



OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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MEMORANDUM FOR T. KEITH FOGG
ASSOCIATE AREA COUNSEL/RICHMOND (CC:SB:2:RCH)

FROM: Joseph W. Clark
Senior Technician Reviewer, Branch 2 (CBS)

SUBJECT: Offers in Compromise for Exempt and Abandoned Property

This Chief Counsel Advice responds to your memorandum dated April 16, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

ISSUE:

Do the provisions of I.R.C. § 7122 apply when the Service consents to release its lien for a discharged tax period upon payment of less than the full value of its interest in property subject to the lien?

CONCLUSION:

Amounts discharged in bankruptcy are accounted for by abatement under I.R.C. § 6404(c) rather than compromise under I.R.C. § 7122.

FACTS:

A task force under the Insolvency Manager for Area 4 is developing uniform, area-wide procedures for collection from exempt, abandoned or excluded property where a notice of federal tax lien was filed and where the underlying tax liability is discharged in bankruptcy. As explained in Notice CC-2001-014, abatements made pursuant to I.R.C. § 6404(c) to account for bankruptcy discharges do not invalidate otherwise proper assessments nor extinguish otherwise proper liabilities. When a tax liability is discharged in bankruptcy, the Service still may enforce a surviving tax lien against property which is exempt, abandoned or excluded from the bankruptcy estate. In some cases, you note, the Service may wish to accept less than the full value of its interest in the property, because levy or seizure is impractical or may result in severe financial hardship. You ask if the Service releases its tax lien in such cases, whether that action is subject to the Offer in Compromise provisions of I.R.C. § 7122?

LAW AND ANALYSIS:

A discharge order in bankruptcy discharges the debtor from a personal obligation to pay and creates an injunction barring creditors from attempting to collect discharged debts from the debtor personally. B.C. § 524(a)(1), (2). The discharge does not destroy the pre-petition liability, however. Johnson v. Home State Bank, 501 U.S. 78, 84, 111 S. Ct. 2150 (1991) (“a bankruptcy discharge extinguishes only one mode of enforcing a claim -- namely, an action against the debtor in personam”); see also In re Conston, 181 B.R. 769, 773 (D. Del. 1995) (collecting cases).

When the Service learns of a taxpayer's discharge from bankruptcy, the Insolvency function Tax Examiner or Bankruptcy Specialist evaluates the taxpayer's various tax liabilities to decide which have been discharged by the bankruptcy. See generally IRM 5.9.12.5 (describing procedures for evaluating and processing discharge). If the Insolvency employee decides that the costs of working the case do not warrant collection of the amounts involved, then the Insolvency employee must bring the balance due in each discharged tax liability module to zero by inputting adjusting credit Transaction Codes (TCs) to offset whatever debit TCs were used to account for the liabilities. Because the Service's accounting system is designed so that a prior transaction is never erased or extinguished or eliminated from the record, the abatement always takes the form of a credit transaction entered to bring the balance due to zero.¹

Adjustments made to account for bankruptcy discharges are abatements made pursuant to section 6404(c). A section 6404(c) adjustment is caused by the Service's decision that, despite section 6301's direction to collect taxes, it is not in the public interest to collect a particular liability because of the costs involved. Section 6404(c) authorizes the Service to abate the unpaid portion of any assessment when the Service decides "under uniform rules prescribed by the Secretary that the administration and collection costs involved would not warrant collection of the amount due." This abatement has nothing to do with a judgment about whether the assessment reflects the taxpayer's true liability; it only

¹ Although the Insolvency employee does make a collectibility determination, the freeze code TC 530 cannot be used because (1) that would shut down collection on every tax module of the entire account and (2) the eventual reversal of the TC 530 would cause collection to commence against all of the taxpayer's property. Only by abating specific tax assessments (the ones for discharged taxes) can the Insolvency employee continue to collect the nondischarged taxes and, if the opportunity arises, collect the discharged taxes out of the property to which the lien for those taxes still attaches.

represents the Service's judgment that collecting the account is not cost-effective.² In effect the Service excuses its collector's obligation to account for the tax liability, but does not excuse the taxpayer's liability. See Crompton-Richmond v. U.S., 311 F. Supp. 1184, 1186 (S.D.N.Y. 1970) (Service can revive an assessment abated under section 6404(c) because the abatement of an uncollectible tax does not cancel the tax). See also Carlin v. U.S., 100 F. Supp. 451, 454-55 (Ct. Cl. 1951) (IRS cannot relieve a taxpayer of tax liability merely because it is uncollectible, but can only abate it as a bookkeeping entry); Sugar Run Coal Mining v. U.S., 21 F. Supp. 10, 12 (E.D. Pa. 1937) (an abatement made because of a collectibility determination does not extinguish the liability).

