

Area of Focus #9 The IRS Has Improved Its Internal Guidance for Retirement Levies But More Can Be Done

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- *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*

DISCUSSION

Americans are facing a crisis in saving for retirement. Forty-five percent of all working-age households have no retirement account assets.² The situation is particularly bleak for low income individuals. In one survey, 94 percent of respondents with a family income over \$100,000 reported having some retirement savings while among respondents making under \$40,000 per year, only 44 percent had any retirement savings.³ Stagnant wages and burgeoning student loan debt, for both students and their parents, may be responsible for low levels of retirement savings.⁴ The National Institute on Retirement Security points out that it is “highly unlikely that most individuals and households will be able to fill such a large retirement income gap by themselves” and suggests that public policy could play a “critical role” in addressing this retirement shortfall.⁵

While any collection action taken by the IRS can affect a taxpayer, levies on assets in retirement accounts may have a particularly negative effect on a taxpayer's future well-being.⁶ As a result, the IRS must balance the need for efficient collection of tax with the public policy that encourages saving for

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are now listed in the Internal Revenue Code (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 National Institute on Retirement Security, *The Continuing Retirement Savings Crisis* 8 (Mar. 2015).

3 Board of Governors of the Federal Reserve System, *Report on the Economic Well-Being of U.S. Households in 2015* 59-61 (May 2016). The lack of retirement savings is better understood by considering that only 54 percent of respondents to the same survey reported that they could “fairly easily handle” a hypothetical emergency expense of \$400. Board of Governors of the Federal Reserve System, *Report on the Economic Well-Being of U.S. Households in 2015* 22 (May 2016). Women and minorities also face lower levels of saving for retirement. Joint Economic Committee, Ranking Democrat Carolyn B. Maloney, *Social Security and Retirement Savings in the United States* (Aug. 2016).

4 Abha Bhattarai, *Two-Thirds of Americans Aren't Using This Easy Way to Save For Retirement*, WASH. POST., Feb. 22, 2017.

5 National Institute on Retirement Security, *The Continuing Retirement Savings Crisis* 17 (Mar. 2015).

6 In some instances, a taxpayer can experience additional harm on top of losing the contents of his or her retirement account. First, pursuant to IRC § 408(d), generally, the entire amount paid from a retirement account or any distribution, is considered gross income and is subject to taxation. The payor is generally required to withhold twenty percent. IRC § 3405(c)(1). However, IRS offers no withholding guidance with the levy issued to payors. In some instances, payors fail to withhold and taxpayers have no resources to pay the tax liability created by the distribution. The taxpayer may be liable for a state income tax as well. TAS is working on a project that will look to provide better guidance to payors so that under withholding can be avoided.

retirement.⁷ The National Taxpayer Advocate previously raised several concerns regarding the inadequacy of IRS internal guidance related to levies on retirement accounts.⁸

Internal Revenue Code (IRC) § 6331 gives the IRS the right to levy on a taxpayer's property and rights to property, including funds held in retirement accounts.⁹ As an acknowledgement that retirement account levies can impact a taxpayer's future well-being, the IRS's internal guidance requires three steps to be taken before the IRS 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, and if there is property other than retirement assets that can be used to collect the liability, or if a payment agreement can be reached, these alternatives are considered before issuing a levy on retirement assets;
2. Determine whether the taxpayer's conduct has been flagrant; and
3. Determine whether the taxpayer depends on the money in the retirement account (or will in the near future) for necessary living expenses.¹⁰

The IRS Has Taken Steps to Improve Internal Guidance, Thereby Ensuring Cases With Retirement Levies Receive Consistent Analysis

One of the National Taxpayer Advocate's main concerns with retirement levy cases is the lack of internal guidance provided to employees. For instance, IRS employees are instructed to make a determination of flagrancy on a case-by-case basis and may consider extenuating circumstances that mitigate otherwise flagrant behavior.¹¹ However, there is no on-point definition of what constitutes "flagrant" behavior in the IRC, accompanying regulations, or the Internal Revenue Manual (IRM).

