



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

OFFICE OF
CHIEF COUNSEL

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MEMORANDUM FOR ASSOCIATE AREA COUNSEL (SBSE), SACRAMENTO
CC:SBSE:7:SAC:1

FROM: Joseph W. Clark
Senior Technician Reviewer, Branch 2
(Collection, Bankruptcy and Summonses)

SUBJECT: Request for Chief Counsel Advice
Offers in Compromise—Release of Co-Obligor Under California
Law

This Chief Counsel Advice responds to your memorandum received on March 23, 2001. In accordance with IRC § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

ISSUES:

1. Whether Pattern Letter P-229 at IRM Exhibit 5.8.6-1 (the common law co-obligor agreement) or Pattern Letter P-230 at IRM Exhibit 5.8.6-2 (the non-common law co-obligor agreement) should be used in the State of California.

CONCLUSION:

1. Selection of either Pattern Letter P-229 or Pattern Letter P-230 will depend on whether California is a common law or non-common state with regard to the liability of a co-obligor, where an offer in compromise is submitted by only one of the obligors of a joint assessment.

FACTS AND LEGAL ANALYSIS:

In a situation involving a joint assessment, the liability for the outstanding federal taxes among the obligors is joint and several. IRC § 6013(d)(3).¹ The Service may collect the

¹ We note that your memorandum requesting advice did not specify what type of joint liability is at issue. For purposes of discussion, we are assuming that the joint liability arose as a result of a joint assessment against husband and wife who filed a

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entire debt from either obligor, or may choose to reach a compromise with one obligor or the other. Where an offer in compromise is submitted by an obligor, and more than one individual is obligated to pay the outstanding tax debt, the Internal Revenue Manual instructs offer specialists to take the steps necessary, where appropriate, to preserve the Government's right to collect from individual(s), other than the offer proponent, who is/are liable for the tax that is the subject of a compromise agreement. IRM 5.8.6.2(1) provides as follows:

“To preserve the ability to collect from the other parties to a joint assessment (husband and wife or other joint obligors), a co-obligor agreement should be secured from the maker of the offer.”

To determine what effect compromise with one obligor will have on the liability of the other obligor(s), the manual relies on the law of the state in which the offer proponent resides.² IRM 5.8.6.2(2) provides, in relevant part, as follows:

“If the taxpayer lives in a jurisdiction where acceptance of an offer in compromise from one of the taxpayers will release not only that taxpayer from further liability for the remaining tax, but will also release the other taxpayer from liability as well,” then Pattern Letter P-229 should be used (the common law co-obligor agreement).

“If, on the other hand, the taxpayer lives in a jurisdiction where the express reservation of the right to proceed against the taxpayer who is not a party to the offer agreement will protect against the release of the noncompromising taxpayer,” then Pattern Letter P-230 should be used (the non-common law co-obligor agreement).

You advise that, in California, the offer specialists in Sacramento have been using Pattern Letter P-229 for co-obligor agreements. Evidently, the Sacramento office is of the view that California follows the common law rule and that the offer in compromise operates as a “release” of the tax debt for all the obligors, governed by the provisions of California Civil Code §§ 1541 through 1543. You indicate that your office advised the offer specialists in Sacramento, by memorandum dated January 4, 2001, that

joint return.

² The law of the state with the most significant relationship to the compromise agreement will govern for purposes of interpreting the agreement. Typically, this will be the taxpayer's state of residence. However, the Service should continue to refer to the law of the state with the most significant relationship to the contract.

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California, in fact, does not follow the common law rule.³ Your memorandum states that California Civil Code § 1543 provides that a release of one of two or more joint debtors does not extinguish the obligations of any of the others. Your office then concluded that Pattern Letter P-230 (the non-common law co-obligor agreement) should be used.

