OFFERS

IN

COMPROMISE

OF

FEDERAL TAX LIABILITIES

BY

GARY D. BOREK
ATTORNEY-AT-LAW

373 DARWIN DRIVE
SNYDER, NY 4226

WWW.TAXLAWCENTER.COM

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I. INTRODUCTION

An offer in compromise is one of several ways of dealing with an outstanding federal tax liability. The IRS offer in compromise program, however, is in a state of change brought about by both legislation and administrative policies. Part V, Chapter 5700, Sections 57(10)(1) et. seq. of the Internal Revenue Manual ***was*** a comprehensive guide for offers in compromises, but many of its sections have become outdated due to changes in the law and IRS administrative changes. It is still a good source of information to fill in the somewhat sparse information provided by the instructions to Form 656 and the recently enacted temporary and proposed regulations (which will govern offers in compromise from July 21, 1999 to July 19, 2002.) Internal Revenue Manual Handbook 5.8 (Offer in Compromise Handbook) will be a better source of information but it has not yet been published. Practitioners should also consult the IRS web site for updated information on a regular schedule.

II. REFERENCES

A. Statute and Regulations

1. §7122 of the Internal Revenue Code, as amended by §3462 of the Internal Revenue Service Restructuring and Reform Act of 1998 (the "RRA of 1998").
2. Temporary and proposed regulations §301.7122-1T (TD 8829) (July 21, 1999)

B. Forms

1. IRS Form 656 and Instructions to Form 656 (Rev. 2 - 1999)
2. IRS Forms 433-A and 433-B

C. Internal Revenue Manual (IRM):

1. Part V - Chapter 5700, Section 57(10)(1) et seq.
2. Offer In Compromise Handbook, IRM Handbook 5.8 (released in May of 1999 but not yet published by Lexis and not yet on the IRS web site)

D. Web sites:

1. www.IRS.ustreas.gov
2. www.TaxLawCenter.com

III. THE BASICS

A. Liabilities subject to compromise by IRS

1. Assessed liability for tax, penalty, and interest
2. Civil or criminal liability
3. Provided the case has not been referred to the Department of Justice for prosecution or defense
4. Unless acceptance expressly provides otherwise, acceptance of an offer to compromise a civil liability does not remit a criminal liability, nor does acceptance of an offer to compromise a criminal liability remit a civil liability.

B. Basis for Compromise by IRS - Overview:

1. Three distinct grounds for compromise:
    - 1.1. Doubt as to Liability
    - 1.2. Doubt as to Collectibility
    - 1.3. Equity-hardship grounds
2. Historical background
    - 2.1. Prior to RRA of 1998 IRS limited to compromises on basis of:
        - a. Doubt as to Liability, or
        - b. Doubt as to Collectibility
    - 2.2. RRA of 1998 authorized IRS to accept offers based on:
        - a. equity,
        - b. hardship, and
        - c. public policy
    - 2.3. On July 23, 1999, IRS issued temporary/purposed regulations under IRC §7122.
        - a. The regulations are supposed to effectuate the provisions of RRA of 1998
        - b. The regulations are to be in effect for three years to allow the IRS to assess them
        - c. The regulations merely set forth the conditions that must be satisfied to accept an offer in compromise
        - d. The regulations do not prescribe the terms or conditions that should be contained in such offers.
        - e. Thus, the amount to be paid, future compliance or other conditions precedent to satisfaction of a liability for less than the full amount due are matters left to the discretion of the Secretary.
3. Review by IRS Chief Counsel
    - 3.1. Section 503 of the Taxpayer Bill of Rights II (the "TBOR 2"), Public Law 104-168.
    - 3.2. IRS Chief Counsel's opinion is required only when the compromised liability is $50,000 or more

IV. BASIS FOR COMPROMISE BY IRS - SPECIFICS:

A. Doubt as to Liability

1. Equivalent of settling a refund case
    - 1.1. Doubt as to liability exists where there is a genuine dispute as to the existence or amount of the correct tax liability under the law.

1.2. Doubt as to liability does not exist where the liability has been established by a final court decision or judgment concerning the existence or amount of the liability

2. Amount of acceptable offer based on "predicted results in litigation".
3. Does not require financial disclosure forms (i.e., Forms 433-A and 433-B)
4. The five-year compliance provision does not apply.
5. Reviewed by Examination Division except the following are reviewed by Collection Division:
   5.1. Trust Fund Recovery penalty (IRC §6672)
   5.2. Personal Liability for Excise Tax (IRC §4103)
   5.3. Employment tax deficiencies arising from Employment Tax Examinations.
6. Offers in compromise based on both doubt as to liability and doubt as to collectibility will be assigned initially to the Collection Division for a collectibility determination.

