Improve Assessment and Collection Procedures

#15 STRENGTHEN TAXPAYER PROTECTIONS IN THE FILING OF NOTICES OF FEDERAL TAX LIENS

Present Law

Under IRC § 6323, the IRS is authorized to file a Notice of Federal Tax Lien (NFTL) in the public record when a taxpayer owes past-due taxes. The NFTL protects the government's interest in property against subsequent purchasers, secured creditors, and judgment lien creditors. Unlike other creditors, the IRS does not need to obtain a judgment to file an NFTL.

IRC § 6320 provides taxpayers with a right to a collection due process (CDP) hearing related to the filing of an NFTL. However, the right to a CDP hearing is triggered only after an NFTL has been filed.

Section 3421 of the IRS Restructuring and Reform Act of 1998 (RRA 98) requires the IRS to adopt procedures under which an employee's determination to file an NFTL would, "where appropriate," be approved by a supervisor and to set out disciplinary actions when such approval is not obtained.

Reasons for Change

An NFTL filing is a significant IRS enforcement tool, but because it can have a devastating financial impact on the taxpayer, due process safeguards are critical. More specifically, the filing of a NFTL can significantly damage the creditworthiness of a taxpayer, which can negatively impact the taxpayer's ability to obtain financing for a home or other major purchases, find or maintain a job, secure affordable rental housing or insurance, and even pay the tax debt. If not properly used, NFTL filings may undermine the government's interest, because when the taxpayer's financial position worsens, he becomes less able to afford to make payments. Several TAS studies show that NFTLs can unnecessarily harm taxpayers and reduce their ability to become or remain compliant with their federal tax filing obligations.

Despite the directive in RRA 98 regarding managerial approval before the filing of NFTLs, the IRS has interpreted the "where appropriate" qualification in the statute narrowly and does not require managerial approval in the majority of cases. Rather, it files most NFTLs automatically based on an arbitrary dollar threshold of the unpaid liability. In addition, there is no requirement in IRS procedures for employees to make, or to attempt to make, interpersonal contact with the taxpayer prior to filing an NFTL. Without any meaningful contact with the taxpayer, determinations to file NFTLs may be made without a full financial evaluation of the taxpayer's financial condition and without consideration of collection alternatives.

The government also has a secondary interest at stake. An NFTL filing may have an immediate impact on a taxpayer's ability to obtain a loan or to keep or obtain employment. If a taxpayer's financial viability is harmed, it may significantly impair the IRS's ability to collect the tax and may hinder future tax compliance. For example, if the NFTL increases the living expenses of the taxpayer and the taxpayer's family, or renders him or her unemployed or underemployed, the government may be forced to provide a social safety net in the form of unemployment benefits, food stamps, and the like, thus increasing the overall societal cost and raising everyone's share of taxes. Yet by automatically filing NFTLs in most the cases, IRS practices focus exclusively on attempting to collect the tax liability and ignore the impact of the NFTL filing on the taxpayer or on other government programs.

Inadequate taxpayer protections in the area of NFTL filings cause an imbalance between the IRS's significant lien power and *a taxpayer's right to a fair and just tax system*, an imbalance Congress sought to correct when it enacted RRA98 and noted its intent to preclude the IRS from "abusively us[ing] its liens-and-seizure authority." In light of current IRS collection practices, additional taxpayer protections are warranted to restore the appropriate balance.

Recommendations

1. Amend IRC § 6323 to provide clear and specific guidance about the factors the IRS must consider in making NFTL filing determinations; require that prior to making a determination to file an NFTL, the IRS must make a "live contact," or at least a good faith effort to make "live contact," with the taxpayer telephonically or in person to obtain financial information and discuss collection alternatives; and allow for pre-filing administrative review of IRS lien determinations by the IRS Office of Appeals.
2. Amend IRC § 7433 to allow civil actions for damages that result from NFTL filings made in violation of the required NFTL filing determination procedures.
3. Codify and expand § 3421 of RRA 98 to require IRS employees to obtain managerial approval prior to filing an NFTL where it is likely that the NFTL will cause a hardship, will be unlikely to protect the government's interest in the taxpayer's property or rights to property, or will impair the taxpayer's ability to pay the tax; require the IRS supervisor, as part of the approval process, to consider whether the NFTL would attach to property, whether the benefit of filing an NFTL for the government would outweigh the harm to the taxpayer, and whether the NFTL filing will jeopardize the taxpayer's ability to comply with the tax laws in the future; and require the IRS to discipline employees who fail to secure managerial approval prior to filing an NFTL in situations required by law.[89]

89 For additional information on these recommendations, see National Taxpayer Advocate 2016 Annual Report to Congress 386-392 (Legislative Recommendation: *Notices of Federal Tax Lien (NFTL): Amend the Internal Revenue Code to Require a Good Faith Effort to Make Live Contact With Taxpayers Prior to the Filing of the NFTL*); National Taxpayer Advocate 2014 Annual Report to Congress 396-403 (Legislative Recommendation: *Managerial Approval for Liens: Require Managerial Approval Prior to Filing a Notice of Federal Tax Lien in Certain Situations*). We have also made recommendations to provide additional taxpayer protections relating to the treatment of NFTLs by the credit rating agencies. *See* National Taxpayer Advocate 2009 Annual Report to Congress 357-364 (Legislative Recommendation: *Strengthen Taxpayer Protections in the Filing and Reporting of Federal Tax Lien*). Senators Cardin and Becerra proposed similar protections in 2015. *See* the Taxpayer Rights Act of 2015 (S. 2333, 114th Cong. § 303 (2015)/H.R. 4128, 114th Cong. § 303 (2015)).

#16 CODIFY THE RULE THAT TAXPAYERS CAN REQUEST EQUITABLE RELIEF UNDER IRC § 6015(f) ANY TIME BEFORE EXPIRATION OF THE PERIOD OF LIMITATIONS ON COLLECTION

Present Law

Under IRC § 6015, taxpayers may obtain relief from the joint and several liability that results from filing a joint return. IRC § 6015 (b) and (c) both provide for relief from an understatement of tax if certain conditions are met. Both subsections impose a two-year period for requesting relief, which commences when the IRS first takes collection activity against the spouse seeking relief.

If relief is unavailable under IRC § 6015(b) or (c), subsection (f) provides for "equitable" relief from both understatements and underpayments. Subsection (f) does not contain a time limit for requesting relief, but Treasury Regulation § 1.6015-5(b)(1) imposes the same two-year time limit for requesting relief under subsection (f) as the statute imposes with respect to requests for relief under subsections (b) and (c).

