Advising Clients with Tax Troubles

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Let Your Client Know That Ignoring the IRS Won't Make It Go Away.

In fact, if your client disregards correspondence from the IRS, she could be sacrificing valuable taxpayer rights. Contrary to popular belief, most tax returns are not subject to close inspection.[1] Statistically, this means the letter from the IRS that your client may have been ignoring thus far could be only informational in nature. However, on the rare occasion when a tax return is selected for examination by an agent and a discrepancy is found, the IRS fires a series of "warning shots" in the form of written notices addressed to the taxpayer. Because many taxpayers do not realize the extreme importance of these notices, they are often ignored or even disposed of to the taxpayer's detriment.

The first warning that the IRS may send your client is a 30-day letter, which is an explanation of the IRS agent's conclusions after examining the client's return. The 30-day letter is an opportunity for your client to formally contest the agent's findings. Upon receipt of the letter, your client has up to 30 days to file a protest requesting administrative review of the agent's conclusions. Whether your client should make this request is a decision that warrants strategic consideration. Although filing a protest will give your client access to administrative review by the IRS Appeals Office, keep in mind that Appeals Officers are extremely adept at identifying return errors, including those which may not have been spotted by the IRS agent who initially examined your client's return. As a result, gaining audience with the Appeals Office via protest may subject your client to additional assessments of tax. On the other hand, appeals conferences frequently lead to settlement, which could potentially spare your client the pain and expense of litigation.[2] Where litigation is inevitable, be aware that your client may be precluded from an award of attorney's fees otherwise available to her if there has not been at least one request for an appeals conference along the way.

If your client has allowed the 30-day period to expire without taking action (whether intentionally or unintentionally), a 90-day letter from the IRS, also known as a statutory notice of deficiency, should follow.[3] The statutory notice of deficiency

[1] Internal Revenue Service Data Book, 2007, Publication 55B, Table 9: Examination Coverage: Recommended and Average Recommended Additional Tax After Examination, by Type and Size of Return, Fiscal Year 2007 (Washington, DC, March 2008). In 2006, only 0.9% of all US tax returns were examined, including 1.0% of all Individual Income Tax Returns and 0.9% of all Small Corporation Returns.

[2] Internal Revenue Service Data Book, 2007, Publication 55B, Table 21, Appeals Workload, by Type of Case, Fiscal Year 2007 (Washington, DC, March 2008). Approximately 93.4% of appeals from Examination are resolved.

[3] 26 USC § 6212(a). Note that a 90-day (or 150-day) letter will also be issued where the taxpayer did

gives your client up to 90 days to file a petition for judicial review in the US Tax Court.[4] Because the statutory notice of deficiency represents an opportunity to obtain judicial review without first paying the tax in question (and thus may be the sole means for obtaining judicial review for low-income taxpayers), this is a highly valuable piece of correspondence which should not be taken lightly or overlooked. The opportunity for prepayment review is even more crucial if the tax in question exceeds a client's ability to pay. A timely petition to Tax Court also provides another opportunity for your client to appeal any issues that she has not yet put before the Appeals Office. In any event, if your client fails to file a Tax Court petition within the 90-day statutory period, her ability to obtain prepayment judicial review will be forever lost.[5] Many taxpayers unknowingly sacrifice this valuable option of prepayment review when they fail to open and carefully inspect correspondence received from the IRS.

Even if your client has been shut out of Tax Court, she can take steps toward other (albeit more expensive) means of judicial review by paying the tax (assuming your client can afford to do so) and applying for a refund.[6] After evaluating your client's refund request, the IRS will generally append its decision to a 30-day notice which, as described earlier, allows your client 30 days to protest the decision and move the case to Appeals. Considering that proceedings in federal court are typically more expensive, more involved, and more protracted than in Tax Court, the cost-benefit shift may increase the attractiveness of diverting the case to Appeals at this point.

If your client's request for a refund is denied, or if more than 6 months have passed since the request was made and the IRS has not yet issued a decision, your client may petition for review in either the Federal District Court or the Court of Federal Claims. The deadline for filing a petition is generally 2 years from the date the IRS mails the notice disallowing the request for refund.[7] Take note, however, that the IRS is not required to issue a formal notice of disallowance, and therefore it does not always do so.[8] Because the date of notice marks the beginning of the 2-year window during which your client can file suit, failure by the IRS to send such a notice may permit filing for suit well beyond the statutory 2-year limit as long as your client's right to receive notice has not been waived (otherwise, the 2-year window would begin on the date the written waiver of notice was filed with the IRS).[9] As is true in most cases, however, early action is always preferable to the risks inherent in delayed action (i.e., be sure your client doesn't wait any longer than necessary: if your client has decided to take this route, she should either petition the court 6 months after the request for refund is filed or petition the court on the heels of a notice of denial if one is issued to her within 6 months of her request for refund).

appeal but was unable to resolve the issue in the Appeals Office (i.e., the case remains unagreed).

[4] 26 USC § 6213(a). The statutory period is typically 90 days and is increased to 150 days for taxpayers outside US.

[5] 26 USC § 6213(c).

[6] Flora v. U.S., 362 US 1455 (1960).

[7] 26 USC § 6532(a)(1).

[8] Smith v. U.S., 31 AFTR 2d 73-1213 (5th Cir. 1973); SCA 200111043 (2001).

[9] 26 USC §6532(a)(3). Waiver of the statutory notice of disallowance is generally in written form and may be effected by executing IRS Form 2297.

The Road to Hell Is Paved with Uninformed Decisions

The opportunity to select one's own litigation forum is rare indeed. Consequently, the decision about where your client should litigate should be informed by a careful evaluation of your client's particular tax matter in view of the courts under consideration.

