October 27, 2006

Hon. Mark W. Everson
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Comments in Response to Notice 2006-68, Requirement of Partial Payment with Submission of Offer in Compromise

Dear Commissioner Everson:

Enclosed are comments in response to Notice 2006-68 regarding the requirements of partial payment with the submission of offers in compromise. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association and should not be construed as representing the policy of the American Bar Association.

Sincerely,

Susan P. Serota
Chair, Section of Taxation

Enclosure

cc: Donald L. Korb, Chief Counsel, Internal Revenue Service
    Eric Solomon, Acting Deputy Assistant Secretary (Tax Policy), Treasury Department
    Michael J. Desmond, Tax Legislative Counsel, Treasury Department
    William F. Conroy, Office of Associate Chief Counsel (Procedure & Administration), Internal Revenue Service
 COMMENTS IN RESPONSE TO NOTICE 2006-68 REGARDING REQUIREMENT OF PARTIAL PAYMENT WITH SUBMISSION OF OFFERS IN COMPROMISE

These comments (“Comments”) are submitted on behalf of the Section of Taxation of the American Bar Association (“Tax Section”) and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Katherine E. David and Joseph Barry Schimmel of the Tax Section’s Low Income Taxpayers Committee. Substantive contributions were made by Leslie M. Book, Diana Leyden, and William P. Nelson of the Low Income Taxpayers Committee and by Carol M. Luttati of the Committee on Administrative Practice. The Comments were reviewed by Elizabeth J. Atkinson, Chair of the Low Income Taxpayers Committee, Thomas J. Callahan, Chair of the Tax Section’s Committee on Administrative Practice, Robert E. McKenzie of the Tax Section’s Committee on Government Submissions, Sharon Stern Gerstman, Council Director for the Low Income Taxpayers Committee, and Charles A. Pulaski, Jr., Council Director for the Committee on Administrative Practice.

Although some of the members of the Tax Section who participated in preparing these comments have clients who would be affected by the federal tax principles addressed by these comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these comments.

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Date: October 27, 2006
EXECUTIVE SUMMARY

These Comments are submitted in response to the request for comments by the Internal Revenue Service ("Service") in Notice 2006-68, dated July 31, 2006 (the "Notice"), regarding changes to the offer in compromise program (the "OIC Program") enacted as part of the Tax Increase Prevention and Reconciliation Act of 2005 (Pub. L. No. 109-222) ("TIPRA"). The Service requested comments by October 9, 2006.

These comments specifically address the Service’s request for comments on issues that are addressed in the Notice. These Comments refer specifically to issues that are addressed in the Notice.

Section 7122 of the Code authorizes the Secretary of the Treasury to compromise tax liabilities for an amount that is less than the full amount owed. TIPRA amended section 7122 to require the submission of partial payments with offers in compromise. With respect to lump-sum offers in compromise, TIPRA requires the taxpayer to submit with the application a partial payment of 20% of the offer amount. For periodic payment offers, the taxpayer is required to submit the first installment payment with the application and thereafter to comply with the taxpayer’s proposed payment schedule while the Service is considering the offer.

TIPRA provides that, if a taxpayer fails to submit the required initial payment with the offer, the Service may return the offer to the taxpayer as unprocessable. In the case of a periodic payment offer, the Service may treat a taxpayer’s failure to comply with the proposed installment payment schedule while the offer is pending as a withdrawal of that offer. TIPRA authorizes the Secretary of the Treasury to issue regulations waiving the partial payment requirements. TIPRA also provides that unless an offer is rejected within 24 months after the date of submission, the offer is deemed to have been accepted.

The partial payment requirements impose a substantial burden on taxpayers offering to compromise their tax liabilities, which may tend to discourage taxpayers from making adequate offers. As a general matter, we recommend that any regulations issued under section 7122 encourage the processing and acceptance of adequate offers, and provide taxpayers with reasonable opportunities to correct minor failures. For example, except in cases where the taxpayer has a history of delay or noncompliance, the regulations should permit the taxpayer to remedy promptly any failure to submit the required 20% down payment or to comply with the proposed installment payment schedule.

