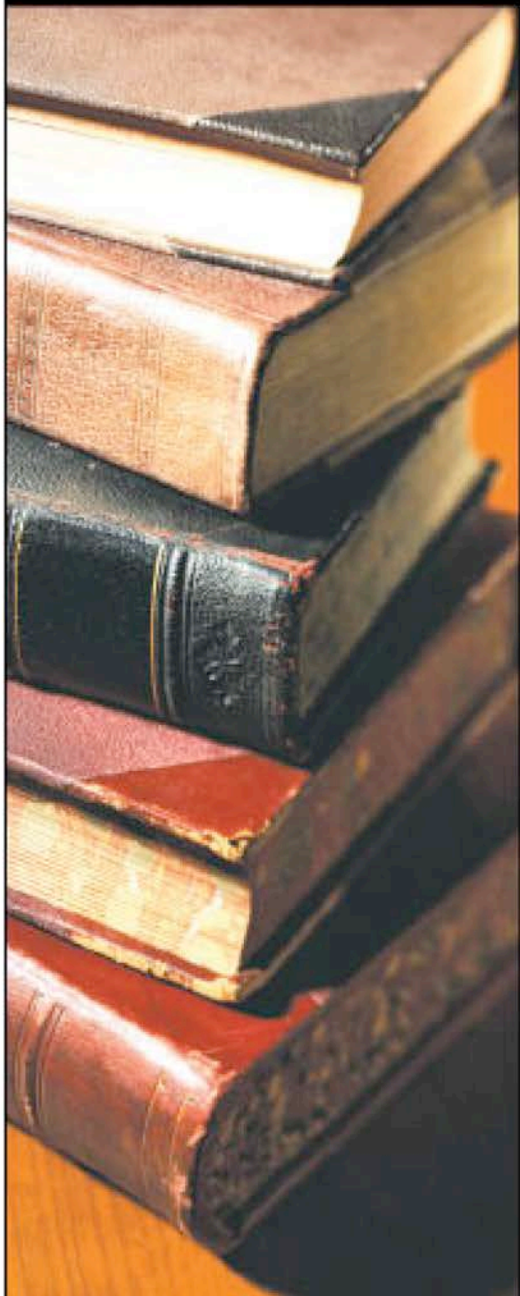
Professional Education Services, LP



Quality education offered by PES...

Settling Tax Debt with the IRS

Course #6810/QAS6810

Course Material

Professional Education Services, LP

The Professional's Choice for CPE. sm

4208 Douglas Blvd. • Suite 50 • Granite Bay, CA 95746

To Order: 1-800-998-5024 • Customer Service: 1-800-990-2731 • Fax: 916-791-4099

www.mypescpe.com • www.pescpe.com • www.pesqascpe.com • www.eacpe.com

Settling Tax Debt with the IRS (Course #6810/QAS6810)

Table of Contents

Table of Contents (cont.)

Table of Contents (cont.)

Chapter 1: Introduction to Settling with the IRS

I. Course Overview

I am sure that most of you have heard the following type of commercials on one of your favorite radio stations:

> *I was tens of thousands of dollars in debt to the IRS. I could not sleep at night and was stressed all of the time. Finally, I called XYZ Tax Resolution Center and they settled my debt for pennies on the dollar. My only regret is that I did not call sooner. Do yourself a favor and call XYZ Tax Resolution Center today.*

These types of claims and commercials have become so prevalent that both the IRS and the Consumer Financial Protection Bureau are considering oversight of this portion of the financial services industry. Concerns have developed based on requirements of large "up front" fees and frequent failures to settle debts based on promised terms. The Federal Trade Commission and state attorneys general also have won some high-profile cases against tax debt firms in recent years.

The fact is that there is an industry dedicated to help taxpayers resolve cases with the IRS. For many taxpayers, hiring a CPA or attorney or resolution company may make sense. For others, it does not. The fact remains, however, that there are a variety of mechanisms in place for taxpayers to resolve disputes, including entering into settlement agreements, appealing IRS assessments and seeking relief as an innocent spouse. There are a variety of problems a taxpayer can have and a variety of ways to try to resolve them.

The following is taken verbatim from the website of one company actively involved in resolving claims with the IRS:

Back Taxes: Settle Tax Debt and IRS Problems

Owe IRS Back Taxes?

Whether the IRS is demanding full payment of back taxes up-front or a payment plan that is substantially higher than what you can afford to pay, we can negotiate an offer in compromise settlement on your behalf for a fraction of what is owed or to set up an arrangement for the lowest possible monthly payment with various options for making those payments, if you qualify.

Don't be afraid of the IRS anymore. Get tax relief fast from the nation's leading expert in resolving back taxes and IRS problems.

Even if you can't afford to pay your back taxes, a Certified Tax Resolution Specialist, tax attorney or CPA, can give you the help you need to settle your IRS debt.

Owe Unpaid Employment Taxes or Delinquent Payroll Taxes?

If you owe back taxes or if you've been threatened with an IRS levy, lien, seizure or the denial or termination of an installment agreement, let us represent you and put an end to your IRS problems! We can help you file an IRS Collection Appeal to stop an IRS levy or seizure.

Check out these tax resolution strategies that can help you resolve your back taxes:

If you owe less than $10,000 in back taxes: If you have a clean IRS record and all your tax returns are filed - you can call the IRS directly and they can (it's guaranteed) arrange a payment plan to be paid in 36 monthly installments.

If you owe $20,000 or more in back taxes: You will want to partner with a Certified Tax Resolution Specialist or a tax attorney to increase your chances of qualifying for an IRS payment plan, helping you settle your back tax debt for the lowest possible amount, and removing bank levies, tax liens or wage garnishments.

Offer in Compromise

If you can't afford to pay your back taxes in full, the Offer in Compromise program provides taxpayers who owe the IRS more than they could ever afford to pay, the opportunity to pay a small amount as a full and final payment. Taxpayers who attempt to file for an Offer in Compromise on their own often put themselves at risk of not qualifying for a settlement or they end up paying more than they have to.

IRS Payment Plans

If you can't pay your back taxes in full but could potentially pay them back over time, you can negotiate a reasonable monthly payment plan with the IRS. Once an IRS Payment Plan (also known as an Installment Agreement) is established, the IRS will not enforce collection action, including the levy of bank accounts or wages, as long as the taxpayer remains current with all filing and payment obligations.

Delinquent Tax Returns

To qualify for an IRS payment plan or Offer in Compromise tax settlement to resolve your back taxes, you need to file all delinquent tax returns with the IRS. Regardless of what you have heard, you have the right to file your original tax return, no matter how late it's filed. Until you have filed all legally required tax returns, the IRS will not entertain any type of tax settlement or payment plan to settle your back taxes.

Expiration of Back Taxes: Statute of Limitations on IRS Collections

This can be one of the most effective ways to eliminate back taxes, especially if they have been assessed against you years ago. The IRS is prohibited, by law, from collecting on expired back taxes. Generally, the IRS has 10 years from the date of assessment (usually close to the filing date or audit assessment date) to collect back taxes. An expert tax attorney, CPA or Certified Tax Resolution Specialist can help resolve your back taxes and other IRS problems by performing a Collection Statute Expiration Date (CSED) analysis. We can determine on what day you will be free of this *obligation. We accomplish this by obtaining and analyzing your IRS Tax Transcripts and Records of Account. If the expiration date is nearing, many times it is advantageous to the consumer to just "do nothing". However, you need an expert to guide you through this process due to the many exceptions and obstacles that can get in the way.*

IRS Bankruptcy Filing for Discharging Back Taxes and IRS Debt

As a last resort for resolving back taxes, you can file for bankruptcy if the IRS rejects your IRS Payment Plan or Offer in Compromise. However, only a seasoned tax attorney, CPA or Certified Tax Resolution Specialist can provide tax help to show you the proper sequence of events to declare bankruptcy and completely eliminate all of your back taxes, if you are eligible.

Offshore Bank Accounts: IRS Tax Settlements

If you owe back taxes on undeclared funds in overseas bank accounts, being proactive about disclosing your foreign funds can help reduce your chances of criminal prosecution, minimize severe IRS penalties and work out a structured IRS payment plan. If you believe that you owe back taxes on your foreign accounts, you will need a tax attorney or certified tax resolution specialist to provide professional tax help and experienced representation to proceed in your best interest.

Innocent Spouse Tax Relief

If you owe back taxes due to your spouse's (or ex-spouses) actions, you may be eligible to obtain tax relief by qualifying as an innocent spouse. This means that if you can prove you are an innocent spouse, as defined by the Internal Revenue Code, the IRS can relieve you of this debt and obtain tax relief, you may not be subject to the taxes caused by their spouses or ex-spouses.

Investment Fraud Representation

If you owe back taxes paid on phantom profits from a fraudulent investment scheme ("Ponzi" Scheme), you may be eligible to take advantage the United States Tax Code (law) to recoup 30% to 40% of your losses. This highly technical and complex process can help you reduce taxes paid in previous years resulting in refund with interest.

Payroll Tax Problems

If you owe back taxes on delinquent payroll and employment taxes, it is important to resolve payroll tax debt problems swiftly to protect the future of your company since the IRS assigns a higher priority to collecting employment taxes than income taxes. We've helped businesses across the nation permanently resolve payroll problems and back taxes.

Freedom of Information Requests

It is important to understand how the IRS has assessed back taxes and penalties against you. You have the right to see governmental documents, including your IRS files, to better understand your IRS problems. The IRS must disclose the information used to assess back taxes and interest against taxpayers.

Why Hire a Tax Attorney or Certified Tax Resolution Specialist?

While taxpayers may always represent themselves before the IRS to resolve back taxes and IRS problems, many taxpayers find dealing with the IRS frustrating, time-consuming, intimidating or all of the above and so they make the decision to hire professional tax help (specialized tax attorney, tax resolution firm, etc.) to negotiate a tax relief settlement with the IRS on their behalf.

*** * * ***

While the truth is that the IRS rarely settles for only pennies on the dollar, there are procedures and rules in place that allow delinquent taxpayers to pay their taxes over time via an installment agreement or to set up a payment plan in which the IRS agrees to accept less than the total due (referred to as an Offer in Compromise). When the amount of tax owed is relatively small (typically under $10,000), taxpayers can often reach an agreement with the IRS themselves. In larger cases, representation is usually recommended.

Table 1.1. Major Types of Relief from Federal Tax Liability.

Installment Agreements	Taxpayer makes payments over time in agreed upon intervals in which full amount of the debt is eventually paid.
Offers in Compromise	Taxpayer makes payments over time in agreed upon intervals but IRS agrees to waive collection of a portion of the taxes owed.
Innocent Spouse Relief	This provides the innocent relief from additional tax owed by a taxpayer if their spouse or former spouse failed to report income, reported income improperly or claimed improper deductions or credits.
Bankruptcy	Some federal taxes can be discharged by filing for bankruptcy protection. Depending on the type of bankruptcy protection sought, the debtor's assets will be sold and used to pay debt or the debtor will enter into a repayment plan. In either care, much of the debt is invariably not paid.

There are also opportunities for taxpayers to challenge determinations made by the IRS through a variety of appeals processes. A delinquent taxpayer may have a number of issues to resolve with the IRS, including liens filed by the IRS on their real property or even wage attachments.

A taxpayer can apply for an OIC *without the help of a third party*. If a taxpayer prefers third-party assistance in negotiating with the IRS, only certain tax professionals – Enrolled Agents (federally-authorized tax practitioners who can represent taxpayers before all administrative levels of the IRS), Certified Public Accountants (CPAs), and attorneys — have the authority to represent third parties. This is particularly important when the amount of debt the taxpayer wishes to compromise is large.

Taxpayers may also contact the Taxpayer Advocate Service, an independent organization within the IRS that provides free help to people who are experiencing financial difficulties or who need help resolving a problem with the IRS.

This course will provide an overview of the major tools that can be used to settle a debt with the IRS, including Offers in Compromise and Installment Agreements. The course also provides an overview of how the IRS goes about enforcing payment of federal taxes, including seizing delinquent taxpayer's property.

II. Overview of IRS Fresh Start Initiative

In early 2011, the IRS announced new efforts to help some taxpayers get a "fresh start" and made major changes in the process it uses to place a lien on taxpayers' property. The goal, according to the IRS, was to help individuals and small businesses meet their tax obligations, without adding unnecessary burden to the taxpayers. "We are making fundamental changes to our lien system and other collection tools that will help taxpayers and give them a fresh start," IRS Commissioner Doug Shulman said at the time. "These steps are good for people facing tough times, and they reflect a responsible approach for the tax system."

The announcement centered on the IRS making important changes to its lien filing practices that will lessen the negative impact on taxpayers. The changes included expanding a streamlined Offer in Compromise program to cover more taxpayers. In May 2012, the IRS again expanded some of the provisions of the Fresh Start program by offering more flexible terms to its Offer in Compromise (OIC) program that will enable some of the most financially distressed taxpayers to clear up their tax problems and, in many cases, more quickly than in the past.

In the past the IRS strictly applied its rules with respect to taxpayers' budgets and valuation of assets. As a result, most taxpayers who sought a compromise received a rejection. Below are the statistics for offer acceptances during the past several years:

Offers	2007	2008	2009	2010	2011
Number Received by IRS	46,000	44,000	52,000	57,000	59,000
Number Approved by IRS	12,000	11,000	11,000	14,000	20,000

The changes focused on the financial analysis used to determine which taxpayers qualify for an OIC. These changes also enable some taxpayers to resolve their tax problems in as little as two years compared to four or five years in the past. The changes announced include:

- Revising the calculation for the taxpayer's future income;
- Allowing taxpayers to repay their student loans;

- Allowing taxpayers to pay state and local delinquent taxes; and

- Expanding the Allowable Living Expense allowance category and amount.

In general, an OIC is a legal contract between a taxpayer and the IRS that settles the taxpayer's tax liabilities for less than the full amount owed. An OIC is generally not accepted if the IRS believes the liability can be paid in full as a lump sum or through a payment agreement. The IRS looks at the taxpayer's income and assets to make a determination of the taxpayer's reasonable collection potential. OICs are subject to acceptance on legal requirements.

When the IRS calculates a taxpayer's reasonable collection potential, it will now look at only one year of future income for offers paid in five or fewer months, down from four years, and two years of future income for offers paid in six to 24 months, down from five years. All offers must be fully paid within 24 months of the date the offer is accepted.

Other changes to the program include narrowed parameters and clarification of when a dissipated asset will be included in the calculation of reasonable collection potential. In addition, equity in income producing assets generally will not be included in the calculation of reasonable collection potential for on-going businesses.

The Allowable Living Expense standards are used in cases requiring financial analysis to determine a taxpayer's ability to pay. The standard allowances provide consistency and fairness in collection determinations by incorporating average expenditures for basic necessities for citizens in similar geographic areas. These standards are used when evaluating installment agreement and offer in compromise requests.

The IRS expanded the National Standard miscellaneous allowance to include additional items. Taxpayers can use the miscellaneous allowance for expenses such as credit card payments and bank fees and charges.

Guidance has also been clarified to allow payments for loans guaranteed by the federal government for the taxpayer's post-high school education. In addition, payments for delinquent state and local taxes may be allowed based on a percentage basis of tax owed to the state and IRS.

<u>CHAPTER 1 – REVIEW QUESTIONS</u>

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. Which of the following is <u>not</u> a situation in which a taxpayer can seek Innocent Spouse Relief:

    a) if the taxpayer's current spouse failed to report income
    b) if the taxpayer wants to make payments of unpaid taxes over time rather than in a lump sum
    c) if the taxpayer's former spouse failed to declare income
    d) if the taxpayer's former spouse claimed improper deductions and now owes additional tax

2. Which one of the following statements about Offers in Compromise is <u>not</u> correct:

    a) the Offer in Compromise requires the taxpayer to pay at least 80% of his or her federal tax debt
    b) the IRS accepts Offers in Compromise only when they believe they could not otherwise collect the entire debt
    c) the IRS investigates a taxpayer's financial situation before accepting an Offer in Compromise
    d) an Offer in Compromise is a binding legal contract

CHAPTER 1 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. This is a situation where a taxpayer may be entitled to file for Innocent Spouse Relief.

   B: Correct. The taxpayer should seek an Installment Agreement rather than file for Innocent Spouse Relief.

   C: Incorrect. Mistakes by a current or former spouse may entitle a taxpayer to Innocent Spouse Relief if he or she meets other filing requirements.

   D: Incorrect. If the taxpayer in this case meets the other requirements of being an innocent spouse, this may be an option.

   (See page 1-4 of the course material.)

2. **A: Correct.** The IRS may settle for substantially less than 80% of the outstanding tax debt depending on the facts and circumstances of the case. There is no maximum percentage.

   B: Incorrect. The IRS will not accept an Offer in Compromise if they think the taxpayer can pay the full amount owed either in a lump sum or through an Installment Agreement.

   C: Incorrect. The IRS wants to be sure the taxpayer is paying the most possible before entering into an Offer in Compromise. The IRS has an obligation to protect the interests of the taxpayers.

   D: Incorrect. The Offer in Compromise is binding on both the IRS and the taxpayer and contains a number of detailed terms that govern the payments.

   (See page 1-6 of the course material.)

Chapter 2: The IRS Collection Process

The collection process is a series of actions that the IRS can take against a taxpayer to collect the taxes owed if the taxpayer does not voluntarily pay them when due or make other arrangements, such as filing for an Offer in Compromise or Installment Agreement. The collection process will begin if a taxpayer fails to make required payments in full and on time, after receiving a bill.

Table 2.1. Common IRS Collection Terminology.

Federal Tax Lien	A legal claim against all of a taxpayer's current and future property, such as a house or car, and rights to property, such as wages and bank accounts. The lien automatically comes into existence if a taxpayer does not pay his or her amount due after receiving a first bill.
Notice of Federal Tax Lien (NFTL)	A public notice to creditors. It notifies them that there is a federal tax lien that attaches to all of a taxpayer's current and future property and rights to property.
Levy	A legal seizure of property or rights to property to satisfy a tax debt. When property is seized ("levied"), it will be sold to help pay an individual's tax debt. If wages or bank accounts are seized, the money will be applied to that individual taxpayer's tax debt.
Seizure	There is no legal difference between a seizure and a levy. These terms are used interchangeably.
Notice of Intent to Levy and Notice of Right to a Hearing	Generally, before property is seized, the IRS must send a taxpayer this notice. If a taxpayer does not pay his or her overdue taxes, make other arrangements to satisfy his or her tax debt, or request a hearing within 30 days of the date of this notice, then the IRS may seize the taxpayer's property.
Summons	A summons legally compels a taxpayer to meet with the IRS and provide information, documents, or testimony.

I. Fresh Start Changes

In early 2012, the IRS announced a variety of new rules to help taxpayers with IRS debts to repay their debts and to avoid liens. The changes to the lien process include the following:

- Significantly increasing the dollar threshold when liens are generally issued, resulting in fewer tax liens;

- Making it easier for taxpayers to obtain lien withdrawals after paying a tax bill;

- Withdrawing liens in most cases where a taxpayer enters into a Direct Debit Installment Agreement;

- Creating easier access to Installment Agreements for more struggling small businesses; and

- Expanding a streamlined Offer in Compromise program to cover more taxpayers.

A. TAX LIEN THRESHOLDS

Under the Fresh Start Initiative, the IRS significantly increased the dollar thresholds when liens are generally filed. The new dollar amount is in keeping with inflationary changes since the number was last revised. Currently, liens are automatically filed at certain dollar levels for people with past-due balances.

B. TAX LIEN WITHDRAWALS

The IRS also modified procedures that make it easier for taxpayers to obtain lien withdrawals. Liens are now withdrawn once the full payment of taxes is made if the taxpayer requests it. The IRS determined that this approach is in the best interest of the government. In order to speed up the withdrawal process, the IRS also streamlined its internal procedures to allow collection personnel to withdraw the liens.

C. DIRECT DEBIT INSTALLMENT AGREEMENTS AND LIENS

The IRS is making other fundamental changes to liens in cases where taxpayers enter into a Direct Debit Installment Agreement (DDIA). For taxpayers with unpaid assessments of $25,000 or less, the IRS will now allow lien withdrawals under several scenarios:

- Lien withdrawals for taxpayers entering into a Direct Debit Installment Agreement;

- The IRS will withdraw a lien if a taxpayer on a regular Installment Agreement converts to a Direct Debit Installment Agreement; and

- The IRS will also withdraw liens on existing Direct Debit Installment Agreements upon taxpayer request.

Liens will be withdrawn after a probationary period demonstrating that direct debit payments will be honored.

II. Process and Procedures for Appeals, Seizure, and Levy

A. OVERVIEW

Most individual tax returns are filed annually by April 15th (or later if the taxpayer requests an extension) or quarterly (most common for self-employed taxpayers). When a taxpayer receives a bill from the IRS (assuming that the bill is accurate), he or she should pay it in full by the due date, if possible. If the taxpayer cannot pay the full bill, he or she should still pay as much as he or she can when due.

If the taxpayer owes taxes and does not submit them with the return, the IRS will send the taxpayer a bill. Based on the return, the IRS will calculate how much the taxpayer owes in income tax plus any applicable interest and penalties. If the taxpayer still does not pay, the IRS will generally send a second bill, referred to as a "final" bill. If the taxpayer does not pay after receiving the final bill, the IRS will begin collection actions. Collection actions can range from applying the taxpayer's previous tax return refund to the current taxes owed to the seizing of property and other assets.

During the collection process, a hearing, or an appeal, a taxpayer can represent themselves or be represented by an attorney, a certified public accountant, an enrolled agent, an immediate family member, or any person enrolled to practice before the IRS. A business can also be represented by full-time employees, general partners, or bona fide officers.

Under federal law, the IRS can attempt to collect federal income taxes for up to 10 years from the date they were assessed. There are, however, exceptions to that timeframe. For example, the IRS may, pursuant to federal law, suspend and extend collection while they are considering a taxpayer's request for an Installment Agreement or Offer in Compromise. If a request is rejected, the IRS will suspend collection for another 30 days, or during any period the Appeals Office is considering an appeals request. If a taxpayer lives outside of the United States continuously for at least six months, collection is suspended while the taxpayer resides outside the U.S. and, if at the time of his or her return the normal collection period would expire before six months from the date of his or her return, the extended period won't expire before the expiration of the six months after the taxpayer's return.

If a taxpayer wants to pay but needs more time, he or she can request a delay in the collection process by filing a Collection Information Statement and providing proof of his or her financial status. Interest and penalties continue to accrue.

B. COLLECTION ACTIONS IN DETAIL/FEDERAL TAX LIENS

1. Federal Tax Lien: A Legal Claim Against Property

A lien is a legal claim against all of a taxpayer's current and future property. When a taxpayer fails to pay his or her first bill for taxes due, a lien is created by law and attaches to that person's property. Liens apply to property (such as a home, car or retirement account) and to any current and future rights the taxpayer has to property (such as an inheritance).

Example.

Bill, a self-employed dentist, owes the IRS $100,000 in back income taxes. He lives in a house worth $500,000. After repeatedly failing to make payments, the IRS filed a Notice of Federal Tax Lien on Bill's home. Bill will be unable to sell the home unless he first extinguishes the debt.

2. <u>Notice of Federal Tax Lien</u>

The filing of a Notice of Federal Tax Lien provides notice to the public – i.e., creditors, that a lien exists. A claim is also filed so that the IRS can establish the priority of their claim over other creditors, such as the holders of a mortgage, car loan or retail credit card account. A Notice of Federal Tax Lien must be filed with local or state authorities, such as a county registrar or secretary of state. The mechanics differ from state to state. If a Notice of Federal Tax Lien is filed against someone, it is often reported by consumer credit reporting agencies and, therefore, can have a negative effect on a person's credit rating. Employers, landlords and others also often use this information when making employment or housing decisions.

3. <u>Responding to the Filing of a Tax Lien</u>

The best case scenario is for the taxpayer to pay the full amount he or she owes the IRS immediately. The notice will only show the assessed balance as of the date of the notice, however. It does not show the payoff balance or include IRS charges for filing and releasing the lien. To find out the full amount that must be paid to have the lien released, the taxpayer will have to contact the IRS.

4. <u>Appealing the Notice</u>

Within five business days of filing the Notice of Federal Tax Lien, the IRS will send the delinquent taxpayer a "Notice of Your Right to a Collection Due Process Hearing". A taxpayer has until the date shown on the notice to request a Collection Due Process hearing with the Office of Appeals.

After a Collection Due Process hearing, the Office of Appeals will issue a determination on whether the Notice of Federal Tax Lien should remain filed, or whether it should be withdrawn, released, discharged, or subordinated. If a taxpayer disagrees with the determination, he or she will have 30 days after it's made to seek a review in the U.S. Tax Court.

If a request for a hearing is not filed within 30 days, the delinquent taxpayer will not be entitled to a Collection Due Process hearing, but may be entitled to an Equivalent Hearing. The request for an Equivalent Hearing, however, does not preclude the IRS from seizing taxpayer assets and does not suspend the 10-year period for collecting tax. In addition, the delinquent taxpayer is not entitled to a judicial review of the decision from an Equivalent Hearing (it cannot be appealed to Tax Court). In addition to any Collection Due Process rights a delinquent taxpayer may have, he or she may also appeal a proposed or actual filing of a Notice of Federal Tax Lien under the Collection Appeals Program.

If the tax periods the IRS is collecting on are included in a bankruptcy petition that has an automatic stay (this issue is discussed in greater detail in Chapter 9), the IRS will suspend collection for the time period the automatic stay was in effect plus six additional months. A taxpayer must request a Collection Due Process hearing. Collection will be suspended from the date of the request until a Notice of Determination is issued or the Tax Court's decision is final.

C. RELEASING OR WITHDRAWAL OF A FEDERAL TAX LIEN

1. Release of Lien

A "release" of a federal tax lien means that the IRS has cleared both the lien for the debt and the public Notice of Federal Tax Lien. This is done by filing a Certificate of Release of Federal Tax Lien with the same state and local authorities with whom the initial Notice of Federal Tax Lien was filed. The IRS will release a lien if:

- The debt is fully paid;
- Payment of the debt is guaranteed by a bond; or
- The period for collection has ended (in which case the release is automatic).

2. Withdrawal of Lien

A "withdrawal" removes the Notice of Federal Tax Lien from public record. The withdrawal tells other creditors that the IRS is abandoning their lien priority. This does not mean, however, that the federal tax lien is released, or that the delinquent taxpayer is no longer liable for the amount due. The IRS may withdraw a Notice of Federal Tax Lien if:

- The taxpayer has entered into an Installment Agreement to satisfy the tax liability, unless the Agreement provides otherwise. For certain types of taxes, the IRS will routinely withdraw a Notice of Federal Tax Lien if a taxpayer has entered into a direct debit installment agreement and meet certain other conditions;
- The IRS believes that withdrawal of the lien will help the taxpayer pay their taxes more quickly;
- The IRS did not follow its own procedures;
- The lien was filed during a bankruptcy automatic stay period; or
- It is in the best interest of the taxpayer (as determined by the Taxpayer Advocate) and in the best interest of the government. For example, this could include when a debt has been satisfied and the taxpayer requests a withdrawal.

D. DISCHARGE AND SUBORDINATION

1. Discharge

A “discharge” removes the lien from specific property. There are several circumstances under which the federal tax lien can be discharged. For example, the IRS may issue a Certificate of Discharge if a taxpayer is selling property and the proceeds can be used to pay the delinquent taxes.

2. Subordination

A “subordination” occurs when a creditor is allowed to move ahead of the government’s priority position. For example, if a taxpayer is trying to refinance a mortgage on his or her home, but is not able to because the federal tax lien has priority over the new mortgage, the taxpayer may request that the IRS subordinate its lien to the new mortgage.

3. Appeal Rights

If the IRS denies a request for a withdrawal, discharge, or subordination, a taxpayer may appeal under the Collections Appeals Program.

E. LEVY: A SEIZURE OF PROPERTY

While a federal tax lien is a legal claim against a delinquent taxpayer’s property, a levy is a legal seizure that actually takes the taxpayer’s property (such as a house or car) or his or her rights to the property (such as his or her income, bank account, or Social Security payments) to satisfy the tax debt. Keep in mind that the IRS may not seize an individual’s property if he or she has a current or pending Installment Agreement or Offer in Compromise. The IRS will also not levy property if they believe that the taxpayer is unable to pay due to economic hardship, meaning seizing his or her property would result in the taxpayer’s inability to meet basic, reasonable living expenses.

1. Reasons and Procedures for the IRS to Levy Property

If a taxpayer does not pay his or her federal income taxes (or make arrangements to settle his or her debt), the IRS may seize and sell the taxpayer’s property. They will usually seize property only after the following have occurred:

- The IRS has assessed the tax and sent the taxpayer a bill;
- The taxpayer neglected or refused to pay the bill; and
- The IRS sent the taxpayer a “Final Notice of Intent to Levy” and “Notice of Your Right to a Hearing” at least 30 days before the seizure.

There are, however, exceptions to the general rule that the IRS provide 30-days notice prior to seizing property. These include situations when:

- The collection of the tax is in jeopardy;

- A levy is served to collect tax from a state tax refund;
- A levy is served to collect the tax debt of a federal contractor; or
- A Disqualified Employment Tax Levy (DETL) is served. A Disqualified Employment Tax Levy is the seizure of unpaid employment taxes and can be served when a taxpayer previously requested a Collection Due Process appeal on employment taxes for other periods within the past two years.

If the IRS serves a levy under one of the above exceptions, they will send the taxpayer a letter explaining the seizure and the taxpayer's appeal rights after the levy is issued.

2. Examples of Property Subject to Levy

a. Wages, Salary, or Commission

If the IRS seizes a taxpayer's rights to wages, salary, commissions, or similar payments that are held by someone else, they will serve the levy once, not each time the individual is scheduled to be paid. The one levy continues until the debt is fully paid, other arrangements are made, or the collection period ends. Other payments the individual may receive, such as dividends and payments on promissory notes, are also subject to seizure. However, the seizure only reaches the payments due or the right to future payments as of the date of the levy.

b. Bank Accounts

Seizure of the funds in a taxpayer's bank account will include funds available for withdrawal up to the amount of the seizure. After the levy is issued, the bank will hold the available funds and give the taxpayer 21 days to resolve any disputes about who owns the account before sending the IRS the money. After 21 days, the bank will send the IRS the money, plus any interest earned on that amount, unless the taxpayer resolved the issue in another way.

c. Federal Payments

As an alternative to the levy procedure used for other payments such as dividends and promissory notes, certain federal payments may be systemically seized through the Federal Payment Levy Program in order to pay an individual's tax debt. Under this program, the IRS may generally seize up to 15% of an individual's federal payments (up to 100% of payments due to a vendor for goods or services sold or leased to the federal government). The IRS will serve the levy once, not each time the individual is paid. The one levy continues until the debt is fully paid, other arrangements are made, the collection period ends, or the IRS releases the levy. The federal payments that can be seized in this program include, but aren't limited to, federal retirement annuity income from the Office of Personnel Management, Social Security benefits under Title II of the Social Security Act (OASDI), and federal contractor/vendor payments.

d. House, Car or Other Property

If the IRS seizes an individual's house or other property, they will sell that individual's interest in the property and apply the proceeds (after the costs of the sale) to the tax debt. Prior to selling the property, the IRS will calculate a minimum bid price. The IRS will also provide the taxpayer with a copy of the calculation and give them an opportunity to challenge the fair market value determination. The IRS will then provide the taxpayer with the notice of sale and announce the pending sale to the public, usually through local newspapers or flyers posted in public places. After giving public notice, the IRS will generally wait 10 days before selling the taxpayer's property. Money from the sale pays for the cost of seizing and selling the property and, finally, the underlying tax debt. If there is any money left after the debt and expenses are paid off, the taxpayer will receive a refund.

3. Property Not Subject to Seizure

Certain property is exempt from seizure. For example, the IRS cannot seize the following:

- Unemployment benefits;
- Certain annuity and pension benefits;
- Certain service-connected disability payments;
- Workers compensation;
- Certain public assistance payments;
- Minimum weekly exempt income;
- Assistance under the Job Training Partnership Act; and
- Income for court-ordered child support payments.

The IRS is also unable to seize a variety of specific items including, schoolbooks, clothing, furniture, and certain tools used in the taxpayer's trade or business. There are also limitations on the ability of the IRS to seize a primary residence and certain business assets.

Lastly, the IRS may not seize a taxpayer's property unless they expect net proceeds to help pay off the person's tax debt.

4. Appealing a Proposed Seizure

A taxpayer may request a Collection Due Process hearing within 30 days from the date he or she receives a "Notice of Intent to Levy" and "Notice of Your Right to a Hearing." An appeal request must be sent to the address specified on the notice. At the conclusion of the hearing, the Office of Appeals will provide a determination. A taxpayer has 30 days after the determination to challenge it in the U.S. Tax Court. If a hearing request is not filed within 30 days, the taxpayer is not entitled to a Collection Due Process hearing, but may be entitled to an Equivalent Hearing. The request for an Equivalent Hearing, however, does not prohibit the IRS from seizing and does not suspend the 10-year period for collecting tax. In addition, a taxpayer will not entitled to a judicial review of the decision from the Equivalent Hearing.

5. Reasons the IRS Will “Release” a Levy

The Internal Revenue Code (IRC) specifically provides that the IRS must release a levy if they determine that:

- The taxpayer paid the amount owed;
- The period for collection ended prior to the levy being issued;
- Release of the levy will help the taxpayer pay his or her taxes;
- The taxpayer entered into an Installment Agreement and the terms of the agreement do not allow for the levy to continue;
- The levy creates an economic hardship on the taxpayer, meaning that the IRS has determined that the taxpayer is unable to meet basic, reasonable living expenses; or
- The value of the property is more than the amount owed and releasing the levy will not hinder the IRS’s ability to collect the amount owed.

In addition, a levy on wages or salary must be released as soon as possible if the IRS determines that the tax is not collectible. The IRS will also release a levy if it was issued improperly. For example, they will release a levy if it was issued:

- Against property exempt from seizure;
- Prematurely;
- Before the required notice was sent to the taxpayer;
- While the taxpayer was in bankruptcy and an automatic stay was in effect;
- Where the expenses of seizing and selling the levied property would be greater than the fair market value of the property;
- While an Installment Agreement request, Innocent Spouse Relief request, or Offer in Compromise is being considered or had been accepted and is in effect; or
- While the Office of Appeals or Tax Court is considering certain appeals and the levy wasn’t a Disqualified Employment Tax Levy to collect employment taxes, a state refund, or jeopardy levy.

6. Reasons the IRS May Return Levied Property

The IRS may return a taxpayer's levied property if:

- Its seizure was premature;
- Its seizure was in violation of the law;
- Returning the seized property will help the IRS to collect the debt owed;
- The taxpayer entered into an Installment Agreement that does not provide for a levy;
- The IRS did not follow their own procedures; or
- It is in the best interest of the taxpayer (as determined by the Taxpayer Advocate) and in the best interest of the government.

If the IRS decides to return the property but it has already been sold, the IRS will refund to the taxpayer the money received from the sale. The taxpayer may file a request for seized property to be returned, or the IRS can return the property upon its own initiative, generally up to nine months after the seizure.

If an individual's property has been seized ("levied") to collect tax owed by someone else, he or she may appeal under the Collection Appeals Program or (within the time prescribed by law), file a claim under Internal Revenue Code section 6343(b), or (within the time prescribed by law) file a suit under Internal Revenue Code section 7426 for the return of the wrongfully seized property.

7. Recovering Sold Real Estate

A taxpayer (or anyone else with a legal interest in the property) has the right to recover real estate sold by the IRS within 180 days of the sale by paying the purchaser what they paid, plus interest at 20% annually.

8. Collecting Damages

If the IRS seizes property in error, a taxpayer's payment was lost or misplaced, or there was a Direct Debit Installment Agreement processing error and the taxpayer incurred bank charges, the IRS may reimburse the taxpayer for charges.[1] If the IRS intentionally or negligently failed to follow Internal Revenue law while collecting taxes, or a taxpayer had his or her property wrongfully seized, he or she may be entitled to recover economic damages.

---

[1] For more information, see Form 8546, Claim for Reimbursement of Bank Charges. If the taxpayer's claim is denied, he or she can sue the federal government for economic damages.

F. APPEALING AN IRS DECISION

Taxpayers may appeal most IRS actions. The main options for an appeal are specified below.

1. Collection Due Process (CDP)

The purpose of a Collection Due Process hearing is to review collection actions that were taken or have been proposed. A taxpayer may request a Collection Due Process hearing if he or she receives any of the following notices:

- Notice of Federal Tax Lien Filing and Your Right to a Hearing;
- Final Notice – Notice of Intent to Levy and Notice of Your Right to a Hearing;
- Notice of Jeopardy Levy and Right of Appeal;
- Notice of Levy on Your State Tax Refund – Notice of Your Right to a Hearing; or
- Notice of Levy and of Your Right to a Hearing.

Taxpayers have 30 days from the date of a notice to request a Collection Due Process hearing. An Equivalent Hearing may be requested within one year of the date of the notice.

2. Collection Appeals Program (CAP)

Under the Collections Appeals Program, if a taxpayer disagrees with an IRS decision and wants to appeal it, he or she can ask an IRS manager to review his or her case. If a taxpayer disagrees with the manager's decision, he or she may continue with the Collection Appeals Program.[2]

[2] Details of this program are outlined in IRS Publication 1660.

<u>CHAPTER 2 – REVIEW QUESTIONS</u>

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. Which of the following IRS actions is a “levy”:

   a) the IRS sends the taxpayer a warning letter saying he or she is delinquent in his or her taxes
   b) the IRS sells a taxpayer’s vacation home and applies the proceeds to the taxpayer’s IRS debt
   c) the IRS files a Notice of Federal Tax Lien
   d) the IRS orders the taxpayer to meet with the IRS

2. The IRS can generally collect taxes up to _______ years from the day they were assessed.

   a) 3
   b) 5
   c) 7
   d) 10

3. A “withdrawal of tax lien” means:

   a) the IRS is removing their lien priority
   b) the debt has been paid in full
   c) the taxpayer is no longer liable for the debt
   d) the IRS is releasing the taxpayer from the debt

4. All of the following properties are exempt from seizure by the IRS <u>except</u>:

   a) income from child support payments
   b) clothing
   c) property that if sold will produce money to decrease taxpayer’s debt
   d) property that if sold will not produce money to decrease taxpayer’s debt

5. Does a taxpayer have any recourse if the IRS improperly seizes his or her property:

   a) No. The IRS is entitled to immunity for any mistaken actions and the taxpayer is simply out of luck
   b) Yes. The taxpayer is always entitled to recover his or her property, but he or she is not entitled to damages
   c) Yes. The taxpayer may be entitled to damages, but there is no way to recover his or her property
   d) Yes. The taxpayer must petition the courts for relief

CHAPTER 2 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. A warning is a precursor to a levy, in which the IRS actually seizes the taxpayer's property or other assets.

   B: Correct. A levy, sometimes called a seizure, occurs when the IRS actually takes the property, sells it, and applies the proceeds to the taxpayer's tax debts.

   C: Incorrect. This is the first step required before a levy can occur later in the process.

   D: Incorrect. This is called a summons.

   (See page 2-1 of the course material.)

2. A: Incorrect. The IRS has a much longer period of time than 3 years to collect federal income taxes from a taxpayer who has not paid.

   B: Incorrect. The IRS has twice the amount of time to collect a taxpayer's unpaid federal income taxes.

   C: Incorrect. The IRS can collect a taxpayer's unpaid federal income taxes for more than 7 years.

   D: Correct. The IRS is able to collect unpaid federal income taxes for up to 10 years from the day they were assessed; however, there are exceptions to that timeframe.

   (See page 2-3 of the course material.)

3. **A: Correct.** A "withdrawal of tax lien" means that the IRS is removing their lien from the taxpayer's property, but the taxpayer is still liable for the debt.

   B: Incorrect. When a "withdrawal of tax lien" is filed, it does not mean that the debt has been paid in full. It only means that the IRS is abandoning their lien on the property.

   C: Incorrect. The taxpayer is still liable for the debt when a "withdrawal of tax lien" is filed.

   D: Incorrect. When a "release of lien" is filed, it releases the taxpayer from his or her debt. When a "withdrawal of tax lien" is filed, the taxpayer is still liable for his or her debt.

   (See page 2-5 of the course material.)

4. A: Incorrect. When a taxpayer receives income from child support payments, this money is exempt from being seized by the IRS.

   B: Incorrect. The IRS is not able to seize a taxpayer's clothes for unpaid tax debt.

   C: Correct. The IRS will seize a taxpayer's property if his or her tax debt can be decreased by the sale of said property.

   D: Incorrect. The IRS cannot seize property that, if sold, would not generate any money to decrease the taxpayer's unpaid debt.

   (See page 2-8 of the course material.)

5. A: Incorrect. There are remedies for taxpayers depending on the circumstances.

   B: Correct. The taxpayer may be entitled to economic damages from the IRS when the IRS loses a taxpayer's payment, unlawfully seizes property, etc. If the taxpayer's property has been sold, however, he or she may not be able to get it back.

   C: Incorrect. Monetary damages are available.

   D: Incorrect. There are procedures available for recovery that do not require judicial intervention.

   (See page 2-10 of the course material.)

Chapter 3: Installment Agreements

I. Overview

Taxpayers who are unable to currently pay the full amount of their tax debt may apply to enter into an Installment Agreement with the IRS. An Installment Agreement allows the taxpayer to pay the IRS the full amount owed over a period of time via "installment" payments. To request an Installment Agreement, a taxpayer must file Form 433-D (a copy of which is included at the end of this course). An Installment Agreement differs from an Offer in Compromise in that such agreements do not actually reduce the amount of tax owed by the taxpayer. Taxpayers who enter into Installment Agreements automatically have any future refunds applied to the tax debt until it is paid in full. Like Offers in Compromise, business entities and individuals are both entitled to file for an Installment Agreement. Different rules may apply depending on the type of business entity. For the most part, this chapter and course focuses on resolving tax disputes between the IRS and individual taxpayers.

The IRS will usually let a taxpayer know within 30 days after they receive the taxpayer's request for an Installment Agreement whether it is approved or denied. However, if this request is for tax due on a return the taxpayer filed after March 31, it may take the IRS longer than 30 days to reply. If the IRS approves the taxpayer's request, they will send the taxpayer a notice detailing the terms of the agreement and requesting the applicable fee (discussed below).

By approving the taxpayer's request, the IRS agrees to let the taxpayer pay the tax he or she owes in monthly installments instead of immediately paying the amount in full. In return, the taxpayer agrees to make monthly payments on time. He or she also agrees to meet all future tax liabilities. This means that the taxpayer must have enough withholding or estimated tax payments so that his or her tax liability for future years is paid in full when the taxpayer timely files his or her return. A taxpayer's request for an Installment Agreement will be denied if all required tax returns have not been filed. Any refund the taxpayer is due in a future year will be applied against the amount the taxpayer owes. If the taxpayer's refund is applied to his or her balance, the taxpayer is still required to make his or her regular monthly installment payment.

A. INTEREST AND PENALTIES

A taxpayer will be charged interest and may be charged a late payment penalty on any tax not paid by its due date, even if a request to enter into an Installment Agreement is granted. Interest and any applicable penalties will be charged until the balance is paid in full. To limit interest and penalty charges, a delinquent taxpayer should file the return on time and pay as much of the tax as possible with the return. The IRS automatically applies all payments received from the taxpayer towards the delinquent account.

B. FEES AND PAYMENT METHODS

Taxpayers can make payments by check, money order, credit card, or one of the other payment methods shown next. The fee for each payment method is shown in Table 3.1 on the next page.

Table 3.1. Installment Agreement Fees.

Payment Method	Applicable Fee
Check, money order, or credit card	$105
Electronic funds withdrawal	$ 52
Payroll deduction Installment Agreement	$105

Certain taxpayers may qualify to pay a reduced fee of $43 if his or her income is below a certain level. The IRS will let the taxpayer know whether he or she qualifies for the reduced fee. If the IRS does not say that the taxpayer qualifies for the reduced fee, the taxpayer can request the reduced fee using Form 13844, Application For Reduced User Fee For Installment Agreements.

C. RECORDS

After the IRS receives each payment, the IRS will send the taxpayer a notice showing the remaining amount he or she owes, and the due date and amount of the next payment. But if the taxpayer chooses to have the payments automatically withdrawn from his or her checking account, he or she will not receive a notice. The taxpayer's bank statement is record of payment. The IRS will also send the taxpayer an annual statement showing the amount owed at the beginning of the year, all payments made during the year, and the amount owed at the end of the year.

D. DELINQUENT PAYMENTS

If the taxpayer does not make payments on time or does not pay any balance due on a return filed later, he or she will be in default on the agreement and the IRS may take enforcement actions, such as the filing of a Notice of Federal Tax Lien or an IRS levy action, to collect the entire amount owed. To ensure that payments are made in a timely manner, the taxpayer should consider making them by electronic funds transfer (EFT) (see the instructions for lines 11a and 11b, later).

E. MODIFICATION AND TERMINATION

After an Installment Agreement is approved, a taxpayer may submit a request to modify or terminate it. Such a request will not suspend the statute of limitations on collection. While the IRS considers a request to modify or terminate the Installment Agreement, the taxpayer must continue to comply with the existing agreement. An Installment Agreement may be terminated if the taxpayer provides materially incomplete or inaccurate information in response to an IRS request for a financial update.

There may be a reinstatement fee if an agreement goes into default. Also remember that penalties and interest continue to accrue until the taxpayer's balance is paid in full. If a taxpayer is in danger of defaulting on his or her payment agreement for any reason, he or she or the taxpayer's representative should contact the IRS immediately. The IRS will generally not take enforced collection actions:

- When an Installment Agreement is being considered;
- While an agreement is in effect;
- For 30 days after a request is rejected; or
- During the period the IRS evaluates an appeal of a rejected or terminated agreement.

A Notice of Federal Tax Lien (NFTL) may be filed to protect the government's interests until the taxpayer pays in full. However, an NFTL is generally not filed with a Guaranteed Installment Agreement, discussed below.

II. Completing Form 9465

A. PURPOSE OF FORM

Use Form 9465 to request a monthly installment plan if the taxpayer cannot pay the full amount he or she owes shown on his or her tax return (or on a notice the IRS sent the taxpayer). Most Installment Agreements meet the IRS' streamlined Installment Agreement criteria. The maximum term for a streamlined agreement is 72 months. In certain circumstances, the taxpayer can have longer to pay or the taxpayer's agreement can be approved for an amount that is less than the amount of tax the taxpayer owes. However, before requesting an Installment Agreement, the taxpayer should consider other less costly alternatives, such as getting a bank loan or using available credit on a credit card.

A taxpayer should use Form 9465 if he or she is an individual who:

- Owes income tax on Form 1040;
- May be responsible for a Trust Fund Recovery Penalty;
- Was self-employed and owes self-employment or unemployment taxes and is no longer operating the business;
- Is personally responsible for a partnership liability and the partnership is no longer operating; or
- Is an owner who is personally responsible for taxes in the name of a limited liability company (LLC) and the LLC is no longer operating.

A taxpayer should not use Form 9465 if he or she:

- Can pay the full amount owed within 120 days; or
- Wants to request an online payment agreement.

If the taxpayer is in business or is a business entity and owes employment or unemployment taxes, he or she should call the telephone number on the most recent notice to request an Installment Agreement.

B. SPECIFIC INSTRUCTIONS

- **Line 1.** If the taxpayer is making this request for a joint tax return, he or she should show the names and social security numbers (SSNs) in the same order as they appear on the tax return.

- **Line 2.** If the address provided on line 1 is new since the taxpayer filed his or her last tax return, check the box on line 2.

- **Line 7.** Enter the total amount the taxpayer owes as shown on the tax return(s) (or notice(s)).

  Notes:

  If the total amount the taxpayer owes is greater than $25,000 but not more than $50,000, he or she must complete line 11 and agree to an Electronic Funds Transfer (EFT) Agreement to qualify for an Installment Agreement (IA) without completing a financial statement. If the taxpayer does not agree to a Direct Deposit Installment Agreement (DDIA), he or she must complete Form 433-F, Collection Information Statement, and mail it with this form.

  If the amount the taxpayer owes is greater than $50,000, he or she must complete Form 433-F and mail it with this form.

  If the total amount the taxpayer owes is not more than $50,000 (including any amounts owed from prior years), the taxpayer does not need to file Form 9465; the taxpayer can request an Installment Agreement online.

- **Line 8.** Even if the taxpayer cannot pay the full amount owed now, he or she should pay as much as possible to limit penalty and interest charges. If the taxpayer is filing this form with the tax return, the payment should be made with the return. For details on how to pay, see the tax return instructions.

  If the taxpayer is filing this form by itself, such as in response to a notice, he or she should attach a check or money order payable to “United States Treasury.” Do not send cash. Be sure that the following is included:

  - The taxpayer’s name, address, SSN/EIN, and daytime phone number.
  - The tax year and tax return (for example, “2011 Form 1040”) for which he or she is making this request.

- **Line 9.** Enter on line 9 the amount the taxpayer can pay each month. He or she should make payments as large as possible to limit interest and penalty charges. The charges will continue until the taxpayer pays in full. If no payment amount is listed on line 9, a payment will be determined for the taxpayer by dividing the balance due by 72 months.

- **Line 10.** The taxpayer can choose the day of each month the payment is due. This can be on or after the 1st of the month, but no later than the 28th of the month. For example, if the taxpayer’s rent or mortgage payment is due on the 1st of the month, he or she may want to make his or her installment payments on the 15th. When the IRS approves the taxpayer’s request, the IRS will tell him or her the month and day that the first payment is due.

If the IRS has not replied by the date the taxpayer chooses for the first payment, he or she can send the first payment to the Internal Revenue Service Center at the address shown earlier that applies to the taxpayer. See the instructions for line 8 above for details on what to write on the payment.

- **Lines 11a and 11b.**

  Tip. Having the taxpayer make the payments by electronic funds transfer (EFT) will help ensure that the payments are made timely and that the taxpayer is not in default of this agreement.

  To pay by electronic funds transfer (EFT) from the taxpayer's checking account at a bank or other financial institution (such as a mutual fund, brokerage firm, or credit union), lines 11a and 11b must be completed. Check with the financial institution to make sure that an EFT is allowed and to get the correct routing and account numbers.

  If the total amount the taxpayer owes is greater than $25,000 but not more than $50,000, the taxpayer must agree to an Electronic Funds Transfer (EFT) Agreement to qualify for an Installment Agreement (IA) without completing a financial statement. If the taxpayer does not agree to a DDIA, the taxpayer must complete Form 433-F, Collection Information Statement, and mail it with this form.

  - **Line 11a.** The routing number must be nine digits. The first two digits of the routing number must be 01 through 12 or 21 through 32. Use a check to verify the routing number. But if the check is payable through a financial institution different from the one at which the taxpayer has his or her checking account, do not use the routing number on that check. Instead, contact the financial institution for the correct routing number.
  - **Line 11b.** The account number can be up to 17 characters (both numbers and letters). Include hyphens but omit spaces and special symbols. Enter the number from left to right and leave any unused boxes blank. Do not include the check number.

  The IRS may have filed a Notice of Federal Tax Lien against the taxpayer's property. If so, he or she may be able to get the Notice of Lien withdrawn. To learn more about lien withdrawals and to see if the taxpayer qualifies, visit IRS.gov and enter "lien withdrawal" in the search box.

  The electronic funds transfer (EFT) from the taxpayer's checking account will not be approved unless he or she (and his or her spouse if filing a joint return) sign Form 9465.

C. WHERE TO FILE

Taxpayers should attach Form 9465 to the front of the return and send it to the address shown in the tax return booklet. If the taxpayer has already filed the return or he or she is filing this form in response to a notice, file Form 9465 by itself with the Internal Revenue Service Center using the address in the table below that applies.

For all taxpayers except those filing Form 1040 with Schedule(s) C, E, or F for any tax year for which this Installment Agreement is being requested.

IF the taxpayer lives in . . .	**THEN use this address . . .**
Alabama, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina, Texas, Virginia	Department of the Treasury Internal Revenue Service P.O. Box 47421 Stop 74 Doraville, GA 30362
Alaska, Arizona, Colorado, Connecticut, Delaware, District of Columbia, Hawaii, Idaho, Illinois, Maine, Maryland, Massachusetts, Montana, Nevada, New Hampshire, New Jersey, New Mexico, North Dakota, Oregon, Rhode Island, South Dakota, Tennessee, Utah, Vermont, Washington, Wisconsin, Wyoming	Department of the Treasury Internal Revenue Service 310 Lowell St. Stop 830 Andover, MA 01810
Arkansas, California, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, New York, Ohio, Oklahoma, Pennsylvania, West Virginia	Department of the Treasury Internal Revenue Service Stop P-4 5000 Kansas City, MO 64999–0250
A foreign country, American Samoa, or Puerto Rico (or are excluding income under Internal Revenue Code section 933), or use an APO or FPO address, or file Form 2555, 2555-EZ, or 4563, or are a dual-status alien or nonpermanent resident of Guam or the U.S. Virgin Islands*	Department of the Treasury Internal Revenue Service 3651 South I-H 35, 5501AUSC Austin, TX 78741
* Permanent residents of Guam or the U.S. Virgin Islands cannot use Form 9465.	

For taxpayers filing Form 1040 with Schedule(s) C, E, or F for any tax year for which this Installment Agreement is being requested.

IF the taxpayer lives in . . .	**THEN use this address . . .**
Alabama, Arkansas, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, North Dakota, Ohio, Oklahoma, Pennsylvania, South Dakota, Tennessee, Texas, West Virginia, Wisconsin	Department of the Treasury Internal Revenue Service P.O. Box 69 Stop 811 Memphis, TN 38101–0069
Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington, Wyoming	Department of the Treasury Internal Revenue Service P.O. Box 9941 Stop 5500 Ogden, UT 84409
Connecticut, Maine, Massachusetts, New Hampshire, New York, Rhode Island, Vermont	Department of the Treasury Internal Revenue Service P.O. Box 480 Stop 660 Holtsville, NY 11742–0480
Delaware, District of Columbia, Florida, Maryland, North Carolina, South Carolina, Virginia	Department of the Treasury Internal Revenue Service Stop 4–N31.142 Philadelphia, PA 19255–0030
A foreign country, American Samoa, or Puerto Rico (or are excluding income under Internal Revenue Code section 933), or use an APO or FPO address, or file Form 2555, 2555-EZ, or 4563, or are a dual-status alien or nonpermanent resident of Guam or the U.S. Virgin Islands*	Department of the Treasury Internal Revenue Service 3651 South I-H 35, 5501AUSC Austin, TX 78741
* Permanent residents of Guam or the U.S. Virgin Islands cannot use Form 9465.	

III. Other Rules

A. GUARANTEED INSTALLMENT AGREEMENT

The IRS cannot turn down a taxpayer's request for an Installment Agreement if he or she does not owe more than $10,000 in taxes and all three of the following apply:

- During the past five tax years, the taxpayer (and his or her spouse if filing a joint return) has timely filed all income tax returns and paid any income tax due, and has not entered into an Installment Agreement for payment of income tax;

- The IRS determines that the taxpayer cannot pay the tax owed in full when it is due and he or she gives the IRS any information needed to make that determination; and

- The taxpayer agrees to pay the full amount he or she owes within three years and to comply with the tax laws while the agreement is in effect.

B. TAXPAYER'S ABILITY TO PAY IN FULL

If the taxpayer can pay the full amount he or she owes within 120 days, he or she should call the IRS to establish the request to pay in full. If the taxpayer can do this, he or she can avoid paying the fee to set up an Installment Agreement. Instead of calling, the taxpayer can also apply online.

C. APPLYING ONLINE FOR PAYMENT AGREEMENT

If the taxpayer's balance due is not more than $50,000, he or she can apply online for a payment agreement instead of filing Form 9465.

D. IN-BUSINESS TRUST FUND EXPRESS INSTALLMENT AGREEMENTS

Small businesses who currently have employees can qualify for an In-Business Trust Fund Express Installment Agreement (IBTF-Express IA). These installment agreements generally do not require a financial statement or financial verification as part of the application process. The criteria to qualify for an IBTF-Express IA are:

- The business owes $25,000 or less at the time the agreement is established. If the business owes more than $25,000, it may pay down the liability before entering into the agreement in order to qualify;

- The debt must be fully paid within 24-months or prior to the Collection Statute Expiration Date (CSED), whichever is earlier;

- The business must enroll in a Direct Debit Installment Agreement (DDIA) if the amount owed is between $10,000 and $25,000; and

- The business must be compliant with all filing and payment requirements.

E. STREAMLINED INSTALLMENT AGREEMENTS

In 2012, the IRS adopted new rules pursuant to its "Fresh Start" program to help more delinquent taxpayers resolve their debts with the IRS. As part of that initiative, the IRS allows more taxpayers to use a system of streamlined Installment Agreements. Under the Fresh Start initiative, the maximum dollar criteria for streamlined Installment Agreements was raised from $25,000 to $50,000 and the maximum term was raised from 60 months to 72 months. These Installment Agreements generally do not require a financial statement, but a limited amount of financial information may be required in the application process. The Streamlined Installment Agreement criteria is divided into two categories, balance due of $25,000 or less, and balance due between $25,001 to $50,000.

1. <u>Streamlined Installment Agreements with Balances of $25,000 or Less</u>

The criteria to qualify for a streamlined Installment Agreement with a balance due of $25,000 or less are:

- The taxpayer owes $25,000 or less at the time the agreement is established. If the taxpayer owes more than $25,000, he or she may pay down the liability before entering into the agreement in order to qualify;

- The debt must be fully paid within 72-months or prior to the Collection Statute Expiration Date, whichever is earlier; and

- The taxpayer must be compliant with all filing and payment requirements.

Individuals who owe any type of tax (Form 1040, Trust Fund Recovery Penalty, etc.) are eligible for this streamlined agreement as are defunct businesses who owe any type of tax and have any type of entity structure (i.e., corporations and limited liability companies). For businesses in operation, the only type of tax debts subject to a streamlined Installment Agreement are income tax liabilities.

2. <u>Streamlined Installment Agreements with Balances Between $25,001 and $50,000</u>

The criteria to qualify for streamlined Installment Agreements with a balance due of $25,001 to $50,000 are:

- The taxpayer owes $25,001 to $50,000 at the time the agreement is established. If the taxpayer owes more than $50,000, he or she may pay down the liability before entering into the agreement in order to qualify;

- The debt must be fully paid within 72-months or prior to the Collection Statute Expiration Date, whichever is earlier; and

- The taxpayer must be compliant with all filing and payment requirements.

Individuals with any type of tax debt (i.e., Form 1040, Trust Fund Recovery Penalty, etc.) are eligible for this type of agreement. However, the only type of business entity entitled to this type of agreement is defunct sole proprietors who owe any type of tax. The taxpayer must also enroll in a Direct Debit Installment Agreement. A limited amount of financial information may also be required during the application process.

Taxpayers seeking Installment Agreements exceeding $50,000 will still need to supply the IRS with a Collection Information Statement (Form 433-A (PDF) or Form 433-F (PDF)).

CHAPTER 3 – REVIEW QUESTIONS

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. A difference between an Installment Agreement and an Offer in Compromise is that:

   a) an Offer in Compromise enables a taxpayer to pay the amount due in installments, rather than in one lump sum like an Installment Agreement
   b) an Offer in Compromise has no effect on the amount the taxpayer owes to the IRS, while an Installment Agreement reduces the amount as long as the taxpayer makes all of the required installments in a timely manner
   c) an Installment Agreement enables a taxpayer to pay the entire amount due in installments, but does not reduce the amount owing to the IRS like an Offer in Compromise
   d) an Installment Agreement is only applicable to business entities, whereas an Offer in Compromise can be used by both individuals and business entities

2. What is the maximum term limit for a streamlined Installment Agreement:

   a) 12 months
   b) 24 months
   c) 36 months
   d) 72 months

3. What was the purpose behind adopting the “Fresh Start” program:

   a) to help more delinquent taxpayers resolve their debt with the IRS
   b) to give businesses but not individuals a chance to start over and erase their debt
   c) to allow a taxpayer owing $75,000 a chance to enter into a streamlined Installment Agreement
   d) to give a taxpayer 36 months to make installment payments, rather than 24 months

4. In order to qualify for a Streamlined Installment Agreement for a tax debt of $25,000 or less, a taxpayer must meet all of the following requirements <u>except</u>:

   a) a defunct limited liability company
   b) an ongoing business that owes trust fund taxes
   c) repay the debt in no more than 72 months or prior to the expiration of the statute of limitations
   d) comply with all filing requirements

CHAPTER 3 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. An Installment Agreement enables a taxpayer to pay the amount due in installments, rather than in a reduced amount like an Offer in Compromise.

   B: Incorrect. An Offer in Compromise reduces the amount a taxpayer owes, whereas the amount remains the same in an Installment Agreement.

   C: Correct. Unlike an Offer in Compromise, an Installment Agreement does not reduce the amount owed to the IRS; it just enables the taxpayer to pay in installments, rather than in one lump sum.

   D: Incorrect. Individuals and business entities are both able to apply for an Installment Agreement or an Offer in Compromise.

   (See page 3-1 of the course material.)

2. A: Incorrect. The maximum term for a streamlined Installment Agreement is much longer than 12 months.

   B: Incorrect. Streamlined Installment Agreements have a maximum term greater than 24 months.

   C: Incorrect. The maximum term for a streamlined Installment Agreement is more than 60 months.

   D: Correct. 72 months is generally the maximum term for a streamlined Installment Agreement. In certain circumstances, the taxpayer can have longer to pay.

   (See page 3-3 of the course material.)

3. **A: Correct.** The "Fresh Start" initiative was put into place to allow more delinquent taxpayers the opportunity to resolve their debt through streamlined Installment Agreements.

   B: Incorrect. Installment options to pay the unpaid debt (not erase the debt) are provided to a taxpayer through the "Fresh Start" program.

   C: Incorrect. In order to qualify for the "Fresh Start" program, a taxpayer cannot owe more than $50,000 in delinquent taxes.

   D. Incorrect. The "Fresh Start" program actually increased the maximum term from 60 to 72 months, not 24 to 36 months.

   (See page 3-8 of the course material.)

4. A: Incorrect. Defunct businesses are eligible if they meet the other requirements.

   B: Correct. An ongoing business does not qualify unless the back taxes are solely income taxes.

   C: Incorrect. This is the maximum time allowed for repayment.

   D: Incorrect. This includes staying current in returns and payments.

   (See page 3-9 of the course material.)

Chapter 4: Grounds for Seeking an Offer in Compromise

I. Overview

In many ways, the IRS is like any other creditor. They want to get paid everything they are owed. Like other creditors, however, they sometimes realize that it is impossible to collect all or a portion of a debt. It is in such a case that the IRS will consider allowing a taxpayer to enter into an Offer in Compromise (OIC). An OIC is an agreement between a taxpayer and the IRS that settles the taxpayer's tax liabilities for less than the full amount owed. An OIC is generally not accepted if the IRS believes the liability can be paid in full, either as a lump sum or a through payment agreement. The IRS looks at the taxpayer's income and assets – as well as a variety of other factors - to make a determination of the taxpayer's reasonable collection potential.

A. GROUNDS FOR OFFERS IN COMPROMISE

The Internal Revenue Code gives the IRS very broad authority to compromise federal tax liabilities (IRC Section 7122). Specifically, the IRS is authorized to settle claims in one of three circumstances[1]:

- Doubt as to Collectability (DATC);
- Doubt as to Liability (DATL); or
- Effective Tax Administration.

IRS Policy Statement P-5-100 states:

> *The 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. An OIC is a legitimate alternative to declaring a case currently not collectable or to a protracted installment agreement. The goal is to achieve collection of what is potentially collectable at the earliest possible time and at the least cost to the Government.*
>
> *In cases where an OIC appears to be a viable solution to a tax delinquency, the Service employee assigned the case will discuss the compromise alternative with the taxpayer and, when necessary, assist in preparing the required forms. The taxpayer will be responsible for initiating the first specific proposal for compromise.*
>
> *The success of the OIC program will be assured only if taxpayers make adequate compromise proposals consistent with their ability to pay and the Service makes prompt and reasonable decisions. Taxpayers are expected to provide reasonable documentation to verify their ability to pay. The ultimate goal is a compromise that is in the best interest of both the taxpayer and the government. Acceptance of an adequate offer will*

[1] Treasury Regulation § 301.7122-1

also result in creating for the taxpayer an expectation of a fresh start toward compliance with all future filing and payment requirements.

Unless special circumstances exist, offers will not be accepted if it is believed that the liability can be paid in full as a lump sum, or by installment payments extending through the remaining statutory period for collection, or other means of collection.

A Doubt As To Collectability (DATC) offer amount must usually equal or exceed a taxpayer's reasonable collection potential (RCP) in order to be acceptable. The exceptions include special circumstances in IRM 5.8.4 and acceptance on the basis of hardship or effective tax administration (ETA) as defined in IRM 5.8.11.

The three circumstances under which the IRS may enter into an OIC each further, in some way, the objectives of the OIC program. Those objectives are to:

- Facilitate collection of what can reasonably be collected at the earliest possible time and at the least cost to the government;
- Achieve a resolution that is in the best interests of both the taxpayer and the government;
- Provide the taxpayer with a fresh start toward future voluntary compliance with all filing and payment requirements; and
- Secure collection of revenue that may not be collected through other means.

B. GENERAL RULES

1. Deal Must Be Good for IRS

The IRS will generally approve an offer in compromise when the amount offered represents the most they can expect to collect within a reasonable period of time. There are some precise calculations involved in coming up with that number that will be explored in great detail later. As with all choices, there are pros and cons to an OIC for a delinquent taxpayer, so a tax advisor should consider all options for their client before applying for an OIC. There are also eligibility criteria, i.e., a taxpayer in the midst of a bankruptcy proceeding is not eligible for an OIC.

2. Where Offers Must Be Denied

The IRS generally does not have the authority to accept an OIC when:

- 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 is in litigation being handled by the Department of Justice;
- The federal tax liability for all or part of the periods the taxpayer owes has been reduced to a judgment;

- An offer is received that covers tax periods for which restitution was ordered. The IRS cannot accept an OIC that in any way modifies the terms of a restitution order. 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;

- The IRS has a civil or criminal prosecution pending against the taxpayer in the Department of Justice or U.S. Attorney's Office; or

- Acceptance by the IRS is dependent upon the Department of Justice accepting a related offer or settlement.

Another limitation is that offers based on Doubt as to Collectability or Effective Tax Administration must include all unpaid tax liabilities and periods for which the taxpayer is liable.

Example.

If a taxpayer submits an OIC for income tax liabilities and the taxpayer is also responsible for employment taxes for a sole-proprietorship, both the income tax and business liabilities must be included in the accepted offer.

An OIC is effective for 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. Neither the taxpayer nor the government can reopen a compromised tax year or period unless there was falsification of information or documents, concealment of ability to pay, or a mutual mistake of a material fact which would be sufficient to set aside or reform a contract.

3. Unassessed Liability

The IRS will not consider an offer that is solely for a tax period or tax year that has not been assessed unless a return has been received or an assessment is pending. Taxpayers may submit, and the IRS will consider, an offer to compromise taxes due on tax returns which have been filed but have not yet been assessed when unpaid liabilities already exist. However, before the offer can be accepted, the unassessed taxes must be assessed.

4. Lapsed Statute of Limitations

If the statute of limitations has passed, the taxpayer is obviously not obligated to pay. Therefore, the IRS will not enter into a compromise when the taxpayer is indeed no longer liable for the tax. If a taxpayer makes a voluntary payment to a liability barred by statute, the IRS is required, pursuant to the Internal Revenue Manual, to inform the taxpayer that the payment is not required and ask if they want the payment applied to their account or returned. The taxpayer must be advised that the payment is purely voluntary.

C. OBLIGATIONS THE IRS MAY NOT COMPROMISE

The IRS does not have the authority to compromise certain financial obligations, including child support orders. If a taxpayer proposes a compromise that includes child support liability, the IRS will ask the taxpayer to remove that from his or her offer. Failure by the taxpayer to abide by such a request will result in a rejection of the offer.

The IRS may not accept an OIC that in any way modifies the terms of a restitution order. Any changes to the terms of a restitution payment must be made pursuant to the direction of the ordering court. There may be situations where the IRS has assessed civil tax liabilities, interests and penalties in excess of the amount that was awarded as restitution. In this situation, the IRS may consider an OIC to pay the additional taxes, penalties, and interest for the same tax periods for which restitution was ordered only if the defendant has paid or will pay as part of the offer the full amount of the restitution.

