957(a). D Corp satisfies the requirements of section 953(e)(3) and is a qualifying insurance company. D Corp is a 40 percent partner of DJ Partnership, a Country G partnership. DJ Partnership is a qualified business unit of D Corp, within the meaning of section 989(a), and is licensed by the applicable insurance regulatory body for Country G to sell insurance to persons other than related persons in its home country within the meaning of section 953(e)(4)(A). DJ Partnership receives income from persons who are not related persons, within the meaning of section 954(d)(3), from investments that satisfy the requirements of section 954(i)(2). D Corp's distributive share of DJ Partnership's income from investments that satisfy the requirements of section 954(i)(2) will not be treated as foreign personal holding company income because D Corp will satisfy the special rule of section 954(i) for income derived in the active conduct of insurance business. DJ Partnership is a qualifying insurance company branch within the meaning of section 953(e)(4) and its income is qualified insurance income within the meaning of section 954(i)(2). D Corp does not have any foreign personal holding company income as a result of its distributive share of DJ Partnership income that is attributable to the partnership's qualifying insurance income.

(iv) [Reserved].

(v) *Effective date.* This paragraph (a)(5) applies to taxable years of a controlled foreign corporation beginning on or after July 23, 2002.

* * * * *

6. In § 1.954–3, paragraph (a)(6) is added to read as follows:

§ 1.954–3 Foreign base company sales income.

(a) * * *

(6) *Special rule applicable to distributive share of partnership income*—(i) *In general.* To determine the extent to which a controlled foreign corporation's distributive share of any item of gross income of a partnership would have been foreign base company sales income if received by it directly, under § 1.952–1(g), the property sold will be considered to be manufactured, produced or constructed by the controlled foreign corporation, within the meaning of paragraph (a)(4) of this section, only if the manufacturing exception of paragraph (a)(4) of this section would have applied to exclude the income from foreign base company sales income if the controlled foreign corporation had earned the income directly, determined by taking into account only the activities of, and property owned by, the partnership and not the separate activities or property of the controlled foreign corporation or any other person.

(ii) *Example.* The application of paragraph (a)(6)(i) of this section is illustrated by the following example:

Example. CFC, a controlled foreign corporation organized under the laws of Country A, is an 80 percent partner in Partnership X, a partnership organized under the laws of Country B. Partnership X performs activities in Country B that would constitute the manufacture of Product O, within the meaning of paragraph (a)(4) of this section, if performed directly by CFC. Partnership X, through its sales offices in Country B, then sells Product O to Corp D, a corporation that is a related person with respect to CFC, within the meaning of section 954(d)(3), for use within Country B. CFC's distributive share of Partnership X's sales income is not foreign base company sales income because the manufacturing exception of paragraph (a)(4) of this section would have applied to exclude the income from foreign base company sales income if CFC had earned the income directly.

(iii) *Effective date.* This paragraph (a)(6) applies to taxable years of a controlled foreign corporation beginning on or after July 23, 2002.

* * * * *

7. In § 1.954–4, paragraph (b)(2)(iii) is added to read as follows:

§ 1.954–4 Foreign base company services income.

* * * * *

(b) * * *

(2) * * *

(iii) *Special rule applicable to distributive share of partnership income.* A controlled foreign corporation's distributive share of a partnership's services income will be deemed to be derived from services performed for or on behalf of a related person, within the meaning of section 954(e)(1)(A), if the partnership is a related person with respect to the controlled foreign corporation, under section 954(d)(3), and, in connection with the services performed by the partnership, the controlled foreign corporation, or a person that is a related person with respect to the controlled foreign corporation, provided assistance that would have constituted substantial assistance contributing to the performance of such services, under paragraph (b)(2)(ii) of this section, if furnished to the controlled foreign corporation by a related person. This paragraph (b)(2)(iii) applies to taxable years of a controlled foreign corporation beginning on or after July 23, 2002.

* * * * *

8. In § 1.956–2, paragraph (a)(3) is added to read as follows:

§ 1.956–2 Definition of United States property.

(a) * * *

(3) *Property owned through partnership.* For purposes of section 956, if a controlled foreign corporation is a partner in a partnership that owns property that would be United States property, within the meaning of paragraph (a)(1) of this section, if owned directly by the controlled foreign corporation, the controlled foreign corporation will be treated as holding an interest in the property equal to its interest in the partnership and such interest will be treated as an interest in United States property. This paragraph (a)(3) applies to taxable years of a controlled foreign corporation beginning on or after July 23, 2002.

* * * * *

David A. Mader,

Deputy Commissioner of Internal Revenue.

Approved: July 16, 2002.

Pamela F. Olson,

Acting Assistant Secretary of the Treasury.

[FR Doc. 02–18453 Filed 7–22–02; 8:45 am]

BILLING CODE 4830–01–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 301

[TD 9007]

RIN 1545–AW87

Compromise of Tax Liabilities

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations relating to the compromise of internal revenue taxes. The regulations adopt the rules of the temporary regulations and reflect changes to the law made by the Internal Revenue Service Restructuring and Reform Act of 1998 and the Taxpayer Bill of Rights II.

EFFECTIVE DATE: These regulations are effective July 18, 2002.

FOR FURTHER INFORMATION CONTACT: Frederick W. Schindler, (202) 622–3620 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains final regulations amending the Procedure and Administration Regulations (26 CFR part 301) under section 7122 of the Internal Revenue Code (Code). The regulations reflect the amendment of section 7122 by section 3462 of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 1998), Public Law 105–206 (112 Stat. 685, 764) and by section 503 of the Taxpayer Bill of Rights II, Public Law 104–168 (110 Stat. 1452, 1461).

