CDP AND COLLECTIONS: PERCEPTIONS AND MISPERCEPTIONS

by Leslie Book

Writing in these pages almost seven years ago, I described the then-new collection due process taxpayer rights. At the time, I questioned whether collection due process (“CDP”) struck the right balance between the interests of taxpayers and the government. We now have the benefit of time to assess CDP’s merits, and look back at some of the IRS Restructuring and Reform Act of 1998’s (RRA 98) changes to the tax administration landscape. This is particularly important in light of a few recent developments. First, enforced collection activities are on the upswing, with leading indicators like collection revenue and levies on the increase following the post-RRA 98 general enforcement decline. Yet, despite this increase, there is still a sense that the IRS can be doing more to collect assessed liabilities, which becomes more pronounced during periods of deficits. Practical limitations on IRS budgeting has, in part, fueled the demand for (i) injecting private parties into the tax collection process and (ii) questioning whether existing procedural protections (like CDP) may create improper resource demands on IRS personnel, thus improperly draining away scarce IRS resources from the essential task of collecting taxes. Further, a respected observer of tax procedure and collection process in particular, has declared that CDP adds “no value,” is an “undesirable growth in the tax administration forest” and has called for CDP’s repeal. In light of this current situation, this essay addresses some of the common misperceptions about collection in general and CDP in particular, and considers the implications of Robinette v. Commissioner, a recent case about the manner of judicial review of CDP determinations.
Perceptions

The discrediting of much of the testimony leading up to RRA 98 regarding IRS abuses suggested that IRS procedures were not in need of systemic changes.

Journalists and academics alike have commented on how many of the stories of IRS abuse that the Senate Finance Committee uncovered leading up to RRA 98 were, at best, overblown, and at worst, not true. What conclusion follows from this? While I am not entirely sure, it does not support the conclusion that all of RRA 98's statutory changes and additional procedural protections (like CDP) were unnecessary. Despite RRA 98's legislative process failures, there is a fundamental soundness in the underlying rationale of CDP, i.e., that adversarial processes and external checks on agency discretion contribute to better agency practice and protect taxpayer rights. Many respected observers, including the GAO and some of the country's top experts on tax procedure, testified and reported of routine IRS violations of procedures and how, in the collection process, unfettered discretion contributed to risks of agency error and taxpayer harm. While CDP might be underinclusive in some respects and overinclusive in others (and as such CDP would benefit from some legislative and administrative changes, as I discuss in a recent article published in the Houston Law Review), it is fair to say there was a genuine consensus that IRS collection practices were in need of reform. However, there was, and still is, a difference of opinion as to whether those changes should be generated from internal processes, through better management and employee training, for example, or external processes like a greater and more independent role for Appeals and a new judicial check on certain collection actions. Yet, in areas where RRA 98 did not systemically alter collection processes, like general offer in compromise (OIC) review, IRS internal changes have not materially improved administration, leading respected observers to question whether the IRS is falling short in protecting taxpayer rights, delivering quality service and collecting otherwise uncollected revenues.

Tax collection is ultimately a matter of inventory management, resulting in a belief that IRS collection practice can best be improved through increased centralization.

Many tax collection decisions are really just a matter of automatic actions, undertaken at the level of computer-generated actions. In any system involving hundreds of thousands or millions of actions, like tax collection, it is unrealistic to expect individualized decisions on all collection determinations. Not only is it unrealistic, it also would be
foolish practice, for many determinations do not involve unreasonable prospects of harming individual interests or carry with them serious risk of government mistake.

At the same time, the danger of relying too much on treating all collection determinations as matters which the IRS can manage as inventory is that there are real and varying individual interests implicated in collection determinations, individual interests which IRS bulk processing and over-reliance on centralization will likely shortchange. Adversarial review proceedings work best when there is a need for individualized determinations, where there is a need for the IRS to exercise judgment and discretion concerning a taxpayer’s individual circumstances. Internal IRS incentives to properly classify taxpayers in the collection stage provide a powerful tool to ensure acceptable agency practice without the need for external review in most, though not all, determinations. Fixing or improving the processing of centralized review will not necessarily lead to acceptable performance. IRS failure to give consideration to individualized factors, or improper analysis of a taxpayer’s particular facts and circumstances, contributes to risk of error and risk of taxpayers’ unwillingness to accept agency decisions, even if those decisions are substantively proper. Characteristics of many lower-income taxpayers, including language and literacy barriers, and a lack of ready access to obtain and copy documentation, can contribute to rote rejection, with little room for individual judgment about a taxpayer’s particular circumstances. Increased unfair rejections (and possibly improper acceptances) will likely accompany an over-reliance on remote centralized review.

The tough question for administrators or the legislature is to gauge which determinations require or would benefit from individualized determinations. One way to approach this issue is to borrow a utilitarian approach that balances interests, an approach inherent in procedural due process jurisprudence. That analysis considers the adequacy of existing procedures by applying a three-part inquiry considering the private interest affected by the official action; the risk of depriving that interest through procedures used, as well as probable value of additional safeguards; and the government’s interest, including the administrative burden that additional requirements would impose. This approach reflects the normative view that not all government decisions are equal—some deserve more protective procedures on the adversarial model, and others fewer. The danger with the view of tax collection that treats all collection decisions as inventory management is that it tends to treat all agency collection decisions with a broad brush, and fails to distinguish that different collection determinations should trigger different processes because there are different interests at stake and different risks of error. For example, individuals have strong interests in correct determinations regarding certain collection alternatives, like OICs, that lead to the possibility of a permanent solution to a possibly crippling tax debt. Further, the failure to consider matters appropriately places government interests at risk, interests that extend beyond the government’s general desire for good administration. After all, insights from procedural justice scholars suggest strongly that individuals’ willingness to accept decisions (and hence their likely future compliance) is not just tied to outcome.

CDP may turn Appeals into a mini-tax court and rob it of its informal traditions.

In some sense, CDP, with its requirement of judicial review (albeit limited) of IRS collection determinations is a reflection of Congress’ desire to inject some adversarial process and individualized determination into the collection process. In reaching a determination regarding taxpayer CDP requests, Appeals is supposed to, for example, balance the government’s need to collect taxes with the individual’s interest in having the taxes collected in the least intrusive way possible. Moreover, Appeals, upon taxpayer request, is supposed to make an independent determination regarding the IRS’s rejection of a proposed collection alternative. At the conclusion of the process, Appeals is supposed to issue a written determination notice setting forth its conclusion and summarizing the basis for its conclusion.