Specifically, we recommend that regulations address the following:

How the taxpayer may specify the application of the user fee to the taxpayer’s tax liability;

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2 Notice 2006-68 (July 31, 2006), sec. 5.01.
3 References herein to the “Code” refer to the Internal Revenue Code of 1986, as amended.
4 Unless otherwise stated, references herein to “sections” are to sections of the Code.
5 Defined as any offer of payment made in five or fewer installments. Section 7122(c)(1)(a)(ii). Unless otherwise stated herein, references to section 7122 are to the provision as amended by TIPRA.
6 Section 7122(c)(1)(A)(i).
7 Defined as any offer of payment made in six or more installments. Notice 2006-68, supra note 2.
8 Section 7122(c)(1)(B).
9 Section 7122(d)(3)(C).
10 Section 7122(c)(1)(B)(ii).
11 Section 7122(c)(2)(C).
12 Section 7122(f).
Under what circumstances the Service will accept for processing periodic payment offers submitted with an initial payment less than the required partial payment;

Under what circumstances the Service will permit continued processing of a periodic payment offer where the taxpayer has not tendered a required periodic payment;

When the balance of a partial payment or installment payment has been solicited, payment may be tendered with a period of at least 30 days;

How the taxpayer will be notified that an offer is being treated as withdrawn for failure to tender payment;

As of what effective date an offer is withdrawn, returned, or treated as withdrawn;

How the taxpayer may establish that the Service received an offer; and

That the 24-month acceptance period includes time required by the Internal Revenue Service Office of Appeals in considering a rejected offer.

We also recommend that the Service institute a process for crediting excess payments and prepayments toward periodic payment offers.

The Tax Section has, on two occasions, expressed to Congress its opposition to TIPRA’s partial payment requirements. The Tax Section also has submitted comments regarding issues not addressed in the Notice, and regarding the definition of “low-income” for purposes of waiving the partial payment requirements and user fee. As stated above, these Comments are directed solely toward the Service’s specific request for comments on issues addressed in the Notice.

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COMMENTS

Section 7122 authorizes the Secretary of the Treasury to compromise tax liabilities for an amount that is less than the full amount owed. Policy Statement P-5-100\(^\text{16}\) (the “Policy Statement”) provides in part, “[the] Service will accept an offer in compromise when it is unlikely that the tax liability can be collected in full and the amount offered reasonably reflects collection potential.”\(^\text{17}\) The Policy Statement recognizes that an offer in compromise is a legitimate alternative to placing the case in currently not collectible status or to entering into a protracted installment agreement because “the goal is to achieve collection of what is potentially collectible at the earliest possible time and at the least cost to the Government.”\(^\text{18}\) Moreover, the Policy Statement provides that acceptance of an adequate offer can create for the taxpayer a “fresh start toward compliance with all future filing and payment requirements.”\(^\text{19}\)

TIPRA amended section 7122 to require the submission of partial payments with offers in compromise, effective for offers made on or after July 16, 2006. With respect to lump-sum offers in compromise, TIPRA requires the taxpayer to submit with the application a partial payment of 20% of the offer amount.\(^\text{20}\) For periodic payment offers, the taxpayer is required to submit the first installment payment with the application, and thereafter to comply with the taxpayer’s proposed payment schedule while the Service is considering the offer.\(^\text{21}\)

TIPRA authorizes the Secretary of the Treasury to issue regulations waiving the partial payment requirements for low-income taxpayers (the “low-income waiver”) and for offers relating only to issues of liability.\(^\text{22}\)

The Notice provides interim guidance on the application of certain of TIPRA’s provisions to the OIC Program, and requests comments on that guidance.\(^\text{23}\)

APPLICATION OF THE USER FEE

Regulations finalized in 2003\(^\text{24}\) require the taxpayer to pay a $150 user fee for processing an offer in compromise, subject to exceptions for certain low-income taxpayers and for offers based solely on doubt as to liability.\(^\text{25}\)

