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

SMALL BUSINESS/SELF-EMPLOYED DIVISION

May 20, 2013

Control Number: SBSE-05-0513-032
Expiration: December 1, 2013
Impacted: IRM 5.8.5

MEMORANDUM FOR DIRECTORS, FIELD COLLECTION AREA OPERATIONS
(CALIFORNIA, GULF STATES, AND SOUTH ATLANTIC)

DIRECTORS, CAMPUS COMPLIANCE SERVICES
(BROOKHAVEN AND MEMPHIS)

FROM: Scott D. Reisher **/s/ Scott D. Reisher**
Director, Collection Policy

SUBJECT: Interim Guidance Memorandum for Offer in Compromise
Defined in IRM 5.8.5, *Financial Analysis*

The purpose of this memorandum is reissue IGM 05-0512-041, Interim Guidance Memorandum for Offer in Compromise Defined in IRM 5.8.5, *Financial Analysis*, which provides expanded guidance to IRM 5.8.5. Significant information in this memorandum include defining equity in an on-going business, evaluation of money in bank accounts, reducing the equity in a vehicle, dissipated assets, retired debt, student loans, allowance for delinquent state and local income tax liabilities, and the future income multiplier. The attached updates were implemented May 21, 2012, and will be incorporated in the next revision of Internal Revenue Manual (IRM) 5.8.5, *Offer in Compromise - Financial Analysis*.

This memorandum superseded Interim Guidance Memorandums SBSE-05-0212-010, *Offer in Compromise Streamline Offer Processes for Field Offer Specialists*, and SBSE-05-0511-026, *Centralized Offer in Compromise Streamline Offer Processes*. The expectation is that the offer employee should continue to:

- Rely on internal record checks to determine ownership and equity in real and personal property, including motor vehicles,
- Use the telephone as your primary form of contact,
- Accept oral testimony, unless the information provided appears to be questionable, and
- Use the quick notes, when appropriate.

If you have any questions, please contact me, or a member of your staff may contact Diane Morris, Senior Program Analyst. COIC personnel should direct any questions through the appropriate management chain.

Attachments: (1)

cc: Chief, Appeals
Director, Field Collection
Director, Campus Compliance Services
Director, Filing and Payment Compliance
Assistant Division Counsel, SBSE
National Taxpayer Advocate
www.irs.gov

Attachment 1
IRM 5.8.5, *Financial Analysis*

IRM 5.8.5.5.1, Income-Producing Assets

(3) As a general rule, equity in income producing assets will not be added to the RCP of a viable, ongoing business unless it is determined the assets are not critical to business operations. The following examples provide guidance in evaluating equity and income produced by assets.

> Example (1) A business depends on a machine to manufacture parts and cannot operate without this machine. The equity is $100,000. The machine produces net income of $5,000 monthly. The RCP should include the income produced by the machine, but not the equity. Equity in this machine will generally not be included in the RCP because the machine is needed to produce the income, and is essential to the ability of the business to continue to operate.
>
> Note: It is in the government's best interest to work with this taxpayer to maintain business operations, particularly in a bad economy.
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> Example (2) The same business in the prior example, but the business can continue to operate without the machine, i.e. the equipment is not used in the process of generating the key product of the business. The machine generates only $500 net monthly income. Consider including the equity in the RCP and remove $500 from the business income.
>
> Example (3) A trucking company has ten trucks. Eight are fully encumbered and two trucks have no encumbrances and $30,000 in equity. The two trucks combined generate net income of $12,000 per year. Add the net income from the trucks to the RCP and do not add the equity.
>
> Example (4) The same trucks described in the previous example generate only $1000 per year in net income, but have $30,000 in equity. If the business can successfully operate without the two trucks, consider removing the income from the RCP and including the equity in the RCP.
>
> Example (5) A real estate salesman has a vehicle with $30,000 in equity. The vehicle is used to transport clients and assists in the production of income. The taxpayer's net monthly disposable income is $3000. The equity in the vehicle generally will not be included in the RCP.
>
> Example (6) The same salesman in the previous example only has net monthly disposable income of $500 per month. Consider including the equity in the vehicle, yet allow for the impact the loss of the vehicle may have on the taxpayer's income.