First, be certain that the court you select will have jurisdiction over your client's tax matter to avoid wasting time. In general, the Tax Court has jurisdiction over matters involving income tax, estate tax, gift tax, and a few other limited tax matters such as certain employment tax concerns, limited declaratory judgments, and some innocent spouse matters.[10] More specifically, the Tax Court has jurisdiction only where the following jurisdictional prerequisites are met: (1) the IRS has determined that a tax deficiency exists, (2) the IRS has issued a notice regarding the deficiency, and (3) the taxpayer has petitioned the Tax Court within 90 days of the mailing of the statutory notice of deficiency. One of the only exceptions to the 90-day notice requirement (if not the only exception) allows Tax Court review of the determination or denial of a reward paid to an IRS informant for information regarding tax law violations.[11] Caution your client to decide with care: once she has elected to pursue her case in Tax Court, her decision cannot be retracted to pursue her case elsewhere.[12]

Other questions of subject matter jurisdiction should also be considered when selecting the appropriate forum. For example, the US Supreme Court recently held that the Tax Court is the exclusive forum for judicial review where the IRS fails to abate interest which is attributable to its own unreasonable error or delay.[13] Conversely, the Tax Court generally does not have the jurisdiction to grant equitable relief, such as determining whether a tax overpayment or underpayment occurred in a tax year for which the statute of limitations is closed.[14] However, for Tax Court actions in which a final decision has not been rendered as of August 17, 2006, the Tax Court may apply the doctrine of equitable recoupment to the same extent that the US Court of Federal Claims or a Federal District Court can.[15]

If your client's tax matter qualifies as a small tax claim, i.e., the tax deficiency is $50,000 or less, she may elect to have her case heard in a more informal Tax Court setting.[16] The protocol for small tax cases is not nearly as complex as procedures required in the Federal District Court or the Court of Federal Claims, and therefore small tax cases are typically far less expensive and more expeditious by comparison.[17] The drawback to this option is that decisions rendered in small tax cases are not appealable and may not be used as precedent in later litigation.[18] Currently, the fee for filing a small tax case is $60.00, which is the same as the fee for filing a regular Tax Court petition.[19]

If your client has recently filed a petition in Bankruptcy Court, or if she is

[10] 26 USC §§ 6512(b)(1), 7436(a), 6015(e)(1).

[11] 26 USC § 7623(b)(4).

[12] Estate of William R. Ming, Jr. v. Comm., 62 TC 519 (1974).

[13] Hinck v. U.S., 99 AFTR 2d 2007-2814 (Fed. Cir. 2007); IRC § 6404(e)(1).

[14] Estate of Mueller v. Comm. 107 TC 189 (1996) (aka Mueller III); Mueller v. Comm., 82 AFTR 2d 98-5737 (6th Cir. 1998) (reversing Mueller II).

[15] 26 USC § 6214(b). USTR, EXP ¶62,144.02. The doctrine of equitable recoupment allows either the taxpayer or the government to set aside the statute of limitations to avoid unfair double taxation or unfair tax avoidance, respectively.

[16] 26 USC § 7463(a).

[17] US Tax Court Rules of Practice and Procedure, Title XVII, Rules 170 – 175 (2003).

[18] 26 USC § 7463(b).

[19] US Tax Court Rules of Practice and Procedure, Title XVII, Rule 173(a)(2) (2003).

planning to do so in the near future, the Bankruptcy Court may be the only court with jurisdiction over her tax matter. While your client's case is pending before the Bankruptcy Court, beginning with the date her bankruptcy petition is filed, the Bankruptcy Court has sole jurisdiction to determine her tax liability with very few exceptions.[20] Further, although bankruptcy law does not affect the actual making of an IRS assessment against your client, the automatic stay triggered by a bankruptcy petition does affect her timing and opportunity for filing a Tax Court petition and may also affect the running of the period of limitations on assessment depending on the circumstances.

In general, the automatic bankruptcy stay prevents your client from filing or continuing a Tax Court case during her Bankruptcy Court proceedings and for 60 days thereafter.[21] Consequently, the 90-day Tax Court option conferred by the statutory notice of deficiency is extended by 60 additional days during which a Tax Court petition may be filed once the automatic bankruptcy stay is lifted.[22] The bankruptcy stay is lifted once the bankruptcy case is closed, dismissed, or a discharge is granted or denied by the Bankruptcy Court. After the automatic stay is lifted, any unused portion of your client's 90-day Tax Court option should be available for filing her Tax Court petition, as should any unused portion of the additional 60-day grace period.[23] Unfortunately, the statutory period during which the IRS may assess a deficiency against your client (this is usually a 3-year period measured from the date of the return in question, but may be longer in cases involving fraud or failure to file a return, for example) is also suspended while bankruptcy proceedings are being conducted and for 60 additional days thereafter.[24] The effects of the bankruptcy stay are best illuminated with a few detailed examples.[25]

Assuming your client is a taxpayer who is located in the US, if she received a statutory notice of deficiency from the IRS more than 90 days before she filed her bankruptcy petition, she will have the standard 90-day option to file a Tax Court petition.[26] As usual, the notice of deficiency will trigger a 90-day waiting period during which the IRS cannot assess the tax while your client is deciding whether to file in Tax Court.[27] However, if your client allows her 90-day Tax Court option to lapse without filing a Tax Court petition, the IRS will be free to assess the tax against her, even if her bankruptcy proceedings are already in progress. If your client does exercise her option to file a Tax Court petition during the allotted 90-day period, the IRS must wait until after the Tax Court decision is final to assess the tax. In either event, the running of the statutory assessment period is not affected because the 90-day Tax Court option will have expired prior to the filing date of the bankruptcy petition.[28]

