



MANUAL TRANSMITTAL

Department of the Treasury
Internal Revenue Service

5.8.6

OCTOBER 19, 2023

EFFECTIVE DATE

(10-19-2023)

PURPOSE

- (1) This transmits revised IRM 5.8.6, Offer in Compromise, Collateral Agreements.

MATERIAL CHANGES

- (1) This IRM section was updated to incorporate the following changes.

IRM Subsection	Change
5.8.6.1	Editorial changes, included link to IRM with policy statement.
5.8.6.2.1(5)	Clarified any payments received after CSED expiration are returned to the taxpayer.
5.8.6.2.1.1, 5.8.6.2.2, 5.8.6.2.3	Removed reference to addendum. Instructions to use date of Form 656 being accepted are clear.
5.8.6.2.2(6)	Slight change in verbiage regarding taxation of homestead proceeds.
5.8.6.2.3	Included additional description of losses in (1) and revised order of paragraphs. Moved paragraphs (8) and (9) regarding NOLs to 5.8.6.2.3.1.
5.8.6.2.3(7)	Removed from second example: "Alternately, you may use paragraph 2 of the Form 2261-C..." as it is duplicative of information in IRM 5.8.2.3.1(4).
5.8.6.2.3	Included more description in (1); moved former (7) to (2) and moved (8) and (9) to IRM 5.8.6.2.3.1 for more accurate flow.
5.8.6.2.3.1	Removed detailed information about NOL rules from prior years and added definition and reference to IRM 4.11. Added note re: beginning year.
5.8.6.2.3.2	Added note re: beginning year.

IRM Subsection	Change
5.8.6.2.4	Added section "Taxpayers Who Also Owe Restitution-Based Assessments."
5.8.6.4	Replaced paragraphs referencing refund offset. As of November 1, 2021 the OIC refund recoupment process is no longer applicable for offsetting to tax periods included on the Form 656. Added guidance for instances when a significant refund is expected.
5.8.6.5.2(1)	Added example of special use collateral agreement.
5.8.6.5.2(4)	Added steps required to record in AOIC the need to monitor RBA payments.

- (2) Incorporated SBSE-05-1021-0063, Interim Guidance on Refund Recoupments.
- (3) Editorial changes were made throughout the document.

EFFECT ON OTHER DOCUMENTS

This material supersedes IRM 5.8.6, dated 06/25/2021 and incorporates SBSE-05-1021-0063 dated 10-28-2021, Interim Guidance on Refund Recoupments.

AUDIENCE

SB/SE Compliance employees

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5.8.6
Collateral Agreements

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5.8.6.1
(10-19-2023)
Program Scope and Objectives

- (1) **Purpose:** A collateral agreement enables the government to collect funds in addition to the payments offered in Form 656 or to add additional terms not included in the standard Form 656 agreement, thereby recouping part of the difference between the amount of the offer or additional terms of the offer and the liability compromised. This section discusses how to evaluate circumstances that may warrant such an agreement, and how to utilize the various collateral contracts.
- (2) **Audience:** These procedures apply to IRS employees who are responsible for investigating offers.
 - Offer examiners (OE) in Centralized Offer in Compromise (COIC)
 - Offer specialists (OS) in the field offer territories (FOIC)
 - Additional IRS employees assigned to the offer program and employees who conduct offer in compromise investigations
- (3) **Policy Owner:** Director, Collection Policy, SBSE
- (4) **Program Owner:** Collection Policy, SBSE, Offer in Compromise (OIC) Program
- (5) **Primary Stakeholders:** COIC and FOIC employees
- (6) **Program Goals:** Policy Statement 5-100, IRM 1.2.1.6.17, explains the objective of the OIC as a collection tool. By following the procedures in this IRM, employees engaged in the investigation of offers will determine when a collateral agreement may be appropriate, and the actions necessary when a collateral agreement is a component of an offer in compromise.

5.8.6.1.1
(06-25-2021)
Background

- (1) An offer in compromise (referred to as an offer or OIC) is a way for the IRS to recoup a portion of the monies owed by taxpayers unable to pay their taxes in full. Revenue Procedure 2003-71 and Notice 2006-68 explain the procedures applicable to the submission and processing of offers to compromise a tax liability under Section 7122 of the Internal Revenue Code.
- (2) This section provides information regarding the various collateral agreements that may be secured in conjunction with an offer in compromise.

5.8.6.1.2
(10-19-2023)
Authority

- (1) Authorities relating to this section include:
 - IRC 7122 - Compromises
 - 26 CFR 301.7122-1 - Compromises
 - Policy Statement 5-100, IRM 1.2.1.6.17, Offers will be accepted
 - Rev. Proc. 2003-71
 - Notice 2006-68
 - IRM 1.2.2.6.1, Delegation Order 5-1 (Rev 5), To Accept, Reject, Return, Terminate or Acknowledge Withdrawals of Offers in Compromise

5.8.6.1.3
(06-25-2021)
Responsibilities

- (1) The Director, Collection Policy, SBSE is responsible for all policies and procedures within the Offer in Compromise program.
- (2) The National Program Manager, Offer in Compromise is responsible for development and delivery of policies and procedures within the program.

