SPECIAL REPORT

PILLA TALKS TAXES

DAN PILLA'S MONTHLY TAX AND FINANCIAL BULLETIN

December 2023
Vol. 35 Issue 10

How to Release Wage and Bank Levies

A Deep Dive Into the Idea of "Economic Hardship"

The IRS issues hundreds of thousands of wage and bank levies annually. At best, the levies cause much disruption in one's life as bank accounts and paychecks get swept up. At worst, the levies cause serious economic hardship as they put the victim in the position of being forced to pay delinquent taxes at the expense of feeding one's family.

In this Special Report I examine at length the legal authority for releasing levies that cause "economic hardship" due to lack of ability to pay necessary living expenses. I also explain the process of obtaining a release of levy.

THE SOURCE OF LEVY AUTHORITY

Internal Revenue Code section 6331(a) provides the IRS with authority to issue third-party levies if a delinquent citizen "neglects or refuses" to pay the tax liability. Section 6331 expresses many rules on the levy process and delineates certain limitations regarding levies. One such limitation is that before a levy may be issued, the IRS must mail a Notice of Intent to Levy. See: §6331(d). That notice must explain a person's right to seek a Collection Due Process (CDP) hearing in accordance with section 6330.

Too often, citizens do not request a CDP hearing because they either don't understand the importance of such a hearing or don't know how to properly request one. Just as often, ignorant and frightened citizens don't even open mail they receive from the IRS, and therefore don't realize they ever had the right to such a hearing. In any case, once CDP rights have expired the IRS is free to collect through enforcement action, such as with third-party levies.

THE REACH OF A LEVY

A levy generally reaches all of the "property possessed and obligations existing" at the time the levy is issued. See: IRC § 6331(b). The phrase "property possessed" refers to property owned by the taxpayer at the time of the levy, as for example, the balance of one's bank account. The phrase "obligations existing" refers to the

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obligation of a third-party to pay the delinquent taxpayer. For example, your employer has an obligation to pay wages for services rendered. As such, one's entire paycheck and bank account balance are attached once the levy is issued (although wages are subject to a modest exemption under section 6334).

In the case of a levy on "salary or wages," such levy is deemed "continuous from the date such levy is first made until such levy is released under section 6343." See: IRC § 6331(e). This is the provision that can cause serious financial hardship because, unlike other third-party levies, a levy on wages in not a one-and-done event. It continues from payperiod to payperiod until the tax is either paid in full or the levy is specifically released under section 6343. I discuss section 6343 in detail below.

Levies that make it impossible to pay necessary living expenses constitute a financial chokehold on the victim. That's why every tax professional must know how to win the release of third-party levies generally, and in particular, what the IRS means by the phrase "economic hardship."

The concept of "economic hardship" comes into play in a number of circumstances, including: 1) the negotiation of an Offer in Compromise (OIC), 2) the closing of a case as currently not collectible (CNC), 3) the establishment of an installment agreement, and 4) perhaps most importantly, winning the release of third-party levies.

GENERAL RULES FOR RELEASING LEVIES

While it is true that much of what the IRS offers in terms of settlement options is discretionary (such as an OIC and most installment agreements), that is not the case with releasing certain levies. The question of when the IRS must release levies is controlled generally by Code section 6343, Release of Levy. Subsection (a) provides that the IRS "shall release the levy" in any of five different circumstances.

Note the use of the term "shall." When used in a statute or regulation, the term "shall" expresses an affirmative duty to act that is not subject to the discretion of the person to whom the command is directed. In this case, the command is directed to the "Secretary" of the Treasury and his delegates within the IRS. Thus, the IRS has the non-discretionary duty to release a levy if at least one of the five statutory conditions exists.

The five conditions identified in section 6343(a)(1) are:

1. The tax liability which is the subject of the levy has been paid or is legally "unenforceable by reason of lapse of time,"

2. Release of the levy will "facilitate the collection of such liability,"
3. The taxpayer has entered into an installment agreement to pay the tax over time,
4. The IRS determines that the levy "is creating an economic hardship due to the financial condition of the taxpayer," and
5. The fair market value of the property levied exceeds the tax liability subject to collection, and release of the levy on such property will not hinder collection of the tax. See: IRC § 6343(a)(1)(A) – (E).