(4) When considering equity in income producing assets and the effect on income streams and expenses, you must exercise sound judgment consistent with the unique facts of each case.

(5) Each case must be thoroughly documented regarding equity decisions in income producing property.

IRM 5.8.5.6, Cash

(1) Use the amount listed on the Form 433-A (OIC) for the amount of cash in the taxpayer's bank accounts. Reduce the total amount listed by $1,000. If the total amount listed on the Form 433-A (OIC) is over $1,000 and you have reason to believe the money will be used to pay for the taxpayer's monthly allowable living expenses, do not include it on the AET. Document the AOIC or ICS history with the findings.

(2) Review checking account statements over a reasonable period of time, generally three months for wage earners and six months for in-business taxpayers. Look for any unusual activity, such as deposits in excess of reported income, withdrawals, transfers, or checks for expenses not reflected on the CIS. The OE/OS should discuss these inconsistencies, if appropriate, with the taxpayer.

Example: The taxpayer lists $10,000 on Form 433-A (OIC). The taxpayer's allowable living expenses are $3,000. Include $6,000 ($10,000 less $1,000 less $3000) as an asset value on the AET.

Example: The taxpayer lists $3,000 on the Form 433-A (OIC) and his allowable living expenses are $2,700. Do not include any amount on the AET since the $300 difference is less than $1000.

(3) Review savings account statements over a reasonable period of time, generally three months.

- If the account has little withdrawal activity, use the ending balance on the latest statement, less $1,000, if not previously applied to other accounts, as the asset value for the AET.

- If it is apparent that the account is used for paying monthly living expenses, treat it as a checking account and follow the instructions in paragraphs (1) and (2) above to determine its value.

(4) If analysis of the bank statement reveals large amounts of recently expended funds, see IRM 5.8.5.16 below for a full discussion of the treatment of dissipated assets.

(5) If the taxpayer offers the balances of accounts (for example, certificate of deposit, savings bonds, etc.) to fund the offer, allow for any penalty for early withdrawal and the expected current year tax consequence.

IRM 5.8.5.11, Motor Vehicles, Airplanes, and Boats

(2) Exclude $3,450 per car from the *net* equity valuation of vehicles owned by the taxpayer(s) and used for work, the production of income, and/or the welfare of the taxpayer's family, up to two cars per household.

IRM 5.8.5.16, Dissipation of Assets

(1) Inclusion of dissipated assets in the calculation of the reasonable collection potential (RCP) is no longer applicable except in situations where it can be shown the taxpayer has sold, transferred, encumbered or otherwise disposed of assets in an attempt to avoid the payment of the tax liability or used the assets or proceeds (other than wages, salary, or other income) for other than the payment of items necessary for the production of income or the health and welfare of the taxpayer or their family, after the tax has been assessed or within six months prior to the tax assessment.

(2) Generally, a three year timeframe will be used to determine if it is appropriate to include a dissipated asset in RCP. Include the year of submission as a complete year in the calculation, For example, if the offer is submitted in 2012, any asset dissipated prior to 2010 should not be included.

- If the tax liability did not exist prior to the transfer or the transfer occurred prior to the taxable event giving rise to the tax liability, generally, a taxpayer cannot be said to have dissipated the assets in disregard of the outstanding tax liability.

- If a taxpayer withdraws funds from an IRA to invest in a business opportunity but does not have any tax liability prior to the withdrawal, the funds were not dissipated.

(3) If it is determined inclusion of a dissipated asset is appropriate and the taxpayer is unwilling or unable to include the value of the dissipated asset in the offer amount, the offer should be rejected as not in the government's best interest.

NOTE: Even if the transfer and/or sale took place more than three years prior to the offer submission, it may be appropriate to include the asset in the calculation of RCP if the asset transfer and/or sale occurred either within six months prior to or within six months after the assessment of the tax liability.

