Practice

By Charles P. Rettig

A Fresh Start for Struggling Taxpayers

The IRS has attempted to balance enforcement efforts with an understanding of the financial hardship incurred by many taxpayers resulting from our struggling economy. During the past few years, IRS employees have had more authority to suspend collection actions in certain hardship cases where taxpayers are unable to pay and increased flexibility for previously compliant individuals in existing installment payment agreements having difficulty making payments because of a job loss or other financial hardship.[1]

On February 24, 2011, IRS Commissioner Doug Shulman announced a "Fresh Start" initiative to help people get a fresh start with their tax liabilities stating, "We are making fundamental changes to our lien system and other collection tools that will help taxpayers and give them a fresh start. These steps are good for people facing tough times, and they reflect a responsible approach for the tax system."[2] The Fresh Start initiative focuses on changes to IRS collection and lien practices, including:

- Adjustments to IRS lien policies including: (i) significantly increasing the dollar threshold when liens are generally issued, resulting in fewer tax liens; (ii) making it easier for taxpayers to obtain lien withdrawals after paying a tax bill; and (iii) withdrawing liens in most cases where a taxpayer enters into a Direct Debit Installment Agreement.
- Creating easier access to Installment Agreements for small businesses with employees.
- Expanding the streamlined Offer in Compromise (OIC) program to cover more taxpayers.

Adjustments to IRS Lien Policies

The IRS is modifying procedures to make it easier for taxpayers to obtain lien withdrawals once the liabilities have been satisfied if the taxpayer requests

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the withdrawal. In order to speed up the withdrawal process and give the taxpayer a "fresh start," the IRS is going to streamline its internal procedures to allow collection personnel to withdraw the liens.[3] A federal tax lien gives the IRS a legal claim to a taxpayer's property for the amount of an unpaid tax debt. Usually the government is not the only creditor to whom the taxpayer owes money and the filing of a Notice of Federal Tax Lien sets the priority rights against certain other creditors. A lien filing informs the public that the U.S. government has a claim against all property, and any rights to property, of the taxpayer including property acquired after the lien filing.

Increase in the lien filing threshold. Under the Fresh Start initiative, the threshold for filing a Notice of Federal Tax Lien will be increased from $5,000 to $10,000. Liens may still be filed on amounts less than $10,000 under appropriate circumstances. However, the IRS will not retroactively apply the new $10,000 lien threshold and automatically withdraw a previously filed lien.

Lien withdrawal after paying a tax liability. Taxpayers requesting a lien withdrawal after paying a tax liability must request the withdrawal in writing by filing IRS Form 12277, *Application for Withdrawal* (attaching a copy of the Form 668(Y), *Notice of Federal Tax Lien*, if available). On item 8, "Reason for requesting withdrawal," check box d, the "best interest" provision. Form 12277 should be mailed to the IRS, ATTN: Technical Services Advisory Group Manager, in the area where the taxpayer resides (use Publication 4235, *Technical Services Advisory Group Addresses*, to determine where to mail Form 12277). If a determination is made to withdraw the filed Form 668(Y), the IRS will send the taxpayer a Form 10916(c), *Withdrawal of Filed Notice of Federal Tax Lien*, and will notify the taxpayer's creditors if provided with the names and addresses of the credit reporting agencies or financial institutions.

Lien withdrawal after entering into a direct debit installment agreement (DDIA). Qualifying taxpayers requesting a lien withdrawal after entering into a DDIA must request the withdrawal in writing by filing IRS Form 12277, *Application for Withdrawal* (attaching a copy of the Form 668(Y), *Notice of Federal Tax Lien*, if available). On item 8, check box b, the "entered into an installment agreement" provision. Qualifying taxpayers include individuals (Form 1040 liabilities), businesses with income tax liability only and out-of-business entities with any type of tax liability.

