[4830-01-u]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 301

[TD 8829]

RIN 1545-AW87

Compromises

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations that provide additional guidance regarding the compromise of internal revenue taxes. The temporary regulations reflect changes to the law made by the Internal Revenue Service Restructuring and Reform Act of 1998 and the Taxpayer Bill of Rights II. The text of these temporary regulations serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the **Federal Register**.

DATES: Effective date. These temporary regulations are effective July 21, 1999.

Applicability date. For dates of applicability, see §301.7122-1T(j) of these regulations.

FOR FURTHER INFORMATION CONTACT: Carol A. Campbell, (202) 622-3620 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains temporary regulations amending the Procedure and Administration Regulations (26 CFR part 301) under section 7122 of the Internal Revenue Code (Code). The regulations reflect the amendment of section 7122 by section 3462 of the Internal Revenue Service Restructuring and Reform Act of 1998 (“RRA 1998”) Public Law 105-206, (112 Stat. 685, 764) and by section 503 of the Taxpayer Bill of Rights II Public Law 104-168, (110 Stat. 1452, 1461).

As amended by RRA 1998, section 7122 provides that the Secretary will develop guidelines to determine when an offer to compromise is adequate and should be accepted to resolve a dispute. The legislative history accompanying RRA 1998 explains that Congress intended that factors such as equity, hardship, and public policy be evaluated in the compromise of individual tax liabilities, in certain circumstances, if such consideration would promote effective tax administration. H. Conf. Rep. 599, 105th Cong., 2d Sess. 289 (1998).

The current regulations under Treasury regulation §301.7122-1 permit the compromise of cases on only the grounds of doubt as to collectibility, doubt as to liability, or both. These regulations are being removed. Like the current regulations, the temporary regulations provide for compromise based on doubt as to liability and doubt as to collectibility; however, they also provide for compromise based upon specific hardship and/or equitable criteria if such a compromise would promote effective tax administration. The inclusion in these regulations of a standard that will allow compromise on grounds other than doubt as to liability or doubt as to collectibility represents a significant change in the IRS' exercise of compromise authority.

Section 7122 of the Code provides broad authority to the Secretary to compromise any case arising under the internal revenue laws, as long as the case has not been referred to the Department of Justice for prosecution or defense. Although the statutory language of Section 7122 does not explicitly place limits on the Secretary's authority to compromise, opinions of the Attorney General and the regulations issued under section 7122 prior to RRA 1998 authorized the Secretary to compromise a liability under the revenue laws only when there was doubt as to liability (uncertainty as to the existence or amount of the tax obligation) or doubt as to collectibility (uncertainty as to the taxpayer's ability to pay). The opinion of the Attorney General most often cited as the principal source of these limitations is the 1933 opinion of Attorney General Cummings that was issued in response to an inquiry from then Acting Secretary of the Treasury Acheson.

In requesting an opinion from the Attorney General, Acting Secretary of the Treasury Acheson expressed concern that the country was trying to recover from the depression. He suggested that the public interest required compromise of tax claims where collection of the tax would "destroy a business, ruin a tax producer, throw men out of employment, or result in the impoverishment of widows or minor children of a deceased taxpayer." The Secretary expressed the belief that in ordinary times, compromise of cases on public policy grounds should be rare but that, in light of the current state of the country, public policy should play a significantly greater role.

Expressing the belief that it was more important that "the business of the taxpayer be preserved and not destroyed," Acting Secretary Acheson suggested that cases should be compromised where the taxpayer is insolvent, even though the tax is fully collectible, and that penalties and certain interest charges should be "compromisable wherever justice, equity, or public policy seems to justify the compromise... ." Letter from Treasury Department, XIII-47-7137 (July 31, 1933).

Attorney General Cummings replied that "[t]here is much to be said for the proposition that a liberal rule should exist, but my opinion is that if such a course is to be taken it should be at the instance of Congress. I conclude that where liability has been established by a valid judgment or is certain, and there is no doubt as to the ability of the Government to collect, there is no room for 'mutual concessions,' and therefore no basis for a 'compromise.'" Op. Atty. Gen. 6, XIII-47-7138 (October 24, 1933). See also Op. Atty. Gen. 7, XIII-47-7140 (October 2, 1934), wherein Attorney General Cummings stated that "[t]here appears to be no statutory authority to compromise *solely* upon the ground that a hard case is presented, which excites sympathy or is merely appealing from the standpoint of equity, but the power to compromise clearly authorizes the settlement of any case about which uncertainty exists as to liability or collection."

