

**Tax Compliance, Economic Hardship and the IRS Levy:
The Recent Tax Court Decision in *Vinatieri v. Commissioner* Changes the
Impact of Tax Compliance on Hardship Cases**

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The IRS Restructuring and Reform Act of 1998 created Collection Due Process (“CDP”) rights for taxpayers in IRS Collection matters. These CDP rights give taxpayers the right to have a hearing with an Appeals Officer, referred to as a Settlement Officer, to try and resolve the collection issue in a less intrusive way than by enforced collection (i.e. levy against the taxpayer’s income and/or property).

The IRS has generally required that, for a taxpayer to obtain a collection alternative, whether installment agreement, offer in compromise or having their account placed in a currently not collectible (“CNC”) status, the taxpayer had to be in current compliance with his or her tax obligations, meaning all tax returns have been filed and the taxpayer has been making all necessary tax deposits or estimated payments. Any failure by the taxpayer to maintain compliance generally resulted in the refusal by either the Collection Division or Appeals Division to provide any opportunity for a collection alternative.

Recently the United States Tax Court decided in *Vinatieri v. Commissioner*¹ that, in cases where a levy would create an economic hardship, requiring compliance before any collection alternative would be considered was an abuse of discretion, effectively overturning a holy grail of IRS doctrine and creating a new puzzle for the IRS as to how to handle hardship taxpayers who are not in tax compliance.

¹ 133 T.C. No. 16 (12/21/2009)

Tax Compliance

Taxpayers are expected to maintain “compliance” in order to obtain any relief from enforced collection measures (ie. levies). The Internal Revenue Manual (“IRM”) requires ongoing compliance for any collection alternative,² including installment agreements,³ offers in compromise,⁴ and being designated as currently not collectible.⁵

Compliance, for IRS collection purposes, means the filing of all outstanding tax returns and the payment of the most recent estimated tax payment due (for self-employed individuals) or that withholding is now being done on behalf of the taxpayer (for employees).⁶

The failure to become compliant often results in the refusal by the IRS to provide the taxpayer any collection alternative. With no payment alternative available, and assuming the taxpayer could not full pay his or her liability, the IRS would resort to enforced collection, including bank levy, a levy on wages and levies being issued to vendors who may owe the taxpayer money.

Vinatieri v. Commissioner

Ms. Vinatieri received a Final Notice of Intent To Levy and filed a timely request for a CDP hearing. At the hearing she provided financial information indicating that she was unable to make any payments above her allowable living expenses, which was supported by her documentation. The taxpayer also provided information that she suffered from pulmonary fibrosis and had a life expectancy of no more than 10 years, had been beaten by her ex-husband and lived alone with her 11 year-old daughter. The Settlement Officer noted that the taxpayer’s

² IRM 5.1.11.2.3 (6/2/04)

³ IRM 5.14.1.4.1(4)-(6) (9/26/08)

⁴ IRM 5.8.3.13(1), (2), (4) (9/23/08)

⁵ IRM 5.16.1.1(5) and (6), 5.16.1.2.9(8) (5/5/09)

⁶ IRM 5.14.1.4.1 (9/26/08)

account should be placed in currently not collectible status; however the 2005 and 2007 income tax returns had not been filed. After allowing the taxpayer some time to try and locate the 2007 return and attempt to obtain her W-2 so she could file the 2005 return, the Settlement Officer noted the taxpayer could not get into tax compliance and determined that enforced collection action (i.e. levy on the taxpayer's wages) was appropriate. The decision letter to the taxpayer stated:

“Appeals has verified, or received verification, that applicable laws and administrative procedures have been met; has considered the issues raised; and has balanced the proposed collection with the legitimate concern that such action be no more intrusive than necessary by IRC Section 6330(c)(3).

“Collection alternatives include full payment, installment agreement, offer in compromise and currently-not-collectible. However, since unfiled tax returns exist, the only alternative at present is to take enforced action by levying your assets. It is Appeals decision that the proposed levy action is appropriate. The proposed levy action balances the need for the efficient collection of the taxes with the legitimate concern that any collection action be no more intrusive than necessary.”⁷

The taxpayer filed a petition in the United States Tax Court as a pro se plaintiff. The IRS Area Counsel responded for the government with a Motion for Summary Judgment, arguing that the taxpayer was not in compliance with her filing requirements and therefore the Settlement Officer did not abuse her discretion by denying the taxpayer a collection alternative.

⁷ Kathleen A. Vinatieri v. Commissioner of Internal Revenue, 133 T.C. No. 16, Pages 6-7, 2/21/2009.

IRC § 6343

The Internal Revenue Code authorizes the IRS to release a levy under specific conditions. One of the conditions is if the levy is shown to be “creating an economic hardship due to the financial condition of the taxpayer.”⁸

In *Vinatieri*, the Tax Court noted that IRC § 6343 requires the IRS to release a levy on taxpayers where the levy will cause economic hardship, and that the regulations prescribed by the Secretary of the Treasury state that “if satisfaction of a levy in whole or in part will cause an individual taxpayer to be unable to pay his or her reasonable basic living expenses” then such levy would be causing an economic hardship.⁹

In light of both the statute and regulation, the court reasoned that any levy on Ms. Vinatieri would need to be immediately released because of the hardship it would cause by preventing her from paying for her basic living needs. The court also noted that there was no requirement for tax compliance when deciding to release a levy due to economic hardship under IRC § 6343. In denying the IRS motion for summary judgment, the court stated:

“Proceeding with the levy would be unreasonable because [section] 6343 would require its immediate release, and the determination to do so was arbitrary. The determination to proceed with the levy was wrong as a matter of law and, therefore, an abuse of discretion.”¹⁰

Conclusion

So where does the IRS go from here?

⁸ IRC § 6343(a)(1)(D)

⁹ Reg. § 301.6343-1(b)(4)

¹⁰ Kathleen A. Vinatieri v. Commissioner of Internal Revenue, 133 T.C. No. 16, Page 18, 2/21/2009

The longstanding rule of compliance before any collection alternative will be considered has now been determined to be invalid in cases where clients would otherwise qualify as currently not collectible. The decision in *Vinatieri* raises new issues and operational challenges for the IRS in both Collection and Appeals.

Though the decision does create breathing space for taxpayers who are having difficulty obtaining financial information to get delinquent returns filed, the decision also creates a new area for taxpayer abuse where clients simply refuse to come into compliance. Prior to *Vinatieri* the IRS had the threat of levy and refusal for a collection alternative as leverage with taxpayers to bring them into compliance. The failure of clients to provide returns, particularly self-employed individuals who are currently in an economic hardship situation, will create an administrative challenge for the IRS. Without the missing returns the IRS will not be able to determine how much is actually owed by the taxpayer. Though the IRS could send the cases to the Revenue Officers to use their power to issue an administrative summons to obtain the information, the additional workload and expense will simply add to a system already overburdened due to the increase in collection cases since the economic downturn.

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