

Area of
Focus #3

Despite Insufficient Internal Guidance, the IRS Continues to Levy on Retirement Accounts and Has Completed a Pilot for Levying on Thrift Savings Plan Accounts Through the Automated Collection System

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

Background

While any collection action taken by the IRS could affect a taxpayer, levies on assets in retirement accounts may have a particularly negative effect on a taxpayer's future well-being.² As a result, the IRS should issue internal guidance that balances the need for efficient collection of tax with the public policy that encourages saving for retirement.³ The National Taxpayer Advocate previously raised several concerns regarding the inadequacy of IRS internal guidance related to levies on retirement accounts.⁴

Internal Revenue Code (IRC) § 6331 gives the IRS the right to levy on a taxpayer's property and rights to property. This power allows the IRS to levy on funds held in retirement accounts.⁵ The IRS has established three steps that must be taken before it can issue a notice of levy on a taxpayer's retirement account:

1. Determine what property (retirement assets and non-retirement assets) is available to collect the liability;
2. Determine whether the taxpayer's conduct has been flagrant; and

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR that was adopted by the IRS are now listed in the IRC. See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 One survey found that 31 percent of non-retired respondents had no retirement savings or pension. The amount of retirement savings increased with the amount of income. Eighty-two percent of the respondents making over \$100,000 per year had at least some retirement savings or pension. Meanwhile, among respondents making under \$40,000 per year, only 42 percent had any retirement savings. Board of Governors of the Federal Reserve System, *Report on the Economic Well-Being of U.S. Households in 2014* 38-39 (May 2015).

3 Understanding the importance of Americans having sufficient retirement savings, Congress has formulated policies to not only provide Social Security income to retirees, but to protect the rights of individuals to pensions and to encourage retirement savings accounts. For example, the Employee Retirement Income Security Act of 1974 was enacted to provide protection for participants in pension and health plans in private industry. Pub. L. No. 93-406, 88 Stat. 829 (1974).

4 National Taxpayer Advocate 2015 Annual Report to Congress 100-11 (Most Serious Problem: *Levies on Assets in Retirement Accounts: Current IRS Guidance Regarding the Levy of Retirement Accounts Does Not Adequately Protect Taxpayer Rights and Conflicts with Retirement Security Public Policy*); National Taxpayer Advocate Fiscal Year 2016 Objectives Report to Congress 53-58 (Area of Focus: *IRS Procedures for Levies on Retirement Plan Assets Create Financial Harm and Undermine Taxpayer Rights*).

5 For information on what constitutes a retirement plan, see IRC § 4974(c). The IRS may also levy on retirement income or distributions once the taxpayer retires. Internal Revenue Manual (IRM) 5.11.6.1, *Retirement Income* (Jan. 22, 2010).

3. Determine whether the taxpayer depends on the money in the retirement account (or will in the near future) for necessary living expenses.⁶

IRS Guidance for Levying Assets in Retirement Accounts Is Insufficient to Protect Taxpayers' Rights

As noted above, the IRS must determine if a taxpayer engaged in flagrant conduct prior to issuing a levy on a retirement account.⁷ The IRM does not define what constitutes flagrant conduct.⁸ The IRS must make this determination based on examples in the IRM guidance. IRS employees are instructed to consider extenuating circumstances that mitigate otherwise flagrant behavior and to review each situation on a case-by-case basis, but examples of extenuating circumstances were not included.⁹ As a result of TAS's negotiations with the IRS, the IRS recently updated the IRM with several examples of extenuating circumstances and flagrant conduct.¹⁰

Without clear guidance, an IRS employee's assessment of what constitutes flagrant conduct is subjective and susceptible to personal judgment. This could lead to inconsistent treatment of similarly-situated taxpayers, which could erode taxpayers' confidence in a fair tax system and decrease voluntary compliance.

The IRM Guidance Regarding Flagrant Conduct Lacks Definition and Clarity

A taxpayer cannot adequately challenge the decision to levy without a detailed analysis of the basis for levy, a situation which impacts the taxpayer's *right to privacy*, which provides that taxpayers have the right to expect any IRS inquiry, examination, or enforcement action will comply with the law and be no more intrusive than necessary. Without clear guidance, taxpayers do not know what they need to do to comply with tax laws, which diminishes the *right to be informed*.