Although the 1933 opinion of Attorney General Cummings is the most often cited opinion regarding the limits of the IRS' compromise authority (prior to RRA 1998), the conclusion he reached mirrored conclusions reached by a number of his predecessors. Thus, since 1868, a number of Attorneys General opined that when liability is not at issue, the Secretary's compromise authority permitted compromise only when "the full amount of the debt" could not be collected. See, e.g., 12 Op. Atty. Gen. 543 (1868); 16 Op. Atty. Gen. 617 (1879) (the Secretary's authority to compromise does not permit the "voluntary relinquishment" of any part of a lawfully assessed tax from a solvent person or corporation).

Following the issuance of Attorney General Cummings' 1933 opinion, Commissioner Helvering established a policy that IRS tax collectors should make every endeavor to secure offers that represent the taxpayer's "maximum capacity to pay." Commissioner's Statement of Policy with Respect to the Compromise of Taxes, Interest, and Penalties, July 2, 1934. Commissioner Helvering recognized that the Attorney General's opinion did not specify or quantify the amount of doubt necessary to compromise, but concluded that "...the Treasury Department does not propose to compromise when there is merely the possibility of doubt. The doubt as to liability or collectibility must be supported by evidence and must be substantial in character, and when such doubt exists, the amount acceptable will depend upon the degree of doubt found in the particular case." Id. Implementing the policy established by Commissioner Helvering, the IRS concluded that an offer premised upon doubt as to collectibility should be accepted only when the amount offered represented the maximum amount the taxpayer could pay, taking into account net equity in assets and both current and future income.

The interpretation of section 7122 adopted by Attorney General Cummings (and reflected in Treasury reg. §301.7122-1(a)), together with the "maximum capacity to pay" policy established by Commissioner Helvering, have been the fundamental guiding principles for IRS offer in compromise programs for the past 65 years. From the 1930's to the early 1990's, offers to compromise were not widely used to resolve tax cases. In the early 1990s, however, the IRS determined that expanded use of offers to compromise could contribute to more effective tax administration in two important respects. First, the IRS determined that compromise could be used as a technique to enhance overall compliance by providing taxpayers with a reasonable avenue to resolve past difficulties. Second, the IRS determined that it should make more effective use of offers to compromise to help manage the inventory of delinquent tax accounts. Accordingly, while still operating within the basic legal and policy guidelines established in the 1930's, the IRS initiated two significant changes intended to enhance the compromise program.

In 1992, the IRS adopted a new compromise policy and issued revised compromise procedures. The policy provides that an offer to compromise will be accepted when it is unlikely that the tax liability can be collected in full and the amount offered reasonably reflects collection potential. As set forth in the new policy statement, the goal of the compromise program is to achieve collection of what is potentially collectible at the earliest possible time and at the least cost to the government while providing taxpayers with a fresh start toward future voluntary compliance. Policy Statement, P-5-100. In administering its policies under the offer program, the threshold question of "doubt as to liability or doubt as to collectibility" set forth in the regulations constituted a legal requirement that must be followed; once that threshold was met, however, the IRS could legally accept less than the taxpayer's maximum capacity to pay. References in the offer procedures to "maximizing collection" and "maximum capacity to pay" were replaced with "reasonably reflects collection potential." Id.

In determining whether an offer reasonably reflects collection potential, the IRS takes into consideration amounts that might be collected from (1) the taxpayer's assets, (2) the taxpayer's present and projected future income, and (3) third parties (e.g., persons to whom the taxpayer had transferred assets). Although most doubt as to collectibility offers only involve consideration of the taxpayer's equity in assets and future disposable income over a fixed period of time, the IRS on occasion also will consider whether the taxpayer should be expected to raise additional amounts from assets in which the taxpayer's interest is beyond the reach of enforced collection (e.g., interests in property located in foreign jurisdictions or held in tenancies by the entirety). IRM 57(10)(10).1.

The compromise program was also affected by a 1995 IRS initiative designed to ensure uniform treatment of similarly situated taxpayers. In administering its collection operations, including both the installment agreement program and the compromise program, the IRS has always permitted taxpayers to retain sufficient funds to pay reasonable living expenses. Certain commentators had asserted that there were wide variances in the type and amount of such reasonable expense allowances within and between districts. In September of 1995, the IRS adopted and published national and local standards for determining allowable expenses, designed to apply to all collection actions, including offers to compromise. National expense standards derived from the Bureau of Labor Statistics Consumer Expenditure Survey were promulgated for expense categories such as food, clothing, personal care items, and housekeeping supplies. Local expense standards derived from Census Bureau data were promulgated for housing, utilities, and transportation.

