Federal (IRS) and Louisiana (LDR) Offers in Compromise

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The information presented herein is intended for educational purposes only, and provide general information and guidance with respect to the submission of Offers in Compromise (OICs) to the Internal Revenue Service (IRS) and/or Louisiana Department of Revenue (LDR). These materials should not be interpreted as providing legal or tax advice, nor construed as a recommendation as to the likelihood of success of a contemplated or pending OIC. The examples of specific outcomes included herein are provided for illustrative purposes only, and are not included as "predictions" as to how the IRS and/or LDR may perceive a contemplated or pending OIC. Although every precaution has been taken in the preparation of these materials, the presenter assumes no liability for inadvertent errors and/or omissions.

I. Overview of Federal Offers in Compromise

A. General

1. An Offer in Compromise (an "Offer", or an "OIC") is an agreement between the Taxpayer and the IRS that settles (compromises) the Taxpayer's tax liabilities for <u>less than</u> the full amount owed. Stated differently, the Taxpayer is able to satisfy his/her tax debts, *at a discount*.

2. OICs may be submitted under one of three basic frameworks, Doubt as to Collectibility, Effective Tax Administration, or Doubt as to Liability[1]:

   a) <u>Doubt as to Collectibility ("DATC")</u>: the Taxpayer owes the liabilities subject of the Offer but has insufficient assets and income to pay the full amount of the liabilities subject of the Offer;

   b) <u>Effective Tax Administration ("ETA")</u>: the Taxpayer owes the liabilities subject of Offer <u>and</u> has sufficient assets to pay the full amount of said liabilities, however, due to exceptional circumstances, requiring full payment would cause an economic hardship or would be unfair and inequitable, given the Taxpayer's circumstances; and

   c) <u>Doubt as to Liability ("DATL")</u>: the Taxpayer has a genuine

[1] Offers submitted under the Doubt as to Collectibility or Effective Tax Administration frameworks are submitted using IRS Form 656 (Offer in Compromise). Offers submitted under the Doubt as to Liability Framework are submitted using IRS Form 656-L {Offer in Compromise (Doubt as to Liability)}.

dispute as to the existence or amount of the correct tax debt. (Doubt as to liability does not exist if the tax debt has been established by a final court decision or judgment concerning the existence or amount of the tax debt or if the tax debt is based upon current law.)

3. The Service will accept an Offer (DATC) when it is unlikely that the tax liability can be collected in full, and the amount offered *reasonably reflects collection potential*.

4. The Offer (DATC) will not be accepted if the Service believes that <u>the liability can be paid in full</u> through a payment (installment) agreement or with a lump-sum payment.

5. The IRS reviews the Taxpayer's (a) income and (b) assets in its effort to make a determination of the Taxpayer's ***reasonable collection potential*** ("RCP") for purposes of Offers submitted under DATC or ETA.

6. Regardless of whether an Offer is submitted under DATC or ETA, an Explanation of Circumstances should be submitted, explaining unplanned events or special circumstances, such as serious illness, in which paying the full amount of the liabilities subject of the Offer or the Minimum Offer Amount calculated pursuant to an individual Taxpayer's Collection Information Statement might impair the Taxpayer's ability to provide for himself/herself and his/her family. Supporting documentation should be provided. Based upon a Taxpayer's special circumstances, the IRS may accept the Offer Amount proposed by the Taxpayer, and has the discretion to disregard financial analysis that might otherwise suggest that a Taxpayer has the ability to pay an increased Offer Amount or "full pay" the liabilities subject of the Offer.

7. We have witnessed the Service deviate from its calculation protocol on the basis that a Taxpayer is not <u>currently</u> realizing his/her full income potential (example: the Client is a "personal injury" attorney with big verdicts or case settlements "in the pipeline"), or if the Service "expects" that the Taxpayer may earn more in the future, than he/she is presently earning.

B. Authority/Jurisdiction of the IRS

1. The IRS may not have the authority to accept an OIC when:

   a) Questions concerning the amount of the Taxpayer's liability or the collection of a liability for all or part of the

periods the Taxpayer owes are in litigation being handled by the Department of Justice ("DOJ").

b) The federal tax liability for all or a portion of the periods the Taxpayer owes has been reduced to a judgment.[2]

c) An Offer proposed covers tax periods for which restitution has been ordered.[3] The Service cannot accept an OIC that is inconsistent with a Restitution Order, or any provision of an existing court-ordered restitution payment plan. The IRS may consider an OIC for periods for which restitution was ordered ***only if*** the defendant has paid or will pay the full amount of the restitution as part of the Offer.

d) The IRS has referred the Taxpayer's civil or criminal case to the DOJ for prosecution or defense.

e) Acceptance by the IRS is dependent upon the DOJ accepting a related Offer or settlement.

2. In some instances, the DOJ may request the case be forwarded to them for inclusion in pending litigation. However, in Doubt as to Collectibility ("DATC") Offers, the DOJ generally requests that the Field Offer Specialist conduct the investigation and make a recommendation to accept or reject the Offer. In those cases, the Field Offer Specialist will coordinate with Area Counsel to determine if the request should be worked as a courtesy investigation or if Collection has jurisdiction to process the Offer.

C. Trends

1. Our office has recently submitted Offers for amounts which would historically be considered extremely low which have, after negotiation, been accepted. Stated differently, the IRS has accepted surprisingly low amounts in settlement of significant delinquent tax debts, presumably as a result of the Government's budgetary and cash flow problems.

2. Disturbingly, on a related level, we have noticed a significant increase in processing errors by the Memphis Centralized Offer

[2] See IRM 5.8.10, *Special Case Processing,* for additional information on DOJ and docketed cases.
[3] Refer to IRM 5.1.5.18.6, *Balancing Civil and Criminal Cases – Offers in Compromise (OIC) and Restitution*.

in Compromise Unit, including:

a) The failure to make proper designations within the Service's Computer System, resulting in the erroneous issuance of Levy Notices while an Offer is under review;

b) The improper application of a Taxpayer's periodic (monthly) Offer Payments (e.g., to a previously withdrawn Offer);

c) The processing of a photocopy of a Pending Offer (the IRS Form 656 submitted by the Taxpayer) provided to the Service in response to numerous Levy Notices issued for tax periods subject of the Pending Offer, resulting in duplicated Offers (and mass confusion); and

d) The failure to properly account for the payments made by a Taxpayer, resulting in the appearance that a Taxpayer is not "in compliance" with the terms of his/her Offer (which could result in that Offer being returned without further consideration).

In all of these instances, we have been forced to expend time (and our Client's resources) in addressing these IRS-caused errors.

D. Statutory Authority

1. Code §7122 authorizes the IRS to compromise any civil or criminal case, before referral to the Justice Department for prosecution. (After a "criminal referral", only the Attorney General may authorize a compromise.)

2. The Offer must be submitted upon IRS Form 656 and must specifically identify all liabilities to be compromised, the legal grounds for compromise, the amount offered by the Taxpayer, payment terms, and other information.

E. Liabilities to be Compromised

1. An OIC (if accepted) compromises the entire assessed liability for tax, penalties, and interest for the years or periods covered by the Offer. All questions of tax liability for the years or periods covered by the agreement are conclusively settled.

2. Neither the Taxpayer nor the Government can reopen a compromised tax year or period unless there was:

    a) Falsification of information or documents;

    b) Concealment of ability to pay and/or assets; or

    c) A mutual mistake of material fact that would be sufficient to cause the agreement to be set aside or reformed.

