

#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.