Continuing our series in tax resolution, we take a look the option of an Offer in Compromise. An offer in compromise (OIC) is an agreement between the IRS and you that settles your tax debt for less than the full amount of federal tax owed. If you can fully pay the federal tax burden through an installment agreement or other means, however, you probably will not be eligible for an OIC. The IRS generally will not accept an OIC unless the amount you offer is equal to or greater than the reasonable collection potential (the RCP).

The RCP is how the IRS measures your ability to pay. It includes the value of your assets, such as real estate, automobiles, bank accounts, and other property. The RCP also includes expected future income, reduced by certain amounts allowed for basic living expenses.

The IRS may accept an OIC based on three grounds. First, federal tax law allows settlement if there is doubt as to liability. Second, federal tax law allows settlement if there is doubt that the amount owed is collectible. Doubt exists in any situation where your assets and income are less than the full amount of the tax debt. Third, federal tax law allows settlement based on effective tax policy. Stated simply, the IRS may accept an offer when there is no doubt that it can collect, but requiring payment in full would create an economic hardship or would be unfair because of exceptional circumstances.

Typically, you must send a $150 application fee when submitting an OIC. There are two exceptions to this requirement. First, the application fee is not required if the OIC is there is a dispute that your tax debt is correct. Second, the fee is not required if you qualify for the low-income exception. This exception applies if your total monthly income falls far below the poverty line.

You may choose to pay the OIC amount in a lump sum or in installment payments. Tax law rules provide for "lump sum offers" and "periodic payment offers." A lump sum offer is an offer payable in five or fewer installments. The IRS requires a nonrefundable payment equal to 20 percent of the offer amount when applying for a lump sum OIC. The 20 percent amount is "nonrefundable" even if the IRS rejects or returns the offer without acceptance. The IRS, however, does apply the 20 percent amount to your tax debt.

A "periodic payment offer" OIC is payable in six or more installments. You must include the first proposed installment payment, along with the required IRS forms, when submitting a periodic payment offer. The total amount is also nonrefundable. It is required that you continue to make the installment payments under the terms of the OIC while the IRS evaluates the OIC. These amounts are also nonrefundable.

Federal law suspends the time that the IRS can make collection efforts during the period of OIC evaluation or later appeal. The IRS expects that you will have no further delinquencies and will fully comply with the tax laws if it accepts your offer. The IRS may also determine that the OIC is in default if you do not satisfy all terms and conditions. You must timely file all tax returns and timely pay all taxes for 5 years, or until the offered amount is paid in full, to avoid default. The agreement is no longer in effect when default occurs, and the IRS may then collect the amounts originally owed, plus interest and penalties.

The IRS will notify you by mail if it rejects an OIC. This letter explains the reason that the IRS rejected the offer and will provide detailed instructions on how you may appeal. You must appeal within 30 days from the date of the letter if you choose to appeal. An OIC is returned to you in some cases, rather than rejected, because you have not submitted necessary information or for other reason. A return is different from a rejection because there is no right to appeal the IRS's decision to return the offer.

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