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# TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION



*Important Improvements Have Been Made in  
the Offer in Compromise Process; However,  
Additional Efficiencies Can Be Gained*

**October 12, 2016**

**Reference Number: 2017-30-009**

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

**Redaction Legend:**

1 = Tax Return/Return Information

3 = Personal Privacy Information

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## HIGHLIGHTS

**IMPORTANT IMPROVEMENTS HAVE BEEN MADE IN THE OFFER IN COMPROMISE PROCESS; HOWEVER, ADDITIONAL EFFICIENCIES CAN BE GAINED**

## Highlights

**Final Report issued on October 12, 2016**

Highlights of Reference Number: 2017-30-009 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

### IMPACT ON TAXPAYERS

An offer in compromise is an agreement between a taxpayer and the Government that settles a tax liability for a payment of less than the full amount owed. The Government, like other creditors, encounters situations in which an account receivable cannot be collected in full or there is a legitimate dispute as to what is owed. It is an accepted business practice to resolve these issues through negotiation and compromise. Consistent and timely treatment of offers in compromise ensures that taxpayers are treated equitably.

### WHY TIGTA DID THE AUDIT

This audit was initiated as a follow-up to a prior TIGTA review of offers in compromise. The Internal Revenue Manual states that the success of the offer in compromise program will be assured only if taxpayers make adequate compromise proposals consistent with their ability to pay and the IRS makes prompt and reasonable decisions. The overall objective of this review was to determine whether offers in compromise were timely and appropriately processed.

### WHAT TIGTA FOUND

The IRS has made changes designed to improve the offer in compromise process for both taxpayers and the IRS. Specifically, management has updated the application forms, created an online prequalifier tool, established a group of offer specialists to work payroll service

provider cases, and encouraged more taxpayers to consider whether offers would benefit them.

However, offer employees did not always complete the initial processing timely, contact taxpayers by the promised date, or send interim letters when promised dates were not met. Additionally, TIGTA found that 10 (11 percent) of 92 rejected offer cases did not include any documentation that alternative resolutions were discussed with the taxpayer.

### WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS: 1) remind employees of the requirement to complete the processing determinations within the required 16 days and contact the taxpayer within 120 days; 2) ensure that employees are aware of the requirements for sending interim letters when the initial 120-day contact date is not met; and 3) update the review guidance to specifically include verification that alternative resolutions were discussed with taxpayers when an offer is not accepted. Additionally, management should emphasize the need to discuss alternate resolutions in operational reviews of subordinate managers and in refresher training.

In response to the report, IRS officials agreed with the recommendations. The IRS agreed to issue a memorandum reminding employees and managers that processing determinations must be completed within 16 days of IRS receipt, taxpayer contact must be made within 120 days, and an interim letter must be sent if taxpayer contact is not made within the initial 120 days. Additionally, the IRS agreed to add or revise review guidance to include verification that alternative resolutions were discussed with the taxpayer when applicable, and plans to conduct alternative resolution refresher training.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

October 12, 2016

**MEMORANDUM FOR** COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED  
DIVISION

**FROM:** Michael E. McKenney  
Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – Important Improvements Have Been Made in the  
Offer in Compromise Process; However, Additional Efficiencies Can  
Be Gained (Audit # 201530016)

This report presents the results of our review to determine whether offers in compromise were timely and appropriately processed. This audit was included in our Fiscal Year 2016 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

Management's complete response to the draft report is included as Appendix VI. Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations.

If you have any questions, please contact me or Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations).



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## *Abbreviations*

COIC	Centralized Offer in Compromise
EQRS	Embedded Quality Review System
FY	Fiscal Year
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
NQRS	National Quality Review System
OIC	Offer in Compromise



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## *Background*

An offer in compromise (OIC) is an agreement between a taxpayer and the Government that settles a tax liability for a payment of less than the full amount owed.<sup>1</sup> The Government, like other creditors, encounters situations in which an account receivable cannot be collected in full or there is a legitimate dispute as to what is owed. It is an accepted business practice to resolve these issues through negotiation and compromise.

The Secretary of the Treasury is granted broad authority to compromise tax liabilities in Internal Revenue Code Section (§) 7122. The Commissioner of the Internal Revenue Service (IRS) is authorized to compromise a liability and delegates this authority to accept, reject, terminate, or acknowledge withdrawals of OICs.<sup>2</sup> An OIC is a legitimate alternative to declaring a case currently not collectible or a protracted installment agreement. The objectives of the OIC program are to:

- Effect collection of what can reasonably be collected at the earliest possible time and at the least cost to the Government.
- Achieve a resolution that is in the best interest of both the individual taxpayer and the Government.
- Provide the taxpayer a fresh start toward future voluntary compliance with all filing and payment requirements.
- Secure collection of revenue that may not be collected through any other means.

