How to Get Tax Amnesty

Daniel J. Pilla

CPE Edition

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Course Information

Course Title: How to Get Tax Amnesty

Learning Objectives:

- Choose the definition which best describes the tax gap
- Recognize what creates the tax gap problem
- Select one definition of tax amnesty
- Ascertain what could allow taxpayers the opportunity to extend payment of their taxes due up to six months
- Determine the job of the tax auditor
- Identify what generates a taxpayer's DIF score
- Select what TIGTA has referred to as an epidemic facing taxpayers
- Pinpoint the Internal Revenue Code section that refers to offenses involving the failure to pay tax at the time required
- Recognize the most critical of all evidence needed to sustain a tax conviction based on proof beyond a reasonable doubt
- Select the single most important aspect of a criminal case from a taxpayer's standpoint
- Identify the most crushing blow the IRS can deal in the collection context
- Determine which category is exempt from lien by merely capping its value
- Choose an IRS policy designed to minimize a potential collection surprise
- Spot a goal in avoiding tax enforcement
- Choose a situation in which the IRS can avoid normal deficiency procedures
- Discern how a CDP hearing is usually conducted
- Recognize the effect of a tolling event
- Chapter 6
- Ascertain the purpose of the subordination procedure
- Select a little-known federal law that authorizes one to sue the United States to settle an ownership of property issue with respect to a tax lien
- Spot the IRS code section that authorizes an administrative appeal of the imposition of a lien
- Determine how long funds remain in an account after the IRS issues a bank levy
- Pinpoint the concern IRS employees had over section 1203 of the IRS Restructuring and Reform Act of 1998
- Recognize the specific type of case in which a Taxpayer Assistance Order is appropriate
- Identify the chief way to bring a case to the attention of the Taxpayer Advocate Service
- Choose the minimum amount of income that a married couple with no children must earn before they are required to file a joint return
- Select the percentage of a taxpayer's prior year's tax liability that must be paid in order to avoid both a tax delinquency and the penalty for underpayment of estimated taxes
- Determine the maximum payment amount a tax debtor should never exceed when under an installment plan
- Identify the most common error made by people when making penalty cancellation requests
- Pinpoint the key problem with the with the frivolous submission penalty
- Ascertain what the IRS must prove if a frivolous submission is omitted from the IRS list of positions it deems frivolous
- Recognize the IMF transaction code that reflects the assessment date based on a return filed by the taxpayer
- Determine the effect a levy has on the Collection Statute Expiration Date (CSED)
- Select an action that tolls the collection statute

- Spot the first step toward achieving uncollectible status
- Choose a viable alternative for collection if the citizen can only pay a small portion of the tax liability
- Identify what, by its definition, should be excluded from negotiations when negotiating for a PPIA
- Recognize the current stated IRS business practice when faced with collection issues
- Select the compromise reached under an OIC based on doubt as to collectability
- Determine the maximum payment period of an OIC cash offer based on the "future income asset"
- Pinpoint a benefit to the government of a Future Income Collateral Agreement
- Ascertain who administers a wage-earner's repayment plan
- Identify a non-dischargeable tax debt
- Choose the 1984 Tax Court case that established the well-accepted definition of a tax return
- Spot the bankruptcy code rule that is consistent with the IRS rule for determining disposable income
- Identify the program administered under Chapter 7 of the bankruptcy code
- Select an example of consumer debt
- Determine the perception one should have toward his or her ability to file bankruptcy when dealing with the IRS and unmanageable tax debts

Subject Area: Taxation

Prerequisites: None

Program Level: Overview

Program Content: In this course you'll learn about: stabilizing collection; coping with liens, levies, and seizures; emergency measures to stop collection; the nonfiler program, forgiveness of penalties, the collection statute of limitations, tax amnesty programs, and much more.

Advance Preparation: None

Recommended CPE Credit: 22 hours

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About the Author

For over three decades, **Dan Pilla** has been America's leader in taxpayers' rights defense and IRS abuse prevention and cure. Regarded as one of the country's premiere experts in IRS procedures and general financial problems resolution techniques, he has helped hundreds of thousands of citizens solve personal and business tax and financial problems they thought might never be solved

As the author of fourteen books, dozens of research reports and hundreds of articles, Dan's work is regularly featured on radio and television, as well as in major newspapers, leading magazines and trade publications nationwide. Dan is a frequent guest on numerous talk radio programs where he is heard by millions of people each year. His fast-paced interviews provide hard-hitting answers to even the toughest questions. His many media appearances include CBN, CNN, CBS, CNBC, Fox News and Fox Business, C-SPAN, the CBS Radio Network, the USA Radio Network and many others. His books have been recommended by prominent magazines and financial publications such as *Money*, *Family Circle*, *Investor's Business Daily*, and more. Dan has written or contributed to major articles for *Reader's Digest*, *National Review*, *Reason*, *USA Today Magazine* and others. The Associated Press once commented that, "Dan Pilla probably knows more about the IRS than the Commissioner." *The Wall Street Journal* ranked his book, *The IRS Problem Solver*, as the number one tax book in America.

Dan was a consultant to the National Commission on Restructuring the IRS in 1997. He works with numerous public policy research institutes and presented testimony to Congress on several occasions. His testimony to the Senate Finance Committee blew the lid off IRS abuse and led to many new taxpayers' rights and protections. Dan is admitted to practice before the United States Tax Court and is enrolled to practice before the IRS.

Preface

Throughout the course of this text, I discuss several IRS forms and publications. Many of them are necessary to carry out the tax amnesty plans. I strongly suggest you gather these forms and publications and have them available while you read this treatise. By having them in front of you while you read, it will be easier to comprehend the points I make about completing and using them.

Forms and publications are easily downloadable from the IRS's website, which is www.IRS.gov.

Chapter 1
Promises of Hope

Amnesty: *The act of an authority (as a government) by which pardon is granted to a large group of individuals.*
Webster's Ninth New Collegiate Dictionary

Learning Objectives

- Choose the definition which best describes the tax gap
- Recognize what creates the tax gap problem
- Select one definition of tax amnesty

Introduction

In the same breath with the term "amnesty" we call to mind the terms "leniency," "forgiveness" and "fresh start." The idea of "amnesty" is a kind of "welcome home." It embodies the notion of coming in from the cold. It means that the slate is wiped clean and the sins of the past are dropped into the sea of forgetfulness.

Historically, however, there has been no such thing as *tax amnesty*. As a matter of fact, the attitude of the tax system has been precisely the opposite. Rather than encourage non-compliant citizens to come in from the cold, the IRS's enforced collection policies and practices often drive citizens further from the gates of forgiveness, in the opposite direction—down the path of lost hope.

While many of the individual states have, at times, entertained some type of tax amnesty program, the IRS rejected such an idea for fear it would weaken the agency's iron grip on the throat of society. The IRS, you may know, goes to great lengths each year to publicize its enforcement activity. This is designed to send the clear message to the masses that even the slightest departure by a citizen from total compliance with the tax laws will be met with the full brunt of the agency's enforcement arsenal.

If this is true, why the book, *How to Get Tax Amnesty*?

The first edition of this book was released in 1992. In early 1992, the media released a spattering of stories suggesting that the IRS was softening its enforcement touch. The stories originated with statements from then-IRS Commissioner Shirley Peterson. Her statements, while never using the word "amnesty," led me to conclude that the IRS was at least getting more realistic in its attitude about collecting delinquent taxes.

For example, in a statement to *Forbes Magazine* in March 1992, Mrs. Peterson declared, "You can't get blood out of a turnip, and if we're dealing with turnips, then we're better off cutting our losses and moving on." The old saying, "You can't get blood out of a turnip," is the ultimate justification for debt forgiveness. After all, when you cannot extract anything of value anyway, what else is left but to forgive?

Since its initial release in 1992, this book in its several incarnations has helped well over 230,000 people negotiate with the IRS and resolve tax debt problems they thought might never be solved. In fact, this book is singularly responsible for the creation of an entire industry: the tax resolution industry. You see, prior to the release of the first edition of *How to Get Tax Amnesty*, there were but a handful of tax professionals in the country working on behalf of taxpayers to solve IRS enforcement problems; contrast that with the number of tax return preparers (CPAs and the like) in the country—you could and still can find a preparer on just about every corner.

Since 1992, the IRS's policies that make up what I call the tax amnesty attitude have ebbed and flowed. I have seen periods when the IRS made it more difficult and periods when the IRS made it less difficult to achieve the results I talk about here. However, as the IRS's pendulum of reasonableness swings back and forth, it remains true that by following the procedures set forth in this book, you will enjoy the very real expectation that you will find an amicable resolution to any tax problem you face. The fact is there is no such thing as a hopeless tax case. I don't care how long you've struggled with your tax problem. I don't care what you've done to try to resolve it. I don't care who told you it can't be resolved. There is a way to solve your problem and you'll find it in this book.

But if the IRS is determined *not* to use the term "amnesty," and if the agency continues to use heavy-handed enforcement actions, one must wonder why the IRS has in place procedures that allow for the negotiation and resolution of outstanding tax debt. I believe there are four reasons for this. I address them in turn.

The IRS – A Kinder and Gentler Agency?

The rights and procedures I talk about in this book have, for the most part, always existed. The problem is that the IRS has either lied about these rights or simply failed to discuss them. In fact, for decades I have repeatedly indicted the IRS for not telling the truth about taxpayers' rights. I'm not alone in these allegations. The National Taxpayer Advocate confirmed this in her 2013 Annual Report to Congress, where she pointed out that "IRS employees do not always clearly communicate these rights to taxpayers at appropriate times." NTA, 2013 Annual Report, 51. Even this is a bit of an understatement since the IRS *rarely* communicates to taxpayers what their rights are at all—clearly or otherwise. This is why most people don't believe they have *any* rights at all when dealing with the IRS.

Beginning in 1992 (and thus the impetus for the first edition of this book), the IRS undertook or broadened several programs pointed at delinquent citizens, designed to bring them in from the cold. The programs were designed to assist delinquent taxpayers with arranging payment terms which, in the description of one IRS official, "will not tear them apart." This, by itself, represented quite a departure from the IRS's typical approach to the collection of delinquent taxes. Historically, when faced with unpaid tax debts, one could expect to be forced into such a substantial monthly payment that even a subsistence level of existence was difficult. In the worst case, the IRS would levy all or nearly all one's pay, driving that person into the financial underground. Current programs, which I discuss at length, require the IRS to establish payment terms based on *realistic* financial considerations.

This type of program, by itself, hardly constitutes tax amnesty. In fact, the IRS's initial approach to any collection situation continues to be driven by the idea that the IRS will not cut anyone's tax bill, or otherwise do them any favors. Rather, the IRS's initial approach is very simple and can be summarized in three words: *get the money*.

What kind of amnesty program is that? If there is no forgiveness and no terms are offered that might soften the blow, what is the benefit?

But the number of delinquent taxpayers continues to rise, and—owing chiefly to the financial crisis that began in 2008—there are more people in tax trouble today than ever before. Because of that, the agency is forced not only to acknowledge that it cannot get blood from turnips, but to actually operate policies grounded in that philosophy.

The recession of 2008 was not the first time in history that America has been in recession. It was not the first time that millions of citizens lost jobs, had homes foreclosed and struggled to make ends meet. However, it is one of the few times in history that the IRS Commissioner understood what people were going through and that they needed help dealing with the challenges they faced.

On January 6, 2009, then-Commissioner Douglas Shulman's office issued a five-point directive to all IRS personnel instructing them to be "sensitive to taxpayers, especially previously compliant taxpayers who are, for the first time, having a hard time paying the IRS." This came on the heels of a December 16, 2008, announcement by the Commissioner that offered help to citizens faced with federal tax liens that prevented them from refinancing their homes.

In the January 6, 2009, statement, Shulman outlines the following instructions to IRS employees:

a. Field collection and Automated Collection Service employees were given greater authority to suspend collection in cases where citizens cannot pay. Typically, the IRS's "shoot first and ask questions later" attitude requires that the citizen exhaust all possible means of raising money to pay in full before the IRS considers suspending collection (a process I call "uncollectible status").

See Chapter 11. This involves requiring the citizen to seek loans from multiple sources, including up to three banks and from relatives. The IRS would also require one to liquidate assets to pay the tax if there were substantial equity, even if the equity was insufficient to fully pay the tax. In other words, the citizen would have to liquidate everything first before the IRS would consider freezing collection action.

b. The IRS will be more flexible with citizens who miss a payment under a formal installment agreement. See Chapter 5 for procedures on setting up an installment agreement. Historically, if you miss a payment under an installment agreement, the IRS will cancel the agreement and resume enforcement action. And while appeal rights exist, the process requires the citizen to be very aggressive in getting the agreement reinstated. Also, once an agreement defaulted, the IRS was reluctant to establish a new agreement. Former Commissioner Shulman instructed the IRS to "work with taxpayers" who miss a payment, taking into consideration the facts and circumstances of the case and considering whether adjustments to the agreement are necessary to address the citizen's specific economic facts and circumstances.

c. The IRS has more flexibility in negotiating Offers in Compromise (OIC) for citizens who have equity in assets, chiefly a home. The Offer in Compromise is discussed in Chapter 12. The number-one, biggest stumbling block for those trying to negotiate an OIC is when they have equity in a home. The IRS expects that the value of the equity be included in the OIC amount. Thus, if a citizen has $50,000 equity in a home, an OIC must present a settlement offer of at least $50,000. But the real estate market is unlike anything seen in this country in a very long time. Since 2009, real estate values dropped across the board and are still soft as of this writing. Moreover, it is harder than ever to liquidate real estate to raise cash, and banks have cooled off on home equity lending. Because of this, the IRS set up a special team within the OIC Unit to review real estate valuations that may not be accurate due to current market conditions.

d. The IRS has greater flexibility with required payments under an accepted OIC. Those who have successfully negotiated an OIC often must make monthly payments under the terms of the deal. If you miss a required payment, the OIC defaults and the IRS can reinstate the full tax liability. But under the Commissioner's directive, the IRS "will work with taxpayers" who are unable to meet a required payment. Rather than just pulling the plug, the IRS considers the facts and circumstances of a person's situation and is flexible in resolving the situation without defaulting the OIC.

e. The IRS will expedite levy releases. The IRS issues around 3.5 to 4 million third-party levies—wage and bank levies—*every year*. And once a levy is in effect, the citizen must jump through numerous hoops to get it released. The process for seeking levy release is discussed in Chapter 6. In the meantime, the levy often causes serious financial hardship by attacking the citizen's primary, and often only, source of income. The IRS is required to consider whether a levy would cause a hardship, but often the levies are issued automatically. No evaluation is done. In light of this, the IRS is now instructed to expedite levy releases in order to minimize the hardship caused by the levy (see: IRS Notice No. IR-2009-2, January 6, 2009).

As we see, while the IRS is not necessarily a "kinder and gentler agency," it does recognize, for *selfish reasons*, that its heavy-handed collection practices not only fail to collect the back taxes, but by driving citizens underground, the IRS then fails to collect current and future taxes as well.

Economic Realities Force IRS to Reexamine its Policies

The IRS, much like every government agency, is amazingly incapable of seeing the whole picture. Thus, when it comes to collecting delinquent taxes, the IRS cannot seem to comprehend that while a citizen may very well *owe* the money, his inability to *pay* often renders the amount of the debt a moot point. The real question thus is not how much does a person owe, but rather, what can he *realistically* afford to pay.

Over the years, I have been involved in countless negotiations with IRS personnel. The negotiations often involve the amount of one's underlying tax liability, payment terms, installment amounts, penalty assessments, property values, etc., with disputes arising in one or more of these areas. When they do, tax officials attempting to justify generally unreasonable demands commonly resort to saying, "Your client wouldn't have this problem if he would have just paid the tax in the first place."

What a stupid thing to say!

If my client *had the money* in the first place, he undoubtedly would have paid the tax. But rather than work to reach a reasonable solution to the problem, the IRS officer just plods along wearing his bureaucratic blinders to the economic realities of the situation. Often, the reality is that the citizen did not have the capacity to pay in the first place, at a time when all he owed was just the tax. How can he be expected to regurgitate the money now, at a time when the bill has doubled or tripled because of interest and penalties?

Despite the economic realities, demands for payment persist unabated. With each bill the IRS adds even more interest and penalties. Assessments reach a point where many people just throw up their hands in futility. The result is that citizens are driven underground just to survive and the IRS ends up accumulating accounts receivable that will never be paid.

Writing for the IRS's Collection division on April 13, 1992, the Assistant IRS Commissioner for Collection at the time explained that these economic realities must be taken into consideration by the IRS. In an internal memorandum directed to all Collection Field Function Personnel, the deputy chief tax collector explained:

> *"A collection of $1,000 today is equal to almost $1,500 collected five years from now (present value). Additionally, the $1,000 is real, and the $1,500 is speculative."*

As we examine in detail later, the IRS Collection function must consider the economic realities of delinquent citizens. But since the IRS often ignores its own rules and fails to properly inform taxpayers of their rights, it falls to you to know how to push these matters in your own case. That is among the things you will learn in this book.

Political Realities Force IRS into a More Realistic Support

The tax gap is a matter of great debate and concern with Congress each year. The tax gap is defined by the IRS as the difference between the amount of tax owed and that which is paid without the need of enforcement action. The tax gap increases year after year. As of 1992, estimates put the tax gap figure at about $110 billion. By 2010, the tax gap was estimated to be $350 billion to $370 billion. And there is no end in sight.

Given Congress's wild, uncontrolled spending habits, you can well fancy why the tax gap is a pressing issue. And knowing of Congress's propensity to chase dollars to fund its ongoing spending spree, each year IRS officials ask Congress for more money, more manpower and more equipment. The agency argues that with more money, manpower and equipment, they can reduce the tax gap by $X billion per year. The song goes like this: "If you give us more computers, we will do computerized audits and catch cheaters. If you give us more collection officers, we will chase the deadbeats and make them pay. And if you give us more money, we will accomplish a myriad of goals hitherto only dreamed of by political oppressors of yore." Congress is only too happy to oblige. The agency's budget for 2014 was in excess of $12 billion with a staff of some 95,000 people worldwide—an ominous force to be sure. Moreover, Congress has handed the IRS just about every information gathering tool, information reporting tool, audit tool, enforced collection tool and criminal prosecution tool it ever asked for.

Despite this landslide of financial and legal support, the tax gap continues to increase. Why do you suppose that is? The answer evades Congress and the IRS because they search for it in all the wrong places. I have repeatedly stated that the traditional view of why the tax gap increases is simply *not valid*. The traditional view suggests that the tax gap increases because more and more citizens cheat. That is simply *not true*. Precious few citizens cheat on their taxes because, thanks to IRS propaganda, they understand that the penalty for doing so is simply too great. Of the many thousands of delinquent taxpayers I have dealt with in my career, I have never met a person who woke up one day and said to himself, "How can I tick off the IRS today? I know. I'll stop paying my taxes." Nobody does that.

The tax gap grows because, increasingly, people have to make the impossible choice between paying their taxes and feeding their families. And when faced with that cruel dilemma, a person will opt to feed his family—and he'll make that his first choice *every time*. The growing tax gap is not attributable to cheating, it's attributable to the fact that people need to survive in an increasingly difficult economy under a tax system that lays a growing mountain of financial and information reporting burdens at their feet. Just for example, under the Patient Protection and Affordable Care Act (Obamacare), taxpayers must now verify to the federal government through the IRS that they have purchased government-approved health care for themselves and their families. If they fail to do so, they can be charged a penalty, which is known by the Orwellian phrase "shared responsibility payment." See IRC §5000A(b).

As an example of this burden, I have a client with substantial delinquent tax liabilities. She is unable to afford health insurance because she can barely afford to keep up with her house payments. She was hit with an assessment for the "shared responsibility payment." She asked, "How can they expect me to pay this when I can hardly make my mortgage payment?" Good question. And what makes anybody believe that people struggling in this way will give two hoots about a "shared responsibility payment," especially when they already owe tens of thousands of dollars in taxes they cannot pay?

The short answer to the tax gap problem is that the government itself creates the tax gap by creating heavy burdens that a growing number of people simply cannot lift, despite their best intentions.

Even many of the installment agreements worked out by the IRS do not solve the problems of tax delinquency because of the onerous burdens of penalties and interest. In the IRS memorandum I referred to earlier, the former Assistant Commissioner addressed the issue, saying, "In many cases, the taxpayer is not paying enough to cover the accruals (interest and penalties) and will *never satisfy* the liability." (Emphasis added by author.)

In sum, the IRS memos mentioned above (and others discussed throughout this book) show that the agency recognizes the political reality that the tax gap cannot be controlled without addressing the root cause—which is the excessive burdens the system places on individual taxpayers.

The Education Factor

Since my first book was released in 1986, I have made well over five thousand appearances on radio and television, in newspapers, magazines and newsletters. I have shouted from the rooftops the fact that citizens have rights and the IRS has limitations. One sign of the effectiveness of my work comes in the form of the hundreds of letters I receive from grateful citizens. The letters explain how my books helped them solve seemingly hopeless tax problems. The letters tell stories of those who saved $200 or $200,000 in taxes by following my simple tips and procedures. Throughout this book, I share some of those letters. They, more than anything, prove that there really is no such thing as a hopeless tax case.

Most satisfying, however, is the fact that my work has caused substantial positive changes to the system, as is evidenced throughout this book. One reason for this is the education factor. In my radio shows, I explain to countless numbers of desperate citizens how to solve their problems. I explain that tax penalties can be abated, in many cases, with nothing more than a simple letter. I explain that the law allows the IRS to forgive uncollectible taxes if the citizen can only demonstrate that he cannot pay. I explain that when the decision of a tax auditor is challenged, the citizen wins his case 60 to 90 percent of the time.

Perhaps the greatest factor most dispositive in forcing the policy changes we now see is that I disclosed in 1988—publicly and for the first time—the fact that federal income taxes are dischargeable in bankruptcy. Prior to that revelation, this was the best kept legal secret in the nation, and it remains a point of great misunderstanding even today. Since 1988, we have discharged in bankruptcy millions of dollars in taxes which could never be paid. As if this were not enough, the information I broadcast on penalty abatements has led to the cancellation of billions of dollars in improper penalty and interest assessments over the years.

The change in the IRS's hard-fisted collection attitude is not due to the fact that its leaders "got religion" and decided to do you a favor. The change is attributable to the fact that the IRS got a billion-dollar legal education stuffed down its throat a nickel at a time by citizens who learned their rights and stood tall in the face of IRS challenges.

What "Tax Amnesty" Really Is

If the IRS is not offering tax amnesty through a formal "amnesty" program, you are no doubt wondering who is offering amnesty and what it really is. The answer to the first question is that I am offering tax amnesty by exposing IRS policies that allow for the forgiveness of tax debt. The hopeless citizen burdened with unmanageable tax debts is entitled to drink from the cup of relief. My years of labor in the vineyards of pressuring the IRS and in the proclamation of taxpayers' rights have produced substantial results. The IRS may not be offering "amnesty" in the strictest sense, but the agency realizes the political and economic necessity to provide relief to those who know how to ask for it. But ask you must, for it is written, "Ask, and it will be given you; seek, and you will find; knock, and it will be opened to you."

As to the question what is tax amnesty, the answer is simple. It is freedom from the oppression of tax debt. It is freedom from the pressure of relentless IRS collection efforts. It is freedom from running and hiding that desperate people are often pushed into. It is freedom to once again be a productive citizen.

Review Questions

1. What is the chief reason for a recent increase in the number of delinquent taxpayers?
    A. Lack of IRS sensitivity toward delinquent taxpayers
    B. The IRS will not negotiate Offers in Compromise (OIC)
    C. The IRS does not communicate to taxpayers what their rights are
    D. Financial crisis of 2008

2. Which of the following causes continuous increases in the tax gap?
    A. The choice between paying taxes and feeding a family
    B. Congress will not provide the IRS with the necessary enforcement tools
    C. More and more citizens cheat on their taxes
    D. Congress is not concerned with the tax gap

3. Which 1988 revelation has led to the reduction of millions of dollars in taxes owed?
    A. Demonstration by taxpayers of their inability to pay
    B. Taxes are dischargeable in bankruptcy
    C. IRS offers of installment agreements
    D. The IRS "woke up" and started doing a favor to taxpayers

Review Answers

1. A. Incorrect. Lack of IRS sensitivity toward delinquent taxpayers is not the chief reason for a recent increase in the number of delinquent taxpayers. In 2009, then-Commissioner Douglas Shulman's office issued a directive to all IRS personnel instructing them to be sensitive to taxpayers.
   B. Incorrect. Non-negotiation of OICs by the IRS is not the chief reason for a recent increase in the number of delinquent taxpayers. IRS employees have been told to show more flexibility in negotiating OICs for citizens who have equity in assets.
   C. Incorrect. The chief reason for a recent increase in the number of delinquent taxpayers is not because the IRS does not communicate to taxpayers what their rights are. The IRS rarely communicates to taxpayers what their rights are at all – clearly or otherwise.
   D. **Correct.** The number of delinquent taxpayers continues to rise, chiefly due to the financial crisis that began in 2008.

2. A. **Correct.** The tax gap continues to grow because people have to make the impossible choice between paying taxes and feeding their families.
   B. Incorrect. The reason for continuous increases in the tax gap is not because Congress will not provide the IRS with the necessary enforcement tools; instead, Congress has handed the IRS just about every enforcement tool that it ever asked for.
   C. Incorrect. Continuous growth in the tax gap is not due to more and more citizens cheating on their taxes. Although the traditional view is that the tax gap increases because more and more citizens cheat, that is simply not true as precious few citizens cheat on their taxes because they know that the penalty for doing so is too great.
   D. Incorrect. Continuous growth in the tax gap is not due to a lack of concern about the gap by Congress. The tax gap is a matter of great debate and concern with Congress each year.

3. A. Incorrect. Demonstration by taxpayers of their inability to pay was not a 1988 revelation that led to the reduction in millions of dollars of taxes owed. The law allows the IRS to forgive uncollectible taxes if the citizen can only demonstrate that he or she cannot pay.
   B. **Correct.** The 1988 revelation that taxes are dischargeable in bankruptcy has led to the reduction in millions of dollars in taxes owed.
   C. Incorrect. IRS offers of installment agreements is not the 1998 revelation that has led to millions of dollars of tax reductions. Installment agreements worked out by the IRS do not solve the problems of tax delinquency because of the onerous burdens of penalties and interest.
   D. Incorrect. Millions of dollars of taxes owed have not been reduced because the IRS "woke up" in 1988 and started doing favors for taxpayers. Changes in the IRS rules occurred that were caused by factors other than the IRS changing its attitude.

Chapter 2
How Do I Owe Thee? Let Me Count the Ways!

Learning Objectives

- Ascertain what could allow taxpayers the opportunity to extend payment of their taxes due up to six months
- Determine the job of the tax auditor
- Identify what generates a taxpayer's DIF score

Introduction

He who owes another is, in a very real way, enslaved. This is particularly true in light of modern lending practices which include detailed financial statements, lengthy mortgage documents, ongoing monthly payments, liens that create public records of debt and, of course, compound interest that substantially increases the principal debt. This does not even consider the potential for foreclosures in the event of default, which outright dispossess people of their property.

Excessive debt saps the borrower's strength. Over time, he loses the will to work. As a lender's demands increase, the debtor's ability to be productive, provide for himself and his family and service the debt greatly diminish. As he falls further behind, the feelings of helplessness and hopelessness escalate. Eventually, he may become wholly disheartened and entirely unproductive, running from the very world in which he lives.

Another terrible aspect of debt is that it often inextricably binds one to the mistakes of the past. Debt is continuing evidence of one's past poor judgment. Bad business decisions or unsound personal choices follow you like a ball and chain, keeping you from moving ahead.

Desperation is not uncommon when the subject is tax debt. With every other type of debt, there seems to be at least some sprinkle of hope. After all, one can possibly negotiate with creditors for more-acceptable terms. Maybe he can liquidate property to pay claims. In the worst case, he can turn to a bankruptcy court and stake a legal claim to a fresh start.

Unfortunately, most people do not ascribe the same potential remedies to tax debts. Most people believe that the IRS would sooner put someone in jail than negotiate a tax debt. Often, property cannot be liquidated due to oppressive tax liens or because a person owes more to the lender than the property is worth. Most of all, because the IRS lied to the public for twenty-two years about the right to discharge taxes in bankruptcy, most people (including too many bankruptcy attorneys) believe taxes are not dischargeable. Given these facts, too many people living the ungodly nightmare of tax debt believe they must take the debt to their graves.

In her testimony to the House Government Operations Committee in June, 1992, former IRS Commissioner Shirley Peterson confirmed what I have said a thousand times, both before and after her testimony, regarding the reasons the vast majority of tax delinquencies exist in the first place. She said, "Many taxpayers may want to comply, but cannot because they don't have the money to pay the tax due. When this happens, they often decide not to file a return. They may eventually drop out of the system altogether." Mrs. Peterson also correctly observed that "a good part of what we call noncompliance with the tax laws is caused by taxpayers' lack of understanding of what is required in the first place."

In this chapter, I provide the profile of what the IRS calls the "non-compliant taxpayer." I describe in detail the most common ways one becomes a delinquent taxpayer. What you are about to read constitutes the eight most devastating tax collection problems in America. If you find yourself identifying with one or more of these problems, then indeed, amnesty can be yours.

Failure to File a Tax Return

Failure to file a tax return is considered by the IRS to be an egregious form of non-compliance. Each year, millions of citizens and businesses fail to file required returns for a host of reasons. There seem to be two general reasons why this occurs. The first, most common reason is due to financial problems. The second reason is much broader in scope. It relates to causes not necessarily tied merely to dollars and cents. I address each group in turn.

Financially-Induced Failure to File

Life regularly forces citizens into the unenviable position of having to choose between paying their taxes and feeding their families. In that situation, one always chooses to feed the family. That creates a problem at tax time. The fear and uncertainty of dealing with the IRS leads many of these people to avoid filing a return altogether, a mistake that adds insult to injury later.

In many cases, the IRS is directly responsible for exacerbating the situation. Many of these people would not avoid filing if the IRS told the truth. For years, the IRS falsely informed citizens that they have no right to obtain an extension of time to pay taxes. I speak personally with hundreds of citizens who tell me they called the IRS seeking advice on what to do when they do not have the money to pay. Time and again, the IRS explains there is no right to obtain an extension of time to pay. If you cannot pay the tax, IRS advises you to simply file and "hope for the best."

Unfortunately, most citizens are well aware of the IRS's capacity to inflict harm in the process of tax collection. Thus, they are unwilling to just "hope for the best." The result is, rather than file the return without paying the tax, they file no return at all.

This particular non-filing problem would be greatly reduced if the IRS just told the truth about Form 1127, *Application for Extension of Time to Pay Tax*. If that form is filed on or before April 15, one can potentially win an extension of up to six months to pay. Not only would the non-filing problem be mitigated, but the public would save tens of millions dollars in failure to pay penalties and interest. For more on Form 1127, please see Chapter 9 of my book, *The IRS Problem Solver*.

Once the first return goes unfiled, a dangerous pattern begins. The citizen tells himself, "I'll get the money in the next few months or so and file late." Sometimes he files an extension of time to file the return (Form 4868), sometimes not. Inevitably, however, financial hardship continues and he never finds the tax money. Before long, he faces the requirement to file his next return and has yet to file the previous return.

Now, fear sets in. In some cases, the initial financial problems spill over from one year to the next. In other cases, the fear of exposure immobilizes the citizen. In either case, one unfiled return becomes two, then three. Before you know it, one is mired in a pattern of delinquency and facing a mountain of taxes and penalties with no hope of solving the problem.

Unusual Circumstances Cause Failure to File

Not all failures to file are due to financial problems. There are a variety of other reasons. Recordkeeping problems and medical crises are among the leading causes of non-financially motivated failure to file. Let me give some examples.

Recordkeeping Problems

Deb's husband ran a small construction company and traveled a lot. While he worked the business, Deb raised their children. Deb's husband was not an organized person when it came to recordkeeping. Like many citizens uneducated in accounting and recordkeeping, he operated his business out of his pocket. His file cabinet was mostly the floor of the front seat of his truck. The standard by which he judged the success of his business was simple. "If I had money, I was doing okay. If I didn't, I wasn't." Who needs an accountant to figure that out?

Deb and her husband were not criminals and they were not tax cheats. They were, however, confused by a complicated system and fell victim to their own reservations and ignorance. As a result of their lack of organization, Deb and her husband did not file their tax return for one year, and that began a pattern that continued for the next eight years. That is when the IRS finally knocked on the door and put the fear of God into Deb.

Consider the case of Doug. He, too, operated a small business but did so out of a briefcase rather than the floor of his truck. At one point, Doug's car was parked at a local service garage for repair. Before leaving it, Doug removed the items of value but left two boxes containing his financial records for the year in question.

While the vehicle was at the service garage, it was broken into and, you guessed it, various worthless items were stolen, including his records. This happened in February, just two months prior to the tax return filing deadline. Doug had no idea what to do, so, like many others who have lost records, he did nothing. He filed no return and submitted no extension of time to file. After all, why ask for an extension of time when he did not have any records from which to prepare the return anyway? Over time, Doug's single act of non-filing turned into many such acts. Perceiving that he could not file his next return because of the initial unfiled return, he suddenly had two unfiled returns. Then two became three.

Recordkeeping problems may be occasioned for reasons other than confusion or ignorance. You may have lost records due to fire, flood, hurricane, civil disorder or some other casualty. In one case, I dealt with a woman who moved several times within just a few years. Her records ended up with all of her old issues of National Geographic, buried deep within some recycling bin. This started her on a pattern of non-filing that continued for four years.

Some IRS personnel might scoff at the above factors and say, "Those reasons are no excuse for not filing *subsequent* returns." They might concede that reasonable cause existed for not filing the initial return, but they assert there is no justification for allowing the pattern to continue. The hardness of their hearts leads them to simply blame the taxpayer and exclaim, "They deserve what they get!"

The fact is, the agency itself is chiefly responsible for a great deal of the non-compliance that exists today. The IRS, and no one else, goes to great lengths to terrify the public. It leads the nation to believe that if you run afoul of the agency, you will be destroyed. Why would anybody wish to bring that kind of wrath upon himself by stepping forward after making a mistake?

The IRS, no one else, has lied to the public about the ability to obtain an extension of time to pay taxes. Those lies continue to this day. If the public had any idea of this right, the millions of tax returns which go unfiled because of financial shortcomings would likely be filed on time.

The IRS, no one else, lobbies Congress annually for increased penalty and interest tools with which to club the public when they make mistakes. Using these tools unashamedly, the IRS routinely doubles, triples—or more—a tax bill attributable to failure to file. Then to add insult to injury, the IRS lies to the public about the right to cancel those penalties. IRS employees regularly claim that nothing can be done about penalty assessments, and yet, that is simply not true.

When a citizen finally does step forward or is found out, it is the IRS, no one else, that imposes enforced collection, often sending the citizen right back into hiding. After all, how can anyone be expected to pay taxes at the expense of feeding his family? I do not care what you may think, the reality is that when faced with a choice between feeding the family and paying the tax, the family will be fed—period.

The fact is, compassion for the unintentional, the ignorant, the confused or misled citizen nets the agency more revenue and good will then does the Darth Vader approach to tax collection. After all, these are *fellow Americans* the IRS grinds into powder.

Medical Problems

A Phoenix man I will call Bill was faced with a real crisis. His wife was diagnosed with cancer and the outlook was not good. Bill immediately began to do everything in his power to keep his wife alive. He went from specialist to specialist and from one treatment program to another.

The disease progressed, but slowly at first. Bill's search for hope and a cure went on. Diverting all his resources toward the battle, he used every available dollar to pay for doctors, hospitals and clinics. As financial demands grew, Bill met them by funneling tax money into the war. When faced with the prospect of paying the tax or potentially keeping his wife alive, Bill's choice was simple and he made it without hesitation.

When the time came to file his tax return, he was struck with a harsh reality. His wife's illness and care consumed both his resources and his time. Even if Bill had the money to pay the tax, there was no way to prepare a correct return because he spent no time attending to his financial affairs. Bill's decision, like that of keeping his wife alive, was made quickly. He simply failed to file.

Eventually, Bill and his wife lost their physical battle, but not before piling up several years of tax return non-filing. Having emerged from one critical war a loser, Bill now faced another. And his prospects for winning the second war seemed no better than the first. In the second fight, however, Bill had nowhere to turn, so in his retreat, the problem only grew worse.

Rod also had a medical problem. He was an alcoholic and his problem was out of control, so much so that he could not hold a job and he lost his wife. During that period, Rod went four years without filing. His affairs were in such disarray he could not begin to construct a return even if he were sober long enough to recognize the requirement. Eventually, Rod got help with his drinking problem and dried out. While surveying the damage from his new position of sobriety, he realized, among other things, that he failed to file several tax returns. He anonymously phoned the IRS seeking advice.

What he learned was not promising. He would have to file the returns, he was told. No surprise there. He was also told that interest and penalties would be added to the bill. Likewise, that came as no surprise. He then asked if terms could be worked out. He was told the IRS was not a bank and if he could not pay, he could expect wage levies and tax liens.

Rod went several years without filing returns and heard nothing. When he voluntarily stepped forward seeking help, he was threatened. His concern turned to fear, then to bewilderment. "Why," he asked, "would they do nothing when I was not filing, then threaten to crush me the minute I stepped forward to fix the problem?"

Good question. There are legal and procedural reasons (which I address later) why this occurs. However, by following the procedures in this book, you will avoid this problem entirely.

Rod could not pay the tax and he could not survive wage levies. The agency gave him no hope. Therefore, he continued in the pattern of non-filing. Eight years went by before he came to grips with the trouble.

Rod's story evidences a phenomenon that bears discussion. Citizens can go for years without filing tax returns. In the process, it is very common that they hear absolutely nothing from the IRS. That is one reason we see the non-filing pattern continue for so long. When one fails to file the first time, he expects the IRS to be at the door within just a few months. But the agency not only does not come to the door, it sends no letters and makes no phone calls. After the shock and dismay wear off, it becomes slightly easier to skip the second year, then the third. All the while the citizen expects somehow to raise the money, but never is contacted by the agency.

After filing the tax returns, it seems the roof caves in. Almost overnight, the IRS records tax liens, sends penalty notices and issues demands for payment in full. The IRS may also assign a Revenue Officer (RO) who makes personal contact with the citizen to demand payment in full.

Please note none of this should be construed as encouraging the failure to file tax returns, nor should it be construed as encouraging the pattern of non-filing. I am simply pointing out the psycho-dynamics of the non-filer. I know because I speak with hundreds of them every year. I help them solve the problem and break the pattern. If the IRS did what I do, there would not be millions of non-filers every year.

Filing a Tax Return without Paying the Tax

Another common way of becoming indebted to the IRS is by filing a return that *reports* tax due but without *paying* the tax. Any number of financial, medical or other factors can affect one's ability to pay. However, most people in this situation file the return *without* taking protective measures.

After filing a return, the tax becomes "assessed." This is the process of recording the debt on the IRS's books as an official liability. The assessment affords the IRS the right to collect the tax. Collection begins with a series of notices and demands. If the tax is not paid within thirty days of the IRS issuing a *Final Notice, Notice of Intent to Levy* (discussed in detail in Chapter 4), the agency may enforce collection. This is the reason people can go years without filing a return and never hear from the agency only to have the roof cave in just months after filing a single return. The assessment, created at the time of filing, releases the dogs and unless you meet and neutralize the attack, you are fresh meat.

Tax Debt Created by Tax Audits

The stated purpose of a tax audit is nothing more or less than the process of determining the correctness of a tax return. In the civil tax environment, the citizen bears the burden of proof with regard to all issues claimed on the return. That does not mean you go to jail if the IRS accuses you of a crime and you cannot prove your innocence. It means if the IRS challenges a claim in your return, you must prove the correctness of the claim. If you cannot, it is disallowed. If disallowed, the IRS recalculates your tax bill and assesses you the difference, including interest and penalties. If you incur tax debt as a result of an audit, you may lay claim to at least one form of forgiveness. Most importantly, you can prevent that debt from driving you underground.

General Tax Audits

The IRS pretends the tax audit is merely a tool to check the accuracy of tax returns. In reality, the audit process leads to big bucks for the agency. The process leads to billions of dollars in additional tax and penalty assessments each year. According to the IRS, about 88 percent of all returns are incorrect at some level. When audited, the alleged errors lead to wholesale assessments of interest and penalties.

But as I document in my book, *How to Win Your Tax Audit*, many of the techniques employed by tax auditors are carefully contrived bluffs designed to obtain bogus tax assessments. This claim is proven each time I speak with another discouraged citizen seeking an explanation for the incredible claims made by the IRS in *his* audit.

No decision of an auditor is final and when you appeal your audit, your chances of winning are substantial. For example, the IRS's own statistics (addressed at length in *How to Win Your Tax Audit*) show that the IRS's audit results are wrong between 60 to 90 percent of the time. Statistics also show that the IRS collects substantially less from those who appeal audit decisions versus those who do not.

The reality, however, is that most people do not understand that you can say "no" to an auditor and make it stick. Most people cringe at the thought of challenging an IRS official. And the IRS knows this. Consequently, it continues the practice of extracting money from citizens under the guise of correcting errors.

Because tax auditors have nothing whatsoever to do with collecting the final assessment, they could not care less whether you can actually *pay the bill*. Their job is simply to determine the "correct liability." It is the job of a Revenue Officer (RO) to collect the assessment. Once the case is handed to an RO, his only concern is to collect the tax—and he could not care less whether you *actually owe* it.

Each year, hundreds of thousands of citizens are caught in this trap. The result is a tax bill they generally cannot explain and a tax collector who does not care even if they could.

IRS Errors

In my book, *The IRS Problem Solver*, I document that for more than thirty years, the IRS has been deliberately sending notices to the public which it knows are wrong or incomprehensible. Despite this knowledge, the IRS does little or nothing to correct a problem that costs the public billions of dollars annually. Consider the following examples.

Computer Notices

The IRS conducts computerized audits of every tax return filed. Those audits lead to a flurry of notices as well as millions of face-to-face examinations annually. The number of notices issued climbs into the tens of millions each year.

When conducting these audits, IRS views at least four items. First, it determines the mathematical correctness of the entries in the return. Second, it ascertains mechanical correctness. By that I mean it verifies whether all necessary supporting schedules are attached and whether all required entries are present and in the proper line, etc. Third, it compares all information returns, such as Forms W-2 and 1099 bearing your Social Security number, with the income reported on your return. This is to ensure that you accurately report all income. Fourth, it conducts a Discriminate Income Function (DIF) analysis of your return.

The DIF program is a sophisticated program that compares every entry on your return with averages for a person in your same income category and profession. If any line of your return is out of sync with the averages, the difference is "scored." This is referred to as a DIF score. The higher the score, the more likely your return will be audited.

Any of these first three functions regularly lead to the issuance of computer notices. The notices explain that an error was made in the return and was corrected by the IRS. The notices may explain the nature of the error or they may not. They do, however, point out that interest and penalties were added and demand payment. In my book, *The IRS problem Solver*, I dissect these notices and show step-by-step procedures to deal with them. Most people do not deal with them properly. As a result, they find themselves in debt for taxes not legally owed.

Information Returns

Errant computer notices are not always the fault of IRS. Each year, the IRS processes well over one *billion* information returns. The mountain of paperwork is prepared by industry and submitted to the IRS in two forms. The first form is the actual paper documents and the second is the computerized documents submitted on machine readable media. The common thread running through both types of submissions is that they are prepared and processed by humans—and humans make mistakes. According to the IRS, the private sector error rate found in information returns is about 5 percent. While that may seem like a small number, it means at least 50 *million* errant information statements are filed each year. And with Congress passing new information reporting laws regularly, the number of information returns required grows steadily. Before long, we all will be required to report the number of times per month we mow the lawn. For more on this, see Chapter 2 of *How to Win Your Tax Audit*, which is entitled, "The IRS Moves Closer to 'Big Brother'."

For the same reasons expressed in the previous section, most citizens are not successful in correcting errant notices. The result is that the IRS demands payment of taxes based on income the citizen never received or mistakes he never made.

Divorce and Spousal Abandonment

Unfortunately, the sad reality is that the consequences of a broken marriage go beyond the impact it has on the children. Broken marriages carry serious financial implications often reaching well into the sphere of income tax matters.

Virtually without exception, all married couples file *joint* federal tax returns—and for good reason. The joint income tax rates are much less expensive than the married filing separately rates. For example, the tax on $40,000 (using 2015 rate tables) computed at the *married filing jointly* rates, is $5,069. However, if just one spouse earns $40,000 and elects to be taxed at the *married filing separately* rates, the tax is $5,863. Thus, the sole breadwinner pays a penalty of $794 to elect to file a separate tax return. And this is after Congress allegedly fixed the so-called "marriage penalty."

Many people believe the IRS gives the break to married citizens because they generally have children and thus face a greater financial burden. However, this is simply not the case. A growing number of single people have children and they do not receive the same break. The same $40,000 of income taxed at the *head of household* rates creates a tax liability of $5,356. That is $287 more than the tax on the same income at the married filing jointly rates.

The cheaper rates for married citizens filing jointly are designed solely to *induce* the filing of joint returns. When filing a joint tax return, both parties are *jointly responsible* for the debt regardless of who *actually* earned the income. Consequently, a husband could be responsible for earning all the income, file a joint tax return, and then desert his wife without paying the tax. Because of the joint return, the wife can be forced to pay the tax even though she earned none of the money.

Why would the IRS do this? The answer is very simple. Virtually all married couples hold their assets jointly. As such, each possesses an equal legal interest in the property. A problem for the IRS arises when separate returns are filed but the tax is not paid. The IRS *cannot* seize joint property to satisfy the liability of a single spouse without compensating the non-debtor spouse. I discuss this further in Chapter 6. This makes it more difficult for the IRS to collect from joint assets. The problem is eliminated by simply bribing the married couple to file a joint return. That way, both are equally liable for the tax and assets can more easily be seized to pay a potentially unsatisfied bill, regardless of whose name the assets are held.

I speak with many women who, after obtaining a divorce, believe they are protected from unpaid tax bills by virtue their divorce decree. The typical language in such an order holds that the husband is responsible to pay any unsatisfied tax. However, if the IRS cannot find the husband, it ultimately attacks the wife. Unfortunately, the divorce decree is not binding on the IRS. The divorce decree does not pretend to, nor could it vitiate the legal liability established by the federal tax laws. Therefore, when the wife complains that the divorce court held the husband liable, the IRS is unimpressed. Despite the fact that she may have been left with little or nothing but the children to support, the IRS chases her for the unpaid bill.

Cancellation of Debt Income Due to the American Debt Crisis

The debt and credit crisis that began in earnest in America in 2008 caused profound financial problems for many middle-income citizens. Some of the harshest ways these problems manifest themselves is with: 1) substantial credit card debt, 2) bankruptcies, and in the worst case, 3) homes and other property lost to short sales, foreclosures or repossessions.

Because of the high amount of debt that many families carry, many have pursued one or more of four strategies to reduce or eliminate their debt. They have: 1) negotiated full or partial debt cancellation directly with their credit card companies, 2) negotiated loan modifications with their mortgage lenders, 3) turned to bankruptcy to resolve their debt problems, and 4) perhaps worst of all, either voluntarily or through legal foreclosure, lost their home to the mortgage company or gave up other property, such as a vehicle, to a lender in exchange for debt forgiveness. Home foreclosures during 2008 through 2013 were at record highs, as tens of millions of Americans suffered the heartache of losing their residences.

As bad as it is to lose your home through financial catastrophe, the heartache doesn't end there. To add insult to injury, the cancellation of debt—whether through voluntary negotiation, bankruptcy or as a result a home foreclosure—often leads to tax problems. This happens when the creditor issues Form 1099-C, *Cancellation of Debt* (or in the case of a short sale, Form 1099-A, *Abandonment*) to you and the IRS. The Form 1099-C (or Form 1099-A) shows that you had income in the year the debt was canceled. Now the IRS wants you to pay taxes on the so-called "income" reported on the Form 1099.

You may ask how debt forgiveness has anything to do with one's tax liability in the first place. Unfortunately, most people never see the connection until after the damage is done. Simply put, if you borrow money but later all or part of the debt is forgiven, the amount of the debt forgiveness is generally considered taxable income to you. The tax law refers to this as "cancellation of debt" (COD) income or "discharge of debt" income. In most cases, you must pay taxes on the amount of debt that is forgiven.

Does this sound crazy? Well, think about this. When you get a loan from a bank, say $50,000, you are not taxed on the loan proceeds. You can use the money any way you like. The loan is non-taxable because you are obligated to repay the principal. When you receive the loan and then pay it back, there is no increase in your wealth. Hence, no income tax is owed. Likewise, when you repay the principal, you are not entitled to any deduction for the principal amount of the loan, though you might be able to write off the interest.

But look what happens if you *do not* repay the principal. In that case, you receive $50,000, which increases your wealth, without ever having to pay it back. And because you do not have to pay it back, the nature of the transaction changes from that of loan (non-taxable) to that of an "*accession to wealth*" (which is taxable).

In the case of credit card debt for example, the "accession to wealth" occurs in the form of all the things you purchased with the credit card. You may have used the card to purchase any number of goods and services that you used and consumed. When the debt is not paid back, the IRS treats that "*accession to wealth*" as taxable income.

In the case of a home foreclosure or short sale, there is a "double-whammy" that makes matters worse. That is, the "accession to wealth" is often phantom. The reason is that all the "wealth" is tied up in the home itself, which now belongs to the bank. Also, the foreclosure or short sale *always* occurs at a time when the individual is the least "wealthy." Otherwise, why would he lose his home to foreclosure?

Of course, the same can be said of debt forgiveness that arises in any of the four common scenarios outlined above. People do not negotiate with credit card companies when they *can pay* their credit card debt. And they certainly do not file bankruptcy when they have other options available to resolve their debts. In each of these areas, the citizen faces a profound hardship that is only made worse by the IRS demanding the payment of taxes on the canceled debt.

Business Debt

Before embarking on a new business, many entrepreneurs incorporate their businesses. The pervasive belief is that the corporate structure provides a jacket of insulation from potential creditors which might grow out of the venture. However true this may be of *other* creditors, it *does not* hold water with the IRS.

The theme with businesses that have gone south is very much the same regardless of the nature of the operation. Bad economic conditions, poor management or a thief in their midst leads to seriously reduced cash flow. At that point, an elaborate juggling act begins, designed to float creditors as long as possible with the hope that sufficient funds materialize to stand the business back on its feet.

Any business with employees is required to withhold federal income and Social Security taxes. The withheld funds are referred to as *trust fund* taxes. This is because the law establishes a trust relationship between the IRS and the employer. The employer withholds the money and is required to send it and an accurate report (Form 941) to the IRS. The funds are therefore held in trust by the employer on behalf of the employee and the IRS. The trust relationship is satisfied by paying the tax in full and on time.

In addition, employers are required to make matching payments of Social Security and Unemployment taxes. These funds are referred to as *non-trust taxes*. They are non-trust because the funds do not originate with the employee. Rather, they come from company revenue. Non-trust taxes are reported both on Form 941 (matching Social Security taxes) and on Form 940 (unemployment contributions).

At the heart of the juggling act is the IRS. When a business finds itself in trouble, it quickly falls behind in the payment of employment taxes (trust fund and non-trust fund alike). This happens for two reasons. The first is the practical reason. When cash flow is tight, businesses often operate on what is referred to as *net payroll*, because often they have no other choice. To illustrate net payroll, suppose you have one employee who grosses $1,000 per month. Suppose further that your trust tax withholding obligation is about 25 percent, or $250 (to be withheld from the employee). Also, suppose your non-trust liability is another 15 percent, or $150 (to be paid directly by the employer).

In order to meet the total burden of the $1,000 per month payroll, you must have $1,150 on hand. Because of sour cash flow, you do not. However, due to wage withholding considerations, you actually pay the employee just $750 ($1,000 gross pay minus $250 trust fund withholding). By paying the employee $750 and not paying the taxes, you operate on net payroll. This process reduces your immediate cash requirement by $400 ($250 + $150 in taxes not paid). When you extrapolate this over five, or ten, or fifty employees, you easily see how a company gets behind very quickly.

The second reason employment tax debts occur is grounded in emotional factors. Company heads faced with serious financial constraints often fool themselves. They convince themselves that the slowdown is only temporary. They sell themselves on the idea that business will turn around in two or three months and when it does, they will pay all the taxes at once. They point to this "big deal" or that "pending sale" as proof of their contentions.

Too often, however, this "big deal" or that "pending sale" never materializes. The result is things go from bad to worse. Very few companies ever recover from excessive employment tax burdens. The primary reason is the IRS is unforgiving of the net payroll problem. It considers employers in that position to have "stolen" the money and used it to run their business at the expense of the U.S. Government. When these cases fall into the hands of ROs, the result is always aggressive enforced collection.

After seizing company assets, the IRS turns its attention to corporate officers and business heads. Under the law, the IRS has the power to hold corporate officers and certain other company officials *personally* responsible for unpaid trust taxes. One can be held personally liable if he was responsible to withhold, truthfully account for, and pay trust taxes to the IRS but deliberately failed to do so at a time when he knew they were owed. IRC §6672. When the IRS decides to hold an individual accountable for unpaid trust taxes, it assesses him personally with an amount equal to the delinquent trust taxes. The assessment is known as the Trust Fund Recovery Penalty.

After the assessment, the IRS pursues *personal* income and assets to satisfy the tax. Thus, the corporate veil is never an absolute protection from trust taxes. However, amnesty is available to those facing these assessments.

Tax Protesters

Tax protesters are nothing new. They have been around as long as taxes themselves. Tax laws spawn tax protesters for three reasons. First, some believe the laws are illegal, unconstitutional, immoral, oppressive or unreasonable. Second, some do not agree with the way the money is spent. Third, some are simply greedy and do not wish to pay. The United States has its share of tax protesters motivated by all three reasons.

The history of the modern tax protest movement dates to the mid-60s. It began with individuals who believed our tax laws violate the Constitution in a number of ways. Most notably, the theory was that by signing a Form 1040, you waive your Fifth Amendment right against self-incrimination. Since the Constitution provides that no person may be compelled to give testimony against himself, protesters argued that no one can lawfully be required to sign a tax return.

This theory and many variations were tested by the courts and IRS over a period of five-plus decades. Since the middle 1960s, the IRS developed and regularly revises its tax protester training manuals and instituted detailed policies and procedures for dealing with protesters. The IRS trains its field personnel in the various protester arguments and how to counter them. In addition, the IRS publishes on its website a list of what it considers "frivolous" tax arguments, the assertion of which can lead to the assessment of substantial penalties (see http://www.irs.gov/Tax-Professionals/The-Truth-About-Frivolous-Tax-Arguments-Introduction). I discuss the "frivolous" penalty later in this section.

The Internet is alive with people asserting these arguments in various incarnations. Often the advocates publish how-to books instructing people on the ways to "eliminate" paying income taxes. Tax protester seminars have been very popular over the years. The seminars feature protest leaders discussing their most recent research and findings. A common thread is defiant opposition to the tax laws on legal, Constitutional, moral or religious grounds. Seminar promoters offer books and literature for sale purporting to support their positions. The speakers at these seminars are particularly adept at selling their position. They cleverly present select provisions of the tax code or carefully excised portions of court decisions that purport to support their claims.

Given the fact that audiences are made up entirely of tax neophytes (with the exception of the undercover IRS agents), many attendees are easily persuaded of the truth of the presentations and the idea that the IRS is stuck because the particular position is entirely legal. In fact, the IRS points out in numerous internal memoranda and lawsuits against promoters that ignorant citizens could likely be swayed by these presentations. I can testify that without a good working knowledge of the tax code, an ignorant person could be made to believe just about anything by selective presentation of code sections. To this day, countless people are duped in this manner into taking improper or illegal stances on their tax returns.

Irwin Schiff was once a very vocal and high profile tax protester so sure of his theory that he offered a $100,000 reward to any person who could prove him wrong. He used the offer as an advertising ploy for his book. I debated Schiff publicly throughout the nation over a period of several years (before he went to jail for tax evasion, where he died in October 2015, at the age of eighty-seven). In response to the reward offer, I once wrote a lengthy letter to Schiff citing sections of the tax code along with supporting case law showing how his theory was not only invalid, but was expressly rejected by federal courts on several occasions. At the conclusion of the letter, *I claimed the $100,000 reward!* Sadly, he never paid me. Ironically, Schiff went to jail—not once, not twice, but *four times* in connection with tax violations as a result of following his own advice.

The specific claims of the various leaders are as varied as you can imagine. At one time or another, protesters have claimed that the tax laws are:

- Unconstitutional because they create a condition of slavery, prohibited by the Thirteenth Amendment;
- Do not apply to wage earners because the law taxes only income and wages are not *income*;

- Voluntary, and that is why the IRS regularly uses the phrase "voluntary compliance" in describing them. Because they are voluntary, one has the legal option to pay or not pay; and
- Apply only to resident and non-resident aliens, not persons born in the United States.

The link on the IRS's website (mentioned above) provides a detailed list of just about all the various arguments that have been offered over the years under which a person can allegedly "untax" himself.

Regardless of the nature of the claim, or the means by which it is put into effect, all of the protester arguments have one thing in common: they simply do not work—period. The courts at every level reject them repeatedly.

The irony is the vast majority of citizens involved in the tax protester movement are honest citizens who believe they are doing the right thing. With precious few exceptions, no one would have taken such steps if they had any idea what the IRS's true reaction would be. Most took the steps because they were convinced by apparently knowledgeable authorities that: 1) the stance is perfectly legal, fully supported by the law, and 2) there is nothing the IRS could or would do about it precisely because the position is legal.

The fact is the IRS has a potpourri of weapons available to force compliance. Not the least potent of these is the ability to determine a tax liability for those who do not file a return. After doing so, the citizen bears the burden to disprove its accuracy. If he fails or refuses, the tax is assessed and enforced collection follows. The most potent weapon is that of criminal prosecution for either failure to file a tax return or tax evasion. IRC §§7203 and 7201. Failure to file is a misdemeanor and evasion is a felony. I discuss this further in Chapter 3.

The IRS has reached the outer limits of its tolerance with these arguments. And while most tax protesters will not likely be prosecuted (see Chapter 3), they will be pounded with penalties. In the Pension Protection Act of 2006, Congress broadened considerably the scope of the penalty the IRS imposes in cases when these arguments are submitted. Under code section 6702, the IRS can penalize a person for filing a "frivolous return." This is a return that: 1) "does not contain information on which the substantial correctness of the self-assessment may be judged" (such a return that pleads the Fifth Amendment), or 2) "contains information that on its face indicates that the self-assessment is substantially incorrect" (such as a return that claims wages are not income).

Moreover, the penalty now extends well beyond the scope of just tax returns. The penalty now applies to "submissions," which include all of the following:

1. A request for a Collection Due Process hearing as to either a *Final Notice of Intent to Levy* (Letter 1058 or LT11) or a Notice of Filing Federal Tax Lien (Letter 3172). I discuss this procedure at length in Chapter 4;
2. An application for an Installment Agreement, also discussed in Chapter 5;
3. An Offer in Compromise, discussed in Chapter 12, and
4. An Application for a Taxpayer Assistance Order, discussed in Chapter 7.

As it is now, not only do you face potential debilitating tax assessments when you follow the tax protester theology, but you face a penalty of up to $5,000 for filing returns or other submissions that present these arguments. I discuss this penalty in further detail in Chapter 9.

Nothing convinces a tax protest follower of the error of his ways faster than the one-two-three punch flurry of tax frivolous penalty assessments, liens and levies. By the time the matter progresses to that point, most protest followers are absolutely disillusioned with their leaders and bitter about being misled. Further, they are *desperate* to solve the problem and put a major mistake behind them. They are anxious to settle with the IRS and they are sure they will never do anything like that again.

The difficulty is that the IRS can be extremely vindictive, especially with tax protesters. It seems IRS leaders are as guilty as tax protester leaders about misleading their followers. IRS leaders have their followers convinced that all tax protesters are dirty cheaters who must be taught a lesson once and for all and in the process, get that pound of flesh. With its foot on the neck of the downed protester, the IRS's desire is to press harder rather than let him up.

This unreasonable behavior prevents many protesters from squaring with the IRS. Observing this behavior manifested with their friends who do step forward, those remaining simply dig themselves deeper underground, determined that anything is better than what the IRS has in store for them. The IRS's behavior serves only to galvanize the protesters' feelings that the agency is universally unjust and there is no hope of reconciling. Most of these people, people who were misled to begin with, feel lost and trapped. Some feel they can never live a normal life again. We shall see.

To help people stay away from these arguments, I produced and published a research report entitled, "The Untax Promise." This report addresses all of the key "untax" arguments. I outline the nature of the various claims made and provide the solid legal reasoning why these arguments are not valid and fail in court when presented. The report is available free of charge on my website. Unfortunately, too many people read this report after they were already scammed by one or more tax protester promoters.

Conclusion

Against this backdrop of factual and financial circumstances, I will prove my claim that there truly is *no such thing as a hopeless tax case*. I have proven—and the countless letters in my files verify—that *there is a way out* of the wilderness.

Review Questions

1. What is the most common reason citizens and businesses fail to file required tax returns?
    A. Recordkeeping problems
    B. Financial problems
    C. Non-filing is encouraged by IRS lack of action
    D. Medical issues

2. Which of the following is the stated purpose of a tax audit?
    A. To originally assess taxes due
    B. Collection enforcement
    C. To determine the correctness of a tax return
    D. To establish additional tax and penalty assessments

3. According to the IRS, what percentage of all returns are incorrect at some level?
    A. 88%
    B. 50%
    C. 60% to 90%
    D. 75%

4. Why are lower tax rates available to married citizens that file joint returns?
    A. Married couples usually have children and face a greater financial burden
    B. To relieve the IRS's burden by reducing the number of tax returns filed
    C. To protect spouses that earn little or none of the couple's joint income
    D. Both parties are jointly responsible for their tax debt

5. Of the following, which is referred to as a "trust fund" tax?
    A. Withheld federal income tax
    B. Matching payment of unemployment tax
    C. Recovery Penalty
    D. Company-paid Social Security tax

6. What is the argument that led to the beginning of the modern tax protest movement?
    A. Individuals disagree with the way the money is spent
    B. Taxpayers are tax neophytes
    C. Tax laws violate the Constitution
    D. People are greedy and don't want to pay taxes

7. What is one thing that all of the tax protester arguments have in common?
    A. The vast majority of citizens involved in the tax protester movement are dishonest individuals
    B. Tax protesters are a new phenomenon
    C. They do not work
    D. Most protesters know how the IRS will react to their actions

Review Answers

1. A. Incorrect. Recordkeeping problems are not the most common reason citizens and businesses fail to file required tax returns; although, recordkeeping is one of a variety of reasons for failures to file.
   B. **Correct.** The most common reason that millions of citizens and businesses fail to file required tax returns is due to financial reasons.
   C. Incorrect. The failure to file tax returns is not because non-filing is encouraged by IRS lack of action. It is common that non-filers do not hear anything from the IRS for a long period of time, sometimes not until a return is filed.
   D. Incorrect. Medical issues are not the most common reason citizens and businesses fail to file required tax returns; although, medical crises are one of a variety of reasons for failures to file.

2. A. Incorrect. The stated purpose of a tax audit is not to originally assess taxes due. When a citizen or business files a return, the tax becomes assessed.
   B. Incorrect. Collection enforcement is not the stated purpose of a tax audit. If the tax is not paid within thirty days of the IRS issuing a Final Notice, the agency may enforce collection.
   C. **Correct.** The stated purpose of a tax audit is nothing more or less than the determination of the correctness of a tax return.
   D. Incorrect. Establishing additional tax and penalty assessments is not the stated purpose of a tax audit. In reality, IRS audits lead to billions of dollars in additional tax and penalty assessments each year.

3. A. **Correct.** According to the IRS, about 88% of all returns are incorrect at some level.
   B. Incorrect. The percentage of all filed returns that contain errors at some level is not 50%. About half of criminal investigations involve legal-source income cases.
   C. Incorrect. The IRS estimate of filed returns that are incorrect is not 60% to 90%. The IRS's own statistics reflect that IRS audit results are wrong 60% to 90% of the time.
   D. Incorrect. The IRS estimate of returns that are filed incorrectly at some level is not 75%. Of the total criminal investigations undertaken annually, about 75% of those run their full course and result in prosecution.

4. A. Incorrect. Having children and a greater financial burden are not the reasons why lower tax rates are available to married couples filing joint returns. Many people believe the government gives married citizens a tax break because they usually have children and a greater financial burden.
   B. Incorrect. Lower tax rates for married citizens filing joint returns are not due to relieving the IRS's enforcement burden by requiring fewer returns to be filed. Some married individuals still file separate returns although their overall tax rate is higher.
   C. Incorrect. Lower tax rates are not offered to married individuals filing joint returns to protect spouses that earn little or none of the joint income. A married spouse with no income is still treated as earning part of the joint income.
   D. **Correct.** The cheaper rates for married citizens filing jointly are designed solely to induce the filing of joint returns since both parties are jointly responsible for the tax debt regardless of who actually earns the income.

5. A. **Correct.** Federal income taxes withheld from employees' wages and salaries are referred to as "trust fund" taxes.
   B. Incorrect. A company's matching payment of unemployment tax is not referred to as a "trust fund" tax. Employers are required to make matching payments of unemployment taxes, and these are referred to as "non-trust" taxes.
   C. Incorrect. A Recovery Penalty is not referred to as a "trust fund" tax. An individual held accountable for unpaid trust taxes can be assessed personally for a Trust Fund Recovery Penalty.

D. Incorrect. Company-paid Social Security taxes are not referred to as "trust fund" taxes. Employers are required to make matching payments of Social Security taxes, and these payments are referred to as "non-trust" taxes.

6. A. Incorrect. Individuals' disagreement with the way the money is spent by the government was not the reason for the beginning of the modern tax protest movement. However, some protesters don't agree with the way the money is spent.
   B. Incorrect. The reason for the beginning of the modern tax protester movement is not due to taxpayers being tax neophytes. Many tax seminar attendees are tax neophytes.
   C. **Correct.** The modern tax protest movement began with individuals who believed our tax laws violate the Constitution.
   D. Incorrect. The modern tax protester movement did not begin with people who are greedy and don't want to pay. Many tax protesters are motivated by being simply greedy and do not wish to pay taxes.

7. A. Incorrect. One thing that all tax protest arguments have in common is not that the vast majority of citizens involved are dishonest individuals. The irony is that the vast majority of citizens involved in the tax protester movement are honest citizens that believe they are doing the right thing.
   B. Incorrect. One thing that all tax protester arguments have in common is not that tax protesters are a new phenomenon. Tax protesters have been around as long as taxes themselves.
   C. **Correct.** The one thing that all tax protester movements have in common is that they don't work.
   D. Incorrect. Knowing how the IRS will react to the protesters' actions is not the one thing that all tax protester arguments have in common. Many protesters would not have taken the position they took if they had known how harshly the IRS would react.

Chapter 3
Am I Going to Jail?

Learning Objectives

- Select what TIGTA has referred to as an epidemic facing taxpayers
- Pinpoint the Internal Revenue Code section that refers to offenses involving the failure to pay tax at the time required
- Recognize the most critical of all evidence needed to sustain a tax conviction based on proof beyond a reasonable doubt
- Select the single most important aspect of a criminal case from a taxpayer's standpoint

Introduction

In Chapter 2, I wrote about Deb, who was as distraught as any person I have ever met. She and her husband did not file tax returns for a number of years. A revenue officer (RO) paid an unannounced visit to Deb at home and caught her at a most inopportune time. Deb had just stepped out of the shower and was unclothed. After leaving the bathroom, she found the RO *standing in her kitchen*. Without invitation, the RO saw fit to just walk in the door. The only thing that prevented total humiliation for Deb was the fact that the RO happened to be a woman. The officer quickly left after giving strict instructions for Deb to call her.

Deb called and a meeting was arranged. Deb was instructed to bring in all her books and records for eight years. She was told that because tax returns were not filed, the IRS would "help" prepare them. She was warned to attend the meeting and be prepared to cooperate. The meeting took place a very short time after the phone conversation.

At the meeting the RO was all business. She demanded all the records and wanted them "now." Deb explained that she did not have time to gather and organize the records. In the few days that passed since the phone conversation, Deb worked hard on "locating, sorting, separating, compiling and posting" the documents covering eight years. There just simply was not enough time to have them fully prepared for the meeting. Deb asked for more time and assured the RO that she recognized her duty to "cooperate fully."

At that, the RO put the fear of God into Deb. The RO explained that because Deb "refused to comply," she could expect "the U.S. Marshall to arrest me at any time. No ifs, ands, or buts." Deb asked three different ways whether this was the only solution, and why no additional time could be given. Deb was "repeatedly told to expect—without warning—to be picked up by a Marshall" and jailed.

But the RO was wrong. The real tragedy in Deb's story is that not only did an RO threaten a citizen who was honestly attempting to resolve a problem, but she did so by *lying through her teeth!* Under the circumstances of Deb's case, which is very illustrative of the typical non-filer or delinquent citizen, there was in fact virtually no chance of going to jail. Even if there was any risk of jail, the RO had nothing whatsoever to say about it. She was simply using her power and position *unjustly* to further terrify an already extremely fearful citizen.

Despite all I said in Chapter 2 about what goes on in the mind of a non-filer, you may still have doubts as to why a person would not simply step forward and say, "Hey, I haven't filed. I need to get that fixed." Stories of what happens to people like Deb get around and they get around fast. And the IRS wants it that way. It wants people terrified so that the public will dance to all its tunes. However, the terror campaign has a significant negative impact. A growing number of citizens simply run further into the woods, more determined to stay out of sight. Hence, the most non-compliant taxpayers—non-filers and delinquent taxpayers—*are taught* that stepping forward is the last thing any sensible person should do.

For this reason, I address clearly what does and does not constitute a true criminal risk.

What are the *Real* Chances of Going to Jail?

IRS statistics indicate that between 5,000 and 6,000 cases are referred for a criminal investigation annually. Let me put that into perspective. In 2015, about 146 *million* individual income tax returns were filed with the IRS. That does not include business tax returns, which add at least another 100 million to the pool of tax returns. For simplicity sake, I'll use only individual tax returns as the universe of potential criminal targets (146 million returns). Dividing that number by the number of criminal investigation referrals (no more than 6,000 annually—and usually less), we find that a given person has at best a .004 percent chance of being targeted for criminal prosecution by the IRS.

Let's break this down a little further, since we all agree that the percent chance of contracting, say, the Black Plague, while admittedly just as slight, is meaningless if you are among the precious few persons who make up the .004-percent pool.

Very generally speaking, there are three broad categories of tax crimes the IRS investigates. They are: 1) legal-source tax crimes, 2) illegal-source tax crimes, and 3) narcotics-related financial crimes. Under the Legal Source Tax Crimes Program, IRS's Criminal Investigation (CI) function identifies, investigates and assists in the prosecution of crimes involving legal industries, legal occupations and, more specifically, legally earned income. These crimes are what we might call "typical" tax crimes. They involve the failure to file tax returns, filing false tax returns or other documents, tax evasion and the like.

Under the Illegal Source Financial Crimes Program, CI identifies, investigates and assists in the prosecution of crimes involving income derived from illegal sources (other than narcotics, discussed next). Illegal-source income is any income earned through any illegal business activity; for example, illegal gun sales, gambling, extortion or prostitution. Such crimes encompass all tax crimes as well as money laundering and currency violations.

Under the Narcotics-Related Financial Crimes Program, CI identifies, investigates and assists in the prosecution of the most significant narcotics-related tax and money laundering offenders.

Historically, of the total criminal investigations begun in a given year, about 50 percent involve narcotics and illegal-source income cases such as organized crime and public corruption. Only about half of the criminal investigations involve legal-source income cases, what you might consider typical tax crimes. These numbers have held more or less consistently since the first edition of this book was released in 1992. So, if you do not derive your income from some illegal source, such as being a drug dealer, crime boss, or corrupt politician, right out of the chute you see that your chance of being implicated in a tax crime is cut in half.

A phenomenon that has presented itself to the IRS in recent years—which was virtually non-existent just fifteen years ago—is the crime of identity theft. ID theft was first identified as a problem for the agency in 2004 but has since grown into a beast. The number of ID theft cases handled by the IRS is growing at an alarming rate. For example, the number of cases reported to the IRS's Identity Protection Specialized Unit increased by 78 percent in just one year, from 2011 to 2012. And the Taxpayer Advocate Service (TAS) saw an increase in its ID theft cases of 60 percent during that same year. However, since 2008, the number of ID cases reported to TAS has increased by more than 650 percent. National Taxpayer Advocate (NTA), 2012 Annual Report to Congress, p. 43.

The Treasury Inspector General for Tax Administration (TIGTA) calls ID theft an "epidemic" facing taxpayers. In 2013, the head of TIGTA testified during a Senate Committee hearing that ID theft scams "have become so prevalent that they are being called the 'crime of the 21st century'." Testimony of J. Russell George, TIGTA, April 10, 2013.

Because this is such a huge problem, and because the IRS has made controlling ID theft such a priority, ID theft cases are among the most aggressively prosecuted criminal cases today. According to the IRS's criminal investigation and prosecution data for 2013, about 29 percent of the 4,364 cases recommended for prosecution that year involved identity theft. See IRS Criminal Investigation, Fiscal Year 2013, National Operations Annual Report, February 2014. As such, if you stay away from ID theft schemes, your chances of being targeted by the IRS for prosecution drop considerably.

Let me bring all of this into sharp relief. Keep in mind that in 2015, about 146 million individual income tax returns were filed. When that figure is compared to the approximately 6,000 criminal investigations undertaken annually, you quickly realize that you have a greater chance of being eaten by a shark than you do of being implicated in a criminal tax investigation.

And we can hone the numbers down ever further. Because while about 6,000 *investigations* are undertaken annually, only about 75 percent of those run their full course and actually result in a full scale, liberty-threatening criminal prosecution. And fully 50 percent of those involve illegal source income, such as narcotics crimes and ID theft.

When considered in this light, I would have to say the answer is, no, *you are not going to jail!*

The Signposts of a Criminal Investigation

There is no need to lay awake at night wondering whether you will go to jail if you *step forward* or whether you will go to jail if you *do not step forward*. There is no need to panic if told by an IRS employee, as Deb was, that you are in *fact* going to jail. You can often answer for yourself, quickly and accurately, whether there is any realistic chance that your case has or may take the shape of a criminal prosecution. Reading the clear signposts along the route of compliance enforcement tells the tale.

The first and most important fact to remember is that the IRS is a decentralized agency. It divides the duties of the agency into distinct functions, each with a clear and unique responsibility. The three main functions that citizens may encounter are:

- **The Examination function.** Its task is to audit tax returns and determine tax, interest and penalty liabilities. Employees in this function are known as revenue agents or tax auditors;
- **The Collection function.** Its task is to collect tax assessments, conduct employment tax examinations and secure tax returns from non-filers. Employees in this function are known as revenue officers;
- **The Criminal Investigation function.** Its task is to conduct investigations of possible violations of the criminal tax and related federal laws and to assist the Department of Justice in the prosecution of citizens ultimately charged with crimes. Employees in this function are known as special agents (SA). Special agents are highly trained to investigate whether a tax or other financial offense has occurred and to gather the evidence needed to prove the crime in court.

Whenever there is a sufficiently strong indication of possible criminal activity, the case is referred to CI for investigation as soon as possible. The Internal Revenue Manual (IRM) requires that the referral be made at the earliest opportunity upon the discovery of evidence that the failure to file "is willful or there is any indication of fraud." IRM 5.1.11.6(1). Under this provision, an RO such as the woman who interviewed Deb is instructed to not even attempt to secure delinquent returns in cases of potential fraud, but rather to make a fraud referral.

Both the Examination and Collection functions have embedded employees known as Fraud Technical Advisors. An FTA is not an investigator, but merely an evaluator. If, say, a revenue officer suspects fraud, she will first discuss the case with her manager and then with the FTA. The FTA, who is better trained in the criminal elements of tax law, makes the determination whether the case should be referred for further analysis and possible investigation by CI. As such, individual agents, whether tax auditors or tax collectors, *never* make the final decision to start a criminal investigation, as was threatened by Deb's RO. And in no situation does a criminal investigation begin with the U.S. Marshall making an arrest.

If the FTA decides the case should be referred for investigation, the matter then goes to CI for further evaluation. The evaluation is performed on the evidence already in the IRS's possession. If the evidence shows "firm indications of fraud," "freeze codes" are placed on the citizen's tax account. A special agent is then assigned to the case and the SA becomes responsible for handling the case going forward.

At the point where the case is frozen, a special agent has sole control of the case and begins a full scale investigation. Thereafter, the IRS makes *no effort* to assess or collect taxes, nor does it attempt to secure unfiled returns without the knowledge and consent of the special agent. (I explain why later in this chapter.) However, it is entirely possible that a tax auditor or RO will continue to make contact with the taxpayer and may not disclose the fact of the criminal investigation. This happens in what is known as a parallel investigation, where the criminal and civil aspects of the case are worked conterminously.

For example, suppose a person owes taxes for the years 2005-2007, and has not filed his returns for subsequent years. The revenue officer's FTA decides to make referral for criminal investigation as to the non-filing years. After a review of the case, the special agent instructs the RO to continue working the collection aspects of the *earlier* years, while the special agent conducts the investigation on the later years. In all events, the special agent controls the direction of the entire case.

The freeze codes are indicated in the citizen's Individual Master File (IMF) "account transcript." The IMF account transcript is a blueprint of all audit, collection and enforcement activity that occurs in a case. The IMF is available by making a request under the Freedom of Information Act (FOIA) to the IRS's Disclosure Office using IRS Form 4506-T, *Request for Transcript*. A criminal freeze is indicted in the Master File with the transaction code 914. This code indicates that a criminal investigation is in progress. In Chapter 3 of my book, *Taxpayers' Ultimate Defense Manual*, I provide the details of submitting a request under the FOIA and show you how to read an IMF printout and interpret the entries.

The procedure outlined above requires us to take a brief notice of another fraud-related phenomenon that began sweeping the country in about 2012—the crime of IRS impersonation. It works this way. An individual phones a taxpayer and announces that he is from the Treasury Department or the IRS. He states that the target owes taxes and if the amount of X dollars is not paid immediately—over the phone with a credit card—the target will be arrested. Thousands of citizens have been scammed by this fraud. Those who are not outright scammed are often terrorized, believing (as the caller suggests) that law enforcement officers will be sent out immediately and the target will be jailed that very day or soon thereafter. *All of this is pure nonsense.*

The Treasury Inspector General for Tax Administration reported in 2015 that it gets 12,000 calls per week to its fraud hotline from people reporting this scam. TIGTA calls this the "largest, most pervasive IRS impersonation scam in the history of the agency." For a more detailed analysis of the actual phone calls that people receive, see my book, *How to Win Your Tax Audit*, Chapter 19, under the heading, "Avoid Phone and E-mail Scams."

The second signpost of a criminal case occurs when the SA begins the actual investigation. The SA's first step in an active investigation is to contact the citizen face-to-face to ask pointed questions. An SA will *never* make a phone call to the target in the first instance and will never threaten to send out a Marshall or sheriff to arrest you if X dollars are not paid with a credit card immediately.

When a special agent makes contact with a citizen, he reads to the citizen the "Miranda" warning. The Miranda warning explains that the special agent's purpose is to conduct a criminal investigation and that any statements or documents provided could be used against you in court. And that's exactly what he means. You will also be advised that you have the right to have counsel present during questioning. You should take that advice. If you are ever read your rights by an IRS agent, *never say one word without first consulting experienced counsel*.

The third signpost occurs either apart from or in connection with the direct contact by a special agent. Because the IRS bears the burden of proof in criminal cases, the agency must gather evidence sufficient to persuade a jury of your guilt. It gathers this evidence by issuing summonses to third parties, such as your banks, employer, credit union, mortgage lender, etc. IRS Form 2039, *Summons*, requires the named party to release to the special agent the requested records. Summonses are also used to obtain testimony from third parties.

It is true that when a criminal investigation begins, special agents are often assisted by revenue agents. The latter handle the tax liability aspects of the investigation, or as indicated above, may work other aspects of a case. It is not true, however, that revenue agents or revenue officers act independently of special agents. In a criminal investigation, the special agent is in charge of and directs the case. It is also true that prior to a formal referral to CI for a full-blown investigation (and thus, no SA is yet assigned), the FTA may instruct an auditor or RO to see if they can get "more information" from the taxpayer that might indicate "willfulness" (defined later in this chapter) or fraud. This is where potential criminal cases may get very tricky because these agents, of course, will not tell you they have been instructed to see if they can get you to incriminate yourself. That is another reason it is so important to get counsel sooner rather than later if you suspect there are any criminal implications to your case.

Therefore, the fourth and a very important signpost of a criminal investigation is the absence of an independent revenue agent (civil tax auditor or examiner) or revenue officer (civil collection officer). If an auditor is present but is acting in conjunction with the special agent, that is a direct indication of a criminal case.

You may be asking why civil tax examiners or collectors fade from view when the case assumes criminal implications. The answer is found in a long history of litigation involving criminal investigations and the propriety of the conduct of IRS personnel. The rules established through litigation dictate that when the IRS obtains evidence from a citizen through deceit, trickery or fraud, that evidence may not be used in a prosecution. See *United States v. Tweel*, 550 F.2d 297 (5th Cir. 1977). Trickery and deceit exist when revenue agents or special agents seek and obtain evidence directly from a citizen without explaining the fact that a criminal investigation is under way. If an investigation is truly criminal in nature, the special agent must explain this before obtaining evidence. Evidence obtained by misleading the citizen is considered to have been obtained in violation of law.

On the other hand, civil investigators do not have to independently inform a taxpayer (such as by issuing a Miranda warning) that they are concerned about or might even suspect fraud. For example, a discussion by an RO with his FTA does not constitute a referral for investigation such as would enlist the aid of a special agent. Therefore, information gathered by a civil investigator while working with his FTA prior to a referral to CI is not considered improperly obtained evidence. See *United States v. Grunewald*, 987 F.2d 531 (8th Cir. 1993).

The next phase of a criminal investigation is a recommendation for prosecution by the special agent. When the investigation is complete, the special agent makes a recommendation for prosecution if he believes that the evidence establishes that a crime was committed. The recommendation is made to the Office of Area Counsel. These are the IRS's in-house attorneys. Their function in this regard is to review the evidence, and consider possible legal defenses and other potential problems with the case. They determine whether a criminal case should be pursued further.

Assuming Area Counsel agrees with the recommendation, the case is sent to Washington. The act of transmitting the case to Washington constitutes the formal recommendation for criminal prosecution. Justice Department attorneys in Washington then make the final determination whether and to what extent any criminal charges are filed.

These facts plainly evidence that the claims made to Deb by the revenue officer were false and terribly misleading. The revenue officer acted as though she had the authority to commence a criminal case on her own. As you now know, not only does she not have the authority to instigate a *criminal prosecution*, she does not even have the authority to instigate a *criminal investigation*. The RO certainly could have raised the issue with her FTA, but the decision to go further rested with the FTA, not with the RO.

If you are threatened with criminal action by a revenue agent or RO and are unsure of the true posture of your case, you should ask pointedly whether: 1) you are, in fact, under a criminal investigation, 2) whether the case has been discussed with the agent's FTA, and 3) whether the IRS intends to make a referral to CI. While agents have been known to lie, there are consequences for such actions. I already explained that evidence obtained using trickery, deception or fraud may be subject to suppression later. If the agent answers affirmatively to any of the above questions, or the agent refuses to answer one way or the other, you must immediately (but politely) end the interview and consult experienced counsel.

Tax Crimes and the Statute of Limitations

There is one very sure way to know whether any substantial risk of criminal prosecution exists for non-filing or non-payment of taxes. That is to determine whether the statute of limitations governing the ability to charge and prosecute a crime has expired.

The Internal Revenue Code contains approximately seventeen provisions defining and setting penalties for criminal conduct. Among these are the more famous crimes of tax evasion, failure to file tax returns and submitting false documents. Among the less famous are the crimes of failure to collect taxes and making fraudulent statements.

Code section 6531 establishes the limitation period within which a person may be charged with any of these criminal offenses. The statute reads in part,

No person shall be prosecuted, tried or punished for any of the various offenses arising under the internal revenue laws unless the indictment is found or the information instituted within three years next after the commission of the offense.

This creates the general three-year period of limitation for prosecuting a criminal offense. The three-year rule applies to approximately half of the criminal provisions of the tax code, as there are eight exceptions to the rule built into code section 6531. In any one of those eight circumstances, a citizen may be charged with a crime within *six* years after the commission of the offense. These are the exceptions:

1. **Fraud.** Offenses involving fraud or an attempt to defraud the United States in any manner under 18 U.S.C. (U.S. Criminal Code) §1001;
2. **Evasion.** Offenses involving an attempt in any manner to evade or defeat any tax or payment of any tax under code §7201;
3. **Aiding and assisting.** Offenses related to aiding and assisting in, or counseling, or advising in the preparation or presentation to the IRS of a false or fraudulent return, statement or other document under code §7206(2);
4. **Failure to file or pay.** Offenses involving the failure to file returns or failure to pay a tax at the time required by law under code §7203;
5. **False return.** Offenses involving the preparation and presentation to the IRS of a false or fraudulent return, statement or other document under sections §§7206(1) and 7207;
6. **Intimidation.** Offenses relating to making threats against or intimidating IRS agents while in the act of performing their duties, code §7212(a);
7. **Unlawful acts of agents.** Any unlawful act committed by an IRS agent, officer or employee in connection with the performance of his duties, such as extortion, accepting bribes, etc., under code §7214; and
8. **Conspiracy.** Offenses involving a conspiracy, the object of which is to attempt in any manner to evade or defeat the payment of any tax or to defraud the United States by impeding and impairing the lawful functions of the IRS under 18 U.S.C. §371.

Jail threats may quickly lose their sting when measured against the yard stick of the statute of limitations. I believe it is important to know and use this information when dealing with oppressive agents. Just by informing them that you understand the statute of limitations, you make great strides toward eliminating potential abuse, and that leaves you to deal with the case on its merits.

This is not to say that all non-filers have nothing to fear when it comes to criminal prosecution. In fact, when former Commissioner Peterson testified to the House Government Operations Committee in June 1992, she specifically addressed the non-filer issue. She recognized that most non-filers are not criminals. As we explore in Chapter 8, she instituted a non-filer program designed to bring them in from the cold, which has helped countless thousands of citizens get square with the IRS over the past twenty-plus years.

At the same time, however, she made it clear that the IRS will use a stick in addition to the carrot to bring non-filers into compliance. In her testimony she stated, “But for those taxpayers who do not accept our encouragement, we will use a more direct approach.” That approach is to use “criminal sanctions in appropriate cases.” Since that time, the IRS has dedicated substantial time and energy to investigating and prosecuting non-filers. The pursuit of those who object or refuse to file returns or pay taxes is and will remain a high priority with the IRS.

What Determines Who Will and Will not be Prosecuted?

Why is it that not everyone who fails to file a tax return or fails to pay taxes is prosecuted? One answer is the IRS certainly does not have the budget or manpower to chase every possible case. But that is not the only answer. It is not even the most *significant* reason most tax violations are never prosecuted.

The most significant reason the vast majority of delinquent citizens are not prosecuted is because legally, criminal tax cases are remarkably different than civil cases. In civil tax examination and collection cases, the *citizen* bears the burden of proof on virtually all matters. The IRS rarely has to prove you made a mistake or owe taxes. Rather, you must prove that you did not make a mistake or do not owe taxes.

This is not so with criminal cases. In every criminal prosecution, including tax prosecutions, the accused enters the case with the protection of the three most important legal concepts ever devised. Every citizen should know and understand these concepts because they form the very heart of our legal system. Let me examine them.

1. **The Presumption of Innocence.** In any criminal case, the accused enters the prosecution cloaked with the presumption of innocence. This means simply that the defense never has to prove anything because the defendant begins the trial as an innocent man, and that presumption remains throughout the trial. This constitutional safeguard guarantees that innocent citizens are not punished merely because they are unable to prove a negative.
2. **The Burden of Proof.** In all criminal prosecutions, including tax cases, the government bears the sole burden of proof. The burden of proof refers to the government's affirmative duty to bring forth legally acceptable evidence to prove that the accused is guilty as charged. The accused has no burden of proof in a criminal tax case with regard to the essential elements of the crime. The government alone must prove those elements.
3. **Reasonable Doubt.** The burden of proof that must be met in a criminal case is proof beyond a reasonable doubt. Reasonable doubt is the kind of doubt that would cause a person to hesitate in making the most important decisions of his personal life. When such doubt is established, the defendant must be considered not guilty. This is an extremely strict burden. It rises above the burden often used in general civil cases and surpasses the burden applied even in civil tax fraud cases.

It is not a simple matter to flippantly accuse a person of tax fraud, tax evasion or criminal failure to file a tax return. The stringent criminal law environment does not permit the kind of willy-nilly decisions often made by tax auditors. Consequently, before making the decision to prosecute a citizen for a tax crime, the IRS conducts a thorough investigation. Thereafter, referrals and reviews take place at the highest levels of both the IRS and Justice Department. The IRS must be sure that before anyone is prosecuted, the government has sufficient evidence to sustain a conviction.

The Element of Willfulness

The most critical of all evidence needed to sustain a tax conviction is proof beyond a reasonable doubt of the element of "*willfulness*." In reviewing the language of the criminal statutes cited above, you find that the term willfulness appears in each one of them. For example, in the statute addressing failure to file a tax return, the law provides that anyone required to "make a return...who willfully fails to...file such return...shall be guilty of a misdemeanor..." IRC §7203. Thus, in a failure to file case, the government bears the burden of proving beyond a reasonable doubt not only that a citizen was required to file a return and did not, but that his failure to do so was "willful."

The term willfulness is defined as a voluntary, intentional violation of a known legal duty. The requirement to prove willfulness is designed to prevent the conviction of a person who makes an honest mistake, or who, due to negligence or some other non-criminal reason, does not do what the law requires. In order to be convicted of a tax offense, one must know what the law requires and he must deliberately and intentionally *set out* to break the law.

We have all heard the axiom that "ignorance of the law is no excuse." That principle applies only to offenses that are characterized as *malum in se* in nature. *Malum in se* is a Latin phrase meaning "a wrong in itself; an act involving illegality from the very nature of the transaction, based upon principles of natural, moral and public law." See Black's Law Dictionary, second edition. Examples of such an offense are murder, rape and theft.

Tax laws do not fall into this category. Rather, they are classified as malum prohibitum offenses. That Latin phrase means "an act prohibited; a thing which is wrong only because prohibited; an act which not inherently immoral, but becomes so because its commission is expressly forbidden by law." See Black's Law Dictionary, second edition. The concept of malum prohibitum is very different than malum in se.

Tax laws are classified as malum prohibitum because it is not inherently immoral to fail to file a tax return or pay taxes, as it is, say, to rob or murder someone. Because of the character of a tax crime, the government must prove the accused had the specific intent to break the law. Such intent is a state of mind referred to as mens rea. That term is defined as a guilty or wrongful purpose. Without proof of a guilty or wrongful purpose, a criminal conviction cannot stand.

The Supreme Court described it this way: "Even a dog distinguishes between being stumbled over and being kicked." Morissette v. United States, 342 U.S. 246 (1952). Many a person may stumble over one or more of the nearly four million words in the tax code. Many a person may stumble over the two- to three-thousand tax forms and the tens of thousands of pages of instructions. Many a person may stumble over the court opinions and IRS rulings so voluminous as to fill a gymnasium. Very few people, however, make up their mind in advance to break the law by lying, cheating or deceiving the IRS.

The legal principles outlined above dictate that no person should ever be convicted of violating the tax laws where his actions were merely negligent, mistaken, inadvertent or grew out of a good faith misunderstanding of the requirements of the law. The criminal statutes apply only to the willful or intentional violator, not to the mistaken, misled or negligent person. And they certainly do not apply to a person who, through no fault of his own, was forced to make the difficult choice between paying his taxes and feeding his family.

How to Prevent a Criminal Case

Please understand that in addition to the legal considerations examined above, the IRS's attorneys carefully consider all the facts and circumstances of each case before undertaking a criminal prosecution. In weighing these factors, attorneys speak in terms of "jury appeal." By that, they are referring to the way in which a given factor may likely influence a jury. If a factor has positive jury appeal, it means that from the standpoint of the IRS, the factor may tend to influence the jury to convict the accused. If a factor has negative jury appeal, such factor may weigh more in favor of the accused, thus influencing the jury to acquit.

To prevent a criminal case, one must point up, highlight and underscore the facts and circumstances which weigh in favor of the citizen. There are certain ways this can be done effectively and we address them here.

First, I must give this caution. Please read this carefully. If, after reading to this point, you still believe you are truly at risk of a criminal prosecution, if you believe the facts and circumstances of your case indicate the government may pursue a criminal case, you should immediately consult experienced tax counsel. If you have already been confronted by a special agent or recognize one or more of the other signposts of a criminal investigation, you should immediately consult experienced tax counsel. If you are unsure whether you have been targeted, make an FOIA request for your IMF to learn whether a criminal freeze is in effect.

A true criminal investigation and potential prosecution is very serious and should be handled only by an attorney experienced in dealing with CI, Area Counsel and the Justice Department. Under no circumstances should you consult a lawyer off the street to handle such a problem.

The Voluntary Disclosure

At one time the IRS administered a formal policy which held that a citizen's voluntary disclosure of a crime prior to detection by the IRS would not lead to prosecution. The formal policy was criticized and eventually abandoned. The spirit of the policy lives on, however, and the IRS continues to adhere to a softer form of the predecessor.

The current policy is that although a voluntary disclosure does not necessarily preclude prosecution, such disclosure "is a factor to be considered when deciding to recommend prosecution." As such, the IRS considers favorably the voluntary disclosure and weighs it with all other facts and circumstances in deciding whether or not to recommend prosecution. See IRM 9.5.3(1).

Merely disclosing the possible violation is no guarantee that one will not be prosecuted. Still, a true voluntary disclosure weighs heavily in favor of the citizen, especially in non-filer cases where the driving factor in not filing was financial or other circumstances beyond the taxpayer's control. The IRS has learned the hard way that evidence of a truly penitent spirit along with the lack of criminal intent weighs heavily with a jury in favor of the taxpayer.

Years ago, the IRS's Phoenix office developed and distributed a brochure describing the IRS's Non-Filer Program. The brochure was entitled, "Come On In." It strongly encouraged non-filers to step forward. It stated, "If you voluntarily come in now, we will help you file your returns and make arrangements for you to pay what you owe." However, the brochure warned, "If you choose not to take advantage of our current efforts to assist Non-filers, you could face criminal charges for failure to file, in addition to severe penalties." Notice that the threat of criminal prosecution was pointed at those who did not step forward. For those who did so voluntarily, there was the offer of help. In fact, the brochure concluded by saying, "Coming forward voluntarily is the best way to avoid criminal prosecution."

