When the IRS Strikes with a Wage or Bank Levy

[HOW TO GET OUT OF A BIND]

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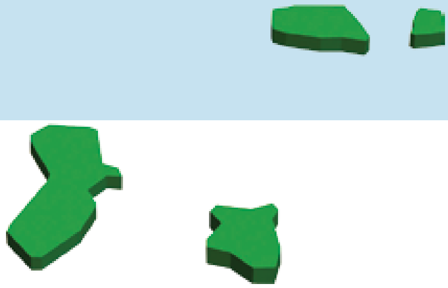
WHEN THE IRS STRIKES WITH A LEVY, BAD THINGS CAN HAPPEN. Even though money is needed to put food on the table, an IRS wage levy will permanently freeze wages until it is released. A bank levy will suddenly clean out an account, making checks bounce and putting mortgage and car payments in default. An IRS levy leads to dire and stressful situations, requiring immediate relief.

In fiscal year 2010, the IRS sent more than 3.6 million levies on third parties who were identified as holding liquid assets. By comparison, the IRS Data Book reflects that there were 605 seizures of real and personal property. Although our clients are often most concerned with the IRS taking their house, car, or personal possessions, the reality is that most IRS levies are on liquid assets, such as bank accounts, wages, subcontractor pay, and to a lesser extent, accounts receivable.

A levy situation gives us an opportunity to make a difference in our clients' lives by helping them out of a bind. Make no mistake about it, your clients will value your poise and knowledge and appreciate the results you achieve in quickly maneuvering within the IRS to get a levy released.



Problems in Negotiating Levy Releases

An IRS levy is not only an attempt to collect a debt, but it is also an effort to grab the attention of a taxpayer after less intrusive methods of resolution have failed. The IRS sends both "soft" notices (such as a balance due statement) and "hard" notices (such as a final notice of intent to levy) to resolve its collection cases. These notices get more threatening as they go, and ignoring them results in enforcement by levy.

The need for the levy release is immediate; but what the IRS wants takes time, and that often presents a dilemma.

In most cases, the IRS will not release a levy unless it receives the case resolution it had been seeking in return. Case resolution usually includes making a full financial disclosure so the IRS can determine how the taxes can be repaid. If there are unfiled returns or missing estimated tax deposits, presume full compliance will also be demanded as a prerequisite to levy release.

The need for the levy release is immediate; but what the IRS wants takes time, and that often presents a dilemma. It is consuming to interview your client and prepare a proper financial statement (Form 433A, 433B, or 433F—Collection Information Statement for Wage Earners and Self-Employed Individuals, Collection Information Statement for Businesses, and Collection Information Statement, respectively)). The IRS will also require verification of what is on the financial statement (including pay stubs, bank statements, and proof of living expenses). Medical expenses may have to be verified if they exceed the IRS standard allowance of $60/person ($144 if sixty-five years or older) in the household. Sometimes, the IRS will ask for documentation that may not have been expected, whether it is a car title, mortgage payoff, or auto insurance verification, which can set the negotiations back.

The documentation the IRS requests is up to the discretion of the IRS employee handling the case. It is best to obtain the most documentation possible on the front end to avoid the delays in having to go back to the drawing board and call the IRS a second or third time. In other words, if it is on the financial statement, be prepared to verify it, whether you are asked to or not.

The need for unfiled tax returns can drag the release process out longer, and it is often complicated by obtaining documents to complete the returns, especially for a self-employed client who has poor records.

After a financial statement is ready with verification and any delinquent returns are prepared so they can be filed, the information must be presented to the IRS. A negotiation ensues over what your client can or cannot pay. This often dead ends with the inequitable application of the IRS collection financial standards, which limit the amount of living expenses your client can claim. IRS living expense guidelines allow only expenses it deems to be reasonable. The effect is "phantom income" for your client from the disallowed expenses.

Final result: the IRS may be willing to release the levy, but with a monthly installment agreement your client cannot afford.

But there are solutions. Sometimes, after a close review, a levy which seems to be devastating may not have the impact your client envisions. Bankruptcy and streamlined installment agreements are ways to eliminate the financial disclosures that can bottleneck negotiations and get an immediate release of an IRS levy, no questions asked. The phantom income the IRS wants from application of its living expense allowances can be unraveled by using Internal Revenue Manual provisions that permit excessive expenses. Precedent exists in case law and in the Internal Revenue Code that unfiled returns do not need to be filed as a condition of levy release when economic hardship is proven.

What is the impact of the levy?

In determining how to handle a levy, it is important to understand how it affects your client.

BANK LEVY

A levy on a bank account attaches only to funds in your client's account at the time the bank processes the levy. Any future deposits are not subject to the levy.