If your client received a deficiency notice from the IRS less than or equal to 90 days before her bankruptcy petition was filed, the bankruptcy petition will immediately suspend her ability to file a Tax Court petition. Any

[20] 11 USC § 505(a)(1).
[21] 11 USC §§ 362(a), IRC § 6213(f).
[22] 26 USC § 6213(f).
[23] 11 USC §§ 362(c)(2), 6213(f)(1).
[24] 26 USC §§ 6501(a), 6503(a)(1), 6503(h)(1).
[25] Rev. Rul. 2003-80, 2003-2 CB 83.
[26] 26 USC § 6213(a). Note that the Tax Court option period for taxpayers located outside the US is 150 days rather than 90 days.
[27] 26 USC § 6213(a).
[28] 26 USC § 6503(a)(1).

unused portion of her 90-day Tax Court option period will be deferred until 60 days after her bankruptcy proceedings are terminated when the bankruptcy stay is lifted. The first date that your client may file a Tax Court petition will be 61 days after the stay is lifted, and the absolute last date she may file a Tax Court petition may be anywhere between 1 and 90 days later, depending on how much of the 90-day Tax Court option had passed by the time she filed her bankruptcy petition. The statutory assessment period will exclude the total number of days between the notice of deficiency and the last date for filing a Tax Court petition, plus an additional 60 days.

If the deficiency notice is received on or after the bankruptcy filing date, the bankruptcy stay will already be in effect to prevent your client from filing a Tax Court petition. As a result, the entire 90-day Tax Court option period will be deferred until 60 days after the bankruptcy stay is lifted at the end of bankruptcy proceedings. The first date that your client may file a Tax Court petition in this case will be 61 days after the stay is lifted, and the absolute last date that she may file a Tax Court petition will be 90 days later. As above, the statutory assessment period will exclude the total number of days between the notice of deficiency and the last date for filing a Tax Court petition, plus an additional 60 days.

Even if your client files a Tax Court petition before she files a Bankruptcy Court petition, the automatic stay triggered by the bankruptcy petition will prevent the Tax Court from adjudicating her tax claims if it has not already done so at the time the Bankruptcy petition is filed.[29] Finally, if your client has not petitioned any court for judicial review of her tax matter by the time she files her Bankruptcy Court petition, the automatic stay will prevent her from doing so until 60 days after the proceedings in Bankruptcy Court have been completed.[30] As you can see, if it becomes necessary to coordinate a Tax Court petition with a Bankruptcy Court filing, timing is everything.

Court precedent is by no means a minor consideration when selecting a forum. Unless the Supreme Court has provided an opinion which all other courts can look to for guidance, the Tax Court is bound to follow decisions of the Court of Appeals for the circuit in which the Tax Court is hearing cases, even in small tax cases from which there is no appeal.[31] The problem that taxpayers routinely face under this practice is that the Courts of Appeal do not always agree with the Tax Court or with one another, especially where the applicable rule of law is characterized by subjective elements.[32] For example, in a situation where a partnership deducted research expenditures purportedly connected to its business, the Ninth Circuit struck down the Tax Court's finding that the expenditures at issue were not deductible because the taxpayer's position lacked substantial authority. Although the Tax Court found the taxpayer negligent and imposed a substantial underpayment penalty, the Ninth Circuit concluded that the taxpayer's position did, indeed, have a realistic probability of success.[33]

In two other related cases, the Eleventh Circuit upheld a Tax Court ruling of

[29] 11 USC §§ 505(a)(1), 505(a)(2).

[30] 11 USC § 362(a).

[31] 26 USC § 7463(b); Carolyn Ann Harris v. Commissioner, TC Summary Opinion 2004-85 (2004).

[32] Jack E. Golsen v. Commissioner, 54 TC 742 (1970).

[33] Scoggins v. Comm., 75 AFTR 2d 95-762 (9th Cir. 1995).

non-deductibility as well as a subsequent imposition of additional interest on substantial underpayments.[34] The Tax Court had concluded (and the Eleventh Circuit agreed) that the underpayments were attributable to tax-motivated transactions by the partnership. Amazingly, on the very same facts litigated by different partners in the same business, the Sixth Circuit allowed the taxpayers to prevail on the merits and applied no penalty.[35] At the very least, these examples prove that careful research regarding past decisions of all potential forums as to your tax matter is extremely important, especially with respect to issues that the Supreme Court has not yet resolved.

One feature peculiar to the Tax Court bears mentioning here: only the Tax Court allows representation by a non-attorney.[36] As in other forums, a client may also represent herself ("pro se") in Tax Court. That being said, however, a review of the foregoing paragraph should be enough to convince your client that representation by a tax attorney is always advisable, and especially so where the tax matter is a complicated one that may require extensive legal research.

Another feature of Tax Court which may be extremely attractive to your client is the ability to proceed without first paying the tax owed, as discussed above. It should be noted, however, that, although your client is not required to pay the tax to have her case heard in Tax Court, she does have the option to pay the tax if she so chooses. Although the value of voluntarily paying the tax may not be apparent at first glance, doing so may be desirable if forestalling interest accumulation is a priority. Interest may be also avoided by posting a bond with the court in the amount of the tax at issue.

Your client should also be forewarned that if she chooses to litigate in Tax Court, she will be subject to further assessment based on information that arises during Tax Court proceedings. This is often referred to as the "Tax Court Trap" for obvious reasons, and it may be a significant deterrent if your client has tax debt that the government somehow overlooked on its first pass.

