

**Legislative Recommendation #17****Amend IRC § 7122 to Require the IRS to Refund Any Payment Collected Pursuant to a Federal Tax Lien That Exceeds the Amount of an Accepted Offer in Compromise****PRESENT LAW**

IRC § 7122 authorizes the Secretary to sign an agreement (an “offer in compromise” or OIC) with a taxpayer to settle the taxpayer’s tax liabilities for less than the amount owed. OICs take one of two forms: (i) the taxpayer may pay the agreed amount in a single lump-sum or (ii) the taxpayer may pay the agreed amount through periodic payments, generally monthly. Treas. Reg. § 301.7122-1(b) provides that the IRS may compromise liabilities to the extent there is doubt as to liability or doubt as to collectibility, or to promote effective tax administration. With respect to offers based on doubt as to collectibility, the Service has a legal basis to compromise when the taxpayer’s equity in assets and future income potential are less than the taxpayer’s liabilities. The IRS follows guidelines set forth in Internal Revenue Manual (IRM) 5.8.5 to evaluate a taxpayer’s equity in assets and future income potential. According to IRS Policy Statement 5-100, an OIC is considered a “legitimate alternative to declaring a case as currently not collectible or to a protracted installment agreement” and the goal is to “achieve the collection of what is potentially collectible at the earliest possible time and at the least cost to the government.”

Taxpayers seeking an OIC must complete Form 656, Offer in Compromise. Taxpayers seeking an OIC based on Doubt as to Collectibility must also complete a Collection Information Statement on Form 433. Section 7 of Form 656 includes certain terms and conditions a taxpayer must accept when submitting an OIC. In Paragraph (o) of Section 7, taxpayers agree that failure to meet the terms of an OIC, such as by missing payments, may cause default of the offer, possibly resulting in reinstatement of the full tax liability, plus penalties and interest. In Paragraph (q) of Section 7, taxpayers agree that:

The IRS may file a Notice of Federal Tax Lien during consideration of the offer or for offers that will be paid over time. If the offer is accepted, the tax lien(s) for the periods and taxes listed in Section 1 will be released within 35 days after the payment has been received and verified. The time it takes to transfer funds to the IRS from commercial institutions varies based on the form of payment. If I have not finished paying my offer amount, then the IRS may be entitled to any proceeds from the sale of my property. The IRS will not file a Notice of Federal Tax Lien on any individual shared responsibility debt.

IRC § 6331(a) authorizes the IRS to “levy upon all property and rights to property,” but the IRS generally will not seek to enforce a levy while an offer is pending, for 30 days following the rejection of an offer, or during any period when an appeal is being considered.<sup>1</sup> When an OIC paid through periodic payments is accepted, however, the IRS may maintain a lien on any property owned by the taxpayer until all payments are made.<sup>2</sup>

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<sup>1</sup> See IRC § 6331(k).

<sup>2</sup> IRS Form 656-B, Offer in Compromise (Apr. 2020).

## REASONS FOR CHANGE

When the IRS accepts an OIC, the IRS contracts to settle a tax liability for less than the full amount of the liability. Prior to accepting an OIC, the IRS carefully reviews and verifies the taxpayer's financial condition.<sup>3</sup> It calculates a taxpayer's "reasonable collection potential" (RCP), accounting for assets, future income, other lienholders, and allowable living expenses.<sup>4</sup> Generally, an OIC is not accepted unless the offer proposed by the taxpayer is equal to or greater than the RCP, as calculated by the IRS.

In certain situations where the IRS has filed a lien on taxpayer property, the IRS may end up collecting more than the amount originally calculated as the taxpayer's reasonable collection potential. IRS internal guidance calls for a lien on property to remain in place until the taxpayer has made all payments.<sup>5</sup> If a taxpayer sells property subject to lien prior to completing payment on the OIC, the IRS may take the net sale proceeds up to the full amount of its original lien, as authorized by Section 7, Paragraph (q), of Form 656. As a result, the IRS may collect more money than was originally determined when the taxpayer's reasonable collection potential was determined and the OIC executed.

## RECOMMENDATION

- Amend IRC § 7122 to require the IRS to refund any payment collected pursuant to a federal tax lien that exceeds the amount of an accepted OIC, provided the taxpayer disclosed all material income and assets to the IRS on his or her application and made all payments in accordance with the terms of the agreement.

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<sup>3</sup> IRM 5.8.5, Financial Analysis (Mar. 23, 2018).

<sup>4</sup> IRM 5.8.4.3.1, Doubt as to Collectibility (Apr. 30, 2015).

<sup>5</sup> IRM 5.8.10.6, Discharge and Subordination Request (July 20, 2020).