> **Example.**
>
> *The court orders payment of restitution to the IRS for the 2008 tax year in the amount of $50,000. The IRS assesses civil tax liabilities, interest, and penalties in the amount of $80,000 for the same tax year. The IRS may compromise the additional assessed as civil tax liabilities ($30,000), only if the defendant has paid or will pay the full amount of the restitution ($50,000).*

The IRS also will not consider an offer based on Doubt as to Collectability or Effective Tax Administration for "non-restitution" taxes or years because those offers must include a compromise of all unpaid taxes.

> **Example.**
>
> *The court awards restitution payable to the IRS in the amount of $50,000 for the tax years 2005 and 2006. The IRS assesses civil tax liabilities in the amount of $25,000 for tax year 2007. The IRS may not compromise the civil tax liability for the 2007 tax year based on doubt as to collectability or effective tax administration because the offer would have to include tax years for which restitution was ordered payable to the IRS.*

If an OIC is submitted by a taxpayer that includes tax periods for which criminal restitution was ordered payable to the IRS, the IRS will not consider the offer unless it provides for full payment of the amount of restitution. Taxpayers submitting such offers will be informed by the IRS that only the district court that entered the restitution order can modify the order.

D. NOTE ON TAXPAYERS WHO SUBMIT MULTIPLE OFFERS

When a taxpayer files a Doubt as to Liability (DATL) and Doubt as to Collectability (DATC) at the same time, the IRS cannot consider both offers simultaneously. In most instances, the IRS will consider the DATL offer first and return the second offer. The taxpayer, however, will be given the opportunity to select which offer to have considered first.

II. Doubt as to Liability Offer in Compromise

Remember that the IRS will only consider an OIC if it falls into one of the three categories listed above, one of which is called Doubt as to Liability, or DATL. An OIC based on DATL must be submitted to the IRS using Form 656-L.

A. WHAT IS A DOUBT AS TO LIABILITY OFFER

"Doubt as to liability[2]" exists where there is a genuine dispute as to the existence or amount of the correct tax debt under the law. 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 on current law.

B. REQUIRED DOCUMENTATION

A taxpayer seeking relief must provide the IRS with the supporting documentation or evidence that will show the reason or reasons the taxpayer doubts the accuracy of the assessed tax debt. The taxpayer must include within his or her application a written statement explaining why the debt or a portion thereof is incorrect. The amount of a taxpayer's offer should be based on what he or she believes is the correct amount of debt as opposed to what the IRS says is owed. The offer must be more than zero.

C. TAXPAYER MUST CHOOSE APPROACH

Taxpayers may not submit an offer based on DATL (Form 656-L) and an offer based on Doubt As To Collectability (Form 656 or 656-B) at the same time, claiming that they do not believe the tax debt is correct (doubt as to liability) and that they are unable to pay it (doubt as to collectability). It is in the best interest of most taxpayers to resolve any disagreements about the validity of the tax debt before filing an offer based on doubt as to collectability. If a taxpayer sends applications for both kinds of offers at the same time, the doubt to collectability offer will be returned by the IRS without further consideration.

D. BASIS FOR OFFER

Generally, a taxpayer will submit a doubt as to liability offer when he or she is unable to dispute the amount of tax the IRS claims he or she owes during the time allowed by the Internal Revenue Code or IRS guidelines. Possible reasons for submitting a doubt as to liability offer in compromise include the following:

- The examiner made a mistake interpreting the tax law;
- The examiner failed to consider all of the evidence presented; or
- New evidence is available to support a change to the assessment.

[2] Juxtapose "doubt as to liability" with "doubt as to collectability." A doubt as to collectability offer is when a taxpayer agrees that he or she owes the taxes but cannot pay the tax debt in full. To be considered for a doubt as to collectability offer, a taxpayer must make an appropriate offer based on what the IRS considers the taxpayer's true ability to pay.

The following examples illustrate the type of circumstances in which it is generally advisable to file an application based on "doubt as to liability" theory.

Example.

William filed his tax return reporting stock options as valued by his employer, which created a large tax liability including Alternative Minimum Tax (AMT). William paid part of the tax debt, but could not pay the full amount owed. He later discovered that the stocks were not worth as much as he originally reported. This was due to fraudulent acts by the broker and/or his employer. William filed a claim for a refund based on the reduced value of stock options. The IRS told William that the full amount of the tax debt had to be paid before they could consider his claim and denied his claim for refund. This situation may warrant an OIC based on Doubt as to Liability.

Example.

Sally received a notice from the IRS that she was being audited. Immediately thereafter, her records were destroyed in a house fire and she missed the meeting with the auditor. She never followed up. The IRS disallowed all expenses and determined that Sally owed the IRS a substantial sum of money. When Sally tried to borrow money, she determined that the IRS had filed a federal tax lien. Sally was able to reconstruct her books and records with the correct expenses that would significantly lower her tax debt. This situation may warrant an OIC based on Doubt as to Liability.

Example.

Mike is an officer of a corporation that has employees. Mike is not in a decision-making position nor does he have the authority to pay bills or sign checks. The business is struggling to make ends meet. In order to pay suppliers, the money that should have been paid to the IRS as a federal tax deposit was used to continue business operation. In an effort to collect the trust fund part of the employee's wages, the IRS assessed the trust fund portion of the tax against Mike and all the other officers of the corporation. Mike was not a person responsible for collecting and paying the withheld income and employment taxes. He has supporting statements and documentation to support that fact. This situation may warrant an OIC based on Doubt as to Liability.

E. DOUBT AS TO LIABILITY OFFER WITHDRAWN

If the IRS and taxpayer reach an agreement on the <u>correct</u> tax liability, a "compromise" is not required. That is because, by definition, if the parties agree on the level of tax owed there is no doubt as to the amount due. When an agreement is made, the taxpayer must therefore withdraw his or her offer in compromise. Any adjustments required to correct the outstanding tax liability are then accomplished through abatement of any erroneously assessed tax. A taxpayer may agree to a portion of the adjustment and disagree with the remaining liability. This should be treated as a partial agreement. The remaining portion of the disagreed liability is then treated as a rejection of the OIC.

F. DOUBT AS TO LIABILITY OFFER REJECTED

If the taxpayer does not agree with the IRS's conclusions and does not withdraw his or her offer, the IRS will prepare a report to reflect any decrease in tax and penalties (based on the correct tax liability determined by the IRS examiner). If requested, the IRS must explain to the taxpayer the recommendation with the caveat that it is subject to review. If the taxpayer does not agree with the examiner's conclusions, the case is processed as a rejection and any partial abatement (in arriving at the correct tax) is made before the file is forwarded for final processing. The taxpayer has 30 days from the date of the rejection letter to file an appeal request.

G. CIRCUMSTANCES WHEN DATL CANNOT BE CONSIDERED

The IRS will not consider DATL offers if any of the following conditions exist:

- It is clearly not the taxpayer's intention to compromise the tax liability based on the belief that it is not incorrect. For example, taxpayers may erroneously submit the Form 656-L when the intent is to request an installment agreement to pay the existing liability or to compromise the liability on the basis that they cannot pay;

- The liabilities involve Bureau of Alcohol, Tobacco, and Firearms (BATF) penalties;

- The taxpayer seeks to compromise a tax period for an unassessed liability; or

- A determination is pending before the Tax Court.

H. DATL OFFERS MADE SOLELY TO DELAY COLLECTION

The IRS will reject offers based on DATL when the offer is made solely to delay collection efforts. Examples include:

- Resubmission of offers that are based on offer explanations that have previously been rejected or previously returned offers for which the taxpayer has not provided any new information;

- Claims that the liability stems from the operation of a law that is unfair (e.g., liability based on withdrawing funds from a 401(k) plan);

- Claims based on a divorce decree which stipulates the spouses each owe certain portions of a joint liability (the government is not party to such agreements);

- Those that do not raise a valid liability issue or that give no reason for DATL basis; or

- Frivolous or patently groundless offers.

III. Doubt as to Collectability

The most common basis upon which the IRS will agree to an OIC is when there is Doubt as to Collectability (DATC), meaning that the IRS does not believe it is likely they can collect the full amount of the debt from the taxpayer either presently or in the near future. In these cases, the taxpayer agrees that he or she is unable to pay the debt in full.

A. GENERAL GUIDELINES

The IRS will not accept an offer in compromise if the tax can be paid in full as a lump sum or can be paid pursuant to an installment agreement, unless special circumstances are identified that warrant consideration of a lesser amount. Once the ability to make payments is established, the IRS will determine if a greater amount can be collected through an installment agreement than is being offered. If so, the IRS will reject the offer of a compromise absent special circumstances. To determine if the taxpayer can pay his or her tax debt in full, the IRS must base the calculation on the balance due at the time the offer was submitted.

B. DETERMINING REASONABLE COLLECTION POTENTIAL (RCP)

For DATC offers, the IRS's decision to accept or reject the offer usually rests on whether the amount offered reflects the Reasonable Collection Potential (RCP). Generally, this means the most the IRS can expect to get from the delinquent taxpayer taking into consideration his or her financial condition, including income and assets. The exception to this rule is for offers not accepted based on public policy reasons. RCP is defined as the amount that can be collected from all available means, including administrative and judicial collection remedies. Generally, the components of collectability will be included in calculating the total RCP. In determining the taxpayer's future ability to pay, the IRS is required to give full consideration to the taxpayer's overall general situation, including such factors as age, health, marital status, number and age of dependents, education or occupational training, and work experience.

The IRS will not accept an OIC when the tax can be paid in full as a lump sum or can be paid under installment agreement guidelines, unless special circumstances are identified that warrant consideration of a lesser amount. Once the ability to make payments is established, the IRS is required to determine if a greater amount can be collected through current installment agreement guidelines than is being offered. If so, the IRS will generally reject the offer unless special circumstances warrant acceptance. To determine if a taxpayer can pay in full, the IRS makes the calculation based on the balance due at the time the offer was submitted.

Table 4.1. Components of Collectability.

The following four components of collectability will ordinarily be included in calculating the Reasonable Collection Potential for offer purposes:

<table>
<tr><th>Components</th><th>Definition</th></tr>
<tr><td>Assets</td><td>The amount collectable from the taxpayer’s net realizable equity in assets.</td></tr>
<tr><td>Future Income</td><td>The amount collectable from the taxpayer’s expected future income after allowing for payment of necessary living expenses.
For Lump Sum Cash offers, (1) if the offer is payable in five or fewer installments within five months – project for the next 48 months or the remaining statutory period, whichever is less; (2) if the offer is payable in five or fewer installments in more than five months and less than 24 months – project for the next 60 months or the remaining statutory period, whichever is less; (3) if the offer is payable in five or fewer installments in more than 24 months – project through the statutory period
For Short Term Periodic Payment offers, it is the amount collectable over the next 60 months or the remaining statutory period, whichever is less.
For Deferred Periodic Payment offers, it is the amount that is collectable over the life of the collection statute.</td></tr>
<tr><td>Amount Collectable from third parties</td><td>The amount we could expect to collect from third parties through administrative or judicial action. For example, amounts collectable through a transferee assessment, nominee lien, or suit to set aside a fraudulent conveyance.</td></tr>
<tr><td>Assets and/or income that are available to the taxpayer but are beyond the reach of the government</td><td>Assets that the lien will not attach, such as equity in assets located outside the country.</td></tr>
</table>

Once the IRS calculates a Reasonable Collection Potential for a case, they will process the case as follows in the Table 4.2.

Table 4.2. Actions Based on Reasonable Collection Potential.

If…	Then…
The offer must be increased before recommending for acceptance	The IRS will contact the taxpayer by telephone to discuss amending the offer to the acceptable amount. If the taxpayer's response does not change the case determination, the IRS will issue a rejection letter. If the taxpayer agrees to pay the higher amount, the IRS will send them an amended Form 656 for the taxpayer's signature.
The analysis shows the taxpayer can fully pay the tax through liquidating assets and/or installment payments	The IRS will contact the taxpayer by telephone to discuss withdrawing the offer and entering into an alternative resolution. If the taxpayer's response does not change the case determination, the IRS will issue a rejection letter. If the taxpayer provides additional information, the IRS will make the appropriate adjustment to the RCP and contact the taxpayer by telephone to discuss the case decision.
The offer amount equals or exceeds the RCP and the offer is otherwise acceptable	The IRS will issue an acceptance letter.
Special circumstances are identified that warrant acceptance for less than the RCP	The IRS will consider a compromise based on Effective Tax Administration or Doubt as to Collectability with Special Circumstances.

1. Actions Based on Reasonable Collection Potential

Once the RCP has been calculated, the IRS will compare that figure with the amount offered by the taxpayer. If the offer is below the RCP calculated by the IRS, the IRS will contact the taxpayer and give them the opportunity to increase his or her offer. If the taxpayer is unwilling to increase his or her offer, the IRS will reject the offer. If the analysis shows that the taxpayer can fully pay the tax either through liquidation and/or installment payments, the IRS will notify the taxpayer that an OIC will not be accepted. Absent special circumstances (discussed below), the offer of the taxpayer must be at least equal to or higher than the RCP figure or the offer must be rejected.

2. Filing Notice of Federal Tax Lien When OIC Is Rejected

After rejecting an OIC, the IRS may elect to file a Notice of Federal Tax Liability in order to protect the government's collection rights. A NFTL will generally be filed whenever the unpaid aggregate balance of assessments exceeds $10,000, and an offer is recommended for rejection, return, withdrawal, or acceptance for the following:

- Lump sum cash offer (20%), and five or fewer installments paid in six months or more;
- Short term periodic payment offer; or
- Deferred periodic payment offers.

A lien notice will generally not be filed on accepted offers when the offer amount will be paid in five months or less.

Example.

A taxpayer submits an offer for $20,000. He pays 20% or $4,000. The remaining balance is $16,000. If the taxpayer offers to pay the $16,000 within five months from the date of acceptance, the IRS will not file a Notice of Federal Tax Lien. That is certainly good for the taxpayer, whose credit would be adversely affected by the filing of a NFTL.

IV. Effective Tax Administration and Doubt as to Collectability with Special Circumstances (DCSC)

When investigating any OIC, the IRS requires its staff to give consideration to the following issues when present, whether identified by the taxpayer or not:

- Economic Hardship – when a taxpayer is unable to pay necessary basic living expenses; and
- Public Policy or Equity – 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 can be considered under ETA criteria when:

- There is no doubt the tax is owed and no doubt that the full amount owed can be collected from the taxpayer;
- The taxpayer has a proven economic hardship or has presented facts that would support acceptance under the public policy/equity basis; and
- Compromise would not undermine compliance with tax laws.

Offers can be considered under DCSC criteria when:

- The taxpayer cannot fully pay the tax due; and
- The taxpayer has proven special circumstances that warrant acceptance for less than the amount of the calculated RCP.

Factors establishing special circumstances under DATC are the same as those considered under ETA.

A. LEGAL BASIS FOR EFFECTIVE TAX ADMINISTRATION OFFER

Before the IRS will consider an OIC based on economic hardship or public policy/equity considerations, three factors must exist:

- A liability has been or will be assessed against taxpayer(s) before acceptance of the OIC;

- The sum of net equity in assets, future income, and the other components of collectability 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.

B. COMPARISON TO OTHER TYPES OF COMPROMISES

1. <u>Compared to Doubt as to Collectability (DATC)</u>

In a DATC offer, the tax liability equals or exceeds the taxpayer's Reasonable Collection Potential (RCP), which is: (a) net equity, plus (b) future income, and (c) other components of collectability. In an Effective Tax Administration offer, the tax liability is less than the taxpayer's RCP. The RCP shows the taxes owed can be collected in full either in a lump sum or through an installment agreement. A DATC offer does not convert to an ETA offer if the IRS and the taxpayer cannot agree on an acceptable offer amount.

2. <u>Compared to Doubt as to Collectability with Special Circumstances (DCSC)</u>

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.

> **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.*

3. <u>Compared to Doubt as to Liability</u>

An offer can be considered under ETA provisions only when there are no DATL issues. In reaching these determinations, the IRS will generally comply with the rules detailed in Table 4.3, below:

Table 4.3. Comparing ETA with Doubt as to Liability.

If…	Then…
The IRS determines that there is doubt as to the amount of the liability the taxpayer owes	The taxpayer is not eligible for ETA consideration. The taxpayer's offer will be considered based on the DATL issue.
The IRS determines that the taxpayer's equity in assets plus future income (RCP) does not exceed the amount of the tax liability	The taxpayer is not eligible for an ETA offer. The OIC is considered based on DATC. However, hardship or public policy/equity may be present in the case to allow consideration under DCSC.
The IRS determines the taxpayer is not eligible for compromise based on DATL or DATC, and the taxpayer can demonstrate that collection of the tax liability in full would create economic hardship, or demonstrate that there is compelling public policy or equity issues in the case that would provide sufficient basis for compromise	The taxpayer would be eligible for ETA consideration.

C. ECONOMIC HARDSHIP CONSIDERATIONS

When a taxpayer's liability can be collected in full but collection would create an economic hardship, an Effective Tax Administration (ETA) offer based on economic hardship can be considered. The definition of economic hardship as it applies to ETA offers is derived from Treasury Regulations § 301.6343-1. Economic hardship[3] occurs when a taxpayer is unable to pay reasonable basic living expenses. The determination of a reasonable amount for basic living expenses will be made by the Commissioner of the IRS and will vary according to the unique circumstances of the individual taxpayer. Unique circumstances, however, do not include the maintenance of an affluent or luxurious standard of living.

1. Basic Living Expenses

The IRS will examine the taxpayer's financial information and special circumstances to determine if he or she qualifies for an ETA offer based on economic hardship. Financial analysis includes reviewing basic living expenses as well as other considerations. The taxpayer's income and basic living expenses must be considered to determine if the claim for economic hardship should be accepted. Basic living expenses are those expenses that provide for health, welfare, and production of income of the taxpayer and the taxpayer's family. National and local standard expense amounts are designed to provide accuracy and consistency in determining a taxpayer's basic living expenses. These standards are guidelines and if it is determined that a standard amount is inadequate to provide for a specific taxpayer's basic living expenses, the IRS is allowed to deviate from them. However, the IRS will require the taxpayer to provide reasonable substantiation and document the case file.

[3] Because economic hardship is defined as the inability to meet reasonable basic living expenses, it applies only to individuals (including sole proprietorship entities). Compromise on economic hardship grounds is not available to corporations, partnerships, or other non-individual entities.

2. Other Factors

In addition to the basic living expenses, other factors the IRS will consider that impact the taxpayers financial condition include:

- The taxpayer's age and employment status;

- Number, age, and health of the taxpayer's dependents;

- Cost of living in the area the taxpayer resides; and

- Any extraordinary circumstances such as special education expenses, a medical catastrophe, or natural disaster.

Note that the above list is not all-inclusive. The IRS may consider other factors in making an economic hardship determination.

3. Factors Supporting Economic Hardship Argument

Factors that support an economic hardship determination may include:

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

- The taxpayer may have a set monthly income and no other means of support and the income is exhausted each month in providing for the care of dependents; and

- The taxpayer has assets, but is unable to borrow against the equity in those assets, and liquidation to pay the outstanding tax liabilitie(s) would render the taxpayer unable to meet basic living expenses.

These factors are representative of situations the IRS regularly encounters when working with taxpayers to resolve delinquent accounts. They are not intended to provide an exhaustive list of the types of cases that can be compromised based on economic hardship.

4. Examples

The following examples illustrate the types of cases that may be compromised under the economic hardship standard.

Example.

The taxpayer has assets sufficient to satisfy the tax liability and provides full time care and assistance to a dependent child, who has a serious long-term illness. It is expected that the taxpayer will need to use the equity in assets to provide for adequate basic living expenses and *medical care for the child. The taxpayer's overall compliance history does not weigh against compromise.*

Example.

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.

Example.

The taxpayer is disabled and lives on a fixed income that will not, after allowance of adequate basic living expenses, permit full payment of the liability under an installment agreement. The taxpayer also owns a modest house that has been specially equipped to accommodate for a disability. The equity in the house is sufficient to permit payment of the liability owed. However, because of the disability and limited earning potential, the taxpayer is unable to obtain a mortgage or otherwise borrow against this equity. In addition, because the taxpayer's home has been specially equipped to accommodate the disability, forced sale of the taxpayer's residence would create severe adverse consequences for the taxpayer, making such a sale unlikely. The taxpayer's overall compliance history does not weigh against compromise.

The economic hardship standard authorizes the IRS to compromise regardless of the cause of the liability, provided compromise does not undermine compliance by other taxpayers.

Example.

The taxpayer submitted an ETA offer based on economic hardship. The financial statement appears to support the offer. When a research of the county property records is conducted, it is noted that the home was transferred to a child for $100 plus love and affection. The transfer of the home was made after the tax was assessed. It is confirmed that deliberate actions were taken to avoid the payment of tax; therefore, the offer should not be accepted.

In economic hardship cases, an acceptable offer amount is determined by analyzing the financial information, supporting documentation, and the hardship that would be created if certain assets, or a portion of certain assets, were used to pay the liability.

Example.

The taxpayer was diagnosed with an illness that eventually will hinder any ability to work. Although currently employed, the taxpayer will soon be forced to quit his job and will use personal funds for basic living expenses. The taxpayer owes $100,000 and has a reasonable collection potential of $150,000. An offer was *submitted for $35,000. Through the investigation, it is determined that collecting more than $50,000 would cause an economic hardship for the taxpayer. A determination on economic hardship was made due to the fact the taxpayer's reasonable living expenses, including ongoing medical costs, will exceed his or her income once the taxpayer is unemployed. The taxpayer is advised to raise the offer to $50,000 since it is the amount the IRS can collect without creating an economic hardship.*

The existence of economic hardship criteria does not dictate that an Offer in Compromise must be accepted. An acceptable offer amount must still be determined based on a full financial analysis and negotiation with the taxpayer. When hardship criteria are identified but the taxpayer does not offer an acceptable amount, the IRS will generally not approve the offer.

D. PUBLIC POLICY OR EQUITY GROUNDS

Acceptance of an OIC based on considerations of equity and public policy will generally be based on a combination of facts and circumstances. Where there is no DATL, no DATC, and the liability could be collected in full without causing economic hardship, the IRS 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. Because the IRS assumes that Congress imposes tax liabilities only where it determines it is fair to do so, compromise on these grounds is rare.

The IRS recognizes that compromise on these grounds will often raise the issue of disparate treatment of taxpayers who can pay in full and whose liabilities arose under substantially similar circumstances. Taxpayers seeking compromise on this basis bear the burden of demonstrating circumstances that are compelling enough to justify compromise notwithstanding this inherent inequity.

All non-hardship ETA offers should meet the following requirements:

- The taxpayer has remained in compliance since incurring the liability and overall his or her compliance history does not weigh against compromise;

- The taxpayer must have acted reasonably and responsibly in the situation giving rise to the liabilities; and

- The circumstances of the case must be such that other taxpayers would view the compromise as a fair and equitable result. For example, it should not appear to other taxpayers that the result of the compromise places the taxpayer in a better position than he or she would occupy had the taxpayer timely and fully met his or her obligations.

Generally, tax liabilities associated with the taxpayer's participation in abusive tax avoidance transactions will not be compromised under these procedures.

1. Public Policy or Equity Compelling Factors

Compromise may promote ETA where a taxpayer's liability was directly caused by a processing error on the part of the IRS and would otherwise have been avoided. Compromise to remedy the mistake may be appropriate to the extent correction of the mistake (such as through abatements, reversal of credits, etc.) does not put the taxpayer back in the same position that he or she would have occupied if the error had not been made.

Example.

The taxpayer is a closely-held corporation. The IRS audited the taxpayer's tax returns for 2000, 2001, and 2002 and determined that the taxpayer was a personal holding company liable for personal holding company tax. The taxpayer agreed to immediate assessment of the tax, but attempted to take advantage of the deduction for deficiency dividends under section 547. Although the taxpayer made the distributions necessary to qualify for the deduction, the IRS made several errors in executing the required agreements and other paperwork. As a result, the taxpayer could not avail itself of the section 547 deduction. Under the statute, applicable regulations, and pertinent case law, there is no means by which the mistakes can be corrected to allow the taxpayer to take advantage of the deduction. There is documentary evidence that all of the required Service officials intended to complete the processing of the agreements and that, but for their failure to do so, the taxpayer would have qualified for the deduction. The taxpayer has no prior history of noncompliance.

The fact that the tax liability was caused solely by an error on the part of the IRS supports the determination that collection in full would cause other taxpayers to question the fairness of the tax system. Furthermore, the policies underlying the imposition of the personal holding company tax and the rules regarding deficiency deductions are not undermined by compromise under these circumstances. The IRS may consider accepting a compromise that would reflect the amount the taxpayer would now owe had the IRS not made an error.

Compromise may promote ETA where the taxpayer incurred the liability because of having followed erroneous advice or instructions from the Service. The advice or instructions caused the taxpayer to incur a tax liability that would not otherwise have been incurred.

Example.

The taxpayer is a salaried sales manager at a department store who has been able to place $2,000 in a tax-deductible IRA account for each of the last two years. The taxpayer learns that a higher rate of interest can be earned on his IRA savings by moving the savings from a Money Management account to a Certificate of Deposit at a different financial institution. Prior to transferring the savings, the taxpayer submits an E-mail inquiry to the IRS at its Web Page, requesting information about the steps needed to preserve the tax benefits currently enjoyed and to avoid any penalty. The IRS responds in an answering E-mail that the taxpayer *may withdraw the IRA savings from the neighborhood bank, but it must be redeposited in a new IRA account within 90 days. The taxpayer withdraws the funds and redeposits them in a new IRA account 63 days later. Upon audit, the taxpayer learns that he has been misinformed about the required rollover period and is now liable for additional taxes, penalties and interest for not redepositing the amount within 60 days. Had the advice provided been accurate, the taxpayer would have redeposited the funds in a timely manner. The taxpayer is able to provide documentation that demonstrates the taxpayer was provided incorrect information. The taxpayer's overall compliance history does not weigh against compromise.*

Because the tax liability in this example was caused by relying on the IRS's erroneous statement, and the taxpayer clearly could have avoided the liability had the Service given correct information, it is reasonable to conclude that collection in full would cause other taxpayers to question the fairness of the tax system. The IRS may consider accepting a compromise that would reflect the amount the taxpayer would now owe had the Service not made an error.

If actions or inaction of the IRS unreasonably delayed resolution of the taxpayer's case and interest or penalty abatement is not available, compromise may still be warranted if the circumstances are sufficiently compelling. An OIC should not be accepted under ETA provisions, in lieu of abatement under IRC Section 6404(e), when appropriate.

These provisions may allow for relief if the taxpayer alleges that the criminal or fraudulent act of a third party is directly responsible for the tax liability. The taxpayer should be able to provide supporting documentation that the act occurred and was the direct cause of the delinquency. The taxpayer should also be able to show that the nature of the crime was such that even a prudent, responsible business owner would have been misled to believe the tax obligations were properly addressed. There should be evidence that the funds required for the payment of the taxes were segregated or otherwise identified and were available to pay the taxes in a timely manner. Compromise would promote ETA in such situations only where the failure to comply is directly attributable to intervention by a third party and where the taxpayer has made every effort to comply and taken reasonable precautions to prevent the criminal or fraudulent acts at issue. The taxpayer's efforts to mitigate the damages by pursuing collection from the third party should also be considered. Compromise for this reason would only promote ETA where there is a very close nexus between the actions at issue and the failure to comply.

Example.

The taxpayer was using a payroll service provider (PSP) who deducted all tax payments from the taxpayer's bank account, yet did not remit them to the Service. The taxpayer took all reasonable precautions to prevent this from occurring. The PSP also falsified documents to conceal the embezzlement. Since the abatement of interest is not available under 6404(e) on employment taxes, an offer in the amount of the tax balance may be accepted. The taxpayer's overall compliance history does not weigh against acceptance of the offer.

The IRS will not compromise on public policy or equity grounds solely on the argument that the acts of a third party caused the unpaid tax liability. Third parties include: representatives, partners, agents, or employees. The actions of the third party may be part of a fact pattern that, viewed as a whole, present compelling public policy or equity concerns justifying compromise. As with all compromises based on public policy or equity, the taxpayer's situations must be compelling enough to justify compromise even though similarly situated taxpayers may have paid in full.

Compromise may be appropriate where there is clear and convincing evidence that rejecting the OIC, and pursuing other collection alternatives, would have a significantly negative impact on the community in which the taxpayer lives or does business, i.e., does the taxpayer provide essential services to the community that would be lost if the tax liability was collected in full? The taxpayer should be asked to provide documentation that full payment of the tax liabilities would likely result in the inability of the business to provide these essential services. The businesses that would typically qualify under this provision are not for profit, charitable, or exempt organizations.

Example.

A non-profit organization provides quality health and human services to indigent, low-income and under-served residents in two counties. Rejecting the offer and pursuing collection action for full payment would result in forcing the center to choose between paying the delinquent taxes or providing competent medical care. After conducting a thorough review of the facts, it was determined that services would not be provided to the community if the taxpayer was no longer able to operate. Since the taxpayer took all reasonable actions to prevent the delinquency from occurring and the taxpayer's overall compliance history does not weigh against acceptance of the offer, an offer amount for less than the remaining tax balance may be considered.

Compromise may promote ETA where the taxpayer was incapacitated and thus unable to comply with the tax laws.

Example.

In October 2003, the taxpayer developed a serious illness that resulted in almost continuous hospitalization for a number of years. The medical condition was such that during this period, the taxpayer was unable to manage any of his financial affairs. The taxpayer has not filed tax returns since that time. The taxpayer's health has now improved and has promptly begun to attend to tax matters. The taxpayer discovered that the IRS prepared a substitute for return for the 2003 tax year based on information documents it had received and assessed a tax deficiency. When the taxpayer discovered the liability, with penalties and interest, the tax bill was more than three times the original tax liability. The taxpayer's overall compliance history does not weigh against compromise. In this situation, the IRS should first work with the taxpayer and attempt to prepare an accurate return for the 2003 tax year and adjust the taxpayer's account accordingly. The IRS should also work with the taxpayer to secure the filing of any missing returns. Following that, the IRS should *consider accepting a compromise that would approximate the amount the taxpayer would have been assessed had he been able to comply with his filing and payment responsibilities in a timely manner. Such a compromise would be fair and equitable to the taxpayer and, under these circumstances, would advance the public policy of voluntary compliance with the tax laws.*

Focusing still on the above example, it would not promote ETA to compromise with the taxpayer, if the investigation revealed that the taxpayer was able to attend to financial matters during the time of the illness. For example, assume the taxpayer paid all other bills and continued to successfully operate a business during the illness. Under such circumstances, compromise would not promote ETA, and could serve to undermine compliance by other taxpayers.

Compromise on public policy or equity grounds is not authorized based solely on a taxpayer's belief that a provision of the tax law is itself unfair. Where a taxpayer is clearly liable for taxes, penalties, or interest due to operation of law, a finding that the law is unfair would undermine the will of Congress in imposing liability under those circumstances.

Example.

The taxpayer argues that collection would be inequitable because the liability resulted from a discharge of indebtedness rather than from wages. Because Congress has clearly stated that a discharge of indebtedness results in taxable income to the taxpayer, it would not promote ETA to compromise on these grounds.

Example.

In 2000, the taxpayer invested in a nationally marketed partnership which promised the taxpayer tax benefits far exceeding the amount of the investment. Immediately upon investing, the taxpayer claimed investment tax credits that significantly reduced or eliminated the tax liabilities for the years 1997 through 2000. In 2001, the IRS opened an audit of the partnership under the provisions of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). After issuance of the Final Partnership Administrative Adjustment (FPAA), but prior to any proceedings in Tax Court, the IRS made a global settlement offer in which it offered to concede a substantial portion of the interest and penalties that could be expected to be assessed if the IRS's determinations were upheld by the court. The taxpayer rejected the settlement offer. After several years of litigation, the partnership level proceeding eventually ended in Tax Court decisions upholding the vast majority of the deficiencies asserted in the FPAA on the grounds that the partnership's activities lacked economic substance.

The taxpayer has now offered to compromise all the penalties and interest on terms more favorable than those contained in the prior settlement offer, arguing that TEFRA is unfair and that the liabilities accrued in large part due to the actions of the Tax Matters Partner (TMP) *during the audit and litigation. Neither the operation of the TEFRA rules nor the TMP's actions on behalf of the taxpayer provide grounds to compromise. Compromise on those grounds would undermine the purpose of both the penalty and interest provisions at issue and the consistent settlement principles of TEFRA. Furthermore, reducing the risks of participating in tax shelters would encourage more taxpayers to run those risks, which would undermine compliance. Depending on the taxpayer's particular facts and circumstances, however, compromise may be authorized on the grounds of Doubt as to Collectability (DATC), or because collection of the full liability would cause an economic hardship.*

In both of the above examples, the taxpayers are essentially claiming that Congress enacted unfair statutes and are arguing that the Service should use its compromise authority to rewrite those statutes based on a perception of unfairness. Compromise for that reason would not promote ETA. The compromise authority under Section 7122 is not so broad as to allow the Service to disregard or override the judgments of Congress.

There may be other circumstances involved in a case that would lead a reasonable third party to conclude that acceptance of the OIC would be fair, equitable, and promote effective tax administration. Other factors not discussed above may be present to support the conclusion that the case presents compelling public policy or equity considerations sufficient to justify compromise. The IRS is very critical in making such determinations, however, because of the impact they could have on future cases.

2. Compromise Would Not Undermine Compliance With Tax Laws

Compromise under the ETA economic hardship or non-economic hardship provisions are permissible if acceptance does not undermine compliance. The public should not perceive that the taxpayer whose offer is accepted benefited by not complying with the tax laws. Factors supporting (but not conclusive of), a determination that compromise would undermine compliance includes, but is not limited to:

- The taxpayer has an overall history of noncompliance with the filing and payment requirements of the Internal Revenue Code;
- The taxpayer has taken deliberate actions to avoid the payment of taxes; and
- The taxpayer has encouraged others to refuse to comply with the tax laws.

There may be other situations where compromise would be undermined.

Chapter 4 – Review Questions

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. Which of the following statements best describes a situation where Doubt as to Liability exists:

   a) when the taxpayer asserts that federal income taxes are unconstitutional
   b) when a federal tax court assesses a specific amount of tax due
   c) when the taxpayer believes they should not have to pay the tax due
   d) when the taxpayer has evidence to show that the tax assessed is too high

2. How does the IRS generally determine whether or not to accept an Offer in Compromise based on Doubt as to Collectability:

   a) when it is obvious from reviewing the taxpayer's application that the taxpayer is a deadbeat
   b) when the amount offered represents the most the IRS can reasonably expect to receive from the taxpayer
   c) when the IRS determines that the taxpayer has made every effort to pay his or her tax debt
   d) when the amount offered is at least half of what the taxpayer owes

3. The IRS will generally consider an Offer in Compromise based on Effective Tax Administration under any of the following <u>except</u>:

   a) when the taxpayer faces dire economic circumstances
   b) when there is real doubt that the taxpayer owes all of the money being assessed
   c) when the IRS does not believe it will be able to collect any of the debt without entering into the compromise
   d) when the IRS does not believe the compromise will encourage other taxpayers to be delinquent

4. Which of the following is <u>not</u> a factor considered by the IRS when a taxpayer seeks to compromise his or her tax debt based on Effective Tax Administration:

   a) health care expenses
   b) equipment needed by the taxpayer for his business
   c) housing
   d) reasonable vacations

Chapter 4 – Solutions and Suggested Responses

1. A: Incorrect. This type of argument does not give rise to a Doubt as to Liability Offer in Compromise with the IRS. An application submitted based on this type of constitutional argument will be rejected.

   B: Incorrect. When a court of competent jurisdiction has entered a judgment, that amount cannot be compromised based on Doubt as to Liability.

   C: Incorrect. The taxpayer must have a legitimate argument that he or she does not owe the full amount being sought by the IRS.

   D: Correct. This is a situation where there is a legitimate argument that the tax is not owed and, therefore, is the proper subject of a Doubt as to Liability Offer in Compromise.

   (See page 4-5 of the course material.)

2. A: Incorrect. A detailed financial analysis is required before the IRS will agree to accept an Offer in Compromise.

   B: Correct. The IRS calculates the Reasonable Collection Potential of each case, which is how much they can reasonably hope to collect from the delinquent taxpayer. If the offer is at least that amount, the IRS will accept it.

   C: Incorrect. The IRS always undertakes a specific financial analysis to determine the precise amount the taxpayer can afford to pay.

   D: Incorrect. There is no percentage formula. The IRS will not accept less than they can reasonably expect to collect, whether it is 40%, 20% or less.

   (See page 4-8 of the course material.)

3. A: Incorrect. Economic hardship to the taxpayer is one of the many circumstances the IRS will consider when evaluating an offer.

   B: Correct. Under these circumstances, the taxpayer should appropriately seek relief based on Doubt as to Liability.

   C: Incorrect. Collectability is not a controlling factor with this type of compromise.

   D: Incorrect. Unless the agreement would undermine the public confidence in the administration of the tax system, the IRS is willing to compromise tax obligations in certain circumstances.

   (See pages 4-11 to 4-12 of the course material.)

4. A: Incorrect. Health care expenses are included in determining the basic amount of living expenses needed by a taxpayer.

   B: Incorrect. If a piece of equipment is needed to generate income, it is considered by the IRS.

   C: Incorrect. Reasonable housing costs are included.

   D: Correct. Vacations are never considered, as they are not necessary.

   (See page 4-13 of the course material.)

Chapter 5: Applying for an Offer in Compromise

I. Overview

The previous chapter reviewed the different situations in which the IRS will generally accept an Offer in Compromise (OIC). Therefore, remember that submitting an offer application does not ensure that the IRS will accept the offer. Submission of the offer merely begins a process of evaluation and verification by the IRS, taking into consideration any special circumstances that might affect the taxpayer's ability to pay. Generally, the IRS will not accept an offer if they believe that the taxpayer can pay his or her tax debt in full via an installment agreement or a lump sum. This chapter will review the process of applying for an OIC, including the specific forms that must be filed. All of those forms are reproduced at the end of this course.

The key eligibility requirements that must be met prior to filing an offer include:

- The taxpayer must have filed all legally required tax returns;

- The taxpayer must have made all required estimated tax payments for the current year; and

- For a business with employees seeking a compromise, the taxpayer must have made all required federal tax deposits for the current quarter.

In addition, if an individual taxpayer or business is in an open bankruptcy proceeding, they are not eligible to submit an offer. Any resolution of outstanding tax debts under those circumstances must take place within the context of the bankruptcy proceeding.

Applicants must complete IRS Form 656. However, taxpayers who have a legitimate doubt that they owe all or a portion of the assessed tax will need to complete Form 656-L, Offer in Compromise (Doubt as to Liability). This form is also included at the end of the course.

CPAs considering advising their clients to apply for an Offer in Compromise should also be aware of the following facts:

- Penalties and interest will continue to accrue while the IRS is evaluating an OIC;

- The IRS may file a Notice of Federal Tax Lien while they are investigating an offer;

- Taxpayers may not submit an offer that is only for a tax year or tax period that has not been assessed;

- The law also requires the IRS to make certain information from accepted offers available for public inspection and review. These public inspection files are located in designated IRS Area Offices;

- If a business owes trust fund taxes[1] and responsible individuals may be held personally liable for the trust fund portion of the tax, the business is not eligible to submit an OIC unless the trust fund portion of the tax is paid or the Trust Fund Recovery Penalty determinations have been made on all potentially responsible individuals;

- The IRS will keep any refund, including interest, for tax periods extending through the calendar year during which the IRS accepts an OIC. For example, if a taxpayer's offer is accepted in 2012 and the taxpayer files his or her 2012 Form 1040 showing a refund, the IRS will apply the refund towards the tax debt; and

- The IRS may keep any proceeds from a levy served prior to the taxpayer submitting his or her offer. The IRS may levy the taxpayer's assets up to the time that the IRS official signs and accepts the offer as pending.

Finally, if a taxpayer currently has an approved installment agreement with the IRS and is making installment payments, then he or she may stop making those installment agreement payments when the taxpayer submits his or her OIC. If the OIC is returned for any reason, the taxpayer's installment agreement with the IRS will be reinstated with no additional fee.

II. Application Process

The application process generally involves sending the IRS the following:

- Form 656 (or Form 656-L, Offer in Compromise, Doubt as to Liability);

- Completed Form 433-A (OIC), Collection Information Statement for Wage Earners and Self-Employed Individuals, if applicable;

- Completed Form 433-B (OIC), Collection Information Statement for Businesses, if applicable;

- A $150 application fee, unless the taxpayer meets low income certification; and

- An initial offer payment, unless the taxpayer meets low income certification.

A. NOTE ABOUT SPOUSES

If a taxpayer and his spouse have both joint tax debts and individual tax debt, the taxpayer will send the IRS two forms. He will send a single Form 656 with all of the individual tax debt(s) and the taxpayer and his spouse will send a second Form 656 with his joint tax debts.

In the case where a married couple has joint tax debt and each spouse also has separate tax debt, each spouse will have to send in a separate Form 656. Each spouse will complete one form setting out his or her individual debt and also the joint debt.

[1] Trust fund taxes are the money withheld from an employee's wages, such as income tax, Social Security, and Medicare taxes.

If a taxpayer and his or her spouse/ex-spouse have a joint tax debt and his spouse/ex-spouse does not want to submit a Form 656, the taxpayer may submit a Form 656 on his own to compromise his responsibility for the joint debt.

Each Form 656 will require the $150 application fee and initial down payment unless the taxpayer's household meets the Low Income Certification guidelines set forth on Form 656 (found in the Appendix of this course).

B. INITIAL STEPS FOR COMPLETING THE OIC

Before completing Form 656 containing his or her offer, the taxpayer must gather information about his or her financial situation, including cash, investments, available credit, assets, income and debt. The taxpayer will also need to gather information about his or her average gross monthly household income and expenses. The entire household includes spouse, significant other, children, and others that reside in the taxpayer's household. This is necessary for the IRS to accurately evaluate the offer. In general, the IRS will not accept expenses for tuition for private schools, college expenses, charitable contributions, and other unsecured debt payments as part of the expenses calculation.

Table 5.1. Steps for Completing the Application Package.

Step 1: Fill out the Form 433-A (OIC), Collection Information Statement for Wage Earners and Self-Employed Individuals	Fill out the Form 433-A (OIC) if the taxpayer is an individual wage earner and/or a self-employed individual. This will be used to calculate an appropriate offer amount based on the taxpayer's assets, income, expenses, and future earning potential. The taxpayer will have the opportunity to provide a written explanation of any special circumstances that affect his or her financial situation.
Step 2 – Fill out Form 433-B (OIC), Collection Information Statement for Businesses	Fill out the Form 433-B (OIC) if the taxpayer's business is a Corporation, Partnership, Limited Liability Company (LLC) classified as a corporation, single member LLC, or other multi-owner/multi-member LLC. This will be used to calculate an appropriate offer amount based on the business's assets, income, expenses, and future earning potential. If the taxpayer has assets that are used to produce income (for example, a tow truck used in a business for towing vehicles), the taxpayer may be allowed to exclude equity in these assets.

Step 3 – Attach required documentation[2]	The taxpayer will need to attach supporting documentation with Form(s) 433-A (OIC) and 433-B (OIC). A list of the documents required is included at the end of each form.
Step 4 – Fill out Form 656, Offer in Compromise	Fill out Form 656. The Form 656 identifies the tax years and type of tax the taxpayer would like to compromise. It also identifies the taxpayer's offer amount and the payment terms. The Low Income Certification guidelines are included on Form 656. If the taxpayer is an individual and meets the guidelines, the Low Income Certification box in Section 4, on Form 656 should be checked.
Step 5 – Include initial payment and $150 application fee	In most cases, a taxpayer must include a check, cashier's check, or money order for his or her initial payment based on the payment option he or she selected (20% of offer amount or first month's installment). A separate check or money order must be included for the $150 application fee. If the taxpayer meets the Low Income Certification guidelines, the initial payment and application fee are not required.

The final step is for the taxpayer to mail all of the above information to the IRS.

After submitting the OIC, the taxpayer must file all required federal returns, make all required federal estimated payments and tax deposits due for current taxes, and make all required periodic offer payments. In addition, the IRS will often request additional information while evaluating an OIC. Failure to reply to such request in a timely manner could result in the offer being rejected.

C. REQUIRED INFORMATION

A taxpayer must complete all parts of the Form 656 (i.e., name, address, social security number, etc.), including the basis upon which he or she proposes to compromise. Remember we saw in the previous chapter that there are three bases upon which the IRS will enter into an OIC. The total amount of money offered must be indicated and must be more than zero. The amount offered may not include money already paid, expected future refunds, funds attached by levy, or anticipated benefits from capital/net operating losses.

[2] A completed Form 433-A (OIC) and/or Form 433-B (OIC) must be included with the Form 656 application.

D. PAYING FOR THE OFFER

Generally, taxpayers are expected to pay the entire amount offered in as short of time as reasonably possible. Acceptable offer terms should be determined by the IRS staff evaluating the offer and should not be limited to the proposal of the taxpayer. The amounts and due dates of payments must be specified. There are three types of payment terms that the IRS and the taxpayer may agree to, each of which is specified below in detail.

E. STANDARD CONDITIONS

Taxpayers must agree to all the standard conditions of the agreement as they are printed on the Form 656.

F. TOTAL LIABILITY

Each separate tax period and type of tax must be indicated on the Form 656. If a taxpayer submits an offer that does not include all outstanding liabilities, the IRS will require the taxpayer to amend the offer to include all outstanding tax liabilities prior to considering acceptance. An offer submitted on Form 656-L, under DATL criteria, will be accepted for only the tax periods that are in question.

G. EXPLANATION OF CIRCUMSTANCES

Taxpayers may use the designated space on the Form 656, Offer in Compromise, or attach a separate statement to explain why they are submitting the offer. If a special circumstance exists, the taxpayer should explain the situation and include all supporting documents to assist in verification of the special circumstance that is being claimed.

H. SIGNATURE REQUIREMENTS

Each taxpayer that is party to an OIC should personally sign the Form 656. When unusual circumstances prevent this (e.g., the taxpayer is incapacitated), an authorized representative may sign for the taxpayer. Remember that the Form 656 is considered a legal, binding contract and therefore must have an original signature. All parties, or their designated representative (CPA, attorney), must sign the Form 656 to ensure the provisions of the agreement bind all parties.

1. <u>Offer on Behalf of Corporation</u>

Offers submitted for corporations should reflect the corporate name on the first signature line. The signature name and title of the authorized officer should be reflected on the second line.

2. <u>Offer on Behalf of Estate</u>

An offer submitted by the fiduciary of an estate of a deceased taxpayer will be binding on the taxpayer's estate to the extent that it would be binding on a taxpayer who submits an offer on his or her own behalf. A copy of the fiduciary's appointment document must be included with the application. If an offer is submitted on behalf of a deceased taxpayer, when there is no estate, the individual who signs the offer must have authority. This authority can be designated by a will appointing that individual as the executor or by written authorization from the probate court.

I. EXPEDITED HANDLING

There may be occasions where a taxpayer or representative may request expedited processing of his or her OIC due to an emergency or perceived emergency situation. Situations that may warrant expedited case processing include:

- A contract or business agreement requiring the taxpayer, as a condition of the contract or agreement, to resolve the tax liability by a specific date;

- Availability of the money to fund the offer is limited to a certain time; or

- A terminal illness may affect the ability to complete the payment terms.

The IRS will consider all requests for an expedited handling of the application. In such cases, the IRS will attempt to make a decision within 90 days of submittal of the OIC.

III. <u>Paying for the Offer in Compromise</u>

A. APPLICATION FEE

Submittal of a Form 656 requires a one-time application fee of $150. However, taxpayers who meet the Low Income Certification guidelines set forth on Form 656 (included in the Appendix) are not required to pay the application fee.

B. PAYMENT TERMS

Payment terms in an Offer in Compromise are negotiable, but the IRS will always look to ensure that the payment of the offered amount is in the least time possible. For example, if a 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. Likewise, if the taxpayer is planning to borrow a portion of the money, the IRS will determine when the loan will be received and the payment terms of the offer should provide for payment of the borrowed portion at the time the funds are received.

Offers in Compromise must be accompanied by partial payment of the proposed offer amount. These payments are applied to the tax liabilities included on the offer and are in addition to any application fee imposed. The form of these partial payments depends on the taxpayer's proposed offer and its terms. There are generally two types of payment options associated with an OIC:

- **Lump Sum Cash**: The taxpayer must submit an initial payment of 20 percent of the total offer amount with the application. The remaining balance must be paid in five or fewer payments; or

- **Periodic Payment**: The initial payment must be submitted with the application and the taxpayer must continue to make the periodic payments while the IRS is evaluating the offer.

A periodic payment (defined as payable in six or more installments or through the statutory period) must be accompanied by payment of the first proposed installment, and additional payments must be paid in accordance with the taxpayer's proposed offer terms while the IRS evaluates the offer. If the taxpayer qualifies for the Form 656-A waiver, the taxpayer is not required to pay the application fee, or installment payment(s), including any future payments, until accepted.

If a short-term offer is accepted, the 24-month timeframe for paying the accepted offer amount will start on the date of written notice of acceptance. At that time, the taxpayer will begin making the payments in accordance to the terms of the accepted offer. While a periodic payment offer is being evaluated by the IRS, the taxpayer must make subsequent proposed payments as they become due. There is no requirement that the payments be made monthly or in equal amounts. The IRS is not bound by either the offer amount or the terms. The IRS offer may determine that the proposed offer amount is too low or the payment terms too protracted to recommend acceptance. In this situation, the IRS may advise the taxpayer that a larger amount or different terms would likely be recommended for acceptance.

Taxpayers may designate how the required payments are to be applied to their liabilities. The request for designation must be made in writing when the offer is submitted (in the case of the initial partial payments) or when the payment is made (in the case of subsequent installment payments made for a periodic payment offer). Once a designation of payment is made, it cannot be changed at a later time. The written payment designation must clearly explain how these payments are to be applied to specific tax periods or liabilities (e.g., income taxes, employment taxes, trust fund portions of employment or excise taxes, etc.). This written payment designation must become part of, and remain with, the offer case file. In the absence of any written payment designation by the taxpayer when the offer was submitted or when the payment is made, the IRS will apply the payments in the best interest of the government.

Generally, the IRS will approve offers based on the payment terms set forth in the table below.

Table 5.2. Payment Terms Required by IRS.

Payment Type	Payment Terms	Number of Months Future Income Required
Lump Sum Cash	5 or fewer installments within 5 months	48 months or the remaining statutory period, whichever is less
Lump Sum Cash	5 or fewer installments paid in more than 5 months and less than 24 months	60 months or the remaining statutory period, whichever is less
Lump Sum Cash	5 or fewer installments paid in more than 24 months	Number of months remaining on the statute
Short Term Periodic Payment	Within 6 to 24 months	60 months or the remaining statutory period, whichever is less
Deferred Periodic Payment	Within time remaining on the statute	Number of months remaining on the statute

C. MISSED PAYMENT(S)

If the taxpayer fails to make a proposed installment for a periodic payment offer, the IRS will allow one opportunity to pay the missing amount(s). If the taxpayer submits the payment(s) within 30 calendar days from the date of the letter sent by the IRS requesting payment (allowing 15 calendar days for mail), the IRS will continue processing the application. If the taxpayer fails to submit the payment or request an extension of time within 30 calendar days from the date of the letter, the IRS will generally consider the taxpayer to have withdrawn his or her offer unless special circumstances exist.

Taxpayers will be afforded one opportunity to make up the missed payment(s) for a periodic payment offer, including any amended offers, unless special circumstances exist. The proposed offer amounts and terms submitted by a taxpayer dictate the required partial offer payments. The IRS is not bound by those same terms in determining an acceptable offer.

D. REQUEST FOR LARGER PAYMENT(S): REVISIONS OF OIC

While the IRS is considering a periodic payment offer in compromise, the taxpayer must make subsequent proposed installment payments as they become due. There is no requirement that the payments be made monthly or in equal amounts. However, the IRS is not bound by either the offer amount or the terms. The IRS may determine that the proposed offer amount is too low or the payment terms too protracted to recommend acceptance. In this situation, the IRS will generally advise the taxpayer of a larger amount or different terms that would likely be considered for acceptance.

Example.

Acceptable Payment Terms for a Short Term Periodic Payment Offer – A taxpayer submits an offer for $10,000. The IRS received date is January 1, 2007. The taxpayer's offer of $10,000 was accepted in November 2007, and the taxpayer remained current on all required payments during the investigation. During the investigation, the taxpayer paid $500. The taxpayer has 24 months from the date of acceptance to complete the terms of the offer. The terms of the offer were $100 every other month for a total of 23 months and the balance would be due on the 24th month. On the 24th month, January 2009, the taxpayer would then be required to pay the balance of $8,300 ($10,000 less $1,700 [$1,200 in installments plus $500 in installments paid during the investigation]). No adjustments to the terms would be required.

Example.

Unacceptable Payment Terms for a Short Term Periodic Payment Offer – A taxpayer submits an offer for $1,000. The IRS received date is January 5, 2010. The taxpayer has 24 months to complete the offer. The taxpayer pays $100 with the offer as the first payment. The taxpayer structures the remaining payments as follows: $100 within 90 days from written notice of acceptance; $100 by the 4th month following the date of the written notice of acceptance of the offer; $100 per month for the next 7 months thereafter for a total of $1,000 ($100 times 10 payments).

Remember that although the taxpayer may technically structure payments in the manner described above, the IRS is not bound by either the offer amount or the terms proposed by the taxpayer, and the IRS may negotiate a different offer amount or terms when appropriate. In the above example, the taxpayer has proposed payment terms that may not meet the requirements of a short term payment offer, and the taxpayer will be contacted to re-negotiate the offer terms.

The types of actions required when the IRS requires an increased payment are set forth in Table 5.3, below:

Table 5.3. IRS Requests for Revised OIC.

If...	And...	Then...
Original offer was a lump sum cash offer	Revised offer is a lump sum with a greater proposed offer amount	Taxpayer must pay 20% of the revised amount, less the partial payment made with the original offer, with the revised OIC.
Original offer was a periodic payment	Revised offer is a lump sum	Taxpayer must pay 20% of revised offer amount, less any installment payments already paid toward the original offer, with the revised OIC.
Original offer was periodic payment	Revised offer is periodic payment with greater proposed offer amount and/or different proposed installment amounts or schedule	Taxpayer must make the initial proposed installment in accordance with the terms of the revised offer, and continue to make the proposed installments during evaluation of the OIC.
Original offer was lump sum cash offer	Revised offer is periodic payment with greater proposed offer amount	Taxpayer must make the initial proposed installment in accordance with the terms of the revised offer, and continue to make the proposed installments during evaluation of the revised OIC.

IV. Returned and Withdrawn Offers

A. RETURN FOR FAILURE TO PROVIDE INFORMATION

An offer may be returned at any time during processing if the taxpayer fails to provide information necessary for the IRS to determine whether it should be accepted or rejected. The IRS will make every reasonable effort to secure sufficient information needed so a recommendation can be made. If the taxpayer has substantively complied or if only limited information is missing, the IRS will attempt to contact the taxpayer by telephone to secure the missing information prior to returning the offer. In those cases where the taxpayer or his or her representative has attempted to cooperate with any requests, the IRS will attempt a second telephone call to the taxpayer or his or her representative to request the additional information prior to returning the offer.

B. WITHDRAWAL OF AN OFFER IN COMPROMISE

There are two kinds of withdrawn offers; they are (1) voluntary and (2) mandatory. A taxpayer may voluntarily withdraw an offer at any time during the offer investigation. A mandatory withdrawal of an offer is an action that may be taken by the IRS during the offer investigation.

1. Voluntary Withdrawal

Taxpayers may voluntarily withdraw their OIC at any time after the offer has been submitted. When an OIC cannot be recommended for acceptance, the IRS will normally give the taxpayer an opportunity to voluntarily withdraw the offer and at the same time inform the taxpayer that withdrawing the offer forfeits his or her appeal rights. For example, if the IRS determines that a taxpayer can fully pay his or her tax debt through an Installment Agreement, they will inform the taxpayer of that determination so the taxpayer can withdraw his or her offer and enter into an installment agreement.

A voluntary withdrawal request may be made orally, by fax, or in writing. The IRS is required to encourage taxpayers to provide the withdrawal in writing, but if a taxpayer or authorized representative provides a clear statement, either in writing or orally, indicating a wish to withdraw the offer, the offer may be closed as a withdrawal.

If a request for a voluntary withdrawal is made and a deposit has been received, the taxpayer will be asked to:

- Provide a request in writing clearly indicating a desire to withdraw the offer;
- Include a statement indicating that it is understood that rights to appeal are forfeited by a withdrawal;
- Include a statement indicating how any deposit made (if any) should be disposed (i.e., should it be refunded or applied to the tax debt); and
- Sign and date the request.

2. Mandatory Withdrawal

Taxpayers are required to submit an initial payment with the offers. If the taxpayer sends a portion of the required payment, the IRS is required to attempt to contact the taxpayer before closing the offer. If the taxpayer fails to pay the remainder of the initial payment within the deadline given, the offer will be considered a mandatory withdrawal.

If during the investigation the taxpayer fails to make the required subsequent periodic payments as required by the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA), the offer also may be considered withdrawn.

The IRS is required to make one request for the missed payment(s) by telephone. If the taxpayer or his or her representative cannot be contacted by telephone, a letter is issued requesting the missed payment(s). If the contact is by telephone, the taxpayer is allowed 15 calendar days to submit the payment(s) before taking the next action. If the contact is written, the taxpayer is allowed 15 calendar days from the date of the letter to submit the payment(s) (plus 15 calendar days for mailing for a total of 30 calendar days), before taking the next action. The IRS should document the case history.

If the taxpayer provides a reasonable explanation for missing the payment(s) (i.e., special circumstances exist), the investigation of the offer by the IRS will continue.

C. CIVIL PENALTIES FOR FRIVOLOUS OFFERS

If a taxpayer files an offer in compromise (OIC) that states the OIC should be accepted based on a frivolous position or reflects a desire to delay or impede the administration of federal tax laws, the IRS may determine that the taxpayer should be subject to a civil penalty under Internal Revenue Code section 6702(b)[3]. In such cases, the taxpayer will

---

[3] **26 USC § 6702 - Frivolous tax submissions**
(a) Civil penalty for frivolous tax returns
A person shall pay a penalty of $5,000 if—
(1) such person files what purports to be a return of a tax imposed by this title but which—
(A) does not contain information on which the substantial correctness of the self-assessment may be judged, or
(B) contains information that on its face indicates that the self-assessment is substantially incorrect, and
(2) the conduct referred to in paragraph (1)—
(A) is based on a position which the Secretary has identified as frivolous under subsection (c), or
(B) reflects a desire to delay or impede the administration of Federal tax laws.
(b) Civil penalty for specified frivolous submissions
(1) Imposition of penalty
Except as provided in paragraph (3), any person who submits a specified frivolous submission shall pay a penalty of $5,000.
(2) Specified frivolous submission
For purposes of this section—
(A) Specified frivolous submission
The term “specified frivolous submission” means a specified submission if any portion of such submission—
(i) is based on a position which the Secretary has identified as frivolous under subsection (c), or
(ii) reflects a desire to delay or impede the administration of Federal tax laws.
(B) Specified submission
The term “specified submission” means—
(i) a request for a hearing under—
(I) section 6320 (relating to notice and opportunity for hearing upon filing of notice of lien), or
(II) section 6330 (relating to notice and opportunity for hearing before levy), and
(ii) an application under—
(I) section 6159 (relating to agreements for payment of tax liability in installments),
(II) section 7122 (relating to compromises), or
(III) section 7811 (relating to taxpayer assistance orders).
(3) Opportunity to withdraw submission
If the Secretary provides a person with notice that a submission is a specified frivolous submission and such person withdraws such submission within 30 days after such notice, the penalty imposed under paragraph (1) shall not apply with respect to such submission.
(c) Listing of frivolous positions
The Secretary shall prescribe (and periodically revise) a list of positions which the Secretary has identified as being frivolous for purposes of this subsection. The Secretary shall not include in such list any position that the Secretary determines meets the requirement of section 6662 (d)(2)(B)(ii)(II).
(d) Reduction of penalty
The Secretary may reduce the amount of any penalty imposed under this section if the Secretary determines that such reduction would promote compliance with and administration of the Federal tax laws.
(e) Penalties in addition to other penalties
The penalties imposed by this section shall be in addition to any other penalty provided by law.

be given 30 days to withdraw or amend his or her offer in order to avoid the IRS's attempt to collect the penalty.

The IRS must make the opportunity to withdraw or amend the offer in writing and included in correspondence that advises the taxpayer that actions to avoid the $5,000 IRC 6702(b) penalty are either to withdraw the offer or amend the offer so it only includes a valid reason for acceptance based on existing law.

V. <u>Mandatory Acceptance</u>

Under Internal Revenue Code Section 7122(f), an Offer in Compromise (OIC) will be deemed accepted if the IRS does not make a determination regarding whether to accept the offer and notify the taxpayer of its determination within two years of the date the IRS receives the offer. Any period during which any tax liability that is the subject of such [OIC] is in dispute in any judicial proceeding shall not be taken into account in determining the expiration of the 24-month period.

An OIC will not be deemed to be accepted pursuant to section § 7122(f), if within the 24-month period, the OIC is:

- Rejected by the IRS;
- Returned by the IRS to the taxpayer;
- Withdrawn by the taxpayer; or
- Treated as withdrawn under section § 7122(c)(1)(B)(ii) because the taxpayer failed to make the second or later installment due on a periodic payment OIC.

VI. <u>Forms 433-A and 433-B</u>

Part of the application process for requesting an Offer in Compromise from the IRS is completion of Form 433-A or Form 433-B. These forms (A for individuals and B for businesses) gives the IRS detailed financial information about the taxpayer requesting an offer. This information allows the IRS to calculate its Reasonable Collection Potential – how much money it can realistically expect to collect – and therefore decide whether or not to accept the OIC. Taxpayers seeking to compromise relatively small amounts are exempt from these additional filing requirements. The calculation of Reasonable Collection Potential (RCP) is discussed in greater detail in Chapter 7.

A. INSTRUCTIONS FOR FORM 433-A

- **Section A: Accounts / Lines Of Credit**

  List all accounts, even if they currently have no balance. However, do not enter bank loans in this section.

- **Section B: Real Estate**

  List all real estate taxpayer owns or is purchasing including his or her home. Include insurance and taxes in the monthly payment. The county and description is needed if different than the address and county taxpayer listed above. To determine equity, subtract the amount owed for each piece of real estate from its current market value.

- **Section C: Other Assets**

  List all cars, boats, and recreational vehicles with their make, model, and year. If a vehicle is leased, write “lease” in the “year purchased” column. List whole life insurance policies with the name of the insurance company. List other assets with a description such as “paintings”, “coin collection”, or “antiques”. To determine equity, subtract the amount owed from its current market value.

- **Section D: Credit Cards**

  List all credit cards and lines of credit, even if there is no balance owed.

- **Section E: Wage Information**

  Provide the name and address of employers for taxpayer and taxpayer’s spouse. Include both spouses’ income, even if the tax liability is not the result of a jointly filed return. Check the appropriate box indicating how taxpayer is paid. List employment information for a second or part time job on a separate sheet of paper.

- **Section F: Non-Wage Household Income**

  Enter monthly amounts for all sources of household income. For any income not received monthly, calculate the monthly amount as follows:

  - If received quarterly - divide by three.
  - If received weekly - multiply by 4.3.
  - If received biweekly - multiply by 2.17.

  Net Self-Employment Income is the amount taxpayer earns after he or she pays ordinary and necessary monthly business expenses. This figure should relate to the yearly net profit from Schedule C on taxpayer’s Form 1040 or the current year profit and loss statement. Please attach a copy of taxpayer’s current year profit and loss statement. If net income is a loss, enter “0”.

  Net Rental Income is the amount taxpayer earns after he or she pays ordinary and necessary monthly rental expenses. This figure should relate to the amount reported on Schedule E of your Form 1040 (do not include depreciation expenses). If net rental income is loss, enter “0”.

  Other Income may include distributions from an IRA or reported on a K-1, agricultural subsidies, oil credits, gambling income, etc.

- **Section G: Monthly Necessary Living Expenses**

  Enter monthly amounts for expenses. For any expenses not paid monthly, calculate the monthly amount as follows:

  - o If paid quarterly - divide by three.
  - o If paid weekly - multiply by 4.3.
  - o If paid biweekly - multiply by 2.17.

  For expenses claimed in boxes 1 and 4, taxpayer may provide actual expenses or the IRS allowable standards. IRS allowable standards can be found by accessing http://www.irs.gov and entering “Collection Financial Standards” in the search field. Substantiation may be required for any expenses over the standard once the financial analysis is completed. The amount claimed for Miscellaneous cannot exceed the standard amount for the number of people in taxpayer’s family. The miscellaneous allowance is for expenses incurred that are not included in any other allowable living expense items. Examples are credit card payments, bank fees and charges, reading material and school supplies. If taxpayer does not have access to the IRS web site, itemize his or her actual expenses and the IRS will ask for additional proof, if required. Documentation may include pay statements, bank and investment statements, loan statements and bills for recurring expenses, etc.

  Rent - Do not enter mortgage payment here. Mortgage payment is listed in Section B.

  Medical - Enter only ongoing medical expenses. Out-of-pocket health care expenses include:

  - o Medical services
  - o Prescription drugs
  - o Medical supplies, including eyeglasses and contact lenses.

  Child/Dependent Care - Enter the monthly amount taxpayer pays for the care of dependents that can be claimed on Form 1040.

  Estimated Tax Payments - Calculate the monthly amount taxpayer pays for estimated taxes by dividing the quarterly amount due on Form 1040ES by 3.

  Life Insurance - Enter the amount taxpayer pays for term life insurance only. Whole life insurance has cash value and should be listed in Section C.

  Delinquent State & Local Taxes - Enter the minimum amount taxpayer is required to pay monthly. Be prepared to provide a copy of the statement showing the amount taxpayer owes and if applicable, any agreement taxpayer has for monthly payments.

  Student Loans - Minimum payments on student loans for the taxpayer’s post-secondary education may be allowed if they are guaranteed by the federal government. Be prepared to provide proof of loan balance and payments.

Court Ordered Payments - For any court ordered payments, be prepared to submit a copy of the court order portion showing the amount taxpayer is ordered to pay, the signatures, and proof of taxpayer making the payments. Acceptable forms of proof are copies of cancelled checks or copies of bank or pay statements.

B. INSTRUCTIONS FOR FORM 433-B

This form is used to collect information from businesses seeking to compromise tax liability with the IRS.

- **Section 1: Business Information**

  Include the name, address and type of entity, i.e., partnership, corporation, etc. The form also seeks information about the number of employees the taxpayer has and the regular payroll costs.

- **Section 2: Business Personnel**

  This section requires the taxpayer to specify all partners, officers, LLC members and major shareholders. The IRS also wants to know which people are responsible for depositing payroll taxes since those persons can be individually liable for certain delinquent payments.

- **Section 3: Other Financial Information**

  This section seeks information about the business's payroll service, if any, and pending lawsuits, whether the business has ever filed for bankruptcy protection, whether any related parties owe the business money, whether any assets have been transferred from the business for less than full value, whether the business has any other business affiliates and whether the business anticipates a near-term increase in revenue.

- **Section 4: Business Asset and Liability Information**

  In this section, the IRS asks the business to provide information about the amount of cash it has on hand and specific bank account information. It also seeks information about outstanding accounts receivable, investments and outstanding credit, including credit lines and credit cards. If applicable, this section requires a listing of all real property owned by the business, vehicles both purchased and leased to the business, business equipment, and intangible assets, as well as business liabilities.

- **Section 5: Monthly Income and Expenses**

  This final section seeks to help the IRS understand the monthly cash flow of the business by seeing the monthly income and expenses. Income includes gross receipts from sales or services, gross rental income, interest income, dividends and cash receipts. Expenses requested include rents, materials or inventory purchased, supplies, utilities, wages, insurance and taxes.

