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The IRS Collection Division: Contacts and Settlements

Abstract

In his study -The IRS Collection Division: Contacts and Settlements - by John M. Tarras, Assistant Professor School of Hotel, Restaurant and Institutional Management, Michigan State University, Tarras initially states: "The collection division of the internal revenue service is often the point of contact for many hospitality businesses. The author describes how the division operates, what the hospitality firm can expect when contacted by it, and what types of strategies firms might find helpful when negotiating a settlement with the IRS."

The author will have you know that even though most chance meetings with the IRS Collection Division are due to unfortunate tax payment circumstances, there are actually more benign reasons for close encounters of the IRS kind. This does not mean, however, that brushes with the IRS Collection Division will end on an ever friendlier note.

"...the Tax Reform Act of 1986 with its added complexity will cause some hospitality firms to inadvertently fail to make proper payments on a timely basis," Tarras affords in illustrating a perhaps less pugnacious side of IRS relations.

Should a hospitality business owner represent himself/herself before the IRS? Never, says Tarras. "Too many taxpayers ruin their chances of a fair settlement by making what to them seem innocent remarks, but ones that turn out to be far different," warns Professor Tarras.

Tarras makes the distinction between IRS the Collection Division, and IRS the Audit Division. "While the Audit Division is interested in how the tax liability arose, the Collection Division is generally only interested in collecting the liability," he informs you. Either sounds firmly in hostile territory.

They don't bluff. Tarras does want you to know that when the IRS threatens to levy on the assets of a hospitality business, they will do so. Those assets may extend to personal and real property as well, he says. The levy action is generally the final resort in an IRS collection effort.

Professor Tarras explains the lien process and the due process attached to that IRS collection tactic.

"The IRS can also levy a hospitality firm owner's wages. In this case, it is important to realize that you are allowed to exempt from levy \$75 per week, along with \$25 per week for each of your dependents (unless your spouse works)," Professor Tarras says with the appropriate citation.

What are the options available to the hospitality business owner who finds himself on the wrong side of the IRS Collection Division? Negotiate in good faith says Professor Tarras. "In many cases, a visit to the IRS office will greatly reduce the chances that a simple problem will turn into a major one," Tarras advises. He dedicates the last pages of the discussion to negotiation strategies.

Keywords

John M. Tarras, The IRS Collection Division: Contacts and Settlements, Problem Resolution, Installment schedule, Tax liability, Collateral agreement

The IRS Collection Division: Contacts and Settlements

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The Collection Division of the Internal Revenue Service is often the point of contact for many hospitality businesses. The author describes how the division operates, what the hospitality firm can expect when contacted by it, and what types of strategies firms might find helpful when negotiating a settlement with the IRS.

It is an unfortunate fact that hospitality business owners sometimes encounter financial difficulties. Depending on the seriousness of the trouble, firms may find that they are unable to pay their taxes. The unpredictable nature of the hospitality industry has caused many such firms to come into contact with the Internal Revenue Service Collection Division. Even firms with no financial difficulties may have to deal with the Collection Division, because not all contacts with the division are a result of a troubled business. For instance, the Tax Reform Act of 1986 with its added complexity will cause some hospitality firms to inadvertently fail to make proper payments on a timely basis.

As a general rule, a hospitality business owner should not represent himself before the IRS. Too many taxpayers ruin their chances of a fair settlement by making what to them seem innocent remarks but ones that turn out to be far different. However, one should never completely rely on one's advisor (usually a CPA or an attorney) in these important matters. An informed owner can be of great assistance to his professional representative. By understanding how the Collection Division works, an owner has a much better chance of bettering his cause through an informed discussion with his tax professional.

Collection Division Differs from Audit Division

The Collection Division differs significantly from the IRS Audit Division. While the Audit Division is interested in how the tax liability arose, the Collection Division is generally only interested in collecting the liability.