Both the Notice and section 7122(c)(2)(B) provide that user fees made in conjunction with an offer in compromise will be treated as payments against tax, interest, and penalties to which the offer relates. The Notice states that, “[b]ecause section 7122(c)(2)(B) does not allow taxpayers to specify how the $150 user fee will be applied, the Service will apply the user fee in the best interests of the government.”\(^\text{26}\) However, this provision of the Notice is not supported by section 7122(c)(2)(B), which provides as follows:

\[
\text{(B) Application of user fee. In the case of any assessed tax or other amount imposed under this title with respect to such tax which is the subject of an offer-in-}
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\(^{16}\) IRM § 1.2.1.5.18 (rev. 01-30-1992). References in the footnotes to the “IRM” are to the Internal Revenue Manual.
\(^{17}\) Id., ¶ 1.
\(^{18}\) Id.
\(^{19}\) Id.
\(^{20}\) Section 7122(c)(1)(A).
\(^{21}\) Section 7122(c)(1)(B).
\(^{22}\) Section 7122(c)(1)(C).
\(^{23}\) Notice 2006-68, supra note 2, sec. 5.01.
\(^{24}\) T.D. 9086 (08/18/2003).
\(^{25}\) Treas. Reg. § 300.3.
\(^{26}\) Notice 2006-68, sec. 2.05.
compromise to which this subsection applies, such tax or other amounts shall be reduced by any user fee imposed under this title with respect to such offer in compromise.

Section 7122(c)(2)(B) must be read in context with the other provisions of section 7122(c)(2), all of which are included for the protection of the taxpayer. Section 7122(c)(2)(A) (“use of payment”) grants to the taxpayer (and not to the Service) the right to specify how partial payments are applied to the taxpayer’s liability. Section 7122(c)(2)(C) authorizes the Service to issue regulations waiving the partial payment requirements. We believe that, similarly, section 7122(c)(2)(B) is intended not to prohibit the taxpayer from specifying how the user fee will be applied to the taxpayer’s liability, but to require the Service to apply the user fee to the taxpayer’s liability. We therefore recommend that the Service issue regulations under section 7122(c)(2)(B) authorizing the taxpayer to specify how the user fee will be applied, consistent with any regulations issued under section 7122(c)(2)(A).

APPLICATION OF PAYMENTS

The Notice provides that if, in connection with an offer in compromise, a taxpayer voluntarily submits payments in excess of the partial payment required by section 7122(c)(1), such excess payments will be treated as refundable deposits unless the taxpayer designates them as tax payments. We commend the Service for providing this taxpayer-friendly rule. However, we are concerned that, if a taxpayer submits multiple payments within a single calendar month, the Service may have difficulty determining which payments should be treated as refundable deposits, and which were intended to satisfy the taxpayer’s partial payment requirements for a subsequent month. Such difficulty may result in a taxpayer’s failure to satisfy the partial payment requirement for the subsequent month, even though the taxpayer’s aggregate payments and deposits would have satisfied the partial payment requirements. For example, a taxpayer whose monthly partial payment is $200 may submit $200 on the first of the month and an additional $200 on the fifteenth, but may not submit any payment during the following month. In this example, it is probable (in the absence of the taxpayer’s affirmative statement to the contrary) that the taxpayer intended to prepay the second month’s partial payment.

We therefore recommend that the Service institute a process for crediting payments, including prepayments, toward the partial payment requirements whenever those requirements would not otherwise be met. We believe such process should be set forth in the Internal Revenue Manual, rather than in regulations.

SOLICITATION OF PAYMENTS

The Notice provides that, if the payment submitted with a lump sum offer is less than the 20% required amount, the Service may accept the offer for processing and solicit payment of the remaining portion of the 20% amount. If the taxpayer fails to make full payment of the unpaid portion within the time allowed by the Service, the Service may return the offer as unprocessable unless the Service determines that continued processing of the offer would be in the best interests of the government.

