



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
Washington, DC 20224

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SMALL BUSINESS / SELF-EMPLOYED DIVISION

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Impacted IRM 5.8.5

MEMORANDUM FOR DIRECTORS, COLLECTION AREA OPERATIONS  
DIRECTORS, CAMPUS COMPLIANCE OPERATIONS AND  
CHIEF, APPEALS

FROM: Frederick W. Schindler /s/ **Frederick W. Schindler**  
Director, Collection Policy

SUBJECT: Interim Guidance for Calculation of Future Income in Offer in  
Compromise Cases

The purpose of this memorandum is to provide revised guidance in the computation of the taxpayer's future income value during the evaluation of an offer in compromise.

Internal Revenue Manual (IRM) 5.8.5 defines future income as an estimate of the taxpayer's ability to pay based on an analysis of gross income, less necessary living expenses, for a specific number of months into the future. The number of months used depends on the payment terms of the offer. In general, a taxpayer's current income will be used in the analysis of future ability to pay.

Attached to this memorandum is a revision to sections of IRM 5.8.5, Financial Analysis which discuss the calculation of future income and the use of collateral agreements.

The revisions include specific examples of when the use of income averaging and/or a collateral agreement is appropriate.

These procedures are effective upon the date of issuance and should be applied to any offer currently under consideration. Additionally, these procedures may be applied to offers previously rejected which are currently in their appeal period or where the taxpayer has requested appeals consideration. These procedures will be incorporated into the next revision of IRM 5.8 Offers in Compromise.

If you have any questions, you may contact me, or a member of your staff may contact Thomas B. Moore, OIC Senior Program Analyst. Territory or Campus personnel should direct any questions, through their management staff, to the appropriate Area or Campus contact.

Attachment

cc: Commissioner, Small Business/Self-Employed Division  
National Chief, Appeals  
Chief Counsel  
National Taxpayer Advocate

**5.8.5.6  
Future Income**

(1) Future income is defined as an estimate of the taxpayer's ability to pay based on an analysis of gross income, less necessary living expenses, for a specific number of months into the future.

(2) As a general rule, the taxpayer's current income will be used in the analysis of future ability to pay.

This includes situations where the taxpayer's income is recently reduced based on a change in occupation or employment status.

(3) Consideration should be given to the taxpayer's overall general situation including such facts as age, health, marital status, number and age of dependents, level of education or occupational training, and work experience.

(4) Situations that may warrant placing a different value on future income than current or past income indicates are discussed in the table below. Additionally, securing a future income collateral agreement based on the taxpayer's earnings potential may be appropriate and are discussed in more detail in IRM 5.8.5.19 and IRM 5.8.6, Collateral Agreements.

If...	Then...
Income will increase or decrease or current necessary expenses will increase or decrease	Adjust the amount or number of payments to what is expected during the appropriate number of months.
A taxpayer is temporarily or recently unemployed or underemployed	<p>Use the level of income expected if the taxpayer were fully employed and if the potential for employment is apparent. Each case should be judged on its own merit, including consideration of special circumstances or ETA issues.</p> <p>Example: Unemployed – The taxpayer is a construction worker and between jobs. A review of the taxpayer's previous annual income and/or income averaging may be the appropriate method to determine taxpayer's income for calculation purposes.</p> <p>Example: Underemployed – If a taxpayer is a teacher but recently moved and is currently at a lesser paying job until a teaching position</p>

	<p>becomes available, or has been hired and does not begin work until the school season begins, the taxpayer is considered to be currently underemployed. Use the anticipated income once the taxpayer is fully employed.</p>
<p>A taxpayer is unemployed and is not expected to return to their previous occupation or previous level of earnings</p>	<p>Contact the taxpayer to discuss the expected future level of income. When considering future income, also allow anticipated increases in necessary living expenses and/or applicable taxes.</p> <p>Each case should be judged on its own merit, including consideration of special circumstances or ETA issues.</p>
<p>A taxpayer is long-term unemployed</p>	<p>Use of income averaging is not required; the taxpayer's current income may be used in the future income calculation.</p> <p>Example: Taxpayer has been unemployed for over one year. There are currently no employment opportunities for the taxpayer and the household is living on one income. Use of the taxpayer's current income with a future income collateral agreement is appropriate.</p>
<p>A taxpayer is long-term underemployed</p>	<p>Do not income average; use the taxpayer's current income.</p> <p>Example: The taxpayer was previously employed in a manufacturing plant making \$75,000 per year. There are currently no opportunities for the taxpayer to secure employment making the same rate of pay as their prior job. Their income is now \$25,000 per year with no anticipated increase. Use the current income only.</p>
<p>A taxpayer has an irregular employment history or fluctuating income</p>	<p>Average earnings over the three prior years. The use of a time period other than three years should be the exception and only when specific</p>

	<p>circumstances are present.</p> <p>Example: The taxpayer is a stock broker whose income in 2007 was \$150,000 and income in 2008 was \$25,000. In this case, you should consider income averaging the prior three years or secure a future income collateral agreement if the offer is accepted.</p> <p>Note: This practice does not apply to wage earners. Wage earners should be based on current income unless the taxpayer has unique circumstances.</p>
<p>A taxpayer is in poor health and their ability to continue working is questionable</p>	<p>Reduce the number of payments to the appropriate number of months it is anticipated the taxpayer will continue working. Consider special circumstance situations when making any adjustments.</p> <p>Example: Taxpayer has a serious health issue and it is anticipated they will be unable to work after six months. Use the taxpayer's current income for six months then reduce their income to the anticipated amount they will be receiving after they are unable to work.</p>
<p>A taxpayer is close to retirement and has indicated they will be retiring</p>	<p>If the taxpayer can substantiate retirement is imminent, adjust the taxpayer's future earnings and expenses accordingly. If it cannot be substantiated, base the calculation on current earnings. At this point, it may be appropriate to discuss other options available to the taxpayer, for example an installment agreement.</p> <p>Example: The taxpayer is 65 years of age and has indicated they will retire at the age of 66. They provide copies of documents that have been submitted to their employer discussing their retirement date. Use the taxpayer's current income until the taxpayer's</p>

