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INSIDE THE LAW

WINTER 2021

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Why Don't I Qualify for an Offer in Compromise?

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When a new client with back taxes reaches out to me, inevitably the first question out of their mouth is whether the Internal Revenue Service (IRS) is willing to compromise on the amount owed. In what almost certainly sounds like a lawyer's answer, my response is always, "It depends."

That's because it does depend on a bunch of factors the IRS evaluates when an offer in compromise – an agreement where the IRS accepts a set payment from the taxpayer in exchange for eliminating a larger tax assessment – is received from a taxpayer. For whatever reasons, many accountants and attorneys do not really understand what drives success in this area. The reality is that the process is much more mechanical than many would consider fair, but also that the rigidity of the guidelines the IRS must follow actually makes success much more predictable for qualifying taxpayers.

WHY THE IRS WON'T SETTLE

There are a lot of reasons the IRS does not liberally grant offer in compromise requests. First and foremost, the IRS generally has a priority position ahead of unsecured creditors in a taxpayer's assets. From the date on which taxes are assessed, a lien is automatically created in favor of the government. This lien may then be recorded against a taxpayer in a personal capacity or as a claim on property they own. In addition to liens, the IRS has the legal power to garnish wages, intercept payments from contractors, and even reach out to banks and drain accounts in order to collect. Although taxpayers benefit from a lot of procedural safeguards that are in place to ensure they do not fall victim to sudden and overzealous collections tactics, the IRS's power to enforce collections is expansive.

The IRS also has a big job on its hands. Annually, the IRS collects approximately $3.5 trillion in receipts. Individual income taxes alone make up $2 trillion of this total. This is an astronomical amount of funds, especially considering a significant portion of collections depends on whether folks voluntarily file their annual income tax returns. It is pretty clear the voluntary compliance system would be fundamentally undermined if taxpayers could reasonably expect each year that they can ultimately compromise away significant portions of their tax liability.

For these important reasons, the IRS has carefully circumscribed the criteria under which an offer in compromise will be granted. Although rigid, the guidelines are fair in the sense that the IRS must adhere to its own rules in evaluating offers and granting relief.

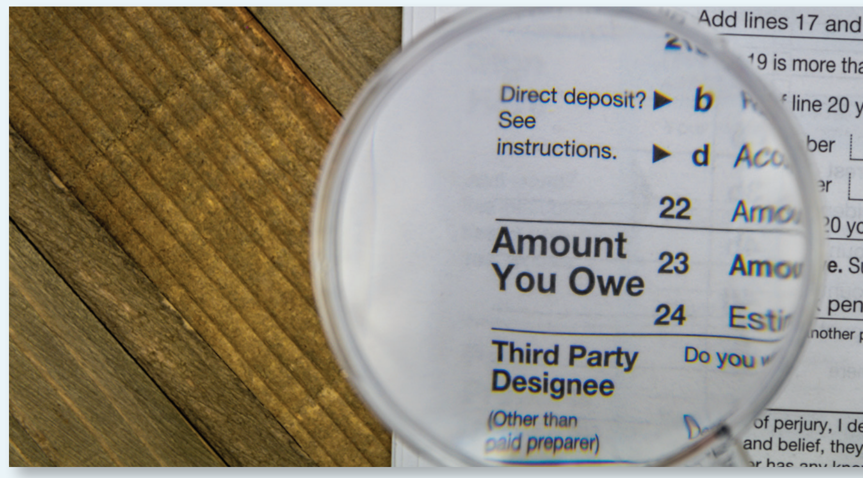
WHEN THE IRS WILL SETTLE

Preparing an offer in compromise requires that the taxpayer come up with an offer amount which the IRS measures against its internal collection potential guidelines. The IRS will either accept or reject the offer, or alternatively request more information. The process requires taxpayers pay an application fee, and for some types of offers, up to 20% of the amount of the proposed settlement amount. In the event the IRS declines to accept the offer, the 20% down payment on the offer is not returned and is instead applied to the outstanding tax due. Consequently, the cost of making an ill-conceived offer can be high, especially considering a rejected offer may still take up to eighteen months to resolve.

Where most taxpayers or inexperienced practitioners fail is in their understanding of the offer guidelines. For example, the IRS will not even consider accepting an offer in compromise if the taxpayer is able to fully pay all of the debt due before the statute of limitations on collections closes. This is a deal breaker if the taxpayer has a relatively modest amount of debt relative to their current income. A taxpayer also will not qualify if they are not caught up on their current filing and payment obligations, excluding the old debt.

The IRS does not have a lot of secret procedures that are used to evaluate offers. These guidelines and procedures are public information. If an offer is at or above the amount the IRS estimates is collectible on an account, then the offer is in the government's interest and will be accepted. It's that simple. Where folks seem to disagree with the IRS is in measuring the amount of collectability on an account.

