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TAX WORKOUTS
DEALING WITH THE IRS AS A CREDITOR

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I. POST ASSESSMENT PROCESS

Unless the taxpayer or his representative intervenes to negotiate a special arrangement for deferred payment, security, or compromise of a liability, IRS collection cases generally proceed in predictable steps.

A. Assessment.

"Assessment" simply means that the taxpayer's name and the liability are recorded on a list of debts due to the Internal Revenue Service ("IRS"). I.R.C. § 6203. The statute of limitations for collection of tax by levy or judicial proceeding runs for ten years from the date of assessment. I.R.C. § 6502. Assessment can result from:


2. Mathematical and clerical errors: I.R.C. § 6213(b) permits the Service Center to assess deficiencies based on errors appearing on the face of a return.

3. Audit deficiencies: I.R.C. § 6213(a) generally permits assessment of tax not reported on a return only after:
   a. The taxpayer agrees to the deficiency and signs a waiver of limitations on assessment (Form 870);
   b. The IRS issues a statutory notice of deficiency and the taxpayer fails to petition the Tax Court for a redetermination within 90 days; or
   c. The Tax Court's determination of liability becomes final.


B. Notice and Demand.

Within 60 days after an assessment, the IRS Service Center sends the taxpayer a written notice of the liability and demand for payment. Failure to pay in
full within 10 days of notice and demand triggers penalties under I.R.C. § 6651(a)(3).

C. Statutory Lien.

The notice and demand creates an automatic statutory lien on all of the taxpayer's property, retroactive to the assessment date. I.R.C. §§ 6321-22. The lien attaches to the taxpayer's interest in jointly owned property and to property interests acquired after the date of the lien. Reg. § 301.6321-1; Glass City Bank v. United States, 326 U.S. 265 (1945).

D. Assignment to Collection.

If the liability remains unpaid, the Service Center sends the taxpayer follow-up notices of increasing stridency: a "Second Notice;" a "Request for Immediate Payment;" and a certified "Final Notice." Following the Final Notice, the file is referred to the Collection Division of IRS ("Collection") as a "Taxpayer Delinquent Account" (TDA).

E. Notice of Lien.

The automatic statutory lien of I.R.C. § 6321 is not effective to defeat the interest of a bona fide purchaser, secured creditor, or judgment lien creditor until a Notice of Lien is filed with the appropriate office for the state in which the property is located. I.R.C. § 6323(a). Revenue officers are instructed by the Internal Revenue Manual to consider filing appropriate notices of lien if they have made a reasonable effort but have been unable to contact the taxpayer and schedule an appointment within 60 days of referral of the TDA. IRM 5424.11-.12. Under extraordinary circumstances, a revenue officer, with his manager's approval, may refrain from filing a notice of lien if the taxpayer can demonstrate that filing the lien would hamper collection. IRM 5357.

F. Investigation.

The revenue officer normally identifies the taxpayer's assets and evaluates her ability to pay by calling her in for an interview. If the taxpayer fails to appear for the interview or refuses to cooperate, the revenue officer can issue a summons requiring her to appear and provide financial information. In cases involving substantial delinquent accounts, the revenue officer may conduct an independent investigation to locate the taxpayer's assets and sources of income by examining
prior tax returns, reviewing local real property, personal property and motor vehicle records, and making third party inquiries.

G. **Levy and Seizure.**

Any time after 10 days following the Notice and Demand, I.R.C. § 6331 gives Collection the power to levy on the taxpayer's salary, wages, and other property (subject to relatively insignificant exemptions set forth in I.R.C. § 6334). Normally, the revenue officer must give the taxpayer 30 days notice of his intention to levy. IRC § 6331(2); IRM 5361(2). Following service of a levy, the revenue officer is authorized to seize the property "by any means." In general, a levy permits seizure only of property owned by the taxpayer and obligations due to the taxpayer at the time of the levy. Treas. Reg. § 301.6331-1(a)(1). However, a levy on wages or salary is continuous and permits seizure of funds accruing after the date of the levy so long as the liability remains unpaid. I.R.C. § 6331(e).

H. **Sale of Seized Property.**

Following the seizure of property (other than currency), the Revenue Officer must give the taxpayer notice of the seizure, an accounting for the property seized, and a final chance to pay the liability. I.R.C. § 6335(a). At the same time, the revenue officer may publish a notice of the sale of the property. I.R.C. § 6335(b). The property can be sold at public auction not less than 10 days nor more than 40 days following the notice. I.R.C. § 6335(d).

