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#20**OFFERS IN COMPROMISE: Despite Congressional Actions, the IRS Has Failed to Realize the Potential of Offers in Compromise****RESPONSIBLE OFFICIALS**

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DEFINITION OF PROBLEM

An offer in compromise (OIC) is an agreement between a taxpayer and the government that settles a tax liability for payment of less than the full amount owed. The IRS has authority to accept offers pursuant to Internal Revenue Code (IRC) § 7122.¹ Treasury Regulations provide three grounds for an offer:

- A. Doubt as to liability;²
- B. Doubt as to collectability;³ and
- C. Effective tax administration (ETA).⁴

Legislators have long viewed the OIC as a viable and reasonable collection alternative.⁵ The IRS Restructuring and Reform Act of 1998 (RRA 98) introduced the Effective Tax Administration offer and provided specific guidance to the IRS on accepting such offers.⁶ However, IRS policies and procedures do not foster flexible use of the OIC.⁷

In fiscal year (FY) 2014, the IRS received 66,155 offers and accepted 26,924.⁸ The number of accepted offers decreased approximately 13 percent compared to FY 2013, when the IRS received 71,644 new offers and accepted 30,840 offers.⁹ Meanwhile, the IRS continues to place billions of dollars' worth of accounts in its collection "Queue" and other inactive statuses.¹⁰ As of September 30, 2014, the Queue held

1 See Treas. Reg. 301.7122-1(b)(1).

2 See *id.* Doubt as to liability exists where there is a genuine dispute as to the existence or amount of the correct tax liability under the law. Doubt as to liability does not exist where the liability has been established by a final court decision or judgment concerning the existence or amount of the liability.

3 See Treas. Reg. 301.7122-1(b)(2). Doubt as to collectability exists in any case where the taxpayer's assets and income are less than the full amount of the liability.

4 See Treas. Reg. 301.7122-1(b)(3). There are two grounds for ETA offers: 1) If the Secretary determines that, although collection in full could be achieved, collection of the full liability would cause the taxpayer economic hardship within the meaning of Treas. Reg. § 301.6343-1 and; 2) If there are no grounds for an offer under the other OIC criteria, the IRS may compromise to promote effective tax administration where compelling public policy or equity considerations identified by the taxpayer provide a sufficient basis for compromising the liability. Compromise will be justified only where, due to exceptional circumstances, collection of the full liability would undermine public confidence that the tax laws are being administered in a fair and equitable manner.

5 IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206 (1998); H.R. Conf. Rep. 599, 105th Cong., 2d Sess. 288-289 (1998).

6 H.R. Conf. Rep. No. 105-599 at 289 (1998).

7 See National Taxpayer Advocate 2012 Annual Report to Congress 354-355. See also Most Serious Problem: *OFFERS IN COMPROMISE: The IRS Does Not Comply with the Law Regarding Victims of Payroll Service Provider Failure*, *infra*.

8 IRS, *OIC Executive Summary Report* (Sept. 2014). The amount reported is the net receipt of OICs on a national level, which is defined as the amount of national new receipts plus the amount of national doubt as to liability receipts.

9 *Id.* The amount reported is the net receipt of OICs on a national level, which is defined as the amount of national new receipts plus the amount of national doubt as to liability receipts.

10 Taxpayer Delinquent Accounts (TDAs), IRS NO-5000-2, *Taxpayer Delinquent Cumulative Report*, Part 1 (July 2014).

3,097,401 taxpayer delinquent account (TDA) modules valued at \$57.7 billion.¹¹ As of September 30, 2014, cases in “shelved” status totaled 1,777,346 TDAs with a value of \$8.3 billion.¹²

With the current system, the IRS is not only gradually losing the ability to collect any revenue on aging collection inventory, but is denying taxpayers a timely resolution of their tax problems, thereby violating the *right to finality*.¹³ Additionally, when the IRS unreasonably denies an OIC and resumes collection activity, it may violate the taxpayer’s *right to privacy* which ensures that any IRS enforcement action be *no more intrusive than necessary* (emphasis added).¹⁴ Lastly, the IRS approach to OICs may deny offers to eligible taxpayers by not considering all the facts and circumstances affecting an underlying liability, thereby undermining the *right to a fair and just tax system* and harming future compliance.¹⁵

ANALYSIS OF PROBLEM

Congress Envisioned a Flexible OIC Program that Could Improve Compliance.

