Johnson v. Commissioner, 136 T. C. 475 (2011) (United States Tax Court, 2011)

In Johnson v. Commissioner, the U. S. Tax Court upheld the IRS's rejection of Stephen Johnson's offer-in-compromise to settle his tax liabilities, affirming the agency's discretion in calculating the taxpayer's reasonable collection potential (RCP). The court found that the IRS did not abuse its discretion by including dissipated assets and projected future income in the RCP calculation, emphasizing the importance of such considerations in assessing the viability of compromise offers. This decision underscores the IRS's authority in evaluating the financial capability of taxpayers seeking to settle tax debts.

Parties

Stephen J. Johnson, the Petitioner, sought review of the IRS's determination regarding his tax liabilities for the years 1999 and 2000. The Respondent was the Commissioner of Internal Revenue.

Facts

Stephen Johnson, a former investment banker, established Asiawerks Global Investment Group, Pte. , Ltd. in Singapore in 1999. His primary income sources during the relevant years were his salary from Asiawerks and annual tribal income. Johnson had significant taxable income in 1999 and 2000, amounting to $1. 7 million and $1. 8 million, respectively, which resulted in federal income tax liabilities of $514,164 for 1999 and $565,268 for 2000. Despite filing his tax returns in 2002, Johnson paid no income tax for these years. The IRS assessed his tax liabilities and, upon Johnson's failure to pay, issued notices of federal tax lien (NFTL) and proposed levy to collect a total of $1,586,952. 45, including interest and penalties. Johnson requested a collection due process (CDP) hearing, during which he proposed multiple offers-in-compromise (OICs), which he amended several times. During the CDP proceedings, Johnson liquidated investments but did not use the proceeds to pay his tax liabilities, instead reinvesting them into Asiawerks or using them for personal expenses. The IRS ultimately rejected Johnson's final OIC of $140,000 and issued a notice of determination sustaining the lien and levy actions.

Procedural History

Johnson filed a petition with the U. S. Tax Court challenging the IRS's determination. The IRS moved for remand due to the lack of explanation in the notice of determination regarding the calculation of Johnson's RCP. The Tax Court granted the remand, and a supplemental CDP hearing was conducted. Following the remand, the IRS issued a supplemental notice of determination, again rejecting Johnson's OIC and sustaining the collection actions. The case was submitted to the Tax Court on a stipulated record.

Issue(s)

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Whether the IRS's Office of Appeals abused its discretion in rejecting Stephen Johnson's offer-in-compromise?

Whether the IRS properly included dissipated assets and projected future income in calculating Johnson's reasonable collection potential?

Rule(s) of Law

The Internal Revenue Code authorizes the Secretary to compromise civil or criminal cases arising under the internal revenue laws (26 U. S. C. § 7122(a)). The IRS may compromise a tax liability based on doubt as to collectibility if the taxpayer's assets and income are less than the full amount of the liability (26 C. F. R. § 301. 7122-1(b)(2)). An offer-in-compromise based on doubt as to collectibility will be accepted only if it reflects the taxpayer's reasonable collection potential (RCP), which is calculated by adding the net equity in the taxpayer's assets to the taxpayer's monthly disposable income multiplied by the number of months remaining in the statutory period for collection (Rev. Proc. 2003-71, § 4. 02(2)). Dissipated assets may be included in the RCP calculation if the taxpayer cannot substantiate their use for necessary living expenses (IRM pt. 5. 8. 5. 5(1)).

Holding

The U. S. Tax Court held that the IRS did not abuse its discretion in rejecting Johnson's offer-in-compromise and sustaining the proposed collection actions. The court affirmed the IRS's inclusion of dissipated assets and future income potential in calculating Johnson's RCP, finding that Johnson failed to substantiate that the dissipated assets were used for necessary living expenses and that his projected future income was reasonably calculated.

Reasoning

The Tax Court's reasoning focused on the IRS's discretion in evaluating OICs and calculating RCP. The court noted that the IRS's decision to reject an OIC is reviewed for abuse of discretion, and it will not be disturbed unless it is arbitrary, capricious, or without sound basis in fact or law. The court found that Johnson's repeated amendments and withdrawal of his OICs indicated that he was no longer offering the previously proposed amounts, thus justifying the IRS's non-acceptance of those offers. Regarding the calculation of RCP, the court upheld the IRS's inclusion of dissipated assets, such as the proceeds from Johnson's investment liquidations, because Johnson failed to provide documentation substantiating their use for necessary living expenses. The court also upheld the IRS's calculation of Johnson's future income potential, considering his professional background and earning history, and found that the IRS reasonably disallowed certain expenses, such as a monthly loan payment, due to lack of substantiation. The court rejected Johnson's arguments that the IRS reneged on any deal and that the length of the CDP proceedings constituted an abuse of discretion, emphasizing that the IRS's actions

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were within its authority and justified by Johnson's changing financial circumstances and failure to provide required documentation.

Disposition

The U. S. Tax Court entered a decision for the respondent, allowing the IRS to proceed with collection actions against Stephen Johnson's outstanding tax liabilities.

Significance/Impact

Johnson v. Commissioner reaffirms the IRS's discretion in evaluating offers-in-compromise and calculating reasonable collection potential. The case highlights the importance of taxpayers providing complete and current financial information during CDP hearings, especially regarding the use of dissipated assets and the substantiation of expenses. The decision also clarifies that settlement officers lack the authority to accept OICs, and that the IRS's consideration of future income potential is a legitimate factor in assessing a taxpayer's ability to pay. This ruling serves as a reminder to taxpayers of the need to engage fully and transparently with the IRS during the OIC process to avoid the inclusion of dissipated assets in their RCP calculation.

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