

Statement before the
Committee on Ways and Means
Subcommittee on Select Revenue Measures
United States House of Representatives
Hearing on Small Business and Tax Reform

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Chairman Tiberi, Ranking Member Neal, and distinguished members of the Subcommittee on Select Revenue Measures, thank you for the opportunity to provide comment on the special burdens that the tax code imposes on small businesses and pass-through entities. I represent individuals and small businesses, including pass-through entities, with tax issues pending before the IRS and, for that reason, I have unique first-hand knowledge of the tax issues and problems relating to “unnecessary burdens” imposed by the IRS on pass-through entities and their equity owners.

The reference by the Committee to the term “special burdens” on pass-through is an understatement because many of the burdens imposed by the IRS represent misconduct. The term “misconduct” is a term I deem appropriate in circumstances where a tax code, tax regulations or Internal Revenue Manual is clear and the IRS actions are inconsistent with the clear statement of the law or the intent of Congress in connection with law, regulations and administrative guidelines.

IRS Levy Misconduct

Individual and business taxpayers, at times, fall behind in paying their tax liability. When that happens, the IRS appropriately can take enforced collection actions to collect an unpaid tax debt. However, there is clear law that the IRS shall not levy if the levy will create an economic hardship (§ 6343(a)(2)(D)²). This tax code provision has an interpretative tax regulation that defines “economic hardship” as a levy that denies the taxpayer the funds needed for food, housing transportation, medicine, health insurance, child care, court ordered payments, and other reasonable and necessary living expenses (Treasury Reg. § 301.6343-1(b)(4)). There is repetitive IRS misconduct of its power to levy as indicated by the following:

- The IRS **will levy the gross income of small business taxpayers** (including pass-through entities) even if that income is needed to pay necessary business expenses such as payroll, income tax payroll taxes and other necessary business expenses. These levies

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² § 6342(a)(2)(D) states that the IRS **shall release the levy** if the IRS *has determined that such levy is creating an economic hardship due to the financial condition of the taxpayer.*

are continuous levies. No business can survive if its gross income is subject to a continuous levy. Gross income levies on a business cause its failure and the subsequent job losses for its employees. It is misconduct where the business is otherwise viable.

Who are the losers with this IRS abuse of a clear and unambiguous tax statute? Treasury loses the tax revenue from the closed business and the tax revenue from its jobless employees. The former employees seek unemployment benefits, and there is an additional burden on the social service networks. Simply put, businesses cannot survive if their gross income is subject to a continuous levy. These gross income levies do more than create an economic hardship on a business, these levies destroy the business. Employees without income cannot make rent or mortgage payments resulting in additional home foreclosures. The local economy is also a loser. This is a systemic problem, not an isolated case. The IRS routinely uses its power to levy on the business gross income of Taxpayers even in circumstances where the Taxpayer has the ability to fully pay its tax liability. I see this willful misapplication of 6343(a)(2)(D) repeatedly in cases where the business is viable and there is also excess income available to make payments on the outstanding tax debt in installments. It is one of the clearest cases of IRS “misconduct.” The tax policy of Congress and the Administrated is united in the policy of growing businesses and growing jobs. Unfortunately, the IRS does not follow that tax policy or take that policy into account. These decisions to levy gross income are made by low level Revenue Officers who are not independently trained on the economic viability of a business. Managers routinely sign-off on these business-destroying continuous levies that are, in my opinion, clear cases of documentable “misconduct.”

- The IRS will also levy a taxpayer’s business bank account and retain funds earmarked in that account to pay income tax, payroll tax liabilities, necessary business expenses and employee salaries. Without those funds, taxpayers get behind in their payroll tax and income tax debt. The bank account levy is a slower death for a business. Although the bank account levy is not a continuous levy, IRS Revenue Officers will often repeat bank account levies. Taxpayers have the opportunity to request a refund of the funds necessary to continue their business operations. The problem here is that the refund procedure, even when favorable, is not immediate and it remains difficult for these taxpayers to continue their business operations. This is another case of IRS misconduct (violation of § 6343(a)(2)(D) prohibition of a levy that causes economic hardship) because these bank account levies take funds essential to sustain the ongoing business operations. There are alternatives to enforced collection. A business bank account levy should only take place in circumstances when the business has no potential to repay any of its tax debt. Congress has made it clear to the IRS that collecting some revenue in a part-pay Installment Agreement (one that will not fully pay the tax debt within the 10-year statute of limitation for collections on a tax debt)³ is preferable to having no viable collection at all. Part-payment Installment Agreements represent extremely strong Congressional guidance to get some money paid in by delinquent Taxpayers. Some tax debt repayment is better than closing the business with the resulting domino effect of lost jobs and lost Treasury revenue. The failure of the IRS to follow the economic hardship prohibition and the clear guidance of Congress is another instance of IRS misconduct.