WHAT IS "ECONOMIC HARDSHIP"?

For purposes of this discussion, I address only the "hardship" element in point 4 above. The phrase "economic hardship" is defined by IRS regulations as the inability to pay "reasonable basic living expenses." TreasuryReg. section 301.6343-1(b)(4)(i) states as follows:

> This condition applies if satisfaction of the levy in whole or in part will cause an individual taxpayer to be unable to pay his or her reasonable basic living expenses. The determination of a reasonable amount for basic living expenses will be made by the Commissioner and *will vary according to the unique circumstances of the individual taxpayer*. Unique circumstances, however, do not include the maintenance of an affluent or luxurious standard of living. (Emphasis added.)

The above regulation sets up a good news/bad news scenario.

The bad news is that the determination of what constitutes "basic living expenses" is determined, at least in part, by the IRS. That determination is made based on the IRS's allowances for personal living expenses in accordance with its published National Standards (NS), Local Standards (LS), and Transportation Standards (TS). Unfortunately, these expense standards, especially the LS charts for housing and utilities, are often well below the actual expenses one incurs for such items. At the 2023 Defense Conference, I taught a two-hour session on how to overcome the expense standards the IRS tries to cram down the throats of delinquent taxpayers. See also: chapter 5, ***How to Get Tax Amnesty***.

The good news is that the regulation clearly states that the IRS must take into account "the unique circumstances of the individual taxpayer." Thus, the agency is not free to simply disregard the specific factors of a person's life that render the standards insufficient to provide for the payment of necessary living expenses, or expenses necessary for the citizen to earn income. In fact, Internal Revenue Manual (IRM) part 5.8.11.3.1(2) (dealing with OIC negotiations) acknowledges that the standards are guidelines only, subject to modification based on individual circumstances. Indeed, that provision of the IRM cites to Treas. Reg. section 301.6343-1(b)(4)(i) (quoted above) as authority for this proposition.

Thus, the determination of hardship in a given case must take into account the totality of one's financial circumstances, as well as non-financial circumstances that bear, directly or indirectly, on one's ability to pay the tax. I discuss such factors in detail later.

REFINING THE DEFINITION OF HARDSHIP

Treasury Reg. section 1.6161-1(b) provides further guidance on the issue. That regulation deals with the application for an extension of time to pay taxes, available under Code section 6161. That regulation states that, "The term 'undue hardship' means more than an inconvenience to the taxpayer."

Here we see that there is a clear distinction between the inability to, say, fund a planned family vacation (inconvenience), and the inability to make monthly mortgage payments, car payments and health insurance premiums. See: *In Re Carlson*, 189 B.R. 454 (Bankr. N.D. 1995). The IRS will not consider the inability to fund discretionary, non-necessary personal expenses to constitute a hardship at a time when taxes are owed.

The regulation goes on to state that hardship, at its core, implies "substantial financial loss" to a taxpayer forced to pay taxes at a given time. The regulation reads, "It must appear that substantial financial loss … will result to the taxpayer for making payment on the due date…"

Failure to make mortgage or car payments on time leads to substantial financial loss in the form of, at a minimum, damage to one's credit score, and in the worst case, the loss of a home or car through foreclosure or repossession. One might even risk the loss of a job due to a wage levy, or face eviction from, or loss of, rented business or personal property. The loss of heath or life insurance can arise from the lack of premium payments. The inability to pay necessary business expenses can lead to the decline and failure of one's business. These examples are the essence of financial hardship.

The regulation itself provides an example of hardship where the sale of property to fund the payment of the tax is considered. The complete sentence in question (which I edited above for clarity of focus) states:

> It must appear that substantial financial loss, for example, loss due to the sale of property at a sacrifice price, will result to the taxpayer for making payment on the due date of the amount with respect to which the extension is desired. If a market exists, the sale of property at the current market price is not ordinarily considered as resulting in an undue hardship.