The Senate intended that the IRS would adopt a “liberal acceptance policy for [offers] to provide an incentive for taxpayers to continue to file tax returns and continue to pay their taxes.”¹⁶ This view was also adopted in the conference report for RRA 98:

The conferees believe that the IRS should be flexible in finding ways to work with taxpayers who are sincerely trying to meet their obligations and remain in the tax system. Accordingly, the conferees believe that the IRS should make it easier for taxpayers to enter into offer-in-compromise agreements, and should do more to educate the taxpaying public about the availability of such agreements.¹⁷

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- 11 Taxpayer Delinquent Accounts (TDAs), NO-5000-2, *Taxpayer Delinquent Accounts Report* (Sept. 2014). For information on the Queue, see National Taxpayer Advocate 2010 Annual Report to Congress, vol. 2, 39-70, (Research Study: *An Analysis of the IRS Collection Strategy: Suggestions to Increase Revenue, Improve Taxpayer Service, and Further the IRS Mission*).
- 12 Taxpayer Delinquent Accounts (TDAs), NO-5000-149, *Recap of Accounts Currently Not Collectible Report* (Sept. 2014). “Shelved” cases are accounts that are not actively assigned, or are removed from active inventory due to their relatively low case assignment priority. See National Taxpayer Advocate 2013 Annual Report to Congress 124. See also Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2006-30-030, *High-Risk Work Is Selected From the Unassigned Delinquent Account Inventory, But Some Unassigned Accounts Need Management’s Attention* 16 (2006). Unlike “shelved” cases, the Queue holds cases until they can be assigned to Collection function employees. Cases in the Queue may end up being put in shelved status.
- 13 IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>. The right to finality provides that “[t]axpayers have the right to know the maximum amount of time they have to challenge the IRS’s position as well as the maximum amount of time the IRS has to audit a particular tax year or collect a tax debt. Taxpayers have the right to know when the IRS has finished an audit.” (emphasis added). The collection industry estimates that the probability of collecting unpaid accounts falls to 70 percent after three months, 52 percent after six months, and 23 percent after a year. See, e.g., TIGTA, Ref. No. 2011-30-112, *Reducing the Processing Time Between Balance Due Notices Could Increase Collections* 8 (2011) (citing collectability statistics based on a survey conducted by the Commercial Collection Agency Association).
- 14 In the collection arena, the right to privacy becomes meaningful and significant through Collection Due Process (CDP). IRC §§ 6320, 6330. Congress created CDP rights to provide extra measures of protection for taxpayers against abuse in the collection arena and included the balancing test among the three major elements of a CDP hearing to ensure that any collection action be “no more intrusive than necessary.” IRC § 6330(c)(3)(C). See also H.R. REP. No. 105-599, at 263 (1998) (Conf. Rep.); S. REP. No. 105-174, at 68 (1998).
- 15 TAS research has shown that factors related to trust in government and fairness appear to have significant influence on the taxpayer compliance behavior of self-employed taxpayers. National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2, 33-56 (Research Study: *Small Business Compliance: Further Analysis of Influential Factors*).
- 16 S. REP. No. 105-174 at 88 (1998).
- 17 RRA 98, Pub. L. No. 105-206 (1998); H.R. REP. No. 105-599, at 288-89 (1998) (Conf. Rep.).

In particular, Congress provided direct guidance to the IRS in its desire to see the implementation of ETA offers with RRA 98:

...[T]he conferees anticipate that the IRS will take into account factors such as equity, hardship, and public policy where a compromise of an individual taxpayer's income tax liability would promote effective tax administration. The conferees anticipate that ... the IRS may utilize this new authority to resolve longstanding cases by forgoing penalties and interest which have accumulated as a result of delay in determining the taxpayer's liability.¹⁸

The OIC Program Benefits Taxpayers and the IRS Alike by Improving Compliance and Bringing Finality to Accounts.

With a flexible offer program, the IRS wins by receiving money that it could not have collected through other means and achieving a promise of voluntary tax compliance from the taxpayer (at least for the next five years, which is long enough to create long-term change in noncompliant behavior).¹⁹ If the taxpayer does not follow the terms of the agreement, the OIC defaults and the debt is reinstated.²⁰ Offers accepted in FY 2013 have a 2013 compliance rate of 95.2 percent while the 2013 compliance rate for offers accepted in FY 2009 is 88.1 percent.²¹ The FY 2009 rate, which is the compliance rate after five years, is significantly higher than the comparable voluntary compliance rate for tax year (TY) 2009 for the individual taxpayers with tax delinquent accounts, which is 42 percent.²² For the taxpayer who has been noncompliant in the past, an accepted offer may become a fresh start. For the IRS, the OIC converts a noncompliant taxpayer into a compliant one. Overall, a flexible OIC program promotes effective and just tax administration.²³

Other IRS collection practices cannot claim the same positive outcomes. In 2011, TAS research showed that taxpayers with liens filed against them are less likely to reduce their initial liabilities and file required tax returns.²⁴ A 2012 TAS research study found 80 percent of taxpayers in currently not collectible (CNC) hardship status who also had offers had no tax liability at the end of the study, compared to about 20 percent of CNC hardship taxpayers without offers.²⁵

18 H.R. REP. No. 105-599, at 289 (1998) (Conf. Rep.).

19 IRS, Form 656-B, *Offer In Compromise* 5 (Jan. 2014).

20 See Internal Revenue Manual (IRM) 5.8.9.3, *Potential Default Cases*, (April 15, 2011); IRS, Form 656-B, *Offer In Compromise* (Jan. 2014).

21 IRS response to fact check (Nov. 26, 2014). The compliance rate is computed as $\{1 - (\text{default OICs} / \text{accepted OICs})\}$.

