

The Offer In Compromise And Its Less Well Known Cousin
By Jeff DeRosier¹

TWO AVENUES FOR REDUCING A LIABILITY

Many clients and attorneys are aware, generally, that there are programs available to help taxpayers who feel they cannot repay their federal tax liabilities. Clients seem to have the general impression that reducing the liability is an exercise in horse-trading; attorneys seem to understand there is more to it than that, but don't know exactly what is entailed. This article will discuss two programs that may allow delinquent taxpayers to pay less than the entire balance owed; the Partial Pay Installment Agreement ("PPIA") and the Offer In Compromise ("OIC").

Partial Pay Installment Agreement ("PPIA")²

The PPIA was established by the American Jobs Creation Act of 2004, amending §6159(a) to include language approving full or partial collection of a given liability³. Prior to this change, if a taxpayer could not afford to full pay via an installment agreement, an OIC was the sole option.⁴

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² Internal Revenue Manual §5.14.2.1. While the Internal Revenue Code (hereinafter "IRC") authorizes the Partial Pay Installment Agreement, the Internal Revenue Manual (hereinafter "IRM") is the primary source of guidance for implementation of any PPIA.

³ I.R.C. §6159(a).

⁴ <http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Legislation-Allows-Partial-Payment-Option>

Assume the following:

1. Taxpayer owes \$118,000.00 (including all penalties and interest) as follows:

Year	Liability
2007	\$15,000.00
2008	\$23,000.00
2009	\$35,000.00
2010	\$45,000.00

Total: \$118,000.00

2. Client is unmarried and is solely responsible for the liability.
3. Client has demonstrated an ability to pay of \$500.00 per month⁵.
4. Client has no retirement accounts, no cash value life insurance or annuities, and rents an apartment.
5. Client has no equity in client's automobile.
6. The Client will begin making installment payments on August 15, 2014.

The Collection Statute Expiration Date ("CSED") is ten years from the date the tax is assessed for any given year.⁶ Any liability, penalties, and interest still outstanding after the CSED expires become uncollectable.⁷ Generally, tax is assessed when the taxpayer submits a tax return that is accepted by the IRS.⁸ If the taxpayer never files a return and the IRS files one on the taxpayer's behalf, the filing of that return begins the CSED for that year.⁹

⁵ See Internal Revenue Manual §5.14.2.1.1 for PPIA requirements. The taxpayer seeking a PPIA must submit a financial statement, form 433A; the taxpayer must submit form 433B (business financial statement) for each closely held business entity the taxpayer owns.

⁶ Internal Revenue Code §6502(a)(1). Note that there are several events which toll the statute of limitations and extend the collection period. Requesting an installment agreement which causes the IRS to review a financial statement; IRC §6331(k)(2); filing of a bankruptcy petition; IRC §6503(h); submission of an offer in compromise; IRC §6331(i)(5), 6331(k)(1);

⁷ I.R.M. §5.1.19.1(2).

⁸ IRS §6203.

⁹ I.R.M. §25.6.1.9.4.5(1).

Assume the following CSEDs:

Year	Liability	CSED
2007	\$15,000.00	4/15/2020
2008	\$23,000.00	4/15/2020
2009	\$35,000.00	4/15/2022
2010	\$45,000.00	4/15/2023 ¹⁰
Total: \$118,000.00		

The taxpayer will make \$500.00 payments beginning August 15, 2014; each successive payment is due on the 15th of each successive month. Generally, the IRS will apply payments to the oldest CSED first in order to collect as much as possible of the oldest liability before the CSED expires.¹¹ All payments made subsequent to the first CSED expiration will be applied to the next oldest CSED.¹²

There are sixty-eight (68) months between the client's first payment and the CSED for 2007 and 2008.¹³ As such, the payments will be applied as follows:

¹⁰ CSEDs, in fact, can be any date whatsoever; there is no requirement that a CSED coincide with April 15, even though that is the date returns are due each year.

