MSP #10 LEVIES ON ASSETS IN RETIREMENT ACCOUNTS: Current IRS Guidance Regarding Levies on Retirement Accounts Does Not Adequately Protect Taxpayer Rights and Conflicts with Retirement Security Public Policy

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TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Be Informed*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

DEFINITION OF THE PROBLEM

Taxpayers rely on Individual Retirement Accounts (IRAs) or defined contribution plans, such as 401(k) plans, or Thrift Savings Plans (TSPs) for federal employees, to fund living and other expenses after retirement. With rising medical and hospice care costs, many retirees are struggling to cover their basic living expenses. The Employee Benefits Retirement Institute (EBRI) estimates only 56.7 percent to 58.5 percent of Baby Boomers and Gen Xers are sufficiently funded for life after retirement.[2] Social Security benefits account for only about 40 percent of retirees' total income, meaning Americans should be funding retirement plans to make up the shortfall.[3] Understanding the importance of Americans having sufficient retirement savings, Congress for years encouraged retirement savings and formulated policies to protect the rights of individuals to pensions.[4]

Congress has given the IRS broad powers to collect taxes, including the authority to levy on a taxpayer's property and rights to property.[5] This power to levy extends to funds held in retirement accounts. Given the long-term importance of retirement assets to individuals' future welfare, the IRS regards retirement levies as "special cases" that require additional scrutiny and managerial approval.[6] However, the IRS

1 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 Jack VanDerhei, *"Short" Falls: Who's Most Likely to Come Up Short in Retirement, and When?*, Employee Benefits Retirement Institute Notes, Vol. 35, No. 6, June 2014, *available at* http://www.ebri.org/pdf/notespdf/EBRI_Notes_06_June-14_ShrtFlls-HSAs.pdf. For purposes of this study, Baby Boomers are defined as the generation born between 1948 to 1964 and Gen Xers are the generation born between 1965 and 1974.

3 *See* Social Security Administration (SSA), *available at* http://www.ssa.gov/policy/docs/ssb/v65n3/v65n3p1.html (last visited Dec. 4, 2015); SSA, *Retirement Planner: Learn About Social Security Programs*, *available at* http://www.socialsecurity.gov/planners/retire/r&m6.html (last visited Dec. 4, 2015); Association for the Advancement of Retired Persons, Affording Retirement: Social Security Alone Isn't Enough, *available at* http://www.aarp.org/work/social-security/info_06_2010/ss_isnt_enough.html (last visited Dec. 4, 2015).

4 For example, the Employee Retirement Income Security Act of 1974 (ERISA) was enacted to provide protection for participants in pension and health plans in private industry. *See* Pub. L. No. 93–406, 88 Stat. 829 (1974).

5 *See* IRC § 6331.

6 Internal Revenue Manual (IRM) 5.11.6.2(3) (Sept. 26, 2014).

guidance that explains the steps required before a retirement account can be levied contains inadequate detail and is insufficient to protect taxpayer rights.[7]

The National Taxpayer Advocate has highlighted several concerns to show current guidance is not sufficient to protect taxpayer rights including the following:

- The guidance regarding flagrant conduct (a prerequisite for the levy) lacks definition and clarity;
- There is inadequate instruction for analyzing future retirement calculations and no requirement to provide those calculations to the taxpayer;
- The IRS does not educate the taxpayer about what to do to avoid a levy, or discuss alternative collection options with the taxpayer prior to a levy on a retirement account;
- The IRS does not conduct a risk analysis similar to the pre-seizure and pre-levy considerations;
- The IRS does not track levies that are issued against particular retirement accounts and therefore is unable to conduct quality reviews to ensure taxpayers are being treated uniformly and employees are following existing guidance; and
- The IRS proposed a TSP levy pilot program within its Automated Collection System (ACS) unit, which could automate much of the decision to levy on a TSP retirement account, and would result in disparate collection treatment of TSP accounts compared to other retirement accounts.

The current Internal Revenue Manual (IRM) procedures and the proposed ACS pilot undermine both taxpayer rights and retirement security policy.

ANALYSIS OF PROBLEM

Background

Internal Revenue Code (IRC) § 6331 gives the IRS the right to levy on a taxpayer's property and rights to property. This power allows the IRS to levy on funds held in retirement accounts.[8] Generally, the levy on a retirement account will only reach the funds over which the taxpayer has a present withdrawal right (*i.e.*, a levy will not attach until the taxpayer has a present right to withdraw funds from the plan).[9]

The IRS has established three steps that must be taken before it can issue a notice of levy on a taxpayer's retirement account:

1. Determine what property (retirement assets and non-retirement assets) is available to collect the liability;
2. Determine whether the taxpayer's conduct has been flagrant; and
3. Determine whether the taxpayer depends on the money in the retirement account (or will in the near future) for necessary living expenses.[10]

7 *See* IRM 5.11.6.2(4)-(7) (Sept. 26, 2014).

