What to Do When You Can't Pay Your Income Taxes

Edward L. Perkins
JD, LLM (Tax), CPA

Gibson & Perkins, PC
www.gibperk.com

UNIT ONE- Penalties

Learning Objectives

After completing this Unit, you should be able to:-

- ✓ Calculate the penalty for a failure to file a tax return.-
- ✓ Calculate the penalty for a failure to pay tax.-
- ✓ Calculate the penalty for failure to pay estimated income taxes.
- ✓ Identify when payments of estimated tax installments are due.
- ✓ Identify situations in which exceptions to these penalties apply.

Course Material

I. IRC § 6651 (a)(1) - Failure to File Tax Return.

A. In case of failure to file an income tax return on the due date *with extensions, the penalty for failure to file is:*

1. Five (5%) percent of the amount of the tax due if the failure is for not more than 1 month,

2. With an additional five (5%) percent for each additional month or fraction thereof during which such failure continues.[1]

3. The penalty cannot exceed twenty-five (25%) percent in the aggregate.

B. In the case of a failure to file an income tax return within 60 days of the date prescribed due (with extensions), the penalty is not to be less than the lesser of $135 or 100 percent of the amount required to be shown as tax on such return.

C. If any failure to file any return is *"fraudulent"*, the penalty is applied—

1. By substituting "15 percent" for "5 percent" each place it appears, and

2. By substituting "75 percent" for "25 percent".

---

[1] For purposes of applying the penalties under section 6651, a "month" is defined as follows: (1) If the date prescribed for filing the return or paying tax is the last day of a calendar month, each succeeding calendar month or fraction thereof during which the failure to file or pay tax continues will constitute a month for purposes of section 6651. (2) If the date prescribed for filing the return or paying tax is a date other than the last day of a calendar month, the period which terminates with the date numerically corresponding thereto in the succeeding calendar month and each such successive period will constitute a month for purposes of section 6651. If, in such successive period will constitute a month for purposes of section 6651. If, in the month of February, there is no date corresponding to the date prescribed for filing the return or paying tax, the period from such date in January through the last day of February will constitute a month for purposes of section 6651. Thus, if a return is due on January 30, the first month will end on February 28 (or 29 if a leap year), and the succeeding months will end on March 30, April 30, etc. (3) If a return is not timely filed or tax is not timely paid, the fact that the date prescribed for filing the return or paying tax, or the corresponding date in any succeeding calendar month, falls on a Saturday, Sunday, or a legal holiday is immaterial in determining the number of months for which the addition to the tax under section 6651 applies.

D. The penalty does not apply if the failure is shown to be due to *reasonable cause* and *not due to willful neglect*.

1. Both elements are required to qualify for the exception.

2. The absence of willful neglect alone is not sufficient.

3. A delay is due to reasonable cause if the taxpayer exercised ordinary business care and prudence but was, nevertheless, unable to file the return within the prescribed period.

4. To claim a reasonable cause exception, the taxpayer must file a written statement, signed under penalties of perjury that affirmatively shows facts sufficient to indicate the existence of a reasonable cause for failing to timely file the return.

II. <u>IRC § 6651 (a)(2) - Failure to Pay Tax</u>

A. <u>Penalty for Failure to Pay Tax Shown on the Return</u>.

1. In case of a failure to pay the amount shown as tax on any return, the penalty is:

a. One-half of one (0.5%) percent of the amount of the tax due if the failure is for not more than 1 month,

b. With an additional one-half of one (0.5%) percent for each additional month or fraction thereof during which such failure continues.

c. The penalty cannot exceed twenty-five (25%) percent.

2. The penalty does not apply if the failure is shown to be due to *reasonable cause* and *not due to willful neglect*.

B. <u>Penalty for Failure to Pay Tax Not Shown on the Return</u>.

1. In the case of failure to pay any amount of any tax required to be shown on a return *that is not so shown (i.e. additional taxes due to an audit)* within 21 calendar days from the date of the IRS notice and demand (10 business days if the amount assessed and shown on the notice and demand equals or exceeds $100,000), a penalty is also imposed in an amount equal to:

a. One-half of one (0.5%) percent of the amount stated in the IRS notice and demand if the failure is for not more than 1 month, with an additional five (5%) percent for each additional month or fraction thereof during which the failure continues.

b. The penalty cannot exceed twenty-five (25%) percent in the aggregate.

2. The "*taxes required to be shown*" include any assessment made pursuant to section 6213(b), with certain exceptions.[2]

3. The penalty does not apply if the failure is shown to be due to *reasonable cause* and *not due to willful neglect*.

C. Increase in Penalty Due to Fraud.

1. If any part of any underpayment of tax required to be shown on a return is due to fraud, there will be added to the tax an amount equal to seventy-five percent (75%) of the portion of the underpayment which is attributable to fraud.[3]

2. In the context of the penalty at issue, "*fraud"* is a taxpayer's intentional wrongdoing with the specific intent to avoid a tax that he or she knew was owed.[4]

3. Such intent can be inferred from strong circumstantial evidence, but cannot be sustained when there is only a suspicion of fraud.[5]

D. Increase in Penalty for Failure to Pay Tax in Certain Cases.

The penalty for failure to pay is increased from one-half of one percent (0.5%) to one percent (1%): (i) on the day 10 days after the date on which *notice of intention to levy* is given[6]; and (ii) on the day on which *notice and jeopardy demand for immediate payment* is given.[7]

E. Returns Prepared by the Secretary.

1. In certain cases a Secretary of a person may fail to file a return but disclose the information necessary to prepare that return.[8]

2. In those cases the return will be disregarded for purposes of determining failure to file penalty, but, will be treated as the return filed by the taxpayer for purposes of determining the amount of the failure to pay penalty.

F. Reduction of Failure to Pay Penalty.

If a return is filed by an individual on or before the due date for the return (including extensions), during the period an installment agreement is in effect for the payment of such tax, the penalty is reduced to one-quarter of one percent (0.25%) instead of one-half of one percent (0.5%).[9]

III. Failure by Individual to Pay Estimated Income Tax.

---

[2] IRC § 6213(b) provides certain exceptions to restrictions on assessment, including: (1) assessments arising out of mathematical or clerical errors; (2) assessments arising out of tentative carryback or refund adjustments; (3) assessment of amount paid; and (4) certain orders of criminal restitution.

[3] See IRC § 6663

[4] Akland v. Commissioner, 767 F.2d 618, 621, 56 AFTR 2d 85-5649 (9th Cir. 1985).

[5] Christianson v. Comm. 87 AFTR 2d 2001-813

[6] See IRC § 6331(d).

[7] See IRC § 6331(a).

[8] See IRC § 6020(b)

[9] This reduction applies for purposes of determining additions to tax for months beginning after December 31, 1999.

A. Addition to the Tax.

1. IRC § 6654 provides that, with exceptions, in the case of any underpayment of estimated tax by an individual, a penalty is added to the income tax, the self-employment tax, and the unearned Medicare contribution.

2. The penalty is an amount determined by applying: (i) the *"underpayment rate",* (ii) to the *"amount of the underpayment",* (iii) for the *"period of the underpayment".*

B. The "Underpayment Rate". The *"underpayment rate"* is the rate established under § 6621(a)(2).[10]

C. The "Amount of Underpayment". The *"amount of the underpayment"* is the excess of—(i) the required installment, over (ii) the amount (if any) of the installment paid on or before the due date for the installment.

D. The "Period of Underpayment".

1. The period of the underpayment runs from the due date for the installment to whichever of the following dates is earlier—(i) the 15th day of the 4th month following the close of the taxable year, or (ii) with respect to any portion of the underpayment, the date on which such portion is paid.

2. Payments of estimated tax are credited against unpaid required installments in the order in which such installments are required to be paid.

E. Number of Required Installments.

For purposes of this section there are four required installments for each taxable year.

F. Required Due Dates. The due date for the installments is:

1st	April 15
2nd	June 15
3rd	September 15
4th	January 15

G. Amount of Required Installments.

1. In general. The amount of any required installment is twenty-five (25%) percent of the "*required annual payment*".[11]

[10] The underpayment rate established under that Code section is the sum of (A) the Federal short-term rate determined under subsection (b), plus (B) 3 percentage points.

[11] There is an exception in a case where an individual establishes an annualized income installment is less than otherwise required annual payment.

2. Required Annual Payment.

a. The term "*required annual payment*" means the lesser of

(1) Ninety (90%) percent of the tax shown on the return for the taxable year (or, if no return is filed, ninety (90%) percent of the tax for such year), or

(2) One-hundred (100%) percent of the tax shown on the return of the individual for the preceding taxable year.

b. Clause (2) above, does not apply if the preceding taxable year was not a taxable year of 12 months or if the individual did not file a return for such preceding taxable year.

3. Limitation on Use of Preceding Year's Tax.

a. In general. If the adjusted gross income shown on the return of the individual for the preceding taxable year beginning in any calendar year exceeds $150,000, the required annual payment is determined by substituting the *"applicable percentage"* for "100 percent".

b. For purposes of the preceding sentence, the *applicable percentage* is determined in accordance with the following table:

If the preceding taxable year begins in:	*The applicable percentage is :*
1998	105%
1999	108.6%
2000	110%
2001	112%
2002 or thereafter	110%

c. This rule *does not apply* in the case of a preceding taxable year beginning in calendar year 1997.

4. Separate Returns.

In the case of a married individual who files a separate return for the taxable year for which the amount of the installment is being determined, subparagraph 3a will be applied by substituting "$75,000" for "$150,000".

H. Special Rules.

1. Annualization. The taxable income, alternative minimum taxable income, and adjusted self-employment income will be placed on an annualized basis under regulations prescribed by the Secretary.

2. Applicable percentage. In the case of the following required installments: The applicable percentage is:

1st	22.5%
2nd	45%
3rd	67.5%
4th	90%

3. Adjusted self-employment income. The term *“adjusted self-employment income”* means *“self-employment income*” as defined in section 1402(b); except that section 1402(b) shall be applied by placing *“wages” (within the meaning of section 1402(b))* for months in the taxable year ending before the due date for the installment on an annualized basis consistent with the above.

I. Exceptions.

1. Where tax is small amount.

No penalty addition to tax will be imposed if the tax shown on the return for such taxable year (or, if no return is filed, the tax), is less than $1,000.

2. Where no tax liability for preceding taxable year.

No penalty is imposed for any taxable year if—(i) the preceding taxable year was a taxable year of 12 months, (ii) the individual did not have any liability for tax for the preceding taxable year, and (iii) the individual was a citizen or resident of the United States throughout the preceding taxable year.

3. Waiver in certain cases.

a. In general. No penalty is imposed with respect to any underpayment to the extent the Secretary determines that by reason of casualty, disaster, or other unusual circumstances the imposition of such addition to tax would be against equity and good conscience.

b. Newly retired or disabled individuals. No penalty is imposed with respect to any underpayment if the Secretary determines that—(i) the taxpayer (a) retired after having attained age 62, or (b) became disabled in the taxable year for which estimated payments were required to be made or in the taxable year preceding such taxable year, and (ii) such underpayment was due to reasonable cause and not to willful neglect.

IV. Tax computed after application of credits against tax.

For purposes of § 6621(a)(2), the term “tax” means: (i) the normal income taxes and surtaxes; plus (ii) the self-employment tax; plus (iii) the unearned income Medicare contribution; minus (iv) the credits against those taxes (other than the credit relating to tax withheld on wages).

V. Application in Case of Tax withheld on Wages.

A. In general.

For purposes of applying § 6621(a)(2), the amount of the credit for tax withheld on wages for the taxable year will be deemed a payment of estimated tax, and an equal part of such amount will be deemed paid on each due date for such taxable year, unless the taxpayer establishes the dates on which all amounts were actually withheld, in which case the amounts so withheld will be deemed payments of estimated tax on the dates on which such amounts were actually withheld.

B. Separate application.

The taxpayer may apply paragraph V. A., above separately with respect to—(i) wage withholding, and (ii) all other amounts withheld for which credit is allowed under section 31.

VI. Special Rule where return filed on or before January 31.

If, on or before January 31 of the following taxable year, the taxpayer files a return for the taxable year and pays in full the amount computed on the return as payable, then no penalty is imposed with respect to any underpayment of the 4th required installment for the taxable year.

VII. Special Rules for Farmers and Fishermen.

A. In general.

1. If an individual is a “*farmer*” or *“fisherman”* for any taxable year only one installment is required for the year,

2. The due date for the installment is January 15 of the following taxable year,

3. The amount of the installment is equal to the required annual payment determined under paragraph IIIG2 (a)(1), above by substituting “66 2/3 percent” for “90 percent” and without regard to limitation on the use of the preceding year’s tax as provided in IRC § 6654 (d)(1)(C) will be applied—(i) by substituting “March 1” for “January 31”, and (ii) by treating the required installment as the 4th required installment.

B. Farmer or fisherman defined.

An individual is a “*farmer”* or *“fisherman*” for any taxable year if:

1. The individual's gross income from farming or fishing (including oyster farming) for the taxable year is at least 66 2/3 percent of the total gross income from all sources for the taxable year, or

2. Such individual's gross income from farming or fishing (including oyster farming) shown on the return of the individual for the preceding taxable year is at least 66 2/3 percent of the total gross income from all sources shown on such return.

VII. Special Rules for Nonresident Aliens.

A. Overview - In the case of a nonresident alien, there are three required installments for the taxable year.

B. Time for payment of installments. The due dates for required installments under this subsection will be determined under the following table:

1st	June 15
2nd	September 15
3rd	January 15

C. Amount of required installments.

1. First required installment. In the case of the first required installment, paragraph III.G.1., will be applied by substituting “50 percent” for “25 percent”.

2. Determination of applicable percentage. The “applicable percentage” for purpose of paragraph III.H.2., will be determined under the following table: In the case of the following required installments:

1st	45%
2nd	67%
3rd	90%

VIII. Fiscal years and Short years.

A. Fiscal years.

In applying this section to a taxable year beginning on any date other than January 1, there will be substituted, for the months specified in this section, the months which correspond thereto.

B. Short taxable year.

This section will be applied to taxable years of less than 12 months in accordance with regulations prescribed by the Secretary.

X. Estates and Trusts.

A. In general. With certain exceptions, estimated tax payments will also be required of estates and trusts.

B. Exception for estates and certain trusts. With respect to any taxable year ending before the date 2 years after the date of the decedent's death, estimated payments will not be required of: (i) the estate of such decedent, or (ii) any trust—all of which was treated as owned by the decedent, and to which the residue of the decedent's will pass under his will (or, if no will is admitted to probate, which is the trust primarily responsible for paying debts, taxes, and expenses of administration).

C. Exception for charitable trusts and private foundations. This section will not apply to any trust which is subject to the tax on unrelated business income imposed by section 511 or which is a private foundation.

XI. Special rule for Medicare tax.

For purposes of this section, the additional Medicare tax imposed under section 3101(b)(2) (to the extent not withheld) will be treated as the self-employment tax imposed under chapter 2 of the IRC .

