



TAX FACTS 2000-2

Offer in Compromise

By law, taxes should be paid in full and on time. When that is not possible, other options may be available. For example, a payment plan in which the amount due (plus any penalty and interest that is charged after the filing deadline) is paid in monthly installments with interest accruing monthly on the unpaid tax and penalty amount.

If a payment plan will not work, you may ask the Department of Taxation (Department) to compromise on the amount of the tax, penalty, and interest due. This request to pay less than what is actually owed to settle a taxpayer's delinquency is known as an offer in compromise.

The following answers some of the most commonly asked questions about offers in compromise.

1 What is an offer in compromise?

An offer in compromise is a request by you to the Department to pay less than the total amount of delinquent tax, penalty, and interest actually owed to the state.

2 When is an offer in compromise appropriate?

An offer in compromise may be appropriate when there is doubt as to the amount of the tax liability or doubt as to the collectability of the tax liability, or upon both doubt as to liability and doubt as to collectability. However, doubt as to liability, will always be addressed first. A person may also file an offer in compromise based on doubt as to collectability based on exceptional circumstances (effective tax administration). See question 5.

3 What is doubt as to liability?

Doubt as to liability means that there is some uncertainty about whether the amount that the Department says is owed is in fact the correct amount.

Possible reasons for submitting a doubt as to liability offer in compromise include the following: the examiner made a mistake interpreting the tax law, the examiner failed to consider the evidence presented, or new evidence is available to support a change to the assessment.

Caution: You may not ignore audit notifications sent by the Department and later attempt to make an offer in compromise based on doubt as to liability based on records that were available to you at the time of the audit but chose not to produce. An offer in compromise is not a substitute for appearing at an examination and producing records to support your position.

4 What is doubt as to collectability?

Doubt as to collectability means that the Department does not think that you will ever be able to pay the full amount of the taxes, penalties, and interest owed no matter how long the Department waits.

For example, there may be doubt as to collectability when you have an outstanding tax liability and no assets, are in poor health (which is substantiated with a physician's report), and have no future earning potential.

5 What is exceptional circumstances (effective tax administration)?

Exceptional circumstances (effective tax administration) means that although you have sufficient assets to pay the full amount of tax owed, due to exceptional circumstances, requiring full payment would cause an economic hardship or would be unfair and inequitable.

For example, you may have a serious illness such that paying the full amount of tax owed would impair your ability to provide for yourself and your family.

6 Should I attach an offer in compromise to my tax return if I cannot pay the full amount of tax shown on the return?

No. File the tax return and wait until you receive a bill from the Department. That will allow the Department to process your return and determine the actual amount of your tax delinquency.

After you receive the bill, contact the Department at the telephone number listed on the bill. Our collection staff will first try to determine if a payment plan is a valid option. If not, then an offer in compromise may be appropriate.

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For more information, visit the Department of Taxation's website at tax.hawaii.gov

Note: If you are being represented by a tax professional, you must complete a power of attorney (Form N-848) authorizing the Department to discuss your situation with that person. Form N-848 may be obtained from any district tax office, by calling the Department at 808-587-4242 (toll-free at 1-800-222-3229), or on the Department's website at tax.hawaii.gov.

7 How do I submit an offer in compromise?

Complete Form CM-1, Offer in Compromise, and submit it to the Department. Attach a Statement of Financial Condition and Other Information (Form CM-2 for an individual taxpayer or Form CM-2B for a corporation, partnership or other non-individual taxpayer) to Form CM-1.

Forms CM-1, CM-2, and CM-2B are available from the Department collector who is handling your account or from the Department's website at tax.hawaii.gov.

Taxpayers must be in compliance with all tax filing requirements. All tax returns must be filed prior to or with Form CM-1.

To submit your offer in compromise to the Department by mail, mail your completed Forms CM-1, CM-2, and CM-2B, together with payment, to: Hawaii Department of Taxation, Attn: Collections Branch, P. O. Box 259, Honolulu, HI 96809.

Note: All offers in compromises must be accompanied by a minimum payment. See question 12.

8 Can I use federal Form 656, Offer in Compromise, to submit an offer in compromise to the state?

No. Federal Form 656 cannot be substituted for the Department's Form CM-1. However, copies of documents that you submit to the Internal Revenue Service (IRS), such as your current financial statements, may be submitted to the Department.

9 Will the Department continue its collection activities after an offer in compromise is submitted?

Except for the filing of additional State tax lien or liens for all assessed, outstanding, unpaid tax debts, said lien or liens will be filed and recorded to secure the State's position as your creditor. However, no collection action (i.e. levies, garnishments, or referrals to outside collection agencies) against you with regards to the offer in compromise are suspended while your offer is being investigated and evaluated. The offer in compromise refers to the taxpayer's total tax debt, regardless of tax type. Taxpayer must be in full compliance with all tax filing requirements, or the offer is subject to automatic rejection.

Note: Internal offsets of tax credits are not considered collection activities and therefore, are not suspended while your offer is being evaluated.

If the Department finds that your offer in compromise is a tactic to delay collection actions or if the delay jeopardizes the Department's ability to collect the outstanding tax liabilities, the Department will take action to protect the state's interests and the offer in compromise will be summarily rejected.

10 I am currently on a payment plan. Do I need to continue making my monthly payments after submitting an offer in compromise?

Yes. You must continue making your monthly installment payments per your installment agreement while your offer in compromise is being considered.

