AN OFFER IN COMPROMISE YOU CAN'T CONFUSE: IT IS NOT THE OPENING BID OF A DELINQUENT TAXPAYER TO PLAY LET'S MAKE A TAX DEAL WITH THE INTERNAL REVENUE SERVICE

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The author dedicates this article to his wife Peggy Katz who throughout months of endless writing and editing was unwavering in her unconditional love and support. Without her inspiration and patience, the completion of this Article would have not been possible.

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INTRODUCTION

Tax relief "pitch men" who promise to settle substantial tax liability with the Internal Revenue Service (Service)[1] for "pennies on the dollar" would lead delinquent taxpayers to believe that an offer in compromise (Offer) is an opening bid to engage in tax gamesmanship. In reality, they are either deceiving their clients,[2] lack a true understanding of the state of the law, or are in denial of the Service's mission to collect the total amount of tax due with the presumption "that the correct application of the tax laws produces a fair and equitable result, absent exceptional circumstances."[3]

Although it is true that section 7122 of the Internal Revenue Code of 1986 (Code) grants the Service the authority to "compromise any civil or criminal case arising under the internal revenue laws prior to reference to the Department of Justice for prosecution or defense,"[4] it is inconceivable that Congress would have created an income tax system that would foster open negotiations between taxpayers and the Service to make tax deals. Stated differently, if tax liability was negotiable, all taxpayers would be "delinquent" taxpayers because they would have no incentive to pay the amount due, opting instead to cut a better deal with the Service to pay a lower amount. Consequently, the income tax laws would not be taken seriously and the actual amount of tax revenues collected by the Service would be unpredictable.

Therefore, Congress must have intended the Service's compromise authority to be consistent with the integrity of the tax system. In fact, the appropriate level of authority was derived from the meaning of the word "compromise." A compromise is the resolution of a dispute between two parties who, due to the

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[1] For purposes of this Article, the terms "Service" and "Commissioner" are used interchangeably.

[2] See *Texas v. Taxmasters, Inc.*, No. D-1-GV-10-000486, 2012 WL 1141528 (Tex. D. Ct., Travis Cnty. March 30, 2012), as an example of such deception. In that case, a jury rendered a verdict against the infamous "pennies on the dollar" Taxmasters and its founder Patrick Cox to pay $195 million in restitution and penalties with respect to its multitude of gullible clients who were defrauded and misled by deceptive practices and false promises of pennies-on-the-dollar settlements of tax liability with the Service.

[3] T.D. 9007, 2002-2 C.B. 349, 350.

[4] I.R.C. § 7122(a) (2006).

uncertainty of their positions, reach some middle ground by means of mutual concessions. So if a taxpayer is capable of paying a valid tax liability in full, there is no reason for the Service to compromise any portion of the liability. On the other hand, if the validity of the tax liability or the taxpayer's ability to pay it in full is uncertain, there is a legitimate basis for the Service to compromise. Not surprisingly, the original two bases for compromise were 1) doubt as to liability and 2) doubt as to collectability.

Yet, if a valid tax liability is exorbitant, a taxpayer compelled to pay it in full may be forced to go out of business or become financially unable to provide for her basic living expenses. This scenario was not uncommon during the Great Depression. Consequently, in the midst of that period, to provide those taxpayers with relief, the Secretary of the United States Department of the Treasury (Secretary of the Treasury) proposed that the Service be permitted to consider factors such as financial hardship, equity, and public policy as the basis for an Offer. Unfortunately, in spite of being sympathetic to the plight of such taxpayers, the Attorney General of the United States (Attorney General) ruled that the Service lacked the authority to compromise the tax liability of a taxpayer capable of paying it in full regardless of the resulting debilitating adverse financial consequences.

From the 1930s until the early 1990s, Offers were rarely made because Offer policy and procedures were unknown to most taxpayers, the actual mechanics of the Offer process were vague and inexact, and—perhaps most importantly—they were disfavored by the Service. In 1992, in an effort to bolster lackluster collections and to collect as much of the $111 billion of delinquent tax liability as possible, the Service instituted dramatic changes to its Offer policy by adopting more realistic collection objectives, creating a quantitative formula to compute an acceptable Offer as well as making the process more user friendly and accessible for the taxpayer.

Then, in 1998, in an apparent effort to liberalize the Offer process even further, Congress enacted the Internal Revenue

Service Restructuring Act of 1998.[5] In the legislative history, Congress encouraged the Service to design new types of Offers based on financial hardship, equity, and public policy. Although the Service did respond by creating those types of Offers, the Service imposed stringent restrictive acceptance standards that most taxpayers were unable to meet.

Ironically, although the Internal Revenue Service Restructing Act of 1998 also granted taxpayers a judicial review of Offers rejected by the Service as a procedural safeguard against the Service's aggressive collection actions, in operation, it actually emboldened the Service's increasingly hard-line acceptance standards. This was because most court decisions upheld the Service's Offer rejections; and, thus, validated whatever rationale the Service advanced for rejecting the taxpayer's Offer. Therefore, the Service had no reason to ease its acceptance standards.

Moreover, as evidenced by the enactment of the Tax Increase Prevention and Reconciliation Act of 2005,[6] Congress demonstrated its approval of a stringent Offer policy. In that legislation, Congress made the Offer process more problematic for the taxpayer by requiring taxpayers to make up-front non-refundable payments as a condition of submitting an Offer. In essence, a taxpayer desiring to make an Offer would be required to pre-fund it without any assurance that it would be accepted. So, as this is the current state of the law, the likelihood of a taxpayer submitting an acceptable Offer remains very low.

The purpose of this Article is to explain how the Offer process has evolved into what it is today, i.e., a collection alternative that is by no means a panacea for the delinquent taxpayer, by chronicling and analyzing every relevant major development from the infancy of federal income taxation to the present day.

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[5] Pub. L. No. 105-206, 112 Stat. 685 (1998).

[6] Pub. L. No. 109-222, 120 Stat. 345 (2006).

I. DEVELOPMENT OF OFFER POLICY IN THE EARLY YEARS OF FEDERAL INCOME TAXATION

A. A Landmark Supreme Court Decision Held that Section 3229—the First Offer Statute—Prescribed the Exclusive Method for Compromising Tax Cases

Section 7122 of the Code is one of the longest running statutes in the history of American taxation. Originally enacted as Revised Statute 3229 of the Act of 1868,[7] and subsequently amended by the Act of 1874,[8] section 3229 remained in effect with the passage of the Revenue Act of 1913.[9] Section 3229 provided as follows:

> The Commissioner of the Internal Revenue, with the advice and consent of the Secretary of the Treasury, may compromise any civil or criminal case arising under the internal revenue laws instead of commencing suit thereon; and, with the consent of said Secretary and the recommendation of the Attorney General, he may compromise any such case after a suit thereon has been commenced. Whenever a compromise is made in any case there shall be placed in the office of the Commissioner, the opinion of the Solicitor of Internal Revenue, or of the office acting as such, with his reasons therefore, with a statement of the amount of tax assessed, the amount of additional tax or penalty imposed by law in consequence of the neglect or delinquency of the person against whom the tax is assessed, and the amount actually paid in accordance with the terms of the compromise.[10]

Significantly, section 3229 divided tax cases into two categories: 1) those not yet in litigation; and 2) those in which a suit had been commenced. In the first category of cases, the Service lacked the authority to accept an Offer without the approval of the Secretary of the Treasury. In the second category of cases, the Attorney General's approval was also required. In all cases, the solicitor of

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[7] H.R. 1284, 40th Cong., ch. 186 (2d Sess. 1868), 15 Stat. 125, 166.
[8] H.R. 1215, 43rd Cong. (1st Sess. 1868).
[9] Ch. 16, 38 Stat. 114 (1913).
[10] 15 Stat. 125, 166.

the Internal Revenue Service was required to file a written opinion explaining the rationale for the acceptance of the Offer in the office of the Commissioner.

Botany Worsted Mills v. United States, decided in 1929, was the only Supreme Court decision to interpret section 3229 or any of its successor sections.[11] In that case, after protracted negotiations, the taxpayer and the Service agreed to resolve a tax dispute by the taxpayer conceding the Service's disallowance of a bonus deduction in exchange for the Service conceding the taxpayer's claim for a reserve charged off as an expense.[12] In executing the agreement, however, none of the protocol of section 3229 was followed.

Consistent with the agreement, the taxpayer filed an amended return and paid the additional tax.[13] Subsequently, the taxpayer reneged on the agreement and filed a claim for a refund of the tax attributable to the bonus deduction.[14] After the Service rejected the taxpayer's claim, the taxpayer filed a petition for refund in the Court of Claims.[15]

The issue presented was whether the agreement between the Service and a taxpayer that did not follow the protocol of section 3229 was enforceable by the Service. Arguing that section 3229 prescribed the exclusive way to resolve tax cases, the taxpayer contended that any other type of settlement agreement was non-binding.[16] Conversely, the Service contended that the taxpayer was estopped to challenge the validity of the agreement because the taxpayer had enjoyed the tax benefit of the Service's concessions of the reserve issue.[17] Accepting the Service's estoppel argument, the Court of Claims ruled in the Service's favor.[18]

Significantly, on appeal to the Supreme Court, the Service abandoned its estoppel argument and argued the case on the

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[11] 278 U.S. 282 (1929).
[12] *Id.* at 284-86.
[13] *Id.* at 284, 286-87.
[14] *Id.* at 284-85.
[15] *Id.* at 284.
[16] *Id.* at 287.
[17] *Id.* at 286.
[18] *Id.* at 285.

merits of its previous disallowance of the bonus deduction.[19] Ironically, in holding against the taxpayer on the merits, the Supreme Court endorsed the taxpayer's position that "Congress intended by [section 3229] to prescribe the exclusive method by which tax cases could be compromised . . . . When a statute limits a thing to be done in a particular mode, it includes the negative of any other mode."[20] Thus, *Botany Worsted Mills* established the precedent that a compromise between the Service and the taxpayer was not binding on either party unless it complied with the protocol of section 3229.

B. Attorney General Dictated Offer Acceptance Standard to be Implemented by the Service

In the interpretation of tax statutes, it is the normal function of the Service to establish the parameters of their scope through the promulgation of appropriate regulations. This was not the case with regard to section 3229, however, as the standards for acceptable Offers were established in numerous Attorney General opinions—many of which predated the enactment of the Sixteenth Amendment.

1. Attorney General Proclaimed Doubt as to Liability or Doubt as to Collectability as the Sole Basis for Compromise

At first blush, it would have appeared that section 3229 granted the Service limitless authority to accept taxpayer Offers. This was because, other than requiring high-level approval for final acceptance, section 3229 provided no specific limitations or guidelines with regard to the Service's authority to "compromise." Yet, in spite of the absence of any restrictive provisions, it was clear from the outset that the Offer process was never intended to be an exercise of tax gamesmanship between the taxpayer and the Service. Indeed, in numerous opinions issued prior to and following the enactment of the Revenue Act of 1913, the Attorney

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[19] *Id.* at 287-88. In fact, in the solicitor general's brief, the Service essentially conceded its estoppel argument accepting that binding agreements between the taxpayer and the Service must conform with all statutory formalities of section 3229. *Id.*

[20] *Id.* at 288-89.

General had ruled that the Service's authority to compromise was very restrictive. Those opinions focused on the meaning of the word "compromise" as a give-and-take proposition in which the taxpayer and the government both had something to gain and lose.[21] To illustrate this point, one such Attorney General opinion defined the parameters of a "compromise" as: "A compromise implies some mutuality of concession, some real doubt about the legality of the claim, or the ability to meet it . . . ."[22]

So, as to a taxpayer capable of paying a valid tax liability in full, the Service would have nothing to compromise. On the other hand, if the validity of the underlying tax liability were questionable (i.e., the taxpayer could potentially prevail in litigation) or the taxpayer lacked the financial resources to pay the liability in full, a compromise would be mutually beneficial to resolve the taxpayer's tax liability for a lesser amount and to save the Service the costs of pursing collection that would likely yield no more than the amount offered. Accordingly, the Attorney General established doubt as to liability and doubt as to collectability (Collectability Standard) as the sole basis for compromise.[23] In fact, long before the enactment of the Revenue Act of 1913, numerous Attorney General opinions ruled that the valid tax liability of a solvent taxpayer could never be compromised.[24] Consistent with those opinions, early income tax treasury regulations adopted the same rule.[25]

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[21] *See* Compromise of Claims Under §§ 3469 and 3229 of the Revised Statutes—Power of the Att'y Gen. in Matters of Compromise, 38 Op. Att'y Gen. 98 (1933); Auth. of Sec'y of the Treas. to Compromise Final Judgments, 36 Op. Att'y Gen. 40 (1929); Sec'y of Treas.—Compromise of Judgment, 23 Op. Att'y Gen. 18 (1900); Internal Revenue, 16 Op. Att'y Gen. 248 (1879).

[22] 16 Op. Att'y Gen. at 250.

[23] In *Botany Worsted Mills*, had the Commissioner and the taxpayer actually compromised their dispute in accordance with the formalities of section 3229, there would have been doubt as to the liability compromise since the deductibility of the bonuses and reserve were at issue. *See* 278 U.S. at 289.

[24] *See* 16 Op. Att'y Gen. at 250 ("The authority conferred by Revised Statutes, section 3229, to compromise a case arising under the internal-revenue laws, does not permit the voluntary relinquishment of a part of a tax lawfully assessed upon and due from a solvent person or corporation.").

[25] Rev. Rul. 20-1006, 2 C.B. 178 (1920) ("The Commissioner of Internal Revenue has no power under the provisions of section 3229 . . . to compromise taxes legally due from a solvent taxpayer.").

As an example of an early high profile compromise based on the Collectability Standard, in the mid-1920s, the taxpayer, Atlantic Gulf and West Indies Steamship Corporation offered approximately $2.6 million to compromise an outstanding liability in excess of $9 million.[26] In considering the Offer, the Service's investigation of Atlantic Gulf's financial condition revealed that the value of its assets, less mortgages superior to the government's claims, would not be nearly sufficient to pay the liability in full.[27] Additionally, the Service determined that aggressive collection action pursued against Atlantic Gulf might force the company into bankruptcy; and, thus, potentially result in no funds being collected by the government.[28] In explaining the Service's rationale for accepting Atlantic Gulf's Offer, Secretary of the Treasury Andrew W. Mellon stated: "The situation was, therefore, similar to any other compromise between a creditor and a debtor having many debts and few assets. . . . If the United States had insisted on its strict legal rights it might well have got nothing."[29]

2. Attorney General Deviated From Collectability Standard and Approved Financial Hardship as a Basis to Compromise Penalties and Interest

In addition to the underlying tax, the assessment of excessive penalties and interest might double or even triple the amount of the overall liability and cause even a solvent taxpayer to suffer severe financial hardship. Yet, similar to the underlying tax liability, the strict application of the Collectability Standard would not permit the Service to compromise penalties and interest assessed against a solvent taxpayer. For that reason, in 1919, the Service requested the Attorney General's approval to allow it to consider a taxpayer's financial hardship in the interest of "justice,

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[26] *Ask Couzens To Pay $10,000,000 In Taxes; He Charges Revenge*, N.Y. TIMES, Mar. 10, 1925, at 1, 6.

[27] *Id.*

[28] *Id.*

[29] *Id.* (The Offer was funded by the proceeds of a bank loan and the satisfaction of a judgment in Atlantic Gulf's favor.).

equity, and public policy"[30] as a basis for compromising a taxpayer's liability for penalties and interest (Penalty Hardship Standard).

Notwithstanding the absence of any specific language in section 3229 suggesting that a more lenient standard applied to compromise penalties and interest, the Attorney General ruled the Service's authority to compromise those assessments was much broader than its authority to compromise the underlying tax liability.[31] Accordingly, the Attorney General ruled that this broader authority could be invoked if the best interests of the United States would be served by exercising leniency in compromising "penalties resulting from accident, negligence, or technical omission, . . ."[32] Implicit in this rationale was the notion that penalties as compared to taxes were punitive in nature so that the interests of the United States in enforcing penalties were not purely monetary. Therefore, if the monetary severity of the penalty outweighed the culpability of the taxpayer, even the liability of a solvent taxpayer could be compromised by the Service.[33]

3. An Attorney General Opinion Ruling the Collectability Standard Was to Be Applied to Compromises of Tax, Penalties and Interest Marked the End of the Penalty Hardship Standard

Although the word "solvent" had never been defined in any Attorney General opinion or treasury regulation, it was clear that a taxpayer who was financially insolvent was not necessarily insolvent for purposes of the Collectability Standard. So, although a taxpayer would be financially insolvent if the sum of her liabilities (including delinquent tax) exceeded the value of her assets, the Service would nonetheless deem the taxpayer to be "solvent" for tax collection purposes if the value of her assets exceeded the sum of her liabilities with priority over the tax

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[30] Compromise of Penalties Arising Under Income-Tax Laws, 31 Op. Att'y Gen. 459, 460 (1919).

[31] *Id.* at 460-62.

[32] *Id.* at 463.

[33] *See, e.g.*, Treas. Reg. 33, art. 54 (1918) (in which the Service adopted the Attorney General's ruling).

liability owing to the government. In other words, the taxpayer was expected to liquidate a sufficient amount of unencumbered assets to pay her tax liability to the exclusion of the inferior obligations she owed to her other creditors. Unfortunately, after paying off the government, the taxpayer's inability to pay her general creditors could lead to financial ruin including the destruction of her business. Moreover, workers who the taxpayer employed would be added to the unemployment rolls.

In 1933, because of the Great Depression, this scenario was not uncommon, the acting Secretary of the Treasury, Dean Acheson, asked the Attorney General to permit the Service to deviate from the Collectability Standard under the following circumstances:[34] First, to allow the Service to compromise the tax liability and the six percent interest assessed against financially insolvent taxpayers who might be forced out of business if compelled to pay the liability in full;[35] second, to allow the Service to compromise penalties and the onerous twelve percent interest assessed against any taxpayer "wherever justice, equity, or public policy seem[ed] to justify the compromise, . . ."[36] Although Acheson did not articulate any specific standard to be implemented in the consideration of either compromise, he did advocate that a more "liberal" standard be applied to compromise penalties and excessive interest than would be applied to the compromise of tax and reasonable interest.[37] Without specifically referencing the Penalty Hardship Standard, Acheson's position was consistent with its rationale that enforcing penalties was more punitive than monetary; and, thus, warranted a more liberal acceptance policy.[38]

In an opinion dated October 24, 1933, the Attorney General denied Acheson's request on all counts.[39] First, the Attorney General ruled that there were no circumstances that would justify the Service to deviate from the long standing Collectability

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[34] Rev. Rul. 47-7137, 13-2 C.B. 441 (1934).

[35] *Id.*

[36] *Id.* at 442.

[37] *Id.*

[38] Compromise of Penalties Arising Under Income-Tax Laws, 31 Op. Att'y Gen. 459 (1919).

[39] Compromise of Claims Under §§ 3469 and 3229 of the Revised Statutes, 38 Op. Att'y Gen. 94 (1933); *see* Rev. Rul. 47-7138, 13-2 C.B. 441 (1934).

