

Legislative Recommendation #19**Improve Offer in Compromise Program Accessibility by Repealing the Upfront Payment Requirements****SUMMARY**

- *Problem:* Financially struggling taxpayers who cannot afford to pay their tax liabilities in full may apply for an offer in compromise (OIC). Under an OIC, the IRS agrees to accept less than full payment in satisfaction of the debt. Currently, taxpayers are required to include non-refundable partial payments with their OIC applications. The Treasury Department has acknowledged that the partial payment requirement may substantially reduce access to the OIC program and has estimated that repealing the requirement would raise revenue.
- *Solution:* Repeal the requirements that taxpayers include partial payments with OIC applications.

PRESENT LAW

IRC § 7122(a) authorizes the IRS to settle a tax debt by accepting an OIC. According to Policy Statement 5-100, the IRS will “accept an offer in compromise when it is unlikely that the tax liability can be collected in full and the amount offered reasonably reflects collection potential.”¹ Taxpayers whose offers are accepted must file and pay their taxes for the next five years, as stated on IRS Form 656, Offer in Compromise. If they fail to remain in compliance for the five-year period, the IRS may seek to collect the amounts it compromised.

IRC § 7122(c)(1)(A) requires a taxpayer who would like the IRS to consider a “lump-sum” offer – payable in five or fewer installments – to include a nonrefundable partial payment of 20 percent of the amount of the offer with the application. IRC § 7122(c)(1)(B) requires a taxpayer who would like the IRS to consider a “periodic payment” offer – an offer payable in six or more installments – to include the first proposed installment with the application and to continue to make installment payments while the IRS is considering it. In addition to these upfront partial payments, Treas. Reg. § 300.3 requires that most offer applications include a \$205 user fee. IRC § 7122(c)(3) provides that taxpayers with low incomes (*i.e.*, taxpayers with adjusted gross incomes for the most recent tax year, or taxpayers with household gross monthly incomes multiplied by 12 months, that do not exceed 250 percent of the Federal Poverty Level guidelines) are not subject to the user fee or the partial payment requirement.² They may apply for a waiver on Form 656.

REASONS FOR CHANGE

By accepting an offer, the IRS often collects money it would not otherwise collect and may convert a noncompliant taxpayer into a compliant one by requiring the taxpayer, as a condition of the agreement, to timely file returns and pay taxes for the following five years. The Treasury Department’s General Explanations of the Administration’s Fiscal Year 2017 Revenue Proposals acknowledged the benefit of offers and proposed to repeal the partial payment requirement, explaining that the requirement “may substantially reduce access to the offer in compromise program [and] [r]educing access to the offer-in-compromise program makes it

1 Internal Revenue Manual 1.2.1.6.17, Policy Statement 5-100, Offers Will Be Accepted (Jan. 30, 1992), https://www.irs.gov/irm/part1/irm_01-002-001.

2 See also Treas. Reg. § 300.3(b)(ii), (iii).

more difficult and costly to obtain the collectable portion of existing tax liabilities.”³ The Treasury Department estimated that repealing the requirement would raise revenue.⁴

A 2007 TAS study found that taxpayers above the low-income threshold were no better able to afford to make partial payments than those below it and that those below it frequently did not obtain a waiver.⁵ Similarly, a 2005 Treasury Inspector General for Tax Administration (TIGTA) report found that when the IRS first imposed a user fee (it was \$150 in 2003), OIC submissions declined by more than 20 percent among taxpayers at every income level, including those who were eligible for a fee waiver.⁶ Furthermore, after the partial payment requirement was imposed, there was a 26 percent decrease in submitted offers and only a slight increase in the offer acceptance rate, suggesting that higher upfront costs deterred many taxpayers from submitting acceptable offers. Thus, upfront payments such as the user fee and the partial payment requirement likely reduce collections and increase enforcement costs.

RECOMMENDATION

- Amend IRC § 7122(c) to remove the requirement that taxpayers include a partial payment with offer applications and to provide that any user fee that is imposed will not be required as an upfront payment but rather will be collected out of amounts otherwise due on accepted offers.⁷

3 Dep’t of the Treasury, *General Explanations of the Administration’s Fiscal Year 2017 Revenue Proposals* 220 (Feb. 2016) (Revise Offer-in-Compromise Application Rules), <https://home.treasury.gov/system/files/131/General-Explanations-FY2017.pdf>.

4 In the past, the IRS expressed concern that repealing the partial payment requirement or limiting the user fee might have the effect of increasing the number of frivolous offers. The tax code discourages frivolous submissions by imposing a penalty of \$5,000 on any person who submits a frivolous OIC application. See IRC § 6702(b).

5 National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, at 76 (*Effect of Tax Increase and Prevention Reconciliation Act of 2005 on IRS Offer in Compromise Program*), https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/arc_2007_vol_2.pdf.

6 TIGTA, Ref. No. 2005-30-096, *The Implementation of the Offer in Compromise Application Fee Reduced the Volume of Offers Filed by Taxpayers at All Income Levels* (2005).

7 For legislative language generally consistent with the recommendation to repeal the partial payment requirement, see Small Business Taxpayer Bill of Rights Act of 2023, S. 1177 and H.R. 2681, 118th Cong. § 17 (2023); Small Business Taxpayer Bill of Rights Act of 2022, H.R. 7033, 117th Cong. § 17 (2022). We recommend that the language in these bills be modified to avoid eliminating the exception to user fees for low-income taxpayers in IRC § 7122(c)(3). For additional background, see, e.g., National Taxpayer Advocate 2006 Annual Report to Congress 507 (Legislative Recommendation: *Improve Offer in Compromise Program Accessibility*), https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/2006_arc_section2_v2.pdf.