DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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OFFICE OF
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MEMORANDUM FOR ASSOCIATE AREA COUNSEL (SB/SE), AREA 7,
SACRAMENTO

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

SUBJECT: Offers in Compromise and Partnership Liabilities

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

ISSUE:

Where the Service compromised with one or more general partners for the employment tax liabilities of a partnership, can the Service later pursue collection of the unpaid balance of the liabilities from other general partners not party to the compromise agreement?

CONCLUSION:

Yes. Although it is the Service's policy to compromise the employment tax liabilities of a partnership at the partnership level only, it is possible for the Service, under certain circumstances, to compromise with one general partner while preserving its right to collect from other general partners or the assets of the partnership itself. In the cases you have presented, the Service has entered into binding compromises with one or more partners without extinguishing the liability of the partnership or prejudicing its rights to collect from other sources. In future cases, however, we recommend that compromises with individual partners not be entered into absent a change in the Service's policy or authorization from the Office of Compliance Policy in the Small Business/Self Employed Division's National Office.

BACKGROUND:

The Service's policy with regard to compromising the employment tax liabilities of partnerships is that the entire liability should be compromised at one time. The Offer in Compromise Handbook, IRM 5.8, provides:

> The amount that must be offered to compromise a partnership tax liability must include the maximum collection potential for the partnership and all general partners. Secure Collection Information Statements from the partnership and all partners before beginning your analysis.

IRM 5.8.1.12(1). Although it has long been recognized that individual partners are jointly and severally liable for the partnership unpaid employment taxes, the handbook contains no guidance on compromising an individual partner's derivative liability. The Service has concluded that because the employment tax liabilities are a single liability owed by the partnership itself, the Service can best maximize collection and protect its collection rights by compromising these liabilities at the partnership level only.

You have requested our advice regarding two cases in which the Service has, in fact, compromised employment taxes with one or more, but not all, of the individual general partners of partnerships. The compromises were made prior to revision of the Internal Revenue Manual to read as quoted above. At the time, the manual included a procedure for compromises with one partner while reserving the right to collect from other partners and/or from the assets of the partnership itself. In both cases, both the partners' offers and the Service's acceptances clearly indicate that the agreements related only to any personal liability on the part of the partners offering to compromise, and that those partners were not acting in their capacities as agents of the partnerships. Also in both cases, so called "co-obligor collateral agreements" were obtained from the partners. These collateral agreements clarify that while the parties intended the compromise to conclusively settle the Service's ability to collect from the partners named in the compromise, the compromises did not serve as releases from liability that would in any way prejudice the Service's right to collect from other parties liable in any capacity for the taxes at issue.

Your memorandum expresses concern over whether collection can be pursued against other partners not named in any of the compromises. That concern is in part based on prior advice from this office, in which we explained the reasoning behind the Service's current policy and expressed our opinion that the policy of compromising with all partners together is prudent in light of those considerations. We continue to believe that the Service's current policy has merit given the significant risks to which the Service would be exposed if a contrary policy were followed. We have nevertheless concluded that the Service can collect from other, non-compromising general partners in the two cases you have presented.

LAW & ANALYSIS:

Although the Code creates a single employment tax liability for which a partnership acting as employer is liable, the Service can collect the unpaid liability from individual

general partners based on state laws making general partners liable for partnership debts. See Remington v. United States, 210 F.3d 281, 283 (5th Cir. 2000) ("The partnership is the primary obligor and its partners are jointly and severally liable on its debts."); Ballard v. United States, 17 F.3d 116, 119 (5th Cir. 1994); United States v. Hays, 877 F.2d 843, 844 n.3 (10th Cir. 1989); Tony Thornton Auction Service, Inc. v. United States, 791 F.2d 635, 637-38 (8th Cir. 1986); Calvey v. United States, 448 F.2d 177, 180 (6th Cir. 1971); Young v. Riddell, 283 F.2d 909, 910 (9th Cir. 1960); United States v. Underwood, 118 F.2d 760, 761 (5th Cir. 1941); United States v. West Productions, Ltd., 2001 TNT 78-74 (S.D.N.Y. March 30, 2001). California partnership law, consistent with the common law rule and the laws of most jurisdictions, states that general partners are jointly and severally liable for the debts and obligations of the partnership. See Cal. Corp. Code § 16306.

