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WHEN, AND HOW, THE "TAX MAN" COMPROMISES[1]

Clients with tax problems often come to me and ask, "can't we just get the IRS (or the State) to let us pay off that $20,000 in taxes and waive the penalties, so we can get back on our feet?" Others see those late night TV commercials, telling how people paid the IRS off at 10-20¢ on the dollar, and they want to know why they can't just do that. The IRS and State taxing agencies can compromise and settle with you on your old tax debts, but the guidelines are very strict.

Section 7122 of the Internal Revenue Code provides that the IRS may compromise any civil or criminal tax case for one of three reasons – doubt as to liability, doubt as to collectibility, or the promotion of efficient tax administration. In most cases, there is no doubt as to whether or not a taxpayer owes delinquent taxes, so a taxpayer will usually seek to establish doubt as to collectibility.

In order to show doubtful collectibility, a taxpayer must provide the IRS with a detailed statement of his assets, liabilities, income and expenses (on Form 433-A (OIC)), as well as backup records such as bank statements and cancelled checks. The IRS will review the information furnished to determine the answers to two questions. First, the IRS will want to know if the taxpayer liquidated his or her available property TODAY, how much could he or she realize from the sale of those assets (the "Net Asset Sale Value"). Second, the IRS will compare the taxpayer's regular monthly income with his or her reasonable living expenses, based upon family size and certain average amounts spent by families nationwide according to the government statistics. The amount left over after meeting these expenses is known as "Net Disposable Income." The IRS will multiply Net Disposable Income times 12 (to come up with an annual figure), and add that number to Net Asset Sale Value. An Offer in Compromise to the IRS due to doubt as collectibility will be accepted only if the amount of the offer exceeds the taxpayer's Net Asset Sale Value plus 12 times the taxpayer's Net Disposable Income. For example, if a taxpayer owes $100,000 in back taxes, but his Net Asset Sale Value is only $5,000, and his available monthly Net Disposable Income is $200 per month, then the IRS will not accept a compromise offer unless it exceeds $7,400 ($5,000 + $200 x 12).

It is not unusual for an Offer In Compromise to be "countered" with a higher proposed number the first time around. Experienced tax counsel will know how to negotiate to get the number down to something the taxpayer can afford. IRS personnel are not being "cold and heartless" if they refuse your Offer to Compromise, nor are they just out to get you. Under the law, they can only accept Offers in Compromise which meet the guidelines established by Congress. So it's the law and plain old MATH you have to fight with, not the guy or gal at the IRS.