TAS casework illustrates the harm that can be caused when there is no clear guidance on what constitutes flagrancy. One case involved a 64 year-old, unemployed taxpayer.¹¹ In 2012, a revenue officer determined that the taxpayer's monthly expenses exceeded his income and placed the taxpayer's account in currently not collectible (CNC) status. At the time, the revenue officer also analyzed the ability for the IRS to levy the taxpayer's retirement account according to the procedures set forth in IRM 5.11.6.2. The revenue officer confirmed that the retirement account should not be levied because the taxpayer's behavior

⁶ IRM 5.11.6.2(4)-(7) (Sept. 26, 2014).

⁷ IRM 5.11.6.2(5), *Funds in Pensions or Retirement Plans* (Sept. 26, 2014). The guidance points out if a taxpayer has not engaged in flagrant conduct, then the retirement account should not be levied. *Id.* Thus, the determination of flagrant conduct is critical for determining whether to levy on a retirement account.

⁸ The National Taxpayer Advocate recommended a definition of flagrant conduct that includes a "willful action (or failure to act) which 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." See National Taxpayer Advocate 2015 Annual Report to Congress 341. Bills were introduced in the House and Senate in 2015 that recommended a stricter standard for defining flagrant conduct. The proposed definition of flagrant conduct includes: "(A) the filing of a fraudulent return by the taxpayer, or (B) that the taxpayer acted with the intent to evade or defeat any tax imposed by this title or the collection or payment thereof." Taxpayer Rights Act of 2015, S. 2333, 114th Cong. § 307 (2015); Taxpayer Rights Act of 2015, H.R. 4128, 114th Cong. § 307 (2015). For more information on the bill, see Senator Ben Cardin, *Cardin and Becerra Introduce Plan to Protect Taxpayers' Rights*, <https://www.cardin.senate.gov/newsroom/press/release/cardin-and-becerra-introduce-plan-to-protect-taxpayers-rights>. As of June 16, 2016, the House bill has been referred to the Committee on Ways and Means and to the Committee on Financial Services. The Senate bill has been referred to the Committee on Finance.

⁹ IRM 5.11.6.2(5), *Funds in Pensions or Retirement Plans* (Sept. 26, 2014).

¹⁰ IRM 5.11.6.2(5), *Funds in Pensions or Retirement Plans* (June 14, 2016).

¹¹ In this instance, the taxpayer has provided written consent for the National Taxpayer Advocate to use facts specific to the taxpayer's case. Release signed by the taxpayer dated Apr. 5, 2016 (on file with TAS).

was not flagrant, and since the taxpayer was no longer employed and CNC, the taxpayer would need this asset in retirement.

In 2015, the case returned to the field with less than a year on the collection statute expiration date (CSED).¹² The new revenue officer determined that the taxpayer (67 years old at that time) could afford a modest installment agreement, a determination contested by the taxpayer's representative. The revenue officer also decided to levy on the retirement account. There is no analysis in the internal record to explain the legal or other basis for this decision until after the levy occurred. The revenue officer levied the retirement account on January 6, 2016, and the CSED expired on January 14, 2016.¹³

Following the levy, internal notes indicate that the decision to levy was based on flagrant conduct. The revenue officer determined that the taxpayer exhibited flagrant conduct since he continued to make contributions to his retirement account while he knew there was an outstanding balance.

Internal records do not show that the taxpayer was informed to stop making retirement account contributions while his account was in CNC status, or that failure to do so might result in his conduct being determined "flagrant" and lead to a levy on that account. From a policy perspective, taxpayers approaching retirement should not be discouraged from contributing to their retirement. In fact, in the years since the CNC determination, this taxpayer had begun to make withdrawals from his retirement account. Through TAS advocacy, the IRS released the levy on the taxpayer's retirement account. The CSED has expired and the taxpayer can now be assured that the issue is resolved.

A Detailed Necessary Living Expenses Calculation Should Be Documented Prior to Issuing a Levy on a Retirement Account

The final step in deciding whether a levy on retirement assets is appropriate is to determine if the taxpayer depends on the money in the retirement account for necessary living expenses (or will in the near future).¹⁴ To conduct this analysis, employees are instructed to use the standards in IRM 5.15, *Financial Analysis*, to estimate how much can be withdrawn annually from the retirement account while leaving enough for necessary living expenses over the taxpayer's remaining life expectancy.¹⁵

The guidelines for completing the financial analysis are woefully insufficient. For example, there is no requirement to document any minimum retirement age for each type of retirement plan the taxpayer is vested in (*e.g.*, Social Security, Individual Retirement Account, 401(k), Thrift Savings Plan (TSP)). A sound analysis would include simulations comparing scenarios where the taxpayer elects to take distributions at the earliest date allowable with scenarios where the taxpayer elects to take distributions at various other dates to determine the optimal age at which the taxpayer should begin taking distributions from various retirement sources. The financial analysis handbook does not take into account cost of living increases or adjustments for increased expenses due to advanced age, such as rising health care or hospice costs.