One observer has concluded that this process, and the possibility of judicial review in particular, threatens to turn Appeals into a mini-administrative law judge (ALJ) or Tax Court. I think this concern is overstated. For informal adjudications in other agencies, practice varies considerably, with some proceedings even less formal than Appeals conferences have traditionally...
been, while others contain many procedural protections akin to formal ALJ hearings. In other areas of administrative law, many administrative determinations are informal adjudications that require no formal ALJ, with a limited statutory mandate as to what procedures are applicable at those hearings—essentially the right to counsel and a brief statement explaining the agency’s findings if it denies relief. Yet, courts review a significant amount of those determinations on an abuse of discretion basis, and the proceedings are often conducted informally, without many procedural rights associated with formal ALJ proceedings or trial courts. In fact, some administrative law scholars consider these informal adjudications as outside the Administrative Procedure Act (APA), because the APA provides essentially no minimal procedural requirements for those types of adjudications.

The variety of procedures that other agencies use in their informal adjudications suggests that CDP need not change Appeals into a miniaturized Tax Court or change Appeals Officers into quasi-ALJs. Yet, in administrative law, judicial review done on an abuse of discretion basis does have as its focal point the evidence that the agency considered below in making its determination. This focus on the evidence before the administrative agency brings into question the role of the record and evidence that Appeals considers, which leads to a discussion of the controversial case of *Robinette v. Commissioner*, and considers further whether CDP’s mode of judicial review alone creates the risk that Appeals will transform to an ALJ-type body.

**An Application of the Abuse of Discretion Review Standard in CDP**

*Robinette v. Commissioner*

In *Robinette*, the Tax Court held, in a divided opinion, that in reviewing a CDP determination for abuse of discretion the Tax Court may consider evidence at trial which was not included in Appeals’ administrative record. In doing this, the Tax Court held that the IRS had abused its discretion in terminating an offer in compromise based upon doubt as to collectibility, because the taxpayer’s subsequent breach of the offer terms was not material. The facts were sympathetic for reversing Appeals’ determination: the taxpayer fully paid a considerable offer amount and the taxpayer was compliant with his filing and payment obligations except for one oversight. The error was that within the five-year period following the OIC’s acceptance, the taxpayer filed a tax return requesting a small refund one day late. After declaring that the taxpayer’s OIC was in default, the IRS sent the taxpayer an intent to levy, carrying with it the right to request a CDP hearing. At the hearing, the Appeals Office, finding that the taxpayer breached the offer, sustained the OIC’s default and upheld the determination to proceed with enforced collection. The Tax Court’s holding that the breach was not material relied, in part, on evidence suggesting that the taxpayer had acted in good faith.

Many of this evidence regarding the good faith of the taxpayer was not before Appeals, apparently because the Appeals Officer did not consider anything to be relevant apart from certified or registered mail receipts that would go to the timeliness of the actual return. At trial, this evidence included the taxpayer and his wife’s testimony regarding his filing patterns, other years’ tax returns establishing his filing pattern and practice, his accountant’s testimony regarding the Appeals Officer’s unwillingness to consider issues apart from whether the taxpayer timely filed his return, and his accountant’s telephone records, phone log and daily calendar.

The most controversial aspect of *Robinette* is the issue relating to the Tax Court’s ability to consider evidence not before Appeals. This controversy relates to the nature of Tax Court review of IRS determinations, which have traditionally involved redeterminations of deficiencies done on a *de novo* basis, with a *de novo* scope of review. Even in cases where there has been abuse of discretion review of deficiency determinations, the Tax Court has allowed taxpayers to introduce evidence not before Appeals, and the application of the abuse of discretion standard of review closely approximates review done on a *de novo* basis.

**Bringing Robinette in Line with General Administrative Law Principles**

The Tax Court approach to letting in evidence is inconsistent with general administrative law principles and case law interpreting the application of the APA. As the IRS argued in *Robinette*, the APA mechanism for judicial review of informal agency adjudications turns
POVERTY LEVELS AND FEDERAL TAX THRESHOLDS: 2004

by Jonathan Barry Forman and Nina Jung

(c) Jonathan Barry Forman 2005

Jonathan Forman and Nina Jung set forth the income amounts at which various low-income families will owe taxes using the poverty income guidelines and factoring in the earned income credit and the child tax credit.

This article compares the federal tax thresholds of various family units with their poverty income guidelines. Basically, this article shows that low-income families with children will generally not owe any federal taxes for 2004. On the other hand, at least some low-income unmarried individuals and married couples without children will owe federal taxes for 2004, as their federal tax thresholds are lower than their poverty income guidelines.

Poverty Levels and Net Federal Tax Thresholds

At the outset, Table 1 compares the 2004 federal tax thresholds and poverty income guidelines for unmarried individuals and for married couples. Consider a family of four consisting of a married couple and two children. Row 1 of Table 1 shows that this family unit’s poverty income guideline for 2004 is $18,850.

Row 2 of Table 1 shows the simple income tax thresholds for family units of different sizes. These are determined by summing each family unit’s standard deduction and its personal exemptions. For 2004, a married couple with two children can file a joint tax return and claim a $9,700 standard deduction and four $3,100 personal exemptions. Consequently, the couple will not have to pay any income tax unless its income exceeds its $22,100 simple income tax threshold ($22,100 = $9,700 + 4 × $3,100).

Row 3 of Table 1 shows each family unit’s income tax threshold after taking into account the effects of the earned income credit and the child tax credit. For example, for 2004, a typical married couple with two young children can claim an earned income credit of up to $4,300 and two child tax credits worth up to $1,000 per child. Consequently, taking into account the earned income and child tax credits, a typical married couple with two children will not actually owe any income tax until its income exceeds $40,200.

On the other hand, because the Social Security tax system has no standard deductions or personal exemptions, family units must pay Social Security taxes starting with their first dollar of earned income. Hence, Row 4 of Table 1 shows that zero is the Social Security tax threshold for all family units.

Finally, Row 5 of Table 1 shows the combined income and Social Security tax thresholds (i.e., net federal tax thresholds) for various family units. These thresholds occur at the income level at which a taxpayer’s preliminary income plus Social Security tax liabilities minus earned income and child tax credits equals zero. For example, a typical married couple with two children will not actually have a net federal tax liability for 2004 unless its income exceeds $30,166.

Similarly, Table 2 compares the 2004 federal tax thresholds and poverty income guidelines for heads of household with one to four children.

