



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

OFFICE OF  
CHIEF COUNSEL

March 16, 2001

Number: **200119052**  
Release Date: 5/11/2001

CC:PA:CBS:Br2  
GL-119545-01  
UILC: 17.23.00-00  
9999.98-00

MEMORANDUM FOR ASSOCIATE AREA COUNSEL (SB/SE), AREA 5 (DENVER)

FROM: Kathryn A. Zuba  
Chief, Branch 2 (Collection, Bankruptcy & Summonses)

SUBJECT: Choice of Law in Offers in Compromise - Reconsideration

This memorandum responds to your request for advice dated April 24, 2000, and supplements our memorandum of July 25, 2000. This document may not be cited as precedent.

ISSUE:

When the Service compromises with one party to a joint and several tax liability, what law governs for purposes of determining the effect of that compromise on the liability of the other joint obligor.

CONCLUSION:

The effect of a compromise under section 7122 of the Internal Revenue Code on the obligations of other parties who are jointly and severally liable for the taxes compromised is governed by that section and Treasury Regulations issued pursuant to that section. However, to foreclose disputes on the question of whether such a compromise has the effect of releasing other parties from liability for the taxes at issue, we continue to recommend that the Service take the steps necessary, under the law of the state of residence of the compromising taxpayer, to preserve the ability to collect from other parties.

BACKGROUND:

The Internal Revenue Code permits married individuals to elect to file a joint return for income taxes. See I.R.C. § 6013(a). If a married couple elects to do so, liability for the taxes of the year covered by the return is joint and several. See I.R.C. § 6013(d)(3). As a joint and several debt, the Service may collect the entire debt from either spouse, or may choose to reach a compromise with one spouse or the other.

The Internal Revenue Manual instructs offer specialists to take the steps necessary, where appropriate, to preserve the Government's right to collect from other individuals liable for the tax that is the subject of a compromise agreement. See IRM 5.8.6.2(1). To determine what effect compromise with one spouse will have on the liability of the other spouse, the manual relies on the law of the state in which the offer proponent resides. See IRM 5.8.6.2(2). Based upon the rule followed in the particular jurisdiction, the manual provides collateral agreements which are to be secured as additional consideration for the compromise.

Your memorandum questioned the Service's assumption that the law of the offer proponent's state of residence will govern for purposes of determining the effect of a compromise on the liability of a taxpayer who is jointly and severally liable for the same taxes. Our response concluded that the Service's procedures are consistent with the rule that a contract is governed by the law of the forum which has the most significant contacts with the subject matter of the contract. However, our memorandum incorrectly stated this view as a conclusion that the law of the taxpayer's state of residence will always govern for purposes of interpreting the compromise agreement. We wish to clarify our position on this matter.

#### LAW & ANALYSIS:

Agreements to compromise federal tax liabilities have generally been interpreted by the courts by applying contract principles. See United States v. Feinberg, 372 F.2d 352 (3d Cir. 1967); United States v. Lane, 303 F.2d 1 (5th Cir. 1962). However, compromise agreements are also governed by statutes and Treasury regulations. Regulations limit the scope of a compromise agreement as follows: "Acceptance of an offer to compromise will conclusively settle the liability of the taxpayer specified in the offer." Temp. Treas. Reg. § 301.7122-1T(d)(5) (emphasis added). Thus, the regulations limit the effect of a compromise to the release of only the party named on the offer. Where the Internal Revenue Code establishes that taxpayers are jointly and severally liable for the tax, the Government's ability to collect from one taxpayer is not prejudiced by compromise with a different taxpayer.

However, some courts have relied upon state law contract principles for the rule of decision when faced with a dispute between the Service and a taxpayer regarding the interpretation or effect of a compromise. See, e.g., United States v. Ross, 176 F. Supp. 932 (D. Neb. 1959). For this reason, we have advised the Service to take the steps necessary to protect the Service's ability to collect from a non-compromising spouse whenever a compromise with one spouse is recommended for acceptance. The Service's procedures for the compromise of joint and several liabilities incorporate our prior advice. We continue to believe it prudent to take these preventive measures. For these purposes, the Service should continue to refer to the law of the state with the most significant relationship to the contract. We agree with the offer in compromise handbook's conclusion that this will generally be the state of residence of the proponent of the offer.

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