

**The Internal Revenue Service Needs to
Consistently Use Special Circumstances in
the Offer in Compromise Program**

May 2001

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

May 31, 2001

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION

Pamela J. Gardiner

FROM: (for) Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Audit Report - The Internal Revenue Service Needs to
Consistently Use Special Circumstances in the Offer in
Compromise Program

This report presents the results of our review of the Internal Revenue Service's (IRS) use of the special circumstance provisions in the Offer in Compromise (OIC) Program. The overall objective of our review was to determine if procedures for accepting OICs based on special circumstances were being consistently, uniformly, and appropriately applied.

In summary, although the IRS has taken many actions to implement the changes to the OIC Program, special circumstance criteria were not always considered and consistently applied in OIC cases.

We recommended that the Commissioner, Small Business/Self-Employed Division, improve the communication of quality review results to help ensure consistency in the application of the special circumstance provisions. In addition, detailed instructions in accounting for special circumstance offers on the OIC management information system should be issued to the field, and the procedures for submitting special circumstance offers for the 100 percent review program should be re-emphasized. Finally, the Commissioner should seek clarification from the Congress as to whether the practice of permitting a taxpayer to withdraw his/her offer, after a decision has been made that the offer cannot be accepted, is contrary to the IRS Restructuring and Reform Act of 1998 (RRA 98)¹ requirement for an independent review of rejected offers.

¹ Pub. L. No. 105-206, 112 Stat. 685.

Small Business/Self-Employed Division management agreed with and plans to take corrective actions on all but one of the recommendations in the report. They did not agree to seek clarification from the Congress as to whether the practice of permitting a taxpayer to withdraw his/her offer, after a decision has been made that the offer cannot be accepted, is contrary to the RRA 98 requirement for an independent review of rejected offers.

We continue to believe that some withdrawals are very similar to rejects and that these offers are not subject to an independent review. While we agree that the withdrawal option can be advantageous to both the taxpayer and the IRS, we do not believe that the IRS should tell or otherwise encourage taxpayers to withdraw their offers. This causes the taxpayers to be removed from the independent review process. We believe our recommendation is worthwhile; however, we do not intend to elevate our disagreement to the Department of the Treasury for resolution.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Gordon C. Milbourn III, Associate Inspector General for Audit (Small Business and Corporate Programs), at (202) 622-3837.

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in the Offer in Compromise Program**

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Executive Summary

The Collecting Mission of the Internal Revenue Service (IRS) is to collect promptly the proper amount of federal tax from all persons who have not filed returns and/or paid tax as required by law and to encourage future compliance with the law. At times, the IRS encounters situations where the taxes owed cannot be collected in full or where there is a dispute as to what is owed.

Internal Revenue Code § 7122¹ gives the IRS the authority to “compromise” a tax liability. An offer in compromise (OIC) allows the taxpayer to settle unpaid tax accounts for less than the full amount of the assessed balance due. Under this Code section, there are two bases on which an offer can be made: doubt as to liability for the amount owed and doubt as to collectibility (when it is unlikely that the liability can be paid in full). Generally, taxpayers must offer an amount equal to the net value of their assets plus the amount that could be obtained from their future income. However, the IRS can accept a lesser amount under special circumstances, such as advanced age or serious illness of the taxpayer. These OICs are called doubt as to collectibility with special circumstances (DCSC).

The Congress expanded the OIC Program in Section 3462 of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98).² This section provides for compromise when collection of the tax would create an economic hardship or such an inequity as to be detrimental to voluntary compliance. This type of offer is called an effective tax administration (ETA) offer. The RRA 98 also requires the IRS to establish procedures for an independent administrative review of any rejection of a proposed OIC and allows the taxpayer to appeal any rejection of an offer.

Our overall objective was to determine if procedures for accepting OICs based on special circumstances³ were being consistently, uniformly, and appropriately applied. The audit was requested by the Deputy Commissioner.

¹ Internal Revenue Code, 26 U.S.C. § 7122 (1986).

² Pub. L. No. 105-206, 112 Stat. 685.

³ When we refer to offers based on special circumstances in this report, we are referring to both ETA offers and DCSC offers.

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Results

The IRS has taken many actions to implement changes required by the RRA 98. Specifically, the IRS issued temporary Treasury regulations and revised the Internal Revenue Manual (IRM) to provide additional guidance regarding the compromise of federal taxes. The offer specialist training course was revised to include ETA offers and to re-emphasize the DCSC offers, and the course was given to specialists who work offer cases. To ensure procedures are consistently applied and to identify trends for improvement, the IRS initiated a 100 percent review of all offers with special circumstances. In addition, it initiated a separate review of a sample of offers as part of the Collection Quality Measurement System (CQMS).

The use of special circumstance provisions, however, varies significantly depending upon which specialist works the case and where the taxpayer lives. This is due in part to the subjectivity of the factors involved in each case. In addition, the IRS' policy of allowing taxpayers to withdraw their offers, rather than having the IRS reject them after the investigations determine more can be collected than was offered, bypasses the independent review provided for by the Congress.

The Internal Revenue Service Provided the Necessary Training on the Changes to the Offer in Compromise Program

The IRS revised its offer specialist training course to increase the emphasis on, and to help ensure consistency in, the application of special circumstance criteria. The material covered the various standards and factors to be considered as special circumstances and provided examples of each.

Special Circumstance Criteria Were Not Always Considered and Consistently Applied to Offer in Compromise Cases

Offer specialists did not always consider special circumstance provisions while working offers filed for doubt as to collectibility. Special circumstances were present in 11 of the 114 doubt as to collectibility offers we reviewed that the IRS rejected or the taxpayers withdrew. These cases could have been accepted under the special circumstance provisions.

IRS managers in the three offices we visited had different attitudes about accepting offers with special circumstances. Managers in one office were aggressive in implementing the program and advised the taxpayers they may qualify for special circumstances, even if the taxpayers did not raise the issue. On the other hand, managers in another office did not appear to be strong proponents of the use of these procedures and stated it was not the offer specialists' responsibility to advise the taxpayer of special circumstance options. Managers' attitudes towards offers in the third office were in the middle of the other two.

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Some offices have expanded the factors that can be considered in determining whether to accept an offer based on special circumstances. Some offices are accepting special circumstance offers based on the decision that the amount offered was more than they thought the IRS would reasonably collect from the taxpayer through normal collection activities. Not all offices applied this expanded interpretation.

The subjectivity of the factors involved in each case and the differing management views is evidenced by the variance in the number of special circumstance offers worked nationally. The number of special circumstances offers worked in Fiscal Year (FY) 2000 ranged from a low of 10 in 1 office (which represented .55 percent of the total offers worked in that office) to a high of 253 in another office (which represented 6.67 percent of the total offers worked in that office).

The issue of not always considering special circumstances was also raised in the *National Taxpayer Advocate's FY 2000 Annual Report to Congress* (issued in December 2000), which outlined the 20 most serious problems encountered by taxpayers. The report stated that, "Sustained effort is needed to change the mindsets of those working offer cases. While the implementation of the temporary regulations and provisions in the RRA 98 provided flexibility, some field personnel continue to...ignore special circumstances that would allow consideration or acceptance."

Not All Special Circumstance Offers Are Properly Accounted for on the Management Information System

In a June 2000 audit report⁴ on the implementation of the RRA 98 concerning the OIC Program, the Treasury Inspector General for Tax Administration (TIGTA) recommended the IRS establish a management information system (MIS) to monitor, summarize, and report on special circumstance offers on a national level. The IRS agreed with this recommendation and implemented the necessary changes.

