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IRS Collection Alternatives: Options for Taxpayers Who Cannot Pay Their Taxes in Full

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The last few years have been challenging for many taxpayers. COVID-19, inflation, supply-chain issues and financial losses have left many taxpayers struggling. Matters have recently worsened as COVID-related tax relief measures have mostly expired and the IRS is slowly catching up on its backlog. The latest infrastructure law is also giving more money to the IRS to increase audits. These factors mean that taxpayers must understand their options if they cannot pay their taxes in full. This article provides an overview of the most common collection alternatives.

IRS Collection Tactics

The IRS has an arsenal of tools they can use to compel individuals and businesses to pay their taxes. These include liens, levies, wage garnishment, penalties, passport revocation and criminal prosecution. Notably, in the case of businesses that owe taxes, the government can also go after the personal assets of certain responsible persons instead of just the assets of the business. This applies to IRS income taxes, social security taxes and Medicare taxes withheld from employee paychecks.

To avoid these consequences, taxpayers should consider an Installment Agreement, Offer in Compromise and/or Currently Not Collectible Status if they cannot pay their tax bill.

Installment Agreement

An IRS Installment Agreement (IA)[1] allows taxpayers to pay their bills over time. However, interest and penalties will continue to accrue on unpaid tax balances. As a result, this option is often best for taxpayers who have adequate income, but who cannot obtain a loan to pay the entire bill at once.

There are several types of installment agreements, each with its own requirements. These include the following:

• Guaranteed IA. This IA requires that:

- The amount of tax owed is less than $10,000 (not including interest and penalties);
- The taxpayer filed and paid all taxes due for the last five years;
- The taxpayer did not have had an IA with the IRS in the previous five years;
- The taxpayer can pay the full amount owed within three years; and
- The taxpayer agrees to pay the liability before the period for collecting the tax expires.

Note that a taxpayer is not required to submit a financial statement to qualify and may use the IRS's online service or phone to apply.

• Streamlined IA. A taxpayer may qualify if:

- The amount of tax owed is $50,000 or less (not including penalties and interest);
- The taxpayer can pay in full within 72 months and within the time limit for the IRS to collect the tax; and
- The taxpayer enters into a direct debit agreement if there is an assessed balance of $25,001-$50,000.

As with guaranteed IAs, streamlined IAs do not require a financial statement and one may use the IRS's online service or phone to apply.

• Non-streamlined IA. The requirements are:

- The taxpayer is an individual;
- The amount owed is $250,000 or less;
- The debt is paid within the remaining statute of limitations; and
- The taxpayer enters into a direct debit agreement if required to do so at the discretion of the IRS.

• In-Business Trust Fund Express IA. A business may qualify if:

- It currently has employees;
- Owes $25,000 or less at the time the agreement is established;
- The debt will be paid in full within 24 months; and
- It complies with all filing and payment requirements.

Note that taxpayers can apply either online or by mail.

• Routine IA. Taxpayers that do not qualify under any of the previous categories may obtain a routine IA. The full amount must be paid within the statute of limitations for collections and the taxpayer must stay current on all payments or the IA will default. Note that individuals who owe more than $50,000 or need more than six years to pay may be asked for additional financial information. If the debt cannot be paid in six years, the taxpayer may be given one year to modify or eliminate excessive unnecessary expenses.

• Partial Payment IA. This is available for taxpayers who cannot afford to pay their debt in full but do have the resources to pay a portion of it. The IRS will consider the taxpayer's assets and income less reasonable expenses to determine whether they qualify. Taxpayers must provide a financial statement and supporting documentation. Note that a partial payment IA is subject to IRS review every two years and may be changed upon review.

Pandemic Relief

Notably, during the pandemic, additional relief efforts were implemented for installment agreements and remain in effect including the following:

- Taxpayers with short-term payment plans have 180 days to pay instead of 120 days.
- Individuals who owe up to $250,000 may be able to set up non-streamlined IA's without financial documentation if their monthly payment proposal is sufficient and has not yet been assigned to a revenue officer.
- For individuals who were notified of taxes owed with liabilities up to $250,000 for Tax Year 2019 only, the IRS can offer one Installment Agreement opportunity with no lien filed.

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• For individuals and out-of-business entities, the IRS will automatically include certain new tax year balances accrued in existing IAs so these taxpayers can avoid a default of the agreement.

Offer in Compromise (OIC)

An OIC[2] is a settlement agreement in which the taxpayer's liability is generally reduced to an amount that the taxpayer can afford to pay, not what the taxpayer owes. The IRS usually conducts an intensive review of a taxpayer's financial information before acceptance of an offer. To qualify, taxpayers must show one of three grounds:

• **Doubt as to liability (DATL)**—the taxpayer can establish a genuine dispute as to the existence or amount of the correct tax debt under the law;

• **Doubt as to collectability (DATC)**—the taxpayer's assets and income are less than the full amount of the tax liability; or

• **Effective tax administration (ETA)**—the taxpayer may be able to fully pay the tax, but such payment would cause an economic hardship or there are compelling public policy or equity considerations.

Generally, the IRS will not accept an OIC on DATC grounds unless the amount offered reflects what the IRS would reasonably collect from the taxpayer (the Reasonable Collection Potential or RCP). The RCP is determined by looking at the taxpayer's net equity in assets and anticipated future income less specified amounts allowed for reasonable living expenses.

For ETA, the taxpayer must show that they can pay the balance in full but that it would cause an economic hardship and would not leave them with sufficient assets or income to meet their basic living expenses. Hardship is often accepted in cases involving advanced age or illness and where the taxpayer has minimal to no future earning potential and unknown future living expenses.

A taxpayer can also show that public policy or equity would allow the OIC, such as if they relied on erroneous advice or instructions issued by the IRS or a criminal or fraudulent act committed by a third party created the tax debt.

By entering into an OIC with the IRS, the taxpayer agrees to the following terms:

• The taxpayer will pay the offer amount agreed upon in the OIC;

• The taxpayer will file tax returns and pay taxes for the following five years;

• The taxpayer agrees that the IRS will keep any tax refunds, payments and credits applied to the taxpayer's tax debts prior to the submission of the OIC;

• The taxpayer agrees to forfeit any tax refunds that would have been payable during the pendency of the OIC.

Note that due to the pandemic, the IRS stated that it will provide relief for taxpayers having difficulty meeting the terms of previously accepted OICs.

Currently Not Collectible (CNC) Status

Another option for taxpayers is Currently Not Collectible (CNC) status, which provides temporary relief from collections. To qualify, taxpayers must show that they cannot pay both their taxes and basic living expenses. While the taxpayer's account is in CNC status, the IRS generally won't try to collect, but will still assess interest and penalties and may keep and apply tax refunds to the tax debt.

The IRS will conduct a periodic review of the taxpayer's financial situation and may remove them from CNC status if it is determined that they can pay some or all of their liability. Further, the IRS may ask taxpayers to:

• File any past-due returns;

• Complete a Collection Information Statement (Form 433-A or Form 433-F, and/or Form 433-B), and provide supporting documentation; and/or

• Continue to make Estimated Tax Payments and Federal Tax Deposits on time.

Conclusion

This is just a partial list of collection alternatives when taxes cannot be paid in full. The best option for a taxpayer depends on their individual circumstances.

1. https://www.irs.gov/payments/payment-plans-installment-agreements.
2. https://www.irs.gov/payments/offer-in-compromise.

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