³ § 6159(d).

- The individual owners of the pass-through businesses end up with the tax debt. Even where there is no business levy, the IRS will violate the tax code limitation on “economic hardship” by levying funds needed for housing, transportation, health insurance and other reasonable and necessary living expenses. Here again, there is repeated IRS misconduct (violation of 6343(a)(2)(D) prohibition of a levy that causes “economic hardship”).
- The National Taxpayer Advocate and the IRS have taken the position that a business cannot have an economic hardship⁴ within the meaning of section 6343(a)(2)(D)⁵. The IRS and NTA positions are each wrong (hence “misconduct”) because § 6343(a)(2)(D) and Reg. § 301.6343-1(a) do not distinguish between individual and business “economic hardship.” A plain reading of § 6343(a)(2)(D) states that the IRS shall not levy in any manner that creates an economic hardship. The IRS and the NTA cannot deny the reality in our present economy, or at any other time, that businesses can suffer an economic hardship. The incredulous position of the IRS that a business cannot suffer an economic hardship from a tax levy is contrary to the reality of business failures caused by levies of either assets or gross income that destroys the business and the jobs of the employees who worked in that business. It even fails common sense for the NTA and the IRS to take a position that a business cannot suffer an economic hardship. Since that error is discernable from the plain language of § 6343(a)(2)(D), it meets my definition of misconduct.
- IRS wage levies do not include specific instructions as the allowable amount of income that may be paid due to the garnishment. This leads to garnishments that create an economic hardship for the taxpayer. I also view this as misconduct because § 6343(a)(2)(D) uses mandatory language prohibiting levies that create an economic hardship on the employee taxpayer. For this reason, employers invariably over pay the IRS income needed by the taxpayer for reasonable and necessary living expenses. This is a practice well known to the NTA who has never advised Congress of this abusive IRS willful nonfeasance. For that reason, employers think all of the employee’s wages must be handed over to the IRS. Each request for levy of wages is accompanied by Publication 1494⁶ which identifies the amounts excluded from levy under § 6334⁷. The statutory exclusions from income under § 6334 are quite limited and are essentially summarized in the chart within Publication 1494. For example, in the case of a single person, the amount required to be paid to the Taxpayer is \$791.67 per month, an amount below the poverty level. Publication 1494 does not test for economic hardship contrary to the explicit intent of Congress as expressed in the economic hardship prohibitions

⁴ The regulations under § 301.6343-1 are incomplete in that they have not been promulgated for businesses. However, the statute is unqualified and applies to both individuals and businesses under the clear unqualified language of § 6343. The IRM of the NTA does not discuss this issue, but it only addresses “individual” economic hardship. See IRM 13.1.

⁵ TD 9007 that published the final OIC regulations on July 23, 2002. TD 9997 states that the economic hardship standard of § 301.6343-1 if the regulations “specifically applies only to individuals.”

⁶ Publication 1494 (2011)

⁷ These are statutory exclusions that include wearing apparel, school books, workmen’s compensation and other items specified in this statute.

expressed under § 6343(a)(2)(D). The employers are given no instructions to pay the employee all of the earned income needed for the employee's reasonable and necessary living expenses. This trickery is coupled with IRS nonfeasance for its failure to instruct employers that they must not pay all of the remaining income to the IRS. This is a systemic IRS practice and for that reason I view it as systemic misconduct.

