MSP #2

The IRS Needs to More Fully Consider the Impact of Collection Enforcement Actions on Taxpayers Experiencing Economic Difficulties

Responsible Officials

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Definition of Problem

For the last eight years, the National Taxpayer Advocate has criticized the IRS for its continuing failure to fully and properly utilize alternatives to collection enforcement actions.[1] In light of the recent downturn in the United States economy, it is imperative for the IRS to consider the circumstances of taxpayers facing economic hardship before initiating enforcement actions. In today's economic environment, taxpayers who previously were able to pay their taxes find themselves unemployed, behind on housing payments, and unable to meet their basic living expenses. Thus, the ranks of taxpayers who are unable to meet their tax obligations will swell.

The IRS is entrusted with a wide variety of powerful enforcement tools (*e.g.*, federal tax liens, levies, property seizures, suits to foreclose the federal tax lien, and summonses) to collect delinquent tax revenue. The National Taxpayer Advocate recognizes the need for appropriate enforcement action against uncooperative or evasive taxpayers. However, when the IRS too quickly initiates "hard line" enforcement, regardless of the taxpayer's level of cooperation and compliance, and without careful consideration of the facts and circumstances and the full impact of these actions, the end result will likely be undue economic hardship on the taxpayer. This might ultimately lessen the ability of the taxpayer to resolve the debt and remain in compliance with future tax obligations.

The National Taxpayer Advocate has identified the following concerns with the IRS's current collection strategy, which, if left unchecked, will create far more problems than it resolves – worsening the financial woes of many American taxpayers, while recovering

1 *See* National Taxpayer Advocate 2007 Annual Report to Congress 374-87 (Most Serious Problem, *Offers in Compromise*), 388-94 (Most Serious Problem, *Inadequate Training and Communication Regarding Effective Tax Administration Offers*), 432-47 (Status Update, *IRS Collection Strategy*); National Taxpayer Advocate 2006 Annual Report to Congress 62-82 (Most Serious Problem, *Early Intervention in IRS Collection Cases*), 83-109 (Most Serious Problem, *IRS Collection Payment Alternatives*), 507-19 (Key Legislative Recommendation, *Improve Offer in Compromise Program Accessibility*); National Taxpayer Advocate 2005 Annual Report to Congress 270-91 (Most Serious Problem, *Allowable Living Standards for Collection Decisions*); National Taxpayer Advocate 2004 Annual Report to Congress 226-45 (Most Serious Problem, *IRS Collection Strategy*), 311-41 (Most Serious Problem, *Offers in Compromise*), 433-50 (Key Legislative Recommendation, *Offers in Compromise: Effective Tax Administration*); National Taxpayer Advocate 2003 Annual Report to Congress 99-112 (Most Serious Problem, *Offers in Compromise*); National Taxpayer Advocate 2002 Annual Report to Congress 15-24 (Most Serious Problem, *Processing of Offer in Compromise Cases*); National Taxpayer Advocate 2001 Annual Report to Congress 202-15 (Most Serious Problem, *IRS Collection Procedures*).

much less revenue than the IRS could potentially realize through more cooperative payment arrangements:

- Current IRS enforcement initiatives do not reflect a proper balance between service and enforcement;
- Increased enforcement actions such as liens and levies do not necessarily translate into increased collection revenue;[2]
- Current IRS guidance provides little direction to prevent undue economic hardship for affected taxpayers; and
- The IRS has multiple collection alternatives at its disposal, such as installment agreements (IA) and offers in compromise (OIC), but fails to properly utilize them. For example, the number of *accepted* offers has decreased by over 72 percent from fiscal year (FY) 2001 to FY 2008.[3]

Under current economic conditions, it is reasonable to expect taxpayers to experience other financial stresses, such as foreclosure on a home, unemployment, or even bankruptcy. Recent reports indicate bankruptcy filings have now increased by 29 percent from FY 2007 to FY 2008,[4] foreclosures have risen by 71 percent in the third quarter of 2008 compared to the same period in 2007,[5] and the nation's unemployment rate now stands at six percent.[6] Thus, if there was ever a time for the IRS to reevaluate its collection tactics, this would be it. An approach that balances the need for enforcement with an equal concern for customer service and taxpayer rights is more essential now than ever.

Analysis of Problem

Background

Congress Has a Long History of Emphasizing the Need for Restraint in the Use of IRS Collection Tools.

Section 6331(a) of the Internal Revenue Code (IRC) authorizes the IRS to collect taxes "by levy upon all property and rights to property" belonging to a person who "neglects or refuses to pay" any tax, and IRC § 6331(b) defines "levy" as including "the power of distraint and seizure by any means." However, over the past 30 years, Congress has enacted several

2 The number of levies issued by the IRS increased by 1,608 percent (from 220,000 to roughly 3.76 million) from FY 2000 to FY 2007. However, the increase in total collection yield during this period was only slightly less than 45 percent. Moreover, from 1998 to 2000, IRS levies *decreased* from over 2.5 million to 220,000, yet collection yield during this period actually *increased*. From FY 2001 to FY 2002, the use of IRS levies almost doubled (increased by 91 percent), yet collection yield increased by only two percent. Our analysis is based on an IRS study: IRS, Small Business/Self-Employed Division (SB/SE) Research, *"Liens, Levies, Seizures, and Total Yield: 10 Year Filing Trend,"* (Aug. 19, 2005) and then supplemented with data from various SB/SE Collection Activity Reports and Statistics of Income (SOI) Data Book information for FY 1999 to FY 2007.

3 SB/SE Collection Activity Report, *NO-5000-108* (FY 2001 - FY 2008). In FY 2001, the IRS accepted 38,643 OICs compared to 10,677 in FY 2008.

4 *See* United States Bankruptcy Court, *at* http://www.uscourts.gov/Press_Releases/2008/bankrupt_newstat_ftable_mar2008.xls (last visited Nov. 14, 2008).

5 Alan Zibel, *US Foreclosure filings up 71 percent in 3Q*, Associated Press, Nov. 6, 2008.

6 *See* United States Bureau of Labor Statistics, *at* http://www.bls.gov (last visited Nov. 14, 2008).

key pieces of legislation to properly restrain the IRS's awesome collection powers. Most recently, the IRS Restructuring and Reform Act of 1998 (RRA 98) had a profound impact on the IRS's approach to enforcement actions.[7] This important legislation placed a renewed emphasis on customer service and taxpayer rights. For example, RRA 98 significantly changed the management and oversight structure of the IRS. It also strengthened and enhanced the rights and protections applicable to taxpayers, such as:

- Establishing collection due process (CDP) hearing rights;[8]
- Requiring that the IRS receive the written approval of a U.S. District Court judge or magistrate prior to seizure of a principal residence;[9]
- Requiring an administrative review and appeal of any rejected OIC or IA;[10] and
- Realigning the IRS's method of measuring its employees' performance to encourage and achieve an even-handed approach to tax administration, particularly as it relates to enforcement activities.[11]

Over the years, the IRS has attempted to emphasize the need for an approach to administering the tax laws with proper balance between enforcement and service. IRS policies involving the collection of delinquent taxes include:

- Policy Statement P-5-1, which states, "The Service is committed to educating and assisting taxpayers who make a good faith effort to comply... In determining the appropriate enforcement action to take, factors such as the taxpayer's delinquency history should be considered. Promotion of long-term voluntary compliance is a basic goal of the Service, and in reaching this goal, the Service will be cognizant not only of taxpayers' obligations under our system of taxation but also of their rights."[12]
- Policy Statement P-5-34, which states, "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 may include

7 The Internal Revenue Service Reform and Restructuring Act of 1998 (RRA 98), Pub. L. No. 105-206, 112 Stat. 685 (1998).

8 RRA 98 § 3401(a) adding IRC § 6320 which allows a taxpayer the right to a CDP hearing within five days after filing of the first notice of federal tax lien with respect to a tax liability; RRA 98 § 3401(b) adding IRC § 6330 which allows a taxpayer the right to a CDP hearing prior to the first levy (except in special or jeopardy situations).

9 RRA 98 § 3445(a) (amending IRC § 6334(a)(13)); RRA 98 § 3445(b) (amending IRC § 6334(e)).

10 RRA 98 § 3462(c)(1) and (c)(2) (adding IRC §§ 7122(d) and 6159(e), respectively).

11 For a more detailed discussion of IRS measures, see Most Serious Problem, *Customer Service Within Compliance, infra*.