8 For information on what constitutes a retirement plan, see IRC § 4974(c). The IRS may also levy on retirement income or distributions once the taxpayer retires. IRM 5.11.6.1, *Retirement Income* (Jan. 22, 2010).

9 IRM 5.11.6.2(8) (Sept. 26, 2014).

10 IRM 5.11.6.2(4)-(7) (Sept. 26, 2014).

The Small Business/Self-Employed (SB/SE) Area Director, Field Collection, must approve the notice of levy by signing the form as the Service Representative or by following IRM 5.11.1.3.5.[11] However, any notice of levy that requires the approval of the SB/SE Collection Area Director must include a memorandum explaining the IRS employee's justification for the levy.[12] The written information provided to the manager must include:

1. A summary of any information the taxpayer has provided that may affect the decision to levy, *e.g.*, claims that the assessment is wrong;
2. If the taxpayer has submitted such information, an analysis of that information and why the notice of levy should still be served;
3. Verification that the amount is still owed, *e.g.*, IDRS confirms the amount is still unpaid;
4. An explanation that the notice of levy is appropriate in consideration of the amount owed and any circumstances that are known about the taxpayer and the liability; and
5. Other collection alternatives considered and rejected.[13]

When a distribution occurs as the result of a levy, the taxpayer will experience tax consequences. First, pursuant to IRC § 408(d), generally, the entire amount paid from a retirement account or any distribution, is considered gross income and is subject to taxation. In the instance of a levy on a retirement account, the payor would be required to withhold ten percent.[14] However, this amount of withholding is not guaranteed to be sufficient to cover the federal tax liability created by the distribution, and the taxpayer may be liable for a state income tax as well.[15]

The IRM Guidance Regarding Flagrant Conduct Lacks Definition and Clarity

Understanding the importance of Americans having sufficient retirement savings, Congress for years encouraged retirement savings and formulated policies to protect the rights of individuals to pensions.

According to IRM guidance, if the IRS determines that a taxpayer has engaged in flagrant conduct, it may levy on a retirement account.[16] However, the guidance also provides that if a taxpayer has *not* engaged in flagrant conduct, then the levy should not occur.[17] Thus, the determination of flagrant behavior is a prerequisite for determining to levy on a retirement account. IRS employees are instructed to make a determination of flagrancy on a case-by-case basis and may consider extenuating circumstances that mitigate otherwise flagrant behavior.[18]

However, there is no on-point definition of what constitutes "flagrant" behavior in the IRC, accompanying regulations, or the IRM. The IRS has addressed "flagrant" in regulations related to excise taxes on exempt organizations (EOs). That guidance provides that "a willful and flagrant act (or failure to act) is one which is voluntarily, consciously, and knowingly committed in violation of any

11 IRM 5.11.6.2(10) (Sept. 26, 2014).

12 IRM 5.11.1.3.5(6) (Aug. 1, 2014).

13 IRM 5.11.1.3.5(2) (Aug. 1, 2014).

14 IRC § 3405(b)(1). The payor generally is responsible for making this withholding, but the plan administrator may be liable in the case of certain plans. IRC § 3405(d)(1).

15 Generally, there is a ten percent additional tax on early distributions from a qualified retirement plan but this additional tax does not apply to distributions made from an account because of an IRS levy. IRC § 72(t)(2)(A)(vii).

16 IRM 5.11.6.2(5) (Sept. 26, 2014).

17 *Id.*

18 *Id.*

provision of chapter 42 (other than IRC §§ 4940 or 4948(a)) and which appears to a reasonable man to be a gross violation of any such provision."[19] The United States Tax Court applied this definition in determining that a trustee's actions were flagrant and therefore subject to a penalty assessment under IRC § 6684.[20] This language could provide an analytical framework for defining "flagrancy" in the IRM as it relates to retirement accounts. Without a clear definition of flagrant conduct, this vital element of the analysis cannot occur on a consistent and meaningful basis. The key elements for a flagrant act should be that it is committed in a willful and voluntary manner and that a reasonable person would view it as a gross violation.[21]

Without a definition of flagrant conduct, the IRS employee must make this determination based on examples in the IRM guidance. Several examples of flagrant conduct listed in the IRM include the following:

- Taxpayers who continue to make voluntary contributions to retirement accounts while asserting an inability to pay an amount that is owed; or
- Taxpayers who voluntarily contributed to retirement accounts during the time period the taxpayer knew unpaid taxes were accruing.[22]

By statute, federal employees, without their consent, are automatically enrolled to have a certain percentage (typically three percent) of their salary contributed to the TSP.[23] This is done to encourage saving for retirement and to take advantage of employer matching; federal employees must take an affirmative step to stop these automatic contributions.[24] Other employer plans adopt a similar "opt-out" approach to automatically enroll employees.[25] Thus, an employee may have been contributing to a retirement plan via automated payroll deductions for years before incurring an IRS debt and may not be aware the IRS views such contributions to be flagrant conduct. Indeed, if the IRS adopted an EO definition of flagrant conduct discussed above (*i.e.*, voluntary, conscious, and knowing), it is questionable whether their contributions would constitute flagrant conduct.

