

PUBLISHED IN "CAL TAX NETWORK" the NEWSLETTER OF THE TAX PROCEDURE AND LITIGATION COMMITTEE – TAXATION SECTION OF THE STATE BAR OF CALIFORNIA - 2010

Yes, Virginia, There is Collection Due Process

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Virginia O'Hanlon, a skeptical eight-year-old, wrote a letter to the editor of the New York *Sun* questioning the existence of Santa Claus. The editorial response was printed on September 21, 1897. Virginia was counseled to beware of skepticism because, yes, there is a Santa Claus, he exists as certainly as love and generosity and devotion exist.

A lawyer or a delinquent taxpayer might share Virginia's skepticism when considering whether Collection Due Process really exists. Taxpayer victories in IRS Collection Due Process cases in the Tax Court have not been frequent. There are many reasons for this, but the taxpayer's chances of success are limited by the relevant standard, abuse of discretion. Sometimes it has seemed that the Commissioner's discretion has no bounds in collection matters. The Tax Court reviews the Appeals Office determination for abuse of discretion. An abuse of discretion occurs if the Appeals Office exercises its discretion "arbitrarily, capriciously, or without sound basis in fact or law." *Woodral v. Commissioner*, 112 T.C. 19 (1999).

The *Vinatieri* opinion

In the *Vinatieri* case (*Vinatieri v. Commissioner*, 133 T.C. ___, No. 16 (December 21, 2009)) the Tax Court judge made it clear that there is a line that the IRS may not cross. Specifically, an IRS levy may not cause economic hardship to a taxpayer, even if the taxpayer is not current in his or her return filing responsibilities. The case was decided by Judge Howard A. Dawson, Jr. who was appointed to the Court in 1962 and now serves on senior status.

In *Vinatieri*, the Service sent the taxpayer a notice of intent to levy to collect unpaid Federal income taxes for 2002, somewhere between \$5,000 and \$10,000. The taxpayer timely requested a hearing in the Appeals Office. She submitted to the settlement officer Form 433-A, Collection Information Statement for Wage Earners and Self-Employed Individuals, indicating she had monthly income of \$800 and expenses of \$800, had \$14 cash on hand, and owned a 1996 Toyota Corolla four-door sedan with 243,000 miles and a value of \$300. The Court determined that, if the taxpayer's wages are levied on she will be unable to pay her reasonable basic living expenses. If her car is levied on, she will be unable to work.

The Appeals officer stated in her log that the taxpayer meets the criteria to have her account reported as currently not collectible because of hardship in accordance with the Internal Revenue Manual (IRM). However, the Appeals Office issued a notice of determination to proceed with levy, stating that the taxpayer was not entitled to collection alternatives because she had not filed her 2005 and 2007 Federal income tax returns. The taxpayer timely petitioned the Tax Court for review of that determination under section 6330(d), I.R.C. The Service filed a motion for summary judgment. The taxpayer,

proceeding pro se, responded with a lengthy letter describing her dysfunctional marriage, her extreme financial condition, and her health problems (pulmonary fibrosis) which made it impossible for her to work more than part-time. She also described her efforts to file her tax returns.

Under the regulations, the Secretary must release a levy upon all, or part of, a taxpayer's property or rights to property if, *inter alia*, the Secretary has determined that the levy is creating an economic hardship due to the financial condition of the taxpayer. Sec. 6343(a)(1)(D), I.R.C. The regulations provide that a levy is creating an economic hardship due to the financial condition of an individual taxpayer and must be released "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." Treas. Reg. 301.6343-1(b)(4).¹ The determination of a reasonable amount for basic living expenses 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. Treas. Reg. 301-6343-1(a).

The Court denied the government's summary judgment motion.

The Court held that the statute and regulations require release of a levy that creates an economic hardship regardless of the taxpayer's noncompliance with filing required returns. § 6343(a)(1)(D), I.R.C., and Treas. Reg. 301.6343-1(b)(4).

¹ The Regulations provide that, in determining a reasonable amount for basic living expenses the director will consider any information provided by the taxpayer including —

(A) The taxpayer's age, employment status and history, ability to earn, number of dependents, and status as a dependent of someone else;

(B) The amount reasonably necessary for food, clothing, housing (including utilities, home-owner insurance; home-owner dues, and the like), medical expenses (including health insurance), transportation, current tax payments (including federal, state, and local), alimony, child support, or other court-ordered payments, and expenses necessary to the taxpayer's production of income (such as dues for a trade union or professional organization, or child care payments which allow the taxpayer to be gainfully employed);

(C) The cost of living in the geographic area in which the taxpayer resides;

(D) The amount of property exempt from levy which is available to pay the taxpayer's expenses;

(E) Any extraordinary circumstances such as special education expenses, a medical catastrophe, or natural disaster; and

(F) Any other factor that the taxpayer claims bears on economic hardship and brings to the attention of the director.