B. Doubt as to Collectibility

1. NOT a percentage of the amount owed.
2. Based on the amount the IRS could reasonably expect to recover from the taxpayer from four components:
   2.1. Net equity in assets
   2.2. Installment payments over a term of four years (or the time left on statutory period for collection, whichever is less).
   2.3. Prior transfers reachable by IRS (because of lien or transferee liability)
   2.4. IRS may also consider whether the taxpayer should be expected to raise additional amounts from assets in which the taxpayer's interest is beyond the reach of enforced collection (e.g., interests in property located in foreign jurisdictions or held in tenancies by the entirety).
3. Net equity in assets component
   3.1. Quick sale value - is the amount which would be realized from the sale of an asset in a situation where financial pressures cause the taxpayer to sell in a short period of time.
   3.2. Minimum bid amount may also be used. Minimum bid should be determined in accordance with Policy Statement P-5-35 and IRM 56(13)5.1
4. Installment payment component:
   4.1. Gross Income minus Allowable Expenses
   4.2. Gross income includes all income, even if it is not taxable and even if it cannot be levied upon by the IRS.
   4.3. The amount of allowable expenses is to be based upon an evaluation of the individual facts and circumstances presented by the taxpayer's case.

4.4. Allowable Expenses for Food, clothing, housing, and transportation

a. The IRS has published guidelines for national and local living expense standards

b. Latest guidelines were updated in October of 1998. See Exhibit 1

4.5. Other allowable expenses include:

a. state and local taxes,

b. FICA taxes withheld

c. alimony

d. child support

e. medical and dental costs

f. attorney and accountant fees for tax advice

4.6. The Service also takes into consideration the amount that can be collected from the taxpayer's future income.

a. in evaluating those future prospects, the taxpayer's education, profession or trade, age and experience, health, past and present income will be considered.

b. In evaluating future income potential an evaluation must be made of the likelihood that any increase in real income will be available to pay the delinquent taxes.

c. The increasing cost of living is also a factor in determining amounts potentially collectible from future income.

5. Spouses

5.1. The assets and income of a nonliable spouse will not be considered in determining the amount of an adequate offer, except to the extent property has been transferred by the taxpayer to the nonliable spouse under circumstances that would permit the IRS to effect collection of the taxpayer's liability from such property.

5.2. The IRS can request information regarding the assets or income of the nonliable spouse for the sole purpose of verifying the amount of, and responsibility for, expenses claimed by the taxpayer.

6. Conditioned on 5-year future compliance record

7. If accepted, amount offered can be payable (with interest from date of acceptance to date of payment) as follows:

7.1. Full payment within 90 days

7.2. Short term installment payments

7.3. Long term installment payments

8. Generally reviewed by Collection Division

C. Equitable Considerations

1. Added by the RRA of 1998

2. The temporary regulations provide that the IRS can compromise a tax liability "to promote effective tax administration" when:

    2.1. Collection of the full liability will create economic hardship within the meaning of Regulations §301.6343-1; or

    2.2. Regardless of the taxpayer's financial circumstances, exceptional circumstances exist such that collection of the full liability will be detrimental to voluntary compliance by taxpayers; and compromise of the liability will not undermine compliance by taxpayers with the tax laws.

3. The determination to accept or reject an offer to compromise made on the ground that acceptance would promote effective tax administration will be based upon consideration of all the facts and circumstances, including the taxpayer's record of overall compliance with the tax laws.

4. Factors supporting (but not conclusive of) a determination of economic hardship include:

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

    4.2. Although taxpayer has certain assets, liquidation of those assets to pay outstanding tax liabilities would render the taxpayer unable to meet basic living expenses; and

    4.3. Although taxpayer has certain assets, the taxpayer is unable to borrow against the equity in those assets and disposition by seizure or sale of the assets would have sufficient adverse consequences such that enforced collection is unlikely.

