

# Don't go it alone\*

## The IRS collection process

### Introduction

Taxpayers periodically request assistance with IRS collection matters. IRS collection contacts can appear intimidating, and taxpayers often reach out to their advisors for immediate assistance. The purpose of this paper is to examine the various steps of the IRS collection process and to provide guidance for taxpayers and their advisors.

Typically, PricewaterhouseCoopers (PwC) assistance is requested after a taxpayer receives a notice and has not succeeded in resolving the issue using internal resources. Occasionally, the taxpayer is called or visited by the IRS regarding a collection situation involving a tax delinquency or a delinquent filing situation. Taxpayers do not face this type of IRS interaction frequently. However, when collection situations occur, it is important for taxpayers and their advisors to understand the IRS process and react as soon as possible.

### IRS emphasis on increasing tax collection

The IRS faces a major problem known as the "Tax Gap"—that is, the difference between the tax amount actually owed by taxpayers and the amount that has been paid to the government. The annual tax gap has been currently estimated at \$345 billion. Efforts by the IRS to reduce the gap through enforcement are increasing due to Congressional pressure, policy changes, budget allocations, and increased IRS staffing.

This results in pressure on IRS collection employees to increase collected revenue and secure delinquent returns. At the same time, this pressure would not justify IRS employees in assuming that particular taxpayers do not wish to be compliant or in disregarding taxpayer rights. Taxpayers may need to act promptly in these situations with the help of experienced tax professionals to avoid the consequences of any precipitous use of enforcement tools by IRS employees.

## The IRS collection process

To help understand why taxpayers may be negatively impacted if they try to "go it alone," it is important to understand the process and tools the IRS uses to resolve unpaid accounts and unfiled tax returns.

IRS Publications 1 and 594 provide an outline of taxpayer rights and the steps the IRS follows during the collection process. Nonetheless, it is important to understand that the collection process has some flexibility and each case should be addressed as a unique situation.

Experience shows that IRS employees are trained to follow procedures and often use a checklist approach to document their actions. While this may promote uniformity within the IRS, it often is perceived by taxpayers as a "one size fits all" process.

The IRS collection process involves several of the following steps, roughly in the following order:

- A taxpayer files a tax return without full payment and the return is processed by the IRS campus.
- The *Notice of Tax Due and Demand for Payment* is issued by IRS through certified mail.
- Taxpayers pay in full, arrange for an installment agreement, or reply to the notice in writing or by phone.
- The taxpayer may dispute an assessment and request reconsideration by providing proof of prior payment.
- **Ten days after the taxpayer fails to remit the full amount due, a statutory tax lien arises and the IRS is authorized to collect the tax.**

When taxes remain unpaid, progressively more aggressive and demanding notices are issued:

- A Final Demand Notice is issued prior to enforced collection.
- Contact by the Automated Call Site (ACS) is made in an attempt to collect the assessed amount by telephone.
- Depending on the amount due, a Notice of Federal Tax Lien may be filed in the taxpayer's jurisdiction and the taxpayer is notified after the actual filing.
- IRS refunds are offset and applied to the remaining balance due.
- The IRS can levy or seize assets, including pay checks, bank accounts, personal and real property, and third-party accounts receivable, and federal payments from other agencies are offset (e.g., Social Security and federal contract payments.)
- The tax delinquency assessment (TDA) may be assigned to a Revenue Officer for face-to-face collection. Tools used by these employees include summons, notice of levy, financial statement analysis, additional Notice of *Federal Tax Lien filing*, seizure and sale of real and personal property, litigation to recover assets, trust fund recovery assessments, investigation for assets, and interview of third parties.

A number of actions may be initiated in seeking to resolve the collection issue:

- Assessments previously paid can be resolved through administrative steps. This would typically include misapplied deposits and IRS errors.
- Cases that are currently uncollectible can be closed, pending follow-up at a later time during the 10-year collection statute period.
- Taxpayers can propose a partial settlement based on doubt as to collectivity, doubt as to liability, or for purposes of effective tax administration. **This is done through an offer in compromise.**
- Penalties may be abated for reasonable cause or for a number of similar reasons.
- Liens may be released, withdrawn, subordinated, discharged, or corrected with a certificate of non-attachment due to an issue involving a similar name, etc.
- The 10-year statute to collect tax may be extended through a voluntary statute extension waiver, offer in compromise, bankruptcy, etc.