Federal Taxes at the Poverty Level

The two tables in this section show the 2004 federal tax liabilities of various family units with earnings exactly equal to their respective poverty income guidelines. At the outset, Table 3 shows the 2004 federal tax liabilities at the poverty level for unmarried individuals

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**TABLE 1. POVERTY LEVELS AND NET FEDERAL TAX THRESHOLDS AFTER TAX CREDITS IN 2004, BY FAMILY SIZE, UNMARRIED INDIVIDUALS AND MARRIED COUPLES**

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<td>18,850</td>
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<td>25,210</td>
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<td>7,950</td>
<td>15,900</td>
<td>19,000</td>
<td>22,100</td>
<td>25,200</td>
<td>28,300</td>
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<td>3 Income Tax Threshold after the Earned Income and Child Tax Credits</td>
<td>9,484</td>
<td>15,900</td>
<td>30,436</td>
<td>40,200</td>
<td>49,967</td>
<td>59,733</td>
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<tr>
<td>4 Social Security Tax Threshold</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>5 Combined Income and Social Security Tax Threshold (i.e., net federal tax threshold)</td>
<td>5,100</td>
<td>5,100</td>
<td>23,513</td>
<td>30,166</td>
<td>33,551</td>
<td>38,697</td>
</tr>
</tbody>
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Continued on page 6
and for married couples. Again, consider a hypothetical family of four consisting of a married couple with two children. Row 1 again shows that the couple’s poverty income guideline in 2004 is $18,850.

Assuming that the couple has exactly that much earned income in 2004, Row 2 shows that the couple will be entitled to an income tax refund of $4,713.10 Row 3 of Table 3 shows that the couple’s Social Security tax liability for 2004 will be $1,442.11 As the couple’s income tax refund in Row 2 will be greater than its Social Security tax liability in Row 3, the couple will be entitled to receive a net refund of $3,271 from the federal government, as shown in Row 4.12 Finally, Row 5 expresses the couple’s net federal tax liability as a percentage of income: for 2004, the couple will have a net federal tax liability equal to -17.4 percent of its poverty-level income.13

Conclusion

The four tables in this article show that hardly any low-income workers will owe federal taxes for 2004.14 Quite simply, the earned income tax credit and the child tax credit will offset the Social Security and preliminary income tax liabilities of millions of low-income workers. In fact, most low-income families with children will receive significant subsidies from the federal government—via the earned income and child tax credits. All in all, the earned income tax credit and the child tax credit are important programs for low-income workers.

Copyright 2005, Jonathan Barry Forman. Professor of Law, University of Oklahoma; B.A. 1973, Northwestern University; M.A. (Psychology) 1975, University of Iowa; J.D. 1978, University of Michigan; M.A. (Economics) 1983, George Washington University. Delegate to the 2002 National Summit on Retirement Savings; Member of the Board of Trustees of the Oklahoma Public
Childless individuals between the ages of 25 and 65 are entitled to an earned income credit of up to $390. The credit is computed as 7.65 percent of the first $5,100 of earned income. For married couples filing joint returns, the maximum credit is reduced by 7.65 percent of earned income (or adjusted gross income, if greater) in excess of $5,100 and is entirely phased out at $10,200 of income. For heads of household and single individuals, the maximum credit phases out over the range from $6,300 to $11,400.

For example, for 2004, a married couple with two children with income (I) in excess of the $36,400 level at which the taxpayer enters the 15 percent tax bracket, the couple’s income tax liability (T) can be determined by the following formula:

\[ T = 1,430 + 0.15 \times (I - 36,400) - (2 \times 1,000) \]

Setting T equal to zero and solving for I shows that the couple’s income tax threshold after the earned income and child tax credits is $40,200.


9 Algebraically, each computation in Row 5 involved determining the appropriate equation for computing each family unit’s income tax liability after its earned income and child tax credits and solving for the income level at which that income tax liability is equal to zero.

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Effective Tax Administration

THE EFFECTIVE TAX ADMINISTRATION OFFER IN COMPROMISE

by Brian C. Bernhardt

Like all creditors, there are times when the IRS is unable to collect a debt from a taxpayer or when a taxpayer disagrees with the exact amount owed to the IRS. It is an accepted part of the operation of the IRS Collection Division and its revenue officers to resolve these issues through negotiation and compromise.¹

The Offer in Compromise Program in General

The IRS negotiates and compromises taxpayer liabilities through its Offer in Compromise program, which is authorized under Internal Revenue Code (“IRC”) section 7122. An Offer in Compromise is an agreement between a taxpayer and the government that settles a tax liability for payment of less than the full amount owed.²

Historically, there have been two methods for taxpayers to compromise their tax liability through the Offer in Compromise program. The first method, an offer to compromise a tax liability based on doubt as to collectibility, requires the taxpayer to establish, through the production of documented financial statements, that it is unlikely the IRS could collect the tax liability in full and the amount the taxpayer is offering to pay reasonably reflects the collection potential. The second method, an offer to compromise a tax liability based on doubt as to liability, requires the taxpayer to establish that there is a genuine dispute as to the existence or amount of the correct tax liability under the law. Before a doubt as to liability offer can be accepted, there must be some doubt as to the correctness of the liability based on an evaluation of the law, supporting documentary evidence, and circumstances.³

More recently, however, as a result of the 1998 IRS Restructuring and Reform Act, the IRS has implemented a third basis for taxpayers to use in the Offer in Compromise program—the IRS will now compromise tax liabilities to promote effective tax administration.⁴

The remainder of this article will address this new method for taxpayers to compromise their tax liabilities for less than the total amount owed to the IRS.

Effective Tax Administration Offers in Compromise

The IRS is now entitled to compromise tax liabilities to promote effective tax administration in two situations.⁵ First, the IRS may compromise tax liabilities to promote effective tax administration when it determines that, even though it could collect the outstanding tax liability in full from the taxpayer, doing so would cause the taxpayer economic hardship. In such cases, the IRS will collect only as much of the tax liability as it can collect without causing economic hardship to the taxpayer and that amount will vary depending on each individual’s facts and circumstances. Second, the IRS may compromise tax liabilities to promote effective tax administration when it determines that there are compelling public policy or equity considerations. An Offer in Compromise in such a circumstance is generally only justified when, due to exceptional circumstances, collection of the full tax liability would undermine public confidence in the fair and equitable administration of the tax laws.⁶

In order for a taxpayer to submit an Offer in Compromise on the basis of effective tax administration that is acceptable to the IRS, the IRS must establish that the tax liabilities are valid and that the taxpayer could fully pay the liability.

Tax Liabilities Must Be Valid and Collectible

In order for a taxpayer to submit an Offer in Compromise on the basis of effective tax administration that is acceptable to the IRS, the IRS must establish that the tax liabilities are valid and that the taxpayer could fully pay the liability.⁷

If the IRS determines that there is doubt as to the validity of the tax liability, then the taxpayer is not eligible for an Offer in Compromise on the basis of effective tax administration; the Offer in Compromise will instead be considered based on doubt as to liability. As a general rule, the tax liabilities will be considered accurate unless the taxpayer raises issues questioning the validity of the assessment or the IRS Offer in Compromise specialist handling the Offer in Compromise establishes that the liabilities are questionable.⁸

As a practical matter, if the taxpayer concedes that the liabilities are valid, then this requirement will be satisfied.

