Understanding the IRS' OIC

By Michael Slotopolsky

Can you really settle your tax debt with Uncle Sam for pennies on the dollar? That's what the offer in compromise is all about. Our columnist fills you in on what you need to know to start the process.

IF THE IRS IS AFTER YOU TO collect a tax liability that's beyond your capacity to pay, you should be aware of a technique that may allow you to settle you tax debt for a fraction of its face value. It's called an offer in compromise (OIC) and it's an agreement between you and the IRS that settles tax liabilities for less than the full amount owed.

Like any creditor, the IRS prefers a partial payment to no payment at all. The IRS is often willing to settle a tax liability for less than the full amount with taxpayers for a variety of reasons: the taxpayer is unable to pay the full amount; there's doubt as to how much the tax liability is; collecting the liability creates economic hardship; or compelling public policy or equity considerations exists and due to exceptional circumstances the IRS' collection of the full tax liability would undermine public confidence that tax laws are being fairly and equitable administered.

In most cases, the IRS will not accept an OIC unless the amount offered by the taxpayer is equal to or greater than the reasonable collection potential (RCP). The RCP is how the IRS measures the taxpayer's ability to pay and includes the value that can be realized from the taxpayer's assets and anticipated future income.

In order to determine if you're eligible for an offer in compromise the first step is to address the following requirements. If you currently have an open bankruptcy preceding, you're not eligible to proceed with an OIC. Your offer must include a $150 application fee or completion of the proper form to apply for waiver of the fee due to income. In 2006, the IRS made changes to the OIC that required an up-front 20% lump sum payment offer or a first installment payment of a periodic payment offer.

In order to fully evaluate your offer, the IRS must have received all tax returns you were legally required to file prior to submitting the OIC, including all applicable business and personal returns. If you're a business with employees then you must have made all required federal tax deposits for the current quarter. In addition you must remain current on all filing and deposit requirements while your offer is being investigated. If your estimated tax payments are not up to date for the current year then the IRS won't consider your offer. In addition to the above you must complete Form 656 which is the official compromise agreement. Another needed form is Form 433-A and/or Form 433-B which contains information about your current financial affairs that detail your personal and business income, expenses, and assets and liabilities or your net worth.

The IRS processes these forms and has a formula which determines whether your offer equals or exceeds your reasonable potential amount. Through analysis of your financial forms, they determine your net equity of assets as well as evaluate future income potential. If their analysis indicates you have the ability to fully pay the tax liability, either immediately or though an installment agreement, then your offer will probably be rejected.

In order to determine this amount and put forth an accurate and reasonable offer the IRS provides the taxpayer with worksheets which show how to calculate a reasonable and acceptable offer. Once determined, the taxpayer has the option of submitting the offer with payment terms of a lump sum, usually paid in five installments within five months or less; a lump sum paid in five installments in more than five months but less than 24 months; a short-term periodic payment paid within six to 24 months; or a deferred periodic payment paid within the remainder of the statutory period of collection.

Once received an examiner will evaluate your offer and additional documentation may be required. If the offer is accepted then you'll comply with the terms as outlined in the offer. If the examiner decides that a larger offer amount is necessary to justify acceptance you'll have an opportunity to amend your offer. While the offer is being considered, the IRS generally won't try to collect the tax, in addition to giving the taxpayer 30 days after the offer is rejected or while a rejected offer is appealed. It's important to remember that if your offer is rejected your deposited amount is not returned but is applied to your outstanding tax liability.

The offer in compromise oftentimes enables delinquent taxpayers to make a fresh start after crushing circumstances. But it's important you work with a tax professional to properly navigate the rather complicated OIC process. ❑

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