3. Exceptions to Liabilities to be Compromised

    a) An OIC may not be appropriate in the following situations:

        (1) Unassessed Liability: The Service will not consider an Offer that is solely for a tax period or tax year that has not been assessed due to non-filing situations, unless the IRS indicates that a return has been received or an assessment is pending.[4]

        (2) Expired Liability: An OIC will not be accepted with respect to any tax liability that has become unenforceable due to the expiration of the statutory period for collecting the debt.[5]

        (3) Non-Tax Liability: Internal Revenue Code §6305 requires the Secretary of the Treasury to assess and collect certain child support obligations certified by the Secretary of Health and Human Services. The Secretary of the Treasury is not authorized to compromise these liabilities.[6]

F. IRS Form 656, *Offer in Compromise*

1. OIC requests are submitted upon IRS Form 656 (DATC) or Form 656-L (DATL).

2. The Taxpayer must agree to all the standard conditions of the agreement as they are printed upon IRS Form 656.

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[4] See IRM 5.8.1.5.1.
[5] See IRM 5.8.1.5.2.
[6] See IRM 5.8.1.5.3.

3. If the Taxpayer submits an Offer, making alterations to any of the provisions of Section 8 (Offer Terms) of IRS Form 656, the Offer will be returned, and the Service may pursue collection action with respect to the tax periods subject of that Offer.[7]

4. Each separate tax period and type of tax for which the Taxpayer is liable must be indicated upon IRS Form 656.

G. Basis for Compromise

1. When submitting an Offer, a Taxpayer must indicate the basis(es) upon which the Taxpayer proposes to compromise.

2. The statutory grounds[8] which authorize a compromise of the liability owed include:

a) Doubt as to Liability ("DATL"): The Taxpayer doesn't owe the tax. Under this authority, the Taxpayer may have an examination re-opened or otherwise revisit a "final" liability.

(1) The analysis utilized, according to the Internal Revenue Manual (Section 5.8), will consider an amount "acceptable" if the amount reasonably reflects the amount the IRS would expect to collect through litigation. This analysis would necessarily therefore include the *hazards of litigation*. Rev. Proc. 2003-71, 2003-2 C.B. 517.

(2) The IRS will waive the $186 Application Fee for Offers on this basis (DATL), or for "low income" Taxpayers. IRS Fact Sheet 2006-22.

b) Doubt as to Collectibility ("DATC"): The Taxpayer cannot pay the full amount owed.

(1) For DATC Offers, the decision to accept or reject rests upon whether the amount offered reflects the reasonable collection potential ("RCP"). {RCP is defined as ***the amount that can be collected from all available means, including administrative and judicial collection remedies***.}

[7]See IRM 5.8.1.9.5, *Standard Conditions*.
[8] Code §7122. See also Treasury Regulation §301.7122-1(b).

(2) In determining the Taxpayer's future ability to pay, full consideration should be given to the Taxpayer's overall situation including factors such as age, health, marital status, number and age of dependents, education or occupational training, work experience, and present and future employment status.

(3) The Taxpayer must demonstrate, through financial information submitted upon IRS Forms 433-A (OIC) (Collection Information Statement for Individuals, including the Self-Employed) and/or 433-B (OIC) (Collection Information Statement for Businesses) that he/she does not have the ability to pay the full amount owed.[9]

c) Doubt as to Collectibility with Special Circumstances ("DATCSC"):

(1) Offers can be considered under Doubt as to Collectibility *with Special Circumstances* when:

(a) The Taxpayer cannot fully pay the tax due;

(b) The Taxpayer has proven special circumstances that warrant acceptance of an amount less than the amount of the calculated RCP; and

(c) Stated differently, an amount less than the "Minimum Offer Amount" calculated by the IRS may be accepted, based upon a Taxpayer's Special Circumstances.

d) Effective Tax Administration ("ETA"): The IRS determines that *exceptional circumstances* exist which warrant consideration of a compromise, in cases in which full payment would create an **economic hardship**, or in which it would be unfair and inequitable for the Service to require full payment.

[9] Note that IRS Forms 656, 433-A (OIC), and 433-B (OIC) were all revised in January, 2015, and the current January 2015 versions of these Forms should be submitted with the current IRS Form 656. These Forms are available, together, along with (limited) instructions and guidance, within the IRS' Form 656-B (a "Booklet"), which can be downloaded from the IRS website. A copy of the Offer Booklet is attached hereto.

(1) Offers can be considered under Effective Tax Administration criteria when:

(a) The tax is owed and the full amount owed can be collected from the Taxpayer (i.e., the Taxpayer would not be eligible to submit an Offer based exclusively upon their inability to pay the liabilities owed);

(b) The Taxpayer has proven economic hardship or has presented facts that would support acceptance under the basis of public policy or equity; and

(c) Compromise would not undermine compliance with tax laws.

(2) For example, we previously represented a mentally-disabled Taxpayer who possessed sufficient funds to fully pay his delinquent income taxes. Our office submitted an Offer based upon ETA, since the Taxpayer could not earn additional funds, and had no means to provide for his future support, apart from the use of these funds. The IRS is sensitive to, and attempts to avoid acceptance of, Offers that, because of either the circumstances or identity of the Taxpayer, would undermine the public's confidence in the fair administration of the tax laws.

e) Successive Offers: Our office has filed, first, an Offer under Doubt as to Liability that successfully reduced the liability and, then, an Offer under Doubt as to Collectibility that resulted in compromise of the resulting debt.

3. When investigating any OIC, the Offer Examiner may consider the following issues when present, regardless of whether identified by the Taxpayer:

a) Economic Hardship: This consideration is made when a Taxpayer is unable to pay necessary basic living expenses.[10]

b) Public Policy or Equity: This consideration is made where, due to exceptional circumstances, collection in

[10] Economic Hardship is further defined in IRM 5.8.11, *Economic Hardship*.

full would undermine the public's confidence that the tax laws are being administered in a fair and equitable manner.[11]

H. The Amount Offered

1. The total amount of money offered must be indicated by the Taxpayer and must be more than zero.[12]

2. The amount offered may **not** include:

   a) Money already paid;

   b) Expected future refunds;

   c) Funds attached by levy; or

   d) Anticipated benefits from capital/net operating losses.

I. Accompanying Payment/Processability Requirements

1. In ***IR News Release 2006-106***, the Service explained how the Tax Increase Prevention and Reconciliation Act of 2006 ("TIPRA") changed its processing of Offers in Compromise.

2. Taxpayers are expected to pay the entire amount offered in as short a period of time as reasonably possible. The amounts and due dates of payments must be specified by the Taxpayer.[13]

3. There are two types of payment terms offered on Form 656 to which the Service and the Taxpayer may agree:

   a) <u>Lump Sum Offer</u>: This is any Offer proposed to be paid in full within five or fewer installments within five months of Offer acceptance.

      (1) A Taxpayer must generally make a 20% <u>non-refundable</u>, up-front payment accompanying submission of the lump-sum Offer.

      (2) For "lump sum" Offers, unaccompanied by the 20% payment, the Service will demand the deficiency by

[11] Public Policy or Equity is further defined in IRM 5.8.11, *Public Policy or Equity Grounds*.
[12] See IRM 5.8.1.9.3.
[13] See IRM 5.8.1.9.4, *Payments*.

a deadline, after which Form 656 will be returned without further processing, and the IRS will retain the $186 processing fee. The required $186 processing fee generally will reduce the assessed amounts (but not the "amount accepted" by the IRS). Code §7122(c)(2)(B).

(3) In certain cases, more flexible payment terms may be warranted, however, those payment terms may not exceed 24 months. In such case, while the Offer may be submitted and considered as a cash Offer, the RCP should be calculated as a periodic (installment) payment Offer (24 months).[14]

b) Periodic Payment/Installment Payment Offer: This is an Offer payable in six or more installments. The total installments may not exceed 24 months.

(1) Taxpayers proposing periodic payment Offers must generally make a non-refundable, up-front payment in the amount of the first proposed monthly installment, with *continuing monthly installments* while the IRS evaluates the Offer. {Certain Taxpayers may qualify for "Low-Income Certification" based upon monthly income guidelines contained within IRS Form 656 (the Offer in Compromise), excusing such Taxpayers from submitting continuing installments during the consideration of their Offer.}

(2) For "periodic payment" Offers unaccompanied by the required payment, the IRS indicates that it will return Form 656 and the $186 fee.