The IRS Created Guidance for Considering Extenuating Circumstances

To its credit, the IRS has worked with TAS to address some concerns with how the determination to levy a retirement account impacts taxpayer rights.¹² For instance, through discussions, the IRS agreed to provide guidance on what constitutes an extenuating circumstance. The IRS now provides guidance to employees that extenuating circumstances are "at times situations beyond the control of taxpayers."¹³ Examples of extenuating circumstances include illness, loss of employment, a personal loss (family or loved one), identity theft or return preparer misconduct, and "natural acts of nature."¹⁴

7 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).

8 National Taxpayer Advocate 2015 Annual Report to Congress 100-11; National Taxpayer Advocate 2015 Annual Report to Congress 340-45 (Legislative Recommendation: *Levies On Retirement Accounts: Amend IRC § 6334 to Include a Definition of Flagrancy and Require Consideration of Basic Living Expenses at Retirement Before Levying on Retirement Accounts*); National Taxpayer Advocate Fiscal Year 2016 Objectives Report to Congress 53-58.

9 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).

10 IRM 5.11.6.2(4) - (7) (June 14, 2016).

11 IRM 5.11.6.2(5) (Revision June 14, 2016).

12 National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress 94-101.

13 IRM 5.11.6.2(5) (June 14, 2016).

14 *Id.*

IRS Guidance Now Encourages Communication With the Taxpayer Prior to Levy Action

The National Taxpayer Advocate has also called for more taxpayer education around the issue of retirement levies. The IRS recently adopted guidance which promotes greater communication with taxpayers prior to a levy on their retirement account. Guidance to IRS employees reads: “Prior to levy, attempt to advise taxpayers that contributions to voluntary retirement plans are not a necessary expense.”¹⁵ Most importantly, taxpayers will be informed that continuing to make voluntary contributions to retirement accounts, while asserting an inability to pay an amount that is owed, may be considered flagrant conduct, and could result in a levy on retirement accounts.¹⁶ However, the IRS is not prohibited from making the determination to levy on a retirement account if this conversation does not take place.¹⁷

The IRS Can Do More to Improve Internal Guidance for Retirement Levies

A Definition of Flagrancy Is Still Needed

The IRS cannot levy on a taxpayer’s retirement account unless the IRS determines the taxpayer has exhibited flagrant conduct.¹⁸ Unfortunately, the IRS guidance in this area does not include a definition of what constitutes flagrant conduct. The IRS explains flagrant conduct through a list of examples.¹⁹

Through negotiation with TAS, the IRS recently agreed to strengthen the examples of flagrant conduct. For example, the IRS considers a taxpayer to be exhibiting flagrant conduct if he or she either voluntarily contributes to a retirement account during the time period he or she knew unpaid taxes were accruing, or the taxpayer continues to make voluntary contributions to retirement accounts while asserting an inability to pay an amount that is owed.²⁰ The IRS has added a note to its internal guidance to explain that if a taxpayer verifies he or she has been automatically enrolled to have a limited percentage of his or her basic pay deducted and deposited into a retirement account, this should not be considered flagrant conduct.²¹ However, the IRS continues to refuse to provide a definition of flagrant conduct.²²

The National Taxpayer Advocate believes that without a definition of flagrant conduct, taxpayers do not know what they need to do to comply with tax laws, which diminishes the *right to be informed*. The National Taxpayer Advocate believes a definition of flagrant conduct is essential to proper analysis of these cases and will continue to advocate for a definition of flagrancy that includes a willful action (or failure to act) which is voluntarily, consciously, and knowingly committed, and which appears to a reasonable person to be a gross violation of tax laws.²³

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15 IRS, Director, Collection Policy, *Interim Guidance for Revenue Officers regarding Levies on Retirement Plans* (Jan. 13, 2017); IRM 5.15.1.27(2) (Jan. 23, 2017).