Section 7122 of the Internal Revenue Code grants the Secretary broad compromise authority. "The Secretary may exercise his discretion to compromise any civil or criminal liability arising under the internal revenue laws." Temp. Treas. Reg. § 301.7122-1T(a)(1). Further, the Service may, at its discretion, choose to compromise with only one of several parties responsible for the same tax liability. See id. at (d)(5) (providing that compromise conclusive settles the liability of "the taxpayer specified in the offer").

In the two cases at issue, the Service exercised its discretion to compromise with some partners and pursue different collection methods with others. Although a general partner may act as an agent for the partnership and form a binding agreement on the partnership's behalf, see, e.g., Cal. Corp. Code § 16301, the compromises made in these cases clearly stated that the partners were acting in their individual capacities and not as agents for their respective partnerships. Thus, the compromises had the effect of finally resolving the Service's rights to collect from the compromising partners and did not eliminate the underlying liability or the Service's right to pursue any other collection avenue provided by law.

Should the Service's ability to collect from other sources be challenged on the theory that these compromises have had some broader effect, we are confident that, under the particular facts presented, the Service would prevail. When interpreting or determining the effect of compromises under section 7122, courts have generally applied contract principles. See e.g., United States v. Feinberg, 372 F.2d 352 (3d Cir. 1967); United States v. Lane, 303 F.2d 1 (5th Cir. 1962). The goal in interpreting contracts and other legally operative documents is to arrive at a construction that gives effect to the parties' intent as expressed at the time the document was executed. See Corbin on Contracts VII (Rev. ed. 1998). The plain language of the document has long been the preferred source of authority regarding the parties intent, but extrinsic evidence of intent has also come to play a prominent role in modern principles of contract interpretation. See, e.g., Town v. Eisner, 245 U.S. 418, 425 (1918); Pacific Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co., 442 P.2d 641, 644 (Ca. 1968); John D. Calamari & Joseph M. Perillo, The Law of Contracts 166-67 (3rd ed. 1987).

In both of these cases, the language of the agreements and the extrinsic circumstances show a clear intent to resolve only collection from the individual partners offering to compromise. In the first case, the partner amended his offer prior to acceptance to state that it related only to his personal liability, including specific language stating that he was not acting as agent for the partnership. In the second case, similar limiting language was used in both compromises, referring to the liabilities as those of "former partners" of the by-then defunct partnership. Both compromises included the collateral agreement clarifying that the underlying partnership liability itself was not extinguished and could be collected from other sources. The Service's recording of the compromises on its books–taking steps to maintain a separate accounting of the compromises and their effect so that it could continue to pursue collection from other partners–provides extrinsic evidence of the intended effect of the compromises. The very fact that the Service considered and accepted separate compromises from multiple partners in the same partnership is further evidence that no one of the compromises was intended to resolve the case with regard to any and all other partners.

For these reasons, we conclude that the compromises in these cases did not extinguish the liabilities of the partnerships or prejudice the Service's ability to collect from other partners. Because we have concluded that collection against other partners was unaffected by these compromises, we have not addressed the specific collection actions being contemplated in the two cases. Whatever collection methods were available to the Service before the compromises remain viable options with respect to collection from any remaining partners.

We must note that our conclusions in no way override or modify the Service's policy as expressed in the Internal Revenue Manual. We continue to believe that the policy has merit, and, in future cases, recommend that the policy be observed unless it is changed or a deviation is authorized by the Office of Compliance Policy, Small Business/Self Employed Division.

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