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Outside Counsel

Actor Wesley Snipes' Offer in Compromise Got Sniped by the IRS

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If you watch TV, listen to the radio, read a newspaper or hear conversations, invariably you will notice many organizations offering their services to settle tax liabilities for pennies on the dollar. How real are these offers to help a delinquent taxpayer?

There is no question that the Internal Revenue Service (IRS) has liberalized its collection policies and procedures. Specifically, the agency has established a "Fresh Start" initiative to permit qualified taxpayers a means to pay less taxes through the Offer in Compromise (O.I.C.) program. The IRS also grants different types of installment arrangements for taxpayers who may not qualify for an O.I.C.

The IRS collection process commences once an IRS assessment is due. The taxpayer has about 30 days to address the underlying liability from the initial assessment notice. Generally, collection cases for liabilities that are under $100,000.00 are assigned to the automated collections system (ACS). However, certain collection cases are assigned to an IRS Revenue Officer, typically when the liability is above the ACS threshold, or if the taxpayer has an adverse collection history. It is imperative to file the appropriate response to the taxpayer's assessment notice(s) within the prescribed time therein; otherwise, the taxpayer may forfeit certain rights.

In order for a taxpayer to request a collection alternative, such as an O.I.C. or Installment Agreement, the taxpayer has to first be compliant with all filing requirements. In addition, prior to submitting an O.I.C., the taxpayer must complete the prequalifier, located on the IRS website. If it is determined that the taxpayer qualifies for an O.I.C., the taxpayer must submit a completed Financial Disclosure, i.e., Form 433-A (Individuals) or Form 433-B (Businesses), as well as the executed offer proposal on the Form 656. The O.I.C. packet must also include all back-up documentation, such as bank statements, recent pay-stub, mortgage statement, etc. Lastly, the taxpayer has to pay a filing fee of $186.00 and make a payment for 20 percent of the offer amount, unless the taxpayer is low-income certified.

The O.I.C. program can be used to compromise any tax type. It is not limited to personal income. Thus, business liabilities may also be compromised. The Regulations also make clear that an agreement to compromise criminal liabilities are permitted. See 26 CFR 301.7122-1.

Once the IRS receives the O.I.C. packet, it is screened by Agents for compliance of the aforementioned requirements. If all of the Forms are filled out correctly, with the necessary backup documentations, the taxpayer is compliant with his/her filing requirements, the appropriate payments are made, then the case

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will be assigned to the O.I.C. unit for further consideration. Sometimes, the Agent may request additional backup information during the review stage. After the initial review is completed, the O.I.C. unit will send the taxpayer and/or the taxpayer's representative a letter informing the taxpayer that the case has been received by that unit and will include a projected date in which it will be decided. Usually, all collection action is stayed once the collection matter is assigned to the O.I.C. unit for consideration.

In order for an Offer to be accepted, the taxpayer must offer at least his/her Reasonable Collection Potential (RCP), i.e., the amount that the IRS could reasonably expect to collect by ordinary collection activities. An Agent determines the RCP based on the taxpayer's financial disclosures, the back-up documentation and the Agent's own research. Generally, agents are directed to reject offers substantially below the taxpayer's RCP unless "special circumstances" justify acceptance of such an offer. See *Fairlamb v. Commissioner*, T.C. Memo. 2010-22, slip op. at 11; Rev. Proc. 2003-71, sec. 4.02(2), 2003-2 C.B. 517, 517.

There are many ways in which special circumstances can be demonstrated by the taxpayer and is a case-based determination. The O.I.C. unit requires legitimate documentation explaining said circumstances, especially when the taxpayer has the ability to full pay the tax liability. Some examples of special circumstances may include the taxpayer's age and lack of savings, the taxpayer's health, etc. The Regulation specifically provides for a compromise of a tax debt if it is determined "that, although collection in full could be achieved, collection of the full liability would cause the taxpayer economic hardship" as defined in IRS Regulation Sec. 301.6343-1.

The O.I.C. review process is fairly simple and usually decided from the documents submitted. However, the O.I.C. agent, also known as a Settlement Officer, has discretion in considering additional factors when accepting an Offer. It should be noted though, that the actions and determinations of the Settlement Officer cannot be arbitrary or capricious.

While most O.I.C.'s are submitted because a taxpayer genuinely cannot fully pay his/her tax liability, some O.I.C.s are submitted simply to delay collection action. As mentioned earlier, certain collection cases are assigned to Revenue Officers. Although collection is stayed once the O.I.C. is filed, a Revenue Officer, especially an aggressive one, may prevent the taxpayer's O.I.C. from being accepted into the O.I.C. program for consideration. The Revenue Officer can accomplish this by informing the O.I.C. unit that the proposed Offer is simply to hinder collection and that the taxpayer has the ability to fully pay the liability. Under these circumstances, the O.I.C. unit will return the taxpayer's O.I.C., without any further review and without any Appeal rights.