II. **SPECIAL COLLECTION PROCEDURES**

A. **Transferee and Fiduciary Liability.** I.R.C. § 6901.

If a taxpayer's inability to pay an assessed liability is attributable to prior transfers of assets, the IRS may be able to collect the tax from the transferee or from a fiduciary who authorized the transfer.

1. Equitable transferee liability. Like any creditor the IRS can collect from a transferee who received assets by "fraudulent conveyance" under relevant state law. While the tests for transferee liability vary somewhat from state to state, the IRS must generally show:
a. The tax claim arose before the transfer;

b. The IRS has exhausted its remedies against the taxpayer;

c. The transfer was for less than fair market value; and

d. The taxpayer was insolvent at the time of, or as a result of, the transfer.

Zeddies v. United States, 357 F.2d 897 (7th Cir. 1966); Victoria Saba v. Comm'r, 39 T.C.M. 242 (1979).

2. Contractual transferee liability. If a purchaser of assets from the taxpayer agreed to assume some or all of the taxpayer's liabilities, the IRS may be able to collect tax liabilities as a third-party beneficiary of that contract under relevant state law. American Equitable Assurance Co. of New York v. Comm'r, 27 B.T.A. 247 (1932), aff'd, 68 F.2d 46 (2d Cir. 1933).

3. Statutory transferee liability. I.R.C. § 6324 imposes transferee liability on (a) the recipient of a gift to the extent that the donor fails to pay gift tax liability arising from the gift, and (b) a transferee of property includible in a decedent's estate to the extent the estate fails to pay tax.

4. Fiduciary liability. Under 31 U.S.C. § 3713(b), a fiduciary who pays any debt of an estate, trust, or other taxpayer before paying a valid tax liability becomes personally liable for the tax, to the extent of the payment. Courts have recognized that the scope of the statute should be limited to cases in which the fiduciary knew or should have known of the tax liability. L.T. McCourt v. Comm'r, 15 T.C. 734 (1950).

5. Burden of proof.

a. The IRS has the burden of proving that a transferee is liable. I.R.C. § 6902.

b. Once transferee liability is established, the transferee has standing to contest the underlying assessment, but he has the burden of proving that the taxpayer was not liable. W. Wiener v. Comm'r, 12 T.C. 701 (1949).
6. Statute of limitations. The period for assessment of transferee liability extends one year beyond the statute of limitations for assessment against the transferor. Additional one year periods are added for each successive transfer. I.R.C. § 6901(c).

7. Procedure. Transferee liability is assessed in the same manner, and subject to the same limitations, as the tax with respect to which it is asserted. I.R.C. § 6901(a). Accordingly, a transferee is entitled to a statutory notice of liability, administrative review in the Appeals Office, and Tax Court review before he can be assessed income, estate or gift taxes of a transferor. Treas. Reg. § 301.6901-1(a)(3).

8. The IRS uses transferee liability as a collection device. If more than one transferee has received assets from the taxpayer, Collection can assess the liability against any or all of them, but it will collect only the balance due from the taxpayer and abate the remaining assessments. Similarly, if the taxpayer pays some or all of the liability following an assessment against a transferee, Collection will abate the transferee assessment accordingly.

B. 100 Percent Penalty for Failure to Collect and Pay Over Withholding Tax.

I.R.C. § 6672 imposes a penalty on a person responsible for the collection and payment of withholding taxes equal to 100 percent of the taxes he willfully fails to withhold and pay over. The penalty is routinely and aggressively asserted by Collection against the "responsible officers" of a failed business that owes withholding liabilities.

1. Standard of liability. I.R.C. § 6672 has been interpreted liberally by the IRS and the courts as imposing liability on every person in the business organization who had either the duty to withhold and pay over tax or the power to direct that it be done. Thus, a senior corporate officer, director, or owner cannot avoid liability on the ground that he delegated responsibility to a subordinate. Rizzo v. United States, 73-1 U.S.T.C. ¶ 9268 (N.D. Ind. 1973). If a partnership was a "responsible person," all partners may be liable for the penalty, regardless of their personal responsibility. Fowler v. United States, 78-2 U.S.T.C. ¶ 9800 (N.D. Calif. 1978). The courts have interpreted "willfulness" for purposes of I.R.C.
§ 6672 as an intentional failure to act by a person who was aware of the responsibility to withhold. Barnett v. United States, 594 F.2d 219 (9th Cir. 1979).