While changes were made to the OIC MIS, it still does not accurately account for special circumstance offers. The OIC MIS showed there were 1,016 special circumstance offers closed during FY 2000. However, we identified another 316 special circumstance offers that were closed during FY 2000 and incorrectly recorded on the MIS as doubt as to collectibility offers. Managers in one office advised us they were unaware of the changes to the MIS system, while managers in another office stated they were confused as to how ETA and DCSC offers were to be recorded. Managers in all three offices indicated that some offers were incorrectly recorded due to an oversight.

⁴ *More Taxpayers Can Benefit From the New Offer in Compromise Provisions* (Reference Number 2000-40-093, dated June 2000).

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Permitting Taxpayers to Withdraw Their Offers Instead of Rejecting Them May Be Contrary to Congressional Intent for an Independent Review

The RRA 98 requires the IRS to perform an independent review of any rejection of a proposed OIC and allows a taxpayer to appeal any rejection. Withdrawn offers are not subjected to the independent review process. The IRS procedures provide that if the offer cannot be given favorable consideration, the taxpayer should be given the opportunity to withdraw the offer and be advised that by withdrawing the offer he/she loses any appeal rights on that offer.

In 23 of the 60 withdrawn doubt as to collectibility offers we reviewed, the IRS' offer investigation concluded that more money could be collected than was offered and, therefore, the offer could not be accepted. The taxpayers were either told to withdraw their offer or given the option to withdraw or have it rejected. Since these offers were closed as being withdrawn, they were not subjected to the independent administrative review process. The Congress' intent in the RRA 98 was that rejected offers receive an independent review and the taxpayers be offered appeal rights to the rejections. The policy of permitting taxpayers to withdraw their offers in these situations eliminates the independent review and, therefore, may be contrary to the Congress' intent. In addition, in 15 of the 23 offers, the taxpayers were not advised they forfeited their appeal rights if they withdrew their offers.

This issue was also discussed in the June 2000 TIGTA audit report on the IRS' implementation of the RRA 98 concerning the OIC Program. The TIGTA recommended the OIC guidelines be changed to discontinue the withdrawal request option. IRS management did not agree with the recommendation and stated, "...allowing the taxpayer to withdraw the offer provides an uncomplicated way to close the offer investigation..." However, we still believe that, in most situations, the taxpayers' rights would be better served by subjecting the decision not to accept the offer to the independent administrative review process and allowing the taxpayer to appeal the proposed rejection.

The Review Process to Identify Trends or Inconsistencies in the Application of Special Circumstances Can Be Improved

While the IRS has set up review procedures to help ensure consistency in the application of special circumstance provisions, the review process can be improved. Independent administrative reviewers in the field offices did not always receive results of the 100 percent review process. Further, field managers did not use CQMS review results because they were not aware that the results were available on the IRS intranet.

In addition, not all the closed special circumstance offers were included in the 100 percent review program. According to the OIC MIS, there were 839 special

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circumstance offers closed between October 1, 1999, and August 31, 2000. We determined that 404 of these were not reviewed by the 100 percent review team.

Summary of Recommendations

The Commissioner, Small Business/Self-Employed (SB/SE) Division, needs to improve the communication of quality review results to help ensure consistency in the application of the special circumstance provisions. In addition, detailed instructions in accounting for special circumstance offers on the OIC MIS should be issued to the field, and the procedures for submitting special circumstance offers for the 100 percent review program should be re-emphasized. Finally, the Commissioner should seek clarification from the Congress as to whether the practice of permitting a taxpayer to withdraw his/her offer, after a decision has been made that the offer cannot be accepted, is contrary to the RRA 98 requirement for an independent review of rejected offers.

Management's Response: SB/SE Division management agreed with all of our recommendations except one. They plan on revising the IRM to address the need to discuss with taxpayers potential special circumstance situations early in the OIC investigation; to emphasize how special circumstance offers should be accounted for on the OIC MIS; and to emphasize taxpayers must be advised that by withdrawing their offers they will forfeit any appeal rights.

In addition, they plan to explore a process to provide direct feedback to field managers on specific cases where quality review disagrees with the conclusion reached in the offer investigation. SB/SE Division management discontinued issuance of the 100 percent review process digest summaries and will provide the field periodic trend analyses of special circumstance reviews. They will also issue memoranda to the field regarding where and how to access the quality review results and re-emphasizing procedures for submitting special circumstance offers to quality review. In addition, they will explore the use of a process that would periodically generate a list of offers from the OIC MIS to compare to the quality review database.

However, SB/SE Division management did not agree to seek clarification from the Congress as to whether the IRS' policy permitting taxpayers to withdraw offers in those instances where the investigation concluded the offer could not be accepted was contrary to the Congress' intent in the RRA 98. SB/SE Division management believes allowing for withdrawals serves the interest of both the government and taxpayer by avoiding unnecessary costs to both parties.

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Office of Audit Comment: We continue to believe that some withdrawals are very similar to rejects and that these offers are not subject to an independent review. While we agree that the withdrawal option can be advantageous to both the taxpayer and the IRS, we do not believe that the IRS should tell or otherwise encourage taxpayers to withdraw their offers. This causes the taxpayers to be removed from the independent review process.

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Objective and Scope

The objective of our review was to determine if the procedures for accepting OICs based on special circumstances were being consistently, uniformly, and appropriately applied.

Our overall objective was to determine if the procedures for accepting offers in compromise (OICs) based on special circumstances¹ were being consistently, uniformly, and appropriately applied. The audit was requested by the Deputy Commissioner.

To accomplish our objective, we evaluated the adequacy of the training provided regarding OICs based on special circumstances and determined the adequacy of the Internal Revenue Service's (IRS) reviews of these offers. We also reviewed a sample of rejected and withdrawn offers not based on special circumstances closed from May 1 through July 31, 2000, to determine if special circumstances factors should have been considered when working the offers.

Our review was conducted between June and December 2000 in what were the North Texas, Pacific-Northwest, and Upstate New York Districts.² This audit was performed in accordance with *Government Auditing Standards*.

Details of our audit objective, scope, and methodology are presented in Appendix I. Major contributors to this report are listed in Appendix II.

¹ When we refer to offers based on special circumstances in this report, we are referring to both effective tax administration offers and doubt as to collectibility with special circumstances offers.

² On October 1, 2000, the IRS dissolved its long-standing geographical structure based on districts and regions and reorganized into four main operating divisions based on types of taxpayers. At this time, the OIC Program became the responsibility of the Director, Compliance in the Small Business/Self-Employed (SB/SE) Division.

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Background

The Collecting Mission of the IRS is to collect promptly the proper amount of federal tax from all persons who have not filed returns and/or paid tax as required by law and to encourage future compliance with the law. At times, the IRS encounters situations where the taxes owed cannot be collected in full or where there is a dispute as to what is owed.

Internal Revenue Code § 7122³ gives the IRS the authority to “compromise” a taxpayer’s tax liability for less than the full amount of the assessed balance due. Under this Code section, there are two bases on which an offer can be made: doubt as to liability for the amount owed and doubt as to collectibility (when it is unlikely that the liability can be paid in full).

Generally, taxpayers must offer an amount equal to the net equity of their assets plus the amount that could be obtained from their future income. However, the IRS can accept a lesser amount under special circumstances, such as advanced age or serious illness of the taxpayer. These OICs are called doubt as to collectibility with special circumstances (DCSC) offers.