Subsequently, you were provided with a copy of a memorandum dated June 8, 1979, from District Counsel, San Francisco, addressed to Special Procedures. That memorandum advised that California does follow the common law rule. You indicate that the reasoning of the June 8, 1979 memorandum was that an offer in compromise is not a “release,” which is governed by the provisions of California Civil Code §§ 1541 through 1543, but instead an “accord and satisfaction,” which is governed by California Civil Code §§ 1521 through 1525. In light of the San Francisco District Counsel memorandum, you indicate that your office is reviewing the advice contained in your January 4, 2001 memorandum.⁴

Although the Service has maintained its position that an offer in compromise is not a contract in common law, when interpreting agreements to compromise federal tax liabilities under IRC § 7122, courts have applied generally accepted contract principles. See United States v. Feinberg, 372 F.2d 352 (3d Cir. 1965); United States v. Lane, 303 F.2d 1 (5th Cir. 1962). However, compromise agreements are also governed by IRC § 7122 and the Treasury Regulations thereunder.

The Secretary’s authority to compromise tax cases is contained in IRC § 7122. The Secretary is empowered to set the threshold requirements for consideration of a proposed compromise. All offers to compromise must be submitted in accordance with the procedures prescribed by the Secretary. See Treas. Reg. § 301.7122-1T(c)(1).

The Treasury 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.” 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 in 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.

³ Under the common law rule, the release of one of two or more joint and several debtors could extinguish the obligations of all the debtors.

⁴ It appears that, prior to the January 4, 2001, memorandum from your office, both Sacramento and San Francisco were of the view that California follows the common law rule with regard to a co-obligor’s liability.

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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). Therefore, as discussed above, the Service should take the steps necessary to protect its ability to collect from a non-compromising spouse whenever a compromise with one spouse is recommended for acceptance. See IRM 5.8.6.2(1) and IRM 5.8.6.2(2).

The decision whether Pattern Letters P-229 or P-230 should be used in co-obligor situations is based on analysis of state law. In your request for advice, you indicate that your analysis of California law reveals a possible conflict between California Civil Code §§ 1521 through 1525 (referring to “accord and satisfaction”) and §§ 1541 through 1543 (referring to “release”), and that it is unclear which provisions an offer in compromise may fit under. You conclude that if an offer is an “accord and satisfaction,” then common law applies and Pattern Letter P-229 should be used. On the other hand, if an offer is akin to a “release,” then California could be considered a non-common law state, and Pattern Letter P-230 should be used.

In general terms, accord and satisfaction is defined as a new contract which is substituted for an old contract, whereby one party agrees to give and the other party agrees to accept something with the view of settlement of a claim. Black’s Law Dictionary 17 (7th ed. 1999). “[A]n accord is an agreement for the settlement of some previously existing claim by a substituted performance. It will be found that this definition of accord also includes all compromises; they are agreements for the settlement of a previously existing claim by a substituted performance.... [T]he previous claim may be one that is in doubt or in dispute, or one that is certain, liquidated, and undisputed.”⁵ 6 Corbin on Contracts at 1278 (1962). The two parties may first make an accord executory, that is, a contract for the future discharge of the existing claim by a substituted performance still to be rendered. When this executory contract is fully performed as agreed, there is said to be accord and satisfaction, and the previously existing claim is discharged. See 6 Corbin on Contracts at 1276 (1962).

A “release” is defined as the actual discharge of the obligation. It may take the form of a writing or an oral statement manifesting an intention to discharge another from an existing or asserted duty. A release may be secured gratuitously or for consideration.

⁵ A review of California case law, however, reveals that an essential element for an accord and satisfaction is the existence of a legitimate dispute as to the amount due. Rued v. Cooper, 119 Cal. 463, 51 P. 704 (1897); Clejan v. Reisman, 5 Cal. App. 3d 224, 84 Cal. Rptr. 897 (2d Dist. 1970). An offer in compromise submitted under IRC § 7122 may be accepted on the basis of doubt as to collectibility or to promote effective tax administration, as well as doubt as to liability, so that there is not always a “dispute” as to the amount actually owed by the proponent of the offer.

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Black's Law Dictionary 1292 (7th ed. 1999). A release is a writing manifesting an intention to discharge another from an existing or an asserted duty. 5A Corbin on Contracts at 1238 (1964).

