

Legislative Recommendation #17**Amend IRC § 6402(a) to Prohibit Offset of the Earned Income Tax Credit Portion of a Tax Refund****PRESENT LAW**

IRC § 6343(a)(1)(D) requires the Secretary to release a levy if she determines the levy “is creating an economic hardship due to the financial condition of the taxpayer.”

IRC § 7122 authorizes the IRS to accept offers in compromise and requires the Secretary to publish guidelines for evaluating offers to ensure “that taxpayers entering into a compromise have an adequate means to provide for basic living expenses.”

IRC § 6402(a) generally authorizes the IRS to offset a taxpayer’s refund and apply it to satisfy a prior-year federal tax liability, but it does not require the IRS to do so. For taxpayers who are experiencing an economic hardship, the IRS may “bypass” the offset and issue the refund to the taxpayer.¹ This is referred to as an “offset bypass refund” (OBR).² The timeframe for requesting an OBR is narrow. The IRS must approve an OBR between the date the return is filed and the date the IRS assesses the tax shown on the return. This period is approximately ten to 20 days when a return is filed electronically.³ Once an offset has taken place, the IRS does not have the legal authority to pay the refund even if a taxpayer can demonstrate economic hardship.

The Earned Income Tax Credit (EITC) is a refundable credit for low-income working individuals and families.⁴ For tax year 2020, the maximum amount of the credit was \$6,660 for a family consisting of one adult with three children and earning between \$14,800 and \$19,349.⁵ The EITC is claimed on a tax return and is included in the computations that determine whether a taxpayer is entitled to receive a refund and, if so, the amount of the refund. Therefore, when a refund is offset to satisfy a prior-year federal tax liability, the taxpayer will not receive some or all of the EITC for which he or she is otherwise eligible.

REASONS FOR CHANGE

Congress created the EITC to provide financial support for low-income individuals and families, enhance workforce participation, and reduce poverty. It enacted such statutes as IRC §§ 6343(a)(1)(D) and 7122, to protect taxpayers from IRS collection actions where these actions would leave a taxpayer unable to pay his or her basic living expenses. To determine whether a collection action would leave a taxpayer in that position, the IRS publishes schedules of national and local allowances annually known as “Allowable Living Expenses” (ALEs). The IRS generally will refrain from taking collection actions if it determines that a taxpayer’s ALEs are less than the taxpayer’s income. However, the IRS may continue to offset refunds the taxpayer claims on a return, unless the taxpayer knows to request an OBR.

The OBR process is obscure and difficult to navigate. OBRs may only be approved during the short timeframe between the date a tax return is filed and the date the tax is assessed – typically, ten to 20 days.

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- 1 Treas. Reg. § 301.6343-1(b)(4)(i) provides that an economic hardship exists when an IRS action would cause an individual taxpayer to be unable to pay his or her reasonable basic living expenses.
 - 2 However, if the taxpayer has non-tax federal debts, past due child support, or state income tax or unemployment compensation debts, the IRS must make an offset with respect to those liabilities. See IRC § 6402(c) & (d).
 - 3 With the IRS transitioning to CADE 2, this period will become shorter. Internal Revenue Manual 21.2.1.4, Customer Account Data Engine 2 (CADE 2) (Jan. 4, 2012), explains in paragraph (2) that some of the benefits of CADE 2 are daily transaction posting and quicker refunds.
 - 4 IRC § 32.
 - 5 IRS, Pub. 596, Earned Income Credit (EIC) 34 (Jan. 26, 2021).

In fiscal year 2021, only 511 taxpayers received OBRs.⁶ Particularly during the last two years when many Americans have been struggling financially due to the COVID-19 pandemic, significantly more taxpayers could have benefited from an OBR but did not know to request one.

Consistent with congressional intent that the IRS refrain from taking collection actions that will impose economic hardships on taxpayers, the National Taxpayer Advocate recommends that Congress prohibit the IRS from offsetting the portion of a taxpayer's refund attributable to the EITC. While EITC eligibility is not the sole indicator of economic hardship, it provides a good approximation because the credit is only available to taxpayers whose incomes are below a specified threshold. The credit in tax year 2020 plateaued at \$538 for a single taxpayer with no qualifying children who earned between \$7,000 and \$8,749. The same credit plateau applied to married taxpayers filing jointly with no qualifying children who earned between \$7,000 and \$9,200. For a single taxpayer with three qualifying children earning between \$14,800 and \$19,349, the credit plateaued at \$6,660.⁷

Using the EITC as a proxy for economic hardship for purposes of OBR eligibility will also eliminate the administrative burden the current process imposes on both taxpayers, who have to produce substantiation of hardship, and the IRS, which must review each request on a case-by-case basis. To be clear, we are not recommending that the full refund be released – just the amount attributable to the EITC. Programming would be straightforward, rendering it easily administrable.⁸

RECOMMENDATION

- Amend IRC § 6402(a) to prohibit offset of the EITC portion of a taxpayer's refund to satisfy prior-year tax liabilities.

6 IRS, Compliance Data Warehouse, Individual Master File Transaction History table (data as of Oct. 28, 2021).

7 IRS, Pub. 596, Earned Income Credit (EIC) 32-34 (Jan. 26, 2021).

8 The Section of Taxation of the American Bar Association (ABA) has also advocated for a prohibition against offsetting the refunds of EITC recipients. It recently wrote: "OBRs are narrow in the relief they provide, typically only resulting in a payment of the amount of the specifically demonstrated past due bill or other emergency. This might provide only temporary relief when the taxpayer's hardship is a recurring expense, or when the hardship is one that is not easily quantified (for example, food insecurity)." ABA, Comments Regarding Review of Regulatory and Other Relief to Support Taxpayers During COVID-19 Pandemic (Jan. 15, 2021), <http://www.americanbar.org/content/dam/aba/administrative/taxation/policy/2021/011521comments.pdf> (footnote omitted).