

## Alphabet Soup for Offers In Compromise (OIC)

### I. Concept and Goals

- a. Taxpayers who have few assets and little prospect of generating sufficient income to pay a tax liability in full may be allowed to strike a settlement for less than the full amount due to settle their case.
- b. The IRS's acceptance of an offer in compromise conclusively settles the liability, absent fraud or mistake.
- c. What is the policy goal? To achieve collection of what is potentially collectible at the earliest possible time and at the least cost to the government while providing taxpayers with a fresh start toward future voluntary compliance.
- d. The IRS will compromise tax liability on three grounds:
  - i. Doubt as to liability,
  - ii. Doubt as to collectability, and
  - iii. Promotion of effective tax administration.
- e. The IRS allows taxpayers three different payment options:
  - i. A cash, lump sum offer, usually payable within 90 days;
  - ii. A short-term periodic payment offer, payable over a two-year period; and
  - iii. A deferred periodic payment offer, payable over the number of years remaining in the statute of limitations on collection.

### II. Offer in Compromise Application

- a. A taxpayer requests an offer in compromise by submitting one of two forms:
  - i. Form 656 ⇒ To request relief based on doubt as to collectability and/or effective tax administration (includes a checklist for the taxpayer to use to determine whether he is eligible to

file an offer in compromise);

ii. Form 656-L ⇒ To request relief based on doubt as to liability.

#### b. Processing Fee

i. Taxpayers must submit a \$150 processing fee for offers based on doubt as to collectability and effective tax administration. This fee does not apply to offers based on doubt as to liability.

ii. This fee is mandatory if the taxpayer earns \$24,000 or more and is single. However, it can be waived in the case of low-income taxpayers – those with income at or below 250% of the poverty rate.

iii. The processing fee is not refundable, even if the IRS declares that the offer request is incomplete or incorrect and cannot be processed.

iv. The user fee may be refunded if:

1. The IRS accepts the offer based on effective tax administration, or

2. The IRS accepts the offer because of doubt as to collectability and collection of an amount greater than that offered would create economic hardship for the taxpayer.

#### c. Down payment

i. Most taxpayers must submit a down payment before the IRS will process their application. This advance payment is generally not refundable even if the IRS rejects the taxpayer's offer request.

ii. For lump sum offers, the taxpayer must remit 20% of the amount of the lump sum offer.

iii. For periodic payment offers, the taxpayer must remit the amount of the first proposed installment and comply with her or her own proposed payment schedule while the offer is being considered.

iv. The IRS waives the down payment requirement for low-income taxpayers and for offers based on doubt as to liability.

### III. Processing the Application

a. The IRS will process an offer in compromise only if the taxpayer:

- i. Remits the required payments,
- ii. Completes the application in full,
- iii. Has filed all required tax returns, and
- iv. Is not in bankruptcy

b. If the IRS returns an offer to the taxpayer stating that it cannot be processed, can the taxpayer appeal the decision? No.

#### **IV. What happens when the IRS accepts an offer in compromise?**

a. The settlement will not be reopened unless the taxpayer has falsified information, concealed assets, or there was a mutual mistake of fact.

b. The taxpayer must agree to fully comply with all filing and payment requirements for five years from the date the IRS accepts the offer.

c. If the taxpayer fails to carry out his obligations under the agreement, the IRS can terminate the agreement and collect the originally determined liability.

d. What happens if the IRS intends to reject the taxpayer's offer in compromise?

1. First, an independent review of any proposed rejection must take place. The IRS may not reject an OIC until this independent administrative review has occurred.
2. Second, if the IRS rejects the offer, the IRS must inform the taxpayer.
3. Third, the taxpayer has the right to appeal the rejection to the IRS Appeals Division. He or she has 30 days from the date of the rejection letter to request an appeal.

