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INTERNAL REVENUE SERVICE
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MEMORANDUM FOR DISTRICT COUNSEL, NORTH FLORIDA DISTRICT

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.

LEGEND:

Taxpayer
Company A
Company B
X
Y
Z
Year 1
Year 2
Year 3
Year 4
Year 5
Date A
Date B
Date C
Date D
Date E
Date F
Date G

Date H
Date I
Date J
Date K
Date L
Date M
Date N
Date O
Date P
Date Q
Date R
Month/Day 1
AA
BB
CC
DD

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.[1]

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

[1] 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.

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 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.[2]

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

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

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 which he had no knowledge.[3] 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.[4] 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,

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[3] 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.

[4] 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).

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:

> 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.[5] 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,

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[5] 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.

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.[6] 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 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."

If you have any questions, please contact the attorney assigned to this case at (202) 622-3620.

cc. Assistant Regional Counsel (GL), Southeast Region

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[6] 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.