To be eligible, the current liability must be $25,000 or less (if the liability exceeds $25,000, the taxpayer should pay down the balance to $25,000 prior to requesting the lien withdrawal to be eligible); the DDIA must full pay the liability within 60 months or before the Collection Statute Expiration Date (CSED), whichever is earlier; the taxpayer must be in full compliance with other filing and payment requirements; the taxpayer must have made three consecutive direct debit payments (a probationary period demonstrating that direct debit payments will be honored); the taxpayer cannot have previously received a lien withdrawal for the same taxes unless the withdrawal was for an improper filing of the lien; the taxpayer cannot have defaulted on their current, or any previous, DDIA; if currently on a regular installment agreement, the taxpayer may convert to a DDIA (to convert a regular installment agreement to a DDIA, the individual taxpayer may use the Online Payment Agreement available at *irs.gov* while individual and business taxpayers can visit their local IRS office or call Individuals (Wage & Salary Earners) 1-800-829-0922; Individuals (Self-Employed) 1-800-829-8374; Businesses 1-800-829-0115. If the taxpayer defaults on their DDIA after the lien is withdrawn, a new notice of lien may be filed and collection efforts may resume.

Installment Agreements and Small Businesses

Under the Fresh Start initiative, small businesses with 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. To qualify, the taxpayer-business must $25,000 or less at the time the agreement is established (if the liability exceeds $25,000, the taxpayer should pay down the balance to $25,000 prior to requesting the lien withdrawal to be eligible); the liability must be full paid within 24 months or prior to the CSED, whichever is earlier; the taxpayer must enroll in a DDIA if the liability is between $10,000 and $25,000; and the taxpayer must be compliant with all filing and payment requirements.

To request an IBTF-Express IA, call the number on the most recent IRS billing notice or 1-800-829-4933, visit the local IRS office, or complete IRS Form 9465, *Installment Agreement Request*, and send it to the address on the most recent billing notice. If the taxpayer does not have a recent IRS billing notice, Form 9465 should be sent to the address on page 2 of Form 9465, *Business Trust Fund Express Installment Agreements*.

Streamlined OIC Program

As a result of a study conducted on the OIC program in 2009, a streamline offer program was implemented on June 28, 2010, in the Brookhaven and Memphis Centralized Offer in Compromise (COIC) Campuses of the IRS. Under the streamlined OIC program, there are fewer requests for additional financial information; if necessary, requests for additional information are made by phone, not by mail, and there is greater flexibility when considering the ability of the taxpayer to pay.

The IRS has expanded the new streamlined OIC program to allow taxpayers with annual incomes up to $100,000 to participate. In addition, the current limitation of having a tax liability of $25,000 or less has been increased to participants having a tax liability of less than $50,000, including accruals.[4] Qualifying taxpayers are wage earners, the unemployed and, self-employed taxpayers with no employees and gross receipts under $500,000.

An OIC is an agreement between a taxpayer and the IRS that settles the taxpayer's tax liabilities for less than the amount of the outstanding liability. 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 and/or assets, or a mutual mistake of a material fact which would be sufficient to set aside or reform a contract.

Generally, an OIC will not be accepted if the IRS believes that the liability can be paid in full as a lump sum or through an installment payment agreement based on a detailed review of the taxpayer's income and net realizable value in their assets. The objectives of the OIC program are to effect 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 individual taxpayer and the government, provide the taxpayer a fresh start toward future voluntary compliance with all filing and payment requirements, and secure collection of revenue that may not be collected through any other means.[5]

The IRS will accept an OIC when it is unlikely that the tax liability can be collected in full and the amount offered reasonably reflects collection potential.[6] An OIC is a legitimate alternative to declaring a case currently not collectible or to a protracted installment agreement. The goal is to achieve collection of what is potentially collectible at the earliest possible time and at the least cost to the government. The IRS will not accept an OIC unless the amount offered by the taxpayer is equal to or greater than the reasonable collection potential (RCP). The RCP is how the IRS measures the taxpayer's ability to pay and includes the value that can be realized from the taxpayer's assets, such as real property, automobiles, bank accounts and other property. The RCP also includes anticipated future income, less certain amounts allowed for basic living expenses.

Taxpayers are typically expected to provide reasonable documentation to verify their ability to pay. The objective of the OIC program is to accept an OIC when it is in the best interest of both the taxpayer and the government and promotes voluntary compliance with all future payment and filing requirements. Acceptance of an adequate offer will also result in creating for the taxpayer an expectation of and a fresh start toward compliance with all future filing and payment requirements.

