



COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

October 28, 2004

The Honorable Max Baucus
Ranking Member
Committee on Finance
United States Senate
Washington, DC 20510

Dear Senator Baucus:

I am responding to your September 2, 2004, request for information about IRS' administration of the offer in compromise (OIC) program. The Treasury Department and the Congress share a common interest in ensuring that tax administration is carried out efficiently, effectively, and fairly. I believe this response will illustrate that, while there remains room for improvement, we have made considerable progress in the OIC program.

Your letter states you have received feedback from practitioners and other interested parties maintaining the IRS has placed improving inventory management above quality casework. I can assure you we are maintaining a focus on quality casework while accomplishing improvements to inventory management and cycle time. The expectation is to efficiently and conscientiously evaluate each case based on its individual merits.

I have responded to your specific questions below:

- 1. Please provide the offer-in-compromise inventory and cycle time for processing offers for the past ten years.**

The tables below show the OIC ending inventory and processing cycle time. The OIC inventory is at its lowest point since early 1999, and the number of cases we are able to process in less than six months has steadily improved since 2001. Revised procedures and the implementation of two Centralized OIC (COIC) processing sites in 2001 have contributed significantly to reversing upward trends in both categories. In particular, the centralized sites have proven effective in handling certain front-end case actions, such as processability determinations and the processing of application fees. They also operate in a very cost effective manner and provide timely service on less-complex OIC cases. I want to reiterate that we are maintaining a focus on quality casework while accomplishing these improvements.

OIC Ending Inventory										
1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004*
30817	38384	39554	32279	37941	62551	87456	94931	74765	65327	49683

* Through June 2004

OIC Cycle Time											
	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004*
0 – 6 months	53%	56%	59%	64%	61%	51%	38%	32%	38%	56%	55%
6 – 12 months	35%	34%	32%	29%	33%	40%	45%	43%	36%	28%	28%
Over 12 months	12%	10%	9%	7%	7%	9%	17%	25%	26%	16%	17%

* Through June 2004

2. **The IRS is expected to use national standards as a guideline when considering a taxpayer's offer-in-compromise. The IRS is also expected to consider a taxpayer's facts and circumstances in determining whether the national standards are an appropriate guideline for a taxpayer. Please explain the current practices used by the IRS in considering an offer-in-compromise.**

We developed national and local standards to promote consistency among IRS collectors in the amounts routinely allowed for taxpayer expenses. Our employees are, however, authorized to deviate from these standards in certain situations. Internal Revenue Manual, IRM 5.8.5.5.1(2) states:

“National and local expense standards are guidelines. If it is determined that a standard amount is inadequate to provide for a specific taxpayer's basic living expenses, allow a deviation. Require the taxpayer to provide reasonable substantiation and document the case file.”

We reemphasize this direction to OIC personnel on a regular basis. During the past year, the IRS also has asked the Taxpayer Advocate Service (TAS) and the American Institute of Certified Public Accountants (AICPA) to provide examples of any unreasonably rigid adherence to the national standards in OIC casework for evaluation. Upon receipt of these examples, we plan to use them to enhance OIC processing.

3. It is our understanding that prior to 2000, the IRS would consider an offer-in-compromise when a bankruptcy proceeding was pending. Why was this practice discontinued? We further understand that recent court proceedings have directed the IRS to consider an offer-in-compromise during a bankruptcy proceeding. What is the current IRS position on this matter?

The IRS Office of Chief Counsel explained the policy against considering offers in compromise from taxpayers in bankruptcy in Notice CC-2004-025 released July 12, 2004 (copy enclosed).

4. How many offers-in-compromise did the IRS return in fiscal years 2002, 2003, and 2004? What circumstances resulted in their return? How many offers were rejected over the same period? For what reasons were the offers rejected? For those offers returned or rejected in fiscal years 2002 and 2003, how much has been collected, and by what means, since the return or rejection of the offer? Does the IRS have procedures allowing it to collect information and analyze whether rejected offers should have been accepted (e.g., procedures ensuring that accounts are being worked and information about amounts that have been collected)? If so, please provide.

The table below shows annual figures:

Offers In Compromise			
	FY 2002	FY 2003	FY 2004*
Returned As Not Processable	33,044	30,440	35,764
Returned After Deemed Processable	50,584	49,118	30,035
Rejected	17,031	27,345	23,115
Accepted	29,166	21,629	17,740

* Through August

We return offers as not processable for five reasons. The reasons, in order of volume of occurrence, are:

- (1) The taxpayer has not filed all required returns.
- (2) The taxpayer did not attach the application fee or waiver request.
- (3) The taxpayer did not include all appropriate forms.
- (4) The taxpayer is in bankruptcy.
- (5) The offer is from a business with employees and the business has failed to timely make required federal tax deposits for the current quarter and the two immediate quarters.

We reject offers when the amount offered does not meet or exceed what we determine to be the reasonable collection potential.

We are currently working with the Office of Program Evaluation & Risk Analysis (OPERA) to analyze the ultimate outcomes of cases that involve returned or rejected OICs. The purposes are to validate the methods used to determine reasonable collection potential and to make adjustments as appropriate. While the OPERA analysis is not complete, we have already used early results to improve our processes. More detailed information is provided in items 8 and 9 below.

To reduce the number of un-processable offers we return, we recently revised the OIC application package, Form 656. The new instructions include additional direction and guidance to help taxpayers avoid submitting un-processable OICs. We received considerable input from internal and external stakeholders that went into the development of the revised Form 656 package. Because of the improved instructions, we believe we will receive fewer un-processable OICs in FY05.

- 5. The Chief of Appeals has indicated that 86% of all offers rejected are appealed. Does the IRS have research identifying the number of rejected offers reversed on appeal? If so, please provide. Does the IRS have a system for reviewing the reasons why reversed decisions were not resolved correctly through initial contact with the IRS? If so, please provide. Has the IRS provided feedback to employees so that corrective actions can be taken to promote a reduction in cases going to Appeals?**

Data shows taxpayers appeal 58 percent of rejected OICs. The Chief of Appeals has validated this percentage and confirmed they previously used an incorrect figure. Appeals accepts offers from 30 percent of those taxpayers. Many involve situations where taxpayers provide information to Appeals that they did not submit to OIC personnel. Others involve taxpayers increasing their offers during the appeals process.

OIC program management communicates regularly with Appeals to identify issues contributing to OIC rejections that Appeals routinely reverses. For example, the Small Business/Self-Employed (SB/SE) Division revised its approach to evaluating transportation expenses. The ongoing sharing of information with Appeals was a major contributing factor to this revision. Additionally, SB/SE and Appeals have scheduled a comprehensive review of rejected OIC cases that Appeals subsequently accepted. This joint review, the first since the OIC program was revamped, is scheduled for the first quarter of FY05. It will give both organizations a comprehensive analysis of this issue and could lead to additional process changes.

- 6. Describe the case quality measures for the field and centralized offers-in-compromise program. Does the IRS conduct a separate customer satisfaction survey of the offers-in-compromise program? If so, please provide detailed information, including the adequacy of the survey sample size.**

We are in the process of implementing an improved quality measurement system in our OIC operations. We implemented this new process in the COIC operation this fiscal year and we anticipate implementing it in the OIC field operation during FY05. The enhanced system better links to the evaluations of employees actually conducting OIC casework and measures various aspects of quality in areas such as procedural accuracy, regulatory accuracy, timeliness, customer accuracy, and professionalism.

While we do not conduct a separate OIC program customer satisfaction survey, the enhancements outlined above will provide information to assist in addressing factors impacting customer satisfaction.

- 7. Taxpayers sometimes submit offers based on both doubt as to collectibility (DATC) and doubt as to liability (DATL). It is our understanding that the IRS first processes the DATC component before determining whether the taxpayer actually owes the tax, in whole or in part (DATL). Please explain the IRS rationale for this processing approach.**

We have found that in cases where the taxpayer requests consideration of an OIC on the basis of both doubt as to collectibility (DATC) and doubt as to liability (DATL), liability issues rarely exist. Generally, these cases involved requests for interest and/or penalty abatements or other adjustments to the balances due that do not require re-examination of the tax returns. Our assessment is that taxpayers who request both DATC and DATL consideration are generally trying to cover all options when in reality DATC is the appropriate option. Therefore, we process the DATC aspect of combination offers first. If the recommendation is to reject the DATC offer, we forward it to examination personnel for consideration.

In the past, examination consideration of DATL offers involved a lengthy and costly process. We recently completed a pilot project that involved centralizing the processing of DATL claims. We found that one unit can efficiently process most DATL offers. We plan to implement this approach in FY05. We believe processing all DATL OICs in one unit at the Brookhaven Service Center will enable them to service these requests in a much timelier manner.

Recently, the National Taxpayer Advocate (NTA) commented that, in combination cases where the IRS accepts an offer based on DATC, current procedures assume the DATL claim is moot and not considered. We are revising our procedures to ensure taxpayers clearly understand that they can request consideration of a DATL offer to continue in this situation if a legitimate concern about the validity of the tax liability exists. We have asked the NTA for specific examples of cases that involve this issue, which we can use to further improve the processing of OIC cases.

- 8. When a DATC offer is submitted, we understand that the IRS first determines whether the taxpayer can full-pay the outstanding liability, based on information provided by the taxpayer on financial statements. Further, we understand that in making this determination, the IRS calculates the ability to**

pay, in part by computing the monthly installment payment the taxpayer can pay for the remainder of the statutory collection period, plus 5 years. Please explain the IRS's basis for this decision, particularly in light of the IRS's policy statement language that an offer is a viable collection alternative to a protracted installment agreement.

The law permits the IRS to ask a taxpayer to extend the collection statute in conjunction with the acceptance of an installment agreement. IRS policy limits these extensions to five years.

One of the considerations during the evaluation of an OIC is whether a taxpayer can full pay the liability within the parameters of an installment agreement, i.e., the time remaining until the collection statute expiration date, plus five years.

As I mentioned before, the OPERA analysis on returned and rejected OICs showed a need for the IRS to revisit this concept and decide if the approach is the most appropriate way to consider OIC applications. We are looking for and evaluating data that will assist in determining if the reasonable collection potential calculations that result from this approach are reasonable and realistic.

- 9. We understand that the IRS has recently implemented a user fee for offers. Taxpayers whose offers have initially passed screening for full-pay and initial processability will be returned, without appeal rights, and the user fee retained, if they do not respond to an IRS request for additional information. Other taxpayers who have offers returned without appeal rights have their user fee refunded. Why is there a difference in handling of user fees between these two types of returned offers? How many of these taxpayers resubmit offers? What happens when these offers are re-submitted (e.g., are taxpayers required to pay the user fee again)?**

We refund the OIC application fee to taxpayers who submit un-processable offers. Please refer to the outline in question 4 about items considered during the processability determination. We can identify these conditions with little investment of resources.

