August 3, 2006

Hon. Mark W. Everson
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC  20224

Re: Comments in Response to Notice 2006-68 Regarding Requirement of Partial Payment with Submission of Offers in Compromise

Dear Commissioner Everson:

Enclosed are comments in response to Notice 2006-68 regarding the requirement of partial payment with the submission of offers in compromise. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association and should not be construed as representing the policy of the American Bar Association.

Sincerely,

Dennis B. Drapkin
Chair, Section of Taxation

Enclosure

cc:  Donald L. Korb, Chief Counsel, Internal Revenue Service
     Eric Solomon, Acting Deputy Assistant Secretary (Tax Policy), Treasury Department
     Michael J. Desmond, Tax Legislative Counsel, Treasury Department
     William F. Conroy, Office of Associate Chief Counsel (Procedure & Administration), Internal Revenue Service
These comments (“Comments”) are submitted on behalf of the Section of Taxation of the American Bar Association (“Tax Section”) and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Leslie M. Book and Joseph Barry Schimmel of the Tax Section’s Low Income Taxpayers Committee. Substantive contributions were made by Katherine E. David, Diana Leyden and William P. Nelson of the Low Income Taxpayers Committee, and by Carol M. Luttati of the Committee on Administrative Practice. The Comments were reviewed by Elizabeth J. Atkinson, Chair of the Low Income Taxpayers Committee, Thomas J. Callahan, Chair of the Tax Section’s Committee on Administrative Practice, Robert E. McKenzie of the Tax Section’s Committee on Government Submissions, Sharon Stern Gerstman, Council Director for the Low Income Taxpayers Committee, and Charles A. Pulaski, Jr., Council Director for the Committee on Administrative Practice.

Although some of the members of the Tax Section who participated in preparing these comments have clients who would be affected by the federal tax principles addressed by these comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these comments.

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Date: August 3, 2006
EXECUTIVE SUMMARY

These Comments are submitted in response to the request for comments by the Internal Revenue Service (“Service”) in Notice 2006-68, dated July 11, 2006 (the “Notice”), regarding changes to the offer in compromise program (the “OIC Program”) enacted as part of the Tax Increase Prevention and Reconciliation Act of 2005 (Pub. L. No. 109-222) (“TIPRA”). These Comments specifically address the Service’s request for comments on issues not addressed in the Notice that should be addressed in regulations or other guidance. The Tax Section intends to submit additional comments regarding issues addressed in the Notice, and regarding the definition of “low-income.”

Section 7122 of the Code authorizes the Secretary of the Treasury to compromise tax liabilities for an amount that is less than the full amount owed. Policy Statement P-5-100 (the “Policy Statement”) provides in part, “[t]he Service will accept an offer in compromise when it is unlikely that the tax liability can be collected in full and the amount offered reasonably reflects collection potential.” The Policy Statement recognizes that an offer in compromise is a legitimate alternative to placing the case in currently not collectible status or to entering into a protracted installment agreement because “the goal is to achieve collection of what is potentially collectible at the earliest possible time and at the least cost to the Government.” Moreover, the Policy Statement provides that acceptance of an adequate offer can create for the taxpayer a “fresh start toward compliance with all future filing and payment requirements.” The Policy Statement also provides that, while the taxpayer is expected to initiate the first specific offer, the Service “will discuss the compromise alternative with the taxpayer and, when necessary, assist in preparing the required forms” in those cases in which an offer is a viable option.

Regulations finalized in 2003 require the taxpayer to pay a $150 user fee for processing an offer in compromise, subject to exceptions for certain low-income taxpayers and for offers based solely on doubt as to liability. TIPRA amends section 7122 of the Code to require the submission of partial payments with offers in compromise, effective for offers made on or after July 16, 2006. With respect to lump-sum offers in compromise, TIPRA requires the taxpayer to submit with the application a down payment of 20% of the offer amount. For periodic payment offers, the taxpayer is required to submit the first installment payment with the application and thereafter to comply with the taxpayer’s proposed payment schedule while the Service is considering the offer.

