

# *What Constitutes “Gross Monthly Income” for OIC Purposes*

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1

1

Since the merger of The Tax Practice and Lawler & Witkowski in 2019, LG Brooks and Angelene Wierzbic have been a tax resolution team. With the decades of knowledge and experience LG Brooks brings to tax resolution, and Angelene's strong analytical background we have been able to work tons of cases, everything from audits to collections.

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2

2



## Definition of Gross (Taxable) Income



- Internal Revenue Code (IRC) §61, “**Gross Income Defined**” provides a detailed explanation of the types of income that are required to be recognized and reported as taxable income pertaining to income tax filing purposes.
- The income defined via IRC §61 is required to be reported and is subject to the appropriate personal or corporate tax (subject to certain legally allowable exclusions).
  - Exclusions: For example, income exempt from tax such as child support funds, certain social security benefits, tax exempt interest, etc.
- IRC §61 further explains that “except as otherwise provided, gross income means all income from whatever source derived .....
  - Derived (Income earned, received, constructively received, received via distribution, recognized via a pass-thru entity, etc.)

## Tax Law Commentary



- Do you know how to compute or calculate the “Earned Income Credit” (EIC)?
- Do you know how to compute or calculate “Straight Line Depreciation?”
- Do you know how to report & calculate “Capital Gains & Losses?”

**Of course, you do.** Now tell me, do you know how to calculate monthly gross income for OIC purposes?

- Well, your answer may be ..... **I’m not absolutely sure.**

## Determining & Defining Individual CIS Income

### Internal Revenue Manual (IRM) 5.15.1.12

- Income consists of the following:
  - Wages – Other money or compensation received by the taxpayer
  - Interest & Dividends – Funds received, credited to an account or allowed to be withdrawn
  - Net Income from Self-Employment or Schedule C – Amount earned after payment of ordinary and necessary business expenses
  - Net Rental Income - Amount earned after payment of ordinary and necessary monthly rental expenses



## Determining & Defining Individual CIS Income

### Internal Revenue Manual (IRM) 5.15.1.12

- More Income Sources:
  - Pensions – Includes Social Security, IRA, Profit-Sharing Plans, etc.
  - Child Support – Include the actual amount received
  - Other Income - Represents income received that does not fit into a specific category



## Determining & Defining Business CIS Income

### IRM 5.15.1.19

- Income represents the return in money from a business, labor or capital investment & includes (but is not limited to):
  - Gross Receipts or Sales – Gross receipts represents money received by the business entity
  - Dividends – Represents receivables or money received by the entity.
  - Interest Income – Represents money received from bank accounts or investments
  - Gross Rents – Payments received for the use of corporate assets



## Determining & Defining Business CIS Income

### IRM 5.15.1.19

- Income represents the return in money from a business, labor or capital investment & includes (but is not limited to):
  - Gross Royalties – Payments received (similar to gross rents)
  - Capital Gain Net Income – Proceeds received from the sale of an asset
  - Other Income – Represents income received that does not fit into a specific category





## Accrual Basis Taxpayers & CIS Gross Income

- Publication 5059, (Pub 5059) “*How to Prepare a Collection Information Statement-Form 433-B*” provides the official instructions pertaining to the proper preparation of Form 433-B related to Partnerships, Corporations, Exempt Organization, S Corporations & Limited Liability Companies.
- *Pub 5059 also explains that any of the above entities are required to:*
  - “Identify a time period that reflects the typical business income”;
  - “Complete the average monthly income for a stated time period”, and states that;
  - “The business information should reconcile with your business profit & loss statement”

## How is Accrual Based Income Reported via a CIS?



- Neither “Pub 5059” nor the IRM provide official guidance regarding the treatment of “accrual basis” income (financial information) when preparing a CIS
- However, in practice, “Accrual Basis Taxpayers” are required to convert all financial information to the “cash basis” when submitting a CIS.

## Review Analysis of Individual & Business CIS Income

Based upon the review & analysis of the previous IRM provisions pertaining to “*The Determination of Individual or Business Income*”, it should be clear & irrefutable that the presentation and/or recognition of “Monthly Gross Income” reported via a “**Collection Information Statement**”, is in-fact based upon the concept of “income being received” by a taxpayer and **not just merely reported to a taxpayer.**

## Review Analysis

- Additionally, the determination of “gross monthly income” based upon the concept of “receipt”, is synonymous with the “*Cash Flow*” method. Although IRM 5.15.1.16, explains the basis of “cash flow”, it does not provide a “**plain English**” explanation which states that CIS income should be or is required to be submitted on a “cash flow” basis (cash-in/cash-out), with the exception of IRS National & Local Standards.
- Also, please note that an accrual basis taxpayer would be required to “convert” their financial information to the cash basis to conform to CIS & IRM provisions as noted above.



## Other Determinations of Income Issues

### IRM 5.8.5.20-6

- The taxpayer has been receiving gifts from their parents to meet current living expenses for the past six months. The taxpayer has no "guaranteed right to the funds" in the future and the amount does not appear to be based on the transfer of assets to the parents. **DO NOT** include the gift amount as income.

### IRM 5.8.5.20-6

- The taxpayer had gambling winnings over a period of time but is not consistent. **DO NOT** include these winnings as additional income on the IET. (This provision does not apply to professional gamblers).



## Other Determinations of Income Issues

### IRM §5.8.5.20-5

If the taxpayer is a wage earner, the use of income averaging over the prior three years of income **is not appropriate**.