XII. Interest.

A. Interest is typically added to any unpaid tax from the time that the payment of tax was due until the date the tax is paid. Interest rates are set by the IRS every three months. Currently, the IRS interest rate for underpayments of tax is 4% per year (IR-2016-159).

B. The interest is calculated for each day the taxpayer's balance due is not paid in full. Interest is assessed on the unpaid amount of tax plus any late filing or late payment penalties. (IRC § 6601.)

Unit 1 Quizzer-

1. In the case of the failure to pay penalty, which of the following is a true statement?

A The penalty is one-half of one (0.5%) percent of the amount of the tax due if the failure is for not more than 1 month.

Correct. The penalty is one-half of one (0.5%) percent of the amount of the tax due if the failure is for not more than 1 month with an additional one-half of one (0.5%) percent for each additional month or fraction thereof during which such failure continues.

B The penalty is abated if the taxpayer files their tax return on a timely basis.

Incorrect. The penalty will be incurred if the tax is not paid even if the tax return is filed timely.

C The penalty cannot exceed forty-five (45%) percent.

Incorrect. The penalty cannot exceed twenty-five (25%) percent

D The penalty applies even if the failure is shown to be due to reasonable cause and not due to willful neglect.-

Incorrect. The penalty does not apply if the failure is shown to be due to reasonable cause and not due to willful neglect.

UNIT TWO- Payment Options

Learning Objectives

After completing this Unit, you should be able to:

- ✓ Know the criteria for streamlined installment agreements vs. guaranteed installment agreements.
- ✓ Know the 3 reasons the IRS may accept an Offer in Compromise.
- ✓ Identify when a taxpayer can discharge a tax debt in bankruptcy.
- ✓ Identify the ways in which a spouse, or former spouse, may be relieved of tax, interest, and penalties on a joint tax return and the requirements for each.

Course Material

I. Ways to Pay Taxes

A. In order to minimize interest and penalties, it is a good idea for the taxpayer to pay their taxes in full.

B. However, if the taxpayer is unable to pay in full, the taxpayer has options including the following:

1. Installment Agreement
2. Offer in Compromise
3. Bankruptcy
4. Innocent Spouse Relief

II. Options for Paying in Full

A. Electronic Payments

1. Direct Pay

a. Direct Pay is a convenient, secure way to pay the taxpayer's individual tax bill or estimated tax payment directly from the taxpayer's checking or savings account at no cost to the taxpayer.

b. For more information, visit www.irs.gov/Payments/Direct-Pay .

2. Electronic Federal Tax Payment System (EFTPS).

a. Another electronic payment option is the Electronic Federal Tax Payment System (EFTPS).

b. To enroll, visit www.eftps.com or call 1-800-555-4477. For more information, see Publication 966, Electronic Choices to Pay All the taxpayer's Federal Taxes.

B. Pay by Credit Card

1. Pay with the taxpayer's credit or debit card

2. For a fee, the taxpayer can pay by credit or debit card by using an electronic payment service provider.

3. For more information on making payment using a credit or debit card, visit www.irs.gov/e-pay.

C. Pay by Mail or in Person at a Local IRS Office

The taxpayer can mail a check to the IRS at the address listed on the taxpayer's bill or bring it to the taxpayer's local IRS office. Make checks payable to the Department of the Treasury.

III. Options if the Taxpayer Can't Pay in Full Now

A. If the Taxpayer Needs More Time to Pay

1. Extensions Up to 120 Days

a. If the taxpayer cannot pay in full immediately, the IRS offers additional time, up to 120 days to pay in full.

b. There are, therefore, no forms to be filled out by the taxpayer. The IRS simply informs the taxpayer of these extensions (after a request by the taxpayer) either in person, by telephone, or by letter

c. For information on the additional extension of time up to 120 days, the taxpayer should call the IRS at 800-829-1040 (individuals) or 800-829-4933 (businesses), or use the Online Payment Agreement application on www.irs.gov.

d. There is no user fee for an extension request; however, interest and any applicable penalties will continue to accrue until the taxpayer's liability is paid in full.

e. Taxpayers who request and are granted an additional 120 days to pay the tax in full generally will pay less in penalties and interest than if the debt were repaid through an installment agreement over a greater period of time.

2. Reasonable cause exception to penalty for failure to pay tax.

Reasonable cause for failure to pay tax exists to the extent the taxpayer can satisfactorily show that he exercised ordinary business care and prudence in providing for the payment of his tax liability, but was nevertheless either unable to pay the tax or would have suffered "undue hardship" if he paid on the due date. "Undue hardship" has the same meaning as it has under the regs governing extensions of time to pay tax.

In determining whether the taxpayer was unable to pay the tax in spite of the exercise of ordinary business care and prudence in providing for payment of his tax liability, consideration is given to all the facts and circumstances of the taxpayer's financial situation, including the amount and nature of the taxpayer's expenditures in light of the income (or other amounts) he could reasonably have expected, at the time he made the expenditures, to receive before the tax payment due date.

For example, a taxpayer may incur lavish or extravagant living expenses to such an extent that the remainder of his assets and anticipated income would be insufficient to pay his tax. Such a taxpayer is not considered to have exercised ordinary business care and prudence in providing for the payment of his tax liability.

Also, a taxpayer who invested funds in speculative or “illiquid” assets isn't considered to have exercised ordinary business care and prudence in providing for the payment of his tax liability unless, at the time of the investment, the remainder of the taxpayer's assets and estimated income were sufficient to pay his tax or it could be reasonably foreseen that the speculative or “illiquid” investments made by the taxpayer could be utilized (by sale or as security for a loan) to realize enough funds to satisfy the tax liability.

A taxpayer is considered to have exercised ordinary business care and prudence if he made reasonable efforts to conserve sufficient assets in marketable form to satisfy his tax liability but was unable to pay all or part of the tax when it became due. 39

Thus, there was no reasonable cause where a taxpayer had sufficient assets (a brokerage account and stock) to pay his tax and blamed his failure to timely pay on the illiquidity of his assets. This illiquidity was a result of voluntary investment decisions.39.1

Consideration is given to the nature of the tax which the taxpayer has failed to pay. For example, what constitutes reasonable cause for nonpayment of a taxpayer's own income taxes may not constitute reasonable cause for his failure to pay over taxes collected or withheld from another. 40

A taxpayer could not claim that he had a reasonable excuse for failure to pay the tax because he made an offer in compromise, where the offer didn't meet IRS requirements. 42

Except where the return filing extension rules in ¶ V-1681 apply, a taxpayer who wishes to avoid the penalty must make an affirmative showing of all facts alleged as a reasonable cause in the form of a written statement containing a declaration that it is made under penalties of perjury. The statement should be filed with the IRS officer with whom the return must be filed.

Summary judgment imposing the penalty was appropriate where the taxpayer (T) wrote bad checks to IRS, even though he argued that one bank's failure to contact him about the insufficiency of the funds and a delay in a wire transfer to the other bank from his brokerage firm provided him with reasonable cause for the delay in payment. The facts as alleged by T could not establish reasonable cause, because T did not show that he was unable to pay his taxes on time or would have suffered undue hardship by paying (footnote 39, above). T, seeking to keep his money in securities until the last minute, took a calculated risk that he could cover the checks. 44.2

Summary judgment imposing the penalty was also appropriate where taxpayers timely sent IRS a check for $179,501 for their taxes, but the check was underencoded and IRS received only $179.50. There was no evidence of financial hardship or an inability to pay at the time the taxes were due, so there was no reasonable cause for the taxpayers' failure to write a check for the unpaid balance. There were sufficient funds in the taxpayers' account when they discovered that the check had been improperly processed, and they were required to make full payment once they discovered the error. The district court termed the taxpayers' decision to spend their resources on other matters after they became aware of the insufficient payment, "reckless indifference" or "intentional failure."44.3

2. Undue Hardship

a. Under Reg. Sec. 1.6161-1(a), a qualifying individual may request an extension of time to pay and have late payment penalties waived as part of the IRS Fresh Start initiative, due to "undue hardship".

b. The term "undue hardship" means more than an inconvenience. The taxpayer must show that he or she will have a substantial financial loss (such as selling property at a sacrifice price) if they pay their tax on the date it is due. If a market exists, the sale of property at the current market price is not ordinarily considered as resulting in an undue hardship.

c. To qualify the taxpayer must file Form 1127, Application for Extension of Time for Payment of Tax Due to Undue Hardship, by the due date of the tax return.

d. Such application shall also be accompanied by a statement of the assets and liabilities of the taxpayer and an itemized statement showing all receipts and disbursements for each of the 3 months immediately preceding the due date of the amount to which the application relates.

e. An extension of more than 6 months generally will not be granted to pay the tax shown on a return, unless the taxpayer is out of the country.

f. An extension to pay an amount determined as a deficiency is generally limited to 18 months from the date payment is due.

g. However, in exceptional circumstances, an additional 12 months may be granted.

Note. An extension to pay a deficiency will not be granted if the deficiency is due to negligence, intentional disregard of rules and regulations, or fraud with intent to evade tax.

h. The taxpayer must pay the tax before the extension runs out, and should not wait to receive a bill from the IRS.

3. Currently Not Collectible

a. If the taxpayer can't pay any of the amount due because payment would prevent the taxpayer from meeting basic living expenses, the taxpayer can request that the IRS delay collection as currently not collectible ("CNC") until the taxpayer is able to pay.

b. The IRS will determine whether the taxpayer qualifies as CNC based the taxpayer's assets and equity, income and expenses:

(1) A hardship exists if a taxpayer is unable to pay reasonable basic living expenses.

(2) The basis for a hardship determination is from information about the taxpayer's financial condition provided on Form 433–A, *Collection Information Statement for Wage Earners and Self-Employed Individuals* or Form 433–B, *Collection Information Statement for Businesses*.

(3) Generally, these cases involve no income or assets, no equity in assets or insufficient income to make any payment without causing hardship.

(4) An account generally will not be considered as CNC if the taxpayer has income or equity in assets, and enforced collection of the income or assets would not cause hardship.

c. Be aware that in many cases as part of agreeing to place an account in CNC, the IRS may file a Notice of Federal Tax Lien. This is more likely to be done for cases with a balance due over $10,000.

d. Upon a determination of CNC status, the Service will however immediately release any levies on wages or salary.

e. Please remember that even if the IRS delays collection, the IRS will still charge applicable penalties and interest until the taxpayer pays the full amount, and the IRS may file a Notice of Federal Tax Lien.

f. In most cases, the IRS will not cease collection action until the taxpayer is in compliance; i.e., the taxpayer must file any missing tax returns and must address any ongoing underpayment situation.

g. For example, if the reason the taxpayer owes delinquent taxes is because the taxpayer does not have sufficient income tax withheld from his or her paycheck, the IRS will not close the case as CNC (and will not suspend enforced collection action) until the taxpayer adjusts his or her withholding.

h. If the IRS allows a case to be closed CNC, the case will usually automatically be re-opened and returned to active collection status if the taxpayer fails to file a tax return in the future, accrues a new tax liability, or the taxpayer's financial situation changes sufficiently to allow payments to be made against the back tax debt. For example, when the IRS closes a case CNC, they close it CNC at $35,000. If the taxpayer's annual income exceeds $35,000 in the future, the case will be reactivated and sent back to collection.

i. Also, in some cases, the IRS places a follow-up date on any particular case. When that date arrives, the IRS reactivates the case and sends it back to collection. For example, the IRS may close a case CNC with a two year follow-up. After two years, regardless of any other fact, the case is sent back to collection.

j. Be aware that CNC status is usually a temporary solution; the tax is not forgiven or compromised, and interest and penalties continue to accrue.

4. <u>How Long the IRS has to Collect Taxes</u>

a. The IRS can attempt to collect the taxpayer's taxes up to 10 years from the date they were assessed.

b. However, there are ways this time period can be suspended. For example, by law, the time to collect may be suspended while:

(1) The IRS is considering the taxpayer's request for an Installment Agreement or Offer in Compromise. If the taxpayer's request is rejected, the IRS will suspend collection for another 30 days, and during any period the Appeals Office is considering the taxpayer's appeal request.

(2) The taxpayer lives outside the U.S. continuously for at least 6 months. Collection is suspended while the taxpayer is outside the U.S.

(3) The tax periods the IRS is collecting on are included in a bankruptcy with an automatic stay. The IRS will suspend collection for the time period the IRS can't collect because of the automatic stay, plus 6 months.

(4) The taxpayer requests a Collection Due Process hearing. Collection will be suspended from the date of the taxpayer's request until a Notice of Determination is issued or the Tax Court's decision is final.

(5) The IRS is considering the taxpayer's request for Innocent Spouse Relief. Collection will be suspended from the date of the taxpayer's request until 90 days after a Notice of Determination is issued, or if the taxpayer files timely petition to the Tax Court, until 60 days after the Tax Court's final decision.

(6) If the taxpayer appeals the Tax Court's decision to a U.S. Court of Appeals, the collection period will begin 60 days after the appeal is filed, unless a bond is posted.

B. Installment Agreements

1. Overview

a. Under §6159, a taxpayer that cannot timely pay the full amount of taxes due may be allowed to pay the taxes in installments

b. An installment agreement with the IRS means that the IRS will allow the taxpayer to make smaller periodic payments over time if the taxpayer can't pay the full amount at once.

2. Guaranteed Installment Agreement.

a. The taxpayer is eligible for a guaranteed installment agreement if

(1) The unpaid assessments the taxpayer owes is not more than $10,000;

(2) During the past 5 tax years, the taxpayer (and his or her spouse if filing a joint return) has timely filed all income tax returns and paid any income tax due, and has not entered into an installment agreement for payment of income tax;

(3) The taxpayer agrees to pay the full amount he or she owes within 3 years and to comply with the tax laws while the agreement is in effect; and

(4) The taxpayer is financially unable to pay the liability in full when due.

b. The unpaid balance of assessments includes tax, assessed penalty and interest, and all other assessments. It does not include accrued but unassessed penalty and interest.

c. It is the practice of the Internal Revenue Service to grant these installment agreements even if the taxpayer can pay their liability in full if the tax owed is not more than $10,000 and the taxpayer meets the other criteria.

3. Streamlined Installment Agreements

a. Streamlined installment agreements may be approved for taxpayers under the following circumstances:

(1) The aggregate unpaid balance of assessments is $50,000 or less.

(2) The minimum payment amount is determined by dividing the aggregate unpaid balance of assessments due by 72.

b. All tax returns that are due before entering into the agreement must have been filed.

c. The key advantages of a streamlined agreement are that they can be processed quickly. No financial disclosure or IRS managerial approval is needed.

d. Streamlined agreements are available even if the taxpayer can fully pay the liability.

e. A taxpayer owing more than $50,000 still may qualify for a streamlined agreement if they first pay the assessed amounts down to $50,000.

f. Streamlined installment agreements with a balance between $25,001 and $50,000 must be established as a Direct Debit or a Payroll Deduction.

