The Allowable Living Expense (ALE) Standard Does Not Reflect the Realistic Costs of Maintaining a Basic Standard of Living

**TAXPAYER RIGHTS IMPACTED**
- The Right to Privacy
- The Right to a Fair and Just Tax System

**DISCUSSION**

Internal Revenue Code (IRC) § 7122(d)(2)(A) mandates that the IRS “develop and publish schedules of national and local allowances designed to provide that taxpayers entering into a compromise have an adequate means to provide for basic living expenses.” Most importantly, Congress instructed the IRS to analyze the facts of each case involving these allowances and stipulated that if application of the allowances results in a taxpayer not being able to provide for basic living expenses, then the allowances should not be used. The resulting Allowable Living Expense (ALE) standards have come to play a major role in analyzing several types of IRS collection cases.

The IRS allows an expense if it is “necessary to provide for a taxpayer's and his or her family's health and welfare and/or production of income.” In its efforts to base the allowed expenses on reliable and consistent data, the IRS relies heavily on the Bureau of Labor Statistics. In particular, the IRS uses the Consumer Expenditure Survey, which gathers expenditure information for consumers. Since this survey measures what people spend to live, it does not take into account what the goods or services actually cost to live. Taxpayers who are of limited means pay for what they can afford, and thus may forego expenses otherwise determined by the IRS definition to be necessary. Additionally, some essential expenses are not included in the category of “necessary” expense, preventing any taxpayer from claiming them.

By focusing on what expenses are allowable instead of adequate, the IRS has exercised its discretion in a way that does not meet congressional intent, since “allowable” is not synonymous with “adequate” or “basic.” Instead, the IRS should adopt standards that allow for a sufficient or adequate standard of living.

---

2. See also Treas. Reg. § 301.7122-1(c)(2)(i).
4. Form 433-A, Collection Information Statement for Wage Earners and Self-Employed Individuals, is used to determine monthly expenses and primarily relies on the Allowable Living Expense (ALE) standards. This form is necessary for many types of case resolutions, including certain installment agreements and offers in compromise (OIC). Internal Revenue Manual (IRM) 5.15.1.1(3), Overview and Expectations (Nov. 17, 2014).
5. IRM 5.15.1.7(1), Allowable Expense Overview (Oct. 2, 2012).
7. Congressional intent for maintaining an adequate and basic standard of living can be seen in how Congress has addressed “economic hardship” for IRS Collection purposes, which is defined as an inability to pay “reasonable basic living expenses.” Treas. Reg. § 301.6343-1(b)(4).
8. “Sufficient” is defined as “adequate; of such quality, number, force, or value as is necessary for a given purpose.” Whereas, “allowable” is defined as “acceptable according to the rules; permissible.” Black’s Law Dictionary (10th ed. 2014).
The IRS Continues to Decrease ALEs Despite Data That Show Expenses Are on the Rise

Before the IRS can establish a standard for living expenses, it must understand what amount of money is sufficient for a basic standard of living. The IRS has not established how much it costs to maintain a basic standard of living. As a baseline, the United States often uses the poverty threshold to determine if a person has enough money to survive day-to-day. A person is considered to be living in poverty if his or her family’s income falls below an income threshold set up by family size and composition.9 The current method for determining the poverty level was developed between 1963 and 1964 by Mollie Orshansky, an economist at the Social Security Administration (SSA).10 The official measure multiplies by three the cost of a minimum food diet from 1963 prices in today’s prices.11 The poverty threshold is not a measure of a sufficient standard of living.

Based on concerns identified by the National Taxpayer Advocate, the IRS and TAS reached a joint agreement in 2007 whereby “the allowance amount for any ALE category cannot be decreased unless something economic changes significantly, such as a major sustained recession or depression.”12 In violation of this agreement, on March 28, 2016, the IRS announced that new ALE standards took effect and that “some ALE amounts reflect a decrease from last year’s standard amounts based on current data showing a decline in expenditures.”13 Between 2015 and 2016, the expenses allowed for out-of-pocket healthcare and transportation decreased, as did the national standards for food, clothing, housekeeping supplies, and miscellaneous.14

It is difficult to find evidence to support the proposition that expenditures have actually declined. Instead, data appears to show the opposite. One source has reported on the impact of the Great Recession. It found that from 2004 to 2008, median household income grew by 1.5 percent while median expenditures grew by 11 percent.15 However, the 2014 median income has decreased by 13 percent from 2004 levels while expenditures increased by nearly 14 percent.16 One example of this can be seen with health insurance costs. The cost of employer-sponsored health plans has consistently increased at a rate greater than wage

11 U.S. Census Bureau, Measuring America: How Census Measures Poverty, https://www.census.gov/library/visualizations/2014/demo/poverty_measure-how.html. Food was chosen as the original standard of adequacy because it was the only generally accepted standard available at the time. Mollie Orshansky, Counting the Poor: Another Look at the Poverty Profile, 28 SOC. SEC. BULL. 5 (1965). The multiplier of three for costs of food was used since research at the time showed that families spent one-third of their budget on food. Id. at 9. For a discussion on how Ms. Orshansky came to this decision, see Gordon M. Fisher, The Development and History of the Poverty Thresholds, 55 SOC. SEC. BULL. 5 (Winter 1992).
14 TAS Research analysis of IRS 2015 ALE Standards and IRS 2016 ALE Standards. Housing costs also decreased in 2,314 counties out of 3,221 counties.
16 Id.
Between 2006 and 2015, the average deductible has tripled (from $303 to $1,077), which is seven times faster than wage growth during the same period.\textsuperscript{17}

TAS is unaware of how IRS assumptions can be tested using the current system of ALE standards, since the standards are based on averages spent by consumers, rather than an analysis of what individuals and families actually need to provide for a basic living. Despite TAS’s concerns with the IRS decision last year, the IRS recently announced ALE standards for 2017 that include decreased amounts for a second year.\textsuperscript{18} To be exact, 415 categories of expenses will be decreasing, including out-of-pocket healthcare costs.\textsuperscript{19} Some of the categories of expenses increased. TAS is concerned that the IRS continues to make decisions regarding ALEs without fully understanding how the decisions impact taxpayers.