- (3) Managers of employees investigating offers are responsible for ensuring these procedures are followed and employee actions are timely and accurate.
- (4) Offer examiners, offer specialists, and other employees investigating offers are responsible for following the procedures in this IRM.

5.8.6.1.4
(06-25-2021)
**Program Management
and Review**

- (1) Operational and program reviews are conducted on a yearly basis by the Director, Specialty Collection Offer in Compromise, (SCOIC) and Collection Policy, respectively, with the use of data and reports from the Automated Offer In Compromise (AOIC) system and ENTITY case management system. See IRM 1.4.52, Resource Guide for Managers - Offer in Compromise Manager's Resource Guide.
- (2) Managerial case reviews are also completed as defined in IRM 1.4.52, Offer in Compromise Manager's Resource Guide. These reviews are a method to determine if the offer amount accurately reflects the reasonable collection potential (RCP) as defined in Policy Statement 5-100.
- (3) National quality reviews and consistency reviews are routinely conducted to ensure program consistency and effectiveness in case processing. As a result of these reviews, procedural changes may be required to improve the quality and effectiveness of the program.

5.8.6.1.5
(10-19-2023)
Program Controls

- (1) AOIC is used to track offers submitted by taxpayers and record case actions and history. Ability to take action on AOIC is limited to specific offer employees. Additional permissions are provided based on an employee's duties and responsibilities.
- (2) ICS is used by FOIC as a method for inventory control and history documentation.
- (3) Managers are required to follow program management procedures and controls addressed in IRM 1.4.52, Offer in Compromise Manager's Resource Guide.
- (4) Managerial Requirements for case approval are defined in IRM 1.2.2.6.1, Del. Order 5-1 (Rev. 5), To Accept, Reject, Return, Terminate or Acknowledge Withdrawals of Offers in Compromise. Approving officials ensure collateral agreements are secured when appropriate.
- (5) The Office of Chief Counsel conducts reviews of certain offers in accordance with 26 CFR 301.7122-1 - Compromises.
- (6) Monitoring OIC (MOIC) monitors the collateral agreement provisions through the life of the contract.

5.8.6.1.6
(10-04-2017)
**Terms/Definitions/
Acronyms**

- (1) Collateral agreement - A contract associated with a Form 656 that provides additional terms to the standard contract.
- (2) For a list of common abbreviations, definitions and acronyms used throughout this IRM, see IRM 5.8.1-1, Common Abbreviations Used in the IRM.
- (3) Additional acceptable acronyms and abbreviations are found in the ReferenceNet Acronym Database, which may be viewed at <http://rnet.web.irs.gov/Resources/Acronymdb.aspx>.

5.8.6.1.7
(06-25-2021)

Related Resources

- (1) Additional resources can be found in:

IRM	Title	Guidance On
5.8.4	Investigation	Conducting the different types of offer investigations
5.8.5	Financial Analysis	Evaluation of assets and income
5.8.7	Return, Terminate, Withdraw, and Reject Processing	Requirements when recommending rejection of an offer
5.8.8	Acceptance Processing	Requirements when recommending acceptance of an offer
5.8.1.5	Protecting Taxpayer Rights	Rights afforded by Internal Revenue Code and Taxpayer Bill of Rights (TBOR)
5.19.7	Monitoring Offer in Compromise	MOIC procedures for processing and monitoring accepted offers in compromise

- (2) Employees can find helpful information on these websites:

- SERP: <https://serp.enterprise.irs.gov>.
- Interim Guidance memorandums at <https://imdtrack.web.irs.gov/search.aspx>.

5.8.6.2
(06-25-2021)

Collateral Agreements

- (1) Collateral agreements may be appropriate in situations where a significant recovery is anticipated or securing a collateral agreement will facilitate resolution. The monitoring aspects of the agreement should also be considered when making the decision as to whether a collateral agreement is appropriate. The basis for securing the collateral and reasoning why additional recovery is being sought must be fully documented in the AOIC and/or ICS history.
- (2) *Do not* use a collateral agreement to accept an offer amount less than the taxpayer's reasonable collection potential.
- (3) A collateral agreement may be appropriate in the following situations:

If the taxpayer...	Then consider securing a...
Anticipates a substantial increase in future income	Future income collateral agreement.
Is compromising the income tax liability of a defunct professional corporation	Future income collateral agreement from the majority or sole owner of the professional corporation to collect from their future individual income.
Has real or personal property that is being depreciated	Collateral agreement to reduce the basis of the asset.
Has net operating losses or capital losses arising from prior years available for deduction in future years	A collateral agreement to waive the loss. Note: Monitoring for this type of collateral is limited to the Collection Statute Expiration Date (CSED) timeframe for the tax periods on the accepted offer.
Is seeking to compromise a TFRP and qualifies to take a capital loss benefit from the defunct corporation on Form 1040	A collateral agreement from the individual taxpayer to waive the capital loss. Note: Monitoring for this type of collateral is limited to the CSED timeframe for the tax periods on the accepted offer.