4. Liability over $50,000

a. Applying for IRS Approval

(1) In order to apply for IRS approval of an installment agreement when the tax, the taxpayer must also file Form 9465, Installment Agreement Request, or by complete an application for on Online Payment Agreement through the IRS's website.

(2) In addition, to be eligible for an installment agreement:

(a) The taxpayer must file all required tax returns.

(b) Prior to approving the taxpayer’s Installment Agreement request, the IRS will generally ask the taxpayer to complete a Collection Information Statement (Form 433F, 433-A and/or Form 433-B) and provide proof of the taxpayer’s financial status.

(c) The taxpayer should have financial information available if the taxpayer applies over the phone or at an IRS office.

(3) The mere fact that a taxpayer may not be able to immediately pay a balance due does not automatically translate into an installment agreement. The IRS looks at the taxpayer's household income to determine the taxpayer's ability to pay. Though certain kinds of income may be partially exempt from levy, they are nevertheless included in the analysis of the taxpayer's financial condition

(4) The IRS will analyze the taxpayer's income and expenses to determine the amount of disposable income (gross income less all allowable expenses) available to apply to the tax liability, and also analyzes assets to resolve any balance due accounts.

(5) The IRS's policy is to request immediate payment if the taxpayer has cash equal to the total liability.

b. Six Year Rule

(1) If a taxpayer is unable to full pay immediately, the taxpayer still may qualify for the “six-year rule”, i.e., the IRS generally will allow the taxpayer to enter into an installment agreement and will allow all of the taxpayer's expenses if:

(A) the taxpayer establishes that he or she can stay current with all payment and filing requirements; (B) the tax liability, including projected accruals, can be fully paid within six years and within the collection statute of limitations, and (C) the expense amounts are reasonable.

(2) Taxpayers who cannot full pay their accounts within six years may be given up to one year to modify or eliminate excessive necessary expenses (i.e., the one-year rule). By modifying or eliminating some conditional expenses, a taxpayer may be able to full pay the liability plus accruals within the six-year limit.

5. Partial Payment Agreements.

a. The IRS may allow for an installment agreement that does not result in full payment.

b. Such an agreement is known as a Partial Payment Installment Agreement (PPIA)

c. Taxpayers who request a PPIA must provide a full Form 433 collection information statement.

(1) Only necessary expenses (discussed below) are allowed in determining the monthly payment amount.

(2) The IRS also will require the taxpayer to make a good faith effort to utilize equity in assets to reduce or fully pay the amount of the outstanding liability, and may request that assets be sold or that equity be borrowed against.

(3) However, complete utilization of equity is not always required as a condition of a PPIA (e.g., where the assets have minimal equity or the equity is insufficient to allow a creditor to loan funds)

d. If a taxpayer qualifies for a PPIA, the IRS will encourage the taxpayer to pay using the direct debit option.

e. A taxpayer that is granted a PPIA is subject to financial review every two years. If, as a result of this review, the IRS determines that the taxpayer's financial condition has improved, the IRS may request an increase in the amount of the installment payments or may terminate the agreement altogether.

6. IRS Determination

a. Approval - If the IRS approves the taxpayer’s request, the IRS will still charge applicable interest and penalties until the taxpayer pays the amount or balance due in full, and may file a Notice of Federal Tax Lien.

b. Rejection - If the IRS rejects the taxpayer’s installment agreement request, the taxpayer may request that the Office of Appeals review the taxpayer’s case. For more information, see Publication 1660, Collection Appeal Rights.

c. Modification and Termination of the Agreement

Once the installment agreement is executed, the IRS may not alter, modify, or terminate the agreement during its term unless:

(1) The information that the taxpayer provided to the IRS before entering into the agreement was inaccurate;

(2) The IRS determines that collection of the tax is in jeopardy;

(3) The taxpayer fails to pay an installment under the agreement, accrues additional tax liabilities or fails to provide the IRS with an updated statement of financial condition when requested to do so; or

(4) The IRS determines that the taxpayer's financial condition has significantly changed and sends notice of termination of the installment agreement at least 30 days before terminating or modifying the agreement.

7. Ways to Apply for an Installment Agreement

a. Apply Online

(1) Online, using the Online Payment Agreement application at http://www.irs.gov/Individuals/Online-Payment-Agreement-Application.

(a) Apply online if the taxpayer owes $50,000 or less in the combined balance total of individual income tax, penalties and interest.

(b) If the taxpayer owns a business and owes $25,000 or less in combined payroll taxes, penalty and interest for the current and prior calendar year, the taxpayer can also use the Online Payment Agreement to request a payment agreement.

(2) To view an instructional video on the Online Payment Agreement application, visit http://www.irsvideos.gov/Individual/PayingTaxes/OPA.

b. Apply by Phone

Apply by calling the number on the taxpayer's bill or 1-800-829-1040.

c. Apply by Mail

(1) Complete Form 9465, Installment Agreement Request.

(2) In addition to Form 9465, if the taxpayer wants to make the taxpayer's payments by payroll deduction, complete Form 2159, Payroll Deduction Agreement.

(3) If the taxpayer owes more than $50,000, the taxpayer will also need to complete Form 433F, Collection Information Statement. Mail the taxpayer's form to the address on the taxpayer's bill.

d. Apply In Person at the Taxpayer's Local IRS Office Near the Taxpayer,

(1) Visit www.irs.gov/localcontacts to locate an office.

(2) If the taxpayer requests a payment plan, the taxpayer can reduce the accrual of penalties and interest by making voluntary payments according to the proposed plan's terms until the taxpayer is notified whether the IRS accepted the taxpayer's payment plan request.

(a) The IRS's acceptance of the taxpayer's interim payments doesn't mean the IRS approved the taxpayer's request.

(b) The IRS will notify the taxpayer in writing once the IRS has made their decision.

8. Payment Options.

a. With an Installment Agreement, the taxpayer can pay by direct debit, through payroll deductions, electronic funds transfer or check.

b. There's a user fee for Installment Agreements.

c. If the taxpayer meets the IRS's low-income guidelines, the taxpayer can pay a reduced user fee. For more information, see Form 13844, Application for Reduced User Fee for Installment Agreements.

d. The taxpayer does not need to submit the user fee for an installment agreement with the application. The fee can be taken from the initial payments made once the installment agreement is accepted.

e. If the taxpayer is unable to meet the terms of the taxpayer's approved Installment Agreement, the taxpayer should contact the IRS immediately.

9. Effect of Installment Agreement on Collection Activity

(a) The IRS may not levy:

(1) During the period that a request for an installment agreement is pending;

(2) During the 30-day period following rejection of the request;

(3) During the period that an installment agreement is in effect;

(4) During the 30-day period following termination of an agreement; and

(5) If such rejection or termination is appealed, during the period the appeal is pending.

(b) The collection statute of limitations is suspended by operation of law while the installment agreement is requested, under consideration, terminated, or appealed.

(c) The statute of limitations is only extended while an installment agreement is actually in effect to the extent the taxpayer and the IRS enter into a separate written waiver of the statute of limitations

C. Offer in Compromise

1. Overview –

a. The taxpayer may be eligible for an Offer in Compromise if the taxpayer can't pay the amount the taxpayer owes in full or through installments.

b. By requesting an Offer in Compromise, the taxpayer is asking to settle unpaid taxes for less than the full amount the taxpayer owes, based upon the taxpayer's reasonable collection potential ("RCP"),

2. IRS Acceptance - The IRS may accept an Offer in Compromise if:

a. The IRS agrees that the taxpayer's tax debt may not be accurate ("Doubt of Liability"),

b. The taxpayer has insufficient assets and income to pay the amount due ("Doubt of Collectability'), or

c. Because of the taxpayer's exceptional circumstances, paying the amount due would cause an economic hardship or would be unjust ("Promotes Effective Tax Administration").

3. Application Fee - For an Offer in Compromise to be considered, the taxpayer must pay an application fee and make an initial or periodic payment.

a. However, low income taxpayers may qualify for a waiver of the application fee and initial or periodic payment. For more information, please see the Low Income Certification on Form 656, Offer in Compromise.

b. This form is contained in Form 656-B, Offer in Compromise Booklet.

c. The taxpayer can use the Offer in Compromise Pre-Qualifier tool at http://irs.treasury.gov/oic_pre_qualifier/ to explore the possibility that the Offer in Compromise program may be a realistic option to resolve the taxpayer's balance due.

4. Pre-qualification - In order to pre-qualify the taxpayer must:

a. Not be involved in an open bankruptcy proceeding;

b. Have filed all required federal tax returns;

c. Have made all required estimated payments; and

d. If self-employed and has employees, has the taxpayer submitted all required federal tax deposits?

5. Application - To apply for an Offer in Compromise, the taxpayer completes one of the following forms:

a. Form 656-L, Offer in Compromise (Doubt as to Liability) Complete this form if the taxpayer think the taxpayer's tax debt isn't accurate.

b. Form 656, Offer in Compromise Complete this form if the taxpayer is unable to pay the amount due, or has an economic hardship, or has another special circumstance that would cause paying the amount due to be unjust.

c. For more information, see Form 656-B, Offer in Compromise Booklet or visit www.irs.gov/Individuals/Offer-in-Compromise-1.

6. Determination of an Acceptable Offer Based on Doubt of Collectability

a. Overview

(1) The IRS will consider an offer based on Doubt of Collectability.

(2) In determining whether an offer made by the taxpayer is acceptable, the IRS will attempt to access the reasonable collection potential ("RCP") of the taxpayer.

(3) The IRS will not consider offers in compromise for unassessed taxes where no return has been filed. If a return has been filed, the IRS will consider a compromise.

(4) However, before an offer in compromise can be accepted, the taxes should be assessed. When spouses are jointly and severally liable for an assessed tax, the taxpayers may submit one joint offer or individual offers.

(5) When separate offers are submitted and there are jointly held assets, the IRS will carefully review state law to determine each taxpayer's interest in the asset.

b. Determination of Reasonable Collection Potential

A taxpayer's "reasonable collection potential" ("RCP") is based on the following formula:

SETTLEMENT AMOUNT = THE NET REALIZABLE EQUITY OF THE TAXPAYER'S ASSETS + THE AMOUNT WHICH CAN BE COLLECTED FROM FUTURE INCOME

c. Net Realizable Equity of Assets

(1) Valuing Real Property and Personal Property

In determining "net realizable equity"("NRE"), a taxpayer is generally permitted to use "quick sale value" ("QSV") for real property and personal assets.

(a) QSV is defined as an estimate of the price a seller could get for the asset in a situation where financial pressures motivate the owner to sell in a short period of time, usually 90 calendar days or less.

(b) Generally, QSV is an amount less than fair market value ("FMV"), reduced by amounts owed to secured lien holders with priority over the federal tax lien, if applicable and applicable exemption amounts

(c) Normally, QSV is calculated at 80% of FMV.

(i) A higher or lower percentage may be applied in determining QSV when appropriate, depending on the type of asset and current market conditions.

(ii) If, based on the current market and area economic conditions, it is believed that the property would quickly sell at full FMV, it may be appropriate to consider QSV to be the same as FMV.

(iii) This is occasionally found to be true in real estate markets where real estate is selling quickly at or above the listing price.

(iv) As long as the value chosen represents a fair estimate of the price a seller could get for the asset in a situation where the asset must be sold quickly (usually 90 calendar days or less) then it would be appropriate to use a percentage other than 80%.

(d) When a particular asset has been sold (or a sale is pending) in order to fund the offer, no reduction for QSV should be made.

(3) Valuing other Assets

(a) In valuing an Individual Retirement Account or §401(k) plan, the IRS allows the taxes and early withdrawal penalty that would be due on the distribution to be subtracted in determining the net realizable equity if the taxpayers are using the plan funds to pay the offer in compromise.

(b) A qualified profit sharing plan, pension plan or defined benefit plan will be treated as having a zero value for purposes of the offer if the taxpayer has no current right to withdraw funds from the plan.341

(c) The cash value of a whole life insurance policy also must be considered in the equity calculation.

(d) In determining the value of property owned in joint tenancy with a non-liable taxpayer, only the taxpayer's interest is included in the value of the taxpayer's net equity.

(e) The IRS normally averages the ending balance in the taxpayer's bank accounts for at least three months to determine the bank balance amount for equity purposes.

(f) A $3,450 exclusion may apply to a vehicle used for work, the production of income, or and/or the welfare of the taxpayer's family. A taxpayer who files jointly may claim the exclusion on two vehicles.

(g) Special rules may apply to income-producing assets and dissipated assets.

(4) Third Party Sources

For purposes of determining the taxpayer's reasonable collection potential ("RCP"), information provided by the taxpayer and third party sources available to the IRS should be reviewed to arrive at an appropriate FMV of the property.

d. Future Income Factor

(1) In General.

(a) The amount to be collected from future income is calculated by taking the projected *gross monthly income*, less *allowable expenses*, and multiplying the difference by the number of months applicable to the terms of offer.

(b) "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. The number of months used depends on the payment terms of the offer.

(2) Payment Period. The deferred payment option which allows payment over the life of the statute is no longer available.

(a) With implementation of the 12 and 24 month multipliers, the maximum number of months for a periodic payment offer cannot exceed 24 months.

(b) For lump sum cash and periodic payment offers, when there are less than 12 or 24 months remaining on the statutory period for collection, use the number of months remaining on the statutory period for collection.

(3) Gross Monthly Income

According to IRS issued guidance provided in the IRM addressing future income determinations in OIC cases.

(a) Taxpayer's current income generally will be used in the analysis of future ability to pay, but consideration should be given to the taxpayer's overall general situation, including such factors as age, health, marital status, number and age of dependents, level of education or occupational training, and work experience.

(b) The IRM states that there are situations that may warrant placing a different value on future income than on current or past income such as where income will increase or decrease, or current necessary expenses will increase or decrease.

(c) Other situations may include where a taxpayer: (i) is temporarily or recently unemployed or underemployed; (ii) is unemployed and not expected to return to a previous occupation or previous level of earnings; (iii) is long-term unemployed; (iv) is long-term under-employed; (v) has an irregular employment history or fluctuating income; (vi) is in poor health and the ability to continue working is questionable; (vii) is close to retirement and has indicated he or she will be retiring; or (viii) will file for bankruptcy.

(4) <u>Allowable Expenses</u>

There are three types of allowable expenses: (i) “allowable living expenses”, (ii) “other necessary” expenses, and (iii) “other conditional” expenses.

(a) In determining allowable living expenses the amount shown in the expense standard schedules is used unless that amount would result in the taxpayer not having adequate means to provide for basic living expenses.

(b) National and Local Expense standards serve as guidelines to provide accuracy and consistency in determining a taxpayer's basic living expenses. The standards are available on the IRS web site and are periodically updated.