The Congress expanded the OIC Program in Section 3462 of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98).⁴ This section provides for compromise when collection of the tax would create an economic hardship or such an inequity as to be detrimental to voluntary compliance. This type of offer is called an effective tax administration (ETA) offer.

The factors to be considered for ETA offers are basically the same as those for DCSC offers. The main difference between the two is whether the taxpayer’s net equity in

³ Internal Revenue Code, 26 U.S.C. § 7122 (1986).

⁴ Pub. L. No. 105-206, 112 Stat. 685.

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assets plus the value of the future ability to pay is greater (ETAs) or less than the taxpayer's liability (DCSCs).

The RRA 98 also required the IRS to establish procedures for an independent administrative review of any rejection of a proposed offer in compromise and allowed a taxpayer to appeal any rejection of an offer.

Results

The IRS issued temporary Treasury Regulations, revised its OIC training course, and initiated a quality review program to ensure offers based on special circumstances were being consistently considered.

The IRS took many actions to implement the expanded OIC Program required by the RRA 98. It issued temporary Treasury Regulations⁵ on July 21, 1999, providing additional guidance regarding ETA OICs. In addition, it issued many interim procedural memoranda and revised the Internal Revenue Manual (IRM).

The offer specialist training course was revised to include ETA offers and to re-emphasize accepting offers based on special circumstances.

To ensure procedures are consistently applied and to identify trends so that additional policies and procedures could be developed and refined, the IRS initiated a 100 percent review of all special circumstance offers. In addition, the IRS initiated a separate review of a sample of offers as part of the Collection Quality Measurement System (CQMS). The IRS also established procedures for an independent administrative review of proposed rejected offers to ensure that the rejection was proper and that any special circumstances were considered.

However, special circumstance factors are not always being identified by offer specialists. This is due in part to the subjectivity of the factors involved in each offer.

In addition, the IRS' procedure of permitting a taxpayer to withdraw his/her offer, rather than having the IRS reject it after the investigation determines more can be collected than was offered, may violate the Congress'

⁵ Treas. Reg. § 301.7122-1T.

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intent for an independent review. Further, not all offers with special circumstances are properly accounted for on the IRS' management information system (MIS). Finally, while the IRS set up review procedures to ensure consistency, not all special circumstance offers were being reviewed, and the results of the quality reviews could be better communicated to the field.

The Internal Revenue Service Provided the Necessary Training on the Changes to the Offer in Compromise Program

The IRS provided the appropriate training on the new procedures for, and the increased emphasis on, offers with special circumstances.

The IRS revised its offer specialist training course to increase the emphasis on, and to help ensure consistency in, the application of special circumstance criteria. The material covered the various standards and factors to be considered as special circumstances and discussed examples of each.

The RRA 98 was passed in July 1998 and was effective for offers submitted after that time. The IRS prepared and, in July 1999, issued the temporary Treasury Regulations. In October 1999, taxpayers could start filing ETA offers.

Each office sent two employees to three train-the-trainer sessions that were held between August 1999 and February 2000. These employees were then responsible for providing training to the offer specialists in their respective offices. The revised training class for offer specialists was finalized and first offered in February 2000. Our review determined that all offices provided the revised training and that training was provided to the majority of the offer specialists in the three offices we visited.

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Special Circumstance Criteria Were Not Always Considered and Consistently Applied to Offer in Compromise Cases

Special circumstance criteria were not consistently applied because of the subjectivity of the factors involved in each case, the differing management attitudes towards the OIC Program, and the expanding definitions of what can be considered a special circumstance.

There are numerous situations in which an offer can be accepted with special circumstances, such as advanced age or serious illness of the taxpayer. The facts and circumstances of each case will vary and must be considered in their totality. However, our review determined that the special circumstance criteria were not always considered and consistently applied to OIC cases, as required by IRS procedures.

While training adequately covered special circumstance criteria, the subjectiveness of the area makes it difficult to apply the criteria consistently. Also, management attitudes towards accepting special circumstance offers varied among the three offices we visited. In addition, some offices have expanded the definition of special circumstances.

As a result, the use of these provisions varies significantly depending upon where the taxpayer lives. For example, the number of special circumstance offers worked in Fiscal Year (FY) 2000 ranged from a low of 10 in 1 office (which represented .55 percent of the total offers worked in that office) to a high of 253 in another office (which represented 6.67 percent of the total offers worked in that office). The national average was 105, or 2.17 percent of the total offers worked. Appendix VI contains the number of offers and the percentage of special circumstance offers by office. However, as discussed later in the report, these numbers may not be completely accurate, due to the inaccuracy of the IRS' management information system.

The *National Taxpayer Advocate's FY 2000 Annual Report to Congress* (issued in December 2000) outlining the 20 most serious problems encountered by taxpayers also raised this issue of not always considering special circumstances. The report cited in part, "The Offer in Compromise Program does not assist taxpayers that are

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suffering from severe or unusual financial hardships.”
The report went on to say:

Sustained effort is needed to change the mindsets of those working offer cases. While the implementation of the temporary regulations and provisions in RRA 98 provide flexibility, some field personnel continue to adhere to rigid enforcement of financial standards and to ignore special circumstances that would allow consideration or acceptance.

Special circumstance criteria are very subjective

IRS procedures require that, prior to considering special circumstances, the normal offer investigation must be concluded. Only after the IRS determines that the offer cannot be accepted based on doubt as to collectibility (i.e., the taxpayer’s net equity in assets plus future ability to pay is less than the liability) will special circumstances be considered.

Special circumstances were present but not considered by the offer specialists in 11 of the 114 closed offers we reviewed.

We reviewed 114 doubt as to collectibility offers that were rejected by the IRS or withdrawn by the taxpayers from May 1 through July 31, 2000, in the 3 offices in our review to determine if offer specialists considered whether the taxpayers qualified for special circumstances. Special circumstances were present in 11 of the offers reviewed, and they could have been accepted under the special circumstance provisions. Appendix V contains two hypothetical examples showing how special circumstances can be present but not considered by the offer specialist.

While training and the temporary regulations covered the factors that need to be considered and provided examples of cases that can be compromised under special circumstance criteria, the subjectiveness of the area makes it difficult to apply the criteria consistently.

The subjectiveness of the area is demonstrated, in part, by the IRS’ responses to the 11 cases we identified. We asked managers in the offices visited and the national coordinator in charge of the 100 percent review program

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Managers in the three offices we visited displayed differing attitudes towards special circumstance offers, ranging from strong to minimal support.

to review these cases. The IRS managers agreed with our conclusions in only 2 of the 11 cases, while the national coordinator agreed with us in 8 of the 11 cases.

Managers in the offices visited had different attitudes about special circumstance offers

Managers in the three offices visited had different attitudes about circumstance offers. Managers in one office were very aggressive in implementing the program. They stated they have emphasized to the offer specialists the need to consider special circumstances in every case. It is their policy to advise taxpayers they may qualify for special circumstance consideration, even if the taxpayers do not raise the issue.

Managers in another office did not appear to be strong proponents of the use of special circumstances. Their position was that the offer specialists should not be advocates for the taxpayer; it was not their responsibility to assist the taxpayer in obtaining an acceptable offer; and it was not their responsibility to advise the taxpayer of special circumstance options.

While not as strong a proponent as the first office, managers in the third office were more accepting of the special circumstance options than those in the second office.