12 Internal Revenue Manual (IRM) 1.2.14.1.1 (Aug. 18, 1994).

an installment agreement, offer in compromise, notice of levy, or lien foreclosure. Seizure action is usually the last option in the collection process."[13]

- Policy Statement P-5-2, which states, "Case resolution, including actions such as lien, levy seizure of assets, installment agreement, offer in compromise, substitute for return, summons, and IRC 6020(b), are important elements of an effective compliance program. When it is appropriate to take such actions, it should be done promptly, yet judiciously, and based on the facts of each case."[14]

Moreover, the IRS revamped its procedural guidance to require collection employees (*i.e.*, revenue officers) to determine whether a taxpayer presents a "will pay," "can't pay," or "won't pay" situation when a seizure is contemplated. The guidance further stated, "Generally, seizures should be limited to those taxpayers who represent true 'won't pay' situations."[15]

IRS Enforcement Initiatives Do Not Reflect a Proper Balance Between Service and Enforcement.

In recent years, the tone of communications from the IRS Commissioner's office began to drift from the guidance drafted after RRA 98, by focusing more on enforcement than service. As former Commissioner Mark Everson noted in a 2004 speech to the Internal Revenue Service Advisory Council (IRSAC), "The word 'enforce' is one that people didn't even like to use when I turned up here. That's not the case anymore."[16] Not surprisingly, the IRS's use of enforcement tools has significantly increased each year since the lows in the years following the implementation of RRA 98. For example,

- Levies have increased by 1,608 percent (220,000 issued in FY 2000 compared to 3,757,190 in FY 2007);[17]
- Notice of federal tax lien (NFTL) filings have increased by 308 percent (167,867 filed in FY 1999 compared to 683,659 in FY 2007);[18] and
- Seizures have increased by 320 percent (161 conducted in FY 1999 compared to 676 in FY 2007).[19]

13 IRM 1.2.14.1.8 (2) (May 28, 1999).

14 IRM 1.2.14.1.2 (Feb. 17, 2000).

15 IRM 5.10.1.4 (Oct. 1, 2004) provides a detailed description of these three categories.

16 Heidi Glenn and Warren Rojas, *Everson Delays EITC Certification Effort, Backs Other IRSAC Ideas*, 105 Tax Notes 905 (2004).

17 SB/SE Collection Activity Reports and SOI Data Book information for FY 2000 to FY 2007. *See* National Taxpayer Advocate 2006 Annual Report to Congress 110-29. Note: For the purpose of our analysis, 2008 data was not used due to the impact of the 2008 economic stimulus payment (ESP) on IRS collection activities. The IRS was forced to shift many of its Automated Collection System (ACS) resources away from normal collection work for several months to focus on answering ESP questions.

18 Various SB/SE Collection Activity Reports and SOI Data Book information for FY 1999 to FY 2007. Note that the FY 2007 figures were 79 percent higher than the FY 1998 figures (382,755).

19 SB/SE Collection Activity Report, *Seizure Disposition Reports, NO-5000-33*, and SOI Data Book information for FY 1999 to FY 2007. While the current number of seizures represents only a small fraction of the FY 1998 total (2,259), the significant increase in recent years bears watching.

These increases reflect areas of emphasis within the IRS Collection program in recent years. For example, the Small Business/Self-Employed (SB/SE) Division's FY 2008 Collection Program Letter directed priority attention to "increase the timely pursuit and appropriate application of complex enforcement tools such as seizures, nominee liens, transferee assessments, and suits to protect the government's interest in liabilities owed."[20] Accordingly, the IRS developed and delivered specialized training to its collection employees on these subjects in FY 2007 and early FY 2008. Training sessions for employees working bankruptcy cases placed a great deal of emphasis on subjects such as pursuing collection actions against exempt, excluded, or abandoned assets at the conclusion of a Chapter 7 bankruptcy proceeding,[21] and initiating suits to enforce the federal tax lien in lieu of conducting an administrative seizure.[22]

The National Taxpayer Advocate has maintained a vigilant watch on these trends and devoted a large portion of her 2006 and 2007 Annual Reports to Congress to the IRS's collection strategy and programs.[23] In response to the issues raised and recommendations proposed in these reports, the IRS agreed to collaborate with TAS on several collection task forces. TAS and the IRS established five such working groups in February 2008 to address the IRS's application of allowable living expense (ALE) standards, collection payment alternatives (OIC and IA), the levy program, and early intervention techniques.[24] More recently, the IRS Chief of Collection agreed to collaborate with the National Taxpayer Advocate to develop training for collection employees on taxpayer rights and the proper use of collection alternatives.

While these joint task forces are a step in the right direction, the National Taxpayer Advocate has still noted an emerging trend in TAS cases involving collection issues. TAS is now seeing an IRS inclination to use enforcement very early in the case, rather than as a last resort. Local TAS offices and practitioners confirm the Collection function is more frequently requiring taxpayers to liquidate equity in assets, including personal residences and retirement accounts, to pay delinquent tax bills or the IRS will use its powerful collection

20 SB/SE, *SB/SE Collection Program Letter FY 2008*, 6.

21 U.S. Bankruptcy Code § 541(a)(1) provides that when a person files a bankruptcy petition, a bankruptcy estate is created consisting of "all legal and equitable interests of the debtor in property as of the commencement of the case," except for the interests identified in subsections (b) and (c)(2). Section 541(b) excludes from the bankruptcy estate certain types of property, including interests in Individual Retirement Accounts and Qualified Tuition Programs, more commonly known as 529 plans. Section 541(c)(2) excludes from the bankruptcy estate, property which is subject to an anti-alienation provision enforceable under applicable non-bankruptcy law. The Supreme Court in *Patterson v. Shumate*, 504 U.S. 753, 759-760 (1992) held that ERISA qualified pension plans are excluded from the bankruptcy estate under this section. Additionally, the debtor is allowed to exempt certain property from the bankruptcy estate under § 522. Further, property that is considered burdensome or of inconsequential value to the estate can be abandoned as property of the estate by the trustee. As a general rule, exempt or abandoned property cannot be used to satisfy any pre-petition debts during and after the bankruptcy case, unless the liens encumbering such property survive bankruptcy which would occur only if a prepetition notice of tax lien had been filed. U.S. Bankruptcy Code § 522(c)(2)(B). Unlike exempt or abandoned property, which was initially property of the estate, excluded property never becomes part of the bankruptcy estate. As such, excluded property can be used to satisfy prepetition debts *in rem* without regard to whether a prepetition notice of federal tax lien was filed because unlike with property of the estate, liens against excluded property cannot be avoided.

22 The government uses a suit to foreclose a tax lien where there is a specific, presently available source of collection. In a foreclosure action, the Department of Justice often requests a judgment against the taxpayer.

23 *See* National Taxpayer Advocate 2007 Annual Report to Congress 324-95, 432-47; National Taxpayer Advocate 2006 Annual Report to Congress 31-171.

24 For a detailed discussion of the five task forces, see National Taxpayer Advocate Fiscal Year 2009 Objectives Report to Congress 39-40.

tools to do so. IRS consideration of the current economy and the hardship consequences of these actions are not evident in many of these cases. We believe the dilemma facing these taxpayers is often a "false choice" - liquidate your assets or the IRS will do it for you. As a result, we have seen an increase in the need for TAS involvement and the use of Taxpayer Assistance Orders to provide relief in these situations.[25]

Increased Enforcement Actions Such as Liens or Levies Do Not Necessarily Translate Into Increased Collection Revenue.

