AN INSIDE LOOK AT THE IRS COLLECTION DIVISION

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A common myth about the IRS is that they routinely take cars, houses and business assets from collection targets. While this activity does occur, the reality is that, in many instances, the property is protected from the IRS collection process.

The IRS will not seize an asset unless the enforcement results in a net recovery after expenses of sale. This eliminates IRS seizures of no equity vehicles, no equity houses and no equity business assets.

The property that the IRS cannot or will not seize is itemized in the Internal Revenue Code and by internal procedure in the Internal Revenue Manual.

In order to determine the sources of collection, the IRS requires a target to complete financial statements. The IRS generally will not negotiate a solution to a tax liability without first extracting financial information from the collection target.

IRS Financial Statements

The financial statement used by the IRS for individuals is known as a Form 433-A, while businesses are required to use a Form 433-B. A self-employed target is required to fill out both the Form 433A and Form 433B as his personal assets and business assets are on the line from conducting business as a sole proprietorship.

The IRS financial statements require the disclosure and valuation of the target's income and expenses as well as all assets, including accounts receivable, equipment, tools and machinery, ownership of real estate, automobiles, bank account information and retirement accounts.

If a collection target does not voluntary disclose financial information, the IRS will heat up its collection action. The IRS can issue a summons for the information if not voluntarily provided. The IRS is also more likely to commence enforcement action in cases of with a lack of cooperation from the target. If negotiations breakdown after financial statements are provided, the IRS has obtained the information it needs to commence collection action, which is always a risk to the target.

The financial statements are dissected by the IRS for a determination of (1) the collection target's equity in assets and (2) how much the target can pay on a monthly basis from income and expenses.

Liquidating Assets

The IRS will first review the collection target's assets and, in many cases, demand that an enforcement target liquidate any equity in assets that is not otherwise exempt. The IRS will not consider an installment agreement if the target has real or tangible assets that will allow a lump sum remittance. If an asset has equity, the IRS will demand that the target voluntarily liquidate the asset and turn over the proceeds to the government.

The IRS will set a timeline to complete the liquidation, which is often 90 days or less. Failure to liquidate the asset in a timely manner or to cooperate may result in the IRS taking immediate enforcement action against the target's bank account or wages. The IRS will seize bank accounts or wages when a target is not cooperating in liquidating a larger asset as bank accounts and wages can be quickly and readily attached.

Before making any asset seizure, the IRS must first determine if the asset has equity and if the seizure will result in any net proceeds to the government.

Determining Equity

In making its equity determinations, the IRS reduces the value of assets such as real estate and automobiles from fair market value to what it refers to as quick sale value. The IRS theory is that they will not recover the full value of an asset if it is seized and sold involuntarily. As such, the IRS commonly reduces that value of real estate and automobiles by 20%. For example, a house with a $200,000 fair market value would be analyzed by the IRS for equity at $180,000, a 20% reduction. If a first mortgage is valued at $180,000, the IRS will not consider the asset to have equity. These value reductions are a benefit to a target that otherwise may have value in the property.

No Equity Assets

The IRS will not seize assets in which there will be no net recovery after expenses of sale. This "no equity" provision is codified in Section 6331(f) of the Internal Revenue Code.

The rule against no equity seizures eliminates the majority of potential asset seizures, including those involving automobiles, personal residences and business equipment and machinery. For example, an automobile worth $2,000 will be reduced in value to a $1,600 quick sale equity valuation. This equity is likely to be insufficient to result in a seizure and sale. A personal residence is often mortgaged to an 80/20 loan value, also resulting in no equity for IRS purposes. Cars often have loans and liens encumbering the title to a point of no equity. And the equipment and machinery of a business is often secured by bank financing.

Exempt Assets

Section 6334 of the Internal Revenue Code identifies essential items that are protected from IRS enforcement activity even if the asset has equity.

The IRS cannot take the furniture and household goods of most collection targets up to $7,040 in value. Tools necessary for the trade, business or profession of a target are protected from the IRS up to $3,520 in value. Clothing that is necessary for the target and his or her family is also exempt from enforcement. Unemployment benefits, workmen's compensation, court-ordered child support and supplemental social security benefits are also protected under Section 6334.

Business Assets

The IRS uses a multi-tier approach in evaluating whether to seize assets used in operating a business.

To begin with, if the assets have no equity, they will not be seized. If the assets have equity, the seizure must be approved in writing by an IRS Area Director if the business is a sole proprietorship. Seizures of the assets of corporations or partnerships do not require the higher level approval.

A seizure will be approved only after the Area Director makes a determination that the target's other assets are insufficient to pay the amount due. As a practical matter, the IRS is hesitant to seize the assets of an ongoing business that is compliant on its taxes, especially if the asset is used to produce income that can be used to repay the taxes. An uncooperative target who is still pyramiding liabilities will receive less forgiveness.

The IRS breaks down the determination as to whether to seize business assets by what is referred to as "Will Pay"/"Can't Pay" and "Won't Pay" factors.

The IRS will generally not seize assets of collection targets who "Will Pay/Can't Pay". These targets are able to demonstrate to the IRS that (1) they will be able to full pay the liability within a reasonable time frame (2) require time to obtain a loan against the asset or to voluntarily liquidate it (3) qualify for and submit a meaningful offer in compromise or (4) have no ability to make installments and have no equity in their assets (known as being "uncollectible").

The "Won't Pay" targets are those that (1) will not liquidate assets voluntarily (2) continue to pyramid and accrue additional tax liabilities, usually by not depositing payroll taxes or making estimated tax payments (3) will not cooperate with the IRS or (4) do not adhere to IRS time deadlines.

Personal Residences

In addition to equity factors, the IRS is prohibited from seizing any personal residence if the balance owes is less than $5,000. This applies not only to the target's own personal residence but to any real estate the target is renting to another as that person's residence.

Additionally, the IRS cannot seize a target's house on its own administrative decision. Any seizure of a personal residence requires the IRS to petition a U.S. District Court for an order permitting the seizure and sale. The IRS will usually seize a personal residence in egregious cases only.

Retirement Plans

Retirement funds, which are generally exempt to the collection efforts of other creditors under most state laws, are not exempt from IRS collection actions. Still, the IRS is generally reluctant to seize funds in a target's retirement account.

The Internal Revenue Manual guidelines limit the power of the IRS in seizing retirement assets to cases where a target has engaged in flagrant conduct. Flagrant conduct is deemed to be committed by targets that raise frivolous arguments, make contributions to the retirement account while accruing tax liabilities, are convicted of tax evasion or fraud, have a pattern of uncooperative behavior or who continue to incur and pyramid liabilities.

The IRS will also consider the cost of the levy, the amount of the net proceeds and other alternatives before levying on retirement accounts.

Most Common IRS Seizures

Because of these limitations, the most common assets that the IRS will seize are wages, bank account and accounts receivable. There are minimal limitations and restrictions (other than providing a due process Notice of Intent to Levy) on these types of seizures. These assets are quantifiable, identifiable and readily available. And a continuing wage garnishment or loss of large account receivable can be extremely damaging to a target that is not cooperating with an IRS Collection Officer.

The loss of wages can cripple a target as much as other more intrusive seizures. A business having its bank accounts continually seized and receivables garnished will not be able to operate regardless of how much equity it has in its assets.

In many cases, a recalcitrant target may never have real and tangible equity assets seized, but he also may never see a full paycheck, be able to use a bank account or carry accounts.