In the United States Bankruptcy Court

for the Northern District of Iowa

Western Division

CHARLES L. HOBBS
Debtor(s).

Bankruptcy No. 95-51466XS
Chapter 7

CHARLES L. HOBBS
Plaintiff(s)

vs.

UNITED STATES OF AMERICA
Internal Revenue Service
Defendant(s)

Adversary No. 95-5131XS

ORDER RE: MOTIONS FOR SUMMARY JUDGMENT

On August 14, 1995, Plaintiff Charles Hobbs filed a complaint to determine the dischargeability of his federal income tax liability for tax years 1986 and 1987. On March 15, 1996, Hobbs filed a motion for summary judgment. On March 28, 1996, Defendant Internal Revenue Service filed a resistance to Plaintiff's motion and a cross motion for summary judgment. Hearing on the motions was held April 23, 1996. Attorney Wil Forker appeared for Hobbs. Assistant United States Attorney Joan Stentiford Ulmer appeared on behalf of the Internal Revenue Service. The court now issues its ruling on the motions. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(I).

Summary judgment is governed by Fed.R.Civ.P. 56, made applicable in bankruptcy adversary proceedings by Fed.R.Bankr.P. 7056. A party may move with or without supporting affidavits for a summary judgment in the party's favor. Fed.R.Civ.P. 56(a). A party is entitled to summary judgment if:

> the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.

Fed.R.Civ.P. 56(c). The parties agree that the material facts are not in dispute and that the determinative issue is a matter of law. The court bases its decision on the following uncontested facts:

Charles Hobbs filed a Chapter 7 bankruptcy petition August 7, 1995.

Hobbs incurred federal income tax liability for tax years 1986 and 1987 as a result of corporate transactions. The tax liabilities for 1986 and 1987 were assessed on July 13, 1992. (Answer, 4.) Neither party has stated an amount believed owing for the 1986 tax year. Government's Exhibit D, attached to Document 15, appears to show there is none.[(1)] The parties agree that as of the date Hobbs filed his bankruptcy petition, his tax liability for the 1987 tax year was $334,515.63. (Doc. 12, Affidavit of Charles L. Hobbs.)

On November 19, 1992, Hobbs made an offer to compromise his tax liability for $38,000 (Doc. 15, Exhibit A), and submitted that amount with the offer. Hobbs submitted the offer in compromise on IRS Form 656 as required by Treasury Regulations. 26 C.F.R.

§§ 301.7122-1(d)(1), 601.203(b). The form contains the following language at paragraph eight:

> The taxpayer-proponents agree to the waiver and suspension of any statutory periods of limitations for assessment and collection of the tax liability described in paragraph (1) while the offer is pending, during the time any amount offered remains unpaid and for one (1) year after the satisfaction of the terms of the offer. The offer shall be deemed pending from the date an authorized official of the Internal Revenue Service accepts taxpayer-proponents' waiver of the statutory periods of limitation and shall remain pending until an authorized official of the Internal Revenue Service formally, in writing, accepts, rejects or withdraws the offer. If there is an appeal with respect to this offer, the offer shall be deemed pending until the date the Appeals office formally accepts or rejects this offer in writing. If within thirty (30) days of being notified of a right to protest a determination with regard to this offer, no protest is filed, the taxpayer-proponents agree to waive the right to a hearing before the Appeals office for this offer in compromise.

The offer was signed on December 12, 1992 by Revenue Officer Gordon Zens, accepting the waiver of the statutory period of limitations. Federal tax liability may be compromised only upon grounds of doubt as to liability or doubt as to collectibility. 26 C.F.R. §§ 301.7122-1(a), 601.203(a)(2). Hobbs based his offer on doubtful collectibility of the tax claim.

On February 25, 1994, the IRS rejected the offer in compromise and advised Hobbs of his right to appeal the decision. (Doc. 15, Exhibit C.) By letter April 8, 1994, Adam Chavis, Hobbs' representative, appealed the rejection of the offer. (Doc. 12, Exhibit B.) The IRS treated the appeal as timely. The case was referred to Robert Amick in the Omaha Appeals Office. Amick requested information from Chavis and others about Hobbs' financial condition, including an explanation of the circumstances of the sale of a promissory note prior to making the offer in compromise. (Doc. 15, Decl. of Robert Amick, Exhibits G, H, I.)