This limited example applies to liquidation of property at fire sale prices to pay the tax. Such an act constitutes financial hardship. When a citizen has substantial equity in assets sufficient to cover the tax liability, the IRS generally requires such equity to be liquidated to pay the tax. However, when it can be shown that liquidating such property will itself constitute a hardship, such liquidation cannot be forced. The regulation uses the example of selling property at a loss. Other factors that might apply are spelled out in the following scenarios:

1. Taxpayer has substantial equity in a home and is on a fixed income sufficient only to pay necessary living expenses. Taxpayer cannot borrow against the home due to insufficient net income to service the debt. If the taxpayer sells the home, she will be unable to provide sufficient living accommodations for herself and minor children due to limited income.

2. Taxpayer is self-employed and operates a business out of the home. If the taxpayer were to sell the home and relocate to smaller accommodations, he would then have to lease commercial space for the business. This added business expense would substantially reduce net income, thus affecting the ability to pay necessary living expenses, and would even reduce his ability to pay the tax.

The liquidation of a tax-deferred retirement savings plan can cause "substantial financial loss" leading to hardship, which most people (especially the IRS) overlook. Consider this example:

1. Taxpayer owes $100,000 to the IRS and has $100,000 in an IRA. He is under 59½ years of age. If he liquidates the savings plan to pay the tax, he will incur current federal, and possibly state, income taxes on the distribution, as well as the 10% early withdrawal penalty. The combination of these taxes reduce his net distribution by about 40%. Thus, his $100,000 withdrawal would leave him with just $60,000 to pay the delinquent tax. He's lost 100% of his retirement plan but still owes the IRS $40,000.

Treasury Reg. section 301.6651-1(c)(1) (addressing the penalty for failure to pay the tax on time) provides additional guidance on what the IRS looks for in determining "hardship." That regulation provides, in part, that

> …consideration will be given to all the facts and circumstances of the taxpayer's financial situation, including the amount and nature of the taxpayer's expenditures in light of the income (or other amounts) he could, at the time of such expenditures, reasonably expect to receive prior to the date prescribed for the payment of the tax. * * *

In the context of a hardship levy release, the key factor here is the question of the citizen's *current* financial situation based on the facts and circumstances of his own case. The totality of the circumstances must be reviewed in making the decision about whether the levy is causing a hardship.

The regulation goes on to provide a caveat regarding unnecessary spending. It states:

> Thus, for example, a taxpayer who incurs lavish or extravagant living expenses in an amount such that the remainder of his assets and anticipated income will be insufficient to pay his tax, has not exercised ordinary business care and prudence in providing for the payment of his tax liability. Further, a taxpayer who invests funds in speculative or illiquid assets has not exercised ordinary business care and prudence in providing for the payment of his tax liability unless, at the time of the investment, the remainder of the taxpayer's assets and estimated income will be sufficient to pay his tax or it can be reasonably foreseen that the speculative or illiquid investment made by the taxpayer can be utilized (by sale or as security for a loan) to realize sufficient funds to satisfy the tax liability." Ibid.

Between this language and that of Treas. Reg. section 1.6161-1(b) (above), we can conclude that the term "hardship" does not include: a) mere financial "inconvenience," b) the inability to fund a "lavish or extravagant lifestyle," or c) funding investments in "speculative or illiquid assets." Thus, the mere showing that one faces financial difficulties does not by itself constitute "hardship." *Synery Staffing, Inc. v. United States*, 323 F.3d 1157, 1160 (9th Cir. 2003).

The question is, why does the financial difficulty exist? If it is attributable to any of the three factors just mentioned, the IRS will require the taxpayer to make lifestyle changes before considering long-term tax relief. If the financial difficulty is attributable to other factors (explained below) that make it impossible to pay "reasonable basic living expenses," then a hardship does exist. See: Treas. Reg. § 301.6343-1(b)(4)(i).

CONSIDERING THE TOTALITY OF CIRCUMSTANCES

In determining "hardship," the IRS must consider the totality of one's individual specific facts and circumstances. The factors the IRS must look at are found in various regulations and IRM provisions. As the Tax Court stated in discussing these various provisions, the listed factors are "not conclusive or exclusive" in determining the essential issue of "hardship." See: *Pomeroy v. Commissioner*, T.C. Memo. 2013-26. Any circumstance that bears on the question of hardship must be considered.