As the nation faces a period of economic decline, with a corresponding decrease in tax revenues and an increase in the federal budget deficit, it is natural for the IRS to ramp up efforts to ensure all taxpayers pay their fair share of taxes. Intuitively, it seems to follow that a significant increase in the use of the IRS's more powerful collection tools would lead to a corresponding increase in collected revenue. Surprisingly, an analysis of data representing IRS enforcement actions and results does not support this assumption. In the years immediately following RRA 98, the use of traditional IRS collection enforcement actions fell substantially, primarily because of the need to implement the changes brought about by the new law. This decline eventually led to a perception that the IRS tax enforcement programs were underutilized and "out of balance." *Interestingly, IRS studies have shown the total Collection yield was actually higher from FY 2000 to FY 2002 (the years when, according to many sources, IRS Collection went "out of business") than in FY 1995 and FY 1996, the peak years for levies and seizures.*[26]

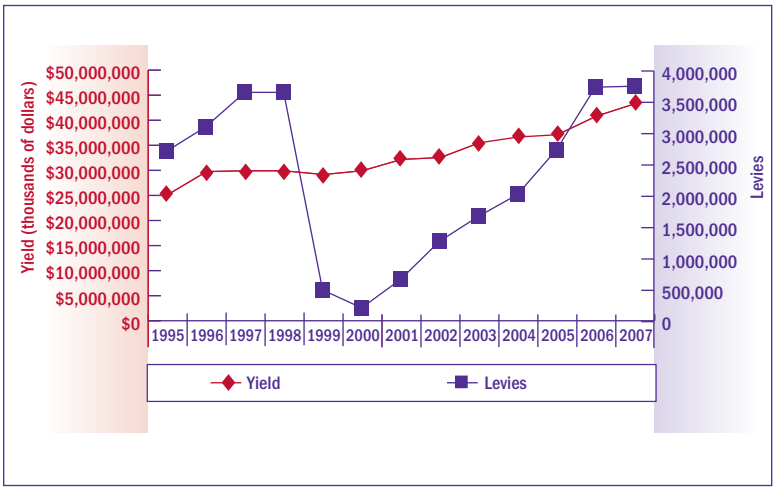
For example, the number of levies issued by the IRS increased by 1,608 percent (from 220,000 to roughly 3.76 million) from FY 2000 to FY 2007. The increase in total collection yield during this period was only about 45 percent. An analysis of this relationship on a year-to-year basis shows no direct correlation between the volume of levies issued and the corresponding collection yield. As the following chart reveals, from FY 1998 to FY 2000, IRS levies *decreased* from over 2.5 million to 220,000. Yet, collection yield during this period actually *increased!* From FY 2001 to FY 2002, the use of IRS levies almost doubled (increased by 91 percent), yet collection yield increased by only two percent. An IRS research study has concluded that although traditional enforcement actions declined substantially post-RRA 98, "total collection yield was not dramatically impacted by RRA 98," and actually increased in every year but one after RRA 98![27]

25 IRC § 7811 authorizes the National Taxpayer Advocate to issue a Taxpayer Assistance Order (TAO) when a taxpayer is suffering or about to suffer a significant hardship as a result of the manner in which the tax laws are being administered if relief is not granted. *See also* IRM 13.1.20.2 (Dec. 15, 2007). In certain circumstances, the National Taxpayer Advocate or her delegate may issue a TAO to direct the IRS to take a specific action, cease a specific action, or refrain from taking a specific action, or to direct the IRS to review at a higher level, expedite consideration of, or reconsider a taxpayer's case. IRM 13.1.20.3 (Dec. 15, 2007). In FY 2008, TAS issued 28 TAOs on collection-related matters. This accounts for slightly more than 41 percent of all TAOs issued.

26 SB/SE Research, *Liens, Levies, Seizures, and Total Yield: 10 Year Filing Trend* (Aug. 19, 2005).

27 *Id.*

CHART 1.2.1, Total Collection Yield and Levies Issued FY 1995 – FY 2007



One possible explanation for this result is that if the public perceives a more open and flexible IRS, taxpayers with collection problems might be more willing to come forward and "get right" with their government.[28] Another possible explanation is that the IRS filed liens and issued levies inappropriately – *i.e.*, in unproductive cases. It is clear that the IRS Collection operation did not actually go "out of business" during the post-RRA 98 years, but rather replaced its more traditional tools with new alternatives, including earlier intervention on employment tax cases and expanded use of streamlined IAs. While levy and seizure authority are important collection tools that allow the IRS to address serious incidents of non-compliance (*i.e.*, taxpayers who clearly "won't pay"), the data indicates that expanded use – as opposed to judicious use – of these tools does not necessarily translate into tax dollars collected. Moreover, the data indicates that reasonable collection alternatives and methods may be more effective at collecting delinquent liabilities for taxpayers having trouble in paying their tax debts.

IRS Guidance Provides Little Direction to Prevent Undue Economic Hardship on Affected Taxpayers.

TAS has reviewed the IRS procedural guidance to Collection employees that governs the nature of enforcement actions, in order to identify the degree to which an overly aggressive approach to enforcement may be facilitated, or even encouraged, by system design or emphasis. In general, we have found that the Collection portions of the Internal Revenue Manual (IRM) pertaining to enforcement actions provide little or no direction to IRS employees regarding proper pre-decisional consideration of economic hardship issues. Economic hardship is derived from IRC § 6343; however, the IRM procedures provide very

28 *See* National Taxpayer Advocate 2007 Annual Report to Congress 156-61 (Most Serious Problem, *Taxpayer Service and Behavioral Research*); National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 158-67 (*Normative and Cognitive Aspects of Tax Compliance: Literature Review and Recommendations for the IRS Regarding Individual Taxpayers*).

little actual guidance about applying this concept to actual case decisions, particularly in the areas governing enforced collection. IRM 5.19.4.4.10(j) does include an adequate explanation of economic hardship, but this guidance is for consideration *after* the IRS issues a levy, not before.

Policy Statement P-5-71 states that, "A hardship exists if the levy action prevents the taxpayer from meeting necessary living expenses. In each case a determination must be made as to whether the levy would result in actual hardship, as distinguished from mere inconvenience to the taxpayer."[29] Yet, the most commonly used enforcement action — a levy of a taxpayer's salary, wages, or bank account — is predominantly issued via automation. Thus, the IRS requires little to no human intervention to make a distinction of hardship or "mere inconvenience."[30] Similarly, the IRS's Automated Collection System's (ACS) current process of systemically filing an NFTL on cases that are "shelved" or placed into the queue (regardless of whether the IRS made or initiated contact with the taxpayer), has the potential for further economic harm in today's economic times.[31] At a time when so many homes are in foreclosure, the IRS should use caution when issuing federal tax liens, which are often more damaging than bankruptcy to taxpayers' attempts to secure credit.

Bankruptcy Does Not Always Provide a "Fresh Start" for Taxpayers with IRS-Related Debts – Even When the Tax Debts Are Discharged.

It seems that obvious economic hardship is most likely in situations where IRS enforcement actions will cause the loss of a taxpayer's home or retirement assets. The loss of a home invariably will affect the ability of a typical taxpayer to meet today's necessary living expenses, and in many cases, the loss of retirement assets will have a significantly negative impact on the taxpayer's ability to meet future living expenses. Yet, consider current IRS procedures involving taxpayers who have filed for bankruptcy protection utilizing Chapter 7 of the United States Bankruptcy Code (11 USC), commonly known as a "liquidating bankruptcy." In Chapter 7 proceedings, a debtor may claim certain property as "exempt." The trustee cannot liquidate such property, nor can it be used to satisfy a debt, except in the case of alimony, security interests, non-dischargeable tax debts, and dischargeable taxes secured by an NFTL.[32] A common asset claimed as "exempt" is the debtor's home. Other types of property are considered "excluded" from the bankruptcy estate. Generally, "excluded" property involves retirement assets (*e.g.*, Employment Retirement Income Security Act (ERISA) qualified pension plans and Individual Retirement Accounts).[33] In these

29 IRM 1.2.14.1.14 (Nov. 19, 1980).

30 For a more detailed discussion of IRS levies, *see* National Taxpayer Advocate 2006 Annual Report to Congress 110-29.

31 IRM 5.19.4.5.2 (Apr. 26, 2006).

32 IRM 5.9.17.4(1) (May 16, 2008).

33 IRM 5.9.17.4(3) (May 16, 2008). *See also*, Most Serious Problem, *Customer Service Issues in the IRS's Automated Collection System (ACS), infra.*

situations, the ability of debtors to retain their homes and retirement assets are a critical component of the "fresh start" concept that is a key element of the bankruptcy process.[34]

The IRC, on the other hand, allows the IRS to pursue assets claimed as "exempt" or "excluded" in the bankruptcies, provided the prepetition tax lien encumbering those assets survived the bankruptcy even where the taxes have been discharged. Unlike exempt property where an NFTL must have been filed prepetition for a lien to survive bankruptcy, an NFTL need not be filed prepetition in order for the IRS to take collection action against excluded property, as the statutory lien under IRC § 6321 survives bankruptcy and is sufficient to allow the IRS to collect the discharged taxes from excluded property.[35]