- Tax code § 7811 authorizes the National Taxpayer Advocate (NTA) to issue a “Taxpayer Assistance Order” (TAO) if the NTA *determines the taxpayer is suffering or about to suffer a **significant hardship*** as the result of the manner in which the IRS is administering the tax law. A TAO⁸ would require that the IRS not levy or file a tax lien if those actions would create a “significant hardship.” The definition of a “significant hardship” means a serious privation⁹. For all practical purposes, the NTA has ignored this statute. In the NTA 2010 annual report to Congress, the NTA received nearly 300,000 requests for assistance and issues a TAO is less than ½ of 1% of the requests for TAO assistance. To underscore the lack of importance of TAOs to the NTA, the numbers of TAOs issued were listed in a single footnote to a 600 page 2010 report to Congress. The unused TAOs would, if used, order the IRS revenue officers and their manager to refrain from the kind of IRS levy misconduct I have identified above. Congress would not authorize the NTA to use TAOs under § 7811 unless they were also concerned with the lack of taxpayer assistance. Congress did not pass § 7811 with the intent that it not be used to stop IRS abuses of power, abuses of discretion and clear misconduct of the kind that I have identified. Accordingly, the clear failure of the NTA to use that authority is a serious administrative failure of that office and it meets my definition of misconduct¹⁰.
- Since the NTA has a clear record of substantial noncompliance with § 7811, the NTA has also proven the point that the 2,000 employees under the NTA are neither needed nor necessary. If administrative cuts are necessary at the IRS for budgetary reasons, the first place to start is with the office of the NTA and all of the employees under that office. The NTA operates mostly as an ombudsman to provide helpful liaison services. Indeed, those liaison services are helpful, but those services are inconsistent with the overriding mandate of Congress to issue TAOs in hardship situations. The NTA does not need a staff of 2,000 to write 600 page reports that few read.
- Revenue officers, other collection personnel, including the IRS service centers, will sometimes use their authority to reduce a levy or even release a levy in the event that the levy is creating an economic hardship. Some levy relief is possible from these sources. Most often the service centers request up to 30 days to consider a request for levy relief even when the levy is creating a current economic hardship.

⁸ The application for a Taxpayer Assistance order is made on Form 911.

⁹ Reg. § 301.7811-1(a)(4).

¹⁰ This is another case of nonfeasance. This nonfeasance is very serious because the TAOs would be effective to stop IRS levy, tax lien, and other abuses and/or misconduct that have injured taxpayers and businesses every since that authority was established in 1998.

- Installment Agreements¹¹ are options in all cases to prevent a levy and to stop a levy. However, financial statements are required before the IRS will consider an Installment Agreement and those financial statements.¹² Those financial forms require attached documentation and the process is too cumbersome and time consuming stop a business-destructive IRS levies to complete the required forms before the Taxpayer's business suffers irreparable harm. This is a problem that could be alleviated by a TAO (as intended by Congress under § 7811), but that assistance is never available. The other problem with Installment Agreements is that they are subject to the discretion of an IRS Revenue Officer. Under the Internal Revenue Manual, a Taxpayer will not qualify for installment payments unless all funds used for "unsecured debt" are paid over to the IRS as the mandated installment payment. Businesses have to make payments on unsecured loans and other unsecured debt (e.g., inventory or back rent) to stay afloat. Even though there is strong tax policy for the IRS to encourage full payment of a tax debt, the IRS creates difficult guidelines and administrative barriers before they will accept an Installment Agreement. The IRS is not tuned into the reality that businesses will fail and jobs will be lost under the existing inflexible, bureaucratic and cumbersome qualifying procedures before an Installment Agreement is approved. There is a streamline Installment Agreement procedure for taxpayers with tax liabilities of \$25,000 or less that does not require a financial statement. That \$25,000 limitation is far too low and ineffective for the pass through entities under consideration in this Hearing. There is no downside to raising that threshold because the Installment Agreement will be terminated automatically if the installment payments are not made. It is my opinion that the IRS has been misapplying § 6159 and, hence, meets my definition of "misconduct." The statute requires the IRS to make a determination that the Installment Agreement *will facilitate full or partial collection of the tax debt*. The IRS needs to be reminded that their administration of delinquent Taxpayers is to collect revenue in installments in those cases where full payment is not possible.

IRS Tax Lien Misconduct

The IRS uses tax liens for enforced collection of a tax debt even if the tax lien serves no economic purpose for many pass-through entities. A tax lien, when filed in the public records, gives the IRS priority status over property and not income. In the case of a service business (insurance agency, stock or mortgage brokerage firm, CPA firm, etc.), the assets are nominal and the lien serves no economic purpose for the IRS. Other pass-through businesses have no asset equity value that is more than nominal. In these situations, the tax lien will destroy the credit of the business, it will go on the credit report of the Taxpayer and remain there for 7 years after the debt is discharged. The net effect of a tax lien is that it makes it difficult for the business to grow. In many cases, the business is forced to close with a tax lien on their credit report.