The application fee regulations specify, however, that the IRS will not refund the fee to taxpayers whose offers the IRS returns after initial acceptance for processing. Generally, returns following a determination that an offer was "processable" result when taxpayers fail to provide complete and timely responses to IRS requests for additional information. In these situations, we have invested considerable resources in a processability determination, application fee processing, and initial financial analysis. If these taxpayers choose to submit another OIC at a later date, they must pay another application fee. The ongoing OPERA analysis will provide additional information about offer resubmissions.

These return procedures have been valuable in our efforts to process the entire OIC inventory in a timely and responsible manner. Past analysis showed that multiple follow-ups on requests for additional information contributed to inventory backlogs. We based its return procedures on the concept that inappropriate delays by some should not negatively impact its ability to provide timely service to all. The IRS believes requiring taxpayers who want OIC approval to respond timely and completely to requests for information necessary to fully process their cases is reasonable. In FY04, 40 percent of the cases in our COIC operations where the IRS accepted the offer package for processing, but later returned it to the taxpayer, involved taxpayers who did not provide a response to requests for additional information.

We continue to evaluate our return procedures this year to ensure all returns are reasonable and appropriate. For example, in situations where taxpayers made substantially complete responses to additional information requests, but did not include some information, they try an additional contact to obtain the missing information before returning the OIC. We also developed reconsideration procedures to address situations where taxpayers could not respond due to circumstances beyond their control. Returns following initial acceptance for processing have declined 30 percent in FY04, a good indication that the revised procedures are working as intended.

10. Please describe the implementation of the conference report language pertaining to effective tax administrations (ETA) offers, including the issuance and implementation of Treasury regulation section 301.7122-1(c)(3). What is the process for identifying offers based on equitable considerations and public policy, particularly where the taxpayer does not specifically check the "ETA" box on Form 656? Which employees and/or managers identify these offers? Please provide us with copies of any guidance, training, desk procedures, and check sheets that assist IRS employees in identifying these offers.

The Treasury Department published temporary and proposed regulations expanding the IRS' authority to compromise in July 1999 and adopted them as final regulations in July 2002. In adopting the final regulations on compromise based on public policy or equity, the IRS committed to a three-pronged implementation plan to:

- (1) Conduct training for all offer specialists in identifying such cases
- (2) Establish a specialized group of offer specialists to work the cases
- (3) Periodically convene a "policy-level" group, with representatives from SB/SE, Appeals, NTA, and the Office of Chief Counsel, to review closed cases and determine whether further guidance is needed

We developed procedures for identifying and working OICs on the basis of effective tax administration (ETA) and issued them in Internal Revenue Manual, IRM 5.8.11 (copy enclosed). We trained all OIC investigators on ETA issues in FY03. I also enclosed a copy of this material for your review. Our procedures direct OIC investigators to be aware of issues for consideration under the ETA criteria, and give full consideration to

those issues even in situations where taxpayers did not specifically check the ETA box on Form 656.

Because we give full consideration to ETA criteria regardless of whether the ETA box is checked and because many taxpayers check the ETA box when the DATC box is more appropriate, we have not systemically tracked the number of OICs involving requests for ETA consideration.

11. We understand that a separate group of Revenue Officers (RO) evaluates “non-hardship” ETA offers. How many levels of review does such an offer go through prior to being evaluated by this group? Do ROs in this group discuss these offers with taxpayers or their representatives prior to rejection? If not, please explain. How many “non-hardship” ETA offers were accepted in fiscal years 2002 and 2003 and fiscal year 2004 to date?

Our response to questions 11 and 12 are combined below.

12. What factors does the IRS take into consideration in determining whether to accept or reject a non-hardship ETA offer? What is the difference, if any, between the analysis of non-hardship ETA offers and DATC offers raising special circumstances? Are DATC offers raising special circumstances involving equity and public policy also considered by the ETA group?

The “non-hardship” ETA OIC is a situation where no doubt that the liability is valid exists, and the taxpayer has the financial ability to pay the delinquency in full. Additionally, payment of the tax would not create an economic hardship on the taxpayer. However, due to the circumstances of the case, the inequity of requiring the taxpayer to pay the entire liability would be so apparent that as a matter of IRS policy, the IRS should allow the taxpayer to compromise the tax debt for less than the amount owed. In theory, this component of the OIC program was designed to allow the IRS to settle difficult or unusual cases, where other collection alternatives did not seem appropriate. In practice, however, we have found very few cases meet these criteria.

In FY03, we decided to centralize the processing of non-hardship ETA OICs in one field group in Cincinnati, Ohio. We did this to ensure consistency in processing these cases and to facilitate oversight of the process. This summer, representatives from SB/SE, TAS, Counsel, and Appeals reviewed this process. The group reviewed the work papers of all referrals into the ETA group and all OICs worked to completion within the group during its first year of operation. Although the group identified opportunities to improve the referral process and document case decisions, the review team did not identify any cases in which the IRS rejected an offer it should have accepted as a “non-hardship” ETA OIC.

One of the charges of the review team was to identify examples of issues or factors that could warrant the acceptance of an ETA OIC. While they did not identify any one issue or factor that standing alone would routinely warrant the acceptance of an ETA offer,

they did recognize a combination of factors that lead the IRS to accepting such an offer. We expect to issue enhanced directions, including these examples to SB/SE and Appeals in FY05.

The analysis indicates the most problematic component of the “non-hardship” ETA OIC involves the requirement that the taxpayer have a clear ability to full pay the tax liability without creating economic hardship. While the NTA has shared anecdotal and theoretical examples of such cases, they have not provided any actual cases where compromise on the basis of public policy or equity was clearly the appropriate resolution for the tax debt. The examples they have provided as potential candidates, as well as many of the cases included in the joint review, would actually create the appearance of inequity if the IRS did accept the offers. Routine acceptance of offers in such cases would have a detrimental impact on voluntary compliance.

We believe cases that could warrant consideration as “non-hardship” ETA offers are actually resolved through the OIC program earlier in the process. Generally, experience shows that the inequitable conditions that contribute to the tax delinquencies also tend to create economic hardship on the affected taxpayers. We routinely accepts ETA OICs based on economic hardship, as well as doubt as to collectibility OICs involving special circumstances. These OIC categories are worked within all OIC field groups, as well as COIC. Because DATC OICs with special circumstances do not involve situations where the taxpayers can clearly full pay the tax debts, the ETA group does not control them. Rather, we handle them as routine cases and local management has the authority to approve these case decisions.

13. What guidance has the IRS issued to its employees (including training guides, IRM, memoranda, and desk guides for OIC, RO and Appeals employees) pertaining to the implementation of the provision in the RRA 98 Conference Report directing the IRS to compromise long-standing cases where penalty and interest have accrued because of delay in determining the tax liability? What is the IRS’s position about the interplay between that language and interest abatement under IRC 6404(e)?

We have not issued any internal guidance that specifies when delays in determining the liability will represent compelling public policy or equity considerations justifying compromise under the regulations. We evaluate such cases on their particular facts and circumstances. The preamble to the final regulations sets forth the IRS’ position on the interplay between compromise authority under section 7122 and the authority to abate interest under section 6404(e) as follows:

“The IRS and Treasury Department do not believe that it would promote effective tax administration to authorize compromise solely on the basis of an asserted delay by the IRS, particularly delay that does not support relief under section 6404(e) with respect to accrued interest . . . Nevertheless, cases in which a taxpayer believes the liability was caused, in whole or in part, by delay on the part of the IRS . . . may be appropriate for compromise under the public policy and equity standard. Such

cases, however, are expected to be rare, as the taxpayer must identify compelling public policy or equity concerns that satisfy the standard set forth above.”

(Compromise of Tax Liabilities, 67 Fed. Reg. 48025, 48027) (July 23, 2002).

We do not interpret section 7122 to preclude the compromise of interest whenever the IRS denies abatement under section 6404. We do, however, continue to adhere to the principle that the IRS should never exercise settlement authority in a manner that would cavalierly disregard the effect of settlement policy, or a particular settlement, on the administration of other provisions of the Code. Using the interest abatement provisions as an example, our view is that the compromise of interest, whether or not the interest is subject to abatement under section 6404, should take place only under the standards articulated in the compromise regulations. We have in fact used its settlement authority to compromise interest attributable to delays by IRS employees. In such situations, the accepting official has determined that the standard in the regulations is met and that the circumstances are of such a compelling and unique nature that the interest abatement rules of section 6404 are not undermined by the compromise of interest on fairness grounds.

14. What guidance has the IRS issued to its employees (including training guides, IRM, memoranda, and desk guides for OIC, RO, and Appeals employees) pertaining to the compromise of liabilities attributable to the Alternative Minimum Tax arising from the exercise of incentive stock options?

We have issued no formal guidance to its employees specifically pertaining to the compromise of liabilities attributable to the Alternative Minimum Tax issue. However, we have issued the following guidance in IRM 5.8.11.2.2(3):

“Compromise on public policy or equity grounds is not authorized based solely on a taxpayer’s belief that a provision of the tax law is itself unfair. Where a taxpayer is clearly liable for taxes, penalties, or interest due to operation of law, a finding that the law is unfair would undermine the will of Congress in imposing liability under those circumstances.”

The Alternative Minimum Tax’s interaction with incentive stock options is a component of the Tax Code that falls within this direction.

In closing, administration of the OIC program in a manner that ensures the IRS makes reasonable collection decisions, with the proper context of fairness for all taxpayers, is challenging. For several years, the NTA has reported the OIC program as one of the most significant problems facing taxpayers in dealing with the IRS. While the NTA may believe this to be true, the IRS notes that less than 1 percent of all IRS collection cases are actually resolved through the OIC process. In addition, OIC matters account for less than 2 percent of TAS’ total workload. Based on the Taxpayer Advocate Management Information System (TAMIS), this percentage has been consistent over the last three years.

I believe we have made significant progress in improving the OIC program over the past several years and will continue to seek ways to make further improvements.

I am sending a similar response to Senator Grassley. I would be happy to meet with you to discuss these issues. If you have questions or would like to schedule a meeting, please contact me or Floyd Williams, National Director, Office of Legislative Affairs at (202) 622-9511.

Sincerely,

A handwritten signature in black ink, appearing to read "Mark W. Everson". The signature is fluid and cursive, with the first name "Mark" being the most prominent.

Mark W. Everson

Enclosures (3)

PURPOSE

- (1) This transmits a change to IRM 5.8, Offer in Compromise, Section 11 - Effective Tax Administration.

NATURE OF CHANGES

- (1) This transmittal issues the following changes:
- Section 5.8.11.1(5) - Adds language to clarify that economic hardship standards only apply to individuals.
 - Section 5.8.11.2(3)b - Changes detriment to voluntary compliance to public policy or equity
 - Section 5.8.11.2(4) - Changes to public policy or equity
 - Section 5.8.11.2.1 - Rewrite of this section and clarification that economic hardship offers only apply to individuals.
 - Section 5.8.11.2.2 - Rewrite of this section under the new definition of Public Policy or Equity.
 - Section 5.8.11.3(3) - Adds a note that the ETA economic hardship only applies to individuals
 - Section 5.8.11.4(2) - Describes initial steps in determining whether effective tax administration should be considered.
 - Section 5.8.11.4(3) - Adds the requirement to address potential special circumstances on the first personal contact.
 - Section 5.8.11.4.2(2) - Changes language to public policy or equity.
 - Section 5.8.11.6(2) - Changes the If-Then chart to reflect the current AOIC procedures.