A request for an OIC is submitted on Form 656, *Offer in Compromise*, and may require an application fee of \$186 and a nonrefundable payment equal to 20 percent of the offer amount or the initial periodic payment. The requirement of the fee and payment depends on the type of offer and whether the taxpayer qualifies for the low-income exemption or is filing a doubt as to liability offer. All initial offer receipts are processed by one of the Centralized Offer in Compromise (COIC) sites located in the Brookhaven and Memphis Campuses. If the IRS does not make a determination on an OIC within 24 months, it will be deemed accepted.<sup>3</sup>

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<sup>1</sup> See Appendix V for a glossary of terms.

<sup>2</sup> Delegation Order No. 5-1 (Rev. 4) in Internal Revenue Manual 1.2.44, *Delegation of Authorities for the Collecting Process*.

<sup>3</sup> Internal Revenue Code § 7122(f).



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The IRS may accept an offer based on three grounds:<sup>4</sup>

- Doubt as to liability – A compromise meets this criterion only when there is a genuine dispute as to the existence or amount of the correct tax debt under the law.
- Doubt that the amount owed is fully collectible – Doubt as to collectibility exists in any case in which the taxpayer's assets and income are less than the full amount of the tax liability. An offer may be accepted if the taxpayer has proven special circumstances that warrant acceptance for less than the amount of the calculated reasonable collection potential.
- Effective tax administration – An offer may be accepted based on effective tax administration when there is no doubt that the tax is legally owed and that the full amount owed can be collected, but requiring payment in full would either create an economic hardship or would be unfair and inequitable because of exceptional circumstances.

The Internal Revenue Manual (IRM) states that the success of the OIC program will be assured only if taxpayers make adequate compromise proposals consistent with their ability to pay and the IRS makes prompt and reasonable decisions.<sup>5</sup> Taxpayers are expected to provide reasonable documentation to verify their ability to pay. According to the National Taxpayer Advocate's *Annual Report to Congress 2014*, the processing of OICs continues to be one of the most serious problems affecting taxpayers.<sup>6</sup>

This review was performed with information obtained from the Small Business/Self-Employed Division Headquarters in New Carrollton, Maryland, during the period March 2015 through March 2016 and was initiated as a follow-up to a prior Treasury Inspector General for Tax Administration OIC review.<sup>7</sup> A recent Treasury Inspector General for Tax Administration report included a review of whether accepted OIC program files stored at the OIC public inspection file sites contained properly redacted Taxpayer Identification Numbers.<sup>8</sup> We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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<sup>4</sup> Treas. Reg. § 301.7122(b).

<sup>5</sup> IRM 5.8.1.1.3(3) (Feb. 26, 2013).

<sup>6</sup> National Taxpayer Advocate, *Annual Report to Congress 2014*, p. 22.

<sup>7</sup> Treasury Inspector General for Tax Administration, Ref. No. 2012-30-033, *Increasing Requests for Offers in Compromise Have Created Inventory Backlogs and Delayed Responses to Taxpayers* p. 4 (Mar. 2012).

<sup>8</sup> Treasury Inspector General for Tax Administration, Ref. No. 2016-IE-R006, *Procedures to Protect Taxpayer Information at Offer in Compromise Public Inspection File Locations Should Be Enhanced* (Mar. 2016).





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## *Results of Review*

### **Management Made Changes to Improve the Offer Process**

Over the past few years, the IRS has made changes designed to improve the OIC process for both taxpayers and the IRS. Specifically, management has:

- Updated the application forms.
- Created an online prequalifier tool.
- Established a group of offer specialists to work payroll service provider cases.
- Encouraged more taxpayers to consider whether offers would benefit them.

These changes are positive, and there is evidence that they have resulted in quantifiable benefits. For example, taxpayers who use the new online tool are more likely to receive an accepted OIC than taxpayers who do not use the tool.

The IRS updated the Form 656 application in January 2014 to include more specific details about the information and supporting documentation that needs to be submitted with the application. The form now directs the taxpayer to include the application fee; payment; a completed Form 433-A (OIC), *Collection Information Statement for Wage Earners and Self-Employed Individuals*, or Form 433-B (OIC), *Collection Information Statement for Businesses*; and supporting documentation.

In Fiscal Year (FY) 2013, the IRS determined that almost 5,000 Forms 656 were received without Forms 433-A (OIC) or 433-B (OIC). To address this issue, the IRS removed the standalone Form 656 from the IRS website. After removing the standalone Form 656, the number of applications received without Forms 433-A (OIC) or 433-B (OIC) went down significantly to approximately 3,400 in FY 2014 and 1,800 in FY 2015. Additionally, the IRS has revised the form annually since FY 2011, with the exception of FY 2013, based on input from stakeholders. For example, Form 656 was updated in February 2016 to add a direct link to the online tool.