Chapter 5 – Review Questions

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. A taxpayer who wishes to enter into an Offer in Compromise with the IRS must:

   a) have filed his or her federal return for the year in which he or she is filing the Offer in Compromise
   b) never have filed for bankruptcy
   c) complete Form 656
   d) not owe more than $50,000

2. Does a taxpayer seeking an Offer in Compromise need to send the IRS money along with his or her application:

   a) the taxpayer must generally send both an application fee, and an initial payment
   b) the taxpayer must submit an application fee, but is not required to make a payment unless and until the offer is accepted
   c) there is no application fee associated with a submitted an Offer in Compromise
   d) the taxpayer must always submit an initial payment of 10% of his or her outstanding tax liability

3. Under which of the following situations might the IRS return an Offer in Compromise to the taxpayer:

   a) if the taxpayer fails to provide the IRS with requested information
   b) if the taxpayer fails to include a required initial payment with his or her application
   c) if the taxpayer fails to complete the entire application
   d) all of the above

Chapter 5 – Solutions and Suggested Responses

1. A: Incorrect. A taxpayer must have filed all legally required tax returns to be eligible for an Offer in Compromise, not simply in the year in which he or she is seeking the compromise.

   B: Incorrect. Taxpayers currently in bankruptcy are not eligible, but a former bankruptcy does not render the taxpayer ineligible.

   C: Correct. The form must be completed by the taxpayer.

   D: Incorrect. There is no maximum tax debt for Offers in Compromise.

   (See pages 5-1 to 5-2 of the course material.)

2. **A: Correct**. There is a one-time $150 application fee. The taxpayer must also submit an initial payment, the amount of which depends on the type of offer being sought.

   B: Incorrect. An initial payment is required.

   C: Incorrect. There is an application fee of $150 that is only waived in the event the taxpayer meets a low-income threshold.

   D: Incorrect. The amount depends on the type of offer being submitted.

   (See page 5-6 of the course material.)

3. A: Incorrect. The IRS will make reasonable attempts to contact the taxpayer for additional information required to process the application. If the taxpayer is not responsive, the application may be returned. However, this is not the best answer.

   B: Incorrect. An initial payment is required when the application is submitted. If the payment – or only a portion thereof – is included, the IRS will contact the taxpayer to secure the remainder. Failure to comply will result in a return of the offer. However, this is not the best answer.

   C: Incorrect. All portions of the application must be completed. However, this is not the best answer.

   D: Correct. All of the above are grounds for the IRS to return an Offer in Compromise.

   (See pages 5-9 to 5-10 of the course material.)

Chapter 6: Rejecting Offers in Compromise

When the facts of the case do not support acceptance of the taxpayer's Offer in Compromise – and the taxpayer is unwilling to amend his or her offer – the IRS will inform the taxpayer that his or her offer is being rejected. When the offer is rejected, the taxpayer will be notified in writing and the letter will explain how the taxpayer may exercise his or her appeal rights. Generally, rejections on offers based on Doubt as to Liability are because the tax is believed to be correct as assessed.

The most common reason for rejecting an offer based on Doubt as to Collectability is because it has been determined that more can be collected than was offered. The IRS generally notifies taxpayers by telephone prior to the issuance of the rejection letter that an acceptance cannot be recommended. At this time, the taxpayer is given a final opportunity to submit any additional financial information (except for those cases rejected under "public policy" or as not in the "best interest of the government"). When an offer is rejected, there is no obligation on the part of the taxpayer to continue to make periodic payments pursuant to the offer schedule, even if the taxpayer has appealed the rejection.

I. Offers Submitted Solely to Delay Collection

When the IRS determines that an OIC has been submitted solely to delay collection, the offer will be returned to the taxpayer without further consideration. The term "solely to delay collection" means an offer was submitted for the sole purpose of avoiding or delaying collection activity. A determination that an offer is submitted solely for the purpose of delaying collection should be apparent to an impartial observer.

A. REJECTION OF PRIOR OFFER NOT DETERMINATIVE

The fact that a prior offer was submitted and rejected does not necessarily mean that the second offer is intended solely to delay collection. However, when a taxpayer submits an offer that is not materially different from a previous offer that was considered and rejected with appeal rights, the offer may be returned as solely to delay collection.

The offer may be considered as materially different when the amount reflected on the re-submission is substantially similar to, less than, or the same as the prior offer and the following exists:

- The taxpayer's financial situation has changed. A change in the taxpayer's financial situation may include: (1) a change in employment and/or income, (2) a change in marital status affecting future ability to pay, (3) a change in ownership of assets or significant decline in the value of any assets, (4) the loss of an asset that was included in the original offer investigation, or (5) a change in circumstances that would affect allowable expenses and future ability to pay; or

- The taxpayer has raised special circumstances that were not considered during the prior investigation.

B. SOLELY TO DELAY EXAMPLES AND DISCUSSION

The following are examples of offers considered submitted solely to delay collection based on re-submission after a prior rejection or return:

Example.

During initial analysis by the IRS, it is discovered that the taxpayer had a previous offer returned six months ago in which the taxpayer failed to respond to requests for additional information from the IRS. The taxpayer did not provide any bank statements with the first offer and did not respond to a letter requesting the necessary documentation to determine an accurate RCP. The initial analysis indicated bank statements are required to determine an accurate Reasonable Collection Potential; however, none was provided with the new offer and there was no indication from the taxpayer the accounts were closed. No special circumstances were indicated. This offer will be rejected.

Example.

The taxpayer submitted an offer for $10,000. The IRS computed the Reasonable Collection Potential to be $20,000. The taxpayer refused to increase the offer to the computed Reasonable Collection Potential. A rejection letter was issued, and the taxpayer did not appeal. One month later, the taxpayer resubmitted an offer for $10,100. A thorough analysis indicated there is no change in the taxpayer's financial condition and no special circumstances were indicated. This offer will be rejected.

Example.

A taxpayer submits an offer for $3,000 to be paid within 90 days of acceptance. A prior offer was submitted for $10,000 to be paid within 90 days. The investigation of the initial offer submission resulted in the offer being rejected with appeal rights. During that offer investigation it was determined that a piece of property was transferred to a non-liable spouse for no consideration and that a clear transferee issue exists. The value placed on the transferred property was $30,000, and was included in the Reasonable Collection Potential. The taxpayer failed to request a timely appeal on the rejected offer. There were no special circumstances indicated. This offer will be rejected.

Example.

During initial processing of an OIC, the IRS learns that there have been three offers submitted by the taxpayer over the past 18 months. All three were returned for failure to provide requested financial information. The closed return file indicates the taxpayer was asked to provide a financial statement for a closely held corporation, which the taxpayer holds 75% interest in and is the corporate president. A Form 433-B for this corporation was requested during the offer investigation. The offer specialist clearly documented in the file the taxpayer's interest and position in this corporation. The request was clear and specific and the taxpayer refused to provide this information, claiming the IRS has no right to place a value on the corporation when determining his ability to pay on *personal tax liabilities. The newly submitted offer package does not include a Form 433-B for the corporation and the Form 433-A indicates the same corporation is the taxpayer’s current employer. The offer will be rejected.*

Example.

An offer is submitted for $30,000 payable within 90 days of acceptance. Research on AOIC indicates the second offer submitted by the taxpayer. A prior offer was submitted for $20,000 payable within 90 days of acceptance. The original offer was rejected with appeal rights, the taxpayer filed a timely appeal, and Appeals sustained the rejection. A review of the prior offer file indicates the taxpayer has the ability to full pay the outstanding liability through an installment agreement. The total liability is for $40,000. A review of the financial information indicates the taxpayer still has the ability to full pay the liability. The original offer was received 18 months ago and no payments have been made during this period. There is no change indicated on the financial statement, except the taxpayer has a new employer. The taxpayer's income remained the same. There are no special circumstances indicated. The offer will be rejected.

In some situations, it may be determined that an offer is submitted as solely to delay collection when no prior offer has been submitted. When a collection employee has contacted the taxpayer and determined that the next action necessary is to enforce collection through levy or seizure, but the taxpayer files an offer to delay this enforcement action, the offer may be returned as solely to delay collection, unless there is a change of circumstances not considered by the collection employee.

II. <u>Frivolous Offers</u>

A taxpayer may submit an OIC which provides a frivolous or groundless position as the reason the OIC should be accepted. In these instances, the IRS will return the offer. In certain cases, the IRS will treat the offer as if it was never made. The collection statute expiration date will not be suspended and any application fee and offer payment will be required to be returned if the offer is treated as though it was never submitted.

The taxpayer's basis for submitting the offer is deemed frivolous if it includes a tax argument discussed in Internal Revenue Service Notice 2010-33 including, but not limited to, federal income taxes are unconstitutional, enforcement of the tax laws invades a taxpayer's privacy under the Fourth Amendment, or the Fifth Amendment privilege against self-incrimination grants taxpayers the right not to file returns or the right to withhold all financial information from the IRS.

If the taxpayer includes any of the positions listed in Notice 2010-33 as the reason an offer in compromise should be accepted, then the assertion of a penalty for a frivolous submission under IRC 6702(b) may be appropriate. IRC 6702(b) provides for a penalty in situations when there is a frivolous offer submission or an offer submission in which the taxpayer has demonstrated a desire to delay or impede the administration of federal tax laws.

III. Not in the Best Interest of the Government

An offer rejection may also be based on a determination that acceptance of the specific offer at hand is not in the best interest of the government. The IRS requires that rejections under this provision must be fully supported by the facts outlined in the record. Offers rejected under this section require the review of an IRS manager. Below is an example of a situation that may warrant rejection as not being in the best interest of the government.

Example.

An offer in compromise in the amount of $100 is submitted by a taxpayer who has a history of filing frivolous returns. The OIC includes tax assessments which were completed by the IRS under substitute for return procedures. The financial statements submitted with the offer include very little income on which minimal estimate tax payments have been made. Information from internal sources reveals the taxpayer has additional income not being reported on the financial statement. It is not in the government's interest to investigate an OIC until the taxpayer demonstrates compliance with filing and payment of the appropriate tax.

Other bases for rejecting an offer as not in the best interests of the government include the following situations:

- An in-business taxpayer compromising employment taxes, where financial analysis indicates the business does not have the ability to fund the offer, remain current with future tax obligations, and meet the business's normal operating expenses;
- Any offer involving deferred payment where financial analysis indicates the taxpayer cannot fund the offer and an acceptable explanation as to where the additional funds may be secured is not provided;
- The taxpayer is the primary responsible party for a related entity, i.e., corporation, partnership, etc., that is not in compliance with its filing and paying requirements; or
- The offer is from an ongoing business that appears to be insolvent, and it appears that the government's position would be better protected through a formal insolvency proceeding.

A. PUBLIC POLICY REJECTION

The Internal Revenue Manual establishes that offers may be rejected on the basis of public policy if acceptance might in any way be detrimental to the interests of fair tax administration, even though it is shown conclusively that the amount offered is greater than could be collected by any other means, provided no Effective Tax Administration issues exist. A decision to reject an offer for public policy reason(s) by the IRS must be based on the fact that public reaction to the acceptance of the offer could be so negative as to diminish future voluntary compliance by the general public. Decisions to reject offers for this reason should be rare. Below are some examples of situations that may warrant rejection based on a public policy decision:

- The taxpayer has in the past, and continues to openly encourage others to refuse to comply with the tax laws;

- Indicators exist showing that the financial benefits of a criminal activity are concealed or the criminal activity is continuing; or

- The taxpayer engaged in a pattern of conduct suggesting intentional dissipation of assets.

Example.

The taxpayer, a payroll service provider, has received from its clients payments of employment taxes in the amount of $10 million. The taxpayer remits to the Service an amount equal to the trust fund portion of the employment taxes and designates the payment for application to the trust fund portion of the tax. The taxpayer pays no more of the employment tax. Meanwhile, the taxpayer dissipates all of its remaining assets, reducing its reasonable collection potential to $0. The taxpayer then submits an OIC for $10,000. Because the OIC exceeds reasonable collection potential, the taxpayer would qualify for the OIC on the grounds of doubt as to collectability. Nevertheless, the OIC should be rejected on public policy grounds.

An offer will not be rejected on public policy grounds solely because: (a) it would generate considerable public interest, some of it critical; or (b) a taxpayer was criminally prosecuted for a tax or non-tax violation.

IV. Other Notes on Rejection of Offers in Compromise

A. INDEPENDENT IRS REVIEW

IRC § 7122(d)(1) requires the IRS to conduct an independent administrative review of a proposal to reject an OIC. The review must be conducted prior to the rejection being communicated to the taxpayer. The Independent Administrative Reviewer (IAR) is responsible for conducting this review. The IAR is responsible for reviewing each case to determine if the proposed rejection is reasonable based on the taxpayer's facts and circumstances.

B. BASIC APPEAL RIGHTS

Treasury Regulation 301.7122-1 (f) (5) gives taxpayers 30 days to appeal a rejection of an offer in compromise. The 30-day period to request an appeal starts the day after the date on the rejection letter. The rejected offer must be suspended during this 30-day period to allow the taxpayer an opportunity to request an appeal, even if the taxpayer advises the IRS that no appeal is desired. If the 30th day falls on a Saturday, Sunday, or holiday the date for timely submission will be the next business day. For example, the 30th day for appeal falls on Saturday, August 7, 2012. The request for the appeal is dated Monday, August 9, 2012. This is considered to be a timely appeal because it was postmarked on the first regular business day following the 30th calendar day.

V. <u>Actions on Post-Accepted Offers</u>

During the time an accepted offer is monitored, a determination to terminate or rescind an existing compromise agreement may need to be made. A determination whether to compromise an existing accepted offer may also be considered.

A. RESCISSION OF ACCEPTED OFFERS

An Offer in Compromise is an agreement which is binding on both the government and the taxpayer, and precludes further inquiry into the matters to which it relates, unless fraud or a mutual mistake of fact is identified. An offer may be rescinded or set aside when there was a mutual mistake as it relates to a material fact or a false representation that was made by one party. A "mutual mistake of fact" is defined as an erroneous belief held by both parties about the facts as they existed at the time the contract was entered into. The mere fact that both parties are mistaken with respect to the same basic assumption about an existing fact does not, of itself, provide reason for the affected party to void the contract. Rescission is only appropriate where a mistake of both parties has such a material effect on the agreed exchange of performance that it upsets the very basis of the offer in compromise. To constitute fraud or false representation, the following must be present:

- The representations related to material facts were false;
- The maker knew or should have known the facts to be false; and
- The facts were made for the purpose of inducing, and did induce the other party to make the contract, and that the latter had the right to rely on them, and did rely on them, thereby sustaining injury.

B. COMPROMISE OF A COMPROMISE

The compromise of a compromise is rare. However, in cases where the taxpayer is unable to pay the balance of an accepted offer, the balance of a non-rebate erroneously issued refund, or the balance of the contingent liability under the terms of a collateral agreement and the investigation reveals that extreme hardship or special circumstances exist, which would justify that a default is not in the best interest of the government, the IRS has the option to:

- Adjust the payment terms of the offer;
- Formally compromise the existing compromise; or
- Obtain managerial approval to settle the offer for the amount already paid and not default the offer.

A proposal to compromise the balance of an accepted offer must rest on DATC, DATC with special circumstances, or effective tax administration (ETA).

Chapter 6 – Review Questions

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. What is the most common reason for the IRS to reject a taxpayer's Offer in Compromise based on Doubt as to Collectability:

   a) the IRS believes the taxpayer owes all of the assessed tax
   b) the taxpayer has filed for bankruptcy
   c) the IRS believes the taxpayer can afford to pay more than is being offered
   d) the IRS is not in the business of accepting less than the total amount owed

2. Which of the following arguments in support of an Offer in Compromise would be rejected by the IRS as frivolous:

   a) income taxes are unconstitutional
   b) the IRS's assessment was incorrect
   c) the taxpayer cannot fully pay the tax based on his current income
   d) collection of the tax would violate public policy

Chapter 6 – Solutions and Suggested Responses

1. A: Incorrect. This is a basis for rejecting an Offer in Compromise based on Doubt as to Liability, not based on Doubt as to Collectability.

   B: Incorrect. An open bankruptcy case will prevent the taxpayer from submitting an offer; it is not a basis for rejecting the offer.

   C: Correct. The IRS will not generally accept an Offer in Compromise based on Doubt as to Collectability unless it believes it is collecting the most the taxpayer can reasonably be expected to pay based on his or her circumstance.

   D: Incorrect. The basis of an Offer in Compromise is that the IRS is accepting less than the total owed.

   (See page 6-1 of the course material.)

2. **A: Correct.** This argument is deemed frivolous by the IRS and will result in an automatic rejection and potentially a fine as well.

   B: Incorrect. This would give rise to an Offer in Compromise based on Doubt as to Liability and is not a frivolous argument.

   C: Incorrect. This would give rise to an Offer in Compromise based on Doubt as to Collectability and is not a frivolous argument.

   D: Incorrect. This would give rise to an Offer in Compromise based on Effective Tax Administration and is not a frivolous offer.

   (See page 6-3 of the course material.)

Chapter 7: Financial Analysis of Offers in Compromise

A prior chapter discussed Reasonable Collection Potential, which is the amount of money the IRS believes the taxpayer should be able to pay in an Offer in Compromise based on Doubt as to Collectability. This chapter reviews how that analysis is done in detail. Since a taxpayer will want to know how much he or she will be expected to pay in the event he or she submits an OIC, CPAs should be able to do a rough calculation of what the IRS will likely expect from their client.

I. Calculating the Taxpayer's Ability to Pay: An Overview

When the IRS evaluates a taxpayer's ability to pay tax debt, the determination is made on the liability due at the time the offer is submitted. The IRS will complete an initial calculation to determine if the taxpayer can pay his or her tax debt in full either presently or through an installment agreement[1] prior to considering whether to accept the Offer in Compromise. The standards the IRS staff must use to calculate the taxpayer's present ability to pay is made using detailed criteria set forth in the Internal Revenue Code, Internal Revenue Manual and other regulations. Many of those rules are condensed and explained in this chapter.

A. INITIAL DETERMINATION

If the initial calculation indicates the taxpayer is unable to fully pay his or her tax debt either presently or through an installment agreement, the IRS must calculate the Reasonable Collection Potential. This determination will be made from evaluating a variety of sources, including the Collection Information Statements (CIS) that the taxpayer must submit with the offer.

B. INFORMATION MUST BE CURRENT

Collection Information Statements (CIS) and related documentation submitted with an OIC should reflect information no older than the prior six months from the date of the OIC submission.

If during the investigation, the financial information becomes older than 12 months and it appears that significant changes have occurred, the IRS will normally request updated information from the taxpayer.

In certain situations, information may become outdated due to significant processing delays caused by the IRS and through no fault of the taxpayer. In those cases, the IRS may rely on the outdated information if there is no indication the taxpayer's overall situation has significantly changed. If there is any reason to believe the taxpayer's situation may have significantly changed, a taxpayer may be asked to submit a new CIS.

[1] With an Installment Agreement, the taxpayer pays off his or her entire debt by making periodic payments over an agreed-upon timeframe.

C. VERIFICATION

The IRS will thoroughly review the taxpayer's financial statements submitted with the OIC. They will also review all of the internal records they already have about the taxpayer, i.e., prior tax returns, to ensure that the information provided by the taxpayer is correct.

Collection issues that have been previously addressed during a prior investigation will not be re-examined unless there is convincing evidence that such reinvestigation is absolutely necessary. Investigative actions that are less than 12 months old may be used to evaluate the OIC, unless the taxpayer indicates there has been a material change or there is evidence indicating his financial situation has changed in the intervening months.

1. Credit Reports

In verifying taxpayer information, the IRS may secure a full credit report to assist in locating taxpayer assets, verifying financial information, and/or determining an alternative resolution to an OIC. A full credit report will generally be requested prior to the IRS accepting an offer when the current balance exceeds $100,000. When computing equity in real estate or allowable motor vehicles, and the taxpayer has not submitted substantiation of loan balances claimed on the Form 433-A, the IRS will generally request a credit report and use the loan balance information to determine the current balances of any relevant loans from commercial lenders. If the loan is from a private source, the IRS will contact the taxpayer for more information.

2. Verification Through Taxpayer Contact

If not present in the file when assigned for investigation and internal sources are not available or indicate a discrepancy, appropriate documentation should be requested from the taxpayer, either verbal or written, to verify the information on the CIS. A request for additional information and verification should be based on the taxpayer's circumstances and the information must be necessary to make an informed decision on the acceptability of the taxpayer's OIC. A blanket request should not be made for information that would have no impact on the case resolution. Also, no request should be made for any information that is available internally.

The table below provides guidance to the types of information that may be needed to verify the CIS if not included or addressed with the original Form 656, 433-A, or 433-B. This list is not all inclusive.

Table 7.1. Information Required to Verify Taxpayer Information.

Taxpayer Documentation	**The IRS Will …**
Wage Earner — wage statements for the prior three months or a statement with current year-to-date figures	• Compare average earnings to the income declared on the CIS. • Verify adequate tax withholding. • Identify payroll deductions. • Identify deductions to savings accounts, credit union accounts, or retirement accounts.
Self-employed – proof of gross income (accounts receivable, commission statements, etc.) for the prior six months for operating businesses Seasonal businesses may require up to 12 months of verified income.	Compare average earnings to the income declared on the CIS
Bank statements – three current months showing the monthly transactions, withdrawals, and deposits for IMF accounts and six months for operating businesses	Compare deposit amounts to income reported on the tax return and CIS. Question deposits that exceed reported income and unusual expenses paid[2]
Retirement account statements and brochures, brokerage account statements, securities, or other investments	Identify the type (mandatory/voluntary), conditions for borrowing, conditions for withdrawal, and current market value.
Life insurance policies	Identify the cash value of the policy.
Motor vehicle statements from the lender	Verify monthly payment and payoff amount.
Real estate lender statements	Identify the payoff amount and monthly payment expense and verify the property address on the real estate or lender statement.
Court orders and court ordered payments for child support/alimony	Verify responsibility for child support/alimony, that the payments are actually being made, and the length of time payments are required to be made.

[2] The IRS may request specific cancelled checks and deposit items if questionable items cannot be adequately explained.

II. Calculating Equity in Assets

Proper asset valuation is essential for the IRS to determine RCP. In some cases, the IRS may need to review the following documents to determine undisclosed assets or income and assist in valuing the property:

- Divorce decrees or separation agreements to determine the disposition of assets in the property settlements;

- Homeowners or renters insurance policies and riders to identify high value personal items such as jewelry, antiques, or artwork; and

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

For an on-going business, the IRS will make calls to validate the existence and value of business assets and inventory. The IRS may also make field calls on non-operating businesses or individuals after all internal research has been exhausted.

A. NET REALIZABLE EQUITY

For purposes of evaluating an OIC, the IRS will value assets at net realizable equity (NRE). Net realizable equity is defined as quick sale value (QSV) less amounts owed to secured lien holders with priority over the federal tax lien, if applicable, and levy exemption amounts. QSV is defined as an estimate of the price a seller could get 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 less than fair market value (FMV). For purposes of determining the taxpayer's reasonable collection potential (RCP), information provided by the taxpayer and third party sources available to the IRS will be reviewed to arrive at an appropriate FMV of the property.

Normally, QSV is calculated at 80% of FMV. A higher or lower percentage may be applied in determining QSV when appropriate, depending on the type of asset and current market conditions. If, based on the current market and area economic conditions, it is believed that the property would quickly sell at full FMV, then the IRS may consider QSV to be the same as FMV. This is occasionally found to be true in real estate markets where real estate is selling quickly at or above the listing price. As long as the value chosen represents a fair estimate of the price a seller could get for the asset in a situation where the asset must be sold quickly (usually 90 calendar days or less) then it would be appropriate to use a percentage other than 80%. Generally, it is the policy of the IRS to apply QSV in valuing property for offer purposes.

When a particular asset has been sold (or a sale is pending) in order to fund the offer, no reduction for QSV will be made. Instead, the IRS will verify the actual sale price, ensuring that the sale is an arms-length transaction, and use that amount as the QSV. A reduction may be made for the costs of the sale and the expected current year tax consequence to arrive at the NRE of the asset.

B. JOINTLY HELD ASSETS

When taxpayers submit separate offers but have jointly owned assets, the IRS will allocate equity in the assets equally between the owners, with the following exceptions:

- If the joint owners demonstrate their interest in the property is not equally divided, then the IRS will allocate the equity based on each owner's contribution to the value of the asset; and

- If the joint owners have joint and individual tax liabilities included in their offer, the IRS will apply the equity first to the joint liability and then to the individual liability.

For property held as tenancies by the entirety when the tax is owed by only one spouse, the taxpayer's portion is usually 50% of the property's Net Realizable Equity (NRE), which is the amount a taxpayer would receive if he or she sold the asset, less an amount owed on that asset.

The IRS will review applicable state law, including the effect community property and registered domestic partnership laws have on property ownership rights in order to determine the taxpayer's interest in assets that should be included in the RCP.

III. <u>Valuing Business Assets</u>

A. INCOME-PRODUCING ASSETS

When investigating the Reasonable Collection Potential for an offer that includes business assets, the IRS will try to determine whether certain assets are essential for the production of income. When it has been identified that an asset or a portion of an asset is necessary for the production of income, the IRS may adjust the income or expense calculation for that taxpayer 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. When valuing income-producing assets, the IRS will follow the guidelines set forth in Table 7.2 on the next page.

Table 7.2. Valuing Income Producing Assets.

If…	Then the IRS will…
There is no equity in the assets	There is no adjustment necessary to the income stream.
There is equity and no available income stream (i.e., profit) produced by those assets	There is no adjustment necessary to the income stream. The IRS will consider including the equity in the asset in the RCP.
There are both equity in the assets that are determined to be necessary for the production of income and an available income stream produced by those assets	Compare the value of the income stream produced by the income producing asset(s) to the equity that is available. Determine if an adjustment to income or expenses is appropriate.
An asset used in the production of income will be liquidated to help fund an offer	Adjusting the income to account for the loss of the asset.
A taxpayer borrows against an asset that is necessary for the production of income, and devotes the proceeds to the payment of the offer	Consider the effect that loan will have on future expenses and the future income stream.
The taxpayer is either unable or unwilling to secure a loan on the equity in income producing assets	Compare the equity in the assets with the income produced by those assets. Determine if an adjustment to income stream is appropriate to account for the potential loss of the assets.

The IRS is required to document the above considerations and evaluations in the case file. Below are some examples of the type of consideration the IRS gives certain types of business property.

Example.

A self-employed construction tradesman sells a truck, which he uses to haul materials, and devotes the proceeds to his OIC. The IRS will have to consider allowing the expected cost of delivery services as a future business expense.

Example.

Assume the same facts as above, except that instead of selling the truck, the tradesman takes out a loan using the truck as collateral and uses the proceeds of the loan towards paying the IRS. The IRS will have to consider allowing the loan repayment to be included as a business expense.

Example.

Again using the scenario above, assume that the tradesman cannot secure a loan and that the sale of his truck would create an economic hardship. In this situation, the IRS will need to compare the equity in the *truck with the income produced by the asset to determine if an adjustment to the individual's income stream is appropriate to account for the potential loss of the assets*.

Example.

An outside salesman owns an expensive luxury automobile. Since any type of car is likely acceptable for the salesman to conduct his work, the IRS will consider the value in determine the taxpayer's RCP. He might, therefore, be forced to sell the car and purchase a less expensive one.

Example.

A company delinquent in tax payments owns a vacation home used occasionally for board meetings. The IRS will not consider the payment on the property as a required business expense because it is not crucial to the operations of the business. The taxpayer may, therefore, be forced to sell the property or allow the bank to take it back.

B. ASSETS HELD BY OTHERS AS TRANSFEREES, NOMINEES OR ALTER EGOS

A critical part of the financial analysis is done by the IRS to determine what degree of control the taxpayer has over assets and income in the possession of others. This is especially true when the offer will be funded by a third party. If the taxpayer has a beneficial interest in the asset or income stream, then the value should be reflected in the RCP. This may require the taxpayer to submit completed financial statements for the entity identified.

If the taxpayer is unwilling or unable to provide the financial information requested, the IRS may simply assign a value based on available information. If information necessary to determine whether the taxpayer's offer should be accepted is not provided, the IRS may simply return the taxpayer's offer. If, however, the information that was provided is sufficient for the IRS to calculate the RCP and the taxpayer's assets – other than the transferred property – are greater than the offer amount – the offer will likely be rejected.

C. ACCOUNTS AND NOTES RECEIVABLE

Accounts and notes receivable are considered assets unless the IRS makes a determination to treat them as part of the income stream when they are required for the production of income. When it is determined that liquidation of a receivable would be detrimental to the continued operation of an otherwise profitable business, it may be treated as future income.

1. <u>Accounts Receivable</u>

The IRS will normally value all accounts receivable at 100% of the balance due, unless the taxpayer can substantiate the account has been delinquent over 90 days. Accounts receivable that are current (i.e., less than 90 days past due) generally should not be discounted at Quick Sale Value (QSV). If the account is determined to be delinquent, the IRS may discount appropriately based on the age of the receivable and the potential for collection.

2. <u>Notes Receivable</u>

To determine the value of a note receivable, the IRS will consider the following:

- Whether it is secured and if so by what asset(s);
- What is collectable from the borrower; and
- If it could be successfully levied upon.

D. INVENTORY, MACHINERY, EQUIPMENT AND TOOLS OF THE TRADE

Inventory, machinery, and equipment may be considered income-producing assets when it is determined that liquidation of these assets would be detrimental to the continued operation of an otherwise profitable business. To determine the value of business assets, the IRS will generally use the following:

- For assets commonly used in many businesses, such as automobiles and trucks, the value may be easily determined by consulting trade association guides;
- For specialized machinery and equipment suitable for only certain applications, the IRS will consult a trade association guide, secure an appraisal from a knowledgeable and impartial dealer, or contact the manufacturer; and
- Consider asking the taxpayer to secure an appraisal from a qualified business appraiser.

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). This exemption for tools of the trade generally does not apply to automobiles. The levy exemption amount is updated on an annual basis.

E. BUSINESS AS A GOING CONCERN

Evaluation of a business as a going concern is sometimes necessary when determining RCP of an operating business owned individually or by a corporation, partnership, or LLC. This analysis recognizes that a business may be worth more than the sum of its parts, when sold as a going concern. To determine the value of a business as a going concern, the IRS will consider the value of assets, future income, and intangible assets such as:

- Ability or reputation of a professional;
- Established customer base;
- Prominent location;
- Well known trade name, trademark, or telephone number; and

- Possession of government licenses, copyrights, or patents.

Generally, the difference between what an ongoing business would realize if sold on the open market as a going concern and the traditional the RCP analysis is attributable to the value of these intangibles. When determining the equity to include in RCP for an individual taxpayer who has an interest in a business entity, the IRS will give consideration to the taxpayer's control over the business.

F. LIMITED LIABILITY COMPANY (LLC) ISSUES

Collection from a LLC involves unique issues especially when the liabilities include employment or excise taxes. While investigating an offer in compromise that involves an LLC, knowing the classification for federal tax purposes is necessary. Yet, classification of the LLC for federal tax purposes does not negate state law provisions concerning the legal status of the LLC. For example:

- Classification of an LLC as a partnership does not mean the member/owners have liability for LLC debts as would be the case in a state law partnership; and

- Under certain circumstances, an LLC may be disregarded as an entity separate from its owner. This classification does not mean that an LLC owned by an individual is the equivalent of a sole proprietorship.

As with any entity, the IRS must secure sufficient information to make an informed decision on the acceptability of the taxpayer’s compromise proposal. In all instances, a financial statement will be required from the LLC. This includes employment tax liabilities for wages paid where the classification of the LLC is a disregarded entity even though the LLC is not the liable taxpayer.

Financial information of all member owners will also be collected by the IRS. When a member owner holds only a negligible or token interest, has made no or minimal investment, and exercises no control over the corporate affairs, financial information may not be required unless other factors are present to indicate the information is necessary to determine the acceptability of the taxpayer’s offer. If the taxpayer is unwilling or unable to provide the financial information requested and the information is necessary to determine whether the taxpayer’s offer should be accepted, the IRS is likely to return the offer to the taxpayer.

IV. Dissipation of Assets

The IRS will not automatically include the value of dissipated assets in the calculation of the RCP. Each particular case is evaluated on its own merit. During its investigation of an offer, the IRS may discover, for example, that assets (liquid or non-liquid) have been sold, gifted, transferred, or spent on non-priority items or debts and are no longer available to pay the tax liability. Once it is determined that a specific asset has been dissipated, the IRS will investigate whether the value of the asset, or a portion of the value, should be included in an acceptable offer amount. A determination that assets were dissipated by the IRS will include an analysis of the following facts:

- When the asset(s) were dissipated in relation to the offer submission. Absent unique circumstances, the value of assets dissipated more than five years prior to the offer submission will not be included in the RCP;

- When the assets were used by the taxpayer to pay for existing on-going business operating expenses, the funds should not be considered to be a dissipated asset;

- When the asset(s) were dissipated in relation to the liability;

- How the asset was transferred;

- If the taxpayer realized any funds from the transfer of assets;

- How any funds realized from the disposition of assets were used; and

- The value of the assets and the taxpayer's interest in those assets.

When it can be shown through internal research or substantiation provided by the taxpayer that the funds were needed to provide for necessary living expenses, the IRS will not include them in the RCP calculation.

Example.

John, who is applying for an OIC, dissolved his IRA during a period of unemployment. The IRS's review verified the John's income was insufficient to meet necessary living expenses. In this case, the IRS will not include the funds up to the amount needed to meet allowable expenses in the RCP calculation.

Example.

Tina is applying for an OIC. The IRS determined that Tina withdrew a substantial amount of money from her bank accounts. She provided the IRS with supporting documentation to show that the funds were used to pay for unexpected medical expenses. This amount will not be included in the RCP calculation.

If the IRS determines during the course of evaluating the OIC that the taxpayer's assets have been dissipated with a disregard of the outstanding tax liability, the IRS will consider including the value in the RCP calculation. Dissipated assets that may result in an increase to the RCP calculation include dissolving an IRA account or refinancing equity in property to pay for a child's wedding or vacation, and sale of real estate and gifting the funds from the sale to family members. On the other hand, if the taxpayer refinanced his or her home and used a portion of the funds to pay for living expenses or medical costs, only the portion of the funds that were not used for necessary living expenses should be considered for inclusion as a dissipated asset when calculating the RCP.

Prior to including the dissipated asset in the RCP, the IRS will normally contact the taxpayer and provide them with the opportunity to explain or verify the dissipation of the asset. If during the investigation it is determined the assets were deliberately dissipated in anticipation of the tax liability or the filing of the OIC, the IRS may reject the offer under public policy criteria.

V. Valuing an Individual Taxpayer’s Assets

A. CASH

The IRS will determine the taxpayer's interest in bank accounts by ascertaining the manner in which it is held. They will verify whether deposits in escrow or trust accounts are actually held for the benefit of others. They will also review checking account statements over a reasonable period of time, generally three months for wage earners and six months for in-business taxpayers.

The checking account would normally be valued at the lowest daily balance during the month. If the lowest balance is not available, the ending balance may be used, if it is determined to approximate a reasonable value for the account.

An individual account may be valued at zero if the monthly ending or lowest daily balance is minimal, income and expenses are approximately equal on the taxpayer’s application, the only deposits into the account are from the taxpayer’s wages/salary or pension, and the taxpayer does not have any other account from which he or she pays expenses.

The IRS will also analyze the statement for any unusual activity, such as deposits in excess of reported income, withdrawals, transfers, or checks for expenses not reflected on the taxpayer’s application. The IRS will question any inconsistencies.

> **Example.**
>
> *A review of the bank statement of a taxpayer seeking an OIC shows a beginning balance of $10,000. Discussion with the taxpayer revealed that he maintains a $10,000 monthly balance after allowable living expenses. The IRS will include the $10,000 as an asset when calculating the taxpayer’s RCP.*

The IRS will also undertake the following actions:

- Review savings accounts statements over a reasonable period of time, generally three months; and

- If the account has little withdrawal activity, use the ending balance on the latest statement as an asset in determining the taxpayer’s RCP. If it is apparent that the account is used for paying monthly living expenses, the IRS will treat it as a checking account.

If analysis of the bank statement reveals large amounts of recently expended funds, the IRS will fully investigate the disposition of those assets. Also, in circumstances where a taxpayer offers the balances of accounts (for example, certificate of deposit, savings bonds, etc.) to fund the offer, the IRS will allow for any penalty for early withdrawal and the expected current year tax consequence.

B. SECURITIES AND STOCKS OF CLOSELY HELD ENTITIES

Financial securities are considered an asset and their value is included by the IRS in calculating the taxpayer's RCP. In cases where the taxpayer will liquidate the investment to fund the offer, the IRS will allow associated fees in addition to any penalty for early withdrawal and the current year tax consequence. To determine the value of publicly traded stock, the IRS will research a daily paper, other internal sources, or inquire with a broker for the current market price. Then, the IRS will allow for the estimated costs of the sale to arrive at the QSV. To determine the value of closely held stock that is either not traded publicly or for which there is no established market, the IRS will consider the following methods of valuing the company and assign the applicable portion of the company's value to the taxpayer's stock or other interest:

- Secure and verify a CIS;
- Review recent year's annual report to stockholders;
- Review recent year's corporate income tax returns; and
- Request an appraisal of the business as a going concern by a qualified and impartial appraiser.

When a taxpayer holds only a negligible or token interest, has made no investment, and exercises no control over the corporate affairs, the IRS may assign no value to the stock.

C. LIFE INSURANCE

The IRS will identify the type, conditions for borrowing or cancellation, and the current loan and cash values of any life insurance. Life insurance as an investment (e.g., whole life) is not considered necessary. Reasonable premiums for term life policies may be allowed as a necessary expense. The IRS will also verify the amount of the premiums and ensure payments are being made. When determining the value in a taxpayer's insurance policy, the IRS will make valuations as set forth in the table below.

Table 7.3. Valuing Insurance.

If…	Then the IRS will value…
The taxpayer will retain or sell the policy to help fund the offer	Equity as the cash surrender value.
The taxpayer will borrow on the policy to help fund the offer	Equity as the cash loan value less any prior policy loans or automatic premium loans required to keep the contract in force.

D. RETIREMENT OR PROFIT SHARING PLANS

Funds held in a retirement or profit sharing plan are considered an asset and must be valued for offer purposes. Contributions to voluntary retirement plans are not a necessary expense for purposes of determining RCP. If a taxpayer plans on liquidating the retirement plan to contribute towards the OIC, the IRS will allow any penalty for early withdrawal and the current year tax consequence.

When determining the value of a taxpayer's pension and profit sharing plans, the IRS generally follows the rules set forth below:

Table 7.4. Valuing Retirement Plans.

If…	**And…**	**Then…**
The account is an Individual Retirement Account (IRA), 401(k), or Keogh Account	The taxpayer is not retired or close to retirement	Equity is the cash value less any tax consequences for liquidating the account and early withdrawal tax.
The account is an Individual Retirement Account (IRA), 401(k), or Keogh Account	The taxpayer is retired or close to retirement	Equity is the cash value less any tax consequences for liquidating the account and early withdrawal tax. The plan may be considered as income, if the income from the plan is required to provide for necessary living expenses.
The contribution to a retirement plan is required as a condition of employment	The taxpayer is able to withdraw funds from the account	Equity is the amount the taxpayer can withdraw less any tax consequences and early withdrawal tax.
The contribution to an employer's plan is required as a condition of employment	The taxpayer is unable to withdraw funds from the account but is permitted to borrow on the plan	Equity is the available loan value.
Any retirement plan that may not be borrowed on or liquidated until separation from employment	The taxpayer is retired, eligible to retire, or close to retirement	Equity is the cash value less any tax consequences for liquidating the account and early withdrawal tax, or consider the plan as income if the income from the plan is necessary to provide for necessary living expenses.
The plan may not be borrowed on or liquidated until separation from employment and the taxpayer has no vested interest	The taxpayer is not eligible to retire until after the period for which we are calculating future income	The plan has no equity.
The plan includes a stock option	The taxpayer is eligible to take the option	Equity is the value of the stock at current market price less any expense to exercise the option.

E. FURNITURE, FIXTURES AND PERSONAL EFFECTS

The taxpayer's declared value of household goods is usually acceptable unless there are articles of extraordinary value, such as antiques, artwork, jewelry, or collector's items. 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. This exemption applies only to individual taxpayers. When determining the value, the IRS will consider the factors in the Table below:

Table 7.5. Valuing Furniture, Fixtures and Personal Effects.

If…	Then the IRS will…
The taxpayer qualifies as head of household, single, or married	Grant a reduction in the value of personal effects for the levy exemption amount.
The property is owned jointly with any person who is not liable for the tax	Determine the value of the taxpayer's proportionate share of property before allowing the levy exemption.
Some of the furniture or fixtures are used in a business	Say that they are not personal effects, but they may qualify for the levy exemption as tools of a trade.
If the property has an encumbrance with priority over the Notice of Federal Tax Lien	Allow the encumbrance in addition to the statutory exemption.

F. MOTOR VEHICLES, AIRPLANES AND BOATS

Equity in motor vehicles, airplanes, and boats must be determined and included in the RCP. The general rule for determining NRE, as discussed above, applies when determining equity in these assets. Unusual assets such as airplanes and boats may require an appraisal to determine FMV, unless the items can be located in a trade association guide.

The IRS will normally not personally inspect automobiles used for personal transportation. When it appears reasonable, they will accept the taxpayers stated value. If the taxpayer failed to provide the value or the value appears to be unreasonable, the IRS will consult a trade association guide. Generally, the Private Party or equivalent value will be used. In most cases, the vehicle will be discounted for the FMV to 80% to arrive at the QSV. When these assets are used for business purposes, they may be considered income-producing assets.

G. REAL ESTATE

The IRS will verify types of ownership through warranty and mortgage deeds to determine the FMV. For purposes of real estate, FMV 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. The IRS will use the following methods may be used to establish FMV:

- Recent purchase price or an existing contract to sell;
- Recent appraisals;
- Real estate tax assessment;
- Market comparables; and
- Homeowner’s insurance policy(s).

Once the FMV of real estate is established, the IRS will make a determination regarding a reduction of value for offer purposes must be made. Equity in real estate is included when calculating the taxpayer's RCP in an acceptable offer amount. This may be established through HUD closing statements, statements from the lenders, etc. For real estate and other related property held as tenancies by the entirety when the tax is owed by only one spouse, the taxpayer's portion is usually 50% of the property's NRE.

H. RETIRED DEBT

Retired debt is defined as an expected change in necessary or allowable expenses. The necessary/allowable expenses may decrease, which would change the taxpayer's ability to pay.

> **Example.**
>
> *John is seeking an OIC. He is currently paying child support for his 17-year-old son who resides with his ex-wife. When his son turns 18, John will no longer be obligated to make those payments. Since the required child support payments will stop before the future income period ends, the retiring of those payments will increase the amount of money John will have available towards resolving his tax debt.*

Inclusion of retired debt should not be automatically included in the calculation of the RCP by the IRS. The IRS will evaluate on a case-by-case basis whether inclusion of the retired debt is appropriate based on the facts of the case.

I. FUTURE INCOME

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[3]. As a general rule, the taxpayer's current income should be used in the analysis of future ability to pay. This may include situations where the taxpayer's income is recently reduced based on a change in occupation or employment status.

1. <u>Considerations Made by IRS</u>

The IRS will also give consideration to the taxpayer's overall general situation including such facts as age, health, marital status, number and age of dependents, level of education or occupational training, and work experience. Situations that may warrant placing a different value on future income than current or past income are discussed in the table below. Additionally, in some cases, the IRS may request a future income collateral agreement based on the taxpayer's earnings potential.

---

[3] See IRM 5.8.5.23(2) table for calculation.

Table 7.6. Calculating Future Income.

If…	Then the IRS will…
Income will increase or decrease or current necessary expenses will increase or decrease	Adjust the amount or number of payments to what is expected during the appropriate number of months.
A taxpayer is temporarily or recently unemployed or underemployed	Use the level of income expected if the taxpayer were fully employed and if the potential for employment is apparent. Each case should be judged on its own merit, including consideration of special circumstances or ETA issues. **Example:** *Unemployed – The taxpayer is a construction worker who currently is not employed due to lack of work during the winter months. Since this loss of employment during the winter is normal for the taxpayer, use of the taxpayer's previous annual income or income averaging may be used to accurately determine the taxpayer's income.* **Example:** *Underemployed – The taxpayer is a teacher and is currently employed at a lesser paying job, yet will begin or return to work as a teacher when the school year begins in the fall. The taxpayer is considered to be currently underemployed. The anticipated income once the taxpayer is fully employed is used.*
A taxpayer is unemployed and is not expected to return to his or her previous occupation or previous level of earnings	Contact the taxpayer to discuss the expected future level of income. When considering future income, also allow anticipated increases in necessary living expenses and/or applicable taxes. **Note:** *Each case should be judged on its own merit, including consideration of special circumstances or ETA issues.*
A taxpayer is long-term unemployed	Not income average. The taxpayer's current income should be used in the future income calculation. If there is a verified expectation the taxpayer will be securing employment, then the use of anticipated future income may be appropriate. Anticipated future income should not be used in situations where the future employment is uncertain.

If…	Then the IRS will…
	Example: *Taxpayer has been unemployed for over one year. There are currently no employment opportunities for the taxpayer and the household is living on one income. Use of the taxpayer's current income with a future income collateral agreement is appropriate.*
A taxpayer is long-term underemployed	Not income average. Use the taxpayer's current income. **Example:** *The taxpayer was previously employed in a manufacturing plant making $75,000 per year. There are currently no opportunities for the taxpayer to secure employment making the same rate of pay as his or her prior job. The taxpayer's income is now $25,000 per year with no anticipated increase. Use the current income only.*
A taxpayer has an irregular employment history or fluctuating income	Average earnings over the three prior years. The use of a time period other than three years should be the exception and only when specific circumstances are present. **Example:** *The taxpayer is a stock broker whose income in 2007 was $150,000 and income in 2008 was $25,000. In this case, you should consider income averaging the prior three years or secure a future income collateral agreement if the offer is accepted.* **Note:** *This practice does not apply to wage earners. Wage earners should be based on current income unless the taxpayer has unique circumstances.*
A taxpayer is in poor health and his or her ability to continue working is questionable	Reduce the number of payments to the appropriate number of months it is anticipated the taxpayer will continue working. Consider special circumstance situations when making any adjustments. **Example:** *Taxpayer has a serious health issue and it is anticipated he or she will be unable to work after six months. Use the taxpayer's current income for six months, then reduce his or her income to the anticipated amount the taxpayer*

If…	Then the IRS will…
	will be receiving after he or she is unable to work.
A taxpayer is close to retirement and has indicated he or she will be retiring	If the taxpayer can substantiate retirement is imminent, adjust the taxpayer's future earnings and expenses accordingly. If it cannot be substantiated, the calculation will be based on current earnings. At this point, it may be appropriate to discuss other options available to the taxpayer, for example, an installment agreement. **Example:** *The taxpayer is 65 years of age and has indicated he will retire at the age of 66. The taxpayer provided copies of documents that have been submitted to his employer discussing his retirement date. Use the taxpayer's current income until the taxpayer's anticipated retirement date, and then adjust the taxpayer's income to reflect the amount expected in retirement.* **Example:** *The taxpayer is 62 years of age, is in good health, and has remained stable for the past three years. The taxpayer states she would like to retire at age 65. Use the taxpayer's current income and if the RCP exceeds the offer amount, discuss the option of securing an installment agreement until the taxpayer actually retires, at which time an offer may be appropriate.*
A taxpayer will file a petition for liquidating bankruptcy	Consider reducing the value of future income. The total value of future income should not be reduced to an amount less than what could be paid toward non-dischargeable periods, or what could be recovered through bankruptcy, whichever is greater. When considering a reduction in future income, the IRS will also consider the intangible value to the taxpayer of avoiding bankruptcy.

The IRS will consider all circumstances of the taxpayer when determining the appropriate application of income averaging, including special circumstances and ETA considerations. Below are some examples of when income averaging may or may not be appropriate.

Example.

A taxpayer's spouse has not worked for over two and one-half years and has no expectations of returning to work. The IRS will not average income for the spouse's past employment under these circumstances.

Example.

The taxpayer has been unemployed for over one year and provided proof that Social Security Disability is the sole source of income. The IRS will not apply income averaging in this case, but use current income to determine the taxpayer's future ability to pay.

Example.

The taxpayer was incarcerated and unable to work for the past four years and provided proof that a relative is paying for all expenses, including child support payments. The taxpayer has no skills or promise of work in the near future, but is planning on attending trade school to improve his chances of getting a job. The IRS will not include income prior to the incarceration. In this case, since the taxpayer has no skills or promise of employment, his future income value may be determined to be zero. The IRS will give consideration to whether it would be in the best interest of the government to accept the offer or reject the offer in favor of other case resolutions.

Example.

The taxpayer recently began working after several months of unemployment. The IRS will use the most recent three months pay statements to determine future income. Since the taxpayer is a wage earner, the use of income averaging over the prior three years of income is not appropriate.

In situations where the taxpayer's income does not appear to meet his or her stated living expenses, the difference should not be included as additional income to the taxpayer, unless there are clear indications additional income not included on the collection information statement is being received and will continue to be received by the taxpayer. The IRS must speak with the taxpayer in order to determine the appropriateness of including an additional amount in the calculation of future income. Verification of the source of unexplained bank deposits or statements from the source of gifts may be required to correctly determine the taxpayer's current income.

Example.

The taxpayer has been receiving gifts from 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 appear to be based on the transfer of assets to the parents. The gift amount should not be included as income.

Example.

The taxpayer has been receiving an amount each month that only began recently, which he states is a gift from a friend. Further research has determined the taxpayer is in business with the friend and the amount is from their business. This amount should be included as income to the taxpayer.

Example.

The taxpayer had gambling winnings over a period of time, but is not consistent. Do not include those winnings as additional income on the Income and Expense Table (IET). This does not apply to professional gamblers.

Example.

The collection information statement (CIS) submitted by the taxpayer included $3,000.00 of monthly income, which is verified by paystubs. The CIS submitted by the taxpayer includes $4,000.00 of expenses. An additional $1,000.00 should not be added to the taxpayer's income based solely on the fact it appears the taxpayer has been meeting the living expenses included on the CIS. The IRS will speak with the taxpayer to clarify the discrepancy prior to including the amount as additional income.

2. <u>Future Income Collateral Agreements</u>

In some instances, it may be difficult for the IRS to calculate the taxpayer's anticipated income. While the use of income averaging is one method available and is used when averaging the taxpayer's income provides a reasonable calculation of the taxpayer's future earnings potential, the IRS may choose to use the taxpayer's current income and secure a future income collateral agreement. The use of a future income collateral agreement is used to protect the government's interest in any substantial increase in the taxpayer's earnings. A future income collateral agreement is normally used 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. The IRS will consider securing a future income collateral agreement.

Example.

A taxpayer recently secured a job as an attorney with a starting salary of $80,000 per year, with potential for significant increases in salary. The IRS will consider securing a future income collateral agreement.

Example.

A taxpayer is a real estate agent who has had two years of high income and the current income is significantly diminished. Based on the current real estate market, it may be appropriate for the IRS to use the taxpayer's current income and secure a future income collateral agreement in lieu of income averaging.

VI. Allowable Expenses

Allowable expenses consist of necessary and conditional expenses[4]. The IRS is required to use the amount shown in the expense standard schedules unless that amount would result in the taxpayer not having adequate means to provide for basic living expenses. Once allowable expenses are determined, they are used to calculate the amount that can be collected from the taxpayer's future income.

A. NECESSARY EXPENSES

A necessary expense is one that is necessary for the production of income or for the health and welfare of the taxpayer's family. IRM 5.15.1, Financial Analysis Handbook, discusses the national and local expense standards, which serve as guidelines to provide accuracy and consistency in determining a taxpayer's basic living expenses. The standards are available on the IRS web site and are periodically updated.

Taxpayers are allowed the National Standard Expense amount for their family size, without questioning the amount actually spent. If the total amount claimed is more than the total allowed by the National Standards, the taxpayer must provide documentation to substantiate and justify that the allowed expenses are inadequate to provide basic living expenses. National and local expense standards are guidelines. If it is determined a standard amount is inadequate to provide for a specific taxpayer's basic living expenses, the IRS may allow a deviation.

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. There may be reasonable exceptions. An example would include foster children or children for whom adoption is pending, or if a custodial parent released the dependency exemption to his or her ex-spouse.

A deviation from the standards should not be considered merely because it is inconvenient for the taxpayer to dispose of high value assets. In some situations, taxpayers may be expected to make life-style choices that will facilitate collection of the delinquent tax.

1. Housing and Utilities

When determining a taxpayer's housing and utility expense, the IRS will use an amount sufficient to provide for basic living expenses. They will use the amount shown in the expense standard schedules as a guideline unless such use results in the taxpayer not

[4] This is defined in IRM 5.15.1, Financial Analysis Handbook.

having adequate means to provide for basic living expenses. If it is determined that a standard amount is inadequate to provide for basic living expenses, the IRS will allow a deviation. If the amount of the payment cannot be verified through other sources (such as, bank statements), the IRS will require the taxpayer to provide reasonable substantiation. Deviations from the expense standards must be verified and reasonable. Below are two examples, which are not all inclusive. Each decision should be based on the merits of the particular case.

> **Example.**
>
> *A taxpayer with a physical disability or an unusually large family requires a housing cost that is not covered by the local standard. The IRS will require the taxpayer to provide copies of mortgage or rent payments, utility bills and maintenance costs to verify the necessary amount.*
>
> **Example.**
>
> *A taxpayer has owned his home for several years and the payment is above the established standard. The IRS investigation indicates the taxpayer would not be able to rent an apartment for less than his current loan payment. In that case, the IRS will likely allow the full amount of the loan payment.*

Absent special circumstances, when determining a taxpayer's housing and utility expense, the IRS will use the amount that is claimed or the standard, whichever is less.

2. <u>Transportation Expenses</u>

Transportation expenses are considered necessary when they are used by taxpayers and their families to provide for their health and welfare and/or the production of income. The transportation standards consist of nationwide figures for loan or lease payments, referred to as ownership costs, and additional amounts for operating costs broken down by Census Region and Metropolitan Statistical Area. Operating costs include maintenance, repairs, insurance, fuel, registrations, licenses, inspections, parking and tolls.

a. Ownership Expenses

These expenses are allowed for the purchase or lease of a vehicle. Taxpayers will be allowed the local standard or the amount actually paid, whichever is less, unless the taxpayer provides documentation to verify and substantiate that the higher expenses are necessary. Generally, auto loan or lease payments will not continue as allowed expenses after the terms of the loan/lease have been satisfied. However, depending on the age or condition of the vehicle, the complete disallowance of the ownership expense may result in a transportation expense allowance that does not adequately meet the necessary expenses of the taxpayer.

b. Operating Expenses

The IRS will allow the full operating costs portion of the local transportation standard, or the amount actually claimed by the taxpayer, whichever is less, unless the taxpayer provides documentation to verify and substantiate that the higher expenses are necessary. Substantiation for this allowance is not required.

In situations where the taxpayer has a vehicle that is currently over six years old or has reported mileage of 75,000 miles or more, an additional monthly operating expense of $200 will generally be allowed per vehicle.

Example.

The taxpayer who has a 1998 Chevrolet Cavalier with 50,000 miles, will be allowed the standard of $231 per month plus $200 per month operating expense (because of the age of the vehicle), for a total operating expense allowance of $431 per month.

Example.

The taxpayer has a 1995 Ford Taurus, with 90,000 reported miles. The vehicle was bought used, and the auto loan will be fully paid in 30 months, at $300 per month. In this situation, the taxpayer will be allowed the ownership expense until the loan is fully paid; i.e., $300 plus the allowable operating expense of $231 per month, for a total transportation allowance of $531 per month. After the auto loan is "retired" in 30 months, the ownership expense is not applicable; however, at that point, the taxpayer will be allowed a $200 operating expense allowance, in addition to the standard $231, for a total operating expense allowance of $431 per month.

If a taxpayer claims higher amounts of operating costs because he commutes long distances to reach his place of employment, he may be allowed greater than the standard. The additional operating expense would generally meet the production of income test and, therefore, be allowed if the taxpayer provides substantiation.

If the amount claimed is more than the total allowed by any of the transportation standards, the taxpayer must provide documentation to verify and substantiate that those expenses are necessary. All deviations from the transportation standards must be verified, reasonable and documented in the case history.

3. <u>Other Expenses</u>

Other expenses may be allowed in determining the value of future income for offer purposes. The expense must meet the necessary expense test by providing for the health and welfare of the taxpayer and/or his or her family or must be for the production of income. This is determined based on the facts and circumstances of each case. Repayment of loans incurred to fund the offer and secured by the taxpayer's assets will be allowed, if the asset is necessary for the health and welfare of the taxpayer and/or his or her family, i.e., taxpayer’s residence, and the repayment amount is reasonable. The same rule applies whether the equity is paid to the IRS before the offer is submitted or will be paid upon acceptance of the offer.

Example.

The taxpayer has secured a 2nd mortgage against her residence which will be paid toward the offer amount upon acceptance. The payment is reasonable based on the amount borrowed and terms of repayment. The payment should be allowed as an expense by the IRS.

Example.

A taxpayer may have a liability for a court ordered judgment that is senior to the Notice of Federal Tax Lien. Unless the taxpayer is actually making payments on that liability, it is not considered as an allowable monthly expense.

4. <u>Student Loans/Education Expenses</u>

Repayment of student loans secured by the federal government will be allowed only for the taxpayer's post-secondary education. If student loans are owed but no payments are being made, they are not allowed, unless the non-payment is due to temporary job loss or illness.

Education expenses will be allowed only for the taxpayer, and only if they are required as a condition of present employment. 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.

5. <u>Child Support Payments</u>

Child support payments for natural children or legally adopted dependents may be allowed based on the taxpayer's situation. A copy of the court order and proof of payments should be provided. If no payments are being made, the IRS will not allow the expense, unless the nonpayment was due to temporary job loss or illness. In situations where a court order is pending, additional verification may be required. For example, a draft or copy of the court order may be requested.

Example.

The taxpayers are separated and a court date has not been established but child support payments are being made and the taxpayer provided verification of payments. Such payments will be used to determine the taxpayer's Reasonable Collection Potential.

The IRS will not allow payments for expenses, such as college tuition or life insurance for children, made pursuant to a court order. 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. Therefore, the fact that the taxpayer is under court order to provide a payment should not in the ordinary course elevate that expense to allowable status as an offer expense, when the IRS would not otherwise allow it.

6. Health Care Expenses

Substantiation of claimed health care expenses of less than the allowable standard is not required.

7. State or Local Taxing Agencies

Monthly payments to state or local taxing agencies should not be allowed as a necessary expense, even if the state or local taxing agency has a lien that is senior to the IRS's lien or is collecting funds through a wage attachment or approved installment agreement. State and federal liens (regardless of priority) attach simultaneously to after-acquired-property. In general, if the federal tax lien attaches to after-acquired-property simultaneously with a competing perfected lien, the federal tax lien will take priority.

Since future earnings of the taxpayer are after-acquired-property, the IRS has first right to the earnings. The IRS will explain to the taxpayer in such a situation that although the payment may be allowed in an installment agreement, where the tax will be paid in full, it will not be allowed for computation of an acceptable offer amount because the federal government has priority rights to the funds. State or local liens may enjoy a priority in fixed payment streams such as annuity payments.

Current taxes are allowed regardless of whether the taxpayer made them in the past or not. If an adjustment to the taxpayer's income is made, an adjustment of the tax liability must also be made. Current taxes include federal, state, and local taxes. In a wage earner situation, allow the amount shown on the pay stub. If the current withholding amount is insufficient, the tax expenses should be based on the actual tax expense.

8. Charitable Contributions

Generally, charitable contributions are not allowed in the RCP calculation. However, charitable contributions may be an allowable expense if they are a condition of employment or meet the necessary expense test. For example, a minister may be required to tithe according to the terms of his employment contract.

9. Shared Expenses

Generally, a taxpayer will be allowed only the expenses the taxpayer is required to pay. Consideration must be given to situations where the taxpayer shares expenses with another. Shared expenses may exist in one of two situations:

- An offer is submitted by a taxpayer who shares living expenses with another individual who is not liable for the tax; and

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

Generally, the assets and income of a not liable person are excluded from the computation of the taxpayer's ability to pay. An exception exists for related offers that include both joint and separate liabilities, i.e., in the case of registered domestic partners. In such a case, the amount of both offers should equal the total amount collectable from the shared household.

Chapter 7 – Review Questions

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. Under which of the following circumstances will the IRS consider property owned by a business necessary to the production of income:

   a) a company owns a limousine that is occasionally used to transport large clients
   b) a company owns a vacation home where the Board of Directors meets annually
   c) a delivery company owns a truck used to make 80% of its deliveries
   d) a company owns 40 delivery trucks, 25 of which are used on a daily basis

2. For purposes of calculating the Reasonable Collection Potential, which of the following statements about how insurance policies are treated by the IRS is true:

   a) they are completely ignored since they do not pay until the insured dies
   b) the IRS believes that whole life insurance policies held as an investment is a necessary expense
   c) any cash surrender value is used to determine the taxpayer's RCP
   d) premiums for term life insurance policies are never allowed as a necessary expense

3. When calculating a taxpayer's necessary living expenses, how are the costs for housing determined by the IRS:

   a) the taxpayer is allowed to include as a necessary expense whatever his or her cost is at the time the Offer in Compromise is submitted
   b) the IRS allows the taxpayer an amount necessary for basic expenses only
   c) there is a flat rate determined annually by the IRS that applies nationwide
   d) 20% of the taxpayer's take-home pay

Chapter 7 – Solutions and Suggested Responses

1. A: Incorrect. This is clearly not instrumental to the company's income stream, and the value would be considered an asset that could be used towards repayment of tax debt under an Offer in Compromise.

   B: Incorrect. Clearly the Board can meet almost anywhere, so this is not considered property necessary for maintaining the income stream of the company.

   C: Correct. The truck in this case is needed to produce income, so the value of the truck cannot be used in calculating the ability of the company to repay its debt through an Offer in Compromise.

   D: Incorrect. Since only 25 trucks are used regularly, the IRS will likely consider the value of the remainder to be part of the repayment calculation.

   (See pages 7-5 to 7-6 of the course material.)

2. A: Incorrect. Many policies are investment vehicles with cash value and can be considered.

   B: Incorrect. The opposite is true.

   C: Correct. In cases where there is a cash value, that amount is factored in when determining a taxpayer's RCP.

   D: Incorrect. They can be allowed by the IRS in certain cases.

   (See page 7-12 of the course material.)

3. A: Incorrect. The cost may have to be adjusted down if the current expense is not considered necessary.

   B: Correct. In some cases, therefore, a taxpayer may be forced to move.

   C: Incorrect. There are rates adopted that are regional in nature that can be used as a guide, but there is no single national rate.

   D: Incorrect. There is no such percentage formula.

   (See pages 7-21 to 7-22 of the course material.)

Chapter 8: Relief from Liability for Joint Returns

I. Overview

When a couple elects to file a joint return, both taxpayers are jointly and severally liable for the tax and any additions to tax, interest, or penalties that arise as a result of the joint return, even if they later divorce. Joint and several liability means that each taxpayer is legally responsible for the entire liability. Thus, both spouses are generally held responsible for all the tax due, even if one spouse earned all the income or claimed improper deductions or credits. This is also true even if a divorce decree states that a former spouse will be responsible for any amounts due on previously filed joint returns. In some cases, however, a spouse can get relief from joint and several liability.

There are three types of relief from joint and several liability for spouses who filed joint returns:

- **Innocent Spouse Relief:** This provides the innocent relief from additional tax owed by a taxpayer if his or her spouse or former spouse failed to report income, reported income improperly, or claimed improper deductions or credits;

- **Separation of Liability Relief**: This provides for the allocation of additional tax owed between a taxpayer and his or her former spouse or current spouse from whom he or she is separated because an item was not reported properly on a joint return. The tax allocated to the taxpayer is the amount for which he or she is responsible; or

- **Equitable Relief:** This type of relief may apply when a taxpayer does not qualify for innocent spouse relief or separation of liability relief for something not reported properly on a joint return and generally attributable to his or her spouse. A taxpayer may also qualify for equitable relief if the correct amount of tax was reported on his or her joint return but the tax remains unpaid.

Married persons who did not file joint returns but who live in community property states may also qualify for relief. This will be discussed later in this chapter.

Generally, the IRS has ten years to collect federal taxes. This is the collection statute of limitations. By law, the IRS is not allowed to collect from a taxpayer after the 10-year statute ends. If a taxpayer requests relief for any tax year, the IRS cannot collect from the taxpayer for that year while the request is pending but interest and penalties continue to accrue. A taxpayer's request is generally considered pending from the date the IRS receives his or her Form 8857 until the date the request is resolved. This includes the time the Tax Court is considering the request. After the case is resolved, the IRS can begin or resume collection proceedings. The 10-year period will be increased by the amount of time the taxpayer's request for relief was pending plus 60 days.

II. Requesting Relief

A taxpayer seeking Innocent Spouse Relief must file Form 8857, a copy of which is provided at the end of this course. Taxpayers seeking relief for more than three tax years must file an additional Form 8857.

A. OVERVIEW

By requesting innocent spouse relief, a taxpayer can be relieved of responsibility for paying tax, interest, and penalties if his or her spouse (or former spouse) improperly reported items or omitted items on his or her tax return. Generally, the tax, interest, and penalties that qualify for relief can only be collected from his or her spouse (or former spouse). However, a taxpayer is jointly and individually responsible for any tax, interest, and penalties that do not qualify for relief. The IRS can collect these amounts from either spouse or former spouse.

A taxpayer must meet all of the following conditions to qualify for innocent spouse relief:

- He or she filed a joint return;
- There is an understated tax on the return that is due to erroneous items (defined later) of his or her spouse (or former spouse);
- He or she can show that when they signed the joint return he or she did not know, and had no reason to know, that the understated tax existed (or the extent to which the understated tax existed); and
- Taking into account all the facts and circumstances, it would be unfair to hold the taxpayer liable for the understated tax.

Innocent spouse relief will not be granted if the IRS proves that the taxpayer and his or her spouse (or former spouse) transferred property to one another as part of a fraudulent scheme. A fraudulent scheme includes a scheme to defraud the IRS or another third party, such as a creditor, former spouse, or business partner.

B. WHEN TO FILE

A taxpayer seeking relief should file Form 8857 as soon as he or she becomes aware of a tax liability for which he or she believes that only his or her spouse or former spouse should be liable. There are a variety of ways a taxpayer could become aware of such a liability, including the following:

- The IRS is examining his or her tax return and proposing to increase his or her tax liability; or
- The taxpayer receives a notice of assessment from the IRS.

1. <u>Two-Year Rule</u>

Form 8857 must generally be filed no later than two years after the date on which the IRS first attempted to collect the tax[1]. For this reason, a taxpayer should not delay filing because he or she does not have all the documentation.

[1] If a taxpayer is requesting relief based on community property laws, a different filing deadline applies.

Collection activities that may start the 2-year period are:

- The IRS offsets a taxpayer's income tax refund against an amount owed on a joint return for another year and the IRS informed the taxpayer about his or her right to file Form 8857;

- The filing of a claim by the IRS in a court proceeding in which the taxpayer was a party or the filing of a claim in a proceeding that involves the taxpayer's property. This includes the filing of a proof of claim in a bankruptcy proceeding;

- The filing of a suit by the United States against the taxpayer to collect the joint liability; or

- The issuance of a section 6330 notice, which notifies the taxpayer of the IRS' intent to levy and his or her right to a collection due process (CDP) hearing.

2. <u>Exception for Equitable Relief</u>

In 2011, the IRS issued Notice 2011-70[2] expanding the amount of time to request equitable relief. The amount of time to request equitable relief depends on whether the taxpayer is seeking relief from a balance due, seeking a credit or refund, or both:

- Balance Due – Generally, a taxpayer must file his or her request within the time period the IRS has to collect the tax. The IRS typically has 10 years from the date the tax liability was assessed to collect the tax. In certain cases, the 10-year period is suspended. The amount of time the suspension is in effect will extend the time the IRS has to collect the tax.

- Credit or Refund – Generally, a taxpayer must file his or her request within three years after the date the original return was filed or within two years after the date the tax was paid, whichever is later. But a taxpayer may have more time to file if he or she lives in a federally declared disaster area or he or she is physically or mentally unable to manage his or her financial affairs.