AUDIENCE

SB/SE Compliance employees

Cheryl Sherwood
Director
Payment Compliance

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5.8.11.1 (05-15-2004) Overview

- (1) As part of the IRS Restructuring and Reform Act of 1998 (RRA 98), Congress added section 7122(c) to the Internal Revenue Code. That section provides that the Service shall set forth guidelines for determining when an offer in compromise should be accepted. Congress explained that these guidelines should allow the Service to consider:

- Hardship,
- Public policy, and
- Equity

Treasury Regulation 301.7122-1 authorizes the Service to consider offers raising these issues. These offers are called Effective Tax Administration (ETA) offers.

- (2) The availability of an Effective Tax Administration (ETA) offer encourages taxpayers to comply with the tax laws because taxpayers will:

- Believe the laws are fair and equitable, and
- Gain confidence that the laws will be applied to everyone in the same manner.

The Effective Tax Administration (ETA) offer allows for situations where tax liabilities should not be collected even though:

- The tax is legally owed, and
- The taxpayer has the ability to pay it in full.

- (3) If a taxpayer submits an Effective Tax Administration (ETA) offer, first investigate the offer for:

- Doubt as to Liability (DATL), and/or
- Doubt as to Collectibility (DATC).

An Effective Tax Administration (ETA) offer can only be considered when the Service has determined that the taxpayer does not qualify for consideration under Doubt as to Liability (DATL) and/or Doubt as to Collectibility (DATC).

The taxpayer must include the Collection Information Statement (Form 433-A and/or Form 433-B) when submitting an offer requesting consideration under Effective Tax Administration (ETA).

- (4) Economic hardship standard of § 301.6343-1 specifically applies only to individuals.

5.8.11.2 (05-15-2004) Legal Basis for Effective Tax Administration Offer

- (1) **Compared to Doubt as to Collectibility (DATC)**
In a Doubt as to Collectibility (DATC) offer, the tax liability equals or exceeds the taxpayer's reasonable collection potential (RCP) which is:

- Net equity, plus
- Future income

In an Effective Tax Administration (ETA) offer, the tax liability is less than the taxpayer's reasonable collection potential (RCP). The taxes owed can be collected in full either:

- In a lump sum, or
- Through an installment agreement (IA)

A Doubt as to Collectibility (DATC) offer does not convert to an Effective Tax Administration (ETA) offer if the Offer Investigator and the taxpayer cannot agree on an acceptable offer amount.

(2) **Compared to Doubt as to Collectibility with Special Circumstances (DCSC)**

Taxpayers may qualify for an Effective Tax Administration (ETA) offer when their reasonable collection potential (RCP) is greater than the liability but there are economic or public policy/equity circumstances that would justify accepting the offer for an amount less than full payment.

Example: The taxpayer owes \$20,000. The reasonable collection potential (RCP) is \$25,000. The taxpayer could have an offer accepted for less than the total liability of \$20,000 under the Effective Tax Administration (ETA) provisions if economic hardship, or public policy/equity issues exist which would support an acceptance recommendation.

Taxpayers could have an offer accepted under Doubt as to Collectibility with Special Circumstance (DCSC) when their reasonable collection potential (RCP) is less than their liability, but there are economic hardship or public policy/equity factors that would justify accepting the offer for an amount less than the reasonable collection potential (RCP).

Example: The taxpayer owes \$20,000. However his reasonable collection potential (RCP) is \$15,000. The offer does not meet the legal basis for an Effective Tax Administration (ETA) because the RCP is lower than the liability. However, applying the same factors of economic hardship, or public policy/equity, an offer could be accepted for less than the RCP (\$15,000) under Doubt as to Collectibility with Special Circumstance (DCSC) provisions.

(3) **Compared to Doubt as to Liability**

An offer can be considered under Effective Tax Administration (ETA) provisions only when there are no doubt to liability issues.

(4) In reaching these determinations:

If...	Then...
The Service determines that there is doubt as to the amount of the liability the taxpayer owes	Taxpayer is not eligible for Effective Tax Administration (ETA) consideration. The offer is considered based on the Doubt as to Liability (DATL) issue.
The Service determines that the taxpayer's equity in assets plus future income (RCP) does not exceed the amount of the tax liability	Taxpayer is not eligible for an Effective Tax Administration offer. The offer is considered based on Doubt as to Collectibility (DATC). However, hardship or public policy/equity may be present in the case to allow consideration under Doubt as to Collectibility with Special Circumstances (DCSC).

If...	Then...
<p>The Service determines the taxpayer is not eligible for compromise based on Doubt as to Liability (DATL) or Doubt as to Collectibility (DATC) and the taxpayer can demonstrate that collection of the tax liability in full would create economic hardship, or demonstrate that there is compelling public policy or equity issues in the case that would provide sufficient basis for compromise</p>	<p>The taxpayer would be eligible for Effective Tax Administration (ETA) consideration.</p>

- (5) Before we can consider a compromise based on economic hardship or public policy/equity considerations, three factors must exist:
 - a. A liability has been or will be assessed against taxpayer(s) before acceptance of the offer.
 - b. The net equity in assets plus future income or reasonable collection potential (RCP) must be greater than the amount owed.
 - c. Exceptional circumstances exist, such as the collection of the tax would create an economic hardship, or there is compelling public policy or equity considerations that provide sufficient basis for compromise.

5.8.11.2.1
 (05-15-2004)
Economic Hardship

- (1) When a taxpayer's liability can be collected in full but collection would create an economic hardship, an Effective Tax Administration (ETA) offer based on economic hardship can be considered.
- (2) The definition of economic hardship as it applies to Effective Tax Administration (ETA) offers is derived from Treasury Regulations 301.6343-1. Economic hardship occurs when a taxpayer is unable to pay reasonable basic living expenses. The determination of a reasonable amount for basic living expenses will be made by the Commissioner and will vary according to the unique circumstances of the individual taxpayer. Unique circumstances, however, do not include the maintenance of an affluent or luxurious standard of living.

Note: Because economic hardship is defined as the inability to meet reasonable basic living expenses, it applies only to individuals (including sole proprietorship entities). Compromise on economic hardship grounds is not available to corporations, partnerships, or other non-individual entities.

- (3) The taxpayer's financial information and special circumstances must be examined to determine if they qualify for an effective Tax Administration (ETA) offer based on economic hardship. Financial analysis includes reviewing basic living expenses as well as other considerations.
- (4) The taxpayer's income and basic living expenses must be considered to determine if the claim for economic hardship should be accepted. Basic living expenses are those expenses that provide for health and welfare and production of income of the taxpayer and the taxpayer's family. Some basic living expenses are limited to the National Standards while other expenses are limited to Local Standards. Deviation from these standards is permissible if and when the taxpayer is able to justify expenses that exceed these limits.

(5) In addition to the basic living expenses, other factors to consider that impact upon the taxpayer's financial condition include:

- The taxpayer's age and employment status,
- Number, age and health of the taxpayer's dependents,
- Cost of living in the area the taxpayer resides, and
- Any extraordinary circumstances such as special education expenses, a medical catastrophe or natural disaster.

Note: This list is not all-inclusive. Other factors may be considered in making an economic hardship determination.

(6) Factors that support an economic hardship determination may include:

1. The taxpayer is incapable of earning a living because of a long term illness, medical condition, or disability and it is reasonably foreseeable that the financial resources will be exhausted providing for care and support during the course of the condition.
2. The taxpayer may have a set monthly income and no other means of support and the income is exhausted each month in providing for the care of dependents.
3. The taxpayer has assets, but is unable to borrow against the equity in those assets, and liquidation to pay the outstanding tax liability(s) would render the taxpayer unable to meet basic living expenses.

Note: These factors are representative of situations the Service regularly encounters when working with taxpayers to resolve delinquent accounts. They are not intended to provide an exhaustive list of the types of cases that can be compromised based on economic hardship.

(7) Compromise under the Effective Tax Administration (ETA) economic hardship provision is permissible if acceptance does not undermine compliance. The public should not perceive that the taxpayer whose offer is accepted benefited by not complying with the tax laws. Factors supporting a determination that compromise would undermine compliance include, but are not limited to:

- The taxpayer has a history of noncompliance with the filing and payment requirements of the Internal Revenue Code.
- The taxpayer has taken deliberate actions to avoid the payment of taxes.
- The taxpayer has encouraged others to refuse to comply with the tax laws.

Note: There may be other situations where compromise would be undermined.

(8) The following examples illustrate the types of cases that may be compromised under the economic hardship standard.

Example: The taxpayer has assets sufficient to satisfy the tax liability and provides full time care and assistance to a dependent child, who has a serious long-term illness. It is expected that the taxpayer will need to use the equity in assets to provide for adequate basic living expenses and medical care for the child. The taxpayer's overall compliance history does not weigh against compromise.

Example: The taxpayer is retired and the only income is from a pension. The only asset is a retirement account and the funds in the account are sufficient

to satisfy the liability. Liquidation of the retirement account would leave the taxpayer without adequate means to provide for basic living expenses. The taxpayer's overall compliance history does not weigh against compliance.

Example: The taxpayer is disabled and lives on a fixed income that will not, after allowance of adequate basic living expenses, permit full payment of the liability under an installment agreement. The taxpayer also owns a modest house that has been specially equipped to accommodate for a disability. The equity in the house is sufficient to permit payment of the liability owed. However, because of the disability and limited earning potential, the taxpayer is unable to obtain a mortgage or otherwise borrow against this equity. In addition, because the taxpayer's home has been specially equipped to accommodate the disability, forced sale of the taxpayer's residence would create severe adverse consequences for the taxpayer, making such a sale unlikely. The taxpayer's overall compliance history does not weigh against compliance.

- (9) The economic hardship standard authorizes compromise regardless of the cause of the liability, provided compromise does not undermine compliance by other taxpayers.

Example: The taxpayer submitted an Effective Tax Administration (ETA) offer based on economic hardship. The financial statement appears to support the offer. When a research of the county property records is conducted, it is noted that the home was transferred to a child for \$100 plus love and affection. The transfer of the home was made after the tax was assessed. It is confirmed that deliberate actions were taken to avoid the payment of tax, therefore the offer should not be accepted.

Note: Regardless of the economic hardship issue, the Service will not accept an offer when it is demonstrated that acceptance would undermine compliance.

- (10) In economic hardship cases, an acceptable offer amount is determined by analyzing the financial information, supporting documentation, and the hardship that would be created if certain assets, or a portion of certain assets, were used to pay the liability.