### IRM §5.8.5.20-6

In situations where the taxpayer's income does not appear to meet their stated living expenses the differences **should not be included as additional income** to the taxpayer, unless there are clear indications additional income not included on the collection information statement **is being received** and **will continue to be received** by the taxpayer.

## IRS Misconception/Mistreatment of “Gross Monthly Income”



What IRS thinks  
Taxpayers can obtain  
from their business....



What Taxpayers can  
really get....

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15

15

## K-1 Income Issue

Based upon my vast experience related to the preparation, submission and representation of taxpayers concerning Offer-in-Compromise income disclosure & calculation matters, I have determined that the inclusion of “K-1 Income” by the IRS has been and is one of the most misconceived, misapplied & miscalculated components with respect to the evaluation & consideration of “Gross Monthly Income”.



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16

16



## The K-1 Income Problem

Although “Ordinary Income” reported via a Form K-1 is reportable, recognizable & taxable related to income tax reporting purposes, however “Ordinary Income” may NOT be really what constitute “Gross Monthly Income” for CIS and OIC purposes. Recent additions to the IRM in 5.8.5.8 have clarified a process for Offer Examiners (OE) & Offer Specialists (OS) to determine K-1 income and the inclusion of certain business assets. These changes clarify what items are to be included in the income component of the taxpayer’s “Reasonable Collection Potential” (RCP).



## Analysis of K-1 Income Prior to April 2024 Changes

- Little to no guidance was provided relating to closely held pass-through entity income. K-1's were referenced as a source of “verification” of ownership in the IRM, however this was in a section relating to documentation to verify asset ownership. This was often misconstrued allowing OE & OS staff to utilize “phantom income” to inflate personal RCP on the CIS. Based upon further IRM analysis, individual income should be distributions received by the entity, and any benefits which were paid by the business on the individual's behalf.
- Guidance was provided to include a valuation of the entity's “stock” on the individual's CIS.



## Analysis of Pass-Through Entity Income for OICs (IRM 5.8.5.8-7 Post April 2024 Changes)

### Compensation of Officers

- wages & other compensation (aka - draws & distributions)
- IRS to review “Reasonable Compensation” from the entity. Instructed to review Allowable Living Expense standards to determine compensation along with ownership interest, individual financial condition, local economy & the control of the taxpayer over their compensation.
- Excessive compensation can be added back into business income.



## Analysis of Pass-Through Entity Income for OICs (IRM 5.8.5.8-7 Post April 2024 Changes)

### Repayment of Loans to Officers

- Loans should be considered as an account receivable based upon collectability.
- To be reviewed for indications of paying personal shareholder expenses in lieu of salary. If being consistently received, these can be included in the Income Expense Table (IET). Also instructed to look at Alter Ego possibilities depending upon amounts taken from the entity
- If taxpayer is not taking a reasonable salary and making excessive loan repayments, OS or OE instructed to refer the case to exams and return the OIC.



## Analysis of Pass-Through Entity Income for OICs (IRM 5.8.5.8-7 Post April 2024 Changes)

### Undistributed K-1 Income

- IRS acknowledges K-1 reports may include “Phantom Income” reportable for income tax purposes but not received by the taxpayer.
- OS & OE instructed “The amount reported on the K-1 should be used as a source to verify the individual taxpayer’s income. **If, the taxpayer indicates they did not receive the amount reported on the K-1,** an adjustment may be necessary to remove the undistributed income from the IET.



## The Undistributed Income Asset Issue (IRM 5.8.5.8-7 Post April 2024 Changes)

### Undistributed K-1 Income

- The use of Undistributed K-1 income must still be determined.
  - If the entity is holding the “undistributed K-1 Income” in the bank or other account, **then the amount of cash being held can be added to the individual’s Asset Equity Table (AET).**
  - If the funds were used to purchase an asset, then the asset can be included in determining the taxpayer’s interest in the business.



## How IRS Can Use the K-1 Income

- **K-1 income allowed to be used as income source**
  - Does not reflect the distributed income (phantom income)
  - Does not accurately reflect future income
- **IRS to review for back earnings that could be distributed**
  - Non-distributed amounts in cash accounts may be considered asset for individual owner's RCP



## Practitioner Approach to Alleged K-1 Undistributed Income

- **K-1 does not reflect the distributed income**
- Provide proof of distributions received by the taxpayer
  - Actual K-1 form shows distributions
  - Form 7203 (S-Corps)
  - Personal Bank Account deposit history
- **Undistributed K-1 Income as Individual's RCP**
- Review & provide business financials focusing on uses of cash:
  - Can the business afford to distribute to the owners?
  - Is it being used for the business continuing operations?
  - Are the funds used to pay loans?
  - Are funds held for future projects?



## Closely Held Entity Guidance on Asset Valuations (IRM 5.8.5.8-5 Post April 2024 Changes)

For entities that do not have publicly traded stocks to determine asset value:

- The taxpayer's interest in the business must be determined and added to RCP.
- To determine the RCP of a taxpayer's interest, consider the following to determine the value of the company's assets and assign a value to the taxpayer's interest that is equal to their percentage of ownership in the cumulative assets.



## Verification of Asset Sources

- Secure and verify a CIS for the S Corp., Partnership, or LLC
- Recent year's annual report to stockholders
- Recent year's corporate income tax returns.
- Secure and review statements for bank accounts or other investments, mortgage statements, or other loan documents.
- Research IRPTRO and internet sources, including online real estate valuation resources, to identify or value assets.
- Determine the net realizable equity (NRE) of the corporate assets including cash, property interests, or other holdings.
- Consider requesting an appraisal of the business as a going concern by a qualified and impartial appraiser.
  - Note: Use business appraisals only when the cost of the appraisal is justified by the complexity of the business activity.





