ARTICLE

GETTING MORE BY ASKING LESS: JUSTIFYING AND REFORMING TAX LAW'S OFFER-IN-COMPROMISE PROCEDURE

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The Offer in Compromise (OIC) is a procedure by which the IRS may agree to forgive a portion of the tax liabilities of certain taxpayers. This Article suggests a framework for evaluating the effectiveness of any proposed reforms to this procedure. It presents three arguments that support forgiving tax debts through devices such as the OIC. These arguments are rooted in revenue-raising, fairness, rehabilitative, and socioeconomic considerations. Unfortunately, an analysis of the OIC's recent history shows that its current structure tends to undermine its effectiveness. The power to effectuate the procedure is dispersed among four stakeholders with divergent interests: Congress, the IRS, the taxpayer, and financial and other supporters of the taxpayer. Each of these players has conflicting and contradictory interests in OIC-procedure outcomes. Over time, the actions and decisions of each of these players can lead to conflicting and counterproductive behaviors and responses by other players, and this undermines the program's overall effectiveness. Given this dynamic among stakeholders, reforms that

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would minimize or eliminate such downward-spiraling interactions of divergent interests should be adopted. Conversely, reforms likely to provoke or exacerbate such interactions should be avoided. This Article provides examples of each type of reform.

INTRODUCTION

What should happen when a taxpayer cannot pay her taxes? Should the taxpayer, who may be experiencing financial hardship or facing exceptional personal circumstances, always be compelled to pay the full amount of her tax liability, no matter the consequences? And what measures can or should the taxing authority take against a taxpayer who cannot pay? Under what circumstances should tax debts be forgiven in order to further greater societal and revenue goals? The answers to these and other questions are of vital importance in analyzing the law of tax collections. With a few notable exceptions,[1] however,

[1] *See, e.g.*, Bryan T. Camp, *The Failure of Adversarial Process in the Administrative State*, 84 IND. L.J. 57, 88-111 (2009) [hereinafter Camp, *Failure of Adversarial Process*] (criticizing the 1998 "Collection Due Process" reforms that were designed to improve administrative and judicial review of IRS tax collection decisions); Bryan T. Camp, *Tax Administration as Inquisitorial Process and the Partial Paradigm Shift in the IRS Restructuring and Reform Act of 1998*, 56 FLA. L. REV. 1, 82 (2004) [hereinafter Camp, *Tax Administration as Inquisitorial Process*] (distinguishing the procedural rights provided in the criminal justice system from those available in civil tax collection disputes); Danshera Cords, *Administrative Law and Judicial Review of Tax Collection Decisions*, 52 ST. LOUIS U. L.J. 429, 474 (2008) (arguing for more consistent application of administrative law procedures between tax collection cases in the Tax Court and those in the district courts); Steve R. Johnson, *An IRS Duty of Consistency: The Failure of Common Law Making and a Proposed Legislative Solution*, 77 TENN. L. REV. 563, 578 & n.86 (2010) (questioning whether the Administrative Procedure Act creates a duty for the IRS to treat similarly situated taxpayers consistently in tax collection cases); Leandra Lederman, *Tax Compliance and the Reformed IRS*, 51 U. KAN. L. REV. 971, 992-96 (2003) (concluding that improved customer service by the taxing authorities does not increase tax collections and compliance).

the academic literature tends to treat these collections issues as an afterthought, secondary in importance to more substantive or theoretical issues such as the tax base, tax rates, tax expenditures, and even tax penalties. These tax collections issues therefore tend to be understudied and underanalyzed.[2] Yet these issues have great policy significance because the ways in which we collect taxes that have been assessed and are owed implicate important tax policy concerns, including efficiency, equity, administrability, and distributive justice.

In this Article, I analyze one of the tools in the IRS's collections toolkit—its power to compromise a tax liability via the Offer-in-Compromise (OIC) procedure[3]—and propose an analytical framework through which the procedure should be understood and ultimately reformed. Generally speaking, the OIC procedure is a collections procedure by which the IRS may forgive a portion of the debts owed by certain taxpayers who are having difficulty paying the full amount owed. Such a taxpayer may offer to settle her tax liability by paying only a portion of the total taxes due. The taxpayer must meet certain requirements and conditions in order to qualify, and the IRS has the discretion to accept or deny the offer. The OIC procedure is therefore an important way in which the tax system copes with the problem of taxpayers who are unable to pay their taxes. However, there is almost no academic literature on the subject.[4]

My study of the OIC procedure has both programmatic and philosophical goals: I examine the procedure in the interest of program-

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[2] There is literature on the question of whether some degree of evasion should be permitted. However, this literature does not generally address directly the question of how to respond to inability to pay or taxpayer distress. *See, e.g.*, James Andreoni, *IRS as Loan Shark: Tax Compliance with Borrowing Constraints*, 49 J. PUB. ECON. 35, 44 (1992) (arguing that full tax compliance may not be desirable because the IRS can smooth consumption of borrowing-constrained taxpayers by permitting some amount of evasion, thereby "partially completing capital markets"); Louis Kaplow, *Optimal Taxation with Costly Enforcement and Evasion*, 43 J. PUB. ECON. 221 (1990) (analyzing the distortionary impacts of raising tax rates versus increasing enforcement activity in determining optimal enforcement policy).

[3] This Article refers to the Offer-in-Compromise procedure as the "OIC procedure" or simply as "OIC."

[4] As discussed in this Article, the National Taxpayer Advocate, the Government Accountability Office, and the Treasury Inspector General for Tax Administration have studied and written about the procedure. However, there is little academic scholarship about the procedure. A notable exception is a 1994 law review article on the question of whether a compromise of a tax liability is taxable income. *See* Richard C.E. Beck, *Is Compromise of a Tax Liability Itself Taxable? A Problem of Circularity in the Logic of Taxation*, 14 VA. TAX REV. 153 (1994).

specific reform and also as a gateway to the consideration of broader issues of when, why, and to what extent a tax liability should be forgiven. I argue that important revenue-raising, fairness-based, rehabilitative, and socioeconomic arguments weigh in favor of having a systematic and effective "escape valve" for tax-debt forgiveness. Most pertinently, IRS collections data show that the IRS ultimately collects more per dollar of outstanding tax liability through accepted offers in compromise than it does from offers it has rejected.[5] OICs also yield more cents on the dollar than do regular collections methods with respect to certain categories of delinquent tax debts.[6] But despite these encouraging numbers, an analysis of the procedure's recent history reveals problematic trends that suggest that it is not operating as effectively as it could be.

I argue that the OIC procedure is structured in a way that systematically undermines its effectiveness. Problematically, the power to effectuate the OIC procedure is dispersed among four stakeholders with divergent interests: (1) Congress, (2) the IRS, (3) the taxpayer, and (4) financial and other supporters of the taxpayer. Each of these players has conflicting and contradictory interests in how tax forgiveness should operate in general, and in how the OIC procedure should function in particular. Moreover, the actions and decisions of each of the players may provoke counterproductive responses from other players, such that, over time, the program's effectiveness is weakened. I therefore suggest that reforms likely to provoke or exacerbate these undesirable stakeholder dynamics should be disregarded. Conversely, reforms likely to minimize the effects of power dispersal and interest divergence should be adopted.

In Part I, I describe the basic features of the OIC procedure and explain its importance. I first describe the procedure as it currently exists on paper. I then defend the need for a robust but tailored debt-forgiveness procedure by arguing that such a procedure (1) enables the IRS to collect more revenue, (2) reflects a rich conception of distributive justice that looks beyond assessed tax liabilities, and (3) comports with the realities of a world in which debtors sometimes cannot repay their debts. Such a system serves society's interests in debtor rehabilitation as well as social and economic stabilization.

I then turn to a discussion of how OIC has functioned over time. In Part II, I discuss two observable trends in the OIC procedure's re-

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[5] *See infra* subsection I.B.1.

[6] *See infra* subsection I.B.1.

cent history that give rise to concerns that the procedure is ineffective, and I provide some background regarding the historical context in which these two trends arose. I then present, in Part III, a power-dispersal and interest-divergence analysis of the OIC procedure's functioning, showing that the dynamics between the four stakeholders have caused the procedure to perform less well over time than one might have hoped. I argue that the OIC procedure must be reformed to counteract these problematic stakeholder dynamics. This can happen by either (1) centralizing power among fewer stakeholders or (2) adopting proposals that eliminate or minimize the likelihood of downward-spiraling interactions among stakeholders with divergent interests. The second of these strategies is the more promising simply because it is difficult to change the realities underlying the relationships and dynamics among the stakeholders.

Finally, in Part IV, I describe two concrete proposals that align with my suggested framework: (1) empowering an independent decision-maker to consider offer proposals and (2) making user fees and the required partial down payments on offers refundable. I further argue that an alternative reform suggested by the Treasury Inspector General for Tax Administration—the introduction by the IRS of more aggressive follow-up collection tactics for rejected OICs—is unlikely to succeed because such a move would result in unproductive and dissonant responses on the part of taxpayers.

The OIC procedure is just one discrete tool at the IRS's disposal, but the implications of my analysis are broad. Thinking analytically about whether and how to operate and improve such a program demonstrates how stakeholder dynamics can impact tax administration. It also opens a window to the consideration of broader philosophical issues and tensions in the area of tax collections, including whether a taxing authority can act as an altruistic creditor toward tax debtors, how much flexibility is necessary in our system of tax collections, and what role forgiveness should play in the tax system.

I. THE OFFER IN COMPROMISE: WHAT IT IS AND WHY IT MATTERS

In this Part, I provide an overview of the OIC procedure and describe its main features. I then present three arguments to support the proposition that a workable tax-debt forgiveness procedure is an important feature of our tax law. The analysis presented in the remainder of this Article is predicated on the assumption that an effective system of tax-debt relief is justifiable in at least some situations.

A. *The OIC Procedure: A Brief Description*

The OIC procedure is a method by which a taxpayer may settle her unpaid tax debts for an amount less than the full sum of taxes, interest, and penalties she owes. These settlements are distinct from installment agreements, under which a taxpayer who cannot immediately pay her taxes in full agrees to pay her debt to the IRS in installments over time.[7] Section 7122 of the Internal Revenue Code authorizes the IRS to enter into OICs, specifically providing that the IRS may compromise a civil or criminal tax case prior to the case being referred to the Department of Justice for prosecution or defense.[8]

In exchange for the IRS settling the tax debt for less than full payment, the taxpayer becomes subject to certain requirements, conditions, and consequences, including a requirement that she file tax returns and remain compliant with the tax laws for the subsequent five years.[9] The statute of limitations on collection is also suspended while the offer is being considered and for the duration of any appeals of rejected offers.[10] While the OIC is being evaluated and processed, the IRS also may credit overpayments of the taxpayer's other tax liabilities against the liability sought to be compromised and many offset such overpayments against other liabilities owed to the extent authorized by the Code.[11]

On the other hand, the taxpayer also receives valuable safeguards. For example, the IRS is prohibited from levying on property with respect to the unpaid tax while the offer is pending, for thirty days following rejection of the offer, and while a timely appeal is pending.[12] Thus,

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[7] *See* I.R.C. § 6159 (2006) (authorizing such agreements). However, under a partial payment installment agreement, the taxpayer will not necessarily need to pay the full amount of the liability. *See* IRM 5.14.2.1 (Mar. 11, 2011). The most current version of the Internal Revenue Manual (IRM) is available on the IRS's website. *Internal Revenue Manual*, IRS, http://www.irs.gov/irm (last visited Jan. 15, 2012).

[8] I.R.C. § 7122(a). After the case has been referred to the Department of Justice, the power to compromise a tax liability lies with the Attorney General. *Id.*

[9] *See* IRS, FORM 656: OFFER IN COMPROMISE 3 (2011) [hereinafter IRS, FORM 656]; I.R.S. Chief Couns. Mem. 200102001 (Jan. 12, 2001) ("Should the taxpayer fail to keep [the] promise [to comply], the Service may terminate the compromise and take action to collect the full balance of the unpaid tax liabilities covered by the compromise."); *see also* MICHAEL I. SALTZMAN, IRS PRACTICE AND PROCEDURE, ¶ 15.07[8] (2010).

[10] *See* I.R.C. § 6331(k)(3) (stating that I.R.C. § 6331(i)(5), which suspends the statute of limitations on collection, also applies to pending OICs and appeals of denied OICs). This discourages taxpayers from submitting offers simply to run out the statute of limitations on collection.

[11] Treas. Reg. § 301.7122-1(g)(5) (2002); *see also* I.R.C. § 6402.

[12] I.R.C. § 6331(k)(1).

the OIC procedure offers benefits that make it an attractive option for a delinquent taxpayer.

While the OIC procedure is a creature of statute, looking only to the statute and accompanying regulations will not yield a complete picture of the procedure's operation. Specific details on how the IRS executes the OIC procedure are contained in the Internal Revenue Manual.[13] The Manual also describes four key policy objectives of the OIC procedure:

- Effect collection of what can reasonably be collected at the earliest possible time and at the least cost to the government.
- Achieve a resolution that is in the best interests of both the individual taxpayer and the government.
- Provide the taxpayer a fresh start toward future voluntary compliance with all filing and payment requirements.
- Secure collection of revenue that may not be collected through any other means.[14]

However, the Internal Revenue Manual does not specify how to prioritize or weight these four objectives. This lack of guidance, paired with the fact that these objectives may conflict, can create implementation problems.

Under the OIC regulations, there are three permissible grounds for compromise of a tax liability: (1) doubt as to collectibility, (2) doubt as to liability, and (3) the promotion of effective tax administration.[15]

1. Doubt as to Collectibility

The IRS most commonly accepts offers for the reason of doubt as to collectibility.[16] Doubt as to collectibility exists where the taxpayer is unable to pay the full amount of the tax liability owed because "the taxpayer's assets and income are less than the full amount of the liability."[17] Thus, these OICs require the IRS to determine the taxpayer's ability to pay.[18] Treasury Regulations provide that, in determining ability to pay, taxpayers will be allowed to retain sufficient funds to pay

[13] *See generally* IRM ch. 5.8.

[14] *Id.* 5.8.1.1.4 (Sept. 23, 2008).

[15] Treas. Reg. § 301.7122-1(b).

[16] U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-06-525, IRS OFFERS IN COMPROMISE: PERFORMANCE HAS BEEN MIXED; BETTER MANAGEMENT INFORMATION AND SIMPLIFICATION COULD IMPROVE THE PROGRAM 1 (2006) [hereinafter 2006 GAO REPORT].

[17] Treas. Reg. § 301.7122-1(b)(2).

[18] *Id.* § 301.7122-1(c)(2)(i).

basic living expenses.[19] When calculating basic living expenses, IRS guidelines on national and local living expense standards must be considered, however individual facts and circumstances will also be taken into account.[20]

Whether a doubt-as-to-collectibility offer will be accepted depends on whether the offer reflects the "reasonable collection potential" (RCP).[21] The Internal Revenue Manual defines the RCP as "the amount that can be collected from all available means, including administrative and judicial collection remedies."[22] The RCP calculation will generally take into account (1) the amount collectible from the taxpayer's "net realizable equity" in her assets, (2) the taxpayer's expected future income after taking into account necessary living expenses, (3) the amount collectible from third parties, and (4) the taxpayer's income or assets that are available to the taxpayer but beyond the reach of the IRS, such as property held abroad.[23] The "net realizable equity" in an asset is the "quick sale value" of the asset minus any amounts owed to lien holders with priority over the federal tax lien and levy exemption amounts.[24] Essentially, in determining whether a doubt-as-to-collectibility offer should be accepted, the IRS has to analyze the taxpayer's assets, expenses, and liabilities.

A doubt-as-to-collectibility offer will generally not be accepted where the taxpayer is capable of paying the tax in full as a lump sum or where the tax is payable under an installment agreement.[25] In such situations, the offer will be denied unless special circumstances exist to justify consideration of a lesser amount.[26]

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[19] *Id.*

[20] *Id.*

[21] IRM 5.8.4.3(2) (June 1, 2010).

[22] *Id.*

[23] *Id.* 5.8.4.3.1; *see also* SALTZMAN, *supra* note 9, ¶ 15.07[6][a].

[24] IRM 5.8.5.4.1(1) (Oct. 22, 2010). The "quick sale value" is generally the estimated price of an asset where financial pressures have caused the asset's owner to sell it within ninety days. *Id.* 5.8.5.4.1(2). Unless circumstances indicate differently, the IRS generally presumes the quick sale value to be equal to eighty percent of the asset's fair market value. *Id.* 5.8.5.4.1(3).

[25] *Id.* 5.8.4.3(3) (June 1, 2010).

[26] *Id.* Such special circumstances include economic, public policy, or equity concerns. IRM 5.8.11.2(2) (Sept. 23, 2008). The Internal Revenue Manual lists factors to consider in making a hardship or public policy/equity determination. *See* IRM 5.8.11.2.1; *id.* 5.8.11.2.2.

2. Doubt as to Liability

Doubt as to liability exists where there is a "genuine dispute" about "the existence or amount of the correct tax liability."[27] However, it does not exist where there is a final court decision or judgment establishing the liability.[28] Such offers usually arise when a taxpayer seeks to contest an assessed tax liability that she failed to petition to the tax court within the applicable time period.[29] In order for this type of offer to be successful, the taxpayer must show that she would suffer a hardship if she had to pay the disputed tax upfront and then later file a refund suit.[30]

3. Effective Tax Administration

As a result of changes brought about by the Internal Revenue Service Restructuring and Reform Act of 1998,[31] there is now a third ground for compromising a tax liability—the promotion of "effective tax administration" (ETA).[32] Under the regulations, an ETA offer may be accepted when "collection in full could be achieved, [but] collection of the full liability would cause the taxpayer economic hardship."[33] In the absence of economic hardship, the IRS may nonetheless compromise a tax liability on ETA grounds "where compelling public policy or equity considerations identified by the taxpayer provide a sufficient

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[27] Treas. Reg. § 301.7122-1(b)(1) (2002).

[28] *Id.*

[29] SALTZMAN, *supra* note 9, ¶ 15.07[1][b][i]. The petition filing period is ninety days. *Id.*

[30] *Id.*

[31] Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of I.R.C.).

[32] Treas. Reg. § 301.7122-1(b)(3). The Committee Report for the IRS Restructuring and Reform Act of 1998 expressed the intent to expand use of the OIC procedure beyond the two traditional grounds:

> [T]he conferees expect that the present regulations will be expanded so as to permit the IRS, in certain circumstances, to consider additional factors . . . in determining whether to compromise the income tax liabilities of individual taxpayers. For example, the conferees anticipate that the IRS will take into account factors such as equity, hardship, and public policy where a compromise of an individual taxpayer's income tax liability would promote effective tax administration.

H.R. REP. NO. 105-599, at 289 (1998) (Conf. Rep.).

[33] Treas. Reg. § 301.7122-1(b)(3)(i). The Internal Revenue Manual lists a number of factors to consider in determining whether economic hardship exists and provides examples of when such hardship is present. *See* IRM 5.8.11.2.1 (Sept. 23, 2008).

basis for compromis[e]."[34] Regardless of whether the ETA offer is based on hardship, public policy, or equity, ETA offers will be considered only if the taxpayer does not qualify for compromise under the two traditional bases discussed above.[35]

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A taxpayer seeking to compromise her tax liability under the OIC procedure must submit her offer on IRS Form 656.[36] The submission must include detailed information about the taxpayer's tax liabilities, the grounds for the compromise request, the proposed compromise amount, and the payment terms.[37] The taxpayer must also submit a "Collection Information Statement" that requires detailed information about her finances.[38] If the IRS rejects an offer that contains all of the required information, the taxpayer may appeal to the IRS Office of Appeals within thirty days by requesting administrative review "in the manner provided by the Secretary."[39] If, however, the IRS cannot evaluate an offer because the taxpayer provided insufficient information (i.e., the offer is "nonprocessable"), or because the offer was submitted solely to delay the collection of tax, then the offer will be "returned."[40] When OIC documents are "returned" to the taxpayer, it is not considered a rejection, and the taxpayer is not entitled to an appeal.[41] Thus, the right to appeal is contingent on an actual determination on the merits.

B. *A Preliminary Case for a Robust Offer-in-Compromise Procedure*

It may not be immediately clear that the OIC procedure is desirable or, more generally, that any sort of tax-debt relief procedure is justifia-

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[34] Treas. Reg. § 301.7122-1(b)(3)(ii); *see also* IRM 5.8.11.2.2 (explaining when non-hardship ETA offers should be considered); *id.* 5.8.11.2.2.1 (providing examples of factors to consider in making public policy or equity determinations).

[35] IRM 5.8.11.1(5).

[36] IRS, FORM 656, *supra* note 9.