On September 19, 1994, Adam Chavis wrote to Amick regarding Hobbs' offer in compromise. The letter stated in part:

> At this time Mr. Hobbs is also requesting that the $38,000.00 deposit which he made to the Internal Revenue Service on November 2, 1992 be returned to him. Once the Offer in Compromise is accepted by the Internal Revenue Service the $38,000.00 offer amount will be remitted in full. Please return the deposit to P.O. Box 1, Whiting, Iowa 51063.

(Doc. 15, Exhibit P.)

On February 13, 1995, Amick again wrote to Chavis about the offer in compromise. Following is the body of the letter in its entirety:

> I apologize for the delay in responding since our last discussions. I have been waiting for additional information from Collection in Aberdeen, South Dakota.
>
> During my wait, I have discussed the case with our District Counsel attorneys, who originally rejected the offer. They indicated that three things need to occur before the offer could be accepted. They indicated the facts presented by you and the government would reject the offer, as they had previously.
>
> * The offer form needs to be resubmitted on the 1993 revision form.
>
> * The offer must be amended to change the terms from $38,000 paid with the offer to $38,000 will be paid within "X" number of days from the date of the acceptance of the offer.
>
> * You must submit evidence substantiating the fair market value and arms length transaction regarding the sale of corporation notes to the taxpayer's relative.
>
> **Do not send this information to me. I am in the process of returing [sic] the case to the Collection Division for further investigation. They will contact you.**

> Your cooperation has been appreciated.

(Doc. 15, Exhibit N, emphasis in original.) Hobbs did not submit anything in response to the February 13 letter.

The Internal Revenue Manual describes procedures for handling an offer in compromise. The manual states that a Form 1271 should be completed for all offer in compromise cases which are being rejected or withdrawn. (Doc. 15, Exhibit K, § 8(13)62.2.) An example of Form 1271 was submitted as Government's Exhibit L. (Doc. 15.) The IRS file containing all documents relating to the offer in compromise submitted by Hobbs does not contain a Form 1271. (Doc. 15, Decl. of Joan S. Ulmer.) Pattern rejection letters referred to in the Internal Revenue Manual state that "your offer is rejected" and demand payment of the taxpayer's account in full. (Doc. 15, Exhibit M.)

DISCUSSION

The taxing authority bears the burden of proof by a preponderance of the evidence that taxes are nondischargeable, even if the complaint to determine dischargeability is brought by the debtor. Langlois v. United States, 155 B.R. 818, 820 (N.D.N.Y. 1993); Aberl v. United States (In re Aberl), 159 B.R. 792, 795 (Bankr. N.D. Ohio 1993), *aff'd*, 175 B.R. 915 (N.D. Ohio 1994), *aff'd*, 78 F.3d 241 (6th Cir. 1996). The exceptions to a Chapter 7 discharge are to be construed narrowly in favor of the debtor. Caspers v. Van Horne (Matter of Van Horne), 823 F.2d 1285, 1287 (8th Cir. 1987).

Dischargeability of tax liability is governed by 11 U.S.C. § 523(a)(1) which provides that a Chapter 7 discharge does not discharge any debt:

> for a tax or a customs duty--
>
> A. of the kind and for the periods specified in section 507(a)(2) or 507(a)(8) of this title, whether or not a claim for such tax was filed or allowed;
> B. with respect to which a return, if required--
> i. was not filed; or
> ii. was filed after the date on which such return was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition; or
> C. with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax.

11 U.S.C. § 523(a)(1). Hobbs claims that he has met all the timing requirements of § 523(a)(1)(A), incorporating § 507(a)(8), and § 523(a)(1)(B). The IRS contends that Hobbs' tax liability is a nondischargeable priority claim under 11 U.S.C. § 507(a)(8)(A)(ii). That section provides eighth priority for:

> allowed unsecured claims of governmental units, only to the extent that such claims are for--
>
> A. a tax on or measured by income or gross receipts--
>
> ...
>
> ii. assessed within 240 days, plus any time plus 30 days during which an offer in compromise with respect to such tax that was made within 240 days after such assessment was pending, before the date of the filing of the petition....

