The IRS Disqualified Employment Tax Levy

Just When the Client Thought It Was Safe to Owe Money Again…

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Your client calls frantic one morning just as you are sitting down to your desk. "Joe, what's up?" you ask genially as you reach for your coffee.

"The IRS just cleaned out my bank account!" yells Joe.

"What do you mean? We worked out a payment plan a year ago at our Collection Due Process hearing with the settlement officer. I thought you paid that off."

"I did," says Joe, "but we filed our 941 a few weeks ago and had another balance I couldn't pay."

"A few weeks ago? Did they send you the Notice of Intent to Levy yet?"

"No."

So you call the revenue officer. After explaining that he just levied your client and was supposed to give notice, the revenue officer laughs. "Sorry, but I'm afraid you're wrong. Your client had a Collection Due Process a year ago. He has now run up another debt within two years. It's called a 'Disqualified Employment Tax Levy,' and we don't have to give him notice beforehand."

The IRS Restructuring and Reform Act

Prior to the Internal Revenue Service Restructuring and Reform Act of 1998 (the Reform Act)[1], taxpayers indebted to the Internal Revenue Service (IRS) were subject to intrusive, unfair, and arbitrary acts committed in furtherance of the IRS's efforts to administer the tax code (IRC). Testimony produced at hearings in front of members of the Senate Finance Committee detailed various abuses including deprivation of due process, commission of perjury by IRS agents, and an overarching policy of intimidating financially distressed taxpayers.[2]

[1] *See* IRS Restructuring and Reform Act of 1998, Pub. L. No. 105-206, §§ 1001-9016, 112 Stat. 685 (1998).

[2] *See IRS Restructuring: Hearings on Internal Revenue Service Restructuring Before the Senate Finance Comm.*, 105th Cong., *(1998)* (statement of Robert S. Schriebman), *available in* 1998 WL 47010.

On July 22, 1998, former President Bill Clinton signed into law the Reform Act as a response to the overwhelming dissatisfaction with the IRS expressed by the American taxpayer. Representing the largest overhaul of the IRS since the 1950s,[3] the Reform Act required the IRS to change its organizational culture, modernize, and improve taxpayer protections rights. With a new focus toward taxpayer service, the Reform Act was intended to make the IRS more user-friendly and to provide a greater degree of accountability to taxpayers.

The transformation required changes to almost every aspect of the organization. First, the IRS reorganized from a geographically based organization to a customer-based organizational structure with four operating divisions: (1) Wage and Investment, (2) Small Business and Self-Employed, (3) Large and Mid-Size Business, and (4) Tax Exempt and Government Entities.[4]

Second, the IRS developed a new mission statement embodying its enhanced focus on taxpayer service, with accompanying new measures of organizational performance including business results, customer satisfaction, and employee satisfaction.[5]

Additionally, new safeguards were implemented to make certain that enforcement statistics were no longer relied on as a basis for employee evaluations. Finally, the IRS made progress toward modernization by providing expanded electronic filing, developing a website with information directed toward taxpayer assistance, and installing a telephone routing system to answer taxpayers in a more effective and efficient manner. [6]

Arguably, the most important changes affected by the Reform Act concerned heightened protections for taxpayers. Included among these taxpayer protections was a shift of the burden of proof in a tax dispute from the taxpayer to the IRS,[7] the creation of an IRS Oversight Board,[8] the formation of the Treasury Inspector General for Tax Administration (TIGTA), and an enhancement of taxpayers' rights to sue the government for civil damages.[9]

Perhaps the greatest tool provided to the taxpayer through the Reform Act, though, was the creation of Collection Due Process (CDP) hearings.[10] CDP hearings provide taxpayers with an independent review by the IRS Office of Appeals (Appeals) regarding certain proposed collection actions by the IRS and were created to ensure that taxpayers are aware of their rights regarding liens and levies. It also allows taxpayers access to the United States Tax Court if a taxpayer believes the IRS abused its discretion in not providing the taxpayer a collection alternative. ▶

[3] Treasury Inspector General for Tax Administration Report, *The Internal Revenue Service Restructuring and Reform Act of 1998 Was Substantially Implemented but Challenges Remain*, Ref. No. 2010-IE-R002, March 1, 2010.

[4] *Id.*

[5] *Id.*

[6] *Id.*

[7] *See* Reform Act, *supra* note 4, at § 3001, 112 Stat. 726.

[8] *Id.* at § 1101, 112 Stat. 691.

[9] *Id.* at §§ 3101, 3102, 112 Stat. 727, 730 (1998).

[10] *Id.* at §§ 3401, 112 Stat. 685, 746 (1998).