Standard to compromise the liability of a financially insolvent taxpayer capable of paying it in full.[40] While acknowledging the potential benefits of a hardship compromise standard, the Attorney General believed that any modification of the Collectability Standard should be made by Congress.[41]

In addressing the issue of compromising penalties separately, the Attorney General renounced the application of a more liberal rule based on his perception of congressional intent. The opinion noted that Congress had once enacted a statute (section 5293) that had granted the Service limited authority to compromise penalties up to a relatively small amount.[42] In 1922, however, Congress repealed the statute and has never since restored the Service's authority.[43] So by inference, the Attorney General concluded that Congress would have never intended section 3229 to grant the Service unlimited authority to compromise penalties of potentially much greater amounts.[44]

Finally, the Attorney General also ruled that the interest component of an overall liability could not be compromised separately from the underlying tax.[45] In support of this position, the Attorney General cited numerous statutes providing that interest was to be collected as part of the tax; and, thus, as a single tax liability.[46] For that reason, the Attorney General concluded, "that the tax and interest constitute[d] one liability which goes to make up a 'case' arising under the internal revenue laws within the meaning of section 3229."[47]

4. High Ranking Treasury Officials Echoed Attorney General's Rejection of a Compromise Standard Based On Economic Hardship

Apparently, the views of Acheson regarding an economic hardship compromise policy were not shared by other

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[40] Rev. Rul. 47-7138, 13-2 C.B. 442, 443 (1934).
[41] Rev. Rul. 47-7136, 13-2 C.B. at 443.
[42] *Id.*
[43] *Id.* at 444.
[44] *Id.*
[45] *Id.*
[46] *Id.* at 444 n.1.
[47] *Id.* at 444.

contemporary, high-ranking treasury officials. For example, in 1934, future Supreme Court Justice Robert H. Jackson, then Assistant General Counsel of the U.S. Treasury Department, defended restrictive compromise standards.[48] In Jackson's view, collection of outstanding taxes in full was the highest congressional objective as evidenced by federal bankruptcy law granting priority status of tax liability over the claims of the taxpayer's general creditors, in addition to being non-dischargeable in bankruptcy.[49] Additionally, Jackson dismissed pleas that the Service should take into account financial hardship to preserve a taxpayer's ongoing business and continue to employ workers as an excuse for not setting "aside reserves to pay income tax."[50] Finally, Jackson asserted that a compromise standard based on financial hardship would be impossible to administer and potentially lead to favoritism among taxpayers; and, thus, discriminate against those taxpayers who paid their tax liabilities in full.[51]

The views of Jackson and the Attorney General were echoed by Arthur H. Kent, Assistant to the Assistant General Counsel for the Bureau of Internal Revenue.[52] As to the Service's role in administering tax law, Kent stated:

> It is the duty of [tax] administrators to collect, so far as it is possible, the taxes which the Congress has imposed and to which the Government is found under the law to be entitled. Save for the limited power of compromise, no power to forgive a tax obligation exists in any Treasury official.
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[48] *See* Robert H. Jackson, Assistant Gen. Counsel, U.S. Treas. Dep't, Changes in Treasury Tax Policy, Address Before the Ninth Annual Meeting of the Federation of Bar Associations of Western New York at Niagara Falls, N.Y. (June 30, 1934), *in* 12 TAX MAG. 342 (1934).

[49] *Id.* at 344.

[50] *Id.*

[51] *Id.*

[52] *See* Arthur H. Kent, Assistant to the Assistant Gen. Counsel, Bureau of Internal Revenue, The Treasury Point of View Relative to Some of the Current Problems of Federal Tax Law, Address Before the Tax Clinic at the American Bar Association Meeting at L.A., Cal. (July 17, 1935), *in* 13 TAX MAG. 511 (1935).

> So far as inequities and hardships may be due to imperfections in the revenue laws themselves, there is little, if anything, which the [Service] can do about it, beyond bringing such imperfections through proper channels to the attention of the Congress and advising as to ways and means for their correction.[53]

In further elaborating on the limited power of the Service to compromise, Kent viewed tax administrators as "fiduciaries" obligated to protect the revenues of the government.[54] Thus, regardless of the harsh financial plight of some delinquent taxpayers, it was not within the Service's discretion "to barter or give away tax claims of the Government . . . ."[55] Similar to Jackson's views, Kent believed that a compromise based on financial hardship "in the absence of fairly precise legislative standards and criteria, would be fraught with serious dangers of favoritism, special influence, and other abuses."[56] In other words, a compromise standard that rewarded non-compliance by allowing delinquent taxpayers to pay less than compliant ones would undermine the viability and integrity of the tax system.[57]

5. Did an Executive Order and Two 1934 Attorney General Opinions Grant the Attorney General Exclusive Compromise Authority with Greater Discretion to Approve Offers in Cases Referred to the Department of Justice?

a. The Attorney General Opinions and the Executive Order

Although section 3229 granted pre-litigation compromise authority exclusively to the Service, once a suit was commenced, the recommendation of the Attorney General was also required. Prior to 1934, however, none of the Attorney General opinions

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[53] *Id.* at 511-12.

[54] *Id.* at 512.

[55] *Id.* at 512.

[56] *Id.* at 513.

[57] In the same vein, Wright Matthews, Assistant to the Commissioner, explained the dangers of a liberal compromise policy stating: "If the government were to waive its claims simply because the taxpayer had been negligent in not making provision to meet them when the money was in hand, it would place a premium on such ill-advised procedure and the only possible result would be confusion." *Only 5% of Payers Balk at Income Tax*, N.Y. TIMES, Aug. 19, 1935.

suggested that once a case was referred to the Department of Justice (DOJ), the Attorney General's jurisdiction was exclusive or that his discretion to accept Offers was any broader than the Service's limited authority to compromise. Two 1934 Attorney General opinions suggested otherwise.

The first opinion was in response to an inquiry by Secretary of the Treasury, Henry Morgenthau, Jr., requesting further clarification of the Collectability Standard.[58] Although Morgenthau did not raise the issue, the opinion proclaimed the Attorney General had exclusive authority to compromise a tax case once it had been referred to the DOJ.[59] Specifically, the Attorney General opinion cited section 5 of Executive Order No. 6166, of June 10, 1933[60] in which the president had granted the Attorney General with the exclusive jurisdiction to prosecute government claims.[61]

In direct response to Morgenthau's question, the opinion reaffirmed the rigidity of the Collectability Standard as it applied to the Service and asserted that there was "no statutory authority to compromise *solely* upon the ground that a hard case is presented, which excites sympathy or is merely appealing from the standpoint of equity, but the power to compromise clearly authorizes the settlement of any case about which uncertainty exists as to liability or collection."[62] Yet, as to the authority of the Attorney General, the opinion asserted that he was not bound by the Collectability Standard because his discretionary authority to compromise tax cases was much broader than the Service's authority.[63] In support of the Attorney General's broader authority to settle disputes, the opinion cited an array of cases, statutes, etc. to that effect[64] and stated:

> [W]hether attaching to the office or conferred by statute or Executive order, to be exercised with wise discretion and

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[58] Compromise of Claims Under §§ 3469 and 3229 of the Revised Statutes—Power of the Att'y Gen. in Matters of Compromise, 38 Op. Att'y Gen. 98 (1934), Rev. Rul. 47-7137, 13-2 C.B. 441, 445 (1934).

[59] *Id.*

[60] 38 Op. Att'y Gen. at 99; 13-2 C.B. at 446.

[61] 13-2 C.B. at 448.

[62] *Id.* at 446 (emphasis in the original).

[63] *Id.* at 446-48.

[64] *Id.* at 447-48.

> resorted to only to promote the Government's best interest or to prevent flagrant injustice, but that it is broad and plenary may be asserted with equal assurance, and it attaches, of course, immediately upon the receipt of a case in the Department of Justice, . . .[65]

Thus, in contrast to the rigidity of the Collectability Standard as a limitation of the Service's compromise authority, the words "flagrant injustice" indicated that the Attorney General possessed the discretion to compromise a tax case in "situations in which the enforced collection of the full liability would close down a business which employs a large number of persons, some of whom thereupon would become charges on the community."[66] In other words, the very hardship standard the Service was not permitted to consider in comprising tax cases prior to their referral to the DOJ could be invoked by the Attorney General once they were within his exclusive jurisdiction.

The second opinion reiterated the exclusivity of the Attorney General's jurisdiction[67] and much broader discretionary authority to compromise any tax case referred to the DOJ.[68] At first blush, the Attorney General's assertions of superior authority could have led to the development of a dysfunctional working relationship between the Service and the Attorney General. Moreover, taxpayers might have been inclined to seek ways to bypass dealing with the Service to pursue a potentially more favorable compromise with the Attorney General. As discussed *infra*, it did not appear that the Attorney General opinions or the executive

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[65] *Id.* 448.

[66] Abbott M. Sellers, *Disposing of Federal Tax Litigation—Extra-Judicially*, 1 S.C. L.Q. 76, 83 (1948) (Sellers, the Attorney in Charge, Compromise Section, Tax Division, Department of Justice, explained the circumstances under which the Attorney General was empowered to compromise a tax case to prevent a flagrant injustice.).

[67] Power of the Att'y Gen. in Matters of Compromise, 38 Op. Att'y Gen. 124 (1934); Op. Att'y Gen. 10-7359, 14-1 C.B. 442 (1934).

[68] As to the scope of the Executive Order cited in the first Attorney General opinion, the opinion stated: "It merely withdrew from all other officers such power and authority as the theretofore held, leaving the Attorney General in plenary control of any case once it has been referred to the Department of Justice." 14-1 C.B. at 442-43. As to the Attorney General's broad authority to compromise, the opinion stated: "He may dismiss a suit or abandon defense at any stage when in his sound professional discretion it is meet and proper to do so. It follows that he may compromise any case on such terms as he sees fit, . . ." *Id.* at 443.

order, however, were ever implemented in a way that created a double compromise standard or had a negative impact on the working relationship between the Attorney General and the Service.

b. The Attorney General Opinions and Executive Order did not Deter the Attorney General and the Service from Working Together in Unison After Tax Cases were Referred to the Department of Justice

From all indications, in spite of the implications from the Attorney General opinions and the executive order to the contrary, the Service and the Attorney General worked in unison after a tax case was referred to the DOJ. A portent of the spirit of cooperation was indicated in the last paragraph of the second Attorney General opinion as follows:

> I do not understand that it was intended by Executive Order No. 6166 that the combined efforts of both departments might not be availed of where it would be beneficial to the United States . . . . I also feel, . . . that it would be not only highly desirable but most helpful to continue to receive the views and recommendations of [the Service]. After all, both departments are serving the same interests and have a common end in view.[69]

The Attorney General's message of cooperation between the DOJ and the Service was echoed by Samuel O. Clark, Jr., an Assistant Attorney General during the years following the issuance of the opinion. Noting the DOJ's close working relationship with the Service, Clark explained that Offers submitted to the DOJ were routinely referred to the Service for the recommendation of the chief counsel.[70] Similarly, a contemporary high-ranking attorney in the collection section, tax division, and DOJ described the relationship between the Service and the DOJ as follows:

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[69] *Id.* at 444.

[70] Samuel O. Clark, Jr., Assistant Att'y Gen., Tax Compromises in the Department of Justice—Some Aspects of Procedure and Policy, Address Before the Tenth Tax Clinic of the Section of Taxation of the American Bar Association, at Hotel Mayflower, Wash., D.C. (Mar. 23, 1940), *in* 18 TAXES 280, 282 (1940).

> [B]efore action is taken on any [Offer] the Tax Division [of the DOJ] invariably solicits the views of the [Service], which occupies a relationship to the Justice Department akin to that of client to attorney. It is not often that a firm recommendation by the [Service] will be overridden; much importance is attributed to the views of its experienced staff of attorneys, investigating agents, engineers and accountants.[71]

c. Attorney General Adhered to the Collectability Standard in His Consideration of Offers Submitted to the DOJ

Statements made by Clark indicating the Attorney General's reluctance to compromise a tax case based on economic hardship suggested that the Collectability Standard was applied by the Attorney General in the same way it was applied by the Service. To that end, Clark asserted that compromises proposed on the basis of economic hardship were rare and invariably rejected.[72] Only under extraordinary circumstances in which a lump sum payment of the tax liability would cause the taxpayer to go into bankruptcy or suffer an irreparable adversity would such an Offer be considered.[73] Yet, even in those cases, Clark asserted that the DOJ would go no further than accept installment payments of the amount offered in compromise plus interest and collateral pledged by the taxpayer.[74]

Thus, in spite of the two Attorney General opinions and the executive order, it appeared that the Attorney General and the Service applied uniform Offer standards and worked closely together in considering Offers submitted under the jurisdiction of the DOJ. This was a sound practice as it would have been imprudent for a taxpayer to believe she could compromise a better deal with the Attorney General than she could with the Service.

C. The Commissioner's Statement of Policy with Respect to the Compromise of Taxes, Interest, and Penalties Dated July 2,

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[71] Sellers, *supra* note 66, at 79.
[72] Clark, s*upra* note 70, at 281.
[73] *Id.*
[74] *Id.*

1934, Established Maximum Collection Amount as the Baseline for an Acceptable Offer

In 1934, Commissioner Guy T. Helvering realized that the Attorney General opinions provided no specific guidelines as to how to determine whether there was doubt as to a taxpayer's financial ability to pay her tax liability in full; and, if so, how to ascertain the amount of a viable Offer.[75] In order to fill the void, at least to some extent, Helvering issued the Commissioner's Statement of Policy with Respect to the Compromise of Taxes, Interest, and Penalties, dated July 2, 1934 (Commissioner's 1934 Compromise Policy Statement).[76] In clarifying the meaning of "doubt of collectability," the statement declared that it could not be a mere possibility of doubt, but rather real and substantial as supported by credible financial documentation submitted by the taxpayer.[77] Additionally, the statement established the baseline amount of a viable Offer to be the maximum amount the taxpayer was capable of paying based on the value of the net equity of her assets as well as both current and future income (Maximum Collection Amount).[78]

Although the Commissioner's 1934 Compromise Policy Statement referred to "current and future income" as a financial resource available to the taxpayer, it failed to explain how that component of the equation was to be quantitatively factored into the consideration mix of a viable Offer. As a result, the Offer process remained shrouded in uncertainty until 1992 when the Service finally created a quantitative formula of the income component to be used in the computation of an acceptable Offer amount.[79] Perhaps, as discussed *infra*, the lack of a quantitative formula was a portent of corruption in the implementation of Offer policy that would taint the integrity of the Service during the 1950s.

II. CONGRESSIONAL INVESTIGATIONS OF CORRUPTION IN THE SERVICE IN THE EARLY 1950S LED TO TRANSPARENCY OF OFFER

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[75] *See* T.D. 8829, 64 Fed. Reg. 39020, 39021 (July 21, 1999).

[76] *Id.*

[77] *Id.*

[78] *Id.*

[79] *See infra* Section IV.B.1.a.ii.

ACCEPTANCES AND OTHER CHANGES IN THE OFFER APPROVAL PROCESS

A. President Truman Yielded to Congressional Pressure and Issued an Executive Order Directing Accepted Offers be Open to Public Inspection

If there was any question of Congress's endorsement of the rigid adherence to the Collectability Standard as a prerequisite for the acceptance of Offers, a congressional investigation into corruption in the Service was indicative of its full support. In 1951, Denis W. Delaney, an Internal Revenue Collector (Collector) was indicted for receiving bribes or "fees" from taxpayers seeking to compromise outstanding tax liabilities.[80] The wrongdoings of Delaney and other tax officials triggered the creation of a House Ways and Means subcommittee to investigate "corruption" in the Service.[81]

On the Senate side, Senator John J. Williams launched his own investigation revealing that the Service had accepted Offers from racketeers and politically connected individuals on terms that were arguably more generous than Offers submitted by average taxpayers.[82] To illustrate his point, Williams noted a case in which the Service accepted an Offer of $850,000 to compromise a tax liability of $38 million, or three percent of the liability submitted by a taxpayer with political connections.[83] Also, Williams questioned the integrity of the Service's overly generous compromises of "at least forty-eight tax cases of more than $250,000 each over the last ten years [including the settlement of] a $888,021 claim for a mere $1,000."[84]

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[80] *See Delaney Must Stand Trial*, N.Y. TIMES, Nov. 21, 1951, at 23.

[81] *See House Group to Sift Tax Bureau Charges*, N.Y. TIMES, July 29, 1951. The scandal resulted in the resignation of the assistant commissioner in charge of operations, the chief counsel, the assistant attorney general in charge of the tax division of the Department of Justice, and nine of the sixty-four internal revenue collectors. Of the latter group, three were criminally prosecuted. *See* Bryan T. Camp, *Theory and Practice in Tax Administration*, 29 VA. TAX REV. 227, 241 (2009).

[82] *See* Frank O'Brien, *Commissioner Says Collectors Getting All Possible Taxes*, BIG SPRING WKLY. HERALD, Aug. 15, 1952, at 1.

[83] *Williams Says 38 Million Tax Case Settled for 3% With Boyd Aid; New Charge Made in Tax Scandals*, N.Y. TIMES, June 27, 1952, at 1.

[84] *Williams Assails Tax Compromises*, N.Y. TIMES, July 3, 1952.

Contemporaneously, the American Society of Newspaper Editors' Freedom of Information Committee (ASNE) also voiced its concern about the Service's preferential treatment of certain high profile taxpayers in its acceptance of Offers.[85] Eventually, succumbing to pressure from Congress and ASNE to become more transparent in explaining the Service's rationale for accepting Offers, Commissioner John B. Dunlap announced "details of tax compromises would be disclosed whenever a case was challenged in Congress."[86] In a telegram to Dunlap, however, James S. Pope (editor of the Louisville Courier-Journal), speaking on behalf of ASNE, expressed dissatisfaction that the promised disclosure would not go far enough, stating:

> When the revenue bureau settles a tax case for a few cents on the dollar, the people who pay in full are entitled to know of it, . . . Yet under your new policy these transactions would remain secret if the bureau can keep them secret. The people have no FBI of their own to ferret out the names of favored tax evaders.[87]

Finally, on August 20, 1952, President Truman issued Executive Order 10386 directing the Service to open for public inspection any accepted Offer including schedules or other documents relevant to the Offer.[88] Issued on the same day, a treasury decision approved by President Truman provided the specific details.[89] For each Offer accepted on or after August 20, 1952, a copy of the summary sheet (abstract) setting forth a brief explanation of the reasons for the approval would be made available for public inspection in the office of the information officer of the Service.[90] Upon further request, the specific information attached to the summary statement, or the statement itself, would also be made available to the public.[91] As to Offers accepted before August 20, 1952, no summary sheets were to be

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[85] *See* O'Brien, *supra* note 82.
[86] *Id.*
[87] *Id.* (internal quotation marks omitted).
[88] Exec. Order No. 10386, 1952-2 C.B. 299 (1952).
[89] I.R. Mimeo. 26, 1952-2 C.B. 299, 299-300 (1952).
[90] *Id.* at 300.
[91] *Id.*

made available for public inspection unless a "request identifying the taxpayer" whose Offer was accepted was submitted.[92]

B. Public Disclosure of Accepted Offer Details Revealed Service Bias and Incompetency in Processing Offers

Although the executive order did not require the Service to do so, within days after its issuance, the Service voluntarily released the details of two groups of Offers it had accepted prior to August 20, 1952. As well meaning as this gesture of transparency might have been, the revelations reflected poorly on the Service. The first group of disclosures involved Offers submitted by two disreputable profile taxpayers, one a gangster and the other a corrupt political lieutenant.[93] The second group included the Service's acceptance, over the recommendation of rejection by the examiner of an Offer of $2600 to compromise a liability of $15,500.[94] In that case, the investigating examiner disapproved of the Offer because the taxpayer "did not make any sincere effort to pay off any part of this tax liability and [since 1945] she lived somewhat beyond her means."[95] On her wages as a part-time worker in a shoe factory, while not paying her taxes, the taxpayer paid for her two children to go to summer camp and purchased two fur coats.[96] Yet, inexplicably, the Service accepted the taxpayer's Offer.[97]

These revelations of apparently preferential or overgenerous settlements of substantial tax liability further tainted the integrity of the Offer process. In a defensive response to innuendos of improper compromises, Commissioner Dunlap stated:

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[92] *Id.*

[93] *See Guzik Paid $100,000 of $890,000 Taxes; In Opening Settlement Files, Bureau Reveals Capone Aide had First Offered $5,000*, N.Y. TIMES, Aug. 29, 1952. In 1942, the Service accepted the Offer of John Guzik, the former treasurer of Al Capone's gang. The other high profile Offer was made by the estate of William D. Boyle once a lieutenant in Kansas City's Pendergast machine whose tax liability was attributed to embezzled money.