The IRS allowable expense criteria play an important role in determining whether taxpayers are candidates for compromise or installment agreements. Although offers to compromise and installment agreements are separate mechanisms for resolving outstanding tax liabilities, there often is a significant interplay between the two programs, because a taxpayer's income available to satisfy the tax liability is determined after the deduction of allowable expenses. In some cases, the allowable expense criteria may be the determining factor in whether the taxpayer receives an installment agreement or a compromise. An installment agreement must provide for payment in full of the amount of the outstanding liability through regular, periodic payments (generally monthly). I.R.C. §6159. An offer to compromise, by contrast, reflects the fact that the taxpayer has no ability to pay the liability in full. Accordingly, taxpayers entering into compromise agreements can pay an amount less than the full amount due in satisfaction of the liability.

Congress now has directed the Secretary to consider factors other than doubt as to collectibility and doubt as to liability in determining whether to accept an offer to compromise. Under §7122(c), added by RRA 1998, factors such as equity, hardship, and public policy will be considered in certain circumstances where such consideration will promote effective tax administration. The legislative history of this provision (H. Conf. Rep. 599, 105th Cong., 2d Sess. 289 (1998)) states that --

> ...the conferees expect that the present regulations will be expanded so as to permit the IRS, in certain circumstances, to consider additional factors (i.e., factors other than doubt as to liability or collectibility) in determining whether to compromise the income tax liabilities of individual taxpayers. For example, the conferees anticipate that the IRS will take into account factors such as equity, hardship, and public policy where a compromise of an individual taxpayer's income tax liability would promote effective tax administration. The conferees anticipate that, among other situations, the IRS may utilize this new authority, to resolve longstanding cases by forgoing penalties and interest which have accumulated as a result of delay in determining the taxpayer's liability. The conferees believe that the ability to compromise tax liability and to make payments of tax liability by installment enhances taxpayer compliance. In addition, the conferees believe that the IRS should be flexible in finding ways to work with taxpayers who are sincerely trying to meet their obligations and remain in the tax system. Accordingly, the conferees believe that the IRS should make it easier for taxpayers to enter into offer-in-compromise agreements, and should do more to educate the taxpaying public about the availability of such agreements.

Another consideration for compromise cases is Chief Counsel review. Since its enactment in section 102 of the Act of July 20, 1868 (15 Stat. 166), the statute authorizing the Secretary to compromise liabilities has contained a requirement that Counsel issue opinions regarding certain of those compromises. Section 7122(b) of the Code requires that the opinion of Counsel, with the reasons therefor, be placed on file whenever a compromise is made by the IRS. Chief Counsel opinions assess both whether the offer meets the legal requirements for compromise and whether the offer conforms to IRS policy and procedure. The opinion provided by Chief Counsel, however, does not have to be in favor of compromise. Pursuant to delegated authority, district directors, service center directors, and regional directors of Appeals have the authority to accept an offer that Counsel has opined does not conform to IRS policy.

Until passage of the Taxpayer Bill of Rights II (TBOR 2), Chief Counsel review was required in all cases in which the liability compromised was $500 or more. Under TBOR 2, such an opinion is required only in cases where the compromised liability is $50,000 or more.

Explanation of Provisions

The temporary regulations continue the traditional grounds for compromise based on doubt as to liability or doubt as to collectibility. In addition, to reflect the changes made in RRA 1998, the temporary regulations allow a compromise where there is no doubt as to liability or as to collectibility, but where either (1) collection of the liability would create economic hardship, or (2) exceptional circumstances exist such that collection of the liability would be detrimental to voluntary compliance. Compromise based on these hardship and equity bases may not, however, be authorized if it would undermine compliance. Although the temporary regulations set forth the conditions that must be satisfied to accept an offer to compromise liabilities arising under the internal revenue laws, they do not prescribe the terms or conditions that should be contained in such offers. Thus, the amount to be paid, future compliance or other conditions precedent to satisfaction of a liability for less than the full amount due are matters left to the discretion of the Secretary.

