be that a Notice of Federal Tax Lien ("NFTL") encumbers property in which a person not liable for the tax has an interest, and, in order to sell the property, such person pays the Government the amount listed in the NFTL.

DISCUSSION

In Williams, the Service filed NFTLs against a husband for his separate liabilities after he had transferred real property to his wife in exchange for her assuming certain of his liabilities. Thereafter, the wife attempted to sell the property, and the Service filed additional NFTLs, including a lien in the wife's name as nominee. Having discovered the tax liens one week before closing, and being threatened with suit from the puchaser if the sale did not go through on schedule, the wife authorized disbursement of the sale proceeds to the Service, under protest, in order to obtain a discharge of the tax lien and accomplish the sale. The wife then requested a refund, alleging that she took the property free of the tax lien against her husband as purchaser. The Service denied her claim on the ground that as a non-taxpayer she could not obtain a refund.

The Court held that the wife could make an administrative claim for refund under the Internal Revenue Code and could sue for a refund under 28 U.S.C. § 1346(a), rejecting the Service's position that these provisions could only apply to the taxpayer against whom the tax is assessed. The Court held that section 1346 does not limit a federal court's jurisdiction to cases where only the taxpayer is claiming a refund. The Court noted that the Government's position would leave people in the wife's position without a meaningful remedy, since the wife could not bring a wrongful levy action in the absence

of a levy, a quiet title action would not permit her to quickly sell the property, and the Government was not under any obligation to enter into a lien substitution agreement section 6325(b)(3), i.e., relief under section 6325(b)(3) is discretionary.

After the Williams decision, RRA 98 added sections 6325(b)(4)(A) and 7426(a)(4). Section 6325(b)(4)(A) provides that an owner of property who is not the taxpayer may request a certificate of discharge of the federal tax lien on that property, and the Internal Revenue Service ("Service") shall issue such certificate if such owner takes one of the following payment options. The first option is such owner deposits with the Service an amount equal to the value of Government's interest in the property. I.R.C. § 6325(b)(4)(A)(i). The second option is such owner furnishes to the Service a bond in like amount. I.R.C. § 6325 (b)(4)(A)(ii).

Section 6325(b)(4)(B) provides that the Service shall refund the deposit with interest or release the bond if the tax liability can be satisfied from a different source or the value of the Service's lien interest is less than the amount previously determined.

Section 7426(a)(4) provides that if a certificate of discharge is issued to such person under section 6325(b)(4), that person may, within 120 days after the day on which such certificate is issued, bring a civil action in federal district court for a determination of the value on the Government's interest in the property.

The legislative history does not discuss whether a Williams suit could be filed after the enactment of sections 6325(b)(4)(B) and 7426(a)(4). The legislative history, however, does state that pursuant to the amendments the Service "would have no discretion to refuse to issue a certificate of discharge if this procedure is followed, thus curing the defects in this remedy that the Supreme Court found in Williams." S. Rep. No. 105-174, at 54 (1998).

In prior litigation, the Office of Chief Counsel has advised the Department of Justice that in cases instituted after July 22, 1998, (the effective date of RRA 98) the Government will take the position that third parties may no longer maintain a Williams suit for refund. In these circumstances, section 7426(a)(4) is the exclusive judicial remedy. The rational for this position is that section 6325(c)(4) fixes the defect that Williams found with the discretionary certificate of discharge, i.e., the issuance of a certificate of discharge is now mandatory. Also, section 7426(a)(4) expressly provides that "[n]o other action may be brought by such person for such a determination." This would preclude a Williams refund action.

Bankruptcy, Proof of Claim, Secured by ERISA Pension Plan

UILC 09.19A.02-00
UILC 09.26.04-00

April 11, 2000

CC:EL:GL:BR1:DMGrogan
GL-609302-97

MEMORANDUM FOR DISTRICT COUNSEL, VIRGINIA-WEST VIRGINIA

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

SUBJECT: Pensions as Property of the Bankruptcy Estate

By memorandum dated July 16, 1996 (digested in GL Bulletin No. 431), we took the position that the bankruptcy court's opinion in In re Lyons, 148 B.R. 88 (Bankr. D.D.C. 1992) is legally unsound and, therefore, should not be followed. We understand that several District Counsel offices, as well as the Tax Division of the Department of Justice, have questioned whether our position is correct. By memorandum dated August 28, 1997, you requested that we reconsider our position.