[94] *$140,000 Tax Cases Settled For$15,500: Woman Who 'Lived Beyond Means' Among 2d Group of 'Compromises' Disclosed*, N.Y. TIMES, Aug. 30, 1952.

[95] *Id.*

[96] *Id.*

[97] *Id.*

> The law says the [Service] can compromise tax liabilities and that's all we do . . . . When a taxpayer goes bankrupt or into receivership, the Government does not forgive his tax liability. It merely settles on a cold-blooded business basis by taking every dime the taxpayer's net worth reveals he has. If it shows he has assets of $5,000, the Government takes the $5,000.[98]

Arguably the most embarrassing Offer the Service accepted from a high profile taxpayer was submitted by Ethel Barrymore, a famous Hollywood and Broadway actress. In 1937, the Service accepted her Offer of $7500 to compromise a tax and interest liability of approximately $99,000,[99] based on the determination that at the age of "about 61," she was "broke" and had "no future on the stage."[100] Apparently, the Service underestimated the actress's future earning capacity as she subsequently revitalized her acting career by starring in a successful play with a three year run as well as in numerous Hollywood films.[101]

Obviously, the Service would have collected more; if not the entire underlying liability if it had the foresight to tap into Barrymore's future earnings. As a result of this embarrassing oversight, the Service subsequently developed a policy of insisting on a future income collateral agreement when the amount offered was small in proportion to the underlying tax liability.[102] As discussed in more detail *infra*, in addition to any amount paid with the Offer, pursuant to a future income collateral agreement, the taxpayer must pay an amount equal to a certain percentage of future earnings over a certain base amount retained by the taxpayer to pay living expenses.[103] So, if and when the taxpayer's financial condition improved, more of the compromised tax would be recouped from the taxpayer's additional collateral agreement payments.

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[98] *Dunlap Very 'Tired' of Tax Innuendos*, N.Y. TIMES, Sept. 5, 1952.

[99] *U.S. Erred $90,000 on Actress' Future,* N.Y. TIMES, Sept. 21, 1952.

[100] *Id.*

[101] *Id.*

[102] *See* Urban C. Bergbauer, Jr., *Offers in Compromise—Their Use and Justification*, 35 TAXES 301, 305 (1957).

[103] See *infra* notes 124, 156-163 and accompanying text for a discussion of future income collateral agreements.

C. Overhaul of the Service Pursuant to Reorganization Plan No. 1 Resulted in a More Streamlined Offer Process

In the early 1950s, corruption and ineptitude by the Service were not the only problems in the Offer process. In addition, the tedious red tape beginning with the submission of an Offer through its final acceptance was unduly cumbersome. Even an Offer compromising a minimal underlying tax liability required multiple reviews, high level approvals, and a legal opinion prepared by the chief counsel. The process would begin with the taxpayer's submission of an Offer in the appropriate local office of the Collector.[104] If the compromised liability was less than $1000, and did not include a fraud penalty, the Collector would make the initial investigation to determine whether the taxpayer had the ability to pay the liability in full.[105] Next, the Collector would send a report recommending approval or rejection of the Offer to the local staff division office. If the staff division head recommended acceptance, he would initial a form letter to be sent to the Secretary of the Treasury.[106] From the Secretary of the Treasury's office, the case would be transferred to division counsel for further review. If division counsel approved the Offer, he would initial a memorandum and send the case file to the Commissioner's office for yet another review. If the Commissioner approved, he would recommend the Offer for acceptance by the Secretary of the Treasury. From there, the case file would be sent to the chief counsel who was responsible for drafting the legal opinion. If the chief counsel approved, the case file would be reviewed by an assistant to the general counsel of the treasury department. Finally, if the general counsel approved the Offer, the case file would be sent back to the Secretary of the Treasury for final formal approval.[107]

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[104] Treas. Reg. § 601.4(c)(1) (1949). There were sixty-four collectors throughout the United States. *See* Camp, *supra* note 81, at 241.

[105] *See* Daniel S. Berman & Joseph Berman, *Closing Agreements and Compromises Under the New Policy of the Internal Revenue Board*, 25 MISS. L.J. 236, 239 (1954) (If the compromised tax was more than $1000 or included a fraud penalty, an agent would conduct the investigation.).

[106] *Id.*

[107] *Id.*

Fortunately, pursuant to the Reorganization Plan No. 1 of 1952 (Reorganization Plan) much needed changes to the Offer process were made as a result of the decentralizing and reorganizing of the functions and offices of the Service.[108] As fully implemented, the country was divided into nine geographical regions and sixty-four districts.[109] The positions of collectors were replaced by district directors[110] who were placed in charge of each district in which they assumed the responsibility of all functions of tax administration.[111]

Subsequently, the Service issued Revenue Ruling 117[112] delegating "certain duties, functions, and responsibilities with respect to the processing and disposition of offers in compromise"[113] to the district directors. Part of the delegation included granting the district director full authority to accept Offers compromising liabilities of less than $500 (including tax, penalties, and interest) without any further review or approval by the Commissioner or the Secretary of the Treasury or a formal legal opinion prepared by the chief counsel.[114] If the district director accepted such an Offer, he would prepare an abstract and statement explaining his reasons for endorsing the Offer that would serve as the statutorily required legal opinion.[115]

As to Offers of compromising liabilities of $500 or more, the district director's authority was limited to recommending such Offers for approval. Similar to the less than $500 Offers, the district director would prepare "an appropriate schedule and abstract and statement"[116] explaining his reasons for

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[108] Approved by Congress, the Reorganization Plan was proposed by President Truman under the authority of the Reorganization Act of 1949, Pub. L. No. 109, 63 Stat. 203.

[109] Camp, *supra* note 81, at 242.

[110] *Id.*

[111] *Id.*

[112] 1953-1 C.B. 498 (1953).

[113] *Id.* at 499.

[114] *Id.* at 502.

[115] *Id.* When Congress re-designated section 3761 of the Internal Revenue Code to section 7122, pursuant to the 1954 re-codification of the Code, the new section 7122 eliminated the requirement of a legal opinion with regard to the compromise of tax, penalties, and interest of less than $500. Internal Revenue Code of 1954, Pub. L. No. 83-591, 68 Stat. 730.

[116] 1953-1 C.B. at 502.

recommending the Offer and forward the entire compromise file to the Commissioner for final approval.[117]

Thus, Revenue Ruling 117 implemented a significant first step in streamlining the Offer process by granting the district director full autonomy to approve Offers of liabilities of less than $500 as well as eliminating cumbersome red tape with respect to all other Offers. Subsequently, perhaps to deal with a backlog of Offers, effective December 2, 1955, pursuant to Delegation Order No. 11, the Service further expanded the district director's authority to accept Offers of compromised liabilities of less than $5000.[118]

Shortly thereafter, however, Revenue Procedure 56-26 cut back the district director's authority with regard to Offers compromising liabilities greater than $500 and less than $5000.[119] For those Offers, the district director no longer had the authority to accept; and, instead, was required to send his recommendation of approval to the appropriate regional counsel for final acceptance.[120] Although a better policy might have been to allow the district director to retain the authority to accept all Offers compromising liabilities of less than $5000, delegating the authority previously held exclusively by the Commissioner and the Secretary of the Treasury to the regional counsel was nonetheless an improvement.

III. SERVICE'S OFFER POLICY: 1953-1992

A. Case Study Models of the Offer Review Process Published in Revenue Ruling 117 Provided Little Insight of How to Factor Present and Future Income into the Computation of the Maximum Collection Amount

For the first time since the Commissioner's 1934 Policy Statement, perhaps due in part to the public disclosure of the Service's acceptance of questionable Offers, Revenue Ruling 117

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[117] *Id.* Although not articulated in the revenue ruling, it appeared that if the Commissioner approved the Offer, the district director's abstract and statement would serve as the statutorily required legal opinion.

[118] 1956-1 C.B. 1010 (1956).

[119] 1956-2 C.B. 1383 (1956).

[120] *Id.* at 1385.

included case study models to illustrate the process by which Offers were to be evaluated by the district director.[121] Specifically, Exhibit A[122] and Exhibit F[123] provided the analysis and rationale for the rejection and acceptance of an Offer, respectively. Unfortunately, although somewhat helpful, neither case study provided any meaningful insight as to how to quantify the present and future income component of the Maximum Collection Amount in determining the amount of a viable Offer.

In Exhibit A, a taxpayer corporation submitted an IRS Form 656 (Offer in Compromise) offering a lump sum of $10,000 to compromise a tax liability of $32,000. On IRS Form 433 (Collection Information Statement), the taxpayer set forth a detailed disclosure of its financial condition including a list of assets and liabilities. From a balance sheet perspective, the taxpayer was financially insolvent because the total amount of its liabilities (including non-tax related liabilities) exceeded the total value of its assets whether valued at book value, fair market value, or forced sale value. Yet, despite the taxpayer's financial insolvency, the projected proceeds of a hypothetical liquidation of the taxpayer's unencumbered assets at the forced sale value (the lowest valuation) would satisfy the tax liability in full. Consequently, because collectability was not in doubt, there was no reason to consider the taxpayer's present and future income as a collection resource. For that reason, the district director rejected the Offer.

In Exhibit F, an individual taxpayer who was the president of a stock brokerage company submitted an IRS Form 656-C to make a deferred installment payment Offer in the principal amount of $5000 to compromise a liability of approximately $13,000. The payment terms were as follows: A down payment of $1000 with the balance of $4000 payable in installments of $500 plus six percent interest (accruing on the unpaid balance of the Offer) every six months for a period spanning four and a half years. Also, the taxpayer executed a future income collateral agreement agreeing to make additional payments of twenty percent of his annual income in excess of $7500, but not more than $10,000;

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[121] *See* 1953-1 C.B. 498 (1953).

[122] *Id.* at 507 ex. A.

[123] *Id.* at 514 ex. F.

thirty percent of his annual income in excess of $10,000, but not more than $15,000; and fifty percent of his annual income in excess of $15,000. Similar to the deferred installment payments, any additional payment would also be subject to six percent interest accruing on the unpaid balance of the Offer. So, if over the four and a half year period, the taxpayer's annual income never exceeded $7500, the taxpayer would pay no more than the Offer amount of $5000, i.e., the sum of the down payment plus the deferred installment payments (not including interest). On the other hand, if the taxpayer's annual income exceeded $7500 in one or more of those years, the additional payment(s) might be sufficient to satisfy the compromised tax liability in full.[124]

Similar to Exhibit A, the district director began his analysis with a thorough evaluation of the taxpayer's financial condition. According to the taxpayer's balance sheet on Form 433, a hypothetical liquidation of the taxpayer's unencumbered assets at the forced sale value would have yielded no more than $2450, well below the amount of the underlying tax liability. Because recent severe losses incurred by his company resulted in a substantial reduction of the taxpayer's monthly salary, it was unlikely that the amount of his income would increase in the foreseeable future.[125] Moreover, over the most recent twelve-month period, the taxpayer's receipts (salary, dividends, and loan proceeds) were offset by an equal amount of expenses.[126]

Ultimately, the district director accepted the taxpayer's Offer based on his determination that the $5000 offered exceeded his net equity by at least $3000 and provided adequate consideration for his present earning capacity.[127] Although no explanation for that conclusion was given, perhaps the district director was swayed by the additional payment potential of the future income

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[124] Interestingly, if the Service had insisted Ethel Barrymore execute a similar future income collateral agreement, the amount of her compromised tax liability would have likely been paid in full. *See supra* notes 99-103 and accompanying text.

[125] 1953-1 C.B. at 518-19.

[126] *Id.* (Among the taxpayer's expenses were "living expenses" of $3805 and club dues of $422.). Although there was no analysis of the living expenses, it was apparent that the district director must have found them to be reasonable. As to club dues, the district director determined it was essential for the taxpayer's business to maintain business contacts "necessitating membership in social clubs and doing considerable entertaining in connection with securing accounts for the firm." *Id.* at 519.

[127] *Id.*

collateral agreement.[128] In any event, it was unclear whether the district director would have recommended acceptance of the Offer in the absence of a collateral agreement.

B. Some Offers Mandate Taxpayer Concessions of Certain Tax Benefits

1. Tax Benefit Collateral Agreements

Unlike statutorily granted tax benefits such as certain exclusions from gross income or net operating losses, the Service's decision to accept a taxpayer's Offer to pay an amount less than the outstanding tax liability based on the taxpayer's inability to pay it in full is completely discretionary. Nevertheless, an accepted Offer does confer a tax benefit to the taxpayer to the extent of her tax savings. So, consistent with the Service's goal of collecting the Maximum Collection Amount, it was understandable for the Service to insist that a taxpayer give up certain tax saving benefits otherwise available to her as another means of collecting more of the compromised tax liability.

By analogy, section 108(a) of the Code excludes certain types of discharge of debt income from gross income[129] with a mandatory corresponding reduction of certain tax attributes that would have provided her with future tax saving benefits.[130] Similarly, as an offset to the tax savings of an accepted Offer, the Service developed several types of collateral agreements designed to potentially recoup some or all of the compromised tax liability.

Pursuant to a Collateral Agreement—Adjusted Basis of Specific Assets,[131] the basis of certain assets are reduced to quick sale value.[132] For example, in computing the collection potential of a taxpayer's net equity, an asset with a tax basis of $100,000, but a quick sale value of $70,000, would be valued at the latter amount. If the taxpayer were to sell the asset for its quick sale

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[128] *Id.* at 520.

[129] See I.R.C. § 108(a)(1)(A)-(D) (2006) for the four types of discharge of debt income excluded from gross income.

[130] See I.R.C. § 108(b)(2)(A)-(G) (2006) for the seven specific tax benefits to be reduced by the amount of the excluded discharge of debt income.

[131] *See* IRS Form 2261-B (revised Jan. 2012).

[132] *See* IRM 57(10)(11).421(1) (Nov. 15, 1985).

value, however, she could potentially recognize a $30,000 taxable loss.[133] So, as a result of the $30,000 basis reduction, instead of a potential tax loss, the taxpayer's tax liability would be greater than it would have been without the basis reduction.[134]

Likewise, if the asset were depreciable, the basis reduction would eliminate the tax benefit of $30,000 of cumulative depreciation deductions over the tax life of the asset. Therefore, the taxpayer's tax liability would be correspondingly greater in those tax years. So, in tax years following the tax year of the compromise, by virtue of the additional tax attributable to the lost depreciation deductions, all or some of the compromised liability could be potentially recouped.[135]

Similarly, pursuant to a Collateral Agreement—Waiver of Net Operating Losses and Capital Losses,[136] the taxpayer would waive the right to claim net operating loss and capital loss carryovers incurred in taxable years before and/or after the year the Offer was accepted.[137] By waiving the use of those losses to other tax years, the taxpayer's tax liability in those tax years would be correspondingly higher than it would have been with their allowance; and, thus, the additional tax liability would be a recoupment of all or some of the compromised liability.[138]

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[133] *See* I.R.C. § 1001(a) (2006).

[134] This is because the amount realized of $70,000 less the reduced basis of $70,000 would result in no gain or loss.

[135] Under no circumstances would the aggregate of actual payments (exclusive of interest) plus the amount of additional tax paid by the taxpayer attributable to the basis reduction (or any other collateral agreement in effect) exceed the compromised liability, plus interest and penalty that would have accrued in the absence of the compromise. *See* IRM 57(10)(11).421(2) (Nov. 15, 1985).

[136] Before they became obsolete, the collateral agreement also included a waiver of unused investment credits.

[137] *See* IRM 57(10)(11).43(1) (Nov. 15, 1985).

[138] Under no circumstances would the aggregate of actual payments (exclusive of interest) plus the amount of additional tax paid by the taxpayer attributable to the waiver of losses (or any other collateral agreement in effect) exceed the compromised liability, plus interest and penalty that would have accrued in the absence of the compromise. *See* IRM 57(10)(11).421(3). Also, at one time, there was also a collateral agreement to waive disallowed bad debt or other losses. IRM 57(10)(11).44, MT 5700-1 (Nov. 15, 1985).

2. Other Tax Benefit Concessions

Obviously, the collateral agreements described *supra* would be of no consequence to taxpayers who did not have those specific beneficial tax attributes. Over the years, however, certain standard tax benefit concessions applicable to all taxpayers have been incorporated in IRS Form 656 as a means to offset the tax savings of the compromise. Those concessions include the following:

- Waiver of right to receive refunds or credits for all tax years including tax year of compromise up to the difference between the comprised liability and the amount offered.
- Waiver of the statute of limitations on assessment and collection.
- Suspension of the running of the statute of limitations on assessment and collection during the period the Offer is pending.
- Waiver of right to contest validity of the underlying tax liability if the Offer is accepted.
- In the event of default of an accepted Offer, waiver of any statutory restrictions on assessment and collection including the right to receive notice prior to the Service's pursuit of assessment and collection.

Clearly, the above listed tax benefit concessions are consistent with the Service's goal of maximizing collection. For example, by waiving the right to receive refunds and credits, the Service can collect funds that would have otherwise been payable to the taxpayer as a resource from which to recoup all or part of the compromised liability. Obviously, it would make no sense for the Service to on one hand accept the taxpayer's Offer of less than the outstanding liability; and, then on the other hand, issue a refund or credit, or allow the taxpayer to apply it as all or part of the amount offered.

As another example of the virtues of taxpayer concessions, the suspension of the running of the statute of limitations on

collection serves two purposes. One purpose is to deter taxpayers from submitting an Offer as a delay tactic. In other words, if the statute of limitations on collection continued to run during the time the Service was considering the Offer, a taxpayer might be tempted to make an Offer solely to "run out the clock" with the hope that it would expire before the Service rejected or accepted the Offer. If successful, the taxpayer could effectively eliminate her entire tax liability without making any payment. The other purpose is to provide the Service with adequate time to consider the Offer without being concerned that the statute of limitations on collection might run prior to its completion of the Offer process. Otherwise, to protect its collection interests, depending on the time remaining on the statute of limitations, the Service might be inclined to hastily reject an Offer without giving it due consideration.

