**DANIEL S. ROSEFELT** is an Attorney and Certified Public Accountant with more than two decades of experience resolving complex civil and criminal tax controversies.

# Practice

## *Doubt as to Liability Offer in Compromise: An Under-Utilized Tool for Correcting IRS Assessments*

By Daniel S. Rosefelt*

A potential client meets with you to discuss an IRS levy notice. Initial consultation reveals an IRS CP504 Notice of Intent to seize (levy) property or rights to property. You ask if there are any other notices and a stack of unopened notices is set upon the desk. They mention being behind in filing a few years of tax returns. Amongst the letters, is a Statutory Notice of Deficiency ("SNOD").[1] You explain the deadline to file a petition in U.S. Tax Court within 90 days was missed and the IRS filed "ghost returns," or Substitute for Returns ("SFRs").[2] As a result, the IRS assessed tax, penalties and interest without taking account many potential deductions.[3]

This is an all too familiar and common situation that can result in enormous assessments based on information reported to the IRS (*e.g.* Form 1099, K-1, *etc.*), without considering deductions, cost basis, gain exclusions or other lawful offsets. Adding insult to injury, the delinquency is subject to the failure to file and failure to pay penalties resulting in mind-boggling assessments.[4]

In addition to an SFR, there are other situations where taxpayers may need to correct an assessment:

- Did not appear for an audit and failed to file a timely petition in the U.S. Tax Court in response to a SNOD;
- Failed to respond to an IRS Math or Clerical Error Notice or CP2000 issued by the Automated Under Reporter (AUR) program proposing changes to a tax return;[5]
- Failed to file an administrative appeal of a Trust Fund Recovery Penalty ("TFRP");[6] or
- Employer's Quarterly Tax Return Form 941 assessed by estimate.[7]

## Assessment Correction Options

Under current law, a taxpayer seeking to correct or challenge the merits of a tax assessment has limited options:

  

### Claim for Refund

A taxpayer can seek judicial review by paying the assessment and filing an administrative claim for refund with the IRS. Upon denial or if no action is taken within 6 months, file a refund law suit in U.S. District Court or U.S. Court of Federal Claims.[8] Filing a refund claim and law suit is often not a realistic option because the economics of paying the delinquent tax and hiring an attorney to prosecute a federal case can be cost prohibitive.

### Bankruptcy

A taxpayer can potentially file bankruptcy and seek redetermination of the tax assessment.[9] However, few taxpayers are enthusiastic about filing bankruptcy unless there are other serious financial issues and/or IRS collection enforcement becomes unmanageable requiring protection under the automatic stay provisions of the bankruptcy code.[10]

*The DATL OIC program is an unusual process.*

### Audit Reconsideration

Audit Reconsideration is a discretionary IRS process to reevaluate and potentially correct a prior assessment.[11] Generally, the IRS will abate an unpaid assessment of tax which is excessive, assessed after expiration of the limitations periods, or erroneously or illegally assessed.[12] Audit Reconsideration is an uncertain process with no legal right to a collection hold, putting the taxpayer in a compromising and risky situation for an indeterminant period.[13]

### Doubt as to Liability Offer in Compromise

A Doubt As to Liability Offer In Compromise ("DATL OIC") is very different than a Doubt As to Collectability Offer In Compromise ("DATC OIC"). In a DATC OIC, the taxpayer does not dispute the amount of tax owed. Instead, the taxpayer submits he or she does not have an ability to pay all or part of the tax delinquency and wants to compromise with the government based on their Reasonable Collection Potential. In a DATL OIC, the taxpayer disputes the amount of tax owed and submits an offer for what the correct tax liability should be. Ability to pay is not an issue. No collection information statement Form 433 is submitted and there is no filing fee.[14] The amount offered is what the correct tax liability should be. Upon processing of the request, a collection hold is placed on the account by law—not by IRS discretion.[15] For this reason alone, a DATL OIC can provide a significant advantage in correcting tax assessments.

## How Does a DATL OIC Work?

Pursuant to Code Sec. 7122(a) and (d)(3)(B), the IRS may compromise a case which relates to issues of liability of a taxpayer. Under Reg. §301.7122-1(b)(1):

> Doubt as to liability exists where there is a genuine dispute as to the existence or amount of the correct tax liability. Doubt as to liability does not exist where the liability has been established by a final court decision or judgment concerning the existence or amount of the liability.

Additionally, "[of]fers submitted on the basis of doubt as to liability cannot be rejected solely because the IRS is unable to locate the taxpayer's return or return information for verification of the liability."[16]

A DATL OIC is commenced upon submission of a completed IRS Form 656-L including:

- A written statement explaining why the tax assessment is incorrect;
- Supporting documentation or evidence;
- An explanation supporting reasonable doubt justifying reduction of the tax debt if unable to reconstruct books and records; and
- Must be signed by the taxpayer under penalty of perjury.[17]

The DATL OIC will be returned and not processed if the above information is not included, if it is determined the offer was submitted solely to delay collection or is otherwise not processable.[18] The offer should be based on what the correct amount of tax should be. If no tax is believed to be owed, the offer should be for $1. No deposit or application fee is required. The DATL OIC should include only the tax years at issue and not submitted contemporaneously with a DATC OIC or Effective Tax Administration OIC. Additionally, a DATL OIC should not be submitted for any year involving a pending request for Audit Reconsideration.