In 2009, the Tax Court, in *Lantz v. Commissioner*, held the regulation imposing the two-year limit for requesting equitable relief under IRC § 6015(f) is invalid. The IRS appealed *Lantz* and similar decisions, and three U.S. Courts of Appeals overturned the Tax Court and upheld the validity of the two-year limit. The National Taxpayer Advocate has consistently advocated for removing the two-year rule for obtaining equitable relief.

In July 2011, the IRS changed its position and issued Notice 2011-70, which provides that taxpayers may request equitable relief within the IRC § 6502 period of limitation on collection or, for any credit or refund of tax, within the IRC § 6511 period of limitation. Proposed Treasury regulations to remove the two-year deadline consistent with Notice 2011-70 were published on August 13, 2013 (RIN 1545-BK51, 78 Fed. Reg. 49242-01), and public comment on the proposed regulations was invited. None of the four persons who submitted comments opposed removing the two-year rule, yet to date the regulations have not been finalized.

Reasons for Change

Although the IRS no longer imposes the two-year rule in section 6015(f) cases and has published guidance to that effect, the statute should be amended to make this rule permanent under the law.

Recommendation

Amend IRC § 6015(f) to provide that taxpayers may request equitable relief within the period of limitation on collection in IRC § 6502 or, for any credit or refund of tax, within the period of limitation in IRC § 6511.[90]

90 *See* Taxpayer Rights Act of 2015, H.R. 4128 and S. 2333, 114th Cong. § 303 (2015); Taxpayer Protection Act of 2016, S. 3156, 114th Cong. § 113 (2016); and Strengthening Taxpayer Rights Act of 2017, H.R. 3340, 115th Cong. § 202 (2017). All three of these bills contain language that is generally consistent with this recommendation.

#17 AUTHORIZE THE IRS TO RELEASE LEVIES THAT CAUSE ECONOMIC HARDSHIP FOR BUSINESS TAXPAYERS

Present Law

IRC § 6343(a)(1)(D) requires the IRS to release a levy if "the Secretary has determined that such levy is creating an economic hardship due to the financial condition of the taxpayer." Treasury Regulation § 301.6343-1(b)(4) defines economic hardship as arising when "[t]he levy is creating an economic hardship due to the financial condition of an individual taxpayer. This condition applies if satisfaction of the levy in whole or in part will cause an individual taxpayer to be unable to pay his or her reasonable basic living expenses." The regulatory definition of economic hardship as the inability to pay reasonable basic living expenses means only individuals (including sole proprietorship entities) can experience economic hardship.

Reasons for Change

The effect of the Treasury regulations and IRS procedures is to impede businesses from settling their tax debts with collection alternatives. Allowing the IRS to release levies issued to collect the tax debts of businesses that are experiencing an economic hardship would permit the IRS and the taxpayers to work toward resolution of the case through collection alternatives (rather than enforced collection) and give businesses a second chance when facing economic hardship. This is important because forcing viable businesses to declare bankruptcy to protect themselves against a past tax liability often means that the business will terminate, employees will be let go, and the delinquent tax may never be collected. Moreover, lessening the harshness of IRS enforcement actions may avert noncompliance to the extent harsh enforcement actions sometimes force taxpayers into the cash economy.

Recommendation

Amend IRC § 6343 to authorize the IRS to release a levy if it determines that the levy is creating an economic hardship due to the financial condition of the taxpayer's viable trade or business. The legislation should require the IRS, in making the determination to release a levy against a business on economic hardship grounds, to consider the economic viability of the business, the nature and extent of the hardship (including whether the taxpayer exercised ordinary business care and prudence), and the potential harm to individuals if the business is liquidated.[91]

In addition, we recommend Congress clarify that in determining whether to release a levy against a business on economic hardship grounds, the IRS should also consider whether the taxes could be collected from a responsible person through an IRC § 6672 trust fund recovery penalty assessment.

91 *See* H.R. 4368, 112th Cong. § 1 (2012); Taxpayer Rights Act of 2015, H.R. 4128 114th Cong. § 304 (2015) and S. 2333, 114th Cong. § 304 (2015) containing language that is generally consistent with this recommendation. In the antitrust context, courts strictly interpret the "failing firm" defense, which may permit an anticompetitive merger or acquisition, and the burden of proof falls on the parties invoking the defense. *See*, *e.g.*, *Citizen Pub. Co. v. U.S.*, 394 U.S. 131 (1969).

#18 EXTEND THE TIME LIMIT FOR TAXPAYERS TO SUE FOR DAMAGES FOR IMPROPER COLLECTION ACTIONS

Present Law

IRC § 7433(a) provides that in connection with any collection of Federal tax, if an IRS employee recklessly or intentionally, or by reason of negligence, disregards any provision of the IRC or any regulation, then that taxpayer may sue the United States for damages. Under IRC § 7433(d)(3) and the regulations thereunder, suit must be brought within two years after the date on which the taxpayer has had a reasonable opportunity to discover all essential elements of a possible cause of action. Under IRC § 7433(d)(1), before bringing suit, the taxpayer must first file an administrative claim with the IRS. Treasury Regulation § 301.7433-1(d) further provides that taxpayers may not file suit in court until the earlier of: six months after filing their administrative claim or the date the IRS renders a decision on their claim. However, if the claim is filed within the last six months of the two-year period for filing suit, then the taxpayer can file suit at any time before expiration of the two-year period.

Reasons for Change

A taxpayer who has been subjected to improper collection action must first file an administrative claim for damages. While the claim is pending, the two-year period for filing suit in a U.S. district court continues to run. Thus, a taxpayer who files an administrative claim within the final six months of the two-year window may be forced to incur the expense of filing suit in a district court rather than allowing the IRS to first make a decision on a pending administrative claim.

Recommendation

Amend IRC § 7433(d)(3) to allow taxpayers who have filed an administrative claim to file a civil action in U.S. district court any time after the earlier of: the date that is six months from the date of filing the administrative claim; the date on which the IRS renders a decision on the administrative claim; or the date that is within two years after the date on which the taxpayer reasonably could have discovered that the actions of the officer or employee were taken in disregard of a provision of this title or any regulation promulgated under this title.[92]

92 The Taxpayer Bill of Rights Enhancement Act of 2017, S. 1793, 115th Cong. § 201 (2017) contains language that is generally consistent with this recommendation.

#19 PROTECT RETIREMENT FUNDS FROM IRS LEVIES IN THE ABSENCE OF "FLAGRANT CONDUCT" BY A TAXPAYER

Present Law

The IRS has wide discretion to exercise its levy authority. IRC § 6331(a) provides that the IRS generally may "levy upon all property and rights to property," which includes retirement savings. Some sources of income are exempt from levy pursuant to IRC § 6334. As a policy matter, the IRS has decided it will not levy on a taxpayer's retirement savings unless it has made a determination of "flagrant conduct."[93] Neither the Code, regulations, nor internal IRS guidance defines "flagrant conduct" for purposes of this analysis. Under IRC § 6331(h), the IRS may place a continuing levy on a series of specified payments to or received by a taxpayer, which will run from the date the levy is first made until the date the levy is released.