C. General Public Unawareness of Offer Procedure, the Lack of a Quantitative Formula to Compute the Maximum Collection Amount, and Tedious Hard-to-Monitor Collateral Agreements Stifled Offer Submissions and Acceptances

1. The Salient Details of Offer Policy and Procedure Found Exclusively in the Internal Revenue Manual—A Document Not Available to the General Public

Inexplicably, following the Commissioner's 1934 Policy Statement, Revenue Ruling 117 was the only official publically published document providing any insight into the Service's evaluation of Offers.[139] In fact, over time, the salient details of Offer policy and procedure were developed exclusively in the Internal Revenue Manual (Manual) a document providing instructions and guidance to be followed by Service personnel in administering tax law.[140] As an internal document, however, the Manual was not available to the general public. So, in the absence of any public pronouncements of Offer policy and procedure (other than Revenue Ruling 117), most taxpayers submitting an Offer

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[139] See *supra* Section III.B. for a detailed discussion of Rev. Rul. 117.

[140] *See* Archie W. Parnell, Jr., *The Internal Revenue Manual: Its Utility and Legal Effect*, 32 TAX LAW. 687 (1979).

would have no way to ascertain whether their Offers had any chance of being accepted by the Service.

Finally, in 1974, prompted by a Sixth Circuit decision[141] ordering the Service to disclose certain portions of the Manual pursuant to section 3(b)(C) of the Freedom of Information Act,[142] the Service voluntarily released the entire Manual to the public.[143] Yet, as a practical matter, however, the Manual would have been accessible only to those who subscribed to the Commerce Clearing House (CCH) tax service (the company that published the Manual).[144] Since most subscribers were specialized tax practitioners, taxpayers without such representation would likely be unenlightened as to the pertinent Offer policies and procedures. Moreover, Service personnel were directed not to assist uninformed taxpayers and were specifically instructed not to request a taxpayer to submit an Offer or to suggest the specific amount or terms to be included in an Offer.[145]

2. Lack of Quantitative Formula to Compute the Maximum Collection Amount

Yet, even a taxpayer who had access to the Manual would be hard pressed to understand the nuances of submitting a viable Offer. Over the years, the lack of clarity in Revenue Ruling 117 in how to integrate the present and future income component of the Maximum Collection Amount had not been rectified in the Manual. An examination of the Manual issued on November 15, 1985 provides insight as to the vagueness of the criteria used by Service personnel in computing the Maximum Collection Amount.

According to the Manual, the computation of the Maximum Collection Amount began with the determination of the taxpayer's net equity in her assets.[146] Net equity was defined as the difference between the quick sale value, less any encumbrances, with priority over the government's tax lien. "Quick sale value" was the estimated proceeds realized from a hypothetical sale to be

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141 Hawkes v. IRS, 507 F.2d 481 (6th Cir. 1974).
142 5 U.S.C. § 552(a)(2)(C) (2006).
143 *See* Parnell, *supra* note 140, at 690.
144 *Id.*
145 IRM 57(10)1.5(2)(b) (Nov. 15, 1985).
146 *See* IRM 57(10)7.51(3) (Nov. 15, 1985).

consummated as soon as possible due to adverse financial circumstances.[147] Assuming but for a compromise, the taxpayer would face a threat of imminent collection by the Service, the Manual indicated the use of the quick sale value was a compromise between fair market value[148] and forced sale value.[149] In other words, the use of fair market value would not be appropriate because it is unlikely that a distraint sale of the taxpayer's assets would bring that kind of return. Similarly, the use of forced sale value would not reflect any concession by the taxpayer as the net proceeds would reflect the same amount the Service would likely recover from a distraint sale of the taxpayer's assets.[150]

In determining quick sale value, the Manual directed Service personnel to consider local conditions such as "availability of mortgage money, appropriateness of the assets to local conditions . . . health of the local economy, etc." that should normally "not be less than 70% of fair market value."[151] Although the Manual encouraged open negotiation between the Service and the taxpayer in determining ultimate valuations, setting the quick sale value of a given asset based on those rather vague guidelines was likely to be a contentious issue. In any event, if the taxpayer's net equity was determined to be equal or greater than the outstanding liability, the net realizable proceeds from a hypothetical liquidation would be sufficient to pay it in full so there would be no need to consider the taxpayer's current and future income.

On the other hand, if the taxpayer's net equity was determined to be less than the outstanding liability, then the taxpayer's present and future income would also be evaluated. According to the Manual, however, there was no fixed percentage

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147 *Id.*

148 *Id.* (The Manual defined "fair market value" as the value determined by a willing buyer and willing seller, or the maximum value of any asset.).

149 *Id.*

150 *Id.*

151 *See* IRM 57(10)7.51(4). In the event it was in the "best interest of the Government," the Service would accept a forced sale valuation of the taxpayer's assets. IRM 57(10)7.51(5). On the other hand, one scholar noted that in his experience revenue officers tended to value assets "much closer to market value" than to quick sale value. Daniel T. Maggs, *Section 7122 of The Internal Revenue Code: The Offer in Compromise*, 11 GONZ. L. REV. 481, 496 (1976).

of a taxpayer's income that had to be considered.[152] Even more problematic in determining a taxpayer's future "income" was the lack of any rules or guidelines for an allowance of some measure of necessary living expenses.[153] Ultimately, the adequacy of the Offer amount attributable to the taxpayer's income was determined by an examining officer's subjective evaluation of the taxpayer's earning capacity based on "[her] education, profession or trade, age and experience, health, past and present income, and future prospects . . . ."[154] So, in the absence of a quantitative formula to determine the monetary value of a taxpayer's current and future income and because Service personnel were not allowed to suggest Offer amounts,[155] a taxpayer had no assurance that the amount offered would be acceptable.

3. Collateral Agreements Were Tedious to Complete and Hard to Monitor

As discussed, *supra*, it was not uncommon for the Service to insist upon the execution of one or more types of collateral agreements to supplement the amount offered by the taxpayer. In some ways, such collateral agreements were potentially beneficial to the Service and the taxpayer. From the Service's prospective, depending on the potential improvement of the taxpayer's financial circumstances, the additional payments collected by the Service might actually satisfy the entire liability including accrued interest and penalties. From the taxpayer's perspective, her willingness to enter into a collateral agreement might entice the Service to accept an otherwise unacceptable Offer; and, unless the taxpayer's financial condition improved, the Service would have no recourse to collect any more of the compromised liability from the taxpayer.

Unfortunately, the devil was in the details as collateral agreements were not user friendly for either party because they

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[152] *See* IRM 57(10)8.(15)1 (Nov. 15, 1985).

[153] Although in the context of a future income collateral agreement, the Manual did provide an allowance for ordinary and necessary living expenses, there was no indication that a similar allowance would be used in the determination of present and future income.

[154] IRM 57(10)7.51(6) (Nov. 15, 1985).

[155] *See supra* note 145.

were tedious to complete, spanned a relatively long period of time, and required mandatory annual filings by the taxpayer. Moreover, only with continuous monitoring would the Service be able to verify the taxpayer's compliance over the term of the agreement. Thus, from a cost benefit analysis, the difficulties of completion and compliance often outweighed the potential benefits.

For example, if the amount offered was small in proportion to the outstanding liability, the Service would often insist on the execution of a Future Income Collateral Agreement (FICA).[156] In essence, a FICA was an agreement to make additional payments ranging from twenty to fifty percent of gross annual income over an agreed upon baseline amount.[157] "Gross" annual income was the sum of all the taxpayer's financial income with the taxpayer's adjusted gross income as defined under section 62 of the Code as the starting point. Added back to that amount were non-financial tax losses including those recognized from the sale or exchange of capital assets, bad debts, as well the reversal of the deduction for long-term capital gains then allowed under section 1202 of the Code. Additionally, all nontaxable financial income and profits from any source including the fair market value of gifts, bequests, devises, inheritances, sick pay, insurance proceeds, and nontaxable gains from a condemnation award or involuntary conversion pursuant to section 1033 of the Code were added back to that amount.[158] Finally, after deducting the federal income tax paid in the year in which the annual income was computed, as well as any payment required under the terms of the Offer, the end result was gross annual income.[159]

The baseline amount was the taxpayer's estimated "ordinary and necessary" living expenses unique to each individual taxpayer and subject to negotiation between the taxpayer and the Service.[160] Factors to be considered by Service personnel included

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156 IRM 57(10)2.25(6)(a) (Nov. 15, 1985). On the other hand, in lieu of a FICA, the Service could be persuaded to accept an increase of "at least an amount equivalent to what the government could reasonably expect to recover via the [FICA]" to the amount offered. IRM 57(10)(11).412 (Nov. 15, 1985).

157 IRM 57(10)(11).413(1) (Nov. 15, 1985).

158 IRM 57(10)(11).416(2)(a)1-3 (Nov. 15, 1985).

159 IRM 57(10)(11).416(2)(b)1-2.

160 IRM 57(10)(11).413(2). These expenses were claimed by the taxpayer on one of three forms: IRS Form 433-A (revised Jan. 2008), IRS Form 433-B (revised Jan. 2008),

"the anticipated rate of inflation, expected changes in the size of the family, state and local taxes, [social security and Medicare taxes] withheld and unusual expenses, such as alimony, child support and abnormal medical and dental costs."[161] For each year the FICA was in effect (potentially as long as five years),[162] the taxpayer was required to submit an IRS Form 3439 (Statement of Annual Income), her federal income tax return, and a payment—if required.[163] The amount paid through a FICA could never exceed the total amount of tax, penalties, and interest less any amounts paid as a lump sum or an installment payment.

Unquestionably, the two tax benefit collateral agreements, Collateral Agreement—Adjusted Basis of Specific Assets (BRCA) and Collateral Agreement—Waiver of Net Operating Losses and Capital Losses (LWCA) were the most tedious and complex. Unlike a FICA that required actual monetary payments, increases of a taxpayer's tax liability attributable to the temporary or permanent reduction of certain tax attributes would be treated as "payments" to be applied to the compromised tax liability. Consequently, it was an administrative nightmare to keep track of the amounts paid with the Offer (including installment payments and FICA payments), plus the tax increase payments to assure that the aggregate amount did not exceed the compromised liability plus accrued interest and penalties. Moreover, if through the various sources of payment the compromised tax liability was satisfied in full, a "readjustment" of any remaining tax attributes legitimately still available to the taxpayer might be required. Thus, the complexity of computing and keeping track of all the "payments," eliminating or correcting erroneous adjustments, and assuring compliance, presented daunting tasks for the taxpayer and the Service.

Specifically, pursuant to a BRCA, the bases of certain assets were reduced to quick sale value to be used for "the life of the asset or until the full amount of liability which was compromised, plus interest and penalty that would have been due in the absence

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or IRS Form 4822 (revised Apr. 2012) (Statement of Annual Estimated Personal and Family Expenses); *see also* IRM 57(10)(11).413(3).

[161] IRM 57(10)(11).413(2).

[162] IRM 57(10)(11).413(5).

[163] IRM 57(10)(11).413(1).

of the compromise, is recouped by payments on the [O]ffer and any related collateral agreements."[164] So, depending on the amount of the compromised liability and the depreciation life of the asset, the taxpayer might be compelled to use the reduced basis for many years or possibly permanently. As a further complication, if through happenstance, the compromised liability was completely recouped and the taxpayer still owned the asset, the basis of the asset would be recomputed for the remaining depreciation period.[165] So, to assure the taxpayer's compliance with these complicated rules, the Service would have to monitor the taxpayer's income tax returns to determine whether the taxpayer used the reduced basis throughout the period in which the compromised liability remained unsatisfied; and, if applicable, properly recomputed it in the event the compromised liability was recouped.

Finally, a LWCA was commonly executed by taxpayers with net operating losses or capital losses incurred before, during, or after the periods covered by the Offer.[166] According to its terms, the taxpayer waived the right to carryover those losses to years ending after the date of acceptance of the Offer.[167] Similar to a BRCA, the waiver of losses was effective until the full amount of the liability was recouped.[168] In the event the compromised liability was completely recouped, the amount of any remaining loss carryover available for future use would be recomputed.[169] To assure taxpayer compliance with these complicated rules, the Service would have to monitor the taxpayer's applicable income tax returns and amended income tax returns to determine whether the taxpayer honored the waiver. In the event the compromised tax was recouped, the Service would then have to monitor subsequently filed returns to ascertain whether the

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[164] IRM 57(10)(11).422 (Nov. 15, 1985).

[165] *Id.* The recomputed basis would be the "pre-compromise" basis less the amount of allowable depreciation that would have been taken in the absence of the compromise.

[166] IRM 57(10)(11).43(1) (Nov. 15, 1985).

[167] *Id.*

[168] IRM 57(10)(11).43(3).

[169] *Id.* The recomputed loss carryover would be the amount of the original loss reduced by the amount of the loss that would have been taken in the absence of the compromise.

amount of any remaining available loss carryover was properly recomputed and applied.

So considering the complex computations and multiple annual filings required from the taxpayer, as well as Service manpower necessary to administer and monitor taxpayer compliance with a high likelihood of taxpayer default, it was not surprising that an Offer that included collateral agreements was not enthusiastically embraced by either party as a viable collection option.

IV. THE SERVICE'S 1992 MAJOR OVERHAUL OF THE OFFER PROGRAM

A. Low Offer Submissions and Acceptances Attributable to Lack of Service Personnel Commitment to Offers and Uncertainty in Determining the Adequacy of an Offer

Prior to 1992, there was a dearth of Offers made by taxpayers.[170] In no particular order, there were various explanations for this phenomenon. One explanation was high-level Service personnel did not favor or encourage Offers, and consistent with that policy, revenue officers assigned to a taxpayer's account were not permitted to solicit Offers as a means of resolving collection issues.[171] Additionally, the level of commitment to the Offer process as a viable collection tool varied from district to district due to "the attitude of district supervisory officials concerning optimum collection technique, the discretion left to district personnel by the broad guidelines set by the National Office, and the importance of various statistical data reflecting case closings."[172] Finally, as discussed in Sections III.D.2 and D.3 *supra*, the lack of a quantitative formula to

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[170] *See* T.D. 8829, 64 Fed.Reg. 39020, 39022 (July 21, 1999) ("From the 1930's to the early 1990's, offers in compromise were not widely used to resolve tax cases."); *see also*, MICHAEL I. SALTZMAN, IRS PRACTICE AND PROCEDURE ¶ 15.03[4][a] n.34 (2d ed. 1991) (citing IRS ANNUAL REPORT 54 tbl.13 (1988)) (reporting that of the 2.6 million taxpayer delinquent accounts closed in 1987 and 1988, only 7000 Offers were made).

[171] *See* IRM 57(10)1.5(2)(b) (Nov. 15, 1985); Robert H. Breakfield & Charles E. Alvis, *Author's Update: Revised IRS Procedures For Offers in Compromise Under Section 7122*, 72 TAXES 277, 277 n.3 (1994) (citing the EXECUTIVE SUMMARY OF THE COMMISSIONER'S ADVISORY GROUP MEETING (1991)).

[172] SALTZMAN, *supra* note 170, ¶ 15.03[4][a].

compute the Maximum Collection Amount, coupled with the Service's insistence of the inclusion of tedious collateral agreements, likely resulted in a small number of Offer submissions and an even smaller number of acceptances.

B. Due to Lackluster Collections of Delinquent Tax Liabilities the Service Revised Its Offer Objectives and Procedures

By all accounts, the objective of the Offer program "to effect maximum collection with the least possible loss or cost the Government"[173] had been a dismal failure. By the end of fiscal year 1991, there was approximately $111 billion of outstanding nationwide delinquent tax liability.[174] Moreover, a review conducted by the General Accounting Office (GAO) revealed that for all rejected Offers, the Service collected only 5 percent of the amount offered at a later date. For example, if the Service rejected a taxpayer Offer of $10,000, and then pursued normal collection action, it was likely to collect only $500.[175] Consequently, the Service's Offer rejection policy was not cost effective as the follow up collection efforts yielded far less tax dollars than the taxpayers had previously offered.

On February 26, 1992, the Service issued Policy Statement P-5-100 in which it revised its collection priorities by implementing the following new Offer objectives:

- To resolve accounts receivable which cannot be collected in full . . . ;[176]
- To effect collection of what could reasonably be collected at the earliest time possible and at the

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[173] IRM 57(10)1.4(1) (Nov. 15, 1985).

[174] Collection Division Manager, Internal Revenue Service, Remarks at the Meeting of the District of S.C. Association of CPAs in Columbia, S.C. (Nov. 19, 1992); *see* Breakfield & Alvis, *supra* note 171, at 278; *see also* Terri Gutierrez, *Easier Offers in Compromise: Revised Guidelines on Acceptable Living Expenses Make OICs More Attractive*, J. ACCT. (Dec. 1997), *available at* http://www.journalofaccountancy.com/Issues/1997/Dec/gutier.

[175] Breakfield & Alvis, *supra* note 171, at 278.

[176] IRM 57(10)1.2(1) (Feb. 26, 1992).

least cost to the government (Reasonable Collection Potential);[177]

- To give taxpayers a fresh start to enable them to voluntarily comply with the tax laws (Taxpayer Compliance);[178] and
- To collect funds which may not be collectible through any other means.[179]

Although the Service's new objectives collectively reflected a liberalization of its Offer policy, it did not extend to accepting Offers on basis of equity or hardship.[180] The most significant change was the Service's decision to lower collection expectations by replacing the Maximum Collection Amount with the Reasonable Collection Potential as the baseline for an acceptable Offer, based on the belief that collecting a potentially lesser amount over a much shorter period of time was a more attainable and realistic goal. Additionally, the Service believed that more user friendly Offer policies and procedures would encourage many delinquent taxpayers to settle their outstanding tax liability and re-enter the tax system as compliant taxpayers going forward.

1. The Service Created a Mathematic Formula to Compute the Reasonable Collection Potential

As discussed in Section III.C.2 and C.3 *supra*, the inexactness in the computation of the Maximum Collection Amount often mandated the Service's insistence of the inclusion of one or more collateral agreements to make an Offer viable. So in an effort to provide certainty and eliminate the necessity of those cumbersome agreements, the Service created a mathematic formula to compute the Reasonable Collection Potential (Reasonable Collection Potential Formula). Also, consistent with its desire to expedite collection, the Service's new policy included the acceptance of only

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177 IRM 57(10)1.2(2).

178 IRM 57(10)1.2(3).

179 IRM 57(10)1.2(4).

180 See IRM 57(10)(10).1(2) (Feb. 26, 1992), in which the Manual made it clear that Offers based on equity and hardship would not be consistent with Attorney General opinions barring such compromises.

cash Offers payable within ninety days of approval, or deferred payment Offers payable in no more than two years from approval unless the taxpayer could demonstrate extraordinary circumstances justifying a longer period.

a. The Reasonable Collection Standard Formula

i. Net Equity Component

Similar to the computation of the Maximum Collection Amount, the starting point of the Reasonable Collection Potential Formula was the taxpayer's net equity in her assets.[181] Although the formula retained the Manual's previous definition of net equity as the difference between the quick sale values of the taxpayer's assets,[182] less any encumbrances, with priority over the government's tax lien, the Service expressed a willingness to accept the lower forced sale value or the even lower minimum bid value, if warranted under the circumstances.[183] Additionally, the Service encouraged its personnel to be open in negotiations with taxpayers "to avoid inflexible, non-negotiable values."[184]

ii. Present and Future Income Component

The new formula incorporated workable criteria to quantify the present and future income component to be included in the Offer amount. For this purpose, the concept of "income" was recast as "disposable income," i.e., the taxpayer's financial income less an allowance for reasonable "lifestyle expenses"[185] and "allowable expenses."[186] In the computation of disposable income, an allowance for lifestyle expenses (such as a manner of dress or type of automobile) would be granted if it was consistent with the

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181 *Id.*

182 *Id.* (The taxpayer's "assets" included those beyond the reach of government collection such as property located outside of the U.S. or property own by tenancy or the entirety.).