The Notice also provides that, with respect to a period payment offer accepted for processing, if the second or subsequent proposed installment is not fully paid, the Service may solicit payment of the unpaid installment. If the taxpayer fails to make full payment of the unpaid amount within the time

27 Id., sec. 1.03.
28 Id., sec. 2.02.
29 Id.
30 Id., sec. 3.02.
allowed by the Service, the Service may treat the offer as withdrawn unless the Service determines that continued processing of the offer would be in the best interests of the government.\textsuperscript{31}

However, the Notice also provides that a periodic offer in compromise submitted on or after July 16, 2006 will be returned as not processable, if the submission of the offer is not accompanied by the full amount of the first proposed installment.\textsuperscript{32} Solicitation of the unpaid amount will not be made.

We recommend that the rule applicable to lump-sum payments be extended to periodic payments; namely, that, if a periodic payment offer in compromise is submitted with a partial payment less than the full amount of the first proposed installment, the Service may accept the offer for processing and solicit payment of the unpaid portion of the first periodic payment. As with lump sum offers, we further recommend that, if the taxpayer does not pay the balance of the first periodic payment within the time allowed by the Service, the Service may return the offer as not processable unless the Service determines that continued processing of the offer would be in the best interests of the government.

We recommend that the Service issue regulations clarifying the circumstances under which it will return offers for failure to pay the balance of a payment within the time allowed, and that – in this context – the regulations clearly define the phrase “in the best interests of the government.” We believe that the government’s interests are almost always best served by the continued processing of non-frivolous offers. Thus, we recommend that the regulations endorse continued processing for most cases.

**TREATMENT OF OFFER UPON FAILURE TO MAKE SUBSEQUENT PAYMENTS**

Section 7122(c)(2)(B)(ii) provides that upon a taxpayer’s failure to make an installment payment (other than the first installment payment) during the period an offer in compromise is being evaluated, the Service may treat such failure as a withdrawal of the offer. The Notice makes several references to this rule, using inconsistent language. In particular, the Notice (i) provides that a taxpayer’s failure to make an installment payment “may be treated as a withdrawal of the offer;”\textsuperscript{33} (ii) refers to an offer being “deemed withdrawn under [section] 7122(c)(2)(B)(ii);”\textsuperscript{34} and (iii) provides that the Service may issue a letter advising the taxpayer that the offer “is considered withdrawn if the taxpayer does not make the full payment of the installment within the time allowed.”\textsuperscript{35} To avoid confusion, we recommend that the regulations use consistent language when referring to the rule in section 7122(c)(2)(B)(ii). We further recommend that the regulations clarify those circumstances under which the Service will treat a failure to make an installment payment as a withdrawal of the offer.

**TIME TO TENDER ADDITIONAL PAYMENT**

If the Service has solicited a payment, the Notice requires the taxpayer to pay the balance of the amount “within the time allowed by the Service.”\textsuperscript{36} In order to ensure that taxpayers are treated consistently and to ensure that offers are not unreasonably returned as not processable, we recommend that the regulations provide that, if the Service has solicited payment, it will allow the taxpayer a period of at least 30 days in which to tender the solicited amount.

**NOTIFICATION THAT OFFER IS BEING TREATED AS WITHDRAWN**

\textsuperscript{31} Id.
\textsuperscript{32} Id., sec. 3.01.
\textsuperscript{33} Id., sec. 1.03.
\textsuperscript{34} Id., sec. 1.07.
\textsuperscript{35} Id., sec. 3.02.
\textsuperscript{36} Id., secs. 2.02, 3.02.
The Notice provides that the date an offer is rejected for purposes of section 7122(f) is the date on which the Service issues a written notice of rejection under Treas. Reg. §301.7122-1(f)(1). The Notice does not indicate how the date an offer is returned, withdrawn, or “treated as withdrawn” for failure to make a required payment is determined. Absent clear regulations governing when an offer will be “treated as withdrawn” and how taxpayers will be notified of such treatment, we are concerned that taxpayers might not realize that their offers are being treated as withdrawn. In such cases, taxpayers may tender periodic payments for offers that no longer are being evaluated, detrimentally relying on the false assumption that their offers continue to be processed. We recommend that the regulations indicate how the Service will notify taxpayers that their offers are being treated as withdrawn and clarify on what effective date an offer is returned, withdrawn, or treated as withdrawn.