Types of OICs. The IRS may accept an OIC based on: (i) Doubt as to collectibility—Doubt exists that the taxpayer could ever pay the full amount of tax liability owed within the remainder of the statutory period for collection; (ii) Doubt as to liability—A legitimate doubt exists that the assessed tax liability is correct. Possible reasons to submit a doubt as to liability offer include: (a) the examiner made a mistake interpreting the law, (b) the examiner failed to consider the taxpayer's evidence or (c) the taxpayer has new evidence; and (iii) Effective tax administration—There is no doubt that the tax is correct and there is potential to collect the full amount of the tax owed, but an exceptional circumstance exists that would allow the IRS to consider an OIC. To be eligible for compromise on this basis, a taxpayer must demonstrate that the collection of the tax would create an economic hardship or would be unfair and inequitable.

Qualifying for an OIC. Taxpayers are candidates for an OIC if they are not a debtor in an open bankruptcy proceeding, submit the $150 application fee or a signed Form 656-A, *Income Certification for Offer in Compromise Application Fee and Payment*, and submit one of the following payments with the offer: (i) for a lump-sum offer, 20-percent payment or a signed From 656-A, *Income Certification for Offer in Compromise Application Fee and Payment*, or (ii) for a periodic payment offer, the first installment or a signed Form 656-A, *Income Certification for Offer in Compromise Application Fee and Payment*.

OIC payment options. In general, a taxpayer must submit a $150 application fee and initial payment along with the Form 656, *Offer in Compromise*. The total amount of money offered must be indicated and must be more than zero and may not include money already paid, expected future refunds, funds attached by levy or anticipated benefits from capital/ net operating losses. Taxpayers may choose to pay their OIC in one of three payment options:

- Lump-sum cash offer—Payable in nonrefundable installments, the offer amount must be paid in five or fewer installments upon written notice of acceptance. A nonrefundable payment of 20 percent of the offer amount along with the $150 application fee is due upon filing the Form 656. If the offer will be paid in five or fewer installments in five months or less, the offer amount must include the realizable value of assets plus the amount that could be collected over 48 months of payments or the time remaining on the statute, whichever is less. If the offer will be paid in five or fewer installments in more than five months and within 24 months, the offer amount must include the realizable value of assets plus the amount that could be collected over 60 months of payments, or the time remaining on the statute, whichever is less. If the offer will be paid in five or fewer installments in more than 24 months, the offer amount must include the realizable value of assets plus the amount that could be collected over the time remaining on the statute.
- Short-term periodic payment offer—Payable in nonrefundable installments; the offer amount must be paid within 24 months of the date the IRS received the offer. The first payment and the $150 application fee are due upon filing the Form 656. Regular payments must be made during the offer investigation. The offer amount must include the realizable value of assets plus the total amount the IRS could collect over 60 months of payments or the remainder of the statutory period for collection, whichever is less.
- Deferred periodic payment offer—Payable in nonrefundable installments; the offer amount must be paid over the remaining statutory period for collecting the tax. The first payment and the $150 application fee are due upon filing the Form 656. Regular payments must be made during the investigation. The offer amount must include the realizable value of assets plus the total amount the IRS could collect through monthly payments during the remaining life of the statutory period for collection.

The IRS is not bound by either the offer amount or the terms proposed by the taxpayer. The OIC investigator may negotiate a different offer amount and terms, when appropriate. The investigator may determine that the proposed offer amount is too low or the payment terms are too protracted to recommend acceptance. In this situation, the OIC investigator may advise the taxpayer as to what larger amount or different terms would likely be recommended for acceptance.

Payments and application fees. When filing an OIC, two separate remittance documents should be sent—one for the application fee and the other for the required offer payment. All payments should be made by check or money order made payable to the United States Treasury. Practitioners who file multiple OICs at the same time should not combine application fees for multiple clients.

The Form 656-PPV, *Offer in Compromise Payment Voucher*, included in the Form 656, should be completed and attached to any periodic payment(s) that becomes due. Failure to submit any required periodic payments, after the initial payment has been submitted, will result in the offer being declared withdrawn. For offers originally sent to Holtsville, NY, send payments to: P.O. Box 9011, Holtsville, NY 11742. For offers originally sent to Memphis, TN, send payments to: AMC Stop 880, P.O. Box 30834, Memphis, TN 38130-0634.

