THE FIVE BIGGEST MISTAKES TAX PRACTITIONERS MAKE WHEN FILING AN OFFER-IN-COMPROMISE

by Eric L. Green

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MISTAKE # 1

Not Pulling Transcripts to See How Much Time Remains on the Statute of Limitations

There is a ten-year collection statute. What this means is the IRS has ten years from the date it assesses the tax liability to collect that tax. Easy enough. However, taxpayers often do things that may toll or freeze the statute, preventing it from running. These actions include anything that prevents the IRS from taking collection action, including:

- Filing an Offer-in-Compromise
- Filing bankruptcy
- Filing a request for an installment agreement (payment plan)

Practitioners who are considering an Offer-in-Compromise for a client should first obtain power-of-attorney and pull updated transcripts for taxpayers, because it is critical to understand what has occurred and how much time remains on the statute. The reason is that if the ten-year statute is about to run out, then the last thing practitioners should do is file an Offer-in-Compromise [1]. Instead Practitioners should consider filing a Collection Information Statement (Form 433-A) and arguing for a taxpayer to be deemed un-collectable, which does not stop the collection statute from running. Why have the taxpayer incur the expense and stress of fighting for an Offer if we can allow time to take care of the liability? By filing an Offer without considering the statute of limitations, practitioners may be doing extreme harm to their clients, and arguably are committing malpractice.

1. There may be an exception to this rule if the taxpayer owns real estate that has equity in it, but this topic is beyond the scope of this paper.

Solution:

Unless the practitioners just filed the tax returns so they know for certain there are still ten years left, the first step in resolving an outstanding tax debt should always be to pull the taxpayers' account transcripts.

Internal Revenue Service
United States Department of the Treasury

This Product Contains Sensitive Taxpayer Data

Account Transcript

Request Date: 04-08-2014
Response Date: 04-08-2014
Tracking Number: 200191107146

FORM NUMBER: 1040
TAX PERIOD: Dec. 31, 2011

TAXPAYER IDENTIFICATION NUMBER: 999-99-9999
SPOUSE TAXPAYER IDENTIFICATION NUMBER: 888-88-8888

SANTA & JESSICA CLAUS

<<<<POWER OF ATTORNEY/TAX INFORMATION AUTHORIZATION (POA/TIA) ON FILE>>>>

--- ANY MINUS SIGN SHOWN BELOW SIGNIFIES A CREDIT AMOUNT ---

ACCOUNT BALANCE:	0.00	
ACCRUED INTEREST:	0.00	AS OF: Jul. 01, 2013
ACCRUED PENALTY:	0.00	AS OF: Jul. 01, 2013

MISTAKE # 2

Not Dealing with the Taxpayer's Current Compliance

In order to make a deal with the IRS – any deal – the taxpayer must be in "tax compliance." "Tax Compliance" means that they have filed all the tax returns required and are making their current tax payments. For businesses, this means they are making their current quarter's payroll tax deposits. For individual taxpayers, it means they are having either the proper taxes withheld from their pay (wage earners) or have made the current year's estimated tax payments (if self-employed).

Taxpayers who are not in compliance are not eligible for an Offer-in-Compromise, and any Offer filed will be returned and the filing fee and deposit paid with it kept by the IRS.

Often when taxpayers arrive in their practitioner's office whining about the hundreds of thousands of dollars they owe to the IRS, they will proceed to tell the practitioner that they were up late last night and watched this late night commercial that said they can settle the whole IRS debt for fifty cents.

There are many Americans who do not know what an estimated tax payment is or why it is important. Do not be surprised if, when asked about their current estimated tax payments, the taxpayers look surprised. They will (usually) say one of two things, either:

1. "That's this year's return which isn't due yet, so who cares about that?" or
2. "What's an estimated tax payment?"

Solution:

It is critical that the practitioner not only confirm current compliance (or get the taxpayer into compliance) but also discuss ongoing compliance. Taxpayers who file Offers that are accepted are required to maintain their compliance for the next FIVE YEARS! Nobody wants to pay to resolve their debt through an Offer-in-Compliance to have the whole deal voided when they fall out of compliance the following year.

MISTAKE # 3

Not Properly Calculating Future Income

So many taxpayers and practitioners list taxpayer's income and then deduct what the taxpayers are actually spending, the result being the taxpayers show no future income! It's terrific: the taxpayers have zero future income in their Offer calculation and can offer almost nothing, just like those late night commercials.