That still remains true today, but in order for a voluntary disclosure to be of any effect, it must be truly "voluntary." That is, it must not have been influenced by IRS enforcement action or external events making it likely the IRS would discover the malfeasance, such as the discovery of evidence that might link you to a tax offense. Disclosure is voluntary when:

1. It is made prior to the commencement of any audit or investigation. Certainly it is voluntary when done after a general solicitation by the IRS such as by the brochure mentioned above;
2. It is made prior to the citizen's knowledge of the IRS obtaining information from third party sources which may lead to the discovery of the wrongdoing;
3. If an investigation is pending, the disclosure is voluntary if made prior to the citizen having any knowledge of it;
4. The disclosure is truthful and complete as to all material matters; and
5. The citizen agrees to and in fact does cooperate with the IRS in determining his correct tax liability. In failure to file cases, this is accomplished by either filing correct tax returns or providing information to the IRS to allow the agency to determine one's correct tax liability.

In the case of failure to file, the concept of voluntary disclosure may be a moot point if, at the time the return is filed, the statute of limitations has lapsed. One cannot be prosecuted for failure to file after six years from the due date of the return. However, upon filing a past due return, you must expect the IRS to scrutinize it. If it is found to be false, the door is opened to possible prosecution for submission of a false document. The statute of limitations covering a false return expires six years from the date the return is presented to the IRS.

Upon making a true voluntary disclosure, one where all of the facts of the case so justify (particularly considering the effect of the voluntary disclosure on jury appeal), CI at that moment considers whether to drop the criminal investigation (if one was ever started). If the investigation is dropped, the matter is transferred to the Examination function to address the civil tax aspects. Any tax owed is assessed, including interest and penalties. The case is then handed to Collection to secure payment.

Cooperating with the Investigation

If one finds himself the target of a criminal investigation, he is immediately faced with a very difficult decision. The decision must never be made in a vacuum and should be reached only after thoughtful consultation with experienced tax counsel. The decision is whether to cooperate with the investigators or remain silent per your constitutional right under the Fifth Amendment. Experienced attorneys are divided on which is the best approach. Some tell you to keep your mouth shut and hope for the best. Others advise you to disgorge and hope they do not thump you.

It is the classic Fifth Amendment dilemma. If you do not cooperate, they may construe that fact in a negative light. But if you do cooperate, you have not only waived your Fifth Amendment rights, but you may well provide all the evidence eventually used against you in court. Often, it is impossible to know what the best approach is. Generally, it is a judgment call that must be made only on the basis of the facts of each individual case.

I personally believe that generally, the innocent citizen—the one caught in a tangle of tax regulations or financial hardships, or who was misled by purported experts—is better served by cooperating. This involves filing all required returns and proving their accuracy. If possible, make full payment of all taxes. In Chapter 8, I discuss at length how to "step forward" before the IRS commences a criminal or civil inquiry. The most important thing to remember is that special agents will interview you if you choose to cooperate. You should have counsel present during the interview and you should discuss your statement with counsel before talking with the agents.

Bearing in mind that the government must prove you acted willfully for a prosecution to succeed, take every opportunity to provide tangible evidence that your actions or lack thereof were based on good faith and not on criminal intent. This is the single most important aspect of the case. It is important because regardless of what you did or did not do, you cannot legally be convicted of a tax crime unless you deliberately intended to break the law.

Without saying so, special agents hunt for evidence of this critical element. As a practical matter, you alone can provide it because no one can pry into your head to examine your thoughts from years past. Be prepared to offer detailed explanations of what you were thinking at the time you acted or failed to act. The evidence must support the claim that you did not intend to break the law. Experienced tax counsel are able to evaluate the potential impact, or jury appeal, of your statements. Counsel are able to assist in bringing forth and emphasizing factors pointing to good faith and the lack of criminal intent.

Even if the special agent is not persuaded of your good faith, you have an opportunity to meet with Area Counsel, and later with Justice Department attorneys, before a final decision is made. Your counsel should take these opportunities to press the issue of good faith. After making the decision to cooperate and disgorge, do not turn back. Press to the end in an effort to prevent a criminal prosecution.

If you choose not to cooperate, the investigation will run its course naturally. Special agents will pursue third party sources for information, such as banks, employers, brokerage houses, etc., and interview all possible witnesses looking for evidence to prove their case.

One significant advantage of not cooperating is that the IRS obtains no statements from you which could be used against you. In my experience with criminal prosecutions, particularly with tax protester cases, the only evidence of willfulness the government ever has is what it obtains from the citizen's own lips.

The major disadvantage of not cooperating, however, is that the special agent will likely never hear an innocent explanation of your deeds. He considers the evidence in a negative light and unless you cast positive favor upon it, none ever surfaces.

As you can see, it is a tough call. Almost always, the factors to consider go well beyond those addressed here. All we know for sure is each case is different and special agents are highly trained investigators who must never be underestimated. That is why it is important to seek experienced tax counsel who knows how to match wits with them.

Conclusion

Terror can be immobilizing. Overwhelming fear often leads an otherwise perfectly rational person to carry out irrational acts. You can never set your tax problems straight until you cast off the chains that bind you to fear. That begins with understanding what we taught in this chapter.

Review Questions

1. Which category of tax crimes includes those referred to as “typical”?
   A. Narcotics-related
   B. Legal-source
   C. Money laundering
   D. Illegal-source

2. Who has sole control of a “frozen” tax case?
   A. Special agent
   B. Revenue officer
   C. Tax auditor
   D. Revenue agent

3. Which government action involves trickery and deceit?
   A. An investigation does not inform a taxpayer that fraud is suspected
   B. A special agent issues summons to third parties to gather evidence against a taxpayer
   C. An agent obtains evidence from a taxpayer without explaining that a criminal investigation is under way
   D. After being read his or her rights by an IRS agent, the taxpayer discusses the case without consulting experienced counsel

4. In which case does the taxpayer bear the burden of proof?
   A. Civil tax collection
   B. Tax evasion
   C. Criminal failure to file a tax return
   D. Tax fraud

5. What is an example of a taxpayer’s voluntary disclosure?
   A. Disclosure of a wrongdoing after becoming knowledgeable of the IRS’s evidence requests from third party sources
   B. Disclosure is truthful but vague as to some material matters
   C. Disclosure of an issue is made upon commencement of an audit
   D. Disclosure is made without knowledge that an investigation of the taxpayer is pending

Review Answers

1. A. Incorrect. Narcotics-related tax crimes are not referred to as "typical." The IRS's Criminal Investigation (CI) function identifies and investigates most significant narcotics-related tax offenders.
   B. **Correct.** Crimes involving legally earned income are what might be called "typical" tax crimes.
   C. Incorrect. Money laundering is not a category of tax crimes that is referred to as "typical." Money laundering is included in the category of illegal-source crimes.
   D. Incorrect. Illegal-source tax crimes are not referred to as "typical." Illegal-source income is any income earned through any illegal business activity.

2. A. **Correct.** At the point where a tax case is "frozen," a special agent has sole control of the case and begins a full-scale investigation.
   B. Incorrect. A revenue officer does not have sole control of a "frozen" tax case. Employees in the IRS Collection function are known as revenue officers.
   C. Incorrect. A tax auditor does not have sole control of a "frozen" tax case. Employees in the Examination function of the IRS include tax auditors.
   D. Incorrect. Revenue agents do not have sole control of a "frozen" tax case. Revenue agents are employed within the IRS's Examination function.

3. A. Incorrect. If an investigation does not inform the taxpayer that fraud is suspected, this action does not involve trickery and deceit. Civil investigators do not have to independently inform a taxpayer that they are concerned about fraud.
   B. Incorrect. Summons issued by a special agent to third parties to gather evidence against a taxpayer do not involve trickery and deceit. Third parties must release requested information about a taxpayer to the special agent.
   C. **Correct.** Trickery and deceit exist when revenue agents or special agents seek and obtain evidence from a citizen without explaining the fact that a criminal investigation is under way.
   D. Incorrect. If a taxpayer discusses his or her case with an IRS agent after being read his or her rights, this does not involve trickery or deceit. If an IRS agent ever reads a taxpayer his or her rights, nothing should be said before the taxpayer contacts experienced counsel.

4. A. **Correct.** In civil tax examination and collection cases, the citizen bears the burden of proof on virtually all matters.
   B. Incorrect. The taxpayer does not bear the burden of proof in tax evasion cases. Tax evasion involves criminal activity and the government bears the sole burden of proof.
   C. Incorrect. The taxpayer does not bear the burden of proof if the criminal failure to file a tax return exists. Since this involves criminal activity, the government bears the sole burden of proof.
   D. Incorrect. The taxpayer does not bear the burden of proof when tax fraud is involved. Tax fraud is criminal activity and the government bears the sole burden of proof in such matters.

5. A. Incorrect. An example of a taxpayer's voluntary disclosure does not include disclosure of a wrongdoing after becoming knowledgeable of the IRS's request for taxpayer information from third parties. To be voluntary, the disclosure must be made before the taxpayer has knowledge of the IRS obtaining information from third party sources.
   B. Incorrect. Disclosures that are truthful but are vague as to some material matters are not voluntary. Voluntary disclosure must be truthful and complete as to all material matters.
   C. Incorrect. Taxpayer disclosures made upon commencement of an audit are not voluntary. Disclosure is voluntary if made prior to the commencement of any audit.
   D. **Correct.** If an investigation is pending, a disclosure is voluntary if made prior to the citizen having any knowledge of it.

Chapter 4
The Tax Man Cometh

Learning Objectives

- Identify the most crushing blow the IRS can deal in the collection context
- Determine which category is exempt from lien by merely capping its value
- Choose an IRS policy designed to minimize a potential collection surprise

Introduction

The IRS has more tools to enforce collection and fewer limits on the use of those tools than any other creditor or government agency. In fact, that is why Congress continually hands the IRS the task of collecting debts for other agencies, such as delinquent student loans and child support. Here we examine those tools in very general terms. I outline what to expect from the IRS if you owe money. Then, in Chapters 5, 6 and 7, I show you how to neutralize collection to keep the IRS from grinding you into powder.

The IRS's Collection Powers

The IRS's collection arsenal consists of four primary weapons. They are the "summons," the "tax lien," the "tax levy" and the "seizure." Let us address them in turn.

The Summons

The summons is an investigative tool, not to be confused with a subpoena (which flows from the jurisdiction of a court). The summons is used by all IRS enforcement functions to gather information. Revenue officers use summonses to gather information concerning income sources and asset locations, which is then translated into potential levy or seizure action.

There are several versions of the summons in common use, because it would be too simple to have just one form. The most common is Form 2039, *Summons*. The summons typically states:

> *"You are hereby summoned and required to appear before an officer of the Internal Revenue Service, to give testimony and to bring with you and to produce for examination the following books, records, papers, and other data relating to the tax liability or the collection of the tax liability or for the purpose of inquiring into any offense connected with the administration or enforcement of the internal revenue laws concerning the person identified above for the periods shown.*

The summons then lists the documents you are required to bring and the tax periods in question.

In collection matters specifically, two other summons forms are used. The first is pointed at those who filed tax returns but have not paid the tax. That is IRS Form 6637, *Collection Summons*, subtitled, "*Collection Information Statement*." A *Collection Information Statement* (CIS) is IRS Form 433-A (for individuals) or 433-B (for corporations, partnerships and other business entities). A CIS is always sought as an initial step in the collection of delinquent accounts. The CIS is a detailed financial statement showing income and expenses, assets and liabilities. It is used as a guide to ascertain a person's ability to pay the tax, pursue available assets and determine whether an installment agreement is appropriate and the amount of the monthly payment. I discuss the *Collection Information Statement* in detail in Chapter 5.

The second version of the summons used by revenue officers is aimed at those who have *not* filed tax returns. That is IRS Form 6638, *Collection Summons*, subtitled, "*Income Tax Return*." Form 6638 is substantively the same as Form 6637. However, it states that the information sought is to be used "to enable us to prepare a federal income tax return" for any years that were not filed.

We discuss the summons and its uses in more detail in Chapter 5.

The Tax Lien

The tax lien is the tool the IRS uses to make public record the fact that one owes outstanding tax debts. IRS Form 668 is the *Notice of Federal Tax Lien*. It is reproduced below as Exhibit 4-1.

Exhibit 4-1 – IRS Form 668, *Notice of Federal Tax Lien*

Form 668 (Y)(c) (Rev. February 2004) 1872

Department of the Treasury - Internal Revenue Service

Notice of Federal Tax Lien

Area:
SMALL BUSINESS/SELF EMPLOYED AREA #6
(800) 829-3903

Serial Number [redacted]

For Optional Use by Recording Office

As provided by section 6321, 6322, and 6323 of the Internal Revenue Code, we are giving a notice that taxes (including interest and penalties) have been assessed against the following-named taxpayer. We have made a demand for payment of this liability, but it remains unpaid. Therefore, there is a lien in favor of the United States on all property and rights to property belonging to this taxpayer for the amount of these taxes, and additional penalties, interest, and costs that may accrue.

- This Notice of Federal Tax Lien has been filed as a matter of public recorc
- IRS will continue to charge penalty and interest until you satisfy the amount you owe.
- Contact the Area Office Collection Function for information on the amount you must pay before we can release this lien.
- See the back of this page for an explanation of your Administrative Appeal rights.

Name of Taxpayer [redacted]

Residence [redacted]

301905

IMPORTANT RELEASE INFORMATION: For each assessment listed below, unless notice of the lien is refiled by the date given in column (e), this notice shall, on the day following such date, operate as a certificate of release as defined in IRC 6325(a).

Kind of Tax (a)	Tax Period Ending (b)	Identifying Number (c)	Date of Assessment (d)	Last Day for Refiling (e)	Unpaid Balance of Assessment (f)
1040	12/31/2009	XXX-XX-[redacted]	01/13/2014	02/12/2024	6033.95
1040	12/31/2010	XXX-XX-[redacted]	01/13/2014	02/12/2024	9731.64
1040	12/31/2011	XXX-XX-[redacted]	08/24/2015	09/23/2025	15059.50
1040	12/31/2012	XXX-XX-[redacted]	08/24/2015	09/23/2025	11345.27

Place of Filing
SECRETARY OF STATE
STATE OF COLORADO
DENVER, CO 80202

Total 42170.36

This notice was prepared and signed at SEATTLE, WA, on this,

the 08th day of October, 2015.

Signature
Cheryl Cordero
for G.J. CARTER-LOUIS

Title
ACS SBSE
(800) 829-3903
26-00-0008

(**NOTE:** Certificate of officer authorized by law to take acknowledgment is not essential to the validity of Notice of Federal Tax Lien Rev. Rul. 71-466, 1971 - 2 C.B. 409)

Part 3 - Taxpayer's Copy

CAT. NO 60025
Form 668 (Y)(c) (Rev. 02-0

The purpose of a tax lien is to: 1) "secure" the tax debt to a citizen's property, and 2) put the public on notice that the IRS claims an interest in a person's property. This prevents him from disposing of property without paying the tax. It is important to note that the lien does not transfer title of your property from you to the IRS. It merely establishes the IRS's claim to an interest in the property attributable to the tax debt.

A tax lien arises at the time the tax debt is established. It becomes perfected when the Notice is filed with the county recorder's office. The lien attaches to "all property and rights to property" owned by the citizen at the time of its filing. It also attaches to "after-acquired property," which is property acquired after the date the lien is filed. See IRC §6321.

Because the lien appears on your credit report, the lien not only encumbers assets, it can destroy your credit. Banks and other lenders often refuse to lend money when a credit report reveals a tax lien. Consequently, those seeking to borrow funds to pay the tax are routinely turned away because of the outstanding lien. Ironically, when asked to release the lien to facilitate a loan (so the tax can be paid), the IRS often refuses. This is a problem we address and solve in Chapter 6.

Coping with Liens, Levies and Seizures

Wage and Bank Levies

Wage and bank levies—indeed all third-party levies—are perhaps the most crushing blows the IRS can deal in the collection context. Directed to your employer, bank account or other revenue source, the levy instructs a third party to pay the IRS all funds owed to you. Thus, unlike liens, a levy *does* transfer your property to the IRS. Levies are used to reach not only banks and employers, but pension funds (including Social Security), business accounts receivable, securities accounts or any other third party in possession of funds belonging to the delinquent citizen.

The IRS uses several forms to carry out levies. The most common are: 1) Form 668-A, *Notice of Levy*, used on banks and other third parties, and 2) Form 668-W, *Notice of Levy on Wages, Salary and Other Income*, used on employers to levy wages. See Exhibit 4-2.

One very troublesome aspect of the wage levy is that it is considered "continuing." That is, it is effective beginning with the date of service and remains effective until the tax is fully paid or the levy is otherwise released. That means that the IRS need serve only one *Notice of Levy* on an employer to seize wages over an extended period of time. But, to be considered a "continuing" levy, it must be issued to a source that pays a "fixed and determinable" amount on an ongoing basis. This includes wages and pension payments, such as Social Security. On the other hand, a levy not directed against a "fixed and determinable" income stream is not continuing. A bank levy, for example, is therefore a one-time levy, effective to reach only the money in your account on the day of the levy.

Property Seizures

A property seizure involves the confiscation and sale of assets held by the citizen himself (subject to limitations discussed below). Key examples of such assets are personal property such as boats, automobiles and real estate holdings that do not constitute the taxpayer's main home. Examples include a vacation home or investment property. Special rules apply if the IRS intends to seize your main home (which I discuss below). The IRS can also reach business equipment, supplies, office furniture, fixtures, material, inventory and accounts receivable, but only within certain limitations (also discussed below).

After seizing tangible property, the IRS must issue a notice to the owner indicating specifically what was seized. The notice is provided on Form 2433, *Notice of Seizure*. Once seized, the property must be sold "not less than 10 days or more than 40 days" from the date of seizure. IRC §6335(d). Notice of the sale must be given to the citizen using Form 2434, *Public Auction Sale*. It explains when the sale is to occur, what is to be sold and the terms of the sale.

Exhibit 4-2 – IRS Form 668-W, *Notice of Levy on Wages, Salary and Other Income*

Form 668-W(ICS)
(Rev. July 2002)

Department of the Treasury – Internal Revenue Service
Notice of Levy on Wages, Salary, and Other Income

DATE: 05/12/2014
REPLY TO: Internal Revenue Service
[redacted]

TELEPHONE NUMBER
OF IRS OFFICE: [redacted]

NAME AND ADDRESS OF TAXPAYER:
[redacted]

TO: [redacted]

IDENTIFYING NUMBER(S): [redacted]

MENS

Kind of Tax	Tax Period Ended	Unpaid Balance of Assessment	Statutory Additions	Total
1040	12/31/2006	$31,498.88	$1,673.63	$33,172.51
1040	12/31/2007	$51,398.73	$2,872.22	$54,270.95
CIVPEN	12/31/2005	$17,454.48	$296.58	$17,751.06
CIVPEN	12/31/2006	$5,859.64	$99.57	$5,959.21
Employer or Other Addressee: Please complete the back of this page.			Total Amount Due ⇒	$111,153.73

We figured the interest and late payment penalty to 06/11/2014

Statement of Exemptions and Filing Status (*To be completed by taxpayer; instructions are on the back of Part 5*)

My filing status for my income tax return is (check one): ☐ Single; ☐ Married Filing a Joint Return; ☐ Married Filing a Separate Return; ☐ Head of Household; or ☐ Qualifying Widow(er) with dependent child

ADDITIONAL STANDARD DEDUCTION: ________________ *(Enter amount only if you or your spouse is at least 65 and/or blind.)*

I certify that I can claim the people named below as personal exemptions on my income tax return and that none are claimed on another Notice of Levy. No one I have listed is my minor child to whom (as required by court or administrative order) I make support payments that are already exempt from levy. I understand the information I have provided may be verified by the Internal Revenue Service. Under penalties of perjury, I declare that this statement of exemptions and filing status is true.

Name (Last, First, Middle Initial)	Relationship (*Husband, Wife, Son, Daughter, etc.*)	Social Security Number (*SSN*)

Taxpayer's Signature | Date

Part 3a – Return to IRS   Catalog No. 35390F   www.irs.gov   Form 668-W(ICS) (7-2002)

Property Exempt from Levy and Seizure

Code section 6334 provides a list of thirteen categories of property that are legally beyond the reach of the IRS. In two cases, the law merely caps the value of the exempt asset, allowing the IRS to reach any amount above that exemption. Assets exempt from levy are as follows:

1. Wearing apparel and school books necessary for the citizen and his family;
2. Personal household goods, furnishings, food and fuel, the value of which does not exceed $9,080;*

3. Tools and equipment necessary for the citizen to carry on his trade or business, the value of which does not exceed $4,540* (discussed further below);
   * These items are adjusted for inflation, and thus increase annually. The IRS publishes all current, inflation-adjusted amounts on its website (www.IRS.gov).
4. Unemployment benefits in any amount;
5. All undelivered mail;
6. Railroad Retirement Act pension benefits and pension benefits payable to a person listed on the Medal of Honor roll of any military branch;
7. Workman's compensation benefits in any amount;
8. So much of the salary or wages as are necessary to comply with court ordered child support;
9. A minimum amount of wages or salary determined by reference to one's filing status and personal dependent exemptions (I present more on this important item in Chapter 7);
10. Service-connected disability payments in any amount;
11. State, local and Federal government public assistance or aid payments;
12. Payments to a participant under the Job Training Partnership Act in any amount; and
13. The principal residence of a citizen is exempt from levy under any circumstances if the tax liability does not exceed $5,000. Even if the liability does exceed $5,000, the IRS cannot levy the property through the administrative process. That is to say, a Notice of Levy issued by an IRS employee *cannot* reach your home. That is not to say the IRS can never seize your home. It can, but the process is much more complicated. I address this important provision in more detail below.

The Exemption for Business Tools and Equipment

A provision of code section 6334(a)(13) creates an exception broader than merely the dollar amount mentioned above. It applies to all "tangible personal property or real property (other than real property which is rented) used in the trade or business of an individual taxpayer." On its face, this statute creates an exemption from levy for any property used in a business. However, the exemption only applies to the levy actions of revenue officers and their immediate managers. Code section 6334(e)(2) provides that an area director must make the decision to levy business equipment. An area director is the highest IRS official with a given revenue district (or area), consisting of several states.

To proceed with the levy of business assets, the levy must be personally approved (in writing as explained), or the IRS must determine that the collection of tax is in "jeopardy." In either case, revenue officers acting alone cannot take it upon themselves to put a company out of business. The statute also dictates that a levy against business assets cannot be approved "unless the official determines that the taxpayer's other assets subject to collection are insufficient to pay the amount due." Thus, the decision to levy business assets is purely a matter of last resort.

The Exemption for a "Principal Residence"

Just about every citizen with a tax debt is worried about losing his home. It is one of the first two or three questions I am asked in every case where taxpayers face potential enforcement action. Code section 6334(a)(13) limits the IRS's capacity to seize a person's principle residence (the main home where a person lives) in two ways. Let us examine both.

1. **Subsection (a)(13)(A).** This subsection prevents seizure of a principle residence in "small deficiency cases." As mentioned above, this is defined as a debt that does not exceed $5,000. In that case, the IRS cannot seize your home or any other real estate you own if that property is used by another person as a residence (unless it is rental property). For example, suppose you own two homes. One you live in with your family and the other is a vacation home occupied by your in-laws. You owe $5,000 or less to the IRS. In that case, the IRS simply cannot seize either home to pay the debt.
2. **Subsection (a)(13)(B).** This section prevents seizure of your home through the administrative process, regardless of how much you owe. To seize your home, the IRS must file a lawsuit in federal court, and the final decision to seize the home is made by a federal judge. The suit must be au-

thorized by IRS counsel locally and then commenced by the Justice Department in Washington, D.C. The process is much like the criminal prosecution we discussed in Chapter 3.

Suits to attach residential property occur very rarely. They arise generally in cases where there is both a substantial tax liability and substantial equity in the home. Such suits generally occur only in cases where the IRS is running out of time to collect because of the collection statute of limitations. As such, this is an action of last resort. See Chapter 10 for details on the collection statute of limitations.

Based on the above, any threat by a revenue officer to seize your main home is generally a hollow threat. All he can do is recommend that an action be started, but he is far from the final authority on the process. This is why the number of home seizures by the IRS plummeted dramatically since 1998, when Congress added this provision as part of the IRS Restructuring and Reform Act of 1998.

What to Expect from Enforced Tax Collection

Let us now address when and how the IRS is most likely to utilize the four collection tools. Before we get specific, let me introduce you to what I believe could be the single most important development in taxpayers' rights since the adoption of the Internal Revenue Code in 1913. I speak of the Collection Due Process (CDP) appeal.

The IRS Restructuring and Reform Act of 1998 created the CDP appeal by adopting code sections 6320 and 6330. These provisions are designed to prevent unfettered enforcement action from going forward before a citizen has the opportunity to present alternatives to enforcement action. Section 6320 addresses CDP lien appeals. Section 6330 addresses CDP levy appeals. I discuss CDP rights in more detail later, explaining both the timing and procedure for carrying out a CDP appeal.

As you read Chapter 2, you noticed that collection cases fall into two general categories. The first is where you file a tax return but do not pay the tax (including liabilities determined after you file, such as through an audit, etc.). The second is where you fail to file a return. These two categories apply whether the debt is for personal or business taxes. What follows is an explanation of the procedures pursued by the IRS in both situations.

When You File but Do Not Pay

Filing a tax return triggers a series of events within the IRS designed to place the agency in position to legally collect the tax. When a return hits the service center, it is processed in the manner discussed in Chapter 2, under the heading, "IRS Error."

What we did not address is a very important legal principle governing the collection of taxes. The principle is that unless there is a legitimate tax *assessment* obtained in accordance with all administrative procedures, no tax is owed. An assessment is born when an assessment officer signs an assessment certificate, generally IRS Form 23C. The certificate must show the amount and type of tax, the year in question and the name and Social Security number of the citizen. When the certificate is signed, the assessment is recorded in that citizen's Individual Master File for the year involved.

The assessment, now an official tax debt, is then offset by withholding credits or payments submitted with the return. If there is an outstanding liability, the matter is then handed to the Collection function for action. Collection operates a function known as the Automated Collection Service (ACS). ACS is responsible for collecting, to the fullest extent possible, all outstanding amounts.

Collection begins with a friendly written reminder. The first notice is usually Notice CP14. It follows the filing of your tax return by about sixty to ninety days. It states that a balance is due and requests immediate payment. It explains that interest and penalties continue to accumulate until you pay in full. The notice does not outright threaten levy action. If full payment is not made, expect to receive Notices CP501 and CP503. The tone and severity of each notice increases, with CP503 threatening to "take other steps" to collect if you do not pay. The notices arrive at intervals of approximately four to six weeks, but there is no firm formula.

The next letter in the sequence is Notice CP504, shown here as Exhibit 4-3. This is one of the notices required by code section 6331. That section requires, among other things, that the IRS issue a specific notice before levying a state tax refund, and a separate notice before levying any other asset. Notice

CP504 is the notice required before the IRS can levy a state tax refund. After reading the notice carefully, you see that the threat of levy is pointed solely at a state tax refund, though it also says the IRS will also "begin to search for other assets" it can seize. However, Notice CP504 does not authorize the IRS to seize a bank account, paycheck or any other asset.

Exhibit 4-3 – IRS Notice CP504

IRS
Department of the Treasury
Internal Revenue Service
Cincinnati, OH 45999-0030

CAF

	5B
Notice	CP504
Tax Year	2014
Notice date	July 6, 2015
Social Security number	[redacted]
To contact us	Phone 1-800-829-8374

Page 1 of 4

009448.571864[redacted] 1 SP[redacted]

[redacted]
%DANIEL J PILLA
215 MYRTLE ST W
STILLWATER MN 55082-4804158

009448

Notice of intent to seize ("levy") your state tax refund or other property

Amount due immediately: $42,805.55

As we notified you before, our records show you have unpaid taxes for the tax year ending December 31, 2014 (Form 1040). If you don't call us immediately or pay the amount due, we may seize ("levy") your property or rights to property (including any state tax refunds) and apply it to the $42,805.55 you owe.

Billing Summary

Amount you owed	$42,566.26
Failure-to-pay penalty	165.76
Interest charges	73.53
Amount due immediately	**$42,805.55**

What you need to do immediately

Pay immediately

- Pay the amount due of $42,805.55 or we may seize ("levy") your property or rights to property (including any state tax refunds). If you fail to pay by July 16, 2015, interest will increase and additional penalties may apply. **You can pay online now at www.irs.gov/e-pay.**

Continued on back..

IRS

Payment

[redacted]
%DANIEL J PILLA
215 MYRTLE ST W
STILLWATER MN 55082-4804158

Notice	CP504
Notice date	July 6, 2015
Social Security number	[redacted]

- Make your check or money order payable to the United States Treasury.
- Write your Social Security number [redacted] the tax year (2014), and the form number (1040) on your payment and any correspondence.

Amount due immediately $42,805.55

INTERNAL REVENUE SERVICE
CINCINNATI, OH 45999-0030

[redacted] XD [redacted] 30 0 201412 670[redacted]

Before the IRS may levy a bank account, paycheck or any asset other than a state tax refund, code section 6331 requires that the IRS mail a *Final Notice, Notice of Intent to Levy and Notice of Your Right to a Hearing*. As the name implies, it is the last notice in the sequence of collection letters. The notice informs you: 1) of the amount of the debt, 2) of the fact that you have thirty days from the date of the notice to pay before levy action can be taken, and 3) that you have the right to request a Collection Due Process appeal within that thirty-day period.

The IRS uses several forms to communicate this information because it would be too simple to use one just letter. The most common letters are Notice LT11 and Letter 1058. The IRS also uses CP90. An example of Notice LT11 and Letter 1058 are shown here as Exhibits 4-4 and 4-5, respectively. I refer to these two letters collectively throughout the remainder of this book as the “Final Notice” or “CDP Notice.”

Exhibit 4-4 – IRS Notice LT11

IRS
Department of Treasury
Internal Revenue Service
ACS Support - Stop 5050
P.O. Box 219236
Kansas City, MO 64121-9236

Notice	LT11
Notice Date	February 11, 2015
Taxpayer ID number	XXX-XX[redacted]
Case reference number	[redacted]
To contact us	1-800-829-7650

Page 1 of 5

005162.531420.36772[redacted]

[redacted]
C/O DANIEL J PILLA
215 MYRTLE ST W
STILLWATER MN 55082

005162

Notice of intent to levy

Intent to seize your property or rights to property

Amount due immediately: $25,968.68

We haven't received a payment despite sending you several notices about your overdue taxes. The IRS may seize (levy) your property or your rights to property on or after March 13, 2015.

Property includes:

- Wages and other income
- Bank accounts
- Business assets
- Personal assets (including your car and home)
- Alaska Permanent Fund Dividend and state tax refund
- Social Security benefits

Billing Summary

Amount you owed	$23,824.42
Additional penalty charges	1,374.30
Additional interest charges	769.96
Amount due immediately	**$25,968.68**

Continued on back...

IRS

Payment

[redacted]
C/O DANIEL J PILLA
215 MYRTLE ST W
STILLWATER MN 55082

Notice	LT11
Notice date	February 11, 2015
Taxpayer ID number	XXX[redacted]
Case reference number	[redacted]

- Make your check or money order payable to the United States Treasury.
- Write your Taxpayer ID number [redacted] and the tax period(s) on your payment and any correspondence.

Amount due **$25,968.68**

INTERNAL REVENUE SERVICE
ACS SUPPORT - STOP 5050
P.O. BOX 219236
KANSAS CITY, MO 64121-9236

XX[redacted]00 [redacted] 30 0 200312 [redacted]

Notice	LT11
Notice Date	February 11, 2015
Taxpayer ID number	XXX-X[redacted]
Case reference number	[redacted]
Page 2 of 5	

What you need to do immediately

Pay immediately

- **Send us the amount due of $25,968.68, or we may seize (levy) your property on or after** March 13, 2015.
- If you can't pay the amount due, pay as much as you can now and make payment arrangements that allow you to pay off the rest over time. Visit www.irs.gov/payments for more information about:
  - Installment and payment agreements-download required forms or save time and money by applying online if you qualify
  - Automatic deductions from your bank account
  - Payroll deductions
  - Credit card payments

  Or, call us at 1-800-829-7650 to discuss your options.
- If you've already paid your balance in full or think we haven't credited a payment to your account, please send proof of that payment.

Right to request a Collection Due Process hearing

If you wish to appeal this proposed levy action, complete and mail the enclosed Form 12153, Request for a Collection Due Process or Equivalent Hearing, by March 13, 2015. Send the form to us at the address listed at the top of page 1. Be sure to include the reason you are requesting a hearing (see section 8 of, and the instructions to, Form 12153) as well as other information requested by the form. If you don't file Form 12153 by March 13, 2015, you will lose the ability to contest Appeals' decision in the U.S. Tax Court.

IRS

Contact information

[redacted]
C/O DANIEL J PILLA
215 MYRTLE ST W
STILLWATER MN 55082

Notice	LT11
Notice date	[redacted]
Taxpayer ID number	XXX-XX-[redacted]
Case reference number	[redacted]

If your address has changed, please call 1-800-829-0922 or visit www.irs.gov.

☐ Please check here if you've included any correspondence. Write your Taxpayer ID number [redacted] and the tax period(s) on any correspondence.

Primary phone	Best time to call	Secondary phone	Best time to call
	☐ a.m. ☐ p.m.		☐ a.m. ☐ p.m.

INTERNAL REVENUE SERVICE
ACS SUPPORT - STOP 5050
P.O. BOX 219236
KANSAS CITY, MO 64121-9236

[redacted] 00 [redacted] 30 0 200312

Notice	LT11
Notice Date	February 11, 2015
Taxpayer ID number	[redacted]
Case reference number	[redacted]

005162

What you need to do immediately – continued

About Federal Tax Liens

The tax lien is a claim against all of your property that arises once you have not paid your bill. If you don't pay the amount due or call us to make payment arrangements, we can file a Notice of Federal Tax Lien at any time, if we haven't already done so. The Notice of Federal Tax Lien publically notifies your creditors that the IRS has a lien (or claim) against all your property, including property acquired by you after the Notice of Federal Tax Lien is filed. Once the lien's notice to creditors has been filed, it may appear on your credit report and may harm your credit rating or make it difficult for you to get credit (such as a loan or credit card). It cannot be released until your bill, including interest, penalties, and fees, is paid in full, we accept a bond guaranteeing payment of the amount owed, or we determine that you don't owe or the liability is reduced to zero. The lien's notice to creditors may be withdrawn under certain circumstances. You can find additional information about tax liens, including helpful videos, at http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Understanding-a-Federal-Tax-Lien or by typing lien in the IRS.gov search box.

If we don't hear from you

If you don't call us immediately, pay the amount due, or request a hearing by March 13, 2015, we may seize (levy) your property or your rights to property. Property includes:

- Wages and other income
- Bank accounts
- Business assets
- Personal assets (including your car and home)
- Social Security benefits

Your billing details

Tax period ending	Form number	Amount you owed	Additional interest	Additional penalty	Total
12/31/2003	1040A	$20,973.79	$677.83	$1,167.62	$22,819.24
12/31/2005	1040A	$2,850.63	$92.13	$206.68	$3,149.44

Penalties

We are required by law to charge any applicable penalties.

Failure-to-pay

When you pay your taxes after the due date, we charge a penalty of 0.5% of the unpaid amount due per month, up to 25% of the amount due. Beginning 10 days after we issue a notice of intent to levy, the penalty increases to 1.0% for each month the amount remains unpaid. We count part of a month as a full month. (Internal Revenue Code Section 6651)

For a detailed calculation of your penalty charges, call 1-800-829-7650.

Continued on back..

Notice	LT11
Notice Date	February 11, 2015
Taxpayer ID number	XXX-XX[redacted]
Case reference number	[redacted]
Page 4 of 5	

Penalties — **continued**

Removal or reduction of penalties

We understand that circumstances—such as serious illness or injury, a family member' death, or loss of financial records due to natural disaster—may make it difficult for yo to meet your taxpayer responsibility in a timely manner.

If you would like us to consider removing or reducing any of your penalty charges, please do the following:

- Identify which penalty charges you would like us to remove or reduce (e.g., 2005 late filing penalty).
- For each penalty charge, explain why you believe removal or reduction is appropriate.
- Sign your statement, and mail it to us with any supporting documents.

We will review your statement and let you know whether we accept your explanation as reasonable cause to reduce or remove the penalty charge(s).

Removal of penalties due to erroneous written advice from the IRS

If you were penalized based on written advice from the IRS, we will remove the penal if you meet the following criteria:

- If you asked the IRS for written advice on a specific issue
- You gave us complete and accurate information
- You received written advice from us
- You relied on our written advice and were penalized based on that advice

To request removal of penalties based on erroneous written advice from us, submit a completed Claim for Refund and Request for Abatement (Form 843) to the IRS service center where you filed your tax return. For a copy of the form or to find your IRS servi center, go to www.irs.gov or call 1-800-829-7650.

Interest charges

We are required by law to charge interest when you don't pay your liability on time. Generally, we calculate interest from the due date of your return (regardless of extensions) until you pay the amount you owe in full, including accrued interest and any penalty charges. Interest on some penalties accrues from the date we notify you the penalty until it is paid in full. Interest on other penalties, such as failure to file a t return, starts from the due date or extended due date of the return. Interest rates are variable and may change quarterly. (Internal Revenue Code Section 6601)

For a detailed calculation of your interest, call 1-800-829-7650.

Additional information

- Visit www.irs.gov/lt11
- For tax forms, instructions and publications, visit www.irs.gov or call 1-800-TAX FORM (1-800-829-3676).
- Review the enclosed documents:
  - IRS Collection Process (Publication 594)
  - Collection Appeals Rights (Publication 1660)
  - Request for a Collection Due Process Hearing (Form 12153)
- Keep this notice for your records.

Notice	LT11
Notice Date	February 11, 2015
Taxpayer ID number	XXX-XX[redacted]
Case reference number	[redacted]
Page 5 of 5	

005162

Additional information — **continued**

We're required to send a copy of this notice to both you and your spouse. Each copy contains the same information about your joint account. Please note: Only pay the amount due once.

If you need assistance, please don't hesitate to contact us.

Exhibit 4-5 – IRS Letter 1058

POA Copy

Internal Revenue Service
1314 GRISWOLD PLAZA
ERIE, PA 16501-9998

Department of the Treasury

Date:
10/21/2015
Social Security or
Employer Identification Number
[redacted]
Person to Contact:
[redacted]
Contact Telephone Number:
[redacted]
Employee Identification Number:
[redacted]

CERTIFIED MAIL - RETURN RECEIPT

[redacted]

FINAL NOTICE
NOTICE OF INTENT TO LEVY AND NOTICE OF YOUR RIGHT TO A HEARING
PLEASE RESPOND IMMEDIATELY

Why We Are Sending You This Letter
Your federal tax is still unpaid. We asked you to pay the tax, but we still haven't received your payment. This letter is your notice of our intent to levy (under Internal Revenue Code (IRC) Section 6331) and your right to request an Appeals hearing (under IRC Section 6330(a)).

What You Need To Do
Please send us a full payment today to prevent additional collection action. Make your check or money order payable to "United States Treasury". Write your Social Security number or Employer Identification Number on your payment. Send your payment to us in the enclosed envelope, along with a copy of this letter. The amount you owe through 11/21/2015 is $168,428.95. Additional penalty and interest charges will be due if you pay after this date.

If you wish to request an Appeals hearing, complete the enclosed Form 12153, *Request for a Collection Due Process or Equivalent Hearing,* and send it to us within 30 days from this letter's date. You must complete, sign, and return this form to the above address within 30 days to preserve your rights to contest an Appeals' decision in the U.S. Tax Court.

Information about Interest and Penalty Charges
The unpaid amount from prior notices may include tax, penalties, and interest you still owe. It also includes any credits and payments we've received since we sent our last notice to you. Below is a brief explanation of the interest and/or failure to pay penalty that may be included in the amount you owe:

Interest - Internal Revenue Code Section 6601
We charge interest when your tax is not paid on time. Interest is computed from the due date of your return (regardless of extensions) until paid in full. Interest is also charged on penalties for late filing and failure to pay tax owed. Interest compounds daily, except on late or underpaid estimated income taxes for individuals or corporations.

Page 1

Letter 1058 (Rev. 10-2008)
Catalog Number: 40488S

POA Copy

Taxpayer Identification Number: [redacted]

Corporate Interest – We charge additional interest of 2 percent if, according to our records, you didn't make your corporate tax (income, employment, excise, etc.) payment within 30 days after we notified you of the underpayment of tax. This interest begins on the 31st day after we notify you of the underpayment of tax amounts you owe over $100,000, minus your timely payments and credits.

Paying Late - Internal Revenue Code Section 6651(a)(2), (a)(3) and (d)(1)
We charge a late penalty of ½ percent of the tax owed each month or part of a month that the tax remains unpaid from the due date, up to a maximum of 25 percent of the tax due. The ½ percent increases to 1 percent for each subsequent month or part of a month if the tax remains unpaid 10 days after we issue a notice of intent to levy.

What We Are Going To Do
We may file a Notice of Federal Tax Lien at any time to protect the government's interest. A lien is a public notice to your creditors that the government has a right to your current assets, including any assets you acquire after we file the lien.

If you don't pay the amount you owe, make alternative arrangements to pay, or request an Appeals hearing within 30 days from this letter's date, we may take collection action against your property, or rights to property, such as real estate, automobiles, business assets, bank accounts, and other income.

How To Get Help
If you have recently paid this tax or if you can't pay it, call us immediately at the telephone number shown at the top of this letter.

The enclosed Publication 594, *The IRS Collection Process*, and Publication 1660, *Collection Appeal Rights*, provide more information.

Sincerely yours,

[redacted]
REVENUE OFFICER

Enclosures:
Copy of this letter
Publication 594
Publication 1660
Form 12153

The table below shows the amount you owe:

Form Number	Tax Period	Unpaid Amount from Prior Notices	Additional Penalty	Additional Interest	Amount You Owe
1040	12/31/2006	$78,459.86	$0.00	$1,077.78	$79,537.64
1040	12/31/2007	$49,995.38	$0.00	$686.77	$50,682.15
1040	12/31/2008	$37,691.40	$0.00	$517.76	$38,209.16
				Total:	$168,428.95

Page 2

Letter 1058 (Rev. 10-2008)
Catalog Number: 40488S

The IRS must mail a Final Notice for each tax period in question in order to take any levy or seizure action (though it can offset a state tax refund if it issues Notice CP504). This is one reason it is vital to pay close attention to all IRS correspondence. The agency cannot act unless it follows the collection rules carefully, and your rights to challenge collection actions are dependent upon acting within the thirty-day period described in the Final Notice.

If you file a *Request for Collection Due Process Hearing* within the thirty-day period starting with the date on the Final Notice, two important things happen. First, all collection action is stayed pending resolution of the appeal. The IRS cannot commence collection until after you have had a hearing with the IRS's

Office of Appeals. Secondly, the Appeals Office now controls the case. Appeals has full authority to consider challenges to the collection action and any collection alternative posed by the taxpayer.

The CDP appeal is a very important process because when properly prosecuted, it allows you to avoid collection entirely and to reach an amicable settlement. It also allows you to challenge the assessment in certain circumstances, which I discuss further in Chapter 5. A request is filed using IRS Form 12153, *Request for Collection Due Process Hearing*. An example of Form 12153 is shown here as Exhibit 4-6. To be considered timely to stop collection and obtain a CDP hearing, your Form 12153 must be postmarked within thirty days from the date of the Final Notice. See also: the instructions for Form 12153, and IRS Publications 1660, *Collection Appeal Rights* and 594, *The IRS Collection Process*.

Exhibit 4-6 – IRS Form 12153, *Request for Collection Due Process Hearing*

Form **12153** (Rev. 12-2013) | **Request for a Collection Due Process or Equivalent Hearing**

Use this form to request a Collection Due Process (CDP) or equivalent hearing with the IRS Office of Appeals if you have been issued one of the following lien or levy notices:

- Notice of Federal Tax Lien Filing and Your Right to a Hearing under IRC 6320,
- Notice of Intent to Levy and Notice of Your Right to a Hearing,
- Notice of Jeopardy Levy and Right of Appeal,
- Notice of Levy on Your State Tax Refund,
- Notice of Levy and Notice of Your Right to a Hearing.

Complete this form and send it to the address shown on your lien or levy notice. Include a copy of your lien or levy notice to ensure proper handling of your request.

Call the phone number on the notice or 1-800-829-1040 if you are not sure about the correct address or if you want to fax your request.

You can find a section explaining the deadline for requesting a Collection Due Process hearing in this form's instructions. If you've missed the deadline for requesting a CDP hearing, you must check line 7 (Equivalent Hearing) to request an equivalent hearing.

1. Taxpayer Name: (Taxpayer 1) ______

Taxpayer Identification Number ______

Current Address ______

City ______ State ______ Zip Code ______

2. Telephone Number and Best Time to Call During Normal Business Hours

Home ______ ☐ am. ☐ pm.
Work ______ ☐ am. ☐ pm.
Cell ______ ☐ am. ☐ pm.

3. Taxpayer Name: (Taxpayer 2) ______

Taxpayer Identification Number ______

Current Address ______

(*If Different from Address Above*) City ______ State ______ Zip Code ______

4. Telephone Number and Best Time to Call During Normal Business Hours

Home ______ ☐ am. ☐ pm.
Work ______ ☐ am. ☐ pm.
Cell ______ ☐ am. ☐ pm.

5. Tax Information as Shown on the Lien or Levy Notice (*If possible, attach a copy of the notice*)

Type of Tax (Income, Employment, Excise, etc. or Civil Penalty)	Tax Form Number (1040, 941, 720, etc)	Tax Period or Periods

ISA Form **12153** (Rev. 12-2013) www.irs.gov Department of the Treasury - **Internal Revenue Service**

Form **12153** (Rev. 12-2013) | **Request for a Collection Due Process or Equivalent Hearing**

6. Basis for Hearing Request (Both boxes can be checked if you have received both a lien and levy notice)

☐ Filed Notice of Federal Tax Lien ☐ Proposed Levy or Actual Levy

7. Equivalent Hearing (See the instructions for more information on Equivalent Hearings)

☐ I would like an Equivalent Hearing - I would like a hearing equivalent to a CDP Hearing if my request for a CDP hearing does not meet the requirements for a timely CDP Hearing.

8. Check the most appropriate box for the reason you disagree with the filing of the lien or the levy. **See page 4 of this form for examples.** You can add more pages if you don't have enough space. If, during your CDP Hearing, you think you would like to discuss a Collection Alternative to the action proposed by the Collection function it is recommended you submit a completed Form 433A (Individual) and/or Form 433B (Business), as appropriate, with this form. See www.irs.gov for copies of the forms. Generally, the Office of Appeals will ask the Collection Function to review, verify and provide their opinion on any new information you submit. We will share their comments with you and give you the opportunity to respond.

Collection Alternative ☐ Installment Agreement ☐ Offer in Compromise ☐ I Cannot Pay Balance

Lien ☐ Subordination ☐ Discharge ☐ Withdrawal

Please explain:

My Spouse Is Responsible ☐ Innocent Spouse Relief (Please attach Form 8857, *Request for Innocent Spouse Relief,* to your request.)

Other (*For examples, see page 4*) ☐

Reason (*You must provide a reason for the dispute or your request for a CDP hearing will not be honored. Use as much space as you need to explain the reason for your request. Attach extra pages if necessary.*):

9. Signatures — I understand the CDP hearing and any subsequent judicial review will suspend the statutory period of limitations for collection action. I also understand my representative or I must sign and date this request before the IRS Office of Appeals can accept it. If you are signing as an officer of a company add your title (*president, secretary, etc.*) behind your signature.

SIGN HERE

Taxpayer 1's Signature	Date
Taxpayer 2's Signature (*if a joint request, both must sign*)	Date

☐ I request my CDP hearing be held with my authorized representative (*attach a copy of Form 2848*)

Authorized Representative's Signature	Authorized Representative's Name	Telephone Number

IRS Use Only

IRS Employee (Print)	Employee Telephone Number	IRS Received Date

Form **12153** (Rev. 12-2013) www.irs.gov Department of the Treasury - **Internal Revenue Service**

Code section 6320 provides CDP appeal rights in connection with the filing of a federal tax lien. The statute operates much the same as section 6330, with this important distinction. The CDP levy appeal is a *pre-action* remedy. That is, when you file the appeal on time, the IRS cannot take levy action until *after* the Appeals Office conducts a CDP hearing. On the other hand, the CDP lien appeal is a *post-action* remedy. That is, the IRS files a lien *first*, then offers the opportunity for a CDP hearing to address the propriety of the lien.

Section 6320 provides that the IRS must notify you of the filing of a federal tax lien within five days of the date the lien is filed. Letter 3172 is used to communicate this. See Exhibit 4-7. You have thirty days from the date on Letter 3172 in which to file a CDP levy appeal. The deadline for filing the appeal is usually expressed in Letter 3172. A CDP lien appeal is conducted in the same manner as a CDP levy appeal.

A lien appeal provides you with every opportunity to present collection alternatives, and in the proper circumstances, challenge the propriety of the underlying tax liability. I discuss the CDP process in more detail in Chapter 5.

Exhibit 4-7 – IRS Letter 3172

IRS Department of the Treasury
Internal Revenue Service
[redacted]
ERIE, PA 16501

CERTIFIED MAIL
930711075[redacted]

Letter Date: 11/03/2015
Taxpayer Identification Number:
XXX-XX-[redacted]
Person to Contact:
[redacted]
Contact Telephone Number:
[redacted]
Employee Identification Number:
[redacted]

[redacted]

000806

Notice of Federal Tax Lien Filing and Your Right to a Hearing Under IRC 6320

Dear [redacted]

We filed a Notice of Federal Tax Lien on 11/03/2015 .

Type of Tax	Tax Period	Assessment Date	Amount on Lien
1040	12/31/2006	06/08/2015	78459.86
1040	12/31/2007	06/08/2015	49995.38
1040	12/31/2008	06/08/2015	37691.40

NOTE: Please contact the person whose name and telephone number appears on this notice to obtain the current amount you owe. Additional interest and penalties may be increasing the amount on the lien shown above.

A lien attaches to all property you currently own and to all property you may acquire in the future. It also may damage your credit rating and hinder your ability to obtain additional credit.

You have the right to a hearing with us to appeal this collection action and to discuss your payment method options. To explain the different collection appeal procedures available to you, we have enclosed Publication 1660, Collection Appeal Rights.

You must request your hearing by 12/10/2015 . Please complete the enclosed Form 12153, *Request for a Collection Due Process or Equivalent Hearing,*and mail it to:

Internal Revenue Service
1314 GRISWOLD PLAZA, ROOM 105
ERIE, PA 16501

Letter 3172 (DO) rev. (3-2
Catalog No. 267671

We will issue a Form 668(Z), Certificate of Release of Notice of Federal Tax Lien, within 30 days:

- After you pay the full amount of your debt;
- We accept a bond guaranteeing payment of the amount owed; or
- A decision is made to adjust your account (i.e., during an Appeals hearing).

We have enclosed Publication 1450, Instructions on How to Request a Certificate of Release of Federal Tax Lien.

If you have any questions, please contact the person whose name and telephone number appear at the top of this letter.

Sincerely,

Cheryl Cordero

Director, Specialty Collections

Enclosures:
Publication 594, *The Collection Process*
Publication 1450
Publication 1660
Form 668 (Y) (C), *Notice of Federal Tax Lien*
Form 12153

Letter 3172 (DO) rev. (12-2014)
Catalog No. 267671

It is common that high-dollar cases, or cases involving multiple tax years, be assigned to a local revenue officer (RO) for collection after ACS issues the initial notices. In that case, the RO makes contact with the delinquent citizen, usually in person. The contact is designed to obtain payment of the outstanding balance. If you cannot make payment in full, the RO demands that you complete a financial statement. He uses that information either to enforce collection or to establish an installment agreement.

As with ACS, revenue officers wield the power to lien, levy and seize assets. Expect this treatment if you do not cooperate with the collection process. However, no enforcement can be executed until a Final Notice as been issued. ROs routinely issue these notices. In addition, expect the RO to issue a collection summons to secure financial data if it is not provided upon request.

I have been told repeatedly by citizens facing enforcement action that they never received a Final Notice or a lien letter (Exhibits 4-4, 4-5 and 4-7) prior to IRS issuing a levy or after filing a tax lien. This is not likely. Confusion, though, arises when you owe taxes for several years in the far past. For example, suppose you owe for 2005, 2006 and 2007. It is now 2016. The IRS is required to issue just one Final Notice and one lien letter for each tax year. Once thirty days pass from the date of the Final Notice, the IRS is free to levy. Suppose the IRS issued the Final Notice for tax year 2005 in 2008. The agency does not have to issue another Final Notice to execute wage levies in 2016. Because the IRS issued the Final Notice letter years prior, it may seem like the levy came out of the blue.

Two polices are designed to minimize the effect of such delay. First, the IRS is required to inform a citizen at least annually of any outstanding tax debt. Thus, a person should not go years without some notice that a debt remains on the books. The form used for this is Notice CP71 or CP71A. It states that there is a balance owed and that interest and penalties continue to accrue. It is not a collection notice but encourages the recipient to resolve the problem.

The second notice is Letter 3174. See Exhibit 4-8. This letter looks much like Letter 1058 (Exhibit 4-5). But there is a remarkable difference: Letter 3174 does not mention anything about CDP appeal rights. The reason, as stated, is that the IRS must offer CDP appeal rights only one time. Once the Final Notice is mailed, the agency will not send another one. Letter 3174 is used when a period of at least six months has lapsed from the mailing of the Final Notice but no collection action was taken during that period. The IRS also uses Letter 2050 for this purpose.

When You Did Not File

If you did not file a tax return, collection enforcement takes a different course. The fundamental difference between filing and non-filing is that after a return is filed, the IRS possesses a legal assessment which it may collect immediately. When no return is filed, though, the IRS must *first* obtain a legal assessment *before* commencing collection action.

This legal axiom explains the phenomenon discussed in Chapter 2 where we examined the case of a citizen who went years without filing a return but was never contacted. When he finally filed the returns, the IRS came down on him with both feet. "Why," he asked, "did they do nothing all those years I was in hiding only to clobber me when I finally attempted to resolve my non-filing?" The answer is that during all those years he did nothing, the IRS had no assessment to collect. Once he filed the returns, the IRS obtained an assessment and ACS took over. ACS is nothing more than a huge computer designed to chase delinquent citizens. Unless you have some understanding of how to handle it, it can swallow you quickly.

Because of the need for an assessment, the IRS's first contact with delinquent filers is designed to secure an assessment. The approach can be either benign or malignant, but both eventually lead to an assessment. Once an assessment exists, the IRS pursues collection in precisely the manner outlined above. Because of the similarities in actual collection action, I limit the following conversation to the manner in which the agency obtains an assessment.

The Benign Approach

IRS computers are designed to compare information returns, such as W-2s and 1099s, with income tax returns. The computers search for both non-filers and under-reporters. When an under-reporter is unearthed, the computer corrects the return and issues a notice and demand for payment.

After detecting a non-filer, the agency establishes a Tax Delinquency Investigation (TDI). The TDI begins with a notice to the citizen explaining that no return was filed, though IRS records indicate one was due. The notice is referred to as a tax delinquency inquiry. It demands the filing of the return or an explanation as to why one is not due.

Upon filing the return, an assessment follows and in turn, collection commences. If a return or an adequate explanation as to why one is not required is not submitted, expect the TDI to take another course. That would be the malignant approach.

Exhibit 4-8 – IRS Letter 3174

Internal Revenue Service
6717 SHAWNEE MISSION PARKWAY
SUITE 500
OVERLAND PARK, KS 66202

Department of the Treasury

Letter Date:
09/09/2015
Taxpayer Identification Number
[redacted]
IRS Employee to Contact:
[redacted]
Employee Identification Number:
[redacted]
Contact Telephone Number:
[redacted]

[redacted]

COPY

Although we previously sent you a notice of our intention to collect your unpaid tax through enforced collection, our records show that you still have not paid the amount you owe. Enforced collection may include placing a levy on your bank accounts, wages, receivables, commissions, etc. It could also involve seizing and selling your property, such as real estate, vehicles, or business assets.

To prevent collection action, please pay the amount you owe by 09/24/2015.

Make your check or money order payable to the United States Treasury, and write your social security number or employer identification number on it. Send your payment to us in the enclosed envelope with a copy of this letter. **The amount you owe is shown on the next page.**

If you recently paid this or if you can't pay it, call as soon as you get this letter. Our telephone number is at the top of this letter. If you disagree with our taking enforcement action, you may be able to work out another solution. Speak to the person whose name appears at the top of this letter, or ask for that person's manager. If you do not agree with the results, you may ask for appeals consideration.

The unpaid amount from prior notices may include tax, penalties, and interest you still owe. It also includes credits and payments we have received since our last notice to you.

Interest - Internal Revenue Code Section 6601
We charge interest when your tax is not paid on time. Interest is computed from the due date of your return (regardless of extensions) until paid in full or to the date of this notice. Interest is also charged on penalties assessed on your account. Interest compounds daily except on underpaid estimated taxes for individuals or corporations.

Paying Late - Internal Revenue Code Section 6651(a)(2)
We charge a penalty when your tax is not paid on time. Initially, the penalty is ½ of 1% of the unpaid tax for each month or part of a month the tax was not paid.

Page 1 Letter 3174 (CG)(Rev. 11-2006)

Number of this letter: 3174
Date of this letter: 09/09/2015
Taxpayer Identification Number: [redacted]

If you have any questions about your account or would like a further detailed explanation of the penalty and interest charges on your account, please call me at the telephone number shown at the top of the first page of this letter.

Thank you for your cooperation.

Sincerely,

[redacted]
REVENUE OFFICER

Enclosures:
Envelope

The amount you owe is:

Form Number	Tax Period	Unpaid Amount from Prior Notices	Additional Penalty	Additional Interest	AMOUNT YOU OWE
CIVPEN	03/31/2007	$1,849.17	$0.00	$104.36	$1,953.53
CIVPEN	09/30/2007	$1,976.62	$0.00	$112.76	$2,089.38
CIVPEN	09/30/2008	$4,221.18	$0.00	$240.79	$4,461.97
CIVPEN	12/31/2008	$3,666.30	$0.00	$209.14	$3,875.44
CIVPEN	03/31/2009	$3,215.41	$0.00	$183.42	$3,398.83
CIVPEN	06/30/2009	$7,135.53	$0.00	$407.04	$7,542.57
CIVPEN	09/30/2009	$7,724.69	$0.00	$435.95	$8,160.64
CIVPEN	12/31/2009	$3,826.35	$0.00	$218.28	$4,044.63
CIVPEN	03/31/2010	$993.09	$0.00	$56.66	$1,049.75
CIVPEN	06/30/2010	$1,373.47	$0.00	$78.35	$1,451.82
				Total:	$38,028.56

Page 2 Letter 3174 (CG) (Rev.11-2006)

The Malignant Approach

I refer to this process as the "malignant approach" because it is accompanied by demands, threats and the potential for punishment. The malignant approach grows out of a tax delinquency inquiry that is ignored. It can also spawn on its own without prior notice of any kind. As you recall from our discussion in Chapter 3, Deb's initial contact was a personal visit from a revenue officer. Deb's case is the quintessential example of the malignant approach. The malignant approach is undertaken by either the Collection or the Examination function.

The Examination function is solely responsible for conducting audits and determining tax liability. Consequently, it is natural for Examination to secure unfiled tax returns. When Exam gets involved in a delinquency case, it immediately assigns a revenue agent. The agent then issues a letter to the citizen explaining that his tax affairs are under examination. He sets a meeting at which he requests that you present all records of income and expenses. Alternatively, the agent may demand that you submit the missing returns directly to him, together with all necessary supporting documentation.

Generally speaking, revenue agents are much easier to deal with than revenue officers for the simple reason that revenue agents have no power. Unlike revenue officers, they cannot lien, levy or seize assets. Furthermore, they cannot issue unilateral determinations of your income tax liability. Their every decision is subject to appeal. The questions of how to handle audits and revenue agents are beyond the scope of this work. However, my book, *How to Win Your Tax Audit* provides details and step-by-step procedures for handling every aspect of the audit and appeals process.

A revenue agent is less likely to issue a summons for records than a revenue officer. That is because revenue agents have the authority to make *recommendations* concerning your tax liability in the absence of records. The recommendations may be based on: 1) prior years' tax returns, 2) Bureau of Labor Statistics, or 3) a good solid (or not-so-solid) guess. In computing the tax in one of these ways, the agent affords the benefit of only a standard deduction and one dependent exemption. Of course, his recommendation may be appealed. Please see *How to Win Your Tax Audit* for more information.

The revenue officer's approach is slightly different. Rather than holding out for records, he is likely to merely demand that returns be filed. Revenue officers are not tax auditors. They are not trained in determining tax liabilities. They are tax collectors—period. Therefore, they are likely to demand returns and threaten a terrible future for you if they are not filed.

Let us look at Deb's case for a moment. She was contacted by a revenue officer in the first instance. There was no tax delinquency inquiry. The RO explained the nature of the contact, set a meeting and demanded that Deb appear with completed returns or records with which to prepare them. Because of the magnitude of the work and minimal time allotted, Deb was unable to do either. When she appeared at the meeting, the threats and intimidation began in earnest.

Next, the revenue officer served a summons on Deb. The RO demanded production of all documents needed to prepare the unfiled returns. Again, despite working diligently, Deb was unable to comply. As a result, the revenue officer went ballistic. She made it clear that Deb would be "hauled off to jail" some night, without warning and in the presence of her children.

This grossly unprofessional conduct coupled with outright lies reduced Deb to a puddle of tears. She was terrified at the thought of being hauled away to jail while her children slept in their beds, at a time when her husband was thousands of miles from home earning a living. Through various maneuvers I explain later in this book, we were able to completely neutralize the revenue officer. We were able to communicate the fact that we knew she was lying and could not, in fact, carry out any of her threats. Though the RO clearly did not like hearing this, she was in no position to do anything about it.

It is equally clear, however, that if Deb did not have the benefit of this information going into her confrontation, there is no telling how much damage could have resulted. As it turned out, Deb ended up gaining total control of a situation that began entirely *out of control*.

Collecting Employment Taxes

For the reasons explained in Chapter 2, under the heading, *Business Debt*, the IRS pursues unpaid employment taxes tenaciously. Whether the employment tax returns are filed timely or not, the course of action does not vary widely. Naturally, the agency uses all the collection tools at its disposal as outlined above. For example, when dealing with unfiled returns, expect the malignant approach.

In the case of an operating corporation, the IRS demands current financial statements covering both the business itself (Form 433-B) and the corporate officers and key employees (Form 433-A). The IRS seeks financial data from the corporate officers and certain employees for the purpose of determining whether (and against whom) to immediately pursue an assessment of the Trust Fund Recovery Penalty. If the corporation liquidated its assets (or had none to begin with), or otherwise shows little capacity to pay the employment taxes in full, the IRS assesses the Trust Fund Recovery Penalty against the responsible officers. At that point, collection is pursued from the personal assets of the responsible officers.

It is important to understand that employment tax collection is subject to the same Final Notice and CDP appeal rights as personal income tax assessments. Namely, a Final Notice must be issued to the corporation (or responsible officer in the case of a Trust Fund Recovery Penalty assessment) before any levy action is authorized. The taxpayer has CDP appeal rights within thirty days of the Final Notice. There is an important exception to this rule that applies only if the corporation had a prior CDP appeal specifically on employment tax assessments. I discuss this topic in more detail in Chapter 5, under the heading, *Limitations on Certain Employment Tax CDP Appeals*.

To avoid an assessment of the Trust Fund Recovery Penalty, make every effort to pay the trust fund portion of the tax as quickly as possible; more on this in Chapter 5, under the heading, *Special Considerations for Employment Taxes*. In the case of an operating business, do not expect the IRS to forestall enforced collection, either personally or otherwise, for any length of time unless you immediately agree to an aggressive installment payment. What that looks like depends upon the financial facts and circumstances of the business measured against the amount of the tax owed.

In any event, do not be surprised if the RO exhibits a less than sympathetic attitude toward a business with delinquent employment taxes. When trust fund amounts are concerned, ROs believe they are doing you a favor by closing the business. And in an odd sort of way, this may be true if you cannot get and stay current with ongoing employment tax liabilities. In that case, by closing the business, at least you will not sink further into tax debt.

Another risk is the reality that the IRS may pursue accounts receivable for collection. This often negatively impacts the business by discouraging otherwise faithful customers from continuing their relationship (not to mention the effects on your business of lost revenue). Nobody wants to be mixed up with an IRS problem if they can help it.

Despite the fact that employment tax cases are very sensitive, it is possible to avoid utter destruction. Furthermore, even in the worst case, amnesty is available to prevent the mistakes of the past from following you into the future.

Conclusion

Fear of the unknown and misinformation about what the IRS can do are among the biggest reasons delinquent citizens do not step forward. For many people, however, the IRS makes the choice for them. As happened with Deb, the IRS simply “finds you.” You must then take steps to resolve your tax delinquency in a manner which satisfies the IRS but does not destroy you in the process. That is what I teach in the remainder of this book.

Review Questions

1. Which of the following is a summons form aimed at those who have not filed tax returns?
   - A. 6638
   - B. 668-A
   - C. 6637
   - D. 2433

2. What is exempt from IRS levy and seizure?
   - A. Personal household goods valued up to $18,000
   - B. Unemployment benefits in excess of $400
   - C. Wearing apparel of the citizen and his family regardless of amount
   - D. Workman's compensation benefits in any amount

3. What is noted as perhaps the most important development in taxpayers' rights since the adoption of the Internal Revenue Code?
   - A. IRS Restructuring and Reform Act
   - B. CDP appeal
   - C. CIS
   - D. ACS

4. Of the following, which initiates a tax assessment?
   - A. Form 668(Y)
   - B. Notice CP14
   - C. Form 23C
   - D. Notice CP504

5. What is <u>not</u> used by the IRS to issue a final notice of collection before levy?
   - A. Letter 1058
   - B. Due Process appeal
   - C. Notice LT11
   - D. CP90

6. Which two things both occur if a timely *Request for Collection Due Process Hearing* is filed?
   - A. Collection action is avoided and settlement must occur
   - B. Assessment is automatically challenged and collection action ends
   - C. Collection action is stayed and the Appeals Office takes control
   - D. Collection action is stopped and the IRS may settle the case

7. According to Code section 6320, within how many days of the date a federal tax lien is filed must the IRS notify the taxpayer of the filing?
   - A. Thirty
   - B. Ten
   - C. Fifteen
   - D. Five

8. What is the purpose of Notice CP71?
   - A. Informs the taxpayer that a balance is due and that interest and penalties continue to accrue
   - B. Serves as a collection notice
   - C. Notifies the taxpayer of amount due six months after the mailing of the Final Notice
   - D. Assigns the collection to a local revenue officer

9. Which of the following provides the IRS with a legal assessment?
   A. Non-filing of a return
   B. Collective action
   C. Filing a return
   D. Contact with a delinquent filer

10. What grows out of a tax delinquency inquiry that is ignored?
    A. Malignant approach to collection
    B. Tax Delinquency Investigation
    C. Benign approach to collection
    D. The revenue agent issues a unilateral determination on the tax liability

11. Which of the following most accurately defines a revenue officer?
    A. Tax auditor
    B. Determinant of a tax liability
    C. Powerless
    D. Tax collector

12. What is utilized by the IRS to demand financial data from corporate officers with respect to a corporation's unpaid employment taxes?
    A. Letter 2050
    B. Form 433-A
    C. Form 668(z)
    D. Form 433-B

Review Answers

1. A. **Correct.** The summons that is aimed at those that have not filed tax returns is IRS Form 6638.
   B. Incorrect. IRS Form 668-A is not a summons form aimed at those that have not filed tax returns. Form 668-A is one of several forms used to carry out levies.
   C. Incorrect. IRS Form 6637 is not a summons form aimed at citizens that have not filed tax returns. Form 6637 is pointed at those who filed tax returns but have not paid the tax.
   D. Incorrect. IRS Form 2433 is not a summons form aimed at citizens that have not filed tax returns. Form 2433 is a notice used to inform owners of their seized tangible property.

2. A. Incorrect. Assets exempt from levy do not include personal household goods valued up to $18,000. Exempt personal household goods cannot exceed $9,080 (adjusted for inflation).
   B. Incorrect. The exemption from levy for unemployment benefits is not limited to $400. Unemployment benefits in any amount are exempt.
   C. Incorrect. Wearing apparel, regardless of amount, for the citizen and his family is not exempt from levy. Specifically, wearing apparel necessary for the citizen and his family is exempt.
   D. **Correct.** Workman's compensation benefits in any amount are exempt from IRS levy and seizure.

3. A. Incorrect. The IRS Restructuring and Reform Act is not noted as perhaps the most important development in taxpayers' rights since the adoption of the Internal Revenue Code. Congress included a provision as part of the IRS Restructuring and Reform Act that prevents seizure of a taxpayer's residence through the administrative process.
   B. **Correct.** The Collection Due Process (CDP) appeal is noted as possibly the single most important development in taxpayers' rights since the adoption of the Internal Revenue Code.
   C. Incorrect. A CIS (Collection Information Statement) is not the most important development in taxpayers' rights since the adoption of the Internal Revenue Code. The CIS is a financial form used as the initial step in the collection of delinquent accounts.
   D. Incorrect. The ACS (Automated Collection Service) is not thought of as the most important development in taxpayers' rights since the adoption of the Internal Revenue Code. ACS is responsible for collecting, to the fullest extent possible, all outstanding tax amounts.

4. A. Incorrect. IRS Form 668(Y) is not used to initiate a tax assessment. Form 668(Y) is the Notice of Federal Tax Lien form.
   B. Incorrect. Notice CP14 is not used to initiate a tax assessment. Collection begins with a friendly written reminder, and the first notice is usually Notice CP14.
   C. **Correct.** A tax assessment is born when an assessment officer signs an assessment certificate, generally IRS Form 23C.
   D. Incorrect. Notice CP504 is not used to initiate a tax assessment. Notice CP504 is the notice required before the IRS can levy a state tax refund.

5. A. Incorrect. Letter 1058 is one of several forms used by the IRS as last notice in a sequence of collection letters before levy; thus, this answer is incorrect.
   B. **Correct.** Due process appeal is not used by the IRS to issue final notice of collection before levy. The final notice regarding collection does inform the taxpayer that he or she has the right to request a Collection Due Process appeal within a thirty-day period.
   C. Incorrect. Notice LT11 is one of several forms used by the IRS as last notice in a sequence of collection letters before levy; therefore, this answer is incorrect.
   D. Incorrect. CP90 is one of several forms used by the IRS as last notice in a sequence of collection letters before levy; therefore, this answer is incorrect.

6. A. Incorrect. Avoided collection action and the occurrence of settlement must not both occur if a timely *Request for Collection Due Process Hearing* is filed. A successful CDP appeal allows collection to be avoided entirely, and allows the possibility to reach an amicable settlement.
   B. Incorrect. An automatic challenge to assessment and the termination of collection action must not both occur if a timely *Request for Collection Due Process* is filed. If such as request is filed, collection action is stayed pending resolution, and a CDP appeal allows a challenge to the assessment in certain circumstances.
   C. **Correct.** If a *Request for Collection Due Process* if timely filed, all collection action is stayed pending resolution of the appeal, and the Appeals Office takes control of the case.
   D. Incorrect. Termination of collection action and possible IRS settlement of the case do not both occur if a *Request for Collection Due Process* is timely filed. Collection action is stayed pending resolution of the appeal; however, the Appeals Office, and not the IRS, may settle the case.

7. A. Incorrect. Code section 6320 requires the IRS to notify the taxpayer of a federal tax lien sooner than within thirty days of the filing. A taxpayer has thirty days from the date of the lien notice in which to file a CDP levy appeal.
   B. Incorrect. Code section 6320 requires the IRS to notify the taxpayer of a federal tax lien sooner than within ten days of the filing. Beginning ten days after the IRS issues a notice of intent to levy, the penalty associated with the amount unpaid increases.
   C. Incorrect. Code section 6320 requires the IRS to notify the taxpayer of a federal tax lien sooner than within fifteen days of the filing. Letter 3172 must be sent out much sooner than fifteen days following the lien date.
   D. **Correct.** Code section 6320 provides that the IRS must notify a taxpayer of the filing of a federal tax lien within five days of the date the lien is filed.

8. A. **Correct.** Notice CP71 is used to annually inform the taxpayer that there is a balance owed and that interest and penalties continue to accrue.
   B. Incorrect. Notice CP71 does not serve as a collection notice. Notice CP71 is not a collection notice but encourages the recipient to resolve the problem.
   C. Incorrect. Notice CP71 does not notify the taxpayer of an amount due six months after the mailing of the Final Notice. Letter 3174 reminds the taxpayer of an amount due and is used when a period of at least six months has lapsed from the mailing of the Final Notice.
   D. Incorrect. Notice CP71 is not used to assign collection to a local revenue officer. It is common that high-dollar cases be assigned to a local revenue officer for collection after ACS issues the initial notices.

9. A. Incorrect. The non-filing of a tax return does not provide the IRS with a legal assessment. When no return is filed, the IRS must first obtain a legal assessment.
   B. Incorrect. Collection action is not what provides the IRS with a legal assessment. The IRS must obtain a legal assessment before commencing collection action.
   C. **Correct.** After a tax return is filed, the IRS possesses a legal assessment that it may collect immediately.
   D. Incorrect. Contact with a delinquent filer does not give the IRS a legal assessment. Because of the need for an assessment, the IRS's first contact with a delinquent filer is designed to secure an assessment.

10. A. **Correct.** The malignant approach toward collection grows out of a tax delinquency inquiry that is ignored.
    B. Incorrect. A Tax Delinquency Investigation (TDI) does not grow out of a tax delinquency that is ignored. After detecting a non-filer, the IRS establishes a TDI that includes a notice to the taxpayer.

C. Incorrect. The benign approach to collection does not grow out of a tax delinquency that is ignored. Using the benign approach, IRS computers search for both non-filers and underreporters.
D. Incorrect. Issuance of a unilateral determination on the tax liability by a revenue agent does not grow out of a tax delinquency that is ignored. Revenue agents cannot issue unilateral determinations of a citizen's tax liability.

11. A. Incorrect. Tax auditor does not most accurately define a revenue officer. Revenue officers are not trained to examine tax returns.
B. Incorrect. A revenue officer is not defined as a determinant of a tax liability. Revenue officers are not trained in determining tax liabilities.
C. Incorrect. Revenue officers should not be defined as powerless. Revenue agents are easier to deal with than revenue officers for the reason that revenue agents have no power.
D. **Correct.** Revenue officers are tax collectors that are likely to merely demand that returns be filed.

12. A. Incorrect. Letter 2050 is not used by the IRS to demand financial data from corporate officers with respect to the company's unpaid employment taxes. Letter 2050 is sometimes used for collection after six months has passed from the mailing of a Final Notice.
B. **Correct.** In the case of an operating corporation with unpaid employment taxes, the IRS may demand current financial statements covering corporate officers using Form 433-A.
C. Incorrect. Form 668(z) is not utilized by the IRS to demand financial data from corporate officers with respect to the company's unpaid employment taxes. Once an individual with a tax lien has paid the amount due, the IRS will issue Form 668(z) to reflect a release of notice of a federal tax lien.
D. Incorrect. Form 433-B is not used to demand financial statements from corporate officers. Form 433-B is used to demand financial statements covering the business itself.

Chapter 5
Damage Control: How to Stabilize Collection

Learning Objectives

- Spot a goal in avoiding tax enforcement
- Choose a situation in which the IRS can avoid normal deficiency procedures
- Discern how a CDP hearing is usually conducted
- Recognize the effect of a tolling event

Introduction

Now that you understand exactly *what* the IRS does to enforce collection, let us examine how to insulate yourself from the ravages of enforced collection. In this chapter, I explain how to stabilize collection if it is now ongoing, and how to avoid enforcement entirely. The goal is to establish either an installment agreement or, in some cases, achieve what the IRS calls "currently not collectible" status (CNC) (what I refer to as "uncollectible status").

An installment agreement based on your ability to pay does several important things. First, it prevents further enforcement for the reasons explained in detail later. Second, it enables you to pursue one or more of the amnesty programs discussed later in this book, without ongoing collection harassment. Moreover, in some cases, an installment agreement by itself can solve the delinquency problem. But even if you cannot pay in full through an installment agreement, it is often an important stepping-stone on the path to relief.

In cases where there is financial hardship and one is unable to make a payment, and thus an installment agreement is not viable, the IRS institutes a collection "freeze." This is where the IRS declares a case to be "currently not collectible." As such, IRS effectively pushes the "hold" button on its collection machine, but it *does not* eliminate the tax. The debt remains viable, although collection is not pursued due to the financial shortcomings of the citizen. We discuss uncollectible status in detail in Chapter 11. What you learn here will prepare you to argue for uncollectible status in the right situation.

How to Avoid Automated Collection Action

All that is necessary for the IRS to resort to enforced collection is for you to do nothing. In that case, Automated Collection (ACS) will follow the natural course outlined in Chapter 4, and that will lead to wage and bank (or other third party) levies, as well as the filing of tax liens. Inaction might also lead to property seizures. It is important to note, however, that the IRS cannot take any enforcement action without first issuing a Final Notice, either Letter 1058 or LT11, for each and every delinquent tax period. See Exhibits 4-4 and 4-5.

The Collection Due Process Appeal

As you will recall from Chapter 4, to begin a timely CDP appeal, you must mail a *Request for Collection Due Process Hearing*, Form 12153, within thirty days of the date on the Final Notice (Letter 1058 or LT11), or within the deadline provided on the *Notice of Filing Federal Tax Lien* (Letter 3172) (Exhibits 4-4, 4-5 and 4-7). Mail the hearing request to the IRS person or office that mailed the letter. The name and address is shown plainly in the top left corner of the letter. Be sure to mail your request using certified mail with return receipt requested. Include a copy of the letter with your hearing request and be sure to keep a copy of everything you send.

When you do this, the IRS cannot enforce collection while the appeal is pending. Moreover, subsequent collection action must be carried out only in accordance with the determination of the Appeals Office. Given that, let us turn our attention to discussing Collection Due Process (CDP) appeal procedures.

If your hearing request is not filed timely, you are not entitled to a CDP hearing. However, if you file a late hearing request within one year of the date of the Final Notice, the IRS may give you what is known as an "Equivalent Hearing" (EH). An Equivalent Hearing is a hearing that is "equivalent to" a CDP hearing, except there is no right to a Tax Court appeal of the determination. The Tax Court appeal process is discussed below, under the heading, *Judicial Review of CDP Decisions*. I also address other options available if you do not file a timely CDP request.

Upon filing a timely CDP request, the IRS's Office of Appeals assumes jurisdiction of your case. A settlement officer (SO) is assigned to review your case and pass on your appeal. The appeal must be handled by an Appeals employee with no prior involvement with the case. Moreover, the Appeals employee is not allowed to have *ex parte* communications with anybody outside of the Appeals Office regarding the merits of your case. An *ex parte* communication is one in which you or your representative is not involved. Thus, for example, the SO is not allowed to initiate contact with, or engage in contact from, the RO handling your case. See *Drake v. Commissioner*, 125 T.C. 201 (October 12, 2005).

The first order of business in a CDP appeal is for the SO to determine that all procedures required as a prerequisite to enforcement were followed. IRC §6330(c)(1). In this respect, the IRS has a burden of proof, which in itself is unusual in collection cases. Normally, the agency does not have to prove anything. In terms of ascertaining that the IRS followed all required procedures, this involves, at a minimum: a) verifying that an assessment is on the books and is legally collectible, b) that the IRS issued the proper notices prior to beginning enforcement action, and c) that the IRS followed the proper deficiency procedures in obtaining its assessment.

The deficiency procedures are a critical part of the process. They involve the notice and appeal rights you enjoy in an audit situation before the actual assessment of the tax. I discuss these in detail throughout this book, and in my book, *Taxpayers' Defense Manual*. If the SO finds that the IRS made a procedural error, he must reverse the collection process until that error is corrected.

Issues that May be Raised in a CDP Appeal

As part of your CDP appeal, you have the right to raise "any relevant issue" as a defense to collection. IRC §§6330(c)(2) and (3). These issues may include:

Spousal defenses under code section 6015. Code section 6015 provides three different spousal defenses that I discuss in more detail in Chapter 6. To summarize quickly, these defenses include:

a. The innocent spouse defense
b. The separate spouse election
c. Equitable relief

Any of these can be raised as a defense in a CDP appeal.

The appropriateness of collection action. When you demonstrate that levy action or the filing of a tax lien is overly aggressive or unwarranted under the circumstances, the SO has the authority to order that some less intrusive action be taken. In fact, the SO is obligated to engage in a "balancing test" in which the government's need to collect the revenue as quickly as possible is balanced against the citizen's concern that "collection action be no more intrusive than necessary." IRC §6330(c)(3). See *Living Care Alternatives of Utica v. United States*, 411 F.3d 621 (6th Cir. 2005). Collection must be carried out in the least invasive manner. This is discussed in more detail below.

Potential collection alternatives. You have the right to present proposed collection alternatives, which are proposals to manage and resolve the tax debt through some means other than full enforcement. IRC §6330(c)(2). Collection alternatives can include:

a. **An installment agreement where the tax is paid over time.** Installment agreements are discussed below in more detail.

b. **Obtaining uncollectible status because a person is either unemployed or underemployed, and his reasonable necessary monthly living expenses consume all income.** In that case, a person has no capacity to make a payment. This is discussed in more detail in Chapter 11.
c. **An Offer in Compromise (OIC).** An OIC is the process the IRS uses to negotiate settlements for less than what is owed. If accepted, an OIC fully resolves the tax debt for the amount negotiated. The OIC is discussed in detail in Chapter 12.
d. **Selective and controlled liquidation of assets or refinancing.** If you have equity in one or more assets sufficient to pay the tax, you can persuade the IRS to hold off collection while you either sell an asset or refinance it to raise cash. It is in the IRS's best interest to allow this alternative since when it sells seized assets, it does so at much reduced prices, often stripping the property of valuable equity needed to pay the tax. Likewise, getting a loan to pay the tax is much more efficient than collecting through periodic wage levies, especially if there is a large debt.
e. **Withdrawing or subordinating liens that destroy credit.** The IRS files a tax lien to protect its interest in your property. However, in many cases, the lien does more harm than good, especially if the lien is filed against a business that needs credit to operate. The tax lien often ruins that credit, thereby threatening the life of the business. Withdrawal or subordination of a lien actually affords the IRS a better chance to collect since it allows the business to continue to operate and pay the tax. This is especially true if the business has no equity in assets anyway. In that case, the lien is purely punitive since there is no equity for the lien to protect. All the lien does is ruin the business's credit. See Chapter 6 for more details on liens.

Challenges to the underlying tax. Many audit assessments are simply bogus. I point out in my book, *How to Win Your Tax Audit*, that the IRS's own statistics prove that audit assessments are wrong between 60 and 90 percent of the time. Most people do not correctly challenge audit decisions, and just as often, the IRS does not follow the proper deficiency procedures leading to an assessment in the first place. The key element of the deficiency procedures is the so-called Notice of Deficiency (NOD). The NOD is the letter the IRS must mail following an audit but before it may assess the tax. The Notice of Deficiency explains how the tax was calculated, and explains that if you wish to contest the deficiency, you have ninety days from the date of the Notice in which to file a petition with the United States Tax Court. See Chapter 4 of my *Taxpayers' Defense Manual*. If you fail to file a timely petition, the tax is assessed and is collectible. In this sense, the assessment is procedurally correct even though the tax may be improperly calculated.

If the IRS failed to follow the deficiency procedures, you have the right to challenge the correctness of the assessment in a CDP hearing. In doing so, you will be able to present your documents and records to show your correct tax liability. Likewise, if you never received the Notice of Deficiency (even though the IRS may have sent it), you have the same right to challenge the assessment. This is an important right because the IRS often fails to issue an NOD, or it sends the notice to an old or otherwise improper address.

This problem presents itself quite often in non-filer cases. When a person fails to file a return, the IRS may file a return for him. Such return is known as a "substitute for return" (SFR). It is based upon "available information," which can mean, literally, anything. Substitute for returns are not immune to the deficiency procedures. The IRS must still issue a Notice of Deficiency before it can make an SFR assessment, but the agency often does not. It simply jumps to assessment, and then begins enforcement action. Improper SFR assessments are subject to review through the CDP appeal process.

Even a properly filed tax return is subject to review through the CDP process. Suppose you file a return that shows you owe X dollars, which you cannot pay. Sometime after filing the return you realize that you failed to claim a number of deductions you are entitled to, which when claimed, will reduce your liability considerably. This is known as challenging a self-assessment. You are allowed to challenge a self-assessment through the CDP process if you had no prior opportunity to have the self-assessment reviewed. See *Montgomery v. Commissioner*, 122 T.C. 1 (2004) – IRS acquiescence Notice CC-2006-005 AOD 2005-03.

Another challenge to the underlying tax liability arises when dealing with the Trust Fund Recovery Penalty (TFRP), as discussed in Chapter 2, under the heading, *Business Debt*. Two problems often arise in the assessment of the TFRP. Both of them can be addressed through the CDP appeal process.

The first is that the TFRP is an "assessable" penalty. That means the IRS does not have to follow the deficiency procedures that apply to income taxes in obtaining the assessment. As a result, the IRS may assess and begin collecting from the alleged responsible officers even before any appeals take place.

Secondly, the IRS often takes a shotgun approach in assessing the TFRP. In the case of a corporation with multiple owners, the IRS often assesses all owners with the penalty, even though not all may have had the power to make decisions regarding the taxes. Likewise, any person whose name appears on corporate financial documents, including bank accounts, tax forms, corporate contracts, etc., is often assessed with the penalty regardless of whether that person actually had the authority to make final decisions regarding company assets. A CDP appeal can address and resolve these issues.

The statutes of limitations. While most people think the IRS can chase you forever, that is certainly not true. Statutes of limitations govern exactly how long the IRS has to enforce the law. Among others, there is a statute of limitations regarding the assessment of tax and one that governs the collection of tax. Generally, the IRS has just three years from a date a tax return is filed in which to audit and assess a tax. Once the tax is assessed, the agency has ten years to collect. Once the statutes expire, the IRS's rights to enforcement expires. The assessment statute of limitations is discussed in detail in my book, *How to Win Your Tax Audit*. The collection statute of limitations is discussed in Chapter 10. The CDP process is an effective way to challenge violations of either the assessment or collection statute of limitations.

Penalties. Every penalty you might face is subject to cancellation if you can show that you acted in good faith and based upon a reasonable cause for your actions. Penalties apply only when you deliberately disregard IRS rules and regulations. The IRS must review the correctness of penalty assessments in the CDP appeal process if challenged. See *Downing v. Commissioner*, 118 T.C. 22 (2002). More specifics on challenging penalties are provided in my book, *The IRS Problem Solver* and here in Chapter 9.

Misapplication of prior payments. When you make a voluntary payment to the IRS, the IRS must apply that payment as instructed by you in writing. This is known as the right to designate payments. I discuss this process at length at the end of this chapter, under the heading, *Designating Payments*. Unfortunately, the IRS does not always apply the payments in the manner designated. When the agency fails to do so, you can force it to correct the mistake through the CDP appeal process. See *Richard v. Commissioner*, T.C. Summ. Op. 2005-151 (2005).

Raise all available issues in your CDP appeal. If you fail to raise an issue, you waived it. You cannot raise it later. In addition, all evidence to support your arguments must be presented at the time of the hearing or prior. You cannot present evidence later that was not presented at the administrative hearing. See *Robinette v. Commissioner*, 2006 TNT 46-11 (8th Cir. 2006)

Issues that May Not be Raised in a CDP Appeal

There are certain issues that cannot be raised in a CDP appeal. Let us discuss them in general terms.

Issues raised in a previous hearing. If you already had a hearing on an issue, either before the U.S. Tax Court or in the administrative context with the IRS, the Appeals Office will not reconsider the issue in a CDP appeal. For example, suppose you appealed your audit determination to the Tax Court and the court ruled that you owe X dollars. You cannot question the same underlying tax liability in a CDP appeal. The issue is considered adjudicated and resolved.

However, this rule does not apply if you did not "meaningfully participate" in the hearing. If for some reason you had no opportunity to participate in the hearing or somehow were not notified, you may be able to raise the issue in a CDP appeal. It might be said that you had no meaningful opportunity to participate if you had ineffective assistance of counsel. Likewise, if you can show that there is a material change in your circumstance fundamentally altering the factual basis of the prior decision, the Appeals Office may review the matter. IRC §§6330(c)(4) and (d)(2).

Tax protest issues. The Appeals Office will not consider any challenge to the tax system that constitutes a "tax protester" or "tax defier" argument. These are arguments that suggest that the tax laws are illegal, or unconstitutional, etc. See Chapter 2, under the heading, *Tax Protesters*. Moreover, by submitting an appeal that raises such issues, you run the risk of being penalized for filing a "frivolous submission." This is $5,000 penalty under code section 6702. I discuss this in more detail in Chapter 9.

The CDP Hearing

The CDP hearing is usually conducted over the phone. Prior to the hearing, you will get a letter from your SO that gives you the time and date of your hearing. The letter also offers the opportunity for a face-to-face hearing at the Appeals Office nearest your home. You can request a face-to-face hearing by responding in writing to your SO asking for such a hearing. You also have the opportunity to change the date and time of the hearing if the date is not convenient or you need more time to prepare.

The SO also gives you a deadline by which all documents and evidence must be submitted. For the reasons stated above, you must have your evidence in the SO's hands prior to the hearing. Keep in mind that the burden of proof is on you to show that you are entitled to the collection alternative you seek.

If you are arguing for an installment agreement, uncollectible status or an Offer in Compromise, you must present detailed financial information on Forms 433-A and (if applicable) 433-B, as discussed later. You must also present all the supporting documentation called for in those forms. Without detailed financial information, the IRS will not rule in your favor. You must understand that you are the "prosecutor" in this case. If you want relief, you have to make your case and present your evidence.

On the other hand, the IRS is the "goalie." The SO will not "lead" you in how to present your arguments or necessarily suggest alternatives that might be appropriate in your case. You must be aggressive and go into the hearing with a clear agenda. Make careful notes before the hearing as to the issues you want to cover and be sure to address all the evidence that supports those issues. Do not be shy and do not be intimidated. You will have every chance to present your case.

Expect the SO to bring up a question or issue that requires you to submit additional information. Such questions might include employment information or information regarding the ownership or disposition of assets. You have every right to provide additional information on all questions. Moreover, the SO must give you reasonable time to do so. Make sure you ask for time and then send the information within that time. The SO may want to set a time for a follow up hearing after reviewing all the additional information.

The Final Determination

Once the hearing (including any potential follow up conferences) is completed and all the evidence is evaluated, the SO must issue a determination. The determination will be in writing and is referred to as a *Notice of Determination*. The determination must address all of the issues outlined here:

1. **Verification of the legal process.** The SO must review and ascertain whether the IRS followed all of the proper legal and administrative procedures. This means that, among other things, if your tax debt is based upon an audit or an IRS-filed substitute for return, the agency must have sent a Notice of Deficiency. The burden is on the IRS to affirm that all the legal processes were followed. If they were not, the assessment is invalid and subject to abatement.
2. **Consideration of all issues.** The SO must consider and evaluate all the issues you present. You have the burden to prove that you are entitled to any relief you assert in your CDP appeal. The SO must evaluate your evidence and determine whether to grant relief or provide some other alternative, based upon the facts and circumstances of the case.
3. **The "balancing test."** Code section 6330(c)(3)(C) creates the so-called "balancing test." The law states that the IRS must determine whether any proposed collection action balances the need for the efficient collection of taxes with the legitimate concern of the person that any collection action be no more intrusive than necessary.

While it is true that the IRS wants the tax now, if you qualify for an installment agreement or some other relief, the agency must provide that relief. In deciding the issue, the SO must address your facts and show that the balancing test was performed. Failure to properly conduct this balancing test is grounds for challenging the SO's determination, as discussed below. See *Living Care Alternatives of Utica v. United States*, 411 F.3d 621 (6th Cir. 2005)

Judicial Review of CDP Decisions

CDP decisions are reviewable by the Tax Court. Under code section 6330(d), you have thirty days from the date of the *Notice of Determination* in which to file an appeal with the Tax Court. This gives you another level of appeal. Once a case is started in the Tax Court, the IRS's attorneys get involved. This gives you the opportunity to work out a solution to the case. For more details on filing a Tax Court petition and the CDP judicial appeal, please see my book, *Taxpayers' Defense Manual*.

Please note that the right to a Tax Court appeal is available only if you file a timely CDP request. If you fail to file the request on time, the IRS instead gives you an Equivalent Hearing. The determination in an Equivalent Hearing is not appealable. This is why your very best leverage in negotiating with the IRS comes through the CDP process. The IRS knows you have judicial appeal rights in this process, and is therefore more inclined to pay attention to the facts of your case and the applicable law.

An Important Caveat Regarding CDP Appeals

As discussed at length in Chapter 10, the IRS has just ten years from the date a tax is assessed in which to collect it. However, there are certain actions you can take that "toll" or stop the statute from running. These are called "tolling events." You must understand that filing a timely *Request for Collection Due Process Hearing* (Form 12153) stops the running of the collection statute of limitations. This means that the IRS has more time to collect. The collection statute is tolled during the time the appeal is pending, including a Tax Court judicial appeal, plus ninety days. IRC §6330(e).

This is why you must know when your statute of limitations expires. If you are already on the threshold of the statute expiring, you should carefully consider whether it is wise to file a CDP request and thereby toll the statute. On the other hand, if the IRS has several years left on the ten-year statute, filing the CDP request will not likely have a negative impact. In any event, determine when the statute expires before taking any action that tolls it.

Limitations on Certain Employment Tax CDP Appeals

The Collection Due Process appeal greatly limits the otherwise broad power of the IRS to lien, levy and seize assets. But there is an important exception in CDP appeals involving employment taxes. Employment taxes include taxes withheld from the pay of workers by the employer. As explained earlier, these taxes are known as trust fund taxes. When an employer breaks that trust by not paying the taxes on time, the IRS usually moves quickly with all collection tools available.

Unlike income taxes, trust taxes are assessed on a quarterly basis. That is, companies with employees must file employment tax returns four times per year and must make deposits of trust taxes regularly, as often as weekly, depending upon gross payroll. It is not unusual for employment tax liabilities to encompass multiple periods over several years. Because of this, the IRS may have to send several Final Notices (Letter 1058 or LT11) before enforcing collection as to each period. And with each Final Notice, the law allows a separate CDP hearing.