**POSTMARKS AS EVIDENCE OF RECEIPT OF OFFER**

The Notice provides that the date of submission of an offer is the date on which the Service receives the offer, and that the postmark date is irrelevant in determining when an offer is submitted. This provision may create the incorrect impression that postal service or private delivery service records are irrelevant to the offer process. To the contrary, where the Service is unable to locate a taxpayer’s offer (or partial payment), such records may be necessary to prove that the Service in fact received the offer. We recommend that regulations provide that, if a taxpayer submits an offer via certified or registered mail or approved private delivery service (consistent with I.R.C. §7502(f)), return receipts, or other postal service or private delivery service acknowledgments will be relevant in determining that the offer (or partial payment) was received.

**24-MONTH ACCEPTANCE PERIOD**

Section 7122(f) provides that an offer in compromise “shall be deemed to be accepted by the Secretary if such offer is not rejected by the Secretary before the date which is 24 months after the date of the submission of such offer.” It is not clear from the language of the statute whether the term “rejected by the Secretary” means “rejected by the offer in compromise unit” or “finally rejected by the Office of Appeals following the taxpayer’s appeal of a rejection by the offer in compromise unit.” The Notice provides that the period during which the Office of Appeals considers a rejected offer in compromise is not included as part of the 24-month acceptance period.

The distinction is significant. If, consistent with the Notice, the phrase “rejected by the Secretary” means “rejected by the offer in compromise unit,” taxpayers and the government could be subject to unreasonable burdens and delays. Specifically, the offer in compromise unit could delay making a decision with respect to a pending offer until the 24-month acceptance period is nearly expired. Immediately before the acceptance period’s expiration, the offer in compromise unit could summarily reject the offer, requiring the taxpayer to appeal. The statute of limitations, which had been suspended for the nearly 24 months that the offer in compromise unit had the offer, would remain suspended while the offer is under consideration by the Office of Appeals. This result would be unduly burdensome (and unfair) to taxpayers who seek to resolve their tax liabilities.

Also, it is implicit in the partial payment requirements that the taxpayer is required to continue making periodic payments until the offer is rejected, withdrawn or treated as withdrawn. We do not believe Congress intended for periodic payments to cease while the offer is under consideration by the Office of

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37 Id., sec. 1.07.
38 Id.
39 Id.
Appeals. However, we believe that, if an offer is rejected for purposes of section 7122(f), it must also be rejected for purposes of the periodic payment requirements under section 7122(c)(1)(B)(ii). Therefore, the result under the Notice also would be inimical to the interests of the government (and inconsistent with the Policy Statement), as it prematurely terminates the periodic payment requirements while simultaneously delaying the date by which a reasonable offer is accepted.

The Notice is consistent with Treas. Reg. §301.7122-1(f)(1), which provides that “an offer in compromise has not been rejected until the IRS issues a written notice to the taxpayer or his representative advising of the rejection, the reason(s) for the rejection, and the right to an appeal.” We believe the interests of taxpayers and the government would be best served by amending Treas. Reg. §301.7122-1(f)(1) to provide that, for purposes of section 7122(f), where the offer in compromise unit has rejected an offer and the taxpayer has timely filed an appeal, the term “rejected by the Secretary” shall mean “rejected in writing by the Internal Revenue Service Office of Appeals.” Such an amendment would require the offer in compromise unit – and Appeals, as necessary – to complete their collective evaluation of an offer within a 24-month period. This amendment would benefit taxpayers by preventing unlimited suspension of the statute of limitations. It would benefit the government by ensuring that periodic payments continue while the taxpayer’s appeal of any rejected offer is pending. It would benefit all parties by promoting efficient resolution of taxpayer liabilities.