2 Notice 2006-68 (July 11, 2006), sec. 5.01.
3 Id.
4 Id., sec. 5.02.
5 References herein to the “Code” refer to the Internal Revenue Code of 1986, as amended.
6 IRM § 1.2.1.5.18 (rev. 1-30-1992). References in the footnotes to the “IRM” are to the Internal Revenue Manual.
7 Id. ¶ 1.
8 Id.
9 Id.
10 T.D. 9086 (08/18/2003).
11 Treas. Reg. § 300.3.
12 Unless otherwise stated, references herein to “sections” are to sections of the Code.
13 Defined as any offer of payment made in five or fewer installments. Section 7122(c)(1)(a)(ii). Unless otherwise stated herein, references to section 7122 are to the provision as amended by TIPRA.
14 Section 7122(c)(1)(A)(i).
15 Defined as any offer of payment made in six or more installments. Notice 2006-68, supra note 2.
16 Section 7122(c)(1)(B).
TIPRA requires that, if a taxpayer fails to submit the required initial payment with the offer, the Service may return the offer to the taxpayer as unprocessable.\textsuperscript{17} In the case of a periodic payment offer, the Service is permitted to treat a taxpayer’s failure to comply with the proposed installment payment schedule during the pendency of the offer as a withdrawal of that offer.\textsuperscript{18} TIPRA authorizes the Secretary of the Treasury to issue regulations waiving the partial payment requirements.\textsuperscript{19} TIPRA also provides that, unless an offer is rejected within 24 months after the date of submission, the offer is deemed to have been accepted.\textsuperscript{20}

The TIPRA amendments raise a number of questions concerning the administration of the partial payment requirements that were not addressed in the Notice, including the following:

- Whether partial payments will be considered part of the taxpayer’s reasonable collection potential;
- For periodic payment offers, where and how second or subsequent installment payments should be made;
- How the partial payment requirements will apply to repeat offers in compromise; and
- Whether TIPRA will be interpreted to override the current regulatory rule permitting a refund of the user fee in furtherance of “effective tax administration” and certain other offers.

We recommend that the Service should address these issues promptly and should also consider making any such guidance effective for offers made on or after July 16, 2006. We note that certain issues may require a technical correction.

The Tax Section has, on two occasions, expressed to Congress its opposition to TIPRA’s partial payment requirements.\textsuperscript{21} However, as stated above, these Comments are directed solely toward the Service’s specific request for comments on issues raised by these requirements that were not addressed in the Notice.

\textsuperscript{17} Section 7122(d)(3)(C).
\textsuperscript{18} Section 7122(c)(1)(B)(ii).
\textsuperscript{19} Section 7122(c)(2)(C).
\textsuperscript{20} Section 7122(f).
PARTIAL PAYMENTS SHOULD BE CREDITED AS PART OF THE REASONABLE COLLECTION POTENTIAL

Under the OIC Program, both the Service and the taxpayer are required to calculate and to propose the taxpayer’s reasonable collection potential (the “RCP”), which is the target amount for an offer in compromise. The Notice does not address whether partial payments should affect the calculation of the taxpayer’s RCP. We believe that partial payments (and any user fees) should be subtracted from the taxpayer’s RCP.

For example, assume a taxpayer’s RCP is $5,000, and the taxpayer borrows $1,000 from a family member to fund the lump-sum partial payment requirement. If the Service agrees that the taxpayer’s RCP is $5,000, the taxpayer should be required to pay an additional $4,000, not the full RCP unreduced by the partial payment.

We recommend that the Service promptly provide guidance regarding the impact of partial payments (and user fees) on RCP. We further recommend that the Service consider making such guidance effective for offers made on or after July 16, 2006.

SUBMISSION OF SECOND AND SUBSEQUENT INSTALLMENT PAYMENTS

For periodic payment offers, the taxpayer is required to submit the first installment payment with the application and thereafter to comply with the taxpayer’s proposed payment schedule while the Service is considering the offer. The Notice does not address where subsequent installment payments should be sent or how the Service will associate such payments with the related offer. Further, in the case of a payment for which the taxpayer has not specified how the payment is to be applied, the Notice does not prevent the Service from applying the payment to taxable years or periods that are not the subject of the offer. We are concerned that the Service has not implemented internal procedures to associate such payments with the taxpayer’s offer in a timely manner.