16 *Id.*

17 *Id.*

18 IRM 5.11.6.2(5) (June 14, 2016).

19 IRM 5.11.6.2(6) (June 14, 2016).

20 *Id.*

21 *Id.*

22 National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress vol. 2, 59.

23 National Taxpayer Advocate 2015 Annual Report to Congress 341.

The IRS Has Changed Policy to Allow Retirement Levies at the Request of Taxpayers

Prior to June 2016, the IRS specifically did not levy on retirement accounts at the request of taxpayers.²⁴ The guidance read, in part:

Because of the exception to the 10 percent additional tax made on account of a levy, occasionally taxpayers may ask the Service to levy the funds in the retirement accounts. Even though the taxpayer may be able to voluntarily withdraw money in a lump sum from a retirement account and apply it to the outstanding tax liability, do not levy on retirement assets at the request of the taxpayer.²⁵

However, against the recommendation of TAS, the IRS has implemented a change in policy that allows taxpayers to “request” retirement levies. This change goes directly against the policy mentioned above that treats retirement levies as special cases, requiring the three-step analysis, including the determination of flagrant conduct. If a taxpayer requests a levy on his or her retirement account, the guidance now requires that the IRS employee analyze what other assets are available for levy and determine whether the taxpayer needs the retirement assets for necessary living expenses.²⁶ Notably, IRS employees are instructed to *not* make a determination of flagrant conduct, which is otherwise necessary prior to levying on a retirement account.²⁷ To its credit, the IRS accepted a TAS recommendation to make sure the taxpayer’s request is in writing and recorded in the case history.²⁸

In practice, it will not be as simple as the taxpayer choosing to pay his or her debt with a retirement account. The IRS employee will consider the retirement account while conducting his or her financial analysis under IRM 5.15.1.1, which provides the “basis for determining a taxpayer’s ability to pay delinquent tax liabilities, which enables Collection employees to make appropriate collection decisions to resolve cases.”²⁹ Once the retirement account is part of the analysis, a conversation about liquidating the asset can occur without regard to a flagrancy determination.

The IRS justified this change in policy by arguing that all taxpayers should be able to avoid the early withdrawal penalty, not just those taxpayers who receive an IRS levy on their retirement account.³⁰ While a “voluntary” levy may appear to be an attractive tool for taxpayers who want to avoid the additional ten percent tax on retirement distributions before the age of 59½, TAS is concerned that the special analysis that protects retirement accounts will be lost through this new procedure.

Furthermore, taxpayers may not realize the long-term tradeoff they are making when they request this option. The potential for abuse in this area is enormous. Since IRS employees are instructed to “emphasize to the taxpayer how much the Service expects from them rather than how the Service expects them to spend their money,” it is easy to see how in the normal course of working a collection case, the existence of a retirement account will now become part of a financial analysis stripped of the necessary flagrancy determination.³¹ The typical taxpayer will feel pressure to give up his or her retirement account

24 Generally, there is a ten percent additional tax on early distributions from a qualified retirement plan, but this additional tax does not apply to distributions made from an account because of an IRS levy. IRC § 72(t)(2)(A)(vii).

25 IRM 5.11.6.2(3) (Sept. 26, 2014).

26 IRM 5.11.6.2(3) (June 14, 2016).

27 *Id.*

28 *Id.*

29 IRS response to TAS information request (Mar. 24, 2017).

30 *Id.*

31 IRM 5.15.1.1(11) (Nov. 17, 2014).

when it is part of a financial analysis and the IRS employee cannot establish flagrant conduct on the part of the taxpayer. This undermines the entire public policy protection of retirement accounts.

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

TAS remains 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.³² 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 additionally silent on factoring any growth in retirement funds or projecting future increases in necessary living expenses. TAS has created a proposed model of a “retirement needs” calculator. See Figures 1.9.1 and 1.9.2 in Appendix A immediately following for the calculator and accompanying example. TAS is offering its assistance to the IRS in developing a retirement needs calculator based on this theoretical model.

CONCLUSION

Congress has granted the IRS the ability to levy on retirement accounts. However, given the low levels of retirement savings and the impact this will have on Americans’ retirement, the IRS should exercise this option only when the taxpayer’s behavior is flagrant and where the levy will not place the taxpayer in a situation where he or she cannot function in retirement. Adopting a definition of flagrant conduct and the use of a retirement calculator, such as the one TAS proposes, will allow for sufficient analysis prior to levying on a retirement account.