- Both a Balance Due and a Credit or Refund – If a taxpayer is seeking a refund of amounts he or she paid and relief from a balance due over and above what he or she has paid, the time period for credit or refund will apply to any payments the taxpayer has made, and the time period for collection of a balance due amount will apply to any unpaid liability.

3. <u>Form 8857 Filed by or on Behalf of a Decedent</u>

An executor (including any other duly appointed representative) may pursue a Form 8857 filed during the decedent's lifetime. An executor (including any other duly appointed representative) may also file Form 8857 as long as the decedent satisfied the eligibility requirements while alive. For purposes of separation of liability relief (discussed later), the decedent's marital status is determined on the earlier of the date relief was requested or the date of death.

[2] Available at www.irs.gov/irb/2011-32_IRB/ar11.html.

C. SITUATIONS WHERE RELIEF IS NOT AVAILABLE

A taxpayer is not entitled to innocent spouse relief for any tax year to which the following situations apply:

- In a final decision dated after July 22, 1998, a court considered whether to grant the applicant relief from joint liability and decided not to do so;

- In a final decision dated after July 22, 1998, a court did not consider whether to grant the taxpayer relief from joint liability, but the taxpayer meaningfully participated in the proceeding and could have asked for relief;

- He or she entered into an offer in compromise with the IRS; or

- He or she entered into a closing agreement with the IRS that disposed of the same liability for which he or she is seeking relief.

1. Exception for Agreements Relating to TEFRA Partnership Proceedings

A taxpayer may be entitled to relief if he or she entered into a closing agreement for both partnership items and non-partnership items, while he or she was a party to a pending TEFRA partnership proceeding[3]. A taxpayer is not entitled to relief for the non-partnership items, but will be entitled to relief for the partnership items (if he or she otherwise qualifies).

2. Transferee Liability Not Affected

The innocent spouse relief provisions do not affect tax liabilities that arise under federal or state transferee liability or property laws. Therefore, even if a taxpayer is relieved of the tax liability under the innocent spouse relief provisions, he or she may remain liable for the unpaid tax, interest, and penalties to the extent provided by these laws.

> **Example.**
>
> *Herb and Wanda timely filed their 2008 joint income tax return on April 15, 2009. Herb died in March 2010, and the executor of Herb's will transferred all of the estate's assets to Wanda. In August 2010, the IRS assessed a deficiency for the 2008 return. The items causing the deficiency belong to Herb. Wanda is relieved of the deficiency under the innocent spouse relief provisions, and Herb's estate remains solely liable for it. However, the IRS may collect the deficiency from Wanda to the extent permitted under federal or state transferee liability or property laws.*

D. IRS MUST CONTACT SPOUSE OR FORMER SPOUSE

By law, the IRS must contact a taxpayer’s spouse or former spouse when he or she files for relief as an innocent spouse. There are no exceptions to this notification requirement.

---

[3] *TEFRA* is an acronym that refers to the “Tax Equity and Fiscal Responsibility Act of 1982” that prescribed the tax treatment of partnership items.

The IRS will inform the applicant's spouse or former spouse that a Form 8857 has been filed and allow him or her to participate in the process. If the applicant is requesting relief from joint and several liability on a joint return, the IRS must also inform the spouse or former spouse of the applicant of its preliminary and final determinations regarding relief.

E. TAX COURT REVIEW OF REQUEST

After filing Form 8857, a taxpayer may be able to petition (ask) the United States Tax Court to review his or her request for relief in the following two situations:

- The IRS sends the taxpayer a final determination letter regarding his or her request for relief; or

- The taxpayer does not receive a final determination letter from the IRS within six months from the date he or she filed Form 8857.

If a taxpayer seeks equitable relief for an underpaid tax, he or she will be able to get a Tax Court review of his or her request only if the tax arose or remained unpaid on or after December 20, 2006.

A taxpayer must file a petition with the United States Tax Court in order for it to review his or her request for relief. The petition must be filed no later than the 90th day after the date the IRS mails its final determination notice. If a petition is not filed in a timely manner, the Tax Court cannot review a request for relief.

III. <u>Community Property Laws</u>

A taxpayer must generally follow community property laws when filing a tax return if he or she is married and lives in a community property state. Community property states are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin. Generally, community property laws require an individual to allocate community income and expenses equally between both spouses. However, community property laws are not taken into account in determining whether an item belongs to an individual or his or her spouse (or former spouse) for purposes of requesting any relief from tax liability.

A. RELIEF FOR MARRIED PERSONS WHO DID NOT FILE JOINT RETURNS

Married persons who live in community property states, but who did not file joint returns, have two ways to get relief.

1. <u>Relief From Liability Arising from Community Property Law</u>

A taxpayer is not responsible for the tax relating to an item of community property if all of the following are true:

- He or she did not file a joint return for the tax year(s) in question;

- He or she did not include the item of community income in gross income; and

- The item of community income the taxpayer did not include is one of the following:

    - o Wages, salaries, and other compensation his or her spouse (or former spouse) received for services he or she performed as an employee;

    - o Income his or her spouse (or former spouse) derived from a trade or business he or she operated as a sole proprietor;

    - o His or her spouse's (or former spouse's) distributive share of partnership income;

    - o Income from his or her spouse's (or former spouse's) separate property (other than income described in (a), (b), or (c)). Use the appropriate community property law to determine what is separate property; or

    - o Any other income that belongs to his or her spouse (or former spouse) under community property law.

- It is established that the taxpayer did not know of, and had no reason to know of, that community income; and

- Under all the facts and circumstances, it would not be fair to include the item of community income in the taxpayer's gross income.

2. <u>Actual Knowledge or Reason to Know</u>

A taxpayer will be deemed to have known or had reason to know of an item of community property if:

- He or she actually knew of the item of community income, or

- A reasonable person in similar circumstances would have known of the item of community income.

a. Amount of community income unknown.

If a taxpayer is aware of the source of the item of community income or the income-producing activity, but is unaware of the specific amount, he or she is considered to know or have reason to know of the item of community income. Not knowing the specific amount is not a basis for relief.

b. Reason to know.

The IRS will consider all facts and circumstances in determining whether a taxpayer had reason to know of an item of community income. The facts and circumstances include:

- The nature of the item of community income and the amount of the item relative to other income items;

- The financial situation of the taxpayer and his or her spouse (or former spouse);

- The taxpayer’s educational background and business experience; and

- Whether the item of community income represented a departure from a recurring pattern reflected in prior years' returns (for example, omitted income from an investment regularly reported on prior years' returns).

3. <u>Indications of Unfairness for Liability Arising from Community Property Law</u>

The IRS will consider all of the facts and circumstances of the case in order to determine whether it is unfair to hold a taxpayer responsible for the understated tax due to the item of community income. The following are examples of factors the IRS will consider:

- Whether the taxpayer received a benefit, either directly or indirectly, from the omitted item of community income (defined below);

- Whether his or her spouse (or former spouse) deserted the applicant seeking relief; and

- Whether the applicant and his or her spouse have been divorced or separated.

A benefit includes normal support, but does not include very small amounts. Evidence of a direct or indirect benefit may consist of transfers of property or rights to property, including transfers received several years after the filing of the return. For example, if a taxpayer received property, including life insurance proceeds, from his or her spouse (or former spouse) and the property is traceable to omitted items of community income attributable to his or her spouse (or former spouse), he or she is considered to have benefitted from those omitted items of community income.

B. EQUITABLE RELIEF

If an individual does qualify for the relief described above and is now liable for an underpaid or understated tax he or she believes should be paid only by his or her spouse (or former spouse), he or she may request equitable relief (discussed later).

A taxpayer may request relief by filing Form 8857. For relief from liability arising from community property law, a taxpayer must file Form 8857 no later than six months before the expiration of the period of limitations on assessment (including extensions) against his or her spouse for the tax year for which he or she is requesting relief. However, if the IRS begins an examination of a taxpayer’s return during that 6-month period, the latest time for requesting relief is 30 days after the date of the IRS' initial contact letter to the taxpayer. The period of limitation on assessment is the amount of time, generally three years, that the IRS has from the date a taxpayer filed the return to assess taxes that he or she owes.

IV. <u>Innocent Spouse Relief in Detail</u>

By requesting innocent spouse relief, a taxpayer can be relieved of responsibility for paying tax, interest and penalties if his or her spouse (or former spouse) improperly reported items or omitted items on his or her tax return. Generally, the tax, interest and penalties that qualify for relief can only be collected from the taxpayer’s spouse (or former spouse). However, a taxpayer is jointly and individually responsible for any tax, interest and penalties that do not qualify for relief. The IRS can collect these amounts either from the taxpayer or his or her spouse (or former spouse).

To qualify for innocent spouse relief, a taxpayer must meet all of the following conditions:

- The taxpayer filed a joint return;

- There is an understated tax on the return that is due to erroneous items of his or her spouse (or former spouse);

- The taxpayer can show that when he or she signed the joint return, he or she did not know, and had no reason to know, that the understated tax existed or the extent to which the understated tax existed; and

- Taking into account all of the facts and circumstances, it would be unfair to hold the taxpayer liable for the understated tax.

Innocent spouse relief will not be granted if the IRS proves that the applicant or his or her spouse (or former spouse) transferred property to one another as a part of a fraudulent scheme. A fraudulent scheme includes a scheme to defraud the IRS or another third party, such as a creditor, former spouse or business partner.

A. UNDERSTATED TAX

A taxpayer has an understated tax if the IRS determined that his or her total tax should be more than the amount that was actually shown on his or her return.

B. ERRONEOUS ITEMS

Erroneous items are either of the following.

1. Unreported Income

This is any gross income item received by a taxpayer’s spouse (or former spouse) that is not reported.

2. Incorrect Deduction, Credit, or Basis

This is any improper deduction, credit, or property basis claimed by a taxpayer’s spouse (or former spouse).

3. Examples

The following are examples of erroneous items:

- The expense for which the deduction is taken was never paid or incurred. For example, a taxpayer’s spouse, a cash-basis taxpayer, deducted $10,000 of advertising expenses on Schedule C of a joint Form 1040, but never paid for any advertising;

- The expense does not qualify as a deductible expense. For example, an individual's spouse claimed a business fee deduction of $10,000 that was for the payment of state fines. Fines are not deductible; or

- No factual argument can be made to support the deductibility of the expense. For example, a taxpayer's spouse claimed $4,000 for security costs related to a home office, which were actually veterinary and food costs for the family's two dogs.

C. ACTUAL KNOWLEDGE OR REASON TO KNOW

A taxpayer will be deemed to have had reason to know of an understated tax if:

- He or she actually knew of the understated tax; or

- A reasonable person in similar circumstances would have known of the understated tax.

1. Actual Knowledge

If a taxpayer actually knew about an erroneous item that belongs to his or her spouse (or former spouse), the relief discussed here does not apply to any part of the understated tax due to that item. The taxpayer and his or her spouse (or former spouse) will remain jointly liable for that part of the understated tax.

2. Reason to Know

If a taxpayer had reason to know about an erroneous item that belongs to his or her spouse (or former spouse), the relief discussed here does not apply to any part of the understated tax due to that item. The taxpayer and his or her spouse (or former spouse) will remain jointly liable for that part of the understated tax. The IRS will consider all facts and circumstances in determining whether a taxpayer had reason to know of an understated tax due to an erroneous item. The facts and circumstances include:

- The nature of the erroneous item and the amount of the erroneous item relative to other items;

- The financial situation of the taxpayer and his or her spouse (or former spouse);

- The taxpayer's educational background and business experience;

- The extent of the taxpayer's participation in the activity that resulted in the erroneous item;

- Whether the taxpayer failed to ask, at or before the time the return was signed, about items on the return or omitted from the return that a reasonable person would question; and

- Whether the erroneous item represented a departure from a recurring pattern reflected in prior years' returns (for example, omitted income from an investment regularly reported on prior years' returns).

3. Partial Relief When a Portion of Erroneous Item Is Unknown

An individual may qualify for partial relief if, at the time he or she filed his or her return, he or she had no knowledge or reason to know of only a portion of an erroneous item. The taxpayer will be relieved of the understated tax due to that portion of the item if all other requirements are met for that portion.

> **Example.**
>
> *At the time John signed his joint return, he knew that his wife did not report $5,000 of gambling winnings. The IRS examined John’s tax return several months after he filed it and determined that his spouse's unreported gambling winnings were actually $25,000. John established that he did not know about, and had no reason to know about, the additional $20,000 because of the way his wife handled gambling winnings. The understated tax due to the $20,000 will qualify for innocent spouse relief if John meets the other requirements. The understated tax due to the $5,000 of gambling winnings John knew about will not qualify for relief.*

D. INDICATIONS OF UNFAIRNESS FOR INNOCENT SPOUSE RELIEF

The IRS will consider all of the facts and circumstances of the case in order to determine whether it is unfair to hold a taxpayer responsible for the understated tax. The following are examples of factors the IRS will consider:

- Whether the taxpayer received a significant benefit (defined below), either directly or indirectly, from the understated tax;

- Whether his or her spouse (or former spouse) deserted the taxpayer;

- Whether the taxpayer and his or her spouse have been divorced or separated; and

- Whether the taxpayer received a benefit on the return from the understated tax.

1. Significant Benefit

A significant benefit is any benefit in excess of normal support. Normal support depends on a taxpayer’s particular circumstances. Evidence of a direct or indirect benefit may consist of transfers of property or rights to property, including transfers that may be received several years after the year of the understated tax.

Example.

Randi receives money from her husband that is beyond normal support. The money can be traced to Randi's husband Bob's lottery winnings that were not reported on their joint return. Randi will be considered to have received a significant benefit from that income. This is true even if Bob's spouse gives Randi the money several years after he received it.

V. Separation of Liability Relief

Under this type of relief, the understated tax (plus interest and penalties) on a taxpayer's joint return is allocated between the individual and his or her spouse (or former spouse). The understated tax allocated to the taxpayer is generally the amount he or she is responsible for. This type of relief is available only for unpaid liabilities resulting from the understated tax. Refunds are not allowed. To request separation of liability relief, a taxpayer must have filed a joint return and meets either of the following requirements at the time he or she files Form 8857:

- The taxpayer is no longer married to, or is legally separated from, the spouse with whom he or she filed the joint return for which the taxpayer is requesting relief. (Under this rule, a taxpayer is no longer married if he or she is widowed.); or
- The taxpayer is not a member of the same household (explained below) as the spouse with whom he or she filed the joint return at any time during the 12-month period ending on the date he or she filed Form 8857.

A. MEMBERS OF THE SAME HOUSEHOLD

A taxpayer and his or her spouse are not members of the same household if they are living apart and are estranged. However, a taxpayer and his or her spouse are considered members of the same household if any of the following conditions are met:

- The taxpayer and his or her spouse reside in the same dwelling;
- The taxpayer and his or her spouse reside in separate dwellings but are not estranged, and one of them is temporarily absent from the other's household as explained immediately below; or
- Either spouse is temporarily absent from the household and it is reasonable to assume that the absent spouse will return to the household, and the household or a substantially equivalent household is maintained in anticipation of the absent spouse's return. Examples of temporary absences include absence due to imprisonment, illness, business, vacation, military service, or education.

B. BURDEN OF PROOF

A taxpayer must be able to prove that he or she meets all of the requirements for separation of liability relief (except actual knowledge) and that he or she did not transfer property to avoid tax (discussed later). He or she must also establish the basis for allocating the erroneous items.

C. LIMITATIONS ON RELIEF

Even if the taxpayer meets the requirements discussed previously, separation of liability relief will not be granted in the following situations:

- The IRS proves that the applicant and his or her spouse (or former spouse) transferred assets to one another as part of a fraudulent scheme. A fraudulent scheme includes a scheme to defraud the IRS or another third party, such as a creditor, former spouse, or business partner.

- The IRS proves that at the time the applicant signed his or her joint return, he or she had actual knowledge (explained below) of any erroneous items giving rise to the deficiency that were allocable to the applicant's spouse (or former spouse).

- The applicant's spouse (or former spouse) transferred property to them to avoid tax or the payment of tax.

D. ACTUAL KNOWLEDGE

The relief discussed here does not apply to any part of the understated tax due to the taxpayer's spouse's (or former spouse) erroneous items of which the applicant had actual knowledge. The applicant and his or her spouse (or former spouse) remain jointly and severally liable for this part of the understated tax. If an applicant had actual knowledge of only a portion of an erroneous item, the IRS will not grant relief for that portion of the item.

A taxpayer is deemed to have had actual knowledge of an erroneous item if:

- He or she knew that an item of unreported income was received. (This rule applies whether or not there was a receipt of cash.);

- He or she knew of the facts that made an incorrect deduction or credit unallowable; and

- For a false or inflated deduction, he or she knew that the expense was not incurred, or not incurred to the extent shown on the tax return.

Knowledge of the source of an erroneous item is not sufficient to establish actual knowledge. Also, an individual's actual knowledge may not be inferred when that person merely had a reason to know of the erroneous item. Similarly, the IRS does not have to establish that an applicant knew of the source of an erroneous item in order to establish that he or she had actual knowledge of the item itself.

An individual's actual knowledge of the proper tax treatment of an erroneous item is not relevant for purposes of demonstrating whether he or she had actual knowledge of that item. Neither is the individual's actual knowledge of how the erroneous item was treated on the tax return. For example, if an individual knew that his or her spouse received dividend income, relief is not available for that income even if that individual did not know it was taxable.

Example.

Bill and Karen Green filed a joint return showing Karen's wages of $50,000 and Bill's self-employment income of $10,000. The IRS audited their return and found that Bill did not report $20,000 of self-employment income. The additional income resulted in a $6,000 understated tax, plus interest and penalties. After obtaining a legal separation from Bill, Karen filed Form 8857 to request separation of liability relief. The IRS proved that Karen actually knew about the $20,000 of additional income at the time she signed the joint return. Bill is liable for all of the understated tax, interest, and penalties because all of it was due to his unreported income. Karen is also liable for the understated tax, interest, and penalties due to the $20,000 of unreported income because she actually knew of the item. The IRS can collect the entire $6,000 plus interest and penalties from either Karen or Bill because they are jointly and individually liable for it.

1. <u>Factors Supporting Actual Knowledge</u>

The IRS may rely on all facts and circumstances in determining whether an applicant for relief actually knew of an erroneous item at the time he or she signed the return. The following are examples of factors the IRS may use:

- Whether the individual made a deliberate effort to avoid learning about the item in order to be shielded from liability; and

- Whether the individual and his or her spouse (or former spouse) jointly owned the property that resulted in the erroneous item.

2. <u>Exception for Spousal Abuse or Domestic Violence</u>

Even if an applicant for relief had actual knowledge, he or she may still qualify for relief if it can be established that:

- He or she was the victim of spousal abuse or domestic violence before signing the return; and

- Because of that abuse, the individual did not challenge the treatment of any items on the return because he or she was afraid his or her spouse (or former spouse) would retaliate against them.

If an applicant for relief establishes that he or she signed his or her joint return under duress (threat of harm or other form of coercion), then it is not a joint return, and that applicant is not liable for any tax shown on that return or any tax deficiency for that return. However, that applicant may be required to file a separate return for that tax year.

E. TRANSFERS OF PROPERTY TO AVOID TAX

If an applicant's spouse (or former spouse) transfers property (or the right to property) to the applicant for the main purpose of avoiding tax or payment of tax, the tax liability allocated to that applicant will be increased by the fair market value of the property on the date of the transfer. The increase may not be more than the entire amount of the liability. A transfer will be presumed to have as its main purpose the avoidance of tax or payment of tax if the transfer is made after the date that is one year before the date on which the IRS sent its first letter of proposed deficiency. This presumption will not apply if:

- The transfer was made under a divorce decree, separate maintenance agreement, or a written instrument incident to such an agreement; or

- The applicant for relief is able to establish that the transfer did not have as its main purpose the avoidance of tax or payment of tax.

If the presumption does not apply, but the IRS can establish that the purpose of the transfer was the avoidance of tax or payment of tax, the tax liability allocated to the taxpayer will be increased as explained above.

VI. Equitable Relief

If a taxpayer does not qualify for innocent spouse relief, separation of liability relief, or relief from liability arising from community property law, he or she may still be relieved of responsibility for tax, interest, and penalties through equitable relief. Unlike innocent spouse relief or separation of liability relief, a taxpayer may qualify for equitable relief from an understated tax or an underpaid tax. An underpaid tax is an amount of tax that a taxpayer properly reported on his or her return but has not paid. For example, if an individual's joint 2009 return shows that he and his wife owed $5,000 but they paid only $2,000 with the return, the individual has an underpaid tax of $3,000.

A. CONDITIONS FOR GETTING EQUITABLE RELIEF

A taxpayer may qualify for equitable relief if he or she meets all of the following conditions:

- He or she is not eligible for innocent spouse relief, separation of liability relief, or relief from liability arising from community property law;

- He or she has an understated tax or an underpaid tax;

- He or she did not pay the tax;

- He or she established that, taking into account all the facts and circumstances, it would be unfair to hold them liable for the understated or underpaid tax;

- He or she and his or her spouse (or former spouse) did not transfer assets to one another as a part of a fraudulent scheme. A fraudulent scheme includes a scheme to defraud the IRS or another third party, such as a creditor, former spouse, or business partner;

- His or her spouse (or former spouse) did not transfer property to the taxpayer for the main purpose of avoiding tax or the payment of tax;

- He or she did not file or fail to file his or her return with the intent to commit fraud; and

- The income tax liability from which the applicant is seeking relief must be attributable to an item of the spouse (or former spouse) with whom he or she filed the joint return, unless one of the following exceptions applies:

    - The item is attributable or partially attributable to the applicant for relief solely due to the operation of community property law. If an individual meets this exception, that item will be considered attributable to his or her spouse (or former spouse) for purposes of equitable relief;

    - If the item is titled in the applicant's name, the item is presumed to be attributable to the taxpayer. However, an individual can rebut this presumption based on the facts and circumstances;

    - He or she did not know, and had no reason to know, that funds intended for the payment of tax were misappropriated by his or her spouse (or former spouse) for his or her benefit. If the individual meets this exception, the IRS will consider granting equitable relief although the underpaid tax may be attributable in part or in full to the taxpayer's item, and only to the extent the funds intended for payment were taken by his or her spouse (or former spouse); or

    - He or she established that they were the victim of spousal abuse or domestic violence before signing the return, and that, as a result of the prior abuse, he or she did not challenge the treatment of any items on the return for fear of his or her spouse's (or former spouse's) retaliation. If an individual meets this exception, relief will be considered although the understated tax or underpaid tax may be attributable in part or in full to the taxpayer's item.

B. FACTORS IN DETERMINING WHETHER TO GRANT EQUITABLE RELIEF

The IRS will consider all of the facts and circumstances in order to determine whether it is unfair to hold an applicant for relief responsible for the understated or underpaid tax. The following are examples of factors that the IRS will consider to determine whether to grant equitable relief. The IRS will consider all factors and weigh them appropriately.

1. <u>Relevant Factors</u>

The following are examples of factors that may be relevant to whether the IRS will grant equitable relief.

- Whether the applicant for relief is separated (whether legally or not) or divorced from his or her spouse. A temporary absence, such as an absence due to imprisonment, illness, business, vacation, military service, or education, is not considered separation for this purpose. A temporary absence is one where it is reasonable to assume that the absent spouse will return to the household, and the household or a substantially equivalent household is maintained in anticipation of the absent spouse's return;

- Whether the applicant for relief would suffer a significant economic hardship if relief is not granted. (In other words, that individual would not be able to pay his or her reasonable basic living expenses.);

- Whether the applicant for relief has a legal obligation under a divorce decree or agreement to pay the tax. This factor will not weigh in favor of relief if the individual knew or had reason to know, when entering into the divorce decree or agreement, that his or her former spouse would not pay the income tax liability;

- Whether the individual received a significant benefit (beyond normal support) from the underpaid tax or item causing the understated tax;

- Whether the individual has made a good faith effort to comply with federal income tax laws for the tax year for which he or she is requesting relief or the following years; and

- Whether the individual knew or had reason to know about the items causing the understated tax or that the tax would not be paid, as explained next.

2. Knowledge or Reason to Know

In the case of an underpaid tax, the IRS will consider whether an applicant for relief did not know and had no reason to know that his or her spouse (or former spouse) would not pay the income tax liability.

In the case of an income tax liability that arose from an understated tax, the IRS will consider whether the applicant seeking relief did not know and had no reason to know of the item causing the understated tax. Reason to know of the item giving rise to the understated tax will not be weighed more heavily than other factors. Actual knowledge of the item giving rise to the understated tax, however, is a strong factor weighing against relief. This strong factor may be overcome if the factors in favor of equitable relief are particularly compelling.

In determining whether an applicant for relief had reason to know, the IRS will consider the individual’s level of education, any deceit or evasiveness of his or her spouse (or former spouse), applicant’s degree of involvement in the activity generating the income tax liability, his or her involvement in business and household financial matters, his or her business or financial expertise, and any lavish or unusual expenditures compared with past spending levels.

Example.

Linda and Mike, a married couple, filed a joint 2009 return. That return showed that Mike owed $10,000. Linda had $5,000 of her own money and she took out a loan to pay the other $5,000. Linda gave two checks for $5,000 each to Mike to pay the $10,000 liability. Without telling Linda, Mike took the $5,000 loan and spent it on himself. Linda and Mike were divorced in 2010. In addition, Linda had no knowledge or reason to know at the time she signed the return that the tax would not be paid. These facts indicate to the IRS that it may be unfair to hold Linda liable for the $5,000 underpaid tax. The IRS will consider these facts, together with all of the other facts and circumstances, to determine whether to grant Linda equitable relief from the $5,000 underpaid tax.

3. Factors Weighing in Favor of Equitable Relief

The following are examples of factors that will weigh in favor of equitable relief, but will not weigh against equitable relief:

- Whether the applicant's spouse (or former spouse) abused them; and
- Whether the applicant was in poor mental or physical health on the date he or she signed the return or at the time he or she requested relief.

VII. Refunds

If an applicant is granted relief, refunds are:

- Permitted under innocent spouse relief;
- Not permitted under separation of liability relief; and
- Permitted in limited circumstances under equitable relief.

A. PROOF REQUIRED

The IRS will only refund payments an applicant made with his or her own money. However, the applicant must provide proof that he or she made the payments with his or her own money. Examples of proof are a copy of a bank statement or a canceled check. No proof is required if the individual's refund was used by the IRS to pay a tax the individual owed on a joint tax return for another year.

B. REFUNDS UNDER EQUITABLE RELIEF

In the following situations, a taxpayer is eligible to receive a refund of certain payments he or she made.

1. Underpaid Tax

If a taxpayer is granted relief for an underpaid tax, he or she is eligible for a refund of separate payments that he or she made after July 22, 1998. However, an individual is not eligible for refunds of payments made with the joint return, joint payments, or payments that his or her spouse (or former spouse) made. For example, withholding tax and estimated tax payments cannot be refunded because they are considered made with the joint return.

2. Understated Tax

If a taxpayer is granted relief for an understated tax, he or she is eligible for a refund of certain payments made under an Installment Agreement that was entered into with the IRS, if he or she has not defaulted on the Installment Agreement. A taxpayer is not in default if the IRS did not issue a notice of default or take any action to end the Installment Agreement. Only installment payments made after the date the taxpayer filed Form 8857 are eligible for a refund.

3. Limit on Amount of Refund

The amount of a refund is limited, as shown on Table 8.1 below:

Table 8.1. Limited on Amount of Refund.

IF the applicant for relief filed Form 8857...	**THEN the refund cannot be more than...**
Within three years after filing his or her return	The part of the tax paid within three years (plus any extension of time for filing his or her return) before he or she filed Form 8857.
After the 3-year period, but within two years from the time he or she paid the tax	The tax the taxpayer paid within two years immediately before he or she filed Form 8857.

VIII. Specific Instructions for Completing Form 8857

Lines 1 through 5

The taxpayer **must** complete lines 1 through 5 to determine if he or she should file Form 8857.

Line 2

The taxpayer must indicate that he or she wants a refund in order for the IRS to consider whether he or she is entitled to it. If the taxpayer is granted relief, refunds are:

- Permitted under innocent spouse relief as explained later under *Limit on Amount of Refund*.
- Not permitted under separation of liability relief.
- Permitted in limited circumstances under equitable relief, as explained under *Refunds Under Equitable Relief* later.

Proof Required. The IRS will only refund payments the taxpayer made with his or her own money. However, the taxpayer must provide proof that he or she made the payments with his or her own money. Examples of proof are a copy of a bank statement or a canceled check. No proof is required if the taxpayer's individual refund was used by the IRS to pay a tax he or she owed on a joint return for another year.

Refunds Under Equitable Relief. In the following situations, the taxpayer is eligible to receive a refund of certain payments he or she made.

- **Underpaid tax.** If the taxpayer is granted relief for an underpaid tax, he or she is eligible for a refund of separate payments that were made after July 22, 1998. However, the taxpayer is not eligible for refunds of payments that his or her spouse (or former spouse) made. For example, withholding tax and estimated tax payments cannot be refunded because they are considered made with the joint return.

  The amount of the refund is subject to the limit discussed later under *Limit on Amount of Refund.*

- **Understated Tax**. If the taxpayer is granted relief for an understated tax, he or she is eligible for a refund of certain payments made under an Installment Agreement that was entered into with the IRS, if the taxpayer has not defaulted on the Installment Agreement. The taxpayer is not in default if the IRS did not issue a notice of default or take any action to end the Installment Agreement.

  The amount of the refund is subject to the limit discussed next.

Line 3

Check "Yes" for any tax year to which all of the following apply.

- The taxpayer filed a joint return for the year listed on line 1.

- At the time the taxpayer filed the joint return, his or her spouse owed past-due federal tax, state income tax, spousal support, or federal non-debt tax, such as a student loan.

- The IRS used (offset) the refund to pay the taxpayer's spouse's past-due amount.

If all three of the above apply, do not file Form 8857 for that tax year. However, the taxpayer may be able to get back his or her share of the refund for the tax year if he or she files Form 8379, Injured Spouse Allocation.

If all three of the above do not apply, check “No and go to line 4.

Line 4

Check “Yes” if a return claiming married filing jointly status was filed for the tax year listed on line 1. Check “yes” even if the taxpayer signed the return under duress or his or her signature was forged.

Line 6

Enter the taxpayer’s current name, social security number, current mailing address and best daytime phone number. Also enter the taxpayer’s county.

If the taxpayer’s current name is different from the name as shown on his or her tax return for any year for which he or she is requesting relief, enter the former name in parentheses after his or her current name. For example, enter “Jane Maple (formerly Jane Oak).”

Foreign address. Enter the information in the following order: city, province or state, and country. Follow the country’s practice for entering the postal code. Do not abbreviate the country name.

Change of address. If the taxpayer moves after he or she files Form 8857, use form 8822, Change of Address, to notify the IRS of the new address.

Line 7

Enter the taxpayer’s current name and SSN (if known) of the person to whom the taxpayer was married at the end of the year(s) listed on line 1.

P.O. Box. Enter the box number only if: You do not know the street address, or the Post Office does not deliver mail to the street address.

Foreign address. See instructions for line 6 above.

Line 12

By law, if a person’s name is signed to a return, it is presumed to be signed by that person. The taxpayer must prove that his or her signature on a joint return was forged or that he or she signed under duress (threat of harm or other form of coercion). Attach a statement explaining why the taxpayer believes his or her signature was forged or signed under duress.

Forged signature. The taxpayer’s signature on a joint return is considered to be forged if it was not signed by him or her and he or she did not authorize (give tacit consent) the signing of his or her name to the return.

Tacit consent. Tacit consent means that, based on his or her actions at the time the joint return was filed, the taxpayer agreed to the filing of the joint return even though the taxpayer now claims the signature on the return was not theirs. Whether he or she tacitly consented to the filing of the joint return is based on an examination of all the facts of the case. Factors that might support a finding that the taxpayer consented to the filing of the joint return include the following:

- The taxpayer gave tax information (such as Forms W-2 and 1099) to his or her spouse.
- The taxpayer did not object to the following:
  - There was an apparent advantage to the taxpayer in filing a joint return.
  - The taxpayer filed joint returns with his or her spouse or former spouse in prior years.
  - The taxpayer failed to file a married filing separate return and he or she had a filing requirement.

Signing under duress. An individual is considered to have signed under duress (threat of harm or other form of coercion) if he or she was unable to resist demands to sign the return and would not have signed the return except for the constraint applied by his or her spouse or former spouse. The duress must be directly connected with the signing of the joint return.

Line 20

The taxpayer may not be entitled to relief if either of the following applies:

- His or her spouse (or former spouse) transferred property (or the right to property) to the taxpayer for the main purpose of avoiding tax or payment of tax. A transfer will be presumed to meet this condition if the transfer is made after the date that is one year before the date on which the IRS sent its first letter of proposed deficiency.
- The IRS proves that the taxpayer and his or her spouse (or former spouse) transferred property to one another as part of a fraudulent scheme. A fraudulent scheme includes a scheme to defraud the IRS or another third party such as a creditor, former spouse, or business partner.

Fair market value. Fair market value is the price at which property would change hands between a willing buyer and a willing seller when both have reasonable knowledge of the relevant facts and neither has to buy or sell.

Line 23

See the instructions for line 20 for the definition of fair market value.

Sign Form 8857. If the taxpayer does not sign Form 8857, the IRS cannot consider his or her request and will return it to the taxpayer. Also be sure to date it.

CHAPTER 8 – REVIEW QUESTIONS

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. Which one of the following is <u>not</u> a condition that must be met in order for a spouse to seek innocent spouse relief:

   a) the taxpayer filed individually
   b) the taxpayer filed jointly
   c) the taxpayer can prove that when he or she signed the joint return, he or she did not have knowledge of the underrepresented amounts
   d) it is clear that the taxpayer should not be held responsible for the underrepresented amounts that the taxpayer's spouse reported

2. When determining whether or not a taxpayer had knowledge of an item of community income, the IRS will take into consideration all of the following <u>except</u>:

   a) the taxpayer's financial situation
   b) the taxpayer's educational background
   c) the nature of the item
   d) the sentimental value of the item

3. If a taxpayer had knowledge of only a portion of an erroneous item listed on a joint tax return that he or she signed but later the IRS determined that amount to be significantly more, the taxpayer is responsible for paying taxes on:

   a) the entire amount of the erroneous item that was underreported
   b) his or her half of the total amount that was misrepresented
   c) only the portion of the erroneous item that the taxpayer had knowledge of
   d) none of the erroneous amount; the taxpayer's spouse is responsible for the entire amount

4. If a taxpayer can prove that his or her joint tax return was signed under duress, he or she is still liable for:

   a) the entire amount of unpaid taxes for that year's tax return
   b) the entire amount of delinquent taxes for that year's tax return
   c) only the portion of unpaid taxes that the taxpayer had knowledge of
   d) neither the tax amount owing nor any delinquent taxes for that year

CHAPTER 8 – SOLUTIONS AND SUGGESTED RESPONSES

1. **A: Correct.** The taxpayer must have filed jointly in order to qualify for innocent spouse relief.

   B: Incorrect. Filing jointly is one of the requirements to qualify for innocent spouse relief.

   C: Incorrect. In order to be able to qualify for innocent spouse relief, the taxpayer needs to be able to show that he or she had no knowledge or recollection of the existence of the understated tax.

   D: Incorrect. One of the requirements to qualify for innocent tax relief is that it needs to be obvious that the taxpayer should not be responsible for the understated tax.

   (See page 8-2 of the course material.)

2. A: Incorrect. The taxpayer's financial situation is taken into consideration when the IRS is determining whether or not he or she had knowledge of an item of community income.

   B: Incorrect. When the IRS is determining if a taxpayer knew of an item of community income, his or her educational background is taken into account.

   C: Incorrect. The nature of the item is considered when the IRS is deciding whether or not the taxpayer had knowledge of the item of community income.

   D: Correct. An item's sentimental value is not taken into consideration when the IRS is determining whether or not the taxpayer had knowledge of the item of community income.

   (See page 8-6 to 8-7 of the course material.)

3. A: Incorrect. The taxpayer is not responsible for paying taxes on the entire amount that was underreported on a joint return; the taxpayer is only responsible for the portion he or she had knowledge of.

   B: Incorrect. Even though a joint return was filed, the taxpayer is only responsible for paying taxes on the amount of the erroneous item that he or she was aware of.

   C: Incorrect. The taxpayer's knowledge of the portion of the erroneous item that was understated makes him or her accountable for paying taxes on that portion.

   D: Incorrect. The taxpayer's spouse is responsible for paying taxes on the entire amount of an erroneous item on a joint return if the taxpayer can prove that he or she had absolutely no knowledge of it.

   (See page 8-10 of the course material.)

4. A: Incorrect. If a taxpayer can prove that he or she signed a joint tax return under duress, the tax return is considered not a joint return and the taxpayer is not responsible for any of the tax owing on that return.

   B: Incorrect. If a taxpayer signed a joint tax return under duress, he or she is not responsible for any of the delinquent taxes owing on that joint tax return.

   C: Incorrect. The taxpayer is not responsible for any portion owing on a joint tax return that the taxpayer signed under duress.

   D: Correct. If a taxpayer signed his or her joint return under duress, he or she is not liable for any tax amount owing on that return whether it is delinquent or not.

   (See page 8-13 of the course material.)

Chapter 9: Resolving Delinquent Taxes Via Bankruptcy

Not surprisingly, an individual who is delinquent on his or her federal taxes often faces other debts, including late mortgage payments and credit card debt. There may, therefore, be circumstances when a CPA should recommend that his or her client consider filing for bankruptcy protection. Bankruptcy protection addresses all types of debt, including federal taxes. Before doing so, CPAs must understand the type of jurisdiction bankruptcy courts have over tax matters, particularly federal income tax. Bankruptcy is a major undertaking that can have a significant impact on the individual’s credit and should not be entered into lightly. On the other hand, there is also damage to an individual’s credit when he or she is the subject of a federal tax lien. Before declaring bankruptcy, CPAs should help their clients explore all other tax resolution options discussed in this course, including requesting abatement of penalties, installment agreements, innocent spouse relief, and an Offer in Compromise.

The primary tax-related downside to filing for bankruptcy protection is the additional collection time it allows the IRS: The collection statute of limitations is suspended while a bankruptcy is in process. Chapter 7 proceedings usually take four to six months. However, this is a concern only when the taxpayer emerges from a bankruptcy still owing the IRS. Once taxes are assessed, the IRS normally has a total of 10 years to collect them, along with penalties and interest. Therefore, once a bankruptcy case is over, the IRS retains whatever time remaining on the original 10 years, plus the time the bankruptcy case was pending, plus an additional six months under Internal Revenue Code Section 6503(h)(2)).

I. Overview of Major Bankruptcy Chapters

A. CHAPTER 7

One of the primary purposes of bankruptcy is to discharge certain debts to give an honest individual debtor a "fresh start." Generally, in a Chapter 7 case, the bankruptcy trustee gathers and sells the debtor's nonexempt assets and uses the proceeds of such assets to pay creditors in accordance with the provisions of the Bankruptcy Code. Part of the debtor's property may be subject to liens and mortgages that pledge the property to other creditors. In addition, the Bankruptcy Code will allow the debtor to keep certain "exempt" property; but a trustee will liquidate the debtor's remaining assets. Accordingly, potential debtors should realize that the filing of a petition under Chapter 7 may result in the loss of property.

1. Chapter 7 Eligibility

To qualify for relief under Chapter 7 of the Bankruptcy Code, the debtor may be an individual, a partnership, a corporation, or other business entity. Subject to the “means test”, relief is available under Chapter 7 irrespective of the amount of the debtor's debts or whether the debtor is solvent or insolvent. An individual cannot file under Chapter 7 or any other Chapter, however, if during the preceding 180 days a prior bankruptcy petition was dismissed due to the debtor's willful failure to appear before the court or comply with orders of the court, or the debtor voluntarily dismissed the previous case after creditors sought relief from the bankruptcy court to recover property upon which they hold liens.

In addition, no individual may be a debtor under Chapter 7 or any chapter of the Bankruptcy Code unless he or she has, within 180 days before filing, received credit counseling from an approved credit counseling agency either in an individual or group briefing. There are exceptions in emergency situations or where the U.S. trustee (or bankruptcy administrator) has determined that there are insufficient approved agencies to provide the required counseling. If a debt management plan is developed during required credit counseling, it must be filed with the court.

Table 9.1. Overview of Major Bankruptcy Chapters*.

Chapter	**Eligible Persons/Entities**	**Basic Overview**
Chapter 7	Individuals, partnerships, corporations, or other business entities	This is liquidation bankruptcy. All of the debtor's non-exempt property is sold and proceeds distributed to creditors to satisfy a portion of the debt. Once the proceeds are disbursed, there is no further repayment required by the debtor, though some of the debtor's property may be subject to liens.
Chapter 11	Individuals or businesses	Reorganization bankruptcy, usually involving a corporation or partnership. Can be filed by the debtor or creditor, i.e., voluntary or involuntary (forced by creditors). Goal is to keep the business alive and allow the debtor to repay at least a portion of debts over time.
Chapter 13	Reorganization for individuals with regular income	Allows an individual debtor to keep his or her property and repay debts over time. There is a cap on the amount of debt for individuals to be eligible. The debtor makes periodic payments to the bankruptcy trustee who then distributes payments to creditors.

**Two other bankruptcy chapters are Chapter 9, which applies to municipalities such as a city or county and Chapter 12, which addresses debtors who are family farmers or family fishermen.*

2. The Mechanics of Chapter 7

A Chapter 7 case begins with the debtor filing a petition with the Bankruptcy Court serving the area where the individual lives or where the business debtor is organized or has its principal place of business or principal assets. Debtors must also provide the assigned case trustee with a copy of the tax return or transcripts for the most recent tax year as well as tax returns filed during the case (including tax returns for prior years that had not been filed when the case began).

Commencement of a bankruptcy case creates an "estate." The estate technically becomes the temporary legal owner of all the debtor's property. It consists of all legal or equitable interests of the debtor in property as of the commencement of the case, including property owned or held by another person if the debtor has an interest in the property. Generally speaking, the debtor's creditors are paid from nonexempt property of the estate.

An individual debtor with primarily consumer debts has additional document filing requirements. He or she must file: a certificate of credit counseling and a copy of any debt repayment plan developed through credit counseling; evidence of payment from employers, if any, received 60 days before filing; a statement of monthly net income and any anticipated increase in income or expenses after filing; and a record of any interest the debtor has in federal or state qualified education or tuition accounts. A husband and wife may file a joint petition or individual petitions. Even if filing jointly, a husband and wife are subject to all the document filing requirements of individual debtors.

As with the other chapters, there is a case filing fee associated with filing a bankruptcy petition. If the debtor's income is less than 150% of the poverty level (as defined in the Bankruptcy Code), and the debtor is unable to pay the Chapter 7 fees even in installments, the court may waive the requirement that the fees be paid.

In order to complete the Official Bankruptcy Forms that make up the petition, statement of financial affairs, and schedules, the debtor must provide the following information:

- A list of all creditors and the amount and nature of the claims;
- The source, amount, and frequency of the debtor's income;
- A list of all of the debtor's property; and
- A detailed list of the debtor's monthly living expenses, i.e., food, clothing, shelter, utilities, taxes, transportation, medicine, etc.

Married individuals must gather this information for his or her spouse regardless of whether he or she is filing a joint petition, separate individual petitions, or even if only one spouse is filing. In a situation where only one spouse files, the income and expenses of the non-filing spouse are required so that the court, the trustee and creditors can evaluate the household's financial position.

Among the schedules that an individual debtor will file is a schedule of "exempt" property. The Bankruptcy Code allows an individual debtor to protect some property from the claims of creditors because it is exempt under federal bankruptcy law or under the laws of the debtor's home state. Many states have taken advantage of a provision in the Bankruptcy Code that permits each state to adopt its own exemption law in place of the federal exemptions. In other jurisdictions, the individual debtor has the option of choosing between a federal package of exemptions or the exemptions available under state law. Thus, whether certain property is exempt and may be kept by the debtor is often a question of state law. The debtor should consult an attorney to determine the exemptions available in the state where the debtor lives.

3. Automatic Stay

Filing a petition under chapter 7 "automatically stays" most collection actions against the debtor or the debtor's property. The stay arises by operation of law and requires no judicial action. As long as the stay is in effect, creditors generally may not initiate or continue lawsuits, wage garnishments, or even telephone calls demanding payments. The bankruptcy clerk gives notice of the bankruptcy case to all creditors whose names and addresses are provided by the debtor.

Between 21 and 40 days after the petition is filed, the case trustee will hold a meeting of creditors. If the U.S. trustee or bankruptcy administrator schedules the meeting at a place that does not have regular U.S. trustee or bankruptcy administrator staffing, the meeting may be held no more than 60 days after the order for relief. During this meeting, the trustee puts the debtor under oath, and both the trustee and creditors may ask questions. The debtor must attend the meeting and answer questions regarding the debtor's financial affairs and property. If a husband and wife have filed a joint petition, they both must attend the creditors' meeting and answer questions.

It is important for the debtor to cooperate with the trustee and to provide any financial records or documents that the trustee requests. The Bankruptcy Code requires the trustee to ask the debtor questions at the meeting of creditors to ensure that the debtor is aware of the potential consequences of seeking a discharge in bankruptcy such as the effect on credit history, the ability to file a petition under a different chapter, the effect of receiving a discharge, and the effect of reaffirming a debt. Some trustees provide written information on these topics at or before the meeting to ensure that the debtor is aware of this information. In order to preserve their independent judgment, bankruptcy judges are prohibited from attending the meeting of creditors.

4. Role of the Trustee

When a Chapter 7 petition is filed, the U.S. trustee appoints an impartial case trustee to administer the case and liquidate the debtor's nonexempt assets. If all the debtor's assets are exempt or subject to valid liens, the trustee will normally file a "no asset" report with the court, and there will be no distribution to unsecured creditors. Most Chapter 7 cases involving individual debtors are no asset cases. But if the case appears to be an "asset" case at the outset, unsecured creditors must file their claims with the court within 90 days after the first date set for the meeting of creditors. A governmental unit (i.e., the IRS), however, has 180 days from the date the case is filed to file a claim.

In the typical no asset Chapter 7 case, there is no need for creditors to file proofs of claim because there will be no distribution. If the trustee later recovers assets for distribution to unsecured creditors, the Bankruptcy Court will provide notice to creditors and will allow additional time to file proofs of claim. Although a secured creditor does not need to file a proof of claim in a Chapter 7 case to preserve its security interest or lien, there may be other reasons to file a claim. A creditor in a Chapter 7 case who has a lien on the debtor's property should consult an attorney for advice.

The primary role of a Chapter 7 trustee in an asset case is to liquidate the debtor's nonexempt assets in a manner that maximizes the return to the debtor's unsecured creditors. The trustee accomplishes this by selling the debtor's property if it is free and clear of liens (as long as the property is not exempt) or if it is worth more than any security interest or lien attached to the property and any exemption that the debtor holds in the property. The trustee may also attempt to recover money or property under the trustee's "avoiding powers." The trustee's avoiding powers include the power to:

- Set aside preferential transfers made to creditors within 90 days before the petition;
- Undo security interests and other prepetition transfers of property that were not properly perfected under nonbankruptcy law at the time of the petition; and
- Pursue nonbankruptcy claims such as fraudulent conveyance and bulk transfer remedies available under state law.

In addition, if the debtor is a business, the bankruptcy court may authorize the trustee to operate the business for a limited period of time, if such operation will benefit creditors and enhance the liquidation of the estate.

5. Distribution of Assets to Creditors

Section 726 of the Bankruptcy Code governs the distribution of the property of the estate. Under § 726, there are six classes of claims; and each class must be paid in full before the next lower class is paid anything. The debtor is only paid if all other classes of claims have been paid in full. Accordingly, the debtor is not particularly interested in the trustee's disposition of the estate assets, except with respect to the payment of those debts which for some reason are not dischargeable in the bankruptcy case. The individual debtor's primary concerns in a Chapter 7 case are to retain exempt property and to receive a discharge that covers as many debts as possible.

6. Discharge Under Chapter 7

A discharge releases individual debtors from personal liability for most debts and prevents the creditors owed those debts from taking any collection actions against the debtor. Because a Chapter 7 discharge is subject to many exceptions, debtors should consult competent legal counsel before filing to discuss the scope of the discharge. Generally, excluding cases that are dismissed or converted, individual debtors receive a discharge in more than 99 percent of Chapter 7 cases. In most cases, unless a party in interest files a complaint objecting to the discharge or a motion to extend the time to object, the bankruptcy court will issue a discharge order relatively early in the case – generally, 60 to 90 days after the date first set for the meeting of creditors.

The grounds for denying an individual debtor a discharge in a Chapter 7 case are narrow. Among other reasons, the court may deny the debtor a discharge if it finds that the debtor:

- Failed to keep or produce adequate books or financial records;
- Failed to explain satisfactorily any loss of assets;
- Committed a bankruptcy crime such as perjury;
- Failed to obey a lawful order of the bankruptcy court;
- Fraudulently transferred, concealed, or destroyed property that would have become property of the estate; or
- Failed to complete an approved instructional course concerning financial management.

7. Reaffirmation of Certain Debts

Secured creditors may retain some rights to seize property securing an underlying debt even after a discharge is granted. Depending on individual circumstances, if a debtor wishes to keep certain secured property (such as an automobile), he or she may decide to "reaffirm" the debt. A reaffirmation is an agreement between the debtor and the creditor that the debtor will remain liable and will pay all or a portion of the money owed, even though the debt would otherwise be discharged in the bankruptcy. In return, the creditor promises that it will not repossess or take back the automobile or other property so long as the debtor continues to pay the debt.

If the debtor decides to reaffirm a debt, he or she must do so before the discharge is entered. The debtor must sign a written reaffirmation agreement and file it with the court. The Bankruptcy Code requires that reaffirmation agreements contain an extensive set of disclosures described in the Bankruptcy Code[1]. Among other things, the disclosures must advise the debtor of the amount of the debt being reaffirmed and how it is calculated and that reaffirmation means that the debtor's personal liability for that debt will not be discharged in the bankruptcy. The disclosures also require the debtor to sign and file a statement of his or her current income and expenses which shows that the balance of income paying expenses is sufficient to pay the reaffirmed debt. If the balance is not enough to pay the debt to be reaffirmed, there is a presumption of undue hardship, and the court may decide not to approve the reaffirmation agreement. Unless the debtor is represented by an attorney, the bankruptcy judge must approve the reaffirmation agreement.

8. Effect of Discharge/Remaining Debts

If an individual receives a discharge for most of his or her debts in a Chapter 7 bankruptcy case, a creditor may no longer initiate or continue any legal or other action against the debtor to collect a discharged debt. But not all of an individual's debts are discharged in Chapter 7. Debts not discharged include debts for alimony and child support, certain taxes, debts for certain educational benefit overpayments or loans made or guaranteed by a governmental unit, debts for willful and malicious injury by the debtor

[1] 11 U.S.C. § 524(k).

to another entity or to the property of another entity, debts for death or personal injury caused by the debtor's operation of a motor vehicle while the debtor was intoxicated from alcohol or other substances, and debts for certain criminal restitution orders. The debtor will continue to be liable for these types of debts to the extent that they are not paid in the Chapter 7 case. Debts for money or property obtained by false pretenses, debts for fraud or defalcation while acting in a fiduciary capacity, and debts for willful and malicious injury by the debtor to another entity or to the property of another entity, will be discharged unless a creditor timely files and prevails in an action to have such debts declared non-dischargeable.

9. Revocation of Discharge

The court may revoke a Chapter 7 discharge on the request of the trustee, a creditor, or the U.S. trustee if the discharge was obtained through fraud by the debtor, if the debtor acquired property that is property of the estate and knowingly and fraudulently failed to report the acquisition of such property or to surrender the property to the trustee, or if the debtor (without a satisfactory explanation) makes a material misstatement or fails to provide documents or other information in connection with an audit of the debtor's case.

B. CHAPTER 11

A case filed under chapter 11 of the United States Bankruptcy Code is frequently referred to as a "reorganization" bankruptcy.

An individual cannot file under Chapter 11 or any other chapter if, during the preceding 180 days, a prior bankruptcy petition was dismissed due to the debtor's willful failure to appear before the court or comply with orders of the court, or was voluntarily dismissed after creditors sought relief from the bankruptcy court to recover property upon which they hold liens. In addition, no individual may be a debtor under Chapter 11 or any chapter of the Bankruptcy Code unless he or she has, within 180 days before filing, received credit counseling from an approved credit counseling agency either in an individual or group briefing. There are exceptions in emergency situations or where the U.S. trustee (or bankruptcy administrator) has determined that there are insufficient approved agencies to provide the required counseling. If a debt management plan is developed during required credit counseling, it must be filed with the court.

1. Filing of Voluntary or Involuntary Petition

A Chapter 11 case begins with the filing of a petition with the bankruptcy court serving the area where the debtor has a domicile or residence. A petition may be a voluntary petition, which is filed by the debtor, or it may be an involuntary petition, which is filed by creditors that meet certain requirements. Unless the court orders otherwise, the debtor also must file with the court: (1) schedules of assets and liabilities; (2) a schedule of current income and expenditures; (3) a schedule of executory contracts and unexpired leases; and (4) a statement of financial affairs. If the debtor is an individual (or husband and wife), there are additional document filing requirements. Such debtors must file: a certificate of credit counseling and a copy of any debt repayment plan developed through credit counseling; evidence of payment from employers, if any, received 60 days before filing; a statement of monthly net income and any anticipated increase in income or expenses after filing; and a record of any interest the debtor has in federal or state qualified education or tuition accounts. A husband and wife may file a joint petition or individual petitions.

As with other chapters, there are filing fees and administrative fees the court must assess. The fees must be paid to the clerk of the court upon filing or may, with the court's permission, be paid by individual debtors in installments. The final installment must be paid not later than 120 days after filing the petition. For cause shown, the court may extend the time of any installment, provided that the last installment is paid not later than 180 days after the filing of the petition. If a joint petition is filed, only one filing fee and one administrative fee are charged. Debtors should be aware that failure to pay these fees may result in dismissal of the case.

2. Debtor in Possession

The voluntary petition will include standard information concerning the debtor's name(s), social security number or tax identification number, residence, location of principal assets (if a business), the debtor's plan or intention to file a plan, and a request for relief under the appropriate chapter of the Bankruptcy Code. Upon filing a voluntary petition for relief under Chapter 11 or, in an involuntary case, the entry of an order for relief, the debtor automatically assumes an additional identity as the "debtor in possession." The term refers to a debtor that keeps possession and control of its assets while undergoing a reorganization under Chapter 11, without the appointment of a case trustee. A debtor will remain a debtor in possession until the debtor's plan of reorganization is confirmed, the debtor's case is dismissed or converted to Chapter 7, or a Chapter 11 trustee is appointed. The appointment or election of a trustee occurs only in a small number of cases. Generally, the debtor, as "debtor in possession," operates the business and performs many of the functions that a trustee performs in cases under other chapters.

3. Plan of Reorganization

Generally, a written disclosure statement and a plan of reorganization must be filed with the court. The disclosure statement is a document that must contain information concerning the assets, liabilities, and business affairs of the debtor sufficient to enable a creditor to make an informed judgment about the debtor's plan of reorganization. Information required is governed by judicial discretion and the circumstances of the case. In a "small business case", the debtor may not need to file a separate disclosure statement if the court determines that adequate information is contained in the plan. The contents of the plan must include a classification of claims and must specify how each class of claims will be treated under the plan. Creditors whose claims are "impaired," i.e., those whose contractual rights are to be modified or who will be paid less than the full value of their claims under the plan, vote on the plan by ballot. After the disclosure statement is approved by the court and the ballots are collected and tallied, the court will conduct a confirmation hearing to determine whether to confirm the plan.

In the case of individuals, Chapter 11 bears some similarities to Chapter 13, discussed below. For example, property of the estate for an individual debtor includes the debtor's earnings and property acquired by the debtor after filing until the case is closed, dismissed or converted; funding of the plan may be from the debtor's future earnings; and the plan cannot be confirmed over a creditor's objection without committing all of the debtor's disposable income over five years unless the plan pays the claim in full, with interest, over a shorter period of time.

4. Reorganization of Business

Chapter 11 is typically used to reorganize a business, which may be a corporation, sole proprietorship, or partnership. A corporation exists separate and apart from its owners, the stockholders. The Chapter 11 bankruptcy case of a corporation (corporation as debtor) does not put the personal assets of the stockholders at risk other than the value of their investment in the company's stock. A sole proprietorship (owner as debtor), on the other hand, does not have an identity separate and distinct from its owner(s). Accordingly, a bankruptcy case involving a sole proprietorship includes both the business and personal assets of the owners-debtors. Like a corporation, a partnership exists separate and apart from its partners. In a partnership bankruptcy case (partnership as debtor), however, the partners' personal assets may, in some cases, be used to pay creditors in the bankruptcy case or the partners, themselves, may be forced to file for bankruptcy protection.

Section 1107 of the Bankruptcy Code places the debtor in possession in the position of a fiduciary, with the rights and powers of a Chapter 11 trustee, and it requires the debtor to perform all but the investigative functions and duties of a trustee. These duties, set forth in the Bankruptcy Code and Federal Rules of Bankruptcy Procedure, include accounting for property, examining and objecting to claims, and filing informational reports as required by the court and the U.S. trustee or bankruptcy administrator (discussed below), such as monthly operating reports. The debtor in possession also has many of the other powers and duties of a trustee, including the right, with the court's approval, to employ attorneys, accountants, appraisers, auctioneers, or other professional persons to assist the debtor during its bankruptcy case. Other responsibilities include filing tax returns and reports which are either necessary or ordered by the court after confirmation, such as a final accounting. The U.S. trustee is responsible for monitoring the compliance of the debtor in possession with the reporting requirements.

5. U.S. Trustee of Bankruptcy Administrator

The U.S. trustee plays a major role in monitoring the progress of a Chapter 11 case and supervising its administration. The U.S. trustee is responsible for monitoring the debtor in possession's operation of the business and the submission of operating reports and fees. Additionally, the U.S. trustee monitors applications for compensation and reimbursement by professionals, plans and disclosure statements filed with the court, and creditors' committees. The U.S. trustee conducts a meeting of the creditors, often referred to as the "section 341 meeting," in a chapter 11 case. The U.S. trustee and creditors may question the debtor under oath at the section 341 meeting concerning the debtor's acts, conduct, property, and the administration of the case.

The U.S. trustee also imposes certain requirements on the debtor in possession concerning matters such as reporting its monthly income and operating expenses, establishing new bank accounts, and paying current employee withholding and other taxes. By law, the debtor in possession must pay a quarterly fee to the U.S. trustee for each quarter of a year until the case is converted or dismissed. The amount of the fee, which may range from $250 to $10,000, depends on the amount of the debtor's disbursements during each quarter. Should a debtor in possession fail to comply with the reporting requirements of the U.S. trustee or orders of the bankruptcy court, or fail to take the appropriate steps to bring the case to confirmation, the U.S. trustee may file a motion with the court to have the debtor's Chapter 11 case converted to another chapter of the Bankruptcy Code or to have the case dismissed.

6. Creditors' Committees

Creditors' committees can play a major role in Chapter 11 cases. The committee is appointed by the U.S. trustee and ordinarily consists of unsecured creditors who hold the seven largest unsecured claims against the debtor. Among other things, the committee: consults with the debtor in possession on administration of the case; investigates the debtor's conduct and operation of the business; and participates in formulating a plan. A creditors' committee may, with the court's approval, hire an attorney or other professionals to assist in the performance of the committee's duties. A creditors' committee can be an important safeguard to the proper management of the business by the debtor in possession.

In some smaller cases, the U.S. trustee may be unable to find creditors willing to serve on a creditors' committee, or the committee may not be actively involved in the case. The Bankruptcy Code addresses this issue by treating a "small business case" somewhat differently than a regular bankruptcy case. A small business case is defined as a case with a "small business debtor." In a small business case, the debtor in possession must, among other things, attach the most recently prepared balance sheet, statement of operations, cash-flow statement, and most recently filed tax return to the petition or provide a statement under oath explaining the absence of such documents and must attend court and the U.S. trustee meeting through senior management personnel and counsel. The small business debtor must make ongoing filings with the court concerning its profitability and projected cash receipts and disbursements, and must report whether it is in compliance with the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure and whether it has paid its taxes and filed its tax returns.

In contrast to other Chapter 11 debtors, the small business debtor is subject to additional oversight by the U.S. trustee. Early in the case, the small business debtor must attend an "initial interview" with the U.S. trustee at which time the U.S. trustee will evaluate the debtor's viability, inquire about the debtor's business plan, and explain certain debtor obligations including the debtor's responsibility to file various reports. The U.S. trustee will also monitor the activities of the small business debtor during the case to identify as promptly as possible whether the debtor will be unable to confirm a plan. Because certain filing deadlines are different and extensions are more difficult to obtain, a case designated as a small business case normally proceeds more quickly than other Chapter 11 cases.

7. Appointment of Trustee

Although the appointment of a case trustee is a rarity in a Chapter 11 case, a party in interest or the U.S. trustee can request the appointment of a case trustee or examiner at any time prior to confirmation in a Chapter 11 case. The court, on motion by a party in interest or the U.S. trustee and after notice and hearing, shall order the appointment of a case trustee for cause, including fraud, dishonesty, incompetence, or gross mismanagement, or if such an appointment is in the interest of creditors, any equity security holders, and other interests of the estate. Moreover, the U.S. trustee is required to move for appointment of a trustee if there are reasonable grounds to believe that any of the parties in control of the debtor "participated in actual fraud, dishonesty or criminal conduct in the management of the debtor or the debtor's financial reporting." The trustee is appointed by the U.S. trustee, after consultation with parties in interest and subject to the court's approval. Alternatively, a trustee in a case may be elected if a party in interest requests the election of a trustee within 30 days after the court orders the appointment of a trustee.

The case trustee is responsible for management of the property of the estate, operation of the debtor's business, and, if appropriate, the filing of a plan of reorganization. Section 1106 of the Bankruptcy Code requires the trustee to file a plan "as soon as practicable" or, alternatively, to file a report explaining why a plan will not be filed or to recommend that the case be converted to another chapter or dismissed. Upon the request of a party in interest or the U.S. trustee, the court may terminate the trustee's appointment and restore the debtor in possession to management of bankruptcy estate at any time before confirmation.

8. <u>Automatic Stay</u>

The automatic stay provides a period of time in which all judgments, collection activities, foreclosures, and repossessions of property are suspended and may not be pursued by the creditors on any debt or claim that arose before the filing of the bankruptcy petition. As with cases under other chapters of the Bankruptcy Code, a stay of creditor actions against the Chapter 11 debtor automatically goes into effect when the bankruptcy petition is filed. The filing of a petition, however, does not operate as a stay for certain types of actions listed under 11 U.S.C. § 362(b). The stay provides a breathing spell for the debtor, during which negotiations can take place to try to resolve the difficulties in the debtor's financial situation.

Under specific circumstances, the secured creditor can obtain an order from the court granting relief from the automatic stay. For example, when the debtor has no equity in the property and the property is not necessary for an effective reorganization, the secured creditor can seek an order of the court lifting the stay to permit the creditor to foreclose on the property, sell it, and apply the proceeds to the debt.

9. <u>Filing a Plan</u>

The debtor (unless a "small business debtor") has a 120-day period during which it has an exclusive right to file a plan. This exclusivity period may be extended or reduced by the court. But in no event may the exclusivity period, including all extensions, be longer than 18 months. After the exclusivity period has expired, a creditor or the case trustee may file a competing plan. The U.S. trustee may not file a plan.

A Chapter 11 case may continue for many years unless the court, the U.S. trustee, the committee, or another party in interest acts to ensure the case's timely resolution. The creditors' right to file a competing plan provides incentive for the debtor to file a plan within the exclusivity period and acts as a check on excessive delay in the case.

10. Avoidable Transfers

The debtor in possession or the trustee, as the case may be, has what are called "avoiding" powers. These powers may be used to undo a transfer of money or property made during a certain period of time before the filing of the bankruptcy petition. By avoiding a particular transfer of property, the debtor in possession can cancel the transaction and force the return or "disgorgement" of the payments or property, which then are available to pay all creditors. Generally, and subject to various defenses, the power to avoid transfers is effective against transfers made by the debtor within 90 days before filing the petition. But transfers to "insiders" (i.e., relatives, general partners, and directors or officers of the debtor) made up to a year before filing may be avoided.

11. Conversion or Dismissal

A debtor in a case under Chapter 11 has a one-time absolute right to convert the chapter 11 case to a case under Chapter 7 unless: (1) the debtor is not a debtor in possession; (2) the case originally was commenced as an involuntary case under Chapter 11; or (3) the case was converted to a case under Chapter 11 other than at the debtor's request. A debtor in a Chapter 11 case does not have an absolute right to have the case dismissed upon request.

12. The Discharge

With some exceptions that are beyond the scope of this course, confirmation of a reorganization plan generally discharges a debtor from any debt that arose before the date of confirmation. After the plan is confirmed, the debtor is required to make plan payments and is bound by the provisions of the plan of reorganization. The confirmed plan creates new contractual rights, replacing or superseding pre-bankruptcy contracts.

C. CHAPTER 13

1. General Requirements

Chapter 13 of the Bankruptcy Code allows an individual debtor to consolidate his or her debt and make payments over a three to five year period. Some of the debt is extinguished during the process and the debtor has the ability to retain most of his or her property, including a personal residence, so long as he or she complies with the terms of the plan.

Any individual, whether employed or self-employed, may seek Chapter 13 protection so long as the individual's unsecured debts are less than $360,475 and secured debts are less than $1,081,400. These amounts are adjusted periodically to reflect changes in the consumer price index. Corporations and partnerships are not eligible for Chapter 13 protection.

Other specific criteria apply. For example, a debtor may not seek Chapter 13 (or any other type of bankruptcy protection) if, during the preceding 180 days, a prior bankruptcy petition was dismissed due to the debtor's willful failure to appear before the court or comply with orders of the court or was voluntarily dismissed after creditors sought relief from the bankruptcy court to recover property upon which they hold liens.

In addition, in most circumstances no individual may be a debtor under Chapter 13 or any Chapter of the Bankruptcy Code unless he or she has, within 180 days before filing, received credit counseling from an approved credit counseling agency either in an individual or group briefing.

2. Initiating the Proceeding

A Chapter 13 case is initiated when the debtor files a petition with the federal courts seeking bankruptcy protection. The debtor must file, among other things:

- A schedules of assets and liabilities;
- A schedule of current income and expenditures;
- A schedule of contracts and unexpired leases; and
- A statement of financial affairs.

The debtor must also file a certificate showing that he or she completed mandatory credit counseling. The debtor must provide the Chapter 13 case trustee with a copy of the tax return or transcripts for the most recent tax year as well as tax returns filed during the case (including tax returns for prior years that had not been filed when the case began). There are other requirements as well, so this material should not be construed as a complete list of required documentation. A married couple has the option of filing a joint petition or individual petitions.

3. Appointment of Trustee and Automatic Stay

In the case of Chapter 13 bankruptcy, a trustee is appointed who is responsible for collecting payments from the debtor and distributing them to the creditors according to the terms of a plan approved by a judge.

Filing of the petition under Chapter 13 "automatically stays" most collection actions against debtors by creditors. As long as the stay remains in effect, creditors generally may not initiate or continue lawsuits, wage garnishments, or even make telephone calls demanding payments. The bankruptcy clerk gives notice of the bankruptcy case to all creditors whose names and addresses are provided by the debtor.

4. Impact on Foreclosure

An individual may use a Chapter 13 proceeding to save his or her home from foreclosure. The automatic stay stops the foreclosure proceeding as soon as the individual files the Chapter 13 petition. The individual may then bring the past-due payments current over a reasonable period of time. Nevertheless, the debtor may still lose the home if the mortgage company completes the foreclosure sale under state law before the debtor files the petition. The debtor may also lose the home if he or she fails to make the regular mortgage payments that come due after the Chapter 13 filing.

5. Creditors Meeting

Between 21 and 50 days after the debtor files the Chapter 13 petition, the Chapter 13 trustee will hold a meeting of creditors. The meeting may be held no more than 60 days after the debtor files. During this meeting, the trustee places the debtor under oath, and both the trustee and creditors may ask questions. The debtor must attend the meeting and answer questions regarding his or her financial affairs and the proposed terms of the plan. The parties typically resolve problems with the plan either during or shortly after the creditors' meeting. Generally, the debtor can avoid problems by making sure that the petition and plan are complete and accurate, and by consulting with the trustee prior to the meeting.

