



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

OFFICE OF
CHIEF COUNSEL

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MEMORANDUM FOR DISTRICT COUNSEL,

FROM: Joseph W. Clark
Acting Chief, Branch 2 (General Litigation)

SUBJECT:

This memorandum responds to your request for advice dated July 15, 1999. This document is not to be cited as precedent.

LEGEND

Taxpayer X
Amount A
Date A
Year 1
Year 7
Year 8
Year 9
Year 11
Year 12
Year 13
Year 14
Date B
Date C
Date D
Date E
Date F
Date G
Date H

ISSUE

Whether an offer in compromise which has been terminated by the Service due to a taxpayer's default can later be reinstated by the Service.

CONCLUSION

Once an offer in compromise has been terminated for default by the taxpayer, the Service lacks the authority to reinstate the agreement.

BACKGROUND

On Date A, the Service accepted two separate offers in compromise from Taxpayer X ("taxpayer"), one for the years Year 1 to Year 7 and one for the years Year 8 and Year 9. The earlier liabilities were incurred jointly with his deceased spouse. The taxpayer made timely payments of Amount A, as agreed. Each offer in compromise contained the standard language in which the taxpayer promised to comply with all provisions of the Internal Revenue Code relating to the filing of returns and payment of taxes for five years following acceptance of the offer. See Form 656, Offer in Compromise, Item 8(d).

The taxpayer's Year 11 and Year 12 income tax returns were due to be filed August 15, Year 12 (as a result of an automatic extension), and April 15, Year 13, respectively. In October Year 14, the Service Center asked that the taxpayer's failure to file those returns be investigated by the field. An Offer in Compromise (OIC) Specialist was assigned to the case. As was the practice in these kinds of cases, the OIC Specialist contacted the taxpayer in an attempt to secure the returns prior to declaring the compromise agreement to be in default.

On Date B, the OIC Specialist sent a letter to the taxpayer requesting the unfiled returns. The letter reminded the taxpayer that failing to file returns constituted default and asked that the taxpayer submit the returns by Date C, or contact the district immediately. No response was received. On Date D, the taxpayer was sent a letters stating that the compromise agreements had been terminated.¹ On

¹ The Date D letters incorrectly stated that the compromise was being terminated for failure to return a refund for the Year 11 tax year, as was required by the compromise agreement. See Form 656, Offer in Compromise, Item 8(g). However, this error did not invalidate the termination. There is no question that the taxpayer received actual notice of the reasons the compromise was in default. Furthermore, under the terms of the compromise, the Service need not give notice to act on default of the agreement. See id. at Item 8(o). See also United States v. Feinberg, 372 F.2d 352, 358 (3d Cir. 1967) (stating that government is not required to issue "warning shot" before taking action on defaulted compromise agreement).

Date E, taxpayer's current wife called to inquire about the status of the compromises and to promise that the returns were forthcoming. The OIC Specialist stated that the compromises would be reinstated if the returns were filed by Date F. The OIC Specialist then called the Service Center and was told that no action would be taken while they awaited receipt of the missing returns. Those returns were received by the OIC Specialist on Date G.

On Date H, the OIC Specialist sent the taxpayer a letter indicating that the compromise agreements had been reinstated. Subsequently the Service Center's OIC Unit concluded that because termination letters had been sent, the compromises could not legally be reinstated. That conclusion was based upon advice previously given by this office. You have asked that we reconsider the question of whether a terminated offer in compromise can be reinstated.

DISCUSSION

A compromise under section 7122 of the Internal Revenue Code (I.R.C. or "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 judicial interpretation using generally accepted contract principles.

