Attorneys & Counselors at Law

Robert J. Fedor Esq., LLC

Resolving Tax Debt With an Offer in Compromise

Overwhelming tax debt can be crushing. Too often taxpayers facing tough economic times make choices or enter into agreements that result in a significant tax liability. Life changes, poor accounting, changes in tax credits, the gig economy, or even a higher income tax bracket can leave you with unexpected taxes and penalties.

An offer in compromise (OIC) is an IRS tool that provides relief to taxpayers when paying their full tax debt would prove an economic hardship. While an OIC can be a useful option, understanding the details is important. This eBook explains the OIC process along with its advantages and disadvantages.

What is an Offer in Compromise?

An offer in compromise can be an attractive proposition for taxpayers with significant tax debt. The process is designed for Americans seeking the means to work out their tax liability by paying what they can afford.

Upon first hearing about an OIC, some people equate the process with bankruptcy—another federal process designed to provide relief to those with overwhelming debt. Others are introduced to the OIC process through advertisements from so-called "OIC mills." These usually unscrupulous businesses charge high fees to prepare an OIC application without counseling the taxpayer on their options—and the likelihood that they may still owe significant money to the IRS even if their offer is accepted.

Oftentimes, applicants do not understand that the amount they may want to pay on their tax liability does not match what the IRS expects as partial payment on their tax debt. Notes the IRS, *"An offer in compromise is a proposal by a taxpayer to the Federal Government that would settle a tax liability for payment of less than the full amount owed. Absent special circumstances, an offer will not be accepted if the IRS believes the liability can be paid in full as a lump sum or through a payment agreement."*

Among other criteria, the IRS will investigate assets, debts, and monthly disposable income during the OIC submission process. While an OIC is a helpful tool for taxpayers to reduce untenable tax debt, it also allows the IRS to collect as much of the tax liability as possible before the Collection Statute Expiration date (the date on which the IRS can no longer collect the tax debt).

The popularity of OICs continues to rise. In 2020, the IRS received 44,809 applications and accepted 14,288 offers. In 2021, taxpayers submitted 49,285 applications while the IRS accepted only 15,154 submissions. If you are interested in exploring an OIC, work with a reputable tax professional, tax attorney, or directly with the IRS. The OIC process takes time, including a detailed exploration of your assets and wealth, and requires an up-front application fee and initial debt payment with your application. Submission of an application does not guarantee the IRS will accept the offer.

If you are considering an OIC, it is important to understand whether this approach is right for you.

Pros and Cons: Is an OIC a good idea for you?

A well-crafted OIC can help you manage and resolve significant tax debt. It could also create financial hardship for which you are unprepared. Consider the advantages and disadvantages of an OIC:

Pros

- **A clean slate:** A successful OIC can eliminate an overwhelming tax liability and any worry about debt collection. Tax debt not only impacts your finances, but it can also reduce or eliminate business opportunities, and create intolerable ongoing stress. As your OIC is under review, tax collection is suspended and eventually terminated when your debt is paid.
- **Control:** An OIC gives you some control of the tax collection process. Through a well-structured OIC, you are better able to create a solution to pay off your tax debt while protecting some income and the assets you wish to retain. An unaddressed tax debt puts you at risk for IRS seizure and sale of assets and garnishment of your wages.

Cons

- **Expiration date:** Speak with your tax attorney about the Collection Statute Expiration Date (CSED). The IRS has a ten-year period from the date of assessment in which to collect taxes from you. If there is a possibility that your tax debt is approaching the CSED, it may not be in your best interests to file an OIC.
- **Lower tax refund:** In the tax year following the acceptance of an OIC, a taxpayer may not claim certain tax credits. A reduction in credits will likely result in a lower tax refund for that year.
- **Rejected application:** You may find you do not qualify for an OIC. If you have assets or wealth, the IRS may reject your application and require you to pay your tax commitment in full. Discuss the desirability of an OIC with your tax attorney, including the full financial disclosure required during the OIC process.
- **Lack of confidentiality:** The OIC process is not confidential. The IRS maintains public inspection files of offers that have been accepted. Upon request, the public can view a report detailing the taxpayer name, region, tax debt, and terms of the offer. Taxpayers whose offers are accepted should understand the basics of their offer are public.

Be sure you understand how an OIC impacts your own financial profile before applying for an OIC to the IRS.