#### **VI. Can IRS Chief Counsel Weigh in and provide an opinion on whether to accept or reject a taxpayer's offer in compromise?**

a. An opinion of IRS counsel is required in all cases where the unpaid tax – including interest, penalties, and additions – is \$50,000 or more.

- b. Counsel review consists of legal and policy review.
- c. Counsel's review is not a veto power, although few revenue officers would settle in the face of a negative Counsel review.

### **VII. What are collateral agreements?**

- a. The IRS may condition acceptance of an OIC on the taxpayer's execution of a collateral agreement to pay the IRS a certain percentage of his or her future income over a specified number of years.
- b. For example, if a taxpayer has the potential to significantly increase his income over a relatively short period of time, the IRS may require the taxpayer to pay over a certain percentage of future income in excess of a negotiated amount.
- c. Suppose that the taxpayer is a lawyer who has accepted a personal injury case on a contingency fee. If the case resolves within a certain number of years (i.e., 5 years), the IRS might insist that it get 25% or 50% of the amount in excess of \$100,000.
- d. The IRS does not like these agreements because they have to monitor them five years into the future.
- e. The IRS may withhold a refund from the taxpayer in the year that a collateral agreement is executed.

### **VIII. Offers based on Doubt as to Collectability**

- a. Most often accepted by IRS.
- b. Exists when the taxpayer cannot pay the full amount of tax liability owed within the remainder of the statute of limitations on collection.
- c. In evaluating offers on this basis, the IRS conducts an examination of the taxpayer's assets, liabilities, and earnings potential.
- d. What standard does the IRS use to determine whether an offer based on doubt as to collectability should be accepted? The standard is: "Does the amount reflect reasonable collection potential?"
- e. Definition of reasonable collection potential
  - i. The offer amount must exceed the sum of:

1. The taxpayer's net equity, and

2. The taxpayer's future income determined over a four or five-year period, depending upon the terms of the offer.

- ii. For example, if the taxpayer owes \$ 80,000 and the reasonable collection potential is \$30,000 but he only offers \$20,000, the taxpayer will have to increase his offer.

f. Calculating the taxpayer's equity in assets

- i. Includes:

1. Cash,

2. Amounts in checking and investment accounts,

3. Cash value of any life insurance policies, and

4. Accounts receivable

- ii. The realizable value of a taxpayer's other real and personal property is its "quick sale" value. The quick sale value is 80% of the current fair market value of the assets.

g. Calculating the taxpayer's future income

- i. When determining whether an offer should be accepted based on doubt as to collectability, the IRS may also consider a taxpayer's earnings potential and the likelihood of any increases in future income.

- ii. Basic idea: The IRS looks at both income and expenses. For income, it projects into the future what it expects the taxpayer to be earning based on his or her present situation and what it expects him or her to be doing in the future. For expenses, the IRS projects into the future what it expects the taxpayer's expenses to be.

- iii. To determine a taxpayer's future income, the IRS uses information from his or her Collection Information Statement (Form 433), in combination with estimated national and local living costs (i.e., collection financial standards). These standards are disregarded if the resulting amount would leave the taxpayer unable to provide for basic living expenses.

iv. A taxpayer's future income = taxpayer's monthly income (-) allowable expenses.

v. Allowable expenses:

1. Food, clothing;

a. Based on a national standard.

2. Out-of-pocket health care expenses;

a. Based on a national standard.

3. Housing and utilities; and

a. Based on standard living costs in the state and county in which the taxpayer lives.

4. Transportation.

a. Consists of ownership and operating costs associated with a car.

b. Ownership costs ⇒ Based on a national standard.

c. Operating costs ⇒ Based on local standards.

