E. Collection Update: The IRS's Tepid Approach to Implementing Recent Changes in Collection Policies Has Limited Taxpayer Access to Important Collection Options

In FY 2011 and 2012, the IRS implemented a series of collection-oriented operational policy changes collectively known as the "Fresh Start" initiative. In the 2012 Annual Report to Congress, the National Taxpayer Advocate commented on the positive trends related to the "Fresh Start" changes. She also noted that the IRS needed to place much more emphasis on delivering services to realize the full benefits of the initiative.[1] More importantly, the IRS needs to more actively support these policy changes though internal and external outreach and training in order to make them part of the Collection philosophy. While important, new policy guidance will only be effective when IRS employees, taxpayers, and tax professionals are aware of the changes and understand the reasoning behind them.

On the one hand, TAS has noted that the policy changes have yielded some positive trends within the Collection program. As of March in FY 2013, the IRS had accepted 15,634 offers in compromise (OIC), an increase of 65 percent over the same period in FY 2011. The overall acceptance rate for OICs was 44 percent at the midpoint of FY 2013.[2] The availability of lien withdrawals has continued to improve,[3] and policy-driven filings of Notices of Federal Tax Lien (NFTL) have declined by 50 percent over the same period in FY 2011.[4] These indicators reflect the intentions of the "Fresh Start" initiative, and represent positive trends that have developed throughout the prior two fiscal years.

On the other hand, the use of installment agreements (IA) for taxpayers to pay their tax debts continues to decline.[5] In light of the significant policy changes made to the "streamlined" IA criteria, the ongoing reduction in IA activity is a matter of concern. Further, while current trends involving the use of OICs and lien withdrawals are positive, the relatively small number of taxpayers receiving consideration for these collection options raises questions about the adequacy of taxpayer access to these important tools.

In the coming year, the National Taxpayer Advocate will examine the internal and external communication strategies employed by the IRS to implement the "Fresh Start" initiative. For example, TAS has noted that procedural guidance developed to implement the new policies has not yet been incorporated into the IRM, although many of the procedures have

1 National Taxpayer Advocate 2012 Annual Report to Congress 348-357 *(Introduction to Collection Issues: The IRS "Fresh Start" Initiative Has Produced Significant Improvements in Some Collection Policies; However, Significantly More Emphasis on Service Delivery Is Necessary to Realize the Full Benefits of These Important Changes).*

2 IRS, Collection Activity Report, NO-5000-108, *Report of Offer in Compromise Activity* (Apr. 2013). As of March 2013, the IRS accepted 15,634 and rejected 4,243 offers in compromise. Through March 2011, the IRS had accepted 9,490 offers and rejected 5,699.

3 IRS, Collection Activity Report, NO-5000-25, *Liens Report* (Apr. 2013). As of March 2013, the IRS issued 6,845 lien withdrawals, an increase of 18 percent over the same period in FY 2012.

4 IRS, Collection Activity Report, NO-5000-25, *Liens Report* (Apr. 2013). As of March 2013, the IRS had filed 307,842 Notices of Federal Tax Liens (NFTL), a decline of 50 percent over the same period in FY 2011.

5 IRS, Collection Activity Report, NO-5000-6, *Installment Agreement Report* (Mar. 2013). Since the "Fresh Start" initiative was implemented in February 2011, IAs for individuals and businesses have each declined by nine percent, while "streamlined" IAs for individuals and businesses have dropped by eleven and three percent, respectively.

been in place for over two years. TAS continues to encounter instances in casework and external outreach sessions where neither IRS Collection employees nor tax professionals are fully aware of the revised policies. Further, an ongoing internal review of TAS cases involving collection issues has confirmed that Collection employees are not routinely adhering to the revised procedures. Additionally, TAS will collaborate with the IRS to identify and remove procedural barriers that may be inadvertently limiting taxpayer access to the taxpayer-friendly provisions of the revised Collection policies.

IRS Collection Policies and Procedures Are Not Effective in Resolving Cases Involving Small Business Taxpayers.