The basis for your offer in compromise

An application for an OIC provides information to the IRS to help them decide whether they will compromise with you on the amount of your tax debt. In your application, the IRS will look for the grounds on which you are filing for relief, which could be the following:

- **Doubt as to collectability:** If there is doubt that you will be able to pay the amount of tax that you owe, the IRS may consider your application for an OIC. To determine collectability, the IRS reviews the financial and other information you provide in your application to make a decision on whether it is in the best interests of the IRS to accept a compromise on your debt. The OIC application to use for an OIC claiming Doubt as to Collectability is Form 656.
- **Doubt as to Liability (DATL):** If you genuinely disagree with the IRS about the amount of tax (if any) that you owe the IRS, you can file an OIC based on a "Doubt as to Liability." This means that you can prove the IRS made a mistake in its calculations. If the amount of your tax debt has already been established through litigation or court order, the IRS will not consider an OIC based on doubt. An OIC based on doubt as to liability requires a written statement and accompanying documents to explain and justify the taxpayer's belief that the amount assessed by the IRS is incorrect. The OIC application to use for an OIC claiming Doubt as to Liability is Form 656-L. The instructions in the booklet offer additional information on this type of OIC. There is no fee or deposit required with a DATL application.
- **Effective tax administration:** If collectability and the legitimacy of your tax debt are not in question, you may still be able to file an OIC based on the concept of effective tax administration (ETA). ETA provides some room for the IRS to accept an Offer in Compromise in order to support the fair and equitable application of tax laws. This could mean a special circumstance such as an illness or caregiving expenses, economic hardship, equity issues, or in the interest of public policy. The OIC application to use for this is also an OIC claiming Doubt as to Liability is Form 656.

When pursuing an OIC, be sure to provide detailed information concerning the basis for your claim on the appropriate application. If your application is incorrect or otherwise missing information, the offer will be returned to you. Depending on the reason for the return, you may—or may not—be able to return the offer for reconsideration upon correction.

An OIC application is complex, and the process takes time and careful attention to detail. Working with a qualified tax professional to ensure your offer is correctly presented saves you time and money—and helps avoid possible rejection of your offer.

Who is eligible to submit an OIC?

There are eligibility requirements for a business or an individual to file an offer in compromise:

- If your tax liability was established or confirmed by a court decision, or if you are currently involved in a bankruptcy action, you are not eligible for the program. Similarly, if you are paying restitution, or the tax debt is currently in litigation with the Department of Justice (DOJ), the IRS will not process an OIC.
- Taxpayers must be current on required tax returns and reports, including payment of estimated taxes.
- Business owners with employees must be current on federal tax deposits and the past two quarters before applying for an OIC.

If you submit an OIC and are found to be ineligible, the IRS will return your application and filing fee. The partial payment required at the time of submission will be applied to your outstanding tax debt.

Overall, it is a good idea to investigate your eligibility prior to applying.

The IRS Pre-qualifier tool

In order to familiarize yourself with the information the IRS needs to process an OIC application, take advantage of the free online IRS OIC Pre-Qualifier tool. The tool gives you a chance to work through the information needed for an OIC submission. Based on the information you provide, the tool generates a preliminary offer. This can be helpful since it gives you an early assessment of how the IRS might handle your situation.

The IRS does not request personally identifying information and does not retain the information you provide in the online tool. The preliminary offer is for your information only and does not obligate the IRS to accept your OIC application.

Some types of information you can expect to provide include:

- You will be asked qualifying questions about bankruptcy and other matters.
- You will be asked to provide basic information like tax filing status and the size of your household.
- The tool has a section on your assets including real property, investments, vehicles, objects of value, etc.
- There is also a section on income information including wages, disability, social security or disability payments, and other revenue streams you may have.
- Expense information is used by the tool to estimate your monthly living needs. You can enter figures on debt, rent or mortgage, vehicle and transportation costs, health and life insurance payments, state and local taxes, and more.

Remember—the intent of an OIC is to serve taxpayers who would suffer economic hardship if they were to pay their full tax debt. Economic hardship is defined by the IRS as a condition that will result in an inability to meet basic living expenses. You should expect liquidation of saleable assets if you do not have the cash to apply to your offer.

