Nuts & Bolts Collections Part IV
Common Issues in Preparing Offers in Compromise

Moderator: Sarah Lora
Legal Aid Services of Oregon LITC
Panelist 1: Shahin Rahimi
Legal Aid Society of San Diego LITC
Panelist 2: Giovanni V. Alberotanza
Rosenberg Martin Greenberg, LLP
Panelist 3: Frank DiPietro
LITC Director – Indiana Legal Services, Inc.

Thursday, February 28, 2019 | 01:00 PM Eastern
Sponsored by the ABA Section of Taxation
OIC? Let’s wait and see

• Is this an Offer that can’t be refused?
  – Before you even think about submitting an OIC packet, you should consider:
    • All returns been filed?
    • All assessments final? (CP 2000, ongoing exam, tax court case pending, etc.)
    • If Client is self-employed, current on Estimated Tax Payments?
On your mark, get set, STOP!

• Is the client a good offer candidate?
• Hold your horses and slow down!
• Evaluate all the factors:
  1. Non-filer?
  2. Non-payer?
  3. Self-Employed?
  4. Gut feeling – do you sense that this client is not going to complete all the required terms?
Evaluate Client

• Before you go over the forms and the documentation necessary, evaluate your client’s story and how they got here.
• Does the taxpayer take responsibility for the predicament they are in OR are they simply looking for a bailout?
• Conduct an in-person meeting to evaluate the client’s demeanor and attitude. Sometimes you can spot a “tax protestor” – you DO NOT want to represent this client!
Evaluate liability

• Do they owe for only 1 year – when they took out retirement money OR do they owe for several years of unfiled returns – liabilities assessed only after IRS filed for them?

• Do they owe for several years due to unreported gambling income OR several years because of a lack of Estimated Tax Payments?
Evaluate Client’s Readiness

- If all the previous hurdles have been cleared (filed returns, assessments final, etc.) the next step is to put the ball in client’s court
- Review the forms with them (656 and 433-A), BUT ask them to take them home, fill out and bring back to your office
- Require them to read the entire section on the contractual terms laid out in 656
Client’s Readiness

• This forces the client to take ownership of the process – the attorney simply provides the vehicle to transport the information to the OIC office

• It’s vital that the Client understands this concept – they are signing the forms under penalty of perjury ---- NOT YOU!
Self-Employed Clients

• Be very weary of SE clients. They will be required to provide a lot more information about their source of income (profit and loss statement, at least 6 months of bank statements [sometimes more] and other financial info)

• Self-Employed clients are also liable to be scrutinized more by Offer Examiners once the packet has been received by Memphis or Holtsville
Self-Employed Clients

- Can the taxpayer provide a clear picture of their business income?
- Do they keep a separate bank account for the business?
- Do they keep track of expenses?
- Do they use an accountant that takes “aggressive” positions on business deductions?
Dissipated Assets

– Dissipation of Assets
  • IRM 5.8.5.18 (03-23-2018)
  • Inclusion of dissipated assets in the calculation of the reasonable collection potential (RCP) is no longer applicable, except in situations where it can be shown the taxpayer has sold, transferred, encumbered or otherwise disposed of assets in an attempt to avoid the payment of the tax liability or used the assets or proceeds (other than wages, salary, or other income) for other than 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 during a period of up to six months prior to or after the tax assessment.
Dissipated Assets

• Therefore, you need to ask the client if he/she sold an asset and spent the proceeds for anything other than the payment of items necessary for the production of income or the health and welfare of the taxpayer or their family.

• For example, Client inherited $10,000 last year and used it to travel abroad – yikes!
Review

• Review from last presentation
  – What needs to be included in an offer application?
    • Signed and dated (by the taxpayer) Form 656
    • Signed and dated (by the taxpayer) Form 433-A (OIC)
    • Application fee and payment towards settlement unless the client qualifies as low income
    • A cover letter
    • Supporting documentation
Review

• What to Offer?
• Determine Reasonable Collection Potential ("RCP")
  – Analyze Income and Expenses
  – Analyze available Equity in Assets
Review

• Income and Expenses
  – Determine total monthly income
  – Determine total monthly necessary living expenses
  – Subtract the total monthly necessary living expenses from the total monthly income to determine the remaining monthly income
Income and Expenses: Common Issues

