By Howard Levy, Esq.

Myth vs. Reality: IRS Collection Threats

Our clients come to us with many different ideas about what the government will do to them because they did not pay their taxes. The information they gather about IRS collection threats often comes from friends, the media, and even the IRS.

Think about their anxiety: Is the IRS going to show up one day and seize my house? Put a levy on my income so I cannot provide for my family? Shut down my business? When do I get my life back?

Fearing the IRS affects health, work, and relationships. From wage earners to middle managers to business owners, IRS problems are all-consuming. But most of what our clients hear—and fear—is more myth than reality.

The realities are often much different than the myths. There are limitations on the IRS that prevent surprise, ensure rights of due process, and permit resolution without the threat of levy. Asset seizure is tempered by Internal Revenue Code (IRC) provisions that restrict what the IRS can take.

Here is a guide to knowing when the IRS can levy and what they are permitted to take.

IRS STARTING POINT: FINAL NOTICE OF INTENT TO LEVY

The starting point in every collection case is the rule that the IRS cannot take property—including wages and bank accounts—until it first sends a letter stating its intentions. This letter is called a Final Notice of Intent to Levy. It provides rights of due process to be heard before any levy or seizure action is taken. The final notice is required to be sent pursuant to IRC Secs. 6330 and 6331.

To the layperson, every notice the IRS sends looks like it gives it the ability to levy. The stream of collection letters the IRS issues can be confusing—they all seem threatening. Be assured that they are not. Let's sort out the various collection notices and get to the notice that has legal significance.

Here is the order in which the IRS issues collection notices:

(1) CP 14: Balance Due
(2) CP 501: Reminder, Balance Due
(3) CP 503: 2nd Notice, Balance Due
(4) CP 504: Final Notice, Balance Due
(5) CP 90: Final Notice of Intent to Levy and Notice of Your Right to a Hearing

This cycle can take several months to complete. Each notice is usually issued about five weeks apart. In high-dollar cases or for businesses, the IRS may sometimes skip the complete cycle and go straight to the final notice.

Of the notices, the only notice that permits any action of consequence is the CP 90, Final Notice of Intent to Levy and Notice of Your Right to a Hearing. This notice is the only one that permits the IRS to start proceedings to take wages, bank accounts, automobiles, real estate, and business assets. It can be issued from the Automated Collection Service (ACS) or by a revenue officer.

The first four notices of balances due (CP 14, CP 501, CP 503, and CP 504) do not give the IRS any legal rights other than to take a state tax refund after the issuance of CP 504, the final notice of a balance due. This limitation holds whether you are dealing with a revenue officer or the IRS ACS.

Do not be confused by the other notices or what the IRS may tell you. These notices may be important and urgent, but they are not as threatening as they may appear. Only the Final Notice of Intent to Levy gives the government the legal right to take action.

Ask your clients to bring in the mail they have received from the IRS. Open it, go through it, look for the Final Notice of Intent to Levy. To supplement what your clients bring in, obtain an IRS account transcript which will indicate whether the IRS has sent out the final notice. Review the notices and account transcripts and let your clients know the reality of whether a collection threat is real.

If the IRS has not sent the CP 90, your client is protected. Any negotiations with the IRS will be without the threat of levy until it is sent.

If the IRS has recently issued the final notice, you have important rights to protect for your client by filing a collection due process (CDP) appeal.

RESPONSE TO NOTICE OF LEVY: COLLECTION DUE PROCESS APPEAL

If the IRS has sent its final notice, it has to wait thirty days after the letter is sent before starting levy action. During this 30-day window, you have the right to file a request for an administrative meeting with an IRS appeals officer. This is known as a CDP.

The purpose of a CDP appeal is to discuss alternatives to the intent to levy and reach case resolution without enforcement.

There are substantial benefits to negotiating with the IRS through a collection due process appeal. The advantages include:

- The IRS is prohibited by law from taking property until the appeal is completed. Typically, it takes the IRS about three to six months to have a case assigned to an appeals officer and for your conference.
- There will be one IRS person assigned to your case, which is a vast improvement from the impersonal and often frustrating negotiations that can take place with ACS. You can even have a face-to-face meeting if you request—unheard of and impossible if ACS had control.
- The appeal will allow you to move the case from the collection division to the appeals division; i.e., from the ACS or a revenue officer to an appeals officer.