In recent years, the IRS has placed greater emphasis in pursuing collection on cases where a prepetition federal tax lien had been filed involving tax periods that were discharged in a Chapter 7 bankruptcy, and the taxpayer claimed a home or retirement accounts as exempt or excluded assets. Once identified, the IRS mails a letter to this taxpayer requiring him or her to either pay in full the outstanding lien interest in the property, or pay an amount equal to the available equity in the asset.[36] Otherwise, the IRS may initiate enforcement action – typically a suit to foreclose on real property or a notice of levy on retirement accounts. In some situations, the IRS may forego immediate collection from exempt property and allow the NFTL to remain on file in the prospect of collecting dischargeable taxes at some future date.[37]

In reviewing IRS procedural guidance in this area, we found very little recognition that the IRS demands on these taxpayers could create an economic hardship. Yet, these taxpayers have already been found insolvent by a bankruptcy court, which certainly would indicate they might have difficulty paying their liabilities. Particularly in light of the current U.S. economy, and the substantial tightening of the credit markets, a requirement for taxpayers to turn over to the IRS an amount equal to the equity in their homes is essentially requiring them to sell their homes in a deflated, stalled market.

We have found no evidence that SB/SE has established management controls to monitor the number of these demand letters or the volume and nature of enforcement actions initiated in these types of insolvency cases. Nor could we obtain reliable data on the number of suit to foreclose recommendations that Collection employees have made in these situations.[38] We have seen firsthand in TAS casework the serious economic harm these actions can create for taxpayers because of these suit recommendations. Consequently, we

34 11 USC § 522. Federal bankruptcy law embraces the entire field of debtor-creditor relationships to provide a uniform and equitable method to distribute the debtor's assets to the debtor's creditors. At the same time, it gives the debtor an opportunity to start over with a clean (or at least improved) financial slate.

35 IRC § 6321. A federal tax lien is created by statute and attaches to a taxpayer's property and rights to property for the amount of the liability. This is known as the "statutory" or "secret" federal tax lien.

36 IRM 5.9.17.4.1(9) (May 16, 2008).

37 IRM 5.9.17.4.2(3) (May 16, 2008).

38 SB/SE response to TAS research request (Oct. 27, 2008).

are very concerned that the increase of enforcement activity in this area, without adequate safeguards and controls or guidance to employees to fully consider the economic harm to taxpayers, may very well create negative consequences for many taxpayers who were seeking a "fresh start" through the insolvency process.

IRS Guidance Lacks Distinction as to What Constitutes a "Won't Pay" Taxpayer.

Another area in which IRS guidance fails to recognize the effects of the current economic environment is its consideration of whether a taxpayer is a "won't pay" or a "can't pay." Presently, only one IRM section contains any reference to the differing characteristics of such taxpayers.[39] Examples of "won't pay" taxpayers include:

- Taxpayers who have the ability to remain current and resolve their delinquent taxes through an alternative collection method but will not do so;
- Taxpayers who do not have the ability to remain current and resolve their liabilities, but have assets in excess of exempt amounts that will yield net proceeds to apply to the liabilities and are unwilling or unable to borrow on or liquidate these assets; and
- Taxpayers who will not cooperate with the IRS (*e.g.*, those that evade contact or withhold financial information).

Unwillingness and evasiveness are legitimate reasons to designate a taxpayer as a "won't pay." However, his or her inability to borrow is not a proper indicator, especially in today's tough lending market. Yet, under current IRS procedures, even if a taxpayer is cooperative, in compliance with current filing and payment requirements, and is making a good faith effort to resolve his or her tax liability but simply cannot quite meet all of the IRS's demands, he or she will be labeled as a "won't pay." By our account, the taxpayer "wants" to comply but "can't." Clearly, there is a significant difference between the two. It is imperative for the IRS to adapt its policies to properly reflect that enforced collection actions should only be taken where unwillingness and a lack of cooperation are present.

Moreover, in many situations where taxpayers have met our three criteria (cooperation, current compliance, and good faith efforts), the IRS uses the noncompliance that led to the taxpayer's deficiencies, and other past behavior, to justify seizure or enforcement action. In general, a taxpayer's current level of cooperation and willingness to find a way to resolve the liabilities should be judged as the standard and in such instances, the IRS should explore a viable collection alternative. This is particularly true in situations where the IRS has devoted little or no effort to contacting the delinquent taxpayers in a timely manner, and has allowed the tax problems to fester – sometimes for many years.[40]

39 IRM 5.10.1.4 (Oct. 1, 2004).

40 For more detail, *see* National Taxpayer Advocate 2006 Annual Report to Congress 62-82 (Most Serious Problem, *Early Intervention in IRS Collection Cases*).

The IRS Has Multiple Collection Alternatives at its Disposal But Fails to Use Them Properly.

Although they are not widely considered as such, IAs and OICs are in fact collection tools and not resolutions of last resort. As IRS Policy Statement P-5-2 makes clear, IAs and OICs are as useful as a lien, levy, or seizure of assets when trying to collect tax.[41] Further, Policy Statement P-5-34 provides that, "Collection enforced through seizure and sale of the assets occurs only after thorough consideration of all factors and of alternative collection methods."[42] Moreover, the statement reminds employees "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... Seizure is usually the last option in the seizure process."[43] However, TAS cases suggest the IRS is taking the position that the taxpayer must sell all assets with equity (including personal residences) or secure financing before the IRS will consider any other collection option, which seems to be contrary to IRS policy.

For example, if a taxpayer has significant equity in assets as well as the ability to make monthly payments but cannot fully pay his or her liabilities prior to expiration of the Collection Statute Expiration Date (CSED), the IRS has several potential collection alternatives at its disposal.[44] The American Jobs Creation Act of 2004 amended IRC § 6159 to clarify that the IRS is authorized to enter into IAs that do not provide for full payment of the taxpayer's liability over the life of the agreement.[45] These agreements are known as Partial Payment Installment Agreements (PPIA). IRS guidance states that, "Before a PPIA may be granted, equity in assets must be addressed, and if appropriate, be used to make payment. In most cases taxpayers will be required to use equity in assets to pay liabilities."[46] However, the same guidance also provides that, "A PPIA may be granted if a taxpayer does not sell or cannot borrow against assets with equity because ... it would impose an economic hardship on the taxpayer to sell property, borrow on equity in property, or use a liquid asset to pay the taxes."[47] Given today's economic conditions (*e.g.*, a slumping real estate market, strict lending requirements, poor credit histories, and a lack of funds to service equity loans), a taxpayer's ability to "cash in" on the equity in his or her assets may be limited. In such cases, it makes good business sense for the IRS to enter into IAs or PPIAs to collect at least those funds that are immediately available, while addressing taxpayers' economic hardship. Yet, the IRS continues to underuse PPIAs. In the past two Annual Reports to Congress, the National Taxpayer Advocate has urged the IRS to increase awareness and

41 IRM 1.2.14.1.2 (Feb. 17, 2000).

42 IRM 1.2.14.1.8(2) (May 28, 1999).

43 *Id.*

44 IRC § 6502(a).

45 *See* H.R. Rep. No. 108-755, at 1697 (2004) (Conf. Rep.).