(c) Taxpayers are allowed the National Standard Expense amount for their family size, without questioning the amount actually spent. If the total amount claimed is more than the total allowed by the National Standards, the taxpayer must provide documentation to substantiate and justify that the allowed expenses are inadequate to provide basic living expenses. All deviations from the national standards must be verified, reasonable and documented in the case history.

(d) A “necessary expense” is one that is necessary for the production of income or for the health and welfare of the taxpayer's family. Such expenses are normally allowed.

(e) A “conditional expenses” is an expense, which may not meet the necessary expense test, but may be allowable, based on the circumstances of an individual case. These expenses may be allowed when the tax will be paid in full by an installment agreement within 6 years. For offer purposes, the full amount of the tax will not be collected, therefore, the rules for conditional expenses do not apply.

(f) The one year rule which allows time for a taxpayer to adjust current expenses to meet the terms of an installment agreement is not allowed for Offers in Compromise.

(5) Special Rules for Third Party Assets and Income

(a) In reviewing the offer in compromise, the IRS makes a determination as to what is an acceptable offer amount by looking at the amounts that can be collected from other parties (e.g., transferee liability).

(b) The IRS also considers assets and income that are available to the taxpayer but beyond the reach of the government (e.g., certain tenancy by the entirety property.

(c) In this instance, the IRS usually will not include the nonliable spouse's earnings in the income and expense analysis of the liable taxpayer.

(d) Instead, the taxpayer's share of expenses is determined based upon actual sums expended where proven or upon pro rata share of expenses based on the taxpayer's percentage of total household income.

(6) The Amount of the Offer

(a) If the offer will be paid in 5 months or less and 5 or fewer payments, the amount of an acceptable offer must equal: (i) the realizable value of assets, plus (ii) the amount that could be collected in 12 months.

(b) If the offer is payable in six to 24 months the amount of an acceptable offer must equal (i) the realizable value of assets, plus (ii) the amount that could be collected in 24 months.

7. Submitting the Offer

The offer-in-compromise must be submitted on Form 656 or Form 656-L and may include a detailed statement in support of the offer.

Form 433-A (Collection Information Statement for Wage Earners and Self-Employed Individuals),370 and/or Form 433-B (Collection Information Statement for Businesses) must be attached if the basis of the offer is doubt as to collectibility or effective tax administration.

There are two different fee/deposit requirements for offers in compromise. First, the IRS imposes a $186 user fee for the handling of offers in compromise that it has accepted for processing on or after January 1, 2014.372 This fee does not apply to offers based on doubt as to liability or offers made by certain low-income taxpayers. In addition, if the IRS accepts an offer based on economic hardship or to promote effective tax administration, the user fee is applied against the amount of the offer or, if the taxpayer requests, refunded to the taxpayer

Second, a nonrefundable advance payment is required:

• If the offer is a lump-sum cash offer or a deferred payment offer with five or fewer payments, a deposit of 20% of the total offer amount must be submitted when Form 656 is filed.

• For deferred payment offers with more than five monthly payments, the proposed payments must begin when Form 656 is submitted and continue while the offer is being considered.

Offers that do not comply with the advance payment requirements may be returned as unprocessable.374 An advance payment will be applied against the offer amount if the offer is accepted, but will not be refunded if the offer is rejected.375 The taxpayer can designate the advance payment to be applied to a specific portion of the outstanding liability.

the offer is submitted on the proper version of Form 656;376.1

• the taxpayer is not in bankruptcy;

• the taxpayer is properly identified (the taxpayer's full name, address, social security number and/or employer identification number must be entered in the designated blocks);377

• the liability is properly identified;

• the amount and terms of payment are properly stated;

• the taxpayer signs the offer;

• a detailed statement and supporting documentation is submitted supporting the request to compromise the liability;

• the user fee of $186 ($150 for offers accepted for processing before January 1, 2014) is paid (if required);

• the advance payment is made (if required).378

All of the other items listed above are required, however, as well as the following additional items:

• completed collection information statements (Forms 433-A and/or 433-B);

documentation that supports current income and living expenses;

• documentation that details and supports asset values and related encumbrances (e.g., real estate appraisals, dates and amounts of encumbrances, descriptions of vehicles with mileage and accessories listed);

• an optional written statement which explains (1) why the IRS cannot collect more than is being offered; (2) the taxpayer's current and future income prospects, educational background and work experience, health; and/or (3) other factors which may impact on collection potential; and

• if the taxpayer has assets or income that are not available to the IRS, an explanation as to why the IRS cannot expect some portion of these assets or income to be paid to the IRS if the IRS compromises the tax liability.

The IRS does not tell the taxpayer what amount to offer. Instead, the taxpayer is responsible for initiating the first specific proposal for compromise. Still, the proposed offer should not be used as a “fishing expedition.” It should be a legitimate compromise proposal based on the taxpayer's ability to pay.379 In addition to the forms, the IRS may request certain information to verify the taxpayer's ability to pay (e.g., bank statements, income records, etc.). The sooner these records are made available, the quicker the IRS can make a decision.

The IRS may not issue a levy while a taxpayer's offer in compromise is pending unless it determines that collection of the liability is in jeopardy.385 An offer in compromise is pending once the IRS accepts the offer in compromise for processing.386 On this date the IRS will issue an initial processability letter. The issuance of the processability letter does not constitute an acceptance of the offer in compromise. An offer is no longer pending for levy purposes once the offer is rejected. A levy cannot be issued during the 30-day period following the rejection of an offer in compromise or, if a timely appeal is filed, while the appeal is pending

Submission of an offer in compromise extends the 10-year collection statute of limitations when Form 656 is countersigned by the IRS. This occurrence is actually a suspension of the statute of limitations resulting by operation of law.389 For offers filed before March 10, 2002, the effect of the offer on the statute of limitations on collection need

The IRS has specific guidelines to follow in determining the adequacy of an offer in compromise.395 To ensure uniformity in the treatment of taxpayers, §7122(d)(2) requires the IRS to use the schedules of national and local allowances (previously discussed above) so that taxpayers have an adequate means to provide for basic living expenses.396 However, the IRS cannot use the schedules to the extent they would result in the taxpayer not having adequate means to provide for basic living expenses, based on the taxpayer's particular situation and needs.397

Merely submitting an offer does not constitute acceptance. The offer is not considered accepted until: (1) the appropriate delegation official approves the offer's acceptance; and (2) the IRS notifies the taxpayer by letter that the offer has been accepted

Acceptable Payment Terms

a. Payment terms are negotiable, but should provide for payment of the offered amount in the least time possible. If a taxpayer is planning to sell asset(s) to fund all or a portion of the offer, the payment terms for the offer should provide for immediate payment of the amounts received from the sale.

b. If the taxpayer is planning to borrow a portion of the money, the OE/OS should determine when the loan will be received and the payment terms of the offer should provide for payment of the borrowed portion at the time the funds are received.

c. For those taxpayers who agree to shorter payment terms, fewer months of future income are required:

Payment Type	Payment Terms	Number of Months Future Income Required
Lump Sum Cash	5 or less installments within 5 months	12 months or the remaining statutory period, whichever is less
Periodic Payment	Within 6 to 24 months	24 months or the remaining statutory period, whichever is less

d. While a periodic payment offer is being evaluated by the Service, the taxpayer must make subsequent proposed installment payments as they become due. There is no requirement that the payments be made monthly or in equal amounts. However, the Service is not bound by either the offer amount or the terms.

e. While the calculation of RCP and consideration of any special circumstances will assist in determining an acceptable offer amount, in situations where the OE/OS determines that the proposed offer payment terms are too protracted to recommend acceptance, the OE/OS should discuss with the taxpayer what may be appropriate payment terms based on the taxpayer's circumstances.

Example: A taxpayer submits an offer for $10,000. The IRS received date is January 1, 2011. The taxpayer's offer of $10,000 was accepted in November 2011, and the taxpayer remained current on all required payments during the investigation. During *the investigation, the taxpayer paid $500. The taxpayer has 24 months from the date of submission to complete the terms of the offer. The terms of the offer were $100 every other month for a total of 23 months and the balance would be due on the 24th month. On the 24th month, January 2013, the taxpayer would then be required to pay the balance of $8,300 ($10,000 less $1,700 [$1,200 in installments plus $500 in installments paid during the investigation]). No adjustments to the terms would be required.*

f. A third party source of funds may be required to make the portion of the monthly payment that is greater than the IRS determines the taxpayer can afford from future income.

In addition to the amount offered, the IRS may require the execution of a collateral agreement before accepting an offer.419 A collateral agreement provides the government additional benefits in addition to the dollar amount actually secured via the offer, thereby allowing the IRS to recoup part or all of the difference between the amount of the offer and the liability compromised

D. Bankruptcy

1. When is a Tax Debt Dischargeable in Bankruptcy

A taxpayer can discharge debts for federal income taxes in Chapter 7 bankruptcy only if *all* of the following conditions are true:

a. The taxes are "income taxes"- Taxes other than income, such as payroll taxes or fraud penalties, can never be eliminated in bankruptcy.

b. The taxpayer did not commit fraud or willful evasion - If the taxpayer filed a fraudulent tax return or otherwise willfully attempted to evade paying taxes, such as using a false Social Security number on the Taxpayer's tax return, bankruptcy can't help.

c. The debt is at least three years old - To eliminate a tax debt, the tax return must have been originally due at least three years before the taxpayer filed for bankruptcy.

d. The taxpayer filed a tax return.

(1) The taxpayer must have filed a tax return for the debt the taxpayer wishes to discharge at least two years before filing for bankruptcy.

(2) If the IRS filed a substitute return on the taxpayer's behalf, the taxpayer has not filed a "return" and cannot discharge the tax. In some courts, the taxpayer can discharge tax debt that is the subject of a late return as long as the taxpayer meets the other criteria.

e. The taxpayer passes the "240-day rule."

(1) The income tax debt must have been assessed by the IRS at least 240 days before the taxpayer files the taxpayer's bankruptcy petition, or must not have been assessed yet.

(2) This time limit may be extended if the IRS suspended collection activity because of an offer in compromise or a previous bankruptcy filing.

2. The Taxpayer Can't Discharge a Federal Tax Lien

a. Even if the taxpayer's taxes qualify for discharge in a Chapter 7 bankruptcy case, bankruptcy will not wipe out prior recorded tax liens.

b. A Chapter 7 bankruptcy will wipe out the taxpayer's personal obligation to pay the debt, and prevent the IRS from going after the taxpayer's bank account or wages, but if the IRS recorded a tax lien on the taxpayer's property before the taxpayer filed for bankruptcy, the lien will remain on the property. This means the taxpayer will have to pay off the tax lien in order to sell the property.

3. Relief from Collection Activities

a. Overview

(1) Filing bankruptcy usually gives a debtor immediate relief from all demands for payment and collection enforcement actions.

(2) IRS employees, upon learning of a bankruptcy, generally should cease all demands and enforcement actions directed against the bankrupt taxpayer (debtor) and take prompt and appropriate corrective actions unless the court determines the automatic stay is not in effect.

(3) Failure to observe an automatic stay may result in the Service being sued for damages and attorney fees, although punitive damages cannot be awarded.

b. Prohibited Activity

The automatic stay may prohibit the following:

(1) Starting or continuing judicial or administrative collection proceedings for pre-petition debts, such as making seizures (Form 668-B) or serving levies (Form 668-A or Form 668-W).

(2) Verbally requesting payment for tax periods ending before the bankruptcy petition date;

(3) Sending notices requesting payment or sending notices of intent to levy regarding pre-petition periods;

(4) Starting a lawsuit or serving or enforcing a summons to collect liabilities;

(5) Making a setoff of any debt (tax or otherwise) owed by the debtor that arose before the commencement of the case against any claim made against the debtor that arose before the commencement of the case;

(6) Attempting to recover a claim from the debtor that arose before the commencement of the case, including trying to enforce a judgment;

(7) Attempting to recover a claim for pre-petition debts from community property, even if the claim is against a non-debtor spouse;

(8) Creating, perfecting, or enforcing a lien on pre-petition periods; or

(9) Retaining pre-petition refunds indefinitely without requesting the automatic stay be lifted – other than temporary retention of refunds prior to Chapter 11 or Chapter 13 confirmation, or longer with written Chief Counsel Recommendation.

IV. Innocent Spouse Relief

A. Overview

1. Generally, both the taxpayer and the taxpayer's spouse are responsible, jointly and individually, for paying any tax, interest, or penalties on the taxpayer's joint return.

2. If the taxpayer believes the taxpayer's current or former spouse should be solely responsible for an incorrect item or an underpayment of tax on the taxpayer's joint tax return, the taxpayer may be eligible for Innocent Spouse Relief.

3. When the taxpayer files a joint income tax return, the law makes both the taxpayer and the taxpayer's spouse responsible for the entire tax liability, i.e., joint and several liability.

4. Joint and several liability applies not only to the tax liability the taxpayer shows on the return but also to any additional tax liability the IRS determines to be due, even if the additional tax is due to income, deductions, or credits of the taxpayer's spouse or former spouse.

5. The taxpayers remain jointly and severally liable for taxes, and the IRS can still collect them from the taxpayer, even if the taxpayers later divorce and the divorce decree states that the taxpayer's former spouse will be solely responsible for the tax.

B. Relief

In some cases, a spouse (or former spouse) will be relieved of the tax, interest, and penalties on a joint tax return. Three types of relief are available to married persons who filed joint returns.

1. Innocent spouse relief.
2. Separation of liability relief.
3. Equitable relief.

C. Innocent Spouse Relief

1. Overview

a. By requesting innocent spouse relief, the taxpayer can be relieved of responsibility for paying tax, interest, and penalties if the taxpayer's spouse (or former spouse) improperly reported items or omitted items on the taxpayer's tax return.

b. Generally, the tax, interest, and penalties that qualify for relief can only be collected from the taxpayer's spouse (or former spouse). However, the taxpayer is jointly and individually responsible for any tax, interest, and penalties that do not qualify for relief.

c. The IRS can collect these amounts from either the taxpayer or the taxpayer's spouse (or former spouse).

2. Conditions for Relief

a. The taxpayer must meet all of the following conditions to qualify for innocent spouse relief:

(1) The taxpayer filed a joint return.

(2) There is an understated tax on the return that is due to erroneous items of the taxpayer's spouse (or former spouse).

(3) The taxpayer can show that when the taxpayer signed the joint return the taxpayer did not know, and had no reason to know, that the understated tax existed (or the extent to which the understated tax existed).

(4) Taking into account all the facts and circumstances, it would be unfair to hold the taxpayer liable for the understated tax.

b. Innocent spouse relief will not be granted if the IRS proves that the taxpayer and the taxpayer's spouse (or former spouse) transferred property to one another as part of a fraudulent scheme. A fraudulent scheme includes a scheme to defraud the IRS or another third party, such as a creditor, former spouse, or business partner.