Unfortunately, this is not how the Offer process works. The IRS uses a taxpayer's gross monthly income and then reduces the income for "allowable expenses", which are frequently less than those actually being paid by the taxpayer. The IRS allowable expense tables are based on the Department of Labor statistics and often represent county or state averages. It is therefore not uncommon for a taxpayer to have negative cash flow when actual expenses are used, but to be positive once the IRS standards are applied. The change can drastically change the results of the Offer calculation and can mean the difference between an Offer that is accepted and another that is ultimately rejected.

Solution:

Practitioners should understand the future income calculation rules of the IRS and review a client's situation thoroughly before filing an Offer that may have zero chance of success once its reviewed by the IRS.

MISTAKE # 4

Not Looking at What the Taxpayers are NOT Spending!

As an extension of Mistake #3 above, when a practitioner calculates the taxpayers' future income based upon IRS allowable expense standards, taxpayers often ends up with a positive cash flow on paper, which can increase the Offer calculation above the point where taxpayers can afford to settle the back tax debt.

But the top IRS practitioner knows another secret: by understanding the allowable expense standards the practitioner can help taxpayers. How? By knowing the game is not only about what the taxpayers are spending, but also about what the taxpayers are NOT spending, the practitioner can help taxpayers to legitimately adjust their financial picture.

A Practitioner should consider what expenses the IRS allows that the taxpayers are currently not spending already and have them adjust their financial picture accordingly. These "allowable" expenses that taxpayers often do not have include insurance, as many taxpayers in financial trouble drop health their health insurance, life insurance and disability insurance, yet these expenses are not only allowed but are necessary to protect the taxpayer's health, family and income sources.

Now, before practitioners run off and slap together Offers listing insurance the taxpayers have only applied for, they need to know that the IRS will only allow those expenses that the taxpayers have a history of paying, meaning for at least three months as reflected by the bank statements or cancelled checks. What do you do if you need time to get this in place yet the IRS is breathing down the taxpayer's neck? Check out our video "Offer-in-Compromise Basics" at http://taxrepllc.com/offer-guide-to-offers/ at a special discounted rate!

Solution:

The practitioner needs to make sure these new expenses (like newly acquired insurance) are being incurred and reflected in the three months of documentation supplied when the Offers are filed. By doing so the practitioner can help their clients become Offer-in-Compromise candidates and reduce the amount of their Offers while increasing the Offer's chance of acceptance!

MISTAKE # 5

Not Properly Calculating Reasonable Collection Potential

What is "Reasonable Collection Potential," or "RCP"?

RCP is the amount the IRS calculates it could collect from the taxpayer if it obtained the net equity in the taxpayer's assets and from twelve months of future income [2]. We discussed the future income calculation in Mistakes #3 and #4. What about the net equity in assets?

The IRS Offer forms contained in the Offer Booklet walk taxpayers through the net equity in assets calculation. The issue arises when taxpayers assume that, because they cannot access the equity in the asset the IRS will not include it in its available equity calculation. This is Mistake #5.

IRC § 7122 authorizes the IRS to agree to a compromise of a taxpayer's debt, but it does not make the acceptance of a taxpayer's Offer mandatory. The decision to accept or reject a taxpayer's Offer rests with the IRS. In fact, the IRS will reject an Offer if the agency feels it is "not in the best interest of the government" to do so.

Practitioners need to remember that, unlike a payment plan or a request to be deemed un-collectable, the Offer-in-Compromise is asking the IRS to write off a debt it is otherwise entitled to, and a debt that most other taxpayers pay every year voluntarily. This is not something the IRS does lightly, and the fact that taxpayers have assets that they cannot access does not change the fact that the taxpayer has assets.

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2. Twelve-months of net-future income is sued for lump-sum offers. If a taxpayer files a deferred offer, the IRS uses twenty-four months of net-future income.

Solution:

Practitioners should warn taxpayers that the IRS will expect either the assets to be liquidated or the equity borrowed against as part of their Offer. Failure to do so will void the Offer, assuming it is not rejected in the first place.

About Eric Green

Attorney Eric Green is a Partner with Green & Sklarz, a boutique tax firm with offices in Connecticut & New York. The focus of Eric's practice is on civil and criminal taxpayer representation before the Internal Revenue Service, Department of Justice Tax Division and state Departments of Revenue. Eric is a frequent speaker on civil and criminal tax issues for the American Bar Association's Tax Section, the National Association of Tax Professionals, the National Association of Enrolled Agents, CCH, and numerous state accounting and law groups. He is the founder of the New England IRS Representation Conference and a self-described "frustrated professor." Eric is one of the founders of Tax Rep LLC, a coaching and consulting group for accountants and lawyers looking to expand their practices in IRS Representation and want help with cases, CPE and marketing along the way.