As amended by RRA 1998, section 7122 provides that the Secretary will develop guidelines to determine when an offer to compromise is adequate and should be accepted to resolve a dispute. The legislative history accompanying RRA 1998 explains that Congress intended that, in certain circumstances, factors such as equity, hardship, and public policy be taken into account by the IRS in evaluating whether the compromise of individual tax liabilities would promote effective tax administration. H. Conf. Rep. 599, 105th Cong., 2d Sess. 289 (1998). On July 21, 1999, temporary regulations (TD 8829; 64 FR 39020) and a notice of proposed rulemaking (REG–116991–98; 64 FR 39106) reflecting these changes were published in the **Federal Register**. Four written comments on the temporary and proposed regulations were received. A public hearing on the regulations was requested but that request was later withdrawn. No public hearing was scheduled or held. The final regulations adopt the rules of the temporary regulations with minor changes.

Explanation of Provisions

A compromise is an agreement between a taxpayer and the Government that settles a tax liability for payment of less than the total amount determined and assessed. Consistent with its mission of applying the tax laws with integrity and fairness to all, the IRS generally expects that all taxpayers will pay the total amount due, regardless of amount. See Policy Statement P–5–2, Collecting Principles (Approved February 17, 2000), reprinted at IRM 1.2.1.5.2. When attempting to resolve a tax delinquency, the IRS will work with taxpayers to achieve full payment of all tax, penalties, and interest imposed by Congress. Where payment in full cannot immediately be achieved, the IRS may, at its discretion, allow taxpayers to pay over time through installment agreements.

The IRS recognizes that it is both sound business practice and good tax policy to settle some cases for less than the total amount due. Prior to issuance of the temporary regulations, the IRS had a longstanding practice of compromising where there was doubt as to the existence or amount of the tax liability or doubt that the total amount due could be collected. The final regulations continue these traditional grounds for compromise. In addition, to reflect the changes made by RRA 1998, the final regulations allow compromise where there is no doubt as to liability or as to collectibility, but where compromise would promote effective tax administration because either (1) collection of the liability would create economic hardship, or (2) compelling public policy or equity considerations provide a sufficient basis for compromising the liability. Compromise based on these hardship and public policy/equity bases, however, may not be authorized if compromise would undermine compliance with the tax laws.

Effective Tax Administration—Economic Hardship

The final regulations retain the reference in the temporary regulations to the economic hardship standard of § 301.6343–1, which defines economic hardship as the inability to pay reasonable basic living expenses. In determining reasonable basic living expenses, § 301.6343–1 directs the IRS to consider relevant information such as the taxpayer's age, employment status and history, number of dependents, and other ''unique circumstances.'' The final regulations supplement this standard by providing a non-exclusive list of factors which support a finding of economic hardship, and by providing examples to illustrate application of the standard.

The fourth example of economic hardship in the temporary regulations, involving a business taxpayer, has been removed in order to eliminate an inconsistency. The economic hardship standard of § 301.6343–1 specifically applies only to individuals. The fourth example was included in the temporary regulations in the event that a standard for evaluating economic hardship with respect to non-individuals could be developed. After evaluating this issue further, the IRS and Treasury Department have concluded that an economic hardship standard for non-individuals does not necessarily promote effective tax administration. Permitting compromise in non-individual cases where there is no doubt as to collectibility, for instance, would raise the issue of whether the Government should be foregoing the collection of taxes to support a nonviable business.

Although economic hardship therefore is not a basis for compromise for non-individuals under the final regulations, IRS experience has shown that the doubt as to collectibility standard often may permit the resolution of cases involving businesses and other non-individual taxpayers. In addition, even if a business or other non-individual is unable to compromise on liability or collectibility grounds, compelling public policy or equity considerations (discussed below) may provide sufficient grounds to compromise the case.

A commenting party suggested that the economic hardship standard and examples were not inclusive enough, specifically stating that the first two examples of economic hardship in the temporary regulations were drawn too narrowly. The first example illustrating economic hardship described a taxpayer whose assets and income are likely to be exhausted caring for a dependent child. The commenting party believed that the regulations would better promote effective tax administration if the example were expanded to include care of a dependent parent or other family member. The second example described a retired taxpayer whose only income is from a pension and whose only asset is a retirement account. The taxpayer could pay the tax liability in full by liquidating his retirement account, but doing so would leave the taxpayer without adequate means of support. The commenting party suggested that the example should specifically state that the age of the taxpayer should be taken into account. Otherwise, a taxpayer close to retirement age may feel compelled to retire so as to eliminate other sources of income and qualify under this example since retirement funds would then be the only source of income. A second commenting party also suggested that the moral or legal obligation to support others be listed as a factor supporting a finding of economic hardship.

The final regulations adopt these suggestions, in part, by stating that one factor supporting a finding of economic hardship might be that all available funds are used for the care of a dependent. Although the final regulations include examples to illustrate the application of the economic hardship standard, the central inquiry is whether full collection of the liability would render the taxpayer unable to provide for reasonable basic living expenses. Facts such as the number of dependents and the age and health of taxpayers and their dependents are factors which § 301.6343–1 provides should be considered when making that economic hardship determination. Furthermore, the examples in the final regulations are not intended to be exclusive and should not be read to suggest that all of the facts discussed in a given example must be present in a case in order for compromise to be authorized.

