

# OFFER IN COMPROMISE

---

## **Abstract:**

In an effort to resolve outstanding taxpayer liability issues, IRS has modified the Offer in Compromise procedures. The IRS may legally compromise a portion of the tax liability if there is doubt as to liability, doubt as to collectibility or for effective tax administration. Effective tax administration means that the collection of the tax would create an economic hardship or would be unfair or inequitable. This material gives the reader an overview of where to begin with the offer in compromise procedure.

---

An Offer in Compromise (OIC) is an agreement between a taxpayer and the IRS that resolves the taxpayer's tax liability. The IRS has the authority to settle or compromise federal tax liabilities by accepting less than full payment under certain circumstances. The IRS may legally compromise for one of the following reasons:

- **Doubt as to liability**—There is doubt that the assessed tax is correct.
- **Doubt as to collectibility**—There is doubt that the amount could ever be paid in full.
- **Effective tax administration**—There is no doubt the tax is correct and no doubt the amount owed could be collected, but an exceptional circumstance exists that allows the IRS to consider an offer. To be eligible for compromise on this basis, the taxpayer must demonstrate that collection of the tax would create an economic hardship or would be unfair or inequitable.

## **ELIGIBILITY FOR CONSIDERATION**

A taxpayer may be eligible for consideration of an Offer in Compromise if any one of the following conditions is met:

1. In the taxpayer's judgment he or she does not owe the tax liability (**doubt as to liability**). There must be a bona fide dispute as to a question of fact or law with respect to the merits of the liability. Taxpayers must submit a detailed written statement explaining why they believe they do not owe the tax liability they want to compromise. They will not be required to submit a financial statement if they are submitting an offer on this basis alone. RRA '98 created new innocent spouse provisions. A taxpayer may claim innocent spouse relief as part of the offer procedure. At that point the offer will be considered an offer with doubt as to liability, and the innocent spouse claim and the offer will be sent to the area examination function for investigation and processing.
2. In the taxpayer's judgment, he or she cannot pay the entire tax liability in full (**doubt as to collectibility**). The taxpayer must submit a statement showing his or her current financial situation. Policy Statement P-5-100 states that the IRS will accept an offer in compromise if the amount offered reasonably reflects collection potential. An offer in compromise is recognized as a viable alternative

to declaring a case currently not collectible or to a protracted installment agreement. This represents a significant change in the IRS's policy. Taxpayers are encouraged to submit an offer. IRS District Counsel will assist in the implementation of this program.

Collectibility determinations by the area Collection function are based on the potential collection from a taxpayer's assets, including present as well as future income. Consideration is to be given to all the priorities granted to the Government by statutes. The offer should reflect the taxpayer's maximum capacity to pay based upon his or her equity in assets and future income potential. If an offer is based in whole or in part on doubt as to collectibility, then a complete financial statement must accompany the offer (Form 433A for individuals and Form 433B for business entities).

Doubt as to collectibility is not a factor in the determination of a deficiency in a tax court case. However, once the liability is agreed upon in a tax court case, an offer in compromise may be proposed based upon collectibility. The amount of the liability should be stipulated and the decision document filed or held in escrow by IRS Area Counsel pending approval of the offer.

3. The taxpayer agrees that the tax liability is correct and he or she is able to pay the balance due in full, but he or she has exceptional circumstances that he or she would like the IRS to consider, including situations involving severe or unusual economic hardship (**effective tax administration**). To receive consideration on this basis the taxpayer must submit a financial statement and a detailed written narrative. The narrative must explain the exceptional circumstances and why paying the tax liability in full would either create an economic hardship or would be unfair and inequitable. The IRS will also consider the taxpayer's overall history of filing returns and paying taxes.

## **INELIGIBILITY FOR CONSIDERATION**

A taxpayer is not eligible for consideration of an Offer in Compromise on the basis of **doubt as to collectibility** or **effective tax administration** if:

1. The taxpayer has not filed all federal tax returns, or
2. The taxpayer is involved in an open bankruptcy proceeding.

<p><b>Practitioner Note.</b> A business taxpayer must have timely filed and timely deposited all employment taxes for the two prior quarters before the offer is submitted. He or she must have also timely made all federal tax deposits during the quarter in which the offer is being submitted.</p>
---

## **SUBMITTING AN OFFER IN COMPROMISE**

Form 656, Offer in Compromise, is the official compromise agreement. Substitute forms, whether computer-generated or photocopies, must affirm that:

1. The substitute form is a verbatim duplicate of the official Form 656.

2. The taxpayer agrees to be bound by all terms and conditions set forth in the official Form 656.

The taxpayer must initial and date all pages of the substitute form, in addition to signing and dating the signature page.