The examples described above are overly broad in terms of discouraging retirement savings for *any* taxpayer with an outstanding liability. The guidance goes against strong public policy that encourages saving

19 Treas. Reg. § 1.507-1(c)(2).

20 *Thorne v. Comm'r.*, 99 T.C. 67, 108-109 (1992). In particular, the court found that the trustee engaged in "willful conduct" by knowing that certain procedures should be followed but not requiring them to be followed. Also, the court found that the trustee did not act reasonably by relying on oral assurances of his tax advisor after he received a notice of deficiency. Furthermore, making grants to himself and trustees' family members for their own travel to conferences was seen as a gross violation.

21 A bill has been introduced in the House and Senate that recommends a stricter standard for defining flagrant conduct. The proposed definition includes: "(A) the filing of a fraudulent return by the taxpayer, or (B) that the taxpayer acted with the intent to evade or defeat any tax imposed by this title or the collection or payment thereof." Taxpayer Rights Act of 2015, S. 2333, 114th Cong. § 307 (2015); Taxpayer Right Act of 2015, H.R. 4128, 114th Cong. § 307 (2015). For more information on the bill, see Senator Ben Cardin, *Cardin and Becerra Introduce Plan to Protect Taxpayers' Rights*, *available at* http://www.cardin.senate.gov/newsroom/press/release/cardin-and-becerra-introduce-plan-to-protect-taxpayers-rights.

22 IRM 5.11.6.2(6) (Sept. 26, 2014). TAS is working with the IRS to revise this IRM section. However, no changes have been made at this time.

23 5 U.S.C. § 8432(b)(2)(A). *See also* Thrift Savings Plan, *Summary of the Thrift Saving Plan* 2, *available at* https://www.tsp.gov/PDF/formspubs/tspbk08.pdf (last visited Dec. 4, 2015).

24 *See* Thrift Savings Plan, *Summary of the Thrift Saving Plan* 2, *available at* https://www.tsp.gov/PDF/formspubs/tspbk08.pdf (last visited Dec. 4, 2015).

25 Automatic enrollment in 401(k) and similar plans was one of the most highly touted changes in the Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780 (2006).

for retirement.[26] Without a definition for flagrancy and an inquiry into whether the taxpayer voluntarily committed a gross violation, the IRS employee could find flagrancy where there was an unconscious and involuntary, or unknowing violation. This means the IRS could be reducing a taxpayer to poverty in retirement because of an involuntary or unknowing act.

Finally, these examples seem counterintuitive in light of the IRS's public guidance providing safe harbors related to automatic contribution features for retirement plans.[27] If voluntarily contributing to a retirement account remains an element of flagrancy, taxpayers should at least be notified and given the opportunity to cease voluntary contributions prior to a levy on their retirement account.

Another example of flagrant conduct includes taxpayers who have demonstrated a "pattern of uncooperative or unresponsive behavior," which includes, "failing to meet established deadlines, failing to attend scheduled appointments, failing to respond to revenue officer attempts to contact."[28] This guidance does not contain any definitive deadlines and is based on a subjective determination by an IRS employee. For instance, one employee may determine that if a taxpayer is 30 days late in submitting documentation, then the taxpayer has been uncooperative, whereas another employee may consider a taxpayer uncooperative after 60 days.

Additionally, while the IRM does address extenuating circumstances that may exist to mitigate a taxpayer's behavior, it does not contain any examples of such extenuating circumstances. Nor does the IRM require the IRS employee to identify the mitigating circumstances, which could include IRS delays and IRS failures to meet appointments or take promised actions. As a result, this IRM is a trap for unwary taxpayers who may experience significant and irreparable harm as a result of a subjective and non-uniform finding of flagrancy by an IRS employee.