22 TAS computed compliance rates with the following formula: $(1 - \text{noncompliance rate})$. The noncompliance rate for tax years for individual taxpayers with delinquent tax accounts was computed by identifying those who had any tax delinquent accounts or delinquent tax investigations for subsequent tax years and dividing it by individual taxpayers with delinquent tax accounts for that year. Individual Taxpayers with TDAs Compliance rates, TAS Research (2014-12), Compliance rate for TY 2009 is $[1 - \{(1,878,396 \text{ taxpayers with TDAs or TDIs}) / (3,255,566 \text{ taxpayers with TDAs})\}]$, which equals 42.3 percent.

23 One attorney who testified before Congress regarding RRA 98 called the IRS's handling of offers "the biggest scandal in American taxation today." The attorney observed, "The IRS is willing to force an otherwise productive taxpayer into bankruptcy rather than to accept a fair offer in compromise." *IRS Restructuring, Hearings Before the S. Comm. on Finance*, 105th Cong. 129 (1998) (statement of Robert Schriebman, Tax Attorney).

24 See National Taxpayer Advocate 2011 Annual Report to Congress, vol 2 94. However, lien filing may have a positive effect on future payment. The study points out that it is unclear if the lien filing improved future payment or if lien filing merely reduces the likelihood that a taxpayer will report a subsequent liability. See National Taxpayer Advocate 2011 Annual Report to Congress, vol. 2 91-112 (Study: *Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*).

25 See National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 123.

However, to be effective the OIC program must analyze the facts and circumstances particular to each taxpayer submitting an offer. A study commissioned by the IRS found that lack of flexibility and consistency in evaluating the overall financial situation of the taxpayer was a recurring perception among study participants.²⁶

In Practice, Many Taxpayers Experience Significant Hardship Due to Underuse of the OIC Program.

In FY 2014, the IRS received 66,155 new offers and accepted 26,924.²⁷ Accepted offers declined by approximately 13 percent from the same period in FY 2013, when the IRS received 71,644 new offer cases and accepted 30,840 OICs.²⁸ Figure 1.20.1 shows received and accepted OICs since FY 2010.²⁹

FIGURE 1.20.1, OIC receipts, acceptances, and receipts by taxpayer type^{30,31,32,33}

Fiscal year	Receipts	Receipts less transfers to Appeals	IMF and BMF taxpayers receipts	Acceptances
2010	56,539	n/a	52,211	13,886
2011	59,411	n/a	54,786	19,562
2012	63,801	n/a	59,515	23,628
2013	74,217	71,644	69,385	30,840
2014	69,735	66,155	61,882	26,924

Meanwhile, the number of taxpayers in CNC hardship status has risen from 2.5 million to 2.8 million, or 11 percent, between September 2007 and September 2014.³⁴ The CNC inventory now holds \$82.5 billion in inventory, a 70 percent increase from September 2007.³⁵

26 MITRE Corporation, *Offer in Compromise Study: Achieving Increased Offer in Compromise (OIC) Program Participation Requires New Approaches* (Jan. 29, 2010). The IRS engaged the MITRE Corporation to study the OIC application process and “provide an independent perspective on the decline in OIC applications.” As one part of the study, MITRE interviewed more than 40 internal and external stakeholders.

27 IRS, *OIC Executive Summary Report* (Sept. 2014). The amount reported is the net receipt of OICs on a national level, which is defined as the amount of national new receipts plus the amount of national doubt as to liability receipts.

28 *Id.*

29 IRS response to TAS research request (July 31, 2014). The number of receipts includes processable receipts. Accepted offers are based on year of receipt.

30 IRS, *OIC Executive Summary Report*, (Sept. 2010–2014), Receipts (New Cases).

31 *Id.* Receipts Less Transfers to Appeals (Net Receipts). IRS began reporting in FY 2013.

32 IRS response to fact check (Nov. 26, 2014), IMF and BMF taxpayers’ receipts.

33 IRS, *OIC Executive Summary Report*, (Sept. 2010 - 2014), Accepts.

34 IRS, NO-5000-149, *Recap of Accounts Currently Not Collectible Report* (Sept. 2007); IRS, NO-5000-149, *Recap of Accounts Currently Not Collectible Report* (June 2014). The 2,515,349 CNC hardship taxpayers increased to 2,794,869 taxpayers from September 2007 to September 2014.

35 *Id.* The CNC inventory went from \$48,690,826,891 in September 2007 to \$82,538,709,904 in September 2014.

With a flexible offer program, the IRS wins by receiving money that it could not have collected through other means and achieving a promise of voluntary tax compliance from the taxpayer (at least for the next five years, which is long enough to create long-term change in noncompliant behavior).

When the IRS determines that a taxpayer cannot afford to pay his or her debt but chooses CNC over an offer as the suitable solution, it denies a prompt resolution for both the taxpayer and the IRS. The IRS can consider offers for low income taxpayers because employees are instructed to not reject an offer solely based on the amount.³⁶ In fact, one 2010 study estimated that \$8.5 million in additional revenue could be obtained by targeting taxpayers facing economic hardship.³⁷ However, several factors are preventing a flexible use of offers.