## Observation: Potential Asset Duplications from Undistributed K-1 Income

- RCP in entity based upon asset valuations instructed in section of IRM regarding “Stocks & Investments”
  - Instructed to review Balance sheets or tax returns to determine valuations
- Further instructions include addition of undistributed K-1 income in the taxpayer’s RCP under “Cash”
  - This amount already reported on balance sheets and could be part of stock



### Polling Question

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27

27

## REMOVE - K-1 Income Solution

Although “Ordinary Income” is NOT a factor of what constitute “Gross Monthly Income” for CIS and OIC purposes, K-1 income identified as **“Distributions” ARE a factor of what constitutes “Gross Monthly Income”** for CIS & OIC purposes. However, OE’s & OS’s consistently demand that all K-1 income be included via a CIS for OIC gross income purposes.



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28

28



## Example Case: Facts & Circumstances

A business prepared a proper CIS with respect to resolution of their federal tax liabilities, which included & disclosed all business income received as required. Also, although the taxpayer reported “K-1 Income” via their previous business tax return, the taxpayer **did not receive nor was currently receiving K-1 distributions** from a third party or related entity. Eventually, the CIS was subsequently reviewed and evaluated by an Appeals Officer pursuant to a Docketed case matter.

### **Statement Made by Appeals Officer**

*“After obtaining information regarding this income, I have found that distributions are considered income and must be used when calculating the Offer. They, the shareholders, are the ones that decide what to do with the income, but we (the IRS) still consider it income to evaluate the Offer amount and cannot be removed”.*

## Future & Disposable Income Issue

- The calculation & basis of “Disposable Income” as well as the calculation & basis of “Future Income” are predicated upon the proper “Determination of Income”. If the IRS is allowed to make an inaccurate & improper “Determination of Income”, the outcome of any **disposable or future income calculation is therefore inaccurate** and possibly substantially overstated.

### **IRM 5.8.5.20-8**

- Revenue Officers, Appeals Officers & other IRS personnel are instructed to:
  - Exercise good judgment when determining future income. The **history must be clearly documented** and support the known facts and circumstances of the case and include analysis of the supporting documents. Each case needs to be evaluated on its own particular set of facts and circumstances. The **history must clearly explain the reasoning behind our actions**.

## Challenging the Veracity of IRS's Determination



As noted above, the IRS's decision and analysis of the "Determination of Income" must be **clearly documented** AND support the known facts & circumstances of the case. Also, it further states that the "history must clearly **EXPLAIN THE REASONING** behind their actions.

## Challenging the Veracity of IRS's Determination



### Considerations:

- (1) Elevate the case (Exhaust your administrative remedy)
- (2) Request the agent's workpapers (to secure the "History")
- (3) Raise any appropriate "argument" or "defense" via the context of a Collection Due Process (CDP) Hearing (if available)

## Challenging the Veracity of IRS's Determination



**NOTE:** Subsequent to the issuance of a “**Notice of Determination**” (regarding a CDP hearing), the taxpayer can only request the court to consider an issue that was **properly raised during the taxpayer’s CDP hearing**. Therefore, it is imperative that the issues & challenges noted above be raised, discussed & documented at the appropriate level.

Polling Question

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33

33

## **Example #1 – K-1 Income**

Mr. Norman is the sole shareholder of the S-corporation Bates Hotel Inc. Bates Hotels shows a large profit on its returns, however the company is also paying a monthly mortgage with most of it. Out of the \$120K in K-1 income, \$105K has been utilized for mortgage payments. The rest is used for operating expenses and distributions. Norman is preparing an individual Offer in Compromise for personal income tax liabilities and needs to report the proper amount on his 433-A(OIC).

**How does all this come into play on the personal 433?**

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34

34

### **Example #1 – K-1 Income**

<b>What IRS Sees...</b>	<b>K-1 Income</b>	<b>\$120,000</b>
Reality of the situation....	Liability Payments	(\$105,000)
	Depreciation	\$ 40,000
	Current Improvements	(\$ 35,000)
	<b>True Cash Income</b>	<b>\$ 20,000**</b>
<b>Impact on Norman...</b>	<b>Distributions</b>	<b>\$ 10,000</b>

\*\* Undistributed K-1 Income arguments?

### **Example #2 – K-1 Income**

Miss Carrie owns 50% of a partnership, Prom Fun LLC. Carrie's Prom Fun K-1 had a large profit of \$125K last year. Carrie's distributions for the year were \$45K. The company has been very profitable. The company paid all of its liabilities the prior year and has \$150K in the bank account which is not necessary for future operations. Carrie is preparing an individual Offer in Compromise for personal income tax liabilities and needs to report the proper amount on her 433-A(OIC).

**How does this impact her individual 433?**

### **Example #2 – K-1 Income**

<b>What IRS Sees...</b>	<b>K-1 Income</b>	<b>\$125,000</b>
Reality of the situation.....	Liability Payments	(\$0)
	<b>True Cash Income</b>	<b>\$ 125,000</b>
<b>Impact on Carrie...</b>	<b>Distributions</b>	<b>\$ 45,000</b>

#### **Does Carrie have access to more than stated?**

- Arguments – Future use of cash at business level?
- Undistributed Income issues

### **Case #1 Background**

Rich Sufferen is a 50% partner in the law firm, Payne & Sufferen, LLP. In 2015, the firm had a large unexpected windfall coming from a case done many years before by Payne. A portion of the funds were used to pay credit cards and liabilities of the business and other operating expenses. The remainder of the funds were split amongst the two partners. Sufferen used his to make a downpayment for a home for him and his young daughter.