Example: The taxpayer was diagnosed with an illness that eventually will hinder any ability to work. Although currently employed, the taxpayer will soon be forced to quit their job and use personal funds for basic living expenses. The taxpayer owes \$100,000 and has a reasonable collection potential of \$150,000. An offer was submitted for \$35,000. Through the investigation, it is determined that collecting more than \$50,000 would cause an economic hardship for the taxpayer since it would hinder the ability to meet reasonable living expenses, including ongoing medical expenses. The taxpayer is advised to raise the offer to \$50,000 since it is an amount the Service can collect without creating an economic hardship.

- (11) The existence of economic hardship criteria does not dictate that an offer must be accepted. An acceptable offer amount must still be determined based on a full financial analysis and negotiation with the taxpayer. When hardship criteria are identified but the taxpayer does not offer an acceptable amount, the offer should not be recommended for acceptance.

5.8.11.2.2
(05-15-2004)
**Public Policy or Equity
Grounds**

- (1) Where there is no Doubt as to Liability (DATL), no Doubt as to Collectibility (DATC), and the liability could be collected in full without causing economic hardship, the Service may compromise to promote Effective Tax Administration (ETA) where compelling public policy or equity considerations identified by the taxpayer provide a sufficient basis for accepting less than full payment. Compromise is authorized on this basis only where, due to exceptional circumstances, collection in full would undermine public confidence that the tax laws are being administered in a fair and equitable manner. Because the Service assumes that Congress imposes tax liabilities only where it determines it is fair to do so, compromise on these grounds will be rare.
- (2) The Service recognizes that compromise on these grounds will often raise the issue of disparate treatment of taxpayers who can pay in full and whose liabilities arose under substantially similar circumstances. Taxpayers seeking compromise on this basis bear the burden of demonstrating circumstances that are compelling enough to justify compromise notwithstanding this inherent inequity.
- (3) Compromise on public policy or equity grounds is not authorized based solely on a taxpayer's belief that a provision of the tax law is itself unfair. Where a taxpayer is clearly liable for taxes, penalties, or interest due to operation of law, a finding that the law is unfair would undermine the will of Congress in imposing liability under those circumstances.

Example: The taxpayer argues that collection would be inequitable because the liability resulted from a discharge of indebtedness rather than from wages. Because Congress has clearly stated that a discharge of indebtedness results in taxable income to the taxpayer it would not promote Effective Tax Administration (ETA) to compromise on these grounds. See Internal Revenue Code (IRC) 61(a)(12).

Example: In 1983, the taxpayer invested in a nationally marketed partnership which promised the taxpayer tax benefits far exceeding the amount of the investment. Immediately upon investing, the taxpayer claimed investment credits that significantly reduced or eliminated the tax liabilities for the years 1981 through 1983. In 1984, the IRS opened an audit of the partnership under the provisions of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). After issuance of the Final Partnership Administrative Adjustment (FPAA), but prior to any proceedings in Tax Court, the IRS made a global settlement offer in which it offered to concede a substantial portion of the interest and penalties that could be expected to be assessed if the IRS's determinations were upheld by the court. The taxpayer rejected the settlement offer. After several years of litigation, the partnership level proceeding eventually ended in Tax Court decisions upholding the vast majority of the deficiencies asserted in the FPAA on the grounds that the partnership's activities lacked economic substance. The taxpayer has now offered to compromise all the penalties and interest on terms more favorable than those contained in the

prior settlement offer, arguing that TEFRA is unfair and that the liabilities accrued in large part due to the actions of the Tax Matters Partner (TMP) during the audit and litigation. Neither the operation of the TEFRA rules nor the TMP's actions on behalf of the taxpayer provide grounds to compromise under the equity provision of paragraph (b)(4)(i)(B) of this section. Compromise on those grounds would undermine the purpose of both the penalty and interest provisions at issue and the consistent settlement principles of TEFRA. Depending on the taxpayer's particular facts and circumstances, however, compromise may be authorized on the grounds of Doubt as to Collectibility (DATC), or because collection of the full liability would cause an economic hardship within the meaning of paragraph (b)(4)(i)(A) of this section.

Note: In both of these examples, the taxpayers are essentially claiming that Congress enacted unfair statutes and are arguing that the Service should use its compromise authority to rewrite those statute based on a perception of unfairness. Compromise for that reason would not promote effective tax administration. The compromise authority under Section 7122 is not so broad as to allow the Service to disregard or override the judgments of Congress.

- (4) Section 6404(e) grants the Service the discretion to abate interest attributable to certain errors and delays by the Service. It would not promote Effective Tax Administration (ETA) to compromise a liability based solely on an assertion of delay by the Service if that delay would not support relief from interest under section 6404(e).
- (5) Compromise may promote Effective Tax Administration (ETA) where the taxpayer was incapacitated and thus unable to comply with the tax laws.

Example: In October 1986, the taxpayer developed a serious illness that resulted in almost continuous hospitalization for a number of years. The medical condition was such that during this period, the taxpayer was unable to manage any of their financial affairs. The taxpayer has not filed tax returns since that time. The taxpayer's health has now improved and has promptly begun to attend to tax matters. The taxpayer discovered that the IRS prepared a substitute for return for the 1986 tax year based on information documents received and assessed a tax deficiency. When the taxpayer discovered the liability, with penalties and interest, the tax bill was more than three times the original tax liability. The taxpayer's overall compliance history does not weigh against compromise.

Note: In this situation, the Service should first work with the taxpayer and attempt to prepare an accurate return for the 1986 tax year and adjust the taxpayer's account accordingly. Following that, the Service should consider accepting a compromise that would approximate the amount the taxpayer would have had there been an ability to comply with his filing and payment responsibilities in a timely manner. Such a compromise would be fair and equitable to the taxpayer and, under these circumstances, would advance the public policy of voluntary compliance with the tax laws.

- (6) It would not promote Effective Tax Administration (ETA) to compromise with the taxpayer in (5), above, if the investigation revealed that the taxpayer was able to attend to matters other than those due in 1986 during the time of the illness. For example, assume the taxpayer discussed, paid all other bills and

continued to successfully operate a business during the illness. Under such circumstances, compromise would not promote Effective Tax Administration (ETA), and could serve to undermine compliance by other taxpayers.

- (7) Compromise may promote Effective Tax Administration (ETA) where the taxpayer's liability was caused by reasonable reliance on a statement issued by the Service that caused the taxpayer to incur a tax liability that would not otherwise have been incurred.

Example: The taxpayer is a salaried sales manager at a department store who has been able to place \$2,000 in a tax-deductible IRA account for each of the last two years. The taxpayer learns that a higher rate of interest can be earned on his IRA savings by moving the savings from a Money Management account to a Certificate of Deposit at a different financial institution. Prior to transferring the savings, the taxpayer submits an E-mail inquiry to the IRS at its Web Page, requesting information about the steps needed to preserve the tax benefits currently enjoyed and to avoid any penalty. The IRS responds by answering the E-mail that the taxpayer may withdraw the IRA savings from the neighborhood bank, but it must redeposit in a new IRA account within 90 days. The taxpayer withdraws the funds and redeposits them in a new IRA account 63 days later. Upon audit, the taxpayer learns that he has been misinformed about the required rollover period and is now liable for additional taxes, penalties and interest for not redepositing the amount within 60 days. Had the advice provided been accurate, the taxpayer would have redeposited the funds timely. The taxpayer retained a copy of the IRS E-mail for his records. The taxpayer's overall compliance history does not weight against compromise.

Note: Because the tax liability in this example was caused by relying on the Service's erroneous statement, and the taxpayer clearly could have avoided the liability had the Service given correct information, it is reasonable to conclude that collection in full would cause other taxpayers to question the fairness of the tax system. The Service may consider accepting a compromise that would reflect the amount the taxpayer would now owe had the service not made an error.

- (8) Compromise may also promote Effective Tax Administration (ETA) where a taxpayer's liability was directly caused by the Service and through no fault of the taxpayer.

Example: The taxpayer is a closely-held corporation. The IRS audited the taxpayer's tax returns for 1996, 1997, and 1998 and determined that the taxpayer was a personal holding company liable for personal holding company tax. The taxpayer agreed to immediate assessment of the tax, but attempted to take advantage of the deduction for deficiency dividends under section 547. Although the taxpayer made the distributions necessary to qualify for the deduction, the IRS made several errors in executing the required agreements and other paperwork. As a result, the taxpayer could not avail itself of the section 547 deduction. Under the statute, application regulations, and pertinent case law, there is no means by which the mistakes can be corrected to allow the taxpayer to take advantage of the deduction. There is documentary evidence that all of

the required Service officials intended to complete the processing of the agreements and that, but for their failure to do so, the taxpayer would have qualified for the deduction. The taxpayer has no prior history of noncompliance.

Note: That the tax liability was caused by an error on the part of the Service supports the determination that collection in full would cause other taxpayers to question the fairness of the tax system. Furthermore, the policies underlying the imposition of the personal holding company tax and the rules regarding deficiency deductions are not undermined by compromise under these circumstances. The Service may consider accepting a compromise that would reflect the amount the taxpayer would now owe had the Service not made an error.

- (9) In contrast, compromise would not be authorized based on mistakes by the Service that did not cause the tax liability. For example, providing an incorrect statement of the balance due does not authorized the compromise of additional interest that may have later accrued. However, any relief from interest attributable to errors or delays by the Service should be granted under the standards set forth in section 6404(e). Compromise that would undermine those standards would not promote Effective Tax Administration (ETA). Similarly, relief from penalties attributable to errors by the Service should be granted pursuant to the standards for relief set forth in section 6404(d) and the IRM.
- (10) The Service will not compromise on public policy or equity grounds based solely on the argument that the acts of a third party caused the unpaid tax liability. Third parties include the taxpayers:
- Representative,
 - Partner,
 - Agent, or
 - employee

Note: The actions of a third party may be part of a fact pattern that, viewed as a whole, presents compelling public policy or equity concerns justifying compromise. As with all compromises based on public policy or equity, the taxpayer's situation must be compelling enough to justify compromise even though similarly situated taxpayers may have paid in full.

- (11) Compromise on public policy or equity grounds promotes Effective Tax Administration (ETA) only where it does not undermine compliance by other taxpayers. In general, compromise would undermine compliance where other taxpayers viewing the compromise may conclude that the taxpayer benefited from a failure to comply with the tax laws (i.e. the result of the compromise places the taxpayer in a position better than they would occupy had they timely and fully met their obligations). Such cases present the danger that other taxpayers may consider it beneficial to take the chance of not complying with the tax laws or litigating an issue they would otherwise concede or settle, and relying on compromise at some later date as a safety net. Factors supporting a determination that compromise would undermine include, but are not limited to:
- The taxpayer has a history of noncompliance with the filing and payment requirements of the Internal Revenue Code.
 - The taxpayer has taken deliberate actions to avoid the payment of taxes.

- The taxpayer has encouraged others to refuse to comply with the tax laws.