If the IRS determines that the taxpayer’s assets and
anticipated future income do not exceed the amount of the tax liability, then the taxpayer is not eligible for an Offer in Compromise on the basis of effective tax administration; the Offer in Compromise will instead be considered based on doubt as to collectibility. However, if the taxpayer's reasonable collection potential indicates that the taxpayer has the ability to fully pay the tax liability, and there is no doubt as to the validity of the tax liability, then an Offer in Compromise on the basis of effective tax administration may be appropriate.

Offer in Compromise Cannot Undermine Compliance With Tax Laws

The IRS may not enter into an Offer in Compromise on the basis of effective tax administration if accepting the Offer in Compromise would “undermine compliance by taxpayers with the tax laws.” As a result, the IRS is required to consider the taxpayer's overall history of compliance before accepting an Offer in Compromise on the basis of effective tax administration.

The Final Regulations list three factors that will support a determination that the Offer in Compromise will undermine tax compliance:

- If the taxpayer has a history on not complying with tax filing and tax payment laws;
- If the taxpayer has taken deliberate actions to avoid the payment of taxes; and
- If the taxpayer has encouraged other taxpayers to refuse to comply with the tax laws.

The IRM lists three additional factors that the IRS should examine:

- The cause of the tax liability;
- The length of time which the taxpayer has not been compliant with the tax laws; and
- Any efforts by the taxpayer to resolve their failure to comply with the tax laws.

Although these factors will support a determination that the Offer in Compromise will undermine tax compliance, they are not conclusive. In addition, because the IRS does not have a minimum compliance requirement, the taxpayer's compliance history is weighed against economic hardship and inequality when determining whether the compromise will undermine tax compliance.

Economic Hardship

The IRS and an individual taxpayer may enter into an Offer in Compromise on the basis of effective tax administration if payment of the full tax liability would cause the taxpayer economic hardship.

In general, economic hardship means that the taxpayer would be unable to pay reasonable basic living expenses. Although the amount a taxpayer needs for reasonable basic living standards is determined on a case-by-case basis by examining the taxpayer's unique circumstances, relevant information includes the taxpayer's age, employment status and history, number of dependents, and other unique circumstances. The amount a taxpayer needs for reasonable basic living standards does not include the maintenance of an affluent or luxurious standard of living. It also does not justify a minimal offer that effectively requests that the IRS forgive the entire tax liability.

Factors Supporting Economic Hardship

The Final Regulations supplement the “reasonable basic living expense” standard by providing a list of factors which support a finding of economic hardship. Three specific factors are listed:

- The taxpayer is incapable of earning a living because of a long term illness, medical condition, or disability, and it is reasonably foreseeable that the taxpayer's financial resources will be exhausted providing for care and support during the course of the condition;
- Although the taxpayer has certain monthly income, that income is exhausted each month in providing for the care of dependents with no other means of support; and
- Although the taxpayer has certain assets, the taxpayer is unable to borrow against the equity in those assets and liquidation of those assets to pay outstanding tax liabilities would render the taxpayer unable to meet basic living expenses.

These factors, however, are not exclusive. Instead, the central inquiry is whether full collection of the tax liability will render the taxpayer unable to provide for reasonable basic living expenses, and these factors are simply some of the methods of analysis acceptable to the IRS.

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Researching Beyond Officially Published Sources

When researching substantive tax law, attorneys find and read the applicable Internal Revenue Code sections, Treasury Regulations, Internal Revenue Service (Service) documents, and cases involving the issues being researched. In performing this function, attorneys do not limit their research to officially published documents or to sources a court will deem authoritative. For example, even though their application is limited to the taxpayers who requested them, private letter rulings should not be ignored. They not only illustrate the Service’s view of a particular transaction, but they also constitute authority for avoiding the substantial understatement penalty.

Taking the correct substantive position is of little value if the taxpayer misses a deadline for filing a return, making an election, or requesting some other action. To avoid such problems, attorneys expand their research to include procedural rules that apply to taxpayers in their dealings with the Service, as well as those that apply to the Service in its dealings with taxpayers.

When searching for procedural rules applicable to taxpayers, attorneys generally consult the same sources (substituting Revenue Procedures for Revenue Rulings) they used in determining the substantive law. When searching for rules applicable to the Service, attorneys should also consult the Internal Revenue Manual (IRM). As is true for private letter rulings, IRM provisions are not binding in litigation, but they do provide guidance. In addition, when the Service fails to follow the IRM, “the National Taxpayer Advocate shall construe the factors taken into account in determining whether to issue a Taxpayer Assistance Order in the manner most favorable to the taxpayer.”

The Internal Revenue Manual

The IRM is available from the Service’s Public Reading Room. An online version appears in its Electronic Reading Room. To enter the Electronic Reading Room, go to the Service’s website and click on the Freedom of Information Act (FOIA) tab. From the FOIA page, go to the Electronic Reading Room page. Two options on that page are relevant: Internal Revenue Manual (IRM) and Chief Counsel (CC) Notices. Information about searching the IRM directly and about CC Notices appears later in this article.

Internal Revenue Manual Structure

The IRM is divided into Parts, many of which are relevant to taxpayers in their dealings with the Service. Although the Parts shown on the Service site are all listed as IRM Parts, they are actually separated into IRM Parts and Chief Counsel Directives Manual (CCDM) Parts. The latter designation covers those topics in Manual Parts 30-42. The CCDM “contains all permanent procedure and policy that remains in effect until specifically cancelled. Text is revised by issuing MANUAL TRANSMITTALS.”

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Internal Revenue Manual Subdivisions

The IRM once employed a numbering system that included both parentheses and decimals. The current system uses decimals to differentiate the Part, Chapter, Section, Subsection, and Sub-Subsection. Many IRM Parts include useful exhibits. Exhibits use the basic numbering system followed by a dash to indicate the Exhibit number.

For example, Part 5 (Collection Process) includes 5.8 Offer in Compromise, which is further divided into such topics as 5.8.6 Collateral Agreements and 5.8.21 Doubt as to Liability Offers. The subdivisions are hyperlinked to further subdivisions and, ultimately, to the relevant text. For example, the hyperlink for Doubt
as to Liability Offers yields the following subdivisions and accompanying hyperlinks:

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The three Pattern Letters cover accepted, withdrawn, and rejected offers.

It is important to note that the Service’s functions may be covered by multiple IRM Parts. For example, the Taxpayer Advocate Service (TAS) is Part 13, but the TAS is also covered directly in Part 5.8 Offer in Compromise. The Overview materials (5.8.1) include a Taxpayer Advocate Service subdivision (5.8.1.6).

Because IRM Parts are not necessarily cross-referenced to each other, locating all Parts covering a particular category requires a word or topic search. The next section illustrates such a search.