For several years, the National Taxpayer Advocate has voiced concerns about the IRS's treatment of small business taxpayers with tax debts.[6] Particularly in the area of employment tax delinquencies, the IRS has proven to be slow to react and provide effective interventions with small business taxpayers. Employment taxes can accumulate rapidly and become exceptionally difficult to collect as they age. Still, the IRS continues to route taxpayers with new employment tax debts, as well as other accounts recorded on the Business Master File (BMF), to its Automated Collection System (ACS). In FY 2012, for example, the IRS sent 82 percent of new BMF taxpayer cases to ACS. However, the ACS does not appear to be effective in resolving these delinquencies. Of the BMF tax dollars routed through the ACS system in FY 2012, 78 percent left ACS as unresolved accounts.[7]

Ironically, IRS policies and procedural restrictions have created significant barriers for small business taxpayers, who cannot immediately pay in full, in resolving BMF tax debts with the ACS. In FY 2012, although the IRS directed 525,425 BMF taxpayer cases to ACS, the unit issued only 31,070 installment agreements on those accounts.[8]

ACS will not discuss an installment agreement, or even obtain a Collection Information Statement, when contacted by a business taxpayer if the delinquency involves unfiled returns.[9] In fact, the IRS does not train ACS assistors to secure and analyze business-related financial statements; nor are ACS assistors authorized to grant non-streamlined

6 National Taxpayer Advocate 2010 Annual Report to Congress, vol. 2, (*Research Study*: An Analysis of the IRS Collection Strategy: Suggestions to Increase Revenue, Improve Taxpayer Service, and Further the IRS Mission) ; National Taxpayer Advocate 2012 Annual Report to Congress, 358-380 *(*Most Serious Problem: *The Diminishing Role of the Revenue Officer Has Been Detrimental to the Overall Effectiveness of IRS Collection Operations)*; National Taxpayer Advocate 2012 Annual Report to Congress, 381-402 (Most Serious Problem: *The Automated Collection System Must Emphasize Taxpayer Service Initiatives to Resolve Collection Workload More Effectively)*.

7 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Report* (Oct. 2012). Looking at all cases reported on the IRS Business Master File (BMF), in FY 2012 the IRS routed delinquent BMF tax accounts valued at approximately $3.5 billion to ACS, but the system only collected about $394 million, or roughly 11 percent of the dollar value of the cases. Of the BMF tax cases that passed through the ACS system in FY 2012, 60 percent, or $2.1 billion in delinquent revenue, were transferred to the Queue. An additional 12 percent of these cases, totaling approximately $426 million, were ultimately transferred to the CFf. Approximately six percent of these accounts, or $201 million, were systemically reported as currently not collectible.

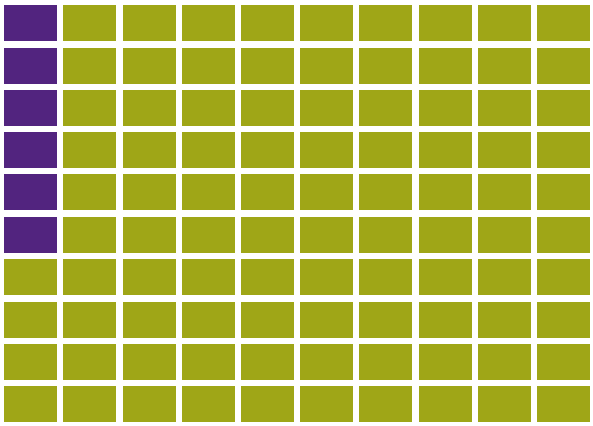
8 IRS, Collection Activity Report, NO-5000-6, Installment Agreement Reports (Oct. 2012); IRS, Collection Activity Report, NO-5000-2, Taxpayer Delinquent Account Report (Oct. 2012). The dollar value of the BMF accounts involving installment agreements issued by ACS in FY 2012 was approximately $205 million.