Note: Additional factors such as the cause of the delinquency, length of non-compliance, and efforts to resolve non-compliance should also be considered. Generally a review of the last 3–5 years of compliance should be completed.

- (12) Once it has been determined that a case raises compelling public policy of equity considerations justifying compromise, the Service must still determine whether the amount offered by the taxpayer should be accepted to resolve the case. An acceptable offer amount should be based on a determination of what is fair and equitable under the circumstances. When public policy or equity considerations are identified but the taxpayer does not offer an acceptable amount, the offer should not be recommended for acceptance.

5.8.11.2.3
(11-01-2000)
Compromise Would Not Undermine Compliance With Tax Laws

- (1) No compromise to promote Effective Tax Administration (ETA) may be entered into if compromise of the liability would undermine compliance by taxpayers with the tax laws. See IRM 5.8.11.2.1(7), 5.8.11.2.1(9) and 5.8.11.2.2(11) for additional information.

5.8.11.3
(05-15-2004)
Initial Processing of Effective Tax Administration Offers

- (1) Offers submitted under the basis of Effective Tax Administration (ETA) will be worked either by the COIC units or field specialists.
- (2) Taxpayers seeking a compromise under Effective Tax Administration (ETA) will submit the Form 656, Offer in Compromise, selecting ETA in Item 6, along with the Collection Information Statement (CIS) Form 433-A and/or Form 433-B. Taxpayers must complete the Form 656, Item 9 and document their special circumstances. The documentation should explain why collection of the liability in full would cause economic hardship, or the public policy/equity issues present that would justify compromising the liability. An additional attachment can be provided if additional space is needed. If the taxpayer does not submit a financial statement with the offer, normal correspondence activity should be undertaken to secure the financial statement, and any other data determined necessary for evaluation of the offer. If the taxpayer fails to provide the requested information, normal "return" procedures should be followed since Effective Tax Administration (ETA) criteria can not be considered until all other bases have been addressed.
- (3) Like all other offers, the Service will only consider an Effective Tax Administration (ETA) offer when taxpayers have met the processability criteria (e.g. paid the application fee or filed Form 656-A; filed all required tax returns; submitted the Form 656, Form 433-A and/or Form 433-B on the latest revision of the forms; and are not a debtor in a bankruptcy proceeding). In-business taxpayers must have timely filed and timely deposited their quarterly federal taxes for the 2 preceding quarters and paid all federal tax deposits during the quarter in which the offer was filed.

Note: Follow IRM 5.8.3, Processability Determination, for initial processing of offers.

- (4) Elements necessary to perfect an offer also apply to Effective Tax Administration (ETA) offers. The requirement to submit complete financial statements for ETA offers is the same as for Doubt as to Collectibility (DATC) offers.

Note: Follow IRM 5.8.3 for procedures on perfecting offers.

- (5) Effective Tax Administration (ETA) offers are initially added to AOIC as Doubt as to Collectibility (DATC) offers. Once the offer investigation reveals that the taxpayer's assets and future income exceed the tax liability thereby indicating no basis for a Doubt as to Collectibility (DATC), the offer should be considered under the ETA provisions. AOIC must be updated to reflect the correct basis for the compromise (e.g. ETA). Refer to IRM 5.8.11.7 for a full discussion of requirements to update AOIC prior to final processing of ETA and Doubt as to Collectibility with special circumstances (DCSC) offers.

5.8.11.4
(05-15-2004)
Evaluation of Offers

- (1) Effective Tax Administration (ETA) offers cannot be considered if the taxpayer qualifies for Doubt as to Collectibility (DATC) or Doubt as to Liability (DATL).

Note: Follow IRM 5.8.4, Evaluation of Offers, for Doubt as to Collectibility (DATC) issues and determining reasonable collection potential (RCP).

- (2) If the assets and future income do not exceed the tax liability and special circumstances exist, the taxpayer's offer must be considered under Doubt as to Collectibility with Special Circumstance (DCSC). The taxpayers may have checked the ETA box and given an explanation of circumstance on the Form 656, however unless they have the ability to full pay the liability, the offer would not meet the legal standard for Effective Tax Administration (ETA) consideration. The offer must be considered under Doubt as to Collectibility with Special Circumstance (DCSC).
- (3) If the taxpayer submits an offer based on Doubt as to Collectibility (DATC) but collection potential exceeds the liability and there are special circumstances, the offer should be considered on the basis of Effective Tax Administration (ETA). The employee that investigates the offer is required to address any potential special circumstances during first contact with the taxpayer or the taxpayer's representative. This will be accomplished in conjunction with the current requirement to verify receipt of Publication 1 and Publication 594 and must be documented in the offer case history. This requirement does not apply where the only taxpayer contact is through correspondence.
- (4) If the offer is rejected, the narrative should describe the considerations of both bases. If the offer is accepted the offer report must reflect the basis upon which the offer is accepted.

5.8.11.4.1
(05-15-2004)
Public Policy/Equity
Issues

- (1) Offers submitted under the Public Policy/Equity provisions are authorized under these guidelines only when there are **exceptional** circumstances. While compromise under these guidelines is expected to be rare, appropriate recommendations for acceptance will be made.
- (2) In order to develop consistency in the interpretation and application of Treasury Regulations (TD 9007) published on July 22, 2002, a Specialty Group has been set up in Cincinnati, Ohio to work these offers.
- (3) Only after consideration has been given to all other potential bases for acceptance (e.g. Doubt as to Liability (DATL), Doubt as to Collectibility (DATC), Doubt as to Collectibility with Special Circumstance (DCSC), and/or Effective Tax Administration (ETA) based on economic hardship) will ETA-Public

Policy/Equity be considered. Therefore, all cases must have been completely developed under all other bases before transfer will be accepted by the Cincinnati Group.

- (4) After all other potential bases have been considered, complete Exhibit 5.8.11-1 "Non-Economic Hardship Effective Tax Administration (ETA) OIC Check Sheet." The check sheet **must** be completed and sent to the Cincinnati group *before* any cases are transferred. The purpose of the check sheet is to document that all issues other than Public Policy/Equity ETA have been evaluated and to provide information on the non-economic ETA factors present.
- (5) The completed check sheet and a copy of the entire Form 656 should be faxed to offer Group Manager in Cincinnati. The sender should include a copy of any letter or document presented by the taxpayer to support the special circumstances. The group will evaluate the information and respond to the sender within 10 workdays. This response will either be an explanation of why the taxpayer's offer cannot be investigated under Public Policy/Equity ETA provisions, or a request to transfer the offer to the Cincinnati group.
- (6) If the Cincinnati group determines that the offer cannot be investigated under the Public Policy/Equity ETA provisions, the information will be faxed back to the sender who will be responsible for issuing the proposed rejection letter to the taxpayer, covering all factors considered.
- (7) If the Cincinnati group determines that the information presented requires further analysis, the sender will be notified to transfer the case to Cincinnati.
 - The sender should contact the taxpayer by telephone and advise the taxpayer of the results of the collectibility and liability portions of the offer investigation prior to transfer. If the taxpayer cannot be reached by phone then a standard transfer letter should be sent.
 - The file should be sent by overnight mail on Form 3210 to the Cincinnati group.
 - At the time of mailing, the case should be transferred on AOIC to Area 6.
 - A history item should be added to AOIC to show the case is being sent to Cincinnati, Area 6.
 - The Cincinnati group will maintain the faxed copies of all check sheets received and appropriate documentation on all offers accepted for transfer. This documentation will provide a historical record too support a decision to accept or reject the offer.

Note: The Offer Examiner or Offer Specialist may also seek guidance from the Cincinnati group on a Doubt as to Collectibility with Special Circumstances (DCSC) offers that involve Public Policy/Equity issues. The guidance should be solicited by preparing a check sheet and documenting the issues involved in the case. However, these cases will not be transferred to the Cincinnati group.

5.8.11.4.2
(05-15-2004)
**Financial Statement
Analysis**

- (1) Offers submitted under Effective Tax Administration (ETA) require the same full financial analysis as Doubt as to Collectibility (DATC) offers in order to determine reasonable collection potential (RCP) and to determine an acceptable offer amount. Procedures for financial analysis are contained in IRM 5.8.5.
- (2) Once reasonable collection potential (RCP) is completed a determination can be made as to whether the offer qualifies for consideration under Effective Tax Administration (ETA) or Doubt as to Collectibility (DATC).

- (3) If the taxpayer's assets and future income exceed the tax liability, the taxpayer's offer can be considered under the effective tax administration basis.

5.8.11.4.3
(05-15-2004)
**Determining an
Acceptable Offer
Amount**

- (1) An acceptable offer amount, based on economic hardship, is determined by analyzing the financial information and the hardship that would be created if certain assets, or a portion of certain assets, were used to pay the liability.

Example: The taxpayer has a \$100,000 liability and a reasonable collection potential (RCP) of \$125,000. To avoid economic hardship, it is determined that the taxpayer will need \$75,000. The remaining \$50,000 should be considered the acceptable offer amount.

- (2) In offers based on Public Policy/Equity, the Service would expect the taxpayer to offer an amount that is fair and equitable under the circumstances.
- (3) Generally, it is the responsibility of the taxpayer to make decisions and take the appropriate actions needed to fund the acceptable offer amount. However, due consideration of these funding options is often needed for the Service to arrive at an acceptable offer amount. For example, in some locations the availability of funding options such as reverse mortgages, assigning deeds of trust, etc. may allow the taxpayer to tap into available equity without creating economic hardship. These options should be taken into consideration in determining an acceptable offer amount for an Effective Tax Administration (ETA) offer based on economic hardship.

5.8.11.5
(11-01-2000)
**Documentation and
Verification**

- (1) To verify the taxpayer's special circumstances and support a basis of Effective Tax Administration (ETA):
 - a. Request supporting documentation of the taxpayer's situation. Exercise sound judgement in determining the degree of verification necessary. For example, verification of a health problem could be a doctor's letter.
 - b. When special circumstances are found to exist, the amount offered will be less than reasonable collection potential (RCP). For Effective Tax Administration (ETA), reasonable collection potential (RCP) is always greater than the full liability. In the report narrative, explain clearly the rationale for acceptance of the amount offered. The documentation must include reasons why some or all of the equity in certain assets is not being offered, how the offer amount is being funded, and any other pertinent information that indicates how the amount offered was determined to be acceptable.

5.8.11.6
(05-15-2004)
Final Processing

- (1) Prior to final processing, AOIC must be updated to indicate the correct basis for closing the offer. This will ensure that all final closing reports generated from AOIC reflect the correct basis. The approval levels indicated on closing reports and letters must be consistent with the basis for closure.