Lack of Appropriate Staffing Precludes a Thorough Review of Submitted Offers.

Since 2000, the OIC program and OIC-related issues have appeared consistently as a Most Serious Problem in the National Taxpayer Advocate's Annual Report to Congress.³⁸ One area of concern is the inadequate staffing for the OIC program.³⁹ In fact, OIC receipts increased steadily from FY 2010 to FY 2013, with a decrease of about 11 percent in FY 2014.⁴⁰ Total OIC staffing has remained virtually constant since 2007 and is approximately half of what it was in 2004, as shown in Fig 1.20.2.

36 See IRC § 7122(d)(3)(A). The National Taxpayer Advocate, who at the time was executive director of the Community Tax Law Project in Richmond, Virginia, testified that "There should be no minimum amount for an offer and compromise based as to doubt as to collectability... Any other policy allows certain taxpayers to buy piece of mind while others cannot." *IRS Restructuring, Hearings Before the S. Comm. on Finance, 105th 125 Cong. (1998)* (statement of Nina E. Olson, Executive Director, Community Tax Law Project).

37 This measurement is an estimate based on 5 percent of 300,000 taxpayers in CNC status. See IRS, *IRS Collection Process Study, Final Report 141-142* (Sept. 30, 2010).

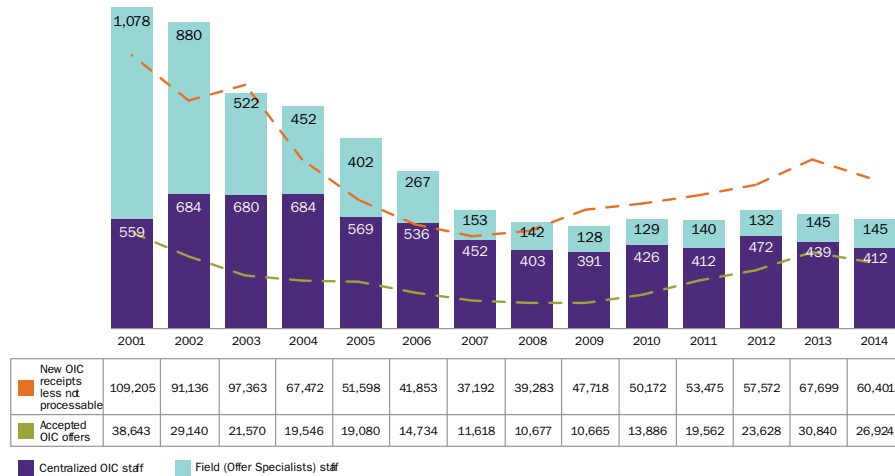
38 See National Taxpayer Advocate 2000-2013 Annual Reports to Congress.

39 TIGTA, Ref. No. 2012-30-033, *Increasing Requests for Offers in Compromise Have Created Inventory Backlogs and Delayed Responses to Taxpayers* (Mar. 30, 2012).

40 IRS Collection Report NO-5000-108, Monthly Report of OIC Activity, Cumulative Through September, 2008-2014. Processable OIC receipts increased an average of 10.5 percent from FY 2008 to FY 2013. The change in processable receipts for FY 2014 from FY 2013 was -10.8 percent.

FIG. 1.20.2⁴¹

OIC staffing and OIC processable receipts and acceptances, FYs 2001-2014



The Treasury Inspector General for Tax Administration (TIGTA) recently recommended that in light of the growth in delinquent accounts and the reduction in IRS staffing, it is “essential that the field inventory selection process identifies the cases that have the highest risk and potential for collection.”⁴² TIGTA also reported that because the probability that revenue will be collected is not “fully considered” when cases are selected for inventory, a large number of cases are assigned to field collection that involve taxpayers who have no ability to pay or cannot be found.⁴³ Since the revenue officers working these cases are already conducting the financial analysis to determine CNC status, a flexible approach to OIC consideration prior to putting a case in CNC status could further Congress’s intent and protect taxpayer rights.

Reliance on the Queue Discourages Use of the OIC.

The Queue is where the IRS holds aging accounts until they are paid, written off, or pulled for assignment to the Collection Field function (Cff). In theory, the assignment of a case to the Queue is a temporary condition; cases reside in the Queue until the Cff has resources to work them.⁴⁴ In practice, the Queue is not “temporary;” rather, the backlog has become an institutionalized segment of the IRS

41 Staffing counts are as of the beginning of the fiscal year, except for the staffing count in 2014, which is as of June 2014. IRS response to TAS research request (July 31, 2014). There is another group of Field OIC staff that the IRS started tracking in 2013. We have limited the discussion to field offer specialists and centralized OIC staff since there is no earlier history on the third group. We are unable to say how the change has occurred over time, since the IRS was not tracking them as it had with the field offer specialists and centralized OIC staff. Also, prior to August 2001, all offers regardless of complexity were handled in the field by revenue officers. In that month, the IRS commenced a new approach to processing offers, the Centralized OIC (COIC) initiative. The initial processing of all offers, and complete processing of wage earner offers is now handled in two campus locations. As a result, the number of revenue officers working offers is sharply reduced as of 2002. See National Taxpayer Advocate 2002 Annual Report to Congress 15.