¹¹ See form 433D terms and conditions,

¹² *§/d.*

¹³ Although it may seem odd that consecutive years have the same CSED, this often occurs because the IRS filed two (2) returns on the taxpayer's behalf (SFR Returns) on the same date. As such, identical CSED dates are not uncommon.

Year	Liability	CSED	Amount Paid	Amount Expired
2007	\$15,000.00	4/15/2020	\$15,000.00 (30 payments)	\$0.00
2008	\$23,000.00	4/15/2020	\$19,000.00 (38 Payments)	\$4,000.00
2009	\$35,000.00	4/15/2022		
2010	\$35,000.00	4/15/2023		
Total:	\$118,000.00		\$34,000.00	\$4,000.00

The sum of all the client's payments as of April 15, 2020 will be thirty-four thousand dollars. Fifteen thousand dollars will be applied to 2007 resulting in the client paying the 2007 liability in full prior to the CSED expiration.¹⁴ The balance of client's payments, nineteen thousand dollars will be applied to 2008, but because the CSED for 2008 expires on the same day, any unpaid amount (four thousand dollars) becomes un-collectable. As a result, the client just achieved a discount on their liability.

There are twenty four months between the expiration of the 2007 and 2008 CSEDs and the 2009 CSED of April 15, 2022. As such, the client's repayment and liability summary is as follows:

¹⁴ This assumes all penalties and interest are included in the \$15,000.00 figure. However, all penalties and interest continue to accrue as long as the liability is outstanding, so actual figures may vary. For example, if principal, penalties and interest as of August 15, 2014, but interest and penalties continue to accrue so that the total balance as of April 15, 2020 is \$17,500.00, then \$17,500.00 worth of the payments will be applied to 2007, with the smaller balance amount then being applied to 2008. Either way, because the taxpayer demonstrated an ability to pay \$500.00 per month *only*, the taxpayer will only be forced to pay that and any excess liability, interest, or penalty will expire.

Year	Liability	CSED	Amount Paid	Amount Expired
2007	\$15,000.00	4/15/2020	\$15,000.00	\$0.00
2008	\$23,000.00	4/15/2020	\$19,000.00 ¹⁵	\$4,000.00
2009	\$35,000.00	4/15/2022	\$12,000.00 (24 payments)	\$11,000.0
2010	\$35,000.00	4/15/2023		
Total	\$118,000.00		\$46,000.00¹⁶	\$15,000.00

After the expiration of the 2009 CSED, there are only another twelve months, and thus twelve payments, before the 2010 CSED expires. The sum of client's payments that will be applied against 2010 is \$6,000.00. The complete picture of client's liability and repayment amount after all CSEDs expire is as follows:

Year	Liability	CSED	Amount Paid	Amount Expired
2007	\$15,000.00	4/15/2020	\$15,000.00	\$0.00
2008	\$23,000.00	4/15/2020	\$19,000.00 ¹⁷	\$4,000.00
2009	\$35,000.00	4/15/2022	\$12,000.00	\$23,000.0
2010	\$35,000.00	4/15/2023	\$6,000.00 (12 payments)	\$29,000.00
Total	\$118,000.00		\$52,000.00¹⁸	\$66,000.00

¹⁵ \$500 x 68 payments = \$34,000.00;

¹⁶ The total amount owed for 2007, 2008, and 2009 was \$73,000.00.

¹⁷ \$500 x 68 payments = \$34,000.00;

¹⁸ The total amount owed for 2007, 2008, and 2009 was \$73,000.00.

As this hypothetical demonstrates, significant savings can occur via installment agreements. However, it would be inaccurate to describe this strategy as a lump sum discount, even though the potential savings can be quantified in terms of a lump sum. At the outset there is a potential savings of \$66,000.00, but there are several risks that accompany that potential savings:

1. All PPIAs are reviewed every two years by the IRS.¹⁹ If, after any review, the client can pay more, the IRS will require that the client pay more.
2. The PPIA described above encompasses an eight year repayment period. The taxpayer must remain compliant²⁰ for the entire eight years.²¹
3. All penalties and interest continue to accrue until the CSED date. If the client's ability to pay increases, the client will have to repay more penalties and interest before the client's payments are allocated to the next expiring CSED period.