3. Indications of Unfairness for Innocent Spouse Relief

a. The IRS will consider all of the facts and circumstances of the case in order to determine whether it is unfair to hold the taxpayer responsible for the understated tax.

b. The following are examples of factors the IRS will consider:

(1) Whether the taxpayer received a significant benefit, either directly or indirectly, from the understated tax.

(2) Whether the taxpayer's spouse (or former spouse) deserted the taxpayer.

(3) Whether the taxpayer and the taxpayer’s spouse have been divorced or separated.

(4) Whether the taxpayer received a benefit on the return from the understated tax.

4. Erroneous Items

a. Erroneous items are either of the following:

(1) Unreported income. This is any gross income item received by the taxpayer’s spouse (or former spouse) that is not reported.

(2) Incorrect deduction, credit, or basis. This is any improper deduction, credit, or property basis claimed by the taxpayer’s spouse (or former spouse).

b. The following are examples of erroneous items:

(1) The expense for which the deduction is taken was never paid or incurred. For example, the taxpayer’s spouse, a cash-basis taxpayer, deducted $10,000 of advertising expenses on Schedule C of the taxpayer’s joint Form 1040, but never paid for any advertising.

(2) The expense does not qualify as a deductible expense. For example, the taxpayer’s spouse claimed a business fee deduction of $10,000 that was for the payment of state fines. Fines are not deductible.

(3) No factual argument can be made to support the deductibility of the expense. For example, the taxpayer’s spouse claimed $4,000 for security costs related to a home office, which were actually veterinary and food costs for the taxpayer’s family's two dogs.

D. Separation of Liability Relief

1. Overview

a. Under this type of relief, the understated tax (plus interest and penalties) on the taxpayer’s joint return is allocated between the taxpayer and the taxpayer’s spouse (or former spouse).

b. The understated tax allocated to the taxpayer is generally the amount the taxpayer is responsible for.

c. This type of relief is available for liabilities resulting from understated tax.

d. However, refunds are not allowed for any liabilities that have been paid.

2. Requirements.

To request separation of liability relief, the taxpayer must have filed a joint return and meet either of the following requirements at the time the taxpayer files Form 8857.

a. The taxpayer is no longer married to, or is legally separated from, the spouse with whom the taxpayer filed the joint return for which the taxpayer is requesting relief. (Under this rule, the taxpayer is no longer married if the taxpayer is widowed.)

b. The taxpayer was not a member of the same household as the spouse with whom the taxpayer filed the joint return at any time during the 12-month period ending on the date the taxpayer files Form 8857.

3. Burden of proof.

a. The taxpayer must be able to prove that the taxpayer meets all of the requirements for separation of liability relief (except actual knowledge) and that the taxpayer did not transfer property to avoid tax (discussed later).

b. The taxpayer must also establish the basis for allocating the erroneous items.

4. Limitations on Relief

a. Even if the taxpayer meets the requirements discussed previously, separation of liability relief will not be granted in the following situations:

b. The IRS proves that the taxpayer and the taxpayer's spouse (or former spouse) transferred assets to one another as part of a fraudulent scheme. A fraudulent scheme includes a scheme to defraud the IRS or another third party, such as a creditor, former spouse, or business partner.

c. The IRS proves that at the time the taxpayer signed the taxpayer's joint return, the taxpayer had actual knowledge of any erroneous items giving rise to the deficiency that were allocable to the taxpayer's spouse (or former spouse). For the definition of erroneous items, see Erroneous Items earlier under Innocent Spouse Relief.

d. The taxpayer's spouse (or former spouse) transferred property to the taxpayer to avoid tax or the payment of the tax.

E. Equitable Relief

1. Conditions for Getting Equitable Relief

In order to be considered for equitable relief from joint and several liabilities, the taxpayer must meet all of the following threshold conditions:

a. The taxpayer is not eligible for innocent spouse relief or separation of liability relief.

b. The taxpayer filed a joint return.

c. The taxpayer timely filed the taxpayer's claim for relief.

d. The taxpayer and the taxpayer's spouse (or former spouse) did not transfer assets to one another as a part of a fraudulent scheme. A fraudulent scheme includes a scheme to defraud the IRS or another third party, such as a creditor, former spouse, or business partner.

e. The taxpayer's spouse (or former spouse) did not transfer property to the taxpayer for the main purpose of avoiding tax or the payment of tax.

f. The taxpayer did not knowingly participate in the filing of a fraudulent joint return.

g. The income tax liability from which the taxpayer seeks relief is attributable (either in full or in part) to an item of the taxpayer's spouse (or former spouse) or an unpaid tax resulting from the taxpayer's spouse's (or former spouse's) income.

2. <u>Grant Equitable Relief</u>

a. If the taxpayer meets all the threshold conditions, the IRS will grant equitable relief if the taxpayer establishes that it would be unfair to hold the taxpayer liable for the understated or unpaid tax.

b. The IRS will consider all facts and circumstances of the taxpayer's case in determining whether it is unfair to hold the taxpayer liable for all or part of the unpaid income tax liability or deficiency, and whether full or partial equitable relief should be granted.

c. The factors listed below are designed as guides and not intended to be an exclusive list. Other factors relevant to the taxpayer's case also may be considered.

d. In evaluating the taxpayer's claim for relief, no one factor or a majority of factors necessarily determines the outcome.

e. The degree of importance of each factor varies depending on the taxpayer's facts and circumstances. Abuse or the exercise of financial control by the taxpayer's spouse (or former spouse) is a factor that may impact the other factors, as described below.

f. Factors the IRS will consider include the following:

(1) Marital status;

(2) Economic hardship;

(3) Knowledge or reason to know:

(4) Legal obligation;

(5) Significant benefit;

(6) Compliance with tax laws;

(7) Mental and Physical health.

Unit 2 Quizzer

2. Which of the following is true in regards to a Streamlined installment Agreement?

A-To be approved, the aggregate unpaid balance of assessments must be $25,000 or less-**Incorrect. To be approved, the aggregate unpaid balance of assessments must be $50,000 or less**

B-The minimum payment amount is determined by dividing the aggregate unpaid balance of assessments due by 12-**Incorrect. The minimum payment amount is determined by dividing the aggregate unpaid balance of assessments due by 72**

C-Streamlined installment agreements between $25,001 and $50,000 must be established as a Direct Debt or a Payroll Deduction-**Correct. Streamlined installment agreements with a balance between $25,001 and $50,000 must be established as a Direct Debit or a Payroll Deduction.**

D-The tax debt must have been originally due at least three years before the taxpayer applied for a streamlined installment agreement. **Incorrect. This is not a requirement before the taxpayer may apply for a streamlined installment agreement; actually this is a requirement for a tax to be dischargeable in bankruptcy.**

3. Which of the following is a requirement for a tax to be dismissed in bankruptcy?

A The taxes are “income taxes”.**-Correct. Taxes other than income, such as payroll taxes or fraud penalties, can never be eliminated in bankruptcy**

B The taxpayer did not commit fraud or willful evasion**-Incorrect. If the taxpayer filed a fraudulent tax return or otherwise willfully attempted to evade paying taxes, such as using a false Social Security number on the Taxpayer’s tax return, bankruptcy can’t help**

C The debt is at least two years old.**-Incorrect. To eliminate a tax debt, the tax return must have been originally due at least three years before the taxpayer filed for bankruptcy.**

D The taxpayer filed a tax return.

Incorrect. The taxpayer must have filed a tax return for the debt the taxpayer wishes to discharge at least two years before filing for bankruptcy. If the IRS filed a substitute return on the taxpayer’s behalf, the taxpayer has not filed a “return” and cannot discharge the tax.

UNIT THREE - The “Fresh Start” Initiative

Learning Objectives

After completing this Unit, you should be able to:

-Recognize the changes made by the Fresh Start Initiative to IRS procedures.

-Identify when tax liens will be withdrawn.

-Pinpoint when small businesses can participate in the streamlined installment agreement process.

-Identify how a financially distressed homeowner can get relief from a federal tax lien.

Course Material

I. Overview

A. In an effort to help struggling taxpayers, the Internal Revenue Service on February 24, 2011, first announced a series of steps to help people get a fresh start with their tax liabilities.

B. The goal is to help individuals and small businesses meet their tax obligations, without adding unnecessary burden to taxpayers. Specifically, the IRS is announcing new policies and programs to help taxpayers pay back taxes and avoid tax liens.

C. The announcement centered on the IRS making important changes to its lien filing practices that will lessen the negative impact on taxpayers. The changes include:

1. Significantly increasing the dollar threshold when liens are generally issued, resulting in fewer tax liens.

2. Making it easier for taxpayers to obtain lien withdrawals after paying a tax bill.

3. Withdrawing liens in most cases where a taxpayer enters into a Direct Debit Installment Agreement.

4. Creating easier access to Installment Agreements for more struggling small businesses.

5. Expanding a streamlined Offer in Compromise program to cover more taxpayers.

II. Tax Lien Thresholds

The IRS increased the dollar thresholds when liens are generally filed.

A. The new dollar amount is in keeping with inflationary changes since the number was last revised.

B. Currently, liens are automatically filed at certain dollar levels for people with past-due balances.

III. Tax Lien Withdrawals

The IRS also modified procedures that will make it easier for taxpayers to obtain lien withdrawals.

A. Liens will now be withdrawn once full payment of taxes is made if the taxpayer requests it. The IRS has determined that this approach is in the best interest of the government.

B. In order to speed the withdrawal process, the IRS will also streamline its internal procedures to allow collection personnel to withdraw the liens.

IV. Direct Debit Installment Agreements and Liens

A. The IRS made other fundamental changes to liens in cases where taxpayers enter into a Direct Debit Installment Agreement (DDIA).

B. For taxpayers with unpaid assessments of $25,000 or less, the IRS will now allow lien withdrawals under several scenarios:

1. Lien withdrawals for taxpayers entering into a Direct Debit Installment Agreement.

2. The IRS will withdraw a lien if a taxpayer on a regular Installment Agreement converts to a Direct Debit Installment Agreement.

3. The IRS will also withdraw liens on existing Direct Debit Installment Agreements upon taxpayer request.

C. Liens will be withdrawn after a probationary period demonstrating that direct debit payments will be honored.

D. In addition, this lowers user fees and saves the government money from mailing monthly payment notices. Taxpayers can use the Online Payment Agreement application on IRS.gov to set-up with Direct Debit Installment Agreements.

V. Installment Agreements and Small Businesses

A. The IRS also made streamlined Installment Agreements available to more small businesses. The payment program will raise the dollar limit to allow additional small businesses to participate.

B. Small businesses with $25,000 or less in unpaid tax can participate. Currently, only small businesses with under $10,000 in liabilities can participate. Small businesses will have 24 months to pay.

C. The streamlined Installment Agreements were made available for small businesses that file either as an individual or as a business. Small businesses with an unpaid assessment balance greater than $25,000 would qualify for the streamlined Installment Agreement if they pay down the balance to $25,000 or less.

D. Small businesses will need to enroll in a Direct Debit Installment Agreement to participate.

VI. Offers in Compromise

A. The IRS also expanded a new streamlined Offer in Compromise (OIC) program to cover a larger group of struggling taxpayers.

B. This streamlined OIC was expanded to allow taxpayers with annual incomes up to $100,000 to participate.

C. In addition, participants must have tax liability of less than $50,000, doubling the current limit of $25,000 or less.

VII. IR-2012-31, March 7, 2012

A. Overview

1. On March 7, 2012, the Internal Revenue Service announced a major expansion of its “Fresh Start” initiative to help struggling taxpayers by taking steps to provide new penalty relief to the unemployed and making Installment Agreements available to more people.

2. Under the new Fresh Start provisions, part of a broader effort started at the IRS in 2008, certain taxpayers who have been unemployed for 30 days or longer will be able to avoid failure-to-pay penalties.

3. In addition, the IRS doubled the dollar threshold for taxpayers eligible for Installment Agreements to help more people qualify for the program.

B. Penalty Relief

1. The IRS announced plans for new penalty relief for the unemployed on failure-to-pay penalties, which are one of the biggest factors a financially distressed taxpayer faces on a tax bill.

2. To assist those most in need, a six-month grace period on failure-to-pay penalties will be made available to certain wage earners and self-employed individuals. The request for an extension of time to pay resulted in relief from the failure to pay penalty for tax year 2011 only if the tax, interest and any other penalties are fully paid by Oct. 15, 2012.

3. The penalty relief will be available to two categories of taxpayers:

   a. Wage earners who have been unemployed at least 30 consecutive days during 2011 or in 2012 up to the April 17 deadline for filing a federal tax return this year.

   b. Self-employed individuals who experienced a 25 percent or greater reduction in business income in 2011 due to the economy.

4. This penalty relief is subject to income limits. A taxpayer’s income must not exceed $200,000 if he or she files as married filing jointly or not exceed $100,000 if he or she files as single or head of household. This penalty relief is also restricted to taxpayers whose calendar year 2011 balance due does not exceed $50,000.

5. Taxpayers meeting the eligibility criteria will need to complete a new Form 1127A to seek the 2011 penalty relief. The new form is available on IRS.gov.

6. The failure-to-pay penalty is generally half of 1 percent per month with an upper limit of 25 percent. Under this new relief, taxpayers can avoid that penalty until Oct. 15, 2012, which is six months beyond this year’s filing deadline. However, the IRS is still legally required to charge interest on unpaid back taxes and does not have the authority to waive this charge, which is currently 3 percent on an annual basis.

C. Installment Agreements

1. The Fresh Start provisions also mean that more taxpayers will have the ability to use streamlined installment agreements to catch up on back taxes.

2. The IRS announced that the threshold for using an installment agreement without having to supply the IRS with a financial statement has been raised from $25,000 to $50,000.

3. Taxpayers who owe up to $50,000 in back taxes will now be able to enter into a streamlined agreement with the IRS that stretches the payment out over a series of months or

years. The maximum term for streamlined installment agreements has also been raised to 72 months from the current 60-month maximum.

4. Taxpayers seeking installment agreements exceeding $50,000 will still need to supply the IRS with a Collection Information Statement (Form 433-A or Form 433-F). Taxpayers may also pay down their balance due to $50,000 or less to take advantage of this payment option.

5. Taxpayers can set up an installment agreement with the IRS by going to the On-line Payment Agreement (OPA) page on IRS.gov and following the instructions.

6. These changes supplement a number of efforts to help struggling taxpayers, including the "Fresh Start" program announced in 2011. The initiative includes a variety of changes to help individuals and businesses pay back taxes more easily and with less burden, including the issuance of fewer tax liens.

D. Offers in Compromise

1. Under the first round of Fresh Start, the IRS expanded a new streamlined Offer in Compromise (OIC) program to cover a larger group of struggling taxpayers

2. The IRS recognized that many taxpayers are still struggling to pay their bills so the agency has been working to put in place more common-sense changes to the OIC program to more closely reflect real-world situations.

3. For example, the IRS has more flexibility with financial analysis for determining reasonable collection potential for distressed taxpayers.