Yet another concern in selecting the appropriate forum is availability of a jury trial. Jury trials are only an option in Federal District Court; they are not available in Tax Court or in the Court of Federal Claims. Moreover, certain tax matters lend themselves less to jury trials than others. For example, where extremely complex tax matters are involved, a jury trial may not be the best option because juries are typically not well-versed in the intricacies of tax. A related consideration is that jury verdicts are not as prone to being overturned on appeal as are verdicts rendered in the absence of a jury. As long as there is some shred of evidence that the jury could have relied on in rendering its verdict, a jury's decision is more likely to stand on appeal. A straightforward tax matter having equitable aspects that may provide opportunities to elicit sympathy for your client's particular situation may be the best-suited case to put before a jury.

Another factor that warrants attention when evaluating possible forums is your client's ability to prove her case. Her burden to do so will be far greater in Federal District Court or in the Court of

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[34] Karr v. Comm., 67 AFTR 2d 91-653 (11th Cir. 1991).
[35] Smith v. Comm., 68 AFTR 2d 91-5076 (6th Cir. 1991).
[36] US Tax Court Rules of Practice and Procedure, Title XX, Rule 200(a)(3).

Federal Claims than it will be in Tax Court. In Federal District Court and in the Court of Federal Claims, it will not be enough to merely show that the IRS was wrong. In these forums, your client will be required to show that she is right and that she is entitled to a refund amount which must be proven with some specificity.[37] If your client is unable to produce sufficient evidence to substantiate both of these elements, she is likely to be better off in Tax Court, where a showing that the IRS was in error can shift the burden of proof onto the IRS and potentially invalidate the entire deficiency (assuming the IRS does not carry its burden sufficiently). And, although the initial burden of proof in Tax Court will generally lie with your client, there has historically been a presumption in favor of the taxpayer that uncontroverted relevant testimony (with the exception of subjective intent) is generally accepted as true.[38] More recently, this standard has morphed into the somewhat narrower requirement that "credible evidence" must be produced on the issue.[39] Even then, the burden can only be shifted to the IRS if your client has consistently complied with the IRS's requests regarding substantiation of items and other evidentiary inquiries. If your client is moved to make implausible factual assertions, frivolous claims, or tax protest arguments, advise her not to bother; these tactics will almost surely guarantee a failure to prove her case.

Remind your client that the likelihood of prevailing is never a foregone conclusion, even with the most thorough investigation as to which court may be the best forum for litigating a particular tax matter. Tax Court is often a favored choice for many of the reasons listed above. On the other hand, taxpayers are purported to lose more often in Tax Court than in other forums, though such a theory seems difficult to qualify given the high number of variables involved.[40] For example, cases litigated in Tax Court outnumber cases litigated in other forums by about 64 to 1 according to 2007 statistics.[41] More cases necessarily mean more taxpayer losses, but more cases also mean more taxpayer victories, more government losses, and more government wins. Without taking into account other key factors, such as win/loss ratios, taxpayer representation, complexity of the tax matter, and details and timing issues of each case, a tally of taxpayer losses alone seems fairly meaningless.

Moreover, because of the relaxed rules in Tax Court, many taxpayers who litigate there do not take advantage of professional representation. In contrast, taxpayers in Federal District Court are more likely to retain an attorney to help them navigate the more complex court procedures in effect there. It stands to reason that taxpayers who rely on an experienced tax attorney for help are more likely to have favorable outcomes. Additionally, Tax Court judges are generally more knowledgeable about tax matters and are more experienced at trying tax cases than are judges in other forums, which could support the theory that taxpayer

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[37] Philip Mangone Co. v. U.S., 10 AFTR 851 (Ct. Cl. 1931).

[38] Herbert v. Riddell, 41 AFTR 961 (S.D. Cal. 1952).

[39] 26 USC §7491(a)(1).

[40] Camilla E. Watson, Tax Procedure and Tax Fraud in a Nutshell, (Minnesota: Thomson/West, 2006), 244.

[41] Internal Revenue Service Data Book, 2007, Publication 55B, Table 27, Chief Counsel Workload: Tax Litigation Cases by Type of Case, Fiscal Year 2007 (Washington, DC, March 2008).

losses are greater in Tax Court. On the other hand, the rules in Tax Court are extremely relaxed to the benefit of the taxpayer, which could arguably support the opposite theory that taxpayer victories (all other things being equal) are more likely to occur in Tax Court than in other forums. Regardless of the forum your client ultimately selects for litigating her particular tax matter, an educated decision based on some degree of calculated risk is always preferable to an uneducated guess.

He Who Has to Pay the Piper Doesn't Necessarily Get to Call the Tune

In the end, if your client is so unfortunate as to become acquainted with IRS Collections, she may have limited options with regard to paying what she owes. The collections function of the IRS pursues taxes that have been reported or assessed but not yet paid. Simply put, the IRS doesn't like to dally once the door to collections is unbarred by the passage of time or by a court decision.