ISSUE

Whether the Internal Revenue Service's (Service) claim in bankruptcy is secured by the debtor's interest in an ERISA-qualified plan or other interest generally subject to a restriction on transfer enforceable under nonbankruptcy law.

CONCLUSION

As discussed below, we have reconsidered our position and have concluded that the holding of the Bankruptcy Court for the District of Columbia (Judge Teel) in Lyons is correct. We believe that the debtor's interest in ERISA-qualified pension plans and similar interests are property of the bankruptcy estate under section 541 of the Bankruptcy Code, but only for the benefit of the Service. Therefore, under section 506 of the Bankruptcy Code, the Service's claim is secured to the extent of the value of such interests.

DISCUSSION

Section 541(a)(1) provides that property of the bankruptcy estate consists of all legal or equitable interests of the debtor in property as of the commencement of the case, except as provided in section 541(b) and (c)(2). Section 541(c)(1) further provides that the debtor's interest in property becomes property of the bankruptcy estate under section 541(a), notwithstanding any restrictions on transfer, except as provided by section 541(c)(2). Section 541(c)(2) provides:

> A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title.

In Patterson vs. Shumate, 504 U.S. 753 (1992), the Supreme Court was presented with the question whether the debtor's interest in an employer pension plan that contained the anti-alienation provision required by Title I of the Employee Retirement Income

Security Act of 1974 (ERISA) [13] was included or excluded from the bankruptcy estate under section 541. [14] The Court held that the term "applicable nonbankruptcy law" in section 541(c)(2) was not limited to state law (and thus included ERISA and other federal law) and that the anti-alienation provision required for qualification under Title I of ERISA was enforceable under applicable nonbankruptcy law. [15] The Court concluded that under section 541(c)(2) the debtor's interest in the pension plan was excluded from the bankruptcy estate. 504 U.S. at 760.

Under ERISA and federal tax law, anti-alienation provisions enforceable under ERISA against creditors generally are not enforceable against the Service. See, e.g., Travelers Insurance Co. v. Ratterman, 96-1 U.S.T.C. ¶ 50,143 (S.D. Ohio 1996) (while ERISA prevents ordinary creditors from attaching pension payments, courts have unanimously held that a federal tax lien or levy may be imposed on ERISA-qualified pension plans); Ameritrust Co., N.A. v. Derakhshan, 830 F. Supp. 406 (N.D. Ohio 1993) (rejecting the assertion of the taxpayer's former spouse that a qualified domestic relations order is the only exception to ERISA's anti-alienation provisions, the district court held that the Service may levy on funds in a taxpayer's individual retirement account (IRA) and Keogh account); In re Jacobs, 147 B.R. 106 (Bankr. W.D. Pa. 1992) (bankruptcy court held that federal tax lien may attach to the taxpayer's ERISA-qualified pension); In re Reed, 127 B.R. 244 (Bankr. D. Haw. 1991) (ERISA anti-alienation provisions do not preclude enforcing a federal tax lien or collection on a judgment resulting from an unpaid tax liability); see also Shanbaum v. United States, 32 F.3d 180 (5th Cir. 1994) (Fifth Circuit stated in dictum that a taxpayer's pension benefits under an ERISA-qualified plan are subject to levy despite the ERISA anti-alienation provision). Because Patterson did not involve a claim of the Service, it did not address the effect of a plan restriction on transfers that is not enforceable against a particular creditor, such as the Service. That question was addressed in Lyons:

> [T]he pension plans' provisions are not, within the language of § 541(c)(2), "enforceable under applicable nonbankruptcy law" with respect to the IRS. Under § 541(c)(1) the debtor's pension rights thus remain property of the

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[13] Section 206(d)(1) of ERISA provides: "Each pension plan shall provide that benefits provided under the plan may not be assigned or alienated." 29 U.S.C. § 1056(d)(1).

[14] Patterson did not involve bankruptcy claims of the Service. The Chapter 7 trustee was seeking to include in the bankruptcy estate the debtor's interest in the qualified plan.

[15] In finding that the phrase "applicable nonbankruptcy law" referred to "any relevant nonbankruptcy law, including federal law such as ERISA," the Court looked to the plain language of section 541(c)(2). 504 U.S. at 757-759. The Court went on to find that (1) the plan contained restrictions on transfer and (2) the restrictions on transfer were enforceable, because a plan participant, fiduciary, or beneficiary, or the Department of Labor could bring a civil action to enjoin any act which violated the terms of the plan or ERISA. 504 U.S. at 760.