6. Creditors Must File Claims

To participate in distributions from the bankruptcy estate under Chapter 13, unsecured creditors must file their claims with the court within 90 days after the first date set for the meeting of creditors. A governmental entity (i.e., the IRS), however, has 180 days from the date the case is filed to file a proof of claim.

II. Bankruptcy Court Jurisdiction Over Tax Matters

A. DETERMINATION OF TAX LIABILITY

Generally, the bankruptcy court has the authority to determine the amount or legality of any tax imposed on a debtor under its jurisdiction and the bankruptcy estate, including any fine, penalty, or addition to tax, whether or not the tax was previously assessed or paid. The bankruptcy court does not have authority:

- To determine the amount or legality of a tax, fine, penalty, or addition to tax that was contested before and adjudicated by a court or administrative tribunal of competent jurisdiction before the date of the bankruptcy petition filing; or

- To decide the right of a tax refund for the bankruptcy estate before the earlier of:

  - A determination for refund by the IRS or other governmental unit; or

  - 120 days since the trustee properly requested the refund.

B. TAX COURT

1. Tax Court Proceedings

The filing of a bankruptcy petition results in an automatic stay that immediately stops the commencement or continuation of certain Tax Court proceedings. In individual bankruptcy cases, the stay prohibits the commencement of a Tax Court case regarding the tax liabilities of the debtor for tax periods ending before the bankruptcy court's order for relief. If the debtor is a corporation, the automatic stay prohibits the commencement or continuation of Tax Court proceedings relating to liabilities for tax periods that the bankruptcy court may determine. Generally, in corporate Chapter 11 cases, the bankruptcy court determines the debtor corporation's tax liabilities for tax periods ending before the date a plan of reorganization is confirmed.

The bankruptcy court has the power to lift the automatic stay and allow the debtor to begin or continue a Tax Court case. Accordingly, during the pendency of the bankruptcy case, in effect, the bankruptcy court has the sole authority to determine whether the tax issue will be decided by the bankruptcy court or Tax Court.

Table 9.2. Conditions for Discharging Federal Income Tax Liability.

Return Due at Least Three Years Ago	The tax debt must be related to a tax return that was due at least three years before the taxpayer files for bankruptcy. The due date includes any extensions.
Return Filed at Least Two Years Ago	The tax debt must be related to a tax return that was filed at least two years before the taxpayer files for bankruptcy. The time is measured from the date the taxpayer actually filed the return.
Tax Assessment at Least 240 Days Old	The IRS must have assessed the tax at least 240 days before the taxpayer files for bankruptcy. The IRS assessment may arise from a self-reported balance due, an IRS final determination in an audit, or an IRS proposed assessment which has become final.
Tax Return Was Not Fraudulent	The tax return cannot be fraudulent or frivolous.
Taxpayer Not Guilty of Tax Evasion	The taxpayer cannot be guilty of any intentional act of evading the tax laws.

a. Suspension of Time for Filing

In any bankruptcy case, the 90-day period for filing a Tax Court petition after the issuance of the Statutory Notice of Deficiency is suspended for the time the debtor is prevented from filing the petition due to the bankruptcy case, and for an additional 60 days thereafter. Accordingly, if the Statutory Notice of Deficiency was issued before the bankruptcy petition was filed, and the 90-day period had not expired, the running of the 90-day period will be suspended while the stay prevents the commencement of the Tax Court case. The 90-day period will begin to run 60 days after the stay against filing the petition ends. The suspension is effective for any part of the 90-day period remaining on the date of the bankruptcy petition filing.

However, the 90-day period for filing a Tax Court petition after issuance of a Notice of Determination in an innocent spouse case is not suspended by filing of a bankruptcy petition. Thus, if the IRS issues a final Notice of Determination denying the debtor's request for innocent spouse relief during the bankruptcy case, the debtor is prohibited from petitioning the Tax Court while the automatic stay is in effect; however, the 90-day period for petitioning the Tax Court is not suspended. In these circumstances, the debtor must file a motion with the bankruptcy court asking the bankruptcy court to lift the automatic stay. If the bankruptcy court lifts the stay, then the taxpayer can petition the Tax Court so long as the 90 days for petitioning has not expired.

b. Trustee May Intervene

The trustee of a bankruptcy estate in any bankruptcy case may intervene on behalf of the estate in any proceeding in the Tax Court to which the debtor is a party.

C. ACTIONS OF IRS FOLLOWING FILING OF BANKRUPTCY PETITION

1. <u>Prohibited Actions</u>

Filing bankruptcy usually gives a debtor immediate relief from all demands for payment and collection enforcement actions. IRS employees, upon learning of a bankruptcy, generally should cease all demands and enforcement actions directed against the bankrupt taxpayer (debtor) and take prompt and appropriate corrective actions unless the court determines the automatic stay is not in effect. Failure to observe an automatic stay may result in the IRS being sued for damages and attorney fees, although punitive damages cannot be awarded. The Bankruptcy Code does not prohibit the gathering of tax information, unless it is an act to collect a prepetition tax in violation of the automatic stay.

Specific actions that are prohibited after the automatic stay also include:

- Starting or continuing judicial or administrative collection proceedings for prepetition debts, such as making seizures or serving levies[2];
- Verbally requesting payment for tax periods ending before the bankruptcy petition date;
- Sending notices requesting payment or sending notices of intent to levy regarding prepetition periods[3];
- Starting a lawsuit or serving or enforcing a summons to collect liabilities;
- Making a setoff of any debt (tax or otherwise) owed by the debtor that arose before the commencement of the case against any claim made against the debtor that arose before the commencement of the case;
- Attempting to recover a claim from the debtor that arose before the commencement of the case, including trying to enforce a judgment;

---

[2] Although Collection Due Process (CDP) hearings may not violate the stay, the Service has decided to suspend such actions while the stay is in effect so the bankruptcy case may resolve the issues raised in the CDP proceeding. (See IRM 8.7.6.2, *Collection Due Process Cases.*)

[3] A notice and demand for payment in connection with a new assessment, assuming the assessment itself is allowable under the Bankruptcy Code, is not prohibited by the stay. Further collection notices demanding payment violate the automatic stay.

- Attempting to recover a claim for prepetition debts from community property, even if the claim is against a non-debtor spouse;

- Creating, perfecting, or enforcing a lien on prepetition periods (lien refiles are allowed); or

- Retaining prepetition refunds indefinitely without requesting the automatic stay be lifted – other than temporary retention of refunds prior to Chapter 11 or Chapter 13 confirmation, or longer with written Counsel recommendation.

If proceeds of a prepetition levy are received by the IRS *after* a bankruptcy petition is filed, they are property of the bankruptcy estate.

2. Permissible Activities

The automatic stay does not prohibit the following activities:

- An audit to determine tax liability;

- Issuance of a notice of tax deficiency;

- Issuance of a final Notice of Determination granting or denying relief from joint and several liability (innocent spouse relief);

- Making of an assessment for most taxes and issuance of one informational notice[4];

- Securing a tax return;

- Accepting payments made with tax returns for prepetition years;

- Refiling a valid prepetition Notice of Federal Tax Lien;

- Beginning or continuing an action or proceeding by a governmental unit to enforce police or regulatory power;

- Opening or continuing a criminal action or proceeding against the debtor;

- The filing of a Tax Court petition by an individual concerning a postpetition tax liability and subsequent Tax Court proceedings for those postpetition tax periods;

- Setoff of prepetition income tax refunds to prepetition income tax liabilities; or

- Offsets for domestic support obligations.

[4] Debtors receive one notice of assessment of a prepetition tax return balance due. Subsequent notices may not be issued. If they are, the IRS must be contacted immediately.

III. Federal Tax Claims

A. PROOF OF CLAIM

Once a bankruptcy petition is filed and the automatic stay is issued, the IRS and other creditors are generally prevented from levying any of the debtor's assets. However, creditors may file a "proof of claim" with the bankruptcy court to protect their rights. The IRS may file a proof of claim with the bankruptcy court in the same manner as any other creditor. This claim may be filed with the bankruptcy court even though taxes have not been assessed or are subject to a Tax Court proceeding.

B. SECURED TAX CLAIMS

If the IRS filed a Notice of Federal Tax Lien (NFTL) before the bankruptcy petition was filed, the IRS will have a secured claim in the bankruptcy case to the extent the lien is attached to equity in the debtor's assets. In Chapter 7 cases, in certain circumstances, the trustee may be able to subordinate the tax lien in order to pay certain non-tax priority claims. In Chapter 11 cases, if the secured claim would otherwise have been entitled to treatment as a priority claim, the Chapter 11 plan must provide for the secured tax claim in the same manner, over the same period, as an unsecured eighth priority tax claim.

C. UNSECURED TAX CLAIMS/EIGHTH PRIORITY TAXES

In general, certain unsecured debts are given priority for payment purposes. Certain tax debts arising before the bankruptcy case was filed are classified as eighth priority claims.

The following federal taxes, if unsecured, are eighth priority taxes of the government:

a. Income taxes on or measured by income or gross receipts for a tax year ending on or before the date of the filing of the petition for which a return, if required, is last due, including extensions, after three years before the date of the filing of the bankruptcy petition.

b. Income taxes on or measured by income or gross receipts assessed within 240 days before the date of the filing of the petition. The 240-day period is exclusive of any time during which an offer in compromise for that tax was pending or in effect during that 240-day period plus 30 days, and exclusive of any time during which a stay of proceedings against collections was in effect in a prior case during the 240-day period plus 90 days.

c. Income taxes that were not assessed before the bankruptcy petition date, but were assessable as of the petition date, unless these taxes were still assessable solely because no return was filed, a late return was filed within two years of the filing of the bankruptcy petition, a fraudulent return was filed, or because the debtor willfully attempted to evade or defeat the tax.

d. Withholding taxes that were incurred in any capacity.

e. Employer's share of employment taxes on wages, salaries, or commissions (including vacation, severance, and sick leave pay) paid as priority claims under title 11 U.S.C. section 507(a)(4), or for which a return was last due within three years of the filing of the bankruptcy petition, including a return for which an extension of the filing date was obtained.

f. Excise taxes on transactions occurring before the date of filing the bankruptcy petition, for which a return, if required, is last due (including extensions) within three years of the filing of the bankruptcy petition. If a return is not required, these excise taxes include only those transactions occurring during the three years immediately before the date of filing the petition.

D. PAYMENT OF TAX CLAIMS

1. Chapter 7 Cases

In a Chapter 7 case, eighth priority taxes may be paid out of the assets of the bankruptcy estate to the extent assets remain after paying the claims of secured creditors and other creditors with higher priority claims.

2. Chapter 11, 12, and 13 Cases

Different rules apply to payment of eighth priority pre-petition taxes under Chapters 11, 12, and 13:

a. A Chapter 11 plan can provide for payment of these taxes, with post-confirmation interest, over a period of five years from the date of the order for relief issued by the bankruptcy court (this is the bankruptcy petition date in voluntary cases), in a manner not less favorable than the most favored non-priority claims (except for convenience claims under section 1122(b) of the Bankruptcy Code).

b. In a Chapter 12 case, the debtor can pay such tax claims in deferred cash payments over time. However, certain priority taxes may be paid as general unsecured claims if they result from the disposition of a farm asset, but only in cases where the debtor receives discharge, and

c. In a Chapter 13 case, the debtor can pay such taxes over three years (or over five years with court approval).

E. HIGHER PRIORITY TAXES

Certain taxes are assigned a higher priority for payment. Taxes incurred by the bankruptcy estate are given second priority treatment, as administrative expenses. In an involuntary bankruptcy case, taxes arising in the ordinary course of business or the debtor's financial affairs (after the filing of the bankruptcy petition but before the earlier of the appointment of a trustee or the order for relief) are included in the third priority payment category. If the debtor has employees, the employees' portion of employment taxes on the first $11,725 (this amount adjusted every three years) of wages that they earned during the 180-day period before the date of the bankruptcy filing or the cessation of the business (whichever occurs first) is given fourth priority treatment. However, the debtor's portion of the employment taxes on these wages, as the employer, is given eighth priority treatment.

F. PENALTIES

A tax penalty which is punitive in nature, that is, not for actual pecuniary loss (monetary), is payable as a general unsecured claim.

1. Relief From Certain Penalties

A penalty for failure to pay tax, including failure to pay estimated tax, will not be imposed if the tax was incurred by the bankruptcy estate as a result of an order of the court finding probable insufficiency of funds of the bankruptcy estate to pay administrative expenses. If the tax was incurred by the debtor, the penalty will not be imposed if:

- The tax was incurred before the earlier of the order for relief or (in an involuntary case) the appointment of a trustee, and

- The bankruptcy petition was filed before the due date for the tax return (including extensions) or the date for imposing the penalty occurs on or after the day the bankruptcy petition was filed.

Note: Relief from the failure-to-pay penalty does not apply to any penalty for failure to pay or deposit tax withheld or collected from others which is required to be paid over to the U.S. government. Nor does it apply to any penalty for failure to file a timely return.

2. FUTA Credit

Employers are generally allowed a credit against FUTA for contributions made to a state unemployment fund if the contributions are paid by the last day for filing a federal unemployment tax return for the tax year. If contributions are paid to the state fund after such date, the allowable credit shall not exceed 90% of the otherwise allowable credit that may be taken against FUTA. However, in the case of wages paid by the trustee of a title 11 bankruptcy estate where the failure to timely pay state unemployment contributions was without fault by the trustee, 100% of the credit is allowed. An employer may also receive an additional credit against FUTA contributions.

G. DISCHARGE OF UNPAID TAXES UNDER SPECIFIC CHAPTERS

The bankruptcy court may enter an order discharging the debtor from tax debts. The order for discharge is a permanent order of the court prohibiting the creditors from taking action against the debtor personally to collect the debt. However, secured creditors with valid pre-bankruptcy liens may enforce them to recover property secured by the lien.

Not all debts are dischargeable. Many tax debts are excepted from the bankruptcy discharge. The scope of the bankruptcy discharge depends on the Chapter under which the case was filed and the nature of the debt. Chapter 7 debtors do not have an absolute right to a discharge; objections may be filed by creditors. Chapters 12 and 13 debtors are generally entitled to discharge upon completion of all payments under the bankruptcy plan.

1. <u>Chapter 7 Cases</u>

For individuals in Chapter 7 cases, the following tax debts (including interest) are not subject to discharge:

- Taxes entitled to eighth priority;
- Taxes for which no return was filed;
- Taxes for which a return was filed late after two years before the bankruptcy petition was filed;
- Taxes for which a fraudulent return was filed; and
- Taxes that the debtor willfully attempted to evade or defeat.

Penalties in a Chapter 7 case are dischargeable unless the event that gave rise to the penalty occurred within three years of the bankruptcy and the penalty relates to a tax that is not discharged. Only individuals may receive a discharge in Chapter 7 cases; corporations and other entities do not.

2. <u>Chapter 11 Cases</u>

The same exceptions to discharge that apply to individuals in Chapter 7 cases also apply to individuals in Chapter 11 cases. However, different rules apply to corporations. A corporation in a Chapter 11 case may receive a broad discharge when the reorganization plan is confirmed; however, secured and priority claims must be satisfied under the plan. There is an exception to discharge for taxes for which the debtor filed a fraudulent return or willfully attempted to evade or defeat.

3. <u>Chapter 13 Cases</u>

A debtor who completes all payments under the Chapter 13 plan shall receive a broad discharge of all debts provided for by the plan. However, priority tax claims must be paid in full under the Chapter 13 plan. The following taxes are excepted from the broad Chapter 13 discharge:

- Withholding taxes for which the debtor is liable in any capacity;
- Taxes for which no return was filed;
- Taxes for which a return was filed late after two years before the bankruptcy petition was filed;
- Taxes for which a fraudulent return was filed; and
- Taxes that the debtor willfully attempted to evade or defeat.

Also, there is an exception from discharge for debts where the creditor, including the IRS, did not receive notice of the Chapter 13 bankruptcy case in time to file a claim.

4. Chapter 13 “Hardship Discharge”

In cases where the failure to complete all payments under the Chapter 13 plan was due to circumstances for which the debtor should not be held accountable, the bankruptcy court may grant a “hardship discharge”. However, all unsecured claims must be paid an amount not less than creditor would have received in a Chapter 7 liquidation.

Note: Debts that would be excepted under an individual Chapter 7 discharge are also excepted from the Chapter 13 hardship discharge.

H. CHAPTER 12 CASES

The same tax debts that are excepted from discharge in Chapter 7 cases of individuals are excepted from discharge in Chapter 12 cases of individuals. The exceptions do not apply to Chapter 12 cases of non-individuals. As in Chapter 13 cases, the debtor may be granted a hardship discharge if appropriate.

I. FEDERAL TAX LIENS

If a tax is discharged, the discharged tax may still be collectable from the debtor's pre-bankruptcy property if the IRS filed a Notice of Federal Tax Lien (NFTL) before the bankruptcy petition was filed. Perfected liens generally pass through bankruptcy proceedings unaffected, even if the debtor's personal liability for the debt is discharged. If the IRS did not file a Notice of Federal Tax Lien before the bankruptcy petition was filed, the tax lien will generally be removed from the debtor's pre-bankruptcy property as a result of the bankruptcy, even if the debtor exempted the property out of the bankruptcy estate. However, a tax lien that arises when a tax is assessed may not be removed from the property upon discharge if the property was excluded from the bankruptcy estate, even if a Notice of Federal Tax Lien was not filed.

CHAPTER 9 – REVIEW QUESTIONS

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. How does the IRS benefit when a taxpayer files for bankruptcy and he or she owes taxes:

   a) it gives the IRS additional time to collect the taxes
   b) it requires the taxpayer to pay his or her taxes immediately
   c) the IRS has five years after a bankruptcy case is over to collect on the assessed taxes
   d) it doesn't benefit the IRS when a taxpayer files for bankruptcy

2. A debtor cannot file for Chapter 7 bankruptcy if:

   a) it is a partnership
   b) it is a corporation
   c) a prior bankruptcy petition was dismissed within the past 180 days
   d) credit counseling was completed within the past 180 days

3. When an "automatic stay" is in effect, this generally forces creditors to:

   a) continue to collect and demand payments from the debtor
   b) put their collection actions on hold while the stay is in effect
   c) garnish debtor's wages
   d) initiate a lawsuit against the debtor

4. Which type of bankruptcy is commonly known as the "reorganization" bankruptcy:

   a) Chapter 7
   b) Chapter 11
   c) Chapter 12
   d) Chapter 13

5. Which one of the following types of debtor is <u>not</u> able to file for Chapter 13 bankruptcy relief:

   a) an employed individual
   b) a self-employed individual
   c) a corporation
   d) none of the above

6. An eighth priority tax claim is:

   a) an unsecured tax debt incurred prior to a debtor filing for bankruptcy
   b) an unsecured tax debt incurred after a debtor filed for bankruptcy
   c) a secured tax debt incurred prior to a debtor filing for bankruptcy
   d) a secured tax debt incurred after a debtor filed for bankruptcy

CHAPTER 9 – SOLUTIONS AND SUGGESTED RESPONSES

1. **A: Correct.** The disadvantage for a taxpayer when he or she files for bankruptcy is it gives the IRS more time to collect on the unpaid taxes.

   B: Incorrect. If a taxpayer files for bankruptcy, he or she is not required to immediately pay his or her unpaid taxes.

   C: Incorrect. The IRS has 10 years, plus six months, plus the time the bankruptcy case was pending to collect on the taxpayer's unpaid taxes.

   D: Incorrect. When a taxpayer files for bankruptcy and he or she owes taxes, it does benefit the IRS because it allows them more time to collect on the taxes.

   (See page 9-1 of the course material.)

2. A: Incorrect. A partnership that meets all the criteria is allowed to file for Chapter 7 bankruptcy relief.

   B: Incorrect. A corporation is able to file for Chapter 7 bankruptcy if it meets all of the required conditions.

   C: Correct. A debtor cannot file for Chapter 7 bankruptcy if he or she filed for bankruptcy within the past 180 days and the bankruptcy had been dismissed.

   D: Incorrect. All debtors filing for bankruptcy are required to receive credit counseling within 180 days of filing for bankruptcy.

   (See page 9-1 to 9-2 of the course material.)

3. A: Incorrect. Creditors are not allowed to continue collecting or demanding payment from a debtor when an automatic stay is in effect.

   B: Correct. Creditors are forced to put their collection actions on hold when an automatic stay is in effect.

   C: Incorrect. Creditors may not garnish debtor's wages when an automatic stay is in effect.

   D: Incorrect. As long as an automatic stay is in existence, creditors cannot file or continue collecting on a lawsuit against the debtor.

   (See page 9-4 of the course material.)

4. A: Incorrect. Chapter 7 bankruptcy provides for liquidation and is not referred to as the “reorganization” bankruptcy.

   B: Correct. Chapter 11 bankruptcy is commonly known as the “reorganization” bankruptcy because the debtor generally proposes a plan of reorganization and pays creditors over time.

   C: Incorrect. Chapter 12 bankruptcy deals with the family farmer or fisherman and provides for adjustment of debts, not reorganization.

   D: Incorrect. Chapter 13 bankruptcy adjusts the debts of an individual with regular income and allows the debtor to pay creditors over a period of three to five years.

   (See page 9-7 of the course material.)

5. A: Incorrect. As long as he or she meets all of the eligibility requirements, any individual is able to file for Chapter 13 bankruptcy relief.

   B: Incorrect. Chapter 13 bankruptcy relief is available to both a self-employed and an employed individual meeting the necessary requirements.

   C: Correct. Neither a partnership nor a corporation can file for Chapter 13 bankruptcy relief.

   D: Incorrect. Chapter 13 bankruptcy protection is not available to either a partnership or a corporation.

   (See page 9-12 of the course material.)

6. **A: Correct.** An unsecured tax debt incurred prior to a debtor filing for bankruptcy is considered to be an eighth priority tax claim.

   B: Incorrect. An eighth priority tax claim is an unsecured tax debt that is incurred prior to a debtor filing for bankruptcy relief, not after.

   C: Incorrect. An unsecured, not a secured, tax debt incurred before a debtor files for bankruptcy is an eighth priority tax claim.

   D: Incorrect. Neither a secured nor an unsecured tax debt is an eighth priority tax claim if it is filed after bankruptcy proceedings have been initiated.

   (See page 9-18 of the course material.)

Chapter 10: Case Studies

The prior chapters have provided an overview of the Installment Agreement and Offer in Compromise process, including the bases upon which an offer can be submitted, the details of the offer, and how the IRS will evaluate the offer and determine how much money the taxpayer will be required to pay. The prior chapters also evaluated how the IRS levies taxpayer property and various appeal rights available to taxpayers. This chapter provides several real case studies to help illustrate how the issues presented in the prior chapters are integrated in a real situation. Fairly straight-forward cases are presented below to help practitioners understand how settlements with the IRS are handled in the real world. These opinions from the United States Tax Court have been edited to remove “legaleeze” not necessary for purposes of these case studies. The case studies address both Offers in Compromise and Installment Agreements.

I. Case Study #1

The first case study involves a taxpayer who applies for an Offer in Compromise. His offer is incredibly low relative to his debt. When the IRS asks for more information in order to evaluate the offer, the representative of the taxpayer refuses to provide that information. The representative also initially refuses to disclose information about the health of the taxpayer, which they allege to be poor. The taxpayer appeals a denial of his application for an Offer in Compromise. This case illustrates the importance of providing complete information to the IRS when seeking a settlement and the importance of being responsive to requests when the IRS requires more information. This case also illustrates that the IRS is normally not in the business of settling for “pennies on the dollar” and will fully evaluate the financial and circumstances of the taxpayer in evaluating an Offer in Compromise.

Edward F. Murphy v. Commission of Internal Revenue
125 T.C. No. 15
UNITED STATES TAX COURT
Edward F. Murphy, Petitioner v. Commissioner of Internal Revenue, Respondent
Docket No. 10239-03L
Filed December 29, 2005

Petitioner asks us to review a determination by respondent’s settlement officer that respondent may proceed with collection by levy of petitioner’s unpaid tax liability for 1999. Petitioner claims that the settlement officer abused her discretion by (1) rejecting petitioner’s offer in compromise, based alternatively on doubt as to collectability and the promotion of effective tax administration, and (2) improperly and prematurely concluding petitioner’s hearing. Respondent objects to petitioner’s testimony as to reasons he did not pay his 1992-2001 tax liabilities as they came due and the settlement officer’s testimony as to entries in her case activity notes and certain aspects of her handling of the case.

1. Held, settlement officer did not err in rejecting offer in compromise based, alternatively, on doubt as to collectability and effective tax administration.
2. Held, further, settlement officer did not err in concluding hearing following petitioner’s failures to meet various due dates, including due date for revised offer in compromise.

3. Held, further, there were no improprieties in settlement officer's actions or hearing procedures.
4. Held, further, settlement officer did not abuse her discretion in determining that respondent may proceed by levy to collect petitioner's unpaid tax liability for 1999.

This case is before the Court to review a determination made by one of respondent's Appeals officers that respondent may proceed to collect by levy unpaid taxes with respect to petitioner's 1999 tax year. We review the determination pursuant to section 6330(d)(1).

A. FINDINGS OF FACT

Petitioner resided in Quincy, Massachusetts, at the time the petition was filed.

On April 15, 2002, respondent issued to petitioner a Final Notice - Notice of Intent to Levy and Notice of Your Right to a Hearing. The notice pertains to petitioner's unpaid Federal income tax for 1999, in the amount of $16,560 (the unpaid tax).

By letter dated April 23, 2002, petitioner's representative, Timothy J. Burke, Esq., submitted an Internal Revenue Service (IRS) Form 12153, Request for a Collection Due Process Hearing, to the IRS on petitioner's behalf. On an attachment to the Form 12153, petitioner asserts: "It is in the best interest of the government and the taxpayer that an Offer in Compromise be entered into." Petitioner raised no other issue on the Form 12153 or during the subsequent hearing accorded him (the section 6330 hearing or, sometimes, the hearing).

On or about September 13, 2002, an Appeals official, Settlement Officer Lisa Boudreau, was assigned to petitioner's case. On September 16, 2002, Ms. Boudreau sent Mr. Burke a letter scheduling a meeting for September 20, 2002. At Mr. Burke's request, that meeting was rescheduled for October 3, 2002 (the October 3 meeting). Ms. Boudreau and Mr. Burke, but not petitioner, attended the October 3 meeting. At the meeting, Mr. Burke submitted to Ms. Boudreau certain collection information statements that had been requested by her and an IRS Form 656, Offer in Compromise. By the Form 656, petitioner proposed to compromise his unpaid income tax liabilities from 1990 through 2001. Petitioner's unpaid income tax liabilities for 1992 through 2001 (the 1992-2001 liability) total $275,777.

Petitioner offered to pay $10,000 in compromise of the 1992-2001 liability, such amount to be paid within 24 months of acceptance of the offer. Petitioner checked boxes on the Form 656 justifying the offer by reason of both "Doubt as to Collectability" (i.e., he had insufficient assets and income to pay the full liability) and "Effective Tax Administration" (i.e., he had sufficient assets to pay the full liability but, due to his exceptional circumstances, requiring full payment would cause an economic hardship or would be unfair and inequitable). In the portion of the form requesting an explanation of circumstances affecting the taxpayer's ability to fully pay the amount due, petitioner stated: "Please see attached." No attachment accompanies the copy of the form stipulated by the parties.

During the October 3 meeting, Ms. Boudreau asked Mr. Burke about the exceptional circumstances claimed by petitioner. Mr. Burke responded that petitioner was ill, but he would not disclose the nature of the illness, citing petitioner's wish on that point. Ms. Boudreau advised Mr. Burke that, unless petitioner disclosed the circumstances of his illness, she would be unable to consider the illness. Mr. Burke said that he understood and had told his client that already. Among other things, Mr. Burke did tell Ms. Boudreau that petitioner was an insurance salesman, owed money on credit cards, owed about $90,000 to the Commonwealth of Massachusetts, and was divorced, with his ex-wife receiving residual payments from insurance contracts that petitioner had sold.

Ms. Boudreau concluded the October 3 meeting by requesting that petitioner submit by October 31, 2002, additional information and documents necessary for her to review the offer in compromise. Petitioner missed that due date. Indeed, following the October 3 meeting, and through February 10, 2003, petitioner repeatedly missed due dates that either Ms. Boudreau or Mr. Burke himself had set for submitting information necessary for Ms. Boudreau to review the offer in compromise. On one occasion during that period, due to petitioner's failure to meet submission due dates, Ms. Boudreau closed petitioner's case and concluded that she should sustain the proposed levy action. She decided to reopen the case only after petitioner belatedly complied with a request for certain information.

By letter dated February 10, 2003, petitioner provided to Ms. Boudreau the last of the information necessary for her to review the offer in compromise.

By March 19, 2003, Ms. Boudreau had reviewed the offer in compromise and supporting information submitted by petitioner and had concluded that the offer was too low. By letter dated March 19, 2003 (the March 19 letter), Ms. Boudreau informed Mr. Burke that an acceptable offer in compromise would have to be of at least $97,884. She enclosed copies of the income/expense and asset/equity tables that she used to compute that amount. Based principally on information provided by petitioner, Ms. Boudreau calculated petitioner's total monthly income to be $4,235 ($2,618 of net business income and $1,617 of pension income) and his necessary monthly living expenses to be $3,107, with a difference of $1,128. Ms. Boudreau multiplied the difference times 60 to determine the amount petitioner could pay over 60 months; viz, $67,680. Also based principally on information provided by petitioner, Ms. Boudreau calculated petitioner's net realizable equity to be $30,204. The sum that petitioner could pay over 60 months, $67,680, and his net realizable equity, $30,204, is $97,884 (the amount Ms. Boudreau had identified as an acceptable offer in compromise). Ms. Boudreau invited petitioner to submit an amended offer in compromise in the amount of $97,884 by April 9, 2003.

In response to the March 19 letter, Mr. Burke telephoned Ms. Boudreau on April 1, 2003, and agreed to amend the offer in compromise by April 18, 2003. No amended offer was received by that date. On April 25, 2003, Mr. Burke telephoned Ms. Boudreau and reported that petitioner was in the hospital. He also told Ms. Boudreau that, no later than April 29, 2003, he would submit a copy of petitioner's 2002 Federal income tax return (the 2002 return), which had become due and was necessary to process any offer in compromise.

April 29, 2003, passed without Ms. Boudreau's receiving either the 2002 return or an amended offer in compromise. On Thursday, May 1, 2003, she called Mr. Burke and left a voice message directing him to return her call on Monday, May 5, 2003. Mr. Burke called as requested. He reported that petitioner was out of the hospital, although he remained ill and continued to prohibit Mr. Burke from disclosing the nature of his illness. Mr. Burke also reported that he would meet with petitioner later that week and contact Ms. Boudreau by May 9, 2003.

Neither Mr. Burke nor petitioner contacted Ms. Boudreau by May 9, 2003.

On May 12, 2003, Ms. Boudreau noted in her case activity record that the deadline set for May 9, 2003, as well as previous deadlines, had been missed. She also noted that no viable collection alternative had been proposed and she had decided that respondent's proposed collection action should stand.

On May 14, 2003, Ms. Boudreau submitted an IRS Form 5402-c, Appeals Transmittal and Case Memo, to her supervisor recommending that the proposed collection action stand. In an attachment to the Form 5402-c (the attachment), Ms. Boudreau states that she has verified that all legal and administrative requirements that needed to be satisfied with respect to collection by levy had been satisfied. She describes petitioner's offer to compromise the 1992-2001 liability ("approximately $260,000") for $10,000. She states that the offer was submitted on the alternative grounds of effective tax administration and doubt as to collectability. She concludes that, because she is prohibited from accepting an offer in compromise based on effective tax administration unless the Commissioner could collect the outstanding liability in full, and petitioner has insufficient resources from which the Commissioner could collect the 1992-2001 liability in full, effective tax administration is unavailable as a ground for an offer in compromise. She concludes that, although petitioner cannot pay the entire 1992-2001 liability and may qualify for an offer in compromise based on doubt as to collectability: "[H]e can pay considerably more than the $10,000 being offered."

On the attachment, she calculates the amount she believes that petitioner can pay in much the same way that, in the March 19 letter, she calculated what she described as an acceptable offer in compromise (at least $97,884). The only apparent difference is that she reduced her estimate of petitioner's monthly net business income from $2,618 to $2,356. She concludes: "The reasonable collection potential based on the income and expense figures provided by Mr. Murphy and calculated utilizing allowable expenses and accepted practices is $82,164.00." She recommends that petitioner's offer in compromise be rejected.

With respect to balancing the need for the efficient collection of the taxes due with the concern that the collection action be no more intrusive than necessary, she concludes: "This analysis indicates that this action is now necessary to provide for the efficient collection of the taxes despite the potential intrusiveness of enforced collection."

Ms. Boudreau's proposed disposition of petitioner's case was approved by her supervisor on May 19, 2003.

On May 23, 2003, Ms. Boudreau returned a telephone call from Mr. Burke. She informed him that she had rejected the offer in compromise because it was too low and had closed the case because of missed deadlines. Mr. Burke said petitioner was ill and had finally permitted him to disclose the nature of his illness (which Mr. Burke disclosed to Ms. Boudreau). After the phone conversation, Mr. Burke faxed a letter to Ms. Boudreau asking that she reconsider her decision to close petitioner's case. The letter contains no new financial information and makes no new offer. Ms. Boudreau reviewed the letter and the case file and concluded that her decision to reject the offer should stand.

Petitioner timely petitioned this Court for review of the notice of determination.

B. OPINION

1. Introduction

Petitioner has assigned error to Appeals' (Ms. Boudreau's) determination that respondent may proceed to collect the unpaid tax by levy (the determination).

****

2. The Parties' Arguments

In support of his assignment of error, petitioner avers that (1) acceptance of an offer in compromise was in the best interests of respondent and petitioner, and (2) Ms. Boudreau improperly and prematurely concluded the section 6330 hearing. With respect to the averments, petitioner asks us to consider not only the administrative record of the hearing, which consists of documents stipulated by the parties (the hearing record), but also petitioner's and Ms. Boudreau's trial testimony.

Respondent answers that Ms. Boudreau did not abuse her discretion in rejecting the offer in compromise and determining that respondent may proceed to collect the unpaid tax by levy, nor did she prematurely and improperly conclude the hearing. Respondent objects to the admission of both petitioner's and Ms. Boudreau's trial testimony on the ground that the testimony is not relevant to our deciding whether Ms. Boudreau abused her discretion.

****

a. Discussion

1) Introduction

Petitioner's underlying tax liability is not at issue. The appropriate standard of review is, as respondent claims, abuse of discretion.

2) Petitioner's Trial Testimony

The sole issue raised by petitioner at the section 6330 hearing was a collection alternative; i.e., the offer in compromise. Petitioner submitted to Ms. Boudreau an IRS Form 656, Offer in Compromise, on which he checked boxes indicating that the basis of the offer was either doubt as to collectability or effective tax administration. He indicated on the form that there were special circumstances (which he may have neglected to describe). During the October 3 meeting, Ms. Boudreau asked Mr. Burke to describe petitioner's special circumstances. Mr. Burke responded, but not fully, since petitioner had prohibited him from discussing the nature of petitioner's illness. At trial, Mr. Burke stated that petitioner wished to testify so that he could explain why he had failed to pay the 1992-2001 liability as it came due. That explanation, claimed Mr. Burke, would convince the Court that it would not have been contrary to public policy for Ms. Boudreau to have accepted the offer in compromise. On brief, petitioner argues that he qualifies for an offer in compromise based on “equity”; i.e., “requiring the Respondent to act fairly in compromising outstanding taxes in those instances where a rigid interpretation of the Respondent’s rules * * * precludes the resolution of an issue.” Considerations of hardship, public policy, and equity figure in compromises grounded on both doubt as to collectability and effective tax administration. We accept that, at the section 6330 hearing, petitioner attempted to convince Ms. Boudreau that special circumstances justified her agreeing to an offer in compromise based on hardship, public policy, or equity considerations. Therefore, as was the case in Robinette v. Commissioner, supra, petitioner’s trial testimony relates to an issue he raised at the section 6330 hearing.

Nevertheless, petitioner’s testimony regarding special circumstances is not relevant to the question of whether Ms. Boudreau abused her discretion in rejecting the offer in compromise to the extent the offer was grounded on effective tax administration. If for no other reason, that is because Ms. Boudreau’s rejection of petitioner’s offer to the extent that the offer was grounded on effective tax administration was based on her conclusion that respondent could not collect the full 1992-2001 liability from petitioner (the potential of collection in full being a prerequisite to any consideration of special circumstances, such as hardship or equity, justifying an offer in compromise grounded on effective tax administration). We also think that petitioner’s testimony is not relevant to the question of whether Ms. Boudreau abused her discretion in rejecting the offer to the extent the offer was grounded on doubt as to collectability.

The 1992-2001 liability ($275,777) exceeds both the amount Ms. Boudreau determined to be the reasonable collection potential of the case ($82,164) and the amount petitioner offered ($10,000). Because the offer was in an amount less than what she determined to be the reasonable collection potential, Ms. Boudreau could not consider the offer unless there were special circumstances. Nevertheless, petitioner did not timely provide her with all of the evidence that he now believes should be taken into account in determining whether there are special circumstances. An appeals officer does not abuse her discretion when she fails to take into account information that she requested and that was not provided in a reasonable time. As explained in the next paragraph, that is the case here with respect to petitioner’s trial testimony. Here, evidence that petitioner might have presented at the section 6330 hearing (but chose not to) is not admissible in a trial conducted pursuant to section 6330(d)(1) because it is not relevant to the question of whether the Appeals officer abused her discretion.

Petitioner was represented by counsel, Mr. Burke, at all stages of the section 6330 hearing. Petitioner had been informed by Mr. Burke that, unless petitioner disclosed the nature of his illness, Ms. Boudreau would not take illness into account. Nevertheless, petitioner refused to disclose the nature of his illness until after Ms. Boudreau had twice decided to close his case for missed due dates and, in the second instance, lack of a viable collection alternative. Petitioner had more than an adequate opportunity to provide Ms. Beaudreau with all of the evidence he thought necessary to convince her of special circumstances during the course of the hearing and before May 12, 2003, when Ms. Boudreau decided that respondent’s proposed collection action should stand. Moreover, petitioner does not claim any change in his circumstances arising after the conclusion of the hearing.

3. Abuse of Discretion

a. Introduction

We must now decide whether Ms. Boudreau abused her discretion in determining that respondent may proceed by levy to collect the unpaid tax. Petitioner claims that Ms. Boudreau did, because (1) acceptance of an offer in compromise was in the best interests of respondent and petitioner and (2) Ms. Boudreau improperly and prematurely concluded the hearing.

b. The appeals officer did not err in rejecting the offer in compromise

We do not conduct an independent review of what would be an acceptable offer in compromise. The extent of our review is to determine whether the Appeals officer's decision to reject the offer in compromise actually submitted by the taxpayer was arbitrary, capricious, or without sound basis in fact or law.

Ms. Boudreau concluded that petitioner could not pay his liability (the 1992-2001 liability) in full and, therefore, did not qualify for an offer in compromise based on effective tax administration. Certainly, her conclusion about petitioner's inability to pay in full agrees with the information petitioner provided her, and we see no error in that conclusion or in her decision, based on that conclusion, to reject effective tax administration as a ground for compromising the 1992-2001 liability. Section 301.7122-1(b)(3)(ii), Proced. & Admin. Regs., makes the ability to make full payment a precondition to any offer in compromise based on effective tax administration.

Nor do we see any error in Ms. Boudreau's decision to reject petitioner's offer of $10,000 in settlement of the 1992-2001 liability of $275,777 on the ground of doubt as to collectability. She reviewed the information submitted by petitioner during the hearing. She found that petitioner was operating a business and earning more than $30,000 a year. Combined with his monthly pension income, and after subtracting his claimed expenses, she found that, from his net monthly income alone, he could, over time, afford to pay more than $10,000 towards the 1992-2001 liability.[1] She also calculated that he had net realizable equity of $30,204, which was more than the $10,000 he had offered. She calculated a reasonable collection potential of $82,164. Because the offer was less than the reasonable collection potential she had calculated, the offer was, in the absence of special circumstances, unacceptable under the Commissioner's procedures for the submission and processing of offers in compromise. Moreover, petitioner provided Ms. Boudreau with insufficient information to justify her accepting an offer based on special circumstances in any amount less than what she had calculated as the reasonable collection potential of the case. Therefore, we must determine only whether the Appeals officer's calculations are reasonable. We conclude that her computations were reasonable, and she did not err in rejecting the offer in compromise based on doubt as to collectability.

[1] Ms. Boudreau did not calculate the present value of his net monthly income, and we are unsure whether her assumption in calculating what petitioner could pay is that petitioner would make installment payments. Taking into account any reasonable interest rate, however, the present value of petitioner's net monthly income is still a substantial amount.

c. The appeals officer did not improperly and prematurely conclude the hearing

1) Introduction

On brief, petitioner argues not only that Ms. Boudreau prematurely concluded the hearing but also that she (1) did not conduct the hearing in good faith, (2) failed to negotiate during consideration of the offer, (3) was inflexible in considering petitioner's case, (4) was biased in concluding that the hearing had to be promptly concluded, and (5) was not impartial since she both conducted the hearing and negotiated the offer. Petitioner further argues bias in the section 6330 hearing procedures because (1) there was no administrative review of Ms. Boudreau's rejection of the offer, and (2) petitioner had no right to appeal Ms. Boudreau's rejection of the offer.

2) Hearing Was Not Prematurely Concluded

In Clawson v. Commissioner, T.C. Memo. 2004-106, fewer than 3 months passed between the taxpayer's filing a request for a section 6330 hearing concerning a proposed levy and an adverse determination by the Appeals officer. Approximately 1 month passed after the Appeals officer's offer of a telephonic conference until the adverse determination, and only 9 days passed after the telephone conference until the adverse determination. The taxpayer argued that the Appeals officer abused his discretion because he reached his decision to sustain the proposed levy in "barely one month" after he contacted petitioners. We held: "[T]here is neither requirement nor reason that the Appeals officer wait a certain amount of time before rendering his determination as to a proposed levy." As authority, we cited section 301.6330-1(e)(3), Q&A-E9, Proced. & Admin. Regs., which provides that there is no period of time in which Appeals must conduct a section 6330 hearing or issue a notice of determination: "Appeals will, however, attempt to conduct a * * * [section 6330 hearing] and issue a Notice of Determination as expeditiously as possible under the circumstances."

In this case, Ms. Boudreau reached her decision that respondent's collection action should stand more than 8 months after she was assigned to petitioner's case. On being assigned to the case, she contacted petitioner's representative, Mr. Burke, and promptly met with him. She received from him an offer in compromise and certain supporting information. She requested from him additional information and documents necessary for her to review the offer. Mr. Burke missed numerous due dates for submitting additional information, and, on one occasion, she closed the case because of Mr. Burke's failure to meet submission due dates. It took Mr. Burke more than 4 months to provide to Ms. Boudreau the last of the information necessary for her to review the offer in compromise. When her review showed that the offer was not acceptable, she gave petitioner the opportunity to submit an acceptable offer. Again, due dates were missed, and no new offer was submitted. Ms. Boudreau waited almost 2 months for an acceptable offer before deciding that respondent's proposed collection action should stand. Eleven days after she made her decision (and 6 days before the notice of determination was issued), Mr. Burke finally disclosed to Ms. Boudreau the nature of petitioner's illness. Ms. Boudreau considered that information and decided that her decision should stand. We do not think that Ms. Boudreau prematurely concluded the hearing.

3) Other Arguments

Respondent argues that we should disregard petitioner's other arguments since he did not raise them in the petition. We construe the petition broadly, however, see Rule 31(d), and give petitioner the benefit of the doubt that his averment that Ms. Boudreau improperly concluded the hearing encompasses his other arguments. In any event we have made extensive findings from the record, which we think belie petitioner's claims. We address each claim briefly.

Petitioner claims: Ms. Boudreau "did not conduct the hearing in good faith." As an example, petitioner recites that Ms. Boudreau made her initial contact with petitioner by a letter sent on September 16, 2002, which scheduled a meeting for September 30, 2002. Petitioner recites: "This action is assuredly indicative of the Settlement Officer's predisposition toward an expedient conclusion of Petitioner's matter." We do not reach that conclusion since, when Mr. Burke telephoned Ms. Boudreau on September 17, 2002, apparently in response to her letter, she agreed to move the meeting to October 3, 2002. Petitioner complains that Ms. Boudreau's "lack of economic perspicacity" reflected in her calculations (using national and local expense standards) "shows that the Hearing was not conducted in good faith." We cannot agree with that complaint since Ms. Boudreau adopted petitioner's claimed expenses as a basis for her calculations. Considering all of petitioner's claims of bad faith, we fail to find that Ms. Boudreau conducted the hearing in bad faith.

Petitioner claims: Ms. Boudreau "did not act with flexibility but with a clear predisposition toward an inflexible and expeditious determination of the Petitioner's matter." The facts in evidence hardly lead to that conclusion. Ms. Boudreau tolerated numerous missed due dates. She reopened the case after she had closed it on account of a missed due date. After rejecting the offer in compromise, she invited another offer. When that offer was not timely received, she closed the case but considered reopening it when Mr. Burke belatedly telephoned her. We do not find that Ms. Boudreau was inflexible. While she may have been predisposed to an expeditious conclusion of petitioner's case, we see nothing wrong with that, given the facts before us.

Petitioner claims: Ms. Boudreau "was biased by her belief that the hearing had to be promptly concluded." Besides the fact that Ms. Boudreau rejected the offer and, after almost 2 months, gave up on petitioner's promise to submit a new offer, petitioner has shown no facts that would support his claim of bias. As we made plain supra p. 35 of this report, there is no requirement that an Appeals officer wait a certain amount of time before concluding a section 6330 hearing. Petitioner has failed to show bias.

Petitioner claims: Ms. Boudreau "was not impartial as [since] she both conducted the hearing and negotiated the offer." That, however, is precisely the scheme contemplated by section 6330. Section 6330(c)(2)(A)(iii) permits a taxpayer to offer collection alternatives, including offers in compromise, at a section 6330 hearing, and section 6330(c)(3) provides that the determination of the Appeals officer conducting the section 6330 hearing shall take into consideration any collection alternative offered by the taxpayer at the hearing. Petitioner argues: "It is constitutionally impermissible for the Respondent to assign the same person to negotiate an OIC [offer in compromise] and thereafter rule on the fairness of her negotiations." Section 6330(b)(3) ensures a measure of impartiality by requiring that, unless the taxpayer waives the requirement, the section 6330 hearing be conducted by an Appeals officer who has had no prior involvement with the unpaid tax at issue in the hearing. Petitioner's claim is without merit.

Petitioner claims: Ms. Boudreau "failed to negotiate during the consideration of the OIC." Petitioner argues: "In failing to negotiate a reasonable offer the Settlement Officer failed to meet her responsibility to hold a fair hearing at which she was to negotiate, be flexible and to make it easier for taxpayers to enter into OICs." We need not in this case decide whether the Secretary "must" negotiate an offer in compromise. In this case, although Ms. Boudreau rejected the offer in compromise, she told petitioner what would be an acceptable offer in compromise and provided petitioner almost 2 months to submit a new offer before she closed the case. In that regard, there was no error in her actions. Cf. id. (with respect to taxpayer's argument that Appeals officer failed to negotiate and make a counter-offer during course of section 6330 hearing: "Given * * * [the taxpayer's] sluggish and inadequate response, the appeals officer was certainly not required, nor was she able, to make a meaningful counter-offer.").

Finally, petitioner complains that the absence of administrative review of the rejected offer in compromise as well as the Secretary's failure to grant him administrative appeal rights evidences bias in the section 6330 hearing procedures.[2] Here, the record shows that Ms. Boudreau's decision to reject the offer was reviewed and approved by her supervisor. Moreover, petitioner does have the right to appeal. Petitioner's complaint is without merit.

4) Conclusion

We find no merit in petitioner's arguments that Ms. Boudreau improperly and prematurely concluded the hearing.

d. conclusion

Ms. Boudreau did not abuse her discretion in determining that respondent may proceed by levy to collect the unpaid tax.

4. Conclusion

To reflect the foregoing,

Decision will be entered for respondent.

[2] Sec. 301.7122-1(f), Proced. & Admin. Regs., requires administrative review of a rejected offer in compromise and accords the taxpayer a right of appeal.

CASE STUDY #1 – REVIEW QUESTIONS

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. Why did the IRS initially reject Mr. Murphy's Offer in Compromise of $10,000:

    a) because his offer should have been based on Doubt as to Liability
    b) because he could afford to pay substantially more
    c) because he could afford to pay off the debt in full
    d) because he qualified for a guaranteed Streamlined Installment Agreement and did not fill out the proper forms

2. The Tax Court ______ the IRS's decision to reject an Offer in Compromise based on Effective Tax Administration because ______.

    a) upheld; the taxpayer was unable to fully pay the tax debt
    b) upheld; the taxpayer was able to fully pay the tax debt
    c) overturned; the taxpayer was unable to fully pay the tax debt
    d) overturned; the taxpayer was able to fully pay the tax debt

CASE STUDY #1 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. There was no doubt here as to the amount owed, only as to the amount collectable.

   B: Correct. The IRS calculated the Reasonable Collection Potential at close to $100,000.

   C: Incorrect. He could not afford to pay in full but could afford to pay almost 10 times the amount being offered.

   D: Incorrect. The debt was too large for a streamlined agreement, and he sought an Offer in Compromise rather than an Installment Agreement.

   (See page 10-4 of the course material.)

2. **A: Correct.** The court ruled that the IRS acted properly in dismissing a claim of Effective Tax Administration based on the taxpayer's Reasonable Collection Potential.

   B: Incorrect. Effective Tax Administration is not available as a basis of compromise unless the taxpayer has the ability to fully repay the debt.

   C: Incorrect. The decision to reject the application was upheld.

   D: Incorrect. The decision to reject the application was upheld as the ability to make a full repayment is a condition to this type of compromise.

   (See page 10-6 of the course material.)

II. Case Study #2

In this case study, the taxpayer received an acceptance of his Offer in Compromise. After failing to timely file his income tax return, the IRS terminated his Offer in Compromise and the taxpayer appealed. The Tax Court ruled that the IRS did not have cause to terminate the agreement simply because the tax return was not filed, as the one-time failure did not constitute a material breach. The breach, according to the court, was not material because the taxpayer was in fact due a refund for the year in question and, therefore, the IRS suffered no harm. The IRS had sufficient collateral (control of the refund) to ensure the breach was not material, the court said. The court, therefore, ordered that the Offer in Compromise be reinstated.

James M. Robinette v. Commission of Internal Revenue
123 T.C. No. 5
UNITED STATES TAX COURT
James M. Robinette, Petitioner v. Commissioner of Internal Revenue, Respondent
Docket No. 12052-01L
Filed July 20, 2004

On Oct. 31, 1995, petitioner and respondent entered into an offer-in-compromise. The terms of the offer-in-compromise required petitioner to, among other things, timely file his 1995 through 1999 tax returns. On the morning of Oct. 15, 1999, the day petitioner's 1998 return was due, petitioner's accountant prepared petitioner's return. That afternoon, accountant drove to petitioner's office to obtain petitioner's signature on petitioner's return. Accountant returned to his office. Thereafter, accountant affixed postage to the envelope containing petitioner's return using a private postage meter. Accountant deposited the envelope containing petitioner's return in a U.S. Postal Service mailbox in his office building.

Respondent's records indicate that respondent received all of petitioner's returns except for petitioner's 1998 return. Respondent declared petitioner's offer-in-compromise in default. After a hearing in which petitioner raised the issue of compliance with the terms of the offer-in-compromise, respondent issued a notice of determination in which respondent determined to proceed with collection of the unpaid tax liabilities.

1. Held: Pursuant to sec. 6330(c), I.R.C., abuse of discretion is the applicable standard of review.
2. Held, further, when reviewing respondent's determination for an abuse of discretion under sec. 6330, I.R.C., we may consider evidence presented at trial which was not included in the administrative record.
3. Held, further, respondent abused his discretion in determining to proceed with collection.

This case was commenced in response to a Notice of Determination Concerning Collection Action(s) Under Sections 6320[3] and/or 6330. The issue is whether respondent may proceed with collection of petitioner's 1983, 1984, 1985, 1986, 1987, 1988, 1989, 1990, and 1991 tax liabilities.

[3] Unless otherwise indicated, all section references are to the Internal Revenue Code, and all Rule references are to the Tax Court Rules of Practice and Procedure. All amounts are rounded to the nearest dollar.

A. FINDINGS OF FACT

Some of the facts have been stipulated and are so found. The stipulation of facts, first supplemental stipulation of facts, second supplemental stipulation of facts, and the attached exhibits are incorporated herein by this reference. At the time he filed the petition, petitioner resided in Jonesboro, Arkansas.

Since approximately 1990, Douglas W. Coy has served as petitioner's accountant. Mr. Coy has prepared petitioner's tax returns for all the tax years in which he has represented petitioner.

1. Petitioner's Offer-in-Compromise

On October 31, 1995, petitioner and respondent entered into an offer-in-compromise. The offer-in-compromise related to income tax liabilities for 1983, 1984, 1985, 1986, 1987, 1988, 1989, 1990, and 1991, and trust fund recovery penalties for unpaid employment taxes for periods ending March 31, June 30, and September 30, 1988, June 30 and December 31, 1989, and March 31, June 30, and September 30, 1990. The offer-in-compromise was submitted on the basis of doubt as to collectability. The amount of individual income tax and statutory additions compromised totaled $989,475. Petitioner offered to pay $100,000 to compromise the outstanding liabilities and penalties.[4] Petitioner paid $1,000 with the submission of the offer and the remaining $99,000 with borrowed funds within 60 days after acceptance of the offer.

Petitioner agreed to the following terms and conditions:

(d) I * * * will comply with all the provisions of the Internal Revenue Code related to filing my * * * returns * * * for five (5) years from the date IRS accepts the offer.

****

(j) I * * * understand that I * * * remain responsible for the full amount of the tax liability unless and until IRS accepts the offer in writing and I * * * have met all the terms and conditions of the offer. IRS won't remove the original amount of the tax liability from its records until I * * * have met all the terms and conditions of the offer.

****

(o) If I * * * fail to meet any of the terms and conditions of the offer, the offer is in default, and IRS may:

****

(iv) file suit or levy to collect the original amount of tax liability, without further notice of any kind.

[4] As additional consideration, petitioner signed a Form 2261, Collateral Agreement, in which he also agreed to pay 40 percent of his annual income in excess of $100,000 and not in excess of $130,000; 50 percent of annual income in excess of $130,000 and not in excess of $150,000; and 60 percent of annual income in excess of $150,000. Petitioner's annual income was less than $100,000 for 1995, 1996, 1997, 1998, and 1999. Accordingly, petitioner was not required to pay additional consideration.

2. Petitioner's 1998 Individual Income Tax Return

Petitioner received an extension to file his 1998 individual income tax return (petitioner's 1998 return) on or before October 15, 1999. On the morning of October 15, 1999, Mr. Coy received via facsimile petitioner's Schedule K-1, Shareholder's Share of Income, Credits, Deductions, etc., for Professional Acres Leasing Group from the accounting firm of Osborne & Osborne. Upon receipt of the Schedule K-1 on October 15, 1999, Mr. Coy completed petitioner's 1998 return. For 1998, petitioner was entitled to a refund of $3,300.

At approximately 3:45 to 4 p.m. on October 15, 1999, Mr. Coy left his office in Little Rock, Arkansas, en route by car to three other cities in Arkansas in order to review State and Federal income tax returns with four of his clients, including petitioner, and to obtain his clients' signatures on their returns. First, Mr. Coy drove to Mount Pleasant, Arkansas, to deliver the returns of Howard and Jane Lamb for review and signatures. After the Lambs signed their tax returns, Mr. Coy drove to Melbourne, Arkansas, to deliver the returns of David and Theresa Sharp for review and signatures. After the Sharps signed their tax returns, Mr. Coy delivered the returns of Fred Lamb, also in Melbourne, Arkansas, for review and signature. After Mr. Lamb signed his tax returns, Mr. Coy drove to Jonesboro, Arkansas, to deliver the returns of petitioner for review and signature.

Mr. Coy arrived at petitioner's office between 8:45 and 9 p.m. Petitioner signed the returns in the presence of Mr. Coy and Frances Robinette, petitioner's wife and office manager.

After the clients signed their tax returns, Mr. Coy took the signed returns from his clients so that he could mail them from his office in Little Rock, Arkansas.

Mr. Coy returned to his office in Little Rock, Arkansas, sometime after 11 p.m., but before midnight. Mr. Coy made a copy of the signature page of petitioner's 1998 return. Mr. Coy affixed postage to the envelope containing petitioner's 1998 return using a private postage meter. The postage from the private postage meter displayed a postmark of October 15, 1999. Before midnight, Mr. Coy placed the envelope containing petitioner's 1998 return in a U.S. Postal Service mailbox in the building where his office is located.

At this same time, Mr. Coy mailed the returns of Mr. Sharp. Mr. Sharp was not assessed late filing penalties or late payments by the Internal Revenue Service (IRS) with respect to his 1998 individual income tax return.

3. Petitioner's 1995, 1996, 1997, 1999, and 2000 Individual Income Tax Returns

Petitioner received extensions to file his 1995 individual income tax return on or before October 15, 1996. Petitioner's 1995 individual income tax return was prepared by Mr. Coy on October 15, 1996. For 1995, petitioner paid the $2,593 shown as owed on his return.

Petitioner received extensions to file his 1996 individual income tax return on or before October 15, 1997. Petitioner's 1996 individual income tax return was received by the IRS on October 20, 1997. For 1996, petitioner was entitled to a refund of $14,435.

Petitioner received extensions to file his 1997 individual income tax return on or before October 15, 1998. Petitioner's 1997 individual income tax return was prepared by Mr. Coy on October 14, 1998, and received by the IRS on October 19, 1998. For 1997, petitioner was entitled to a refund of $5,644.

Petitioner received extensions to file his 1999 individual income tax return on or before October 15, 2000. Petitioner's 1999 individual income tax return was prepared by Mr. Coy on October 15, 2000, and received by the IRS on October 19, 2000. For 1999, petitioner was entitled to a refund of $2,631.

Petitioner received extensions to file his 2000 individual income tax return on or before October 15, 2001. Petitioner's 2000 income tax return was received by the IRS on October 17, 2001.

Each of the aforementioned years, including 1998, on or about October 15, Mr. Coy, or a person from Mr. Coy's office, delivered to petitioner at petitioner's office his original individual income tax return, and petitioner would sign it.

4. IRS Collection Efforts

On February 21, 2000, the IRS sent petitioner a "Request for Your Tax Return" for 1998. Petitioner received this letter. On March 17, 2000, the IRS notified petitioner that it had received his required Statement of Annual Income for 1998 but needed a copy of his 1998 Form 1040, U.S. Individual Income Tax Return. On April 17, 2000, the IRS sent petitioner a letter stating: "Your Tax Return is Overdue -- Contact us Immediately" for 1998. The letter also stated:

> *** OFFER IN COMPROMISE ***
> Our records indicate that we've accepted an offer in compromise from you. You agreed to file and pay all your federal taxes for the five (5) year period after we accepted this offer. If you don't file the requested delinquent return, we may reinstate the amount you owe that we previously compromised.

Petitioner forwarded to Mr. Coy by fax all notices from the IRS concerning his 1998 return and offer-in-compromise, as he was "scared to death" of these notices.

The Austin, Texas, Service Center monitored petitioner's offer-in-compromise. Revenue Officer Kathy Santino of the Oklahoma City, Oklahoma, office was assigned to examine whether petitioner's offer-in-compromise was in default. She examined petitioner's offer-in-compromise "as a courtesy to the Austin Service Center [because] they were overloaded in potentially defaulted offers". Ms. Santino knew of the 5-year filing requirement, but she did not know what years were covered by petitioner's offer-in-compromise. In her courtesy investigation of petitioner's offer-in-compromise, she did not look at the transcripts for 1995, 1996, or 1997. She did not consider petitioner's pattern of filing his returns on or about October 15. Ms. Santino never spoke with petitioner or Mr. Coy.

On July 13, 2000, Ms. Santino sent petitioner a letter declaring petitioner's offer-in-compromise in default. The basis for the default was that the IRS had not received petitioner's Form 1040 for 1998.

On September 28, 2000, the IRS issued a Final Notice—Notice of Intent to Levy and Your Right to a Hearing.

On October 6, 2000, petitioner, through his authorized representative Mr. Coy, filed a Form 12153, Request for a Collection Due Process Hearing. Petitioner stated the basis for the appeal as: "We do not believe the taxpayer owes the amounts stated in the Notice of Intent to Levy and would like the opportunity to resolve these matters at a Collection Due Process Hearing."

On January 10, 2001, Appeals Officer Troy C. Talbott of the Oklahoma City, Oklahoma, office sent Mr. Coy a letter identifying the options available for resolution of petitioner's tax liability (such as full payment, installment agreement, offer-in-compromise, or determination that petitioner's account is currently not collectible) and asking for more details as to why petitioner did not owe the amount stated in the notice of intent to levy. Mr. Talbott also requested and reviewed the IRS administrative file related to the default of the offer-in-compromise. On January 24, 2001, Mr. Talbott looked at petitioner's transcript of account for 1998. Mr. Talbott's case activity record states: "Per research on IDRS, no record of 98 1040 being filed. * * * Per IRP information, TP had a filing requirement, but may have been due a refund." Mr. Talbott concluded that petitioner had defaulted on the offer-in-compromise.

On January 29, 2001, in a telephone section 6330 hearing (the hearing), Mr. Coy stated to Mr. Talbott that he mailed petitioner's 1998 return on October 15, 1999. Specifically, Mr. Coy told Mr. Talbott that he prepared petitioner's return, took the return to petitioner, obtained petitioner's signature, and mailed the return on October 15, 1999.

The only evidence Mr. Talbott would consider for proof of mailing was a certified mail or registered mail receipt. Mr. Talbott did not consider petitioner's pattern of filing returns on October 15, despite having looked at the transcripts for 1995, 1996, 1997, and 1999.

Mr. Talbott believed he had no authority to reinstate petitioner's offer-in-compromise. He believed only the National Office could reinstate the offer-in-compromise. He stated: "The National Office would still have to do the reinstatement by itself" and the "National Office would have the call". Mr. Talbott reviewed the Internal Revenue Manual. The manual was silent as to whether an Appeals officer has authority to reinstate an offer-in-compromise.

Mr. Coy sent Mr. Talbott a copy of petitioner's 1998 return. Mr. Talbott received the copy of petitioner's 1998 return on February 16, 2001. Mr. Talbott forwarded it to the Austin Service Center, where it was processed by the IRS as an original return. Petitioner's transcript of account for 1998 states "return filed and tax assessed" on April 2, 2001.

Petitioner never personally met with, or spoke to, Mr. Talbott.

The Appeals settlement memorandum prepared by Mr. Talbott concluded that the notice of intent to levy was appropriate. Mr. Talbott's evaluation concluded:

> The Offer in Compromise was defaulted because the IRS did not have a record of the taxpayer filing Form 1040 for 1998. The taxpayer's representative claimed to have timely mailed the tax return for 1998 on October 15, 1999, but the tax return was not sent by certified mail and the representative does not have any evidence to prove that the return was mailed. The taxpayer did not respond to the IRS's requests to file the tax return, which resulted in the offer being defaulted.

On August 21, 2001, the IRS issued to petitioner a Notice of Determination Concerning Collection Action(s) Under Section 6320 and/or 6330 determining to proceed with collection. Petitioner timely filed a petition with the Court.

B. OPINION

1. <u>Section 6330</u>

Section 6331(a) provides that if any person liable to pay any tax neglects or refuses to do so within 10 days after notice and demand, the Secretary can collect such tax by levy upon property belonging to such person. Pursuant to section 6331(d), the Secretary is required to give the taxpayer notice of his intent to levy and within that notice must describe the administrative review available to the taxpayer, before proceeding with the levy. See also sec. 6330(a).

Section 6330(b) describes the administrative review process, providing that a taxpayer can request an Appeals hearing with regard to a levy notice. At the Appeals hearing, the taxpayer may raise certain matters set forth in section 6330(c)(2), which provides, in pertinent part:

> SEC. 6330(c). Matters Considered at Hearing.—In the case of any hearing conducted under this section—

****

(2) Issues at hearing.--

(A) In general.--The person may raise at the hearing any relevant issue relating to the unpaid tax or proposed levy, including--

(i) appropriate spousal defenses;

(ii) challenges to the appropriateness of collection actions; and

(iii) offers of collection alternatives, which may include the posting of a bond, the substitution of other assets, an installment agreement, or an offer-in-compromise.

(B) Underlying liability.--The person may also raise at the hearing challenges to the existence or amount of the underlying tax liability for any tax period if the person did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability.

Pursuant to section 6330(c)(2)(A), a taxpayer may raise at the section 6330 hearing any relevant issue with regard to the Commissioner's collection activities, including spousal defenses, challenges to the appropriateness of the Commissioner's intended collection action, and alternative means of collection.

Pursuant to section 6330(d)(1), within 30 days of the issuance of the notice of determination, the taxpayer may appeal that determination to this Court if we have jurisdiction over the underlying tax liability.

2. Standard of Review

The parties dispute the standard of review to be applied in this case. Although section 6330 does not prescribe the standard of review that the Court is to apply in reviewing the Commissioner's administrative determinations, we have stated that where the validity of the underlying tax liability is properly at issue, the Court will review the matter de novo. Where the validity of the underlying tax liability is not properly at issue, however, the Court will review the Commissioner's administrative determination for abuse of discretion.

Generally, under section 6330(c)(2)(B), issues that are reviewed de novo include those such as a redetermination of the tax on which the Commissioner based the assessment, provided that the taxpayer did not have an opportunity to seek such a redetermination before assessment. Whether the Commissioner's assessment was made within the limitation period also constitutes a challenge to the underlying tax liability.

Under an abuse of discretion standard, "we do not interfere unless the Commissioner's determination is arbitrary, capricious, clearly unlawful, or without sound basis in fact or law." Ewing v. Commissioner, 122 T.C. 32, 39 (2004); see also Woodral v. Commissioner, 112 T.C. 19, 23 (1999). Review for abuse of discretion includes "any relevant issue relating to the unpaid tax or the proposed levy", including "challenges to the appropriateness of collection actions" and "offers of collection alternatives" such as offers in compromise. Questions about the appropriateness of the collection action include whether it is proper for the Commissioner to proceed with the collection action as determined in the notice of determination, and whether the type and/or method of collection chosen by the Commissioner is appropriate.

Abuse of discretion is the proper standard of review in this case. The introductory language of section 6330(c)(2)(A) encompasses the situation at bar. Mr. Talbott's conclusion that respondent had acted properly in declaring petitioner's offer-in-compromise in default and that issuing a notice of determination was proper is a "relevant issue relating to the unpaid tax or the proposed levy". Further, offers in compromise are a specifically mentioned collection alternative. Additionally, whether respondent may proceed with collection of petitioner's unpaid liability is a challenge to the appropriateness of collection.

Petitioner argues that a de novo standard of review is appropriate because he "put forth the argument of the validity of the underlying taxes--i.e., the petitioner does not owe the tax, nor the additions to the tax, since the tax was previously discharged by an Offer in Compromise which was improperly defaulted by the respondent". We view petitioner's argument as a challenge to the appropriateness of collection, rather than as a challenge to the underlying tax liability.

a. Whether the evidence presented at trial relates to issues raised at the hearing

Respondent, citing Magana v. Commissioner, 118 T.C. 488, 493 (2002), contends that "only 'arguments, issues and other matter' presented to Appeals are relevant to the determination whether an appeals officer abused his or her discretion." Further, respondent argues that "judicial review of respondent's exercise of discretion in this case should be based solely on the information presented to, and considered by, the appeals officer." We disagree with respondent's interpretation of Magana.

In a review for abuse of discretion of the Commissioner's determination under section 6330(d)(1), "generally we consider only arguments, issues, and other matter that were raised at the collection hearing or otherwise brought to the attention of the Appeals Office." Magana v. Commissioner, supra at 493 (emphasis added). "We did not say in Magana that the taxpayer would be limited to the administrative record or that the taxpayer may not offer evidence in the proceeding in this Court."