There Is Inadequate Instruction for Analyzing Future Retirement Calculations and No Requirement to Provide Those Calculations to the Taxpayer

The last step in determining if a levy on a retirement account is appropriate is to determine if the taxpayer depends on the money in the retirement account (or will in the near future) for necessary living expenses.[29] To conduct this analysis, employees are instructed to use the standards in IRM 5.15, *Financial Analysis*, to establish necessary living expenses and the life expectancy tables in Publication 590-A, *Individual Retirement Arrangements (IRAs)*, to estimate how much can be withdrawn annually to deplete the retirement account in the taxpayer's remaining life.[30]

26 Congress has focused its efforts on improving retirement savings for Americans. Senator Orrin Hatch recalled in 2014 that, "[t]he retirement policies we have pursued have always been about helping Americans help themselves save more of their hard-earned money, not less." *Retirement Savings 2.0: Updating Savings Policy for the Modern Economy, Hearing Before the Committee on Finance*, 113th Cong. (Sept. 16, 2014) (statement of Orrin Hatch, ranking member, Committee on Finance).

27 Rev. Proc. 2015-28. In response to the issuance of this published guidance, Senator Ron Wyden, Finance Committee ranking member, applauded administration efforts claiming, "[t]hese improvements from the Treasury and the IRS mark an important step in helping millions of Americans save for a secure retirement. Automatic enrollment in retirement plans is a promising method to increase retirement savings. The changes made today will make it easier for smaller businesses to set up a retirement plan with automatic enrollment features and help more middle-class Americans prepare for retirement." Senator Ron Wyden, *Wyden Applauds Administration Efforts to Improve Retirement Saving* (Apr. 2, 2015) *available at* http://www.finance.senate.gov/newsroom/ranking/release/?id=3daed452-120a-45ab-b5fd-a9a4e21c05f4.

28 IRM 5.11.6.2(6) (Sept. 26, 2014).

29 IRM 5.11.6.2(7) (Sept. 26, 2014). Employees are instructed not to levy on the retirement account if it is determined that the taxpayer depends on the money in the retirement account (or will in the near future). *Id*.

30 IRM 5.11.6.2(7) (Sept. 26, 2014). When conducting this financial analysis, employees are reminded to consider special circumstances that may be present on a case-by-case review.

While the guidance refers the employee to IRM 5.15 to determine necessary living expenses, there is no discussion on determining the taxpayer's potential retirement income. Additionally, there is no requirement to document the actual calculations, making it impossible to verify that a consistent method is used in all retirement levy cases. The financial analysis handbook does not take into account cost of living increases or adjustments for increased expenses due to advanced age, such as rising health care or hospice costs. Finally, the guidance lacks a safeguard that if the IRS determines a 50-year-old taxpayer does not currently rely on the retirement account (and will not rely on it in the near future), the taxpayer has sufficient opportunity to rebuild the retirement account back up to a level that provides for a stable retirement.

> **Example:** Assume a taxpayer is 50 years old, expects to retire at age 62, and has a $40,000 tax liability with $54,000 in his TSP account. Further assume the taxpayer will begin receiving $2,000 per month from his federal pension and another $1,200 per month from Social Security at age 62, with a life expectancy of 80. The $54,000 TSP corpus (the years from the taxpayer's retirement age of 62 to 80) divided by 18 years leaves an average of $3,000 per year, or $250 per month. Thus at age 62, the taxpayer expects to have $3,450 of monthly income from all sources ($2,000 pension, $1,200 Social Security, $250 TSP). The IRS estimates the taxpayer will have necessary living expenses of $3,300 per month at retirement. Based on this financial analysis, if the IRS were to levy the entire TSP corpus, the taxpayer's monthly retirement income would be reduced to $3,200, and he could not meet his necessary living expenses of $3,300. An IRS levy should be limited to 60 percent of the TSP corpus, or $32,400, based on the crude estimate that the taxpayer would need to rely on only 40 percent of his TSP to cover necessary living expenses ($100 out of an available $250 per month). However, there are currently no safeguards to prevent the IRS from levying the *entire* TSP corpus, regardless of whether it would leave the taxpayer unable to meet necessary living expenses upon retirement.

IRM 5.11.6.2(7) does not instruct employees to provide the basis of a decision or calculations to the taxpayer. Without this information, the taxpayer cannot substantively address the IRS's determination to proceed with the levy. The IRS should consider the impact of the levy on the taxpayer's retirement security, including estimating future retirement income if the account were levied. This could be done by utilizing the Social Security Administration (SSA) and TSP websites and online calculators.[31] Alternatively, the IRS could create its own calculators for this purpose.