183 *See* IRM 57(10)(10).1(2) (Sept. 22, 1994). The "minimum bid value" is an amount equal to twenty percent of the forced sale value not to exceed the total amount of tax, penalty, interest, lien fees, expenses of levy and sale and other charges. IRM 5.10.4.8(6) (July 3, 2009).

184 *See* IRM 57(10)(10).1(2).

185 IRM 57(10)(13).10(1)(b) (Sept. 22, 1994).

186 IRM 57(10)(13).10(1)(b)(4).

expectations of the taxpayer's profession.[187] As an illustration, a real estate agent listing and selling upscale homes would be expected to drive a moderately expensive, late model, full size car in transporting her wealthy cliental from property to property. So, in that case, a relatively high car loan payment would be deemed to be a reasonable expense.[188] Conversely, because a physician's ownership of a vacation home would have no connection with her practice of medicine, and, thus, there would be no allowance for the mortgage payment because it would be considered a lifestyle choice that was "both excessive and unnecessary for maintaining her professional image."[189]

In contrast to lifestyle expenses, "allowable expenses" were more fundamental to the taxpayer's ability to meet her basic living necessities. Although the Manual did not elaborate on the scope of the allowance, it did cross reference to the section of the Manual[190] dealing with installment agreements.[191] Unlike an Offer, in an installment payment agreement, the taxpayer must pay the entire amount of the outstanding tax liability over an agreed upon period.[192] In negotiating payment amounts with the taxpayer, IRM 5323 directed revenue officers not to make demands that would jeopardize the taxpayer's ability to support her family, pay current taxes, or earn income from which to make the installment payments. So, by cross-referencing IRM 5323, the Service's new policy allowed an offering taxpayer to retain sufficient funds to pay for her basic necessities.[193]

Thus, a taxpayer's monthly disposable income was the difference between monthly financial income and reasonable monthly lifestyle and allowable expenses computed over a sixty-month period. Additionally, as an incentive to encourage

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187 IRM 57(10)(13).10(1)(b).

188 IRM 57(10)(13).10(1)(b)(1).

189 IRM 57(10)(13).10(1)(b)(3).

190 IRM 5323 (Aug. 29, 1985).

191 IRM 57(10)(13).10(1)(b)(4) (referring to IRM 5323); IRM 57(10)(10).1(4) (Feb. 26, 1992).

192 *See* I.R.C. § 6159 (2006).

193 *See* Prop. Treas. Reg. § 301.7122, 64 Fed. Reg. 39022, 39022 (July 21, 1999) (The Service acknowledged the relevance of "allowable expenses" in post-1992 Offers stating, "In administering its collection operations, including both the installment agreement program and the compromise program, the IRS has always permitted taxpayers to retain sufficient funds to pay reasonable living expenses.").

taxpayers to pay the Offer amount relatively quickly, the Service would apply a present value discount to the taxpayer's monthly disposable income if it was paid within ninety days of acceptance. For example, assuming a current interest rate of seven percent, the present value of $300 per month over a sixty-month period, or $18,000, would be $15,228.[194] On the other hand, if the Offer amount was payable over a term greater than ninety days of acceptance, there would be no present value discount. So, in the latter case, the Service would not consider an Offer that did not include the entire $18,000.[195] Consequently, in this example, by paying the Offer amount within ninety days of acceptance, the taxpayer would have saved $2772 on what would have otherwise been the minimal amount the Service would have been willing to accept.

2. Another Service Objective—Taxpayer Compliance

Taxpayer Compliance was another main objective in the Service's revision of its Offer policy. The goal was to encourage a taxpayer to resolve her delinquent tax liability with the expectation that she would re-enter the voluntary tax system as a complaint taxpayer who would be current on her ongoing tax filing and payment obligations. To accomplish this goal, the Service took the following steps.

First, pursuant to a new Manual section titled *Advising Taxpayers of Offer Provisions*,[196] a Service employee (such as a revenue officer) was directed to discuss the possibility of an Offer with a delinquent taxpayer who was financially unable to pay her tax liability in full.[197] In that discussion, the Service employee was to advise the taxpayer of the Offer policy and procedures, the forms to be completed (with the Service employee's assistance, if

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[194] *Id*.

[195] *Id*. The Service's new Offer policy clearly favored cash Offers. As to deferred payment Offers, the general rule limited the payout period to no more than two years from the date of acceptance. IRM 57(10)6.4(3) (Sept. 22, 1994). Although the Manual indicated a longer payout period might be acceptable under extraordinary circumstances, such circumstances were not defined. *See* IRM 57(10)6.4(3)(a).

[196] IRM 57(10)5 (Feb. 26, 1992).

[197] IRM 57(10)5.1(1) (Sept. 22, 1994).

necessary), as well as the benefits the taxpayer would receive from an accepted Offer.[198]

Second, the Service introduced a new five-year mandatory compliance period as an additional Offer prerequisite.[199] Prior to the 1992 Offer changes, an Offer was not contingent on the taxpayer's future compliance with her ongoing tax obligations. Therefore, as long as the taxpayer complied with the terms of the Offer, her failure to be current with those obligations would not jeopardize the status of the compromise. So under this new Offer provision, a taxpayer was subject to a five-year mandatory compliance period from the date the Service accepted the Offer.[200] Consequently, a taxpayer who fell out of compliance during the mandatory period would be in default of the Offer, providing the Service with the option to retroactively reinstate the amount of the compromised liability (less a credit for amounts paid by the taxpayer).[201]

C. Modifications to the 1992 Offer Policy

1. A 1993 GAO Study Noted Lack of Uniformity in Offer Policy

According to a December 1993 GAO report critiquing the Service's 1992 Offer policy,[202] there was a wide disparity of Offer acceptance percentages among the nation's sixty-three district offices.[203] One explanation for this disparity was the lack of uniform guidelines that established the amount of allowable

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[198] IRM 57(10)5.1(2). An additional sampling of disclosures made by the Service employee to the taxpayer included advising her of the suspension of collection during the processing of the Offer, the duty of the taxpayer to initiate the first specific Offer proposal, and the making of a voluntary good faith deposit with the submission of the Offer. IRM 57(10)5.1(3)-(5).

[199] IRM 57(10)5.1(9).

[200] *See* IRS Form 656, at 8(d) (revised Sept. 1993).

[201] *Id.* (Significantly, the five year mandatory compliance period was not limited to deferred payment Offers. Even a taxpayer who made a lump sum Offer was required to remain current throughout the period. If she failed to do so, the Service could declare the Offer to be in default and require payment of the difference between the compromised liability and the lump sum payment.).

[202] U.S. GEN. ACCT. OFFICE, GAO/GGD-94-47, TAX ADMINISTRATION**:** CHANGES NEEDED TO COPE WITH GROWTH IN OFFER IN COMPROMISE PROGRAM 1 (1993).

[203] *Id.* at 15. In the first ten months of the 1993 fiscal year, the lowest and highest Offer acceptance rates were seventeen percent and seventy-nine percent, respectively. *Id.*

monthly expenses. Because monthly net disposable income was the difference between the taxpayer's income and the amount of allowable monthly expenses, higher allowable monthly expenses would result in lower monthly disposable income. Although allowable expenses were defined as those necessary to carry on the taxpayer's business and provide minimal support for her family, the determination of the amount and type of expense actually allowed in any given case was left to the discretion of the revenue officer. Consequently, an Offer acceptable in a district with a liberal policy regarding allowable monthly expenses might be rejected in a district with a more restrictive policy.

2. The Service's New Standards for Allowable Monthly Expenses Were Criticized

On August 29, 1995, in an effort to establish nationwide uniformity with regard to allowable expenses, the Service revised IRM 5323 to create two types of allowable expense—necessary expenses and conditional expenses.[204] With respect to the Reasonable Collection Potential Formula, only necessary expenses, however, were considered in the computation of disposable income.[205]

Necessary expenses were defined as any reasonable expense required to provide for the taxpayer's family's health and welfare or for the production of income.[206] In an effort to establish "uniformity," certain expenses were subjected to a national standard while others were subjected to a local standard. For example, the allowance for food, housekeeping supplies, apparel, and services, as well as personal care products and services, was subject to a national standard promulgated by the Bureau of Labor Statistics.[207] Conversely, the allowance for housing (including utilities) and transportation expenses was subject to a local standard.[208] Finally, the allowance for any other necessary

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[204] IRM 5323.12(1) (Aug. 29, 1995).
[205] *See* IRM 5.8.4.2.2 (May 26, 1999).
[206] IRM 5323.12(1)(a).
[207] IRM 5323.12(1)(a)(1).
[208] IRM 5323.12(1)(a)(2).

expenses was to be determined by the Service employee responsible for the case.[209]

Yet, in spite of these efforts, tax practitioners criticized the Service's adherence to the national standards as being unrealistic. For example, the national standard for food costs (effectively an "average" of nationwide food costs) failed to account for the significant variances in such costs across the country. In fact, in some locales, the national standard discriminated against taxpayers living in the inner city who had higher food costs as compared to taxpayers living in the suburbs.[210] Thus, in many instances, the uniformity the Service sought to achieve led to unintended inequities.

3. The Service Unceremoniously Modified the Reasonable Collection Potential Formula by Substituting Current Market Value for Quick Sale Value and Eliminating the Present Value Discount in Computation of Monthly Disposable Income

As discussed in Section IV.B.1.b. *supra*, pursuant to the Reasonable Collection Potential Formula, the amount of an adequate Offer paid within ninety days of acceptance by the Service was the sum of the taxpayer's net equity plus the present value of sixty months of disposable income. Yet, in 1997, without any forewarning or explanation in the Manual or elsewhere,[211] on a revised IRS Form 656, the Service made significant modifications to the formula that were detrimental to the taxpayer. First, assets were to be valued at "current market value," rather than the much lower quick sale value.[212] Second, the present value discount was totally eliminated.[213] By virtue of these changes, the amount of a viable Offer as computed on the revised Form 656 was significantly higher than it would have been

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[209] IRM 5323.12(1)(a)(3).

[210] *See* George E. Marifian, *Offers-in-Compromise: Did the IRS Get the Message?*, 1 J. TAX PRAC. & PROC. 25, 26 (1999).

[211] *See* Lawrence D. Garr, *Cutting a Deal With the IRS in 1997: Forms Over Substance*, TAX NOTES, July 28, 1997, at 547, 548-49 ("While the offer program may be alive and well in the Manual, and the IRS has issued no policy statements to the contrary, the program is being killed by IRS forms, instructions, and worksheets.").

[212] IRS Form 656, at 4-5 (revised Mar. 2011).

[213] *Id.* at 5.

according to the criteria set forth in the Manual.[214] Obviously, these austere modifications made it more difficult for taxpayers to submit viable Offers; and, thus, decreased the number of accepted Offers.[215]

In response to criticism that the formula modifications were unfair to taxpayers, Harry T. Manaka, the IRS National Director for Collection Services, justified the changes as being necessary to "curtail the number of non-processable offers that waste everybody's time."[216] Perhaps a more cynical explanation was the Service's desire to revert back to its old policy of maximizing collections.

4. The Taxpayer Bill of Rights 2 Eliminated Some Red Tape in the Offer Process

On a positive note, section 503(a) of the Taxpayer Bill of Rights 2 (amending section 7122(b) of the Code) streamlined the Offer acceptance process by eliminating the requirement of a written legal opinion from the chief counsel with regard to Offers of compromised tax liability of less than $50,000.[217] Prior to the amendment, the chief counsel was required to submit a written legal opinion for all Offers of compromised tax liability in excess of $500. As a result, virtually every Offer required a legal opinion creating a layer of red tape that further delayed formal acceptance. As a consequence of the amendment, the acceptance of Offers of compromised tax liability of less than $50,000 was delegated to middle managers of the collection division; and, thus, significantly reduced the response time.[218]

V. CONGRESS'S LIFTING OF THE ATTORNEY GENERAL'S BAN ON CONSIDERING FINANCIAL HARDSHIP, EQUITY AND PUBLIC

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[214] *See* Lawrence D. Garr, *The IRS—Still Going for the Jugular*, WASH. TIMES, Jan. 12, 1998, at A15 (noting that IRS Form 656 was modified without any corresponding change to the Manual). Apparently, the changes on the revised IRS Form 656 escaped the notice of commentators who continued to rely on the values set forth in the Manual. *See, e.g.*, Robert H. Breakfield & Charles E. Alvis, *Author's Update: IRS Procedures for Offers-In-Compromise Under Section 7122*, 75 TAXES 337, 339-41 (1997).

[215] Garr, *supra* note 211, at 548.

[216] Garr, *supra* note 214 (internal quotation marks omitted).

[217] Pub. L. No. 104-168, 110 Stat. 1461 (1996).

[218] Breakfield & Alvis, *supra* note 214, at 338.

POLICY AS THE BASIS FOR AN OFFER FAILED TO LIVE UP TO ITS PROMISE

Prior to the enactment of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 1998),[219] in spite of the liberalization of its Offer objectives discussed *supra*, the Service continued to adhere to the Attorney General's longstanding ban on financial hardship, equity, and public policy as being the basis for an Offer (Attorney General's Ban).[220] Finally, more than six decades after the Attorney General insisted that any reversal of the ban be made by Congress,[221] Congress finally acted. In the legislative history of RRA 1998, Congress proclaimed that it "anticipate[d] that the [Service] will take into account factors such as equity, hardship, and public policy where a compromise of . . . income tax liability would promote effective tax administration."[222] Moreover, viewing compromise as a constructive way to settle outstanding tax liability and enhance taxpayer compliance, Congress encouraged the Service to make it easier for taxpayers to make Offers and to "do more to educate the taxpaying public about [their] availability . . . ."[223]

Although the positive tone of the legislative history suggested that a wide sweeping reform of the Offer process was in the offing, the actual statutory amendments to section 7122 of the Code fell well short of that goal. In fact, the most significant statutory provisions simply directed the Service to do what it had already done, i.e., establish adequate allowances for basic living expenses. Beyond that specific statutory directive, any further pro-taxpayer equitable reform of the Offer process was left to the discretion of the Service. Subsequently, as promulgated in temporary and final

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[219] Pub. L. No. 105-206, 112 Stat. 685.

[220] *See* IRM 57(10)(10).1 (Feb. 26, 1992) (clarifying that Offers based on equity and hardship would not be consistent with Attorney General opinions barring such compromises).

[221] *See supra* Section I.B.3.a for a detailed discussion of the Attorney General's Ban.

[222] H.R. REP. NO. 105-599, at 289 (1998). Congress's directive was reminiscent of the Penalty Hardship Standard that allowed the Service to consider an Offer by a solvent taxpayer to compromise a penalty in the interest of "justice, equity, and public policy." For a discussion of the Penalty Hardship Standard approved by the Attorney General in 1919, and its subsequent renouncement by the Attorney General in 1934, see *supra* Section I.B.2. and Section I.B.3.a., respectively.

[223] H.R. REP. NO. 105-599, at 289.

regulations, the Service appeared to embrace the spirit of the legislative history by introducing new hardship and public policy based Offers. Unfortunately, the Service established such stringent standards for taxpayer eligibility that were nearly impossible to meet. So, as a practical matter, the Service failed to extend the contours of its authority to incorporate hardship, equity, and public policy factors in a very meaningful way.

A. New Section 7122(c) Directing the Service to Establish Adequate Allowances for the Basic Living Expenses of Taxpayers Submitting Offers was Underwhelming

As described *infra*, newly enacted section 7122(c)[224] directed the Service to establish what it had already established, i.e., adequate allowances for basic living expenses to be granted to taxpayers submitting Offers. First, section 7122(c)(1) provided that the Service "*shall*" prescribe guidelines to determine whether an Offer is adequate and should be accepted. Next, section 7122(c)(2)(A) stated that in prescribing the above referenced guidelines, the Service "*shall* develop and publish schedules of national and local allowances" to assure that taxpayers who submit Offers would be allowed to retain adequate resources to provide for basic living expenses. Finally, pursuant to section 7122(c)(2)(B), "the guidelines *shall* provide that officers . . . of the [Service] *shall* determine, on the basis of the facts and circumstances of each taxpayer, whether the use of the schedules . . . is appropriate and *shall* not use the schedules to extent such use would result in the taxpayer not having adequate means . . . for basic living expenses" (emphasis added).

Simply stated, the sum and substance of sections 7122(c)(1) and (c)(2) was to require the Service to factor a taxpayer's financial ability to pay basic living expenses into the computation of an acceptable Offer amount. The only significant enhancement achieved by this directive was the additional proviso that would require the Service to disregard the national or local standards if as applied to a given taxpayer would not leave her with adequate

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[224] Pursuant to the enactment of the Tax Increase Prevention and Reconciliation Act of 2005, Pub. L. No. 109-222, 120 Stat. 345 (2006), section 7122(c) of the Code was renumbered as section 7122(d). All references herein to section 7122(c) or its subsections are to current section 7122(d).

means to cover those expenses. In that case, the Service was directed to disregard the standards and grant allowances based on the peculiar facts and circumstances of the taxpayer. Although the codification of that directive should not be minimized, section 7122(c) fell far short of a much broader congressional promise to inject financial hardship and public policy considerations into the Offer process.[225]

B. Actions Speak Louder Than Words—Two New Types of Effective Tax Administration Offers were of Questionable Utility to the Taxpayer

1. The Temporary Regulations

In spite of statutory language that did not match the fervor of the legislative history, the Service appeared to embrace the spirit of the latter by taking into account equity, hardship, and public policy factors in formulating new Offer policy. The temporary regulations established two new Offer types that purportedly incorporated those factors. One Offer type was based on economic hardship that would result from the collection of the full liability (Hardship Offer),[226] and the other Offer type was based on exceptional circumstances such that, regardless of the taxpayer's financial situation, the collection of the full liability would be detrimental to voluntary compliance by taxpayers (Public Policy Offer)—collectively referred to as the "ETA Offers."[227] Importantly, a taxpayer was eligible to submit an ETA Offer only if she was ineligible to submit any other type of Offer. So, if liability was at issue, or the taxpayer lacked the resources to pay

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[225] I.R.C. § 7122(c)(3)(A) (2006). The final equity hardship based provision barred the Service from rejecting an Offer submitted by a low-income taxpayer solely on the basis of the amount offered. *Id*. This provision, however, has little practical significance. Considering the limited financial resources that would be available to such an impoverished taxpayer, it is unlikely she would ever be capable of satisfying her liability. So even without the statutory ban, acceptance of a minimal Offer in lieu of an extended installment agreement or placing the taxpayer in uncollectable status would in most cases be in the best interest of the Service.