In Magana, the issue for decision on the Commissioner's motion for summary judgment was whether the Court "shall consider a new issue that was not raised by the petitioner at his collection hearing with respondent's Appeals Office." In the taxpayer's request for a collection hearing and at the hearing, the only issue raised was whether the period of limitations had expired under section 6502. The taxpayer did not raise the issue of hardship.

In his petition to the Court, the taxpayer "for the first time, raised hardship as an objection to respondent's lien filings (namely, petitioner's physical illness and the resulting cloud on title to petitioner's residence, petitioner's only significant asset)." At the oral argument on the Commissioner's motion for summary judgment, the taxpayer's counsel "acknowledged that * * * [the taxpayer's] ill health was not recent but had extended over 20 years." In response to the Court's questioning, the taxpayer's counsel "acknowledged that he had had an opportunity at the collection hearing to raise hardship but that he had chosen not to do so."

In the discussion section of the Opinion, under the heading "New Issue", we reasoned:

> In this case, because petitioner's alleged longstanding illness and hardship were not raised as an issue and were not otherwise brought to respondent's attention in connection with petitioner's collection hearing with respondent's Appeals Office, petitioner may not now raise hardship for the first time before this Court. * * * [Id. at 493-494.]

The cases cited for support of the holding in Magana were issue preclusion cases. Unlike the taxpayer in Magana, petitioner is not raising a new issue in his petition. At the hearing, petitioner raised the issue of compliance with the terms of the offer-in-compromise. Mr. Coy asked Mr. Talbott to reinstate the offer-in-compromise. Mr. Coy brought to the attention of Mr. Talbott the fact that he mailed petitioner's 1998 return on October 15, 1999. Mr. Talbott's notes in his case activity record indicate that Mr. Coy raised the issue and brought to his attention that Mr. Coy mailed the return on October 15, 1999. Shortly after the hearing, Mr. Coy wrote Mr. Talbott stating: "As I had mentioned, I prepared the return for [petitioner], obtained his signature, and mailed the return to the Service Center on the evening of October 15, 1999." This was brought to the attention of Mr. Talbott.

Accordingly, we may consider evidence regarding this issue at trial, if it is otherwise admissible under the Federal Rules of Evidence.

b. Whether the evidence is admissible under the federal rules of evidence

While we are not limited by the APA's judicial review provisions in our proceedings arising under section 6330(d), our review of materials not included in the Commissioner's administrative record is subject to the Federal Rules of Evidence. Section 7453 and Rule 143(a) provide that the Court's proceedings are to be conducted in accordance with the rules of evidence applicable in trials without a jury in the U.S. District Court for the District of Columbia. Consistent with section 7453 and Rule 143(a), we must decide whether evidence in this case which was not included in the administrative record is admissible under the Federal Rules of Evidence in our proceedings arising under section 6330(d).

Respondent moved to strike the evidence on the ground of relevancy. "All relevant evidence is admissible. * * * Evidence which is not relevant is not admissible." Relevant evidence "means evidence having any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable than it would be without the evidence." Therefore, we must determine whether the evidence presented at trial that respondent characterizes as "outside of the administrative record" has any tendency to make the existence of any fact that is of consequence in determining whether the Appeals officer abused his discretion more probable or less probable than it would be without the evidence. We find that the evidence does have a tendency to show the Appeals officer abused his discretion in determining to proceed with collection.

Petitioner's testimony is relevant. Petitioner was not present at the hearing. Petitioner's testimony shows that he signed the 1998 return on October 15, 1999. Petitioner's testimony shows that he had filed his returns for 1995, 1996, 1997, 1999, and 2000 on or about October 15 in the same pattern and practice as he did for 1998. Petitioner's testimony shows that he acted in good faith in complying with the terms of the offer-in-compromise.

Petitioner's tax returns for 1995, 1996, 1997, 1999, and 2000 are relevant. They show a pattern and practice of petitioner's filing his returns on or about October 15. They show petitioner generally received refunds for the period in issue. While the Appeals officer reviewed petitioner's transcripts for 1995, 1996, 1997, and 1999, he did not consider petitioner's pattern and practice of timely filing. After reviewing petitioner's transcripts, the Appeals officer concluded petitioner was probably entitled to a refund for 1998. These facts, however, were of no consequence to him when he reviewed whether the offer-in-compromise should have been defaulted.

Mr. Coy's private postage meter log, cellular telephone records, credit card records, and daily calendar for October 15, 1999, are relevant. They corroborate Mr. Coy's statements regarding mailing. The Appeals officer, however, refused to consider any evidence of mailing, other than a certified or registered mail receipt.

Frances Robinette's testimony is relevant. Under Davis v. Commissioner, 115 T.C. 35 (2000), taxpayers are not entitled to call witnesses at the hearing. Mrs. Robinette's testimony corroborates petitioner's good faith and compliance with the terms of the offer-in-compromise.

Mr. Coy's statements at trial that he did not make to Mr. Talbott are relevant. Mr. Coy's testimony indicates the Appeals officer's unwillingness to consider in depth certain issues that he raised at the hearing.

Accordingly, respondent's motion to strike will be denied.

3. Whether Respondent Abused His Discretion

Where, as here, the validity of the underlying tax liability is not at issue, we review the determination for abuse of discretion. In doing so, we review whether the Appeals officer's determination was arbitrary, capricious, or without sound basis in fact or law. Having observed the appearance and demeanor of the witnesses testifying for petitioner at trial, including petitioner, we find them to be honest, forthright, and credible.

Taking into account all the facts and circumstances, we conclude that on the basis of the record before us, respondent abused his discretion in determining to proceed with collection.

a. Whether petitioner's return was timely filed

We note at the outset that contrary to petitioner's contentions, we find that petitioner's return was not timely filed. Filing, generally, "is not complete until the document is delivered and received". Section 7502 provides an exception to this rule. Section 7502(a)(1) provides that, in certain circumstances, a timely mailed document will be treated as though it were timely filed. Section 7502(a)(2) provides that the timely mailing/timely filing rule applies if the postmark date on an envelope falls within the prescribed period or on or before the prescribed date.

In the case of postmarks not made by the U.S. Postal Service, the timely mailing/timely filing rule applies "only if and to the extent provided by regulations prescribed by the Secretary". The postmark in this case was made by a private postage meter. Section 301.7502-1(c)(1)(iii)(b), Proced. & Admin. Regs., provides:

> If the postmark on the envelope or wrapper is made other than by the United States Post Office, (1) the postmark so made must bear a date on or before the last date, or the last day of the period, prescribed for filing the document, and (2) the document must be received by the agency, officer, or office with which it is required to be filed not later than the time when a document contained in an envelope or other appropriate wrapper which is properly addressed and mailed and sent by the same class of mail would ordinarily be received if it were postmarked at the same point of origin by the United States Post Office on the last date, or the last day of the period, prescribed for filing the document. However, in case the document is received after the time when a document so mailed and so postmarked by the United States Post Office would ordinarily be received, such document will be treated as having been received at the time when

> a document so mailed and so postmarked would ordinarily be received, if the person who is required to file the document establishes (i) that it was actually deposited in the mail before the last collection of the mail from the place of deposit which was postmarked (except for the metered mail) by the United States Post Office on or before the last date, or the last day of the period, prescribed for filing the document, (ii) that the delay in receiving the document was due to a delay in the transmission of the mail, and (iii) the cause of such delay. If the envelope has a postmark made by the United States Post Office in addition to the postmark not so made, the postmark which was not made by the United States Post Office shall be disregarded, and whether the envelope was mailed in accordance with this subdivision shall be determined solely by applying the rule of (a) of this subdivision. [Emphasis added.]

Mr. Coy testified that he placed petitioner's return in the mail between 11 p.m. and midnight. Petitioner presented no evidence that this was before the last collection for that mailbox. Petitioner presented no evidence as to a delay in the transmission of the mail. Petitioner presented no evidence as to the cause of a delay. Petitioner has failed to meet the requirements of the regulation. See Fishman v. Commissioner, 420 F.2d 491, 492 (2d Cir. 1970), affg. 51 T.C. 869 (1969); cf. Jones v. Commissioner, T.C. Memo. 1998-197 (the taxpayer met requirements of non-U.S.-postmark regulation when evidence established, in part, that he deposited the envelope in the mail before the last collection).

Petitioner argues that Estate of Wood v. Commissioner, 909 F.2d 1155 (8th Cir. 1990), affg. 92 T.C. 793 (1989), and not the regulation, controls this issue. In Estate of Wood, the Court of Appeals for the Eighth Circuit, the court to which an appeal of this case would lie, discussed section 7502 in the situation where the taxpayer's return was not received by the IRS. Petitioner's reliance on Estate of Wood is misplaced. The presumption of delivery discussed in Estate of Wood is raised only when a timely mailing occurs. As petitioner's return was not timely mailed, the presumption of delivery discussed in Estate of Wood has not been raised.

On the basis of the foregoing, we hold that petitioner has not proven that he filed his return on October 15, 1999. Mr. Coy sent Mr. Talbott a copy of petitioner's 1998 return. On February 16, 2001, Mr. Talbott received the copy of petitioner's 1998 return, which he forwarded to the Austin Service Center and which was then processed by the IRS as an original return. Petitioner's transcript of account for 1998 states: "return filed and tax assessed" on April 2, 2001. Thus, petitioner's return was late filed.

b. Whether petitioner materially breached the offer-in-compromise

Despite the late filing of petitioner's return, under the facts and circumstances of this case, respondent abused his discretion in determining to proceed with collection. The Appeals officer acted arbitrarily and without sound basis in law and had a closed mind to the arguments presented on petitioner's behalf. He failed to consider the facts and circumstances of this case. He determined to proceed with collection even though the breach in the contract was not material and under contract law the contract remained in effect.

1) Jurisdiction to Consider Petitioner's Offer-in-Compromise

Respondent contends that the Court has no jurisdiction to determine whether petitioner's offer-in-compromise was properly terminated. Respondent contends that only the Court of Federal Claims or a U.S. District Court may review this determination. We disagree.

In Roberts v. United States, 242 F.3d 1065 (Fed. Cir. 2001), the Court of Appeals for the Federal Circuit reversed and remanded the order of the U.S. District Court for the Eastern District of Missouri transferring the case to the Court of Federal Claims for lack of jurisdiction. The Court of Appeals held that the U.S. District Court did have jurisdiction over the taxpayer's claim for refund, even though the tax liability resulted from an offer-in-compromise that the IRS had defaulted. The Court of Appeals reasoned:

> Roberts is not requesting, for example, damages from the government for breach of contract, which would constitute a claim based purely upon a government contract. Certainly, the district court does not have jurisdiction over additional contract claims Roberts may wish to assert against the government under the terms of the OIC * * *.
>
> Instead, Roberts has paid taxes that he alleges were illegally or erroneously collected. Tax cases heard in the district courts often involve offers in compromise * * *. The fact that the alleged collection error stems from the cancellation of Roberts's OIC contract with the IRS does not negate the fact that the monies at issue were paid pursuant to the internal-revenue laws. [Id. at 1069.]

The Court of Appeals found that the taxpayer had satisfied the jurisdictional requirements for a tax refund suit. Thus, the U.S. District Court could review whether the taxpayer's offer-in- compromise had been properly defaulted.

In this case, petitioner is not asserting a cause of action under contract law. Petitioner seeks a finding from the Court that respondent abused his discretion in determining to proceed with collection, which is within our jurisdiction under section 6330. Respondent's determination to proceed with collection arises from defaulting petitioner's offer-in-compromise. Whether the offer-in-compromise was properly defaulted is a relevant issue relating to the unpaid tax or proposed levy. Sec. 6330(c)(2)(A). Respondent issued petitioner a notice of intent to levy on the basis of petitioner's unpaid tax liability.

2) Whether the Breach of the Offer-in-Compromise Was Material

Applicable Law

"An accepted offer in compromise is properly analyzed as a contract between the parties." Dutton v. Commissioner, 122 T.C. 133, 138 (2004). Offers in compromise are governed by "general principles of contract law." "If the plaintiff's breach is material and sufficiently serious, the defendant's obligation to perform may be discharged. * * * Not so, however, if the plaintiff's breach is comparatively minor."

In determining whether a failure to perform is material, the following five circumstances are significant:

In determining whether a failure to render or to offer performance is material, the following circumstances are significant:

> (a) the extent to which the injured party will be deprived of the benefit which he reasonably expected;
>
> (b) the extent to which the injured party can be adequately compensated for the part of that benefit of which he will be deprived;
>
> (c) the extent to which the party failing to perform or to offer to perform will suffer forfeiture;
>
> (d) the likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances;
>
> (e) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing. [1 Restatement, Contracts 2d, sec. 241 (1981).]

Arkansas law adopts this analysis. The standard of materiality "is to be applied in the light of the facts of each case in such a way as to further the purpose of securing for each party his expectation of an exchange of performances."

Cases in which courts have found offers in compromise materially breached, and thus in default, generally involve taxpayers who either fail to make payments agreed to in the offer-in-compromise to pay off the amount compromised, or fail to pay taxes owed during the 5-year period after the offer has been accepted.

Analysis

<u>Loss of benefit to injured party</u>. In petitioner's late filing of his 1998 return, in which he was due a refund, the extent of the benefit that respondent was deprived of was not significant. Inherent in the requirement that taxpayers comply with the provisions of the Internal Revenue Code for 5 years is the IRS expectation that the taxpayer will pay the taxes owed on time. In this case, however, petitioner was due a refund.

As stated <u>supra</u>, petitioner's return was not timely filed. Not every delay, however, constitutes a material breach. There must also be a causal connection between the delay and the damages suffered by respondent, in order for a material breach to be found on the basis of the delay. Respondent suffered no monetary damage from petitioner's late filing of the 1998 return. Under the facts of this case, the late filing, by itself, is not sufficient basis for a material breach of the contract.

<u>Adequacy of compensation for loss</u>. The IRS was adequately compensated for its "loss". Respondent suffered minimal, if any, damages, as he held petitioner's refund as security.

Forfeiture by party who fails. Under this factor, the comments in the Restatement explain: "[A] failure is less likely to be regarded as material if it occurs late, after substantial preparation or performance, and more likely to be regarded as material if it occurs early, before reliance." In this case, petitioner had substantially performed under the terms of the offer-in-compromise at the time the offer was declared in default. Petitioner's untimely mailing of the return occurred in the fourth year of a 5-year agreement. Petitioner had already paid the full amount of the offer-in-compromise, with borrowed funds, within 60 days after the offer had been accepted. Petitioner had complied with the filing requirements for the first 3 years of the agreement. Further, at the time the Appeals officer determined to proceed with collection, petitioner had filed his 1998 return and complied with all other terms of the offer-in-compromise.

Uncertainty. Under this factor, the comments in the Restatement note:

> To the extent that expectation is already reasonably secure, in spite of the failure, there is less reason to conclude that the failure is material. The likelihood that the failure will be cured is therefore a significant circumstance in determining whether it is material * * *. The fact that the injured party already has some security for the other party's performance argues against a determination that the failure is material. [1 Restatement, supra, sec. 241, comment e.]

As stated supra, respondent was reasonably secured. Respondent had possession of petitioner's 1998 refund, making it likely that petitioner would perform under the agreement by filing his 1998 return. Respondent also had received $100,000 within 60 days of his acceptance of the offer, which was the amount offered and accepted as payment of petitioner's outstanding tax liabilities from 1983 to 1991. Additionally, before the Appeals officer determined to proceed with collection, petitioner had cured the defect. Petitioner submitted his 1998 return to the Appeals officer, at the request of the Appeals officer, to be filed as an original return.

Absence of good faith or fair dealing. Petitioner acted in good faith. Petitioner signed his 1998 return on the due date and gave it back to Mr. Coy for mailing. This was the pattern and practice petitioner had used in filing the returns prepared by Mr. Coy. He paid the full amount of the offer-in-compromise within 60 days after acceptance of the offer, with borrowed funds. He timely filed his returns for 1995, 1996, 1997, 1999, and 2000.[5] Except for 1995, petitioner's returns indicate that petitioner was entitled to refunds. For 1998, petitioner was entitled to a refund. Before respondent issued the notice of determination, petitioner had filed his 1998 return. Indeed, when petitioner received the notices from the IRS, he called Mr. Coy to discuss them and also forwarded the notices by fax to Mr. Coy, as he was "scared to death".

Additionally, Mr. Talbott did not have an open mind to the issues Mr. Coy presented at the hearing. He did not consider that petitioner had acted in good faith. Mr. Talbott did not consider petitioner's pattern of filing of returns on or about October 15, despite having looked at the transcripts for 1995, 1996, 1997, and 1999.

[5] We note that by the terms of the offer-in-compromise, the offer-in-compromise did not apply to 2000.

Mr. Talbott did not have an open mind regarding reinstatement. Moreover, he failed to independently analyze whether the terms of the offer-in-compromise had been materially breached. Mr. Talbott believed he had no authority to reinstate petitioner's offer-in-compromise. He believed only the National Office could reinstate the offer-in-compromise. Neither the Internal Revenue Code nor the Internal Revenue Manual, however, states that he could not reinstate the offer-in-compromise. Mr. Talbott reviewed the Internal Revenue Manual. The manual was silent as to whether he could reinstate the offer-in-compromise.

On the basis of the facts and circumstances of this case, we conclude that petitioner did not materially breach the terms of the offer-in-compromise. As the offer-in-compromise was not in default, it was an abuse of discretion for respondent to determine to proceed with collection of petitioner's tax liability.

In reaching all of our holdings herein, we have considered all arguments made by the parties, and to the extent not mentioned above, we find them to be irrelevant or without merit.

To reflect the foregoing,

An appropriate order and decision will be entered.

CASE STUDY #2 – REVIEW QUESTIONS

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. Why did the IRS terminate the Offer in Compromise with the taxpayer and demand full payment of the back taxes:

    a) because the taxpayer missed two required payments
    b) because the taxpayer failed to file a required Form 1040 for one year
    c) because the IRS determined that the taxpayer's circumstances had changed and he was not able to repay the debt in full
    d) because the taxpayer did not comply with any of the terms of the Offer in Compromise

2. On what grounds did the Tax Court order the IRS to reinstate the Offer in Compromise with the taxpayer:

    a) the court said the IRS does not have authority to terminate Offers in Compromise without prior judicial approval
    b) the court believed the CPA that he did in fact mail in the return
    c) the court did not believe that the missing tax return constituted a "material" breach of the Offer in Compromise
    d) the court said the IRS did not follow their own internal procedures for terminating an Offer in Compromise

CASE STUDY #2 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. There were no missed payments. The issue was the fact that the IRS did not receive one tax return that the taxpayer's CPA said he mailed.

   B: Correct. The terms of the Offer in Compromise required the timely filing of all tax returns for a specified period. The CPA for the taxpayer said he mailed the return, though it was never received by the IRS.

   C: Incorrect. This is not correct. In fact, the IRS protected its interests by negotiating a collateral agreement.

   D: Incorrect. There was only a single breach of the terms of the Offer in Compromise, namely the one missing return. All other requirements were met by the taxpayer.

   (See page 10-13 of the course material.)

2. A: Incorrect. The IRS does have discretion to terminate an agreement when there has been a material breach.

   B: Incorrect. Whether or not the CPA mailed in the return or whether the court believed he did was not material to the determination in this case.

   C: Correct. The government was not harmed by the breach, the court said, because the taxpayer was actually owed a refund for the tax year in question.

   D: Incorrect. The IRS followed proper procedures; they just abused their authority in so doing.

   (See page 10-27 of the course material.)

III. <u>Case Study #3</u>

This case addresses a business that has financial problems and is delinquent in its federal tax payments. The IRS refused to enter into an Installment Agreement or subordinate its Notice of Federal Tax lien to a private line of credit that would have allowed the business to repay its delinquent taxes. The court said that the IRS has to be flexible in some cases to best serve the interests of the government. In this case, helping facilitate the taxpayer's business would have led to repayment.

Alessio Azzari, Inc. v. Commissioner of Internal Revenue
136 T.C. No. 9
UNITED STATES TAX COURT
Alessio Azzari, Inc., Petitioner v. Commissioner of Internal Revenue, Respondent
Docket No. 27532-08L
Filed February 24, 2011

Petitioner's business experienced financial difficulties and cash flow problems, and petitioner fell behind on its Federal employment tax deposits. Petitioner later received financing from a lender which made loans secured by an interest in petitioner's accounts receivable. The lender's financing helped petitioner remain current with its tax deposits for six consecutive quarters. During that time, respondent filed a Notice of Federal Tax Lien (NFTL) for the tax petitioner still owed. Petitioner's lender refused to extend any more credit to petitioner because of the NFTL unless respondent agreed to subordinate the NFTL to the lender's security interest.

Petitioner requested that respondent subordinate the NFTL and grant it an installment agreement to satisfy its tax liabilities. Because the lender's security interest antedated the NFTL, respondent determined that the lender's security interest already had priority in petitioner's accounts receivable and that it was unnecessary to subordinate the NFTL. In part on account of its inability to borrow against its accounts receivable because of the NFTL, petitioner again fell behind on its employment tax deposits, and respondent therefore refused to consider petitioner's proposed installment agreement.

1. Held: It was an abuse of discretion for respondent to refuse to consider petitioner's request to subordinate the NFTL on the basis of respondent's erroneous conclusion of law that the lender's security interest already had priority over the NFTL in petitioner's accounts receivable.
2. Held, further, it was an abuse of discretion for respondent to deny petitioner's request for an installment agreement on the basis of petitioner's failure to stay current on its tax deposits where respondent's abuse of discretion in refusing to consider subordination of the NFTL to petitioner's lender's security interest contributed to petitioner's falling behind on its tax deposits and where respondent did not allow petitioner the opportunity to become current again.

A. OPINION

WELLS, Judge: This case is before the Court on respondent's motion for summary judgment and petitioner's cross-motion for summary judgment pursuant to Rule 121. We must decide whether respondent's settlement officer abused his discretion in denying petitioner's request to subordinate or withdraw a notice of Federal tax lien (NFTL), or in denying petitioner's request for an installment agreement.

B. BACKGROUND

The record consists of the parties' pleadings; their respective cross-motions for summary judgment; various responses, declarations, and memoranda in support of or opposition to the motions; and the administrative record from the collection due process hearing.

Petitioner is a New Jersey corporation with its principal place of business in Mickleton, New Jersey. Petitioner's business relates to the home building industry.

For the quarters ending September 30 and December 31, 2005, petitioner did not timely file its employer's quarterly tax returns. Petitioner timely filed its employer's quarterly tax returns for the quarters ending March 31, June 30, September 30, and December 31, 2006. Respondent assessed the tax shown on the return for each period, but petitioner did not fully pay its liabilities. Petitioner's unpaid employment tax liabilities total $1,100,622 for the quarters ending September 30 and December 31, 2005, and March 31, June 30, September 30, and December 31, 2006 (collectively, the periods in issue).

On or about November 6, 2007, respondent mailed petitioner a Final Notice - Notice of Intent to Levy and Notice of Your Right to a Hearing (notice of intent to levy), informing petitioner that respondent intended to levy to collect petitioner's unpaid employment tax liabilities. Petitioner did not request a hearing or otherwise dispute the notice of intent to levy. Respondent subsequently filed an NFTL with respect to petitioner's unpaid quarterly employment tax liabilities for the periods in issue.

Respondent notified petitioner on November 27, 2007, of the NFTL filing. On or about January 2, 2008, petitioner timely submitted Form 12153, Request for a Collection Due Process or Equivalent Hearing. Petitioner checked the boxes on Form 12153 requesting that an installment agreement be considered as a collection alternative and that the lien be withdrawn. In the attached explanation, petitioner stated that the lien made it more difficult for petitioner to satisfy its tax liabilities by making it impossible to sell its accounts receivable to a factor.

On January 25, 2008, and before receiving any reply from respondent, petitioner submitted a written request to respondent asking that the NFTL be subordinated to a line of credit from Penn Business Credit, LLC (Penn Business Credit). Petitioner also asked that respondent agree to a proposed installment agreement attached to the letter. In a footnote to petitioner's request, petitioner explained that there had been a misunderstanding about the nature of the financing relationship with Penn Business Credit when it filed the Form 12153 and that petitioner's counsel had not yet obtained the loan documents at that time. After examining the documents, petitioner's counsel ascertained that the financial relationship with Penn Business Credit was lending, not factoring, and that petitioner should be eligible to have the NFTL subordinated to the line of credit from Penn Business Credit.[6] Therefore, in its January 25, 2008, letter, petitioner

---

[6] Factoring would have entailed the discounted sale of petitioner's accounts receivable to Penn Business Credit. In a factoring transaction, the financing company purchases the accounts receivable without recourse and acts as the principal in the debt collection process. See Downes & Goodman, Dictionary of Finance & Investment Terms (7th ed. 2006). Because factoring involves selling the accounts receivable rather than lending collateralized by the accounts receivable, the financing company is not a creditor and therefore possesses no lien of its own to which the tax lien may be subordinated. Accordingly, when petitioner believed that the relationship was factoring, it requested that the lien be withdrawn; but once it realized that the relationship was lending involving Penn Business Credit as a creditor, petitioner changed its request to ask that the lien be subordinated.

replaced its request in its Form 12153 that respondent withdraw the NFTL with a request that respondent subordinate the NFTL to Penn Business Credit's security interest.

In the January 25, 2008, letter, petitioner explained that it had fallen behind on its employment tax payments during the periods in issue, through the end of 2006, because of slowing demand in the market for new home construction and because many of petitioner's major customers had become unable to timely pay their invoices or had entirely defaulted on their obligations. Petitioner also explained that the situation left it in a "cash crisis" without available funds to both pay its employment taxes and have the cash necessary to operate its business.

During January 2007, as part of its effort to address the cash crisis, petitioner had entered into a financing agreement with Penn Business Credit (financing agreement). Under the terms of the financing agreement, Penn Business Credit extended credit to petitioner equal to the lesser of 50 percent of its qualifying accounts receivable[7] or $1 million. On February 2, 2007, Penn Business Credit filed with the State of New Jersey a financing statement to record its security interest under the financing agreement. The financing statement covered, among other things, "accounts", "accounts receivable", and "all other rights to the payment of money whether or not yet earned, for services rendered or goods sold, consigned, leased, or furnished" by petitioner.

In its January 25, 2008, request, petitioner stated that the financing agreement with Penn Business Credit had enabled petitioner to begin paying its employment taxes even though its own customers continued to lag behind in their payments. Without the financing from Penn Business Credit, petitioner predicted that it would be unlikely to have sufficient cash flow to satisfy the terms of its proposed installment agreement. To support its contention, petitioner attached two cash flow projections prepared by its accountant.

Petitioner also informed respondent in its January 25, 2008, letter that Penn Business Credit had refused to make any loans to petitioner since learning of the NFTL. However, petitioner asserted that Penn Business Credit would resume making loans to petitioner under its financing agreement if respondent would subordinate his lien to Penn Business Credit's security interest. Petitioner attached documentation from Penn Business Credit affirming that the lender would, indeed, resume making loans to petitioner if respondent subordinated the NFTL. In a footnote at the end of the letter, petitioner's counsel wrote:

> As a protective measure, <u>because the need for subordination at this time is critical</u>, the undersigned intends to send on the behalf of * * * [petitioner] a letter to * * * [respondent's] District Director applying for a Certificate of Subordination of Federal Tax Lien. Such letter is intended to complement and not supersede this letter. [Emphasis added.]

[7] The financing agreement defines which accounts receivable qualify as part of the borrowing base. Considerations include the solvency of the debtors, the finality of the sale, the terms of the account, and other factors that might affect the collectability of the account.

For almost 4 months, respondent's office did not reply to petitioner's request. On May 12, 2008, respondent mailed to petitioner's counsel a letter informing him that the case had been forwarded to respondent's Philadelphia Office of Appeals. On May 20, 2008, respondent's Appeals Office confirmed its receipt of petitioner's request for a collection due process hearing and scheduled a telephone conference at 11 a.m. on June 17, 2008. On June 12, 2008, petitioner's counsel contacted respondent's settlement officer Darryl K. Lee (Mr. Lee) and requested a face-to-face conference hearing in respondent's Philadelphia Office of Appeals and a minimum 1-week extension to prepare documents requested by Mr. Lee.

Petitioner complied with Mr. Lee's document requests and also submitted a revised collection alternative with two cash flow projections, one with the accounts receivable financing from Penn Business Credit and one without. Petitioner explained that it had experienced a greater loss in revenue and higher fuel costs than anticipated and stated that it would be unable to satisfy the terms of its original proposed installment agreement.

Petitioner's counsel met with Mr. Lee in person on June 26, 2008. At the meeting, petitioner's counsel again requested that the lien be subordinated to Penn Business Credit's security interest. Mr. Lee told petitioner that the lien could not be subordinated because it did not have priority over Penn Business Credit's security interest since the NFTL had been filed later than the security agreement with Penn Business Credit. Mr. Lee suggested that the lien might be withdrawn if petitioner would pay $300,000 immediately and enter an installment agreement to pay off the balance of the liability within 10 years. At the time, Mr. Lee also warned that petitioner would have to stay current with its deposits for its Federal employment tax liabilities if it wanted to be eligible for an installment agreement.

Petitioner fully paid its employment taxes throughout 2007 and the first half of 2008 but began to fall behind on its deposits during the third quarter of 2008. By September 22, 2008, petitioner had not made any Federal tax deposits for its third quarter employment taxes, and Mr. Lee called petitioner's counsel to inform him that if these deposits were not made, petitioner would not be eligible to proceed with the installment agreement. Mr. Lee also stated his belief that petitioner's proposed installment agreement was unrealistic given the current state of petitioner's business and the housing market.

After conferring with petitioner, petitioner's counsel confirmed that petitioner had not made any deposits for employment taxes during the period ending September 30, 2008. In a letter to Mr. Lee dated September 26, 2008, petitioner's counsel explained that the housing crisis had dramatically worsened during the third quarter of 2008. However, petitioner contested Mr. Lee's assertion that it would be unable to meet its obligations under the installment agreement, explaining that it had recently taken steps to cut its costs and diversify its business. Since July 1, 2008, petitioner had laid off 45 employees, more than half of its work force, and it had recently secured 10 contracts outside the home building industry as well as a large housing contract. In the letter, petitioner again contended that it had been "severely hurt" by its inability to borrow against accounts receivable since the filing of the NFTL. Petitioner also stated that it "is certain that it will make the late deposits on or before September 30, 2008 and will keep current."

On September 29, 2008, upon receipt of petitioner's letter dated September 26, 2008, Mr. Lee called petitioner's counsel and told him that even if petitioner made its deposits by September 30, 2008, penalties would be assessed and he would not consider an installment agreement under those circumstances. On October 9, 2008, respondent issued petitioner a Notice of Determination Concerning Collection Action(s) Under Section 6320 and/or 6330 (the notice of determination). The notice of determination explained that petitioner's request to have the lien withdrawn was being denied because respondent's Appeals Office had determined on the basis of the amount due and petitioner's compliance record that withdrawal would not facilitate collection. The Appeals Office rejected petitioner's proposed installment agreement because petitioner had not remained current with its Federal tax deposits for the quarter ending September 30, 2008. The notice of determination did not address petitioner's request to subordinate the NFTL.

C. DISCUSSION

Rule 121(a) allows a party to move "for a summary adjudication in the moving party's favor upon all or any part of the legal issues in controversy." Rule 121(b) directs that a decision on such a motion shall be rendered "if the pleadings, answers to interrogatories, depositions, admissions, and any other acceptable materials, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that a decision may be rendered as a matter of law." The moving party bears the burden of demonstrating that no genuine issue of material fact exists and that the moving party is entitled to judgment as a matter of law. Facts are viewed in the light most favorable to the nonmoving party.

Where the underlying tax liability is not in issue, we review the determination of the Appeals Office for abuse of discretion. In reviewing for abuse of discretion, we review the reasoning underlying the settlement officer's determination to decide whether it was arbitrary, capricious, or without sound basis in fact or law. Petitioner does not dispute the underlying liabilities. Consequently, we review the determination of the Appeals Office for abuse of discretion.

1. <u>Whether Respondent's Appeals Office Abused Its Discretion by Denying Petitioner's Request to Subordinate or Withdraw the NFTL</u>

Petitioner contends that the Appeals Office abused its discretion when it refused to consider the subordination of the NFTL to Penn Business Credit's security interest.

Section 6325(d)(2) allows the Commissioner to issue a certificate of subordination to a Federal tax lien if:

> the Secretary believes that the amount realizable by the United States from the property to which the certificate relates, or from any other property subject to the lien, will ultimately be increased by reason of the issuance of such certificate and that the ultimate collection of the tax liability will be facilitated by such subordination * * *

Internal Revenue Service (IRS) guidelines instruct:

> The Service must exercise good judgment in weighing the risks and deciding whether to subordinate the federal tax lien. The Service's judgment is similar to the decision that an ordinarily prudent business person would make in deciding whether to subordinate his/her rights in a debtor's property in order to secure additional long run benefits.

In a collection due process hearing in which the taxpayer has requested that the Federal tax lien be subordinated, it is the task of the IRS Appeals Office to determine whether subordination will ultimately facilitate collection of the tax liability.

Mr. Lee did not reach the question of whether subordinating the Federal tax lien would facilitate collection because he determined that the Federal tax lien was already junior to the security interest held by Penn Business Credit. In determining the order of priority, Mr. Lee simply compared the dates on which the financing statements had been filed. Because Penn Business Credit's financing statement had been filed on February 2, 2007, and the NFTL had not been filed until November 26, 2007,[8] Mr. Lee determined that Penn Business Credit already had a priority interest in petitioner's accounts receivable and that it was not possible to subordinate the NFTL. Petitioner contends that Mr. Lee's determination was an error of law[9] and that the Federal tax lien does have priority over Penn Business Credit's security interest in after-acquired accounts receivable.

In a priority dispute involving a Federal tax lien, the Supreme Court has held that questions of whether a property interest exists and the nature of that interest are State law issues, but Federal law governs the question of priority between conflicting interests. Before the Federal Tax Lien Act of 1966, Pub. L. 89-719, 80 Stat. 1125, the Code did not contain any rules for resolving priority contests between Federal tax liens and liens arising under State law. Therefore, before 1966 the Supreme Court determined the relative priority of a rival lien as against a Federal tax lien by applying the common law principle of "'first in time is first in right'". Bremen Bank & Trust Co. v. United States, 131 F.3d 1259, 1263 (8th Cir. 1997) (quoting State Bank of Fraser v. United States, 861 F.2d 954, 963 (6th Cir. 1988)); see, e.g., United States v. City of New Britain, 347 U.S. 81, 85 (1954). A competing lien was considered in existence for "first in time" purposes only when it had been perfected; that is, when "the identity of the lienor, the property subject to the lien, and the amount of the lien are established." United States v. City of New Britain, supra at 84. The latter rule is known as the "choateness" doctrine.

The "first in time" and choateness tests were modified by the Federal Tax Lien Act of 1966, which "recognized the priority of many state claims over federal tax liens Congress enacted the Federal Tax Lien Act of 1966 to "'[improve] the status of private secured creditors' and prevent impairment of commercial financing by '[modernizing] . . . the relationship of Federal tax liens to the interests of other creditors.'" Id. (quoting S. Rept. 1708, 89th Cong., 2d Sess. 1-2 (1966) (alterations in original)).

---

[8] The NFTL shows that it was prepared and signed on Nov. 15, 2007, and petitioner contends that it was filed on that date; but respondent denies that was the date it was filed. However, respondent does not offer an alternative date for the filing. New Jersey State records provided by petitioner and included in the administrative record show that the NFTL was filed on Nov. 26, 2007, and we therefore find Nov. 26, 2007, as the date of filing of the NFTL.

[9] An error of law by the Appeals Office may be an abuse of discretion. See Swanson v. Commissioner, 121 T.C. 111, 119 (2003).

Among other changes, the legislation modified the priority rule for commercial transaction financing agreements by adding a 45-day safe-harbor period, codified at section 6323(c).[10] Bremen Bank & Trust Co. v. United States, supra at 1263. Under the "first in time" and choateness tests, a creditor would have priority over the Federal tax lien only if its interest was filed first and was choate at the time the NFTL was filed. In relevant part, section 6323(c) modifies the result under the first in time and choateness tests by providing that a Federal tax lien will not have priority against a "security interest" in "qualified property" arising from a loan made to a taxpayer within 45 days after the NFTL filing and before the lender acquires actual knowledge of the NFTL. The "qualified property" must be covered by a written agreement constituting a "commercial transactions financing agreement" that was entered into before the NFTL filing date. Under the statute, "qualified property" is limited to "commercial financing security" acquired by the taxpayer within 45 days of the NFTL filing, and "commercial financing security" includes accounts receivable. Sec. 6323(c)(2)(B), (C)(ii). The regulations define an "account receivable" as "any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper." Sec. 301.6323(c)-1(c)(2)(ii), Proced. & Admin. Regs.

[10] The following is the full text of the relevant portion of sec. 6323:

SEC. 6323(c). Protection for Certain Commercial Transactions Financing Agreements, etc.

(1) In general.--To the extent provided in this subsection, even though notice of a lien imposed by section 321 has been filed, such lien shall not be valid with respect to a security interest which came into existence after tax lien filing but which--

(A) is in qualified property covered by the terms of a written agreement entered into before tax lien filing and constituting--

(i) a commercial transactions financing agreement,

(ii) a real property construction or improvement financing agreement, or

(iii) an obligatory disbursement agreement, and

(B) is protected under local law against a judgment lien arising, as of the time of tax lien filing, out of an unsecured obligation.

(2) Commercial transactions financing agreement.-- For purposes of this subsection--

(A) Definition.--The term "commercial transactions financing agreement" means an agreement (entered into by a person in the course of his trade or business)--

(i) to make loans to the taxpayer to be secured by commercial financing security acquired by the taxpayer in the ordinary course of his trade or business, or

(ii) to purchase commercial financing security (other than inventory) acquired by the taxpayer in the ordinary course of his trade or business;

but such an agreement shall be treated as coming within the term only to the extent that such loan or purchase is made before the 46th day after the date of tax lien filing or (if earlier) before the lender or purchaser had actual notice or knowledge of such tax lien filing.

(B) Limitation on qualified property.—The term "qualified property", when used with respect to a commercial transactions financing agreement, includes only commercial financing security acquired by the taxpayer before the 46th day after the date of tax lien filing.

(C) Commercial financing security defined.-- The term "commercial financing security" means (i) paper of a kind ordinarily arising in commercial transactions, (ii) accounts receivable, (iii) mortgages on real property, and (iv) inventory.

(D) Purchaser treated as acquiring security interest.--A person who satisfies subparagraph (A) by reason of clause (ii) thereof shall be treated as having acquired a security interest in commercial financing security.

A “security interest” is defined by section 6323(h)(1), which provides:

> Security interest.--The term “security interest” means any interest in property acquired by contract for the purpose of securing payment or performance of an obligation or indemnifying against loss or liability. A security interest exists at any time (A) if, at such time, the property is in existence and the interest has become protected under local law against a subsequent judgment lien arising out of an unsecured obligation, and (B) to the extent that, at such time, the holder has parted with money or money’s worth.

The regulations provide that, for purposes of the statute, an account receivable is “in existence” when and to the extent that “a right to payment is earned by performance.” Sec. 301.6323(h)-1(a)(1), Proced. & Admin. Regs.

Courts construing section 6323(c) have repeatedly held that if an account receivable is acquired more than 45 days after the NFTL is filed, the lender’s security interest in the account receivable will not have priority over the tax lien even though the agreement conferring the security interest antedates the NFTL filing.

The manner in which section 6323(c) assigns priority with regard to accounts receivable is illustrated by examples in the regulations:

> Example (1). (i) On June 1, 1970, a tax is assessed against M, a tool manufacturer, with respect to his delinquent tax liability. On June 15, 1970, M enters into a written financing agreement with X, a bank. The agreement provides that, in consideration of such sums as X may advance to M, X is to have a security interest in all of M's presently owned and subsequently acquired commercial paper, accounts receivable, and inventory (including inventory in the manufacturing stages and raw materials). On July 6, 1970, notice of the tax lien is filed in accordance with §301.6323(f)-1. On August 3, 1970, without actual notice or knowledge of the tax lien filing, X advances $10,000 to M. On August 5, 1970, M acquires additional inventory through the purchase of raw materials. On August 20, 1970, M has accounts receivable, arising from the sale of tools, amounting to $5,000. Under local law, X's security interest arising by reason of the $10,000 advance on August 3, 1970, has priority, with respect to the raw materials and accounts receivable, over a judgment lien against M arising July 6, 1970 (the date of the tax lien filing) out of an unsecured obligation.
>
> (ii) Because the $10,000 advance was made before the 46th day after the tax lien filing, and the accounts receivable in the amount of $5,000 and the raw materials were acquired by M before such 46th day, X's $10,000 security interest in the accounts receivable and the inventory has priority over the tax lien. The priority of X's security interest also extends to the proceeds, received on or after the 46th day after the tax lien filing, from the liquidation of the accounts receivable and inventory held by M on August 20, 1970, if X has a continuously perfected security interest in identifiable proceeds under local law. However, the priority of X's security interest will not extend to other property acquired with such proceeds.

> Example (2). Assume the same facts as in example 1 except that on July 15, 1970, X has actual knowledge of the tax lien filing. Because an agreement does not qualify as a commercial transactions financing agreement when a disbursement is made after tax lien filing with actual knowledge of the filing, X's security interest will not have priority over the tax lien with respect to the $10,000 advance made on August 3, 1970.

Sec. 301.6323(c)-1(f), Proced. & Admin. Regs.

Petitioner and Penn Business Credit entered into the financing agreement in which Penn Business Credit agreed to make loans to petitioner that would be secured by petitioner's then existing accounts receivable. The arrangement under the financing agreement was structured like a revolving line of credit, allowing petitioner to pay off the loan or a portion thereof and then take out further loans when needed. When Penn Business Credit learned of the NFTL filing, it refused to make any more loans unless and until the Federal tax lien had been subordinated to Penn Business Credit's security interest in petitioner's accounts receivable under the financing agreement.

The facts of the instant case are analogous to an example in the regulations:

> E, a manufacturer of electronic equipment, obtains financing from F, a lending institution, pursuant to a security agreement, with respect to which a financing statement was duly filed under the Uniform Commercial Code on June 1, 1970. On April 15, 1971, F gains actual notice or knowledge that notice of a Federal tax lien had been filed against E on March 31, 1971, and F refuses to make further advances unless its security interest is assured of priority over the Federal tax lien. Upon examination, the district director believes that ultimately the amount realizable from E's property will be increased and the collection of the tax liability will be facilitated if the work in process can be completed and the equipment sold. In this case, the district director may, in his discretion, subordinate the tax lien to F's security interest for the further advances required to complete the work.

However, in petitioner's case, even though Mr. Lee had the discretion, pursuant to the foregoing example, to subordinate the Government's tax lien if it would be in the Government's interest, Mr. Lee did not even consider subordination because he erroneously believed the NFTL did not have priority over petitioner's accounts receivable.

As a preliminary matter, we note that the property over which there is a disagreement about priority is accounts receivable and that Penn Business Credit's financing agreement gave it a security interest in the property. In analyzing a priority dispute under the "first in time" and choateness tests, the Court must first determine what property interest exists under State law and then determine priority under Federal law. Under New Jersey law, an "account" is defined as a right to payment for, among other things, "property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of, * * * [or] for services rendered or to be rendered" that is not "evidenced by chattel paper or an instrument". N.J. Stat. Ann. sec. 12A:9-102(a)(2) (West 2004). Penn Business Credit's financing statement covers, among other things, accounts, accounts receivable, and other rights to payments for services rendered. Neither party contests that the rights covered by the financing statement are accounts receivable under both New Jersey law and section 301.6323(c)-1(c)(2)(ii), Proced. & Admin. Regs.

We proceed to the question of priority in petitioner's accounts receivable, which is governed by Federal law. It may be assumed that the accounts receivable on petitioner's books before the filing of the NFTL were choate because the amounts were fixed and ascertainable at that time. If so, Penn Business Credit had a priority interest in that property. However, accounts receivable petitioner had not yet acquired at the time the NFTL was filed were inchoate. To the extent that accounts receivable were acquired more than 45 days after the NFTL was filed or after Penn Business Credit had actual knowledge of the NFTL, whichever was earlier, the Government's tax lien had priority in such property.

Although the Commissioner's Appeals Office has discretion under section 6325(d) to determine whether it is in the Government's interest to subordinate a Federal tax lien, it appears that Mr. Lee's refusal to consider petitioner's request to subordinate the lien was based on an error of law. To the extent it was based upon an error of law, his determination constitutes an abuse of discretion. Accordingly, we hold that it was an abuse of discretion for respondent's settlement officer to fail to consider petitioner's request to subordinate the Federal tax lien on the basis of an erroneous conclusion of law that the Federal tax lien did not have priority.

Petitioner contends that it requested only that respondent withdraw the NFTL as an alternative in the event that respondent determined that it was impossible to subordinate the Federal tax lien. Because we hold that the Federal tax lien could have been subordinated and that respondent's settlement officer committed an error of law when he determined that the Federal tax lien could not have been subordinated, we need not consider the question of whether he abused his discretion by refusing to withdraw the NFTL.

2. Whether Respondent Abused His Discretion by Declining to Enter Into an Installment Agreement With Petitioner

Respondent contends that because petitioner had fallen behind on its obligation to make timely deposits of its employment taxes, it was ineligible for an installment agreement. Respondent urges us to hold that the issue of subordination of the tax lien is irrelevant because even if the tax lien had been subordinated, petitioner still would have been ineligible for a collection alternative because it was not in compliance with its employment tax deposits. In his briefs respondent did not even address the relevant law governing the priority of tax liens, nor did he bother to respond to petitioner's arguments that Mr. Lee erred in his interpretation of that law.

Instead, respondent rests his entire argument on a previous case in which we upheld the Commissioner's policy of rejecting collection alternatives when taxpayers have failed to pay their current taxes. See Giamelli v. Commissioner, 129 T.C. 107, 111 (2007). However, respondent's reliance on Giamelli is misplaced. In Giamelli and other previous cases in which we have upheld the Commissioner's rejection of collection alternatives because the taxpayers had failed to satisfy current tax obligations, the Commissioner had done nothing to contribute to the taxpayers' failures to remain current with their tax liabilities. In contrast, respondent's abuse of discretion contributed to petitioner's failure to make timely tax deposits.

After remaining current with its employment tax deposits for six quarters, petitioner failed to make timely deposits of its employment taxes during the third quarter of 2008. It was at that point that respondent issued his notice of determination rejecting petitioner's request for an installment agreement. Petitioner contends that it would have been able to remain current with its employment tax deposits if it had been able to borrow against its accounts receivable. However, because of the NFTL, Penn Business Credit had exercised its right under the security agreement to refuse to extend further loans to petitioner. Petitioner informed respondent of the importance of the accounts receivable financing in its January 25, 2008, letter, and it explained that its request to subordinate the NFTL was urgent. Nevertheless, respondent did not reply to petitioner for nearly 4 months.

When respondent's settlement officer, Mr. Lee, met with petitioner's counsel on June 26, 2008, Mr. Lee declined to even consider subordination of the NFTL because of his erroneous conclusion that the NFTL did not have priority over Penn Business Credit's security interest in petitioner's accounts receivable. At that date, petitioner was still current on its employment tax deposits. Had petitioner been able to borrow against its accounts receivable in June or even earlier, it contends that it would have been able to timely make its deposits for the third quarter of 2008. Accordingly, it appears that petitioner's failure to make timely deposits of employment taxes for the third quarter of 2008 was not independent of Mr. Lee's erroneous determination that it was impossible to subordinate the NFTL, which we have held was an abuse of his discretion.

We do not accept respondent's argument that Mr. Lee's decision regarding subordination of the tax lien is irrelevant. Indeed, accepting respondent's contention would be tantamount to granting respondent the power to abuse his discretion at will as long as petitioner eventually misses a deposit on its employment taxes. In situations similar to the instant case, where petitioner's business is in a dire position largely due to industry conditions beyond its control, the Commissioner's decision not to subordinate an NFTL could exacerbate taxpayers' cashflow problems and make it difficult, if not impossible, for taxpayers to remain current with their tax deposits while continuing to run their businesses. The Commissioner could hold off issuing a notice of determination indefinitely until the taxpayer missed a deposit, and the Commissioner could then refuse to grant an installment agreement on the basis of the taxpayer's failure to remain current with its tax deposits. Because the taxpayer would have already fallen behind on current tax liabilities, we would be unable to meaningfully review the Commissioner's decision not to subordinate the NFTL. We find such a scenario unacceptable.

The Commissioner has discretion to enter into an installment agreement with a taxpayer if he determines "that such agreement will facilitate full or partial collection of such liability." Sec. 6159(a). The IRM advises: "When taxpayers are unable to pay a liability in full, an installment agreement (IA) <u>should</u> be considered." IRM pt. 5.14.1.2(4) (July 12, 2005) (emphasis added). The IRM also instructs: "Compliance with filing, paying estimated taxes, and federal tax deposits must be current from the date the installment agreement begins."

Accordingly, the Commissioner must consider whether the installment agreement will facilitate collection of the liability, but he may not authorize an installment agreement until the taxpayer is current with its Federal tax deposits. However, nothing in the Code, the regulations, the IRM, or our decisions requires that the Commissioner deny the taxpayer's request for an installment agreement simply because it is not, at that moment, current with its Federal tax deposits. The Commissioner could, instead, wait until the taxpayer is current and then enter into the installment agreement. Even when an installment agreement is in place and the taxpayer fails to remain current with its tax liabilities, the Commissioner is not required to terminate the agreement; rather, he has the discretion to do so.

Mr. Lee would not even consider petitioner's efforts to become current on its deposits for the third quarter of 2008. After receiving a letter from petitioner's counsel promising that petitioner would make the late deposits by the end of the third quarter, Mr. Lee telephoned petitioner's counsel and effectively told him that it was too late and that petitioner should not bother because Mr. Lee's decision was already made.

Accordingly, we hold that it was an abuse of discretion for respondent's settlement officer to refuse to enter into an installment agreement on the basis of petitioner's failure to stay current with its tax deposits where respondent's abuse of discretion in refusing to consider subordination of the NFTL contributed to petitioner's falling behind on its tax deposits and where petitioner was not given the opportunity to become current.

Consequently, we will deny respondent's motion for summary judgment, grant petitioner's motion for summary judgment, and remand this case to respondent's Appeals Office for reconsideration of petitioner's request to subordinate the NFTL and enter into an installment agreement.[11]

In reaching these holdings, we have considered all the parties' arguments, and, to the extent not addressed herein, we conclude that they are moot, irrelevant, or without merit.

To reflect the foregoing,

An appropriate order will be issued.

[11] Some of Mr. Lee's notes in his case activity log suggest that Mr. Lee's belief that petitioner's proposed installment agreement was unrealistic may have been a factor in his denial of the installment agreement. On remand, we also direct the Appeals Office to consider Internal Revenue Manual (IRM) pt. 5.14.1.4(8) (June 1, 2010), which does not contemplate rejecting an installment agreement simply because the Commissioner believes that the installment agreement is unrealistic given the taxpayer's financial condition. Insofar as Mr. Lee's determination to reject the installment agreement was based in any part on his assessment that petitioner could not afford to meet its obligations under the installment agreement, such reasoning does not appear to be in accord with the IRM. See Lites v. Commissioner, T.C. Memo. 2005-206.

CASE STUDY #3 – REVIEW QUESTIONS

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. Under what circumstances does the IRS have authority to subordinate their claims to that of a third party:

   a) in all cases in which the request is made in good faith by the taxpayer
   b) never, as the Internal Revenue Code expressly forbids subordination
   c) in cases where the third party posts a surety bond
   d) when the IRS determines based on application of good judgment that such a decision is in the best interests of the government

2. The judge ______ with the IRS that the taxpayer was not eligible for an Installment Agreement ______.

   a) agreed; stating that no one with a history of delinquent payments can be eligible for an Installment Agreement
   b) disagreed; stating that the taxpayer should have been given the chance to become current in employment tax deposits and enter into an Installment Agreement
   c) agreed; stating that an Installment Agreement is not available to taxpayers who have been late with trust fund taxes
   d) disagreed; saying that all taxpayers are entitled to an Installment Agreement no matter what their circumstances as a matter of law

CASE STUDY #3 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. The IRS must evaluate such requests carefully.

   B: Incorrect. Section 6325(d)(2) of the Internal Revenue Code actually authorizes subordination.

   C: Incorrect. There is no surety provision.

   D: Correct. The IRS must carefully evaluate whether subordination furthers its interests by making it more likely that the taxpayer will be able to repay his or her tax debt.

   (See page 10-34 of the course material.)

2. A: Incorrect. Taxpayers who were always current would have no need for an Installment Agreement.

   B: Correct. The court rejected the notion that the taxpayer was automatically disqualified from entering into an Installment Agreement.

   C: Incorrect. There is no such prohibition, and many businesses enter into Installment Agreements.

   D: Incorrect. There are eligibility criteria.

   (See page 10-41 of the course material.)

IV. Case Study #4

T.C. Memo. 2012-53
UNITED STATES TAX COURT
MATTHEW L. KARAKAEDOS AND DIANE D. KARAKAEDOS, Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent
Docket No. 11011-10L. Filed February 27, 2012.

A. MEMORANDUM FINDINGS OF FACT AND OPINION

MORRISON, Judge: The petitioners, Matthew L. Karakaedos and Diane L. Karakaedos, challenge the determination of the IRS Appeals Office sustaining the July 21, 2009, filing of a notice of federal tax lien relating to the petitioners' unpaid income-tax liabilities for tax years 2004, 2005, and 2006. Our jurisdiction over the dispute is established by sections 6320(c) and 6330(d) of the Internal Revenue Code (Code). Unless otherwise indicated, all references to sections are to the Code, as amended. The issue for decision is whether the Appeals Office abused its discretion by sustaining the filing of the notice of federal tax lien. We hold that the Appeals Office did not abuse its discretion, except that, as the respondent essentially concedes, the Appeals Office should have abated the fees that had been charged to the petitioners to reinstate installment agreements as to which they were repeatedly declared by the IRS to be in default.

B. FINDINGS OF FACT

The petitioners resided in Pennsylvania at the time they filed the petition. The petitioners were, and are, married. They filed joint income-tax returns for the 2004, 2005, and 2006 tax years. As shown on the table below, they filed the returns late, and they did not pay the full amounts of the liabilities reported on the returns.

Joint income tax returns for 2004, 2005, and 2006			
Year	**Date Filed**	**Tax Liability Reported**	**Income-tax Withholding Reported**
2004	April 10, 2007	$12,390	$5,179
2005	June 4, 2007	12,749	5,630
2006	May 7, 2007	12,218	5,928

The IRS assessed the tax liabilities, additions to tax, and interest for the 2004 tax year on May 28, 2007, for the 2005 tax year on July 16, 2007, and for the 2006 tax year on May 28, 2007. On the same dates, the IRS issued statutory notices of balance due for each of the three respective years.

The IRS negotiated various installment agreements with the petitioners that required them to make monthly payments towards their tax liabilities for the 2004, 2005, and 2006 tax years. The table below summarizes these installment agreements:

Installment agreements between the IRS and petitioners			
Date of Agreement	**Tax Years**	**Date of default or date of IRS's notice of default**	**Provisions in agreement regarding ability of IRS to file lien notice**
Unknown	Unknown	The IRS issued a Nov. 10, 2008 notice of default for failure to pay additional taxes.	Unknown
Jan. 8, 2009	2001 2003 2004 2005 2006	The IRS issued an Apr. 6, 2009 notice of default for failure to pay additional taxes	Allowed IRS to file notice of lien
April 10, 2009	2003 2004 2005 2006	The IRS issued a June 15, 2009 notice of default for failure to provide an updated financial statement	Allowed IRS to file notice of lien
July 14, 2009	2001 2002 2003 2004 2005 2006	No notice of default is in the record, but the parties stipulated that petitioners were in default on the July 14, 2009 agreement sometime after the notice of lien was filed on July 21, 2009.	Allowed IRS to file notice of lien if petitioners do not meet all conditions of agreement
Oct. 20, 2009	2003 2004 2005 2006	No notice of default is in the record. On Apr. 1, 2010, the IRS Appeals Office agreed to allow petitioners to enter into an installment agreement, which suggests that by then the IRS considered petitioners in default on the Oct. 20, 2009 installment agreement.	Allowed IRS to file notice of lien

In July 2008, the petitioners apparently had an installment agreement with the IRS, because on July 2, 2008, the IRS sent them a monthly statement informing them that their next installment payment of $500 was due July 10, 2008. The statement indicated that installment agreement payments would be applied to the "oldest tax owed, then penalties, then interest." The statement showed that the most recent payment, $500, was applied to the balance of a tax liability for the 2001 tax year. Apparently this tax liability, and all liabilities referred to in the notices described in this opinion, were joint income-tax liabilities of the petitioners. The $500 payment was presumably made pursuant to the same installment agreement that required the payment on July 10, 2008. The statement showed that the unpaid balance was $616.97 for the 2001 year (including a penalty of $75.07 and interest of $541.90), $1,910.11 for the 2002 year (including a penalty of $69.59 and interest of $350.67), and $7,493.67 for the 2003 year (including a penalty of $769.33 and interest of $1,605.15). The statement indicated that "Liabilities not shown:" were $31,303.15, including a penalty of $1,031.85 and interest of $2,251.15. The terms of the installment agreement to which the statement referred are not in the record.

On July 10, 2008, the petitioners paid the IRS $500. The IRS applied the payment to their 2001 tax liability.

On August 13, 2008, the petitioners paid the IRS $500. The IRS applied the payment to their 2001 tax liability. The record does not explain how the petitioners' unpaid 2001 tax liability could have absorbed this entire $500 payment. As we note below, the respondent (whom we refer to as the IRS) concedes there were "some problems" with respect to the 2001 tax liability, which presumably means problems with the IRS's ongoing calculations of the unpaid amount of the liability.

On September 10, 2008, the petitioners paid the IRS $500. The IRS applied the payment to their 2002 tax liability.

On October 14, 2008, the petitioners paid the IRS $500. The IRS applied the payment to their 2001 tax liability. The record does not explain how the petitioners still had an unpaid 2001 tax liability after application of their prior payments.

On November 10, 2008, the IRS notified the petitioners that they had defaulted on an installment agreement. The notice said:

> This is a formal notice of our intent to terminate our installment agreement 30 days from the date of this notice. You defaulted on your agreement because <u>you didn't pay the additional federal tax you owe</u>. The agreement states that we may terminate your agreement and collect the entire amount of your liability if you don't meet all the conditions.

The notice stated: "To prevent collection action you must <u>pay in full any additional federal taxes you owe</u>. We will charge a reinstatement fee that we will take from your first payment." The notice informed the petitioners that they had an unpaid balance of $472.40 for the 2002 year, including a penalty of $69.59 and interest of $370.87. As explained later, the IRS does not ultimately take the position in this litigation that the petitioners defaulted on the installment agreement about which the IRS issued a November 10, 2008 notice of default.

On November 14, 2008, the petitioners paid the IRS $500. The IRS applied the payment to their 2001 tax liability. The record does not explain how the petitioners had an unpaid 2001 tax liability at this time.

On November 26, 2008, the petitioners received a bill from their accountant, Michael Horn. The bill sought fees for the following services: "Appeared before the Internal Revenue Service to petition successfully for reinstatement of a lapsed payment agreement with automatic debit from taxpayer's checking account."

On December 3, 2008, the petitioners' accountant submitted to the IRS a Form 433-D, Installment Agreement. Apparently, the proposal reflected on the Form 433-D was the result of the negotiations for which the petitioners' accountant billed them on November 26, 2008. The Form 433-D requested a direct debit installment agreement for the tax years 2003, 2004, 2005, and 2006. (It is unclear from the record exactly what years were covered by the installment agreement or agreements that governed the monthly payments made by petitioners up to this point.) The Form 433-D contains a section entitled "Terms of this agreement". One of the terms was: "We [the IRS] may file a Federal Tax lien if one has not been filed previously." Another term was: "You must pay a $43 user fee, which we have authority to deduct from your first payment(s)." Another term was: "If you default on your installment agreement, you must pay a $24 reinstatement fee if we reinstate the agreement." As noted below, the IRS accepted the installment agreement on January 8, 2009.

On December 8, 2008, the petitioners paid the IRS $1,045. The IRS applied this payment to their 2003 tax liability. The payment represented a $500 payment for January, a $500 payment for February, and a $45 "fee", according to a later letter from the petitioners to the IRS.

On December 8, 2008, the IRS notified Diane Karakaedos that $500 of tax had been overpaid for the 2001 tax year and that the IRS applied the overpayment to the 2002 liability (to the extent of $472.67) and to the 2003 liability (to the extent of $27.33). Neither party suggests that it is significant that this notice and some other subsequent notices were sent to one petitioner rather than both. The way in which the IRS applied the $500 payment suggests that an IRS employee believed that as of December 8, 2008, the petitioners had an outstanding balance of $472.67 for 2002.

The record does not reveal why this $472.67 amount is slightly different from the $472.40 balance noted on the November 10, 2008 notice. On December 31, 2008, the IRS sent the petitioners a monthly statement reminding them that their next payment of $500 was due on January 10, 2009. The statement indicated that installment payments would be applied to the "oldest tax owed, then penalties, then interest." The statement showed that the petitioners' last payment of $500 had been applied to their 2001 tax liability. In addition, the monthly statement showed that the current balance was $75.08 for 2001 (including a penalty of $75.07 and interest of $0.01), $6,674.57 for 2003 (including a penalty of $839.65 and interest of $1,788.06), and $13,257.94 for 2004 (including a penalty of $685.04 and interest of $1,297.21). The statement reflected that "Liabilities not shown:" were $19,417.44, including a penalty of $870.31 and interest of $1,802.67. (This monthly statement was attached to the Form 433-D that we discussed earlier. The parties do not explain how a monthly statement with a date of December 31, 2008, came to be attached to the Form 433-D, which was submitted to the IRS on December 3, 2008.)

On January 8, 2009, the IRS issued to the petitioners a letter accepting their December 3, 2008 request for a direct debit installment agreement. The letter stated that the agreement covered the tax years 2001, 2003, 2004, 2005, and 2006, even though the petitioners' Form 433-D did not refer to the year 2001. The letter stated that the IRS would deduct a payment of $500 from the petitioners' bank account on the 10th day of every month.

On March 10, 2009, the petitioners paid the IRS $500. The IRS applied the $500 payment to their 2001 tax liability (to the extent of $75.08) and their 2003 tax liability (to the extent of $424.92).

On March 30, 2009, the IRS sent Matthew Karakaedos a notice that the 2001 tax account was overpaid by $75.08 and that the $75.08 was applied to the 2003 tax liability.

On March 30, 2009, the IRS sent the petitioners a letter stating that it had no record that they had responded to “our [the IRS’s] previous notices.” The letter went on to say: “As a result, your account has been assigned to this office for enforcement action, which could include seizing your wages or property.” On April 6, 2009, the IRS sent the petitioners a notice informing them that they had defaulted on their installment agreement (presumably the January 8, 2009, agreement). The letter stated:

> This is a formal notice of our intent to terminate your installment agreement 30 days from the date of this notice. You defaulted on your agreement because <u>you didn’t pay the additional federal tax you owe</u>. The agreement states that we may terminate your agreement and collect the entire amount of your tax liability if you don’t meet all the conditions.

The notice stated: “To prevent collection action you must pay in full any additional federal taxes you owe. We will charge a reinstatement fee that we will take from your first payment.” The notice contained an “Account Summary” showing a current balance of $6,268.20 on the 2003 tax account (including a penalty of $866.89 and interest of $1,854.45). The notice does not contain information about tax years other than 2003. As explained later, the IRS does not ultimately take the position in this litigation that the petitioners defaulted on the installment agreement.

On April 10, 2009, the IRS wrote the petitioners a letter accepting their offer to enter into another installment agreement. The date of the petitioners’ offer is not revealed by the record, and no written offer is in the record. The heading of the letter reflected that the letter, and therefore the installment agreement, concerned the tax years 2003, 2004, 2005, and 2006. The letter did not indicate what arrangement was made, if any, for payment of the 2001 or 2002 balance, or whether balances still existed for these years. The letter stated: “Thank you for making arrangements to resolve your account. We’ve accepted your offer to have your monthly installment payments automatically taken from your checking account.” The IRS stated that it would deduct a $500 payment on the 10th day of each month. It also stated that it would charge a $52 user fee to cover the cost of providing the installment agreement. The letter warned the petitioners that:

> You need to meet all of the conditions of the Installment Agreement. When someone doesn’t meet the terms of their Installment Agreement, we cancel it. We then begin to act to collect the full amount of the tax liability. In addition, canceled Installment Agreements that we later reinstate require the payment of a $45 reinstatement fee.

The letter listed 10 conditions of “this agreement”. The 10th condition was: “We may file a federal tax lien to protect the interest of the federal government.”

On April 13, 2009, the IRS wrote Matthew Karakaedos a letter informing him that "We have no record that you responded to our previous notices. As a result, your account has been assigned to this office for enforcement action, which could include seizing your wages or property." The letter asked him to pay $75.08 for the 2001 tax liability. The letter stated that the $75.08 amount comprised accrued interest of $.01 and a late payment penalty of $75.07. A similar letter was sent to Diane Karakaedos.

On April 15, 2009, the petitioners paid the IRS $500. The IRS applied the payment to their 2003 tax liability.

On May 13, 2009, the petitioners paid the IRS $455. The IRS applied the payment to their 2001 tax liability.

On June 11, 2009, the petitioners paid the IRS $500. The IRS applied the payment to their 2003 tax liability.

On June 15, 2009, the IRS sent the petitioners a notice informing them that they had defaulted on their installment agreement (presumably the April 10, 2009, installment agreement). The letter stated:

> This is a formal notice of our intent to terminate your installment agreement 30 days from the date of this notice. You defaulted on your agreement because <u>you didn't provide an updated financial statement as we requested</u>. The agreement states that we may terminate your agreement and collect the entire amount of your tax liability if you don't meet all the conditions.

The letter continued: "To prevent collection action, you must <u>provide us with your updated financial statement</u>. We will charge a reinstatement fee that we will take from your first payment." The notice contained an account summary showing $13,683.06 as the unpaid balance for the 2004 year, including a penalty of $865.32 and interest of $1,542.05. The notice did not contain information regarding tax years other than 2004. As explained later, the IRS does not ultimately take the position in this litigation that the petitioners defaulted on the April 10, 2009, installment agreement.

On July 14, 2009, the IRS issued the petitioners a letter informing them that their installment agreement had been reinstated for the six tax years 2001 through 2006. The letter stated:

> This is in response to our telephone conversation on July 2, 2009, requesting a payment arrangement to resolve your account with the IRS.
>
> Based on your payment proposal, we have established an installment plan for you on the tax periods shown above. Your payment is $500.00, due on the 10TH of each month, beginning on Aug. 10, 2009.

The letter also stated:

> We charge a $45.00 user fee to cover the cost of providing installment agreements. The fee will be deducted from your first payment. YOUR FIRST PAYMENT MUST BE AT LEAST $500.00 TO COVER THE FEE,

> EVEN THOUGH YOUR REMAINING PAYMENTS MAY BE FOR LESS. Please write "User Fee" on the first payment so that the payment will be properly credited.

The letter listed seven conditions of the installment agreement. There was no condition that allowed the IRS to file a notice of tax lien without the petitioners having defaulted on the installment agreement, as there was with the January 8 and April 10, 2009 installment agreements. The letter stated that if the petitioners did not meet all the conditions of the installment agreement, the IRS could cancel the agreement and could take enforcement actions to collect the full amount of the liability, including "filing a lien against your property". The letter stated that "If we cancel your installment agreement and you later apply for and receive reinstatement, you will have to pay a reinstatement fee."

On July 21, 2009, the IRS filed a notice of lien with Philadelphia County, Pennsylvania, to secure the collection of the petitioners' federal income-tax liabilities for tax years 2004, 2005, and 2006. On the same day the IRS mailed a letter to the petitioners notifying them that it had filed a notice of lien and informing them that they had the right to request an administrative hearing to appeal the filing of the notice of lien. Although the notice of lien was filed on July 21, 2009, it was prepared and signed on July 8, 2009, in Detroit, Michigan.

The parties have stipulated that "Subsequent to the filing of the notice of federal tax lien, petitioners' installment agreement defaulted."