**Searching in the Internal Revenue Manual**

To search the IRM on the Service’s website, click on the website’s Advanced Search link. Click on the Internal Revenue Manual check box and indicate that you want documents that “Must Contain” the words “Taxpayer Advocate” in the “Body.” Refine your search by date, adding additional words that cover a particular topic, or requiring that the results “Must Contain,” “Must Not Contain,” or “Should Contain” particular terms. It is also possible to search for either words or phrases in the “Body,” “Title,” “Description,” or “Key Words.”

Although using the Advanced Search option provides more information than simply using the Manual Parts as a guide, commercial services are much easier to use for this purpose. Services that cover the IRM include Tax Analysts OneDisc, Kleinrock’s Federal TaxExpert (Penalty Handbook only), LexisNexis, and Westlaw.

**Updating for Chief Counsel Notices**

Because new Chief Counsel directives may not be immediately added to the Manual, it may also be necessary to search the CC Notices option on the IRS website. For example, CC-2004-036 (Sept. 22, 2004), which deals with Penalty Administration, will be cancelled when its text is incorporated into the CCDM.

Although CC Notices may be viewed on the IRS website, it is not possible to search them by IRS Part number.

**Advanced Search Option**

The CC Notices section merely lists the Notices in CC number order. A commercial service is better suited to searching by topic. For example, the LexisNexis IRS Chief Counsel Notices file can be used to search for CC Notices dealing with penalties. It will locate not only CC-2004-036, but other relevant CC Notices as well.

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7 IRM 30.2.1.1.4.
8 CCDM 30.2.1.4.2.
The right to a de novo scope of review in CDP cases also reflects the reality that many taxpayers before the IRS are not represented and may not be able to present sufficient evidence to Appeals, due to a number of reasons, including lack of sophistication and resources.
CDP cases also reflects the reality that many taxpayers before the IRS are not represented and may not be able to present sufficient evidence to Appeals, due to a number of reasons, including lack of sophistication and resources. Further, it also reflects the reality that informal procedures at Appeals may result in the IRS not considering information that might be relevant.

Yet, a failure to abide by the APA’s general approach toward reviewing only material before an agency (called the “On the Record” rule in administrative law) creates some risk that the IRS will take less care with its procedures at the hearing-level. For example, the On the Record rule creates incentives for the agency to conduct adequate procedures and provide sufficient explanations, so that a reviewing court will be able to perform its task of considering what an agency has decided, and the decision’s rationale. Courts following the On the Record rule may conclude that the agency has acted improperly, through a failure to consider relevant material or explain actions rationally, which should result in a remand and hopefully corrective agency practices. Often, better agency practice initially, compelled by the searching light of judicial review into what the agency did, provides more meaningful taxpayer protections than the possibility of more searching review.  

CDP creates challenges for the IRS and courts applying its provisions. At a time when many administrative law scholars are wrestling with injecting a floor of procedural protections in informal adjudications and lamenting their all but exclusion from the APA, cases like Robinette reflect an aversion to injecting principles inherent in administrative law to tax determinations. While Robinette is ostensibly a taxpayer-friendly decision, its pedigree is one of isolation from broader administrative law principles. The Tax Court’s casting its lot with the administrative law mainstream would ultimately provide a more systemic basis for taxpayer protection. The danger with the majority approach in Robinette is that it provides the cover for a judicial usurping of administrative function, which will not likely produce long-term systemic taxpayer benefits, though it may result in individualized correct decisions. Moreover, while arguably consistent with past Tax Court practice, it reflects a more radical approach to reviewing agency actions, departing from a pre-1998 universe of no judicial review to a more aggressive outcome-determinative review more akin to review of deficiency determinations. If the IRS knows that the court will consider new evidence on appeal and effectively substitute its judgment for that of the IRS, it creates little incentives to improve agency practice in the first instance.

**Conclusion**

Dread over injecting adversarial process in collection determinations is overstated, and minimizes the challenges that the IRS has experienced with some of its collection determinations. IRS performance in the collection function has been spotty at best, especially in connection with its administration of offers in compromise, where it has had almost absolute discretion and performed as both an evidence-gatherer and decision-maker. CDP, while born out of a far-from-perfect legislative process, reflects a legislative shift away from absolute discretion and toward judicial review, albeit limited, of IRS collection action. This shift away from absolute decision-making agency power and toward a limited review, while radical for tax administration in the collection context, is consistent with administrative law’s mainstream. While far from perfect, CDP deserves to continue, mature, and hopefully evolve.  

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1061 (2003).

6 Camp, supra note 3, at 1415; see also Bryan T Camp, Point & Counterpoint: Should Collection Due Process Be Repealed?, 24 A.B.A. NEWS Q. SEC. TAXN. 11 (Fall 2004).


9 Leslie Book, The Collection Due Process Rights: A Mistep or a Step in the Right Direction?, 41 HOUS. L. REV. 1145, 1147 n. 3, 1157 n.44 (concerning the need to introduce a third party to protect both the government’s and the taxpayers’ rights in the tax collection process).

10 Id.


12 For example, in her recent report, the National Taxpayer Advocate raises serious questions regarding the IRS’s ability to determine the correct offer amount for taxpayers submitting offers based upon doubts as to collectability. National Taxpayer Advocate, 2004 Annual Report to Congress, Vol. I at 34 n.73 (2004), available at http://www.irs.gov/pub/irs-utl/nta/2004/annualreport.pdf (data indicates that in FY 03 IRS ability to determine correct ability to pay declined by 9 percent compared to FY 01); see also Fowler v. Commissioner, 88 T.C.M. (CCH) 17 (2004) (in the context of review of a CDP determination, holding that IRS’s Appeals Officer’s use of national standards rather than actual expenses in determining a taxpayer’s ability to fund an OIC was an abuse of discretion).


16 Camp, supra note 3, at 1451.

17 See id.


19 See Ronald J. Krotoszynski, Jr., Taming the Tail That Wags the Dog: Ex Post and Ex Ante Constraints on Informal Adjudication, 56 ADMIN. L. REV. 1057, 1058 (2004); see also Edward Rubin, It’s Time to Make the Administrative Procedure Act Administrative, 89 CORNELL L. REV. 95, 108 (2003) (“the APA does not actually use the term informal adjudication at all, and barely acknowledges the concept”).


21 Robinette, 123 T.C. at 95.

22 Id. at 112.

23 Id. at 86-90.

24 Id.

25 Id.

26 Id. at 90-92. The IRS had no record of the taxpayer filing the return one day late, and the taxpayer’s accountant told the Appeals Officer that he filed the return on behalf of the taxpayer on October 15, on extension. The Appeals Officer requested that the accountant provide a copy of a certified or registered mail receipt, which the accountant could not do, because in filing the return, he used a private postage meter and testified at trial that he had deposited the return in a US postage box at 11:00 PM.