When Sufferen prepared his tax return for 2015, there was a large balance from the self-employment taxes which he could not afford to pay. He tried to set up an installment agreement, but because he was making the payments, he didn't make estimates and fell further behind. After four years of attempting to catch up through installment agreements, he accumulated a debt of \$152K.

After years of struggle, and the inability to get out from under his IRS debts, he hired our firm for assistance with the matter in 2020.

### **Case #1 Financial Situation: ASSETS as of February 2020**

Asset	Fair Market Value	Loans	Value for OIC
Checking	\$15	\$0	\$0
Residence	\$233,400	\$210,645	\$0
Vehicle	\$35,452	\$36,815	\$0
Boat	\$21,643	\$39,153	\$0
Furnishing/ Personal Items	\$7,500	\$0	\$0
<b>Total Equity</b>	<b>\$298,010</b>	<b>\$286,613</b>	<b>\$0</b>

### **Case #1: Distributions from Partnership**

Date	Amount	Date	Amount
8/2/2019	\$3,000	10/25/2019	\$2,500
8/8/2019	\$1,500	11/1/2019	\$2,000
8/14/2019	\$2,000	11/8/2019	\$2,000
8/22/2019	\$800	11/18/2019	\$2,000
8/29/2019	\$3,500	11/21/2019	\$2,000
9/6/2019	\$2,000	11/30/2019	\$3,000
9/17/2019	\$2,000	12/6/2019	\$2,000
9/24/2019	\$2,000	12/21/2019	\$2,000
10/1/2019	\$2,000	12/31/2019	\$2,000
10/11/2019	\$2,000	1/11/2020	\$2,000
10/15/2019	\$1,000	1/22/2020	\$2,000
10/18/2019	\$2,000	<b>TOTAL</b>	<b>\$43,300</b>

Cash Distributions  
 $\$43,300 / 6 \text{ months} =$   
**\$7,216.67**

Non-Cash Distributions  
 Health Insurance  
 \$603  
 Personal Truck Payment  
 \$961

**Total Distributions**  
 $\$7,216.67 + \$603 + \$961 =$   
**\$8,780.67**



## Case #1 Financial Situation: EXPENSES

Income/Expense	Actual Payments	Allowed for OIC
Food, Clothing, Misc.	\$1,288	\$1,288
Housing & Utilities	\$2,385	\$1,661
Vehicle Loan	\$961	\$508
Vehicle Operating	\$511	\$210
Public Transportation	\$30	\$30
Health Insurance Premiums	\$603	\$603
Out of Pocket Health	\$110	\$110
Current Taxes	\$2,385	\$2,385
Student Loan	\$799	\$799
Delinquent Taxes	\$738	\$162
<b>Total Expenses</b>	<b>\$9,810</b>	<b>\$7,756</b>



41

## Case #1 Offer in Compromise

Income/Expense	Allowed for OIC
Distributions	\$8,781
Food, Clothing, Misc.	\$1,288
Housing & Utilities	\$1,661
Vehicle Loan	\$508
Vehicle Operating	\$210
Public Transportation	\$30
Health Insurance Premiums	\$603
Out of Pocket Health	\$110
Current Taxes	\$2,385
Student Loan	\$799
Delinquent Taxes	\$162
<b>Remaining Monthly Income</b>	<b>\$1,025</b>

Assets for OIC Purposes: \$ 0

Income for OIC Purposes \$ 1,025

Multiplier  $\times$  24

OIC Cash Component \$ 24,592

**TOTAL OIC \$ 24,592**

**Amount of Debt \$152,000**

42

## 43

43

44

## Case #1 Areas of Contention

1. AET – Value of Residence
  - IRS Used Zillow valuation
2. AET – Value of Father's Residence
  - Father transferred to kids with life estate
  - 50% ownership with sister
  - Father's mortgage is still on the property
  - IRS used Zillow valuation
3. **IET – Income from the Partnership**
  - **IRS used K-1 income for the calculation**
4. IET – Inconsistent updates for standards
  - Housing & Utilities were not updated
  - Vehicle Ownership was not updated
5. IET – Denial of all state tax payment
6. Other issue – IET – Increase for current tax rates



## Case #1 Issue #3 IRS Income Calculation

RICH SUFFEREN  
1 HOMESTEAD DR  
MARYLAND  
STATE: MD ZIP: 21000-0000

PAYER ENTITY DATA: TIN 11111111  
PAYNE & SUFFEREN LLP  
PO BOX 1  
MARYLAND MD 21000

SUBMITTED TO: IRS ELECTRONICALLY

PARTNER SHARE BEGINNING: 000.600  
PARTNER SHARE ENDING: 000.700  
IRA SEP KEOGH IND: BOX IS NOT CHKD  
BEGINNING TAX PERIOD: 201901  
ENDING TAX PERIOD: 201912

INTEREST.....\$2+  
OR INC K-1.....\$168,730+  
GUAR PAYMT.....\$8,081+  
RECOURBEG.....\$26,260+

Income	\$168,730
Guaranteed Payment	\$ 8,081
Total	\$176,811
<b>Monthly Amount</b>	<b>\$ 14,735</b>

