

The IRS Collection Process: What You Need to Know to Advise Your Clients

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OBJECTIVE: IRS Collection Options
How to Use and How to Litigate!

Only two IRS Collection Options Without any
Judicial Review

- Uncollectible Status: “53” the Transaction Code
- CAP Hearing – Request to Not File Notice of Tax Lien

OBJECTIVE: IRS Collection Options
How to Use and How to Litigate!

Innocent Spouse: Tax Court Review

Offers-in-Compromise and Installment Agreements

- Tax Court Review: “Appeal” --
Only After Collection Due Process Hearing

**How is the IRS Doing?
According to:
Taxpayer Advocate Reports
2011 - Currently**

**DEAR CONGRESS, LAST YEAR I MISMANAGED
MY FUNDS & THIS YEAR I CANNOT DECIDE ON
A BUDGET. UNTIL I HAVE COME TO A UNIFIED
DECISION THAT FITS ALL OF MY NEEDS &
INTERESTS, I WILL HAVE TO SHUT DOWN MY
CHECKBOOK & WILL NO LONGER BE ABLE TO
PAY MY TAXES. I'M SURE YOU'LL
UNDERSTAND. THANK YOU VERY MUCH FOR
SETTING AN EXAMPLE WE CAN ALL FOLLOW.**

2011 Collection Issues

- Lien Filing
- Personal TP contact
- Levy on Social Security

2012 Collection Issues:

- Improve Telephone & Correspondence
- Online Services
- Delays in 2848 processing
- RO role not being used effectively
- ACS –increase service and effectiveness
- Lien Filing policies
- Early intervention for victims of failed payroll services

2013 Objectives

- Improve small business “fresh start”
- Improve criteria in lien filing
- Use collection resources (RO’s) prudently
- Re-evaluate focus of collections field oper.

2014 Objectives

- Collection policies & procedures –SB TP
- Safeguards for TP facing foreclosure
- Improve federal levy program re: hardship
- Eliminate procedural barriers to IA & OIC

2013 Good News

- Lien filing and withdrawal
- Small business IA's
- Streamlined OIC's and IA's
- Fresh start OIC terms-
 - Student loans, state tax debt, unsecured pmts

2013 Bad News

- Small business IA's declined
- Identify barriers to SB IA's and OIC's
- Liens based on facts/circumstances
- Meaningful, fair, realistic lien criteria
- Train employees on new lien rules
- Inadequate resources for fresh start
- Focus of collection field operations

2014- Good News

- OIC's higher acceptance rate
- Fewer liens filed
- More liens withdrawn
- New safeguards for judicial foreclosures
- Hardship levy release even if unfiled returns

2014 – Bad News

- Collection philosophy training
- IA's declined
- Few IA's and OIC's
- Identify barriers to new policies
- ACS not effective with SB
- Levies on social security if unfiled returns
- IRS procedures narrow use of IA and OIC

Offer-in-Compromise and Installment Agreements: Collection Due Process Hearing And The Appeal

Taxpayer's Right to Notice and a Collection Due Process Hearing

- I.R.C. §§ 6330 and 6331
- The CDP Hearing Request
 - Practical tips for completing Form 12153
 - What should be attached?
 - Offer in Compromise?
 - Installment Agreement request?
 - Other?
- Suspension of collections and statute of limitations

The CDP Hearing

- Face to face or in person?
- Materials submitted?
- Recorded?
- Client attend?
- Can witnesses be subpoenaed/examined?
- The benefit of having two representatives present
- AJAC

Notice of Determination

- NOD issued at conclusion of the CDP hearing— advises taxpayer of right to seek judicial review of decision
- Tax Court has exclusive jurisdiction over CDP appeals
- Can you work with the Settlement Officer to define the issues in the Notice of Determination?
- Do you work with the Settlement Officer when you are having the hearing to decide how you want the Notice of Determination to read?
- NOTE: Tax Court will only consider an issue that was properly raised in the CDP hearing

Tax Court Review of the NOD

- Standard of review
 - Abuse of discretion
 - *Dalton v. Commissioner*
 - De Novo
- Scope of review
- Practical considerations at and subsequent to the CDP hearing with litigation in mind

Results: Best – Do Over?