### **Additional Forms Required**

- Form 433-A, Collection Information Statement for Individuals, if the taxpayer is submitting an offer as an individual
- Form 433-A and 433-B, Collection Information Statement for Businesses, if the taxpayer is submitting an offer as a self-employed person
- Form 433-B, if the taxpayer is submitting an offer as a corporation or other business taxpayer
- The IRS may also require Forms 433-A from corporate officers and individual partners

**Practitioner Note.** The taxpayer should personally sign the offer as well as any required information statements unless unusual circumstances prevent him or her from doing so. If an authorized power of attorney signs the offer because of unusual circumstances, a completed Form 2848, Power of Attorney and Declaration of Representative, must be included with the offer. All forms can be ordered by calling (800) 829-1040, by visiting the local IRS office, or by accessing the IRS Web site at [www.irs.gov](http://www.irs.gov). The Web site has an interactive Installment Agreement calculator as well as information on Offer In Compromise.

## **DETERMINING PAYMENT TERMS**

The Offer in Compromise program's purpose is to settle tax debts for the maximum amount that a taxpayer can pay. In some cases, the taxpayer is best able to settle the debt by paying it off over a period of time. The IRS recently announced a new, simplified method of settling taxpayer debts by providing taxpayers a fixed monthly payment option. This new method will assist taxpayers and practitioners in situations where taxpayers are willing to pay their debts, but the maximum amount they can pay is not sufficient to pay off the full amount of the debt. In this situation taxpayers are not eligible for ordinary installment agreements, but they will be eligible for the new, fixed monthly payment option.

### **Three Ways to Pay:**

1. Cash (paid in 90 days or less)
2. Short-term deferred payment (more than 90 days, up to 24 months), or
3. Deferred payment (offers with payment terms over the remaining statutory period for collecting the tax)

**Practitioner Note.** The IRS requires full payment of accepted **doubt as to liability** offers at the time of mutual agreement of the corrected liability. If the taxpayer is unable to pay the corrected amount he or she must also request compromise on the basis of **doubt as to collectibility**.

## **NO INTEREST CHARGED**

The latest change to streamline the Offer in Compromise program eliminates confusion associated with interest calculations for deferred payments. Under the old system, the interest could be adjusted up to four times a year. With deferred payments spread out for up to 10 years, this created complicated calculations and uncertainty for the IRS, tax practitioners, and taxpayers. It also meant the IRS had to leave room at the back end of the deferred payment plan to factor in interest. Under the new system, **interest is not charged on offered amounts**. The IRS will now be able to precisely calculate the exact amount the person will owe during the life of the Offer in Compromise payments, without any of the uncertainty and imprecision involved with fluctuating interest rates.

**Policy Adopted for Other Options.** The IRS has adopted the same fixed-payment policy for taxpayers choosing the other two Offer in Compromise payment options: cash or short-term payments. The fixed payment combines all debts, including interest and penalty, owed by the taxpayer under the Offer in Compromise terms into a single payment that reflects the maximum the taxpayer can pay after covering basic living expenses.

**If the taxpayer defaults on the Offer in Compromise agreement, the entire tax liability will be reinstated, along with interest and penalties, since the statutory requirement for interest accrual will remain in place.** Taxpayers will also be responsible for interest accrued after they entered into the agreement.

## **WITHHOLDING COLLECTION ACTIVITIES**

The IRS will withhold collection activities while the offer is being considered. It will not act to collect the tax liability:

- While the IRS investigates and evaluates the offer
- For 30 days after the IRS rejects the offer, or
- While the taxpayer appeals an offer rejection

Withholding collection will not apply if the IRS finds that the taxpayer submitted the offer to delay collection or if a delay will jeopardize its ability to collect the tax.

**Practitioner Note.** Taxpayers who have an installment agreement when they submit an offer must continue making the agreed upon monthly payments while the IRS considers the offer. The offer process could take six months or longer.