FOCUS FOR FISCAL YEAR 2018


In Fiscal Year 2018, TAS will:

- Issue an Internal Guidance Memorandum to TAS employees regarding effective advocacy in retirement levy cases, including the use of the retirement calculator in TAS cases, the National Taxpayer Advocate’s proposed definition of flagrant conduct, and pushing back against “voluntary” levies;
- Conduct training for TAS employees so they can effectively advocate in cases involving retirement levies, particularly with respect to the taxpayer’s financial security in retirement, whether the taxpayer’s conduct is flagrant, and undue pressure on taxpayers to consent to “voluntary” levies;
- Work with the IRS to improve internal guidance by developing a definition for flagrant conduct;
- Issue a Taxpayer Advocate Directive ordering the use of the retirement calculator; and
- Draft better guidance for payers so that problems with insufficient withholdings can be avoided for taxpayers who receive a levy on their retirement accounts. TAS will encourage the IRS to publish the improved guidance.

32 IRM 5.11.6.2(7) (June 14, 2016). When conducting this financial analysis, employees are reminded to consider special circumstances that may be present on a case-by-case review.

APPENDIX A

FIGURE 1.9.1, Calculating the Need for Retirement Assets



CALCULATING THE NEED FOR RETIREMENT ASSETS

When IRS considers levy of a taxpayer’s retirement account assets, Internal Revenue Manual 5.11.6.2(7), *Funds in Pension or Retirement Plans*, states the IRS must “determine whether the taxpayer depends on the money in the retirement account (or will in the near future) for necessary living expenses.” The guidance in making this determination is limited.

This document provides a consistent method for calculating the need for retirement account assets to advocate for a taxpayer whose retirement account assets have been levied or are under the threat of levy. The method can be used to verify or challenge the IRS determination.¹

Five Steps for Calculating the Need for Retirement Assets	
1	<p>Calculate the taxpayer’s necessary living expenses. See Collection Financial Standards² and Internal Revenue Manual 5.15, <i>Financial Analysis</i>.³</p>
2	<p>Calculate the taxpayer’s life expectancy. See Life Expectancy Tables in the appendices of Publication 590-B, <i>Distributions From Individual Retirement Arrangements (IRAs)</i> at www.irs.gov (updated annually). Use the life expectancy to determine the number of months income from retirement assets will be required.</p>
3	<p>Calculate the taxpayer’s future Social Security Administration (SSA) benefits (if the taxpayer is eligible). See the SSA Quick Calculator.⁴</p> <p>CAUTION: The SSA Quick Calculator is the least accurate method to estimate benefits. Encourage the taxpayer to secure an estimate by creating an online account at www.ssa.gov or by using the Retirement Estimator on that site. These calculators use the taxpayer’s actual income rather than estimates used by the Quick Calculator.</p>
4	<p>Calculate the monthly income that is required from the taxpayer’s retirement assets to meet necessary living expenses. Total income from all sources other than the retirement assets considered for levy, then subtract necessary living expenses.</p>
5	<p>Calculate the number of monthly distributions from retirement assets until they are depleted.⁵ See Retirement Income Calculator.⁶</p> <p><i>Note: 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.</i></p>

¹ The method in this document factors no growth in retirement assets or inflation of necessary living expenses. Attempting to estimate these future financial uncertainties would include too many variables to ensure a consistent application for all taxpayers.

² <https://www.irs.gov/businesses/small-businesses-self-employed/collection-financial-standards>.

³ Calculate current necessary living expenses without factoring future growth or inflation. Allow for known increases (e.g., health insurance or medical costs certain to increase upon retirement).


⁴ Calculate SSA income without factoring future growth or inflation. <https://www.ssa.gov/OACT/quickcalc/index.html>.

⁵ Calculate retirement income without factoring future growth or inflation.

⁶ The calculator assumes funds are in a Thrift Savings Plan but can be used for any type of retirement account assets. <https://www.tsp.gov/PlanningTools/Calculators/retirementCalculator.html>.