46 IRM 5.14.2.2(2) (July 12, 2005).

47 IRM 5.14.2.2.2(2)(E) (July 12, 2005). TAS applauds the IRS for including language referencing an economic hardship in this IRM section and encourages the IRS to place similar guidance within all sections related to enforced collection actions.

usage of PPIAs.[48] In FY 2008, the IRS granted 22,555 PPIAs, which accounts for less than one percent of all IAs granted.[49]

An even more useful and successful collection payment alternative is the streamlined IA. The IRS may approve a streamlined IA where the aggregate unpaid balance of tax liabilities is $25,000 or less, and can be fully paid within 60 months or prior to the CSED, whichever comes first.[50] These agreements do not require detailed financial analysis or approval by IRS managers, and may be granted even when a taxpayer could pay the full balance sooner.[51] Yet, the IRS has recently restricted the use of streamlined IAs by requiring loan denial letters from taxpayers who would otherwise qualify if financial information reveals potential equity in assets.[52]

Although RRA 98 promoted the use of IAs as a viable collection tool, the number of agreements granted by the IRS also declined in the years after the law took effect. From 1998 to 2001, IAs decreased by over 680,000. From 1999 to 2002, the IRS experienced a corresponding decrease in revenue dollars collected through IAs – approximately $485.8 million.[53] The IRS Office of Chief Counsel's position, which questioned the authority of the IRS to enter into IAs that would not fully pay the outstanding tax liabilities, may have contributed significantly to these reductions.[54] Not until the American Jobs Creation Act of 2004 was the IRS able to resume granting IAs that would only partially pay the outstanding tax liabilities, known as PPIAs. However, as noted above, the number of PPIAs granted since the legislative change represents only a fraction of the decrease in IA activity and revenue dollars collected. We continue to question whether the IRS's overly cautious use of the PPIA represents lost opportunities to collect a significant amount of additional revenue, and afford many more taxpayers reasonable payment solutions for their tax debts.

In RRA 98, Congress encouraged the IRS to be flexible in its use of OICs.[55] Yet since the 2001 centralization of offer processing, both the number of offers submitted and the number of offers accepted have declined. Over this period, the IRS introduced many strict procedural requirements aimed at greater "efficiencies" in processing, and narrowly

48 National Taxpayer Advocate 2007 Annual Report to Congress 432-47; National Taxpayer Advocate 2006 Annual Report to Congress 86-87.

49 SB/SE Collection Activity Report, *NO- 5000-6, Installment Agreement Cumulative Report* (Sept. 29, 2008). A total of 2,624,487 IAs were granted in FY 2008.

50 IRM 5.14.5.2 (Sept. 26, 2008).

51 *Id.*

52 IRM 5.19.1.5.4.2(3) (Apr. 28, 2008).

53 SB/SE Collection Activity Report, *NO-5000-6, Installment Agreement Cumulative Report*, FY 1999 to 2002. For our analysis of dollars collected via installment agreements, we used FY 1999 to FY 2002 data to account for the fact that the revenue for installment agreements is not likely to be fully received within the same year the IA is granted.

54 *See* National Taxpayer Advocate 2001 Annual Report to Congress 210-14.

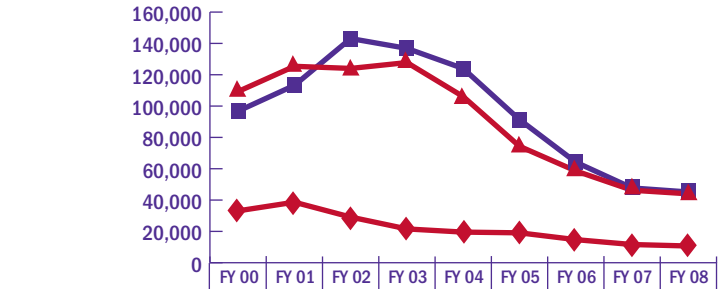
55 The conference report for RRA 98 states,

> The conferees believe that the IRS should be flexible in finding ways to work with taxpayers who are sincerely trying to meet their obligations and remain in the tax system. Accordingly, the conferees believe that the IRS should make it easier for taxpayers to enter into offer-in-compromise agreements, and should do more to educate the taxpaying public about the availability of such agreements.

H.R. Conf. Rep. 599, 105th Cong., 2d Sess., 289 (1998).

interpreted requirements imposed by Congress.[56] Not surprisingly, this approach has substantially chilled the submission of "good" OICs, with accepted offers declining by over 72 percent from FY 2001 to FY 2008.[57] As a result, and as the following chart vividly illustrates, taxpayers and practitioners no longer view the IRS offer program as a viable collection alternative.

CHART 1.2.2, IRS OIC Program, FY 2000 - FY 2008[58]



	FY 00	FY 01	FY 02	FY 03	FY 04	FY 05	FY 06	FY 07	FY 08
Receipts	109,296	125,390	124,033	127,769	106,025	74,311	58,586	46,270	43,989
Dispositions	96,763	113,209	143,102	136,822	123,970	91,343	64,169	47,719	45,163
Accepted	33,114	38,643	29,140	21,570	19,546	19,080	14,734	11,618	10,677
% Accepted	34%	34%	20%	16%	16%	21%	23%	24%	24%

Similarly, under another provision of RRA 98, Congress granted the IRS authority to accept an OIC based on Effective Tax Administration (ETA), which the IRS interprets as allowing it to compromise based on "economic hardship" or "equity and/or public policy."[59] For an individual to qualify for an ETA offer based on economic hardship, he or she must have net equity of his or her assets plus future income (reasonable collection potential) which must be greater than the amount owed and exceptional circumstances, such as when the collection of the tax in full would create an economic hardship.[60] However, guidance addressing ETA offers based on hardship is conspicuously absent from published policies and procedures governing the Collection program.[61] As discussed in the 2007 Annual Report to Congress, this guidance should include, among other things, a requirement to consider

56 *See* T.D. 9086, 68 Fed. Reg. 48,785 (Aug. 15, 2003); Treas. Reg. § 300.3 (explaining the IRS's ability to charge a user fee for offer processing and investigation); Pub. L. No. 109-222 § 509, 120 Stat. 362 (2006), effective July 16, 2006, and codified at IRC § 7122(c)(1) (explaining The Tax Increase Prevention & Reconciliation Act of 2005 (TIPRA) and allowing the IRS to require a nonrefundable partial payment of 20 percent at the time of offer submission or monthly installment payments depending on the offer type and terms). For more information regarding IRS's processing of offers, see IRM 5.8.3.4 (Sept. 23, 2008).

57 SB/SE Collection Activity Report, *NO-5000-108* (FY 2001 - FY 2008). In FY 2001, the IRS accepted 38,643 OICs compared to 10,677 in FY 2008.

58 SB/SE Collection Activity Report, *NO-5000-108* (FY 2000 - FY 2008).

59 RRA 98; H.R. Conf. Rep. 599, 105th Cong., 2d Sess., 289 (1998); Treas. Reg. § 301.7122-1(b)(3). "Economic hardship" occurs when an individual taxpayer is unable to pay reasonable basic living expenses. *See* Treas. Reg. § 301.6343-1.

60 IRM 5.8.11.2.1 (Sept. 1, 2005).

61 For a more detailed discussion of ETA OICs, *see* National Taxpayer Advocate 2007 Annual Report to Congress 388-94.

whether an ETA offer might be an appropriate collection alternative before determining to seize or recommending foreclosure on a personal residence.[62] This reminder remains a necessity as TAS continues to encounter situations where the IRS has pursued collection on the equity in taxpayers' homes, with no consideration of whether the ETA offer is a viable option.

Conclusion

The IRS has many powerful enforcement tools at its disposal to help administer the nation's tax laws. However, effective tax administration calls for the IRS to reserve the more intrusive of these tools for situations involving uncooperative taxpayers who refuse to voluntarily comply with their filing and payment requirements and who will not work with the IRS to establish reasonable payment plans. The line between "won't pay" and "can't pay" is a fine one, especially in today's tough economic times when taxpayers feel desperate. As more and more taxpayers suddenly find themselves struggling to make ends meet, it is incumbent upon the IRS to take into account the economic realities of the day. In fact, there is nothing new about this duty – it is already incorporated into many of the IRS's longstanding policy statements. When the IRS moves too quickly to collect revenue and fails to consider each taxpayer's specific circumstances, an imbalance between customer service, taxpayer rights, and enforcement is the unnecessary byproduct.

To more effectively deal with taxpayers in these difficult economic times, the IRS should consider taking the following actions: clarify or develop a new uniform policy statement that defines the concept of economic hardship; provide specific guidance requiring predecisional consideration of the concept of economic hardship in all IRM sections related to IRS Collection enforcement activities; review polices and procedures related to insolvency and the pursuit of exempt and excluded assets and establish adequate managerial safeguards and controls for situations when enforcement is appropriate; remove any procedural guidance related to the need to secure loan denial letters when a streamlined IA is an acceptable alternative; review and revise all existing policies and procedures related to collection payment alternatives such as OICs and PPIAs to allow for more flexibility and better usage in situations where economic hardship is present; continue to review and revise current case assignment practices to provide earlier intervention and resolution before a taxpayer's financial uncertainty worsens; and proceed in partnership with the National Taxpayer Advocate to develop training for collection employees on taxpayer rights and collection alternatives.