27 Id. at 104.

28 Id. at 91.

29 Id. at 94-95.


32 Id. at 97.

33 Id.

34 See Robinette, 125 T.C. at 126.

35 As support for this conclusion note that the Supreme Court has held that courts should narrowly construe exceptions to the APA’s rules of general applicability. Dickinson v. Zurko, 527 U.S. 150,155 (1999) (in considering review of a decision from the Patent and Trademark Office, Court held that the correct standard of review is that set forth in the APA rather than the “clearly erroneous” standard unrecognized by the APA unless there are policy reasons justifying such an exception).

36 For a discussion of the interplay of the Anti-Injunction Act and non-review of collection decisions, see Book, supra note 9, at 1155 nn.23-25.

37 See Flora v. United States, 362 U.S. 145 (1960) (holding that courts lack jurisdiction to hear refund suits unless the outstanding assessment is paid in full and the taxpayer has filed a timely refund claim with the IRS).


39 See supra notes 9 and 36.

40 Id.

41 Cords, supra note 20.

42 Krotoszynski, supra note 19, at 1058 (criticizing ex post models of accountability).

Examples of Economic Hardship

The Final Regulations also supplement the “reason-able basic living expense” standard by providing examples that illustrate the application of this standard. Three specific example are listed:21

• The taxpayer, who has assets sufficient to satisfy the tax liability, provides full time care and assistance to her dependent child, who has a serious long-term illness. It is expected that the taxpayer will need to use the equity in his assets to provide for adequate basic living expenses and medical care for his child.

• The taxpayer is retired and living on a fixed income. The taxpayer’s only asset is a retirement account, the value of which will satisfy the tax liability. Liquidating the retirement account, however, would leave the taxpayer without adequate means to provide for basic living expenses.

• A disabled taxpayer lives on a fixed income that will not, after allowance of basic living expenses, permit full payment of his liability under an installment agreement. The taxpayer also owns a modest house, specially equipped to accommodate his disability, the equity in which is sufficient to permit payment of the liability he owes. Because of the taxpayer’s disability and limited earning potential, however, the taxpayer is unable to obtain a mortgage or otherwise borrow against this equity. In addition, because the taxpayer’s home has been specially equipped to accommodate his disability, a forced sale of it would create severe adverse consequences for the taxpayer.

The Final Regulations should not be read to suggest that all of the factors in any one or more of these examples must be present in order for an Offer in Compromise on the basis of effective tax administration to be authorized.23 Instead, these are merely examples of situations in which the Final Regulations would allow an Offer in Compromise on the basis of effective tax administration.

Compelling Public Policy Or Equity Considerations

If an Offer in Compromise on the basis of effective tax administration for economic hardship is not available to the taxpayer, the IRS may accept an Offer in Compromise on the basis of effective tax administration if compelling public policy or equity considerations provide a sufficient basis.24

This type of Offer in Compromise is only justified where, due to exceptional circumstances, collection of the full tax liability would undermine public confidence that the tax laws are being administered in a fair and equitable manner.25 The IRS expects that the cases in which the equity and public policy standards will be satisfied will be rare; the IRS presumes that the correct application of the tax laws produces a fair and equitable result, absent some exceptional circumstance.26

For example, the IRS acknowledges that the Offer in Compromise program implicitly takes into account the fact that similarly situated taxpayers will sometimes have different results—some taxpayers will pay the full tax liability while other taxpayers will pay less than the full liability.27 As a result, a taxpayer proposing an Offer in Compromise on the basis of effective tax administration for public policy or equitable reasons must demonstrate circumstances that justify the offer even though similarly situated taxpayers may have paid the tax liability in full.28 Disparate treatment alone, then, is not a sufficient public policy or equity reason to support an Offer in Compromise on the basis of effective tax administration.29

Examples Satisfying Standard

The Final Regulations provide two examples of cases that satisfy the public policy and equity provisions for Offer in Compromise on the basis of effective tax administration:30

• In late 1986, the taxpayer developed a serious illness requiring almost continuous hospitalizations for a number of years. Due to the taxpayer’s medical condition, he was unable to manage any of his financial affairs and he did not file tax returns since that time. When the taxpayer’s health improved, he promptly began to attend to his tax affairs. He discovered that the IRS prepared a substitute for return for 1986 and had assessed a tax deficiency. The total liability, with penalties and interest, was more than three times the original tax liability.

• The taxpayer submits an e-mail inquiry to the IRS inquiring about how to transfer an IRA from one financial institution to another while preserving tax benefits and avoiding penalties. The IRS provides an erroneous response and, relying on that advice, the taxpayer fails to timely roll-over the IRA. Had it not been for the erroneous advice reflected in the taxpayer’s retained copy of the IRS e-mail response to his inquiry, the taxpayer would have redeposited the amount within the required time period.
Examples That Do Not Satisfy Standard

The Final Regulations do not provide any examples of cases that do not satisfy the public policy and equity provisions for Offer in Compromise on the basis of effective tax administration. However, the Preamble to the Final Regulations, two internal administrative notices, and one case provide such examples. These examples show that the IRS is serious when it indicates that an Offer in Compromise on the basis of effective tax administration on public policy or equitable grounds will be rare.

The Preamble to the Final Regulations provides two broad examples of cases which do not meet the requisite standard of public policy or equitable concerns. First, an offer based solely on an asserted delay by the IRS will not qualify. Second, an offer based on grounds that a third party, such as the taxpayer's business partner, defrauded or otherwise caused financial harm to the taxpayer will not qualify. These two examples are notable because after the IRS issued Temporary Regulations addressing Offers in Compromise on the basis of effective tax administration, practitioners proposed that the Final Regulations incorporate these two grounds as sufficient for the public policy and equity Offer in Compromise on the basis of effective tax administration. The IRS, however, specifically rejected the suggestion, although it did note that such cases might be appropriate for compromise under public policy or equitable grounds if there were also other compelling public policy or equity concerns; that caveat, however, would appear to be meaningless, since compelling public policy or equity concerns are always required in any case.

Two Chief Counsel Advices also provide examples of cases that do not meet the requisite standard of public policy or equitable concerns. In both cases, the tax liability arose through the innocent actions of the taxpayer, but an Offer in Compromise on the basis of effective tax administration for public policy or equitable reasons was not authorized. In the first case, the taxpayer's liability arose out of his interest in a partnership, an interest that turned out to be, unbeknownst to him, an interest in a tax shelter. The taxpayer investigated the partnership and then invested, as a limited partner, with a legitimate profit motive. The partnership, however, turned out to be a sham tax shelter; the taxpayer had been fraudulently induced to invest by his business partner. The IRS ruled that an Offer in Compromise on the basis of effective tax administration for public policy or equity reasons was not warranted, concluding that to do so would require the IRS to, essentially, guarantee taxpayer business decisions.

