DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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OFFICE OF
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MEMORANDUM FOR DISTRICT COUNSEL, VIRGINIA-WEST VIRGINIA DISTRICT

FROM: Mitchel S. Hyman
Senior Technician Reviewer, Branch 2 (General Litigation)

SUBJECT: Offers in Compromise - Agreements with States

This responds to your request for assistance dated July 19, 1999. This document is not to be cited as precedent.

ISSUE

Whether the district could enter into agreements with the states of Virginia and West Virginia for the acceptance of joint or simultaneous offers to compromise both Federal and state tax liabilities.

CONCLUSION

We conclude that there are no legal impediments to entering into such agreements. However, such an agreement may be inconsistent with IRS policy with respect to the acceptance of offers. Therefore, we advise the district to consult with the Office of Special Procedures to insure that any agreements reached with the states are consistent with Service-wide policy for the acceptance of offers in compromise.

BACKGROUND

By memorandum dated June 14, 1999, the district director for the Virginia-West Virginia District asked whether the district could enter into agreements with the states of Virginia and West Virginia for the acceptance of joint or simultaneous offers to compromise both Federal and state tax liabilities. On July 19, 1999, you requested our assistance in this matter.

The request from the district contains no details on how such an agreement would be structured. For purposes of this memorandum, we have assumed that the agreement would be similar to those Fed-State agreements which the Service has

typically entered into for the collection of liabilities through installment agreements. Pursuant to these arrangements with various states, the Federal and state governments receive an agreed upon percentage of the income available to fund the agreements, computed after allowing for necessary and reasonable living expenses. Because the standards for determining whether an offer in compromise is acceptable require the Service to include equity in assets as an element of collectibility, we also assume that there would be some agreed-upon division of net realizable equity.

DISCUSSION

Installment agreements and offers in compromise are fundamentally different. One product of these differences is seen in the way the Service's collection financial standards are applied within each program.

The collection financial standards were developed as a result of a 1995 IRS initiative designed to ensure uniform treatment of similarly situated taxpayers. The IRS had always permitted taxpayers to retain the funds necessary to pay for reasonable living expenses. In response to claims that the standards applied varied widely across districts, the Service published national and local standards for necessary expenses. National standards apply to categories such as food, clothing, personal care items, and housekeeping supplies. Local standards, which are published by county, apply to housing, utilities, and transportation. The IRM also contains rules for the allowance of "conditional" expenses, defined as expenses which may be allowed if certain requirements are met. See generally IRM 105.1, Collecting Contact Handbook, Section 3.3. Since the adoption of these procedures by the IRS, Congress has enacted legislation requiring the development and maintenance of these standards to insure that taxpayers who compromise their tax liabilities are left with adequate means to pay basic living expenses. See I.R.C. § 7122(c).

An installment agreement is a payment arrangement through which the Service achieves full payment of the tax liability at issue. See Treas. Reg. §301.6159-1(a). The agreement is not a final determination of the tax at issue. McIntyre v. United States, 1987 U.S. Dist. LEXIS 16151 (D. Colorado July 1, 1987). Rather, it is a mechanism through which the Service allows the taxpayer to take an extended period of time to meet his or her past-due obligations.

The standards used to determine allowable expenses when a taxpayer requests an installment agreement reflect the fact that the Service expects full payment of the liability. If the taxpayer qualifies for a "streamlined" installment agreement ($25,000 or less owed and achieving full payment within five years), then no financial analysis is necessary. IRM 105.1.2.4.4. Even if the taxpayer does not fall within this criteria, the procedures provide a great deal of flexibility in applying the allowable expense standards. Many expenses which would not be classified as

necessary under the financial standards are permitted as conditional expenses, provided the taxes will be fully paid within a reasonable period of time. See IRM 105.1.3.3(3)-(5).

Thus, in order for the taxpayer to be granted an installment agreement, full payment of the taxes must be achieved, even if a set percentage of monthly disposable income is going to fund an agreement with the state government. The interests of Federal-state comity and cooperation are served by such an agreement, and the taxpayer is given a workable solution to his or her tax difficulties. Furthermore, these agreements with the states can be honored within the existing standards for the evaluation and acceptance of proposed installment agreements.

Offers in compromise differ from installment agreements in that, by definition, a compromise means payment of some amount less than the full tax liability. The Service has promulgated a policy statement to inform taxpayers and Service employees of the goals of the offer in compromise program and to guide them in the submission and acceptance of offers. See Policy Statement P-5-100. That policy states that the goal of the offer in compromise program is "to achieve collection of what is potentially collectible at the earliest possible time and at the least cost to the government." Id. To that end, offers are accepted "when it is unlikely that the tax liability can be collected in full and the amount offered reasonably reflects collection potential." Id.

Because the Government will not achieve full collection of the liability through the compromise, the Service's procedures take a much more restrictive view with respect to what expenses will be permitted. The financial analysis in offer cases allows only "necessary" expenses. IRM 5.8, Offer in Compromise Handbook, Section 5.7(4). Additional expenses may only be permitted if they meet the necessary expense test. That is, they must be necessary for the health or welfare of the family or for the production of income. IRM 105.1.3.3(2). No "conditional" expenses are permitted, since the standard for allowing them is full payment within a reasonable period of time.

As for state and local taxes, the IRM handbook contains guidance on how they should be classified for expense purposes. Current state and local taxes are necessary expenses, while delinquent taxes are considered necessary only to the extent they have lien priority over the delinquent Federal taxes. See IRM 105.1, Exhibit 3-2. The agreement suggested by the district would apparently disregard this standard, allowing payment of delinquent state taxes in a set percentage, regardless of their priority vis-a-vis the Federal taxes. Such an offer is unlikely to meet the "reasonable collection potential" standard for acceptance, since the Service has agreed to forego funds which it has determined to be collectible. Additionally, allowing payment of delinquent state taxes only in states with agreements appears counter to the Service's long-term efforts to bring a sense of uniformity and fairness to the offer in compromise program.

The statute governing the evaluation of offers allows the Service to deviate from the standards adopted, but only after a case-by-case determination as to whether the allowable expense standards should be applied in the particular taxpayer's case. The standards will not be applied where they would result in the taxpayer being left without adequate means to provide for basic living expenses. See I.R.C. § 7122(c)(2)(B). The agreement suggested here would apply different standards to a group of taxpayers within a specific district based upon owing money to particular creditor–the state–and without examining the particular taxpayer's circumstances. Deviation from the standards for this reason does not appear to be considered anywhere in the Service's current policies or procedures.

CONCLUSION

The proposed agreements with the states of Virginia and West Virginia would represent a departure from the Internal Revenue Service's established policies with regard to offers in compromise and could be viewed as counter to the Service's long-term efforts to achieve uniformity and fairness in the offer in compromise program. For these reasons we recommend that such agreements only be considered after a decision is reached, at the Service-wide level, that they can be structured in a manner that is consistence with the Service's policies with regard to the evaluation and acceptance of offers in compromise.

If you have any questions, please contact the attorney assigned to this case at (202) 622-3620.