

INTERNAL REVENUE SERVICE

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MEMORANDUM FOR PENNSYLVANIA DISTRICT COUNSEL
Attn: David Breen

FROM: Kathryn A. Zuba
Chief, Branch 2 (General Litigation)

SUBJECT: CSED Recovery Project: Offers in Compromise

This responds to your memorandum dated October 22, 1998. This document is not to be cited as precedent.

LEGEND:

Taxpayers	
Years 1-16	Date M
Period A	Date N
Date A	Date O
Date B	Date P
Date C	Date R
Date D	Amount A
Date E	Amount B
Date F	Amount C
Date G	Amount D
Date H	Amount E
Date I	Amount F
Date J	Amount G
Date K	Amount H
Date L	Amount I

ISSUES

1. Whether the Service may retain the amount paid by the taxpayers pursuant to a joint offer in compromise for income tax liability for Year 2 and Year 12, where the statute of limitations for collection of Year 2 taxes had expired prior to the submission and acceptance of the offer and the amount of money paid with the offer exceeded the taxpayers' Year 12 tax liability.

2. Whether the Service may retain the amount paid by the taxpayer husband pursuant to an offer in compromise for his separate tax liability for Period A.
3. Whether the Service may retain any refunds otherwise due to the taxpayers for years prior to and including the year in which the two offers in compromise were accepted by the Service.

CONCLUSIONS

1. The Service may retain the amount necessary to satisfy the taxpayers' Year 12 tax liability. The remaining amount constitutes a tax overpayment and should be refunded to the taxpayers in accordance with the discussion below.
2. The Service may retain the full amount accepted under the taxpayer husband's offer in compromise.
3. The Service may retain any refund otherwise due to the taxpayer husband and apply these amounts to the taxpayer husband's compromised liability pursuant to the terms of the offer in compromise.

FACTS

We understand the relevant facts to be as follows. The taxpayers had outstanding income tax liabilities for Years 1, 2, 3, 4, and 5.¹ On Date A, the taxpayers signed a payroll deduction installment agreement under which Amount A was deducted from the taxpayer husband's wages and remitted directly to the Service by the taxpayer husband's employer. The installment agreement was approved on Date B. The taxpayers' account shows that timely and regular payments were made between June of Year 12 and July of Year 15.

On Date C, or approximately one year after the taxpayers entered into an installment agreement, the Service asked the taxpayers to execute a Form 900 Tax Collection Waiver extending the statute of limitations on collection of Year 1 and Year 2 tax liabilities. The ten-year statute of limitations on collection of these taxes was due to expire on Date F. The letter requesting the waiver from the taxpayers provided as follows: "In order for [the installment] agreement to remain in effect, it will be necessary for you to sign and date the enclosed Form 900."

In response, the taxpayers executed two waivers. The first waiver extended the collection period for Year 1 liability until Date G. The second waiver extended the

¹ Subsequent to entering into the installment agreement, the taxpayers incurred additional income tax liabilities. The liability for Year 11 was assessed on Date D, and the liabilities for Years 12 and 13 were assessed on Date E.

statute for collection of Year 2 tax liability until Date H. According to the Service's records, both of these waivers were signed by the taxpayers on Date I, and accepted by the Service on Date J.²

The taxpayers refused to sign additional tax collection waivers requested by the Service. The statute of limitations for collection of Year 3 and Year 4 income tax liability expired in July and August of Year 15, respectively. No payments were applied to these tax liabilities subsequent to the expiration of the collection period.

Sometime in Year 14, the Service terminated the taxpayers installment agreement and referred the case to the Collection Division for collection.³ On Date L, the Revenue Officer assigned to the case requested that Notice of Federal Tax Lien be filed to protect the Government's interest. Also on the same date, the Service issued to the taxpayers a final notice of its intent to levy. Sometime thereafter, the Service levied on the taxpayers' wages. The Service also received approximately Amount B in proceeds from a sale of the taxpayers' former residence .