Reasons for Change

Under IRC § 6334, the IRS is prohibited from levying on certain sources of payment, such as unemployment benefits and child support. These exceptions reflect policy determinations. For example, Congress has determined that the IRS should not levy on child support payments because doing so would likely harm the children who rely on those benefits for support. Similarly, there is a strong public policy reason to protect retirement savings. Almost all workers eventually retire, and generally they will rely on their retirement savings for support.

The IRS has taken some steps to protect retirement savings by requiring a specialized analysis prior to levy, which includes a determination of whether the taxpayer engaged in "flagrant conduct." However, recent changes in IRS procedures have eroded these protections. Specifically, the IRS recently adopted new procedures that allow taxpayers to request or agree to "voluntary" levies on retirement accounts.[94] If a taxpayer agrees to a "voluntary" levy, the IRS bypasses the determination of "flagrant conduct."

Without protection from levy, taxpayers who have not engaged in "flagrant conduct" in their tax matters and who therefore would have been shielded from levies on their retirement accounts in the past may agree to "voluntary" levies out of fear or anxiety and thus find themselves in economic hardship during retirement.

Recommendations

Amend IRC § 6334(a) to include qualified retirement savings as a category of property exempt from levy if it is determined that (i) the levy would create in retirement an economic hardship within the meaning of Treas. Reg. § 301.6343-1(b)(4)(i) based on a review of the taxpayer's financial condition and (ii) the taxpayer has not engaged in "flagrant conduct."

Amend IRC § 6331 to stop the accrual of penalties and interest when a levy has attached to a retirement account and the period of limitation in IRC § 6502 has passed (generally ten years from the date of assessment of the liability). Consider a levy on retirement funds to be unenforceable after the period of limitations provided in IRC § 6502 has passed.

93 IRM 5.11.6.3(5) (Aug. 16, 2017).

94 IRM 5.11.6.3(3) (Aug. 16, 2017).

Amend IRC § 6334 to define "flagrant conduct" as willful action (or failure to act) that is voluntarily, consciously, and knowingly committed in violation of any provision of chapters 1, 61, 62, 65, 68, 70, or 75, and which appears to a reasonable person to be a gross violation of any such provision.[95]

95 H.R. 4912, 114th Cong. § 203 (2016) and S. 2333 and H.R. 4128, 114th Cong. §§ 306, 307 (2015) contain language that is generally consistent with these recommendations.

#20 TOLL THE TIME PERIODS FOR REQUESTING THE RETURN OF LEVY PROCEEDS WHILE THE TAXPAYER OR A PERTINENT THIRD PARTY IS FINANCIALLY DISABLED

Present Law

Under IRC § 6331, the IRS is authorized to collect outstanding tax by levying against a taxpayer's nonexempt property and rights to property. In certain circumstances, under IRC § 6343 and the related regulations, levies must be released and levied property may, or in some situations must, be returned to its owner.

An administrative wrongful levy claim under IRC § 6343(b) is a request, made by a person other than the taxpayer who owes the taxes, for the return of property believed to be wrongfully levied upon or seized. Generally, the person making the request (the third party) believes the levy is wrongful because the property levied belongs to him, or he believes he has a superior claim to the property that is not being recognized by the IRS.

IRC § 6343(b) provides that if the IRS wrongfully levies on specific property, it may return the property at any time. With regard to the return of money wrongfully levied upon, however, there are strict time constraints. Under IRC § 7426, the third party may file an administrative claim for the return of the levied property or bring a civil action against the United States in a U.S. district court. If the third party files an administrative claim for the return of levied property, IRC § 6532(c) requires that the claim be made in writing to the appropriate IRS office within two years from the date of the levy. If the third party brings a civil action against the United States without having first filed an administrative claim, the third party has two years from the date of the levy to file the suit. If the third party files an administrative claim and the IRS rejects it, the third party can still file suit. In this circumstance, the time period for filing suit will be extended for the shorter of the following two periods:

(1) A period of 12 months from the date of filing the request, or

(2) A period of 6 months from the date a notice of disallowance is mailed to the third party by registered or certified mail.

If a taxpayer (as opposed to a third party) seeks the return of money levied upon, the taxpayer may request return of the levy proceeds under IRC § 6343(d). Generally, the taxpayer making the request believes the IRS should return the levied property because one of the conditions in IRC § 6343(d)(2) has been met. IRC § 6343(d) provides that the provisions of IRC § 6343(b) shall apply in the same manner as if the property had been wrongfully levied, except that no interest shall be allowed. Thus, a taxpayer seeking return of levied property faces the same time constraints as a third party (two years from the date of the levy) to file a written administrative claim. Unlike a third party, however, a taxpayer has no right to seek judicial review if a request for the return of levy proceeds is denied by the IRS under IRC § 6343(d).

Reasons for Change

The law, as currently written, prevents the IRS from returning levied funds in situations where a taxpayer who is an individual, due to a physical or mental impairment, does not file a request for the return of levied money until after the two-year period. Likewise, a district court lacks jurisdiction over a wrongful levy suit filed by a third party if the deadline for filing the suit is missed due to a health problem of the third party.

To ensure that an impaired taxpayer or third party (who is an individual) can have his or her request for return of levy proceeds considered by either the IRS or the courts, the two-year period should be tolled if the taxpayer or third party can show that he or she was financially disabled during the period. Without this

change, an impaired taxpayer or other third party who is prevented due to the impairment from requesting the return of levied funds in a timely manner will not be able to get back levy proceeds that otherwise would be eligible for return under IRC §§ 6343(b) and 6343(d), even in cases where the IRS violated the law.

Recommendation

Amend IRC §§ 6343(b) and 6532(c) to toll the time periods for filing a claim for the return of levy proceeds, a wrongful levy claim, and a wrongful levy suit during any period in which an individual is financially disabled.

#21 REQUIRE THE IRS TO WAIVE USER FEES FOR TAXPAYERS WHO ENTER INTO LOW-COST INSTALLMENT AGREEMENTS AND EVALUATE THE POTENTIAL REVENUE AND COMPLIANCE COSTS OF FUTURE USER FEE INCREASES

Present Law

In cases where a taxpayer is unable to pay the full amount of his or her liability in a single lump sum, IRC § 6159(a) authorizes the IRS to enter into an installment agreement (IA) under which a taxpayer will pay the full amount of tax due in monthly installments. A taxpayer can apply for an IA on paper or by using an online payment agreement (OPA).