ENTER=(N)EXT, (P)REVIOUS, (S)UMMARY, (W)HITE OUT, IRPO(L), (O)NLINE, HARD(C)OPY



## **Case #1 Arguments Provided**

1. AET – Value of Residence
  - Submitted realtor valuation
2. AET – Value of Father’s Residence
  - Submitted deed to show 50% ownership
  - Submitted copy of mortgage statement
  - Obtained 3<sup>rd</sup> party home valuation
3. **IET – Income from the Partnership**
  - **Provided evaluation of distributions**
  - **Proof with 12 months bank statements**
4. IET – Inconsistent updates for standards
  - Written request to update standards consistently
5. IET – Denial of all state tax payment
  - Evaluation based on new income levels
6. Other issue – IET – Increase for current tax rates
  - Provided new estimates



## **Case #1 Appeals Officer Responses**

1. AET – Value of Residence
  - **Zillow valuation**
2. AET – Value of Father’s Residence
  - **Allowed 50% of value**
  - **Allowed 50% of mortgage**
  - Zillow valuation
3. **IET – Income from the Partnership**
  - **Would not concede IRS position**
  - **Agreed with K-1 amounts**
4. IET – Inconsistent updates for standards
  - **Believed prior standard limitations were actual expenses**
  - **Denied updates for Housing & Vehicle Ownership standards**
  - **Updated non-appealed out of pocket medical standard**
5. IET – Denial of all state tax payment
  - **Disallowed “unverified” but records were submitted with OIC**
6. **Other issue – IET – Increase for current tax rates**
  - **Allowed changes to 2019 return amounts**



## **Case #1 Issues Raised to Manager**

1. **AET – Valuation of Properties**
  - Use of Zillow
2. **IET – Income from the Partnership**
  - Would not concede IRS position
  - Agreed with K-1 amounts
  - Insistence that “ATM deposits” equaled cash by appeals officer
3. **IET – Inconsistent updates for standards**
  - Believed prior standard limitations were actual expenses
  - Denied updates for Housing & Vehicle Ownership standards
  - Updated non-appealed out of pocket medical standard
4. **IET – Denial of all state tax payment**
  - Disallowed “unverified” but records were submitted with OIC



## **Case #1 Interesting Notes**

- Appeals Manager did **NOT** know how to treat business income
- We sent a memo regarding the calculation of future income to the manager upon elevation request
- He sent our memo to IRS Technical Analyst
- **Analyst AGREED with our memo**
- Manager requested updated records
- Provided proof of distributions for whole 2019 year which (IRS was using K-1 from that year to calculate income)
- Appeals Manager requested property valuations



Date	Memo	Distribution	Other	
1/11/2019	Counter Deposit	\$ 2,000.00		
1/22/2019	Cash Deposit	\$ 2,000.00		
2/1/2019	Check Deposit	\$ 1,000.00		
2/1/2019	Cash Deposit	\$ 2,000.00		
2/4/2019	Cash Deposit	\$ 1,000.00		
2/14/2019	Counter Deposit	\$ 3,000.00		
2/25/2019	Cash Deposit	\$ 1,800.00		
3/1/2019	Counter Deposit	\$ 3,008.00		
3/22/2019	Counter Deposit	\$ 2,216.74		
4/1/2019	Counter Deposit	\$ 2,000.00		
4/12/2019	Counter Deposit	\$ 2,200.00		
5/2/2019	Check Deposit	\$ 2,000.00		
5/10/2019	Adjustment	\$ 2,000.00		
5/20/2019	Cash Deposit	\$ 2,400.00		
6/24/2019	TransferMDPort		\$ 1,632.28	Daughter 529 Plan
6/24/2019	TransferMDPort		\$ 6,291.72	Daughter 529 Plan
6/28/2019	Check Deposit	\$ 2,000.00		
7/5/2019	Counter Deposit	\$ 1,000.00		
7/12/2019	Check Deposit	\$ 2,000.00		
7/19/2019	Counter Deposit	\$ 1,500.00		
8/2/2019	Check Deposit	\$ 3,000.00		
8/8/2019	Counter Deposit	\$ 1,500.00		
8/14/2019	Counter Deposit	\$ 2,000.00		
8/22/2019	Cash Deposit	\$ 800.00		
8/29/2019	Check Deposit	\$ 3,500.00		
9/6/2019	Counter Deposit	\$ 2,000.00		
9/17/2019	Counter Deposit	\$ 2,000.00		
9/23/2019	Paypal Return		\$ 199.99	
9/24/2019	Counter Deposit	\$ 2,000.00		
10/1/2019	Check Deposit	\$ 2,000.00		
10/11/2019	Check Deposit	\$ 2,000.00		
10/15/2019	Cash Deposit	\$ 1,000.00		
10/18/2019	Counter Deposit	\$ 2,000.00		
10/25/2019	Counter Deposit	\$ 2,500.00		
11/1/2019	Counter Deposit	\$ 2,000.00		
11/8/2019	Check Deposit	\$ 2,000.00		
11/18/2019	Counter Deposit	\$ 2,000.00		
11/21/2019	Counter Deposit	\$ 2,000.00		
11/25/2019	Counter Deposit	\$ 2,000.00		
11/29/2019	Counter Deposit	\$ 1,500.00		
12/9/2019	Cash Deposit	\$ 1,000.00		
12/11/2019	Check Deposit	\$ 2,000.00		
12/19/2019	Counter Deposit	\$ 4,000.00		
12/27/2019	Check Deposit	\$ 2,000.00		
Totals		\$ 81,924.74	\$ 8,123.99	
Average Monthly Totals		\$ 6,827.06		

# **Case #1** **Distributions**



Date	Memo	Distribution	Other	
Totals		\$ 81,924.74	\$ 8,123.99	Daughter 529 Plan
Average Monthly Totals		\$ 6,827.06		