Effective Tax Administration—Public Policy and Equity

The temporary regulations provided that the IRS may compromise a liability to promote effective tax administration even if no other basis for compromise is available. (As discussed above, compromise on the basis of economic hardship is not available to non-individuals under the final regulations.) The temporary regulations provided that the IRS may compromise under the non-hardship effective tax administration standard to promote effective tax administration when, ''[r]egardless of the taxpayer's financial circumstances, exceptional circumstances exist such that collection of the full liability will be detrimental to voluntary compliance by taxpayers.''

The ''detrimental to voluntary compliance'' standard in the temporary regulations was intended to indicate that the IRS may compromise in those rare cases where collection of the full liability would adversely affect the overall tax system. Based on public comments and on IRS experience in implementing the temporary regulations, this standard has been restated in the final regulations to clarify the types of cases that may qualify for compromise on these grounds. Compromise under the non-hardship effective tax administration standard in the final regulations, however, still is expected to be appropriate only in those rare cases where collection would adversely affect the overall tax system.

Under the final regulations, a taxpayer seeking to compromise a liability on this basis must identify compelling public policy or equity considerations providing a sufficient basis for compromising the liability. The circumstances must be such that compromise is justified even though a similarly situated taxpayer may have paid his liability in full. Before accepting an offer based on equity and public policy considerations, the IRS must conclude that collection of the full liability would undermine public confidence that the tax laws are being administered in a fair and equitable manner.

The clarification to the non-hardship effective tax administration standard in the final regulations recognizes that compromise on these grounds raises the issue of disparate treatment of taxpayers who are able to pay the full amount of their liabilities without economic hardship. Some taxpayers will pay less than the full amount owed, while others must pay in full. (Some taxpayers who pay in full also may be in situations similar to that of the taxpayer requesting compromise.) Accordingly, the final regulations specify that a taxpayer must demonstrate that the circumstances of the taxpayer's liability implicate public policy or equity concerns compelling enough to justify compromise notwithstanding this inherent inequity. As noted earlier, the cases satisfying the equity and public policy standard are expected to be rare. In applying this standard, the IRS will presume that the correct application of the tax laws produces a fair and equitable result, absent exceptional circumstances.

The notice of proposed rulemaking specifically encouraged the public to make comments or provide examples regarding the particular types of cases or situations in which the Secretary's authority to compromise should be used because: (1) Collection of the full amount of tax liability would be detrimental to voluntary compliance (i.e., may be appropriate for compromise under the non-hardship effective tax administration standard) or (2) IRS delay in determining the tax liability has resulted in the accumulation of significant interest and penalties. Parties providing comments regarding delay in interest and penalty cases were asked to consider the possible interplay between cases compromised under this provision and the relief accorded taxpayers under section 6404(e).

Two parties submitted comments in response to this request. Both suggested that the regulations be expanded to authorize compromise in situations where delay in determining the taxpayer's liability caused substantial interest and penalties to accrue. The first suggested that compromise on the basis that collection in full would be detrimental to voluntary compliance was warranted when any undue delay by the IRS resulted in the accumulation of penalties and interest. The commenting party suggested that the regulations include delay by the IRS in determining the taxpayer's liability, issuing a revenue agent's report or notice of deficiency, or litigating the issues as factors and examples supporting compromise on these grounds. The commenting party did not suggest a standard for determining ''undue delay'' and did not discuss whether this kind of expansion of the compromise regulations would undermine the interest abatement provisions of section 6404(e).

The second party to comment on this provision in the regulations suggested compromise should be authorized where a liability results from factors beyond the taxpayer's control and the accumulation of interest and penalties is disproportionately large compared to the initial liability. The specific example suggested by the commenting party was one in which the Tax Matters Partner (TMP) in a partnership subject to the unified audit procedures of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) fraudulently sells shares in a sham business to other partners and those partners incur substantial interest and penalties attributable to partnership items. According to the commenting party, the failure of the IRS to remove a TMP being investigated for fraud relating to the partnership, and to allow the TMP to continue to represent the partnership during the audit, creates ''exceptional circumstances'' warranting compromise with other partners. The commenting party acknowledged that section 6404(e) would not usually authorize the abatement of interest under such circumstances because the interest does not result from an unreasonable error or delay by an IRS official in performing a ministerial or managerial act. The commenting party also acknowledged that it would be unwise to craft a rule that would make the Government an insurer of individual taxpayer liabilities attributable to the misdeeds of a tax shelter promoter. However, the commenting party believed that where the IRS's failure to remove the TMP contributed to the problem, compromise is warranted.

The IRS and Treasury Department do not believe that it would promote effective tax administration to authorize compromise solely on the basis of an asserted delay by the IRS, particularly delay that does not support relief under section 6404(e) with respect to accrued interest, or on the basis that a third party, such as the taxpayer's partner, is claimed to have defrauded or otherwise caused financial harm to the taxpayer. Nevertheless, cases in which a taxpayer believes the liability was caused, in whole or in part, by delay on the part of the IRS or by the actions of third parties may be appropriate for compromise under the public policy and equity standard. Such cases, however, are expected to be rare, as the taxpayer must identify compelling public policy or equity concerns that satisfy the standard set forth above.

The IRS and Treasury Department are mindful that the Congressional Conference Committee, in adding section 7122(c) as part of RRA 1998, anticipated that the IRS may use the authority provided in section 7122(c) to resolve longstanding cases by foregoing penalties and interest resulting from delays in determining a taxpayer's liability. See H. Conf. Rep. 599, 105th Cong., 2d Sess. 289 (1998). The IRS' experience in applying the temporary regulations is that these regulations have given effect to the intent of Congress, as expressed in the

Conference Report, since cases involving substantial interest and penalties often can be compromised under the standards of doubt as to collectibility and economic hardship. Similarly, although a taxpayer is in the best position to anticipate, and protect himself or herself from, the risks of business associations and transactions, the misdeeds of third parties that may have contributed to a tax liability may be taken into account when determining whether to accept a compromise based on doubt as to collectibility or on a finding that collection would cause economic hardship.