Some offices have expanded the definition of special circumstances

Some offices have expanded the factors that can be considered in determining whether to accept an offer based on special circumstances. The factors originally cited by the IRS that can be considered usually involved, but are not limited to, some type of hardship. These would include such things as advanced age, long term illness, or circumstances in which liquidation of assets would leave the taxpayer unable to meet basic living expenses.

Midway through FY 2000, some offices began accepting special circumstance offers based on the decision that the amount offered was more than they thought the IRS

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would reasonably collect from the taxpayer by normal collection activities. These decisions could be made based on such things as taxpayers being on installment agreements that would not full pay their liabilities before the statute for payment expired and taxpayers who had filed for bankruptcy but had requested dismissal so the offer could be considered.

The national coordinator for the 100 percent review program included a summary of these cases in the digest of case reviews that are sent to each office. The digest concluded that the acceptance of the offer was appropriate in these situations. The national coordinator advised us that the digests were intended to be used as guidelines for the offices in the direction the IRS wanted to take in accepting or rejecting offers.

However, management in the National Headquarters advised us they never endorsed this expanded definition. They also stated the digests were not intended to be policy and were prepared only to ensure consistency in the use of special circumstances. A manager in one of the three offices we visited was not aware of the expanded criteria and thought it was contrary to the IRM. Another manager in this office believed the digests were not binding guidelines like the IRM and so they must follow the IRM first.

Commenting on the appropriateness of the offer acceptance or rejection in the digests does help ensure consistency. However, it also acts as setting policy or guidance, since the districts are being advised as to the appropriateness of accepting offers under certain circumstances.

Recommendations

The Commissioner, SB/SE Division, should:

1. Reinforce to the field offices the expectation that one of the responsibilities of offer specialists is to advise the taxpayer of the various OIC options, including special circumstance provisions.

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2. Clarify the digest process or issue other clarifying instructions so that users understand the current policy on using special circumstance factors.

Management's Response: SB/SE Division management agreed with the recommendations. They plan on revising the IRM to address the need to discuss with taxpayers potential special circumstance situations early in the OIC investigation. They also have discontinued the use of the 100 percent review digests and will now provide periodic trend analyses of the reviews.

Not All Special Circumstance Offers Are Properly Accounted for on the Management Information System

Special circumstance offers are not always accurately accounted for on the OIC MIS. OICs are tracked and controlled on the Automated Offer in Compromise (AOIC) system. The AOIC system manages offer inventories, prepares the necessary forms and correspondence, and generates reports on offer activity. Complete and accurate information is important for use in management decision-making and for tracking the processing of cases.

There were 316 offers closed with special circumstances during FY 2000 that were incorrectly recorded on the AOIC system as doubt as to collectibility offers.

Analysis of the AOIC system showed it contained 1,016 special circumstance offers closed during FY 2000. However, we identified another 316 offers closed with special circumstances during FY 2000 that were incorrectly recorded on the AOIC system as doubt as to collectibility offers.

In a June 2000 audit report⁶ on the IRS' implementation of the RRA 98 concerning the OIC Program, the Treasury Inspector General for Tax Administration (TIGTA) reported the IRS did not have an MIS that provided information on offers accepted based on

⁶ *More Taxpayers Can Benefit From the New Offer in Compromise Provisions* (Reference Number 2000-40-093, dated June 2000).

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special circumstances. The TIGTA recommended the IRS establish an MIS to gather information to track and monitor, summarize, and report on special circumstance offers on a national level. The IRS agreed with this recommendation and implemented the necessary changes.

Managers in one office we visited advised they were unaware the AOIC system was changed to account for ETA offers. Managers in another office stated they were confused as to how special circumstance offers were to be recorded. Managers in all three offices indicated that some offers were incorrectly recorded due to an oversight.

Without an accurate MIS, the IRS cannot gather information needed to evaluate the implementation of the ETA program or the expanded use of DCSC provisions, specifically in regard to consistency among offices.

Recommendation

The Commissioner, SB/SE Division, should:

3. Issue detailed instructions to the field for how and when ETA and DCSC offers are to be accounted for on the AOIC system.

Management's Response: SB/SE Division management agreed with the recommendation and plans to revise the IRM to emphasize the instructions that were issued in October 1999.

Permitting Taxpayers to Withdraw Their Offers Instead of Rejecting Them May Be Contrary to Congressional Intent for an Independent Review

The RRA 98 requires the IRS to perform an independent review of any rejection of a proposed OIC and allows a taxpayer to appeal any rejection. One common reason

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The IRS' policy of allowing a taxpayer to withdraw his/her offer instead of the IRS rejecting it appears to be contrary to the Congress' intent for an independent review.

for rejecting an offer is that it does not reflect an amount the IRS has determined can be collected under normal collection activity.

The IRM provides that if the offer cannot be given favorable consideration, the taxpayer should be provided with the opportunity to withdraw the offer. The IRS is required to advise the taxpayer that withdrawing the offer forfeits any appeal rights on that offer.

Our review of 60 withdrawn doubt as to collectibility offers determined that, in 23 cases, the offer specialists concluded that more money could be collected than was offered. Therefore, they could not accept the offer (i.e., it would be rejected). The taxpayers were either told to withdraw their offers or were given the option to withdraw their offers or have them rejected. Even though these offers would have been rejected, allowing, and especially encouraging, the taxpayers to withdraw their offers bypasses the independent administrative review and may be contrary to the Congress' intent.

This issue was previously reported in the June 2000 TIGTA audit report on the IRS' implementation of the RRA 98 concerning the OIC Program. The TIGTA recommended the OIC guidelines be changed to discontinue the withdrawal request option. IRS management did not agree with the recommendation and stated, "...allowing the taxpayer to withdraw the offer provides an uncomplicated way to close the offer investigation...."

However, we continue to believe that, in most situations, the taxpayer's rights would be better served by subjecting the rejection decision to the independent administrative review process and allowing the taxpayer to appeal the proposed rejection.

As previously stated, 11 of the 114 withdrawn or rejected doubt as to collectibility offers we reviewed contained special circumstances, and the offers could have been accepted under those provisions. Nine of the 11 cases were withdrawn offers. If these offers had been subjected to an independent review, the special

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When taxpayers are given the option to withdraw their offers, they are not always informed this action forfeits any appeal rights on those offers.

circumstances may have been detected by the reviewer and the offer correctly accepted.

In addition, the IRS was not always notifying the taxpayers that by withdrawing the offers they forfeited any appeal rights on those offers. In 15 of the 23 cases where the taxpayers withdrew their offers, the taxpayers were not advised their appeal rights were forfeited. Again, permitting the taxpayers to withdraw instead of rejecting the offers appears to be contrary to the Congress' intent of allowing taxpayers to appeal rejections of their offers.

Managers in the offices visited advised us that the offer specialists know the taxpayers are to be advised of this but may not always document it.

Recommendations

The Commissioner, SB/SE Division, should:

4. Seek clarification from the Congress as to whether permitting taxpayers to withdraw their offers after decisions have been made that the offers cannot be accepted is contrary to the RRA 98 requirement for an independent review of rejected offers. Any additional action will be dependent on the results of the above clarification.
5. Issue instructions reminding offer specialists of the need to advise taxpayers they forfeit their appeal rights if they withdraw their offers.
6. Revise Offer in Compromise (Form 656) and/or its instructions to inform taxpayers that, if they withdraw their offer, they forfeit their appeal rights.