(2) The following is a guide to these determinations:

If...	And...	Then...
The offer was submitted under Effective Tax Administration (ETA)	An economic hardship has been determined to exist, but the reasonable collection potential (RCP) is less than the liability balance due	<ol style="list-style-type: none"> 1. Update the AOIC offer screen to indicate a "C" under the offer type. 2. Generate all closing reports with the proper approving official for Doubt as to Collectibility with Special Circumstances (DCSC).
The offer was submitted under Doubt as to Collectibility (DCSC)	An economic hardship has been determined to exist, and the reasonable collection potential (RCP) is greater than the liability balance due	<ol style="list-style-type: none"> 1. Update AOIC offer screen to indicate "A" under offer type. 2. Generate closing reports with the proper approving official for Effective Tax Administration (ETA) offers.
The offer was submitted under Effective Tax Administration (ETA)	The offer is being recommended for acceptance under Doubt as to Collectibility (DATC) with the offer exceeding the reasonable collection potential (RCP)	<ol style="list-style-type: none"> 1. AOIC offer screen does not require updating for special circumstances. The type of offer on AOIC should reflect "C" for Doubt as to Collectibility (DATC). Generate closing reports with the proper approving official for Doubt as to Collectibility (DATC) without special circumstances.

If...	And...	Then...
<p>The offer was submitted under Doubt as to Collectibility with item 9 of Form 656 completed with circumstances that do not meet any of the elements that define economic hardship, or Public Policy/Equity criteria.</p>	<p>The offer cannot be recommended for acceptance under Doubt as to Collectibility (DATC).</p>	<p>Generate closing reports with the proper approving official for Doubt as to Collectibility (DATC) without special circumstances. Address in the history, why the circumstances described in item 9 do not meet defined economic hardship, or Public Policy/Equity criteria.</p>
<p>The offer was submitted under Effective Tax Administration (ETA) with item 9 of Form 656 completed with circumstances that do not meet ETA criteria.</p>	<p>The taxpayer does not qualify for ETA because the reasonable collection potential (RCP) is less than the liability and the offer cannot be recommended for acceptance under Doubt as to Collectibility with Special Circumstances (DCSC).</p>	<ol style="list-style-type: none"> 1. Update AOIC offer screen to indicate a "C" under special circumstances. 2. Generate closing reports with the proper approving official for Doubt as to Collectibility with Special Circumstances (DCSC).
<p>The offer was submitted under Effective Tax Administration (ETA) with item 9 of the Form 656 completed with circumstances that the investigation reveals do not meet ETA criteria</p>	<p>The offer cannot be recommended for acceptance and the reasonable collection potential (RCP) exceeds the liability</p>	<ol style="list-style-type: none"> 1. Update AOIC offer screen to indicate "A" under offer type. 3. Generate closing reports with the proper approving official for Effective Tax Administration (ETA) offers.
<p>The offer was submitted under Effective Tax Administration (ETA)</p>	<p>The special circumstances do meet economic hardship, or Public Policy/Equity criteria and the reasonable collection potential (RCP) exceeds the tax liability. However, the offer cannot be recommended for acceptance.</p>	<ol style="list-style-type: none"> 1. Update AOIC offer screen to indicate "A" under offer type. 3. Generate closing reports with the proper approving official for Effective Tax Administration (ETA) offers.

If...	And...	Then...
The offer was submitted under Doubt as to Collectibility with Special Circumstances (DCSC)	The special circumstances do meet economic hardship, or Public Policy/Equity criteria and the reasonable collection potential (RCP) is less than the tax liability, however, the offer cannot be recommended for acceptance.	Generate closing reports with the proper approving official for Doubt as to Collectibility with Special Circumstances (DCSC).

5.8.11.6.1
(11-30-2001)
**Rejection/Return/
Withdrawal Processing**

- (1) The procedures in IRM 5.8.7, discussing rejections, withdrawals and returns should be followed when processing Effective Tax Administration (ETA) rejected, withdrawn or returned offers.
- (2) IRM 5.8.12 provides instructions for independent administrative review of rejected offers.
- (3) See Delegation Order 11 for the official with delegated authority based on Effective Tax Administration (ETA). The delegated official's signature is required on the Form 1271 and the closing letter.

5.8.11.6.2
(11-01-2000)
Acceptance Processing

- (1) The procedures in IRM 5.8.8, Acceptance Processing, should be followed when processing accepted Effective Tax Administration (ETA) offers.
- (2) Area Counsel's opinion is required on ETA offers where the unpaid amount of tax assessed (including any interest, addition to the tax, or assessable penalty) is \$50,000 or more.
- (3) See Delegation Order 11 for the official with delegated authority to accept offers based on Effective Tax Administration (ETA). The delegated official's signature is required on the Form 7249 and the acceptance letter.

Exhibit 5.8.11-1 (05-15-2004)

Non-Hardship Effective Tax Administration (ETA) Offer in Compromise (OIC) Check Sheet

Non-Hardship Effective Tax Administration OIC Check Sheet

Taxpayer: _____ SSN/EIN: _____

Employee Name: _____ Employee Ph #: _____

Manager Approval: _____ Date: _____
(signature)

Answer the following questions Yes or No:

Yes No

- 1. Can an offer be accepted under "standard" Doubt as to Collectibility guidelines?
- 2. Can an offer be accepted under Doubt as to Collectibility - Special Circumstances?
- 3. Can an offer be accepted under Doubt as to Liability?
- 4. Can an offer be accepted under ETA - Hardship?

If the answer is YES to any of questions 1 - 4, proceed with the appropriate acceptance recommendation.

If the answer is NO to Questions 1 - 4, but the taxpayer has provided documentation of possible Doubt as to Collectibility with Special Circumstances outlining a public policy or equity issue, or has provided documentation outlining possible ETA Public Policy/Equity factors, outline those factors in the space below. Indicate that you are requesting advice on the applicability of those factors and include your opinion of the information presented by the taxpayer. Use additional sheets if necessary.

_____ Request guidance/advice on applicability of public policy/equity factors on a Doubt as to Collectibility Offer.

Fax this check sheet, along with a copy of the complete Form 656, and any other documentation provided by the taxpayer, to OFFER MANAGER at 513-263-4577 for consideration by the ETA group.

Public Policy/Equity Factors

_____ (This section for use of Cincinnati ETA Processing Site.) _____

- Offer may meet non-hardship ETA criteria and should be sent to Cincinnati for further consideration.
- Offer does not meet non-hardship ETA criteria, and cannot be processed in Cincinnati for the following reasons:

Revised 5/22/03

Offers In Compromise

Promotion of Effective Tax Administration

Course Overview

Introduction In July 2002, the Internal Revenue Service issued Treasury Regulation 301.7122-1, which made permanent the authority to compromise to promote effective tax administration (“ETA offers”). This expansion of the Service’s compromise program was authorized by the IRS Restructuring and Reform Act of 1998 (RRA ’98).

Purpose of This Course The purpose of this Continuing Professional Education course is to provide you with the knowledge and skills:

- to identify and evaluate ETA offers and
- to determine if they can be accepted based on economic hardship or public policy or equity grounds.

Target Audience This course is intended for experienced Revenue Officer OIC specialists, Tax Examiners at the Centralized OIC Campuses, Settlement Officers in Appeals, Independent Administrative Reviewers, CQMS reviewers, and Taxpayer Advocate Service employees.

Course Length The estimated time for completion of the course is two hours.

Student Materials Student Materials needed for this course include:

- student coursebook
- IRM 5.8.11, *Effective Tax Administration*.

In This Course This course contains the following lesson:

Topic	See Page
Promotion of Effective Tax Administration	1-1

Course Overview, Continued

**Name
Disclaimer**

The taxpayer names shown in this publication are hypothetical. They were chosen at random from a list of American colleges and universities as shown in Webster's Dictionary or from a list of names of counties in the United States as listed in the United States Government Printing Office Style Manual.

Lesson 1

Promotion of Effective Tax Administration

Overview

Introduction This lesson discusses the effective tax administration (ETA) offer in compromise (OIC) and the circumstances under which this type of offer can be accepted.

Objectives At the end of this lesson you will be able to:

- Determine if an offer qualifies for consideration based on economic hardship
- Determine if an offer qualifies for consideration based on compelling public policy or equity considerations
- Determine if an offer considered on either of these bases should be accepted

Materials

- Coursebook
- IRM 5.8.11, *Effective Tax Administration*

References

- IRC section 7122(a)
- Treas. Reg. section 301.6343-1
- Treas. Reg. section 301.7122-1, *Compromises*

In This Lesson This lesson contains the following topics:

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Effective Tax Administration Offers

Introduction

As part of the IRS Restructuring and Reform Act of 1998 (RRA 98), Congress added section 7122(c) to the Internal Revenue Code. That section provides that the Service shall set forth guidelines for determining when an offer in compromise should be accepted. Congress explained that these guidelines should allow the Service to consider:

- hardship,
- public policy, and
- equity.

Treasury Regulation 301.7122-1 authorizes the Service to consider these offers raising these issues. These offers are called Effective Tax Administration offers.

Benefits

The availability of effective tax administration offers encourages taxpayers to comply with the tax laws because taxpayers will:

- believe the laws are fair and equitable, and
 - gain confidence the laws will be applied to everyone in the same manner.
-

When to Consider

If a taxpayer submits an ETA offer, you must first investigate the offer for:

- doubt as to liability, and/or
- doubt as to collectibility

You can only consider an ETA offer if the taxpayer does not qualify for the other two types.

Continued on next page

Effective Tax Administration Offers, Continued

Compared to Doubt as to Collectibility

In a doubt as to collectibility offer, the tax liability equals or exceeds the taxpayer's reasonable collection potential (RCP) which is:

- net equity in assets, plus
- future income.

In an ETA offer, the tax liability is less than the taxpayer's RCP. The taxes owed can be collected in full either:

- in a lump sum, or
- through an installment agreement (IA)

A doubt as to collectibility offer does not convert to an ETA offer if you and the taxpayer cannot agree on an acceptable offer amount.

Compared to Doubt as to Collectibility with Special Circumstances

A taxpayer would have an ETA offer when their RCP is greater than the liability but there are economic hardship or public policy/equity circumstances that would justify accepting the offer for an amount less than full payment. For example: The taxpayer owes \$20,000. His RCP is \$25,000. The taxpayer could have an OIC accepted for less than the total liability (\$20,000) under the ETA provisions.

A taxpayer would have a Doubt as to Collectibility with Special Circumstances when their RCP is less than their liability but there are economic hardship or public policy/equity factors that would justify accepting the offer for an amount less than the RCP. For example: The taxpayer owes \$20,000. However his RCP is \$15,000. The offer cannot be accepted under ETA because the RCP is lower than the liability. However, applying the same factors of economic hardship, or public policy/equity, an offer could be accepted for less than the RCP (\$15,000) under the Doubt as to Collectibility with Special Circumstance provisions.

Compared to Doubt as to Liability

An offer can be considered under ETA provisions only when there is not doubt as to liability.

**Legal
Standards**

A taxpayer meets the legal requirements for an ETA offer if:

- there is no doubt as to liability, and
 - there is no doubt as to collectibility, and
 - there are exceptional circumstances such that collecting the tax would create an economic hardship, or there is compelling public policy or equity considerations that provide sufficient basis for compromise.
-

Economic Hardship

Introduction When a taxpayer's liability can be collected in full but collection would create an economic hardship, they can submit an ETA OIC based on economic hardship.