Your memorandum states that the present case requires an examination and application of the law of rescission of contracts. We do not agree that rescission is the issue. Rescission is defined broadly as canceling, nullifying or avoiding a contract. See, e.g., Black's Law Dictionary 1306 (6th ed. 1990). However, there is some disagreement as to the scope of that term in contract law. Some authorities use the term to describe only cases of mutual agreement to discharge the parties' obligations under the contract, see 5A Corbin on Contracts § 1236 (1964 & Supp. 1999); Woodruff v. McClellan, 622 P.2d 1268, 1269 (Wash. 1980), while others also apply the term to situations where the contract authorizes unilateral cancellation upon the occurrence of specific events. See 17A Am.Jur.2d Contracts §§ 539 & 565 et seq.² On one point, however, all authorities appear to be in agreement: a rescission only takes place when a contract is undone from the beginning, placing both parties in the same position they would occupy had they never entered into the contract. See id. at § 539; 17A C.J.S. Contracts § 385(2);

² In Nebco & Associates v. United States, 23 Cl. Ct. 635, 642 (1991), the Claims Court distinguished between "rescission by agreement" and "rescission," which sometimes refers to a power of avoidance arising from fraud or mutual mistake. Id. Use of the term rescission to refer to a unilateral power to cancel a contract finds its roots in the concept that fraud or mistake supports a finding of "implied consent" by the other party. See Dooley v. Stillson, 128 A. 217 (R.I. 1928).

Dairyland Power Coop. v. United States, 27 Fed. Cl. 805, 813 (1993), aff'd 16 F.3d 1197 (Fed. Cir. 1994); Brannock v. Fletcher, 155 S.E.2d 532, 542 (N.C. 1967).

An offer in compromise can only be rescinded if there was a mutual mistake as to a material fact or there was a misrepresentation by one of the parties to the agreement. Treas. Reg. §301.7122-1T(d)(5); IRM 5.8.9.2(2). Action taken by the Service in response to a failure to meet the compliance provisions of Item 8(d) of Form 656 is not a rescission. The parties are not returned to their former positions, as they would be in a rescission. The Service, in response to the taxpayer's breach of the agreement, applies the funds remitted in compromise to the underlying tax liabilities and takes action to collect the balance administratively or through filing a suit. Service procedures term this action a "termination" of the agreement. See IRM 5.8.9.4(5)

Upon breach of a contract, the non-breaching party may cease performance and sue for damages or seek other remedies allowed by law. See Stone Forest Indus., Inc. v. United States, 973 F.2d 1548, 1550 (Fed Cir. 1992). In the offer in compromise context, the agreement clearly spells out that the Service may, without notice to the taxpayer, take action to collect either the unpaid compromise amount or the full amount of the underlying liability. See Form 656, Item 8(o). Although no notice to the taxpayer is required before commencing action, notice is generally given in the form of a "termination letter." This practice has the benefit of showing with certainty that the Service regards the agreement as terminated and establishes the date on which the termination takes effect. We conclude that the Service terminated the offers in compromise on Date D, as evidenced by the letters of that date sent to the taxpayer.