- Taxpayer lives with a person who is not liable for the tax.
  - What is the Taxpayer’s share of household income?
  - What is the Taxpayer’s share of household expenses?
    » IRS will apportion the income and expenses
Income and Expenses: Common Issues

- **IRS Allocation Method:**
  - Determine the total actual household income.
  - Determine what percentage of the total household income the taxpayer contributes.
  - Determine which expenses the taxpayer and others have agreed to share, e.g., taxpayer and non-liable spouse pay their expenses from joint checking account. If there is no agreement, then the expense isn't shared, as is typical for child support, allowable educational loan, or union dues.
  - Apply the taxpayer's percentage of income to the shared expenses.
  - Verify that the taxpayer actually contributes at least this amount to the total household expense. National Standard expenses do not require verification unless the taxpayer claims more than the standard amount.
  - Taxpayer is not allowed any amount paid toward the non-liable person's discretionary expenses.
Income and Expenses: Common Issues

• **What if non-liable person refuses to provide income / expense information to the IRS?**
  
  – If the non-liable person’s income is not provided or cannot be verified internally, allow the liable taxpayer only the national and local standards for 1 person plus any allowable and verifiable dependents. In those cases where the non-liable person refuses to provide the supporting documentation (if the expenses are reasonable) IRS may consider allowing up to 50% of the additional necessary household expenses.
Income and Expenses: Common Issues

- **Future Income Collateral Agreements**
  - Future income is defined as an estimate of the taxpayer's ability to pay based on an analysis of gross income, less necessary living expenses, for a specific number of months into the future.
  - A future income collateral agreement is most appropriate in situations where the taxpayer’s future income is uncertain, but it is reasonably expected that the taxpayer will be receiving a substantial increase in income.

- **Example:**
  - A taxpayer is currently in medical school; upon graduation income should increase dramatically. Consider securing a future income collateral agreement.
Equity in Assets: Common Issues

– Jointly held assets

• General Rule: Allocate the equity in the asset equally between owners.

• Exception to the Rule: If each owner’s interest in the asset is not equal, then allocate the equity in the asset based on each owner’s interest in the asset.
Equity in Assets: Common Issues

Ownership of Stock in a Closely Held Business

• IRS can request a Form 433-B for the business.
• Review recent year’s annual report to stockholders.
• Review recent year’s corporate income tax returns.
• Request an appraisal of the business as a going concern by a qualified and impartial appraiser.
Equity in Assets:
Common Issues

– Dissipation of Assets

• IRM 5.8.5.18 (03-23-2018)

• Inclusion of dissipated assets in the calculation of the reasonable collection potential (RCP) is no longer applicable, except in situations where it can be shown the taxpayer has sold, transferred, encumbered or otherwise disposed of assets in an attempt to avoid the payment of the tax liability or used the assets or proceeds (other than wages, salary, or other income) for other than 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 during a period of up to six months prior to or after the tax assessment.
Offers in Compromise Based on Effective Tax Administration (ETA)

- An Offer in Compromise Based on ETA is not the same as an Offer in Compromise based on Doubt as to Collectability with special circumstances (DCSC).

  • Taxpayers may qualify for an ETA offer when their RCP is greater than the liability but there are economic or public policy/equity circumstances that would justify accepting the offer for an amount less than full payment.

  • Taxpayers may qualify for a DCSC offer when they cannot fully pay the tax due but have proven special circumstances that warrant acceptance for less than RCP. Factors establishing special circumstances under DATC are the same as those considered under ETA. Refer to IRM 5.8.4.2.
Offers in Compromise Based on Effective Tax Administration (ETA)

- **Example:**
  - The taxpayer owes $20,000. The RCP is $25,000. The taxpayer could have an offer accepted for less than the total liability of $20,000 under the ETA provisions if economic hardship, or public policy/equity issues exist which would support an acceptance recommendation.

