

IRS COLLECTION PROCEDURES AND TAXPAYER REMEDIES

By: Daniel J. Cramer
Cramer, Minock & Sweeney, PLC

The IRS has broad powers to enforce tax laws and collect outstanding taxes. The most common IRS collection methods are tax levies, tax liens, and direct contact by a Revenue Officer (RO) with the taxpayer (TP). Once a tax liability has been assessed, the TP will begin receiving notices demanding immediate payment under threat of enforced collection action. If the TP cannot pay the liability in full, the TP should promptly contact the IRS to pursue another available option such as an installment agreement, offer in compromise, or placement into uncollectible status.

I. IRS Enforcement Action

a. Tax Levy

An IRS tax levy may be issued to a third party, such as the TP's bank, employer, or a third party payer, generally one who has issued a Form 1099 to the TP.¹ A levy against a bank account will result in the IRS taking all funds in the account (up to the total tax liability) on the date the levy is served. A levy on the TP's wages will result in funds taken from wages each pay period. A levy on a third party payer will apply to any funds owed to the TP by the payer on the levy date. The IRS may also levy State tax refunds and social security payments. Once the levy has issued, the party receiving the levy must hold the levied funds for 21 days and then turn the funds over to the IRS. Although the TP has the right within the 21-day hold period to contest the levy in US

¹ IRC (Internal Revenue Code) 6331

District Court, such actions are both expensive and unlikely to succeed. The RO who issued the levy has the authority to release the levy, but will generally do so only if the liability is paid in full, a satisfactory payment plan is entered into, or there is some other extenuating circumstance.²

b. Federal Tax Lien

If the tax liability exceeds \$10,000, a federal tax lien is generally recorded at the County Register of Deeds in the county where the TP resides and filed with the Michigan Secretary of State. A Federal tax lien attaches to all of the TP's property.³ Many TPs mistakenly believe that the lien applies only to the real estate at the address on the lien itself. The IRS will generally not proceed with foreclosure, but will wait to collect the tax when the TP's property is sold. The IRS will rarely release a lien until the tax liability has been paid in full or the IRS has been paid the TP's full equity in a specific asset the TP requests be released. The IRS administrative lien release process is cumbersome and may delay the sale of the TP's property if not commenced well in advance of closing. The tax lien sets forth an expiration date (generally ten years after the tax assessment date). Once the lien expires, the IRS will issue a discharge upon request. The IRS may refrain from filing a tax lien on a liability under \$25,000 (and in some circumstances up to \$50,000) upon execution of an installment agreement (Form 433-D) that is short term with payments made through direct withdrawal from the TP's bank account.

c. Direct Contact by IRS Revenue Officer

Although in most cases the initial contact with the TP will be through correspondence, the TP may be contacted directly by a RO knocking on the TP's door

² IRM (Internal Revenue Manual) 5.11.2.3.1

³ IRC 6321, 6322; IRM 5.12.1

requesting payment. The TP would be well advised to refrain from any substantive discussion with the RO and advise the RO that the TP will contact an accountant or attorney, who will then contact the RO. The RO has the authority to issue levies or file a lien upon proper notice and may issue a summons directing the TP to appear at the IRS office for examination, but will generally allow the TP at least ten days to retain representation before taking enforcement action.⁴

II. Taxpayer Remedies

a. The Assessment

Once the TP receives notice of an outstanding tax liability, the TP should first determine whether the assessment is correct. If the assessment is based on a filed return or a closed audit, it is probably correct, although the filing of an amended return or further audit review may be available to correct an error in the return or assessment. If the TP fails to file a return, the IRS may prepare a substitute for return (SFR) based on information available to the IRS. SFR assessments are usually not accurate and can generally be corrected by simply preparing and filing a return.

b. Installment Agreement

The TP may request an installment agreement under which the full tax liability, with interest and penalty, will be paid over time in monthly installments. The amount of the monthly payment depends on the TP's current income and expenses. Allowable expenses are established by the IRS based on national standards. An installment agreement can generally be established by calling the telephone number on the IRS notice. Installment payment options and the national standards for allowable expenses