Collection Due Process Programs and Collection Appeals Procedures

Current law allows taxpayers an opportunity for a meaningful hearing to review the IRS's decision to file a Notice of Federal Tax Lien (NFTL) or propose a levy of a taxpayer's assets.[11] At a CDP hearing, a taxpayer may raise any pertinent issues related to the unpaid tax, the lien, or the proposed levy, including arguments as to the appropriateness of the collection action, alternatives to collection (such as an offer in compromise [OIC] or an installment agreement [IA]), spousal defenses, and, in some instances, the underlying tax liability.[12]

The IRS must provide a CDP notice to the taxpayer after it has filed the first NFTL or generally before its first intended levy for the particular tax and tax period. Specifically, a CDP hearing is available if a taxpayer receives one of the following notices: (1) Notice of Federal Tax Lien Filing and Your Right to a Hearing under IRC 6320; (2) Final Notice – Notice of Intent to Levy and Notice of Your Right to a Hearing; (3) Notice of Jeopardy Levy and Right of Appeal; (4) Notice of Levy on Your State Tax Refund – Notice of Your Right to a Hearing; or (5) Post Levy Collection Due Process (CDP) Notice.[13]

The IRS must provide notice to the taxpayer not more than five business days after the day of filing the NFTL,[14] or not less than 30 days before the proposed levy.[15] In cases where the IRS has filed a lien, the CDP lien notice must include, "in simple and nontechnical terms," that the taxpayer has the right to request a hearing within a 30-day period beginning on the day after the end of the five-business-day period post-filing of the NFTL.[16] And, in cases involving a proposed levy, the CDP levy notice must inform the taxpayer of the right to request a hearing within the 30-day period beginning on the day after the date of the CDP notice.[17]

With respect to both lien and levy procedures, the taxpayer must submit a signed and dated written request for a CDP hearing within the applicable period.[18] The IRS encourages taxpayers to use Form 12153, *Request for a Collection Due Process or Equivalent Hearing,* in requesting a CDP hearing so that the request can be readily identified and forwarded to Appeals.[19]

Generally, the IRS will suspend levy action for the period during which a CDP hearing involving a notice of intent to levy is pending.[20] If, however, the IRS has determined that (1) the collection of tax is in jeopardy, (2) the collection resulted from a levy on a state tax refund, (3) the IRS has served a disqualified employment tax levy, or (4) the IRS has served a federal contractor levy, collection activity will *not* be suspended, and the taxpayer will only be given the opportunity for a hearing within a reasonable period of time *after* the levy, *not* before.[21]

Employment Taxes and The Disqualified Employment Tax Levy

Of particular concern to accountants and attorneys, particularly those representing business owners, is the exception to the pre-levy notice requirement for disqualified employment tax levies (DETL). The Small Business and Work Opportunity Tax Act of 2007 amended IRC §§ 6330(f) and (h) to permit the issuance of a DETL for collection of certain employment taxes without

[11] *See* Internal Revenue Code ("IRC") § 6320(c), *Notice of Opportunity for Hearing Upon Filing of Notice of Lien and § 6330(c), Notice and Opportunity for Hearing Before Levy.*

[12] IRC § 6330(c)(2).

[13] *See* Collection Appeal Rights, Publication 1660 (Rev. 2-2014), https://www.irs.gov/pub/irs-pdf/p1660.pdf.

[14] IRC §§ 6320(a)(2) (2015).

[15] IRC § 6330(a)(2) (2015).

[16] IRC § 6320(a)(3)(B) (2015); Treas. Reg. § 301.6320-1(b)(1) (2006).

[17] IRC § 6330(a)(3)(B) (2015); Treas. Reg. § 301.6330-1(b)(1) (2006).

[18] Treas. Reg. §§ 301.6320-1(c)(2)A-C1(ii) and 301.6330-1(c)(2)A-C1(ii).

[19] Treas. Reg. § 301.6320-1(c)(2)A-C1(iv)

[20] IRC § 6330(e)(1).

[21] IRC § 6330(f).

first giving the taxpayer pre-levy CDP notice. The purpose behind the amendment was to prevent employers from "pyramiding" – which is when an employer continues to incur new payroll tax debts fraudulently while they await their hearing with an appeals officer. Taxpayers who fall within this exception may have their assets levied without the general wait period and warning afforded to others.

The federal government levies payroll taxes on wages and self-employment income. Payroll taxes are a significant part of the federal budget, comprising 33.9 percent (approximately $1.07 trillion) of all federal revenues in 2014.[22] The two main federal payroll taxes levied on wages are known as Federal Insurance Contribution Act (FICA) taxes: the Social Security tax and the Medicare tax. A third prominent payroll tax is the Federal Unemployment Tax Act (FUTA) tax. Employers are responsible for withholding the appropriate amount of tax dollars from their employees' paychecks, paying the employer's share of payroll taxes, depositing the amounts with the federal government on either a semi-weekly or monthly basis,[23] and filing payroll tax returns.[24] The aforementioned collections process will apply to the taxpayer who fails to comply with the various requirements of the IRS's employment tax regime for the first time, but a taxpayer repeatedly facing employment tax liabilities would be well advised to become familiar with the statutory exceptions to CDP requirements.