The IRS Does Not Educate the Taxpayer About What to Do to Avoid a Levy, or Discuss Alternative Collection Options With the Taxpayer Prior to a Levy on the Retirement Account

The current IRM guidance does not require employees to educate the taxpayer as to what he or she needs to do to avoid a levy on their retirement account. Since this levy can cause irreparable harm to the taxpayer's future well-being, it is imperative that the IRS adheres to the taxpayer *right to be informed*. As stated above, an unsophisticated taxpayer who is unaware of the IRM examples regarding flagrant conduct may continue making voluntary contributions to a retirement account, risking his or her retirement assets. The IRS would not tell the taxpayer to stop or reduce contributions to avoid being deemed flagrant, even

31 There are tools publicly available to help taxpayers estimate their retirement earnings. The IRS could use such tools to compute an estimate of benefits. For instance, the SSA provides an online tool to estimate Social Security retirement benefits. *See* SSA, *Retirement Estimator*, *available at* https://www.ssa.gov/retire/estimator.html. The TSP website offers an online calculator to figure out how a TSP contribution will affect account savings over time. *See* TSP, *Paycheck Estimator*, *available at* https://www.tsp.gov/PlanningTools/Calculators/paycheckEstimator.html.

when contributions are automatically made as a part of employment. For the government to encourage retirement contributions, but also deem those contributions as flagrant conduct, without notice to the taxpayer, is a Catch-22 for the taxpayer.

Likewise, the IRS is not proactively informing taxpayers about the tax consequences of a distribution from the retirement account. Pursuant to IRC § 408(d), generally the entire amount paid from a retirement account or any distribution is considered gross income and subject to taxation. In the instance of a levy on a retirement account, the payor would generally be required to withhold ten percent for federal income taxes.[32] It is not guaranteed that the withheld amount will cover the full amount of federal tax liabilities associated with a distribution. No amount is required to be withheld for state income taxes, which could potentially subject the taxpayer to state tax penalties and enforcement activities. These tax consequences could exacerbate the taxpayer's existing financial difficulties by creating a new tax liability the taxpayer is unable to pay, creating a vicious circle of noncompliance.

Without a definition for flagrancy and an inquiry into whether the taxpayer voluntarily committed a gross violation, the IRS employee could find flagrancy where there was an unconscious and involuntary, or unknowing violation. This means the IRS could be reducing a taxpayer to poverty in retirement because of an involuntary or unknowing act.

Educating taxpayers about tax consequences of contributions to and distributions from a retirement account is necessary for fair and just tax administration given public policy to encourage retirement savings. Moreover, communication with the taxpayer about the consequences of a levy on a retirement account (including the loss of retirement savings) might be the one piece of information that could transform a heretofore unresponsive taxpayer into a responsive and cooperative one. Thus, communication can help collect revenue *and* protect retirement savings.

Finally, the IRM makes only minimal mention of collection alternatives. The pertinent section reads: "[i]f there is property other than retirement assets that can be used to collect the liability, or if a payment agreement can be reached, consider these alternatives before issuing a levy on retirement accounts. Also consider the expense of pursuing other assets as well as the amount to be collected."[33] This excerpt only minimally references installment agreements and does not mention currently not collectible status or offers in compromise.[34] Without this information, employees may be guided to focus on the retirement account levy without considering less intrusive alternatives, thereby compromising a taxpayer's *right to privacy*.

32 IRC § 3405(b)(1). The payor generally is responsible for making this withholding, but the plan administrator may be liable in the case of certain plans. IRC § 3405(d)(1).

33 IRM 5.11.6.2(4) (Sept. 26, 2014).

34 When a taxpayer has no assets or income which are, by law, subject to levy, or it is determined that levy action would create a hardship, the liability may be reported as currently not collectible. A hardship exists if the levy action prevents the taxpayer from meeting necessary living expenses. IRM 1.2.14.1.14, *Policy Statement 5-71* (Nov. 19, 1980). *See also* Treas. Reg. 301.6343-1(b)(4). An offer in compromise allows the IRS and the taxpayer to settle an outstanding liability for a reduced amount. IRC § 7122.

The IRS Does Not Conduct a Risk Analysis Similar to the Pre-Seizure and Pre-Levy Considerations

As mentioned above, levies on retirement accounts receive "special" consideration. However, the IRS must perform a general risk analysis prior to seizing a taxpayer's property.[35] A risk analysis should also be required for levies on retirement accounts. The guidance under IRM 5.11.6.2 should also make a cross-reference to IRM 5.11.1.3.1, in which IRS employees are instructed to consider the following prior to imposing a levy:

- The taxpayer's financial condition, including information discussed in IRM 5.1.12.20.1.1 related to economic hardship determinations;
- The taxpayer's responsiveness to attempts at contact and collection;
- The taxpayer's filing and paying compliance history;
- The taxpayer's effort to pay the tax; and
- Whether current taxes are being paid.[36]

This guidance includes a clear reference to economic hardship, which the guidance for retirement levies does not include. Consideration of the taxpayer's recent filing and payment compliance history could be a mitigating factor against a determination of flagrancy. Additionally, IRS employees are instructed to consider the timing of successive seizures to avoid undue hardship and collection alternatives in order to determine the feasibility of a seizure.[37] These considerations allow for greater protection of taxpayer rights and should be incorporated into guidance for retirement levies. Finally, the IRM should require that the levy take place within a reasonable amount of time (*e.g.*, 90 days) of when the risk analysis is completed to avoid a situation of changed circumstances.

