

# QUESTIONS AND ANSWERS ABOUT OFFSET BYPASS REFUNDS



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If a taxpayer has delinquent tax debts, the taxpayer will generally not receive any tax return refunds due to him.<sup>1</sup> The IRS will typically apply whatever refund that taxpayer is owed to a prior year's tax debt. For example, if a taxpayer has a \$5,000 balance owed for her 2018 Form 1040 taxes and she is due a \$3,000 refund upon filing her 2021 Form 1040 return, the IRS will apply her \$3,000 tax refund to the 2018 Form 1040 balance. However, the Offset Bypass Refund (OBR) is available in certain circumstances and allows a taxpayer to keep her tax refund. This article will discuss when a taxpayer qualifies for an OBR including Hardship OBRs as well as the new rules for OBRs related to Offers in Compromise (OICs).

## When taxpayers qualify for OBRs

Taxpayers may qualify for OBRs when there are "hardship circumstances."<sup>2</sup> OBRs may not be available if a taxpayer has other debts subject to the treasury offset program like child support obligations and state tax balances.<sup>3</sup> The IRS recently updated its procedures to allow taxpayers with pending or accepted OICs to request OBRs.<sup>4</sup> OBRs are not available once a tax is assessed unless the IRS makes a clerical error.<sup>5</sup> Assessment typically happens within weeks or even days of a return filing. OBRs may also be available if there is a subsequent adjustment to be made to a taxpayer's module like an amended return posting, an adjustment from an exam, or a credit transfer.<sup>6</sup>

## Hardship OBRs

Taxpayers experiencing a hardship may be eligible for an OBR.<sup>7</sup> The hardship standard is defined by Internal Revenue Code (Code) section 6343.<sup>8</sup> The amount of the OBR is limited to the amount necessary to alleviate the taxpayer's hardship. For example, if a taxpayer is supposed to receive a \$3,000 tax refund and needs \$1,200 to avoid eviction, the taxpayer will receive a \$1,200 OBR.<sup>9</sup>

Under section 6343, a hardship exists when a tax refund offset will prevent a taxpayer from paying his "reasonable basic living expenses."<sup>10</sup> Hardship does not exist when an OBR is necessary to maintain an "affluent or luxurious" lifestyle.<sup>11</sup>

The section 6343 standard considers factors like the number of dependents the taxpayer has, the taxpayer's age, and the cost of living in the taxpayer's locale.<sup>12</sup> Section 6343 considers reasonably necessary expenses for food, clothing, housing, medical care, court-ordered payments, and expenses needed for the production of income like union dues.<sup>13</sup> IRS Collection Standards serve as a yardstick as to what expenses are "reasonable."

**Question 1:** The taxpayer files his 2021 return in February 2022. He is expecting a \$3,500 refund from the 2021 return. His late-model luxury car will be repossessed unless he can make a \$1,000 monthly payment. Does this taxpayer qualify for an OBR?

**Answer:** Probably not. He does not have a hardship because he has a "lavish" lifestyle. As of February

2022, IRS Collection Standards limit automobile ownership expenses to \$533 per month. If we use this as a yardstick, the \$1,000 per-month luxury car payments are not “reasonable” and the taxpayer probably does not meet the hardship criteria.

**Question 2:** The taxpayer files her 2021 return in February of 2022. She is expecting a \$3,500 refund from the 2021 return. She is married and has two children. She needs \$1,800 to prevent an eviction. In her county, the IRS Collection Standard for housing and utilities is capped at \$2,400 per month for a family of four. Does this taxpayer qualify for an OBR?

**Answer:** Perhaps yes. This taxpayer’s housing expenses are most likely “reasonable” because they are below the IRS Collection Standard for her area for a family of her size.

**Question 3:** The taxpayer files his 2021 return in February of 2022. He is expecting a \$3,500 refund from the 2021 return. He requires \$500 per month for prescription medications. Can he qualify for an OBR?

**Answer:** Perhaps yes. Although the collection standard for out-of-pocket medical expenses is \$64 per month as of February 2022, medical care is not capped by Collection Standards. Expenses paid for bona fide medical care are always reasonable. This taxpayer may qualify for an OBR even though his prescription medical expenses exceed the standard.

### OIC OBRs

Before November 1, 2021, the IRS would keep all tax refunds extending through the calendar year in which the IRS accepted an OIC.<sup>14</sup> The IRS recently changed the OBR requirements to allow OBRs for refunds that occur after the date of the OIC acceptance.<sup>15</sup> Hardship OBRs are still available to OIC applicants just as they are available to other taxpayers.<sup>16</sup>

**Question 4:** A taxpayer filed an OIC on March 1, 2018 to settle his 2015 and 2016 Form 1040 liabilities. The IRS accepts his offer on February 1, 2020. He timely files tax returns on April 15 of each year and

each return reports an overpayment. What would happen under the new and old rules?