5. Factors supporting (but not conclusive of) a determination that compromise would not undermine compliance by taxpayers with the tax laws include

    5.1. Taxpayer does not have a history of noncompliance with the filing and payment requirements of the Internal Revenue Code;

    5.2. Taxpayer has not taken deliberate actions to avoid the payment of taxes; and

    5.3. Taxpayer has not encouraged others to refuse to comply with the tax laws.

V. MECHANICS FOR MAKING OFFER IN COMPROMISE

A. Form 656

1. Must be completed for all offers

2. Contains waiver of statute of limitations (see discussion below).

B. Deposits

1. Not needed and should not be used unless

    1.1. Taxpayer needs to "hide" funds from other creditors.

    1.2. Tax practitioner has concerns about client's ability to raise funds for offer

1.3. Source of funds for offer may not be available at later date

2. Will be returned to taxpayer if the offer is rejected or withdrawn unless taxpayer directs that the deposit be applied to tax liability.
3. Interest does not accrue on deposits.
4. Although IRM provides that deposit will be applied to tax liability as of the date taxpayer's written direction to apply deposit is received, the practice has been to retroactively apply the deposit as of the date the deposit was received by the IRS.

C. Forms 433-A and 433-B

1. Form 433-A is personal financial statement
2. Form 433-B is business financial statement
3. Neither form needed for offers based on doubt as to liability

D. Supporting memorandum

1. To accept an offer, the IRS employee must complete a memorandum recommending acceptance that explains the basis for the agreement
2. The taxpayer's representative should submit a supporting memorandum that does the work for the IRS employee:

   2.1. Details the calculation of asset values used to calculate offer amount

   2.2. Addresses calculation of allowable living expenses

VI. STATUTE OF LIMITATIONS ISSUES

A. Waivers for offers prior to January 1, 2000

1. Effective through December 31, 1999, the temporary regulations require the taxpayer to waive the running of the statutory period of limitations on collection as a condition of acceptance of an offer to compromise.

B. Waivers for offers after December 31, 1999

1. See §3461 of IRS Restructuring and Reform Act of 1998.
2. Effective January 1, 2000, waivers of the statute of limitations on collection will no longer be required for an offer to compromise.
3. Effective January 1, 2000, the statute of limitations for collection will be automatically suspended during the period the offer to compromise is under consideration by the IRS because the IRS will be prohibited from taking collection action during the pendency of an offer to compromise.

VII. REJECTION AND APPEAL

A. Rejection v. Return of Offer

1. "Rejection" is a decision not to accept the offer

   1.1. No offer to compromise received from a low income taxpayer may be rejected solely on the basis of the amount of the offer without evaluating whether that offer meets the criteria for any of the three grounds for compromise

1.2. A low income taxpayer is a taxpayer who falls at or below the dollar criteria established by the poverty guidelines updated annually in the Federal Register by the U.S. Department of Health and Human Services under authority of section 673(2) of the Omnibus Budget Reconciliation Act of 1981 or such other measure that is adopted by the Secretary.

2. "Return" is a decision not to consider an offer: Most common reasons for a returning an offer are:

   2.1. The offer was not processable under IRS procedures because:

      a. Amount of offer was less than taxpayer's net equity in assets, or

      b. Forms 656 and, if required, forms 433-A and 433-B were not completed

   2.2. The IRS believes the offer was submitted solely to delay collection, or

   2.3. The taxpayer failed to provide requested additional information after the offer was initially processed

B. Review before final rejection

1. All proposed rejections of offers to compromise will receive independent administrative review prior to final rejection.

2. See Temp Regs §301.7122(d)(1)

C. Appeals

1. The taxpayer has the right to appeal any rejection of an offer to compromise to the IRS Office of Appeals. See Temp Regs §301.7122(d)(2)

2. The taxpayer, however, cannot appeal a "returned" offer, although the taxpayer may have appeal rights for any subsequent collection action under the collection due process procedures.

VIII. STAY OF COLLECTION ACTION DURING PENDENCY OF OFFER

A. Prior to January 1, 2000

1. Submission of offer did not automatically stay collection action

2. Enforcement of collection, however, was usually deferred unless the interests of the United States was in jeopardy

B. Stay of Collection under RRA of 1998

1. Pursuant to IRC §6331(k), as amended by §3462 of RRA 1998, effect for offers pending on or submitted on or after January 1, 2000, The IRS cannot take enforced collection while

   1.1. an offer to compromise is pending, or

   1.2. for the 30 days following any rejection of an offer to compromise, or

   1.3. during any period that an appeal of any rejection, when such appeal is instituted within the 30 days following rejection, is being considered.

