IRS Collections in Troubled Times

By Howard S. Levy

Howard S. Levy examines the current enforcement environment.

As any seasoned Revenue Officer will tell you, IRS collection enforcement comes in peaks and valleys. After a drought that lasted more than a decade, the IRS appears to be back in the business of collecting delinquent taxes. Lien and levy filings are hitting levels equal to the last period of high level enforcement—the early to mid-1990s. Enforcement staffing is following the same upward trend. The backdrop for the IRS is the severest economic downturn since the Great Depression.

The motivations include a new administration with fresh ideas about tax enforcement, including attempts to dismantle off-shore banking activity. But there is more: The budget deficit has tripled in the last year to $1.4 trillion while the tax gap hovers around $300 million.[1] As the money goes out, pressure mounts to bring it back in and balance the books.

The IRS has a unique set of circumstances in its attempts to bring in revenue to the Treasury. Can the agency strike a delicate balance between (1) enforcing tax laws and collecting revenue, (2) demonstrating sensitivity to taxpayers who have had job losses and income reductions from the economy, and (3) not slipping into the bad habits that caused Congressional hearings on IRS collection tactics after the last enforcement wave of the 1990s?

The Peaks and Valleys

The last IRS collection enforcement peak was in 1992. That year, the IRS made 11,033 seizures of real and personal property, 3,252,682 attempts to levy taxpayers' wages and bank accounts and filed 1,452,634 tax liens.[2] Then, in 1998, IRS collection activity came to a crashing halt. Concern grew that the IRS had become an agency out of control. Congressional hearings were conducted on abusive IRS behavior. Negative publicity followed, and from the ashes came new laws that reined in many of the Internal Revenue Service's enforcement powers. The IRS became an agency in retreat and under change.

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After new laws were put in place to address the IRS enforcement abuses, collections plummeted to the lowest of valleys in 2000. IRS seizures of real and personal property dropped to 74.[3] Levies on wages and bank accounts plunged to 219,778.[4] Many IRS claims were left unsecured as only 287,517 tax liens were filed.[5] The impact of the new laws was profound: The IRS made fewer seizures in all of 2000 than they averaged in one week in 1992.

The economy was good; IRS pursuit was not. The culprit for this drop was a surprisingly novel term to IRS collection enforcement: due process. Congress put the brakes on by increasing taxpayers' rights to dispute IRS collection actions before it occurred.

Due process brought the IRS collection machine to a halt. Here's why: The new laws prohibited the IRS from taking a taxpayer's property without (1) providing a notice of intent to do so and (2) giving the taxpayer the right to have the intended levy action reviewed by an IRS appeals officer; if resolution could not be reached in appeals, the taxpayer could have a Tax Court judge review the IRS decision-making process.

The due process laws barred the IRS from levying or seizing property from the date of the notice of intent to levy until the conclusion of the appeals hearing or Tax Court, depending on how far the taxpayer went with the case. These new limitations on IRS collection enforcement created a significant change in government culture during the last 10 years.

IRS Culture Change from Due Process Laws

Bringing due process to IRS levy and seizure actions made the agency passive, partially from the wounds of the Congressional hearings. The IRS became cautious;

it did not want to violate the new laws and sought to avoid adverse publicity. It took the agency time to adjust, understand the new laws and implement procedures to accommodate due process. The result was a 10-year drop in collection enforcement.

The IRS stopped hiring collection enforcement officers at the same time the workforce hit retirement age. Seasoned revenue officers were moved away from the collection function due to the lack of enforcement activity. Revenue officers started appearing in the most unorthodox places. They were now appeals officers in collection due process hearings. A call to the IRS Taxpayer Advocate resulted in a former revenue officer working the case. Due process appeals contributed to making the IRS Office of Appeals a collection function, with 35 percent of its caseload now related to collection due process appeals and offers in compromise.

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The IRS also centralized the offer in compromise process, moving the investigation to often impersonal processing centers in Memphis and Holtsville, New York. Less than a dozen states now have local field offer investigators. Offer in compromise approval rates plunged dramatically, from 38,000 acceptances in 2001 to the current annual rate of 11,000.[6] The IRS had not only simultaneous but dramatic declines in both enforcement and settlement. The IRS may have been more aggressive in enforcement before collection due process laws, but its compromise settlement program was also more of a reality for taxpayers in distress. The agency is now showing signs of regaining its footing.

Getting Back on Track?