4. The Service indicates (in Fact Sheet 2006-22) that any Offer unaccompanied by the required payment "may be" returned as "unprocessible". Code §7122(d)(3)(c).

5. The Taxpayer is allowed to **"specify" the liability to which the required payment is to be applied if the Offer is not accepted** {Code §7122(c)}, which may be very important if, for instance, the 10 year statute of limitations for collection is approaching, or if liability of one or more Taxpayers is at issue (for instance, if

[14] See IRM 5.8.1.9.4, *Payments*, for instances in which the exception may be allowed to the five month payment requirement.

the Taxpayer may apply his/her payment to the "Trust Fund" portion under Code §6672).

6. The Taxpayer must make such specification at the time the payment is submitted, or the IRS will apply the payment as it sees fit (in the Government's best interest).

7. The Taxpayer may designate Tax Increase Prevention and Reconciliation Act of 2006 (TIPRA) payments (pre-acceptance) to a specific liability including the trust fund recovery penalty. Once the Offer has been accepted, the funds are applied in the Government's best interest, and the Taxpayer no longer has the right to designate payments.

J. Withholding Collection

1. For Offers pending on or after December 31, 1999, collection by levy on property owned by the Taxpayer is prohibited while the Offer is pending (unless collection is in jeopardy) and for 30 days thereafter, if the Offer is rejected.

a) If the Taxpayer appeals the rejection of the Offer, collection by levy is also generally prohibited while the appeal is pending.

b) Collection is generally not considered to be "in jeopardy" simply because an undisclosed asset was discovered during the investigation.

2. The prohibition on levy does not require release of a levy that was served prior to the Offer submission. The IRS may consider the Taxpayer's circumstances when making a determination of whether to release a levy or keep it in place while the Offer is pending.

a) Collection by levy is not prohibited (and the collection statute is not suspended) if the Taxpayer has filed a written notice waiving the restrictions on levy.

b) While an Offer is pending, there is no prohibition on filing Notices of Federal Tax Lien. However, unless a jeopardy situation exists, a Notice of Federal Tax Lien will usually not occur until a final determination has been made on the Offer.

c) All collection action must be suspended when a Taxpayer is

identified as being located in a Combat Zone area.

II. Investigation

A. Components of Collectibility

1. The following four components of collectibility will ordinarily be considered when calculating the RCP for (DATC) Offer purposes:

   a) **Assets**, which are defined as the amount collectible from the Taxpayer's *net realizable equity in assets*.

   b) **Future Income**, which is defined as the amount collectible from the Taxpayer's *expected future income after allowing for payment of necessary living expenses*.

      (1) Lump Sum Cash Offers – When calculating future income, a projection is made with respect to the next 12 months or the remaining statutory period, <u>whichever is less</u>.

      (2) Periodic (Installment) Payment Offers – When calculating future income, a projection is made with respect to the next 24 months or the remaining statutory period, <u>whichever is less</u>.

   c) **Amount Collectible from Third Parties**, which is defined as the amount the IRS could expect to collect from third parties through administrative or judicial action.

      (1) An example of this is an amount collectible though a transferee assessment, nominee lien, or suit to set aside a fraudulent conveyance.

   d) **Assets and/or Income which are available to the Taxpayer but which are beyond the reach of the Government**, defined as assets to which the lien will not attach, such as equity in assets located outside the country.

B. Actions Based Upon Reasonable Collection Potential

1. Once the RCP has been calculated, the case is processed as

follows:

a) If the Offer must be increased before recommending acceptance:

(1) The Offer Specialist/Offer Examiner ("OS/OE") will generally contact the Taxpayer/Power of Attorney ("POA") by telephone to discuss amending the Offer to reflect the acceptable amount.

(2) If the Taxpayer's response does not change the case determination, the OS/OE will issue the rejection letter containing an option to increase the Offer amount.

(3) If the Taxpayer agrees, the OS/OE will issue the appropriate letter with the addendum for signature.

b) If the analysis shows the Taxpayer can fully pay the tax (liability) through liquidating his/her assets (without incurring economic hardship) and/or installment payments:

(1) The OS/OE will generally contact the Taxpayer/POA by telephone to discuss the Taxpayer's withdrawal of the Offer and alternative resolutions.

(2) If the Taxpayer's response does not change the case determination, the OS/OE will issue a rejection letter reflecting the determination that the Taxpayer can fully pay the liability.

(3) If additional information is provided by the Taxpayer, the OS/OE will make the appropriate adjustments to the RCP and contact the Taxpayer by telephone to discuss the case decision.

c) If the Offer amount equals or exceeds the RCP and the Offer is otherwise acceptable:

(1) The OS/OE should issue the acceptance letter.[15]

d) If special circumstances are identified that warrant acceptance for less than the RCP:

[15] See IRM 5.8.8, *Acceptance Processing*.

(1) The OS/OE will consider a DATCSC Offer. Factors establishing special circumstances under DATCSC are the same as those considered under ETA.[16]

C. Related Cases in Appeals

1. Taxpayers may have liabilities for related entities, one of which is undergoing evaluation in Appeals while the other is in Centralized Offer in Compromise ("COIC") or Field Collection.

2. Related cases will be those related to any joint or individual Offer involving the separate liabilities of one or both spouses (e.g., sole proprietorship liabilities, trust fund recovery penalties, or liabilities from a prior marriage).

3. In a situation involving married Taxpayers with two separate Offers related to jointly-owed liabilities, the Offers will generally be considered related only if the Taxpayers are domiciled (living) together.

4. An Offer involving one or more closely-held corporations or LLCs owned by one or both spouses in the joint or individual Offer will **not** be forwarded to Appeals, but instead the Offer will be investigated and an appropriate determination will be made.

III. Financial Analysis

A. Ability to Pay

1. The ability to pay determination will typically consider only those liability(s) due at the time the Offer was submitted.

2. The initial calculation will determine if the Taxpayer can fully pay through the Installment Agreement guidelines based upon Taxpayer submitted substantiation, including the application of standards and allowances.

3. Exception: If the Taxpayer indicates special circumstances or ETA criteria, then the Offer Investigation should continue without completing the initial calculation to determine if the Taxpayer can fully pay via an Installment Agreement.

4. If the initial calculation indicates the Taxpayer cannot fully pay

[16] See IRM 5.8.11, *Effective Tax Administration*.

through an Installment Agreement, the investigation should continue in order to determine the RCP.

B. Documentation

1. The Taxpayer should submit (recently revised) IRS Forms 656 (Offer in Compromise based upon either Doubt as to Collectibility or Effective Tax Administration) or 656-L (Offer in Compromise based upon Doubt as to Liability) and either Form 433-A (OIC) (Collection Information Statement for Wage Earners and Self-Employed Individuals), or Form 433-B (OIC) (Collection Information Statement for Businesses), or both, and a Power of Attorney (Form 2848).

2. Collection Information Statements ("CIS") and related documentation submitted with an OIC should reflect current information as of (or as close as possible to) the date of the OIC submission.

3. If, during the investigation, the financial information becomes older than 12 months, and it appears significant changes have occurred, the IRS will request updated information from the Taxpayer. (Our experience is that the Service will almost always request updated Bank/Financial Account Statements.)

4. If there is any reason to believe that the Taxpayer's situation may have significantly changed (i.e., change of employment, loss of job, etc.), the IRS may request a new CIS from the Taxpayer.

5. Documentation of "Small Offers"

    a) The Service has streamlined procedures to include a *limited* "investigation" of small Offers (an aggregate liability of tax, penalty, and interest of less than $50,000), which may reduce the documentation {submitted with Forms 433-A or B (OIC)} to three months of pay stubs, verification of the mortgage or car loan principal, and a credit report.

C. Verification

1. A thorough verification of the Taxpayer's CIS, Form 433-A (OIC) and/or Form 433-B (OIC), involves reviewing Taxpayer submitted documentations and information available from

internal sources.

