

Office of Chief Counsel
Internal Revenue Service
Memorandum

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to: Associate Area Counsel
SB/SE:5 (Las Vegas)

from: Mitchel S. Hyman
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(Procedure & Administration)

subject: **IRC SECTION 6673(a)(1) and OFFERS-IN COMPROMISE**

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUE

Should the Internal Revenue Service ("Service") consider an offer-in-compromise submitted by a taxpayer with respect to an I.R.C. § 6673(a)(1) penalty?

CONCLUSION

The Secretary can, as legal matter, compromise section 6673(a)(1) penalties. However, policy concerns exist that weigh against compromising section 6673(a)(1) penalties.

BACKGROUND

During a collection due process ("CDP") hearing, a taxpayer may attempt to raise various issues regarding a section 6673(a)(1) penalty imposed by the Tax Court in an earlier CDP proceeding. In particular, a taxpayer may attempt to submit offers-in-compromise in satisfaction of section 6673(a)(1) penalties. Section 7122(b) states that whenever the Secretary enters into a compromise, a statement shall be made consisting of the following: (1) the amount of the tax assessed, (2) the amount of

interest, additional amount, addition to the tax, or assessable penalty, imposed by law on the person against whom the tax is assessed, (3) the amount actually paid in accordance with the terms of the compromise. You interpret the phrase “imposed by law” in section 7122(b)(2) to mean a tax or penalty that is determined or assessed by the Service pursuant to the Internal Revenue Code. As section 6673(a)(1) penalties are imposed as a matter of judicial discretion, you determine that section 7122 does not authorize the Secretary to compromise them. Additionally, your incoming memo states that section 7122(b) indicates that an offer-in-compromise applies to only certain types of liabilities: a tax, interest, an additional amount, addition to tax, or an assessable penalty. You determine that a section 6673(a)(1) penalty is a sanction or award for costs and, as such, is not included in the type of liabilities covered by section 7122(b).

Your memo further states that, assuming section 7122 does apply to section 6673(a)(1) penalties, these penalties may not be compromised under either “doubt as to liability” or “effective tax administration” standards. In addition, you conclude that the penalties should not be compromised under “doubt as to collectibility” standards.

LAW AND ANALYSIS

A section 6673(a)(1) penalty is unique in that it is imposed solely as a matter of judicial discretion. This office has previously determined that collection due process (“CDP”) rights extend to the collection of these penalties. Pursuant to I.R.C. § 6671(a), section 6673(a)(1) penalties are assessed and collected in the same manner as a tax. I.R.C. § 6330(a)(1) states that no levy may be made on any person unless such person has been notified in writing before such levy is made. Section 6330(3)(A) states that the required notice must include the amount of the unpaid tax. Because a section 6673(a)(1) penalty is assessed and collected as a tax, notice of a right to an administrative hearing must be given to a taxpayer when the Service intends to collect this penalty.

Section 7122(a) states that:

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; and the Attorney General or his delegate may compromise any such case after reference to the Department of Justice for prosecution or defense.

Section 7122(a) grants the Secretary broad authority in determining what types of liabilities to compromise.¹ The express language of the section states that the Secretary may compromise “any civil or criminal case arising under the internal revenue laws.” This code section does not limit this authority to any particular type of liability and should not be interpreted in a manner to limit the Secretary’s discretion to compromise.

¹ Additionally, Treas. Reg. § 301.7122-1(a)(2) states that an agreement to compromise may relate to a civil or criminal liability for taxes, interest, or penalties.

Your incoming memo argues that section 7122(b) only applies to penalties that are “imposed by law” and you interpret this phrase to refer to taxes or penalties that are determined and assessed by the Service pursuant to the Internal Revenue Code. This argument, however, fails to consider the fact that section 7122(a) conveys to the Secretary broad discretion in compromising liabilities. There is no indication either in the Code or legislative history that section 7122(b) is, in any way, intended to limit the scope of section 7122(a). Further, it is irrelevant to section 7122 whether the Service makes the determination of the amount of penalty due or whether the penalty is determined by the Tax Court.