12 The CSED is the amount of time that the IRS has to collect a taxpayer's liability. Generally, the IRS has ten years to collect a debt after assessment. IRC § 6502.

13 Internal guidance provides that there must be a full analysis prior to levying on a retirement account. The imminent expiration of a CSED is not sufficient to justify the decision to levy a retirement account. IRM 5.11.6.2(3) (Sept. 26, 2014).

14 IRM 5.11.6.2(7), *Funds in Pension or Retirement Plans* (Sept. 26, 2014). Employees are instructed not to levy on the retirement account if it is determined the taxpayer depends on the money in the retirement account (or will in the near future).

15 *Id.*

Since June 2015, TAS has been holding discussions with the IRS to define flagrancy, revise the flagrant conduct examples, and revisit pre-levy considerations in the IRM on retirement accounts. Certain progress has been made, including:

- Modification of six of the seven flagrant conduct examples;
- Updated guidance on pre-levy considerations;
- Revision of the Levy Source Screen on the Integrated Collection System (ICS) to include the type of assets being selected for the levy in order to assist the revenue officer in perfecting the levy; and
- A tentative agreement to revise the IRM to require revenue officers to advise affected taxpayers to cease contributions to retirement accounts prior to making a flagrancy determination based on the fact of such contributions.

However, despite the progress over the course of several meetings, we have not obtained agreement on several key issues:¹⁶

- While the IRS has incorporated several examples of flagrant conduct in the IRM based on discussions with TAS, it refuses to provide a clear and unambiguous definition of such conduct. As a result, the decision as to whether a taxpayer is flagrant is still dependent upon the subjective judgment of individual revenue officers relying on IRM examples.
- The IRS continues to resist incorporating risk analysis in the retirement levy determination and adopting a standardized Area Director Approval Memorandum to be uploaded into the ICS history.
- The IRS has not agreed to document the taxpayer's ability to pay determination in the ICS history. The determination should be based on a calculation of whether the taxpayer depends on the money in the retirement account for necessary living expenses in retirement and provide the taxpayer an opportunity to respond to those calculations.

The IRS Should Adopt a “Retirement Needs” Calculator Based on a Theoretical Model Developed by TAS

The IRS refused to adopt the National Taxpayer Advocate's recommendation to identify calculators that it can use, such as those provided by the Social Security Administration (SSA) or TSP, to determine the impact of a levy on a retirement account on the taxpayer's future well-being or, in the alternative, create its own calculator.¹⁷ We remain concerned that there is inadequate instruction to employees for analyzing future retirement calculations. Collection employees are instructed to use the standards in IRM 5.15, *Financial Analysis*, to establish necessary living expenses and the life expectancy tables in Publication 590-B, *Distributions From Individual Retirement Arrangements (IRAs)*, to estimate how much can be withdrawn annually to deplete the retirement account in the taxpayer's remaining life.¹⁸ However, these instructions are silent on what type of calculators to use to determine when funds will be depleted. In addition to the variety of methods that could be used by different revenue officers, the IRM is silent on

16 TAS teleconferences with Small Business/Self-Employed Collection Policy, call notes (May 16 and June 10, 2016) (on file with TAS). See also National Taxpayer Advocate 2017 Objectives Report to Congress vol. 2 (IRS Responses and National Taxpayer Advocate's Comments Regarding Most Serious Problems Identified in 2015 Annual Report to Congress; anticipated publication late July 2016, www.TaxpayerAdvocate.irs.gov/2017ObjectivesReport).

17 See also National Taxpayer Advocate 2017 Objectives Report to Congress vol. 2 (IRS Responses and National Taxpayer Advocate's Comments Regarding Most Serious Problems Identified in 2015 Annual Report to Congress; anticipated publication late July 2016, www.TaxpayerAdvocate.irs.gov/2017ObjectivesReport).