One reason the IRS is not fond of delayed payment is reflected in a 2001 study of IRS collection activities, which indicates that collection cases more than 24 months overdue yield less than 15 cents on the dollar.[42] The study also showed that outstanding amounts are virtually uncollectible after 3 years; in fact, these uncollectible accounts made up approximately 65% of the IRS's collection accounts in September of 2006.[43]

In an attempt to relieve a backlog of over $120 billion in uncollected tax assessments, the IRS instituted a debt collection initiative in 2004 that allowed for assigning taxpayer accounts to private debt collection agencies.[44] As of 2006, it appeared that the IRS was spending more money on commissions and plan administration than it would have spent collecting the tax itself. Coupled with cited problems such as diminished customer service, inconsistent treatment of similarly situated taxpayers, and questionable transparency of operations, the success of the initiative is questionable and, to the potential relief of taxpayers, the future of the IRS's newfound friendship with private collection agencies seems uncertain. In any event, the IRS continues to lag in collections; since 2005, the IRS collections inventory has increased at least 8% per year, and from 2006 to 2007 the increase reached a high of 16%.[45]

Given the incidence of failed collections, the IRS is highly motivated to collect what it is owed – but primarily only by certain favored means, such as liens, levies, and seizures.[46] Although there are a number of alternative means of collection that could net the IRS some recovery of funds (rather than expensive recovery or no recovery at all), the IRS makes only limited

[42] National Taxpayer Advocate 2006 Annual Report to Congress, 31.
[43] National Taxpayer Advocate 2006 Annual Report to Congress, 31.

[44] National Taxpayer Advocate 2006 Annual Report to Congress, 36.
[45] Internal Revenue Service Data Book, 2007, Publication 55B, Table 16, Delinquent Collection Activities, Fiscal Years 2004 - 2007 (Washington, DC, March 2008).
[46] Internal Revenue Service Data Book, 2007, Publication 55B, Table 16, Delinquent Collection Activities, Fiscal Years 2004 - 2007 (Washington, DC, March 2008). In 2007, the number of lien notices generated was 683,659; the number of levy notices generated was 3,742,276; the number of seizures was 590.

use of them.[47] One possible reason for the IRS's limited use of alternative collection agreements is a desire not to undermine taxpayer compliance with tax law. Generally, the IRS will consider alternative collection arrangements only where a taxpayer does not have a history of failing to pay taxes, has not deliberately avoided payment of taxes, and has not encouraged others to eschew compliance with tax laws.[48]

Offers in Compromise (OIC) are agreements in which your client can offer to pay the IRS a sum that is less than what she actually owes. The amount can be remitted to the IRS (1) within 90 days after the OIC is accepted (cash payment), (2) from 90 days up to 2 years after the OIC is accepted (short-term deferred payment), or (3) up to the expiration of the statute of limitations (deferred payment).[49] For periodic payments, your client must include the amount of the first proposed installment with her OIC.[50] One of the biggest advantages of an OIC is that, once the OIC is accepted, your client's tax liability issue is closed and can only be reopened if she provided false information to the IRS, concealed her ability to pay, or if both she and the IRS made a mistake about a material fact during creation of the agreement.[51] Additionally, an OIC may give your client greater control over collection activity than she might otherwise have had. OICs are supported by Congress, and should be supported by the IRS, as long as your client is making a valid effort to comply and her offer is reasonable.[52] Be aware, however, that revenue officers and revenue agents have not been delegated authority to bind the IRS to a compromise, and compromise agreements are invalid unless signed by an IRS employee who does have such authority.[53] Authorization to bind the IRS to a compromise may also be determined by the amount of the settlement.[54]

Your client may submit an OIC to the IRS if there is (1) doubt that she owes the tax, or (2) doubt that she can pay the tax.[55] The IRS may also accept an OIC where full collection of the tax due is possible but where it would work a hardship on your client.[56] This is a generous position, but is unlikely in view of the fact that 84% of levies issued in 2006 under the Federal Payment Levy Program involved taxpayers who were elderly, disabled, or both.[57] If

[47] National Taxpayer Advocate 2006 Annual Report to Congress 89. From 1998 through 2003, the IRS collected less than 50% of the amounts taxpayers offered to pay in just under half of rejected OIC submissions. In 1/3 of the OIC submissions, the IRS collected less than 10% of what was offered, and in just under ¼ of OIC submissions the IRS collected nothing at all.

[48] Michael I. Saltzman, IRS Practice and Procedure, Revised Second Edition Student Edition, (New York: RIA, 2006), 15-85.

[49] IRM 5.8.1.9.4(3), Payment Terms (Sep. 1, 2005).

[50] 26 USC § 7122(c)(1)(B)(i).

[51] 26 CFR §301.7122-1(e)(5).

[52] IRS Restructuring and Reform Act of 1998, Pub. L. No. 105-206, § 3642 (1998); Joint Committee on Taxation Report JCS-6-98, General Explanation of Tax Legislation Enacted in the 105th Congress (Nov. 24, 1998).

[53] Reimer v. US, 27 AFTR 2d 71-1197 (5th Cir. 1971) (US not bound by apparent settlement where Revenue Agent was without authority to compromise taxpayer's tax liability).

[54] Brooks v. US, 60 AFTR 2d 87-6063 (4th Cir. 1987) (Letter accepting compromise held ineffective because liability in excess of $100,000 required approval of Regional Commissioner or Counsel).

[55] 26 CFR § 301.7122-1(b)(1), (b)(2).

[56] 26 CFR § 301.7122-1(b)(3).

[57] National Taxpayer Advocate 2006 Annual Report to Congress, 32.

your client submits an OIC because her ability to pay is in question, she must also submit either a $150 user fee or a low income fee waiver request.[58] Additionally, you should make your client aware that she must consent to file returns and pay taxes for five years if the OIC is accepted, and she must also waive her right to any refunds for which she may be eligible during this period.[59] If your client fails to uphold the commitment to file and pay taxes anytime during the 5-year period, the IRS can reinstate the full liability and collect what she owes immediately and by whatever means they prefer.