The temporary regulations also add provisions relating to the promulgation of requirements for providing for basic living expenses, evaluating offers from low income taxpayers, and reviewing rejected offers, as required by RRA 1998. The temporary regulations also add provisions relating to staying collection, modifying the dollar criteria for requiring the opinion of Chief Counsel in accepted offers, and setting forth the requirements regarding waivers and suspensions of the statute of limitations. Except for the provision related to dollar criteria for Chief Counsel review, all of the additional provisions of §301.7122-1T are authorized by RRA 1998. The modification of dollar criteria for Chief Counsel review is authorized by section 503(a) of the Taxpayer Bill of Rights II.

As required by §7122(c)(2)(A) and (B), added by RRA 1998, the temporary regulations provide for the development and publication of national and local living allowances that permit taxpayers entering into offers to compromise to have an adequate means to provide for their basic living expenses. The determination whether the published standards should be applied in any particular case must be based upon an evaluation of the individual facts and circumstances presented. The Secretary will determine the appropriate means to publish these national and local living allowances.

In accordance with §7122(c)(3)(A), the temporary regulations also require the development of supplemental guidelines for the evaluation of offers from “low income” taxpayers. The temporary regulations permit the Secretary to determine which taxpayers qualify as “low income” taxpayers based upon current dollar criteria applied by the U.S. Department of Health and Human Service under authority of section 673(2) of the Omnibus Budget Reconciliation Act of 1981, or any other measure reasonably designed to identify such taxpayers.

In accordance with §7122(d)(1), the temporary regulations provide that all proposed rejections of offers to compromise will receive independent administrative review prior to final rejection. Section 7122(d)(2) requires and the temporary regulations also provide that the taxpayer has the right to appeal any rejection of an offer to compromise to the IRS Office of Appeals. The temporary regulations provide, however, that when the IRS returns an offer to compromise because it was not processable under IRS procedures, because the offer was submitted solely to delay collection or because the taxpayer failed to provide requested information required by the IRS to evaluate the offer, such a return of the offer does not constitute a rejection and thus, does not entitle the taxpayer to appeal rights under this provision. In the event that an offer to compromise is returned under these circumstances and the IRS institutes collection action, the taxpayer may have the right to consideration of the whole of his or her collection case under other provisions of the Code.

Pursuant to section 6331(k) of the Code, as amended by section 3462 of RRA 1998, the temporary regulations also provide that for offers pending on or submitted on or after January 1, 2000, no enforced collection activity may be taken by the IRS to collect a liability while an offer to compromise is pending, or for the 30 days following any rejection of an offer to compromise, or during any period that an appeal of any rejection, when such appeal is instituted within the 30 days following rejection, is being considered. Collection activity will not, however, be precluded in any case where collection is in jeopardy or the offer to compromise was submitted solely to delay collection.

Effective through December 31, 1999, the temporary regulations continue to require the taxpayer to waive the running of the statutory period of limitations on collection as a condition of acceptance of an offer to compromise. Effective January 1, 2000, waivers of the statute of limitations on collection will no longer be required for the acceptance of an offer to compromise. Instead, the statute of limitations for collection will be suspended during the period the offer to compromise is under consideration by the IRS.   This provision of the temporary regulations implements section 3461 of RRA 1998.

The temporary regulations also implement section 503(a) of the Taxpayer Bill of Rights II by specifying that Chief Counsel review of an accepted offer to compromise is required only for offers in compromise involving $50,000 or more in unpaid liabilities.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that sections 553(b) & (d) of the Administrative Procedure Act (5 U.S.C. chapter 5) do not apply to these regulations. Please refer to the cross-referenced notice of proposed rulemaking published elsewhere in this issue of the Federal Register for the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6). Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these temporary regulations is Carol A. Campbell of the

Office of Assistant Chief Counsel (General Litigation). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301--PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

§301.7122-1--[**Removed**]

Par. 2. Section 301.7122-1 is removed.

Par. 3. Sections 301.7122-0T and 301.7122-1T are added to read as follows:

<u>§301.7122-1T-0 Table of contents</u>.

This section list the captions that appear in the temporary regulations under §301.7122-1T.

<u>§301.7122-1T Compromises (temporary)</u>.

(h) Statute of limitations.
(i) Inspection with respect to accepted offers to compromise.
(j) Effective date.

§301.7122-1T Compromises (temporary).

(a) In general. (1) The Secretary may exercise his discretion to compromise any civil or criminal liability arising under the internal revenue laws prior to reference of a case involving such a liability to the Department of Justice for prosecution or defense.

(2) An agreement to compromise may relate to a civil or criminal liability for taxes, interest, or penalties. Unless the terms of the offer and acceptance expressly provide otherwise, acceptance of an offer to compromise a civil liability does not remit a criminal liability, nor does acceptance of an offer to compromise a criminal liability remit a civil liability.

