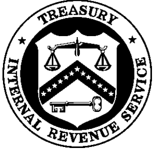

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224
June 25, 2001

OFFICE OF CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR ASSOCIATE AREA COUNSEL (SBSE), AREA 4, DETROIT, MICHIGAN

FROM: Lawrence H. Schattner
Chief, Branch 2 (Collection, Bankruptcy & Summonses)

SUBJECT: Default of Offer-in-Compromise

This Chief Counsel Advice responds to your memorandum dated May 8, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

ISSUES

Whether the Internal Revenue Service ("Service") may unilaterally default a joint offer in compromise when Taxpayer-Husband breached his obligations under a separate but related offer in compromise on the basis of an oral agreement tying the two offers together.

CONCLUSIONS

No. Treasury Regulations specifically require that offers in compromise be reduced to writing and thus cannot be altered by an oral agreement.

FACTS

A joint offer in compromise was accepted by the Service to resolve Taxpayers' outstanding income tax liabilities. The notice of acceptance stated, "our acceptance is subject to the terms and conditions on the enclosed form 656, Offer in Compromise." Taxpayers fulfilled their obligations under the offer in compromise by paying the total due plus interest.

The Service also accepted Taxpayer-Husband's individual offer in compromise to resolve his outstanding employment tax liabilities. The notice of acceptance contained the same language as above. Taxpayer-Husband never made any

payments under his offer in compromise and the Service defaulted both compromise agreements.

According to your memo, it was the practice of the local offer in compromise group to inform taxpayers orally that individual and joint agreements were tied together. Your memo does not state if Taxpayers in this case were specifically told that default of one offer would result in default of the other and whether Taxpayers agreed. Your memo also states that current practice is to make agreements tying the two offers together in writing.

LAW AND ANALYSIS

The Nature of an Offer in Compromise

An offer in compromise is a statutory creation. I.R.C. section 7122(a) states:

> The Secretary may compromise any civil or criminal case arising under the internal revenue laws prior to reference to the Department of Justice for prosecution or defense; and the Attorney General or his delegate may compromise any such case after reference to the Department of Justice for prosecution or defense.

I.R.C. § 7122(a). Thus, any offer in compromise is to be strictly construed according to the statutory requirements. Botany Worsted Mills v. United States, 278 U.S. 282 (1929); Klien v. Commissioner, 899 F.2d 1149 (11th Cir. 1990); Bowling v. United States, 510 F.2d 112 (5th Cir. 1975);.

It has also been said that an offer in compromise is a contract and is subject to the general rules governing contracts. United States v. Feinberg, 372 F.2d 352 (3rd Cir. 1967); United States v. Lane, 303 F.2d 1 (5th Cir. 1962); Kurio v. United States, 429 F.Supp. 42 (S.D. Tex. 1970). However, the rules of contracts cannot abrogate the statutory requirements governing offers in compromise. Bowling, 510 F.2d at 113.

Requirement of a Writing

Temporary Treasury Regulation section 301.7122-1T(c)(1) requires that all offers in compromise be submitted in writing on forms prescribed by the Service.[1] In accordance with this regulation the Service now requires that all offers must be submitted on Form 656. IRM 5.8.1.4(1)

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[1]Acceptances must also be in writing. Temp. Treas. Reg. § 301.7122-1T(d)(1). These writing requirements were also in effect when the offers at issue were accepted. See, Treas. Reg. § 301.7122-1(d) (1960).

In Boulez v. Commissioner, 810 F.2d 209 (D.C. Cir. 1987) a taxpayer challenged the Treasury regulation's writing requirement, arguing that he had a binding oral compromise agreement. Pierre Boulez ran afoul of U.S. tax law by failing to include certain income on his tax returns. Id. at 210. After extensive negotiations, Boulez reached an oral compromise agreement with the Service. Id. In an unrelated audit, the Service discovered more tax deficiencies and issued a notice of deficiency. Id. at 211. Boulez argued that the oral agreement settled all of his tax liabilities, including these newly discovered deficiencies, and was binding on the Service. Id. The court of appeals disagreed and found that Treasury Regulation section 301.7122-1(d) (1960) required an offer in compromise to be set out in writing and that this requirement was "entirely reasonable, and a wholly permissible interpretation of Section 7122." Boulez, 810 F.2d at 214. In addition the court stated that the writing requirement could not simply be overlooked as it is "a fundamental tenet of formalizing agreements." Id. at 216. Thus, because the agreement did not conform to statutory requirements it was not binding on the Service.

The holding of Boulez was followed in In re Aberl, 159 B.R. 792 (Bankr. N.D. Ohio 1993), aff'd, 175 B.R. 915 (N.D. Ohio 1994), aff'd, 78 F.2d 241 (6th Cir. Ohio 1996). The Aberl court refused to find that oral negotiations between a taxpayer and the Service constituted an offer in compromise. "This Court agrees . . . that '[Treas. Reg. § 301.7122-1(d)], which requires that all compromises be reduced to writing, has the force and effect of law, and that the [IRS] lacked authority to waive it.'" In re Aberl, 159 B.R. at 799, citing Boulez, 810 F.2d at 211 (alteration in original) (citations omitted).

