Delinquent Taxpayers: Avoiding Passport Revocations, Statutes of Limitations, OICs and Penalties

WEDNESDAY, JULY 24, 2019, 1:00-2:50 pm Eastern

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Delinquent Taxpayers

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What we are going to cover:

- Refund Statutes of Limitations
- Assessment Statutes of Limitations
- Collection Statutes of Limitations

Statutes of Limitation

- What is a statute of limitation?
  - A time period established by law to review, analyze and resolve taxpayer and/or IRS tax related issues

- IRC provisions require that the IRS will assess, refund, credit, and collect taxes within certain time limits

- When these periods expire, the IRS can no longer assess additional tax, allow a claim for refund by the taxpayer, or take collection action

CLAIMS FOR REFUND
Statutes of Limitations

- IRC § 6511

- General Rule in § 6511(a)
  - 3 years from date of filing, or
  - 2 years from date of payment

- If return is filed or payment is made prior to the due date (determined without regard to any extended due date), then it is considered filed or paid as of the last date to do so
  - Ex. – Form 1040 filed on March 1 is considered filed on April 15

Refund Statutes of Limitations Cont'd

- For claims for refund not filed within the 3 year period, the amount of refund is limited to the portion of the tax that was paid within the two years preceeding the filing of the claim
  - See IRC § 6511(b)

- 2 Years from date of payment
  - Withholdings and estimated tax payments are considered to be paid on April 15 (Return due date)
  - When a return is not filed, then you have to file within 2 years of the date of payment to get the refund

Refund Statutes of Limitations Cont'd

- Exceptions
  - Taxpayers have up to seven years to claim a refund resulting from deductions for bad debt or worthless securities.
  - The three-year statute of limitations does not apply in situations where taxpayers are unable to manage their financial affairs due to physical or mental impairments.

Refund Statutes of Limitations Cont'd

- **What Happens to the Refund after these periods?**
  - "Excess Collection"
  - Money cannot be refunded to the taxpayer
  - Money cannot be applied as payment toward a future tax year
  - Money cannot be applied to another year as an estimated tax payment

ASSESSMENT
Statutes of Limitations

- IRC § 6501

- General Rule in § 6501
  - 3 years from the due date of the return, or
  - 3 years from date received

- If return is filed prior to the due date (determined without regard to any extended due date), then it is considered filed as of the last date to do so
  - Ex. – Form 1040 filed on March 1 is considered filed on April 15

Assessment Statutes of Limitations Cont'd

EXCEPTIONS

- Substantial Understatement of Gross Income – 6 years
- Omitted income of $5000 on foreign financial assets – 6 years
- False or Fraudulent Returns – Indefinitely

The Statute of Limitations cannot start to run until a return has been filed. For unfiled returns, the statute will remain open.

Assessment Statutes of Limitations Cont'd

- **SUBSTANTIAL UNDERSTATEMENT OF GROSS INCOME**
  - IRC 6501(e)(a)(A)(i)
  - Period of assessment is 6 years

- **What is a substantial understatement of gross income?**
  - Taxpayer omits from gross income an amount in excess of 25% of the amount of gross income stated in the return
  - An understatement of gross income caused by an overstatement of basis is an omission from gross income for the tax period for which the assessment statute was open on July 31, 2015 and for returns filed after July 31, 2015
  - Does not apply of the understatement was due to the overstatement of deductions or credits

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Assessment Statutes of Limitations Cont'd

- **OMITTED INCOME OF $5,000 FROM FOREIGN FINANCIAL ASSETS**
  - IRC 6501(e)(1)(A)(ii)
  - Period of assessment is 6 years
- **APPLIES EVEN IF:**
  - Taxpayer disclosed the existence of the account on the return
  - Taxpayer filed an FBAR reporting the existence of the account

Assessment Statutes of Limitations Cont'd

- **FALSE OR FRAUDULENT TAX RETURNS**
  - IRC 6501(c)(1)
  - Where taxpayer has filed a false or fraudulent return with the intent to evade tax
  - No period of limitations – tax can be assessed at any time
  - Burden of proof is on the Government
  - Determination of fraud under 6501(c)(1) is the same as the fraud penalty under IRC 6663
    - Fraud Handbook – IRM 25.1
    - Kohan v. C'r, TC Memo 2019-85 (July 9, 2019)