(b) Grounds for compromise. (1) In general. The Secretary may compromise a liability on any of the following three grounds.

(2) Doubt as to liability. Doubt as to liability exists where there is a genuine dispute as to the existence or amount of the correct tax liability under the law. Doubt as to liability does not exist where the liability has been established by a final court decision or judgment concerning the existence or amount of the liability. See §301.7122(e)(4) for special rules applicable to rejection of offers in cases where the IRS is unable to locate the taxpayer's return or return information to verify the liability.

(3) Doubt as to collectibility. (i) In general. Doubt as to collectibility exists in any case where the taxpayer's assets and income are less than the full amount of the

assessed liability.

(ii) Allowable Expenses. A determination of doubt as to collectibility will include a determination of ability to pay. In determining ability to pay, the Secretary will permit taxpayers to retain sufficient funds to pay basic living expenses. The determination of the amount of such basic living expenses will be founded upon an evaluation of the individual facts and circumstances presented by the taxpayer's case. To guide this determination, guidelines published by the Secretary on national and local living expense standards will be taken into account.

(iii) Nonliable spouses. (A) In general. Where a taxpayer is offering to compromise a liability for which the taxpayer's spouse has no liability, the assets and income of the nonliable spouse will not be considered in determining the amount of an adequate offer, except to the extent property has been transferred by the taxpayer to the nonliable spouse under circumstances that would permit the IRS to effect collection of the taxpayer's liability from such property, e.g., property that was conveyed in fraud of creditors, or as provided in paragraph (b)(3)(iii)(B) of this section. The IRS may, however, request information regarding the assets and/or income of the nonliable spouse for the sole purpose of verifying the amount of and responsibility for expenses claimed by the taxpayer.

(B) Exception. Where collection of the taxpayer's liability from the assets and/or income of the nonliable spouse is permitted by applicable state law (e.g., under state community property laws), the assets and income of the nonliable spouse will be considered in determining the amount of an adequate offer except to the extent that the taxpayer and the nonliable spouse demonstrate that collection of such assets and income would have a material and adverse impact on the standard of living of the taxpayer, the nonliable spouse, and their dependents.

(4) Promote effective tax administration. If there are no grounds for compromise under paragraphs (b)(2) and (3) of this temporary regulation, a compromise may be entered into to promote effective tax administration when--

(i) Collection of the full liability will create economic hardship within the meaning of §301.6343-1; or

(ii) Regardless of the taxpayer's financial circumstances, exceptional circumstances exist such that collection of the full liability will be detrimental to voluntary compliance by taxpayers; and

(iii) Compromise of the liability will not undermine compliance by taxpayers with the tax laws.

(iv) Special rules for evaluating offers to promote effective tax administration. (A) The determination to accept or reject an offer to compromise made on the ground that acceptance would promote effective tax administration within the meaning of this section will be based upon consideration of all the facts and circumstances, including the taxpayer's record of overall compliance with the tax laws.

(B) Factors supporting (but not conclusive of) a determination of economic hardship under paragraph (b)(4)(i) include–

(1) Taxpayer is incapable of earning a living because of a long term illness, medical condition, or disability and it is reasonably foreseeable that taxpayer's financial

resources will be exhausted providing for care and support during the course of the condition;

(2) Although taxpayer has certain assets, liquidation of those assets to pay outstanding tax liabilities would render the taxpayer unable to meet basic living expenses; and

(3) Although taxpayer has certain assets, the taxpayer is unable to borrow against the equity in those assets and disposition by seizure or sale of the assets would have sufficient adverse consequences such that enforced collection is unlikely.

(C) Factors supporting (but not conclusive of) a determination that compromise would not undermine compliance by taxpayers with the tax laws include--

(1) Taxpayer does not have a history of noncompliance with the filing and payment requirements of the Internal Revenue Code;

(2) Taxpayer has not taken deliberate actions to avoid the payment of taxes; and

(3) Taxpayer has not encouraged others to refuse to comply with the tax laws.

(D) Examples. The following examples illustrate cases that may be compromised under the provisions of paragraph (b)(4)(i):

Example 1. Taxpayer has assets sufficient to satisfy the tax liability. Taxpayer provides full time care and assistance to her dependent child, who has a serious long-term illness. It is expected that the taxpayer will need to use the equity in her assets to provide for adequate basic living expenses and medical care for her child. Taxpayer's overall compliance history does not weigh against compromise.