9 IRM 5.19.1, *Balance Due* (Nov. 3, 2010).

installment agreements on employment tax cases.[10] Consequently, BMF accounts assigned to field-based revenue officers are frequently aged, and involve problems that are much more difficult to resolve.

As the nation's economy continues to recover slowly, the IRS needs to be more responsive and flexible in working with small business taxpayers, with a goal of helping otherwise viable businesses get back into compliance. The National Taxpayer Advocate will work with the IRS in identifying Collection policies that serve more as barriers than potential solutions for small businesses attempting to resolve tax debts. She will continue to urge the IRS to use more of its Collection resources to service these accounts in a timely, problem-solving manner.

Automated Collection System issues installment agreements in just 6% of business tax cases



In FY 2012, although the IRS directed 525,425 business taxpayer cases to ACS, the unit issued only 31,070 installment agreements on those accounts.

TAS Advocacy and Collaboration with the IRS Result in Safeguards for Taxpayers Facing Foreclosure Actions.

The National Taxpayer Advocate and her staff have worked very closely with the IRS to develop procedures that protect taxpayer rights in cases where the IRS is considering a judicial foreclosure sale of a taxpayer's home to collect delinquent taxes. This important guidance has been completed and formally issued as of April 30, 2013.[11] The new policy requires Collection, prior to initiating foreclosure suits, to consider precautions similar to those required for seizures of personal residences. The IRS guidance includes direction to Collection staff to attempt personal contact with the taxpayer and consider other payment options before initiating a suit to foreclose on a primary residence. When the foreclosure may create economic hardship, the guidance requires Collection to inform the taxpayer of the availability of TAS assistance prior to sending the recommendation for a suit to the Department of Justice.

10 IRS response to TAS information request (Sept. 13, 2012).

11 IRS, *Principal Residence Suit Foreclosure Recommendations*, SBSE 05-0413-035 (Apr. 30, 2013).

TAS has recently become aware that the IRS has recommended foreclosure actions where the negative impact on the taxpayers would be severe. Although the taxpayers were already dealing with documented economic hardships, the suit recommendations still went forward. Of particular concern was that revenue officers had documented in the case histories that seizure would not be appropriate due to the taxpayers' circumstances, but did not perceive the recommendations for judicial foreclosure in the same manner – even though the results of a foreclosure suit and an administrative seizure are essentially the same.

Reflecting statutory protections, IRS Collection policies require that the seizure and sale of a taxpayer's principal residence generally occur only after a thorough review of the taxpayer's circumstances, full consideration of alternative collection methods, and confirmation that the seizure will not create economic hardship.[12] The IRC specifies the actions required prior to initiating the seizure of a taxpayer's assets, and provides special rules related to the seizure and sale of a principal residence.[13] As a matter of IRS policy, seizure is generally the last option considered in the collection process.[14] With the issuance of the new guidance, it is now IRS policy that suits to foreclose on a taxpayer's home should be approached in a similar manner, with proper consideration for the potentially negative impact on the taxpayer or other occupants. The National Taxpayer Advocate sincerely appreciates the cooperation and support of the IRS in developing and implementing this important new policy. In FY 2014, the National Taxpayer Advocate will recommend that this issue be included in the Treasury Department's Priority Guidance Plan for incorporation into the official Treasury Regulations.

The Federal Payment Levy Program (FPLP) Continues to Harm Taxpayers Suffering Economic Hardship.

TAS continues to assist taxpayers experiencing economic hardship whose income or bank accounts are being levied. IRC § 6343(a)(1)(D) requires the IRS to release a levy if the taxpayer is in economic hardship, and according to the holding in *Vinatieri v. Commissioner,* the IRS cannot proceed to levy on a taxpayer in economic hardship, even where there are unfiled returns.[15] Pursuant to the Federal Payment Levy Program (FPLP), authorized by IRC § 6331(h), the IRS may continuously levy up to 15 percent of certain federal payments, including Social Security benefits, on taxpayers with unpaid tax liabilities.

