

 Fact Sheet

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Revamped Offer in Compromise Program Plays New Role in Collection Process

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Effective July 16, 2006, a new federal law will change the way the offer in compromise (OIC) program operates and its role in the Internal Revenue Service collection process. In general, this means that:

- Taxpayers submitting lump-sum offers must make a 20 percent nonrefundable, up-front payment to the IRS;
- Taxpayers submitting a periodic-payment OIC must make a nonrefundable, up-front payment, plus any other proposed payments that may be due, while the IRS is evaluating the offer; and
- An OIC application is deemed accepted if the IRS fails to act upon it within two years.

The Collection Process

Most taxpayers file tax returns and pay what they owe on time. If a taxpayer does not pay, the IRS sends the taxpayer a bill. This begins the collection process. Along with the bill, which is called a notice, the IRS automatically sends Publication 1, Your Rights as a Taxpayer, and Publication 594, Understanding the Collection Process. These publications explain the various options and rights taxpayers have in dealing with the IRS.

Some taxpayers believe they cannot pay what they owe. However, taxpayers should consider liquidating assets (such as bank accounts, financial investment accounts, cars, boats, real estate, life insurance and 401(k) plans) to satisfy their tax debts. Taxpayers should also attempt to get a loan, if possible, to pay what they owe. Loan costs may be lower than the combination of interest and penalties imposed by the Internal Revenue Code (IRC). See, "How Full Payment of Taxes Saves Money," on the IRS Web site at <http://www.irs.gov/businesses/small/article/0,,id=124483,00.html>.

The IRS recognizes that sometimes taxpayers are unable to pay. Taxpayers who are unable to pay what they owe should contact the IRS as soon as possible. There are a number of payment solutions the IRS may be able to offer to the taxpayer including:

- **Extension of Time to Pay** — Taxpayers may be eligible for a short extension of time to pay of up to 120 days. Taxpayers should request an extension if they would be able to pay their taxes in full within the extended timeframe.
- **Installment Agreement** — In FY 2005, 2.6 million taxpayers paid their tax bills in monthly payments. Installment agreements paid directly from a bank account or payroll deduction from wages eliminate the need to mail payments and save postage costs, as well. By insuring that the IRS receives payments on time, these automatic payment methods also help taxpayers avoid defaulting on their installment agreements.
- **Delaying Collection** — If the IRS determines that a taxpayer is unable to pay, it may delay collection until the taxpayer's financial condition improves.
- **Offer in Compromise** — Some taxpayers are able to settle their tax bill for less than the amount they owe by submitting an offer in compromise. However, the criteria for accepting an offer are strict and relatively few offers are accepted each year.

An offer in compromise may be considered only after all other payment options have been exhausted.

Taxpayers who are unable to pay their taxes in full and who have explored the various options should use the checklist in the Form 656, Offer in Compromise, package to determine if they are eligible for an offer in compromise.

New Law

The Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA), section 509, made major changes to the IRS OIC program. These changes affect all offers received by the IRS on or after July 16, 2006. The postmark date on the offer is irrelevant.

TIPRA section 509 amends IRC section 7122 by adding a new subsection (c) “Rules for Submission of Offers-in-Compromise.”

A taxpayer filing a lump-sum offer must pay 20% of the offer amount with the application (IRC 7122(c)(1)(A)). A lump-sum offer means any offer of payments made in five or fewer installments.

A taxpayer filing a periodic-payment offer must pay the first proposed installment payment with the application and pay additional installments while the IRS is evaluating the offer (IRC section 7122(c)(1)(B)). A periodic-payment offer means any offer of payments made in six or more installments.

Taxpayers can avoid delays in processing their OIC applications by making all required payments in full and on time. Failure to pay the 20 percent on a lump-sum offer, or the first installment payment on a periodic-payment offer, will result in the IRS returning the offer to the taxpayer as nonprocessable (IRC section 7122(d)(3)(C) as amended by TIPRA).

The 20 percent payment for a lump-sum offer and the installment payments on a periodic-payment offer are “payments on tax” and are not refundable deposits (IRC section 7809(b) and Treasury Regulation 301.7122-1(h)).

Taxpayers must specify in writing when submitting their offers how to apply the payments to the tax, penalty and interest due. Otherwise, the IRS will apply the payments in the best interest of the government (IRC section 7122(c)(2)(A)).

The OIC application fee reduces the assessed tax or other amounts due. A taxpayer may not specify how to apply the \$150 application fee.

Taxpayers failing to make installment payments on periodic-payment offers after providing the initial payment will cause the IRS to treat the offer as a withdrawal. The IRS will return the offer application to the taxpayer (IRC section 7122(c)(1)(B)(ii)).

A lump-sum offer accompanied by a payment that is below the required 20 percent threshold will be deemed processable. However, the taxpayer will be asked to pay the remaining balance in order to avoid having the offer returned. Failure to submit the remaining balance will cause the IRS to return the offer and retain the \$150 application fee.

Taxpayers filing periodic-payment offers must submit the full amount of their first installment payment in order to meet the processability criteria. Otherwise, the IRS will deem the offer as unprocessable and will return the application to the taxpayer along with the \$150 fee.

Under the new law, taxpayers qualifying as low-income or filing an offer solely based on doubt as to liability qualify for a waiver of the new partial payment requirements. Taxpayers qualifying for the low-income exemption or filing a doubt-as-to-liability offer only are not liable for paying the application fee, or the payments imposed by TIPRA section 509.

A low-income taxpayer is an individual whose income falls at or below poverty levels based on guidelines established by the U.S. Department of Health and Human Services (HHS). Taxpayers claiming the low-income exception must complete and submit the *Income Certification for Offer in Compromise Application Fee* worksheet, along with their Form 656 application package.

The IRS will deem an OIC “accepted” that is not withdrawn, returned, or rejected within 24 months after IRS receipt. When calculating the 24-month timeframe, the IRS will disregard any time periods during which a liability included in the OIC is the subject of a dispute in any judicial proceeding (IRC section 7122(f) as amended by TIPRA).

Additional information is available in IRS Publication 594, Understanding the IRS Collection Process, and Form 9465, Installment Agreement Request. These documents provide complete information on all options available and help taxpayers determine if they qualify for a payment program.

Related Items:

Form 656, Offer in Compromise [PDF 2.63MB](http://www.irs.gov/pub/irs-pdf/f656.pdf), (<http://www.irs.gov/pub/irs-pdf/f656.pdf>)