Upon processing the DATL OIC, the IRS Collection Division will enter the collection hold and transfer the case to the examination division where it is typically assigned to an examiner.[19] An advantage of a DATL OIC over Audit Reconsideration, is that the taxpayer has specific person to work with to resolve the case. In evaluating DATL OIC cases, the IRS considers "doubt as to liability" and "hazards of litigation." DATL OIC cases involving a TFRP assessment are processed by IRS Collections and not forwarded to Examinations.

The DATL OIC program is an unusual process. In a typical case, the IRS never actually "accepts" the DATL

OIC. Instead, the IRS approves the assessment correction, and responds with an IRS account transcript correcting the tax assessment. The IRS then requests the taxpayer to withdraw the DATL OIC without an actual acceptance. An OIC accepted for processing, will be deemed accepted if not rejected within 24 months.[20]

The situation described at the beginning of this column is an example of a typical SFR assessment, that this author has had corrected by DATL OIC on multiple occasions. To do so, IRS Form 656-L is submitted with an explanation of the circumstances, a draft tax return for computational purposes, supporting documents substantiating the return and a brief memorandum explaining the law and facts entitling the taxpayer to an adjustment. A cover letter sets forth: (i) that the DATL OIC cannot be rejected solely because the IRS is unable to locate the taxpayer's return per Reg. §301.7122-1(f)(4) and (ii) that a collection hold shall be placed on the account under Reg. §301.7122-1(g). Otherwise, the IRS sometimes mistakenly rejects the offer for processing and requests the tax return be submitted for audit reconsideration.

Although the instructions to Form 656-L sets forth that an SFR should be submitted for audit reconsideration, this is not binding. Under Code Sec. 7122 and Reg. §301.7122, the IRS is required to process the DATL OIC, enter a collection hold and cannot reject even though no previous tax return was filed.

*This author has found the DATL OIC process one of the best ways to correct IRS assessments where the taxpayer has failed to timely file a Tax Court Petition.*

## Conclusion

This author has found the DATL OIC process one of the best ways to correct IRS assessments where the taxpayer has failed to timely file a Tax Court Petition. There are practical advantages over other methods including no requirement to pre-pay the disputed tax, a legal right to a collection hold and assignment to an IRS Examiner who can be directly communicated with.



### ENDNOTES

* Daniel S. Rosefelt represents individuals and businesses in the Washington D.C. Metropolitan, in Florida and throughout the United States. He has spoken at national tax controversy forums for tax attorneys, CPA's and Enrolled Agents. He also has served as Adjunct Professor of Law for Federal Income Tax Law, and for Legal Research & Writing at Stetson University College of Law, where he graduated with honors and was a published member of Law Review. He can be reached by email at *drosefelt@rosefeltlaw.com* or telephone (301) 656-4424.

1 If the IRS determines there is a tax deficiency, Code Sec. 6212(a) authorizes the IRS to send a notice of deficiency to a taxpayer.

2 Code Sec. 6020(b) authorizes the IRS to file tax returns for delinquent taxpayers based upon available information; however, the IRS can only assess income tax under the deficiency procedures set forth in Code Sec. 6213.

3 Code Sec. 6213(c) generally authorizes the IRS to assess the deficiency set forth in the notice under Code Sec. 6212(a) if the taxpayer fails to file a petition within 90 days.

4 Code Sec. 6651 authorizes the IRS to assess an addition to tax a penalty for failure to file a tax return or pay tax. The failure to file penalty is 5% per month of the amount due on the return per month past the due date of the return with a maximum 25% penalty. The failure to pay penalty is 0.5% per month of the delinquent balance with a maximum 25% penalty.

5 Absent a request for Abatement within 60 days, Code Sec. 6213(b) and (g) grants an exception to the deficiency requirement for math and clerical error corrections and provides the IRS authority to assess and collect tax without providing a right to first go to U.S. Tax Court.

6 The TFRP is a penalty provide by Code Sec. 6672 against any person required to collect, account for, and pay over taxes held in trust who willfully fails to perform any of these activities in connection with employment taxes. *See* IRM §5.7.3.1.1 (08-06-2015).

7 Payroll withholding taxes may be assessed without following the deficiency procedures. Code Secs. 6212(a) and 6213.

8 *See* Code Secs. 6511, 6532 and 7422.

9 *See* 11 USC §505 Determination of Tax Liability.

10 *See* 11 USC §362 Automatic Stay.

11 *See* IRM §4.13.16 (12-16-2015).

12 *See* Code Sec. 6404(a) Abatements.

13 IRS Publication 3598 sets forth that "[w]hen we receive your documentation, we may delay our collection activity. However, we may resume collection activity if the documentation is not sufficient to support your position and you do not respond to any requests for additional information within 30 calendar days."

14 Reg. §301.7122-1(d)(1).

15 Reg. §301.7122-1(g)(1).

16 Reg. §301.7122-1(f)(4).

17 Reg. §301.7122-1(d)(1).

18 Reg. §§301.7122-1(d)(2) and (g)(4).

19 Reg. §301.7122-1(g).

20 Code Sec. 7122(f).



  