In these instances, a determination on whether the funds were used for health/welfare of the family or production of income would be appropriate.

(4) See below for examples of the types of situations where it may be appropriate to include, or not include, the value of an asset in the calculation of RCP. The examples provided are not meant to be all inclusive as each case must be evaluated on its own merit.

(5) Examples of situations in which the value of an asset *should* be included in RCP include, but are not limited to:

Note: Each of the examples in paragraph (5) occurred within three years prior to the offer submission or during the offer investigation, and the taxpayer dissipated the assets after incurring the tax liability or within six months prior to the tax assessment.

- The taxpayer dissolved an IRA or other investment account to pay for specific non-priority items, i.e. child's wedding, child's university tuition, extravagant vacation, etc.

- The taxpayer refinanced their house and used the funds to pay off credit card and non-secured debt. The credit cards were NOT used for payment of necessary living expenses and/or the production of income.

- The taxpayer inherited funds and used the funds for non-priority items (other than health/welfare of the family or production of income).

- The taxpayer closed bank/investment accounts and will not disclose how the funds were spent or if any funds remain.

- A taxpayer filed a CAP to avoid the filing of a NFTL and insisted the lien would impair his credit and his ability to successfully operate his business. After the non-filing was granted, the taxpayer fully encumbered his assets, used the funds for non-priority items (items not necessary for the production of income or the health and welfare of the taxpayer and/or their family) and then submitted an OIC.

- The taxpayer sold real estate and gifted the funds from the sale to family members.

(6) Situations may occur in which the transfer happened over 3 years prior to the offer submission, yet because of the timing of the transfer (within six months prior to or six months after the tax assessment), the inclusion of the asset in RCP may be appropriate.

Example: The taxpayer filed tax returns for five years (2001 - 2005) in February of 2007, which were assessed in March 2007. In January of 2007, the taxpayer transferred real property to a family member for no consideration. An offer was submitted in January 2012. In this instance, since the transfer was within six months of the tax assessments, it may be appropriate to include the value of the real property in RCP.

(7) Examples of situations in which the value of an asset *should NOT* be included in RCP, include but are not limited to:

- When it can be shown through internal research or substantiation provided by the taxpayer that the funds were needed to provide for necessary living expenses, these amounts should not be included in the RCP calculation.

- Dissolving an IRA during unemployment or underemployment. Review of available internal sources verified the taxpayer's income was insufficient to meet necessary living expenses. In this case, do not include the funds up to the amount needed to meet allowable expenses in the RCP calculation.

- Substantial amount withdrawn from bank accounts. Taxpayer provided supporting documentation that funds were used to pay for medical or other necessary living expenses. This amount will not be included in the RCP calculation.

- Disposing of an asset and using the funds to purchase another asset that is included in the offer evaluation. Do not include the value of the asset disposed of as a dissipated asset.

(8) Prior to including the dissipated asset in the RCP, the taxpayer should be contacted by telephone and afforded the opportunity to explain or verify the dissipation of the asset.

(9) The case history must be clearly documented with the basis for your decision regarding the dissipated asset.

IRM 5.8.5.17, Retired Debt

(3) Do not retire the first $400 of a loan on a vehicle (limited to one vehicle for a single taxpayer and two vehicles for a joint offer)

> **Example:** If the taxpayer has a car payment of $750 per month and the maximum standard is $450, $50 would be retired beginning the date the loan is paid.

IRM 5.8.5.20.3, Transportation Expenses

(5) When the taxpayer owns a vehicle that is six years or older or has reported mileage of 75,000 miles or more, allow an additional operating expense of $200 or more per vehicle. The additional operating expense will be allowed on any vehicle meeting the criteria, up to two cars per household.

> **Example:** The taxpayer who has a 1998 Chevrolet Cavalier with 50,000 miles will be allowed the standard of $231 per month plus $200 per month operating expenses for a total operating expense of $431 per month.