42 TIGTA, Ref. No. 2014-30-068, *Field Collection Could Work Cases With Better Collection Potential* 4 (Sept. 12, 2014).

43 *Id.* at 5-7 (Sept. 12, 2014). The report shows that 40 percent of TDAs closed by field collection are determined to be CNC.

44 For more information on the Queue, see National Taxpayer Advocate 2010 Annual Report to Congress, vol. 2, 39-70 Research Study: *An Analysis of the IRS Collection Strategy: Suggestions to Increase Revenue, Improve Taxpayer Service, and Further the IRS Mission*.

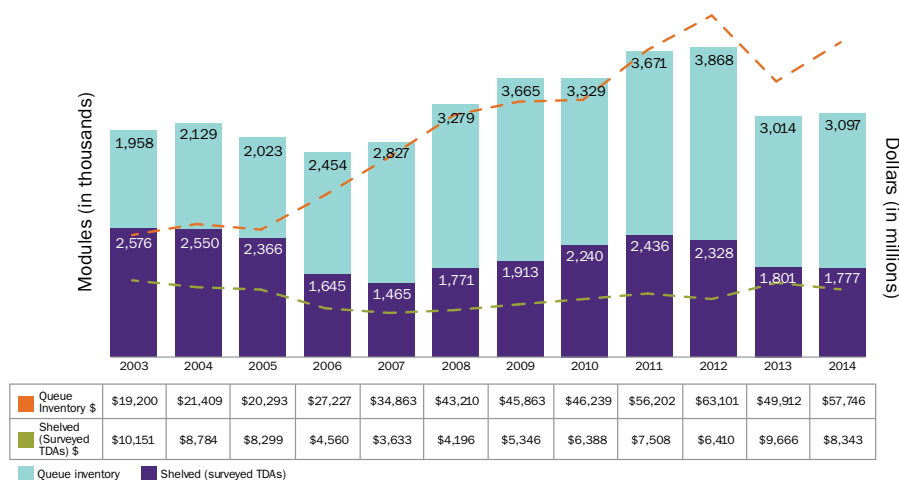
collection process.⁴⁵ The Queue’s inventory has increased 26 percent since 2006; as of September 30, 2014, the Queue held 3,097,401 TDA modules, valued at \$57.7 billion.⁴⁶

Recently, the IRS has also been placing Automated Collection System (ACS) cases in a “shelved” status, closed as CNC, as another means of moving cases from active collection status.⁴⁷ The cases in this status have risen from 1.5 million TDAs in September 2007 to 1.8 million in September 2014, an increase of roughly one fifth.⁴⁸ However, the dollar amount in inventory has jumped from \$3.6 billion in September 2007 to \$8.3 billion in September 2014, an increase of 130 percent.⁴⁹ This is a large increase in potentially lost revenue.

Figure 1.20.3, below, shows the growth of inventories in the Queue and shelved status between FYs 2003 and 2014. In particular, the Queue experienced growth between 2005 and 2009, and then declined in FY 2010, followed by increases in fiscal years 2011 and 2012. The Queue decreased in FY 2013, and was flat in FY 2014. The cases in shelved status increased from FY 2008 to FY 2011, but have been in a decline since.

FIGURE 1.20.3⁵⁰

Queue inventory and shelved (surveyed TDAs), modules, FYs 2003-2014



45 The National Taxpayer Advocate concluded in 2012 that the “use of the Queue appears to have heavily contributed to the indifference of the IRS to the aging of collection accounts, and to the negative outcomes that the delays in case processing have for taxpayers and the IRS’s business results.” See National Taxpayer Advocate 2012 Annual Report to Congress 370.

46 IRS, NO-5000-2, *Taxpayer Delinquent Accounts Report* (Oct. 2006); IRS, NO-5000-2, *Taxpayer Delinquent Accounts Report* (Sept. 2014). Queue inventory went from 2,453,556 cases in September 2006 to 3,097,401 cases in September 2014.

47 For information on shelved status, see National Taxpayer Advocate 2013 Annual Report to Congress 124. See also TIGTA, Reference No. 2006-30-030, *High-Risk Work Is Selected From the Unassigned Delinquent Account Inventory, But Some Unassigned Accounts Need Management’s Attention* 16 (Feb. 2006).

48 IRS, NO-5000-149, *Recap of Accounts Currently Not Collectible Report* (Sept. 2007); IRS, NO-5000-149, *Recap of Accounts Currently Not Collectible Report* (Sept. 2014).

49 *Id.* The dollar amount in TDA inventory went from \$3,632,927,063 in September 2007 to \$8,342,735,676 by September 2014.