On July 29, 2009, the IRS sent the petitioners a monthly statement reminding them that their next payment of $500 was due on August 10, 2009. The statement indicated that installment payments would be applied to "the oldest tax owed, then penalties, then interest." The statement showed that the current balance was $75.08 for 2001 (including a penalty of $75.07 and interest of $.01), $4,894.17 for 2003 (including a penalty of $888.97 and interest of $1,915.34), and $13,834.66 for 2004 (including a penalty of $865.32 and interest of $1,621.21). It reflected that "Liabilities not shown:" were $20,253.38 (including a penalty of $1,228.68 and interest of $2,280.24).

On August 18, 2009, the petitioners sent the IRS a request for an administrative hearing. In the request, they stated they wished the IRS to consider an installment agreement. They also challenged the filing of the notice of lien. The request did not contest the underlying liabilities.

On August 31, 2009, the IRS notified Matthew Karakaedos that the 2001 tax account was overpaid by $455 and that the IRS had applied the $455 payment to the 2003 tax liability.

On October 5, 2009, the IRS notified Matthew Karakaedos that the 2001 tax account was overpaid by $500 and that the IRS had applied the $500 payment to the 2003 tax liability.

On October 20, 2009, the IRS sent the petitioners a letter accepting their offer to enter into another installment agreement. The date of the offer is not reflected in the record, and no written offer is in the record. The IRS letter identified the tax periods in question as 2003, 2004, 2005, and 2006. It stated:

Thank you for making arrangements to resolve your account. We've accepted your offer for an Installment Agreement. The agreement covers the tax period(s) shown above. Please make your first payment of $500.00 by November 10, 2009. Thereafter, send us that amount by the 10th of each month, until you've paid the full amount you owe.

The letter stated further:

> We charge a $105 User Fee to cover the cost of providing an Installment Agreement regardless of the amount of your agreed to payment. Although your approved Installment Agreement payment may be for less than $105, your first payment should be for at least $105 to cover the fee.

The letter warned the petitioners that

> You need to meet all the conditions of the Installment Agreement. When someone doesn't meet the terms of their Installment Agreement, we cancel it. We then begin to act to collect the full amount of the tax liability. In addition, canceled Installment Agreements that we later reinstate require the payment of a $45 reinstatement fee.

The letter listed 10 conditions of the agreement. The 10th condition was: "We [the IRS] may file a federal tax lien to protect the interest of the federal government." There is no offer letter or other document in the record describing the offer that was accepted.

On November 30, 2009, the IRS notified Matthew Karakaedos that "We have no record that you responded to our previous notices. As a result, your account has been assigned to this office for enforcement action, which could include seizing your wages or property." The IRS asked him to pay the $75.08 balance on the 2001 tax account by December 16, 2009. The notice stated that the $75.08 amount comprised accrued interest of $.01 and a late payment penalty of $75.07. The IRS sent a similar notice to Diane Karakaedos.

On December 28, 2009, the IRS notified Diane Karakaedos that "We have no record that you responded to our previous notices. As a result, your account has been assigned to this office for enforcement action, which could include seizing your wages or property." The notice asked her to pay the $75.08 tax liability for 2001 by January 13, 2010. The notice stated that the $75.08 amount comprised accrued interest of $.01 and a late payment penalty of $75.07.

On February 8, 2010, the IRS notified Diane Karakaedos that the 2001 tax account was overpaid by $500 and that the IRS had applied the $500 overpayment to the 2003 tax liability. The IRS Appeals Office assigned a settlement officer to handle the administrative hearing that the petitioners had requested on August 18, 2009. The Appeals Office wrote a letter to the petitioners on February 16, 2010, informing them that it had received their request for an administrative hearing. It scheduled a telephone conference call for March 23, 2010.

On March 23, 2010, the Appeals Office conducted a teleconference with the petitioners. The parties have stipulated that during the teleconference the petitioners "requested an installment agreement, withdrawal of the tax lien, and abatement of penalties and interest." The Appeals Office contacted the petitioners again by telephone on April 1,

2010. The parties have stipulated that the Appeals Office “agreed to allow petitioners to enter into an installment agreement” but that “Petitioners did not agree with sustaining the lien.”

On April 16, 2010, the IRS Appeals Office issued a determination to the petitioners. The Appeals Office stated: “You did not present any information that would qualify you for a withdrawal of the NFTL. It is therefore Appeals [sic] determination that you be denied relief from the filing of the Notice of Federal Tax Lien (NFTL).” The Appeals Office also stated:

> It appears that your previous IA defaulted due to a balance on another module that you say was fully paid. The IRS had the right to file a lien because you received a CP 523 letter informing you that a tax lien could be filed.
>
> The Settlement Officer reviewed your financial information and at this point if an IA was granted, a federal tax lien would be filed if one was not already in place (due to the amount you owe and the type of IA).
>
> According to your account transcripts; [sic] the previous IA was a Partial Payment IA, which means that the time the IRS has to collect from you will expire before you have fully paid your balance. A lien determination is required for this type of IA.

(A CP 523 letter is a notice from the IRS to a taxpayer that the taxpayer had defaulted on an installment agreement. The letters of November 10, 2008, April 6, 2009, and June 15, 2009 were CP 523 letters.) The Appeals Office also stated: “The Settlement Officer did not consider the abatement of penalties and interest due to your IA defaulting because you had the right to appeal your defaulted IA with the CP 523 letter.”

C. OPINION

1. Collection-Review Hearings

The IRS is authorized to assess federal tax liabilities. Sec. 6201(a); 26 C.F.R. sec. 301.6201-1(a) (Apr. 1, 2011). Assessment occurs when the liability is recorded on the books of the IRS. Sec. 6203; 26 C.F.R. sec. 301.6203-1 (Apr. 1, 2011). The IRS is required by statute to notify the taxpayer within 60 days of assessing the tax and to demand payment. Sec. 6303(a). If the taxpayer refuses to pay after payment is demanded, a lien arises on the property of the taxpayer in favor of the federal government. Sec. 6321. The lien relates back to the time of assessment. Sec. 6322; William D. Elliott, Federal Tax Collections, Liens, and Levies, para. 9.03[1], at 9-6 (2008).

Until it files a notice of lien, the federal government’s claim against the taxpayer is not valid against four classes of other creditors: purchasers, holders of security interests, mechanic’s lienors, and judgment-lien creditors. See sec. 6323(a). An unfiled federal tax lien is not valid against someone who purchases property from the taxpayer. Sec. 6323(a); see also sec. 6323(h)(6) (defining “purchaser”). Thus, if a taxpayer who owns property burdened by an unfiled federal tax lien sells all the interests in the property to a third party, the government will generally have no interest in the property. Once the notice of lien is filed in the appropriate state or local government office, the federal tax lien is valid against any purchaser, holder of a security interest, mechanic's lienor, or judgment-lien creditor.

Not more than five business days after filing the notice of lien, the IRS must provide the taxpayer written notice of the filing and must advise the taxpayer of the right to a hearing with the IRS Appeals Office. Sec. 6320(a)(1), (2), and (3). At the hearing, the Appeals Office must "obtain verification * * * that the requirements of any applicable law or administrative procedure have been met", consider any relevant issues raised by the taxpayer (including installment agreements and challenges to the appropriateness of collection actions), and consider whether any proposed collection action balances the need for efficient collection of taxes with the legitimate concern that any collection action be no more intrusive than necessary. Sec. 6330(c)(1), (2)(A)(iii), (3). The Tax Court is authorized by section 6330(d)(1) to review the determination of the Appeals Office. Where the underlying tax liability is not at issue, the Tax Court reviews the determination of the Appeals Office for abuse of discretion. See Sego v. Commissioner, 114 T.C. 604, 610 (2000). The petitioners do not dispute their underlying liabilities. Consequently, we review the determination of the Appeals Office for abuse of discretion.

2. <u>Contentions of the Parties</u>

The petitioners contend that the IRS filed the notice of lien because the IRS concluded--erroneously--that they had defaulted on the April 10, 2009, installment agreement. They argue in their brief: "the Respondent's representative that initiated the Federal Tax Lien in July 2009 abused his discretion as the installment agreement defaulted without any fault of the Petitioners." Similarly, they argue: "Petitioners never had a federal tax lien filed for tax years 2004, 2005 and 2006 until their installment agreement defaulted for the fourth time due to IRS clerical errors in July 2009". Petitioners also contend that the July 14, 2009, installment agreement did not provide for a notice of lien to be filed.

The petitioners ask for three items of relief. First, they seek "the reimbursement of all fees associated with the reinstatement of 4 installments caused by IRS clerical errors". Second, they ask for reinstatement of an installment agreement for the 2004, 2005, and 2006 tax years. Third, they want the notice of lien to be withdrawn.

The IRS argues that the notice of lien was filed because the installment agreements were partial payment installment agreements, not because the IRS had declared the petitioners in default on several of the installment agreements. A partial payment installment agreement, according to the IRS, is an installment agreement that allows a taxpayer to make payments in amounts less than the amounts that would be required to pay the outstanding liability before the collection period of limitations expires. The IRS contends that the Appeals Office had concluded that the notice of lien was filed because the installment agreement was a partial payment installment agreement. The IRS contends that it has a policy of filing a lien notice when it enters into a partial payment installment agreement. As to the petitioners' argument that the July 2009 installment agreement did not provide for a notice of lien to be filed, the IRS responds that "As a condition of reinstating the petitioners' prior installment agreement dated April 10, 2009, in a letter dated July 14, 2009, respondent reserved the right to file a federal tax lien to protect the interest of the government." The IRS makes the more general argument that an installment agreement does not preclude the filing of a tax lien. The IRS concedes that "there are unanswered questions surrounding the defaulting of the installment agreements". It states that some documents in the record indicate that there "were some problems with respect to petitioners' 2001 tax liability that may have affected the installment agreements for the years at issue" although it also asserts that "the notices advising petitioners that they had defaulted on their installment agreements indicated that the problem was for a year other than the 2001 tax year." Its brief continues:

> In any event, due to the issues with respect to petitioners' 2001 tax year, respondent will abate the fees charged to petitioners for the reinstatement of the installment agreements for the years in issue. Respondent will also ensure that the issues involving petitioners' account for the taxable year 2001 are resolved.

In its briefs the IRS does not take the position that the petitioners defaulted on (1) the installment agreement that was declared in default on November 10, 2008, (2) the installment agreement established January 8, 2009, or (3) the installment agreement established April 10, 2009.

3. Analysis

a. The July 14, 2009, installment agreement did not require the IRS to withdraw the July 21, 2009 notice of lien

The first question disputed by the parties is whether the July 14, 2009, installment agreement required the IRS to withdraw the notice of tax lien that it filed on July 21, 2009. In evaluating the significance of the July 14, 2009, installment agreement, we must consider section 6159, a provision related to installment agreements that was originally added to the Code in 1988, and section 6323(j), a provision related to withdrawals of notices of tax lien that was originally added to the Code in 1996. Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, sec. 6234(a), 102 Stat. at 3735; Taxpayer Bill of Rights #2, Pub. L. No. 104-168, sec. 501(a), 110 Stat. at 1460. Section 6159(a) authorizes the IRS to enter into installment agreements, and section 6159(b)(1) provides that "Except as otherwise provided in this subsection, any agreement entered into * * * under subsection (a) shall remain in effect for the term of the agreement." Section 6159(b)(2) allows the IRS to terminate an installment agreement if the taxpayer had provided inaccurate or incomplete information to the IRS before the execution of the installment agreement or if the IRS believes that collection of the tax is in jeopardy.

Section 6159(b)(3) provides that the IRS may alter, modify, or terminate an installment agreement if the IRS determines that the financial condition of the taxpayer has significantly changed. Section 6159(b)(4) provides that the IRS may alter, modify, or terminate an installment agreement if the taxpayer fails to make an installment payment, pay any other tax liability when due, or provide a financial condition update requested by the IRS. Section 6159(b)(5) provides that the IRS cannot take any actions under section 6159(b)(2), (3), or (4) unless the IRS gives the taxpayer 30 days of advance notification. 26 C.F.R. sec. 301.6159-1(d) (Apr. 1, 2009) provided that

> Except as otherwise provided by the installment agreement, during the term of the agreement the director may take actions to protect the interests of the government with regard to the unpaid balance of the tax liability to which the installment agreement applies * * *, including any actions enumerated in the

> agreement. The actions include, for example--* * * (3) Filing or refiling notices of federal tax lien.[12]

The July 14, 2009 installment agreement stated that the IRS could file a notice of lien if the petitioners defaulted on that installment agreement. The legal effect of such a provision is found in the regulations interpreting section 6323(j), to which we turn next. Section 6323(j)(1) provides:

> In general--The Secretary [of the Treasury] may withdraw a notice of a lien filed under this section * * * if the Secretary determines that--
>
> (A) the filing of such notice was premature or otherwise not in accordance with administrative procedures of the Secretary,
>
> (B) the taxpayer has entered into an agreement under section 6159 to satisfy the tax liability for which the 26 C.F.R. sec. 301.6159-1(f)(3)(i) (Apr. 1, 2011) lien was imposed by means of installment payments, unless such agreement provides otherwise,
>
> (C) the withdrawal of such notice will facilitate the collection of the tax liability, or
>
> (D) with the consent of the taxpayer or the National Taxpayer Advocate, the withdrawal of such notice would be in the best interests of the taxpayer (as determined by the National Taxpayer Advocate) and the United States.

Interpreting section 6323(j)(1), 26 C.F.R. sec. 301.6323(j)-1(c) (Apr. 1, 2011) (effective June 22, 2001), provides:

> The Commissioner must determine whether any of the conditions authorizing the withdrawal of a notice of federal tax lien exist if a taxpayer submits a request for withdrawal in accordance with paragraph (d) of this section. The Commissioner may also make this determination independent of a request from the taxpayer based on information received from a source other than the taxpayer. If the Commissioner determines that conditions authorizing the withdrawal are not present, the Commissioner may not authorize the withdrawal.

If the Commissioner determines conditions for withdrawal are present, the Commissioner may (but is not required to) authorize the withdrawal.[13]

---

[12] This regulation was later amended on November 25, 2009. T.D. 9473, 2009-52 I.R.B. 945. Because the amendment was "applicable on November 25, 2009", id., 2009-52 I.R.B. at 951, it does not govern the notice of lien at issue in this case, which was filed against the petitioners' property on July 21, 2009. As amended, the regulation now reads:

> The IRS may take actions other than levy to protect the interests of the Government with regard to the liability identified in an installment agreement or proposed installment agreement. Those actions include, for example-- * * * (B) Filing or refiling notices of Federal tax lien; * * *.

[13] "[P]aragraph (d) of this section", referred to in the regulation quoted above, provides that a request for a withdrawal of a notice of lien must be made in writing in accordance with procedures prescribed by the Commissioner of Internal Revenue and it sets forth the information that must be included in the request. 26 C.F.R. sec. 301.6323(j)-1(d) (Apr. 1, 2011) (effective June 22, 2001).

26 C.F.R. sec. 301.6323(j)-1(b)(5), Example 2 (Apr. 1, 2011) (effective June 22, 2001) provides:

> A owes $1,000 in federal income taxes. A enters into an agreement to pay the outstanding federal income tax liability in installments. The agreement provides that a notice of federal tax lien may be filed if the taxpayer defaults. A timely pays the installments each month and has not defaulted in any way. Eleven months after entering into the installment agreement, the Internal Revenue Service files a notice of federal tax lien. Noting that there has been no default, the taxpayer asks the Internal Revenue Service to withdraw the notice of federal tax lien. In this situation, the Commissioner may withdraw the notice of federal tax lien because the taxpayer has entered into an installment agreement.

Example 2 evinces an interpretation that if (1) the IRS enters into an installment agreement that provides that a notice of lien may be filed if the taxpayer defaults, (2) the taxpayer does not default, and (3) the IRS files a notice of lien, then the IRS "may" later withdraw the notice of lien. That the IRS "may" withdraw the notice suggests that the IRS is not required to withdraw the notice. Like the installment agreement described in Example 2, the July 14, 2009 installment agreement provided that a notice of lien could be filed if the petitioners defaulted, and the IRS filed a notice of lien. We conclude that the effect of this installment agreement is that the IRS may withdraw the notice of lien it filed against the petitioners, but it is not required to do so.

b. None of the other installment agreements required the IRS to withdraw the July 21, 2009 notice of lien

Thus far our analysis has been limited to the July 14, 2009 installment agreement. In determining whether the IRS was required to withdraw the notice of lien, we also consider the potential relevance of the provisions of the prior installment agreements. The petitioners contend that they did not default on prior installment agreements, and the IRS does not ultimately contend otherwise. If the petitioners did not default on one of the prior installment agreements (or they were not otherwise terminated), then that prior installment agreement, and not the July 14, 2009 agreement, would arguably govern whether the IRS was required to withdraw the notice of lien it filed on July 21, 2009. The petitioners allege that the IRS erroneously declared them to have defaulted on four installment agreements. In their count they include the July 14, 2009 installment agreement. However, they stipulated that they were in default on this agreement, a stipulation that we construe to mean that the petitioners were in default on the agreement. Setting aside the July 14, 2009 installment agreement leaves three installment agreements: the agreement on which they were declared in default in November 2008, the agreement established January 8, 2009, and the agreement established April 10, 2009. There is no information in the record about the terms of the installment agreement on which they were declared in default in November 2008. Therefore we cannot determine that its provisions were relevant to the Appeals Office's decision not to withdraw the notice of lien. The January 8 and April 10, 2009, installment agreements were more permissive than the July 14, 2009 installment agreement regarding the filing of notice of tax lien. The January 8, 2009, installment agreement had the following term (which is found in the Form 433-D that petitioners submitted on December 3, 2008): "We may file a Federal Tax lien if one has not been filed previously." The April 10, 2009, installment agreement contained the following condition: "We may file a federal tax lien to protect the interest of the federal government." In providing that a notice could be filed without regard to the petitioners' being in default on the agreement, these two agreements gave more latitude to the IRS than the July 14, 2009 installment agreement, which had provided that a notice could be filed in the event of default. Thus, these last two installment agreements do not serve as a basis for mandatory withdrawal of the notice of lien filed against the petitioners.

c. The timing of the filing of the notice of lien – seven days after the establishment of the new installment agreement – does not suggest that the IRS erred in failing to withdraw the notice

We also consider the petitioners' suggestion that the notice of lien should have been withdrawn because its filing was an indirect result of the IRS's erroneous determination that they had defaulted on the April 10, 2009 installment agreement. As discussed before, the IRS declared them in default on the April 10, 2009 installment agreement on June 15, 2009; it entered into a new installment agreement on July 14, 2009; and on July 21, 2009, it filed a notice of lien. The fact that the notice of lien was filed seven days after the establishment of the new installment agreement suggests that the notice of lien was filed because the IRS had entered into a new installment agreement. If the new installment agreement caused the IRS to file the notice of lien, then one could also surmise that the filing of the notice of lien would not have occurred but for the supposed default on the April 10, 2009, installment agreement. However, even if this chain of causality is correct, the Appeals Office did not err in its refusal to withdraw the lien filing. Its decision comported with the duties imposed on it by statute. The first set of duties is set forth in section 6330(c)(1), which requires the Appeals Office to consider whether the "requirements of any applicable law or administrative procedure have been met." Sec. 6330(c)(1). The Appeals Office determined that the requirements for filing a notice of lien had been met. It determined that a notice and demand for payment had been made, see sec. 6303, that a notice of federal tax lien filing had been issued,[14] that a notice of a right to a collection-review hearing had been issued, see sec. 6320(a)(3)(B), that a timely assessment had been made, see secs. 6201(a)(1), 6501(a), and that the tax had not been paid, see sec. 6321.

The second relevant set of duties is set forth in section 6330(c)(2)(ii) and (3)(C). The Appeals Office was required by section 6330(c)(2)(ii) to consider challenges to the appropriateness of the filing of the notice of lien; and it was required by section 6330(c)(3)(C) to consider whether the filing of the notice of lien balanced the need for the IRS to collect taxes with the legitimate concern of the petitioners that collection actions be no more intrusive than necessary. The Appeals Office determined that the filing of the notice of lien was appropriate and that the need to collect taxes was appropriately balanced with the concern of the petitioners. This determination was not an abuse of discretion. The notice of lien protected the government's right to receive full payment of the tax liabilities. The petitioners had entered into installment agreements to pay only $500 per month, and the Appeals Office concluded that these monthly payments would not have resulted in the full payment of the petitioners' tax liabilities.

[14] The petitioners argue that they did not receive notice of the filing of the notice of lien within five business days after it was filed. Sec. 6320(a) provides that if the IRS chooses to file a notice of lien, it must provide the taxpayer with written notice of the filing not more than five business days after the filing. The IRS filed the notice of lien on July 21, 2009. On the same day, the IRS notified the petitioners that it had filed the notice of lien. Therefore, the IRS provided timely notification. The petitioners claim that the notice of lien was filed on July 8, 2009. But that was the date the notice was prepared, not the date the notice was filed.

In considering the appropriateness of filing the notice of tax lien and the petitioners' concern that the collection action be no more intrusive than necessary, it is conceivably appropriate to consider whether the terms of one of their installment agreements might have led the petitioners to reasonably believe that their compliance with an installment agreement would prevent the filing of a notice of lien and whether they took actions in reliance on such a belief. The January 8 and April 10, 2009, installment agreements both provided that the IRS could file a notice of lien. It was not until July 14, 2009, that the IRS entered into an installment agreement that contained the seemingly less permissive provision that a notice of lien could be filed in the event of default. This provision could have led the petitioners to believe that a notice of lien could be filed only in the event of default.

But the notice of lien was filed only seven days after the July 14, 2009 agreement was accepted. The record does not suggest that during this short seven-day period the petitioners took any action in reliance on the IRS's leaving its lien unfiled. Because the January 8 and April 10, 2009, installment agreements warned the petitioners that the IRS could file a notice of tax lien at any time, and because the July 14, 2009 installment agreement was in place only seven days before the lien was filed, it does not appear that the provision in the July 14, 2009 installment agreement that a lien could be filed in the event of default affects the issues of whether the filing of the lien notice was appropriate and whether the filing of the lien notice appropriately balanced the need to collect taxes against the petitioners' legitimate concern that collection actions be no more intrusive than necessary.

d. The appeals office did not err in considering whether to reinstate the installment agreement

The next point to consider is the petitioners' request that the Court order the IRS to reinstate an installment agreement. The petitioners claim that reinstatement is justified because they did not default on their prior installment agreements. Even if the petitioners did not default on one or more of their installment agreements, there was no error in the Appeals Office's handling of the matter of reinstating the installment agreement. The Appeals Office agreed to allow the petitioners to enter into a new installment agreement.

e. The appeals office did not err in not offering a full payment installment agreement

The petitioners also argue that the Appeals Office erred by not offering to replace their partial payment installment agreement with a full payment installment agreement. They argue that a full payment installment agreement would have obviated the need for the IRS to file a notice of lien. We do not believe the Appeals Office erred in not offering a full payment installment agreement. A full payment installment agreement would have required an increase in the monthly payments from the $500 monthly amount that the petitioners had negotiated with the IRS. If the petitioners wanted to renegotiate the $500 amount to a higher amount, they should have attempted to do so. They did not.

f. The appeals office erred by not abating fees imposed for reinstating installment agreements

The petitioners also seek reimbursement of all fees associated with the reinstatement of four installment agreements. The petitioners were declared in default on the first installment agreement on November 10, 2008. On December 3, 2008, the petitioners offered to enter into a new installment agreement. Their offer form said that a $43 user fee would be paid. The offer was accepted on January 8, 2009. After the petitioners were declared to be in default on April 6, 2009, the IRS issued a letter on April 10, 2009 reinstating the agreement and stating that the reinstatement fee was $52. After they were declared in default on this agreement on June 15, 2009, the IRS issued a letter on July 14, 2009, reinstating the agreement and stating that the fee for reinstatement was $45. After the petitioners defaulted on this agreement, the IRS issued a letter on October 20, 2009 reinstating the agreement and stating that the reinstatement fee was $105. The IRS's position on whether these fees should have been abated is tantamount to a concession.[15]

Although on brief the IRS implies that the petitioners may have defaulted on the first three installment agreements, the IRS does not actually take the position that they did default. Furthermore, the Appeals Office, whose action we are reviewing, made no determination of whether the petitioners defaulted on the installment agreements. The Appeals Office acknowledged that the petitioners contended that the April 10, 2009 agreement--the third agreement referred to in the record--was wrongfully terminated by the IRS: "It appears that your previous IA defaulted due to a balance on another module that you say was fully paid." Having acknowledged that this contention was made, the Appeals Office did not disagree with it. Nor does the IRS explain why the Appeals Office's failure to abate the installment-agreement fees was not an abuse of discretion. The only real position taken by the IRS in its brief regarding whether the Appeals Office should have abated the fees is the promise that the fees will be abated in the future. Because (1) the Appeals Office did not determine that the petitioners defaulted on the prior installment agreements, (2) the IRS does not ultimately contest that the petitioners complied with the prior installment agreements, and (3) the IRS does not explain why the Appeals Office's failure to abate the installment-agreement fees did not constitute an abuse of discretion, we hold that the Appeals Office erred in failing to abate the fees charged for establishing the following installment agreements: (1) the installment agreement established January 8, 2009, (2) the installment agreement established April 10, 2009, (3) the installment agreement established July 14, 2009, and (4) the installment agreement established October 20, 2009. Although the petitioners in their pretrial memorandum state that the fees they were charged for these agreements were $247, the correspondence from the IRS refers to only $245 in user fees and reinstatement fees (that is, $43 + $52 + $45 + $105). Therefore we consider the Appeals Office to have erred in failing to abate fees of $245. If the IRS had an argument that the petitioners were not entitled to abatement of the $105 fee for the October 20, 2009 installment agreement (on the grounds that the petitioners have stipulated that they genuinely defaulted on the prior agreement of July 14, 2009, and therefore the fee for reinstating the agreement should not be abated), the IRS did not articulate the argument in its brief, and we need not consider it.

To reflect the foregoing,

An appropriate order and decision will be entered.

[15] Although the petitioners seek reimbursement of the fees rather than abatement, it is more appropriate for the fees to be abated.

CASE STUDY #4 – REVIEW QUESTIONS

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. The taxpayers in this case entered into what type of agreement with the IRS:

    a) Offer in Compromise
    b) Streamlined Installment Agreement
    c) Partial Pay Installment Agreement
    d) Effective Tax Administration Offer in Compromise

CASE STUDY #4 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. This case deals with Installment Agreements, not Offers in Compromise.

   B: Incorrect. The level of tax debt was too high for a Streamlined Installment Agreement.

   C: Correct. A Partial Pay Installment Agreement is when the IRS is accepting less than the full amount owed, similar to an Offer in Compromise, except that the taxpayers are given more time to pay.

   D: Incorrect. The agreement is an Installment Agreement.

   (See page 10-53 of the course material.)

V. Case Study #5

In this case, the taxpayers argued that the IRS should not have rejected their Offer in Compromise – even though the offer was much less than they could afford to pay – based on Effective Tax Administration. The court found the IRS acted properly in rejecting the offer because there was no basis under Effective Tax Administration to allow the taxpayers to pay substantially less than they could afford.

T.C. Memo. 2007-56
UNITED STATES TAX COURT
GARY AND JOHNEAN HANSEN, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent
Docket No. 11175-05L. Filed March 8, 2007.

A. MEMORANDUM FINDINGS OF FACT AND OPINION

LARO, Judge: Petitioners petitioned the Court under section 6330(d) to review the determination of respondent's Office of Appeals (Appeals) sustaining a proposed levy related to petitioners' 1989 Federal income tax year. Petitioners argue the proposed levy is improper because, they state, Appeals was required to accept their offer of $90,258 to compromise what they estimated is their $260,143 Federal income tax liability (inclusive of additions to tax, penalties, and interest) for 1987 through 1998[16]. We decide whether Appeals abused its discretion in rejecting that offer. We hold it did not.

B. FINDINGS OF FACT

The parties filed with the Court stipulations of fact and accompanying exhibits. The stipulated facts are found accordingly. When the petition was filed, petitioners resided in Kennewick, Washington.

Beginning in 1987, petitioners' Federal income tax returns claimed losses and credits from their investment in partnerships organized and operated by Walter J. Hoyt III (Hoyt). One of these partnerships was Timeshare Breeding Service 1989-1 (TBS). Hoyt was TBS's general partner and tax matters partner, and TBS was subject to the unified audit and litigation procedures of the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. 97-248, sec. 402(a), 96 Stat. 648. Hoyt was convicted on criminal charges relating to the promotion of TBS and other partnerships.

Petitioners' claim to losses and credits passing to them from TBS resulted in the underreporting of their 1989 taxable income. On October 22, 2002, respondent mailed to petitioners a Letter 1058, Final Notice of Intent to Levy and Notice of Your Right to a Hearing. The notice informed petitioners that respondent proposed to levy on their property to collect Federal income tax (and any related amount) that they owed for 1989. The notice advised petitioners that they were entitled to a hearing with Appeals to review the propriety of the proposed levy.

On November 18, 2002, petitioners asked Appeals for the referenced hearing. On January 11, 2005, Linda Cochran (Cochran), a settlement officer in Appeals, held the hearing with petitioners' counsel. Cochran and petitioners' counsel discussed two

[16] Petitioners submitted to respondent Form 656, Offer in Compromise, indicating that they were offering to compromise their tax liability for 1987 through 1996. Petitioners included with that submission a letter in which they stated that they wished to compromise their tax liability for 1987 through 1998. We read petitioners' offer to include 1987 through 1998.

issues. The first issue concerned petitioners' intent to offer to compromise their 1987 through 1998 Federal income tax liability to promote effective tax administration. Petitioners contended that Appeals should accept their offer as a matter of equity and public policy. Petitioners stated that it took a long time to resolve the Hoyt partnership cases and noted that Hoyt had been convicted on the criminal charges. The second issue concerned an interest abatement case under section 6404(e) that petitioners then had pending in this Court at docket No. 18896-03. That case related to 1989, the year at issue here, and petitioners claimed that the proposed levy should be rejected because the case was pending. On April 28, 2005, the Court entered a decision in that case stating that the parties agreed that petitioners were not entitled for 1989 to an abatement of interest under section 6404. That decision is now final.

On February 15, 2005, petitioners tendered to Cochran on Form 656, Offer in Compromise, a written offer to pay $90,258 to compromise their estimated $260,143 liability. The offer was limited to a claim of effective tax administration because petitioners had sufficient assets to pay their tax liability in full. Petitioners supplemented their offer with a completed Form 433-A, Collection Information Statement for Wage Earners and Self-Employed Individuals, four letters totaling approximately 65 pages, and volumes of documents. The Form 433-A reported that petitioners owned assets with a total current value of $311,994, inclusive of the following[17]:

Assets	Current value
Cash in accounts	$101,981
Retirement accounts	120,903
Vehicles:	
1992 Chevy Lumina	200
1993 Mercury Villager	1,340
1999 Buick LeSabre	3,230
Home	84,340
	$ 311,994

The Form 433-A also reported the following monthly items of income and expense:

Items of Income	Amount
Husband's wages	$8,512
Wife's wages	3,427
	$11,940 (as rounded)

Items of Expense	Amount
Food, clothing, and miscellaneous	$2,000
Housing and utilities	1,500
Transportation	300
Medical expenses	400
Taxes	4,000
Life insurance	227
Other expenses	275
	$8,702

[17] Form 433-A states that each asset reported on the form should be valued at its "current value", defined on the form as "the amount you could sell the asset for today".

Cochran determined that petitioners' net realizable equity in their cash was either the $101,981 reported in their bank accounts or $96,954[18] and that petitioners' net realizable equity in their retirement accounts and home was the same as the reported values. Cochran also reduced the values of petitioners' vehicles by 20 percent to reflect their "quick sale values".[19] Cochran summarized petitioners' assets and liabilities as follows:

Assets	Fair Market Value	Quick Sale Value	Encumbrance or Exemption	Net Realizable Equity
Cash	$101,981	--	--	$101,981
Vehicles:				
1992 Chevy Lumina	$200	$160	--	160
1993 Mercury Villager	1,340	1,072	--	1,072
1999 Buick Le Sabre	3,230	2,584	--	2,584
Retirement accounts	$120,903	--	--	$120,903
Real Estate	$84,340	--	--	$84,340
	$311,994	3,816	$0	$311,040

Cochran made three adjustments to petitioners' reported expenses. First, she allowed $1,280 (instead of $2,000) for monthly food, clothing, and miscellaneous expenses. Cochran made this adjustment in accordance with respondent's national guideline amounts based on petitioners' monthly income and household size. Cochran also considered petitioners' particular circumstances but noted that they did not warrant allowing the higher figure submitted by petitioners. Second, Cochran allowed $1,093 (instead of $1,500) for monthly housing expenses. She made this adjustment in accordance with respondent's local guideline amounts and noted that petitioners had not documented any reason for deviating from these guidelines. Finally, Cochran allowed $2,100 (instead of $4,000) for monthly tax expenses. She arrived at this figure by calculating petitioners' monthly income and determining their approximate monthly tax liability. She noted that petitioners resided in Washington, which does not have a State income tax. In sum, Cochran concluded that petitioners had allowable monthly expenses of $5,675.

Cochran determined that petitioners' net realizable equity in their assets was either $311,200 or $306,013, and that petitioners had a monthly disposable income of $6,265 ($11,940 in monthly income less $5,675 of monthly allowable expenses). Cochran also determined that petitioners could pay $300,720 from their future income. In sum, Cochran concluded, petitioners' net realizable equity in assets and future income equaled $611,920 or alternatively $606,734.

[18] Cochran arrived at the latter figure by reducing the amount of cash in petitioners' bank accounts by the cash they proposed to pay as part of the offer-in-compromise. Petitioners stated on their Form 656 that "The taxpayers have placed a total of $85,231 on account as advance deposits; the remainder is from cash assets." Cochran subtracted the claimed advance deposits ($85,231) from the offer amount ($90,258) and reduced the net realizable equity by $5,027 (from $101,981 to $96,954).

[19] Cochran was told by petitioners that they had ascertained the value of each vehicle by using its trade-in value and considering its condition to be "fair."

On May 12, 2005, Appeals issued petitioners a notice of determination sustaining the proposed levy. The notice concludes that petitioners' $90,258 offer-in-compromise is not an appropriate collection alternative to the proposed levy. The notice, citing Internal Revenue Manual (IRM) sections 5.8.11.2.1 and 5.8.11.2.2, states that petitioners' offer does not meet the Commissioner's guidelines for consideration as an offer-in-compromise to promote effective tax administration on the basis of economic hardship or equity and public policy. Cochran noted that since petitioners' representative had not specified the basis on which they were making their effective tax administration offer, she considered it under both economic hardship and equity and public policy grounds.

As to petitioners' offer-in-compromise to promote effective tax administration due to economic hardship, the notice states that "the taxpayers have the ability to meet all their necessary living expenses and to pay all amounts owed from either their equity in assets or their income stream and still have equity and income". As to petitioners' offer-in-compromise to promote effective tax administration based on equity and public policy, the notice states: "the taxpayers' Effective Tax Administration offer proposal fails to meet the criteria for such consideration under Internal Revenue Manual 5.8.11.2.2 * * * [and], therefore, cannot be considered further." The notice further states as to Cochran's balancing of efficient collection with the legitimate concerns of taxpayers that:

> The taxpayers' concerns about the proposed collection action generally fall into two areas: (1) pending litigation (the interest abatement case) and (2) a viable collection alternative in the form of their $90,258 offer in compromise.
>
> The Settlement Officer has balanced the taxpayers' first area of concern by withholding further collection activity regarding [sic] such time as the pending interest abatement case regarding 1989 (for the accrued interest still unpaid) or the pending TEFRA penalty case regarding 1989 (for the accrued failure to pay penalty) is decided.
>
> With respect to the taxpayers' second area of concern, the Settlement Officer has evaluated the taxpayers' $90,258 offer to compromise the underlying liabilities as a collection alternative to the proposed levy action. Based on that evaluation, the taxpayers' offer of $90,258 could not be recommended for acceptance, and therefore cannot be considered as a collection alternative.

The notice states that petitioners have neither offered an argument nor cited any authority to permit Appeals to deviate from the provisions of the IRM.

As to petitioners' claim at the hearing for an interest abatement, Cochran ascertained that petitioners had filed the case in this Court seeking an abatement of interest under section 6404(e) for 1989. Cochran stated in the notice of determination that she had decided to stay collection activity relating to interest amounts while petitioners' interest abatement case for 1989 was pending in this Court.

C. OPINION

This case is another in a long list of cases brought in this Court involving respondent's proposal to levy on the assets of a partner in a Hoyt partnership to collect Federal income taxes attributable to the partner's participation in the partnership. Petitioners argue that Appeals was required to let them pay $90,258 to compromise their estimated $260,143 Federal income tax liability for 1987 through 1998. Where an underlying tax liability is not at issue in a case invoking our jurisdiction under section 6330(d), we review the determination of Appeals for abuse of discretion. We reject the determination of Appeals only if the determination was arbitrary, capricious, or without sound basis in fact or law. See Cox v. Commissioner, 126 T.C. 237, 255 (2006); Murphy v. Commissioner, 125 T.C. 301, 308, 320 (2005), affd. 469 F.3d 27 (1st Cir. 2006).

Where, as here, we decide the propriety of Appeal's rejection of an offer-in-compromise, we review the reasoning underlying that rejection to decide whether the rejection was arbitrary, capricious, or without sound basis in fact or law.

We do not substitute our judgment for that of Appeals, and we do not decide independently the amount that we believe would be an acceptable offer-in-compromise. See Murphy v. Commissioner, supra at 320; see also Clayton v. Commissioner, supra; Barnes v. Commissioner, supra; Fowler v. Commissioner, T.C. Memo. 2004-163; Fargo v. Commissioner, T.C. Memo. 2004-13, affd. 447 F.3d 706 (9th Cir. 2006). Nor do we usually consider arguments, issues, or other matters raised for the first time at trial, but we limit ourselves to matter brought to the attention of Appeals. See Murphy v. Commissioner, supra at 308; Magana v. Commissioner, 118 T.C. 488, 493 (2002). "[E]vidence that * * * [a taxpayer] might have presented at the section 6330 hearing (but chose not to) is not admissible in a trial conducted pursuant to section 6330(d)(1) because it is not relevant to the question of whether the Appeals officer abused her discretion." Murphy v. Commissioner, supra at 315.[20]

Section 6330(c)(2)(A)(iii) allows a taxpayer to offer to compromise a Federal tax debt as a collection alternative to a proposed levy. Section 7122(c) authorizes the Commissioner to prescribe guidelines to determine when a taxpayer's offer-in-compromise should be accepted. The applicable regulations, section 301.7122-1(b), Proced. & Admin. Regs., list three grounds on which the Commissioner may accept an offer-in-compromise of a Federal tax debt. These grounds are "Doubt as to liability", "Doubt as to collectability", and to "Promote effective tax administration". Sec. 301.7122-1(b)(1), (2), and (3), Proced. & Admin. Regs. Petitioners reported on their Form 433-A that they had assets worth $311,994. Cochran determined that petitioners' reasonable collection potential

[20] In Murphy v. Commissioner, 125 T.C. 301 (2005), affd. 469 F.3d 27 (1st Cir. 2006), the Court declined to include in the record external evidence relating to facts not presented to Appeals. The Court distinguished Robinette v. Commissioner, 123 T.C. 85 (2004), revd. 439 F.3d 455 (8th Cir. 2006), and held that the external evidence was inadmissible in that it was not relevant to the issue of whether Appeals abused its discretion. In a memorandum that petitioners filed with the Court on April 13, 2006, pursuant to an order of the Court directing petitioners to explain the relevancy of any external evidence that they desired to include in the record of this case, petitioners made no claim that they had offered any of the external evidence to Cochran. Instead, as we read petitioners' memorandum in the light of the record as a whole, petitioners wanted to include the external evidence in the record of this case to prove that Cochran abused her discretion by not considering facts and documents that they had consciously decided not to give to her. Consistent with Murphy v. Commissioner, supra, we sustained respondent's relevancy objections to the external evidence. Accord Clayton v. Commissioner, T.C. Memo. 2006-188; Barnes v. Commissioner, T.C. Memo. 2006-150.

(taking into account their assets as well as future income) was either $611,920 or $606,734. Petitioners can afford to pay their estimated $260,143 tax liability in full and do not argue that the liability is in doubt. They seek to qualify for an offer-in-compromise to promote effective tax administration. See sec. 301.7122-1(b)(3), Proced. & Admin. Regs.; cf. Fargo v. Commissioner, 447 F.3d 706 (9th Cir. 2006) (taxpayers made an offer-in-compromise to promote effective tax administration where they had sufficient assets to pay their tax liability in full).

Petitioners argue that respondent was required to compromise their tax liability to promote effective tax administration. The Commissioner may compromise a tax liability to promote effective tax administration when collection of the full liability will create economic hardship and the compromise would not undermine compliance with the tax laws by taxpayers in general. If a taxpayer does not qualify for effective tax administration compromise on grounds of economic hardship, the regulations also allow the Commissioner to compromise a tax liability to promote effective tax administration when the taxpayer identifies compelling considerations of public policy or equity.

Cochran considered all of the evidence submitted to her by petitioners and applied the guidelines for evaluating an offer-in-compromise to promote effective tax administration. Although petitioners did not specifically state on which basis they were submitting their effective tax administration offer-in-compromise, Cochran considered it under both economic hardship and public policy and equity grounds. Cochran determined that petitioners' offer was unacceptable because they had not demonstrated that they would suffer economic hardship and public policy and equity reasons did not weigh in favor of accepting their offer. Cochran's determination to reject petitioners' offer-in-compromise was not arbitrary, capricious, or without a sound basis in fact or law, and it was not abusive or unfair to petitioners. Cochran's determination was based on a reasonable application of the guidelines, which we decline to second-guess.

Petitioners make six arguments in advocating a contrary result. First, petitioners argue that the Court lacks jurisdiction to review the rejection of their offer in compromise.

Petitioners allege that Hoyt had a conflict of interest that prevented him from extending the periods of limitation for the partnerships in which petitioners were partners. Petitioners conclude that any consents signed by Hoyt to extend the periods of limitation were invalid, which in turn means that the Court lacks jurisdiction because the applicable periods of limitation have otherwise expired. Petitioners' challenge to this Court's jurisdiction is groundless, frivolous, and unavailing. It is well settled that the expiration of the period of limitation is an affirmative defense and not a factor of this Court's jurisdiction. Where, as here, the claim of a time bar relates to items of a partnership, the claim must be made in the partnership proceeding and may not be considered at a proceeding involving the personal income tax liability of one or more of the partners of the partnership.

Second, petitioners argue that Cochran's rejection of their offer-in-compromise conflicts with the congressional committee reports underlying the enactment of section 7122. According to petitioners, their case is a "longstanding" case, and those reports require that respondent resolve such cases by forgiving interest and penalties that otherwise apply. We disagree with petitioners' reading and application of the legislative history underlying section 7122. Petitioners' argument on this point is essentially the same argument that was considered and rejected by the Court of Appeals for the Ninth Circuit in Fargo v. Commissioner, 447 F.3d at 711-712. We do likewise here for the same reasons stated in that opinion. We add that petitioners' counsel participated in the appeal in Fargo as counsel for the amici. While petitioners in their brief suggest that the Court of Appeals for the Ninth Circuit knowingly wrote its opinion in Fargo in such a way as to distinguish that case from the cases of counsel's similarly situated clients (e.g., petitioners), and otherwise to allow those clients to receive an abatement of their liability attributable to partnerships such as those here, we do not read the opinion of the Court of Appeals for the Ninth Circuit in Fargo to support that conclusion.

Third, petitioners argue that Cochran inadequately considered their unique facts and circumstances. We disagree. Cochran reviewed and considered all information given to her by petitioners. On the basis of the facts and circumstances of petitioners' case as they were presented to her, Cochran determined that petitioners' offer did not meet the applicable guidelines for acceptance of an offer-in-compromise to promote effective tax administration based on economic hardship or public policy or equity grounds. We find no abuse of discretion in that determination. Nor do we find that Cochran inadequately considered the information actually given to her by petitioners. With the exception of expenses that exceeded respondent's guidelines and excessive claimed tax expenses, Cochran allowed the full amount of petitioners' expenses. Moreover, Cochran allowed the full $400 that petitioners claimed in medical expenses even though they provided no documentation of any such expenses. Finally, Cochran allowed petitioners more than a month after their collection due process hearing to submit additional documents to support their position. We find that Cochran gave thorough consideration to all of petitioners' claims.

Fourth, petitioners argue that public policy demands that their offer-in-compromise be accepted because they were victims of fraud. We disagree. While the regulations do not set forth a specific standard for evaluating an offer-in-compromise based on claims of public policy or equity, the regulations contain two illustrative examples. See sec. 301.7122-1(c)(3)(iv), Examples (1) and (2), Proced. & Admin. Regs. The first example describes a taxpayer who is seriously ill and unable to file income tax returns for several years. The second example describes a taxpayer who received erroneous advice from the Commissioner as to the tax effect of the taxpayer's actions. Neither example bears any resemblance to this case. Unlike the exceptional circumstances exemplified in the regulations, petitioners' situation is neither unique nor exceptional in that petitioners' situation mirrors that of numerous taxpayers who claimed tax shelter deductions in the 1980s and 1990s, obtained the tax advantages, promptly forgot about their "investment", and now realize that paying their taxes may require a change of lifestyle.[21] See Clayton v. Commissioner, T.C. Memo. 2006-188; Barnes v. Commissioner, T.C. Memo. 2006-150.

[21] Of course, the examples in the regulations are not meant to be exhaustive, and petitioners' situation is not identical to that of the taxpayers in Fargo v. Commissioner, 447 F.3d 706, 714 (9th Cir. 2006), affg. T.C. Memo. 2004-13, regarding whom the Court of Appeals for the Ninth Circuit noted that "no evidence was presented to suggest that Taxpayers were the subject of fraud or deception". Such considerations, however, have not kept this Court from finding investors in Hoyt's shelters to be culpable of negligence, see, e.g., Keller v. Commissioner, T.C. Memo. 2006-131, nor prevented the Courts of Appeals for the Sixth, Ninth, and Tenth Circuits from affirming our decisions to that effect in Hansen v. Commissioner, 471 F.3d 1021 (9th Cir. 2006), affg. T.C. Memo. 2004-269; Mortensen v. Commissioner, 440 F.3d 375 (6th Cir. 2006), affg. T.C. Memo. 2004-279; and Van Scoten v. Commissioner, 439 F.3d 1243 (10th Cir. 2006), affg. T.C. Memo. 2004-275.

We also believe that compromising petitioners' case on grounds of public policy or equity would not promote effective tax administration. While petitioners portray themselves as victims of Hoyt's alleged fraud and respondent's alleged delay in dealing with Hoyt, they take no responsibility for their tax predicament. We cannot agree that acceptance by respondent of petitioners' $90,258 offer to satisfy their estimated $260,143 tax liability would enhance voluntary compliance by other taxpayers. A compromise on that basis would place the Government in the unenviable role of an insurer against poor business decisions by taxpayers, reducing the incentive for taxpayers to investigate thoroughly the consequences of transactions into which they enter. It would be particularly inappropriate for the Government to play that role here, where the transaction at issue involves a tax shelter. Reducing the risks of participating in tax shelters would encourage more taxpayers to run these risks, thus undermining rather than enhancing compliance with the tax laws[22].

Fifth, petitioners argue that Cochran failed to balance efficient collection with the legitimate concern that collection be no more intrusive than necessary. We disagree. Cochran thoroughly considered this balancing issue on the basis of the information and proposed collection alternative given to her by petitioners. She concluded that "the proposed levy action regarding the taxpayers represents the only efficient means for collection of the liabilities at issue in this case". While petitioners assert that Cochran did not consider all of the facts and circumstances of this case, "including whether the circumstances of a particular case warrant acceptance of an amount that might not otherwise be acceptable under the Secretary's policies and procedures", sec. 301.7122-1(c)(1), Proced. & Admin. Regs., we find to the contrary. Cochran thoroughly considered petitioners' arguments for accepting their offer-in-compromise, and she rejected the offer only after concluding that petitioners could pay much more of their tax liability than the $90,258 they offered. Cf. IRM sec. 5.8.11.2.1(11) ("When hardship criteria are identified but the taxpayer does not offer an acceptable amount, the offer should not be recommended for acceptance").

Sixth, petitioners argue that Cochran inappropriately failed to consider whether they qualified for an abatement of interest for reasons other than those described in section 6404(e). We disagree. We note that in the notice of determination, Cochran decided to stay collection of interest while petitioners' interest abatement case was pending in this Court. Moreover, we find nothing to suggest that Cochran believed that petitioners' sole remedy for interest abatement in this case rested on the rules of section 6404(e). In fact, regardless of the rules of section 6404(e), Cochran obviously would have abated interest

---

[22] Nor does the fact that petitioners' case may be "longstanding" overcome the detrimental impact on voluntary compliance that could result from respondent's accepting petitioners' offer-in-compromise. An example in IRM sec. 5.8.11.2.2 implicitly addresses the "longstanding" issue. There, the taxpayer invested in a tax shelter in 1983, thereby incurring tax liabilities for 1981 through 1983. He failed to accept a settlement offer by respondent that would have eliminated a substantial portion of his interest and penalties. Although the example, which is similar to petitioners' case in several respects, would qualify as a "longstanding" case by petitioners' standards, the offer was not acceptable because acceptance of it would undermine compliance with the tax laws. in the unenviable role of an insurer against poor business decisions by taxpayers, reducing the incentive for taxpayers to investigate thoroughly the consequences of transactions into which they enter. It would be particularly inappropriate for the Government to play that role here, where the transaction at issue involves a tax shelter. Reducing the risks of participating in tax shelters would encourage more taxpayers to run those risks, thus undermining rather than enhancing compliance with the tax laws.

in this case had she agreed to let petitioners compromise their estimated $260,143 liability by paying less than the amount of interest included within that liability.

We hold that Appeals did not abuse its discretion in rejecting petitioners' $90,258 offer-in-compromise. In so holding, we express no opinion as to the amount of any compromise that petitioners could or should be required to pay, or that respondent is required to accept. The only issue before us is whether Appeals abused its discretion in refusing to accept petitioners' specific offer-in-compromise in the amount of $90,258. We have considered all arguments made by petitioners for a contrary holding and have found those arguments not discussed herein to be irrelevant and/or without merit. An appropriate order will be issued.

CASE STUDY #5 – REVIEW QUESTIONS

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. Upon what basis did the taxpayer seek to obtain an Offer in Compromise:

   a) Doubt as to Collectability
   b) Doubt as to Liability
   c) Effective Tax Administration
   d) Lapsed Statute of Limitations

2. Why does the court believe that acceptance of the taxpayer's Offer in Compromise would be bad public policy:

   a) because the taxpayer was an educated person
   b) because it would take responsibility away from the taxpayer to investigate business opportunities and investments
   c) because the taxpayer made money on the deal
   d) because the court disapproves of most compromises

CASE STUDY #5 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. Indeed, the taxpayer had sufficient funds to fully repay the delinquent taxes.

   B: Incorrect. The taxpayer had no argument that the taxes were not properly assessed.

   C: Correct. The taxpayers' argument, though not specific, was that they should be allowed to compromise their tax liability based on the theory of Effective Tax Administration. This theory can encompass several arguments, including financial hardship and public policy.

   D: Incorrect. This argument would be properly raised as Doubt as to Liability and was not at issue in this case.

   (See page 10-62 of the course material.)

2. A: Incorrect. We do not know the educational level of the taxpayer in this case.

   B: Correct. The taxpayer's debt is based on a tax shelter that turned out not to be legal. The government does not want to discourage investors from studying their investments in detail, particularly where the investment is intended to reduce tax liabilities.

   C: Incorrect. In the end, the taxpayer did not make money because he was assessed the tax in question.

   D: Incorrect. In cases where it is against public policy, the courts do not favor acceptance of Offers in Compromise.

   (See page 10-69 of the course material.)

Appendix

Form 433-A – Collection Information Statement for Wage Earners and Self-Employed Individuals

Form 433-B – Collection Information Statement for Businesses

Form 433-D – Installment Agreement

Form 433-F – Collection Information Statement

Form 656 – Offer in Compromise

Form 656-L – Offer in Compromise (Doubt as to Liability)

Form 8857 – Request for Innocent Spouse Relief

Form 9465 – Installment Agreement Request

Form **433-A**
(Rev. December 2012)
Department of the Treasury
Internal Revenue Service

Collection Information Statement for Wage Earners and Self-Employed Individuals

Wage Earners Complete Sections 1, 2, 3, 4, and 5 including the signature line on page 4. *Answer all questions or write N/A if the question is not applicable.*

Self-Employed Individuals Complete Sections 1, 3, 4, 5, 6 and 7 and the signature line on page 4. *Answer all questions or write N/A if the question is not applicable.*

For Additional Information, refer to Publication 1854, "How To Prepare a Collection Information Statement."

Include attachments if additional space is needed to respond completely to any question.

Name on Internal Revenue Service (IRS) Account	Social Security Number *SSN* on IRS Account	Employer Identification Number *EIN*

Section 1: Personal Information

1a Full Name of Taxpayer and Spouse *(if applicable)*	**1c** Home Phone ( )	**1d** Cell Phone ( )
1b Address *(Street, City, State, ZIP code) (County of Residence)*	**1e** Business Phone ( )	**1f** Business Cell Phone ( )
	2b Name, Age, and Relationship of dependent(s)	
2a Marital Status: ☐ Married ☐ Unmarried *(Single, Divorced, Widowed)*		

	Social Security No. *(SSN)*	Date of Birth *(mmddyyyy)*	Driver's License Number and State
3a Taxpayer			
3b Spouse			

Section 2: Employment Information for Wage Earners

If you or your spouse have self-employment income instead of, or in addition to wage income, complete Business Information in Sections 6 and 7.

Taxpayer		**Spouse**	
4a Taxpayer's Employer Name		**5a** Spouse's Employer Name	
4b Address *(Street, City, State, and ZIP code)*		**5b** Address *(Street, City, State, and ZIP code)*	
4c Work Telephone Number ( )	**4d** Does employer allow contact at work ☐ **Yes** ☐ **No**	**5c** Work Telephone Number ( )	**5d** Does employer allow contact at work ☐ **Yes** ☐ **No**
4e How long with this employer *(years)* *(months)*	**4f** Occupation	**5e** How long with this employer *(years)* *(months)*	**5f** Occupation
4g Number of withholding allowances claimed on Form W-4	**4h** Pay Period: ☐ Weekly ☐ Bi-weekly ☐ Monthly ☐ Other	**5g** Number of withholding allowances claimed on Form W-4	**5h** Pay Period: ☐ Weekly ☐ Bi-weekly ☐ Monthly ☐ Other

Section 3: Other Financial Information *(Attach copies of applicable documentation)*

6 **Are you a party to a lawsuit** *(If yes, answer the following)* ☐ **Yes** ☐ **No**

☐ Plaintiff ☐ Defendant	Location of Filing	Represented by	Docket/Case No.
Amount of Suit $	Possible Completion Date *(mmddyyyy)*	Subject of Suit	

7 **Have you ever filed bankruptcy** *(If yes, answer the following)* ☐ **Yes** ☐ **No**

Date Filed *(mmddyyyy)*	Date Dismissed *(mmddyyyy)*	Date Discharged *(mmddyyyy)*	Petition No.	Location Filed

8 **In the past 10 years, have you lived outside of the U.S for 6 months or longer** *(If yes, answer the following)* ☐ **Yes** ☐ **No**

Dates lived abroad: from *(mmddyyyy)*	To *(mmddyyyy)*

9a **Are you the beneficiary of a trust, estate, or life insurance policy** *(If yes, answer the following)* ☐ **Yes** ☐ **No**

Place where recorded:		EIN:
Name of the trust, estate, or policy	Anticipated amount to be received $	When will the amount be received

9b **Are you a trustee, fiduciary, or contributor of a trust** ☐ **Yes** ☐ **No**

Name of the trust:	EIN:

10 **Do you have a safe deposit box (business or personal)** *(If yes, answer the following)* ☐ **Yes** ☐ **No**

Location *(Name, address and box number(s))*	Contents	Value $

11 **In the past 10 years, have you transferred any assets for less than their full value** *(If yes, answer the following)* ☐ **Yes** ☐ **No**

List Asset(s)	Value at Time of Transfer $	Date Transferred *(mmddyyyy)*	To Whom or Where was it Transferred

Section 4: Personal Asset Information for All Individuals

12 CASH ON HAND Include cash that is not in a bank **Total Cash on Hand** $

PERSONAL BANK ACCOUNTS Include all checking, online and mobile *(e.g., PayPal)* accounts, money market accounts, savings accounts, and stored value cards *(e.g., payroll cards, government benefit cards, etc.)*.

Type of Account	Full Name & Address *(Street, City, State, ZIP code)* of Bank, Savings & Loan, Credit Union, or Financial Institution	Account Number	**Account Balance** As of ______ *mmddyyyy*
13a			$
13b			$
13c			**$**

13d Total Cash *(Add lines 13a through 13c, and amounts from any attachments)* $

INVESTMENTS Include stocks, bonds, mutual funds, stock options, certificates of deposit, and retirement assets such as IRAs, Keogh, and 401(k) plans. Include all corporations, partnerships, limited liability companies, or other business entities in which you are an officer, director, owner, member, or otherwise have a financial interest.

Type of Investment or Financial Interest	Full Name & Address *(Street, City, State, ZIP code)* of Company	Current Value	Loan Balance *(if applicable)* As of ______ *mmddyyyy*	**Equity** Value minus Loan
14a	Phone	$	$	$
14b	Phone	$	$	$
14c	Phone	$	$	$

14d Total Equity *(Add lines 14a through 14c and amounts from any attachments)* $

AVAILABLE CREDIT Include all lines of credit and bank issued credit cards. Full Name & Address *(Street, City, State, ZIP code)* of Credit Institution	Credit Limit	Amount Owed As of ______ *mmddyyyy*	**Available Credit** As of ______ *mmddyyyy*
15a Acct. No	$	$	$
15b Acct. No	$	$	$

15c Total Available Credit *(Add lines 15a, 15b and amounts from any attachments)* $

16a LIFE INSURANCE Do you own or have any interest in any life insurance policies with cash value (*Term Life insurance does not have a cash value)*

☐ **Yes** ☐ **No** If yes, complete blocks 16b through 16f for each policy.

16b Name and Address of Insurance Company(ies):			
16c Policy Number(s)			
16d Owner of Policy			
16e Current Cash Value	$	$	$
16f Outstanding Loan Balance	$	$	$

16g Total Available Cash *(Subtract amounts on line 16f from line 16e and include amounts from any attachments)* $

REAL PROPERTY Include all real property owned or being purchased

	Purchase Date *(mmddyyyy)*	Current Fair Market Value (FMV)	Current Loan Balance	Amount of Monthly Payment	Date of Final Payment *(mmddyyyy)*	**Equity** FMV Minus Loan
17a Property Description		$	$	$		$
Location *(Street, City, State, ZIP code)* and County		Lender/Contract Holder Name, Address *(Street, City, State, ZIP code),* and Phone Phone				
17b Property Description		$	$	$		$
Location *(Street, City, State, ZIP code)* and County		Lender/Contract Holder Name, Address *(Street, City, State, ZIP code),* and Phone Phone				
17c **Total Equity** *(Add lines 17a, 17b and amounts from any attachments)*						$

PERSONAL VEHICLES LEASED AND PURCHASED Include boats, RVs, motorcycles, all-terrain and off-road vehicles, trailers, etc.

Description (Year, Mileage, Make/Model, Tag Number, Vehicle Identification Number)		Purchase/ Lease Date *(mmddyyyy)*	Current Fair Market Value (FMV)	Current Loan Balance	Amount of Monthly Payment	Date of Final Payment *(mmddyyyy)*	**Equity** FMV Minus Loan
18a Year	Make/Model		$	$	$		$
Mileage	License/Tag Number	Lender/Lessor Name, Address *(Street, City, State, ZIP code),* and Phone Phone					
Vehicle Identification Number							
18b Year	Make/Model		$	$	$		$
Mileage	License/Tag Number	Lender/Lessor Name, Address *(Street, City, State, ZIP code),* and Phone Phone					
Vehicle Identification Number							
18c **Total Equity** *(Add lines 18a, 18b and amounts from any attachments)*							$

PERSONAL ASSETS Include all furniture, personal effects, artwork, jewelry, collections *(coins, guns, etc.)*, antiques or other assets. Include intangible assets such as licenses, domain names, patents, copyrights, mining claims, etc.

	Purchase/ Lease Date *(mmddyyyy)*	Current Fair Market Value (FMV)	Current Loan Balance	Amount of Monthly Payment	Date of Final Payment *(mmddyyyy)*	**Equity** FMV Minus Loan
19a Property Description		$	$	$		$
Location *(Street, City, State, ZIP code)* and County		Lender/Lessor Name, Address *(Street, City, State, ZIP code),* and Phone Phone				
19b Property Description		$	$	$		$
Location *(Street, City, State, ZIP code)* and County		Lender/Lessor Name, Address *(Street, City, State, ZIP code),* and Phone Phone				
19c **Total Equity** *(Add lines 19a, 19b and amounts from any attachments)*						$

If you are self-employed, sections 6 and 7 must be completed before continuing.

Section 5: Monthly Income and Expenses

Monthly Income/Expense Statement *(For additional information, refer to Publication 1854.)*

Total Income		Total Living Expenses		IRS USE ONLY
Source	Gross Monthly	Expense Items [6]	Actual Monthly	Allowable Expenses
20 Wages (Taxpayer) [1]	$	**35** Food, Clothing and Misc. [7]	$	
21 Wages (Spouse) [1]	$	**36** Housing and Utilities [8]	$	
22 Interest - Dividends	$	**37** Vehicle Ownership Costs [9]	$	
23 Net Business Income [2]	$	**38** Vehicle Operating Costs [10]	$	
24 Net Rental Income [3]	$	**39** Public Transportation [11]	$	
25 Distributions (K-1, IRA, etc.) [4]	$	**40** Health Insurance	$	
26 Pension (Taxpayer)	$	**41** Out of Pocket Health Care Costs [12]	$	
27 Pension (Spouse)	$	**42** Court Ordered Payments	$	
28 Social Security (Taxpayer)	$	**43** Child/Dependent Care	$	
29 Social Security (Spouse)	$	**44** Life Insurance	$	
30 Child Support	$	**45** Current year taxes (Income/FICA) [13]	$	
31 Alimony	$	**46** Secured Debts (Attach list)	$	
Other Income (Specify below) [5]		**47** Delinquent State or Local Taxes	$	
32	$	**48** Other Expenses (Attach list)	$	
33	$	**49** Total Living Expenses (add lines 35-48)	$	
34 Total Income (add lines 20-33)	$	**50** Net difference (Line 34 minus 49)	$	

1 **Wages, salaries, pensions, and social security:** Enter gross monthly wages and/or salaries. Do not deduct tax withholding or allotments taken out of pay, such as insurance payments, credit union deductions, car payments, etc. To calculate the gross monthly wages and/or salaries:

If paid weekly - multiply weekly gross wages by 4.3. Example: $425.89 x 4.3 = $1,831.33

If paid biweekly (every 2 weeks) - multiply biweekly gross wages by 2.17. Example: $972.45 x 2.17 = $2,110.22

If paid semimonthly (twice each month) - multiply semimonthly gross wages by 2. Example: $856.23 x 2 = $1,712.46

2 **Net Income from Business:** Enter monthly net business income. This is the amount earned after ordinary and necessary monthly business expenses are paid. **This figure is the amount from page 6, line 89.** If the net business income is a loss, enter "0". Do not enter a negative number. If this amount is more or less than previous years, attach an explanation.

3 **Net Rental Income:** Enter monthly net rental income. This is the amount earned after ordinary and necessary monthly rental expenses are paid. Do not include deductions for depreciation or depletion. If the net rental income is a loss, enter "0." Do not enter a negative number.

4 **Distributions:** Enter the total distributions from partnerships and subchapter S corporations reported on Schedule K-1, and from limited liability companies reported on Form 1040, Schedule C, D or E. Enter total distributions from IRAs if not included under pension income.

5 **Other Income:** Include agricultural subsidies, unemployment compensation, gambling income, oil credits, rent subsidies, etc.

6 **Expenses not generally allowed:** We generally do not allow tuition for private schools, public or private college expenses, charitable contributions, voluntary retirement contributions or payments on unsecured debts. However, we may allow the expenses if proven that they are necessary for the health and welfare of the individual or family or the production of income. See Publication 1854 for exceptions.

7 **Food, Clothing and Miscellaneous:** Total of food, clothing, housekeeping supplies, and personal care products for one month. The miscellaneous allowance is for expenses incurred that are not included in any other allowable living expense items. Examples are credit card payments, bank fees and charges, reading material, and school supplies.

8 **Housing and Utilities:** For principal residence: Total of rent or mortgage payment. Add the average monthly expenses for the following: property taxes, homeowner's or renter's insurance, maintenance, dues, fees, and utilities. Utilities include gas, electricity, water, fuel, oil, other fuels, trash collection, telephone, cell phone, cable television and internet services.

9 **Vehicle Ownership Costs:** Total of monthly lease or purchase/loan payments.

10 **Vehicle Operating Costs:** Total of maintenance, repairs, insurance, fuel, registrations, licenses, inspections, parking, and tolls for one month.

11 **Public Transportation:** Total of monthly fares for mass transit *(e.g., bus, train, ferry, taxi, etc.)*

12 **Out of Pocket Health Care Costs:** Monthly total of medical services, prescription drugs and medical supplies *(e.g., eyeglasses, hearing aids, etc.)*

13 **Current Year Taxes:** Include state and Federal taxes withheld from salary or wages, or paid as estimated taxes.

Certification: *Under penalties of perjury, I declare that to the best of my knowledge and belief this statement of assets, liabilities, and other information is true, correct, and complete.*

Taxpayer's Signature	Spouse's signature	Date

After we review the completed Form 433-A, you may be asked to provide verification for the assets, encumbrances, income and expenses reported. Documentation may include previously filed income tax returns, pay statements, self-employment records, bank and investment statements, loan statements, bills or statements for recurring expenses, etc.

IRS USE ONLY *(Notes)*

Sections 6 and 7 must be completed only if you are SELF-EMPLOYED.

Section 6: Business Information

51 Is the business a sole proprietorship *(filing Schedule C)* ☐ **Yes**, Continue with Sections 6 and 7. ☐ **No**, Complete Form 433-B.
All other business entities, including limited liability companies, partnerships or corporations, must complete Form 433-B.

52 Business Name & Address *(if different than 1b)*

53 Employer Identification Number	54 Type of Business	55 Is the business a Federal Contractor ☐ **Yes** ☐ **No**
56 Business Website (web address)	57 Total Number of Employees	58 Average Gross Monthly Payroll
59 Frequency of Tax Deposits	60 Does the business engage in e-Commerce *(Internet sales)* If yes, complete *lines 61a and 61b* ☐ **Yes** ☐ **No**	

	PAYMENT PROCESSOR *(e.g., PayPal, Authorize.net, Google Checkout, etc.)* Name & Address *(Street, City, State, ZIP code)*	Payment Processor Account Number
61a		
61b		

CREDIT CARDS ACCEPTED BY THE BUSINESS

	Credit Card	Merchant Account Number	Issuing Bank Name & Address *(Street, City, State, ZIP code)*
62a			
62b			
62c			

63 **BUSINESS CASH ON HAND** Include cash that is not in a bank. **Total Cash on Hand** $

BUSINESS BANK ACCOUNTS Include checking accounts, online and mobile *(e.g., PayPal)* accounts, money market accounts, savings accounts, and stored value cards *(e.g., payroll cards, government benefit cards, etc.).* Report Personal Accounts in Section 4.

	Type of Account	Full name & Address *(Street, City, State, ZIP code)* of Bank,Savings & Loan, Credit Union or Financial Institution.	Account Number	**Account Balance** As of ______ *mmddyyyy*
64a				$
64b				$
64c	**Total Cash in Banks** *(Add lines 64a, 64b and amounts from any attachments)*			$

ACCOUNTS/NOTES RECEIVABLE Include e-payment accounts receivable and factoring companies, and any bartering or online auction accounts. *(List all contracts separately, including contracts awarded, but not started.)* **Include Federal, state and local government grants and contracts.**

	Accounts/Notes Receivable & Address *(Street, City, State, ZIP code)*	Status *(e.g., age, factored, other)*	Date Due *(mmddyyyy)*	Invoice Number or Government Grant or Contract Number	**Amount Due**
65a					$
65b					$
65c					$
65d					$
65e					**$**
65f	**Total Outstanding Balance** *(Add lines 65a through 65e and amounts from any attachments)*				$

BUSINESS ASSETS Include all tools, books, machinery, equipment, inventory or other assets used in trade or business. Include a list and show the value of all intangible assets such as licenses, patents, domain names, copyrights, trademarks, mining claims, etc.