The IRS needs to work with TAS in a joint study to measure a basic standard of living for taxpayers. The joint study could consider how the SSA implements the cost of living adjustment (COLA) for its benefits program. For both the Social Security program and for Supplemental Security Income (SSI), the SSA uses the Consumer Price Index for Urban Wage Earners and Clerical Workers. However, unlike the IRS and its ALE standards, the COLA has never decreased.\textsuperscript{20} The worst situation that a recipient will experience is no increase.

The ALE Standards Should Be Updated to Include Expenses Necessary to Maintain the Health and Welfare of Households Today

TAS continues to study how the ALE standards can be updated to conform with a basic lifestyle today. TAS previously recommended that the IRS expand the ALEs to include child care, an allocation for a basic home computer, and minimal retirement savings as an acknowledgement that these expenses are necessary for maintaining the health and welfare of today’s families.\textsuperscript{21} TAS is studying the possibility of considering other expenses. For instance, in the United Kingdom (U.K.), the minimum income standard (MIS) is defined as the “income that people need in order to reach a minimum socially acceptable standard of living in the U.K. today, based on what members of the public think.”\textsuperscript{22} The MIS definition allows for “social and cultural” participation expenses, which includes things such as gifts and recreation.\textsuperscript{23} TAS will research the ability to include a small allotment for entertainment and recreation. Additionally, TAS will research an allowable expense for higher education or trade school. TAS will share its results with the IRS.

The IRS Should Study How Its Recent Deviation Involving ALEs Impacts Taxpayers

The IRS implemented a deviation from normal procedures for certain Automated Collection System and Compliance Services Collection Operations cases between December 17, 2015 and September 30, 2016 that involve financial analysis for particular types of installment agreements and currently not collectible.

\textsuperscript{17} Noam N. Levey, \textit{LA Times}, \textit{Healthcare Costs Rise Again, and the Burden Continues to Shift to Workers} (Sept. 22, 2015).
\textsuperscript{19} TAS Research analysis of IRS 2016 ALE Standards and IRS 2017 ALE Standards.
\textsuperscript{21} National Taxpayer Advocate 2016 Annual Report to Congress 200.
\textsuperscript{22} Joseph Roundtree Foundation, \textit{A Minimum Income Standard for the UK in 2014} 8 (July 2014). The minimum income standard (MIS) is based on input from focus groups comprised of various segments of the population and experts in particular fields of study.
\textsuperscript{23} Id. at 20.
(CNC) cases. For instance, one collection tool is a partial-pay installment agreement (PPIA), which is an installment agreement that does not pay the tax liability in full prior to the collection statute expiration date (CSED). PPIAs require a full collection information statement from the taxpayer, which is where the ALEs are considered. The IRS’s deviation will allow certain IRS employees to process PPIA requests without requesting substantiation of ALE expenses unless there is a large discrepancy.

TAS planned to report on the results of this deviation, however, since the deviation was done to address a backlog of work and not to study ALE standards; the IRS did not track details of cases, such as how each case was resolved or which expenses were allowed a deviation. Instead, the IRS tracked cases in the deviation to ensure that procedures of the deviation were followed.

The IRS extended the deviation through fiscal year 2017. During the extended deviation, the IRS will track the total number of non-streamlined installment agreements, PPIAs, and currently not collectible accounts. However, there is no mechanism for the IRS to track which expenses were most likely to be allowed during the deviation or which expenses most often required substantiation. The IRS could have used this type of deviation to closely study the ALEs. For instance, it could find out which expenses were most often allowed a deviation and by how much.

CONCLUSION

Taxpayers are responsible for paying their tax liabilities. However, Congress intended for the IRS to allow enough expenses to ensure taxpayers have an adequate means to provide for basic living expenses prior to resolving their outstanding tax debts. The current ALE standard is not based on an amount of money that allows for a basic standard of living. It also does not take into account all expenses that are necessary for a basic standard of living today. The IRS should reevaluate how it measures and implements the ALE standard so that taxpayers do not face a hardship while complying with their tax responsibilities, and it should not continue to decrease the amount of ALEs.

FOCUS FOR FISCAL YEAR 2018

In Fiscal Year 2018, TAS will:

- Research alternative methods to calculate the cost of providing for the health and welfare of households and share this information with the IRS;
- Issue a Taxpayer Advocacy Directive ordering the IRS to expand the categories available in the ALE standards and to stop decreasing the amount of ALEs; and
- Issue an Internal Guidance Memorandum to provide guidance to TAS employees about how to advocate for deviation from the current ALEs when applicable.

---

24 Director, Collection Policy and Director, Campus Collection, Memorandum for SBSE Directors, Collection Policy and Campus Collection, IRM Deviation for ACS/ACSS/CSCO Collection Information Statement (CIS) Case Processing (Dec. 17, 2015).
26 Director, Collection Policy and Director, Campus Collection, Memorandum for SBSE Directors, Collection Policy and Campus Collection, IRM Deviation for ACS/ACSS/CSCO Collection Information Statement (CIS) Case Processing 2 (Dec. 17, 2015). Furthermore, IRS employees are instructed to accept verbal substantiation unless the taxpayer cannot explain the discrepancy.
27 National Taxpayer Advocate 2016 Annual Report to Congress 198.
29 IRS response to TAS information request (Mar. 31, 2017).