The Independent Offices Appropriations Act (IOAA) of 1952 (31 U.S.C. § 9701) and OMB Circular A-25 authorize the IRS to set user fees by regulation. In 2016, the IRS used this authority to increase the IA fee.[96] Pursuant to Treas. Reg. § 300.1, the IRS now charges $225 for entering into paper IAs and $149 for entering into OPAs. If the taxpayer authorizes the IRS to "direct debit" a bank account each month, the fee is reduced to $107, unless the taxpayer also applies online using an OPA, in which case it is reduced to $31. These fees recover the IRS's full costs of providing IAs. In addition, the fee is set at $43 for low income taxpayers, unless they qualify for the lower $31 rate applicable to direct-debit OPAs.

Reasons for Change

Even a modest IA user fee could discourage some taxpayers from applying for an IA and paying their taxes voluntarily. Some taxpayers cannot afford to pay a fee, even if they do not qualify as low income. Almost by definition, taxpayers who require IAs are experiencing some level of financial hardship. Even those who qualify as low income sometimes pay the full fee.[97] The cost to the IRS of OPAs and direct debits is so low that if it discourages even a small percentage of taxpayers from paying voluntarily, this reduced compliance is likely to cost the government more — in lost tax revenue and increased enforcement costs — than the user fee brings in. For the same reasons, the IRS should evaluate the potential for lost revenue and increased enforcement costs before imposing or increasing any fees under the IOAA.

Recommendations

Amend IRC § 6159 to require the IRS to waive the user fee for direct debit OPAs. Also amend IRC § 7805 to prohibit the IRS from increasing user fees unless it first determines, after considering public comments, that the increase will not exacerbate financial hardship for taxpayers who are voluntarily trying to pay their tax liabilities, reduce government revenue by eroding voluntary tax compliance, or increase government expenses by requiring the IRS to take more costly collection actions against taxpayers who are discouraged by the user fees from complying voluntarily.[98]

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96 *See User Fees for IAs*, T.D. 9798, 81 Fed. Reg. 86,955 (Dec. 2, 2016).

97 *See* American Bar Association Section of Taxation, *Comments Concerning User Fees for Processing Installment Agreements and Offers in Compromise* 2 (Oct. 1, 2013) ("many low-income taxpayers are charged the full user fee, despite qualifying for the reduced amount").

98 For related recommendations, *see, e.g.*, Legislative Recommendation: *User Fees: Prohibit User Fees That Reduce Revenue, Increase Costs, or Erode Taxpayer Rights*, vol. 1, *supra*. S. 1793, 115th Cong. § 301 (2017) and S. 1321, 109th Cong. § 301 (2006) would waive the fee for direct-debit installment agreements (IAs). For low income taxpayers, S. 3156, 114th Cong. § 114 (2016) would waive the fee for direct-debit IAs and refund it to others upon completion of the IA.

#22 HOLD TAXPAYERS HARMLESS WHEN THE IRS RETURNS FUNDS LEVIED FROM A RETIREMENT PLAN OR ACCOUNT

Present Law

Several types of retirement plans are described in IRC § 402(c)(8)(B), including individual retirement arrangements (IRAs) and employer-sponsored retirement plans. The applicable tax rules vary depending on whether the retirement vehicle is a particular type of IRA or retirement plan. With certain exceptions depending on the type of plan, any distribution from an IRA or an employer-sponsored retirement plan, including a distribution that results from a Federal tax levy, is considered taxable income to the taxpayer in the year in of the distribution, unless the money is rolled over into a qualifying retirement plan or account within 60 days.[99]

IRC §§ 6343(b) and (d) allow the IRS to return levy proceeds to taxpayers or third parties in certain situations. However, the Code does not authorize the taxpayer to return the money into a retirement plan or account and have it treated as a rollover contribution, which means the taxpayer may be taxed on the amount of funds the IRS levied, even where the levy is improper.

In 2016, the IRS issued Revenue Procedure 2016-47, 2016-37 I.R.B. 346, to try to address this problem. Rev. Proc. 2016-47 allows a taxpayer, if certain conditions are met, to self-certify to his or her retirement plan or account trustee or administrator that the returned retirement funds are eligible for the 60-day rollover rule where "the distribution was made on account of a levy under IRC § 6331 and the proceeds of the levy have been returned to the taxpayer."

Reasons for Change

Retirement plans provide financial security for many Americans. When the IRS, sometimes wrongfully or prematurely, levies on a taxpayer's retirement plan or account, the taxpayer suffers several repercussions. Each must be addressed in order for the taxpayer to be made completely whole. Rev. Proc. 2016-47 offers some relief for taxpayers, as it allows returned money to be contributed by the taxpayer to a qualifying retirement plan or account as a valid rollover. However, this relief is not available by statute, and the revenue procedure does not address all the ways in which a taxpayer must be made whole.

Specifically, some taxpayers will be harmed by the loss of growth in retirement earnings that otherwise would have accrued in his or her account or plan. To alleviate this concern, the IRS should be required to allow the returned money to be treated as a rollover contribution. In the case of a wrongful, premature, or improper levy, any accrued interest paid with the refund should be treated as non-taxable if it is rolled over into the taxpayer's retirement account along with the returned levy proceeds. If the levy was served in a previous year, the returned money should not impact the contribution limit for the current year, but rather, be treated in the same manner as a rollover.

In addition, because the rules in this area are complex, at the time of returning the levy proceeds the IRS should be required to notify the taxpayer that he or she has the option to contribute the returned funds as a rollover to a qualifying retirement plan or account before the due date of the tax return for the taxable year in which the money was returned.

99 IRC §§ 402(c)(3) and 408(d)(3).

Recommendation

Amend IRC § 6343 to stipulate that when the Secretary returns levy proceeds under IRC § 6343(b) or (d) to a taxpayer and the proceeds were originally obtained by levying against the taxpayer's benefits in a qualifying retirement plan or account described in IRC § 402(c)(8)(B), the taxpayer may contribute the amount of money plus interest (if applicable) back into the a plan or account as a tax-free rollover contribution if allowable under the terms of the plan or account, provided that the contribution is made no later than the due date (not including extensions) for filing the tax return for the taxable year in which the money was returned.

This provision should further provide that the Secretary shall inform the taxpayer at the time the money is returned that a rollover contribution may be made, that the contribution will not affect the current year's contribution limit, that interest paid (when a wrongful levy occurs under IRC § 6343(b) or (d)(2)(A)) shall be treated as earnings within the plan after the contribution (and thus will not be considered gross income), and that any tax previously imposed as a result of the levy shall be abated.[100]

100 S. 1793, 115th Cong. § 302 (2017); S. 3156, 114th Cong. § 104 (2016); H.R. 5719, 110th Cong. § 12 (2008); H.R. 1528, 108th Cong. § 109 (2004) contain language that is generally consistent with this recommendation except that this treatment should apply in any case where the IRS returns under IRC § 6343(b) or (d) funds levied from a retirement plan or account.