I have seen businesses delinquent on trust taxes for as many as twenty quarters, or five years, and in rare cases, even more than that. In such cases, the business may have received several Final Notices. For example, the first Final Notice may cover just four quarters. Another notice may cover the next four quarters, and so on. The only rule is that one Final Notice must be issued to the business for each delinquent period or the IRS may not enforce collection as to that period.

Because of this, a business might use multiple CDP appeals to stop collection even while the business continues to amass further employment tax debts. In that situation, the law allows the IRS to continue to collect where the agency has served a "disqualified employment tax levy" (DETL). This means that with respect to certain levies issued *only* in employment tax cases, the IRS may continue to enforce collection despite the CDP appeal. The levy must meet the statutory definition a DETL, which is very precise.

What is a Disqualified Employment Tax Levy?

A disqualified employment tax levy is defined in code section 6330(h). A DETL has the following three attributes:

a. A levy issued to collect employment taxes,
b. The levy is for taxes owed by a business (or a predecessor of that business) that previously requested a CDP hearing, and
c. The prior CDP request involved employment taxes that arose in the two-year period *before* the period for which the levy is served.

It is important to understand that the law *does not* eliminate the collection stay in every employment tax CDP appeal. Rather, it focuses only on cases where a prior CDP hearing was requested by the same delinquent business. With that understanding, let us consider more carefully the elements of DETL.

First, there must have been a prior, timely CDP request. Any CDP request submitted outside the thirty-day window is treated as an Equivalent Hearing, and thus, is not a prior request for purposes of section 6330(h). On the other hand, when a proper CDP request is made in a timely manner, such request does form the basis for a DETL, even if the business later withdraws the CDP request and no hearing is actually held. The reason is that collection is stayed upon filing a timely request and remains stayed until the request is withdrawn or otherwise disposed of.

Second, the prior CDP request must involve *employment* taxes. Thus, a prior CDP request that had only to do with, say, income taxes, does not trigger the DETL limitations.

The third element is that the prior CDP request must involve employment taxes that arose during the two years *prior* to the beginning of the tax period to which the current Final Notice applies. The two-year lookback period applies to the tax itself, not the date of filing a prior CDP request. Suppose the current levy is for employment taxes for the first quarter of 2008. That period begins January 1, 2008. Given this, the two-year look back period is from January 1, 2006 to December 31, 2007. Any levy for the first quarter 2008 is a DETL if a prior CDP request was filed regarding any of the eight quarters during 2006 and 2007.

Here are some examples of how this is calculated.

Example 1:

- Business owes employment taxes for the fourth quarter 2005 (the period ended 12/31/2005)
- Business filed a timely CDP request
- Business accumulates additional employment taxes for the quarter ended 6/30/2006
- The latter liability constitutes a DETL because the business requested a hearing for a period within the two years between April 1, 2004 and June 30, 2006

Example 2:

- Business owes for the first quarter 2006 (quarter ended 3/31/2006)
- Business files a timely CDP request
- Subsequently, IRS assesses additional employment taxes for the quarter ended 12/31/2005 (which period begins 10/1/2005)
- Business requests a second CDP hearing
- The additional liability does *not* constitute a DETL because the prior hearing was requested for the period ended 3/31/2006, which is *outside* the two years between October 1, 2003 and October 1, 2005

What constitutes "predecessor business?" The phrase "predecessor business" means a new company that has the same ownership, control and assets of a prior business. For example, suppose Corporation A goes out of business owing substantial employment taxes. Corporation B is formed on its heels. Corporation B is owned or controlled by the same officers or employees as Corporation A. Corporation B is in essentially the same business with assets and customers acquired from Corporation A. Corporation B is considered a "predecessor business" to Corporation A. As such, any CDP request filed by Corporation A will be taken into account in collecting against Corporation B, if it becomes delinquent.

A Post-Levy CDP Appeal Request

It is important to understand that the above rules *do not* deprive a business of a CDP hearing. It is just that enforced collection may continue during the appeal. The IRS explains the DETL process in Letter 1058(D). Letter 1058(D) is substantially similar to Letter 1058 (Exhibit 4-5). The IRS must mail Letter 1058(D) within ten days of issuing a DETL. At that point, you have thirty days from the date of that letter in which to file a CDP request. Please note that all the other CDP rules apply to the DETL, with the sole exception that collection may continue during the appeal.

When you file a timely CDP request, your right to Tax Court review of the Appeals Office determination is preserved. The Tax Court has jurisdiction to determine whether the IRS may continue to collect during the appeals process.

Before submitting a CDP request for employment taxes, be careful to determine whether a prior CDP request was submitted within the look back period. If so, you must know that the IRS may continue to enforce collection despite the appeal. But that alone should not deter the CDP request.

Negotiating with the IRS When You Have No CDP Rights

I regularly deal with people who, for one reason or another, have lost their CDP rights. Perhaps they never replied to the Final Notice, or they did not reply correctly or on time. In any event, you can still negotiate with the IRS. While you have lost leverage by not filing a timely CDP request, you may nevertheless attempt to win an installment agreement or uncollectible status either by dealing with Automated Collection (ACS) or with a revenue officer.

The best way to start the process is with Form 9465, *Installment Agreement Request*. This form effectively stops collection because of the mandatory collection freeze that goes into effect when it is filed. Under code section 6331(k)(2), there are four specific circumstances under which enforced collection is frozen in connection with an installment agreement. They are listed here.

1. **During the period a request for an installment agreement is pending.** Any request for an installment agreement is effective to stay collection, even a verbal request made over the phone to ACS. I discuss this further in Chapter 10. When the IRS processes the request, whether verbal or through Form 9465, the agency cannot enforce collection until the application is disposed of.
2. **If the request for installment agreement is rejected,** the stay continues in effect for thirty days after the date of the letter informing you of the rejection. During that period, you have the right to file a protest letter asking for an appeal. If your protest letter is filed in time, collection remains frozen during the appeal. I discuss the appeals process later in this chapter.
3. **If you come to terms with the IRS on an installment agreement and the agreement is formalized,** the IRS cannot enforce collection as long as the agreement remains in effect. The agreement is formalized with Form 433-D, *Installment Agreement*.
4. **If the IRS terminates an existing installment agreement,** you have thirty days from the date of the termination notice in which to file an appeal. If you appeal on time, collection remains frozen during the appeal.

As long as a collection freeze is in effect for one of the reasons expressed above, the IRS cannot enforce collection.

The *Installment Agreement Request* (Form 9465) can be utilized in a number of ways. It can be submitted to ACS in response to collection notices. Using it at this early stage often prevents the case from going further down the collection path until you can develop a comprehensive strategy for solving the problem. You can also submit the request directly to a revenue officer should you be contacted personally. This helps to stabilize enforcement action. You can also submit the form with your tax return in the first instance. If you know you cannot pay at the time you file your return, this strategy can avoid potential levies and seizures.

In addition to submitting Form 9465, include a letter explaining the following points: 1) you do not have sufficient income or assets to pay the tax in full, 2) you have no creditors who can be put off, thus allowing you to pay in a short time, and 3) your necessary monthly living expenses make it impossible to pay more than you suggest. Include a simple worksheet of your income and expenses to show that the proposed payment is reasonable. If seeking uncollectible status, show that monthly expenses meet or exceed income. I discuss this more later in this chapter and in Chapter 11.

The IRS will generally respond to your request by asking for financial information. I discuss the process of providing that information later in this chapter.

An Important Caveat Regarding Installment Agreement Applications and Appeals

Because of the collection hold that goes into effect when submitting a request for installment agreement, the act is considered a tolling event. That means the collection statute stops running while the application is pending. In fact, section 6331(k) identities three circumstances in which the collection statute is tolled during installment agreement negotiations. They are listed here.

1. **During the period a request for an installment agreement is pending.** The period begins with the date the IRS accepts any installment agreement request for processing, whether the request is made verbally, or in writing using Form 9465 (or even a simple letter). The tolling ends with the date of disposition. See Chapter 10 for more details.
2. **If the request is rejected, tolling continues for thirty days after the date of the IRS's letter so informing you.** If you appeal the determination within that thirty days, tolling continues while the appeal is pending.
3. **If the IRS terminates your agreement, tolling continues for thirty days after the date of the letter so informing you.** If you appeal the determination within that thirty days, tolling continues while the appeal is pending.

It is important to note that *no tolling* occurs while the agreement is in effect. Thus, when you come to terms on an installment agreement, the collection statute begins running and ticks all the while the agreement is in effect. In some cases, installment agreements can last for years. In that case, the collection statute runs the entire time.

Should I Call Automated Collection?

If you know that you have no CDP rights because you received both a Final Notice and Lien Letter (remember, you have CDP rights as to *each* IRS action), and did not respond to either one within the required time, it is sometimes beneficial to call ACS to win either an installment agreement or uncollectible status. Since 2008, when former IRS Commissioner Shulman put into effect the so-called "Fresh Start" initiatives to help delinquent citizens, ACS tends to be more helpful in setting up installment agreements and granting uncollectible status than in the past.

There are a number of things to keep in mind if you intend to call ACS to stop collection action. I address them here.

1. **Have your financial information organized.** Be prepared to give your income and expense information over the phone. Thus, you need to be organized before you make the call. As explained more thoroughly below, you will need information on all your monthly income and living expenses organized by category. The categories are set forth on page 4 of Form 433-A, which I discuss later.
2. **Have supporting documents available.** The IRS will want proof of certain items of income and expenses. Expect them to ask for bank statements for the past three months, year-to-date earnings statements, and proof of payment of monthly living expenses, such as your mortgage payment, medical insurance, car payments, etc.
3. **Make a checklist of the points to present in your discussion.** In addition to presenting specific financial information, you need to argue that:

   a. You do not have sufficient funds available to pay in a lump sum,
   b. You do not have sufficient equity in assets that can be liquidated to pay in full,
   c. You have no creditors to whom payments can be stalled enabling you to pay in full within a very short period of time, and
   d. Monthly income and expenses necessary to meet the health and welfare needs of your family (food, clothing and shelter and the support of dependents) are such that you can make monthly payments of just X dollars, or no payment at all.
4. **Give yourself time.** You might sit on hold for up to one hour before even getting to speak with an ACS representative. Once you get through, it can take another hour to go through all the information needed to evaluate your situation.
5. **Call from a location where you have a dedicated fax line available.** This is very important if you want to stabilize collection with just one phone call. When the ACS rep asks for, say, proof of year-to-date earnings and bank statements, you can fax them while you are on the phone. That way, you do not have to call back at some later time (after the documents are mailed, say) and start the process all over again.
6. **Be specific about what you are asking for.** Ask specifically for a determination that you are uncollectible (see Chapter 11 for more details) or for an installment agreement of X dollars per month. Keep in mind that the philosophy of ACS is to get the money. As such, you may deal with a belligerent, uncooperative or even outright nasty IRS rep. Stick to your guns and push for the relief you seek.
7. **Always be polite and professional, but firm and direct.** This is especially important if you are dealing with a belligerent or nasty agent. In some cases, when I encounter such a person, I politely end the call by saying, "Oh, look at the time! Gotta go." Then I call back a half hour later. It is guaranteed that you will get another person.
8. **If you cannot accomplish your goal, ask to speak with a manager.** Say, for example, that your financial information supports an installment payment of $200 per month, but the ACS rep insists on $600 per month. Ask to speak with a manager. The rep will not pass the phone to a manager. Instead, this is a callback situation, and it usually takes about forty-eight hours. That means you must leave your phone number and the best hours to reach you. Have your financial information with you at all times in anticipation of the call.
9. **If you cannot come to terms with the ACS, you have the right to appeal the denial of an installment agreement,** as I stated earlier. While your case is on appeal, the IRS cannot take levy action. I discuss the appeal process later.
10. **Whenever you have a phone conversation with anybody from the IRS, keep careful notes of your discussion.** Include the date, the phone number you called, the name and identification number of the person you spoke with (they will offer this information so write it down). Also, as thoroughly as possible, make an "I said—He said" memo. You might need this information later.

    If your call is successful, you will avert enforced collection action, and you will have stabilized the collection situation. You may then turn your attention to one or more of the amnesty programs discussed later in this book.

Negotiating with a Revenue Officer

Depending on the amount of tax owed, staffing considerations, and the workload of your local IRS office, you may be contacted personally by a revenue officer. This occurs after all initial billing notices are sent but prior to the issuance of the Final Notice. In many cases, revenue officers themselves issue the Final Notice, either by mailing it to your last known address, or by hand-delivering it to your home. If you received a Final Notice more than six months prior, the RO may mail or hand-deliver Letter 3174 (Exhibit 4-8) to re-start the collection process.

A visit from an RO is often shocking, as was Deb's experience. ROs do not generally announce the visit in advance. Further, IRS policy is to attempt to collect in full on the first visit. Therefore, expect the RO to demand immediate, full payment of the entire tax. If you respond simply that you cannot pay, the

RO asks when you can. Unless you take some affirmative action to direct the course of the conversation, expect the RO to merely make demands, issue potential levy threats, and push paperwork under your nose.

Keep the following tips in mind for dealing with a surprise visit from an RO.

1. **Do not engage in substantive discussion about the case at that point.** Politely explain that you are not prepared to discuss the case with him; that you recognize the need to get the situation resolved; and that you wish to discuss the matter with counsel. Ask him to leave all the paperwork he has for you along with this contact information.
2. **Do not sign *anything*.** He may ask you to sign forms or fill out a financial statement. Politely decline to do either. Signing forms under these conditions is generally a serious mistake. For example, a financial statement must be signed under the penalty of perjury. It is a felony to knowingly submit false information. Therefore, provide only absolutely correct and complete information. This *cannot* be done on the spot.
3. **Be especially careful about <u>*not*</u> signing Form 900, *Tax Collection Waiver*.** This form extends the collection statute of limitations. It is often falsely represented as the form you need to sign if "you need more time to pay" or to obtain an installment agreement. In reality, it gives the IRS more time to collect. See Chapter 10 for more details. Instead, reiterate that you wish to consult counsel first. You have the absolute right to counsel *whenever* dealing with the IRS. Code section 7521(b)(2) provides that if a person clearly states to an IRS employee that he wishes to consult counsel, "such officer or employee shall suspend such interview regardless of whether the taxpayer may have answered one or more questions."
4. **Do not refuse to pay.** The last statement you want to make to an RO is that you will not pay the tax. If you do, he is likely to resort to the full arsenal of collection weapons as soon as possible. Therefore, it is critical to communicate your desire to cooperate and that you recognize your obligation but need assistance in reaching amicable terms. Even if you believe you do not owe the tax, establish a reasonable working relationship before addressing the merits of the tax. Keep in mind, you generally have the right to challenge an assessment in some fashion and you have the right to make a claim for refund of taxes improperly paid or collected. See Chapter 5, *Taxpayers' Defense Manual*, for more on the refund process. Other suggestions for challenging the underlying assessment come later in this book.
5. **Before ending the contact, make sure you know exactly what forms and documents the RO wants and the deadline for complying.** If he leaves you with a Final Notice, you have thirty days to file a CDP request, regardless of what other demands he makes. Moreover, filing a CDP request on time removes jurisdiction from the RO to the Appeals Office, as explained above.

The next step (assuming the case is *not* subject to a CDP appeal), is to meet the RO's deadline and provide the information he asked for. This will involve discussions with the RO. Approach those discussions just as I explained regarding dealing with ACS over the phone. See above, under the heading, *Should I Call Automated Collection?*

Negotiations with an RO can be sensitive and stressful. However, if you recognize the purpose of the meeting and the goals of both parties, they do not have to be difficult. Citizens experience the most trouble when they do not cooperate with the collection process. When you step forward and in essence do the RO's job for him, you fare much better than if you attempt to dodge the process. This is true even if you believe you do not owe the tax. The merits of the liability may always be addressed after neutralizing threats of enforced collection.

To do the revenue officer's job for him, provide the required financial statement and supporting documents in a timely manner. Work in good faith to answer questions about your income and expenses. This is not to say that you should roll over to every demand regardless of whether it is reasonable or proper. You must walk a fine line between good faith cooperation and mindless capitulation. You may be surprised to learn that when you stand up to unreasonable or improper demands, the RO often gains a measure of respect for you. That makes the job of handling his reasonable and legitimate requests that much easier. It also tells him that you are not an easy mark and cannot be run over.

How to Win an Installment Agreement

What follows is a specific discussion of how to win an installment agreement. These rules and techniques apply equally whether you are negotiating with a revenue officer, dealing with ACS, or dealing with the Appeals Office in a CDP or other collection appeal.

The Guaranteed Right to an Installment Agreement

Code section 6159(c) sets forth the grounds under which the IRS "shall enter into an [installment] agreement." That is to say, you have a right to pay delinquent taxes over time if you qualify. Let us discuss the criteria.

1. **The taxpayer must be an "individual."** A corporation, partnership or other business entity is not guaranteed the right to an installment agreement. This does not mean these entities cannot obtain such an agreement. They can. However, it is a matter of discretion with the IRS.
2. **The citizen must "offer" the agreement.** The IRS will not contact you and explain that it is bound to enter into an agreement. The offer is made using IRS Form 9465, *Installment Agreement Request*, or verbally over the phone, as explained above. You can also send a simple letter asking for an agreement. If you use a letter, you must state that you qualify for a guaranteed installment agreement by meeting the terms of the statute.
3. **Your debt cannot exceed $10,000, *exclusive* of penalties and interest.** Be careful about determining how much tax you owe. Simply using the balance stated on billing notices is not likely accurate since notices include penalties and interest. To determine the precise amount of tax only, obtain an Individual Master File (IMF) transcript for all the years in question. This transcript gives you the breakdown of taxes, interest and penalties for each period.
4. **You must not have failed to file any return or failed to pay any tax on time during the past five years.** If you are married, this applies also to your spouse.
5. **You must not have entered into an installment agreement for other back tax debts within the last five years.** If you are married, this applies also to your spouse.
6. **The IRS must determine that you are unable to pay in full and you must submit the information required to make this determination.** You must prove that you cannot pay on time, or that full payment will cause financial hardship. Therefore, you must submit all financial information necessary for the IRS to make that determination. This is done with Form 433-A (discussed later), and the required supporting documentation. Note, however, that the IRS does have "streamlined" procedures in some cases, which I discuss below.
7. **The agreement must provide for full payment of the entire liability within three years.** This means that all the tax, interest and penalties must be paid in full within that time. However, as to penalties, see Chapter 9, where I discuss the cancellation of penalties.
8. **You must comply with all the provisions of the tax code while the agreement is in effect.** That means you must file your tax returns and pay your taxes on time. This also means that you must make your estimated tax payments on time and in the correct amounts. If you have information reporting requirements, such as the duty to file Forms W-2 or 1099 for workers, those too must be filed on time.

If you meet all these criteria, you are permitted an installment agreement as a matter of right. If you do not meet all the criteria (which, frankly, is the case with most people), do not panic. You nevertheless have the ability to enter into either a streamlined or a discretionary installment agreement. IRS policies instituted since 2008 under the "Fresh Start" program make this easier than in the past. Let me outline them here.

Streamlined Agreements for Individuals

If you owe $50,000 or less in tax, penalties and interest combined, and can full pay within seventy-two months or the time left on the collection statute (whichever is less), the IRS will enter into a streamlined installment agreement. See IRM part 5.14.5.2(1). A streamlined agreement can be obtained *without* having to provide detailed financial information. IRM part 5.14.5.1(1). This makes the process quite simple as the IRS just about rubberstamps your installment agreement application. You must agree to make the payment through direct debits from your bank account or through a payroll deduction agreement. The IRS will provide all the forms (which I discuss later) to execute either arrangement.

Streamlined Agreements for Businesses

Operating businesses that owe $25,000 or less may qualify for a streamlined agreement. Such an agreement applies only to business income taxes, not employment taxes. I discuss installment agreements for employment taxes later. The tax must be paid within seventy-two months or the time left on the collection statute (whichever is less). If you do not qualify for a streamlined agreement, you may nevertheless obtain a discretionary agreement, as I discuss later.

In all cases, penalties and interest continue to accrue until the tax is paid, and all required returns must be filed. Thus, it is imperative to get all delinquent returns filed as soon as possible. I discuss this later in this chapter.

How to Establish the Installment Payment Amount

If you do not qualify for a guaranteed or streamlined installment agreement, the question becomes, how much per month are you able to pay? That is answered based upon your financial condition—specifically, your income and expenses, assets and liabilities. The RO's first job in such cases is to obtain a financial statement. Forms 433-A and 433-B are used for this purpose.

Form 433-A is used for wage earners and self-employed persons functioning only as sole proprietors without any formal business structure (i.e., without a corporation or partnership, etc.). Pages 1 through 4 of Form 433-A seek an accounting of personal income, expenses and assets, such as your home and auto. Pages 5 and 6 seek an accounting of business assets, income and expenses. Report only your personal information on pages 1 through 4 and sole proprietor information on pages 5 and 6.

If your business operates under a formal structure such as a corporation, partnership, or LLC, or any other business organized under the laws of a state, the business's financial information is presented on Form 433-B. If you are using both a Form 433-A and B, be careful not to duplicate entries from one form to the other.

The purpose of a financial statement is two-fold and you must understand *both*. First, the IRS uses it to determine whether, in fact, you are unable to pay in full. If the statement reveals sufficient income and equity in assets from which to pay, negotiating a long-term installment agreement is very difficult.

However, short-term arrangements are very common. A short-term agreement enables you to selectively liquidate certain assets, adjust your living expenses, or otherwise make arrangements to raise funds. Of course, along with revealing your income and assets—and their locations—you provide the RO with possible levy sources, and that is the second purpose of the financial statement. However, this is an unavoidable risk because unless you qualify for a streamlined agreement, you cannot win an installment agreement without providing a financial statement, and any financial statement must be true and correct to avoid the risk of prosecution for submitting a false document.

Next, the RO analyzes your monthly income and expenses to determine the payment the IRS expects. You cannot simply declare, "I'll pay you $100 per month" and expect the RO to accept it without question. On the other hand, the IRS's payment demands cannot be arbitrary. The payment must be based upon your gross monthly income, less all necessary living expenses, including current taxes, and any expenses necessary to earn income. The difference between monthly gross income and personal living expenses is defined as "disposable income." Disposable income is the amount available to pay the tax.

Determine Your Monthly Income

The first step is to establish your gross monthly income. For wage earners, this is a simple matter. Year-to-date earnings statements for yourself and your spouse show the total income paid to the most recent point in the year. Divide the total earnings by the number of months in the year to date, and that is your average monthly gross income. This must include overtime pay and bonuses. You must also consider other income sources, such as Social Security or pension income, alimony payments, regular distributions from estates or trusts, etc. See Form 433-A, page 4, lines 20-34.

Do not use past earnings if there has been a substantial change in your situation. For example, if you changed jobs and your new job pays less, or your wife quit her job, use only *current* earnings as gross monthly income.

For self-employed persons who do not draw W-2 wage income, you must use your net business income as your starting point. Net business income is your monthly gross income less all non-personal expenses necessary to earn income. These include advertising, travel or mileage, rent, utilities, supplies, etc. Any expense that you would claim as a business expense deduction on your tax return is subtracted in reaching business net income. While certain expenses are fixed each month (such as rent), others vary from month to month (such as travel, supplies, advertising). That is why it is best to produce a year-to-date Profit and Loss Statement. This is nothing more than a worksheet showing your total gross income to date, with a listing by category of all expenses.

To determine your sole proprietorship net business income, subtract the year-to-date total of all necessary business expenses from the year-to-date total of gross income. Divide that difference by the number of months in the year to date, and that is your average monthly gross income. For example, suppose it is June 15. Your total gross business income to that point is $21,780. Suppose your total business expenses to that point equal $14,500. Total net income through June 15 is $7,280. That is the money available to pay *personal* living expenses, since $14,500 paid only necessary *business* expenses. The average net monthly business income from January to June 15 is $1,324 (21,780 minus 14,500 divided by 5.5 months). To this you would add any other sources of income, such as spousal wages, pension income, etc. See Form 433-A, page 6, Section 7.

Determine Your Monthly Living Expenses

Allowable monthly living expenses must be subtracted from gross monthly income to arrive at disposable income, which then is the installment payment amount. Start with all deductions from gross income for current taxes, including federal, state, Social Security, and federal Medicare taxes. Current taxes are your tax obligations for the current year only, not delinquent taxes. If you are self-employed, you must figure your federal and state estimated tax obligations as your current taxes. Also consider other mandatory deductions, such as child support, alimony, union dues, etc. Any other payments required as a condition of your employment are deductible.

Figuring Allowable Expenses

Determining your allowable expenses can be tricky because the IRS may simply disallow certain of your expenditures. The result is to artificially increase your disposable income, thus increasing the amount of your payment. This is done without regard to the effect on other creditors or your lifestyle. The decision is imposed on the basis of the IRS's National Standards (LS), Local Standards (LS) and Transportation Standards (TS) for allowable expenses, which I discuss now.

First, understand what an "allowable expense" is. The IRM classifies allowable expenses into the following three categories.

Allowable Living Expenses

These expenses are allowed on a no-questions-asked basis. The amounts in this category are based on the IRS's published NS, LS and TS tables, discussed below. The tables are updated periodically and are published on the IRS's website here:
https://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Collection-Financial-Standards.

Other Necessary Expenses

These are expenses beyond the NS, LS and TS tables. Such expenses must be "necessary." A "necessary" expense is one which either: a) provides for the "health and welfare" of the taxpayer and his family, or b) is incurred for the "production of income." IRM part 5.15.1.7. Health and welfare expenses include housing, food, medical care, personal care items, clothing, utilities, transportation, childcare, insurance, payments for secured or legally perfected debts, etc. Expenses necessary to earn income include necessary travel, transportation, telephone, supplies, office expenses, etc. They can also include educational expenses when required by law or by your employer.

Other Conditional Expenses

This is an important category that the IRS almost always *ignores* in determining ability to pay. As such, your disposable income is pushed higher than is realistic under the circumstances. "Other Expenses" are defined as follows:

> *"Other expenses may be Necessary or Conditional. Other Necessary expenses meet the necessary expense test and normally are allowed. The amount allowed must be reasonable considering the taxpayer's individual facts and circumstances. Other Conditional Expenses* ***may not*** *meet the necessary expense test, but may be allowable based on the circumstances of an individual case."* (IRM part 5.15.1.10(1))

This IRM provision is critical because it requires the IRS to look at each person's "individual facts and circumstances," rather than cramming the often-restrictive NS, LS and TS tables down your throat. Based upon this IRM provision, you can often avoid having your disposable income, and thus your installment payment amount, artificially inflated.

National Standards, Local Standards, Transportation Standards, and Medical Expense Standards

To "standardize" the process of determining one's ability to pay, the IRS uses fixed expense standards to limit allowable expenses. Let us discuss the four different standards for expenses.

1. **The National Standards (NS) include food, clothing, personal care items, and miscellaneous expenses.** NS expenses vary depending upon your family size. See the tables on the IRS's website, cited above. These expenses are allowed on a "no questions asked" basis.
2. **The Local Standards (LS) cover housing and utilities.** They include rent or mortgage payment, real estate taxes, utilities, insurance and maintenance. The IRS has a fixed LS amount for each county in the nation. The agency applies the LS amount based upon your physical location and family size.
3. **Transportation Standards (TS) include the ownership costs for up to two vehicles (if married), and vehicle operating expenses.** The operating expenses are fixed based upon your geographic location, as set forth in the tables on the IRS's website.
4. **Out-of-pocket health care costs.** The IRS allows actual expenses for medical insurance for yourself and family plus all out-of-pocket costs that you document. The standard for medical expenses applies only to out-of-pocket medical costs, not the cost of insurance. However, the allowance for out-of-pocket medical works the opposite of other allowances. That is, you are allowed the standard amount or your actual expenses, whichever is *greater*. There is no logic for this reasoning, other than, perhaps, the IRS believes it is more important that you pay medical expenses than it is to maintain your home. As of this writing, the standard is $60 per month per person in the family for those under age 65, and $144 per month for persons 65 or older.

In the case of LS and TS expenses, the IRS allows the standard amount or your actual expenses, whichever is *less*. For example, if your actual housing costs (mortgage payment, utilities, etc.) are $2,150 per month, but the LS allowance for your family size and your county is $1,825, the IRS will simply disallow the excess. The agency falsely claims (as presented below) that the standards *alone* determine the allowable amounts. You are expected to simply pay the excess to the IRS.

Facing Down NS, LS and TS Allowances

The IRS's position universally is that NS, LS and TS allowances are carved in stone regardless of your actual expenses. However, this position is simply *not* supported by either the Internal Revenue Code or the Internal Revenue Manual. Code section 7122(d)(2) reads as follows:

> *"The guidelines [expense standards] shall provide that officers and employees of the Internal Revenue Service shall determine, on the basis of the* ***facts and circumstances of each taxpayer,*** *whether the use of the schedules published under subparagraph (A) is appropriate and shall not use the schedules to the extent such use would result in the taxpayer* ***not having adequate means*** *to provide for basic living expenses."*
> (Emphasis added by author.)

As you see, the law plainly states that the IRS is to consider the specific "*facts and circumstances*" of each taxpayer's situation. This is impossible if the IRS blindly applies pre-determined standards based on a one-size-fits-all analysis.

Moreover, IRM part 5.15.1.1(7) reads:

> *"The standard amounts set forth in the national and local guidelines are designed to account for basic living expenses. In some cases, based on a taxpayer's individual facts and circumstances, it will be appropriate to deviate from the standard amount when failure to do so will cause the taxpayer economic hardship (See IRM 5.15.1.1(8)). The taxpayer must provide reasonable substantiation of all expenses claimed that exceed the standard amount."*

Clearly, the IRS has the authority to "deviate from the standard amount" when one's individual circumstances dictate, and the taxpayer proves the expenses in excess of the standard. The IRM simply does *not* limit allowable expenses to the NS, LS and TS tables. Recall that IRM part 5.15.1.10(1) (quoted earlier) provides the definition of "Other Expenses," explaining that they are allowed above the NS, LS and TS amounts, based upon the facts and circumstances of a particular taxpayer's case. In fact, the IRM contains a chart of "other expenses" allowable in excess of the NS, LS and TS amounts. The chart is found at IRM part 5.15.1.10(3). Among the items on the chart, we find the following:

- Legal and accounting fees necessary to deal with the IRS or that are otherwise necessary to produce income
- Charitable contributions necessary as a condition of employment or that somehow provide for the health and welfare of the family (for example, a minister is required to tithe as a condition of employment)
- Child care expenses including baby-sitting, day care, preschool, etc., when they are reasonable and necessary for the production of income, i.e., parents need day care in order to work
- Dependent care for the elderly, invalid or handicapped if there is no alternative to the taxpayer paying the expense
- Court ordered payments such as alimony, child support, or other court-enforced payments
- Dependent care for persons other than children, such as elderly, handicapped or invalid family members
- Education expenses when required for a physically or mentally handicapped child or when required as a condition of employment;
- Delinquent state and local taxes, but you must provide proof of the liability
- Student loans for the taxpayer's education if secured by the federal government
- Secured or legally perfected debt, if it meets the "necessary expense" test. This is the key provision that allows for payment of housing costs in excess of the LS allowance, since a home mortgage is a legally perfected debt (see below for more details)
- Life insurance if the payment is for a term policy
- Unsecured debts for such things as credit cards and personal loans, but only minimum payments when it is shown that the payments are necessary for the health and welfare of the family or are necessary to produce income
- Payment of unsecured loans, such as from friends, family or through credit cards, if the proceeds were used to pay federal taxes

The unfortunate reality is that too many IRS employees simply do not read their own manual. This is one reason why so many citizens run into a brick wall when trying to support expenses exceeding the standards. Be prepared to cite chapter and verse of the IRM to support the position that expenses in excess of the standards are allowed when they can be justified and shown to be reasonable.

It is important to note that the NS, LS and TS standards *do not apply* to expenses necessary to produce income. The standards only apply to *personal living* expenses. Therefore, before completing Form 433-A, carefully analyze all monthly expenses. Those that can fairly be said to constitute expenses necessary to earn income should be so classified. To be allowed, they must be verified and reasonable.

For example, a wage earner may have substantial unreimbursed employee business expenses. They might include business licenses, car expenses including tolls, parking, etc., office supplies, tools or equipment, education expenses, meals and entertainment and similar expenses. If you are self-employed, use page 6 of Form 433-A to show all business expenses. As explained above, only net business income is transferred to page 4 of Form 433-A as personal income. By classifying as many expenses—as truthfully as possible—as expenses necessary to earn income, you minimize disputes over the NS, LS and TS amounts.

Arguing for an Upward Deviation from the Housing Standards

The starting point in winning an upward deviation from the housing allowance is to show that your home mortgage and utility costs are necessary, as opposed to a matter of convenience. A house payment is a basic living expense, especially when the house payment is for a modest home that meets only your family's basic needs—that is, the home is not opulent or extravagant, nor is the payment excessive under the circumstances.

Recall that in the chart of "other expenses" in IRM part 5.15.1.10(3), we find that "secured or legally perfected debts" are allowable if the expense meets the necessary test. Without question, the loan on your house is a secured debt, and is necessary because it provides directly for housing, which undeniably aids the health and welfare of your family. As long as you substantiate that you are making the payment and that it is not extravagant, the expense must be allowed, regardless of the housing standards.

Furthermore, failure to pay the mortgage leads to foreclosure on the home. That causes substantially more expenses, including the costs of relocating your family. But because of your tax debt and a potential foreclosure, you will not be able get a loan for a new home. You will have to rent. What will it cost to rent adequate living facilities in your area to provide for your family? Most likely, the cost exceeds what you currently pay to own your home. Beyond that, if you lose your home, you also lose the tax deductions for mortgage interest and real estate taxes. In that case, your current tax debt increases. The IRS must provide for the payment of your current taxes in figuring your ability to pay. That means that your monthly expenses increase anyway because of the increased cost of paying for rental property. In short, it is not an advantage to the IRS to disallow your actual housing costs.

Arguing for an Upward Deviation from the Transportation Allowance

When figuring allowable transportation costs, the IRS allows two components of expenses. The first is vehicle "ownership costs." This is the purchase or lease payment, capped as of this writing at $517 per month. The second component is "operating costs." These costs include maintenance, repairs, insurance, fuel, registrations, licenses, inspections, parking and tolls. The allowance for operating expenses varies depending upon where you live. The allowance ranges from about $200 per month on the low side to about $350 on the high side. The IRS allows expenses for up to two vehicles if you are married.

For a complete list of all the specific cities and the allowance amounts, go to: https://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Local-Standards-Transportation

The TS allowances are largely unrealistic given today's fuel, insurance and maintenance costs. It is not uncommon for people to spend $200 to $300 per month just on fuel, depending on their daily commute. I had a client who spent nearly $600 per month on fuel costs because of his commute. In addition to gas, you must also consider insurance, licenses, maintenance, tolls, etc. There is simply no way the typical person can cover all the necessary costs of vehicle operation within the allowance provided by the IRS.

Additional Costs for an Older Vehicle

In many cases, people own older vehicles, and those vehicles are often paid for. In that case, the IRS asserts that because you have no monthly payment, you have no ownership costs. Thus, they disallow any claimed ownership costs, including the standard allowance, and allow only the operating expenses.

Of course, just because you make no payment on a vehicle does not mean you have no ownership costs. The fact is, the older the vehicle, the more likely it is that you incur substantial maintenance costs to keep that vehicle running. Citizens must be allowed to claim their vehicle maintenance costs in addition to their normal operating costs. The IRM recognizes this truth. IRM part 5.8.5.22.3(6), Transportation Expenses, reads as follows:

In situations where the taxpayer has a vehicle that is currently over six years old or has reported mileage of 75,000 miles or more, an additional monthly operating expense of $200 will generally be allowed per vehicle, (up to two vehicles).

Thus, you are entitled to an additional $200 per month in vehicle operating expenses, whether or not the car is paid off, to cover maintenance costs.

Proving Your Actual Expenses

To have any hope of persuading the IRS to allow an upward deviation from the standards, you must prove your actual expenses. With respect to the housing expense, provide records to show:

- The mortgage payment,
- Real estate taxes,
- Insurance,
- All utility charges,
- Repairs and maintenance fees, and
- Association fees, if applicable.

With respect to transportation expenses, provide documents to support the following items:

- The payment,
- Fuel,
- Insurance,
- Repairs and maintenance,
- Driver and vehicle licenses, and
- Parking and tolls.

Often, expenses for repairs and maintenance are not consistent. For that reason, you need to take a wide enough measure to get a reasonably accurate average. For example, you might have to look back as many as six to twelve months to get a true picture of your housing and auto repair costs. This is especially true in the case of insurance, which you likely pay once every six months, and in the case of driver and vehicle licenses, which you renew annually.

Forcing the Issue on an Upward Deviation

Despite the plain language of the statute and the IRM, the agency flatly refuses to grant upward deviations from fixed expense standards in all but rare cases. Why? Most people do not understand the law and most people do not know how to force the issue. Here are a couple of ways to do just that.

Installment Agreement and Uncollectible Status Negotiations

The IRS's actions of rejecting an installment agreement or an uncollectible status proposal, or in revoking an existing installment agreement, are appealable. If the IRS refuses to be reasonable, you should file a protest letter (discussed later) within thirty days of the agency's determination letter. With your case before the Appeals Office, you are more likely to deal with a reasonable person who understands the law.

Collection Due Process Appeals

As discussed early in this chapter, filing a Request for Collection Due Process Hearing (Form 12153) kicks the case into the Appeals Office where you have the right to present "collection alternatives." The advantage with CDP appeals is that you have a further appeal to the United States Tax Court if you cannot come to terms with the Appeals Office. If the IRS rejects the plain language of the law, regulations or its manual provisions in the Appeals process, the Tax Court will overturn the IRS's determination.

The "one-year" rule. If you are paying excessive necessary or conditional expenses, the so-called "one-year" comes into play. IRM part 5.14.1.4.1(2) provides:

> *"One-Year Rule: Taxpayers who cannot full pay their accounts within six years may be given up to one year to modify or eliminate excessive necessary expenses. By modifying or eliminating some conditional expenses, a taxpayer may be able to full pay the liability plus accruals within the six-year limit. This would enable a taxpayer to retain some conditional expenses."*

Under this rule, your installment agreement begins at a lesser amount than may otherwise be required, and then escalates after one year. Suppose your allowable expenses dictate that you should pay $1,000 per month. However, your actual expenses are such that you believe $500 is reasonable. In that case, the agreement can start at $500, and then escalate to $1,000 after one year. This gives you time to make adjustments to expenses without having the higher payment thrust upon you immediately.

Formalizing the Installment Agreement

It is within this broad framework that you negotiate to determine the amount of your monthly payment. After reaching an agreement, the details are reduced to writing on IRS Form 433-D, *Installment Agreement*. See Exhibit 5-1. Please carefully read the terms of the agreement on page 2 of Exhibit 5-1.

Recognize the RO's Job

In these negotiations, never lose sight of the fact that the RO's job is to *get the money!* Everything he says and does revolves around that general goal. These are the steps he might take to reach that goal.

1. Obtaining information on all possible sources of levy, including the location and value of assets, bank accounts, etc. The financial statement serves this purpose.
2. Asking for a signed Form 900, *Tax Collection Waiver*, if the financial statement indicates that immediate or short-term collection is not possible.
3. Filing a *Notice of Federal Income Tax Lien* in the county where you live. This protects the IRS's interest in your assets and may legally "secure" its claim.
4. After analyzing the financial statement, expect the RO to seek liquidation of assets in which there is sufficient equity to generate positive revenue. If, for example, you own a lake home and would realize substantial revenue by selling it, the RO wants it sold. He may threaten to seize the asset if you do not sell willingly.
5. The RO also wants you to explore the possibility of obtaining a loan by refinancing property. Be careful, however, not to use credit cards as a means of raising cash for *partial* payments. That merely increases your monthly expenses without eliminating the collection problem.

Before finalizing any agreement, the RO submits it to his immediate supervisor for approval. You *may* be forced back to the table. On the other hand, you have the right to appeal to that supervisor (and to the Office of Appeals) if you cannot agree with the RO, as discussed next.

Exhibit 5-1 – IRS Form 433-D, *Installment Agreement*

Form **433-D**
(Rev. January 2015)

Department of the Treasury - Internal Revenue Service
Installment Agreement
(See instructions on the back of this page)

Name and address of taxpayer(s)

Social Security or Employer Identification Number (SSN/EIN)
(Taxpayer) *(Spouse)*

Your telephone numbers *(including area code)*
(Home) *(Work, cell or business)*

For assistance, call: 1-800-829-0115 (Business), or
1-800-829-8374 (Individual – Self-Employed/Business Owners), or
1-800-829-0922 (Individuals – Wage Earners)

Or write
(City, State, and ZIP Code)

☐ Submit a new Form W-4 to your employer to increase your withholding.

Employer *(Name, address, and telephone number)*

Financial Institution *(Name and address)*

Kinds of taxes *(Form numbers)*	Tax periods	Amount owed as of
		$

I / We agree to pay the federal taxes shown above, PLUS PENALTIES AND INTEREST PROVIDED BY LAW, as follows

$ ______ on ______ and $ ______ on the ______ of each month thereafter

I / We also agree to increase or decrease the above installment payments as follows:

Date of increase *(or decrease)*	Amount of increase *(or decrease)*	New installment payment amount

The terms of this agreement are provided on the back of this page. Please review them thoroughly.

☐ Please initial this box after you've reviewed all terms and any additional conditions.

Additional Conditions / Terms *(To be completed by IRS)*

Note: Internal Revenue Service employees may contact third parties in order to process and maintain this agreement.

DIRECT DEBIT — Attach a voided check or complete this part only if you choose to make payments by direct debit. Read the instructions on the back of this page.

a. Routing number

b. Account number

I authorize the U.S. Treasury and its designated Financial Agent to initiate a monthly ACH debit (electronic withdrawal) entry to the financial institution account indicated for payments of my federal taxes owed, and the financial institution to debit the entry to this account. This authorization is to remain in full force and effect until I notify the Internal Revenue Service to terminate the authorization. To revoke payment, I must contact the Internal Revenue Service at the applicable toll free number listed above no later than 14 business days prior to the payment (settlement) date. I also authorize the financial institutions involved in the processing of the electronic payments of taxes to receive confidential information necessary to answer inquiries and resolve issues related to the payments.

Your signature	Title *(if Corporate Officer or Partner)*	Date
Spouse's signature *(if a joint liability)*		Date

FOR IRS USE ONLY

AGREEMENT LOCATOR NUMBER: _ _ _ _

Check the appropriate boxes:

☐ RSI "1" no further review ☐ AI "0" Not a PPIA
☐ RSI "5" PPIA IMF 2 year review ☐ AI "1" Field Asset PPIA
☐ RSI "6" PPIA BMF 2 year review ☐ AI "2" All other PPIAs

Agreement Review Cycle _ _ _ _ _ _ Earliest CSED ______

☐ Check box if pre-assessed modules included

Originator's ID number ______ Originator Code ______

Name ______ Title ______

A NOTICE OF FEDERAL TAX LIEN *(Check one box below)*

☐ HAS ALREADY BEEN FILED
☐ WILL BE FILED IMMEDIATELY
☐ WILL BE FILED WHEN TAX IS ASSESSED
☐ MAY BE FILED IF THIS AGREEMENT DEFAULTS

NOTE: A NOTICE OF FEDERAL TAX LIEN WILL NOT BE FILED ON ANY PORTION OF YOUR LIABILITY WHICH REPRESENTS AN INDIVIDUAL SHARED RESPONSIBILITY PAYMENT UNDER THE AFFORDABLE CARE ACT.

Agreement examined or approved by *(Signature, title, function)* | Date

ISA www.irs.gov
Part 1 — IRS Copy
Form **433-D** (Rev. 1-2015)

INSTRUCTIONS TO TAXPAYER

If not already completed by an IRS employee, please fill in the information in the spaces provided on the front of this form for:

- Your name *(include spouse's name if a joint return)* and current address;
- Your social security number and/or employer identification number *(whichever applies to your tax liability)*;
- Your home and work, cell or business telephone numbers;
- The complete name, address and phone number of your employer and your financial institution;
- The amount you can pay now as a partial payment;
- The amount you can pay each month *(or the amount determined by IRS personnel)*; and
- The date you prefer to make this payment *(This must be the same day for each month, from the 1st to the 28th)*. We must receive your payment by this date. If you elect the direct debit option, this is the day you want your payment electronically withdrawn from your financial institution account.

Review the terms of this agreement.
When you've completed this agreement form, please sign and date it. Then, return Part 1 to IRS at the address on the letter that came with it or the address shown in the "For assistance" box on the front of the form.

Terms of this agreement

By completing and submitting this agreement, you *(the taxpayer)* agree to the following terms:

- This agreement will remain in effect until your liabilities *(including penalties and interest)* are paid in full, the statutory period for collection has expired, or the agreement is terminated. You will receive a notice from us prior to termination of your agreement.
- You will make each payment so that we *(IRS)* receive it by the monthly due date stated on the front of this form. ***If you cannot make a scheduled payment, contact us immediately.***
- This agreement is based on your current financial condition. We may modify or terminate the agreement if our information shows that your ability to pay has significantly changed. You must provide updated financial information when requested.
- While this agreement is in effect, you must file all federal tax returns and pay any *(federal)* taxes you owe on time.
- We will apply your federal tax refunds or overpayments *(if any)* to the entire amount you owe, including the shared responsibility payment under the Affordable Care Act, until it is fully paid or the statutory period for collection has expired.
- You must pay a $120 user fee, which we have authority to deduct from your first payment(s) *($52 for Direct Debit)*. You may be eligible for a reduced user fee of $43. See Form 13844 for qualifications and instructions.
- If you default on your installment agreement, you must pay a $50 reinstatement fee if we reinstate the agreement. We have the authority to deduct this fee from your first payment(s) after the agreement is reinstated.
- We will apply all payments on this agreement in the best interests of the United States. Generally we will apply the payment to the oldest collection statute, which is normally the oldest tax year or period.
- **We can terminate your installment agreement if:**
  - You do not make monthly installment payments as agreed. You do not pay any other federal tax debt when due. You do not provide financial information when requested.
- If we terminate your agreement, we may collect the entire amount you owe, EXCEPT the Individual Shared Responsibility Payment under the Affordable Care Act, by levy on your income, bank accounts or other assets, or by seizing your property.
- We may terminate this agreement at any time if we find that collection of the tax is in jeopardy.
- This agreement may require managerial approval. We'll notify you when we approve or don't approve the agreement.
- We may file a Notice of Federal Tax Lien if one has not been filed previously which, may negatively impact your credit rating, but we will not file a Notice of Federal Tax Lien with respect to the individual shared responsibility payment under the Affordable Care Act.

HOW TO PAY BY DIRECT DEBIT

Instead of sending us a check, you can pay by direct debit *(electronic withdrawal)* from your checking account at a financial institution *(such as a bank, mutual fund, brokerage firm, or credit union)*. To do so, fill in Lines a and b. Contact your financial institution to make sure that a direct debit is allowed and to get the correct routing and account numbers.

Line a. The first two digits of the routing number must be 01 through 12 or 21 through 32. Don't use a deposit slip to verify the number because it may contain internal routing numbers that are not part of the actual routing number.

Line b. The account number can be up to 17 characters. Include hyphens but omit spaces and special symbols. Enter the number from left to right and leave any unused boxes blank.

CHECKLIST FOR MAKING INSTALLMENT PAYMENTS:

1. Write your social security or employer identification number on each payment.
2. Make your check or money order payable to *"United States Treasury."*
3. Make each payment in an amount at least equal to the amount specified in this agreement.
4. Don't double one payment and skip the next without contacting us first.
5. Enclose a copy of the reminder notice, if you received one, with each payment using the envelope provided. Make a payment even if you do not receive a reminder notice. Mail the payment to the IRS address indicated on the front of this form.
6. If you didn't receive an envelope, call the number below.

This agreement will not affect your liability *(if any)* for backup withholding under Public Law 98-67, the Interest and Dividend Compliance Act of 1983

QUESTIONS? — If you have any questions about the direct debit process or completing this form, please call the applicable telephone number below f[illegible] assistance.

1-800-829-0115 ***(Business)***
1-800-829-8374 ***(Individuals – Self-Employed / Business Owners)***
1-800-829-0922 ***(Individuals – Wage Earners)***

Catalog Number 16644M | www.irs.gov | Form **433-D** (Rev. 1-201

Part 2 – Taxpayer's Copy

How to Appeal an Installment Agreement Rejection or Termination

One of the problems with an installment agreement is that even when it is signed and sealed, it is never a true "final agreement" in the sense of a contract. The reason is that the IRS has the power to review your financial situation periodically to determine whether the agreement should be "altered, modified or terminated." See IRC §6159. You must provide updated information when asked, and the IRS can alter your agreement based upon your current situation. If you do not go along with the new terms, the agency simply pulls the plug on the agreement. Likewise if you miss a payment, incur new liabilities, or somehow fail to meet the terms of the agreement, the IRS can terminate the agreement.

If the IRS rejects your application for an installment agreement, or alters or terminates an accepted installment agreement, it must send a written notice to that effect. The form letter the agency generally uses is Notice CP523 or a similar letter. See Exhibit 5-2. It explains that the IRS intends to "terminate your installment agreement thirty days from the date of this notice." The notice also states that after thirty days, the agency can enforce collection.

Exhibit 5-2 – IRS Notice CP523

Department of the Treasury
Internal Revenue Service
Philadelphia, PA 19154-0030

CAF

SB

Notice	CP523
Tax Period	2006
Notice date	November 17, 2014
Employer ID number	[redacted]
To contact us	Phone 1-800-829-0115
Page 1 of 5	

009968.505312 [redacted] 1 SP [redacted]

009968

[redacted]
%DANIEL J PILLA
215 MYRTLE ST W
STILLWATER MN 55082-4804158

[redacted]*

Notice of intent to levy

Intent to terminate your Installment Agreement

Amount due immediately: $18,824.94

The monthly payment for your installment agreement is overdue. Since we did not receive one or more payments from you as agreed to in your installment agreement, your installment agreement will be terminated on December 17, 2014.

In addition, the IRS may seize ("levy") any state tax refund to which you're entitled and apply it to your $18,824.94 in overdue taxes on or after February 15, 2015.

Billing Summary

Amount you owed	$16,725.16
Interest charges	2,099.78
Amount due immediately	**$18,824.94**

Continued on back

IRS

Payment

[redacted]
%DANIEL J PILLA
215 MYRTLE ST W
STILLWATER MN 55082-4804158

Notice	CP523
Notice date	November 17, 2014
Employer ID number	[redacted]

- Make your check or money order payable to the United States Treasury.
- Write your Employer ID number [redacted] the tax period (December 31, 2006) and the form number (943) on your payment and any correspondence.

Amount due immediately | **$18,824.94**

INTERNAL REVENUE SERVICE
P.O. BOX 80110
CINCINNATI, OH 45280-0010

[redacted] 11 2 200612 670 [redacted]

The thirty-day window gives you the time needed to appeal the determination, and the IRS cannot collect while the appeal is pending. Your written protest letter must contain the following elements:

1. Your name, address and Social Security number,
2. A statement that you want to appeal the decision to reject or terminate your installment agreement,
3. The date of Notice CP523 or similar letter and copy thereof,
4. The tax periods in question,
5. The statement that you disagree with the decision to reject or terminate your agreement,
6. A statement of the facts supporting the reasons you disagree with the decision,
7. A statement saying that the Internal Revenue Code allows you to enter into an installment agreement when you do not have the income and assets to pay the tax in full, and
8. A declaration under penalty of perjury that your statement of facts is true and correct. Do this by adding the following statement to your letter, just above your signature:

   "I declare under penalty of perjury that the facts presented in this protest letter are, to the best of my knowledge, true and correct."

Mail your protest letter using certified mail with return receipt requested, to the address shown on the Notice CP523 or similar letter. Include a copy of the notice or letter. Keep a copy of everything you send. Soon, your case will land in the IRS's Office of Appeals. An appeals officer will contact you and ask for updated financial information. You must provide the information using Forms 433-A and, if applicable, B. You will be given a deadline by which to submit the information and supporting documents. A date will be set for an Appeals conference, which will likely be a phone conference very similar to the CDP hearing described above. Since you have the burden to prove that you are entitled to an installment agreement, you must provide all the information and arguments to support your position.

Life Under an Installment Agreement

Once in place, the installment agreement remains in force throughout its duration unless, a) you provided incorrect or incomplete information while negotiating the agreement, or asked for updated information, b) you fail to carry out all its terms or, c) collection of the tax is in jeopardy. A tax is in jeopardy when the citizen takes steps to dispose of or conceal assets, or is preparing to flee the jurisdiction of the IRS. Such a situation is very rare.

Installment payments can operate automatically through the cooperation of either your employer or your bank. Expect the RO to push for either of these automated programs. Under a *Payroll Deduction Agreement*, Form 2159, your employer mails the payment to the IRS at the time of issuing your paycheck. Under a Direct Debit Installment Agreement, your payment is debited directly from your bank account each month on the agreed upon date. A Direct Debit Installment Agreement is set up by providing your bank account information to the IRS on Form 433-D. See Exhibit 5-1.

What to Expect while the Agreement is in Effect

Throughout the duration of the agreement, expect the following:

1. Installment agreements are generally short-term propositions. The IRS is not a bank and unless you qualify for a guaranteed installment agreement, the agency does not routinely enter into fixed, long-term agreements. This *does not* mean, however, that you must pay substantial debts in just a few months. Rather, the IRS establishes a *series* of short-term agreements. For example, if you agree to a $100 per month installment agreement, the IRS reviews the agreement periodically to determine whether it should be modified. Modifications are based upon any substantial changes in your ability to pay. Should your income rise or your fixed expenses diminish, expect the payment to increase.
2. If the liability cannot be satisfied within the time left on the collection statute, the RO may demand that you sign a Form 900, *Tax Collection Waiver*, which extends the statute. However, the

IRS cannot obtain a Form 900 waiver unless it is signed by you in connection with an installment agreement. In any event, you must be careful if the IRS seeks such a *Waiver*. The implications are profound. See Chapter 10 for more details.

3. You must be current and remain current with all tax obligations. The IRS will not enter into an agreement or permit an agreement to continue if you incur other outstanding tax liabilities or delinquent returns. Further, once an agreement is finalized, it is considered in default if subsequent returns are unfiled or taxes are not paid on time, including any legitimate extensions. See Chapter 8 for details on how to get and stay current. Because of the special problems presented to the non-filer, they are treated later in this chapter. See the discussion under the heading, *The Tax Delinquency Investigation*.
4. The agency routinely requests updated financial statements, though the timing of such requests is inconsistent. The information is used to determine whether to alter the terms of the agreement. If income rises or expenses decrease, expect the IRS to increase the payment. On the other hand, you may use the same review process to reduce your payment if your income decreases or expenses escalate. I discuss this further below, under the heading, *Renegotiating Your Agreement*.
5. The very least you can expect once the agreement is formalized is to make the payment! You cannot expect the IRS to keep the installment agreement in force if you do not meet the payment terms. The IRS monitors your performance. If you miss payments, notice CP523 (Exhibit 5-2) will be mailed. You thus run the risk of reigniting enforced collection.

A Caveat: Installment agreements generally are not considered the *final solution* to most collection problems. Even in the best case, the problem is not solved until the tax is *paid in full*. And since penalties and interest continue to run, and since the agreements are subject to review, the problem is not solved simply because an agreement is in effect. Therefore, the installment agreement is a mere stepping-stone—albeit an important and necessary one—on the path to the financial Promised Land. It is an important tool for stabilizing an otherwise volatile collection situation, but should be used in conjunction with other techniques that more fully address your problem.

When the IRS Alters or Modifies Your Agreement

Code section 6159 gives the IRS the authority to alter or modify your installment agreement any time a substantial change occurs in your financial condition. The IRS must notify you of any such decision. They use Notice CP523 (Exhibit 5-2) to communicate that decision. You have thirty days from the date of the CP523 in which to appeal the decision. An appeal is carried out by filing a written *Protest Letter*. I discussed this at length above, under the heading, *How to Appeal an Installment Agreement Rejection or Termination*.

Under section 6159(b), the IRS has limited reasons why it may alter, modify or terminate an agreement. They are:

1. You provided inaccurate or incomplete information prior to entering into the agreement,
2. The IRS believes collection of the tax is in jeopardy,
3. The IRS believes your financial condition has significantly changed,
4. You failed to pay an installment on time,
5. You failed to pay another tax liability on time, or
6. You failed to provide a financial condition update as requested.

Be prepared to document the fact that you continue to meet the terms of the agreement as established. You must prove that none of the above six reasons applies in your case.

Renegotiating Your Agreement

If you can no longer afford to make the payments, or if the payments were too much to begin with, you have the right to re-negotiate your agreement. Treasury Regulation section 301.6159-1(e)(3) provides the procedure for seeking a modification to an existing installment agreement. The request for modification must be in writing. You must send it certified mail to the IRS office where you send your payment. If you set up your IA through a revenue officer, send your request directly to the RO, and include the information shown here.

1. **A detailed explanation of the change in circumstances.** This could be either a decrease in your income or an increase in necessary living expenses, or both. Whatever the case, be specific and provide proof.
2. **A current financial statement, Form 433-A and B (if necessary).** Also provide the supporting documents (bank statements, pay stubs, etc.). Make sure your information provides specifics as to the decreased income or increased living expenses. Provide copies of all receipts and canceled checks that support the expenses.
3. **If your circumstances are such that you cannot make any payment, specifically ask for uncollectible status.** See Chapter 11. This freezes the collection account so that no payment is required.

Be prepared to submit additional information if requested, even if you already sent it. You cannot expect the IRS to rule in your favor if you withhold information. Be sure to provide what they ask for as quickly as possible. Do not forget that the burden of proof is on you and you cannot over-prove your case.

One effective way to renegotiate an installment agreement you can no longer afford is to simply stop making the payments. When you stop making payments, the IRS considers that you defaulted on your agreement. The agency then issues Notice CP523. As stated above, you have thirty days from the date of the notice in which to file a protest letter seeking an appeal. By getting your case before the Appeals Office, you have the opportunity to re-negotiate your agreement without the risk of levy action.

The Tax Lien

A natural outgrowth of an installment agreement is a tax lien. The lien secures the government's interest in your property. The tax lien is the one element of enforced collection over which we have the least control. The lien generally issues from ACS long before other signs of enforced collection manifest themselves. If not issued by the time an RO is assigned to the case, its filing is usually his first order of business, often before making direct contact with you. Keep in mind, however, that tax liens are subject to Collection Due Process Appeal rights to the same extent as a Final Notice. See Chapter 4 for details. Chapter 6 discusses several options for dealing with liens.

The Tax Delinquency Investigation (TDI)

Revenue Officers are often more intimidating when dealing with non-filers than when dealing with mere payment delinquencies. Therefore, I afford special attention to that problem here.

A Tax Delinquency Investigation (TDI) begins as outlined in Chapter 4, under the heading, *What to Expect From Enforced Tax Collection*. You avoid a potential TDI if you file delinquent tax returns before being contacted by the IRS. How to step forward to file delinquent returns is the subject of Chapter 8.

Upon filing the late returns, the IRS processes them like any other. If you are able to pay the tax, naturally do so at the time of filing. Then, expect a bill for interest and penalties. Methods for dealing with penalty assessments are discussed in Chapter 9. If you cannot pay the tax at the time of filing, or if you cannot pay subsequent interest and penalties, be prepared for contact from ACS. Handle ACS as outlined above. Your goal is to negotiate an installment agreement or obtain uncollectible status.

If you file delinquent returns *before* the IRS instigates a TDI, you will not be saddled with unreasonable filing demands either by a revenue officer or a tax auditor. Once the IRS establishes a TDI, it hands the case either to Exam or Collection to secure the returns. When the case finds its way to an RO, the Tax Delinquency Investigation becomes a Tax Delinquency Account (TDA). At that point, the RO's job is both to secure the missing returns and collect the taxes.

A lesson learned in Deb's case is that revenue officers are not necessarily *friendly*. They often go to great lengths to intimidate taxpayers. Rather than offering a feasible way to solve the problem, they regularly present demands that render compliance virtually impossible. It is almost as though their primary objective is not to secure compliance, but rather, to make life as miserable as possible for you. No doubt you were left with a horrible taste in your mouth after our discussion of Deb's bout with her revenue officer. Eventually, however, Deb's maneuvers won a reasonable amount of time to comply without further harassment from the RO.

Before we examine those maneuvers, let us understand the two possible approaches used by a revenue officer in a non-filer case. As it happened, both approaches were used in Deb's situation. First, the RO demanded she file tax returns for numerous prior years "within thirty days." When Deb made it clear that she could not comply with such a request, the RO issued a collection summons demanding records from which to prepare the returns. When Deb could not produce the records with sufficient speed, the RO huffed and puffed, then threatened to blow the house down. Let us discuss how to handle both demands.

"File the Returns within Thirty Days"

At the first contact by a revenue officer working a TDA, she demands the filing of returns. Expect to be lectured on the fact that your returns are years late and you had plenty of time to prepare them. Some revenue officers may be willing to extend a reasonable amount of time to do the job. Others, however, like Deb's RO, may be entirely unrealistic.

The key to winning time to file is to show a willingness to cooperate. Make it perfectly clear that you *understand* your obligation to file a "true and correct return." Explain that if you are forced to file a return without adequate time to gather and organize your records, you cannot file an accurate return. Ask the RO whether she wants your returns to be true, correct and complete in all respects, as indicated on the signature line of Form 1040. What do you suppose will be her answer? Once securing an admission that the returns must be accurate, explain that accurate returns can be prepared only if you have sufficient time.

At that point, you effectively cornered the revenue office with a principle she believes in and accepts; that is, we all must file *correct* returns. It is contradictory to recognize, on the one hand, the obligation to file a correct return, and on the other hand to refuse to provide adequate time to do so.

Next, provide a definitive timetable in which to prepare and submit the returns. A generally acceptable timetable is thirty to sixty days per return. Suppose you have four unfiled returns. Your filing proposal might suggest one return every sixty days. After submitting the final return, you address, if necessary, any financial delinquency.

The number one key to diffusing a revenue officer and winning cooperation is to do the RO's work for her. I mentioned this earlier. In this context, that means affirmatively recognizing the delinquency. It means definitively proposing a means to correct the delinquency. It means setting forth a firm timetable in which to do so. Contrast this approach with the vast majority of delinquent citizens who generally run and hide. They do not return phone calls. They duck written contacts and the only way the IRS gets their attention is to bash them with liens and levies.

When you make it clear that you understand the purpose of her visit and intend to make her job easier, you reap dividends in terms of her cooperation. Naturally, the lip service does little if you do not meet the obligations you claim to recognize. When that happens, expect the RO to force the issue by using the collection tools at her disposal.

Never forget, however, that an RO cannot legally utilize the tools of lien, levy and seizure unless and until there is a valid assessment. That assessment usually does not exist if no returns are filed. The assessment is not born until you either file the returns, sign a consent to assessment of the tax, or a Notice of Deficiency is mailed and ninety days expire from the date thereof. For more information on tax assessment rules, please see the *Taxpayers' Defense Manual*. It is also true that no collection action can be taken unless a Final Notice has been mailed and more than thirty days have gone by since the date of its issuance.

Therefore, do not be taken in by threats of immediate, enforced collection if the returns are not filed **TODAY**. Please recall that Deb's RO made such threats. But Deb explained that she knew her rights, and as intimidating as the RO was, Deb exercised her rights.

Provided the RO is the least bit reasonable, expect to win sufficient time to prepare and file accurate returns. After filing the returns, the RO's focus changes. She now demands payment of the tax, interest and penalties. To handle this aspect of the TDA, revert to the techniques for negotiating an installment agreement.

The Collection Summons Demanding Records

If the RO is not the least bit reasonable or you did not clearly communicate the points I outlined, expect a collection summons demanding the production of books and records. See Chapter 4. This is done to enable the IRS to prepare the returns for you. This threat was also made against Deb. "If you do not get those records in here," she was told, "we will prepare the returns for you." The threat did not have much impact because Deb realized that the IRS's tax liability determination is appealable before it becomes final.

Without a doubt, however, Deb was terrified and the RO did her best to maintain the terror. When Deb appeared in response to the summons, she did so without any of the requested records. Instead, she pointed out that she could not organize them in such a short period of time. Thus, she could not possibly prepare truthful returns. Deb was threatened with jail but I knew she would not go to jail and I told her so. To understand the significance of what we did, you must appreciate some background on the nature of an IRS summons.

When a citizen does not comply with a summons, the IRS may seek "judicial enforcement" of the summons. That involves a *civil proceeding*, not a criminal prosecution. Because the summons is not self-enforcing, the IRS must ask a federal court to back it up. If the IRS believes the facts justify, it seeks judicial enforcement by filing a civil petition in the federal district court where you reside. You have an opportunity to present your side of the story before the court makes a ruling.

The decision to commence a summons enforcement proceeding is not and cannot be made by an RO. The decision is made by the Office of Area Counsel based upon all the facts and circumstances of the case. Area Counsel are the IRS's in-house lawyers. If the record reveals a recalcitrant citizen evading his obligations, expect Counsel to recommend a summons enforcement proceeding.

However, I would never expect Counsel to take action when a citizen makes every possible effort to comply in the face of unreasonable demands, and I said exactly that to Deb. When the RO explained she was submitting the case for "court action," I explained to Deb what that meant and we wrote a letter to Counsel. The letter explained everything Deb did to comply with the summons. It explained the nature of the RO's demands and the fact that she was unwilling to afford even minimal time to gather and organize records, never mind prepare accurate returns. The letter stressed that at no time did Deb refuse to cooperate. We stressed that she never failed to appear at any meeting. We stressed that Deb recognized her obligations and intended to cooperate fully—in fact, *was cooperating*—but simply needed more time. We proposed to file delinquent returns in thirty-day intervals. Deb sent the letter via certified mail, return receipt requested.

The letter she received in reply arrived just one week before Christmas—just days after the RO promised Deb she would be arrested, at home and probably at night, and taken away to jail in the presence of her children. (By the way, the details of that threat were also plainly spelled out in our letter.) Counsel's response was music to Deb's ears.

Not only did the IRS attorney agree to our filing schedule, but he pointedly assured Deb that she would not be arrested and would not be hauled off to jail at night in the presence of her children, or in any other manner. And he went one step further. He assured Deb that "no further enforcement" steps would be taken provided Deb met the filing schedule.

Deb never had to talk with that revenue officer again. Her next meeting was solely for the purpose of delivering the first of the required returns. Thereafter, at thirty-day intervals, Deb presented the other returns, just as promised. Each time she did, she displayed only her classic, southern, lady-like politeness.

And the RO *hated it!* She was livid that Deb went over her head. She was incensed that a citizen had the audacity and know-how to short-circuit her threats and power. *But what upset her most was the reality that she could do absolutely nothing about it—and Deb knew it!*

Once you get past a belligerent revenue officer and comply with the filing requirement, your attention must focus on paying the taxes. To establish an installment agreement, follow the steps and procedures outlined above. If you do not owe any money after filing the returns, your tax problem is over.

Employment Taxes and the Installment Agreement

Employment tax delinquencies present special problems. Because the IRS views them in a more serious light, it moves to enforce collection more aggressively. To understand the special problems, let us begin by exploring exactly what constitutes employment tax liabilities.

The total employment tax liability is comprised of two segments. The first is the so-called "trust fund" portion. Trust fund taxes are those that are withheld from the employee on account of his personal income and Social Security tax obligations. The employer then bears the burden to truthfully account for and pay the withheld taxes on time. They are referred to as trust taxes because a fiduciary relationship exists between the employer, the employee, and the IRS. The employer acts as a trustee over the funds he withholds from the employee.

The second segment is the non-trust portion. Non-trust taxes are comprised of the employer's matching Social Security (FICA) and unemployment compensation (FUTA) payments. Those taxes, generally about 20 percent of the total employment tax burden, do not originate from the employee's pay. They represent excise taxes imposed directly on the employer based on his payroll. Those taxes are therefore paid directly by the employer from company profits. Because they are not withheld from the employee's pay, they create no trust relationship.

Businesses find themselves in trouble with employment taxes for many of the reasons discussed in Chapter 2, under the heading, *Business Debt*. In any case, expect the IRS to pursue collection of employment taxes in precisely the same manner. However, an additional factor must be considered when the delinquent taxpayer is a corporation. In that case, when it is not possible to collect from the income or assets of the corporation itself, the IRS assesses the Trust Fund Recovery Penalty against corporate officers and other responsible parties. I discuss the Trust Fund Recovery Penalty in Chapter 4 under the heading, *Collecting Employment Taxes*.

First, Stop the Bleeding

The single most important aspect of stabilizing an employment tax problem has nothing whatsoever to do with the IRS. The patient will not get well until you *stop the bleeding!* In this context, I mean very simply that you must immediately cease the practice of operating on net payroll. If you are filing 940 and 941 tax returns without paying the tax, you must end that practice *immediately*. If you are not filing due to lack of funds, you must also stop that practice *immediately*.

I emphasized earlier that the key to success in installment agreement negotiations is to *get and remain current* in your tax return filings and payments. Nowhere is this more important than with employment taxes. A revenue officer will *not for a moment* entertain an installment agreement or, for that matter, anything short of full liquidation, if filing or payment delinquencies continue. When delinquencies continue period after period, the IRS refers to that as "cascading liabilities." In that case, the RO believes that putting you out of business actually does you a favor since it stops the cascading.

There are only three ways I know of to stop the bleeding. While this answer is simple, I do not pretend that implementing it is. Very simply, you must reduce the number of employees to a level that allows you to timely pay all employment taxes. If you cannot afford to pay any employment taxes in a timely manner, then all employees must go and they must go now. Naturally, the problem of making timely payments disappears if the employees disappear. If you cannot operate without help, find a way to do it without employees. That might mean working longer hours yourself or using legitimate independent contractors. So be it. You have no choice.

I once worked with a man who operated a small business with about a dozen employees. He was tens of thousands of dollars behind in his employment taxes, and the IRS was threatening liquidation. My first suggestion was he cut the employees to a level that would allow him to pay current taxes when due. He said, "I can't do that. I need these people to operate my business."

I said, "Bob, if you don't immediately stop the net payroll game, you will not have any business to operate. They will shut you down." I explained that he would have to find a way to turn out the work with fewer employees or *none at all*.

Next, Bob protested that if he did not have employees, he could not operate profitably. Knowing the answer, I asked an obvious question. “Are you earning a profit now?” Obviously, he said “no.” After all, if he were, he would not have employment tax problems. I then asked, “If you aren’t making a profit *with* the employees, how can matters get any worse *without* them?” Bob had no answer.

Finally, I said, “Look Bob, you are the captain of a sinking ship. You must either plug the hole or get the heck out because as it stands now, the ship is *going down*. You don’t have any other choices. The longer you continue with this pattern, you make matters worse—you take on more water.”

I know this is very difficult, but the business owner *must* recognize the point of no return. In all my experience with employment tax disputes, I very seldom see companies work themselves out of the problem. It can be done, but it takes firm managerial resolve and the ability to make hard choices fast and stick with them. And it takes strong and consistent cash flow.

So the first of the three hard choices is to cut employees—*now*. If the number of employees remains constant, your problem only grows. The second challenge is to generate more cash flow—*now*. Without cash flow, you cannot pay the trust liabilities when due. And the third challenge is to make your company more profitable—*now*. Without profit, the non-trust taxes cannot be paid.

If you cannot do those three things in the ratios needed to stop the bleeding, then you must move to the fourth step. That is to shut down the business—*now*. You have no choice. Do not allow your emotions and wishful thinking to stand in the way of the cold reality that the IRS *will* shut down the business for you—without hesitation or remorse—and in a fashion that serves the government’s best interests, *not yours*.

Only after you prove that your company can remain current on its employment taxes does the RO entertain the idea of an installment agreement. File all delinquent employment tax returns as soon as possible, and then address the matter of payment. Carefully follow the steps discussed above to secure an installment agreement and pay close attention to the special considerations discussed below.

Special Considerations for Employment Taxes

The most important special consideration is the fact that when collecting employment (or any other) taxes, revenue officers never disclose a significant reality. That reality is that when receiving partial payment, they apply those payments in a manner which best suits the government, not the company or citizen.

More specifically, the RO applies partial payment first to non-trust taxes. Only after you pay the non-trust taxes in full for all delinquent quarters does the IRS apply payments to the trust taxes. Why do you suppose that is? I promise—they will never tell you what you are about to read.

First, if the taxpayer is a corporation, the non-trust taxes *cannot* be assessed against an individual. Only trust taxes may become personal liabilities through the Trust Fund Recovery Penalty. Therefore, as long as the IRS milks funds from an active corporation, it applies them to the tax that cannot be passed on to an individual. The agency theorizes that if the corporation goes south, it will never be able to collect the non-trust amounts. However, the trust amounts may potentially be collected by pursuing the responsible officers personally.

But if the taxpayer is a non-corporate entity such as a partnership or sole-proprietorship, it is not necessary to assess the Trust Fund Recovery Penalty. The nature of the business structure renders trust tax debts personal liabilities from the beginning. However, as you learn later in this book, non-trust taxes may be discharged in bankruptcy while trust taxes cannot be. Consequently, the RO makes every effort to apply as much as possible to the non-trust taxes before his actions potentially force a taxpayer into bankruptcy.

Designating Payments

When making a voluntary payment to the IRS, you have the absolute right to “designate” that payment to apply in the manner which best suits you, not the IRS. This law is expressed in the case of *O'Dell v. United States*, 326 F.2d 451 (10th Cir. 1964), and it is enforced by all the courts in the land, and the IRS knows full well that it exists. See also *Amos v. Commissioner*, 47 T.C. 65 (1966). In fact, in the case of *Dixon v. Commissioner*, 141 T.C. No. 3 (2013), the IRS expressly acknowledged in court that it has a policy of "honoring an employer's designation of voluntary payments" between trust and non-trust taxes. It must follow that policy. See Revenue Procedure 84-58 (1984).

The key to enjoying this right is to make a "voluntary payment." A payment is voluntary when not procured by a levy, a refund offset, or a court proceeding in which the government seeks collection. Under this definition, payments made by the taxpayer to an RO are voluntary payments. When properly designated, they must be applied per the election of the taxpayer.

To constitute a proper designation, it must:

1. **Be made by the taxpayer.** In the case of a corporation, the corporate president or other responsible officer must make it.
2. **Be made at or before the time of submitting the payment.**
3. **Be specific.** Funds designated only to a specific quarter but not directed to trust taxes for that quarter may be applied to non-trust taxes for that quarter.
4. **Be in writing.** I recommend making the designation on both the payment device itself and with an accompanying cover letter. The statement should read, "Apply to trust fund taxes for __________ quarter (i.e., 2nd quarter, 2015). Apply any excess to trust fund taxes for __________ quarter." Include your Social Security number or employer identification number on both the payment device and the cover letter. Keep copies of both the letter and the payment device for your records. Mail the payment using certified mail with return receipt requested.

To follow the progression of your payments, obtain a statement from the RO reflecting the outstanding trust and non-trust assessments at the time the payments commence. Monitor the balances to ensure the payments are applied in the manner you designate. Do this by reviewing the Business Master File (BMF) record covering the periods in question.

Be aware of the fact that if you intend to work the corporation out of the tax problem, you must eventually pay the non-trust taxes. The IRS does not look favorably upon an operating corporation with outstanding employment tax debts, even if they do represent non-trust amounts.

How to Determine the Employment Tax Installment Payment

The Internal Revenue Manual expressly provides for installment agreements in employment tax cases for operating businesses, but as stated above the business must be current with return filings and tax payments.

Substantive negotiations on the amount of the installment payment are no different than those for personal taxes. The heart and soul of the process is the financial statement. For business entities, that is Form 433-B. You ascertain the amount of the payment in negotiation with the revenue officer.

Businesses are not subject to any of the expense standards that apply to individuals. Instead, the standard used to evaluate business expenses is the same standard used in an audit to determine whether expenses are allowable deductions. That is, the expenses must be ordinary and necessary to produce income, and must be reasonable under the circumstances.

Thus, you must show that your business expenses are necessary to the success of the business. For example, if you run a delivery business, it is reasonable to incur substantial vehicle expenses. They must be allowed in order to earn income. On the other hand, if your business is purely an Internet business, it may not be reasonable to incur substantial vehicle expenses. The determination of business expenses is based upon the facts and circumstances of each case. Normally, the IRS accepts all reasonable business expenses upon proof of payment of the expenses. The IRS does not allow expenses that you are not paying.

Often, corporation installment negotiations are accompanied by two further demands. First, the RO asks you to complete and submit Form 4180, *Report of Interview with Individual Relative to Trust Fund Recovery Penalty*. The purpose is to ascertain who is to be targeted with the Trust Fund Recovery Penalty. The RO may demand a personal interview with corporate officers or key employees to collect this information. You are entitled to counsel in any such interview.

Secondly, the RO may ask you to consent to an assessment of the Trust Fund Recovery Penalty. I recommend that not be done if possible. Keep in mind, however, that the RO does not need your consent to assess the penalty.

Conclusion

I must end this discourse by repeating an observation made earlier. The installment agreement is generally not an end unto itself. It is the means to an end, that being the final resolution of the tax dispute. An installment agreement to pay $100 per month against a $20,000 tax liability will never resolve the dispute. The interest and penalties more than consume that meager monthly payment. The key, though, is the agreement gives you peace of mind to pursue other avenues to resolve your case, knowing that you are free of levies and seizures. The chapters that follow address those other avenues.

Review Questions

1. Which action is typically taken by the IRS in the case of a taxpayer's financial hardship and inability to pay?
   A. Installment agreement
   B. Collection pursuit
   C. Collection freeze
   D. Elimination of the tax

2. What is the first order of business in a CDP appeal?
   A. The settlement officer confers with the revenue officer handling the case
   B. An Appeals employee has ex parte communication with a revenue officer
   C. The taxpayer assumes the burden of proof
   D. The settlement officer determines that all required procedures were followed

3. Which collection alternative specifically allows a business to continue to operate and pay the tax due?
   A. Withdrawing or subordinating the lien
   B. Installment agreement
   C. Offer in Compromise
   D. Obtain uncollectible status

4. Which issue may not be raised in a CDP appeal?
   A. Misapplication of prior payments
   B. Challenges to the underlying tax
   C. Appropriateness of collection action
   D. Tax protest issues

5. What is issued by the settlement officer upon completion of the CDP hearing?
   A. Notice of Determination
   B. Balancing test
   C. Notice of Deficiency
   D. Judicial Review

6. What is a disadvantage of an Equivalent Hearing determination?
   A. Taxpayers have only thirty days to file an appeal with the Tax Court
   B. It is not appealable
   C. IRS attorneys get involved in the appeal process
   D. Installment agreements are not available

7. With respect to employment taxes, which of the following allows the IRS to continue its collection efforts even though a CDP appeal is in progress?
   A. LT11
   B. DETL
   C. Form 433-D
   D. CDP appeal

8. In which installment agreement situation does the collection statute continue to run?
   A. Immediately upon termination of an agreement
   B. The agreement is in effect
   C. A request for agreement is pending
   D. Immediately upon rejection of an installment request

9. What is a suggested action if you receive an unannounced visit from a revenue officer?
    A. Execute Form 900
    B. Refuse to pay the tax
    C. Reiterate that you wish to consult with counsel
    D. Keep the conversation focused on the facts of the case

10. What is one of the qualifications for entering into an installment agreement?
    A. The agreement must provide for full payment of the liability within three years
    B. The tax owed cannot exceed $20,000
    C. An installment agreement must not have been entered into within the last three years
    D. The IRS must offer the agreement

11. Of the following, which is an IRS-approved Local Standard (LS) cost?
    A. Food
    B. Out-of-pocket medical costs
    C. Utilities
    D. Vehicle operating costs

12. If Notice CP523 is received by a taxpayer, what is likely occurring?
    A. A Tax Collection Waiver is being requested
    B. The IRS plans to terminate an installment agreement
    C. A federal income tax lien has been filed
    D. Updated financial information is being requested

13. Non-compliance with a collection summons may result in what action?
    A. Judicial enforcement
    B. Notice of Deficiency
    C. Criminal prosecution
    D. Summons enforcement made by the revenue officer

14. Which best describes a taxpayer's voluntary payment?
    A. Refund offset
    B. Non-specific payment
    C. IRS-directed application of funds
    D. Designated payment

Review Answers

1. A. Incorrect. An installment agreement is not the typical action taken by the IRS in the case of a taxpayer's financial hardship and inability to pay. If a taxpayer is unable to make a payment, an installment agreement is likely not viable.
   B. Incorrect. The IRS will not typically pursue collection in the case of a taxpayer with financial hardship. The IRS may not pursue collection but the taxpayer is still liable for the tax.
   C. **Correct.** In cases where there is financial hardship and one is unable to make a payment, the IRS typically institutes a collection "freeze."
   D. Incorrect. In cases where there is financial hardship and one is unable to make a payment, the IRS may not expect immediate collection but the tax is not eliminated.

2. A. Incorrect. A conversation between the settlement officer and the revenue officer handling the case is not the first order of business in a CDP appeal. Upon the filing of a timely CDP request, the settlement officer is not allowed to initiate contact with the revenue officer handling the case.
   B. Incorrect. An Appeals officer does not have ex parte communication with a revenue officer as the first order of business in a CDP appeal. An Appeals employee is not allowed to have ex parte communications with anybody outside of the Appeals Office regarding the merits of a case.
   C. Incorrect. A taxpayer does not assume the burden of proof as the first order of business in a CDP appeal. The IRS has the burden of proof to reflect the correct collectible adjustment and to issue the proper pre-enforcement notices.
   D. **Correct.** The first order of business in a CDP appeal is for the settlement officer to determine that the IRS has followed all correct procedures.

3. A. **Correct.** Withdrawal or subordination of the lien specifically affords the IRS a better chance to collect since it allows the business to continue to operate and pay the tax.
   B. Incorrect. An installment agreement is not the collection alternative that specifically allows a business to continue to operate and pay the taxes due. An installment agreement is a collection alternative that allows payment of the taxes due over time.
   C. Incorrect. An Offer in Compromise (OIC) is not the collection alternative that specifically allows a business to continue to operate and pay the taxes due. An OIC is a potential collection alternative that allows the taxpayer to negotiate settlement for less than what is owed.
   D. Incorrect. Obtaining uncollectible status is not a collection alternative that specifically allows a business to continue to operate and pay the taxes due. Obtaining uncollectible status may be the best option when the person owing the tax has no capacity to make a payment.

4. A. Incorrect. Misapplication of a taxpayer's prior payments by the IRS is an issue that can be raised in a CDP appeal; therefore, taxpayers have the right to designate payments.
   B. Incorrect. Challenging the underlying tax is an issue that may be raised in a CDP appeal. Many audit assessments are simply bogus and should be challenged by taxpayers.
   C. Incorrect. The appropriateness of a collection action is an issue that may be raised in a CDP appeal. A settlement officer has the authority to order a less intrusive action if a levy action or a tax lien is overly aggressive or unwarranted.
   D. **Correct.** The Appeals Office will not consider any challenge to the tax system that constitutes a "tax protester" argument.

5. A. **Correct.** Once the CDP hearing is completed and all the evidence is evaluated, the settlement officer must issue a *Notice of Determination*.
   B. Incorrect. A balancing test is not issued by the settlement officer upon completion of the CDP hearing. A *Notice of Determination* must consider whether a proposed action balances the need for collection with the concern for the person affected.

C. Incorrect. A Notice of Deficiency is not issued upon completion of the CDP hearing. If a tax debt is based upon an audit, or an IRS-filed substitute for return, the agency must send a Notice of Deficiency.
D. Incorrect. A Judicial Review is not issued upon completion of the CDP hearing. CDP decisions are reviewable by the Tax Court, and the taxpayer has thirty days from the *Notice of Determination* in which to file an appeal with the Court.

6. A. Incorrect. A disadvantage of an Equivalent Hearing determination is not that taxpayers have only thirty days to file an appeal with the Tax Court. Taxpayers have thirty days from the *Notice of Determination* to file an appeal.
B. **Correct.** A disadvantage of an Equivalent Hearing is that the determination is not appealable.
C. Incorrect. The involvement of IRS attorneys in the appeal process is not a disadvantage of an Equivalent Hearing determination. If a CDP decision is appealed to the Tax Court, the IRS's attorneys get involved.
D. Incorrect. The unavailability of installment agreements is not one of the disadvantages of an Equivalent Hearing determination. The Final Determination resulting from a CDP appeal may include an installment agreement.

7. A. Incorrect. An LT11 does not allow the IRS to continue its collection efforts even though a CDP appeal is in progress. Because employment tax liabilities can encompass multiple periods, the IRS may have to send several Final Notices (Letter 1058 or LT11) before enforcing collection as to each period.
B. **Correct.** A disqualified employment tax levy (DETL) allows the IRS to continue to enforce collection despite the CDP appeal.
C. Incorrect. Form 433-D does not allow the IRS to continue its collection efforts even though a CDP appeal is in progress. An installment agreement is formalized with Form 433-D.
D. Incorrect. The CDP appeal is not what allows the IRS to continue its collection efforts in employment tax cases even though a CDP appeal is in progress. Although the CDP appeal normally limits the broad levy power of the IRS, in employment tax cases the IRS usually moves quickly with all collection tools available.

8. A. Incorrect. The collection statute does not continue to run immediately upon termination of an installment agreement. If the IRS terminates an agreement, tolling continues for thirty days after the date of the IRS's letter informing the taxpayer of the termination.
B. **Correct.** The collection statute begins running when the installment agreement is effective and continues while the installment agreement is in effect.
C. Incorrect. The collection statute does not continue to run while a request for an installment agreement is pending. The collection statute is tolled during the period a request for an installment agreement is pending.
D. Incorrect. The collection statute does not continue to run immediately upon rejection of the installment request. If the request is rejected, tolling continues for thirty days after the date of the IRS's letter informing the taxpayer.

9. A. Incorrect. If you receive an unexpected visit from a revenue officer, you should not file Form 900. One should be careful about not signing Form 900, which extends the statute of limitations.
B. Incorrect. A taxpayer should not flatly refuse to pay the tax if approached by a revenue officer. You should not indicate that you will not pay the tax, but that you need assistance in reaching amicable terms.
C. **Correct.** The suggested action if you receive an unannounced visit from a revenue officer is to reiterate that you first wish to consult with counsel.
D. Incorrect. If a revenue officer confronts you without warning, you should not keep the conversation focused on the facts of the case; instead, you should not engage in substantive discussion about the case at that point.

10. A. **Correct.** One of the requirements for entering into an installment agreement is that full payment of the liability must occur within three years.
    B. Incorrect. It is not a requirement of an installment agreement that the tax owed cannot exceed $20,000; instead, the debt cannot exceed $10,000, exclusive of penalties and interest.
    C. Incorrect. It is not a qualification of an installment agreement that another agreement must not have been entered into within the last three years. The taxpayer must not have entered into an installment agreement for other back tax debts within the past five years.
    D. Incorrect. It is not a qualification for entering into an installment agreement that the IRS must offer the agreement. The citizen must "offer" the agreement.

11. A. Incorrect. Food is not an IRS-approved LS cost. Food is in the National Standard (NS) category of expenses.
    B. Incorrect. Out-of-pocket medical costs are not classified as an LS cost. Out-of-pocket health care costs are separately categorized within the Medical Expense Standards.
    C. **Correct.** The Local Standards (LS) cover housing and utilities.
    D. Incorrect. Vehicle operating expenses are not categorized as LS costs. Transportation Standards (TS) include vehicle operating expenses.

12. A. Incorrect. If a Notice CP523 is received, a Tax Collection Waiver is not being requested. If a financial statement indicates potential collection is unlikely, a Form 900, Tax Collection Waiver, may be requested.
    B. **Correct.** If Notice CP523 is received by a taxpayer, the IRS intends to terminate the installment agreement thirty days from the date of the notice.
    C. Incorrect. If a federal tax lien has been filed, the IRS does not use Notice CP523 to notify the taxpayer. Filing a tax lien protects the IRS's interest in a taxpayer's assets.
    D. Incorrect. A CP523 is not used by the IRS to request updated financial information. A taxpayer must provide updated financial information when asked, and the IRS can alter an installment agreement based on updated information.

13. A. **Correct.** When a citizen does not comply with a summons, the IRS may seek "judicial enforcement" of the summons.
    B. Incorrect. Non-compliance with a collection summons does not result in a Notice of Deficiency. A Notice of Deficiency can initiate an assessment.
    C. Incorrect. When a citizen does not comply with a summons, criminal prosecution does not result. A civil petition can be filed but not a criminal action.
    D. Incorrect. Non-compliance with a collection summons does not result in summons enforcement made by the revenue officer. The decision to commence a summons enforcement proceeding is not and cannot be made by a revenue officer.

14. A. Incorrect. The best description of a taxpayer's voluntary payment is not refund offset. A payment is voluntary when not procured by a refund offset.
    B. Incorrect. A non-specific payment does not best describe a taxpayer's voluntary payment. To qualify as such, a voluntary payment must be specific.
    C. Incorrect. An IRS-directed application of funds is not the best description of a taxpayer's voluntary payment. The IRS does not designate a voluntary payment's application.
    D. **Correct.** When making a voluntary payment to the IRS, the taxpayer has the absolute right to designate that payment to apply in the manner that best suits the taxpayer.

Chapter 6
Coping with Liens, Levies, and Seizures

Learning Objectives

- Ascertain the purpose of the subordination procedure
- Select a little-known federal law that authorizes one to sue the United States to settle an ownership of property issue with respect to a tax lien
- Spot the IRS code section that authorizes an administrative appeal of the imposition of a lien
- Determine how long funds remain in an account after the IRS issues a bank levy

Introduction

Liens, levies and seizures can destroy your credit score, intercept paychecks and other streams of income, smother businesses, and generally mess up a person's life. And while there are useful tools for handling them, the IRS almost never talks about them. Therefore, this chapter presents remedial procedures for handling liens, levies and seizures and I address them in that order.

The Federal Tax Lien

Before I address specific procedures to ameliorate a tax lien, keep in mind that when the IRS first issues a federal tax lien, it must at that time provide you with notice that it filed the lien. The notice comes in the form of IRS Letter 3172, *Notice of Filing Federal Tax Lien and Notice of Your Right to a Hearing*. A sample of that letter is provided as Exhibit 4-7.

Letter 3172 explains your right to file a *Request for Collection Due Process Hearing* (Exhibit 4-6) within the time limit specified in Letter 3172. In Chapter 5, under the heading, *The Collection Due Process Appeal*, I discuss the Collection Due Process (CDP) appeal at length. In such an appeal, you have the right to challenge a lien using any appropriate argument that I outline in Chapter 5, in addition to any of the strategies discussed below.

Keep in mind that if you do not have CDP rights with regard to your lien, you still have the right to seek an Equivalent Hearing if you file Form 12153 (Exhibit 4-6) within one year of the date of IRS Letter 3172. And even if you are past the one-year period, the strategies I explore below are available through other channels, as indicated.

In the midst of the serious financial problems Americans began facing in 2008, then-IRS Commissioner Doug Shulman announced several changes to the IRS's lien-filing policies. Shulman stated that the policy changes were intended to "make it easier for financially distressed homeowners to avoid having a federal tax lien block refinancing of mortgages or the sale of a home." The specific procedures are pointed at removing tax liens, and Shulman assured us that the lien relief process "will be expedited." See IRS News Release IR-2008-141, December 16, 2008. Nevertheless, it falls on you to push the issue by using the proper procedures and presenting the correct information. Here, I show you how to do that.

General Lien Filing Guidelines

While the agency does so regularly, it is not supposed to file liens automatically just because an outstanding debt exists. The Internal Revenue Manual (IRM) provides that a lien filing determination must be made in "deciding whether to file, defer, or not file" a lien. See IRM part 5.12.1.2(1). The following factors are among the key things the IRS must consider before filing a lien.

1. **The balancing test.** I discussed at length the so-called balancing test that must be performed in a CDP appeal. Under that test, the IRS must balance the need for efficient tax collection with the taxpayer's legitimate concern that collection action be no more intrusive than necessary. IRC

§§6320(c) and 6330(c)(3)(C). This applies to lien filings in general, and most certainly applies in CDP lien appeals. See IRM part 5.12.2.3(2). Thus, the IRS must somehow make an initial determination that the factors weighed in the balancing test support the filing of a tax lien. Since most tax liens come from ACS, it is highly unusual that any such balancing test was performed.

2. **Protecting the government's interests.** The one key overarching factor in deciding to file a lien is for the protection of the government's interests. See IRM part 5.12.2.3(3)(C). If there is a substantial outstanding liability, and the citizen owns equity in assets which can pay the tax at least in part, that is a factor weighing heavily in favor of filing a lien. However, most people with substantial debt do not have *any* equity in assets. This is especially true if they went through a bankruptcy, lost property to foreclosure or repossession, or liquidated retirement savings to pay business or living expenses, such as substantial medical bills. In such a case, a lien does nothing to protect the government since the citizen owns nothing to which the lien can attach. In fact, the National Taxpayer Advocate has stated in many of her Annual Reports to Congress that tax liens do little to aid collection, and in fact, do not generally improve tax compliance at all. All a lien accomplishes in most cases is to mess up a person's credit score, making it more difficult to obtain a better paying job, housing or lines of credit.
3. **Overall compliance history.** A person's past compliance history must be considered in determining whether to file a lien. See IRM part 5.12.2.3(3)(A). If a person has a long history of full compliance and the tax debt in question is a one-time aberration, that fact weighs strongly in favor of not filing a lien, especially if there is no equity in assets to which a lien could attach in the first place. However, if a person has a history of non-compliance, such as being a long-term non-filer, the IRS may consider it necessary to protect its interests by filing a lien.
4. **The lien will hamper collection.** Where the determination is made that filing a lien will cause more harm than good, a lien should not be filed. See IRM part 5.12.2.3(3)(D). For example, suppose a company has a revolving line of credit with a bank. The line of credit is needed for supplies and inventory, and to cover shortfalls in current employment tax obligations. The bank has made it clear that a federal tax lien will jeopardize the company's standing with the bank, and will lead to either a substantial reduction in the line of credit, or the termination of the line altogether. Losing the line of credit will have a direct, immediate, negative impact on the company's ability to earn income going forward. In such a case, the collection of the tax is rendered less likely by filing the lien, since it will jeopardize the company's capacity to earn income and stay current with its employment tax obligations. This, in connection with the balancing test mentioned above, constitutes a strong argument that a lien should not be filed.
5. **Certain installment agreements are in effect.** If you are under an approved Streamlined Installment Agreement, or Guaranteed Installment Agreement, a tax lien should not be filed, or if one was filed prior to establishing the agreement, the lien should be withdrawn. See IRM part 5.12.2.3.1(1). See my discussion of such agreements in Chapter 5, under the heading, *How to Win an Installment Agreement*. The IRS's current policy is to withdraw any tax lien for which the unpaid assessment (tax, penalties and interest) is $25,000 or less and you have a Direct Debit Installment Agreement in place. See IRS Memo SBSE-05-0411-036 (April 13, 2011), discussed further below.
6. **Small balance tax liabilities.** Effective March 2011, the IRS increased the lien filing threshold from $5,000 to $10,000. That is to say, if you owe less than $10,000 no lien should be filed at all, unless there are unusual circumstances present in your case that otherwise justify a lien. See IRS Memo SBSE-05-0311-039 (March 28, 2011); IRM part 5.12.2.4.1(1); IRM part 5.12.2.5.1(1); and IRM part 5.12.2.6(3), Lien Filing Criteria. However, the IRS routinely fails to acknowledge the $10,000 threshold. For example, in Doug's case, the IRS had a substitute for return assessment against him in excess of $50,000, for a year in which he failed to file. We filed a correct return for Doug, and using the audit reconsideration procedures (see *How to Win Your Tax Audit*, Chapter 13), we got the assessment corrected. After the adjustment, Doug owed just under $1,000. The IRS filed a tax lien following the adjustment. I phoned the revenue officer who filed the lien. I argued that the outstanding balance was well below the threshold of $10,000, and as

such, the lien was improper. The RO did not know anything about the reduced threshold, so I had to contact his manager. After a discussion with the manager, during which I pointed to the IRM provisions mentioned in this paragraph, the lien was withdrawn.