Meeting with an IRS appeals officer usually gives you the best chance at reaching a fair resolution. IRS appeals officers tend to be best equipped to resolve your case in a manner that is fair to you and your client. Negotiating without being in a corner from the threat of levy has its advantages.

If you cannot agree with IRS Appeals over how to resolve your case, you have the right to have an independent Tax Court judge review it. In such a case, the appeals officer should consider how a Tax Court judge would rule in deciding the case. This is a rare opportunity to go outside the IRS for resolution of a collection case. The hold on collection will continue through Appeals and while your Tax Court case is pending and until it is decided, which can take twelve months.

Solutions you can request from Appeals and have reviewed by the Tax Court include requests for an installment agreement, hardship "uncollectible status," an offer in compromise, or innocent spouse treatment. Remember that Appeals will decide these issues, not ACS or revenue officers.

It is important to remember that timely CDP appeals are those that are filed within thirty days after the Final Notice of Intent to Levy is issued. But even if it has been more than thirty days since the IRS sent the final notice, you still have options.

IRS administrative policy (see Internal Revenue Manual 5.1.9.3.2.2) is to process a late-filed CDP appeal if it is filed within one year after the final notice is sent. Filing your appeal late gives you the same administrative rights as filing timely—a hold on collection and a meeting with an appeals officer. What you lose by filing late is the right to go to Tax Court.

EXCEPTIONS: WHEN A NOTICE OF INTENT TO LEVY IS NOT REQUIRED

There are a few extreme circumstances where the IRS is permitted to go after property and bypass the requirement of notice.

Here are two situations where the IRS can catch your client by surprise:

- **Jeopardy levy.** If the IRS has reason to believe that collection of the tax is in jeopardy, IRS does not have to give warning before levying. IRS collections are in jeopardy if assets are being moved out of the United States, or being concealed, dissipated, or transferred to third parties. The immediate harm that can be caused by these actions gives the

IRS the ability to seize without sending out advance notice.

- **Disqualified employment tax levy.** This levy can happen if there is "pyramiding" of employment tax liabilities. IRS defines pyramiding as a fraudulent practice where a business withholds payroll taxes but intentionally fails to remit them. A common characteristic of businesses involved in pyramiding is to file for bankruptcy, start a new business under a different name, and then begin the scheme again. The IRS takes this very seriously, and Congress agreed, resulting in an exception to the ordinary requirement of notice and rights of appeal before levy and seizure.

A disqualified employment tax levy would come into play if the IRS sent a Final Notice of Intent to Levy to collect an older employment tax period which was the subject of a CDP appeals hearing. If, during the two years since the appeal new employment tax debts came due, the IRS could levy the new tax periods—those that are being pyramided—without notice.

Putting those exceptions aside, bear in mind that once the IRS issues the final notice for a tax period, it does not have to do it again. So it is important to know where your client is in the IRS collection system. You can be surprised by an IRS levy—even if the exceptions to notice do not apply—if the IRS long ago issued the CP 90 and the rights to appeal have lapsed.

WHAT CAN THE IRS REALLY SEIZE?

If the IRS is in position to levy or seize, it is important to know what is at risk.

No matter what the IRS may tell your clients or what you may have heard, it is very unlikely the IRS will levy on a house, car, furniture, or equipment. The assets that clients may be the most concerned about—their stuff—are the items the IRS is least likely to take. This is important to know in negotiating with the IRS.

In 2009, the IRS made 581 seizures of "hard" assets such as houses, cars, and other personal property. By comparison, in the same year the IRS sent out almost 3,500,000 levies on "soft" assets, such as bank accounts and wages.

IRS attempts to seize "hard" assets are serious, make no mistake about it. But the IRS is clearly more intent on tying up cash.

The reasons for the focus on cash, not personal property, are in the IRC and the Internal Revenue Manual. Both provide that if an asset—for instance a house—lacks equity, the IRS is prevented from seizing it. This eliminates a vast majority of potential seizures. Even if an asset has equity, it cannot be taken if it is listed as exempt in the IRC and is protected from the IRS as a matter of public policy.

Does the property have equity?