BANKRUPTCY TAX “MYTHS”

#1 Must have a bankruptcy purpose – other than tax claim – NO

#2 Bankruptcy Judges do not like or understand tax cases – NO

BANKRUPTCY TAX “MYTHS”

#3 Bankruptcy Lawyers do not understand tax issues, or tax litigation!

NOT A MYTH – Your Job!

#4 Tax Lawyers do not understand bankruptcy tax litigation

NOT A MYTH – My Job!

Bankruptcy Objectives

A. Discharge: Full Absolution!!

Exception:

- Notice of Federal Tax Lien
- ERISA Qualified – Not Property of Estate

COMPLICATED

Bankruptcy Objectives

B. Deferred Payment:

- Ch. 13 – 3 Years Automatic (2 more if you ask)
- Ch. 11 – 5 Years -- Prepare

Bankruptcy -- Tax Objectives

C. Bankruptcy Court Tax Litigation Objection to Claim (11 U.S.C. § 502(b) And FRBP 3007)

- Motion to Determine Liability
(11 U.S.C. § 505)
- Complaint to Determine Dischargeability
(11 U.S.C. § 523)

TAXES DISCHARGEABLE IN BANKRUPTCY

(Applicable in 7, 11 or 13)

Timing Rules

(Bankruptcy Filing After)

11 USC § § 523(a)(1) And 507(a)(8)

- 3 Year Rule: Due date of return
§ 507(a)(8)(A)(i) (as Extended)
December 12, 2013 – 2010 and earlier – GONE
- 2 Year Rule: Late filed returns, § 523(a)(1)(B)(ii)
(After date of filing)
- 240 Day Rule: New assessments, § 507(a)(8)(A)(ii)
(Not on return)

Bankruptcy Discharge Prohibited



- Made a Fraudulent Return; or (§ 523(a)(1)(C))
- Willfully attempted, in any manner, to evade or to defeat to pay (§ 523(a)(1)(C))
- Trust Fund Taxes (§ 507(a)(8)(C))
- Not Assessed – but assessable taxes (§ 507(a)(8)(A)(iii))

Collection After Bankruptcy?

“Secured” Tax Liability **[Even if Discharged]**

- Only if Notice of Federal Tax Lien filed before bankruptcy. IRC §§ 6321, 6322
- Limited to pre-petition assets (including appreciation)

“Not Discharged – Of Course!”

When Does the Debtor Get a Discharge?

1. Chapter 7 – When the court enters the discharge order, § 727. **[3 to 6 months after petition filed]**
2. Chapter 13 – After the last plan payment is made, unless there is hardship, § 1328. **[3 to 5 years]**
3. Chapter 11 – After the last plan payment is made. **[Or Plan confirmed provides otherwise]**

CHAPTER 7 – Individual Assume Discharge

ADVANTAGES

- a. Certainty: ?*
- b. Short timeframe
pre-petition assets
- c. Post-Petition: New Income
and assets – Not subject to
tax claim/or lien

DISADVANTAGES

- a. Pass “means” test
- b. Tax Lien: Remains on
(only matters if exempt)
- c. Lose all assets
Not Exempt

* Rely on The Law – Not Certain

File Complaint to Determine Dischargeability – CERTAIN

Debt Limits

CHAPTER 13

BEST USE: Cannot discharge all tax (or significant lien problem), but can pay out non-dischargeable portion.

ADVANTAGES

- a. Certainty -- YES
- b. Keep property
- c. Lien: Value Capped
- d. Interest does not accrue post-petition on dischargeable

DISADVANTAGES

- a. Plan payments 3-5 yrs.
- b. Lien remains
- c. All post-bankruptcy income goes to plan
- d. Possible default – All tax stays

Restructure Debt – “The Plan”

CHAPTER 11

**USE: Extended Pay Out – Orderly Liquidation –
Deal with Creditors**

ADVANTAGES

- a. Certainty
- b. Pay % unsecured
- c. Keep property
- d. No debt limits
- e. Debtor is Trustee
- f. Flexibility of Plan