⁴IRC 7602; IRM 5.1.10.7.2

change from time to time so the TP should check the IRS website at www.irs.gov for current information. An installment agreement does not release a lien or stop the accrual of interest. However, if the liability is less than or is reduced below a specified amount and an installment agreement is approved, the IRS will not file a lien. Once the installment agreement is in place the IRS will not initiate further enforcement action, unless the TP defaults. If the TP cannot meet the terms of the installment agreement, the IRS must be contacted before default to request modification of the agreement. Once the TP has defaulted, the IRS is reluctant to reinstate or enter into another installment agreement.

c. Offer In Compromise

The offer in compromise (OIC or Offer) program permits the TP to settle an outstanding liability for less than the amount owed. An OIC is filed on Form 656, which sets forth the available bases for the Offer and options for payment. Most Offers are based on doubt as to collectability. The OIC instructions provide step-by-step calculations for the TP to determine whether he or she qualifies for OIC consideration. If the TP has sufficient assets or income to pay the liability in full, an OIC is unlikely to be accepted. Although the OIC process limits the scope of negotiation, the TP should not assume he or she does not qualify solely on the basis of the IRS worksheet. Upon receipt, the OIC will be assigned by the IRS to an Offer Specialist. In evaluating the Offer, the Specialist will review the TP's supporting documentation and determine whether the Offer may be accepted based upon the combined value of the TP's assets (using a quick sale analysis—80% of FMV) and the TP's income less expenses multiplied by a set number of months based on the proposed payment period. Several

points worth noting are that an OIC cannot be submitted unless all tax returns have been filed and the OIC must include all tax liabilities of the TP. Once the OIC has been accepted, the TP must meet all stated terms of the Offer, including filing all returns and paying all taxes during the five year period after acceptance, or the OIC will default. Any recorded tax lien will remain in place until the last payment on the OIC is made. The IRS will also keep any tax refunds due through the year of acceptance of the Offer. The OIC process will generally take at least five months and may take up to a year.

d. Bankruptcy

Although certain Federal taxes, such as payroll (trust fund portion) taxes, are not dischargeable in bankruptcy, most taxes are dischargeable if the assessment arises from a return filed more than three years before the bankruptcy petition filing date, or more than two years after the filing of a late return, whichever is later.⁵ If the TP never filed a return or the assessment is based on a SFR prepared by the IRS, the time period is deemed not to have commenced and the taxes will not be discharged. If the TP does not qualify for a Chapter 7 discharge, the TP may qualify for a reduced liability payable in installments under a Chapter 13 plan.⁶ A discharge in bankruptcy does not release the TP's property from a previously filed Federal tax lien.⁷ The TP may be surprised to learn that property retained or exempted in bankruptcy remains subject to the lien even after entry of the order of discharge. The discharge of a specific tax assessment should be reviewed with the TP's bankruptcy attorney. A bankruptcy petition may also be considered as a defensive measure to forestall execution by the IRS under the automatic stay when seizure has taken place or appears imminent.

⁵ 11 USC 507(a)(8), 523

⁶ 11 USC 1322, 1327

⁷ IRM 5.9.17.4.2, 5.17.9.14

e. Statute of Limitations

The limitation period on tax assessments is three (3) years from the due date for a timely filed return.⁸ The statute of limitations on collection of taxes is ten years from the assessment date,⁹ unless the period is extended by the TP or the IRS reduces the assessment to a judgment.¹⁰ The TP may extend the limitation period by written consent, by filing an OIC, or by filing a bankruptcy petition, which tolls the running of the limitation period. The limitation period does not commence for unfiled returns, even if the IRS has prepared a SFR. The IRS generally does not initiate court action to reduce an assessment to a judgment so it is not uncommon for the collection period to expire and the tax become uncollectable.

f. Penalty Abatement

A common request by the TP is the abatement of penalties and interest. The IRS does not generally abate interest. Penalties may be abated based upon a showing of reasonable cause. Although the standards for reasonable cause as defined by the IRS may seem difficult to meet, the IRS has sufficient flexibility in its determination of reasonable cause to merit filing a request for abatement in many situations. The type of penalty is an important factor in the IRS decision. The IRS will generally abate a penalty for failure to timely file an information return, such as a return by a tax exempt organization or fiduciary, but is less likely to abate a failure to file penalty on a Form 1040. The TP may

⁸ IRC 6501 The limitation period on assessments may be longer than three years under certain circumstances.