In January 2013, the IRS launched an online tool on IRS.gov to help practitioners and taxpayers determine eligibility for an OIC. In March 2013, the IRS began monitoring the use of the online tool by tracking activity on the website. Additionally, in January 2014, Form 656 was updated to include a checkbox for taxpayers to indicate if the online tool was used prior to submitting their offer. Tracking of the use of the online tool based on the checkbox began in May 2014. Between May and December 2014, taxpayers indicated on Form 656 that they used the online tool prior to submitting their applications on more than 24,000 (36 percent) of the 66,000 offers



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submitted. Preliminary data provided by IRS management show that using the online tool is beneficial. In FY 2015, approximately 43 percent of all OIC applications were accepted. In comparison, when taxpayers used the online tool, the acceptance rate was 49 percent.<sup>9</sup> If the online tool advises taxpayers that they are ineligible for an offer, they may discontinue pursuing an offer, which reduces both taxpayer and IRS burden for processing offers that will be rejected. To test the accuracy of the online tool, we input information from a judgmental sample of 13 OIC applications that were rejected and 13 OIC applications that were accepted. We determined that the tool appears to work effectively in that it would have informed the taxpayer of his or her eligibility if it had been available for his or her use.<sup>10</sup>

The Consolidated Appropriations Act of 2014 required the IRS to give special OIC consideration to taxpayers who have been victimized by a third-party payroll service provider.<sup>11</sup> To ensure that these offers received timely and efficient treatment, the IRS created a group of offer specialists to work all payroll service provider offers. We identified 93 offers submitted between June 2013 and November 2014 by taxpayers who were harmed by a payroll service provider. Of these 93 offers, 84 were closed, which enabled us to review IRS decisions on the cases:

- 68 were closed as accepted.
- 4 were rejected.
- 12 were either withdrawn or returned to the taxpayer.

We reviewed the 16 offers that were rejected, returned, or withdrawn and a judgmental sample of 41 of the 68 accepted offers and determined that all included sufficient documentation to support the decision made by the offer specialist.

The IRS has encouraged more taxpayers and tax practitioners to consider OICs as a payment alternative through the IRS National Tax Forums, YouTube videos, Twitter feeds, and periodic news releases. Additionally, in January 2016, the IRS updated all balance due notices with information about OICs and the online tool.<sup>12</sup>

### **Offer Processing Time Frames and Promised Contact Dates Were Not Always Met**

We reviewed two separate random samples for a total of 190 OIC cases (98 accepted and 92 rejected) closed in FYs 2013 and 2014 to determine if OIC applications were timely

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<sup>9</sup> Acceptance rates are tracked by fiscal year, while online tool usage was tracked by calendar year.

<sup>10</sup> When testing the online tool, we did not have all of the taxpayer's information, so the results may have been different if the taxpayer had used the tool.

<sup>11</sup> Consolidated Appropriations Act, 2014, Pub. L. No. 113-76.

<sup>12</sup> The balance due notices provide the taxpayer the initial information regarding taxes that are due. At the same time, the notices can provide the taxpayer with options with how to resolve their tax liability.



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processed, interim letters were sent to the taxpayers, and the taxpayers were timely contacted.<sup>13</sup> After an offer is received, COIC site employees verify, if applicable, receipt of the initial payment of the offer and the application fee; perform the research necessary to determine if the taxpayer is currently in bankruptcy or the existence of any other collection actions that could affect the offer; request additional information from the taxpayer; and transfer the case to the field if the offer meets certain criteria. Our case review showed that the IRS did not always complete the initial processing timely, contact taxpayers by the promised date, or send interim letters when promised dates were not met. We previously reported that the IRS did not always contact taxpayers by the date promised.<sup>14</sup>

The IRS Embedded Quality review process includes the Embedded Quality Review System (EQRS) and the National Quality Review System (NQRS). Collection function managers use the EQRS to complete all case reviews for revenue officers, advisors, bankruptcy specialists, property appraisal and liquidation specialists, tax examiners, and OIC specialists. The system provides a structured context for evaluating employee performance and creating related documentation. Under the EQRS, Collection function managers use many of the same quality attributes for employee case reviews that the NQRS staff uses to assess organizational quality. For NQRS reviews, the reviewers provide independent collection review information from which management may draw inferences regarding overall case quality for a given operational segment.<sup>15</sup> The Automated Offer in Compromise system randomly selects closed OIC cases weekly for NQRS reviews.<sup>16</sup>

### **Untimely initial processing of OIC applications**

IRS procedures require preliminary review of OIC applications to be completed within 16 calendar days of the received date to determine whether they can be processed.<sup>17</sup> There are several reasons why an OIC application cannot be investigated and will therefore be returned to the taxpayer. For example, offers may not be processed due to taxpayer bankruptcy, a missing application fee, or a missing initial payment.

However, our case review showed that the processing determination for 24 (13 percent) of 190 sampled cases was not completed within the required 16 days. On average, the late determinations were completed in 24 days, with a range of 19 days to 32 days. Based on our sample results, we estimate that 7,288 taxpayers who submitted offer applications in FYs 2013

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<sup>13</sup> For purposes of this report, each offer case is considered as “one taxpayer” and “one taxpayer account” even though each case or account may in fact concern multiple taxpayers, as in the case of joint filers.

<sup>14</sup> Treasury Inspector General for Tax Administration, Ref. No. 2012-30-033, *Increasing Requests for Offers in Compromise Have Created Inventory Backlogs and Delayed Responses to Taxpayers* (Mar. 2012).

