

April 2006

# IRS OFFERS IN COMPROMISE

Performance Has  
Been Mixed; Better  
Management  
Information and  
Simplification Could  
Improve the Program



G A O

Accountability \* Integrity \* Reliability



Highlights of [GAO-06-525](#), a report to the Committee on Finance, U.S. Senate

### Why GAO Did This Study

Taxpayers unable to fully pay their tax liabilities may apply for an offer in compromise (OIC), an agreement with IRS to pay what they can afford. IRS writes off the rest of the liability. In 2005, IRS accepted over 14,000 offers. Because of concerns about program performance and a new category of offers based on exceptional circumstances, GAO was asked to (1) describe the trends in program's performance and their causes and (2) determine whether IRS's regulations for exceptional circumstance offers are consistent with statute. GAO examined five program objectives: timeliness, quality, accessibility, compliance, and cost.

### What GAO Recommends

GAO recommends that IRS (1) measure accessibility, compliance, and timeliness by taxpayer; (2) set timeliness goals by taxpayer; (3) analyze causes of trends in repeat offers, timeliness, and accessibility; (4) adjust staffing to correspond with workload; and (5) eliminate the distinction between most exceptional circumstances offers and offers based on inability to fully pay.

IRS partially agreed with our recommendations. IRS agreed to consider tracking compliance, study repeat offers, and reduce staffing. IRS did not agree to measuring or set goals for timeliness from the perspective of taxpayers. IRS said it will study whether our other recommended changes should be implemented. [www.gao.gov/cgi-bin/gettrf?GAO-06-525](http://www.gao.gov/cgi-bin/gettrf?GAO-06-525).

To view the full product, including the scope and methodology, click on the link above. For more information, contact James R. White at (202) 512-9110 or [whitej@gao.gov](mailto:whitej@gao.gov).

## IRS OFFERS IN COMPROMISE

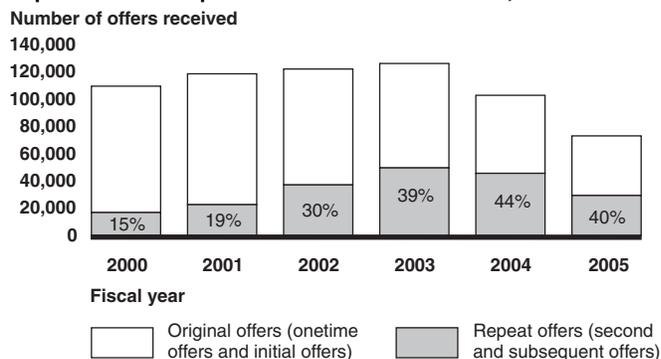
### Performance Has Been Mixed; Better Management Information and Simplification Could Improve the Program

#### What GAO Found

OIC Program performance has been mixed. Timeliness improved for taxpayers making one offer to 5.8 months in 2005 but stayed constant, at an average of two years, for those making repeat offers. Quality goals have been met but IRS does not routinely track compliance and accessibility. Further, cost per offer has increased in that IRS has not decreased staffing since fiscal year 2003 in proportion to declines in offers. Improving the program depends on how well IRS management understands the reasons for the program's performance. One step in understanding performance is measuring it. However, IRS does not measure timeliness from the perspective of the taxpayer—for taxpayers with repeat offers IRS measures the time to decide each offer but not the overall time to resolve the taxpayer's liability. IRS lacks compliance and accessibility trend data useful for assessing performance. Another step in understanding performance is setting goals. IRS set numeric goals for timeliness and quality, but IRS's timeliness goals do not have a rationale and are not based on taxpayer needs or other benefits. A third step in understanding performance is analysis. While IRS has done some analyses that led to program changes, IRS has not analyzed the effect of repeat offers on timeliness to determine whether it would be less costly to deal once with a taxpayer rather than have to process repeat offers. IRS also has not analyzed whether the decrease in offers accepted since fiscal year 2003 reflects a decrease in program accessibility, or whether the efforts to improve the compliance of program participants have been successful.

IRS's regulations for exceptional circumstance offers, intended for taxpayers who can fully pay, are consistent with statute. However, most exceptional circumstance offers are granted to taxpayers who cannot fully pay. These offers are not meaningfully distinct from the more common offers based on inability to fully pay. The lack of distinction causes unnecessary program complexity and confusion. Taxpayers are faced with the paradoxical process of proving that they can pay their tax liability and then explaining why they cannot.

**Repeat Offers Compared to Total Offers Received, Fiscal Years 2000-2005**



Source: GAO analysis of IRS's AOIC database.

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United States Government Accountability Office  
Washington, D.C. 20548

April 20, 2006

The Honorable Charles E. Grassley  
Chairman  
The Honorable Max Baucus  
Ranking Minority Member  
Committee on Finance  
United States Senate

In fiscal year 2005, the Internal Revenue Service's (IRS) Offer in Compromise (OIC) Program reached agreements with taxpayers to accept over 14,000 offers. An OIC is an agreement in which IRS and a taxpayer agree to settle or compromise the taxpayers' federal tax liability for less than the full amount owed. Generally, IRS accepts offers in cases in which taxpayers cannot afford to pay their full tax liability. In 2005, the OIC Program accepted offers in which taxpayers paid on average 16 percent of their tax liability. IRS wrote off the rest of the liability, about \$1 billion, for those taxpayers.

For years, Congress has been concerned about the performance of the OIC Program. In 2002, we issued a report that you requested on the inventory of OIC cases and the quality and timeliness of decisions.<sup>1</sup> Since that time, concerns about performance, including the timeliness of offer processing, the quality of performance decisions, and the accessibility of the program to taxpayers, have persisted. Other concerns include whether offer mills (tax practitioners that consistently use negligent or deceptive practices to exploit taxpayers and the OIC Program by making misleading claims and submitting unrealistic offers) have been affecting program performance, whether taxpayers have been accorded their appeal rights granted in statute, and whether IRS has been using its authority to grant offers for exceptional circumstances as Congress intended. Offers are most commonly accepted when taxpayers cannot pay the full amounts they owe. These offers are called doubt as to collectibility (DATC) offers. According to IRS regulations, offers for exceptional circumstances, called effective tax administration (ETA) offers, are granted in cases where taxpayers can fully pay their tax liabilities but where collecting the full amount would create economic hardship or where compelling public policy or equity reasons provide sufficient basis for compromise. Because of these

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<sup>1</sup>GAO, *Tax Administration: IRS Should Evaluate the Changes to Its Offer in Compromise Program*, GAO-02-311 (Washington, D.C.: Mar. 15, 2002).

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concerns about the program, IRS instituted a number of initiatives intended to reduce unrealistic offers from taxpayers and improve program performance, including centralized processing of less complex cases, a revised application form, an offer application fee of \$150, and increased emphasis on taxpayer communication.

Because of your continuing interest in ensuring that IRS is administering the OIC Program as efficiently and effectively as possible, you requested this review. As agreed, the objectives of our review were to (1) describe the trends in OIC program size; (2) describe the trends in program performance and assess the extent to which IRS has researched the reasons for the trends; (3) assess whether offer mills affect taxpayers and OIC processing; (4) assess how well IRS ensures that taxpayers are provided the right to appeal a rejected offer; and (5) determine whether Treasury's ETA regulations are consistent with the provision of the IRS Restructuring and Reform Act of 1998 (Restructuring Act).<sup>2</sup> Near the end of our review, your staff asked that we comment on a legislative proposal that would require OIC applicants requesting an offer in compromise to make a partial payment.<sup>3</sup>

To address these objectives, we reviewed the Internal Revenue Manual (IRM) and an IRS policy statement<sup>4</sup> to determine the OIC Program's objectives; obtained a copy of IRS's Automated Offer in Compromise (AOIC) database, the primary management information system for the program; and used that database to develop trend data on the program. We performed various data reliability analyses and determined that the AOIC database was sufficiently reliable for the purposes of our work. We also obtained data from IRS on its program staffing levels and the results of its OIC case quality reviews. We interviewed program officials at IRS's Small Business/Self-Employed Operating Division headquarters in Washington, D.C., IRS's centralized OIC processing center in Brookhaven, New York, and IRS's Austin Compliance Center in Texas, which houses key OIC managerial operations and maintains the AOIC database. We also obtained

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<sup>2</sup>Pub. L. No. 105-206, 112 Stat. 685 (July 22, 1998).

<sup>3</sup>This provision is being considered with H.R. 4297, which has been passed by both the House and the Senate and was in conference as of April 6, 2006. Although not included in the original House bill, the Senate-passed version of H.R. 4297 incorporated certain additional provisions that were originally included in S. 2020, including this provision related to deposits for offers.

<sup>4</sup>This refers to IRS policy statement P-5-100.

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information from IRS's Office of the Chief Counsel, Office of Professional Responsibility (OPR), Office of Program Evaluation and Risk Analysis (OPERA), and the National Taxpayer Advocate (Taxpayer Advocate) of the Taxpayer Advocate Service, in Washington, D.C., and interviewed representatives from several tax practitioner organizations, the Federation of Tax Administrators, and an official from a state attorney general's office. Appendix I provides a more detailed description of the scope and methodology for this review, and appendix II provides technical details on how we analyzed the AOIC database. We performed our work from February 2005 through February 2006 in accordance with generally accepted government auditing standards.

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## Results in Brief

During fiscal years 2000 to 2005 the OIC Program decreased in size, according to a variety of measures, although the number of repeat offers—revised offers submitted by taxpayers after IRS closed their earlier cases—increased. IRS accepted over 14,000 offers in 2005, down by more than half from 2000. The amount of delinquent tax debt covered by accepted offers decreased to \$1.5 billion in 2005 (of which \$.24 billion was accepted in the compromises) from \$2.4 billion in 2000. During the same years, the number of repeat offers grew from about 20,000 to 31,000 and the proportion of offers received by IRS that were repeats more than doubled.

OIC Program performance relative to five objectives—timeliness, quality, accessibility, compliance, and cost—has been mixed. We identified the five objectives by reviewing the IRM and an IRS policy statement. IRS officials said that they track the program's performance for timeliness, quality, and cost and noted that although accessibility and compliance are not formally tracked, they are program aims.

- **Timeliness:** For taxpayers who submitted one offer, case processing time improved from 8.4 months on average in fiscal year 2000 to 5.6 months in 2005. For taxpayers who submitted repeat offers, processing time stayed at over 22 months from the first offer to the disposition of last offer. IRS does not measure or set goals for timeliness from the perspective of the taxpayer. It measures timeliness for each offer, but this masks the time taxpayers with repeat offers wait for a final disposition. In addition, IRS has not analyzed the reasons for the number or growth of repeat offers or their impact on timeliness. Without such an analysis IRS does not know whether it would be less costly to deal once with a taxpayer, even if it takes more time to work the single offer, than to process repeat offers.

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- **Quality:** According to its new quality measurement system, IRS met its case processing quality goals of 94 percent for less complex cases in fiscal year 2005, the first year for which data are available relative to a goal. IRS also met its quality goal of 84 percent for more complex cases, but is in the process of changing that measurement system. IRS measures quality according to whether case processing procedures are followed by the OIC Program staff.
  - **Accessibility:** Declines in OIC participation rates, combined with the concerns of outside observers, such as the Taxpayer Advocate and some tax practitioner organizations, raise questions about whether the offer program's accessibility has decreased. While not a direct measure of accessibility, which we define as the ease of participation in the OIC Program, participation rates might be an indicator of changes in accessibility. One measure of participation is the number of offers accepted relative to the number of delinquent taxpayers fiscal year. The number of accepted offers has gone down by more than half since fiscal year 2000 while the number of delinquent taxpayers has stayed roughly constant. IRS has not done an analysis of whether accessibility has changed and, if so, why. Without such an analysis, IRS will not know whether the questions raised by the declining participation rate should be of concern.
  - **Compliance:** While IRS monitors each accepted offer to determine if taxpayers fulfill the terms of their offer agreements and future tax filing and payment requirements, it does not routinely track overall compliance trends for all OIC program participants, including those whose offers were not accepted. IRS issued a study of compliance in 2004 and cited costs as a reason for not repeating it. However, we identified several lower cost methods for measuring compliance, including aggregating individual offer information IRS already collects. Aggregate compliance data would be useful because, in response to its compliance study, IRS created a new unit called the Hand-Off Unit to pursue collection actions with taxpayers whose offers were rejected or withdrawn. Without compliance data, IRS would be unable to determine the effectiveness of its new Hand-Off Unit or other improvement initiatives.
  - **Cost:** Offers closed declined faster than program staffing since fiscal year 2003. For example, from fiscal years 2003 to 2005, the number of less complex offers closed declined from almost 91,000 to 53,000 while

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the number of full-time equivalent staff (FTE)<sup>5</sup> assigned to those cases declined from 362 to 320. This represented a productivity decline of 251 cases closed per FTE to 165 and an increase in cost per case. For more complex offers, the productivity decline during these years was smaller, from 156 cases closed per FTE to 152. If IRS had maintained fiscal year 2003 productivity levels in fiscal year 2005, it would have needed about 117 fewer FTEs that could have been reallocated to other work.

Evidence of offer mills' impact on OIC processing and on taxpayers is limited because offers mills cannot easily be distinguished from legitimate practitioners. The available evidence suggests that the impact is not large. For example, an IRS study published in 2004,<sup>6</sup> while subject to limitations, found that a small number of offers submitted with the assistance of professional practitioners were abusive and concluded that offer mills were not driving abuse in the system.

IRS notifies taxpayers whose offers are rejected of their appeal rights through various channels, including the offer form instructions, the rejection letter, and the IRS Web site. In fiscal year 2004, more than half of the taxpayers whose offers were rejected by the OIC Program submitted appeals, indicating that many taxpayers were aware of their appeal rights.

IRS's ETA regulations are consistent with the provisions of the Restructuring Act, which are broadly written. The regulations were intended to expand the basis on which IRS would grant compromises and created two forms of ETA offers—hardship and non-hardship. From fiscal year 2001 to 2005, IRS accepted more than 400 ETA offers annually. In fiscal year 2005, IRS accepted 30 non-hardship ETA offers, up from 1 in fiscal year 2004. Hardship ETA offers are not meaningfully distinct from DATC offers. In both cases, the decision to accept the offer is based on taxpayers' assets, future income, and reasonable living expenses. The lack of distinction between hardship ETA offers and DATC offers causes unnecessary program complexity and confusion to taxpayers and tax practitioners. For example, taxpayers applying for hardship ETA offers are

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<sup>5</sup>An FTE generally consists of one or more employed individuals who collectively complete 2,080 hours work in a given year. Therefore, one full-time employee or two half-time employees equal one FTE.