Management's Response: SB/SE Division management agreed with recommendations 5 and 6. They plan to modify the IRM to emphasize that taxpayers must be advised that any withdrawal will forfeit their appeal rights. In addition, they plan on revising the withdrawal letter to refer to the loss of appeal rights when the offer is withdrawn. They are forwarding the recommendation

The Internal Revenue Service Needs to Consistently Use Special Circumstances in the Offer in Compromise Program

regarding revising Form 656 to the reengineering team studying the OIC Program for its consideration.

However, SB/SE Division management did not agree with the recommendation to seek clarification from the Congress. In the IRS' reply to the TIGTA's prior report, management expressed the opinion, "both the taxpayer and the offer process is [sic] better served by returning rather than rejecting the proposed offer." SB/SE Division management continues to believe that allowing for withdrawals serves the interest of both the government and taxpayer by avoiding unnecessary costs to both parties. Management sees no justification, nor do they believe it is appropriate, to seek clarification from the Congress.

Office of Audit Comment: We continue to believe that some withdrawals are very similar to rejects and that these offers are not subject to an independent review. While we agree that the withdrawal option can be advantageous to both the taxpayer and the IRS, we do not believe that the IRS should tell or otherwise encourage taxpayers to withdraw their offers. This causes the taxpayers to be removed from the independent review process.

The Review Process to Identify Trends or Inconsistencies in the Application of Special Circumstances Can Be Improved

The IRS established review procedures to help ensure consistency in the application of special circumstance provisions. We believe this review process and the communication of the review results to field offices can be improved, which could improve consistency in the use of special circumstances.

To help ensure consistency in the application of special circumstance provisions, the IRS initiated a review of all closed special circumstance offers called the 100 percent review program. The IRS also expanded the CQMS quality review program to include a sample of OIC

The Internal Revenue Service Needs to Consistently Use Special Circumstances in the Offer in Compromise Program

cases. In addition, the IRS established an independent administrative review of rejected offers to ensure that taxpayers' rights were protected and that rejection of the offer was the correct decision.

Not all special circumstance offers were being subjected to review

Not all special circumstance offers were being subjected to the 100 percent review program.

While a 100 percent review program was initiated, we found that only 52 percent of closed special circumstance offers were being subjected to the review process. The OIC MIS shows there were 839 special circumstance offers closed between October 1, 1999, and August 31, 2000. Comparison of these cases to the cases received for review showed that 404 (48 percent) were not received by the review team.

Managers in two of the offices we visited advised they were aware of the procedures for sending offers for review and it was an oversight that some were not sent. Management in the third office stated they were not aware of the proper procedures for which cases to send.

Quality review programs may not be applying the same standards

The two different quality review programs may not be applying the same standards to their reviews.

The two quality review programs - the 100 percent review and the CQMS review - may not be applying the same standards. As previously stated, the subjectivity of the factors involved in each offer makes it difficult to ensure consistency in the application of special circumstance offers. This subjectivity also makes it difficult to have a consistent quality review process.

Our review of 68 rejected or withdrawn doubt as to collectibility offers that were reviewed by the CQMS quality review team identified 6 offers where special circumstances were present, but only 1 was questioned by the reviewers. The national coordinator of the 100 percent review program reviewed these 6 cases and agreed that all 6 should have been considered for acceptance based on special circumstances.

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The results of the quality reviews could be better communicated to the field offices

The quality review results could be better communicated to the field offices.

Digests were prepared for each of the special circumstance cases reviewed in the 100 percent review program and were intermittently distributed around the country from December 1999 to June 2000. The review coordinator also periodically prepared a report showing summary review statistics. The CQMS review team posted statistical data from their reviews on their web site.

While the digests of the 100 percent review were sent to each field office, they were not routinely forwarded to the independent administrative reviewers. Since the reviewers see only rejected offers, the digests would give them a better perspective of what is being accepted and would provide a better basis for making their reviews of rejected offers.

Managers in the three offices visited stated they have never seen any statistical analysis conducted by the 100 percent review team or by the CQMS review team. The coordinator for the 100 percent review process advised us that she sent the statistical analysis to the old Regional offices and did not know what they did with it.

While the CQMS quality review results are posted on their web site, none of the offices we visited were aware the results were available there. The National Headquarters had issued a memorandum to all former District Directors on April 21, 2000, advising them that paper copies of the CQMS reports will no longer be distributed and how and where to access electronic versions of the reports on their web site.

Neither quality review function provided direct feedback on specific cases to the offices that worked the offers when the review disagreed with the conclusion reached. Direct feedback would surface differing interpretations of guidelines and help promote consistency in the application of the offer provisions.

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Recommendations

The Commissioner, SB/SE Division, should:

7. Better communicate the quality review results to field offices to help ensure consistency in the application of special circumstance provisions by:
 - A. Implementing procedures providing for direct feedback on specific cases where quality review disagrees with the conclusion reached in the offer investigation.
 - B. Ensuring the 100 percent review digest summaries are distributed to all relevant individuals, including the independent administrative reviewers.
 - C. Re-issuing instructions to the field offices regarding where and how to access the CQMS review results.
8. Re-emphasize to the field offices the procedures for submitting special circumstance offers for the 100 percent review program. The Director should also implement controls to ensure all closed special circumstance offers are submitted for the 100 percent review program. This could include periodically generating a list of closed special circumstance offers from the AOIC system to compare to the database of cases reviewed in the 100 percent review program.
9. Review the standards being used by the 100 percent review team and the CQMS review team to ensure consistency in reviews.

Management's Response: SB/SE Division management agreed with the recommendations. They plan to explore a process to provide direct feedback to field management on specific cases where quality review disagrees with the conclusion reached in the offer investigation. They have discontinued the issuance of 100 percent review digest summaries and will provide the field periodic trend analyses of reviews. In addition,

The Internal Revenue Service Needs to Consistently Use Special Circumstances in the Offer in Compromise Program

they will issue a memorandum to the field regarding where and how to access the CQMS review results.

They will issue a memorandum to the field re-emphasizing the procedures for submitting special circumstance offers for the required review. In addition, they will explore the use of a process that would periodically generate a list of closed special circumstance offers from the AOIC system and match them against the CQMS database.

SB/SE Division management has disbanded the 100 percent review team. Both the 100 percent review and the CQMS review are now done by one site. The CQMS OIC standards were approved and disseminated to the field and CQMS reviewers to ensure consistency in the review process.

Conclusion

The use of special circumstances in OICs varies significantly depending on which specialist works the case and where the taxpayer lives. This is due, in part, to the subjectivity of the factors involved in each case and the differing philosophies of local management towards the OIC Program.

The IRS' policy of permitting taxpayers to withdraw their offers instead of rejecting the offers appears to be contrary to the Congress' intent of an independent administrative review of all rejected offers. In addition, when taxpayers are permitted to withdraw their offers, they are not always advised that they forfeit their appeal rights for those offers.

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Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to determine if procedures for accepting offers in compromise based on special circumstances¹ were being consistently, uniformly, and appropriately applied. We:

- I. Determined the adequacy of the training provided regarding effective tax administration (ETA) and doubt as to collectibility with special circumstances (DCSC) offers.
 - A. Reviewed the material presented in the train-the-trainer orientation sessions on ETA and DCSC offers.
 - B. Attended and evaluated a training class provided to offer in compromise specialists on the new ETA offer procedures and the re-emphasis provided to DCSC offers.
 - C. Determined if all offices provided the revised training and if the training was given to all 126 applicable employees (including independent administrative reviewers) in the 3 field offices in our review.
- II. Determined the adequacy of the Internal Revenue Service's (IRS) review of offers to ensure consistency and evaluated the actions taken on these reviews.
 - A. Evaluated the procedures established for the independent administrative review of rejected offers, the 100 percent national review of special circumstance offers, and the Collection Quality Measurement System (CQMS) offer in compromise review process as they relate to ensuring consistency in applying special circumstance procedures.
 - B. Determined if the above reviews identified any national trends and determined what actions, if any, were taken on these trends.
 - C. Analyzed the database of the 100 percent national review and the CQMS for offers to identify any trends and determined if those trends had been identified by operations.