> estate and under § 506(a) the IRS has an allowed claim against the pension rights to the extent of their value.

148 B.R. at 94. [16]

The court noted that its interpretation was "compelled" by the plain language of section 541(c)(2), as well as policy considerations:

> Outside bankruptcy, the IRS would have an enforceable lien against the debtor's vested right to receive a future stream of pension income despite spendthrift provisions in the pension plans. There is no evidence that in enacting § 541(c)(2) Congress intended the intervention of bankruptcy to alter the IRS's powers as a tax creditor.

148 B.R. at 93. As you point out, this same policy consideration–replicating within bankruptcy the result that would occur outside bankruptcy–was also recognized by the Supreme Court, which stated that the Patterson decision "ensures that the treatment of pension benefits will not vary based on the beneficiary's bankruptcy status." 504 U.S. at 764.

Judge Teel revisited this issue in In re Jones, 206 B.R. 614 (Bankr. D.D.C. 1997), a case concerning whether a Thrift Savings Plan (TSP) account is property of the bankruptcy estate. [17] Jones recognized the unique position of the United States as a creditor in bankruptcy:

> A TSP account becomes property of the estate only to the extent that the account is not beyond the reach of creditors outside bankruptcy. ... Accordingly, as regards state-created statutory liens, a TSP account would not be property of the estate and, accordingly, 11 U.S.C. § 506(a) would be inapplicable to such liens. [footnote omitted.]
>
> Nevertheless, as this court has held on slightly different facts, the TSP account would in effect have a split personality by remaining property of

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[16] Lyons involved plans under the Teachers Insurance and Annuity Association (TIAA)/College Retirement Equities Fund (CREF). In footnote 6 of the opinion, Judge Teel left undecided whether the result of the case would be different if the plans at issue were ERISA-qualified plans, rather than merely TIAA/CREF plans. However, based on the case law cited above, holding that ERISA's anti-alienation provision does not bar federal tax collection, we believe that the reasoning of Lyons is equally applicable to ERISA plans.

[17] Like ERISA-qualified plans, TSP accounts are generally protected from alienation provision. Funds held in the Thrift Savings Fund "may not be assigned or alienated and are not subject to execution, levy attachment, garnishment or other legal process." 5 U.S.C. § 8437(e)(2).

the estate for purposes of federal tax claims even though it is not property of the estate for the purposes of other creditors' claims. [Footnote omitted.]

206 B.R. at 621.

We believe that the disparate treatment of the Service and other creditors under section 541 is entirely appropriate and, as you noted in your memorandum, occurs elsewhere in the Bankruptcy Code. We agree with your conclusion that the treatment of property held by tenants by the entireties under section 522 offers a good analogy to the treatment of ERISA-qualified plans under section 541. Section 522(b)(2)(B) refers to nonbankruptcy law and gives effect to the requirements of such law, resulting in property being in the bankruptcy estate for (and to the benefit of) certain creditors, but not others. Similarly, section 541 draws on nonbankruptcy law that should be given effect in bankruptcy.

Not following Lyons leads to results that are straightforward: ERISA-qualified plans and similar interests are excluded from the bankruptcy estate with respect to the Service and all other creditors. Because they are not property of the estate, they cannot be used in determining the value of the Service's secured claim. On the other hand, to the extent that the Service has a lien that survives the bankruptcy, it can pursue collection outside bankruptcy. However, given the statutory framework of sections 541 and 506 and the Supreme Court's reasoning in Patterson discussed above, upon reconsideration we now believe that the holding in Lyons is correct. The wording of each section, on its face, supports the court's reasoning. In addition, there is nothing in the legislative history that would call for a different result. Similarly, there is no case law contrary to Lyons. [18]

In your memorandum, you stated that following Lyons has advantages in Chapter 13 cases.