Assessment Statute of Limitations Cont'd

- **FRAUD NOT LIMITED TO THE FRAUD OF THE TAXPAYER**
  - Exception may apply if a tax return preparer committed the fraud, even if the taxpayer did not commit fraud and did not know of the other person's fraudulent intent at the time the return was filed
- **JOINT RETURNS**
  - In the case of a joint return, fraud by either taxpayer suspends indefinitely the period of limitations for both taxpayers
  - Richardson v. C'r, TC Memo 2006-69, aff'd F.3d 736(6th Cir. 2007)

Assessment Statute of Limitations Cont'd

- **EXTENSIONS**
  - Extension of Time by Agreement
    - Form 872
    - The period for claiming a credit or refund is also extended until 6 months after the expiration of the consent
    - If the consent is restricted to certain items, the claim is similarly restricted for credit or refund
  - Statutory Notice of Deficiency
    - SOL extended during the 90 days the taxpayer has to petition the Tax Court and the time the IRS is prohibited from making the assessment plus 60 days
    - If petition filed, SOL extended until decision becomes final
    - If no petition filed, IRS has 60 days plus whatever time was left on the SOL when the notice was issued

COLLECTION
Statutes of Limitation

- IRC § 6502

- General Rule in § 6502
  - 10 years from the date of assessment
  - Each additional assessment of tax carries its own CSED
    - Ex. Original tax due and tax due on amended return

- <u>NOT</u> 10 years from the due date of the return

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Collection Statutes of Limitations Cont’d

- **EXTENSIONS OF COLLECTION PERIOD**
  - Only in two situations:
    - 1) Where the extension is agreed to at the same time as an installment agreement entered into between the taxpayer and the IRS
    - 2) Where the extension is agreed to prior to a release of levy under IRC 6343 which occurs after the expiration of the 10-year period

Collection Statutes of Limitations Cont'd

ACTIONS THAT POSTPONE OR SUSPEND THE CSED

- If taxpayer filed for bankruptcy protection
  - While automatic stay is in effect, plus six months
- If the taxpayer resides outside of the US for at least six months;
- If the taxpayer files a request for a collection due process hearing;
- If the taxpayer files a claim for innocent spouse relief;
- If the taxpayer files for an offer-in compromise (OIC); and
- While there is a pending installment agreement request.

Collection Statutes of Limitations

- **BEYOND THE 10-YEAR PERIOD**
  - Reducing Assessments to Judgment
  - Voluntary consent with a partial payment installment agreement

Statutes of Limitations

Final Thoughts

What we are going to cover:

Reducing a taxpayer’s liability through penalty abatement

- First Time Penalty Abatement
- Penalty Abatement due to Reasonable Cause
- Penalty Relief due to Statutory Exception

PENALTY ABATEMENT

- **FIRST TIME PENALTY ABATEMENT**
  - Administrative Waiver found in IRM 20.1.1.3.3.2.1
  - Implemented in 2001

PENALTY ABATEMENT

- **TYPES OF PENALTIES ELIGIBLE FOR RELIEF**
  - Failure to timely file
    - IRC 6651(a)(1)
    - IRC 6698(a)(1)
    - IRC 6699(a)(1)
  - Failure to timely pay
    - IRC 6651(a)(2) and/or 6651(a)(3)
  - Federal tax deposit penalties
    - IRC 6656

PENALTY ABATEMENT

REQUIREMENTS FOR FTA

- Filing compliance
  - Must have filed (or filed a valid extension) all required returns
- Payment compliance
  - Must have paid, or arranged to pay, all tax due
- Clean penalty history
  - Must have no unreversed penalties (except an ES penalty) assessed for the previous 3 filing years.