**Answer:** Under the old rules, the IRS will keep his 2017 refund (return filed April 15, 2018), his 2018 refund (return filed April 15, 2019), his 2019 refund (return filed April 15, 2020), and his 2020 refund because 2020 is the calendar year of his OIC acceptance. The IRS will not keep any refunds he is owed for the 2021 tax year or later (assuming she continues to remain in compliance).

Under the new rules, the IRS will still keep the refunds for the 2017 and 2018 periods because the taxpayer filed the 2017 and 2018 returns before the date of OIC acceptance. The IRS would not keep the 2020 refund because the 2020 refund would be issued some time on or about April 15, 2021, which is a full year after acceptance.

At issue are tax periods that occur before the date of acceptance, but after the OIC filing. The new OBR rules require a taxpayer not receive a refund “for a tax period in which the original assessment was prior to the offer acceptance.” The timing of a return filing (and the IRS’ tax assessment subsequent to the return filing) can make a difference in whether or not a taxpayer keeps a refund.

**Question 5:** A taxpayer files an OIC on March 15, 2022 for her 2017 and 2018 balances. The IRS accepts her OIC on March 1, 2024. She timely files her 2021, 2022, 2023, and 2024 returns on April 15 each year and reports an overpayment on each return. What will happen to the 2021 and 2022 refunds?

**Answer:** The IRS will keep her 2021 and 2022 refunds. The IRS will have made its original assessment of the 2021 tax on or about April 15, 2022 and the 2022 tax on or about April 15, 2023. Both of these dates are before the OIC acceptance date in 2024. The IRS will not keep refunds for the 2023 and 2024 tax years. The IRS original assessment will occur sometime on or after April 15, 2024 which is after the March 1, 2024 OIC acceptance. Likewise, the IRS will not keep the taxpayer’s refunds for the 2024 tax year.

**Question 6:** A taxpayer files an OIC for his 2017 and 2018 liabilities on December 1, 2021. He timely filed his 2020 return in February 2021 and the IRS assessed the tax upon filing. The IRS accepts his OIC in late 2022. In early 2023, he files an amended 2020 return claiming a refund. Will this taxpayer be able to keep the refund claimed on the 2020 return?

**Answer:** This taxpayer will not be able to keep the refund claimed on his 2020 amended return because the original assessment occurred when he filed his original 2020 return which was prior to the acceptance of the OIC.<sup>17</sup>

**Question 7:** A taxpayer files an OIC for her 2019 and 2020 balances in early 2022. In April 2023 she is working with an IRS Offer Specialist and is optimistic the IRS will accept her offer in a few weeks. She expects a large refund on her 2022 tax return. What should she do?

**Answer:** She should file an extension for the 2022 tax year. If she files her return on or before April 15, the IRS could make an assessment on the 2022 tax year before the IRS accepts her offer. This would

make the 2022 refund subject to an OBR. On the other hand, if she files an extension there is a chance the IRS will accept the offer before it assesses a tax for the 2022 tax year.

### Applying for an OBR

There is no form required for an OBR. OBRs can be made by contacting the IRS by phone.<sup>18</sup> Taxpayers may seek to obtain the assistance of the Taxpayer Advocate Service by filing a Form 911 to assist in the process.

It is helpful to have a Form 433-A or Form 433-F executed by the taxpayer along with any substantiating documents showing an immediate and urgent financial hardship like utility shut off notices or eviction notices. Having the standard financial documents needed for a typical collections case like pay stubs, bank statements, and other financial documentation can be helpful as well. One should also work quickly when requesting for an OBR because once the IRS assesses the tax for the return at issue, the OBR will generally not be available. 🔥

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#### Notes

- 1 IRC § 6402(a). The statute refers to tax refunds as overpayments.
- 2 IRM § 3.17.79.3.16(1).
- 3 See IRM § 3.17.79.3.16(2). See also IRC § 6402.
- 4 See IRS Mem. SBSE-05-1021-0063 (Oct. 28, 2021), available at <https://www.irs.gov/pub/foia/ig/sbse/sbse-05-1021-0063redacted.pdf>.
- 5 IRM § 21.4.6.5.11.1(6).
- 6 IRM. § 3.17.79.3.16(6).
- 7 See IRM § 21.4.6.5.11.1(1).
- 8 Id.
- 9 IRM § 21.4.6.5.11.1(14).
- 10 Treas. Reg. § 301.6343-1(b)(4).
- 11 Id.
- 12 Id.
- 13 Id.
- 14 See IRS Mem., supra note 4.
- 15 Id.
- 16 Id.
- 17 Id.
- 18 See IRS Mem., supra note 4.