Kreit Mechanical Associates, Inc. v. Commissioner of Internal Revenue, 137 T. C. 123 (2011)

In Kreit Mechanical Associates, Inc. v. Commissioner, the U. S. Tax Court upheld the IRS's rejection of an offer-in-compromise for unpaid employment taxes, ruling that the IRS did not abuse its discretion. The taxpayer, a plumbing subcontractor, argued that its accounts receivable should be heavily discounted, but the court found the IRS's valuation reasonable given the company's financial growth and failure to provide complete documentation, affirming the IRS's decision to proceed with collection actions.

Parties

Kreit Mechanical Associates, Inc. (Petitioner) v. Commissioner of Internal Revenue (Respondent). Kreit Mechanical Associates, Inc. was the plaintiff at the trial level in the U. S. Tax Court. The Commissioner of Internal Revenue was the defendant at the trial level and respondent on appeal.

Facts

Kreit Mechanical Associates, Inc. , a commercial plumbing subcontractor, owed employment taxes, penalties, and interest for the third quarter of 2005 and all four quarters of 2006. After receiving a Final Notice and Notice of Intent to Levy from the IRS on May 29, 2007, Kreit requested a collection due process (CDP) hearing and proposed an offer-in-compromise (OIC) based on doubt as to collectibility. The OIC offered $369,192. 27 payable over 120 months. Kreit listed its accounts receivable at $250,000, a significant discount from their face value of $1,065,408, arguing that the receivables were subject to industry-standard adjustments and joint check payments to suppliers. The IRS, represented by Settlement Officer Alicia A. Flores, reviewed Kreit's financial information, including its profit and loss statements, which showed net income of $412,218 in 2008. Officer Flores rejected the OIC, citing Kreit's failure to provide complete financial information, its net income, and the value of its accounts receivable at face value, which suggested more could be collected than the OIC amount. Kreit subsequently filed a petition with the U. S. Tax Court challenging the IRS's determination.

Procedural History

After receiving the Final Notice and Notice of Intent to Levy on May 29, 2007, Kreit Mechanical Associates, Inc. requested a CDP hearing on June 26, 2007, and proposed an OIC. The IRS Appeals Office received the OIC on September 4, 2007, and after several requests for additional information, rejected the OIC on April 1, 2009. On May 22, 2009, the Appeals Office issued a Notice of Determination Concerning Collection Action(s), upholding the decision to proceed with the levy. Kreit timely filed a petition with the U. S. Tax Court on June 16, 2009. The Tax Court denied the IRS's motion for summary judgment and motion in limine to exclude

© 2025 SCOTUSreports.com. All rights reserved.

expert testimony, and after a trial on June 16, 2010, upheld the IRS's determination on October 3, 2011.

Issue(s)

Whether the IRS Appeals Officer abused her discretion in rejecting Kreit Mechanical Associates, Inc. 's offer-in-compromise and determining that the proposed collection action was appropriate?

Rule(s) of Law

The court applies an abuse of discretion standard when reviewing an IRS determination to reject an offer-in-compromise. *See Murphy v. Commissioner*, 125 T. C. 301, 320 (2005), aff'd, 469 F. 3d 27 (1st Cir. 2006). An abuse of discretion occurs if the decision is arbitrary, capricious, or without sound basis in fact or law. *See Woodral v. Commissioner*, 112 T. C. 19, 23 (1999). The IRS may compromise a tax liability on the basis of doubt as to collectibility if the liability exceeds the taxpayer's reasonable collection potential. *See Murphy v. Commissioner*, 125 T. C. 301, 309-310 (2005).

Holding

The U. S. Tax Court held that the IRS Appeals Officer did not abuse her discretion in rejecting Kreit Mechanical Associates, Inc. 's offer-in-compromise and determining that the proposed collection action was appropriate, given the taxpayer's financial information, net income, and the valuation of its accounts receivable.

Reasoning

The court reasoned that the IRS's rejection of Kreit's OIC was not an abuse of discretion. The court found that Officer Flores considered all relevant financial information provided by Kreit, including its net income of $412,218 in 2008, which indicated that more than the OIC amount could be collected. The court also noted that Kreit failed to provide complete documentation, such as bank statements and personal financial information, which could have affected the valuation of its assets. Regarding the valuation of accounts receivable, the court observed that Kreit's own billing methodology already accounted for adjustments like change orders and retention, and Officer Flores's decision to value the receivables at face value was not arbitrary or capricious. The court further emphasized that the IRS has no binding duty to negotiate with a taxpayer before rejecting an OIC. The court concluded that Officer Flores's determination was based on a reasonable evaluation of Kreit's financial situation and did not constitute an abuse of discretion.

Disposition

The U. S. Tax Court entered a decision for the respondent, affirming the IRS's determination to proceed with the proposed levy.

© 2025 SCOTUSreports.com. All rights reserved.

Significance/Impact

The Kreit Mechanical Associates, Inc. v. Commissioner case underscores the deference given to IRS determinations in rejecting offers-in-compromise under an abuse of discretion standard. It highlights the importance of taxpayers providing complete and accurate financial information to support their OIC proposals. The case also clarifies that the IRS's valuation of a taxpayer's assets, including accounts receivable, will be upheld if it has a sound basis in fact and law, even if the taxpayer disagrees with the valuation methodology. This decision has implications for tax practitioners advising clients on OIC submissions and underscores the need for thorough documentation and justification of proposed asset valuations. Subsequent cases have cited Kreit for its application of the abuse of discretion standard and its guidance on the IRS's discretion in evaluating OICs.

© 2025 SCOTUSreports.com. All rights reserved.