Example 2. Taxpayer is retired and his only income is from a pension. The taxpayer's only asset is a retirement account, and the funds in the account are sufficient to satisfy the liability. Liquidation of the retirement account would leave the taxpayer without an adequate means to provide for basic living expenses. Taxpayer's overall compliance history does not weigh against compromise.

Example 3. Taxpayer is disabled and lives on a fixed income that will not, after allowance of adequate basic living expenses, permit full payment of his liability under an installment agreement. Taxpayer also owns a modest house that has been specially equipped to accommodate his disability. Taxpayer's equity in the house is sufficient to permit payment of the liability he owes. However, because of his disability and limited earning potential, taxpayer is unable to obtain a mortgage or otherwise borrow against this equity. In addition, because the taxpayer's home has been specially equipped to accommodate his disability, forced sale of the taxpayer's residence would create severe adverse consequences for the taxpayer, making such a sale unlikely. Taxpayer's overall compliance history does not weigh against compromise.

Example 4. Taxpayer is a business that despite the adoption of a wide array of precautions, including the employment of outside auditors, suffered an embezzlement loss. Although the taxpayer reviewed and signed employment tax returns and signed checks for payment of all employment tax liabilities, the embezzling employee successfully intercepted these checks and diverted the funds. At the time taxpayer discovers the diversions, taxpayer promptly contacts the IRS and begins proceedings to obtain recovery from the employee and the auditor. Taxpayer is unsuccessful in obtaining any recovery from either the employee or the auditor. While taxpayer has accounts receivable that will satisfy the tax delinquencies, taxpayer would be unable to remain in business if those receivables were seized by the IRS. Further, while taxpayer will continue to generate some profit if permitted to remain in business, those profits would not be sufficient to pay the accrued liabilities prior to the time collection of the liabilities became barred by the statute of limitations. Taxpayer's overall compliance history does not weigh against compromise.

(E) The following examples illustrate cases that may be compromised under paragraph (b)(4)(ii):

Example 1. In October of 1986, taxpayer developed a serious illness that resulted in almost continuous hospitalizations for a number of years. The taxpayer's medical condition was such that during this period the taxpayer was unable to manage any of his financial affairs. The taxpayer has not filed tax returns since that time. The taxpayer's health has now improved and he has promptly begun to attend to his tax affairs. He discovers that the IRS prepared a substitute for return for the 1986 tax year on the basis of information returns it had received and had assessed a tax deficiency. When the taxpayer discovered the liability, with penalties and interest, the tax bill is more than three times the original tax liability. Taxpayer's overall compliance history does not weigh against compromise.

Example 2. Taxpayer is a salaried sales manager at a department store who has been able to place $2,000 in a tax-deductible IRA account for each of the last two years. Taxpayer learns that he can earn a higher rate of interest on his IRA savings by moving those savings from a money management account to a certificate of deposit at a different financial institution. Prior to transferring his savings, taxpayer submits an E-Mail inquiry to the IRS at its Web Page, requesting information about the steps he must take to preserve the tax benefits he has enjoyed and to avoid penalties. The IRS responds in an answering E-Mail that the taxpayer may withdraw his IRA savings from his neighborhood bank, but he must redeposit those savings in a new IRA account within 90 days. Taxpayer withdraws the funds and redeposits them in a new IRA account 63 days later. Upon audit, taxpayer learns that he has been misinformed about the required rollover period and that he is liable for additional taxes, penalties and additions to tax for not having redeposited the amount within 60 days. Had it not been for the erroneous advice that is reflected in the taxpayer's retained copy of the IRS E-Mail response to his inquiry, taxpayer would have redeposited the amount within the required 60-day period. Taxpayer's overall compliance history does not weigh against compromise.

(c) Procedures for submission and consideration of offers. (1) In general. An offer to compromise a tax liability pursuant to section 7122 must be submitted according to the procedures, and in the form and manner, prescribed by the Secretary. An offer to compromise a tax liability must be signed by the taxpayer under penalty of perjury and must contain the information prescribed or requested by the Secretary. However, taxpayers submitting offers to compromise liabilities solely on the basis of doubt as to liability will not be required to provide financial statements.