11 U.S.C. § 507(a)(8)(A)(ii). Collection activities are not necessarily stayed while an offer in compromise is pending. 26 C.F.R. § 301.7122-1(d)(2). If the IRS chooses to defer collection during the pendency of an offer, however, § 507(a)(8)(A)(ii) assures the IRS 240 days prepetition in which to collect assessed taxes. Aberl, 159 B.R. at 798.

The IRS assessed Hobbs' tax liability on July 13, 1992. He filed his bankruptcy petition on August 7, 1995. The tax liability is not a priority tax claim, and is thus dischargeable, if 240 days passed between assessment and filing. The 240-day period is tolled during the time the offer in compromise was pending plus 30 days. The offer was deemed pending as of December 10, 1992, the date IRS Officer Zens accepted the waiver of the statutory periods of limitation

for assessment and collection. (Doc. 15, Exhibit A.) An offer remains pending after appeal of a rejection "until the date the Appeals office formally accepts or rejects [the] offer in writing." (Id.) A taxpayer may withdraw an offer at any time prior to its acceptance. 26 C.F.R. § 301.7122-1(d)(4). The issue is whether the conduct of either party had the legal effect of terminating the offer in compromise. Hobbs argues that either of two events terminated the offer. First he says that after he requested the IRS to return the $38,000 submitted with the offer, he considered the offer withdrawn. (Doc. 12, Affidavit of Hobbs.) This claim is contradicted by the language of the letter requesting return of the money. On September 19, 1994, Adam Chavis wrote, "Once the Offer in Compromise is accepted by the Internal Revenue Service the $38,000.00 offer amount will be remitted in full." (Doc. 15, Exhibit P.) Hobbs still desired that the offer would be accepted. The IRS apparently will consider an offer without the offer amount on deposit. The Treasury Regulations prescribe that an offer in compromise "should generally be accompanied by a remittance representing the amount of the compromise offer or a deposit if the offer provides for future installment payments." 26 C.F.R. § 301.7122-1(d)(1). The court concludes that the offer was pending after September 19, 1994.

The second event that Hobbs argues terminated the offer was the IRS letter of February 13, 1995. (Doc. 15, Exhibit N.) If Hobbs is correct that his offer was no longer pending after February 13, 1995, the tax liability would be dischargeable. Between the July 13, 1992 assessment date and December 10, 1992, when IRS Officer Zens signed the offer, 149 days passed. The thirtieth day after February 13, 1995 was March 15. From March 16, 1995 through August 6, 1995, the day before Hobbs filed his Chapter 7 petition, 144 days passed, for a total of 293 days. Because this number exceeds 240, Hobbs' tax liability would not be a priority claim under 11 U.S.C. § 507(a)(8)(A)(ii).

The IRS contends that the February 13, 1995 letter was not a rejection but an explanation of the need for additional information, and that the offer is still pending. The IRS emphasizes that the letter did not contain specific language found in pattern rejection letters used by the IRS and that the IRS did not prepare a Form 1271, memorandum of withdrawal or rejection, for Hobbs' file. Hobbs claims that his offer was no longer pending after February 13, 1995. He argues that the letter made it clear that the IRS would no longer consider acceptance of his offer and requested him to propose a new offer. The court agrees with Hobbs.