4. Generally, an offer will not be accepted if the IRS believes that the liability can be paid in full as a lump sum or through a payment agreement. The IRS looks at the taxpayer's income and assets to make a determination regarding the taxpayer's ability to pay.

VIII. IR-2012-53

A. Overview

1. On May 21, 2012, the Internal Revenue Service announced another expansion of its "Fresh Start" initiative by offering more flexible terms to its Offer in Compromise (OIC) program that will enable some of the most financially distressed taxpayers to clear up their tax problems and in many cases more quickly than in the past.

2. "This phase of Fresh Start will assist some taxpayers who have faced the most financial hardship in recent years," said IRS Commissioner Doug Shulman. "It is part of our multiyear effort to help taxpayers who are struggling to make ends meet."

3. The announcement focused on the financial analysis used to determine which taxpayers qualify for an OIC. This announcement also enables some taxpayers to resolve their tax problems in as little as two years compared to four or five years in the past.

4. In certain circumstances, the announcement includes:

a. Revising the calculation for the taxpayer's future income.

b. Allowing taxpayers to repay their student loans.

c. Allowing taxpayers to pay state and local delinquent taxes.

d. Expanding the Allowable Living Expense allowance category and amount.

5. When the IRS calculates a taxpayer's reasonable collection potential, it will now look at only one year of future income for offers paid in five or fewer months, down from four years, and two years of future income for offers paid in six to 24 months, down from five years.

a. All offers must be fully paid within 24 months of the date the offer is accepted.

b. The Form 656-B, Offer in Compromise Booklet, and Form 656, Offer in Compromise, has been revised to reflect the changes.

6. Other changes to the program include narrowed parameters and clarification of when a dissipated asset will be included in the calculation of reasonable collection potential.

7. In addition, equity in income producing assets generally will not be included in the calculation of reasonable collection potential for on-going businesses.

B. Allowable Living Expenses

1. The Allowable Living Expense standards are used in cases requiring financial analysis to determine a taxpayer's ability to pay. The standard allowances provide consistency and fairness in collection determinations by incorporating average expenditures for basic necessities for citizens in similar geographic areas. These standards are used when evaluating installment agreement and offer in compromise requests.

2. The National Standard miscellaneous allowance has been expanded to include additional items. Taxpayers can use the miscellaneous allowance for expenses such as credit card payments and bank fees and charges.

3. Guidance has also been clarified to allow payments for loans guaranteed by the federal government for the taxpayer's post-high school education. In addition, payments for delinquent state and local taxes may be allowed based on percentage basis of tax owed to the state and IRS.

C. Student Loans.

1. As part of its "Fresh Start" initiative, which is designed to help struggling taxpayers who owe taxes, IRS recently announced that it will allow taxpayers to repay their student loans and state and local delinquent taxes.

2. In IR 2012-53, IRS announced that collection guidance had been clarified to allow payments for loans guaranteed by the federal government for the taxpayer's post-high school education and that payments for delinquent state and local taxes may be allowed based on a percentage basis of tax owed to the state and IRS.

3. IRS has also recently expanded its "Fresh Start" initiative by making streamlined installment agreements available to more taxpayers.

a. IRS may enter into written agreements with any taxpayer. IRS generally must enter into an installment agreement requested by an individual whose aggregate tax liability isn't more than $10,000, if IRS determines that the taxpayer is financially unable to pay the liability in full when due.

b. In IR 2012-31, IRS allowed taxpayers who owe up to $50,000 in back taxes to enter into a streamlined agreement with IRS that stretches out the payment over a series of months or years.

c. IRS also raised the maximum term for streamlined installment agreements to 72 months from the previous 60-month maximum.

d. The SB/SE Memo says that when analyzing income and expenses to determine a taxpayer's ability to pay, minimum payments on student loans guaranteed by the federal government will be allowed.

IX. IRS Speeds Lien Relief for Homeowners Trying to Refinance, Sell

A. Overview

1. Pursuant to IR-2008 -141, the Internal Revenue Service announced on December 16, 2008, an expedited process that will make it easier for financially distressed homeowners to avoid having a federal tax lien block refinancing of mortgages or the sale of a home.

2. If taxpayers are looking to refinance or sell a home and there is a federal tax lien filed, there are options. Taxpayers or their representatives, such as their lenders, may request that the IRS make a tax lien secondary to the lien by the lending institution that is refinancing or restructuring a loan. Taxpayers or their representatives may request that the IRS discharge its claim if the home is being sold for less than the amount of the mortgage lien under certain circumstances.

3. The process to request a discharge or a subordination of a tax lien takes approximately 30 days after the submission of the completed application, but the IRS will work to speed those requests in wake of the economic downturn.

B. Federal Tax Lien Process

1. Filing a Notice of Federal Tax Lien is a formal process by which the government makes a legal claim to property as security or payment for a tax debt. It serves as a public notice to other creditors that the government has a claim on the property.

2. In some cases, a federal tax lien can be made secondary to another lien, such as a lending institution's, if the IRS determines that taking a secondary position ultimately will help with collection of the tax debt.

3. That process is called subordination. Taxpayers or their representatives may apply for a subordination of a federal tax lien if they are refinancing or restructuring their mortgage.

4. Without lien subordination, taxpayers may be unable to borrow funds or reduce their payments. Lending institutions generally want their lien to have priority on the home being used as collateral.

C. Application for a Certificate of Lien Subordination

1. To apply for a certificate of lien subordination, people must follow directions in Publication 784, How to Prepare an Application for a Certificate of Subordination of a Federal Tax Lien. There is no form but there must be a typed letter of request and certain documentation.

2. The request should be mailed to one of 40 Collection Advisory Groups nationwide. See Publication 4235, Collection Advisory Group Addresses, for address information.

3. Taxpayers or their representatives may apply for a certificate of discharge of a tax lien if they are giving up ownership of the property, such as selling the property, at an amount less than the mortgage lien if the mortgage lien is senior to the tax lien.

a. The IRS may also issue a certificate of discharge in other circumstances if the taxpayer has sufficient equity in other assets, can substitute other assets, or is able to pay the IRS its equity in the property.

b. Without a tax lien discharge, the taxpayer may be unable to complete the home ownership change and the ownership title will remain clouded.

4. To apply for a tax lien discharge, applicants must follow directions in Publication 783, Instructions on How to Apply for a Certificate of Discharge of a Federal Tax Lien. There is no form but there must be a typed letter of request and certain documentation. The request should be mailed to one of 40 Collection Advisory Groups nationwide. See Publication 4235 for address information.

5. The IRS also urges people to contact the agency's Collection Advisory Group early in the home sale or refinancing process so that it can begin work on their requests. People sometimes delay informing lenders of the tax liens, which only serves to delay the transaction.

UNIT FOUR - Appeal Rights

Learning Objectives

After completing this Unit, you should be able to:

-Distinguish the ways in which to appeal an IRS decision.

-Identify how to request a Collection Due Process hearing and what occurs in one.

-Identify how to enter the Collection Appeals Program and what occurs if the taxpayer disagrees with the decision.

-List the various parties who may represent a taxpayer during the collection process.

Course Material

I. How to Appeal an IRS Decision

A. The taxpayer has the right to appeal most collection actions to the Office of Appeals (Appeals). Appeals are separate from and independent of the IRS Collection office that initiates collection actions.

B. Appeals ensures and protects its independence by adhering to a strict policy prohibiting certain communications with the IRS Collection office or other IRS offices, such as discussions regarding the strength or weakness of the taxpayer's case.

C. When an IRS office is to be engaged in discussions, the taxpayer will be invited to participate in the conference or provide any written document to give the taxpayer an opportunity to comment.

D. The taxpayer's main options for appeals are either the Collection Due Process or the Collection Appeals Program

II. Collection Due Process

A. The Purpose of Collection Due Process

The purpose of a Collection Due Process hearing is to have Appeals review collection actions that were taken or have been proposed. After Appeals has made their determination and the taxpayer does not agree, the taxpayer can go to court to appeal the Appeals' Collection Due Process determination.

B. Request for Hearing

1. When Appropriate- The taxpayer can request a Collection Due Process hearing if the taxpayer receives any of the following notices:

a. Notice of Federal Tax Lien Filing and the Taxpayer's Right to a Hearing

b. Final Notice—Notice of Intent to Levy and Notice of the Taxpayer's Right to a Hearing

c. Notice of Jeopardy Levy and Right of Appeal

d. Notice of Levy on the Taxpayer's State Tax Refund—Notice of the Taxpayer's Right to a Hearing

e. Notice of Levy and of the Taxpayer's Right to a Hearing

2. How to Request

a. To request a Collection Due Process hearing, complete Form 12153, Request for a Collection Due Process or Equivalent Hearing or a written request containing the same information as contained in Form 12153, and send it to the address on the taxpayer's notice.

b. The taxpayer must request a Collection Due Process hearing by the date indicated in the notice the IRS sends the taxpayer (for proposed levies, that date is 30 days from the date of the letter).

c. The request must be filed timely to preserve the taxpayer's right to judicial review of the determination issued in the taxpayer's Collection Due Process hearing.

d. If the taxpayer's request for a Collection Due Process hearing is not timely, the taxpayer can request an Equivalent Hearing within one year from the date of the notice, but the taxpayer cannot go to court if the taxpayer disagrees with Appeals' decision.

C. The Hearing

1. During a Collection Due Process hearing, the 10-year period for collecting taxes is suspended and the IRS is generally prohibited from seizing (levying) the taxpayer's property, if seizing the taxpayer's property is the subject of the hearing.

a. The IRS is permitted to seize the taxpayer's property during an Equivalent Hearing or a Collection Due Process hearing about filing of a Notice of Federal Tax Lien, but normally the IRS will not seize property during these hearings.

b. The 10-year period for collecting taxes is not suspended during an Equivalent Hearing.

2. The taxpayer is entitled to one Collection Due Process lien hearing and one levy hearing for each tax period or assessment.

a. The taxpayer is entitled to propose collection alternatives, such as entering into an installment agreement or an offer-in-compromise, for consideration by Appeals in the hearing.

b. It may be necessary for the taxpayer to submit financial information or tax returns to qualify for such collection alternatives.

c. All issues should be raised and all necessary supporting information presented to Appeals at the hearing.

d. The taxpayer is prevented from raising issues during a judicial review that were not properly raised with Appeals in the Collection Due Process hearing.

e. The taxpayer's Appeals conference may be held by telephone, correspondence, or, if the taxpayer qualifies, in a face-to-face conference at the Appeals office closest to the taxpayer's home or place of business.

f. The taxpayer may be denied a face-to-face conference if the taxpayer raises issues that are deemed frivolous or made with a desire solely to delay or impede collection.

g. For a nonexclusive listing of issues identified by the IRS as frivolous, see "The Truth About Frivolous Tax Arguments" on www.IRS.gov.

III. Collection Appeals Program

A. The Program

1. Under the Collections Appeals Program, if the taxpayer disagrees with an IRS employee's decision regarding any levy, seizure, or Notice of Federal Tax Lien filing and wants to appeal it, the taxpayer can ask to have a conference with the employee's manager.

2. If the IRS seizes the taxpayer's house, car, or other property in order to sell the taxpayer's interest in the property to apply the proceeds to the taxpayer's tax debt, the taxpayer must make the request within 10 business days after the Notice of Seizure is given to the taxpayer or left at the taxpayer's home or business.

3. There is no deadline to request a manager conference when a levy is served for other types of property (such as wages or bank accounts) or a levy or seizure or lien filing is proposed. The collection action may go forward if a conference is not requested within a reasonable time period.

B. If the Taxpayer Disagrees

1. If the taxpayer then disagrees with the manager's decision, the taxpayer may request the IRS Office of Appeals review the taxpayer's case under the Collection Appeals Program as outlined in Publication 1660.

a. If the taxpayer's case is assigned to a revenue officer, the taxpayer's request for Appeals consideration should be made within three (3) business days of the conference with the manager or collection actions may resume.

b. The taxpayer must submit the taxpayer's request for Appeals consideration in writing, preferably on Form 9423, Collection Appeal Request.

c. If the taxpayer's case is not assigned to a Revenue Officer, the taxpayer can appeal the manager's decision in writing or orally and the taxpayer's case will be forwarded to Appeals for review. The taxpayer's request for Appeals consideration should be made within three (3) business days of the conference with the manager or collection actions may resume.

2. If the taxpayer requests a conference and is not contacted by a manager or his/her designee within two (2) business days of making the request, the taxpayer may contact Collection again and request Appeals consideration.

a. If the taxpayer submits Form 9423, note the date of the taxpayer's request for a conference in Block 15 and indicate that the taxpayer was not contacted by a manager.

b. The Form 9423 should be received or postmarked within four (4) business days of the taxpayer's request for a conference as collection action may resume. Submit Form 9423 to the revenue officer involved in the lien, levy or seizure action.

c. If the taxpayer files a Collection Appeals Request and does not agree with Appeals decisions, the taxpayer cannot proceed to court. Instances in which the taxpayer can pursue the Collection Appeals Program include, but aren't limited to:

(1) Before or after the IRS files a Notice of Federal Tax Lien

(2) Before or after the IRS seizes ("levy") the taxpayer's property

(3) After the IRS rejects, terminates, or proposes to terminate the taxpayer's Installment Agreement (a conference with the manager is recommended, but not required). Submit the taxpayer's written Installment Agreement Appeal request, preferably using Form 9423, Collection Appeal Request, within the timeframe listed in the taxpayer's notice.

d. For more information about the Collection Due Process and Collection Appeals Program, please see Publication 1660, Collection Appeal Rights or visit http://www.irs.gov/Individuals/Appealing-a-Collection-Decision.

IV. Relief Representation during the Collection Process

A. During the collection process, or an appeal before the IRS Office of Appeals the taxpayer can be represented by themselves, an attorney, a certified public accountant, an enrolled agent, an immediate family member, or any person enrolled to practice before the IRS. If the taxpayer is a business, full-time employees, general partners, or bona fide officers can also represent the taxpayer.

B. To have the taxpayer's representative appear before the IRS, contact the IRS on the taxpayer's behalf, and/or receive the taxpayer's confidential material, file Form 2848, *Power of Attorney and Declaration of Representative.*

C. To authorize someone to receive or inspect confidential material, file Form 8821, *Tax Information Authorization.*

V. Sharing the Taxpayer's Tax Information

During the collection process, the IRS is authorized to share the taxpayer's tax information in some cases with city and state tax agencies, the Department of Justice, federal agencies, people the taxpayer authorizes to represent the taxpayer, and certain foreign governments (under tax treaty provisions).

VI. The IRS May Contact a Third Party

The law allows the IRS to contact others (such as neighbors, banks, employers, or employees) to investigate the taxpayer's case. The taxpayer has the right to request a list of third parties contacted about the taxpayer's case.

VII. Past Due Tax Returns

A. File all tax returns that are due, regardless of whether or not the taxpayer can pay in full. File a past due return at the same location where the taxpayer would file an on-time return.