Let us now turn our attention to the specific strategies for dealing with a tax lien, whether in the context of a CDP or Equivalent Hearing, or through other channels.

The Lien Withdrawal

Code section 6323(j) gives the IRS the authority to "withdraw" a lien after it is filed, even if the tax is not paid. The statute delineates four possible grounds for withdrawal. They are:

1. The lien was premature or otherwise not in accordance with IRS's administrative procedures,
2. You have an approved installment agreement, unless the agreement specifically provides for a lien,
3. Withdrawal of the lien will facilitate tax collection, or
4. With the consent of the citizen or the Taxpayer Advocate (see Chapter 7), withdrawal of the lien would be in the best interests of the citizen (as determined by the Taxpayer Advocate) and the United States.

If a lien is not filed in accordance with IRS's administrative procedures, it must be withdrawn. In this regard, the IRS must follow the deficiency procedures to obtain an assessment (rare exceptions apply). If the deficiency procedures are not followed, the assessment is invalid. In that case, the IRS does not have the right to enforce collection, and that means the lien is likewise invalid. The deficiency procedures are outlined in detail in Chapters 8 and 9, *Taxpayers' Defense Manual*.

Regarding point 2 and an installment agreement, IRS Form 433-D, *Installment Agreement*, provides for the filing of a tax lien, if so indicated on the form. If a lien was not specifically provided for in the agreement, the lien should be withdrawn. As mentioned above, the IRS's administrative procedures provide for the withdrawal of any lien when a Direct Debit Installment Agreement (DDIA) is in effect. According to IRS Memo SBSE-05-0411-036 (April 13, 2011), the agency will withdraw a lien against either an individual or business if all of the following conditions are met:

1. The unpaid balance is $25,000 or less,
2. The total can be paid within sixty months or the time left on the collection statute, whichever is less,
3. A request for withdrawal is made in writing (as discussed below),
4. You have DDIA in effect (this is provided for on the on face of Form 433-D, *Installment Agreement*, as discussed in Chapter 5),
5. At least three DDIA payments were made and there are no defaults, and
6. You have had no prior lien withdrawn for any of the years in question.

The application for withdrawal is submitted on Form 12277, *Application for Withdrawal of Filed Form 668(Y), Notice of Federal Tax Lien*. See Exhibit 6-1. You will file the form with either: a) the revenue officer working your case, b) the Technical Services Advisory Group Manager if there is no RO on your case, the addresses of which are listed in IRS Publication 4235 (see instructions to Form 12277), or c) if your case is on collection appeal, the settlement officer working your appeal.

Perhaps the two most compelling elements of section 6323(j) are items 3 and 4. Item 3 gives the IRS the authority to withdraw a lien when withdrawal will "facilitate tax collection." This is a broad, undefined phrase that can operate to your advantage. We know that a tax lien not only encumbers your property, but it destroys your credit. That makes it impossible get a loan to pay the taxes. And as I discuss in the opening portion of this chapter, liens often provide little or no advantage to the IRS in the collection process if you have no equity in assets to begin with.

On the other hand, suppose you have substantial equity in your home sufficient to pay the tax. Your bank may be perfectly willing to lend money—but only if the lien is removed first. But the IRS does not release its lien unless the tax is paid—first. Of course, you cannot pay the tax unless the lien goes away, since the source of funding is the bank loan. This standoff creates a situation where tax collection is not facilitated *because* of the lien. Under the circumstances, withdrawal does indeed "facilitate tax collection."

Exhibit 6-1 – IRS Form 12277, Application for Withdrawal of Filed Form 668(Y), Notice of Federal Tax Lien

Form **12277**
(October 2011)

Department of the Treasury — Internal Revenue Service

Application for Withdrawal of Filed Form 668(Y), Notice of Federal Tax Lien

(Internal Revenue Code Section 6323(j))

1. Taxpayer Name *(as shown on the Notice of Federal Tax Lien)*
2. Social Security/Employer Identification No.
3. Taxpayer's Representative, if applicable, or Name and Title of contact person, if taxpayer is a business
4. Address *(Number, Street, P.O. Box)*
5. City
6. State
7. ZIP code
8. Phone Number
9. Attach copy of the Form 668(Y), Notice of Federal Tax Lien, if available, OR, if you don't have a copy, provide the following information, if available:

   Serial number of Form 668(Y) *(found near the top of the document)*

   Date Form 668(Y) filed

   Recording office where Form 668(Y) was filed

10. Current status of the federal tax lien *("x" appropriate box)*

    ☐ Open ☐ Released ☐ Unknown

11. Reason for requesting withdrawal of the filed Notice of Federal Tax Lien *("x" appropriate box(es))*

    ☐ The Notice of Federal Tax Lien was filed prematurely or not in accordance with IRS procedures.

    ☐ The taxpayer entered into an installment agreement to satisfy the liability for which the lien was imposed and the agreement did not provide for a Notice of Federal Tax Lien to be filed.

    ☐ The taxpayer is under a Direct Debit Installment Agreement.

    ☐ Withdrawal will facilitate collection of the tax.

    ☐ The taxpayer, or the Taxpayer Advocate acting on behalf of the taxpayer, believes withdrawal is in the best interest of the taxpayer and the government.

12. Explain the basis for the withdrawal request *(attach additional sheets and other documentation that substantiates your request, as needed)*

Affirmation

Under penalties of perjury, I declare that I have examined this application (including any accompanying schedules, exhibits, affidavits, and statements) and, to the best of my knowledge and belief, it is true, correct, and complete

Signature *(Taxpayer or Representative)*	Title *(if business)*	Date

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Another example involves the potential sale of a home. Substantial equity in the home makes it possible to pay off the debt but the lien may prevent a clear title from passing to the buyer. Therefore, the title company is unwilling to close the sale unless the lien is removed. Even if the title company was to escrow money to pay the tax, the buyer cannot be assured of a clear title unless the lien is removed. That is because the lien attaches to the *property* itself. It *follows* the property from owner to owner when title is transferred. Under our example, if the lien is withdrawn, title may pass to the new owner, allowing the title company to close the sale. Likewise in the case of a home refinance. Subordination allows you to refinance at a lower interest rate even if the IRS does not get any money out of the transaction. That way, you may have recourses available to pay the IRS in installments. Under the circumstances, withdrawal does indeed "facilitate tax collection."

Item number 4 under section 6323(j) allows the lien to be removed when the Taxpayer Advocate (see Chapter 7) agrees that withdrawal is in the "best interests" of the citizen and the IRS. This too is broad, undefined authority which can operate to your advantage.

What the IRS is unwilling to do through its field offices, such as Collection, it can sometimes be forced to do through the Taxpayer Advocate (TA). Code section 7811(a) provides the Office of the Taxpayer Advocate with the authority to order the IRS to take any action, or refrain from taking any action, against a citizen if he is "suffering or about to suffer a significant hardship." See Chapter 7 for details on the TA and "significant hardship."

When the TA is satisfied that the presence of the lien does more to prevent collection, or otherwise cause financial hardship, than it does to protect the IRS's interests, the TA can order the lien to be withdrawn.

Make an application for lien withdrawal in writing using Form 12277 as explained above. Follow the instructions for completing the form, and mail it using certified mail, return receipt requested to the appropriate address as indicated earlier. See also: IRS Publication 783, *Instructions on How to Apply for a Certificate of Discharge of Property From Federal Tax Lien*.

When the IRS agrees to withdraw its lien, a written notice to that effect must be filed in the same local government office as the original lien. You must be given a copy of the notice. What is more, when you ask *in writing*, the IRS must "promptly make reasonable efforts to notify credit reporting agencies, and any financial institution or creditor whose name and address is specified in such request, of the withdrawal of such notice." IRC §6323(j)(2).

If the lien was filed in error, the IRS must so state in its withdrawal. IRC §6326(b). This helps to "repair" your credit. You have the duty to provide the IRS with the names and addresses of those you want notified. Thereafter, it is the agency's duty to send the notice vindicating you from the damaging lien.

The Lien Subordination

Another effective method of dealing with liens is a process known as "subordination." Under this technique, the IRS agrees to make its lien subordinate, or secondary, to that of another creditor, such as a bank. Since 2008, the IRS has been more willing to use the subordination process as a simplified means of allowing citizens with equity in their homes or other assets to refinance the asset to pay off their tax debts, and even to refinance at lower interest rates even if no equity is available to pay the tax. This can not only lower your mortgage payments, but it can save a property from foreclosure.

Here is an example of how this can work. Jim was a psychiatrist with a successful practice until his business and personal tax returns were audited with a vengeance. Jim ended up owing $53,000. Jim owned a home on three acres. It was worth about $250,000 and the bank held a $100,000 mortgage. The $150,000 equity was more than adequate to pay the tax and Jim made arrangements to borrow the money. The sole proviso was the IRS must agree to lift its lien, allowing the bank's mortgage to be first in line.

Hoping to put the matter behind him, Jim phoned the RO and presented his plan. He would pay the tax in full "within three days" if the IRS would simply lift the lien. The answer was as unreasonable as it was short: "No." Jim was eventually pushed into bankruptcy by a combination of IRS incompetence and its unwillingness to find a solution. The RO failed to explain that under code section 6325(d), the IRS has authority to subordinate its lien when,

1. The IRS is paid an amount equal to its lien or interest in that property, or
2. The IRS will ultimately collect more by subordinating the lien, and collection of the tax is facilitated by subordinating.

The very purpose of the subordination procedure is to "facilitate tax collection." That is, to allow the IRS to do its job. The subordination process begins with IRS Form 14134, *Application for Certificate of Subordination of Federal Tax Lien*. See Exhibit 6-2. File it in accordance with the instructions provided above, where I discuss Form 12277, *Application for Withdrawal of Filed Form 668(Y), Notice of Federal Tax Lien*. See also IRS Publication 784, *How to Prepare an Application for a Certificate of Subordination of Federal Tax Lien*.

Revenue regulation 301.6325-1(d)(1) speaks directly to this matter. It states, in part:

> *"For example, if a notice of Federal tax lien is filed and a delinquent taxpayer secures a mortgage loan on a part of the property subject to the tax lien and pays over the proceeds of the loan to a district director after an application for a certificate of subordination is approved, the district director will issue a certificate of subordination. This certificate will have the effect of subordinating the tax lien to the mortgage."*

Jim "secured the mortgage" and intended to pay the proceeds to the IRS. This would have satisfied his liability. But Jim was unaware of the requirement to make an application and the RO refused to tell him. According to the above regulation, the application must be "in writing." And following Form 14134, it must present the following details:

1. Your name, address, and Social Security number,
2. Whether the subordination is made under the first criterion (relating to "payment to the IRS of the amount subordinated," or the second criterion (relating to "facilitating the collection of tax") of Treasury Regulation sections 301.6325-1(d)(1) and (2), (see Form 14134, line 7),
3. A detailed description of the property in question, including the street address and legal description,
4. A copy of the Notice of Federal Tax Lien (Form 668) including a statement showing the IRS office originating the lien, the name and address of the citizen shown on the lien, and the date and place of its filing,
5. A copy of the proposed loan documents that create the liability to which the tax lien will be subordinate, such as a mortgage for a bank loan, including a description of the transaction (for example, "mortgage to pay tax"), and the date the transaction is to be completed,
6. If other encumbrances exist on the property, they must be disclosed, including the name of the holder of the encumbrance, the date it was created, the principle amount due and a description of the encumbrance,
7. An estimate of the fair market value of the property,
8. When seeking the subordination to obtain a mortgage, you must state the amount of money to be paid to the IRS if the subordination is granted,
9. When seeking the subordination in order to "facilitate the collection of taxes," you must state why you believe this is accomplished if the subordination is granted,
10. Any other information you believe has a bearing on the decision to subordinate, and
11. Your signature over a statement declaring that, "under penalty of perjury, all facts contained in the application are true and correct," and which specifically requests that the application be granted.

The "Fresh Start" policies of the IRS tell us that they will expedite the processing of lien subordination applications. Countless thousands of people have been able to either sell or refinance their homes using this procedure over the past several years.

Exhibit 6-2 – IRS Form 14134, Application for Certificate of Subordination of Federal Tax Lien

Form **14134** (June 2010)	Department of the Treasury — Internal Revenue Service **Application for Certificate of Subordination of Federal Tax Lien**	OMB No. 1545-2174

Complete the entire application. Enter NA *(not applicable)*, when appropriate. Attachments and exhibits should be included as necessary. Additional information may be requested to clarify the details of the transaction*(s)*.

1. Taxpayer Information ***(Individual or Business named on the notice of lien)***

Name *(Individual First, Middle Initial, Last)* or *(Business)* as it appears on lien		Primary Social Security Number *(last 4 digits only)*
Name Continuation *(Individual First, Middle Initial, Last)* or *(Business d/b/a)*		Secondary Social Security Number *(last 4 digits only)*
Address *(Number, Street, P.O. Box)*		Employer Identification Number
City	State	ZIP Code
Telephone Number *(with area code)*	Fax Number *(with area code)*	

2. Applicant Information ☐ Check if also the Taxpayer *(If not the taxpayer, attach copy of lien. See Sec.10)*

Name *(First, Middle Initial, Last)*	Relationship to taxpayer
Address *(Number, Street, P.O. Box)*	

City	State	ZIP Code
Telephone Number *(with area code)*	Fax Number *(with area code)*	

3. Property Owner ☐ Check if also the Applicant

	Relationship to Taxpayer

4. Attorney/Representative Information Attached: Form 8821 or Power of Attorney Form 2848 ☐ Yes ☐ No

Name *(First, Middle Initial, Last)*	Interest Represented *(e.g. taxpayer, lender, etc.)*
Address *(Number, Street, P.O. Box)*	

City	State	ZIP Code
Telephone Number *(with area code)*	Fax Number *(with area code)*	

5. Lending/Finance Company

Company Name	Contact Name	Contact Phone Number

Type of transaction *(For example, loan consolidation, refinance, etc)*

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6. Monetary Information

Amount of existing loan *(if refinancing)*	
Amount of new loan	
Amount to be paid to the United States *(6325(d)(1) applications only)*	

7. Basis for Subordination: Check the box below that best addresses what you would like the United States to consider in your application for subordination. *(Publication 784 has additional descriptions of the Internal Revenue Code sections listed below.)*

☐ 6325(d)(1) the United States will receive an amount equal to the lien or interest to which the certificate of subordination is issued *(provide amount in Section 6 above)*

☐ 6325(d)(2) the issuance of the certificate of subordination will increase the government's interest and make collection of the tax liability easier. ***(Complete and attach a signed and dated statement describing how the amount the United States may ultimately realize will increase and how collection will be facilitated by the subordination.)***

Statement ☐ Attached ☐ NA

8. Description of property *(For example, 3 bedroom rental house; 2002 Cessna twin engine airplane, serial number AT91900000000X00; etc.):*

Address of real property *(If this is personal property list the address where the property is located)*:

Address *(Number, Street, P.O. Box)*

City	State	ZIP Code

Real Estate:
Legible copy of deed or title showing legal description ☐ Attached ☐ NA

9. Appraisal and Valuations

<u>Appraisal</u>: (Professional appraisal completed by a disinterested third party but it is not required for a subordination)	☐ Attached
<u>OR</u> ONE OF THE FOLLOWING VALUATIONS:	
County valuation of property *(real property)*	☐ Attached
Informal valuation of property by disinterested third party	☐ Attached
Proposed selling price *(for property being sold at auction)*	☐ Attached
Other: ______________________________	☐ Attached

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10. Copy of Federal Tax Lien(s) *(Complete if applicant and taxpayer differ)* ☐ Attached ☐ No

OR list the lien number(s) found near the top right corner on the lien document(s) *(if known)*

11. Copy of the proposed loan agreement *(if available)* ☐ Attached ☐ No

AND

Describe how subordination is in the best interests of the United States:

12. Copy of a current title report *(required for subordination)* ☐ Attached ☐ No

OR

List encumbrances with seniority over the Federal Tax Lien. Include name and address of the holder; description of the encumbrance, e.g., mortgage, state lien, etc.; date of agreement; original loan amount and interest rate; amount due at time of application; and family relationship, if applicable. Include any home equity line of credit (HELOCs) advances beginning the 46th day after the NFTL was filed, through the date you submit your application, and include expected advances through the date the certificate will be issued. ***(Attach additional sheets as needed)***:

13. Copy of proposed closing statement ***(aka HUD-1)*** ☐ Attached ☐ No

OR

Itemize all proposed costs, commissions, and expenses of any transfer or sale associated with property ***(Attach additional sheets as needed):***

14. Additional information that may have a bearing on this request, such as pending litigation, explanations of unusual situations, etc., is attached for consideration ☐ Yes ☐ No

15. Declaration

Under penalties of perjury, I declare that I have examined this application, including any accompanying schedules, exhibits, affidavits, and statements and to the best of my knowledge and belief it is true, correct and complete.

Signature/Title Date

Signature/Title Date

www.irs.gov Form **14134** (Rev. 06-2010)

The Bond

A more cumbersome but equally effective process of accomplishing a lien release is available if the IRS is unwilling to subordinate a lien for some reason. I explain it here. Tom owed the IRS about $50,000, and he decided to sell his vacation condo to pay the IRS. Tom came to terms with a buyer. The only hitch was the tax lien. The closing company made it clear that unless the lien was removed, the sale would not close.

Tom took his case to the RO who filed the lien. Tom logically suggested that if the IRS released the lien and permitted the sale to close, it would receive full payment out of the proceeds. But equity or no equity, the RO would not release the lien without full payment. Historically, what happened under these circumstances is that after killing a sale, the IRS would seize the property and then sell it for a fraction of what the agency would have realized had it simply permitted the sale to close in the first place. The result is the owner loses all his equity and ironically, the IRS receives but a fraction in payment. However, the collection appeal procedures discussed throughout this book can prevent that from happening.

Given the fact that Tom had significant equity in the condo, I recommended he provide the IRS with a bond. If accepted, it leads to release of the lien. Code section 6325(a)(2) authorizes the IRS to release a tax lien within thirty days after being provided with a bond for the tax and interest. We contacted a local bonding company to write the bond. After paying the fee, the company issued a bond meeting IRS requirements. To be valid, the bond must provide for full payment within six months prior to the expiration of the collection statute of limitations. Chapter 10 explains how to calculate the collection statute expiration date.

At last check, the IRS has no form for preparing the bond. Your revenue officer can provide the information you need. The bond is completed by the citizen or his bonding company and signed by both. For general information, see IRS Publication 1450, *Instructions on How to Request Release of Federal Tax Lien*.

The bond enabled Tom to guarantee that the sale of his condo would not be killed by the tax lien, and it took the condo out of the grasp of the IRS. Tom was thus able to pay his taxes with the least amount of financial harm.

Property Double the Amount of the Liability

The lien need not identify a particular parcel of property. It is a "general" lien, attaching to "all property and rights to property." Because of the all-inclusive nature of the tax lien, the IRS regularly ties up property significantly greater in value than the liability. Code section 6325(b) provides a remedy to that.

Suppose, for example, you own three separate properties. The first is your principle residence where you live, and the other two are rental properties. Assume your home is paid for and worth $100,000. Each rental property is worth $75,000 but the bank has a first mortgage on each unit equal to $25,000. Based upon all of this, your net worth (assuming no other assets or liabilities) is $200,000.

Now assume you owe the IRS $25,000. The IRS filed a lien and because of it, the bank will not make a loan. The negotiation goal is to persuade the IRS to withdraw its lien from the homestead. This allows the bank to make a loan of $25,000 to pay the tax. Full payment releases the remaining properties from the lien. Under code section 6325(b)(1), the IRS may discharge a portion of property from a lien when:

> *"the fair market value of that part of the property remaining subject to the lien is at least double the sum of the amount of the unsatisfied liability secured by the lien and of the amount of all other liens upon the property which have priority over the lien."*

Under our example, we have three parcels of property. The combined fair market value (what a willing buyer would pay a willing seller) is $250,000. The prior liens for the bank mortgages equal $50,000 (two mortgages at $25,000 each). Now add the value of the unsatisfied tax liability ($25,000) to the amount of the prior liens ($50,000). The sum is $75,000.

Before the IRS withdraws the lien on the homestead, you must demonstrate that the fair market value of the remaining properties (the two rental homes) is at least twice the amount of $75,000 (the sum of the tax liability and the two prior mortgages). In this example, the combined fair market value of the rental properties is $150,000 ($75,000 each). That is "at least double" the value of all liens in question.

To win withdrawal of the lien, present the RO, or if your case is on appeal, the settlement officer, with the accounting necessary to demonstrate these calculations. This move allows a person to obtain financing to pay the tax. In turn, it prevents the IRS from selling any property at a fraction of its worth. Your presentation should be in writing, fashioned after the "subordination" outlined above. There is no IRS form covering this procedure.

The "Quiet Title" Action

A quiet title action is a suit in federal district court that seeks to settle the question of property ownership. The action is usually brought when one party disputes another's claim of ownership interest in real property. By filing a tax lien against real estate, the IRS effectively claims an ownership interest in the property to the extent of its lien. A quiet title action can sometimes clear the lien.

Doug underwent an audit in which the IRS disallowed several of his deductions. He ended up paying the tax and believed the matter was closed. Over two years later, however, he began receiving collection notices. They stated that the tax liability was not paid and Doug owed $25,000. Knowing the tax was paid and confident that someone merely overlooked this fact, Doug sent a pleasant letter to the IRS pointing this out. For convenience, he enclosed copies of his canceled checks. A few months later, he received another letter. Like the first, it stated that he owed taxes and they better be paid. This time, Doug got on the phone.

He was able to persuade someone to recognize that, yes, an error was made. If he would just send another copy of his canceled checks, the discrepancy could be rectified. Doug again mailed copies of the canceled checks with a cover letter reciting the details of the conversation. About a month later, he received *another* threatening notice and then, much to his bewilderment, IRS filed a lien. It came at just the time he was attempting to sell his house.

Frustrated, Doug turned to the federal courts for help. A little-known federal law contained in the United States code of civil procedure authorizes one to sue the United States if the purpose of the suit is to "quiet title to...real estate or personal property on which the United States has or claims a mortgage or other lien." 28 U.S.C. §2410. When circumstances are ripe, the quiet title statute is an effective way to force the IRS to settle the issue of a tax lien.

The specific procedures for filing a quiet title action are set forth in Chapter 10, *Taxpayers' Defense Manual*. An important point is that before suing the IRS, one must first pursue and exhaust all administrative remedies. One key administrative remedy is the right to "appeal" the filing of a tax lien, which I examine later in this chapter.

After filing suit, the attorney assigned to the case contacted Doug and discussions began. Doug provided proof that his tax liability was paid. The attorney then agreed to order the IRS to lift the lien if Doug would drop his suit. Doug agreed, and thus obtained a certificate of release of federal tax lien, which he carried to the courthouse and filed.

Expiration of the Lien

In Chapter 10, I explain the law regarding the collection statute of limitations. In general, the IRS has just ten years from the date a tax is assessed in which to collect it. Thereafter, unless the statute is extended by one or more of the methods outlined in Chapter 10, the tax is unenforceable. Treasury Regulation section 301.6325-1(a) provides that the IRS must release its lien when "the entire tax liability listed in such notice of Federal tax lien has been fully satisfied...or has become legally unenforceable."

The above regulation provides that when requesting a release of lien, your written request must,

1. Be sent to the IRS office that filed the lien,
2. State the name and address of the person making the request,
3. Include a copy of the lien in question,
4. State "the grounds upon which the release is sought," and
5. Contain a declaration made under the penalty of perjury that the facts in the application are "true and correct in all respects."

There is no IRS form for this application. However, I provide an example of an application in the *Taxpayers' Defense Manual*. File it with the IRS at the appropriate address show in Publication 4235. As with all submissions, mail it to the IRS using certified mail with return receipt requested.

Failure to Release a Lien

The ultimate responsibility for obtaining a lien release rests on your shoulders. You must make the application or the IRS is not likely to remove the lien. This is true even if the tax is paid and even if the collection statute has expired. If an application is not made, there is nothing to suggest that the IRS will voluntarily release the lien. However, if the IRS fails to release an improper lien, turn to code section 7432. It allows you to sue the United States when the IRS "knowingly, or by reason of negligence, fails to release a lien." The statute allows the citizen to recover the actual, direct damages sustained as a result of the lien, plus the costs of the action. Chapter 10 of the Defense Manual guides one through this process.

The Lien Appeal

Code section 6326 authorizes an administrative appeal of "the imposition of a lien." Do not confuse this process with the Collection Due Process lien appeal under code section 6320. The lien appeal process described here is limited in scope, as explained below. On the other hand, the CDP lien appeal allows you to challenge the filing of a tax lien on "any appropriate ground." See the discussion of the CDP appeal in Chapter 5.

The key limitation with a CDP lien appeal (Chapter 5) is procedural, in that it must be executed within thirty days of receiving Letter 3172. After that, you have no right to a CDP appeal. However, an appeal under section 6326 can be filed within one year after you become "aware of the erroneously filed lien," as explained below.

The circumstances under which one may execute an appeal under section 6326 are:

1. The tax liability that gave rise to the lien was paid in full prior to its filing,
2. The tax liability was assessed in violation of the deficiency procedures,
3. The tax liability was assessed in violation of Title 11 of the United States Code (the Bankruptcy Code), or
4. The collection statute of limitations expired prior to filing the lien. See Treas. Reg. §301.6326-1(b).

The lien appeal must include:

1. The name, current address, and Social Security number of the person appealing the lien,
2. A copy of the Notice of Lien in question, and
3. A clear and concise statement of the grounds upon which the lien is appealed. Treas. Reg. §301.6326-1(d)(2).

If the lien is appealed on the ground that the tax liability was satisfied prior to the lien's filing, you must provide proof of payment in one of the following forms:

1. An IRS receipt showing full payment of the tax prior to the date of the lien filing,
2. A canceled check to the IRS in an amount sufficient to satisfy the tax, or
3. Any other documents proving that you paid, such as evidence of an electronic funds transfer to the IRS. See Treas. Reg. §301.6326-1(e).

If you argue that filing the lien is in violation of the deficiency procedures (code section 6213), explain how the assessment is erroneous. Detailed guidance on the deficiency procedures is set forth in the *Taxpayers' Defense Manual*, Chapters 8 and 9.

If you argue that the lien is in violation of the Bankruptcy Code, you must provide,

1. The specific bankruptcy court your petition was filed in, and
2. The docket number and the date of filing the petition. Treas. Reg. §301.6326-1(d)(2)(C).

The appeal must be filed within one year after you "become aware of the erroneously filed tax lien." Treas. Reg. §301.6326-1(d)(2)(C)(3). Note this language carefully. The one-year rule does not start with the date of *filing* the lien. It begins with the date you become *aware* of it. Exercising the right of lien appeal is a necessary prerequisite to filing suit and obtaining damages under code section 7432. For more details on the lien appeal, a sample lien appeal form, and how to file suit for failure to release the lien, see the *Defense Manual*, Chapter 10.

Proving Your Case

Never forget that you have the burden of proof in any civil situation with the IRS. This applies fully when you seek lien relief, especially in CDP cases. The IRS does not have to prove you are *not* entitled to lien (or levy) relief. Rather, you must prove that you *are* entitled to the relief you seek. The IRS generally does nothing more than "play goalie," finding (or creating) reasons to kick away your proposals rather than finding reasons to accept them.

For this reason, it is useful to examine a Tax Court case in which a taxpayer was successful in obtaining lien relief in the context of a CDP hearing. The case is *Alessio Azzari, Inc. v. Commissioner*, 136 T.C. 178 (2011). Alessio Azzari, Inc. was a home construction company ravaged by the recession. Alessio was behind on employment taxes for several periods during 2005 and 2006. In January 2007, Alessio obtained a revolving line of credit from a bank that gave Alessio access to up to $1 million. The line of credit was secured by Alessio's accounts receivable and certain other assets.

Alessio used the line of credit to begin making payments on the delinquent taxes and to stay current on employment taxes going forward. But in November 2007, the IRS filed a tax lien against Alessio. Once the bank became aware of the lien, it pulled Alessio's line of credit. Without the line of credit, Alessio would not be able to stay current going forward because of the fact that its own customers lagged behind on the money they owed to Alessio. The bank was willing to restore the line of credit, but only if the IRS would subordinate its lien to the bank's claim, giving the bank first claim to Alessio's receivables and other assets.

In response to the lien filing, Alessio submitted Form 12153, *Request for Collection Due Process Hearing*, to the IRS seeking: 1) subordination of the tax lien to the bank's claim against the receivables, and 2) an installment agreement on the delinquent taxes. Ultimately, Alessio prevailed in its appeal due to the nature of the evidence it provided. What we learn from the case is instructive in any lien situation.

Consider the following elements of proof the company offered.

1. Alessio presented two different cash flow projections to the settlement officer. The first showed the negative financial consequences that would result if the lien was not subordinated, and the second showed the positive financial outcome if the lien was subordinated. From these projections, Alessio argued that lien subordination would "facilitate collection of the tax." Even in the case of an individual, you should present projections of how your situation—and therefore ability to pay—will be improved by the IRS removing its lien.
2. Alessio presented data to show that they could remain current going forward. Specifically, they showed that: a) they cut payroll substantially by laying off employees, b) they implemented specific cost-cutting strategies in other areas, and c) they moved their business into areas other than the depressed new home construction market. Staying current is vital for all taxpayers, and showing that you can do so must be part of your presentation.
3. Allesio provided documentation from the bank showing that: a) the bank terminated the line of credit only because of the federal tax lien, and b) the bank would indeed reinstate the line if the lien was subordinated. Definitive evidence of the damage the lien will do (or is doing) is vital.
4. Allesio provided a specific plan to show how the *current taxes* were to be paid going forward.
5. Allesio provided a specific installment agreement plan with all supporting financial information to pay the *delinquent taxes*.
6. Finally and notably, Alessio made its proposals to the settlement officer in writing. This is important because there is no formal record made of any discussions you have with the IRS, including those that take place in a CDP hearing. Submitting your proposals and material in writing is especially important in CDP cases because without documentation, it is hard to prove to the Tax Court exactly what you presented to support your case.

Releasing Wage and Bank Levies

Code section 6343 provides the primary authority for releasing a levy or property seizure for any one or more of the following five reasons:

1. The tax liability is satisfied or is unenforceable because the collection statute of limitations expired,
2. Release of the levy will facilitate collection,
3. You entered into an installment agreement, unless the agreement specifically allows for the seizure,

4. The levy is creating an economic hardship due to your financial condition, or
5. The fair market value of the property exceeds the liability, and release of the levy on a part of the property will not hinder collection.

Let us analyze these factors in more detail.

Installment Agreement in Effect

An approved installment agreement prohibits any levy, whether on a bank account or any other property. However, the IRS routinely issues levies shortly after it has approved an installment agreement simply because the agency often fails to put the appropriate freeze codes on the computer. Such action is clearly not legal unless the agreement expressly provides for the levy, which is highly unlikely. This law gives you the right to have such a levy removed and the seized property returned, as discussed below.

However, this levy proscription does not apply to the levy of federal or state tax refunds. Thus, the IRS will intercept (offset) your refunds, even in the face of an approved installment agreement. In the case of state tax refunds, the IRS must first issue a notice that it intends to levy your state refund. It does so with notice CP504. See Exhibit 4-3. Given that, you may receive a CP504 even though you have an approved installment agreement.

Economic Hardship

It is not difficult to imagine how wage and bank levies cause "economic hardship." When the IRS enforces collection, it often places one into a position of having to choose between paying his taxes and feeding his family. In fact, levies are just the kind of action that drives people underground.

To show economic hardship, you must provide the IRS with financial information, either in writing or by telephone, exactly as outlined in Chapter 5. Given the immediacy of an actual levy, I would call ACS or your RO (whoever issued the levy) to explain that the levy will cause hardship by making it impossible to pay necessary living expenses. Following the guidelines set forth in Chapter 5, illustrate exactly how the levy is causing hardship. It is not enough to make the bare allegation of hardship. You must give examples, such as you are unable to make a mortgage or auto payment, or you have several outstanding checks that will bounce, thereby destroying your good standing with merchants and creditors. Show your fixed monthly living expenses and the amount you are left with after the levy. Argue that because of the levy, you risk the loss of your home, auto, health insurance, etc.

As I explain in Chapter 5, the IRS evaluates your living expenses in light of its fixed standards and generally attempts to squeeze as much from you as possible. In addition to the law and Internal Revenue Manual parts that I describe in detail in Chapter 5, Treasury Regulation section 301.6343-1(b)(4)(ii)(A)-(F), provides even more help in pushing the IRS to allow your actual expenses as a means of establishing hardship in connection with a levy. That regulation provides that the IRS must take into consideration the following information for purposes of determining the extent to which a person's living expenses are "reasonable:"

1. Your age, employment status and history, ability to earn income, and the number of dependents,
2. The amount reasonably necessary for food, clothing, housing (including utilities, home-owner insurance, home-owner dues, etc.), medical expenses including health insurance, transportation, current tax payments (including federal, state, and local), alimony, child support, or other court-ordered payments, and expenses necessary to produce income (such as dues for a trade union or professional organization, or child care payments that allow you to be gainfully employed),
3. The cost of living in the geographic area where you live,
4. The amount of property exempt from levy that is available to pay your living expenses,
5. Any extraordinary circumstances such as special education expenses, a medical catastrophe, or natural disaster, and
6. "Any other factor that the taxpayer claims bears on economic hardship and brings to the attention" of the IRS. Treas. Reg. §301.6343-1(b)(4)(ii)(A)-(F).

Make a specific and clear request that the levy be lifted immediately. Keep in mind that if you withhold information regarding your financial status and ability to pay, you will at least delay the process. More likely, your request to release the levy will simply be denied. Consistent with this observation, IRS regulations require that you act in good faith. See Treas. Reg. §301.6343-1(b)(4)(iii). Examples of failure to act in good faith include (but are not limited to) falsifying financial information, inflating actual expenses or costs, and failing to disclose assets. Therefore, do not withhold information or misstate your financial condition and expect the IRS to release the levy.

Use exactly the same procedure for dealing with bank levies. When the IRS issues a bank levy, the agency does not immediately take possession of the funds. The funds are frozen but remain in the account for twenty-one days. This holding period allows you to take action as outlined here, before losing the money. Moreover, unlike wage levies, bank levies are a one-time levy. That is to say, they are effective to reach the money in the account *only* on the day the levy hits the account. For example, if you have $100 in the account the day the levy is issued, the levy is effective only against that $100, even if your payroll check is deposited electronically the next day. Wage levies, on the other hand, continue indefinitely until either the tax is paid, or they are specifically released.

In connection with a bank levy, illustrate that the freeze on your account may cause outstanding checks to bounce, in turn ruining your good standing with creditors. I would make a list of all outstanding checks, including whom they were issued to, and why the expense is necessary. Also, argue that the lack of funds makes it impossible to pay necessary living expenses or business operating expenses that are ripe for payment. Have a list of these expenses available as well.

Have a fax number for your employer's payroll department or your bank on hand when you phone the IRS. Push either ACS or your revenue office to fax a *Release of Levy* (IRS Form 668-D) directly to both you and your employer or bank. Form 668-D is shown here as Exhibit 6-3.

If you cannot get an agreement to release the levy, ask to speak with a manager and then handle that conversation as outlined in Chapter 5. If you cannot come to terms with a manager, you have the right to an administrative appeal known as a CAP appeal. You can also turn to the Office of the Taxpayer Advocate in emergency situations. I discuss both options in Chapter 7.

Facilitate Collection of the Liability

Code section 6343 uses the broad, undefined phrase "facilitate the collection of the liability" as a potential reason for releasing a levy. This general language invites any reasonable argument to remove the levy when it can be shown that the IRS's action is likely to do more harm than good. IRS regulations give some idea of just how broad this remedy may be. Treasury Regulation section 301.6343-1(b)(2) provides:

> *"A director has the discretion to release the levy in **all situations**, including those where the proceeds from the sale will not fully satisfy the tax liabilities of the taxpayer, under terms and conditions as he or she determines are warranted."*
> (Emphasis added by author.)

To win a release under this section, show that the IRS's action will make full payment more difficult. The following scenario provides an example of how a release might facilitate collection.

Suppose you are an independent contractor doing business with several customers. The IRS issues levy notices to all your customers. Afterward, your customers make it clear that they will not continue doing business with you if they must contend with the IRS in the process. You risk losing your primary source of income and hence, your means of paying the tax and supporting your family. By releasing the levies, the IRS ensures that your customers do not abandon you. This enables you to structure and fund a plan to pay off your debt and stay alive (and current) at the same time.

Some companies have written policies stating that wage levies will lead to termination. Certainly the loss of one's job constitutes economic hardship and destroys your capacity to pay. Collection of the tax is clearly "facilitated" by removing that wage levy.

Exhibit 6-3 – IRS Form 668-D

Form **668-D** (Rev. April 2012) | Department of the Treasury - Internal Revenue Service

Release of Levy/Release of Property from Levy

To

[redacted]

Taxpayer(s)

[redacted]

Identifying Number(s)

[redacted]

A notice of levy was served on you and demand was made for the surrender of:

☐ all property, rights to property, money, credits and bank deposits of the taxpayer(s) named above, except as provided in 6332(c) of the Internal Revenue Code--"Special Rule For Banks." See Page 2 regarding this exception.

☒ wages, salary and other income, now owed to or becoming payable to the taxpayer(s) named above.

The box checked below applies to the levy we served on you.

Release of Levy

☐ Under the provisions of Internal Revenue Code section 6343, all property, rights to property, money, credits, and bank deposits of the taxpayer(s) named above are released from the levy.

☒ Under the provisions of Internal Revenue Code section 6343, all wages, salary and other Income now owed to or becoming payable to the taxpayer(s) named above are released from the levy.

Release of Property from Levy

☐ Under the provisions of Internal Revenue Code section 6343, all property, rights to property, money, credits, and bank deposits greater than are released from the levy. The levy now attaches only to this amount.

☐ Under the provision of Internal Revenue Code section 6343, all property, rights to property, money, credits, and bank deposits up to the amount of _ are released from the levy. The levy continues to attached to all amounts greater than_.

☐ The last payment we received from you was dated_. The amount the taxpayer still owes is . When this amount is paid to the Internal Revenue Service, the levy is released. If you sent us a payment after the last payment date shown, subtract that from the amount you send now.

☐ Under the provisions of Internal Revenue Code section 6343, all wages, salary and other income ☐ greater than ☐ less than each now owed to or becoming payable to the taxpayer(s) named above are released from the levy.

Dated at WEST PALM BEACH, FL (Place) May 29, 2014 (Date)

Signature	Telephone Number	Title
[redacted]	[redacted]	REVENUE OFFICER

Part 1 - To Addressee Form 668-D (DO/CG) (Rev. 4-2012)

The Fair Market Value of Property

Code section 6343 also talks about releasing a levy when the fair market value of the property seized exceeds the tax debt. In that case, the IRS must release so much of the property as exceeds the debt. The IRS gives this factual example in Treasury Regulation section 301.6343-1(b)(5):

> *"The Internal Revenue Service levies upon ten widgets which belong to the taxpayer to satisfy the taxpayer's outstanding tax liabilities. Subsequent to the levy, the taxpayer establishes that market conditions have increased the aggregate fair market value of widgets so that the value of seven widgets equals the aggregate anticipated expenses of sale*

> *and seizure and the tax liabilities for which the levy was made. The director must release three widgets from the levy and return them to the taxpayer."*

Also note that code section 6331(f) expressly prohibits the levy of any asset that has no equity. Suppose your vehicle is worth $5,000 but you have a bank loan on the car for at least that much. You have no equity in the car and the bank's security interest is ahead of the IRS's. If the IRS were to sell the asset, only the bank would get paid and there would be no proceeds to apply to the tax debt. Under the circumstances, seizure of the asset is purely punitive, and therefore, illegal.

In your written request for release of levy, provide the facts and information needed to establish the value of the property in question and any security claims against it, such as bank mortgages.

Levy Release and Non-filers

It is not uncommon for the IRS to issue wage and bank levies to non-filers. In fact, this is a common way the IRS wins the attention of non-filers, since they often ignore other IRS correspondence. When non-filers contact the IRS for a release of levy, the agency often explains that an installment agreement is unavailable until all delinquent returns are filed and estimated tax payments are made current. Said another way, the IRS says it will not release the levy before you cure all the delinquencies. This presents a serious problem if you have a substantial number of unfiled returns. How will a person be able to survive with a wage levy in effect if it will take months to complete a series of delinquent returns? And how will you make payment of current taxes if your money is taken for the back taxes?

The IRS is misleading at best when it causes non-filers to believe they cannot get levy relief until after filing delinquent returns and getting current with estimated payments. It is true that one must be current with return filing and estimated payments before the IRS will establish an installment agreement. Code section 6159 and the various IRM provisions discussed in Chapter 5 are clear on that. However, the release of levies is controlled by code section 6343, not code section 6159.

Section 6343, as explained above, expressly provides that the IRS "shall release the levy" that "is creating an economic hardship due to the financial condition of the taxpayer." IRC §6343(a)(1)(D). This is a clear statutory mandate to release a levy *as a matter of law* if the taxpayer is suffering hardship because of it. There are no other conditions on this release but that you prove the hardship claim. The hardship determination is based upon your income and expenses, as well as the other factors bearing on the question of hardship, each of which I discussed at length earlier. A hardship determination has nothing whatsoever to do with whether you have unfiled tax returns.

In the case of *Vinatieri v. Commissioner*, 133 T.C. 392 (2009), the Tax Court made it perfectly clear that my reading of the statute is correct. That case involved a Collection Due Process appeal by a taxpayer who argued in her hearing that she should be granted uncollectible status. She proved that levies would cause hardship, and that she had no capacity to make an installment payment. The IRS's settlement officer ruled that she was not entitled to uncollectible status because she had several unfiled returns and was not current with estimated payments.

The Tax Court examined the statutes, regulations, the IRM, and court decisions controlling the matter. The Court said:

> *"We have found no cases addressing the requirement that the taxpayer be current with filing returns in a levy case involving economic hardship under section 6343(a)(1)(D) and section 301.6343-1(b)(4), Treas. Regs. Neither section 6343 nor the regulations condition a release of a levy that is creating an economic hardship on the taxpayer's compliance with filing and payment requirements."*

Thus, it is simply not true that a taxpayer must be current in order to have a levy released. If you are unable to communicate this fact to your RO or the ACS representative you talk with, you must take the issue to a manager. In a CDP case, you have the right to a Tax Court appeal if you cannot resolve the case amicably.

Return of Seized Property

In addition to authorizing a release of levy, section 6343(b) allows the IRS to return property (including money) that was already taken. The property can be returned if the IRS determines:

1. The levy was premature or otherwise not in accordance with IRS's administrative procedures,
2. The citizen entered into an installment agreement, unless the agreement provides otherwise,
3. Return of the property will facilitate collection of the tax, or
4. With the consent of the taxpayer or the Taxpayer Advocate (see Chapter 7), return of the property would be in the best interests of the citizen (as determined by the Taxpayer Advocate) and the United States. See IRC §6343(d).

This statute contains the broad and undefined use of the phrases "facilitate tax collection" and "the best interests" of the citizen and the IRS as determined by the TA. As we discussed earlier, this provides an invitation to use creative, logical arguments to win return of property the IRS levied. For example, I had a client who suffered a bank levy that took $20,000 in cash. My client just started a new business and faced substantial cash demands to fund the business. We argued that it was imperative for the IRS to refund the cash. Otherwise, the client would be unable to make the business profitable. The RO did not buy the argument, but I took the matter to her manager. I was able to persuade the manager that the IRS's best hope of collecting the delinquent tax in the future was to refund the cash and allow the taxpayer to work his business. I was able to recover all $20,000.

A Written Request for Release of Levy or Return of Property

You should begin levy release discussions verbally (either with your RO or with ACS as discussed in Chapter 5). However, unless you get immediate relief, be prepared to submit a written request for release of levy. With respect to seeking the return of levied property, that should be done in writing, in addition to any verbal efforts you make.

To make a request for release of levy or return of seized property under section 6343, submit a letter that contains, at a minimum, the following:

1. Your name, address, and Social Security number or TIN,
2. A description of the levied property,
3. The type of tax and the periods in question,
4. The date of the levy and the IRS office that issued it,
5. A clear and concise statement of the grounds that support your position, including copies of documents to support your arguments, and
6. A statement above your signature declaring under penalty of perjury that the facts presented are true and correct in all respects. See Treas. Reg. §301.6343-1(c)(1). There is no specific IRS form for making this request. Therefore, do it in letter form and submit it as quickly as possible.

If the property levied upon is personal property "essential" to carrying on your business, your request for release of levy should so state. At code section 6343(a)(2), the law declares,

In the case of any tangible personal property essential in carrying on the trade or business of the taxpayer, the Secretary shall provide for an expedited determination…if levy on such tangible personal property would prevent the taxpayer from carrying on such trade or business.

In your request for release, describe the specific property taken, its relationship to the operation of your business, and how being deprived of such property prevents you from doing business. The expedited review and response to the request for release of business property must occur within ten days of making the request. Treas. Reg. §301.6343-1(d)(1).

Using the Taxpayer Advocate

If your request for either release of levy or return of levied property is not successful, take the issue to the Office of the Taxpayer Advocate (TA). Use the same type of letter, stating your case clearly and using specific examples and statutory references to buttress your claims. Provide a copy of your initial request and explain that the IRS has failed and refused to correct the damaging assault on your financial life. Ask the TA for specific relief in the form of removing the levy and establishing a reasonable installment agreement or uncollectible status. See Chapter 7 for more details on the TA. You can also use a CAP appeal in emergency situations. I discuss that process in Chapter 7 also.

Coping with Property Seizures

Property seizures include real estate, automobiles, business equipment and inventory, and personal property of every description. While there are certain amounts and classes of property exempt from levy (which I identified in Chapter 4, under the heading, *Property Exempt From Levy and Seizure*), you face the risk that any property you own outright or in which you have an ownership interest may be seized. This means you must understand how to neutralize the impact of seizures. This starts with understanding the guidelines the IRS must follow before seizing property. I review them here.

Property Seizure Guidelines

The seizure of property is never to be considered the solution of first resort. Such action is to be the last resort only, and executed only after "thorough consideration of all the factors and of alternative collection methods." See IRS Policy Statement 5-34; IRM part 1.2.14.1.8(1). In particular, revenue officers are given the following key instructions:

> *"The facts of a case and alternative collection methods must be thoroughly considered before determining seizure of personal or business assets is appropriate. Taxpayer rights must be respected. The taxpayer's plan to resolve past due taxes while staying current with all future taxes will be considered. Opposing considerations must be carefully weighed, and the official responsible for making the decision to seize must be satisfied that other efforts have been made to collect the delinquent taxes without seizing. Alternatives to seizure and sale action may include an installment agreement, offer in compromise, notice of levy, or lien foreclosure. Seizure action is usually the last option in the collection process."* (IRM part 1.2.14.1.8(2))

In guiding ROs in the decision making process, IRM part 5.10.1.6 sketches out the profiles of three different taxpayers. They are: 1) those who will pay the tax but need time, 2) those who cannot pay in full, and 3) those who simply will not pay. The IRM provides illustrations of each category of person.

Under IRM part 5.10.1.6(1), the IRS must not resort to levy action in cases where the citizen will pay the tax but needs time, or in cases where the citizen cannot pay in full. Such persons include those who:

- Do not agree with the assessment and are working with the IRS to properly adjust their account,
- Will full pay their liability within a reasonable time,
- Require reasonable time to sell an asset or secure a loan,
- Qualify for and submit an offer in compromise,
- Have no ability to make payments and have no equity in assets (currently not collectible), or
- Request and qualify for an installment agreement.
- IRM part 5.10.1.6(2) defines those "who won't pay" as those who:
- Have the ability to remain current and resolve their delinquent taxes through an alternative collection method but will not do so,
- Cannot remain current and resolve their liability, but who have assets in excess of exempt amounts (see Chapter 4) that will yield net proceeds but are unwilling or unable to borrow against or liquidate these assets,
- Are pyramiding liabilities,
- Use tax protester arguments and continue to resist the requirements to file and pay,
- Will not cooperate with the IRS (they evade contact or will not provide financial information),
- Will not comply with the results of the IRS's financial analysis or will not enter into an installment agreement or OIC,

- Are wage earners who have not paid their tax liability and will not adjust their withholding to prevent future delinquencies,
- Are self-employed, have not paid their tax liability and will not make estimated payments to prevent future delinquencies, and
- Do not meet their commitments (without a valid reason) as set forth by an installment agreement, OIC, or extension of time to pay.

Even in the case of those who will not pay, an RO may not seize assets unless the required Final Notice has been mailed, as discussed in Chapter 4. Moreover, all other alternatives must have been considered. If you provide a specific plan for "alternative collection methods," this must be considered and if reasonable, pursued. But the IRS will not create such a plan for you, nor even suggest the idea. You must do so.

To this end, I offer the following strategies for dealing with property levies and seizures.

Your Principal Residence

Revenue officers routinely threaten to seize your home as a means of enforcing collection. Normally, this is an entirely hollow threat, since a home is generally exempt from administrative seizure in the first place. Not only would an RO have to determine that you "won't pay," but the seizure would have to be authorized by a federal court. Recall that we discussed this in Chapter 4, under the heading, *Property Exempt From Levy and Seizure*.

The Minimum Bid Worksheet

The IRS's minimum bid worksheet is submitted to the citizen after property is seized but before it is sold. It communicates the figures used to calculate the minimum amount the IRS will accept when selling it. You have five days to object to the minimum bid price. Look at it carefully, because the IRS sometimes accepts ridiculously low bids. For example, Don's real estate was seized by the IRS and was about to be sold. Though the market value of the property was about $85,000, the minimum bid worksheet revealed that the IRS planned to offer the property for just over $2,000 (that is not a misprint).

Within the five-day period, we responded to that worksheet by pointing out exactly how the minimum bid was both grossly understated, and that increasing the minimum bid would only serve to "facilitate tax collection." The letter caused the RO to re-compute the minimum bid, raising it substantially. This benefited Don in a number of ways. First, with the substantially higher minimum bid price, the chances of selling the property were greatly diminished. The higher the price of an item, the fewer buyers there are willing and able to purchase it.

More importantly, the RO was forced to postpone the original sale date. This allowed Don the time he needed to maneuver into position to keep the IRS from selling the property altogether. See Chapter 13.

The Lawsuit for Injunction

In certain circumstances, where you have lost your appeals rights and the IRS is threatening enforced collection, one method of stopping property seizures is to sue the IRS in federal district court, and as part of that process, apply for an injunction preventing the seizure. However, this route poses a special problem due to a federal law preventing many such suits.

Code section 7421 is known as the anti-injunction act. It generally deprives federal courts of jurisdiction to stop the IRS. However, there is one little known and even less understood exception to that rule. The exception is based upon the Supreme Court case of *Commissioner v. Shapiro*, 424 U.S. 614 (1976).

Under *Shapiro*, when an assessment is arbitrary and erroneous and the citizen can demonstrate that, 1) collection of the tax will cause irreparable harm, and 2) no adequate remedy exists to prevent the harm, a court can enjoin collection despite section 7421. For greater detail on this process, including forms for carrying it out, see the *Taxpayers' Defense Manual*, Chapters 8, 9, and 12.

When you show that a tax assessment is both arbitrary and erroneous, it is no longer considered a "tax" subject to section 7421. Rather, it is considered an "exaction in the guise of a tax." *Miller v. Standard Nut Margarine Co.*, 248 U.S. 498 (1932). If the IRS cannot support its assessment with facts sufficient to establish the substantial likelihood that you in fact owe it, a court may decree that the tax is "arbitrary and erroneous." See the *Defense Manual* for more details.

The Separate Interest

Very often, property is owned jointly by a husband and wife. It is also common for one spouse, say, the husband, to owe taxes but not the wife. Despite the fact that the wife may not owe taxes, the Supreme Court has ruled that a court can allow the IRS to sell joint property to liquidate the sole debtor's interest. *United States v. Rogers*, 461 U.S. 677 (1983). Note, however, that if both spouses sign a joint return for the delinquent year, the debt is jointly owed, so the IRS can collect from assets owned by either or both parties, even if only one earned the income. The exception to this is where one spouse is considered an "innocent spouse" under either code section 6015 or 63(c). For more on the innocent spouse, see the discussion below.

While it is true that the property may be sold (but only on the order of a court), the non-debtor spouse must be compensated for her interest. This means simply that the non-debtor must be treated as if she holds a lien against the property equal to half its equity.

The IRS invariably overlooks this minor detail. You learn of its intentions by reviewing the minimum bid worksheet. If the IRS proposes to sell any more than a one-half interest in the property, assume it does not intend to consider the ownership interest of the non-debtor spouse. The "wrongful levy statute" provides a remedy to this problem. Code section 7426 allows a person to enjoin a levy or sale if the IRS proposes to overlook the ownership interests of a non-debtor.

Margaret filed such a suit in the district court in Chicago. Her husband owed thousands of dollars in taxes and the IRS seized the couple's jointly-owned rental property with the intention of selling it. In her suit, Margaret established her ownership interest by presenting the court with copies of the deed of title. In its order, the court instructed the IRS to restructure its sale to protect Margaret's interest.

The law generally requires that one exhaust "administrative remedies" before suing the IRS. In Chapter 12 of the *Taxpayers' Defense Manual*, I take you through both the process of filing an administrative claim for release of wrongfully levied property, and the process of filing a suit under section 7426.

It is important to note that in the case of *United States v. Rogers*, the Supreme Court ruled that courts possess the power to *prevent* the sale of one's principle residence under certain circumstances. The court held that code section 7403 (the statute which authorizes the sale of property) does not "require" the property be sold. Rather, when the non-debtor spouse cannot be adequately compensated with money, a court should prevent the sale entirely. The Supreme Court correctly observed that "money is not always adequate compensation for a roof over one's head."

When you can demonstrate that the non-debtor will be irreparably harmed if the home is sold and that "money's worth compensation" is not adequate to rectify the damage, sale of the home can be prevented. By asserting the separate interest claim under the wrongful levy statute, a non-debtor spouse can be spared the misery of such a great loss.

The Premature Assessment

Assessments are premature if they are not made in accordance with the deficiency procedures under code section 6213. I have talked about these procedures at length. However, the IRS routinely makes premature assessments. Most often, this is done when a citizen fails to file a tax return. Under those conditions, the IRS files for him, using what it calls a "substitute for return" (SFR). Once the SFR is filed and the tax is assessed, collection begins. I discuss SFRs in more detail in Chapter 8.

When an assessment is made in violation of the deficiency procedures, even an SFR assessment, the IRS must both terminate enforcement action, including releasing liens and levies, and it must abate the assessment. If it is convinced that the tax is truly owed, it must follow the deficiency procedures to obtain a valid assessment before resuming enforcement.

Levy on an IRA or 401(k)

Perhaps the single largest and most dangerous misunderstanding about the IRS's levy power is the question of whether it can reach an IRA or 401(k). Ordinary creditors cannot reach these assets since, in order to qualify for favorable tax treatment, the account must meet the requirements of the Employees' Retirement Income Security Act (ERISA). This law requires a so-called "spend-thrift" clause in pension contracts. Simply put, it prevents creditors from attaching retirement funds.

However strong and sound the ERISA safe-guards are vis-à-vis other creditors, *they do not apply to the IRS*. Code section 6334 specifies property exempt from IRS levy. We examined those exemptions in Chapter 4. Code section 6334(c) states:

> *"Notwithstanding any other law of the United States (including section 207 of the Social Security Act), no property or rights to property shall be exempt from levy* ***other than the property specifically made exempt by subsection (a)****."* (Emphasis added by author.)

Subsection (a) of section 6334 *does not* create an exemption for IRAs or 401(k)s. Therefore, these accounts can be *and are* levied by the IRS. And when they are seized, the IRS rubs salt in the wound in a big way. Therefore, preventing seizure of these assets is of paramount importance.

Suppose you owe back taxes of $25,000 and you have $10,000 in an IRA. Now let us suppose the IRS seizes the IRA. When the IRS seizes assets, it has the right to apply the proceeds of the levy in the manner that best suits the IRS. This is so because a seizure is not a "voluntary payment" subject to being "designated" as I explain in Chapter 5. The IRS does not have to take your best interests into consideration and you can be sure *it will not*. Thus, the entire $10,000 is applied to the *back tax* debt.

This does two things. First, it reduces the delinquency by $10,000. However, it also creates a current tax liability equal to about 40 percent of the amount seized. That is because whenever a withdrawal is taken from an IRA or 401(k), you create a liability for both federal and state income taxes in the year of the withdrawal.

"But wait," you say. "I didn't withdraw the money. The IRS took it."

That is true, but the withdrawal operated to your economic benefit because the proceeds reduced *your* tax delinquency. Therefore, *you are* liable for the current federal and state income taxes on $10,000 worth of income—the amount of the withdrawal—in the year the account is seized. That amounts to a current tax bill of about $4,000, which of course is *unfunded* because the IRS applied 100 percent of the money to the delinquency.

As a result, you lose about *140 percent* of the value of your IRA. One hundred percent of the proceeds (the cash value of $10,000) are applied to back taxes, and about 40 percent more (the current tax obligation) becomes an unfunded debt in the year the money is levied. And, the IRS looks to *you* for payment. The only good news in this scenario is that under code section 72(t)(2), the IRS cannot hit you with the 10 percent "early withdrawal" penalty on the distribution.

It takes no economist to realize that such an act creates a substantial economic hardship. Any levy threat on an IRA must be addressed quickly. Argue that such a levy would: 1) create economic hardship in that you will lose your retirement funds, and 2) that it is not in the best interest of either you or the IRS to carry out the levy due to its creating a current, unfunded tax debt. If the IRS in fact levied the IRA, make a quick application for full release based on the points just articulated. At a minimum, you must insist (for what it is worth) that sufficient amounts be applied to current taxes, and be sure to insist that the state income tax be paid in the process. Otherwise, the levy does nothing more than create another set of problems.

It may be that you are best served by taking the money yourself if a levy becomes unavoidable. By doing so, you can provide for payment of the current taxes and the early withdrawal penalty (which will apply if you take the money at a time when you are under 59.5 years of age) through voluntary, estimated payments. These must be honored if they are clearly marked in writing as payments designated to the current year. See our discussion about designating payments in Chapter 5. The balance of the money is then left in your possession. In turn, that can be used to fund an Offer in Compromise (see Chapter 12) or otherwise resolve the debt.

By following this process, you lose 100 percent of your IRA, as opposed to losing 140 percent (or more) if the IRS were to seize it.

The Injured Spouse

One common way the IRS collects delinquent taxes is to seize tax refunds owed for the current year. The process is known as "offset." The IRS offsets the refund against the outstanding tax. A problem arises when the citizen files a joint return and his spouse does not owe the debt.

As stated above, the spouse who does not owe the debt is considered a non-debtor. That spouse is "injured" when her share of the refund is seized to pay a debt (including non-tax debts such as delinquent child support) she does not owe. As an example, a married couple files a joint tax return and is owed a $1,500 refund. However, the husband has a delinquent tax debt for years prior to their marriage. The IRS seizes the entire refund and applies it to the debt. The wife is "injured" by this action to the extent that a portion of the refund belongs to her but she does not owe the debt.

The law provides special remedies for recovering the non-debtor spouse's share of the refund. The first step of the process is to establish that you are an "injured" spouse. To meet this burden, you must prove:

- You do not owe the debt,
- You earned and reported income on the joint tax return,
- You made and reported tax payments on the joint return, and
- You do not live in a community property state.

The rule of law here is simple. While signing a joint income tax return creates a joint tax liability for the year of the joint return, it *does not* create a joint liability for a delinquent debt, nor does it create joint ownership of the overpayment (the amount to be refunded), unless you live in a community property state. In non-community property states, any overpayment must be returned to the person who made it. Only the portion of the overpayment belonging to the debtor can be offset against the delinquency.

The rule is different in community property states. Under community property rules, each spouse has a vested, one-half interest in the property of the other spouse. This includes both wages and other property, including a tax refund. However, state law determines the extent to which community property can be offset for the separate or premarital debts of one spouse.

In Texas, California, Idaho and Louisiana, state law generally allows complete offset. As a result, the IRS does not issue injured spouse refunds to people living in these states. However, the law is different in Arizona, Nevada, New Mexico, Washington and Wisconsin. There, state law provides that community property is not subject to the separate or pre-marital debts of either spouse. As a result, the IRS must issue injured spouse refunds in those states. If you live in a community property state, please check the status of your law before pursuing an injured spouse claim. The question you must answer is whether community property can be used to satisfy the separate or pre-marital debts of one spouse.

To establish the four points outlined above and make the injured spouse claim for refund, use IRS Form 8379, *Injured Spouse Claim and Allocation*. File Form 8379 as soon as the IRS notifies you that the refund is to be offset. Send it via certified mail to the service center where you file your return. As a cautionary measure, you can submit Form 8379 with your joint return *at the time of filing* if you know the IRS will offset the refund. Place Form 8379 on top of Form 1040, and mail the entire package using certified mail, return receipt requested. Note that Form 8379 cannot be e-filed. Therefore, you will have to submit a paper return if you are filing the form with your tax return.

The amount of refund you are entitled to as an injured spouse is based upon your share of the joint income tax liability and the payments you personally made against it. If, for example, your joint tax return shows payments made only through the husband's wage withholding, there will be no injured spouse refund if the husband owes the debt. You face a similar result if the joint return shows income earned only by the husband.

Therefore, to compute your refund, first calculate your income tax liability separately. This process is referred to in Form 8379 as an "allocation." Set forth both the income and deductions which are attributable to either spouse. The income you personally earned must be allocated to you. If you claimed a standard deduction, each spouse is entitled to one-half of the deduction. However, itemized deductions can be allocated "in any manner." If the deductions are not allocated on the form, they cannot be allocated later.

Exemptions must be allocated as whole numbers. That is, if you have three exemptions, you cannot allocate one and one-half to each spouse. Each spouse must claim the exemptions they would have been entitled to if they filed separate returns.

After allocating income and deductions, compute your share of the joint tax liability. Figure your share using "married filing separately" rules. That is not to say, however, that you must now be subjected to the married filing separately *rate*. The applicable rate is the *married filing jointly* rate. It is only *your share* that is computed under the married filing separately rules. For a more detailed explanation, see Revenue Ruling 85-70, 1985-1 C.B. 361, and the instructions for Form 8379.

Having calculated your share of the joint tax liability, now allocate payments against the tax. Allocate wage withholding payments to the spouse who paid them. Similarly, allocate separate estimated tax deposits to the spouse who made them. However, a) joint estimated payments, b) payments made with the return at the time of filing, and c) payments made with a filing extension may be allocated between the spouses at their discretion.

To determine your portion of the total overpayment (which becomes the amount refundable), simply subtract your share of the joint tax liability from your contribution to it. For example, suppose your share of a $5,000 total tax bill is $2,000. Suppose you contributed $2,500 to the joint tax bill. Your share of the refund is $500 ($2,500, your contribution, minus $2,000, your share of the tax bill).

The IRS actually figures the tax refund. It is supposed to use the procedures and formulas set forth in Revenue Ruling 85-70. However, you provide the underlying numbers through your allocation of income, deductions and payments. Despite the fact that IRS actually performs the refund calculation, you too should perform the exercise to double-check its work.

The Innocent Spouse

When you file a joint return with your spouse, both of you are equally liable for the tax, even though only one of you may have earned the income. This joint liability causes serious problems if, say the wife, had no idea of, or control over her husband's business practices or spending. The IRS moves to collect the entire tax from the easiest target, and this is true even if the couple later divorces. A divorce does not dissolve a joint income tax liability, even if a local family court orders one spouse to pay the tax. The "innocent spouse" rules can solve this problem. Expressed under code sections 63(c) (applicable to community property states) and 6015, they are among the most important and least understood provisions of the tax code. They can relieve a spouse of liability on a joint return in certain circumstances.

The law establishes three grounds upon which one may obtain innocent spouse status. Let us address each of them in turn.

Traditional Innocent Spouse Relief

This provision applies to married (or formerly married) couples who signed a joint return for the period in question. In order to be an innocent spouse under section 6015(b), you must prove the following elements:

1. **You signed a joint tax return for the period in question.** If there is no joint return, you cannot be responsible for the tax debts of your spouse in the first place.
2. **There is an understatement of tax attributable to an "erroneous item" on the return.** An erroneous item is any incorrect tax return item. This could be unreported income, invalid deductions, exemptions or credits, etc. It makes no difference whether the erroneous item is the result of a good faith error or a flatly bogus claim. The understatement of tax can be in any amount. So whether you owe the IRS $5,000 or $500,000, it does not matter, nor does it matter that you might be able to write a check for the tax owed. Under section 6015(b), you are either innocent or not, and the fact that you might have the money to pay plays no role in considering your culpability.
3. **You must prove that in signing the return, you did not know or have reason to know of the understatement.** In other words, if you knew (or should have known) that there was unreported income or incorrect deductions on the return, you cannot obtain innocent spouse relief unless you

were forced to sign the return under duress. Proving lack of knowledge is somewhat akin to proving a negative but it is far from impossible. Lack of knowledge can be inferred from all the facts and circumstances of the case.

For example, suppose you have a tax debt attributable to your husband's failed business. Suppose also that you were: 1) disconnected from the business because you played no role whatsoever in its operation, 2) specifically unaware of what your husband was doing because he kept you ignorant of his affairs by refusing to talk with you about it or by lying to you about it, and 3) otherwise generally unfamiliar with his day-to-day operations because of your own pursuits, such as working your own job or taking care of small children. In this case, you can establish that you did not know or have reason to know about the errors in the return. *The Taxpayers' Defense Manual*, Chapter 12, illustrates this clearly and gives examples of how to make this case.

Innocent spouse relief under 6015(b) is not an "all or nothing" proposition. Section 6015(b)(2) provides that your liability is limited to the portion of the tax that the innocent spouse knew or should have known existed. For example, if you were aware that certain business deductions were questionable but were unaware of hidden cash income, you cannot be held liable for the tax, interest or penalty on the unreported income. The extent of your liability is attributable only to what you knew or should have known (here, the questionable business deductions).

Please note that section 6015(b) applies only to "understatements" of tax, not to "underpayments." An understatement is a condition in which the tax return does not show the full and correct tax liability. For example, say you file a joint return that does not report $10,000 of income. After audit, the IRS increases your tax. This is an understatement of tax.

On the other hand, suppose you file a joint return showing $5,000 of tax due from your husband's business. The tax is not paid at the time the return is filed. The IRS begins enforcement action to collect. This is an "underpayment." That is, you did not pay the tax that was shown due on the return. And because you are aware (or should be aware) of the tax when you file the return (it is, after all, shown right on the return that you signed), you *are not* an innocent spouse under this subsection. However, relief may nevertheless be available under another provision, as discussed below.

4. **The innocent spouse must prove that based upon all the facts and circumstances, it is inequitable to hold her accountable for the tax.** This is an intangible element that is determined on a case-by-case basis. I once had a case in which the husband was guilty of massive credit card fraud. The wife knew nothing about his actions. After the FBI busted him for the fraud (and exonerated her), the IRS assessed millions of dollars in taxes, penalties and interest for not claiming the income from the fraud operation. Because the wife signed a joint return, the IRS assessed the tax against her also. In our innocent spouse case, we proved that she was as much a victim of the husband's criminal acts as the IRS. She was lied to, kept ignorant, denied access to any records his activities, etc. When the couple split, she was left with nothing since the house and cars were repossessed by creditors. Moreover, she was the sole supporter of their three children. To top it off, the now-former husband was in jail and there was no hope of his providing any support. These facts were enough to persuade the IRS that it would indeed be unfair to hold her responsible for the tax. For more on how to do this, please see *Taxpayers' Defense Manual*, Chapter 12.
5. The innocent spouse must file for relief under code section 6015(b) "not later than" two years after the IRS begins collection activities. The "collection activities" must be pointed at the innocent spouse. Such activities are defined by Treasury Regulation section 1.6015-5(b)(2)(i) as follows:
    a. The issuance of a *Final Notice of Intent to Levy and Notice of Your Right to a Hearing*, Letter 1058 or LT11 (see Exhibits 4-4 and 4-5),
    b. The offset of a federal or state tax refund,
    c. A lawsuit by the United States against the innocent spouse under section 7403 (as explained above, this is usually a suit seeking court permission to seize your main home),
    d. Filing a claim by the United States in any court proceeding in which the innocent spouse is a party, or which involves property owned by the innocent spouse, or

e. Any levy or seizure of a bank account, paycheck, or personal property such as an automobile, etc.

Please note that the mere filing of a tax lien does not start the two-year clock running. Under the terms of the regulation mentioned above, the filing of a lien is not a "collection action."

Use Form 8857, *Request for Innocent Spouse Relief*, to make an innocent spouse claim. Please see *Taxpayers' Defense Manual*, Chapter 12 for more details on submitting the claim.

Partial Relief for Divorced or Separated Couples

Code section 6015(c) provides a remedy for spouses who become divorced or separated after filing a joint tax return. This often arises when, pursuant to a divorce or separation agreement, one spouse is ordered to pay the outstanding taxes on the joint return, but that spouse runs—not only avoiding child support in some cases but dodging the IRS as well. That forces the innocent spouse to deal with the IRS despite the fact she probably paid her share of the taxes through wage withholding.

Under traditional innocent spouse provisions, relief is not available because the innocent spouse knew about the tax debt. It was shown on the return at the time of filing and simply was not paid. It is no defense that the debt was really the other spouse's. A joint return creates a joint liability and each party is responsible for its payment. However, code section 6015(c) creates relief in this situation.

This section carries the same two-year claim period that I just explained. This election, however, is not for "innocent spouse" treatment as outlined above. Remember, you are not "innocent" when you know or have reason to know about the understatement. Moreover, it is not an *understatement* when the tax is shown due on the return and is simply not paid. That is an *underpayment* of tax.

The election available under section 6015(c) is an election to be treated as a separate taxpayer. That is to say, you have the right to terminate your joint filing status and separate yourself from your husband's unpaid tax debt. The beauty of this is that you do not need your spouse's consent to make the election. However, other limitations apply. Let us discuss them.

1. At the time of the election, you must be divorced or legally separated from the spouse in question. If not, you may make the election if you have not been living with your spouse at any time during the one-year period preceding the date of filing the election. If your spouse is deceased, you are not living with your spouse.
2. You bear the burden of proving your separate tax liability. You must show your separate income, your share of itemized deductions, if any, and your wage withholding or other payments. This is similar to the injured spouse procedures discussed earlier, and is subject to review and challenge by the IRS.
3. The IRS has the right to disregard the election if it can show fraudulent transfers of assets between the spouses prior to divorce or separation. Suppose the husband transfers all his assets to his wife and then seeks a divorce. There is a large joint tax debt and the wife seeks the separate spouse election. If granted, she ends up with all the property and has no tax debt while the ex-husband has the tax debt but no property. In that case, the IRS can disregard the election. This rule does not apply to assets transferred incident to a divorce or separate maintenance agreement but you must prove that the principal purpose of the agreement was not to avoid taxes.

Code section 6015(c) does not relieve a citizen of all tax debt. To the extent not paid, you are still responsible for your separate tax debt. This section merely allows you to unravel the ill effects of a joint tax return. Without a section 6015(c) election, the IRS can and will pursue you for payment of a joint tax debt even if your spouse was ordered by a family court to pay the taxes, since a family court judge does not have the power to vitiate federal tax statutes.

Equitable Relief When Other Remedies do not Apply.

Code section 6015(f) provides a kind of "catch all" provision available if subsections (b) and (c) do not apply. If for any reason you cannot obtain relief under either of those sections, the IRS may nevertheless grant relief, if, based upon "all the facts and circumstances, it is inequitable to hold the individual liable for any unpaid tax."

This section is very broad and has no limitations. It grants the IRS wide ranging discretion to look at each case on an individual basis to see whether a spouse should be relieved of a joint liability. Even the two-year limitation period applicable under subsections (b) and (c) does not apply to an equitable relief claim under section (f). See *Lantz v. Commissioner*, 132 T.C. 131 (2009); and IRS Notice No. 2011-70, July 25, 2011.

The key is that you must prove that it is "inequitable" (unfair) to be held responsible for the tax. Treasury Regulation section 1.6015-2(d) provides guidance on the definition of the term "inequitable." It states, in part, as follows:

> *"All of the facts and circumstances are considered in determining whether it is inequitable to hold a requesting spouse jointly and severally liable for an understatement. One relevant factor for this purpose is whether the requesting spouse significantly benefited, directly or indirectly, from the understatement. A significant benefit is any benefit in excess of normal support. Evidence of direct or indirect benefit may consist of transfers of property or rights to property, including transfers that may be received several years after the year of the understatement. Thus, for example, if a requesting spouse receives property (including life insurance proceeds) from the non-requesting spouse that is beyond normal support and traceable to items omitted from gross income that are attributable to the non-requesting spouse, the requesting spouse will be considered to have received significant benefit from those items. Other factors that may also be taken into account, if the situation warrants, include the fact that the requesting spouse has been deserted by the non-requesting spouse, the fact that the spouses have been divorced or separated, or that the requesting spouse received benefit on the return from the understatement."*

Because there are no limitations on granting relief under section 6015(f), there is no limit to the kind of circumstances that might give rise to relief. However, the IRS has created some basic requirements that must be met before it will consider granting equitable relief. They are set forth in Revenue Procedure 2000-15, as follows:

1. Relief is not available under section 6015(b) or 6015(c). If your case can be considered under either of those provisions, you must seek relief there first; and
2. No assets were transferred between you and your spouse as part of "a fraudulent scheme" to avoid paying the tax.

Assuming you meet those requirements, the IRS will generally grant relief when you meet these following factual circumstances:

1. At the time you seek relief, you are no longer married to, or are legally separated from your spouse, or have not been a member of the same household as your spouse at any time during the twelve-month period ending on the date relief is requested;
2. At the time of signing the tax return, you did not know or have reason to know that the tax would not be paid. You must establish that it was reasonable for you to believe that your spouse would pay the tax; and
3. You will suffer economic hardship if relief is not granted. The determination of economic hardship is made using the same rules the IRS uses in determining hardship for levy purposes. See Treas. Reg. §301.6343-1(b)(4), discussed above.

The Right of Tax Court Review

Section 6015(e) provides that in the event of an adverse determination of your claim, you may file a petition in the Tax Court for review of the decision. You have ninety days from the date your claim is rejected in which to file a petition. The law also gives you a Tax Court option if the IRS fails to act on your application in a timely manner. You may file the petition with the Tax Court any time after six months from the date of submitting your claim if the IRS fails to answer. This provision prevents the IRS from stonewalling your claim. To review the step-by-step process of filing and prosecuting a Tax Court claim, please see Chapter 4 of *The Taxpayer's Defense Manual*.

While the ninety-day appeal period and your Tax Court action is pending (if a timely petition is filed), the IRS cannot collect until the Tax Court decision becomes final. See IRC §6015(e)(1)(B). If the IRS tries to collect, the Tax Court has jurisdiction to stop the IRS.

Impact on the Collection Statute of Limitations

The bad news is that while the IRS is prohibited from collecting the tax, the statute of limitations on collection is tolled. See IRC §6015(e)(2). This means you must carefully evaluate the merits of filing an innocent spouse claim prior to taking action. You must know how much time is left on the collection statute *before* taking any action to toll it. To figure the time left on your collection statute, please see Chapter 10.

Conclusion

Enforced collection through liens, levies and seizures is always a risk when you owe the IRS. However, the tools described above allow you to neutralize, minimize and in most cases eliminate the risk. Normally, one must act quickly and decisively when dealing with levies and seizures. Hesitation and inaction only make matters worse. Therefore, it is always best to know *in advance* what to do if a given situation presents itself. That is how to survive enforced collection.

Review Questions

1. Effective March 2011, the lien-filing threshold became what amount?
   A. $5,000
   B. $50,000
   C. $1,000
   D. $10,000

2. Which element of Code section 6323(j) is most compelling toward the taxpayer?
   A. The statute provides five possible grounds for withdrawal of the lien
   B. The lien was premature
   C. Withdrawal will facilitate tax collection
   D. An approved installment agreement exists

3. Form 14134 is used to initiate which procedure?
   A. Withdrawal of a lien
   B. Subordination of a lien
   C. Preparation of a bond
   D. Direct Debit

4. Which lien release option involves a federal court action?
   A. Bond
   B. Subordination
   C. Value double the liability
   D. Quiet title

5. After becoming aware of an erroneously filed lien, how long does the taxpayer have to file an appeal under Code section 6326?
   A. Thirty days
   B. Ten years
   C. Three years
   D. One year

6. Although an installment agreement is in effect, which of the following may be levied without notice?
   A. Federal tax refunds
   B. Bank accounts
   C. Automobiles
   D. State tax refunds

7. If you have $500 in your bank account the day a levy is issued, and an additional $300 is deposited the next day, what is the amount that is subject to the levy?
   A. $0
   B. $500
   C. $800
   D. $300

8. Which Code section controls the release of levies?
   A. 6331(f)
   B. 6343
   C. 6159
   D. 6326

9. What is described in IRM part 5 as a citizen who won't pay the tax owed?
   A. Requires reasonable time to sell an asset or to secure a loan
   B. Does not agree with the assessment and is working with the IRS to adjust his or her account
   C. Wage earner that has not paid and will not adjust his or her withholdings
   D. Has no ability to make payments and has no equity in assets

10. What is perhaps the single largest and most dangerous misunderstanding about the IRS's levy power?
    A. Basing a levy on an SFR
    B. The ability to seize a citizen's home
    C. Use of the minimum bid worksheet
    D. The ability to levy an IRA or 401(k)

11. Which community property state generally allows complete offset for the separate debts of one spouse?
    A. Wisconsin
    B. Arizona
    C. Texas
    D. Washington

12. Which Code section provides potential "catch all" equitable relief for an innocent spouse?
    A. 6015(f)
    B. 6015(c)
    C. 6015(b)
    D. 6015(e)

Review Answers

1. A. Incorrect. Effective March 2011, the IRS did not fix the lien-filing threshold at $5,000. However, the lien-filing threshold was $5,000 prior to March 2011.
   B. Incorrect. Effective March 2011, the IRS lien-filing threshold was not $50,000. The IRS will file a lien for taxpayers owing much less than $50,000.
   C. Incorrect. In March 2011, the IRS lien-filing threshold was not $1,000. A taxpayer must owe a greater amount in order for the IRS to file a lien.
   D. **Correct.** Effective March 2011, the IRS increased the lien-filing threshold to $10,000.

2. A. Incorrect. An element of Code section 6323(j) that is most compelling toward the taxpayer is not that the statute provides five possible grounds for withdrawal of the lien; instead, the statute delineates four possible grounds for withdrawal.
   B. Incorrect. An element of Code section 6323(j) that is most compelling toward the taxpayer is not that the lien was premature. A lien that was premature or otherwise not in accordance with the IRS's administrative procedures is one of the grounds for withdrawal.
   C. **Correct.** An element of Code section 6323(j) that is the most compelling for taxpayers is that lien withdrawal will facilitate tax collection.
   D. Incorrect. An element of Code section 6323(j) that is most compelling toward the taxpayer is not that there is an installment agreement in place. One of the grounds for withdrawal is that the taxpayer has an approved installment agreement.

3. A. Incorrect. Form 14134 is not used to initiate withdrawal of a lien. An application for withdrawal of a federal tax lien is filed on Form 12277.
   B. **Correct.** Form 14134 is filed to apply for subordination of a federal tax lien.
   C. Incorrect. Form 14134 is not used in preparation of a bond. There is no current form available for bond preparation.
   D. Incorrect. Direct Debit is not the subject of Form 14134. IRS administrative procedures provide for the withdrawal of a lien when a Direct Debit Installment Agreement (DDIA) is in effect.

4. A. Incorrect. A bond is not a lien release option involving a federal court action. If the IRS accepts the offer of a bond, it can lead to the release of a lien.
   B. Incorrect. Subordination of a lien is not a release option that involves a federal court action. The purpose of a subordination procedure is to facilitate tax collection.
   C. Incorrect. Value double the liability is not a lien release option involving a federal court action. Under Code section 6325(b)(1), the IRS may discharge a portion of property from a lien when the fair market value of the property remaining subject to the lien is at least double the sum of the amount of the unsatisfied liability secured by the lien plus the amount of other liens upon the property.
   D. **Correct.** A quiet title action is a suit in federal district court that seeks to settle the question of property ownership, and a quiet title action can sometimes clear a lien.

5. A. Incorrect. After becoming aware of an erroneously filed lien, a taxpayer does not have only thirty days to file an appeal. However, a CDP lien appeal must be filed within thirty days of receiving Letter 3172.
   B. Incorrect. After becoming aware of an erroneously filed lien, a taxpayer does not have ten years to file an appeal. As a general rule, the IRS has just ten years from the date a tax is assessed in which to collect it.
   C. Incorrect. After becoming aware of an erroneously filed lien, a taxpayer does not have three years to file an appeal. Generally, the IRS has just three years from the date a tax return is filed in which to audit and assess a tax.
   D. **Correct.** An appeal under Code section 6326 can be filed within one year after the taxpayer becomes aware of an erroneously filed lien.

6. A. **Correct.** Although an installment agreement is in effect, the IRS may levy a federal tax refund without notice.
   B. Incorrect. The IRS cannot levy bank accounts if an installment agreement is in effect. An approved installment agreement prohibits any levy on a bank account.
   C. Incorrect. Although an installment agreement is in effect, automobiles may not be levied without notice. An approved installment agreement prohibits any levy of property.
   D. Incorrect. When an installment agreement is in effect, the IRS will not levy state tax refunds without notice. However, the IRS can issue a notice that it intends to levy a state refund, and with such notice it can do so.

7. A. Incorrect. If you have $500 in your bank account the day a levy is issued, and an additional $300 is deposited the next day, the amount subject to the levy is not $0. Levies on bank accounts are effective and some amount is subject to the levy.
   B. **Correct.** If you have $500 in your bank account the day a levy is issued, and an additional $300 is deposited the next day, the amount subject to the levy is $500, the amount in the account on the day the levy was issued.
   C. Incorrect. If you have $500 in your bank account the day a levy is issued, and an additional $300 is deposited the next day, the amount subject to the levy is not $800. The entire balance is not subject to levy.
   D. Incorrect. If you have $500 in your bank account the day a levy is issued, and an additional $300 is deposited the next day, the amount subject to the levy is not $300. The amount subject to levy is greater than $300.

8. A. Incorrect. Code section 6331(f) is not the Code section that controls the release of liens. Section 6331(f) prohibits the levy of any asset that has no equity.
   B. **Correct.** Code section 6343 controls the release of levies.
   C. Incorrect. Code section 6159 does not control the release of levies. Code section 6159 makes it clear that one must be current with return filing and estimated payments before the IRS will establish an installment agreement.
   D. Incorrect. Code section 6326 does not control the release of levies. Code section 6326 authorizes an administrative appeal of the imposition of a lien.

9. A. Incorrect. An individual that requires reasonable time to sell an asset or secure a loan is not described in IRM part 5 as one that won’t pay the tax. Such a taxpayer needs more time or may not pay in full.
   B. Incorrect. A citizen that does not agree with the assessment and is working with the IRS to adjust the account is not described in IRM part 5 as one that won’t pay the tax; instead, such a person needs more time or may not pay in full.
   C. **Correct.** A citizen that is a wage earner that has not paid the tax, and will not adjust his or her withholdings, is described in IRM part 5 as one that won’t pay the tax.
   D. Incorrect. A person that has no ability to make payments and has no equity in assets is not described in IRM part 5 as one that won’t pay the tax. Such person either needs more time or will just not pay the amount due in full.

10. A. Incorrect. Basing a levy on an SFR is not the single largest and most dangerous misunderstanding about the IRS’s levy power. When a citizen fails to file a tax return, the IRS routinely files for that person, using an SFR (substitute for return).
    B. Incorrect. The ability to seize a person’s home is not the single largest and most dangerous misunderstanding about the IRS’s levy power. Revenue officers sometimes threaten taxpayers with the seizure of their home, although a home is generally exempt from administrative seizure.

C. Incorrect. The use of the minimum bid worksheet is not the single largest and most dangerous misunderstanding about the IRS's levy power. The IRS communicates to a taxpayer the figures used to calculate the minimum amount the IRS will accept when selling seized property.

D. **Correct.** Perhaps the single largest and most dangerous misunderstanding about the IRS's levy power is the question of whether it can reach an IRA or 401(k).

11. A. Incorrect. Wisconsin is a community property state but does not generally allow complete offset for the separate debts of one spouse. State law provides that community property is not subject to the separate debts of either spouse.

B. Incorrect. Arizona is a community property state but does not generally allow complete offset for the separate debts of one spouse. State law provides that community property is not subject to the separate debts of either spouse.

C. **Correct.** Texas is a community property state and it generally allows community property to be offset for the separate debts of one spouse.

D. Incorrect. Washington is a community property state but does not generally allow complete offset for the separate debts of one spouse. State law provides that community property is not subject to the separate debts of either spouse.

12. A. **Correct.** Code section 6015(f) provides potential "catch all" equitable relief for an innocent spouse.

B. Incorrect. Code section 6015(c) does not provide "catch all" equitable relief for an innocent spouse. Section 6015(c) provides a remedy for spouses who become divorced or separated after filing a joint return.

C. Incorrect. Code section 6015(b) does not provide potential "catch all" equitable relief for an innocent spouse. Section 6015(b) provides traditional innocent spouse relief.

D. Incorrect. Code section 6015(e) does not provide potential "catch all" equitable relief for an innocent spouse. Section 6015(e) provides that in the event of an adverse determination of a claim, a Tax Court petition for review of the decision may be available.

Chapter 7
Dial 911 – Emergency Measures to Stop Collection

Learning Objectives

- Pinpoint the concern IRS employees had over section 1203 of the IRS Restructuring and Reform Act of 1998
- Recognize the specific type of case in which a Taxpayer Assistance Order is appropriate
- Identify the chief way to bring a case to the attention of the Taxpayer Advocate Service

Introduction

The events of September 1997 remain etched clearly in my mind, even after nearly two decades. That is when the Senate Finance Committee held explosive televised hearings on allegations of IRS abuse. The hearings came on the heels of the report of the National Commission on Restructuring the Internal Revenue Service, to which I was a consultant and provided detailed recommendations on changing the Internal Revenue Code to better protect taxpayers. The Commission's report documented specific instances of IRS abuse of taxpayers and the disregard of federal law in collecting taxes.

The nation was riveted to the television as nearly a dozen citizens told heart-wrenching stories of how the IRS ran them over in the collection process. IRS officials tried to spin the stories as mere "isolated occurrences," while arguing that most people had favorable experiences with the agency, but even IRS employees testified about the culture of abuse that permeated the agency. The employees testified while hidden behind screens with their voices electronically altered so as not to disclose their identity. It seemed more like a Mafia trial than a Senate hearing.

In my own testimony, I documented thirteen specific ways the IRS abuses citizens. I pointed out that revenue officers use tactics of bluff and intimidation, misinformation and disinformation, and in many cases they outright lie to people concerning taxpayers' rights and the agency's limitations. I proved that IRS abuse of citizens was a regular practice.

As a result of the report of the National Commission on Restructuring the IRS and the Senate hearings into IRS abuse, Congress passed the Internal Revenue Service Restructuring and Reform Act of 1998. Among the substantial changes to the tax code made by the Restructuring Act, Congress adopted the Collection Due Process Appeal rights (Chapters 4 and 5), broader and more comprehensive innocent spouse rules (Chapter 6) and made the Office of the Taxpayer Advocate (discussed below) more independent.

In the two years immediately following the adoption of the Restructuring Act, the enforcement actions of the IRS nearly disappeared. For the first time in the modern history of the agency, the IRS executed virtually no enforcement actions—the incidents of liens, levies and seizures dropped by more than 95 percent across the board. People believed that the Restructuring Act was a wooden stake driven into the heart of the blood-sucking beast known as the IRS. People believed that the agency was—if not dead—defanged by the Restructuring Act and would never pose a threat to Americans again.

As it turned out, that was too much to ask.

The chief reason collection actions ground to a halt was that the IRS spent tens of thousands of man hours retraining employees to deal with the new rules and procedures created by the Restructuring Act. Another key factor in chilling collection was a provision of the act that came to be known colloquially as the "10 Deadly Sins." I refer to section 1203 of the Act, which contains a provision stating that an IRS employee "must be terminated" for violating any one of the ten proscriptions set forth in that section while in the act of carrying out his duties. Among the actions on the list that could lead to mandatory termination are a violation of any constitutional right of a taxpayer, and a violation of the tax code, regulations or IRS policies "for the purposes of retaliating against or harassing a taxpayer or other employee of the IRS."

Apparently, this provision intimidated IRS employees to the point where they were afraid to carry out their duties for fear of getting fired. Why would IRS employees fear getting fired for merely carrying out collection actions? Evidently, the idea of taxpayer abuse was so far ingrained in the consciousness of IRS employees that they simply could not imagine how one could carry out collection functions without violating the law or the constitutional rights of taxpayers.

In any event, section 1203(c) contains an "escape clause" for the IRS. That section provides that, while section 1203(a) says a violation must lead to termination, the IRS Commissioner may take action against an employee "other than termination." Hence, the very broad latitude afforded the commissioner in section 1203(c) vitiates the threat of termination contained in section 1203(a).

By 2001, then-IRS Commissioner Charles Rossotti assured IRS employees that in fact they would not be subject to termination under section 1203 of the Restructuring Act. And indeed, since that time, just about the only reason any IRS employees have been fired from the agency is because of their own failures to file tax returns or pay taxes. I cannot think of any IRS person fired for violating the constitutional rights of a taxpayer or for violating the tax code or regulations while in the act of collecting taxes.

With the threat of termination well quashed, and with the IRS workforce educated on the nuances of the Restructuring Act, the IRS's Collection function was resurrected. Collection actions began again in earnest in the early 2000s. In fact, when Mark Everson assumed command of the agency in 2003, he announced that the IRS was "back in the collection business." And indeed, back it is. Since that time, the collection actions of liens, levies and seizures have been restored to at least historical levels, and in the case of third-party levies, have surpassed pre-Restructuring Act levels.

And through it all, taxpayers are no more familiar with their rights today than they were in the aftermath of the Restructuring Act, when the issue was featured on the evening news. And now that we are nearly two decades removed from the fireworks of the Senate hearings, the IRS goes about the business of squeezing people to within an inch of their financial lives as though the Restructuring Act never passed. That is why you must know how to seek quick and effective help to stop the enforcement steamroller if the situation gets out of control. I address those measures in this chapter.

The Equivalent Hearing

The Collection Due Process appeal for liens and levies is by far the most important and effective rights you have for protection against potentially abusive collection enforcement. However, to enjoy those rights, you must file the CDP appeal within thirty days of the *Final Notice of Intent to Levy* (Letter 1058 or LT11) or Notice of Filing Federal Tax Lien (Letter 3172).

If you fail to file your appeal within that time you lose the CDP appeal right, but you may be entitled to an Equivalent Hearing (EH). You have one year from the date the IRS issues the *Final Notice, Notice of Intent to Levy* or *Notice of Filing Federal Tax Lien* in which to file a request for an EH, assuming you missed your CDP filing deadline.

An EH is a hearing that is "equivalent to" a Collection Due Process hearing in form and structure. That is, you have the opportunity to present collection alternatives and to challenge the underlying tax assessment in appropriate cases. Furthermore, the IRS must verify that the assessment is valid and that all required administrative steps were followed in obtaining the assessment.

There are several important differences between a CDP hearing and the EH. I discuss them here.

No guarantee of a collection freeze. When a timely CDP appeal is filed, you are guaranteed that the IRS cannot pursue collection while the appeal is pending. There is no such guarantee with an EH appeal. However, as a general rule, the IRS stops collection while your EH is pending unless it believes you filed a frivolous appeal solely to hinder collection. The fact that the IRS generally does stop collection is what makes this appeal very useful and effective as an emergency measure. Moreover, just as in the case of a CDP appeal, your EH is handled by the IRS's Appeals Office. As discussed, Appeals personnel are more prone to be reasonable in resolving collection cases.

There is no right to a Tax Court appeal. The IRS's CDP determination is appealable to the Tax Court. There is no such right for an EH. Thus, the IRS's determination is final. However, nothing stops you from going back to the IRS with subsequent EH requests (provided they are timely) if your circumstances change. For example, say the Appeals Office determines that you can pay X dollars through an installment agreement but you subsequently suffer a pay cut. In that case, you can ask the Appeals Office to reevaluate your ability to pay given your new income.

How to Carry out an Equivalent Hearing Appeal

Request an Equivalent Hearing by using IRS Form 12153, Request for Collection Due Process or Equivalent Hearing. See Exhibit 4-6. Check the box on line 7 (page two) of the form. This tells the IRS that you want an EH.

An EH is conducted identically to a CDP hearing. As such, you must think like a prosecutor because you have the burden of proof. You must organize your facts, documents and arguments and present them just as you would in a CDP appeal. Review the discussion of the CDP appeal in Chapter 5.

The CAP Appeal

Yet another helpful administrative collection appeal process is the Collection Appeal Program (CAP). It is particularly useful in emergency situations, as I explain below. It is available as an option even if you cannot use either the CDP or EH appeal due to the passage of time. A CAP appeal can be executed at any time in the collection process. You can use the CAP appeal to challenge a tax lien filing, a wage or bank levy, property seizure (auto, boat, etc.), and the rejection or termination of an installment agreement.