PENALTY ABATEMENT

- FTA only applies to one tax period
- FTA waivers are not penalty specific
  - If there are <u>any</u> unreversed penalties (except ES penalties) in the 3-year look back period, then no waiver
- FTA criteria are applied before reasonable cause
- If granted, the taxpayer will be notified that the IRS removed the penalty based on prior history of compliance

PENALTY ABATEMENT

- Additional Requirements for BMF Accounts
  - FTA will not be met if:
    - A total of 4 or more FTD penalty waiver codes are present in the taxpayer’s 3-year penalty history
    - The FTD penalty is charged for EFTPS avoidance
    - For Form 1120 or 1120-S penalties, if in the 3-year look back period, a return was filed late but not penalized
    - If the penalty charged is for an incomplete 1120-S under IRC 6699(a)(2) or an incomplete Form 1065 under IRC 6698(a)(2)

PENALTY ABATEMENT

- Penalty relief under the FTA waiver does not apply to the following:
  - Returns with an event based filing requirement
    - For example - Form 706 and Form 709
  - Daily delinquency penalty for Exempt Organizations Filings
  - Information reporting that is dependent on another filing
    - For example, penalties assessed against a late or unfiled Form 5471

PENALTY ABATEMENT

PENALTY ABATEMENT DUE TO REASONABLE CAUSE

- Reasonable cause means…
  - That you used all ordinary care and prudence to meet your Federal tax obligations but were nevertheless unable to do so
- Ordinary care and prudence means…
  - Taking that degree of care that a reasonable prudent person would exercise
  - Includes making provisions for business obligations to be met when reasonably foreseeable events occur

PENALTY ABATEMENT

- Sound reasons, if established, include:
  - Casualty, fire, natural disaster or other disturbance
  - Inability to obtain records
  - Death, serious illness, incapacitation or unavoidable absence of the taxpayer or a member of the taxpayer's immediate family
  - Any other reason which establishes that you used all ordinary business care and prudence to meet your tax filing and payment obligations, but were nevertheless unable to do so.

PENALTY ABATEMENT

- Facts Needed to Establish Reasonable Cause:
  - What happened and when did it happen?
  - During the period of non-compliance, what facts and circumstances prevented the taxpayer from filing a return, paying a tax, and/or otherwise complying with the law?
  - How did the facts and circumstances result in the taxpayer not complying?
  - How did the taxpayer handle the remainder of his or her affairs during this time?
  - Once the facts and circumstances changed, what attempt did the taxpayer make to comply?

PENALTY ABATEMENT

- IRS will consider:
  - Taxpayer's reason addressing the penalty imposed
    - Dates and explanations clearly corresponding with events upon which the penalties are based
  - Compliance history for at least 3 years
  - Length of time between the event cited as the reason for noncompliance and subsequent compliance
  - Circumstances beyond the taxpayer's control
    - Whether or not the taxpayer could have anticipated the event that caused the noncompliance

PENALTY ABATEMENT

- Consider examples from Treasury Regulations

Regulation	Penalty Type
1.6664-4	Accuracy-related Penalties
301.6651(1)(c)	Failure to File a Tax Return and/or Failure to Pay Tax Penalties
301.6724	Information Return Penalties
1.6694-2(e)(1)-(6)	Tax Return Preparer Penalties
301.6707-1(e)(3)	Material Advisor Penalties

PENALTY ABATEMENT

- Documentation that may be helpful:
  - Hospital or court records or a letter from a physician to establish illness or incapacitation, with specific start and end dates
  - Documentation of natural disasters or other events that prevented compliance

PENALTY ABATEMENT

- Penalty Relief Due to Statutory Exception
  - Examples:
  - IRC 6404(f) – abatement of any penalty or addition to tax attributable to erroneous written advice by the IRS
  - IRC 6654(e)(1),(2) or (3) – estimated tax penalties

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PENALTY ABATEMENT

- Methods of Appealing Penalties
  - Deficiency procedures
    - Review of penalty prior to assessment
  - Post-Assessment Review
    - By written request
    - Form 843
    - If denied, then request Appeals consideration
  - Abatement and refund after payment
    - File claim for refund

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FINAL THOUGHTS

IRS Collection Alternatives & Payment Plans

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Collection Alternatives/Payment Plans:

- Installment Agreement (non-streamlined)
- Offer In Compromise
  - Typically used for taxpayers who cannot afford to pay the IRS in full or who suffer from exceptional circumstances
- Offer In Compromise – Doubt as to Liability
  - Typically used for taxpayers who have a final assessment, but may not actually owe the liability
- Currently not collectible hardship status
  - Typically used for taxpayers who cannot afford to pay anything towards their tax debt, but whose circumstances may change in the future
- Bankruptcy

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Installment Agreement

- Long-term (over 120 days) payment plan
- Pay amount owed in full over time
- Interest and some penalties continue to accrue until balance is paid in full
- Requires an application by the taxpayer
- Requires taxpayer to be currently compliant with all required tax returns filed and to stay compliant (filing and paying taxes owed going forward)

Offer In Compromise

- Pay the IRS over a period of time up to 24 months
  - Lump sum (5 months or less)
  - Periodic payments (6 to 24 months)
- Pay only a portion of amount owed
  - Determined by ability to pay, actual income, allowable expenses, asset equity
- Penalties and interest do not accrue on accepted OIC
- Requires application and supporting documentation
- Offer is accepted, unless IRS notifies taxpayer, in writing, within 24 months of the date the offer received, that it has been rejected

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Offer In Compromise (Doubt as to Liability)

- Use the Form 656-L
- Include written statement and supporting documentation to prove why the tax debt (or portion of the tax debt) is incorrect
- Offer should be in the amount of the correct tax (or a minimum of $1 if no tax is believed to be owed)
- Should only be used when there are no other avenues to dispute the tax assessment (do not file prematurely)
- Not recognized by all states, could get a federal tax liability abated by an OIC-DATL, but still have a derivative state tax liability

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Currently not collectible status

- Temporary hardship status where the IRS agrees not to take collection action (liens, levies, etc.) against a taxpayer
- Interest and some penalties continue to accrue on the balance
- Generally requires taxpayer to be currently compliant with all required tax returns filed
- Financial information and supporting documents required
- Subject to periodic review to determine if status/ability to pay has changed

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Bankruptcy

- Overlooked and underutilized collection alternative resource
- A client may not want to file for bankruptcy, but if the client is eligible, determining how much of the liability would have to be paid, may be helpful in compromising a tax debt
- Income taxes, interest, and penalties may be discharged
- Tax liability must not have arisen due to fraud or willful evasion
- Generally, tax liability must be at least three years old

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Collection Information Statement (CIS)

- This statement is required for most collection alternative requests
- A CIS is current if it less than twelve months old as of the date it is received by Appeals
  - Don't let the IRS bully you into starting over if your client's CIS is still valid
  - See IRM 8.22.7.2
- Use the correct form
  - 433-A, 433-B, 433-F (alternatives other than taxpayer proposed OIC)
  - Form 656-B and Form 433-A (OIC) and/or Form 433-B(OIC) (for taxpayer proposed OIC)

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Allowable Living Expenses

- National Standards vs. Local Standards
  - National standards for food, clothing and other items apply nationwide
  - National standards for minimum allowances for out-of-pocket healthcare
  - Local standards for maximum allowances for monthly housing, utilities, and transportation
- Exceptions
  - Documentation that uses national and local expense standards leave a taxpayer with inadequate means of providing for basic living expenses

Documentation is Key

- Double-check form instructions
- Double-check dates and signatures
- Confirm client documents for accuracy and completeness
- Scrutinize client documents – what story do the bank statements and other required documents tell and is it consistent with your client's narrative?
- IRS requested information is the minimum to provide – expand the narratives and documents needed to ensure your client's full story is being told

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What if your collection alternative request is denied?

- Taxpayer Issues
  - If required documentation was missing/insufficient and a more complete package can be provided, try again
  - If client's situation has worsened (job loss, etc.), try again
  - Look to other alternatives – If OIC-DATL denied, is client eligible for regular OIC?
  - If OIC denied, is client eligible for Installment Agreement?
  - Additional client counseling may be needed – are the taxpayer's expectations unrealistic?

What if your collection alternative request is denied?