<sup>15</sup> IRM 5.13.1.1 (Oct. 28, 2014).

<sup>16</sup> IRM 5.13.1.10.1.1 (July 2, 2011).

<sup>17</sup> IRM 5.8.2.3 (Nov. 4, 2014).



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and 2014 may not have had the processing determination made timely.<sup>18</sup> The NQRS and EQRS review criteria include verification that employees are completing the initial processing determinations within the required 16 days.

### **Returned OICs**

There is a significant impact to taxpayers as to whether an OIC is *rejected* as opposed to *returned*. The rejection of an OIC indicates a decision on the merits of the offer whereas an OIC that is returned indicates that the offer was not processable or that during the offer investigation the taxpayer failed to comply with a request for additional information which may include required tax returns, estimated tax payments or Federal tax deposits, or it was determined the offer was filed solely to delay collection efforts. When an OIC is rejected, the law requires an independent administrative review (performed within the Collection function) as well as the ability of the taxpayer to appeal the rejection to the IRS Office of Appeals.<sup>19</sup> There is no review afforded to an OIC that is returned; however, the taxpayer can resubmit the offer for reconsideration.

Reducing the number of applications that cannot be processed benefits both the taxpayers and the IRS. The IRS benefits because it can focus its resources on offers that can be processed. Taxpayers benefit because they spend less time responding to requests for additional information and improve their chances of obtaining an accepted offer. For example, in FY 2015, the IRS accepted nearly three times more offers than it rejected when it was able to work the case to conclusion.

We selected and reviewed a separate judgmental sample of 31 returned offers to determine why they were returned to the taxpayer.<sup>20</sup> Our review showed that the applications were returned to the taxpayers for various reasons, and nearly half were returned for multiple reasons. A majority were returned due to a missing payment. Specifically, 16 applications were returned because the taxpayer did not include the application fee or the down payment with the offer. Other reasons included missing supporting documentation, taxpayers who applied but were not current with their tax filing and payment obligations, and applications that were filed solely to delay collection action. Periodic refinement of the language and information in the OIC applications could help reduce the number of applications that need to be returned to taxpayers.

### **Untimely initial contact on OIC cases**

If the offer can be processed, a confirmation letter is sent to inform the taxpayer that he or she will be contacted within 120 days regarding his or her application. The offer case is then sent to be worked at one of the COIC sites or transferred to Field Collection if the case meets certain

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<sup>18</sup> The point estimate projection is based on a two-sided 90 percent confidence interval. We are 90 percent confident that the number of taxpayers is between 5,119 and 9,980.

<sup>19</sup> Internal Revenue Code § 7122(e)(1) and (2).

<sup>20</sup> A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.



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criteria.<sup>21</sup> Our case review showed that the taxpayer was not contacted by the initial 120-day contact date in 18 (10 percent) of 190 of the sample cases. On average, the untimely initial contact was made in 161 days, with a range of 124 days to 208 days. Based on our sample results, we estimate that 5,466 taxpayers who submitted offer applications in FY 2013 and FY 2014 were not contacted by the date promised by the COIC site or Field Collection staff.<sup>22</sup> The NQRS and EQRS reviews include verification of timely actions.

When the initial 120-day contact is not met, the IRM requires that an interim letter be sent or telephone contact be made to notify the taxpayer of a new contact date. The letter advises the taxpayer that contact will be made within 90 days from the date of the interim letter.<sup>23</sup> Currently, there is a systemic process for generating interim letters for unassigned OIC cases that eliminates the possibility of employees failing to send the letter in a timely manner. However, the systemic process does not apply to cases that have been assigned to an employee to determine the acceptability of the offer. For the assigned cases, the interim letters have to be prepared manually. For the cases that did not include contact by the date promised in the initial letter, we reviewed the case history and researched the Integrated Data Retrieval System to determine if a follow-up interim letter was sent to the taxpayer or a telephone call was made to inform the taxpayer of the delay. Our review showed that an interim letter was not sent for 18 cases for which the initial 120-day contact was not met. Our observations are consistent with several operational reviews of the OIC program conducted by the Small Business/Self-Employed Division in FYs 2013 and 2014 that also identified concerns with informing taxpayers of delays with their offers.

The IRM requires that initial offer actions be completed within 30 calendar days<sup>24</sup> of the date an offer is assigned to an offer employee.<sup>25</sup> Once the initial analysis is complete, the employee may contact the taxpayer for additional information.<sup>26</sup> If a case is assigned between 91 and 120 days, the interim letter will not be sent because they are sent systemically only for unassigned cases. On these assigned cases, unless the employee is able to complete the initial actions before the 120 day promised contact date has expired or send an interim letter to notify the taxpayer that contact will be delayed, taxpayer contact within the 120 days will not be met. For example, an offer case is assigned to an employee 110 days after the initial letter was sent informing the taxpayer that he or she will be contacted within 120 days, but because the employee has 30 days

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<sup>21</sup> Reasons why cases will be transferred to Field Collection include: corporations; employment tax from partnerships; estates and trusts; currently incarcerated taxpayers; any business with employees; individual taxpayers whose primary source of income is from a partnership; sole proprietors with gross receipts more than \$500,000; and International taxpayers.