Once a tax liability has been determined to exist, the Collection Division will normally be informed through internal IRS channels (usually by computer printout). The IRS will also mail a computer notice to the hospitality firm demanding payment of the taxes owed,

along with interest and penalties. The computer notices will be sent to the hospitality firm generally every four weeks. If several notices have been ignored by the hospitality firm, the IRS will send out a final form, appropriately entitled "Final Notice and Demand for Payment." On this form the IRS tells the hospitality firm that previous notices have been ignored and that unless payment of tax, interest, and penalty is made within 10 days, the IRS will levy on assets of the hospitality firm.

The IRS is not bluffing once notice of levy has been threatened and will levy on all the known assets of the hospitality firm, including not only bank accounts, but also personal and real property. The IRS may not know of all the assets of the hospitality firm, and will often utilize the "IRS Automated Collection System," which will dial the number of the hospitality firm or its owner(s) over and over during the business day. If the phone is answered, an IRS employee will talk to a representative of the firm and request additional information concerning assets which may be levied.

In a hospitality operation run as a sole proprietorship or general partnership, the owner(s) will be personally liable for any taxes owed by the business. In addition, owners of a closely-held corporation or certain key officers can also be held liable for payroll taxes owed by a hospitality firm in the form of a 100 percent penalty, a collection device usually assessed only when the tax cannot be collected from the firm, and resulting in a personal liability not dischargeable by bankruptcy.

If the hospitality firm does not pay the taxes owed or ignores previous attempts at contact by the automated collection system, the firm's file is forwarded to a revenue officer for disposition. A revenue officer is also involved in cases in which the hospitality firm voluntarily enters into negotiations for payment of back taxes.

The Internal Revenue Code gives revenue officers a tremendous amount of power to collect any taxes owed the U.S. government.¹ For instance, if a revenue officer thinks that a hospitality firm is not going to pay its back taxes, he may seize and close the business.² In addition, revenue officers have the authority to issue a summons,³ enforceable by a U.S. District Court,⁴ if need be, requesting information from the hospitality firm.

Because a revenue officer's powers are so broad, a closer examination of these powers is in order. Two of his most powerful collection devices are a federal tax lien and levy.

Federal Tax Lien Attaches to All Property

The authority to file a federal tax lien is one of the most effective tools at the disposal of the revenue officer. After a tax has been assessed and demanded, and the taxpayer either can't or refuses to pay it, the amount owed constitutes a lien in favor of the United States until the tax is paid. The lien attaches to all property—real, personal, tangible, and intangible. However, until notice of a tax lien has been filed, it is not valid against any purchaser, holder of a security interest, judgment lien creditor, or mechanics lienor.⁵ In the case of a tax lien

against a hospitality firm, it is generally filed in the county where the firm is located. However, a tax lien on real property must be filed in the county where the property exists.⁶

If the hospitality firm works out a compromise with the IRS and makes timely payments, there are circumstances in which a tax lien may be lifted. The IRS is likely to release any liens in which a superior lien attaches or the hospitality firm has no real equity in that property.⁷ If the hospitality firm does have an equity interest in the property, the IRS will lift the lien if the hospitality firm agrees to distribute all net proceeds to the IRS.⁸ The hospitality firm should be aware that the IRS will not permit the hospitality firm to share in the proceeds of the sale.

The IRS also has provisions allowing a hospitality firm to borrow against its property. Basically, the hospitality firm must show before it allows its interest to be subrogated or subordinated that it will not be in an inferior position after the borrowing than it was before.⁹ Of course, if the hospitality firm is borrowing to pay the IRS off, the service will agree to this.

If a hospitality firm pays all of its back taxes owed, it should make sure that any liens against it are lifted. Many firms have experienced great difficulty in securing financing for expansion because lenders run across an old lien still recorded against the property. A taxpayer should pay the taxes in person with a certified or cashier's check and obtain the release of the lien(s) immediately. Payment by personal check usually involves a waiting period before the IRS will release the lien.

The Levy Is Final Resort

One of the more dreaded events that can occur to a hospitality firm is when the IRS decides to levy on its assets.¹⁰ The Collection Division, if it complies with all of the statutory and judicial requirements in obtaining a consent order, can padlock the business and close operations. If a levy has begun, in many cases there is a very good chance that if you or your representative can contact the revenue officer directly and assure him that it would be in the best interest of the government to keep the business open, the IRS will release the property from the levy.