There are strong indications that the IRS is mindful of where it has been, and knows where it needs to go. Revenue officers are being hired in an attempt to replace the attrition of the last decade and increase collections. Some early indicators point to attention being given to improving the offer in compromise program. And public statements put out by the IRS as the recession became apparent suggest a desire be judicious in the treatment of delinquent taxpayers.

Increased Enforcement Staffing

According to remarks made by Fred Schindler, Director, IRS Collection Policy, on August 9, 2009, at the National Tax Practice Institute in Baltimore, the IRS will be bringing on board almost 2,000 new Revenue Officers in the next two years. Expect 1,072 new Revenue Officers to start this fall (2009). An additional 350 Revenue Officers are slated to hit next year (2010), with 500 more to begin in 2011. There will be delays for training and some expected attrition, but the focus is back.

This will bring Revenue officer staffing to over 7,000 agents, in line with 1995 enforcement levels, when there were 8,100 Revenue Officers. The hiring represents an increase of over 30 percent in high level collection enforcement staffing.

Getting Aggressive to Bring in Revenue

What will the game plan be for the IRS with its new enforcement officers? The focus will likely be on employment tax cases, nonfilers and repeat offenders who pyramid and owe the IRS year after year. The IRS is currently accelerating the collection process when possible and appropriate, including in these four ways:

- **Serving a Final Notice of Intent to Levy during Revenue Officer's first taxpayer contact.** This can force the longer appeal process, but can be a landmine for taxpayers who do not have representation, fail to file a due process appeal and have a breakdown in negotiations.
- **Levies issued immediately after expiration of 30-day collection due process appeal period.** The IRS is currently making immediate matches on bank accounts and wages sources if it believes a due process appeal has not been timely filed. This has systematically resulted in levies placed on taxpayers who have filed timely appeals that have not been processed by the IRS.
- **Increased use of disqualified employment tax levies.** To get tough with businesses pyramiding employment tax liabilities, the IRS can levy on new employment tax delinquencies without a Final Notice if the business had requested a due process hearing on older taxes within the prior two years. Expect this to be used when appropriate.
- **Quicker processing of collection due process appeals and addressing frivolous Tax Court cases.** When the due process appeals first went into

effect, it could routinely take the IRS six to 12 months to process an appeal and hold a hearing. That time has been cut in half. And if a Tax Court petition is filed without merit and for delay only, expect a motion for summary judgment to accompany a motion for sanctions.

Resuscitating the Offer in Compromise?

There have been signs that the offer in compromise (OIC) may eventually make a comeback from its current moribund condition. In May 2009, the House Ways and Means Oversight Committee Chairperson Charles Lewis and Ranking Member Charles Boustany introduced H.R. 2343, the Tax Compromise Improvement Act of 2009. The bill would eliminate the requirement of Code Sec. 7122(c) that lump-sum offers must be accompanied by an upfront payment equal to 20 percent of the value of the compromise. The bill would also eliminate the requirement that periodic payment offers must have the proposed payments made while the compromise is pending. All of these payments are nonrefundable, that is, if the compromise is rejected, the money is lost.

The bill was introduced from hearings the House Ways and Means Oversight Subcommittee conducted on February 26, 2009, as to assisting taxpayers with economic difficulties. IRS Taxpayer Advocate Nina Olsen submitted testimony to the Oversight Committee recommending the change. It is also possible that the Office of Professional Responsibility may turn its attention to so-called offer mills to crack down on the bad offers that make the process harder for those that have merit.

The IRS has also announced the formation of an OIC Project Team. According to the Taxpayer Advocate's 2010 Fiscal Year Objectives, the IRS has contracted with the MITRE Corporation and Porter Novelli Public Strategies to study the characteristics of desired offer candidates and to increase the number of qualified offer in compromise candidates.

Efforts to Accommodate Taxpayers with Economic Hardships

As the recession deepened in early 2009, the IRS made high-profile announcements of its efforts to work with taxpayers in economic turmoil. Linda Stiff, IRS Deputy Commissioner for Services and Enforcement, offered the following in her testimony before the House Ways and Means Subcommittee on Oversight on assistance for distressed taxpayer:

- Examination employees have been given latitude to consider collectability at the beginning of audits and offer installment agreements at the conclusion.
- Collection personnel can postpone enforcement actions without further documentation in cases of job loss, where Social Security is the sole source of income or if there is a devastating illness or significant medical bills.
- Taxpayers are to be given flexibility for missed payments in installment agreements and assistance in reducing payments in the case of job loss or financial hardship.
- To prevent defaults of accepted offers, the IRS will send a letter to taxpayers who are unable to complete the terms of the offer with options to avoid default.
- Collection is to provide expedited levy releases to avoid hardship by faxing the release to the taxpayer's bank or employer immediately rather than by ordinary mail alone.
- Offers in compromise that require home valuations are to have additional review to ensure the values used by an offer investigator reflect with current real estate conditions.

