

Legislative Recommendation #19**Require the IRS to Release All Levies Upon Acceptance of an Offer in Compromise and Return to the Taxpayer Any Amount Collected Pursuant to the Levies in Excess of the Agreed Payment Amount****SUMMARY**

- *Problem:* When the IRS considers a taxpayer's application for an offer in compromise (OIC), it generally computes the maximum amount it believes the taxpayer can afford to pay while still leaving the taxpayer with enough funds to pay for his or her basic living expenses, such as food, shelter, and clothing. In some cases, the IRS collects more than the agreed amount stipulated in the OIC through a continuous levy or a levy on a taxpayer's fixed and determinable right to payment, potentially leaving the taxpayer without enough funds to pay for basic living expenses.
- *Solution:* Require the IRS to release all levies when an OIC is accepted and to return to the taxpayer any amounts collected by levy in excess of the accepted offer amount.

PRESENT LAW

IRC § 7122 authorizes the IRS to compromise tax liabilities and, in doing so, to make allowances to ensure that taxpayers are left with "an adequate means to provide for basic living expenses."¹ OICs are a routinely-used vehicle for addressing these tax liabilities.

IRC § 6331 authorizes the IRS to levy on a taxpayer's property and rights to property to collect a tax liability, following notice and demand. Under IRC § 6331(b), "a levy shall extend only to property possessed and obligations existing at the time thereof." However, a levy may attach to future payments where the IRS issues a continuous levy on salary and wages,² or issues a levy on certain federal payments,³ or on a fixed and determinable right to payment.⁴

IRC § 6331(k)(1) and Treas. Reg. § 301.7122-1(g)(1) provide that the IRS will not levy against the property or rights to property of the taxpayer while an OIC is pending, during the 30 days following rejection of the OIC, or during a timely appeal of the rejection decision. But where a levy that attaches to future payments is already in place, the IRS takes the position that it is not legally prohibited from continuing to collect through the levy, even after an OIC is pending or accepted.⁵ Further, the IRS takes the position that it has no obligation to repay amounts collected under such levies, even if the amounts collected ultimately exceed the amount agreed to in the OIC, because the levy payments do not create overpayments.⁶

REASONS FOR CHANGE

When a taxpayer submits and the IRS accepts an OIC, the agreement generally reflects an IRS determination that the OIC amount is the maximum payment the taxpayer can afford to make while still retaining enough funds to pay his or her basic living expenses. Prior to accepting an OIC, the IRS carefully reviews and

1 IRC § 7122(d).

2 IRC § 6331(e).

3 IRC § 6331(h).

4 Treas. Reg. § 301.6331-1; Treas. Reg. § 301.6343-1(b).

5 This position is also supported by *U.S. v. Ryals*, 480 F.3d 1101, 1109 (11th Cir. 2007).

6 IRC § 6402; *Jones v. Liberty Glass*, 332 U.S. 524, 531 (1947) (defining "overpayment" as "any payment in excess of that which is properly due").

verifies the taxpayer's financial condition and calculates the taxpayer's "reasonable collection potential" (RCP), accounting for assets, future income, other lienholders, and allowable living expenses. An OIC generally is not accepted unless the amount proposed by the taxpayer is equal to or greater than the RCP, as calculated by the IRS.⁷

In some cases, the IRS will have served a levy on a taxpayer's income stream, such as Social Security benefits, or a continuous levy on wages before the taxpayer submitted an OIC.⁸

The IRS may leave the levy in place while it considers the OIC, and it may even leave the levy in place while the taxpayer is making payments on an accepted OIC.⁹ In cases where the IRS receives payments from a levy after an OIC is accepted but before all payments under the OIC have been received from the taxpayer, it will collect more from the taxpayer than the agreed amount stipulated in the OIC and typically more than the maximum amount it computed the taxpayer can afford to pay. This can leave the taxpayer without sufficient funds to pay his or her basic living expenses.

Example: A taxpayer subject to a wage levy submits an OIC. The IRS calculates the taxpayer's RCP to be \$5,000. The terms of the OIC require the taxpayer to pay \$4,000 upon acceptance and \$1,000 six months after acceptance. The IRS receives \$1,200 on the wage levy after acceptance and before the \$1,000 payment is received. The \$1,200 is applied to the unpaid liability and not treated as a payment on the OIC. The IRS would collect \$1,200 more than it determined that the taxpayer could reasonably afford to pay.

The National Taxpayer Advocate believes that when the IRS performs a financial analysis and determines a taxpayer's reasonable collection potential, it generally should not collect amounts in excess of the RCP. Outstanding levies against the taxpayer should be discontinued unless the payments obtained through the levies are a part of the OIC agreement or the taxpayer has acted in bad faith, and amounts collected in excess of the RCP should be returned to the taxpayer. In most cases, the IRS does release levies when it accepts an OIC, particularly levies other than continuous wage levies or those attached to fixed and determinable rights to payment, but taxpayers currently have no straightforward legal protection if routine procedures go awry.

RECOMMENDATION

- Amend IRC §§ 7122 and 6343 to require the IRS to release all levies when an OIC is accepted and to return to the taxpayer any amounts collected by levy in excess of the accepted offer amount, unless the taxpayer and the IRS reach a contrary agreement or the taxpayer did not disclose all material income and assets to the IRS.

7 The recommendation is generally focused on OICs based on doubt as to collectibility, which constitute the overwhelming majority of OICs received and processed. It should be noted, however, that OICs may be submitted on any of four grounds: doubt as to collectibility, doubt as to liability, effective tax administration (ETA) due to economic hardship, or ETA due to public policy or equitable considerations. See Treas. Reg. § 301.7122-1(b). The IRS does not perform a financial analysis for OICs based on doubt as to liability. See IRC § 7122(d)(3)(B)(ii). For ETA offers, a full financial analysis is required to determine the RCP and an acceptable OIC amount. However, the IRS only considers an ETA OIC if the taxpayer's RCP exceeds his or her tax liability. Internal Revenue Manual (IRM) 5.8.11.5.2, Financial Statement Analysis (Aug. 5, 2015) and IRM 5.8.11.3(5), Legal Basis for Effective Tax Administration Offer) (Oct. 4, 2019).

8 IRC §§ 6331(e) & 6631(h).

9 See IRS Form 656 (Rev. 4-2022), section 7(g); IRM 5.8.8.14(1), Continuous Wage Levy (Dec. 17, 2019).