Definition The definition of economic hardship as it applies to ETA offers is derived from Treas. Reg. 301.6343-1. This regulation concerns release of levy.

Economic hardship occurs when a taxpayer is "...unable to pay his or her reasonable basic living expenses. The determination of a reasonable amount for basic living expenses will be made by the director and will vary according to the unique circumstances of the individual taxpayer. Unique circumstances, however, do not include the maintenance of an affluent or luxurious standard of living."

Qualifications To qualify for consideration as an economic hardship ETA offer:

- the taxes must be collectable in full, and
- the taxpayer must be an individual, not a corporation, partnership or other non-individual entity.

Only individuals qualify because economic hardship means the inability to meet reasonable basic living expenses.

The taxpayer must fully explain:

- their special circumstances, and
 - why they qualify for an ETA offer based on economic hardship.
-

Investigation You must examine the taxpayer's financial information and special circumstances to determine if they qualify for an ETA offer based on economic hardship. Financial analysis includes reviewing basic living expenses as well as other considerations.

Continued on next page

Economic Hardship, Continued

Basic Living Expenses

You must consider the taxpayer's income and basic living expenses when you determine if their ETA hardship offer is acceptable.

Basic living expenses are those expenses that provide for the:

- health and welfare, and
- production of income

of the taxpayer and their family.

Some basic living expenses are limited to the National Standards while other expenses are limited to local standards. The taxpayer must justify expenses that exceed these limits.

Other Considerations

In addition to the basic living expenses, you must consider other factors that impact upon the taxpayer's financial condition, including:

- the taxpayer's age and employment status
- number, age and health of the taxpayer's dependents
- cost of living in the area the taxpayer resides, and
- any extraordinary circumstances such as special education expenses, a medical catastrophe or natural disaster.

This list is not all-inclusive. You may consider other factors in your economic hardship determination.

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Economic Hardship, Continued

Supporting Factors

Some factors that support an economic hardship determination are that the taxpayer:

- cannot earn a living because of a long-term illness, medical condition or disability and it is foreseeable that they will exhaust their financial resources for their support and care.
- exhausts his or her monthly income providing for the care of a dependent, such as a parent or other family member, with no other means of support.
- is unable to borrow against the equity in assets because repayment of the loan would not allow them to meet necessary living expenses.

These factors are not all inclusive. They represent situations the Service frequently encounters. You may encounter other situations that would support an economic hardship ETA offer.

Compliance Considerations

When you consider recommending acceptance of an ETA offer based on economic hardship you must ensure acceptance does not undermine compliance. The public should not perceive that the taxpayer whose offer is accepted benefited by not complying with the tax laws.

Accepting an ETA offer in compromise would undermine compliance if the taxpayer:

- has a history of noncompliance.
- took deliberate actions to avoid paying the tax, such as transferring assets.
- encouraged others not to comply with tax laws.

There may be other situations where compliance would be undermined.

Continued on next page

Economic Hardship, Continued

Examples of Economic Hardship

The following examples illustrate when an ETA offer under the economic hardship standard may be appropriate. You can assume that the taxpayers' overall compliance histories do not weigh against compromise.

Example 1

John Perry was diagnosed with an illness that will eventually make him unable to work. Although currently employed, he was forced to reduce his hours. Mr. Perry has sufficient funds in his bank account to full pay the tax liability, however, he will soon need to quit his job and use those funds to support himself.

Example 2

Margaret Hudson supports her daughter who requires extensive medical care and physical therapy for a disability. Ms. Hudson has sufficient equity in her home to full pay the tax liability but will need the equity to continue to pay her daughter's medical expenses.

Example 3

Carol Ross is retired and receives social security and a small teacher's retirement pension. She is not eligible for an installment agreement. Ms. Ross owns her house, which is unencumbered. The value of the house is sufficient to full pay the tax liability. She does not qualify for a loan against the house and if she sells it, she would not be able to find an affordable place to live.

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Economic Hardship, Continued

Determining an Acceptable Offer Amount

To determine an acceptable amount, analyze:

- financial information
- supporting documents, and
- the hardship that would be created if the taxpayer liquidated all or a portion of certain assets.

The existence of economic hardship does not require you to recommend acceptance of the offer. When you identify economic hardship criteria, but the taxpayer does not offer an amount that is the difference between their total equity and the amount necessary to prevent economic hardship, you should not recommend acceptance of the offer.

Examples of Acceptable Amounts

Example 1

Dennis Zavala was diagnosed with an illness that eventually make him unable to work. He is currently employed but will soon need to quit his job and use personal funds to support himself. His tax liability is \$8,500. He submitted an offer for \$500. His RCP is \$35,000. Through your investigation, you determine that collecting more than \$5,000 would cause an economic hardship for Mr. Zavala. He would not be able to meet his reasonable living expenses. An acceptable offer is \$5,000. It is the amount the Service can collect without creating an economic hardship. You advise the taxpayer to increase his offer from \$500 to \$5,000.

Example 2

Diana Duquesne owes \$17,500 and has a reasonable collection potential of \$25,000. She submits an offer for \$3,500. Ms. Duquesne supports her father who requires extensive medical care and physical therapy for a disability. As a result of your investigation you conclude that collection of more than \$2,000 would cause economic hardship for her because she would be unable to meet her reasonable basic living expenses. You should recommend acceptance of her \$3,500 offer.

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Economic Hardship, Continued

Examples of Acceptable Amounts, Continued

Example 3

Bill Hope lives on a fixed income that does not, after payment of reasonable basic living expenses, allow full payment of his liability through an installment agreement. He owes \$65,000 and submitted an offer for \$15,000. Mr. Hope owns his house which has a small mortgage but has equity sufficient to pay the tax liability in full. He does not qualify for a loan against the house and if he sells it, he would not be able to find an affordable place to live. Based on your investigation you determine that collection of more than \$42,000 would cause the taxpayer economic hardship. You advise Mr. Hope he must increase his offer to \$42,000.

Compliance Considerations Not Supporting Acceptance

Regardless of economic hardship, the Service will not accept an offer where compliance is undermined. The following examples illustrate some of these situations.

Example 1

Charlotte Becker qualifies for an ETA offer to compromise income and self-employment taxes based on economic hardship. You conduct a compliance check and learn Ms. Becker did not make estimated tax payments for several years prior to the liability years included in the offer. For the last three years she had employees. She filed Form 941 late each quarter and did not pay the tax on time. Since Ms. Becker has a history of noncompliance, her offer should not be accepted. Acceptance of the offer would undermine the public's confidence that the tax laws are being administered fairly.

Example 2

Phil McMurray submitted an ETA offer based on economic hardship. His financial statement appears to support the offer. When you research the county property records you learn Mr. McMurray transferred his home to his daughter for \$100 plus love and affection. He transferred the home after the tax was assessed. Mr. McMurray took deliberate actions to avoid the payment of tax, therefore his offer should not be accepted.

Continued on next page

Economic Hardship, Continued, Continued

**Compliance
Considerations
Not Support
Acceptance
Continued**

Example 3

Jim King qualifies for an ETA offer based on economic hardship according to the financial information you secured. During the course of your investigation, you learn he is a member of an organization that conducts tax evasion seminars. Since this factor undermines compliance, Mr. King's offer should not be accepted.

**Cause of the
Liability**

The cause of the liability for which the economic hardship offer is made does not affect acceptance unless it undermines compliance. For example, if the liability is due to unpaid self-employment tax, the offer can be accepted unless the taxpayer has a long history of failing to make estimated tax payments.

Exercises – Economic Hardship

Exercise 1

Answer the following questions true or false.

Question 1

Elena Racine wants to submit an ETA offer under the economic hardship provision. Her net realizable equity is less than her tax liability. She should submit this offer.

_____ true _____ false

Question 2

An economic hardship occurs whenever a taxpayer can no longer maintain their current lifestyle.

_____ true _____ false

Question 3

A partnership can submit an ETA offer under economic hardship provisions.

_____ true _____ false

Question 4

A sole proprietor can submit an ETA offer under economic hardship provisions.

_____ true _____ false

Question 5

In addition to economic hardship, you must consider compliance factors before recommending acceptance of an ETA economic hardship offer.

_____ true _____ false

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Exercises – Economic Hardship, Continued

Exercise 2

Answer the following questions as indicated.

Question 1

List three factors to consider in an economic hardship ETA case besides basic living expenses.

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-
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Question 2

Andy Osborne appears to qualify for an ETA economic hardship offer. Shortly before the audit assessment for which he is submitting the OIC, he retitled his house and his car to a corporation. He is the president and sole shareholder of the corporation. Would you recommend accepting his ETA offer? State your reasons.

Public Policy or Equity

Definitions

According to Black's Law Dictionary, public policy is:

“Community common sense and common conscience, extended and applied throughout the state to matters of public morals, health, safety, and welfare, and the like; it is that general and well-settled public opinion relating to man's plain, palpable duty to his fellowmen, having due regard to all circumstances of each particular relation and situation.”

The same source defines equity as:

“Justice administered according to fairness as contrasted with the strictly formulated rules of common law.”

The definition of these terms provide the basis for understanding ETA offers for which public policy or equity standards are applied. This type of offer was previously known as a compromise because collection would be detrimental to voluntary compliance.

Criteria

In order for an ETA offer based on public policy or equity to be accepted the following criteria must be present:

- there is no doubt as to liability
- there is no doubt as to collectibility, and
- the liability could be collected in full without causing economic hardship.

Compromise is authorized because there are **exceptional** circumstances such that collecting the tax in full would cause the public to doubt the tax laws are being administered fairly. When you investigate this type of offer you should ask yourself:

Are there exceptional circumstances in this case such that the general public would view full collection of the tax liability as unfair or inequitable?

Compromise under these guidelines will be rare.

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Public Policy or Equity, Continued

Burden of Proof

The taxpayer bears the burden of proof to show their offer qualifies for public policy or equity consideration. They must show that their circumstances are compelling enough to justify acceptance of their offer compared to other taxpayers in similar circumstances.

It is important that the public does not perceive that some taxpayers receive more favorable treatment than others.

Determining an Acceptable Amount

Once you decide to recommend acceptance of an OIC under public policy or equity criteria, you must determine if the amount offered is appropriate. You must base your determination on what is fair and equitable under the circumstances. Thoroughly document the case file history with the basis for your determination.

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Public Policy or Equity, Continued

Examples

The following examples illustrate situations where an ETA offer under the public policy or equity standard may be appropriate.

Example 1

In January of 1995, Ed Yuma became seriously ill and was hospitalized on and off for five years. During that time, he was unable to manage his financial affairs. He did not file any tax returns. In 2001 his health improved. During the same year he was contacted by a revenue officer and subsequently filed and paid all the delinquent tax returns. The IRS, however, had prepared a substitute for return for 1994. The balance due for 1994 including interest and penalties was now three times more than the original tax liability.