2. Assertion of the penalty. Whenever withholding liabilities are unpaid after notice and demand, Collection will investigate possible assertion of the 100 percent penalty. Procedures to assess the penalty will then proceed simultaneously with procedures to collect from the taxpayer. Although the terms of I.R.C. § 6672 would permit the IRS to collect the 100 percent penalty from one or more responsible persons in addition to collecting the withholding tax from the taxpayer, as a matter of policy the IRS uses I.R.C. § 6672 only as a collection device. IRM 5631(1); Policy Statement P-5-60. The penalty is collected only once and is abated to the extent the taxpayer pays.

3. Procedures. The normal limitations on assessment of taxes and penalties do not apply to I.R.C. § 6672 assessments, which can be made summarily without a statutory notice or an opportunity for Tax Court review. The IRS has adopted administrative notice and review procedures. IRM 5634.3 et seq.
   a. Notice. Each person tentatively identified by the revenue officer as a responsible person receives a preliminary notice letter and an opportunity to schedule a conference with the revenue officer to explain why he should not be held liable.
   b. 30-day letter. If the recipient of a notice letter fails to respond or fails to reach agreement with the revenue officer, he will be issued a notice of proposed assessment.
   c. Appeals Office review. The taxpayer can obtain an Appeals Office conference by filing a protest within 30 days of the notice.
   d. Assessment. If no protest is filed or if Appeals agrees with the revenue officer, the penalty is assessed promptly.

4. Avoiding collection of the 100 percent penalty.
   a. Deferral pending collection from taxpayer. Normally, the revenue officer will not pursue
collection of the 100 percent penalty until he has attempted to collect from the taxpayer, so long as the responsible person provides full financial information showing that collection would not be jeopardized by delay.

b. Earmarked payments by taxpayer. Left to its own devices, Collection will apply delinquent tax payments first to general tax and penalty liabilities that are not collectible from responsible officers. However, so long as a payment does not result from a levy or other coercive collection procedure, the taxpayer has a right to designate it as payment of a particular liability. Accordingly, whenever 100 percent penalties have been or are likely to be asserted, the taxpayer's representative should do everything possible to have payments to the IRS earmarked as payments of the trust fund portion of withholding liabilities.

c. Stay of collection. I.R.C. § 6672(b) requires the IRS to stay collection of the 100 percent penalty pending judicial review if the taxpayer pays the portion of the tax attributable to one taxable period; posts a bond equal to 150 percent of the unpaid balances; and files a claim for refund of the tax paid. The legislative history of I.R.C. § 6672(b) contains an explicit admonition to the IRS that the statutory stay should not be the only procedure for pre-payment judicial review of an I.R.C. § 6672 liability and that, under appropriate circumstances, the IRS should defer collection pending judicial resolution of a suit for refund of a portion of the asserted liability. The IRS has adopted a policy of forbearing from collection when a refund suit is pending for a partial payment of a divisible penalty. See IRM, Policy Statement P-5-15.

III. TERMINATION AND JEOPARDY ASSESSMENTS

A. Termination Assessments.

1. Grounds. The IRS in certain circumstances may make an immediate determination of tax for the current taxable year or for the preceding taxable year, or both; assess the amount of the tax, including interest and penalties; and demand immediate
payment of the tax. This procedure may be invoked if the IRS finds that collection would be jeopardized by delay because the taxpayer intends quickly (a) to depart from the U.S., (b) to remove his property from the U.S., (c) to conceal himself or his property in the U.S., or (d) to do any other act "tending to prejudice" the collection of tax for the current or the immediately preceding taxable years. Treas. Reg. § 1.6851-1(a) also provides for termination assessments when the taxpayer is dissipating property or transferring it to other persons, or where the taxpayer's financial solvency is imperiled. The tax for the current year is computed as if the date of the assessment were the end of a taxable year. I.R.C. § 6851(a).

2. Notice of deficiency. After making a termination assessment, the IRS must issue a notice of deficiency within 60 days from the later of the due date of the taxpayer's returns for the year, including extensions, or the date the return is actually filed. I.R.C. § 6851(b). The taxpayer can then file a petition in the Tax Court for a redetermination of the amount of liability assessed.

B. Jeopardy Assessments.

1. Grounds. If the IRSbelieves for any reason that the assessment or collection of any deficiency will be jeopardized by delay, it can immediately assess the deficiency (including interest and penalties), issue notice, and demand payment. I.R.C. § 6861(a). While termination assessments apply only to the current year or the immediately preceding year, a jeopardy assessment may be made for any year.