For example, if there is $200 in the bank when the levy is processed, the bank will take that out and hold it for twenty-one days before sending it to the IRS. If a $1,000 deposit is made the next day, that money is not subject to the levy. The levy was extinguished when the $200 was deducted.

The IRS would have to send a brand new levy to get money from the account again. This is certainly possible, but in most Automated Collection Service (ACS) cases, a second bank levy is unlikely to happen in rapid-fire succession.

The pressure for an immediate release is minimized on a $200 loss. This amount, while important to your client, does not necessarily dictate quick action, but rather reflection on the best course of action. A full financial disclosure may not justify recovering $200. For example, if there is limited time left on the 10-year IRS statute of limitations on collection, bank balances remain low, and there is minimal collection risk elsewhere for your client. Running out the collection timeframe on a low-key basis could be best.

If an IRS levy hits when there is a significant balance in the account, the 21-day hold provides a window of opportunity to contact the IRS, negotiate a release of the levy, and have the funds restored to your client's account.

WAGE LEVY

In contrast, a levy on wages is continuous and impacts every paycheck your client receives until it is released.

Careful use of IRS levy exemptions can be beneficial to the process and eliminate the need for a release. Internal Revenue Code Sec. 6334(a)(9) gives every taxpayer an amount of wages that are protected from levy. With the notice of levy, the IRS will provide an employer with a Statement of Exemption and Filing Status (found in Parts 3, 4, and 5 of Form 668-W(c)(DO)). The employer should provide this to its employee to complete and return to claim the amounts that can be kept from a levied paycheck. The exemption amounts are found in IRS Publication 1494 (Tables for Figuring Amount Exempt from Levy on Wages, Salary, and Other Income—Forms 668-W(ACS), 668-W(c)(DO), and 668-W(ICS)).

Consideration should be given to whether letting the levy stand with a claim of exemptions provides a better result than a negotiated levy release.

A good example of the use of the levy exemptions is the client who files jointly with her husband and has a family of four. She claims three exemptions against the levy, one for her and two for her children. If the client is paid biweekly, and using the exemption tables in the publication, she would be able to keep $873.08 of every paycheck on a net basis after taxes and employee deductions (health insurance, etc.). This may entitle her to keep more of every paycheck than a financial disclosure and negotiation, especially after considering the impact of her husband's wages on reducing the household living expenses, which could increase her ability to pay. Sometimes, letting the levy go and claiming exemptions can bring better results than release, especially in light of other household income or assets.

SUBCONTRACTOR INCOME AND ACCOUNTS RECEIVABLE

A levy on subcontractor income and accounts receivable reaches only what your client has a present right to at the time the levy is issued. These levies are not continuing. See Internal Revenue Manual 5.11.6.7 and 5.11.5.3. In other words, the IRS stands in the shoes of the client—the levy takes no more than what the client is entitled to. This rule also pertains to retirement accounts (i.e., if a client has no access to a 401(k) account until separation from employment, neither does the IRS).

An excellent example of the "stand-in-your-shoes" concept is the Sunday pianist for the church choir. The IRS sends a levy to the church, which the church receives on a Thursday. At that time, there is no money owed to the pianist as he is paid in cash after the performance is completed on Sunday morning. The church does not owe the client any money on Thursday when the levy is received, nor does the client have any right to funds from the church. The church returns the levy to the IRS marked "No funds due." The IRS would literally need to be at church and serve the levy on Sunday to get paid.

Quick Ways to Get an IRS Levy Released, No Questions Asked

The log jam that can be part of the levy release process—completing a financial statement, securing verification, preparing unfiled returns, and negotiating the IRS living expense allowances—is often too time-consuming for the immediate needs of our clients. In those situations, there are options to get a levy released within twenty-four hours, no questions asked, no negotiation, and no financial disclosure necessary.

BANKRUPTCY

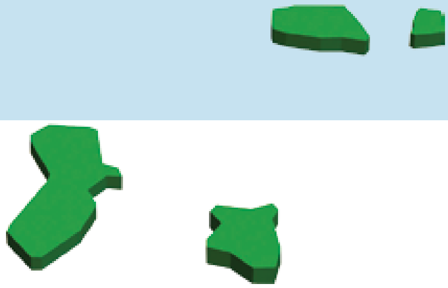
Although often a course of last resort, bankruptcy results in an immediate release of an IRS levy, no questions asked. Filing for bankruptcy causes what is known as an "automatic stay" on collection actions by all creditors, including the IRS. The stay is imposed by law from Sec. 362(a) of the bankruptcy code and requires that creditors (including the IRS) not only release levies and garnishments, but also stop lawsuits as well.