In light of a 2008 National Taxpayer Advocate study of more than 185,000 FPLP cases which suggested a significant number of taxpayers were subject to levies on their Social Security income even though the levy would create an economic hardship – requiring immediate levy release under IRC § 6343(a)(1)(D) – the IRS agreed to adopt a filter designed

12 Treas. Reg. § 301.6334-1(d). See also IRM 5.10.1, IRM 5.10.2.18.

13 IRC §§ 6331(j) and 6334(e). The IRS cannot levy on a taxpayer's residence without obtaining court approval first.

14 IRM 1.2.14.1.8, Policy Statement 5-34.

15 *Vinatieri v. Comm'r*, 133 T.C. 392 (2009). The Tax Court held that the IRS abused its discretion when it determined to proceed with a levy on the bank account of a taxpayer with unfiled returns, even though the taxpayer had shown she was in economic hardship.

to prevent FPLP levies on low income taxpayers.[16] The filter, triggered when taxpayer income is below 250 percent of the federal poverty level, is a proxy for hardship under IRC § 6343(a)(1)(D).[17] The *Vinatieri* case had not yet been decided when the IRS agreed to implement the filter, and the filter excluded accounts of taxpayers with indications of unfiled returns.[18] Consequently, the IRS still places FPLP levies on payments to taxpayers in economic hardship. TAS advocates with the IRS to release these levies, place the accounts in currently not collectible (CNC) status, and return any levy proceeds to the taxpayer.[19]

The National Taxpayer Advocate believes that excluding taxpayers from the FPLP filter because of unfiled returns contravenes the holding in *Vinatieri*, causes the IRS to treat similarly situated taxpayers differently, and leads to negligent collection actions which could give taxpayers the right to recover damages in a suit before a US district court.[20] The existence of unfiled returns does not vitiate the mandate of IRC § 6343(a)(1)(D): where a taxpayer is in economic hardship, the IRS must release the levy. The FPLP filter is a proxy for economic hardship, and a taxpayer's economic hardship is not a function of whether there are delinquent returns. In FY 2014, we will continue to advocate for reprogramming the FPLP filter to include accounts of taxpayers with indications of unfiled returns. The National Taxpayer Advocate has already issued a Taxpayer Assistance Directive (TAD) on this issue which was appealed by the Commissioner of Small Business/Self-Employed.[21] The National Taxpayer Advocate will now elevate this TAD to the Deputy Commissioner and Commissioner of Internal Revenue if necessary.

IRS Procedural Barriers Needlessly Restrict or Delay Taxpayer Access to Collection Payment Options.

The IRS Restructuring and Reform Act of 1998 (RRA 98) included provisions to ensure taxpayers have fair access to IRS payment options, such as installment agreements (IA)

16 National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, *Building a Better Filter: Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program.*

17 The Deputy Commissioner of the Small Business/Self-Employed division, the Commissioner of the Wage & Investment division, and the Director of Campus Compliance requested TAS to identify an appropriate filter amount, then agreed with TAS that 250 percent of the federal poverty level fairly approximates the regulatory definition of significant hardship for Social Security recipients and makes it unnecessary to construct an algorithm to identify taxpayers who would experience economic hardship.

18 For a complete discussion of the FPLP and the IRS's implementation of the FPLP filter, see National Taxpayer Advocate 2011 Annual Report to Congress 350, 353 (Most Serious Problem: *The New Income Filter for the Federal Payment Levy Program Does Not Fully Protect Low Income Taxpayers from Levies on Social Security Benefits).*

19 IRC § 6343(d)(2) authorizes the IRS to return levied payments where: the levy was premature or otherwise not in accordance with administrative procedures; the taxpayer has entered into an installment agreement, unless the agreement provides otherwise; the return of such property will facilitate the collection of the tax liability, or with the consent of the taxpayer or the National Taxpayer Advocate, the return of such property would be in the best interests of the taxpayer (as determined by the National Taxpayer Advocate) and the United States.