2. As a general rule, additional documentation will not be requested from the Taxpayer when the information is readily available from internal sources or would not change the recommendation.

3. Verification through Internal Research

    a) The Service verifies as much of the CIS as possible through internal sources.

    Internal and external information sources will be considered by the Service including, but not limited to, state motor vehicle records, real estate records, and credit reports.

4. Securing Credit Reports to Verify Taxpayer Information

    a) When computing equity in real estate or allowable motor vehicles, in circumstances in which the Taxpayer has not submitted substantiation of loan balances claimed on Form 433-A (OIC), the OS/OE will request a credit report and may use the loan balance information to determine the current balances of any relevant loans from commercial lenders.

5. Verification through Taxpayer Contact

    a) If information is not present within the file when assigned for investigation and internal sources are not available or indicate a discrepancy, appropriate documentation will be requested from the Taxpayer either verbally or in writing, to verify the information upon the CIS.

    b) Such requests should be based upon the Taxpayer's circumstances, and the information must be necessary to make an informed decision with respect to the acceptability of the Taxpayer's OIC.

    c) For purposes of Taxpayer documentation, "current" is generally defined as three (3) months as of the date the Form 656 was <u>signed</u>, not the date the Form 656 was received.

D. Special Assets/Considerations

1. Proper asset valuation is essential to determine RCP. In some instances, the Service may find it necessary to review the following documents to determine undisclosed assets or income and assist in valuing the property:

    a) Divorce decrees or separation agreements;

    b) Homeowners or renters insurance policies and riders to identify high value personal items;

    c) Financial statements recently provided to lending institutions or others to identify assets or income that may not have been revealed upon the CIS.

2. For an on-going business, field calls should be expected to validate the existence and value of business assets and inventory.

3. Assets are valued at net realizable equity ("NRE"), which is defined as the quick sale value ("QSV") less amounts owed to secured lien holders with priority over the federal tax lien, if applicable, and applicable exemption amounts.

    a) QSV is defined as an estimate of the price a seller could reasonably expect to receive for the asset in a situation where financial pressures motivate the owner to sell in a short period of time, usually 90 calendar days or less. Generally, QSV is an amount <u>less than the fair market value</u> ("FMV").

    b) If the OE/OS determines the FMV of an asset to be greater than the amount listed by the Taxpayer, the IRS will typically discuss the issue with the Taxpayer/POA to determine if the Taxpayer has any additional information to assist in correctly determining the FMV of the asset.

    c) The IRS generally assumes that QSV is calculated at 80% of FMV.

4. Jointly Held Assets: When Taxpayers submit separate Offers but have jointly owned assets, equity in assets is allocated equally

between the owners.[17] However:

a) If the joint owners demonstrate their interest in the property is not equal, then the equity should be allocated based upon each owner's contribution to the value of the asset.

b) If the joint owners have joint and individual tax liabilities included within the Offer, then the equity should be applied first to the joint liability and then to the individual liability.

5. Assets Held by Others: The IRS will consider the degree of control the Taxpayer has over assets and income in the possession of others, especially when the Offer will be funded by a third party.

6. Securities and Stocks of Closely Held Entities: Financial securities are considered an asset and their value will be determined and included in the RCP when the IRS investigates an Offer.

a) When the Taxpayer will liquidate the investment to fund the Offer, associated fees, in addition to any penalty for early withdrawal, and the current tax year consequences should be allowed.

b) To determine the value of closely-held stock that is either not traded publicly or for which there is no established market, the following information/documentation may be considered by the IRS in valuing the company:

(1) A CIS from the company;

(2) Recent year's annual report to stockholders;

(3) Recent year's corporate income tax returns; and

(4) An appraisal of the business as a going concern by a qualified and impartial appraiser.

c) The applicable portion of the company's value will be

[17] It may be necessary to review applicable state law, including the effect of community property laws on property ownership rights in order to determine the Taxpayer's interest in assets that should be included in RCP.

assigned to the Taxpayer's stock or other interest.

d) When a Taxpayer holds only a negligible or token interest, has made no investment, and exercises no control over the corporate affairs, no value should be assigned to the stock.

7. Life Insurance: The type, conditions for borrowing or cancellation, and the current loan and cash values must be identified by the Taxpayer.

   a) When determining the value of a Taxpayer's life insurance policy, the following considerations should be made:

      (1) If the Taxpayer will retain or sell the policy to help fund the Offer, then the equity is the cash surrender value.

      (2) If the Taxpayer will borrow on the policy to help fund the Offer, then the equity should be the cash loan value <u>less</u> any prior policy loans or automatic premium loans required to keep the contract in force. (See IRM 5.8.5.23, *Conditional Expenses* and the discussion below for allowance of the payment.)

   b) Life insurance as an investment (e.g., whole life) is generally not considered a <u>necessary</u> expense.

   c) Reasonable premiums for term life policies <u>may be</u> allowed as a necessary expense.

8. Retirement and Profit Sharing Plans: Funds held in a retirement or profit sharing plan are considered an asset and must be valued for purposes of the Offer.

   a) Contributions to voluntary retirement plans are generally not a <u>necessary</u> expense.

9. Furniture, Fixtures, and Personal Effects: The Taxpayer's declared value of household goods is usually acceptable unless there are articles of extraordinary value. (Examples include antiques, artwork, jewelry, or collector's items.)

   a) There is a statutory exemption from levy that applies to

the Taxpayer's furniture and personal effects. This exemption amount is updated on an annual basis ($9,080, for 2015) and applies only to individual Taxpayers.

10. Motor Vehicles, Airplanes, and Boats: Equity in motor vehicles, airplanes, and boats must be determined and included in the RCP.

    a) Unusual assets such as airplanes and boats may require an appraisal to determine the FMV, unless the items can be located in a trade association guide (e.g., NADA Guides).

11. Real Estate: Equity in real estate is included when calculating the Taxpayer's RCP.

    a) The FMV of the property must be established, which is defined as the price at which a willing seller will sell and a willing buyer will pay for the property, given time to obtain the best and highest possible price.

    b) Once the FMV of the real estate is established, a determination regarding a reduction of value for Offer purposes is made.

12. Accounts and Notes Receivable: Accounts and notes receivable are considered assets unless a determination is made to treat them as part of the income stream when they are required for the production of income.

    a) All accounts receivable are valued at 100% of the balance due, unless the Taxpayer can substantiate the account has been delinquent over 90 days.

        (1) Current accounts receivable generally will not be discounted at QSV.

        (2) If the account is determined to be delinquent, it may be discounted appropriately based upon the <u>age</u> of the receivable and the <u>potential for collection</u>.

13. Income-Producing Assets: The Internal Revenue Manual (IRM Section 5.8.5.15; see Example 3 therein) provides that ***equity within income-producing assets will generally not be***

included in the calculation of RCP.

a) When investigating the RCP for an Offer that includes business assets, it is necessary to perform an analysis in order to determine if certain assets are essential for the production of income.

b) When an asset or a portion of an asset has been identified as necessary for the production of income, it is appropriate to adjust the income or expense calculation to account for the loss of income stream if the asset was either liquidated or used as collateral to secure a loan to fund the Offer.

c) As a general rule, equity in income-producing assets will not be added to the RCP of a viable, ongoing business unless it is determined the assets are not critical to business operations.

(1) Exception: Equity in real property will generally be included in the calculation for RCP even if the property is necessary for the production of income.

14. Inventory, Machinery, Equipment, and Tools of the Trade: Inventory, machinery, and equipment may be considered income producing assets. (See IRM 5.8.5.15, *Income Producing Assets*, discussed above, when it is determined that liquidation of these assets would be detrimental to the continued operation of an otherwise profitable business.)

a) Business appraisals may be requested when the cost of the appraisal is justified by the complexity of the business activity and where there is a market for similar businesses in the Taxpayer's location.

b) There is a statutory exemption from levy that applies to an individual Taxpayer's tools used in a trade or business, which will be allowed in addition to any encumbrance that has priority over the Notice of Federal Tax Lien ("NFTL").