2. Applies to offers pending on, or submitted on or after, January 1, 2000,

3. Collection activity is not precluded in any case where collection is in jeopardy or the offer to compromise was submitted solely to delay collection.

4. An offer to compromise becomes pending when it is accepted for processing. 301.7122-1T(c)(2)

5. An offer returned following acceptance for processing is deemed pending only for the period between the date the offer is accepted for processing and the date the IRS returns the offer to the taxpayer

IX. WITHDRAWAL AND ACCEPTANCE.

A. Withdrawal

1. An offer to compromise a tax liability may be withdrawn by the taxpayer or the taxpayer's representative at any time prior to the IRS' acceptance of the offer to compromise.

2. An offer will be considered withdrawn upon the IRS' receipt of written notification of the withdrawal of the offer by personal delivery, or by certified mail, or upon issuance of a letter by the IRS confirming the taxpayer's intent to withdraw the offer.

B. Acceptance

1. An offer to compromise has not been accepted until the IRS issues a written notification of acceptance to the taxpayer or the taxpayer's representative.

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

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

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

5. Acceptance of an offer to compromise will conclusively settle the liability of the taxpayer specified in the offer. Neither the taxpayer nor the Government will, following acceptance of an offer to compromise, be permitted to reopen the case except in instances where

   5.1. False information or documents are supplied in conjunction with the offer;

   5.2. The ability to pay and/or the assets of the taxpayer are concealed; or

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

C. Public Record of accepted Offers

1. if an offer to compromise is accepted, there will be placed on file for public inspection

   1.1. The amount of tax assessed;

1.2. The amount of interest, additional amount, addition to the tax, or assessable penalty, imposed by law on the person against whom the tax is assessed;

1.3. The amount actually paid in accordance with the terms of the compromise, and

1.4. If required, the opinion of the Chief Counsel for the IRS with respect to such compromise, along with the reasons therefor.

EXHIBIT 1 - COLLECTION FINANCIAL STANDARDS

General

Collection Financial Standards are used to help determine a taxpayer's ability to pay a delinquent tax liability. Allowances for food, clothing and other items, known as the National Standards, apply nationwide except for Alaska and Hawaii, which have their own tables. Taxpayers are allowed the total National Standards amount for their family size and income level, without questioning amounts actually spent. Maximum allowances for housing and utilities and transportation, known as the Local Standards, vary by location. Unlike the National Standards, the taxpayer is allowed the amount actually spent or the standard, whichever is less.

Food, Clothing and Other Items

National Standards for reasonable amounts have been established for five necessary expenses: food, housekeeping supplies, apparel and services, personal care products and services, and miscellaneous. All standards except miscellaneous are derived from the Bureau of Labor Statistics (BLS) Consumer Expenditure Survey (CES). The miscellaneous standard has been established by the IRS.

Alaska and Hawaii

Due to their unique geographic circumstances and higher cost of living, separate standards for food, clothing and other items have been established for Alaska and Hawaii.

Housing and Utilities.

The housing and utilities are derived from Census and BLS data, and are provided by state down to the county level.

Transportation

The transportation standards consist of nationwide figures for monthly loan or lease payments referred to as ownership costs, and additional amounts for monthly operating costs broken down by Census Region and Metropolitan Statistical Area (MSA). Public transportation is included under operating costs. A conversion chart has been provided with the standards which shows which IRS districts fall under each Census Region, as well as the counties included in each MSA. The ownership cost portion of the transportation standard, although it applies nationwide, is still considered part of the Local Standards. The ownership costs provide maximum allowances for the lease or purchase of up to two automobiles if allowed as a necessary expense. The operating costs are derived from BLS data. If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense. If a taxpayer has no car payment, or no car, only the operating costs portion of the transportation standard is used to come up with the allowable transportation expense.

Recent Revisions

The Local Standards for housing and utilities and transportation were revised in 1998 to:

(1) Add family size to the housing and utilities allowances (two or less, three, and four or more);

(2) Base automobile ownership/leasing costs on the five-year average of new and used car financing data compiled by the Federal Reserve Board of Governors; and,

(3) Reflect updated information from the Bureau of Labor Statistics.

The revised Local Standards for housing and utilities and transportation are effective for financial analysis conducted on or after October 15, 1998.