¹ When we refer to offers based on special circumstance, we are referring to both effective tax administration offers and doubt as to collectibility with special circumstances offers.

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- D. During visits to the three field offices, met with the administrative reviewer and reviewed any applicable documentation on the results of the administrative review of rejected offers.
 - E. Reviewed a random sample of 20 of the first 75 ETA offers that were reviewed from November 1999 to May 2000 as part of the 100 percent national review to evaluate the adequacy of the review.
 - F. Reviewed 28 of the 32 rejected and 40 of the 41 withdrawn offers that had been reviewed by CQMS for the 3 offices in our review between March 27, 2000 (the start of the CQMS review program), and July 7, 2000 (when we made our selection). The 5 offers not reviewed were unavailable.
 - G. Compared the 839 offers closed as special circumstances on the Automated Offer in Compromise (AOIC) system between October 1, 1999, and August 31, 2000, to the 617 offers received by the 100 percent review team during Fiscal Year (FY) 2000 to determine if all special circumstance offers were subjected to the review program. (The AOIC contained 84,004 OICs closed during FY 2000, of which 1,016 were special circumstance offers. We limited our analysis for this test to those 839 special circumstance offers closed earlier than September 1, 2000, to allow time for the offer to be sent to and received by the 100 percent review team by September 30, 2000.)
- III. Determined if offer specialists consider economic hardship or public policy factors when working doubt as to collectibility offers
- A. Reviewed a random sample of 54 rejected and 60 withdrawn doubt as to collectibility offers for the 3 selected field offices and determined if the taxpayers appeared to have qualified for a special circumstance offer and if the case file was documented to show the offer specialist considered special circumstances. The sample was drawn from 105 rejected and 350 withdrawn doubt as to collectibility offers received by the IRS later than September 30, 1999, and closed from May 1, 2000, through July 31, 2000.
 - B. For all 114 offers identified in III.A above where the taxpayer appears to have qualified for a special circumstance offer, but the case file was not documented to show the offer specialist considered it, determined the results of the post reviews of the offer.
 - C. Analyzed FY 2000 statistics regarding the number of offers worked versus the number of special circumstance offers worked and determined any variance in the statistics by office.
 - D. Compared the 617 special circumstance offers received by the 100 percent review program during FY 2000 to the AOIC system and determined if they were properly recorded on the AOIC system.

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in the Offer in Compromise Program**

Appendix II

Major Contributors to This Report

Gordon C. Milbourn III, Associate Inspector General for Audit (Small Business and Corporate Programs)

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in the Offer in Compromise Program**

Appendix III

Report Distribution List

Commissioner N:C
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 Commissioner, Small Business/Self-Employed Division S:C:CP:I

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Appendix IV

Outcome Measures

This appendix presents detailed information on the impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to the Congress.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Actual; 11 taxpayers affected (see page 6).

Methodology Used to Measure the Reported Benefit:

We selected a random sample of 114 rejected or withdrawn doubt as to collectibility offers out of the 455 that were received by the Internal Revenue Service (IRS) after September 30, 1999, and closed after April 30, 2000, for the 3 offices we visited.

Type and Value of Outcome Measure:

- Reliability of Information – Actual; 316 closed offers affected (see page 9).

Methodology Used to Measure the Reported Benefit:

We compared the 617 special circumstance offers received by the 100 percent review program during Fiscal Year 2000 to the Automated Offer in Compromise (AOIC) system to determine if they were properly recorded on the AOIC system.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Potential; 23 taxpayers affected (see page 11).

Methodology Used to Measure the Reported Benefit:

We selected a random sample of 60 withdrawn doubt as to collectibility offers out of the 350 that were received by the IRS after September 30, 1999, and closed after April 30, 2000, for the 3 offices we visited.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Actual; 15 taxpayers affected (see page 12).

Methodology Used to Measure the Reported Benefit:

We selected a random sample of 60 withdrawn doubt as to collectibility offers out of the 350 that were received by the IRS after September 30, 1999, and closed after April 30, 2000, for the 3 offices visited.

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Appendix V

Hypothetical Examples of Scenarios Where There Is Potential for Special Circumstances

This appendix presents hypothetical examples of scenarios that would result in potential acceptance of an offer in compromise based on special circumstances.

Example One - Doubt as to Collectibility with Special Circumstance Offer

Assume that Mr. and Mrs. Taxpayer A owe approximately \$13,000 for individual income tax for 2 years. The taxpayers showed up at a Problem Solving Day and the employee assisting them indicated they may qualify for a hardship offer and helped them prepare an Offer in Compromise (Form 656). They submitted a doubt as to collectibility offer for \$800.

Also, assume that Mr. Taxpayer A is 51 years old and Mrs. Taxpayer A is 41. Mr. Taxpayer A is partially paralyzed due to a stroke and has other serious ailments. Mrs. Taxpayer A is in good health. Mr. Taxpayer A does not work, while Mrs. Taxpayer A is self-employed. She makes an average of \$1,600 a month. Since Mr. Taxpayer A suffered a stroke, Mrs. Taxpayer A has used all her income to provide necessary living expenses instead of making estimated tax payments. The taxpayers had filed for bankruptcy prior to filing an offer and were discharged from all debts except taxes.

The Internal Revenue Service would have conducted an offer investigation. Assume that it revealed the taxpayers have monthly expenses totalling about \$1,700, which exceeds income by \$100. The taxpayers' assets consisted of \$500 in cash and 2 cars valued at \$500 and \$4,700, for a total net worth of \$5,700. The offer specialist would have advised the taxpayer that the offer of \$800 was too low and needed to be increased to \$5,700. The taxpayers may have responded they could increase the offer to \$1,800, but the offer specialist would still have stated that was too low and would have recommended rejecting or withdrawing the offer and reporting the accounts as currently not collectible.

This case qualifies for special circumstances. Based on the fact that the taxpayers' monthly expenses exceed income and what little income they have is used for the husband's medical expenses, the taxpayers appear to qualify for economic hardship. Since the taxpayers' net equity is less than the liability owed, the offer would qualify for doubt as to collectibility with special circumstances.

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Example Two - Effective Tax Administration Offer

Assume Mr. and Mrs. Taxpayer B owe approximately \$700 for 1 tax year and that they submitted a doubt as to collectibility offer for \$100. The taxpayers also claimed special circumstances, stating they are not in good health and have limited income that does not meet basic needs.

Also, assume that Mr. and Mrs. Taxpayer B are 64 and 60 years old, respectively. Neither taxpayer works and their sole source of income is social security and disability. Their monthly expenses exceed monthly income and therefore there is no future income value. At the time the offer was filed, the taxpayers' financial statement showed assets of a car with \$3,000 equity, a trailer home worth \$13,000, and one-fourth ownership in some rental property.

By the time the offer was investigated, the taxpayers had sold their trailer home and used the proceeds for basic living expenses and to move to another town closer to their daughter. The offer specialist would not have investigated the taxpayers' part ownership of rental property, which they claim is worthless. Therefore, the combined net worth appears to be \$3,000 (value of car).