Reg. 301.6343-1(b)(4)(ii).

The Court further held that a levy on the taxpayer's wages or car would cause the taxpayer to be unable to pay her reasonable basic living expenses, creating an economic hardship that would require release of the levy pursuant to section 6343(a)(1)(D), I.R.C., and Treas. Reg. 301.6343-1(b)(4).

Finally, the Court held that the motion for summary judgment should be denied because the government's determination to proceed with the levy was wrong as a matter of law and, therefore, was an abuse of discretion.

Impact of this case

Vinatieri essentially requires that the Appeals officer must make a determination that the levy will not create an economic hardship. The Appeals officer must verify that the requirements of applicable law and administrative procedure have been met, and whether any proposed collection action balances the need for the efficient collection of taxes with the taxpayer's legitimate concern that any collection action be no more intrusive than necessary. Sec. 6330(c)(2)(A). In *Vinatieri*, the judge determined that, when a taxpayer establishes that the proposed levy would create an economic hardship, it is unreasonable for the settlement officer to determine to proceed with the levy which section 6343(a)(1)(d) would require the IRS to immediately release. A determination to proceed with a levy that will cause economic hardship is wrong as a matter of law and, therefore, is an abuse of discretion.

This result applies equally to a collection officer's actions in the field. If a levy will cause economic hardship, the collection officer may not proceed. Under section 6343 and the supporting regulations, a levy that causes economic hardship must be released and should not be imposed in the first place, even if the taxpayer has failed to file one or more required returns. Collection officers frequently use the threat of a levy to spur the taxpayer to file delinquent returns. Under *Vinatieri*, the collection officer will need to be careful that the threatened levy is not one that will cause economic hardship.²

The key to the *Vinatieri* case is the literal language of section 6343 and the supporting regulations. This language simply requires that a levy must be released if it creates an economic hardship. In contrast, the Internal Revenue Manual provides that a collection alternative (e.g., installment agreement, offer-in-compromise, currently not collectible status) will not be available if the taxpayer has failed to file a required tax return. The Court correctly declined to read these Internal Revenue Manual requirements into the statute. (The *Vinatieri* case will be surprising to many IRS agents in the field who view the Manual as the gospel.) Query whether the result in *Vinatieri* would be differ if the return filing requirement were to be incorporated into the regulations. Would the regulation be valid?

² The Regulations provide that a taxpayer may inform the Service that a levy is creating economic hardship and request that the levy be released. Reg. 301.6343-1(c). However, the Regulations also make it clear that, even if the taxpayer does not request a release, if the Service determines that a levy is creating an economic hardship, the levy must be released and the taxpayer must be promptly notified. Reg. 301.6343-1(a).

Likewise, the reasons for the non-filing may be important. In *Vinatieri*, the taxpayer was unable to obtain a copy of the W-2 for 2005 because the payroll company that had prepared it had gone out of business. The taxpayer claimed she had filed a late 2007 return but the settlement officer was unable to find a record of it. Neither the settlement officer or the judge criticized the taxpayer's efforts to file her returns, or described her efforts as lacking in good faith. On the other hand, the regulations impose a good faith requirement in Reg. 301.6343-1 (b)(4)(iii), as follows:

(iii) Good faith requirement. In addition, in order to obtain a release of a levy under this subparagraph, the taxpayer must act in good faith. Examples of failure to act in good faith include, but are not limited to, falsifying financial information, inflating actual expenses or costs, or failing to make full disclosure of assets.

A tax protestor who refused to file returns based on frivolous grounds might well fail this test. A taxpayer who is grossly negligent in failing to file required returns would present an interesting case.

It is noteworthy that this result was achieved by a *pro se* taxpayer. The taxpayer's written response, quoted at length in the opinion, would tug at the heartstrings of anyone (except, obviously, the Commissioner of Internal Revenue). However, the taxpayer did not set forth a legal argument or any legal analysis. It would have been easy for the Court to grant the government's motion, or to dismiss the case for failure to properly prosecute. However, it appears that Judge Dawson concluded that the tax law and the collection due process scheme surely cannot condone a levy on a taxpayer in such sadly compelling circumstances, and who would sustain extreme hardship as a result of the levy. Judge Dawson dug in, did the work, and found the legal support for the laudable result.

So, Virginia, is there Collection Due Process? It would be an overstatement to say, without qualification, yes. However, the *Vinatieri* decision should increase public confidence that the Collection Due Process procedures, buttressed by Tax Court review, are effective safeguards against unduly harsh collection activity.

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