In addition to the joint income tax liabilities, the taxpayer husband was also liable to the Service for trust fund recovery penalty ("TFRP"). While originally the Service made assessments for several quarters of Year 3 and Year 5, most of these assessments were later abated and some of the periods were allowed to expire. As of Date M, the only outstanding liability was for the Period A. The limitations period for collection of

² The extensions of the limitations period were not posted to the taxpayers account until after the original statutes had expired. Due to this late posting, the Service inadvertently released its liens for Year 1 and Year 2 on Date K. The Service subsequently revoked the erroneous release pursuant to I.R.C. § 6325(f)(2). The taxpayers dispute the propriety of this action and claim that the Service should be bound by the release. Because we conclude that the extensions of the statute of limitations in question are invalid, we also conclude that the Service did not have a statutory lien for income tax liabilities for Year 1 and Year 2 after Date F. I.R.C. § 6322.

³ It is not clear whether the installment agreement was terminated because the taxpayers failed to pay their taxes for Year 12 and Year 13 or, because the taxpayers refused to sign additional collection waivers.

this liability, calculated without regard to the taxpayer husband's accepted Offer in Compromise, is due to expire on Date N.⁴ It is not clear whether the TFRP liability was covered by the taxpayers' payroll deduction installment agreement.

Since the termination of the taxpayers' installment agreement, the taxpayers have submitted several offers in compromise. With the exceptions of the two offers which the Service ultimately accepted, these offers were determined to be unprocessable and were returned to the taxpayers. In the meantime, the Service continued its efforts to collect on the unpaid tax liabilities.

The taxpayers submitted their current offers in compromise based on doubt as to collectibility on Date P. At that time, the Service's records showed an outstanding income tax liability for Year 2 of Amount C and for Year 12 of Amount D. The taxpayer husband's liability for the TFRP for the Period A, was in Amount E. The taxpayers offered to pay Amount F in compromise of their Year 2 and Year 12 income tax liabilities. The taxpayer husband offered to pay Amount G in compromise of his TFRP for Period A.⁵ The Service has determined that the taxpayers' offers exceeded what the Service could reasonably collect from the taxpayers.⁶

The Service accepted both offers on Date M. On the same date, the Service deposited the taxpayers' two checks in the Amount F and Amount G⁷, respectively, and mailed to the taxpayers two acceptance letters. One letter informed the taxpayers of the acceptance of their joint offer; the other informed the taxpayer husband of the

⁴ The original statute of limitations for this liability was due to expire on Date O. However, due to an earlier Offer in Compromise , the statute was suspended for one year, five months, and 24 days.

⁵ The taxpayers originally proposed to pay Amount H to compromise all of their tax liabilities, both joint and individual. Because individual and joint liabilities of married taxpayers cannot be compromised on the same offer agreement, the taxpayers were asked to submit separate offers for their joint and individual liabilities.

⁶ The present value of the taxpayers' future income was determined to be , and the net realizable equity in assets was determined not to exceed Amount I. Accordingly, the total amount offered exceeded the Service's collection potential.

⁷ The payment in Amount F was credited to the taxpayers' Year 12 income tax liability. No portion of this amount was applied to the taxpayers' Year 2 tax module.

acceptance of his individual offer. In all other respects, the acceptance letters were identical. They explained to the taxpayers their obligations under the offers, including the Service's right to retain any refunds or credits otherwise due to the taxpayers for Year 16 and prior.

The case was referred to this office in connection with the Collection Statute Expiration Date ("CSED") Recovery Project to consider the validity of the taxpayers' two offers in compromise, and the Service's right to retain the funds paid in connection with these offers, in light of the Service's earlier determination that the statute of limitation on collection of one of the liabilities covered by the taxpayers' joint offer in compromise expired prior to the acceptance of that offer by the Service.⁸

LAW & ANALYSIS:

The Service is provided a broad authority to compromise any civil or criminal case arising under the internal revenue laws prior to the reference of that case to the Department of Justice pursuant to I.R.C. § 7122. A tax liability may be compromised only if there is either a doubt as to the Service's ability to collect the tax liability or legal uncertainty as to the amount of the liability. Treas. Reg. § 301.7122-1(a). A tax may not be compromised if the tax liability has been established by a valid judgment and there is no doubt as to the ability of the Government to collect the amounts owing with respect to such liability. Id.