IRM 5.8.5.20.4, Other Expenses

(3) Minimum payments on student loans guaranteed by the federal government will be allowed for the taxpayer's post-high school education. Proof of payment must be provided. If student loans are owed, but no payments are being made, do not allow them, unless the non-payment is due to circumstances of financial hardship, e.g. unemployment, medical expenses, etc.

(7) When a taxpayer owes both delinquent federal and state or local taxes, and does not have the ability to full pay the liabilities, monthly payments to state taxing authorities may be allowed in certain circumstances.

a) Determine the disposable income on a Collection Information Statement (CIS), Forms 433-A (OIC) or 433-B (OIC). Do not include any amount that is being paid for outstanding state or local tax liabilities in the calculation of the future income value component (FIV) of the reasonable collection potential (RCP). FIV is the difference between gross income and allowable living expenses.

Calculate the dollar amounts for IRS and state or local payments based on the total liability owed to each agency (including penalties and interest to date).

> Example: The taxpayer owes the state $20,000 and owes the IRS $100,000, a total of $120,000 ($20,000/$120,000 = 17%; $100,000/$120,000 = 83%). The taxpayer has disposable income of $300 per month. A monthly payment to the state taxing authority of $51 may be allowed until the debt is retired. See the If/Then table below for examples.

- Seventeen percent (17%) of $300 = $51
- Eighty-three percent (83%) of $300 = $249

b) To determine allowable payments for delinquent state or local tax debts follow the procedures below:

If…	**And…**	**Then…**
(1) The taxpayer does	Provides a complete CIS	Follow procedures in

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IRM 5.8.5, *Financial Analysis*

If…	**And…**	**Then…**
not have an existing agreement for payment of the delinquent state or local tax debts,	and verification of state or local tax debts,	paragraph (a) above to establish the calculated percentage amount that will be determined as the allowable monthly payment for delinquent state or local taxes.
(2) The taxpayer has an existing agreement for delinquent state or local tax debts, which was established **after** the earliest IRS date of assessment,	The payment amount on the state or local agreement is **less** than the calculated percentage amount,	The monthly amount due on the existing state or local agreement will be listed as the allowable delinquent state or local tax payment. Example: The calculation based on the example in paragraph (a) above shows the taxpayer should pay $51 but the State agreement is for $50. Allow the State agreed payment of $50. The payment to IRS will be increased by the amount allowed for the monthly state or local payment when the state or local liability is scheduled to be full paid.
(3) The taxpayer has an existing agreement for delinquent state or local tax debts, which was established **after** the earliest IRS date of assessment,	The payment amount on the agreement is **more** than the calculated percentage amount,	The amount allowed as the delinquent state or local tax payment will be the calculated percentage amount. Advise the taxpayer that he/she can use the amount IRS allows for Miscellaneous expenses under National Standards to pay the additional amount due for the delinquent state or local tax payment.

If…	And…	Then…
		Example: The calculation based on the example in paragraph (a) above shows the taxpayer should pay $51 but the State agreement is for $52. Allow the calculated payment of $51. The payment to IRS will be increased by the amount allowed for the monthly state or local payment when the state or local liability is scheduled to be full paid.
(4) The taxpayer has an existing agreement for delinquent state or local tax debts, which was established **prior** to the IRS earliest date of assessment	The payment is not greater than the taxpayer's net disposable income	Allow the state or local tax agreement.

IRM 5.8.5.23, Calculation of Future Income

(2) Future income is defined as an estimate of the taxpayer's ability to pay based on an analysis of gross income, less necessary living expenses, for a specific number of months into the future. The number of months used depends on the payment terms of the offer.

If…	Then…
The offer will be paid in 5 or fewer installments in 5 months or less	Use the realizable value of assets plus the amount that could be collected in 12 months.
The offer will be paid in more than 5 installments or more than 5 months up to a maximum of 24 months	Use the realizable value of assets plus the amount that could be collected in 24 months.

Note: The deferred payment option which allows payment over the life of the statute is no longer available. With implementation of the multipliers, the maximum number of months for a deferred payment cannot exceed 24 months.