By Howard S. Levy, JD

Statute of Limitations on Collection

ARE YOU UNWITTINGLY GIVING THE IRS MORE TIME TO COLLECT?

CHANCES ARE, when you get a call from a prospective client with a nagging tax problem, he is thinking "offer in compromise." This is understandable as the compromise has certainly made it to the mainstream, from the television and radio spots promoting it to the efforts of the IRS to prevent abuse of the program. This has led the public to believe the only way out is a compromise. Without it there is a sense of desperation and the feeling that the IRS will follow forever.

Lost in the hoopla is the fact that the Internal Revenue Code Sec. 6502 puts a limit on how long the IRS can pursue the collection of a tax debt. The timeframe is ten years from when the IRS puts a liability on its books (the date of assessment). The IRS has an internal acronym for its collection timeframe—CSED—meaning Collection Statute Expiration Date. The CSED is also commonly referred to as the statute of limitations on collection.

The statute of limitations on collection will make most every IRS collection problem come to an end. This is a reality check our clients appreciate hearing. But knowing there is an end is really just the beginning.

The axiom "time is money" is true when it comes to resolving an IRS collection case. The element of time weaves in and out of most every step we take seeking resolution for our clients. Many popular sources of resolution—such as an offer in compromise, collection due process appeal, and innocent spouse claim—extend the time the IRS has to collect while they are pending. Other possible solutions, such as filing a Chapter 13 bankruptcy, could take longer to complete than the timeframe that may be left on the collection statute.

Before jumping in the water, it is important to make sure the timeframe for resolution, coupled with the potential for success, is greater than the risk of extending the collection timeframe and making a tax problem linger.

Think of this with a sports metaphor. We are starting on the 1-yard line when assessment is made, and we need to take the ball all the way down the field to the goal line—100 yards in football, ten years with the IRS. The decisions we make in between (the plays we call) affect the end result.

Offer in Compromise

The filing of an offer in compromise will extend the statute of limitations on collection by the time it is pending, plus thirty days. If you have been through the compromise process, then you know that on average the IRS can take at least six to twelve months to complete an initial investigation of an offer in compromise.

If the initial investigation results in a proposed rejection, an appeal can be made for further review. The offer appeal process can take another six to nine months, sometimes longer.

In sum, prepare for anywhere between six to eighteen months from the time of offer submission to acceptance. During this timeframe the statute of limitations on collection is tolled, primarily because the IRS cannot levy or seize property during the investigation.

Also, factor into the decision to pursue an offer in compromise the fact that, statistically, the IRS does not have an open-door policy to offers. The *2010 IRS Data Book* reports that compromise acceptance rates typically hover around twenty-five percent. The compromise program is viable in the right circumstances, and many offers may have a higher chance of acceptance than twenty-five percent, but the realities of success must be parlayed against the risk of not only lost time on the collection statute, but also consideration of how much time remains on it.

A common (and unfortunate) scenario occurs when multiple compromises have been submitted over time, each one having been rejected. Had the client simply held tight and fully considered all his strategies and options (such as payment plans or financial hardship/uncollectible) that do not extend the statute of limitations on collection rather than twist in the wind with the compromises, he would have been finished with the IRS by the time he consults us. Instead, the client gave the IRS precious years, and he is back to where he started.

Time must be factored in even if an offer in compromise is ultimately accepted. For example, if the offer took only twelve months to be investigated, and then another two years would be needed to pay in the value, your client is looking at three years to complete the settlement process. Although the collection timeframe is only tolled while compromise is being investigated—from submission to rejection/acceptance—the time it takes to pay in the value is still relevant. What if there were four years left on the collection statute but compromise took three years to be investigated and paid?

Prior to submitting an offer, consider whether it is really the best and lowest cost risk/reward option under the circumstances, with an eye on time. For example, if the collection timeframe is short, consider whether there are assets being paid as part of the compromise settlement (such as the value of real estate or vehicles) that the IRS is unlikely to seize before the statute expires. Would the cost of an installment agreement over the remaining years be a better approach?

And consider that a compromise entails a five-year probationary period to remain current on all filings and payments. That is not a problem for most but a consideration nonetheless.

Collection Due Process Appeal

The ability to file a collection due process (CDP) appeal is probably the most powerful right our clients have in defending against IRS enforcement by levy or seizure. In most every case, the IRS cannot begin enforcement action to seize property (bank accounts, wages, real and personal property) until it provides notice and rights of due process. Collection due process rights include participation in an appeals hearing to explore collection alternatives to levy or seizure, all while a hold is put on that action.

During this hold on enforcement, the statute of limitations on collection is tolled. What you get, you give back.

In most cases a CDP appeals hearing can last as long as six months, often more. If necessary, a CDP appeal can even give Tax Court jurisdiction to review an unfavorable appeals' collection decision. Tax Court can take a year for trial, plus the time it takes the Court to issue a decision. While a Tax Court petition is pending the collection hold continues, as does the tolling of the collection statute.