National Allowable Living Expenses for Food, Clothing and Other Items

Includes food, housekeeping supplies, clothing, services, personal care products & services. and miscellaneous

	Number of Persons in Household				
Total Gross Monthly Income	One	Two	Three	Four	Each Add'l Person
Less than $830	$341	$461	$573	$717	$125
$831 to $1,249	$387	$520	$639	$753	$135
$1,250 to $1,669	$429	$622	$728	$790	$145
$1,670 to $2,499	$521	$675	$771	$819	$155
$2,500 to $3,329	$548	$758	$851	$912	$165
$3,330 to $4,169	$612	$818	$935	$1,049	$175
$4,170 to $5,829	$761	$944	$1,004	$1,154	$185
$5,830 and over	$977	$1,218	$1,379	$1,453	$195

Transportation Allowance

Ownership Costs		
Applies to:	First Car	Second Car
National	$372	$294

Operating Costs & Public Transportation Costs			
MSA	No Car	One Car	Two Cars
New York City	$264	$318	$372
Buffalo	$129	$183	$237
All Other	$203	$256	$310

The Operating Costs and Public Transportation Costs section of the Transportation Standards are provided by Census Region and Metropolitan Statistical Area (MSA). The following table lists the states which comprise each Census Region. Once the taxpayer's Census Region has been ascertained, to determine if an MSA standard is applicable, use the definitions below to see if the taxpayer lives within an MSA (MSAs are defined by county and city, where applicable). If the taxpayer does not reside in an MSA, use the regional standard.

MSA Counties

New York City: Bronx, Dutchess, Kings, Nassau, New York, Orange, Putnam, Queens, Richmond, Rockland, Suffolk, Westchester

Buffalo Erie, Niagara

Housing and Utilities Allowable Living Expenses for New York

	SIZE OF HOUSEHOLD				SIZE OF HOUSEHOLD		
COUNTY	2 OR LESS	3 OR LESS	4 OR MORE	COUNTY	2 OR LESS	3 OR LESS	4 OR MORE
Albany	$959	$1,128	$1,297	**Niagara**	**$774**	**$910**	**$1,047**
Allegany	$615	$724	$832	Oneida	$759	$893	$1,027
Bronx	$1,054	$1,240	$1,426	Onondaga	$892	$1,049	$1,206
Broome	$832	$979	$1,126	Ontario	$879	$1,034	$1,189
Cattaraugus	$635	$747	$859	Orange	$1,138	$1,339	$1,540
Cayuga	$755	$888	$1,021	Orleans	$772	$908	$1,044
Chautauqua	$675	$794	$913	Oswego	$766	$902	$1,037
Chemung	$688	$810	$931	Otsego	$728	$856	$985
Chenango	$730	$859	$987	Putnam	$1,345	$1,583	$1,820
Clinton	$773	$909	$1,045	Queens	$1,023	$1,203	$1,384
Columbia	$846	$995	$1,144	Rensselaer	$886	$1,043	$1,199
Cortland	$737	$867	$997	Richmond	$1,146	$1,349	$1,551
Delaware	$702	$825	$949	Rockland	$1,424	$1,675	$1,927
Dutchess	$1,142	$1,344	$1,546	Saratoga	$993	$1,168	$1,343
Erie	**$812**	**$955**	**$1,099**	Schenectady	$903	$1,063	$1,222
Essex	$682	$802	$922	Schoharie	$716	$843	$969
Franklin	$640	$753	$866	Schuyler	$663	$780	$897
Fulton	$680	$800	$920	Seneca	$738	$868	$999
Genesee	$796	$936	$1,076	St. Lawrence	$632	$743	$855
Greene	$793	$932	$1,072	Steuben	$678	$797	$917
Hamilton	$638	$751	$863	Suffolk	$1,250	$1,471	$1,691
Herkimer	$654	$769	$884	Sullivan	$875	$1,029	$1,184
Jefferson	$760	$894	$1,028	Tioga	$834	$982	$1,129
Kings	$1,055	$1,242	$1,428	Tompkins	$925	$1,088	$1,252
Lewis	$646	$760	$874	Ulster	$936	$1,101	$1,266
Livingston	$827	$973	$1,119	Warren	$875	$1,029	$1,184
Madison	$786	$925	$1,064	Washington	$754	$887	$1,020
Monroe	$966	$1,136	$1,307	Wayne	$846	$995	$1,144
Montgomery	$703	$827	$951	Westchester	$1,732	$2,037	$2,343
Nassau	$1,395	$1,641	$1,887	Wyoming	$692	$814	$937
New York	$2,178	$2,562	$2,947	Yates	$668	$786	$904