<sup>6</sup>Department of the Treasury, Internal Revenue Service SB/SE Payment Compliance and Office of Program Evaluation and Risk Analysis, *IRS Offers in Compromise Program: Analysis of Various Aspects of the OIC Program* (Washington, D.C.: September 2004).

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faced with the paradoxical process of proving that they can pay the tax liability and then explaining why they cannot afford to pay it. Only non-hardship ETA offers are meaningfully distinct from DATC offers. Because of the broad language in the Restructuring Act, whether the number of non-hardship ETA offers satisfies Congress's intent is not clear.

A legislative proposal that would require taxpayers to make a partial payment with their offer applications raises several questions for IRS. For example, IRS would need to determine how the requirement would apply to taxpayers with repeat offers and whether it would affect the program's accessibility.

To better manage and simplify the OIC Program, we are recommending that IRS develop a more meaningful measure of timeliness, accessibility, and compliance; set timeliness goals that measure timeliness from the perspective of the taxpayer; determine the reasons for the trends in repeat offers, timeliness, and accessibility; determine the effectiveness of the Hand-Off Unit to conduct follow-up collection efforts on taxpayers whose offers were rejected or withdrawn; eliminate the distinction between hardship ETA and DATC offers; and reduce staff to increase productivity and reduce cost per offer. In addition, if Congress's intent regarding the number of non-hardship ETA offers has not been met, Congress should provide IRS with more specific guidance on the criteria for such offers.

In commenting on a draft of this report (see app. III), the Commissioner of Internal Revenue partially agreed with our recommendations. IRS agreed to explore methods for gathering compliance information, study repeat offers, and reduce staffing. IRS did not agree to measure or set goals for timeliness from the perspective of the taxpayer. In addition, IRS indicated that eliminating the distinction between economic hardship and doubt as to collectibility offers may not be the best approach but that it is open to suggestions on clarifying the offer instructions. The Commissioner said that IRS will study whether our other recommended changes should be implemented.

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## Background

Section 7122 of the Internal Revenue Code authorizes the Secretary of the Treasury to compromise tax delinquencies. The purpose of the OIC Program is to (1) collect what can be fairly and reasonably collected from taxpayers who cannot fully pay their delinquent tax liability, (2) collect the tax in a timely and cost-effective manner, and (3) provide taxpayers with a fresh start toward complying with all future tax filing and payment

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requirements. Generally, IRS views the OIC Program as a last resort after taxpayers have explored all other available voluntary payment options, such as installment agreements. IRS resolves less than 1 percent of all balance due accounts through the OIC Program.

In recent years, the OIC Program underwent numerous program changes intended to reduce the number of inappropriate offers submitted by taxpayers and improve its operations. The changes include the following. In 2001, IRS established the centralized OIC (COIC) processing centers in Brookhaven, New York, and Memphis, Tennessee, to reduce inventory and processing times and reduce costs. Process examiners, lower-grade staff at the COICs, perform the initial processing of new offer applications, which includes determining whether taxpayers' applications meet IRS's processability criteria. Offer examiners, higher-grade staff at these COICs, process less complex offers to completion by reviewing taxpayers' financial information and making decisions about whether to accept the offers. COICs primarily examine offers involving wage and investment income. Based on a pilot test, IRS plans to have COIC staff work some offers from taxpayers with self-employment income starting in the summer of 2006. More complex offers are sent to IRS field offices around the country where offer specialists, who are higher graded than offer examiners, work the offers to completion. These offers take longer to investigate and may require face-to-face meetings with the taxpayers. In 2003, IRS implemented an offer application fee requirement. Taxpayers submitting offer applications must include a \$150 fee unless they qualify for a fee waiver. In 2004, IRS revised the OIC application form to make it more user-friendly to taxpayers. In that same year, IRS management put more emphasis on communicating with taxpayers while processing offers. In addition to these program changes, the Restructuring Act also mandated a new basis for accepting offers ETA.

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### Three Types of Compromise

According to IRS regulations and guidance, compromises can be granted for one of the following three reasons:

- Doubt as to liability (DATL)—Doubt exists that the assessed tax liability is correct.
- DATC—Doubt exists that the taxpayer could ever pay the full amount of tax owed.

- 
- Effective Tax Administration (ETA)—No doubt exists that the taxpayer can fully pay the taxes owed, but exceptional circumstances nonetheless lead IRS to compromise.

IRS has two categories of ETA offers, hardship and non-hardship. According to IRS's regulations, hardship ETA offers are those that IRS grants because collecting the full liability would create economic hardship for the taxpayer, while non-hardship ETA offers are granted on a basis of equity and public policy. (How economic hardship qualifies a taxpayer for an ETA offer will be addressed later in the report.) According to IRS, equity and public policy considerations may be used to accept an offer when doing so would not adversely affect voluntary compliance for taxpayers in general.

While an offer is being reviewed, the statute of limitations for collection and collection actions<sup>7</sup> are suspended. The statute of limitations for collection generally restricts the time IRS has to collect delinquent taxes to 10 years from the date of assessment. The statute of limitations for collection and collection actions continues to be suspended if IRS rejects an offer through the 30-day period that a taxpayer has to make a decision on whether to appeal the rejection decision. If a taxpayer appeals, the suspensions continue through the end of the appeal process.

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## IRS's Process for Making Offer Determinations

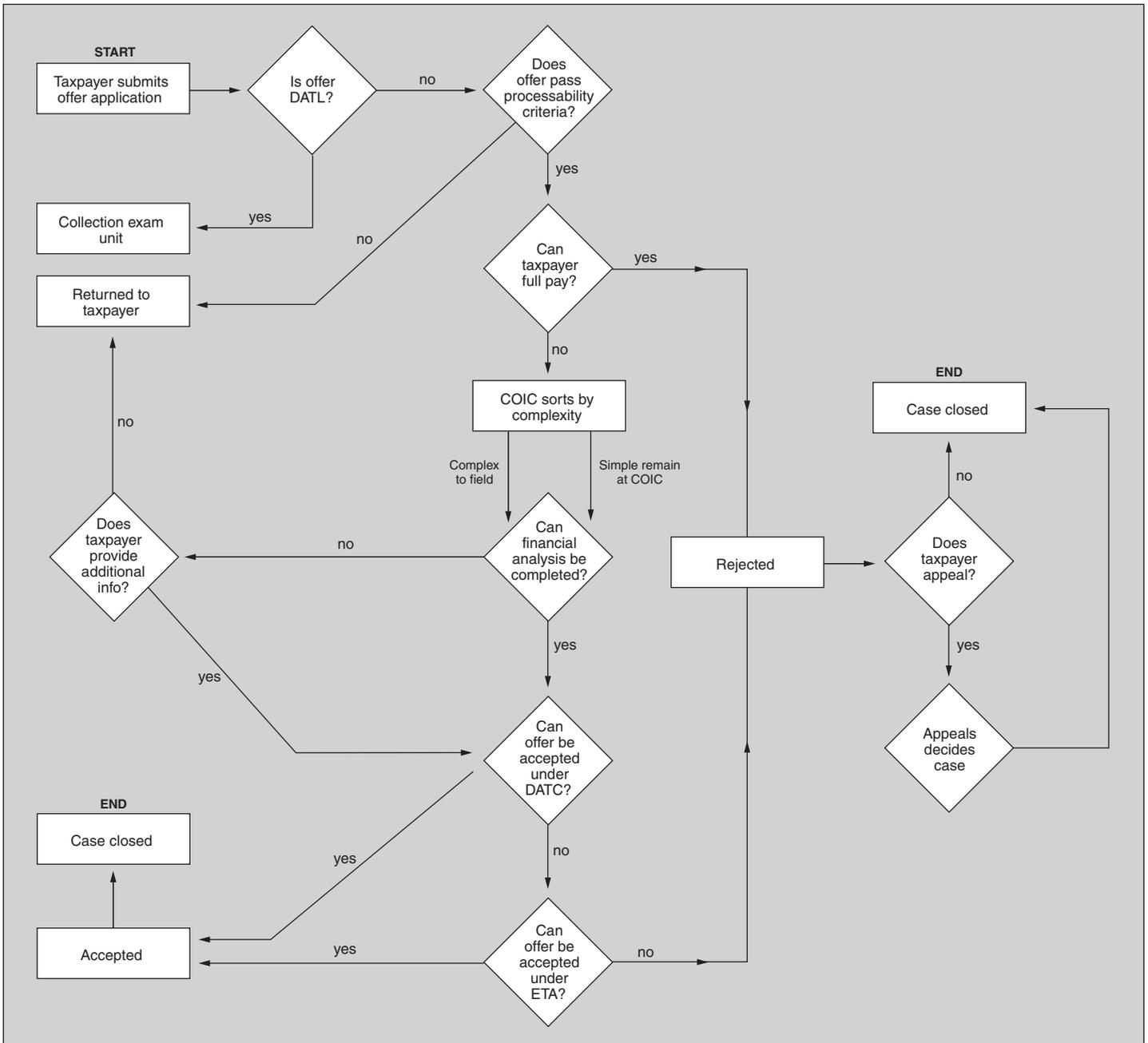
As illustrated in figure 1, the offer process starts when an offer application is submitted by a taxpayer. The application package, Form 656, consists of over 50 pages that include detailed instructions on determining eligibility for filing an offer and a worksheet for calculating the offer amount for individual and business taxpayers. The offer<sup>8</sup> must be supported by a current statement of the taxpayer's financial condition, including data on assets, liabilities, and monthly income and expenses.

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<sup>7</sup>IRS's collection actions can include notices demanding payment; liens (legal claims filed against a taxpayer's property as security or payment for the tax debt); and levies (legal seizures of taxpayers' assets to satisfy tax debts). However, a Notice of Federal Tax Lien may be filed at any time while the offer is being considered if IRS determines that the collection of the liability is in jeopardy.

<sup>8</sup>Except offers based on DATL.

**Figure 1: Simplified OIC Process**



Source: GAO analysis of IRS data.

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IRS typically receives and begins the processing of offers in one of two COICs. The first step is screening out offers based on DATL. DATL offers involving trust fund recovery penalties<sup>9</sup> and personal liability for excise taxes are processed by the OIC Program and all others are referred to IRS examination staff. IRS then screens the remaining offers for processability, using five criteria:

1. current version of OIC application form used,
2. \$150 application fee included,<sup>10</sup>
3. all required federal tax returns filed,
4. employment taxes current,<sup>11</sup> and
5. taxpayer not in bankruptcy proceeding.

Generally, if any of the five requirements are not met, the application is returned to the taxpayer as “not processable.” According to IRS officials, since fiscal year 2003, the requirement to use the current application form has not been enforced although it remains part of IRS’s processability criteria. Program officials said that they do not want to return offer applications to taxpayers solely because the most current form was not used.

Next, IRS screens out taxpayers who, based on their self-reported financial data, can fully pay their tax debts. The financial data include income, assets, and living expenses. If, after subtracting the taxpayers self-reported living expenses from their income and assets, IRS determines taxpayers

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<sup>9</sup>Trust fund recovery penalties are assessed against taxpayers because they withheld taxes from others but did not make a timely federal tax deposit or payment in that amount. Trust fund taxes are withheld income and employment taxes, including Social Security taxes, railroad retirement taxes, and collected excise taxes.

<sup>10</sup>The \$150 application fee is waived if (1) the offer is submitted based solely on “doubt as to liability” or (2) the taxpayer’s total monthly income falls at or below income levels based on the Department of Health and Human Services’ poverty guidelines.

<sup>11</sup>Taxpayers are required to have filed and paid any required employment tax returns on time for the two quarters prior to filing the OIC, and must be current with deposits for the quarter in which the OIC was submitted.

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can fully pay their tax debt and no exceptional circumstances exist, the offers are rejected without further processing.

IRS then sorts offers by complexity. Complex offers, such as those that are business related or those from individual taxpayers required to file Schedule C (Profit or Loss from Business), are generally sent to field offices. The less complex offers remain in COIC for processing. Next, IRS reviews each offer to determine whether the taxpayer provided enough financial information for a decision to be made about whether to accept the offer. If not, IRS requests more information from the taxpayer. If the taxpayer does not provide the information, the offer is returned and the offer is closed. A returned offer has not been rejected.

When IRS has sufficient financial information to make a decision, it first determines whether an offer can be accepted on the basis of DATC. If not, IRS considers the offer under ETA rules. At any point during the process, taxpayers may withdraw their applications.

The step of rejecting an offer includes an administrative review. When OIC staff propose rejecting an offer, IRS is required by the Restructuring Act to conduct an independent administrative review. If the offer is rejected, the taxpayer has the right to appeal the decision. Offers that are returned, withdrawn, or deemed unprocessable do not have appeals rights. If IRS accepts the offer, it monitors the taxpayer for 5 years to ensure that the taxpayer remains compliant with the agreement and future tax obligations.

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## The OIC Program Has Decreased in Size, and Repeat Offers Have Increased

From fiscal years 2000 through 2005 the OIC Program decreased in size, according to measures such as the number of offers received by IRS, the number of offers accepted, and the dollar amount accepted in compromises. During the same years, repeat offers, as a percentage of offers received, grew significantly.

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## In Recent Years, IRS's OIC Program Has Decreased in Size

According to a variety of summary measures, IRS's OIC Program has decreased in size. The number of offers received peaked in fiscal year 2003, and in fiscal year 2005 was lower than any year since fiscal year 2000 (see table 1). Offers accepted and the year-end inventory of open offers both peaked in fiscal year 2001 and were lower in 2005 than previous years.

**Table 1: OIC Program Statistics, Fiscal Years 2000-2005**

Fiscal year	2000	2001	2002	2003	2004	2005
Offers received	109,818	118,893	122,405	126,466	103,106	73,301
Offers accepted <sup>a</sup>	31,609	37,071	27,692	18,340	14,636	14,526
End of year inventory	88,982	92,324	68,187	54,326	35,882	18,500
Amount of delinquent tax liability (in billions)	\$2.43	\$2.45	\$2.25	\$1.32	\$1.32	\$1.49
Amount of accepted offers (in billions)	\$0.28	\$0.31	\$0.27	\$0.19	\$0.19	\$0.24
Amount of tax liabilities written off as a result of OIC (in billions)	\$2.15	\$2.14	\$1.98	\$1.13	\$1.13	\$1.25
Percentage of total tax liability accepted in compromise	12	13	12	14	15	16

Source: GAO analysis of IRS's AOIC database.