2. Notice of deficiency. Within 60 days of making a jeopardy assessment, the IRS must issue a notice of deficiency. I.R.C. § 6861(b).

3. Effect of Tax Court proceeding. A jeopardy assessment may be made after a notice of deficiency is issued, whether or not the taxpayer has filed a Tax Court petition. If a proceeding is pending in the Tax Court, that Court has jurisdiction to redetermine the entire amount of the deficiency. I.R.C. § 6861(c). If the jeopardy assessment is made after the decision of the Tax Court is rendered, it cannot exceed the amount of deficiency determined by that Court. I.R.C. § 6861(d). No jeopardy
assessment may be made after the Tax Court decision has become final or after the taxpayer has filed a petition to review the Tax Court’s decision. I.R.C. § 6861(e).

C. Review of Assessments.

1. Administrative review. Within five days of a jeopardy or termination assessment, the IRS must provide the taxpayer with a written statement containing the factual basis for the assessment. The taxpayer may request Appeals Office review within 30 days after this statement is given or, if the IRS fails to provide such a statement, within 35 days of the assessment. The request must contain a reason for the review and should be supported with evidence. Treas. Reg. § 301.7429-2(a); I.R.C. § 7429(a)(3). The appeals officer will, when feasible, grant a conference. Appeals, with the concurrence of District Counsel, has the authority to “compromise” a jeopardy or termination assessment by agreeing to abate some or all of the liability in return for the taxpayer’s agreement to pay a deposit or post a bond or collateral.

2. Judicial review. I.R.C. § 7429(b) permits expedited judicial review of a termination or jeopardy assessment in federal district court. The taxpayer must file an action within the earlier of 30 days of the determination or 45 days of the request for redetermination. I.R.C. § 7429(b)(2) requires the district court to determine within 20 days of the commencement of the action whether the assessment was reasonable and the amount appropriate. The government may not seek to extend this 20-day period unless it joins the taxpayer’s request to do so (Treas. Reg. § 301.7429-3(b)) and such an extension may not exceed 40 days. I.R.C. § 7429(c).


   a. The IRS has the burden of proving that its determination of jeopardy was reasonable under the circumstances, which "means something more than 'not arbitrary or capricious,' and something less than 'supported by substantial evidence.'" Vernon v. United States, 586 F. Supp. 115, 118 (M.D. N.C. 1984); Berkery v. United States, 544 F. Supp. 1, 5 (E.D. Pa. 1982).
b. The IRS must provide a written basis for the amount of a termination or jeopardy assessment. I.R.C. § 7429(g)(2). If the taxpayer disputes the amount, he has the burden of proving that the amount assessed was arbitrary or excessive. If the IRS fails to provide an adequate written basis or the taxpayer meets his burden, the court may order the IRS to abate the entire assessment or to redetermine its amount.

c. If the court determines that the IRS' finding of jeopardy was reasonable but the amount assessed is inappropriate, it may stay the assessment until a more accurate determination can be made. See Krivacek v. United States, 508 F. Supp. 246 (C.D. Calif. 1981); DeLauri v. United States, 492 F. Supp. 442, 446 (W.D. Tex. 1980); Fidelity Equipment Leasing Corp. v. United States, 462 F. Supp. 845, 851-52 (N.D. Ga. 1978). One lesson from these decisions is that it is important for counsel for the taxpayer to demand information supporting the assessment early and often in the administrative process. The taxpayer's position in court is greatly enhanced if the IRS, having been asked for detailed information in support of the assessments, fails to provide it.

D. Collection of Termination and Jeopardy Assessments.

1. If the taxpayer does not pay the tax, collection will proceed unless he posts a bond equal to the full amount assessed pursuant to I.R.C. § 6863.

2. Levy and seizure. The normal 10 day notice prior to levy does not apply in jeopardy or termination cases. I.R.C. § 6331(d)(3). If a levy has been made or is about to be made on any property, the IRS can compel "any person having custody or control of any books or records containing evidence or statements relating to the property" to produce those records to aid collection. I.R.C. § 6333.

IV. MITIGATING THE IMPACT OF THE COLLECTION PROCESS

In the normal case, there is simply no way that a taxpayer with significant assets or income can defeat the collection process. Except in the rarest of circumstances, no court can enjoin the collection of an assessed tax. I.R.C. § 7421; see
Enochs v. Williams Packing & Navigation Co., 370 U.S. 1 (1962). A taxpayer who transfers assets or assigns income to avoid payment of assessed taxes risks a jeopardy or termination assessment for subsequent periods and criminal prosecution for willful failure to pay (I.R.C. § 7203) or evasion of payment (I.R.C. § 7201). Moreover, the IRS may be able to void the transfers based on its statutory lien or collect the tax liability from the transferees. In order to mitigate the impact of the process, the taxpayer’s representative must intervene between the revenue officer and the taxpayer, bargain creatively, and persuade Collection that it would be in the best interest of the IRS to forego coercive collection methods in favor of a negotiated resolution.