B. If the taxpayer does not voluntarily file the taxpayer's individual income tax return the taxpayer risks losing the taxpayer's refund and the IRS may file a substitute return for the taxpayer.

1. This return might not give the taxpayer credit for deductions and exemptions the taxpayer may be entitled to receive.

2. The IRS may send the taxpayer a Notice of Deficiency proposing a tax assessment.

3. Filing a past due return after the Notice of Deficiency was sent does not extend the 90 day period for filing a petition to the United States Tax Court.

4. However, the past due return will be considered in determining whether there will be a reduction in the amount of tax increase previously proposed in the Notice of Deficiency.

5. If the taxpayer does not file a petition in Tax Court and a tax increase has been determined, the IRS will proceed with the IRS's proposed assessment as a substitute return.

6. If the IRS files a substitute return, it is still in the taxpayer's best interest to file the taxpayer's own tax return to take advantage of any exemptions, credits and deductions the taxpayer is entitled to receive. The IRS will generally adjust the taxpayer's account to reflect the correct figures.

3. Which of the following is not a person who can represent the taxpayer during the collection process or an appeal before the IRS Office of Appeals?
   A. Officers of a business, if the taxpayer is a business. **Incorrect. If the taxpayer is a business, full-time employees, general partners, or bona fide officers can represent the taxpayer if authorized on Form 2848.**
   B. The taxpayer's CPA. **Incorrect. A certified public accountant can represent the taxpayer if they are authorized on Form 2848.**
   C. The taxpayer's friend who works as a plumber. **Correct. Only certain groups of people are allowed to represent a taxpayer before the IRS. Friends of the taxpayer are not a group who can represent them unless the friend is an attorney, CPA, enrolled agent, etc., authorized on Form 2848.**
   D. The taxpayer's sister who works as an artist. **Incorrect. A member of the taxpayer's immediate family can represent the taxpayer if they are authorized on Form 2848.**

UNIT FIVE - Understanding Collection Actions

Learning Objectives

After completing this Unit, you should be able to:

-Define certain words and phrases commonly used in the collections process.

-List the steps a taxpayer should take if a Notice of Federal Tax Lien is filed against them.

-Identify the differences between a “release”, a “withdrawal”, and a “discharge” of a federal tax lien and the reasons why the IRS may allow each.

-Identify when the IRS will seize a taxpayer’s property and the steps on how to appeal a seizure.

-Identify what an IRS summons is and what may be required of a taxpayer who receives one.

Course Material

I. <u>Words and Phrases</u>

There are several words and phrases particular to the collection process. Here, the IRS defined some of the most commonly used collection terms:

Federal Tax Lien: A legal claim against all the taxpayer’s current and future property, such as a house or car, and rights to property, such as wages and bank accounts. The lien automatically comes into existence if the taxpayer doesn’t pay the taxpayer’s amount due after receiving the taxpayer’s first bill.

When the taxpayer doesn’t pay the taxpayer’s first bill for taxes due, a lien is created bylaw and attaches to the taxpayer’s property. It applies to property (such as the taxpayer’s home and car) and to any current and future rights the taxpayer has to property.

Notice of Federal Tax Lien: A Notice of Federal Tax Lien gives public notice to creditors. It notifies them that there is a federal tax lien that attaches to all the taxpayer’s current and future property and rights to property. The IRS files the Notice of Federal Tax Lien so the IRS can establish the priority of the IRS’s claim versus the claims of other creditors. The Notice of Federal Tax Lien is filed with local or state authorities, such as county recorder of deeds or the Secretary of State offices. If a Notice of Federal Tax Lien is filed against the taxpayer, it’s often reported by consumer credit reporting agencies. This can have a negative effect on the taxpayer’s credit rating and make it difficult for the taxpayer to receive credit (such as a loan or credit card). Employers, landlords and others may also use this information and not favorably view the fact that a Notice of Federal Tax Lien has been filed against the taxpayer. However by law, there will be no filing of the Notice of Federal Tax Lien or enforcement action taken to collect an individual shared responsibility payment associated with the Affordable Care Act.

Levy: A legal seizure of property or rights to property to satisfy a tax debt. When property is seized (“levied”), it will be sold to help pay the taxpayer’s tax debt. If wages or bank accounts are seized, the money will be applied to the taxpayer’s tax debt. There is no legal difference between a seizure and a levy.

Notice of Intent to Levy and Notice of the Taxpayer’s Right to a Hearing: Generally, before property is seized, the IRS has to send the taxpayer this notice. If the taxpayer doesn’t pay the taxpayer’s overdue taxes, make other arrangements to satisfy the tax debt, or request a hearing within 30 days of the date of this notice, the IRS may seize the taxpayer's property.

Summons: A summons legally compels the taxpayer or a third party to meet with an officer of the IRS and provide information, documents and/or testimony.

II. Collections Actions

A. In General

1. What to do if a Notice of Federal Tax Lien is filed Against the Taxpayer

a. The taxpayer should pay the full amount the taxpayer owes immediately.

b. The Notice of Federal Tax Lien only shows the taxpayer's assessed balance as of the date of the notice. It doesn't show the taxpayer's payoff balance or include the IRS's charges for filing and releasing the lien.

c. To find out the full amount the taxpayer must pay to have the lien released, call 1-800-913-6050 or 859-669-4811 if the taxpayer is calling from outside of the United States.

d. If the taxpayer has questions, call the number on the taxpayer's lien notice or 1-800-829-1040 or visit www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Understanding-a-Federal-Tax-Lien, or view instructional videos at http://www.irsvideos.gov/Individual/IRSLiens.

2. How to Appeal a Notice of Federal Tax Lien

a. Within five business days of the first filing of the Notice of Federal Tax Lien for a specific debt, the IRS will send the taxpayer a Notice of Federal Tax Lien Filing and Your Right to a Collection Due Process Hearing.

b. The taxpayer will have until the date shown on the notice to request a Collection Due Process hearing with the Office of Appeals.

c. Send the taxpayer's Collection Due Process hearing request to the address on the notice. For more information, see Form 12153, Request for collection Due Process or Equivalent Hearing.

d. After the taxpayer's Collection Due Process hearing, the Office of Appeals will issue a determination on whether the Notice of Federal Tax Lien should remain filed, or whether it should be withdrawn, released, discharged or subordinated.

e. If the taxpayer disagrees with the determination, the taxpayer has 30 days after it's made to seek a review in the U.S. Tax Court.

f. In addition to any Collection Due Process rights the taxpayer may have, the taxpayer may also appeal a proposed or actual filing of a Notice of Federal Tax Lien under the Collection Appeals Program.

3. Reasons the IRS Will "Release" A Federal Tax Lien

a. A "release" of a federal tax lien means that the IRS has cleared both the lien for the taxpayer's debt and the public Notice of Federal Tax Lien.

b. The IRS does this by filing a Certificate of Release of Federal Tax Lien with the same state and local authorities with whom the IRS filed the taxpayer's Notice of Federal Tax Lien.

c. The IRS will release the taxpayer's lien if:

(1) The taxpayer's debt is fully paid,

(2) Payment of the taxpayer's debt is guaranteed by a bond, or

(3) The taxpayer has met the payment terms of an Offer in Compromise which the IRS has accepted, or

(4) The period for collection has ended. (In this case, the release is automatic.)

d. For more information, see Publication 1450, Instructions on *How to Request a Certificate of Release of Federal Tax Lien.*

4. <u>Reasons the IRS may "Withdraw" a Notice of Federal Tax Lien</u>

a. A "withdrawal" removes the Notice of Federal Tax Lien from public record. The withdrawal tells other creditors that the IRS is abandoning the IRS's lien priority.

b. This doesn't mean that the federal tax lien is released or that the taxpayer is no longer liable for the amount due.

c. The IRS may withdraw a Notice of Federal Tax Lien if:

(1) The taxpayer entered into an Installment Agreement to satisfy the tax liability, unless the Agreement provides otherwise. For certain types of taxes, the IRS will routinely withdraw a Notice of Federal Tax Lien if the taxpayer entered into a direct debit installment agreement and meets certain other conditions,

(2) It will help the taxpayer pay the taxpayer's taxes more quickly,

(3) The IRS didn't follow IRS procedures,

(4) It was filed during a bankruptcy automatic stay period, or

(5) It's in the taxpayer's best interest and in the best interest of the government. For example, this could include when the taxpayer's debt has been satisfied and the taxpayer requests a withdrawal.

d. For more information, see Form 12277, Application for Withdrawal of Filed Notice of Federal Tax Lien or the instructional video at http://www.irsvideos.gov/Individual/IRSLiens/LienNoticeWithdrawal.

5. <u>How to Apply for A "Discharge" of a Federal Tax Lien from Property</u>

a. A "discharge" removes the lien from specific property.

b. There are several circumstances under which the federal tax lien can be discharged.

c. For example, the IRS may issue a Certificate of Discharge if the taxpayer is selling property and a Notice of Federal Tax Lien has been filed; the taxpayer may be able to remove or discharge the lien from that property if the government receives its interest through the sale. For more information on whether the taxpayer qualify for a discharge, see Publication 783, Instructions on How to Apply for a Certificate of Discharge of Property from Federal Tax Lien. To watch an instructional video about Publication 783, visit http://irsvideos.gov/Individual/IRSLiens.

6. How To Make The Federal Tax Lien Secondary To Other Creditors ("Subordination")

a. What is It?

(1) "Subordination" is where a creditor is allowed to move ahead of the government's priority position.

(2) For example, if the taxpayer is trying to refinance a mortgage on the taxpayer's home, but isn't able to because the federal tax lien has priority over the new mortgage, the taxpayer may request that the IRS subordinate the IRS's lien to the new mortgage.

(3) For more information on whether the taxpayer qualifies for a subordination, see Publication 784, How to Prepare an Application for a Certificate of Subordination of Federal Tax Lien. To watch an instructional video about Publication 784, visit http://irsvideos.gov/Individual/IRSLiens.

b. Appeal Rights For Withdrawal, Discharge Or Subordination

(1) If the taxpayer's application is denied the taxpayer will receive Form 9423, Collection Appeal Request and Publication 1660, Collection Appeal Rights, with an explanation of why the taxpayer's application was denied.

(2) If the IRS denies the taxpayer's request for a withdrawal, discharge, or subordination, the taxpayer may appeal under the Collections Appeals Program.

B. Levy: A Seizure Of Property

1. While a federal tax lien is a legal claim against the taxpayer's property, a levy is a legal seizure that actually takes the taxpayer's property (such as the taxpayer's house or car) or the taxpayer's rights to property (such as the taxpayer's income, bank account, or Social Security payments) to satisfy the taxpayer's tax debt.

2. The IRS can't seize the taxpayer's property if the taxpayer has a current or pending Installment Agreement, Offer in Compromise, or if the IRS agrees that the taxpayer is unable to pay due to economic hardship, meaning seizing the taxpayer's property would result in the taxpayer's inability to meet basic, reasonable living expenses.

C. Reasons the IRS May Seize ("Levy") the Taxpayer's Property or Rights to Property

1. If the taxpayer doesn't pay the taxpayer's taxes, or make arrangements to settle the taxpayer's debt, the IRS could seize and sell the taxpayer's property.

2. The IRS will not seize the taxpayer's property to collect an individual shared responsibility payment. The IRS usually seizes only after the following things have occurred:

a. The IRS assessed the tax and sent the taxpayer a bill,

b. The taxpayer neglected or refused to pay the tax, and

c. The IRS sent the taxpayer a Final Notice of Intent to Levy and Notice of the Taxpayer's Right to a Hearing at least 30 days before the seizure.

3. However, there are exceptions for when the IRS doesn't have to offer the taxpayer a hearing at least 30 days before seizing the taxpayer's property. These include situations when:

a. The collection of the tax is in jeopardy,

b. A levy is served to collect tax from a state tax refund,

c. A levy is served to collect the tax debt of a federal contractor, or

d. A Disqualified Employment Tax Levy (DETL) is served. A DETL is the seizure of unpaid employment taxes and can be served when a taxpayer previously requested a Collection Due Process appeal on employment taxes for other periods within the past two years.

4. If the IRS serves a levy under one of these exceptions, the IRS will send the taxpayer a letter explaining the seizure and the taxpayer's appeal rights after the levy is issued.

5. What the taxpayer should do if the taxpayer's property is seized ("levied"). If the taxpayer's property or federal payments are seized, call the number on the taxpayer's levy notice or 1-800-829-1040. If the taxpayer is already working with an IRS employee, call him or her for assistance.

D. <u>Examples of Property the IRS Can Seize ("Levy")</u>

1. Wages, salary, or commission held by someone else

If the IRS seizes the taxpayer's rights to wages, salary, commissions, or similar payments that are held by someone else, the IRS will serve a levy once, not each time the taxpayer is paid. The one levy continues until the taxpayer's debt is fully paid, other arrangements are made, or the collection period ends. Other payments the taxpayer receives, such as dividends and payments on promissory notes are also subject to seizure. However, the seizure only reaches the payments due or the right to future payments as of the date of the levy.

2. The taxpayer's bank account

Seizure of the funds in the taxpayer's bank account will include funds available for withdrawal up to the amount of the seizure. After the levy is issued, the bank will hold the available funds and give the taxpayer 21 days to resolve any disputes about who owns the account before sending the IRS the money. After 21 days, the bank will send the IRS the taxpayer's money, and any interest earned on that amount, unless the taxpayer has resolved the issue in another way.

3. The taxpayer's federal payments

As an alternative to the levy procedure used for other payments such as dividends and promissory notes, certain federal payments may be systemically seized through the Federal Payment Levy Program in order to pay the taxpayer's tax debt. Under this program, the IRS can generally seize up to 15% of the taxpayer's federal payments (up to 100% of payments due to a vendor for goods or services sold or leased to the federal government).

The IRS will serve the levy once, not each time the taxpayer is paid. The levy continues until the taxpayer's debt is fully paid, other arrangements are made, the collection period ends, or the IRS releases the levy. The federal payments that can be seized in this program include, but aren't limited to, federal retirement annuity income from the Office of Personnel Management, Social Security benefits under Title II of the Social Security Act (OASDI), and federal contractor/vendor payments.

4. The taxpayer's house, car, or other property

If the IRS seizes the taxpayer's house or other property, the IRS will sell the taxpayer's interest in the property and apply the proceeds (after the costs of the sale) to the taxpayer's tax debt. Prior to selling the taxpayer's property, the IRS will calculate a minimum bid price. The IRS will also provide the taxpayer with a copy of the calculation and give the taxpayer an opportunity to challenge the fair market value determination.

The IRS will then provide the taxpayer with the notice of sale and announce the pending sale to the public, usually through local newspapers or flyers posted in public places. After giving public notice, the IRS will generally wait 10 days before selling the taxpayer's property. Money from the sale pays for the cost of seizing and selling the property and, finally, the taxpayer's tax debt. If there's money left over from the sale after paying off the taxpayer's tax debt, the IRS will tell the taxpayer how to get a refund.