50 IRS, Queue Inventory: Collection Report No. 5000-2, *Taxpayer Delinquent Account Cumulative Report, Part 1 - TDA’S* (2003-2014) and IRS, Shelved (Surveyed TDAs): IRS Collection Report No. 5000-149, *Recap of Accounts Currently Not Collectible Report* (2003-2014).

The number of accepted offers decreased approximately 13 percent compared to fiscal year 2013, when the IRS received 71,644 new offers and accepted 30,840 offers. Meanwhile, the IRS continues to place billions of dollars' worth of accounts in its collection "Queue" and other inactive statuses.

The primary reason for rejected and returned offers since 2010 has been the IRS's determination that the taxpayer can pay in full.⁵¹ However, a 2004 IRS study showed that reliance on this determination can lead to the IRS rejecting an offer and then ultimately not collecting anything from the taxpayer.⁵² The study found that in 31 percent of the rejected OIC cases reviewed, the IRS collected less than 10 percent of the offered amounts and in 21 percent the IRS collected nothing at all.⁵³ Similar to our measurements today, this study reported that "in most situations the decision to reject an OIC was based on a determination by the IRS that it could collect more than the offer amount."⁵⁴ Yet the 2004 study shows that in a significant number of cases, the IRS did *not* collect more revenue and walked away from dollars that were actually offered.⁵⁵ The study also found that of the rejected or withdrawn offers in CNC status, 27 percent of individual offers and 49 percent of business offers were in CNC status while the offer was being considered.⁵⁶ Since the taxpayer was not collectible, it is likely the taxpayer was offering funds that were supplied by someone who has no liability for the tax debt, *e.g.*, a parent, a friend, or a church or charity. By rejecting or requiring withdrawal of the offer, the IRS turned down funds that it could not otherwise reach. These 2004 observations are relevant today, given the growth in CNC inventory.

The IRS Discourages a Flexible Use of the ETA Offer.

The ETA offer allows the IRS to consider the circumstances that led to a delinquency and weigh the long-term benefits of allowing an otherwise viable taxpayer to become compliant.⁵⁷ ETA offers are allowed even if the IRS could achieve full collection when that full collection would create an economic hardship for

51 IRS response to TAS research request (July 31, 2014). The IRS relies on IRM 5.8.4.3 when determining if a taxpayer can full pay. IRM 5.8.4.3, *Doubt as to Collectibility*, (May 10, 2013).

52 In FY 2003, SB/SE and the Office of Program Evaluation and Risk Analysis (OPERA) analyzed the OIC program to study, among other things, the ultimate collection outcomes of offers that had been closed as either rejected, withdrawn, or returned. OPERA, *IRS Offers in Compromise Program, Analysis of Various Aspects of the OIC Program 2-6* (Sept. 2004). The study highlighted the fact that the value of an accepted offer is more than the actual money generated from the offer but that "potentially lost revenue can be 'protected' by correcting the delinquent behavior, and getting these taxpayers on the right taxpaying track."

53 *Id.* at 11. The study involved analysis of every closed OIC during the period of October 1998 through July 2003. See also National Taxpayer Advocate 2006 Annual Report to Congress 106.

54 *Id.* at 8.

55 *Id.* at 9. The study reported that offers accepted between 1995 and 2001 had a 60 percent compliance rate, and this could go to 80 percent when taxpayers with first collection notices are excluded. This compliance rate is much higher than the 39 percent compliance rate for rejected cases that either full paid or entered into an installment agreement. Acceptance of these rejected offers could have generated greater compliance and payments received.

56 OPERA, *IRS Offers in Compromise Program, Analysis of Various Aspects of the OIC Program 9* (Sept. 2004).

57 For information on how the low ETA offer acceptance rate affects business taxpayers in particular, see Most Serious Problem: *OFFERS IN COMPROMISE: The IRS Does Not Comply With the Law Regarding Victims of Payroll Service Provider Failure*, *infra*; National Taxpayer Advocate 2013 Annual Report to Congress 134-146 (Most Serious Problem: *COLLECTION PROCESS: IRS Collection Procedures Harm Business Taxpayers and Contribute to Substantial Amounts of Lost Revenue*); National Taxpayer Advocate 2012 Annual Report to Congress 348-357 (Introduction: *The IRS "Fresh Start" Initiative Has Produced Significant Improvements in Some Collection Policies; However, Significantly More Emphasis on Service Delivery Is Necessary to Realize the Full Benefits of These Important Changes*). See also National Taxpayer Advocate 2012 Annual Report to Congress 426-444 (Most Serious Problem: *Early Intervention, Offers in Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance*).

the taxpayer.⁵⁸ The IRS also accepts ETA offers when the taxpayer identifies “compelling public policy or equity considerations.”⁵⁹

In light of the growth in the Queue, shelving, and CNC, we should see more ETA offers being accepted. The acceptance rate rose from 40 percent in 2010 to 52.9 percent in 2014.⁶⁰ The acceptance rate of non-economic hardship (NEH) ETA offers increased from 31.4 percent in FY 2010 to 58.4 percent in FY 2014.⁶¹ Figure 1.20.4 shows the ETA and NEH ETA offers received and accepted by the IRS between FYs 2010 and 2014.⁶²