<sup>a</sup>Acceptances are shown before any taxpayer appeals to the IRS Appeals function (Appeals). See table 10 for offers accepted by Appeals.

The amount of delinquent tax liability covered by accepted offers ranged annually from about \$1.3 billion to \$2.5 billion during fiscal years 2000 to 2005. The amount accepted in a compromise of annual delinquent tax liability increased from 12 percent in fiscal year 2000 to 16 percent in fiscal year 2005. The amounts of delinquent tax liability covered by accepted offers, the amounts accepted, and amounts written off were lower at the end of the period than at the beginning but with some upswing over the last 3 years. While not a measure of program size, the percentage of delinquent tax liability covered by accepted offers increased to 16 percent in fiscal year 2005.

IRS attributes the decline in inventory to a combination of factors, including the centralized processing established in August 2001 and the decrease in offers received.

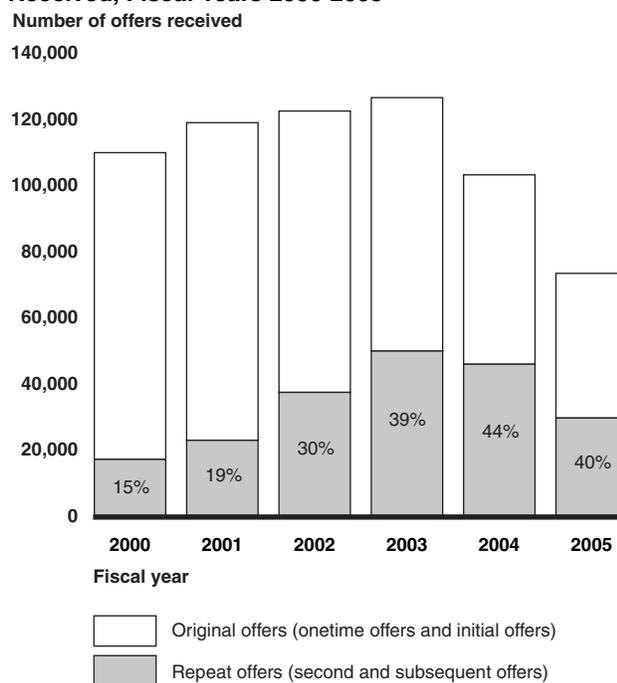
## Repeat Offers Have Grown Significantly

Repeat offers, as a percentage of offers received, grew significantly from fiscal year 2000 to 2005. Repeat offers occur when a taxpayer submits an offer that IRS does not accept, IRS closes the case, and then the taxpayer submits another offer covering at least some of the same tax liability. Some taxpayers submit several repeat offers.

The number and percentage of repeat offers more than doubled from fiscal year 2000 to 2003 (see fig. 2). After that, the number declined, but because

the number of offers received also declined, the percentage stayed about the same. In fiscal year 2005, 40 percent (or 29,527) of the offers received were repeat offers.

**Figure 2: Number and Percentage of Repeat Offers Compared to Total Offers Received, Fiscal Years 2000-2005**



Source: GAO analysis of IRS's AOIC database.

Note: Some taxpayers make only one effort to compromise a tax liability. We call these offers "onetime offers." Other taxpayers make multiple attempts to compromise a tax liability. We call the first of these attempts an "initial offer" and each subsequent attempt a "repeat offer."

Thousands of offers were multiple repeats. Of the 29,527 repeat offers received in fiscal year 2005, table 2 shows that for example 17,511 (or 59 percent) were second offers and 6,901 were third offers<sup>12</sup> (see table 2).

<sup>12</sup>Some taxpayers may submit more than one repeat offer in the same year. For example, a taxpayer could have submitted a fourth offer in early 2005 and a fifth offer in late 2005. Offers submitted in fiscal year 2005 may also have preceding offers submitted in earlier years.

Taxpayers whose repeat offers were received in 2005 submitted 2.8 offers on average.

**Table 2: Numbers of Repeat Offers Received in Fiscal Year 2005**

Order of offer	Number of offers
2 <sup>nd</sup>	17,511
3 <sup>rd</sup>	6,901
4 <sup>th</sup>	2,908
5 <sup>th</sup>	1,214
6 <sup>th</sup>	525
7 <sup>th</sup>	247
8 <sup>th</sup>	103
9 <sup>th</sup>	52
10 <sup>th</sup> or greater	66
<b>Total</b>	<b>29,527</b>

Source: GAO analysis of IRS's AOIC database.

IRS has not analyzed the reasons for the proportion of repeat offers, the substantial increase since fiscal year 2000 shown in figure 2, or the number of multiple repeats shown in table 2. There are a range of possible reasons. On the one hand, repeat offers could be the product of IRS attempts to reduce inventory and close offer cases more quickly. Closing cases quickly could leave some taxpayers still wanting to negotiate over the amount of their offers—they would have to submit repeat offers. On the other hand, repeat offers could be the result of taxpayer confusion or a tactic to delay collection action.

## OIC Program Performance Has Been Mixed, and IRS Has Not Researched the Reasons for Some Performance Trends

Based on our analysis of OIC data, program performance has been mixed relative to five objectives—timeliness, quality, accessibility, compliance, and cost. We identified these objectives by reviewing the IRM and an IRS policy statement. IRS's performance in one measure of timeliness has improved, and the program has met its quality goals. However, some taxpayers wait more than 2 years to get an offer accepted, and cost per offer has increased. Some of IRS's measures mask this performance because IRS measures performance by offer and not by taxpayer. Furthermore, IRS has not researched the causes of some performance trends.

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## OIC Performance Can Be Measured Relative to Five Objectives

Based on the IRM and an IRS policy statement, we identified five performance objectives for the OIC Program:

- timeliness—time taken to make a decision on an offer application,
- quality—extent to which IRS follows OIC Program procedures and makes appropriate determinations,
- accessibility—ease that taxpayers eligible for offers have participating in the program,
- compliance—extent to which taxpayers who submit offers pay their delinquent and future tax obligations, and
- cost—resources used to process offers.

IRS officials said that they track the program's performance with respect to timeliness, quality, and cost. They also said that they do not measure the program's success by measuring compliance and accessibility but agreed these were aims of the program. IRS has numeric targets for timeliness and quality. The officials also view taxpayer service as another program objective. We agree that taxpayer service should be a program objective. In IRS's telephone assistance program, service is measured by a combination of timeliness, quality, and accessibility. While there may be other measures of service, we believe that service to taxpayers is covered by the above five objectives.

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## Timeliness Has Improved for Some Taxpayers but Remains Mixed, and IRS's Timeliness Goals Are Set for Offers, Not Taxpayers

The OIC Program measures timeliness based on how long it takes to make a decision about an offer and not how long it has taken taxpayers, some of whom have repeat offers, to get their tax liabilities finally resolved. IRS has a 6-month target for making decisions on offers in COICs and a 9-month target for making a decision on offers in the field. Measured on an offer basis, IRS met its COIC 6-month target for 94 percent of offers and its field 9-month target for 62 percent of offers in fiscal year 2005.

The picture looks different when timeliness is measured by how long it takes taxpayers to have their tax liabilities ultimately resolved—the elapsed calendar time from when IRS first receives an offer to when IRS makes a decision on a taxpayer's final offer. In fiscal year 2005, IRS took about 6 months on average to process onetime offers (both COIC and field)

but took far longer to resolve the tax liabilities of taxpayers with repeat offers. The timeliness of onetime offers has improved from an average of 8.4 months in fiscal year 2000 to an average of 5.6 months in fiscal year 2005, as shown in table 3.

**Table 3: Average Processing Times for Onetime and Repeat Offers by Year Case Was Closed, Fiscal Years 2000-2005**

Fiscal year	Average processing times in months	
	Onetime offers	Repeat offers <sup>a</sup>
2000	8.4	23.3
2001	9.6	25.8
2002	9.8	23.9
2003	7.9	20.7
2004	7.2	21.4
2005	5.6	22.4

Source: GAO analysis of IRS's AOIC database.

Note: Times represent OIC Program processing times and do not include time in Appeals for appealed cases.

<sup>a</sup>Elapsed calendar time between IRS receipt of first offer and disposition of final offer.

The average elapsed calendar time it takes for taxpayers with repeat offers to get their cases finally resolved was over 22 months in fiscal year 2005—close to the same elapsed time as in 2000. Taking almost 2 years to resolve cases could result from the growth in the proportion of repeat offers or other factors, such as the time taxpayers wait before submitting repeat offers.

Timeliness from the perspective of accepted offers is shown in table 4, which shows that 40 percent of offers accepted in fiscal year 2005 had elapsed calendar times of more than 12 months from IRS receipt of first offer to final disposition of the last offer, and over 18 percent had elapsed calendar times of more than 24 months. Over 91 percent of the accepted offers taking more than 24 months were repeats.

**Table 4: Distribution of Elapsed Calendar Time for All Offers Accepted in Fiscal Year 2005**

	0 to 6 months	>6 to 12 months	>12 to 24 months	More than 24 months
Numbers of offers closed by elapsed time	4,427 (30.5 percent)	4,176 (28.8 percent)	3,240 (22.3 percent)	2,683 (18.5 percent)

Source: GAO analysis of IRS data.

Note: Times represent OIC Program processing times and do not include time in Appeals for appealed cases.

Even though IRS may be meeting its timeliness targets for processing most offers, measuring timeliness by offer masks the elapsed calendar time between receipt of a first offer and disposition of a final offer for taxpayers filing repeat offers. Furthermore, IRS has not analyzed the effect of the number and growth of repeat offers on timeliness. An analysis of the extent timeliness could be improved, if at all, by reducing repeat offers could help program managers make decisions about whether program changes to improve timeliness would be justified. For example, it might be less costly for IRS to deal once with a taxpayer, even if it takes more time to work the single case, rather than have to process repeat offers.<sup>13</sup>

Another issue is that IRS does not have a rationale for its numeric goals for processing times. In 2002, after we recommended that IRS set a timeliness goal for the offer program based on taxpayer needs, other benefits such as compliance, and program cost, IRS retained its old goal of 6 months for COIC offers and established a separate goal of 9 months for field offers. However, the two current goals still are not based on a documented analysis of taxpayer needs, other benefits, and program costs.

Without measuring timeliness from the perspective of the taxpayer and without a rationale for timeliness goals set for taxpayers, IRS may be missing an opportunity to effectively drive program improvements from a taxpayer's perspective. As we discussed in other reports, industry guidance for customer service recommended setting goals based on how long

<sup>13</sup>Our analysis of timeliness indicates that one initiative to reduce costs by increasing timeliness, IRS's upfront screening for processability, is working as intended. In fiscal year 2005, 75 percent of initial offers were not processable and were sent back to taxpayers on average in 10 days.

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customers were willing to wait for the service, the value of the service to the organization, and the costs of providing the service.<sup>14</sup> Measuring timeliness from the perspective of taxpayers and setting goals based on taxpayer needs would inform IRS management of any gaps between actual timeliness and the goal providing a better basis for making decisions about program improvements.

IRS officials expressed concern about whether setting timeliness goals by taxpayer would be feasible or desirable. In terms of feasibility, the officials said because it does not know whether or when a taxpayer whose offer is not accepted would submit another offer, it would be difficult to develop a timeliness goal from the perspective of taxpayers. While it may be difficult to predict individual taxpayers' behavior, IRS has historical data that may be helpful for establishing timeliness goals from the perspective of taxpayers. For example, average timeliness for taxpayers from previous years might be a benchmark useful for setting goals for future average timeliness. In terms of desirability, IRS officials said a measure of timeliness from the perspective of taxpayers might be interpreted by some as an indication that offer policies might be compromised in order to meet the goal. IRS has quality measures intended to ensure that appropriate decisions are made in offer processing. Furthermore, IRS currently sets timeliness goals for offers despite the fact that the same incentives to compromise quality seem to apply.

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**IRS's Data Show That  
Quality Goals Have Been  
Met**

Measured by both IRS's internal customer accuracy measures and decisions by the Appeals function (Appeals), IRS has met its quality goals for the OIC Program (see table 5).

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<sup>14</sup>GAO, *Tax Administration: IRS Should Evaluate the Changes to Its Offer in Compromise Program*, [GAO-02-311](#) (Washington, D.C.: Mar. 15, 2002), and *Tax Administration: IRS Needs to Further Refine Its Tax Filing Season Performance Measures*, [GAO-03-143](#) (Washington, D.C.: Nov. 22, 2003).

**Table 5: Accuracy Rates for COIC Cases and Field Cases, Fiscal Year 2005**

<b>Location</b>	<b>OIC work type</b>	<b>Accuracy rate achieved (percentage)</b>
Brookhaven	Preliminary screening	100
	Financial analysis and offer decision	97.7
	Average	<b>98.9</b>
Memphis	Preliminary screening	95.0
	Financial analysis and offer decision	95.6
	Average	<b>95.3</b>
Field offices	Financial analysis and offer decision	<b>84.4</b>

Source: IRS.

In the COICs, IRS measures the customer accuracy rate using the embedded quality measurement system (EQMS) that was implemented in fiscal year 2004. IRS exceeded its goal of 94 percent for fiscal year 2005. For the OIC Program, EQMS measures how well employees follow offer processing procedures. Quality is measured by the sample of cases reviewed that met the standards for following the required steps, such as contacting the taxpayer or getting managerial review to process cases. IRS believes that offer examiners make more consistent decisions when they follow all the required processing steps. According to the OIC Program Manager, EQMS is better than the system previously used in the centralized processing centers, the collection quality measurement system (CQMS). CQMS is still being used in field offices but is to be phased out in fiscal year 2006 as EQMS is being phased in. IRS also met its field quality goal of 84 percent using CQMS for fiscal year 2005. According to the OIC Program Manager, IRS plans to set a field goal using EQMS after collecting and analyzing data for field cases during the first year that EQMS is implemented in field offices.

Appeals data offer some additional evidence about the quality of OIC Program decisions, although the data are a limited quality indicator because only rejected offers can be appealed. Of rejected offers appealed, in fiscal year 2005, Appeals sustained 65 percent of rejection decisions while deciding to accept offers in 24 percent of the cases, as shown in table 6 (11 percent were withdrawn). A decision by Appeals to accept an offer is not always the same as overruling the OIC Program. Appeals accepted some offers that the OIC Program had rejected because taxpayers provided Appeals with new financial information. An IRS study of 113 cases where offers were accepted in Appeals concluded that 38 percent of offers were

accepted by Appeals based on taxpayers providing new financial information rather than Appeals disagreeing with the OIC Program decisions.<sup>15</sup> Table 6 also shows some improvement in the sustention rate from fiscal years 2002 through 2005.