[37] *See* SALTZMAN, *supra* note 9, ¶ 15.07[4]; Steven R. Mather & Paul H. Weisman, *Federal Tax Collection Procedure—Defensive Measures*, TAX. MGMT. PORTFOLIOS, no. 638-3d, 2010, at A-46 to -48.

[38] IRS, FORM 433-A: COLLECTION INFORMATION STATEMENT FOR WAGE EARNERS AND SELF-EMPLOYED INDIVIDUALS (2008).

[39] Treas. Reg. § 301.7122-1(f)(5)(i).

[40] *Id.* § 301.7122-1(f)(5)(ii).

[41] *Id.* The IRS may also levy to collect the outstanding liability at any time after the offer is returned to the taxpayer. *Id.* § 301.7122-1(g)(4).

ble. There are a few seemingly obvious arguments against compromising tax debts. First, forgiving tax liabilities that have already been assessed may seem facially unfair. Specifically, it seems inequitable to forgive the tax debts of some taxpayers while insisting that others pay in full, particularly when the law has already determined that both groups owe the same amount of tax. Second, a viable tax-debt compromise procedure may create a moral hazard problem. If taxpayers know that these programs exist, they may be incentivized to engage in risky behaviors that may result in an inability to pay the tax in the first place. Third, a robust tax forgiveness program may be hard to justify because the government must incur administrative costs to provide tax-debt relief.

The unfairness, moral hazard, and cost arguments relate to three traditional criteria of tax policy analysis—equity, efficiency, and administrability.[42] However, the limitations of these traditional analytical criteria have previously been noted in the literature.[43] The analysis of whether OIC fails to meet these criteria is further complicated by the presence of distressed taxpayers who are actually unable to pay their tax liabilities.[44] Tax policy analysis frequently asks what, in the abstract,

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[42] The efficiency criterion relates to the moral hazard problem in the sense that information asymmetry between the IRS and the taxpayer might lead to the provision of too much or too little tax-debt forgiveness.

[43] *See, e.g.*, LIAM MURPHY & THOMAS NAGEL, THE MYTH OF OWNERSHIP: TAXES AND JUSTICE 38-39 (2002) ("Once we abandon the presumption of the moral significance of the pretax world, we see that differential treatment of people with the same income may or may not be warranted depending on our overall theory of justice."); Anthony C. Infanti, *Tax Equity*, 55 BUFF. L. REV. 1191, 1220 (2008) (arguing that "traditional tax analysis" is "inhospitable" to critical perspectives that take into account the possibility of invidious discrimination (citing Charles O. Galvin, *Taking Critical Tax Theory Seriously—A Comment*, 76 N.C. L. REV. 1749, 1749 (1998))); Michael A. Livingston, *Reinventing Tax Scholarship: Lawyers, Economists, and the Role of the Legal Academy*, 83 CORNELL L. REV. 365, 380-94 (1998) (describing challenges to traditional tax scholarship); Nancy C. Staudt, *The Hidden Costs of the Progressivity Debate*, 50 VAND. L. REV. 919, 957-79 (1997) (noting that "embedded assumptions found in traditional tax theory" have resulted in a failure to consider the positive rights of the poor).

[44] Such a situation may raise questions about the application of tax policy's "ability to pay" or "faculty" concept, which states that taxes should be levied based on the ability of each person to pay the tax. However, there is more than one way to understand "ability to pay." *See* MURPHY & NAGEL, *supra* note 43, at 20-30. On the one hand, if a taxpayer really cannot pay, one might conclude that the underlying system of tax liability determination has violated the "ability to pay" concept by overestimating the *actual* ability to pay. *See* Sagit Leviner, *From Deontology to Practical Application: The Vision of a Good Society and the Tax System*, 26 VA. TAX REV. 405, 427-28 (2006) (arguing that focusing on "actual economic standing" instead of "potential economic ability" is the proper way to approach the ability to pay principle). On the other hand, an "endowment"

the correct tax policy choice should be.[45] However, the application of tax policy analysis to this situation—where a taxpayer has already been adjudged to owe tax under a given set of rules but is unable to pay—raises additional complications. In this situation, other competing policy considerations may outweigh the traditional tax policy criteria. Thus, these traditional tax policy tools may need to be supplemented with others, such as concepts from debtor-creditor law, to be applicable in the context of debt forgiveness.

The three arguments set forth below support constructing and implementing a meaningful tax-debt forgiveness procedure.[46] The discussion, necessarily limited, does not aim to prove that the OIC program should necessarily be expanded to any particular extent. Instead, the point is to show that an effective debt forgiveness procedure is a justifiable feature of our tax system. That the procedure needs to be reformed is a plausible conclusion given its current state.

1. Revenue Benefits

A well-designed tax-debt forgiveness procedure can increase revenue collections, both for dollars collected from currently outstanding accounts and dollars collected through future compliance. The IRS's existing data supports this argument in two ways. First, IRS data shows that when the IRS rejects a taxpayer's OIC, the IRS has seldom been able to effectively collect on the underlying tax liability.[47] The IRS is

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understanding of ability to pay would not necessarily lead to this conclusion since it focuses on *potential* ability to pay. *See* MURPHY & NAGEL, *supra* note 43, at 20 (defining endowment taxation as taxing people according to their potential to "earn income and accumulate wealth").

[45] Traditional tax policy analysis generally attempts to address theoretical normative issues. For example: What is the appropriate tax base? Is the treatment of a particular tax item satisfactory, or can it be reformed? On what basis should tax law make a decision between two alternatives? *See, e.g.*, J. Clifton Fleming, Jr. et al., *Fairness in International Taxation: The Ability-to-Pay Case for Taxing Worldwide Income*, 5 FLA. TAX REV. 299, 309 (2001) (discussing the question of "whose ability to pay is relevant in an international context"); Richard S. Markovits, *On the Economic Efficiency of Using Law to Increase Research and Development: A Critique of Various Tax, Antitrust, Intellectual Property, and Tort Law Rules and Policy Proposals*, 39 HARV. J. ON LEGIS. 63, 69 (2002) (focusing on the "abstract goal" of explaining how "allocative-efficiency analyses should be structured"); David A. Weisbach, *Line Drawing, Doctrine, and Efficiency in the Tax Law*, 84 CORNELL L. REV. 1627, 1633 (1999) (attempting to devise a rule for how "a policymaker should respond to the typical, real-life situation" of line drawing in the tax code).

[46] These arguments largely support the doubt-as-to-collectibility OIC.

[47] *See* 1 NAT'L TAXPAYER ADVOCATE, 2006 ANNUAL REPORT TO CONGRESS 89 (2006) [hereinafter 2006 NTA ANNUAL REPORT] (reporting that "over 40 percent of tax modules

often unable to collect even the amount the taxpayer offered; in fact, many of these taxpayer accounts are deemed "currently not collectible."[48] The National Taxpayer Advocate (Taxpayer Advocate or NTA)[49] has opined that, while IRS rejections of offers proposed by taxpayers would be justified if the IRS were able to then collect more than the amounts offered, this has not been the case.[50] The collections outcome data for rejected offers suggests that there are revenue gains to be captured by accepting some offers that are currently rejected.

Second, the IRS generally collects more cents on the dollar through accepted OICs than it ultimately collects through its usual collections process. In the 2007 fiscal year, for example, accepted OICs generated seventeen cents for each dollar owed, compared to the thirteen cents on the dollar the IRS has historically collected on two-year-old debts.[51] Moreover, the IRS historically has collected al-

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associated with rejected and withdrawn OICs are ultimately reported as not collectible, with many more remaining unresolved in 'active' collection status" (footnote omitted)).

[48] The NTA's 2006 Annual Report notes that from 1998 to 2003, the IRS collected less than 50% of what individual taxpayers offered to pay in 44% of cases involving rejected OICs, it collected less than 10% of taxpayer-offered amounts in 31% of these cases, and it collected nothing in 21% of these cases. *Id.*

[49] The National Taxpayer Advocate is an independent position within the IRS created as part of the Taxpayer Bill of Rights. *See* Taxpayer Bill of Rights 2, Pub. L. No. 104-168, § 101, 110 Stat. 1452, 1453-56 (1996). The Taxpayer Advocate supervises the Office of the Taxpayer Advocate. I.R.C. § 7803(c)(1)(B)(i) (2006). The Office of the Taxpayer Advocate is tasked with assisting taxpayers in resolving problems with the IRS, identifying problem areas within the IRS, and proposing legislative and administrative changes. *Id.* § 7803(c)(2)(A). The Taypayer Advocate is required to submit two annual reports to Congress: an "Objectives" Report in June and an "Activities" Report in December. *Id.* § 7803(c)(2)(B). The Activities Report must contain a description of at least twenty of the most serious problems taxpayers encounter. *Id.* § 7803(c)(2)(B)(ii)(III). The current Taxpayer Advocate is Nina E. Olson.

[50] *See* 2006 NTA ANNUAL REPORT, *supra* note 47, at 89 (pointing out that "the majority of delinquent tax dollars in cases involving rejected OICs tend *not* to be collected"); Nina E. Olson, *Minding the Gap: A Ten-Step Program for Better Tax Compliance*, 20 STAN. L. & POL'Y REV. 7, 26 (2009) (noting that for 2008 "in 44% of rejected or withdrawn offers from individuals, the IRS later collected less than 50% of the amount offered by the taxpayer"). Arguably, taxpayers whose offers are rejected may not have been able to successfully complete their proposed offers had they been accepted, and thus comparing the amounts offered but rejected to the amounts ultimately collected is overly simplistic. However, if the taxpayer defaults on her OIC, the IRS can immediately resume attempts to collect the entire original tax liability. *See* Mather & Weisman, *supra* note 37, at A-50. Thus, there is little downside to the IRS accepting more taxpayer offers.

[51] 1 NAT'L TAXPAYER ADVOCATE, 2007 ANNUAL REPORT TO CONGRESS 375 (2007) [hereinafter 2007 NTA ANNUAL REPORT]. In financial years 2008 and 2009, accepted OICs generated twenty cents and eighteen cents on the dollar, respectively. 1 NAT'L TAXPAYER ADVOCATE, 2009 ANNUAL REPORT TO CONGRESS 205 n.53 (2009) [hereinafter 2009 NTA ANNUAL REPORT].

most nothing on debts three or more years old.[52] These numbers suggest that far from being a drain on the national revenue, a well-administered tax-debt compromise program can generate more collections than other methods currently in use.[53] The higher collections numbers from accepted offers—as compared to both rejected offers and the general collections baseline—may possibly be due to the OIC program's ability to draw in additional funds from third-party financial supporters of the delinquent taxpayer.[54] This factor may explain why the IRS has been able to generate increased collection through the OIC procedure than through other collections methods.

Arguably, despite the apparent revenue benefits, making the OIC procedure more robust could cause lower levels of tax payment and compliance due to increased moral hazard, thereby erasing anticipated revenue gains. However, the user fee and down payment requirement,[55] as well as the requirement that taxpayers agree to and engage in ongoing compliant behaviors, may limit these potential problems.[56] If the submission of such an offer results in costs to the taxpayer—in the form of user fees, down payments, or required future compliance—taxpayers are less likely to abuse the procedure or to view their failure to pay taxes as costless.

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[52] 2007 NTA ANNUAL REPORT, *supra* note 51, at 375. This may reflect the fact that such older debts are likely to be nonpriority tax claims that are dischargeable in bankruptcy. *See* 11 U.S.C. § 507(a)(8) (listing newer tax liabilities as priority taxes); *id.* § 523(a)(1) (excepting such priority taxes from bankruptcy discharge). If so, accepting offers in a way that reduces the likelihood of the taxpayer filing for bankruptcy may improve IRS collections outcomes for liabilities that might otherwise be discharged.

[53] *See* TREASURY INSPECTOR GEN. FOR TAX ADMIN., 2006-30-100, THE OFFER IN COMPROMISE PROGRAM IS BENEFICIAL BUT NEEDS TO BE USED MORE EFFICIENTLY IN THE COLLECTION OF TAXES 3-7 (2006) [hereinafter TIGTA JULY 2006 FINAL AUDIT REPORT] (comparing estimated OIC program labor costs with estimated revenue, and concluding that in financial year 2004, "[t]he OIC program generated direct revenue in excess of the direct cost of administering the program"); *see also* Olson, *supra* note 50, at 25-26 (2009) (characterizing OICs as a "win-win situation for taxpayers and the IRS" and noting that "OICs, on average, resulted in more tax collected per dollar owed than traditional IRS enforcement efforts and converted a substantial portion of noncompliant taxpayers into compliant ones").

[54] *See infra* subsections III.A.4 and IV.A.2.

[55] *See infra* subsections II.A.5-6.

[56] These requirements are similar in effect to deductibles and copayments in the insurance context. *See* Adam Feibelman, *Defining the Social Insurance Function of Consumer Bankruptcy*, 13 AM. BANKR. INST. L. REV. 129, 136 (2005) (describing deductibles and co-insurance as devices used to mitigate moral hazard problems); Louis Kaplow & Steven Shavell, *Fairness Versus Welfare*, 114 HARV. L. REV. 961, 1066 n.224 (2001) (positing that "deductibles and co-insurance requirements" are one way in which insured persons are incentivized to avoid accidents).

Finally, in addition to boosting collection of taxes currently owed, a procedure that allows the debtor a "fresh start" and reintegration into the world of tax compliance may benefit revenue collection in future years.[57] The OIC procedure requires that taxpayers have filed all previous required tax returns; moreover, the taxpayer must remain in compliance for the subsequent five years,[58] and studies show that a majority of taxpayers whose OICs are accepted remain in compliance.[59] Thus, in addition to boosting collection of presently owed dollars, the forgiveness of tax debts can enhance collections in future tax years.[60]

2. Interrogating the Finality of the Assessed Tax Liability—Toward a Broader Conception of Distributive Justice

An important feature of the OIC procedure that may be particularly troubling to a critical observer is that a taxpayer whose debt is compromised is relieved from having to pay a tax liability that has already been assessed. Assessment—the step whereby a tax liability is recorded—is an important tax event.[61] It seems intuitive that failure to pay an assessed tax violates fairness or equity requirements. Horizontal equity, an integral though heavily debated concept in tax policy, dictates that "similarly situated" taxpayers should be treated similarly.[62]

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[57] The IRS included this "fresh start" policy in a 1992 Policy Statement. *See* I.R.S. Policy Statement 5-100, IRM 1.2.14.1.17 (Jan. 30, 1992) ("Acceptance of an adequate offer will also result in creating for the taxpayer an expectation of and a fresh start toward compliance with all future filing and payment requirements.").

[58] Mather & Weisman, *supra* note 37, at A-43; *see also* IRS, FORM 656, *supra* note 9 (requiring the taxpayer to agree to "file tax returns and pay required taxes for the five year period beginning with the date of acceptance" of the offer in compromise).

[59] *See* 2009 NTA ANNUAL REPORT, *supra* note 51, at 205 (noting that about eighty percent of taxpayers whose offers were accepted between 1995 and 2001 stayed compliant with subsequent tax filing and payment obligations); *see also* TIGTA JULY 2006 FINAL AUDIT REPORT, *supra* note 53, at 7 ("Taxpayers generally do remain in compliance when offers are accepted.").

[60] *Cf.* Nina E. Olson, *Taxpayer Rights, Customer Service, and Compliance: A Three-Legged Stool*, 51 U. KAN. L. REV. 1239, 1247 (2003) ("[O]ffers provide the IRS with an opportunity to bring taxpayers into compliance, particularly when we don't accept the offer.").

[61] *See* I.R.C. § 6201 (2006) (authorizing and requiring the "assessments of all taxes . . . imposed by" the Internal Revenue Code); *see also* SALTZMAN, *supra* note 9, ¶ 10.02.

[62] *See generally* David Elkins, *Horizontal Equity as a Principle of Tax Theory*, 24 YALE L. & POL'Y REV. 43, 46 (2006) (considering in detail the question of whether "similarly situated taxpayers [should] necessarily face the same tax burden"); Brian Galle, *Tax Fairness*, 65 WASH. & LEE L. REV. 1323, 1327-28 (2008) (defending the principle of horizontal equity); Richard A. Musgrave, *Horizontal Equity, Once More*, 43 NAT'L TAX J. 113 (1990) (arguing that horizontal equity, as compared to vertical equity, has greater independent

The existence of any tax-debt forgiveness program might seem to contravene horizontal equity because, given the same assessed tax amount,[63] such a program would demand full payment from some taxpayers while partially releasing others from their obligation.[64] A straightforward tax policy analysis thus might suggest that having any tax-compromise procedure is a deviation from what is fundamentally fair.

Yet, despite its intuitive appeal, the amount of tax assessed may not reflect whether two individuals are truly similarly situated. Thus, it does not follow that the assessed tax amount should be regarded as a perfectly fair and immovable baseline from which any deviations are a per se horizontal equity violation. Interrogating the assessed tax amount is a vital step in conceptualizing a richer vision of tax justice than one based merely on the income tax return computation, because the process of arriving at the assessed tax liability suffers from three types of indeterminacy. I call these baseline indeterminacy, policy indeterminacy, and computational indeterminacy. Some aspects of these indeterminacies have been previously identified in the scholarly literature, while other aspects, including the application of such concepts to the question of tax-debt forgiveness, are new.

Baseline Indeterminacy. As Liam Murphy and Thomas Nagel have argued, the "pre-tax income baseline"—roughly speaking, the gross income[65] an individual earns before taxes, which is generally the number with which tax computation and assessment begin—is not an independent, neutral dollar amount that is "owned" by the individual.[66] Rather, "pre-tax income" is really a dependent variable because it is predicated on the underlying social, economic, and governmental structures and conditions that permit such income to be earned in the first place.[67] It follows that any injustices, inequalities, and disparities

significance when viewed in the real world); Louis Kaplow, *A Note on Horizontal Equity*, 1 FLA. TAX. REV. 191, 192 (1992) (criticizing Musgrave's approach).

[63] *See* I.R.C. §§ 6201–6207.

[64] *Cf.* Paul R. McDaniel & James R. Repetti, *Horizontal and Vertical Equity: The Musgrave/Kaplow Exchange*, 1 FLA. TAX REV. 607, 613 (1993) ("[W]ith respect to [horizontal equity], once one has decided on the tax base . . . then all that is required is a definition of income . . . . [O]nce income is defined, those with equal amounts of income will, by definition, be taxed equally.").

[65] *See* I.R.C. § 61 (defining gross income).

[66] MURPHY & NAGEL, *supra* note 43, at 175; *see also id.* ("We have to think of property as what is created by the tax system, rather than what is disturbed or encroached on by the tax system. Property rights are the rights people have in the resources they are entitled to control after taxes, not before.").

[67] *See id.* at 32 ("There is no market without government and no government without taxes . . . . In the absence of a legal system supported by taxes, there [could] be . . . none

embedded in these underlying structures have the propensity to affect a person's opportunity or ability to earn pre-tax income such that distributive justice is undermined. There are many such inequalities and disparities. They include, for example, wage inequalities based on gender or race.[68] The inherent dependency of the "pre-tax income" variable on such inequalities or disparities should make us question whether it is equitable to tax two persons the same simply because they have accumulated the same amount of gross income. Put differently, if it is the case that Person *A*—due to underlying social structures and known disparities—has put in the same amount of inputs (e.g., effort, education, and time) but earns less pre-tax income than Person *B*, then is it fair to tax them equally?[69]

This line of thinking has also been explored in the critical tax scholarship. Anthony Infanti, for example, has pointed out the misleadingly "homogenizing" effects of the tax equity concept and the

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of the institutions that make possible the existence of almost all contemporary forms of income and wealth. It is therefore logically impossible that people should have any kind of entitlement to all their pretax income."); *see also* Galle, *supra* note 62, at 1326-27 (discussing Murphy and Nagel's position and noting that "the argument that equals must be treated fairly depends on an assumption that we each have come fairly to where we now stand").

[68] *See, e.g.*, Ledbetter v. Goodyear Tire & Rubber Co., 550 U.S. 618, 621-22 (2007) (asserting a claim of wage discrimination based on gender under Title VII), *superseded by statute*, Lily Ledbetter Fair Pay Act of 2009, Pub. L. No. 111-2, 123 Stat. 5; U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-04-35, WOMEN'S EARNINGS: WORK PATTERNS PARTIALLY EXPLAIN DIFFERENCE BETWEEN MEN'S AND WOMEN'S EARNINGS 57 (2003) (contending that because "women are more likely than men to have primary responsibility" for their families, they likely make career decisions that result in them earning less income); Bruce Western & Becky Pettit, *Black-White Wage Inequality, Employment Rates, and Incarceration*, 111 AM. J. SOC. 553, 558 (2005) (arguing that "because joblessness among blacks is relatively high" as compared to whites, "estimates of inequality based just on observed wages . . . will underestimate inequality in the economic standing of black men"); Laura Fitzpatrick, *Why Do Women Still Earn Less than Men?*, TIME (Apr. 20, 2010), http://www.time.com/time/nation/article/0,8599,1983185,00.html (reporting that sex discrimination still contributes to the wage disparity between men and women and that in 2008 "women still earned only 77 cents on the male dollar").

