Offers in Compromise

This letter is intended to answer in more detail your question regarding the use of the IRS's Offers in Compromise program to settle your tax liability with the IRS at a possible discount. There are some ground rules that clearly must be part of any deal that will be made for you with the IRS. Here is a summary of the operative rules as they now exist.

First contact. The first contact that the taxpayer who needs an offer in compromise will generally have with the IRS is on audit. There, the IRS examiner will make an assessment of taxes owed, and issue a notice of deficiency. Offers in compromise as to doubt of liability usually take place at an earlier stage than offers based on doubt as to collectibility. Offers in compromise as to doubt of collectibility almost always take place at the collection stage, after a liability has been reduced to judgement or is uncontested by the taxpayer. Some taxpayers combine the two grounds for an offer as a strategic move, on the assumption that the IRS will assume that the odds are greater that the amount will not be collected.

Financial statement. The financial statement form that a taxpayer is required to file with a formal offer in compromise is at the heart of the IRS's examination of whether an offer is acceptable. Documentation required for the IRS's financial statement analysis must include a full credit report for liabilities greater than $100,000. Financial statements must reflect information no older than the six-month period prior to submission of the offer in compromise.

Quick sale value, which is used to value most assets, generally is an amount less than fair market value (FMV), but greater than forced sale value (generally 75% of FMV). Determining fair market value for many items turns into a matter of opinion in many situations and it is often good strategy to document how valuation is determined on the taxpayer's property so that the IRS is not tempted to call for its own valuation. Fair market value itself can reasonably vary by 15 or 20% depending upon the type of property and market conditions, which in turn can lower the figure set for quick sale value. The IRS cannot use the hindsight of any actual sale after the offer in compromise is in place to negate the agreement (absent a showing of fraud). However, taxpayers who wish to renegotiate a compromise offer may introduce evidence of a sale that brought in substantially less than had been anticipated on the financial statement.

Agent's Worksheets. The IRS agent is instructed to use worksheets in evaluating an Offer in Compromise. Made available to tax professionals through the Freedom of Information Act, we know that this form requires that the IRS agent weigh nine principal factors included in "total income" compared against ten factors included in necessary living expenses. Necessary living expenses include:

*the National Standard expense;
*housing and utilities;
*transportation;
*health care;
*taxes;
*court ordered payments;
*child/dependent care;
*life insurance;
*secured or legally perfected debt;
*other miscellaneous expenses.

Offer rejection? Having an Offer in Compromise rejected should not deter a taxpayer from further action. The taxpayer may ultimately win through an appeals process, through a resubmitted Offer, or through alternative terms such as an installment agreement.

The IRS Restructuring and Reform Act of 1998 requires the IRS to implement procedures to review all proposed rejections of taxpayer offers in compromise prior to the rejection being communicated to the taxpayer. This review is not conducted by the front line manager with direct supervisory authority over revenue officers working in compromise cases. The taxpayer's second bite at the apple comes after the rejection letter is sent. Appeals rights are available to the taxpayer when any reasonable offer is rejected. Collection is prohibited during the appeal period.

So, ... the upshot of all this information is that you may stand "a fighting chance" to strike a compromise with the IRS on your tax liability through their "new and improved" offers in compromise program. The IRS is still not "giving it away," however, though with careful adherence to their new, less stringent guidelines, compromise is certainly more likely now than ever before. Please call if you have any specific questions concerning how these rules apply to you.