**Table 6: Disposition by IRS Appeals of OIC Rejected Offers, Fiscal Years 2002-2005**

<b>Disposition</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
OIC rejection accepted in Appeals (percentage)	29.0	29.6	28.2	23.5
OIC rejection sustained in Appeals (percentage)	57.6	57.3	62.0	65.1
Offer withdrawn in Appeals (percentage)	13.5	13.1	9.7	11.4

Source: GAO analysis of IRS's AOIC database.

### Declines in OIC Program Size Combined with Trends in IRS's Other Collection Programs Raise Questions about OIC Program Accessibility

Declines in OIC participation rates since fiscal year 2000 raise questions about whether accessibility has decreased. We define accessibility as how easy it is for potentially eligible taxpayers to participate in the OIC Program. IRS officials agreed with this definition but said that they do not measure accessibility and do not monitor changes in accessibility over time. Tracking accessibility could provide information about the effectiveness of efforts to reduce barriers to program participation for taxpayers wishing to make legitimate offers. For example, IRS recently made changes to the offer application form intended to make the offer application process easier for taxpayers to understand.

Furthermore, the Taxpayer Advocate, the American Institute of Certified Public Accountants, and the National Association of Enrolled Agents have raised concerns about barriers to OIC Program access. They cited confusion about the offer requirements and procedures, the lengthy time needed to get offers resolved, and the difficulty in getting what they believe are reasonable offers accepted as deterrents to taxpayers' ability to participate in the program. The Taxpayer Advocate stated that some practitioners are often not willing to recommend the program to their

<sup>15</sup>In the SB/SE Collection/Appeals Joint Program Review, October 18 through 22, 2004, IRS reviewed a random sample of 113 cases that had been rejected by COICs and accepted by Appeals in July and August 2004.

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clients because of these issues. A small number of practitioners we spoke with, as well as the practitioner organizations we contacted, made the point that the OIC process is too burdensome for taxpayers. Without a measure of accessibility, it is difficult to assess the merits of these concerns.

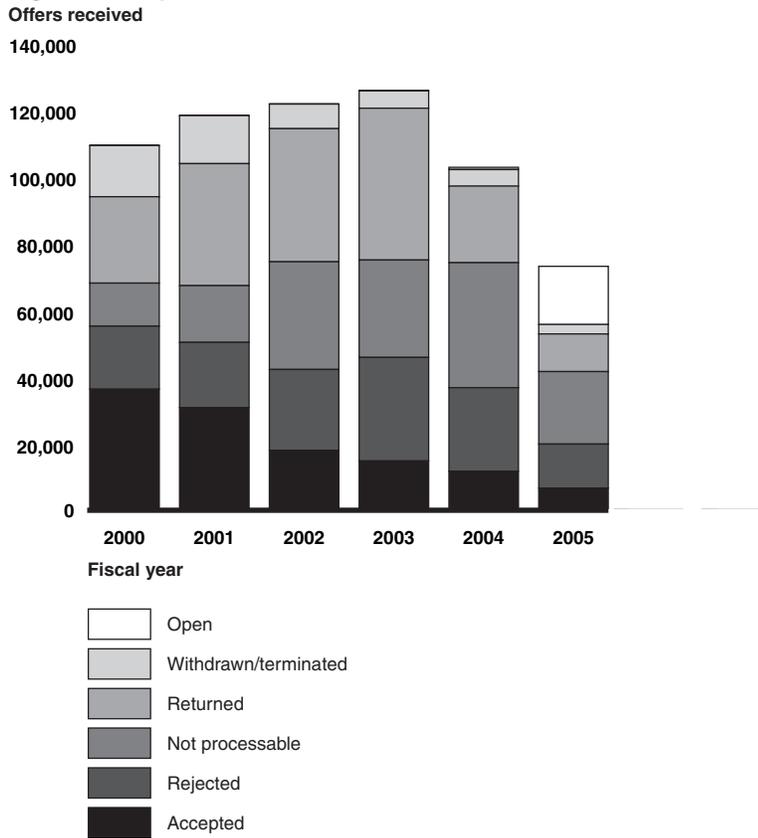
Measuring access, or ease of participation, may require questioning taxpayers about why they did or did not participate in the program. Such direct evidence does not currently exist. However, it is possible to measure participation with readily available data. While not the same as accessibility, trends in participation rates might be an indicator of whether changes in accessibility have occurred. A measure of participation would compare OIC Program participation to the pool of potentially eligible taxpayers.

Over the years 2000 to 2004, the number of accepted offers declined by more than half, as shown in figure 3. Over the same years, one proxy measure of potentially eligible taxpayers, the number of delinquent taxpayers, stayed roughly constant at 5.9 million delinquent taxpayer accounts in fiscal year 2000 and 6.0 million in 2004.<sup>16</sup> It seems likely that the number of potentially eligible taxpayers is correlated with the number of delinquent taxpayers. Not all delinquent taxpayers are eligible for the OIC Program, but it seems likely that an increase in delinquent taxpayers would also increase the number of taxpayers potentially eligible for an offer.

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<sup>16</sup>Delinquent taxpayer accounts in fiscal year 2001 were 5.4 million; in 2002, 5.7 million; and in 2003, 6.2 million. Data were not available for 2005.

**Figure 3: Disposition of Offers Received, Fiscal Years 2000-2005**



Source: GAO analysis of IRS's AOIC database.

Note: Because many of the offers received in fiscal year 2005 have not been disposed of, the numbers of accepted and rejected offers shown in the table will grow.

The fact that accepted offers declined by more than half at the same time that the number of delinquent taxpayers was staying roughly constant raises the question of whether something has happened to reduce the program's accessibility.<sup>17</sup> The two trends do not demonstrate that accessibility has declined because they do not directly measure ease of use. It is possible that taxpayers decided for reasons unrelated to accessibility to reduce their participation in the program. However, it is possible that

<sup>17</sup>Other measures of participation could be constructed. For example, the dollar amount of tax liability compromised could be compared to the dollar amount of aggregate delinquent tax debt.

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concerns like those expressed by the Taxpayer Advocate explain the decline. IRS has not done an analysis to determine whether the ease of using the program has changed, and, if so, why.

IRS officials told us that the reason they do not measure accessibility is that the program is available to all eligible taxpayers and that taxpayers self-select their participation. They also said that IRS has not measured the decline in the size of the program relative to changes in the pool of potentially eligible taxpayers. On the other hand, IRS has taken steps, such as requiring a \$150 offer application fee and revising the offer application form, intended to reduce the number of unrealistic offers without reducing the accessibility of the program to potentially eligible taxpayers. In addition, the OIC Program Manager told us that to determine whether there are eligible taxpayers who do not participate in the program, IRS is considering studying whether some taxpayers with delinquent accounts are eligible for offers.

Without a measure of accessibility that gauges ease of use, IRS does not know whether accessibility has changed over time. As a consequence, IRS does not know whether the declines in participation rates indicate a decline in accessibility, nor does IRS know whether the concerns raised by the Taxpayer Advocate and others about a decline in accessibility are correct. Furthermore, IRS would be unable to evaluate whether its efforts to reduce inappropriate offers, without reducing accessibility by eligible taxpayers, have been successful.

There may be more than one way to measure accessibility. One way would be to measure program participation rates and, if participation is changing, do follow-up questioning of taxpayers about whether ease of use had changed. Potentially eligible taxpayers could be asked, for example, about whether they perceived barriers to their participating in the program. If accessibility is found to be declining, then analysis of what IRS did to cause the decline would be useful for making decisions about whether and how to address the decline.

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## IRS Monitors Taxpayer Compliance with the Terms of Their Accepted Offers, but Does Not Routinely Track Aggregate Compliance Trends for Program Participants

IRS Policy Statement P-5-100 and the IRM state that by accepting offers, the OIC Program should provide taxpayers a fresh start toward future voluntary compliance with their filing and payment requirements. IRS rejects offers on the basis of a financial analysis of taxpayers' assets, expected income, and reasonable living expenses—an analysis that IRS uses to show whether taxpayers have the ability to pay more of their tax debt than they offered to pay in their OIC applications.

In accordance with the compliance objective for accepted offers, IRS has a unit called Monitoring OIC (MOIC), which monitors the compliance of taxpayers with accepted offers for 5 years, and possibly beyond 5 years in cases of deferred payment offers, where payments are made over the remaining life of the collection statute. MOIC, however, does not routinely report to OIC management its aggregate data on taxpayer compliance, which would show trends on the compliance of taxpayers with accepted offers. In 2004, IRS completed a study that addressed several aspects of the OIC Program, including compliance.<sup>18</sup> According to the study, about 80 percent of individual taxpayers with accepted offers from calendar years 1995 and 2001 remained in compliance with filing and payment requirements, excluding taxpayers who had received only one collection notice.

The study also examined the compliance of taxpayers whose offers were rejected, withdrawn, or returned. The study found that follow-up collection actions had not been completed in many cases, even though the taxpayers had submitted offer applications stating a willingness and ability to pay part of their delinquent tax debt and even though IRS had concluded for rejected offers that the taxpayers could pay more than the amount they offered. For example, 42 percent of rejected offers during the study period, calendar years 1998 to September, 8, 2003, were pending collection action, and 15.7 percent had been declared currently not collectible (see table 7).<sup>19</sup>

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<sup>18</sup>Department of the Treasury, Internal Revenue Service SB/SE Payment Compliance and Office of Program Evaluation and Risk Analysis.

<sup>19</sup>Although OPERA collected compliance data on business taxpayers, the IRS study cautioned that the business data were not reliable for an analysis similar to the individual master file data analysis because researchers did not verify the continued operation of businesses that had interacted with the program.

**Table 7: Percentage of Individual Taxpayers in Collection Statuses by Offer Disposition from 1998 to 2003**

Collection status <sup>a</sup>	Withdraw	Reject	Return
Full pay	30.6	19.4	10.6
Other resolution <sup>b</sup>	8.4	8.3	4.6
Currently not collectible	16.7	15.7	18.6
Installment	15.8	14.6	9.2
Pending action	28.4	42.0	57.2
<b>Total<sup>c</sup></b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: GAO analysis of IRS data.

<sup>a</sup>In cases where the taxpayers had tax liabilities for more than one year or tax period, OPERA used IRS's most recent information on the taxpayer's collection status.

<sup>b</sup>Includes cases that were "full pay" where the collection statute expiration date occurred or taxpayer filed bankruptcy.

<sup>c</sup>Columns may not add up to 100 percent because of rounding.

IRS created a new unit called the Hand-Off Unit partly because the 2004 study concluded that rejected offers languished without further collection action. The Hand-Off Unit takes the rejected or withdrawn cases and initiates appropriate collection procedures with taxpayers using the financial information gained during the OIC process. Like MOIC, the Hand-Off Unit currently does not analyze compliance trends on a routine basis, although officials told us that IRS would eventually have that capability but has not set a date. To properly assess IRS performance on achieving its compliance objective, IRS also would need to collect and assess such trend information on a periodic basis.

The 2004 study represents a useful assessment of OIC's compliance benefits for one time and uses an appropriate measurement unit—the taxpayer. However, it is no longer useful for ongoing management decisions because the data in the study are now about 3 to 11 years old. The study period predated many of IRS's recent program changes, which might affect the program's performance with respect to compliance. For example, the new Hand-Off Unit, which was started after the 2004 report, may help achieve greater compliance of taxpayers with rejected or withdrawn offers, but IRS will not know whether it works if it does not track overall compliance trends.

The OIC Program Manager said that IRS found the 2004 study too costly to repeat, requiring thousands of staff hours from the OIC Program and

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expertise from OPERA. However, only a portion of the work for the 2004 study was devoted to studying compliance; the Program Manager said that he did not know how much it would cost to repeat the compliance portions alone. Further, IRS does not use alternatives for the kind of compliance-benefit information the 2004 study provided, although such alternatives exist and some are lower cost. For example, IRS could repeat only the compliance portion of its OPERA study or use the existing status reports collected by MOIC, which cover taxpayers who default on their offers but are not routinely aggregated for OIC managers, to monitor trends on the compliance of taxpayers with accepted offers. The only additional costs to use the MOIC reports would be aggregating the data. The Treasury Inspector General for Tax Administration (TIGTA) also conducted a file review of accepted offers to assess aggregate compliance performance, which the OIC Program could use as a model. According to a TIGTA audit manager, the TIGTA study was something IRS should be able to do at a lower cost than the OPERA report. Using the MOIC data that are already available or employing the TIGTA approach would not yield as elaborate a study as IRS's 2004 study, but the alternative methods would provide information more useful to managers than having no information at all.

We previously concluded that having the proper performance measures in place is critical for successful program adjustments and in assessing achievement of objectives.<sup>20</sup> Because aggregate compliance trends are not tracked and analyzed periodically, IRS does not know the effects that recent program changes have had on taxpayer compliance; furthermore, IRS will have greater difficulty determining what additional program changes may be needed to ensure its best performance on achieving its compliance objective.

Trend information on compliance also is necessary to assess the performance of IRS's new Hand-Off Unit. In our 2002 report,<sup>21</sup> we said that IRS should develop evaluation plans before starting new initiatives; it did not do so in this case.

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<sup>20</sup>See GAO, *Executive Guide: Effectively Implementing the Government Performance and Results Act*, [GAO/GGD-96-118](#) (Washington, D.C.: June 1996), 23, and [GAO-03-143](#), 45.

<sup>21</sup>[GAO-02-311](#), 37.

## Offers Closed Declined Faster Than FTEs, Resulting in Productivity Declines and Increased Costs per Offer

Productivity of both COIC and field staff, measured by the ratio of offers closed per FTE, declined from fiscal years 2003 to 2005 (see tables 8 and 9). While productivity improved from fiscal years 2002 to 2003, the productivity declines in the following years resulted from IRS reducing offer processing staff at a lower rate than the decline in offers closed. For example, the average number of closed offers per FTE in COIC decreased from 251 to 165 from fiscal years 2003 through 2005. Other factors equal, decreases in productivity increase cost per offer.