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FIGURE 1.9.2, Calculating the Need for Retirement Assets – Case Example



CALCULATING THE NEED FOR RETIREMENT ASSETS

Case Example

Assumptions About the Taxpayer

- Age 61, single, no dependents, and his date of birth is December 31, 1954.
- A wage earner, with no defined benefit retirement plan.
- Current annual wage income is \$75,000.
- Plans to retire December 31, 2016, upon turning age 62.
- Owns a 401k account with a current balance of \$250,000 and an Individual Retirement Arrangement with a current balance of \$50,000.
- Owns no real property, rents an apartment, and owns one auto with a loan balance and no equity.
- Health care expenses are \$300 per month. Health insurance will increase \$32 per month upon retirement.
- Estimated tax on retirement account withdrawals is \$68 per month.

Five Steps for Calculating the Need for Retirement Assets

1 Calculate the taxpayer's necessary living expenses. See [Collection Financial Standards¹](#) and Internal Revenue Manual 5.15, *Financial Analysis*.²

The example assumes Form 433A, *Collection Information Statement for Wage Earners and Self-Employed Individuals*, has been completed and the current monthly allowable necessary living expenses are \$2,968.³

2 Calculate the taxpayer's life expectancy. See Life Expectancy Tables in the appendices of Publication 590-B, *Distributions From Individual Retirement Arrangements (IRAs)* at www.irs.gov (updated annually). Use the life expectancy to determine the number of months income from retirement assets will be required.

Publication 590-B, Table I shows a life expectancy of 24.4 years (292 months) for the taxpayer's current age of 61. Therefore, upon retirement in seven months, the taxpayer's income must meet his necessary living expenses for 23 years and nine months (285 months).


¹ <https://www.irs.gov/businesses/small-businesses-self-employed/collection-financial-standards>.

² Calculate current necessary living expenses without factoring future growth or inflation. Allow for known increases (e.g., health insurance or medical costs certain to increase upon retirement).

³ To make an accurate comparison of living expenses and income, this example uses today's dollars for necessary living expenses with no future growth rate.

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FIGURE 1.9.2, Calculating the Need for Retirement Assets – Case Example (continued)



CALCULATING THE NEED FOR RETIREMENT ASSETS

3 Calculate the taxpayer's future Social Security Administration (SSA) benefits (if the taxpayer is eligible). See the [SSA Quick Calculator](#).⁴

CAUTION: The SSA Quick Calculator is the least accurate method to estimate benefits. Encourage the taxpayer to secure an estimate by creating an online account at www.ssa.gov or by using the Retirement Estimator on that site. These calculators use the taxpayer's actual income rather than estimates used by the Quick Calculator.

The SSA calculator shows the taxpayer's monthly benefits to be \$1,394, beginning age 62.⁵

4 Calculate the monthly income that is required from the taxpayer's retirement assets to meet necessary living expenses. Total income from all sources other than the retirement assets considered for levy, then subtract necessary living expenses.

Monthly necessary living expenses (\$2,968) plus anticipated monthly health insurance increase (\$32) minus monthly SSA benefits (\$1,394) equals monthly income required from retirement assets (\$1,606).

5 Calculate the number of monthly distributions from retirement assets until they are depleted.⁶ See [Retirement Income Calculator](#).⁷

Note: 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.

The Retirement Income Calculator shows the monthly distributions of \$1,606 would be depleted in 15 years and seven months (187 months), which is 98 months short of the taxpayer's expected life span.⁸ Therefore, the retirement account assets should not be levied upon.

⁴ Calculate SSA income without factoring future growth or inflation. <https://www.ssa.gov/OACT/quickcalc/index.html>.

⁵ The Social Security Administration Quick Calculator allows the user to estimate today's dollars or inflated (future) dollars. To make an accurate comparison of living expenses and income, this example uses today's dollars.

⁶ Calculate retirement income without factoring future growth or inflation.

⁷ The calculator assumes funds are in a Thrift Savings Plan but can be used for any type of retirement account assets. <https://www.tsp.gov/PlanningTools/Calculators/retirementCalculator.html>.

⁸ The Thrift Savings Plan Retirement Income Calculator allows the user to estimate an annual rate of return to include in the projected earnings. In order to make an accurate comparison of living expenses and income, this example uses zero percent annual rate of return.

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