



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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MEMORANDUM FOR DISTRICT COUNSEL, MANHATTAN 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 28, 2000. This document may not be cited as precedent by taxpayers.

LEGEND:

Year 1
Year 2
Year 3
Year 4
Date A
Date B
Date C
Date D
X
Y
Partnership

ISSUE:

Is the failure to pay a deficiency resulting from a tax year prior to acceptance of an offer in compromise, but for which a notice and demand was issued after acceptance the offer, a violation of the compliance provision of the compromise agreement?

CONCLUSION:

In the compromise agreement, the taxpayer promised to comply with all payment provisions of the Internal Revenue Code for a period of five years after acceptance of the offer. The Code requires that taxes be paid upon notice and demand by the

Secretary. The failure to pay violated a payment provision of the Code and, thus, constituted default of the compliance term of the compromise agreement.

BACKGROUND:

On Date A, the Service accepted the taxpayers' offer to compromise their Year 1, Year 2, and Year 4 tax liabilities. At the time the offer was accepted, there was no assessed liability outstanding for the Year 3 tax year. The taxpayers made all payments required under the compromise shortly after acceptance as agreed. The offer in compromise contained the standard term requiring compliance with the tax laws for five years following acceptance of the offer. See Form 656, Offer in Compromise, Item 8(d) (Rev. 1-2000).

In Year 3 and Year 4, the taxpayers were limited partners in Partnership, a TEFRA partnership. The partnership filed a petition with the Tax Court with respect to its Year 3 and Year 4 tax years on Date B. The Tax Court dismissed the case on Date C, and assessments against the taxpayers were made in Date D. The taxpayers claim to have been unaware of the Tax Court proceeding involving Partnership when they reached a compromise with the Service.

When the taxpayers were notified of their tax liability for Year 3, they submitted an offer in compromise for that year. That offer was rejected because the Service believed that the liability could be collected in full. The taxpayers then proposed to make an immediate \$X payment and pay the remaining liability through an installment agreement of \$Y per month. The district apparently rejected the agreement because it believed that the unpaid assessment for Year 3 placed the taxpayers in default of the prior compromise. It is unclear from your memorandum what course of action the district proposed pursuing with respect to either the compromise or the Year 3 assessment.

An offer in compromise conclusively settles the tax liability specified in the offer. Temp. Treas. Reg. § 301.7122-1T(d)(5). As the Year 4 income tax liabilities were settled by the prior compromise, the taxpayers are not liable for the assessment relating to that year which resulted from the TEFRA partnership audit. However, the compromise did not cover the tax year Year 3. The taxpayers remain liable for the partnership assessment for that year. The question referred to your office by the district is whether that liability has placed the taxpayers in default of the future compliance provisions of the compromise agreement.

Your office has advised the district that the failure to pay the subsequent assessment may or may not constitute default of the compromise agreement. The question turns on the interpretation of the compliance provision quoted above. You reasoned that the compliance provision is ambiguous. It could be read as a promise: 1) to comply with any filing or payment requirement of the Code which arises during the five years following acceptance of the offer, regardless of the tax period to which the obligation relates, or 2) to comply with any filing or payment

requirement relating to the five taxable years following acceptance of the offer. Given this uncertainty, you advised the district to leave the prior offer undisturbed and reach some arrangement with the taxpayer for payment of the subsequent assessment of income taxes for Year 3.

LAW & ANALYSIS:

A compromise under section 7122 of the Internal Revenue Code is recognized as a contract. See United States v. Feinberg, 372 F.2d 352 (3d Cir. 1967); United States v. Lane, 303 F.2d 1 (5th Cir. 1962). As such, the compromise agreement is subject to interpretation using generally accepted contract principles.

The purpose of interpretation is to give the contract the meaning intended by the parties at the time the contract was formed. Corbin on Contracts VII (Rev. ed. 1998). The oldest and most frequently relied upon rule of interpretation is the Plain Meaning Rule. The rule states: “[I]f a writing, or the term in question, appears to be plain and unambiguous on its face, its meaning must be determined from the four corners of the instrument without resort to extrinsic evidence of any nature.” John D. Calamari & Joseph M. Perillo, The Law of Contracts 166-67 (3rd ed. 1987).

The provision at issue states, in relevant part:

I/we will comply with all provisions of the Internal Revenue Code relating to filing my/our returns and paying my/our required taxes for 5 years or until the offered amount is paid in full, whichever is longer.

Form 656, Offer in Compromise, Item 8(d) (Rev. 1-2000). Should the taxpayer fail to keep this promise, the Service may terminate the compromise and take action to collect the full balance of the unpaid tax liabilities covered by the compromise. See id. at Item 8(o). The compliance requirement is in keeping with the Service’s expectation that a compromising taxpayer will make a fresh start toward future compliance with the tax laws. See Policy Statement P-5-100.

Taking the quoted language at its face, the taxpayer has made a promise to comply with all the filing and payment provisions of the Code. See Restatement (Second) Contracts § 202(3)(a) (“[W]here language has a generally prevailing meaning, it is interpreted in accordance with that meaning.”). The promise is not qualified to apply only to particular tax periods, or to exclude obligations relating to past years. The five year time frame is the length of the obligation to comply, and imposes no further limit on the promise. For instance, the term could have expressly stated that the taxpayer will comply with filing and payment obligations “relating to the next 5 tax years.” Giving “5 years” the meaning it is commonly understood to have, it expresses a length of time that the promise will be kept.

In this case, a tax liability was determined and assessed against the taxpayers. As the Code requires, the Service sent a notice and demand for payment. See I.R.C.

§ 6303(a). Upon receipt of the notice and demand, the taxpayers were required to pay the tax shown therein. I.R.C. § 6155(a). The failure to do so violated a payment provision of the Code and constituted default of the compromise agreement.

HAZARDS AND OTHER CONSIDERATIONS

We do not believe that the compliance provision can reasonably be read to be limited only to the five tax years immediately following acceptance of the offer. However, the Plain Meaning Rule has been increasingly criticized in favor of more liberal approaches to contract interpretation. See Calamari, supra, at 167. The weight of modern authority would require a court to go beyond an analysis of the plain meaning of the words employed. Commentators and courts have come to realize that no language can be so clear that it is not subject to some dispute regarding its meaning. Id. at 166; Towne v. Eisner, 245 U.S. 418, 425 (1918). The trend in contract interpretation is to focus not solely on the language employed, but to determine the intended meaning by taking into account all relevant extrinsic evidence, regardless of whether a contract term can be said to be ambiguous. See, e.g., Pacific Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co., 442 P.2d 641, 644 (Ca. 1968).





A conclusion that the compromise agreement has been violated does not dictate the course of action that the Service must follow. As is discussed above, the agreement gives the Service the right to take action to collect in the event of default. The offer in compromise handbook makes clear that termination of the agreement is not to be an automatic response in the event a taxpayers defaults. See IRM 5.8.9.4. The first step in the event of a default is to make an attempt to secure compliance. Id. at (3). The facts and circumstances of the case must be examined before a decision can be made to terminate the offer, allow time to come into compliance, or take other action. Id. at (4). In this case, the district has the discretion, if it concludes it is appropriate, to resolve the case as the taxpayers have proposed.

CONCLUSION:

We conclude that the failure to pay a deficiency upon notice and demand is a violation of the Code which constitutes default of the compromise agreement. However, that interpretation of the contract could be subject to dispute. Further, the Service has the discretion to resolve that deficiency through an installment agreement and to leave the compromise undisturbed.

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

cc. Assistant Regional Counsel (GL), Northeast Region