A. Deferred Payment.

The easiest arrangement to work out with Collection is a deferral of collection action in return for the taxpayer’s commitment to pay the full liability. It is the policy of the IRS to accommodate bona fide liquidity problems by agreeing to deferred or installment payment tax. IRM, Policy Statement P-5-14. A revenue officer can grant an extension of up to 45 days without any formalities. IRM 5331.32. In order to allow longer deferral or installment payments, he must obtain financial information and a written contract.

1. Prerequisites to an installment agreement.

a. Financial information (Form 433). A revenue officer cannot enter into an agreement for deferred payment of an assessment until the taxpayer has provided, under oath, a comprehensive statement of his financial condition, including a list of his assets and liabilities and a schedule of his sources of income and recurring expenses. IRM 5331.1(1).

b. Current compliance. Collection will generally not consider an installment agreement unless the taxpayer has complied with filing, payment, withholding and estimated tax requirements for the current year. IRM 5331.1(2)-(3).

c. Levy source disclosures. The revenue officer will normally insist that the taxpayer provide "levy source" information (such as the name and address of his employer and the location and identification of bank accounts and assets) that would facilitate collection by
levy in the event of default on the installment agreement. IRM 5331.1(4).

2. Terms of installment agreement. In evaluating an installment proposal, the revenue officer is instructed to make an objective economic judgment: how much can the IRS take without jeopardizing the taxpayer's ability to support his family, pay current taxes, and earn income from which to pay future installments. See IRM 5323. The taxpayer's representative should emphasize the taxpayer's need to retain assets and incur expenses in order to pay the liability and should avoid appeals to public policy, sympathy or compassion.

a. Initial Payment. If the taxpayer has cash in excess of his current business needs, readily marketable non-business assets, or substantial equity against which he could borrow, the revenue officer will generally insist on an immediate payment of part of the liability.

b. Amount of monthly installments. Most installment agreements call for equal monthly payments, for the simple reason that such agreements are easy for the Service Center to monitor by computer. See IRM 5331.1(5). A revenue officer who agrees to variable installments or installments that are not payable monthly must take responsibility for monitoring compliance. IRM 5334. Revenue Officers follow a simple formula for negotiating the installment amounts:

1. Estimate the taxpayer's annual gross income;

2. Subtract estimated taxes and "allowable" expenses (those necessary to carry on his business or employment and to provide minimal support for his family); and

3. Divide the balance into 12 equal monthly installments.

A level payment installment agreement is undesirable if the taxpayer's income is variable or uncertain, since the short-fall in any month must come out of the amount allocated to the taxpayer's needs. If the revenue officer will not agree to variable installments of a percentage of monthly income
(or the excess of monthly income over current allowable expenses), the taxpayer's representative should press to build into the agreement a cushion of liquid assets or monthly income in order to avoid default in low income months.

c. Collateral. It is often possible to negotiate a longer payment term if some or all of the liability can be collateralized, for example with a mortgage on real property or security interest in inventory or intangible assets. Collateral arrangements can also be used to resolve disagreements between the revenue officer and the taxpayer over the advisability of selling particular investments or other property to make an initial payment on the tax liability. If the taxpayer believes that he can realize more by holding the asset, Collection may be willing to accept a security interest rather than insist on sale. (Collection is generally reluctant to hold physical collateral, because it has no facilities for storage and security.)

d. Liens. Collection reserves the right to file and renew notices of lien for liabilities that are deferred under an installment agreement. IRM 5331.1(15). A revenue officer has discretion to forego filing notices of lien if he is persuaded that the liens might hinder the collection process by impairing the taxpayer's ability to do business or to secure funds or credit with which to pay his tax liability. IRM 5355.11; 5357.

e. Review and adjustment. Installment agreements are subject to review and adjustment if the taxpayer's financial condition changes. If the installments are to continue for more than 12 months, the revenue officer may insist that the taxpayer provide follow-up financial information periodically or on request. In return, the taxpayer's representative should try to build in a mechanism for adjusting the monthly payment or avoiding default in the event of reduced income or unanticipated expenses.