Internal Revenue Manual 5.10.1.2 states that seizures are prohibited "where the taxpayer has insufficient equity in the property." IRC Sec. 6331(f) prevents the IRS from making an "uneconomical levy," meaning the IRS must get an economic recovery from the levy to do it.

Examples: If a car is worth $7,500, and there is a bank loan of $7,500 on it, there is no equity, and the IRS is not interested. For a house, take the value, subtract the mortgage, and reduce it further by the costs of sale. There has to be a fairly substantial amount left afterwards for the IRS to be interested under the equity rules.

Even if there is equity, a seizure is still generally something the IRS does not desire to do. In most situations a lack of cooperation after repeated attempts by the IRS is a precursor. Many seizures need managerial approval before being sent to an IRS property liquidation specialist. And some, such as a personal residence, require outside court approval. (See {IRC Sec. 6334(e)((1).})

Is the property exempt and protected from seizure?

In addition to the protection the tax code gives to any property that lacks equity, Sec. 6334 of the IRC lists specific types of property that are protected from IRS collection actions. These protections are known as exemptions.

The assets that are exempt from the IRS under Sec. 6334 include the following:

- Necessary clothing. Bear in mind that the tax code uses the words "necessary" in describing the clothing that is exempt from IRS collections, meaning the IRS can technically take clothing that is not necessary, such as designer shoes, handbags, etc. But the IRS is not taking your client's television, bed, or lawn mower.
- Household goods and furnishings, currently exempted up to $8,250 in value; and
- Tools of a trade or business, exempted up to $4,120 in value.

There are also sources of income that are protected from IRS' power to levy under Sec. 6334, including:

- Unemployment benefits;
- Workers' compensation benefits;
- Service-connected veteran's disability benefits;
- Income needed to pay court-ordered child support;
- Supplemental social security for the aged, blind, or disabled; and
- State and local public assistance or welfare programs which are based on need or income.

It should be noted that the income protections alluded to under Sec. 6334 for unemployment benefits, workers' compensation benefits, and veteran's disability benefits are tempered by the Federal Levy Program. This program—permitted under IRC Sec. 6331(h)—allows the IRS to take fifteen percent of these benefits. Although fifteen percent is technically permitted to be taken by law, current IRS policy does not permit the fifteen percent levy on these otherwise exempt benefits. See Internal Revenue Manual 5.11.7.2.1(5).

The statutory design of Sec. 6334 means that if an asset or source of income is not specifically excluded from the IRS by statute, it is fair game. This permits the IRS to take retirement accounts, which are not listed in Sec. 6334 but are protected from all other creditors.

It is important to remember these exemptions when completing IRS financial statements, such as Form 433A (Collection Information Statement for Wage Earners and Self-Employed Individuals). Claim the value of protected assets as exempt. In an offer in compromise, make sure that these assets are not included in the value of the offer as they are off limits to the IRS; again, claim it as exempt.

CONCLUSION

IRS problems are serious matters, but effective representation requires understanding the procedural realities of tax enforcement.

The IRC has limits on when the IRS can levy on property and boundaries on what it can take. With few exceptions the IRS cannot act with surprise. The IRS has to provide taxpayers with due process—notice and a right to be heard—before it can take someone's property.

The IRS issues many look-a-like notices, but the one that starts the levy process is the Final Notice of Intent to Levy. A CDP appeal filed in response to the final notice allows resolution of IRS problems without the threat of levy. The appeal also stops IRS collection action, moves a collection case into appeals, and can provide outside relief from the Tax Court.

Even if the IRS is procedurally able to start levy action, it is important to know that, for practical purposes, their resources are overwhelmingly devoted to taking bank accounts and wages, not personal property. Even if the IRS desires to seize personal property, there are limitations on what can be taken. The IRS cannot make a seizure when there is no recovery. Property specifically listed as exempt in the IRC is also off limits.

Every IRS collection threat should be handled based on the realities of what the IRS can do, not the myths. EA

About the Author

Howard S. Levy Esq. is a former trial attorney for the IRS and an instructor at NTPI. He has over twenty years of experience in IRS collection proceedings, Tax Court litigation, IRS administrative appeals, and the use of bankruptcy to resolve IRS controversies. Howard is a member of Voorhees & Levy LLC in Cincinnati, OH, and can be contacted at howard@voorheeslevy.com or at www.howardlevyirslawyer.com.