(1) This exemption for tools of the trade does not generally apply to automobiles.

15. Dissipation of Assets: The inclusion of dissipated assets within

the calculation of the RCP will be considered in certain circumstances. (See IRM 5.8.5.18, *Dissipation of Assets*.)

a) The value of dissipated assets generally should only be included in situations where it can be demonstrated that the Taxpayer has sold, transferred, encumbered, or otherwise disposed of assets or proceeds (other than wages, salary, or other income) for reasons other than for the payment of items necessary for the production of income or the health and welfare of the Taxpayer or their family, after the tax has been assessed or within six months prior to the tax assessment.

b) The Internal Revenue Manual provides several examples of situations in which "dissipated" asset(s) <u>would be</u> included in the RCP (see IRM Section 5.8.5.16, example 5), such as the consumption of an IRA or Investment Account to pay for a child's wedding or university tuition, or a vacation, refinancing a residence to pay off credit card debt, the use of inherited funds for non-priority items, and the sale of real estate with the proceeds then being donated to family members.

c) The Manual also provides examples of instances in which the value of the dissipated asset(s) <u>should not be</u> included in the RCP calculation (see IRM Section 5.8.5.16, example 7), such as the use of the funds for necessary living expenses, the consumption of an IRA during periods of unemployment or underemployment while the Taxpayer's income was insufficient to meet necessary living expenses, and the use of the funds for medical or other necessities. In IR 2012-53, the Service provided that the National Standard for miscellaneous allowance has been expanded to include additional items such as credit card payments and bank fees and charges. Guidance has been clarified to allow payments for loans guaranteed by the federal government for the Taxpayer's post-high school education; payments for delinquent state taxes may be allowable, based upon a "*percentage basis*" of the combined tax owed to the state and IRS. Income potential for a Taxpayer with sporadic income may be averaged over the most recent three years.

16. Finally, charitable contributions are generally not allowable

unless required as a condition of the Taxpayer's employment. **Pixley v. Comm.**, 123 TC 15 (2004).

17. Assets donated, transferred[18], or sold below market value will often be included in the RCP calculation.

18. Pensions are included within the RCP calculation (classified as a seizable[19] or realizable "asset"); however, a pension balance may instead be classified as "income", for a Taxpayer that is either retired or approaching retirement.

E. Future Income

1. Future income is defined as an estimate of the Taxpayer's ability to pay based upon an analysis of gross income, less necessary living expenses, for a specific number of months into the future.[20]

a) General rule: The Taxpayer's current income should be used in the analysis of his/her future ability to pay.

b) In situations in which the Taxpayer's income does not appear to meet his/her stated living expenses, the difference should not be included as additional income to the Taxpayer unless there are clear indications that additional income not included upon the Collection Information Statement is being received and will continue to be received by the Taxpayer. The IRS will review the documents submitted by the Taxpayer to determine how the Taxpayer is paying current expenses in excess of income and the appropriateness of including an additional amount in the calculation of future income.

c) The following examples provide guidance with respect to whether the additional income of the Taxpayer should be included in the Taxpayer's Collection Information Statement as income:

(1) The Taxpayer has been receiving gifts from his/her parents to meet current living expenses for the past six months. The Taxpayer has no guaranteed right to the funds in the future, and the amount does not

[18] A *transfer* outside the reach of the Service may also theoretically have **criminal** implications, since the evasion statute (Code §7201) sanctions "Any person who willfully attempts …to evade or defeat any tax … or the payment thereof …".
[19] Taxpayers are frequently surprised to open their mail and find a levy of their Social Security benefits.
[20] See IRM 5.8.5.25, *Calculation of Future Income*, table for calculation.

appear to be based upon the transfer of assets to the parents. The gift amount should not be included as income.

(2) The Taxpayer has been receiving an amount each month that only began recently, which he/she states is a gift from a friend. Further research has determined that the Taxpayer is in business with the friend, and the amount received is from their business. This amount should be included as income to the Taxpayer. Additionally, consideration should be given with respect to referring the Taxpayer and the business income tax return to Examination.

(3) The Taxpayer had gambling winnings over a period of time, but the winnings are not consistent. Those winnings typically would not be included as additional income on the Income/Expense Table ("IET"). This does not apply to professional gamblers.

F. Future Income Collateral Agreements (discussed in more detail below): The calculation of future earnings can also lead to the request by the IRS that a collateral agreement be executed, in order to protect the Government's interest with respect to any substantial increase in the Taxpayer's earnings. A future income collateral agreement is appropriate in situations in which the Taxpayer's future income is uncertain, but it is reasonably expected that the Taxpayer will be receiving a substantial increase in income in the future.

G. Expenses

1. Allowable expenses consist of necessary and conditional expenses (which are discussed below, in turn).

a) <u>Necessary Expenses</u>: A necessary expense is one that is necessary for the production of income or for the health and welfare of the Taxpayer's family.

(1) National Standard Expenses – Taxpayers are allowed the National Standard Expense amount based upon the size of their family, without questioning the amount actually spent. All deviations

from the National Standards (if accepted) must be reasonably verified and documented within the case history. National and local expense standards are guidelines. If a standard amount is determined to be inadequate to provide for a specific Taxpayer's basic living expenses, a deviation will be allowed. Generally, the total number of persons allowed for National Standard Expenses should be the same as those allowed as dependents on the Taxpayer's current year income tax return. These established standards apply to Food, Clothing, and Other Items and Out-of-Pocket Health Care Expenses.

(2) Housing and Utilities – When determining a Taxpayer's housing and utility expense, an amount sufficient to provide for basic living expenses will be used. Local standards are established for each county within a state and are based upon the size of the Taxpayers family. The standard amount should be used as a guideline unless such use results in the Taxpayer not having adequate means to provide for basic living expenses.

i. Absent special circumstances, when determining a Taxpayer's housing and utility expense, the amount that is claimed or the standard, whichever is less, should be used.

(3) Transportation Expenses – Transportation expenses are considered necessary when such expenses are necessary to provide for the Taxpayer and his/her family's health and welfare and/or the production of income. Expenses that appear excessive will be questioned and, in appropriate situations, disallowed.

(4) Other Expenses – Other expenses may be allowed in determining the value of future income for Offer purposes provided that the expenses meet the necessary expense test (i.e., the expense provides for the health and welfare of the Taxpayer and/or his or her family or is for the production of income). This is determined based upon the facts and circumstances of each case.

i. Repayment of loans incurred to fund the Offer and secured by the Taxpayer's assets will be allowed if the asset securing the loan is necessary for the health and welfare of the Taxpayer and/or his/her family.

ii. Expenses for dependents to attend colleges, universities, or private schools will not be allowed unless the dependents have special needs that cannot be met by public schools.

iii. Child support payments for natural children or legally adopted dependents may be allowed based upon the Taxpayer's situation. A copy of the Court Order and proof of payments should be provided.

iv. Payments for expenses such as college tuition or life insurance for children, made pursuant to a Court Order, will typically not be allowed. The fact that the Taxpayer may be under Court Order to make payments with respect to such expenses does not change the character of the expense. Stated differently, when the Service would not otherwise allow the expense, a Taxpayer under Court Order to provide payment should not in the ordinary course elevate that expense to allowable status.

v. Current taxes, including current federal, FICA, Medicare, state and local taxes, are allowed regardless of whether the Taxpayer paid them in the past or not.

b) Conditional Expenses: A conditional expense is an expense which may not meet the necessary expense test, but may be allowable based on the circumstances of an individual case. Other conditional expenses may also be allowable if the Taxpayer qualifies for the six-year rule, which allows the tax to be paid in full by an Installment Agreement within six (6) years.[21]

2. Shared expenses may exist in one of two situations:

[21] See IRM 5.8.23, *Conditional Expenses* and IRM 5.15.1.7, *Allowable Expense Overview*.

a) An Offer is submitted by a Taxpayer who shares living expenses with another individual who is not liable for the tax.

