

## #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.<sup>99</sup>

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.

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<sup>99</sup> 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.<sup>100</sup>

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<sup>100</sup> 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.