Let's start by looking at Treas. Reg. section 301.6343-1(b)(4)(ii)(A)-(F). Recall that Code section 6343(a)(1)(D) carries the non-discretionary mandate that the IRS must release a levy that is causing a hardship. This regulation spells out factors to consider in answering the hardship question. They are:

1. The age, education, employment status/history of the taxpayer; his ability to earn income, the number of dependents, or his status as a dependent of someone else;

2. Resources needed for food, clothing, housing, medical expenses, transportation, current tax payments, court-ordered payments, and expenses necessary to produce income;

3. The cost of living in the area where the taxpayer lives, including transportation expenses, local taxes, etc;

4. Unusual circumstances, including special education/rehabilitation expenses, medical catastrophe, illness/injury, disability, natural disaster; and

5. "Any other factor"that bears on the financial condition of the taxpayer at the time of the levy action. As the *Pomeroy* court stated, and as confirmed in the regulation itself, the above list is "not all inclusive." See: Treas. Reg. § 301.6343-1(b)(4)(ii)(F). Any and all factors identified by the citizen must be evaluated. See also: IRM 5.8.11.2. and 5.8.11.3. The key is, such factors must be identified and corroborated by the taxpayer.

Other regulatory authority supports the above reading of the "hardship" concept. Treasury Reg. section 301.7122-1(c)(3)(i) is the general authority for the IRS's ability to consider and accept an OIC based upon Effective Tax Administration (ETA). One situation when the IRS will accept an ETA-OIC is where full payment of the tax will cause "hardship."

Factors the IRS must consider, per the regulation, include ("but are not limited to") situations where:

1. The taxpayer can't earn income due to injury/illness/disability and it is likely his resources will be used up providing necessary care/support;

2. Monthly income is used up providing for the care of dependents with no other means of support; and

3. The taxpayer can't borrow equity in assets, and sale would make it impossible to meet basic living expenses.

IRM part 5.8.11.3.1 likewise addresses the factors the IRS is to evaluate in considering whether to accept an ETA-OIC based on "economic hardship." IRM parts 5.8.11.3.1(5) and 5.8.11.3.1(6) are a restatement of the three items identified in the regulation cited above. Part 5.8.11.3.1(5) carries the following caveat for OIC evaluators:

> Note: This list is not all-inclusive. Other factors may be considered in making an economic hardship determination.

IRM 5.8.11.3(7) provides specific examples of ETA-OIC cases that would be recommended for acceptance under the "hardship" criterion. The IRM examples are as follows:

> Example: The taxpayer has assets sufficient to satisfy the tax liability and provides full time care and assistance to a dependent child, who has a serious long-term illness. It is expected that the taxpayer will need to use the equity in assets to provide for adequate basic living expenses and medical care for the child. The taxpayer's overall compliance history does not weigh against compromise.
>
> Example: The taxpayer is retired and the only income is from a pension which does not meet his necessary living expenses. The only asset is a retirement account and the funds in the account are sufficient to satisfy the liability. Liquidation of the retirement account would leave the taxpayer without adequate means to provide for basic living expenses. The taxpayer's overall compliance history does not weigh against compromise.
>
> Example: The taxpayer is disabled and lives on a fixed income that will not, after allowance of adequate basic living expenses, permit full payment of the liability under an installment agreement. The taxpayer also owns a modest house that has been specially equipped to accommodate for a disability. The equity in the house is sufficient to permit payment of the liability owed. However, because of the disability and limited earning potential, the taxpayer is unable to obtain a mortgage or otherwise borrow against this equity. In addition, because the taxpayer's home has been specially equipped to accommodate the disability, forced sale of the taxpayer's residence would create severe adverse consequences for the taxpayer, making such a sale unlikely. The taxpayer's overall compliance history does not weigh against compromise.

The totality of the statutes, regulations and IRM provisions outlined above give us the full picture of what constitutes "economic hardship" as that phrase is used in Code section 6343.

"ECONOMIC HARDSHIP" RENDERS LEVY ILLEGAL

Section 6343(a)(1)(D) expressly provides that the IRS "shall release the levy" that "is creating an economic hardship due to the financial condition of the taxpayer." This is a clear mandate to release a levy *as a matter of law* if the taxpayer is suffering hardship because of it. There are no other conditions on this release but that you prove the hardship claim (discussed below).