[69] Murphy and Nagel have expressed similar reservations in critiquing the tax policy notion of "ability to pay," as expressed through the "equal sacrifice" and "equal proportional sacrifice" concepts. *See* MURPHY & NAGEL, *supra* note 43, at 30 ("If the idea of taxation in accordance with ability to pay is made concrete through the principle of equal sacrifice, it depends on the radical view that the distribution of welfare produced by the market is presumptively just."). Other similar critiques have been leveled against the use of actual income as the tax base. *See, e.g.*, Daniel Shaviro, *Endowment and Inequality*, *in* TAX JUSTICE: THE ONGOING DEBATE 123, 124-25 (Joseph J. Thorndike & Dennis J. Ventry, Jr. eds., 2002).

false sense of neutrality that its use has cast over tax policy debates.[70] With regard to equity and distributive justice, then, it is overly simplistic to privilege the assessed tax liability as per se fair, and thus it is not necessarily unfair to forgive some of that liability in some circumstances.

Policy Indeterminacy. Problems surrounding the "myth"[71] of pre-tax income aside, the indeterminacy of policy choices embedded in the computation of tax liability should caution against using the computed and assessed tax liability as a privileged standard to argue about horizontal equity. The federal tax liability computation consists of a series of income inclusions, deductions, and credits that are associated with particular types of activities—for example, wages from work,[72] gains from sales of assets,[73] and deductions for medical expenses.[74] Each of these tax "items" represents the choice to select one particular policy over other viable options.[75] Indeed, different policy choices with respect to each tax item—accompanied by different distributive conse-

[70] *See* Infanti, *supra* note 43, at 1201, 1209 ("By assuming a far more homogeneous population than the one that actually exists, horizontal and vertical equity screen from the tax policy debate many issues relating to race, ethnicity, gender, sexual orientation, and disability, and they tend to transmute any remaining issues into ones of economic class."); *see also* Dorothy A. Brown, *Racial Equality in the Twenty-First Century: What's Tax Policy Got to Do with It?*, 21 U. ARK. LITTLE ROCK L. REV. 759, 766, 768 (1999) (discussing how the tax laws "exacerbate" employer wage discrimination and proposing solutions such as excluding from income the wages of employees who have been discriminated against based on race).

[71] *See generally* MURPHY & NAGEL, *supra* note 43, at 20-30.

[72] *See* I.R.C. § 61(a)(1) (2006) (including compensation for services in the definition of "gross income").

[73] *See id.* § 1221 (defining capital assets); *see also id.* § 61(a)(3).

[74] *See id.* § 213 (allowing a deduction for certain medical expenses); *id.* § 162(*l*) (allowing self-employed individuals to deduct health insurance expenditures).

[75] The policy choices embedded in particular decisions to tax, to exempt from tax, or to allow as deductions or credits have been long recognized in areas such as tax expenditure analysis and critical tax scholarship. *See, e.g.,* Anthony C. Infanti, *A Tax Crit Identity Crisis? Or Tax Expenditure Analysis, Deconstruction, and the Rethinking of a Collective Identity,* 26 WHITTIER L. REV. 707, 744-52 (2005) (conceptualizing the tax expenditure concept as a deconstructionist analysis of tax law); Edward D. Kleinbard, *How Tax Expenditures Distort Our Budget and Our Political Processes,* 123 TAX NOTES 925, 925 (2009) (discussing how tax expenditures "distort not only tax policy, but also our whole concept of the size and activities of the federal government"); Beverly I. Moran & William Whitford, *A Black Critique of the Internal Revenue Code,* 1996 WIS. L. REV. 751, 753 ("[M]any provisions of the Internal Revenue Code deviate from the ideal of taxing all income in the comprehensive income tax base. Sometimes the Code compromises the ideal in order to achieve a more administratively practical rule. More often, Congress has decided to encourage particular lifestyles or behaviors by holding out tax benefits as an incentive.").

quences—may have been made in the past.[76] Each policy choice, of course, reflects a decision point where power, special interests, or politics may have intervened to influence the eventual outcome.[77] Furthermore, as between taxpayers at a given income level, any set of policy choices will create better results for some than for others.[78] Once we recognize that the tax law's treatment of individual tax items is neither immutable nor necessarily beyond critique and that any theoretically ideal tax base or general principle would deviate in actual policy formulation and implementation, it becomes far less obvious that we should default to considering the sum total of all of these policy choices (that is, the assessed tax liability amount) as a per se equitable outcome. This is true even if we do generally accept this outcome for administrability reasons.

Executional Indeterminacy. Finally, even assuming that all of the legal and policy choices surrounding each individual tax item are not outcome indeterminate, our schedule- and tax year–based tax computation system suffers from a different type of pervasive indeterminacy in execution. Because of the idiosyncrasies and intricacies of the on-the-ground operation of the tax system, even tax items such as income, deductions, and credits that appear reasoned, rational, and equitable in the abstract may give rise to irrational or unequal outcomes in practice. This "executional indeterminacy" stems from certain underlying features of the tax system: the timing principle that "each tax year stands alone," deviations from this principle that allow losses from one year to offset gains from another, the ability of certain taxpayers to use certain deductions, and bunching issues[79] that lead to certain taxpayers being placed in higher or lower tax brackets in seemingly unprincipled ways, to name a few issues.

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[76] The evolving treatment of annuities is an example. *See* MARVIN A. CHIRELSTEIN, FEDERAL INCOME TAXATION ¶ 2.02, at 34-36 (11th ed. 2009).

[77] *See generally* DANIEL A. FARBER & PHILIP P. FRICKEY, LAW AND PUBLIC CHOICE: A CRITICAL INTRODUCTION (1991); *see also id.* at 38 (arguing "that the political process may be corrupted by special interests"); Ittai Bar-Siman-Tov, *Lawmakers as Lawbreakers*, 52 WM. & MARY L. REV. 805, 841-43 (2010) (discussing the importance of the policy motivations of legislators).

[78] *See, e.g.*, Elkins, *supra* note 62, at 48-49 (arguing that when the government introduces taxes and subsidies to reduce negative externalities and increase positive ones, "horizontal equity is violated in order to further economic efficiency" since "[e]qually well-off individuals will pay unequal amounts of tax because of the nature of their productive activities or their preferences for education").

[79] See *infra* note 81 for a discussion of bunching issues.

For example, while horizontal equity from the point of view of an ideal tax base might theoretically require the inclusion of all business profits in gross income, when a taxpayer is able to carry over losses from previous tax years in which perhaps different rates were in effect in order to offset her current profits, it may lead to indeterminacy on a balance-sheet basis.[80] To take another example, a taxpayer who has a less consistent level of income than another taxpayer may be pushed into a higher tax bracket in some years but a lower bracket in others, giving rise to disparate treatment of the two taxpayers despite their equivalent earnings overall.[81] Tax shelter cases are the most obvious incarnation of such executional indeterminacy, wherein rules that are logical on their own give rise to irrational outcomes in the right convergence of circumstances.[82] Such executional indeterminacy has arguably led to the creation of common law doctrines to fill in the statutory gaps, such as the assignment-of-income,[83] claim-of-right,[84] and economic substance[85] doctrines. While the comparison may seem

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[80] *See generally* I.R.C. §§ 165, 172, 1222 (2006) (permitting deductions related to losses).

[81] Take as an example Taxpayer *A*, who earns $50,000 in Year 1 and $50,000 in Year 2, and Taxpayer *B*, who earns $100,000 in Year 1 and $0 in Year 2. Assuming that tax rates stay constant between Year 1 and Year 2, Taxpayer *B* might be subject to higher maximum marginal tax rates in Year 1 than Taxpayer *A* and hence might have a higher tax burden over the two years. Scholars have presented proposals to fix such "bunching" problems. *See, e.g.*, Lily L. Batchelder, *Taxing the Poor: Income Averaging Reconsidered*, 40 HARV. J. ON LEGIS. 395, 397 (2003) (suggesting a tax policy that would permit taxpayers to "smooth their income over two years for the purpose of calculating the [Earned Income Tax Credit]" and "carry back for one year their unused standard deductions and personal and dependent exemptions").

[82] *See, e.g.*, Michael L. Schler, *Ten More Truths About Tax Shelters: The Problem, Possible Solutions, and a Reply to Professor Weisbach*, 55 TAX L. REV. 325, 331 (2002) (proposing that a tax shelter be defined as a transaction "that (1) arguably complies as a literal matter with the Code and regulations, (2) is accompanied by some level of tax motivation, and (3) reaches a tax result unintended by Congress or the regulations").

[83] *See, e.g.*, Helvering v. Horst, 311 U.S. 112, 118 (1940) ("The power to dispose of income is the equivalent of ownership of it. The exercise of that power to procure the payment of income to another is the enjoyment, and hence the realization, of the income by him who exercises it.").

[84] *See, e.g.*, N. Am. Oil Consol. v. Burnet, 286 U.S. 417, 424 (1932) ("If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent.").

[85] *See, e.g.*, ACM P'ship v. Comm'r, 157 F.3d 231, 246 (3d Cir. 1998) ("[A] transaction that is 'devoid of economic substance . . . simply is not recognized for federal taxation purposes.'" (quoting Lerman v. Comm'r, 939 F.2d 44, 45 (3d Cir. 1991))); *see also* I.R.C. § 7701(o) (Supp. IV 2011) (codifying the economic substance doctrine).

strange and unintuitive, the relief of tax debts at the collections stage in certain circumstances may be viewed as a similar "gap filler," albeit one targeted at tax-burden injustices as opposed to tax-shelter abuses.

Baseline indeterminacy, policy indeterminacy, and executional indeterminacy all suggest that the computed and assessed tax liability should not be viewed as the neutral and equitable "baseline" without further investigation.[86] Accordingly, a compromise of an assessed tax liability is not just a deviation from a neutral baseline. Rather, the OIC procedure should be reconceived as an additional tax instrument that has the power, albeit imperfectly, to better account for big-picture, balance-sheet inequities between two taxpayers who have the same line-item tax computation figure. Viewed in this light, a functional procedure to forgive tax debts is consistent with horizontal equity.

In conclusion, two points must be reiterated. First, arguments about indeterminacy, standing alone, are inadequate to answer the questions of precisely which taxpayer has been subject to inequities and exactly whose and how much tax debt should be forgiven.[87] The foregoing arguments do not attempt to provide a comprehensive answer to these questions. Rather, the point of the discussion is to challenge the threshold notion that because tax liability has already been determined, forgiving such tax liability is a radical step that is necessarily unjust. Critically interrogating that threshold notion is a precondition for engaging in a meaningful discussion of whether and how extant procedures for tax-debt forgiveness should be reformed. Second, I do not mean to suggest that tax law's fundamental indeterminacy makes tax enforcement or administration impossible or that anarchy in tax administration is required and inevitable. I am simply describing a tension that exists between having an administrable and enforceable tax collections system and recognizing that tax-debt relief may be justi-

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[86] *See* MURPHY & NAGEL, *supra* note 43, at 175 (challenging "the idea that people's pretax income and wealth are theirs in any morally meaningful sense" and arguing that "[p]roperty rights are the rights people have in the resources they are entitled to control after taxes, not before").

[87] Bankruptcy law confronts the same problem of imperfectly distinguishing between debtors who deserve relief and those who do not. *See* Feibelman, *supra* note 56, at 167 (noting that, "with few exceptions, [bankruptcy] is equally available to the spendthrift as it is to the honest but unfortunate debtor"); Melissa B. Jacoby, *Collecting Debts from the Ill and Injured: The Rhetorical Significance, but Practical Irrelevance, of Culpability and Ability to Pay*, 51 AM. U. L. REV. 229, 270-71 (2001) (arguing against then-proposed bankruptcy reforms because they would not help better distinguish between deserving and undeserving debtors and concluding that "courts will evaluate [such debtors] principally on their balance sheets, not on the details of their financial demise").

fied in some circumstances. Both features are important components of good tax administration.

3. Negotiating a Reality Where People Sometimes Cannot Pay: Tax Policy Considerations in Dialogue with Debtor-Creditor Policy Considerations

As suggested above, traditional tax-policy analysis standing alone may prove insufficient in the "second-best" world in which we live.[88] We do not live in a perfect world in which every debtor unfailingly pays her debts. Rather, we live in a world where credit exists; the terms of obtaining credit are not always fair; borrowers sometimes cannot repay creditors; debts are sometimes forgiven either through the bankruptcy system, through nonbankruptcy debtor-creditor law, or through formal or informal agreements between individual debtors and creditors negotiated "in the shadow"[89] of legal rules; and some debts go unpaid.[90]

The debtor-creditor world just described includes, of course, tax debtors and the sovereign creditor. In the tax collections context, the IRS is, in effect, the creditor, and the delinquent taxpayer is the debtor.[91] The IRS is compelled to extend credit to the taxpayer as a result of imperfections in withholding, the largely annual nature of the

[88] *See, e.g.*, Kaplow, *supra* note 62, at 192 (arguing that horizontal equity "is achieved as a by-product in so many distributive theories because they are usually explicated in a first-best world" and that "such theories may not respect [horizontal equity] when they are elaborated in a second-best setting"); Richard A. Musgrave, *Horizontal Equity: A Further Note*, 1 FLA. TAX REV. 354, 354 (1993) (drawing a distinction "between viewing the problem in a first best setting where taxes can be arranged so as to fully comply with equity norms and situations where, due to political or other constraints, the choice is among second best solutions"); Musgrave, *supra* note 62, at 120 ("[W]hen having to choose among second-best arrangements, differences in [horizontal equity] might be a decisive factor.").

[89] *Cf., e.g.*, Robert H. Mnookin & Lewis Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 YALE L.J. 950, 968 (1979) (explaining that parties to a divorce "bargain in the shadow of the law" because "the outcome that the law will impose if no agreement is reached gives each parent certain bargaining chips").

[90] *See, e.g.*, Olson, *supra* note 60, at 1247 (arguing that the OIC program "truly gives meaning to the concept of a fair and just tax system, an acknowledgement that facts and circumstances may impair even the most sincere taxpayer's ability to comply with the Internal Revenue laws").

[91] *See* United States v. Kimbell Foods, Inc., 440 U.S. 715, 736 (1979) ("The United States is an involuntary creditor of delinquent taxpayers, unable to control the factors that make tax collection likely.").

filing and collection process, and the availability of filing extensions.[92] The IRS may also be a voluntary creditor in situations in which it enters into an installment agreement with the taxpayer or if it agrees to delay collection under a payment plan.[93] Once the IRS-taxpayer relationship is viewed in the real-world context of debtor-creditor relationships and distressed debt, it makes sense that taxpayers, like other debtors, will sometimes be unable to pay their assessed taxes, interest, and penalties, thus requiring a system that effectively copes with these exigencies.

Of course, the above analysis does not necessarily justify the "should not have to pay" situation.[94] However, there are several general points that are true in the "cannot pay" situation.[95] First, in the world in which we live, people do sometimes fail to pay, sometimes pay late, and sometimes forgive or renegotiate debts. Second, in our legal world, there are systems already in place that permit the settlement of debts for less than their full amount. Accepting this as true, it becomes clear that the real question is not *whether* tax debts should be forgiven, but *how* to manage the compromise process in order to ensure the best possible consequences for the taxpayer, the taxing authority, and society.[96]

While tax policy analysis has scarcely confronted this set of questions, scholars of debtor-creditor relations have long recognized that a system that forgives some debts can yield benefits and that these benefits may outweigh the costs.[97] For example, some bankruptcy scholars have pointed to the social insurance function of our consumer bankruptcy system.[98] From this perspective, the existence of a federal bankruptcy

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[92] In this sense, the IRS's position may not be so different from that of other involuntary creditors, such as tort victims. *See generally* David W. Leebron, *Limited Liability, Tort Victims, and Creditors*, 91 COLUM. L. REV. 1565, 1601 (1991).

[93] *See* I.R.C. § 6159 (2006) (authorizing the use of installment agreements).

[94] In other words, the analysis does not address the situation in which the tax debtor can pay but perhaps should not have to do so, based on hardship or other grounds. That is, it does not justify offers based on Effective Tax Administration or Doubt as to Liability. *Cf.* Camp, *Failure of Adversarial Process*, *supra* note 1, at 73-75 (describing differences between "can't-pays" and "won't-pays" in the OIC context).

[95] These are situations presented by the doubt-as-to-collectibility offer.

[96] I develop these concepts further in subsequent work. *See* Shu-Yi Oei, Who Wins When Uncle Sam Loses? Social Insurance and the Forgiveness of Tax Debts (Jan. 18, 2012) (unpublished manuscript) (on file with author).

[97] *See, e.g.*, Jacoby, *supra* note 87, at 239 ("The standard justification for unconditional debt relief . . . is that debt relief brings significant social and economic benefits to the larger community.").

[98] *See, e.g.*, Feibelman, *supra* note 56, at 129-30 & nn.2-3 (surveying the literature that discusses bankruptcy as theoretical or functional social insurance); Todd J. Zywicki,

procedure reflects society's decision that it is beneficial to smooth the consumption power of individual debtors in times of financial distress by letting them discharge debt through a unified proceeding, with such discharge being funded ex ante via higher borrowing costs.[99] The price of or premium for this social insurance is borne by debtors in the form of increased interest rates, and the risk of debtor default is spread to creditors in exchange for increased upfront costs of borrowing.[100] Other bankruptcy scholars have pointed out that the bankruptcy system is part of the nation's social safety net.[101] In addition, the value of debtor rehabilitation and the resulting "fresh start" are central policy concerns in debtor-creditor and bankruptcy scholarship.[102] The continued existence of a federal bankruptcy procedure shows that lingering concerns—about moral hazard, about whether a given debtor deserves forgiveness, and about the fairness of forgiving only some debts—have not, by themselves, been sufficient to trump the societal benefits noted above. These concerns can, in fact, be offset by other competing policy rationales.

An Economic Analysis of the Consumer Bankruptcy Crisis, 99 NW. U. L. REV. 1463, 1473 (2005) (describing the traditional model of bankruptcy as "a form of insurance designed to protect individuals from overwhelming indebtedness or from sudden and unexpected exogenous shocks to their incomes or expenses").

[99] *See* Feibelman, *supra* note 56, at 130 ("[B]ankruptcy relief . . . satisfies the basic economic definition of insurance. It transfers risk from a debtor (the insured) to his or her creditor (the insurer), for which the creditor seeks compensation in the form of an increased interest rate."); *see also* Zywicki, *supra* note 98, at 1473.

[100] *See* Jean Braucher, *Consumer Bankruptcy as Part of the Social Safety Net: Fresh Start or Treadmill?*, 44 SANTA CLARA L. REV. 1065, 1069 (2004) (arguing that consumers pay for this social safety net "in higher interest and in the stress and stigma of the experience both of bankruptcy and over-indebtedness," but noting that "the credit industry also pays to some extent in lower profits"). The transfer of risk to creditors in exchange for a price is what allows bankruptcy to meet the theoretical definition of insurance.

[101] *See, e.g.*, TERESA A. SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT 3-5 (2000) (summarizing the findings of an empirical study of debtors who filed for bankruptcy and concluding that the system's "social safety net" function provided "people who were once solidly middle class . . . a chance . . . to retain their middle-class status").

[102] *See* Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934) ("One of the primary purposes of the bankruptcy act is to 'relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes.'" (citing Williams v. U.S. Fid. & Guar. Co., 236 U.S. 549, 554-55 (1915))); *see also* Charles G. Hallinan, *The "Fresh Start" Policy in Consumer Bankruptcy: A Historical Inventory and an Interpretive Theory*, 21 U. RICH. L. REV. 49, 53 (1986) (discussing the history of the "fresh start" theory and its "current manifestation" in the bankruptcy code).

As in the bankruptcy context, social insurance, social safety net, and debtor-rehabilitation concerns are important considerations in the context of nonbankruptcy tax-debt relief. From a social-insurance standpoint, for example, one might argue that imposing higher effective tax rates on all taxpayers to compensate for relief of tax debts for some under certain circumstances is justifiable, because the transfer of risk from taxpayer debtors to the government creditor in exchange for a price facilitates important social policy goals.[103] From a social safety net perspective, the forgiveness of tax debts by the government-creditor is substantially the same as direct government spending on transfer and welfare programs, because both represent a revenue cost.[104] Finally, when viewed as a "fresh start" for tax debtors, a key requirement—and a key revenue benefit—of the OIC procedure is that the taxpayer must remain in compliance with the tax laws for the next five years. Thus, just like the bankruptcy system, the OIC procedure has the potential to rehabilitate tax debtors into compliance.