	Purchase/ Lease Date *(mmddyyyy)*	Current Fair Market Value (FMV)	Current Loan Balance	Amount of Monthly Payment	Date of Final Payment *(mmddyyyy)*	**Equity** FMV Minus Loan
66a Property Description		$	$	$		$
Location *(Street, City, State, ZIP code)* and Country	Lender/Lessor/Landlord Name, Address *(Street, City, State, ZIP code),* and Phone Phone					
66b Property Description		$	$	$		$
Location *(Street, City, State, ZIP code)* and Country	Lender/Lessor/Landlord Name, Address *(Street, City, State, ZIP code),* and Phone Phone					
66c **Total Equity** *(Add lines 66a, 66b and amounts from any attachments)*						$

Section 7 should be completed only if you are SELF-EMPLOYED

Section 7: Sole Proprietorship Information *(lines 67 through 87 should reconcile with business Profit and Loss Statement)*

Accounting Method Used: ☐ Cash ☐ Accrual

Use the prior 3, 6, 9 or 12 month period to determine your typical business income and expenses.

Income and Expenses during the period *(mmddyyyy)* *to (mmddyyyy)*

Provide a breakdown below of your average monthly income and expenses, based on the period of time used above.

Total Monthly Business Income		**Total Monthly Business Expenses** (Use attachments as needed)	
Source	Gross Monthly	Expense Items	Actual Monthly
67 Gross Receipts	$	**77** Materials Purchased 1	$
68 Gross Rental Income	$	**78** Inventory Purchased 2	$
69 Interest	$	**79** Gross Wages & Salaries	$
70 Dividends	$	**80** Rent	$
71 Cash Receipts not included in lines 67-70	$	**81** Supplies 3	$
Other Income (Specify below)		**82** Utilities/Telephone 4	$
72	$	**83** Vehicle Gasoline/Oil	$
73	$	**84** Repairs & Maintenance	$
74	$	**85** Insurance	$
75	$	**86** Current Taxes 5	$
76 **Total Income** (Add lines 67 through 75)	$	**87** Other Expenses, including installment payments (Specify)	$
		88 **Total Expenses (Add lines 77 through 87)**	$
		89 **Net Business Income (Line 76 minus 88)** 6	$

Enter the monthly net income amount from line 89 on line 23, section 5. If line 89 is a loss, enter "0" on line 23, section 5. Self-employed taxpayers must return to page 4 to sign the certification.

1 **Materials Purchased:** Materials are items directly related to the production of a product or service.

2 **Inventory Purchased:** Goods bought for resale.

3 **Supplies:** Supplies are items used in the business that are consumed or used up within one year. This could be the cost of books, office supplies, professional equipment, etc.

4 **Utilities/Telephone:** Utilities include gas, electricity, water, oil, other fuels, trash collection, telephone, cell phone and business internet.

5 **Current Taxes:** Real estate, excise, franchise, occupational, personal property, sales and employer's portion of employment taxes.

6 **Net Business Income:** Net profit from Form 1040, Schedule C may be used if duplicated deductions are eliminated (e.g., expenses for business use of home already included in housing and utility expenses on page 4). Deductions for depreciation and depletion on Schedule C are not cash expenses and must be added back to the net income figure. In addition, interest cannot be deducted if it is already included in any other installment payments allowed.

IRS USE ONLY *(Notes)*

Form **433-B (OIC)**
(Rev. May 2012)

Department of the Treasury — Internal Revenue Service

Collection Information Statement for Businesses

Complete this form if your business is a

- Corporation
- Partnership
- Limited Liability Company (LLC) classified as a corporation
- Other multi-owner/multi-member LLC
- Single member LLC

If your business is a sole proprietorship (filing Schedule C), do not use this form. Instead, complete Form 433-A (OIC) Collection Information Statement for Wage Earners and Self-Employed Individuals.

Include attachments if additional space is needed to respond completely to any question.

Section 1 Business Information

Business Name	Employer Identification Number
Business address *(street, city, state, zip code)*	County of Business Location
	Description of Business and dba or "Trade Name"
Primary Phone ( ) -	Secondary Phone ( ) -
Mailing address *(if different from above or Post Office Box number)*	
Business website address	
Fax Number ( ) -	
Does the business outsource its payroll processing and tax return preparation for a fee? ☐ Yes ☐ No If yes, list provider name and address in box below *(Street, City, State, ZIP Code)*	
Federal Contractor ☐ Yes ☐ No	Total Number of Employees
Frequency of tax deposits	Average gross monthly payroll $

Provide information about all partners, officers, LLC members, major shareholders (foreign and domestic), etc., associated with the business. Include attachments if additional space is needed.

Last Name	First Name	Title
Percent of Ownership and annual salary	Social Security Number – –	Home address *(Street, City, State, ZIP Code)*
Primary Phone ( ) -	Secondary Phone ( ) -	
Last Name	First Name	Title
Percent of Ownership and annual salary	Social Security Number – –	Home address *(Street, City, State, ZIP Code)*
Primary Phone ( ) -	Secondary Phone ( ) -	
Last Name	First Name	Title
Percent of Ownership and annual salary	Social Security Number – –	Home address *(Street, City, State, ZIP Code)*
Primary Phone ( ) -	Secondary Phone ( ) -	

Section 2 Business Asset Information

Gather the **most current** statement from banks, lenders on loans, mortgages *(including second mortgages)*, monthly payments, loan balances, and accountant's depreciation schedules, if applicable. Also, include make/model/year/mileage of vehicles and current value of business assets. To estimate the current value, you may consult resources like Kelley Blue Book *(www.kbb.com),* NADA *(www.nada.com)*, local real estate postings of properties similar to yours, and any other websites or publications that show what the business assets would be worth if you were to sell them. Asset value is subject to adjustment by IRS. Enter the total amount available for each of the following *(if additional space is needed, please include attachments)*.

If any line item is zero or less, enter "0". Do not enter negative numbers on this form.

☐ Cash ☐ Checking ☐ Savings ☐ Money Market ☐ Online Account ☐ Stored Value Card		
Bank Name	Account Number	(1a) $
☐ Checking ☐ Savings ☐ Money Market ☐ Online Account ☐ Stored Value Card		
Bank Name	Account Number	(1b) $
☐ Checking ☐ Savings ☐ Money Market ☐ Online Account ☐ Stored Value Card		
Bank Name	Account Number	(1c) $
Total value of bank accounts from attachment		(1d) $
Add lines (1a) through (1d) =		**(1) $**
Investment Account: ☐ Stocks ☐ Bonds ☐ Other		
Name of Financial Institution	Account Number	
Current Market Value $______ X .8 = $______	Less Loan Balance – $______ =	(2a) $
Investment Account: ☐ Stocks ☐ Bonds ☐ Other		
Name of Financial Institution	Account Number	
Current Market Value $______ X .8 = $______	Less Loan Balance – $______ =	(2b) $
Total of investment accounts from attachment. [current market value X.8 less loan balance(s)]		(2c) $
Add lines (2a) through (2c) =		**(2) $**
Notes receivable Do you have notes receivable? ☐ Yes ☐ No **If yes**, attach current listing which includes name and amount of note(s) receivable.		
Accounts Receivable Do you have accounts receivable? ☐ Yes ☐ No **If yes,** you may be asked to provide a list of name and amount of the Account(s) Receivable.		

Section 2 *(Continued)* Business Asset Information

If the business owns more properties, vehicles, or equipment than shown in this form, please list on an attachment.

Real Estate *(Buildings, Lots, Commercial Property, etc.)* **Do not use negative numbers.**

Property Address *(Street Address, City, State, ZIP Code)*	Property Description	Date Purchased	
	County and Country		
Current Market Value $____ X .8 = $____	Less Loan Balance *(Mortgages, etc.)* – $____	Total Value of Real Estate =	(3a) $
Property Address *(Street Address, City, State, ZIP Code)*	Property Description	Date Purchased	
	County and Country		
Current Market Value $____ X .8 = $____	Less Loan Balance *(Mortgages, etc.)* – $____	Total Value of Real Estate =	(3b) $
Total value of property(s) listed from attachment [current market value X .8 less any loan balance(s)]			(3c) $
		Add lines (3a) through (3c) =	**(3) $**

Business Vehicles *(cars, boats, motorcycles, trailers, etc.)*. If additional space is needed, list on an attachment.

Vehicle Make & Model	Year	Date Purchased	Mileage or Use Hours	
☐ Lease ☐ Loan	Monthly Lease/Loan Amount $			
Current Market Value $____ X .8 = $____	Less Loan Balance – $____		Total value of vehicle *(if the vehicle is leased, enter 0 as the total value)* =	(4a) $
Vehicle Make & Model	Year	Date Purchased	Mileage or Use Hours	
☐ Lease ☐ Loan	Monthly Lease/Loan Amount $			
Current Market Value $____ X .8 = $____	Less Loan Balance – $____		Total value of vehicle *(if the vehicle is leased, enter 0 as the total value)* =	(4b) $
Vehicle Make & Model	Year	Date Purchased	Mileage or Use Hours	
☐ Lease ☐ Loan	Monthly Lease/Loan Amount $			
Current Market Value $____ X .8 = $____	Less Loan Balance – $____		Total value of vehicle *(if the vehicle is leased, enter 0 as the total value)* =	(4c) $
Total value of vehicles listed from attachment [current market value X .8 less any loan balance(s)]				(4d) $
			Add lines (4a) through (4d) =	**(4) $**

Other Business Equipment

Current Market Value $____ X .8 = $____	Less Loan Balance – $____	Total value of equipment *(if leased, enter 0 as the total value)* =	(5a) $
Total value of equipment listed from attachment [current market value X .8 less any loan balance(s)]			(5b) $
		IRS allowed exemption for professional books and tools of trade -	(5c) $ [4,290]
		Total value of all business equipment = **Add lines (5a) and (5b) minus line (5c), if number is less than zero, enter zero =**	**(5) $**
		Do not include the amount on lines with a letter beside the number. **Add lines (1) through (5) and enter the amount in Box 1 =**	**Box 1 Available Equity in Assets** **$**

Section 3 Business Income Information

Enter the **average** gross monthly income of your business. To determine your gross monthly income use the most recent 6-12 months documentation of commissions, invoices, gross receipts from sales/services, etc.; most recent 6-12 months earnings statements, etc., from every other source of income (such as rental income, interest and dividends, or subsidies); or you may use a most recent 6-12 months Profit and Loss (P&L) to provide the information of income and expenses.

Note: If you provide a current profit and loss statement for the information below, enter the total gross monthly income in Box 2 below. Do not complete lines (6) - (10).

Gross receipts	(6) $
Gross rental income	(7) $
Interest income	(8) $
Dividends	(9) $
Other income *(Specify on attachment)*	(10) $
Add lines (6) through (10) and enter the amount in Box 2 =	**Box 2 Total Business Income** **$**

Section 4 Business Expense Information

Enter the average gross monthly expenses for your business using your most recent 6-12 months statements, bills, receipts, or other documents showing monthly recurring expenses.

Note: If you provide a current profit and loss statement for the information below, enter the total monthly expenses in Box 3 below. Do not complete lines (11) - (20).

Materials purchased *(e.g., items directly related to the production of a product or service)*	(11) $
Inventory purchased *(e.g., goods bought for resale)*	(12) $
Gross wages and salaries	(13) $
Rent	(14) $
Supplies *(items used to conduct business and used up within one year, e.g., books, office supplies, professional equipment, etc.)*	(15) $
Utilities/telephones	(16) $
Vehicle costs *(gas, oil, repairs, maintenance)*	(17) $
Insurance *(other than life)*	(18) $
Current taxes *(e.g., real estate, state, and local income tax, excise franchise, occupational, personal property, sales and employer's portion of employment taxes, etc.)*	(19) $
Other expenses *(e.g., secured debt payments. Specify on attachment. Do not include credit card payments)*	(20) $
Add lines (11) through (20) and enter the amount in Box 3 =	**Box 3 Total Business Expenses** **$**
Subtract Box 3 from Box 2 and enter the amount in Box 4 = If number is less than zero, enter zero.	**Box 4 Remaining Monthly Income** **$**

Section 5 Calculate Your Minimum Offer Amount

The next steps calculate your minimum offer amount. The amount of time you take to pay your offer in full will affect your minimum offer amount. Paying over a shorter period of time will result in a smaller minimum offer amount.

If you will pay your offer in 5 months or less, multiply "Remaining Monthly Income" (Box 4) by 12 to get "Future Remaining Income."

Enter the amount from Box 4 here			Box 5 Future Remaining Income
$	X 12	=	$

If you will pay your offer in more than 5 months, multiply "Remaining Monthly Income" (from Box 4) by 24 to get "Future Remaining Income."

Enter the amount from Box 4 here			Box 6 Future Remaining Income
$	X 24	=	$

Determine your minimum offer amount by adding the total available assets from Box 1 to amount in either Box 5 or Box 6.

Enter the amount from Box 1 here* Do not enter a number less than zero		Enter the amount from either Box 5 or Box 6		Offer Amount Must be more than zero
$	+	$	=	$ ____________

If you have special circumstances that would hinder you from paying this amount, explain them on Form 656, Offer in Compromise, Page 2, "Explanation of Circumstances."

***You may exclude any equity in income producing assets shown in Section 2 of this form.**

Section 6 Other Information

Additional information IRS needs to consider settlement of your tax debt. If this business is currently in a bankruptcy proceeding, the business is not eligible to apply for an offer.

Is the business currently in bankruptcy?

☐ Yes ☐ No

Has the business ever filed bankruptcy?

☐ Yes ☐ No

If yes, provide:

Date Filed *(mm/dd/yyyy)* __________ Date Dismissed or Discharged *(mm/dd/yyyy)* __________

Petition No. __________ Location Filed __________

Does this business have other business affiliations *(e.g., subsidiary or parent companies)*?

☐ Yes ☐ No

If yes, list the Name and Employer Identification Number:

Do any related parties *(e.g., partners, officers, employees)* owe money to the business?

☐ Yes ☐ No

Is the business currently, or in the past, a party to a lawsuit?

☐ Yes ☐ No **If applicable**, date the lawsuit was resolved: __________

In the past 10 years, has the business transferred any assets for less than their full value?

☐ Yes ☐ No **If applicable**, provide date and type of asset transferred:

____

Has the business been located outside the U.S. for 6 months or longer in the past 10 years?

☐ Yes ☐ No

Does the business have any funds being held in trust by a third party?

☐ Yes ☐ No **If yes**, how much $ __________ Where: __________

Does the business have any lines of credit?

☐ Yes ☐ No **If yes**, credit limit $ __________ Amount owed $ __________

What property secures the line of credit? __________

Section 7 Signatures

Under penalties of perjury, I declare that I have examined this offer, including accompanying documents, and to the best of my knowledge it is true, correct, and complete.

Signature of Taxpayer	Title	Date *(mm/dd/yyyy)*

Remember to include all applicable attachments from list below.

- ☐ A current Profit and Loss statement covering at least the most recent 6-12 month period, if appropriate.
- ☐ Copies of the most recent statement for each bank, investment, and retirement account.
- ☐ If an asset is used as collateral on a loan, include copies of the most recent statement from lender(s) on loans, monthly payments, loan payoffs, and balances.
- ☐ Copies of the most recent statement of outstanding notes receivable.
- ☐ Copies of the most recent statements from lenders on loans, mortgages (including second mortgages), monthly payments, loan payoffs, and balances.
- ☐ Copies of relevant supporting documentation of the special circumstances described in the "Explain special circumstances" section on page 2 of Form 656, if applicable.
- ☐ Attach a Form 2848, Power of Attorney, if you would like your attorney, CPA, or enrolled agent to represent you and you do not have a current form on file with the IRS.

Privacy Act Statement

The information requested on this Form is covered under Privacy Act and Paperwork Reduction Act Notices which have already been provided to the taxpayer.

Form **433-D**
(Rev. January 2012)

Department of the Treasury — Internal Revenue Service

Installment Agreement

(See Instructions on the back of this page)

Name and address of taxpayer*(s)*

Social security or employer identification number
(Taxpayer) *(Spouse)*

Your telephone numbers *(including area code)*
(Home) *(Work, cell or business)*

For assistance, call: **1-800-829-0115** ***(Business),*** or
1-800-829-8374 ***(Individual – Self-Employed/Business Owners),*** or
1-800-829-0922 ***(Individuals – Wage Earners)***

☐ Submit a new Form W-4 to your employer to increase your withholding.

Or write:______________________________
(City, State, and ZIP Code)

Employer *(Name, address, and telephone number)*______________________________

Financial Institution *(Name and address)* ______________________________

Kinds of taxes *(Form numbers)*	Tax periods	Amount owed as of ________ $

I / We agree to pay the federal taxes shown above, PLUS PENALTIES AND INTEREST PROVIDED BY LAW, as follows:

$ ____________ on ____________ and $ ____________ on the ____________ of each month thereafter

I / We also agree to increase or decrease the above installment payment as follows:

Date of increase ***(or decrease)***	**Amount of increase** ***(or decrease)***	**New installment payment amount**

The terms of this agreement are provided on the back of this page. Please review them thoroughly.

☐ Please initial this box after you've reviewed all terms and any additional conditions.

Additional Conditions / Terms *(To be completed by IRS)*	**Note:** Internal Revenue Service employees may contact third parties in order to process and maintain this agreement.

DIRECT DEBIT—Attach a voided check or complete this part only if you choose to make payments by direct debit. Read the instructions on the back of this page.

a. Routing number: ☐☐☐☐☐☐☐☐☐

b. Account number: ☐☐☐☐☐☐☐☐☐☐☐☐☐☐☐☐☐

I authorize the U.S. Treasury and its designated Financial Agent to initiate a monthly ACH debit *(electronic withdrawal)* entry to the financial institution account indicated for payments of my Federal taxes owed, and the financial institution to debit the entry to this account. This authorization is to remain in full force and effect until I notify the U.S. Treasury Financial Agent to terminate the authorization. To revoke payment, I must contact the U.S. Treasury Financial Agent at the applicable toll free number listed above no later than 14 business days prior to the payment *(settlement)* date. I also authorize the financial institutions involved in the processing of the electronic payments of taxes to receive confidential information necessary to answer inquiries and resolve issues related to the payments.

Your signature	**Title** ***(if Corporate Officer or Partner)***	**Date**
Spouse's signature ***(if a joint liability)***		**Date**
Agreement examined or approved by ***(Signature, title, function)***		**Date**

FOR IRS USE ONLY

AGREEMENT LOCATOR NUMBER: ____ ____ ____ ____

Check the appropriate boxes:

☐ RSI "1" no further review
☐ RSI "5" PPIA IMF 2 year review
☐ RSI "6" PPIA BMF 2 year review
☐ AI "0" Not a PPIA
☐ AI "1" Field Asset PPIA
☐ AI "2" All other PPIAs

Agreement Review Cycle:__ __ __ __ __ __ Earliest CSED:__________

☐ Check box if pre-assessed modules included

Originator's ID #:__________ Originator Code:__________

Name:____________________ Title:____________________

A NOTICE OF FEDERAL TAX LIEN *(Check one box below.)*

☐ **HAS ALREADY BEEN FILED**
☐ **WILL BE FILED IMMEDIATELY**
☐ **WILL BE FILED WHEN TAX IS ASSESSED**
☐ **MAY BE FILED IF THIS AGREEMENT DEFAULTS**

Collection Information Statement

Name(s) and Address	Your Social Security Number or Individual Taxpayer Identification Number
	Your Spouse's Social Security Number or Individual Taxpayer Identification Number
☐ If address provided above is different than last return filed, please check here	Your Telephone Numbers Home: ______ Work: ______ Cell: ______ / Spouse's Telephone Numbers Home: ______ Work: ______ Cell: ______
County of Residence	

Enter the number of people in the household who can be claimed on this year's tax return including you and your spouse. Under 65 ____ 65 and Over ____

If you or your spouse are self employed or have self employment income, provide the following information:

Name of Business	Business EIN	Type of Business	Number of Employees *(not counting owner)*

A. ACCOUNTS / LINES OF CREDIT Include checking, online, mobile (e.g., PayPal) and savings accounts, Certificates of Deposit, Trusts, Individual Retirement Accounts (IRAs), Keogh Plans, Simplified Employee Pensions, 401(k) Plans, Profit Sharing Plans, Mutual Funds, Stocks, Bonds and other investments. If applicable, include business accounts. *(Use additional sheets if necessary.)*

Name and Address of Institution	Account Number	Type of Account	Current Balance/Value	Check if Business Account
				☐
				☐
				☐
				☐
				☐
				☐
				☐

B. REAL ESTATE Include home, vacation property, timeshares, vacant land and other real estate. *(Use additional sheets if necessary.)*

Description/Location/County	Monthly Payment(s)	Financing		Current Value	Balance Owed	Equity
		Year Purchased	Purchase Price			
☐ Primary Residence ☐ Other		Year Refinanced	Refinance Amount			
		Year Purchased	Purchase Price			
☐ Primary Residence ☐ Other		Year Refinanced	Refinance Amount			

C. OTHER ASSETS Include cars, boats, recreational vehicles, whole life policies, etc. Include make, model and year of vehicles and name of Life Insurance company in Description. If applicable, include business assets such as tools, equipment, inventory, etc. *(Use additional sheets if necessary.)*

Description	Monthly Payment	Year Purchased	Final Payment *(mo/yr)*	Current Value	Balance Owed	Equity
			/			
			/			
			/			
			/			
			/			
			/			
			/			

NOTES *(For IRS Use Only)*

TURN PAGE TO CONTINUE

D. CREDIT CARDS *(Visa, MasterCard, American Express, Department Stores, etc.)*

Type	Credit Limit	Balance Owed	Minimum Monthly Payment

E. BUSINESS INFORMATION

Complete E1 for Accounts Receivable owed to you or your business. *(Use additional sheets if necessary.)* Complete E2 if you or your business accepts credit card payments.

E1. Accounts Receivable owed to you or your business

Name	Address	Amount Owed
	List total amount owed from additional sheets	
	Total amount of accounts receivable available to pay to IRS now	

E2. Name of individual or business on account

Credit Card *(Visa, Master Card, etc.)*	Issuing Bank Name and Address	Merchant Account Number

F. EMPLOYMENT INFORMATION

If you have more than one employer, include the information on another sheet of paper.
(If attaching a copy of current pay stub, you do not need to complete this section.)

Your current Employer *(name and address)*

How often are you paid? *(Check one)*
☐ Weekly ☐ Biweekly ☐ Semi-monthly ☐ Monthly

Gross per pay period ____________

Taxes per pay period *(Fed)* ________ *(State)* ________ *(Local)* ________

How long at current employer ____________

Spouse's current Employer *(name and address)*

How often are you paid? *(Check one)*
☐ Weekly ☐ Biweekly ☐ Semi-monthly ☐ Monthly

Gross per pay period ____________

Taxes per pay period *(Fed)* ________ *(State)* ________ *(Local)* ________

How long at current employer ____________

G. NON-WAGE HOUSEHOLD INCOME

List monthly amounts. For Self-Employment and Rental Income, list the monthly amount received after expenses or taxes and attach a copy of your current year profit and loss statement.

Alimony Income		Net Rental Income		Interest/Dividends Income	
Child Support Income		Unemployment Income		Social Security Income	
Net Self Employment Income		Pension Income		Other:	

H. MONTHLY NECESSARY LIVING EXPENSES

List monthly amounts. (For expenses paid other than monthly, see instructions.)

1. Food / Personal Care ***See instructions. If you do not spend more than the standard allowable amount for your family size, fill in the Total amount only.***

Food	
Housekeeping Supplies	
Clothing and Clothing Services	
Personal Care Products & Services	
Miscellaneous	
Total	

2. Transportation

Gas/Insurance/Licenses/Parking/ Maintenance etc.	
Public Transportation	

3. Housing & Utilities

Rent	
Electric, Oil/Gas, Water/Trash	
Telephone/Cell/Cable/Internet	
Real Estate Taxes and Insurance *(if not included in B above)*	
Maintenance and Repairs	
Total	

4. Medical

Health Insurance	
Out of Pocket Health Care Expenses	

5. Other

Child / Dependent Care	
Estimated Tax Payments	
Term Life Insurance	
Retirement *(Employer Required)*	
Retirement *(Voluntary)*	
Union Dues	
Delinquent State & Local Taxes *(minimum payment)*	
Student Loans *(minimum payment)*	
Court Ordered Child Support	
Court Ordered Alimony	
Other Court Ordered Payments	
Other *(specify)*	
Other *(specify)*	
Other *(specify)*	

Under penalty of perjury, I declare to the best of my knowledge and belief this statement of assets, liabilities and other information is true, correct and complete.

Your Signature	Spouse's Signature	Date

Form **656**
(Rev. May 2012)

Department of the Treasury — Internal Revenue Service

Offer in Compromise

Attach Application Fee and Payment *(check or money order)* here.

IRS Received Date

Section 1 Your Contact Information

Your First Name, Middle Initial, Last Name

If a Joint Offer, Spouse's First Name, Middle Initial, Last Name

Your Physical Home Address *(Street, City, State, ZIP Code)*

Mailing Address *(if different from above or Post Office Box number)*

Business Name

Your Business Address *(Street, City, State, ZIP Code)*

Social Security Number (SSN) *(Primary)*	*(Secondary)*	Employer Identification Number *(EIN)*	*(EIN not included in offer)*
– –	– –	–	–

Section 2 Tax Periods

To: Commissioner of Internal Revenue Service

In the following agreement, the pronoun "we" may be assumed in place of "I" when there are joint liabilities and both parties are signing this agreement.

I submit this offer to compromise the tax liabilities plus any interest, penalties, additions to tax, and additional amounts required by law for the tax type and period(s) marked below:

☐ 1040 Income Tax-Year(s) ______

☐ 1120 Income Tax-Year(s) ______

☐ 941 Employer's Quarterly Federal Tax Return - Quarterly period(s) ______

______

☐ 940 Employer's Annual Federal Unemployment (FUTA) Tax Return - Year(s) ______

______

☐ Trust Fund Recovery Penalty as a responsible person of *(enter corporation name)* ______
for failure to pay withholding and Federal Insurance Contributions Act taxes (Social Security taxes), for period(s) ending

______

______

☐ Other Federal Tax(es) [specify type(s) and period(s)] ______

______

Note: If you need more space, use attachment and title it "Attachment to Form 656 dated ______." Make sure to sign and date the attachment.

Section 3 Reason for Offer

☐ **Doubt as to Collectibility** - I have insufficient assets and income to pay the full amount.

☐ **Exceptional Circumstances (Effective Tax Administration)** - I owe this amount and have sufficient assets to pay the full amount, but due to my exceptional circumstances, requiring full payment would cause an economic hardship or would be unfair and inequitable. I am submitting a written narrative explaining my circumstances.

Section 3 *(Continued)* Reason for Offer

Explanation of Circumstances ***(Add additional pages, if needed)***

The IRS understands that there are unplanned events or special circumstances, such as serious illness, where paying the full amount or the minimum offer amount might impair your ability to provide for yourself and your family. If this is the case and you can provide documentation to prove your situation, then your offer may be accepted despite your financial profile. Describe your situation below and attach appropriate documents to this offer application.

____

____

____

____

____

____

Section 4 Low Income Certification *(Individuals Only)*

Do you qualify for Low-Income Certification? You qualify if your gross monthly household income is less than or equal to the amount shown in the chart below based on your family size and where you live. If you qualify, you are not required to submit any payments during the consideration of your offer.

☐ **Check here if you qualify for Low-Income Certification based on the monthly income guidelines below.**

Size of family unit	48 contiguous states and D.C.	Hawaii	Alaska
1	$2,327	$2,679	$2,910
2	$3,152	$3,627	$3,942
3	$3,997	$4,575	$4,973
4	$4,802	$5,523	$6,004
5	$5,627	$6,471	$7,035
6	$6,452	$7,419	$8,067
7	$7,277	$8,367	$9,098
8	$8,102	$9,315	$10,129
For each additional person, add	$825	$948	$1,031

Section 5 Payment Terms

Check one of the payment options below to indicate how long it will take you to pay your offer in full

Lump Sum Cash

Enter the amount of your offer $ ____________________

☐ **Check here if you will pay your offer in five or fewer payments:**

Enclose a check for 20% of the offer amount (waived if you are an individual and met the requirements for Low-Income certification) and fill in the amount(s) and date(s) of your future payment(s). Your offer must be fully paid 24 months from the date your offer is accepted.

Total Offer Amount	-	20% Initial Payment	=	Remaining Balance
$	-	$	=	$

You may pay the remaining balance in one payment after acceptance of the offer or up to five payments.

1) $__________ paid on the _______ (day), _______ month(s) after acceptance.

2) $__________ paid on the _______ (day), _______ month(s) after acceptance.

3) $__________ paid on the _______ (day), _______ month(s) after acceptance.

4) $__________ paid on the _______ (day), _______ month(s) after acceptance.

5) $__________ paid on the _______ (day), _______ month(s) after acceptance.

Periodic Payment

Enter the amount of your offer $ ____________________

☐ **Check here if you will pay your offer in full in more than five monthly installments.**

Enclose a check for one month's installment (waived if you are an individual and met the requirements for Low-Income certification)

$ _________ is being submitted with the Form 656 and then $ _________ on the _______ (day) of each month thereafter for a total of_______ months *(may not exceed 23)*. Total payments must equal the total Offer Amount.

You must continue to make these monthly payments while the IRS is considering the offer. Failure to make regular monthly payments will cause your offer to be returned.

Section 6 Designation of Down Payment and Deposit *(Optional)*

If you want your payment to be applied to a specific tax year and a specific tax debt, please tell us the tax form __________ and Tax Year/Quarter __________ . If you do not designate a preference, we will apply any money you send in to the governments best interest.

If you are paying more than the required payment when you submit your offer and want any part of that payment treated as a deposit, check the box below and insert the amount.

☐ I am making a deposit of $ _______________ with this offer.

Section 7 Source of Funds and Making Your Payment

Tell us where you will obtain the funds to pay your offer. You may consider borrowing from friends and/or family, taking out a loan, or selling assets.

____

____

Include separate checks for the payment and application fee.

Make checks payable to the "United States Treasury" and attach to the front of your Form 656, Offer in Compromise. All payments must be in U.S. dollars. **Do not send cash.** Send a separate application fee with each offer; do not combine it with any other tax payments, as this may delay processing of your offer. Your offer will be returned to you if the application fee and the required payments are not properly remitted, or if your check is returned for insufficient funds.

Section 8 Offer Terms

By submitting this offer, I/we have read, understand and agree to the following terms and conditions:

Terms, Conditions, and Legal Agreement

a) I request that the IRS accept the offer amount listed in this offer application as payment of my outstanding tax debt (including interest, penalties, and any additional amounts required by law) as of the date listed on this form. I authorize the IRS to amend Section 2 on page 1 in the event I failed to list any of my assessed tax debt. I understand that my offer will be accepted, by law, unless IRS notifies me otherwise, in writing, within 24 months of the date my offer was received by IRS.

IRS will keep my payments, fees, and some refunds.

b) I voluntarily submit the payments made on this offer and **understand that they are not refundable even if I withdraw the offer or the IRS rejects or returns the offer.** Unless I designated how to apply the required payment (page 3 of this application), the IRS will apply my payment in the best interest of the government, choosing which tax years and tax liabilities to pay off. The IRS will also keep my application fee unless the offer is not accepted for processing.

c) The IRS will keep **any** refund, including interest, that I might be due for tax periods extending through the calendar year in which the IRS accepts my offer. I cannot designate that the refund be applied to estimated tax payments for the following year or the accepted offer amount. If I receive a refund after I submit this offer for any tax period extending through the calendar year in which the IRS accepts my offer, I will return the refund as soon as possible.

d) The IRS will keep any monies it has collected prior to this offer and any payments that I make relating to this offer that I did not designate as a deposit. Only amounts that exceed the mandatory payments can be treated as a deposit. Such a deposit will be refundable if the offer is rejected or returned by the IRS or is withdrawn. I understand that the IRS will not pay interest on any deposit. The IRS may seize ("levy") my assets up to the time that the IRS official signs and accepts my offer as pending.

Pending status of an offer and right to appeal

e) Once an authorized IRS official signs this form, my offer is considered pending as of that signature date and it remains pending until the IRS accepts, rejects, returns, or terminates my offer or I withdraw my offer. An offer is also considered pending for 30 days after any rejection of my offer by the IRS, and during the time that any rejection of my offer is being considered by the Appeals Office. An offer will be considered withdrawn when the IRS receives my written notification of withdrawal by personal delivery or certified mail or when I inform the IRS of my withdrawal by other means and the IRS acknowledges in writing my intent to withdraw the offer.

f) I waive the right to an Appeals hearing if I do not request a hearing within 30 days of the date the IRS notifies me of the decision to reject the offer.

I must comply with my future tax obligations and understand I remain liable for the full amount of my tax debt until all terms and conditions of this offer have been met.

g) I will file tax returns and pay required taxes for the five year period beginning with the date of acceptance of this offer. If this is an offer being submitted for joint tax debt, and one of us does not comply with future obligations, only the non-compliant taxpayer will be in default of this agreement.

h) The IRS will not remove the original amount of my tax debt from its records until I have met all the terms and conditions of this offer. Penalty and interest will continue to accrue until all payment terms of the offer have been met. If I file for bankruptcy before the terms are fully met, any claim the IRS files in the bankruptcy proceedings will be a tax claim.

i) Once the IRS accepts my offer in writing, I have no right to contest, in court or otherwise, the amount of the tax debt.

I understand what will happen if I fail to meet the terms of my offer (e.g., default).

j) If I fail to meet any of the terms of this offer, the IRS may levy or sue me to collect any amount ranging from the unpaid balance of the offer to the original amount of the tax debt without further notice of any kind. The IRS will continue to add interest, as Section 6601 of the Internal Revenue Code requires, on the amount the IRS determines is due after default. The IRS will add interest from the date I default until I completely satisfy the amount owed.

I agree to waive time limits provided by law.

k) To have my offer considered, I agree to the extension of the time limit provided by law to assess my tax debt (statutory period of assessment). I agree that the date by which the IRS must assess my tax debt will now be the date by which my debt must currently be assessed plus the period of time my offer is pending plus one additional year if the IRS rejects, returns, or terminates my offer or I withdraw it. (Paragraph (e) of this section

Section 8 - *(Continued)* Offer Terms

defines pending and withdrawal). I understand that I have the right not to waive the statutory period of assessment or to limit the waiver to a certain length or certain periods or issues. I understand, however, that the IRS may not consider my offer if I refuse to waive the statutory period of assessment or if I provide only a limited waiver. I also understand that the statutory period for collecting my tax debt will be suspended during the time my offer is pending with the IRS, for 30 days after any rejection of my offer by the IRS, and during the time that any rejection of my offer is being considered by the Appeals Office.

I understand the IRS may file a Notice of Federal Tax Lien on my property.

l) The IRS may file a Notice of Federal Tax Lien during the offer investigation. The IRS may file a Notice of Federal Tax Lien to protect the Government's interest on offers that will be paid over time. This tax lien will be released when the payment terms of the accepted offer have been satisfied.

I authorize the IRS to contact relevant third parties in order to process my offer

m) By authorizing the IRS to contact third parties including credit bureaus, I understand that I will not be notified of which third parties the IRS contacts as part of the offer application process, as stated in section 7602(c) of the Internal Revenue Code.

I am submitting an offer as an individual for a joint liability

n) I understand if the liability sought to be compromised is the joint and individual liability of myself and my co-obligor(s) and I am submitting this offer to compromise my individual liability only, then if this offer is accepted, it does not release or discharge my co-obligor(s) from liability. The United States still reserves all rights of collection against the co-obligor(s).

Section 9 Signatures

Under penalties of perjury, I declare that I have examined this offer, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct and complete.

Signature of Taxpayer/Corporation Name	Phone Number	Date *(mm/dd/yyyy)*
Signature of Taxpayer/Authorized Corporate Officer	Phone Number	Date *(mm/dd/yyyy)*

Section 10 Paid Preparer Use Only

Signature of Preparer	Phone Number	Date *(mm/dd/yyyy)*
Name of Paid Preparer	Preparer's CAF no. or PTIN	
Firm's Name, Address, and ZIP Code		

Include a valid, signed Form 2848 or 8821 with this application, if one is not on file.

Section 11 Third Party Designee

Do you want to allow another person to discuss this offer with the IRS? ☐ Yes ☐ No

If yes, provide designee's name | Telephone Number ( )

IRS Use Only

I accept the waiver of the statutory period of limitations on assessment for the Internal Revenue Service, as described in Section 8 (k).

Signature of Authorized Internal Revenue Service Official	Title	Date *(mm/dd/yyyy)*

Privacy Act Statement

We ask for the information on this form to carry out the internal revenue laws of the United States. Our authority to request this information is Section 7801 of the Internal Revenue Code.

Our purpose for requesting the information is to determine if it is in the best interests of the IRS to accept an offer. You are not required to make an offer; however, if you choose to do so, you must provide all of the taxpayer information requested. Failure to provide all of the information may prevent us from processing your request.

If you are a paid preparer and you prepared the Form 656 for the taxpayer submitting an offer, we request that you complete and sign Section 10 on Form 656, and provide identifying information. Providing this information is voluntary. This information will be used to administer and enforce the internal revenue laws of the United States and may be used to regulate practice before the Internal Revenue Service for those persons subject to Treasury Department Circular No. 230, Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, Enrolled Actuaries, and Appraisers before the Internal Revenue Service. Information on this form may be disclosed to the Department of Justice for civil and criminal litigation.

We may also disclose this information to cities, states and the District of Columbia for use in administering their tax laws and to combat terrorism. Providing false or fraudulent information on this form may subject you to criminal prosecution and penalties.

Form **656-L** (February 2012)	Department of the Treasury — Internal Revenue Service **Offer in Compromise *(Doubt as to Liability)***	OMB No. 1545-1686

Section 1 **Your Contact Information** | **IRS Received Date**

Your First Name, Middle Initial, Last Name

If a Joint Offer, Spouse's First Name, Middle Initial, Last Name

Your Physical Home Address *(Street, City, State, ZIP Code)*

Mailing Address *(if different from above or P.O. Box number)*

Business Name

Business Address *(Street, City, State, ZIP Code)*

Social Security Number (SSN) *(Your SSN)*	*(Spouse SSN)*	Employer Identification Number *(EIN)*	*(EIN not included in offer)*
– –	– –	–	–

Section 2 To: Commissioner of Internal Revenue Service

I/We submit this offer to compromise, based on doubt as to liability plus any interest, penalties, additions to tax, and additional amounts required by law (tax debt) for the tax type and period(s) marked below:

[Please mark an "X" in the box for the correct description and fill-in the correct tax period(s)].

☐ **1040/1120** Income Tax [List all year(s); for example 1040 2009, 1120 2010, etc.]

☐ **941** Employer's Quarterly Federal Tax Return [List all quarterly period(s); for example 03/31/2009, 06/30/2010, 09/30/2010, etc.]

☐ **940** Employer's Annual Federal Unemployment (FUTA) Tax Return [List all year(s); for example 2010, 2011, etc.]

☐ **Trust Fund Recovery Penalty** as a responsible person of *(enter corporation name)*______________________________ , for failure to pay withholding and Federal Insurance Contributions Act taxes (Social Security taxes), for period(s) ending [List all quarterly period(s); for example 03/31/2009, 06/30/2009, etc.]

☐ **Other Federal Tax**(es) [specify type(s) and period(s)]

Note: If you need more space, use a separate sheet of paper and title it "Attachment to Form 656-L Dated _______________ ." Sign and date the attachment following the listing of the tax periods.

Section 3 Amount of the Offer

I/we offer to pay $ ______________________________

Must be more than zero ($0) and payable within 90 days of the notification of acceptance, unless an alternative payment term is approved at the time the offer is accepted.

Section 4 Terms

By submitting this offer, I/we have read, understand and agree to the following terms and conditions:

Terms, Conditions, and Legal Agreement

In the following agreement, the pronoun "we" may be assumed in place of "I" when there are joint liabilities and both parties are signing this Agreement.

I/we agree to the following conditions:

Section 4 Terms *(Continued)*

a) I/we voluntarily submit all payments made on this offer.

b) The IRS will apply payments made under the terms of this offer in the best interest of the government.

If the IRS rejects or returns the offer or I/we withdraw the offer, the IRS will return any amount paid with the offer. If I/we agree in writing, the IRS will apply the amount paid with the offer to the amount owed. If I/we agree to apply the payment, the date the IRS received the offer remittance will be considered the date of payment. I/we understand the IRS will not pay interest on any amount I/we send with the offer.

IRS will keep my/our payments and fees

c) The IRS will keep all payments and credits made, received, or applied to the total original tax debt before I/we send in the offer or while it is under consideration. The IRS may keep any proceeds from a levy served prior to submission of the offer, but not received at the time the offer is sent in.

If you currently have an approved installment agreement with IRS and are making installment payments, then you may stop making those installment agreement payments when you have been notified your offer has been assigned for consideration. If your offer is rejected or returned for any reason, your installment agreement with IRS will be reinstated with no additional fee.

If the Doubt as to Liability offer determines that you do not owe the taxes, or the IRS ultimately over-collected the compromised tax liability, the IRS will refund the over-collected amount to you, unless such refund is legally prohibited by statute.

I/we agree to waive time limits provided by law

d) To have my offer considered, I/we agree to the extension of time limit provided by law to assess my tax debt (statutory period of assessment). I/we agree that the date by which the IRS must assess my/our tax debt will now be the date by which my/our debt must currently be assessed plus the period of time my/our offer is pending plus one additional year if the IRS rejects, returns, or terminates my/our offer or I/we withdraw it. [Paragraph (i) of this section defines pending and withdrawal]. I/we understand I/we have the right not to waive the statutory period of assessment or to limit the waiver to a certain length or certain periods or issues. I/we understand, however, the IRS may not consider my/our offer if I/we decline to waive the statutory period of assessment or if I/we provide only a limited waiver. I/we also understand the statutory period for collecting my/our tax debt will be suspended during the time my/our offer is pending with the IRS, for 30 days after any rejection of my/our offer by the IRS, and during the time any rejection of my/our offer is being considered by the Appeals Office.

I/we understand I/we remain responsible for the full amount of the tax liability

e) The IRS cannot collect more than the full amount of the tax debt under this offer.

f) I/we understand I/we remain responsible for the full amount of the tax debt, unless and until the IRS accepts the offer in writing and I/we have met all the terms and conditions of the offer. The IRS will not remove the original amount of the tax debt from its records until I/we have met all the terms of the offer.

g) I understand the tax I/we offer to compromise is and will remain a tax debt until I/we meet all the terms and conditions of this offer. If I/we file bankruptcy before the terms and conditions of this offer are completed, any claim the IRS files in bankruptcy proceedings will be a tax claim.

h) Once the IRS accepts the offer in writing, I/we have no right to contest, in court or otherwise, the amount of the tax debt.

Pending status of an offer and right to appeal

i) The offer is pending starting with the date an authorized IRS official signs this form. The offer remains pending until an authorized IRS official accepts, rejects, returns, or acknowledges withdrawal of the offer in writing. If I/we appeal an IRS rejection decision on the offer, the IRS will continue to treat the offer as pending until the Appeals Office accepts or rejects the offer in writing. If I/we do not file a protest within 30 days of the date the IRS notifies me of the right to protest the decision, I/we waive the right to a hearing before the Appeals Office about the offer in compromise.

I/we understand if IRS fails to make a decision in 24-months my/our offer will be accepted

j) I/we understand under Internal Revenue Code (IRC) § 7122(f), my/our offer will be accepted, by law, unless IRS notifies me/us otherwise, in writing, within 24 months of the date my offer was initially received.

I/we understand what will happen if I/we fail to meet the terms of my/our offer (e.g. default)

k) If I/we fail to meet any of the terms and conditions of the offer and the offer defaults, then the IRS may do the following:

- immediately file suit to collect the entire unpaid balance of the offer;
- immediately file suit to collect an amount equal to the original amount of the tax debt as liquidating damages, minus any payment already received under the terms of this offer;
- disregard the amount of the offer and apply all amounts already paid under the offer against the original amount of the tax debt;
- file suit or levy to collect the original amount of the tax debt, without further notice of any kind.

Section 4 Terms *(Continued)*

The IRS will continue to add interest as provided in IRC Section § 6601 on the amount the IRS determines is due after default. The IRS will add interest from the date the offer is defaulted until I/we completely satisfy the amount owed.

I/we understand the IRS may file a Notice of Federal Tax Lien on my/our property

l) The IRS may file a Notice of Federal Tax Lien to protect the Government's interest during the offer investigation. If the offer is accepted, the tax lien will be released when the terms of the offer agreement are satisfied.

I/we authorize the IRS to contact relevant third parties in order to process my/our offer

m) I/we understand that IRS employees may contact third parties in order to respond to this request, and I/we authorize the IRS to make such contacts. Further, in connection with this request, by authorizing the IRS to contact third parties, I/we understand that I/we will not receive notice of third parties contacted as is otherwise required by IRC § 7602(c).

Section 5 Explanation of Circumstances

THIS SECTION MUST BE COMPLETED.

Explain why you believe the tax is incorrect. **Note:** *You may attach additional sheets if necessary. Please include your name and SSN and/or EIN on all additional sheets or supporting documentation.*

Section 6 Mandatory Signature(s)

Taxpayer Attestation: If I/we submit this offer on a substitute form, I/we affirm this form is a verbatim duplicate of the official Form 656-L, and I/we agree to be bound by all the terms and conditions set forth in the official Form 656-L. Under penalties of perjury, I/we declare that I/we have examined this offer, including accompanying schedules and statements, and to the best of my/our knowledge and belief, it is true, correct and complete.

Signature of Taxpayer	Daytime Telephone Number ( )	Date *(mm/dd/yyyy)*
Signature of Taxpayer		Date *(mm/dd/yyyy)*

Section 7 Application Prepared by Someone Other than the Taxpayer

If this application was prepared by someone other than you (the taxpayer), please fill in that person's name and address below.

Name	
Address *(if known) (Street, City, State, ZIP code)*	Daytime Telephone Number ( )

Section 8 Paid Preparer Use Only

Signature of Preparer		
Name of Preparer	Date *(mm/dd/yyyy)*	Preparer's CAF no. or PTIN
Firm's Name, Address, and ZIP Code		Daytime Telephone Number ( )

Include a valid, signed Form 2848 or 8821 with this application or a copy of a previously filed form.

Section 9 — Third Party Designee

Do you want to allow another person to discuss this offer with the IRS? ☐ Yes. Complete the information below. ☐ No

Designee's Name	Telephone Number
	( )

Include a valid, signed Form 2848 or 8821 with this application or a copy of a previously filed form.

IRS Use Only
I accept the waiver of the statutory period of limitations on assessment for the Internal Revenue Service, as described in Section 5 (d).

Signature of Authorized IRS Official	Title	Date *(mm/dd/yyyy)*

Privacy Act Statement

We ask for the information on this form to carry out the internal revenue laws of the United States. Our authority to request this information is contained in Section 7801 of the Internal Revenue Code.

Our purpose for requesting the information is to determine if it is in the best interests of the IRS to accept an offer. You are not required to make an offer; however, if you choose to do so, you must provide all of the information requested. Failure to provide all of the information may prevent us from processing your request.

If you are a paid preparer and you prepared the Form 656-L for the taxpayer submitting an offer, we request that you complete and sign Section 8 on the Form 656-L, and provide identifying information. Providing this information is voluntary. This information will be used to administer and enforce the internal revenue laws of the United States and may be used to regulate practice before the Internal Revenue Service for those persons subject to Treasury Department Circular No. 230, Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, Enrolled Actuaries, and Appraisers before the Internal Revenue Service. Information on this form may be disclosed to the Department of Justice for civil and criminal litigation.

We may also disclose this information to cities, states and the District of Columbia for use in administering their tax laws and to combat terrorism. Providing false or fraudulent information on this form may subject you to criminal prosecution and penalties.

Application Checklist

- ☐ Did you complete all fields and sign the Form 656-L?
- ☐ Did you make an offer amount that is greater than zero ($0)?
- ☐ If you want to allow the IRS to discuss your offer with another person did you complete the "Third-Party Designee" section on the Form 656-L?
- ☐ If someone other than you completed the Form 656-L, did that person sign it?
- ☐ Did you sign and include the Form 656-L?
- ☐ If you want a third party to represent you during the offer process, did you include a Form 2848 or Form 8821 unless one is already on file?
- ☐ Did you include supporting documentation and an explanation as to why you doubt you owe the tax?

Note: There is no application fee or deposit required for a Doubt as to Liability offer.

Mail your package to:

Brookhaven Internal Revenue Service
COIC Unit
P.O. Box 9008
Holtsville, NY 11742-9008

Form **8857**
(Rev. September 2010)
Department of the Treasury
Internal Revenue Service (99)

Request for Innocent Spouse Relief

▶ See separate instructions.

OMB No. 1545-1596

Important things you should know

- **Do not file this form with your tax return.** See *Where To File* in the instructions.
- Answer all the questions on this form that apply, attach any necessary documentation, and sign on page 4. Do not delay filing this form because of missing documentation. See instructions.
- By law, the IRS must contact the person who was your spouse for the years you want relief. There are no exceptions, even for victims of spousal abuse or domestic violence. Your personal information (such as your current name, address, and employer) will be protected. However, if you petition the Tax Court, your personal information may be released, unless you ask the Tax Court to withhold it. See instructions for details.
- If you need help, see *How To Get Help* in the instructions.

Part I Should you file this form? You **must** complete this part for each tax year.

			Tax Year 1		Tax Year 2		Tax Year 3*	
1	**Enter each tax year you want relief.** It is important to enter the correct year. For example, if the IRS used your 2009 income tax refund to pay a 2007 tax amount you jointly owed, enter tax year 2007, not tax year 2009 . . . . ▶	1						
	Caution. The IRS generally cannot collect the amount you owe until your request for each year is resolved. However, the time the IRS has to collect is extended. See *Collection Statute of Limitations* on page 3 of the instructions.							
2	**Check the box for each year you would like a refund if you qualify for relief.** You may be required to provide proof of payment. See instructions . . . . ▶	2	☐		☐		☐	
			Yes	No	Yes	No	Yes	No
3	**Did the IRS use your share of the joint refund to pay any of the following past-due debts of your spouse: federal tax, state income tax, child support, spousal support, or federal non-tax debt such as a student loan?** • If "Yes," **stop here;** do not file this form for that tax year. Instead, file Form 8379, Injured Spouse Allocation. See instructions. • If "No," go to line 4 . . . . ▶	3	☐	☐	☐	☐	☐	☐
4	**Was a return claiming married filing jointly status filed for the tax year listed on line 1? See instructions.** • If "Yes," skip line 5 and go to line 6. • If "No," go to line 5 . . . . ▶	4	☐	☐	☐	☐	☐	☐
5	**If a joint return for that tax year was not filed, were you a resident of Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, or Wisconsin?** • If "Yes," see *Community Property Laws* on page 2 of the instructions. • If "No" on both lines 4 and 5, **stop here.** Do not file this form for that tax year . . . ▶	5	☐	☐	☐	☐	☐	☐

*If you want relief for more than 3 years, fill out an additional form.

Part II Tell us about yourself

6	Your current name (see instructions)	**Your social security number**	
	Your current mailing address (number and street).	Apt. no.	**County**
	City, town or post office, state, and ZIP code. If a foreign address, see instructions.	Best daytime phone number	

Part III Tell us about you and your spouse for the tax years you want relief

7 **Who was your spouse for the tax years you want relief?** File a separate Form 8857 for tax years involving different spouses or former spouses.

That person's current name	**Social security number** (if known)
Current home address (number and street) (if known). If a P.O. box, see instructions.	Apt. no.
City, town or post office, state, and ZIP code. If a foreign address, see instructions.	Best daytime phone number

Note. If you need more room to write your answer for any question, attach more pages. Be sure to write your name and social security number on the top of all pages you attach.

Part III *(Continued)*

8 **What is the current marital status between you and the person on line 7?**

- ☐ Married and still living together
- ☐ Married and living apart since ________ (MM DD YYYY)
- ☐ Widowed since ________ (MM DD YYYY) Attach a photocopy of the death certificate and will (if one exists).
- ☐ Legally separated since ________ (MM DD YYYY) Attach a photocopy of your entire separation agreement.
- ☐ Divorced since ________ (MM DD YYYY) Attach a photocopy of your entire divorce decree.

Note. A divorce decree stating that your former spouse must pay all taxes does not necessarily mean you qualify for relief.

9 **What was the highest level of education you had completed when the return(s) were filed?** If the answers are **not** the same for all tax years, explain.

- ☐ High school diploma, equivalent, or less
- ☐ Some college
- ☐ College degree or higher. List any degrees you have ▶

List any college-level business or tax-related courses you completed ▶

Explain ▶

10 **Were you a victim of spousal abuse or domestic violence during any of the tax years you want relief?** If the answers are **not** the same for all tax years, explain.

- ☐ Yes. **Attach a statement** to explain the situation and **when** it started. Provide photocopies of any documentation, such as police reports, a restraining order, a doctor's report or letter, or a notarized statement from someone who was aware of the situation.
- ☐ No.

11 **Did you (or the person on line 7) incur any large expenses, such as trips, home improvements, or private schooling, or make any large purchases, such as automobiles, appliances, or jewelry, during any of the years you want relief or any later years?**

- ☐ Yes. **Attach a statement** describing (a) the types and amounts of the expenses and purchases and (b) the years they were incurred or made.
- ☐ No.

12 **Did you sign the return(s)?** If the answers are **not** the same for all tax years, explain.

- ☐ Yes. If you were forced to sign under duress (threat of harm or other form of coercion), check here ▶ ☐ . See instructions.
- ☐ No. Your signature was forged. See instructions.

13 **When any of the returns were signed, did you have a mental or physical health problem or do you have a mental or physical health problem now?** If the answers are **not** the same for all tax years, explain.

- ☐ Yes. **Attach a statement** to explain the problem and **when** it started. Provide photocopies of any documentation, such as medical bills or a doctor's report or letter.
- ☐ No.

Part IV Tell us how you were involved with finances and preparing returns for those tax years

14 **How were you involved with preparing the returns?** Check all that apply and explain, if necessary. If the answers are **not** the same for all tax years, explain.

- ☐ You filled out or helped fill out the returns.
- ☐ You gathered receipts and cancelled checks.
- ☐ You gave tax documents (such as Forms W-2, 1099, etc.) to the person who prepared the returns.
- ☐ You reviewed the returns before they were signed.
- ☐ You did not review the returns before they were signed. Explain below.
- ☐ You were not involved in preparing the returns.
- ☐ Other ▶

Explain how you were involved ▶

Note. If you need more room to write your answer for any question, attach more pages. Be sure to write your name and social security number on the top of all pages you attach.

Part IV (Continued)

15 **When the returns were signed, what did you know about any incorrect or missing information?** Check all that apply and explain, if necessary. If the answers are **not** the same for all tax years, explain.

☐ You knew something was incorrect or missing, but you said nothing.
☐ You knew something was incorrect or missing and asked about it.
☐ You did not know anything was incorrect or missing.
Explain ▶

16 **When any of the returns were signed, what did you know about the income of the person on line 7?** Check all that apply and explain, if necessary. If the answers are **not** the same for all tax years, explain.

☐ You knew that person had income.

List each type of income on a separate line. (Examples are wages, social security, gambling winnings, or self-employment business income.) Enter each tax year and the amount of income for each type you listed. If you do not know any details, enter "I don't know."

Type of income	Who paid it to that person	Tax Year 1	Tax Year 2	Tax Year 3
		$	$	$
		$	$	$
		$	$	$

☐ You knew that person was self-employed and you helped with the books and records.
☐ You knew that person was self-employed and you did not help with the books and records.
☐ You knew that person had no income.
☐ You did not know if that person had income.
Explain ▶

17 **When the returns were signed, did you know any amount was owed to the IRS for those tax years?** If the answers are **not** the same for all tax years, explain.

☐ Yes. Explain when and how you thought the amount of tax reported on the return would be paid ▶

☐ No.
Explain ▶

18 **When any of the returns were signed, were you having financial problems** (for example, bankruptcy or bills you could not pay)? If the answers are **not** the same for all tax years, explain.

☐ Yes. Explain ▶

☐ No.
☐ Did not know.
Explain ▶

19 **For the years you want relief, how were you involved in the household finances?** Check all that apply. If the answers are **not** the same for all tax years, explain.

☐ You knew the person on line 7 had separate accounts.
☐ You had joint accounts but you had limited use of them or did not use them. Explain below.
☐ You used joint accounts. You made deposits, paid bills, balanced the checkbook, or reviewed the monthly bank statements.
☐ You made decisions about how money was spent. For example, you paid bills or made decisions about household purchases.
☐ You were not involved in handling money for the household.
☐ Other ▶
Explain anything else you want to tell us about your household finances ▶

20 **Has the person on line 7 ever transferred assets (money or property) to you?** (Property includes real estate, stocks, bonds, or other property that you own.) See instructions.

☐ Yes. List the assets, the dates they were transferred, and their fair market values on the dates transferred. Explain why the assets were transferred ▶

☐ No.

Part V Tell us about your current financial situation

21 **Tell us the number of people currently in your household.** Adults ____________ Children ____________

22 **Tell us your current average monthly income and expenses for your entire household.** If family or friends are helping to support you, include the amount of support as gifts under **Monthly income.** Under **Monthly expenses,** enter all expenses, including expenses paid with income from gifts.

Monthly income	Amount	Monthly expenses	Amount
Gifts		Federal, state, and local taxes deducted from your paycheck	
Wages (Gross pay)		Rent or mortgage	
Pensions		Utilities	
Unemployment		Telephone	
Social security			
Government assistance, such as housing, food stamps, grants		Food	
		Car expenses, payments, insurance, etc.	
Alimony		Medical expenses, including medical insurance	
Child support		Life insurance	
Self-employment business income		Clothing	
Rental income		Child care	
Interest and dividends		Public transportation	
Other income, such as disability payments, gambling winnings, etc. List the type below:		Other expenses, such as real estate taxes, child support, etc. List the type below:	
Type		Type	
Type		Type	
Type		Type	
Total ▶		**Total** ▶	

23 **Tell us about your assets.** Your assets are your money and property. Property includes real estate, motor vehicles, stocks, bonds, and other property that you own. Tell us the amount of cash you have on hand and in your bank accounts. Also give a description of each item of property, the fair market value of each item, and the balance of any outstanding loans you used to acquire each item. Do not list any money or property you listed on line 20. If you need more room, attach more pages. Write your name and social security number on the top of all pages you attach.

24 **Please provide any other information you want us to consider in determining whether it would be unfair to hold you liable for the tax.** If you need more room, attach more pages. Write your name and social security number on the top of all pages you attach.

Caution

By signing this form, you understand that, by law, we must contact the person on line 7. See instructions for details.

Sign Here

Under penalties of perjury, I declare that I have examined this form and any accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Keep a copy for your records.

Your signature	Date

Paid Preparer's Use Only

Preparer's signature	Date	Check if self-employed ☐	Preparer's SSN or PTIN
Firm's name (or yours if self-employed), address, and ZIP code		EIN	
		Phone no.	

Form **9465**
(Rev. December 2012)
Department of the Treasury
Internal Revenue Service

Installment Agreement Request

▶ **Information about Form 9465 and its separate instructions is at** *www.irs.gov/form9465.*
▶ **If you are filing this form with your tax return, attach it to the front of the return.**
▶ **See separate instructions.**

OMB No. 1545-0074

Tip: If you owe less than $50,000, you may be able to establish an installment agreement on-line, even if you have not yet received a bill for your taxes. Go to IRS.gov to apply to pay on-line.

Caution: *Do not file this form if you are currently making payments on an installment agreement or can pay your balance in full within 120 days. Instead, call 1-800-829-1040. If you are in bankruptcy or we have accepted your offer-in-compromise, see* **Bankruptcy or offer-in-compromise,** *in the instructions.*

This request is for Form(s) (for example, Form 1040 or Form 1040EZ) ▶ and for tax year(s) (for example, 2011 and 2012) ▶

1 Your first name and initial | Last name | **Your social security number**

If a joint return, spouse's first name and initial | Last name | **Spouse's social security number**

Current address (number and street). If you have a P.O. box and no home delivery, enter your box number. | Apt. number

City, town or post office, state, and ZIP code. If a foreign address, enter city, province or state, and country. Follow the country's practice for entering the postal code.

2 If this address is new since you filed your last tax return, check here . . . . ▶ ☐

3 Your home phone number | Best time for us to call

4 Your work phone number | Ext. | Best time for us to call

5 Name of your bank or other financial institution:
Address
City, state, and ZIP code

6 Your employer's name:
Address
City, state, and ZIP code

7 Enter the total amount you owe as shown on your tax return(s) (or notice(s))
Note: If the amount on line 7 is greater than $25,000 but not more than $50,000, you **must** complete line 11. If you owe more than $50,000, complete Form 433-F and attach it to your request. See instructions 7

8 Enter the amount of any payment you are making with your tax return(s) (or notice(s)). See instructions 8

9 Enter the amount you can pay each month. **Make your payments as large as possible to limit interest and penalty charges.** The charges will continue until you pay in full. If no payment amount is listed on line 9, or the proposed payment does not meet our streamlined processing criteria, a payment will be determined for you by dividing the balance due by 72 months 9

10 Enter the date you want to make your payment each month. **Do not** enter a date later than the 28th ▶

11 If you want to make your payments by electronic funds withdrawal from your checking account, see the instructions and fill in lines 11a and 11b. This is the most convenient way to make your payments and it will ensure that they are made on time.

▶ **a** Routing number

▶ **b** Account number

I authorize the U.S. Treasury and its designated Financial Agent to initiate a monthly ACH debit (electronic withdrawal) entry to the financial institution account indicated for payments of my Federal taxes owed, and the financial institution to debit the entry to this account. This authorization is to remain in full force and effect until I notify the U.S. Treasury Financial Agent to terminate the authorization. To revoke payment, I must contact the U.S. Treasury Financial Agent at **1-800-829-1040** no later than 14 business days prior to the payment (settlement) date. I also authorize the financial institutions involved in the processing of the electronic payments of taxes to receive confidential information necessary to answer inquiries and resolve issues related to the payments.

Your signature | Date | Spouse's signature. If a joint return, **both** must sign. | Date

Glossary

Abatements: Reductions in tax assessments. Abatements may occur for a number of reasons. For example, a taxpayer may file an amended return claiming a lower tax liability than previously reported or a qualifying corporation may claim a net operating loss which created a credit that can be carried back to reduce a prior year's tax liability.

Asset Equity Table (AET): A table listing all of a taxpayer's assets, encumbrances, and exemptions. It is used to calculate the equity which is included in calculating a taxpayer's Reasonable Collection Potential (RCP).

Automatic Stay: The automatic stay provides a period of time in which all judgments, collection activities, foreclosures, and repossessions of property are suspended and may not be pursued by the creditors on any debt or claim that arose before the filing of the bankruptcy petition.

Collection Appeals Program (CAP): Under the Collection Appeals Program, if a taxpayer disagrees with an IRS decision and wants to appeal it, he or she can ask an IRS manager to review his or her case. If a taxpayer disagrees with the manager's decision, he or she may continue with the Collection Appeals Program.

Collection Due Process: A hearing in which a taxpayer can request to appeal various IRS notices, including a Notice of Federal Tax Lien.

Collection Information Statement (CIS): A financial statement listing assets, income, liabilities, and expenses submitted by the taxpayer. This financial statement can be submitted on Form 433-A, Collection Information Statement for Wage Earners and Self-Employed Individuals, or Form 433-B, Collection Information Statement for Businesses. It is used by the IRS in evaluating Offers in Compromise.

Direct Debit Installment Agreement (DDIA): An Installment Agreement in which payments are automatically debited from the taxpayer's bank account and transferred to the IRS. This is required by the IRS under certain circumstances.

Discharge: A "discharge" removes the lien from specific property. There are several circumstances under which the federal tax lien can be discharged. For example, the IRS may issue a Certificate of Discharge if a taxpayer is selling property and the proceeds can be used to pay the delinquent taxes.

Doubt as to Collectability (DATC): Basis for acceptance of an Offer in Compromise where there is doubt that the tax can be paid in full. The IRS will evaluate the assets of the taxpayer and consider whether to take less than the amount owed based on the fact that they are unlikely to recoup all of the amount owed.

Doubt as to Liability (DATL): Basis for acceptance of an offer where there is doubt that the liability is correct. There must be a genuine dispute as to whether the amount assessed by the IRS is actually due.

Doubt as to Collectability with Special Circumstance (DCSC): Basis for acceptance of an offer where there is doubt that the tax can be paid in full and special circumstances exist that warrant accepting the offer for less than the reasonable collection potential (RCP).

Effective Tax Administration (ETA): Basis for acceptance of an offer where this is no doubt that the liability is correct or can be paid in full. However, requiring the taxpayer to fully pay the tax would either create an economic hardship or be a public policy/equity issue.

Equitable Relief: This type of relief may apply when a taxpayer does not qualify for innocent spouse relief or separation of liability relief for something not reported properly on a joint return and generally attributable to his or her spouse. A taxpayer may also qualify for equitable relief if the correct amount of tax was reported on his or her joint return but the tax remains unpaid.

Independent Administrative Reviewer (IAR): An independent third party who reviews a decision to reject an offer prior to that decision being conveyed to a taxpayer. This person is not in the chain of command of the IRS employees responsible for the rejection of an Offer in Compromise.

Innocent Spouse Relief: This provides the innocent relief from additional tax owed by a taxpayer if his or her spouse or former spouse failed to report income, reported income improperly, or claimed improper deductions or credits.

Net Realizable Equity (NRE): For purposes of determining whether to accept an Offer in Compromise, the IRS values a taxpayer's assets as net realizable equity (NRE). Net realizable equity is defined as quick sale value (QSV) less amounts owed to secured lien holders with priority over the federal tax lien, if applicable, and levy exemption amounts.

Notice of Federal Tax Lien (NFTL): A federal tax lien is the federal government's legal claim against a taxpayer's property when the taxpayer neglects or fails to pay a tax debt. The lien protects the government's interest in all of the taxpayer's property, including real estate, personal property, and financial assets. A federal tax lien exists after the IRS assesses the taxpayer's liability, sends the taxpayer a bill that explains how much is owed, and the taxpayer refuses or neglects to pay the debt in full.

Notice of Intent to Levy: Generally, before property is seized, the IRS must send a taxpayer this notice. If a taxpayer does not pay his or her overdue taxes, make other arrangements to satisfy his or her tax debt, or request a hearing within 30 days of the date of this notice, then the IRS may seize the taxpayer's property.

Reasonable Collection Potential (RCP): The amount that could reasonably be collected from the taxpayer towards an Offer in Compromise. This figure takes into account both the current and likely future assets and liabilities of the taxpayer. The IRS will generally not accept an Offer in Compromise that is less than the taxpayer's RCP.

Separation of Liability Relief: This provides for the allocation of additional tax owed between a taxpayer and his or her former spouse or current spouse from whom he or she is separated because an item was not reported properly on a joint return. The tax allocated to the taxpayer is the amount for which he or she is responsible.

Subordination: A “subordination” occurs when a creditor is allowed to move ahead of the government’s priority position. For example, if a taxpayer is trying to refinance a mortgage on his or her home, but is not able to because the federal tax lien has priority over the new mortgage, the taxpayer may request that the IRS subordinate its lien to the new mortgage.

Trust Fund Recovery Penalties (TFRP): These are the assessments made against responsible business officers of a company that have not paid the taxes it withholds from employees’ wages, such as social security or individual income tax withholding to the IRS. The IRS may record assessments against each of several individuals for the employee-withholding component of payroll tax liability of a given business in an effort to collect the total tax liability of the business. Although assessed against multiple parties, the liability need only be paid once. Thus, two or more assessments exist for the same tax liability. For financial reporting purposes only, one can be considered the account of record and the others are duplicates.

Index

R

S

W