# **Case #1** **Distributions**





## Case #1 Our (AET)

	Taxpayer FMV	IRS FMV	Correct Amt	QS%	Quick Sale Amt	Encumbrance	Exemption	Net Equity
Checking Account	\$ 15.00	\$ 498.00	\$ 498.00	100%	\$ 498.00		\$ 1,000.00	\$ -
<b>Residence</b>	<b>\$ 233,400.00</b>	<b>\$ 329,360.00</b>	<b>\$ 244,267.00</b>	<b>80%</b>	<b>\$ 195,413.60</b>	<b>\$ 210,645.00</b>		<b>\$ -</b>
<b>Real Estate – Father’s Life Estate</b>	<b>\$ -</b>	<b>\$ 152,000.00</b>	<b>\$ 69,466.50</b>	<b>80%</b>	<b>\$ 55,573.20</b>	<b>\$ 45,337.00</b>		<b>\$ 10,263.20</b>
Furniture/Personal Effects	\$ 7,500.00	\$ 7,500.00	\$ 7,500.00	80%	\$ 6,000.00		\$ 9,790.00	\$ -
Car#1 - Chevy Truck	\$ 35,452.00	\$ 35,452.00	\$ 35,452.00	80%	\$ 28,361.60	\$ 36,815.00		\$ -
Other Asset - Boat	\$ 21,643.00	\$ 21,643.00	\$ 21,643.00	80%	\$ 17,314.40	\$ 27,549.00		\$ -
Other Asset College Fund	\$ -	\$ 7,924.00	\$ 7,924.00	80%	\$ 6,339.20			\$ 6,339.20
						<b>Net Equity in Assets</b>		<b>\$ 16,575.40</b>



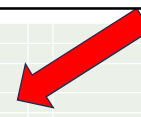
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53

53

## Case #1 Our (IET)

Income Type		Income Reported	IRS Verified	Correct Amount		
Other Income - Truck & Health Ins pad by Biz		\$ 1,564.00	\$ 1,564.00	\$ 1,564.00		
<b>Other Income - Sch E</b>		<b>\$ 8,781.00</b>	<b>\$ 14,735.00</b>	<b>\$ 6,827.00</b>		
					<b>Total Income</b>	<b>\$ 8,391.00</b>
Expense Type	TP Claimed	IRS Verified	Per IRS	Correct Amount	Percentage	Net Allowed Amount
Food, Clothing Misc	\$ 1,288.00		\$ 1,298.00	\$ 1,298.00	100%	\$ 1,298.00
<b>Housing &amp; Utilities</b>	<b>\$ 1,661.00</b>		<b>\$ 1,661.00</b>	<b>\$ 1,686.00</b>	<b>100%</b>	<b>\$ 1,686.00</b>
<b>Ownership of Car</b>	<b>\$ 508.00</b>	<b>\$ 508.00</b>	<b>\$ 521.00</b>	<b>\$ 521.00</b>	<b>100%</b>	<b>\$ 521.00</b>
Operating Costs	\$ 210.00		\$ 193.00	\$ 193.00	100%	\$ 193.00
Health Insurance	\$ 603.00		\$ 603.00	\$ 603.00	100%	\$ 603.00
Other Health Care	\$ 110.00		\$ 112.00	\$ 112.00	100%	\$ 112.00
<b>Current Taxes</b>	<b>\$ 2,385.00</b>		<b>\$ 2,385.00</b>	<b>\$ 2,897.67</b>	<b>100%</b>	<b>\$ 2,897.67</b>
Student Loan	\$ 799.00		\$ 799.00	\$ 799.00	100%	\$ 799.00
State Taxes	\$ 162.00		\$ -	\$ 38.00	100%	\$ 38.00
	Assets	\$ 16,575.40		Total Expenses		\$ 8,147.67
				Net Income		\$ 8,391.00
	OIC Income	\$ 243.33		Gross Monthly		\$ 8,391.00
		X 12		Less Household Exps		\$ 8,271.67
		\$ 2,919.96		<b>Total Net Monthly Inc</b>		<b>\$ 243.33</b>
				Months of Future Income	X 111	
	<b>New OIC</b>	<b>\$ 19,495.36</b>		Future Income		\$ 27,009.63
				<b>Amount That Could be paid</b>		<b>\$ 43,585.03</b>



54

## Case #1 Sad Reality...

- Appeals sustained the rejection of the OIC
- We obtained a FOIA to review what happened
  - Appeals Officer did not take into consideration any of the information provided by our office to the Appeals Manager
- We did not have tax court rights since OIC was not submitted under CDP



## Case #1 FOIA Excerpts

From: Appeals Officer <Appeals.Officer@irs.gov>  
Sent: Thursday, January 20, 2022 9:38 AM  
To: Mister Manager <Mister.Manager@irs.gov>  
Subject: FW: Fax was received from 8880000000

Mister,

I have reviewed information you forwarded to me.

POA did not provide any new information that were not already provided and considered by the IRS and Appeals. POA provided summary of all deposits made to the personal bank account in 2019 in total of \$91,924.74, average monthly \$6,827.06.

K1 income per IDRS IRPTRO

2019 IRPTRO

INTEREST.....\$2+

OR INC K-1.....\$168,730+

GUAR PAYMT.....\$8,081+

RECOURBEG.....\$26,260+

K1 and guar paymt total \$ 176,811 – average monthly 14,734

TP did not provide verifiable information to explain the income difference of 7,907 (\$14,734 – \$6,827)

Summary of deposits to bank account is not sufficient verification to warrant income reduction to amount of \$6,872 considering that income can be distributed through other ways.