Social insurance, social safety net, and "fresh start" arguments for debt relief take on added complexity in the tax-debts arena because of the unique nature of the relationship between the sovereign as creditor and taxpayer as debtor. The IRS is different from private creditors because the government also provides welfare, transfers, and other benefits to its citizens. In other words, the government's function has both a taxing side and a spending side.[105] It does not benefit society if the government as creditor exacts too much from a struggling tax debtor, leaving the taxpayer economically vulnerable and dependent upon the government's social safety net spending.[106]

The argument can also be expressed in terms of revenue expenditures: tax collection is only one side of the revenue equation. Spending on the social safety net constitutes the other side. In cases where expenditures and other costs are likely to outweigh collections, it may be better for the national balance sheet if the government forgives some

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[103] For a more extended discussion, see Oei, *supra* note 96.

[104] *But see id.* (arguing that forgiveness of tax debts may have different distributive consequences than direct social welfare programs).

[105] The spending side encompasses welfare and benefits spending as well as tax expenditures.

[106] The Taxpayer Advocate has expressed similar concerns about the IRS's use of liens and levies. *See* 1 NAT'L TAXPAYER ADVOCATE, 2008 ANNUAL REPORT TO CONGRESS 21-24 (2008) [hereinafter 2008 NTA ANNUAL REPORT] ("At a time when so many homes are in foreclosure, the IRS should use caution when issuing federal tax liens, which are often more damaging than bankruptcy to taxpayers' attempts to secure credit.").

tax debts that would otherwise cause delinquent debtors to become dependent upon the social safety net.

On the other hand, there are countervailing revenue considerations. In order to provide a social safety net and any public goods, the government needs to raise revenue. That the sovereign creditor has revenue-raising and public-provision functions suggests that the IRS should perhaps be *less* willing to forgive tax debtors or should forgive fewer cents for each dollar owed than a private creditor would.[107] In addition, other arguments in favor of consumer debt relief are not pertinent to the tax-debtor context. For example, unfair lending practices and information and power disparities between sophisticated lenders and consumer debtors simply do not apply in the case of tax debts.[108]

These two considerations may suggest that the level of debt relief provided by the sovereign creditor should be less than that undertaken by a private creditor. However, neither consideration leads to the conclusion that the sovereign creditor should not forgive tax debts at all. Instead, these considerations, if accepted, yield two articulable rules. First, the sovereign creditor should forgive tax debts in an amount larger than zero but somewhat less than nongovernment creditors would forgive. And second, the government should cease to collect delinquent taxes at the point where the costs of collection—including any resulting costs to the government of increased societal support to the taxpayer, costs to other taxpayers, and costs of OIC program administration—exceed the benefits of collection, including the concrete benefit of collecting the amount of outstanding tax owed.[109] While the exact magnitude of debt relief may be difficult to calculate, a principled approach to the question is possible.

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[107] *See* Barbara K. Morgan, *Should the Sovereign Be Paid First? A Comparative International Analysis of the Priority for Tax Claims in Bankruptcy*, 74 AM. BANKR. L.J. 461, 463 (2000) (noting the argument that bankruptcy priority for tax claims "protects the revenue base for the common good, and avoids shifting the burden of the debtor's unpaid taxes to other taxpayers" (footnotes omitted)); *see also* Adam Feibelman, *Federal Bankruptcy Law and State Sovereign Immunity*, 81 TEX. L. REV. 1381, 1409 (2003) (noting that state creditors "often have a dual purpose—pecuniary and regulatory—for pursuing tax claims").

[108] *Cf.* Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 72 (2008) ("In theory, lenders can be deterred from offering unsafe credit products by the threat that debt incurred through such unsafe products will be discharged in bankruptcy. The potential efficacy of such a threat is evident from lenders' intense lobbying to restrict consumers' access to bankruptcy.").

[109] *But cf.* Kaplow, *supra* note 2, at 223 ("[O]ptimal enforcement will be dictated not only by its direct resource cost and the revenue it raises, but also by the distortion it

Two other considerations must be mentioned in conclusion. First, the extent to which distressed taxpayers should be relieved of their tax debts will necessarily depend on the factual exigencies and background legal rules surrounding the tax debt owed. For example, if the delinquent taxpayer also owes money to other creditors, then the tax authority should consider whether private creditors instead of the taxpayer will capture the benefits of any tax-debt relief.[110] Factors such as whether the taxpayer is insolvent, the relationship between the taxpayer and her other creditors, the amount and type of debt that she owes, and the underlying laws, including bankruptcy and state debtor-creditor laws, will determine whether this benefit transfer to nongovernmental creditors occurs.

Second, a successful procedure for bilateral tax-debt relief must determine how such a procedure will interact with other legal provisions for debt relief—most notably, the federal bankruptcy laws. Two important concepts in federal bankruptcy law are priority of claims[111] and dischargeability of claims.[112] The rules for priority set forth the order in which claims are paid out.[113] The IRS can have a secured, unsecured, or undersecured tax claim in a bankruptcy proceeding.[114] In addition, certain unsecured tax claims are designated "priority claims," meaning that they receive priority in payment over general unsecured claims.[115] The bankruptcy discharge generally voids any judgments with respect to discharged debts[116] and prohibits creditors from collecting on discharged debts.[117] However, some debts, including certain tax debts, are excepted from discharge, which means that the creditor will not be enjoined from collecting on such debts after the conclusion of the

causes, the distortion caused by increases in tax rates, and the marginal benefit of government expenditures.").

[110] For a more thorough analysis, see Oei, *supra* note 96.

[111] *See* 11 U.S.C. § 507 (2006) (codifying the priority of claims).

[112] *See id.* § 727 (describing discharge in Chapter 7 cases); *id.* § 1141(d) (noting that Chapter 11 plan confirmation generally discharges pre-confirmation debts).

[113] *Id.* § 507.

[114] For a discussion of the status of tax clams in bankruptcy, see William Tatlock, *Discharge of Indebtedness, Bankruptcy and Insolvency*, TAX MGMT. PORTFOLIOS, no. 540-3D, 2010, at A-4 to -5, which analyzes the general classification of federal tax claims in bankruptcy. *See also* Mather & Weisman, *supra* note 37, at A-56 (same).

[115] *See* 11 U.S.C. § 507(a)(8) (granting eighth priority to "unsecured claims of government units," subject to some conditions).

[116] *See id.* § 524(a)(1) (voiding judgment with respect to discharged debts).

[117] *See id.* § 524 (describing the effects of discharge); *see also id.* § 727(b) (stating that creditors may not collect on debts arising before the date of the order for relief issued in the Chapter 7 bankruptcy case).

bankruptcy case.[118] While a detailed description of the treatment of tax claims in bankruptcy is beyond the scope of this Article,[119] the priority status of the tax liability and whether it is dischargeable in bankruptcy will clearly affect the sovereign's determination of how much liability to forgive, and therefore should influence the ultimate design of a tax compromise procedure.[120]

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The arguments outlined above provide preliminary support for the development and institution of a viable procedure for the forgiveness of tax debts, but the discussion is necessarily limited. The arguments I have presented are primarily applicable to taxpayers that are natural persons, and may be less applicable to situations involving entity or nonhuman taxpayers. In these situations, the interests involved might be less about fairness, social insurance, or a fresh start for the debtor and more about preserving business value. These arguments do not offer a foolproof method of distinguishing between taxpayers who are unable to pay and those who simply will not pay, nor do they establish a method of distinguishing between taxpayers who have suffered inequities and deserve relief and those who have simply made bad decisions, perhaps with the expectation of being bailed out.[121] However,

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[118] *See id.* § 523(a)(1) (listing several exceptions, including certain tax or customs duties).

[119] The treatment of tax debts in bankruptcy has been described elsewhere. *See, e.g.*, Gregory Germain, *Discharging Income Tax Liabilities in Bankruptcy: A Challenge to the New Theory of Strict Construction for Scrivener's Errors*, 75 UMKC L. REV. 741, 744-45 (2007) (addressing the potentially "profound effect" on the priority rules for tax debts of a minor grammatical change introduced by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005); Jack F. Williams, *Rethinking Bankruptcy and Tax Policy*, 3 AM. BANKR. INST. L. REV. 153, 153-54 (1995) (analyzing "conflicts between bankruptcy and tax policy" and "the special treatment afforded tax claims in bankruptcy" with the hope of "beginning to build an analytical model providing a coherent and internally consistent logic of bankruptcy taxation"); Burton J. Haynes, *Handling Bankruptcy Tax Debts After BAPCPA*, MD. B.J., Nov.–Dec. 2006, at 20 (summarizing features of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005).

[120] The optimal way in which IRS procedures for tax-debt relief should interact with bankruptcy proceedings has not yet been explored in the literature and is an avenue I explore in future research. *See* Oei, *supra* note 96.

[121] *But see* Camp, *Failure of Adversarial Process*, *supra* note 1, at 73-77 (2009) (describing tax collection as a "dynamic process" of classifying taxpayers as "can't-pays" or "won't-pays"). Distinguishing between "can't-pays" and "won't-pays" is actually a deeply complex inquiry. The fundamental distinction is not one that can be resolved simply by looking at the taxpayer's financial snapshot because this will not reflect the motivations and circumstances surrounding the taxpayer's decisions that led to her current

this shortcoming is to some extent unsurprising, since distinguishing between deserving and undeserving debtors is a problem that also confronts our bankruptcy system and remains imperfectly resolved in that context. Ultimately, a full theoretical or philosophical treatment is beyond the scope of this Article. However, I develop these concepts further and discuss theoretical and practical problems associated with their implementation in a workable system of tax-debt forgiveness, in a later work.[122]

II. THE PROCEDURE IN ACTION: TWO PROBLEMATIC TRENDS IN HISTORICAL CONTEXT

While the arguments above do not describe the precise shape the OIC procedure should take, a strong argument can be made that the procedure could be more effective. Commentators such as the Taxpayer Advocate, the U.S. Government Accountability Office,[123] and practitioners have recently criticized the procedure. Most of these criticisms stem from observations about two recent problematic trends: (1) a growing inventory backlog and longer processing times,[124] and (2) declines in offer submissions and acceptances paired with increases in returns to taxpayers of "non-processable" offer submissions.[125] This Part discusses these two trends. These trends, however, cannot be understood independently of the historical context from which they

situation. Put differently, even if the tax system were able to accurately separate out "can't-pay" taxpayers from "won't-pay" taxpayers on a snapshot basis, this would not adequately interrogate the personal choices or exigencies that led the tax debtor to her present situation. Two taxpayers who cannot pay based on current asset levels may have arrived at that point through very different circumstances. Thus, the project of accurately distinguishing deserving from undeserving debtors is almost impossible. *See* Jacoby, *supra* note 87, at 233 (noting that "the principles of repayment and culpability which instinctively seem like relevant factors to distinguish [an undeserving taxpayer's] entitlement to debt relief from [a deserving taxpayer's] actually play very little systematic role in the U.S. bankruptcy system"); *see also* Feibelman, *supra* note 56, at 167.

[122] *See* Oei, *supra* note 96.

[123] The Government Accountability Office (GAO) is a congressional agency that serves as a "watchdog" for federal government accountability and job performance. *See About GAO*, U.S. GOV'T ACCOUNTABILITY OFF., http://www.gao.gov/about/index.html (last visited Jan. 15, 2012) (describing the GAO's mission, values, and responsibilities). The GAO performs its work at the request of congressional committees and subcommittees, and its duties include "auditing agency operations to determine whether federal funds are being spent efficiently and effectively," "reporting on how well government programs and policies are meeting their objectives," and "performing policy analyses and outlining options for congressional consideration." *Id.*

[124] *See infra* subsection II.B.1.

[125] *See infra* subsection II.B.2.

arose. Thus, to contextualize this analysis, I begin with a brief overview of watershed events in the OIC procedure's evolution over the last two decades.

A. *Watershed Moments in the Procedure's Recent History*

A statute authorizing tax-liability compromise has existed since at least 1863.[126] Of course, the content of the statute, as well as its interpretation and administration, have since evolved. The statute's early history is not relevant for our purposes and as such this Article will focus on changes to the procedure that have occurred since the passage of the Tax Reform Act of 1986,[127] the last major legislation to overhaul the tax code.

1. 1992 Changes

In 1992, the IRS issued Policy Statement 5-100, which represented a significant change from the IRS's prior policy concerning the OIC procedure.[128] Prior to the Policy Statement's release, the OIC procedure was little known and seldom used, and the IRS accepted an offer only if it resulted in "*maximum collection* with the least possible loss or

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[126] Section 10 of the Act of March 3, 1863, provided,

> [U]pon a report by a district attorney, or any special attorney or agent having charge of any claim in favor of the United States, showing in detail the condition of such claim, and the terms upon which the same may be compromised, and recommending that the same be compromised upon the terms so offered, and upon the recommendation of the solicitor of the treasury, the Secretary of the Treasury be, and he is hereby, authorized to compromise such claim accordingly.

Act of Mar. 3, 1863, ch. 76, § 10, 12 Stat. 737, 740-41. Section 102 of the Act of July 20, 1868, subsequently provided, in part, that

> in all cases arising under the internal revenue laws where, instead of commencing or proceeding with a suit in court, it may appear to the commissioner of internal revenue to be for the interest of the United States to compromise the same, he is empowered and authorized to make such compromise with the advice and consent of the Secretary of the Treasury . . . .

Act of July 20, 1868, ch. 186, § 102, 15 Stat. 125, 166.

[127] Pub. L. No. 99-514, 100 Stat. 2085 (codified as amended in scattered sections of I.R.C.).

[128] *See* I.R.S. Policy Statement 5-100, IRM 1.2.14.1.17 (Jan. 30, 1992) (relaxing the standards under which the IRS would accept an offer); *see also* PAUL M. PREDMORE, IRS OFFERS IN COMPROMISE (2001), *available at* http://www.gslaw.com/resources/pdf/IRS_compromise.pdf (describing the change as a "shift in IRS policy").

cost to the government."[129] The 1992 Policy Statement provided instead that the IRS would accept offers "when it is unlikely that the tax liability can be collected in full and the amount offered reasonably reflects collection potential."[130] The OIC program, the Statement further explained, is "a legitimate alternative to declaring a case currently not collectible or to a protracted installment agreement," and "[t]he goal is to achieve collection of what is *potentially collectible* at the earliest possible time and at the least cost to the government."[131] Thus, the 1992 Policy Statement reflected a clear shift in approach.[132]

The Statement also reflected other taxpayer-friendly positions. First, it required IRS employees to "discuss the compromise alternative with the taxpayer and, when necessary, assist in preparing the required forms" in situations where an OIC appears to be a "viable solution."[133] Second, it stated that "[t]he ultimate goal is a compromise which is in the best interest of both the taxpayer and the Service."[134] And third, it envisioned that acceptance of OICs would "result in creating for the taxpayer an expectation of and a fresh start toward compliance with all future filing and payment requirements."[135]

In the same year, the IRS also made substantial changes to provisions of the Internal Revenue Manual that govern OICs to reflect the Service's new approach.[136] Such changes included simplified financial disclosure forms and more relaxed asset-valuation guidelines.[137]

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[129] PREDMORE, *supra* note 128, at 1 (emphasis added) (quoting IRM 57(1) 1.4 (Aug. 24, 1989)); *see also IRS Restructuring: Hearings on H.R. 2676 Before the S. Comm. on Fin.*, 105th Cong. 459-60 (1998) [hereinafter *IRS Restructuring Hearings*] (statement of the Illinois State Bar Association) (stating that the new procedures "greatly increased the chances that a troubled taxpayer might be able to make a partial payment in settlement of his tax liability"); PREDMORE, *supra* note 128, at 3 (noting significant increase in offers received and accepted after the issuance of Policy Statement 5-100 in 1992).

[130] I.R.S. Policy Statement 5-100, *supra* note 128.

[131] *Id.* (emphasis added).

[132] This shift reflected an IRS initiative to bring taxpayers back into compliance by 2000. *See* PREDMORE, *supra* note 128, at 1 (explaining the motivation behind Policy Statement 5-100).

[133] I.R.S. Policy Statement 5-100, *supra* note 128. However, the taxpayer still retains responsibility for making the OIC proposal.

[134] *Id.*

[135] *Id.*

[136] PREDMORE, *supra* note 128, at 2.

[137] *Id.* As Paul Predmore explained,

> The most significant IRM changes included: (1) IRS personnel were instructed to discuss the possibility of an offer in compromise with taxpayers whose financial position make it unlikely that their tax debt will be paid in full; (2) collectibility offers were to be processed by a Revenue Officer, often one familiar with

2. 1995 Introduction of Nationalized Standards

In August 1995, the IRS started to use national and local standards to determine "ability to pay" for purposes of considering taxpayer offers, an approach that persists today.[138] These standards established expenses considered "allowable" in evaluating a taxpayer's ability to pay.[139] While necessary expenses for housing and utilities were standardized locally, other necessary expenses, such as for food, medical supplies, and clothing, were standardized nationally.[140] In addition to "necessary" expenses, the IRS also established "conditional" expenses.[141] However, conditional expenses were used only to evaluate ability to pay if the entire tax obligation could be paid off within three years.[142] Some commentators subsequently argued that the standards were rigid and unrealistic and that they had adverse effects on taxpayers looking to compromise a tax liability.[143]

3. 1998 IRS Restructuring and Reform Act

The 1998 IRS Restructuring and Reform Act (the 1998 Act or the 1998 Restructuring Act) was a watershed piece of tax legislation that introduced important changes to various tax administration provisions.[144] The Act's many changes included changes to the OIC stat-

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> the account, rather than by Special Procedures Function; (3) simplified financial disclosure forms; (4) more liberal valuation guidelines and considerations for certain property interests; (5) a present value analysis of the taxpayer's current ability to make installment payments over a sixty-month period; (6) a five-year compliance period upon acceptance of the offer; and (7) discouraged use of collateral agreements with the offer.

Id.

[138] *Id.* at 4 (citing IRM 5323.12(1) (Aug. 29, 1995)); *see also* IRM 5.8.5.20 (Oct. 22, 2010); *id.* 5.8.5.20.1; *id.* 5.15.1.7; *id.* 5.15.1.8; *id.* 5.15.1.9.

[139] PREDMORE, *supra* note 128, at 4.

[140] *Id.*

[141] *Id.*

[142] IRM 5323.12(1)(b) (Aug. 29, 1995). Under the current IRM, conditional expenses are no longer allowable in evaluating OICs. IRM 5.8.5.2(1) (Oct. 22, 2010).

[143] *See, e.g.*, *IRS Restructuring Hearings*, *supra* note 129, at 460 (statement of the Illinois State Bar Association) (arguing that national standards mean that "a taxpayer's ability to pay a tax liability is no longer based upon the taxpayer's particular facts and circumstances," that the IRS's employees lack discretion to determine whether an offer will facilitate collection, and characterizing adoption of national standards as an "impediment" to tax collection); *see also infra* note 148 and accompanying text.

[144] Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of I.R.C.). The Act has been the subject of much scholarly attention. *See, e.g.*, Camp, *Failure of Adversarial Process*, *supra* note 1, at 77-80 (noting the Act's importance in establish-

ute.[145] These changes were motivated partly by mounting criticism of both the OIC program and other IRS practices and procedures.[146] This criticism included claims that the IRS was using "enforcement minded revenues officers" to administer the program,[147] that the IRS was using overly rigid and unrealistic national standards for evaluating and accepting offers,[148] and that IRS revenue officers were being told by management to ignore the law.[149] In the 1998 Act, Congress added a provision to the OIC statute that required the Treasury to prescribe employee guidelines for determining the circumstances under which a submitted offer is adequate and should be accepted and to take a

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ing "collection due process"); Camp, *Tax Administration as Inquisitorial Process*, *supra* note 1, at 91 (highlighting the Act's "significant structural changes"); Cords, *supra* note 1, at 440 (describing how the Act sought to "increase taxpayer rights" and "reduce some of the inequities"); Danshera Cords, *How Much Process Is Due? I.R.C. Sections 6320 and 6330 Collection Due Process Hearings*, 29 VT. L. REV. 51, 62-65 (2004) (analyzing the law and its effects on collection due process hearings); Lederman, *supra* note 1, at 972 (discussing the "enormous changes" brought about by the Act).