(1) Generally, the assets and income of a non-liable person are excluded from the computation of the Taxpayer's ability to pay.

b) Separate Offers are submitted by two or more persons who owe joint liabilities and/or separate liabilities and who share the same household.

c) Exception: In community property states, the community property laws must be followed to determine which assets and income of the non-liable person are subject to the collection of tax.[22]

d) After determining the percentage of income of the liable Taxpayer, that percentage is applied to the Allowable Living Expense ("ALE") Standard amounts for the household. If the Taxpayer's calculated percentage amount for National Standards for Food, Clothing and Other Items and for Out-of-Pocket Health Care Costs, is less than the standard amount for one person, the liable Taxpayer will be allowed the standard amount. For other ALE expenses (Transportation and Housing/Utilities), the liable Taxpayer will be allowed the calculated percentage amount or the standard amount, whichever is less.

H. Financial Analysis of Business Entities

1. With regard to any Business Taxpayer (such as a Corporation or LLC) submitting an Offer, sufficient supporting information and documentation must be provided (Financial Statements, Bank Account Statements, detailed lists of assets, copy of the most recent Federal Income Tax Return, etc.), such that the IRS can make an informed decision as to the acceptability of the Business Taxpayer's Compromise proposal.

2. In addition to requiring a Business Taxpayer submitting an Offer to provide the information indicated above {included with IRS Form 433-B(OIC), submitted by the Business}, the Internal Revenue Manual discusses considerations relevant to the

[22] See IRM 25.18, *Community Property*.

collection of outstanding liabilities and the evaluation of Offers involving Business Entities (for instance, the interest of an Individual Taxpayer in a Business, discussed within Section III, D Special Assets, above, and with respect to LLCs, particularly those considered Disregarded Entities, discussed immediately below).

I. Disregarded Entities (Single Member LLCs) Involve Unique Issues.[23]

1. A *single member LLC* is considered to be a Disregarded Entity for Federal income tax purposes. The Internal Revenue Manual generally characterizes a Disregarded Entity as an entity in which, although its sole member enjoys *general* protection from the LLC's debts and liabilities, the sole member, not the LLC, is considered to be the Taxpayer responsible for the Federal income tax liability of the LLC.

2. When submitting an Offer on behalf of a Disregarded Entity or its sole member, the Taxpayer submitting the Offer must be properly identified as either the Disregarded Entity or the sole member of the LLC, depending upon the nature of the liabilities to be subject of the OIC.[24]

   a) If the liabilities subject of the OIC are attributable to the LLC (such as IRS Form 940 or 941 employment/payroll tax liabilities), the OIC should generally be submitted by the LLC (not its single member, although the member may have exposure to the Trust Fund Recovery Penalty, which would be properly included within that individual's OIC).

   b) If the liabilities subject of the OIC are attributable to the single member of the LLC (such as the federal income tax that flows through to the member), the OIC should generally be submitted by the individual member (not the LLC).

3. If there are liabilities attributable to both the Disregarded Entity (employment/payroll taxes) and the sole member (individual income tax) related to the Disregarded Entity's business operations, those liabilities must be included within separate OICs (one submitted on behalf of the Disregarded Entity, and one submitted on behalf of its sole member).[25]

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[23] See IRM 5.8.5.26, *Limited Liability Companies (LLC) Issues* and IRM 5.1.21.1, *Introduction*.
[24] See IRM 5.1.21.7.2, *Offers in Compromise.*
[25] See IRM 5.1.21.7.2, *Offers in Compromise.*

J. Payment Terms

1. Payment terms are negotiable, but should provide for payment of the offered amount in the least time possible.

2. If the Taxpayer is planning to sell asset(s) to fund all or a portion of the Offer, the payment terms for the Offer should provide for immediate payment of the amounts received from the sale.

3. For those Taxpayers who agree to shorter payment terms, fewer months of future income are required.[26]

   a) For a Lump Sum Cash payment, the payment terms should be five (5) or less installments within five (5) months. The number of months of future income required is twelve (12) months or the remaining statutory period, whichever is less.

   b) For a Periodic (Installment) Payment, the payment terms should be within 6 to 24 months. The number of months of future income requires is 24 months or the remaining statutory period, whichever is less.

IV. The IRS "Fresh Start" Initiative

A. Guidelines

1. The Service has adopted guidelines for the compromise of tax liabilities, as described above, referred to as the **reasonable collection potential** ("RCP"), which focuses upon the following:

   a) The calculation of the Taxpayer's discounted future *levels* of disposable income, <u>in addition to</u>

   b) *Realizable equity* in the Taxpayer's assets.

   c) See, for instance, pages 2 through 5 of IRS Form 433-A (OIC) {and pages 2 through 4 of Form 433-B (OIC)} that suggests that the IRS will consider a discount of 20%[27]

[26] See IRM 5.8.5.28, *Payment Terms.*

[27] The IRS may allow a discount of 30% in arriving at the quick sale value with respect to *pretax* assets, such as pensions, apparently intended to recognize the Taxpayer's obligation to pay the current income tax resulting from the seizure of these assets. See page 2 of Form 433-A (OIC). Obviously, for a *high-income* Taxpayer with unpaid tax obligations, this discount should be increased to at least a 45% *aggregate* federal and state rate, since the current marginal rates stand at 39.6% (federal) and 6% (Louisiana).

{described by Collection Agents as the **quick sale value**[28] ("QSV")} from the fair market value of personal and business assets, then apparent exemptions.[29]

2. Trends

a) The IRS has historically utilized a formula to determine the *discounted valuation* of the Taxpayer's monthly "disposable income", at a level equivalent to either 48 or 60 future months {dependent upon whether the payment terms were less than 6 months, or more (but less than 2 years)}.

b) For payment plans longer than 24 months, the number of months used to calculate the "disposable income" factor has only been limited to the length of time remaining with respect to the 10 year statute of limitations. Fortunately, the IRS has revised these guidelines, recognizing that many Taxpayers struggle to pay their delinquent tax and other debts.

3. Fresh Start Initiative

a) In IR 2012-53 (which IRS refers to as its ***Fresh Start Initiative***), the Service announced that, in calculating a Taxpayer's RCP, for Offers paid in five or fewer months, it will now look at only ***one year of future income***, instead of the four years described above.

b) For Offers paid within six to 24 months, the IRS will now only consider ***two years of future income***, rather than five years. Installment Payment Offers must be fully paid within 24 months from the date the OIC is accepted, and "Lump-Sum" Offers must be fully paid within 5 months from the date of acceptance.

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[28] If the quick sale value exceeds the Taxpayer's adjusted basis in the asset, the Internal Revenue Manual authorizes the Agent to allow a reduction (of the QSV) for several factors associated with presumed disposition, including costs of sale/disposition (realtor's or broker's commission, penalty for premature distribution of an IRA, penalty for early withdrawal, etc.), as well as "…the *expected current year tax consequence* to arrive at the net realizable equity of the asset …".

[29] The exemptions for calendar year 2015 for furniture and personal effects, etc., is $9,080 and for books and tools used in the Taxpayer's trade or business is $4,540 (See Rev. Proc. 2014-61).

V. Collateral Agreements

A. Overview

1. A Collateral Agreement ("CA") enables the Government to collect funds in addition to the amount actually secured by the Offer or to incorporate additional terms not included in the standard Form 656, thereby recouping part or all of the difference between the amount of the Offer or additional terms of the Offer and the liability compromised.

2. The refusal to enter into an appropriate Collateral Agreement after consideration of all the facts and circumstances may be a reason to reject the Taxpayer's Offer.

