

Compromising Your Federal Tax Liability

The Pinnacle

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In these difficult economic times, people may have problems paying a variety of their bills, including those to the Internal Revenue Service. Most creditors have fairly basic remedies if a person does not pay his or her bills, which include suing the person or, if the creditor is a secured creditor, foreclosing on whatever collateral was pledged for a loan. However, the IRS has additional remedies, such as being able to impose a federal tax lien, garnishing wages and even seizing assets in order to get paid. If a person owes a lot of money to the IRS and the person wants to try to resolve the debt, then they may be able to negotiate an installment agreement or an offer-in-compromise. This article will focus on offers-in-compromise and the criteria to qualify for an offer-in-compromise (“OIC”).

The OIC program has been around for at least 15 years with the IRS and is an excellent program for those who qualify. However, it is important to note that not everyone qualifies. I am sure that we have all seen the television ads by various individuals or groups promising to settle your tax debt for pennies on the dollar. You should know right up front that absolutely no one can promise that the IRS will accept your OIC and settle your tax debt for pennies on the dollar. Every taxpayer’s situation is different and each OIC will be individually evaluated by the IRS. The various individuals or groups that promise to settle a person’s tax debt for pennies on the dollar are not legitimate organizations and have no basis upon which to make these promises.

The IRS will consider accepting an OIC based upon one of three reasons: (i) doubt as to collectability; (ii) doubt as to liability; and (iii) exceptional circumstances (which the IRS refers to as “effective tax administration”). Doubt as to collectability means that there is doubt that the taxpayer could ever pay the full amount of tax within the remainder of the statutory period to collect the tax. (As a general rule, the IRS has 10 years after the tax has been assessed against an individual in which to collect the tax). An example of doubt as to collectability would be someone that is barely paying their bills on a monthly basis, that has no likely increase in income in the foreseeable future and that owes a very large tax bill. Also, the person either has no valuable assets or if the person owns their home or other real estate or valuable assets, then those assets are all encumbered with mortgages or other liens (such as creditor liens, judgment liens or otherwise) that essentially render the assets worth very little or nothing.

Doubt as to liability means that there is a legitimate doubt that the taxpayer owes all or part of the tax that has been assessed against the person. An example would be if a person is assessed an income tax liability from their former spouse for a tax period that arose after their separation or divorce. The IRS may have assessed this tax as a mistake and this could serve as the basis for a doubt as to liability OIC.

The final basis for an OIC is exceptional circumstances or effective tax administration. This means that the taxpayer does not have any doubt that the tax is correct and there is the potential to collect the full amount of the tax owed, but an exceptional circumstance exists that would allow the IRS to consider an OIC. While the IRS carefully scrutinizes any doubt as to collectability offer or doubt as to liability offer, the IRS very carefully scrutinizes an exceptional circumstances offer. The taxpayer must have a really exceptional circumstance in order for the IRS to consider this type of offer. Exceptional circumstances could possibly be advanced age or serious illness. A taxpayer should only consider making an exceptional circumstances offer if there is a truly compelling and unique situation that the IRS may legitimately consider accepting such an offer.

A person must meet a number of criteria before the IRS will process and evaluate an OIC. First, the person must not be in bankruptcy. Second, all of the taxpayer's returns must be filed and the taxes assessed by the IRS. Third, if a business is filing an OIC, then the business must have made all federal tax deposits for the current quarter. Fourth, if a business is filing an OIC, then the business must remain current on all tax return filings and tax deposit payments while the IRS is evaluating the OIC. Fifth, all estimated tax payments must be up to date for the current year. Finally, the IRS can only consider and evaluate an OIC on tax years that have been assessed. The IRS will not consider an OIC for anyone that has not filed their tax returns. In addition, the IRS will not process an OIC for the current tax year in which the OIC is submitted. (For example, a person could not submit an OIC in 2009 for their 2009 tax liability).

A person will need to submit a personal financial statement (IRS Form 433-A) along with the actual offer-in-compromise form (IRS Form 656). The person will also need to submit part of the proposed OIC amount along with the OIC application. There are several different payment plans with the IRS in order to pay the OIC amount. The first payment plan is a lump sum payment, the second is a short term payment plan and the third is a deferred periodic payment plan. If the person is making a lump sum OIC, then the person will need to submit 20% of the proposed lump sum amount with the application. If the person wants to set up a short term payment plan or a deferred periodic payment plan, then he or she will need to submit the first payment of the plan with the application.

This article has briefly summarized the OIC program with the IRS. There are many additional factors that a person needs to know and understand before submitting an OIC. A person should consult with a certified public accountant or an attorney that is knowledgeable about the OIC program to determine whether or not he or she is qualified for the OIC program.

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