For starters, the IRS will want an offer to include a certain amount of the taxpayer's available net equity in assets. This contrasts with the process for obtaining an installment agreement, which is typically based on current income alone. Net equity is also an IRS term of art in this context; it is not simply the fair market value of a taxpayer's assets minus debts.



The IRS will additionally apply a very rigid analysis to determine whether a taxpayer has net income available for collections. The income and expense analysis is primarily cash-flow based, but the expense portion takes into consideration the lesser of a taxpayer's actual living expenses or IRS standard allowances. The catch here is that the expense allowances used by the IRS are spartan; many affluent taxpayers find that the IRS wants a piece of their monthly income that is already being applied to credit card minimum payments or a sizeable mortgage. Unfortunately, the IRS does not deviate from these expense allowance standards. Taxpayers who are truly overextended on various consumer debts may find that an offer under these circumstances is simply too high to be acceptable.

Together, the net assets and net income of a taxpayer over a certain time frame are used to come up with an acceptable offer amount. Unless the amount of collection potential on an account shows a taxpayer can fully pay over the life of the debt, the total amount of debt owed is not part of the equation.

WHAT CAN YOU DO?

A basic understanding of the offer in compromise rules is frequently not enough. Knowing net assets are considered in the equation by the IRS, taxpayers sometimes develop the mistaken belief that they should engage in actions to spend their net assets down before making an offer. The IRS will respond to this behavior by instead denying the offer. This does not mean, however, that taxpayers can't take financial actions in order to increase the chances their offer will be accepted.

Although giving the answer "it depends" is usually an out a professional will use to avoid the possibility of being wrong, with offer in compromise work, this is always the right answer when taking on a new matter. A competent advisor in this area of practice should be able to determine the amount a taxpayer owes, whether they are ready and able to make an offer, and the amount of the offer needed to satisfy the IRS's guidelines. There is additional work in getting the IRS to actually follow through and process the offer correctly, but a lot of wasted effort can be avoided if taxpayers are advised not to make offers that will automatically be rejected.

A competent advisor in this area of practice should be able to determine the amount a taxpayer owes...

If you would like to know whether you or your business are a candidate for an offer in compromise, please reach out to us. We can usually determine whether this is an option for you after an initial consultation. We are also equipped to discuss alternative workout arrangements. FT

Business Liability Insurance – An Introduction to Causes of Action

by Michael E. Brangwynne, Esq. | 617-336-2281 | mbrangwynne@fletchertilton.com

This is the third article in a series on the circumstances that attach to a civil lawsuit. Earlier articles in the series can be found on Fletcher Tilton's website under ARTICLES.

BUSINESS LIABILITY INSURANCE

In order to lay a proper foundation, it seems necessary to take one final detour before diving into the most common causes of action. As we saw in the second installment of this series, based on the principal of respondeat superior, an employee's single careless act can have dramatic consequences on his employer's business. By incorporating, business owners usually can protect their personal assets from exposure to liability. Nevertheless, the assets of the business--which can be substantial--are still exposed to liability.

To avoid the risk that an employee's actions might bankrupt the business, most business owners will invest in business liability insurance, which insures the business against liability up to a certain amount for a variety of claims that might be asserted. If a lawsuit is filed against the business for a claim that is covered by the policy, then the insurance company will retain legal counsel to defend the business. If necessary, the insurance company will pay to settle the claim, or pay a judgment entered against the business--up to the policy limits.

Business liability insurance is a critical tool in protecting business assets, but it is not foolproof. There are of course limitations on the amount of liability insured, with the level of protection naturally affecting the cost of premiums. Furthermore, as we will see, there are many different causes of action, and all claims will not necessarily be covered.

It is important for business owners to understand the coverage provided by their insurance policy. A commercial general liability policy will typically insure against claims by third parties for bodily injury and property damage caused by the employees of the business. Nevertheless, almost every policy of liability insurance will have exclusions--claims for which the insurance company does not provide coverage.

For example, any loss or damage to a third party that is caused deliberately by an employee (rather than just carelessly) will likely be excluded from coverage under a general liability policy. For this and other reasons, claims of employment discrimination practices may not be covered. Furthermore, certain types of damages claims--such as a claim for psychological injuries like mental anguish and emotional distress--may not be covered under a general liability policy.

Indeed, if you or your business is the subject of a claim and your insurer issues a "Reservation of Rights" letter, your insurer is notifying you that it may deny coverage on some or all of the claims that have been asserted. My colleague, attorney Adam C. Ponte, has written in more detail on the conflicts that can arise under such a situation, and his article can be found on Fletcher Tilton's website under ARTICLES ("Why You Should Choose Your Own Lawyer When Your Insurer Issues a Reservation of Rights Letter").