For purposes of the DETL exception, IRC § 6330(h) defines it as a levy to collect the employment tax liability of a taxpayer (or predecessor) who requested a CDP hearing for unpaid employment taxes in the two-year period prior to the beginning of the taxable period for which the levy is served.[25] Accordingly, the three components of a DETL are: (1) a levy served to collect employment taxes; (2) a taxpayer (or its predecessor) who has previously requested a CDP levy hearing relating to employment taxes; and (3) the prior CDP hearing included unpaid employment taxes that arose within the two-year period prior to the beginning of the period for which the levy is served.[26]

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[22] Tax Policy Center, *What are the Sources of Revenue for the Federal Government*, www.taxpolicycenter.org/briefing-book/what-are-sources-revenue-federal-government-0.

[23] Treas. Reg. § 31.6302 (2011).

[24] Notice 931, *Deposit Requirements for Employment Taxes.*

[25] IRC § 6330(h)(1).

[26] IRM *Background, Pre-Levy Actions, Restrictions on Levy & Post-Levy Actions,* § 5.11.1.5.

(continued)

In other words, if a taxpayer incurs an employment tax liability, requests a CDP hearing, and subsequently incurs a new or additional employment tax liability within two years, the IRS is not required to issue a pre-levy notice to the taxpayer and may immediately levy the taxpayer's assets.[27]

Questions over the use of the term "requested" within the statutory language have resulted in situations where a taxpayer may have requested a CDP hearing but been denied for lack of timeliness or otherwise. The tax code does not require that the taxpayer actually be given a CDP hearing in order for the taxpayer to be subject to the DETL.

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Questions over whether a newly formed business constitutes a "predecessor business" for purposes of the DETL exception have also arisen. The IRS has provided the following factors to offer some guidance to assist taxpayers in determining "predecessor business" status under IRC § 6330(h): (1) the taxpayer has substantially the same owner(s) or shareholder(s) and the same officer(s) as the prior business; (2) the same individual(s) are actively involved in running the taxpayer that were actively involved in running the prior business, regardless of whether they are officially listed as the owners/shareholders/officers; (3) there is no evidence that the taxpayer's owner(s) or shareholder(s), if different than before, acquired the business in an arm's length transaction for fair market value; (4) the taxpayer provides substantially the same product(s), service(s), or function(s) as the prior business; (5) the taxpayer has substantially the same customers as the prior business; (6) the taxpayer has substantially the same assets as a prior business; and (7) the taxpayer has the same location, telephone, fax number, etc. as the prior business.

No one factor is determinative and the analysis will depend on the facts and circumstances surrounding the taxpayer and the prior business. Note, however, that a business will generally not be considered a predecessor if there has been a genuine change in control and ownership of the business, which is typically evidenced by an arm's length transaction for fair market value and the previous owner ceasing all involvement in running the business.

The IRS has had the authority to utilize DETLs since the Small Business and Work Opportunity Tax Act of 2007, but for reasons known only unto itself, has chosen not to use them on any large scale until recently. No longer. Since the beginning of 2016, the IRS Collection Division has been given new instructions to make greater use of the DETL when they come across situations where it is applicable. Letter 903, which is sent out to businesses not paying their payroll taxes, was revised in March of 2016 and explains that unless the taxpayer's account does not become current with the required deposits within 30 days of the date of the letter, the IRS may seize the taxpayer's property to satisfy the tax debt.

Conclusion

Although the IRS has rarely utilized the DETL, that appears to be quickly changing. It is imperative, therefore, for accountants and tax practitioners to be fully aware of the DETL exception for clients who have a payroll tax issue and to advise such clients that failure to maintain payroll tax compliance may result in levy action by the IRS in the future, with the client's first notice of the problem happening only when they find out they have no money in the bank.

[27] The following is an illustrative example: Taxpayer owes taxes on Form 941 for the fourth quarter 2012 (ending Dec. 31, 2012). The taxpayer timely requested a CDP hearing. The taxpayer subsequently accrues additional employment tax liability on Form 941 for the second quarter 2013 (ending June 30, 2013). The liability period for additional tax began on April 1, 2013. The additional liability for the second quarter 2013 qualifies for a DETL because the taxpayer requested a prior levy hearing for a quarter that ended (Dec. 31, 2012) within the two-year lookback period (April 1, 2011 through April 1, 2013).

[28] IRM § 5.1.9.3; IRM § 5.1.9.3.16.

[29] IRM § 5.11.1.5.3.

[30] *Id.*

[31] Your author had two clients receive such notices and when he called the IRS Director of Field Collections was told that the IRS had given the field new instructions to make more use of the DETL.

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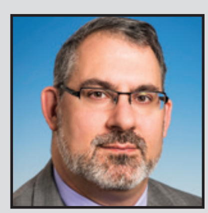

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