Amount of Compromise if Basis for Compromise Exists

The final regulations set forth the permissible bases for compromise, one of which must be established in order to accept an offer to compromise liabilities arising under the internal revenue laws. They do not, however, prescribe the amount which must be offered in order for an offer to be acceptable. The amount to be paid, future compliance, or other conditions precedent to satisfaction of a liability for less than the full amount due are matters left to the discretion of the Secretary. For the sake of clarity, the final regulations now expressly state this principle, which was stated only in the preamble to the temporary regulations.

As required by section 7122(c)(2)(A) and (B), added by RRA 1998, the final regulations provide for the development and publication of national and local living allowances that permit taxpayers entering into offers to compromise to have an adequate means to provide for their basic living expenses. The determination of whether the published standards should be applied in any particular case must be based upon an evaluation of the individual facts and circumstances presented. The Secretary will continue to determine the appropriate means to publish these national and local living allowances.

A commenting party suggested that the national and local living allowance standards be eliminated in favor of a rule requiring all offer specialists to look only to an individual taxpayer's actual facts and circumstances to determine the amount necessary to provide for reasonable basic living expenses. According to the commenting party, IRS employees rarely depart from the national and local standards, which, in practice, serve as a ''cap'' on expenses, rather than as a general guide to be applied based on the specific facts of a case.

Because publication of the national and local standards is required by section 7122(c)(2)(A), the suggestion that the standards be eliminated has not been adopted. In accordance with section 7122(c)(2)(B), the final regulations require that the IRS consider the facts and circumstances of the case when determining basic living expenses. Consistent with this requirement in the statute and regulations, the IRS has issued internal guidance requiring that the particular facts and circumstance of a taxpayer's case be considered whenever the expense standards are applied, and that expense allowances beyond the standards be used whenever use of the standards would result in a taxpayer not having adequate means to provide for basic living expenses.

Other Provisions

Section 7122(c)(3)(A) prohibits the rejection of an offer to compromise by a low income taxpayer based solely on the amount of the offer. The final regulations expand this rule to apply to all taxpayers regardless of income level. The final regulations state that no offer may be rejected based solely on the amount of the offer. Offers will only be rejected when the IRS determines that no basis for compromise under this section is present or that the offer is unacceptable under the Secretary's policies and procedures.

In accordance with section 7122(d)(1), the final regulations provide that all proposed rejections of offers to compromise will receive independent administrative review prior to final rejection. Section 7122(d)(2) requires and the regulations also provide that the taxpayer may appeal any rejection of an offer to compromise to the IRS Office of Appeals. The final regulations provide, however, that when the IRS returns an offer to compromise because the offer was submitted solely to delay collection, or because the taxpayer failed to provide requested information required by the IRS to evaluate or process the offer under IRS procedures, the return of the offer does not constitute a rejection and, thus, is not subject to appeal. In the event that the IRS institutes collection action following the return of an offer to compromise, the taxpayer may have the right to consideration of the whole of his collection case under other provisions of the Code.

Although not required by any provision of the Code, the temporary regulations provided that an offer could not be returned to a taxpayer for failure to submit requested financial information until an independent administrative review of the proposed return was completed. The requirement of an independent administrative review of proposed returns was the source of significant delays and was redundant because an IRS manager must review and approve all returns of offers for failure to submit requested financial information. The final regulations therefore require review only by an IRS manager in these cases.

Pursuant to section 6331(k), the final regulations also provide that the IRS may not levy to collect a liability while an offer to compromise is pending, or for the 30 days following any rejection of an offer to compromise, or during any period that an appeal of any rejection is being considered, when such appeal is instituted within the 30 days following rejection. Levy will not, however, be precluded in any case where collection is in jeopardy or the offer to compromise was submitted solely to delay collection. The regulations also correct for an omission in the temporary regulations by providing that the IRS may not refer a case to the Department of Justice to collect an unpaid tax through a judicial proceeding while an offer to compromise that tax is pending or while a rejection of such an offer is being considered by the IRS Office of Appeals. The IRS may, however, authorize the Department of Justice to file a counterclaim in any refund proceeding commenced by a taxpayer, participate in bankruptcy or insolvency cases commenced by or against the taxpayer, or join a taxpayer in any other proceeding in which liability for the tax at issue may be established or disputed.

The final regulations also implement section 503(a) of the Taxpayer Bill of Rights II by specifying that Chief Counsel review of an accepted offer to compromise is required only for offers in compromise involving $50,000 or more in unpaid liabilities.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the preceding temporary regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Frederick W. Schindler of the Office of Associate Chief Counsel (Procedure and Administration), Collection, Bankruptcy & Summonses Division.

List of Subjects in 26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

1. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

2. Sections 301.7122–0 and 301.7122–1 are added to read as follows:

§ 301.7122–0 Table of contents.

This section lists the major captions that appear in the regulations under § 301.7122–1.

§ 301.7122–1 Compromises.

(a) *In general*—(1) If the Secretary determines that there are grounds for compromise under this section, the Secretary may, at the Secretary's discretion, compromise any civil or criminal liability arising under the internal revenue laws prior to reference of a case involving such a liability to the Department of Justice for prosecution or defense.

(2) An agreement to compromise may relate to a civil or criminal liability for taxes, interest, or penalties. Unless the terms of the offer and acceptance expressly provide otherwise, acceptance of an offer to compromise a civil liability does not remit a criminal liability, nor does acceptance of an offer to compromise a criminal liability remit a civil liability.