<sup>22</sup> The point estimate projection is based on a two-sided 90 percent confidence interval. We are 90 percent confident that the number of taxpayers is between 3,588 and 7,915.

<sup>23</sup> IRM 5.8.3.10(12) (July 28, 2015).

<sup>24</sup> In situations where the Field Offer Specialist is not in the same location as the group manager, an additional five days will be allowed from the assignment date to complete the initial case actions.

<sup>25</sup> IRM 5.8.4.7(1) (Jan. 1, 2015).

<sup>26</sup> IRM 5.8.4.8(1) (Jan. 1, 2015).



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to start working the case, the employee may be unaware that the promised contact date was missed until 140 days after the initial letter.

The NQRS reviews include verification that the interim letter was sent if the taxpayer was not contacted within 120 days. The EQRS reviews do not include verification of the interim letter; however, they do include verification that employees meet the 30-day requirement to begin working the offer case. Of the 18 offer cases that we identified as not receiving an interim letter:

- \*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*;  
\*\*\*\*\*1\*\*\*\*\*
- \*\*1\* cases were assigned between 90 and 120 days of the initial contact letter. According to IRS management, the interim letters are now sent when a case is in the holding inventory file for 75 days. If cases are assigned, management is responsible for issuing an interim letter allowing the employee to complete their initial offer actions.
- \*1\* cases were assigned more than 120 days after the initial contact date. According to IRS management, \*\*\*\*\*1\*\*\*\*\* cases were before a new procedure for working errors from the systemic issuance process was implemented. The remaining \*1\* offers were processed by \*\*\*\*\*3\*\*\*\*\*  
\*\*\*\*\*3\*\*\*\*\*.

IRS management advised us that they did not meet the time frames for initial processing and taxpayer contact because of attrition, staffing issues, training concerns, and the Government shutdown for 16 calendar days in October 2013. These delays in OIC processing could impede the taxpayers' ability to make other financial decisions while waiting for a decision on the offer or jeopardize the taxpayers' ability to pay the amount they initially offered because their financial circumstances could change. Consistent and timely treatment of OIC ensures that taxpayers are treated equitably.

## ***Recommendations***

The Director, Collection Policy, Small Business/Self-Employed Division, should:

**Recommendation 1:** Remind employees of the requirement to complete the processing determinations within the required 16 days and taxpayer contact within 120 days.

**Management's Response:** IRS management agreed with this recommendation. Management agreed to issue a memorandum reminding employees and managers that processing determinations must be completed within 16 days of IRS receipt, and taxpayer contact must be made within 120 days of the confirmation letter date or 90 days of the most recent interim letter, whichever is later.





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**Recommendation 2:** Ensure that employees are aware of the requirements for sending interim letters when the initial 120-day contact date is not met. This includes reminding employees of the procedures for working error reports and managers of their responsibility to verify that the interim letters are sent when required.

**Management's Response:** IRS management agreed with this recommendation. Within the same memorandum as outlined in the response to Recommendation 1, management will remind managers and employees that an interim letter must be sent if contact is not made with the taxpayer 120 days from the date of the confirmation letter. The memorandum will also remind employees of the procedures for working the error report, which alerts them to situations in which the systemic process did not generate the required interim letter so they can manually send the letter.

**Alternate Payment Methods Were Not Always Discussed When Offers Were Closed Other Than Accepted**

The IRM provides that when an OIC investigation is being closed as other than accepted, the employee should discuss with the taxpayer alternative resolutions to pay the balance due.<sup>27</sup> If an agreement is not reached with the taxpayer, the employee should take the appropriate actions to assign the balance due account to the appropriate function or report the account as uncollectible. The employee should document the case history with the proposed actions to be taken on the taxpayer's account for any remaining liability. An employee can report the account as uncollectible if current payment would create an undue hardship, the taxpayer is deceased and there is no probate, or the taxpayer is now unable to be located. For NQRS reviews of Field Collection OIC cases, reviewers must verify that the file includes documentation that alternative resolutions were discussed with the taxpayer. However, the NQRS review for COIC site OIC cases does not specifically include this requirement.

Our case review of rejected offer cases showed that 10 (11 percent) of 92 cases did not include any documentation that alternative resolutions were discussed with the taxpayer. The majority of the 10 cases were closed by the COIC site. Our observations are consistent with several operational reviews of the OIC program conducted by the Small Business/Self-Employed Division in FYs 2013 and 2014, which also identified concerns with alternate resolutions discussions.

IRS management stated that employees may be discussing the alternative resolutions with taxpayers but are not documenting the discussions in the case histories. Without alternatives being discussed with the taxpayer and not considering if the account will become uncollectible in the offer determination process, potential revenue may not be collected.

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<sup>27</sup> IRM 5.8.7.10 (Mar. 7, 2014).



