DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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July 7, 2000

MEMORANDUM FOR ROBERT C. LONGFORD
CHIEF, RETURN DELINQUENCY & DISTRICT OFFICE
SUPPORT SECTION

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

SUBJECT: Advisory Opinion–Refund of Third-Party Deposits Upon Rejections of Offers in Compromise

This memorandum responds to a request for advice from Vicki L. O'Hara by e-mail on April 7, 2000, concerning refunds of deposits when the Service rejects an offer in compromise, particularly when a third party has provided the deposit. You have asked us to consider the following question: When a third party has provided the deposit for a taxpayer's offer in compromise, is the Service required or authorized to refund the deposit to the third party upon rejection; and if not, should the Service disclose this prior to taking the deposit? For the reasons which follow, we would advise that all deposits be returned to the taxpayer.

DISCUSSION

The Code, the regulations, and Form 656 state in varying language that deposits should be returned to the taxpayer. The Internal Revenue Code states that on rejection of an offer in compromise, the Service shall refund the deposit to the "maker" of the offer. I.R.C. § 7809(b). Language on Form 656 also states the assumption that deposits will be returned to the taxpayer: "the IRS will return any amount paid with the offer." Although Treas. Reg. §301.7122-1T states only that the deposit "will be refunded" in the event of rejection, it does give only the "taxpayer" the authority to authorize the Service to apply the deposit to tax liabilities. Further, the Internal Revenue Manual, in its provisions relating to deposits, clearly contemplates refunding the deposit to the taxpayer. For instance, I.R.M. 5.8.7.7(2) states that the Service should request the taxpayer to sign Form 3040, authorizing them to apply the deposit to outstanding liabilities in the event the

offer is not accepted; however, it further provides, "If the taxpayer does not authorize application of the deposit, the deposit **must** be refunded to the taxpayer" (emphasis in original). Further, I.R.M. 5.8.2.5, relating to the disposition of deposits received with unprocessable offers in compromise, provides "[d]eposits received with offers that are not processable must be returned to the taxpayer," and that the employee making the determination is "responsible for sending the deposit back to the taxpayer."

None of these sources, however, directly addresses the return of deposits made by third parties on behalf of the taxpayer. As a general rule, the Service would want to return funds received for the payment of tax liabilities to the taxpayer. This rule relieves the Service from becoming embroiled in debates over the ownership of funds submitted for the payment of taxes. This is illustrated by Ralston Steel Corp. v. United States, 340 F.2d 663 (Cl. Ct. 1965), cert. denied, 381 U.S. 950 (1965). Here, a third party advanced deposit money through an escrow agent, along with written statements that the taxpayer had borrowed the deposit money, that the offer expired on a certain date, and that the Service should return the deposit to the escrow agents if it did not accept the offer by that date. Before the Service acted on the offer, the third party asked to withdraw it and demanded return of the deposit. The Service refused and later accepted the offer in compromise. The third party then brought suit, seeking a refund of the deposit. Id. at 666.

At the time of this decision, Treas. Reg. § 301.7122-1(d)(4) provided "[a]n offer in compromise may be withdrawn by the proponent at any time prior to its acceptance." Thus, the court's analysis turned on the question whether a nonparty who had provided the deposit could be considered a proponent of the offer with the power to withdraw it. The court took a narrow view of the word proponent, and held that "'proponent,' . . . does not go beyond an offeror and, more especially, does not impose any duty on the Government to determine the real owner of the funds accompanying the offer." Id. at 670-71.

Although the court in Ralston did not consider the precise issue of whether the Service may refund a deposit to a third party, its analysis is instructive in its reluctance to impose a duty on the Service to determine the owner of deposit funds or to refund them to anyone besides the actual taxpayer.

In Dynamic Service, Inc. v. Granquist, 56-2 U.S.T.C. 9784 (D. Or. 1956), the court considered a deposit made by a third party to be "a payment made by the taxpayer," and stated that "the $1,000.00 in dispute was for purposes of this case taxpayer's money." The court dismissed the case, holding that the third party did not have standing to bring suit to recover the deposit.

From the language of the Code, the regulations, and the IRM, we presume that the Service has made a policy decision to return any funds submitted for the payment of taxes to the taxpayer rather than to a third party source of the funds. The courts

that have considered similar cases have agreed that third parties cannot compel the Service to return funds to them that they may have provided to taxpayers who have made offers in compromise. Thus, unless the taxpayer has signed a Form 3040 authorizing application of the deposit to tax liabilities, the Service should refund the deposit to the taxpayer upon rejection of the offer in compromise. Advising third parties that any funds they provide will be returned to the taxpayer may prevent later misunderstandings with third parties, but the Service has no legal obligation to do so.

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