(b) *Grounds for compromise*—(1) *Doubt as to liability.* Doubt as to liability exists where there is a genuine dispute as to the existence or amount of the correct tax liability under the law. Doubt as to liability does not exist where the liability has been established by a final court decision or judgment concerning the existence or amount of the liability. See paragraph (f)(4) of this section for special rules applicable to rejection of offers in cases where the Internal Revenue Service (IRS) is unable to locate the taxpayer's return or return information to verify the liability.

(2) *Doubt as to collectibility.* Doubt as to collectibility exists in any case where the taxpayer's assets and income are less than the full amount of the liability.

(3) *Promote effective tax administration.* (i) A compromise may be entered into to promote effective tax administration when the Secretary determines that, although collection in full could be achieved, collection of the full liability would cause the taxpayer economic hardship within the meaning of § 301.6343–1.

(ii) If there are no grounds for compromise under paragraphs (b)(1), (2), or (3)(i) of this section, the IRS may compromise to promote effective tax administration where compelling public policy or equity considerations identified by the taxpayer provide a sufficient basis for compromising the liability. Compromise will be justified only where, due to exceptional circumstances, collection of the full liability would undermine public confidence that the tax laws are being administered in a fair and equitable manner. A taxpayer proposing compromise under this paragraph (b)(3)(ii) will be expected to demonstrate circumstances that justify compromise even though a similarly situated taxpayer may have paid his liability in full.

(iii) No compromise to promote effective tax administration may be entered into if compromise of the liability would undermine compliance by taxpayers with the tax laws.

(c) *Special rules for evaluating offers to compromise*—(1) *In general.* Once a basis for compromise under paragraph (b) of this section has been identified, the decision to accept or reject an offer to compromise, as well as the terms and conditions agreed to, is left to the discretion of the Secretary. The determination whether to accept or reject an offer to compromise will be based upon consideration of all the facts and circumstances, including whether the circumstances of a particular case warrant acceptance of an amount that might not otherwise be acceptable under the Secretary's policies and procedures.

(2) *Doubt as to collectibility*—(i) *Allowable expenses.* A determination of doubt as to collectibility will include a determination of ability to pay. In determining ability to pay, the Secretary will permit taxpayers to retain sufficient funds to pay basic living expenses. The determination of the amount of such basic living expenses will be founded upon an evaluation of the individual facts and circumstances presented by the taxpayer's case. To guide this determination, guidelines published by the Secretary on national and local living expense standards will be taken into account.

(ii) *Nonliable spouses*—(A) *In general.* Where a taxpayer is offering to compromise a liability for which the taxpayer's spouse has no liability, the assets and income of the nonliable spouse will not be considered in determining the amount of an adequate offer. The assets and income of a nonliable spouse may be considered, however, to the extent property has been transferred by the taxpayer to the nonliable spouse under circumstances that would permit the IRS to effect collection of the taxpayer's liability from such property (e.g., property that was conveyed in fraud of creditors), property has been transferred by the taxpayer to the nonliable spouse for the purpose of removing the property from consideration by the IRS in evaluating the compromise, or as provided in paragraph (c)(2)(ii)(B) of this section. The IRS also may request information regarding the assets and income of the nonliable spouse for the purpose of verifying the amount of and responsibility for expenses claimed by the taxpayer.

(B) *Exception.* Where collection of the taxpayer's liability from the assets and income of the nonliable spouse is permitted by applicable state law (e.g., under state community property laws), the assets and income of the nonliable spouse will be considered in determining the amount of an adequate offer except to the extent that the taxpayer and the nonliable spouse demonstrate that collection of such assets and income would have a material and adverse impact on the standard of living of the taxpayer, the nonliable spouse, and their dependents.

(3) *Compromises to promote effective tax administration*—(i) Factors supporting (but not conclusive of) a determination that collection would cause economic hardship within the meaning of paragraph (b)(3)(i) of this section include, but are not limited to—

(A) Taxpayer is incapable of earning a living because of a long term illness, medical condition, or disability, and it is reasonably foreseeable that taxpayer's financial resources will be exhausted providing for care and support during the course of the condition;

(B) Although taxpayer has certain monthly income, that income is exhausted each month in providing for the care of dependents with no other means of support; and

(C) Although taxpayer has certain assets, the taxpayer is unable to borrow against the equity in those assets and liquidation of those assets to pay outstanding tax liabilities would render the taxpayer unable to meet basic living expenses.

(ii) Factors supporting (but not conclusive of) a determination that compromise would undermine compliance within the meaning of paragraph (b)(3)(iii) of this section include, but are not limited to—

(A) Taxpayer has a history of noncompliance with the filing and payment requirements of the Internal Revenue Code;

(B) Taxpayer has taken deliberate actions to avoid the payment of taxes; and

(C) Taxpayer has encouraged others to refuse to comply with the tax laws.

(iii) The following examples illustrate the types of cases that may be compromised by the Secretary, at the Secretary's discretion, under the economic hardship provisions of paragraph (b)(3)(i) of this section:

Example 1. The taxpayer has assets sufficient to satisfy the tax liability. The taxpayer provides full time care and assistance to her dependent child, who has a serious long-term illness. It is expected that the taxpayer will need to use the equity in his assets to provide for adequate basic living expenses and medical care for his child. The taxpayer's overall compliance history does not weigh against compromise.