An IRS revenue officer or ACS employee should release a levy immediately upon being provided with the bankruptcy case number. If not, a call should be placed to the IRS Centralized Insolvency Unit at 800-973-0424 for release.

As the release is a matter of law, no financial statements (Forms 433A, 433B, and 433F) are required. There is no need for disclosures or negotiations with the IRS. Another advantage in using bankruptcy to release a levy is that the IRS is required to release it even if there are unfiled returns (although the returns will need to be filed for bankruptcy purposes). The bankruptcy stay also prevents the IRS from filing a federal tax lien if one has not yet been filed.

The relief provided by bankruptcy usually continues while the bankruptcy is pending, preventing the IRS from issuing future levies and tax liens. In most cases, the stay on future levies continues until the bankruptcy case is closed, the bankruptcy is dismissed, or a final discharge of debt is granted or denied.

In Chapter 7 bankruptcy filings, the stay on the IRS should last between four to six months. A Chapter 7 is known as a liquidating bankruptcy. In a Chapter 7, our clients will have to demonstrate an inability to repay their debts to qualify. If the qualifications are met and the Chapter 7 is filed on older income taxes, it can eliminate tax debts.



Correcting the harsh results of IRS living expense allowances is the icing on the cake to levy release in a Chapter 13.

The bankruptcy stay lasts longer in Chapter 13 reorganizations, usually between three to five years. A Chapter 13 takes longer than a Chapter 7 because it involves partial or full repayment to creditors, including the IRS. In many Chapter 13 cases, the IRS can be paid less than what it is owed (known as a cramdown) and interest accruals stop. Chapter 13 is for the client who can afford monthly payments to creditors, including the IRS. It can also reorganize multiple layers of debt, meaning the client who has both credit card and IRS debt and cannot pay both can force the credit cards to take less and free up money for the IRS. Chapter 13 solves the common problem of how to divide the pie.

An additional benefit to a Chapter 13 is that it can eliminate the often inequitable outcomes from the IRS applying its living expense allowances. Bankruptcy courts want reasonable expenses too, but there is often much more lenience than that of the strict IRS internal allowances. It is common for a Chapter 13 to result in a payment based on the reality of a client's living expense situation. It is also possible that the client would even qualify for a Chapter 7 and not need to make repayment when IRS expense allowances give way to bankruptcy court standards. Correcting the harsh results of IRS living expense allowances is the icing on the cake to levy release in a Chapter 13 and a Chapter 7.

STREAMLINED INSTALLMENT AGREEMENT

If your client owes $25,000 or less to the IRS, he will qualify for a repayment agreement and levy release with no financial disclosures necessary. This is known as a streamlined installment agreement. In exchange for entering into the agreement, the IRS will release a levy, no questions asked.

These agreements are "streamlined" as they eliminate the need for IRS financial statements (Forms 433A, 433B, and 433F) and result in an automatic agreement with the IRS to repay the taxes of $25,000 and under over a course of sixty months. Streamlined installment agreements should be completed over the phone with ACS or a revenue officer with one phone call. Although the IRS representative is scripted to inquire where your client banks and works when setting up a streamlined installment agreement, the information does not have to be provided to finalize the agreement. At the end of the call when the streamlined installment agreement is input into the IRS computer system, the IRS representative should immediately release the levy against your client.

Depending on the amount owed, sometimes it is advisable for a client to pay down the amount he owes to $25,000 or under to qualify to get the quick levy release and avoid financial disclosures.

Another benefit to a streamlined installment agreement is that your client's monthly payment could be less than if financial statements detailing income and living expenses were provided to the IRS. This is because the most your client will be committed to paying the IRS is approximately $425/month ($25,000/60 months). The payment amount can be much lower depending on the balance owed. Your client should be advised to send voluntarily more than the minimum amount to pay the IRS off sooner if possible.

A streamlined installment agreement does not require managerial approval. There is no application of the IRS living expense allowances. Asset disclosure is also avoided. Streamlined installment agreements are available even in full-pay situations. The IRS will require, however, any unfiled returns be brought current (usually encompassing the prior six years) and full compliance before the agreement is finalized and the levy released.

OFFER IN COMPROMISE OR INNOCENT SPOUSE CLAIMS

Although it is not as absolute as bankruptcy or streamlined installment agreements, the filing of an offer in compromise or innocent spouse claim can result in a levy release without negotiation.

The IRS is required by law to suspend collection efforts when either a compromise or an innocent spouse claim is filed. Technically, this means the IRS is prevented from sending out future levies, not releasing one already sent. However, an IRS employee can exercise discretion to release an existing levy automatically once an OIC or innocent spouse claim is filed.