3. It appears that the Service may be increasing its use of Collateral Agreements, such as a *future-income collateral agreement* (discussed in more detail, below) whereby the Taxpayer commits to pay (in addition to the lump-sum or periodic Offer amount) a fixed *percentage of future income* exceeding a predetermined base-level for a specified period of time.

4. Another type of Collateral Agreement is the Taxpayer's waiver or relinquishment of potentially-attractive tax attributes, such as a net operating loss ("NOL") or capital loss carryforward.

B. Use of Collateral Agreements

1. Collateral Agreements may be appropriate in situations where a significant recovery is anticipated or securing a Collateral Agreement will facilitate resolution.

2. A Collateral Agreement should not be used to accept an Offer amount less than the Taxpayer's financial condition indicates.

3. Collateral Agreements may be appropriate in the following situations:

   a) The Taxpayer anticipates a substantial increase in future income;

   b) The Taxpayer is compromising the income tax liability of a defunct professional corporation;

   c) The Taxpayer has real or personal property that is being

depreciated;

d) The Taxpayer has net operating losses or capital losses arising from prior years available for deduction in future years; or

e) The Taxpayer is seeking to compromise a Trust Fund Recovery Penalty ("TFRP") and qualifies to take a capital loss benefit from the defunct corporation on IRS Form 1040.

C. Future Income Collateral Agreements

1. A future income collateral agreement is appropriately considered for individuals, limited liability companies, and corporations when the investigation reveals that a substantial increase in the Taxpayer's future income is expected.

2. A future income collateral agreement will typically **not** be secured under the following circumstances:

   a) To collect future income that should be included in the Offer amount;

   b) Merely on unfounded speculation about an increase in income;

   c) To cover statistically improbable events, such as lottery winnings; or

   d) To attempt collection of a potential inheritance.

3. Future income collateral agreements must be monitored annually for the life of the agreement.

4. Form 2261/2261-A:

   a) Form 2261, Collateral Agreement – Future Income (Individual) is used for individual Taxpayers, and Form 2261-A, Collateral Agreement – Future Income (Corporation) is used for corporate Taxpayers.

   b) Offers with future income collateral agreements must be approved by the authorized approving official of the Offer in Compromise. The approving official will indicate

approval by signing Form 7249, Offer Acceptance Report, and the acceptance letter.

VI. Return, Withdraw, Terminate, and Reject Processing

A. General

1. Offers that are not recommended for acceptance will be closed by one of the following methods: return, withdrawal, termination, or rejection.

B. Returns

1. An Offer can be returned as either a “not processable” or “processable”, the distinction of which is important.

2. Not Processable: An Offer is determined to be “Not Processable” if any of the following criteria, is present:

   a) Taxpayer in Bankruptcy: An Offer will not be considered while a taxpayer is in bankruptcy. See IRM 5.8.2.3.2.

   b) Taxpayer did not submit the application fee with the Offer: The application fee must be submitted with each Form 656, *Offer in Compromise*, or the low income certification box checked in the applicable section of Form 656.

   c) Taxpayer did not submit the required initial payment with the Offer: (1) Lump Sum Cash offers must include 20% of the offered amount or the low income certification box checked in the applicable section of Form 656; (2) Periodic Payment offers must include initial proposed installment payment or the low income certification box checked in the applicable section of Form 656.

   d) Department of Justice: the IRS may not process any Offer to Compromise a liability previously referred to the Department of Justice (DOJ) for prosecution or defense. If IRS retains jurisdiction on any tax liabilities then the Offer is processable.

   e) Unassessed Liabilities: Offers submitted solely to compromise a tax period or tax year that has not been assessed will be deemed not processable.

f) Offer submitted solely for tax period(s) with expired Collection Statute: An Offer will not be considered when the Collection Statute has expired for all liabilities sought to be compromised.

3. Processable Returns: This includes all returns after the Offer has been determined to be processable.

   a) A processable return results in suspension of the collection statute for the period of time for which the Offer was considered processable and will result in the Service keeping the application fee and applicable TIPRA payment(s).

C. Withdrawal

1. There are two kinds of withdrawn Offers:

   a) *Voluntary* Withdrawal of Offers – An action that may be taken by the Taxpayer at any time during the Offer Investigation.[30]

   b) *Mandatory* Withdrawal Offers – An action that may be taken by an OE/OS during the Offer Investigation.[31]

2. Internal Revenue Manual Section (IRM) 5.8.7.4.2, *Mandatory Withdrawal*, provides that, if during the investigation of the Offer, the Taxpayer fails to make periodic payments as required by the terms of the Taxpayer's Offer, the Offer may be considered or "deemed" Withdrawn.

D. Termination

1. Consideration of an Offer must be terminated upon the death of the Taxpayer.[32]

E. Rejection

1. Many Offers are properly rejected by the Service for failure to satisfy the guidelines for acceptance. The IRS cannot provide a Notice of Rejection to the Taxpayer until an independent

[30] See IRM 5.8.7.4.1, *Voluntary Withdrawal*, for more information.
[31] See IRM 5.8.7.4.2, *Mandatory Withdrawal*, for more information.
[32] See IRM 5.8.10.4, *Death of a Taxpayer*, for actions that must be taken prior to termination when one party to a joint Offer has died.

administrative review of the proposed rejection is completed.

2. If a Taxpayer's Offer is "closed" as a "Return" or "Mandatory Withdrawal", the Taxpayer is left with no Appeal rights. It is helpful to contrast the scenario described above to that in which a Taxpayer has been contacted for preliminary discussions (or a letter has been issued to the Taxpayer) advising that the Offer would be "rejected".

    a) In this case, the Taxpayer's subsequent failure to remain in compliance with required Offer payments permits the Service to proceed with rejection of the Offer without contacting the Taxpayer to discuss the non-compliance.

    b) In this case, the Service should issue a "Rejection Letter", which should provide the Taxpayer with his/her Appeal rights. (Note the important distinction between a "Returned" or "Mandatorily Withdrawn" Offer, which does not afford appeal rights, versus a "Rejected" Offer, which triggers Appeal rights.) Treasury Regulation §301.7122-1(f)(2).

3. In addition, the Service may not reject an Offer in Compromise from a low income Taxpayer *solely* because the offered amount is too low. Code §7122(c). The Taxpayer can appeal rejection of the Offer to the Appeals Division within 30 days. See IRS Form 13711.

VII. Acceptance Processing

A. Overview

1. The acceptance of an OIC is based upon sound decisions relating to an analysis of the Taxpayer's facts, circumstances, and financial situation.

B. Deemed Acceptance

1. An OIC will be deemed accepted if the IRS does not make a decision with respect to the OIC and notify the Taxpayer of that decision within two years of the IRS received date, which is stamped on Form 656 upon receipt.

2. After confirming that the IRS did not make a determination with regard to the OIC within two years of its receipt, the Taxpayer

must be issued an acceptance letter under §7122(f).

3. In IR News Release 2006-106, the IRS confirms that, generally, any Offer that is neither withdrawn, returned, nor rejected within 24 months (our office has experienced similar delays) after IRS receipt will be "deemed accepted".

4. This period is extended for the time during which any portion of the liability proposed to be compromised is being litigated. Code §7122(f). The new 24 month rule may change the Taxpayer's strategy once, for instance, the Offer has been pending for more than a year.

5. We represent a Taxpayer who submitted an *Amended* Offer in Compromise in order to Offer the increased Offer Amount proposed by the IRS following its rejection of her original Offer in Compromise. The Taxpayer's Amended Offer in Compromise was not subsequently rejected. Pursuant to the terms of the Amended Offer, as set forth within the amended IRS Form 656, which had been prepared and supplied by the Service and properly submitted by the Taxpayer, we have adopted the position that this Offer should be deemed accepted by the Service. Unfortunately, the IRS has refused to recognize the deemed acceptance of our Client's Offer.