Example 2. The taxpayer is retired and his only income is from a pension. The taxpayer's only asset is a retirement account, and the funds in the account are sufficient to satisfy the liability. Liquidation of the retirement account would leave the taxpayer without an adequate means to provide for basic living expenses. The taxpayer's overall compliance history does not weigh against compromise.

Example 3. The taxpayer is disabled and lives on a fixed income that will not, after allowance of basic living expenses, permit full payment of his liability under an installment agreement. The taxpayer also owns a modest house that has been specially equipped to accommodate his disability. The taxpayer's equity in the house is sufficient to permit payment of the liability he owes. However, because of his disability and limited earning potential, the taxpayer is unable to obtain a mortgage or otherwise borrow against this equity. In addition, because the taxpayer's home has been specially equipped to accommodate his disability, forced sale of the taxpayer's residence would create severe adverse consequences for the taxpayer. The taxpayer's overall compliance history does not weigh against compromise.

(iv) The following examples illustrate the types of cases that may be compromised by the Secretary, at the Secretary's discretion, under the public policy and equity provisions of paragraph (b)(3)(ii) of this section:

Example 1. In October of 1986, the taxpayer developed a serious illness that resulted in almost continuous hospitalizations for a number of years. The taxpayer's medical condition was such that during this period the taxpayer was unable to manage any of his financial affairs. The taxpayer has not filed tax returns since that time. The taxpayer's health has now improved and he has promptly begun to attend to his tax affairs. He discovers that the IRS prepared a substitute for return for the 1986 tax year on the basis of information returns it had received and had assessed a tax deficiency. When the taxpayer discovered the liability, with penalties and interest, the tax bill is more than three times the original tax liability. The taxpayer's overall compliance history does not weigh against compromise.

Example 2. The taxpayer is a salaried sales manager at a department store who has been able to place $2,000 in a tax-deductible IRA account for each of the last two years. The taxpayer learns that he can earn a higher rate of interest on his IRA savings by moving those savings from a money management account to a certificate of deposit at a different financial institution. Prior to transferring his savings, the taxpayer submits an e-mail inquiry to the IRS at its Web Page, requesting information about the steps he must take to preserve the tax benefits he has enjoyed and to avoid penalties. The IRS responds in an answering e-mail that the taxpayer may withdraw his IRA savings from his neighborhood bank, but he must redeposit those savings in a new IRA account within 90 days. The taxpayer withdraws the funds and redeposits them in a new IRA account 63 days later. Upon audit, the taxpayer learns that he has been misinformed about the required rollover period and that he is liable for additional taxes, penalties and additions to tax for not having redeposited the amount within 60 days. Had it not been for the erroneous advice that is reflected in the taxpayer's retained copy of the IRS e-mail response to his inquiry, the taxpayer would have redeposited the amount within the required 60-day period. The taxpayer's overall compliance history does not weigh against compromise.

(d) *Procedures for submission and consideration of offers*—(1) *In general.* An offer to compromise a tax liability pursuant to section 7122 must be submitted according to the procedures, and in the form and manner, prescribed by the Secretary. An offer to compromise a tax liability must be made in writing, must be signed by the taxpayer under penalty of perjury, and must contain all of the information prescribed or requested by the Secretary. However, taxpayers submitting offers to compromise liabilities solely on the basis of doubt as to liability will not be required to provide financial statements.

(2) *When offers become pending and return of offers.* An offer to compromise becomes pending when it is accepted for processing. The IRS may not accept for processing any offer to compromise a liability following reference of a case involving such liability to the Attorney General for prosecution or defense. If an offer accepted for processing does not contain sufficient information to permit the IRS to evaluate whether the offer should be accepted, the IRS will request that the taxpayer provide the needed additional information. If the taxpayer does not submit the additional information that the IRS has requested within a reasonable time period after such a request, the IRS may return the offer to the taxpayer. The IRS may also return an offer to compromise a tax liability if it determines that the offer was submitted solely to delay collection or was otherwise nonprocessable. An offer returned following acceptance for processing is deemed pending only for the period between the date the offer is accepted for processing and the date the IRS returns the offer to the taxpayer. See paragraphs (f)(5)(ii) and (g)(4) of this section for rules regarding the effect of such returns of offers.

(3) *Withdrawal.* An offer to compromise a tax liability may be withdrawn by the taxpayer or the taxpayer's representative at any time prior to the IRS' acceptance of the offer to compromise. An offer will be considered withdrawn upon the IRS' receipt of written notification of the withdrawal of the offer either by personal delivery or certified mail, or upon issuance of a letter by the IRS confirming the taxpayer's intent to withdraw the offer.

(e) *Acceptance of an offer to compromise a tax liability.*—(1) An offer to compromise has not been accepted until the IRS issues a written notification of acceptance to the taxpayer or the taxpayer's representative.

(2) As additional consideration for the acceptance of an offer to compromise, the IRS may request that taxpayer enter into any collateral agreement or post any security which is deemed necessary for the protection of the interests of the United States.

(3) Offers may be accepted when they provide for payment of compromised amounts in one or more equal or unequal installments.

(4) If the final payment on an accepted offer to compromise is contingent upon the immediate and simultaneous release of a tax lien in whole or in part, such payment must be made in accordance with the forms, instructions, or procedures prescribed by the Secretary.

(5) Acceptance of an offer to compromise will conclusively settle the liability of the taxpayer specified in the offer. Compromise with one taxpayer does not extinguish the liability of, nor prevent the IRS from taking action to collect from, any person not named in the offer who is also liable for the tax to which the compromise relates. Neither the taxpayer nor the Government will, following acceptance of an offer to compromise, be permitted to reopen the case except in instances where—

(i) False information or documents are supplied in conjunction with the offer;

(ii) The ability to pay or the assets of the taxpayer are concealed; or

(iii) A mutual mistake of material fact sufficient to cause the offer agreement to be reformed or set aside is discovered.