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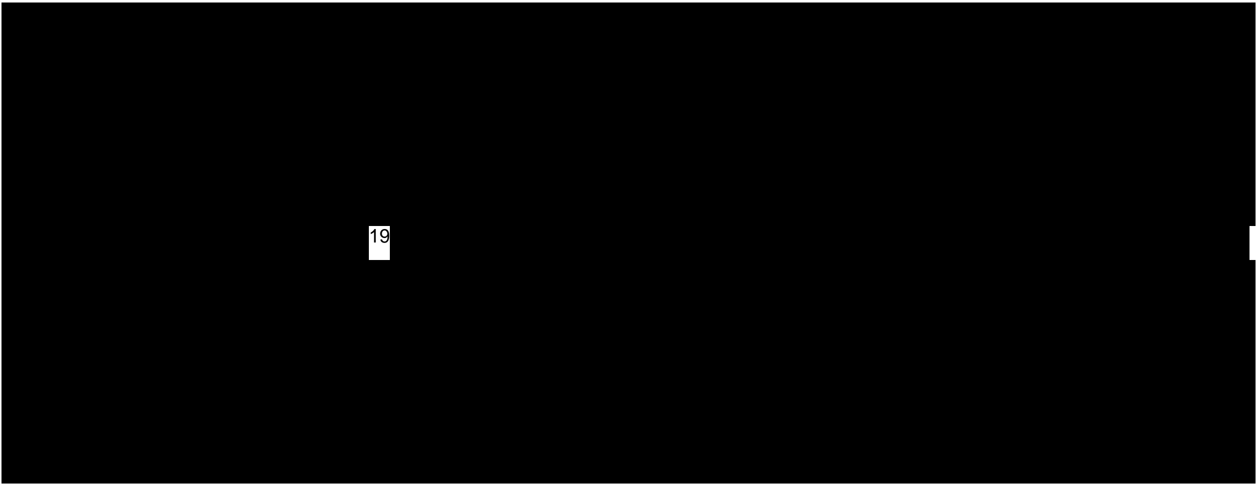
[18] In fact, there have not been many cases on this issue since Lyons and Jones were decided. There is one case, In re Persky, 98-2 U.S.T.C. ¶ 50,786, that has distinguished Jones. The court in Persky held that an interest in a spendthrift trust was not property of the bankruptcy estate, and, therefore, the Service's claim was not secured to the extent of the interest in the trust. The debtors cited Jones, asserting that the Service's claim was secured under section 506 to the extent of its prepetition lien on the trust. The court found that the debtors' reliance on Jones was misplaced because, unlike Jones and Lyons, the parties stipulated that the interest was excluded from the bankruptcy estate. Because of the parties' stipulation, the court did not have to address the section 541 issue. Several other cases have concluded that the Service's claim is secured to the extent of the debtor's interest in an ERISA-qualified plan, and therefore seemingly lend support to Lyons. However, these cases are not particularly strong support for Lyons because while they reach the same result regarding the determination of the Service's secured claim, they, unlike Lyons, did so after holding that ERISA-qualified plans are excluded from the bankruptcy estate.



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Because, under Lyons, ERISA-qualified plans are property of the bankruptcy estate only for the purposes of the Service's claims, we believe that the property should be abandoned by the trustee. In a Chapter 7 case, the trustee is required to collect, liquidate, and distribute the property of the bankruptcy estate "as expeditiously as is compatible with the best interests of parties in interest." B.C. § 704(a). In accordance with this obligation, section 554 provides for the abandonment of property "if it is not needed by the estate and its retention serves no purpose in effectuating the goals of the Bankruptcy Code." [21] 5 Collier on Bankruptcy ¶ 554.01. See, e.g., In re MCI, Inc., 151 B.R. 103 (E.D. Mich. 1992)(Chapter 7 trustees have a duty not to administer property that will not generate funds for unsecured claimants). In In re Groves, 120 B.R. 956 (Bankr. N.D. Ill. 1990), a pre-Patterson case [22] not involving the Service, the bankruptcy court found that the debtor's interest in a state retirement plan was property of the estate that could only be sold for the benefit of the creditors or abandoned. In a post-Patterson/Lyons world, there is no benefit to the other creditors in selling the interest, so it should be abandoned.

Offer in Compromise; Promotion of Effective Tax Administration

July 19, 2000

CC:PA:CBS:Br2
GL-602202-00
UILC: 17.07.00-00

MEMORANDUM FOR DISTRICT COUNSEL, NORTH FLORIDA DISTRICT

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[21] Specifically, section 554 provides that the trustee, after notice and a hearing, may abandon property of the bankruptcy estate that is burdensome to or of inconsequential value and benefit to the estate. B.C. § 554(a). Alternatively, a party in interest can request that the bankruptcy court, on the same grounds, order the trustee to abandon the property. B.C. § 554(b).