11 How much should I offer for the compromise?

The amount that the Department will accept for an offer in compromise will vary depending on the reason for the compromise.

If the compromise is offered because there is doubt as to liability, then the amount offered may be the amount that you believe is the correct tax liability owed.

If the compromise is offered because there is doubt as to collectability, then the amount offered is usually the amount that you believe is appropriate given your current financial condition and future earning potential.

12 Is any part of the amount offered in the compromise required to be paid when Form CM-1 is submitted?

Yes. All offers in compromise must be accompanied by a minimum payment. For a lump sum offer in compromise, at least 20% of the proposed offer must accompany the offer. For an offer in compromise that will be paid in periodic installments, an amount equal to the first periodic payment must accompany the offer. However, the Department may waive these payment requirements for individuals who meet the low income certification guidelines published by the IRS.

If the offer in compromise is rejected, any payment made with the offer in compromise will be kept by the Department and will be applied to your tax debt. Payments are applied first to recover costs incurred by the Department, then to any interest due, then to penalties, and finally, to taxes.

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13 What happens after an offer in compromise is submitted to the Department?

The offer in compromise filed, doubt as to collectability, will go to the collector assigned to the account for an initial review.

The collector verifies that you have filed all required tax returns to ensure that your total tax liability is known.

The collector will review and evaluate the offer in compromise forms and documents submitted. Selected information will be verified and additional documentation may be requested from you to clarify or substantiate any claims made.

Finally, the collector makes the initial determination to either accept or reject the offer in compromise as filed. The collector may recommend that the offer in compromise be accepted with modifications. For example, the collector could recommend acceptance if the amount offered was larger, or if you agreed to sign a collateral agreement pertaining to future earnings or tax benefits. These modifications to the offer in compromise are open for discussion and limited negotiation.

In general, an offer in compromise that is tentatively accepted by the collector is reviewed first by division supervisors before going to the Director of Taxation (Director). Prior to the Director's approval, the offer in compromise is posted to the Department's website for at least five calendar days. If the Director approves the offer in compromise, the offer is then forwarded to the Governor for final review and approval signature.

Note: Section 231-3(10), Hawaii Revised Statutes (HRS), grants the Director the authority to approve offers in compromise without the Governor's review and approval if the tax liability, excluding penalties and interest, is \$50,000 or less.

You will receive written notification of whether your offer in compromise is rejected or approved.

14 What is a collateral agreement?

A collateral agreement requires you to make additional payments in the future if certain conditions are met.

Usually, the collateral agreement is effective for a five- to ten-year period after your offer in compromise is accepted. If your annual income exceeds a certain amount in any year covered by the collateral agreement, you are required to pay to the state a percentage of that excess amount.

The Department may require a collateral agreement as a condition for accepting your offer in compromise, particularly if you have an on-going business or if you have the potential for future

earnings. While the collateral agreement is in effect, you must file all your tax returns on time and pay any tax owed in full; if not, the offer in compromise will be voided.

Obtain Collateral Agreement Forms CM-3 (for individuals) and CM-4 (for corporations) from the Department collector who is handling your account.

15 Are the offers in compromise and all related information kept confidential?

No. A statement about each approved offer in compromise is required to be on file at the Department and open to public inspection. The statement contains the following information:

- Name of the taxpayer and the amount and type of tax;
- Amount of penalties and interest imposed, or that could have been imposed by law;
- Total tax liability pursuant to the terms of the offer in compromise, actual payments made, and the dates the payments were made; and
- Reasons for the compromise.

In addition, each proposed offer in compromise that does not require the Governor's approval (offers in compromise where the tax liability, excluding penalties and interest, are \$50,000 or less) must be posted on the Department's website for at least five calendar days before the Director signs it.

16 Do the Department and IRS have a joint offer in compromise program?

No. A joint compromise program was attempted, but statutory requirements and other significant differences have prevented its implementation.

17 Do the Department and IRS have similar procedures for reviewing offers in compromise?

Generally yes, but there are significant differences in the way offers in compromise are processed and evaluated by each agency.

For example, the IRS has personnel specifically assigned to the evaluation of offers in compromise. The Department does not have specialized personnel for this purpose. The same collector initially assigned to a taxpayer's account also evaluates and reviews an offer in compromise submitted by that taxpayer.

18 If an offer in compromise has been accepted by the IRS, will a similar offer in compromise be automatically approved by the Department?

No. Acceptance of an offer in compromise by the IRS does not automatically guarantee acceptance by the Department and vice versa. An offer in compromise sent to the Department is reviewed and evaluated on its own merits.

19 If an offer in compromise is accepted, what happens to any liens that the Department placed on my assets?

The liens will be released once the offer in compromise is paid in full. The release is given to you to record at the Bureau of Conveyances.

20 The Department accepted my offer in compromise. Can I go on a payment plan?

Yes. However, it is in your best interest to pay the offer in compromise in full upon notification of approval. Reason for this is that if an installment is late or not made, the offer in compromise is voided and the liability is reinstated to its full amount. Also, liens are not released until the entire offer in compromise is paid in full.

21 Where can I find more information?

You can find more information in section 231-3(10), HRS, and section 18-231-3-10, Hawaii Administrative Rules, which are available on the Department's website at tax.hawaii.gov.

Where to Get Forms and Information

Website: tax.hawaii.gov

Telephone: 808-587-4242

Toll-Free: 1-800-222-3229

Telephone for the hearing impaired: 808-587-1418

Toll-Free for the hearing impaired: 1-800-887-8974

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