As such, any description of a PPIA that characterizes the repaid amount as a lump sum is inherently inaccurate. Any discount that may occur because of the use of a PPIA is strictly conditioned on the passage of time and continuing to make payments. In other words, if the taxpayer were to call the IRS after establishing the PPIA and offer to make a lump sum payment of \$52,000.00, the IRS would not accept even if that is the amount ultimately repaid; all it accepted was the monthly payment amount.

THE OFFER IN COMPROMISE

The Offer In Compromise ("OIC")²² is one alternative to a PPIA. Like a PPIA, whether an OIC is accepted or rejected depends on the financial statement submitted and whether it

¹⁹ IRM §5.14.2.1.4(7).

²⁰ IRM §5.14.1.2(8)(f). All returns must be filed on time, all liabilities as reported must be paid on time (the new balances cannot be added to the liabilities that are part of the PPIA); payroll taxes, withholding, filing, or estimated tax deposits must be timely for the duration of the PPIA.

See Table 2. The default rate for PPIAs is greater than the default rate for normal "Full Pay" Installment Agreements. However, there is also a possibility that the taxpayer's payments may go down. *Id* at p. 5.

reasonably reflects collection potential.²³ Unlike a PPIA, an OIC is submitted on the basis of a lump sum offer amount.²⁴ Even though the OIC is submitted on the basis of a lump sum, installment payments can still be made if accepted by the IRS.²⁵

In order to determine the offer amount, an analysis of the payment options is essential because the taxpayer may not be able to meet certain payment options, thus threatening the viability of the OIC. For example, an offer can be paid in one lump sum, in five (5) months or less²⁶, or by payments lasting up to twenty-four (24) months.²⁷ The following would be the payment options using the same \$500.00 per month payment amount:²⁸

<u>Option</u>	<u>Amount Offered</u>	<u>Payment Amount</u>
1 time lump sum	\$6,000.00	\$6,000.00 (one time, submitted with the OIC)
5 months or less	\$6,000.00	\$1,200.00/month (first payment submitted with OIC, 4 monthly payments to follow).
More than 5 months (but not more than 24 months)	\$12,000.00	\$500.00/month, 24 months.

Some pitfalls of the OIC are evident in the table above. Most taxpayers are interested in paying as little as possible; doing so, however, may put the taxpayer in a position where the offered payment terms cannot be honored. If the taxpayer demonstrated an ability to pay \$500.00 per month, the taxpayer may have difficulty coming up with a \$6,000.00 one-time

²² Authorized by I.R.C. §7122.

²³ I.R.M. 57.10.10.1(1).

²⁴ See form 433-A (OIC) p. 7. The OIC form is number 656; submitted along with form 656 is form 433-A, which is the same form as 433-A used to validate the PPIA. The 433-A submitted with the OIC, however, is specially designated "433-A (OIC)" and contains the calculation page to determine the amount of the offer. The standard 433-A does not contain that calculation page.

²⁵ *Id.* and form 656, page 3. Many taxpayers seem to think that an OIC must be paid on a one-time lump-sum basis, and are therefore discouraged from even submitting an OIC. This is incorrect, even though the payment amount may differ from the PPIA, installment payments are still a viable method of paying an accepted OIC.

²⁶ I.R.M. 5.8.5.28(2). The payment period may be shorter if the CSED expires within the repayment period.

²⁷ See form 433-A (OIC) page 5.

²⁸ *Id.*

lump-sum payment.²⁹ Similarly, if the taxpayer can only pay \$500.00/month, the taxpayer may default on a \$1,200.00 monthly payment. Thus, the taxpayer may be forced to offer the larger OIC amount simply due to the taxpayer’s ability to commit to and honor the monthly payment amount.