[145] *See generally* Paul M. Predmore, *IRS Offers in Compromise: An Historical Look and What's New* (confirming the IRS trend toward encouraging more compromise offers), *in* TAX CONTROVERSIES: WHAT TO DO WHEN THE IRS CALLS 211, 218-19 (2001). In 1996 some minor legislative changes occurred. The 1996 Taxpayer Bill of Rights 2 dramatically raised the threshold dollar amount above which the Treasury Department General Counsel (or her delegate) would be required to file a statement of the reasons for accepting an OIC. Prior to this change, the threshold figure was $500. I.R.C. § 7122(b) (1994) (amended 1996). Effective July 30, 1996, no General Counsel opinion would be required for the compromise of civil tax cases in which the unpaid tax liability (including interest, additional amounts, additions to tax, and penalties) was less than $50,000. Taxpayer Bill of Rights 2, Pub. L. No. 104-168, § 503(a), 110 Stat. 1452, 1461 (1996) (codified as amended at I.R.C. § 7122(b) (2006)). However, such OICs would be newly subject to "continuing quality review by the Secretary." *Id.* The previous $500 threshold made little sense. *See, e.g.*, Christopher J. Fenn, *The New IRS Offers in Compromise Policy*, J. ACCT., Nov. 1992, at 75, 77 (characterizing the old law as "every bit as sensible as the New England blue law prohibiting taking a bath on Sunday" and explaining that when the limit was set over sixty years ago, "$500 was equivalent to several months' wages of most Americans").

[146] *See IRS Restructuring Hearings*, *supra* note 129, at 308 (statement of Michael E. Mares, American Institute of Certified Public Accountants) (describing how the IRS and its employees had been "the subject of unprecedented criticism").

[147] *Id.* at 99 (statement of Bryan E. Gates, Chair, Federal Regulatory Subcommittee, National Association of Enrolled Agents).

[148] *See id.* at 225 (statement of Donald C. Alexander, former Comm'r, Internal Revenue Service) (encouraging the IRS to use more "liberal standards" in the compromise program).

[149] *See id.* at 186 (statement of Sen. William V. Roth, Jr., Chairman, S. Comm. on Fin.) (expressing his concerns regarding testimony from a revenue officer who said management pressured officers to ignore legal issues that might slow down collection); *see also id.* at 274 (statement of Sheldon S. Cohen, Former Comm'r, Internal Revenue Service) ("This is a management problem, not a problem with the law.").

"facts and circumstances" approach in making such a determination.[150] The Act called for the Secretary to "develop and publish schedules of national and local allowances designed to provide that taxpayers entering into a compromise have an adequate means to provide for basic living expenses."[151] The GAO subsequently commented that the IRS had fulfilled this congressional directive.[152]

Prior to the 1998 Act, the only grounds for accepting an OIC were doubt as to collectibility and doubt as to liability. The conference report accompanying the 1998 Act evinced Congress's expectation that the Treasury Regulations would be expanded to permit the IRS to consider other factors.[153] The Treasury responded to Congress by enacting and finalizing regulations that allowed the IRS to compromise liabilities in situations where compromise would promote "effective tax administration."[154]

The 1998 Act introduced the further requirement that the IRS establish "independent administrative review of any rejection of a proposed offer-in-compromise" before communicating the rejection to the taxpayer, as well as a process for taxpayers to appeal rejections to the IRS Office of Appeals.[155] In final Treasury Regulations promulgated on July 19, 2002, however, the Treasury took the position that taxpayers would not have the right to appeal where the taxpayer submitted the offer solely to delay collection, where the taxpayer did not submit the required information, or where the offer was returned as "nonpro-

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[150] Internal Revenue Service Restructuring and Reform Act of 1998, § 3462(a), 112 Stat. 685, 764-65 (codified at I.R.C. § 7122(d)).

[151] *Id.* § 3462(a), 112 Stat. at 765.

[152] U.S. GEN. ACCOUNTING OFFICE, GAO-02-311, TAX ADMINISTRATION: IRS SHOULD EVALUATE THE CHANGES TO ITS OFFER IN COMPROMISE PROGRAM 31 (2002) [hereinafter 2002 GAO REPORT].

[153] As the conference report stated,

> [T]he conferees expect that the present regulations will be expanded so as to permit the IRS, in certain circumstances, to consider additional factors (i.e., factors other than doubt as to liability or collectibility) in determining whether to compromise the income tax liabilities of individual taxpayers. For example, the conferees anticipate that the IRS will take into account factors such as equity, hardship, and public policy where a compromise of an individual taxpayer's income tax liability would promote effective tax administration.

H.R. REP. NO. 105-599, at 289 (1998) (Conf. Rep.).

[154] *See* Treas. Reg. § 301.7122-1(b)(3)(ii) (2003) (stating that "compelling public policy or equity considerations" may justify a compromise that would not otherwise be approved); *id.* § 301.7122-1(c)(3) (providing examples of compromises that achieve "effective tax administration").

[155] § 3462(c)(1), 112 Stat. at 766 (codified at I.R.C. § 7122(e)).

cessable" because returns for these reasons would not constitute a rejection.[156]

Finally, the 1998 Act provided that offers from low-income taxpayers could not be rejected "solely on the basis of the amount of the offer."[157] In the Act's legislative history, Congress expressed its desire that the IRS do a better job of informing taxpayers that the OIC procedure is available to resolve tax debts.[158]

4. 2001 Introduction of Centralized Processing

The year 2001 saw important changes in the administration of the OIC procedure. In 2001, the IRS stopped processing all offers in field offices, instead establishing centralized processing centers in Brookhaven, New York, and Memphis, Tennessee, for processing certain offers.[159] Under centralized processing, simpler OICs would generally be processed in Brookhaven and Memphis, while more complex offers would continue to be processed by local field offices.[160] This move was made to reduce case inventory backlog and processing times.[161] However, centralized processing subsequently came under fire for ultimately reducing the effectiveness of the program.[162]

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[156] Treas. Reg. § 301.7122-1(f)(5)(ii); *see also supra* notes 40-41 and accompanying text.

[157] § 3462(a), 112 Stat. at 765 (codified at I.R.C. § 7122(d)(3)(A)).

[158] *See* H.R. REP. NO. 105-599, at 289 (1998) (Conf. Rep.) ("[T]he IRS should make it easier for taxpayers to enter into offer-in-compromise agreements, and should do more to educate the taxpaying public about the availability of such agreements."); *see also* 2002 GAO REPORT, *supra* note 152, at 13 (describing IRS efforts to inform the public of OIC options, including "outreach and education efforts").

[159] *See* 2002 GAO REPORT, *supra* note 152, at 19; *see also* 1 NAT'L TAXPAYER ADVOCATE, 2004 ANNUAL REPORT TO CONGRESS 313 (2004) [hereinafter 2004 NTA ANNUAL REPORT] (discussing various aspects of the "OIC inventory reduction strategy" that involved centralized processing in Brookhaven and Memphis); TREASURY INSPECTOR GEN. FOR TAX ADMIN., REFERENCE NO. 2003-30-182, CONTINUED PROGRESS IS NEEDED TO IMPROVE THE CENTRALIZED OFFER IN COMPROMISE PROGRAM 1-3 (2003) (summarizing progress of the "Centralized Offer in Compromise" program).

[160] *See* TREASURY INSPECTOR GEN. FOR TAX ADMIN., REFERENCE NO. 2005-30-013, IMPROVEMENTS ARE NEEDED IN THE TIMELINESS AND ACCURACY OF OFFERS IN COMPROMISE PROCESSED BY FIELD OFFER GROUPS 3 (2004); *see also* 2004 NTA ANNUAL REPORT, *supra* note 159, at 313.

[161] *See* 2002 GAO REPORT, *supra* note 152, at 18 (outlining efforts to improve efficiency).

[162] For example, some practitioners have complained that using the "strict gatekeeper" model to reduce backlog creates the illusion of programmatic success by summarily returning offers with minor incompleteness to the taxpayer. *See, e.g.*, Robert E. McKenzie, Am. Bar Ass'n Section of Taxation, Statement at the IRS Oversight Board

5. 2003 Introduction of User Fee Requirements

In 2003, final Treasury Regulations introduced a $150 user fee requirement for submission of certain OICs.[163] Those regulations, still in force, provide that no user fees are charged for offers based solely on doubt as to liability, and the fee is also waived for offers made by low-income taxpayers.[164] For offers accepted on effective tax administration grounds or on grounds of doubt as to collectibility where collecting a greater amount than that offered would create economic hardship, the user fee is generally applied against the amount of the offer.[165] However, if the taxpayer specifically requests reimbursement, the fee will be refunded.[166] The user fee is otherwise nonrefundable once the OIC has been accepted for processing.[167]

6. 2005–2006 Legislative Changes

The most recent set of major statutory changes was made by the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA)[168] and the Tax Relief and Health Care Act of 2006.[169] As a result of TIPRA, a partial payment of the proposed offer must now accompany

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Hearing (Jan. 27, 2003) (transcript available at http://www.treasury.gov/irsob/meetings/1-27-03/abast.pdf) ("This strict 'gatekeeper' approach is not consistent with recent congressional efforts to liberalize the OIC program and to encourage reasonable collection alternatives."); *see also* 2004 NTA ANNUAL REPORT, *supra* note 159, at 314 (noting that because a larger number of offers were being returned to the taxpayer as "not processable," the "IRS has been evaluating the substance of *fewer* offers since centralized OIC processing was adopted"). The Taxpayer Advocate has also questioned the effectiveness and impacts of centralized processing. *See* 2009 NTA ANNUAL REPORT, *supra* note 51, at 196, 201 (reporting that "OIC centralization has created a 'bottleneck'" because the "IRS placed more emphasis on 'moving' the workload" than "resolving collection cases"); 2008 NTA ANNUAL REPORT, *supra* note 106, at 264 (identifying the impacts of centralization as one of the twenty most serious problems facing taxpayers); *see also* Letter from Robert A. Zarzar, Am. Inst. of Certified Pub. Accountants, to Dale Hart, Comm'r, Internal Revenue Serv., Small Bus./Self-Employed Div. (Oct. 14, 2003), *reprinted in* TAX NOTES TODAY, Oct. 16, 2003, *available at* LEXIS, 2003 TNT 200-38 (expressing concern that "IRS employees at the [centralized OIC] sites might be reducing OIC inventory levels based on implementation of rigid procedures; tight rules regarding what constitutes a 'processable' offer and short time frames for submitting updated or missing documents").

[163] Treas. Reg. § 300.3(b)(1) (2004).
[164] *Id.* § 300.3(b)(1)(i)–(ii).
[165] *Id.* § 300.3(b)(2).
[166] *Id.*
[167] *Id.* § 300.3(b)(3).
[168] Pub. L. No. 109-222, § 509, 120 Stat. 345, 362-64 (2006).
[169] Pub. L. No. 109-432, div. A, § 407, 120 Stat. 2922, 2960-62.

any OIC that is submitted.[170] For lump-sum offers, a payment equal to twenty percent of the amount of the offer must accompany the submission.[171] For periodic payment offers, a payment in the amount of the first proposed installment must accompany the submission.[172] Under TIPRA, a periodic payment or lump-sum OIC that is not accompanied by the required partial payment "may be returned to the taxpayer as unprocessable."[173] After TIPRA was enacted, however, the IRS adopted procedures to allow continued processing of lump-sum offers in cases where less than the full amount of the partial payment required was included in the submission.[174] An insufficient periodic payment will still cause the offer to be unprocessable.[175] Furthermore, for periodic payment offers, the taxpayer must also continue to make installment payments due under the offer while the offer is pending, and failure to do so is regarded by the IRS as a withdrawal of the offer.[176] Advance partial payments made by an OIC applicant will not be refunded by the IRS if the OIC is rejected.[177]

The IRS also announced in 2006 that it would waive the partial payment requirements for offers submitted by low-income taxpayers and for offers based solely on doubt as to liability.[178] Nonetheless, there was a subsequent disproportionate decline in the number of offers submitted by taxpayers below the poverty line.[179] Finally, as a result of

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[170] I.R.C. § 7122(c) (2006).

[171] *Id.* § 7122(c)(1)(A)(i). A "'lump-sum offer-in-compromise' means any offer of payments made in 5 or fewer installments." *Id.* § 7122(c)(1)(A)(ii).

[172] *Id.* § 7122(c)(1)(B)(i).

[173] *Id.* § 7122(d)(3)(C).

[174] *See* IRM 5.8.2.4.1(1) (Mar. 26, 2010) (identifying criteria that will cause an offer to be returned as not processable and expressly excepting insufficient lump-sum payments); *id.* at 5.8.2.8(4) (stating that insufficient initial lump-sum payments will be considered a perfection issue and may still be processed).

[175] *Id.* 5.8.2.8(5).

[176] I.R.C. § 7122(c)(1)(B)(ii).

[177] *See* I.R.S. Notice 2006-68 §§ 1.02–.03, 2006-2 C.B. 105 (explaining that partial payments and installment payments on OICs will be considered payments of tax and not refundable deposits); I.R.S. News Release IR-2006-106 (July 11, 2006) ("All installment payments are nonrefundable."); I.R.S. Fact Sheet FS-2006-22 (July 2006) (stating that advance partial payments are considered "payments on tax" rather than refundable deposits (citing I.R.C. § 7809(b); Treas. Reg. § 301.7122-1(h) (2002)).

[178] I.R.S. Notice 2006-68 § 4.02–.03, 2006-2 C.B. 105, 106. A "low-income taxpayer" is defined as "an individual whose income falls at or below poverty levels based on guidelines established by the U.S. Department of Health and Human Services under the authority of section 673(2) of the Omnibus Reconciliation Act of 1981, or another measure that is adopted by the Secretary." *Id.* § 4.02 (citation omitted) (citing Pub. L. No. 97-35, § 673(2), 95 Stat. 357, 511-12).

[179] *See infra* subsection II.B.2.

the TIPRA changes, the IRS now has twenty-four months to consider an offer and after that time the offer will be deemed accepted.[180]

Also in 2006, Congress in the Tax Relief and Health Care Act of 2006 amended I.R.C. § 6702 to impose a $5000 penalty for "specified frivolous submissions," including submission of a frivolous Offer in Compromise.[181] That same Act authorized the IRS to disregard any portion of an OIC application that is frivolous and to treat it as if it were never submitted.[182]

B. *Two Problematic Trends in Historical Context*

The OIC procedure has seen significant changes over the past twenty years. Several of these changes were implemented or enacted in response to real or perceived program flaws and shortcomings. Against this historical backdrop of changes, two problematic trends have emerged: (1) an increase in the case inventory backlog and processing times; and (2) a decline in the number of offers received and offers accepted, and an increase in offers returned to taxpayers. Most of the commentary and criticism that has been levied against the OIC procedure over the years stems from discontent regarding one or both of these troubling trends.

1. 1997–2001: Increased Inventory Backlog and Longer Processing Times

Between 1997 and 2001, the IRS's OIC program was clearly suffering from a growing inventory backlog and longer processing times.[183]

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[180] Tax Increase Prevention and Reconciliation Act of 2005, Pub. L. No. 109-222, § 509, 120 Stat. 345, 362-63 (2006) (codified at I.R.C. § 7122(f) (first of two subsections (f))).

[181] Pub. L. No. 109-432, div. A, § 407(a), 120 Stat. 2922, 2960-61 (codified at I.R.C. § 6702(b)).

[182] *Id.* § 407(d), 120 Stat. at 2962 (codified at I.R.C. § 7122(f) (second of two subsections (f))). A submission is frivolous if the Secretary of the Treasury identifies it as frivolous or if any portion of the submission "reflects a desire to delay or impede the administration of Federal tax laws." I.R.C. § 6702(b)(2)(A). These new rules regarding frivolous offers apply to "submissions made and issues raised after the date on which the Secretary first prescribe[d] a list" of frivolous claims, as required under the new section 6702(c). Tax Relief and Health Care Act of 2006, § 407(f), 120 Stat. at 2962. The IRS first issued such a list in 2007. I.R.S. Notice 2007-30, 2007-14 C.B. 883. The list was revised in 2008 and 2010. I.R.S. Notice 2008-14, 2008-1 C.B. 310; I.R.S. Notice 2010-33, 2010-17 I.R.B. 609.

[183] *See, e.g.*, Sheryl Stratton, *Offers in Compromise Program Logjammed, IRS Official Says*, 89 TAX NOTES 856, 856 (2000) ("The IRS is having problems working all the

In a 2002 study, the GAO found that from 1997 to 2001, the percentage of OICs resolved in fewer than six months had fallen from sixty-four percent to thirty-two percent, while the percentage of OICs closed between six and twelve months rose from twenty-nine percent to forty-three percent.[184] More problematically, the percentage of OICs that took at least a year to close more than tripled from seven percent to twenty-five percent.[185] In fiscal year 2000, it took the IRS an average of 292 days to close an OIC case, and in fiscal year 2001, that figure rose to 312 days.[186] Furthermore, the year-end inventory—that is, the backlog of cases—had risen from 32,279 in 1997 to 94,931 by 2001.[187]

In the 2000 Annual Report to Congress, the Taxpayer Advocate noted these "unacceptable" processing times.[188] While commending recent measures taken by IRS staff to improve the program, the Taxpayer Advocate still found that "time frames for acknowledging and processing offers remain[ed] at an unacceptable level of service."[189] In her 2001 Annual Report to Congress, the Taxpayer Advocate again cited the large backlog and delays in deciding offers as one of the most serious problems faced by taxpayers.[190]

Commentators provided various explanations and solutions for the backlog and processing time problems. The GAO concluded in its 2002 study that these problems were largely due to changes in the OIC program caused by the 1998 Restructuring Act and IRS actions.[191] Accord-

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offers. . . . There are simply not enough trained people in the offers in compromise program . . . .").

[184] 2002 GAO REPORT, *supra* note 152, at 10. The GAO conducted its review of the IRS's administration of the OIC program at the request of Senators Max Baucus and Charles Grassley, in large part in order to investigate concerns about a "growing backlog of cases and longer processing times." *Id.* at 1.

[185] *Id.* at 10.

[186] *Id.* at 11.

[187] *Id.* at 10.

[188] NAT'L TAXPAYER ADVOCATE, FY 2000 ANNUAL REPORT TO CONGRESS 36 (2000); *see also id.* at 36-39 (discussing the Taxpayer Advocate's concerns and the IRS's initiatives designed to address the problem).

[189] *Id.* at 39.

[190] NAT'L TAXPAYER ADVOCATE, FY 2001 ANNUAL REPORT TO CONGRESS 52 (2001) [hereinafter 2001 NTA ANNUAL REPORT]. Indeed, in every year between 2001 and 2010, the Taxpayer Advocate directly or indirectly listed problems with the OIC program in her list of the most serious problems confronting taxpayers. *See* 1 NAT'L TAXPAYER ADVOCATE, 2010 ANNUAL REPORT TO CONGRESS 311 & n.1 (2010) [hereinafter 2010 NTA ANNUAL REPORT].

[191] 2002 GAO REPORT, *supra* note 152, at 12-15. The 2002 GAO Report sought to determine (1) the cause of the increased backlog and processing times, (2) the viability of any IRS initiatives to reduce the backlog and processing times, (3) whether the IRS

ing to the report, these changes led to an increased demand for OICs, more processing steps, and an increase in the number of staff hours required to process an offer—all of which outpaced staffing increases to the OIC program.[192] This increased demand was driven in part by the 1998 Restructuring Act requirement that the IRS inform taxpayers about the OIC program, and in part by practitioners' increased publicization of OICs.[193] Adding to the burden, in 1999 the IRS began processing incomplete applications while working to obtain the necessary missing information, instead of returning them.[194] Furthermore, as a result of the 1998 Restructuring Act, the IRS expanded the base of taxpayers eligible for offers in compromise by adding the current "effective tax administration" category and offering a new long-term deferred payment option that increased the affordability of OICs.[195] The GAO also noted that, according to IRS officials, the Restructuring Act increased workload and added steps to the OIC process by mandating independent administrative review of proposed rejections, and by requiring taxpayers to resubmit applications that had originally been made using what had become nonconforming contract forms.[196] Finally, the 2002 GAO Report found that the elimination of partial payment installment agreements in 1998 had caused more people struggling to pay their taxes to turn to the OIC program for relief.[197] All of these changes led to more OIC requests and a resulting increase in the need for staff; the IRS could not keep pace in the face of such increased demand.[198]

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was fulfilling the Restructuring Act's mandate to provide independent review of all proposed OIC rejections, and (4) the impact on taxpayers of a 1998 IRS counsel's decision that the Service lacked legal authority to enter into partial payment installment agreements. *Id.* at 1.

[192] *Id.* at 12-18.

[193] *Id.* at 13; *see also* Steve Johnson, *The 1998 Act and the Resources Link Between Tax Compliance and Tax Simplification*, 51 U. KAN. L. REV. 1013, 1039-42 (2003) (describing how "new demands" imposed by the 1998 Restructuring Act, including OIC program "liberalization," led to an IRS "resource squeeze").

[194] *See* 2002 GAO REPORT, *supra* note 152, at 14.

[195] *Id.*

[196] *Id.* at 15.

[197] *Id.* at 14. In 1998, IRS counsel had determined that the IRS lacked legal authority to enter into certain partial payment installment agreements. *Id.* In 2004, Congress reversed this decision by amending I.R.C. § 6159(a), which authorized the IRS to enter into partial payment installment agreements. *See* American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 843(a)(1), 118 Stat. 1418, 1600 (codified at I.R.C. § 6159(a) (2006)).