Taxpayers' Joint Offer in Compromise

The taxpayers submitted a joint offer in compromise to compromise their income tax liabilities for Year 2 and Year 12. The Service should not have compromised Year 2 tax liability because at the time the taxpayers' joint offer was submitted the statute of limitations for collection of Year 2 liability had expired. Thus, the liability was no longer enforceable and should not have been compromised.

Likewise, the taxpayers' liability for Year 12 should not be compromised by the Service because there was no basis for the compromise. The taxpayers offer cited doubt as to collectibility as the reason for the compromise. However, no doubt as to collectibility existed at the time the offer.

Prior to the acceptance of the taxpayers' joint offer in compromise, the Service had

⁸ Pursuant to Counsel's earlier advice, the Service has determined on Date R that the waivers obtained with respect to Year 1 and Year 2 are invalid and that any payments applied to these tax liabilities after Date F are statutory overpayments subject to offset or refund pursuant to I.R.C. §§ 6401, 6402 and 6511(b). Before the Service was able to take appropriate steps to correct the taxpayers' account, however, another function within the Service processed and accepted the taxpayers' two offers.

determined that the statutes of limitations with respect to Year 1 and Year 2 were improperly extended. The statute of limitation for collection of the liabilities with respect to both of these years had expired on Date F. Under section 6401(a) of the Internal Revenue Code, any payment of internal revenue tax, whether voluntary or involuntary, collected after the expiration of the collection period is an overpayment of tax. I.R.C. § 6401(a). Tax overpayments may be credited to other outstanding federal tax liabilities subject to the restrictions set forth in I.R.C. §§ 6402 and 6511(b).⁹ In the case at hand, several payments made by the taxpayers pursuant to their installment agreement were applied to Year 1 and Year 2 after the expiration of the collection statute. Subject to the restrictions set forth in section 6511(b), these payments may be offset against the taxpayers' Year 12 liability. While we do not know the exact amount available for offset, we know that this amount is more than sufficient to extinguish the taxpayers' joint liability for Year 12. Thus, at the time the taxpayers' joint offer in compromise was evaluated by the Service, there was no doubt as to the Service's ability to collect the Year 12 liability and no basis upon which the taxpayers' compromise could be accepted.

Because the Service should not have accepted the taxpayers' joint offer in compromise, the Service may not retain the full amount paid by the taxpayers with the offer. The portion of the payment which exceeds the taxpayers' Year 12 tax liability is an overpayment of tax, which should be refunded to the taxpayers and/or offset to the taxpayer husband's TFRP liability in accordance with the discussion below. In addition, the Service should reverse all transaction codes relating to the taxpayers' joint offer in compromise, including any suspensions of the statute of limitations on collection agreed upon in conjunction with the offer.

Taxpayer Husband's Individual Offer in Compromise

The individual and joint tax liabilities of married taxpayers cannot be compromised on the same offer agreement. If both spouses wish to compromise all of their liabilities, separate agreements must be secured. Each of these agreements will constitute a separate offer in compromise. Each agreement must be fully sustainable on its own merits. Inability of the Service to accept one of the offers, thus, does not impact the Service's ability to accept the other.

⁹ Section 6511(b) limits the amount which can be refunded to the taxpayer or credited against other liability to taxes paid in the two years immediately preceding the date the taxpayer's claim for a refund is filed or, if no claim is filed, the date the refund is allowed. In this case, the taxpayers did not file a claim for refund.