Assume that the offer specialist made one contact with the taxpayer and concluded that in view of the taxpayers' limited income, this situation called for the liability to be placed in currently not collectible status and not an offer in compromise. The taxpayers' accounts would have already been placed in currently not collectible status prior to their filing the offer, due to the tolerance condition. The specialist would have advised the taxpayers to withdraw their offer, and they would have.

This case qualifies for special circumstance consideration. The taxpayers are unemployed and living on social security and disability, with monthly expenses exceeding monthly income. The offer specialist concluded the account could not be collected and should be reported as currently not collectible. Since the taxpayers' net equity is greater than the liability, the offer would qualify as an effective tax administration offer.

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Appendix VI

Percent of Processable Offers with Special Circumstances by Office¹

Office	Closed in Fiscal Year 2000	Open as of September 30, 2000	Total Offers	Special Circumstances	Percent
1	591	1237	1828	10	0.55%
2	1570	2433	4003	28	0.70%
3	3608	5625	9233	83	0.90%
4	2675	5514	8189	74	0.90%
5	2570	2549	5119	47	0.92%
6	1269	3260	4529	48	1.06%
7	4343	8028	12371	135	1.09%
8	1698	1818	3516	51	1.45%
9	1810	1220	3030	44	1.45%
10	2100	2014	4114	70	1.70%
11	3964	2922	6886	122	1.77%
12	1575	963	2538	45	1.77%
13	2268	3490	5758	107	1.86%
14	1371	2050	3421	67	1.96%
15	4275	6209	10484	211	2.01%
16	1887	1881	3768	76	2.02%
17	2180	2805	4985	101	2.03%
18	1726	1321	3047	64	2.10%
19	3548	2796	6344	135	2.13%
20	1862	1770	3632	80	2.20%
21	1818	1842	3660	86	2.35%
22	1406	2674	4080	103	2.52%
23	1501	3072	4573	119	2.60%
24	895	1678	2573	73	2.84%
25	1643	1646	3289	94	2.86%
26	2440	3520	5960	172	2.89%
27	1561	1434	2995	94	3.14%
28	2967	2303	5270	171	3.24%
29	2243	1892	4135	151	3.65%
30	1987	2595	4582	202	4.41%
31	1528	2516	4044	179	4.43%
32	1157	1929	3086	159	5.15%
33	2071	1721	3792	253	6.67%
Total	70107	88727	158834	3454	2.17%

¹ Source: Automated Offer in Compromise System and the 100 Percent Review Team Data File. These numbers may not be entirely accurate, since as reported on Page 9 special circumstance offers are not properly accounted for on the Automated Offer In Compromise System

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Appendix VII

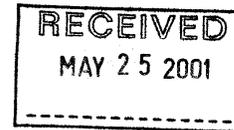
Management's Response to the Draft Report



COMMISSIONER
SMALL BUSINESS/Self-EMPLOYED DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

May 25, 2001



MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Joseph Kehoe *for Deputy Inspector*
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – The Internal Revenue Service Needs to Consistently Use Special Circumstances in the Offer in Compromise Program

We appreciate your comments to help us improve the consistency and effectiveness of the Offer in Compromise (OIC) program as outlined in your recent report, "The Internal Revenue Service Needs to Consistently Use Special Circumstances in the Offer in Compromise Program."

Your recommendations will contribute to the effort we already have in place to reengineer the OIC program. We are moving quickly to centralize our OIC operation, and, at the same time, to reengineer the process so that we can ensure that our administration of this important program works correctly for taxpayers.

Here is an outline of our key program reforms. A discussion of your recommendations follows.

- 1. Centralization:** Based on pilot projects conducted in upstate New York and Fresno Service Center we are centralizing the work for less complex OIC cases into two service centers - Brookhaven and Memphis. By centralizing, we hope to accomplish several things:
 - Expedite the initial case activities by bulk processing in an environment familiar with that type of work process;
 - Draw on the knowledge and wisdom of specialized staff to prepare cases for both center and field investigation;
 - Make case preparation and case handling more consistent for all OIC cases;
 - Manage lower graded case activities for all OIC cases more appropriately; and,
 - Ensure consistency especially for lower income and less complicated OIC cases.
- 2. Reengineering:** We established a team to do a top to bottom review of the OIC program. Their mission is to develop short and long term improvements and recommendations. So far, this team has:

The Internal Revenue Service Needs to Consistently Use Special Circumstances in the Offer in Compromise Program

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- Framed the problem;
- Established a baseline of understanding the backlog inventory and characteristics of the current OIC process; and,
- Developed a package of process reforms, which is currently under review.

Our comments on the recommendations in this report are as follows:

IDENTITY OF RECOMMENDATION 1: Reinforce to the field offices the expectations that one of the responsibilities of offer specialists is to advise the taxpayer of the various OIC options, including special circumstance provisions.

ASSESSMENT OF CAUSE(S): The review determined that the special circumstance criteria were not always considered and consistently applied to OIC cases, as required by IRS procedures.

Special circumstance criteria were not consistently applied because of the subjectivity of the factors involved in each case, the differing management attitudes towards the OIC program, and the expanding definitions of what can be considered a special circumstance.

CORRECTIVE ACTION(S): The Internal Revenue Manual (IRM), section 5.8.11.2(1) advises OIC specialists to first consider doubt as to collectibility or doubt as to liability prior to considering an ETA offer. The IRM will be revised to address the need to discuss with taxpayers potential special circumstance situations early in the OIC investigation.

IMPLEMENTATION DATE: September 1, 2001

RESPONSIBLE OFFICIAL: Commissioner, Small Business/Self Employed Division

CORRECTIVE ACTION(S) MONITORING PLAN: The Director, Filing and Payment Compliance, will ensure the appropriate staff completes the corrective action in a timely manner. The Commissioner, Small Business/Self Employed, will be advised of any delays.

IDENTITY OF RECOMMENDATION 2: Clarify the digest process or issue other clarifying instructions so that users understand the current policy on using special circumstance factors.

ASSESSMENT OF CAUSE(S): The digests were not intended to be policy and were prepared to ensure consistency in the use of special circumstances. Some field offices have incorrectly interpreted the digests as policy.

CORRECTIVE ACTION(S): National Office has discontinued the issuance of the digest. We will provide periodic trend analysis of ETA/Special Circumstance reviews to promote consistency in the application of ETA provisions.

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IMPLEMENTATION DATE: August 1, 2001

RESPONSIBLE OFFICIAL: Commissioner, Small Business/Self Employed Division

CORRECTIVE ACTION(S) MONITORING PLAN: The Director, Filing and Payment Compliance, will ensure the appropriate staff completes the corrective action in a timely manner. The Commissioner, Small Business/Self Employed, will be advised of any delays.

IDENTITY OF RECOMMENDATION 3: Issue detailed instructions to the field for how and when ETA and DCSC offers are to be accounted for on the AOIC system.

ASSESSMENT OF CAUSE(S): Some field employees were unaware of how and when to account for ETA and DCSC cases on the AOIC system. The AOIC transmittal was not reinforced with an update of the IRM.

CORRECTIVE ACTION(S): National Office issued instructions through AOIC Transmittal Number 99-03 on October 20, 1999. The AOIC application was installed onto the AOIC system on November 1, 1999, however the instructions were not included in the IRM. IRM procedures will be revised to emphasize these provisions.