#23 MODIFY THE REQUIREMENT THAT THE OFFICE OF CHIEF COUNSEL REVIEW CERTAIN OFFERS IN COMPROMISE

Present Law

IRC § 7122 authorizes the Secretary to enter into an agreement with a taxpayer that settles the taxpayer's tax liabilities for less than the full amount owed, as long as the liabilities have not been referred to the Department of Justice. Such an agreement is known as an "offer in compromise" (OIC). Treas. Reg. § 301.7122-1(b) provides that the IRS may compromise liabilities to the extent there is doubt as to liability, doubt as to collectability, or to promote effective tax administration. The regulations further define these terms and provide instances when compromise is appropriate.

IRC § 7122(b) requires the Treasury Department's General Counsel review and provide an opinion in support of accepted OICs in all criminal cases and in civil cases where the unpaid amount of tax assessed (including any interest, additional amount, addition to tax, or assessable penalty) is $50,000 or more. This authority is exercised by the IRS Office of Chief Counsel.

Reasons for Change

The IRS receives tens of thousands of OICs every year and has established a specialized unit for each type of OIC. Each unit is responsible for processing only that particular type of OIC, and the unit verifies that the legal, as well as IRS policy, requirements for compromise are met prior to proposing acceptance of the OIC.

The requirement that the Office of Chief Counsel review and provide an opinion for every criminal OIC and civil OIC where the unpaid amount of tax assessed is $50,000 or more burdens taxpayers by significantly delaying OIC processing decisions. Delays in OIC processing may impede a taxpayer's ability to make other financial decisions while waiting for a response and may even jeopardize the taxpayer's ability to pay the amount offered if his financial circumstances change. The counsel review requirement is also burdensome for the IRS, requiring that Office of Chief Counsel employees learn the facts of each case and write supporting opinions. This work is oftentimes duplicative of the work the IRS has already performed in processing the OIC.

The National Taxpayer Advocate believes the OIC process would be improved if the blanket requirement for counsel review of all OICs in civil cases where the unpaid tax assessed is $50,000 or more is repealed and replaced with language authorizing the Secretary to require counsel review in cases that present significant legal issues.

Recommendation

Amend IRC § 7122(b) to repeal the requirement that counsel review all OICs in civil cases where the unpaid amount of tax assessed (including any interest, additional amount, addition to tax, or assessable penalty) is $50,000 or more and replace it with language authorizing the Secretary to require counsel review of OICs in cases that he determines present significant legal issues.[101]

101 For language that is generally consistent with this recommendation, *see* S. 1578, 114th Cong., § 403 (2015), S. 882, 108th Cong., § 104 (2003) and H.R. 1528, 108th Cong., § 304 (2004).

#24 CONTINUE TO LIMIT THE IRS'S USE OF "MATH ERROR AUTHORITY" TO CLEAR-CUT CATEGORIES SPECIFIED BY STATUTE

Present Law

Before assessing a deficiency, the IRS is ordinarily required by IRC § 6213(a) to send the taxpayer a statutory notice of deficiency that gives the taxpayer 90 days (150 days if addressed to a taxpayer outside the U.S.) to contest it by filing a petition with the U.S. Tax Court (known as "deficiency procedures"). The taxpayer's ability to appeal a deficiency determination to the Tax Court before paying is central to the taxpayer's right to appeal an IRS decision in an independent forum. As an exception to that requirement, IRC § 6213(b)(1) authorizes the IRS to summarily assess and collect tax after 60 days, without first providing the taxpayer with a statutory notice of deficiency or access to the Tax Court, to correct "mathematical and clerical" errors (known as "math error authority"). Taxpayers who do not contest a proposed deficiency within this shorter period lose the opportunity to do so in court before paying. Under current law, the IRS may summarily assess 17 types of "mathematical or clerical error," which are codified at IRC § 6213(g)(2) (in subparagraphs A-Q).

Reasons for Change

Congress established and required the IRS to follow deficiency procedures to provide taxpayers with notice and a reasonable opportunity to challenge an adverse IRS tax adjustment. Math error authority, which provides fewer taxpayer protections, was authorized as a limited exception to regular deficiency procedures. It allows the IRS to make adjustments in cases of clear taxpayer error, such as where a taxpayer incorrectly adds numbers or incorrectly transcribes a number from one form to another. Because taxpayers have fewer protections under math error procedures, the procedures are not intended to be used where a substantive disagreement may exist. When Congress has expanded the IRS's math error authority, it has done so only where it has been convinced that taxpayer error is relatively clear-cut and no substantive disagreement is likely to exist.

Because math error procedures are cheaper and simpler for the IRS than standard deficiency procedures, the Department of the Treasury on several recent occasions has requested that Congress grant it the authority to add certain categories of "correctable errors" by regulation.[102]

The National Taxpayer Advocate understands the administrative simplicity of math error procedures, but is concerned about the impact of a broad grant of regulatory authority on taxpayer rights. In her reports to Congress, she has documented circumstances in which the IRS has used math error authority to address discrepancies and mismatches that go beyond simple arithmetic mistakes and have undermined taxpayer rights.[103]

If the IRS uses math error authority to address complex issues that require additional fact finding, the assessments are more likely to be wrong, and the IRS's computer-generated notices, which confuse many taxpayers in the simplest of circumstances, are likely to become even more difficult to understand. Shorter

102 *See* Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals*, 245-246 (Feb. 2015), https://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2016.pdf (last visited Dec. 20, 2017).

103 *See, e.g.*, National Taxpayer Advocate 2015 Annual Report to Congress 329-339; National Taxpayer Advocate 2014 Annual Report to Congress 163-171; National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 5, 91-92; National Taxpayer Advocate 2011 Annual Report to Congress 74-92; National Taxpayer Advocate 2006 Annual Report to Congress 311; National Taxpayer Advocate 2003 Annual Report to Congress 113; National Taxpayer Advocate 2002 Annual Report to Congress 25, 186; National Taxpayer Advocate 2001 Annual Report to Congress 33.

deadlines and confusing notices will prevent some taxpayers from responding timely. As a result, these taxpayers will lose the opportunity to challenge the adjustments in court before paying. The IRS may also waste resources responding to calls and letters, reviewing additional documentation, and processing abatement requests from taxpayers whose returns were correct as filed. It may even seek to collect inaccurate assessments from them. Thus, expanding math error authority into more complicated areas will burden taxpayers unnecessarily, erode taxpayer rights, and sometimes waste IRS resources.

