DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

November 5, 2001

Number: **200210007**
Release Date: 3/8/2002
CC:PA:APJP:3
UILC: 7121.00-00

INTERNAL REVENUE SERVICE NATIONAL OFFICE CHIEF COUNSEL ADVICE

MEMORANDUM FOR CC:SBSE:4

FROM: Assistant to the Chief, Branch 3

SUBJECT: _____

This Chief Counsel Advice responds to your memorandum dated July 6, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

LEGEND

Date 1:
Taxpayer 1:
Taxpayer 2:
Date 2:
Date 3:
Date 4:
Date 5:
Date 6:
Date 7:
Date 8:
Deficiency:
Penalties:
Interest:
Pension:
Social Security:
Additional Interest:
Purchase Date:
Purchase amount:
Date 9:

Mother:
Annuity Co.:
Annuity:
Brother:
Date 10:
Date 11:
Date 12:
Date 13:
Amount:
Interest 2:
Date 14:
Basis:
Distribution:
Distribution Interest:
Date 15:

We received your request for Chief Counsel Advice concerning the Service Center's issuance of a closing letter in the above-referenced case, and the impact that closing letter has on a pending Tax Court case concerning the same taxpayers for the same year. The closing letter was issued shortly after the petitioners filed their petition in the United States Tax Court.

ISSUE

Whether the issuance of a "no-change" letter under the described circumstances requires Area Counsel to concede a pending Tax Court case in the same matter.

FACTS

On Date 1, the Service Center audited Taxpayer 1 and Taxpayer 2 by correspondence. On Date 2, Taxpayer 1 and 2 submitted their response to the Service Center, noting that they disagreed with the proposed changes.

On Date 3, the taxpayer representative wrote to the Service Center concerning the disputed transaction. On Date 4, a statutory notice of deficiency was issued to the taxpayers. On Date 5, and Date 6, the taxpayers' representative submitted additional information to the Service Center. On Date 7, the taxpayers filed the petition in the United States Tax Court. On Date 8, the Service Center issued a closing letter for the same taxpayers and tax period.

You indicate that the petitioners brought the closing letter to the attention of the Appeals office, and that this letter was not otherwise in the administrative file for this case.

In the statutory notice of deficiency dated Date 4, the Service determined a deficiency in the amount of Deficiency, and assessed penalties in the amount of Penalties. The notice of deficiency determined additional interest in the amount of Interest, pension in the amount of Pension, and social security/retirement in the amount of Social Security. Interest on the deficiency was also assessed in the amount of Additional Interest.

It is our understanding that this annuity was purchased on Purchase Date, for Purchase Amount. On Date 9, after Mother's death, Annuity Company paid Annuity. This amount was divided equally between Mother's two sons - Brother and Taxpayer 1.[1] On or about Date 10, Annuity Company sent a "corrected" Form 1099-R to the taxpayers. On the "corrected" form, Annuity Company checked box 2(b), which denoted that it had not determined the taxable amount of the gross distribution. This letter was forwarded to the Service by letter dated Date 11, by the taxpayers' representative. By letter dated Date 12, a different version of the "corrected" Form 1099-R had been submitted to the Service, one which did not have box 2(b) checked.

By correspondence dated Date 13, the preparer argued that the distribution was not taxable because the purchase price of the annuity exceeded the total funds available and paid.

We note that in the Tax Court petition, the petitioners state that:

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On Date 15, the petitioners' representative sent a letter to the Service Center, in which he attached a fax sheet from Annuity Company with a corrected Form 1099-R for 1998. The representative also attached a form which purportedly showed the original investment in the annuity to be Purchase Amount. The representative's argument that the distribution was not taxable was that because each beneficiary received less than the original investment in the annuity, they were not taxable distributions.

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[1] It is our understanding that Brother is not a party to these proceedings.

On Date 6, the representative sent another letter to the Service Center, including a "delivery statement" on the annuity.

Despite the fact that a petition was filed on Date 7, a closing letter was issued by the Service Center on Date 8. That letter provided that:

> We are pleased to tell you that, with your help, we are able to clear up the differences between your records and your payer's records. If you sent us a payment based on our proposed changes, we will refund it to you if you owe no other taxes or have no other debts the law requires us to collect.
>
> If you have already received a notice of deficiency, you may disregard it. **You won't need to file a petition with the United States Tax Court to reconsider the tax you owe. If you have already filed a petition, the Office of the District Counsel will contact you on the final closing of the case.** (Emphasis added).