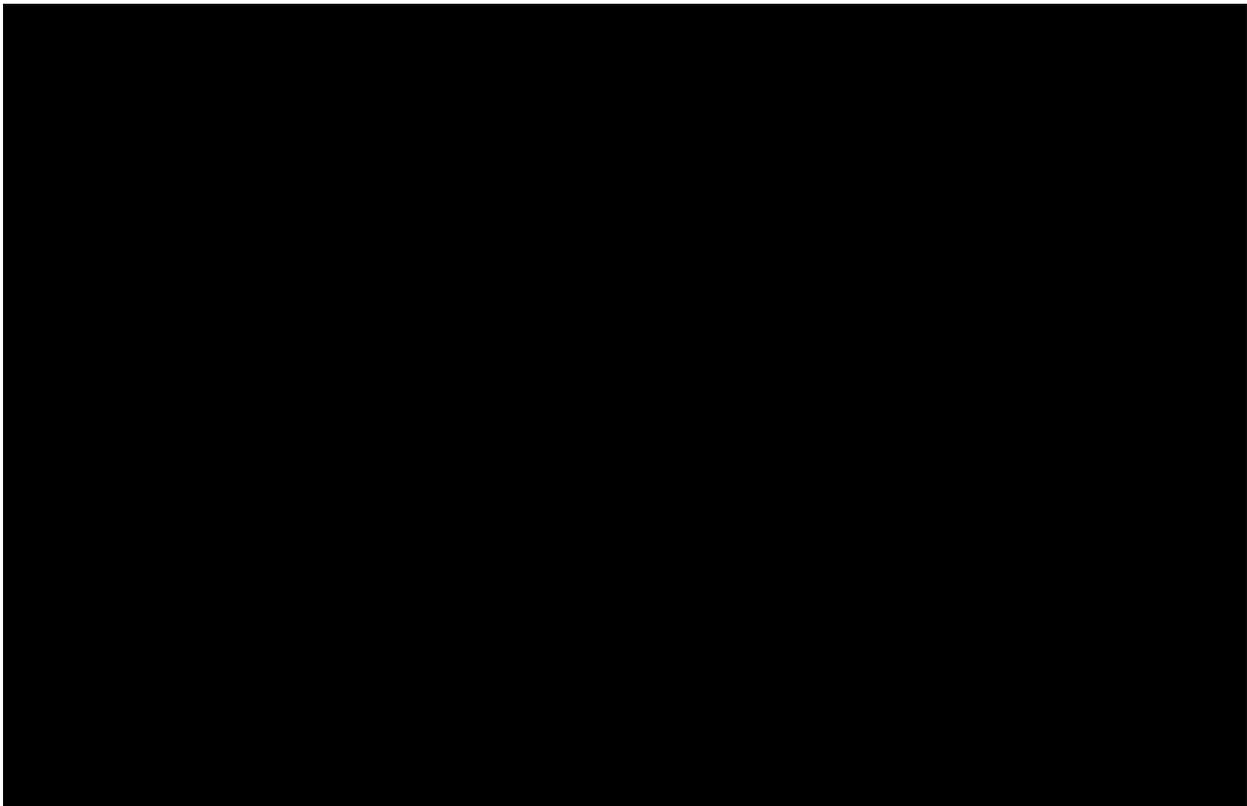
You cite the proposition that a rescinded contract can be reinstated by mutual agreement of the parties. The difference between rescission and termination of a contract in response to default illustrates why reinstatement is not such a simple matter in this case. As stated above, the parties to a rescinded contract are restored to their former positions. They are then free to reinstate the contract through an exchange of the same promises that formed consideration for the original contract. Such an act is indistinguishable from forming a new contract. In the context of termination of a defaulted contract, however, one party or another may have partially or fully performed under the contract. As such, the promise they receive from the other party in reviving the contract may be considered gratuitous—not supported by any consideration flowing in return. "A contract must be supported by consideration to be valid and legally enforceable." 17 C.J.S. Contracts § 71. See Aviation Contractor Employees, Inc. v. United States, 945 F.2d 1568, 1574 (Fed. Cir. 1991).

In this case, the Service would revive the compromise agreement in return for current and future compliance with applicable provisions of the Internal Revenue Code, acts the taxpayer was already legally obligated to perform. A promise to

perform on a pre-existing legal obligation cannot be consideration for a contract. See 17A Am.Jur.2d Contracts § 144. For offers in compromise, consideration is found in the potential for mutual concessions which exists after doubt as to liability or collectibility has been established. See Op. Att. Gen. 6, XIII-47-7138 (October 24, 1933). Such concessions form the bases for “compromise,” and these bases have been incorporated into the regulations delineating the authority of the Service to compromise tax liabilities. See Treas. Reg. §301.7122-1T(b)(2) & (3). See also Treas. Reg. §301.7122-1T(b)(4) (providing additional authority where compromise would promote effective tax administration). Thus, even if contract law would allow the compromise to be reinstated, we question whether the Service has the authority to reinstate a compromise absent a finding that one of the bases in the regulation is present.

Based on the foregoing, we stand by our prior advice that a terminated offer in compromise cannot be reinstated. The “reinstatement” essentially forms a new agreement between the taxpayer and the Service. As such, it must be executed in accordance with accepted principles of contract law. Furthermore, because the Service’s authority to compromise is circumscribed by the Code and Treasury regulations, a new agreement requires a finding that there is an authorized basis for compromise.

HAZARDS & OTHER CONSIDERATIONS





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

cc. Assistant Regional Counsel (GL),