- **Example:**
  - The taxpayer owes $20,000. However his RCP is $15,000. The offer does not meet the legal basis for an ETA because the RCP is lower than the liability. However, applying the same factors of economic hardship, or public policy/equity, an offer could be accepted for less than the RCP ($15,000) under DCSC provisions.
Offers in Compromise Based on Effective Tax Administration (ETA)

- OIC based on ETA considered only if all of the following factors are satisfied:
  - A liability has been or will be assessed before OIC acceptance;
  - The sum of net equity in assets, future income, and the other components of collectibility making up RCP must be greater than the amount owed; AND
  - Exceptional circumstances exist, such as the collection of the tax would create an economic hardship, or there is compelling public policy or equity considerations that provide sufficient basis for compromise.

- 2 Types of ETA situations:
  - Economic Hardship
  - Public Policy or Equity Grounds
Offers in Compromise Based on Effective Tax Administration (ETA)

- **Example of ETA with Economic Hardship:**
  
  - The taxpayer is retired and the only income is from a pension. The only asset is a retirement account and the funds in the account are sufficient to satisfy the liability. Liquidation of the retirement account would leave the taxpayer without adequate means to provide for basic living expenses. The taxpayer's overall compliance history does not weigh against compromise.
Offers in Compromise Based on Effective Tax Administration (ETA)

– ETA based on Public Policy or Equity Grounds:

• Where there is no DATL, no DATC, and the liability could be collected in full without causing economic hardship, the Service may compromise to promote ETA where compelling public policy or equity considerations identified by the taxpayer provide a sufficient basis for accepting less than full payment. Compromise is authorized on this basis only where, due to exceptional circumstances, collection in full would undermine public confidence that the tax laws are being administered in a fair and equitable manner.
Offers in Compromise Based on Effective Tax Administration (ETA)

– ETA based on Public Policy or Equity Grounds:

• Some examples that MAY provide relief:
  – The taxpayer was incapacitated and thus unable to comply with the tax laws.
  – Criminal or fraudulent actions of a third party.
  – Reliance on erroneous advice or instructions from an IRS employee.
  – Liability was directly caused by a processing error on the part of the IRS and would otherwise have been avoided.
Communicating and Advocating For Your Client With the Offer Unit

• Begins with the submission of the OIC
  – Offer Examiners look at hundreds of offers every year
  – OIC Package should be clear and organized
  – If possible, keep either a scanned or paper exact copy of all documents sent to the offer unit
Communicating and Advocating For Your Client With the Offer Unit

• Cover Letter
  – Not Required
  – Allows you to make your client’s case upfront
  – Presents your client’s case “beyond the numbers”
  – Highlight certain factors that promote acceptance of your offer by the IRS
Sample Cover Letter

Brookhaven IRS Center
COIC Unit
P.O. Box 9007
Holtsville, NY 11742-9007

RE: John Doe – SSN# 999-99-9999

Dear Sir or Madam,

Please find the enclosed forms and documents with which to make an Offer In Compromise for John Doe.

- IRS Form 433-A (OIC)
- IRS Form 656
- IRS Form 2848
- Social Security Award Letter
- Three Months Bank Statements

Origin of Tax Liability
Medical Diagnosis and Disability
Household Information
Income and Expenses
Assets

While John Doe acknowledges his liability to the IRS, he does not have any expendable income or valuable assets with which to pay it. As such, on behalf of Mr. Doe, we are offering a one-time lump-sum payment of $10 to settle the debt from the 2012 & 2013 tax year.
Helpful Documentation That is Not Required

• Medical Documentation
• Pictures of Special Use Items
• Pictures of Current Living Conditions
• Outstanding Bills
• Client Impact Statement
Prompt Response Required

• After OIC Examiner Initial Review
  – OIC Examiner will contact POA to notify them of recommendation of approval, ask for additional documentation or clarification
  – Must return call with 72 hours, or “need for contact” letter can be issued.
  – Failure to respond to “need for contact” letter within 1 week can result in offer being returned.
Negotiation

- Examiners Will Often Request Higher Payment Amounts
- Switch Offer Types
- Shorter Payment Times
Offer Denied

- Request Administrative Appeal
- Offer Part of CDP Hearing
  - Review Offer With CDP Officer
  - Judicial Review
    - Not question of whether offer should have been accepted
    - Question of “abuse of discretion”
Offer Acceptance
Lien Discharge

• IRM 5.12.3.5.3
  – “When an offer in compromise (OIC), including a collateral agreement, is accepted, the NFTL is released upon payment of the offered amount.”
  – IRS generally has 30 days to notify county clerk of lien release.