The IRS has the plenary power to file a "Notice of Federal Tax Lien" (NFTL) tax lien in the public records on a taxpayer if there is any tax liability¹³. The IRS Internal Revenue Manual requires the filing of a tax lien for tax assessment balances of \$5,000 or more and states that the

¹¹ § 6159 Installment Agreements are discretionary.

¹² Form 433A or Form 433F for individuals and Form 433B for businesses

¹³ Section 6321

tax lien should be filed even if the tax balance is less than \$5,000 if the filing of the tax lien will promote payment compliance¹⁴. The tax lien will not be released until the tax debt is paid or otherwise discharged. The NFTL has severe negative economic consequences on individual and business taxpayers often initially and long after any tax obligation is resolved.

The IRS files a NFTL in the public records. Most businesses cannot function profitably if they cannot get credit. When requests are made for credit, lenders always check the most recent credit scores. I have seen lenders immediately withdraw funds from an account and I have seen other businesses denied loans. Customers also do credit checks on suppliers and then shop for a different supplier since they feel the lien makes the business a greater risk. It is very difficult for any business to remain a viable business after their credit reports reflect IRS tax liens. When the businesses close, jobs are lost, and taxable revenue is lost.

All of the U.S. credit agencies record tax liens in their credit reports, and that tax lien remains in place under the tax debt is discharged. At the present time, credit reports are instantly available and they are commonly referenced for most commercial and employment practices. Even if the IRS tax lien has a short life, the credit agencies will still keep that tax lien in their credit reports for seven years after the IRS releases its tax lien. For this reason IRS tax liens are a long term economic disaster for individual and business taxpayers.

It is not unusual for a business to have a tax debt at the end of its tax year that it cannot fully pay at the time the tax return is filed. The failure to full pay a tax debt by any individual or business is common. Yet the IRS will file a credit-destructive and business-destructive tax lien even if the taxpayer agrees to fully pay the outstanding tax liability with interest and penalties in an Installment Agreement, documenting the financial ability to fully pay that tax liability. The results of a tax lien include loss of credit, business failures, job losses, and a loss of tax revenue from the income. The federal loss is exasperated because those who lose jobs must survive on federal and local assistance provisions for the unemployed. In this chain reaction of events, creditors of the business reduce profit with even a greater loss of tax revenue collected by Treasury. Consequently, the capricious and mechanical filing of tax liens under current IRS administrative practices cause irreparable economic harm, especially in situations where the business taxpayers have the ability to make payments on their tax debt.

In the case of individual taxpayers who have received IRS tax liens, the loss of credit impacts negatively on their ability to get employment and housing. Employers and landlords commonly take into account IRS tax liens identified in credit reports. This credit impairment means that the individual taxpayer will less likely to buy a car, a home and other items that stimulate economic activity and grow taxable business income. The counterproductive policy of the IRS for filing tax liens is one haplessly ignored by the IRS and Treasury.

Obviously, there are reasons that justify a tax lien filed in the public records. A tax lien gives the IRS a secured priority interest against other unsecured creditors. That priority is meaningless if there are no significant assets subject to seizure and sale. As a general rule, the IRS seizures are limited to real estate that with equity in excess of 20% of the fair market. Absent that equity interest, there are zero reasons that your justify a tax lien that will destroy the credit of the

¹⁴ IRM 5.12.2.4.1 (10-30-2009).

Taxpayer and serve no other purpose but to harm the ability of the taxpayer to grow income and jobs.

There are taxpayers and businesses with no serious assets. Some of these businesses are service businesses, yet the IRS will still file a tax lien even in these cases where there are no assets to give the IRS a secured creditor preference. In these circumstances, the tax lien only serves the purpose of destroying the credit of the business and the individual taxpayers. Tax liens filed in these circumstances are frivolous, punitive and imprudent. In some cases, the filing of a tax lien, when it will obviously cause irreparable harm, is malicious. It is my personal opinion that the IRS use of tax liens without regard to its usefulness is counterproductive and not what Congress intended when it enacted § 6321.