Math error authority may be appropriate to use in instances where required schedules are omitted, or annual or lifetime dollar caps have been exceeded. It also may be appropriate to use where there is a discrepancy between a return entry and data available to the IRS from a reliable government database, such as records maintained by the Social Security Administration. But the IRS alone should not be the arbiter of that reliability. Rather, Congress should retain full authority to determine whether the administrative "efficiency" of using math error authority in these instances outweighs the loss of the significant taxpayer protections that deficiency procedures provide.

Recommendation

Continue to limit the IRS's use of "math error authority" to clear-cut categories specified by statute. Because the standard deficiency procedures created by Congress provide important taxpayer protections, the IRS should not be authorized to add new categories by regulation.

Instead, amend IRC § 6213(g) to authorize the IRS to summarily assess a deficiency due to "clerical errors" only pursuant to Congressional authorization and where: (1) there is a discrepancy between a return entry and reliable government data; (2) the IRS's notice clearly describes the discrepancy and how to contest it; (3) the IRS has researched all information in its possession that could help reconcile the discrepancy; (4) the IRS does not have to evaluate documentation to make a determination; and (5) there is a low abatement rate for taxpayers who respond. In addition, amend IRC § 6213(g) to provide that the IRS is not authorized to use any new criteria or data to make summary assessments unless the Department of the Treasury, in conjunction with the National Taxpayer Advocate, has evaluated and publicly reported on the reliability of the criteria or data for that intended use.[104]

104 For a more limited recommendation, *see* National Taxpayer Advocate 2015 Annual Report to Congress 329-339 (Legislative Recommendation: *Authorize the IRS to Summarily Assess Math and "Correctable" Errors Only in Appropriate Circumstances*).

#25 AMEND IRC § 7524 TO REQUIRE THE IRS TO MAIL NOTICES AT LEAST QUARTERLY TO TAXPAYERS WITH DELINQUENT TAX LIABILITIES

Present Law

IRC § 7524 requires the IRS, "[n]ot less often than annually," to send to taxpayers with delinquent accounts a reminder notice that sets forth the amount of the tax delinquency as of the date of the notice.

Reasons for Change

The IRS satisfies the IRC § 7524 requirement by sending taxpayers with delinquent accounts Notice CP-71, *Reminder Notice*, once a year. The infrequency of IRS billing notices leaves collectible revenue uncollected and subjects taxpayers who would make payments if they received more frequent reminders to additional penalties and interest charges.

We acknowledge that sending more frequent notices after the IRS's initial notice stream would entail additional postage and processing costs. Therefore, the projected revenue that would be collected from sending more frequent notices must be weighed against the projected costs to determine whether more frequent notices would be cost effective. Significantly, private sector businesses face this same trade-off, and private businesses, including credit card issuers and retailers, almost uniformly send billing notices more frequently than once a year. Most send delinquency notices on at least a monthly basis. Thus, there is clearly a consensus in the private sector that the collection costs of mailing more frequent notices more than pay for themselves.

We believe the IRS, too, would collect more revenue, net of any costs, if it sends more frequent notices. A recent IRS lien study showed that monthly collection notices generated more revenue than notices that were sent just once. In addition, taxpayers receiving more frequent notices would be more likely to notice that penalties and interest charges continue to accrue, causing their balances to increase. This would provide an additional incentive for them to resolve their liabilities.

Recommendation

Amend IRC § 7524 to require the IRS to mail notices at least quarterly to taxpayers with delinquent tax liabilities.

#26 PROVIDE ADDITIONAL TIME FOR TAXPAYERS OUTSIDE THE UNITED STATES TO REQUEST ABATEMENT OF A MATH ERROR ASSESSMENT EQUAL TO THE TIME EXTENSION ALLOWED IN RESPONDING TO A NOTICE OF DEFICIENCY

Present Law

IRC § 6213(b) authorizes the IRS to make a summary assessment of tax arising from mathematical or clerical errors as defined in IRC § 6213(g), bypassing the deficiency procedures. Thus, a taxpayer has no right to file a petition with the U.S. Tax Court based on a math error notice. Under IRC § 6213(b)(2)(A), a taxpayer has 60 days, after a math error notice is sent, to file a request with the IRS for an abatement of the assessment for mathematical or clerical errors. However, if the taxpayer makes a timely abatement request, the IRS must abate the assessment and follow deficiency procedures under IRC § 6212 to reassess the increase in the tax shown on the return. If the taxpayer does not submit an abatement request within 60 days, the taxpayer forfeits his right to file a petition in the Tax Court. No additional time to request abatement is allotted when the math error notice is addressed to a taxpayer outside the United States.

By contrast, certain taxpayers who receive notices of deficiency from the IRS are given additional time to file petitions in the Tax Court. Taxpayers may generally file a petition with the Tax Court for a redetermination of the deficiency within 90 days from the date the notice is mailed. When the notice of deficiency is addressed to a taxpayer outside the United States, IRC § 6213(a) provides that the taxpayer has 150 days from the date the notice is mailed to file a Tax Court petition. The 150-day period for filing a petition applies to a taxpayer who is located outside the United States even if the notice of deficiency is sent to an address within the United States, as well as to a taxpayer when the notice of deficiency bears an address outside the United States.[105] Thus, the law allows an additional 60 days for taxpayers to file a petition for redetermination of a deficiency when the notice of deficiency is addressed to a taxpayer outside the United States.

Reasons for Change

Approximately nine million U.S. citizens live abroad,[106] along with more than 190,000 U.S. military service personnel and their families, and hundreds of thousands of students and foreign taxpayers with U.S. tax obligations. Taxpayers living (temporarily or permanently) abroad typically require more time to respond to IRS notices than taxpayers living in the United States for several reasons. First, mail takes longer to be delivered in both directions — in some cases, depending on where the taxpayer is located, substantially longer. Second, persons temporarily abroad often do not have access to their tax or financial records, making it impossible for them to respond immediately.

By giving taxpayers living abroad 60 additional days to file a petition with the Tax Court in response to a notice of deficiency, Congress recognized that holding overseas taxpayers to the same deadlines as taxpayers living in the United States would not be fair or realistic. The same considerations apply with respect to the deadline for responding to math error notices. In fact, the need for additional time to respond may be greater

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105 The phrase “addressed to a person outside the United States” is ambiguous, and the Tax Court construes it broadly. *See, e.g.*, *Levy v. Comm’r*, 76 T.C. 228 (1981) (holding that the 150-day rule is applicable to a U.S. resident who is temporarily outside of the country when the notice is mailed and delivered); *Looper v. Comm’r*, 73 T.C. 690 (1980) (holding that the 150-day rule is applicable where a notice is mailed to an address outside the United States); *Lewy v. Comm’r*, 68 T.C. 779 (1977) (holding that the 150-day rule is applicable to a foreign resident who is in the United States when the notice is mailed, but outside the United States when the notice is delivered); *Hamilton v. Comm’r*, 13 T.C. 747 (1949) (holding that the 150-day rule is applicable to a foreign resident who is outside the United States when the notice is mailed and delivered).