- (4) Because a collateral agreement changes the terms of the Form 656, the approval authority in IRM 1.2.2.6.1, Delegation Order 5-1 applies. The delegated official for the offer approval signs the collateral agreement.
- (5) It is important to communicate the purpose of the collateral agreement and to review the language to ensure the taxpayer understands the consequences. In lieu of a collateral agreement, the taxpayer may increase the amount of the offer equivalent to what the government could reasonably expect to recover through the collateral agreement.
- (6) After consideration of all the facts and circumstances, the refusal to enter into an appropriate collateral agreement may be a reason to reject the taxpayer's offer. The offer file must be clearly documented with the basis for the rejection. If the offer amount would otherwise be acceptable, the basis for the rejection is Not in the Best Interest of the Government (NIBIG). See IRM 5.8.6.5.1.
- (7) Use the most current revision of the collateral forms on the publishing website.

5.8.6.2.1
(10-19-2023)
Future Income

- (1) It is appropriate to consider future income collateral agreements for individuals, limited liability companies, and corporations when the investigation reveals that a substantial increase in the taxpayer's future income is expected.
- (2) The use of a future income collateral agreement may be an option when current income is lower than the taxpayer's earnings potential. Scenarios where the taxpayer's future income may be substantially higher include the following:
 - a. The taxpayer's past income does not provide an accurate analysis for what may be earned in the future based on their earnings potential due to their training or education.

Example: The taxpayer is a student and is expected to graduate soon and begin earning a significant annual income.

- b. The taxpayer's current income is minimal or considerably less than what the taxpayer has earned in the past and a reasonable expectation exists that the taxpayer's earnings will be increasing substantially prior to the expiration of the CSED.

Example: The taxpayer is an engineer, but is currently employed as a salesperson earning less than half of their prior salary due to difficulty they have had in obtaining a job in the engineering field at the present time.

Note: Judgment should be used in determining the appropriate time to apply income averaging on a case by case basis. All circumstances of the taxpayer should be considered when determining the appropriate application of income averaging, including special circumstances and ETA considerations. See IRM 5.8.5.20, Future Income.

- (3) *Do not* secure a future income collateral agreement:
 - To collect future income that should be included in the offer amount.
 - Merely on unfounded speculation about an increase in income.
 - To cover statistically improbable events, such as lottery winnings.
 - To attempt collection from a potential inheritance.
- (4) Future income collateral agreements must be monitored annually for the life of the agreement. The cost of monitoring and the difficulty in tracing income structured through other entities should be considered when deciding whether such an agreement is warranted. If the anticipated income is non-taxable and/or may not appear on a return, it may be necessary to include additional language in the collateral or provide specific instruction to MOIC to assist in monitoring.

Note: Consult Area Counsel relative to the wording of unique collateral agreement situations.

- (5) If amounts accrue under Form 2261, Collateral Agreement - Future Income (Individual), or Form 2261-A, Collateral Agreement - Future Income Corporation, but are not paid to the IRS on or before the CSED, amounts received thereafter are statutory overpayments under IRC Section 6401(a). Per Rev. Rul. 74-580 and IRM 5.19.7.8, Applying Payments on Accepted OICs, any payments received after CSED expiration are returned or refunded. Collection

of amounts paid under a collateral agreement relating to an OIC is based on an assessment and is subject to the period of limitations for collection under IRC 6502 for that assessment just like the amounts paid under the OIC. Just as there can be no agreement between the taxpayer and IRS to extend the period for collection in the terms of the OIC, a collateral agreement cannot extend that period.

5.8.6.2.1.1
(10-19-2023)
**Form 2261/2261-A
Completion**

- (1) Use Form 2261, Collateral Agreement — Future Income (Individual), for individual taxpayers or Form 2261-A, Collateral Agreement — Future Income (Corporation) for corporate taxpayers.
- (2) If married taxpayers submit separate but related offers, secure one Form 2261. The Form 2261 advises that married taxpayers entering into the collateral agreement are responsible for submitting one Form 3439, Statement of Annual Income, regardless of whether their filing status subsequently changes.

Exception: If the taxpayers are separated and maintain separate households, make a determination based on their individual anticipated income and expenses. If it appears the spouses will be filing separate income tax returns in the future and only one spouse has the potential for higher income, it is not necessary or desirable to secure a collateral from both spouses.

- (3) Use the date of the Form 656 (or amended Form 656) that is being accepted.
- (4) The beginning year is defined as the year following acceptance of the offer. The ending year is defined as the last year for which the collateral agreement will remain in effect.
- (5) The period of time a future income collateral agreement should cover will be determined by the circumstances identified in the offer investigation based on the taxpayer's financial situation. The offer file should document the basis for the time frame used for each collateral agreement. Generally the period of time the agreement covers should coincide with the 5 year future compliance provision, extending five tax years after the year of offer acceptance. Only include the current tax year if there is a high likelihood the taxpayer's annual earnings could increase above the collateral threshold.

Example: The offer is accepted September 1, 2023 and you do not expect the taxpayer's earnings to dramatically increase by the end of the year. The future income collateral agreement should start in tax year **2024** and extend through 2028.

Example: The offer is accepted February 1, 2023. The taxpayer has a pending lawsuit that could settle this year, resulting in payment of several years of unpaid compensation. The future income collateral agreement should start in tax year **2023** and extend through 2027. MOIC will monitor for five tax years starting the current year.

Note: Payments cannot be applied after the CSED expires.