The Collection Division usually seizes property only when it feels there is very little likelihood of collecting the taxes from continued operation of the business. The levy is also often used by a revenue officer when the hospitality firm doesn't cooperate in the collection process. Clearly, it's important for the hospitality firm to keep an open line of communication with the revenue agent. Many times this is the best chance a hospitality firm has in keeping the business operating.

A revenue officer may also levy on money owed the hospitality firm from third parties. Generally, a third party has ten days to comply with a levy order. Hospitality firms in this situation should attempt to get this levy lifted and ask the third party to delay paying until the last possible moment.

The IRS can also levy a hospitality firm owner's wages. In this case, it is important to realize that you are allowed to exempt from levy \$75 per week, along with \$25 per week for each of your dependents (unless your spouse works).¹¹

If the IRS seizes the firm, the revenue officer will inventory all its assets.¹² It is very important to be present at this inventory, since this is your only way of proving that items existed if they should ever turn up missing after the property is released. The revenue officer is required not only to list the assets, but also to determine their value. This sale worksheet is used to establish the sales price of the various items.¹³

A hospitality firm has five days in which to protest the value determined by the revenue officer. The IRS may establish a minimum bid price for each asset. If the IRS fails to receive that bid price at sale, the law requires that the assets be released back to the hospitality firm.¹⁴ The firm should be careful not to buy back its own assets, since they can be seized by the IRS again.

Negotiating Strategies Are Numerous

Obviously there is no foolproof method of dealing with the IRS. Each situation is unique and is likely to require different strategies at different moments in the collection process.

One important fact to remember is that the IRS Collection Division has a reputation for being very inefficient. Delays, lost checks, failure to give credit for payments made, and failure by appropriate officials to respond to your questions are just some of the more common complaints in dealing with this division. Therefore, hospitality firms will be well served to be patient. In many cases, a visit to the IRS office will greatly reduce the chances that a simple problem will turn into a major one. The hospitality firm should document in detail all correspondence with IRS representatives, including getting the names of the individuals contacted. This will serve to demonstrate good faith if later a revenue officer charges that you've been uncooperative.

If you find that there is an impasse with the revenue officer in trying to settle your case, you should give serious consideration to utilizing the IRS Problem Resolution Office which can be used if you have attempted at least twice to resolve the matter through appropriate channels. Although it is often difficult to reach, the Problem Resolution Office is especially appropriate where there is a great deal of antagonism between you and the revenue officer.

Usually the Collection Division will attempt to work out a payment schedule with a firm, especially when it appears that it is the best way for them to collect the taxes owed. In general, there are three scenarios in which a delinquent hospitality firm will not be closed and its assets sold at auction for non-payment of back taxes.

The first is when the hospitality firm is experiencing temporary financial difficulties, but is likely to be able to pay the taxes owed sometime soon. In this situation, it is usually possible to get the IRS to hold off collection proceedings until such time in the near future that the hospitality firm is able to pay the back taxes in full. This

method is usually appropriate where the nonpayment is due to a one-time set of events beyond the hospitality firm's control (such as an incompetent bookkeeper).

The second scenario is when the hospitality firm has fallen behind in paying its taxes but can keep current presently, and is willing to pay off its back taxes on the installment method. In such a case, the revenue officer can (but is not obligated to) agree to an installment payment schedule. The length of the repayment plan is negotiable with the revenue officer. Usually the revenue officer will want the shortest time period possible to limit the exposure of loss. It's also in the hospitality firm's interest to pay the obligation off as soon as possible, since interest will continue to accrue on the outstanding balance owed.

Before the revenue officer will allow a hospitality firm to go on the installment plan, he will insist that the hospitality firm (and, where appropriate, key shareholders and officers) provide detailed financial statements. Typically, the hospitality firm must detail all sources of income and the location of all assets. The balance sheet portion of the financial disclosure form should show the assets at liquidation value, not the fair market. This is usually documented on Form 433-A. The representative of the hospitality firm signs Form 433-A under penalties of perjury with all of its legal ramifications.