Conclusion

Historically, the IRS has compromised taxpayer liabilities on two grounds: doubt as to collectibility and doubt as to liability. The 1998 IRS Restructuring and Reform Act, however, now allows the IRS and taxpayers to compromise tax liabilities on the grounds of effective tax administration, which can be implemented through economic hardship or through public policy and equitable grounds. Recently, the requirements of the 1998 IRS Restructuring and Reform Act were implemented through Final Regulations, which replaced prior Temporary Regulations.

Under the Final Regulations, the IRS may now compromise tax liabilities to promote effective tax administration when it determines that, even though it could collect the outstanding tax liability in full from the taxpayer, doing so would cause the taxpayer economic hardship.

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In the second case, the taxpayer's tax liability also arose out of his interest in a partnership, an interest that turned out to be, unbeknownst to him, an interest in a tax shelter. The taxpayer investigated the partnership and then invested, as a limited partner, with a legitimate profit motive. The partnership, however, turned out to be a sham tax shelter; the taxpayer had been fraudulently induced to invest by his business partner. The IRS ruled that an Offer in Compromise on the basis of effective tax administration for public policy or equity reasons was not warranted, concluding that to do so would require the IRS to, essentially, guarantee taxpayer business decisions.

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Under the Final Regulations, the IRS may now compromise tax liabilities to promote effective tax administration when it determines that, even though it could collect the outstanding tax liability in full from the taxpayer, doing so would cause the taxpayer economic hardship. The Final Regulations also allow the IRS to compromise tax liabilities to promote effective tax administration when, due to the exceptional circumstances of certain rare cases, collection of the full tax liability would undermine public confidence in the fair and equitable administration of the tax laws.

Both of these new grounds require an extensive facts and circumstances analysis. They also require an extensive financial review, as neither is available if the taxpayer lacks the financial wherewithal to pay the liability in full and, in the case of the economic hardship grounds, they require a determination of whether that full payment will leave the taxpayer unable to pay reasonable basic living expenses.

The Final Regulations provide new opportunities for taxpayers to obtain financial freedom from the IRS. At the same time, they create a maze of requirements that
must be traversed. The failure to meet these requirements can and will cause the IRS to reject an Offer in Compromise, a result that will have far-reaching negative impact of the taxpayer’s relationship with the IRS. As a result, taxpayers considering an Offer in Compromise on the basis of effective tax administration should contact a tax practitioner experienced in dealing with the IRS on administrative matters for advice.

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3 I.R.M. § 5.8.1.1.3(1) (Nov. 15, 2004); I.R.M. § 5.8.21.2 (Feb. 1, 2004).


5 As with Offers in Compromise on the grounds of doubt as to collectibility and doubt as to liability, a taxpayer submitting an Offer in Compromise on the basis of effective tax administration must execute a Form 656, Offer in Compromise, and, as may be required by the instructions to the Form 656, a Form 433-A, Collection Information Statement for Wage Earners and Self-Employed Individuals, and Form 433-B, Collection Information Statement for Businesses.


7 T.D. 9007 (2002); I.R.M. § 5.8.11.2(1) (May 15, 2004); see Treas. Reg. § 301.7122-1(b)(3).  

8 See I.R.M. § 5.8.11.2 (May 15, 2004); I.R.M. § 5.8.22.1 (January 1, 2000).

9 As with an Offer in Compromise on the basis of doubt as to collectibility, assets and anticipated future income for purposes of an Offer in Compromise on the basis of effective tax administration for economic hardship grounds are determined through the execution of a Form 433-A, Collection Information Statement for Wage Earners and Self-Employed Individuals and, as necessary, a Form 433-B, Collection Information Statement for Businesses.


12 I.R.M. § 5.8.11.2.3 (November 1, 2000).


14 I.R.M. § 5.8.11.2.2(11) (May 15, 2004).

15 See Treas. Reg. § 301.7122-1(c)(3); I.R.M. § 5.8.22.2(2) (January 1, 2000).

16 An Offer in Compromise on the basis of effective tax administration for economic hardship is not a basis of compromise for non-individuals. See T.D. 9007 (2002).

17 Treas. Reg. § 301.6343-1(b)(4)(i); I.R.M. § 5.8.11.2.1(2) (May 15, 2004); see also T.D. 9007 (2002) (citing Treas. Reg. § 301.6343-1);

18 Razo v. Commissioner, T.C. Memo 2004-101 (IRS did not abuse discretion in rejecting Offer in Compromise on the basis of effective tax administration for economic hardship when taxpayers made de minimus offer of $100, despite owning automobiles that, if sold, would allow them to pay the entire tax liability).


21 Id.


25 Id.

26 T.D. 9007 (2002); see also Chief Couns. Adv. 200121012 (May 25, 2001) (Offer in Compromise on the basis of effective tax administration on public policy and equitable grounds not justified with respect to tax-motivated interest on interest in tax shelter because tax-motivated interest rate was a specific Congressional policy choice enacted elsewhere in the IRC via an express and comprehensive scheme which dictated a certain result and a decision to categorically disregard that scheme was beyond the Service’s authority); I.R.M. § 5.8.11.2.2(3) (May 15, 2004).


29 See, e.g., Fargo v. Commissioner, T.C. Memo 2004-13 (IRS abatement of the tax shelter participant’s interest assessment did not require it to compromise taxpayers’ interest assessment since different factors were relevant to each form of relief, and each taxpayer faced different circumstances).


32 See also Fargo v. Commissioner, T.C. Memo 2004-13 (delay in assessing unpaid tax liability from a tax shelter investment not due to IRS but was instead due to TEFRA partnership procedures which, even after IRS won litigation relating to partnership, required IRS to negotiate closing agreements with each affiliated partnership, including the taxpayers’ partnership); I.R.M. § 5.8.11.2.2(4) (May 15, 2004).

33 See also I.R.M. § 5.8.11.2.2(3) (May 15, 2004) (noting, however, that such situations may qualify for an Offer in Compromise on the grounds of doubt as to collectibility or economic hardship).


THE NATIONAL TAXPAYER ADVOCATE'S OFFER IN COMPROMISE RECOMMENDATIONS:

In her 2004 Annual Report to Congress, the National Taxpayer Advocate, Nina Olson, made the following recommendations for offers in compromise.

Add new paragraph 7122(c)(4) of the Code to read as follows:

Special Rules Relating to Offers Based Upon Equitable Considerations. — Notwithstanding any other provision of this title, the Secretary shall compromise a liability when it is inequitable to collect any unpaid tax (or any portion thereof, including penalties and interest).

