

Legislative Recommendation #23**Protect Retirement Funds From IRS Levies, Including So-Called “Voluntary” Levies, in the Absence of “Flagrant Conduct” by a Taxpayer****SUMMARY**

- *Problem:* Congress has provided significant tax incentives to encourage Americans to save for retirement. Those policies reflect recognition that almost all workers eventually retire and require retirement savings to pay their basic living expenses and that retirees who do not have savings often end up on costly public assistance programs. Those policies are undermined when the protections for retirement savings from levy are a matter of IRS policy, rather than codified in statute, and the IRS encourages or allows taxpayers with tax liabilities to agree to “voluntary” levies on their retirement accounts.
- *Solution:* Prohibit the IRS from levying on retirement accounts unless a taxpayer has engaged in “flagrant conduct.”

PRESENT LAW

The IRS has wide discretion to exercise its levy authority. IRC § 6331(a) provides that the IRS generally may “levy upon all property and rights to property” of the taxpayer, which includes retirement savings. Some property is exempt from levy pursuant to IRC § 6334.

As a policy matter, the IRS has decided not to levy on the assets in a taxpayer’s retirement account unless it determines the taxpayer has engaged in “flagrant conduct.”¹ However, the term “flagrant conduct” is not defined for purposes of this analysis in the IRC or Treasury regulations. Although the Internal Revenue Manual (IRM) provides examples of flagrant conduct,² it does not provide taxpayer protections. Taxpayers generally may not rely on IRM violations as a basis for challenging IRS actions in court, and the IRS may modify or rescind IRM provisions at any time without congressional or public input.

REASONS FOR CHANGE

Congress has provided significant tax incentives to encourage taxpayers to save for retirement. There are strong public policy reasons to encourage retirement savings and to shield retirement savings from IRS levies. Almost all workers eventually retire, and they require retirement savings to pay for basic living expenses. In addition, retirees who do not have sufficient savings are more likely to experience economic hardship and qualify for public assistance, which taxpayers pay to provide.

The IRS has taken certain steps to protect retirement savings by requiring a specialized analysis prior to levy, including a determination of whether the taxpayer engaged in “flagrant conduct.” However, certain changes in IRS procedures have eroded these protections. In 2017, the IRS modified the IRM to adopt procedures

1 IRM 5.11.6.3(5), Funds in Pension or Retirement Plans (May 26, 2021), https://www.irs.gov/irm/part5/irm_05-011-006. The IRS will also consider collection alternatives and whether the taxpayer relies on funds in the retirement account (or will in the near future) for necessary living expenses. IRM 5.11.6.3(3), (4), and (7), Funds in Pension or Retirement Plans (May 26, 2021), https://www.irs.gov/irm/part5/irm_05-011-006.

2 The IRM provides 13 examples of flagrant conduct. See IRM 5.11.6.3(6), Funds in Pension or Retirement Plans (May 26, 2021), https://www.irs.gov/irm/part5/irm_05-011-006.

that allow taxpayers to request “voluntary” levies on retirement accounts.³ If a taxpayer requests a “voluntary” levy, the IRS bypasses the determination of “flagrant conduct.”⁴

As a result, taxpayers who have not engaged in “flagrant conduct” in their tax matters and who therefore would have been shielded from levies on their retirement accounts in the past may agree to “voluntary” levies out of fear or anxiety and thus may find themselves in economic hardship during retirement.

Because retirement accounts are critical to retirees’ financial well-being, we recommend that Congress codify the levy protections, rather than leaving their scope to the IRS’s discretion. Under IRC § 6334, the IRS is prohibited from levying on certain sources of payment, such as unemployment and child support. These exceptions reflect policy determinations. For example, Congress has determined that the IRS should not levy on child support payments because doing so would likely harm the children who rely on those benefits for support. To better protect retirement savings, the National Taxpayer Advocate believes that retirement savings should be added to the list of exempt property, absent “flagrant conduct,” and that the term “flagrant conduct” should be defined in the statute.⁵

RECOMMENDATIONS

- Amend IRC § 6334(a) to include qualified retirement savings as a category of property exempt from levy unless it is determined that the taxpayer has engaged in “flagrant conduct” and the levy would not create an economic hardship.⁶
- Amend IRC § 6334 to define “flagrant conduct” as an action with the intent to evade or defeat any tax imposed by Title 26 or the collection or payment of any such tax.⁷

3 IRM 5.11.6.3(3), Funds in Pension or Retirement Plans (May 26, 2021), https://www.irs.gov/irm/part5/irm_05-011-006.

4 The IRS will still consider collection alternatives and whether the taxpayer relies on funds in the retirement account (or will in the near future) for necessary living expenses, as well as verify that the taxpayer received collection due process rights. IRM 5.11.6.3(3), (4), and (7), Funds in Pension or Retirement Plans (May 26, 2021), https://www.irs.gov/irm/part5/irm_05-011-006.

5 We recognize that adopting these recommendations would impact taxpayers who might want to dip into their retirement savings to pay their tax debts and request a levy to avoid the ten percent tax that applies to early distributions from retirement accounts. On balance however, we believe the greater protections afforded to retirement savings by our recommendations outweigh this impact.

6 In rare cases, a taxpayer with millions of dollars in retirement savings may be delinquent in paying his or her tax debts without having engaged in flagrant conduct. To avoid providing an unlimited exemption from levy in these cases, Congress could make the levy exemption subject to a cap, such as \$1 million in qualified retirement savings, and index it for inflation to maintain its value in future years.

7 For legislative language generally consistent with these recommendations, see, e.g., John Lewis Taxpayer Protection Act, H.R. 3738, 117th Cong. § 203 (2021); Taxpayer Protection Act, H.R. 2171, 115th Cong. § 203 (2017); and Taxpayer Rights Act, S. 2333 and H.R. 4128, 114th Cong. §§ 306 & 307 (2015).