[198] 2002 GAO REPORT, *supra* note 152, at 15-18.

The Taxpayer Advocate attributed the increase in inventory (and thus the backlog) to (1) IRS service improvements and changes to the criteria for a "processable" offer, (2) the fact that taxpayers unable to pay in full could no longer enter into partial payment installment agreements and had to submit "deferred payment offers," (3) a lack of agreement or understanding regarding the purposes of the OIC program, and (4) the expansion of the program by the 1998 Restructuring Act.[199] The Taxpayer Advocate noted that the great increase in the number of offer applications submitted in the years leading up to 2001 had caused the delays and backlog despite IRS efforts to improve the program, which had included committing additional resources.[200] And further, the backlog itself created additional work, because "[b]y the time an OIC specialist receives an offer, the information may be outdated."[201]

In response to the backlog and processing time problems, the IRS introduced centralized processing of offers and imposed user fees and frivolity penalties.[202] At the time, it was unclear whether these measures would be effective. Subsequent developments revealed that the effects of these initiatives—both good and bad—were profound.[203]

2. 2000–2009: Decline in the Number of Received and Accepted Offers and Increase in "Repeat Offers"

Another problematic trend has been a decline in both the number of submitted and accepted offers between 2000 and 2009. From 2000 to 2005, the number of submitted offers declined from 109,818 to 73,301, while the number of accepted offers declined from 31,609 to 14,526.[204] This decline of offers received and accepted continued through 2008.[205] On the other hand, between 2000 and 2005, repeat offers in-

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[199] 2001 NTA ANNUAL REPORT, *supra* note 190, at 52, 54.

[200] *Id.* at 52-54.

[201] *Id.* at 53.

[202] *See supra* subsections II.A.4-6.

[203] *See infra* Section III.B.

[204] 2006 GAO REPORT, *supra* note 16, at 12 tbl.1. While there was an increase in offers received between 2000 and 2003, offers received fell in 2004 and 2005. Likewise, there was an increase in offers accepted in 2001 but acceptances declined thereafter from 2002 to 2005. *Id.*

[205] *See* 2010 NTA ANNUAL REPORT, *supra* note 190, at 313 (noting that "the program . . . experienced a steady decline in offers received and accepted since FY 2001 with a slight improvement in FY 2010"). In the fourth quarter of 2010, centralized OIC locations "accepted 87 percent more offers than in the same period of FY 2009, and the dollars accepted in these offers increased by 64 percent." *Id.* at 316. The Taxpayer Advocate

creased from 15% to 40% (reaching 44% in 2004), and 2005 data showed that many of these were multiple repeats.[206] The percentage of offers returned to taxpayers as "not processable" or after acceptance for processing increased from 39% in 2001 to 57% in 2004.[207]

Various commentators have attempted to explain the decline in submitted and accepted offers and the increase in the percentage of repeat offers and offer returns. In seeking to explain the increased percentage of repeat offers, the GAO suggested that this change could be the result of taxpayer confusion or collection delay tactics.[208] However, it also acknowledged that the IRS's attempts to close cases quickly and to reduce case inventory could be responsible for creating a situation where taxpayers are unable to fully negotiate their offers before they are closed and thus submit repeat offers.[209] With respect to the decline in submissions and acceptances in the program, the GAO questioned whether a decrease in program accessibility was the cause.[210] The GAO noted that the Taxpayer Advocate, the American Institute of Certified Public Accountants, the National Association of Enrolled Agents, and practitioners and practitioner organizations had cited confusion about program requirements, lengthy processing times, difficulty in getting reasonable offers accepted, and the burdensomeness of the program as barriers to accessibility.[211] However, the GAO conceded that reduced program participation could have

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attributed the 2010 uptick to new procedures introduced by the IRS to "streamline" the centralized OIC process and found the increase "very encouraging." *Id.* at 315-16.

[206] 2006 GAO REPORT, *supra* note 16, at 12-14. "Repeat offers occur when a taxpayer submits an offer that [the] IRS does not accept, [the] IRS closes the case, and then the taxpayer submits another offer covering at least some of the same tax liability." *Id.* at 12.

[207] 2004 NTA ANNUAL REPORT, *supra* note 159, at 314.

[208] 2006 GAO REPORT, *supra* note 16, at 14.

[209] *Id.* The GAO noted that the IRS itself had not investigated the reasons for the increased proportion of repeat offers. *Id.*

[210] *Id.* at 20-23. The GAO defines "accessibility" as "how easy it is for potentially eligible taxpayers to participate in the OIC Program." *Id.* at 20.

[211] *Id.* at 20-21. In addition, the GAO report criticized the IRS's use of offers based on "effective tax administration" grounds. *Id.* at 33-35. While the GAO conceded that Congress's intent in regard to ETA offers was not clear, the GAO did fault the IRS for implementing standards that rendered hardship ETA offers and doubt-as-to-collectibility offers "effectively indistinguishable from each other." *Id.* at 33-37. Indeed, the report pointed out that the new ETA category may have created confusion. *Id.* at 37-38. The GAO also investigated "offer mills"—practitioners who "consistently use[] negligent or deceptive practices to exploit taxpayers or the OIC Program"—but concluded that the impact of offer mills on OIC processing was negligible. *Id.* at 28-31. Finally, the GAO concluded that appeals were being afforded as Congress intended. *Id.* at 31-32.

occurred for reasons other than barriers to accessibility and noted that the IRS had neither analyzed whether the accessibility of the OIC program had changed, nor compared the declining numbers against the changes in the pool of "potentially eligible taxpayers."[212] The GAO concluded that the IRS did not know whether reduced accessibility led to the declining participation, and, moreover, whether the concerns raised by the Taxpayer Advocate and others were correct.[213]

The Taxpayer Advocate has also pointed to possible reasons for this trend and has discussed this trend almost every year in the Annual Report to Congress. For example, the 2004 Report cited the IRS's adoption of "inflexible policies and automated processes" designed to manage OIC inventory as being responsible for the increase in OIC returns and rejections.[214] Further, the number of offers being "substantively" evaluated by the IRS had decreased since the adoption of centralized OIC processing.[215] The Taxpayer Advocate also complained that IRS data on OIC dispositions did not indicate whether centralized processing was "actually more efficient at substantive OIC processing" or whether centralization was just better at "quickly returning" OICs.[216] The Taxpayer Advocate also cited the $150 user fee, the IRS's refusal to process OICs from taxpayers undergoing bankruptcy proceedings, the IRS's rigid and unrealistic expectations in processing and evaluating submitted offers, and the IRS's policy of rejecting offers where taxpayers appeared likely to qualify for long-term installment agreements as contributing to high numbers of returns.[217] Expressing concern about these trends, the 2006 NTA Annual Report noted that, based on focus group studies, "external stakeholders" (i.e., practitioners) agreed that the OIC was "no longer a viable collection alternative" and "felt that the IRS's first task was to find a reason—any reason—to reject the offer."[218]

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[212] *Id.* at 22-23.

[213] *Id.* at 23.

[214] 2004 NTA ANNUAL REPORT, *supra* note 159, at 313. The Report also mentioned OIC processing centralization, reduction in the number of attempts the Small Business/Self-Employed Division would make to obtain information from taxpayers ("from 'at least two' to one"), and imposition of a user fee for OIC submissions as contributors to the problem. *Id.* at 313-14.

[215] *Id.* at 315.

[216] *Id.*

[217] *Id.* at 319-24.

[218] 2006 NTA ANNUAL REPORT, *supra* note 47, at 91. These focus group participants "agreed that offers [were] not receiving fair consideration." *Id.*

The Taxpayer Advocate voiced concern that TIPRA's new partial payment requirements, coupled with the nonappealability of returned offers, had led to a decline in viable offers being submitted.[219] In 2007, the Taxpayer Advocate reiterated some of her 2006 comments, opining that new rules (including the 2003 introduction of the $150 user fee requirement and the TIPRA partial payment requirement), the high rate of returned OICs, and the lack of an avenue for appeal of such returns had together made it more difficult and expensive for taxpayers to submit OICs.[220] Finally, in 2009, the Taxpayer Advocate again voiced these concerns, citing the "daunting" application process, centralized processing, the IRS's internal attitudes, new legislation making submission of an offer more expensive, and negative public perception as the causes of the program's decline.[221]

In addition to the Government Accountability Office and the National Taxpayer Advocate, the Treasury Inspector General for Tax Administration (TIGTA) has studied the causes of declining program participation.[222] In a March 2010 evaluation report, TIGTA, like the

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[219] *Id.* at 507-19. The Taxpayer Advocate thus recommended elimination of the 2005 TIPRA partial payment requirement, institution of an appeals procedure for returned offers, and expansion of exceptions to the partial payment requirements. *Id.* at 508-09, 518-19.

[220] 2007 NTA ANNUAL REPORT, *supra* note 51, at 376-81. The report also noted that the fee waiver for low-income applicants had been ineffective, as evidenced by the fact that submissions from low-income taxpayers had fallen even more than for other taxpayers after imposition of the user fee. *Id.* at 377.

[221] 2009 NTA ANNUAL REPORT, *supra* note 51, at 199-204. In the 2008 Annual Report, the NTA also listed "[t]he [i]mpact of IRS [c]entralization on [t]ax [a]dministration" as one of the top twenty problems and listed centralization of the OIC program as "an example of a flawed centralization initiative." 2008 NTA ANNUAL REPORT, *supra* note 106, at 260, 264. In 2009, the Taxpayer Advocate recommended changes to improve the program and better effectuate congressional intent, including reinstatement of 1992 Internal Revenue Manual provisions, reinstatement of "one-stop" customer service, better determinations of "reasonable collection potential," and use of enforcement actions against "unskilled and unscrupulous" OIC preparers. 2009 NTA ANNUAL REPORT, *supra* note 51, at 204-07.

[222] TIGTA provides independent oversight of the IRS. *Information About the Treasury Inspector General for Tax Administration*, TREASURY INSPECTOR GEN. FOR TAX ADMIN., http://www.treasury.gov/tigta/about/tigta_brochure.pdf (last visited Jan. 15, 2012). TIGTA conducts audits of various tax administration matters and recommends reforms and improvements. *See Audit Reports*, TREASURY INSPECTOR GEN. FOR TAX ADMIN., http://www.treasury.gov/tigta/oa_auditreports.shtml (last visited Jan. 15, 2012); *Office of Audits (OA)*, TREASURY INSPECTOR GEN. FOR TAX ADMIN., http://www.treasury.gov/tigta/oa.shtml (last visited Jan. 15, 2012). Various aspects of the IRS's administration of the OIC program are among the items TIGTA studies. TIGTA's reports evince agreement with some, though not all, of the problems and criticisms identified by the Taxpayer Advocate and the Government Accountability Office.

Taxpayer Advocate, pointed to the implementation of the $150 user fee as a possible cause of the decline in OICs.[223] In addition, in a June 2005 audit report, TIGTA found that the user fee reduced the volume of offers filed at all income levels.[224] Despite an exemption from the user fee for poverty-level taxpayers, the decline was steeper for those taxpayers.[225]

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In sum, there have been two negative trends in OIC program administration in recent years: (1) in the period between roughly 1997 and 2001, an inventory backlog and processing time problem developed, and (2) between 2000 and 2008, there were declining submissions and acceptances as well as an increase in the proportion of repeat offers and offers returned to taxpayers. Chronologically speaking, these trends roughly correlate with (1) the 1998 Restructuring Act and (2) the changes to the procedure adopted between 1998 and 2006, respectively. These trends have elicited a number of different critiques of the OIC procedure,[226] although critics disagree about the

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[223] *See* TREASURY INSPECTOR GEN. FOR TAX ADMIN., REFERENCE NO. 2010-IE-R002, THE INTERNAL REVENUE SERVICE RESTRUCTURING AND REFORM ACT OF 1998 WAS SUBSTANTIALLY IMPLEMENTED BUT CHALLENGES REMAIN 39-40 (2010) (noting that in the first two years after the user fee was implemented OIC receipts declined from 127,769 to 74,311).

[224] *See* TREASURY INSPECTOR GEN. FOR TAX ADMIN., REFERENCE. NO. 2005-30-096, THE IMPLEMENTATION OF THE OFFER IN COMPROMISE APPLICATION FEE REDUCED THE VOLUME OF OFFERS FILED BY TAXPAYERS AT ALL INCOME LEVELS 2-3 (2005) [hereinafter TIGTA JUNE 2005 FINAL AUDIT REPORT] (reporting an overall decline of 28%).

[225] *See id.* at 3 (reporting that filings by taxpayers below the poverty level declined by 36% while filings by those above the poverty level declined by only 26%). This decline occurred in spite of the IRS's early 2004 media campaign that alerted taxpayers about the exemption for poverty-level taxpayers. *Id.* at 4.

[226] For example, the Taxpayer Advocate has repeatedly identified problems surrounding the OIC program in its list of the most serious problems affecting taxpayers. *See supra* note 190. TIGTA has generally been more positive than the Taxpayer Advocate, though it did find room for improvement in the centralized processing system. *See* TREASURY INSPECTOR GEN. FOR TAX ADMIN., *supra* note 159 (acknowledging progress and making additional recommendations to facilitate processing); *see also* TREASURY INSPECTOR GEN. FOR TAX ADMIN., REFERENCE NO. 2004-30-043, MONITORING OF ACCEPTED OFFERS IN COMPROMISE IS GENERALLY EFFECTIVE BUT SOME IMPROVEMENT IS NEEDED 8-10 (2004) (noting the lack of an organized method for handling new OICs); TREASURY INSPECTOR GEN. FOR TAX ADMIN., REFERENCE NO. 2005-30-013, IMPROVEMENTS ARE NEEDED IN THE TIMELINESS AND ACCURACY OF OFFERS IN COMPROMISE PROCESSED BY FIELD OFFER GROUPS 5-10 (2004) (criticizing the time it takes to process certain complex OICs).

source of the problem and the appropriate response. In the next two Parts, I present a unifying framework for understanding and evaluating these problematic trends in the OIC procedure. Based on an analysis of stakeholder interests and behaviors, I argue that reforms should be adopted that take into account the roles played by divergent interests and power dispersal in determining program outcomes.

III. EXPLAINING WEAKNESS: A STAKEHOLDER DYNAMICS ANALYSIS

The power to affect the OIC procedure's effectiveness is dispersed among four players: (1) Congress, (2) the IRS, (3) the taxpayer, and (4) financial supporters of the taxpayer. Each of these players is capable of derailing the procedure through action or inaction and each has divergent and sometimes contradictory interests in how tax-debt relief in general, and the OIC procedure in particular, should operate. Moreover, the actions of any one of these players can have feedback effects on the interests and actions of other players. In this way, the divergent interests and behavioral responses of these stakeholders combine to weaken the procedure over time. Thus, the single most important factor in determining whether to adopt a reform is whether it exacerbates or ameliorates the downward-spiraling effects of these stakeholder interactions. In this Part, I briefly summarize the different roles and interests of these four players. I then describe concretely how the divergent interests and behaviors of these players have led to suboptimal outcomes over time, as evidenced by the trends discussed in Section II.B.

A. *Four Stakeholders with Divergent Interests*

1. Congress and Other Legislative Actors

Congress has the power to define the content and shape of federal tax legislation. But, of course, tax legislation is not created in a vacuum. Rather, other participants in the legislative process play important roles in shaping federal tax legislation.[227] Such participants include

[227] *See generally* 4A BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶¶ 116.1–.3 (2d ed. 1992 & Supp. 2011) (describing the legislative process for tax law, emphasizing that the President, the Treasury Department, and others influence the House of Representatives, and noting that the House uses a wide array of specialists, including accountants, econometricians, and tax attorneys, in shaping new legislation).

committees, lobbyists, and aides. These legislative players, mediated by congressional action, have the power to suggest, enact, amend, and abolish tax legislation.[228] The interactions between Congress and the other participants in the tax legislative process are well illustrated in the hearings and testimony leading up to the enactment of the 1998 Restructuring Act.[229]

Congressional priorities change over time. The motivations underlying the 2003–2006 statutory changes were far different from those underlying the 1998 changes. The 1998 changes were aimed at curbing excesses in the IRS's collection function[230] and broadening the application of the OIC program,[231] while the 2003–2006 changes showed concern about managing the problems of an overburdened IRS.[232] Furthermore, the composition and activities of interest groups and other legislative participants that influence Congress are not static. It is beyond the scope of this Article to survey the vast literature on how Congress behaves, including literature on capture, principal-agent problems, and interest-group theory. The point here is merely that Congress is the source of the legislation that established the OIC procedure. However, its implementation in practice depends on the actions of other players, so congressional mandate is not determinative of program outcomes.

[228] How such stakeholders, interest groups, and other legislative actors interact to produce outcomes is, of course, the subject of extensive theoretical literature. *See, e.g.*, William W. Buzbee, *The One-Congress Fiction in Statutory Interpretation*, 149 U. PA. L. REV. 171, 207-09 (2000) (discussing actors in the legislative process and their roles in crafting new legislation).

[229] The hearings included testimony before the Senate Committee on Finance from the IRS Commissioner, the President of the National Society of Accountants, several tax attorneys, and a director of the General Accounting Office, among others. *See IRS Restructuring Hearings*, *supra* note 129, at 20-49, 59-104, 106-30.

[230] *See* WILLIAM V. ROTH, JR. & WILLIAM H. NIXON, THE POWER TO DESTROY 217-29 (1999) (arguing that the 1998 changes came in response to a new "awareness that all was not well inside an organization whose congressionally granted power allowed it to invade the lives of ordinary Americans").

[231] *See* 2004 NTA ANNUAL REPORT, *supra* note 159, at 312 (noting that the "intended effect" of the 1998 Act's expansion of the bases for compromise to include "effective tax administration" offers was "generally to increase the IRS' flexibility in accepting OICs" (citing Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685; H.R. REP. NO. 105-599, at 288-89 (1998) (Conf. Rep.))).

[232] *See supra* subsections II.A.5-6.

2. The IRS

While the power to enact legislation lies with Congress, the power to administer the OIC statute is vested in the IRS. The IRS is responsible for promulgating the regulations and the rulings that interpret and implement the relevant statutes, designing the OIC Form (Form 656), and handling logistical issues related to OIC filings (such as deciding whether processing should be centralized and what kinds of employees should process filings).[233]

The actions and decisions of the IRS in implementing the procedure are an important reason why the intentions of Congress, as expressed in the statute, have not always had the anticipated results.[234] Practitioners and others have complained that the IRS's actions have not always reflected an interest in increased taxpayer access to or greater functionality of the procedure.[235] This may be due to a number of reasons. Given that the IRS's central job is the collection of revenue and enforcement of the tax laws, it may not be well suited to the administration of a tax compromise procedure.[236] It may be too much to ask for an agency like the IRS to change its enforcement culture overnight, even in the face of a major piece of legislation such as the 1998 Restructuring Act. This point is not new: the perils of expanding the job of the IRS beyond its fundamental collection mission have also been raised in the context of the agency's expanding role in administering social programs.[237]

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[233] *See, e.g.*, TREASURY INSPECTOR GEN. FOR TAX ADMIN., *supra* note 159, at 2 (discussing IRS initiation of the centralized processing program for offers, including the roles of different types of employees).

[234] *See infra* Section III.B.

[235] *See* 2010 NTA ANNUAL REPORT, *supra* note 190, at 314 (noting practitioner concerns that "IRS employees . . . see the practitioners as the enemy and will not work with them to get the offer accepted"); 2006 NTA ANNUAL REPORT, *supra* note 47, at 91. The Taxpayer Advocate "has also encountered what practitioners have described . . . as 'another agenda'" on the part of the IRS, including (1) concern that an increase in the use of collection alternatives will harm voluntary compliance, (2) reluctance to appear to be an installment lending institution, and (3) desire to discourage abuse of the OIC procedure. *Id.* at 99.

[236] *See, e.g.*, *IRS Restructuring Hearings*, *supra* note 129, at 412 (statement of Bruce A. Strauss, Enrolled Agent) (stating that the IRS's "attitude" in the years preceding the 1998 Act was that it must "[p]rotect the government['s] interest").