106 The Department of State estimates that 9,000,000 U.S. citizens live abroad. U.S. Department of State, Bureau of Consular Affairs, *CA by the Numbers, Fiscal Year 2015 data*, updated June 2016. *See* https://web.archive.org/web/20160616233331/https://travel.state.gov/content/dam/travel/CA_By_the_Numbers.pdf.

in the case of math error notices because the standard response deadline is 60 days (as opposed to 90 days for filing a Tax Court petition in response to a notice of deficiency).

The right of a taxpayer to respond to an adverse tax adjustment and have his response fairly considered is central to a fair tax system.[107] Giving taxpayers the same additional 60-day period to respond to math error notices when the notices are addressed to them outside the United States as the law currently provides for these taxpayers to file petitions in response to deficiency notices would help ensure that their rights to challenge adverse IRS tax adjustments are comparable to the rights of U.S. taxpayers who are not absent from the United States.

Recommendation

Amend IRC § 6213(b)(2)(A) to allow 120 days to request abatement when the math error notice is addressed to taxpayers outside the United States.

107 The following specific taxpayer rights apply in this situation: *the right to pay no more than the correct amount of tax*, *the right to challenge the IRS's position and be heard*, and *the right to appeal an IRS decision in an independent forum.*

#27 IMPROVE OFFER IN COMPROMISE PROGRAM ACCESSIBILITY BY REPEALING THE PARTIAL PAYMENT REQUIREMENT

Present Law

IRC § 7122(a) authorizes the IRS to settle a tax debt by accepting an offer in compromise (OIC). According to IRS Policy Statement 5-100, the IRS will "accept an offer in compromise when it is unlikely that the tax liability can be collected in full and the amount offered reasonably reflects collection potential." Taxpayers must also file and pay their taxes for five years after an offer is accepted, as provided by IRS Form 656, *Offer in Compromise* (2017) (item j).

IRC § 7122(c)(1)(A) requires a taxpayer who would like the IRS to consider a "lump-sum" offer — payable in five or fewer installments — to include a nonrefundable partial payment of 20 percent of the amount of the offer with the application. IRC § 7122(c)(1)(B) requires a taxpayer who would like the IRS to consider a "periodic payment" offer — an offer payable in six or more installments — to include the first proposed installment with the application and continue to make installment payments while the IRS is considering it. In addition to these partial payments, Treas. Reg. § 300.3 requires offer applications to include a user fee. Taxpayers with low incomes — less than 250 percent of the Federal poverty level — can apply for a waiver of the fee and the partial payment requirement.

Reasons for Change

By accepting an offer, the IRS collects money it would not otherwise collect and turns a noncompliant taxpayer into a compliant one by requiring the taxpayer, as a condition of the agreement, to timely file returns and pay taxes for the following five years. The Treasury Department's *General Explanations of the Administration's Fiscal Year 2017 Revenue Proposals* acknowledged the benefit of offers by proposing to repeal the partial payment requirement, explaining that it "may substantially reduce access to the offer-in-compromise program. … Reducing access to the offer-in-compromise program makes it more difficult and costly to obtain the collectable portion of existing tax liabilities." The Treasury Department estimated that repealing the requirement would have a positive revenue impact.

A 2007 TAS study found that taxpayers above the low income threshold were no better able to afford to make partial payments than those below it, and that those below it frequently did not obtain a waiver. Similarly, a 2005 Treasury Inspector General for Tax Administration report found that when the IRS first imposed a $150 OIC fee in 2003, offer submissions declined by more than 20 percent among taxpayers at every income level. Thus, the partial payment requirement likely decreases collections and increases enforcement costs.

Recommendation

Amend IRC § 7122(c) to remove the requirement that taxpayers include a partial payment with "lump-sum" and "periodic payment" offer applications.[108]

108 For more detail, *see*, *e.g.*, National Taxpayer Advocate 2006 Annual Report to Congress 507-519 (Legislative Recommendation: *Improve Offer in Compromise Program Accessibility*). H.R. 4994, 111th Cong. § 202 (2010) (as passed by the House), H.R. 4912, 114th Cong. § 206 (2015), and H.R. 2171, 115th Cong. § 206 (2017) contain language that is generally consistent with this recommendation.

#28 AMEND IRC § 7403 TO PROVIDE TAXPAYER PROTECTIONS BEFORE THE IRS RECOMMENDS THE FILING OF A LIEN FORECLOSURE SUIT ON A PRINCIPAL RESIDENCE

Present Law

IRC § 7403 authorizes the Department of Justice (DOJ) to file a civil action in a district court of the United States against a taxpayer to enforce a tax lien and foreclose on a taxpayer's property, including on a taxpayer's principal residence. IRC § 7403(c) directs the court to "[f]inally determine the merits of all claims to and liens upon the property." The court can order the sale of the residence and the distribution of the sale proceeds in accordance with the court's findings regarding the claimants' interests.

Reasons for Change

The IRS has two options, which cannot be used concurrently, to collect against the principal residence of a taxpayer or a residence that is owned by the taxpayer but occupied by the taxpayer's spouse, former spouse, or minor child. One option is to obtain a court order allowing administrative seizure of a principal residence under IRC § 6334(e)(1). Administrative seizures are subject to specified statutory taxpayer protections. The other option is a suit to foreclose the federal tax lien against a principal residence under IRC § 7403. Under the lien foreclosure route, the IRS requests that the DOJ file suit under IRC § 7403 to enforce the tax lien and sell the taxpayer's principal residence at a judicial sale to satisfy the tax debt in whole or in part. In this circumstance, the statutory protections applicable to administrative seizures do not apply.[109]

To protect taxpayers from inappropriate referrals to the DOJ requesting foreclosure of a tax lien on a principal residence, the IRS has written procedures into its Internal Revenue Manual (IRM) that apply to lien foreclosure suit referrals. The IRM prescribes certain initial steps IRS employees must take, such as attempting to identify the occupants of a residence and advising the taxpayer about Taxpayer Advocate Service assistance options, and sets forth an internal approval process prior to referring a lien enforcement case to the DOJ. However, the IRM is simply a set of instructions to IRS staff. Taxpayers generally may not rely on IRM violations as a basis for challenging IRS actions in court, and the IRS may modify or rescind IRM provisions at any time.