The general rule regarding OICs is that reasonable offers must be considered, and further must be accepted where it is likely that the tax cannot be collected in full, although statistics show that only 26% of the OICs submitted in 2007 were actually accepted.[60] Even more astounding is that, of the 8,240 delinquent accounts in 2007, only 46 OICs were submitted – a mere 0.5%![61] The OIC option is apparently not common enough knowledge among taxpayers. Even where the OIC is known and understood, it seems to be viewed with suspicion among taxpayers given the IRS's track record of OIC rejection.[62] Another factor influencing the low OIC submission rate could be the requirement to submit 20% of the OIC offered amount along with the OIC, which amount the IRS will keep and apply to the deficiency whether or not it accepts the OIC.[63] Your client will have only a limited say about where her payment should be applied, and no say at all about whether her payment will be retained by the IRS and credited against her delinquency.[64] The only hope that your client may have for avoiding the 20% payment is if the IRS waives the requirement for payment from the outset, but this is uncommon.[65]

A determination by the IRS as to whether your client's OIC is reasonable should not be based solely on the amount of her offer.[66] The IRS's decision to accept or reject your client's OIC must be based on all of the facts and circumstances, and exceptional circumstances must be considered.[67] If your client's offer was based on doubtful collectability, the IRS will assess her offer in light of what it believes she can afford (yet still be left with some ability to pay her living expenses, a factor which is discussed in greater detail below. If your client's offer was made based on doubtful liability for the tax in question, the IRS may not reject her offer because it cannot locate her return.[68] Further, the IRS

[58] 26 USC § 7122(c)(2)(B). National Taxpayer Advocate 2007 Annual Report to Congress, 377. A recent study showed that nearly half of taxpayers below the poverty level (and thus eligible for waiver) did not submit the waiver.

[59] IRS Form 656, Offer in Compromise (Feb. 2007).

[60] IRM 5.8.1.1.3 (Sep. 1, 2005); Internal Revenue Service Data Book, 2007, Publication 55B, Table 16, Delinquent Collection Activities, Fiscal Years 2004 - 2007 (Washington, DC, March 2008).

[61] Internal Revenue Service Data Book, 2007, Publication 55B, Table 16, Delinquent Collection Activities, Fiscal Years 2004 - 2007 (Washington, DC, March 2008); National Taxpayer Advocate 2007 Annual Report to Congress, 374. In fact, the receipt of offers declined by 63% between 2001 and 2007, and acceptance of OICs declined by over 70% during that time.

[62] National Taxpayer Advocate 2006 Annual Report to Congress, 91.

[63] 26 USC § 7122(c)(1)(A), (c)(2)(B); 26 CFR § 301.7122-1(h).

[64] 26 USC § 7122(c)(2)(A); 26 CFR § 301.7122-1(h).

[65] 26 USC § 7122(c)(2)(C).

[66] 26 USC § 7122 (d)(3)(A); 26 CFR § 301.7122-1(f)(3).

[67] 26 CFR § 301.7122-1(b)(3)(ii) and (c)(1).

[68] 26 USC § 7122 (d)(3)(B).

may not require her to submit a financial statement when her OIC is made on the basis of doubtful liability.[69] In any case, the IRS must act on your client's OIC within 24 months of her submission, else her OIC will be deemed accepted by default.[70] The 24 month countdown is paused during any judicial proceeding related to the tax in question.

When your client submits an OIC, the IRS may ask her to execute a collateral agreement as a condition of accepting her OIC. A collateral agreement enables the IRS to collect additional funds or add additional terms to the OIC agreement, such as where the IRS has information that your client expects to receive a substantial increase in future income. The IRS should not ask your client to sign a collateral agreement based on unfounded speculation or a statistically improbable event such as winning the lottery or collecting an inheritance.[71]

If your client's OIC is ultimately rejected, all may not be lost. First, your client should not receive a notice of rejection until there has been an independent administrative review of the denial, usually at a managerial level within the IRS.[72] Second, your client may request administrative review of the IRS's decision to reject her OIC within 30 days of the rejection.[73] However, administrative review will not be available if (1) your client's OIC was returned to her as non-processable (if she omits the 20% required payment, for example) or (2) the IRS believes your client submitted the OIC merely to delay her case. Third, if your client makes a good faith revision of her offer, she may resubmit it within 30 days of the rejection.[74] As long as the revision is not made for the purpose of delay, collection will be suspended during re-consideration of your client's request. The difficulty with resubmission is rooted in simple economics. In order to resubmit your OIC, your client must submit a second 20% fee based on her revised offer, but the IRS's retention of the 20% fee from the original offer may make resubmission an altogether unaffordable option in some cases.

Often, accounts for which OICs have been rejected are relegated to the "currently not collectible" inventory (CNC).[75] Once a delinquency is relocated to the CNC inventory, successful collection is rare. For example, from 2000 to 2006, the IRS collected less than 2% of CNC delinquencies.[76] Interestingly, the IRS has even rejected OICs where the tax in question was already in the CNC inventory before the OIC was submitted.[77] This statistic may justify the seeming reluctance of the IRS to accept compromises – even where it may be harmed by not doing so. Having your client's account reach CNC status may give her a brief respite by default, but there is no assurance that the IRS will not revisit your client's delinquent account and try to collect from her again

[69] 26 USC § 7122 (d)(3)(B)(ii).
[70] 26 USC § 7122 (f).
[71] IRM 5.8.6.3.1(6), Future Income (Sep. 1, 2005).
[72] 26 USC § 7122(e)(1); 26 CFR § 301.7122-1(f)(2).
[73] 26 USC § 7122 (e); 26 CFR § 301.7122-1(f)(5).