When you owe taxes but do not qualify for an OIC

Through the pre-qualifying tool or your own estimation, you may learn that the IRS considers you capable of paying your tax liability in full—without an OIC. As a general rule, the IRS will not accept an OIC if it finds you can pay the debt through an installment plan or liquidation of your existing asset equity. Before submitting an OIC in these cases, consider your options for managing your tax debt. Prior to submitting an OIC, the Taxpayer Advocate Service (TAS) suggests that you consider the following:

- Create and review your financials. If you have assets that can be used to pay the debt, consider paying the debt or entering a monthly installment plan with the IRS.
- Investigate an installment plan with the IRS. While the IRS offers 180 days to pay a tax debt in full, you can create a longer payment plan with the IRS. If the IRS agrees to an installment plan, you will continue to accrue penalties and interest on the amount owing to the IRS. Using a personal loan or credit card to pay off the debt can eliminate the IRS obligation and additional interest and penalties.
- If you have no money to pay toward your tax debt, you may be able to work with the IRS to consider your tax debt uncollectible at present. If the IRS agrees to Currently Not Collectible status after carefully reviewing your documentation, your tax debt will be considered presently uncollectible by the IRS.

By suspending collection efforts, the IRS will also likely halt the ten-year window in which the IRS can pursue your tax debt. By temporarily suspending the window of opportunity for collection, you remain liable for the tax debt for a full ten years, whenever that occurs. Despite uncollectible status, the IRS will continue to add penalties and interest to your existing tax debt and send you an annual statement of the amount owing. The IRS may also keep any tax refunds that are due to you during this time.

An OIC is a good option for some taxpayers and not for others. While an OIC is often marketed as a “fresh start,” or payment of “pennies on the dollar,” it is not a forgiveness program. Acceptance of your offer means the IRS expects you to pay your debt, even to the point of liquidating assets important to you. Consider all payment options for paying your tax debt before submitting an OIC.

If your offer is not accepted by the IRS, your application and application fee will be returned. The partial compromise payment that must accompany your application will be applied to your current tax debt.

Understanding Reasonable Collection Potential (RCP)

After you submit your OIC, the IRS will review your figures and circumstances to determine your *reasonable collection potential (RCP)*. The RCP is the measure of money the IRS calculates that you will be able to pay. The IRS pre-qualifier tool can help you understand what the IRS might consider to be your RCP. Your compromise offer is expected to be at least equal to the RCP, if not greater.

When you submit an offer, the IRS conducts a comprehensive review of the financial information you provide in the *collected information statement (CIS)* provided in your offer. The focus of the initial review is whether the tax debt can be paid in full based on your present financial circumstances. If the IRS confirms full payment is not likely, it will proceed with the review for the reasonable collection potential. Some points to understand about the review process include:

- If financial information provided by you appears to be dated, or if the IRS believes changes to your status have occurred, it may request updated information.
- For a joint OIC submitted by two spouses who do not live together, the IRS may ask for two separate OICs in order to maintain confidentiality and to accurately assess each CIS.
- The IRS is not likely to accept offers from taxpayers who are unwilling to provide initial or subsequent information requested by the IRS. The OIC process scrutinizes all forms of income, assets, and debt on which the IRS may have additional questions.
- During their analysis, the IRS will review internally available information on your tax and income status along with the information you provide. Take note, the internal and external resources reviewed by the IRS are extensive and include state motor vehicle records, credit reports, Google Maps, real estate, financial and asset ownership records, underpinning tax documents, and more.
- For taxpayers submitting an OIC who have had an earlier collection matter with the IRS, the IRS generally does not reopen an earlier investigation—unless evidence clearly indicates the need to do so. If an investigation was concluded less than 12 months earlier, the IRS may compare that data with the currently submitted OIC to review for changes in status that impact the compromise offer.
- Asset evaluation is critical to determining RCP. The IRS may review renter or homeowner policies and riders, divorce documents, documents provided during loan transactions, and more to discern equity held in assets. Assets are valued at net realizable equity. That equity is defined as the quick sale value (QSV) less any other claims or exemptions.
- The IRS considers quick sale value to be the price a seller could expect if required to liquidate the asset within approximately 90 days. The QSV is about 80 percent of fair market value. When evaluating the value of your assets for an OIC, the IRS generally uses the quick sale value.

There are other factors considered by the IRS when developing your RCP. Work with a reputable tax professional to evaluate your income, assets, debt, and circumstances with the same critical eye with which the IRS will assess your offer.