The primary differences between the CAP appeal and other appeal programs are discussed here.

1. The CAP appeal generally addresses just one element of the case. In a CDP or EH appeal, you can raise "any appropriate defense" to the collection action, including the propriety of the underlying assessment. Say, for example, the IRS levies your paycheck, taking more money than the law allows. A CAP appeal could be used to challenge that single action. The CAP appeal cannot be used to challenge the propriety of the tax assessment. You must offer a solution or alternative to the issue at hand. As always, the burden of proof is on you.
2. As in the case of the EH appeal, there is no guarantee of a collection freeze while the CAP appeal is pending. It is likely, however, that the IRS will withhold collection while the CAP appeal is pending.
3. Unlike CDP and EH appeals, a CAP is treated much more expeditiously. It is likely you will get your CAP appeal hearing in weeks (sometimes even days), rather than months. This is very important if the IRS is pushing a wage levy that is causing financial hardship.
4. The CAP appeal is not subject to Tax Court review.
5. The timing of the CAP appeal is much different than that of a CDP or EH. The timing differences are profound enough that I address that issue separately, next.

How to Carry out a CAP Appeal

The CAP appeal is all about timing. Once you reach an impasse with the IRS on a collection issue, you must act quickly or you lose your CAP appeal rights. There are two common circumstances in which you might employ the CAP appeal (assuming your CDP and EH rights are no longer available). The first is when the IRS takes action through a computer notice, such as an ACS levy. The second is after you had personal contact with a revenue officer who proposes specific collection action, such as the seizure of property. Let us address each situation.

1. **ACS collection action.** As quickly as possible after getting the notice, try to make contact with ACS by telephone as I explain in Chapter 5. Explain the problems caused (or that will be caused) by enforcement and propose a specific alternative, including asking for the release of the levy (or lien). If you cannot come to terms with the ACS employee, ask to speak to a manager. However, as explained in Chapter 5, this is a call-back situation. Therefore, provide your phone number and have your material available in anticipation of the call.

In your conference with the manager, repeat your concerns about the levy. Explain specifically how the action is causing, or will cause, hardship and ask for specific relief. Again, you must propose an alternative that addresses your obligations. Keep in mind that uncollectible status is a viable alternative when your income and expenses are such that you cannot make a monthly payment. Provide whatever information the manager asks for.

If you cannot come to terms with the manager, get the manager's mailing address. Also be sure to get the manager's name and IRS employee ID number. Within two days of your phone conversation, you must mail a written request for CAP appeal. Use IRS Form 9423, *Collection Appeal Request*, for this purpose. See Exhibit 7-1. Be sure to mail it using certified mail with return receipt requested. Keep a copy of what you mail. You are also permitted to fax the form to the manager, so ask for a fax number as well.

In the form, argue the facts of your case as you presented them. Add whatever additional information you believe will help. Attach copies of documentation to support your claim whenever possible. Keep in mind that you cannot over-prove your case. Upon receipt of the CAP appeal request, your case will be forwarded to the Office of Appeals for consideration.

2. **Personal contact with a revenue officer.** If your contact with the IRS is personal through an RO, the above procedures change only slightly. Instead of calling ACS, get your RO on the phone. Explain your situation, present your facts and arguments and make your case. The burden of proof is on you so present everything you can.

   If you cannot come to terms, ask for the manager. Have the same discussion with the manager as outlined above. If that is unfruitful, submit your CAP appeal request directly to the manager. This can be done using certified mail or the form can be faxed, as explained above. You have two days from the date of your meeting with the manager in which to submit the request.

   In some cases, an RO might take action without talking with you. In that case, request a conference with the manager within ten business days of the date the *Notice of Lien, Levy or Seizure* is given to you. Make your argument to the manager as discussed above. If you cannot come to terms, you have two days from the date of that conference to submit the CAP appeal request. Follow the above steps in submitting Form 9423 to the manager.

The CAP Appeal Hearing

Once the Appeals Office has your case, you will be contacted by an SO as to the hearing date. Treat the CAP appeal hearing just as you would a CDP hearing. As such, you must think like a prosecutor because you have the burden of proof. You must organize your facts, documents and arguments and present them to the SO just as you would in a CDP case. Review the discussion of the CDP appeal in Chapter 5.

The collection appeal process is described in some detail in IRS Publication 1660, *Collection Appeal Rights*.

The Office of Taxpayer Advocate Service

The Taxpayer Advocate Service (TAS) is intended to function as a liaison between the IRS's enforcement functions, such as Collection, and the citizen. Originally created as part of the 1988 Taxpayers' Bill of Rights Act, it has undergone several changes over the years. Most notably, the Restructuring Act created the National Taxpayer Advocate (NTA). The NTA is now solely responsible for training and overseeing all local TAs in the country.

And unlike earlier incarnations of the Taxpayer Advocate Service, the current Office of the Taxpayer Advocate is completely independent of any IRS enforcement arm. This independence helps create a more citizen-friendly environment within TAS offices. Your local TAS office is very easy to contact. The IRS's website contains a comprehensive link. The following web address gets you access to the local offices, including phone and fax numbers: http://www.irs.gov/advocate/content/0,,id=150972,00.html

TAS is responsible for handling cases when normal channels fail. The purpose is to ensure that you have a place to turn when the system fails. In such cases, TAS can, for example, help hasten the IRS's acceptance of an installment agreement, win the release of levies, and otherwise assist in resolving general collection disputes. TAS can also help break loose frozen refunds, and clear up identity theft issues.

Exhibit 7-1 – IRS Form F9423, *Collection Appeal Request*

Form **9423** (August 2014)

Department of the Treasury - Internal Revenue Service

Collection Appeal Request

(Instructions are on the reverse side of this form)

1. Taxpayer's name	2. Representative *(Attach a copy of Form 2848, Power of Attorney)*

3. SSN/EIN	4. Taxpayer's business phone	5. Taxpayer's home phone	6. Representative's phone

7. Taxpayer's street address

8. City	9. State	10. ZIP code
11. Type of tax *(Tax form)*	12. Tax periods being appealed	13. Tax due

Collection Action(s) Appealed

14. Check the Collection action(s) you are appealing

- ☐ Federal Tax Lien
- ☐ Levy or Proposed Levy
- ☐ Seizure
- ☐ Rejection of Installment Agreement
- ☐ Termination of Installment Agreement
- ☐ Modification of Installment Agreement

Explanation

15. Explain why you disagree with the collection action(s) you checked above and explain how you would resolve your tax problem. Attach additional pages if needed. Attach copies of any documents that you think will support your position. Generally, the Office of Appeals will ask the Collection Function to review, verify and provide their opinion on any new information you submit. We will share their comments with you and give you the opportunity to respond.

Under penalties of perjury, I declare that I have examined this request and any accompanying documents, and to the best of my knowledge and belief, they are true, correct and complete. A submission by a representative, other than the taxpayer, is based on all information of which the representative has any knowledge.

16. ☐ Taxpayer's or ☐ Authorized Representative's signature *(Only check one box)*	17. Date signed

IRS USE ONLY

18. Revenue Officer's name	19. Revenue Officer's signature	20. Date signed
21. Revenue Officer's phone	22. Revenue Officer's email address	23. Date received
24. Collection Manager's name	25. Collection Manager's signature	26. Date signed
27. Collection Manager's phone	28. Collection Manager's email address	29. Date received

ISA Form **9423** (Rev. 8-2014) www.irs.gov Department of the Treasury - Internal Revenue Service

TAS has the power to issue what is called a Taxpayer Assistance Order (TAO). The TAO is designed to prevent or correct IRS actions—or lack of actions—which are causing a "significant hardship" to a taxpayer. As used in connection with TAS, the phrase "significant hardship" is defined differently than the "hardship" concept we discussed in Chapters 5 and 6.

Code section 7811(a)(2) and Treasury Regulation section 301.7811-1(a)(4) define a "significant hardship" for purposes of the Taxpayer Advocate as a "serious privation caused or about to be caused to the taxpayer as a result of the manner in which the tax laws are being administered by the IRS." Mere personal or economic inconvenience does not rise to the level of "significant hardship." See Treas. Reg.

§301.7811-1(a)(4)(ii). However, financial hardship created by wage or bank levies does constitute "significant hardship."

Moreover, "significant hardship" is not limited to financial problems. A "significant hardship" is deemed to exist if one or more of these factors are present:

1. There is an immediate threat of adverse action (such as a levy or seizure),
2. There has been delay of more than thirty days in resolving your account problems (this could include a delayed refund),
3. You face incurring significant costs, "including fees for professional representation," if relief is not granted,
4. You are or will suffer irreparable injury, or a long-term adverse impact, if relief is not granted, such as damage to your credit score or loss of property, or
5. You are suffering or will suffer a "serious privation" as a result of the IRS's actions, including, of course, economic loss (but not "economic or personal inconvenience"). See IRM part 13.1.18.7(3).

Please note that the concept of "significant hardship" is highly subjective, and what is considered hardship by one person may not be hardship to another. Therefore, the determination must be made on a case-by-case basis after careful consideration of the facts. TAS must consider the impact that the IRS's actions will have on you, and not how somebody else might fare under identical circumstances. Therefore, you must be very specific in your presentation about the effect the IRS's actions will have on you in one or more of the five areas identified above. TAS must make the "significant hardship" determination in every case. See IRM part 13.1.18.7.

The IRM provides the following examples of situations that involve significant hardship:

- Lack of funds due to a levy, or a refund not received, and thus you cannot pay for housing and utilities, food, transportation to and from work, or medical treatment,
- You may become unemployed or lose an income source as a result of the IRS's action,
- You will lose the opportunity to acquire real property,
- Your taxpayer's rights have been abridged,
- The IRS handled your case differently than others in similar situations, and the impact will cause serious damage to your ability to earn future income,
- The IRS did not respond in a timely manner,
- Your payment was not applied in the correct manner or to the correct account, and
- You did not receive a statutory Final Notice before enforcement action was taken. See IRM part 13.1.18.7(4).

Here are some important questions to consider in your efforts to prove "significant hardship" in your case:

1. Will you be able to retain your housing, and pay for utilities and buy food?
2. Will you be able to remain employed, and retain or obtain transportation to and from work?
3. Will you be able to pay for essential medical insurance, treatments or medication?
4. Will you be able to buy reasonable clothing for yourself and your family?
5. Will you be able to pay for your education?
6. Will you suffer irreparable damage to your credit rating?
7. Will your business be unable to meet payroll, and pay essential suppliers and creditors, or will it be pushed into bankruptcy?
8. Is the hardship imminent?

Answer these questions by providing detailed, specific information and documentation to the extent possible.

The chief way to bring your case to the attention of the TAS is through the use of Form 911, *Application for Taxpayer Assistance Order*. See Exhibit 7-2. As I note in Chapter 10, however, filing a Form 911 is a tolling event that stops the collection statute. Therefore, you must be careful about using Form 911. In many cases, I invoke the assistance of TAS by writing a simple letter asking for their help, and making my case. This avoids the tolling issue unless TAS specifically issues a *Taxpayer Assistance Order*.

Exhibit 7-2 – IRS Form 911, *Application for Taxpayer Assistance Order*

Form **911** (February 2015)

Department of the Treasury - Internal Revenue Service

Request for Taxpayer Advocate Service Assistance

(And Application for Taxpayer Assistance Order)

OMB Number 1545-1504

Section I – Taxpayer Information *(See Pages 3 and 4 for Form 911 Filing Requirements and Instructions for Completing this Form.)*

1a. Your name as shown on tax return	1b. Taxpayer Identifying Number (SSN, ITIN, EIN)
2a. Spouse's name as shown on tax return *(if applicable)*	2b. Spouse's Taxpayer Identifying Number (SSN, ITIN)
3a. Your current street address *(Number, Street, & Apt. Number)*	
3b. City	3c. State *(or Foreign Country)* / 3d. ZIP code
4. Fax number *(if applicable)* / 5. Email address	
6. Tax form number *(1040, 941, 720, etc.)*	7. Tax year(s) or period(s)
8. Person to contact if Section II is not being used	9a. Daytime phone number / ☐ Check if Cell Phone / 9b. ☐ Check here if you consent to have confidential information about your tax issue left on your answering machine or voice message at this number.
10. Best time to call	

11. Preferred language *(if applicable)*

☐ TTY/TDD Line ☐ Interpreter needed - Specify language other than English *(including sign language)*

☐ Other *(please specify)*

12a. Please describe the tax issue you are experiencing and any difficulties it may be creating
(If more space is needed, attach additional sheets.) (See instructions for completing Lines 12a and 12b)

12b. Please describe the relief/assistance you are requesting *(If more space is needed, attach additional sheets.)*

I understand that Taxpayer Advocate Service employees may contact third parties in order to respond to this request and I authorize such contacts to be made. Further, by authorizing the Taxpayer Advocate Service to contact third parties, I understand that I will not receive notice, pursuant to section 7602(c) of the Internal Revenue Code, of third parties contacted in connection with this request.

13a. Signature of Taxpayer or Corporate Officer, and title, if applicable	13b. Date signed
14a. Signature of spouse	14b. Date signed

Section II – Representative Information *(Attach Form 2848 if not already on file with the IRS.)*

1. Name of authorized representative	2. Centralized Authorization File (CAF) number
3. Current mailing address	4. Daytime phone number ☐ Check if Cell Phone
	5. Fax number
6. Signature of representative	7. Date signed

ISA www.irs.gov Form **911** (Rev. 2-2015)

Releasing Wage Levies

If you hit a wall in your efforts to obtain a release of levy, immediately contact your local TAS office. Use the Internet link above to find the address and phone number. Send a certified letter or a fax explaining that you are under a wage levy and cannot pay your monthly living expenses. Explain that you cannot pay the tax in full and need an installment agreement or uncollectible status. Your letter should include financial information as explained in Chapter 5.

State clearly that starting or continuing a levy will cause significant hardship by making it impossible to pay monthly living expenses. By showing your monthly expenses and how much you have left after the levy, TAS can easily see that you are facing a financial crisis. Argue from the list of elements set forth above that the collection action is causing significant hardship. Negotiate for an installment agreement or uncollectible status as explained in Chapter 5.

Under no circumstance should you permit a wage levy to continue without following these steps. If you do, the levy continues until all the tax, interest and penalties are paid in full. You are likely to be financially destroyed before that occurs. You can use these same procedures to challenge any improper collection action.

Property Exempt from Levy

In Chapter 4, I list the various types and values of property exempt from levy. Perhaps the most important of these are the wage levy exemptions. The law exempts a minimum amount of wages from any levy. Unfortunately, it is common for revenue officers and ACS to ignore these exemptions. The result is that often, nearly 100 percent of a person's wages are clipped, in violation of the law. See Code §6334(d).

The wage levy exemption is based upon the standard deduction applicable to your filing status, and the number of dependent exemptions you are entitled to claim on Form 1040. The value of those amounts is added and that total is divided by the number of weeks in the year if you are paid weekly. If you are paid monthly, the total is divided by the number of months in the year. The resulting number is the amount of your exempt wages.

For example, suppose you are married and have four children. Based upon 2015 tax tables, the married filing jointly standard deduction is $12,600. The value of one dependent exemption is $4,000. You are entitled to claim six dependent exemptions, one for yourself, one for your spouse, and one for each of the four children. The combined value of the exemptions is $24,000 (4,000 x 6). After adding the standard deduction, your exempt wages are $36,900 (12,600 plus 24,000). When you divide $36,900 by 52, the number of weeks in a year, you arrive at $710. If you are paid weekly, that is the amount you are entitled to earn, free of levy. If paid monthly, divide the exempt amount by 12 instead of 52. Under our example, that entitles you to earn $3,075 per month free of levy.

To claim the wage levy exemptions, carefully complete the exemption statement found in Part 3 of Form 668-W, *Notice of Levy on Wages*. Using certified mail, send the form to the RO or ACS office that issued the levy, as well as to your employer. Be sure to maintain a copy for your files. For help in completing this, see IRS Publication 1494, *Table for Figuring Amount Exempt From Levy on Wages*.

If an RO, ACS, or your employer refuses to honor the exemptions, contact the TAS immediately. Send a letter as outlined above with a copy of your exemption statement. Explain that you are being denied your right to exempt property and ask the TAS to step in immediately and correct the injustice. At the same time, seek an installment agreement or uncollectible status. If you proceed as illustrated, expect to win a reduction, if not an outright release of the levy, and to establish either a reasonable installment agreement or uncollectible status.

Conclusion

If an RO threatens any unlawful action at any point in the collection process (such as a threat to seize your home, for example), do not be afraid to go over his head. Many people believe that by doing this, you just make him mad, and now you are really in for it! But if a revenue officer is already unreasonable and acting illegally, you cannot make matters worse by involving the one office that can stop him. Remember what happened in Deb's case when we went over the RO's head. The result was that Deb no longer had to contend with the irrational threats of a person with no interest in seeing that justice was done.

When you are in trouble, dial 911. When dealing with the IRS, this means getting through to the Taxpayer Advocate Service, which can help solve your problem. The Taxpayer Advocate is your voice in the IRS and I have used that office with great success by following the points outlined above. Do not be afraid to use it when the circumstances dictate.

Review Questions

1. Which 1998 event caused significant changes in the IRS's collection efforts?
   A. Mark Everson assumed command of the IRS
   B. The Senate Finance Committee held public hearings on IRS abuse
   C. The Restructuring and Reform Act was passed
   D. The Equivalent Hearing was established

2. Which is a collection appeal option that is the most expeditious?
   A. EH
   B. CAP
   C. ACS
   D. CDP

3. Who can issue a Taxpayer Assistance Order to prevent or correct IRS actions that are causing significant hardship?
   A. National Taxpayer Advocate
   B. Taxpayer
   C. IRS
   D. Taxpayer Advocate Service

4. What is considered a "significant hardship" under IRM part 13?
   A. A payment was not applied in the correct manner
   B. Mere personal or economic inconvenience
   C. Issues limited solely to financial problems
   D. Loss of the opportunity to acquire personal property

5. How is the wage levy exemption determined?
   A. No wage levy exemption is allowed
   B. Specified percentage of wages
   C. Standard deduction amount only
   D. Standard deduction plus exemption amounts

Review Answers

1. A. Incorrect. The 1998 event that caused significant changes in the IRS's collection efforts was not the assumption of control of the agency by Mark Everson. Mr. Everson became Commissioner in 2003 and announced renewed focus on collection efforts.
   B. Incorrect. The 1998 event that caused significant changes in the IRS's collection efforts was not the Senate Finance Committee hearings on IRS abuse. These hearings were held in 1997 during which citizens gave detailed accounts of how they had been abused in the collection process.
   C. **Correct.** The 1998 event that caused significant changes in the IRS's collection efforts was the passage of the IRS Restructuring and Reform Act.
   D. Incorrect. The initiation of the Equivalent Hearing was not the 1998 event that caused significant changes in the IRS's collection efforts. If a taxpayer misses the deadline to file a CDP appeal, he or she may be entitled to an Equivalent Hearing.

2. A. Incorrect. EH (Equivalent Hearing) is not a collection appeal option that is the most expeditious. As a general rule, the IRS stops collection while an EH is pending.
   B. **Correct.** The CAP (Collection Appeal Program) is a helpful administrative collection appeal process that is treated more expeditiously than other appeals.
   C. Incorrect. The ACS (Automated Collection Service) is an automated collection function designed to collect unpaid assessments as quick as possible.
   D. Incorrect. The CDP (Collection Due Process) appeal allows administrative appeals of IRS collective actions.

3. A. Incorrect. The National Taxpayer Advocate (NTA) does not issue Taxpayer Assistance Orders to prevent or correct IRS actions that are causing significant hardship. NTA is solely responsible for training and overseeing all local Taxpayer Advocates.
   B. Incorrect. The taxpayer does not issue a Taxpayer Assistance Order. Taxpayers that experience significant hardship due to IRS collection efforts can benefit from a Taxpayer Assistance Order.
   C. Incorrect. The IRS does not issue Taxpayer Assistance Orders. The Taxpayer Advocate Service works with the IRS enforcement functions and their relationships with taxpayers.
   D. **Correct.** The Taxpayer Advocate Service has the power to issue Taxpayer Assistance Orders that are designed to prevent or correct IRS actions that cause significant taxpayer hardship.

4. A. **Correct.** Under IRM part 13, a situation that involves a significant hardship is that a taxpayer's payment was not applied in the correct manner or to the right account.
   B. Incorrect. Mere personal or economic inconvenience is not a significant hardship situation under IRM part 13. Mere personal or economic hardship dos not rise to the level of significant hardship.
   C. Incorrect. Issues limited solely to financial problems are not situations involving significant hardship under IRM part 13. Financial hardship is not limited to financial problems.
   D. Incorrect. Loss of the opportunity to acquire personal property is not a situation involving significant hardship under IRM part 13; however, significant hardship does include the loss of an opportunity to acquire real property.

5. A. Incorrect. It is not accurate to say that no wage levy exemption exists. The law exempts a minimum amount of wages from any levy.
   B. Incorrect. The wage levy exemption is not determined by a specified percentage of wages. However, revenue officers mistakenly levy nearly 100% of a person's wages, in violation of the law.
   C. Incorrect. The wage levy exemption is not solely based on the taxpayer's standard deduction amount. The standard deduction is part of the wage levy exemption formula.
   D. **Correct.** The wage levy exemption is based upon the standard deduction applicable to the taxpayer's filing status, and the number of dependent exemptions the taxpayer is entitled to claim on Form 1040.

Chapter 8
How to Step Forward: The Non-Filer Program

Learning Objectives

- Choose the minimum amount of income that a married couple with no children must earn before they are required to file a joint return
- Select the percentage of a taxpayer's prior year's tax liability that must be paid in order to avoid both a tax delinquency and the penalty for underpayment of estimated taxes
- Determine the maximum payment amount a tax debtor should never exceed when under an installment plan

Introduction

If you are ever to experience the relief of tax amnesty, accept the fact that the pattern of non-filing—the running and hiding—must end. Up to this point, you were probably concerned that if you did step forward to cure your non-filing, the IRS would sooner make a statistic out of you as assist in solving the problem. There was a time when you were probably right. However, with the adoption of the Non-Filer Program, that is no longer the case.

The Non-Filer Program is intended to offer non-filers an opportunity to get back into the system without being crushed. The fact is that most non-filers stopped filing due to traumatic situations that arose in their lives, not because they are tax cheats. Maybe they had a serious medical problem or accident, a failed business or marriage, financial problems due to economic conditions, suffered disruption due to a natural disaster, or have some other good faith reason why they became delinquent. Once they failed to file the first return, a pattern began and many ended up mired in inaction.

The Non-Filer Program is essentially a carrot and a stick. The carrot is, "You file the returns and we will accept them without nit-picking and without the threat of a criminal prosecution." However, the stick is, if you do not file them, the IRS will use, as stated by former IRS Commissioner Shirley Peterson, "A more direct approach." By that, she meant that repeated, aggravated non-filers will be targeted for potential criminal prosecution. See Chapter 3. This continues to be the attitude of the IRS toward non-filers. As the IRS works to increase its capacity to gather third-party information through a mountain of data-reporting requirements, the IRS uses that information to actively track down non-filers. See IRS Publication 3744, *Strategic Plan, 2014-2017*, June 2014.

Non-filers are often mired in inaction for two reasons. First, they do not have the money to pay the tax and that is how their problem started in the first place. The vast majority of non-filers are not criminals. They are broke. Secondly, they know that the failure to file creates a second problem, which is the failure itself—a problem they believe can land them in jail. And as long as the IRS fails to take enforcement action (as it often does for extended periods of time), one's fear and uncertainty leads him to continue to do nothing.

Unfortunately for non-filers, the reality is you cannot take comfort in the agency's lack of action. The reason is that when a return is not filed, under the assessment statute of limitations, there is no time restriction on the IRS's ability to *assess* a tax. See IRC §6501(c)(3). Do not confuse this with the clear *criminal* statute of limitations discussed in Chapter 3. Though the IRS's ability to prosecute is limited, its capacity to assess taxes is not.

Nor should this be confused with the *collection* statute of limitations, which I discuss in Chapter 10. As I stated repeatedly to this point, once a tax is assessed, the IRS has just ten years to collect it. That period can be extended through any of several tolling events, which I discuss in detail in Chapter 10.

Once a return is filed, the IRS normally has just three years from that date to make an assessment. In some cases, the three-year rule is extended to six years. However, if no return is filed, there is no limitation on the assessment period. Therefore, as many as twenty years may pass from the return's due date and the IRS is nevertheless able to assess a tax for that year. IRC §6501(c)(3). For details on the assessment statute of limitations, see Chapter 8 of *How to Win Your Tax Audit*.

For this reason, the IRS cannot be expected to remain quiet forever. That is why I recommend filing past due returns.

Another important consideration is that as a general rule, the tax amnesty relief I discuss in this book is not available if you do not file delinquent returns (with certain exceptions that I discuss later in this chapter). As a result, this chapter explores how to file delinquent returns when the IRS is not pressing for them.

Filing Delinquent Tax Returns—A Caveat

I must begin this discussion with an important *caveat*. If you intend to pursue bankruptcy as a potential means of obtaining tax amnesty, *do not read* this analysis in a vacuum. Read it in conjunction with the discussion in Chapters 13 and 14. Furthermore, *do not act* on these suggestions without consulting counsel experienced in handling *tax bankruptcies*.

Nobody wants to kick a sleeping lion. Thus, if the IRS is not pursuing you for back tax returns, it seems self-destructive to beckon its attention. That is especially true in light of all you learned thus far. Still, to fully dispose of your problem, that is exactly what must happen.

Who is Required to File

I have talked with hundreds of non-filers over the years. Nearly without exception, each labors under the delusion that all persons are required to file, *without exception*. That is not true. The obligation to file attaches to the receipt of gross income. The duty to file exists only if you received gross income in excess of the statutory filing requirement for the year in question.

Accordingly, the first step to curing a non-filing situation is to determine whether you are required to file the return in the first place. I once worked with a man panicked by a pattern of non-filing stretching over a period of five years. After talking with him, I found that for three of those five years, he was unemployed. He lived with his brother and existed off the charity of his family. Because he earned no income during that three-year period, he had no legal obligation to file.

Each year, the so-called threshold filing requirements change. These requirements refer to the minimum amount of gross income one must earn before being required to file. To figure the filing requirement threshold, add the value of your dependent exemptions (yourself, wife and children) to the amount of the standard deduction for the year in question. That sum constitutes the filing threshold. If you earn less than that, you are not required to file for that year.

Let us look at tax year 2015 as an example. For a single person, the standard deduction is $6,300. The dependent exemption is $4,000. Thus, a single person is not required to file unless he earns $10,300. If you are entitled to file a joint tax return with your spouse, the filing obligation does not attach until joint income reaches $18,300. This is because the standard deduction for married filing jointly taxpayers is $10,330 and you are entitled to at least two dependent exemptions of $4,000 each. If you have dependent children, you add the dependent exemption value for each of your children.

You must use the filing status that is applicable to your circumstances. For example, if you are over age 65, the standard deduction increases. The best advice is to consult IRS Publication 17, Your Federal Income Tax, for the year in question. That document contains a detailed chart illustrating the filing requirements. Also, the instructions for Form 1040 explain the exemption amounts and standard deductions applicable to the year at issue. This material is available on the IRS's website.

If you learn that you are not required to file a return, God bless you! Your problem is solved! However, be prepared to prove it if the IRS asks questions. My books *The IRS Problem Solver* and *How to Win Your Tax Audit* offer guidance for doing that.

How to File Delinquent Returns

If you find that a return is required, the next step is to prepare it, but not yet file it. If you must file past due returns for several years, prepare all the returns first, before filing any of them. You may wish to use a professional return preparer to help with this project. Before embarking, carefully read Chapter 6 of *How to Win Your Tax Audit*. It illustrates exactly what records you need to accurately report your income and deductions. It also illustrates how to reconstruct lost records if necessary. You should also consider audit-proofing your tax returns at the time of filing. This reduces the possibility of the IRS flagging the tardy returns for audit. See *How to Win Your Tax Audit*.

After preparing the returns, sort them into two groups; those which show *no tax* owed (or a refund) and those which show *tax owed*. The returns showing no tax due, or a refund, should be filed first. Because they do not show any tax due, filing these returns creates no collection problem.

Please note that if the return is more than three years late, you lost your right to any refund or credit. That is to say, not only will you not get any money back, the IRS will not apply any overpayment to other years. Therefore, if you believe the IRS owes you a refund on a tardy return, prepare and file that return *before* any of the others and if possible, before the three-year period expires. To illustrate how to compute the three-year period, suppose your 2010 return was due no later than April 15, 2011. If that return is filed after April 15, 2014, you lose your right to a refund or a credit.

After filing all returns showing no tax liability, address those that do. If you can pay the tax owed in a reasonable period of time through an installment agreement, you can send Form 9465, *Installment Agreement Request*, directly with your returns. Review Chapter 5. If not, file the returns anyway, and be prepared to deal with the collection process as I discuss in Chapters 4, 5, and 6. It is important that you not lose sight of the fact that before levy or seizure action can be taken, the IRS must mail a *Final Notice of Intent to Levy* and you have Collection Due Process appeal rights in connection with that letter. That means as long as you pay attention to your mail and respond properly, you will not be exposed to enforcement action that cannot be controlled. At the very least, you will pay the taxes on your terms, not theirs.

Also keep in mind that you should *never* send more than one tax return in a given package. The IRS is notorious for failing to process anything beyond the first return when a group is submitted simultaneously. The preferred method is to file them in separate envelopes at intervals of two or three days. Send each return via certified mail with return receipt requested. Keep signed copies of all returns for your records. And, be sure to keep your postal receipts and proof of delivery for *each return*, and *attach* the mailing documents to your file copy of the return. You must be able to match these up later if your filing is challenged for some reason.

How Far Back Should I go to Cure Delinquent Filings?

This question arises for those with filing delinquencies of more than just a few years. I often run across people who have not filed for eight years, ten years, and even longer. The task of preparing a single tax return is daunting enough. But the idea of preparing ten or more can be overwhelming. Consider Deb's situation. She was pushed to prepare and file returns for eight years, and was given precious little time to do it.

When a revenue officer is in your face demanding returns, it is quite easy to answer the question, "How far back do I go?" The RO answers the question for you, as in Deb's case, by telling you which returns to file. However, when the IRS is not in your face, the question can be difficult to answer, especially if your omissions extend beyond six years. Here are some guidelines to help answer the question. They are derived from my experience and from the law and regulations.

The first guideline is Pilla's Rule of Loose Ends. I do not like loose ends. The whole idea of the amnesty programs is to tie up loose ends and solve problems—to put the delinquencies behind you, to let the dead bury the dead, and to get on with your life. By *not* filing all delinquent returns, you leave loose ends, chiefly because there is no statute of limitations on assessment if you do not file a return for a particular year. As such, the possibility exists—however remote it may be—that at some point, the IRS may come back and rub your nose in the fact that you did not file a given return.

Moreover, generally speaking, all returns should be filed to take full advantage of the relief offered through the various amnesty options. Why, for example, would you attempt to resolve taxes for six unfiled years only to leave the seventh year off the table? The addition of the seventh year, by itself, does nothing to jeopardize the success of your efforts. On the other hand, if, after making a deal, the IRS turns up the unfiled return, it could kill the deal later. Therefore, all things being equal, I would file all delinquent returns whenever that is practical and possible.

The second guideline addresses filing delinquencies of fewer than six years. In this case, *file all returns*, regardless of what the IRS demands. The key reason is that the criminal statute of limitations runs for six years from the due date of the return. See Chapter 3. Furthermore, the IRS's guidelines, which we examine more closely below, indicate plainly that non-filers are expected to cure all delinquencies of at least six years or less.

The key manual part I speak of is IRS Policy Statement P-5-133, found at IRM part 1.2.14.1.18. It provides guidance on just how far back to go when the delinquencies stretch more than six years. The IRS says that normally, non-filers are not required to file *more than* six years' worth of delinquent returns "without prior managerial approval." IRM part 1.2.14.1.18(5). This rule prevails unless the facts and circumstances warrant a different conclusion.

According to the IRS, the factors to be considered in deciding whether to go beyond six years include:

> *"prior history of noncompliance, existence of income from illegal sources, effect upon voluntary compliance, anticipated revenue, and collectibility, in relation to the time and effort required to determine tax due. Consideration will also be given any special circumstances existing in the case of a particular taxpayer, class of taxpayer, or industry, or which may be peculiar to the class of tax involved." IRM part 1.2.14.1.18(4).*

Based on this, we may conclude that if you were self-employed during the delinquency period and earned substantial income, and accumulated substantial assets, the IRS may require returns for all periods even if they go beyond six years. Likewise, if there is evidence of your involvement in illegal activities, or you were engaged in high profile tax protester activity, the agency may likely require the filing of all missing returns.

Conversely, a wage-earner who underwent some wage withholding would likely not be required to file more than six delinquent returns. In addition, a self-employed person with little income during the delinquency period and little or no assets would likewise probably not have to file more than the most recent six missing returns.

Dealing with IRS-Filed Returns

A common problem faced by non-filers is the IRS's so-called Substitute for Return (SFR). We learned from Deb's experience that ROs often threaten to just "file the returns for you" if you fail to "cooperate." To do this properly, the IRS must make a determination of the tax liability, which it does based upon "available" information. That may be information you provide, or it may be W-2 and 1099 information already in the agency's possession. Just as likely, an SFR is based upon a revenue officer gazing up at the stars and scratching his chin to divine that you must have earned "six hundred thousand dollars" during the delinquency years and are entitled to "no deductions."

Once the agency determines your income, it must mail a *Notice of Deficiency*. The NOD explains how the IRS arrived at its figures and offers the opportunity to file a Petition with the Tax Court to contest the proposed assessment before it becomes final. In the Tax Court process, you have the right to present documentation to show your correct income and deductions.

Too often, however, the IRS overlooks the pesky part about the deficiency procedures. Instead, it just assesses the tax based on an SFR. An SFR is made under the authority of code section 6020(b). It allows the IRS to assess a tax where no return is filed based upon "available information." That return is considered correct for all legal purposes and the citizen has the burden to prove it is wrong.

Once an SFR is processed, collection begins with notices from ACS. This is often the first word a non-filer hears from the IRS. He is also flabbergasted at the amount of tax the IRS claims is owed during a year he could not possibly have owed that much. In fact, he may even have been owed a refund if he had claimed all his deductions, etc. Sadly, however, the RO does not care because "the tax is assessed" and it is now in collection.

However, IRS procedures *require* the RO to care. First, if you are the victim of an SFR assessment, you are entitled to an "audit reconsideration." The audit reconsideration is the process by which the IRS opens closed audit cases. While you may never have appeared for an audit, the SFR is essentially the result of an audit. You have the right to re-open an SFR assessment when you can prove that the tax assessment is incorrect.

When collecting a tax based upon an SFR assessment that a citizen disputes, the taxpayer is entitled to an abatement of the excess liability. See IRC §6404(a); IRM part 5.1.15.1.1(2), *Tax Abatements*. But it falls to you to push the issue. The details of this procedure are spelled out in Chapter 13 of *How to Win Your Tax Audit*. We have been very successful using this process to correct inaccurate SFR assessments.

Second, when collecting a tax assessed via SFR, the RO must, upon contact with the taxpayer, explain how the tax was computed and explain that the taxpayer has the opportunity to file a correct return showing all deductions and other information to support a decrease in the assessment. The taxpayer must be given reasonable time to provide this information before collection actions begin. See IRS Fact Sheet, FS-97-27, December, 1997; and IRM part 5.1.15.3.2 (8-11-2015), Criteria for Reconsideration Request. See also Publication 3598, *What You Should Know About the Audit Reconsideration Process*.

And finally, under IRS Policy Statement P-16, the IRS is required to withhold collection "whenever a taxpayer raises a question or presents information creating reasonable doubt as to the correctness or validity of an assessment." IRM part 1.2.14.1.4(2). Such doubt exists when there is an SFR assessment that is not correct because it did take into consideration your proper income, deductions, exemptions and credits.

Contrast these procedures and guidelines with the statements and demands Deb faced. As you can see, it is a new world but it remains your obligation to understand your rights, or you face the real possibility that you will lose them. The book *How to Win Your Tax Audit* provides the details for correcting SFRs.

Get Off the Tax Debt Treadmill

Perhaps the greatest source of frustration for delinquent citizens is that once behind the eight ball, they rarely seem to be able to get off the treadmill. The scenario goes something like this: April 15 arrives, and with it the horror of knowing that you cannot pay your taxes. In the best case, you file a return without the money and await the inevitable onslaught. In the worst case, you file no return—hoping against hope that the money materializes somehow.

The common belief is you will be able to pay the tax out of current income. Though your earnings rarely change, you make every effort to commit all available funds to the task. However, penalties and interest accumulate at staggering rates. Considering the fact that many Americans live paycheck to paycheck, interest and penalties pose a substantial hardship, making it impossible to pay delinquent taxes, necessary living expenses and the current taxes.

Over time, the IRS applies partial payments to the *back* taxes. At the same time, current tax revenue is often diverted to pay living expenses. This creates a second problem. Not only does a liability exist for the first year, but now you are slowly cultivating a liability for the second year of the scenario.

By the time you file the return for the second year, you face two delinquent debts. This pattern generally continues for several years. At some point, you may eventually pay off the first year's debt, but only after substantial penalty and interest assessments. As the pattern continues, tax liabilities multiply at the rate of one or two new years for each old year that is paid off (if any are paid off at all). In other words, for every step forward, you take two steps back. This is one reason so many people just stop filing altogether and go underground.

Given this demoralizing process, I have developed a very effective plan for bringing an end to the madness. I call it getting off the tax debt treadmill. This is the process of "getting current" with the IRS. As a critical element of stepping forward, it is mandatory to get current to have any hope of solving your problem. In fact, if you do not get current, there is no hope of being successful with the amnesty programs.

This is what you must do to terminate your trip through the tax collection Twilight Zone.

1. **Whatever you do, you *must* pay current taxes.** These are the taxes owed on income earned during the *present* year. Do not allow yourself to utilize current tax revenue either to pay back taxes or to pay living expenses. Always remember Pilla's First Rule of Tax Debt Management: If you have money to pay the back taxes, or money to pay the current taxes, but not both, *NEVER PAY THE BACK TAXES*! The back tax debt can *always* be managed through one or more of the techniques discussed in this book. However—and note this carefully—<u>*NONE*</u> of these techniques work if you are not current with your tax payments and filing obligations.

   An essential element of working out your tax debt is to very carefully establish a monthly budget and stick to it. The budget must consider tax payments for federal and state income and Social Security taxes. What you are left with is, of course, net income or take-home pay. Base your personal expenditures on that amount alone. If you are a wage earner, resist the temptation to adjust your withholding allowances to increase your take home pay. That does not solve the back tax problem but rather, creates a current tax problem.

   If you are self-employed, you must use more caution and restraint with your budget because you do not enjoy the "benefit" of wage withholding. You are paid in full by customers or clients, and you bear the burden solely of paying your own taxes. You must make quarterly estimated payments of your current taxes. Make the payments on IRS Form 1040 ES, *Estimated Tax*, a simple payment coupon.

   To avoid both another tax delinquency and the penalty for underpayment of estimated taxes, generally you must pay either 100 percent of your prior year's tax liability (the year preceding the current year), or 90 percent of the current liability, whichever is less. The best way to do this is to ascertain your "effective tax rate" and make estimated payments based on that. The effective tax rate is the percentage of your income you pay in total tax measured against your gross income, *before any deductions*. This is how to compute your effective rate:

   Start by determining your total federal tax for the preceding year, say 2014. Your total 2014 federal tax liability includes Social Security taxes and is the tax liability *before* applying payment credits. Suppose that number is $13,000 for purposes of illustration. Divide that number into your gross income for 2014, *before* considering any deductions or expenses whatsoever. Suppose your gross income was $60,000. By dividing $13,000 into 60,000, you arrive at a fraction, which is .216. Thus, 21.6 percent is your effective federal tax rate. It means that 21.6 percent of *every dollar* you touch goes to federal taxes.

   After finding your effective federal tax rate, do the same for state income taxes. Suppose your state effective tax rate is 7 percent. You must now set aside a total of 28.6 percent (21.6 federal plus 7 percent state) *of every dollar you touch* to cover your total income tax burden. If you earn $60,000 gross, your monthly income is about $5,000. At 28.6 percent, you must set aside $1,430 ($5,000 x .286) to cover your *current* federal and state income, and Social Security tax debt. On a quarterly basis, send a payment to the IRS equal to three monthly estimates using Form 1040 ES, the payment coupon. Make a similar payment to the state using its coupon.

   I recommend that self-employed persons set up a separate bank account to handle the estimated taxes. That way, the money is not co-mingled with business operating funds or personal funds, and you are less likely to spend it. In addition, you get into the habit of writing a check each month for taxes. That way, they become a real part of your budget.

   If you are a wage earner, check your wage withholding using the same procedure to ensure that enough is taken out to cover current taxes. However, do not over-withhold. That just gives the IRS another asset to take from you when you file your return. For more detailed guidance on this process, see Chapters 2 and 3 of my book, *How to Double Your Tax Refund*.

2. Using the techniques and strategies discussed in Chapter 5, **negotiate a reasonable installment plan that takes into consideration necessary living expenses *and* current taxes.** Making payments to the IRS beyond your means only translates to financial problems elsewhere, usually with current taxes. Remember Pilla's First Rule of Tax Debt Management. *Do not* propose a payment, and do not allow yourself to be forced into a payment, in excess of your "disposable income" as

defined and explained in Chapter 5. Such an arrangement cannot help you or the IRS, and usually leads only to further delinquencies.

If you have no disposable income, either because you are unemployed or under-employed, push hard for uncollectible status. See Chapter 11. When classified as uncollectible, the IRS hits the hold button on the collection machine, giving you an opportunity to either get back on your feet or otherwise use one of the amnesty programs to handle the debt.

3. **Request abatement of all penalties.** Many tax delinquencies can be solved through the cancellation of penalties. When the IRS cancels penalties, it also cancels the interest on penalties (but not interest on the tax). This often has the effect of cutting the debt by half and sometimes more, depending upon its age. In any event, canceling penalties makes the debt more manageable. See Chapter 9 for more on penalty cancellation.
4. **Consider a loan to pay the tax.** It is much cheaper to borrow money from a bank or third party than it is to borrow from the IRS. There are several reasons for this.
   a. Interest paid to the IRS is considered personal interest and is not tax deductible. However, interest on a home equity loan or refinance is likely deductible. Handle tax liens standing in the way of a refinance as outlined in Chapter 6.
   b. Loans from a bank or third party carry a fixed interest rate and no penalties. The IRS charges penalties and interest until the tax is paid in full. Furthermore, the interest rate is subject to change twice per year based on prevailing market rates. And as if that is not enough, the IRS compounds interest on the entire unpaid balance on a *daily* basis, meaning that over time, you pay interest on taxes, interest on penalties and *interest on interest*.
   c. Loans from banks and third parties can be amortized over longer periods. This can reduce the monthly installment payment compared to what the IRS might expect.
   d. Short of getting forgiveness of the debt, paying the tax you owe in full is the only sure way to avoid enforced collection action.
5. **Use the tax amnesty programs if necessary.** If you are unable to secure funds from an outside source, or you are otherwise unable to liquidate the debt, you must turn to one of the amnesty programs discussed in this book. Do not be concerned that your bill may be escalating while you make small installment payments or are deemed uncollectible. The IRS cannot chase you forever and cannot get from you what you do not have. Eventually, you *will be* in a position to eliminate the debt somehow, if through no other way than with the expiration of the collection statute of limitations. See Chapter 10. And all the while the debt sits with little or no collection results, you heighten the IRS's willingness to negotiate.

As long as you *get and remain current* with your income return filing and payment obligations, it is unlikely you will force the IRS into irrational collection action before your case is ripe for settlement through one of the amnesty programs.

Conclusion

The best time to step forward is when you are *not* under fire. That way, you enjoy the luxury of handling the problem on your own terms and within your own timetable. This is particularly true if you are able to secure the money to pay the tax over a fairly short period of time.

By filing past due returns as shown here, you very possibly may lick your tax delinquency problem before it becomes a threatening monster. You would be surprised to learn how many citizens are in a self-imposed tax debt prison. In most cases, the citizen himself holds the key to the jail cell door. All he needs is simple instructions on how to work the lock.

Review Questions

1. Which of the following has an unlimited statute of limitations?
    A. Assessments on non-filers
    B. Collections
    C. Criminal actions
    D. Assessments on filers

2. If a taxpayer is filing several delinquent returns more than three years late, and some reflect no tax liability and others show taxes due, what is the suggested filing strategy?
    A. File all returns together in a single package
    B. File returns showing no tax due first
    C. File each return separately as soon as it is prepared
    D. Do not file any returns more than three years late since the statute has run

3. If current year and prior year taxes are owed, but both cannot be paid, what should be paid?
    A. Current year and prior years on a pro-rata basis
    B. Back taxes first
    C. Current taxes first
    D. Only current taxes

Review Answers

1. A. **Correct.** If no return is filed, there is no limitation on the assessment period.
   B. Incorrect. Collections are subject to a statute of limitations. Once a tax is assessed, the IRS has ten years to collect it.
   C. Incorrect. Criminal actions are subject to a statute of limitations, depending on the offense. A general three-year period of limitation exists for prosecuting a criminal offense, but there are eight circumstances, such as fraud, in which a citizen may be charged with a crime within six years after the commission of the offense.
   D. Incorrect. The assessment on filers has a statute of limitations. Once a return is filed, the IRS normally has three years from that date to make an assessment.

2. A. Incorrect. If a taxpayer is filing several delinquent returns more than three years late, and some reflect no tax liability and others show taxes due, all returns should not be filed together in a single package. A taxpayer should never send more than one tax return in a given package since the IRS may process only the first return in the package.
   B. **Correct.** If a taxpayer is filing several delinquent returns more than three years late, and some reflect no tax liability and others show taxes due, the returns showing no tax liability should be filed first since they will not create any collection problems.
   C. Incorrect. If a taxpayer is filing several delinquent returns more than three years late, and some reflect no tax liability and others show taxes due, each return should not be filed as soon as it is prepared. The taxpayer should prepare all of the returns first, before filing any of them.
   D. Incorrect. If a taxpayer is filing several delinquent returns more than three years late, and some reflect no tax liability and others show taxes due, it is not a good strategy to not file the returns that are more than three years late. If not filed, there is no time restriction on the IRS's ability to assess a tax.

3. A. Incorrect. If current year and prior year taxes are owed, but both cannot be paid, current year and prior year taxes should not be paid on a pro-rata basis. There is a preference as to which taxes should be paid, and it is not on a pro-rata basis.
   B. Incorrect. If current year and prior year taxes are owed, but both cannot be paid, the back taxes should not be paid first. There is a preference as to which taxes should be paid, and it is not to pay back taxes first, since these can be managed through various amnesty techniques.
   C. **Correct.** If current year and prior year taxes are owed, but both cannot be paid, it is important to pay the current taxes first.
   D. Incorrect. If current year and prior year taxes are owed, but both cannot be paid, current taxes should be paid and back taxes should then be paid, if there is any left over after payment of current taxes. If not paid, back taxes can be managed through various amnesty techniques.

Chapter 9
Forgiveness of Penalties

Learning Objectives

- Identify the most common error made by people when making penalty cancellation requests
- Pinpoint the key problem with the with the frivolous submission penalty
- Ascertain what the IRS must prove if a frivolous submission is omitted from the IRS list of positions it deems frivolous

Introduction

Rare is the tax bill that does not include one or more of the nearly 140 or so penalty provisions of the code. Both civil and criminal penalties exist for not filing timely, underpaying taxes, overstating deductions, and so on. The most common are civil penalties for negligence and delinquency that manifest in the form of *ad valorem* penalties. An *ad valorem* penalty is one based upon a percentage of the tax.

Penalties are insidious because they often increase the assessment well beyond what can be paid. After adding interest, the bill doubles, triples, or even worse. This strips even the most desirous citizen of not only the *capacity* to pay, but the *will* to pay. I have been told a thousand times, "I can pay my *taxes.* It's the penalties and interest that are killing me. And with the bill constantly going up, there's no point in even trying. I'll never pay it off."

If one could simply eliminate penalties, he might be a long way toward home on his journey to financial freedom. My guess is that a good number of those in trouble with the IRS could put the matter behind them once and for all if they could only be rid of the penalties. Not only can this be done, but the procedure is not nearly as complicated as you might think.

The problem, however, is that the IRS regularly lies to the public concerning the ability to cancel penalties. While a guest on a radio show, I once spoke with a listener who received a notice demanding about $1,000 in penalties. He explained that he called the IRS and asked whether the penalty could be canceled. He told the IRS that he did not believe the penalty was proper and he would like to seek its reversal. He was told there was nothing he could do about it. He was told the penalties were "automatic." If it was included in the bill, he would just have to pay it.

Later, after hearing me explain the right to cancel penalties, the man wrote a letter to the IRS in the fashion I suggested. He gleefully reported that with his simple letter, he was successful in canceling nearly $1,000 in penalties. If he was thrilled to win a $1,000 penalty cancellation, how much more so are those who owe $10,000, or even $50,000, in penalties?

No matter what the amount, the procedures are the same and the chances of winning are substantial. Through the procedures I developed over the years, I have seen consistent success with the cancellation of penalties. And when the IRS cancels penalties, it cancels interest on the penalties as well (though interest on the tax remains). That can lead to profound relief.

The IRS's Penalty Policy

A key problem with penalty assessments is that they are often arbitrary and issued without regard to the facts of the case. In tax law generally, the purpose of penalties is to punish wrongdoers, those who have no regard for the law or who deliberately turn their backs on the requirements of the law. Penalties are intended as a deterrent for those who otherwise would disregard their legal obligations. Penalties are not and never were intended to apply to the ignorant, misled, confused, or to one who, in good faith, misunderstands the law. Yet the IRS bashes those very people with tax penalties to the tune of billions of dollars every year.

In May 1992, as part of the “amnesty” attitude that was ushered in by former Commissioner Shirley Peterson, the agency issued a Policy Statement on penalty assessment and abatement procedures. In addition, the IRS trashed its penalty procedures handbook and re-wrote it entirely. The Policy Statement specifically held that the IRS was not to use penalties for the “raising of revenue,” or imposing “punishment” on a taxpayer, or even to secure “reimbursement of the costs of enforcement.” Under the guidelines adopted at that time, penalties were to be applied “solely on the basis of whether they do the best possible job of encouraging compliant conduct.” IRS Policy Statement P-1-18, May 19, 1992.

This was an incredible admission. All along, I had claimed that the IRS misused penalties to accomplish nothing more than the raising of revenue, with little regard for creating deterrence to non-compliance. Finally, the IRS admitted that while such a practice occurred in the past, *it must end.* This policy remains in effect today. IRS Policy Statement 20-1 (June 29, 2004) is a re-statement of the 1992 declaration. See IRM part 1.2.20.1.1.

The current Policy Statement makes it perfectly clear that penalties are not to be imposed “automatically.” They are not to be arbitrary, but rather they are to be based on the specific facts and circumstances of an individual’s case. IRM part 1.2.20.1.1(4) reads as follows:

> *“In order to effectively use penalties to encourage compliant conduct, examiners and their managers must consider the applicability of penalties in each case, and fully develop the penalty issue when the initial consideration indicates that penalties should apply. That is, examiners and their managers must consider the elements of each potentially applicable penalty and then fully develop the facts to support the application of the penalty, or to establish that the penalty does not apply, when the initial consideration indicates that penalties should apply.”*

The IRM clearly provides that current penalty policy is intended to “ensure consistency.” That is, similarly situated taxpayers are to be treated the same under the law. Under the prior program, the IRS cared little whether its assessments were consistent from one case to another, or from one region of the country to another.

The IRS’s detailed penalty policy, found in IRM, part 20, is known as the Penalty Handbook. The Penalty Handbook is intended to provide guidance to IRS personnel in addressing penalty issues so that penalty administration is both fair and impartial. In fact, the IRM lists four key principles that are to guide the agency’s employees in administrating penalties. They are:

1. **Consistency:** The IRS should apply penalties equally in similar situations. Taxpayers base their perceptions about the fairness of the system on their own experience and the information they receive from the media and others. If the IRS does not administer penalties uniformly, overall confidence in the tax system is jeopardized.
2. **Accuracy:** The IRS must arrive at the correct penalty decision. Accuracy is essential. Erroneous penalty assessments and incorrect calculations confuse taxpayers and misrepresent the overall competency of the IRS.
3. **Impartiality:** IRS employees are responsible for administering the penalty statutes and regulations in an even-handed manner that is fair and impartial to both the Government and the taxpayer.
4. **Representation:** Taxpayers must be given the opportunity to have their interests heard and considered. Employees need to take an active and objective role in case resolution so that all factors are considered. (IRM part 20.1.1.2.2)

Imagine a system with no concern for consistency, the accuracy of results, or the impartiality of the process, and you realize the nature of the system we were forced to live with for decades. The IRM is clear that the current penalty system is intended to provide citizens “with a reasonable opportunity to provide evidence that the penalty should not apply.” IRM part 1.2.20.1.1(9). This means you have the right to present facts and arguments to support your position, not simply be told that “penalties are automatic,” and you therefore must pay them. The system is designed to allow for the reversal of initial penalty assessments when you provide sufficient information to show that the penalty is improper.

Lastly, the system is designed to ensure that penalties are used only for their proper purpose to encourage voluntary compliance, and not as "bargaining points" in resolving or developing other aspects of the case. One of my hottest criticisms of tax auditors is that they regularly threaten penalty assessments against those who do not accept audit decisions. This is true regardless of whether the audit determination is, in fact, correct. As we have just learned, such a practice is improper.

How to Cancel Penalties

Every penalty provision that a typical taxpayer might face contains a "good faith" or "reasonable cause" provision. That means simply that a penalty does not apply when the citizen acted in good faith and based on a reasonable cause for his actions. The purpose of this language is to ensure that penalties are applied only against a deliberately negligent citizen, or one who takes affirmative steps to improperly avoid paying the correct tax.

You must prove that the penalty does not apply. To meet that burden, you must provide a detailed statement to establish all the facts of the case. Offer sufficient detail to support the contention that you acted in good faith, and based upon a reasonable cause for your actions, and not out of a deliberate attempt to cheat, deceive or mislead the IRS. The facts should contradict the IRS's presumption that the penalty applies. Failure to provide detail is the most common error people make when making penalty cancellation requests.

Examples of good faith and reasonable cause can include, but are not limited to:

1. Adverse financial conditions brought on by circumstances beyond your control, such as a failed business or profound personal problems,
2. Medical factors leading to an inability to meet your tax obligations,
3. Lost or destroyed records through no fault of your own,
4. A natural disaster, such as fire, flood, hurricane, etc,
5. Reliance upon the advice of qualified counsel, or on the IRS, which turned out to be wrong,
6. Reliance on IRS statements or publications that turned out to be wrong, or
7. Simple ignorance of the law or requirements in a particular area, where you can demonstrate you made at least minimal efforts to ascertain your responsibilities.

These ideas of reasonable cause are not intended to be exhaustive. The concept of reasonable cause is subjective and turns on the facts of a given situation. What may seem reasonable to one person may not seem so to another. Therefore, present your reasonable cause argument based upon what you knew or believed, not what somebody else knew or believed. Provide documentation to the extent possible to support your reasonable cause argument. For example, if you claim that medical problems were the cause of your failure to file, provide sufficient documents to prove the malady.

The letter seeking abatement must be signed under penalty of perjury. That transforms the mere statement into *sworn testimony*. Mail the letter to the Penalty Abatement Coordinator at the service center where you file your tax return. If your case is handled by a revenue officer, submit the claim directly to the RO. Bear in mind that any initial decision denying the request *is not final*. Whether issued by the RO or some other IRS office, an adverse decision may be appealed to the Appeals Office. There, it receives a fresh review by persons generally better trained to consider your facts and apply the law. If you have a Collection Due Process appeal pending, submit your abatement request to the settlement officer handing your case. An adverse decision from a settlement officer in a CDP case is appealable to the Tax Court, as explained in chapters 4 and 5.

Chapter 4 of my book *The IRS Problem Solver* is the most thorough, definitive discussion ever written to the public on techniques for winning abatement of penalties. Because of that exhaustive analysis, I elect to be brief here. Anyone setting out to challenge tax penalties does himself a disservice if he does not read that discussion. I give numerous examples and ideas on effective arguments.

The "First-Time" Failure

Since 2001, the IRS has had an administrative waiver policy in effect that most people simply do not know about. The policy provides that a person with a clear compliance history is entitled to an abatement of any delinquency penalty in connection with a "first-time" failure to file or failure to pay. The policy is expressed in IRM part 20.1.1.3.6.1(1). It states that the IRS's abatement process provides:

> *"…an option for penalty relief for the [failure to file], [failure to pay], and/or [failure to deposit] penalties if the taxpayer has not previously been required to file a return or if no prior penalties (except the Estimated Tax Penalty, TC 17X) have been assessed on the same [taxpayer] … in the prior 3 years."*

This waiver is referred to as the "First-Time Abate" (FTA) policy. It is the IRS's answer to a "mulligan." Under this policy, you get a "do-over" if you messed up for the first time. I actually had a settlement officer use this very phrase with me in a discussion I had with him about penalty abatement in a client's case. I argued that since it was the client's first failure to file, he was entitled to abatement regardless of what the IRS thought about the reasonable cause argument we presented. He agreed with me, saying that the IRS "will give just about anybody a do-over if it's their first failure."

How the FTA Waiver Works

While this is referred to as the "first-time" waiver, the policy does not require that you have "never" had any problem with failure to file or failure to pay in the past. The two critical factors are either: 1) you were not previously required to file a return, or 2) delinquency penalties were not assessed against you "in the prior 3 years." IRM part 20.1.1.3.6.1(1) and (5)(A).

Let us discuss the "not required to file" element. Suppose you just started a business in 2011. Prior to that, you were a W-2 wage earner with no business background or experience. As part of your new business, you take on an employee and are required to engage in wage withholding on behalf of that employee. You perform the required wage withholding but do not file the Form 941, *Employment Tax Return*, on time. The IRS assesses the penalty for failure to file. Because you were never required to file a Form 941 in the past, you can get relief under the FTA policy.

Now let us look at the "prior three years" element. The phrase "prior three years" betrays the fact that you can actually get this relief once every three years, not just once in a lifetime, as the policy title suggests. This is supported by the language of the IRM sections cited above. So long as you have not been hit with delinquencies within any of the prior three years, you qualify for the FTA policy. Moreover, if you had a penalty abated for reasonable cause within the past three years that is treated as if the penalty was never assessed. IRM part 20.1.1.3.6.1(2).

The FTA waiver can only apply to a single tax period for a given taxpayer. IRM part 20.1.1.3.6.1(3). For example, suppose you are hit with the failure to file penalty for three consecutive years. In that case, the FTA waiver only applies to the earliest tax period, not all three of them. However, after applying the FTA waiver to the first period, the IRS will consider abatement for the subsequent years based on reasonable cause grounds. Thus, if you can establish reasonable cause for not filing in the subsequent years, you will get the penalties canceled for all three years.

Even if the FTA policy does not apply at all, you are nevertheless entitled to argue for abatement based on reasonable cause grounds. IRM part 20.1.1.3.6.1(4). To illustrate, look back at the above example of the new business owner who did not file his Form 941 on time. He obtained an FTA waiver because he was never required to file that form in the past. However, suppose that one year later, he is late with filing another Form 941. He is not entitled to an FTA waiver because he had one within the prior three years. However, he is entitled to present reasonable cause arguments to get the penalty canceled. If he can show that he acted in good faith and the failure to file was due to reasonable cause and not willful neglect, he can still get the penalty canceled.

The failure to deposit penalty for businesses is not subject to the FTA waiver if the penalty is assessed due to the business's failure to use the IRS's electronic payments system (EFTPS) to make the required deposits. IRM part 20.1.1.3.6.1(5)(D).

In the case of a business seeking an FTA waiver, all compliance history in the past three years is reviewed. Let us again refer to our Form 941 example. Suppose the business was operating for several years before filing its first late filed Form 941. In reviewing the business's compliance history, the IRS finds that, two years ago, the business filed its income tax return late. In that case, even though it is the business's first late-filed Form 941, the late-filed income tax return within the past three years precludes relief under the FTA policy. IRM part 20.1.1.3.6.1(5)(F). However, as already stated, the fact that the business cannot get an FTA waiver does not mean it cannot get relief using a reasonable cause argument.

For two reasons, it is important to pursue a reasonable cause abatement even if you do qualify for an FTA waiver. First, as stated, the IRS must consider your reasonable cause argument in any event. Secondly, if you are successful in obtaining a reasonable cause abatement and the penalty is canceled, that is considered compliance for purposes of a future FTA waiver. That is to say, for purposes of the FTA waiver, a delinquency penalty that is waived is considered to have never been assessed.

Reasonable Cause or FTA Waiver?

The fact that reasonable cause will be considered even if an FTA waiver does not apply begs the question why not just seek a reasonable cause abatement in the first place? The answer depends upon the facts and circumstances of your case. In evaluating which argument to make (FTA or reasonable cause), you must honestly evaluate the chances of prevailing on the merits of a reasonable cause argument. Understand that the IRS does not automatically accept every reasonable cause argument presented. While a great number of factors might establish reasonable cause, the fact is that reasonable cause is a harder nut to crack than an FTA waiver. For the details on reasonable cause and how to make such an argument, see my book, *The IRS Problem Solver*, chapters 4 and 8.

For example, let us again look back at our business owner who failed to file his Form 941. Instead of it being the first 941 he was ever required to file, suppose he has a long history of full compliance with his 941 obligations. His failure to file that one form was due to a fire in the office that destroyed some of his documents, making it impossible to file the 941 on time. After reconstructing the lost records, he filed the missing form and has been in full compliance ever since.

In this case, you have a clear choice to argue for either a reasonable cause abatement (fire prevented compliance) or the FTA waiver due to his compliance history. Under these facts, I would make the reasonable cause argument since the facts so strongly support abatement due to the fire. If you can prove the fact of the fire (say through photos, insurance claims, affidavits, etc.), you are sure to prevail on the reasonable cause argument. That leaves a potential FTA abatement available to you for later use if that ever becomes necessary. In other words, why use the "silver bullet" if you do not have to?

On the other hand, the FTA waiver might be more beneficial than a reasonable cause waiver. Suppose, for example, you are charged with the failure to pay penalty, which is assessed on a monthly basis for every part of a month that the tax is late. You experienced medical problems that prevented paying the tax on time. The medical issues continued for two months, at which time they cleared up. However, the tax was not paid until eighteen months later. A reasonable cause argument might win abatement of two months (or more) worth of penalties but maybe not the entire penalty (barring other factors). However, the FTA waiver will eliminate the entire failure to pay penalty.

In considering whether to push for an FTA or reasonable cause waiver, you must also consider the time and energy it will take to make a reasonable cause argument. In order to establish reasonable cause, you must show the facts and circumstances that stood in the way of compliance (medical issues, death in the family, natural disaster, etc.), and present supporting documents to the fullest extent possible. In some cases, this can be a substantial burden, and in other cases, supporting documents simply may not be available. In those cases, you should consider the FTA waiver rather than reasonable cause.

The "Frivolous Submission" Penalty

In chapter 2, under the heading, *Tax Protesters*, I talk about the so-called "frivolous submission" penalty under code section 6702. I explain the circumstances under which the IRS may assess the penalty, and the fact that the IRS is very aggressive about assessing it. Because of the special problems associated with this penalty, I address it in more detail here.

The key problem is that this penalty is not subject to the deficiency procedures that normally apply when the IRS asserts a debt. IRC §6703(b). That is, if the IRS wishes to assess this penalty, it need not issue a Notice of Deficiency. This means that the penalty is subject only to an assessment notice. You have no opportunity to appeal the assessment to the Tax Court prior to the assessment. For more on the deficiency procedures, see my book, *Taxpayers' Defense Manual*.

Even worse, the code provides for no specific appeal procedure as to the penalty. However, section 6702(d) states:

> *"The Secretary may reduce the amount of any penalty imposed under this section if the Secretary determines that such reduction would promote compliance with and administration of the Federal tax laws."*

In this sense, the penalty is like any other penalty, such as the failure to file and failure to pay penalties. That is to say, the IRS has the discretion to reduce the penalty based upon the facts and circumstances of a given case. Your good faith and reasonable cause in filing the submission go to the question of canceling the penalty.

Appealing a Frivolous Submissions Penalty

Because the frivolous submission penalty is not subject to the deficiency procedures, the most effective way to challenge it is through the Collection Due Process appeal procedures. When the IRS issues its *Final Notice of Intent to Levy* (Letter 1058 or LT11), you have thirty days to file a request for a Collection Due Process hearing. This triggers your right to a CDP hearing before a settlement officer. The SO must consider a number of factors at the hearing, not the least of which is the propriety of the underlying tax assessment. See chapter 5.

The United States Tax Court has interpreted the phrase "underlying tax liability" to include "any amount" you owe that is the subject of collection. See *Katz v. Commissioner*, 115 T.C. 329, 338-339 (2000); *Van Es v. Commissioner*, 115 T.C. 324 (2000); *Callahan v. Commissioner*, 120 T.C. No. 3 (2008). Specifically in *Callahan*, the Tax Court expressly stated that the "underlying tax liability" was the frivolous return penalty. The cases of *Wagenknecht v. United States*, 509 F.3d 729 (6th Cir. 2007) and *Yuen v. United States*, 290 F. Supp. 2d 1220 (D. Nev. 2003) also specifically hold that the "underlying tax liability" includes the frivolous return penalty. Therefore, you may challenge the existence or the amount of the frivolous return penalty at a CDP hearing because you did not receive a statutory notice of deficiency or otherwise have an opportunity to dispute the liability. *Lewis v. Commissioner*, 128 T.C. 48 (2007).

When the question of the underlying tax liability is not at issue, the Tax Court reviews the IRS's CDP determination for "abuse of discretion." That means that the court does not judge the ultimate correctness of the determination. Rather, it reviews only the *process* by which the SO arrived at the determination. Since the IRS has discretion in granting relief under the CDP procedures, the Tax Court will not generally substitute its discretion for that of the IRS's. However, when the IRS fails to follow the law or procedures, disregards its regulations or IRM provisions, or fails to consider your specific facts and circumstances in arriving at its determination, an *abuse of discretion* occurs. In that case, the Tax Court remands the case to the Appeals Office for a full and proper hearing.

On the other hand, when the underlying tax liability is properly before the Tax Court, as in the case of an assessment of the frivolous submission penalty, then the Court reviews the IRS determination *de novo*. That means the review process starts from scratch and the Court exercises its own judgment in deciding the issue. This is very important because it is much easier to prevail in a case where the review process is *de novo* versus one based upon abuse of discretion.

A *de novo* review of this penalty is very important because the frivolous submission penalty is one of the rare cases where the IRS has the burden of proof. Code section 6703(a) states:

> *"In any proceeding involving the issue of whether or not any person is liable for a penalty under section 6700, 6701, or 6702, the burden of proof with respect to such issue shall be on the Secretary."*

The IRS must prove that your submission constitutes a "frivolous submission" as defined in section 6702(a). A submission is frivolous if (in the case of a tax return) the document: a) "does not contain information on which the substantial correctness of the self-assessment may be judged," or b) "contains information that on its face indicates that the self-assessment is substantially incorrect." IRC §6702(a).

As to either situation, one of two further elements applies. They are either that the act of filing the document is: a) based on a position "which the Secretary has identified as frivolous," or b) "reflects a desire to delay or impede the administration of federal tax laws." IRC §6702(a)(2)(A) and (B).

The IRS publishes a list of positions it deems to be frivolous. This list is required by code section 6702(c). The list was first published in Notice 2007-30, and is updated annually. It is available on the IRS's web site here: http://www.irs.gov/pub/irs-drop/n-07-30.pdf

Some of the key claims that will lead to a penalty under section 6702 are:

1. There is no law making a person liable to pay income tax. *Yuen v. United States*, *supra* at 122;
2. Wages are not income, or the filed tax return provides inaccurate or no financial information, *Tornichio v. United States*, 263 F. Supp. 2d 1090 (N.D. Ohio 2002);
3. General constitutional objections, or a refusal to pay taxes on general constitutional grounds; *Miller v. United States*, 868 F.2d 236 (7th Cir. 1989); *Leogrande v. United States*, 811 F.2d 147 (2nd Cir. 1987);
4. The tax return or tax laws violate the Fifth Amendment right against self-incrimination, *Kloes v. United States*, 578 F. Supp. 270 (W.D. Wis. 1984); and
5. General moral or religious objections to paying taxes that go toward military spending; *McKee v. United States*, 781 F.2d 1043 (4th Cir. 1986); *Franklet v. United States*, 578 F. Supp. 1552 (N.D. Cal. 1984), affd., 761 F.2d 529 (9th Cir. 1985).

A submission that presents *any* of the arguments identified by the IRS in its published statement of frivolous positions is deemed frivolous as a matter of law. See *Callahan v. Commissioner*, *supra*. In that case, the Tax Court will sustain the penalty.

However, when the submission does not express an argument that is on the "frivolous" list, then before the Court can sustain a penalty, it must find that the position constituted a "desire to delay or impede the administration of federal tax laws." And because the IRS has the burden of proof, it must offer evidence to establish your state of mind at the time of making the submission. Obviously, this is not easy to do. But if there is a pattern of tax protestor or "tax defier" activity in your history, expect the IRS to present such evidence to support the penalty. This could include prior tax returns stating such a position, letters to the IRS, or positions posited in prior court cases.

The question of your "desire to delay" goes squarely to the question of intent. In this regard, you must establish affirmatively that your purpose was *not* to "delay or impede the administration of the tax code." Even if your position is "confusing or unorthodox," as was the case with the refund claim filed in the *Callahan* case, the Court cannot make a finding that the frivolous penalty applies as a matter of law. The record must be fully developed with evidence to show your intent in filing the submission. If the IRS cannot carry its burden of proof, the Court will not sustain the penalty.

CDP Request Itself Subject to the Frivolous Penalty

It is important to note that a CDP request itself is subject to the frivolous penalty. See chapter 2, under the heading, *Tax Protesters*, for a list of submissions that might be considered "frivolous" for purposes of the penalty. Therefore, I strongly recommend that you not use the CDP process to assert the merits of any position published in the IRS's frivolous list.

Strategies to Eliminate a Frivolous Submission Penalty

There are two strategies you can use to eliminate or minimize a frivolous penalty. The first flows from code section 6702(b)(3). That section provides:

> *"If the Secretary provides a person with notice that a submission is a specified frivolous submission and such person withdraws such submission within 30 days after such notice,*

the penalty imposed under paragraph (1) shall not apply with respect to such submission."

When the submission is withdrawn within the specified time, the IRS cannot assess the frivolous penalty. This is not discretionary. But if the IRS fails to abate the penalty despite your withdrawal of the submission, now you can prosecute a CDP appeal on the question of your withdrawal, rather than on the merits of the frivolous position. This gets you a hearing and a potential Tax Court appeal on the penalty without the risk of incurring further frivolous penalties.

The second strategy grows from code section 6702(d). As stated above, that section provides discretionary authority for the IRS to reduce or eliminate the penalty. In connection with this authority, the IRS adopted a "one-time" reduction policy that allows the agency to "reduce all section 6702 penalties assessed against that person to $500." Revenue Procedure 2012-43, 2012-49, I.R.B. 643 (November 5, 2012), §5.

This Revenue Procedure applies to all frivolous submission penalties assessed against an individual that have not been paid. To qualify for the one-time reduction you must comply with all of the requirements listed below:

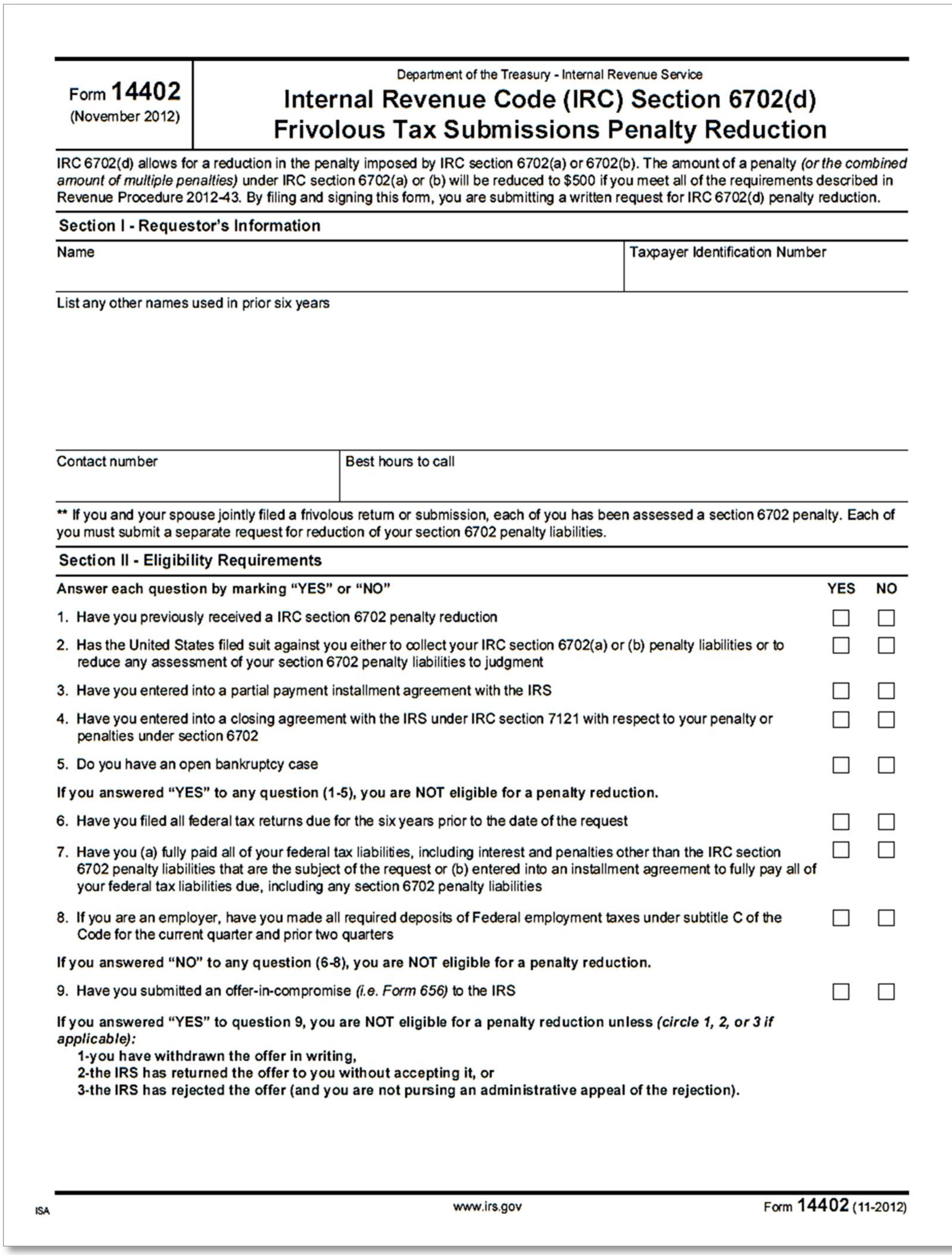
1. Submit the request for reduction on Form 14402, *IRC 6702(d) Frivolous Tax Submissions Penalty Reduction*, which must be signed under penalty of perjury. See Exhibit 9-1.
2. The $500 reduced penalty must be paid by submitting at least $250 with Form 14402, and either: a) paying the balance upon abatement, or b) paying the balance in connection with an installment agreement (already in effect) covering the income tax assessments. If the installment agreement covers the frivolous penalty assessment, and you have already paid more than $500 toward the penalty, you do not have to pay anything additional to qualify for the reduction.
3. You must be in full compliance with all tax return filing requirements.
4. You must have fully paid all income taxes (but not the frivolous filing penalty), or have made arrangements to pay in full through an installment agreement. You must be current with all obligations under the installment agreement.
5. If you are an employer, all employment tax deposits must be current for at least the past two quarters. Rev. Proc. 2012-43, §4.01-4.04.

When all of the above requirements are met, the IRS will reduce the total of all $5,000 frivolous submission penalty assessments to just one $500 penalty. This can provide remarkable relief because in many cases, multiple penalties are assessed against a given individual.

Conclusion

Forgiveness of penalties constitutes amnesty in the truest sense of the word. This is because in many cases, the absence of penalties opens the door to a final resolution of an otherwise uncontrollable tax problem. Just do not look for the IRS to mail any notice suggesting that you seek abatement of penalties as a means of solving your tax delinquency. You must take the initiative.

Exhibit 9-1 – IRS Form 14402, IRC 6702(d) Frivolous Tax Submissions Penalty Reduction



Form **14402** (November 2012)

Department of the Treasury - Internal Revenue Service

Internal Revenue Code (IRC) Section 6702(d)
Frivolous Tax Submissions Penalty Reduction

IRC 6702(d) allows for a reduction in the penalty imposed by IRC section 6702(a) or 6702(b). The amount of a penalty *(or the combined amount of multiple penalties)* under IRC section 6702(a) or (b) will be reduced to $500 if you meet all of the requirements described in Revenue Procedure 2012-43. By filing and signing this form, you are submitting a written request for IRC 6702(d) penalty reduction.

Section I - Requestor's Information

Name	Taxpayer Identification Number

List any other names used in prior six years

Contact number	Best hours to call

** If you and your spouse jointly filed a frivolous return or submission, each of you has been assessed a section 6702 penalty. Each of you must submit a separate request for reduction of your section 6702 penalty liabilities.

Section II - Eligibility Requirements

Answer each question by marking "YES" or "NO"	**YES**	**NO**
1. Have you previously received a IRC section 6702 penalty reduction	☐	☐
2. Has the United States filed suit against you either to collect your IRC section 6702(a) or (b) penalty liabilities or to reduce any assessment of your section 6702 penalty liabilities to judgment	☐	☐
3. Have you entered into a partial payment installment agreement with the IRS	☐	☐
4. Have you entered into a closing agreement with the IRS under IRC section 7121 with respect to your penalty or penalties under section 6702	☐	☐
5. Do you have an open bankruptcy case	☐	☐
If you answered "YES" to any question (1-5), you are NOT eligible for a penalty reduction.		
6. Have you filed all federal tax returns due for the six years prior to the date of the request	☐	☐
7. Have you (a) fully paid all of your federal tax liabilities, including interest and penalties other than the IRC section 6702 penalty liabilities that are the subject of the request or (b) entered into an installment agreement to fully pay all of your federal tax liabilities due, including any section 6702 penalty liabilities	☐	☐
8. If you are an employer, have you made all required deposits of Federal employment taxes under subtitle C of the Code for the current quarter and prior two quarters	☐	☐
If you answered "NO" to any question (6-8), you are NOT eligible for a penalty reduction.		
9. Have you submitted an offer-in-compromise *(i.e. Form 656)* to the IRS	☐	☐

If you answered "YES" to question 9, you are NOT eligible for a penalty reduction unless *(circle 1, 2, or 3 if applicable)*:
1-you have withdrawn the offer in writing,
2-the IRS has returned the offer to you without accepting it, or
3-the IRS has rejected the offer (and you are not pursing an administrative appeal of the rejection).

ISA www.irs.gov Form **14402** (11-2012)

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Section III - Payment Information ***(minimum payment is $250.00 unless you are in compliance with a full payment installment agreement)***

	YES	NO
1. Have you made an electronic payment or included a payment of at least $250 *(and up to $500)* with this request	☐	☐

Amount enclosed	Check number	Electronic payment amount	Payment date

2. Have you entered into an approved installment agreement with the IRS	☐	☐

If you answered "NO" to both questions 1 and 2, then you will NOT receive a reduction of your section 6702 penalty liabilities.

Section IV - Request For Penalty Reduction Relief

Requested Penalty Reduction

Tax form number(s)

Tax year(s)

Section V - Declaration Under Penalties Of Perjury

I understand and agree that if a reduction is granted, I will not be entitled to another reduction if the IRC section 6702 penalty is assessed again.

If I am under an installment agreement, I understand that if I meet all the requirements and my request for reduction is approved, the penalty or penalties will be reduced only upon completion of all payments required to satisfy all outstanding tax liabilities other than the section 6702 penalties that exceed $500 and are the subject of this request. In addition, if prior to completion of these payments, I am declared in default of an installment agreement, the penalty will not be reduced.

I understand that any request for reduction of my section 6702 penalty liabilities will be rejected if it does not meet all of the conditions of Revenue Procedure 2012-43, asserts positions identified as frivolous under section 6702(c), or is determined to have been made with an intention to delay or impede tax administration. I understand that I will be notified of the rejection and that I cannot appeal the rejection of my request to the IRS Office of Appeals for any reason. If my reduction request is rejected, I understand that any payment submitted with this request will be applied against any outstanding section 6702 penalty liability due.

Under penalties of perjury, I declare that I have filed all returns (including any accompanying schedules and statements) and paid or entered into a full payment installment agreement to pay all taxes and liabilities as described in Revenue Procedure 2012-43. To the best of my knowledge and belief, the information on this form is true, correct, and complete.

Signature	Date signed

Privacy Act and Paperwork Reduction Act Notice

We ask for the information on this form to carry out the Internal Revenue Laws of the United States. Section 6702(d) and Revenue Procedure 2012-43 describe the conditions under which you may request a reduction of assessed section 6702 penalty liabilities. Section 6109 requires that you provide your taxpayer identification number (TIN). You may use Form 14402 to request a section 6702 penalty reduction. You are required to provide the information requested on this form only if you wish to have your unpaid section 6702 penalty liabilities reduced. We need this information to ensure that you have met the requirements of section 6702(d) and Revenue Procedure 2012-43. If you do not provide this information, your request will be denied. You may be subject to civil and criminal penalties if you provide false or fraudulent information.

We may disclose this information to the Department of Justice for civil or criminal litigation, and to cities, states, and the District of Columbia for use in administering their tax laws. We may also disclose this information to other countries under a tax treaty, to Federal and state agencies to enforce Federal nontax criminal laws, or to Federal law enforcement and intelligence agencies to combat terrorism. Generally, tax returns and tax return information are confidential, as required by section 6103.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law.

The time needed to complete this form will vary depending on particular circumstances. The estimated average time is:
Recordkeeping...
Learning about the law of the form.........................
Preparing the form..
Copying, assembling, and sending the form to the IRS....

www.irs.gov Form **14402** (11-2012)

Review Questions

1. What is the key problem with penalty assessments?
    A. Penalties are automatic
    B. Penalties are arbitrary
    C. Chances of winning cancellation are small
    D. The most common penalties are criminal

2. Which of the following is a key principle of the IRS's penalty policy?
    A. Reasonable
    B. Proper
    C. Factual
    D. Impartiality

3. What is the benefit of the FTA waiver?
    A. Allows waiver of penalties for multiple tax periods within a three-year period
    B. Penalties for failure to utilize EFTPS may be waived
    C. The waiver only applies to citizens that have never filed a return
    D. Allows abatement of penalties for a first-time failure to file

4. What motive must be proven by the IRS to be a frivolous return submission?
    A. General constitutional objections
    B. Tax laws violate the Fifth Amendment
    C. Desire to delay administration of the tax laws
    D. Moral or religious objections regarding military spending

Review Answers

1. A. Incorrect. The key problem with penalty assessments is not that they are automatic. A current IRS Policy Statement makes it perfectly clear that penalties are not to be imposed "automatically."
   B. **Correct.** A key problem with penalty assessments is that they are often arbitrary and without regard to the facts of the case.
   C. Incorrect. The key problem with penalty assessments is not that the chances of winning cancellation are small. The chances of winning cancellation of penalties are substantial.
   D. Incorrect. It is not a key problem with penalty assessments that the most common penalties are criminal; instead, the most common are civil penalties for negligence and delinquency.

2. A. Incorrect. Being reasonable is not one of the key principles of the IRS's penalty policy. The current penalty system is intended to provide citizens with a reasonable opportunity to provide evidence that a penalty should not apply.
   B. Incorrect. To be proper is not one of the key principles of the IRS's penalty policy. The penalty system is designed to ensure that penalties are used only for their proper purpose.
   C. Incorrect. The key principles of the IRS's penalty policy do not include being factual. Penalties should be based on the specific facts and circumstances of an individual's case.
   D. **Correct.** One of the four key principles that are to guide the IRS's penalty policy is impartiality.

3. A. Incorrect. Allowing waiver of penalties for multiple tax periods within a three-year period is not the benefit of the FTA waiver. The FTA waiver can only apply to a single tax period for a given taxpayer.
   B. Incorrect. Waiver of penalties for failure to utilize EFTPS is not the benefit of the FTA waiver. The failure for deposit penalty for businesses is not subject to the FTA waiver if the penalty is assessed due the business's failure to use the IRS's electronic payments system (EFTPS) to make the required deposits.
   C. Incorrect. Application of the waiver only to citizens that have never filed a return is not the benefit of the FTA waiver. The policy does not require that a citizen has never had any problem with failure to file or pay in the past.
   D. **Correct.** The benefit of the FTA waiver is that it allows abatement of penalties for a first-time failure to file.

4. A. Incorrect. A refusal to pay taxes on general constitutional grounds is not a position that must be proven by the IRS to be frivolous. A claim based on constitutional objections will be automatically deemed to be frivolous.
   B. Incorrect. The argument that tax laws violate the Fifth Amendment is not a position that must be proven by the IRS to be frivolous. The argument that the tax return or tax laws violate the Fifth Amendment right against self-incrimination will be automatically deemed to be frivolous.
   C. **Correct.** If a position is not on the IRS's list of frivolous acts, the IRS must find that the position constitutes a desire to delay administration of the tax laws in order to impose a frivolous submission penalty.
   D. Incorrect. If an individual has moral or religious objections to file because taxes go toward military spending, the IRS does not have to prove that a frivolous position is being taken. General moral or religious objections due to military spending are automatically treated as frivolous.

Chapter 10
The Collection Statute of Limitations

Learning Objectives

- Recognize the IMF transaction code that reflects the assessment date based on a return filed by the taxpayer
- Determine the effect a levy has on the Collection Statute Expiration Date (CSED)
- Select an action that tolls the collection statute

Introduction

The law that caps the amount of time the IRS has to collect a tax once it is assessed is known as the collection statute of limitations. When the statute of limitations expires, the IRS's right to collect dies with it. This alone can end the misery of dealing with the IRS.

Knowing your collection statute expiration date (CSED) can save untold levels of hassle and hardship. That is why you must calculate the CSED in your case as to each tax year for which you owe.

How the Collection Statute of Limitations Operates

The general rule establishing the collection limitation period is set forth in code section 6502(a)(1). Under that provision, the IRS has ten years in which to collect the tax after making an assessment. The manner of achieving an assessment is described in Chapter 4, under the heading, *What to Expect from Enforced Tax Collection*.

Once the period of limitations has expired, the IRS can no longer collect that particular assessment. Each individual tax year is assessed separately. Therefore, each tax year has its own specific CSED.

How to Compute the Collection Statute Expiration Date

The first step in determining the CSED is to ascertain the date of the assessment. This is not the return filing date, nor is it the date the IRS mails any given collection notice, nor is it the date the IRS files a tax lien. The assessment occurs when an assessment officer signs the proper assessment certificate. See IRC §6203. This is an administrative process that occurs entirely behind the scenes. The specific date of this event is then recorded in your Individual Master File (IMF) account transcript for the tax year in question.

Obtain an IMF by making a written request to the service center where you file your tax returns. Ask for the IMF for the year in question. Chapter 3 of *Taxpayers' Defense Manual* provides more details on making this request.

The IMF contains a transaction code (TC) showing the date of the assessment. An assessment made per a return that you filed (the so-called "self-assessment") is shown with a TC 150. In the case of non-filers, if the assessment was made through a substitute for return (SFR), the IMF notes this fact and then references the assessment date with a separate transaction code. Taxes assessed pursuant to an SFR or due to an audit of your return are shown with a TC 290 or 300. Miscellaneous assessments, such as for a Trust Fund Recovery Penalty or frivolous submission penalty, are shown with a TC 240. The eight-digit number adjacent to the TC is the actual assessment date. The ten-year clock starts ticking the next day.

The IRS's *Notice of Filing Federal Tax Lien* states an assessment date on its face. See Exhibit 4-1 for an example. I like to cross-check this with master file data to ensure I have the correct assessment date.

The next step is to count forward ten years, beginning with the day after the assessment date. That will be the *earliest* date that the IRS's right to collect expires.

Certain IMF transcripts show the CSED in encrypted fashion. Transcripts known as "specific" Master File transcripts contain this information. In such transcripts, look for the letters "CSED," followed by an eight-digit number. This is a reference to the CSED as the IRS shows it. The number is the date on which the statute expires.

Extending the Collection Statute

The CSED can be extended in a number of ways. Actions that extend the statute are known as "tolling events." A tolling event stops the ten-year clock for a certain period of time, thus giving the IRS more time to collect. You must know what actions extend the statute and avoid them if possible. If you did take some such action, you need to be able to figure the amount of tolling applicable to a given tax year to ensure that you know the correct CSED. Here I examine all of the tolling events and how they are calculated.

The Voluntary Extension

A common way the collection statute is extended is with a voluntary waiver. Form 900, *Tax Collection Waiver*, is used for this purpose. Form 900 is presented to the citizen when the circumstances make it plain that the IRS cannot collect the full amount within the statutory collection period. This was discussed at length in chapter 5. An example is where the citizen negotiates a long-term installment agreement under which he makes a small monthly payment. A signed Form 900 can be a prerequisite to such an agreement. You have no legal duty to sign such a waiver.

Because there is no legal duty to sign Form 900, the obvious question is, "Why should I sign it?" The short answer is, generally, you should *not*. However, at times, the RO makes the decision a bit trickier. "If you refuse to sign," he may explain, "the agency has no choice but to carry out enforcement action to maximize collection before the statute expires." In other words, if you do not sign, levies and seizures will surely follow in full force. It is the IRS's version of Vito Corleone, the mafia Don depicted in the 1972 movie *The Godfather*, holding a gun to your head and promising that "either your brains or your signature will be on the contract."

Still, one should never sign a Form 900 purely on the basis of statements and demands of an RO. ROs often state that the form is necessary to "give you more time to pay," but in fact, it gives the IRS more time to collect. So before signing, carefully consider all the facts and circumstances of your case. Most importantly, know your CSED.

If the statute does not expire for several years, signing Form 900 may not hurt you. This is especially true if, after stabilizing your collection situation, you move right into using one of the amnesty programs. However, if the statute is to expire within a short period of time, it may be financially better to endure enforced collection than to extend the CSED for several years. Keep in mind that regardless of how long the IRS has to collect, it cannot impose levies or seizures that cause "hardship" as defined in code section 6343. We discussed this at length in Chapters 5, 6 and 7.

Keep in mind, however, that the IRS has the right to file a suit in court before the CSED runs in order to obtain a judgment, which under federal law, is good for twenty years. If Form 900 is not filed you have to consider whether you are at risk for such a suit. I discuss the factors to consider in more detail later in this chapter.

During the Senate Finance Committee hearings into IRS abuse that preceded the 1998 Restructuring Act, much discussion was pointed at the abuse that surrounded the IRS's use of Form 900. As a result of the hearings, two important changes were made to the process by which the IRS uses the waiver.

First, Congress eliminated long-term waivers that stand alone; that is to say, a Form 900 that, by itself, gives the IRS the unfettered right to collect. See Restructuring Act §3461(a), amending code §6502(a). As such, the IRS has no authority to simply ask you to extend the collection statute unless the extension is given in connection with an installment agreement. This gives you the assurance of not having to sign a waiver without the accompanying protection of an installment agreement. The Senate Finance Committee stated clearly that it believes "that the IRS should collect all taxes within ten years, and that such statute of limitations should not be extended." Senate Committee Report S. Rep. 105-174, Act §3461.

Secondly, Congress put a statutory cap on long-term waivers that were already in place. Section 3461(c)(2) of the Restructuring Act provides that in the case of any voluntary waiver signed before December 31, 1999, which extended the collection statute beyond the normal ten-year period, that extension automatically expires on the later of the following dates: 1) the normal ten-year period, or 2) December 31, 2002.

Let me illustrate this. Suppose your tax was assessed on January 1, 1995. The normal ten-year collection period expires January 1, 2005. But on January 1, 1999, you signed a Form 900 that extended the statute another five years. In that case, your collection statute would still automatically expire on January 1, 2005, which is the normal ten-year collection period, since that date is *later* than December 31, 2002. The waiver providing the IRS an additional five years to collect is considered void and does not extend the statute beyond the normal ten-year period.

As another example, suppose your tax was assessed on January 1, 1990. In that case, the normal ten-year collection period expires January 1, 2000. But on January 1, 1999, you signed a waiver that extended the statute for another five years. In that case, the collection statute would automatically expire on December 31, 2002, since that date is later than the normal ten-year collection statute, which was January 1, 2000. However, any right to collect created by the waiver beyond December 31, 2002, automatically dies.

The second change relates to Forms 900 signed in connection with an installment agreement. The statute provides an exception to the general rule of the automatic expiration of certain waivers as I just explained. This exception applies only in cases when the waiver was (or is) signed in connection with an installment agreement. That is, if you signed Form 433-D, *Installment Agreement*, and the waiver was signed to facilitate that agreement, then the waiver is valid for the duration of the installment agreement, plus ninety days. See IRC §6502(a)(2)(A); and Treas. Reg. §301.6502-1(b).

Let me illustrate this. Suppose your tax was assessed on January 1, 2002. The normal ten-year collection period expires January 1, 2012. On January 1, 2010, you enter into an installment agreement to pay $300 per month for five years, or until January 1, 2015. You sign Form 900 in connection with the installment agreement. In that case, the collection statute expires on April 2, 2015, which is ninety days *after* the installment agreement expires. See Treas. Reg. §301.6502-1(b)(1).

Given this backdrop, the only way the IRS can obtain a valid wavier of the collection statute is for you sign the waiver in connection with an installment agreement, Form 433-D.

Levies Extending Beyond the CSED

In chapter 4, I discussed the difference between a "one-time" levy and a "continuing" levy. The distinction is important, not only for the reasons expressed in chapter 4, but because of an obscure rule that allows certain levies to continue *beyond* the CSED. Before getting into that rule, let me be perfectly clear on this point: a levy—regardless of its nature—does *not* extend, toll or suspend the CSED. Rather, certain levies *survive* the CSED, but only as to the specific income stream levied.

Now let me get specific. The general provision for levies is found in code section 6331. Section 6331(b) provides that a levy attaches "only to property possessed and obligations existing at the time thereof." In the case of a bank account, for example, the "property possessed" is the money in the account "existing at the time" of the levy. Money deposited to the account—even as soon as one day later—is not property that was possessed at the time of the levy. The IRS must issue a new levy to reach each subsequent deposit, which it can certainly do per section 6331(c).