## Recommendations

Experience tells us that taxpayers and their employees prefer not to be involved in such an onerous and unfamiliar process. Listed below are some recommendations that should be considered if a taxpayer is faced with an IRS collection matter:

- If the taxpayer acknowledges that the tax is actually owed, the taxpayer should pay the outstanding amount due and limit the accrual of interest and penalties.
- Taxpayers and their representatives should act promptly once an IRS action is underway.
- If the taxpayer has separate tax and payroll departments, this can contribute to IRS collection disputes. Internal communication channels must be kept open.
- As soon as taxpayers read the IRS notice, they should seek assistance in interpreting its significance, rather than trying to "go it alone".
- If called by the IRS, taxpayers should document the facts and make certain that the IRS representative provides a name, ID number, and explains the taxpayer's rights. The taxpayer should volunteer as little information as possible until they are comfortable that they are dealing with a real IRS employee. If there is any doubt, ask for a call back number and check further to determine if the contact is legitimate.
- If there is doubt about the validity of the unpaid assessment, the taxpayer must respond before the due date on the notice passes.
- Assessed penalties may be abated based on the response prepared for the taxpayer.
- If a taxpayer believes the tax has been paid previously, request time to investigate internally before paying the amount due. Previous payments may have been applied incorrectly by the IRS, or there may have been additional taxes assessed.
- If appropriate, taxpayers should be requested to execute a Power of Attorney promptly.
- A current transcript should be secured from the IRS for the period in question.

## Non-filers and trust fund taxes (taxes withheld from employees' pay)

Many IRS collection problems start with a late filed return, a misunderstanding with the IRS over whether a return is required, or an error during IRS return processing. Taxpayers should be encouraged to resolve such issues promptly, and recognize that IRS solutions can be punitive if the issues are ignored.

The following points discuss the steps IRS uses to secure delinquent returns or resolve discrepancies:

### Non-filers

- Many IRS assessments begin as non-filed returns. The IRS views a delinquent return as a very serious matter, but there usually are several periods outstanding before the IRS actively attempts to secure the returns. Late filing penalties can be very costly especially if there is several tax periods involved.
- Ten million returns go unfiled each year. The IRS does not have the resources to investigate every delinquent situation.
- The IRS matches filed returns against the data provided by each taxpayer filing a form SS-4 and requesting a federal identification number. The filing requirements established through the SS-4 and subsequent indicators allow the IRS to determine if business returns should be filed. In addition, forms W-4 processed by employers and 1099s issued by third parties provide information that the IRS uses to generate Taxpayer Delinquency Investigations (TDIs) involving business and individual taxpayers.
- The IRS pursues returns based on priorities set internally. However, the type of tax return, the potential for generating new tax, the filing history of the taxpayer, and the quality of the information that supported the TDI all contribute to establishing IRS priorities.
- The IRS issues notices, makes phone calls, and attempts to secure tax returns administratively and efficiently.
- If routine processing fails to secure a tax return, the IRS uses the Automated Substitute for Return (SFR) system to create an assessment based on information documents such as 1099, W-2, etc. The SFR assessments are proposed alternatives to an unfiled return. Taxpayers should file an accurate return, and the IRS will substitute it for the SFR before (or after) assessment.

### Trust fund taxes

- Payroll taxes actually represent the type of delinquent return and tax due assessment that IRS pursues most aggressively. The IRS considers payroll taxes to be the most important issue to resolve because they know that payroll taxes can pyramid rapidly if deposits are insufficient.
- Trust fund amounts are especially significant because the IRS ultimately credits the amounts withheld when the employees file their own returns, even if the employer did not deposit the trust funds
- The IRS pursues the recovery of trust fund taxes (the employees' portion of withholding tax and FICA) by seizing the assets of the employer (real and personal) and levying bank accounts and accounts receivable.
- A revenue officer is authorized to enforce collection of trust fund taxes by assessing each responsible official involved in the delinquency with a Trust Fund Recovery Penalty (TFRP). For example, if three taxpayer officials are deemed responsible and willful for the decision to not pay \$100,000 payroll trust fund taxes, the revenue officer could assess the TFRP against all three officials and collect from all three cumulatively until the full amount is paid.
- The IRS and the Social Security Administration work together in matching program Forms W-2 and 941. If the "Combined Annual Wage Reporting" process results in a mismatch, taxpayers can be assessed tax and penalty unless they are extremely responsive and correct such issues.