Once the financial information has been provided to the revenue officer, all that remains to be done is to work out a payment schedule. The hospitality firm will need to show that the expenses listed in the financial statements are ordinary and necessary. If you can show that the expenses, if not incurred, will hurt the business, you will have a better chance of having them approved by the revenue officer.

Once you agree to the installment method, it is very important to keep current on taxes owed. If payments are not kept current, or the hospitality firm has not disclosed all of its assets, then the IRS could declare the entire agreement void and begin seizure proceedings. That is why, if the hospitality firm has enough equity in its assets, it is in most cases advisable to borrow on it to pay the taxes owed. The IRS is not the best creditor to have to deal with.

The last scenario is the rarely used "offer in compromise."¹⁵ The IRS can make this offer only when the hospitality firm is not in a condition to pay and in all likelihood will never be able to pay all of the taxes owed and any equity in the assets of the firm would be inadequate to pay the taxes owed. Factors which may contribute to the problem of collecting taxes in their entirety are an amount so great there is no likelihood that it can be paid, the age of the hospitality owner, and poor health of the owner and/or key officers.

A greater degree of financial disclosure is required with this method than under the installment method. The form used in these situations, Form 433, is a much more complex and detailed statement than Form 433-A. The IRS will not accept an offer in compromise for less than the total equity in the assets of the firm.

In addition to the hospitality firm's assets, if the tax liability arose because of non-payment of payroll taxes withheld by the hospi-

tality firm (referred to as the 100% penalty), key people in the organization can be held personally liable for the back taxes if the IRS can show that they were responsible for the collection of taxes,¹⁶ and they acted willfully.¹⁷

The so-called penalty is assessed against all responsible persons, and the IRS can collect from anyone it chooses to. Generally there is no right of contribution for any person who was required to pay the full amount of the penalty (back payroll taxes). Thus, in many instances the assets of key employees can be subject to collection also. This is an important consideration if the hospitality firm is contemplating utilizing the offer in compromise.

With an offer in compromise, the IRS will also insist that the hospitality firm enter into a collateral agreement whereby the firm agrees that, should the income of the firm exceed negotiated limits over a negotiated time limit, a portion of such excess will be payable to the IRS.

There is a price to pay for the collateral agreement, however. The revenue officer will insist that the statute of limitations be extended on collection for the period the offer in compromise is pending plus one year, and the hospitality firm must agree to give up any refunds and tax benefits it has coming upon acceptance of the offer. However, once the collateral offer is accepted, no further tax is due with regard to the taxes compromised unless contingencies in the agreement occur.

Many hospitality firms have ended up for various reasons before the Collection Division of the IRS. The powers that are vested with this area make it a dangerous agency from a business point of view.

Depending on the amount of back taxes owed, it is often advisable to engage the services of an ex-revenue officer of the Collection Division. His contacts and inside knowledge of how the system operates can be invaluable in seeking a payment schedule that is acceptable to your firm.

Most importantly, remember that the Collection Division has heard every story as to why taxes were not paid. They have, in many cases, become skeptical (sometimes justifiably so) of promises of repayment by hospitality firms. Therefore, the best policy is to be honest and not try to hide anything. Under such circumstances, you will usually find the revenue officer to be cooperative.

Only by knowing what to expect from the Collection Division ahead of time and being fully prepared can you hope to present the best possible solution to your tax problems. If your business is facing tax troubles, being well informed may be the difference between whether your business survives or fails.

References

- ¹IRC Sec. 6301.
- ²IRC Sec. 6331(a).
- ³IRC Sec. 7602.
- ⁴IRC Sec. 7604.
- ⁵IRC Sec. 6321.
- ⁶*Ibid.*
- ⁷IRC Sec. 6325(b)(2)(B).
- ⁸IRC Sec. 6325(b)(2)(A).
- ⁹IRC Sec. 6325(a).
- ¹⁰IRC Sec. 6331(d).
- ¹¹IRC Sec. 6334(d).
- ¹²IRC Sec. 6335(a).
- ¹³*Ibid.*
- ¹⁴IRC Sec. 6335(e).
- ¹⁵IRC Sec. 7122.
- ¹⁶IRC Sec. 6672(a).
- ¹⁷*Ibid.*