Regarding your paycheck, there is an important statutory difference. Code section 6331(e) provides that a levy on salary or wages "shall be continuous from the date such levy is first made until such levy is released under section 6343." This is known as a "continuing levy." Future wages paid by the particular employer upon whom the levy was served are subject to seizure effective from the day the IRS issues the levy, until it is released. Thus, a wage levy survives from pay period to pay period, regardless of the time lapse between payments, without the need of the IRS to issue new levies prior to each pay period.

Section 6331(e) refers to section 6343 in connection with a release of the levy. You will recall from our discussions in Chapters 5 and 6 that this section requires the release of a levy in certain situations, chiefly when the levy causes hardship. See IRC §6343(a)(1)(D). But to the question of wage levies and the CSED, number one on the list of reasons a levy must be released is when *"the liability for which such* *levy was made is satisfied* ***or becomes unenforceable by reason of lapse of time****."* See IRC §6343(a)(1)(A). (Emphasis added by author.)

That is to say, when the CSED expires, a wage levy dies right along with it. Treasury Regulation section 301.6343-1(b)(1)(B)(ii) declares that a continuing levy on salary or wages "must be released at the end of the period of limitations." But here is the rub. That same Treasury Regulation goes on to state that if the levy is against a "fixed and determinable" right to payment, the levy survives the CSED as to only that specific income stream.

So the question is what is a "fixed and determinable" source of income? According to *United States v. Morey*, 821 F. Supp. 1438 (W.D. Okla. 1993), "one must be able to fix and determine the value of the taxpayer's property interest on the date of the levy." See also, *United States v. Murray*, 640 F. Supp. 89 (E.D. Tenn. 1986) and In Re Hawn, 149 B.R. 450 (Bankr. S.D. Tex. 1993). That is to say, the right to receive the payment must be firmly established. The amount owed must be clear and specific. Payment of the claim to the taxpayer cannot be subject to the performance by the taxpayer of any future services. And, no further action can be required by the payor to establish his liability to pay the claim.

For example, Social Security benefit payments are "fixed and determinable," in that once your claim is approved, the monthly payments continue with no further action required on your part. Other examples include any "unqualified fixed right to periodic payments or distributions of property," such as payments under a pension or annuity, or any similar payment that continues in the future under the terms of a contract or agreement. See Revenue Ruling 55-210, 1955-1 C.B. 544. This is unlike wage income, where you must work through the next pay period in order to be entitled to receive another paycheck.

If the IRS levies against such a "fixed and determinable" income stream, say your Social Security payments, prior to the CSED expiring, the levy survives the CSED. The levy then continues until the tax is paid, or the levy is released for some other reason (for example, hardship). If the levy is released, the IRS may not then re-issue a new levy after the CSED has passed.

The Installment Agreement

In Chapter 5, I identified the four circumstances under code section 6331(k)(2) in which the IRS is not allowed to take any collection action. To review, they are:

1. When a request for installment agreement (IA) is pending. That is, you have sought an IA but the IRS has neither specifically approved nor rejected your application. An application for an IA is generally (but not exclusively) made on Form 9465, *Installment Agreement Request*.
2. If your application for IA is rejected, during the thirty-day period following the rejection. If you appeal the rejection within that thirty-day period, the IRS cannot levy while your appeal is pending.
3. During the period the IA is in effect once approved. If you make all the payments and perform as required under the IA, the IRS cannot levy. The IRS must specifically revoke or terminate the agreement in writing before it can levy.
4. If your IA is revoked or terminated for any reason, during the thirty-day period following the revocation or termination. As in point 2 above, you have the right to appeal that action. You must file your appeal within the thirty-day period. If you appeal, the IRS cannot levy while your appeal is pending.

Code section 6331 provides for tolling of the collection statute during three of the four above circumstances. Under section 6331(k)(3), the collection statute is tolled for any period the IRS is prevented from collecting taxes under section 6331(k)(2). The only exception to this tolling is when the IA has been approved and is in effect (number 3 above). See IRC §6331(k)(3)(B).

Thus, when you file an application for an installment agreement, or appeal the rejection of an application, or appeal the revocation or termination of an installment agreement, the collection statute is tolled as follows:

1. While the application for an IA is pending, until approved,
2. If the application is rejected, during the thirty-day period following the rejection, and if an appeal is taken, while the appeal is pending, and

3. If an IA is revoked or terminated, during the thirty-day period following the rejection, and if an appeal is taken, while the appeal is pending.

It is important to again point out that while the IA is in effect, *there is no tolling* of the collection statute. If you make payments for, say, four years, all that time the collection statute runs. The longer you stay on an IA, the closer you get to the expiration of the collection statute. However, the IRS knows this too. That is one key reason they review IAs from time to time to determine whether it is in the agency's best interest to keep them in effect.

And it is a key reason that I generally believe installment agreements, standing alone, are rarely the solution to a substantial tax debt. While it is true that you get closer to the CSED, an installment agreement is never permanent, and with the continued accruals of penalties and interest, the debt usually just keeps growing. Moreover, as discussed above, the IRS may insist that you sign Form 900 before accepting your IA. If so, you lose the benefits of a ticking clock. An exception to this can be a Partial Pay Installment Agreement, which I discussed in Chapter 11.

Because tolling applies when there is a pending "application" for an installment agreement, you must understand what constitutes an "application." Treasury Regulation section 301.6331-4(a)(2) provides that a "proposed installment agreement becomes pending when it is accepted for processing." That is, when the IRS receives your request for an installment agreement and inputs it into the system, tolling begins at that point. It continues until:

1. The IRS accepts your proposal,
2. The IRS specifically notifies you in writing that your proposal is rejected, or
3. You withdraw the proposal. See also: Treas. Reg. §301.6159-1(g).

You might think of an "application" as being limited to a *written* request for an installment agreement on Form 9465. However, the IRS takes a much broader view of the matter. The Internal Revenue Manual (IRM) provides that such an application—and hence tolling under the statute—can result from letters, phone conversations, voice mails, even emails (though it is hard to understand how that might happen since the IRS does not utilize emails in its interactions with citizens). Indeed, the IRM is broadly written to encompass essentially any "communications between taxpayers and Service personnel" regarding a request for, or discussion of, installment agreements. See IRM part 5.14.1.3(1); and *Eichler v. Commissioner*, 143 T.C. No. 2 (2014).

All that is necessary to trigger the tolling under section 6331(k)(3) is that the communication (whether verbal or written) constitute a complete installment agreement "request." In that regard, the request must—at a minimum—include the following:

1. Sufficient information to identify you, which includes your name and Social Security number. If you provide your name but no SSN, and your identity can otherwise be determined, then the IA will be considered "pending;"
2. The tax liability to be covered by the agreement;
3. A proposed monthly or other periodic payment of a specific amount; and
4. You must be in compliance with all filing requirements. See IRM part 5.14.1.4; and *King v. Commissioner*, T.C. Memo. 2015-36 (2015).

The only way to know for sure the date on which the IRS accepts an IA request for processing is to consult your IMF transcripts for the years in question. The IMFs show the date on which the processing begins. From there, it is simply a matter of reviewing IRS correspondence to determine the date of rejection or revocation (dates also shown in the IMFs). You must also factor into this the thirty-day appeal period, and any time that your case was on appeal. These dates give you accurate data for determining the effect of any installment agreement tolling on your collection statute.

Based on the broad definition of a "request" for installment agreement, you must be careful if you wish to avoid tolling, but at the same time seek to stabilize collection and remove existing wage or bank levies. A request for uncollectible status (which does not propose a specific installment payment amount), should not rise to the level of a tolling event given the language of IRM part 5.14.1.4 and *King v. Commissioner, supra*.

The Offer in Compromise

The Offer in Compromise (OIC) is the means by which you offer the IRS a lesser amount than is due in satisfaction of an outstanding liability. The OIC is the heart of the tax amnesty program and is discussed at great length in chapter 12. By submitting Form 656, *Offer in Compromise*, you toll the CSED.

Under code section 6331(k)(1), the tolling occurs as follows:

1. During the period the OIC is pending. The OIC is pending beginning the day the IRS accepts it for processing. The agency usually sends a letter confirming that your OIC was accepted for processing as of a given date, and the date is also shown in the IMF. Tolling continues from that date until the OIC is either accepted, withdrawn, or rejected, *plus thirty days*.
2. If the OIC is rejected, tolling continues during the thirty-day period following the rejection. If you file an appeal within thirty days of the date of the rejection letter, tolling remains effective while the appeal is pending. Tolling continues until the Appeals Office either accepts or rejects your OIC, *plus thirty days*.
3. Of course, if the OIC is accepted at any point in the process, tolling becomes a moot point, since the IRS has agreed to compromise the liability for a lesser amount than what is assessed (assuming you pay the compromised amount in full).

The above rules apply to any OIC filed after March 9, 2002.

However, if you filed an OIC prior to March 9, 2002, the rules were different, and in calculating your CSED, you must consider *all OICs you have filed*. Indeed, because of a series of administrative moves by the IRS, and several changes to code section 6331(k) (added by the Restructuring Act), we have a kind of tolling "no man's land" that existed between July 22, 1998 (the date the Restructuring Act went into effect) and March 9, 2002 (when the tolling provisions of section 6331(k) were enacted in their current form, as set forth above).

To sort this out, let me address OICs filed both before and after March 9, 2002.

1. OIC filed prior to July 22, 1998. July 22, 1998 is the date the Restructuring Act went into effect. If you filed an OIC *prior* to that date, the collection statute was tolled for the time the OIC was pending (NOT including appeals), *plus one year*.
2. OIC filed on or after July 22, 1998, but before December 21, 2000. An OIC filed within this timeframe is subject to both the CSED waiver provisions written directly into Form 656, *Offer in Compromise*, and the statutory tolling provision of section 6331(k)(3) as then written. Under these provisions, the collection statute was tolled for the time the OIC was pending, including appeals, *plus thirty days*.
3. OIC filed on or after December 21, 2000, but before May 1, 2001. Statutory tolling was repealed effective December 21, 2000. However, the CSED waiver language was still in Form 656 and operated as a voluntary waiver. This was true until the form was revised effective May 2001. Since the waiver is a voluntary act that you perform when you sign the OIC, that waiver must be given effect, regardless of the statutory language. See *Strange v. United States*, 282 U.S. 270 (1931); *Florsheim Bros. v. United States*, 280 U.S. 452 (1930). Thus, the filing of an OIC after December 21, 2000 but prior to May 2001 tolled the collection statute for the period the OIC was pending, including appeals, *plus thirty days*.
4. OIC filed on or after May 1, 2001, but before March 9, 2002. An OIC filed on Form 656, revised May 2001, did *not* contain *any* waiver language. Moreover, there was no tolling language in the statute at this time. Therefore, an OIC filed during this period has no effect whatsoever on the collection statute of limitations. In any event, review the language of the Form 656 *that you filed*. If the form contains no collection statute waiver language, you did *not* toll the collection statute by filing that form during the period stated in this paragraph.
5. OIC filed on or after March 9, 2002. Congress restored the tolling provisions of code section 6331(k)(3) as set forth in the first part of this discussion, effective on that date. If you filed an

OIC on or after March 9, 2002, *whether or not the Form 656 contained any tolling language*, the collection statute was tolled for the period the offer was pending, including appeals, *plus thirty days*.

Filing Multiple OICs

It is not unusual for a person to file multiple OICs. If you filed more than one OIC, you must give effect to the tolling of each OIC under the tolling rules applicable at the time you filed it. See *Klingshirn v. United States*, 147 F.3d 526 (6th Cir. 1998). Figure the tolling period based upon the timing of your OICs as outlined above. Let me illustrate how you do this.

Suppose your tax was assessed on January 1, 1995. The normal ten-year period to collect would expire on January 1, 2005. Suppose further that you filed two OICs. The first was filed on January 1, 1998. An OIC filed at that time tolled the collection statute for the period the offer was pending, plus one year. Say the offer was pending from January 1 to June 30, 1998. In that case, you would add eighteen months to the collection statute. That would push the expiration date to July 1, 2006.

Suppose you filed the second OIC on June 1, 2002. An OIC filed at that time tolled the statute for the period the OIC was pending, including appeals, plus thirty days. Suppose that OIC, including an appeal, was pending six months. In that case, you would add another six months plus thirty days to the previously extended date of July 1, 2006. This places the new expiration date at January 31, 2007.

If you are not sure of the filing and disposition dates of any prior OIC, you must consult your IMF. That will show the dates of filing and rejection of a past OIC.

Citizen Outside the United States

When a citizen is outside the United States for a continuous period of at least six months, the collection statute is tolled during his absence. IRC §6503(c). By merely setting foot back in the United States within any six-month period, say to have lunch at an airport, you keep the statute from being tolled under this rule.

Judicial Actions

Under some circumstances, judicial actions commenced by a citizen or the government can toll the collection statute of limitations. Three situations come to mind.

1. **Bankruptcy.** Code section 6503(b) specifically states that when the assets of the citizen are in the custody of or under the control of a court, such as occurs when one files bankruptcy, the statute is tolled during such period, and for six months thereafter.

   If you file a bankruptcy at any time during the collection process, the CSED is tolled for the period of time your case is pending in bankruptcy, *plus six months* after the case is closed. A bankruptcy case is pending from the day the bankruptcy petition is filed until the day the debtor receives a discharge or the day the bankruptcy case is dismissed. Naturally, the taxes that are discharged by the bankruptcy are no longer subject to collection regardless of the statute of limitations. That is another of the amnesty programs we address in Chapters 13 and 14.

2. **Civil actions by the United States.** Code section 6502 expressly provides that the normal ten-year period of limitation is extended if, prior to that time, the government commences a suit in court for collection of the tax. Such a suit is contemplated under code section 7403. That section permits the government to sue the citizen to reduce its tax lien to a judgment. It also permits the IRS to seek judicial approval to execute that judgment against any property you own. Once a judgment is in place, federal civil law provides that the judgment is good for *twenty years* from the date the judgment is entered, regardless of the CSED under the tax law.

   If you are on the threshold of the statute expiring and the IRS asks for a signed Form 900, you must consider the chances of its filing a suit in court if you refuse to sign the form. Three considerations are critical. First, as I explained earlier in this chapter, the IRS cannot solicit a Form 900 standing alone. No waiver is permitted unless it is signed in connection with an installment agreement.

Second, do you have equity in assets the IRS could reach if it obtains a judgment? The IRS rarely files a section 7403 suit merely to keep the statute alive. It wants something tangible to grab through collection. For example, if you own a home with equity or have a substantial retirement fund, chances are greater that the IRS may file the suit. Given that the IRS cannot seize your home through the administrative process, it must file suit to reach the equity. In that case, you may be better off signing Form 900 or otherwise attempting settlement under one of the amnesty programs in order to avoid a twenty-year judgment. If you have no assets, it is unlikely the IRS will pursue court action.

The third consideration is the amount of time left before the statute in fact expires. If there is a good deal of time left on the CSED, the agency may have time to consider its options and paste together a court action. Conversely, if the statute is just a few months or even weeks away from expiring, it is unlikely the agency can move before its expiration.

Also take into consideration the cost of your actions. By that I mean you should balance the cost of signing the form, measured in terms of the monthly payment the IRS might receive beyond the normal expiration period, against what the IRS might get if it files suit. The bottom line helps make the decision on what to do.

3. **Suit for refund of trust fund taxes.** After the IRS assesses the Trust Fund Recovery Penalty (TFRP) against any person for failure to pay employment taxes, that person may challenge the assessment through the judicial process. This is done by: a) first paying a "divisible portion" of the tax, which is the tax on one employee for one quarter, then b) filing an administrative claim for refund. If the IRS denies the claim for refund, you have the right to file a suit for refund in the United States District Court. My book, *Taxpayers' Defense Manual* provides all the details on this entire process.

   If you file such a lawsuit, code section 6331(i) prevents the IRS from collecting the balance of any taxes owed if they are directly related to those challenged in the refund suit. Code section 6331(i)(5) tolls the collection statute related to the balance of those taxes for the period your refund lawsuit is pending.

A Wrongful Levy

A wrongful levy exists when the IRS seizes the property of one citizen in an effort to satisfy the tax liability of another citizen. We have all heard of cases where the IRS seizes Junior's bank account because Daddy owes taxes. This gives rise to a typical wrongful levy case.

Code section 6503(f) provides that the collection statute is tolled for the period of time beginning when the IRS receives the wrongfully levied property (including money) until the agency either returns the property, or the citizen obtains a judgment against the IRS under code section 7426, the wrongful levy statute. However, this extension applies only to the portion of the assessment *equal to* the money or value of property returned by the IRS.

Application for Taxpayer Assistance Order

Submitting a Form 911 to the Office of the Taxpayer Advocate (TA) suspends the collection statute per code section 7811(d). The suspension is effective beginning with the date you submit Form 911, and continues to the date of the decision disposing of the application. *It does not matter* whether the Taxpayer Assistance Order is granted. Also, the TA may specify additional time in which the statute is tolled. That is why, in chapter 7, I recommend sending a *letter* to the TA seeking help, *rather* than submitting Form 911. In addition to a letter sometimes being faster, it *does not* toll the statute.

The Collection Due Process Appeal

An appeal under code section 6320 (relating to the filing of a federal tax lien) or section 6330 (relating to a *Notice of Intent to Levy*) tolls the collection statute. Code section 6330(e)(1) states that the collection statute is tolled for the period the request for hearing is pending, including any judicial appeal, *plus ninety days*. Tolling begins with the filing of the *Request for Collection Due Process Hearing*, Form 12153. See chapters 4 and 5. Please note that neither an Equivalent Hearing nor an appeal regarding a disqualified employment tax levy tolls the statute. Likewise, neither a CAP appeal nor lien appeal as discussed in chapter 6 does not toll the statute.

A Request for Innocent Spouse Relief

Code section 6015(e)(2) provides that upon filing a request for spousal relief under section 6015 (as explained in Chapter 6), the IRS is precluded from collecting while that request is pending. Consequently, the collection statute is tolled during the period the IRS is prohibited from collecting. Tolling applies for the period the request is pending, *plus sixty days*. If a petition is filed with the United States Tax Court to review the IRS's determination, the statute remains tolled until the Tax Court case becomes final.

Canceling Expired Assessments

If you believe the collection statute has expired, send a certified letter to the IRS's Centralized Lien Unit in Cincinnati. Ask for an abatement of the tax and release of the liens. The letter should follow the outline of IRS Publication 783, *How to Apply for Certificate of Discharge of Federal Tax Lien*. See Chapter 6. The specific address is available in the instructions to that form.

In your letter, point out that the collection statute has expired. Provide whatever proof you have, including lien documents and IMF printouts. Demand that IRS abate the outstanding tax liability. If any liens are in effect, they must be released once the tax is abated. See Chapter 6 for details on removing liens.

Conclusion

You should never pay a dime to the IRS unless you are certain the statute of limitations has not expired. My experience proves time and again that the IRS lies or deliberately misleads citizens concerning this right. But when you can prove the statute has expired, or can hold on until it does, you are *free, free, free* of the IRS's claim. What is that, if not amnesty?

Review Questions

1. What is the date of assessment for purposes of determining the collection statute expiration date?
   A. Date on which the assessment certificate is signed
   B. Return filing date
   C. Tax lien filing date
   D. Date of mailing of the collection notice

2. In which situation is Form 900 commonly used?
   A. Installment application
   B. Taxpayer Assistance Order
   C. Voluntary waiver
   D. Offer in Compromise

3. During which installment agreement (IA) period is the collection statute tolled?
   A. During the sixty-day period following an IA's application rejection
   B. During the forty-five day period following an IA's termination
   C. When the IA has been approved and is in effect
   D. When the request for an IA is pending

4. Which of the following is the heart of the amnesty program?
   A. Offer in Compromise
   B. Collection Due Process appeal
   C. Taxpayer Assistance Order
   D. Expired assessment cancellation

Review Answers

1. A. **Correct.** The collection assessment occurs when an assessment officer signs the proper assessment certificate.
   B. Incorrect. The date of assessment for purposes of determining the collection statute expiration date is not the return filing date. The return filing date generally determines the statutory period for examination of the return.
   C. Incorrect. The date of assessment for purposes of determining the collection statute expiration date is not the tax lien filing date. The tax lien provides the IRS with a security interest in and to real and personal property.
   D. Incorrect. The date of mailing of the collection notice is not the date of assessment. The collection process usually begins with Notice CP14 stating that a balance is due and requests immediate payment.

2. A. Incorrect. Form 900 is not commonly used to file an application for an installment agreement. An application for an installment agreement is generally made on Form 9465 (although a From 900 could be used to facilitate an installment agreement).
   B. Incorrect. Form 900 is not commonly used to file a Taxpayer Assistance Order. Form 911 is used to apply for a Taxpayer Assistance Order, although sometimes a letter may be more proper than submitting Form 911.
   C. **Correct.** A common way the collection statute is extended is with a voluntary waiver, and Form 900 is used for this purpose.
   D. Incorrect. An Offer in Compromise is not filed using Form 900. An Offer in Compromise is submitted using Form 656.

3. A. Incorrect. The IRS is not allowed to take collective action during the thirty-day period following the rejection of an IA application, but this is not applicable for sixty days. During the extra thirty-day period, the collection statute is not tolled.
   B. Incorrect. During the thirty-day period following an IA's termination, the IRS cannot take any collection action; however, this is not applicable for forty-five days. The collection statute is not tolled during the extra fifteen-day period.
   C. Incorrect. When the IA has been approved and in is in effect, the IRS is not allowed to take any collective action. During this period, the collection statute is not tolled.
   D. **Correct.** During the period the IA application is pending, the IRS cannot take collection action since the statute is tolled.

4. A. **Correct.** The Offer in Compromise (OIC) is the heart of the tax amnesty program.
   B. Incorrect. The Collection Due Process (CDP) appeal is not the heart of the tax amnesty program. The CDP appeal may be taken of any collective action, including liens, levies, and seizures.
   C. Incorrect. The Taxpayer Assistance Order (TAO) is not the heart of the tax amnesty program. The Taxpayer Advocate can issue a TAO requiring the IRS to cease actions against citizens under certain circumstances.
   D. Incorrect. Expired assessment cancellations are not the heart of the tax amnesty program. If the collection statute has expired, the taxpayer should ask for abatement of the tax and release of any liens.

Chapter 11
Tax Amnesty Programs Number 1 and 2: The “Life Jackets”

Learning Objectives

- Spot the first step toward achieving uncollectible status
- Choose a viable alternative for collection if the citizen can only pay a small portion of the tax liability
- Identify what, by its definition, should be excluded from negotiations when negotiating for a PPIA

Introduction

Beginning with this chapter, and drawing upon the delinquency profiles painted in Chapter 2, I preface the discussion of each Tax Amnesty Program with a statement of whom that program will most likely benefit. As you read Chapter 2, you no doubt identified with one or more categories of delinquent citizens. Now, expect to learn how your particular problem can be treated very specifically to tax amnesty.

We start with the life jackets. The purpose of a life jacket is to prevent disaster. It is certainly not the greatest thrill in the world to float freely in the deep blue sea but at least with a life jacket, you can hang on until help arrives. In the context of the IRS, our life jackets are known as “uncollectible status” and the Partial Pay Installment Agreement.

Program No. 1: Uncollectible Status – Who Can Benefit?

The chief beneficiaries of this program are anyone with so little disposable income that any payment whatsoever is impossible. This person is usually temporarily unemployed or under-employed. His personal living expenses meet or exceed his income. A gainfully employed person can also benefit from uncollectible status if his fixed monthly expenses for items necessary to earn income, and for items necessary to provide for the health and welfare of himself and family (including current federal, state and Social Security taxes), consume all or nearly all his income.

At one of the many seminars I conducted for the public, I addressed a man who announced that he owed the IRS $20,000. He explained that he had no assets and was out of work. He wanted to know how he could solve his “tax problem.” I replied to the man by saying, “You don’t have a $20,000 tax problem unless you have $20,000.”

In other words, unless you have something the IRS can take, you have no problem. In fact, I explained to the man, “This is a good news/bad news situation. The bad news is you’re broke. The good news is *you’re broke!*”

While this may seem humorous, it is nevertheless quite true. First of all, I already proved in Chapter 3 that you are not going to jail just because you owe the IRS money you cannot pay. Given that this man had nothing the IRS could get, the agency was really powerless to do much of anything.

You are likely recoiling from this statement. Pointing to the agency’s awesome enforcement power, you may suggest that while you do not have savings piled up, the IRS certainly has ready access to your paycheck or checking account, however modest they may be. However, as I expounded in great detail in Chapters 5 and 6, the IRS *does not* have the legal authority to enforce collection in situations where such action will cause hardship to a citizen by making it impossible to pay necessary living expenses. This is not just magnanimous IRS policy; it is the law. The plain fact is that you are entitled to enjoy “uncollectible status” under the circumstances discussed below.

How to Achieve Uncollectible Status

To best illustrate this program, I point to Steve’s case. Steve made payments to the IRS of about $560 per month for some time. He could not afford the payments, but he made them anyway because he was told by an RO that "he must." In the meantime, Steve fell behind on other living expenses. His rent was late, all recreational activity was practically eliminated, and he was living off credit cards.

Finally, Steve stopped paying the IRS. Within just a short period, the IRS threatened enforcement action. That is when Steve phoned me. He lamented that he simply could not continue paying. His monthly income and personal living expenses were such that there just was no money available to meet his IRS obligation.

I explained to Steve that the first move was to prepare and submit Form 433-A, as explained in Chapter 5. Steve provided information and documentation on current monthly income and monthly living expenses. As you will recall from Chapter 5, the difference between the two figures is referred to as "disposable income." That is "at least" the amount the IRS expects as a monthly installment payment.

In Steve's case, there was no difference between monthly income and living expenses. In fact, he was in the negative when the proper current taxes were figured in. We presented Steve's financial statement to the IRS along with documents to verify all expenses. They included bank statements, proof of monthly income, canceled checks, invoices, etc. We argued that he was uncollectible, and as such, his case should be closed as "currently not collectible."

After carefully reviewing the financial statement and the supporting documents, the RO agreed to classify Steve as "uncollectible." Under that classification, Steve is required to make no monthly payment at all. At the same time, there exists no further risk of a levy as long as "uncollectible status" remains in effect.

This same procedure can be done with ACS over the phone, as explained in Chapter 5. Also, if you filed a timely *Request for Collection Due Process Hearing* (Form 12153), you can argue for uncollectible status as a "collection alternative" in your CDP hearing. You can do the same thing in a CAP appeal as discussed in Chapter 6. Be sure to provide all the required financial information to the settlement officer before the hearing.

The key to obtaining uncollectible status is to painstakingly prepare the financial statement. Before beginning the process, go through your checkbook and bank records carefully. Record your expenses for the last twelve months. This helps you recall all the expenses you face but which do not necessarily recur each month. An example is medical insurance. If, for example, you pay $900 in medical insurance quarterly, divide $900 by 3 to determine the monthly expense. Make an entry of $300 per month for medical insurance on Form 433-A. Repeat this process for each expense that constitutes an allowable expense for purposes of determining the installment agreement amount. Review Chapter 5, under the heading, *How to Establish the Installment Payment Amount*.

Because of the National Standards (NS) and Local Standards (LS) for expenses, the agency routinely looks for ways to squeeze extra money into existence when it may seem to a reasonable person that none exists. For example, suppose you spend, say $2,500 per month for housing and utilities for your family. However, if the local standards for housing and utilities are just $1,850, expect the IRS to insist on capping you housing expenses at the standard, regardless of your actual expenses. That means, in this example, the agency arbitrarily disregards $650 of your monthly expenses. After all, "why do you have to make your mortgage payment?"

Remember to push back hard with the idea that NS and LS expenses are *guidelines* only. As I explain in great detail in Chapter 5, using the law and the Internal Revenue Manual as clear authority, the standards are to be adjusted based on the circumstances of each individual case. Revenue officers and ACS employees do not like to accept this reality, but that is exactly what it is—*reality!* You must use the legal authority I present in Chapter 5 to make the case that NS and LS guidelines are just that. They are *not* Scripture.

Ask yourself, what are the cogent and compelling reasons why your circumstances take you outside the scope of IRS's standards? State your case clearly and document your claims to the fullest extent possible. If you argue that a medical condition exists, provide a statement from a physician, hospital, clinic, insurance company, pharmacist, etc., to support your claim.

A major key to establishing uncollectible status is to *document* all necessary personal living expenses and expenses necessary to earn income. As we learned in Chapter 5, expenses necessary to earn income *are not* subject to the IRS's arbitrary NS and LS figures. They not only must be allowed, but are somewhat subjective in that different people incur different expenses in the process of earning income.

Furthermore, what may be considered a reasonable expense in one situation may not be in another. For example, a person who rides the bus to work every day faces trouble arguing that his car is necessary to earn income. However, a copy machine service rep with the job of driving from office to office servicing and repairing copy machines certainly can argue that his auto is necessary to earn income. As such, it is not a personal expense subject to NS and LS limitations.

Also keep in mind that unreasonable demands for installment payments can be appealed. Depending upon the posture of your case, you can use Form 9423, *Collection Appeal Request*, or if you are in a CDP appeal, your case can be appealed to the Tax Court. See Chapters 6 and 7. You also have the other options talked about in Chapters 12, 13 and 14.

When your necessary and allowable living expenses (including current federal, state and Social Security taxes), as well as expenses necessary to earn income, meet or even exceed your monthly take-home pay, you are considered uncollectible.

Uncollectible Status When You Have Equity in Assets

In some cases, you may have no disposable income but you do have equity in certain assets. This is determined by your financial statement. In addition, the IRS will check public records to determine whether any assets are titled in your name. An example is a senior citizen, living on a fixed pension or Social Security income, but whose home has equity because of having made payments over many years. In that case, the IRS generally asks that the equity be liquidated before granting uncollectible status.

This demand can be avoided if you show that the liquidation would cause a hardship. In the case of the senior citizen with home equity, he may be unable to borrow against the property because his income is insufficient to make an increased mortgage payment. It may also be that he cannot sell the home because the amount left after paying the existing mortgage, with the balance of the proceeds going to the IRS, would be insufficient to provide other suitable living arrangements.

On the other hand, suppose you have a boat or camper that is worth $5,000 and is paid for. Expect the IRS to require the asset be sold and the proceeds paid to the IRS before they grant uncollectible status. It would be very difficult to prove that hardship would result if you did not have your boat. I discuss this further below, under the heading, *The Partial Pay Installment Agreement*.

Uncollectible Status and Unfiled Returns

In Chapter 5, I discussed the concept of hardship in the context of a release of levy. I explained that the legal requirement to release a levy that is causing economic hardship has nothing to do with whether or not a taxpayer has unfiled tax returns. The case of *Vinatiari v. Commissioner*, which I cite in Chapter 5, makes it clear that code section 6343 *does not* condition the release of a levy upon a taxpayer's filing of any missing tax returns.

This means that the IRS does indeed have the authority to grant uncollectible status even if you are delinquent in the filing of one or more tax returns. In fact, IRM part 5.16.1.2.8(12), which addresses the closing of cases as uncollectible, contains this "caution":

If a hardship determination is verified, a levy cannot be issued or left in place to persuade a taxpayer to file. **Note:** Accounts may be reported CNC [currently not collectible] hardship if a CIS [collection information statement, Form 433-A] can be verified, even if there are unfiled returns.

The key is to prove that you have no disposable income, and therefore, levy action will cause hardship. This will lead to the case being closed as uncollectible. Take careful note, however, that just because a case can be closed as uncollectible even if you have unfiled tax returns, it does *not* mean you will qualify for relief under any of the other settlement programs. For example, the IRS will not even entertain an Offer in Compromise (Chapter 12) if you have unfiled returns for at least any of the most recent six years. Therefore, you must get your delinquent returns filed if you are to reach a full and final resolution of your case.

Living with Uncollectible Status

Once you are classified as uncollectible, the IRS reviews your case periodically to determine whether to alter your status. This happens in two ways. The first is on a calendar basis. The IRS reviews the matter every twelve or twenty-four months. It requests an updated 433-A, and again undertakes the process of determining an installment payment amount. If your circumstances have not substantially changed, uncollectible status remains in effect. If there were changes, an installment agreement may be set based on current conditions.

The second method is based upon your current income tax return. The IRS reviews your most recently filed tax return to ascertain the level of income reported. When income exceeds a certain predetermined level, a review takes place. The income level at which the review occurs is determined when your case is initially closed as uncollectible. If, for example, you earn $36,000 per year but cannot afford a payment, the RO may decide to call for a review as soon as your income reaches $38,000.

You can also expect the IRS to file a tax lien if one has not yet been filed and you owe more than $10,000. See IRM part 5.16.1.2(3). However, anytime the IRS files a lien, it is subject to appeal under the Collection Due Process appeal procedures and lien appeal procedures. See Chapters 4, 5 and 6.

Uncollectible status is the truest form of a life jacket. It places you into a position where you can at least survive. If your financial picture does not improve, there is no reason the uncollectible status must change. Bear in mind that the statute of limitations on collection eventually expires. If your circumstances never improve, the statute could expire without the IRS collecting. This is why you must be careful if asked to sign Form 900, since it *extends* the CSED (Chapter 10).

Program No. 2 – The Partial Pay Installment Agreement

What happens if you are able to make a small payment to the IRS but not nearly enough to pay the tax in full? In that case, you do not qualify for uncollectible status, since you can make a payment. But suppose you owe $50,000 and can only pay, say $50 a month. That payment is such that you have no hope of paying off the liability. In that case, the midway point between an installment agreement that would fully pay the tax, and uncollectible status in which no payment is made, is a procedure known as the Partial Pay Installment Agreement. This can prove very beneficial, as outlined here.

A Partial Pay Installment Agreement (PPIA) is an agreement that pays a fixed payment, say $200 per month, regardless of the debt owed, for the time left on the collection statute. For example, suppose you owe $50,000 in total taxes and the IRS has just forty months remaining on the collection statute. In that case, a PPIA might be fixed at $200 per month for forty months. At the forty-month mark, the IRS agrees to allow the collection statute to expire. Once that happens, the remaining balance of the liability is considered legally uncollectible and is abated.

The PPIA was created in 2004 when the American Jobs Creation Act amended code section 6159 to provide this authority. Prior to that, section 6159 dictated that the IRS could enter into an installment agreement in certain cases if the agreement would "facilitate full collection of the liability." Well, obviously in our example, a $200 per month agreement cannot possibly "facilitate full collection" of a $50,000 debt in forty months. Therefore, prior to the amendment, the IRS routinely rejected such proposals. The amendment gives the IRS the authority to accept installment agreements if the agreement "will facilitate full or *partial* collection" of the tax. See IRC §6159(a), as amended; emphasis added.

When Will a PPIA be Considered?

The Internal Revenue Manual discusses two broad scenarios in which a PPIA will be considered. See IRM part 5.14.2.1.2. I explain them here.

No Assets or No Equity in Assets

The primary situation in which a PPIA may be granted is if you either have no assets at all or no equity in assets. Likewise, if you already liquidated whatever assets you had in order to make partial tax payments, the IRS will consider a PPIA. In cases where there are no assets or no equity in assets, an installment agreement is the only hope of getting anything from you. And when the CSED is such that the amount of the agreement cannot pay the tax, the PPIA becomes a viable collection alternative. This is especially true if, in addition to having no assets, you are able to discharge your debt in bankruptcy. In that case, the IRS has a strong motivation to allow a PPIA since if the agency does not it runs the risk of getting nothing in bankruptcy. See Chapters 13 and 14 for more on bankruptcy.

Some Equity in Assets

Even in cases where you have some equity in assets, the IRS may grant a PPIA if the asset cannot be sold or if you cannot borrow against it. There could be a number of reasons for this. Let us address some examples.

- The asset has minimal equity or the equity is insufficient to allow a creditor to lend money. You may have a house worth $150,000 with a current mortgage of $120,000. With a soft real estate market and lending practices what they are, banks are not likely to lend any more than a total of 80 percent of the property's value. In this example, 80 percent of the value is already tied up with the first mortgage. Thus, you cannot borrow more money. Moreover, seizure of the property would not produce any proceeds to apply to the debt.
- You cannot reach the equity due to how the property is titled. Say the property is held by both you and your spouse as joint tenants but only you owe the tax. If your spouse refuses to go along with refinancing, no loan is possible. If the IRS cannot collect sufficient proceeds from a sale of the property (in which they would have to compensate your spouse) the PPIA may be the only answer.
- The asset has value on paper but you cannot sell it due to either market or property conditions. I had a client with three commercial lots on the "wrong side of town" in Dayton, Ohio. The area was very depressed and nothing was moving. There was a building on one of the lots, but it was uninhabitable due to deterioration and building code violations. While the lots were paid for, they could not be sold given market conditions, and the cost of removing the building was more than the property was worth.
- The asset is necessary to generate income for the PPIA and the government will receive more from the income generated by the asset than from its sale. This is almost universally true with small businesses. The assets they hold, while they may be fully paid for, generate the business income needed to operate and pay bills, including the IRS. If the IRS were to seize the assets, the company is out of business and the installment agreement goes down the tubes with it.
- Borrowing against or selling property would create an economic hardship as defined in Treasury Regulation section 301.6343-1. That section defines "hardship" as a situation where you cannot meet "reasonable basic living expenses." See Chapters 5 and 6. If you cannot make the payment required on the borrowed money because of current income limitations, this could constitute a hardship. At the same time, seizure of the property would create a hardship because you cannot afford adequate replacement housing given your income and expenses.
- You simply do not qualify for a loan because of your income and expense situation.

The Decision to Grant a PPIA

A PPIA may be granted when the IRS determines that enforcement action is not warranted under the circumstances. You must prove that levy action will cause hardship and that the PPIA is the only reasonable resolution. If you have no equity in assets and agree to make payments equal to your maximum ability to pay over the remaining life of the collection statute, the PPIA may be granted. Likewise, if you have equity in assets but one or more of the hardship scenarios discussed above is present, the PPIA may be granted.

The IRS expects you to make a good faith effort to liquidate all equity and pay as much as possible before approving either a PPIA or uncollectible status. If you have equity in assets, you must prove that one of the circumstances discussed above (or even something that I did not mention) nevertheless warrants a PPIA or uncollectible status. The IRS expects you to apply normal business standards when seeking a loan. That means providing correct and complete financial information to facilitate getting the loan.

The IRS also expects to see copies of all documents used in the loan application process. This is to ensure that you did not somehow sabotage the financing process.

If you fail to make a good faith attempt to use equity in assets, or if you are not willing to make monthly payments consistent with your ability to pay, the IRS considers that you "won't pay." See Chapter 6. In that case, the revenue officer may recommend enforcement action and a PPIA will not be granted.

To determine ability to pay, the IRS uses its usual financial evaluation procedures, including imposing its National and Local Standards for living expenses. Only necessary living expenses as defined in the IRM are allowable in PPIA negotiations. See my discussion of the standards in Chapter 5.

The PPIA negotiation is handled either by a revenue officer, ACS or an appeals officer in much the same way that we have discussed already. Moreover, IRS personnel will use the agency's Offer in Compromise asset investigation guidelines as well. I address these in Chapter 12. Expect the IRS to do a very thorough examination of your assets and equity. The agency demands bank records, vehicle and property titles, and debt information, and the agency addresses personal property ownership, such as boats or RVs.

To win the PPIA, you must agree to monthly payments to the fullest extent of your ability to pay for the remaining duration of the collection statute. The IRS will also file tax liens for the full liability if they are not already filed.

Beware of a Waiver Request

As explained earlier, the IRS often seeks a Form 900, *Tax Collection Waiver*, during installment agreement negotiations. In fact, this is often the first demand that revenue officers make when the IRS is faced with the expiration of the collection statute and your limited ability to pay. If you are negotiating for a PPIA, by its very definition there should be no collection statute waiver as part of the package. A PPIA means that the collection statute is allowed to expire without an extension. See IRM part 5.14.2.1.3(2) and (3).

In some cases, however, the IRS may seek a waiver in an attempt to reach a specific asset before the statute expires. For example, suppose you have a pension that you can reach in two years but it is still not enough to fully pay the tax. Suppose the collection statute expires in one year. The IRS may agree to a PPIA if you agree to extend the statute for one year to allow the IRS to reach the pension. Thereafter, the collection statute is allowed to expire. In the meantime, you make a monthly payment as required under the PPIA.

Negotiations that involve a waiver of the collection statute must be approached very carefully. The impact of signing such a waiver is profound and should never be done on the spot, and never without careful evaluation. You should always consult experienced counsel before signing a *Tax Collection Waiver*.

The Two-year Review Process

PPIAs that run longer than two years are reviewed at the two-year mark. If there is no significant change to your financial status, the payment amount already determined continues until the statute expires (assuming it does so within the next two years). If your financial status has improved, the IRS has the authority under code section 6159 to terminate the PPIA and negotiate a new agreement. At that point, the IRS might also seek a *Tax Collection Waiver*. See IRM part 5.14.2.1.3(1).

As I mentioned in Chapter 10, there is no such thing as an open-ended or protracted collection statute waiver. Under code section 6502, the length of the waiver cannot exceed five years, and to be valid, the waiver must be signed in connection with an installment agreement. Under no circumstances should you agree to a waiver that gives the IRS more time than is necessary to make payments that satisfy the debt.

In the final analysis, the PPIA is a good news-bad news scenario. The good news is that you get a payment plan that takes you to the expiration of the collection statute, at which time the tax assessment evaporates and the agreement terminates. The bad news is that the plan is not carved in stone. It is reviewed and potentially revised as your circumstances change. Still, it can be an effective way to solve your tax debt if you have little or no equity in assets, and little ability to make a monthly payment, and those factors are not likely to change anytime soon. It is also a way to deal with taxes which the IRS will not compromise (see Chapter 12) for whatever reason, or that are not dischargeable in bankruptcy (see Chapters 13 and 14).

Conclusion

Uncollectible status and a PPIA can keep you afloat until help arrives. In fact, if you can wait out the collection statute of limitations, these programs can lift you out of the sea of financial disaster altogether. By winning uncollectible status or a PPIA, you take much of the risk out of dealing with the IRS. This is important because so often, simple fear keeps people from acting.

Review Questions

1. What is the minimum amount the IRS can require from a monthly installment payment?
   A. Income less NS and LS expenses
   B. Disposable income
   C. Monthly income
   D. Income less expenses, not including taxes

2. Which of the following is the primary situation in which a PPIA may be granted?
   A. Taxpayer has an installment agreement in place
   B. Taxpayer either has no assets or no equity in assets
   C. Taxpayer has some equity in assets
   D. Taxpayer does not qualify for a loan

3. When may a statute waiver make sense in connection with a PPIA?
   A. To allow the IRS to review the taxpayer’s financial status every two years
   B. A waiver is never required in connection with a PPIA
   C. To enable the IRS to reach an asset not available until a future date
   D. To carve the PPIA in stone

Review Answers

1. A. Incorrect. The minimum amount that the IRS can require from an installment payment is not income less NS and LS expenses. NS (National Standards) and LS (Local Standards) costs are guidelines and may understate a taxpayer’s actual expenses.
   B. **Correct.** A citizen’s disposable income is “at least” the amount the IRS expects as a monthly installment payment.
   C. Incorrect. Monthly income is not the minimum amount the IRS can require as an installment payment. The citizen’s monthly income should be reduced by his or her monthly expenses to determine what can be paid.
   D. Incorrect. Income less expenses, not including taxes, is not the minimum amount that the IRS can expect from an installment payment. Proper current taxes should be included in the expense category.

2. A. Incorrect. Having an installment agreement in place is not the primary situation in which a PPIA may be granted. If the IRS and taxpayer already have an installment agreement in place, there is no need for a PPIA.
   B. **Correct.** A citizen that has no assets or any equity in assets is the primary situation in which a PPIA (Partial Payment Installment Agreement) may be granted.
   C. Incorrect. If a taxpayer has some equity in assets, that is not the best scenario for granting a PPIA. However, even in cases where there is some equity in assets, the IRS may grant a PPIA if the asset cannot be sold or borrowed against.
   D. Incorrect. The primary situation in which a PPIA may be granted is not when a taxpayer does not qualify for a loan. However, the IRS may still grant a PPIA in situations where the citizen simply does not qualify for a loan because of his or her income and expense situation.

3. A. Incorrect. A statute waiver in connection with a PPIA would not make sense to allow the IRS to review the taxpayer’s financial status every two years. A PPIA that runs longer than two years is reviewed at the two-year mark, and this includes a review for changes in the taxpayer’s financial status.
   B. Incorrect. It is not accurate to say that a statute waiver in connection with a PPIA is never required. The IRS may seek a waiver although, by PPIA definition, there should be no collection statute waiver as part of the PPIA package.
   C. **Correct.** A statute waiver in connection with a PPIA makes sense if the IRS seeks to reach an asset that is not available before the statute expires.
   D. Incorrect. A statute waiver does not make sense in connection with a PPIA in order to carve the PPIA in stone. The PPIA is not carved in stone and is subject to IRS review and revision as the taxpayer’s circumstances change.

Chapter 12
Tax Amnesty Program Number 3: The Offer in Compromise – "Cents on the Dollar"

Learning Objectives

- Recognize the current stated IRS business practice when faced with collection issues
- Select the compromise reached under an OIC based on doubt as to collectability
- Determine the maximum payment period of an OIC cash offer based on the "future income asset"
- Pinpoint a benefit to the government of a Future Income Collateral Agreement

Introduction

Does the IRS ever agree to accept less than full payment of an outstanding debt? The answer might surprise you. Not only is the answer "yes," but the IRS has a very carefully defined set of rules and procedures for doing just that. I have used these procedures for decades to help countless people resolve tax debts that might never have been settled otherwise.

The procedure is known as the Offer in Compromise (OIC). Early in this book, I quoted a statement from former IRS Commissioner Shirley Peterson in which she remarked, "You can't get blood out of a turnip, and if we're dealing with turnips, then we're better off cutting our losses and moving on." This statement was directed squarely at the IRS's Offer in Compromise policy. That "new attitude" was at least partially forced upon the agency by citizens utilizing their rights in far greater numbers than ever before. In short, the IRS had no choice but to accept reality due to the various factors discussed in Chapter 1, especially *The Education Factor*.

In Chapter 1, I discussed the memorandum issued to Collection personnel that led the way to the formal OIC Policy Statement. Released in February 1992, the statement knocked my socks off. In it, the IRS made the following observation:

The ultimate goal [of the OIC] is a compromise which is in the best interest of both the taxpayer and the Service. Acceptance of an adequate offer will also result in creating, for the taxpayer, an expectation of a *fresh start* toward compliance with all future filing and payment requirements. IRS Policy Statement P-5-100 (1992); emphasis added.

This continues *to this day* to be the stated and published policy of the IRS regarding OICs. See IRM part 1.2.14.1.17; and IRM part 5.8.1.1.3.

In the past, the IRS expressed little concern for the "interest of the taxpayer," and neither did it care whether the citizen could ever look forward to a "fresh start." Instead, its sole concern was whether it could achieve "maximum collection with the least possible loss or cost to the government." Revenue officers were told plainly, "Get all you can get." Not much of a compromising attitude, to be sure. By contrast, when faced with a debt that cannot be collected in full, or for which there is a legitimate dispute as to what is owed, the IRS currently acknowledges that, "it is an accepted business practice to resolve these issues through negotiation and compromise." See IRM part 5.8.1.1(1).

Furthermore, I was particularly intrigued by the IRS's use of the phrase "fresh start" when I first read it. It flew off the page at me because the entire premise of our *bankruptcy laws* is to provide a "fresh start" for those subsumed by debt. The *fresh start* theory has fueled bankruptcy law and policy for well over one hundred years. See Chapters 13 and 14.

What we see here is the manifestation of the fruit of my labor since 1988 in the area of taxes and bankruptcy. For example, in my book, *How Anyone Can Negotiate with the IRS and Win!* (1988), I exposed to the public two very important facts: first, that the IRS had an OIC policy allowing taxpayers to negotiate settlements; and second, that federal income taxes were dischargeable in bankruptcy—thus giving a taxpayer strong leverage to negotiate reasonable settlements the IRS might otherwise not wish to consider.

Between 1988 and 1992, when the first edition of *Tax Amnesty* was released, millions of dollars in federal income taxes, interest and penalties were discharged in bankruptcy. There is no way to know how many lawyers and accountants were educated by *How Anyone Can Negotiate*, and what that education led to in terms of canceling tax debt. I do know that tens of thousands of tax pros read that book over the years.

I also know that the book had a profound impact on how the IRS handles delinquent tax cases. Based on the IRS's 1992 OIC policy statement and other pronouncements we examine later, I know the impact extended to the highest levels of the IRS. Millions of citizens resorted to bankruptcy to discharge their tax debts, a right the IRS lied about for over twenty-two years. As a result, the agency was forced to rewrite its OIC policy in an effort to prevent the wholesale discharge in bankruptcy of delinquent taxes. I discuss this in detail in Chapter 13.

Who Can Benefit from an Offer in Compromise?

Code section 7122 gives the IRS the discretionary authority to “compromise” or reduce any tax liability. An OIC can be considered on any of four grounds. They are:

1. Where there is doubt as to one's actual “liability” for the tax assessed,
2. Where there is doubt as to the IRS's ability to “collect” the full amount of the tax assessed,
3. When full payment will cause a hardship, or where there are sufficient public policy or equity considerations that persuade the IRS to accept less than full payment of the tax. This third element is the so-called Effective Tax Administration OIC. See Treas. Reg. §301.7122-1(b)(3). It grows from the IRS Restructuring Act, in which Congress instructed the IRS to expand its OIC regulations to allow the agency to consider “additional factors” in determining whether to compromise a given debt. Congress instructed the IRS to take into account factors such as: a) the overall fairness (equity) of the situation, b) the economic hardship to a citizen that would result if the tax were paid in full, and c) public policy considerations. And finally,
4. Where there are “special circumstances” that justify accepting an offer based on doubt as to collectability for less than the IRS would otherwise require.

An OIC based upon *doubt as to liability* can help any person who:

- Accepted an audit determination he knows to be incorrect but never appealed the decision,
- Was unable to file a Tax Court petition within the ninety-day grace period, thereby preventing judicial determination of his tax liability, or
- Failed to file tax returns, but against whom the IRS determined a tax liability without considering his proper deductions, allowances, credits, etc. (i.e., the SFR).

An OIC based upon *doubt as to collectability* is by far the most common variety of OIC. It can help any person whose assessed tax exceeds his capacity to pay, considering equity in assets and ability to make payments over the remaining time left on the collection statute of limitations.

An OIC based upon Effective Tax Administration applies only if there are no other grounds for compromise. That is to say, an ETA offer applies only when you, 1) legally owe the tax in the amount assessed, and 2) can pay the tax in full within the collection statute of limitations. See IRM part 5.8.11.1(2). But if full payment would cause hardship, or would create profound unfairness or the perception of unfairness in the manner in which the tax laws are enforced, the IRS is authorized to accept less than full payment.

The fourth variety of OIC is actually a subcomponent of an ETA offer. Ordinarily, if you cannot pay the tax in full, an ETA offer does not apply. In that case, you must offer the IRS an amount equal to your “reasonable collection potential” (RCP), as defined and discussed later. The short answer is that reasonable collection potential is equal to your ability to pay, as determined from your disposable income and equity in assets. In some unique circumstances, however, the payment of one's reasonable collection potential may still pose a hardship, even though it is less than the tax assessment. In that case, IRM part 5.8.4.2(3) gives the IRS the authority to accept an OIC for less than one's RCP in light of those "special circumstances."

Submit an OIC based upon doubt as to collectability or an ETA offer on IRS Form 656. Submit an OIC based upon doubt as to liability on Form 656-L. When the offer is based upon doubt as to liability, provide detailed explanations and supporting documents to prove there exists doubt as to whether you indeed owe it. When the offer is based upon doubt as to collectability, an ETA offer, or an offer based on "special circumstances," provide a full financial profile. Include a current financial statement (Forms 433-A, and if necessary, 433-B). As we address each aspect of the offer, I describe in more detail the nature of the material needed to support it.

Special Conditions of an Offer in Compromise

The most important special consideration for an OIC is the fact that filing one tolls the collection statute of limitations. The CSED is tolled for the period of time the offer is pending, including appeals, *plus thirty days*. See IRC §6331(k), and Chapter 10. This is true whether or not the OIC is accepted. For this reason, take care to ascertain the CSED prior to submitting an offer. You must carefully consider whether it is wise to submit an offer if the collection statute is about to expire.

Next, when your offer is accepted, you must file all of your tax returns and pay all of your taxes on time for the next five years. If you fail in this charge, your offer is reneged and the tax reinstated.

Despite these negative aspects, under the right circumstances, an OIC can be the best way to resolve your situation.

How to Argue for an Offer in Compromise

In this section, I address each of the four types of OICs: the offer based upon doubt as to liability, the offer based upon doubt as to collectability, the ETA offer, and finally, the "special circumstances" offer.

Doubt as to Liability

One example of a successful "liability" offer involves Gerry and his wife Judy, a couple who filed a petition in the U. S. Tax Court. Due to certain procedural failures on their part and because of arguing untenable legal positions, they lost their case. Not only did they lose on the merits of the tax issues, thus incurring a sizable tax liability, but the Court also imposed a penalty of $5,000 under code section 6673 for maintaining a "frivolous" Tax Court case. (The maximum potential penalty under that section is $25,000.) Note this is a different penalty than the so-called "frivolous submissions" penalty under section 6702, which I discussed in Chapter 9.

When the IRS began collection, Gerry and Judy were each presented with separate bills. Each bill was $5,000 above the tax determined by the court. The additional $5,000 purported to cover the penalty. The RO insisted it was assessed against *each person*. We objected to the second $5,000 penalty. I maintained the Tax Court assessed just one penalty against both persons, not one penalty against each. The RO pointed only to the assessment certificate as her proof of the two assessments. We countered that code section 6673 permitted just one penalty per court case. Despite my presentation, the RO would not budge.

To end the standoff, we filed an OIC challenging the validity of the second $5,000 assessment. The offer was based upon doubt as to liability. To prove the second assessment was improper, we submitted a copy of the Tax Court's opinion and judgment, as well as a copy of the statute. The language of the opinion and the statute clearly stated that just one $5,000 penalty was to be assessed. As a result of the OIC, the IRS abated the second $5,000 penalty. The OIC saved Gerry and Judy not only $5,000, but the additional interest and penalties.

Let me give you another example of where an OIC based upon doubt as to liability was effective. Darlene was audited for three years in connection with her small business. She was represented by her CPA, who also prepared all the returns. He convinced Darlene that he had substantial experience in audits and appeals, and could even represent her in the U.S. Tax Court if that became necessary.

In response to a request by the tax examiner, Darlene and the CPA provided all records necessary to prove that her tax returns were correct. However, the tax examiner simply ignored the information and disallowed several key deductions. After the IRS issued its initial examination report, Darlene called the CPA and asked him to accompany her to the IRS office to discuss the proposed changes. Incredibly, he said that he was "too busy" and could not do so. Darlene then called the examiner's manager and asked for a meeting to discuss the issues. The manager explained that no further meetings were possible because the case had already been "sent to the next step."

While Darlene did not know what that meant, the CPA assured her that he would file an appeal and bring the case to the Tax Court if necessary. Sometime later, Darlene received a Notice of Deficiency. She brought it to the CPA right away. Again, he stated that he would file a petition with the Tax Court. He asked for certain information, which Darlene promptly provided. After getting him the information, she just waited.

Sometime later, Darlene began receiving collection notices from the IRS. She followed up with the CPA and discovered that he never filed a petition with the Tax Court. As it turned out, he was not authorized to practice in the Tax Court and thus never had the authority to file a petition on Darlene's behalf, despite his representations to the contrary. Because of his negligent acts and his false statements regarding his ability to represent Darlene in Tax Court, she lost the opportunity to challenge the proposed assessment before it became final.

In the Offer in Compromise process, we submitted the documentation needed to support Darlene's deductions, just as she would have done if the case were submitted to an Appeals Officer. This, of course, is the key to success with any such offer. You must prove the existence of *bona fide* doubt about a question of law or fact addressing the merits of the liability. Darlene's documents did that. When you are able to prove the existence of such doubt, the IRS recognizes there is room for mutual concession on the issue.

In this regard, IRS does not accept vague or undefined claims of error. Expect the agency to presume that the assessment is correct. You have the burden to prove otherwise. To increase the degree of doubt, present all definitive information available at the time of making the offer. You must document your claim, either factually or legally, that the assessed liability is "incorrect." Provide proof as attachments to Form 656-L.

Please note that such offers are rejected if a court already ruled on the question of the liability. The IRS looks at such rulings as "conclusively" determining the issue. Therefore, you must look to other avenues to win relief if, say, the Tax Court already declared you owe the tax.

Also note that when you challenge an improper assessment because IRS failed to consider all deductions, allowances, exemptions and credits to which you are entitled, the matter is handled as a routine audit. After filing the offer, the matter is handed to the Examination function. A tax examiner is assigned to review your documents and determine your correct liability. When the examination is complete, a recommendation is made regarding the OIC. Therefore, you must have all documents necessary to prove your correct tax. These include records pertaining to both your income and deductible expenses. For more information on the type of records needed, see Chapter 6, *How to Win Your Tax Audit*.

Doubt as to Collectability

The second ground for an OIC is based upon doubt as to the "collectability" of the tax. To win acceptance of such an OIC, you must prove—based upon your current financial facts and circumstances—that you cannot pay in full. The compromise is the acceptance of the lesser amount, which must be equal to what the IRS calls "reasonable collection potential" (RCP).

RCP is determined by four components of your financial facts and circumstances. See IRM part 5.8.4.3.1. I address each of them below.

Net Realizable Equity in Assets

This is the amount of equity you have in assets, after considering mortgages, notes or liens against the property that have priority over the IRS's claim. For example, if you have a home with a current fair market value (FMV) of $100,000 and a prior outstanding mortgage balance of $80,000, your equity in the asset is no more than $20,000. In fact, however, the IRS uses an 80-percent factor in figuring the value of assets. If the FMV of the home is $100,000, the IRS figures the value at $80,000 for OIC purposes. The 80-percent value is considered quick sale value (QSV). Thus, in the example above of the house with FMV of $100,000, the QSV is $80,000. We said the prior debt is $80,000. Therefore, there is no equity in that asset for OIC purposes. I discuss the issue of calculating equity in assets in more detail below.

The Future Income Asset

This is determined based on your ability to make payments over a fixed period of time. Future income is your disposable income (see Chapter 5) multiplied by a number of months depending upon your specific OIC. There are two OIC payment options. The most common is a cash offer, which must be paid in full in five or fewer monthly payments. In that case, your future income is equal to twelve months of disposable income. For example, if your disposable income is $300 per month, your future income is $3,600 (300 x 12). Assuming no other assets, the OIC of $3,600 would have to be paid within five months.

The second option is a monthly payment for up to twenty-four months. Under no circumstances will OIC payments be stretched out longer than that. In the case of a $300 disposable income, the IRS will accept an OIC of $7,200, paid at the rate of $300 per month for twenty-four months. The question is of disposable income is determined based upon all the rules we discussed in Chapter 5, and as explained further below.

Amounts Collectible from Third Parties

This issue arises if you transferred assets, such as a home or cash, to third parties, and the IRS believes it can pursue those parties under a nominee or transferee theory to recover the asset. In an OIC environment, however, rather than going through lengthy legal gyrations, the IRS will merely attribute the net equity to your RCP in computing the OIC amount through what it calls "dissipation of assets." I discuss this in more detail below.

Assets Available to You but Out of the Government's Reach

This might include assets that are held offshore. While the IRS may not be able to seize those assets due to limits on its enforcement jurisdiction, it can include their value in RCP for settlement purposes.

If, through the combination of all four elements set forth above, it is determined that your RCP is sufficient to fully pay the tax within the time remaining on the collection statute, you do not qualify for an OIC based upon doubt as to collectability. On the other hand, if your RCP is insufficient to fully pay, you do qualify. For the vast majority of citizens, RCP boils down to the factors explained in the first and second paragraphs above. I address each of them here in more detail.

Determining Asset Values

In determining whether an offer "reasonably reflects collection potential," the starting point is the fair market value of your assets. This is not the amount you paid for an asset, nor is it the replacement cost. It is the amount a willing buyer would pay a willing seller who is not under duress to sell, based upon the asset's current condition, useful life, desirability, etc. In the case of a car, for example, you would use the car's reasonable resale value based upon its mileage, condition, appearance, optional equipment, etc. Figuring the value of most assets is not an exact science, especially considering real estate in a soft market, limited use assets and other factors, such as condition and general marketability.

Once you know the fair market value, you apply the 80-percent factor to determine quick sale value. However, even the 80-percent factor is not carved in stone. Internal Revenue Manual part 5.8.5.4.1(3) provides that 80 percent is the rule of thumb, but goes on to state that, "A higher or lower percentage may be applied in determining QSV when appropriate, depending on the type of asset and current market conditions." For example, in Chapter 10, while discussing the Partial Pay Installment Agreement, I mentioned my client who owned property on the "wrong side of town" in Dayton. The county assessor valued the lots at about $15,000 each. In fact, my client had them for sale for years and they would not sell at any price. Indeed, my client had not paid the real estate taxes in years and not even the county wanted to forfeit the lots for the tax delinquency. Given that, we were able to show that there was actually no value whatsoever to that property.

The IRS generally does not reject offers solely on the basis of narrow asset evaluations, precisely because property values (except cash and cash equivalents) *are not* scientifically exact. Therefore, do not be afraid to engage in negotiations as to the net equity in any asset based on the asset's value. Inflexible property valuations are unusual and should not stand in the way of reaching an acceptable offer.

Let us now examine how the IRS views certain specific assets in OIC negotiations.

Cash

The IRS values cash at face value for OIC purposes. Thus, cash in a checking or savings account is not reduced by QSV factors. However, there are two exclusions that apply to cash. First, the total cash of all accounts must be reduced by $1,000. This applies only to "individual" bank accounts, not business accounts. Secondly, even if the account balance is more than $1,000 and there is "reason to believe the money will be used to pay for the taxpayer's monthly allowable living expenses," it is not to be included in RCP. IRM part 5.8.5.7(1), *Cash*. For example, suppose your checking account balance is $1,600. You need $1,000 to pay current living expenses. The account balance is zero for OIC purposes, because the first $1,000 is excluded for the living expenses, and the remaining balance of $600 is below the $1,000 minimum threshold for account balances. Thus, no cash is added to RCP.

Retirement Accounts

Tax deferred retirement accounts such a 401(k), IRA, and 403(b) are given special consideration due to the tax consequences of a withdrawal from such an account. When you take cash from your retirement account, you have a current income tax liability for both federal and state taxes based upon the amount of the withdrawal. And, if you are under age 59½ at the time of the withdrawal, the early withdrawal penalty of 10 percent is added. This means you can lose up to 40 percent of your retirement account to current taxes. For this reason, when figuring the value of a retirement account, the IRS must "allow for any penalty for early withdrawal and the expected current year tax consequence." IRM part 5.8.5.7(5). To accomplish this, reduce the value of your retirement account to reflect the current tax hit. This becomes the QSV of the account. In most cases, the hit is at least 30 to 40 percent of the face value of the account.

No value for a retirement account should be added to the extent that you will not realize any net proceeds from a distribution. My client Larry had a 401(k) with a face value of about $20,000. He had an outstanding loan against the account of about $12,000. The available cash in the account was $8,000. If he took a distribution of the entire account, the $12,000 loan would have been converted to a taxable distribution. Thus, Larry would have had to recognize $20,000 of income in the year of the distribution, even though he only received the net cash amount of $8,000. And he would have had to use the $8,000 to pay the current taxes incurred on the $20,000 of income. For OIC purposes, the value of Larry's 401(k) was $0.

Motor Vehicles

The value of motor vehicles is figured using FMV and QSV as discussed above. In addition, the first $3,450 of the "net equity valuation of vehicles" is excluded from RCP. IRM part 5.8.5.12(3), *Motor Vehicles, Airplanes and Boats*. This exclusion applies only to automobiles, not recreational vehicles such as campers or boats, and it is limited to two vehicles, if you are married. For example, suppose you have a vehicle with a FMV of $5,000. The QSV is 80 percent, which is $4,000 (5,000 x .8). After subtracting the $3,450 exclusion, the amount added to RCP is just $550 (4,000 QSV – 3,450 exclusion = 550). For the exclusion to apply, the vehicles must be "used for work, the production of income, and/or the welfare of the family." IRM part 5.8.5.12 (3).

Income Producing Assets

A very important exclusion applies to assets of a business necessary to produce income. The IRM provides that "equity in income producing assets will not be added to the RCP of a viable, ongoing business unless it is determined the assets are not critical to business operations." IRM 5.8.5.15(3), *Income Pro-*

ducing Assets. Suppose your business has a machine used to manufacture parts and you cannot operate without this machine. Regardless of the equity in the machine, it is excluded from RCP if the income produced by the machine is included in your earnings. The equity is not included because the machine is needed to produce income, and is essential for the business to operate. IRM part 5.8.5.15(3), Example (1). However, if the equipment produces no income, the equity will be added to RCP.

Note this important admonition in the IRM regarding the IRS's responsibility to be reasonable when it comes to business assets:

> ***Note:*** *It is in the government's best interest to work with this taxpayer to maintain business operations, particularly in a bad economy. IRM 5.8.5.15(3), Example (1); emphasis added.*

This exclusion applies equally to self-employed persons who use personal assets to produce income. Suppose you are a real estate agent. You use your personal vehicle to transport clients throughout the area. In that case, you can exclude the entire net equity in your vehicle as an asset necessary to produce income.

Dissipated Assets

One might wonder, if the IRS considers equity in assets such as cash or real estate in the computation of RCP, why not just give away the asset prior to filing an OIC? The short answer is *fat chance*. During the offer investigation (discussed in detail later in this chapter), the IRS examines public records to determine if assets were recently transferred. They will also review bank statements to see whether cash was spent, or, say, a retirement fund was liquidated.

Suppose you liquidate a $20,000 IRA. The IRS will want an accounting of where the money went. If you cannot establish that the money was used in some acceptable way, the IRS will consider the $20,000 a "dissipated asset." They will add it to RCP and expect your offer to be based on the value of the asset that was dissipated. In the case of transferring, say, a home or car, that might not pose a huge problem since presumably, you could recover the asset and liquidate it to fund the OIC. However, if you simply spent cash, you create a double problem: not only does the IRS add the cash back to RCP, but you likely cannot recover the cash to fund the offer. Therefore, even if the IRS accepts an OIC at the increased amount, you will not be able to fund it. For these reasons, you cannot simply dump your assets before filing an OIC.

Let us understand exactly what constitutes dissipating assets. The IRM provides that dissipation occurs if you have:

> *"sold, transferred, encumbered or otherwise disposed of assets in an attempt to avoid the payment of the tax liability or used the assets or proceeds (other than wages, salary, or other income)* ***for other than*** *the payment of items necessary for the production of income or the health and welfare of the taxpayer or their family…" IRM part 5.8.5.18(1); (emphasis added).*

Thus, if you simply put your house in your brother-in-law's name prior to filing an OIC, that will be considered a dissipated asset. But take notice of the "other than" language in the IRM. This makes it clear that there are perfectly legitimate ways to use cash or assets that do not rise to the level of dissipation. For example, if you use an IRA to pay necessary medical expenses (or other necessary living or business expenses), that is not a dissipation. The Tax Court stated in *Johnson v. Commissioner*, 136 T.C. 475 (2011), that dissipation arises when one takes affirmative steps to "reduce his collection potential by wasting the assets." This would include using the money for lavish or extravagant living expenses, gambling junkets, exotic vacations, frivolous purchases, transferring assets for less than full value, or making substantial cash gifts.

Dissipated assets may also include making risky, frivolous, careless or speculative business investments (other than necessary expenses for an operating business). In the case of *Tucker v. Commissioner*,

T. C. Memo. 2011-67 (2011), for example, the taxpayer blew through $22,000 in less than one year by "day trading." He argued that he made the investments to raise money to pay the IRS. Nice try—but the IRS did not buy it and neither did the Tax Court. He only owed about $45,000 to begin with. If he paid the IRS the cash he had available before "day trading," his problem would mostly have been solved.

The IRM provides that if the transfer or liquidation occurred prior to the event that gave rise to the tax in the first place, *"a taxpayer cannot be said to have dissipated the assets in disregard of the outstanding tax liability."* IRM part 5.8.5.18(2) (Example 1). That is to say, you must be aware that you either owe or will owe a tax in order for the dissipation concept to apply. What is more, if the transfer occurred more than three years before submitting the OIC, the IRM says to generally disregard it. IRM part 5.8.5.18(2).

However, there is an exception to this rule. If the transfer occurred either within six months prior to or after the assessment of the tax, or within six months of the notification that you were being audited, the IRS will consider the transfer. IRM part 5.8.5.18(3) & (6). For example, suppose you liquidated an IRA more than three years before you filed an OIC. However, the liquidation occurred very shortly after you were notified of an audit for the tax years subject to the OIC. In that case, the IRS will consider whether the IRA should be included as a dissipated asset.

In any event, the IRM is crystal clear that any amounts paid for "necessary living expenses…should not be included in the RCP calculation." IRM 5.8.5.18(7)(1). Such expenses include (but are not limited to) medical bills, child support or alimony, other court-ordered payments, housing expenses, necessary insurance, legal fees (even fees incurred to hire counsel to deal with the IRS), real estate taxes, state income taxes, using IRA proceeds to pay living expenses while unemployed, etc.

For a payment to be considered a dissipation, it must rise to the level of deliberately "wasting money." And if there is any doubt about the issue, the doubt must be resolved in favor of the taxpayer, not the IRS. See *Samuel v. Commissioner*, T.C. Memo. 2007-312 (2007). The IRM is clear that a decision to include a dissipated asset in RCP "must be clearly documented with the basis" for the decision. IRM part 5.8.5.18(9). In this regard, the IRS cannot make arbitrary or capricious decisions that are not based on a solid foundation of law or fact. But you have the burden to prove that an expense in question was appropriate under the circumstances.

The Future Income Asset

The second element to consider in determining RCP is the future income asset. As explained, this is your disposable income left after consideration of all necessary living expenses, as explained in detail in Chapter 5. If you have the ability to make a payment to the IRS, the present value of those payments is considered an asset in figuring RCP.

Just as is the case with certain assets, the IRS treats certain income and expense items somewhat differently in OIC negotiations. I discuss those issues here.

Income Averaging

As you know, the starting point in determining disposable income is your gross monthly income from all sources. Generally, the "taxpayer's current income" is to be used for figuring disposable income. IRM part 5.8.5.20(2). A special problem arises in cases where a citizen is either unemployed or underemployed. You are underemployed if your current job provides substantially less income than your training or profession allowed you to earn in the past. Say for example you are an experienced sales person accustomed to earning $100,000 per year. Cutbacks in your company cost you your job. You are currently working as a retail sales clerk earning $30,000 per year. Another example is that of a self-employed person whose income is down due to economic conditions, or whose business has substantially changed due to market conditions or other factors, such as age or health.

In these cases, the IRS often wants to average your income over the past three years to determine your current annual income. From there, IRS applies your allowable necessary living expenses to determine disposable income. The problem with this should be readily apparent. The "average income" you earned over the past three years is more—perhaps substantially more—than your current income. That in turn falsely drives up disposable income to the point where an acceptable OIC becomes impossible to pay.

So the question is what to do if the IRS wants to "income average." First, point out that "income averaging" is merely a speculative stab at what your income *might be* going forward. By its very nature, it cannot be accurate, any more than the NS, LS or TS allowances accurately reflect your expenses. Moreover, the calculation for future income, as a component of valuing an OIC, must be based upon a realistic expectation of what you will be able to pay. Using income averaging when your job or business has substantially changed, or when you are unemployed, does not give such a realistic expectation.

Second, you might propose to enter into a *Future Income Collateral Agreement* as an alternative if the IRS pushes the issue. A *Future Income Collateral Agreement* is a contract to pay an increased percentage of your income in addition to the normal income tax on that income. This is a way to give the IRS a taste of your increased future income, but only if it *actually materializes*.

A collateral agreement is a much better approach to dealing with the problem of uncertain current earnings than income averaging. Most notably, it gives the IRS what it is looking for—more of your money as your earnings increase. But at the same time, the agreement holds no risk for you because you pay additional amounts *only* if you earn additional income. In fact, the United States Tax Court stated that this is the preferred way to address this issue, rather than just "assume[ing] that a [taxpayer] would earn sufficient income" to pay the tax. See *Sampson v. Commissioner*, T.C. Summ. Op. 2006-75 (2006).

In *Sampson*, the Tax Court ruled that the IRS abused its discretion by refusing an OIC in a case where the citizen was unemployed and going to school. The IRS used income averaging based upon prior earnings despite the fact that, at the time of submitting the OIC, Sampson had no income whatsoever. The Court ruled that if the IRS wanted to get a piece of Sampson's future income following school, it should have entered into a collateral agreement rather than include "estimated future income" in determining collection potential.

In all events, document how changes in your employment or business situation clearly show that you are simply not going to earn income at the same levels you did in the past. Guessing at your income and determining a future income asset based upon a guess is nothing more than financial Russian roulette. It effectively denies the economic realities of your situation and puts you into a position where a realistic OIC is impossible. The only reasonable and sensible thing is to base the OIC on the economic realities that you face now. A *Future Income Collateral Agreement* can do that.

The IRS will not just roll over when you suggest a collateral agreement. The agency wants to look back to prior income levels, hoping to squeeze as much blood from the turnip as possible. Your job is to keep them looking forward. To be successful, you must keep the IRS focused on the realities of the circumstances, not the misty memories of your days of high income. Internal Revenue Manual part 5.8.5.20, *Future Income*, helps you do just that.

This manual portion addresses exactly how the IRS is supposed to determine the future income asset when income has fluctuated. The manual gives various "if/then" examples of employment situations and provides instructions on how the IRS must address that situation.

The IRM specifically provides that when a citizen is "long-term unemployed," the "use of income averaging is not required." Rather, the IRS is to use the "taxpayer's current income" in determining the future income calculation. The manual gives the same instruction in cases where the citizen is "unemployed and not expected to return to their previous occupation or previous level of earnings."

Specific examples from the manual include the following:

> *"Taxpayer's spouse has not worked for over two and one-half years and has no expectations of returning to work. Do not average income for the spouse's past employment."*
>
> *"Taxpayer has been unemployed for over one year and provided proof that Social Security Disability is the sole source of income. Do not apply income averaging in this case but use current income to determine the taxpayer's future ability to pay."*
>
> *"Taxpayer recently began working after several months of unemployment. Use the most recent three months pay statements to determine future income. Since the taxpayer is a wager earner, use of income averaging over the prior three years is not appropriate."* (IRM section 5.8.5.20(5))

This same IRM provision also addresses citizens who are "in poor health" or who "are close to retirement" and will be retiring soon. In these cases, the IRS is likewise instructed not to income average. In the case of a person in poor health, the preferred approach is to focus on the citizen's reduced earning potential given the health situation. In the case of a retiring person, the instruction is to use the citizen's retirement income, not his past earnings.

The manual goes on to state the following:

> *"Judgment should be used in determining the appropriate time to apply income averaging on a case-by-case basis. All circumstances of the taxpayer should be considered when determining the appropriate application of income averaging, including special circumstances and ETA [Effective Tax Administration, discussed later] considerations."*

This is a clear directive to consider the facts of the case and not merely apply a cold mathematical formula that results in an OIC that is impossible to pay.

And finally, the IRM specifically addresses the use of a Future Income Collateral Agreement. At IRM part 5.8.5.20(1), the manual reads:

> *"In some instances, it may be difficult to calculate the taxpayer's anticipated income. While the use of income averaging is one method available to calculate future earnings, it may also be appropriate to use the taxpayer's current income and secure a future income collateral agreement. The use of a future income collateral agreement will protect the government's interest in any substantial increase in the taxpayer's earnings."*

The final sentence is the key to a collateral agreement—the "government's interests are protected." That is, the IRS does not give up anything in the negotiation by entering into the agreement; rather, the IRS is assured of getting a taste of any substantial future earnings. This is a compelling reason for the IRS to enter into the agreement rather than force an unrealistic OIC amount through income averaging.

This IRM provision goes on to give several examples of when a future income collateral agreement is the desired option; two of them are key examples. The first key example deals with a situation where the citizen is in school. This example is derived directly from the *Sampson* case, discussed earlier. It reads:

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

The second key example involves a self-employed person whose income is negatively affected by the economy. That example reads:

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

Structuring a Collateral Agreement

A *Future Income Collateral Agreement* has two elements, both of which are fully negotiable. The first is the duration of the agreement. The second is the amount of money you pay under the agreement. Let us address each element.

Duration

The amount of time during which the IRS looks forward for capturing future income depends upon the nature of the offer. For a cash offer, the future income asset is figured over twelve months. In the case of a deferred payment offer, the period is twenty-four months. Based upon this, you should not propose a collateral agreement that extends farther into the future than the period governing the nature of your offer. For example, when making a deferred payment offer, propose to cap the collateral agreement at two years. There is no rule on this. The matter is entirely negotiable. However, expect the IRS to push for a collateral agreement that extends during the five-year window in which you must remain current with future tax return filings and tax payments. See below, under the heading, *Other Factors that Make a Successful OIC*. I would argue that five years would be the *longest* time your collateral agreement should run. In any event, work to get the *shortest* possible agreement the IRS will accept.

Amount

The amount of the agreement is based on a percentage of your income in excess of a threshold amount. The threshold amount is the amount of your current income. In our above example of the salesman working as a sales clerk, his current annual income is $30,000. That is the starting point for launching the agreement. In that case, the agreement should provide that the IRS gets no additional money on the first $30,000 of income for each year the collateral agreement is in effect.

The threshold amount could even be higher depending upon the situation. Suppose that while the salesman currently earns $30,000, his necessary living expenses are such that he is upside down on his monthly expenses. Say that he is behind $300 per month in his bills and makes up the difference with credit cards. In that case, I would argue that the threshold amount should be $33,600, his break-even point.

The next step is to craft an agreement under which the percentage of income the IRS gets paid stair-steps upward as your income grows. The following is an example.

Once your income exceeds the threshold, the IRS gets an additional:

- 10 percent of annual income in excess of $30,000, up to $40,000,
- 15 percent of annual income in excess of $40,000 up to $50,000, and
- 20 percent of annual income in excess of $50,000.

Under this example, suppose your annual income is $45,000 in the first year of your collateral agreement. The increased payment to the IRS is figured as follows:

Income		Additional Money Due		
First $30,000	*	$ 0	– *	The threshold amount
10% of $10,000	**	$ 1,000	– **	The difference between $30,000 and $40,000
15% of $5,000	***	$ 750	– ***	The difference between $40,000 and $45,000

Total additional due = $1,750

(The phrase "annual income" used in the collateral agreement means "adjusted gross income." So, if you are self-employed, all business expenses are deducted before arriving at adjusted gross income.)

As stated above, all elements of this agreement are negotiable. Once they are settled, the agreement is put forth in writing using Form 2261, *Collateral Agreement – Individual Future Income*.

While a collateral agreement solves the problem of income averaging, you cannot use it to lower what otherwise would be the acceptable offer amount. Say for example your realizable equity in assets is $20,000. Based upon that (and assuming no future income asset) your OIC must be at least $20,000. The IRS will not accept a collateral agreement as an incentive to reduce the $20,000 offer to a lesser amount.

Retired Debt

"Retired debt" is a phenomenon that arises when you pay off a loan. Suppose you have a car payment of $450 per month, and the car will be paid off in six months. In that case, the IRS may want to increase your disposable income after six months to reflect the fact that you no longer have the car loan. In doing so, the IRS does not consider that by the time the car is paid for, you would either need a new car or incur more maintenance costs. However, the IRM provides that, "Retired debt should not automatically be included" in RCP. The IRS is required to use "judgment" in determining whether inclusion is appropriate under all the facts and circumstances of the case. IRM part 5.8.5.19(2).

Particularly with regard to car loans, the IRS is precluded from retiring the first $400 of a loan per vehicle, for up to two vehicles (one vehicle for a single taxpayer). IRM part 5.8.5.19. For example, suppose your actual car payment is $475. Under the IRM provision cited here, you are allowed $475 per month until the vehicle is paid off, and $400 per month going forward. This is true unless the vehicle is already paid off when you enter the OIC negotiation. In that case, you may be entitled to an additional operating expense deduction of $200 per month if the vehicle is six years old or older, or has 75,000 or more miles on it, for up to two vehicles. See IRM part 5.8.5.22.3(6), discussed in Chapter 5. Or, you could just buy a new car before entering OIC negotiations, provided that, 1) the vehicle is necessary to earn income or provide for your family's health and welfare needs (especially in light of the age and condition of the old car), and 2) the payment is under the currently allowed standard for vehicle ownership costs.

Transportation Expenses

Speaking of transportation expenses, as we know from Chapter 5, the IRS allows a standard for vehicle operating expenses. The standard purports to include maintenance, repairs, insurance, fuel, registration, license, inspection, parking and tolls. In most cases, the standard is inadequate to cover a person's actual expenses, unless he has a short daily commute and does not use the vehicle for business purposes of any kind. But that is rarely the case.

My client Chuck was a repair technician for his company. He used his own vehicle to drive to various locations around the city to fix equipment the company contracted to repair. His vehicle costs were about $650 per month, more than twice the IRS's allowance. We pointed to IRM part 5.8.5.22.3(3) for the authority that transportation costs greater than the standard are allowed if the taxpayer proves that "higher expenses are necessary." Such additional costs are allowable if they meet the "production of income" test. See IRM part 5.8.5.22.3(5). That certainly was the case with Chuck, and the higher expenses were allowed.

Student Loans and Education Expenses

The IRM provides that you must be allowed "minimum payments on student loans guaranteed by the federal government." IRM part 5.8.5.22.4(3), *Other Expenses*. However, you must prove that you are making the payments. If the loan is in deferment or is otherwise not being paid, no consideration is given for a future payment.

If you incur education expenses as a condition of your employment, they must be allowed. IRM part 5.8.5.22.4(4), *Other Expenses*. For example, suppose you are a medical professional required to undergo continuing education classes in order to maintain your license. In that case, such expenses are a condition of employment and must be allowed. Since such expenses are not usually incurred evenly over the period of a year, you should amortize all such expenses over twelve months to determine the average monthly cost.

Delinquent State and Local Taxes

While the IRS must allow all current taxes (federal and state income and Social Security taxes) in figuring disposable income, the agency is not as understanding when it comes to *delinquent* state tax debt. Often the IRS takes the position that payments for state tax debts are not allowed at all since the IRS's claim generally has priority in time over the state's claim. As such, as far as the IRS is concerned, the state's claim is just another unsecured claim, no different than a credit card debt.

Naturally, however, state taxing agencies do not look at their assessments in the same light. Moreover, states have levy and enforcement powers much like the IRS, and certainly far beyond what any credit card company may enjoy. What often results is a whipsaw situation, where the IRS does not care about a state tax assessment, but the state taxing authority does not care about the IRS's lack of respect, since the state can enforce collection without regard to IRS sanction. Just as with two warring mafia families, the shop owner being extorted is caught in the middle.

The good news is that the IRM expressly provides that payments for delinquent tax debts must be allowed at some level. See IRM part 5.8.5.22.4(7). The payment scheme depends upon whether a payment agreement was reached with the state before or after IRS's assessment. In either event, the IRM provides a three-step formula for determining the starting point to figure how much is allowed as a payment to the state.

Step 1. Figure your disposable income without regard to any payment for delinquent state taxes. For example, suppose your gross income is $4,000 per month and allowable living expenses (including *current* federal, state and local taxes) are $3,700. Disposable income is $300 per month.

Step 2. Determine the fraction of disposable income to apply to the delinquent state taxes, based upon the ratio of state tax debt to total tax debt. For example, suppose your IRS debt is $100,000 and your state debt is $20,000. Your total tax debt is $120,000. In that case, your state tax debt is 17 percent of your total debt (20,000/120,000).

Step 3. Apply the percentage of state tax debt to your disposable income computed in Step 1. In this example, disposable income is $300 and the percentage of state tax debt is 17 percent. Therefore, the allowable payment to the state is $51 (300 x .17). As such, your disposable income for OIC purposes is $249 (300 – 51).

The IRS will use that formula if you have no agreement in effect with the state. Keep in mind that the state is by no means bound by this calculation. This is merely the device the IRS uses to make some accommodation for the economic reality that you owe the state and it will demand some kind of payment.

If an agreement with the state is already in effect by the time you negotiate your OIC, the IRS applies the following rules to that agreement:

1. State agreements established *after* the IRS's assessment. If the payment is equal to or less than the calculated percentage, IRS allows the actual payment. For example, suppose the percentage amount is $100, but your payment agreement is $50. The IRS allows the $50 payment. On the other hand, if the percentage amount is *less than* the agreement, the IRS allows only the percentage amount. For example, suppose the percentage amount is $100 but your payment agreement is $150. The IRS allows only $100 for purposes of figuring disposable income.
2. State agreements established *before* the IRS's assessment. In this case, the IRS must accept the payment agreement, regardless of percentage calculation. This is because the state's assessment has priority in time to the IRS's assessment. See IRM part 5.8.5.22.4(7)(B) for these procedures.

Keep in mind that these limitations are only for purposes of calculating reasonable collection potential in an OIC. It does not mean that you are, in turn, left at the mercy of state enforcement action. Once you have concluded your negotiations with the IRS, and assuming your OIC is accepted, you can turn your attention to the state and do what is necessary to tame that beast once the IRS is off your back and out of your life.

How Much Should I Offer?

The textbook answer is that an OIC based upon doubt as to collectability must offer an amount at least equal to your reasonable collection potential. The final number depends on exactly how your future income asset is calculated. That is determined not only by your income and expenses, but by the payment terms you propose. There are currently two ways to pay a negotiated offer. You make the election on Form 656, *Offer in Compromise*, as to which plan you propose. Let me illustrate the two alternatives and how the future income asset is calculated under each scenario.

A Cash Offer

This is the cheapest settlement option. This option requires the accepted offer amount to be paid within five months, in five or fewer installments, beginning with the date of written notice that your offer was accepted. In this case, your offer must present the total negotiated equity in your assets, plus the amount of your monthly disposable income factored over twelve months. You must make a deposit equal to 20 percent of the amount offered with your offer when you file it.

For example, suppose your net equity in all physical assets is $5,000. Suppose your disposable income is $200. The combination of your equity in assets and the ability to pay $200 per month will not full pay the tax within the time left on the collection statute. In that case, for OIC purposes, your future income asset is $2,400 (200 x 12 months). You must add your equity in assets ($5,000) to the future income asset ($2,400). The total ($7,400) becomes your OIC amount, payable within five months after acceptance of the OIC.

This is another reason it is so important to know how much time is left on your collection statute, and to correctly negotiate your disposable income, as outlined in Chapters 5 and 11, and as discussed above. The IRS almost always figures your future income asset incorrectly in determining whether you qualify for an OIC at all. My client Roger owed about $40,000 for several tax years. The offer examiner correctly determined that Roger had about $600 per month in disposable income. He then projected the $600 over the span of about 80 months, which he said was the time remaining on the collection statute, making the future income asset around $48,000. As such, the offer examiner claimed that Roger could "full pay" the tax. However, there was less than half that much time remaining on the CSED. Upon proving that, it was obvious that $600 per month would not come close to fully paying the tax within the time left on the CSED. Because of that, the future income asset was figured at only twelve months, making Roger's future income asset just $7,200. That made for a very reasonable OIC settlement, since he had no equity in assets.

Periodic Payments

This option requires payment of the offer amount within twenty-four months from the date of acceptance. In this case, you must submit your first payment with your offer when you make it. You must then continue making regular monthly payments while the offer is being negotiated. The IRS will return your offer with no appeal rights if you fail to do so. Use IRS Form 656-PPV, *Offer in Compromise – Periodic Payment Voucher*, when making these payments. Send the form to the address shown in the instructions and be sure to use certified mail when making the payments. Put your Social Security number in the memo section of the check.

A periodic payment OIC must include the negotiated value of your equity in assets plus the amount of your disposable income over twenty-four months. Suppose your equity in assets is $10,000 and your disposable income is $200 per month. Your future income asset is $4,800 (200 x 24). Your total RCP equals $14,800. This is payable at the rate of $617 per month, for twenty-four months.

Now you might say, "Wait a minute. If my disposable income is just $200 per month, how the can the IRS expect me to pay $617 per month for twenty-four months?" In fact, if you could pay $617 per month, would not that figure be used to determine future income rather than $200? In that case, the OIC amount would be pushed even higher. This becomes a dilemma that is created only when a taxpayer has substantial equity in assets.

My client Joe owed more than $412,000 to the IRS for several tax years. We negotiated an OIC for $75,600, based almost entirely on the equity in Joe's home. His disposable income was only $50 per month. There was simply no way Joe could pay $75,600 over twenty-four months, never mind paying it within five months. And keep in mind that a cash offer requires a 20 percent down payment just to start the OIC process. In Joe's case, that would have been more than $15,000, and would have had to come from the equity in his house. That too would have been impossible since the IRS had tax liens on the home, and the only way to get the house refinanced would be if the IRS would release its liens. That was not likely prior to getting an accepted OIC.

To defeat these challenges, we proposed an OIC of $75,600, payable at the rate of $50 per month for twenty-three months, with a balloon payment of $74,450 in the twenty-fourth month. The IRS accepted the OIC, and Joe began making his $50 per month payments. He also secured an equity line of credit on his house, which he had in process while the OIC was being negotiated. In fact, the final OIC amount was determined based upon the amount of money the bank would lend him. Once the loan was approved, the IRS agreed to withdraw its lien. When the loan funded, Joe paid off the balance of the OIC within the twenty-four month time limit.

The OIC Based on Effective Tax Administration (ETA)

An ETA offer becomes viable if there is no other basis for making an OIC. That is to say, if there is no doubt that you owe the tax and you can full pay based on your income and assets, the IRS will generally not consider accepting an OIC. See IRM part 5.8.11.1(5). In that case, however, an OIC based on Effective Tax Administration becomes a viable alternative plan in the strategy to resolve your debt. The reason is that under an ETA offer, the IRS is authorized to accept *less than* your reasonable collection potential if the circumstances justify. See IRM part 5.8.11.2(1)(B).

Treasury Regulation section 301.7122-1(b)(3) provides that an ETA offer can be presented on either of two grounds. The first is that full payment of the tax would cause an economic hardship. The second ground is that there are sufficient public policy or equity (read: "fairness") considerations that justify acceptance of an OIC for less than full payment of the tax. Let us examine each situation.

The ETA Offer Based on Economic Hardship

In order for the IRS to accept an ETA offer on grounds of economic hardship, you must prove that full payment of the tax would cause an "economic hardship" as that phrase is used in Treasury Regulation section 301.6343-1. As we discussed at length in Chapters 5 and 6, that regulation provides that economic hardship exists when you are unable to pay "reasonable basic living expenses." I explained in detail the process the IRS uses to determine one's ability to pay. However, do not forget that NS, LS and TS tables are guidelines only.

Insofar as ETA offers are concerned, the IRS acknowledges this fact in two specific portions of the IRM. IRM part 5.8.11.2.1(2) acknowledges that the amounts allowed for basic living expenses "will vary according to the unique circumstances of the individual taxpayer." Moreover, IRM part 5.8.11.2.1(4) holds unequivocally that the published "standards are guidelines and if it is determined that a standard amount is inadequate to provide for a specific taxpayer's basic living expenses, allow a deviation."

On the basis of the financial evaluation, if you are capable of paying in full on paper, but you can prove that full payment would put you into the position where you cannot pay reasonable basic living expenses going forward, you qualify for an ETA offer on hardship grounds. To make your case, present information on any or all of the factors set forth in Treasury Regulation section 301.6343-1(b)(4)(ii)(A)-(F). I discuss each of these in detail in Chapter 6, under the heading, *Releasing Wage and Bank Levies*.

Be specific about your claims. Provide affidavits to the extent necessary to support your facts. Provide documents to the fullest extent possible to back up your claims. Use Form 433-A to present the basic financial details, and provide third-party statements to support your facts and circumstances.

The IRS's regulations and the IRM offer guidance on the circumstances that give rise to an ETA offer in hardship cases. There are four specific examples. This is not intended to be an exhaustive list. Here are the IRS's examples.

1. You are incapable of earning an adequate living because of a long-term illness, medical condition, or disability, and it is reasonably foreseeable that your financial resources will be exhausted providing for your care and support during the course of the condition.
2. Although you have monthly income, it is exhausted providing for the care of dependents that have no other means of support.
3. Although you have certain assets, you are unable to borrow against those assets due to financial limitations, and liquidation of those assets would put you into a position where you are unable to meet basic living expenses for yourself and family.
4. A pension is your only source of income and your only asset is a retirement account. However, liquidation of the retirement account would leave you without adequate means to provide for your basic living expenses going forward. See Treas. Reg. §301.7122-1(c)(3)(i); and IRM part 5.8.11.2.1(6) and (7).

You must also prove that acceptance of your ETA offer will not "undermine compliance" with the tax laws by others. Keep in mind that the IRS is very sensitive about the "message" it sends to the public when it accepts an OIC. It is not hard to sell the idea that if you simply do not have the capacity to pay in full, acceptance of an OIC based upon doubt as to collectability is reasonable. But an ETA offer is accepted for *less than* your reasonable collection potential—even when you can pay the tax in full. Therefore, you must be clear about the circumstances that justify such a conclusion.

The ETA Offer Based on "Compelling Public Policy" or "Equity" Considerations

If full payment of the tax would not cause economic hardship as outlined above, you may nevertheless qualify for an ETA offer if there are "compelling public policy" or unusual "equity" considerations present in your case that justify a reduction of the tax. These phrases are not defined in the IRS's regulations. Rather, the IRS is instructed to evaluate these offers on a "case-by-case basis" and to use "good judgment" in the process. IRM part 5.8.11.2.2.1(9). Moreover, you do not have to meet both elements. Either "compelling public policy" *or* unusual "equity" considerations may apply individually.

The considerations center on (but are not limited to) the points outlined below.