[237] Commentators have raised this point when considering whether the IRS should be asked to administer the recently enacted Patient Protection and Affordable Care Act. Pub. L. No. 111-148, 124 Stat. 119 (2010) (to be codified as amended in scattered sections of 21, 25, 26, 29, and 42 U.S.C.); *cf.* Jeremiah Coder, *The New IRS: Expanding the Mission?*, 128 TAX NOTES 576, 577-78 (2010) (noting the increase in the IRS's "non-

Other explanations for this tension are also possible. For instance, Bryan Camp has described the 1998 Act as containing a "partial paradigm shift" away from what has traditionally been an "inquisitorial" (i.e., information gathering) model of tax administration toward an "adversarial" model.[238] As evidence of this move, Camp cited the creation of the IRS Oversight Board, TIGTA, the Office of the Taxpayer Advocate, and the Office of Appeals.[239] If Camp's framework is correct, it is possible that the move to an adversarial process in tax administration may be a reason why IRS employees have been less than fully supportive of the OIC procedure. Alternatively, the IRS's reluctance to accept offers may be caused by resource constraints which prevent it from engaging in taxpayer-service oriented activities to the extent Congress envisioned.[240] The IRS may have even taken steps to counteract Congress's excessive demands.[241] This Article does not seek to present a detailed organizational theory as to why the IRS's interests have run counter to those of Congress, taxpayers, and their representatives. Suffice it to say that, as is further described in Section III.B, these divergent interests have operated over time to compromise the effectiveness of the OIC procedure.

3. The Taxpayer

A third player with power to effectuate the OIC procedure is, obviously, the taxpayer herself. The ultimate power of the taxpayer as a stakeholder in the success of the OIC procedure stems from the pro-

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tax responsibilities" and noting the Taxpayer Advocate's recommendation that the IRS adopt an additional mission statement of being a benefits administrator, in addition to a tax collector); Nicholas Duarte, *New Programs Strain IRS Resources, Budget*, 130 TAX NOTES 63 (2011).

[238] Camp, *Tax Administration as Inquisitorial Process*, *supra* note 1, at 3-4; *see also* Camp, *Failure of Adversarial Process*, *supra* note 1, at 57-58 ("Adversary process is not an effective regulatory mechanism to check government abuses in the modern administrative state.").

[239] Camp, *Tax Administration as Inquisitorial Process*, *supra* note 1, at 91-103.

[240] *See* 1 NAT'L TAXPAYER ADVOCATE, 2011 ANNUAL REPORT TO CONGRESS, at vi (2011) (explaining that "despite a huge expansion in the IRS's workload, Congress has reduced the IRS's funding in each of the last two years" and that "the imbalance between [the IRS's] workload and its resources is becoming unmanageable").

[241] *See, e.g.*, Johnson, *supra* note 193, at 1039-42 (arguing that the 1998 Restructuring Act imposed significant new demands on IRS resources, including liberalization of the OIC procedure, and discussing steps taken by the IRS to deal with the resources problem); Lederman, *supra* note 1, at 982-85 (noting that the 1998 Act resulted in "substantial resources" being shifted from tax enforcement to taxpayer service activities, leading to a decline in IRS enforcement activity).

cedure's voluntary nature and the fact that the taxpayer must initiate offers. In order for an offer to be processed and approved, it must first be submitted by the taxpayer. Although certain IRS initiatives have explored how to proactively identify those taxpayers most likely to benefit from the procedure,[242] those initiatives have not changed the underlying structural reality—the taxpayer initiates the filing. The taxpayer confronts the following decisions: whether to file, when to file, how much to offer, and whether to make a lump-sum or a periodic payment offer. Thus, the taxpayer's power in the functioning of the OIC process may be characterized as "soft" or "reactive" in the sense that the taxpayer operates from a position of reactivity to the tax law, both on the book and in actual administration, in deciding whether and how to apply for tax compromise.

The motivations of the taxpayer will generally be to minimize, or at least reduce, the dollar amount she has to pay. However, this deceptively simple statement obscures a more complicated calculus. For example, the taxpayer must weigh the probability and benefits of the offer's being successful against the potential consequences of providing the IRS with further information about the taxpayer's assets and financial situation and ultimately having the offer rejected. Thus, whether to make an offer involves a balancing of the chance of success against the odds of incurring follow-up IRS action. In addition, since the introduction of the partial payment requirement, the taxpayer must also factor in the chance that, if the IRS rejects her offer, it may refuse to return the partial down payment she submitted with the offer.[243] The taxpayer will also have to consider how the submission and acceptance of an offer may impact her ability to pay her other debts, and whether an offer, even if accepted, is likely to be successful in light of these other obligations. Finally, the taxpayer will likely weigh the advantages of a bankruptcy filing, which can take care of many debts at once, over the filing of a tax OIC, which can resolve only the tax debt. The decision will depend on the specifics of each taxpayer's situation, including the amount and type of tax and other debts owed, the years

[242] For example, such an approach was recommended by TIGTA in 2006. *See* TIGTA JULY 2006 FINAL AUDIT REPORT, *supra* note 53, at 18 (arguing that IRS management should first "[d]evelop a strategy to identify potential candidates for the OIC program and then determine how to get these taxpayers into the program").

[243] *See supra* note 177 and accompanying text.

at issue, the availability of bankruptcy as an alternative, and whether the tax and other debts are dischargeable in bankruptcy.[244]

4. Other Stakeholders

In addition to Congress, the IRS, and the taxpayer, the motivations and actions of those who facilitate the taxpayer's offer have to be taken into account. Such parties may include attorneys, tax advisors, and most importantly, those who help bankroll the taxpayer's offer. Often, the taxpayer's ability to propose and complete an offer is dependent on the goodwill and financial assistance of family members, friends, or banks.[245] This is particularly true after the introduction of the partial payment requirement.[246] The introduction of the partial payment requirement and the IRS's policy of retaining this payment even if the offer is rejected have made it more difficult for taxpayers to obtain the means to fund proposed offers because financial supporters (both familial and institutional) may not be willing to provide the funds.[247] Thus, the decisions of these third parties are likely to be critical in determining whether offers are proposed, accepted, and successfully completed.

Unsurprisingly, while the interests of these bankrollers are generally in direct opposition to the interests of the IRS, they may not always be completely in alignment with the taxpayer's interests either. The presence and role of these stakeholders may therefore cause program reforms to have different consequences than what was intended. In performing their calculus, these players may, for example, consider the likelihood of successful debtor rehabilitation and the other nontax debts of the debtor. If the taxpayer's financial backers determine that a proposed offer is likely to be rejected and the down payment forfeited, their unwillingness to extend funds will effectively chill the market for offers, independent of the actions of the taxpayer.

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[244] For a fuller discussion of bankruptcy as an alternative for the distressed taxpayer, see Mather & Weisman, *supra* note 37, at A-53 to -80.

[245] *See generally* 2007 NTA ANNUAL REPORT, *supra* note 51, at 379 (discussing sources of funding for submitted offers).

[246] *See* 2 NAT'L TAXPAYER ADVOCATE, 2007 ANNUAL REPORT TO CONGRESS 76-77 (2007) (discussing the importance of third-party financial assistance for taxpayers seeking to compromise).

[247] *See id.* at 77 ("The most common source of offer funds is family and friends. It is unlikely that these third parties will provide funds for an offer since they are likely to forfeit 20 percent of the offered amount without compromising the liability for the taxpayer.").

In sum, in reforming or improving the OIC procedure, the incentives and motivations of third-party financers must be taken seriously. This is particularly so because one of the IRS's key incentives to compromise with the taxpayer may well be the opportunity to tap into fresh funding sources to help pay delinquent tax debts. The existence of third-party funding sources may explain why accepted offers generate more cents on the dollar than the IRS collects through its usual collections process or than it collects from rejected OICs.[248] Third-party financers are essential to the program's effectiveness, and the incentives that dictate their behaviors should be carefully considered.

B. *Power Dispersal and Interest Divergence in Action—Two Turning Points*

The interests of and interactions between these four stakeholders have had a significant impact on the OIC procedure's recent history. This Section shows that recent negative trends in OIC program performance are, at their core, a result of the divergent interests and dispersed power of the four stakeholders, which create unexpected and suboptimal outcomes.

1. 1998 Restructuring Act Changes and IRS Responses

Dispersed power and interests among stakeholders arguably undermined the "on-the-ground" effectiveness of the 1998 Restructuring Act changes. The 1998 Restructuring Act imposed new requirements on the IRS that were aimed at making the OIC program more accessible to taxpayers.[249] These changes were Congress's response to criticisms that the OIC program was not accessible to taxpayers.[250]

Unfortunately, the divergent interests of the IRS and its responses to the 1998 legislative changes limited the effectiveness of those

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[248] *See supra* subsection I.B.1.

[249] Among these changes were the introduction of the effective tax administration ground for offer acceptances, new requirements for independent administrative review before rejecting an offer, a requirement that a "facts and circumstances" analysis be conducted for each case, and a requirement that the IRS not reject an offer from a low-income taxpayer solely based on the amount of the offer. *See supra* subsection II.A.3; *see also Taxpayer Beware: Schemes, Scams, and Cons: Hearing Before the S. Comm. on Fin.*, 107th Cong. 59 (2001) (statement of Michael Brostek, Director, Tax Issues, U.S. Gen. Accounting Office) (discussing the changes to the OIC procedure after the enactment of the 1998 Restructuring Act).

[250] *See supra* notes 146-49.

changes. As previously discussed, the 1998 Restructuring Act led to an on-the-ground capacity issue, as manifested by an inventory backlog and increased processing times.[251] In response, the IRS undertook its own independent initiatives to cope with the situation.[252] Specifically, the IRS proposed two key initiatives: (1) "centralized" processing, where complex and simple offers would be separated so as to maximize staff efficiency; and (2) "fast track" processing, where the simple offers in the current backlog would be sent to a special "fast track" to be sorted.[253] The idea was that simpler cases required fewer formalities, and thus less staff time.[254] The IRS expected this type of processing to stabilize its backlog and keep pace with its new cases.[255] In addition, the IRS proposed several other measures.[256]

As repeatedly noted by the National Taxpayer Advocate and other commentators, centralized processing may have reduced the number of accepted offers, thereby *reducing* rather than increasing taxpayer accessibility to the program.[257] In her 2009 Annual Report to Con-

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[251] *See supra* subsection II.B.1. The 1998 congressional changes led to greater offer demand, more processing steps, and an increased number of staff hours required to process an offer, all of which essentially outpaced IRS staffing increases. 2002 GAO REPORT, *supra* note 152, at 9-18.

[252] *See* 2002 GAO REPORT, *supra* note 152, at 18-26 (describing these initiatives).

[253] *Id.* at 19-23.

[254] *Id.* at 20. Centralized processing in essence shifted offer processing responsibility away from higher-grade field personnel to lower-grade staff at two campuses. *Id.* at 19.

[255] *Id.* at 20.

[256] For example, the IRS proposed overtime work for some employees at processing centers. *Id.* at 24. It suggested expanding the criteria for returning OICs to taxpayers to reduce time spent on offers that were not serious. *Id.* at 24-25. The IRS also suggested using "quick hits" to consolidate multiple delinquencies into one series of installment payments. *Id.* at 25. Other measures to reduce backlog and wait time included penalizing frivolous offers and suspending the statutory period for collections while OICs are processed, thus minimizing the number of offers filed simply to delay collection until it was too late. *Id.* at 26. The IRS likewise proposed a change in the Internal Revenue Code to mandate counsel review of OICs only when the amount was greater than $250,000, instead of the current $50,000. *Id.* Finally, the IRS requested the assessment of a user fee for OICs, which was eventually implemented. *Id.*

[257] *See supra* subsection II.B.2; *see also* 2009 NTA ANNUAL REPORT, *supra* note 51, at 201 ("[O]ffer acceptances have declined each year since the inception of [centralized] OIC . . . ."). The IRS disagreed, noting that while centralization began in 2001, new offers continued to increase until 2003; the IRS argued, therefore, that the subsequent decline in 2004 was not attributable to centralization but was a consequence of the new user fee. 2008 NTA ANNUAL REPORT, *supra* note 106, at 269. The Taxpayer Advocate countered that the delayed decline may have been attributable to a time lag while taxpayers adjusted their behavior and pointed out that OIC acceptances declined immediately after the IRS instituted centralized processing in 2002. *Id.* at 272 n.32. In its 2002 report, the GAO expressed uncertainty as to whether these initiatives would reduce

gress, the Taxpayer Advocate noted that centralization essentially placed greater emphasis on "'moving' the workload" rather than actually resolving collections cases, and that OIC acceptances declined each year following centralization, demonstrating the "bottleneck" effect of such centralized processing.[258]

IRS responses to the pressures created by the 1998 Restructuring Act—which included advocating for penalties for frivolous offers, proposing imposition of a user fee, introducing a partial payment requirement, and looking at potential suspension of the collection statute when an offer is submitted, all of which eventually were adopted[259]—also had the effect of chilling taxpayer participation in the OIC procedure.[260] Instead of reducing only frivolous offers, such reforms in fact had the effect of reducing *all* offers.[261]

In sum, despite Congress's intention to make the OIC program more accessible, the divergent interests of the IRS and its power to make proposals and adopt procedures to effectuate those interests ultimately undermined the congressional intent behind the 1998 Act. As further described below, the IRS's actions in turn had an impact on the behavior of taxpayers and their supporters—the two other stakeholders with the power to influence eventual program outcomes.

2. Taxpayer and Other Stakeholder Reactions to the Partial Payment Requirement, User Fees, and Frivolity Penalties

The years 2003 to 2006 brought significant changes to the OIC statute.[262] The IRS suggested many of these changes to Congress in response to the inventory backlog and processing time problems created by the 1998 Restructuring Act.[263] Among the changes was a requirement that taxpayers submit a partial payment with OIC proposals.[264]

processing time and the backlog. *See* 2002 GAO REPORT, *supra* note 152, at 18-19. The GAO was ambivalent about the viability of these solutions largely because "[m]any of the [IRS's] underlying assumptions have little empirical basis" and because the IRS had not completed its own evaluation of their effectiveness. *Id.* at 18-19, 27-28.

258 2009 NTA ANNUAL REPORT, *supra* note 51, at 201; *see also supra* subsection II.B.2.

259 *See* 2002 GAO REPORT, *supra* note 152, at 24 tbl.4 (describing the expected results and implementation status of these initiatives).

260 *See infra* subsection III.B.2.

261 *See infra* subsection III.B.2.

262 *See supra* subsections II.A.5-6.

263 *See supra* subsections II.A.4 and III.B.1.

264 *See supra* notes 170-72 and accompanying text. However, partial payments are waived for low-income taxpayers and for OICs submitted based solely on doubts as to liability. *See supra* note 178 and accompanying text.

Thus, under current law, some offers not accompanied by the required partial payment may be returned to the taxpayer as "unprocessable."[265] In addition, the IRS can keep partial payments submitted by OIC applicants even if the OIC is rejected.[266] In 2003, the IRS introduced a $150 user fee requirement,[267] a change it had previously proposed.[268] Finally, in 2006, Congress amended the Internal Revenue Code to impose a $5000 penalty for "specified frivolous submission[s]," including submission of a "frivolous" offer.[269]

By making these changes, the IRS and Congress hoped to manage inventory backlog and processing time problems by eliminating meritless offers.[270] However, as a result of the reactions of taxpayers and their supporters, the 2003–2006 amendments instead had the effect of discouraging *all* taxpayers from submitting OICs.[271] Nonrefundable partial payments, user fees, and frivolity penalties all raised the costs of filing an offer. These changes, therefore, had a feedback effect not only on taxpayers, but also on their financial supporters, who, by providing financial and advisory support, exercised power over the timing and volume of offer submissions. These stakeholders became less inclined to file or fund *any* offers, even those that had not become more costly as a result of the 2003–2006 changes.[272] If the IRS intends

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[265] I.R.C. § 7122(d)(3)(c) (2006); *see also supra* notes 173-75 and accompanying text.

[266] *See supra* note 177 and accompanying text.

[267] Treas. Reg. § 300.3(b)(1) (2004); *see also supra* subsection II.A.5.

[268] User Fees for Processing Offers to Compromise, 67 Fed. Reg. 67,573, 67,574 (Nov. 6, 2002).

[269] Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, div. A, §§ 407(a), (d), 120 Stat. 2922, 2960-62 (codified as amended at I.R.C. §§ 6702(b), 7122(f) (second of two subsections (f))). Congress also added I.R.C. § 7122(f), which authorizes the IRS to disregard any frivolous portion of an OIC application and treat it as if it were never submitted. *Id.* § 407(d) (codified at I.R.C. § 7122(f) (second of two subsections (f))).

[270] *See* TIGTA JUNE 2005 FINAL AUDIT REPORT, *supra* note 224, at 1-3 (discussing the intention behind and the results of the user fee); *see also* 2006 GAO REPORT, *supra* note 16, at 23 (discussing the user fee).

[271] *See supra* subsection II.B.2.

[272] *See supra* subsection III.A.4. For example, TIGTA has noted that the decline in offers after the implementation of the user fee has been strongest among taxpayers below the poverty line, even though the user fee is waived for such taxpayers. TIGTA JUNE 2005 FINAL AUDIT REPORT, *supra* note 224, at 3. Part of the problem, as the Taxpayer Advocate and other commentators have noted, is that taxpayers submitting OICs have not generally had the cash on hand to fund proposed offers and thus may have to borrow from friends, family, or banks. *See* 2007 NTA ANNUAL REPORT, *supra* note 51, at 379 (finding that for "about 70 percent of the offers accepted by the IRS before TIPRA was implemented, the 20 percent partial payment" was not paid from liquid assets held by the taxpayer); 2 NAT'L TAXPAYER ADVOCATE, *supra* note 246, at 81 tbl.2.3.1 (finding fifty-six percent of taxpayers borrowed from friends and family to satisfy OIC demands).

the OIC procedure to add value by drawing fresh sources of payment into tax coffers, then this side effect must be taken seriously.[273]

While the intentions of the IRS in encouraging, and Congress in enacting, the 2003–2006 changes may have been to reduce both the number of frivolous offers and the waste of IRS resources, the adverse reactions of taxpayers and other stakeholders have reduced program viability. These responses show that divergent interests and dispersed power among stakeholders can cause the effects of any tax reforms to be unpredictable, which can lead to unintended consequences.

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Examining these two recent turning points demonstrates how countervailing responses to major OIC program changes can nullify the effectiveness of well-intentioned program changes. Stakeholder reactions to the last two sets of major changes to the OIC program—the IRS's reactions to the 1998 Act and taxpayers' and other stakeholders' reactions to the 2003–2006 changes—suggest that Congress and the IRS, when contemplating OIC reforms, must carefully consider how stakeholder responses may render such reforms ineffective or even detrimental. Part IV furthers this analysis by discussing the kinds of reforms Congress and the IRS should and should not adopt in light of this stakeholder dynamics framework.

IV. Evaluating Proposals for Reform Under the Framework

The power to effectuate the OIC procedure is dispersed among four different players with divergent and competing interests.[274] The actions and reactions of each player can create counterproductive, downward-spiraling effects that may undermine the procedure's efficacy. Under this analysis of stakeholder dynamics, if the IRS and Con-

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The new partial payment requirement and the risk that any incomplete payment may not be refunded likely make financial backers, especially family and friends, less willing to lend to taxpayers negotiating OICs. *Id.* at 77. Banks might be unwilling to lend to taxpayers unless a forgiveness of some tax liability improves their chance of repayment; such banks would therefore be less willing to lend the funds for a partial payment where the funds may be retained if the offer is rejected. In that scenario, the taxpayer would no longer have the money, the underlying tax debt would not be compromised, and the bank's chances of being repaid would be low.

[273] *See infra* subsection IV.A.2.

[274] *See supra* Section III.A.

gress want to strengthen the OIC procedure, then they would need to centralize power among fewer stakeholders, eliminate program characteristics that provoke unproductive interactions and negative feedback effects, or both.

Centralizing power is difficult. The OIC procedure goes to the heart of the debtor-creditor relationship between the taxpayer and the IRS. This relationship is not entirely voluntary, but rather is imposed on the parties by structural features of the tax system.[275] Further, interfering with preexisting relationships between taxpayers and their financial backers, whether familial or arm's length, would also not be easy. Disrupting familial dynamics would require changing the underlying social fabric, just as disrupting arm's length lending relationships would involve fundamental changes to economic and financial norms. Finally, the tax legislative process constitutionally requires Congress as a participant, since the process ensures that proposals from the Treasury, the IRS, and other sources appear before Congress.[276]

Hence, rather than unrealistically trying to centralize power or eliminate stakeholders, reforms should instead focus on eliminating features of the procedure that are likely to provoke unproductive or destructive interactions among stakeholders with divergent interests. Proposals likely to provoke unproductive stakeholder dynamics should be rejected. Instead, Congress and the IRS should adopt reforms that minimize divergent stakeholder reactions. Although it may be difficult to predict in advance which reforms are likely to provoke unproductive stakeholder reactions, it will be possible in at least some cases.

I now suggest two specific reforms that should be adopted because they are consistent with this proposed analytical framework. I then provide one example of a proposed reform that should not be implemented because of the destructive stakeholder interactions it would provoke.

A. *Reforms That Might Work*

Here, I offer two concrete suggestions that should reduce the likelihood of downward-spiraling interactions between stakeholders. First, introducing more independence into the offer adjudication process

[275] *See supra* subsection I.B.3.