The IRS Does Not Track Levies That Are Issued Against Particular Retirement Accounts and Therefore Is Unable to Conduct Quality Reviews to Ensure Taxpayers Are Being Treated Uniformly and That the Guidance Is Being Followed By Employees

The IRS does not have a system for tracking levies that are issued against particular retirement accounts.[38] This means that IRS management and other stakeholders are not able to conduct quality reviews or track retirement levies to ensure that taxpayers are being treated in a uniform manner and that the internal guidance is being followed by employees.[39]

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35 IRM 5.10.1.3.2, *Alternative Methods of Collection* (Aug. 4, 2014). There is no legal distinction between a levy and a seizure. Generally, if the taxpayer is holding the property, or a third party is holding the property and it cannot be turned over by writing a check, the IRS will use seizure procedures. IRM 5.11.1.2.2, *Notice of Levy vs. Seizure* (Aug. 1, 2014). A levy is often used for things such as a taxpayer's bank account, wages, or other income. *Id*.

36 IRM 5.11.1.3.1, *Pre-levy Considerations* (Aug. 1, 2014).

37 IRM 5.10.1.1 (Aug. 4, 2014).

38 IRS response to a TAS information request (May 21, 2015).

39 For information about how the inconsistent use of Designated Payment Codes reduces the ability to assess Collection actions, see Most Serious Problem: *IRS Collection Effectiveness: The IRS's Failure to Accurately Input Designated Payment Codes for All Payments Compromises Its Ability to Evaluate Which Actions Are Most Effective in Generating Payments, infra.*

However, TAS conducted a review of cases from FY 2014 and FY 2015 that were most likely to contain TSP, IRA, or retirement account levies.[40] TAS reviewed 43 possible TSP levy cases and found that in 33 cases, Form 668A, *Notice of Levy*, was generated and issued to the TSP board. In 31 of those cases, the IRS employee did not document managerial approval, as required by the IRM. Additionally, flagrant conduct, a prerequisite for the levy determination, was only recorded in one case. No taxpayers were informed that making contributions could be deemed flagrant conduct. The total amount of levy funds received from these levies totaled approximately $49,000.

TAS also reviewed 128 possible IRA levy cases and found that in 72 cases, Form 668A, *Notice of Levy*, was generated and issued on an IRA account. In 52 of those cases (72 percent), the IRS employee did not document managerial approval, as required by the IRM. Flagrant conduct was documented in 18 cases and the IRS educated just one taxpayer on the effects of continuing to make IRA contributions. The total amount of levy funds received from these levies totaled approximately $2 million.

Last, TAS reviewed 176 possible retirement account levy cases and found that in 66 cases, Form 668A, *Notice of Levy*, was generated and issued on a retirement account. In 29 of those cases (44 percent), the IRS employee did not document managerial approval, as required by the IRM. The IRS documented flagrant conduct in 20 cases and the IRS informed only two taxpayers about the consequences of continued contributions. The total amount of levy funds received from these levies totaled approximately $7.6 million. It is important to make sure that each taxpayer's case receives proper analysis prior to levying on a retirement account, because proceeds from a levied retirement account cannot be returned to the retirement account, even in the event of an erroneous or wrongful levy.[41]

Even With Inadequate Guidance, the IRS Proposes a Pilot Project Within the Automated Collection System, Which Will Compound the Harm to Taxpayers

Considering all of the deficiencies discussed above, the National Taxpayer Advocate is especially concerned with the IRS's pilot program aimed at allowing its ACS to issue levies on TSP accounts.[42] This pilot will treat taxpayers with TSP accounts disparately from taxpayers who have other types of retirement accounts. If a taxpayer has a defined benefit plan and has no present right to withdraw the account balance, the IRS will have no corpus to levy upon at the present time. However, recent changes in the TSP regulations allow a levy on a TSP account to reach up to the entire vested account balance now without restrictions.[43] The IRS has not articulated a reason why it believes this pilot should single out TSP

40 TAS review completed November 17, 2015, on potential retirement account asset levy cases with levies issued between FY 2014 and FY 2015. Note: Because some taxpayers received more than one levy, the total number of cases could be slightly higher than the total number of taxpayers in the review. This review was based on a non-random sample so statistics based on this data may not project to the overall population; however the sample demonstrates that the IRS is not always following necessary procedures.