	<p>anticipated retirement date, then adjust the taxpayer's income to reflect the amount expected in retirement.</p> <p>Example: The taxpayer is 62 years of age, the taxpayer is in good health, and their income has remained stable for the past three years. The taxpayer states they would like to retire at age 65. Use the taxpayer's current income and if the RCP exceeds the offer amount, discuss the option of securing an installment agreement until the taxpayer actually retires, at which time an offer may be appropriate.</p>
<p>A taxpayer will file a petition for liquidating bankruptcy</p>	<p>Consider reducing the value of future income. The total value of future income should not be reduced to an amount less than what could be paid toward non-dischargeable periods, or what would be recoverable through a bankruptcy proceeding. When considering a reduction in future income also consider the intangible value to the taxpayer of avoiding bankruptcy. Refer to IRM 5.8.10.2.</p>

(5) Judgment should be used in determining the appropriate time to apply income averaging on a case by case basis. All circumstances of the taxpayer should be considered when determining the appropriate application of income averaging, including special circumstances and ETA considerations. Below are some examples of when income averaging may or may not be appropriate.

Example: Taxpayer's spouse has not worked for over two and one-half years and has no expectations of returning to work. Do not average income for the spouse's past employment.

Example: Taxpayer has been unemployed for over one year and provided proof that Social Security Disability is the sole source of income. Do not apply income averaging in this case but use current income to determine the taxpayer's future ability to pay.

Example: The taxpayer was incarcerated and unable to work for the past four years and provided proof that a relative is paying for all expenses, including child support payments. The taxpayer has no skills or promise of work in the near future but is planning on attending trade school to

improve his chances of getting a job. Do not include income prior to the incarceration. In this case, since the taxpayer has no skills or promise of employment, their future income value may be determined to be zero. Consideration should be given whether it would be in the best interest of the government to accept the offer or reject the offer in favor of other case resolutions.

Example: The taxpayer recently began working after several months of unemployment. Use the most recent three months pay statements to determine future income. Since the taxpayer is a wage earner, the use of income averaging over the prior three years of income is not appropriate.

(6) In situations where the taxpayer's income does not appear to meet their stated living expenses the difference 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. Discussion with the taxpayer/representative and a review of documents submitted by the taxpayer must take place to determine the appropriateness of including an additional amount in the calculation of future income. Verification of the source of unexplained bank deposits or statements from the source of gifts may be required to correctly determine the taxpayer's current income. Telephone contact is recommended to expedite case processing.

Example: 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. The gift amount should not be included as income.

Example: The taxpayer has been receiving an amount each month that only began recently, which they state is a gift from a friend. Further research has determined the taxpayer is in business with the friend and the amount is from their business. This amount should be included as income to the taxpayer. Additionally, consideration should be given to referring the taxpayer and the business income tax return to Examination.

Example: The taxpayer had gambling winnings over a period of time, but is not consistent. Do not include those winnings as additional income on the IET. This does not apply to professional gamblers.

Example: The collection information statement (CIS) submitted by the taxpayer included \$ 3,000.00 of monthly income, which is verified by paystubs. The CIS submitted by the taxpayer includes \$ 4,000.00 of expenses. An additional \$ 1,000.00 should not be added to the taxpayer's income based solely on the fact it appears the taxpayer has been meeting

the living expenses included on the CIS. Discussion with the taxpayer or representative is necessary to clarify the discrepancy prior to including the amount as additional income.

(7) Employees need 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.

### **Currently 5.8.5.6(7) Future Income Collateral Agreements**

(1) In some instances, it may be difficult to calculate the taxpayer's anticipated income. While the use of income averaging is one method available and should be used when averaging the taxpayer's income provides a reasonable calculation of the taxpayer's future earnings potential, it may also be appropriate to use the taxpayer's current income and secure a future income collateral agreement. The use of a future income collateral agreement will protect the government's interest in any substantial increase in the taxpayer's earnings.

(2) A future income collateral agreement is most appropriate in situations where the taxpayer's future income is uncertain, but it is reasonably expected that the taxpayer will be receiving a substantial increase in income.

(3) A future income collateral agreement should not be used to accept an offer for a lesser amount than the calculated RCP. See IRM 5.8.6.3.1, Future Income, for instructions on completing collateral agreements.

Example: A taxpayer is currently in medical school; upon graduation income should increase dramatically. Consider securing a future income collateral agreement.

Example: A taxpayer recently secured a job as an attorney with a starting salary of \$80,000 per year, with potential for significant increases in salary. Consider securing a future income collateral agreement.

Example: A taxpayer is a real estate agent who has had two years of high income and the current income is significantly diminished. Based on the current real estate market, it may be appropriate to use the taxpayer's current income and secure a future income collateral agreement in lieu of income averaging.

Example: A taxpayer's RCP is \$12,000 but has offered \$10,000 plus a future income collateral agreement. A future income collateral agreement is not appropriate in lieu of the taxpayer increasing their offer to the RCP amount. If the taxpayer is not willing to increase their offer to the RCP amount, the offer should be rejected.