## Additional concerns and tips

- Once contacted by an employee from the ACS (Automated Collection System) function of IRS, the taxpayer should be aware that ACS employees are trained to demand full payment, secure future sources to levy in order to collect the taxes, and document everything the taxpayer says or agrees to do. Over time, they have heard many unconvincing excuses or reasons that taxes are unpaid.
- It will be assumed by IRS employees that the taxpayer owes the tax. However, the IRS should recognize that there are three categories of delinquent taxpayers. Namely, those who refuse to pay, those who cannot pay, and those who try to pay (or at least cooperate to resolve a disputed assessment). The goal should be to work with IRS collection staff in a responsive manner so they realize the taxpayer is trying to reach the correct conclusion to the case.
- The IRS will not accept a call to discuss a taxpayer issue from a representative without a Power of Attorney. ACS employees routinely refuse faxed copies of Form 2848. This delays resolution and can be very frustrating. Filing a Power of Attorney with the IRS CAF (Centralized Authorization File) unit several days before calling ACS can save time and frustration for taxpayers and their representatives.
- Forms 433A and 433B are financial statements and are signed under a penalty of perjury. A taxpayer without previous experience with IRS may find that assistance is helpful in preparing these forms in order to prevent problems in the future with IRS.
- The IRS does not use e-mail to communicate with taxpayers. Do not respond to such an e-mail. It could be fraudulent or a "phishing" attempt.
- A third party in an IRS collection matter that is not the actual taxpayer, should seek advice to avoid summons action, suits, and other legal matters. Unfortunately, the taxpayer's own employees or customers occasionally cause such situations due to their failures to address their personal IRS tax situations.

## Taxpayer rights

Taxpayers are entitled to rights guaranteed in the Tax Code and the Internal Revenue Manual. Key rights involving IRS collection procedures require IRS collection staff to provide accurate and timely notification of the amount due, including the current balance owed plus accruals; tax transcripts; the name and badge number of any IRS employee; Appeals due process and equivalent hearings; access to the collection appeals program; a meeting with a collection manager; support from the Taxpayer Advocate staff; professional representation as designated on a Power of Attorney; consideration of an Offer in Compromise; relief from the filing of a Notice of Federal Tax Lien filed inappropriately; release of a tax lien upon full payment; and certain legal options, including suits for relief when abusive behavior occurs during the collection process.

## Approaches employed by the IRS service team collection professionals

In assisting taxpayers with these matters, the approaches we employ typically include one or more of the following:

- Analyze the taxpayer's unique situation, research the underlying liability, and identify the IRS employees involved, including their chain of command.
- Work with the taxpayer to determine the best resolution to minimize expenses, including interest and penalties.
- Review the available options with the taxpayer and with IRS collection personnel.
- Anticipate the IRS revenue officer's plan of action. Ask the revenue officer to share the plan of action and clarify expectations.
- Develop a clear and logical assessment of the taxpayer's options and base recommendations on our experience and the likely reaction of the IRS employees to any proposals.
- Assess the various options available and determine the option that could be recommended to IRS and the taxpayer, such as: paying in full; requesting an abatement of tax or initiate a payment tracer; an agreement to make monthly payments; post collateral such as a letter of credit or a bond; liquidate certain assets to raise capital; borrow funds; refinance; submit an offer in compromise; file bankruptcy and re-organize; reduce employee headcount; etc.
- Assist the taxpayer with forms and procedures.
- Consider creative solutions to resolve unique taxpayer issues, such as using an "offer in compromise due to effective tax administration."
- Elevate case issues through IRS management levels.
- Work directly with IRS campus employees on procedural matters.
- Request Taxpayer Advocate Service Assistance through a Form 911.
- Request a Collection Due Process hearing or a Collection Appeals Program conference in Appeals.
- Monitor IRS agreements to protect taxpayer rights and prevent procedural missteps by IRS.

## Conclusion

The IRS is stepping up enforcement initiatives to close the tax gap. The collection process as outlined in written IRS materials is a logical one that emphasizes prompt resolution. The consequences for ignoring notices or phone calls can be significant and expensive to resolve. Although the IRS is authorized to demand payment of taxes that are owed, taxpayers have the right to dispute liabilities, receive respectful treatment, have their rights protected, and reach a fair settlement with IRS. When dealing with the IRS on collection matters, don't go it alone!

## Contact

Contact IRS Service Team Directors Jim Donelson (678-419-1798) and Tim Dreyer (904-366-3741) to address any IRS collection matters.

This document is for general information purposes only and does not constitute an opinion on any tax or financial matter. Consequently, the information herein cannot be relied upon for purposes of taking a position for any tax or financial reporting or disclosure purpose. In all instances, the reader should consult with a specialist for specific circumstances as concerns all information herein.