Isley v. Commissioner, 141 T. C. 349 (2013)

In Isley v. Commissioner, the U. S. Tax Court ruled that the IRS could not unilaterally accept an offer-in-compromise (OIC) for tax liabilities that had been referred to the Department of Justice (DOJ) for criminal prosecution, affirming DOJ's exclusive authority over such cases. The court also rejected the taxpayer's argument to offset prior payments against his liabilities, upholding prior judicial decisions. However, it remanded the case for further consideration of collection alternatives, suggesting potential negotiation with DOJ's approval.

Parties

Ronald Isley, as the petitioner, sought relief from the Commissioner of Internal Revenue, the respondent, regarding notices of federal tax lien and notices of levy issued against him for unpaid taxes.

Facts

Ronald Isley, a founding member of the Isley Brothers, failed to pay federal income taxes on much of his income from the group's music career. The IRS attempted to collect unpaid taxes for most years between 1971 and 1995 through two bankruptcy proceedings. Isley was convicted of tax evasion and willful failure to file for tax years 1997-2002, leading to a prison sentence and a three-year probationary period during which he was required to discharge his tax liabilities. After his second bankruptcy, Isley unsuccessfully sought a refund of collected amounts, arguing they should have been offset by payments from the first bankruptcy. The IRS issued notices of federal tax lien and notices of levy covering the assessed liabilities for the conviction years plus 2003, 2004, and 2006. Isley requested a collection due process (CDP) hearing, resulting in an offer-in-compromise (OIC) that was preliminarily accepted but later rejected by an Appeals officer, following a review by an IRS Chief Counsel attorney.

Procedural History

Isley filed for bankruptcy twice, first in New Jersey in 1984 and later in California in 1997, both under Chapter 11 and converted to Chapter 7. The IRS filed proofs of claim in both proceedings, collecting substantial amounts. Isley challenged these collections through a refund suit, which was dismissed on grounds including res judicata and lack of standing. Following his criminal conviction, the IRS issued notices of federal tax lien and notices of levy, leading Isley to request a CDP hearing. The Appeals officer initially accepted Isley's OIC but rejected it after a review by the IRS Chief Counsel attorney. Isley then filed a petition with the U. S. Tax Court, challenging the rejection of his OIC and the offset issue.

Issue(s)

1. Whether I. R. C. § 7122(a) barred the IRS Appeals officer from unilaterally accepting Isley's OIC?

2. Whether the involvement of the IRS Chief Counsel attorney in the rejection of the OIC violated the impartiality requirement of I. R. C. § 6330(b)(3)?
3. Whether the IRS Chief Counsel attorney's communications with non-Appeals IRS personnel constituted improper ex parte communications?
4. Whether the Tax Court has jurisdiction to consider the offset issue, and if so, should it be resolved in Isley's favor?
5. If the rejection of the OIC is upheld, whether the Tax Court should order the return of Isley's 20% partial payment under I. R. C. § 7122(c)?

Rule(s) of Law

I. R. C. § 7122(a) provides that the IRS may compromise civil or criminal cases before referral to the DOJ, while the Attorney General may do so after referral. I. R. C. § 6330(b)(3) mandates that a CDP hearing be conducted by an officer with no prior involvement in the taxpayer's case. I. R. C. § 6330(c)(2)(B) and (c)(4)(A) limit the issues that can be raised during a CDP hearing if the taxpayer had a prior opportunity to dispute the liability or if the issue was previously considered in another proceeding. I. R. C. § 7122(c) requires a 20% payment with a lump-sum OIC, which is nonrefundable under normal circumstances.

Holding

The Tax Court held that: 1) I. R. C. § 7122(a) barred the IRS Appeals officer from unilaterally accepting Isley's OIC; 2) The IRS Chief Counsel attorney's involvement did not violate the impartiality requirement; 3) There were no improper ex parte communications; 4) The Tax Court lacked jurisdiction over the offset issue due to prior judicial decisions; 5) Isley was not entitled to a refund of his 20% partial payment.

Reasoning

The court reasoned that I. R. C. § 7122(a) clearly restricts the IRS's authority to compromise liabilities after referral to the DOJ, thus preventing unilateral acceptance of Isley's OIC. The involvement of the IRS Chief Counsel attorney in reviewing the OIC was proper under I. R. C. § 7122(b), and did not make him a de facto Appeals officer, thereby not violating the impartiality requirement of I. R. C. § 6330(b)(3). The court found no improper ex parte communications because the attorney was not an Appeals employee. Regarding the offset issue, the court ruled it was barred by I. R. C. § 6330(c)(2)(B) and (c)(4)(A) due to Isley's prior opportunity to dispute his liabilities in bankruptcy and the issue being previously considered in his refund suit. The 20% partial payment was deemed nonrefundable under I. R. C. § 7122(c), as there was no evidence of false representation or fraudulent inducement by the IRS. The court emphasized the importance of respecting DOJ's exclusive authority over cases referred for criminal prosecution, while also acknowledging the need for the IRS to explore less intrusive collection alternatives, leading to a remand for further consideration of a new OIC or installment agreement.

Disposition

The court affirmed the IRS's decision not to withdraw the notices of federal tax lien and rejected the determination to sustain the notices of levy, remanding the case to the IRS Appeals office to explore the possibility of a new OIC or installment agreement, subject to DOJ approval.

Significance/Impact

This case reinforces the primacy of the Department of Justice in compromising tax liabilities referred for criminal prosecution, clarifying the IRS's limited authority in such situations. It also underscores the importance of the IRS exploring less intrusive collection alternatives, as required by I. R. C. § 6330(c)(3)(C). The ruling on the offset issue reaffirms the finality of bankruptcy court determinations and the application of res judicata in tax disputes. The case's impact extends to future tax collection efforts, emphasizing the need for coordination between the IRS and DOJ in cases involving criminal tax prosecutions.