[22] The court in In re Groves adopted the pre-Patterson position that a number of courts had taken. It concluded that the exception under section 541(c)(2) applied only to spendthrift trusts under state law. 120 B.R. at 960.

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

SUBJECT: Offer in Compromise -

This memorandum responds to your request for advice dated April 3, 2000. This document is not to be cited as precedent by taxpayers. You requested our views regarding whether the above referenced case could be compromised under the Commissioner's new authority to compromise based on the promotion of effective tax administration. We conclude this case does not present exceptional circumstances such that collection of the full tax liability would be detrimental to voluntary compliance by taxpayers.

BACKGROUND:

The tax liability at issue was assessed against the taxpayer as the transferee of Company A, of which the taxpayer was president until Date D. Company A was incorporated in Year 1. The corporation was owned equally by four shareholders: the taxpayer, X, Y, and Z. On Date A, the taxpayer and his fellow shareholders met to discuss the sale of all of the assets of the company to Company B. At that meeting, they discussed ending their association, but no decision was made to liquidate the company. The transfer of assets to Company B took place on or about Date B.

In Date C, the accounting firm retained to prepare Company A's Year 2 tax return informed X that the sale of assets to Company B would result in a substantial tax liability. Prior to this time, various ways to structure the deal for tax purposes had been discussed. Among the options was liquidation of Company A to take advantage of the nonrecognition of gain permitted by then section 337 when a corporation adopted a plan of liquidation and then liquidated within one year.[23]

In late Year 3 or early Year 4, X and Y prepared a document which purported to be the minutes of the Date A meeting. The minutes falsely reflected that the shareholders had voted to liquidate Company A. The false minutes were attached to Company A's Year 2 Form 1120 and submitted to the Service as evidence that Company A had dissolved. The taxpayer apparently had no knowledge of these acts at the time or when he resigned as president of Company A on Date D.

On Date F, the taxpayer met with IRS agents and was informed that X and Y were under investigation for fraud in connection with the Year 2 return of Company A. At this meeting, he was advised that he would likely be liable for additional taxes resulting from the sale to Company B. He requested a balance due during the meeting and was

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[23] The nonrecognition of gain or loss provisions of section 337 in connection with corporate liquidations were repealed by the Tax Reform Act of 1986, Pub. L. 99-514, § 633(d), 100 Stat. 2085, 2280. A transition rule allowed certain small corporations to be eligible for section 337 nonrecognition for a longer period.

informed that he could not be given one at that time because the investigation had just begun. The taxpayer was again interviewed by IRS agents in connection with the investigation early in Year 5.

A notice of deficiency was issue to Company A in Date G. The company filed a timely petition with the Tax Court. In Date H, the taxpayer testified against X and Y in their trial for fraud. He testified again in Date I, after which X and Y pled guilty and were sentenced for making false statements in income tax returns.[24]

On Date J, the Tax Court upheld the Service's determination of Year 2 tax liabilities against Company A. The Tax Court exhaustively reviewed the events surrounding the sale to Company B and the preparation of the Year 2 return. The court found no intent to liquidate the company and upheld the Service's determination of fraud penalties against X and Y.
In Date K, a 30-day letter was issued to the taxpayer asserting a $AA deficiency as the transferee of Company A. The taxpayer filed a protest, arguing that: 1) the liability resulted from bad advice by tax advisors; 2) when he requested payoff figure and specifically stated that he was concerned about interest and penalties, IRS agents advised him he had nothing to worry about; 3) there was no evidence that he committed fraud so the fraud penalty should not apply; and 4) he had cooperated with the Government at every turn. Appeals reviewed the case and determined that the taxpayer was not liable for the penalties associated with fraud.

On Date L, the taxpayer was sent a corrected Notice of Deficiency. The total liability of Company A was computed as $BB and the taxpayer was liable as a transferee for $CC. The taxpayer paid the transferee liability in full in Date M. The tax was assessed the next month, and the taxpayer received a notice that he was liable for $DD in interest.

On Date N, at the local IRS Problem Solving Day, the taxpayer was advised that he may be eligible for interest abatement under section 6404(e) of the Code. He submitted his abatement request that day, and it was denied on Month/Day 1. On Date O, the taxpayer was informed that the denial of his abatement request was being sustained by Appeals. The final determination by Appeals was issued on Date P. The taxpayer's offer in compromise was submitted on Date R.