However, only timely-filed CDP appeals extend the statute of limitations on collection. (To be timely, the appeal must be filed with the IRS within thirty days after a Final Notice of Intent to Levy is sent.)

A late-filed CDP appeal—defined as filed within one year of the date of the Final Notice of Intent to Levy—does not extend the collection statute but does entitle your client to an appeals hearing (known as an equivalent hearing). The equivalent hearing is not found in the Internal Revenue Code, but it is a creature of IRS administrative practice. (See IRM 5.1.9.3.6 and Treas. Reg 301.6330-1.) Although equivalent hearings are not absolute and are provided on a case-by-case basis, the IRS tends to process a late appeal and provide full appeal rights to the taxpayer's benefit, including a hold on seizure and levy, while not extending the statute of limitations on collection.

A secondary benefit to timing a CDP appeal for late filing is that the bankruptcy rules that require the aging of taxes before they are eligible for a discharge are tolled while a timely CDP appeal is pending, plus ninety days. (See Bankruptcy Code Section 507(a)(8)) Equivalent hearings do not extend the timing rules that make taxes eligible for a bankruptcy discharge. If bankruptcy is being considered, a timely filed CDP will ultimately prolong the time it takes to get there, while an equivalent CDP hearing provides a hearing, a hold on collection, and no tolling of the bankruptcy timing rules.

Although a CDP appeal presents a situation where late-filing with the Internal Revenue Service can actually be advantageous, it is important to consider the downside of equivalent hearings. By late-filing a CDP appeal and requesting an equivalent hearing, you lose the right to go to Tax Court to litigate the IRS Appeals' decision. Bear in mind that prevailing in Tax Court in a collection case is often quite difficult as the Court treads lightly on upsetting the judgment of the IRS in collecting taxes. This is due, in part, to the difficult standard to prevail in Tax Court in collection cases—whether the IRS appeals officer committed an abuse of discretion.

In problem cases, careful consideration should be given to whether there is an impatient revenue officer involved in the case who may pose a problem to processing a late-filed CDP appeal and the ultimate need for Tax Court intervention, weighing that against the time that is added to the collection statute by timely filing.

Bankruptcy

The filing of bankruptcy extends the statute of limitations on collection by the time the bankruptcy is pending, plus six months. If bankruptcy is being filed and there is an IRS liability, it is important to consider whether the bankruptcy is being filed in a manner that will eliminate the tax debt. If the bankruptcy is unsuccessful in eliminating the taxes, the IRS will have more time to collect afterwards.

Time is also an essential component of eliminating and discharging taxes in bankruptcy. As a starting point, taxes can be discharged in bankruptcy only if they were from a return that was due to be filed at least three years before the bankruptcy started and the return was actually filed at least two years before the bankruptcy. In other words, taxes that are a little bit older can be discharged in bankruptcy. Also, income taxes can be discharged; trust fund employment taxes cannot.

The decision to file for bankruptcy should be made after comparing the time remaining on the statute of limitations on collection to the time a bankruptcy would take to complete. For example, a Chapter 13 bankruptcy—which is a court-ordered repayment plan that can often stop interest and penalties and result in a reduction of recovery to the IRS—can take up to five years to complete. If there are two or three years remaining on the collection timeline, embarking on a five-year Chapter 13 repayment plan may not make sense unless there is other nontax debt involved.

If there is no cash flow to repay the taxes (making a Chapter 13 not feasible), a Chapter 7 bankruptcy could eliminate an income tax debt within six months. If your client's returns are not yet old enough to be eligible for a Chapter 7 discharge, holding the IRS off for a few years to meet the bankruptcy timing rules (and achieve a quantifiable result) could be a better risk/reward scenario than spending that time in an offer in compromise, extending the collection timeframe, and being exposed to the low rates of compromise acceptance.

Installment Agreements

Internal Revenue Code Sec. 6331(k) provides protection when an installment agreement is sought with the IRS. The IRS cannot take levy or seizure action while a request for an installment agreement is pending, for thirty days after denial or termination of an installment agreement, or during the time an appeal of a denied or terminated installment agreement is pending. Each of these—like that of an offer in compromise, CDP appeal, and bankruptcy—entails an immediate hold being placed on IRS levy or seizure action. What the IRS gives you—no enforced collection activity—it recovers by adding the time back onto the collection statute. When an installment agreement is in effect and not in dispute, the statute of limitations on collection is not tolled and continues to run.