Please let me know how you want to proceed.

Thanks,  
Appeals

Analyst information?

## **Case #2 Background**

Dr. Molar is the sole owner of the S-Corporation Molar Dental Inc. The business subcontracts for Grindem and Fixem Dental. Molar Dental pays for malpractice insurance, liability insurance, a small amount of office and general expenses. The remainder of the income is allocated to payroll for Dr. Molar. The company generally holds a minimal amount in the bank account after expenses. Mrs. Molar was a dental receptionist for years but can no longer work due to hearing difficulties rendering her legally deaf.

The couple has been struggling with tax issues for almost a decade. The tax difficulties started from a dental practice Dr. Molar had in Alaska.

## **Case #2 Background - IRS Audit**

The couple moved to a small town and started a practice where there was only one competitor, Evil Dental. After an initial successful start the first few years, Molar Dental was audited. It was the first time the Doctor had a business, so he reported a few items on his return erroneously because he did not know how they were supposed to be properly handled. IRS made corrections to two years of S-Corporation returns which led to personal liabilities. Right around the time that the audit was taking place, the couple also faced threats and intimidation from the local community.

## **Case #2 Background – Competition & Collections**

Evil Dental was getting angry that they were losing customers to Dr. Molar's practice. In an effort to run him out of town, the owner of Evil Dental convinced local community members to file complaints with the Dental Board on Dr. Molar. Even people that were proven not to have been patients of Dr. Molar filed complaints.

With a declining business due to the attacks to the Doctors reputation, they could not afford to pay the IRS debts. Dr. Molar used his personal credit cards and a business line of credit to try to maintain the company.

A Revenue Officer was assigned to the case. In an attempt to pay the debt, the couple cleared out their retirement accounts (without taxes withheld) and applied the funds to the IRS balance. This in turn, created further tax issues.


## **Case #2 Background – Continuing Issues**

On top of the shady business intimidation tactics, someone local was making death threats against Mrs. Molar. The couple packed up and moved close to family in Wisconsin for safety.

The complaints to the Dental Board were all eventually determined to be untrue and Dr. Molar was exonerated. Unfortunately, this was after he was forced to leave the community. Dr. Molar sold his patient list due to the damage to his reputation, and the building which held the practice was sold at a major loss. The little amount of funds obtained from the sale of the couple's business and former home in Alaska were used to pay down the IRS debts, but they still had financial issues.

They owed \$270K from 2012, 2013, 2015 and 2016 when Mr. Brooks was hired in 2018 to assist them with their financial issues.

## **Case #2 Financial Situation: ASSETS as of April 2019**



Asset	Fair Market Value	Loans	Value for OIC
Cash on Hand	\$50	\$0	\$50
Checking	\$275	\$0	\$0
401(K)	\$5,917	\$750	\$3,984
Cash Value Life Insurance	\$47,645	\$32,713	\$14,932
Residence	\$152,000	\$12,500	\$109,100
Vehicles	\$19,450	\$0	\$8,660
Furnishing/ Personal Items	\$5,000	\$0	\$0
<b>Total Equity</b>	<b>\$230,337</b>	<b>\$45,963</b>	<b>\$136,726</b>

## **Case #2: Income**

No Cash or Non-Cash  
Distributions

Gross Wages Monthly  
\$6,954

**Total Income**  
**\$6,954**

## Case #2 Financial Situation: EXPENSES

Income/Expense	Actual Payments	Allowed for OIC
Food, Clothing, Misc.	\$1,288	\$1,288
Housing & Utilities	\$1,725	\$1,721
Vehicle Operating	\$392	\$382
Health Insurance Premiums	\$740	\$740
Out of Pocket Health	\$110	\$110
Life Insurance	\$727	\$727
Current Taxes	\$1,359	\$1,359
<b>Total Expenses</b>	<b>\$6,341</b>	<b>\$6,327</b>



63

## Case #2 Offer in Compromise

Income/Expense	Allowed for OIC
Wages	\$6,954
Food, Clothing, Misc.	\$1,288
Housing & Utilities	\$1,721
Vehicle Operating	\$382
Health Insurance Premiums	\$740
Out of Pocket Health	\$110
Life Insurance	\$727
Current Taxes	\$1,359
<b>Remaining Monthly Income</b>	<b>\$627</b>