DISADVANTAGES

- a. Expensive
- b. Substantial Reporting
- c. Post-Petition: Income assets of the estate
- d. Plan Defaults – Tax Remains
- e. Non-Taxpayer
- f. Creditors – More Active, including IRS

GOLD MINE

Lawyer and Client

Individual – Tax Only – CHAPTER 11

ADVANTAGES

- a. Certainty
- b. Keep property
- c. Keep tax attributes
- d. Pay portion of unsecured
- e. Lien released at end
- f. Automatic stay stops levy
- g. Lien value capped

DISADVANTAGES

- a. Plan payments 3-5 yrs.
- b. Lien stays until end
- c. Post-bankruptcy income goes to plan
- d. If default – all tax stays
- e. Debt limits
- f. SOL suspended
- g. Defend objections to Plan, discharge, and exemptions

Late-Filed Returns --

➤ **Discharged in bankruptcy?**

Or

➤ **Not Discharged in bankruptcy?**

Code Sections

I. 11 U.S.C. § 523(a)(1)(B)(i)

2 Year Rule

II. 11 U.S.C. § 523(a)(19) “hanging para.”

“Return” = satisfying non-bankruptcy law requirements, including filing requirements

Returns prepared pursuant to I.R.C. 6020(a), stipulation to judgment, final order

NOT return made pursuant to I.R.C. 6020(b)

Case Law – Part One

- *In re Colson*, 446 F.3d 836 (8th Cir. 2006)
- Returns filed after IRS assesses under 6020(b)
 - Are dischargeable if they meet certain criteria

U.S. v. Hindenlang, 164 F.3d 1029 (6th Cir. 1999)

Returns filed after IRS assesses under 6020(b)

- Are not dischargeable because they serve no tax purpose

Case Law – Part Two

Creekmore v. IRS, 401 B.R. 748 (Bankr. N.D. Miss. 2008)

After-filed return is non-dischargeable unless late
6020(a) return

McCoy v. Mississippi State Tax Comm'n, 666 F.3d 924
(5th Cir. 2012)

Any late return is non-dischargeable

IRS Re-Thinks Position

Chief Counsel Notice CC-2010-016:

Late-filed return filed 2 years before bankruptcy
Dischargeable

Return filed by IRS pursuant to 6020(b)
Non-Dischargeable

Return filed by TP after IRS assesses pursuant to 6020(b)
Dischargeable only as to tax greater than IRS
assessment

Still Confusion

- States are following *McCoy* – late = non-dischargeable
- IRS is usually following CC-2010-016
- Except: *Perry v. US*, (Bankr. M.D. Ala. 2012)
- Some courts don't follow *McCoy*
- *Smythe v. US*, (Bankr. W.D. Wash. 2012)
- Late returns can be dischargeable

Conclusion

Timely returns filed 3 yrs before bankruptcy

Dischargeable

Late returns filed 2 yrs before bankruptcy

Dischargeable

Late returns filed 2 yrs before bankruptcy after IRS assesses

Dischargeable to extent of additional tax

May be dischargeable

Unfiled returns

Non-dischargeable

The American Bar Association Section on Taxation
Innocent Spouse Relief: A Brief Review

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Three Types of Relief

- Traditional Innocent Spouse Relief. IRC § 6015(b)
- Spousal Allocation. IRC § 6015(c)
- Equitable Relief. IRC § 6015(f)

A Few Common Denominators

- A joint tax return
- Applies only to income tax
 - Not e.g. TFRP, or FBAR penalties
- A timely election on Form 8857
 - Timing Under IRC § § 6015(b) and (c)
 - Election must be made within two years of IRS first collection activity
 - Collection activity includes the offset by the IRS of a tax refund of the requesting spouse
 - Timing Under IRC § 6015(f)
 - Generally within the Statute of Limitations on Collection

Spousal Allocation

IRC § 6015(c)

- An electing spouse may allocate any tax deficiency in proportion to each spouse's contribution to the deficiency.
 - The allocation is made without regard to community property laws
 - No refunds are permitted
 - Election may be made only by an individual who at the time of the election is no longer married, or is legally separated from the other spouse, or who is not a member of the same household during the 12 month period ending on the date the election is filed.
- If the IRS demonstrates that the individual making the election had actual knowledge at the time the return was signed, then the election doesn't apply.