The taxpayer's proposed compromise, in essence, states that it would be unfair and inequitable to hold him responsible for interest attributable to the period between when he first requested a balance due until the time he was finally advised of the correct balance due. The taxpayer's request and the district's recommendation raise two main points in support of the assertion that compromise in this case would promote effective tax administration: 1) the Service's delay in informing him of the liability was unreasonable; and 2) the taxpayer should not be liable for interest attributable to criminal acts by the taxpayer's partners in which the taxpayer played no part and of

[24] The taxpayer testified against X and Y for a third time in Date Q.

which he had no knowledge.[25] The district has proposed acceptance of the taxpayer's offer on the grounds that collection of the tax liability in full would be detrimental to voluntary compliance by taxpayers.

DISCUSSION:

The Secretary may compromise a case to promote effective tax administration where: (1) collection of the full liability would create economic hardship within the meaning of section 301.6343-1 of the Treasury Regulations; or (2) exceptional circumstances exist such that collection of the full liability would be detrimental to voluntary compliance by taxpayers. Temp. Treas. Reg. § 301.7122-1T(b)(4). No such compromise may be entered into where it would undermine future compliance with the tax laws. Id.

The district has proposed compromise of this case based on a determination that it would "promote effective tax administration" under the standards articulated in the regulations.[26] It is undisputed that the assessed tax liability, including all interest accruals, could be collected in full without causing the taxpayer economic hardship as defined under the compromise regulations. The taxpayer argues that collection of the full tax liability would be detrimental to voluntary compliance by taxpayers. Where this basis can be established, compromise is authorized regardless of the taxpayer's financial circumstances. See Temp. Treas. Reg. § 301.7122-1T(b)(4)(ii). The regulations do not give a more exact standard or list factors to be considered, but illustrate this basis through two examples. See Temp. Treas. Reg. § 301.7122-1T(b)(4)(iv)(E). The procedures implementing this basis for compromise show that the Service anticipates compromising when collection of the full liability would be unfair or inequitable. See IRM 5.8.11.2.2(3); Form 656, Offer in Compromise (Rev. 1-2000), Instructions at 2.

The taxpayer previously sought abatement of the same interest pursuant to the Commissioner's authority to abate interest under section 6404(e). With respect to the tax periods in question, the Service has the authority to abate the assessment of interest on "any deficiency attributable in whole or in part to any error or delay in performing a ministerial act." I.R.C. § 6404(e) (amended 1996). Treasury regulations define a ministerial act as follows:

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[25] A fact which is heavily emphasized in the taxpayer's offer, the district's report, and various memoranda in the administrative file is that the taxpayer cooperated with the Service in the investigation and prosecution of his fellow shareholders. We disagree with the district's apparent suggestion that such cooperation is a basis for abatement of the taxpayer's liability.

[26] The taxpayer initially proposed compromise based on doubt as to liability. However, as the tax liability has been determined by the Tax Court, compromise on that basis is precluded. See Temp. Treas. Reg. § 301.7122-1T(b)(2).

> Ministerial act means a procedural or mechanical act that does not involve the exercise of judgment or discretion, and that occurs during the processing of a taxpayer's case after all prerequisites to the act, such as conferences and review by supervisors, have taken place. A decision concerning the proper application of federal tax law (or other state or federal law) is not a ministerial act.

Treas. Reg. § 301.6404-2(b)(2). Such an act will be taken into account only if no significant aspect of the error or delay is attributable to acts of the taxpayer. Id. at (a)(2).
The taxpayer's abatement request was denied. The examiner concluded that there was no error or delay, caused by a ministerial act, which authorized the abatement of interest. The denial letter specifically stated: "At the time you requested a pay off amount, Date E, the Agents had not started the examination of the Company and did not know how much the liability might be. The Agents could not provide an estimate. The fact they did not provide an estimate is not a ministerial act."

The compromise proposal is based on the same allegation of unreasonable delay as was the abatement request. The question, then, is whether and to what extent interest should be compromised under section 7122 where Congress has defined the limits of the Commissioner's interest abatement authority elsewhere in the Code. Allowing the compromise of interest for any Service error or delay on the ground that it falls within the intent of Congress to permit compromise based on equity under section 7122 would render the limits of section 6404 superfluous and would arguably constitute an implicit repeal of that section. There is no indication that Congress intended the amendment of section 7122 to repeal section 6404 and to allow the forgiveness of interest where the abatement of that interest would be precluded by section 6404. Moreover, it is a basic canon of statutory interpretation and application that no provision should be interpreted or applied so as to render another provision meaningless or superfluous. See Connecticut National Bank v. Germain, 503 U.S. 249, 253 (1992). We, thus, interpret section 7122 to permit a compromise of interest only where the taxpayer's claim that interest should be compromised presents a set of facts and circumstances surrounding the error or delay which are so egregious that collection of the liability from the taxpayer would be detrimental to voluntary compliance by taxpayers.