This certainly shows a good-faith effort by the IRS.

But how much do these offers of assistance improve on what the IRS already could do in assisting taxpayers who were experiencing economic hardship? First, as to considering collection issues as part of the handling of an audit, it adds nothing to what the IRS could do. INTERNAL REVENUE MANUAL 4.20.2 already covered "examination collectability." This IRM provision makes it clear that a potential collection problem can be cause to survey, no change or limit the scope of an examination.

And postponing collection actions when there is job loss or only source of income is Social Security? The IRS has long been known do this if it caused financial hardship. It is called being "uncollectible." Missing a payment on an installment agreement? The IRS is usually flexible on this—a telephone call to advise the IRS of missed payment in advance is rarely a problem. And for years, the IRS has had a policy of sending a "heads-up" courtesy letter before placing an offer in compromise in default. They are to be commended for having done so for so long.

Lastly, expedited levy releases could be coaxed out of ACS before the economy crashed. Although sometimes inconsistent in agreeing to put a release on the fax, employees in the IRS Automated Collection

Service who are wired to help exercised discretion to fax levy releases in the best of economic times.

The reality is that resolution of hardship situations during the recession comes down to the disposition of the IRS employee on the other end of the phone. There is flexibility from the top; how it is exercised is the essential question.

How the IRS Is Handling Sensitive Situations—A Snapshot

Here are some recent examples of compassion by IRS collection enforcement personnel:

> Business owner in West Virginia was not assessed the trust fund recovery penalty after the Revenue Officer reviewed a personal financial statement and determined the case was uncollectible. Taxpayer had offered to make monthly payments, but Revenue Officer exercised independent judgment that taxpayer over predicted his potential, keeping a case from languishing in the IRS inventory for years.
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> Taxpayer in Ohio owed the IRS over $200,000 was permitted an expense of $2,400/month for credit card debt before repayment of IRS taxes. The taxpayer had sufficient cash flow to pay the credit cards and satisfy the IRS liability in five years. The taxpayer sought to avoid bankruptcy as a means of repayment. The IRS agreed.

There have also been disappointing situations where IRS indifference was the rule. Here are a few of those:

> Elderly taxpayers in Louisiana, husband and wife, each had IRS levy on Social Security and pension income. Financial statement was provided showing that the levies created a hardship, but taxpayers had approximately $20,000 equity in their personal residence. IRS representative refused to release the levies, even conditionally, until submission of a loan denial as to the equity. Arguments that a loan denial was obvious and inevitable based on taxpayers' age and income were rejected.
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> Independent insurance and annuity salesperson in Pennsylvania saw a six-figure income drop from recession and fell behind on monthly expenses. Taxpayer also had undergone treatment for reoccurrence of cancer. Revenue Officer refused to accept financial statement based on current income and sought installment payment based on pre-recession income. Result: Taxpayer filed bankruptcy, eliminating the majority of the taxes as the case would not go temporarily uncollectible, as requested.

Conclusion

What happens when increased collection enforcement needs hit a crossroads with taxpayers feeling the heat of a deep economic recession? The pressure is clearly on for the IRS to perform with a trillion dollar budget deficit and a $300 million tax gap. To that extent, enforcement hiring has increased. Levies and liens have returned to peak levels, leaving only seizures behind at the current rate of 600 per year. Some encouraging movement is being made to make the offer in compromise program once again viable, although the jury remains out on that. And it appears that the IRS has given some direction for enforcement personnel to show compassion, but the application is inconsistent.

There is no doubt that tough times lay ahead for taxpayers with IRS collection problems. Those with IRS problems bear two burdens: the weight of the economy and the power of IRS enforcement actions. For the IRS, the trick will be in how it handles that challenge with an eye on both sensitivity and results.

Endnotes

1 *IRS Updates Tax Gap Estimates,* IR 2006-28 (Feb. 14, 2006).
2 Transactional Records Access Clearinghouse (TRAC), Syracuse University (*available at http://trac.syr.edu/tracirs/highlights/current/collenf.html*).
3 *Id.*
4 *Id.*
5 *Id.*
6 IRS Data Books, 2002 and 2008.