IRS Comments

The IRS understands the sensitive nature of the current economy and the potential effects it is having or will have on taxpayers. The IRS anticipates that taxpayers who previously

62 National Taxpayer Advocate 2007 Annual Report to Congress 388-94.

were able to pay their taxes may be unable to do so as a result of the economic downturn. As reflected in our current case dispositions, we already have procedures in place for taxpayers who are experiencing financial hardships and are unable to pay their tax liability. Collection alternatives such as an installment agreement, an offer in compromise, and currently not collectible status are all used to resolve taxpayer cases. We are closely monitoring our receipt patterns and installment agreement and offer in compromise defaults to be able to effectively manage an increase in taxpayer cases, a subset of which would be those with economic hardship. Additionally, we plan to expand our outreach efforts to ensure taxpayers understand the availability of payment alternatives and where to go for assistance in resolving their tax liability if they are experiencing financial hardship.

We believe our collection policies and procedures maintain the proper balance between service and enforcement. The Fiscal Year 2008 Collection Program Letter outlined collection priorities and our focus on quality and timeliness. As the National Taxpayer Advocate states, a collection priority in FY 2008 was to increase the timely pursuit and appropriate application of enforcement tools. The focus, however, was not to take more enforcement action, but to take timely and appropriate case actions. The Collection Program Letter also included priorities to:

- Ensure that employees consider all available options in resolving taxpayer accounts.
- Improve Field Collection casework quality by ensuring that employees communicate clearly with taxpayers as to what is expected and the possible consequences if expectations are not met, and that there are clear actions dates with timely follow-up.
- Improve service to taxpayers to facilitate their understanding and fulfillment of their tax responsibility.
- Identify and take action to address problems being experienced by taxpayers in the Collection program

The use of enforcement action is authorized by the Internal Revenue Code and Treasury Regulations. IRS policies and procedures provide further guidance and limit the use of enforcement action. There are checks and balances in place to ensure employees follow procedures and adhere to IRS policies. The Treasury Inspector General for Tax Administration (TIGTA) and the Government Accountability Office (GAO) conduct independent reviews of IRS enforcement programs. TIGTA stated in its FY 2008 report, *Review of Compliance with Legal Guidelines When Conducting Seizures of Taxpayers' Property*, that there were no instances in the cases reviewed where taxpayers were adversely affected by the seizure action.[63] In addition, the IRS continuously conducts program reviews to evaluate adherence to policies and procedures. When necessary, changes are made or guidance clarified to improve program effectiveness.

63 TIGTA, Ref. No. 2008-30-126, *FY 2008 Review of Compliance with Legal Guidelines When Conducting Seizures of Taxpayers' Property.*

The National Taxpayer Advocate notes increases in the number of liens, levies, and seizures from 1999 to 2007 and correlates the increase directly to an increased emphasis on enforcement action. However, the message to collection employees was, and continues to be, "take the right action at the right time" to move the case toward resolution. By taking timely and appropriate case actions, we have increased our case dispositions and are able to work more cases. As a result, there is the potential for an increase in the number of levies, liens, and seizures.

The IRS disagrees with the National Taxpayer Advocate's notion that due to the economic decline and possible decrease in tax revenues that it is natural for the IRS to ramp up efforts to ensure all taxpayers pay their fair share of taxes. We will continue resolving cases with timely and appropriate case actions. Each case resolution is determined based on the individual facts and circumstances of the case, including economic hardship. We believe a balanced measure of an effective Collection program includes overall case quality and appropriate case resolutions, and not the number of enforcement actions taken.

Current guidance provides direction to collection employees on addressing situations and resolving cases when taxpayers experience an economic hardship.[64] Levies are released and cases reported currently not collectible based on the taxpayer's inability to pay the tax liability while paying necessary living expenses. Enforcement decisions are made based on the individual facts and circumstances of the case available at the time the action is taken. IRS procedures limit situations in which enforcement actions, such as seizure of a taxpayer's principal residence or levy of certain retirement plans, may be taken.[65] Seizure of a principal residence requires judicial consideration and approval affording the taxpayer the opportunity for a review by an independent third party. Prior to levying on a retirement plan, procedures, which were developed in coordination with the National Taxpayer Advocate, require consideration of the availability of other assets to pay the outstanding liability. Additionally, even if no other assets are available, a determination must be made that the taxpayer's conduct has been flagrant. IRM 5.11.6.2 provides guidance for this type of levy, including examples of flagrant conduct.[66]

The IRS agrees the "fresh start" afforded individual debtors is an important element of bankruptcy policy. The fresh start is just one of the competing policies Congress sought to balance when it created the Bankruptcy Code's comprehensive scheme for treatment of debts. The most recognized example of this balance is found in the numerous exceptions to discharge found in section 523 of the Bankruptcy Code. In balancing the fresh start sought by debtors, creditors' interest in collecting, and the general public's interest in having an orderly process to support the flow of commerce, Congress determined that

64 IRM 5.11.2.2.1 (Jan. 1, 2006); IRM 5.16.1.2.9 (Dec. 1, 2006).

65 IRM 5.10.2 (Nov. 3, 2006); IRM 5.11.6.2 (Mar. 15, 2005).

66 IRM 5.11.6.2 (Mar. 15, 2005).

certain debts would not be discharged, even by a debtor who successfully completed the bankruptcy process.[67]

Similarly, bankruptcy law has long recognized that a bankruptcy discharge does not generally affect lien interests,[68] and the Supreme Court has affirmed that this rule survives under the current Code.[69] Collection from such assets is consistent with the policy decisions made by Congress in establishing and defining the scope and limits of the relief afforded to debtors under the Bankruptcy Code. Any collection actions taken to enforce the federal tax lien against assets that were exempt, abandoned, or excluded from the bankruptcy estate must be in accordance with the provisions of the Internal Revenue Code, Treasury Regulations, and IRS policies and procedures. The same IRS requirements applicable to seizures of principal residences or levying on retirement plans,[70] such as level of approval required, consideration of economic hardship, and use of other collection alternatives, continue to apply when such assets were part of a bankruptcy estate.

The IRS agrees it is important to recognize the effects of the current economic environment and the taxpayer's ability to resolve their tax delinquency. We also believe our current policies and procedures provide sufficient guidance for the "won't pay" determination prior to consideration of seizure action. IRM 5.10.1.4 provides detailed guidance to assist Revenue Officers with this determination.[71] The National Taxpayer Advocate states that enforced collection action should only be taken where unwillingness and a lack of cooperation are present. The actual enforcement decision is often much more complicated. A taxpayer may be willing to make some form of payment and yet still not reach agreement with the IRS on ability to pay or the appropriate resolution of the case. Whether the use of enforced collection action is appropriate must be determined based on all of the facts and circumstances of each individual case.

The IRS agrees installment agreements and offers in compromise are viable collection tools to be used when appropriate to resolve taxpayer liabilities. The IRS uses IAs to collect delinquent taxes and foster compliance. In FY 2007, over 97 percent of the installment agreements granted by the IRS were streamlined agreements which require little or no financial documentation. With respect to documentation requirements, it should be noted that the procedures for streamlined installment agreements have been revised to clarify that loan denial letters are not required as part of the necessary documentation for such agreements

The National Taxpayer Advocate makes the assumption that the reduction in dollars collected via installment agreements is directly related to the number, or reduction in

67 *See Grogan v. Garner*, 498 U.S. 279, 287 (1991). "Congress evidently concluded that the creditors' interest in recovering full payment debts in these categories outweighed the debtors' interest in a complete fresh start.")

68 *See Long v. Bullard*, 117 U.S. 617 (1886).

69 *See Johnson v. Home State Bank*, 501 U.S. 78 (1991); *Dewsnup v. Timm*, 502 U.S. 410 (1992).

70 IRM 5.10.2 (Nov. 3, 2006); IRM 5.11.6.2 (Mar. 15, 2005).

71 IRM 5.10.1.4 (Oct. 1, 2004).

the number, of installment agreements established over a period of time, that being 1999 through 2002, post RRA 98. However, making that assumption may not necessarily be accurate, as the length of the term of a streamlined installment agreement changed from thirty six (36) months to sixty (60) months in April 1999.[72] Reduction in the tax dollars collected could as well be directly attributable to the change in the length of terms in the installment agreements subsequently granted during the same period of time. The change in length from thirty-six (36) months to sixty (60) would correspond with payment amounts being reduced by almost half.