The Offer in Compromise submitted by Hobbs provides that after appeal, the offer is pending until the "Appeals office formally accepts or rejects this offer in writing." Formal acceptance or rejection may refer to acceptance or rejection meeting the requirements of 26 U.S.C. § 7122 and the accompanying regulations promulgated by the Secretary of the Treasury. See Aberl v. United States (In re Aberl), 159 B.R. 792, 800-01 (Bankr. N.D. Ohio 1993), *aff'd*, 175 B.R. 915 (N.D. Ohio 1994), *aff'd*, 78 F.3d 241 (6th Cir. 1996)(discussing cases in which "informal agreements" were not binding because they were not in compliance with applicable statutes and regulations). In Aberl, the court held that a letter asking the IRS to reconsider a pre-assessment offer was not an "offer in compromise" because it did not comply with 26 C.F.R. § 301.7122-1(d)(1). Id., 159 B.R. at 800. Courts have held that the terms of Treasury Regulation § 301.7122-1(d) are mandatory and have the force of law. Boulez v. Commissioner, 810 F.2d 209, 215 & n. 50 (D.C. Cir. 1987), cert. denied, 108 S.Ct. 229 (1987); Aberl, 159 B.R. at 799. Rules contained in the Internal Revenue Manual, in contrast, have been held to govern the internal administration of the IRS; they do not have the binding force and effect of law. United States v. Horne, 714 F.2d 206, 207 (1st Cir. 1983); Continental Illinois Corp. v. United States, 727 F.Supp. 425, 429 (N.D. Ill. 1989); see also Boulez, 810 F.2d at 215 & n. 48 (procedural rules, like provisions of the Internal Revenue Manual, are directory and not mandatory). The Treasury Regulations prescribe no particular formality for rejection of an offer in compromise other than notice in writing. 26 C.F.R.

§ 301.7122-1(d)(4) (the taxpayer "shall be promptly notified in writing"). A letter from the IRS taking a position legally inconsistent with the notion of a pending offer should be construed as terminating the pendency of the offer, notwithstanding the IRS's failure to use specific words prescribed in the Internal Revenue Manual.

There was little evidence presented about the IRS appeal process. The letters written between Amick and others show that the appeal process includes gathering information to decide if grounds for compromise exist. (Doc. 15, Exhibits G, H, I, J.) The substance of the February 13, 1995 letter is that the appeal was terminated and that the offer of November 1992 would no longer be considered. After discussion of Hobbs' offer with District Counsel attorneys, Amick concluded that the offer was unacceptable. The letter set three conditions Hobbs would have to meet before the IRS would consider an offer in compromise of his tax liability. Hobbs would have to submit a new offer and "change the terms" of payment. This requirement is not sufficient in itself to find the offer rejected; it was made necessary by the return of the deposit.

However, the letter as a whole should be construed as a rejection of the offer. Hobbs was to submit a new offer on a different form, including changed terms and new evidence. Finally, Amick told Hobbs not to send any information to him. The appeal was concluded. If Hobbs wanted the IRS to consider an offer in compromise, he would have to begin the process again by submitting a new offer. Hobbs was not required to submit a new offer, and he did not do so.

The IRS controlled the language of the letter. It could have stated that it considered the offer pending. Or it could have stated that if a new offer were not submitted in a specified period of time, the pending offer would be rejected by the appeals office (a notice of proposed rejection). Hobbs would then be on notice that he would have to withdraw the offer to terminate it sooner.

The court concludes that the letter of February 13, 1995 was a formal rejection sufficient to terminate the pendency of Hobbs' offer. Rejection of the offer as of that date allowed in excess of 240 days to pass between the date of assessment of the tax liability and the date of Hobbs' Chapter 7 petition for purposes of 11 U.S.C. § 507(a)(8)(A)(ii). The tax liability is not a priority tax claim and should be held dischargeable.

ORDER

IT IS ORDERED that the motion for summary judgment filed by Charles L. Hobbs is granted.

IT IS FURTHER ORDERED that the cross motion for summary judgment filed by the United States of America, Internal Revenue Service, is denied.

IT IS FURTHER ORDERED that Hobbs' income tax liability to the IRS for tax years 1986 and 1987 is discharged. Judgment shall enter accordingly.

SO ORDERED THIS 5th DAY OF JUNE 1996.

William L. Edmonds
Chief Bankruptcy Judge

I certify that on I mailed a copy of this order and a judgment by U.S. mail to: Wil Forker, Joan Ulmer, U.S. Attorney and U.S. Trustee.

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1. Document 15 consists of the Declaration of Joan S. Ulmer, Declaration of Gordon Zens, Declaration of Larry Paschke, Declaration of Robert Amick and Exhibits A-P.