E. Property That Can't Be Seized ("Levied")

1. Certain property is exempt from seizure. For example, the IRS can't seize the following: unemployment benefits, certain annuity and pension benefits, certain service-connected disability payments, workers compensation, certain public assistance payments, minimum weekly exempt income, assistance under the Job Training Partnership Act, and income for court-ordered child support payments.

2. The IRS also can't seize necessary schoolbooks and clothing, undelivered mail, certain amounts worth of fuel, provisions, furniture, personal effects for a household, and certain amounts worth of books and tools for trade, business, or professions. There are also limitations on the IRS's ability to seize a primary residence and certain business assets.

3. Lastly, the IRS can't seize the taxpayer's property unless the IRS expects net proceeds to help pay off the taxpayer's tax debt.

F. How to Appeal a Proposed Seizure ("Levy")

1. In General

a. The taxpayer can request a Collection Due Process hearing within 30 days from the date of the taxpayer's Notice of Intent to Levy and Notice of the Taxpayer's Right to a Hearing. Send the taxpayer's request to the address on the taxpayer's notice. For more information, see Form 12153, Request for a Collection Due Process or Equivalent Hearing.

b. At the conclusion of the taxpayer's hearing, the Office of Appeals will provide a determination. The taxpayer will have 30 days after the determination to challenge it in the U.S. Tax Court.

c. If Collection Due Process rights aren't available for the taxpayer's case, the taxpayer may have other appeal options, such as the Collection Appeals Program.

2. Reasons the IRS "Releases" A Levy

a. The Internal Revenue Code specifically provides that the IRS must release a levy if the IRS determines that:

(1) The taxpayer paid the amount the taxpayer owes,

(2) The period for collection ended prior to the levy being issued,

(3) It will help the taxpayer pay the taxpayer's taxes,

(4) The taxpayer enters into an Installment Agreement and the terms of the agreement don't allow for the levy to continue,(5) The levy creates an economic hardship, meaning the IRS determined the levy prevents the taxpayer from meeting basic, reasonable living expenses, or

(6) The value of the property is more than the amount owed and releasing the levy won't hinder the IRS's ability to collect the amount owed.

b. The IRS will also release a levy if it was issued improperly. For example, the IRS will release a levy if it was issued:

(1) Against property exempt from seizure,

(2) Prematurely, before the IRS sent the taxpayer the required notice,

(3) While the taxpayer was in bankruptcy and an automatic stay was in effect,

(4) Where the expenses of seizing and selling the levied property would be greater than the fair market value of the property,

(5) While an Installment Agreement request, Innocent Spouse Relief request, or Offer in Compromise was being considered or had been accepted and was in effect, or

(6) While the Office of Appeals or Tax Court was considering a collection due process case and the levy wasn't a Disqualified Employment Tax Levy to collect employment taxes, a state refund, a jeopardy levy, or to collect the tax debt of a federal contractor.

(7) While the Office of Appeals or Tax Court is considering an appeal of the denial of innocent spouse relief.

3. Reasons the IRS May Return Seized ("Levied") Property

a. The IRS may return the taxpayer's property if:

(1) Its seizure was premature,

(2) Its seizure was in violation of the law,

(3) Returning the seized property will help the IRS's collection of the taxpayer's debt,

(4) The taxpayer enters into an Installment Agreement to satisfy the liability for which the levy was made, unless the Agreement does not allow for the return of previously levied upon property.

(5) The IRS didn't follow IRS procedures, or

(6) It's in the taxpayer's best interest and in the best interest of the government.

b. The IRS may return property at any time if the property has not been sold. If the IRS decided to return the taxpayer's property, but it's already sold, the IRS will give the taxpayer the money the IRS received from the sale.

c. The taxpayer can file are quest for return of seized money or money from the sale of seized property, generally up to 9 months after the seizure.

III. <u>How to Recover Seized ("Levied") Property That's Been Sold</u>

A. <u>In General</u>

To recover the taxpayer's real estate, the taxpayer (and anyone with interest in the property) may recoup it within 180 days of the sale by paying the purchaser what they paid, plus interest at 20% annually.

B. <u>If the Taxpayer's Property has been seized ("levied") to Collect Tax Owed by Someone Else</u>.

1. The taxpayer may appeal the seizure under the Collection Appeals Program or file a claim under Internal Revenue Code section 6343(b), generally within 9 months of the seizure, or the taxpayer may file a suit under Internal Revenue Code section 7426 for the return of the wrongfully seized property, generally within 9 months of the seizure.

2. The taxpayer may also appeal the denial of the request to return the wrongfully seized property under the Collection Appeals Program. For more information, see Publication 4528, making an Administrative Wrongful Levy Claim under Internal Revenue Code section 6343(b).

C. <u>How to Recover Economic Damages</u>

1. If the IRS wrongfully seized the taxpayer's property, the IRS lost or misplaced the taxpayer's payment, or there was a direct debit Installment Agreement processing error and the taxpayer incurred bank charges, the IRS may reimburse the taxpayer for charges the taxpayer paid.

2. For more information, see Form 8546, Claim for Reimbursement of Bank Charges. If the taxpayer's claim is denied, the taxpayer can sue the federal government for economic damages.

3. If the IRS intentionally or negligently didn't follow Internal Revenue law while collecting the taxpayer's taxes or the taxpayer is not the taxpayer and the IRS wrongfully seized the taxpayer's property, the taxpayer may be entitled to recover economic damages.

4. Mail the taxpayer's written administrative claim to the attention of the Advisory Group Manager for the taxpayer's area at the address listed in Publication 4235, Collection Advisory Group Addresses.

5. If the taxpayer has filed a claim and the taxpayer's claim is denied, the taxpayer can sue the federal government, but not the IRS employee, for economic damages.

IV. <u>Summons: Used to Secure Information</u>

A. <u>In General</u>

If the IRS is having trouble gathering information to determine or collect taxes the taxpayer owes, the IRS may serve a summons. A summons legally compels the taxpayer or a third party to meet with an officer of the IRS and provide information, documents and/or testimony.

B. What's Required if the IRS Summons the Taxpayer

1. If the taxpayer is responsible for a tax liability and the IRS serves a summons on the taxpayer, the taxpayer may be required to:

a. Testify,

b. Bring books and records to prepare a tax return, and/or

c. Produce documents to prepare a Collection Information Statement, Form 433-A or Form 433-B.

2. If the taxpayer can't make the taxpayer's summons appointment, immediately call the number listed on the taxpayer's notice. If the taxpayer doesn't call the IRS and doesn't attend the taxpayer's appointment, the IRS may sue the taxpayer in federal district court to require the taxpayer to comply with the summons.

3. If the IRS serves a third-party summons to determine the taxpayer's tax liability, the taxpayer will receive a notice indicating that the IRS is contacting a third party. Third parties can be financial institutions, record keepers, or people with information relevant to the taxpayer's case. The IRS won't review their information or receive testimony until the end of the 23rd day after the notice was given. The taxpayer also has the right to:

a. Petition to reject ("quash") the summons before the end of the 20th day after the date of the notice, or

b. Petition to intervene in a suit to enforce a summons to which the third party didn't comply.

4. If the IRS issues a third-party summons to collect taxes the taxpayer already owes, the taxpayer won't receive notice or be able to petition to reject or intervene in a suit to enforce the summons.

4. In which instance will a lien be removed from a specific piece of property?
   A. If the IRS withdraws the Notice of Federal Tax Lien. **Incorrect. A withdrawal removes the Notice of Federal Tax Lien from the public record. The withdrawal tells other creditors that the IRS is abandoning the IRS's lien priority.**
   B. If the IRS discharges the lien. **Correct. A discharge removes the lien from specific property.**
   C. If the IRS releases the lien. **Incorrect. A release of a tax lien means that the IRS has cleared both the lien for the taxpayer's debt and the public Notice of Federal Tax Lien.**
   D. If the IRS subordinates the lien. **Incorrect. Subordination is where a creditor is allowed to move ahead of the government's priority position.**

UNIT SIX - Employment Taxes

Learning Objectives

After completing this Unit, you should be able to:

-Ascertain what employment taxes consist of.

-Identify what the IRS will do in the case of unpaid employment taxes.

-Identify who is responsible for the Trust Fund Recovery Penalty and what to do if the penalty is assessed against a taxpayer.

-Identify the purpose of the Trust fund Recovery Penalty.

Course Material

I. About Employment Taxes

A. Employment taxes are the amount the taxpayer must withhold from the taxpayer's employees for their income tax and Social Security/Medicare tax (trust fund taxes) plus the amount of Social Security/Medicare tax the taxpayer pays for each employee. Federal unemployment taxes are also considered employment taxes.

B. Employment taxes are incurred at the time the taxpayer pays wages and generally paid in semi-weekly or monthly deposits. The taxpayer must use electronic funds transfer to make all federal tax deposits, generally through the Electronic Federal Tax Payment System (EFTPS). See Publication 966, *Electronic Federal Tax Payment System: A Guide To Getting Started.*

II. What the IRS will do if the Taxpayer Doesn't Pay the Taxpayer's Employment Taxes:

A. If the taxpayers don't pay employment taxes

1. Assess a failure to deposit penalty, up to 15% of the amount not deposited in a timely manner.

2. The IRS may propose a Trust Fund Recovery Penalty assessment against the individuals responsible for failing to pay the trust fund taxes.

B. About trust fund taxes

1. Trust fund taxes are the income tax, Social Security tax, and Medicare tax (trust fund taxes) withheld from the employee 'swages.

2. They are called trust fund taxes because the employer holds these funds "in trust" for the government until it submits them in a federal tax deposit.

3. Certain excise taxes are also considered trust fund taxes because they are collected and held in trust for the government until submitted in a federal tax deposit. For more information, see Publication 510, *Excise Taxes*.

4. To encourage prompt payment of withheld employment taxes and collected excise taxes, Congress has passed a law that provides for the Trust Fund Recovery Penalty.

5. For more information on employment taxes or trust fund taxes, see Publication 15, *Circular E, and Employer's Tax Guide.*

III. Trust Fund Recovery Penalty

A. The Trust Fund Recovery Penalty is a penalty that is assessed personally against the individual or individuals who were responsible for paying the trust fund taxes, but who willfully did not do so.

B. The amount of the penalty is equal to the amount of the unpaid trust fund taxes. For additional information, please see Notice 784, Could the Taxpayer be Personally Liable for Certain Unpaid Federal Taxes? or visit http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Employment-Taxes-and-the-Trust-Fund-Recovery-Penalty-TFRP.

C. If the Trust Fund Recovery Penalty is proposed against the taxpayer, the taxpayer will receive a Letter 1153 and Form 2751, Proposed Assessment of Trust Fund Recovery Penalty.

1. If the taxpayer agrees with the penalty, sign and return Form 2751 within 60 days from the date of the letter. To avoid the assessment of the Trust Fund Recovery Penalty, the taxpayer may also pay the trust fund taxes personally.

2. If the taxpayer disagrees with the penalty, the taxpayer has 10 days from the date of the letter to let the IRS know that the taxpayer doesn't agree with the proposed assessment, has additional information to support the taxpayer's case, or wants to try to resolve the matter informally. If the taxpayer can't resolve the disagreement with the IRS, the taxpayer has 60 days from the date of the Letter 1153 to appeal with the Office of Appeals. For more information, see Publication 5, *The Taxpayer's Appeal Rights and How to Prepare a Protest if the Taxpayer Don't Agree.*

3. If the taxpayer doesn't respond to the letter, the IRS will assess the penalty amount against the taxpayer personally and begin the collection process to collect it.

4. The IRS may assess this penalty against a responsible person regardless of whether the company is still in business.

5. If the withheld income and employment taxes are willfully not paid, who is responsible for paying the Trust Fund Recovery Penalty?
   A. The company who failed to pay the taxes. **Incorrect. The individuals responsible for collecting or paying the withheld taxes and willfully fails to collect or pay them are personally responsible for the penalty.**
   B. The employees of the company who had wages withheld to pay the taxes. **Incorrect. The individuals responsible for collecting or paying the withheld taxes and willfully fails to collect or pay them are personally responsible for the penalty.**
   C. The CEO of the company who failed to pay the taxes. **Incorrect. The individuals responsible for collecting or paying the withheld taxes and willfully fails to collect or pay them are personally responsible for the penalty.**
   D. The individuals in the company who were responsible for paying the withheld taxes. **Correct. The individuals responsible for collecting or paying the withheld taxes and willfully fails to collect or pay them are personally responsible for the penalty.**

Final Exam

1. If a taxpayer fails to file an income tax return for a period of 45 days with an amount of tax due of $6300, what is the amount of the failure to file penalty?

    A. $315
    B. $630**-Correct**
    C. $135

2. Which of the following is not a reason the IRS will release a federal tax lien?

    A. The period for collection has ended
    B. The taxpayer entered into an installment agreement to satisfy the liability-**Correct**
    C. Payment of the taxpayer's debt is guaranteed by a bond

3. Under the new rules promulgated by the Fresh Start Initiative, what is the maximum tax liability for a taxpayer participating in the streamlined OIC process?

    A. $10,000
    B. $25,000
    C. $50,000-**Correct**

4. Under which type of relief would an understated tax (plus interest and penalties) on a taxpayer's joint tax return be allocated between the taxpayer and the taxpayer's spouse.

    A. Equitable relief
    B. Separation of liability relief-**Correct**
    C. Innocent spouse relief

5. Which of the following actions can be appealed in court if the taxpayer disagrees with Appeals' determination?

    A. A Collection Due Process hearing. **Correct**
    B. An Equivalent Hearing.
    C. Review under the Collections Appeals Program.

6. What is the purpose of the Trust Fund Recovery Penalty?

    A. To penalize the responsible individuals who failed to pay the trust fund taxes
    B. To encourage prompt payment of withheld employment and collected excise taxes.-**Correct**

C. To recover the funds that should have been paid over to the government.

7. What is the amount of the Section 6654 penalty imposed when a taxpayer fails to pay his estimated income tax which is shown on the return to be $850?

    A. $50
    B. $850
    C. $0**-Correct.**

8. Which of the following is the IRS not allowed to levy?

    A. Taxpayer's bank account
    B. Taxpayer's wages
    C. Taxpayer's workers compensation-**Correct**

9. Under the new rules promulgated by the Fresh Start Initiative, what is the maximum tax liability for a small business to participate in a streamlined installment agreement?

    A. $10,000
    B. $25,000-**Correct**
    C. $50,000

10. If the IRS has not yet filed a Notice of Federal Tax Lien and the taxpayer wants to have Appeals review the proposed action, the taxpayer should:

    A. Request review in a Collections Due Process hearing
    B. File a suit in Tax Court
    C. Request review under the Collection Appeals Program-**Correct**

Final Exam Answer Key

1. B
2. B
3. C
4. B
5. A
6. B
7. C
8. C
9. B
10. C