The Partial Payment Installment Agreement (PPIA) allows a taxpayer to make payments against a tax debt when the payment schedule will not fully pay the liability prior to the expiration of the collection statute. Legislation allowing the use of the PPIA was enacted in 2004; hence, this is a fairly new collection tool for the IRS. In 2006, the first year PPIAs were available, the IRS granted 13,328 agreements. We continue to emphasize the use of PPIAs, when appropriate, to collection employees. We have seen corresponding increases in the number of PPIAs granted in FY 2007 (18,921) and in FY 2008 (22,555).[73] Additionally, a recent change in policy requires that a PPIA must be considered in cases where an offer in compromise is being rejected.

The Offer in Compromise program is an important alternative for taxpayers that are unable to pay in full, particularly those taxpayers that are experiencing economic difficulties. Our goal is to evaluate each offer and make a decision based on the facts presented by the taxpayer. As such, the policies and procedures we have established are meant to ensure that taxpayers who qualify have access to the program at any point during the collection process.[74]

While the total number of offer receipts has declined since 2003, the rate of decline has slowed and, over the past three months, total offer receipts as compared to the same time period last year has increased.[75] There are several factors that have contributed to the decrease in offer receipts, including but not limited to, implementation of the $150 application fee and implementation of the Tax Increase Prevention and Reconciliation Act (TIPRA) of 2005 which mandated a payment equal to 20 percent of the OIC amount with all OIC submissions. In an effort to ensure the accessibility of the OIC program the IRS increased its outreach efforts to identify who qualifies for an OIC and provided clearer instructions and worksheets in the Form 656, *Offer in Compromise.*

The IRS continues to be proactive with internal and external stakeholders by providing outreach and clear guidance on economic hardship, as well as public policy Effective Tax Administration (ETA) offers. Our outreach efforts have been geared toward providing a

72 IRM 21.9.1 (Apr. 1999).

73 IDRS Extracts, SB/SE Collection Activity Report, *NO-5000-6, Installment Agreement Cumulative Report* (Sept. 28, 2008).

74 IRM 5.8 (Sept. 23, 2008).

75 SB/SE Collection Activity Report, *NO-5000-108 (FY 2003-FY 2008), Monthly Report of Offer in Compromise Activity* (FY 2008 and FY 2009).

clear understanding of the regulations governing ETA offers. Publication 594, *The IRS Collection Process*, also discusses ETA offers as an acceptable resolution. In addition, the Form 656, *Offer in Compromise*, definition of an ETA offer was revised to help clarify when an ETA offer is appropriate and outline the documentation a taxpayer should include with an ETA offer. Internal guidance, including several sections of the IRM,[76] specifically discusses ETA offers and alternative resolutions. Effective Tax Administration training was also provided to all field revenue officers during FY 2008.

The National Taxpayer Advocate makes seven specific suggestions to more effectively deal with taxpayers in these difficult economic times. We are taking or have taken the following actions with respect to these issues:

As noted earlier, we believe that current guidance provides sufficient direction to collection employees on addressing situations and resolving cases when taxpayers experience an economic hardship.[77] However, the IRS is looking to expand outreach efforts to ensure taxpayers understand the availability of payment alternatives and where to go for assistance in resolving their tax liability if they are experiencing financial hardship.

Pre-decisional consideration of economic hardship is present as part of the analysis and determination to pursue certain enforcement actions. In order to ensure our employees have the most up to date guidance, IRM sections, including those related to enforcement actions and economic hardship, are continually reviewed and revised to ensure they are in conformance as policies and procedures are updated. Additionally, we are developing a course for FY 2009 Revenue Officer Continuing Professional Education on responding to economic conditions. The course will focus on current economic conditions and the potential impact to taxpayers in general and collection cases specifically.

Managerial safeguards and controls including managerial approval of enforcement action taken against assets that were exempt, abandoned, or excluded from the bankruptcy estate are incorporated into current IRS policies and procedures. Any collection actions taken to enforce the federal tax lien against these assets must be in accordance with the provisions of the Code, Treasury Regulations, and IRS policies and procedures. The same IRS requirements applicable to seizures of principal residences or levying on retirement plans,[78] such as level of approval required, and consideration of economic hardship and use of other collection alternatives, continue to apply even when such assets were part of a bankruptcy estate.

The requirements for streamlined installment agreements have been revised to clarify that loan denial letters are not required as part of the necessary documentation for such

76 IRM 5.8.11 (Sept. 23, 2008); IRM 5.8.7.8 (Sept. 23, 2008); IRM 5.10.1.3.2 (Dec. 13, 2005); IRM 5.15.1.35 (May 9, 2008).

77 IRM 5.16.1.2.9 (Dec. 2006).

78 IRM 5.10.2 (Nov. 3, 2006); IRM 5.11.6.2 (Mar. 15, 2005).

agreements.[79] In FY 2007, over 97 percent of the installment agreements granted by the IRS were streamlined installment agreements.

Current policies and procedures allow for flexibility and use of PPIA and OIC in cases where economic hardship is present. A recent revision to the IRM requires that alternative resolutions, including a PPIA, must be discussed with a taxpayer prior to rejecting an OIC.[80] Additionally, we continue to emphasize the appropriate use of PPIAs to all collection employees.

We agree that reviewing case assignment practices should be an ongoing course of action. The current Consolidated Decision Analytics Project is developing more sophisticated decision analytics to route cases earlier, faster, and more accurately to the correct treatment streams.

The IRS will continue to work with representatives from the National Taxpayer Advocate on established collection improvement teams. These teams are focused on taxpayer rights and issues related to IAs, OICs, notices of federal tax lien, and the Trust Fund Recovery Penalty.

Taxpayer Advocate Service Comments

Troubled economic times require preemptive rather than reactive solutions. Thus, the National Taxpayer Advocate is encouraged that the IRS recognizes that current economic conditions create an environment where many more taxpayers will find it difficult to meet their federal tax obligations in a timely manner, as they struggle financially. We are pleased to note that many of the IRS's comments reflect a proactive approach to dealing with taxpayers who are unable to pay, particularly those affected by the economic uncertainty of the day.

For example, we commend the IRS for its plans to expand outreach efforts so that taxpayers understand the availability of payment alternatives and how to obtain help in resolving their tax liabilities when experiencing financial hardship. Another positive development is the IRS plan to develop a course for revenue officers to provide additional guidance on considering the impact of current economic conditions on taxpayers with IRS tax debts. We expect the IRS will work with TAS in developing this course, particularly since taxpayers with significant hardships frequently end up as TAS cases, and TAS can provide the IRS with valuable information on how the IRS can avoid exacerbating the taxpayers' economic situations. We are very pleased to see that the IRS has clarified its position that loan denial letters are not mandatory prerequisites for streamlined IAs. Moreover, we acknowledge

79 IRM 5.19.1.5.4.2 (Nov. 19, 2008).

80 IRM 5.8.7.8 (Sept. 23, 2008).

recent communications from the IRS to alert taxpayers to the availability of lien subordinations in situations where such actions will facilitate the ability of some taxpayers to refinance their mortgages, rather than lose their homes to foreclosure actions.[81]

The National Taxpayer Advocate also agrees that the IRS actually needs to look no further than its existing collection toolkit to effectively resolve taxpayer cases where economic hardship exists, as it already possesses numerous viable collection alternatives, such as IAs, OICs, and CNC. However, the National Taxpayer Advocate remains concerned that IRS's response to the current economic downturn in regards to collection does not adequately consider the taxpayer's perception of IRS collection practices. Failing to take the appropriate steps to address this economic crisis could result in the perception of the IRS using "harsh" collection tactics in troubled times, thereby, discouraging taxpayers from trying to work things out with the IRS. Conversely, the perception of a more reasonable and flexible IRS is likely to encourage more taxpayers to try.

An Imbalance Between Service and Enforcement Remains.