(6) *Opinion of Chief Counsel.* Except as otherwise provided in this paragraph (e)(6), if an offer to compromise is accepted, there will be placed on file the opinion of the Chief Counsel for the IRS with respect to such compromise, along with the reasons therefor. However, no such opinion will be required with respect to the compromise of any civil case in which the unpaid amount of tax assessed (including any interest, additional amount, addition to the tax, or assessable penalty) is less than $50,000. Also placed on file will be a statement of—

(i) The amount of tax assessed;

(ii) The amount of interest, additional amount, addition to the tax, or assessable penalty, imposed by law on the person against whom the tax is assessed; and

(iii) The amount actually paid in accordance with the terms of the compromise.

(f) *Rejection of an offer to compromise.*—(1) An offer to compromise has not been rejected until the IRS issues a written notice to the taxpayer or his representative, advising of the rejection, the reason(s) for rejection, and the right to an appeal.

(2) The IRS may not notify a taxpayer or taxpayer's representative of the rejection of an offer to compromise until an independent administrative review of the proposed rejection is completed.

(3) No offer to compromise may be rejected solely on the basis of the amount of the offer without evaluating that offer under the provisions of this section and the Secretary's policies and procedures regarding the compromise of cases.

(4) *Offers based upon doubt as to liability.* Offers submitted on the basis of doubt as to liability cannot be rejected solely because the IRS is unable to locate the taxpayer's return or return information for verification of the liability.

(5) *Appeal of rejection of an offer to compromise*—(i) *In general.* The taxpayer may administratively appeal a rejection of an offer to compromise to the IRS Office of Appeals (Appeals) if, within the 30-day period commencing the day after the date on the letter of rejection, the taxpayer requests such an administrative review in the manner provided by the Secretary.

(ii) *Offer to compromise returned following a determination that the offer was nonprocessable, a failure by the taxpayer to provide requested information, or a determination that the offer was submitted for purposes of delay.* Where a determination is made to return offer documents because the offer to compromise was nonprocessable, because the taxpayer failed to provide requested information, or because the IRS determined that the offer to compromise was submitted solely for purposes of delay under paragraph (d)(2) of this section, the return of the offer does not constitute a rejection of the offer for purposes of this provision and does not entitle the taxpayer to appeal the matter to Appeals under the provisions of this paragraph (f)(5). However, if the offer is returned because the taxpayer failed to provide requested financial information, the offer will not be returned until a managerial review of the proposed return is completed.

(g) *Effect of offer to compromise on collection activity*—(1) *In general.* The IRS will not levy against the property or rights to property of a taxpayer who submits an offer to compromise, to collect the liability that is the subject of the offer, during the period the offer is pending, for 30 days immediately following the rejection of the offer, and for any period when a timely filed appeal from the rejection is being considered by Appeals.

(2) *Revised offers submitted following rejection.* If, following the rejection of an offer to compromise, the taxpayer makes a good faith revision of that offer and submits the revised offer within 30 days after the date of rejection, the IRS will not levy to collect from the taxpayer the liability that is the subject of the revised offer to compromise while that revised offer is pending.

(3) *Jeopardy.* The IRS may levy to collect the liability that is the subject of an offer to compromise during the period the IRS is evaluating whether that offer will be accepted if it determines that collection of the liability is in jeopardy.

(4) *Offers to compromise determined by IRS to be nonprocessable or submitted solely for purposes of delay.* If the IRS determines, under paragraph (d)(2) of this section, that a pending offer did not contain sufficient information to permit evaluation of whether the offer should be accepted, that the offer was submitted solely to delay collection, or that the offer was otherwise nonprocessable, then the IRS may levy to collect the liability that is the subject of that offer at any time after it returns the offer to the taxpayer.

(5) *Offsets under section 6402.* Notwithstanding the evaluation and processing of an offer to compromise, the IRS may, in accordance with section 6402, credit any overpayments made by the taxpayer against a liability that is the subject of an offer to compromise and may offset such overpayments against other liabilities owed by the taxpayer to the extent authorized by section 6402.

(6) *Proceedings in court.* Except as otherwise provided in this paragraph (g)(6), the IRS will not refer a case to the Department of Justice for the commencement of a proceeding in court, against a person named in a pending offer to compromise, if levy to collect the liability is prohibited by paragraph (g)(1) of this section. Without regard to whether a person is named in a pending offer to compromise, however, the IRS may authorize the Department of Justice to file a counterclaim or third-party complaint in a refund action or to join that person in any other proceeding in which liability for the tax that is the subject of the pending offer to compromise may be established or disputed, including a suit against the United States under 28 U.S.C. 2410. In addition, the United States may file a claim in any bankruptcy proceeding or insolvency action brought by or against such person.

(h) *Deposits.* Sums submitted with an offer to compromise a liability or during the pendency of an offer to compromise are considered deposits and will not be applied to the liability until the offer is accepted unless the taxpayer provides written authorization for application of the payments. If an offer to compromise is withdrawn, is determined to be nonprocessable, or is submitted solely for purposes of delay and returned to the taxpayer, any amount tendered with the offer, including all installments paid on the offer, will be refunded without interest. If an offer is rejected, any amount tendered with the offer, including all installments paid on the offer, will be refunded, without interest, after the conclusion of any review sought by the taxpayer with Appeals. Refund will not be required if the taxpayer has agreed in writing that amounts tendered pursuant to the offer may be applied to the liability for which the offer was submitted.

