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IRS Tax Resolution Strategies

Settlement options for delinquent filers

By Curtis B. Hunter

We've all seen the commercials of tax "specialists" promising to settle tax disputes with the Internal Revenue Service for a fraction of what is owed. More often than not, these claims are false, with the exception of rare cases involving extenuating circumstances beyond the taxpayer's control. Significant relief, however, may still be obtained before or after tax liens have been filed, enabling taxpayers to save considerably and pay over extended periods of time. The first step is understanding your rights and the defenses available.

Although relatively understaffed, the IRS collections department is actively engaged in prioritizing the collection of delinquent and unreported taxes. In addition to scrutinizing individual taxpayers who have failed to report or pay income taxes, the IRS also cracks down on businesses responsible for filing quarterly employment tax returns and remitting payroll taxes.

Defending against IRS collections matters first requires an understanding of the process, which begins with an established time frame for serving notices to taxpayers. These procedures are designed to provide taxpayers enough time to pay taxes before the IRS files liens. Business owners should note the IRS is significantly more aggressive in collecting employment taxes from businesses. In the collection process, the IRS is not required to prove that notices have been received, as taxpayers often ignore certified notices when they arrive. Documenting the date on which notices were mailed is considered sufficient.

The statutory period within which the IRS can collect delinquent taxes is 10 years from the date they are assessed (or indefinitely in the case of fraud). Penalties and interest can represent a significant portion of the overall tax debt because they accrue during the collection process until the taxes are paid in full. The IRS issues the first notice, Notice of Tax Due and Demand for Payment, as soon as it determines that taxes are delinquent. The notice states the balances due (including penalties and interest), and requests payment within 10 days. Most taxpayers do not realize that a federal tax lien against their property is created with this first demand if they have failed to pay taxes due.

The IRS will then mail three additional notices, with increasingly aggressive language. If the delinquent taxes remain unpaid after the initial four notices, the IRS issues Letter 1058, Final Notice of Intent to Levy. At this point, the IRS typically records the tax liens that were previously established with the first notice, making legal claims to property as security for the payment of taxes. If the taxpayer still does not take action, the IRS will enforce its lien by seizing the taxpayer’s assets, which may include wages, bank accounts, commissions and other property, until the tax debts are completely paid. Additionally, when a business fails to pay employment taxes after demand by the IRS, the IRS can seek recovery of the entire tax debt from the responsible person (i.e., the individual responsible, such as the owner) for withholding and not remitting taxes for the business. This can have devastating consequences for the business and the business owner, which is why it is critical to take action and respond to the Final Notice within the 30-day time period provided.

Assuming the taxes are owed, after the IRS has demanded full payment in its initial notices (or at any time up to and including the filing of a tax lien or notice of levy), the taxpayer can either voluntarily comply by making payments or seek alternative payment arrangements. There are three main arrangements from which to choose: (1) classification of tax debts as currently not collectible; (2) partial or full payment installment agreements; or (3) an offer in compromise. Each of these options requires the filing of a collection information statement and supporting financial documentation to demonstrate the taxpayer’s current financial condition, as well as all tax returns for the relevant tax years. To protect its interest, the IRS can—and usually does—file a tax lien while considering the proposed arrangements.

Currently not collectible status is a financial hardship consideration for taxpayers who do not currently have money available to pay their tax debts. If, after receiving the taxpayer's financial information, the IRS agrees that the taxpayer does not have sufficient income to make monthly payments towards the tax debts, it will mark the status of accounts as currently not collectible and temporarily cease collection efforts. The accounts will remain in uncollectible status until the taxpayer is deemed financially able to make monthly payments; however, penalties and interest will continue accruing. The IRS will review the accounts on, at least, an annual basis to determine if and when taxpayers are able to start making payments.

Installment agreements enable taxpayers to make full payment of the delinquent taxes in smaller, more manageable payments. Generally, the installment agreements require equal monthly payments based on the amounts owed and depend upon the taxpayer's ability to pay the taxes for the duration of the 10-year assessment period remaining. In addition to submitting the collections information statement and filing the tax returns for the years covered, all future returns must also be filed in a timely fashion. When returns are not timely filed after the establishment of installment agreements, the taxpayers will be deemed in default and the total outstanding tax debt (plus any applicable penalties and interest) will be due and payable. The IRS will not levy against the taxpayer's property while installment agreements are being considered, or while they are in effect, but upon default will levy the assets necessary until the taxes are paid in full.

The most forgiving arrangement for taxpayers is the offer in compromise, where the IRS may accept proposals to settle unpaid taxes for less than the full amount of the balance due. The IRS will generally accept an offer in compromise when it determines that it is unlikely that the tax liability can be collected in full and the amount offered equals at least the amount the IRS calculates that it could collect based on the taxpayer's equity in assets and disposable monthly income. The IRS reviews the taxpayer's collection information statements and financial documents, then applies its own established standards for reasonable income, plus housing and living expenses, to determine the taxpayer's eligibility for an offer and an acceptable settlement amount.

The IRS can compromise tax liabilities (settle for less than is owed) for one of three reasons:

1. When doubt as to liability raises legitimate doubt as to whether the taxpayer owes the taxes, or if the assessed taxes are incorrect.

2. When doubt as to collectability makes it doubtful that the taxpayer could ever pay the full amount within the remainder of the statutory collections period (10 years).

3. When the acceptance of an offer would "promote effective tax administration." This occurs in cases where there is no doubt the assessed tax is accurate and that the amount owed could be collected, butthe taxpayer has an economic hardship or special circumstance, which would allow the IRS to accept less than the total owed.

The IRS will only consider these cases (absent special circumstances) where the total amounts of taxes owed is greater than the sum total of the equity value in all of the taxpayer's assets and future income.

In other words, the taxpayer would not be able to pay the taxes in full either by liquidating assets or through installment arrangements. There are three different payment options for offers that are accepted:

(1) pay 20% of the offer and make five or fewer additional installments to pay the balance; (2) pay equal installments over a two year period; or (3) make equal payments over the remaining statutory collection period. Again, if accepted, the taxpayer must remain compliant with the filing requirements for the next five years or the offer will be rescinded, and all outstanding taxes will immediately become payable.

When an offer is rejected, the taxpayer can still request "currently not collectible" status or installment arrangements. Finally, when a Notice of Federal Tax Lien or Notice of Intent to Levy has been issued, the taxpayer has a right to a collection due process (CDP) hearing in which taxes owed may be disputed or defenses to an IRS appeals officer not involved in the case. If, following the CDP hearing, the appeals agent confirms the delinquent taxes are owed, the taxpayer can still request an installment agreement or offer in compromise, or appeal the decision to the U.S. Tax Court or federal district court. CDP hearings can be useful in cases of overly aggressive revenue officers.

Not only are these options available to defend an IRS collections action, but penalties and interest can also be waived by the IRS under certain circumstances. For an abatement of penalties, the taxpayer must show a reasonable cause existed, which prevented payment of taxes (e.g., death or illness in the family, civil disturbance, drug/alcohol/psychological problems or divorce). To abate interest, however, IRS errors or delays must have taken place (i.e., loss of paperwork) in which the taxpayer could not have caused any significant impact.

Obviously, taxpayers should pay delinquent taxes as soon as possible given the levy power of the IRS and accrual of penalties and interest, but when that is not possible, taxpayers should carefully consider their rights and available settlement options and choose the most appropriate courses of action.

About the Author

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