**Table 8: Productivity of COIC Processing by Offers Closed, Fiscal Years 2002-2005**

Fiscal year	Closed offer cases	FTEs	Closed offers per FTE
2002	66,217	380	174
2003	90,888	362	251
2004	80,107	340	236
2005	52,831	320	165

Sources: IRS data and GAO analysis of IRS's AOIC database.

**Table 9: Productivity of Field Processing by Offers Closed, Fiscal Years 2002-2005**

Fiscal year	Closed offer cases	FTEs	Closed offers per FTE
2002	80,325	448	179
2003	49,439	316	156
2004	41,443	305	136
2005	37,852	249	152

Sources: IRS data and GAO analysis of IRS's AOIC database.

If IRS had maintained productivity at fiscal year 2003 levels, the agency would have had the flexibility to reallocate a substantial number of FTEs to other areas. In fiscal year 2005, IRS would have been able to reassign 110 FTEs in COICs and 7 FTEs in field offices. As the inventory of offers, which affects the number of offer closures, declined in fiscal years 2004 and 2005, IRS did reduce FTEs, particularly in the field. However, the number of offers closed declined more rapidly than the number of FTEs, hence the

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decline in productivity. In January 2006, IRS officials told us that they anticipate making additional staff reductions in fiscal year 2006.

OIC officials provided some possible reasons for the decline in productivity, including an increase in offer complexity and a plan to keep more staff working on offers than might have been necessary to ensure that service to taxpayers was maintained. Over the fiscal years 2003 to 2005, however, there is some evidence that offers have not grown more complex. Figure 3 does not show a noticeable change in case complexity. For example, the percentage of not processable offers, the simplest and fastest cases to close, was somewhat higher in fiscal year 2005 than in fiscal year 2003. With respect to the desire to maintain service to taxpayers, IRS has shifted collections staff from one type of case to another. Thus, IRS has flexibility to move staff to maintain service in the face of an unexpected upswing in offer submissions, especially since a pool of experienced OIC processors would be available.

OIC officials told us that since fiscal year 2001, they have substantially reduced the OIC Program's costs, particularly in field offices. Based on IRS information, the number of revenue officers assigned to OIC cases have declined from 1,078 as of April 2001 to 267 in April 2006—a reduction of 811 revenue officers. In March 2006, IRS's OIC Program Manager told us that because IRS will start processing offers from taxpayers filing simpler Schedule C forms at the COICs later in the year, it will further reduce the number of revenue officers in field offices by 100.

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### Limited Evidence Suggests Offer Mills' Effect on OIC Processing May Not Be Large

Reliable and complete data on offer mills' involvement with the OIC Program do not exist, preventing firm assessments on the extent that offer mills affect OIC processing. However, limited evidence from IRS, states, and our own analysis, taken together, suggests that offer mills do not have a large effect on OIC processing. There is, however, anecdotal evidence that offer mills may harm taxpayers. IRS has created procedures and guidance designed to mitigate potential negative effects of offer mills on OIC processing, although the effectiveness of the procedures and guidance cannot be measured.

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### Offer Mills Cannot Be Easily Distinguished from Legitimate Practitioners

IRS collects some information about professional tax practitioners, who assist taxpayers making offers, but the data are not sufficient for distinguishing offer mills from legitimate practitioners.

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For purposes of this report, an offer mill is a professional tax practitioner that consistently uses negligent or deceptive practices to exploit taxpayers and the OIC Program by making misleading claims and submitting unrealistic offers. For example, an offer mill might use deceptive advertising, creating a false expectation that the recipient of the advertisement would qualify for an offer or save as much as the advertisement suggests. An offer mill also might file incomplete or repeat offers to exploit the rule that suspends collection proceedings while offers are being considered.

IRS does collect two types of information about professional practitioners on the OIC application, but this information is not always submitted with the application. First, the OIC application asks enrolled agents<sup>22</sup> to identify themselves on the form and to submit a power of attorney (POA) Form 2848 with the taxpayer's application. In addition, the form asks taxpayers to identify anyone who helped prepare the application. However, non-enrolled agents are not required to sign the offer application. A manager at the Brookhaven COIC said that IRS has had cases in which it has learned that a professional practitioner was used but not identified in the offer application.

IRS designates some offers as solely to delay the payment of taxes, which IRS tracks in the AOIC. The definition of solely to delay applies to any offer—whether submitted by the taxpayer alone or with the assistance of a POA. IRS considers an offer submitted solely to delay as one that is not substantially different from a previous offer that IRS rejected or returned. Solely to delay offers could be linked to POA or other practitioner data in the AOIC, but that data's usefulness is limited because professional tax practitioners are not always identified on OIC applications. Additionally, because determining whether an offer is submitted solely to delay is subjective and may require enough submissions to notice a pattern, IRS may not always detect when an offer has been submitted solely to delay.

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<sup>22</sup>Enrolled agents are tax professionals, such as certified public accountants and attorneys, who are permitted by IRS to act on taxpayers' behalf in tax matters and are subject to Circular 230, IRS's rules of conduct for tax professionals.

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Best Available Evidence,  
Though Incomplete,  
Suggests That Offer Mills Do  
Not Have a Large Effect on  
OIC Processing but That  
They Might Harm Taxpayers

The best available information on offer mills from IRS—although limited by the same factors described in the previous section—suggests that offer mills do not have a large effect on OIC processing.

- An IRS study<sup>23</sup> published in 2004 found that a small number of offers submitted with the assistance of professional practitioners were abusive and concluded that offer mills were not driving abuse<sup>24</sup> in the system.
- The OIC Program can make referrals to OPR regarding suspected practitioner abuse but rarely does so. In November 2005, OPR was investigating only 36 cases involving OIC and practitioners.
- An official with the Maryland OIC program told us that the state program has had no significant problems with offer mills or other practitioners in processing OIC applications there. Furthermore, a representative of the Federation of Tax Administrators, an organization of state tax officials, said that problems state OIC programs have with tax practitioners generally have more to do with consumer rights issues than with tax collection.
- In fiscal year 2005, there were 972 offers with POAs that were returned as “solely to delay.” This was about 1 percent of all cases closed in 2005. The effect of these cases on processing may have been small. IRS returned 83 percent of the offers deemed solely to delay that had POAs in 6 months or less.

Anecdotal evidence also indicates that misconduct by offer mills may have harmed some taxpayers even though there was no effect on OIC processing. For example, the Connecticut Attorney General’s Office investigated one company offering OIC preparation services because the company charged taxpayers for submitting offers but then did not send the offers to IRS. In 2005, the state of Missouri settled with a firm over

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<sup>23</sup>Department of the Treasury, Internal Revenue Service SB/SE Payment Compliance and Office of Program Evaluation and Risk Analysis.

<sup>24</sup>IRS describes potential abuse as a situation in which taxpayers have submitted four or more churns. A churn is an offer for which (1) at least one prior offer was received for the Taxpayer Identification Number, (2) the final disposition letter mail date for at least one of the prior offers was within 180 days of the new offer’s date, and (3) the final disposition for at least one of the prior offers for which the mail date was within 180 days was returned processable, returned not processable, or rejected.

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deceptive advertising tactics and for failing to complete OIC services as promised. OIC processing was not adversely affected in these cases. The Taxpayer Advocate also told us about one case in which an offer mill charged such a large fee that the taxpayer ended up filing for bankruptcy, rather than compromising with IRS.

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### IRS Has Implemented Procedures Designed to Reduce the Impact of Offer Mill Abuse

IRS officials said that current procedures reduce negative effects that offer mills might otherwise cause. For example, in 2004, IRS issued a consumer alert about abusive offer mills because of concerns about potentially deceptive advertising tactics used in the OIC preparation industry. The alert advises taxpayers to be wary of promoters making unrealistic claims about the OIC Program. According to the alert, “Some promoters are inappropriately advising indebted taxpayers to file an OIC application with the IRS. This bad advice costs taxpayers money and time.”

IRS also has given instructions to its OIC processing staff on identifying offer mills that might be violating IRS’s rules for enrolled agents and on making referrals of potential violators to OPR. OIC process examiners and offer examiners sometimes work directly with taxpayers, rather than through offer mills. They do this because while taxpayers may be making good-faith efforts to pay what they can of their taxes by compromising, offer mills may not be making good-faith efforts to help the taxpayers. IRS officials also said that the \$150 OIC application fee discourages frivolous offers.

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### IRS Notifies Taxpayers of Their Appeal Rights through Various Channels

IRS has established formal means to notify taxpayers of their appeal rights, including providing information about appeal rights on the offer application form and in the offer rejection letter that IRS sends taxpayers. In addition, IRS’s Web site and some IRS publications contain information for taxpayers on rights and responsibilities in appealing rejected offers.

The offer application package (Form 656) contains information on taxpayers’ rights to appeal rejected offers. Under step 7 of the application process, “What to Expect after the IRS Receives Your Offer,” is information on what a taxpayer can expect if IRS rejects an offer. Specifically, the application states that taxpayers will be sent a letter explaining why their offers were rejected and their right to submit an appeal.

IRS's Web site also provides information on appealing rejected offers, including links to information about appeal rights and how IRS reviews appeals. The Web site's resources include Tax Topic 204, Offers in Compromise; the Collection Appeal Rights link; IRS Publication 5, Your Appeal Rights and How to Prepare a Protest If You Don't Agree; and a video clip on the offer process with information on how to appeal a rejected offer.

The IRS AOIC database contains entries intended to document the sending of rejection letters, with information on how to appeal, to taxpayers. We tested the AOIC database to ascertain whether such entries were made. Our limited review did not indicate any problems in documenting whether rejection letters and appeals instructions were being sent as required. We did not contact taxpayers to determine whether they actually received the letters.

The percentage of rejected offers that were appealed indicates that many taxpayers were aware of their appeal rights. The percentage of offers appealed ranged from 30 percent to 51 percent (see table 10).

**Table 10: Number and Percentage of Rejected Offers That Taxpayers Appealed, Fiscal Years 2000-2005**

<b>Fiscal year<sup>a</sup></b>	<b>Number of offers rejected by OIC Program</b>	<b>Number of rejected offers appealed by taxpayers</b>	<b>Percentage of rejected offers appealed</b>	<b>Number of offers accepted by Appeals function</b>
2000	13,071	3,976	30	1,393
2001	18,568	6,819	37	1,953
2002	22,287	8,129	36	2,334
2003	35,721	15,376	43	4,464
2004	30,874	15,888	51	3,928
2005	27,409	10,224	37	1,221

Source: GAO analysis of IRS's AOIC database.

<sup>a</sup>Fiscal year in which the OIC Program rejected the offer.

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## ETA Regulations Are Consistent with Statute, but Hardship ETA and DATC Offers Are Not Meaningfully Distinct and Non-Hardship ETA Offers Are Rare

IRS's ETA regulations are consistent with the provisions of the Restructuring Act, which were broadly written. While IRS has annually accepted hundreds of offers based on ETA, non-hardship ETA offers accepted have been rare. However, hardship ETA offers are not meaningfully distinct from DATC offers. The lack of distinction between DATC and hardship ETA offers causes unnecessary program complexity and confusion for taxpayers and tax practitioners.

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## Regulations on ETA Are Consistent with the Restructuring Act

IRS's ETA regulations are consistent with the changes made to the OIC provisions by the Restructuring Act. The law required IRS to develop guidelines for determining when an OIC is adequate and should be accepted to resolve a dispute.<sup>25</sup>

The OIC provisions in the Restructuring Act were written broadly and did not specify criteria for what constitutes an adequate offer or when an offer was appropriate for resolving a dispute. IRS and Treasury staff who drafted the regulations incorporated language from the Restructuring Act's conference report. According to the conference report, the existing OIC regulations should be expanded to permit IRS to consider factors beyond DATL or DATC in determining whether to accept a compromise. The conference report also stated that it was anticipated that IRS would take into account factors such as equity, hardship, and public policy where a compromise of an individual taxpayer's income tax liability would promote ETA. Although the term "effective tax administration" was not defined or addressed in the Restructuring Act, IRS sought to incorporate the conference report's ETA language into its regulations. The conference report also did not specifically define what was meant by effective tax administration.

In addition to using the ETA language from the conference report, IRS's regulations created two categories of ETA offers—non-hardship, which

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<sup>25</sup>Section 3462 of the Restructuring Act also required the Secretary of the Treasury to develop national and local allowances for basic living expenses, create special rules for the treatment of offers, and establish procedures for administrative review of rejected offers.

includes offers granted for reasons of equity and public policy, and hardship, which are granted for cases in which full payment would cause financial strain for the taxpayer.

**IRS Has Accepted Hundreds of ETA Offers Annually since Fiscal Year 2001 but Non-Hardship ETA Offers Are Rare**

IRS accepted hundreds of ETA offers each fiscal year from 2001 to 2005. A small number of those acceptances were non-hardship ETA offers (see table 11). In fiscal year 2005, IRS accepted 467 offers on an ETA basis, with 30 being non-hardship ETA offers.

**Table 11: Number of Accepted Hardship ETA and Non-Hardship ETA Offers, Fiscal Years 2000-2005**

Fiscal year	2000	2001	2002	2003	2004	2005
Hardship ETA offers accepted	177	479	466	498	428	437
Non-hardship ETA offers accepted	-	-	-	-	1	30

Source: GAO analysis of IRS data.

Note: IRS did not compile separate statistics on non-hardship ETA acceptances before 2004.

The low number of non-hardship ETA acceptances is consistent with IRS guidance, which says that IRS should accept non-hardship ETA offers only in rare instances. IRS officials said that non-hardship ETA acceptances should be infrequent to keep the OIC Program from becoming an insurer of last resort. For example, an IRS official said that IRS would be wary of compromising with a business that could afford to pay its taxes but whose payroll manager embezzled company funds if the company were negligent in monitoring the manager because compromising might lead other businesses to become less diligent in protecting against such losses.

On the other hand, the Taxpayer Advocate has said that making non-hardship ETA acceptances difficult to accept may erode taxpayers' faith in the fairness of the income tax system. The Taxpayer Advocate and representatives of tax practitioner groups also have said that the low number of non-hardship ETA acceptances violates Congress's intent in passing the Restructuring Act, which was to make compromises easier for taxpayers to reach by expanding the basis on which compromises would be made.

As already noted, the provisions of the Restructuring Act on offers are broadly written and IRS's ETA regulations are consistent with the Restructuring Act. The act did not define criteria for accepting offers. Consequently, whether the number of non-hardship ETA offers IRS accepted satisfied Congress's intent is not clear.