(2) When offers become pending and return of offers. An offer to compromise becomes pending when it is accepted for processing. If an offer accepted for processing does not contain sufficient information to permit the IRS to evaluate whether the offer should be accepted, the IRS will request the taxpayer to provide the needed additional information. If the taxpayer does not submit the additional information that the IRS has requested within a reasonable time period after such a request, the IRS may return the offer to the taxpayer. The IRS may also return an offer to compromise a tax liability if it determines that the offer was submitted solely to delay collection or was

otherwise nonprocessable. An offer returned following acceptance for processing is deemed pending only for the period between the date the offer is accepted for processing and the date the IRS returns the offer to the taxpayer. See paragraphs (e)(5)(ii) and (f)(2)(iv) of this temporary regulation for rules regarding the effect of such returns of offers.

(3) Withdrawal. An offer to compromise a tax liability may be withdrawn by the taxpayer or the taxpayer's representative at any time prior to the IRS' acceptance of the offer to compromise. An offer will be considered withdrawn upon the IRS' receipt of written notification of the withdrawal of the offer by personal delivery, or by certified mail, or upon issuance of a letter by the IRS confirming the taxpayer's intent to withdraw the offer.

(d) Acceptance of an offer to compromise a tax liability. (1) An offer to compromise has not been accepted until the IRS issues a written notification of acceptance to the taxpayer or the taxpayer's representative.

(2) As additional consideration for the acceptance of an offer to compromise, the IRS may request that taxpayer enter into any collateral agreement or post any security which is deemed necessary for the protection of the interests of the United States.

(3) Offers may be accepted when they provide for payment of compromised amounts in one or more equal or unequal installments.

(4) If the final payment on an accepted offer to compromise is contingent upon the immediate and simultaneous release of a tax lien in whole or in part, such payment must be made in accordance with the forms, instructions, or procedures prescribed by

the Secretary.

(5) Acceptance of an offer to compromise will conclusively settle the liability of the taxpayer specified in the offer. Neither the taxpayer nor the Government will, following acceptance of an offer to compromise, be permitted to reopen the case except in instances where–

(i) False information or documents are supplied in conjunction with the offer;

(ii) The ability to pay and/or the assets of the taxpayer are concealed; or

(iii) A mutual mistake of material fact sufficient to cause the offer agreement to be reformed or set aside is discovered.

(6) Opinion of Chief Counsel. Except as otherwise provided in this paragraph (d)(6), if an offer to compromise is accepted, there will be placed on file the opinion of the Chief Counsel for the IRS with respect to such compromise, along with the reasons therefor. However, no such opinion will be required with respect to the compromise of any civil case in which the unpaid amount of tax assessed (including any interest, additional amount, addition to the tax, or assessable penalty) is less than $50,000. Also placed on file will be a statement of--

(i) The amount of tax assessed;

(ii) 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; and

(iii) The amount actually paid in accordance with the terms of the compromise.

(e) Rejection of an offer to compromise. (1) An offer to compromise has not been rejected until the IRS issues a written notice to the taxpayer or his representative, advising of the rejection, the reason(s) for rejection, and the right to an appeal.

(2) The IRS may not notify a taxpayer or taxpayer's representative of the rejection of an offer to compromise until an independent administrative review of the proposed rejection is completed.

(3) Low income taxpayers. No offer to compromise received from a low income taxpayer may be rejected solely on the basis of the amount of the offer without evaluating whether that offer meets the criteria in paragraph (b) of this section. For purposes of this paragraph (e)(3), a low income taxpayer is a taxpayer who falls at or below the dollar criteria established by the poverty guidelines updated annually in the **Federal Register** by the U.S. Department of Health and Human Services under authority of section 673(2) of the Omnibus Budget Reconciliation Act of 1981 or such other measure that is adopted by the Secretary.

(4) Offers based upon doubt as to liability. Offers submitted on the basis of doubt as to liability cannot be rejected solely because the IRS is unable to locate the taxpayer's return or return information for verification of the liability.

(5) Appeal of rejection of an offer in compromise. (i) In general. The taxpayer may administratively appeal a rejection of an offer to compromise to the IRS Office of Appeals (Appeals) if, within the 30-day period commencing the day after the date on the letter of rejection, the taxpayer requests such an administrative review in the manner provided by the Secretary.

(ii) Offer to compromise returned following a determination that the offer was nonprocessable, a failure by the taxpayer to provide requested information, or a determination that the offer was submitted for purposes of delay. Where a determination is made to return offer documents because the offer to compromise was nonprocessable, because the taxpayer failed to provide requested information, or because the IRS determined that the offer to compromise was submitted solely for purposes of delay under paragraph (c)(2) of this section, the return of the offer does not constitute a rejection of the offer for purposes of this provision and does not entitle the taxpayer to appeal the matter to Appeals under the provisions of this section (e)(5) of this temporary regulation. However, if the offer is returned because the taxpayer failed to provide requested financial information, the offer will not be returned until an independent administrative review of the proposed return is completed.