Example: A taxpayer currently serving in the military is eligible for separation in 9 months. Their training in a specialized field will qualify them for a high salary, so they appear to be a good candidate for a future income collat-

eral agreement. However, less than 3 years remains on the CSED. By the time a full year's higher income would be reported on a tax return and result in payment being due to MOIC under the terms of the collateral agreement, little if any time would remain on the CSED.

- (6) The beginning dollar amount should allow for the taxpayer to meet reasonable and necessary living expenses during the term of the offer. The offer specialist (OS) or offer examiner (OE) should be flexible allowing for the expected rate of inflation, as well as any additional expenses such as those for an expected additional child or a replacement auto which may occur while the collateral agreement is being monitored. Generally, the initial dollar amount should approximate one and one-half times the taxpayer's current necessary and reasonable living expenses, less federal income tax (including self-employment tax, if applicable). If another figure is used, document the reason in the history.

Note: A future income collateral agreement should not be used to recover minimal amounts the taxpayer may receive from future cost of living or other longevity raises. The expected recovery should be based on a reasonable assumption of a substantial increase in the taxpayer's income based on changes in their situation.

- (7) The percentages and amounts determined appropriate in Item 1 of Form 2261 or Form 2261-A are negotiable and should be based on the taxpayer's situation and reflect appropriate anticipated increases in reasonable and necessary expenses. The beginning percentage should be determined based on the facts and circumstances of the case. Increases in the percentage amounts may also be included, when appropriate. The OE/OS should use judgment in determining the amounts used when completing Form 2261.

Example: The taxpayer has submitted an offer which is greater than reasonable collection potential (RCP) and is deemed acceptable. There is also a reasonable basis that the taxpayer's income will increase substantially over the next two years to over \$100,000 per year. The total current reasonable expenses from the income/expense table (IET) used in the offer evaluation is \$4000 per month (\$750 per month is the federal tax liability). The amount used on Form 2261 is 40% of any amount over \$58,500 per year ($4000 - 750 = 3250 \times 1.5 \times 12 = 58,500$).

Example: Taxpayers have submitted an offer which is greater than RCP and is deemed acceptable. The taxpayer has been involved in multi-million dollar developments and there is a reasonable basis to determine the taxpayer may receive a substantial payment from a future development within the next 24 to 48 months. The current reasonable expenses for the household from the IET used in the offer evaluation is \$5000 per month (\$1000 per month is the federal tax liability). Amounts used on Form 2261 are 40% of any amount between \$72,000 ($5000 - 1000 = 4000 \times 1.5 \times 12 = 72,000$) and \$150,000, plus 50% of any amount over \$150,000.

Note: These examples are not meant to be all inclusive; judgment must be used to determine the appropriate percentages and dollar amounts. Because the starting threshold allows one and a half times expenses, an initial percentage of 40% is usually appropriate. To gauge the impact, it is recommended to run calculations using various income scenarios. A set percentage as in the first

example will be appropriate in most instances, but you may consider graduated payments if the anticipated income range is higher.

- (8) Generally, it is not appropriate to attach to 100% of income. However, there can be situations where it could apply.

Example: The taxpayer received \$400,000 bonus income three years ago. Current bonus income is much lower and fluctuates greatly based on project completions, so it's not justifiable to include this income in the RCP via income-average. In the collateral agreement, it may be appropriate to apply a 100% attachment to (after tax) income. For example, based on the taxpayer's current income and expenses, the lowest threshold in the collateral is 40% of (after tax) income above \$60,000. To address the potential spike in income, the top threshold could be 100% of (after tax) income above \$100,000.

- (9) For each year of the collateral agreement, the Monitoring OIC unit (MOIC) prepares and sends a 279C letter, with a "collateral package" to the AOIC address of record. The package includes applicable Form 3439 (individual) or Form 3439-A (business), Statement of Annual Income. The taxpayer is instructed to complete the form and return it to MOIC with a copy of the tax return by the due date of the return, along with any applicable payment.

Note: When negotiating a future income collateral, it may be helpful to review the Form 3439 with the taxpayer. It provides additional information and a better understanding of the obligations imposed by the collateral.

5.8.6.2.2

(10-19-2023)

Adjusted Basis of Specific Assets

- (1) The initial basis of an asset is equal to the cost of acquiring it. Adjustments to the basis are made each year for the cost of improvements and accumulated depreciation. When an asset is sold, the basis is used to determine the amount of capital gain to be taxed.
- (2) A collateral agreement may be used to reduce the basis of a specific asset, after accumulated depreciation (book value), to a lesser amount or zero. The effect of reducing the basis of a specific asset include limiting or eliminating the amount of depreciation deduction allowed in future years, potentially having the taxpayer incur a higher capital gain tax to be paid if the asset is later sold for an amount more than the adjusted basis or reducing the amount of the loss the taxpayer can claim.

Note: If the taxpayer has been depreciating the property to offset taxable income, reduction of basis could result in an increase in tax the year it is effective.

- (3) Use Form 2261-B, Collateral Agreement — Adjusted Basis of Specific Assets.
- (4) Use the date of the Form 656 (or amended Form 656) that is being accepted.
- (5) The beginning year is defined as the year after the last filed tax return. Insert the year of the last filed tax return in the phrase "for all taxable years beginning after". Specifically describe each asset. Set the amount of the basis at the reduced or zero value.

