

**IRS COLLECTION POLICIES AND
PROCEDURES:
A PRACTITIONER UPDATE ON NEW
AND OVERLOOKED IRS
COLLECTION IDEAS**

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IRS Collection Policies and Procedures: A Practitioner Update on New and Overlooked IRS Collection Ideas

Eric L. Green, Esq.

Recently, a number of substantial changes to IRS collection procedures and priorities have been made. This article will summarize the more significant changes and revisit often overlooked strategies that may be of interest to practitioners when dealing with the Internal Revenue Service Collection Division.

I. New Collection Information Statement Forms and new allowable expenses:

The Internal Revenue Service has issued new Collection Information Statements (CIS) forms 433-A and 433-B, which became effective January, 2008. Practitioners should visit the IRS website at www.irs.gov and select the “Forms and Publications” link to obtain these new CIS Forms. New allowable expenses include:

New allowable ownership costs for older vehicles. Generally, the IRS allows taxpayers to take ownership expense for vehicles only if the taxpayer is actually making payments (purchase or lease) on the vehicle. In recognition of the additional expenses which will be incurred by taxpayers when they dispose of their old vehicle, Internal Revenue Manual (“IRM”) Section 5.8.5.5.2 allows taxpayers an ownership expense for “older or high mileage” vehicles of \$200 per month. “Older” vehicles are defined as being *over* 6 years old, and “high mileage” vehicles are vehicles with more than 75,000 miles.

New Out-Of-Pocket Health Care Costs. This new allowance grants an individual \$57 per month for out-of-pocket healthcare costs (\$144 if the individual is age 65 or older), without having to provide any receipts or other documentation. Taxpayers may claim a higher

deduction for actual out-of-pocket health care costs if their actual expense exceeds the \$57 (or \$144 if over age 65) per month automatically allowed by the IRS by providing receipts and other support for the higher expense being claimed.

New allowable expenses for taxpayers. The IRS has made several significant changes to the allowable expense tables. These changes include:

- Allowable Living Expenses (Food, Clothing & Miscellaneous expenses).

Previously, these have been based upon the number of individuals residing in the taxpayer's home and the household's gross monthly income. Based upon feedback from the practitioner community, the Allowable Living Expenses have been adjusted so that the expense allowed is now based solely upon the number of people living in the home, regardless of the household's gross monthly income. In addition, the allowance is a "national standard" for all taxpayers across the country, regardless of where they live. This means that taxpayers who live in cities where the cost of living is high will find themselves having to live on the same monthly allowance as taxpayers in lower cost locales.

- Allowable Housing Allowance and the Allowable Transportation Allowance.

Both have been increased slightly from their 2007 levels.

II. New IRS policies and trends

Returning Offers In Compromise (OIC) for Noncompliance. The Frequently Asked Questions Section for New Offer in Compromise Rules, No. 15, reads: "Is compliance no longer a processability criterion for OIC submissions? Correct. Compliance is not considered to be a processability criterion for OIC initial submissions...."

The IRS appears to be following this rule on OICs; however, the rule only applies at the time the OIC is received by the IRS. If the taxpayer fails to maintain compliance during the time an OIC is being considered, the IRS¹ will still return the offer for noncompliance. Given that most OICs take more than 6 months to process, the risk is high that an OIC will be returned for noncompliance. Though IRM 5.8.7.2.2.1(2) states that a taxpayer is to be given the opportunity to remedy insufficient current year withholding/estimated taxes before an OIC is returned, the IRS often does not give a taxpayer the opportunity to remedy noncompliance in practice. Once an OIC is returned for any reason – even if contrary to the IRM – it is very difficult to have the decision to return the OIC reversed. Therefore, though a taxpayer may not be in compliance when an offer is submitted, he or she must stay in compliance while the offer is being evaluated by the IRS.

Dissipated Assets. Per IRM 5.8.5.4, the IRS can include assets sold by a taxpayer in years prior to submitting the OIC in computing the reasonable collection potential (RCP) for an OIC. Generally, the only defense to having the dissipated asset not included in the RCP is if the funds from the asset sale were used for necessary living expenses or to satisfy a secured creditor. Thus, if the taxpayer sold stock or some other asset and used the proceeds to pay other creditors, the IRS may claim the proceeds should have been used to pay the federal tax debt and will include the asset in the RCP. Though this provision is not new, the IRS only recently seems to have started utilizing IRM 5.8.5.4 routinely to include dissipated assets with OICs. If the IRS applies this provision, taxpayers with significant dissipated assets will be unlikely to satisfy an OIC given that the value of the assets which the taxpayers no longer have will be included in their RCP. Practitioners should be mindful of reviewing a taxpayer's prior tax returns to inspect

¹ IRM 5.8.7.2.2

for sales or transfers of assets that may impact the practitioner's decision to file an OIC for the taxpayer.

Averaging of Income. For OICs, the IRS will generally average the taxpayer's income from the last three years to prevent taxpayers whose business is in a temporary slump from taking advantage of their reduced cash flow to compromise their tax debt. This situation may create problems where a taxpayer's business is in decline since his or her cash flow will be the average of several years, some of which may have been quite profitable. The effect will be to create cash flow on paper where there really may be none, which would undermine the OIC.

In such cases, practitioners should prepare arguments for why the averaging of the income is improper. Examples of when averaging is improper include instances where the taxpayer develops health problems and cannot work at his or her profession as before, a sudden decline or change in the taxpayer's industry, or the taxpayer had one exceptional year. The author has been successful at arguing why a year should be excluded from the calculation because over the taxpayer's work history, that particular year was so exceptional it skewed the calculation and distorted the taxpayer's financial picture.