An ETA offer under the public policy and equity criteria can be considered. Mr. Yuma's failure to comply occurred because he was incapacitated and unable to comply with the tax laws. He is now in compliance and his overall compliance history does not weigh against compromise. It is reasonable to compromise the 1994 liability because Mr. Yuma was physically unable to do anything about the unfilled return and unpaid tax until much later. You should first work with Mr. Yuma to prepare an accurate 1994 return. You can then investigate the offer under public policy or equity grounds.

An acceptable offer amount should approximate the amount Mr. Yuma would have to pay if he had complied timely with filing and payment requirements.

If the investigation reveals that the taxpayer was able to attend to matters other than his taxes during that timeframe, it would not promote effective tax administration to accept his offer.

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Public Policy or Equity, Continued

Examples Continued

Example 2

Bonnie Grant is the manager of a local department store. Each year for the past three years she contributed \$2,000 to an individual retirement account (IRA). Ms. Grant learned she could earn more interest on her account by transferring the funds to a certificate of deposit at another bank. Before she transferred the money, she contacted the IRS by e-mail to find out how to preserve the tax benefits of an IRA account and not incur any penalties. The IRS responded with an e-mail that told her she could withdraw the funds without penalty as long as she redeposited them in a qualifying account within 90 days. Ms. Grant withdrew the funds and 63 days later redeposited them in the new account.

Two years later Ms. Grant is audited. The auditor informed her that she received incorrect information. IRA funds must be redeposited in 60 days to avoid penalties and interest. Ms. Grant is in compliance with all filing and paying requirements. She is eligible to have an ETA offer based on public policy or equity accepted.

Ms. Grant relied on the Service's erroneous information to make her decision. She could have avoided the liability if the Service had given the correct information. It is reasonable to conclude that collection of the liability would cause other taxpayers to question the fairness of the tax system.

An acceptable offer amount should be based on the amount the taxpayer would now owe if the Service had not made an error.

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Public Policy or Equity, Continued

Acts of Third Parties

Generally the Service will not compromise on public policy or equity grounds based solely on the argument that the acts of a third party caused the unpaid tax liability. Third parties include the taxpayer's:

- representative
- partner, or
- employee

Occasionally there may be situations in which the criminal or fraudulent acts of a third party make the payment of a tax liability seem unfair. If the taxpayer were compelled to pay the tax, other taxpayers would question the fairness of the tax system. These include situations where:

- the failure to comply can be directly attributed to intervention by a third party, and
- the taxpayer made every effort to comply and took all reasonable precautions to prevent the criminal or fraudulent act.

Consider any actions the taxpayer took to lessen the effects of the third party's actions. For example, did the taxpayer take reasonable precautions to prevent the acts and pursue collection from the third party once the acts were discovered.

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Public Policy or Equity, Continued

“The law is unfair.”

A taxpayer is not eligible for a public policy or equity ETA offer in situations:

- where they are liable for taxes, penalties or interest due to an operation of law. In other words, the Service cannot accept an offer in compromise because the taxpayer believes that a provision of a tax law is unfair. Or,
- when there are already statutes in place that grant the same relief they are seeking through an offer.

IRC section 7122 is not so broad that it allows the Service to disregard or override the judgments of Congress and statutory provisions.

Example 1

Karla Barton owes taxes due to the discharge of a debt. She submitted an ETA offer based on public policy or equity. She states it is unfair to consider a discharged debt as income.

Congress defined discharge of an indebtedness as income in IRC section 61(a)(12). It would not promote effective tax administration to accept Ms. Barton’s offer under these circumstances.

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Public Policy or Equity, Continued

**“The law is
unfair.”**

Continued

Example 2

Daryl Meeker invested in a nationally marketed partnership that promised a return greater than the amount invested. Mr. Meeker then claimed tax credits for the three preceding tax years that significantly reduced his tax liability. The following year, the IRS began an audit of the partnership. It issued a final report that would increase the taxes of Mr. Meeker as well as numerous other taxpayers. Before the case was heard in Tax Court, the IRS offered to concede a substantial portion of the interest and penalties it expected to assess following a favorable court decision. Mr. Meeker rejected the settlement offer. After several years of litigation, the Tax Court upheld most of the deficiencies assessed by IRS.

Mr. Meeker submitted an ETA offer based on public policy and equity. He claimed there were two reasons his offer qualified for this consideration. The first was that much of the liability was a result of the actions taken by the tax matter partner (TMP) during the audit and litigation. The second was that the underlying law that allowed the IRS to prevail in tax court was unfair.

The offer should not be accepted. Neither the acts of a third party, the TMP, nor the taxpayer's belief that the law is unfair is sufficient to support accepting a public policy or equity ETA offer.

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Public Policy or Equity, Continued

**“The law is
unfair.”**
Continued

Example 3

Paul Martin is a self-employed carpenter. His 1996 income tax return was audited in 1998. The audit resulted in a deficiency of \$11,000 plus applicable interest. In May 2000, Mr. Martin contacted the Service and requested a statement of the balance of his account. The offer investigation later showed that the Service inadvertently issued an incorrect statement.

In January 2001, Mr. Martin submitted an ETA offer on public policy and equity grounds. He claimed that he should not be required to pay the accrued interest on his account due to the Service’s error.

Compromise on public policy and/or equity grounds is not appropriate in this situation since the Service’s error did not cause the deficiency. IRC section 6404(e) provides relief from interest caused by IRS errors or delay. Acceptance of an ETA offer in this situation would not promote effective tax administration.

**Compliance
Considerations**

You must address the same compliance considerations with public policy or equity ETA offers as you do with economic hardship ETA offers.

Exercises – Public Policy or Equity

Exercise 1

Answer the following questions true or false.

Question 1

A public policy or equity ETA offer may also include doubt as to collectibility issues.

true false

Question 2

A public policy or equity ETA offer allows a taxpayer to compromise if they think the law is unfair.

true false

Question 3

It is not necessary for a taxpayer to have a history of complying with the tax laws to qualify for a public policy or equity ETA offer.

true false

Question 4

If a third party caused the liability, a compromise based on public policy or equity is always acceptable.

true false

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Exercises – Public Policy or Equity, Continued

Exercise 2

Question 1

What are the criteria for an ETA offer based on public policy or equity?

- -
 -
-

Answers to Exercises – Economic Hardship

Exercise 1

Question 1

False. The taxpayer must have the ability to pay the tax liability in full to submit an ETA offer.

Question 2

False. If the taxpayer is maintaining an affluent lifestyle, it is not an economic hardship for them to reduce their living expenses.

Question 3

False. Only an individual can submit an economic hardship ETA.

Question 4

True. As long as the taxpayer is an individual, the types of taxes compromised do not matter.

Question 5

True. The public must not perceive that the taxpayer benefited by not complying with the tax laws.

Continued on next page

Answers to Exercises – Economic Hardship, Continued

Exercise 2

Question 1

Three factors to consider for an economic hardship ETA are:

- The taxpayer cannot earn a living because of a long-term illness, medical condition or disability.
- The taxpayer cares for a dependent with no other means of support and exhausts their income.
- The taxpayer is unable to borrow against the equity in assets because repayment of then loan would not allow them to meet necessary living expenses.

Question 2

You should not recommend accepting the ETA offer in this situation. Mr. Osborne took steps to avoid paying the tax by transferring his assets to a corporation.

Answers to Exercise – Public Policy and Equity

Exercise 1

Question 1

False. There may be no doubt as to collectibility issues for a Public policy or equity ETA offer.

Question 2

True. The purpose of public policy or equity ETA offers is not to over ride laws already in existence.

Question 3

False. The taxpayer must have an overall history of compliance with the tax laws to qualify for a public policy or equity ETA offer.

Question 4

False. Generally the Service will not compromise a liability based solely on the argument that a third party caused the liability.

Exercise 2

Question 1

To qualify for an ETA offer based on public policy or equity the following criteria must be present:

- There is no doubt as to liability
 - There is no doubt as to collectibility
 - The liability can be collected in full without causing a hardship
-

CC-2004-25

July 12, 2004

Subject: Offers in Compromise in Bankruptcy **Cancel Date:** Upon incorporation into CCDM

Purpose

This Notice explains the Service's policy of returning administrative offers in compromise as nonprocessable to taxpayers currently in a bankruptcy proceeding. Additionally, this Notice provides clarification regarding the Service's authority to acquiesce in treatment of its claims in bankruptcy cases that is less favorable than that provided for under the Bankruptcy Code.

Discussion

The Service's authority to compromise tax liabilities is provided by I.R.C. § 7122(a), which states as follows:

(a) **AUTHORIZATION.**—The Secretary may compromise any civil or criminal case arising under the internal revenue laws prior to reference to the Department of Justice for prosecution or defense; and the Attorney General or his delegate may compromise any such case after reference to the Department of Justice for prosecution or defense.

The decision to compromise, including whether to consider a compromise and how much to accept, is within the Service's discretion. See Treas. Reg. § 301.7122-1(a). It has been the Service's long-standing policy to compromise cases only when settlement furthers the best interests of both the taxpayer and the Government. See Policy Statement P-5-100 (approved Jan. 30, 1992), reprinted in IRM 1.2.1.5.18. See also Policy Statement P-5-89 (approved July 26, 1960), reprinted in IRM 1.2.1.5.16.

The Commissioner is charged with the power to administer and supervise the execution and application of the Internal Revenue Code. See I.R.C. § 7803(a)(2). Pursuant to

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CC-2004-25

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The decision to compromise, including whether to consider a compromise and how much to accept, is within the Service's discretion. See Treas. Reg. § 301.7122-1(a). It has been the Service's long-standing policy to compromise cases only when settlement furthers the best interests of both the taxpayer and the Government. See Policy Statement P-5-100 (approved Jan. 30, 1992), reprinted in IRM 1.2.1.5.18. See also Policy Statement P-5-89 (approved July 26, 1960), reprinted in IRM 1.2.1.5.16.

The Commissioner is charged with the power to administer and supervise the execution and application of the Internal Revenue Code. See I.R.C. § 7803(a)(2). Pursuant to

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CC-2004-25

July 12, 2004

Subject: Offers in Compromise in Bankruptcy **Cancel Date:** Upon incorporation into CCDM

Purpose

This Notice explains the Service's policy of returning administrative offers in compromise as nonprocessable to taxpayers currently in a bankruptcy proceeding. Additionally, this Notice provides clarification regarding the Service's authority to acquiesce in treatment of its claims in bankruptcy cases that is less favorable than that provided for under the Bankruptcy Code.

Discussion

The Service's authority to compromise tax liabilities is provided by I.R.C. § 7122(a), which states as follows:

(a) **AUTHORIZATION.**—The Secretary may compromise any civil or criminal case arising under the internal revenue laws prior to reference to the Department of Justice for prosecution or defense; and the Attorney General or his delegate may compromise any such case after reference to the Department of Justice for prosecution or defense.

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