(A) It shall be deemed inequitable to collect an income tax liability in excess of the economic benefit received from the transaction to which the liability relates. For purposes of this section, a transaction shall include all related transactions.

(B) In other cases, the Secretary shall consider all of the facts and circumstances, including:

i. whether the taxpayer acted reasonably and in good faith under the circumstances, such as, by taking reasonable actions to avoid or mitigate the situation;

ii. whether an income tax liability is disproportionate to (even if not in excess of) the economic benefit received from the transaction to which the liability relates;

iii. whether the taxpayer is a victim of a third-party bad act or other unexpected event;

iv. whether the taxpayer has a recent history of compliance with tax filing and payment obligations or a reasonable explanation for noncompliance;

v. whether any IRS employee has not followed standard procedures in connection with the case, including applicable published administrative guidance (such as the Internal Revenue Manual);

vi. whether IRS action or inaction has unreasonably delayed resolution of the taxpayer's case; and

vii. any other relevant fact or circumstances indicating that justice, equity or public policy justifies the compromise.

No single fact or circumstance described in clause (i) - (vii), above, shall be determinative of whether to compromise a liability under subparagraph (B). This determination shall be made without regard to the taxpayer's ability to fully pay the liability. Compromises under this paragraph 7122(c)(4) may require appropriate adjustments to basis, carryovers, or other tax attributes.

Add new paragraph 7122(c)(5) of the Code to read as follows:

Rules Relating to Offers Based Upon Hardship. — Notwithstanding any other provision of this title, unless the taxpayer has a recent unexplained history of noncompliance with tax filing or payment obligations, the Secretary may compromise a liability if collection of unpaid tax (or any portion thereof, including penalties and interest) would cause a hardship for the taxpayer or for a third party, without regard to whether the taxpayer is a person or an entity. This determination shall be made without regard to the taxpayer's ability to fully pay the liability.

Add new sub-paragraph 7122(c)(3)(C) of the Code to read as follows:

in the case of an offer-in-compromise submitted on more than one basis, the Secretary shall evaluate the taxpayer's bases for compromise in the order indicated by the taxpayer, and the Secretary's decision to compromise on one basis shall not depend on whether the Secretary would be willing to compromise on another basis; and . . .
Poverty and Taxation: continued from page 7

liability is equal to zero.

For example, for 2004, for a married couple with two children with income (I) in excess of its $22,100 simple income tax threshold and in excess of $23,290 (the point at which the couple can claim the full $2,000 worth of child tax credits) but less than the $35,458 level at which the taxpayer’s earned income credit disappears, the couple’s combined income and Social Security tax liability (T) can be determined by the following formula:

\[ T = 0.10 \times (I - 22,100) + 0.0765 \times I - (4,300 - 0.2106 \times (I - 15,040)) - (2 \times 1,000). \]

Setting T equal to zero and solving for I shows that the couple’s combined income and Social Security tax threshold after the earned income and child tax credits is $30,166.42.

10 Algebraically, each computation in Row 2 involved determining the appropriate equation for computing each family unit’s income tax at the poverty level after taking into account its tax credits. In those instances where the poverty level is less than the simple income tax threshold, there is obviously no preliminary income tax liability, and the earned income credit will generally exceed the worker’s Social Security taxes.

For example, for 2004, for a married couple with two children with income (I) less than its $22,100 simple income tax threshold but in excess of the $15,040 level at which the earned income credit begins to phase out, the couple’s income tax refund (R) can be determined by the following formula:

\[ R = 4,300 - 0.2106 \times (I - 15,040) + 0.15 \times (I - 10,750). \]

Setting I equal to $18,850 and solving for R shows the couple will be entitled to an income tax refund of $4,713 ($4,712.61 = 4,300 - 0.2106 \times (18,850 - 15,040) + 0.15 \times (18,850 - 10,750)).

11 Algebraically, each computation in Row 3 involved multiplying the family unit’s poverty-level income times the 7.65 percent Social Security tax. For example, a married couple with two children and a poverty-level income of $18,850 will owe $1,442 in Social Security taxes for 2004 ($1,442.03 = 0.0765 \times 18,850). Again, only the employee’s portion of Social Security taxes is considered.

12 Algebraically, each computation in Row 4 involved adding the income tax in Row 2 to the Social Security tax in Row 3. For example, a married couple with two children and a poverty-level income of $18,850 will receive a refund of $3,271 ($3,270.58 = -4,712.61 + 1,442.03).

13 Algebraically, each computation in Row 5 involved dividing the net tax liability in Row 4 by the poverty-level income in Row 1. For example, a married couple with two children will receive a refund equal to 17.4 percent of its poverty-level income (-17.35% = -3,270.58 / 18,850).

14 Admittedly, some low-income childless individuals and childless couples will owe federal taxes for 2004. For example, a childless individual who is eligible to claim the earned income credit will have a net federal tax liability if she earns more than $5,100, as her Social Security tax liability will exceed her maximum $390 earned income tax credit. Moreover, she will owe $682 in federal tax if she has a poverty-level income of $9,310 ($681.60 = 0.10 \times (9,310 - 7,950) + 0.0765 \times 9,310 - (390 - 0.0765 \times (9,310 - 6,390))).

Also, an analysis of low-income childless individuals and couples who are ineligible for the earned income credit (e.g., because they are under age 25) would show slightly greater tax liabilities. For example, a 21-year-old childless individual will owe Social Security taxes and so have a net federal tax liability from her very first dollar of earned income. Moreover, she will owe $848 in federal taxes if she earns a poverty-level income of $9,310 in 2004 ($848.22 = 0.10 \times (9,310 - 7,950) + 0.0765 \times 9,310).

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The Community Tax Law Project (CTLP) is a 501(c)(3) Virginia corporation founded in 1992. Its mission is to provide low-income Virginia taxpayers with pro bono representation in federal and state tax disputes and to educate low-income individuals about their rights and responsibilities as U.S. taxpayers. CTLP attempts to help the lower income taxpayer re-enter or remain in the tax system.

The Project accomplishes its mission through a pro bono referral panel of volunteer attorneys, accountants, enrolled agents and an in-house legal staff. It sponsors continuing legal education programs, including one scheduled for September 2005 focusing on tax controversy and litigation. CTLP staff conduct substantial outreach efforts to low-income parents and workers about tax issues impacting their families and their employment. The Project has special initiatives for taxpayers who speak English as a Second Language, to participants in welfare-to-work programs, and to victims of domestic violence. CTLP also runs the Low-Income Taxpayer Clinic (LITC) National Resource Center, a support and training center for LITC clinics nationwide.

Finally, CTLP publishes The Community Tax Law Report, a national semi-annual newsletter about low-income tax policy and practice. The Report provides a forum for in-depth analysis of tax matters that affect low-income individuals.