[276] *See* BITTKER & LOKKEN, *supra* note 227, ¶ 116.1 (noting the constitutional requirement that "all Bills for raising Revenue shall originate in the House of Representatives" (quoting U.S. CONST. art. I, § 7, cl. 1)).

can make it less adversarial and less likely to trigger strongly negative reactions. Second, rethinking the rules governing the partial down payments that accompany failed offers—offers that are not accepted and offers that, though accepted, fail to be completed—can also mitigate counterproductive stakeholder reactions.

1. Creation of a Non-Stakeholder Initial Adjudicator of Offers

Under current procedures, the IRS generally reviews "simple" offers for processability in their centralized offices in Brookhaven or Memphis and then processes the offers.[277] Various parties have criticized aspects of IRS processing for not adequately considering the interests of taxpayers.[278] Real or perceived IRS unfairness in deciding whether to accept offers may make some taxpayers reluctant to submit offers, particularly since the partial payment is nonrefundable.[279] Thus, the agenda of one stakeholder (the IRS) causes another (the taxpayer or the taxpayer's financial backer) to behave differently by withdrawing participation. However, injecting an element of impartiality into the processing of offers could mitigate this unproductive dynamic. Impartiality is valuable because it would promote more balanced consideration of offers by the IRS, which would increase taxpayer confidence in receiving a fair evaluation of a submitted offer.

Impartiality can be incorporated into the process in one of two related ways. First, an independent third-party adjudicator could be responsible for accepting or rejecting offers. The idea that having an independent adjudicator could improve interactions and results between the IRS and a taxpayer is not without precedent. For example, two witnesses at congressional hearings for the 1998 Restructuring Act suggested providing for an independent (or at least a less enforcement-

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[277] *See supra* notes 159-61 and accompanying text.

[278] For example, the Taxpayer Advocate and practitioners have voiced concerns that the IRS fails to consider the individualized circumstances of taxpayers, including the needs of taxpayers in various geographical areas. *See, e.g.*, 2008 NTA ANNUAL REPORT, *supra* note 106, at 264 (noting that centralized processing employs a "cookie-cutter" approach "over an individualized, facts-and-circumstances approach" that limits the OIC program's accessibility); McKenzie, *supra* note 162 (critiquing the IRS's "strict 'gatekeeper' approach," and noting how IRS allowable-expense standards apply uniformly despite geographical variations in cost); *see also* Zarzar, *supra* note 162. More broadly, taxpayers and their advocates have complained that the IRS has a hidden agenda because it is too invested in summarily (and unfairly) rejecting offers. *See supra* note 235 and accompanying text.

[279] *See supra* note 177 and accompanying text.

minded) third-party adjudicator.[280] In addition, the perceived merits of an independent voice in the collections process likely contributed to the creation of the Office of Appeals,[281] to which rejections of proposed offers are currently appealable.[282] The most obvious objection to this reform is that it would likely increase the cost of program administration.

A second, less costly way to create more independence would be to endow the reviewing IRS officer with a new legal status akin to an ombudsperson or trustee. This status would require the reviewing officer to safeguard the rights of both the delinquent taxpayer and the IRS, to mediate the dispute, and to reach a fair determination of what compromise offer is acceptable. Creating a trustee-type legal status also has precedent in federal bankruptcy law. The "trustee in bankruptcy" in reorganization bankruptcies is one example of a legal status created

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[280] *See IRS Restructuring Hearings*, *supra* note 129, at 94 (statement of Douglas C. Burnette, President, National Society of Accountants) (recommending that "the Finance Committee consider removing the offer-in-compromise program from collections and place it in a more suitable location within [the] IRS, such as appeals or an expanded and independent taxpayer advocate's office"); *id.* at 377 (statement of Michael I. Saltzman, Attorney) ("A third party should be interposed in the offer in compromise process to help the taxpayer and the IRS collection officer work out an agreement. . . . The third party should . . . have as his or her objective, the development of a practical and attainable plan to pay as much of the tax as possible. . . . [The third party] may come from a specialized group in the IRS's Appeals Division, the Taxpayer's Advocate Problems Resolution function, or outside private practitioners . . . .").

[281] *See Joint Review of the Strategic Plans and Budget of the Internal Revenue Service, 2005: Hearing Before the J. Comm. on Taxation*, 109th Cong. 67-68 & n.32 (2005) (statement of Nina E. Olson, National Taxpayer Advocate) (discussing the history of the IRS Appeals Office and noting that "to maintain the independent status of Appeals and preserve the principle of separating the Audit and Appeals operations, the Appeals function was carved out and placed under the office of the Assistant Regional Commissioner (Appellate)"); *see also* David M. Fogel, *The Inside Scoop About the IRS's Appeals Division*, 99 TAX NOTES 1503 (June 9, 2003) ("[T]o accomplish its mission, the Appeals function must be fair and free of conflict of interest. This is done by separating Appeals Officers from compliance personnel (for example, Revenue Agent or Revenue Officer).").

[282] *See generally What Can You Expect from Appeals?*, IRS, http://www.irs.gov/individuals/article/0,,id=96765,00.html (last updated Feb. 27, 2009) (summarizing the appeal process and noting that the Appeals department is "independent of any other IRS office"); *Independence of Appeals*, IRS, http://www.irs.gov/individuals/article/0,,id=148490,00.html (last updated Oct. 20, 2010) (stressing the importance of the Appeals department's independence). *But cf.* Camp, *Tax Administration as Inquisitorial Process*, *supra* note 1, at 102-03 (noting that "the infliction of an *ex parte* rule on Appeals is a subtle step on the road to turning the Office of Appeals into an administrative law court").

to safeguard the debtor's rights while ensuring proper distribution to creditors.[283]

To date, the IRS has made strides in implementing a fairer and more independent offer evaluation process. One positive step, for example, is that an independent office reviews appeals of rejected offers. Another reason for optimism is the pilot mediation-and-arbitration program currently available in some cases following unsuccessful attempts to reach a compromise.[284] However, filing an offer, waiting for it to be rejected, and then appealing or applying for mediation is a lengthy process. This system may discourage the initial filing of OICs by taxpayers who are suspicious of the IRS's intentions with respect to OIC program administration.

Creating an independent offer adjudicator, or at least an independent legal status for offer adjudicators, would minimize the detrimental effects of divergent interests. First, this reform reassures taxpayers that they would have a fair opportunity to get their initial offer accepted. This perception of independence would likely improve the current dynamic that discourages certain taxpayers, who feel that they will lose their partial down payment if their offer is rejected, from making make meritorious offers or any offers at all.[285] Creating an independent adjudicator or a position of similar legal status will also lessen counterproductive IRS responses of returning offers as nonprocessable solely in order to reduce caseloads and processing times.[286] Therefore, for both the taxpayer and the IRS, having an independent

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[283] *See* 11 U.S.C. §§ 307, 321–323, 1104 (2006) (establishing the status of trustee and outlining the position's requirements, powers, and appointment procedure).

[284] Section § 7123(b) of the Internal Revenue Code instructed the IRS to establish a pilot program by which the taxpayer and the Office of Appeals can jointly request arbitration for any factual issue left unresolved after an unsuccessful attempt to enter into an OIC. *See* I.R.S. Announcement 2011-6, 2011-4 I.R.B. 433 (extending the two-year pilot mediation-and-arbitration program until December 31, 2012); *see also* Rev. Proc. 2009-44, 2009-40 I.R.B. 462 (expanding the realm of cases eligible for mediation); I.R.S. Announcement 2008-111, 2008-48 I.R.B. 1224 (outlining the mediation and arbitration procedures under § 7123); Rev. Proc. 2006-44, 2006-2 C.B. 800 (establishing the arbitration program within the Office of Appeals "to improve tax administration, provide customer service and reduce taxpayer burden").

[285] *See supra* subsection II.B.2; *see also supra* notes 162, 235 and accompanying text (discussing practitioner concerns about IRS reforms that have limited the efficacy of the procedure).

[286] IRS initiatives aimed at shrinking the backlog through user fees, frivolity penalties, and partial payment requirements have had the undesirable effect of discouraging even meritorious offers. *See supra* subsection III.B.2.

adjudicator of offers should minimize the negative effects of divergent interests and instead produce more successful programs.

2. Rethinking Implementation of User Fees and the Partial Payment Requirement

Reforming how the IRS treats partial payments and user fees for returned or rejected offers could also lessen the effects of interest-divergent behaviors. One of the unhelpful dynamics that has surfaced in the administration of the OIC procedure is that IRS and legislative initiatives to reduce backlog and frivolous offers (such as the imposed user fee, frivolity penalties, and the partial payment requirement) have led to a decline in both legitimate and frivolous offers, and have had a chilling effect, particularly on taxpayers below the poverty line.[287] Most notably, the partial payment requirements for both lump-sum and installment OICs have discouraged taxpayers and their financial backers from submitting offers.[288] The IRS generally will not return the user fee if it accepts a proposed offer for initial processing but subsequently returns it.[289] Additionally, the IRS treats lump-sum or periodic partial payments as payments of tax and therefore as nonrefundable if the IRS returns or rejects the offer.[290]

The partial payment requirement and user fee are not per se bad—such barriers to entry can ensure that taxpayers are more likely to follow through on the offers they make. Furthermore, these barriers may reduce moral hazard, and ultimately the costs of the program, by discouraging submission of unrealistic offers and discouraging bad behavior.[291] In particular, to the extent that the OIC procedure's success depends on drawing in new money to pay off delinquent tax debts, requiring a partial down payment and a user fee may help to distinguish between those cases in which new funds are available and

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[287] *See supra* subsection III.B.2; *see also* TIGTA JUNE 2005 FINAL AUDIT REPORT, *supra* note 224, at 1-3 (discussing the disproportionate decline in offer receipts from poverty-level taxpayers).

[288] *See supra* notes 219-20 and subsection III.B.2.

[289] *See supra* subsection II.A.5.

[290] *See supra* note 177 and accompanying text.

[291] *Cf. supra* note 56 and accompanying text (discussing similar practices in the insurance industry).

those cases in which they are not. Therefore, the solution is not necessarily to eliminate *all* fees and payments.[292]

On the other hand, the current nonrefundability of fees and down payments goes a step too far. While the down payment requirement may guard against unrealistic offers, nonrefundability creates a situation where the taxpayer (or her financial backers) effectively must gamble that her offer will be accepted. The cost of betting wrong is the down payment and, in some cases, the user fee. A taxpayer or her supporters might well conclude that it makes no sense to submit the offer (or, in the case of a financial backer, to lend or give the taxpayer funds), especially since the party reviewing the offer is the taxpayer's creditor, who has an incentive to reject the offer and retain the down payment.[293] The nonrefundability of partial payments also likely creates an incentive for the taxpayer to submit a "low ball" offer, since doing so will reduce the amount forfeited to the IRS if the offer is rejected or returned.[294] Thus, nonrefundability may reduce potential revenues generated by the program.

There are arguments in favor of continuing to impose user fees and down payment requirements in most cases,[295] but partial payments should be refundable to the taxpayer in the case of a returned or rejected offer. This will minimize the likelihood of taxpayers reacting to the partial payment and user fee by "refusing to play." To further encourage taxpayers and their backers to submit offers, the IRS could implement a system whereby partial payments are escrowed while the taxpayer's submitted offer is pending. The payment would then either be applied to the tax liability (if the offer is accepted) or returned to the taxpayer or third-party funder (if the offer is rejected). Such an arrangement accords philosophically with a system that seeks to incentivize good offers and to draw new money into the collection pool.

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[292] Proposed legislation would have repealed the partial payment requirements imposed by TIPRA. *See* Tax Compromise Improvement Act of 2009, H.R. 2343, 111th Cong. § 2 (2009). However, the proposed legislation was never enacted.

[293] This is especially problematic given that a pre-TIPRA IRS study showed that for about seventy percent of OICs accepted before TIPRA, the partial payment amount would not have been available from the taxpayer's liquid assets. 2007 NTA ANNUAL REPORT, *supra* note 51, at 379; *see also* 2 NAT'L TAXPAYER ADVOCATE, *supra* note 246, at 81 tbl.2.3.1. This finding underscores the importance of the taxpayer's financial backers.

[294] The National Taxpayer Advocate has voiced this concern. *See* 2007 NTA ANNUAL REPORT, *supra* note 51, at 379.

[295] The IRS should continue the current practice of relaxing user fee and down payment requirements in appropriate circumstances, such as in the case of low-income taxpayers.

Additionally, it would continue to weed out nonviable offers while mitigating the chilling effect of the current system. Under the framework presented in this Article, the proposed system would continue to serve the interests of the tax collector without incentivizing taxpayers and their backers to react in ways that would jeopardize the effectiveness and relevance of the procedure.

Critics of my proposed changes might argue that since any down payment ultimately constitutes part of the unpaid and delinquent tax liability, it should logically belong to the IRS and thus should not be refunded. However, if OICs truly add value precisely by drawing in fresh sources of funds to pay off a tax liability, then it is not so clear that the partial down payment originates from the taxpayer and is only now being paid over to the IRS. Rather, the down payment actually belongs to someone *other* than the taxpayer or the IRS, namely, the third-party funder of the partial payment.

New funds introduced by a third-party financer in the OIC context are analogous to debtor-in-possession (DIP) financing in a Chapter 11 bankruptcy. Chapter 11 DIP financing can provide a business with the funds that it needs to continue operations.[296] Bankruptcy law does not conceive of the dollars contributed by the DIP lender as belonging to the other creditors of the debtor. Instead, the DIP loan may be given priority status in the bankruptcy.[297] It is well recognized in the bankruptcy context that awarding such priority is necessary to generate the new money needed to keep the debtor afloat.[298] This reasoning is equally applicable in the OIC situation. The third-party backers of submitted offers should also be recognized as having first rights to the return of this money in the event that the IRS rejects a delinquent taxpayer's offer.[299]

[296] *See generally* Marcia Goldstein, *Bankruptcy 2010: Views from the Bench, Debtor in Possession Financing* ("Adequate DIP financing is the lifeblood for most chapter 11 debtors."), *in* LEVERAGED FINANCING 2010, at 129, 131 (PLI Corporate Law & Practice, Course Handbook Series, 2010).

[297] *See* 11 U.S.C. § 364(c) (2006) (authorizing the bankruptcy trustee to obtain postpetition financing that is secured or that has super-priority status).

[298] *See* Goldstein, *supra* note 296, at 132 (noting that the "protections available to the postpetition lender increase[] depending on the availability of other forms of credit" and that "it is extremely rare to see any postpetition lending which is not on a senior secured basis").

[299] Although the IRS has not recognized the rights of third-party backers to these funds, California tax law has. California has its own state-level OIC program. The California program recognizes that if an OIC deposit was "posted" by a third party, the third party must give consent before such deposit can be applied to the underlying tax

B. *One Reform That Probably Will Not Work*

Under the framework proposed in this Article, reforms likely to reduce counterproductive responses by players with divergent interests should be seriously considered. Section IV.A presented two such reforms. Conversely, reforms that will likely give rise to counterproductive responses should be viewed with suspicion. In 2006, TIGTA suggested increasing collections on taxpayer accounts for which OICs were either rejected or returned.[300] TIGTA reported that, while OIC determinations involve the investment of much time and resources, "when an offer evaluation results in a decision not to accept, the IRS generally returns the taxpayer's delinquent account to the normal collection process," and that "[t]he systemic processes involved, in effect, suspend the IRS's contact with the taxpayers while delinquent accounts await assignment to other collection functions."[301] TIGTA recommended that the Commissioner of the Small Business/Self-Employed Division should review the effectiveness of collections efforts on taxpayer accounts for which OICs were not accepted and consider whether more could be done to collect on those accounts.[302] In response, the IRS noted that it was "evaluating the use of a Hand-Off Unit at the Brookhaven campus," which "initiates appropriate collection procedures on rejected or withdrawn cases," and would determine whether such a Unit should be permanent.[303] Based on a December 2006 IRS study, the Hand-Off Unit was subsequently disbanded, though other methods of continuing collections activity on rejected or withdrawn offers continue to be pursued.[304]

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payment. STATE OF CAL. BD. OF EQUALIZATION, OFFER IN COMPROMISE APPLICATION § 3 (2006).

[300] TIGTA JULY 2006 FINAL AUDIT REPORT, *supra* note 53, at 22-26.

[301] *Id.* at 22.

[302] *Id.* at 26.

[303] *Id.*; *see also* 2006 GAO REPORT, *supra* note 16, at 25-26 (describing the Hand-Off Unit procedures).

[304] *See IRS Offers in Compromise: Performance Has Been Mixed; Better Management Information and Simplification Could Improve the Program*, U.S. GOV'T ACCOUNTABILITY OFF., http://www.gao.gov/products/GAO-06-525 (last visited Jan. 15, 2012) ("[I]n December 2006, the IRS completed a pilot study of the hand-off unit and determined that it could use other procedures to more efficiently expedite the handling of rejected and withdrawn offer cases to ACS and field processing."); *see also 2006 Annual Report to Congress: The Most Serious Problems Encountered by Taxpayers*, IRS, http://www.irs.gov/pub/irs-utl/2006_arc_report_card_0907_update.pdf (last visited Jan. 15, 2012) (noting, in the IRS's response to the 2006 NTA Annual Report, that "[t]he results of the test indicate that the same outcome can be achieved by establishing procedures to have the account worked in [the Automated Collection System] or the field where more resources are

It is probably true that more aggressive efforts could be undertaken to generate collections from taxpayers whose offers are not accepted. Because the OIC process may generate contact with the delinquent taxpayer and knowledge of the taxpayer's assets, such efforts may make some sense. But such an initiative must be approached with caution. If potential applicants perceive a substantial risk that any information provided as part of a compromise offer may be used to pursue taxpayers more aggressively after an offer is rejected, then they will most likely be discouraged from submitting an offer altogether. This is especially likely in the current environment, in which taxpayers and their representatives already perceive the IRS's unwillingness to accept offers or to give submitted offers fair consideration. Thus, any gains from more aggressive collection must be balanced against the declining offers and collections that may result.

In sum, the proposal for more aggressive and efficient collections actions is exactly the kind of reform that could cause one stakeholder (the taxpayer-applicant) to react in ways that ultimately harm the effectiveness of the program, even though it was undertaken by another stakeholder (the IRS) with good intentions. The potential adverse implications of this proposal—and any proposal that risks a similar dynamic—therefore need to be seriously analyzed before being adopted.

CONCLUSION

The Offer-in-Compromise procedure has the potential to be an effective and functional program for dealing with the problem of taxpayers who cannot pay. Revenue-based, fairness-based, rehabilitative, and socioeconomic considerations all support the existence of a meaningful tax-debt forgiveness procedure. Unfortunately, most commentators agree that, as currently constituted, the procedure does not function very well. The question then becomes how the program should be rehabilitated. This Article has shown that the fundamental structure of the OIC procedure tends to trigger stakeholder dynamics that may lessen its effectiveness. An important feature of the procedure is the fact that the power over its implementation and effectiveness is dispersed among four stakeholders with conflicting interests as to how the forgiveness of tax debts in general, and the OIC procedure

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available to address collectibility" and that "[t]he IRS is in the process of developing procedures to ensure these cases are immediately worked and the financial information is shared with [the Automated Collection System] and the field").

in particular, should operate. These stakeholders are Congress, the IRS, the taxpayer, and financial and other backers of the taxpayer. Historically, the actions and decisions of each of these players have had feedback effects on the behavior of other players, such that overall program effectiveness has been consistently undermined. In sum, dispersion of power, divergence of interests, and behavioral feedback effects have worked together to ensure that the program perpetually self-corrects toward a weak or ineffective equilibrium.

To counteract these effects, the OIC procedure should be reformed by either centralizing power among fewer stakeholders or eliminating features that provoke downward-spiraling interactions of divergent interests. Since it is difficult to eliminate stakeholders, the latter strategy is more effective. In particular, two concrete reforms could minimize the effects of divergent and competing stakeholder interests: (1) restructuring the program such that an independent adjudicator or a decisionmaker with an independent status or mandate evaluates and determines whether to accept submitted offers, and (2) making the user fee and required partial payments refundable. On the other hand, reforms that have the potential to deter taxpayers from submitting offers—such as the proposal to leverage information from failed compromise offers to support more aggressive collection efforts—should be carefully scrutinized.

I certainly do not mean to suggest that my proposed solutions are the only ways in which the OIC procedure can and should be reformed. On the contrary, there are many avenues for improvement that I have not addressed here. Nor do I imply that there are no other problems with the program besides those discussed under the stakeholder dynamics framework presented in this Article. Rather, my point is that a meaningful understanding and analysis of the structural features of the procedure's administration—in particular, the presence of divergent interests among the key players—is necessary in order to ensure that any proposed changes are effective, rather than counterproductive.