⁹ IRC 6502

¹⁰ IRC 7402, IRM 5.17.4

qualify for abatement under the first-time abate (FTA) policy of the IRS which may be requested if the TP has no history of noncompliance.¹¹

III. Appeals

The TP has a right to appeal most collection actions by the IRS, including denial of an OIC or penalty abatement request. Appeals must be timely filed pursuant to instructions that are included in the IRS notices provided to the TP. The IRS Office of Appeals has a written policy of fairness, impartiality, and independence and most appealable matters are resolved at that level.¹² There are also several specific appeal programs, such as a Collection Due Process (CDP) hearing and the Collection Appeals Program (CAP). Both programs are intended to expedite appeal review in specific cases. A CDP hearing allows the TP to promptly address any impropriety by RO enforcement action and, although generally pointless unless the IRS has failed to follow its own rules, may provide an opportunity to delay enforcement and request an installment agreement. The CAP is designed to provide prompt review of an agent's action by the RO's manager and may be appropriate before filing a formal protest with the Appeals Office.

IV. Practitioner Tips

In order to represent a TP before the IRS, the practitioner must first file a power of attorney (Form 2848) signed by the TP and the practitioner. The POA may be submitted by fax to the IRS CAF (Centralized Authorization File) unit or directly to the assigned RO. Once the POA has been filed, the practitioner may contact the RO or IRS unit to whom the TP has been assigned and propose a plan to resolve the outstanding

¹¹ IRM 20.1.1.3.6.1

¹² IRM 8.1.1.1

liability, such as entering into an installment agreement, filing an OIC, or requesting uncollectible status if the TP has very limited resources. In the event of a levy, if the practitioner convinces the IRS to release the levy, the IRS will, upon request, fax the release directly to the third party before the levied funds have been turned over to the IRS.

Prior to the practitioner calling the IRS, a Collection Information Statement (Form 433-A or 433-F) should be completed so that the practitioner can respond to questions regarding the assets, income and expenses of the TP and supporting documentation such as paystubs, recent bank statements, and verification of any unusual expenses (above the allowable national standards) should be available to fax to the IRS agent if requested. All of the TP's tax returns must be filed before the IRS will enter into a payment arrangement. However, if returns are outstanding, the IRS will usually agree to place a hold on collection for up to thirty days to allow the TP time to complete the returns. If an OIC has been filed, enforcement action will generally be placed on hold until the OIC has been processed. If the IRS indicates that the Offer will be rejected, the practitioner has the opportunity to negotiate asset values, expense allowances, and payment terms with the Specialist and, if successful, the Specialist will prepare an Amended Offer. If negotiations prove unsuccessful, the OIC rejection may be appealed.

Although IRS enforcement action often proceeds through correspondence without the involvement of a RO, most matters can be resolved through telephone contact alone. In the event a specific collection matter involves unusual circumstances or the practitioner seems unable to make progress, the practitioner may request that the file be assigned to a RO. In such circumstances, it may also be helpful to seek the assistance of

the Taxpayer Advocate Service by faxing a Form 911 to the number listed on irs.gov. A TP Advocate will be assigned to the case and will contact the practitioner to assist in resolving the matter.

V. Conclusion

Although IRS collection procedures are both broad and powerful, the IRS is required to provide advance notice of virtually all IRS enforcement action. The notices set forth the time for the TP to respond and provide ample opportunity for the TP to negotiate a resolution of any outstanding liability based on the TP's ability to pay. Resolution through an installment agreement, an OIC, or placement of the account in currently uncollectible status will result in a hold on further enforcement action. Moreover, virtually all IRS determinations and actions are subject to reconsideration through a timely filed appeal. As long as the TP and the practitioner follow IRS procedures and timely respond to IRS correspondence, most IRS collection matters may be resolved in a manner that is within the TP's reasonable means of payment.¹³

¹³ The website of the IRS at www.irs.gov is well organized and includes all IRS forms. Since IRS procedures change periodically, the website should be consulted prior to representing a TP to insure that the practitioner is aware of the options currently available.