- IRS Issues
  - Data entry/calculations errors – contact the OIC specialist or revenue officer for corrections; may be resolved through direct outreach
  - Other type of rejection – follow the Appeals process
  - Collection Appeals Program
  - Appeals mediation pursuant to Rev. Proc. 2014-53

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Passport Revocation or Denial for certain unpaid taxes

As of February 2018, the IRS is sending certifications of unpaid tax debt to the State Department – what does this mean for your clients?

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Is the IRS really allowed to revoke passports?

- Oddly, yes (in conjunction with the Secretary of State)
- The *Fixing America's Surface Transportation Act (FAST)* was passed by Congress on December 3, 2015 to help provide guaranteed long-term funding for surface transportation infrastructure planning and investment.
- It includes a provision (Section 32101) allowing the IRS to transmit certification of seriously delinquent tax debt to the Secretary of State for denial, revocation, or limitation of a passport.

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What is seriously delinquent tax debt?

- See Code Section 7345(f)
- Currently $52,000
- Indexed yearly for inflation (using the cost-of-living adjustment and rounded to the nearest multiple of $1,000)
- The amount owed must have been assessed
- A notice of lien must have been filed and all rights must be exhausted or lapsed OR a levy must have been issued

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Tax Debt not considered seriously delinquent

- Tax debt that is:
  - Being paid timely with an IRS-approved installment agreement
  - Being paid timely with an offer in compromise accepted by the IRS
  - Being paid timely with a settlement agreement entered with the U.S. Department of Justice
  - Subject to a timely requested collection due process hearing regarding a levy to collect the debt
  - Suspended because a request for innocent spouse relief under IRC § 6015 has been made

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Certain passports not at risk

- For any taxpayer:
  - Who is in bankruptcy
  - Who is identified by the IRS as a victim of tax-related identity theft
  - Whose account the IRS has determined is currently not collectible due to hardship
  - Who is located within a federally declared disaster area
  - Who has a request pending with the IRS for an installment agreement
  - Who has a pending offer in compromise with the IRS
  - Who has an IRS accepted adjustment that will satisfy the debt in full

- Certification is <u>postponed</u> for individuals serving in designated combat zones or participating in contingency operations

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What happens after the IRS sends a certification?

- Before a denial, the State Department will hold the passport application for 90 days to allow the taxpayer to:
  - Resolve any erroneous certification issues
  - Make full payment of the tax debt
  - Enter into a satisfactory payment arrangement with the IRS

- What if the taxpayer is already abroad?
  - The State Department may issue you a limited validity passport good only for direct return to the United States

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Taxpayer Notifications

- Notice CP 508C
  - IRS required to notify taxpayer in writing at the time the IRS certifies seriously delinquent tax debt to the State Department
  - IRS will NOT send a copy of CP 508C to a taxpayer's power of attorney

- Notice CP 508R
  - IRS required to notify taxpayer in writing at the time the IRS reverses certification
  - Reversals made within 30 days and the IRS provides notification to the State Department as soon as practicable

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When will the IRS reverse a certification?

- The tax debt is fully satisfied or becomes legally unenforceable
- The tax debt is no longer seriously delinquent
- The certification is erroneous

Certifications not eligible for reversal:

- The IRS will not reverse certification where a taxpayer requests a collection due process hearing or innocent spouse relief on a debt that is not the basis of the certification

- The IRS will not reverse the certification because the taxpayer pays the debt below $50,000

When is a previously certified debt no longer seriously delinquent?

- Taxpayer and the IRS enter into an installment agreement allowing the taxpayer to pay the debt over time
- The IRS accepts an offer in compromise to satisfy the debt
- The Justice Department enters into a settlement agreement to satisfy the debt
- Collection is suspended due an IRC § 6015 innocent spouse relief request
- A timely request is made for a collection due process hearing regarding a levy to collect the debt

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Accidents Happen – Judicial Review

- The State Department is held harmless and cannot be sued for any erroneous notification or failed decertification under IRC § 7345
- A taxpayer can file suit in the U.S. Tax Court of a U.S. District Court to have the court determine whether the certification is erroneous or the IRS erroneously failed to reverse a certification. If the court determines the certification is erroneous or should be reversed, it can order the IRS to notify the State Department that the certification was in error
- No court authority to release a lien or levy or award money damages in a suit to determine whether a certification is erroneous