This reading of the statute was confirmed by the Tax Court in *Vinatieri v. Commissioner*, 133 T.C. 392 (2009). That case involved a Collection Due Process appeal by a citizen who argued in her hearing that she should be granted uncollectible status. She proved that levies would cause hardship, and that she had no capacity to make an installment payment. The IRS's settlement officer (SO) ruled that she was not entitled to uncollectible status because she had several unfiled returns and was not current with estimated payments. As such, the SO placed additional, non-statutory, conditions on avoiding a levy beyond the mere hardship determination.

The Tax Court examined the statutes, regulations, IRM, and court decisions controlling the matter (all of which I analyzed above). The Court said:

> We have found no cases addressing the requirement that the taxpayer be current with filing returns in a levy case involving economic hardship under section 6343(a)(1)(D) and section 301.6343-1(b)(4), Treas. Regs. Neither section 6343 nor the regulations condition a release of a levy that is creating an economic hardship on the taxpayer's compliance with filing and payment requirements.

The plain truth is that there are no conditions beyond "hardship" that must be met to either prevent or release a levy under Code section 6343(a)(1)(D).

PROVING "ECONOMIC HARDSHIP"

The burden to prove "economic hardship" is on the taxpayer alone. The IRS does not have to prove hardship does not exist; the taxpayer must prove it does. However, once the allegation is made and information is provided to support the claim, the IRS must evaluate the claim using all of the criteria discussed above. This fact was made clear by the Tax Court in *Pomeroy v. Commissioner, supra*.

Pomeroy was a CDP case. Mr. and Mrs. Pomeroy owed about $110,000 in tax liabilities and the IRS filed a notice of federal tax lien. The taxpayers submitted a $25,000 OIC as their proposed collection alternative through the CDP appeal. After the Offer Unit began working the case, Mr. Pomeroy suffered a stroke and was "near death." This fact was communicated by Mrs. Pomeroy to the Offer Unit via letter. The Offer Examiner invited the Pomeroy's counsel to submit information showing "a current medical prognosis and diagnosis from your doctor verifying your medical condition and explaining how your medical condition affects you." A tight deadline was given by which to provide the information. *Pomeroy*, pg 2.

Counsel provided additional financial details but did so after the Offer Examiner closed the file and returned the case to the Appeals Office for resolution of the CDP appeal. The AO called counsel after reviewing the file and spoke with him briefly. Counsel just arrived at the office when the AO called, and asked to call her back. Counsel was told to return the call no later than 3:45 that day, or the case would be closed and the lien sustained. Counsel didn't call back. Rather, a doctor's letter describing Mr. Pomeroy's medical condition was submitted, but well after the CDP case was closed.

A timely Tax Court petition was filed by counsel, who alleged that the AO abused her discretion in rejecting the OIC because she did not consider Mr. Pomeroy's medical condition. In its analysis of the law, the Court reviewed all the same authorities that I cited and discussed above. The Court emphasized the requirement that the IRS consider all the circumstances the taxpayer alleges constitute hardship (in this case, in the context of an ETA-OIC).

The IRS acknowledged that the record in the CDP case did establish, even before the late submission of the doctor's statement, that Mr. Pomeroy had a stroke and was in serious condition. The Court observed that Mrs. Pomeroy notified the IRS that she was trying to obtain the medical records necessary, but that the AO "closed the case before [Mrs. Pomeroy was] able to procure the documentation." *Pomeroy*, pg 5.

The Court found that the AO did in fact abuse her discretion by failing to consider Mr. Pomeroy's medical condition. First, the IRS knew that he had a stroke and that his condition could very well have a "drastic effect on his medical expenses" and therefore, his ability to pay the tax. Next, the AO gave Mrs. Pomeroy "only 10 business days" to obtain the required information from their doctor. As it turned out, that was not enough time. And finally, the AO relied only on the record developed by the Offer Examiner, and did none of her own investigation or analysis of the medical problems suffered by Mr. Pomeroy, or their impact on his ability to pay. As the Court stated, the SO "made no attempt to ascertain the current status of Mr. Pomeroy's health or Mrs. Pomeroy's attempt to obtain a diagnosis or prognosis." Ibid.