3. De facto installment agreement. If a formal installment agreement cannot be reached (for example, because the taxpayer is reluctant to
volunteer financial or levy source information) it may be possible to obtain deferral of collection activity through a unilateral written commitment to pay in installments. A revenue officer with a heavy docket of delinquent and non-performing accounts may forbear from coercive collection if the taxpayer is making regular periodic payments.

B. Administrative Redetermination of Assessed Liabilities.

1. Abatement of penalties. Collection has authority to abate penalties that are subject to waiver on a showing of "reasonable cause." IRM 5175.21. Such penalties include late filing, late payment and failure to pay, I.R.C. § 6651 and failure to deposit withholding taxes, I.R.C. § 6656. (Collection cannot unilaterally abate penalties that were asserted by the Examination Division, but the Revenue Officer has discretion to request that Examination reconsider and abate a penalty.)

a. Procedure. Requests for abatement must be filed with the Service Center if the case is not yet in TDA status. Once the case is assigned to a revenue officer, an abatement request can be filed with the revenue officer. The request should include a statement, signed by the taxpayer under penalties of perjury, setting forth the factual basis for reasonable cause. Treas. Reg. §§ 301.6651-1(c), 301.6656-2(c).

b. Reasonable cause. The specific criteria applied by Collection in evaluating reasonable cause claims are contained in the IRS Law Enforcement Manual, which is not available to the public. Treas. Reg. § 301.6651-1(c) describes a stringent standard for abatement of the late filing and late payment penalties, requiring a showing that the taxpayer exercised "ordinary business care and prudence" but was nonetheless "unable" to file or pay on time. The courts have frequently applied a more liberal standard where taxpayers established that their delinquency was not due to "willful neglect." For example, courts have found reasonable cause for failure to file based on advice of counsel, a CPA, or other tax advisor, Miller v. United States, 211 F. Supp. 758 (D. Wyo. 1962), Coldwater Seafood Corp. v. Comm'r, 69 T.C. 966 (1978); the taxpayer's ignorance of technical

c. Appeals Office review. The taxpayer has a right to appeals office review of a revenue officer's denial of a request to abate. Review must be requested in writing within 15 days of the notice of denial. The revenue officer will normally suspend collection action on the penalty pending a decision by appeals. IRM 5175.2.

2. Reconsideration and abatement of deficiency assessments. Part 53(10)4 of the Internal Revenue Manual establishes a little-used procedure under which a Revenue Officer can refer an assessed audit deficiency back to Examination for reconsideration.

a. Preliminary showing. In order to obtain reconsideration, the taxpayer must make a written showing to the revenue officer that (1) he has information or substantiation that would support abatement of some or all of the assessed audit deficiency or penalties; and (2) he was not aware of the deficiency or penalty prior to assessment or otherwise reasonably failed to present the information to Examination. The reconsideration procedure cannot be invoked to collaterally attack a deficiency resulting from an agreed settlement, closing agreement, or final decision of the Tax Court.

b. Request for reconsideration. If the revenue officer concludes that reconsideration is appropriate, he will suspend collection activity and refer the issue to Examination. If Examination determines that some or all of the deficiency was erroneous, it will abate the assessment accordingly.
3. Offer in compromise based on doubt as to liability. Collection has authority to compromise an assessed deficiency or penalty, regardless of the taxpayer's ability to pay, based on doubt that the assessment was valid or that the taxpayer will ultimately be liable for the tax. Treas. Reg. § 301.7122-1(a)(1). Most offers in compromise based on doubt as to liability raise collection-related issues such as the validity of assertion of the 100 percent responsible officer penalty, I.R.C. § 6672; relief from liability under the innocent spouse rule, I.R.C. § 6013(e); the liability of a transferee of the assets of an insolvent taxpayer, I.R.C. § 6901); or the assertion of penalties and additions to tax. However, the offer in compromise procedure can be used to raise any issue of liability that has not previously been determined in a settlement or a final decision of the Tax Court.

a. Procedure. An offer in compromise based in whole or in part on doubt as to liability should be submitted in writing to the revenue officer, together with a statement of facts and authorities supporting the taxpayer's legal position. The normal procedure is to submit with the offer a deposit in the amount of the compromised liability. If the taxpayer so designates, the IRS must return the deposit (without interest) if it rejects the offer. If the taxpayer wants to defer payment of some or all of the compromised liability, he must provide financial information and an explanation of the source of payment and the security that would be provided pending payment.