Designated Payments Toward Trust Fund Portion of Employment Tax Debt for OICs.

Payments made with an OIC submission and payments made monthly as the OIC is being considered (with the deferred payment option), may, according to Internal Revenue Code Section 7122(c)(2)(A),² be designated toward the trust fund portion of a debt. If payments are made that are not designated toward the trust fund portion of the tax liability, they will be applied to non-trust fund debts first, according to IRM Section 8.23.1.4.1.1(1)(F). If the offer is ultimately rejected the taxpayer will have lost the opportunity to reduce the trust fund penalty.

² See also IRS Notice 2006-68 and IRM Section 8.23.1.4.1.1(1)(E).

Number of Months of Future Income in RCP Calculation for OICs.

IRS written guidance states that future income for an OIC is calculated as follows:³

- Lump sum offers - “net monthly income” multiplied by 48 months;
- Short-term (up to two years of payments) deferred payment offers – “net monthly income” multiplied by 60 months; and
- Longer term offers – “net monthly income” multiplied by the number of months left on the collection statute.

The author is aware of some instances where the IRS used the number of months left on the collection statute with lump sum and deferred payment offers. Practitioners should be sure to carefully review correspondence received from the OIC Unit and, where an improper number of months were used to calculate future earnings, file a timely appeal of the OIC Unit’s findings.

Changes in Authority of the Taxpayer Advocate. Many practitioners regularly use the Taxpayer Advocate to solve certain types of collection problems, such as to reverse a levy if an OIC is about to be filed or to remove a garnishment on wages or social security payments. Recently, the IRS changed the ambit of the Taxpayer Advocate to limit its authority in certain areas. The complete description of the modifications exceeds the scope of this article, but may be obtained from the IRS website.⁴ Some of these changes limit Taxpayer Advocate’s ability to assist with collection matters, in particular removing the Taxpayer Advocate’s ability to reverse levies.

³ See, e.g., Form 656 pages 6 and 9. See also IRM Section 5.8.5.5.

⁴ See Modifications to Delegation Order 267 (effective October 1, 2007).

III. Final Regulations § 301.7701.

The IRS finalized the formerly proposed regulations § 301.7701 on August 15, 2007, which state that, though a single member LLC may be disregarded for income tax purposes, it will be treated as a corporation for purposes of employment taxes. So, similar to corporations with employment tax obligations, only the trust fund portion of the payroll taxes will attach to a member-owner of an LLC if such member meets the definition of a responsible party under § 6672.

Designating Payments. As discussed in the earlier paragraph regarding designating voluntary payments in an OIC, when a taxpayer is determined to be a responsible party for Trust Funds under IRC § 6672, the strategy is generally to designate tax payments to the trust fund portion of employment taxes that are owed.

In Revenue Procedure 2002-26 the IRS has restated its position as follows:

“at the time the taxpayer voluntarily tenders a partial payment that is accepted by the Service and the taxpayer provides specific written directions as to the application of the payment, the Service will apply the payment in accordance with those directions.”

Practitioners should be sure to have their clients designate any voluntary payment they make to the trust fund portion of an employment tax liability. Also, given that there is a ten year statute of limitations for collection of assessed taxes, taxpayers should always designate their voluntary payments to the most recent tax period, allowing the statute to continue running

on the oldest tax liabilities, and thereby increasing the chance that the liabilities will expire before the tax is collected in full.

Partial Pay Installment Agreements. The IRS in the past informally permitted partial pay installment agreements in certain circumstances. In 2004, legislation was passed which codified this procedure, known as the “Partial Payment Installment Agreement (PPIA)” for taxpayers who have outstanding federal tax liabilities.⁵ For example, if it is determined that a taxpayer has the ability to pay \$500/month on his or her tax liability, the IRS can accept an installment agreement for that amount even if the payments will not fully pay the tax prior to the collection statute expiring. The agreement ends when the collection statute expires. PPIAs are of particular interest to taxpayers who are not OIC candidates because their monthly income renders an OIC beyond their means. The taxpayer who shows the ability to pay \$500 per month would be required to offer \$24,000 for a lump-sum OIC (48 months multiplied by \$500). That same taxpayer may be a candidate for a PPIA because of his or her ability to pay the same \$500 per month over the life of the statute.

IV. Conclusion

Accountants need to be aware of the recent changes when dealing with the IRS Collection Division, and prepare to deal with the issue of dissipated assets and the averaging of a taxpayer’s income when considering whether an offer-in-compromise is a viable option. If not, consider the new partial pay installment agreement, and remember to always have taxpayers designate any voluntary payment to the IRS to either the trust fund portion of an employment tax liability or to the income tax period that benefits them the most.

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⁵ See IRC § 6159.

Eric L. Green is Of Counsel to Convicer & Percy, LLP in Glastonbury, Connecticut, where he represents individuals and businesses in criminal and civil tax proceedings before the Internal Revenue Service and the Connecticut Department of Revenue Services, and advises in the areas of business tax planning and estate planning for individuals and closely held businesses. He is currently the Vice Chair of the Closely Held Business Tax Committee of the American Bar Association, and has been quoted in several national publications, including *USA Today*, *Consumer Reports Financial*, *the National Underwriter* and *CreditCard.com*. Attorney Green is an honors graduate of New England School of Law and received his Master of Laws degree in Taxation from Boston University School of Law. Mr. Green can be reached at egreen@convicerpercy.com.