## **IX. Offers based on Doubt as to Liability**

a. The taxpayer does not agree that he owes the tax.

b. Given that the taxpayer has other avenues available to negotiate with the IRS over the extent of his tax liability, compromises on the basis of doubt as to liability are rare. For example, through the requirement for a notice of deficiency, taxpayers may contest liability in the Tax Court. Taxpayers may also contest liability in a refund or in a collection suit.

c. Once the liability is judicially contested, the IRS will not consider offers in compromise based upon doubt as to liability.

d. Administratively, taxpayers also have procedural rights, including invoking Appeals Office consideration, to contest liability. Nevertheless, some taxpayers have not had an effective review of their

liability for the assessed taxes. They may not owe the taxes. Therefore, they can use OICs to contest their liability for the underlying taxes.

e. Taxpayers applying for an offer in compromise based on doubt as to liability must file Form 656-L. This form does not require taxpayers to submit a Collection Financial Statement.

#### **X. Offers based on both doubt as to liability and doubt as to collectability**

a. In these combination offers, the liability issues will be considered first by either the examination or collection functions depending on the type of tax.

b. To the extent that the taxpayer is not liable for the tax, there is no reason for a complete investigation of the taxpayer's financial situation.

c. If the revenue agent determines that the taxpayer is liable for the tax, the case will be forwarded to the collection function to consider whether the tax liability is collectible.

#### **XI. Offers Based on Effective Tax Administration**

a. Even if the taxpayer has assets and income that allow him to pay the amount of tax liability owed, the IRS may still accept an offer in compromise so long as it promotes effective tax administration.

b. Compromising the tax liability could promote effective tax administration for any one of the following reasons:

i. Collection of the entire liability would cause the taxpayer economic hardship, or economic hardship might exist if the taxpayer faces a long-term illness, medical condition, or disability and it is foreseeable that his or her financial resources will be exhausted as a result. It can also cover cases where the sale or liquidation of assets to pay a tax bill would prevent the taxpayer from meeting basic living expenses.

ii. Compelling public policy or equity considerations provide a sufficient basis for compromising the liability.

1. Compromise will be justified only where collection of the full liability would undermine public confidence that the tax laws are being administered in a fair and equitable manner.

2. No ETA offer will be accepted if to do so would undermine taxpayer compliance.

c. The IRS will not accept an ETA offer if it determines that the taxpayer also qualifies for an offer based on doubt as to collectability. However, if payment of the liability would still cause the taxpayer economic hardship, the IRS may treat the offer as one based on doubt as to collectability with “special circumstances.” The same factors that the IRS takes into account when processing an ETA offer are taken into account in a special circumstances offer.

## **XII. What effect does an offer in compromise have on collection activities?**

a. Once the taxpayer submits an offer in compromise, the IRS cannot levy against his or her property while it processes the offer.

b. Collection action is postponed for 30 days following rejection of the taxpayer’s offer, and during any appeal of that rejection.

c. However, much to the chagrin of taxpayers, the Statute of Limitations for collection is tolled during any period in which the IRS is prohibited from enforcing collection.

d. If an accepted offer is payable in installments, the taxpayer may be asked to extend the statute of limitations on assessment for the period the offer remains in force.

e. During the taxable year in which the offer is accepted, the IRS will also retain any refund to which the taxpayer would otherwise be entitled and apply that refund against the taxpayer’s outstanding tax liability.

## **XIII. Appealing the rejection of an offer in compromise**

a. When to request an appeal

An appeal must be made within 30 days from the date of a rejection letter. The appeals division has no authority to consider offer in compromise appeals after the 30-day period expires.

b. What does Appeals consider?

i. Appeals considers the same administrative guidelines and requirements that collections relies on. However, the appeals process offers an opportunity for a fresh look at the computation of reasonable collection potential (RCP).

ii. Appeals will use their settlement authority in offers filed based on doubt as to liability.



iii. If a taxpayer's financial situation is complex or asset values must be verified, Appeals must ask Compliance to conduct an evaluation and send them a report. Based on this investigation, the Appeals employee will determine whether an offer is acceptable as submitted, whether the offer amount needs to be raised, or whether it must be rejected.

iv. Whether the Appeals' decision is final is based on the source of offer consideration. In an equivalent hearing, the Appeals' decision is final.