If a levy is requested to be released on the sole basis of the submission of an OIC or innocent spouse relief, a best practice is to have a full financial statement ready to negotiate the release in the event the compromise or innocent spouse claim does not do the trick by itself.

Solutions to the IRS Living Expense Allowances (Collection Standards)

If bankruptcy or a streamlined installment agreement are not options, it is likely you will be faced with negotiating a regular installment agreement or an economic hardship determination. Both of these options require financial disclosure. Economic hardship, also known as currently not collectible, is a finding by the IRS that there is no ability to make payments without impacting basic living necessities. In economic hardship cases, the IRS releases a levy and temporarily suspends any payment requirements, putting enforcement on hold.

Installment agreements and economic hardship determinations both involve the application of the caps the IRS puts on living expenses. The result is that an economic hardship client in the real world can be determined to have cash flow in the world of the IRS.

The usual suspects that create this gap include high housing and utility expenses, high car payments (currently limited to $496/month for one car, $992 for two cars), and conditional expenses such as retirement contributions or loan repayments, charitable contributions, and any unsecured debt (often credit cards). These expenses are either capped by the IRS (such as the housing/utility and car expenses) or completely disallowed (like the credit cards) as not necessary.

This creates a pinch. Enter into an installment agreement that cannot be funded and get the levy released, which will likely lead to a later default, or default on mortgage, auto, or credit card payments and stay in the good graces of the IRS with an installment agreement that adheres to their standards.

Here are some solutions to the living expense dilemma:

FULL PAY IN FIVE YEARS

The Internal Revenue Manual provides for the allowance of all living expenses—even those that exceed the stringent expense allowances—if an installment agreement can be funded that will pay off the liability in full within five years. See IRM 5.15.1.10.

There is magic in five years with the IRS. Without financial disclosure, the IRS will grant a quick streamlined installment agreement and release a levy if the debt is $25,000 or under and can be repaid in five years. With financial disclosure, if the tax liability is over $25,000, the IRS should allow excess living expenses and enter into a regular installment agreement if a taxpayer can repay the taxes in five years. Both approaches eliminate the impact of the expense allowances.

ONE YEAR TO MAKE CHANGES

If more than $25,000 is owed and there is not enough cash flow to repay the taxes in five years, IRM 5.15.1.10 permits allowing the excess living expenses for one year. The intent is to provide time to make expense adjustments to make the higher payment amount. This option should be invoked when necessary as a band-aid, but the reality is that few clients will be able to lower or eliminate mortgage, car, and credit card payments in the 1-year timeframe.

The better option in these scenarios is often Chapter 13 bankruptcy, which provides for repayment of debt under bankruptcy law standards of reasonableness and is usually closer aligned to real world scenarios than to IRS internal guidelines. Chapter 13 often results in an installment agreement that the IRS administratively refuses to take.

Unfiled Returns and Economic Hardship

With the exception of bankruptcy, in virtually every scenario the IRS will require that any unfiled returns be brought current before it will release a levy.

However, the Tax Court case of *Vinatieri v. Commissioner*, 133 TC 392 (2009) changes that and adds a finding of economic hardship to the short list of being able to secure a levy release even though tax returns are unfiled.

Vinatieri involved a collection due process case in which an IRS appeals officer made a finding of economic hardship but would not agree to a hold on levy action until the taxpayer had become current on unfiled tax returns.

The Tax Court held that IRC Sec. 6343(a)(1)(D), which provides for release of an IRS levy upon the finding of economic hardship, had no requirement that unfiled returns had to be brought into compliance as a condition of release. The court found that the IRS was unreasonable in deciding to pursue levy action in an economic hardship case, regardless of the compliance issues.

Although all IRS collection employees may not be thoroughly versed in the *Vinatieri* case, it should be used to make clear to any employee the absolute nature of IRC Sec. 6343 when it comes to economic hardship and levy releases.

After *Vinatieri*, the IRS revised Internal Revenue Manual 8.22.2.4.2 to state, "If a taxpayer is entitled to CNC status based on economic hardship, he or she should be granted CNC status based on economic hardship, even if he or she has not filed all required returns."

In difficult cases when the IRS refuses to recognize *Vinatieri*, the IRS Taxpayer Advocate should be contacted. The Taxpayer Advocate has issued statements in support of the *Vinatieri* case and has expressed a willingness to go to bat for taxpayers in proven economic hardship cases. It is noteworthy that IRS chief counsel has acquiesced with the *Vinatieri* decision as it relates to unfiled returns and economic hardship. See Chief Counsel Notice 2011-005, November 22, 2010.

The *Vinatieri* case provides relief from the constraints of becoming current on tax filings when a levy can be proven to cause economic hardship. **EA**

About the author:

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