Because of these failures, the Tax Court remanded the case to the Appeals Office for a full and proper analysis of the medical issues alleged in the case.

To meet the burden of proof that is on the taxpayer, hardship allegations must be supported, at a minimum, with all of the following information:

1. The specific nature of the hardship claim. Do not be vague or unclear about your situation. Flesh out details to the fullest extent possible.

2. Provide Form 433-A, Collection Information Statement, with supporting documents. The financial statement, Form 433-A (for individuals) must be filled out completely, especially page four, which lists current income and expense information. Supporting documents, including bank statements, brokerage statements, mortgage statements, earnings statements, etc., must be provided and must be current. If the IRS requests additional (or updated) documents, do not balk or complain. Submit what is asked for within the deadline given, or obtain an extension of the deadline, but don't fail to respond.

3. Affidavits and third-party statements. Provide whatever additional information, statements, letters, documents, etc., as are necessary and helpful to prove your case. Statements from third-parties should be provided in the form of an affidavit or declaration signed under penalty of perjury. Document all statements to the fullest extent possible. For example, a medical claim, such as that in *Pomeroy*, should be supported with medical records sufficient to allow the IRS to fully understand the scope of the problem, costs associated with it, and the long-term affect on the taxpayer.

Keep in mind that the burden of proof is on the taxpayer and you cannot over-prove your case. Also keep in mind that the IRS will only react to your allegations and supporting information. They *will not* undertake an independent investigation to uncover facts you don't raise, or gather proof you do not provide. As was the case in *Pomeroy*, if the IRS is not satisfied that you proved the case, they will simply deny relief.

REQUESTING A RELEASE OF LEVY

A levy can be issued from one of two sources: (1) the Automated Collection System (ACS), or (2) a Revenue Officer (RO). You will know who issued the levy by reviewing the bottom of the Notice of Levy itself. The contact information for the source of the levy is found there.

Regardless of who issued the levy, the procedure for getting it released is the same: Call the number on the levy notice and ask that it be released.

In the case of ACS, you will not have a name. You will speak to the person who answers the phone. Provide your identifying information and explain that a levy was issued that will cause economic hardship. Have all of your financial information organized ahead of the call, along with your hardship details. You will be able to fax the information directly to the ACS rep while you're on the phone. Be prepared to spend a substantial amount of time on the phone, as it will take time just to get through to an ACS rep.

In the case of an RO, you will speak directly to the RO who actually issued the levy. Follow the same steps I just explained.

If for any reason you hit a wall in either scenario, ask to speak with a manager. In the case of ACS, the manager will call you back in a day or so. In the case of an RO, get the manager's phone number and call her directly. Repeat your hardship claims and insist that the levy be released. In chapters 5 and 6 of my book, ***How to Get Tax Amnesty***, I discuss this process in great detail. Included there is a discussion of the collection appeal processes that apply if you cannot win the release of the levy.

CONCLUSION

Levies that cause hardship require prompt and particular action. Such levies are regularly released without long delay, but only when you come to the table with all of the tools needed to win the release.

2023 Taxpayers Defense Conference

The 2023 Taxpayers Defense Conference is now in the books. It was our 29th consecutive annual conference and it was a great success. We had about forty people in the room with us in Tampa, FL, and another fifteen streaming live online. Online attendees were able to participate by asking questions through the chat function on our platform.

Our presenters (besides myself) included Scott MacPherson, who did a two-hour ethics session; Steve Klitzner, who did a session on how to challenge underlying assessments in CDP appeals; and for the first time, my daughter MacKenzie Hesselroth (Pilla), who presented a session on how to meet the burden of proof in CDP cases. That session is an outstanding supplement to the above Special Report on releasing levies. All agree that she did a great job with her first-ever presentation of this kind. We will see more of her in the future.

MacKenzie discusses the burden of Proof

If you missed the Conference, we have self-study materials available. You can get tapes of all sessions and all the written handout material we used at the conference. **Call our office at 800-346-6829 to order your set today.**

2023 Defense Conference Speakers left to right: Dan Pilla, Steve Klitzner, MacKenzieHesselroth, Scott MacPherson

Dan Answers Questions

Jean takes questions from online attendees