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## OFFERS IN COMPROMISE: Authorize the National Taxpayer Advocate to Determine Whether an Offer in Compromise Submitted by a Victim of Payroll Service Provider Fraud Is “Fair and Equitable”

### PROBLEM

Many small businesses outsource payroll and related tax duties to third-party payroll service providers (PSPs). If a PSP fraudulently fails to pay the IRS, the business owner remains responsible for unpaid tax, interest, and penalties. PSP fraud often results in significant hardship for the business, which (from its perspective) must pay the tax twice—once to the PSP that dissipated the funds, and again to the IRS.<sup>1</sup>

The IRS has the discretionary authority to accept taxpayers’ offers to compromise their tax debts for less than the full amount owed if certain conditions are met.<sup>2</sup> Under its guidelines for evaluating offers in compromise (OICs) based on effective tax administration (ETA) submitted by victims of PSPs, the IRS is to inquire whether the offer will:

1. Result in a financial gain for the taxpayer; and
2. Be “generally perceived within the community as a fair and equitable solution.”<sup>3</sup>

The National Taxpayer Advocate believes the first part of the inquiry is unnecessary because, by definition, a victim of preparer fraud will never be financially advantaged by the fraud. In the second part of this inquiry, the National Taxpayer Advocate, as the “voice of the taxpayer” inside the IRS, is the appropriate official to assess whether an offer would be perceived as fair and equitable.<sup>4</sup>

### EXAMPLE

In January 2013, small business MomPop LLC enlists the help of Fasten Tax Group, a PSP, to assist in filing its federal and state payroll taxes. Each pay period, MomPop transfers funds to Fasten to meet its payroll tax obligations. In July 2014, the IRS notifies MomPop that no payroll taxes have been filed since December 2013. For the past six months, Fasten Tax Group has received funds from MomPop and nearly 500 other businesses, but has not made any payments to the IRS on behalf of its clients. MomPop has not been able to reach anyone at Fasten Tax Group. Meanwhile, MomPop has cash reserves of \$20,000 and other assets that exceed its tax liability of approximately \$80,000 to the IRS in payroll taxes, interest, and penalties.

- 1 For an in-depth discussion of the challenges faced by victims of PSPs, see Most Serious Problem: *OFFERS IN COMPROMISE: The IRS Does Not Comply with the Law Regarding Victims of Payroll Service Provider Failure*, *supra*.
- 2 See Treas. Reg. 301.7122-1(b)(1). Treasury Regulations provide three grounds for an offer to be accepted: doubt as to liability; doubt as to collectability; and effective tax administration (ETA). For an in-depth discussion of the IRS’s offer in compromise (OIC) authority, see Most Serious Problem: *OFFERS IN COMPROMISE: Despite Congressional Actions, the IRS Has Failed to Realize the Potential of Offers in Compromise*, *supra*.
- 3 Memorandum from Rocco A. Steco, Acting Director, Collection Policy, to Directors, Campus Compliance Operations, and Directors, Field Collection Operations Area, *Interim Guidance on Offers in Compromise from Taxpayers When Payroll Service Provider Issues Are Present* (Sept. 16, 2014). This guidance supplements the procedures found in Internal Revenue Manual (IRM) 5.8.11.2.2.1, *Public Policy or Equity Compelling Factors*, IRM 5.8.11.4.2, *Financial Statement Analysis*, and IRM 5.8.11.5, *Documentation and Verification*, and will be incorporated into the next revision of these IRM sections.
- 4 In 1997, The National Commission on Restructuring the Internal Revenue Service called the Taxpayer Advocate the “voice of the taxpayer.” See National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS*, 48 (1997).

The majority shareholder of MomPop has been in contact with her congressional office about the harm her company has suffered because of Fasten Tax Group's fraudulent actions. A congressional staffer assures her that Congress has given the IRS the ability to work with victims of PSPs in a fair and equitable manner. At the urging of the staffer, MomPop submits an offer in compromise of \$10,000. Despite the congressional directive to give special consideration to offers from victims of PSP fraud, the IRS rejects MomPop's offer, stating that its acceptance would not be perceived within the community as a fair and equitable solution.

