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INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

NOV 23 1999

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GL-114116-99

MEMORANDUM FOR JOEL GOVERMAN
NATIONAL DIRECTOR, COLLECTION REDESIGN

FROM: Joseph W. Clark
Acting Chief, Branch 2 (General Litigation)

SUBJECT: Termination of Installment Agreements Following Failure to File Returns

This memorandum responds to your request for advice, expressed at our meeting of August 13, 1999. In response to our recent memorandum stating that an installment agreement cannot be terminated for a subsequent failure to file a return, you asked that we determine when the Service may terminate for failure to pay a tax that should have been shown on such return. For the reasons stated below, we conclude that, when no income tax return has been filed, an individual taxpayer's installment agreement may be terminated at the time an unpaid income tax liability for the period in question may be assessed.

BACKGROUND

In our memorandum of August 6, 1999, we concluded that installment agreements could not be terminated solely for failure to file subsequent returns, notwithstanding any language in the agreements to the contrary. We reasoned that the Service cannot use its authority to insist on terms and conditions in the agreement to override the exclusive grounds for termination provided by statute. On August 13, 1999, we met with you and your staff to discuss our conclusion and related issues. At that meeting, we agreed to look into the question of when a balance that would have been required to be shown on an unfiled return can be considered due, thus empowering the Service to terminate the installment agreement.

For the purposes of this memorandum, we assume an individual taxpayer ("IMF") is party to an installment agreement with the Service and is current in all payments required by the agreement. However, the taxpayer did not file a return for a recent tax period and the return remains outstanding following the date prescribed for filing. The Service's information reporting system indicates that income was earned that exceeded the statutory thresholds for both the filing of returns and the imposition of tax. Furthermore, based on information available to the Service, an

employee of the Service has developed a good-faith belief that some tax would have been due had a correct return been filed.

DISCUSSION

Section 6159 authorizes the Service to enter into agreements for the payment of taxes in installments. I.R.C. § 6159(a). That section also determines the extent to which such agreements will remain in effect. Subsection 6159(b) states: "Except as otherwise provided in this subsection, any agreement entered into by the Secretary under subsection (a) shall remain in effect for the term of the agreement." I.R.C. § 6159(b)(1). That subsection goes on to enumerate the grounds for which the Service may alter, modify, or terminate agreements. As we stated in our prior memorandum, because failure to file a return is not listed among these exclusive reasons for termination, an agreement may not be terminated solely for a subsequent failure to file a return. However, an agreement may be terminated for failure "to pay any other tax liability at the time such liability is due." I.R.C. § 6159(b)(4)(B). We turn then to your question of when a tax which should have been shown on the as yet unfiled return can be considered "due" for purposes of this section.

The term "due" is not defined or given universal meaning throughout the Code. Whenever a return is required under the Code or regulations, any tax is payable at the time and place for filing that return. I.R.C. § 6151(a). Individual income tax returns must generally be filed by the 15th of April following the close of the calendar year. I.R.C. § 6072(a). Penalties for underpayment of taxes, as well as interest at the statutory rate, will begin to accrue from the required date of filing/payment. See generally I.R.C. § 6651 (penalties); I.R.C. § 6601 (interest). Reading these provisions together, it is reasonable to conclude that taxes are due on the date a return must be filed. For example, if the taxpayer files a return with a balance due, section 6159(b)(4)(B) would authorize the Service to terminate that taxpayer's installment agreement after providing the notice and administrative review required by the Code.

However, other sections of the Code call this interpretation into question in cases where no return has been filed and no assessment can be made. When an individual fails to file a return for income taxes, any tax due for that period is a deficiency as defined by the Code. See I.R.C. § 6211(a). The amount of the deficiency is computed by using zero in place of the "amount shown as the tax by the taxpayer upon his return." Treas. Reg. §301.6211-1(a). See Hartman v. Commissioner, 65 T.C. 542, 546 (1975). The Code places restrictions on the ability of the Service to assess such liabilities, providing that a statutory notice of deficiency must be issued and giving the taxpayer the right to petition the Tax Court to dispute the proposed deficiency. See I.R.C. §§ 6212(a) & 6213(a). Assessment and collection of the deficiency may not commence until the time for petitioning the

Tax Court has passed, the taxpayer has agreed to or paid the liability, or the Tax Court has rendered a determination. See I.R.C. § 6213(a)-(d).

The constraints on the Service's authority to assess when liabilities have not been agreed to by the taxpayer insure that the taxpayer will have some ability to dispute the existence or amount of the liability prior to the time that the Service may use its administrative collection powers. No one has yet suggested that the Service has the power to terminate an installment agreement prior to assessment if the liability in question was an audit deficiency. Such a practice would clearly run counter to the protections afforded by Congress to those who have a genuine dispute regarding a proposed deficiency. To conclude that the Service could consider some deficiencies to be "due" prior to assessment–and thus terminate an installment agreement–while other deficiencies are not considered due until assessment, would require a finding that these types of deficiencies are treated differently under the Code. Since the Service's ability to collect in a deficiency situation is the same regardless of whether a return has been filed, we conclude that the term "due" in section 6159(b)(4)(B) can, in the case of an unfiled return, only be interpreted as describing the time at which the liability can be assessed.

Several other considerations support this conclusion. First, and most importantly, it is possible that no tax is owed by the taxpayer whose installment agreement the Service intends to terminate. Such a taxpayer is the very person the deficiency procedure was intended to protect. We do not believe that the notice and review procedures in the installment agreement statute are a sufficient substitute for access to the Tax Court. Furthermore, we would advise against proposing the termination of installment agreements without certainty that there are sufficient grounds to do so. Proposing termination and then relying upon taxpayers to appeal and prove that no tax is due seems counter to the intent of the notice and review procedures and could subject the Service to criticism.

Second, the Code contains several provisions to deal with the problem of non-filing of tax returns. See I.R.C. § 6020(b) (authorizing Secretary to execute returns when taxpayers fail to do so); I.R.C. § 6501(c)(3) (providing that statute of limitations for assessment will not run when no return has been filed); I.R.C. § 6651(a)(1) (establishing penalty for failure to file return). While we are aware that you view these provisions as inadequate in dealing with the considerable non-filing problem faced by the Service, they show Congressional awareness of the problem and bolster the argument that Congress would have specifically authorized the Service to terminate installment agreements for failure to file if it had so intended.

Finally, the legislative history of section 6159 shows that grounds for termination of installment agreements were paramount considerations for the drafters of that section. As a primary reason for enacting that provision, a Senate report stated that, "the Code should provide standards relating to the termination of installment agreements executed by the IRS." S. Rep. 100-309, at 8 (1988). Given this

statement, we are confident in saying that Congress wished the grounds for termination to be clearly established prior to the Service taking action.

Recent changes to the Code also support this reading of Congressional intent. In 1996, as part of the Taxpayer Bill of Rights II, Congress added a provision allowing taxpayers to seek review of the decision to terminate an installment agreement. See I.R.C. § 6159(d). In the IRS Restructuring and Reform Act of 1998, the Code was amended to prohibit levy for thirty days following termination of an installment agreement, and during a timely filed appeal. See I.R.C. § 6331(k)(2)(D). These provisions support the inference that the Service should only terminate an agreement and take enforced collection action after firmly establishing that a ground for termination, as provided in section 6159(b), is present.

DP

This matter is assigned to Frederick W. Schindler, who can be reached at (202) 622-3620.