[226] Temp. Treas. Reg. § 301.7122-1T(b)(4)(i) (2000).

[227] Temp. Treas. Reg. § 301.7122-1T(b)(4)(ii) (2000).

the tax liability in full, she would be ineligible to submit an ETA Offer.[228]

So, in order to submit a Hardship Offer, a taxpayer would have to demonstrate that, in spite of possessing the resources to pay the liability in full, if compelled to do so, she would be financially incapable of meeting her basic living expenses.[229] The temporary regulations set forth three types of economic hardship, including one in which the taxpayer's medical condition rendered her incapable of earning a living so that her "financial resources will be exhausted providing for care and support during the course of the condition; . . ."[230] Additionally, reminiscent of the inexactness of the computation of the Maximum Collection Amount, the temporary regulations provided four factual examples of financial hardship[231] that purportedly would have qualified for a Hardship Offer with no guidance in how to determine an adequate amount to offer. In fact, the preamble stated that the amount of an acceptable Offer, and any other mandatory terms, were to be left to the discretion of the Service, and, thus, obviously subject to change. So, in the absence of any specific guidance, a taxpayer would be compelled to formulate a Hardship Offer amount based on her special financial needs with no assurance that the Service would accept it.

Conversely, financial hardship was of no relevance in qualifying for a Public Policy Offer. As stated *supra*, a Public Policy Offer would be appropriate in cases where "exceptional circumstances exist such that collection of the full liability will be detrimental to voluntary compliance by taxpayers; . . ."[232] Beyond that statement, the only guidance provided in the temporary

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[228] Temp. Treas. Reg. § 301.7122-1T(b)(4) (2000) (In that case, the taxpayer would be eligible to submit an Offer based on doubt as to liability or doubt as to collectability).

[229] Temp. Treas. Reg. § 301.7122-1T(b)(3)(ii) (2000).

[230] Temp. Treas. Reg. § 301.7122-1T(b)(4)(iv)(B)(1) (2000). A second hardship example involved the need to retain sufficient monthly income to provide care for dependents who have no other means of support. § 301.7122-1T(b)(4)(iv)(D) ex. 1. A third hardship example involved a taxpayer who could not borrow against the equity in his assets; and, if compelled to liquidate those assets, he would be unable to meet his basic living expenses. § 301.7122-1T(b)(4)(iv)(D) ex. 3.

[231] Temp. Treas. Reg. § 301.7122-1T(b)(4)(iv)(D) (2000) (providing three examples of individual taxpayers with financial hardships and one example of a non-individual taxpayer with a financial hardship).

[232] Temp. Treas. Reg. § 301.7122-1T(b)(4)(ii) (2000).

regulations was gleaned from two examples suggesting that a tax liability that was outstanding due to excusable circumstances beyond the control of the taxpayer could potentially be the basis for a Public Policy Offer. Because these examples were retained without change in the final regulations, they are discussed in detail in Section V.B.2 *infra*.

Finally, even assuming hardship or public policy/equitable considerations warranted an ETA Offer, the Service could nonetheless reject it if the Offer would undermine taxpayer compliance with tax laws.[233] More specifically, the temporary regulations stated that the Service would be inclined to reject an ETA Offer made by a taxpayer who had a history of noncompliance with her tax obligations, had taken deliberate actions to avoid paying taxes, or had encouraged others to refuse to comply with tax laws.[234]

2. The Final Regulations Narrowed the Scope and Viability of ETA Offers

Since the terms of accepted Offers are subject to public disclosure, the Service would naturally be concerned with taxpayers' perceptions of the Service's acceptance policy.[235] So, if taxpayers were to view it as being overly liberal, they might be tempted not to pay their tax liabilities with the possibility of a favorable compromise in the offing. Perhaps this was the reason the Service narrowed the scope and viability of ETA Offers in the final regulations.[236]

a. Non-Individual Business Taxpayers Not Eligible for Hardship Offer

One of the examples in the temporary regulations indicated that a non-individual business taxpayer was eligible to submit a

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[233] Temp. Treas. Reg. § 301.7122-1T(b)(4)(iv)(C) (2000).

[234] Temp. Treas. Reg. § 301.7122-1T(b)(4)(iv)(C)(1) to (3) (2000).

[235] *See* I.R.C. § 6103(k)(1) (2006) ("Return information shall be disclosed to members of the general public to the extent necessary to permit inspection of any accepted offer-in-compromise under section 7122 relating to the liability for a tax imposed by this title.").

[236] T.D. 9007, 67 Fed. Reg. 48,025 (July 23, 2002).

Hardship Offer.[237] In the final regulations, the Service reversed course because of concern that accepting such a Hardship Offer would raise the issue of whether the government should forego collection to support a failing business.[238] In other words, the Service feared that financially challenged businesses would be tempted to prioritize the payment of other expenses over tax obligations with the expectation of a favorable compromise of the latter.[239] For that reason, the Service concluded that compromising a tax liability of a non-individual business taxpayer based on economic hardship would not necessarily promote effective tax administration.[240]

b. Final Regulations Effectively Eviscerate the Vitality of Public Policy Offers

i. New Requirements for Public Policy Offers

In the preamble, the Service asserted that its acceptance of Public Policy Offers was expected to be rare,[241] and in deciding whether to accept a Public Policy Offer, "the [Service] will presume that the correct application of the tax laws produces a fair and equitable result, absent exceptional circumstances."[242] More specifically, the Service expressed concern that Public Policy Offers might be inequitable to similarly situated taxpayers who paid their tax liability in full. As discussed in Section V.B. *supra*, the temporary regulations had tersely stated that Public Policy Offers would be considered under "exceptional circumstances . . . such that collection of the full liability will be detrimental to voluntary compliance by taxpayers . . ."[243] and the "[c]ompromise of the [full] liability will not undermine compliance by taxpayers

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[237] Temp. Treas. Reg. § 301.7122-1T(b)(4)(iv)(D) ex. 4 (2000).

[238] T.D. 9007, 67 Fed. Reg. at 48,026.

[239] The preamble left open the possibility, however, of a non-individual taxpayer submitting a potentially viable Public Policy Offer.

[240] *But see* Mayer Inv. Co. v. Comm'r, 99 T.C.M. (CCH) 1216 (2010) (involving a Hardship Offer submitted by a non-individual business that the Service had considered on merits).

[241] T.D. 9007, 67 Fed. Reg. at 48,027.

[242] *Id.*

[243] Temp. Treas. Reg. § 301.7122-1T(b)(4)(ii) (2000).

with the tax laws."[244] The only other insight provided in the temporary regulations was the two examples in which the Service apparently deemed the taxpayer's lack of culpability for the delinquent tax as potential grounds for a Public Policy Offer.[245]

So, to eliminate any potential inequity to compliant taxpayers, the final regulations added the new requirement that a taxpayer submitting a Public Policy Offer must specifically identify the compelling public policy or equity considerations peculiar to her situation, as well as to demonstrate the circumstances "that justify compromise even though a similarly situated taxpayer may have paid his liability in full."[246] Inexplicably, in spite of adding this new requirement, the final regulations retained the above referenced examples that did not address whether the potential compromise would have been fair to similarly situated full paying taxpayers. In fact, as discussed *infra*, rather than providing any meaningful guidance, the two examples demonstrate the questionable utility of a Public Policy Offer.

In the first example, a taxpayer contracted an illness in October 1986 that required several years of nearly continuous hospitalization.[247] During those years, the taxpayer was unable to manage his financial affairs, and thus, did not file his 1986 income tax return.[248] Upon his recovery, the taxpayer discovered that the Service had filed a substitute for a return for the 1986 tax year.[249] The taxpayer's failure to file a return and pay the tax resulted in a liability that including interest and penalties three times the original tax.[250]

Although the taxpayer's debilitating illness certainly would excuse his failure to file and pay the 1986 income tax liability, it is difficult to identify any "equitable" or "public policy" reason to compromise any amount of tax he was clearly obligated to pay. Additionally, throughout the period the tax remained unpaid, the taxpayer enjoyed the economic benefit of the "use" of the tax

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[244] Temp. Treas. Reg. § 301.7122-1T(b)(4)(iii) (2000).
[245] Temp. Treas. Reg. § 301.7122-1T(b)(4)(iv)(E) exs. 1 & 2 (2000).
[246] Treas. Reg. § 301.7122-1(b)(3)(ii) (as amended in 2003).
[247] Treas. Reg. § 301.7122-1(c)(3)(iv) ex. 1 (as amended in 2003).
[248] *Id.*
[249] *Id.*
[250] *Id.*

money. Therefore, any Public Policy Offer submitted by the taxpayer should minimally account for the tax liability plus a reasonable amount of interest. This would leave only the penalties triggered by the taxpayer's excusable late filing and payment as the only purely "equitable" basis for a compromise. Under those circumstances, however, sections 6651(a)(1) and (a)(2) of the Code provide for the abatement of penalties with a showing of reasonable cause,[251] such as the taxpayer's illness.[252] Thus, in view of the availability of an alternative adequate remedy, in this instance, the submission of a Public Policy Offer would be totally unnecessary. So, eliminating the penalties from an Offer consideration, a viable Public Policy Offer would likely have to be an amount approximating the outstanding tax and some measure of reasonable interest.[253] In other words, based on the facts of this example, the actual amount to potentially compromise with the submission of a Public Policy Offer would be minimal.

Additionally, even assuming a Public Policy Offer compromising all or part of the tax liability and interest was appropriate, it would be difficult to justify its fairness to a similarly situated taxpayer who had the foresight to appoint a power of attorney to pay her tax liability for any tax year in which she was incompetent. In other words, although a taxpayer would not likely contract a serious illness to avoid paying taxes, a compromise would be detrimental to voluntary compliance because a taxpayer who did take measures to satisfy his tax liability in the event of his incompetency would pay more tax than a taxpayer who did not make the appropriate arrangements.

In the second example, a taxpayer contemplating the moving of his IRA savings from one financial institution to another sent an e-mail to the Service requesting advice of how to do so without jeopardizing the tax benefits of the IRA or incurring any penalties.[254] In an e-mail response, the Service erroneously advised the taxpayer that the funds withdrawn from his IRA

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[251] I.R.C. § 6651(a)(1), (a)(2) (2006); *see also* Treas. Reg. § 301.6651-1(c)(1) (2003).

[252] *See* IRM 20.2.7.1 (Mar. 9, 2010).

[253] *But see* IRM 5.8.11.2.2(3) (Nov. 1, 2000) (In commenting on that example, the Manual stated that the Service would expect an Offer of an amount at least equal to the amount of tax exclusive of interest and penalty.).

[254] Treas. Reg. § 301.7122-1(c)(3)(iv) ex. 2 (as amended in 2003).

account had to be re-deposited into a new IRA account within ninety days of the withdrawal. Relying on the Service' advice, the taxpayer re-deposited the funds sixty-three days after the withdrawal.[255] Subsequently, the Service audited the taxpayer and assessed tax, penalties, and additions to tax for failing to redeposit his IRA savings within the mandatory sixty-day period.[256] But for the Service's erroneous advice (a copy of the e-mail was retained by the taxpayer), the taxpayer would have made a timely redeposit of the IRA funds, and thus, not incurred any tax or penalties.

Unlike the first example, none of the liability would have been assessed against the taxpayer but for his reliance on the Service's inexcusable erroneous advice. On the surface, this would appear to be sound equitable and public policy grounds to meet the Service's criteria to qualify for a viable Public Policy Offer with respect to the entire liability. As to the penalty and interest portion of the liability "attributable to erroneous written advice by the Internal Revenue Service," however, sections 6404(f) and 6404(e) of the Code specifically provide for their full abatement.[257] So, with the availability of an adequate alternative remedy, the submission of a Public Policy Offer would be unnecessary, if not more time consuming than requesting relief specifically granted under those sections. Therefore, in this example, the utility of a Public Policy Offer would be limited to the tax assessed on the prematurely drawn IRA savings.

Finally, a compromise of the tax liability would not be unfair to similarly situated taxpayers. This is because a taxpayer who seeks written advice from the Service does not do so to avoid paying tax. Moreover, even if the Service were to accept a zero dollar amount Offer, unlike a taxpayer who made a timely transfer of his IRA account and preserved all the inherent tax benefits, all future earnings on the tainted IRA funds of the compromising taxpayer would be taxable. From this perspective, the compromise of the entire tax liability could be viewed as an equitable offset for the valuable tax-free growth he lost as a result of following the Service's erroneous advice.

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[255] Treas. Reg. § 301.7122-1(c)(3)(iv) ex. 2 (as amended in 2003).

[256] I.R.C. § 408(d)(3)(A) (2006).

[257] *See* I.R.C. § 6404(f) (2006).

In the final analysis, rather than provide any meaningful guidance, the two examples in the final regulations actually exemplify the questionable practical utility of a Public Policy Offer. In a scenario similar to the one presented in the first example, it would be difficult to conceive of any equitable or public policy reason that would justify the compromise of a legitimately assessed tax liability regardless of the taxpayer's excusable inability to timely file or pay. Additionally, under no circumstances would such a compromise be considered to be fair to similarly situated full paying taxpayers. On the other hand, although in the second example a Public Policy Offer with respect to the tax triggered solely as the result of following the Service's erroneous written advice would clearly be viable, it would likely be a rare case in which the Service would make such a blatant error. Finally, with regard to the abatement of the penalties assessed in both examples, the availability of a specific remedy elsewhere would render the submission of a Public Policy Offer unnecessary.

ii. The Service Rejected Two Scenarios as Justifying a Public Policy Offer

As a further indication of the unviability of Public Policy Offers, the preamble addressed and rejected two potential scenarios in which a Public Policy Offer appeared to be in line with the intent of the legislative history. The first scenario involved penalties and interest that had accumulated as a result of undue delay by the Service in communicating with the taxpayer in a timely fashion. In the legislative history of RRA 1998, Congress contemplated the Service would use its "new authority" to compromise this type of case.[258] In other words, Congress had singled out the accumulation of penalties and interest in that context as warranting a compromise based on public policy considerations. Interestingly, section 6404(e) of the Code—that pre-dated RRA 1998—would have provided similar relief to the taxpayer without the need to file an Offer.[259] In that regard, Code

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[258] *See* H.R. REP. NO. 105-599, at 289 (1998) ("The conferees anticipate that . . . the [Service] may utilize this new authority to resolve longstanding cases by foregoing penalties and interest which have accumulated as a result of delay in determining the taxpayer's liability.").

[259] The Tax Reform Act of 1986, Pub. L. No. 99-514, § 1563, 100 Stat. 2085.

section 6404(e)(1)(A) authorizes the Service to abate interest attributable "in whole or in part to any unreasonable error or delay by . . . [the Service] in performing a ministerial or managerial act, . . ."[260]

Due to the similarity of the relief sought, however, the Service was concerned that a Public Policy Offer based solely on a delay by the Service that would not have otherwise qualified for relief under section 6404(e) would undermine the integrity of that provision.[261] Consequently, the Service concluded that the acceptance of Public Policy Offers on that basis would not promote "effective tax administration."[262] Yet, in spite of the Service's concern, its position was in direct conflict with congressional intent as expressed in the legislative history. Obviously, any compromise based on equitable or public policy considerations would likely nullify some provision of tax law that would otherwise apply. Moreover, if Congress had intended the Service's authority to compromise penalties and interest to be no greater than it had under section 6404(e), the grant of "new" authority would be meaningless. In any event, the Service's position effectively eliminated an otherwise viable Public Policy Offer contemplated in the legislative history.[263]

The other scenario the Service rejected as the basis for a Public Policy Offer involved a disproportionate accumulation of interest and penalties attributable to actions of a third party that were beyond the taxpayer's control. In that scenario, a Tax Matters Partner (TMP) of a partnership fraudulently sold shares of a sham business to unsuspecting partners.[264] In the course of an audit, despite investigating the TMP for fraud, the Service allowed him to continue to represent the partnership.[265] Ultimately, the Service's assessment against the individual

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[260] I.R.C. § 6404(e)(1(A) (2006) (defining ministerial and managerial acts as well as providing examples of situations warranting the abatement of interest).

[261] *See* T.D. 9007, 67 Fed. Reg. 48,025, 48,027 (July 23, 2002). For example, delays caused by an action by the Service not listed under section 6404(e) in the regulations or by a delay caused by a third party would not be grounds for statutory relief.

[262] *Id.*

[263] *See* T.D. 9007, 67 Fed. Reg. at 48,027. Although the Service left open the possibility that a Public Policy Offer might be appropriate, it also indicated that such cases were expected to be rare. *Id.*

[264] *Id.*

[265] *Id.*

partners included a substantial amount of interest and penalties. The issue was whether the Service should consider Public Policy Offers submitted by the innocent partners to compromise their portion of the interest and penalties resulting from the TMP's fraud. Without explaining its reasoning, the Service reached the disjointed conclusion that third-party fault would not be an appropriate basis for a Public Policy Offer, while also acknowledging (without explanation) that third-party fault could be the basis for such an Offer.[266]

C. The Service Quietly Created a New Type of Hardship Offer Based on Doubt as to Collectability with Special Circumstances

As discussed *supra*, to qualify for a Hardship Offer, a taxpayer had to establish that, in spite of her ability to pay the liability in full, she would suffer financial hardship sufficient to justify a compromise of an amount less than the total liability. In other words, only financially challenged taxpayers capable of paying the entire liability were eligible for a Hardship Offer. Consequently, a taxpayer incapable of paying the full liability who would suffer financial hardship if required to pay the Reasonable Collection Potential would not qualify. From an equitable perspective, it would be incongruous for the latter taxpayer not to be eligible to submit a Hardship Offer.[267]

In 2003, in an apparent effort to address this inequity, the Service created a new type of Offer based on doubt as to collectability with special circumstances (DCSC Offer). It did so, however not by amending the regulations, but pursuant to Revenue Procedure 2003-71.[268] Inexplicably, nowhere in the revenue procedure self-described as an explanation and supplementation of the final regulations, did the Service

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[266] *Id.*

[267] For example, assuming she could establish financial hardship, a taxpayer with the financial resources to pay an outstanding liability of $100,000 would be eligible to submit a Hardship Offer of a lesser amount. Conversely, a similarly financially challenged taxpayer with the financial resources to pay only $70,000 of the outstanding liability would not be eligible to submit a Hardship Offer of less than $70,000.

[268] Rev. Proc. 2003-71, § 4.02(2), 2003-2 C.B. 517. Although revenue procedures may be relied on by taxpayers for guidance as official interpretations of the Service, regulations are accorded the highest level of authority of any pronouncement issued by the Service. *See* Rev. Proc. 89-14, § 7.01(4), 1989-1 C.B. 814.

affirmatively announce the creation of the DCSC Offer. In fact, the genesis of the DCSC Offer was derived from a single sentence in the revenue procedure stating, "In some cases, the Service may accept an offer of less than the total reasonable collection potential of a case if there are special circumstances."[269] The term "special circumstances" was not defined, and beyond that single sentence there was no further discussion of the DCSC Offer.