The OIC application fee reduces the assessed tax or other amounts due. The application fee will be returned if the OIC is deemed not to be processable. Unless the OIC has been submitted under "doubt as to liability" or a completed Form 656-A is included with the Form 656, the $150 application fee must be included with the offer or the IRS will return the offer.

All taxpayers do not qualify for an OIC. Absent special circumstances, if the taxpayer has the ability to fully pay your tax liability in a lump sum or via an installment agreement, an OIC will not be accepted.

OIC payments are nonrefundable. The IRS considers the 20-percent payment for a lump-sum offer and any periodic payments as "payments on tax" and are not refundable, regardless of whether the offer is declared not processable or is later returned, withdrawn, rejected or terminated by the IRS.

Federal tax liens are not released. If there is a Notice of Federal Tax Lien on record prior to acceptance of the offer, the lien is not released until the OIC terms are satisfied or until the liability is paid, whichever comes first. A Notice of Federal Tax Lien may be filed during the course of the OIC investigation.

Payments may be designated. The taxpayer may designate in writing how the IRS should apply payments made with the filing of the offer and while an offer is under investigation. Without a written designation, payments will be applied to the tax liability and in the government's best interest. The $150 application fee cannot be designated, but is applied to the tax liability and in the government's best interest.

Refunds. The IRS will keep any refund, including interest due, because of an overpayment of any tax or other liability, for tax periods extending through the calendar year the IRS accepts the OIC. Exception: Offers submitted under the basis of doubt as to liability.

Levies. The IRS will keep all payments and credits made, received or applied to the total original tax liability before the OIC was submitted. The IRS may also keep any proceeds from a levy that was served prior to the submission of an OIC, but which were not received at the time the OIC was submitted.

Statutory period for collection suspended. The statutory period for collection is suspended during the period that the OIC is under consideration (pending) and is further suspended if the OIC is rejected by the IRS and you appeal the rejection.

Five-year future compliance. If an OIC is accepted, the taxpayer must timely file all tax returns and timely pay all tax for five years or until the offered amount is paid in full, whichever period is longer. Failure to comply will result in default of the OIC and the IRS may then collect the original liability plus penalties and interest.

OIC payment and application fee exceptions. If the taxpayer qualifies for a low-income exception waiver or submits a doubt as to liability offer, they are exempt from the $150 application fee and any OIC payments due upon submission of the OIC or during the course of the investigation. The low income waiver does not apply to business taxpayers.

Appeal. If the OIC is rejected, the taxpayer will have the opportunity to file an appeal which will be heard by the IRS Office of Appeals. There are no appeal rights associated with offers that are returned, withdrawn or terminated.

Approved installment agreement. If the taxpayer has an approved installment agreement and submits a periodic payment offer, they are not required to continue to make the installment agreement payments while the offer is being investigated. However, they will be required to make the OIC periodic payments as they become due.

Mandatory acceptance. The IRS will deem an offer "accepted" if it is not withdrawn, returned or rejected within 24 months of the IRS receipt date. If a liability included in the offer amount is disputed in any judicial proceeding, that time period is omitted from calculating the 24-month time frame.

Public inspection files. The law requires the IRS to make certain information from accepted OIC available for public inspection and review. These public inspection file locations are located in designated IRS Area Offices.

Summary

The Fresh Start initiative is intended to assist struggling taxpayers find a way forward. The IRS is to be commended for recognizing the financial problems of taxpayers who have found themselves in a difficult financial situation in our struggling economy!

Endnotes

1 IR-2009-2, Jan. 6, 2009.

2 IR-2011-20, Feb. 24, 2011.

3 Available online at *http://www.irs.gov/businesses/small/article/0,,id=239094,00.html.*

4 On May 13, 2011 the IRS Director of Collection Policy, Scott D. Reisher, issued a Memorandum for Directors, Collection Area Operations re Centralized Offer in Compromise Streamline Offer Process (SBSE-05-0511-026) summarizing the new processing of streamline OICs.

5 IRS Internal Revenue Manual (IRM) 5.8.1.1.4 (09-23-2008).

6 IRS Policy Statement P-5-100.