CONCLUSION

Prudent business owners can take appropriate action to protect both their personal and business assets from exposure to liability. Not only is it crucial to incorporate, but it is also crucial to obtain and understand appropriate business liability insurance. With these protections in place, the next step is to avoid engaging in conduct that might give rise to liability in the first place. In the next installment, we will begin to explore specific causes of action, and the types of actionable conduct that we should strive to avoid. FT

Understanding the MassHealth Five-Year Look Back

by Lauren E. Miller, Esq. | 508-459-8044 | lmiller@fletchertilton.com

In Massachusetts, when a person enters a nursing home on a long-term basis, there are generally three ways to pay for their care: privately from their funds, from a combination of private funds and long-term care insurance, or by applying for Medicaid benefits (called MassHealth in Massachusetts). Nursing homes typically charge $12,000-$15,000 per month, so most people run out of private funds fairly quickly. If the only option to fund nursing home care is MassHealth, then the applicant must complete the infamous MassHealth Long-Term Care application.

For an unmarried applicant to be financially eligible for MassHealth, their assets must have been reduced below $2,000. In 2021, for a married applicant, who has a spouse living in the community, the total assets of the couple must be reduced below $132,380. However, it is not enough to simply show current bank statement(s) with a combined balance below the asset limit. The applicant must document how their assets were reduced below the asset limit. This is where the five-year look back comes into play.

During the MassHealth application process, MassHealth may request up to five years of financial records for all assets. In addition, MassHealth routinely requests additional information explaining all large transactions, or patterns of deposits or withdrawals for smaller transactions. If a property has been sold in the past five years, documentation must be provided showing that the applicant received fair market value for the sale.

One home, located in the Commonwealth of Massachusetts, does not count towards the assets limit. However, for individual applicants, if the owner is approved for MassHealth benefits, MassHealth will place a lifetime lien on the property. MassHealth will later recover its contribution to the owner's care upon the sale of the property during the life of the applicant, or from their probate estate upon their death. In short, even though MassHealth will deem the home "noncountable," this does not mean that the home is protected from MassHealth.

The applicant must document how their assets were reduced below the asset limit. This is where the five-year look back comes into play.

Each application is reviewed by an individual case worker. While there are general practices and regulations that guide the MassHealth case workers, the way each case worker handles applications can vary. In addition, there are four MassHealth Enrollment Centers in Massachusetts, so there are certain local practices that the case workers follow based upon the enrollment center where they work.

For those who are concerned about the need for nursing home care in the near future, it is prudent to save receipts for all large transactions and avoid gifting, unless it falls under one of the MassHealth transfer exceptions and is clearly documented. In the eyes of MassHealth, no good deed goes unpunished. If it occurs within the five-year look back, a graduation gift to a grandchild or a contribution to the down payment for a child's home will typically trigger a MassHealth penalty period. This penalty is applied starting on the date that the applicant is "otherwise eligible" for MassHealth, meaning that they are in a nursing home and have total assets below the asset limit. The penalty is applied based upon the number of days that the gifted funds would have paid for the applicant's nursing home care using the average daily nursing home rate.

If a client wants to protect assets from the MassHealth spend down, the lifetime property lien, and estate recovery, then planning can be done more than five years before the applying for nursing home care benefits. In addition, if nursing home care is needed and no asset protection planning has been completed, or if the planning was implemented less than five years ago, certain assets can still be protected under the limited exceptions to the transfer rules. For example, MassHealth will not penalize a transfer of assets to a disabled child. In addition, the MassHealth regulations allow an applicant to transfer their home to a "caretaker child" who has lived in the applicant's home for the two years preceding the need for nursing home care, has provided care to the parent that delayed the need for nursing home care, and can provide an affidavit of the applicant's physician attesting to the same.

While there are exceptions to the penalties for transfers or gifts within the five-year look back, they require onerous documentation, and in certain cases are applied at the discretion of the MassHealth agency. These are crisis-planning techniques, and do not guarantee a desirable result. If an individual wishes to protect assets, it is preferable to execute a plan more than five years in advance of the need for nursing home care. FT

UPCOMING WEBINARS

Estate Planning with attorney Michael Lahti

Tues., March 2, 2021 | 10:00-11:30 a.m. | Live Webinar
Tues., March 23, 2021 | 10:00-11:30 a.m. | Live Webinar
Tues., April 13, 2021 | 10:00-11:30 a.m. | Live Webinar
Tues., May 11, 2021 | 10:00-11:30 a.m. | Live Webinar
Tues., June 1, 2021 | 10:00-11:30 a.m. | Live Webinar

For details and registration, visit FletcherTilton.com/seminars

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