Thus, we disagree that a section 6673(a)(1) penalty is not subject to compromise under section 7122. We nonetheless believe that such penalties should only be compromised in limited circumstances as they, generally, fail to qualify for compromise under the standards set out for the three types of compromise in the Treasury Regulations and the Internal Revenue Manual. The three bases under which a liability can be compromised are doubt as to liability, doubt as to collectibility, and effective tax administration. Treas. Reg. § 301.7122-1(b)(1) states that doubt as to liability does not exist where the liability has been established by a court decision or judgment. See also Rev. Proc. 2003-71. Since the 6673(a)(1) penalty is imposed by the court, it has obviously been established by court decision.

The Service could consider compromises for section 6673(a)(1) penalties based on doubt as to collectibility. Policy Statement P-5-89, however, states that an offer-in-compromise may be rejected if acceptance, in any way, would be detrimental to the Government’s interest. Further, IRM 5.8.7.7 states that an offer-in-compromise can be rejected on policy grounds if public reaction to the acceptance would be so negative that future voluntary compliance by the public would be threatened. Compromising a section 6673(a)(1) penalty could diminish the effect that section 6673(a) has on deterring frivolous litigation. This penalty is an important tool to deter taxpayers from making frivolous arguments in the Tax Court. As the penalty is imposed by the Tax Court as a result of taxpayer conduct, institutional comity could best be served by deferring to Tax Court discretion as to when a taxpayer should be relieved of the obligation to pay a Court imposed penalty. Any decision by the Service to compromise a section 6673(a)(1) penalty could be viewed as overriding the court’s determination that a penalty should be imposed.

In light of these factors, we believe that section 6673(a)(1) penalties should not be compromised as a general matter of policy. However, we do not believe that there should be a categorical rule to not compromise these liabilities. Instances could exist where compromise would be appropriate. For example, if a formerly noncompliant taxpayer were to attempt to become compliant and abandon frivolous arguments, then perhaps these circumstances would warrant compromise. It is ultimately the decision of the Service to determine what policy to adopt in this regard.

The same considerations apply to compromises under an effective tax administration standard. Treas. Reg. § 301.7122-1(b)(3)(iii) states that no compromise to promote effective tax administration may be entered into if compromise of the liability would undermine compliance with internal revenue laws. As this penalty was enacted to discourage the filing of frivolous Tax Court litigation, compromise could dilute the value of this penalty and could undermine compliance with the internal revenue laws. Again, the policy decision to compromise under this standard rests with the Service.

Additionally, per conversations we have had with personnel in the Department of Justice, we have been informed that, as a general matter, the Department of Justice does not compromise sanctions imposed under Fed. R. Civ. P. 11 or Fed. R. App. P. 38 for making frivolous arguments. Often times, these penalties are imposed in conjunction with prohibitions on the filing of any additional suits until the penalties are paid. Thus, an unpaid penalty can serve to deter the filing of further frivolous appeals and new cases.

You have also asked this office to address issues concerning the assessment of section 6673(a)(1) penalties. As we understand the problem, there are instances in which assessments for section 6673(a)(1) penalties are undistinguishable from assessments for other types of penalties. Section 6673(a)(1) assessments need to be easily identifiable for compromise purposes. We are working with Compliance and Appeals to ensure that uniform procedures addressing this concern are adopted.

Finally, we note that the issues a taxpayer may raise at a CDP hearing involving a section 6673(a)(1) penalty are limited. The merits of the penalty may not be raised under section 6330(c)(2)(B) and also pursuant to the doctrine of res judicata. Although the Service can as a legal matter compromise the penalty under collectibility or effective tax administration grounds for the reasons stated, we generally recommend against compromise on policy grounds. Additionally, if the taxpayer raises no legitimate verification issues, is not entitled to an installment agreement due to non-compliance with return filing requirements, and raises no other nonfrivolous issue, then consistent with the policy stated in Chief Council Notice 2003-031, the taxpayer is not entitled to a face-to-face hearing. Also, we note that cases involving section 6673(a)(1) penalties are often good cases to file motions for failure to state a claim or summary judgment. Additionally, these cases would generally be appropriate cases in which to file a motion to collect while the case is pending under section 6330 (e)(2). Further, the Service should request that in conjunction with imposing the penalty, the court should issue an order prohibiting the filing of any further appeals by the taxpayer in another CDP case until the penalty is paid.

Please call (202) 622-3610 if you have any further questions.

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