(i) *Statute of limitations*—(1) *Suspension of the statute of limitations on collection.* The statute of limitations on collection will be suspended while levy is prohibited under paragraph (g)(1) of this section.

(2) *Extension of the statute of limitations on assessment.* For any offer to compromise, the IRS may require, where appropriate, the extension of the statute of limitations on assessment. However, in any case where waiver of the running of the statutory period of limitations on assessment is sought, the taxpayer must be notified of the right to refuse to extend the period of limitations or to limit the extension to particular issues or particular periods of time.

(j) *Inspection with respect to accepted offers to compromise.* For provisions relating to the inspection of returns and accepted offers to compromise, see section 6103(k)(1).

(k) *Effective date.* This section applies to offers to compromise pending on or submitted on or after July 18, 2002.

§§ 301.7122–0T and 301.7122–1T [Removed]

3. Sections 301.7122–0T and 301.7122–1T, are removed.

Approved: July 15, 2002.

Charles O. Rossotti,

Commissioner of Internal Revenue.

Pamela F. Olson,

Acting Assistant Secretary of the Treasury (Tax Policy).

[FR Doc. 02–18454 Filed 7–18–02; 12:32 pm]

BILLING CODE 4830–01–P

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Parts 51 and 52

[FRL–7249–5]

Notice of Halting the Sanctions Clocks for the Commonwealth of Virginia's Failure To Submit Required State Implementation Plan for the NO_X SIP Call

AGENCY: Environmental Protection Agency (EPA).

ACTION: Determination regarding state implementation plan; notice of halting the sanctions clocks.

SUMMARY: The EPA is announcing that the State Implementation Plan (SIP) revision in response to the Nitrogen Oxides (NO_X) SIP Call submitted by the Commonwealth of Virginia (Virginia) is complete, thereby halting the sanctions clocks. Under the Clean Air Act (CAA) and EPA's NO_X SIP Call regulations, Virginia was required to submit SIP measures providing for NO_X emissions reductions, by October 30, 2000. On December 26, 2000, EPA made a finding that Virginia had failed to submit a SIP in response to the NO_X SIP Call, thus starting the 18-month and 24-month clocks, respectively, for the mandatory imposition of sanctions and the obligation for EPA to promulgate a Federal Implementation Plan (FIP). On June 30, 2002, Virginia submitted, as a SIP revision, its NO_X Budget Trading Program, in response to the NO_X SIP Call. On July 16, 2002, EPA found Virginia's SIP submission to be complete. The approval of the Virginia SIP revision in response to the NO_X SIP Call will be addressed in a separate rulemaking action.

EFFECTIVE DATE: July 23, 2002.

FOR FURTHER INFORMATION CONTACT: Rose Quinto, (215) 814–2182, or by e-mail at quinto.rose@epa.gov.

SUPPLEMENTARY INFORMATION: On October 27, 1998 (63 FR 57356), EPA published a final rule entitled, ''Finding of Significant Contribution and Rulemaking for Certain States in the Ozone Transport Assessment Group Region for Purposes of Reducing Regional Transport of Ozone,'' otherwise known as the ''NO_X SIP Call.'' On March 2, 2000 (65 FR 11222), the NO_X SIP Call rule was modified establishing emissions budgets for NO_X that each of the identified States must meet through enforceable SIP measures. Various industries and States challenged the final NO_X SIP Call rule by filing petitions for review in the U.S. Court of Appeals for the District of Columbia (D.C. Circuit). State Petitioners challenging the NO_X SIP Call filed a motion requesting the Court to stay the submission schedule until April 27, 2000. In response, in May 1999, the DC Circuit issued a stay of the SIP submission deadline pending further order of the Court. *Michigan* v. *EPA,* No. 98–1497 (D.C. Cir., May 25, 1999) (order granting stay in part). On March 3, 2000, the Court of Appeals issued an opinion, largely upholding the NO_X SIP Call regulations. On April 11, 2000, EPA filed a motion with the Court to lift the stay of the SIP submission date. The EPA requested that the Court lift the stay as of April 27, 2000. On June 22, 2000, the Court ordered that EPA allow the States 128 days from the June 22, 2000 date of the order to submit their SIPs. Therefore, SIPs were due October 30, 2000.

On December 26, 2000 (65 FR 81366), EPA issued findings of failure to officially submit complete submissions to their SIPs, including adopted rules, in response to the SIP Call. The States that received these findings are Virginia, West Virginia, Alabama, Kentucky, North Carolina, South Carolina, Tennessee, Illinois, Indiana, Michigan, Ohio, and the District of Columbia. These findings started an 18-month sanctions clock; if the State failed to make the required submittal which EPA determined to be complete within that period, the emissions offset sanction would apply in accordance with 40 CFR 51.121(n) and 52.31. If the State still had not made a complete submittal which EPA determined to be complete within six months after the sanction is imposed, limitations on the approval of Federal highway funds would apply in accordance with 40 CFR 51.212(a) and 52.31. Conversely, when EPA finds that the State has made a complete SIP submittal under the SIP Call, then the 18-month clock, or additional 6-month clock, stops and the sanctions would be lifted. In addition, CAA section 110(c) provides that EPA can promulgate a FIP immediately after making the findings, as late as two years after making the findings, or any time in between. On July 16, 2002, EPA determined that the Virginia SIP submission is complete; therefore, the sanctions clocks will not take effect.

Administrative Requirements

A. Notice and Comment Under the Administrative Procedure Act

This document is final agency action but is not subject to notice-and-comment requirements of the Administrative Procedures Act (APA), 5 U.S.C. 553(b). The EPA invokes,