Assets for OIC Purposes: \$136,726

Income for OIC Purposes \$ 627

Multiplier  $\times$  24

OIC Cash Component \$ 15,048

**TOTAL OIC \$151,774**

Unable to get home equity **(\$109,100)**

**DATC OIC with special Circumstances \$ 42,674**

Amount of Debt \$270,000



64



## Case #2 IRS Asset Equity Table (AET)

ASSET TYPE	TAXPAYER FMV	IRS FMV	QS%	QSV	RECOMBERANCE	EXEMPTION	NET EQUITY
Cash on Hand	\$ 50.00	\$ -	100.00%	\$ -			\$ -
Checking Accounts	\$ 275.00	\$ 325.00	100.00%	\$ 325.00	\$ -	\$ -	\$ 325.00
Business Bank Account	\$ -	\$ 3,157.00	100.00%	\$ 3,157.00			# \$ 3,157.00
Cash Value Life Ins	\$ 35,112.00	\$ 35,112.00	100.00%	\$ 35,112.00	\$ 32,713.00	\$ -	\$ 2,399.00
Cash Value Life Insurance	\$ 12,533.00	\$ 12,533.00	100.00%	\$ 12,533.00	\$ -	\$ -	\$ 12,533.00
Retirement Account	\$ 5,917.00	\$ 5,917.00	80.00%	\$ 4,733.60			\$ 4,733.60
Real Estate	\$ 152,000.00	\$ 25,700.00	80.00%	\$ 164,560.00	\$ 12,500.00		\$ 152,060.00
2013 Volvo XC60 50000mi	\$ 10,557.00	\$ 10,557.00	80.00%	\$ 8,445.60		\$ -	\$ 8,445.60
2013 Volvo S60 35000mi	\$ 8,893.00	\$ 8,893.00	80.00%	\$ 7,114.40		\$ -	\$ 7,114.40
Retained Earnings	\$ -	\$ 82,474.00	100.00%	\$ 82,474.00			\$ 82,474.00
EQUITY IN ASSETS							\$ 273,241.60

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65

## Case #2 IRS Income Expense Table (IET)

INCOME TYPE	INCOME GROSS REPORTED	IRS VERIFIED		
Wages Salaries TP1	\$ 6,954.00	\$ 5,966.00		
Social Security/Pensions	\$ -	\$ 535.00		
Distributions	\$ -	\$ 3,358.00		
Totals		Total Income		\$ 9,859.00
EXPENSE TYPE	TP CLAIMED AMOUNT	IRS VERIFIED	%	NET ALLOWED AMOUNT
Food Clothing & Miscellaneous	\$ 1,288.00	\$ 1,298.00	100%	\$ 1,298.00
Housing & Utilities	\$ 1,721.00	\$ 1,721.00	100%	\$ 1,721.00
Transportation Operating Expenses	\$ 382.00	\$ 382.00	100%	\$ 382.00
Health Insurance	\$ 740.00	\$ 740.00	100%	\$ 740.00
Other Health Care	\$ 110.00	\$ 228.00	100%	\$ 228.00
Current Taxes	\$ 1,359.00	\$ 2,496.00	100%	\$ 2,496.00
Life Insurance	\$ 727.00	\$ 200.00	100%	\$ 200.00
		Total Expenses		\$ 7,065.00
		Gross Monthly		\$ 9,859.00
		Less Household Exps		\$ 7,065.00
		Total Net Monthly Inc		\$ 2,794.00
		Months of Future Income	X	102
		Amount That Could be paid		\$ 284,988.00
Total Liabilities	\$ 313,606.90	Assets		\$ 273,241.60
Original OIC	\$ 42,665.00	Collectibility		\$ 558,229.60

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66

## **Case #2 Areas of Contention**

1. AET – Inclusion of S-Corporation Items
  - Offer Specialist included business bank account
  - Offer Specialist included business retained earnings
2. AET – Exemptions not included
  - IRS excluded exemption for checking
  - IRS excluded exemptions for cars
3. AET – Retirement Loan
  - IRS didn't include loan on 401(k)
4. AET – Residence
  - Zillow valuation
  - Included Equity even through DATC with Special circumstances
5. **IET – Income from the S-Corp**
  - **IRS used S-Corp taxable income**
6. IET – Income from Levied Pensions
  - Not continuing source of income
7. IET – Life Insurance
  - Allowance for Term life portion of whole life



## **Case #2 Arguments Provided**

1. AET – Inclusion of S-Corporation Items
  - Bank account funds for continuity of the business
  - Retained earnings cannot accessed
2. AET – Exemptions not included
  - Provided IRM citations on exemptions
3. AET – Retirement Loan
  - Provided IRM cites & account statement
4. AET – Residence
  - Provided 3 denials at equity due to lack of credit
5. **IET – Income from the S-Corp**
  - **Provided a breakdown of the distributions**
6. IET – Income from Levied Pensions
  - Submitted proof account was closed
7. IET – Life Insurance
  - Provided proof of minimum term life payments taxpayer makes



## **Case #2 Appeals Officer Responses**

1. AET – Inclusion of S-Corporation Items
  - Appeals officer agreed to remove bank and retained earnings
2. AET – Exemptions not included
  - Agreed to include exemptions
3. AET – Retirement Loan
  - Allowed loan
4. AET – Residence
  - Wanted time to review
5. **IET – Income from the S-Corp**
  - Needed time to review
6. IET – Income from Levied Pensions
  - Did not include in final determination
7. IET – Life Insurance
  - Provided proof of minimum term life payments taxpayer makes



## **Case #2 Appeals Final Determination**

1. Doubt as to Collectibility with Special Circumstances
  - Processed as a regular DATC OIC
2. AET – Residence
  - IRS should not accept OIC due to the equity in home
3. **IET – Income from the S-Corp**
  - Based on prior year, believes potential for more income
  - Used prior year K-1s to determine ability



## Case #2 Continued...

- Appeals sustained the rejection of the OIC
  - Wanted Equity in the home
  - Believed future income from S-Corp \$100K+ per year
- Would not consider Special Circumstances
  - Appeals Officer did not take into consideration the fact the OIC was a DATC with special circumstances due to home equity
- We offered Collateral Agreement
  - Appeals denied
- OIC was filed in a CDP filed Tax Court Petition



### Polling Question

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71

71

## Key Take Aways

1. Future Income for 433 purposes should be calculated on a cash basis
2. How to handle pass through entity income is a major area of IRS inconsistency, but new guidance has been provided
3. Providing good backup can help alleviate some issues with AET/IET figures
- 4. Don't be afraid to elevate the case!!**



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72

72



## **Thank You!**

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