20 IRC § 7433 authorizes a civil action for damages against the United States in district court based upon the negligent or reckless or intentional disregard by IRS personnel of any provision of the Internal Revenue Code or any Regulation promulgated thereunder in connection with the collection of federal tax.

21 Taxpayer Advocate Directive 2012-2 (*Taxpayers Whose Incomes Are Below 250 percent of the Federal Poverty Level Set by the Department of Health and Human Services and who receive Social Security or Railroad Retirement Board Benefits Should Be Screened Out of the Federal Payment Levy Program (FPLP) regardless of unfiled returns or outstanding business debts*) Jan. 12, 2012, available at http://ccintranet.prod.irscounsel.treas.gov/OrgStrat/Offices/CNTA/Pages/default.aspx.

and offers in compromise (OIC).[22] This legislation requires the IRS to refrain from levying when a taxpayer proposes an IA or OIC as a potential resolution for a tax debt, and while the taxpayer's proposal is pending, *i.e.,* being considered by the IRS.[23] If the IRS rejects the proposed OIC or IA, the taxpayer has a right to appeal the rejection.[24] The IRS has implemented procedures that serve to narrow the impact of these legislated safeguards and restrict taxpayer access to these important payment options.

Upon enactment of RRA 98, the IRS developed criteria to define when an IA or OIC would be considered "pending," as well as procedures to allow for immediate rejection of the taxpayer's proposal when it is determined to be frivolous, and made "solely to delay" collection action. Over the years, however, the IRS has increasingly used these criteria to restrict taxpayer access to installment agreements, and reject IAs and OICs without full consideration.

For example, a proposal for an IA or OIC may be classified as being made "solely to delay" when a taxpayer submits a request as a result of being advised by the IRS of a planned levy action, even when the taxpayer's proposal is not clearly frivolous.[25] The IRS will not consider a taxpayer's request for an IA as "pending" if the taxpayer has unfiled returns.[26] Moreover, the IRS will modify a taxpayer's proposed IA by increasing the payment amount to make the IA fit streamlined criteria.[27] This is done without the taxpayer's consent or agreement. TAS has objected to this practice for well over a year, but it continues to this day. This practice deprives taxpayers their right to have their IA proposal considered and if denied, an independent review and an opportunity to appeal the denial as required by IRC § 7122(e). In response to TAS concerns over this practice the IRS has proposed that if a taxpayer does not meet "streamlined" IA criteria and does not include a completed financial statement with an IA proposal, it will not consider the taxpayer's request a "pending IA," and therefore may not afford the taxpayer the protections envisioned in RRA 98.

IRS policy states that taxpayers do not qualify for installment agreements if balance due accounts can be "fully or *partially* (emphasis included in the IRM) satisfied by liquidating assets," unless certain equitable factors are present or the case meets "streamlined" criteria.[28] While this policy allows for consideration of special circumstances, TAS and the Tax Court have seen cases where IRS employees have rigidly adhered to IRM direction to recommend the rejection of IA proposals if the taxpayers do not liquidate assets and make full or partial payment by a set date.[29]

22 Pub L. 105-206, 112 Stat. 685 (1998).

23 IRC § 6331(k).

24 IRC §§ 6159(f) and 7122(e).

25 IRM 5.14.3.2.

26 IRM 5.14.1.4.1(4).

27 IRM.19.1.5.5(16) and IRM 5.19.1.6(21).

28 IRM 5.14.1.4 (5) and (6).

29 For example, *Antioco v. Comm'r*, T.C. Memo. 2013-35.

The National Taxpayer Advocate is concerned that the inflexibility of the IRS in these situations may have a chilling effect on the willingness of taxpayers to contact the IRS and voluntarily attempt to resolve tax debts in a reasonable manner. In FY 2014, TAS will advocate and work with the IRS to review and revise these and other IRS procedural requirements that appear to only serve as barriers to taxpayer access to IAs and OICs. If the IRS fails to adopt guidance that addresses our concerns, the National Taxpayer Advocate will issue a Taxpayer Advocate Directive, elevating the matter to the Commissioner of Internal Revenue.