OIC Policies

On May 21, 2012 the Internal Revenue Service announced another expansion of its “Fresh Start” initiative by offering more flexible terms to its Offer in Compromise (OIC) program. This newest program promises to enable some of the most financially distressed taxpayers an opportunity to clear up their tax problems, and in many cases, more quickly than in the past.

Over the years the IRS offer in compromise program has been the subject of a great deal of criticism by Congress, the National Taxpayer Advocate and taxpayer representatives. The new initiative represents the most dramatic liberalization of IRS settlement policies ever announced. It represents a welcome change from an agency which has always placed substantial roadblocks to those seeking to compromise their tax obligations.

The announcement focused on the financial analysis used to determine which taxpayers qualify for an OIC. This announcement also enables some taxpayers to resolve their tax problems in as little as two years compared to four or five years in the past.

The changes include:

- Revising the calculation for the taxpayer's future income.
- Allowing taxpayers to repay their student loans.
- Allowing taxpayers to pay state and local delinquent taxes.
- Expanding the Allowable Living Expense allowance category and amount.

In general, an OIC is an agreement between a taxpayer and the IRS that settles the taxpayer's tax liabilities for less than the full amount owed. An OIC is generally not accepted if the IRS believes the liability can be paid in full as a lump sum or a through a payment agreement. The IRS looks at the taxpayer's income and assets to make a determination of the taxpayer's reasonable collection potential. OICs are subject to acceptance on legal requirements.

In the past the IRS strictly applied its rules with respect to taxpayers' budgets and valuation of assets. As a result, most taxpayers who sought a compromise received a rejection. Below are the statistics for offer acceptances during the past several years:

Offers	**2007**	**2008**	**2009**	**2010**	**2011**
Received by IRS	**46,000**	**44,000**	**52,000**	**57,000**	**59,000**
Accepted by IRS	**12, 000**	**11,000**	**11,000**	**14,000**	**20,000**

Under the new policy when the IRS calculates a taxpayer's reasonable collection potential, it will now look at only one year of future income for offers paid in five or fewer months, down from four years; and two years of future income for offers paid in six to 24 months, down from five years. All offers must be fully paid within 24 months of the date the offer is accepted. The prior policy resulted in IRS demands for very large compromise payments even when the taxpayer had few assets. The revisions will result in a 75% reduction in the amount required to settle tax obligations in five or fewer months. They will result in a 60% reduction in the amount required to be fully paid within 24 months.

Other changes to the program include narrowed parameters and clarification of when a dissipated asset (one they no longer have) will be included in the calculation of reasonable collection potential. Over the past several years the IRS's used the concept of dissipated assets to demand substantial amounts in compromise of taxes even after the taxpayer had lost the assets. For example, in one matter a taxpayer had lost substantial amounts of money in the 2008 and 2009 stock market collapse. Notwithstanding that loss the IRS offer in compromise examiner took the position that the taxpayer would have to include the value of those losses in his total assets in order to receive a compromise. The IRS also aggressively claimed that taxpayers who lived an upper-middle-class lifestyle after their tax problems arose would be subject to its draconian dissipated asset theory.

The IRS also announced that equity in income producing assets generally will not be included in the calculation of reasonable collection potential for on-going businesses.

Allowable Living Expenses

When reviewing a taxpayer’s budget the IRS applies Allowable Living Expense standards to determine a taxpayer’s ability to pay. The standard allowances impose strict budgets upon a taxpayer in collection determinations by incorporating average expenditures for basic necessities. Notwithstanding substantial criticism of the IRS over the years it has insisted upon applying the same standards for food and clothing in all areas of the country whether high cost locales like Alaska,Hawaii, andNew York City or lower cost Midwestern areas. These standards are used when evaluating offer in compromise requests.

In response to criticisms from the national taxpayer advocate and taxpayer representatives, the IRS expanded the National Standard miscellaneous allowance to include additional items. Taxpayers can use the miscellaneous allowance for expenses such as credit card payments, bank fees and charges.

In the past the IRS refused to recognize very real taxpayer obligations to pay student loans and state tax delinquencies. The new guidance now allows payments for loans guaranteed by the federal government for the taxpayer's post-high school education. In addition, payments for delinquent state and local taxes may be allowed based on percentage basis of tax owed to the state and IRS.

The new offer in compromise policies should dramatically expand the universe of taxpayers eligible to compromise their outstanding tax obligations. In the past taxpayers generally had to pay the IRS the total value of all their assets plus 60 times their net monthly income after using the IRS strict allowable expense standards. The greater flexibility of the new policies will reduce the valuation of taxpayer assets and reduce the value of the future income component used to determine acceptable offers.

Over the past several years the IRS has announced a softening of its collection policies under its Fresh Start Program.

In 2008, IRS announced lien relief for taxpayers trying to refinance or sell a home. The IRS added new flexibility for taxpayers facing payment or collection problems in 2009. The IRS made changes to lien policies in 2011 and expanded the threshold for small businesses to resolve tax issues through installment agreements. And, earlier this year, the IRS increased the threshold for a streamlined installment agreement allowing individual taxpayers to set up an installment agreement without providing a significant amount of financial information.