Note: A specific description of the asset must be included in the collateral agreement in order for MOIC to monitor the agreement. When possible,

document AOIC Remarks where the sale of the asset would be expected to be reported on the tax return: e.g. Form 1040 Schedule D, or Line 14 Other gains or losses with Form 4797. If uncertain, ask the taxpayer's representative.

- (6) While the taxpayer's basis in an asset is permanently reduced by this agreement, adjusted basis collateral agreements are not monitored by MOIC indefinitely. See IRM 5.19.7.12.4, Processing Other Collateral Agreements, for monitoring actions on these offers. Consider the cost to monitor the agreement and the difficulty in tracing the sale or exchange of the property when deciding whether such an agreement is warranted.

Note: Currently, \$250,000 gain from the sale of a homestead (up to \$500,000 for joint) can be excluded from taxation and if the taxable gain is under this amount, is not required to be reported on Form 1040. Keep in mind real estate currently used as rental property may qualify for this exclusion if the owner later occupies it and meets the required ownership and use tests.

5.8.6.2.3 (10-19-2023) Waiver of Losses

- (1) If the taxpayer has a loss that can be carried forward to reduce future taxable income, determine if the value warrants the securing of a Form 2261-C, Collateral Agreement —Waiver of Net Operating Losses, Capital Losses, and Unused Business Credits. If a loss is anticipated to offset future taxable income and reduce future taxes by a meaningful amount, it should generally be waived.
- (2) Waiver of losses collateral agreements must be monitored annually until all the losses are extinguished or the expiration of the CSED(s) on all tax periods included in the offer. Consider the cost to monitor the agreement and potential for recovery of future tax liabilities when deciding whether such an agreement is warranted.
- (3) Use the date of the Form 656 (or amended Form 656) that is being accepted.
- (4) The beginning year is usually defined as the next year after the last filed tax return. Insert the year of the last filed tax return in the phrase "for all taxable years beginning after". Waive net operating losses and capital losses arising from all years prior to and including the last filed tax return. If you elect to start the collateral at a later date, document the reasoning.
- (5) Do not prohibit the deduction of losses that arise in years after the offer is accepted.
- (6) Certain business credits claimed on Form 3800 may be carried forward. These may be located on page 2 of Form 1040 (Schedule 3, Additional Credits and Payments); Form 1120 Schedule J; or Form 1041 Schedule G.
- (7) When completing the forms, consider when you want the agreement to be effective. The waiver of these losses could impact the current year's liability, so the anticipated date of acceptance is a factor. If the collateral agreement is secured relatively early in the year, the agreements should generally be effective after December 31 of the prior year (so the taxpayer cannot claim the loss when they file this year's return). If the collateral agreement is secured toward the end of the year, you may want to have it effective after December 31 of the current year.

Example: The taxpayer has made estimated tax payments for 2023 based on 2022. They agreed to enter into a collateral agreement that would waive their net carry forward loss, but this will result in additional tax due in 2023. The offer and collateral agreement are being submitted for acceptance in October 2023. If the taxpayer does not have the ability to pay the extra tax resulting from the loss waiver, document your reasoning for setting the effective date of the collateral agreement after December 31, 2023.

Example: You are accepting an offer in October 2023, with offer payment terms that extend through December 2024. Disallowance of the net operating loss will increase the taxpayer's tax obligation by \$1,000 / month. If the higher tax obligation will interfere with the taxpayer's ability to pay the offer payments, document the basis for starting the waiver of the net operating loss after December 31, 2024.

- (8) When a Form 2261-C, Collateral Agreement – Waiver of Net Operating Losses, Capital Losses, and Unused Business Credits is being secured, the collateral agreement section of the terms screen must be completed on AOIC in accordance with IRM 5.8.8, Acceptance Processing.

5.8.6.2.3.1
(10-19-2023)
Net Operating Loss

- (1) A net operating loss (NOL) is created when certain deductions exceed income from all sources. Due to fluctuations in income and expenses, a taxpayer can have substantial profits in one year and losses in another. The relief provisions of IRC 172, Net Operating Loss Deduction, provide that an NOL may be carried to other years as a deduction, thereby preserving the economic impact of the loss. The rules regarding the claiming of net operating losses can change based on tax law. See IRM 4.11.11.2, Overview for Net Operating Loss (NOL) and Net Operating Loss Deduction (NOLD). NOLs can provide a significant advantage by reducing future taxes.
- (2) When the taxpayer has claimed a NOL, determine and verify the amount of the loss and the year(s) the loss was incurred. If a taxpayer has been associated with more than one business there may be multiple losses. Often, the tax return will contain an attachment or other information to explain the NOL balance being carried forward. The loss can be located on the "other income" line on Schedule 1 of Form 1040 and should be labeled as NOL. See Pub 536, Net Operating Losses for Individuals, Estates and Trusts for details.
1. Determine the original loss amount claimed on the tax return.
 2. Subtract any carry backs.
 3. Subtract the amounts claimed on subsequent tax returns from the year the NOL was established.

Note: If you are unable to ascertain the initial year of loss (from e-filed Form 1040 or from information requested from the taxpayer), to ensure the collateral agreement addresses all potential losses, set the beginning year 20 years before the current year.

Example: A Form 2261-C secured in 2023 would waive losses with a starting year of 2003.