FIGURE 1.20.4, ETA and NEH ETA offers received and accepted⁶³

Fiscal year	ETA Offers			NEH-ETA Offers			
	Receipts	Dispositions	Accepted	Receipts	Dispositions	Accepted	Accepted other than NEH
2010	1,457	1,136	460	61	51	16	5
2011	1,553	1,479	602	76	89	27	3
2012	2,086	1,841	826	56	67	21	7
2013	2,336	2,352	1,147	77	59	26	4
2014	1,486	2,019	1,069	100	89	52	7

The regulations require the taxpayer submitting an ETA offer on public policy grounds to “demonstrate circumstances that justify compromise even though a similarly situated taxpayer may have paid his liability in full.”⁶⁴ Based on this guidance, the IRS has implemented procedures that may discourage the acceptance of ETA offers. For instance, the IRS acknowledges that when considering an ETA offer on public policy or equity grounds, “the compromise ... will often raise the issue of disparate treatment of taxpayers who can pay in full and whose liabilities arose under substantially similar circumstances.”⁶⁵ A taxpayer seeking an OIC under this category bears the burden of demonstrating “circumstances that are compelling enough to justify compromise notwithstanding this inherent inequity.”⁶⁶

58 See Treas. Reg. § 301.7122-1(b)(3)(i).

59 See Treas. Reg. § 301.7122-1(b)(3)(ii).

60 IRS response to fact check (Nov. 26, 2014). Acceptance rate is computed as accepted ETA offers divided by ETA dispositions.

61 *Id.* Acceptance rate is computed as accepted NEH-ETA offers divided by NEH-ETA dispositions.

62 IRS response to TAS research request (July 31, 2014). Offers submitted under NEH-ETA may also be accepted under doubt as to collectability criteria.

63 IRS response to TAS fact check (Nov. 26, 2014).

64 Treas. Reg. § 301.7122-1(b)(3)(ii).

65 IRM 5.8.11.2.2(3), *Public Policy or Equity Grounds*, (Sept. 23, 2008).

66 *Id.*

In cases involving non-hardship ETA offers, “[t]he circumstances of the case must be such that other taxpayers would view the compromise as a fair and equitable result.”⁶⁷ The IRM goes on to say that “it should not appear to other taxpayers that the result of the compromise places the taxpayer in a better position than they would occupy had they timely and fully met their obligations” (emphasis added).⁶⁸ This language does not appear in the regulations. Under the regulations, ETA offers based on public policy or equity may not be entered into if compromise of the liability “would undermine compliance by taxpayers with the tax laws.”⁶⁹ Factors that could support a determination that compromise would undermine compliance include:

- The taxpayer has a history of noncompliance with filing and payment requirements;
- The taxpayer has taken deliberate actions to avoid the payment of taxes; and
- The taxpayer has encouraged others to refuse to comply with the tax laws.⁷⁰

While achieving a “fair and equitable result” per the IRM is a commendable goal, the IRS’s requirement that the OIC should not be perceived by other taxpayers as placing the noncompliant taxpayer in a better position goes beyond the requirements in the regulations. It may lead to subjective determinations by IRS employees who are not in position to assume the perceptions of other taxpayers.⁷¹ If the IRS persists in requiring this subjective assessment, it should revise its procedures to have the National Taxpayer Advocate, as the voice of taxpayers within the IRS, determine whether other taxpayers would view the compromise as fair and equitable.

ETA offers submitted by businesses are specifically treated with caution to avoid “providing financial advantages through the forgiveness of tax debt.”⁷² As a result, the IRS has adopted an inflexible approach that “generally” requires an OIC submitted by an operating business provide for payment of the full amount of tax, exclusive of interest and penalties.⁷³ This is an illogical distinction to draw for offers submitted by businesses,⁷⁴ as individual taxpayers can also benefit from the acceptance of offers. For instance, if an individual satisfies a liability through an offer, the person may then be able to take vacations or buy cars whereas a taxpayer who has a debt and does not submit an offer or who has consistently paid all of his or her taxes may be struggling.

67 IRM 5.8.11.2.2(3), *Public Policy or Equity Grounds*, (Sept. 23, 2008).

68 *Id.* The taxpayer must also have remained in compliance since incurring the liability and overall their compliance history should not weigh against compromise. The taxpayer must have acted reasonably and responsibly in the situation giving rise to the liabilities.

69 Treas. Reg. § 301.7122-1(b)(3)(iii).

70 Treas. Reg. § 301.7122-1(c)(3)(ii). While the regulations point out that this list is not exhaustive, there is no mention of other taxpayers as a factor.

71 NEH ETA OIC denials based on IRS employees’ subjective determinations of other taxpayers’ potential perceptions may be viewed as arbitrary and capricious, and as such, may violate a taxpayer’s *right to a fair and just tax system*. For taxpayers who cannot access the OIC as a collection alternative, these procedures can undermine the *right to finality*.