C. Trends

1. The Taxpayer Advocate's Fiscal Year (FY) 2014 Report to Congress indicates that as of March of FY 2013, the IRS had accepted 15,634 OICs, an increase of 65% over the same period in FY 2011. In its 2013 Data Book, the IRS disclosed that during FY 2013, 74,000 OICs were received by the Service, and 31,000 were accepted (41.9%). For FY 2012, 64,000 OICs were received by the Service, and 24,000 were accepted (37.5%). For FY 2011, 59,000 Offers were received, and 20,000 were accepted (33.9%). For FY 2010, 57,000 Offers were received, and 14,000 were accepted (24.6%). For FY 2009, 52,000 Offers were received, and 11,000 were accepted (21.0%). The increased percentage, as well as the recent IRS liberalizations ("Fresh Start Initiative"), may evidence a positive trend. As indicated within the Taxpayer Advocate's Fiscal Year 2013 Report to Congress, these "liberalizations" focus upon the financial analysis used to determine which Taxpayers qualify for an OIC, and provide much more flexibility to certain Collection employees in determining the acceptability of Offers. The

revised financial analysis guidance provides allowances for repayment of student loans, payments upon tax debts to state and local governments, and expanded allowances for payments upon unsecured debt.

VIII. Miscellaneous Information Regarding Federal Offers in Compromise

A. Centralization

1. Our office was recently informed that Offers were now being reviewed by the Service Centers, and that many OIC units within the local IRS offices were being dismantled.

B. Evolving Consideration of Individual Offers

1. Our office was recently informed (during a Collection Due Process Hearing) that the Service is developing and instituting new procedures for all Collection Cases, Collection Information Statements, and "significant" information received by the IRS Office of Appeals.

2. These new procedures apparently will include increased scrutiny of Offers submitted by Taxpayers, who operate a viable business (listed as an asset upon their IRS Form 433-A (OIC)), with an increased number of such Offers being examined at "local" Offer in Compromise offices, allowing the Service to focus greater efforts upon verifying the information reported by a Taxpayer.

C. Offers of Businesses/Taxpayers – Officer Compensation

1. The Service appears to be disallowing (as an "allowable" ordinary/reasonable business expense) the amount of compensation paid to the Business Taxpayer's Officers to the extent that such compensation exceeds the applicable National and Local Collection Standards recognized by the IRS with respect to evaluating an *individual* Taxpayer's ability to pay his/her tax liability.[33]

[33] This position was strictly observed in our recent unsuccessful attempts to convince an Offer Examiner and Settlement Officer that our Client, whose Officers' base salaries were (very) modest, that the *commission-based* component of such Officers' compensation should be allowed, since this compensation was generated by these Officers while rendering significant successful efforts to maintain the Business' viability (and thus, maximizing the Business-Taxpayer's ability to pay its outstanding liabilities). The Service, unfortunately, did not agree with our position, resulting in the rejection of this Taxpayer's Offer.

D. Statute of Limitations

1. The statute of limitations relevant to collection is suspended during the pendency of an Offer, and for 60 days after rejection.

E. Other

1. The Taxpayer will be "in default" of his/her compromise agreement with the Service if he/she falls out of "compliance" with the tax laws within a five-year period[34] following Acceptance. Representatives should therefore advise their clients that **the IRS Acceptance must be considered "conditional", until the five-year term expires**. It is critical, as a result, that the Taxpayer timely submit all tax payments (including estimated payments and employment tax deposits) and file all returns timely. **Federal tax liens are not released** until the terms of the compromise are fully satisfied (the "offered" amount is fully paid), except as provided with certain Installment Agreements, as described above. The Service generally may not seize assets during the pendency of an Offer, but may file a new lien. **The IRS retains any refund for the tax year in which the Acceptance occurs**. Certain information (excluding financial information) is subject to public inspection. The Service generally imposes a $186 filing fee for Offers. See the Instructions for IRS Form 656.

IX. Overview of Louisiana Offers in Compromise

A. General

1. LSA-R.S. 47:1578 B(4), subsections (a) through (c), provides as follows:

a) Notwithstanding any other provision of this Chapter, the secretary, with the approval of two assistant secretaries, may compromise any judgments for taxes of five hundred thousand or less exclusive of interest and penalty, including assessments for such amounts which are equivalent to judgments upon a determination that any of the following apply: (i) There is serious doubt as to the collectability of the outstanding judgment. (ii) There is serious doubt as to the Taxpayer's liability for the

[34] If the term of payment in the accepted Offer in Compromise is longer than five years, the Taxpayer must remain in compliance with all filing and payment obligations for this longer period, or all "forgiven" taxes will be *revived*. See the Instructions to IRS Form 656.

outstanding judgment. (iii) The administration and collection costs involved would exceed the amount of the outstanding liability.

b) This authority is wholly discretionary, and no Taxpayer shall have a right to a compromise under the provisions of this Paragraph.

c) A complete record of all such compromises shall be kept by the secretary, shall be open to public inspection, and, notwithstanding the provisions of R.S. 47:1508 and 1508.1, each such compromise shall be published in the Department's annual report.

2. We are significantly uncertain as to the objective standards applied by the Louisiana Department of Revenue ("DOR"), in regard to Offers in Compromise.

3. It is certain that the Department uses a different approach from the guidelines employed by the IRS.

4. We have received informal comments from the Department's employees that it may, under appropriate circumstances, compromise the *penalty and interest* (implying that the Taxpayer must "***pay 100% of the tax***", in all/most circumstances). There appears to be little guidance available. See LSA-R.S. 47:295 and 47:1508.

5. Similar to the IRS, Offers in Compromise on the basis of Doubt as to Collectability (DATC) as well as Doubt as to Liability will *theoretically* be considered by the Louisiana Department of Revenue. However, it has been our recent experience that pursuing an Offer in Compromise with the DOR is extremely unlikely to result in acceptance.

6. Past LDR Annual Reports reflect the following information (upon the following page) with respect to LDR Offers in Compromise, for Fiscal Years 2008-2013[35]:

[35] LA Offer in Compromise Statistics with respect to Fiscal Year 2013-2014 are expected to be made available with the Department's 2015 Annual Report, which is expected to be released in January, 2016.

LDR Offers In Compromise (FYs 2008-2013)

FISCAL YR.	NO.	TOTAL TAX, INT., PEN.	AMOUNT ABATED	AMOUNT PAID
FY 08-09	35	$1,376,858.88	$ 699,568.42	$ 677,290.46
FY 09-10	33	52,583,530.68	52,404,715.00	178,815.68
FY 10-11	34	1,441,257.40	870,451.58	570,805.82
FY 11-12	6	14,425,865.70	1,133,617.70	13,292,248.00
FY 12-13	6	143,532.25	82,564.51	60,967.74

7. Thus, our recent efforts have focused upon *proposing* an Installment Agreement to the Department on behalf of the afflicted Taxpayer, or assisting the Taxpayer in evaluating the potential benefit of participating within the LA Tax Amnesty Program.

8. The LDR Offer in Compromise Program Booklet, Form R-20212, explains the Offer in Compromise requirements and contains all of the required Application and financial disclosure Forms.

9. It appears that the LDR recently modified its Offer in Compromise Program, in July, 2015 (see attached LDR Offer Program Booklet, including all relevant Forms required for the submission of an Offer, to the LDR. Based upon the LDR's Offer Booklet, it appears that in order to apply for an Offer in Compromise, a Taxpayer must submit an Offer in Compromise Application (Form R-20212A), a Statement for Financial Condition for Individuals and/or Businesses (Form R-20223 and 20222, respectively) to the Department of Revenue. If the Taxpayer is applying for the Offer in Compromise based on inability to pay the liability, the Document Checklist for an Offer in Compromise based upon Serious Doubt as to Collectability, Form R-20211, should also be completed and used as a guide for the documents required. Note that the LDR Offer Booklet indicates that, if a Federal Offer in Compromise has been submitted within the previous three months, a copy of the Taxpayer's Federal Offer in Compromise Submission may be accepted by LDR in lieu of the financial disclosure forms.