**No Meaningful Distinction Exists between Hardship ETA and DATC Offers**

Although consistent with the law, regulations and guidance for reviewing hardship ETA offers are so similar to rules and guidance for determining acceptable DATC offers that the two types of offers are effectively indistinguishable from each other. For both types of offers, doubt exists that a taxpayer can afford to fully pay the tax liability owed.

IRS differentiates ETA offers (both hardship and non-hardship) from DATC offers by comparing a taxpayer's equity in assets and future income with the taxpayer's tax liability (see fig. 4). If equity in assets and future income is less than or equal to tax liability, then IRS processes the offer as DATC. If the equity in assets and future income is greater than tax liability, then IRS processes the offer under ETA rules. IRS considers ETA only after it has determined DATC does not apply. According to IRS guidance, taxpayers are eligible for ETA offers only when they can "full pay" the liability out of their equity in assets and future income.

**Figure 4: How IRS Determines Whether an Offer Is Considered for DATC or ETA**

If ...	... then
Equity in assets + future income $\leq$ tax liability	Taxpayer may be considered for DATC
Equity in assets + future income $>$ tax liability	Taxpayer may be considered for ETA

Sources: GAO analysis of IRS Internal Revenue Manual and Treasury regulations.

Once IRS determines that it will consider an offer as DATC or ETA, it calculates acceptable offer amounts following the procedure in figure 5.

**Figure 5: Conceptual Process for Determining Offer Amounts**

<b>Equity in assets + future income – living expenses = acceptable offer</b>
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Sources: GAO analysis of IRS Internal Revenue Manual and Treasury regulations.

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Non-hardship ETA offers are distinguishable from DATC offers in IRS rules and guidance because the criteria used to evaluate non-hardship ETA do not overlap with DATC. However, allowable living expenses that reduce DATC offer amounts are similar to the criteria IRS uses to determine whether taxpayers qualify for hardship ETA offers, making the difference between these two types of offers unclear. For example, a taxpayer applying for a DATC offer with medical expenses would include the medical care costs in calculating an acceptable offer amount; however, the IRM also lists medical expenses as a factor that would lead to consideration for hardship ETA.

Examples from IRS guidance and regulations do not add clarity to the distinction between an acceptable ETA hardship offer and an acceptable DATC offer. One example (see fig. 6) shows that taxpayers can qualify for ETA offers because of dependent care expenses; however, dependent care is also a factor that IRS considers as an allowable expense under DATC. Another example (see fig. 7) shows that taxpayers can qualify for a hardship ETA offer if fully paying their taxes would jeopardize their ability to pay basic living expenses; however, such expenses also comprise a group of factors that reduces a taxpayer's total income for determining the amount of an offer under DATC.

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**Figure 6: Hardship ETA: Qualify Because of Dependent Care Expenses**

The taxpayer has assets sufficient to satisfy the tax liability and provides full time care and assistance to a dependent child, who has a serious long-term illness. It is expected that the taxpayer will need to use the equity in assets to provide for adequate basic living expenses and medical care for the child. The taxpayers overall compliance history does not weigh against compromise.

Source: IRS's ETA regulations.

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**Figure 7: Hardship ETA: Qualify Because of Basic Living Expenses**

The taxpayer is retired and his only income is from a pension. The taxpayer's only asset is a retirement account, and the funds in the account are sufficient to satisfy the liability. Liquidation of the retirement account would leave the taxpayer without an adequate means to provide for basic living expenses. The taxpayer's overall compliance history does not weigh against compromise.

Source: IRS's ETA regulations.

IRS officials said that although overlap exists between DATC and hardship ETA, taxpayers who qualify for hardship ETA today would not have qualified for DATC before the Restructuring Act because IRS did not have the authority to compromise when taxpayers' equity and income exceeded their tax liability. However, in light of the additional legal authority granted by the Restructuring Act that IRS acknowledges, the distinction IRS makes in its rules and guidance between current DATC and hardship ETA offers is not meaningful. Based on our review, only ETA cases accepted on non-hardship grounds are meaningfully distinct from DATC offers because the criteria for accepting them are different.

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**ETA Rules Have Created Complexity and Confusion in the OIC Application Process, According to Tax Professionals**

Instructions on applying for ETA also cause unnecessary program complexity, while ETA rules and regulations cause confusion among taxpayers and professionals, according to the Taxpayer Advocate, practitioner organizations, and individual tax professionals with whom we consulted.

The OIC Program Manager said that it does not matter whether taxpayers check ETA, DATC, or DATL on their applications because each offer is evaluated for all three. Yet taxpayers still must check a box on the OIC application form (Form 656) indicating which type of offer they seek. Having to determine which box to check adds complexity to the process for taxpayers and tax practitioners. The choice among offer types also adds complexity for IRS, which determines which type of offer the taxpayer has made (i.e., DATC, DATL, or ETA). One professional tax practitioner told us that in filling out an OIC application for a client, she checked more than one box even though, according to IRS definitions, the types are mutually exclusive. Confusion and complexity may increase the burden for some taxpayers—the time and costs needed to prepare an offer application. Furthermore, as was discussed earlier, the Taxpayer Advocate has said that confusion about offer requirements and program procedures may reduce the program's accessibility.

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Because of the wording of the instructions, taxpayers applying for hardship ETA also are faced with the paradoxical process of proving that they can pay the tax liability and then explaining in writing why they cannot afford to pay it. According to the definition in the instructions, ETA offers have no “doubt as to collectibility,” but the instructions also say that the applicant must explain the circumstances that would justify an offer—circumstances equivalent to inability to pay.

The National Association of Enrolled Agents said that IRS's ETA rules were complex and difficult to understand, and the American Institute of Certified Public Accountants has said that ETA regulations do not provide sufficient guidance for determining which OICs qualify as ETA offers. The Taxpayer Advocate and other professionals also have said that it is difficult to know what types of offers will qualify for ETA based on the ETA regulations and guidance.

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## Partial Payment Proposal Raises Questions

Proposed legislation, originally introduced in the Senate,<sup>26</sup> would require taxpayers to make a partial payment with their offer applications. Taxpayers seeking a lump-sum offer would be required to pay 20 percent of the amount of the offer as a nonrefundable down payment. The term “lump-sum offer” means any offer of payments made in five or fewer installments. Alternatively, a periodic payment offer would have to be accompanied by the payment of the amount of the first proposed installment. The new provision also gives the Secretary of the Treasury authority to issue regulations waiving any such payment. Finally, no user fee would be imposed on any offer accompanied by a payment. IRS would have 60 days from enactment to implement the changes.

The legislative proposal that would require taxpayers to make a partial payment with their offer applications raises several questions for IRS. One is how the partial payment would apply in the case of repeat offers. For second and subsequent offers, would another partial payment be required? Is the payment nonrefundable for every disposition category? Should the rules for partial payments be consistent with the current rules for

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<sup>26</sup>This provision is being considered with H.R. 4297, which has been passed by both the House and the Senate and was in conference as of April 6, 2006. Although not included in the original House bill, the Senate-passed version of H.R. 4297 incorporated certain additional provisions that were originally included in S. 2020, including this provision related to deposits for offers.

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processing fees? Currently, if an offer fails to meet IRS's processability criteria, IRS returns the \$150 processing fee to taxpayers along with their offer applications.

Another question is whether the proposal might affect the program's accessibility. Would a partial payment requirement discourage eligible taxpayers from submitting offers? As discussed earlier, IRS does not monitor accessibility. Without a measure of accessibility, the impact of a partial payment on accessibility might not be easily determined.

Another question is whether 60 days are enough time to implement the partial payment requirements. IRS officials stated that computer systems would require changes to accommodate the imposition of partial payments. We did not determine how long it would take IRS to make the changes.

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## Conclusions

Because some delinquent taxpayers will always be unable to fully pay their tax debts, IRS's OIC Program is necessary to ensure that taxpayers pay what they can and have a "fresh start" toward complying with their future obligations. The performance of the program is important because factors like the timeliness of offer decisions can have a large impact on taxpayers in difficult financial straits and because the IRS resources devoted to the program are significant.

Opportunities exist to make immediate improvements to the program and lower costs. First, staffing adjustments have not kept pace with declines in cases in recent years, resulting in lower productivity. Reducing staffing to increase productivity to its recent levels would lower program costs. Second, because the distinction between DATC and ETA hardship offers is not meaningful, the program is unnecessarily complex. Practitioners and others have complained about the resulting confusion and burden on taxpayers, which may discourage taxpayers from using the program. Costs to taxpayers and IRS could be reduced by eliminating the distinction.

The success of the program also depends on how well IRS management understands the reasons for the program's performance. One step in understanding performance is measuring it. IRS's measurement of timeliness on an offer basis masks how long it takes to make a final decision for taxpayers to get their liabilities resolved. IRS's tracking of accessibility is also incomplete because it is not done relative to the size of the pool of potentially eligible taxpayers. IRS's tracking of the future

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compliance of program participants is also incomplete because it does not routinely measure compliance.

Another step in understanding performance is setting goals. Numeric goals provide objective criteria for assessing performance. The numeric goals for OIC timeliness still are not based on an analytical assessment of taxpayer needs and other benefits, and the goals are set for each case rather than for taxpayers.

A third step in understanding performance is analysis that determines the causes of performance. By understanding the causes of performance, IRS management can make better-informed decisions about how to improve performance. IRS's 2004 compliance study is an example—it led to the creation of the Hand-Off Unit. Because IRS has implemented several recent improvement initiatives, such as the Hand-Off Unit, additional analysis is necessary to understand their impact on compliance. Further, IRS has not analyzed other trends. IRS has not determined the causes of the large growth in repeat offers since 2000, despite their impact on timeliness from a taxpayer's perspective. In addition, IRS has not analyzed factors that affect trends in the OIC Program's accessibility. Without such an analysis, IRS will not know whether the declining OIC participation rate is an indication of a decrease in accessibility.

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## Recommendations for Executive Action

We recommend that the Commissioner of Internal Revenue:

1. Take the following steps to immediately improve the OIC Program:
  - adjust staffing levels to increase productivity and reduce cost per offer, unless IRS can demonstrate that case complexity has increased and
  - eliminate the distinctions between hardship ETA and DATC in the application, instructions, and procedures to simplify the program.
2. Develop meaningful measures of performance, including
  - a measure of processing timeliness for taxpayers,
  - a measure of accessibility that gauges ease of participation in the programs, and

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- a measure of compliance for all program participants.
3. Set processing timeliness goals for taxpayers that are based on an assessment of taxpayer needs and other benefits.
  4. Conduct analyses of the reasons for performance trends in order to
    - determine causes of the growth in repeat offers;
    - determine how repeat offers affect timelines and, if justified based on the results, take action to meet timeliness goals;
    - determine the reasons for trends in accessibility; and
    - determine the effectiveness of the Hand-Off Unit.

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## Matter for Congressional Consideration

If Congress's intent regarding the number of ETA non-hardship offers has not been met to date, Congress should provide IRS with more specific guidance on the criteria for such offers.

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## Agency Comments and Our Evaluation

In his April 14, 2006, letter the Commissioner of Internal Revenue (see app. III) said that he partially agrees with our recommendations. IRS provided separate technical comments, which we incorporated into our report where appropriate.

The Commissioner indicated that IRS believed that eliminating the distinction between economic hardship and doubt as to collectibility offers may not be the best approach but said that IRS is open to suggestions to clarify offer instructions and will consult with practitioner groups and the Taxpayer Advocate on whether more clarity is needed. The Commissioner said that the distinction is important because the Restructuring Act gave IRS additional authority to accept offers. The Commissioner further stated that the distinction has meaning for potential program participants. However, as we stated in the report, the regulations and guidance for reviewing hardship ETA offers are so similar to rules and guidance for determining acceptable DATC offers that the two types of offers are effectively indistinguishable from each other. IRS's examples of acceptable hardship ETA offers (see pp. 36 and 37 of this report), further illustrate that

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they are not meaningfully distinct from DATC offers because they demonstrate that there is doubt that such taxpayers could provide for their living expenses, which IRS authorizes for all offers, and pay their tax liabilities. This makes the offers in the examples similar to DATC offers. Considering this, the OIC Program could be simplified by eliminating the differences between hardship ETA and doubt as to collectibility offers.

The Commissioner agreed with our recommendation that IRS adjust staffing levels to increase productivity and reduce cost.

The Commissioner said that IRS does not agree that timeliness measured by taxpayer rather than by individual offer would be an effective measure of performance. IRS said that its existing timeliness measure by OIC case closure is sufficient, but it did agree to analyze the affect of repeat offers on timeliness. An analysis of the extent that timeliness could be improved, if at all, by reducing repeat offers could help program managers make decisions about whether program changes to improve timeliness would be justified. However, as the report states, it might be less costly for IRS to deal once with a taxpayer, even if it takes more time to work the single case, rather than have to process repeat offers.

IRS agreed that it could do a better job of compiling information on OIC Program compliance and will explore methods for doing so.

With respect to measuring accessibility, the Commissioner said that IRS is concerned about the perception that the OIC Program is less accessible than in the past. He said that IRS would use a customer satisfaction survey to gain insights into accessibility and might do additional research about barriers to entering the program. As we stated in the report, tracking accessibility could provide information about the effectiveness of efforts to reduce barriers to program participation for taxpayers wishing to make legitimate offers.

With respect to setting timeliness goals for taxpayers based on an assessment of taxpayers' needs and other benefits, the Commissioner said that IRS's current timeliness goals are based in part on such considerations but also said that IRS would consider whether taxpayer feedback reveals additional taxpayer needs. However, as the report states, IRS was unable to provide any analytical support for its 6- and 9-month processing goals. Furthermore, IRS does not set goals from the perspective of taxpayers. We continue to believe measuring timeliness from the perspective of taxpayers and setting goals based on taxpayer needs would inform IRS management

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of any gaps between actual timeliness and the goal of providing a better basis for making decisions about program improvements.

The commissioner agreed to analyze the causes of the growth in repeat offers.

He also agreed to study how repeat offers affect timeliness.

As already noted, the Commissioner agreed to study accessibility using a customer satisfaction survey of taxpayers who participated in the OIC Program. While such a survey may be informative, its benefits may be limited because it does not question nonparticipants. As the report states, measuring access may require questioning taxpayers about why they did not participate in the program.

The Commissioner agreed to study the effectiveness of the Hand-Off Unit.