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## **Recommendation**

**Recommendation 3:** The Director, Collection Policy, Small Business/Self-Employed Division, should update the COIC site NQRS guidance to specifically include verification that alternative resolutions were discussed with taxpayers when an offer is not accepted. Additionally, management should emphasize the need to verify that employees discuss alternate resolutions in operational reviews of subordinate managers and in refresher training.

**Management's Response:** IRS management agreed with this recommendation. Management will add or revise COIC NQRS guidance to include verification that alternative resolutions were discussed with the taxpayer when applicable. IRS management will also conduct alternative resolution refresher training. In addition, the Director, Specialty Collection, Offers, Liens, and Advisory, will include a discussion of alternative resolutions in operational reviews and issue communication to OIC program managers requiring alternative resolutions to be addressed in operational reviews of subordinate managers.





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## **Appendix I**

### *Detailed Objective, Scope, and Methodology*

Our overall objective was to determine whether OICs were timely and appropriately processed.<sup>1</sup> To accomplish this objective, we:

- I. Reviewed Collection function reviews of the OIC program to identify any significant issues affecting the processing of OICs.
- II. Determined if offers are being appropriately and timely processed to ensure that all taxpayers submitting an offer are being treated equitably.
  - A. Selected a random statistical sample of offer cases from the total population of 60,740 offers closed as accepted or rejected in FYs 2013 and 2014.<sup>2</sup> We used random sampling so that we could project our results to the population. This population consisted of 51,001 offers closed as accepted and 9,739 offers closed as rejected.<sup>3</sup> We selected two separate random samples for a total of 190 offer cases (98 accepted cases and 92 rejected cases) using a 90 percent confidence level, a 10 percent error rate, and a  $\pm 5$  percent precision factor. The Treasury Inspector General for Tax Administration's contracted statistician reviewed and assisted in developing the sampling plans and projections.
  - B. Reviewed the cases to determine if OIC processing requirements were consistently followed.
    1. Determined if the offer was timely processed after it was received and the taxpayer was sent the initial contact letter.
    2. If taxpayer contact was not made by the date in the initial letter, determined if an interim letter was sent to the taxpayer with a new contact/follow-up date.
    3. Determined whether alternate payment methods were discussed with the taxpayers for those offers that were rejected.
- III. Determined if the offers received by taxpayers claiming relief from payroll service providers who failed to pay their business payroll taxes were appropriately considered.
  - A. We identified those payroll service provider related offers that were rejected, returned, or withdrawn.

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<sup>1</sup> See Appendix V for a glossary of terms.

<sup>2</sup> The total population used for sample selection excludes appealed cases and payroll service provider related cases.

<sup>3</sup> For purposes of this report, each offer case is considered as "one taxpayer" and "one taxpayer account" even though each case or account may in fact concern multiple taxpayers, as in the case of joint filers.



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*Important Improvements Have Been  
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- B. Determined whether the decision made to reject or return the offer was justified.
  - C. Reviewed a judgmental sample of 41 accepted payroll service provider related offers from the population of 68 to determine if the cases were worked and processed differently from those cases that were not accepted. We used judgmental sampling because we did not intend to project the results to the population.
- IV. Determined the IRS efforts to promote OICs to taxpayers.
- A. Viewed the IRS YouTube video used to promote OICs to the general public.
  - B. Tested the OIC prequalifier tool accessible through the IRS.gov website to determine whether the tool would inform taxpayers of their offer eligibility using a judgmental sample of 13 rejected and 13 accepted offers. The population consisted of 51,001 offers closed as accepted and 9,739 offers closed as rejected. We used judgmental sampling because we wanted to test the accuracy of the online tool but did not need to project the results to the population.
  - C. Reviewed balance due notices that are sent to taxpayers to verify whether an OIC is mentioned as a payment option.
- V. Reviewed a judgmental sample of 31 offers closed as returned to identify the reasons why the offer was returned to the taxpayer. The population consisted of 42,850 offers closed as returned during FYs 2013 and 2014. We used judgmental sampling because we did not intend to project the results to the population.

**Data validation methodology**

During this review, we evaluated the reasonableness of the FYs 2013 and 2014 closed OIC population by comparing the Treasury Inspector General for Tax Administration Data Center Warehouse totals with the FYs 2013 and 2014 IRS Collection Activity Report, *Monthly Report of Offer in Compromise Activity*, Report Symbol NO-5000-108, totals. The comparison supported that the data were sufficiently reliable and could be used to meet the objective of this audit.

**Internal controls methodology**

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: the Small Business/Self-Employed Divisions' policies, procedures, and practices for receiving, reviewing, and making a decision on OIC applications. We evaluated these controls by interviewing IRS management and Collection function employees, reviewing documentation, and reviewing the IRS website.



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## **Appendix II**

### *Major Contributors to This Report*

Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations)  
Carl Aley, Director  
Beverly Tamanaha, Audit Manager  
Michael Garcia, Lead Auditor  
Julian O'Neal, Senior Auditor  
Erik Martinez, Auditor



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## **Appendix III**

### *Report Distribution List*

Commissioner  
Office of the Commissioner – Attn: Chief of Staff  
Deputy Commissioner for Services and Enforcement  
Director, Collection  
Director, Field Collection, Small Business/Self-Employed Division  
Director, Headquarters Collection, Small Business/Self-Employed Division  
Director, Office of Audit Coordination



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## **Appendix IV**

### *Outcome Measures*

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

#### **Type and Value of Outcome Measure:**

- Taxpayer Burden – Potential; 7,288 taxpayers affected (see page 4).

