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TAX MEMORANDUM

TO: CPAs, Clients & Associates

FROM: David L. Silverman, Esq.
Shirlee Aminoff, Esq.

DATE: April 2, 2010

RE: IRS Collections: Defensive Measures

A taxpayer facing IRS collection should initially determine whether the assessment was timely or whether the 10-year collection period will soon expire. Collections may not proceed if the statute of limitations on assessment was time-barred. Agreeing to extend the statute of limitations on assessment or collection, even if immediate assessment or enforcement action will otherwise be threatened, is not always advantageous. One reason is that interest well above the prime rate will continue to accrue. Pursuant to the Freedom of Information Act, 5 U.S.C. § 552, the taxpayer may request copies of (i) the entire transcripts of individual master files; (ii) records relating to filed notices of tax liens; (iii) all records used to conclude that there was a deficiency; and (iv) all records used as a basis to conclude that there was basis for imposing penalties. These records can be invaluable when facing collections.

A new audit may be requested if the taxpayer never had the opportunity to substantiate the

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tax information and may now do so. IRM [4.13]1.3. The IRS may also agree to put collection action on “hold” at the taxpayer’s request. If IRS threatens to file a notice of tax lien, a collection due process hearing may be requested. Injunctive relief may be available in federal district court in certain situations, such as where the IRS attempts to levy when that action is statutorily proscribed. IRC § 6159 authorizes the IRS to enter into an installment agreement if that will facilitate collection. Although financial disclosure is required, the requirement is somewhat perfunctory, in that the Service is without the resources to fully investigate all financial data provided. The IRS may not levy when an installment agreement request is either pending or is in effect.

IRC § 7122 permits IRS, acting as an ordinary creditor would, to accept an offer in compromise based on doubt as to (i) liability or (ii) collectibility. Under (i), the taxpayer sets forth the factual and legal arguments; the IRS may not request financial disclosure. The more common offer under (ii) requires full financial disclosure. Collection activity is normally suspended during the pendency of the offer. However, collection will resume if IRS determines that the offer was submitted to delay collection. Treas. Reg. § 301.7122-1(g)(6). If the taxpayer’s deficiency was in whole or in part attributable to an unreasonable delay by the IRS in performing a ministerial or managerial act, a request for abatement of interest may be filed under IRC § 6404(e). If the IRS rejects the request, appeal may be taken to the Tax Court without prepayment of the interest. If payment of interest has been made, the 5th Circuit recently held that the taxpayer has the option of seeking an interest abatement in federal district court as well. (See *Beall v. U.S.*, 5th Cir. No. 01-41471, 6/27/03).

If spouses filed a joint return, innocent spouse relief under IRC § 6015(e) may be available. The innocent spouse may be relieved from tax liability if (i) the understatement relates to erroneous items of the guilty spouse, (ii) the innocent spouse had no knowledge of the understatement and, (iii) it would be inequitable to hold the innocent spouse liable. Divorce or legal separation is not required for innocent spouse relief, although in those circumstances relief is somewhat more liberal. If the IRS files a notice of federal tax lien (NFTL), the taxpayer may request a collection due process hearing (CDP) within 30 days following of the date when the taxpayer is notified of the filing of the lien.

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Under IRC § 6320, the taxpayer is entitled to judicial review of the Appeals determination.

If IRS collection activities have resulted in, or are about to result in significant hardship, the Taxpayer Advocate, a quasi-independent agency, has authority to issue a Taxpayer Assistance Order requiring the IRS to release filed tax liens, to suspend collection activities, to prevent an IRS levy, or to take any other action. Regs. § 301.6323(j)-1 provides for the withdrawal of a tax lien where the best interests of the taxpayer and the IRS would be served. Since a filed tax lien may impair the taxpayer's ability to conduct business, and ultimately pay the IRS, the Taxpayer Advocate may order the IRS to release the filed lien. Prop. Regs. § 301.6343-3 similarly provides for a return of property levied by the IRS in similar circumstances. Although the IRS Appeals Office historically operated in the audit context, as a result of the 1998 IRS Reform Act, an Appeals Office conference during collection must now be provided (i) following the filing of a federal tax lien, (ii) when a levy is contemplated, (iii) when an installment agreement is to be terminated, (iv) when a request for penalty abatement is denied, or (v) when an offer in compromise is rejected.

Full tax payment will stop IRS collections. A refund claim may then be filed within 2 years from date of payment or 3 years from the due date of the tax return, if later. If the IRS denies or fails to timely respond to the refund claim, a refund action may be commenced in federal district court or the U.S. Claims Court, both taxpayer-friendly venues. The "full payment" rule does not apply to all tax liabilities: if the tax in question is a "divisible" tax, such as withholding tax, a payment of all taxes for a single employee for will confer refund jurisdiction on the federal court. A bankruptcy petition generates an automatic stay that stops virtually all IRS collection action. An eventual discharge can provide the taxpayer "fresh" start. Non-trust fund taxes are dischargeable if they are due more than 3 years, filed more than 2 years, and assessed more than 240 days prior to the filing of a bankruptcy petition.

Certain real and personal property is exempt from creditors even in bankruptcy. Moreover, it is not improper, within reason, to convert nonexempt assets to exempt assets prior to filing a petition. However, this rule favors the IRS, since exempt property surviving bankruptcy will become subject to IRS collection if the taxes are nondischargeable, or if the taxes are dischargeable but they

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are secured by a tax lien filed prior to the bankruptcy petition. A debtor may not obtain a discharge of for any tax for which the related return is fraudulent (11 U.S.C. § 523(a)(1)(C)) or any tax for which the taxpayer willfully attempts to evade or defeat the tax. An automatic stay of any Tax Court proceedings issues upon the commencement of a bankruptcy case. Thereafter, bankruptcy court has jurisdiction to determine the amount and dischargeability of the debtor's tax liabilities.

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