Even though the O.I.C. program has become more commercialized, there are many taxpayers who do not qualify. Last year, Actor Wesley Snipes made headlines when his O.I.C. was rejected by the IRS. Upon information and belief, Snipes failed to file Federal Income Tax Returns for the years 2001-2006, allegedly owing the IRS at least $23.5 million. After the IRS issued numerous collection notices and liens, Snipes filed a Request for a Collection Due Process Hearing. He then submitted an O.I.C. for an $842,061.00 offer in full satisfaction of his $23.5 million debt to the IRS.

The O.I.C. Agent assigned to Snipes' case rejected his offer on the grounds that Snipes allegedly dissipated assets, thus having a greater Reasonable Collection Potential than what was offered. While we cannot comment on Snipes' financial disclosures, the Settlement Officer has the absolute right to consider dissipated assets when determining RCP. Dissipated assets are either liquid or non-liquid assets which were transferred, sold, or spent by the taxpayer. Usually the IRS is limited to a three-year look-back period with O.I.C. cases, pursuant to IRM 5.8.5.18; however, late filers and audits affect this rule.

Procedurally, if a taxpayer's O.I.C. is denied, the taxpayer has a right to Appeal that denial. It is unclear if Snipes exercised his O.I.C. appellate rights. However, he filed his O.I.C. through the Collection Due Process (CDP) unit in response to collection notices. Since Snipes' O.I.C.

was submitted through Appeals, once his case was denied the Appeal officer issued a final Notice of Determination Concerning Collection Action(s) under §6320 and/or 6330. Snipes then filed a petition with the U.S. Tax Court for further consideration. The issue before the Tax Court was "whether the determination to proceed with the Notice of Federal Tax Lien in lieu of a proposed collection alternative was an abuse of discretion." See T.C. Memo 2018-184.

According to the Tax Court decision rendered by Judge Kathleen Kerrigan, Snipes failed to provide sufficient proof of his assets and financial condition and he failed to remedy the disparity in his offer verses his Reasonable Collection Potential. Thus, the Tax Court held that the O.I.C. Agent did not abuse her discretion by rejecting Snipes' O.I.C.

The Tax Court found that Snipes allegedly had numerous assets and real estate holdings which were held by multiple entities. The Settlement Officer was unable to determine whether or not Snipes still owned certain properties which he claimed that he lost or transferred. Based on the investigation, the Settlement Officer determined that Snipes had an RCP of $17,482,152; which was still almost half of what he owed. Instead of increasing his offer to this RCP amount, he allowed his O.I.C. to be rejected.

During the Tax Court hearing, Snipes contended that his financial adviser took out loans and disposed of assets and income on his behalf without his permission or knowledge. Snipes even submitted an affidavit from his advisor supporting these allegations. Nevertheless, the court did not permit a transferee investigation against the advisor. Instead, in a further attempt to settle with Snipes, the settlement officer reduced Snipes' RCP to $9,581,027, which Snipes still failed to accept.

As illustrated in Snipes' case, the IRS carefully scrutinizes the taxpayer's financials to determine the RCP. The taxpayer must be mindful of the requirements regarding the calculation of the RCP. When the taxpayer completes the necessary IRS financial forms, not every expense will be permitted. For example, most, if not all, credit card debts, children's

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extracurricular activities, vacations, and pet care may be disallowed as necessary expenses. The Settlement Officer also evaluates how certain expenses deviate from the national standards used for food, clothing, travel, etc. Actually, the IRS issues acceptable expenses by region of the United States, recognizing the difference in cost of living in different areas of the country. Lastly, the Settlement Officer will include any dissipated assets, or assets that are owned by the taxpayer but not reported on the financial disclosures. It is not unusual for the Settlement Officer to adjust the taxpayer's expenses by calculating the RCP by the allowable expenses only, based on the published regional allowable expenses for housing, transportation, etc. These adjustments increase the taxpayer's ability to pay.

If the RCP is more than what was offered, the Settlement Officer will accept an increased offer instead of denying the submission outright. The taxpayer's goal of any O.I.C. case is to establish the lowest RCP based on legitimate expenses, to accomplish a fair settlement. Even if a taxpayer does not necessarily agree with the Settlement Officer's decision, the alternatives must be carefully considered. An increased offer is almost always better than no offer.

This article is meant to be instructive as to the O.I.C. procedures and requirements. There are other collection alternatives that can also be utilized by the taxpayers, of which all practitioners should be aware.