There are other potential pitfalls to submitting an OIC:

1. **Equity In Assets** All equity in assets must be offered, regardless of whether the taxpayer can actually access that equity.³⁰ To illustrate, consider a variation on the assumptions that guide this discussion; assume the taxpayer has \$6,000.00 in taxpayer’s IRA and \$10,000.00 equity in their homestead in addition to the taxpayer’s ability to pay on a monthly basis. The taxpayer must include those dollar values in taxpayer’s OIC *whether the taxpayer can access those amounts or not*.³¹ Even though the taxpayer is only obligated to value their home at 80%³² of the fair market value, if equity exists it must still be offered. The taxpayer’s revised payment options are:

<u>Option</u>	<u>Amount Offered</u>	<u>Payment Amount</u>
1 time lump sum	\$24,000.00	\$24,000.00 (one time, submitted with the OIC)
5 months or less	\$20,000.00	\$4,000.00/month (first payment submitted with OIC, 4 monthly payments to follow).
More than 5 months (but not more than 24 months)	\$28,000.00	\$1,166.67/month, 24 months.

The above repayment options demonstrate additional tension between the client’s ability to pay and client’s OIC repayment options. It is important that the client not put themselves

²⁹ Note that if the taxpayer has \$6,000.00 in a bank account, that \$6,000.00 must be offered *in addition* to the ability to pay on a monthly basis, thus resulting in an offer amount of \$12,000.00, further escalating the payment. See 433-A (OIC), p. 2.

³⁰ I.R.M. 5.8.5.4(4).

³¹ *Id.*

³² See form 433-A (OIC), p. 3. The allowance of only 80% of the fair market value is an acknowledgement that if the taxpayer were forced to sell their home to pay their tax liability, the taxpayer may be forced to accept a “fire-sale” price. I.R.M. 5.8.5.4.1(2).

under such financial pressure that they would be unable to perform their obligations as submitted to the Offer Unit.

2. Closely Held Business Entity Many times, the client has tax problems because the client is self employed via a closely held business. If such a closely held business entity exists, the client must include that business entity on the OIC financial statement, and must include a value for that business.³³ The IRS may request a valuation by an independent, impartial appraiser.³⁴ To illustrate, assume that the taxpayer asserts and the IRS accepts that the business is worth \$50,000.00 (the assumptions regarding home equity and IRA equity are disregarded here). The taxpayer's OIC options are as follows:

<u>Option</u>	<u>Amount Offered</u>	<u>Payment Amount</u>
1 time lump sum	\$56,000.00	\$56,000.00 (one time, submitted with the OIC)
5 months or less	\$56,000.00	\$11,200.00/month (first payment submitted with OIC, 4 monthly payments to follow).
More than 5 months (but not more than 24 months)	\$62,000.00	\$2,583.33/month, 24 months.

This can be an especially difficult outcome to accept for a taxpayer that cannot sell the business for the estimated value.

THE EQUITY PROBLEM - PPIA v. OIC

³³ See form 433-A (OIC) page 4.

³⁴ I.R.M. 5.8.5.8(4). Even the IRS recognizes that an appraisal is should only be requested when the cost of the appraisal is justified by the complexity of the business entity. Still, even if no appraisal is required and the IRS accepts the taxpayer's approval or a rule of thumb" value, the value must be offered.

How would such equity in assets be handled if present when considering a PPIA? To properly assess whether the taxpayer can access the equity, the IRS may require that the taxpayer attempt to borrow money using real property as collateral (whether the real property is homestead or not), or to take a loan against a retirement account or life insurance policy.³⁵ If the taxpayer cannot access the equity, the IRS may disregard it for purposes of calculating the taxpayer's ability to pay.

CONCLUSION

Although most taxpayers are convinced that an OIC is the result that would be of the greatest benefit to them, that is often not the case. Sometimes, the lump sum payment or increased installment payments make the OIC a bad option (in spite of the promise of more quickly resolving the liability). For those taxpayer's a PPIA, although not without drawbacks, may provide a viable resolution option.

³⁵ I.R.M. 5.14.2.1.2(1)-(6); I.R.M. 5.14.2.1.1(3), (5)(D).