72 IRM 5.8.11.4.3(2), *Determining an Acceptable Offer Amount*, (Sept. 23, 2008). For information on how this impacts businesses that have been victimized by fraudulent payroll service providers, see Most Serious Problem: *OFFERS IN COMPROMISE: The IRS Does Not Comply With the Law Regarding Victims of Payroll Service Provider Failure*, *infra*.

73 IRM 5.8.11.4.3 (Sept. 23, 2008).

74 See National Taxpayer Advocate Fiscal Year 2014 Objectives Report to Congress 19-25; National Taxpayer Advocate 2013 Annual Report to Congress 134-146 (Most Serious Problem: *COLLECTION PROCESS: IRS Collection Procedures Harm Business Taxpayers and Contribute to Substantial Amounts of Lost Revenue*); National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2, 33-56 (Research Study: *Small Business Compliance: Further Analysis of Influential Factors*); National Taxpayer Advocate 2011 Annual Report to Congress (Legislative Recommendation: *Amend IRC § 6343(a) to Permit the IRS to Release Levies on Business Taxpayers that Impose Economic Hardship*). In the context of trust fund recovery penalty, one court noted that the financially struggling business should be allowed “minimum working capital ... to maintain operations and avoid liquidation of the business.” See *In re Rossiter*, 167 B.R. 919 (C.D. Cal. 1994).

These procedures implicate the *right to a fair and just tax system*, which is officially described as the “right to expect the tax system to consider facts and circumstances that might affect [the taxpayer’s] underlying liabilities [and] ability to pay.”⁷⁵ Under the current IRS approach, taxpayers’ circumstances are not the focus of the analysis—rather it is some subjective perception on the part of the IRS about competitive “advantage.” These procedures also go against the clear congressional intent of a flexible OIC program.

The Underutilization of the OIC Program Undermines Taxpayers’ Rights.

Proper and flexible use of OICs is important for taxpayer rights such as *the right to be informed*, *the right to quality service*, *the right to finality*, and *the right to a fair and just tax system*.⁷⁶ Without access to OICs, many taxpayers lose an opportunity to settle their debt in a definitive way, as envisioned by Congress in RRA 98. Business taxpayers may be unable to resolve liabilities and may be forced to cease operations.⁷⁷ The *right to a fair and just tax system* means the IRS should consider the facts and circumstances of each taxpayer during the offer process. Thus, proper and timely consideration of OICs would promote taxpayer rights and result in improved compliance.

CONCLUSION

Congress intended for a flexible use of the OIC program. By not taking a flexible approach to OICs, the IRS is missing opportunities to improve compliance, collect revenue, and support the nation’s economy, including the following:

- The IRS is not following Congress’s mandate to effectively use the OIC as a viable compliance tool for all taxpayers;
- The IRS has greatly underutilized the ETA offer for all taxpayers, but Business Master File taxpayers in particular; and
- The IRS could enhance collection revenue using the OIC as an alternative to CNC status, shelved status, and the Queue.

⁷⁵ IRS, Publication 1, *Your Rights as a Taxpayer* (June 2014).

⁷⁶ See National Taxpayer Advocate 2013 Annual Report to Congress 5-19 (Most Serious Problem: *TAXPAYER RIGHTS: The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration*). To its credit, the IRS on June 10, 2014, adopted the Taxpayer Bill of Rights (TBOR) that the National Taxpayer Advocate has long recommended, pulling together in one basic statement the substantive rights scattered throughout the Internal Revenue Code.

⁷⁷ For instance, when a payroll service provider goes out of business for misappropriating its clients’ funds, the employers remain liable for the unpaid payroll tax, interest, and penalties that they have already paid. See National Taxpayer Advocate 2012 Annual Report to Congress 426-444 (Most Serious Problem: *Early Intervention, Offers in Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance*).

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Increase staffing in the OIC program to 2001 levels and train employees to evaluate complex offers. Staffing available to work offers can be increased by allowing all Revenue Officers to review and accept OICs as part of working their inventory.
2. Expand use of the Effective Tax Administration offer for both individual and business taxpayers with an emphasis on flexibility in evaluation of the taxpayer's circumstances.
3. Proactively identify cases that would be viable candidates for offers and reach out to those taxpayers prior to placing accounts in currently not collectible status, the Queue, or shelved status.
4. Increase the information and training about the OIC program provided to the Automated Collection System so employees can identify good offer candidates; and share more information with the Stakeholder Partnerships, Education and Communication unit, the Low Income Taxpayer Clinics, and the Volunteer Income Tax Assistance program.
5. Revise IRM 5.8.11.2.2(4) to remove the economic competition argument as it is irrelevant and violates the taxpayer's *right to a fair and just tax system*.
6. In the case of non-economic hardship ETA offers, if the IRS persists in requiring the subjective assessment of whether other taxpayers would view the compromise as a fair and equitable result, it should revise its procedures to have the National Taxpayer Advocate, as the voice of taxpayers within the IRS, determine whether other taxpayers would view the compromise as fair and equitable.