## RECOMMENDATION

To address the inherent conflict with the IRS determining whether acceptance of an offer in compromise by a victim who was defrauded by a payroll service provider is fair and equitable, Congress should specify that such determination be made by National Taxpayer Advocate.

## PRESENT LAW

An OIC is an agreement between a taxpayer and the government that settles a tax liability for payment of less than the full amount owed.<sup>5</sup> That is, the IRS has the discretionary authority to accept offers for less than the full amount if certain conditions are met.

In 1998, Congress introduced the concept of accepting OICs based on effective tax administration and provided specific guidance to the IRS on accepting such offers.<sup>6</sup> OICs based on ETA provide the IRS the flexibility to consider all of the circumstances that led to a delinquency. The IRS may accept ETA offers even if it could achieve full collection when such collection would create an economic hardship for the taxpayer or the taxpayer identifies "compelling public policy or equity considerations."

Unsatisfied with the IRS's lack of interest in using its ETA OIC authority for victims of PSPs, Congress specifically mandated in section 106 of the Consolidated Appropriations Act of 2014 that the IRS "shall give special consideration to an offer-in-compromise from a taxpayer who has been the victim of fraud by a third party payroll tax preparer."<sup>7</sup> In 2014, the IRS developed an interim guidance memorandum that supplements its Internal Revenue Manual (IRM) section on OICs.<sup>8</sup> This guidance "allows the offer specialist to investigate and process offers submitted by taxpayers impacted by the fraudulent acts of a PSP in the most expeditious manner possible."<sup>9</sup>

Among the considerations outlined in the guidance is whether payment of less than the remaining tax balance would:

- Result in financial gain for the taxpayer?
- Be generally perceived within the community as a fair and equitable solution?

5 Internal Revenue Code (IRC) § 7122.

6 The IRS Restructuring and Reform Act of 1998, Pub. L. 105-106, 112 Stat. 685 (1998); H.R. REP. No. 105-599, at 289 (1998) (Conf. Rep.).

7 Consolidated Appropriations Act, 2014, Division E, Title I, § 106 (Pub. L. No. 113-76).

8 Memorandum from Rocco A. Steco, Acting Director, Collection Policy, to Directors, Campus Compliance Operations, and Directors, Field Collection Operations Area, *Interim Guidance on Offers in Compromise from Taxpayers When Payroll Service Provider Issues Are Present* (Sept. 16, 2014).

9 *Id.*

In two other provisions of the Internal Revenue Code, Congress has explicitly designated the National Taxpayer Advocate as the one to determine whether an action is in the best interest of the taxpayer. First, in the context of lien withdrawals, it is the IRS that determines whether withdrawing the lien is in the best interest of the United States.<sup>10</sup> However, it is the National Taxpayer Advocate who decides whether it is in the *taxpayer's* best interest to withdraw the lien.<sup>11</sup> This is because, as the voice of the taxpayer, the National Taxpayer Advocate is charged with advocating on behalf of specific groups of taxpayers and all taxpayers.<sup>12</sup> She is thus the appropriate IRS official to make the determination as to what is in the taxpayer's best interest.

A similar provision exists for releasing a levy. In certain circumstances, the National Taxpayer Advocate makes the determination of whether the return of property is in the taxpayer's best interest.<sup>13</sup> Notwithstanding these provisions, under current IRS guidance, the IRS designates itself to decide whether an OIC submitted under ETA authority would be “generally perceived within the community as a fair and equitable solution.”

## REASONS FOR CHANGE

Congress has provided the IRS with the tools to promote the use of OICs as a viable collection alternative for victims of failed PSPs, including compromising the amount of tax in appropriate instances. In practice, the IRS has not embraced its ETA OIC authority; instead, it has consistently underutilized this tool to provide relief to victims. For example, in fiscal years 2013 and 2014, the IRS accepted only 54 non-economic hardship ETA offers submitted by victims of PSPs.<sup>14</sup> The IRS does not track the number of these victims. However, even if considering only the approximately 500 to 600 employers impacted by the AccuPay bankruptcy, accepting 54 non-economic hardship ETA offers over the past two years is hardly the “flexible” use that Congress intended.