b. Examiners' report. Compromise offers raising liability issues (other than the validity of penalties) are processed by the Examination Division; offers to compromise delinquency penalties are processed by the Service Center; and offers involving other penalties are processed by Collection. IRM 57(10)1.81-.83. The examiner assigned the offer prepares a report recommending acceptance or rejection of the offer and stating the facts and legal authorities on which he based his determination. IRM 57(10)(12)-(15).
c. Appeals Office review. The taxpayer can take an adverse determination by the examiner to the Appeals Office by filing a written protest with the District Director within 15 days of transmittal of the examiner’s report. IRM 57(10)(16). The appeals officer has the authority to overrule the examiner or negotiate an amended offer that would be acceptable.

C. Compromising Liability Based on Inability to Pay.

Collection has authority to accept part payment in full satisfaction of the taxpayer’s assessed liabilities if the taxpayer can demonstrate that his current assets and reasonably foreseeable earnings will not permit full payment.

1. Standard for compromising liability. An offer in compromise based on inability to pay must encompass all assessed Internal Revenue liabilities for all years; Collection will not consider piecemeal offers. Collection is not authorized to compromise a collectible liability based on hardship, sympathy or equity. Ops. Atty. Gen., 10/24/33 and 10/2/34, XIII-2 C.B. 442, 445. IRM 57(10)1.1. The revenue officer thus attempts to estimate the total amount that could be realized through levies on the taxpayer’s income and seizure and sale of his assets. An offer of that amount, reduced by the approximate costs of collection, should be acceptable. In some cases, however, the IRS will reject otherwise adequate offers on “public policy” grounds if the taxpayer is notorious, the compromise would set an undesirable precedent, or there is reason to suspect that the taxpayer is engaged in criminal activity or has concealed assets.

2. Determination of amount of offer.

a. Value of assets. The normal standard for estimating the amount collectible from a taxpayer’s assets is their liquidating or "quick sale" value, less encumbrances and costs of sale. Depending on the availability of a ready market, the importance of the taxpayer’s participation in the sale, and other economic factors, quick sale value may be substantially less than fair market value.
b. Going business. The quick sale value of a business may include going concern value, but not if the taxpayer's involvement is an integral part of the business or his cooperation would be necessary to realize going concern value.

c. Trusts, pension plans, etc. The quick sale value of the taxpayer's assets does not include funds held in bona fide trusts, pension plans, etc., that he is not entitled to withdraw or distribute. However, in evaluating an offer in compromise, Collection includes in the taxpayer's assets his interest in a deferred compensation plan, "family trust" or other fund over which he has de facto control.

d. Income. The offer must reflect the value of the taxpayer's income from employment and from other sources. Normally, Collection will require that the valuation include an amount equal to the excess of the taxpayer's projected after-tax income over his estimated allowable expense for at least 3 to 5 years.

e. Impact of transferee liability. Because the IRS can collect certain liabilities directly from responsible officers and transferees (see part II, above), it will compromise a taxpayer's own liability based on his assets, without regard to possible collection from third parties. However, if the taxpayer wants the IRS to agree to forego collection from responsible officers or transferees, he must include in his offer an amount reflecting the value of the IRS' claims against third parties, discounted for hazards of litigations and other relevant factors.

3. Procedures. It is generally advisable to try to negotiate agreed valuations and other terms of the offer informally with the revenue officer before making a formal written offer. The formal offer is reviewed by the IRS Special Procedures staff, which may make its own investigation of the financial information provided by the taxpayer before determining the IRS' response on the offer. The examining agent then holds an offer conference with the taxpayer or his representative for the purpose of soliciting additional information or explanations required to evaluate the offer, suggesting
any amendments necessary to make the offer acceptable, and negotiate the terms of collateral agreements and other "toll charges" required by IRS.

4. Toll charges. The IRS will generally exact various toll charges in return for an agreement to compromise a substantial assessed liability. For example:

a. Waiver of statutes of limitations. If the offer is payable in installments, the taxpayer will be required to agree to suspend the statute of limitations on collection for the period the offer is in force.

b. Waiver of refunds. The taxpayer will normally be required to waive any current and future tax refunds up to the amount to be forgiven.

c. Waiver of tax benefits. A business taxpayer may also be required to forego the tax benefit of net operating loss and investment tax credit carryovers, reduce the tax basis of his assets, or waive bad debt losses and other deductions.

d. Future receipts. The taxpayer may be required to agree to apply specified future or contingent income, bequests, pension plan distributions, or trust distributions, if and when received, to the compromised portion of the tax liability.

e. Income collateral agreement. Unless the taxpayer is prepared to include in a lump sum offer an amount representing the present value of future income, the IRS will normally require an agreement to pay a percentage of actual after-tax income for a period of 3 to 5 years.