**Suspension of the Statute of Limitations.** The collection statute of limitations is suspended for all tax periods included in the taxpayer's offer, during the period the offer is pending. The offer is considered pending:

- While the IRS investigates and evaluates the offer

- For 30 days after the IRS rejects the offer, or
- While the taxpayer appeals an offer rejection

When taxpayers sign the offer, they agree to the suspension of the assessment statute of limitations for all tax periods included in the offer. The signature extends this statute:

- During the time frames listed above
- While the amount taxpayer agreed to pay under an accepted agreement remains unpaid, or
- While any other term or condition of the offer remains unsatisfied

## STEPS IN THE OFFER IN COMPROMISE PROCESS

### Step One: Submission of the Offer in Compromise

The taxpayer submits a completed Form 656, Form 433A, and/or Form 433B. It is critical that the following information is included on or with the Form 656:

- Signature
- The tax liabilities to be compromised (tax years, tax form numbers, and amount), and
- The amount offered (this amount should be equal to or exceed the taxpayer's equity in assets)

IRS has centralized initial processing of Form 656 at two centers—Memphis and Brookhaven (Holtsville).

#### Where to File IF YOU RESIDE IN

the states of Alaska, Alabama, Arizona, California, Colorado, Hawaii, Idaho, Kentucky, Louisiana, Mississippi, Montana, Nevada, New Mexico, Oregon, Tennessee, Texas, Utah, Washington, Wisconsin, or Wyoming,

AND

You are a wage earner or a self-employed individual without employees,

THEN MAIL

Form 656 and attachments to:

Memphis Internal Revenue Service  
 Service  
 Center COIC Unit  
**PO Box 30803, AMC**

AND

You are **OTHER** than a wage earner or a self-employed individual without employees,

THEN MAIL

Form 656 and attachments to:

Memphis Internal Revenue  
 Center COIC Unit  
**PO Box 30804, AMC**

Memphis, TN 38130-0803

Memphis, TN 38130-0804

**IF YOU RESIDE IN**

Arkansas, Connecticut, Delaware, District of Columbia, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Maine, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Nebraska, New Hampshire, New Jersey, New York, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, Puerto Rico, Rhode Island, South Carolina, South Dakota, Vermont, Virginia, West Virginia, or have a foreign address,

**AND**

You are a wage earner or a self-employed earner individual without employees, individual without

**THEN MAIL**

Form 656 and attachments to:  
Brookhaven Internal Revenue Service

Service

Center COIC Unit  
**PO Box 9007**  
Holtsville, NY 11742-9007

**AND**

You are **OTHER** than a wage or a self-employed

employees,

**THEN MAIL**

Form 656 and attachments to:  
Brookhaven Internal Revenue

Center COIC Unit  
**PO Box 9008**  
Holtsville, NY 11742-9008

## **Step Two: The Evaluation of the Offer in Compromise**

An Offer in Compromise specialist will take the information submitted by the taxpayer, analyze the financial statement (Form 433A and/or Form 433B), perform an income and expense analysis, and make a determination as to whether the amount offered represents the taxpayer's equity in assets.

## **Step Three: Acceptance or Rejection of the Offer in Compromise**

A decision will be made and communicated as to whether the offer should be accepted or rejected. If the offer is accepted, the taxpayer must remain current in filing tax returns and the payment of taxes for five subsequent years. Notification of the acceptance will be made by letter. The letter will include the terms of the offer.

Offers in Compromise may be rejected if the taxpayer is not current with all required tax filings or if the taxpayer is in bankruptcy. If the offer is rejected, an independent reviewer, located in the Special Procedures function, will review the decision before the taxpayer is notified. The taxpayer will be notified by letter, and the letter will contain the reason for the rejection. The rejection letter will also outline the taxpayer's right to appeal the decision. RRA '98 amended I.R.C. §7222 to provide that the IRS shall not reject an offer from a low-income taxpayer "solely on the basis of the amount of the offer."

Once an Offer in Compromise is made, it is not accepted until the Commissioner or his delegate executes the appropriate acceptance form, i.e., Form 7249, Offer Acceptance Report, and acceptance letter and the proponent are notified in writing of the acceptance of the offer. An accepted offer constitutes a contract between the government and the

proponent and is legally enforceable provided the consideration is deemed adequate, there is mutual assent, and other provisions of contract law are met.

Fraud will invalidate a compromise if all of the following conditions are met:

1. The representations were false as to a material fact, e.g., concealment of assets.
2. The proponent knew them to be false.
3. They were made to, and did, induce the other party to make the contract.
4. The other party relied on them to his injury.

Once the offer is accepted, the compromise is effective for the entire liability for taxes, including penalties and interest for the periods for which the offer was submitted. All questions of tax liability for those periods are finally settled and that tax year is closed. No refund or addition to tax for that period may thereafter arise.