As discussed above, the IRS's interim guidance on evaluating OICs submitted by victims of PSP fraud provides that the IRS shall inquire whether the offer would be generally perceived within the community as a fair and equitable solution.<sup>15</sup> Just as Congress vested the National Taxpayer Advocate with the authority to make the determination of the taxpayer's best interest with respect to liens and levies, the IRS Commissioner has recognized the National Taxpayer Advocate as the voice of the taxpayer by delegating to her, and to her alone, the authority to issue a Taxpayer Advocate Directive where IRS procedures harm a group of taxpayers or even all taxpayers.<sup>16</sup> Thus, the National Taxpayer Advocate, as the voice of the taxpayer inside the IRS, should be the one to make the determination of whether an offer based on ETA is fair and equitable.

<sup>10</sup> See IRC § 6323(j)(1)(D).

<sup>11</sup> See *id.*

<sup>12</sup> See National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS*, 48-9 (1997). See also IRM 1.2.50.4, Delegation Order 13-3 (formerly DO-250, Rev. 1), *Authority to Issue Taxpayer Advocate Directives* (Jan. 17, 2001); IRM 13.2.1.6, *Taxpayer Advocate Directives* (July 16, 2009).

<sup>13</sup> See IRC § 6343(d)(2)(D).

<sup>14</sup> See IRS follow-up response to fact check (Dec. 8, 2014). While the IRS does not systemically track the number of OICs submitted by victims of PSPs, it stated that it knew of 33 such offers received in fiscal year (FY) 2013 and 57 in FY 2014. See IRS response to fact check (Nov. 26, 2014).

<sup>15</sup> Memorandum from Rocco A. Steco, Acting Director, Collection Policy, to Directors, Campus Compliance Operations, and Directors, Field Collection Operations Area, *Interim Guidance on Offers in Compromise from Taxpayers When Payroll Service Provider Issues Are Present* (Sept. 16, 2014).

<sup>16</sup> See IRM 1.2.50.4, Delegation Order 13-3 (formerly DO-250, Rev. 1), *Authority to Issue Taxpayer Advocate Directives* (Jan. 17, 2001). See also IRM 13.2.1.6, *Taxpayer Advocate Directives* (July 16, 2009).

## EXPLANATION OF RECOMMENDATION

We concur with the current IRS guidance that requires an inquiry as to whether other taxpayers would perceive the proposed offer to be fair and equitable. However, rather than leaving this determination up to the IRS, we recommend that Congress amend section 106 to provide that when evaluating these offers consideration should be given as to whether other taxpayers would perceive the proposed offer to be fair and equitable and to designate the National Taxpayer Advocate to make such an assessment. The National Taxpayer Advocate, as the voice of the taxpayer within the IRS, is uniquely qualified to make this assessment.

In addition, the recommendation proposes that section 106 of the Consolidated Appropriations Act of 2014 also be amended to provide that in evaluating the offer the IRS should not consider whether the taxpayer received financial gain as a result of compromise of tax liabilities attributable to PSP fraud. This inquiry is irrelevant for two reasons:

1. Every compromise of tax in every instance will result in some financial benefit to the taxpayer proposing the compromise; and
2. Victims of PSP fraud have already paid out the tax liability once (albeit to the PSP), and already are economically in the same situation as a taxpayer who paid the payroll taxes directly to the IRS. The victim will, by definition, be economically disadvantaged vis-à-vis other taxpayers by being required to pay one cent more.<sup>17</sup>

Therefore, the inquiry into financial gain or benefit is meaningless. The relevant inquiry is whether the taxpayer timely paid the payroll taxes and withholding to the PSP, and whether the taxpayer received any sort of reimbursement (*e.g.*, from insurance) that mitigated its loss. This is a simple factual analysis that requires no value-laden subjective judgment.

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<sup>17</sup> This assumes the taxpayer has not recovered some or all of the tax payments via insurance, court ordered restitution, payment on a civil judgment, or distributions from a PSP's bankruptcy.