The issue you have presented, however, deals with an oral term within a written offer in compromise rather than an entirely oral agreement. In Keating v. United States, 794 F.Supp. 888 (D. Neb. 1992) the district court concluded that an oral agreement could not supersede the written terms of Form 656. The Keatings submitted a written offer in compromise on Form 656, which expressly informed taxpayers that the United States would retain any tax refunds that arose within the period of the offer. Id. at 889. The Keatings then negotiated with the Service to increase the amount of their offer with the oral understanding that the Service would refund any tax overpayments, notwithstanding the language of Form 656. Id. The Service kept the Keatings' refund and applied it to their tax liability. Id. at 888.

The District Court stated:

> Even assuming that an oral agreement existed between the parties that attempted to supersede Form 656, an oral agreement with the Internal Revenue Service with respect to federal income tax liability cannot bind the government . . . The Internal Revenue Code and the Treasury regulations specifically require a written offer and acceptance of an offer in compromise. (citations omitted)

Id. at 891. Thus, according to the statutory scheme and regulations governing offers in compromise, an oral term cannot be added to a written offer.[2] But see, Engelken v. United States, 823 F.Supp. 845 (D. Colo. 1993) (denying summary judgment because plaintiffs should have been allowed to show an oral modification to their offer in compromise). Without a contract term tying the two offers together, they must each stand alone. The joint offer in compromise has been fully paid. Assuming Taxpayers have complied with all of the filing and payment requirements of the I.R.C. for the five year period following acceptance of their offer as required by condition (d) of Form 656 (Rev. 9-93), the liability has been extinguished. See, Temp. Treas. Reg. § 301.7122-1T(d)(5); Treas. Reg. § 301.7122-1(c) (1960).

Contract Rules Governing Oral Terms

It is our position that I.R.C. section 7122(a) and the regulations thereunder govern the requirements of an offer in compromise and that pursuant to these authorities all the terms of the offer and acceptance of the offer must be in writing. Even under general contract principles, we believe the conclusion would be the same

At the outset, in considering an offer in compromise a court should look to "the rules applicable to contracts generally." Lane, 303 F.2d at 4; see also, United States v. Wainer, 211 F.2d 669, 673 (7th Cir. 1954) (applying common law when analyzing a compromise agreement with the Service).

The parole evidence rule governs when testimony will be allowed to prove an oral term of a written contract. The general rule is that evidence of a prior or contemporaneous agreement, not included in an integrated writing, is not admissible to prove the existence of that agreement. Restatement (Second) of Contracts §§ 215, 216 (1981); Samuel Williston, 4 Williston on Contracts § 631 (3d ed. 1961).[3] Parole evidence is admissible to prove: (1) that the writing is not integrated; (2) the writing is only partially integrated; (3) the meaning of the writing; (4) illegality, fraud, duress, mistake, lack of consideration, or other invalidating cause; (5) grounds for recission, reformation, specific performance, or other remedy. Restatement (Second) of Contracts § 214 (1981). Thus, parole evidence may be used to show that an agreement is not integrated. If the Service were able

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[2]It does not matter that the Keating court dealt with an attempt to supersede a written term of the offer whereas this case deals with an attempt to add a consistent term because the analysis under the statutory scheme is the same. Oral agreements are not enforceable.

[3]Michigan law is in accord with the common law on parole evidence. NAG Enterprise, Inc. v. All State Industries, Inc. 407 Mich. 407 (1979); UAW-GM Human Resource Center v. KSL Recreation Corp., 228 Mich. App. 486 (1998).

to prove that Form 656 is not integrated then it could introduce evidence of a contemporaneous oral agreement to tie the two offers in compromise together.

An agreement is determined to be integrated when the writing constitutes "a final expression of one or more terms of an agreement." Restatement (Second) of Contracts § 209 (1981). Whether an agreement is integrated is to be determined by the court, however, written agreements are presumed to be integrated. Id.; Samuel Williston, 4 Williston on Contracts § 633 (3d ed. 1961). This presumption is particularly strong when the parties use a standardized agreement. Restatement (Second) of Contracts § 211 (1981). Even if an agreement is not fully integrated courts generally will not allow parole evidence of an additional term if that term would normally be included in that type of agreement. Arthur Linton Corbin, 3 Corbin on Contracts § 583 (1960).

A further hazard for the Service is the rule that "in choosing among the reasonable meanings of a promise or agreement or a term thereof, that meaning is generally preferred which operates against the part who supplies the words or from whom a writing otherwise proceeds." Restatement (Second) of Contracts § 206 (1981).[4] A court is particularly likely to construe a contract against the government as the drafting party. Restatement (Second) of Contracts § 207 cmt. a (1981).

The use of parole evidence is decided on a case by case basis by the courts, however, given the rules of contracts as discussed above it is unlikely that the Service would prevail in proving that Form 656 is an unintegrated agreement and that evidence of an oral agreement should be admitted.

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 further questions please contact the attorney assigned to this matter at (202) 622-3620.

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[4]Michigan law is in accord. Hanley v. Porter, 238 Mich. 617 (1927); Stark v. Kent Products, Inc., 62 Mich. App. 546 (1975); Elby v. Livernois Eng'g Co., 37 Mich. App. 252 (1971).