- (3) If the taxpayer has a very large NOL in relation to the tax liability subject to compromise, it may be in the taxpayer's interest to withdraw the offer and

retain the tax advantages afforded by the carry-forward loss. While paragraph 2 of the Form 2261-C could be used to allow for a partial retention of the NOL, any partial retention of loss would postpone additional tax revenues for the IRS until the retained NOL is exhausted, making the collateral agreement less advantageous. In most instances with large NOLs, the IRS should require a full waiver of NOL.

Example: You are preparing to accept a \$20,000 offer from a taxpayer who has no monthly payment ability due to \$5,000/month court-ordered payments required through the remainder of the CSED. The taxpayer owes \$60,000 in taxes, and has \$900,000 in carry-forward net operating losses. When asked to waive the loss via a collateral agreement, the taxpayer's CPA provides calculations that show the carry-forward loss is expected to result in tax savings greater than the \$40,000 balance being compromised (\$60,000 less the \$20,000 offer). If the taxpayer does not agree to a collateral agreement, reject the offer. See IRM 5.8.6.2 and IRM 5.8.6.5.1.

- (4) A waiver of losses collateral agreement may be secured to partially waive a loss, if the facts of the case support this determination. A partial waiver could allow the taxpayer to retain a specific NOL to lower taxes in the immediate future and increase their income stream to pay the offer terms.

Example: You are accepting an offer in October 2023 with offer payment terms that extend through December 2024. Disallowance of the net operating loss will increase the taxpayer's tax obligation by \$1,000 / month. Because the higher tax obligation will interfere with the taxpayer's ability to pay the offer payments, you may allow the taxpayer to retain sufficient NOL to offset the taxable income through the life of the offer terms. Because this is a more complicated computation and more difficult to monitor than specifying the year the NOL is to be waived, as referenced in IRM 5.8.6.2.3(7), partial waivers should be rare.

5.8.6.2.3.2
(06-25-2021)
Capital Loss

- (1) A capital loss is one in which the taxpayer experiences a loss associated with such investments as land, stock, paid in capital, or loans from shareholders. This loss:
- Is found on a Schedule D.
 - Must be offset against only capital gain in the year it is incurred with the remainder carried forward for offset of only capital gain in future years. However, individuals are allowed to offset \$3,000 against ordinary income in the year the capital loss is incurred and each succeeding year thereafter.

Example: A taxpayer has a \$100,000 carry-forward loss from prior years. This year, the taxpayer has a \$40,000 capital gain as well as other income. The taxpayer may offset \$40,000 against the capital gain and an additional \$3,000 loss may be offset against other income, leaving a \$57,000 loss that may be carried forward in future years.

Note: There is no limit on the number of years individuals may carry capital losses forward. Corporations are generally limited to carry capital losses back three years and forward five taxable years.

- (2) When the taxpayer claims a capital loss, determine the origin and amount of the loss.

If...	Then...
The loss is derived from personal investment	The investment can be either loans to the corporation or the individual's capital investment in the corporation.
Determining the remaining amount of the loss once you have determined the origin	Trace the loss forward through the tax return copy or RTVUE.

Note: If you are unable to ascertain the initial year of loss (from e-filed Form 1040 or from information requested from the taxpayer), to ensure the collateral agreement addresses all potential losses, set the beginning year 20 years before the current year.

Example: A Form 2261-C secured in 2023 would waive capital losses from 2003 through the last filed return.

5.8.6.2.3.3 (06-25-2021) Passive Loss

- (1) Passive activity loss is one that involves the conduct of any trade or business in which the taxpayer does not materially participate. **This loss should not be confused with net operating loss.**
- Generally, rental activity is a passive activity, even if the taxpayer does materially participate.
- Note:** There are certain exceptions, including for real estate professionals.
- Losses from a passive activity generally cannot be deducted from other types of income (e.g., wages, interest, or dividends).
 - The amount of the taxpayer's allowable loss is subject to the "at-risk" rules, or the amount that the taxpayer has invested. Generally losses are limited to the amount of the taxpayer's cash contribution, adjusted basis of other property which contributes to the activity, and amounts borrowed for use in the activity if the taxpayer has personal liability for the borrowed amounts.
- (2) Because passive losses are not deducted from earned income, waiving them may have little or no effect. One option is to reduce the basis of the property to zero so that the taxpayer cannot carry the loss over to the tax year in which the property is sold and receive benefit of the loss against a capital gain at that time. Form 2261-B, Collateral Agreement - Adjusted Basis of Specific Assets should be used in these situations.

5.8.6.2.4 (10-19-2023) Taxpayers Who Also Owe Restitution-Based Assessments

- (1) The IRS does not have the authority to compromise restitution-based assessments (RBA), but offers in compromise for civil tax liabilities may be considered. When computing RCP, the IRS allows payments to the amount of restitution ordered by a court. Although RBA is not included in an offer, a taxpayer must remain compliant with restitution payments ordered by the court to avoid potential default of an acceptance. Annual monitoring of the RBA payments is warranted if:

- a. the payment towards the RBA represents a substantial portion of the taxpayer's monthly payment ability, **and**
 - b. allowance of the payment results in a significantly lower RCP than would otherwise be computed.
- (2) Do not request monitoring for RBA payments if the allowance of the RBA payment did not significantly impact the determination to accept an offer.