The IRS recently published IR-2011-20 on February 24, 2011 to be a bit more liberal in its use of tax liens. This information release states that *The IRS will significantly increase the dollar thresholds when liens are generally filed. The new dollar amount is in keeping with inflationary charges since the number was last revised. Currently, liens are automatically filed at certain dollar levels for people with past-due balances.* It is my personal opinion that the policy of the IRS to file mandatory tax liens is a **legislative function**, and therefore misconduct. Congress did not draft a mandatory tax lien statute. The language drafted by Congress under § 6321 creates an unperfected lien, and not one that requires that the tax lien be perfected by a filing of the tax lien in the public records. The statute does not require the IRS to file the notice of lien in the public records. When the IRS created a mandatory filing of tax liens in the public records in its Manual, it converted a discretionary power to a mandatory rule that is in conflict with the intent of Congress. If Congress wanted to write a mandatory lien statute, requiring that unperfected tax liens be filed in the public records, that would be an easy addition to § 6321. The IRS mandatory tax lien policy is direct conflict with the intent of Congress under § 6321 to make the public-record filing of tax liens discretionary. The obvious legislative purpose of a tax lien is to facilitate the collection of assets from a delinquent tax payer. In the case of a consulting or other service business with no significant assets relative to the tax debt, the tax lien will destroy credit, destroy businesses, result in job losses and, overall, reduce the collection of tax revenue. I have no problem quantifying that IRS conduct as an abuse of power, a form of misconduct, because the IRS is transmuting a discretionary tax lien statute into a mandatory tax lien statute. As noted in IR-2011-20, the IRS will always file a tax lien in all cases where the tax debt reaches a yet unannounced threshold.

Call for IRS Abuse Hearings

If Congress and the IRS expect Taxpayers to follow the tax code, then the IRS must certainly follow the tax code. I have noted instance where the IRS, including the NTA, are not following some very important sections of the tax code. All of my comments made in this statement can be documented with actual individual and business clients. Every statement can be supported by witnesses injured by irresponsible and punitive tax levies and tax liens. I have not covered other abuses and misconduct that I have witnessed in civil and criminal examination. Frankly, there is no Congressional oversight on how the IRS administers the tax law. Congress assumes that the NTA and the Treasury Inspector General for Tax Administration (TIGTA) provide that oversight. That assumption is incorrect. As noted above, the NTA has substantively rejected its

authority to issue TAOs. Further, the employees of the NTA and TIGTA are not attorneys; they are substantially untrained on tax law issues. The managers know even less because their training is managerial and report writing. There are also problems with the present administrative structure of the IRS because it is nearly impossible to find a higher level manager who can intervene on a technical issue. The IRS has a cadre of “technical advisors” who are invisible and unnamed for Taxpayers and their representatives. My general sense of the IRS at this time is that it is in dire need of restructuring because it has too many levels of bureaucratic managers who make no contributions to substantive decisions of those in direct contact with Taxpayers and their businesses. The Office of the IRS Chief Counsel has always been and remains a competent professional office, but few decisions reach that level of competence and they are understaffed too to get more directly involved with the front line decisions being made by those in direct contact with taxpayers.

The current tax hearings are intended to support tax reform or tax simplification. That objective is better served by identifying the problems taxpayers have in dealing with the IRS. I have identified just a few of those problems in this Statement. To the extent that we will have improved tax law in the 112th Congress, that result should fix the problems identified by Taxpayers who are called as witnesses to testify about their IRS experiences. Congress cannot fix those problems without identifying those problems.

What is necessary in all of the administrative agencies of the U.S. government is transparency. Due to privacy law, the IRS is especially non-transparent. That lack of transparency can be reversed if Taxpayers are provided a platform to voluntarily upload their experiences with the IRS on a web page, organized by issue. That data, subject to unlimited accumulation, if organized by issue would create a valuable data base available to Congress and to the public. This very simple internet platform will create the missing transparency that could identify IRS abuses and misconduct in its infancy. Consider www.irsforum.org as a vehicle available to the public and Member constituents. The IRS Forum has been recognized as a non-profit educational organization. In effect the IRS Forum web page can provide *de facto* IRS transparency to the extent that it becomes well known to the public and to the constituents of Members of Congress. Any transparency with a taxpayer documented data base would reveal the kind of IRS abuses I have discussed in this Statement.

Respectfully submitted,

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