The National Taxpayer Advocate has repeatedly stated, and the IRS has reiterated "that enforcement and service are not mutually exclusive." The IRS asserts that its collection policies and procedures maintain the proper balance between service and enforcement, but this is not always the case. We acknowledge that the IRS's intent of the FY 2008 Collection Program Letter may have been to focus not on taking *more* enforcement actions, but rather taking *timely* and *appropriate* case actions. In reality, the IRS may have sent mixed signals to its employees by placing a heightened emphasis on maximizing the use of enforcement tools, such as seizure and sale, suits to foreclose on the federal tax lien or reduce the tax liability to judgment, and the pursuit of exempt, abandoned, and excluded assets following a successful Chapter 7 bankruptcy. Considering the training material's lack of direction for employees to consider the potential economic hardship such actions could have on a taxpayer, along with the corresponding lack of procedural guidance in this area, we do not believe that the delivered message adequately reflected a balance of service *and* enforcement.

Moreover, in FY 2008, the IRS continued to issue the majority of its levies via automation (*e.g.*, ACS and the Federal Payment Levy Program), generally initiating such enforcement action prior to attempting a personal contact with the taxpayer. The IRS's stated goal for collection is "taking the right action at the right time." The National Taxpayer Advocate believes the right time and right action are predicated on two simple factors – early intervention and personal contact. By personally interacting with a taxpayer when the problem first arises, it is easier to ascertain the appropriate facts and circumstances *prior* to taking enforcement action and avoid having to deal with negative downstream consequences such as economic hardship and taxpayer burden. The heavy reliance on automated levy and lien

81 *See* IRS News Release IR-2008-141, *IRS Speeds Lien Relief for Homeowners Trying to Refinance, Sell* (Dec. 16, 2008).

filing – without taxpayer contact – undermines the IRS's mission of increasing voluntary compliance.

IRS Guidance for Consideration of Economic Hardship Is Lacking.

The National Taxpayer Advocate respectfully disagrees with the IRS's assertions that its current guidance provides sufficient direction to collection employees on how to address economic hardship. As noted in this report, our review of IRS Collection procedures in Part V of the IRM reveals very little specific guidance on what to include in pre-decisional consideration of economic hardship issues prior to initiating enforcement actions. Moreover, the IRM contains very few meaningful examples to illustrate to IRS Collection employees situations where these factors should lead to the use of collection alternatives, such as PPIAs and OICs. In fact, during the past year the National Taxpayer Advocate has seen a number of IRS Collection cases where these considerations were disregarded.

The IRS also states its guidance for levying on a retirement plan properly accounts for and considers whether the action will impose an economic hardship on a taxpayer. However, the National Taxpayer Advocate recently identified serious concerns with the guidance specifically referenced by the IRS and took exception with the IRS's definition of what constitutes "flagrant conduct." IRM 5.11.6.2 cites several examples of flagrant behavior but many of them focus on past actions of the taxpayer rather than his or her current level of compliance. For example, we agree that a taxpayer who is currently raising frivolous arguments or willfully evading the IRS should be classified as flagrant. However, under existing guidelines, a taxpayer who continues to contribute to a retirement plan while taxes are accruing, or who was assessed a Trust Fund Recovery Penalty ten years ago, would also be considered as having exhibited flagrant behavior.[82] The IRS's rationale is flawed since it fails to consider whether the taxpayer's continued contributions were voluntary or if the IRS ever notified him or her that making future contributions could be construed as flagrant behavior, nor does it account for the current level of compliance by the taxpayer with an old TFRP assessment. The National Taxpayer Advocate has asked the IRS to reconsider this position and to clarify that in general a determination of flagrant behavior should be based on *current* actions rather than historical.

A Fresh Start in the Eyes of Whom?

The National Taxpayer Advocate appreciates the IRS's acknowledgment of the concept of a "fresh start" for taxpayers whose taxes are discharged through a Chapter 7 bankruptcy. We do not disagree that the IRS retains specific authority to enforce the federal tax lien against assets that were exempt, abandoned, or excluded from the bankruptcy estate. However, we are concerned that current IRS guidance provides far too little direction for local offices to determine which assets they wish to pursue. Moreover, the IRS's lack of any mechanism to track enforcement actions taken against these assets makes the matter even more troubling.

82 IRM 5.11.6.2(5) (Mar. 15, 2005).

Since many taxpayers survive bankruptcy proceedings with very little to their names other than their exempt or excluded property, the National Taxpayer Advocate respectfully requests the IRS reconsider its pursuit of these assets and develop specific guidance that incorporates consideration of economic hardship into each and every determination. Although the National Taxpayer Advocate agrees there are specific enforcement authorities for the IRS to pursue assets that were exempt, abandoned, or excluded from the bankruptcy estate, it is important to keep in mind the fundamental concept of bankruptcy – providing taxpayers with a "fresh start."

Limited Use of Available Collection Alternatives

Interestingly, the National Taxpayer Advocate has been engaged in this same dialogue about collection alternatives with IRS Collection management for several years. While we believe that IRS Collection policies and procedures unduly restrict reasonable payment alternatives to many taxpayers who require such flexibility in order to rebuild their lives, the IRS has routinely responded as it has again this year – "we already have procedures in place for taxpayers who are experiencing financial hardships and are unable to pay their tax liability." However, the IRS fails to fully utilize these collection tools now, and continuing this flawed approach is especially shortsighted in these economic times. For example, in FY 2008, the IRS Collection Field operation collected approximately $6.6 billion dollars on delinquent taxpayer accounts (excluding formal installment agreements).[83] Yet, over $11 billion dollars were abated on these accounts, and $12.9 billion were reported as uncollectible.[84] As a percentage of overall case dispositions, the number of taxpayers granted PPIAs and OICs last fiscal year was negligible.[85] The IRS only collected a little more than $200 million with OICs in FY 2008, the lowest amount in many years, and approximately 45 percent of those dollars were accepted by Appeals. Tax practitioners increasingly tell us that the OIC has become irrelevant in their considerations of collection solutions for their clients. At the conclusion of FY 2008, the IRS reported over 9.2 million taxpayer delinquent accounts (TDAs) in active inventory.[86] Of these, approximately 3.3 million – over a third – of these accounts were inactive and assigned to the Collection "queue."[87] Approximately 6.2 million of these accounts involved delinquencies for tax periods from 2004 or older.[88] The IRS response to this report indicates that the emphasis in the Collection program in FY 2008 was "take the right action at the right time," and "we will continue resolving cases with timely and appropriate actions." Unfortunately, the FY 2008 program data does not reflect the IRS position on this matter.

83 SB/SE Collection Activity Report, *Taxpayer Delinquent Account Cumulative Report, NO-5000-2* (Sept. 29, 2008)

84 *Id.*; SB/SE Collection Activity Report, *Recap of Accounts Currently not Collectible Report, NO-5000-149* (Sept. 27, 2008); SB/SE Collection Activity Report, *NO- 5000-6, Installment Agreement Cumulative Report* (Sept. 29, 2008).

85 SB/SE Collection Activity Report, *Report of Offer in Compromise Activity, NO-5000-108* (Sept. 29, 2008).

86 SB/SE Collection Activity Report, *Taxpayer Delinquent Account Cumulative Report, NO-5000-2* (Sept. 29, 2008).

87 *Id.*

88 *Id.*

The National Taxpayer Advocate continues to urge the IRS to reevaluate its Collection strategy, and develop procedures that deliver a true balance of service and enforcement with taxpayers who owe delinquent tax dollars. The conditions discussed in this report are not new. We have identified these concerns for several years. However, the current downturn in the economy has created a situation where many more taxpayers will be suffering through financial difficulties that may lead to tax debts. A continuation of the IRS's current inflexible Collection strategy will likely result in numerous lost opportunities to collect the delinquent revenue while providing service to taxpayers in a manner that fosters voluntary compliance.

Recommendations

The National Taxpayer Advocate recommends that the IRS:

1. Clarify or develop a new uniform policy statement that defines the concept of economic hardship.
2. Provide specific guidance requiring pre-decisional consideration of the concept of economic hardship in all Internal Revenue Manual sections related to IRS Collection enforcement activities.
3. Review all polices and procedures related to insolvency and the pursuit of exempt and excluded assets and establish adequate managerial safeguards and controls for situations when enforcement is appropriate, including the tracking of collection actions against exempt and excluded assets.
4. Continue to review and revise current case assignment practices to provide earlier intervention and resolution before a taxpayer's financial uncertainty worsens.