41 The National Taxpayer Advocate recommended legislative changes to IRC § 401 (for Qualified Pension, Profit Sharing, Keogh, and Stock Bonus Plans), IRC § 408 (for IRA and SEP-IRAs), and IRC § 408A (for Roth IRAs) to authorize the reinstatement of funds to retirement accounts and other pension plans where the IRS levied upon the plans in error or in flagrant disregard of established IRS rules, procedures, or regulations and the funds were returned under IRC § 6343(d). National Taxpayer Advocate 2001 Annual Report to Congress 202-09. 5 C.F.R. § 1653.36(g) states that distributions made to satisfy an IRS levy may not be returned to a participant's TSP account.

42 ACS is a computerized system that maintains balance-due accounts and return delinquency investigations. IRM 5.19.5.2, *What Is ACS?* (Aug. 20, 2013). TSP is a retirement plan for federal employees established under 5 U.S.C. § 8437.

43 5 U.S.C. § 8473(e)(3), 5 C.F.R. § 1653.35, and IRM 5.11.6.2.1, *Thrift Savings Plan* (July 17, 2015).

accounts.[44] As of December 31, 2014, there are approximately 4.7 million TSP participants, so the pool of taxpayers affected by this pilot could be quite large.[45]

TAS was not consulted during the process to create procedures for this pilot, but is providing comments to the draft procedures. As currently written, the procedures provide even fewer safeguards to taxpayer rights than the current IRM guidance for levying on retirement accounts generally.[46] For instance, the procedures treat taxpayers in ACS differently from taxpayers working with a revenue officer.[47] Under the pilot procedures, the IRS employee's financial analysis will be restricted to these two elements:

- Document if there is any information that retirement is impending and that the taxpayer will be relying on funds in the TSP for necessary living expenses. The employee is instructed to use available information to apply the standards in IRM 5.19.13.1.4 and Publication 590-A. If this documentation is present, do not issue the TSP levy; and
- Also, consider any special circumstances in the taxpayer's situation, such as extraordinary expenses, or additional sources of income, including spousal income and assets, other retirement accounts, etc. that will be available to pay expenses during retirement.[48]

There is no mention of reviewing IRM 5.15, *Financial Analysis*. Furthermore, these procedures introduce considerations not found in IRM 5.11.6.2(7), such as imputing spousal income into the financial analysis.[49] TAS is working actively to address the problems with the pilot.

Under ACS, cases are assigned to teams, functions, or units rather than individual employees.[50] It is a computer system that "analyzes for levy sources, undeliverable mail codes, telephone numbers, and other characteristics" in place of an employee. The computer system also "prints letters for mailing and assigns cases to the proper team, function, or units," while a "small percentage of cases meeting specific criteria" are researched by the ACS Support function.[51] ACS provides minimal contact with a taxpayer. For instance, ACS uses "predictive dialer" technology, which automatically makes outbound calls to taxpayers or representatives and if contact is made, the call is transferred to a waiting agent.[52] Last, correspondence

44 In response to an information request asking for the rationale of the pilot program, the IRS explained that "ACS has authority to issue levies on retirement accounts, however, it was not previously utilized. The pilot is an opportunity to determine if this means will be cost effective and meet sound tax administration." IRS response to TAS information request (July 9, 2015).

45 Thrift Savings Fund, *Financial Statements December 31, 2014 and 2013* 6, *available at* http://www.frtib.gov/ReadingRoom/FinStmts/TSP-FS-Dec2014.pdf.

46 IRS, *ACS Thrift Savings Plan Levy Pilot Procedures* (Dec. 9, 2015).

47 *Id*.

48 *Id*.

49 *Id*.

50 IRM 5.19.5.3, *Research on ACS* (Jan. 6, 2015).

51 *Id*.

52 IRM 5.19.5.4.1(1) (Feb. 20, 2015). An automated message is left if an answering machine answers and if there is no answer, the system "updates the account and reschedules the case to the predictive dialer queue for another attempt." *Id*.

submitted by a taxpayer to ACS is actually processed by ACS Support, a different unit.[53] The IRS has confirmed that the ACS pilot will work in a similar fashion.[54]

The taxpayer may struggle to navigate a system in which they receive automated phone contact, but cannot contact an assigned employee.[55] With no employee assigned to the case, each contact or piece of correspondence would be analyzed by a different employee. The National Taxpayer Advocate is concerned that under this system the ACS employee will not be able to make a determination of flagrancy under the proposed definition. As mentioned above, IRM 5.11.6.2.1(5) requires that the IRS employee prepare written analysis for the manager to approve prior to levy. This analysis requires that the employee consider the taxpayer's current situation, his or her conduct, and any mitigating circumstances, as well as the taxpayer's projected economic viability. The National Taxpayer Advocate provided training to the employees assigned to the pilot cases. However, even with training, the minimal contact associated with ACS will make it difficult, if not impossible, for ACS employees to make these determinations accurately. It does not appear the ACS manager will have much information about the taxpayer's financial condition or extenuating circumstances before giving rote approval to a levy that could potentially destroy a taxpayer's retirement income security.