#### **Methodology Used to Measure the Reported Benefit:**

We selected two separate random statistical samples for a total of 190 OIC cases (98 accepted cases and 92 rejected cases) from the total population of 60,740 offers<sup>1</sup> closed as accepted or rejected in FYs 2013 and 2014.<sup>2</sup> This population consisted of 51,001 offers closed as accepted and 9,739 offers closed as rejected. We selected this type of sample so that we could project our results to the population of offers for this time period.

Our case review showed that the processing determination for 24 (13 percent) of 190 sampled cases was not completed within the required 16 days. On average, the late determinations were completed in 24 days, with a range of 19 days to 32 days. Based on our sample results, we estimate that 7,672 offers that affected 7,288 taxpayers who submitted offer applications in FYs 2013 and 2014 may not have had the processing determination made timely. To project the results of our statistical sample, we used a 90 percent confidence level, a 12 percent error rate, and a  $\pm 4$  percent precision factor. The point estimate projection is based on a two-sided 90 percent confidence interval. We are 90 percent confident that the number of taxpayers is between 5,119 and 9,980.

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<sup>1</sup> For purposes of this report, each offer case is considered as “one taxpayer” and “one taxpayer account” even though each case or account may in fact concern multiple taxpayers, as in the case of joint filers.

<sup>2</sup> The total population used for sample selection excludes appealed cases and payroll service provider related cases.



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**Type and Value of Outcome Measure:**

- Taxpayer Burden – Potential; 5,466 taxpayers affected (see page 4).

**Methodology Used to Measure the Reported Benefit:**

We selected two separate random statistical samples for a total of 190 OIC cases (98 accepted cases and 92 rejected cases) from the total population of 60,740 offers<sup>3</sup> closed as accepted or rejected in FYs 2013 and 2014.<sup>4</sup> This population consisted of 51,001 offers closed as accepted and 9,739 offers closed as rejected. We selected this type of sample so that we could project our results to the population of offers for this time period.

Our case review showed that the taxpayer was not contacted by the initial 120-day contact date in 18 (10 percent) of 190 of the sample cases. On average, the untimely initial contact was made in 161 days, with a range of 124 days to 208 days. Based on our sample results, we estimate that 5,754 offers that affected 5,466 taxpayers who submitted offer applications in FYs 2013 and 2014 may not have been contacted by the date promised by the COIC site or Field Collection staff. To project the results of our statistical sample, we used a 90 percent confidence level, a 9 percent error rate, and a  $\pm 3.5$  percent precision factor. The point estimate projection is based on a two-sided 90 percent confidence interval. We are 90 percent confident that the number of taxpayers is between 3,588 and 7,915.

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<sup>3</sup> For purposes of this report, each offer case is considered as “one taxpayer” and “one taxpayer account” even though each case or account may in fact concern multiple taxpayers, as in the case of joint filers.

<sup>4</sup> The total population used for sample selection excludes appealed cases and payroll service provider related cases.



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## Appendix V

### Glossary of Terms

Term	Definition
<b>Campus</b>	The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.
<b>Collection Activity Reports</b>	Reports that provide Collection activity information from the beginning of the fiscal year through the end of the current reporting month.
<b>Field Collection</b>	The unit in the area offices consisting of revenue officers who handle personal contacts with taxpayers to collect delinquent accounts or secure unfiled returns.
<b>Fiscal Year</b>	Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.
<b>Installment Agreement</b>	Arrangement in which a taxpayer agrees to pay his or her tax liability over time.
<b>Integrated Data Retrieval System</b>	The IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.
<b>Internal Revenue Manual</b>	The primary, official source of instructions to staff relating to the organization, administration, and operation of the IRS.
<b>Offer in Compromise</b>	An agreement between a taxpayer and the Government that settles a tax liability for payment of less than the full amount owed.
<b>Payroll Service Provider</b>	A third party paid by an employer to administer the employer's payroll and employment tax responsibilities.
<b>Revenue Officer</b>	Employees in the Field who attempt to contact taxpayers and resolve collection matters that have not been resolved through notices sent by the IRS campuses or the Automated Collection System.