You believe that the closing letter was issued in error and that in fact the explanation in the closing letter does not address several pertinent issues critical to the resolution of the case; namely, (1) the extent of prior annuity distributions to Mother during her lifetime; and, (2) the remaining undistributed investment in the contract, as opposed to earnings and capital gains, included in the final distribution to the beneficiaries.

LAW AND ANALYSIS

Section 7121(a) provides that the Secretary is authorized to enter into an agreement in writing with any person relating to the tax liability of such person (or of the person or the estate for whom he acts) in respect of any internal revenue tax for any taxable period.

Section 7121(b) provides that if such agreement is approved by the Secretary (within such time as may be stated in such agreement, or later agreed to) such agreement shall be final and conclusive, and, except upon a showing of fraud or malfeasance, or misrepresentation of a material fact - (1) the case shall not be reopened as to the matters agreed upon or the agreement modified by any officer, employee, or agent of the United States, and (2) in any suit, action, or proceeding, such agreement, or any determination, assessment, collection, payment, abatement, refund, or credit made in accordance therewith, shall not be annulled, modified, set aside, or disregarded.

In general, the issuance of a closing letter by an officer or agent of the government does not bind or estop the government from taking further action on a case. Graff

v. Commissioner, 74 T. C. 743, 762 (1980), aff'd, 673 F.2d 784 (5th Cir. 1982). Further, the Tax Court has held that "Congress has provided the exclusive means of settling a tax suit or case is by way of the procedure established in 26 U.S.C. § 7121 prescribing a formality with which it should be attested and requiring the concurrence of the Commissioner as the Delegate of the Secretary of Treasury."

Further, the Tax Court noted that "...any reliance on [a] no change letter [is] not reasonable. A no change letter, as distinguished from a closing agreement under section 7121, does not resolve a tax controversy with finality." Miller v. Commissioner, T. C. Memo. 2001-55.

In fact, the Tax Court stated that "[t]here is no statutory basis for a no-change letter, cf. section 7121 (authorizing closing agreements that are generally final and conclusive), and we are aware of no case holding that a no-change letter is binding on the Commissioner..." Nguyen v. Commissioner, T. C. Memo. 2001-41. See also, Ulanoff v. Commissioner, T. C. Memo. 1999-170 ("We observe that petitioner's position [that respondent is precluded from making an assessment for the taxable year 1982 because respondent initially issued a no-change letter for that year] is clearly contrary to well-established law that issuance of a no-change letter generally does not preclude respondent from subsequently issuing a notice of deficiency).

In order for the closing letter to be considered to be binding on the Commissioner, the elements of equitable estoppel must be met. Those elements are:

(1) conduct constituting a representation of a material fact;

(2) actual or imputed knowledge of such fact by the representor;

(3) ignorance of the fact by the representee;

(4) actual or imputed expectation by the representor that the representee will act in reliance upon the representation;

(5) actual reliance thereon; and

(6) detriment on the part of the representee.

Graff v. Commissioner, 74 T. C. 743, 761 (1980), aff'd 673 F.2d 784 (5th Cir. 1982).

Further, even if the elements of estoppel are met, the Tax Court provided that the doctrine of equitable estoppel would not preclude the Commissioner from correcting a mistake of law. Kiourtsis v. Commissioner, T. C. Memo. 1996-534. Thus, in the event the Service Center issued the no change letter improperly, the government

would not be precluded from proceeding with the litigation concerning the statutory notice of deficiency.

You note that the manual at 35.4.17.5 states that if the taxpayer files a "no change" letter with the Tax Court, the Court will consider it as a petitioner's motion for entry of decision, and that the respondent will be required to respond to that motion. You note that the manual provision goes further to state that:

> If respondent becomes aware of (and confirms) a "no change" letter before petitioner forwards a copy to the Tax Court, a stipulated decision reflecting no deficiency should be secured from petitioner and filed with the court. Alternatively, if petitioner's signature to a decision document cannot be secured, respondent may file a motion for entry of decision, attaching a copy of the "no change" letter as an exhibit to the motion.

We note that the courts have addressed the binding nature of manual provisions, and have generally found them to be only directory rather than mandatory. In Rondy, Inc. v. Commissioner, T. C. Memo. 1995-372, the Tax Court noted that "[the procedural rules] are merely directory, not mandatory, and compliance with same is not essential to the validity of a notice of deficiency." We note that the Tax Court in Rondy also pointed out that a no change letter is not the equivalent of a closing agreement under section 7121.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

[redacted]

[redacted]

[redacted]

[redacted]

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

Please call if you have any further questions.