In a more detailed description of a DCSC Offer, the Manual characterized a DCSC Offer as another type of Hardship Offer.[270] Unlike a Hardship Offer, however, to be eligible for a DCSC Offer, the taxpayer's Reasonable Collection Potential would have to be less than the outstanding liability. Otherwise, applying the same financial factors considered in a Hardship Offer, the taxpayer would have to establish that if compelled to pay the Reasonable Collection Potential, she would be unable to meet her necessary basic living expenses, and thus, an Offer of a lesser amount would be warranted.[271]

VI. THE SERVICE'S RESTRICTIVE ACCEPTANCE POLICY OF ETA OFFERS REAFFIRMED ITS DE FACTO COMMITMENT TO MAXIMUM COLLECTION

A. The Limited Judicial Review of Offers Rejected by the Service at a Collection Due Process Hearing Provided by RRA 1998 Benefits the Service Rather than the Taxpayer

Prior to the enactment of RRA 1998, the taxpayer had no right to a judicial review of a rejected Offer. As part of a much larger reform of taxpayer rights, Congress granted taxpayers a number of procedural safeguards with respect to Service collection actions. Unfortunately for the taxpayer, as demonstrated throughout this Section of the Article, the so-called safeguards with regard to Offers have been proven to be more beneficial to the Service than to the taxpayer. Sequentially, a typical fact pattern would be as follows: The Service commences an action against the taxpayer to collect an assessed tax liability by sending

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[269] Rev. Proc. 2003-71, § 4.02(2), 2003-2 C.B. 517.

[270] *See* IRM 5.8.4.3 (Sept. 23, 2008).

[271] *Id.* § 5.8.4.3(3)-(4).

the taxpayer a notice of the filing of a tax lien[272] and/or a notice of intent to levy on the taxpayer's property.[273] Pursuant to sections 6320(b) and 6330(b) of the Code, the taxpayer may request a collection due process hearing (CDP Hearing) before a Service appeals officer to present less intrusive collection alternatives such as the submission of an Offer.[274] If the appeals officer rejects the taxpayer's Offer, she would issue a notice of determination explaining her reasons for rejection.[275] Finally, within thirty days of the notice of determination, the taxpayer is entitled to file a petition in Tax Court for a judicial review of the Service's decision.[276]

Significantly, the standard of review of the appeal is limited to whether the Service abused its discretion in rejecting the Offer as a collection alternative,[277] and not whether the Offer should have been accepted,[278] or what amount would have been an acceptable Offer.[279] In other words, even if the Tax Court determined the Service had abused its discretion, it has no authority to compel the Service to accept the taxpayer's Offer. Instead, the case would be remanded back to an appeals officer for a new hearing to reconsider the taxpayer's Offer.[280]

Although on the surface, judicial review would have appeared to benefit a taxpayer who heretofore had no forum to challenge the propriety of an Offer rejected by the Service, the consequences of judicial review, however, have been decidedly one-sided in favor of the Service. In cases in which the Service's rejection of the taxpayer's Offer is upheld, the decision not only allows the Service to proceed with collection against the taxpayer, it essentially validates the Service's rationale for rejecting the taxpayer's Offer. Consequently, a Tax Court decision in the Service's favor could

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[272] *See* I.R.C. § 6320(a) (2006).

[273] *Id*.

[274] *See* I.R.C. §§ 6320(b), 6330(b) (2006).

[275] *See* Treas. Reg. § 301.6330-1(e)(3)(vi), Q&A (E8) (2003).

[276] *See* I.R.C. § 6330(d)(1). If the Tax Court does not have subject matter jurisdiction over the underlying tax, the taxpayer must file her appeal in district court. *See* I.R.S. Chief Couns. Notice CC 2006-19 (Aug. 18, 2006).

[277] *See* Sego v. Comm'r, 114 T.C. 604, 610 (2000); Goza v. Comm'r, 114 T.C. 176, 182 (2000).

[278] *See* Woodral v. Comm'r, 112 T.C. 19, 23 (1999).

[279] *See* Murphy v. Comm'r, 125 T.C. 301, 320 (2005).

[280] *See* Lunsford v. Comm'r, 117 T.C. 183, 189 (2001).

potentially discourage taxpayers with similar disputes with the Service from submitting Offers. Moreover, even if the taxpayer were to prevail, the Tax Court's remand of the case back to the appeals officer for a second CDP Hearing would not guarantee the acceptance of her Offer. In fact, the appeals officer might find other reasons to reject it.

B. The Ninth Circuit Affirmed Sixteen Tax Court Decisions Holding the Service Did Not Abuse Its Discretion in Rejecting Public Policy and Hardship Offers of Partners Victimized by the Fraudulent Activities of a Tax Shelter Promoter

In *Keller v. Commissioner*[281] exemplified judicial deference to the Service's rationale for rejecting Public Policy and Hardship Offers based upon the fraudulent actions of a third party. In *Keller*, the Ninth Circuit affirmed the consolidated appeals of sixteen Tax Court memorandum opinions each holding that the Service did not abuse its discretion in rejecting the Public Policy or Hardship Offers submitted by the taxpayers who were victimized by the fraudulent activities of a tax shelter promoter.

1. The Service's Twenty-Year Mission to Unravel the Hoyt Partnerships Cumulated in the Assessment of a Substantial Amount of Tax, Interest, and Penalties Against the Taxpayer/Partners

The facts underlying the Service's twenty-year investigation of a fraudulent partnership cumulating in the assessment of a substantial amount of tax, interest, and penalties against the taxpayer/partners were as follows: Between 1971 and 1998, thousands of investors participated in more than 100 cattle and sheep-breeding partnerships (touted as "The 1,000 lb Tax Shelter"),[282] organized and operated by Walter J. Hoyt III (Hoyt Partnerships).[283] For much of that period, Hoyt served as the

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[281] 568 F.3d 710 (9th Cir. 2009).

[282] *Id.* at 714.

[283] River City Ranches #1 Ltd. v. Comm'r, 85 T.C.M. (CCH) 1365, 1367-68 (2003).

partnerships' TMP,[284] and as an enrolled agent, also represented many of the partners before the Service.[285]

Over the years, the partners of the Hoyt Partnerships received distributive shares of tax losses and credits that were ultimately determined to be illegitimate.[286] Prior to that day of reckoning, however, the Tax Court's 1989 decision in *Bales v. Commissioner*[287] appeared to validate the legitimacy of the Hoyt Partnerships. In *Bales*, the Service unsuccessfully challenged the economic substance of partnership transactions underlying those losses and credits.[288]

Yet, notwithstanding the adverse *Bales* decision, the Service continued to aggressively investigate the Hoyt Partnerships for fraudulently overstating the number and value of animals the partnerships purportedly owned.[289] In 1993, the Service and the Hoyt Partnerships executed a global settlement agreement for tax years 1980-1986, establishing a value for each cow and a formula to be used to determine the actual number of cows owned by each Hoyt Partnership.[290] Subsequently, to advance his own self-interests, Hoyt unilaterally allocated deductions and income in a manner that was favorable to certain partners and detrimental to other partners. In an ensuing Tax Court case, the Service successfully challenged the propriety of Hoyt's allocations.[291]

Also, between 1993 and 1999, a number of federal agencies conducted their own fraud investigations of the Hoyt Partnerships.[292] In 1997, the Service disbarred Hoyt as an enrolled agent, followed by the Tax Court removing him as the TMP of the Hoyt Partnerships.[293] Subsequently, in two post-1986 tax year cases decided in 1999 and 2000, the Tax Court disallowed certain tax benefits claimed by three sheep partnerships[294] and

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284 *Id.* at 1369.
285 *Id.*
286 Keller v. Comm'r, 556 F.3d 1056, 1057 (9th Cir. 2009).
287 58 T.C.M. (CCH) 430, 431 (1989).
288 *Id.*
289 *River City Ranches #1 Ltd.*, 85 T.C.M. (CCH) at 1372.
290 Keller v. Comm'r, 568 F.3d 710, 714 (9th Cir. 2009).
291 Shorthorn Genetic Eng'g 1982-2, Ltd. v. Comm'r, 72 T.C.M. (CCH) 1306 (1996).
292 *River City Ranches #1 Ltd.*, 85 T.C.M. (CCH) at 1372-74.
293 *Id.* at 1369.
294 River City Ranches #4 v. Comm'r, 77 T.C.M. (CCH) 2245 (1999).

three cattle partnerships,[295] respectively. Finally, in 2001, Hoyt was convicted on numerous counts of fraud and money laundering and was ordered to pay restitution in excess of $102 million to the investor victims of the Hoyt Partnerships.[296]

Ultimately, as is relevant to the *Keller* case, after making final partnership administrative adjustments to the Hoyt Partnerships, the Service assessed deficiencies, including a substantial amount of interest and penalties against each of the sixteen taxpayer/partners.[297] Thereafter, each taxpayer submitted a Public Policy or Hardship Offer at a CDP Hearing that was rejected by an appeals officer.[298] As discussed *infra*, in all the decisions reviewing the Service's rejections of the taxpayers' Offers, the Tax Court held that the Service had not abused its discretion in rejecting their Offers.[299]

a. The Ninth Circuit Affirmed the Tax Court Decisions Holding that the Service's Rejection of the Taxpayers' Public Policy Offers Based on the Fraudulent Actions of Hoyt and an Undue Delay in the Service's Resolution of Their Tax Liability Was Not an Abuse of Discretion

In the Public Policy Offers submitted by the taxpayers, they sought to compromise the excessive interest and penalties assessed against them based on the assertion that they were victims of the fraudulent actions of Hoyt.[300] In rejecting the taxpayers' position, the Ninth Circuit adopted the Tax Court's conclusion that their equity and public policy arguments were negated by their culpability in investing in the Hoyt Partnerships, which was marketed for its tax benefits and touted as a "1,000 lb

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[295] Durham Farms #1 v. Comm'r, 79 T.C.M. (CCH) 2009 (2000).

[296] United States v. Barnes, No. 3:98-00529-JO-04 (D. Or. July 11, 2001), *aff'd sub nom*. United States v. Hoyt, 47 F. App'x 834 (9th Cir. 2002).

[297] *See, e.g.*, Johnson v. Comm'r, 93 T.C.M. (CCH) 885 (2007); Hubbart v. Comm'r, 93 T.C.M. (CCH) 870 (2007); Ertz v. Comm'r, 93 T.C.M. (CCH) 696 (2007).

[298] Keller v. Comm'r, 568 F.3d 710, 715 (9th Cir. 2009).

[299] *Id.*

[300] Ironically, in the preamble of the final regulations, the Service stated that it would not consider Public Policy Offers in similar factual situations. See Treas. Reg. § 301.7122-1 (as amended in 2003); and *supra* Section V.B.2.B.ii for a more detailed discussion.

Tax Shelter."[301] Also, in a number of prior opinions, the Ninth, Sixth, and Tenth Circuits had uniformly upheld negligence penalties the Service had assessed against Hoyt partners.[302] Thus, in *Keller*, the Ninth Circuit found it anomalous to hold a taxpayer statutorily accountable for penalties in one decision and yet denounce the Service's rejection of an Offer of a lesser amount based on public policy or equity considerations in another decision.[303] Finally, quoting from *Fargo v. Commissioner*,[304]—a case factually similar to *Keller*—the court concluded that the Service's rejection of such Offers would encourage taxpayers who contemplate investing in tax shelters to "research future investments more carefully and to keep in better contact with financial agents (such as TMPs)."[305] Similarly, the Tax Court had stated that the acceptance of a Public Policy Offer under those circumstances "would place the [Service] in the unenviable role of an insurer against poor business decisions by taxpayers, reducing the incentive for taxpayers to investigate thoroughly the consequences . . . into which they enter."[306]

Alternatively, the taxpayers contended a Public Policy Offer was appropriate because of the Service's undue delay in resolving their tax liability. Specifically, the taxpayers argued that it took the Service longer than the "'average' amount of time it takes to conclude [the investigation of] a tax shelter case."[307] According to the taxpayers, ten years was the appropriate amount of time. In support of their position, the taxpayers cited the legislative history of RRA 1998 in which the conferees "anticipate[d] that, among other situations, the [Service] may utilize this new authority to resolve long standing cases by foregoing penalties and interest which have accumulated as a result of delay in determining the taxpayer's liability."[308]

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[301] *Keller*, 568 F.3d at 721.

[302] *Id.* (citations omitted).

[303] *Id.* at 719.

[304] 447 F.3d 706 (9th Cir. 2006).

[305] *Keller*, 568 F.3d at 721 (quoting *Fargo*, 447 F.3d at 714).

[306] *See, e.g.*, Catlow v. Comm'r, 93 T.C.M. (CCH) 946 (2007); Johnson v. Comm'r, 93 T.C.M. (CCH) 885 (2007); Hubbart v. Comm'r, 93 T.C.M. (CCH) 870 (2007); Ertz v. Comm'r, 93 T.C.M. (CCH) 696 (2007).

[307] *Keller*, 568 F.3d at 720.

[308] *Id.* (citing H.R. REP. NO. 105-599, at 288-89 (1998)).

In rejecting the taxpayers' arguments, the Ninth Circuit refused to adopt an arbitrary amount of time to resolve such a case as "requiring the [Service] to abate penalties and interest once an 'average' amount of time for 'average' [tax] shelters has passed."[309] Moreover, the Ninth Circuit disputed the taxpayers' interpretation of the legislative history, emphasizing that Congress had used the word "may" and not "must" in the context of the Service's authority to forego penalties and interest.[310] Finally, the Ninth Circuit concluded that the Service did not abuse its discretion in rejecting the Public Policy Offers because full payment "would encourage future investors to take care before investing in similar tax shelters, whereas less than full payment would discourage potential investors from researching and monitoring similar investments."[311]

In the final analysis, the Ninth Circuit's holding in *Keller*—as reinforced by its earlier holding in *Fargo*—as well as the consistency of the Tax Court decisions in favor of the Service, portend the questionable utility of Public Policy Offers. Although those cases involved disallowed tax shelter losses and credits, it is likely that in future judicial reviews of Offer rejections, courts would defer to the Service's dismissal of the taxpayer's equity arguments based on any plausible counterbalancing reason.

C. Keller *and the Tax Court Opinions it Affirmed Validated the Service's Position that Hardship Offers Must be Considered Within the Framework of Present Circumstances*

1. Speculative Future Medical Expenses not Deemed to be a Financial Economic Hardship

In *Keller*, nine of the sixteen taxpayers also submitted Hardship or DCSC Hardship Offers—collectively referred to as "Hardship Offers."[312] Generally, the taxpayers were retired or

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[309] *Keller*, 568 F.3d at 720.

[310] *Id.*

[311] *Id.*

[312] *Id.* at 717 n.8. Although the Ninth Circuit opinion listed ten taxpayer/partners, the DCSC Hardship Offer submitted by the Lindleys was deemed to be waived, and thus, it was not reviewed by the Tax Court. *See* Lindley v. Comm'r, 92 T.C.M. (CCH) 363 (2006).

near retirement with health issues and offered an amount less than their respective individual Reasonable Collection Potential based on the necessity of retaining financial resources for anticipated future medical expenses. Although the severity of the taxpayers' medical condition varied,[313] it would appear at first blush, that the Hardship Offers submitted by taxpayers with the more severe medical issues had merit. Pursuant to section 301.7122-1(c)(3)(i)(A), a Hardship Offer would be appropriate if it was reasonably foreseeable that a taxpayer with a serious medical condition that rendered her incapable of earning a living would need all of her financial resources to provide for her care and support during the course of the condition.

Although each taxpayer was able to document their medical conditions, the fatal flaw in each Offer, however, was the failure to establish any correlation between the amount of financial resources the taxpayers sought to retain (i.e., the difference between the taxpayer's Reasonable Collection Potential and the amount offered) and the unspecified amount needed to cover future medical expenses. In each instance, the taxpayer's proof consisted of a "retirement analysis" in which there were "general assertions about the increase of medical costs as people age and about the need for some seniors to seek in-home care or nursing home care or to make their houses handicapped assessable."[314] For that reason, each taxpayer's Hardship Offer was rejected by the appeals officer.[315]

Upon review, the Tax Court uniformly held that the Service did not abuse its discretion, finding that the appeals officers' "determination was based on a reasonable application of the

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[313] *Compare* Hubbart v. Comm'r, 93 T.C.M. (CCH) 870, 871 (2007) (heart problems for which taxpayer/partner had an angioplasty and angiogram, required thirty-five sessions of external counterpulsion system and would likely require heart surgery, and ulcerative colitis suffered by wife requiring a yearly colonoscopy), *and* Carter v. Comm'r, 93 T.C.M. (CCH) 861, 863 (2007) (degenerative back problems suffered by taxpayer/partner and congenial birth defect, affecting kidney and bladder function, plus collagenous colitis, sarcoidosis, Wegner's disease, and atrial fibrillation suffered by wife), *with* Smith v. Comm'r, 93 T.C.M. (CCH) 1047, 1051 (2007) (no specific medical issues other than those associated with aging), *and* Johnson v. Comm'r, 93 T.C.M. (CCH) 885, 886 (2007) (arthritis suffered by taxpayer/partner for which medication was required and high blood pressure suffered by wife for which medication was required).

[314] *See, e.g.*, *Johnson*, 93 T.C.M. (CCH) at 889; *Carter*, 93 T.C.M. (CCH) at 866.

[315] *Id.*

guidelines, [and thus] . . . declin[ing] to second-guess."[316] Moreover, the Tax Court accepted the Service's contention that any Offer "must be considered within the framework of present facts."[317] Thus, unless the taxpayer quantified the amount necessary for future medical care, it would be considered speculative, and, therefore, not a present financial hardship.[318]

2. Future Estimated Medical Expenses Not to be Factored into the Computation of Reasonable Collection Potential

As discussed *supra*, a taxpayer's Reasonable Collection Potential is the sum of her net equity plus her future income, less an allowance for necessary living expenses projected, over some measure of time.[319] Thus, the higher the amount allowed for necessary living expenses, the lower the amount of the taxpayer's Reasonable Collection Potential. In *Keller*, several taxpayers objected to the appeals officer's computation of their Reasonable Collection Potential as being too high due to the officer not including future medical expenses.[320] Because these expenses were undocumented, just as the Service rejected the taxpayers' Hardship Offers for failing to quantify estimated medical expenses, the appeals officers refused to grant an allowance for "possible future . . . [medical] expenses" because they "were 'general projections from the taxpayers' representative and may never, in fact, be incurred . . . .'"[321] So, based on the judicial consensus validating the Service's policy on this issue, it is unlikely that future courts would find the Service abused its discretion by refusing to consider speculative expenses either as the basis for a Hardship Offer or as an additional allowance in the computation of a taxpayer's Reasonable Collection Potential.

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[316] *Smith*, 93 T.C.M. (CCH) at 1050.

[317] *Johnson*, 93 T.C.M. (CCH) at 889.

[318] *See* Fargo v. Comm'r, 447 F.3d 706, 710 (9th Cir. 2006) (The Ninth Circuit rejected the taxpayers' contention that they needed $90,000 a year to pay for medical expenses related to the taxpayer/husband's dementia. The taxpayers provided no documentation substantiating the need for nursing care or other expenses.).

[319] *See* IRM 5.8.4.3.1 (June 1, 2010).

[320] *See Smith*, 93 T.C.M. (CCH) at 1051; Estate of Andrews v. Comm'r, 93 T.C.M. (CCH) 891, 894 (2007); *Johnson*, 93 T.C.M (CCH) at 889; Ertz v. Comm'r, 93 T.C.M. (CCH) 696, 701 (2007); Barnes v. Comm'r, 92 T.C.M. (CCH) 31, 35 (2006).