Example: The taxpayer is borrowing \$25,000 from family to compromise \$300,000 in civil tax liabilities (non-RBA periods). Based on a previous agreement stemming from a criminal case, the taxpayer is current with \$1,500 a month payments towards an RBA. The taxpayer's monthly payment ability before considering the RBA is \$2,000. After allowance of the \$1,500 RBA payment, the monthly payment ability is only \$500. The taxpayer has no equity in assets. The RCP computation for a lump sum offer would be \$6,000 (\$500 x 12). If the RBA payment was excluded, the RCP for a lump sum offer would be \$24,000 (\$2,000 x 12). Because the offered amount approximates the full RCP regardless of the RBA payment, do not monitor for payment of the RBA. Allowance of the RBA payment was not a factor in the determination to accept the offer terms of \$25,000.

Example: Instead of \$25,000, the taxpayer above offers \$6,000. If proposing acceptance of the offer for \$6,000, the RBA payments should be monitored/verified.

- (3) If Form 656 contains the RBA default provision, and you've determined monitoring is warranted, include all the information in AOIC that is required. Clearly document the closing AOIC Remarks with the specifics (payment, due dates and duration) of the RBA terms and utilize the collateral section of AOIC Terms Screen. The information typed into the collateral field will be populated into Form 7249 and be part of the public inspection file (PIF), so refer only to the specific section in the Form 656.

Example: "Section 7(l) of Form 656, payment of the amount of restitution ordered by the court and assessed as a RBA applies."

Note: There is no need to add special language to the acceptance letter. See IRM 5.8.6.5.2, Closing Actions in Acceptance Recommendations.

- (4) If the Form 656 revision being accepted does not contain language in Section 7 that advises failure to pay the amount of restitution ordered by a court will provide basis for the default of the OIC for the civil tax assessments, contact Collection Policy to determine if you should secure a special language collateral agreement.
- (5) Specify in the Remarks the duration the monitoring is required. Payments will typically be monitored through the **lesser** of:
- the anticipated repayment period of the RBA,
 - five years, or
 - the remaining CSED.
- (6) The restitution statement in the collateral section of the AOIC Terms Screen will notify MOIC they must monitor for the RBA default as a provision of the

offer. An annual verification of the RBA payments will be conducted for the time specified by the OE/OS in the Remarks. Current payments made to the court pursuant to a restitution order may not always appear on IDRS because of a delay between the payment being made and the payment posting to the MFT 31 module(s). A current accounting of RBA payments can be obtained by requesting a summary of payments made to the court via e-mail to *W&I Criminal Restitution. MOIC may issue a Form 2209 Other Investigation to the requesting group to determine if the taxpayer is in compliance with the RBA terms.

- (7) The above monitoring procedures apply only to RBA assessments.

5.8.6.3
(10-04-2017)
Multiple Agreements

- (1) When related taxpayers submit more than one offer to compromise different tax liabilities, secure only one collateral agreement. Describe on the collateral agreement all the offers to which it relates.

Note: Future income collateral agreements may be an exception. Be certain the collateral agreement correctly identifies the taxpayer.

- (2) When more than one type of collateral agreement is secured for the same offer, separate collateral agreements may be secured or the terms of all the agreements may be incorporated into one form. If you combine collateral agreements, remove duplicate paragraphs.

Type of Agreement...	Statement...
Adjusted basis of assets	<p>“For the purpose of computing income taxes of the taxpayer for all taxable years beginning after _____, the basis for certain assets, under existing law for computing depreciation and the gain or loss upon sale, exchange or other disposition shall be as follows: Name of asset _____ Other Identification _____ Dollar amount _____ That in no event shall the basis set forth above be in excess of the basis that would otherwise be allowable for tax purposes, except for this agreement.”</p>
Waiver of net operating loss	<p>“For the purpose of computing income taxes of the taxpayer for all taxable years beginning after _____, Any net operating losses sustained for the years before _____ shall not be claimed as net operating loss deductions under the provisions of Section 172 of the Internal Revenue Code.”</p>
Waiver of capital losses	<p>“For the purpose of computing income taxes of the taxpayer for all taxable years beginning after _____, Any net capital losses sustained for the years before _____ shall not be claimed as carryovers or carrybacks under the provisions of Section 1212 of the Internal Revenue Code.”</p>

- (3) If there is insufficient space on the form to insert all the necessary paragraphs simply type the paragraph numbers followed by “See Attached” and fasten a separate sheet containing the added provisions.
- (4) When a Form 2261-C, Collateral Agreement – Waiver of Net Operating Losses, Capital Losses, and Unused Business Credits, is being secured or the collateral agreement terms are being incorporated into another collateral form, the collateral agreement section of the terms screen must be completed in accordance with IRM 5.8.8, Acceptance Processing.

5.8.6.4
(10-19-2023)
Waiver of Refunds

- (1) Form 656 with revision dates prior to April 2022 contained a standard term which waived refunds and overpayments for all tax years through the year the offer in compromise was accepted. As of November 1, 2021 the IRS ceased the offer in compromise refund recoupment process for all offers, regardless of the provisions in the Form 656.
- (2) If the determination has been made to accept the offer and you are aware of a significant credit available on the current tax year (or on a return that has been filed or will soon be filed), which is expected to generate a large refund when

the return posts (i.e. \$10,000 or a lesser amount if sufficient to pay in full the existing liability), consider whether further action and review are warranted. Any review should include source of the refund and the circumstances of the case.