Such abatements do not extinguish an otherwise valid tax liability, regardless of the reason for the abatement. Because the section 6404(c) abatement is made on the basis of collectibility and not because the liability was improperly assessed, money may still later be collected, so long as the collection limitations period is open. While the bankruptcy discharge affects the Service's ability to collect the discharged liability, it does not extinguish either the underlying liability or those tax liens which have otherwise survived the bankruptcy. Since the underlying tax liability exists after bankruptcy discharge, it also exists after the assessments for the discharged taxes are abated. To account for the later collection, the section 6404(c) abatement may be reversed.

Bankruptcy Code section 522(c)(2)(B) provides that exempt property is generally not liable for a prepetition debt, except where such debt is secured by a properly filed tax lien. Accordingly, where a Notice of Federal Tax Lien is on file before the petition is filed, it may be possible to collect the dischargeable tax liabilities from prepetition assets that were exempted or abandoned in the bankruptcy. See In re Isom, 901 F.2d 744 (9th Cir. 1990). Although the NFTL may be released pursuant to IRM 5.9.12.12(2) once the section 6404(c) abatement is posted, the Service can reinstate the NFTL under I.R.C. § 6325(f)(2) once the abatement is reversed. Adjustments such as these, because they do not affect tax liability, are not the same as a compromise of the debtor's taxes.

The Service has the authority under I.R.C. § 7122 to compromise tax liabilities. Agreements to compromise federal tax liabilities have generally been interpreted by applying contract principles. See United States v. Feinberg, 372 F.2d 352 (3d Cir. 1967); United States v. Lane, 303 F.2d 1 (5th Cir. 1962); Robbins Tire & Rubber Co., Inc. v. Commissioner, 52 T.C. 420 (1969). Contract formation requires mutual assent among the contracting parties: one party makes an "offer" of a contract and the other party accepts that offer. Some form of consideration also is necessary.

² Treas. Reg. 301.6404-1(d) delegates to the Commissioner the authority to prescribe the uniform rules for making a section 6404(c) determination. The Service has embodied the procedures for bankruptcy discharge determinations in the Bankruptcy Handbook, IRM 5.9.

See Restatement (Second) of Contracts § 22. The Service's determination of collectibility following a section 6404(c) abatement is a unilateral act by the Service which does not incorporate the required contractual elements of offer, acceptance, or consideration.

To enforce the debtor's *in rem* liability, Insolvency makes a non-contractual determination as to the amount that can effectively be collected out of the property to which the lien for those taxes still attaches. See IRM 5.9.12.5.1. That determination is based on myriad factors, including the relative financial condition of the debtor, the net worth of the exempt, abandoned or excluded property, and the total amount of taxes owed. Such a unilateral collectibility determination is not a compromise bargained for with the taxpayer under I.R.C. § 7122.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

The discharge injunction of B.C. § 524(a)(2) prohibits the commencement or continuation of any act to collect, recover or offset any discharged debt. While the bankruptcy discharge affects the Service's ability to collect the discharged liability from the debtor personally, it does not extinguish either the underlying liability or those tax liens which have otherwise survived the bankruptcy. I.R.C. § 6404(c) permits the Service to abate a tax assessment to reflect an administrative determination that collection of a tax is economically unfeasible due to a bankruptcy discharge. Should collection become feasible within the statutory collection period, a section 6404(c) abatement may be reversed without effecting an offer in compromise with the taxpayer under section 7122.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges such as the attorney-client privilege. If disclosure becomes necessary, please contact this office for our views.

If you have any questions, please contact Richard Charles Grosenick at 202/622-3620.