Voluntary Waivers

When entering into an installment agreement, the IRS can request that a taxpayer voluntarily sign a waiver extending the collection statute. Rarely used, it is IRS policy to request voluntary statute extensions only in conjunction with partial-pay installment agreements and only when there is an asset that will come into the possession of the taxpayer after the statute expires. The IRS should not request voluntary waivers of the statute of limitations on collection when the only basis is a continued ability to make monthly payments with no significant change in the ability to pay. IRS administrative practice is also to limit the time of the waiver to no more than five additional years, plus one year to account for changes in the agreement. If there is a wavier, the time to collect expires ninety days after the waiver expires.

Suits to Bring the Liability to Judgment

If the circumstances for a voluntary waiver of the statute of limitations on collection are not present, or if your client refuses to consent to one, the IRS has the ability, pursuant to IRC Secs. 7401 and 7402, to achieve statute extension by filing a lawsuit in federal court to reduce the tax liabilities to a court-ordered judgment. These suits are filed by the Department of Justice to obtain a money judgment.

If judgment is obtained, IRC Sec. 6502(a) provides that the tax can be collected until it is satisfied or becomes unenforceable (i.e., bankruptcy), which is essentially an unlimited period of time. The suit must be filed before the original ten-year statute of limitations expires.

Additionally, the Department of Justice can turn the judgment into what is known as a judgment lien against your client's property. Unlike federal tax liens, which are generally good for the ten-year collection timeframe, a judgment lien is good for an additional twenty years and is subject to renewal for an additional twenty years upon its initial expiration (28 USC 3201). These suits are the exception, not the rule, and generally occur in high-dollar cases where there is a future collection potential from an asset that cannot be liquidated before the ten-year collection statute expires and the asset would make an impact on the liability. These suits must be packaged by a revenue officer and approved by IRS counsel before being sent to the Department of Justice.

Out of the Country

If your client has been out of the country for a continuous period of more than six months, that absence can also extend the statute of limitations on collection. For that reason, the IRS asks on its Form 433A (Collection Information Statement for Wage Earners and Self-Employed Individuals) financial statement whether a taxpayer has been out of the country for more than six months.

For practical purposes, the IRS has established administrative procedures for consistent application of statute extensions for taxpayers who have been out of the country. If the IRS believes the taxpayer has cooperated in regard to his or her tax liabilities (generally meaning those who have been responsive to the Service and provided financial information), the time the statute is extended will be generally limited to five years for taxpayers who are currently in the United States. Where a taxpayer has been uncooperative and has not acted to resolve a liability, the collection statute will be extended for the maximum amount of time there is collection potential.

Innocent Spouse and Taxpayer Assistance Orders

Requests for innocent spouse relief and Taxpayer Assistance Orders both extend the statute of limitations on collection as they entail a hold on enforcement by levy or seizure.

Determining When the Statute of Limitation on Collection Ends

There is one simple way to find out when the statute of limitation on collection is over: call the IRS and ask. The IRS has the end date in its computer database. Simply ask for the CSED. The IRS will know what you are referring to.

Alternatively, or in support of what the IRS tells you, IRS account transcripts can be requested and analyzed to determine the assessment date and to add in any extensions of time (which should be reflected on the transcripts).

If all is quiet and you do not want to make any contact with the IRS and upset a sleeping giant, but you want to get a sense of an end date, reading a federal tax lien can reveal when the statute of limitations on collection expires. Federal tax liens are public record and can be obtained at a county recorder or clerk's office, independently of the IRS.

A federal tax lien will list the date the IRS statute of limitations on collection begins (assessment), as well as the date thirty days after it would end (absent any extensions).

Here is how to read a federal tax lien for the collection expiration date: In the center of the lien are six columns identified with letters (a) through (f). Each column lists (a) the type of tax owed, (b) the tax years, (c) the last four digits of the taxpayer's SSN, (d) the date the IRS put the balance due on its books (assessment), (e) the last day the IRS can refile the lien if the collection statute has been extended, and (f) a balance due.

Column (d) of the tax lien (the date of assessment) is the key to working forward to determine when the collection statute expires: add ten years to it and you have the end date to the statute of limitations on collection. The tax lien does not reflect any possible extensions of the statute, like a compromise or CDP appeal, but will provide a starting point that can be supplemented with information from the client as to any possible time extensions.

What to Do When the Statute Expires

When the statute of limitations on collections expires, IRS transcripts should have the following entry: TC 608, Statute Expiration Date, Clear to Zero. The account would be adjusted with a credit in the amount of the current outstanding balance. The result is an account transcript reflecting a zero balance due. This account transcript can be requested from the IRS and provided to your client as verification that his or her tax debt has come to an end. **EA**

About the Author:

Howard S. Levy is a former trial attorney for the IRS and an instructor at NTPI. He has over twenty years' experience in IRS collection proceedings, Tax Court litigation, IRS administrative appeals, and the use of bankruptcy to resolve IRS controversies. Howard is a member of Voorhees & Levy LLC in Cincinnati, OH and tries really hard to respond to questions. He can be contacted at howard@voorheeslevy.com or at www.howardlevyirslawyer.com.