We commend the Service for stating that it may solicit payment from the taxpayer of the unpaid amount of the subsequent installment, but we are concerned that, if the subsequent installment has been made but not properly credited, such a request will create a substantial burden on both the taxpayer and the Service.

We recommend that the Service provide guidance specifying where subsequent installment payments should be sent and what notation should be set forth on the payments to ensure proper crediting to the offer. We further recommend that the Service implement internal procedures to credit subsequent installment payments promptly and to ensure that offers will not be treated as withdrawn in cases where subsequent payments have been made, but have not been credited to the offer.

PARTIAL PAYMENTS AND REPEAT OFFERS

Repeat offers occur when, after the Service rejects or returns an offer and closes the case, the taxpayer submits a subsequent offer covering at least a portion of the same tax liability. In a recent study (the

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22 See IRM 5.8.4.4.1 (rev. 9-1-2005).
23 Section 7122(c)(1)(B).
24 Notice 2006-68, supra note 2, sec. 3.02.
“GAO Study”), the Government Accountability Office reported that the number of repeat offers has
grown significantly since fiscal year 2000 and represents over 40% (29,527 out of 73,301) of the offers
received during fiscal year 2005. Moreover, the GAO Study reported that thousands of offers were from
taxpayers who submitted repeat offers multiple times. The report provided no explanation for the growth
in repeat offers, primarily because (according to the GAO) the Service has not analyzed the reasons for
repeat offers. However, the GAO Study expressed concern that the trend in repeat offers might indicate a
breakdown in OIC Program processes or might adversely affect performance measures of timeliness and
accessibility. While some repeat offers may be frivolous, it would be premature to conclude that a
significant share of repeat offers are frivolous without a thorough analysis. Such a study should
investigate why taxpayers make repeat offers and should examine the number of, and reasons for, repeat
offers that the Service ultimately accepts. Significantly, the GAO Study noted that best available
evidence, though incomplete, indicates that so-called offer mills, tax practitioners that use negligent or
deceptive practices to exploit taxpayers by submitting unrealistic offers, have little effect on the OIC
Program. In the experience of several of the drafters of these Comments, many repeat offers are
necessitated by a breakdown in OIC Program processes, such as the Service’s failure to give taxpayers
adequate time to submit additional financial documents or its incorrect analysis of the taxpayer’s financial
condition when computing realizable collection potential.

The GAO Study questioned how the partial payment requirements might apply in the case of repeat
offers. Requiring a taxpayer who makes a repeat lump-sum offer to submit an additional partial
payment, without taking into account partial payments made with prior offers, would decrease the
accessibility of the OIC Program and would impose a severe financial hardship on many taxpayers.

We believe that repeat offers can be divided into three categories based on the time elapsed between
rejection of the initial offer and submission of the subsequent offer. They are:

1. Repeat offers submitted within 6 months after rejection of the initial offer. These offers often
   contain terms that are similar to the initial offer and may include additional supporting information
to demonstrate that the offer should be accepted. These offers are more appropriately characterized
   as revisions or refinements of the initial offer, rather than as repeat offers.

2. Repeat offers submitted more than 6 months but within 24 months after rejection of the initial
   offer. These offers may contain terms that are similar to or different from the initial offer, but
   usually represent the taxpayer’s attempt to address the perceived reason for the Service’s rejection
   of the initial offer. These offers are appropriately viewed as repeat offers.

3. Repeat offers submitted more than 24 months after rejection of the initial offer. These offers may
   contain terms that are significantly different from the initial offer and may be essentially unrelated
   to the initial offer. The taxpayer’s financial circumstances may have changed substantially since
   the initial offer was made. These offers are more appropriately characterized as new offers.