- (3) If the refund will full pay the tax liability, contact the taxpayer to request withdrawal of the offer. If the taxpayer refuses, consider if the reasonable collection potential should be recalculated to include the refund amount. This does not require NIBIG rejection.
- (4) If the refund will not fully pay the liability but is significant (i.e. \$10,000), contact Collection Policy to determine if a collateral agreement to secure the refund is warranted. Submit the inquiry through your manager and provide details regarding the source of the credits and the anticipated amount of the tax and refund. If Collection Policy concurs, they will supply suggested language for the collateral agreement. After the offer is accepted, the OE/OS must request and verify input of TC 570 to hold the refund for the applicable year.

Note: Do not pursue a refund offset collateral agreement if the 24-month TIPRA statute is imminent or for offers being accepted under public policy/equity provisions, either Effective Tax Administration or Doubt as to Collectibility with special circumstances.

5.8.6.5
(10-04-2017)
**Closing Actions
Required**

- (1) If the taxpayer's refusal to agree to a collateral agreement impacted the determination to reject the offer, or if a collateral agreement is secured in conjunction with an acceptance recommendation, additional closing actions are required.

5.8.6.5.1
(06-25-2021)
**Closing Actions in
Rejection
Recommendations**

- (1) Document the reason a collateral agreement was considered and the impact on the case decision. Establish support for a collateral in the rejection narrative so Appeals will be aware of the facts.
- (2) In the narrative, provide an estimate of value.

Example: Under the IMF taxpayer's current top tax bracket of 24%, the \$150,000 net operating loss has a potential value of \$36,000.

Example: If the taxpayer's earnings return to the 2021 level, the future income collateral agreement would attach to \$6,000 / year.

- (3) Use the open paragraph option in AOIC to include in the rejection letter that a collateral agreement was requested and refused.

Example: "The refusal to agree to collateral agreement terms to waive the right to carry-forward losses was a factor in our determination not to accept an offer."

- (4) If the offer amount would otherwise be acceptable, the basis for the rejection must be Not in the Best Interest of the Government.

5.8.6.5.2
(10-19-2023)
**Closing Actions in
Acceptance
Recommendations**

- (1) When accepting an offer with a collateral agreement, update the collateral agreement section in AOIC Terms screen. Because this information is populated on the Form 7249 and becomes part of the public inspection file, provide a brief summary vs. detailed collateral agreement language. The collateral agreement term section is added to the end of the Form 656 terms, and should be followed with a **period**.

Example: Form 2261-C, Collateral agreement to waive carry-forward losses.

Example: Form 2261-B, Collateral agreement to reduce basis in asset.

Example: Form 2261-A, Future income collateral agreement.

Example: Special-use collateral agreement for refund retention.

- (2) When composing the acceptance letter, include paragraph option 673-A. You will be prompted for the form/letter number and name of the collateral agreement, but are limited to 50 characters. The entire title may not fit. Type the name of the form, comma, followed by the title.

Example: "Form 2261-C, Waiver of Losses and Credits" vs. the full title, "Waiver of Net Operating Losses, Capital Losses, and Unused Business Credits"

- (3) As opposed to the Form 7249, do **not** include a period or comma at the end of the 673-A field. The form number and name will be populated in the letter and will read "The acceptance date is the date of this letter and acceptance is subject to the terms and condition on the enclosed Form 656, Offer in Compromise and Form 2261-C, Waiver of Losses and Credits."
- (4) If monitoring of RBA payments is required, populate the collateral terms section in AOIC with the applicable section of Form 656. See IRM 5.8.6.2.4, Taxpayers Who Also Owe Restitution-Based Assessments, for the specific information to document in the collateral section for Form 7249 as well as in the AOIC Remarks. No additional language is required in the acceptance letter.
- (5) Review the printed acceptance letter and Form 7249 to ensure the collateral agreement information was populated correctly and there is no erroneous punctuation such as double periods in the acceptance letter.
- (6) Enclose a copy of the collateral agreement and the Form 656 with the acceptance letter.
- (7) Document AOIC Remarks with information that may assist MOIC with the monitoring of the collateral agreement and reduce the need to refer to the physical file. Examples include:
 - The tax year the collateral agreement is effective so MOIC knows when to start monitoring (i.e. Effective tax year 2023, the taxpayer is waiving all NOLs incurred tax year 2022 and prior; or future income collateral agreement to be monitored tax years 2024-2028)
 - Summary of the terms of the future income collateral agreement
 - The approximate amount of the NOL that is being surrendered
 - What items on the tax return should be reviewed to monitor the adjusted basis of an asset (depreciation; where the asset sale will be reflected)

- (8) Consult Area Counsel if you have questions regarding the correct language or structuring of a collateral agreement. If proceeding with acceptance of an offer that does not have concurrence of Counsel, the offer documents must be approved by the Area Director. See IRM 5.8.8.13.2, Counsel Review and Concurrence (Non-Legal Issues).