The seizure of a taxpayer's principal residence may have a devastating impact on the taxpayer and his or her family. Taxpayer protections before foreclosure referrals are made should be clear, and taxpayers should be entitled to cite violations of the protections as a basis for challenging IRS actions. For these reasons, the National Taxpayer Advocate believes the protections should be codified for lien foreclosure suit referrals to the same extent as administrative seizures and should not be left for the IRS to determine through IRM procedures.

109 Depending on the facts of a case, one route may be preferable for the government than the other. For example, the IRS will generally request that the Department of Justice file a lien foreclosure suit when issues arise relating to title, nominees, or the collection statute.

Recommendation

Amend IRC § 7403 to codify current IRM administrative protections and specifically preclude IRS employees from requesting that the DOJ file a civil action in district court seeking to foreclose the tax lien against a taxpayer's principal residence, except where the employee has received executive-level written approval after determining whether (1) the taxpayer's other property or rights to property, if sold, would be insufficient to pay the amount due, including the expenses of the proceedings, and (2) the foreclosure and sale of the residence will not create an economic hardship due to the financial condition of the taxpayer.[110]

110 H.R. 1828, 114th Cong. § 16 (2015); S. 949, 114th Cong. § 16 (2015); and S. 2215, 113th Cong. § 8 (2014) contain language that is generally consistent with these recommendations.

#29 AMEND IRC §§ 6320 AND 6330 TO PROVIDE COLLECTION DUE PROCESS RIGHTS TO THIRD PARTIES HOLDING LEGAL TITLE TO PROPERTY SUBJECT TO IRS COLLECTION ACTIONS

Present Law

Current law authorizes the IRS to file Notices of Federal Tax Lien (NFTLs) and issue levies against a taxpayer's property or rights to property, including property owned jointly, by certain third parties, or secured by certain creditors.[111] However, these third parties are not considered "taxpayers" for purposes of the Collection Due Process (CDP) notice and hearing procedures described in IRC §§ 6320 and 6330, and they are therefore not entitled to CDP rights. For that reason, the IRS does not issue CDP lien notices pursuant to IRC § 6320 or provide notice of proposed levies pursuant to IRC § 6330 to these third parties.

Reasons for Change

The purpose of CDP rights is to give taxpayers a meaningful hearing before the IRS levies their property or immediately after the IRS files a NFTL against their property. During the CDP hearing, a taxpayer has the right to raise defenses, challenge the appropriateness of collection actions, and propose collection alternatives. Third parties such as joint owners or alleged nominees, alter egos, and transferees, do not have these rights, and therefore, are not able to prove their ownership interest in the property until after a lien is filed or the property levied. Without the benefit of the protections afforded by IRC §§ 6320 and 6330, a third party against whom the IRS takes a collection action has limited remedies, and the remedies are provided only after the collection action has occurred. As a result, the collection process gives taxpayers who may owe significant liabilities the right to raise concerns and propose collection alternatives before a collection action is taken while denying joint owners and alleged nominees, alter egos, and transferees – who may be innocent third parties — those same rights. Amending the law to provide CDP rights to third parties who have legal title to the property would give an "affected third party" due process protections comparable to the person who is responsible for the tax.[112]

Recommendation

Amend IRC §§ 6320 and 6330 to extend Collection Due Process rights to "affected third parties," who hold legal title to property subject to IRS collection actions.[113]

111 *See generally* IRC §§ 6321, 6322, 6323(a), (f) and (h)(6), and 6331(a).

112 In the context of explaining the CDP provisions, Senate report accompanying its version of the RRA 98 legislation referred to "[t]he taxpayer (or *affected third party*)." S. Rep. No. 105-174, at 67 (1998) (emphasis added).

113 For more detail, see National Taxpayer Advocate 2012 Annual Report to Congress 544-552 (Legislative Recommendation: *Amend IRC §§ 6320 and 6330 to Provide Collection Due Process Rights to Third Parties (Known as Nominees, Alter Egos, and Transferees) Holding Legal Title to Property Subject to IRS Collection Actions*).

#30 CLARIFY THAT TAXPAYERS MAY RAISE INNOCENT SPOUSE RELIEF AS A DEFENSE IN COLLECTION PROCEEDINGS AND IN BANKRUPTCY CASES

Present Law

Married taxpayers who file joint returns are jointly and severally liable for any deficiency or tax due. Spouses who live in community property states and file separate returns are generally required to report half of the community income on their separate returns. IRC §§ 6015 and 66, sometimes referred to as the "innocent spouse" rules, provide relief from joint and several liability and from the operation of community property rules. Taxpayers seeking innocent spouse relief generally file Form 8857, *Request for Innocent Spouse Relief.* After reviewing the request, the IRS issues a final notice of determination granting or denying relief in whole or in part.

IRC § 6015(e)(1)(a) provides that an individual who seeks relief from joint liability may, "in addition to any other remedy provided by law," petition the United States Tax Court to determine the appropriate relief available. The Tax Court generally has jurisdiction to decide the innocent spouse claim if the petition is filed within 90 days from the date the IRS issues its final notice of determination.

Statutory provisions and judicial precedent make clear that taxpayers may raise innocent spouse relief in deficiency proceedings arising under IRC § 6213, in collection due process hearings arising under IRC §§ 6320 and 6330, in refund suits arising under IRC § 7422, and in bankruptcy proceedings arising under title 11 of the United States Code.

Reasons for Change

While one district court was willing to consider a taxpayer's innocent spouse claim as a defense in an action under IRC § 7402 to reduce federal tax assessments to judgment and under IRC § 7403 to foreclose tax liens on real property, some district courts have refused to allow the defense in these collection suits. These inconsistent decisions have created confusion as to whether the defense is allowed and have resulted in different treatment of similarly situated taxpayers. Moreover, the refusal to allow the innocent spouse defense in collection suits may create hardships because a taxpayer may be left without any forum in which to seek innocent spouse relief prior to having a financially damaging court judgment entered against him or her, or to losing his or her home to foreclosure.

Legislation is needed to clarify that the statutory language of IRC § 6015 conferring Tax Court jurisdiction "in addition to any other remedy provided by law" does not give the Tax Court exclusive jurisdiction to determine innocent spouse claims and that district courts are also authorized to consider, in collection suits, whether innocent spouse relief should be granted.

Recommendation

Amend IRC §§ 6015 and 66 to clarify that taxpayers are entitled to raise innocent spouse relief as a defense in proceeding brought under any provision of Title 26 (including §§ 6213, 6320, 6330, 7402, and 7403) or in cases arising under Title 11 of the United States Code.