The Service's procedures recognize this concept. The Examination Offer in Compromise Handbook gives the following guidance with respect to compromise on the theory that collection would be detrimental to voluntary compliance:

> The examiner should consider equity already established in the tax law in assessing/analyzing the taxpayer's [detriment to voluntary compliance] offer. For example, if the taxpayer is requesting compromise of interest accruals, the examiner should be cognizant of the current tax laws concerning interest abatement (managerial, ministerial act), and why current parameters were so established.

IRM 4.3.21.3.4(3).

The taxpayer's offer states that he played no part in, and had no knowledge of, the acts of his partners in submitting a fraudulent return. In sum, the taxpayer is alleging that the Government should compromise his liability for interest because it arose as a result of fraudulent acts by third parties committed against both himself and the Government which caused a delay in the determination and assessment of his liability.[27] He contends that he should not be liable for the full amount of interest that accrued during the time it took the Service to investigate the fraud of his partners and determine the correct tax liability, since he was not a party to the fraud and assisted the Service in documenting the fraud.

In directing the Service to consider additional bases for compromise in order to promote effective tax administration, we do not believe that Congress intended the Service to adopt a standard where the Government would act as an insurer or would relieve taxpayers of those risks attendant to business and financial transactions. The regulations, which expanded the Commissioner's compromise authority, provide only a general standard for the kinds of cases that fall under this authority. They give two examples of potential compromises based on the conclusion that collection would be detrimental to voluntary compliance by taxpayers. In the first, a taxpayer is incapacitated and unable to comply with the tax laws. Upon regaining his ability to do so, the taxpayer immediately attends to his tax obligations. In the second, the taxpayer incurs a liability when he relies on erroneous advice by the Service and it is clear that he could have, and would have, avoided the liability had the advice been correct. See Temp. Treas. Reg. § 301.7122-1T(b)(4)(iv)(E).

Compromise due to the acts of third parties beyond the control of the Service is a departure from these examples.[28] In both of the examples in the regulations, the implicit assumption is that the taxpayer would have complied but for some occurrence over which he had no control. That is not so in this case. The tax liability arose out of the sale of the assets of Company A to Company B, a transaction in which the taxpayer participated and which took place while he was the president of Company A. The taxpayer now concedes that he should be held liable for the tax. In arguing that the Service's delay was unreasonable, however, he ignores the fact that had a correct return been submitted at the time of the transaction, there would have been no delay whatsoever in determining the liability. While it is not disputed that the taxpayer played

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[27] As the taxpayer paid the assessed tax once a corrected notice of deficiency was issued, it is reasonable to assume that, but for the fraudulent acts of his partners, the tax would have been paid when due and no interest would have accrued.

[28] One of the examples of compromise based on "economic hardship" does present a situation where a business has suffered an embezzlement loss. See Temp. Treas. Reg. § 301.7122-1T(b)(4)(iv)(D), Example 4. However, compromise in that example is not premised on the theory that holding the taxpayer liable for the unpaid tax would be inequitable. Rather, the example makes clear that compromise may be entertained in that case because collection of the full tax liability would create an economic hardship in that the company would be driven out of business.

no role in preparing the fraudulent return, it is also undisputed that the taxpayer had knowledge of the transaction, its proceeds, and the fact that it would have tax consequences.

Under these circumstances, we do not agree that collection would be detrimental to voluntary compliance by taxpayers. To the contrary, compromise of the interest in this case would create an incentive for not inquiring into the consequences of a transaction by relieving those without direct knowledge of interest accruals. As in this case, a corporate officer with full knowledge of the transaction would have no incentive to insure that the return was correct, given that the later discovery of fraud would result in payment of only that amount which would have been owed had the fraud not occurred, with the taxpayer retaining the benefits of the use of those funds during the time that the tax liability went undiscovered. Such a compromise policy would seriously undermine the interest provisions of the Code. For this reason, compromise under these circumstances could not be said to "promote effective tax administration."