IRS Offer in Compromise vs Installment Agreement: Obtaining the Best Arrangement for Your Client

By Karen Tenenbaum

Your client owes money to the IRS but cannot afford to pay. Assuming the amount owed is not in dispute, what is the best option for them to resolve their debt? In many cases, they have two options – an Offer in Compromise (OIC) or an Installment Agreement (IA). Which one is better depends on their circumstances.

IRS Offer in Compromise

An IRS OIC is a settlement agreement in which the taxpayer's liability is generally reduced to an amount that the taxpayer can afford to pay, not what the taxpayer actually owes. In most cases, the IRS will not accept an OIC unless the amount offered is equal to or greater than the reasonable collection potential (RCP) of the taxpayer. The RCP includes amounts that can be realized from the liquidation of the taxpayer's assets, such as real property, automobiles, retirement accounts, investment funds, bank accounts, and other property. In addition, the RCP also includes the taxpayer's anticipated future income less specified amounts allowed for reasonable living expenses. The IRS will examine the taxpayer's financials carefully so be prepared.

An OIC is only available where the taxpayer can demonstrate one of the following grounds: (1) Doubt as to liability (the taxpayer can establish a genuine dispute as to the existence or amount of the correct tax debt under the law); (2) Doubt as to collectability (the taxpayer's assets and income are less than the full amount of the tax liability); or (3) Effective tax administration (the taxpayer may be able to fully pay the tax, but such payment would cause an economic hardship or there are compelling public policy or equity considerations). The second and third grounds are the ones relied on when the taxpayer cannot afford their tax debt.

IRS Installment Agreement

Installment Agreements permit payment over time for those taxpayers who cannot afford to pay at once. There are several types of IAs, including guaranteed, streamlined, partial pay, in-business trust fund, and routine IAs. Each one has its own requirements. For instance, with guaranteed and streamlined IAs, taxpayers do not have to provide a financial statement to qualify. Financial statements are required for partial pay IAs and may be needed for routine IAs. Some IAs are also limited to those who owe less than a certain amount of money, can pay within a specific period of time, or will pay with a direct debit agreement. Taxpayers should take care in choosing which one is best for their circumstances.

Notably, even with an approved IA, interest and penalties will continue to accrue on unpaid tax balances. As a result, installment agreements are often best for taxpayers who have adequate income, but who cannot obtain a loan to pay the bill at once. If a loan is possible, they should consider whether it may be less expensive to pay the loan interest as opposed to the IRS interest and penalties.

Conclusion

If taxpayers cannot obtain an IA or OIC, they may still request Currently Not Collectible (CNC) status if they cannot pay taxes owed and basic living expenses. This will temporarily suspend a specific collection action. Tax professionals must carefully evaluate their client's financial information in order to determine their best option and negotiate a fair settlement.

Karen Tenenbaum, Esq., LL.M. (Tax), CPA *is Founder and Managing Partner of Tenenbaum Law, P.C. (www.litaxattorney.com), a tax law firm in Melville, N.Y., which focuses its practice on the resolution of IRS and New York State tax controversies. Karen can be reached at ktenenbaum@litaxattorney.com and at 631-465-5000.*