Although it may be argued that an offer in compromise is more akin to an "accord and satisfaction" in that the parties have entered into a new arrangement to pay the outstanding taxes (which amount is different from the original amount owed), once the terms of the compromise are satisfied, the debt is discharged and the proponent of the offer is "released" from further liability for those taxes.

Acceptance by the Service of an offer in compromise and the taxpayer's satisfaction of the conditions of the offer (i.e., payment of the offer amount and compliance with the tax laws) result in "release" of the taxpayer from the tax liability that is the subject of the compromise. An offer in compromise also fits the definition of "accord and satisfaction," in that when a taxpayer submits an offer, he is agreeing to pay an amount less than what he owes, and the Service agrees to accept that lesser amount in exchange for discharge of the taxpayer's liability, provided certain conditions are satisfied (i.e., the amount offered is paid and the taxpayer remains current for a specified number of years).

A release under section California Civil Code § 1541 is given to a debtor by a creditor in order to extinguish an obligation. Hawber v. Raley, 92 Cal. App. 701, 268 P. 943 (1928) (execution of release by one party sufficient). See also, IRC § 6325 (certificate of release of federal tax lien). The Notes of Decisions under California Civil Code § 1541 cite the case of Schwartz v. California, 52 Cal. App. 2d 47, 125 P.2d 883 (1942), and provide as follows:

A judgment debtor should not be forced to go into bankruptcy to rid himself of a judgment where he and his creditor are ready, willing, and able to adjust and settle the debt. These are some of the considerations which the Legislature undoubtedly had in mind in the enactment of this section. Further, it should not be the policy of the law to discourage sensible arrangements, under which a creditor can satisfy a judgment for what he thinks it is worth and a debtor for what he can afford to pay.

You cite the case of McCall v. Four Star Music Company, 51 Cal. App. 4th 1394, 59 Cal. Rptr. 2d 829 (2d Dist. 1996), in your memorandum, and indicate that the Court of Appeals of California, in its opinion, did not make any distinction between the concepts of "accord and satisfaction" and "release." The facts in the McCall case indicate that the parties had entered into an accord and satisfaction of an outstanding obligation. The court's opinion stated broadly that it is the rule of California that where fewer than all joint tortfeasors satisfy less than the entire judgment, such satisfaction will not relieve the remaining joint tortfeasors of their obligation under the judgment, citing California Civil Code § 1543.

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It appears that the provisions of California Civil Code §§ 1521 through 1525 and §§ 1541 through 1543 may be read concurrently, rather than as conflicting provisions. California Civil Code §§ 1521 through 1525 discuss the necessary elements for an effective accord and satisfaction (i.e., proper subject matter, competent parties, mutual consent, and consideration), while §§ 1541 through 1543 discuss the effects of a release, once an obligation is deemed to be satisfied. Under California Civil Code § 1523, acceptance of the consideration by a creditor “extinguishes the obligation.” Once the obligation is extinguished with respect to the debtor (who is the party to the contract/agreement), that debtor may be considered “released” from any further obligation, pursuant to California Civil Code § 1541. However, § 1543 provides that no other co-obligors are released from the obligation or debt.⁶

Since selection of either Pattern Letter P-229 or Letter P-230 depends on state law, we recommend that you coordinate this matter with the Associate Area Counsels that are affected within Areas 7 and 8. A thorough analysis of California state law should be performed. It is suggested that those individuals involved with writing or updating your local law supplement participate in resolving this issue. Once it is determined by state law analysis whether California is a common law or non-common law state with respect to this issue, then the choice of the appropriate form letter will be clear.

If you have any questions, please contact the attorney assigned to this case at (202) 622-4114.

⁶ California Civil Code § 1523 is silent with respect to the liability of co-obligors. The provisions in §§ 1521 through 1525 discussing accord and satisfaction appear to refer to specific parties to a specific contract (requiring the elements of a contract: proper subject matter, competent parties, meeting of the minds and consideration). On the other hand, the provisions relating to release specifically provides that “a release of one or more joint debtors does not extinguish the obligation of any of the others.” See California Civil Code § 1543.