IMPLEMENTATION DATE: September 1, 2001

RESPONSIBLE OFFICIAL: Commissioner, Small Business/Self Employed Division

CORRECTIVE ACTION(S) MONITORING PLAN: The Director, Filing and Payment Compliance, will ensure the appropriate staff completes the corrective action in a timely manner. The Commissioner, Small Business/Self Employed, will be advised of any delays.

IDENTITY OF RECOMMENDATION 4: Seek clarification from the Congress as to whether permitting taxpayers to withdraw their offers after decisions have been made that the offers cannot be accepted is contrary to RRA98's requirement for an independent review of rejected offers. Any additional action will be dependent on the results of the above clarification.

ASSESSMENT OF CAUSE(S): TIGTA thinks permitting taxpayers to withdraw their offers instead of rejecting them may be contrary to congressional intent for an independent review.

CORRECTIVE ACTION(S): We disagree with this recommendation. In our reply to a prior TIGTA report, 2000-40-093, management expressed the opinion "both the taxpayer and the offer process is better served by returning rather than rejecting the proposed offer." We continue to believe that allowing for withdrawals serves the interest of both the government and taxpayer by avoiding unnecessary costs to both

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parties. We see no justification nor do we believe that it is appropriate to seek clarification from Congress as to whether the withdrawals are contrary to RRA98 provisions.

IMPLEMENTATION DATE: N/A

RESPONSIBLE OFFICIAL: N/A

CORRECTIVE ACTION(S) MONITORING PLAN: N/A

IDENTITY OF RECOMMENDATION 5: Issue instructions reminding offer specialists of the need to advise taxpayers they forfeit their appeal rights if they withdraw their offers.

ASSESSMENT OF CAUSE(S): When taxpayers are given the option to withdraw their offers, they are not always informed this action forfeits any appeal rights on those offers.

CORRECTIVE ACTION(S): We will modify the IRM to emphasize that taxpayers must be advised that any withdrawal will forfeit any appeal rights. We will also revise language in the withdrawal letter to reference loss of appeal rights when the offer is withdrawn.

IMPLEMENTATION DATE: October 1, 2001

RESPONSIBLE OFFICIAL: Commissioner, Small Business/Self Employed Division

CORRECTIVE ACTION(S) MONITORING PLAN: The Director, Filing and Payment Compliance, will ensure the appropriate staff completes the corrective action in a timely manner. The Commissioner, Small Business/Self Employed, will be advised of any delays.

IDENTITY OF RECOMMENDATION 6: Revise Offer in Compromise (Form 656) and/or its instructions to inform taxpayers that if they withdraw their offer, they forfeit their appeal rights.

ASSESSMENT OF CAUSE(S): When taxpayers were given the option to withdraw their offers, they were not always informed this action forfeits any appeal rights on those offers.

CORRECTIVE ACTION(S): We agree that any revision of form 656 instructions should include a discussion of the implications of a withdrawal. However, we are not planning to track this corrective action through this audit. We will forward this recommendation to the OIC reengineering team for their consideration.

IMPLEMENTATION DATE: N/A

RESPONSIBLE OFFICIAL: N/A

The Internal Revenue Service Needs to Consistently Use Special Circumstances in the Offer in Compromise Program

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CORRECTIVE ACTION(S) MONITORING PLAN: N/A

IDENTITY OF RECOMMENDATION 7: Better communicate the quality review results to field offices to help ensure consistency in the application of special circumstance provisions by:

- A. Implementing procedures providing for direct feedback on specific cases where quality disagrees with the conclusion reached in the offer investigation.
- B. Ensuring the 100 percent review digest summaries are distributed to all relevant individuals, including the independent administrative reviewers.
- C. Re-issue instructions to the field offices regarding whether and how to access the CQMS' review results.

ASSESSMENT OF CAUSE(S): The quality review results could be better communicated to the field offices.

CORRECTIVE ACTION(S):

Corrective Action A: National Office will explore a process to provide direct feedback to field management on specific cases where quality review disagrees with the conclusion reached in the offer investigation. Implementation of such a process will require modification to the Quality Review Measurement System, and may require negotiation with the National Treasury Employees Union.

Implementation Date: November 1, 2001

Corrective Action B: National Office has discontinued the issuance of the digest. We will provide to all field compliance offer personnel, including independent administrative reviewers, periodic trend analysis of ETA and Special Circumstance reviews to promote consistency in the application of these provisions.

Implementation Date: November 1, 2001

Corrective Action C: The CQMS review process began in March 2000. National Office issued, on April 21, 2000, a memorandum to all regional chief compliance officers providing instructions on accessing the collection quality measurement system (CQMS) reports. Due to the reorganization and reconfiguration of the CQMS database that has established Area and Territory Offices, the National Office will re-issue instructions to the field regarding where and how to access the CQMS review results.

IMPLEMENTATION DATE: October 1, 2001

RESPONSIBLE OFFICIAL: Commissioner, Small Business/Self Employed

The Internal Revenue Service Needs to Consistently Use Special Circumstances in the Offer in Compromise Program

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CORRECTIVE ACTION(S) MONITORING PLAN: The Director, Filing and Payment Compliance, will ensure the appropriate staff completes the corrective action in a timely manner. The Commissioner, Small Business/Self Employed, will be advised of any delays.

IDENTITY OF RECOMMENDATION 8: Re-emphasize to the field offices the procedures for submitting special circumstances offers for the 100 percent review program. The Director should also implement controls to ensure all closed special circumstance offers are submitted for the 100 percent review program. This could include periodically generating a list of closed special circumstance offers from the AOIC system to compare to the database of cases reviewed in the 100 percent review program.

ASSESSMENT OF CAUSE(S): Special circumstance cases are not always sent for the 100% CQMS review.

CORRECTIVE ACTION(S):

Corrective Action A: The 100 percent review of ETA and DCSC was transferred to CQMS in March 2000. Although the National Office has communicated in two memoranda the procedures for submitting these types of cases for the required review, a subsequent memorandum is in clearance, which will reemphasize these procedures again. This current memorandum also instructs the field to submit all withdrawal cases as part of the 100 percent review.

Implementation Date: Completed May 11, 2001

Corrective Action B: We will explore the use of a process that would periodically generate a list of AOIC ETA/DCSC closed cases and match them against the CQMS Data base.

IMPLEMENTATION DATE: October 1, 2001

RESPONSIBLE OFFICIAL: Commissioner, Small Business/Self Employed Division

CORRECTIVE ACTION(S) MONITORING PLAN: The Director, Filing and Payment Compliance, will ensure the appropriate staff completes the corrective action in a timely manner. The Commissioner, Small Business/Self Employed, will be advised of any delays.

IDENTITY OF RECOMMENDATION 9: Review the standards being used by the 100 percent review team and the CQMS review team to ensure consistency in reviews.

ASSESSMENT OF CAUSE(S)

The two different quality review programs may not be applying the same standards to their reviews.

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CORRECTIVE ACTION(S): During the course of this audit, the 100 percent review team was disbanded. This eliminates the possibility of inconsistencies between the two review teams. The field was instructed to send all ETA/DCSC cases to the CQMS site in Atlanta for review. The CQMS OIC standards were approved and disseminated to the field and CQMS reviewers to ensure consistency in the review process.

IMPLEMENTATION DATE: Completed

RESPONSIBLE OFFICIAL: Commissioner, Small Business/Self Employed Division

CORRECTIVE ACTION(S) MONITORING PLAN: N/A

If you have any questions, please contact me or Martha Sullivan, Deputy Director, Compliance Policy, Small Business/Self-Employed at 202-622-5558.