



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

SMALL BUSINESS/SELF-EMPLOYED DIVISION

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MEMORANDUM FOR DIRECTOR, SPECIALTY - OFFERS, LIENS AND ADVISORY

FROM: Kristen E. Bailey /s/ *Kristen E. Bailey*
DIRECTOR, COLLECTION POLICY

SUBJECT: Calculation of Reasonable Collection Potential in Certain Offers in
Compromise Cases

This memorandum provides interim guidance (IG) for Collection employees and supplements the procedures found in Internal Revenue Manual (IRM) [5.8.5, Offers in Compromise - Financial Analysis](#), and [IRM 5.8.7, Offers in Compromise, Return, Terminate, Withdraw, and Reject Processing](#). This guidance will be incorporated into the next revision of these IRM sections.

The Procedures section contains instructions on the investigation of offers involving businesses cultivating and selling marijuana, which may be located in states where the activity is permitted by statute even while that activity remains a violation of federal law.

Background

Several state legislatures have passed laws legalizing the cultivation and sale of marijuana. These laws have created a conflict between federal law and state law. Since the Internal Revenue Service must adhere to federal law, these new state statutes do not have any impact on federal tax law when determining allowable expenses for income tax purposes.

[IRM 5.8.7.7.2, Public Policy Rejection](#), provides guidance on when it may be appropriate to reject an offer in compromise (OIC) on the basis of public policy. It references [IRM 1.2.14.1.15, Policy Statement P-5-89](#). This policy statement was issued to clarify when rejection of an offer for public policy reasons is appropriate. The policy statement allows for rejection where acceptance of the OIC may in any way be detrimental to the interest of fair tax administration, even though it is shown conclusively that the amount offered is greater than could be collected by other means, provided no Effective Tax Administration (ETA) issues exist.

Examples cited in [IRM 5.8.7.7.2, Public Policy Rejection](#), include, "Indicators exist showing that the financial benefits of a criminal activity are concealed or the criminal activity is continuing." Although in most instances, the criminal activity referenced refers to violations of federal law, violations of state or local laws may also be considered in rejecting an OIC under the policy.

Procedures

Whether any offer is acceptable remains a determination of the facts and circumstance of the specific case. However, in general do not reject, under public policy provisions, offers falling within the parameters of this guidance.

Two components of collectibility are the taxpayer's net realizable equity in assets, and the amount collectible from taxpayer's expected future income.

Equity in the taxpayer's assets should be determined in accordance with [5.8.5, Offers in Compromise - Financial Analysis](#):

- > fair market value of property;
- > minus any encumbrances determined to have priority over the federal tax lien.

Value of future income should be calculated based on the following guidance:

- > determine the taxpayer's gross income over a specific time period (normally annually);
- > limit allowable expenses consistent with Internal Revenue Code Section 280E, where a taxpayer may not deduct any amount for a trade or business where the trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances;
- > contact the Examination Division, if appropriate, for assistance in determining if the cost of the product or any related expenses, may be allowable under current examination guidelines.

NOTE: Only expenses which are allowable on the taxpayer's income tax return based on current federal law will be included in determining future income value.

Other components of collectibility referenced in [IRM 5.8.4.3.1, Components of Collectibility](#), should also be included in the acceptable offer amount, if appropriate.

If a determination is made that the taxpayer's offer should be accepted based on the calculation of reasonable collection potential as discussed above, the offer should be accepted under Effective Tax Administration, Public Policy and approved by the Field Territory Manager.

These provisions are specific to the marijuana industry, where state statutes allow the activity, and are not intended as guidance for other instances involving taxpayers who are in violation of federal law.

You or a member of your staff may direct any questions to Diana Estey, National Offer in Compromise Program Manager, or Thomas B Moore, Senior Analyst.

cc: Office of Chief Counsel
Chief, Appeals
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