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As agreed with your offices, unless you publicly release the contents earlier we plan no further distribution of this report until 30 days from its date. At that time, we will send copies to interested congressional committees, the Secretary of the Treasury, the Commissioner of Internal Revenue, and other interested parties. The report will also be available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-9110 or [whitej@gao.gov](mailto:whitej@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix IV.



James R. White  
Director, Tax Issues  
Strategic Issues

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# Scope and Methodology

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To identify recent trends in Offer in Compromise (OIC) Program performance, we analyzed information and program statistics in the Internal Revenue Service's (IRS) Automated OIC database (AOIC). Specifically, we developed independent statistical trend analyses for four of five key performance objectives—timeliness of case processing, quality, accessibility, and cost. We reviewed OIC Program data primarily from fiscal years 2000 through 2005. To determine how well IRS understands the reasons for the trends, we interviewed key officials in IRS's SB/SE Division responsible for collection policy and the OIC Program. We also reviewed available evaluations IRS had conducted in examining these trends.

To develop trend information on the timeliness of case processing, we (1) separated offers disposed by the OIC Program from those disposed by the Appeals function (Appeals),<sup>1</sup> and (2) identified the number of onetime and repeat offers and developed statistics on processing times for those offers. Some taxpayers make only one effort to compromise a tax liability. We call these offers onetime offers. Other taxpayers make multiple attempts to compromise a tax liability. We call the first of these attempts an initial offer and each subsequent attempt a repeat offer. To generate statistics on processing times for the various disposition types, we developed disposition categories by aggregating disposition categories from the AOIC database. For more information about how we developed repeat offers and disposition categories, see appendix II.

To assess trends in the quality of the OIC Program, we collected information and interviewed IRS officials on the accuracy rates from IRS's embedded quality measurement system (EQMS) for the centralized processing centers. Field locations only recently implemented EQMS; consequently, we used accuracy rates from IRS's collection quality measurement system for the field locations. We compared the program's accuracy rates against accuracy goals to assess the extent to which IRS staff followed procedures and made appropriate decisions. We also compiled and analyzed data on offer decisions by Appeals from the AOIC database to determine trends by year.

Regarding the OIC Program's accessibility, we compiled statistics on offer receipts and the dispositions of these receipts from the AOIC database. To

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<sup>1</sup>All offers disposed by the Appeals were rejected by the OIC Program. We identified all of these as offers rejected by the offer program and created new disposition dates based on the rejection date for these offers.

develop information on the pool of potentially eligible taxpayers for the program, we obtained data on IRS taxpayer delinquent accounts. We interviewed IRS officials about the measures they used to determine accessibility and also interviewed representatives of tax practitioner organizations and the National Taxpayer Advocate of the Taxpayer Advocate Service for their views about the program's accessibility.

To assess IRS's efforts to measure compliance, we reviewed IRS's reports on compliance by IRS's Office of Program Evaluation and Risk Assessment (OPERA). We used IRS policy statement P-5-100 and information on the OIC Program objectives from the Internal Revenue Manual as criteria for defining compliance, which the OIC Program Director generally confirmed. We also drew on our 2002 study<sup>2</sup> of IRS's OIC program, in which we recommended that IRS make plans to conduct evaluations of initiatives that affect the program's performance. To learn about possible alternatives for measuring compliance, we consulted an official with the Treasury Inspector General for Tax Administration to learn about its methods for studying compliance in one of its reports. We interviewed IRS officials who were knowledgeable about the Monitoring OIC (MOIC) Unit and with the OIC Hand-Off Unit to gather information about how post-OIC compliance was tracked.

We developed data on the productivity of the OIC Program by obtaining information from IRS on the number of full-time equivalent staff working in the OIC Program and compared this to the number of case closures from the AOIC database. We also interviewed IRS officials regarding any IRS analysis on productivity and reasons for productivity trends.

To estimate the extent of offer mills' participation in the OIC Program, we derived the number of offers designated solely to delay in the AOIC database that also were submitted with power of attorney forms. Also using the AOIC database, we measured how long IRS took to process those cases. We interviewed IRS officials with the OIC Program in Austin, Texas, and in Brookhaven, New York, and officials at the Office of Professional Responsibility (OPR), who investigate practitioner misconduct, in Washington, D.C. We also interviewed officials with OPERA about its work on abuse of the OIC Program. We reviewed reports on potential OIC abuse by IRS and internal IRS guidance on handling suspected cases of

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<sup>2</sup>GAO, *Tax Administration: IRS Should Evaluate the Changes to Its Offer in Compromise Program*, GAO-02-311 (Washington, D.C.: Mar. 15, 2002).

practitioner misconduct. We interviewed officials with the Federation of Tax Administrators (FTA), the state of Maryland OIC Program, and the Connecticut Attorney General's Office and compared their experiences with practitioner and offer mill misconduct with those cited by IRS officials. We selected FTA because its membership includes tax administration officials from states that have OIC programs. An FTA official referred us to the Maryland OIC Program. OPR cited the state of Connecticut's involvement with investigating offer mills during an interview. Finally, we conducted literature reviews for information about offer mills.

To assess how well IRS ensures that taxpayers are provided the right to appeal rejected offers, we analyzed the AOIC database to determine whether these taxpayers were sent the rejection letter notifying them of their appeal right. We reviewed IRS publications containing information about taxpayers' rights to appeal rejected offers and searched the IRS Web site for similar information. We performed limited testing of the AOIC database to determine whether appropriate entries were being made that ensured that a computer-generated rejection letter with appeals information had been sent to each taxpayer whose offer was rejected from fiscal years 2000 to 2005. We did not contact taxpayers to determine whether they actually received the letters. We interviewed OIC Program officials about the offer appeals process and followed up with Appeals officials, including Appeals staff at the Brookhaven, New York, campus who review and process rejected offers.

To determine whether IRS's regulations on effective tax administration (ETA) were consistent with the IRS Restructuring and Reform Act of 1998 (Restructuring Act), we reviewed the Restructuring Act, its legislative history, OIC regulations that were in place before the Restructuring Act, and the regulations issued to address the Restructuring Act changes. We met with representatives of the IRS Chief Counsel's Office who were involved in drafting the new and revised regulations on ETA offers. In addition, we reviewed their project files to gather documentation on how the ETA regulations evolved. The files contain documentation, such as internal memorandums, early draft of the regulations circulated to internal stakeholders, and public comments received after the proposed regulations were issued. In addition, we compared IRS's internal guidance on ETA and doubt as to collectibility (DATC) and IRS's regulations on ETA to determine whether they were distinct. We discussed ETA and DATC procedures, guidance, and rules with OIC Program officials and staff in Austin, Texas and staff in IRS's centralized processing center in Brookhaven, New York,

who processes offer applications. To gain perspective from some external OIC Program stakeholders on how IRS implemented ETA rules, we interviewed professional tax practitioners and representatives of the National Association of Enrolled Agents (NAEA) and the American Institute of Certified Public Accountants (AICPA). We selected NAEA and AICPA because they had previously testified or commented about IRS's OIC Program. We also conducted a literature review on ETA.

To comment on the legislative proposal requiring partial payments with offer applications, we drew on the results of our work relating to repeat offers and trends in OIC Program performance. Our review was conducted in accordance with generally accepted government auditing standards from February 2005 through February 2006.

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# Scope and Methodology on Detailed Analysis of IRS's AOIC Database

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To examine various measures of timeliness, quality, accessibility, and cost, we obtained a copy of portions of IRS's AOIC database as of September 30, 2005. The AOIC database contains processing information on offers submitted by taxpayers and related tax liability information since the OIC Program's inception to the current day.<sup>1</sup> The AOIC database is a relational database, and we limited our analysis to selected tables relevant to our objectives.

To ensure the reliability of the computer-based data provided to us, we conducted interviews with key agency personnel to ascertain the types of program edits and controls used to ensure the accuracy of data entry and data migration into the AOIC database from IRS's Master File. We also conducted various reliability analyses on data fields used in our analysis and reproduced reports prepared for program officials for their day-to-day management activities. We concluded that data in the AOIC database are sufficiently reliable for purposes of our engagement.

We concentrated our OIC Program analyses in two main areas: (1) the length of time it takes IRS to process offers by type of offer disposition (for example, accepted or rejected dispositions) and (2) the number of times taxpayers "repeat" offer submissions when a prior submission is not accepted and the length of time this processing of multiple offers takes. We also developed statistics on offer program inventory levels, the amount and percentages of tax debt compromised, and the number of offers processed under ETA regulations. In addition, we identified the number of offers returned to taxpayers because IRS believed a principal reason for the offer submission was to delay collection activities, and we determined how many of these offers had been prepared by professional practitioners. In general, we reported statistics for the 6 most recent fiscal years beginning in fiscal year 2000.

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<sup>1</sup>As of the end of fiscal year 2005, the AOIC database contained 1,239,596 offers, of which 18,500 were still being processed in the Collections function at the end of the fiscal year. Five offers were closed on Saturday, October 1, 2005, before our copy of the database was downloaded to disk. We assume these offers were closed on September 30, 2005, for purposes of our statistics. A total of 4,399 offers had been removed before these counts to prevent duplication because they represented transfers from one area office to another prior to centralization of the AOIC.

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Establishing GAO-Derived  
Dates and Disposition  
Codes

In examining reports IRS prepares from AOIC data, we determined IRS does not produce offer program statistics in a way that would allow us to answer our objectives. For example, IRS's analyses aggregates offer disposition statistics from both IRS's Collections function (i.e., the offer program) and its Appeals function. We wanted to separate these data in order to examine the OIC Program's performance.

We separated offer processing time between the Collection and Appeals functions by examining available date fields in the AOIC database and creating our own starting and ending processing dates. For our Collections function start date, we used the earlier of the dates IRS received an offer from a taxpayer, the IRS Received Date, or the date the offer was initially entered into the AOIC database, the Area Office Opening Date.<sup>2</sup> For our Collections function end date, we used the Area Office Closing Date except for rejected offers. For rejected offers, we checked to see if a rejection letter had been generated and the date on which this occurred. If this date was earlier than the Area Office Closing Date, then we used the rejection letter date.<sup>3</sup> Offers that were still being processed in the Collections function are considered open offers and do not have ending dates.

The Appeals function start date was also based on the earlier of two dates: (1) the date in the AOIC database, known as the Sent to Appeals Date, when it was present, or (2) our Collections function ending date plus 30 days when the Sent to Appeals date was not available or succeeded this date on offers known to have been appealed. The Collections ending date plus 30 days is the legal limit on the amount of time given a taxpayer to appeal a rejected offer.<sup>4</sup> The Appeals function ending date was always the official Area Office Closing date.

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<sup>2</sup>The IRS Received Date was used 99.88 percent of the time, and the Area Office Opening Date was used 0.12 percent of the time. There were 10 instances where the GAO-derived Collections function ending date preceded the available starting dates. In these instances, the starting date was made the same as the ending date.

<sup>3</sup>The Area Office Closing Date was used 92.77 percent of the time. A rejection letter date was used the remaining 7.23 percent of the time.

<sup>4</sup>The GAO-derived Collections function ending date plus 30 days was used 81.30 percent of the time, and the Sent-to-Appeals date was used 18.70 percent of the time. The database contained 83,937 rejected offers sent to Appeals, of which 76,520 had been closed by Appeals by the end of fiscal year 2005.

We also segregated offer disposition types between the Collection and Appeals functions. The AOIC database contains 10 disposition types, of which 3 represent Appeals function dispositions. Offers that are appealed by taxpayers remain open on the AOIC database pending Appeals function disposition decisions. We segregated the dispositions by creating five GAO-derived Collections function dispositions and three Appeals function dispositions. For example, we collapsed all of the offers contained in five of the program's disposition types, as well as certain offers still open on AOIC, into our "Rejected" offers disposition category. This showed the Collections function had rejected 247,780 offers during the program's history. These offers were as follows: (1) the 25,054 offers accepted by IRS's Appeals function, (2) the 43,511 offers where the Appeals Function sustained the Collections function, (3) the 42,880 offers rejected by the Collections function without appeal rights, (4) the 116,787 offers rejected by the Collections function where the taxpayer did not exercise appeal rights, (5) the 7,955 offers withdrawn in Appeals, and (6) the 11,593 offers rejected by the Collections function but not yet closed on AOIC pending possible Appeals function activities. We combined all of these offers to demonstrate that the Collections function had rejected 247,780 offers over the history of the OIC program. Tables 12 and 13 reflect this roll-up and compare other GAO-derived disposition types for the Collections and Appeals functions to IRS's disposition types. We have also included offers currently open in AOIC to balance offers between the two disposition sets.

**Table 12: GAO-Derived OIC Program Disposition Types**

<b>GAO disposition types and offers</b>	<b>Number of offers</b>	<b>Related IRS disposition type</b>
<b>Collections function</b>		
1. Not-processable	421,086	IRS #7
2. Processable return	192,881	IRS #10
3. Withdrawn/terminated	94,849	IRS #6 and #8
4. Rejected	247,780	IRS #2, #3, #4, #5, #9, and #A
5. Accepted	264,500	IRS #1
A. Open in Collections	18,500	IRS #A
<b>Total on the AOIC database</b>	<b>1,239,596</b>	
<b>Appeals function</b>		
1. Accepted by Appeals	25,054	IRS #2
2. Reject sustained by Appeals	43,511	IRS #3
3. Withdrawn in Appeals	7,955	IRS #9

**Appendix II  
Scope and Methodology on Detailed Analysis  
of IRS's AOIC Database**

*(Continued From Previous Page)*

<b>GAO disposition types and offers</b>	<b>Number of offers</b>	<b>Related IRS disposition type</b>
A. Open in Appeals	7,417	IRS #A
<b>Total on the AOIC database</b>	<b>83,937</b>	

Source: GAO analysis of IRS's AOIC database.

**Table 13: IRS OIC Program Disposition Types**

<b>IRS disposition types (or open offers)</b>	<b>Number of offers</b>	<b>Related GAO disposition type</b>
1. Accepted	264,500	Collections #5
2. Accepted by Appeals	25,054	Collections #4, Appeals #1
3. Rejection sustained by Appeals	43,511	Collections #4, Appeals #2
4. Rejected without appeal rights <sup>a</sup>	42,880	Collections #4
5. Rejected taxpayer did not exercise appeal rights	116,787	Collections #4
6. Withdrawn	93,311	Collections #3
7. Returned not processable	421,086	Collections #1
8. Termination of consideration	1,538	Collections #3
9. Withdrawn in Appeals	7,955	Collections #4 and Appeals #3
10. Processable return	192,881	Collections #2
A. Open on the AOIC database <sup>b</sup>	30,093	Collections #4 and #A, Appeals #A
<b>Total on the AOIC database</b>	<b>1,239,596</b>	

Source: GAO analysis of IRS's AOIC database.