[74] 26 CFR § 301.7122-1(g)(2).
[75] National Taxpayer Advocate 2006 Annual Report to Congress, 89. Over 40% of tax modules associated with rejected or withdrawn OICs are ultimately reported as not collectible.
[76] National Taxpayer Advocate 2006 Annual Report to Congress, 31.
[77] National Taxpayer Advocate, 2006 Annual Report to Congress, p. 89. Over 27% of CNC tax modules associated with rejected or withdrawn OICs were in CNC status while the OIC was under consideration.

later. Further, your client should never use OIC as a delay tactic or a means by which to get her account to CNC. First, there is no assurance that her account will be placed into CNC. Second, collection will not be suspended where it is determined that her OIC action was merely dilatory.[78] Third, the IRS has recently been empowered to impose a $5,000 penalty for frivolous OIC submissions.[79]

Another alternative means of collection that the IRS does not appear to favor are installment agreements. Installment payments may be set up so that the entire liability is paid in full by the end of a given period, or the IRS may approve a partial payment installment agreement which does not fully satisfy the liability.[80] Partial installment agreements are subject to review every 2 years.[81] Like OICs, rejected installment agreements are subject to independent administrative review, are appealable, and may be revised and re-submitted within 30 days.[82] Keep in mind, however, that if your client chooses to appeal a rejected or terminated installment agreement under the Collection Appeals Program, the decision will be binding on both your client and the IRS, and she will not be able to obtain judicial review.[83] Also similar to OICs, proposed installment agreements may be returned to your client (and ultimately rejected without the possibility of review) where required information is missing.[84]

Penalties and interest continue to accrue on the unpaid portion of your client's delinquent amount during the installment payment period, but as long as she is actively fulfilling an installment agreement, the IRS cannot issue any levies during this period.[85] The 10-year statute of limitations on collection is also paused during the installment payment period. The same levy and statute suspensions also apply to the following situations: while a proposed installment agreement is pending; during the 30 days following a rejection of a proposed installment agreement; for 30 days following termination of an active installment agreement; and during an appeal filed within 30 days of either a rejection or termination.[86] An active installment agreement may be terminated with 30 days' notice from the IRS (which you will have an opportunity to protest and appeal) where the IRS reviews the installment agreement and finds that your client's financial circumstances have changed significantly, where she fails to fulfill obligations imposed by the agreement, or where collection of the amount due is in jeopardy, for example.

Exceptions to the suspensions on levy and the collection statute of limitations apply where the installment agreement was submitted solely for delay, the tax in question is in jeopardy, or your client has expressly waived the restriction on levy.[87] Although the IRS is limited as noted above with respect to levies, it is not prohibited

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[78] 26 CFR § 301.7122-1(g)(4); Joint Committee on Taxation Report JCS-6-98, General Explanation of Tax Legislation Enacted in the 105th Congress (Nov. 24, 1998).

[79] 26 USC § 6702(b)(2)(B)(ii)(II).

[80] 26 USC §6159(a).

[81] 26 USC §6159(d)

[82] 26 USC §§ 6159(e), 7122(e)(1); 26 CFR § 301.6331-4(a)(3).

[83] IRS Form 9423, Collection Appeals Rights/Collection Appeals Request (Jan. 1999).

[84] 26 CFR § 301.6331-4(a)(2).

[85] 26 CFR § 301.6331-4(a)(1) and (c).

[86] 26 USC § 6159(b)(3) and (b)(4); 26 CFR § 301.6331-4(a)(1) and (c).

[87] 26 CFR § 301.6331-4(a)(4).

from filing a notice of federal tax lien during the installment period, nor is it barred from collection action against a third party who is liable for the tax but is not named in the installment agreement. Additionally, because penalties and interest will continue to accrue over the installment period, your client may be well-served to investigate the cost of borrowing from a third party so that she may conduct a total-cost comparison before entering into an installment agreement.

Even though the IRS is generally not predisposed to enter into installment agreements, it is now required to do so in certain "guaranteed" installment agreement conditions involving income tax. Where the proposed installment agreement accounts for payment of the entire tax due in 3 years or less, the amount of the tax-only liability is less than $10,000 (excluding any assessed penalty or interest), and your client, within the preceding 5 years, (1) has not failed to file a return, (2) has not failed to pay any tax due on a return, and (3) has not entered into any other installment agreement, the IRS must accept her proposed installment agreement.[88] Further, guaranteed installment agreements may be granted by revenue officers without managerial approval and may be granted without regard to whether your client is currently able to pay the delinquency in full.[89]

The IRS may also, at its discretion, approve "streamlined" installment agreements for up to $25,000 (including the tax and any assessed penalty and interest) if the amount due can be paid by the earlier of either 60 months or the expiration of the statute of limitations on collection.[90] Streamlined agreements do not require submission of detailed financial statements to the IRS, and can be secured in person, over the phone, or by correspondence without managerial approval.[91] Like guaranteed installment agreements, streamlined agreements may be granted without regard to your client's current ability to pay in full. It should be noted that agreements requiring extensions of the collection statute of limitations cannot be processed as streamlined agreements.

Other options for installment payment include payroll deduction agreements and direct debit installment agreements. Payroll deduction is available for wage-earning taxpayers and allows an employer to withhold installment payments from the taxpayer's wages and forward them straight to the IRS.[92] One potential drawback of payroll deduction is that, because your client's employer's cooperation is necessary to effect the deductions, she will be made aware of your client's delinquent tax status. The direct debit option allows the IRS access to your client's bank account to withdraw the installment payments directly.[93] This may be a better option than payroll deduction if your client prefers that her employer not know her tax status. Like OIC agreements, installment and deduction agreements waive your client's right to any refund during the installment period. It is not clear from the debit and deduction agreements

[88] 26 USC § 6159(c).