In the instant case, the taxpayer husband offered to pay Amount G to compromise his personal liability for Period A, based on doubt as to collectibility. The Service's financial analysis disclosed that the maximum amount the Service can expect to collect from the taxpayers jointly is approximately Amount I. In July of Year 16, the total balance owed by the taxpayer husband for the Period A was in Amount E. Thus, even if the entire Amount I were property of the taxpayer husband, this amount would not sufficient to fully satisfy the taxpayer husband's TFRP liability. The TFRP, therefore, was susceptible to compromise based on doubt as to collectibility. The offer was properly accepted by the Service and the Service has a right to retain the Amount G payment made by the taxpayer husband's pursuant to his offer in compromise.

Moreover, under the terms of the offer in compromise, the Service has the right to retain any refund due to the taxpayer husband for any tax periods "extending through the calendar year" in which the offer was accepted by the Service. See Form 656, Item 8(g). It is well established that couples filing a joint return have a separate property interest in the resulting overpayment. See, e.g., Rosen v. United States, 397 F. Supp. 342, 343-344 (E.D. Pa. 1975); Gens v. United States, 673 F.2d 366 (Cl. Ct. 1982), cert denied, 459 U.S. 906 (1982); Michaelson v. Commissioner, T.C. Memo 1997-39. Thus, a joint overpayment of tax is allocated to each spouse according to the contribution made by each. Gordon v. United States, 757 F.2d 1157 (11th Cir. 1985); Oman v. Commissioner, T.C. Memo 1984-357. If all of the payments which respect to a joint tax liability are made only by one spouse, the refund of overpayment of tax with respect to that liability belongs to that spouse alone and the other spouse is not entitled to any portion of such refund. Rev. Rul. 74-611, 1974-2 C. B. 399, as amplified by Rev. Rul. 85-70, 1985-1 C.B. 361. Also Rev. Rul. 80-7, 1980-1 C.B. 296, as amplified by Rev. Rul. 85-70, 1985-1 C.B. 361.

The taxpayers' overpaid their taxes for years 1, 2, and 12. The Service should determine what amount of the tax overpayment with respect to each year belongs to the taxpayer husband and which portion belongs to the wife. The amount of the overpayment which is properly allocable to the taxpayer husband may then be offset against the taxpayer husband's compromised TFRP. To the extent the taxpayer husband's share of the tax overpayment exceeds his compromised liability, the difference should be refunded to the taxpayer husband in accordance with section 6511(b) and the applicable refund procedures. The portion of the overpayments for Year 1, Year 2, and Year 12, which is properly attributable to the wife should be refunded to her separately.

HAZARDS AND OTHER CONSIDERATIONS

As noted above, it is not clear whether the Service terminated the taxpayers' installment agreement because the taxpayers had failed to pay their Year 12 and Year 13 income tax liabilities (in which case termination would have been proper) or because the taxpayers refused to execute waivers of the collection period with respect to the Year 3 and Year 4 joint income taxes (in which case termination would not have been proper).

From the documents submitted to us in connection with this case, we were able to determine that the taxpayers' installment agreement was terminated sometime in Year 14. However, the files do not contain any correspondence advising the taxpayers of the termination and their appeal rights. While the computer program designed to monitor the taxpayers' compliance with the installment agreement should have identified the taxpayers' installment agreement as being in default once the new liabilities for Year 12 and Year 13 were assessed on Date E, we do not know whether the taxpayers were notified of this default. The Revenue Officer's notes indicate that the installment agreement was terminated because the taxpayers refused to execute additional tax collection waivers. However, we have no correspondence to discern whether the taxpayers were asked for these additional waivers while in compliance with their installment agreement or, whether they were asked for these waivers as a condition of entering into a new installment agreement after they defaulted on the earlier installment agreement. We recommend that you look into this matter and determine the reason for the termination of the taxpayers' installment agreement and whether or not the taxpayers are entitled to receive additional amounts from the Service pursuant to I.R.C. § 6343(d).

As always, we hope the advice provided herein is helpful in resolving this matter. If you have any questions or concerns please contact the attorney assigned to this matter.

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