1. **Compelling public policy.** Is your tax assessment such that the broader public interest is better served by the IRS compromising the debt rather than collecting it? If so, the public policy element is met. One example may apply in cases where one is victimized by an investment Ponzi scheme. It often happens that innocent citizens are not only duped by polished hustlers, they are also victimized a second time when they find that they owe substantial taxes because their investment is actually considered a scam and therefore non-deductible. The broader public policy interest is that the perpetrators of the scam be punished, not the victims.
2. **Overall fairness or equity considerations that you identify.** Are the circumstances of your case so radically unfair as to undermine the public's confidence that the laws are being administered fairly? If so, fundamental fairness dictates that the IRS look beyond the mere letter of the law and reduce the assessment to something fairer under the circumstances. The goal here is to ensure the highest degree of public confidence in the idea that the tax laws are administered fairly. If you can point to a fundamental unfairness in the liability, there is a chance such an OIC will be accepted.
3. **You must demonstrate facts and circumstances that justify a compromise under this premise** even though a similarly situated citizen may have paid his liability in full. In other words, you must answer the question of why you should be allowed to pay less under similar circumstances than others who might already have paid all their taxes. See Treas. Reg. §301.7122-1(b)(3)(ii). In this regard, bring all arguments, facts and evidence at your disposal to bear on the question. It is a tough sell and you cannot over-prove your case.

One thing Congress clearly intended by creating the ETA offer is to introduce the idea of "tax only offers." That is to say, the IRS is asked to forgive penalties and interest that have accumulated due to long delays involved in determining a person's liability. This can arise in cases which, for whatever reason, have been tied up in court for years and all the while the penalties and interest grew substantially. Once it is determined that the citizen owes the tax, he is then slapped with a mountain of penalties and interest. An ETA offer can eliminate penalties and interest.

To win acceptance of an ETA offer under public policy or equity grounds, you must meet all the requirements discussed here.

1. **You must be in full compliance with your filing and payment obligations since incurring the initial tax liability.** A string of ongoing liabilities will weigh substantially against acceptance of an ETA offer.
2. **Your overall compliance history must be positive.** A long history of full compliance weighs heavily in favor of acceptance. On the other hand, if your compliance history is sketchy, or you have had a prior OIC accepted, those facts weigh against acceptance.
3. **You acted reasonably and responsibly in the situation giving rise to the liabilities.** That is to say, based on all the facts and information available to you at the time, you did the things a reasonable person would do to mitigate the problems that caused the delinquency. If you took no action to control the problems, or took actions that made matters worse, this weighs against acceptance. See IRM part 5.8.11.2.2(4).

The IRS provides some guidance in its regulations and IRM part 5.8.11.2.2.1 as to the cases warranting consideration of an ETA offer under the public policy and equity argument. These include but specifically *are not limited to* the following examples:

1. Substantial penalty and interest assessments occurred during a period of illness or injury, or you were otherwise incapacitated. Once the medical problems passed, you began filing current tax returns and filed all the delinquent returns.
2. The assessment is somehow attributable to erroneous advice or guidance given by the IRS, or due to a processing error by the IRS.
3. The IRS is responsible for unreasonable delay in the processing of your case, but interest or penalty abatement is not available for whatever reason.
4. Tax liability is directly attributable to a criminal or fraudulent act by a third party. For example, suppose your business used a payroll service to handle all your payroll obligations. You complied with all of your responsibilities with respect to the payroll company. However, an employee of that company embezzled the funds for the tax, and consequently your company’s taxes were not paid. If you can establish a direct link between your tax debt and the criminal acts of a third-party, an ETA offer may be accepted.
5. The rejection of your ETA offer would have a significantly negative impact on the community. For example, suppose you live in an area that was hit hard by economic problems or a natural disaster. The problems are widespread. In such a case, the IRS’s failure to be reasonable with ETA offers could have a very negative impact on the entire community.

The above is not an inclusive list of the factors the IRS may consider. In fact, there is no limit to the circumstances that may warrant consideration and acceptance of an ETA offer on public policy or equity grounds. IRM part 5.8.11.2.2.1(8) reads as follows:

> *“There may be other circumstances involved in a case that would lead a reasonable third party to conclude that acceptance of the OIC would be fair, equitable, and promote effective tax administration. Other factors not discussed above or in the IRM, may be present to support the conclusion that the case presents compelling public policy or equity considerations sufficient to justify compromise. Documentation of the presence of those factors which weigh in favor of compromise to promote effective tax administration must be thoroughly documented in the case file.”*

It is a heavy burden of proof to convince the IRS to accept an ETA offer on public policy or equity grounds. Keep mind that you are asking the IRS to reduce a tax assessment that you owe *and can pay*. And in fact, in the case of a public policy or equity ETA offer, you even acknowledge that payment of the tax will not necessarily cause a financial hardship. Rather, you are arguing that the fairness and policy issues surrounding the facts of your case justify a reduction, even in cases where other citizens in the same situation may have paid their taxes.

Because of this, you must meet the additional burden of proving that acceptance of the ETA offer will “not undermine compliance” with the tax laws. See IRM part 5.8.11.2.3. In other words, the public will not be encouraged to fail to pay taxes on the idea that all they have to do is file an ETA offer and they too will get off the hook.

The specific factors the IRS uses in evaluating whether acceptance would undermine compliance include the following:

1. You must not have a history of noncompliance with your tax return filing and payment requirements. You must establish that your current problem is an anomaly caused exclusively by the “exceptional circumstances” you claim justify acceptance of the offer. Habitually noncompliant citizens cannot expect the acceptance of an ETA offer. On the other hand, where your overall pattern is that of timely filing and timely payment, this compliance history bodes well for acceptance.

2. You did not take deliberate steps to avoid filing your tax returns or paying your taxes on time. Those who were found guilty of criminal tax violations or who were assessed with a civil fraud penalty are not likely to have an ETA offer accepted. Likewise, if you took steps to avoid payment by hiding assets, using nominees to hold assets, using fictitious bank accounts, etc., this weighs against having an ETA offer accepted.
3. You must not have encouraged others to refuse to comply with the tax laws. Those involved in the promotion of abusive tax shelters or tax protester activity are considered to be involved with promoting noncompliance. Such people will not likely have an ETA offer accepted.

Real Life Examples of Successful ETA Offers

What follows here are three actual cases in which I successfully negotiated ETA offers.

Example 1

Harry B. Because of a tax audit and the sale of some property, Harry owed the IRS nearly $100,000 at age seventy. He began making installments and liquidated other property to pay the IRS. Over approximately three years, he paid $70,000 but still owed about $50,000. By this time, Harry was diagnosed with a rare form of cancer that carried with it an 80 percent chance of recurrence, and a very poor prognosis if it did return.

He became involved in a research program with experimental drugs to treat his condition. His only real chance at survival was to take advantage of the research program. To participate, he had to travel to Tacoma, Washington on a monthly basis for injections. However, his HMO was in Portland, Oregon. The HMO insisted that he go there for testing. Even worse, his small business was in Arizona. He had to travel constantly between Washington and Oregon to obtain treatment and testing for his cancer, and to Arizona to work his business, which was his only source of income.

Harry had about $120,000 equity in his assets. He had very little cash and his business provided just enough money to pay his living expenses, travel expenses and medical bills. He had equity sufficient to pay the tax but he would have to borrow money to do it. He did not have the capacity to borrow because he could not make the payments due to his limited income and reduced earning capacity. Selling all his assets would leave him without the capacity to earn income, or to travel to receive medical treatment. Because of his weakened physical condition, he had little capacity to work his business aggressively enough to generate more cash to provide for both his living expenses and pay the IRS.

With the sole exception of the year in question, Harry was always current with all tax return filings and tax payments. His tax debt was not attributable to deliberately failing to pay.
Harry submitted an ETA offer arguing that full payment of the tax would cause financial hardship. He offered $5,000. After conducting the offer investigation, the IRS countered with $25,000. While that was certainly better than $50,000, it would not solve the problem. Harry appealed the determination. After several discussions with the Appeals Office, the IRS agreed to settle Harry's case for $8,000.

Example 2

Valerie K. Val was a hairdresser operating her own small beauty shop. She leased space in a local nursing home. She paid the nursing home rent plus a percentage of her gross receipts. Because of changes that management made in their procedures, Val was forced to hire an assistant to perform tasks that were previously done by employees of the nursing home. Then, when Val's contract was renewed, the nursing home substantially raised her rent.

During this same time, Val sustained injuries that prevented her from working full time. At best, she could work just a few hours per week. Eventually, she had to quit her business entirely. She was on Social Security disability, which was her primary source of income. Because of all this, Val fell behind in her payroll taxes and ended up with a tax debt of $103,000.

Between her part-time work and Social Security income, she had just $1,442 gross income per month. She owned a home with equity of about $110,000 but fell behind on the mortgage payments by approximately $5,000. The lender was foreclosing on the home. If the home went through foreclosure, Val risked losing all her equity and would have no capacity to provide for herself going forward. However, she had a buyer willing to pay fair market value for the home. If she could get the IRS to agree to an ETA offer, she could sell the home to avoid foreclosure, and at the same time, retain some of the proceeds to provide for her future living expenses.

Val offered $10,000 in an ETA offer. After several discussions and providing substantial medical records, income information, an estimate of future living expenses, and real estate information, the IRS accepted Val's offer. She was able to get the home sold quickly because the buyer was waiting in the wings. She paid the IRS $10,000 and was able to retain the balance of the sale proceeds to provide for herself going forward.

Example 3

Van F. Van and his wife were 74 and 67 years of age, respectively, at the time they submitted their OIC. Both were retired and living on Social Security, Van's small pension income, and some rental income. Both Van and his wife faced profound medical problems. Van had heart disease and double bypass open-heart surgery. He also suffered from Chronic Obstructive Pulmonary Disease and lung cancer. The upper half of his left lung was eventually removed. As if that was not enough, he also had prostate cancer and went through forty-two radiation treatments. To top it off, Van's wife had a brain tumor. She too was unable to work. At the time of submitting the ETA offer, it was unclear whether and to what extent she could be treated.

The combination of the highly invasive surgeries and the debilitating radiation treatments left Van unable to work. His only source of future income would be Social Security and his modest pension and rental income. Even at that, his income was barely sufficient to pay personal living expenses, not even taking into consideration the profound medical expenses they faced.

At the time of the offer, they owed the IRS about $260,000. Van and his wife owned their personal residence outright and they owned a rental home outright. The combined equity in the houses was $295,000. If they sold both houses, they could pay the tax in full. However, that would leave them with no home and no way to pay for future housing costs because of their living expenses—chiefly, the medical expenses—and the fact that neither could work.

The goal was to persuade the IRS to allow Van and his wife to keep their primary residence while they sold the rental home to fund the ETA offer. We filed an offer of $100,000 to get the ball rolling. We discussed the offer with the IRS over several months, during which time we provided detailed information on the medical problems and the house values. Eventually, the IRS agreed to accept $141,200 in full settlement of the $260,000 tax debt. The settlement was based on the value of the rental house, which was then sold to fund the ETA offer. The IRS forgave the balance.

How Much Should I Offer?

Because an ETA offer is not based on reasonable collection potential, there is no fixed formula for determining the offer amount. In fact, the IRM states, "There is no clearly defined formula to follow" in making the decision whether to accept an ETA offer, or the amount of the offer. See IRM part 5.8.11.2.2.1(9). The matter is controlled by the facts and circumstances of the case and the "good judgment" of offer examiners.

In this regard, the IRS must analyze all financial information, including supporting documents, affidavits, third-party statements, etc. Your job is to present information showing that the amount offered is reasonable. You must have some explanation for how you came to the number. When making a hardship argument, you must clearly illustrate exactly what hardship will arise if forced to use all your assets to pay the tax.

The "Special Circumstances" Offer in Compromise

The fourth and final variation of the Offer in Compromise is the so-called "special circumstances" OIC. This is a kind of hybrid between an offer based on doubt as to collectability and an ETA offer. Recall that in an OIC based on doubt as to collectability, you must offer an amount equal to your reasonable collection potential. If your reasonable collection potential is less than the amount owed, the offer qualifies for consideration. However, you would not qualify for an ETA offer precisely because your reasonable collection potential is less than the amount assessed. Instead, to qualify for an ETA offer, it must be true that you both owe the tax (there is no doubt as to liability) and you can pay the tax in full given your income and equity in assets.

In many cases, however, while it is true that a person cannot pay the tax in full (thus, an ETA offer is precluded), it is equally true that he cannot pay an amount equal to his full reasonable collection potential. For example, suppose you owe $100,000. Your reasonable collection potential is determined to be $50,000. Of that, $40,000 comes from equity in your home. However, you are unable to borrow the equity because of your age, health factors, earning capacity, etc. And you have no capacity to provide for suitable living quarters if you sold the home.

In that situation, IRM part 5.8.4.2(3) allows the IRS to accept an OIC for less than full reasonable collection potential if you can prove that "special circumstances" warrant such an acceptance. The special circumstances can be any of the factors we already discussed in the context of the ETA offer. See IRM part 5.8.4.2(4) & (5). Hence, the ETA factors control the amount of the OIC and whether the IRS will accept it, even though the OIC is essentially based on doubt as to collectability.

As you might imagine, you have the burden to establish what the special circumstances are, and to prove their existence with evidence, including documents, affidavits, third-party statements, etc. See IRM part. 5.8.1.9.7(2).

Other Factors that Make a Successful OIC

Let us now turn our attention to other factors that might increase the likelihood the IRS will accept your OIC. I address them individually here.

Your Health and Education

Your health, education and work experience have a direct bearing on your capacity to earn income. If your health is bad or failing, your capacity to work is diminished. You must point out any health problems that you suffer, document them to the extent possible, and argue that they restrict your capacity to earn income. The IRS is specifically instructed to consider factors such as "age, health, marital status, number and age of dependents," etc., in determining whether to accept an OIC and in what amount. See IRM part 5.8.5.20(3).

This same manual provision instructs the IRS to consider your "level of education or occupational training and work experience." This is especially important if you had a particularized job in a specialty industry that was lost due to economic factors. Be prepared to answer the question of why your level of education and work experience are such that your future earning potential is minimal.

The Bankruptcy Factor

A central question in OIC negotiations focuses on the amount that is reasonably collectible in the shortest period of time. As such, the issue of whether the taxes you seek to compromise are dischargeable in bankruptcy becomes very important. Among the arguments that may prove persuasive in convincing the IRS that the amount offered is all that is reasonably collectible is the fact that your tax bill is dischargeable in bankruptcy.

Of course, to make the argument plausible, you must be able to prove this. That is why it is important to carefully analyze your facts to ascertain whether you indeed qualify for discharging your taxes in bankruptcy. See Chapters 13 and 14 for the discharge rules. Your offer may be quite attractive if the IRS believes a bankruptcy leaves them with less than the amount an OIC would fetch.

For example, suppose the collection statute of limitations does not expire for six years. In that case, the IRS might expect you to make installment payments for that period, rather than compromise the debt. However, suppose your tax bill is ripe for discharge in bankruptcy right now. Under these circumstances, the IRS cannot reasonably expect six years' worth of payments if you can discharge in bankruptcy now, especially if other economic factors are pushing you toward bankruptcy. The fact that you qualify for bankruptcy discharge has the impact of forcing the IRS to reconsider its position.

The key in all of this is negotiation. The purpose of the OIC is to provide the citizen an opportunity for a fresh start and to permit the IRS to collect as much as possible in the shortest period of time. All negotiations should be centered on this premise. If the agency demands large sums of money paid in cash merely because of the present value of an installment agreement, that may well defeat the purpose of the OIC program.

The IRM makes the following statement regarding bankruptcy and the OIC:

> *"If a taxpayer will file a petition for liquidating bankruptcy, consider reducing the value of future income. The total value of future income should not be reduced to an amount less than what could be paid toward non-dischargeable periods, or what could be recovered through bankruptcy, whichever is greater. When considering a reduction in future income, also consider the intangible value to the taxpayer of avoiding bankruptcy. See IRM part 5.8.5.20(4), Chart of future income considerations."*

It is abundantly clear that a dischargeable tax debt opens the door for negotiation beyond the cold algebra the IRS would otherwise stick to. Moreover, that Manual language is a remarkable admission coming from an agency that for years categorically denied that taxes were ever dischargeable in bankruptcy to begin with. In negotiating the offer, the IRS is called upon to weigh two conflicting factors. First is the extent to which a citizen may indeed discharge his taxes, taking into consideration that a tax lien remains in effect as to equity in assets and exempt property. See Chapter 13. Second is the fact that if your tax debts are fully dischargeable, the IRS is rarely better off in bankruptcy because a full discharge prevents any collection. It is within this framework that negotiations are conducted. In these cases, the IRS has to make a calculated business decision to collect more through the OIC than it would in bankruptcy.

There are two elements to consider when negotiating a reduction of your future income asset based upon the bankruptcy factor. The first is whether the tax is dischargeable at the time of filing the OIC. If so, the future income asset has a practical value of zero. If the IRS rejects an otherwise reasonable offer in an effort to force the issue on the future income asset, you have the right to pursue bankruptcy immediately and discharge the debt. That means the IRS cannot collect anything from the future income asset. Your offer must present an amount equal to what the IRS would otherwise get if you filed bankruptcy.

The second is where your case is not ripe for discharge at the time of making the offer. Suppose you owe $35,000 and you must wait twelve months before you can discharge the debt in bankruptcy. Suppose further that the IRS determines that you can pay $800 per month, and there are sixty months left on the collection statute of limitations. In that case, the IRS would argue that you can full pay the tax liability (800 x 60 = 48,000), and the agency would thus prefer to reject the OIC entirely. However, the true value of the future income asset is $800 for twelve months, or $9,600.

In the early 1990s, long before the IRS adopted its more reasonable OIC evaluation factors that I discuss in this chapter, I worked with an elderly lady, Vivian, who owed the IRS $40,000 for taxes over several years. She was contemplating bankruptcy but we opted to file an OIC first in the hope of avoiding bankruptcy. At the time, the OIC procedures were newly revised in light of former Commissioner Peterson's directives.

Vivian offered the IRS $5,000 to satisfy the debt. She explained to the RO who worked the OIC at the time that she would have to borrow the money from her son. As a result, she had nothing the IRS could collect. In response, the RO reported that there was good news and bad news. The good news was the IRS was willing to accept an offer. The bad news was the IRS wanted $8,500, not $5,000. Vivian asked me what she should do.

I asked her a simple question. "Vivian," I said, "do you have $8,500 to give them?"

"No," she replied without hesitation.

We then phoned the RO and explained that $5,000 was all she could come up with. We explained that if the IRS rejected the offer, she would have no choice but to file bankruptcy. If she did, the agency would get *nothing* since even the $5,000 was borrowed money. In other words, we told the IRS, "$5,000 is all there is." Take it or leave it. If you leave it, you get nothing.

After some consideration the RO called her. "It's a deal," she said. "When can you get us the money?"

The bottom line is that a dischargeable tax liability forces the IRS to the table. It forces the agency to make intelligent decisions based upon reality, and not fantasizing about collecting taxes from non-existent revenue sources. Chapters 13 and 14 discuss the bankruptcy rules in detail. You must understand them before negotiating based upon the bankruptcy factor.

The "Public Policy" Factor

In the introductory comments to this chapter I talked about the policy factors that drive the IRS's thinking on the OIC program. The IRS has expressed a clear desire to use the offer process as a means to accomplish more than just collecting revenue. Certainly getting the money is the heart of the process, but it goes beyond that. The OIC process is intended to get delinquent taxpayers back on the beam, and to provide a fresh start by accepting a settlement that is in the best interests of both the IRS and the citizen. See IRM part 5.8.1.1.1.3. Incorporating these policy issues into your argument helps persuade the IRS to accept your offer. The following issues are considered the public policy aspects (not to be confused with the "public policy" ETA offer we discussed above) of the OIC program.

The OIC Promotes Voluntary Compliance

The OIC program essentially acknowledges that squeezing one for funds he does not have only makes matters worse. Under even the best of circumstances, heavy-handed collection creates a pattern of delinquencies even if it does not drive one into hiding. The IRS has observed that through the offer process, it can encourage a citizen to file future tax returns and pay future taxes in a timely manner. This has the effect of "rehabilitating" the delinquent citizen, affording him a fresh start.

In a written explanation attached to Form 656, make a point to emphasize that acceptance of the offer *ends all delinquencies*. Point out that as of the time of filing the OIC all past filing delinquencies have been cured (at least the most recent six years—see Chapter 8), you are current with tax return filings and payments, and you will not fall behind in the future. Affirmatively acknowledge the requirement set out in Form 656 that if your OIC is accepted, you will timely file future returns and pay future taxes when due. A successful OIC must illustrate how acceptance "rehabilitates" you and leads to future return filings and tax payments, thus having a positive impact on voluntary compliance.

An OIC Resolves the Case

The IRS has plainly expressed the desire to use the OIC program as an alternative to reporting cases as "currently not collectible" (see Chapter 11), or to a protracted installment agreement. Too often, such agreements do not even pay accumulating interest and penalties. Such agreements generally only make matters worse for both the IRS and the citizen.

In one successful OIC, Richard explained that on three previous occasions dating back many years, his file was closed as "uncollectible." So, while Richard was asked to pay nothing, the interest and penalties continued to climb, putting the bill further out of reach every day. Richard's offer of $5,000 against a $114,000 debt presented a viable alternative to once again putting the matter on the back burner. The IRS accepted the OIC.

Therefore, a successful offer presents an alternative to uncollectible status or protracted installment payments that may not even pay penalties and interest. The former means no revenue for the IRS whatsoever, and the latter means the bill only gets larger over time, and to make matters worse, the citizen is likely to become delinquent in the future.

An OIC Provides Revenue the IRS Might Not Otherwise Reach

Both Vivian and Richard offered $5,000 to settle their accounts. With letters attached to their offer documents, they pointed out that the money was coming through a loan from their son. In his written explanation, Richard emphasized that if the offer was rejected, the funds would simply not be available to the IRS. The agency certainly has no right to levy his son's money. The letter explained that the funds would be made available upon the IRS's acceptance of the offer but only if payment constituted full and complete settlement of the account.

Therefore, another key to a successful offer is to fund as much of it as possible with revenue from an outside source. Such revenue cannot be attached by the IRS should it refuse the offer. This provides strong encouragement to accept the OIC.

The IRS's Duty under OIC Policy

The IRS's duty under the OIC program is expressed as follows:

> *"The success of the compromise program will be assured only if taxpayers make adequate compromise proposals consistent with their ability to pay and the IRS makes **prompt and reasonable decisions**."* IRM part 5.8.1.1.3(3). (Emphasis added by author)

Richard affirmatively stated in writing that the offer was his best, good faith effort to resolve an otherwise unmanageable tax debt. He backed this up with all the required financial information. He offered an amount that represented his reasonable collection potential. He gently reminded the IRS in his written statement that rejection of the offer would be contrary to the policy mandate that IRS make "reasonable decisions" in these matters.

Therefore, another element of a successful offer is to remind the IRS that the OIC policy cannot be carried out successfully if offers are rejected arbitrarily or without reasonable foundation.

How to File an Offer in Compromise

The core of the OIC is Form 656, *Offer in Compromise*, or Form 656-L, *Offer in Compromise Based upon Doubt as to Liability*. If your OIC is based upon doubt as to collectability, Effective Tax Administration, or "special circumstances," Form 656 is just the beginning. The list of items that follows should be submitted to the IRS to give your OIC the best chance of success.

1. **Form 656.** Be sure to use the latest form and prepare it consistent with the instructions on the form. The IRS has a booklet for OICs called Form 656-B, Offer in Compromise Booklet. It contains instructions for completing Form 656, blank financial statements (discussed below), a checklist of supporting documents the IRS expects, and addresses for where to send your package (discussed further below).
2. **Forms 433-A and 433-B.** You must submit the required financial statements that I discussed throughout this book. In Form 656-B, the IRS provides tear-out forms for this purpose. Note that in the booklet, the IRS provides Form 433-A(OIC) and Form 433-B(OIC). These are essentially the same as the Forms 433-A and B that I discussed above. The forms are designed a bit differently and they provide built-in worksheets for determining the quick sale value of your assets. Prepare your financial statements as discussed above and in Chapters 5 and 11. When making an offer based upon doubt as to liability, you do not have to submit financial statements. However, you must provide proof that you do not owe the assessed tax.
3. **A written explanation of your OIC, provided as an adjunct to Form 656.** In the statement, describe in detail the reasons why the OIC should be accepted. The explanation should encompass all the points outlined above and should argue for acceptance of the offer. Explain clearly why the IRS cannot collect more than your offer. In the case of offers based upon doubt as to liability, provide a worksheet to show how you computed your correct tax, along with the documents needed to verify your claim as mentioned in the previous paragraph.
4. **Individual Master File printouts for the years in question if you argue that your tax debt is dischargeable in bankruptcy.** The IMF will show that all the required rules are met for discharge of taxes in bankruptcy. See Chapter 13 for an explanation of the rules.
5. **If you will borrow money from a third party to fund the OIC, provide a letter from the person agreeing to make loan if the offer is accepted.** The letter should state that the loan will *not* be made if the OIC is rejected.

As you analyze your situation, do not be afraid to provide such additional documentation as you believe necessary and desirable to establish the elements of a successful offer. As in all aspects of dealing with the IRS, you cannot over-prove your case.

Payments Submitted with the Offer

Generally, you must pay both an OIC filing fee and a down payment with the OIC. As of this writing, the filing fee is $186. It must be submitted with the OIC at the time of filing it. The amount of the down payment depends upon the nature of your offer. If you present a lump sum cash offer, you must provide a deposit equal to 20 percent of the amount offered. If your offer is $10,000, your down payment is $2,000. However, there is an exception to both. If you are considered a low-income taxpayer, both the filing fee and down payment are waived. Form 656 contains a chart showing income levels and family sizes for purposes of figuring this exception.

If your offer provides for payments over time, you must pay the filing fee and your first installment at the time of submitting the OIC. In addition, you must continue to make your proposed payment every month while the OIC is pending. When making payments, use IRS Form 656-PPV, *Periodic Payment Voucher*. The instructions for that form tell you where to send the payment. If you qualify as a low-income taxpayer, you are excluded from making these payments.

The IRS will return your OIC if you do not make the required payments as outlined here. However, if your offer is accepted, all payments (except the filing fee) go to reduce the final offer amount agreed upon. I recommend submitting two checks with your OIC. The first check is for the filing fee, and the second is for the down payment or first installment payment. On the memo section of the check for the filing fee, write your SSN and the words "OIC filing fees." On the second check, write your SSN and "OIC down payment," or alternatively, "OIC-first installment payment."

If your offer is rejected, *you do not get your money back*. This is a key reason not to make a frivolous offer solely to delay the collection process. Rather, submit an OIC only after carefully evaluating your situation and determining that the OIC is the best route to go. As an alternative, consult counsel experienced in negotiating OICs.

Finally, Form 656 itself gives you the option to designate where to apply your down payment or installment payments if the OIC is rejected. Consider using this option, depending upon the situation. For example, suppose your tax liability consists of several tax years. Say that some of those tax debts are dischargeable in bankruptcy and some are not. In that case, designate the payments to apply to the *non-dischargeable* tax years. That way, if your OIC is rejected, the amount of tax you must pay after discharging your other taxes in bankruptcy is reduced. I discuss the bankruptcy process in Chapters 13 and 14.

A Processable Offer in Compromise

Unless your offer is *processable*, it will be returned to you—not denied, per se—but simply not considered at all. An OIC is not processable if:

1. It does not identify the citizen,
2. It does not list the tax years, type of tax and total due,
3. The amount offered and the terms of payment are not clear,
4. Form 656 is not signed,
5. A financial statement is not provided, unless the OIC is based upon doubt as to liability,
6. The amount offered does not equal or exceed equity in assets as shown in your financial statements, Forms 433-A and B (unless you present an ETA or "special circumstances" OIC),
7. You use an obsolete Form 656, or
8. You fail to provide the required initial payments, unless you qualify as a low-income taxpayer, in which case the initial payments are waived.

Where to Send Your Offer

Where you send your OIC depends upon the current collection posture of your case. If your opportunity for a Collection Due Process appeal has passed for whatever reason, you must file your OIC through the

IRS's Centralized Offer in Compromise Unit (COIC). This is the function responsible for evaluating and passing on the acceptance of OICs. The COIC Unit receives your OIC, does the background investigation (discussed below), and makes an initial determination on the OIC's acceptability. Filing an OIC directly with COIC is what I refer to as an OIC through "normal channels." For example, suppose you have been in uncollectible status for some time. The IRS previously sent its Final Notice letter, and that is what prompted you to obtain CNC status. In that case, you will not receive another Final Notice, and hence, you have no Collection Due Process appeal rights. Therefore, mail your OIC directly to the COIC Unit.

The COIC Unit operates out of two different offices. One is located in Memphis, Tennessee and one is located in Brookhaven, New York. The one you use depends on whether you are a wage earner, self-employed, a corporation, and where you live. Form 656-B contains a chart showing where to file the form.

On the other hand, the *single best way* to submit an OIC is through the Collection Due Process channel. I refer to this as an OIC through CDP channels. Recall from Chapters 4 and 5 that in a CDP appeal, the IRS must consider any collection alternative you submit as a defense to enforced collection. An OIC is such an alternative. An OIC through CDP channels is much better because under CDP rules, you are entitled to a Tax Court appeal if the IRS rejects your OIC, which I discuss further below.

The OIC Investigation

Whether you file your offer directly to the COIC Unit, or you submit it to a settlement officer (SO) through a CDP appeal, your file will end up the hands of an offer specialist (or offer examiner) within the COIC Unit. The specialist reviews your financial statement, and all supporting information you provide, as well as internal IRS information such as your filing history and whether you have made all current estimated payments. The specialist will also access public records to the extent possible. The IRS looks at property title records for autos, real estate, etc., to ascertain current asset ownership and whether any assets were transferred. They will also determine whether any businesses are recorded in your name, and whether you hold any professional licenses.

At some point, you must expect the specialist to ask for additional information and to ask certain specific questions, say, for example, what you did with a vehicle that was once titled to your name but which is not shown on the financial statement. The IRS may also ask for updated financial information, such as current bank statements, since it may be a matter of many months before an offer specialist is assigned to the case.

Regardless, you must provide whatever additional information is sought, even if you are convinced that you already provided that precise data. Never lose sight of the fact that the acceptance of an OIC is purely discretionary with the IRS. You do not have to provide any of the information they seek, but they do not have to accept your OIC either. Moreover, the burden to prove you are entitled to an OIC is on you. The only excuse the IRS needs to say "no" is to claim that you failed to provide requested information. And in fact, if you fail to provide requested information, the specialist will not "reject" the OIC. Rather, she will "return" it. In that case, you will have no appeal rights (unless your case is on the CDP track, discussed below). Therefore, do not take any chances by fencing with the IRS over whether you already provided what they seek. Just send it again!

After reviewing all relevant data, the offer specialist will send a preliminary determination on the merits of your offer. In the case of an OIC based on doubt as to collectability, expect the IRS to say that your offer is too low. Expect them to tell you that their analysis reveals that you can pay much more than was offered. They may even say you can full pay the tax. This preliminary determination is almost always wrong, and it is your job to point out why.

To do so, you must obtain (if they did not send you) two worksheets that were prepared by the specialist. The first is the so-called Asset/Equity Table. This form lists all of your alleged assets, along with their values and the alleged net equity in each asset. The second worksheet is the so-called Income/Expense Table. This form lists your monthly gross income as you reported it, and as the IRS determined it for OIC purposes. The form also lists all your claimed living expenses versus the amounts allowed by the IRS. This calculation determines the amount of disposable income, which the IRS uses to calculate the future income amount. Recall from the above discussion that total net equity plus future income constitutes your reasonable collection potential.

You must carefully review these worksheets and respond to the specialist as soon as possible. Provide a detailed explanation of all miscalculations and submit additional documents to the extent necessary to support your argument. For example, the IRS may have your monthly gross income figured too high because they used last year's wage information, when in fact you changed jobs and no longer make the same money. In the case of expenses, they may have simply overlooked certain expenses, such as out-of-pocket medical expenses, or legal fees. They may have figured your equity in assets too high because of an erroneous valuation of your home. Whatever the reasons (and there will likely be several), you must respond with details. When explaining facts, be clear and concise and submit your fact statements in the form of an affidavit.

You may ask for a phone conference with the specialist to discuss the issues. The conference will be very informal and will give you the chance to take the examiner by the hand through your material. Before the conference, identify the points of disagreement you found in the worksheets provided. Present your facts, evidence and arguments in an orderly manner. You may go back and forth over more than one conference, since the specialist may want time to review your arguments and may seek even more information, which you may need time to provide.

To be most effective in your conference, consider these important points:

1. **Prepare a checklist of your arguments in advance so you do not forget anything.** Have in front of you all supporting documents, organized to correspond with your arguments so you do not misplace anything.
2. **Move through your arguments systematically, one at a time.** Be sure to clearly state your case as to each issue before moving to the next one. In this regard, you must control the conference. Do not allow the specialist to cut you short or attempt to speed you along. Generally, you should expect to have all the time you need to present your case.
3. **Do not assume the offer specialist read what you submitted, especially if you submitted voluminous data.** Therefore, prepare in advance to reiterate all the key facts and circumstances to support your arguments, and point out the documents you rely on.
4. **Provide your own detailed calculation of RCP.** You know what your equity in assets is, and what your disposable income is. Based on that, present a specific amount that you believe reflects RCP. This may be a compromise on your part. For example, you may be fighting over whether the IRS should allow your full housing and utility expenses, rather than limiting the expenses to the local standards. You might propose to split the difference, which would increase your RPC over the amount offered. In any event, be clear about your settlement offer.
5. **If other issues or questions arise during the conference, ask for reasonable time to provide answers.** This is usually at least two weeks, but I would ask for thirty days. Within the deadline, provide follow-up information and arguments in writing. This can be done by fax or mail. Just be sure to document how you sent it.
6. **Keep in mind that you have the burden of proof on all RCP issues.** You must provide the information necessary to carry that burden. Also bear in mind that if your offer is made through the CDP channel, in determining whether the IRS abused its discretion in rejecting an OIC, the Tax Court *will not* consider evidence that was not provided either to the offer specialist or to the settlement officer.

After all of the back and forth is exhausted, the offer specialist will make a decision. If the decision is to accept the OIC as filed, the recommendation goes to her manager, who must approve it. Generally, offers are approved by management, but in rare cases management may spot some issue or problem that must be worked out. After management approves the recommendation, IRS Counsel must approve it if the liability being compromised is more than $50,000. However, Counsel looks at the offer only for "legal adequacy," not to reexamine the dollars and cents aspects of the deal.

If the recommendation is to accept an offer at an increased amount arrived at through negotiation, you will be asked to file either an amended Form 656 with the new offer amount specified, or to sign Form 14640, *Addendum to Form 656*. The addendum specifies the new offer amount. Once the updated offer forms are filed, the case proceeds to the approval process as I just explained.

If your case was filed through CDP channels, your SO will automatically approve any terms you reach with the COIC Unit. However, the CDP appeal will have to be closed out separately. That can happen in one of two ways. The SO will ask you to sign either IRS Form 12256, *Withdrawal of Request for Collection Due Process Hearing*, or Form 12257, *Summary Notice of Determination and Waiver of Right to Judicial Review*.

It is very important that you *not* sign Form 12256, withdrawing your CDP appeal. That form withdraws the appeal as if you never filed it, meaning that you *do not* have an IRS decision that is enforceable by the Appeals Office. On the other hand, Form 12257 constitutes a decision by Appeals that is binding on the IRS. The terms of your OIC will be set forth in Form 12257 as the decision of Appeals and is fully enforceable later, if necessary. If your SO asks you to sign Form 12256, politely but firmly decline, and expressly ask that he prepare and submit to you Form 12257, which you will be happy to sign. She will do so, and that closes out your CDP appeal.

Finally, you will receive a separate letter from the IRS declaring that your OIC was accepted as of the date of the letter. Your time to pay off the OIC balance begins with the date of that letter. The letter tells you where to send your payments. Be sure to send your payments via certified mail and include a copy of the acceptance letter with each payment. Once your OIC is paid off, the IRS will release any liens filed against you. That takes about thirty days from the date of the final payment. You will then receive a fulfillment letter explaining that you met all the terms of your OIC, and reminding you of the five-year probationary period for full compliance.

What To Do If the Answer Is "No"

If you cannot come to terms with the offer specialist, she will inform you that she will recommend rejection of your offer. In the case of an OIC filed through normal channels, the offer specialist will ask you to "withdraw" your offer. This saves the IRS the time and trouble of writing a formal rejection letter, and it *deprives* you of your appeal rights. Therefore, politely but firmly state that you will not withdraw your offer. That will lead to a formal rejection letter, giving you the right to appeal, as discussed below.

In the case of an OIC filed through normal channels, the appeal procedure is to submit a written protest letter within thirty days of the rejection letter. In Chapter 5, under the heading, *How to Appeal an Installment Agreement Rejection or Termination*, I specifically outline a protest letter in the context of a rejected Installment Agreement Request. Use exactly the same format to appeal a rejected OIC filed through normal channels.

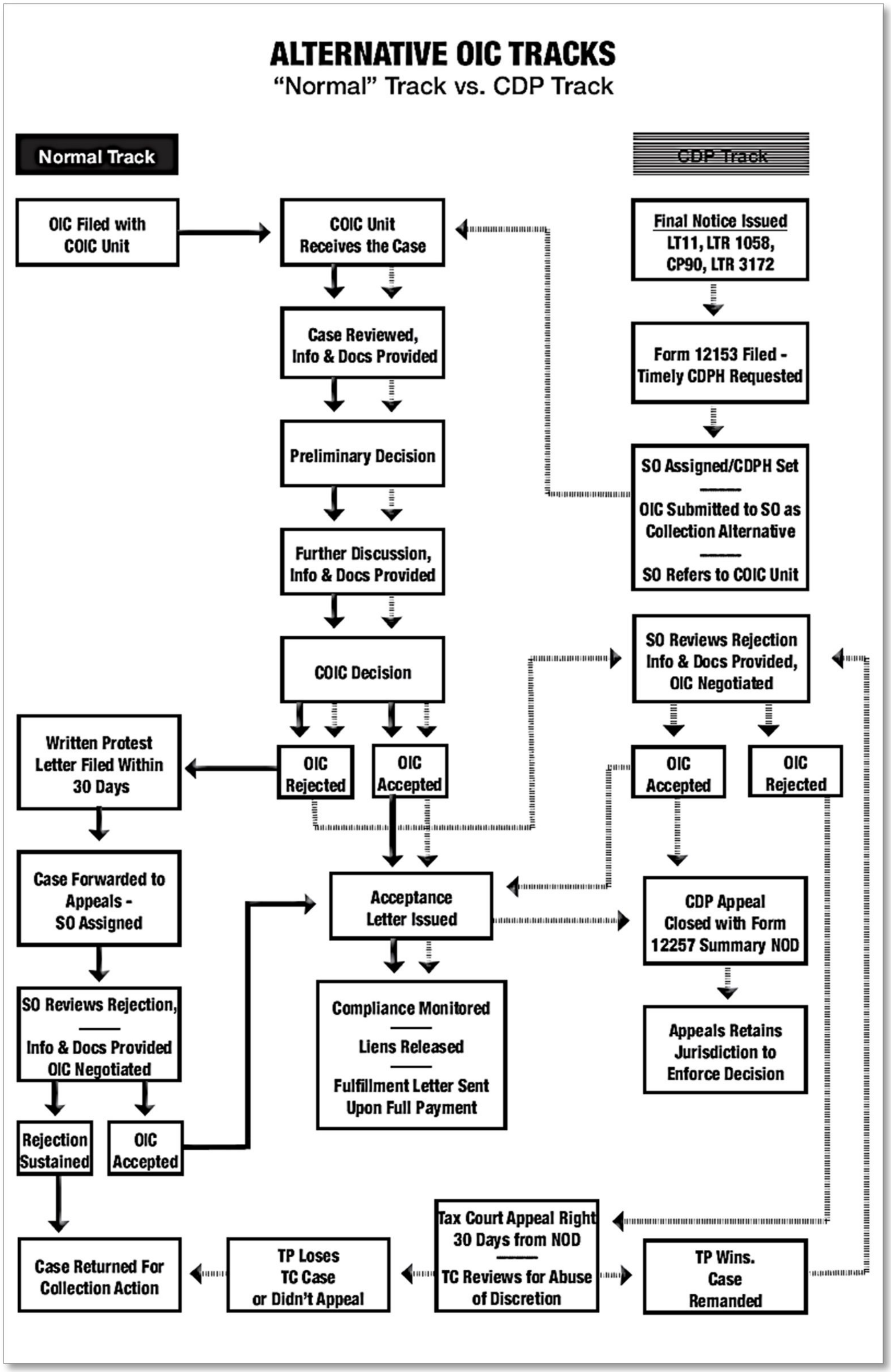
The protest letter must be in writing and submitted on time. As I state in Chapter 5, your letter must explain what part of the decision you disagree with and why. See also: IRS Publication 5, *Preparation of Protests in Unagreed Cases*. Address your letter to the "person to contact" in your rejection letter and send it via certified mail, return receipt requested.

Your case will be forwarded to the Office of Appeals for review. At the appeals level, you have the right to present to a fresh face any additional evidence, information, and arguments to support your position. As I have already explained at length, the Appeals Office is generally far more reasonable than other IRS functions. In an OIC filed through normal channels, the decision of Appeals is final, and that is exactly why I believe that filing your OIC through the CDP channel is much more advantageous.

When an OIC is filed through the CDP channel, if you cannot come to terms with the COIC Unit, the case automatically goes back to the Appeals Office. You do not have to write a protest letter since Appeals has jurisdiction of the case by virtue of your CDP appeal. Now your case is before your SO, whose job it is to review everything the COIC Unit did and to give you an opportunity to reply, just as explained above under the heading, *The OIC Investigation*. If you come to terms with the SO in your CDP appeal, your case will be closed out through Form 12257, per my earlier discussion.

However, if you cannot come to reasonable terms with the SO, there is a very important procedural difference that manifests at this point. In the CDP process, you have the further right to appeal the determination to the Tax Court. If you can prove the IRS abused its discretion in rejecting your OIC, the case will be returned to Appeals for further consideration. You have no such right in an OIC appealed through normal channels. The bottom line is you have more leverage with the IRS when your case is moving along the CDP track. That is why I recommend using the CDP appeal whenever that is possible.

The flowchart provided here graphically illustrates the alternative OIC tracks that I described above.



All Collection Must Stop

As discussed at length in Chapter 10, the IRS is legally prevented from engaging in any collection while an OIC is pending. This means there can be no levy or seizure action whatsoever. See IRC §6331(k). This collection hold continues from the time the OIC is filed (assuming it is deemed processable) until the OIC is accepted, withdrawn or rejected. If the OIC is rejected, the collection stay remains effective for thirty days from the date of rejection. If you appeal during that thirty-day period, the stay remains in effect while the appeal is pending. If the OIC is filed through the CDP channel, it is the CDP request itself that stops collection.

With the benefits of the collection stay comes a detriment: the collection statute of limitations is also tolled while the OIC is pending (see Chapter 10). This is why it is *imperative* to determine the CSED *before* filing an OIC. The last thing you want to do is extend a collection statute if the expiration date is imminent.

If the IRS continues collection illegally while your OIC is pending, you must contact your local Taxpayer Advocate's office. If your OIC is filed through the CDP channel, contact your settlement officer to complain about illegal collection action. In either case, provide a copy of Form 656 along with copies of your certified mail receipts (never send original documents) proving that you filed the OIC. If you received a letter from the COIC Unit stating that your OIC was accepted for processing, also provide a copy of that letter. Finally, provide a copy of the collection notice. Ask the Taxpayer Advocate or settlement officer to stop collection and impose the collection stay required by law.

An OIC and Your Tax Refund

Written into the terms of Form 656, *Offer in Compromise*, is an important proviso regarding tax refunds. The terms provide that the IRS will keep any refund owed up through the tax year in which the OIC is accepted. For example, say your OIC is accepted in March 2016. You file your 2015 tax return in April 2016. You are owed a refund. The IRS will keep this refund because it was due for the year prior to the year in which the OIC was accepted. Now suppose that one year later, you file your 2016 tax return and are owed a refund. IRS will keep that too because it was owed for the tax year in which the OIC was accepted.

For that reason, you must carefully monitor your wage withholding (for employees) or estimated payments (for self-employed persons) during the OIC process. You have much control over whether you get a refund or not. For example, suppose you were owed a refund for the tax year prior to the year in which the OIC was accepted. You can adjust your withholding or estimated payments to reduce what you pay in for the current year, thus reducing or eliminating a refund for this year.

Take great care with this, however, as it is not an exact science—especially if your circumstances change dramatically. Moreover, if your offer is accepted, you must file all tax returns and pay all taxes on time for the next five years or your OIC will default and the amount compromised will be reinstated. Therefore, you cannot be careless or shortsighted in the process of adjusting withholding. For more details on the withholding process, see my book, *How to Double Your Tax Refund*.

Conclusion

An Offer in Compromise is the epitome of amnesty in the administrative context. Given the current climate, those who use it properly often meet with great success. Since my first treatise on the offer process was published in 1988, times have changed incredibly. With the guidance provided in this chapter, I have helped hundreds of thousands of citizens nationwide profit immeasurably from an OIC.

What you have just read is, without a doubt, the most thorough analysis of the offer process ever written for the general public. It may be the most thorough analysis available anywhere. After reading this, you are better equipped than most tax professionals to handle an OIC. Following these procedures, you can achieve tax amnesty and set yourself free of oppressive debt.

Review Questions

1. What is the ultimate goal of the OIC?
   A. A compromise that is in the best interest of both the taxpayer and the IRS
   B. Maximum collection for the government at the least cost
   C. Create a fresh start toward compliance for the taxpayer
   D. To prevent taxpayer bankruptcy

2. What is by far the most common basis for an OIC?
   A. Effective Tax Administration
   B. Doubt as to one's actual liability
   C. Full payment would cause a hardship
   D. Doubt as to collectability

3. What is the most important special consideration for an OIC?
   A. The IRS has discretionary authority to compromise
   B. The taxpayer must file his or her returns and pay taxes on time for the next five years
   C. Filing an OIC tolls the collection statute
   D. An ETA offer applies when there are no other grounds for compromise

4. For the vast majority of taxpayers, reasonable collection potential (RCP) boils down to which factor?
   A. Assets available but out of the government's reach
   B. Amounts collectible from third parties
   C. Determining asset values
   D. Dissipation of assets

5. Marcia has a 401(k) with a face value of $10,000, and has an outstanding loan against the account of $6,000. Assuming a 40% tax rate, what is the value of Marcia's 401(k) for OIC purposes?
   A. $0
   B. $10,000
   C. $4,000
   D. $6,000

6. Which of the following qualifies as a dissipated asset?
   A. Paying necessary expenses for an operating business
   B. Transferring an asset to a friend for much less than fair market value
   C. Using IRA proceeds to pay medical expenses
   D. Transferring an asset to a relative more than three years before submitting an OIC

7. What is the U.S. Tax Court's preference in dealing with the problem of uncertain current earnings in valuing an OIC?
   A. Future Income Collateral Agreement
   B. Dissipation
   C. Income averaging
   D. Estimated future income

8. Which is the longest period a collateral agreement should run?
   A. Seven years
   B. Two years
   C. Twelve months
   D. Five years

9. When determining expenses for purposes of an OIC, what type of tax will likely be challenged by the IRS?
   A. Social security tax
   B. Delinquent state income tax
   C. Current state income tax
   D. Current federal income tax

10. For a non-low income taxpayer, what percentage of an OIC cash offer must be deposited when the offer is filed?
    A. 40%
    B. 0%
    C. 10%
    D. 20%

11. Which of the following is an IRS example of circumstances that would warrant consideration of an ETA offer under the public policy and equity argument?
    A. Although the taxpayer has monthly income, it is exhausted providing for the care of dependents
    B. Substantial penalty and interest occurred during a period of illness or injury but subsequent returns have been timely filed
    C. Taxpayer’s only asset is a retirement account and liquidation of that account would leave no means of future support
    D. Taxpayer has assets but cannot borrow against them due to financial limitations

12. Which form would be filed by a taxpayer seeking an OIC based upon doubt as to liability?
    A. 656-B
    B. 433-B
    C. 656-L
    D. 656

13. After submitting an OIC based on doubt as to collectability for review, what response should be expected by the citizen?
    A. The offer is too low
    B. The offer will be returned
    C. The offer specialist will request a phone conference
    D. The OIC is not processable

14. Which entity has the burden of proof on all RCP issues?
    A. Offer specialist
    B. Taxpayer
    C. Settlement officer
    D. COIC

15. Which statement is accurate about the period during which an OIC is pending?
    A. The IRS may keep any tax refund received by the taxpayer
    B. The collection statute of limitations is not tolled
    C. The IRS is legally prevented from engaging in any collection effort
    D. The taxpayer’s settlement officer is not available to assist

Review Answers

1. A. **Correct.** The ultimate goal of the OIC is a compromise that is in the best interest of both the taxpayer and the IRS.
   B. Incorrect. Maximum collection for the government at the least cost is not the ultimate goal of the OIC. However, in the past, the IRS's sole concern was to achieve maximum collection with the least possible cost to the government.
   C. Incorrect. Creating a fresh start toward compliance for the taxpayer is not the ultimate goal of the OIC. Acceptance of an OIC will result in creating, for the taxpayer, a fresh start toward compliance with future filing and payment requirements.
   D. Incorrect. The ultimate goal of the OIC is not to prevent taxpayer bankruptcy. Countless millions of dollars in federal income taxes, interest, and penalties have been discharged in bankruptcy.

2. A. Incorrect. Effective Tax Administration is not the most common basis for an OIC. An OIC based on Effective Tax Administration applies only if there are no other grounds for compromise.
   B. Incorrect. Doubt as to one's actual liability is not the most common basis for an OIC. Doubt as to one's actual liability is one of the grounds for OIC consideration.
   C. Incorrect. Causing a hardship if full payment is required is not the most common basis for an OIC. An OIC will be considered if full payment will cause a hardship, and this element is included in the so-called Effective Tax Administration OIC.
   D. **Correct.** An OIC based on doubt as to collectability is by far the most common variety of OIC.

3. A. Incorrect. IRS discretionary authority to compromise is not the most important special consideration for an OIC. Code section 7122 gives the IRS the discretionary authority to compromise, or reduce, any tax liability.
   B. Incorrect. The requirement that a taxpayer must file his or her returns and pay tax on time for the next five years is not the most important consideration for an OIC. If a taxpayer's offer is accepted, all tax returns and payments must be on time for the next five years, or the offer will be reneged and the tax reinstated.
   C. **Correct.** The most important consideration for an OIC is the fact that filing one tolls the collection statute of limitations.
   D. Incorrect. The most important special consideration for an OIC is not that an OIC based upon ETA applies when there are no other grounds for compromise. ETA is one of the four grounds for OIC consideration.

4. A. Incorrect. For the majority of taxpayers, RCP does not boil down to assets available but out of the government's reach. One of the components of RCP is the amount of assets available to the taxpayer but out of the government's reach, such as offshore assets.
   B. Incorrect. The amount collectible from third parties is not what RCP boils down to for the majority of taxpayers. The amount collectible from third parties is one of the components of RCP.
   C. **Correct.** For the vast majority of taxpayers, RCP boils down to determining asset values (which includes current and future income assets).
   D. Incorrect. Dissipation of assets is not the factor that RCP boils down to for the majority of taxpayers. The IRS generally views dissipated assets as those disposed of in an attempt to avoid a tax liability.

5. A. **Correct.** If Marcia has a 401(k) with a face value of $10,000, and has an outstanding loan against the account of $6,000, and an effective tax rate of 40%, the value of her account for OIC purposes is $0 ($10,000 less $6,000 equals $4,000, and a tax on $10,000 if withdrawn is $4,000, so the net value is $0).
   B. Incorrect. If Marcia has a 401(k) with a face value of $10,000, and has an outstanding loan against the account of $6,000, and an effective tax rate of 40%, the value of her account for OIC purposes is not $10,000. The face value of the account ($10,000) does not take into consideration the loan or the potential taxes.

C. Incorrect. If Marcia has a 401(k) with a face value of $10,000, and has an outstanding loan against the account of $6,000, and an effective tax rate of 40%, the value of her account for OIC purposes is not $4,000. The face value of the account ($10,000) less the loan ($6,000) equals $4,000; however, this value does not consider the potential tax liability.
D. Incorrect. If Marcia has a 401(k) with a face value of $10,000, and has an outstanding loan against the account of $6,000, and an effective tax rate of 40%, the value of her account for OIC purposes is not $6,000. This amount ($6,000) simply represents the face amount of the account less the tax liability.

6. A. Incorrect. Paying necessary expenses for an operating business does not involve a dissipated asset. Paying necessary business expenses is not a careless or speculative business investment.
B. **Correct.** Transferring an asset to a friend for much less than fair market value would qualify as a dissipated asset. Assuming the taxpayer is aware of the pending claim, a transfer at much less than fair market value would be "wasting money."
C. Incorrect. Using IRA proceeds to pay medical expense does not involve a dissipated asset. Medical bills are considered a necessary living expense and the payment of which would not involve dissipation.
D. Incorrect. Transferring an asset to a relative more than three years before submitting an OIC would not involve dissipation. If a transfer occurs more than three years before submitting an OIC, the IRS will generally disregard it.

7. A. **Correct.** When valuing an OIC, the U.S. Tax Court prefers a Future Income Collateral Agreement when dealing with the problem of uncertain current earnings.
B. Incorrect. When valuing an OIC, the U.S. Tax Court does not favor dissipation when dealing with uncertain current earnings. Dissipation involves the citizen wasting assets or money to reduce his or her collection potential.
C. Incorrect. Income averaging is not preferred by the U.S. Tax Court when dealing with the problem of uncertain current earnings. The argument against income averaging is that it is merely a speculative stab at what the citizen's income might be going forward.
D. Incorrect. When valuing an OIC, the Tax Court does not favor using estimated future income when there are uncertain current earnings. The Court favors another method of valuation instead of estimated future income.

8. A. Incorrect. Seven years is not the longest period that a collateral agreement should run. It is suggested that the taxpayer negotiate for an agreement period much less than seven years.
B. Incorrect. Two years is not the longest period that a collateral agreement should run. In the case of a deferred payment, the future income asset is figured over twenty-four months, and the collateral agreement should be proposed to cover that period; however, the IRS will not likely agree.
C. Incorrect. For a cash offer, the future income asset is figured over twelve months. The maximum period of a collateral agreement will be longer than that, and the length of the agreement will be entirely negotiable.
D. **Correct.** It is suggested that five years should be the longest time a collateral agreement should run.

9. A. Incorrect. When determining expenses for purposes of an OIC, the social security tax is not the type of tax that will be challenged by the IRS. The IRS must allow social security taxes in the calculation of disposable income.
B. **Correct.** When determining expenses for purposes of an OIC, the IRS will likely challenge delinquent state income taxes.
C. Incorrect. When determining expenses for purposes of an OIC, current state income tax is not the type of tax that will be challenged by the IRS. The IRS must allow current state income taxes in figuring disposable income.

D. Incorrect. When determining expenses for purposes of an OIC, current federal income tax is not the type of tax that will be challenged by the IRS. The IRS must allow current federal income taxes in figuring disposable income.

10. A. Incorrect. A non-low income taxpayer filing an OIC cash offer does not have to deposit 40% of the offer when the offer is filed. The required deposit percentage is less than 40%.
B. Incorrect. A non-low income taxpayer filing an OIC cash offer must make a deposit of more than 0% of the offer. A cash deposit of a certain amount is required.
C. Incorrect. A non-low income taxpayer cannot make a deposit in the amount of 10% of the amount offered with the filing of an OIC cash offer. The required percentage is greater than 10%.
D. **Correct.** The taxpayer making a OIC cash offer must make a deposit of 20% of the amount offered.

11. A. Incorrect. If a taxpayer has monthly income, but it is exhausted providing for the care of dependents, this is not an example of circumstances that would warrant consideration of an ETA offer under the public policy and equity argument. However, the above facts describe circumstances that would give rise to an ETA offer as a hardship case.
B. **Correct.** If substantial penalties and interest occurred during a period of illness or injury, but subsequent returns have been timely filed, these circumstances warrant consideration of an ETA offer under the public policy and equity argument.
C. Incorrect. If a taxpayer's only asset is a retirement account and liquidation of that account would leave no means of future support, such circumstances would not warrant an ETA offer under the public policy and equity argument. However, the circumstances described would give rise to an ETA offer as a hardship case.
D. Incorrect. If a taxpayer has assets but cannot borrow against them due to financial limitations, such circumstances would not warrant an ETA offer under the public policy and equity argument. However, the circumstances described would give rise to an ETA offer as a hardship case.

12. A. Incorrect. Form 656-B is not filed by a citizen seeking an OIC based upon doubt as to liability. Form 656-B, Offer in Compromise Booklet, is an IRS booklet for OICs.
B. Incorrect. Form 433-B is not filed by a taxpayer seeking an OIC based on doubt as to liability. Form 433-B is used to submit required business financial statements in connection with an OIC filing.
C. **Correct.** Form 656-L is filed by a taxpayer seeking an OIC based upon doubt as to liability.
D. Incorrect. Form 656 is not filed by a taxpayer seeking an OIC based on doubt as to liability. Form 656 is the basic Offer in Compromise form used for doubt as to collectability, ETA, and "special circumstances."

13. A. **Correct.** In the case of an OIC based on doubt as to collectability, expect the IRS to say that the offer is too low.
B. Incorrect. After submitting an OIC offer based on doubt as to collectability for review, the response to be expected by the citizen is not that the offer will be returned. If the citizen fails to supply requested information, the specialist will return the OIC to the filer.
C. Incorrect. After submitting an OIC offer based on doubt as to collectability for review, the response to be expected by the citizen is not that the offer specialist will request a phone conference. The filer may ask for a phone conference with the specialist to discuss any issues.
D. Incorrect. After submitting an OIC offer based on doubt as to collectability for review, the response to be expected by the citizen is not that the OIC is not processable. Although not expected, unless the offer is processable, it will be returned to the filer, and not denied per se.

14. A. Incorrect. The offer specialist does not have the burden of proof on all RCP issues. Whether an OIC is filed directly with the COIC unit, or it is submitted to a settlement officer through a CDP appeal, the file will end up in the hands of an offer specialist.
    B. **Correct.** The taxpayer has the burden of proof on all RCP issues.
    C. Incorrect. The settlement officer does not have the burden proof on all RCP issues. In determining whether the IRS abused its discretion in rejecting an OIC, the Tax Court will not consider evidence that was not provided either to the offer specialist or to the settlement officer.
    D. Incorrect. The COIC does not have the burden of proof on all RCP issues. The COIC (Centralized Offer in Compromise Unit) is responsible for evaluating and passing on the acceptance of OICs.

15. A. Incorrect. While an OIC in pending, the IRS may not keep any tax refund received by the taxpayer. The IRS will keep any refund owed up through the tax year in which the OIC is accepted.
    B. Incorrect. While an OIC is pending, the collection statute is tolled. This is the detriment associated with the collection stay.
    C. **Correct.** The IRS is legally prevented from engaging in any collection while an OIC is pending.
    D. Incorrect. A taxpayer's settlement officer will be available to assist. If a pending OIC is filed through the CDP channel, the taxpayer can contact his or her settlement officer if a complaint about illegal collection action is warranted.

Chapter 13
Tax Amnesty Program Number 4: Wage-Earners Repayment Plan

Learning Objectives

- Ascertain who administers a wage-earner's repayment plan
- Identify a non-dischargeable tax debt
- Choose the 1984 Tax Court case that established the well-accepted definition of a tax return
- Spot the bankruptcy code rule that is consistent with the IRS rule for determining disposable income

Introduction

At the beginning of this treatise, I offered to prove that there is no such thing as a hopeless tax case. I hope by now you have concluded that there are many more opportunities to solve your problems than you realized—but there is even more. The programs discussed in Chapters 13 and 14 are the essence of the "fresh start" principle. They are intended for those whose debts are so overwhelmingly large, there seems to be no way of living a normal life. These programs are designed for the citizen who is unable to find relief due to unreasonable IRS demands or unrelenting collection action.

Though countless others have tasted success with the programs previously discussed, there is no guarantee of success for every case. The success or failure of a given technique depends, in large part, upon the facts of the case. However, for those who could not, for whatever reason, solve their tax problem using the programs discussed in the previous chapters, there is an important alternative that for many years was relatively unknown.

As of this writing, there are more people in tax trouble than ever before. As millions of citizens sink deeper into tax debt, many turn to public support for their daily bread. Worse, they run for cover in the underground economy. This places dangerously negative pressure on public programs and disrupts the private economy. Those smothered in debt must find relief or everyone suffers. The loss is not just economic. It must also be measured in human terms. These millions of citizens are often unable to earn a living. They cannot provide for their families. They are desperate and usually without hope.

Brenda, for example, a homemaker, was stuck with $1.5 million in tax debts by her ex-husband that grew out of *his* illegal business. All Brenda had to show for her years of marriage was an insurmountable debt and three children. With an $18,000 per-year job, a seven-figure tax debt and three kids to support, how do you suppose Brenda felt about her chances of ever living a normal life?

Jack was a retired firefighter. Lost in a pattern of non-filing, he faced tax assessments far beyond what he could pay, even if he lived to be ninety-five. The IRS began seizing his pension, leaving him just $325 per month to live on. Even if Jack went back to work, there was no hope of ever paying his tax debt.

Don was a truck driver. He was persuaded to invest a small sum in a tax shelter program that he was assured was perfectly legal. In the first two years of the program, Don's investment saved him a few thousand in taxes. But by the time the IRS attacked the shelter and the ensuing litigation ended unfavorably for Don many years later, he faced over $57,000 in tax assessments. In Don's mind, his hope of resolving the problem ended when the levies began.

Marilyn was a victim of her husband's political passion. Her husband Mike was an adamant tax protester and he persuaded Marilyn that she too should carry the banner. The eventual assessments against Mike drove him underground and he was unable to support his family. The emotional strain of continual hiding, and the financial strain caused by living hand-to-mouth contributed to their getting a divorce. After the split, Marilyn stepped forward to reverse a stance that she was never comfortable with from the start. The IRS, however, did not care about Marilyn's change of heart. The IRS was more interested in wringing a pound of flesh from a former "tax protester." Suddenly, Marilyn faced tax assessments in excess of $35,000. On a teacher's salary, what do you suppose her confidence level was that the debt would ever be paid?

The most tragic of all losses is when those trapped in debt abandon all hope, and then turn their desperation and depression inward. One famous story is that of Alex Council, the North Carolina resident who committed suicide so his wife could collect the insurance money to resolve their IRS problem. In Houston, a young couple shot themselves on the front lawn of their home as the IRS sold it to the highest bidder. In Orlando, a fourteen-year-old shot himself as a result of depression caused by the IRS's unmerciful, five-year pursuit of his parents over-fabricated tax debts. In Phoenix, a man exploded his home just prior to being evicted by the IRS. He was inside at the time. He committed suicide over a $15,000 tax bill. Perhaps the most shocking of all such stories is that of a Miami man who hijacked a Dade County school bus and led police on a dramatic fifteen-mile, seventy-five-minute chase. He was killed by Miami police officers. Just days before the hijacking, the IRS filed a tax lien against the perpetrator for nearly $31,000.

Common sense and sound judgment dictate that in the United States of America, there must be some way to avoid this kind of suffering, hopelessness and tragedy. Take heart—there is.

As you read the next two chapters, think of these programs as the end of the tax debt odyssey. While you may have been wandering in the wilderness of debt for years, these programs may be your ticket home. These programs offer the means by which you may cross the river into the promised land of financial liberty, *free at last* from the oppression of unyielding tax debt. To you who hunger and thirst for liberty, I say, welcome home!

Who Can Benefit from the Wage-earner's Repayment Plan?

Any person with *steady monthly income* may benefit from a wage-earner's plan. To succeed with this program, one must have sufficient income after paying all monthly living expenses (without regard to the IRS debt) to enable payment of a "dividend" to the IRS. The overriding potential benefits of this program are:

- Reduce or eliminate prior penalty assessments,
- Reduce or eliminate further accumulation of penalties,
- Eliminate further accumulation of interest in most cases,
- Reduce or eliminate certain sufficiently aged tax debts, including penalties and interest that cannot be repaid.

A wage-earner's repayment plan is administered by the Federal Bankruptcy Court. It is commonly referred to as a Chapter 13 repayment plan. Under Chapter 13 of the Bankruptcy Code (Title 11, United States Code), a person with regular income and debts within certain limits may propose a repayment plan to creditors, including the IRS. A properly drafted plan accomplishes the four points I just mentioned.

> **Note:** Unless otherwise indicated, all references to "the code" in Chapters 13 and 14 of this treatise refer to the United States Bankruptcy Code (Title 11, United States Code). Where reference is made to the Internal Revenue Code, such distinction is clearly indicated.

Common Concerns About Filing Bankruptcy

For most citizens, the "B" word is a horrible prospect. It conjures many negative ideas, not the least of which are embarrassment, failure and abandonment of financial responsibilities. While the feelings are certainly legitimate, the truth is, the perceptions are not. Let me address those concerns.

"Bankruptcy is a Way of Cheating"

The ability to discharge lingering, unmanageable debt in bankruptcy is a right protected by the United States Constitution, Article I, sec. 8, clause 4. It is no more legally or morally correct to suggest one is a "cheater" simply because he filed bankruptcy than it is to suggest he is an anarchist by voting to unseat an incumbent president, or that he is a criminal because he asserts his right to counsel under the Sixth Amendment. The rights and protections expressed in the Constitution were not placed there by our wise and divinely-guided forefathers for the benefit of criminals, cheaters or malcontents. They are intended to ensure the continued political and *economic freedom* and social stability of all citizens, rich or poor. Continual, unmanageable debt is one of the oppressive conditions from which we need to be freed.

The first bankruptcy law in the Unites States was passed in 1800. It was patterned after the English law which dated to the time of Henry VIII. In England, bankruptcy statutes functioned primarily to the benefit of creditors. For the first time, however, the United States' law extended protection to debtors. Drawing on the insight and wisdom of the great English jurist William Blackstone, our Founding Fathers broadened bankruptcy to expand our rights substantially. At the behest of Blackstone, the bankruptcy process was established as a means of humanely resolving creditor/debtor relations. Principally, it was offered as an alternative to "jail-for-debt," a practice regularly utilized in eighteenth-century Europe.

Beginning with the act of 1841, rehabilitation of the debtor became a major objective of the Bankruptcy Code. With that legislation, the idea of a voluntary petition filed by the debtor himself was introduced into our society. The concept of debtor rehabilitation is now embodied in the phrase, "fresh start." It is the promise of a fresh start that drives the majority of citizens to bankruptcy, not the desire to "cheat" creditors. As I stated earlier in this work, I find it fascinating that the IRS chose the phrase "fresh start" to describe its settlement attitude.

We all recognize that those lost in debt are unable to fully participate in or reach their full potential in our society. This is particularly true when such debt is so debilitating that it drives the citizen underground. Now he is not only in debt, but unproductive to himself, his family and society. Not only does he fail to pay his back taxes, but he fails to pay current taxes as well.

"Filing Bankruptcy Will Ruin My Credit"

Certainly, the fact of filing bankruptcy follows a person for some time afterward. Without question, it impacts his "credit worthiness." One man I spoke with about bankruptcy voiced a strong objection on this ground. He owed many thousands to the IRS and it was threatening to levy his paycheck.

I asked him several questions, starting with, "Sir, how much do you presently owe the IRS?" He responded that the total was in excess of $40,000.

"Can you pay the bill?" I asked.

"Not a chance," he said, as I expected.

"Can you get a loan to pay?" I inquired.

"No way," he chirped.

Though I knew the answer, I asked my next question anyway: "Why not?"

He quickly explained that the tax lien scared all banks away from lending to him. "As soon as they discover the tax lien," he said, "they run."

"Let me put this all into perspective," I said. "You owe the IRS forty grand you cannot possibly pay. The tax lien prevents you from getting any kind of loan to pay it. Because of interest and penalties, you can make monthly payments for the rest of your life and owe more when you're dead than you do now. And to top it off, the IRS is presently on your doorstep threatening to levy and seize everything you own. Is that about right?"

"It sure is," he moaned.

Then I said, "I have just one more question. What *credit* are you talking about!?" He slowly nodded his head in both agreement and understanding.

The cold reality is, by the time you reach this stage, IRS has long since settled any questions about the viability of your credit. The answer is *you have no credit a bankruptcy can ruin!* You must recognize that the IRS does far more to ruin your credit and your life than any bankruptcy *will ever do*. Furthermore, the negative effects of the IRS's actions potentially linger much longer than those of a bankruptcy. This is especially true if you extended the collection statute of limitations (see Chapter 10).

However convenient a line of credit may be, face the facts. The lack of it cannot destroy you. On the other hand, the IRS's actions—actual and potential—*can destroy you*, and not just financially, but physically, mentally and morally as well!

"I will Lose Everything in Bankruptcy"

In the first place, if you do not seek the protection of the bankruptcy court in the appropriate circumstances, be assured the IRS will likely see to it that you do "lose everything." The true hardship occurs when the IRS sells your property for a fraction of its value and then leaves you with a remaining, unpaid debt. Not only are you dispossessed of your assets, but you are also faced with a huge tax bill and no way to pay it.

Secondly, both Congress and the various state legislatures have passed "exemption" statutes permitting a debtor in bankruptcy to retain certain assets. The exemptions vary widely from state to state but all generally permit a debtor to retain his personal belongings such as clothing, furniture, an automobile (within a certain value), tools and equipment necessary to earn a living (within a certain value) and other property.

To be sure, one is generally *not* "wiped out" and left as poor as a church mouse when the bankruptcy is complete. In a Chapter 13, depending upon the facts of the case and in light of the manner in which the program operates, one might not lose anything and still emerge from the plan free of IRS debt.

"But I Thought Taxes Were Not Discharged in Bankruptcy!"

The best-kept legal secret in the country is the fact that federal income taxes are often fully dischargeable in bankruptcy, *and they have been so for fifty years!* In 1966, Congress passed the Bankruptcy Reform Act, Public Law 89-496. One purpose of the law was to "make dischargeable in bankruptcy debts for taxes." U.S. Code Congressional and Administrative News, Vol. 2, page 2468 (May 12, 1966).

Because we have all been told that federal income taxes are not discharged in bankruptcy, you may still be questioning the validity of this startling revelation, and justifiably so, because there was a time when this was true. However, after a congressional investigation in 1966, the law was changed. Senate Report No. 1158 accompanying Public Law 89-496 points out that Congress discovered two specific problems created by the fact that taxes were, at the time, non-dischargeable. The first problem was,

> *"Frequently, the [non-dischargeability] prevents an honest but financially unfortunate debtor from making a fresh start unburdened by what may be an overwhelming liability for accumulated taxes. The large proportion of individual and commercial income now consumed by various taxes makes the problem especially acute. [Keep in mind, this was written in 1966.] Furthermore, the non-dischargeability feature of the law operates in a manner which is unfairly discriminatory against the private individual or the unincorporated small businessman. Although a corporation is theoretically not discharged, the corporation normally ceases to exist upon bankruptcy and unsatisfied taxes, as well as other unsatisfied claims, are without recourse even though the enterprise may continue to operate in a new corporate form."* Ibid, Vol. 2, page 2471

The second problem involved the fact that federal taxes were given a "priority" over other debts. That is to say, taxes were always among the *first* debts paid with assets obtained from the debtor. Many times, this left precious little or nothing for other creditors. Congress observed,

> *"The result has frequently been that tax collectors, assured of a prior claim on the assets of a failing debtor and assured of the non-dischargeability of uncollectible tax claims,* ***have allowed taxes to accumulate and remain unpaid for long periods of time.*** *With the proliferation of new taxes and the increased rates of old taxes, often nothing is left for distribution to general creditors who provided goods and services to the bankrupt."* Ibid (Emphasis added by author.)

If this problem were bad enough to require congressional action in *1966*, imagine the breadth and scope of the problem today. Tax, penalty and interest rates are head and shoulders above the levels of that time. What has not changed, however, is the fact that most IRS employees, and the public—even tax and bankruptcy attorneys—continue to hold to the false notion that taxes are not dischargeable. Consequently, we continue to see citizens suffer through collection problems they simply do not have to endure.

Journalists at every level add to the confusion by publishing reports propagating the lie. I have seen such reports in major, respected journals such as *Money Magazine*, *Woman's Day*, *Kiplinger's Personal Finance Magazine* and a host of daily newspapers throughout the United States.

The ignorance reaches to the highest levels of expertise within the bankruptcy community itself. Some time ago, *Money Magazine* published a story claiming taxes were not dischargeable. After seeing it, one of my newsletter subscribers sent the reporter a copy of an earlier edition of this book and several of my newsletters on the subject. The reporter read the material with much interest then phoned me. He asked many questions and I gave him chapter and verse to support my answers. During the conversation, I stated, "There is not one lawyer in a thousand who knows this can be done." He responded by saying, "I know. I called all the major bankruptcy law firms in Manhattan. They all said you could not discharge taxes in bankruptcy." Despite my information, the editors at *Money* chose not to tell the truth about discharging taxes in bankruptcy.

One key reason for the widespread ignorance might be that bankruptcy experts do not often concern themselves with tax laws and tax experts generally do not get involved with bankruptcy matters. A more likely explanation is that the IRS has published the false information for so long very few ever bother to question it.

The IRS has a publication discussing the topic. It is Publication 908, *Bankruptcy Tax Guide*. It is woefully deficient in its explanation of the laws and the rules under which one may discharge tax debts. In the *1982* edition (then entitled *Taxes and Bankruptcy*), under the heading "Discharge of Unpaid Taxes," the document read, "As a general rule, there is no discharge for an individual debtor at the termination of the bankruptcy case for any prepetition (taxes existing prior to filing bankruptcy) taxes."

This explanation clearly left the impression that tax liabilities were simply not discharged. Moreover, questioning most IRS employees usually leads to the same conclusion. While writing the first edition of this book, I phoned IRS Taxpayer Assistance as I sometimes do when I need a laugh. I asked the "expert" whether unpaid taxes could be discharged.

"Absolutely not," she declared without hesitation.

"Not under any circumstances whatsoever?" I probed.

"Positively not," she reassured me.

After asking the same question using different words, she replied, "Taxes are absolutely, positively, definitely, metaphysically [whatever that means] not discharged in bankruptcy."

She went on to give me some advice. She explained that I should contact a bankruptcy lawyer because "a bankruptcy lawyer will verify that taxes cannot be discharged."

Sadly, that is the *only thing* she said that was correct.

The deliberately-false information appearing in Publication 908 led me to blast the document in the May 1988 issue of my newsletter, *Pilla Talks Taxes*. The article criticized the IRS for "intentionally misleading the public." Just *one month* after that newsletter hit the street the IRS issued an internal memorandum addressing the inaccurate publication. The memo, dated June 15, 1988, recalled and ordered *destroyed* all existing copies of the document. The reason given was that revisions to the law made the document "out-of-date and could be misleading to taxpayers." IRS Message 88-00967, June 15, 1988.

Misleading indeed! The publication was downright deceptive. But in light of the 1966 Bankruptcy Reform Act, why did the IRS wait until June of 1988—twenty-two years after the law was changed, but just one month after *Pilla Talks Taxes* printed the *truth*—to acknowledge that the information "could mislead taxpayers?" You can answer that question for yourself.

While the matter of revising Publication 908 was being deliberated by the IRS, we went on the offensive. My long-time friend and associate, tax attorney Donald W. MacPherson, wrote a letter to the IRS's National Office. He pointedly told the IRS that Publication 908 was misleading and he demanded the revised edition tell the truth about federal bankruptcy laws. In early December 1988, the IRS responded to

Mac's letter. The language is dramatic and exciting. More than anything else I can say, it proves that taxes are indeed dischargeable in bankruptcy. In the letter, Michael R. Gallagher, then the Chief, Technical Publications Branch, stated,

> *"Because of your letter, we made additional clarifying changes to the publication's manuscript. We will soon make the revised edition of Publication 908 available to the public.*
>
> *In addition to the actions we have taken to update and revise Publication 908, the IRS's Taxpayers' Service Division, which provides walk-in and telephone tax assistance to the public, will soon remind their field personnel* ***that there can be a discharge in bankruptcy of Federal income tax debt.*** *That division will also cover this matter in future employee training courses."* (Emphasis added by author.)

On February 17, 1989, long after its expected due date, IRS released the revised Publication 908. Despite the fact that the authors made no effort to explain the potentially confusing discharge rules, the IRS nevertheless came clean. That version of Publication 908 basically said that one can be discharged of income tax debts. The current version of Publication 908 (October 2012), states at page 25, as follows:

> *The bankruptcy court may enter an order* ***discharging the debtor from personal liability for certain debts, including taxes****. The order for discharge is a permanent order of the court prohibiting the creditors from taking action against the debtor personally to collect the debt. However, secured creditors with valid pre-bankruptcy liens may enforce them to recover property secured by the lien.* (Emphasis added by author.)

So, yes Virginia, federal income taxes are indeed dischargeable in bankruptcy. We proved it and forced the IRS to change its false publication. Since the cat was out of the bag, the IRS was forced to adopt its "new attitude" on the Offer in Compromise in order to prevent oppressed citizens in wholesale numbers from exercising that right. The agency's worst fear is that this news spreads far and wide. To prevent that, the agency continues to use as much technicality as possible in the language of Publication 908 to prevent people from clearly understanding the discharge rules. Nevertheless, the fact is that the IRS's "fresh start" program is in place not because the agency got religion and decided to do you a favor. Rather, it is there to keep you from turning to bankruptcy and thus preventing the agency from collecting.

You now know why I insist there is no such thing as a hopeless tax case. The bankruptcy laws provide hope and a last-resort remedy. Americans no longer need to be driven to suicide by the actions of their own government.

The Rules for Discharging Taxes in Bankruptcy

The ability to discharge taxes in bankruptcy is entirely dependent upon timing factors that hinge on various dates. There are a total of five rules that must be met in order for a tax debt to be considered dischargeable. The rules are discussed here.

1. **The three-year rule.** The tax must be for a return that was due, including extensions, at least three years prior to filing bankruptcy. BC (Bankruptcy Code) §507(a)(8)(A)(i). For example, suppose you owe taxes for the year 2010. The due date of the 2010 return was April 15, 2011, unless you filed an extension. The three-year rule is met if the bankruptcy petition is filed after April 15, 2014. If you submitted an extension to file, the due-date was pushed to October 15, 2011. In that case, you meet the three-year rule if you file bankruptcy after October 15, 2014.
2. **The 240-day rule.** The tax must be assessed for at least 240 days prior to filing bankruptcy. BC §507(a)(8)(A)(ii). The assessment date is the day on which an assessment officer signs an assessment certificate. That date is then recorded in the master file. It governs for bankruptcy as well for determining the starting point of the CSED.
3. **The post-filing assessment rule.** The tax may not be assessed or assessable after filing the petition in bankruptcy. BC §507(a)(8)(A)(iii). Any assessment meeting the 240-day rule naturally

meets this rule. This rule refers to taxes not yet assessed, such as those pending in a current audit, appeal, or a Tax Court case.

If a tax debt fails to meet each of the above three rules, it is considered a "priority" debt under bankruptcy code section 507(a)(8). The significance is that priority tax debts are never discharged in bankruptcy. A tax debt that meets each of the above three rules is classified as a "non-priority" debt, and is not barred from discharge under code section 507. However, to be fully dischargeable, the debt must also meet two additional two rules (discussed next), which are expressed in bankruptcy code section 523.

4. **The return-filed rule.** A return must be filed for the year in question. Moreover, it must be filed on time. If filed late, the return must be filed for at least two years prior to filing bankruptcy. BC §523(a)(1)(B). Thus, debts attributable to unfiled tax returns will not be discharged in bankruptcy. This important subject warrants further discussion, which I present below.
5. **The no-fraud rule.** The tax cannot be the result of a fraudulent return or a deliberate attempt to evade or defeat the assessment or payment of the tax in any manner. BC §523(a)(1)(C). The IRS has the burden of proof as to any fraud claim. If the agency is able prove fraud with clear and convincing evidence, the tax debt for that year will be rendered non-dischargeable.

Note: In order to be dischargeable, a tax debt must meet ***all five rules*** expressed above. If any one or more of those rules is not met, the tax is considered non-dischargeable. The above five rules apply equally to a Chapter 13 bankruptcy and to a Chapter 7 bankruptcy (discussed in Chapter 14).

Let me elaborate a bit more on these rules so you fully understand their impact, especially in light of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). Like many of the tax/bankruptcy laws, this law created much confusion because of its scope and complexity. Many people are under the impression that tax debts are not dischargeable because of certain provisions of this law. This not true, though the law did raise certain concerns, which created issues that I address here.

Rule 4—The Return-filed Rule

The bankruptcy code specifically states that among the debts that are *not* discharged are taxes for which a return, "if required," was, a) not filed, or b) was filed within two years of filing bankruptcy. See BC §§523(a)(1)(B) and 1328(a)(2). As I stated, to constitute a dischargeable tax debt, a return must be filed on time, or, if filed late, it must be filed at least two years *prior* to filing bankruptcy. While taxes attributable to unfiled returns or late returns filed within two years of filing bankruptcy are *not* dischargeable in bankruptcy, proper planning can still potentially render those taxes dischargeable in time.

Consider this scenario. Suppose the IRS pressures you to file delinquent returns. In response, you file those returns and then establish an installment agreement. By filing the returns, you start the two-year clock running. Once the installment agreement is established, the IRS is now prohibited from enforcing collection. This allows you to make the installment payment free of enforcement action. Keep in mind that the two-year clock is ticking all the while the installment agreement is in effect. Once you meet the two-year waiting period, you can file bankruptcy and potentially discharge the tax (assuming all other rules are met). On the other hand, if you simply file bankruptcy without meeting that two-year waiting period, or you file bankruptcy prior to filing the returns, taxes for those years are definitely not dischargeable.

BAPCPA addresses in four important ways the question of exactly what constitutes a tax return for purposes of this rule. First, Bankruptcy Code section 523(a)(1)(B) uses the phrase "return, or equivalent report or notice" in describing the filing requirement. That is to say, to be dischargeable, you must have filed the required tax "return, or equivalent report or notice." The significance of this arises when addressing the dischargeability of state income taxes.

Keep in mind that bankruptcy laws are federal laws and they govern the debtor-creditor relationship in all cases, including your tax debts with state taxing agencies. In fact, the bankruptcy laws do not specifically mention the IRS. Rather, they refer to "taxing authorities." Thus, state income taxes are dischargeable under the same rules and to the same extent that federal income taxes are dischargeable.

Most states with an income tax "piggyback" their tax law off the federal system. As such, if there is a change in your federal tax liability, there will be a corresponding change in your state tax liability. Because of this, states generally require that if the IRS changes your tax because of an audit or other adjustment, you are required to file a "report or notice," or even an amended return with the state to inform them of that change. The state then makes its own assessment.

Therefore, in order to discharge any state tax debt that grows directly from an IRS audit, you must file the required state report, notice or amended return in accordance with the state's rules and time limits. If such a notice or report is filed late, you must meet the two-year rule with respect to that notice before the state tax is considered dischargeable.

The second—and perhaps more important—aspect of the return-filing rule under bankruptcy code section 523(a) provides that in order to constitute a tax return, the document must satisfy the requirements of non-bankruptcy law. See BC §523(a)(19)+ (the so-called "hanging paragraph" because there is no specific paragraph reference to it). Before BAPCPA was adopted in 2005, the term "tax return" was not defined in either the tax code or the bankruptcy code. However, in 1984, the Tax Court devised a definition of a return which has stood for decades and has been accepted by nearly every federal and state court in the country. To constitute a return, the document must:

1. Contain sufficient information to calculate a tax liability,
2. Purport to be a tax return and not some other filing,
3. Be signed under the penalty of perjury, and
4. Constitute an honest and reasonable effort to comply with the tax law.

These four elements constitute the so-called *Beard* test, named for the case of *Beard v. Commissioner*, 82 T.C. 766 (1984), in which they were articulated. Provided your submission to any taxing agency meets the above requirements, it is considered a tax return for purposes of section 523(a). This issue comes into play in cases where the IRS files a return for you. See my discussion under the heading, *The Substitute for Return*, below.

The third element regarding tax returns addresses IRS-filed tax returns under tax code sections 6020(a) and 6020(b) (and equivalent state law). For non-filers, understanding tax code section 6020 is very important. As you know by now, the IRS is allowed to file a return for you if you fail to file. The IRS's return can be based upon "available information." This usually means somebody at the IRS studies the alignment of the stars and planets, and from that, divines your income—and by extension, your tax liability. It should come as no surprise that tax liabilities determined this way are often excessive.

Under tax code section 6020(a), the IRS may prepare a return for you based upon information you provide, as well as other information such as Forms 1099 and W-2. The IRS then presents the return to you. The law provides that upon signing that return, it "may be received by the Secretary as the return of such person." This becomes your tax return and is effective for bankruptcy if it is submitted on Form 1040.

However, the IRS hardly ever uses Form 1040 for this purpose. Rather, IRS accomplishes the same end by issuing Form 4549, *Income Tax Examination Discrepancies* (used in connection with an audit), or Form 870, *Waiver of Restrictions on Assessment and Collection of Deficiency* (used in connection with audit appeals). In either case, upon your signing the form, the tax becomes assessed. But keep in mind that in order to constitute a tax return for bankruptcy purposes, the submission must meet all of the *Beard* elements. The key here is that it must be signed under penalty of perjury. Neither Form 4549 nor Form 870 contains a perjury clause.

Therefore, to make sure that either form is considered a tax return, you must submit an additional document declaring that the Form 4549 or 870 is intended to be a return, and your document must contain a statement that the information is true and correct under penalty of perjury. When you do that, your Form 4549 or Form 870 will constitute a 6020(a) tax return for bankruptcy purposes. See IRM part 5.9.2.10.1.2; and Revenue Ruling 2005-59.

The IRS may also proceed against non-filers under tax code section 6020(b). That section reads as follows:

> *"If any person fails to make any return required by any internal revenue law or regulation made thereunder at the time prescribed therefor, or makes, willfully or otherwise, a false or fraudulent return, the Secretary shall make such return from his own knowledge and from such information as he can obtain through testimony or otherwise."*

The primary difference between a 6020(a) return and a 6020(b) return is the level of cooperation between the IRS and the citizen. You participate in the 6020(a) process. The IRS acts unilaterally in the 6020(b) process. Returns prepared under 6020(b) are referred to as "substitute for returns" (SFR; which I discussed at length earlier). SFRs expressly *are not* tax returns for bankruptcy purposes. Therefore, any SFR assessment, standing alone, is not dischargeable in bankruptcy, regardless of when it was made. I discuss this in more detail below, under the heading, *The Substitute for Return*.

The fourth and final area of concern regarding tax returns and bankruptcy applies to Tax Court decisions. Section 523(a)(19)(B)+ provides that a tax return includes "a written stipulation to a judgment or final order entered by a non-bankruptcy tribunal." This refers to agreements and court orders issued in United States Tax Court cases. When you appeal an audit decision, the case can eventually go into the Tax Court. To resolve the matter, the case is either settled by agreement—stipulation—or by a final court order. In either case, such a resolution constitutes a tax return for bankruptcy purposes.

This is important in SFR cases. When the IRS follows the proper procedures in an SFR case, it must issue a Notice of Deficiency (NOD) before it can get an assessment. The issuance of the NOD gives you the right to go to the Tax Court. When you resolve your case in Tax Court, either by filing a correct return or through a stipulated decision or a court order, you have effectively filed a tax return for bankruptcy purposes.

Tolling Applicable to the Time Periods in Rules 1 through 3

The time periods specified in section 507(a)(8) (rules 1 through 3) for determining whether a tax debt is considered a priority debt are in place to give the IRS a reasonable opportunity to collect before a person seeks to discharge the debt in bankruptcy. The rules seem simple enough but over the years, glitches developed in two areas.

The first area involves the filing of a prior bankruptcy. When you file a bankruptcy petition, all creditors are precluded from attempting to collect in any way. This is known as the "automatic stay" and is discussed later in this chapter. Because of the stay, the mere act of filing bankruptcy stops collection, regardless of whether the underlying tax debt is ultimately discharged or not.

People would often file bankruptcy to stop the IRS even though the tax debt did not meet one or more of the discharge rules. They would continue in a bankruptcy until the debt did meet all the rules. They would then dismiss the bankruptcy case and immediately file a new bankruptcy petition, claiming the debt was dischargeable because the second bankruptcy met all the discharge timing rules.

The second glitch is in tax law, not bankruptcy law. As I explain in Chapter 10, several provisions of the tax code prohibit the IRS from collecting if the citizen invokes certain remedies under the tax code. Common examples are the filing of an Offer in Compromise and a request for Collection Due Process Hearing. The bankruptcy code includes specific language that addresses these tolling issues. The rules breakdown as follows.

The 240-day Rule and an Offer in Compromise

Under bankruptcy code section 507(a)(8)(A)(ii), if an Offer in Compromise is filed *prior* to the expiration of the 240-day assessment waiting period, the 240-day rule is suspended while the OIC is pending, *and* for thirty days thereafter. The 240-day-rule is also tolled during the time an OIC is "in effect." An OIC is considered "in effect" once it is accepted by the IRS and,

> "*it remains in effect until the offer is defaulted, or the compromised amount is paid in full and the future compliance period has ended*." IRM part 5.9.13.19.3(1) (Emphasis added by author.)

Note that the future compliance period is the five-year probationary period following acceptance of the OIC. See Form 656, *Offer in Compromise*, section 8, " Offer Terms."

Given this, you cannot expect to use an OIC as a "stalling device" to meet the 240-day rule so you can discharge your tax debt in bankruptcy. The best advice generally is to file an OIC after you meet the 240-day rule. Note that the filing of an OIC has no bearing on either the three-year rule or the two-year rule.

The Effect of a Prior Bankruptcy on the 240-day Rule and the Three-year Rule

Under bankruptcy code sections 507(a)(8)(A)(ii) and 507(a)(8)(G)+ (another "hanging paragraph"), any prior bankruptcy filed within the 240-day period or the three-year period tolls both of those waiting periods. The tolling is effective while the bankruptcy is pending, plus ninety days. Again, you must be careful with the timing of a bankruptcy filing just as you are with an OIC filing. You cannot use the automatic stay provisions of the bankruptcy code to hold off the IRS while the 240-day or the three-year clocks tick.

The Three-year Rule, the 240-day Rule and a Collection Due Process Appeal

Bankruptcy code section 507(a)(8)(G)+ also addresses IRS collection matters. This section provides that the three-year and the 240-day waiting periods "shall be suspended" during any period you filed a "request for a hearing and an appeal of any collection action taken or proposed." This section clearly refers to the filing of a *Request for Collection Due Process Hearing*, Form 12153, under tax code section 6330. Under this provision, the IRS is prohibited from collecting while the request for a hearing is pending, including appeals. I discuss CDP hearings at length in Chapters 5 and 6. Given this general tolling language, the filing of a CDP Request merely to hold off the IRS is not effective to meet the bankruptcy timing rules.

When determining whether your specific tax debt is dischargeable in bankruptcy at any given time, take into consideration all the rules explained above. These rules are the most convoluted statements of law I ever read. There is no doubt in my mind that they are written this way to deliberately confuse people, steering them away from the potential benefits of bankruptcy. However, *I cracked the code*! There is no question that tax debts can be discharged. If seeking counsel to assist in this process, be sure, sure, sure he is intimately familiar with these confusing laws. If not, *I promise*, you will come out of bankruptcy with the same problems you had going in.

The Substitute for Return

The IRS's substitute for return (SFR) poses special problems for discharging taxes in bankruptcy. This is because the SFR is not considered a tax return for bankruptcy purposes, as I explained above. But this does *not* mean that you are without options in dealing with an SFR assessment. In this section, I address three common scenarios in which the IRS issues SFRs and how these scenarios play into a potential bankruptcy discharge.

The Notice of Deficiency (NOD) and Tax Court

If the IRS proceeds properly in a non-filer situation, the agency follows the so-called deficiency procedures. This means that before the IRS can get an assessment, it must issue a Notice of Deficiency. No valid assessment can be made under tax code section 6020(b) without an NOD.

After the NOD is issued, you essentially have two options. The first is to agree to the tax. You do that by signing the Form 4549 that comes with the NOD, or Form 870 if you are dealing with the IRS's Office of Appeals. When you do this, you have effectively filed a return, because, as explained above, a signed Form 4549 or Form 870 constitutes a return for bankruptcy purposes when accompanied by a statement that the form is signed under penalty of perjury and purports to be a tax return. See above for my discussion on what constitutes a state income tax return.

The second option arises if you disagree with the tax calculation. In that case, you have the right to petition the Tax Court for a redetermination of the purported tax deficiency within ninety days of the date on the NOD. Once in Tax Court, you negotiate your correct tax liability with the IRS's Appeals Office or Office of Area Counsel—the IRS's attorneys. When the negotiations are finalized, you sign Tax Court decision documents that reflect your correct tax liability, not the trumped-up SFR numbers.

This is the ideal scenario in an SFR case. The reason is that before there is any assessment, you either filed tax returns through the Tax Court process or you submitted sufficient information to allow the IRS to determine your correct tax. In either event, the result is a signed decision document that reflects your correct tax. The assessment is based upon that document. And even better, that document constitutes a tax return for bankruptcy purposes.

The NOD but no Tax Court Case

Unfortunately, not many people know what to do when they receive a Notice of Deficiency. While the notice itself explains your right to file a case in Tax Court, people do not understand how to file and often do not have the money to hire counsel to help. This usually leads to the NOD expiring. In that case, the IRS makes a default assessment based on the SFR.

Even after the assessment is recorded, there are a number of ways to resolve the question of the underlying tax liability. But once an SFR assessment is in place, the capacity to discharge the tax in bankruptcy becomes unlikely. The reason is due to a line of court decisions beginning with *United States v. Hindenlang*, 164 F.3d 1029 (6th Cir. 1999).

The *Hindenlang* case presents a classic example of this scenario. Hindenlang failed to file tax returns and failed to petition the Tax Court within ninety days after the IRS issued its NOD. The IRS assessed the taxes based upon its SFRs. Later, Hindenlang filed his own 1040 forms with information that was substantially the same as the SFRs. In other words, he took the IRS's income and expense information from the NODs, put that information on his own tax returns and filed them. Two years later, he filed a Chapter 7 bankruptcy to discharge his tax debts.

The IRS objected to the discharge and a court fight broke out. The IRS claimed that Hindenlang's returns were not returns within the meaning of the law because they did not constitute "an honest and reasonable attempt to comply with the law," and because they allegedly had no effect for tax purposes. Instead, they merely mirrored the SFRs and were filed solely to trip the two-year clock so Hindenlang could discharge his taxes in bankruptcy later.