(f) Effect of offer to compromise on collection activity. (1) Offers submitted prior to and not pending on or after December 31, 1999. For offers to compromise submitted prior to and not pending on or after December 31, 1999, the submission of an offer to compromise will not automatically operate to stay the collection of any liability. Enforcement of collection may, however, be deferred if the interests of the United States will not be jeopardized thereby.

(2) Offers pending on or made on or after December 31, 1999. (i) In general. For offers pending on or made on or after December 31, 1999, the IRS will not make any levies to collect the liability that is the subject of the compromise during the period the IRS is evaluating whether such offer will be accepted or rejected, for 30 days immediately following the rejection of the offer, and for any period when a timely filed appeal from the rejection is being considered by Appeals.

(ii) <u>Revised offers submitted following rejection</u>. If, following the rejection of an offer to compromise pending on or made on or after December 31, 1999, the taxpayer makes a good faith revision of that offer and submits the revised offer within 30 days after the date of rejection, the IRS will not levy to collect the liability that is the subject of the revised offer to compromise while the IRS is evaluating whether to accept or reject the revised offer.

(iii) <u>Jeopardy</u>. The IRS may levy to collect the liability that is the subject of an offer to compromise during the period the IRS is evaluating whether that offer will be accepted if it determines that collection of the liability is in jeopardy.

(iv) <u>Offers to compromise determined by IRS to be nonprocessable or submitted solely for purposes of delay</u>. The IRS may levy to collect the liability that is the subject of an offer to compromise at any time after it determines, under paragraph (c)(2) of this section, that a pending offer did not contain sufficient information to permit evaluation of whether the offer should be accepted, that the offer was submitted solely to delay collection, or that the offer was otherwise nonprocessable.

(v) <u>Offsets under section 6402</u>. Notwithstanding the evaluation and processing of an offer to compromise, the IRS may, in accordance with section 6402, credit any overpayments made by the taxpayer against a liability that is the subject of an offer to compromise and may offset such overpayments against other liabilities owed by the taxpayer to the extent authorized by section 6402.

(g) <u>Deposits</u>. Sums submitted with an offer to compromise a liability or during the pendency of an offer to compromise are considered deposits and will not be applied to the liability until the offer is accepted unless the taxpayer provides written authorization for application of the payments. If an offer to compromise is withdrawn, is determined to be nonprocessable, or is submitted solely for purposes of delay and returned to the taxpayer, any amount tendered with the offer, including all installments paid on the offer, will be refunded without interest. If an offer is rejected, any amount tendered with the offer, including all installments paid on the offer, will be refunded, without interest, after the conclusion of any review sought by the taxpayer with Appeals. Refund will not be required if the taxpayer has agreed in writing that amounts tendered pursuant to the offer may be applied to the liability for which the offer was submitted.

(h) Statute of limitations. (1) Offers submitted prior to and not pending on or after December 31, 1999. For offers to compromise submitted prior to and not pending on or after December 31, 1999, --

(i) if the 10-year period specified in section 6502(a) will expire prior to December 31, 2002, and

(ii) payments due under the agreement are scheduled to be made after the date upon which the 10-year period specified in section 6502(a) will expire --

no offer will be accepted unless the taxpayer executes a consent to extend the statutory period of limitations on the collection of the liability involved until the date one year subsequent to the date of the last scheduled payment or until December 31, 2002, whichever is earlier.

(2) Offers pending on or made on or after December 31, 1999. For offers pending on or made on or after December 31, 1999, the statute of limitations on

collection will be suspended while collection is prohibited under paragraph (f)(2) of this section.

(3) For any offer to compromise, the IRS may continue to require, where appropriate, the extension of the statute of limitations on assessment. However, in any case where waiver of the running of the statutory period of limitations on assessment is sought, the taxpayer must be notified of the right to refuse to extend the period of limitations or to limit the extension to particular issues or particular periods of time.

(i) Inspection with respect to accepted offers to compromise. For provisions relating to the inspection of returns and accepted offers to compromise, see section 6103(k)(1).

(j) <u>Effective date</u>. Except as otherwise provided, this section applies to offers to compromise submitted on or after July 21, 1999, through July 19, 1999.

Charles O. Rossotti

Commissioner of Internal Revenue

Approved:

Donald C. Lubick

Assistant Secretary of the Treasury (Tax Policy)