5. Effect of compromise agreement. An offer in compromise, once accepted by the IRS, is a binding contract. So long as the taxpayer complies with the terms of the offer, the IRS cannot take collection action on the liabilities waived. However, if the offer is not accepted by an authorized officer of the IRS, or if taxpayer defaults, the IRS is free to collect the entire liability, including penalties and interest accruing while the offer was in force. Reimer v. United States, 441 F.2d 1129 (5th Cir. 1971).
V. BANKRUPTCY OPPORTUNITIES

A. Discharge of Tax Liabilities.

Certain tax liabilities are dischargeable in bankruptcy. With careful planning, an insolvent taxpayer can, therefore, obtain relief from delinquent taxes in a bankruptcy proceeding.

1. Corporate Taxpayers.
   a. Reorganization Proceeding. In a Chapter 11 reorganization, all corporate liabilities that are not provided for in the plan of reorganization are discharged. 11 USC § 1141(d).
   b. Liquidation Proceeding. In a Chapter 11 or Chapter 7 liquidation proceeding, there is no discharge of unpaid tax liabilities. 11 USC § 1141(d)(3); 11 USC § 727(a)(1).

2. Individual Taxpayers.
   a. General Rule. Confirmation of an individual Chapter 11 reorganization or Chapter 7 liquidation discharges income tax liabilities for taxable years for which a return was last due, including extensions, more than 3 years prior to the filing of the bankruptcy petition. 11 USC §§ 507(a)(7)(A)(i) & 523 (a)(1)(A).
   b. Exceptions. Income tax liabilities relating to taxable years for which the return was due more than 3 years before the petition date are not discharged if:
      (1) The liability was assessed within 240 days before the petition date. (If an offer in compromise is made within 240 days of assessment, the 240 day period is extended by the period of time the offer is pending with the IRS plus 30 days.) 11 USC §§ 507 (a)(7)(A)(ii) & 523 (a)(1)(A)).
      (2) The liability was not yet assessed as of the petition date but was assessable after the petition date. 11 USC §§ 507(a)(7)(A)(iii) & 523 (a)(1)(A).
(3) The liability relates to a taxable year for which no return was filed or for which a delinquent return was filed within two years of the petition date. 11 USC § 523 (a)(1)(B).

(4) The liability relates to a fraudulent return. 11 USC § 523 (a)(1)(C).

3. Interest.

a. Pre-Petition Interest. Interest accrued prior to the petition date is dischargeable if it relates to a dischargeable tax liability.

b. Post-Petition Interest. Interest stops accruing on bankruptcy claims as of the petition date. 11 USC § 502(b)(2). However, post-petition interest on non-dischargeable tax liabilities may be collectible from the debtor’s after-acquired property.

4. Penalties.

a. Penalties relating to particular tax return (e.g., fraud, negligence or delinquency) are dischargeable to the same extent as liabilities on that return. 11 USC § 523 (a)(7)(A).

b. Penalties not related to a particular tax return are dischargeable if the events that gave rise to them occurred more than three years prior to the petition date. 11 USC § 523 (a)(7)(B).

c. The 100 percent penalty for failure to withhold taxes (I.R.C. § 6672) is never discharged. 11 USC § 507 (a)(7)(C).

B. Deferred Payment of Tax Claims.

1. Chapter 11. In a Chapter 11 reorganization, a corporate or individual debtor has a statutory right to pay priority tax claims (plus interest) over a period of 6 years from the assessment date. 11 USC § 1129(a)(9)(C).
2. Chapter 13. In a Chapter 13 wage earner plan, the taxpayer has a right to pay tax claims (without interest) over a period of 3 years from the confirmation date.

C. Taxes Resulting from Liquidation of Assets.

An insolvent individual taxpayer faced with sale or foreclosure of appreciated assets to pay taxes or other liabilities may benefit from a prompt bankruptcy filing. If the sale or foreclosure occurs outside of bankruptcy, the tax liability on the gain (and any associated forgiveness of indebtedness income) will be a non-dischargeable priority claim in a Chapter 11 or Chapter 7 proceeding filed within the next 3 years. If the sale occurs after the bankruptcy petition is filed, the resulting tax on the gain becomes a liability of the bankrupt estate.