<sup>a</sup>No longer an available disposition category because all rejected offers may now be appealed.

<sup>b</sup>Of the 30,093 offers open on the AOIC database as of September 30, 2005, 18,500 were still being processed by the Collections function, while 11,593 had been rejected by the Collections function. Of the rejected offers, 7,417 had been appealed and were open in Appeals, and 4,176 were awaiting a taxpayer's decision on whether to appeal.

**Distinguishing between Multiple Offers Submitted by Taxpayers**

Because many taxpayers submit more than one offer in an effort to compromise tax liabilities, and because IRS does not track multiple offers from the same taxpayer, we independently developed estimates of the

average (1) number of offers taxpayers submitted on the same tax liability,<sup>5</sup> (2) time it took IRS to process all of these offers, and (3) calendar time duration between the date the first in a series of offers was submitted and the date the last in the series was closed. In order to track these multiple offer submissions, we coined the term offer sets. Offer sets may contain one or many offers. We defined an offer set with only one offer as a onetime offer. For offer sets containing two or more offers, we defined the first offer in the set as an initial offer and the second and subsequent offers in the set as repeat offers. An offer set with two or more offers was also known as a repeat offer set.

Our criteria for calling a subsequent offer a repeat offer depended on whether tax liability information was available for comparison between two offers. For cases where tax liability information for one or both of two chronological offer dispositions had not been migrated from IRS's Master File to the AOIC database, a common occurrence when offers were closed not processable, we set a 1-year time limit for designating the subsequent offer as a repeat offer. Where the tax liability information was available for two offers, we compared it to see if any one tax liability matched. If it did, we called the subsequent offer a repeat and the length of time between offer submissions did not matter. Finally, any time an offer that was part of a repeat offer set was accepted, we assumed that offer was the last offer in the offer set. Any subsequent attempt by a taxpayer to compromise the same tax liabilities started a new offer set.

We believe a 1-year time limit is reasonable as a criterion for establishing repeat offers because most tax modules are 1 year in length corresponding with a taxpayer's annual filing requirement (for example, a tax module for an individual or corporate taxpayer would represent a calendar year period that they were required to file an income tax return). Taxpayers submitting offers must include all outstanding tax liabilities in the offer submissions, and we believe taxpayers who have not successfully compromised tax liability are not likely to have fully paid that tax liability and at the same

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<sup>5</sup>Individuals and businesses may have more than one tax liability. A tax liability is defined as the tax debt a taxpayer owes on any particular type of tax for any particular tax period. For example, a corporation might owe taxes on annual income for 1 or more years, or tax periods. At the same time, the corporation might also owe employment taxes on one or several quarterly tax periods. Each of these types of taxes and tax periods are separate tax liabilities. When a taxpayer submits an offer application, all outstanding tax liabilities should be included.

time incurred a new tax liability, which they attempt to compromise within that 1-year period.

The actual number of repeat offers and the average duration of time it takes taxpayers to compromise tax liabilities are estimates because (1) taxpayers continue to submit offers in the future for current tax liabilities for which prior offers were not accepted, (2) some taxpayers may fully pay outstanding tax liabilities then immediately incur new liabilities, and (3) some taxpayers filing jointly simultaneously attempt to compromise separate tax liabilities,<sup>6</sup> and it was not always possible to separately identify the two sets of offers. In the first situation, we underestimated the average time it takes to compromise tax liabilities when taxpayers extend that period by making future attempts to compromise their liabilities. In the second situation, we overestimated the number of repeat offers and the average time, but we believe such occurrences are rare. In the third situation, scenarios existed where we could have either underestimated or overestimated the actual number of repeat offers or the average duration times. On balance, we believe the first situation is the most common and that our estimates of the actual number of repeat offers and the average time duration are conservative.

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## Generating Other OIC Program Statistics

We also used our GAO-derived dates and disposition types to develop additional statistics using the AOIC database. For example, when OIC Program staff believe one of the reasons a taxpayer submitted an offer was an attempt to delay the collections process, they will enter one of several codes designating the offer as such in the AOIC database and return the offer to the taxpayer. We analyzed AOIC data by these codes and determined how frequently offers were returned for each code, the percentages of all offers submitted that were solely to delay collection activities, and how many offers involved professional practitioners. We also determined how long it took the OIC Program to return solely to delay offers involving professional practitioners.

In addition, we used the AOIC database to estimate how many ETA offers were processed over time. Before October 2005, IRS did not make a

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<sup>6</sup>This can occur, for example, when an individual taxpayer incurs tax liabilities, then marries and incurs additional tax liabilities with a spouse. The taxpayer is separately liable for the tax liabilities incurred before the marriage, but jointly liable with the spouse for the tax liabilities incurred during the marriage. In these instances, separate offers are required.

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**Appendix II**  
**Scope and Methodology on Detailed Analysis**  
**of IRS's AOIC Database**

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distinction between ETA offers on the AOIC database and offers accepted based on doubt as to collectability with special circumstances. These offers were commingled and categorized as offers where an alternative basis was used for compromise. However, an agency official told us that we could use all offers designated as alternative basis offers as a proxy for the number of ETA offers processed by IRS. The agency added a data field beginning in October 2005 to specifically track ETA offers.

Furthermore, we calculated the Collections function's inventory levels for fiscal years 2000 through 2005. In addition, we used the tax liability and offer amount fields in the AOIC database to determine the percentage of tax debt compromised by IRS's Collection function.

# Comments from the Internal Revenue Service



COMMISSIONER

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

April 14, 2006

Mr. James R. White  
Director, Tax Issues  
Strategic Issues Team  
United States Government Accountability Office  
Washington, DC 20548

Dear Mr. White:

Thank you for the opportunity to respond to your draft report entitled, "IRS Offers In Compromise (OIC) – Performance Has Been Mixed; Better Management Information and Simplification Could Improve the Program," (GAO-06-525).

I am pleased that your report acknowledges many of the improvements we have made in this important program. As you noted, the timeliness of determinations has improved even as the costs of the program have been significantly reduced. This reduction in costs has been primarily achieved by reducing the number of revenue officers dedicated to the program. Freeing up these revenue officers to return to core collection activities also has increased our enforcement presence in other areas, such as employment tax compliance and combating abusive tax avoidance transactions.

The report also confirms that these advances in timeliness and efficiency have not come at the expense of quality. You note that both the field and campus offer in compromise operations have met their quality goals, and that the rate at which the Office of Appeals sustains collection decisions is further evidence that quality goals are being achieved.

With respect to the audit recommendations, we are in partial agreement with each of the four recommendations. Many of your concerns mirror our own and, as a result, we already have efforts under way to address some of these concerns. Our comments on the draft report's specific recommendations are enclosed.

If you have any questions, please call me or Kevin Brown, Commissioner, Small Business/Self-Employed Operating Division, at (202) 622-0600.

Sincerely,

A handwritten signature in black ink, appearing to read "Mark W. Everson".

Mark W. Everson

Enclosure

Enclosure

**Comments of the Internal Revenue Service on the GAO report entitled “IRS Offers In Compromise (OIC) – Performance Has Been Mixed; Better Management Information and Simplification Could Improve the Program” (GAO-06-525)**

**RECOMMENDATION 1**

Take the following steps to immediately improve the OIC program:

- Eliminate the distinctions between hardship-ETA and DATC in the application, instructions, and procedures to simplify the program, and
- Adjust staffing levels to increase productivity and reduce cost per offer, unless IRS can demonstrate that case complexity has increased.

**RESPONSE**

Although we understand the need to simplify the OIC program whenever possible, we believe that eliminating the distinction between economic hardship and doubt as to collectibility offers may not be the best approach. Nonetheless, we are open to the suggestion that the instructions in the Form 656 could be clarified in this area. As we prepare for the next revision of the form, we will consult with practitioner groups and the Taxpayer Advocate on this issue, and we will provide greater clarity.

The distinction between these two types of offers is very important in terms of the additional compromise authority granted in the regulations promulgated after the IRS Restructuring and Reform Act of 1998. In our experience, the distinction also has meaning for many potential program participants. In a doubt as to collectibility situation, the liability could not be collected in full, even taking into account all of the taxpayer’s income and assets. An economic hardship offer can be accepted when the tax liability at issue could be collected in full, but doing so would cause the taxpayer economic hardship. (Economic hardship is defined as the inability to pay reasonable basic living expenses.) Because of the economic hardship guidelines, thousands of taxpayers have had OICs accepted that would have been rejected prior to the regulations being amended. To the extent the delineation of these two types of offers in the instructions may alert some taxpayers that they are potential offer candidates—and may prompt them to better describe the economic hardship that would result from collection—the distinction may be meaningful and helpful in some cases.

We agree that staffing levels should be adjusted in response to changing program needs. As the GAO report confirms, we have made significant adjustments over the past several years. Full-time equivalents (FTEs) in the Centralized OIC sites have been reduced from 380 in 2002 to 320 in 2005 and revenue officers dedicated to the program in the field have been reduced from 1,078 in April 2001 to 267 in April 2006. We have moved cautiously in this area so as to minimize backlogs and gaps in activity, and to ensure that staffing reductions do not impact timely service. The IRS has been in negotiations with the National Treasury Employees Union (NTEU) and recently reached

an agreement that will return about 100 additional revenue officers to general program collection work.

**RECOMMENDATION 2**

Develop meaningful measures of performance including:

- A measure of processing timeliness for taxpayers;
- A measure of compliance for all program participants; and
- A measure of accessibility that gauges ease of participating in the program.

**RESPONSE**

We agree that meaningful measures of performance are an essential part of effective program management. As a result, we have in place a comprehensive suite of operational measures to gauge the progress and effectiveness of the program. The three main OIC program objectives are timeliness, quality, and efficiency, and we are confident that our existing measures provide the necessary information to assess our performance in each of these areas. We measure and report on the timeliness of OIC case closures by tracking the number of months it takes to close each individual OIC case. We measure the quality of casework using the embedded quality system. The draft report acknowledged that the program is meeting its quality goals. The efficiency of the program is measured by both the number of hours taken to close a case and the number of field closures per direct staff year. Consequently, we are not inclined to adopt additional measures at this time.

Based on our experience with the OIC program, we do not agree that timeliness measured by taxpayer rather than by individual offer would be an effective measure of performance. Nonetheless, we do agree that "repeat offers" is an area worthy of additional review, and we have already taken steps to address this issue. By making changes to our processes for requesting additional information from taxpayers, we have significantly reduced the number of offers returned to taxpayers for failure to provide requested information. We believe this reduction in returned offers will help reduce the number of repeat offers because a higher percentage of cases will be worked to a final decision. We also plan to ask the Office of Program Evaluation and Risk Assessment (OPERA) to undertake a small study of repeat offers to get a better sense of whether we need to make additional changes to the program.

We agree that the IRS can do a better job of compiling information regarding compliance during the five year monitoring period following acceptance of an offer. Future compliance is an important potential benefit of the program. We will explore methods for gathering reliable post-acceptance compliance information. We also acknowledge that we have not historically tracked compliance by other program participants. We have begun to gather data on taxpayer behavior following rejection through the handoff unit referenced in Recommendation 4.

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We are concerned about the perception that the offer in compromise program is less accessible than in the past. We expect that the customer satisfaction survey we are currently conducting will give us some insights into the ease or difficulty of navigating the offer process. Depending on those results, we may ask OPERA to do some additional research and analysis on accessibility. We also will engage practitioner groups in discussions of this issue to determine perceived barriers to entering the program and how those barriers might be overcome.

**RECOMMENDATION 3**

Set processing timeliness goals for taxpayers that are based on an assessment of taxpayer needs and other benefits.

**RESPONSE**

We agree that taxpayer needs and other benefits should be taken into account when setting program goals, including goals related to timeliness. Our current processing timeliness goals are based in part on such considerations. Taxpayer and practitioner feedback consistently reveals a need for a quality determination, effective communication, and a resolution at the earliest possible time. Our current timeliness goals were established taking into account these needs, the complexity of cases, and certain legal requirements which tend to have an impact on processing time. We are currently conducting a customer satisfaction survey of taxpayers who participated in the OIC program and will consider whether feedback from that survey reveals additional taxpayer needs that should be taken into account in setting timeliness goals.

**RECOMMENDATION 4**

Conduct analyses of the reasons for performance trends in order to:

- Determine causes of the growth in repeat offers;
- Determine how repeat offers affect timeliness and, if justified based on the results, take action to meet timeliness goals;
- Determine the reasons for trends in accessibility; and
- Determine the effectiveness of the handoff unit.

**RESPONSE**

We agree that an increase in the number of repeat offers could potentially be a sign of breakdowns in the process. We have shared the GAO analysis with our research department and hope to validate those findings in the near future. As referenced in our response to Recommendation 2, we have already taken several steps that we believe will reduce the number of repeat offers in the future. In particular, we recently revised our procedures for requesting missing information or documents from taxpayers. The IRS will now initiate an additional taxpayer contact to secure missing information before an OIC is returned. We have also clarified the steps that must be taken before an OIC will be returned for failure to make estimated tax payments. As noted earlier, we also intend to review a representative sample of repeat offers in order to determine whether

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other changes are appropriate. We will use this sample to analyze the effect, if any, of repeat offers on timeliness.

As your report noted, a decrease in taxpayer participation in a program does not necessarily indicate that the program is less accessible. We have continued to improve our forms and instructions to better inform taxpayers of program requirements and expectations, and believe that some reduction in offers is attributable to taxpayers making a more informed decision as to whether the compromise program is right for them. We hope that our customer satisfaction survey will provide data regarding any difficulties taxpayers face in participating in the program so that appropriate changes in procedures can be made.

We agree that it is important for the IRS to determine the effectiveness of the hand-off unit. We will continue the operational review process now in place and reach a decision about whether the unit is effective and should be made permanent.

# GAO Contact and Staff Acknowledgments

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## GAO Contact

James R. White (202) 512-9110 or [whitej@gao.gov](mailto:whitej@gao.gov)

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## Acknowledgments

In addition to the contact named above, Charlie Daniel, Assistant Director; Evan Gilman; Eric Gorman; Shirley Jones; Susan Mak; Michael Rose; Samuel Scrutchins; and Jennifer Li Wong made key contributions to this report.

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