Create a strategy with your tax advisor around the assets and expenses you seek to protect. If you are a long-term care provider or have extensive medical expenses, these circumstances and numbers should be carefully detailed in your offer. Similarly, explain important priorities such as retaining your home ownership, or paying for a child's education or special needs trust.

By understanding your own financial position, you can better respond to the IRS, argue special circumstances if needed, and plan for how you will pay the offer if accepted.

Types of payment— Periodic payment or lump sum

Before submitting an OIC, it is important to understand the details of the process to which you are applying. As discussed earlier, taxpayers whose application is cursorily prepared through an OIC mill may miss their best chance at submitting an accurate OIC—or even understanding if the process is a good fit for their finances.

Just as an OIC is not a "get out of tax debt-free" process, an OIC does not significantly delay the time in which your agreed-upon offer will come due. Many applicants do not understand they are expected to pay their offer in full at the conclusion of the OIC process—or within a relatively short time of two years.

In accepting your offer, the agency expects the amount of money it would otherwise expect to collect by commencing tax litigation against you. When you submit your offer, you designate whether you will pay in installments or via a lump sum payment. Once your offer is accepted, you cannot change or extend the terms of your offer. Consider these points about payment types:

- **Lump sum payment:** For a lump sum payment, the IRS requires a 20 percent payment to accompany the offer when submitted. If the offer is accepted, the IRS will expect the remaining amount due to be paid in five or fewer payments within five months of the acceptance of your offer by the IRS.
- **Periodic payments:** The first of your payments will be made with the submission of your application for an OIC. You are expected to continue to make monthly payments while the IRS is considering your offer. The payments you make must be equal to the amount of money you have offered in compromise. If you cease making payments during the time that the IRS is evaluating your offer, the offer will be returned to you without an opportunity to appeal. Payments previously made will be applied to your tax debt.

The IRS is clear in the instructions for an OIC. If you do not have the cash to pay for your offer, you may need to take out a loan, borrow from friends or family, borrow against assets, or liquidate assets. An OIC is not a good option for those without the willingness or means to pay a reasonable offer on their tax debt.

Your application for an OIC is returned or rejected. What now?

During the review process, the IRS may return—or reject—your application for several reasons.

- **Your offer was returned:** The IRS will detail the reasons in a letter if your offer is returned. In some cases, the IRS will not reconsider the offer, for example, if you are currently involved in bankruptcy or the IRS believes your offer was made purely to delay collection, among other reasons. If you believe the IRS made a mistake, use the telephone number provided on your IRS return letter and submit your objection within 30 days from the date of the IRS letter notifying you of the return.
- **Your offer was rejected:** Similarly, if your application for an OIC was rejected, you have a 30-day window to follow the instructions in the letter to file an appeal. While it is a small detail, take note of the date of the letter in which the IRS rejects your offer. It is critical to file a timely appeal on your behalf.

Timeline: General steps toward an OIC

The amount of time to complete an OIC is variable. Generally, the IRS reviews and responds to OIC applications within seven months to a year. The steps for a taxpayer to complete an application for an OIC include:

- Determine if you are eligible to apply.
- Decide if you will pay in one lump sum or via installments over approximately 24 months.
- Consider an appropriate offer and submit your offer application.
- As the IRS evaluates your application, the agency suspends collection activity on your debt and can file a Notice of Federal Tax Lien.
- If your offer is accepted, you must fulfill all requirements of your offer, and the IRS will release its lien upon completion.
- If your offer is rejected, you can appeal within 30 days.
- If your offer is accepted, you must ensure your taxes are paid in full on a timely basis for the following five years. If your taxes are not filed and paid, the IRS may terminate your OIC—requiring you to pay the original amount due.

The TAS reminds applicants to keep track of when they submit their offer. If you do not withdraw your offer and the IRS does not otherwise reject or return the offer within two years, the offer is considered accepted by the agency.

Contact us today—and get the right kind of help with your offer in compromise

The OIC process is complex and requires full disclosure of your financial records. Get skilled advice when considering whether an OIC is a good choice for your circumstances.

The experienced tax attorneys at Robert J. Fedor Esq. LLC can guide you through an OIC application or advise you of other options available to you. With years of successful experience representing clients locally, nationally, and abroad, we can answer your questions about the OIC process. Speak with our tax group for strategic guidance and representation. **Call 800-579-0997 or contact us online today.**