[321] *Estate of Andrews*, 93 T.C.M. (CCH) at 894.

D. Perceived Unfair Application of Tax Laws Not an Acceptable Basis for a Public Policy Offer

Because in some instances the application of a particular tax law may be unintentionally inequitable, an aggrieved taxpayer might consider submitting a Public Policy Offer as an appropriate means to compromise the resulting harsh tax consequences. If the Service were to reject the taxpayer's Offer at a CDP Hearing, a petition filed in Tax Court might provide the taxpayer with a "soap box" from which to protest the inequities of certain tax laws. Unfortunately, the taxpayers in *Speltz v. Commissioner* failed on both counts as the Tax Court affirmed the Service's rejection of such an Offer based on the inequitable consequences of an alternative minimum tax liability that was egregiously disproportionate to the taxpayers' economic income.[322]

In *Speltz*, one of the taxpayers was employed as a senior manager of a company earning an annual wage of $75,000.[323] In 2000, in addition to his regular compensation, the taxpayer also received incentive stock options (ISOs) to acquire his employer's stock.[324] In that same year, the taxpayer exercised the ISOs to purchase 2070 shares of stock for $34,254, or $711,118 below the then market value of the stock.[325]

Subsequently, the stock price dropped precipitously from approximately $105 per share on March 10, 2000, to less than a dollar per share on December 30, 2000. In 2002, the taxpayer sold all the shares he had acquired for only $1647.[326] Despite the large decline in the value of the stock for the 2000 tax year, the $711,118 spread between the option price and the market value of the stock at the time of exercise was included in the computation of the alternative minimum tax (AMT). As a result, the taxpayers' AMT liability was $224,869, as compared to their regular tax liability of $18,678.[327]

In November 2001, after making several installment payments to reduce their AMT liability to approximately

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[322] 124 T.C. 165 (2005).
[323] *Id.* at 166.
[324] *Id.* at 165.
[325] *Id.* at 166.
[326] *Id.*
[327] *Id.*

$125,000, the taxpayers submitted a Public Policy Offer of $4457.[328] After a revenue officer rejected that Offer, the taxpayers were issued a Notice of Federal Tax Lien Filing.[329] At a CDP Hearing, the taxpayers' attorney noted the unfairness of AMT as it applied to his clients and asked the appeals officer whether there was any pending legislation that would retroactively change the way AMT was computed.[330] By a letter dated February 13, 2003, the appeals officer answered in the negative; and on August 12, 2003, he sent a notice of determination again rejecting the taxpayers' Offer.[331]

On appeal to the Tax Court, the taxpayers argued the inequity of the "rote application" of the AMT computation by which they were compelled to include over $711,000 of AMT income in spite of actually receiving only $1647, an effective tax rate of 220%.[332] In cases of such blatant unfairness, the taxpayers contended that Congress had intended the Service to use its public policy compromise authority to provide necessary relief.

Despite being sympathetic to the taxpayers' plight, the Tax Court rejected the contention that section 7122 authorized the Service to override other tax law provisions that were perceived to be unfair or inequitable.[333] In doing so, the Tax Court explained that remedying the inequitable consequences of tax laws was a function of Congress, not the judiciary.[334] Accordingly, the Tax Court's holding in *Speltz* should put taxpayers on notice that Public Policy Offers are not a viable option to redress the unintended harsh tax consequences resulting from the application of any particular tax law.

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[328] *Id.* at 166-67. Although, on IRS Form 656 the taxpayers checked the box for "Doubt as to Collectibility," they also included a statement in which they asserted that they were victimized by the impact of AMT. *Id.* at 167.

[329] *Id.* at 167-68.

[330] *Id.* at 168-69.

[331] *Id.* at 169.

[332] *Id.* at 175.

[333] *Id.* at 177.

[334] *Id.* at 176 (The Seventh Circuit stated, "it is not a feasible judicial undertaking to achieve global equity in taxation . . . . And if it were a feasible judicial undertaking, it still would not be a proper one, equity in taxation being a political rather than a jural concept." (quoting Kenseth v. Comm'r, 259 F.3d 881, 885 (7th Cir. 2001))).

VII. THE COURTS ARE SPLIT ON WHETHER THE SERVICE CAN BE COMPELLED TO CONSIDER THE OFFER OF A TAXPAYER IN BANKRUPTCY

In February 1997, the Service reversed its policy of considering Offers submitted by taxpayers in bankruptcy[335] based on its view that doing so was not in the best interest of the government.[336] Instead, the Service determined that the resolution of such a taxpayer's tax obligations was best accomplished "[with]in the context of the bankruptcy proceeding and in accordance with applicable bankruptcy law and procedures."[337] Moreover, as one court noted, in a Chapter 13 or Chapter 11 proceeding, the Service could rationally decide that it should not consider an Offer "in isolation from the terms of a proposed plan and from the plan confirmation process."[338] Moreover, even if the Service were to accept an Offer submitted by a taxpayer in bankruptcy, there would be no guarantee that the taxpayer would be able to comply with its terms based on the viability of a plan the Bankruptcy Court may or may not approve.[339]

In a number of Bankruptcy Court cases, taxpayers challenged the Service's policy of refusing to consider Offers based solely on their status as a debtor in bankruptcy as being inappropriately discriminatory in violation of bankruptcy law. Although no court has ever held that the Service must accept an Offer, the issue was whether the Service can be compelled to at least consider the Offer of a taxpayer in bankruptcy. As discussed in this Section, there is a split of authority on this issue.

A. Cases Holding that the Service Must Consider the Offer of a Taxpayer in Bankruptcy

In *In re Mills*, sometime in 1996, taxpayers with a substantial amount of tax debt filed a Chapter 13 bankruptcy

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[335] *See In re* Mills, 240 B.R. 689, 692 (Bankr. S.D. W. Va. 1999); Rev. Proc. 2003-71, § 5.04(3), 2003-2 C.B. 517, 518.

[336] I.R.S. Chief Couns. Notice CC-2004-25 (July 12, 2004).

[337] *Id.*

[338] *In re* 1900 M Rest. Assocs., Inc., 319 B.R. 302, 311 (Bankr. D.D.C. 2005).

[339] *Id.*

petition.[340] On or about November 6, 1997, several months after the taxpayers had filed their third amended plan, the taxpayers submitted an Offer to the Service.[341] Consistent with its then new policy of not considering an Offer of a taxpayer in bankruptcy, the Service did not process the taxpayers' Offer.[342]

Consequently, the taxpayers filed an adversary proceeding to compel the Service to consider their Offer, contending that the Service's change of policy was an act of inappropriate governmental discrimination against bankruptcy debtors. Specifically, section 525(a) of the Bankruptcy Code prohibited any governmental act that would revoke, suspend, or refuse to renew a license, permit, charter, franchise, or other similar grant with regard to an individual, solely because of her filing for bankruptcy.[343] In making their case, the taxpayers equated an Offer to a license to propose "alternative treatment of their tax obligations to the government."[344] Therefore, because the granting of such a license by the Service required the submission of an Offer pursuant to provisions of section 7122 of the Code, the Service's refusal to consider the Offers of taxpayers in bankruptcy was prohibited governmental discrimination.[345]

The Bankruptcy Court held in favor of the taxpayers for the following reasons: First, although the Bankruptcy Court did not go so far as to characterize an Offer as a "license," it broadly interpreted section 525(a) to prohibit "bankruptcy-based discrimination 'that can seriously affect the debtors' livelihood or fresh start.'"[346] Based upon that expansive view, the Bankruptcy Court concluded that the Service's refusal policy was prohibitive discrimination within the meaning of that section.[347] Second, while the Bankruptcy Court acknowledged that the Service has complete discretion to decide whether to accept or reject an Offer; it determined that the Service had a mandatory statutory

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340 240 B.R. 689 (Bankr. S.D. W. Va. 1999).
341 *Id.* at 691.
342 *Id.* at 691-92.
343 *Id.* at 693.
344 *Id.*
345 *Id.*
346 *Id.* at 695 (citations omitted).
347 *Id.* at 697.

obligation to consider Offers.[348] For that reason, it would be inappropriate for the Service to refuse to consider the Offer of a taxpayer in bankruptcy.

In re Macher was the second major case in which the Service was ordered to consider the Offer of a taxpayer in bankruptcy, albeit based on a different rationale than the *Mills* case.[349] In *Macher*, a Chapter 11 case, the Bankruptcy Court concluded that the Service's policy did not violate section 525(a) of the Bankruptcy Code because "a statutorily authorized procedure by which a taxpayer may submit an offer to the government . . . and have the government consider such [an] offer is not a 'license, permit, charter, franchise or other similar grant . . . .'"[350]

Instead, the Bankruptcy Court determined that the Service's refusal policy conflicted with the broader policies underlying the Bankruptcy Code, particularly Chapter 11 reorganizations.[351] The Bankruptcy Court noted that Chapter 11 reorganizations typically involved significant negotiations between the debtor and creditors because it was often in all the parties' best interest to allow the debtor to reorganize and restructure its obligations to be able to remain in business. Thus, the Service's refusal policy would thwart that process because it would be difficult for the debtor to deal with its other creditors without knowing what concessions the Service might be willing to make. Consequently, if the taxpayer was compelled to obtain the dismissal of its bankruptcy in order to submit an Offer, the taxpayer would lose the benefit of the fundamental purpose of bankruptcy, i.e., a fresh start.[352] Apparently, applying its equitable powers under section 105(a) of the Bankruptcy Code "to issue any order . . . that is necessary or appropriate to carry out the provisions of this title," the Bankruptcy Court ordered the Service to consider the taxpayer's Offer.[353]

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[348] *Id.* at 696.

[349] No. 00-03659-WSR-11, 2003 WL 23169807 (Bankr. W.D. Va. June 5, 2003).

[350] *Id.* at *1.

[351] *Id.* at *2.

[352] *Id.*

[353] In its opinion, the bankruptcy court did not specifically cite section 105(a) as the statutory authority for the order. In affirming the decision, however, the district court surmised it was the basis for the bankruptcy court's order. *In re* Macher, 303 B.R. 798, 801 (Bankr. W.D. Va. 2003).

B. Cases Holding the Service Has No Duty to Consider the Offer of a Taxpayer in Bankruptcy

In *In re 1900 M Restaurant Associates, Inc.*,[354] the Bankruptcy Court rejected the holdings of the *Mills* and *Macher* decisions and held that the Service did not have a duty to consider the Offer of a taxpayer in bankruptcy. Similar to *Macher*, the taxpayer filed an adversary proceeding to compel the Service to consider its Offer after the taxpayer had commenced a Chapter 11 bankruptcy.[355]

In rendering its decision, the Bankruptcy Court agreed with the holding in *Macher* that the Service's refusal policy was not a governmental act that violated section 525(a) of the Bankruptcy Code because an Offer was not a grant that was similar to a license, permit, charter or franchise.[356] Applying the reasoning of a Second Circuit opinion that had defined the word "grant" for purposes of section 525(a) as a transfer of a property right or an agreement that creates certain rights,[357] the Bankruptcy Court concluded that an Offer was neither, and thus did not fit within that definition.[358]

After concluding that the Service's refusal policy was not a discriminatory governmental act, the Bankruptcy Court considered whether the general equitable powers of section 105(a) of the Bankruptcy Court were broad enough to order the Service to consider the taxpayer's Offer. Pursuant to section 105(a), "the court may issue any order, process, or judgment that is necessary and appropriate to carry out the provisions of [the Bankruptcy Code]." In holding in the negative, the Bankruptcy Court compared a section 105(a) order for relief "in the nature of mandamus."[359] So, to qualify for that type of relief, the taxpayer would have to establish that it had: 1) a clear right to have its Offer considered; 2) the Service had a clear duty to consider the

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354 319 B.R. 302 (Bankr. D.D.C. 2005).

355 *Id.*

356 *Id.* at 305.

357 Stolz v. Brattleboro Hous. Auth., 315 F.3d 80 (2d Cir. 2002).

358 *In re 1900 M Rest. Assocs., Inc.*, 319 B.R. at 306.

359 *Id.*

taxpayer's Offer; and 3) there was no adequate alternative remedy available to the taxpayer.[360]

As to the first two requirements, the Bankruptcy Court determined that the Service's discretionary authority under section 7122 of the Code also included deciding whether an Offer should be processed. Thus, for that reason, the taxpayer had no right, and the Service had no duty, to consider its Offer.[361] Finally, with respect to the third requirement, the Bankruptcy Court found that the Service's Offer refusal policy did not foreclose negotiation with the Service. In this case, the taxpayer's adequate alternative remedy was its ability to negotiate its tax liability with the Service through the plan confirmation process.[362]

In the alternative, the Bankruptcy Court addressed the issue of whether the authority of section 105(a) was broad enough to order the Service to consider the taxpayer's Offer so as to carry out the fresh start principle and common sense realities of bankruptcy reorganizations. In dispensing with this issue, the Bankruptcy Court determined that an order issued under section 105(a) would be appropriate only if necessary to preserve an identifiable right conferred elsewhere in the Bankruptcy Code.[363] In this instance, the Bankruptcy Court did not consider the fresh start principle and the common sense realities of bankruptcy reorganizations that favor their successful completion as an identifiable right under the Bankruptcy Code.[364] Moreover, the court noted that the Bankruptcy Code also grants creditors certain rights in the plan confirmation process. Accordingly, the effect of an order compelling the Service to consider an Offer outside of the bankruptcy process would undermine, rather than advance, those provisions of the Bankruptcy Code protecting creditors.[365]

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[360] *Id.* at 307.

[361] *Id.* at 307-09.

[362] *Id.* at 312-13.

[363] *Id.* at 314.

[364] *Id.* 314-15.

[365] *See id.* at 313-15; *see also In re* Shope, 347 B.R. 270 (Bankr. S.D. Ohio 2006); *In re* Uzialko, 339 B.R. 579 (Bankr. E.D. Pa. 2006) (other cases following the court's holding in *In re 1900 M Rest. Assocs., Inc.*).

VIII. THE TAX INCREASE PREVENTION AND RECONCILIATION ACT OF 2005 REQUIRES A TAXPAYER TO PUT HER MONEY WHERE HER OFFER IS

By 2005, Congress should have realized that the Service's stringent and restive acceptance standards had made Hardship Offers and Public Policy Offers unattainable for most taxpayers. Therefore, it was clear that the Service's Offer policy had failed to live up to the ambitious promise of the legislative history of RRA 1998 to incorporate financial hardship, equity, and public policy considerations into the Offer acceptance standards. Yet, if Congress had disapproved, it could have enacted legislation that would have required the Service to ease its standards in a manner consistent with the legislative promise. Instead, Congress took the opposite approach with the enactment of the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA).[366]

Unlike RRA 1998, none of the TIPRA amendments to section 7122 of the Code were designed to make Offers more attainable for taxpayers. In fact, TIPRA incorporated an effective collection tool into the Offer process never before available to the Service that did not require it to engage in aggressive collection action. As a fundamental change to the Offer process, TIPRA provides that no Offer will be considered by the Service unless it included a non-refundable payment(s) to be applied to a taxpayer's outstanding tax liability. In other words, because the payments are treated as "tax" payments, none of the amounts paid to the Service by the taxpayer would be refundable whether or not the Service accepts the Offer.[367]

Specifically, under newly enacted section 7122(c)(1)(A) of the Code, a lump sum Offer (payable in five or fewer installments) must be accompanied with a payment of twenty percent of the amount offered.[368] Additionally, pursuant to section 7122(c)(1)(B) of the Code, a periodic payment Offer (payable in six or more installments) must be accompanied not only with the first proposed installment payment, but also all subsequent proposed installment payments must be made during the entire period in

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366 Pub. L. No. 109-222, § 509, 120 Stat. 345 (2006).

367 *See* I.R.C. § 7122(c)(2)(A) (2006).

368 I.R.C. § 7122(c)(1)(A)(ii) (2006).

which the Service is evaluating the Offer. In the event the taxpayer fails to make a proposed installment, the Service may treat the Offer as being withdrawn with all monies paid in to be applied to the taxpayer's outstanding liability.[369]

For example, if a taxpayer submits a periodic payment Offer of $36,000, payable in $1000 monthly installments, she must pay $1000 with the Offer plus a $1000 installment payment each month thereafter during the time the Offer is being considered. If after twenty-two months the Service rejects the Offer, the $22,000 paid by the taxpayer would be applied to her outstanding tax liability. Alternatively, if before the Service rejects or accepts her Offer, the taxpayer stops making installment payments after the twentieth month, the Service could deem her Offer to be withdrawn and apply the $20,000 paid by the taxpayer against her tax liability.

So, it is clear that TIPRA has stacked the collection cards in the Service's favor. Unless the taxpayer is willing to put her money where her Offer is, she has no right to make an Offer, and thus, the Service would be free to pursue collection. Conversely, if the taxpayer agrees to put her money where her periodic payment Offer is, the Service could collect up to twenty-four months of installment payments without committing to accept or reject the Offer.[370] Yet, even if the Service were to then reject the Offer, it would have potentially received a substantial amount of funds voluntarily paid by the taxpayer. In the final analysis, there should be no doubt that regardless of the modifications made to the Offer process over the years, collection of taxes remains the highest priority to the Service and Congress.

CONCLUSION

For the entire history of federal income taxation, the Congress has empowered the Service to collect taxes, penalties,

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[369] I.R.C. § 7122(c)(1)(B)(ii) (2006). There is, however, an exception for low-income taxpayers who would not be required to make payments as a condition of submitting an Offer. *See* I.R.C. § 7122(c)(2)(C) (2006).

[370] Pursuant to newly enacted section 7122(f), an Offer that is not withdrawn, returned, or rejected within twenty-four months of submission would be deemed to be accepted. Stated differently, the Service has up to twenty-four months to evaluate an Offer. I.R.C. § 7122(f) (2006).

and interest on behalf of the government. During that same period, it has granted the Service the discretion to accept Offers from taxpayers of less than the amount owed. Although the wording of section 7122 of the Code would appear to provide the Service with limitless authority to compromise any liability, based on rulings from Attorney General opinions, and on its own initiative, the Service has exercised this authority very restrictively. Moreover, in spite of the Service's periodic efforts to liberalize the Offer policies and procedures (most notably in 1992), the Service has never swayed very far from its commitment to collect the full amount of any outstanding tax liability.

Although, by enacting RRA 1998 Congress encouraged the Service to accept Offers based on financial hardship, equity, and public policy, the Service's stringent and restive acceptance standards have made Hardship Offers and Public Policy Offers unattainable for most taxpayers. Yet, rather than enacting legislation that would have required the Service to ease its acceptance standards, Congress chose instead to provide the Service with an invaluable collection tool that made it even more problematic for taxpayers to make viable Offers. Pursuant to TIPRA, an Offer must be accompanied with a non-refundable payment(s) for it to be considered. Therefore, any taxpayer, other than a low-income taxpayer seeking to make an Offer, must make a financial commitment to pre-fund the Offer with no assurance that it will be accepted. So, if recent history is any indication, it is clear that the Offer process was never intended to be an open invitation for a taxpayer to engage in tax gamesmanship with the Service. Accordingly, those who would believe in the hollow promises of the pennies-on-the-dollar pitchmen do so at their own peril.