Equitable Relief

IRC § 6015(f)

- Only available if no relief is permitted under IRC § 6015(b) or (c).
- Relief is available for amounts shown on the return, but which remain unpaid
- Refunds are available

Rev. Proc. 2013-34

- A requesting spouse must satisfy ALL of the following threshold conditions to be eligible to submit a request for equitable relief under IRC § 6015(f).
 - Joint return filed
 - Relief is not available under IRC § § 6015(b) or (c)
 - Timely Request
 - No assets were transferred between the spouses as part of a fraudulent scheme by the spouses

Rev. Proc. 2013-34

- The nonrequesting spouse did not transfer disqualified assets to the requesting spouse.
 - Not applicable if the requesting spouse was subject to abuse, or the non-requesting spouse had restricted access to financial information, or was unaware of the transfer
- The requesting spouse did not knowingly participate in the filing of a fraudulent joint return
- The income tax liability from which the requesting spouse seeks relief is attributable (either in full or in part) to an item of the nonrequesting spouse or an underpayment resulting from the nonrequesting spouse's income

Streamlined Determinations

- If the threshold conditions are met the IRS will consider granting equitable relief provided that the requesting spouse:
 - Is no longer married to the nonrequesting spouse
 - Would suffer economic hardship if relief were not granted; and
 - Did not know or have reason to know that there was an understatement or deficiency on the joint return, or did not know or have reason to know that the nonrequesting spouse would not or could not pay the underpayment of tax reported on the joint income tax return
 - This condition does not need to be met if there was abuse by the nonrequesting spouse, or the nonrequesting spouse maintained control over the household finances by restricting access to the financial information

Non-Streamlined Determinations

- Facts and Circumstances. No factor is controlling. Factors are classified as favorable, unfavorable, or neutral. The Rev. Proc. 2013-34 factors are:
 - Marital Status
 - Economic Hardship
 - Lack of economic hardship is neutral (New)

Factors (Cont.)

- Knowledge

- Understatement Cases

- Did not know and had no reason to know of the understatement

- Underpayment Cases

- Whether the requesting spouse knew or had reason to know at the time the requesting spouse signed the joint return that the nonrequesting spouse would not or could not pay the tax liability at the time the joint return was filed or within a reasonably prompt time after the filing of the joint return.

- If a request for an installment agreement to pay the tax was filed by the later of 90 days after the due date for payment, or 90 days after the return was filed then the spouse will be presumed not to know

Reason to Know Criteria Include

- Requesting spouse's level of education
- Any deceit or evasiveness of the nonrequesting spouse
- The requesting spouse's degree of involvement in the activity generating the income tax liability
- The requesting spouse's involvement in business and household financial matters
- The requesting spouse's business or financial expertise, and any lavish or unusual expenditures compared with past spending levels

More Factors

- Abuse by the nonrequesting spouse
 - Contrast abuse v. duress
 - Abuse can be psychological or emotional as well as physical
 - Impact of the nonrequesting spouse's alcohol or drug abuse is considered

More Factors

- Legal obligation
 - This factor will weigh in favor of relief if the nonrequesting spouse has the sole legal obligation to pay the outstanding income tax liability pursuant to a divorce decree or agreement
 - Neutral if the requesting spouse knew or had reason to know, when entering into the divorce decree or agreement, that the nonrequesting spouse would not pay the income tax liability.
 - Against relief if the requesting spouse has the sole legal obligation.
 - If both spouses have a legal obligation to pay the outstanding income tax liability, the spouses are not separated or divorced, or the divorce decree or agreement is silent this factor is neutral.

Yet More Factors

- Significant benefit. Whether the requesting spouse received significant benefit (beyond normal support) from the unpaid income tax liability or item giving rise to the deficiency.
- Compliance with income tax laws. Whether the requesting spouse has made a good faith effort to comply with the income tax laws in the taxable years following the taxable year or years to which the request for relief relates.
- Mental or physical health. Whether the requesting spouse was in poor physical or mental health.
 - This factor is always either positive or neutral