[89] IRM 5.14.5.3(1), Guaranteed Installment Agreements (Jul. 12, 2005).

[90] IRM 5.14.5.2(1), Streamlined Installment Agreements (Jul. 12, 2005).

[91] IRM 5.14.5.2(5) and (6), Streamlined Installment Agreements (Jul. 12, 2005).

[92] IRM 5.14.10.2, Payroll Deduction Agreements (Sept. 30, 2004).

[93] IRM 5.14.10.4, Direct Debit Installment Agreements (Sept. 30, 2004).

what the result would be if the IRS or your client's employer accidentally debits or withholds more than the agreed-upon payment amount, but based on the language in the agreements it is likely safe to assume that any unintended overages would be retained by the IRS and applied to your client's delinquency.[94]

If your client has proposed a general installment agreement (i.e., not guaranteed, streamlined, or otherwise specialized), or if she submitted an OIC made based on an inability to pay the tax, she will be required to provide information to the IRS to allow them to assess her financial situation.[95] The approaches currently used by the IRS to assess payment ability include schedules for determining "Allowable Living Expense" (ALE) and "Maximum Ability to Pay" (MAP). The data in these schedules is based on average taxpayer expenditures according to government sources, and therefore application of the numbers to living, breathing individual taxpayers is not without problems.[96] According to the Internal Revenue Code, the schedules are to serve as a guideline only, and should be applied in light of all the facts and circumstances individual to each taxpayer.[97] In fact, the IRS is prohibited from using these schedules to deprive your client of her ability to cover basic living expenses, but be cautioned that this is not always the case in practice. Also, expenses that your client may deem crucial, such as credit card payments, private school tuition, and voluntary retirement payments, are not likely to be viewed as necessary by the IRS.

When your client executes a general installment agreement, the terms of the agreement typically include a waiver extending the statute of limitations on collection beyond the standard 10-year period. Essentially, because the IRS is prohibited from collections during the installment agreement, they want the additional time to collect from your client in exchange for allowing her to pay in installments. The extension she agrees to will be automatically lengthened by a 90-day grace period during which collection can continue to occur.

One of the most important points for your client to remember is that, once she finds herself in a relationship with IRS Collections, her main priority should become damage control. The primary goal of collections enforcement personnel is full payment, and sympathy for delinquent taxpayers is scarce. The best your client may be able to achieve, even with excellent representation, is avoidance or delay of a lien filing, levy, or seizure. That is not to say that representation is unnecessary once a case reaches the collection point – in fact, vigilant representation at this stage is crucial. Your client should understand that

[94] The terms of agreement listed on IRS Form 433-D (which authorizes direct debit by the IRS) and IRS Form 2159 (which authorizes payroll deduction by an employer) include language stating that the IRS "will apply all payments on this agreement in the best interest of the United States." The terms further include a statement that the IRS will "apply your federal tax refunds or overpayments to the amount you owe until it is fully paid or the statutory period for collection has expired."

[95] National Taxpayer Advocate 2006 Annual Report to Congress, 93.

[96] National Taxpayer Advocate 2006 Annual Report to Congress, 94. A 1996 study showed that 37.3% of taxpayers had housing expenses in excess of the allowable standard, a percentage which increased parallel to increases in family size. 31.3% of taxpayers had transportation expenses in excess of the standard allowance.

[97] 26 USC § 7122(d)(2)(B).

you can not only determine the revenue officer's propensity for taking actions against her, but you can put a degree of separation between your client and the revenue officer, which may be of great benefit to your client if the officer assigned to her case is already set against her. Likewise, you can help your client maintain the perspective necessary for maximizing successful negotiations with the revenue officer.

If you and your client have followed the IRS's prescribed procedures in you dealings with the IRS but are still unable to resolve a problem that develops along the way, your client may also be eligible for taxpayer assistance from the Office of Taxpayer Advocate (OTA). Generally, the OTA may be able to help resolve computer-generated notice problems and, more importantly, the OTA may be able to assist your client in getting injunctive relief from certain administrative actions about to be taken against her.

A Taxpayer Assistance Order, similar to an injunction, may be issued upon your client's request and at the TAO's discretion if your client is about to undergo significant hardship, including an immediate threat of adverse action, a delay of more than 30 days resolving her account problems, an economic burden in the absence of relief, or an irreparable injury or long term adverse impact in the absence of relief.[98] The IRS has developed Form 911 to allow taxpayers to apply for OTA assistance, but the request for assistance does not require use of any specific form. Factors that will be considered by the taxpayer advocate upon your client's application for a assistance order include whether your client will be able to retain her housing; whether she will be able to obtain food, pay for utilities or obtain transportation to and from work; whether she can retain employment, make reasonable clothing purchases for her family, and obtain simple medical treatment should it be necessary; and whether she can avoid damage to her credit rating or financial hardship.[99] Because relief obtainable with OTA assistance may rise to the level of requiring remedial action by the IRS (even to the extent of releasing property from levy), the OTA is a valuable resource that your client should not overlook.

Hopefully, all of the foregoing information will help to illustrate just a few of the potential difficulties that an unwary taxpayer inexperienced in tax practice and procedure may encounter in dealing with the IRS. To that end, the value of providing able representation to help you keep your client's boat afloat in the stormy sea of tax trouble, fully replete with seasickness at times, certainly cannot be overstated.

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[98] 26 USC § 7811(a)(1), (a)(2).

[99] Michael I. Saltzman, IRS Practice and Procedure, Revised Second Edition Student Edition, (New York: RIA, 2006), 15-13.