Eventually, the Sixth Circuit Court of Appeals agreed with the IRS. The *Hindenlang* decision began a string of other litigation as the IRS was emboldened by the Sixth Circuit's ruling. The IRS's position in such litigation is extreme. The agency asserts that *any* tax return filed by a citizen post-SFR assessment is not a return for bankruptcy purposes, regardless of the nature of the information presented, and regardless of why the return is filed. In fact, the Fifth Circuit Court of Appeals held, in *McCoy v. Mississippi State Tax Commission*, 666 F.3d 924 (5th Cir. 2012), that a late filed return—whether it is filed one day late or ten years late—is not a return because it is not filed on time, a requirement of non-bankruptcy law. The bad news is that as of this writing, two other Circuit Courts of Appeals, the Tenth Circuit and the First Circuit, have agreed with the Fifth Circuit that a late-filed return, regardless of how late it is filed, is not a return for bankruptcy purposes. See, *Mallo v. IRS*, 774 F.3d 1313 (10th Cir. 2014); and *Fahey v. Massachusetts Dep't of Revenue (In re Fahey)*, 779 F.3d 1 (1st Cir. 2015).

As of this writing, the only Circuit Court of Appeals that disagrees with the *Hindenlang* doctrine is the Eight Circuit, in *Colsen v. United States*, 446 F.3d 836 (8th Cir. 2006). Colsen filed his returns post-SFR just as Hindenlang did. The difference is that Colsen prepared returns that correctly reflected his actual income and expenses. He did not just parrot the SFR calculations. Colsen's returns showed that he owed less tax than the SFR assessments. The IRS adjusted its assessment to show Colsen's correct tax.

The Eighth Circuit used the *Beard* elements (which, in my opinion, is the only correct approach to the issue) to guide its determination of whether Colsen's returns constituted tax returns for bankruptcy purposes. Recall the four *Beard* elements discussed above. Chiefly, the Appeals Court stated that since Colsen's returns were in fact accurate and the IRS acted on the returns to adjust his account, they constituted an honest and reasonable attempt to comply with the law. Moreover, since the IRS processed the returns and adjusted its assessments based upon those returns, they obviously had effect for tax purposes. The Eighth Circuit declared that Colsen's tax liabilities were in fact discharged by his Chapter 7 bankruptcy.

The lessons here are clear. If you are going to have any hope of discharging an SFR assessment in bankruptcy, you must:

1. File returns with the IRS that correctly reflect your income and expenses,
2. Be prepared to explain that those returns were filed as part of an honest and reasonable attempt to comply with the law, not merely to trip the two-year clock,
3. Work to be sure the IRS processes those returns, such as through the audit reconsideration process, and
4. Wait more than two years from the date of filing those returns in order to meet the two-year rule.

The IRS Fails to Issue an NOD

The law requires the IRS to follow the deficiency procedures in making assessments whether you file a tax return or not. The problem is that the agency does not always follow these procedures. It is not uncommon for the IRS to simply assess taxes based upon its SFRs without ever issuing an NOD. When it does this, it notifies you through a simple computer notice that states words to the effect of, "You didn't file. We filed for you. Here's what you owe. Pay up."

Since such assessments are procedurally invalid, any tax return you file subsequent to such an assessment may be considered a proper return for bankruptcy purposes, provided it meets all of the Beard elements. Upon filing, you must then wait out the two-year rule before filing bankruptcy. However, the result may be different if the IRS pushes the *McCoy* theory that late-filed returns never meet the requirement of non-bankruptcy law.

Given the inherent problems created by unfiled returns, you would do well to consult experienced tax/bankruptcy counsel before filing any bankruptcy.

The Requirement for Credit Counseling

One of the most extraordinary examples of irony emanating from the United States Congress in my memory is the so-called "sense of the Congress" statements found in BAPCPA. Congress noted that over the years leading to the passage of BAPCPA, "consumer debt" was escalating out of control and that consumers needed "education" on how to handle their personal budgets and debt. This philosophy drove the bankruptcy reform movement.

Note that these observations came from an institution that spent the American taxpayer into debt to the tune of about $20 trillion as of this writing. In the "sense of the Congress" notes in BAPCPA, Congress seems confused that citizens are spending themselves hopelessly into debt. I submit that this is largely learned behavior, and the federal government *did the teaching*.

Section 222 of BAPCPA reads:

> *"It is the sense of Congress that States should develop curricula relating to the subject of personal finance, designed for use in elementary and secondary schools."*

This statement is nothing short of fascinating given Congress's insatiable appetite for spending other people's money.

Even so, Bankruptcy code section 109(h) provides that no person can file bankruptcy unless that person has, within the 180-day period prior to filing bankruptcy, received "an individual or group briefing" from "an approved nonprofit budget and credit counseling agency." The required "briefing" must, a) apprise the debtor of the opportunities available for credit counseling, and b) assist the individual in performing a budget analysis.

The bankruptcy court clerk's office maintains a current list of approved credit counseling agencies to which potential debtors can be referred. The list is also provided on the website of the United States Bankruptcy Trustee. The link is: http://www.justice.gov/ust/eo/bapcpa/ccde/cc_approved.htm

The law provides for certain exceptions to this rule. You should consult counsel regarding the exceptions prior to filing a bankruptcy.

Delinquent and Current Tax Returns Must Be Filed

The bankruptcy code imposes the requirement that certain delinquent tax returns be filed in order for a Chapter 13 plan to be confirmed. Bankruptcy code section 1308 requires that any returns due for the four tax years prior to filing bankruptcy must be filed at the time of or soon after filing bankruptcy. In addition, bankruptcy code section 521(j) requires that all returns due while the bankruptcy is pending must be filed on time (including extensions). If the returns are not filed on time, the IRS may seek dismissal of your case.

The requirement to file four delinquent returns raises a planning point that must be considered. As explained above, taxes that are not at least three years old, computed from the due-date of the return (including extensions) are not discharged. Filing these returns upon or after filing bankruptcy does not affect the dischargeability of those taxes. They are not discharged in any event and therefore must be paid under the plan.

However, the return for the oldest year (the fourth year) does meet the three-year rule. That tax debt could be dischargeable once it meets both the two-year rule (return must be filed for two years prior to filing bankruptcy) and the 240-day rule (taxes must be assessed for at least 240 days prior to filing bankruptcy). But the fact that the return is delinquent as of the bankruptcy filing date makes it obvious that it does *not* meet the two-year rule at that time.

It is also important to understand that just because the bankruptcy code requires the filing of the four most recent returns, this does not alter the dischargeability of taxes for older years. Let me give you an example. Suppose you are delinquent for the years 2005 through 2014. You file bankruptcy in June 2015. You are required to file returns for 2014, 2013, 2012 and 2011 upon filing bankruptcy. The law does not require the filing of returns for 2005 through 2010. However, any debts for those years are nevertheless treated as non-dischargeable because the returns were not filed. Even if you file those returns at the time of filing bankruptcy, those debts are still considered non-dischargeable since the delinquent returns were not filed at least two years *prior* to filing bankruptcy (assuming you can get past the *McCoy* problem discussed above).

So do not be confused. Merely because bankruptcy code section 1308 refers only to the past four delinquent returns it does not mean the IRS will turn a blind eye toward other non-filed tax returns. If you are planning to file a Chapter 13, you must fully evaluate all delinquent returns. It bears stating again that taxes for delinquent returns that are not filed at least two years prior to filing bankruptcy are *not discharged*, regardless of how old they, regardless of how long the tax has been assessed, and regardless of whether you file a Chapter 7 or Chapter 13.

How a Chapter 13 Operates

Chapter 13 is a form of reorganization available to the working man. Think of a Chapter 13 plan as a means to consolidate debts and pay creditors in installments over a fixed period. As a general rule, the debt does not bear interest, but there are exceptions. While the plan is in effect, the protections of the bankruptcy court keep aggressive creditors such as the IRS off your back. A Chapter 13 plan is extremely valuable when a person owes priority or otherwise non-dischargeable debts the IRS is pushing to collect. Even non-dischargeable tax debts can be managed through a Chapter 13 plan. This is how it works.

Suppose you owe total taxes of $60,000. Of that, you have *non-priority* tax debts of $50,000. This includes taxes which, 1) are at least three years old computed from the due-date of the return, 2) have been assessed for at least 240 days, and 3) cannot be assessed after filing bankruptcy. See the first three rules for discharging taxes, set forth above. Further, suppose $10,000 of the $60,000 represents priority or otherwise non-dischargeable tax debts. A priority debt is one which does not meet one or more of the first three rules. A non-dischargeable debt is one that does not meet the return-filed rule, or that is attributable to fraud (rules 4 and 5).

Under a wage-earner's plan, you propose to pay the IRS the priority and otherwise non-dischargeable taxes in full over a period of time. The plan is based upon your financial condition. You submit forms and schedules disclosing your gross earnings and net earnings after subtracting all payroll deductions. From there, you submit a budget disclosing all necessary monthly living expenses. This is computed in much the same fashion as an IRS installment agreement with the important exception that the IRS does not have nearly as much authority to nit-pick your expenses.

The difference between your monthly net income and monthly living expenses is called "disposable income." Disposable income is the amount used to fund your plan. Under bankruptcy code section 1322(d), plan payments cannot exceed five years. In some cases, the plan may even be restricted to just three years, depending on your family size and income. See BC §1322(d)(2).

To illustrate this idea, suppose you have gross monthly salary of $3,500 and payroll deductions of $700. Net monthly income is therefore $2,800. Further suppose your monthly living expenses are $2,450. This includes rent or mortgage payments, auto payments, gasoline, insurance, medical bills, food, clothing, utilities, telephone, and other fixed or regularly recurring expenses which are "reasonably necessary to be expended for the maintenance or support of the debtor or a dependent of the debtor." If you run a business, allowed expenses include those incurred "for the payment of expenditures necessary for the continuation, preservation, and operation of such business." BC §§1325(b)(2)(A) and (B).

The difference between $2,800 (net income) and $2,450 (monthly living expenses) is $350. This is your disposable income, the amount available each month to fund a payment plan to priority creditors and the non-dischargeable debts.

The priority tax debts in our example are $10,000. The non-priority, dischargeable debts are $50,000. To be acceptable, a plan of repayment must make provision to pay "in full" all debts entitled to "priority under code section 507." BC §1322(a)(2). In addition, you must pay some, *but not all*, of the non-priority, dischargeable debts. Paying just a few percent of those debts is often acceptable. The partial payment is referred to as a "dividend."

Because the distribution of funds to creditors in Chapter 13 is handled by a Chapter 13 trustee, the plan must provide for payment of the trustee's fee. The fee varies from district to district but is generally about 10 percent of the money handled under the plan.

From this we can determine how much to pay the trustee to complete the plan. If you make payments for the full five years, the plan's gross revenue amounts to $21,000 ($350 x 60 months). Because the trustee receives 10 percent of the funds, the amount remaining for distribution to creditors is $18,900 ($21,000 minus $2,100).

The trustee pays funds to creditors in the order of their priority. Under our example, the IRS must receive $10,000 as payment in full for the priority debt. That leaves $8,900 remaining for distribution to non-priority creditors. The IRS's non-priority, dischargeable debt is $50,000. Under our plan, it is paid a dividend of $8,900, or 18 percent of the total. If you have other non-priority creditors, such as credit cards, the available funds are distributed on a pro rata basis. That way, each creditor receives the same percentage of its total claim.

Figuring Disposable Income

Determining disposable income in bankruptcy is not unlike doing so for purposes of an installment agreement (see Chapter 5). In fact the same principals apply, and even to a certain extent, so do the IRS's National Standards and Local Standards for personal expenses. See BC §1325(b)(3). But the good news is that the use of the standards is limited by two factors.

First, the standards apply only if your monthly income is greater than the median family income for the state in which you live. If your income is under the median, the standards simply do not apply. Your actual expenses are allowed in determining disposable income.

Secondly, even in cases where the standards do apply, there are very important exceptions. And even better, the exceptions are expressed in the statute and are not subject to the IRS's discretion. Let us review the bankruptcy code's rules for determining disposable income under bankruptcy code sections 707(b)(2) and 1325.

1. Gross income generally *excludes* child support, foster care payments and disability payments to a dependent child used for the care of that child. The IRS includes all these income sources in determining your ability to pay. This may vary by district.
2. If you are in business, your disposable net income does not include any expenses necessary for the continuation, preservation and operation of the business. As with the IRS, these expenses are not subject to any standards whatsoever, other than the general discretion of the business owner to determine what is reasonably necessary to operate his business.
3. You are allowed charitable contributions of up to 15 percent of your gross income. This is critical because the IRS never allows charitable contributions in the calculation of an installment agreement or in considering future income in an Offer in Compromise negotiation, unless the contributions are necessary to earn income. An example of this is a church pastor who is required to tithe to his church.
4. In applying the IRS's standards, the bankruptcy code specifically states that not only are the National Standards and Local Standards to be used, but also the IRS's allowances "for the categories specified as Other Necessary Expenses" must be considered. See BC §707(b)(2)(A)(ii)(I). Recall my discussion in Chapter 5 where I state that the IRS routinely *overlooks* such expenses. Key to this discussion is the fact that Other Necessary Expenses include secured debts, such as those for a home or auto. This is important because the IRS places no cap on such expenses, so long as they are necessary to maintain the "health and welfare" of you and your family. Even more to the point, the bankruptcy code specifically states that you are allowed "any payments to secured creditors" that are necessary for you to "maintain possession" of your primary home and automobile "or other property necessary for the support of the debtor and the debtor's dependents." See BC §707(b)(2)(A)(iii)(II). Under this provision, homeowners cannot be forced into a housing allowance or vehicle payment that is unrealistically low.
5. The bankruptcy code allows for the payment of all medical expenses and medical insurance. This is consistent with the IRS's treatment of those expenses but the bankruptcy code goes a step further. It allows the funding of a Health Savings Account. This is an account similar to an IRA but which is used to pay medical expenses not covered by insurance.
6. The bankruptcy code allows expenses that are necessary to maintain your safety and that of your family from family violence.
7. The bankruptcy code allows an upward departure of 5 percent from the IRS's standards for food and clothing.
8. You are allowed all your actual expenses for the care and support of any elderly, chronically ill or disabled "household member," or member of your immediate family. The latter includes a parent, child, sibling, grandparent, grandchild and spouse. This allowance is beyond what the IRS might allow since the IRS often focuses solely on whether such person constitutes an allowable dependent exemption under tax code sections 151 and 152. On the other hand, the bankruptcy code merely stipulates that such person be "unable to pay" his own expenses. See BC §707(b)(2)(A)(ii)(II).
9. You are allowed your actual expenses for administering the Chapter 13 plan, including the trustee's fee, as explained above.
10. You are allowed your actual expenses up to $1,875 per year per child for your children's school, whether public, private or even home schooling. To qualify, the child must be under the age of eighteen. Further, you must show why the expenses are reasonable and necessary and why they are not already accounted for in the IRS's standards. The IRS will never allow expenses for private school except in the most unusual circumstances, such as a handicapped child who cannot obtain adequate education at a public school.
11. You are allowed an upward departure from the IRS's housing standards based on your actual expenses for home energy costs. You must document your actual expenses and show that they are reasonable and necessary.
12. While you are in a Chapter 13 plan, you may continue to repay 401(k) debts and continue to make current 401(k) contributions up to the maximum amount allowed by law. In a Chapter 13,

you can, in effect, choose whether to pay your unsecured creditors or yourself. See BC §§1322(f) and 541(b)(7).

13. Finally, your Chapter 13 budget must take into consideration all your priority and otherwise non-dischargeable debts. After considering the full payment of all non-dischargeable debts, your available income for the payment of dischargeable debts is reduced. This in turn reduces the amount you must pay the IRS on dischargeable tax debts.

The Chapter 13 Discharge

Upon completion of the Chapter 13 plan, the bankruptcy court is required to "grant a discharge of all debts provided for by the plan." See BC §1328(a). But section 1328(g) further provides that no discharge will be granted if you do not complete "an instructional course on personal financial management." Here we see yet another example of congressional hypocrisy.

Under the fact scenario I presented above, the citizen successfully pays $10,000 priority debts and *discharges* $41,100 of non-priority tax. Perhaps more importantly, there are absolutely no further penalties, and generally no interest. This aspect alone can make a Chapter 13 more attractive than an IRS installment agreement in the right circumstances. Under an IRS installment agreement, the penalties and interest often cancel the impact of the monthly payment.

Good Faith Required

The final element necessary to succeed in Chapter 13 is the requirement that the petition and payment plan be submitted in "good faith." See BC §1325(a)(3). The bankruptcy proceeding must be pursued solely to enjoy the statutory rights of reorganization and a fresh start, not for any reason forbidden by law. When the actions of the debtor, taken as a whole, do not indicate an improper purpose, he meets the good faith rule and is entitled to a discharge.

The beauty of a successful Chapter 13 is best explained with the example of Jack, the retired fireman I mentioned earlier. The IRS levied Jack's pension. Jack and his wife were living on just $325 per month, forcing him to file a Chapter 13 petition. Thanks to the so-called *automatic stay*, bankruptcy code section 362, the wage levy was released immediately. Jack had his pension to himself once again. The automatic stay is very important. I discuss it later in this chapter.

Jack owed about $40,000 in taxes. Of that, just $9,000 were considered priority taxes. Jack submitted the necessary forms and proposed a plan of repayment. The plan was to fully satisfy the priority debt. He proposed a dividend of 2 percent, or $625, against non-priority assessments totaling just under $31,000. He also proposed to satisfy the trustee's fee as required.

After some procedural bantering, the plan was accepted and approved by the Court. At that point, he began monthly payments of $195. While the levy was in effect, Jack did not receive enough money each month to live. After filing the bankruptcy and proposing an acceptable plan, Jack was freed from the IRS levy and freed from about $30,000 in taxes he could never pay.

Not all cases can be settled with as little as a two percent dividend against non-priority debts. Several factors apply, not the least of which is the amount of disposable income available to fund the plan and the fact that you generally must pay over a five-year period. Normally, when disposable income is high, the dividend is high. When disposable income is low, the dividend is low. All of the facts of the case must be considered before proposing a plan to the court.

Special Provisions of the Bankruptcy Code

There is more to the bankruptcy code than simply discharging taxes, though clearly that is the most exciting aspect. Two important sections of the code must be addressed. They are examined in turn.

The Automatic Stay—Return of Wages

Bankruptcy code section 362 is called the "automatic stay." Upon filing a petition with the bankruptcy court, the automatic stay immediately kicks into effect. It means, quite simply, that no creditor may initiate or continue any action whatsoever to "recover a claim against the debtor that arose before the commencement of the case." See BC §362(a)(1).

With respect to the IRS, it means wage levies and bank levies must and will stop—now! Upon filing a petition, most bankruptcy clerks provide a document entitled, "Notice of Commencement of Case." This simple form notifies creditors of the pending bankruptcy. After filing bankruptcy, provide a copy of it to the IRS and to your employer, as well as to any others threatened with levy, such as your bank. It leads to an *immediate release* of levy.

Another remarkable aspect of the stay is that it prevents the IRS from taking any "act to obtain possession of property of the (debtor) or to exercise control over the property of the (debtor)." BC §362(a)(3). This means that not only can the IRS no longer seize wages or bank accounts, it cannot seize any other property whatsoever. Perhaps most significantly, even if it already seized property, the IRS *cannot sell* that property. And to go even further, at the request of the citizen, it must return property it seized but did not sell. See BC §542(a); and *United States v. Whiting Pools, Inc*., 426 U.S. 198 (1983).

However, under section 362(a)(8), the IRS can move to collect delinquent taxes that are assessed after the filing of bankruptcy, for tax years that are not covered by the bankruptcy. This is just one more reason you need to stay current with return filings and tax payments as part of your effort to resolve your liabilities, once and for all.

Redetermining a Tax Liability

You may know from your own experiences that the IRS often grossly overstates tax liabilities. A citizen is often at IRS's mercy when it comes to arbitrary tax determinations. If not properly challenged, the overstated liability becomes assessed and the IRS makes every effort to collect it. In this regard, bankruptcy code section 505 stands out as perhaps the most compelling among the numerous benefits of bankruptcy law, especially for a person who was unfairly taken advantage of by IRS auditors. This section hands the bankruptcy court the authority to "determine the amount or legality of any tax, any fine or penalty relating to any tax, or any addition to tax, whether or not previously assessed, (and) whether or not paid."

The advantages of section 505 are clear to even the most casual observer. If a person was denied the ability to contest an IRS determination, he is provided a fresh opportunity to do so after commencing a bankruptcy case. Even if the underlying tax is determined by the court to be a non-dischargeable debt, the assessment may nevertheless be modified to reflect the *correct* tax.

In one case, the benefits of section 505 saved tens of thousands of dollars for a citizen. The IRS assessed taxes arbitrarily against Don for several years. By the time he filed a bankruptcy petition, the IRS demanded just over $69,000. Don did not legitimately owe more than $10,000, and he could prove it if only he could get a hearing. However, Don missed the boat with his various notices and never did have a hearing. That left section 505 and bankruptcy as his only hope.

By the time the dust settled in Don's bankruptcy, we reduced the $69,000 tax assessment to $8,557.40. Don then began making modest monthly payments to a Chapter 13 trustee to satisfy the correct assessment. Before filing bankruptcy, Don stood to lose nearly everything because of a tax assessment that was over eight times higher than what he truly owed. Section 505 prevented that disaster.

Bankruptcy and the Federal Tax Lien

A federal tax lien can have a profound effect on how tax liabilities are treated in bankruptcy. For that reason, I address here two aspects of the tax lien.

Tax Liens and Secured Debt

There is another category of debt which we must discuss in order to fully analyze the effects of a bankruptcy on taxes. We already identified priority debts, non-priority debts, and otherwise non-dischargeable debts (taxes attributable to unfiled returns or taxes attributable to fraud). The last category we need to address is that of secured debts. It is important to consider *secured* tax debts because they, like priority debts, *are not* discharged.

For a tax debt to be secured, *two* elements must be present. First, a federal tax lien must have been properly filed. The lien must be filed in the county where the property in which the IRS claims a secured interest is located. If no lien is filed, if the lien is filed improperly, or if it is filed after the bankruptcy petition, it is invalid. Also, the lien must specify the particular tax debts in question.

The mere presence of the lien, however, is not by itself sufficient to create a secured debt. Many bankruptcy lawyers mistakenly believe it does. A security interest is created only when both essential elements are present.

The second element is the amount of equity in the assets you own at the time of filing bankruptcy. For example, suppose you owe the IRS $100,000. Suppose a lien is filed properly. Suppose further the total equity in assets you own at the time of filing is $20,000. This includes equity in your home and the value of other personal and real property, including exempt property and retirement funds.

The presence of the lien secures the debt, but *only* to the extent of your equity in assets owned *at the time of filing*. See BC §506(a). Based upon this simple example, the *secured* tax debt is just $20,000 (the value of equity in the property), making the balance of the tax debt ($80,000) entirely *unsecured*. Moreover, if such debt is also for non-priority assessments, and *not* for otherwise non-dischargeable assessments, the debt is in fact dischargeable, regardless of the amount stated on the lien.

An acceptable Chapter 13 plan must provide for payment of all secured debts, all priority debts, and all otherwise non-dischargeable debts within the allotted time. The secured debts must receive interest at the current applicable rate. However, the interest charged under bankruptcy law is not compounded daily, as is IRS interest, and no penalties apply.

The End of the Tax Lien

I stated in Chapter 4 that the tax lien attaches to all real and personal property owned *at the time* the lien is filed, and to all property acquired *after* the lien is filed. One of the most important provisions of bankruptcy law is that it destroys the tax lien's ability to encumber "after-acquired property."

After-acquired property is property you acquire *after* filing the bankruptcy petition. Though the tax lien remains effective as to any property owned *prior* to filing, it cannot attach to property acquired later. See BC §522(c). This includes wages. Hence, for all practical purposes, the filing of a bankruptcy kills the tax lien from that day forward. This allows the debtor to purchase property after commencing a bankruptcy case which is not subject to any tax lien filed prior to commencing the case.

Employment Taxes and Chapter 13

It is often employment tax liabilities—not income taxes—that drive a citizen to the doors of the bankruptcy court. Replete throughout this text is the point that the IRS is extremely aggressive, sometimes to the level of ruthlessness, when it comes to employment taxes. If you face employment tax assessments or the Trust Fund Recovery Penalty, there are important aspects of these assessments with which you must be familiar.

First, please recall the difference between trust fund employment taxes and non-trust taxes. I discuss this at length in Chapter 5 under the heading, *Employment Taxes and the Installment Agreement*. Please review it now if you cannot recall the difference between trust and non-trust employment taxes.

Under bankruptcy code section 507(a)(8)(C), the trust portion of employment tax assessments is considered a priority debt. The statute speaks to "employment taxes required to be collected or withheld and for which the debtor is liable in whatever capacity." Clearly, this refers to trust fund taxes. There are no circumstances under which trust taxes are transformed into non-priority debts and therefore, trust assessments are never discharged.

The non-trust portion, however, is a different story. Non-trust taxes are addressed in bankruptcy code section 507(a)(8)(D). It provides that an "employment tax on a wage, salary, or commission," as opposed to withheld taxes, are considered non-priority—and hence dischargeable—when the three-year rule is met. Employment taxes on wages you pay are assessed in the form of the employer's matching FICA taxes and FUTA taxes. Again, the three-year rule states that the tax must be for a period which is more than three years old as of the date of filing the bankruptcy, computed from the due date of the return (whether or not filed), including extensions. Interestingly, code section 507(a)(8)(D) imposes no requirement to meet either the 240-day rule or the post-petition assessment rule (rules 2 and 3), before a non-trust assessment is considered a non-priority debt.

Therefore, when considering a bankruptcy involving employment taxes, separate the assessment into trust and non-trust liabilities. Trust liabilities must be paid in full as priority debts. Non-trust taxes may be discharged under applicable Chapter 13 procedures.

The Final Analysis

Through all of this, you may be asking, "Do I qualify for a Chapter 13?" This question can be accurately answered only after a full evaluation of all your facts and circumstances. However, I can give you some firm guidelines to get you close enough to warrant pursuing the matter with experienced counsel.

1. **Separate your tax debts into the various categories discussed above.** They are: a) priority taxes, b) non-priority taxes, c) taxes not otherwise dischargeable, and d) secured taxes. Be sure to pay close attention to the rules for determining priority and non-priority tax debts, and those that apply to non-filers or late filed returns. Also review the process of determining what is and is not a secured tax debt. Determine the total amount in each category.
2. **Prepare a monthly budget taking into consideration all mandatory payroll deductions and required monthly living expenses.** The difference between monthly income and living expenses is disposable income. Take into account the rules discussed in this chapter for determining disposable income, not just the rules the IRS imposes as discussed in Chapter 5.
3. **Disposable income must provide for full payment of all priority, otherwise non-dischargeable, and secured debts within sixty months.** Remember to take into consideration the 10 percent fee charged by most trustees. Disposable income must also "provide for" non-priority, unsecured debts. Such provision may be as little as two percent. Consider the income of your spouse in determining disposable income, even if that spouse does not have any tax liabilities.

If, after this basic analysis, you are able to fund a plan, pursuing a Chapter 13 may be worthwhile. Bear in mind my caution regarding bankruptcy counsel. Not one lawyer in a thousand even knows this can be done, never mind how to do it! Be sure to find counsel capable of pulling it off.

Conclusion

In my conversation with Jim several years after he filed bankruptcy to stop relentless collection action, he explained, "It was like I died and went to heaven!" The IRS just disappeared. The automatic stay *chases* the agency away and a proper plan of repayment *keeps* it away.

The results are profound. If more citizens understood they have the right to a repayment plan free of crippling interest and penalties, I dare say there would be no more tax-motivated suicides in this country.

Review Questions

1. What is another common term for a wage-earner's repayment plan?
   A. Steady monthly income plan
   B. Chapter 13 repayment plan
   C. IRS dividend
   D. Debt discharge

2. Which of the following prevents a debtor in bankruptcy from losing everything?
   A. Exemption statute
   B. IRS compassion
   C. Credit worthiness
   D. IRS sales of taxpayer property

3. What is the significance of the IRS's 1989 release of the revised Publication 908?
   A. It opined that unpaid taxes could "absolutely" not be discharged
   B. It stated as a "general rule" that there is no discharge of taxes in bankruptcy
   C. It contained deliberately false information
   D. It stated that a taxpayer in bankruptcy could be discharged of income tax debts

4. Which type of tax debt may qualify for discharge?
   A. Debts attributable to unfiled tax returns
   B. Non-priority
   C. Priority
   D. Taxes attributable to a late return file in the year before filing for bankruptcy

5. Why does the IRS's substitute for return (SFR) pose special problems for discharging taxes in bankruptcy?
   A. The SFR is a return prepared under Code section 6020(a)
   B. A Notice of Deficiency is not filed
   C. There are no options in dealing with an SFR assessment
   D. The SFR is not considered a tax return for bankruptcy purposes

6. How many delinquent returns are required to be filed at the time of filing for bankruptcy?
   A. One tax year prior to filing
   B. Two tax years prior to filing
   C. Four tax years prior to filing
   D. Three tax years prior to filing

7. What is the main benefit of bankruptcy code section 505?
   A. Secured debts may be discharged
   B. Potential redetermination of the tax liability
   C. The IRS must return seized property that it did not sell
   D. Automatic stays

8. Which employment taxes may be discharged under applicable Chapter 13 procedures?
   A. No employment taxes are eligible for discharge
   B. Trust taxes
   C. Both trust taxes and non-trust taxes
   D. Non-trust taxes

Review Answers

1. A. Incorrect. Another term for a wage-earner's plan is not a steady monthly income plan. Any person with steady monthly income may benefit from a wage-earner's plan.
   B. **Correct.** A wage-earner's repayment plan is administered by the Federal Bankruptcy Court and is commonly referred to a Chapter 13 repayment plan.
   C. Incorrect. Another term for a wage-earner's plan is not an IRS dividend. To succeed with the wage-earner's plan, one must have sufficient income after paying all monthly living expenses to enable payment of a "dividend" to the IRS.
   D. Incorrect. Debt discharge is not another common term for a wage-earner's plan. The ability to discharge lingering debt in bankruptcy is a right protected by the U.S. Constitution.

2. A. **Correct.** Congress and the various state legislatures have passed "exemption" statutes permitting a debtor in bankruptcy to retain certain assets.
   B. Incorrect. IRS compassion is not what prevents a debtor in bankruptcy from losing everything. If one does not seek the protection of bankruptcy under the right circumstances, the IRS may see to it that the individual loses everything.
   C. Incorrect. Credit worthiness is not what prevents a debtor in bankruptcy from losing everything. The filing of bankruptcy, without question, impacts an individual's credit worthiness.
   D. Incorrect. An IRS sale of a taxpayer's property does not prevent a debtor in bankruptcy from losing everything. A true hardship occurs when the IRS sells a taxpayer's property for a fraction of its value.

3. A. Incorrect. The significance of the IRS's 1989 release of the revised Publication 908 was not that it opined that unpaid tax could "absolutely" not be discharged. In response to the question whether taxes could be discharged in bankruptcy, during a pre-1989 period when they likely could be discharged, the IRS stated that they "absolutely" could not.
   B. Incorrect. The 1989 release of the revised Publication 908 did not state that as a "general rule" there is no discharge of taxes in bankruptcy. The 1982 edition of the Publication did imply that tax liabilities were simply not discharged.
   C. Incorrect. The 1989 revision of Publication 908 did not contain deliberately false information. However, the 1982 edition did contain deliberately false information regarding the ability to discharge taxes in bankruptcy.
   D. **Correct.** The significance of the 1989 version of Publication 908 is that it basically said that one could be discharged of income tax debts in bankruptcy.

4. A. Incorrect. Debts attributable to unfiled tax return do not qualify for discharge. A return must be filed for the year in question in order for the tax debt to be dischargeable.
   B. **Correct.** Tax debts that meet the rules of discharge are referred to as "non-priority" debt, and are not barred from discharge.
   C. Incorrect. Priority tax debt cannot qualify for discharge. Tax debts that fail to meet the discharge rules are referred to as "priority" debt, and such debts are never discharged in bankruptcy.
   D. Taxes attributable to a late return filed in the year before filing for bankruptcy do not qualify for discharge. In order to be considered a dischargeable tax debt, a late return must be filed at least two years prior to filing for bankruptcy.

5. A. Incorrect. The SFR does not pose a special problem for discharging taxes in bankruptcy due to it being a return prepared under Code section 6020(a); instead, SFR returns are prepared under Code section 6020(b) where the IRS acts unilaterally.
   B. Incorrect. The SFR does not pose a special problem for discharging taxes in bankruptcy due to non-filing of a Notice of Deficiency. When the IRS follows proper procedures in an SFR case, it must issue a Notice of Deficiency.

C. Incorrect. The SFR does not pose a special problem for discharging taxes in bankruptcy due to a lack of options in dealing with a SFR assessment. There are options available in dealing with an SFR assessment.
D. **Correct.** The IRS's substitute for return (SFR) poses special problems for discharging taxes in bankruptcy because the SFR is not considered a tax return for bankruptcy purposes.

6. A. Incorrect. At the time of filing for bankruptcy, a delinquent return for one year prior to filing is not the only return required to be filed. The bankruptcy code requires multiple delinquent returns to be filed in order for a Chapter 13 plan to be confirmed.
   B. Incorrect. At the time of filing for bankruptcy, a delinquent return for two years prior to filing are not the only returns required to be filed. The bankruptcy code requires multiple delinquent returns to be filed in order for a Chapter 13 plan to be confirmed.
   C. **Correct.** The bankruptcy code requires that any returns due for the four tax years prior to filing bankruptcy must be filed at the time of or soon after filing bankruptcy.
   D. Incorrect. At the time of filing for bankruptcy, a delinquent return for three years prior to filing are not the only returns required to be filed. The bankruptcy code requires multiple delinquent returns to be filed in order for a Chapter 13 plan to be confirmed.

7. A. Incorrect. The ability to discharge secured debts is not a benefit of bankruptcy code section 505. Security debts are not subject to discharge.
   B. **Correct.** The main benefit of bankruptcy code section 505 is that a person is given a fresh opportunity to contest an IRS determination, even though denied that ability earlier.
   C. Incorrect. It is not a benefit of bankruptcy code section 505 that the IRS must return seized property that it did not sell. Under bankruptcy code section 542(a), the IRS must return property to the taxpayer that it did not sell.
   D. Incorrect. Automatic stays are not the main benefit of bankruptcy code section 505. Bankruptcy code section 362 is called the "automatic stay" and upon filing a petition with the bankruptcy court, the automatic stay immediately kicks into effect.

8. A. Incorrect. It is not accurate to state that no employment taxes are eligible for discharge under applicable Chapter 13 procedures. Certain employment taxes are dischargeable in bankruptcy, depending on the classification.
   B. Incorrect. Trust taxes are not a type of employment tax that can be discharged under applicable Chapter 13 procedures. Employment taxes required to be withheld, and for which the debtor is liable in any capacity, must be paid in full as priority debts.
   C. Incorrect. Both trust taxes and non-trust taxes are not dischargeable in Chapter 13 bankruptcy. Trust liabilities must be paid in full, and non-trust taxes receive different treatment.
   D. **Correct.** Employment taxes classified as non-trust taxes may be discharged under applicable Chapter 13 procedures.

Chapter 14
Tax Amnesty Program Number 5: The "Fresh Start"

Learning Objectives

- Identify the program administered under Chapter 7 of the bankruptcy code
- Select an example of consumer debt
- Determine the perception one should have toward his or her ability to file bankruptcy when dealing with the IRS and unmanageable tax debts

Introduction

The principle of a *fresh start* is embodied in the very spirit of the bankruptcy laws. The IRS has, as least in part, adopted that philosophy in its "fresh start" policy because of the agency's raw experiences with these laws. In fact, at IRM part 5.9.2.2(1), the IRS uses the very phrase "'Fresh Start' Concept" in explaining that the bankruptcy laws give a taxpayer smothered with debt "an opportunity to start over with a clean (or at least improved) financial slate."

Tax Amnesty Program Number 5 takes the IRS's administrative principle of a fresh start one step further. Many citizens faced with IRS debt cannot solve their problem with a wage-earner's plan. However, those with precious few assets to protect, or whose debts are beyond the possibility of repayment, may seek relief through the Fresh Start program, especially if the IRS is unreasonable for any reason in an Offer in Compromise negotiation.

Under the Fresh Start program, qualifying tax debts are simply eliminated. The citizen comes away with a clean slate and the opportunity for a new beginning.

Who Can Benefit From the Fresh Start Program?

This program is designed for those with little to lose and much to gain by exercising the right to wholly eliminate staggering IRS debts. Those who have endured enforced collection over a prolonged period are often ripe for this program. The reason is that the IRS has generally helped themselves to most assets, leaving the citizen well on his way to being destitute, if not fully so already.

Some time ago, I spoke with a lady particularly distraught over the problem she and her husband faced. Jane explained that their assessments were in the neighborhood of $500,000. She was not sure of the exact figure because the problem had persisted for so long and the IRS had previously seized much in assets and cash. Since she never saw actual IMF transcripts, she had no meaningful statement showing assessments and payments.

When I spoke with Jane in the mid-1990s, the IRS had seized and was preparing to sell her home—for the *second* time. That is right. The first time occurred in late 1990. After it was sold, Jane's tax counsel persuaded her to "redeem" the property. Seized property is redeemed by paying an amount equal to the value realized through the sale, plus interest. (Please note that Jane's experience occurred prior to the 1998 IRS Restructuring Act. At that time, the IRS had the administrative authority to seize and sell a taxpayer's primary residence. As you know from my discussion in Chapter 4, the agency may no longer seize a home through the administrative process. But that is not to say it cannot seize a home. The fundamental difference is that a seizure must now be done through the judicial process.)

When the agency sold the home, it did so for the ridiculous price of $7,000. It seemed a simple matter to redeem it. Jane and her husband borrowed $7,000 from relatives, paid it to the IRS, and soon the home was released back to them. However, $7,000 did not come close to satisfying the debt. Consequently, after the property was redeemed and once again was owned by Jane and her husband, it was re-exposed to seizure and sale. And that is exactly what the IRS did. It seized the home a second time. After the second sale, the redemption amount was $15,000.

Jane and her husband were victimized by a phenomenon I addressed in Chapter 13. It is the overwhelming level of ignorance—even among tax professionals—of the ability to discharge taxes in bankruptcy. In Jane's case, the ignorance of her counsel transcended even the subject of bankruptcy. It went to the very core of basic procedural tax matters.

How the "Fresh Start" Program Operates

The program is administered under Chapter 7 of the bankruptcy code. It is often referred to as a liquidation or straight bankruptcy. The term "liquidation" is the source of much consternation for many citizens. However, for those such as Jane facing liquidation at the hands of the IRS, or even worse, those who have already suffered that fate, relief in Chapter 7 can represent the long awaited drink from the cup of forgiveness.

Filing a petition under Chapter 7 creates a legal entity known as the "bankruptcy estate." The estate is comprised of all property owned by the debtor at the time of filing BC (with certain, limited exceptions). See BC §§541 and 522. The estate is administered by the trustee for the benefit of creditors. The trustee's function is to liquidate the estate's property and distribute the proceeds in an orderly and equitable manner to creditors in accordance with bankruptcy law.

If you qualify to file a Chapter 7 case, all non-priority debts, debts that are not otherwise non-dischargeable, and unsecured debts not paid by the proceeds of liquidation are discharged. This is true whether or not the debt is for income taxes. Contrary to Chapter 13 rules, one need not pay any dividend against those debts or otherwise make payments to win a discharge. I discuss the qualification issue below, under the heading, *The Chapter 7 "Means Test."*

For example, suppose you own no assets other than the clothes on your back, some personal furniture and an automobile worth $5,000. Let us further say you owe $50,000 in non-priority, dischargeable taxes. In the Chapter 7, the trustee sells your non-exempt property and pays the proceeds to the IRS. Assuming your personal vehicle is not exempt (state and federal law determine exemptions), and assuming the trustee sold the car for $5,000, you discharge $45,000 in taxes.

Generally, however, it is not quite that simple. The reason is because almost every state enforces laws *exempting* a vehicle and other assets in some amount. Therefore, the trustee in our example is not free to sell it outright. Rather, he offers to sell the non-exempt portion *back to the citizen*. It is this aspect of the Chapter 7 that often prevents the absolute stripping of all of one's assets.

To illustrate, I point to the federal automobile exemption provided under bankruptcy code section 522(d)(2). As of this writing, that exemption is $3,675 (slightly more than the IRS's exemption for purposes of an OIC). Moreover, the exemptions under section 522 are indexed for inflation, and as such, they increase periodically. In our example, the vehicle exceeds the exemption amount. Therefore, expect the trustee to sell the vehicle to *you* at a negotiated price somewhere between the exemption amount ($3,675) and its declared value ($5,000).

Please note that when considering exemptions, we are talking about the equity in the asset, not the total value of the asset. If your vehicle is worth $15,000 but you owe $12,500, you get to keep it because your equity is at or less than the exemption amount of $3,675. Also note that bankruptcy code section 522 sets forth the federal exemption scheme. This is relevant only in the states that have not opted out of the federal exemption scheme. Many states have elected to apply their own exemptions, set by state law. Generally, state exemptions are much more generous than federal exemptions.

Usually, a citizen is able to purchase property from the trustee at rates approaching 50 percent of the declared value. In this case, 50 percent of the difference between the exemption ($3,675) and the declared value ($5,000) is $662.50. That means for the sum of $662.50, you purchase the vehicle from the trustee. Because wage levies or your installment payment to the IRS cease on the day of filing bankruptcy, funds to purchase the vehicle could come from that source. Borrowed money can also aid in purchasing assets.

The beauty of recovering assets in this fashion is two-fold. First of all, in addition to what I said in Chapter 13 of this book, the process of buying back property from a trustee defeats the notion that you "lose everything" in bankruptcy. Secondly, when you purchase the property from the trustee, you purchase it *free of the tax lien*. This is a wild contrast from what Jane did in her case. When she redeemed her home, she did it *subject to the tax lien* and you saw what happened.

Please recall our earlier discussion in Chapter 13 of this book where I pointed out that the lien does not attach to after-acquired property. When you purchase property from the trustee, such property is considered acquired *after* you filed bankruptcy. The reason is simple and perfectly logical.

At the moment of filing bankruptcy your property ceases to be yours. At that moment, it becomes property of the estate. Legal title passes from you to the estate. Paying funds to the trustee to purchase that property is no different than if you ran down to the local car store to buy another auto. Since the new car is after-acquired property, the lien does not attach to it.

At the time of purchasing property from the trustee, title passes back to you, but free of the tax lien. You continue to drive the vehicle but you do so without the risk of the IRS seizing it at any moment. The same result can be achieved with real property, such as your home.

The Chapter 7 "Means Test"

One of the key forces driving bankruptcy reform in 2004-2005 was the idea of reducing bankruptcy abuse. Congressional debate at the time focused on individuals who ran up substantial credit card debt and then filed bankruptcy to discharge that debt, regardless of their ability to pay. This practice arose because the bankruptcy laws generally allowed a debtor to file bankruptcy to liquidate debts purely on a discretionary basis. That is, there were few practical limitations to keeping a person out of bankruptcy. Thus, incentive existed to abuse the system by opting to simply not pay creditors and then file bankruptcy when collection got too hot.

The abuse focused mostly on consumer debts in general and credit card debt in particular. Prior to BAPCPA, it was not unusual to see a person in bankruptcy with tens of thousands of dollars in credit card debt amassed chiefly through irresponsible behavior. Because the bankruptcy code allowed such a debtor to file an unrestricted Chapter 7 at his sole discretion, he could get a full and (generally) automatic discharge of that debt without paying anything to creditors. This was true even though he may have been earning substantial income at the time of filing bankruptcy.

BAPCPA set out to resolve this by, in addition to the requirement that debtors obtain "credit counseling," eliminating the so-called discretionary Chapter 7. Bankruptcy law may now preclude you from filing a Chapter 7 under certain circumstances. You may instead be forced into a Chapter 13 to make payments to creditors over time, as explained in the previous chapter. This way, debtors do not merely skate from their debts but pay something over time. Congress referred to this as a "needs-based" bankruptcy. Pub. Law 109-8, Title I.

Not all debtors can be forced into a Chapter 13. The mandatory Chapter 13 rules apply only in certain cases. Bankruptcy code section 707(b) provides that a mandatory Chapter 13 applies when an individual's debts "are primarily consumer debts." This is very important language that I discuss at length below.

The imposition of the means test has left many with the impression that Chapter 7 is simply no longer an option. Even many revenue officers have this notion. This has sometimes emboldened the agency where settlement discussions are concerned, leaving the IRS believing that it need not be as flexible in negotiations as it might otherwise be. After all, if a citizen has no Chapter 7 option, why cut him a deal in an Offer in Compromise? If that person will be forced to make payments in a Chapter 13, why not impose those same payments upon him through the collection process? The good news is that the IRS's perception of the law is simply wrong.

Bankruptcy code section 707(b)(1) provides that a Chapter 7 bankruptcy will be dismissed or converted to a Chapter 13 if the court finds that granting a discharge would "constitute an abuse" of the bankruptcy code. Under the law, the court is to "presume abuse exists" if the debtor has the capacity to pay at least minimum payments to creditors over time as set forth in section 707(b)(2). I discuss below how this is calculated.

It is important to understand that the means test does not eliminate one's capacity to file a Chapter 7. In fact, there are at least three circumstances where the means test does not even apply. In any one of those situations, Chapter 7 is available to eliminate your tax debt, assuming you meet all the rules for discharge as explained in the previous chapter of this book. I address the three key exceptions here.

The Means Test Applies Only to Debtors Owing "Primarily Consumer Debts"

A careful reading of section 707(b)(1) reveals that a mandatory Chapter 13 applies only in cases where the debts in question are "primarily consumer debts." Let us examine both elements of this statement.

What is a "Consumer Debt?" The answer is found in bankruptcy code section 101(8). That provision reads as follows:

> *"The term 'consumer debt' means debt incurred by an individual primarily for a personal, family or household purpose."*

Debts you owe on credit cards, automobiles, home mortgages, student loans, medical bills, etc., are "consumer debts." Taxes are *not* consumer debts. The United States Court of Appeals for the Sixth Circuit addressed this question head-on in the case of *Internal Revenue Service v. Westberry*, 215 F.3d 589 (6th Cir. 2000). In deciding the question, the Appeals Court carefully evaluated the difference between consumer debt and tax debt. The Court identified four reasons why tax debt cannot be considered consumer debt. They are:

1. A tax debt is "incurred" differently than a consumer debt. Incurring a tax debt "is not voluntary on the part of the taxpayer." The Court noted that "volition is essential" to the classification of a debt as consumer debt.
2. A consumer debt "is incurred for personal or household purposes, as stated in bankruptcy code section 101(8), while taxes are incurred for a public purpose." The Court noted that "taxes are imposed by a government for the public welfare."
3. Taxes arise from "the earning of money, while consumer debt results from its consumption." The Court noted that, "different events give rise to tax debt than to consumer debt." IRS debt arises "from the earning of income, not from expenditures on personal and family items."
4. And finally, unlike taxes, "consumer debt normally involves the extension of credit." Obviously there is no extension of credit involved in accruing tax debt.

The Appeals Court concluded by saying:

> *"The sum of these material differences leads us to conclude that Westberry's tax debts cannot be considered consumer debt."*

Along these same lines, it is also true that business debt does not constitute consumer debt. When the transaction giving rise to the debt "involves a profit motive, it is outside the definition of consumer credit." *Baskin v. G. Fox and Co.*, 550 F. Supp. 64 (D.Conn.1982); *Adema v. Great Northern Development Co.*, 374 F.Supp. 318 (D.Ga.1973). See also: *In re Strausbaugh*, 376 B.R. 631, 636 (Bankr. S.D. Ohio 2007) (defining consumer debt as "debt incurred by an individual primarily for a personal, family, or household purpose," and then recognizing and applying the profit motive test); and *In re Davis*, 378 B.R. 539, 547 (Bankr. N.D. Ohio 2007) ("the test for determining whether a debt should be classified as a business debt, rather than a debt acquired for personal, family or household purposes, is whether it was incurred with an eye toward profit").

If you are unsure whether a given debt is a consumer debt or a business debt, apply this simple test: was the debt "incurred with an eye toward profit?" *In Re Booth*, 858 F.2d 1051 (5th Cir. 1988). If so, it is not a consumer debt. Let me give you some examples.

- You take out a $200,000 mortgage to buy a house. All of the proceeds of the mortgage are used to pay for the house. The $200,000 mortgage constitutes consumer debt in its entirety.
- You own a home with an existing $100,000 mortgage. The entire mortgage was used to pay for the home. You take out a home equity line of credit of $50,000 against the home to purchase a new car and put an addition on the home. The $150,000 debt on the home is consumer debt.

- You own a home with a $100,000 mortgage. The house is worth $300,000. You take out a second mortgage of $200,000. Of that second mortgage, $100,000 is used to pay off the first mortgage and the balance of $100,000 is used to start a business. One-half of the debt is consumer debt and the other half is business debt.
- You incur $50,000 of debt on credit cards. The debt is used to pay business expenses, materials suppliers and employees' wages. The $50,000 credit card debt is business debt.

What Does the Term "Primarily" Mean?

Bankruptcy code section 707(b) uses the term "primarily" to indicate when a mandatory Chapter 13 might come into play. The term "primarily" suggests an overall ratio of "consumer to non-consumer debts of over 50 percent." See In Re Booth, supra. Thus, the mandatory Chapter 13 specified in bankruptcy code section 707(b) applies only when more than 50 percent of your total debt is consumer debt.
Here are some examples:

Example 1

Consumer Debt		Non-Consumer Debt	
Home loan	$100,000	State and Federal taxes	$50,000
Credit cards	20,000		
Car loan	5,000		
Total	**$125,000**		**$50,000**

In this example, about 71 percent of your debts are consumer debts. A mandatory Chapter 13 might apply, subject to the other exceptions discussed below.

Example 2

Consumer Debt		Non-Consumer Debt	
Home loan	$100,000	State and Federal taxes	$100,000
Credit cards	20,000	Business line of credit	50,000
Car loan	5,000	Business suppliers	30,000
		Employees	5,000
Total	**$125,000**		**$185,000**

In this example, about 60 percent of your debts are non-consumer debts. A mandatory Chapter 13 does not apply regardless of the other exceptions discussed below.

Example 3

Consumer Debt		Non-Consumer Debt	
Home loan	$100,000	State and Federal taxes	$125,000
Credit cards	20,000		
Car loan	5,000		
Total	**$125,000**		**$125,000**

In this example, 50 percent of your debts are non-consumer debts. Since the consumer debt is *not more* than 50 percent, a mandatory Chapter 13 does not apply regardless of the other exceptions discussed below. (Note: when counting your tax debt, be sure to include interest and penalties, not just the tax.)

A Mandatory Chapter 13 Does Not Apply to Low-income Citizens

Even if your debts are primarily consumer debts, you may nevertheless avoid a mandatory Chapter 13. If your annual income is under the median income for your state, a discretionary Chapter 7 is still available to you. See BC §707(b)(7)(A).

You can obtain the median income figures for your state and family size from the U.S. Trustee Program website. The link is: http://www.justice.gov/ust/means-testing.

Note that the median income tables vary from year to year. Be sure you are looking at the table applicable to the current year in which you are considering filing bankruptcy.

Here is an example, based upon the median income figures for the State of Minnesota as of November 1, 2015:

Family Size	Median Income
1 person	$51,199
2 persons	$68,515
3 persons	$80,804
4 persons *	$98,447 *

* Add $8,100 for each individual in excess of 4.

Based upon the above, if you are a resident of the State of Minnesota with a family of three and income of $65,000 annually, you may opt for a Chapter 7 filing even if your debts are primarily consumer debts.

A Mandatory Chapter 13 Does Not Apply if You Have Insufficient Disposable Income

If your annual income exceeds your state's median income for your family size, the next question is whether you have sufficient disposable income to require the filing of a Chapter 13. If you do, and your debts are primarily consumer debts, you will be forced into Chapter 13. If you do not have sufficient disposable income, Chapter 7 remains an option for you.

In Chapter 13 of this book, under the heading, *Figuring Disposable Income*, I discuss how the bankruptcy court determines one's disposable income. Once you know your disposable income, multiply that figure by 60. This represents the income available to pay creditors over five years. If the available income is $12,475 or more, Chapter 13 is required. In other words, if your disposable income is at least $208 per month, you must go into a Chapter 13, assuming your debts are primarily consumer debts, *and* your income is above median state income for your family size. See BC §707(b)(2)(A)(i).

Now let us talk about what happens if you earn more than the median income for your state but you do not have at least $208 in monthly disposable income. In this case, the final part of the means test comes into play. If your disposable income is less than $125 per month, a discretionary Chapter 7 is now an option. If your disposable income is between $125 and $208, then disposable income is measured against your dischargeable (non-priority, unsecured) debts. If the amount you can pay is less than 25 percent of your total dischargeable debt, then Chapter 7 remains an option.

Let me illustrate this. Suppose your annual family income is above the median for your state and your total dischargeable debt is $50,000. Twenty-five percent of $50,000 is $12,500. Suppose further that your disposable income is just $200 per month. This is the amount available to pay your otherwise dischargeable debts. Multiply $200 by sixty months. The product is $12,000. Since $12,000 is less than 25 percent of your $50,000 debt, Chapter 7 is available to you regardless of whether your debts are primarily consumer debts.

Now suppose your disposable income is $300 per month and your debts are $50,000. In that case, the $18,000 (300 x 60) of disposable income exceeds 25 percent of your debt. Because of that, you are required to file Chapter 13, assuming your debts are primarily consumer debts.

Four Steps to Figuring Whether Chapter 7 is an Option

Now that you understand the means test, let me set out the four simple steps to determine whether Chapter 7 is an option in your case.

Step1. Determine whether your debts are primarily consumer debts. Classify them into these three categories: 1) tax debt, 2) business debt, and 3) debts incurred to provide for your family support and personal consumption. Only debts in class three are considered consumer debts. If your consumer debt is *50 percent or less* of your total debt, stop. Chapter 7 is available to you. If your consumer debt is *more than* 50 percent of your total debt, go to step two.

Step 2. Determine the median family income for your state and family size. If your annual income is *equal to or less than* the median family income for your state, stop. Chapter 7 is available to you. If your income is *more than* the median family income for your state, go to step three.

Step 3. Figure your monthly disposable income using the guidelines discussed in Chapter 13 of this book. If your disposable income is less than $125 per month, stop. Chapter 7 is available to you. If your disposable income is between $125 and $208, go to step four.

Step 4. Determine the amount of your non-priority debts, unsecured debts, and debts that are not otherwise non-dischargeable. If your dischargeable debts are *equal to or more than* 25 percent of the product of your disposable income multiplied by 60, stop. Chapter 7 is available to you. If your dischargeable debts are *less than* 25 percent of the product of your disposable income multiplied by 60, you must file Chapter 13.

I strongly suggest you consult counsel experienced in tax bankruptcies and the intricacies of computing the means test before filing any bankruptcy.

The Rules for Discharging Taxes in Chapter 7

Shortly after filing a Chapter 7 bankruptcy, the court issues a general discharge order. The order is vague. It does not expressly state which debts are and are not discharged by the order. It states merely that all debts "dischargeable" are "hereby discharged." One must look to the bankruptcy code to determine which debts are and are not discharged.

This can lead to much confusion. The IRS is often of the opinion that a bankruptcy has no impact on tax debt because of the mistaken notion that taxes are "not dischargeable." For this reason, it is necessary to communicate with the IRS after the discharge to prove the tax debt was indeed canceled. Therefore, it is mandatory that you understand the rules for discharging taxes in Chapter 7. See my discussion of the rules in the previous chapter, under the heading, *The Rules for Discharging Taxes in Bankruptcy*. Pay close attention to the tolling provisions under bankruptcy code section 507(a)(8), which I address at length in that discussion.

As you will recall, each of the rules (with the exception of the no-fraud rule) is time-sensitive. That is to say, the ability to discharge taxes in bankruptcy is largely dependent upon timing. You cannot expect to meet with success if you do not understand and apply all the rules to the facts of your case *before you file bankruptcy*.

Permit me to illustrate exactly how effective a Chapter 7 can be under the appropriate circumstances. Virginia owed the IRS $57,662 as a result of tax shelter deductions she claimed. The shelters were simple and sold as what purported to be perfectly legal investment vehicles intended not only to save taxes, but also to earn a profit. As it turned out, the IRS disallowed the investments.

After many years of audits and appeals, the IRS was working hard to collect the assessments through wage levies on Virginia's paycheck. Virginia worked part time at a supermarket as a checker and drew a small pension. Her total monthly income was under $2,500. There was no way she could pay the debt. After paying her normal monthly living expenses, she had just a few hundred dollars available each month to throw at the problem. At that rate, interest and penalties would keep the bill growing until the day she died.

Virginia turned to a Chapter 7 bankruptcy for relief. Upon receiving the discharge order, she wrote a certified letter to the IRS's Insolvency Unit for her state. The Insolvency Unit handles bankruptcy matters for the IRS, including the processing of all relevant forms and tax abatements in the appropriate cases.

Virginia's letter explained that she met each of the five rules required to discharge her taxes. She asked for an abatement of taxes for the years in question. After providing all appropriate documents to verify the bankruptcy, her letter was met with an abatement of all taxes. The format of the letter is the same as that shown in IRS Publication 783, governing applications for certificate of release of federal tax lien. See Chapter 6.

When Virginia walked out of the bankruptcy court, she left behind the mistakes of her past. She walked into a fresh start occasioned by a slate wiped clean through a Chapter 7 discharge.

Special Provisions Relating to Chapter 7

Each of the special provisions of the bankruptcy code that I discuss in the previous chapter of this book likewise apply to a Chapter 7 bankruptcy. This includes the automatic stay under bankruptcy code section 362, the right to redetermine tax assessments under section 505, and the requirement to file delinquent returns for at least the most recent four years.

The Federal Tax Lien

A Chapter 7 bankruptcy has the same impact on a federal tax lien as does a Chapter 13. A tax lien gives rise to the claim that the tax debt is "secured." A secured debt, like a priority debt, is never discharged. However, before a tax debt is secured, not only must the lien be properly filed *prior* to filing bankruptcy, but you must own equity in assets at the time of filing bankruptcy. The tax debt is then secured but only to the extent of your equity in those assets. Please note, however, the level of security is *reduced* in direct proportion to the non-exempt assets sold by the trustee.

For example, suppose you have $25,000 in equity in all of your assets at the time of filing bankruptcy. Of that, $10,000 represents exempt assets, such as furniture, equity in your home, and a car. The remaining $15,000 represents non-exempt assets, such as a non-homestead parcel of real estate. Assume your tax debt is $100,000.

At the time of filing bankruptcy, the secured debt is $25,000 (the value of all equity). The unsecured, dischargeable debt (assuming all five rules are met) is $75,000. The secured debt is reduced if the trustee liquidates the non-exempt assets because the proceeds of the liquidation are designated to the secured debts. Therefore, in this example, the secured tax debt is reduced from $25,000 to $10,000 from the potential sale of the non-exempt assets.

All assessments in excess of your equity are considered unsecured. Hence, they are subject to discharge in Chapter 7 if they meet all five rules.

What Happens if My Equity is Substantial?

As you know, upon discharge, the tax lien remains effective *only* as to property owned at the time of filing bankruptcy, per bankruptcy code section 522(c). After-acquired property is not subject to the lien. This can create a problem if your equity is substantial. There are two factors causing the problem.

First, when the IRS recognizes that substantial equity in exempt assets exists at the time of filing, it does not release its tax lien upon discharge. Second, because secured debts are not discharged, one may face renewed enforced collection after the bankruptcy. For example, if your bankruptcy documents reveal you have $20,000 equity in your house, the IRS may push for collection of that equity once your bankruptcy is closed. Having just passed through bankruptcy, it is unlikely you would have $20,000 in cash to pay the IRS. This potentially places your home at risk.

Simply filing another bankruptcy to stop renewed enforcement is not an option. This is because of the limitations on filing multiple bankruptcy cases. The filing limitations apply as follows:

1. You are allowed one Chapter 7 discharge every eight years,
2. You are limited to one Chapter 13 every four years if you were previously granted a discharge under Chapter 7 (or certain other chapters of the bankruptcy code), and
3. You are limited to one Chapter 13 every two years if you were previously discharged under Chapter 13.

As a consequence of these limitations, you must consider other options for dealing with enforced collection. Such options might include:

1. **Obtaining uncollectible status** if your disposable income is such that you cannot make a payment. Since you have a four-year waiting period from the date of filing your Chapter 7 before filing Chapter 13, it may be possible to wait that out on uncollectible status, and then pursue a Chapter 13 to pay secured debt under the protection of the bankruptcy court if your income increases.
2. **Filing an Offer in Compromise.** Filing an OIC post-Chapter 7 can be very effective since it becomes fairly well settled that you cannot borrow money to pay the IRS. However, you would have to find a way to liquidate any equity in assets to fund the OIC. An Effective Tax Administration OIC may be particularly effective in such a case, especially if your age, health and earning capacity are such that you have a seriously diminished capacity to provide for yourself going forward.
3. **Negotiating a Partial Pay Installment Agreement (PPIA).** A partial pay installment agreement can be very effective when you have equity in assets but no capacity to borrow money. This will stabilize collection while running out the waiting period for a Chapter 13, or even the collection statute of limitations if it is not too far off. See Chapter 11 for my discussion of the PPIA.
4. **Borrowing money from a third party** to fund the payoff of the IRS's lien. In a situation like that, the IRS is often willing to negotiate downward the value of its claim in exchange for cash.

The Final Analysis

As I declared in the previous chapter of this book, an accurate analysis of whether and to what extent a Chapter 7 can benefit you can only be determined after an evaluation of all your facts and circumstances. Here I provide some firm guidelines to get you close enough to warrant further consideration with counsel.

1. Separate your tax debts into the four categories of debt we identified. They are: a) priority debt, b) otherwise non-dischargeable debt (taxes that do not meet the return-filed rule or the no fraud rule), c) secured debt, and d) non-priority debt. Be sure to pay close attention to the rules of determining priority and non-priority debts. Also review the process of determining secured debt. Ascertain the total amount in each category.
2. After determining the amount of tax dischargeable in a Chapter 7, ask yourself whether it is worth filing bankruptcy to win a discharge with respect to that amount.
3. You must then ascertain the amount, if any, of priority debts, secured debts and otherwise non-dischargeable debts remaining after the discharge. If full payment of those amounts is not possible, a Chapter 13, rather than Chapter 7, may be necessary to fully resolve your tax problem.

Planning for Bankruptcy

Nobody wants to file bankruptcy unless there is no other option. More than that, the IRS does not want you to file bankruptcy. It is as afraid of the "B" word as you are. The reason is, in most cases, the IRS gets nothing when one files bankruptcy, especially in a Chapter 7.

Therefore, I say the best way to *avoid* bankruptcy is to carefully plan to *execute* a bankruptcy if necessary. Walk softly, but carry a big stick—the "B" stick. If the IRS proves uncooperative, unreasonable or unwilling to make concessions, use it. Hit the agency over the head—hard. Believe me when I say the IRS has already been stunned by thousands of citizens who have done the same thing.

The following steps should be taken while negotiating with the IRS under any of the other amnesty programs discussed in this book. Taking these steps puts you into position where you can negotiate the best possible solution to your case, and most likely *without* having to file bankruptcy.

Obtain a copy of your Individual Master File (IMF) for each of the years you owe taxes. That document reveals all assessments for tax, interest and penalties for each year in question. It shows the return filing date and the assessment date, etc. It also shows whether a civil fraud penalty has been assessed.

Utilize the IMF to determine priority and non-priority debts. It is the only way to prove with certainty the return filing dates, the assessment dates, and whether the fraud penalty is assessed.

If you are presently under an installment agreement, immediately begin designating all installment payments to priority taxes. This step is important because, as I explained in Chapter 5, undesignated payments are applied in a manner that best suits the IRS. Typically, the IRS applies those payments to the *earliest* tax year in question, then works forward as the liabilities are paid in full.

By applying partial payments to the latest tax year—the priority year—you may accomplish two goals. First, because interest assessments are smaller in the later years, more of the payment applies to the tax so the total liability is satisfied faster. Second, because the priority years are not dischargeable, they must be paid in any bankruptcy. Any payments applied to dischargeable years are, in effect, wasted. By applying them to the priority, non-dischargeable years, you work steadily to reduce the amounts that must be paid anyway. Be warned, however, that the IRS may take the position that it has the right to apply payments under an installment agreement in the manner that best suits the government. But you must try.

If your debts are for *employment taxes*, be careful to designate all payments to the trust fund assessments. Remember, trust fund liabilities are not dischargeable—period.

For the manner in which to designate payments, please see Chapter 5, under the heading, *Special Considerations for Employment Taxes*. Use the letter discussed there to designate income tax payments as well. Simply rephrase the letter to cover the tax year in question.

If your employment tax debts are related to an operating corporation, consider terminating operations immediately if you cannot accomplish the goals stressed in Chapter 5, under the heading, *Stop the Bleeding*. By terminating operations, the trust tax liabilities will not grow worse. Also, when corporate operations are terminated, the IRS assesses the Trust Fund Recovery Penalty against the responsible officers. However, that assessment *cannot include* non-trust taxes. Therefore, you effectively reduce the tax bill by as much as 25 percent, considering penalties. The remaining trust taxes are subject to repayment in a Chapter 13, if that becomes necessary.

Consider a penalty abatement strategy as set forth in Chapter 9. By winning abatement of penalties and the interest on the penalties, you may eliminate the need to file bankruptcy.

Consider filing an Offer in Compromise prior to filing bankruptcy. Given the IRS's "fresh start" administrative policy, you are likely to meet with success, especially if your tax debts are dischargeable in bankruptcy at the time of filing the OIC. As discussed in Chapter 12, that gives you great leverage in negotiating a reasonable settlement.

But pay *close attention* to this word of caution. Keep in mind that filing an OIC before you meet the 240-day rule tolls that waiting period. The 240-day period is tolled for the time the offer is pending, plus thirty days. Review the discussion of the *Rules for Discharging Taxes*, expressed in Chapter 13 of this book.

You might also consider an Effective Tax Administration OIC as a means of presenting a so-called "tax only offer." If accepted, it might eliminate the need to file bankruptcy. A tax only offer is one that proposes to pay just the tax without regard to penalties or interest. Because the penalties and interest may triple a tax bill, this relief alone can be very important.

Moreover, you should know tax penalties are dischargeable in bankruptcy even if the underlying tax is not. Two of the more convoluted bankruptcy code sections dealing with taxes and penalties are sections 523(a)(8)(A) and (B).

After carefully tracing the quadruple negative used in these sections, I conclude that a penalty is dischargeable when it relates to a transaction or event occurring at least three years before filing in bankruptcy. For example, if you are charged with the penalty for failure to pay a tax due more than three years before you filed bankruptcy, the penalty is dischargeable even if the tax is not.

This rule applies equally to the fraud penalty. When fraud is imposed with regard to a particular year, the no fraud rule expressed in section 532(a)(1)(C) prevents discharge of the tax. However, the fraud penalty itself, assessed at the rate of 75 percent of the tax, is dischargeable under 523(a)(8)(B), provided it meets the rule I just articulated. For more guidance on discharge of the fraud penalty, see *Byrum v. Internal Revenue Service*, 92-1 USTC 50,275 (D.C. Cal. 1992). See also: *In re Wilson*, 394 B.R. 531, 542

(Bankr. Colo. 2008); *In re Mixon*, Case No. 05-86866-BJH-7 (Bankr. N.D. Tex. 2008) (Memorandum Opinion); and *In re Pitts*, 497 B.R. 73, 81-82 (Bankr.C.D.Cal., 2013).

The one sure way to guarantee success in any negotiation is to negotiate from a position of strength, not weakness. Do not perceive the need to file bankruptcy as a weakness. When dealing with the IRS, unmanageable tax debts, and potentially unreasonable revenue officers, the ability to file bankruptcy is a compelling *strength*. By maneuvering yourself into a position to strike quickly, you very well may eliminate the need to ever use bankruptcy as a tool.

And the reason you did not have to use it is because you found tax amnesty through one or more of the other strategies addressed in this book. The important thing is to be sure your options are open. You must always consider the long-term implications of your actions. Never employ any tactic without regard to its impact on your overall goal—to win amnesty.

Conclusion

The right to discharge taxes in bankruptcy is the tool that brought the IRS to its knees. It is, more than anything else, what forced the issue on the “fresh start” attitude. Beyond the fact that it can save you a fortune in taxes, it can force the IRS to deal with you more reasonably, more realistically, and in good faith.

Review Questions

1. What is created when a petition is filed under Chapter 7?
   A. Liquidation
   B. Wage-earner's plan
   C. Bankruptcy estate
   D. Straight bankruptcy

2. If an individual's debts are primarily consumer debts, what does the bankruptcy law require?
   A. Chapter 7
   B. Credit counseling
   C. Automatic discharge
   D. Chapter 13

3. What is one of the reasons why tax debt cannot be considered consumer debt?
   A. Consumer debt results from the earning of money
   B. Volition is essential to the classification of the debt
   C. There is no extension of credit involved in accruing tax debt
   D. Consumer debt is incurred for the public welfare

4. How often is a taxpayer allowed a Chapter 7 discharge?
   A. Once every eight years
   B. Once every two years
   C. Once every three years
   D. Once every four years

5. Which of the following should be considered in order to prevent a "tax-only offer"?
   A. Effective Tax Administration OIC
   B. Fresh start policy
   C. Negotiating a PPIA
   D. Borrowing money from a third party

Review Answers

1. A. Incorrect. A liquidation is not created when a petition is filed under Chapter 7. The "fresh start" program is administered under Chapter 7 and it is sometimes referred to as a liquidation.
   B. Incorrect. A wage-earner's plan is not created when a petition is filed under Chapter 7. Many citizens faced with IRS debt cannot solve their problem with a wage-earner's plan, and resort to Chapter 7 "fresh start."
   C. **Correct.** Filing a petition under Chapter 7 creates a legal entity known as the "bankruptcy estate."
   D. Incorrect. A straight bankruptcy is not created when a petition is filed under Chapter 7. The "fresh start" program is administered under Chapter 7 and it is sometimes referred to as a straight bankruptcy.

2. A. Incorrect. The bankruptcy law does not require Chapter 7 if an individual's debts are primarily consumer debts. Bankruptcy law may now preclude a taxpayer from filing under Chapter 7 under certain circumstances.
   B. Incorrect. The bankruptcy law does not require credit counseling if an individual's debts are primarily consumer debts. The Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) requires debtors to obtain credit counseling.
   C. Incorrect. The bankruptcy law does not require automatic discharge if an individual's debts are primarily consumer debts. Credit card debtors used to be able to file an unrestricted Chapter 7 to get a full and automatic discharge of the debt without having to pay anything to creditors.
   D. **Correct.** The bankruptcy code requires that a mandatory Chapter 13 applies when an individual's debts are primarily consumer debts.

3. A. Incorrect. One of the reasons that tax debt cannot be considered consumer debt is not because consumer debt results from the earning of money. Taxes, and not consumer debt, arise from the earning of money.
   B. Incorrect. One of the reasons why tax debt cannot be considered consumer debt is not because volition is essential to the classification of tax debt. Instead, volition is essential to the classification of a debt as consumer debt.
   C. **Correct.** One of the reasons why tax debt cannot be considered consumer debt is that, unlike taxes, consumer debt normally involves the extension of credit.
   D. Incorrect. One of the reasons why tax debt cannot be considered consumer debt is not because consumer debt is incurred for the public welfare. Instead, taxes are imposed by a government for the public welfare.

4. A. **Correct.** An individual is allowed one Chapter 7 discharge every eight years.
   B. Incorrect. A taxpayer is not allowed a Chapter 7 discharge every two years. A citizen is limited to one Chapter 13 every two years under certain circumstances.
   C. Incorrect. A taxpayer is not allowed a Chapter 7 discharge once every three years. Taxpayers may not utilize Chapter 7 as often as every three years.
   D. Incorrect. An individual is not allowed a Chapter 7 discharge once every four years. A taxpayer is limited to one Chapter 13 every four years if he or she was previously granted a discharge under Chapter 7.

5. A. **Correct.** A citizen should consider an Effective Tax Administration OIC as a means of presenting a "tax only offer."
   B. Incorrect. A fresh start policy should not be considered in order to present a "tax only offer." The fresh start program is designed for those with little to lose and much to gain by exercising the right to wholly eliminate staggering IRS debts.

C. Incorrect. Negotiating a PPIA is not what should be considered in order to present a “tax only offer.” A partial pay installment agreement can be very effective when an individual has equity in assets but no capacity to borrow money.
D. Incorrect. Borrowing money from a third party is not to be considered in order to present a “tax only offer.” An option for dealing with enforced collection is the consideration of borrowing money from a third party to fund the payoff of the IRS’s lien.

Abbreviations

ACS—Automated Collection Service
AO—Appeals Officer
BAPCPA—Bankruptcy Abuse Prevention and Consumer Protection Act of 2005
BC—Bankruptcy Code
BMF—Business Master File
CAP—Collection Appeal Program
CDP—Collection Due Process
CI—Criminal Investigation function
CIS—Collection Information Statement
COD—Cancellation of Debt
COIC—Centralized Offer in Compromise Unit
CSED—Collection Statute Expiration Date
DDIA—Direct Debit Installment Agreement
DETL—Disqualified Employment Tax Levy
DIF—Discriminate Income Function
EH—Equivalent Hearing
ERISA—Employees' Retirement Income Security Act
ETA—Effective Tax Administration
FICA—Federal Insurance Contributions Act (Social Security)
FMV—Fair Market Value
FOIA—Freedom of Information Act
FTA—Fraud Technical Advisor, or First Time Abate Policy
FUTA—Federal Unemployment Tax Act
GAO—Government Accountability Office, formerly General Accounting Office
IA—Installment Agreement
IMF—Individual Master File
IRA—Individual Retirement Account
IRC—Internal Revenue Code
IRM—Internal Revenue Manual
IRS—Internal Revenue Service
LS—Local Standards
NFTL—Notice of Federal Tax Lien
NOD—Notice of Deficiency, or in a CDP case, Notice of Determination
NS—National Standards
NTA—National Taxpayer Advocate
OIC—Offer in Compromise
PPIA—Partial Pay Installment Agreement
QSV—Quick Sale Value
RA—Revenue Agent
RCP—Reasonable Collection Potential
RO—Revenue Officer
SA—Special Agent
SO—Settlement Officer
SFR—Substitute for Return
TA—Taxpayer Advocate
TAO—Taxpayer Assistance Order
TAS—Taxpayer Advocate Service
TBRA—Taxpayers' Bill of Rights Act 1988
TBRA2—Taxpayers' Bill of Rights Act 2 1996

TC—Transaction Code
TDA—Tax Delinquency Account
TDI—Tax Delinquency Inquiry
TFRP—Trust Fund Recovery Penalty
TIGTA—Treasury Inspector General for Tax Administration
TS—Transportation Standards
USC—United States Code

Glossary

A

Ad Valorem: Based upon a percentage. Tax penalties are usually ad valorem penalties, based upon a percentage of the tax.

After-Acquired Property: Property acquired after the occurrence of a specific event. As used here, it refers to property acquired after the filing of a Notice of Federal Tax Lien or after the filing of a petition in bankruptcy. See Chapter 7 and Chapter 13.

Anti-Injunction Act: IRC §7421; prevents the federal courts from issuing an order, known as an injunction, stopping the IRS from taking action.

Appeals Office: An IRS function established to negotiate settlements in unresolved cases. Appeals has jurisdiction to settle audits, review penalty assessments, conduct collection due process appeals, and negotiate Offers in Compromise.

Area Counsel: The IRS's staff of in-house lawyers whose job it is to represent the IRS in certain litigation and other legal matters. For example, Area Counsel represents the IRS in all Tax Court proceedings. Area Counsel reviews all recommendations for criminal prosecution and in some cases, Offers in Compromise.

Assessment: The act of recording a debt on the IRS's accounts. Once the assessment is in place, collection may begin. A valid assessment requires a signed assessment certificate, usually IRS Form 23C. See Deficiency Procedures and Notice of Deficiency.

Assessment Statute of Limitations: The legal period in which the IRS may assess a tax. Taxes owed pursuant to a filed return must ordinarily be assessed within three years of filing. Certain circumstances push the assessment limitation to six years. If no return is filed, there is no period of limitation. See *How to Win Your Tax Audit*.

Audit Reconsideration: The procedure for re-opening a closed audit file. This is used to correct improper or erroneous assessments where no previous appeal was taken or available.

Automated Collection Service (ACS): The Automated Collection Service is a collection function designed to collect unpaid assessments as quickly as possible through an automated process. ACS has the power to issue liens and levies if payment is not made. ACS also provides phone service for those calling the IRS regarding collection action. See Collection Function.

Automatic Stay: Bankruptcy code §362. It takes effect immediately upon filing a bankruptcy petition and prevents creditors, including the IRS, from commencing or maintaining any action to collect a debt while the bankruptcy is pending. See Chapter 7 and Chapter 13.

B

Bankruptcy Code: Title 11, United States Code. This is the body of law that sets forth all bankruptcy statutes, rules, and procedures. See United States Code.

Bankruptcy Court: The federal courts that administer bankruptcy filings and related litigation. See Chapter 7 and Chapter 13.

Bankruptcy Estate: The legal entity created upon the filing of a bankruptcy case. The estate becomes the owner of all property the debtor owned at the time of filing bankruptcy. The debtor's non-exempt property is transferred to the estate upon filing bankruptcy. See Exempt Property.

BAPCPA: The Bankruptcy Abuse Prevention and Consumer Protection Act, a bankruptcy reform law passed in 2005.

Burden of Proof: The legal requirement to persuade a fact finder, such as a judge or jury or, in tax controversies, the IRS, of the legitimacy of your claim. If you carry the "burden of proof," you are required to prove you are legally entitled to the relief you seek.

Business Master File (BMF): The IRS's internal record of account for a business tax return, such as Form 1120 (corporate income tax return) or Form 941 (employment tax return). See Individual Master File.

C

CAP Appeal: Collection Appeal Program; this administrative appeal is available to deal with emergency collection situations such as a levy that is improper or causing a hardship. See Collection Due Process Hearing.

Centralized Offer In Compromise Unit (COIC): The function responsible for evaluating and passing on the acceptance of OICs. The COIC Unit receives OICs, does the background investigation, and makes an initial determination on the OIC's acceptability, which is subject to appeal. See Offer in Compromise.

Chapter 7: The chapter of the bankruptcy code that provides for a full liquidation of non-exempt property and discharge of all dischargeable debts. Chapter 7 is sometimes referred to as straight bankruptcy. See Exempt Property.

Chapter 13: The chapter of the bankruptcy code that provides for payment of some debts and partial discharge other debts. it is known as the wage-earner's repayment plan since all creditors in a Chapter 13 must receive a "dividend" or partial payment. The debtor's assets are not liquidated in a Chapter 13.

Collection Due Process Appeal: The process of making an administrative appeal of IRS collection action. The appeal is directed to the appeals office, which has authority to issue binding decisions in collection appeal matters. Appeals may be taken of any collection action, including liens, levies and seizures.

Collection Due Process Hearing: The collection appeal rights under code sections 6320 and 6330. The CDP process allows to you appeal threatened levy action if you respond within thirty days to a Final Notice, Notice of Intent to Levy. You can also appeal the filing of a federal tax lien if you respond within thirty days of receiving notice of a lien filing.

Collection Function: The division of IRS responsible for collecting tax assessments. See Revenue Officer.

Collection Statute of Limitations: Code §6503 provides a limit on the time in which the IRS may collect a tax. Subject to certain acts which extend the collection statute expiration date (CSED), the IRS's right to collect dies after ten years. See Tolling.

Community Property: State law that creates a "community estate" in property acquired during marriage where both husband and wife enjoy a vested, one-half interest in the assets of each other, regardless of whose name the property is held. The community states are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin.

Criminal Investigation (CI): The division of IRS responsible for investigating possible violations of the federal criminal tax laws and related federal laws. See Miranda Warning and Special Agent.

Criminal Statute of Limitations: The time limit under code §6531 in which the IRS may charge a crime. Ordinarily a crime must be charged within six years of the date of filing the return or of the return due date.

Current Taxes: Taxes for the present year. For example, if it is presently the month of March, 2016, the "current" year is 2016, despite the fact that your 2015 return is the next return due to be filed. Being "current" on your taxes also refers to filing the return due for the most recent tax year, which in this example is 2015.

D

Debtor: A person who owes a debt. In the context of the federal bankruptcy laws, the person who filing a petition under Chapter 7 or Chapter 13.

Deficiency Procedures: The administrative procedures the IRS must follow to achieve an assessment. Without a proper assessment, the IRS may not lawfully pursue collection. See Notice of Deficiency.

Designated Payment: A voluntary payment in which the citizen specifically instructs the IRS as to the tax year and type of tax to which the payment must be applied. A voluntary payment is one that is not procured through enforcement action, such as levy, seizure, or offset of a refund.

Discharge: The act or process by which a debtor is relieved of debts pursuant to an order of the Bankruptcy Court.

Discriminate Income Function System (DIF): The computer program used to select most returns for examination. The program compares every line of your return with national and regional averages for a person in your same income category and profession. If any line of your return is at variance with the average, the difference is scored; the higher the score, the greater the likelihood of audit.

Disposable Income: When used in connection with the IRS's installment agreement and Offer in Compromise processes, it is the amount available to make a monthly payment or fund an offer. See local standards, national standards, and transportation standards. When used in connection with the bankruptcy code, it is the amount available to fund a payment plan under a Chapter 13.

District Court: The primary or introductory branch of the federal court system. The district courts have limited jurisdiction to hear controversies involving the tax laws of the United States.

Dividend: A partial payment. When used in connection with Chapter 13, a dividend is a partial payment to a creditor against his claim.

E

Effective Tax Administration OIC: An OIC procedure that allows you to negotiate a settlement for less than the assessed amount, even if you owe the tax and have the resources to pay it. See OFFER IN COMPROMISE.

Effective Tax Rate: The ultimate rate of tax that is paid after considering all income and tax liabilities, without regard to deductions. To figure your effective federal tax rate, add all federal tax liabilities, including income and Social Security taxes. Divide the total by gross income, before any deductions whatsoever. The product (a fraction) is the effective rate at which you pay federal taxes. That fraction is the percentage of tax you pay on every dollar you touch.

Employment Taxes: Taxes assessed on wages paid to employees. These include Social Security (FICA) and unemployment (FUTA) taxes. See Trust Taxes and Non-Trust Taxes.

Equivalent Hearing: A hearing equivalent in scope and format to a CDP hearing. This appeal is available if you missed the thirty-day deadline for filing a CDP hearing but file a request within one year of either the Final Notice or the Lien Notice. The IRS gives you a hearing "equivalent" to a CDP hearing but there is no right to a Tax Court appeal from the decision at the equivalent hearing. See Collection Due Process Hearing.

Examination Function: The IRS function responsible for examining or auditing personal and business tax returns. Its primary function is to determine the "correct" tax liability. See Revenue Agent.

Exempt Property: When used in connection with IRS collection, exempt property is that which is legally beyond the IRS's reach. IRC §6334 spells out property exempt from levy. When used in connection with the bankruptcy code, it is property that does not become a part of the bankruptcy estate. therefore, it is not subject to the trustee's power to liquidate. See Non-Exempt Property.

F

Future Income Collateral Agreement: A contract with the IRS that gives the IRS a percentage of your future income based upon negotiated terms and conditions. This contract is used in the OIC process. See Offer in Compromise.

H

Hardship: When a person is unable to pay ordinary and necessary living expenses. A condition can lead to serious privation if collection action is carried out. See Taxpayer Advocate and Taxpayer Assistance Order.

I

Independent Contractor: A self-employed person who makes his services available to the public on a contract basis. Such a person pays his own expenses, buys his own tools, controls the workplace and the manner in which his work is performed, and pays his own taxes.

Individual Master File (IMF): The IRS's internal record of account for an individual tax return, Form 1040. See Business Master File.

Information Return: A form that transmits information to the IRS. These include: 1) Form W-2, *Wage and Tax Statement*, showing wages and withholdings to employees, and 2) Form 1099, *Non-employee Compensation*, showing payments to non-employees, such as Independent Contractors.

Injured Spouse: A spouse who does not owe money to the IRS but whose separate share of a tax refund owed on a jointly filed tax return is seized to pay the separate debt of her spouse.

Innocent Spouse: One who files a joint income tax return for which the IRS assesses additional taxes because of either unreported income or bogus deductions attributable to the other spouse.

Insolvency Unit: An adjunct to the collection function responsible for handling the procedural aspects of tax bankruptcies.

Installment Agreement: A written agreement to pay a fixed monthly payment to satisfy the tax debt owed. See Partial Pay Installment Agreement.

Internal Revenue Code (IRC): The tax laws as written and enacted by Congress. This is the law of the United States with respect to taxation, codified under Title 26, United States Code. See United States Code.

Internal Revenue Manual (IRM): The administrative procedures written by the IRS to guide its agents, officers, and employees in the conduct of their official duties. The IRM is not law. See Internal Revenue Code.

J

Jeopardy: A condition that exists when one is taking steps to place himself or his assets out of the reach of the IRS. When jeopardy exists, the IRS need not follow the deficiency procedures or issue a Notice of Deficiency to obtain an assessment. rather, it may make a "jeopardy" assessment and immediately begin collection.

Jurisdiction: The legal power or authority of an official body such as a court or agency of government.

L

Levy: The enforced collection process of attaching property such as wages, bank accounts, etc. A levy transfers title of the property to the IRS, subject to certain limitations.

Lien: The enforced collection process of recording a security interest or potential security interest in favor of the IRS in and to real and personal property. A lien does not transfer title of the property. However, it prevents its disposition without satisfying the lien.

Liquidation: The process of forcibly selling assets, especially real estate. This can occur both by the IRS administratively, and by a trustee of the bankruptcy court through the court process.

Local Standards (LS): Fixed personal living expenses the IRS has established to standardize the process of negotiating installment agreements and Offers in Compromise. Local standards apply to housing and utility expenses. See National Standards and Transportation Standards.

M

Miranda Warning: A statement of constitutional rights read by Special Agents to suspects who are targets of a criminal investigation. See Criminal Investigation.

N

National Standards (NS): Fixed personal living expenses the IRS has established to standardize the process of negotiating installment agreements and Offers in Compromise. National Standards apply to food, utilities, housekeeping supplies, clothing and clothing services, personal care products and services, and miscellaneous items. See Local Standards and Transportation Standards.

Net Payroll: The process of paying employees their net wages, after accounting for all tax withholding requirements, but then not paying the taxes to either the IRS or the state authorities. See Employment Taxes, Trust Taxes and Non-Trust Taxes.

Non-Exempt Property: Property not exempt from levy or sale by the IRS. When used in connection with the bankruptcy code, it is property that becomes property of the estate and is therefore subject to liquidation by a trustee.

Non-Filer Program: The IRS program in which non-filers are offered the opportunity to get back into the system without fear of criminal prosecution.

Non-Priority Debt: Debts, including federal income tax debts, which are discharged under bankruptcy law if they meet the applicable rules set forth in bankruptcy code §507(a)(8). See Priority Debt.

Non-Trust Taxes: Employment taxes that are not withheld from the pay of employees. These taxes include unemployment taxes (FUTA) and matching Social Security (FICA) taxes. See Trust Taxes.

Notice of Deficiency (NOD): The final administrative determination that you owe additional taxes. This is the formal notice that must be mailed before the IRS can assess taxes. It provides ninety days in which to file a petition in the tax court. The IRS must wait the ninety-day grace period before making any assessment. If a tax court petition is filed within the ninety-day period, no assessment can be made until the court's decision is final. The NOD is often referred to as the "ninety-day letter." See Deficiency Procedures.

Notice of Determination (NOD): The final administrative determination issued by a settlement officer in a collection due process appeal. This notice must be mailed to the citizen before the IRS may resume collection action. The citizen has thirty-days from the date of the Notice of Determination in which to file a petition with the tax court for a review of the decision.

O

Offer In Compromise (OIC): IRC §7122. The formal process by which one offers the IRS less than full payment of a tax when he can show either that he is unable to pay the amount assessed, does not owe the amount assessed, or that full payment would cause Hardship.

Office of The Taxpayer Advocate: A function of the IRS that is completely independent of any enforcement function of the agency. The Taxpayer Advocate functions as a liaison between the IRS and the taxpayer with the authority to step in when normal channels have failed. The Taxpayer Advocate can order the IRS to take action, or cease any actions, which are causing or will cause hardship to a taxpayer. See Taxpayer Advocate and Taxpayer Advocate Service.

Offset: The process the IRS uses to seize a refund due for any tax year in order to apply it to outstanding assessments for another year.

One-Year Rule: Provides that citizens who have excessive personal expenses above those authorized by national standards, local standards, and transportation standards, are given one year in which to make adjustments to their lifestyle in order that the excess may be applied to the installment payment amount.

P

Partial Pay Installment Agreement: An installment agreement that pays a fixed payment regardless of the debt owed, for the time left on the collection statute. If the collection statute has more than two years left, the agreement runs for twenty-four months and is then subject to review. See Installment Agreement.

Priority Debt: Debts defined under Bankruptcy Code §507 which are never discharged. Taxes are priority debt only if they do not meet the rules set forth in Bankruptcy Code §507(a)(8). See Non-Priority Debt.

Q

Quiet Title Action: Title 28, United States Code, §2410, empowers the federal courts to consider cases in which the United States asserts a claim to real property. The presence of a federal tax lien constitutes such an assertion. Under the law, the court may determine the conflicting interests of the parties and in that manner "quiet" title, meaning settle the title dispute.

R

Reasonable Collection Potential: The amount of money the IRS believes you can pay over time to satisfy your tax debt. This is usually the minimum amount required for the IRS to accept an Offer in Compromise. See Offer in Compromise.

Revenue Agent: An IRS employee responsible for determining one's correct liability through the audit process. See Examination Function.

Revenue Officer: An IRS employee responsible for collecting assessed taxes debts. See Collection Function.

S

Statute: A law of the United States or of a State. See United States Code.

Secured Debt: Bankruptcy Code Section 506 defines a secured debt as one that is perfected by filing the proper documents, such as a mortgage or tax lien, with a public recorder's office. After such filing, the debt is considered secured to the extent of the debtor's equity in the property. Such debts are not discharged in bankruptcy court.

Settlement Officer: An IRS employee within the Office of Appeals who conducts CDP hearings, Equivalent Hearings, and CAP appeals. See Collection Due Process Hearing and Cap Appeal.

Special Agent: An IRS employee responsible for conducting investigations into the possible violations of tax and other criminal financial laws. See Criminal Investigation and Miranda Warning.

Subordination: The process by which the IRS moves its lien into an inferior position to that of another creditor. The priority of one's lien position is generally determined by the timing of its filing. For example, if a bank's mortgage lien pre-dates an IRS lien, the mortgage lien has priority over the IRS lien.

Substitute For Return (SFR): A tax return made by the IRS under the authority of IRC §6020. This allows the IRS to make a return for a citizen when none has been made by him, or where a false return has been filed.

Summons: An administrative tool used to command the production of documents and the testimony of witnesses. It is used by all IRS enforcement functions. IRC §7602.

Summons Enforcement Proceeding: A legal proceeding in District Court in which the IRS seeks a court order requiring a person to comply with a summons.

T

Tax Collection Waiver: A voluntary waiver of the collection statute of limitations by a citizen. The waiver is accomplished by signing IRS Form 900. See Collection Statute of Limitations.

Tax Court: The federal court with the primary authority to resolve disputes between the IRS and a citizen. The court has the authority to "redetermine" deficiency determinations made by the IRS and to review collection due process determinations (among other things). To gain access to the Tax Court, one must have been mailed a *Notice of Deficiency* or *Notice of Determination* (or other appropriate IRS determination), and must file a petition within the time authorized by law.

Taxpayer Advocate (TA): The IRS official within the Office of the Taxpayer Advocate whose duty is to help citizens resolve disputes with the IRS's various enforcement functions. The TA has the authority to issue a Taxpayer Assistance Order to enforce decisions. See Taxpayer Advocate Service.

Taxpayer Advocate Service (TAS): Established under IRC §7811, the Taxpayer Advocate Service is a function entirely separate from, and not answerable to, any enforcement function. The TA has the authority to issue a Taxpayer Assistance Order stopping the IRS from taking action, or ordering the IRS to take action, if the taxpayer establishes that the IRS's actions or failures to act are causing hardship. See Office of The Taxpayer Advocate.

Taxpayer Assistance Order (TAO): An order issued by a Taxpayer Advocate requiring the IRS to cease action it is taking, refrain from taking threatened action, or take particular action. See Hardship and Taxpayer Advocate.

Tolling: The term is used to explain that a statute of limitations has stopped running. As used here, the term refers to the stopping of the collection statute of limitations. Actions that stop the statute from running are referred to as "tolling events." See Collection Statute of Limitations.

Transportation Standards (TS): Fixed expenses the IRS has established to standardize the process of negotiating installment agreements and Offers in Compromise. Transportation Standards apply to vehicle ownership costs, maintenance, operating expenses, and insurance. See National Standards and Local Standards.

Trustee: A person with a fiduciary responsibility over assets. When used in connection with the phrase TRUST TAXES, it refers to an employer who withheld money from the pay of employees. When used in connection with the Bankruptcy Code, it refers to the bankruptcy official responsible for administering the estate of the debtor for the benefit of creditors.

Trust Fund Recovery Penalty: The law allowing the IRS to make a personal assessment equal to the trust taxes that were withheld from the pay of employees but were not paid. To be assessed with this penalty, the person must be the company officer or employee with the responsibility of withholding, truthfully accounting for, and paying the trust taxes, but who willfully failed to do so. An assessment of the Trust Fund Recovery Penalty cannot lawfully include non-trust amounts. IRC §6672. See Willfulness.

Trust Taxes: Taxes withheld from the pay of employees on account of their personal income and Social Security tax debts. See Non-Trust Taxes.

U

Uncollectible Status: The process by which the IRS freezes the collection account. This happens when it is shown that a person's allowable personal living expenses meet or exceed his income, thereby making any payment impossible. The IRS also refers to this status as "currently not collectible."

United States Code (USC): The entire body of United States laws. The code is organized by topic, called a "title." Each title is dedicated to a specific area of the law and is given a number. For example, Title 26 contains all of the laws regarding federal taxes. It is known as the Internal Revenue Code. Title 11 is known as the Bankruptcy Code. Each title is broken down into sections, which are also numbered. Each section is one specific law. Thus, reference to Internal Revenue Code section 6331 is to Title 26, United States Code, section 6331.

W

Wage-Earner's Plan: A payment plan administered under Chapter 13 of the Bankruptcy Code.

Willfulness: When used in connection with the criminal tax laws, it means a voluntary, intentional violation of a known legal duty. It is the opposite of mistake, negligence, inadvertence, or misunderstanding. See Criminal Investigation. When used in connection with the Trust Fund Recovery Penalty, it means simply that a responsible officer paid another creditor at a time when he knew trust taxes were outstanding. In this context, it does not imply a bad purpose or evil motive.