We recommend that, when processing a repeat lump-sum offer, the Service reduce the required partial
payment by the amount of any partial payments made by the taxpayer in connection with any prior offers
that were rejected or withdrawn within the preceding 24 months. For example, suppose Taxpayer A
makes a $500 lump-sum offer as an initial offer. Taxpayer A must submit a partial payment of $100
($500 x 20%) with the offer. If Service rejects the offer and retains the $100 partial payment, the $100
partial payment should be credited to any payments applicable to repeat offers made by Taxpayer A
within the following 24 months. If 10 months later, Taxpayer A makes a $2,000 lump-sum offer, the 20%

25 U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-06-525, IRS OFFERS IN COMPROMISE (Apr. 20, 2006) at 12-

26 Id. at 13-14.
27 Id. at 30.
28 Id. at 13-14.
partial payment required with the repeat offer should be reduced by the $100 payment made with the initial offer, and Taxpayer A should be required to submit a partial payment of only $300 \([($2,000 \times 20\%) - $100]\).

Similarly, suppose Taxpayer B submits an initial offer of $1,800 to be made in 24 periodic monthly payments of $75 each. Taxpayer B makes a $75 partial payment with the submission of the initial offer and continues to pay $75 per month for 3 additional months while the Service considers the offer. In the 4\(^{th}\) month, the Service rejects the offer as inadequate, and Taxpayer B stops making payments. If 10 months later, Taxpayer B makes a lump-sum offer of $2,200, the 20\% partial payment required with the repeat offer should be reduced by the periodic payments made with the initial offer and Taxpayer B should be required to submit a partial payment of only $140 \([($2,200 \times 20\%) – ($75 \times 4)]\).

Further, we are concerned that taxpayers who make repeat offers are especially burdened by the combined effect of the partial payment requirements and the $150 user fee imposed by Treas. Reg. §300.3. Most repeat offers require an additional $150 user fee because the Service does not refund the user fee to the taxpayer if the initial offer is rejected, withdrawn, or returned as unprocessable after acceptance for processing.\(^{29}\)

We recommend that the Service promptly provide guidance regarding the application of the partial payment requirements to repeat offers. We further recommend that the Service consider making such guidance effective for repeat offers made on or after July 16, 2006.

**APPLICATION OF THE USER FEE**

TIPRA also creates ambiguities in connection with the application of the user fee. Section 7122(c)(2)(B) provides that any user fee imposed with respect to an offer in compromise shall be applied to the tax to which the offer relates. Section 7122(c)(2)(B) appears to override Treas. Reg. §300.3(b)(2)(i) and (ii), which provide that, if an offer is accepted to promote effective tax administration, or is accepted based on doubt as to collectibility and collection of an amount greater than the amount offered would create economic hardship, the user fee will be applied against the amount of the offer unless the taxpayer requests that the user fee be refunded.

For offers made on the grounds of effective tax administration or doubt as to collectibility, TIPRA appears to override the existing regulation by precluding both the application of the user fee to the amount of the offer and the refund of the user fee. The legislative history does not indicate that Congress intended to override the existing regulation. The Senate amendment to TIPRA provided that a user fee would not be imposed on any offer in compromise accompanied by a partial payment. While the conference agreement eliminated this provision, the conference report does not evidence any intention to change Treas. Reg. §300.3(b)(2).

For cases described in Treas. Reg. §300.3(b)(2)(i) or (ii), a taxpayer’s ability to apply a user fee against an offer amount is meaningful. Although the $150 amount may be an insignificant fraction of a tax liability, it might be a substantial portion of the offer amount.

Since we believe that no change was intended, we recommend that the regulations clarify that Treas. Reg. §300.3(b)(2) was unaffected by TIPRA.

**SUMMARY**

TIPRA’s changes to the OIC Program create uncertainties in the application of the partial payment requirements. As discussed above, we believe the Notice failed to address several of these issues. To

\(^{29}\) Treas. Reg. § 300.3(b)(3).
address those ambiguities, we recommend that the Service promulgate regulations or other advice to: (i) provide that partial payments (from whatever source) will be considered part of the taxpayer’s reasonable collection potential; (ii) ensure that subsequent installment payments are properly associated with related offers; (iii) address the application of the partial payment requirements to repeat offers; and (iv) clarify that section 7122(c)(2)(B) does not override Treas. Reg. §300.3(b)(2), permitting the application of the user fee to the amount of the offer and the refund of the user fee in certain cases.