Furthermore, the reach of a TSP levy is far more expansive than the levy on a non-TSP retirement account. As discussed above, the levy on a non-TSP retirement account generally only reaches the assets over which the taxpayer has a present withdrawal right. However, recent changes in the law and regulations written by the Federal Retirement Thrift Investment Board that manages TSP accounts, allow a TSP levy to reach up to the vested account balance.[56] Thus, the IRS can levy upon the *entire vested balance* of the TSP account, even if the participant has no current right to access the funds.[57] As a result, a levy on a TSP account could be even more damaging to a taxpayer than a levy on a non-TSP retirement plan (*e.g.*, 401(k) plans). This greater risk of harm should cause the IRS to provide more taxpayer rights protections rather than less. Retirement levy determinations should require assignment to employees with the skills, training, and resources required to ensure appropriate and consistent application of retirement levies.

Educating taxpayers about tax consequences of contributions to and distributions from a retirement account is necessary for fair and just tax administration given public policy to encourage retirement savings.

53 IRM 5.19.6.1, *ACS Support Overview/What Is ACS Support* (June 17, 2014). ACS Support is experiencing a backlog of work and in response the IRS recently announced that ACS Support will, among other things, cease processing paper third-party levy responses in order to address taxpayer correspondence. This deviation will occur until the end of September 2015. Memorandum to Campus Collection Directors from DelRey Jenkins, Director, Campus Collection, *Deviation Authority to Discontinue the Processing of ACS Support (ACSS) Levy Responses* (Mar. 23, 2015).

54 Two or more employees will be designated to work the pilot inventory. The cases will not be assigned to a specific employee. The lead who receives the case will complete the investigation and will make a levy determination if appropriate. If a taxpayer calls in response to the levy, the ACS employee will prepare Form 4442, *Inquiry Referral*, to the levy originator and advise the taxpayer that they will be contacted by the levy originator within 24 hours. IRS, *ACS Thrift Savings Plan Levy Pilot Procedures* (Dec 9, 2015). Any taxpayer correspondence will be routed to the designated leads. IRS response to TAS information request (July 6, 2015).

55 For information on how the lack of an assigned employee can affect taxpayers under correspondence examination, an automated system for examinations, *see* National Taxpayer Advocate 2014 Annual Report to Congress 134-44. This situation is also made worse by the fact that the level of ACS customer service has decreased. Treasury Inspector General for Tax Administration (TIGTA) determined that ACS has answered 25 percent fewer calls even though total calls into the ACS unit have decreased 16 percent since FY 2011. TIGTA, Ref. No. 2015-30-035, *Reduced Budget and Collection Resources Have Resulted in Declines in Taxpayer Service, Case Closures, and Dollars Collected* 10 (May 2015).

56 5 U.S.C. § 8437(e)(3) and 5 CFR § 1653.35.

57 IRM 5.11.6.2.1(1) (July 17, 2015).

CONCLUSION

Current internal guidance does not ensure that a taxpayer's unique facts and circumstances will be considered prior to levy of his or her retirement account and does not fully recognize the importance of retirement savings. It also disregards the balance between the need for enforcement to be no more intrusive than necessary. Without clear guidance, the IRS employee's determination is subjective and susceptible to personal judgment. This could lead to inconsistent treatment of similarly situated taxpayers, which could erode taxpayers' confidence in a fair tax system and decrease voluntary compliance. Moreover, a taxpayer cannot adequately challenge the decision to levy without being provided a detailed analysis of the basis for levy, a situation which impacts the taxpayer's *right to challenge the IRS's position and be heard*. Last, without clear guidance, taxpayers do not know what they need to do to comply with tax laws, which diminishes the *right to be informed*.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. In collaboration with TAS, revise the IRM on retirement account levies to define flagrant conduct, which should include elements of willful and voluntary conduct that appears to be a gross violation from a reasonable person standard, include examples of extenuating circumstances that can mitigate flagrant conduct, require a full pre-levy financial analysis, and educate taxpayers about actions available to avoid a levy on a retirement account.
2. The IRS should identify calculators that it can use, such as those provided by the SSA or TSP, to determine the impact of a levy on a retirement account on the taxpayer's future well-being. Alternatively, the IRS could create its own calculator.
3. Create a unique Designated Payment Code for retirement levy proceeds or a unique identifier within the Integrated Collection System to identify, track, and review retirement levy cases.
4. Postpone the ACS retirement levy pilot program until all of the National Taxpayer Advocate's concerns have been addressed; and if they are not able to be addressed, do not implement the pilot.