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**Appendix VI**

*Management's Response to the Draft Report*



COMMISSIONER  
SMALL BUSINESS/SELF-EMPLOYED DIVISION

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

AUG 11 2016

MEMORANDUM FOR MICHAEL E. MCKENNEY  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Karen Schiller   
Commissioner Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Important Improvements Have Been Made  
in the Offer in Compromise Process; However, Additional  
Efficiencies Can Be Gained (Audit #201530016)

Thank you for the opportunity to review the subject draft report. We appreciate your acknowledgement of the changes we have made to improve the offer in compromise (OIC) program in recent years, which include updating the application forms and creating an online "pre-qualifier" tool. This easy to use online tool helps taxpayers determine whether they meet basic eligibility requirements, are a good offer candidate given their financial circumstances, and what a reasonable offer might be given their circumstances. Taxpayers who use the tool have a higher acceptance rate than those who do not. Since the implementation of Fresh Start procedures in 2012, the OIC acceptance rate as a percentage of dispositions has increased from 34 percent in fiscal year 2011 to 44 percent in fiscal year 2015. As you noted, we have also worked to get the message out about OICs through our National Tax Forums, periodic news releases, YouTube videos and Twitter feeds in order to encourage more taxpayers to consider whether offers would benefit them.

Timely case processing is an important component of customer satisfaction and case quality, and while our timeliness overall is good, you identified areas for improvement. You found instances in which the preliminary review of the OIC application was not completed within the required timeframe. Initial contacts by offer employees were timely in 90 percent of the cases you reviewed, but there were instances in which the initial contact was made outside of the required 120-day period. An interim letter is required to be sent when the initial contact will be made late; however, in some instances we did not send the letter. As we shared with you during the audit, events such as attrition, staffing issues, and government shutdown have had an impact on our ability to meet our established timeframes for making these contacts. We have agreed with your recommendation to issue a memorandum reminding employees and managers of timeliness requirements and of the need to issue the interim letter.





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When an OIC is closed as other than accepted, employees should discuss alternative resolutions for resolving the tax delinquency with the taxpayer. Our employees discussed alternative resolutions in 89 percent of the cases you reviewed. We have agreed to reinforce this requirement through refresher training, quality review guidance, and operational reviews.

In closing, we appreciate your continued support and insight as we strive to further strengthen our OIC program. Attached is a detailed response outlining our corrective actions. If you have any questions, please contact me, or a member of your staff may contact Scott Prentky, Director Collection at (954)-423-7318.

Attachment



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Attachment

**RECOMMENDATION 1:**

The Director, Collection Policy, Small Business/Self-Employed Division, should remind employees of the requirement to complete the processing determinations within the required 16 days and taxpayer contact within 120 days.

**CORRECTIVE ACTION:**

We agree to issue a memorandum reminding employees and managers that processing determinations must be completed within 16 days of IRS receipt and taxpayer contact must be made within 120 days of the combo letter date or 90 days of the most recent interim letter, whichever is later.

**IMPLEMENTATION DATE:**

November 15, 2016

**RESPONSIBLE OFFICIAL:**

Director, Collection Policy, Small Business/Self-Employed Division (SB/SE)

**CORRECTIVE ACTION MONITORING PLAN:**

IRS will monitor this corrective action as part of our internal management system of controls.

**RECOMMENDATION 2:**

The Director, Collection Policy, Small Business/Self-Employed Division, should ensure that employees are aware of the requirements for sending interim letters when the initial 120 day contact date is not met. This includes reminding employees of the procedures for working error reports and managers of their responsibility to verify that the interim letters are sent when required.

**CORRECTIVE ACTION:**

Within the same memorandum as outlined in the response to Recommendation 1, we will remind managers and employees that an interim letter must be sent if contact is not made with the taxpayer 120 days from the date of the combo letter. The memorandum will also remind employees of the procedures for working the Generalized Integrated Data Retrieval System (IDRS) Interface error report. This report alerts us to situations in which the systemic process does not generate the required interim letter so we can manually send the letter.

**IMPLEMENTATION DATE:**

November 15, 2016



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*Important Improvements Have Been  
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2

**RESPONSIBLE OFFICIAL:**

Director, Collection Policy, Small Business/Self-Employed Division (SB/SE)

**CORRECTIVE ACTION MONITORING PLAN:**

IRS will monitor this corrective action as part of our internal management system of controls.

**RECOMMENDATION 3:** The Director, Collection Policy, Small Business/Self-Employed Division, should update the Centralized Offer In Compromise (COIC) site National Quality Review System (NQRS) guidance to specifically include verification that alternative resolutions were discussed with taxpayers when an offer is not accepted. Additionally, management should emphasize the need to verify that employees discuss alternate resolutions in operational reviews of subordinate managers and in refresher training.

**CORRECTIVE ACTIONS:**

1. We will add or revise COIC NQRS guidance to include verification that alternative resolutions were discussed with the taxpayer when applicable.
2. We will conduct alternative resolution refresher training. In addition, the Director, Specialty Collection, Offers, Liens, and Advisory, will include a discussion of alternative resolutions in operational reviews and issue communication to OIC program managers requiring alternative resolutions to be addressed in operational reviews of subordinate managers.

**IMPLEMENTATION DATE:**

1. February 15, 2017
2. February 15, 2017

**RESPONSIBLE OFFICIALS:**

1. Director, Collection Policy, Small Business/Self-Employed Division (SB/SE)
2. Director, Specialty Collection, Offers, Liens, and Advisory, Small Business/Self-Employed Division (SB/SE)

**CORRECTIVE ACTION MONITORING PLAN:**

IRS will monitor this corrective action as part of our internal management system of controls.