18 IRM 5.11.6.2(7) (Sept. 26, 2014). When conducting this financial analysis, employees are reminded to consider special circumstances that may be present on a case-by-case review.

factoring any growth in retirement funds or projecting future increases in necessary living expenses. TAS has created a theoretical model of a “retirement needs” calculator, which includes the following steps in determining the taxpayer’s current or near future need for retirement assets to meet necessary living expenses:

- (1) Calculate the taxpayer’s necessary living expenses using IRM 5.15, *Financial Analysis*; ¹⁹
- (2) Calculate the taxpayer’s life expectancy using Publication 590-B, *Distributions From Individual Retirement Arrangements (IRAs)* and the number of months retirement income will be required;
- (3) Calculate the taxpayer’s future SSA benefits (if applicable) using SSA documentation provided by the taxpayer or the SSA Quick Calculator;²⁰
- (4) Calculate monthly income required from taxpayer’s retirement assets to meet necessary living expenses, which equals income from all sources other than the retirement assets considered for levy minus necessary living expenses; and
- (5) Calculate the number of monthly distributions from retirement assets until they are depleted using the TSP Retirement Income Calculator.²¹

TAS is offering its assistance to the IRS in developing a retirement needs calculator based on this theoretical model.

TAS Will Evaluate the Results of the TSP Levy Pilot Project the IRS Had Completed Within the Automated Collection System

The IRS started a pilot program on January 18, 2016, which allowed its Automated Collection System (ACS) to issue levies on TSP accounts.²² The TSP Levy Pilot ended May 20, 2016.²³ Under ACS, cases are assigned to teams, functions, or units rather than individual employees.²⁴ It is a computer system that “analyzes for levy sources, undeliverable mail codes, telephone numbers, and other characteristics” in place of an employee. The computer system also “prints letters for mailing and assigns cases to the proper team, function, or units,” while a “small percentage of cases meeting specific criteria” are researched by the ACS Support function.²⁵ ACS does not routinely initiate outgoing calls to taxpayers. Correspondence submitted by a taxpayer to ACS is processed by ACS Support.²⁶

As written, the pilot procedures provided fewer safeguards to taxpayer rights than the current IRM guidance for levying on retirement accounts generally.²⁷ For instance, the procedures treated taxpayers

19 Calculate current necessary living expenses without factoring future growth or inflation. Allow for known increases (i.e., health insurance or medical costs certain to increase upon retirement).

20 Calculate SSA income without factoring future growth or inflation. See SSA Quick Calculator, <https://www.ssa.gov/OACT/quickcalc/index.html>.

21 Calculate retirement income without factoring future growth or inflation. See TSP Retirement Income Calculator, <https://www.tsp.gov/PlanningTools/Calculators/retirementCalculator.html>. The calculator indicates annual year-end balances. If retirement funds are not fully depleted by end of life expectancy the remaining balance would be available for levy.

22 ACS is a computerized system that maintains balance-due accounts and return delinquency investigations. IRM 5.19.5.2, *What Is ACS?* (Aug. 20, 2013). TSP is a retirement plan for federal employees established under 5 U.S.C. § 8437.

23 SERP Alert 16A0178 (May 25, 2016).

24 IRM 5.19.5.3, *Research on ACS* (May 2, 2016).

25 *Id.*

26 IRM 5.19.6.1, *ACS Support Overview/What Is ACS Support* (June 17, 2014).

27 IRS, *ACS TSP Levy Pilot Procedures* (Dec. 9, 2015).

in ACS differently from taxpayers working with a revenue officer.²⁸ Under the pilot procedures, the IRS employee's financial analysis was restricted to these two elements:

- Document if there is any information that retirement is impending and that the taxpayer will be relying on funds in the TSP for necessary living expenses. The employee is instructed to use available information to apply the standards in IRM 5.19.13.1.4 and Publication 590-A. If this documentation is present, do not issue the TSP levy; and
- Consider any special circumstances in the taxpayer's situation, such as extraordinary expenses, or additional sources of income, including spousal income and assets, other retirement accounts, *etc.* that will be available to pay expenses during retirement.²⁹

There was no mention of reviewing IRM 5.15, *Financial Analysis*, which is a requirement for revenue officers under IRM 5.11.6.2(7). These procedures introduced considerations not found in IRM 5.11.6.2(7), such as imputing spousal income into the financial analysis.³⁰

The pilot included 244 taxpayers, none of whom received a levy.³¹ One hundred thirty taxpayers were not considered for a TSP levy because of an ongoing Federal Payment Levy Program (FPLP) levy or because the TSP account was owned by a non-liable spouse.³² A TSP levy was considered on the remaining 114 taxpayers. Most of the remaining cases had some sort of resolution, such as being placed in CNC status or entering into an installment agreement.³³ Several cases included non-liable spouse and identity theft issues.³⁴ The pilot results confirm the importance of the taxpayer contact and direct communications with the IRS to resolve a taxpayer's debt:

The majority of the cases where contact was made resulted in the taxpayer being granted a new installment agreement.... Making contact with the taxpayer over the phone proved to be an effective tool in eliminating the case from TSP levy consideration on 33 of the 35 cases.³⁵

Regardless, the IRS has not yet made the decision as to whether TSP account levies will be a permanent part of ACS operations, which does not routinely initiate outgoing calls to taxpayers.³⁶

In order to measure the success of the pilot, the IRS has prepared a data collection instrument (DCI) so that all cases can be reviewed consistently using the same criteria. The IRS did not articulate why TSP accounts were singled out from other retirement accounts or how success of the pilot would be measured.³⁷ While the National Taxpayer Advocate is pleased that the IRS did not levy on any of the taxpayers' TSP accounts, she is concerned that the IRS may consider levying TSP accounts of taxpayers who already have an FPLP levy in place if the TSP levy becomes operational in ACS.³⁸

28 IRS, *ACS TSP Levy Pilot Procedures* (Dec. 9, 2015).

29 *Id.*

30 *Id.*

31 *TSP Levy Pilot Report* (June 8, 2016).

32 *Id.*

33 *Id.* However, only 97 of the remaining 114 cases were resolved.

34 TAS teleconference with W&I (May 23, 2016) (call notes on file with TAS). See also *TSP Levy Pilot Report* (June 8, 2016).

35 *TSP Levy Pilot Report 7* (June 8, 2016).

36 Email from Director, Collection Inventory Delivery and Selection to TAS (June 14, 2016).

37 National Taxpayer Advocate 2015 Annual Report to Congress 108–09.

38 *TSP Levy Pilot Report 3* (June 8, 2016).

The DCI used for the IRS's review included several questions that indicate the IRS was trying to determine if ACS is adequate to issue TSP levies. The adequacy of using ACS to issue retirement levies is a serious concern because ACS operates in a production environment where employees are trained to conduct simple financial analysis. This training does not include the complex collection alternatives such as offers in compromise or more sophisticated installment agreements that may be necessary to address a taxpayer's debt without relying on a TSP levy. Some pertinent questions on the DCI include:

- If a message was left for the taxpayer, did the taxpayer return the call?
- Did the ACS employee find a new address for the taxpayer?
- Does the taxpayer have other available assets?
- Is the taxpayer dependent on the TSP account for living expenses?
- Are there extenuating circumstances?
- In cases where the levy was issued, did it receive managerial approval?

TAS was not consulted in the drafting of this DCI. As stated above, from the perspective of the National Taxpayer Advocate, the IRS should devise a process to resolve the outstanding tax debt with taxpayer communication and collection alternatives, without resorting to a TSP levy. The DCI used by the IRS missed this mark of success in several ways. TAS believes that the IRS should have asked the following questions when reviewing the pilot cases:

- Does the case history indicate any notification to the taxpayer that continued contributions while owing a tax liability could be interpreted as flagrant behavior?³⁹
- Did the taxpayer make prior attempts to contact the IRS?
- How long did the taxpayer stay in the Queue, if at all?
- In cases where the taxpayer returned a call from ACS, was the taxpayer informed of collection alternatives?
- Did the taxpayer report any obstacles trying to communicate with ACS?

Without this additional review of the pilot cases in collaboration with TAS, the IRS should not proceed with making TSP levies operational in ACS, let alone imposing TSP levies on retirement accounts of the taxpayers subjected to the FPLP levy.⁴⁰

39 ACS employees were instructed to inform taxpayers that they should not continue making TSP contributions to avoid a flagrant determination that may lead to a TSP levy. *TSP Levy Pilot Report* 11, 13 (June 8, 2016).

40 When a taxpayer is paying tax debt via an automated FPLP levy, the IRS cannot come to a determination that the taxpayer is flagrant. A reasonable taxpayer might be under the impression that the 15 percent FPLP levy was a monthly installment plan.

FOCUS FOR FISCAL YEAR 2017

In Fiscal Year 2017, TAS will continue to:

- Review the TSP levy cases upon receiving TSP pilot results based on the DCI prepared by the IRS and the additional questions indicated above;
- Work with the IRS to improve the internal guidance and to resolve the remaining disagreements;
- Conduct a training for TAS employees;
- Develop a calculator that will enable Collection and TAS employees to estimate the impact of the levy on the taxpayer's ability to provide for his or her expenses in retirement; and
- Issue interim guidance to TAS employees setting forth how they should assist taxpayers in cases involving levies on retirement accounts, including evidence rebutting any flagrancy determination and the calculation of basic retirement living expenses.