Office of Chief Counsel
Internal Revenue Service
memorandum

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subject: Bond in lieu of Notice of Federal Tax Lien

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUES

Whether it is appropriate for the Service to accept a collateral agreement and bond in lieu of the Service's filing a Notice of Federal Tax Lien (NFTL)?

FACTS

The taxpayer is a privately-owned C Corp. that sells insurance and provides completion and other bonds to contractors . The Service examined the taxpayer for its tax year, and the primary issue was its method of accounting. The taxpayer agreed to a change to its accounting method and to an audit assessment for tax year . The revenue agent agreed not to impose any accuracy-related penalties, and the Service assessed the agreed deficiency in .

The taxpayer paid $ of the liability. Its financial statements show the corporation does not have the ability to currently full pay, and its sole shareholder does not have sufficient assets or equity to currently full pay. The corporation does have the ability to make monthly payments, and it proposes to pay the remaining liability over three years. The remaining liability is over $, which includes some $ of accrued interest.

The taxpayer is offering a bond from and a collateral payment agreement in lieu of the Service's filing an NFTL. The taxpayer alleges that filing an NFTL would ruin its business and prevent it from paying the taxes owed. The amount of the bond it offers is $.

The taxpayer has submitted sample payment bond language and a proposed amortization schedule for its proposed collateral payment agreement. The proposal includes interest at 3% and calls for the first payment of $ on . The taxpayer paid $ when it submitted the proposal in . The proposed payment schedule calls for 12 monthly payments of $, beginning ; then 24 monthly payments of $, beginning ; and a final payment of $ on .

LAW AND ANALYSIS

IRM 5.6.1 addresses collateral agreements, and provides in 5.6.1(1)

> A collateral agreement is executed by the taxpayer and "collateral security" ensures that the taxpayer performs the terms of the agreement. A collateral agreement is a pledge, guaranteed by security, for the performance of a certain act, i.e., payment of a delinquency or the filing of a return. A collateral agreement does not compromise the tax liability and should not be confused with collateral agreements in the context of offers in compromise.

The taxpayer is offering a collateral agreement secured by a bond from . Section 7101 provides for bonds in such form and with such sureties as may be prescribed by regulations. Treas. Reg. 301.7101-1(a) requires execution of a bond on an appropriate form prescribed by the Service and with a satisfactory surety. Treas. Reg. 301.7101-1(b)(1) provides that a surety holding a certificate of authority from the Secretary as an acceptable surety on Federal bonds is a satisfactory surety. The Treasury Department lists approved sureties on its Circular 570. is listed on Circular 570. Thus is a satisfactory surety, and the bond the taxpayer offers is satisfactory collateral surety, provided it is adequate in terms and amount.

IRM 5.6.1(5) requires that the taxpayer be advised that "failure to keep the terms of the collateral agreement will result in the IRS taking the necessary action to liquidate the collateral." IRM 5.6.1(6) includes additional terms which are required for a valid collateral agreement. The additional terms relevant to this case are:

c. A condition that the IRS intends to offset any refunds to the delinquent account covered by the agreement until accounts are paid in full or otherwise satisfied.

d. Provision that the taxpayer must remain current on filing and must not incur any further delinquencies during the term of the collateral agreement.
e. A term that the Service has a unilateral right to liquidate the collateral upon the failure to keep the terms of the agreement.

As required by IRM 5.6.1(4), the taxpayer has outlined the specific dates on which it intends to make payments. However, it proposes amortizing the liability at 3% interest, compounded monthly.

Section 6622 provides that interest on tax liabilities compounds daily. Section 6621(a)(2) provides that the underpayment interest rate is computed by adding 3% to the Federal short-term rate. Section 6621(c)(1) provides that the underpayment rate for large corporate underpayments is the Federal short-term rate plus 5%. Section 6621(c)(3)(A) defines a large corporate underpayment as any underpayment of tax by a C Corporation for any taxable period if the amount of the underpayment exceeds . The Federal short-term rate for the first and second quarters of 2012 is 0%, and the large corporate underpayment rate for the first and second quarters of 2012 is 5%. Rev. Ruls. 2011-32, 2012-8.

The taxpayer is a C Corporation, and its liability for tax year exceeds . Thus, the large corporate underpayment interest rate will apply—currently 5%.

The taxpayer's proposal includes an amortization schedule that includes a fixed interest rate, compounded monthly. However, the large corporate underpayment interest rate varies monthly, depending on the Federal short-term rate, and the Internal Revenue Code requires that interest compound daily, not monthly.[1]

Conclusion:

We conclude that a collateral agreement with a bond is appropriate under these circumstances. However, the collateral agreement should include the terms required by IRM section 5.6.1, and interest will accrue at the large corporate underpayment rate, which should be expected to vary during the term of the agreement.

[1] We note that the revenue officer's memorandum recommending acceptance of the collateral agreement states that the revenue agent agreed not to assess any accuracy-related penalties but that § 6662 penalties were assessed and are being abated. However, neither the proposed amortization schedule nor the revenue officer's memo addresses the § 6651(a)(2) failure-to-pay addition to tax, which would amount to 0.5% of the liability each month for up to 50 months, to a maximum of 25%. Have the Service and the taxpayer reached an agreement with respect to this addition? If not, this will significantly increase the amount of the taxpayer's total payments. This issue should be clearly addressed.

Please call (202) 622-3630 if you have any further questions.