Legislative Recommendation #24

Protect Retirement Funds From IRS Levies, Including So-Called "Voluntary" Levies, Absent Flagrant Conduct by a Taxpayer

SUMMARY

- *Problem:* Congress has provided significant tax incentives to encourage Americans to save for retirement. Those policies reflect a recognition that almost all workers eventually retire and require retirement savings to pay their basic living expenses and that retirees who do not have savings often end up on costly public assistance programs. Those policies are undermined when the protections for retirement savings from levy are a matter of IRS policy, rather than codified in statutes, and the IRS allows taxpayers with tax debt to agree to "voluntary" levies on their retirement accounts.

- *Solution:* Prohibit the IRS from levying on retirement accounts unless a taxpayer has engaged in flagrant conduct.

PRESENT LAW

The IRS has wide discretion to exercise its levy authority. IRC § 6331(a) generally authorizes the IRS to "levy upon all property and rights to property" of the taxpayer, which includes retirement savings. Some property is exempt from levy pursuant to IRC § 6334.

The IRS has taken certain steps to protect retirement savings by requiring a specialized analysis prior to levy, with the steps laid out in the Internal Revenue Manual (IRM). One step is that the IRS has decided not to levy on the assets in a taxpayer's retirement account unless it determines the taxpayer has engaged in flagrant conduct.[1] The IRM does not define the term "flagrant conduct" but does provide 13 examples of such conduct.[2] In 2017, the IRS modified the IRM to adopt procedures that allow taxpayers to request voluntary levies on retirement accounts. If a taxpayer requests a voluntary levy, the IRS bypasses the determination of flagrant conduct.[3]

REASONS FOR CHANGE

Congress has provided significant tax incentives to encourage taxpayers to save for retirement, and the same policy considerations support shielding retirement savings from IRS levies. Almost all workers eventually retire, and they require retirement savings to pay for basic living expenses. In addition, retirees who do not have sufficient savings are more likely to experience economic hardship and qualify for public assistance, which taxpayers pay to provide.

While the IRM contains procedures to protect retirement savings by requiring a specialized analysis prior to levy, these procedures do not provide sufficient taxpayer safeguards. Since the 2017 IRM change, taxpayers who have not engaged in flagrant conduct to evade tax, and therefore would have been shielded from levies

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1 Internal Revenue Manual (IRM) 5.11.6.3(5), Funds in Pension or Retirement Plans (Mar. 14, 2024), https://www.irs.gov/irm/part5/irm_05-011-006. The IRS will also consider collection alternatives and whether the taxpayer relies on funds in the retirement account (or will in the near future) for necessary living expenses. IRM 5.11.6.3(3), (4), and (7), Funds in Pension or Retirement Plans (Mar. 14, 2024), https://www.irs.gov/irm/part5/irm_05-011-006.

2 IRM 5.11.6.3(6), Funds in Pension or Retirement Plans (Mar. 14, 2024), https://www.irs.gov/irm/part5/irm_05-011-006.

3 IRM 5.11.6.3(3), Funds in Pension or Retirement Plans (Mar. 14, 2024), https://www.irs.gov/irm/part5/irm_05-011-006. The IRS will still take the other steps and verify the taxpayer received collection due process rights.

on their retirement accounts in the past, may agree to voluntary levies, perhaps out of fear or anxiety, and consequently find themselves in economic hardship during retirement.

It is important to note that taxpayers generally may not rely on IRM violations as a basis for challenging IRS actions in court, and the IRS may modify or rescind IRM provisions at any time without congressional or public input.

Because retirement accounts are critical to retirees' financial well-being, we recommend that Congress codify levy protections, rather than leaving their scope to the IRS's discretion. Under IRC § 6334, the IRS is prohibited from levying on certain sources of payment, such as unemployment and child support. These exceptions reflect policy determinations. For example, Congress has determined the IRS should not levy on child support payments because doing so would likely harm children. To better protect retirement savings, the National Taxpayer Advocate recommends Congress add retirement savings to the list of exempt property, absent flagrant conduct, and define the term "flagrant conduct" in the statute.[4]

RECOMMENDATIONS

- Amend IRC § 6334(a) to include qualified retirement savings as a category of property exempt from levy unless it is determined that the taxpayer has engaged in flagrant conduct and the levy would not create an economic hardship.[5]
- Amend IRC § 6334 to define "flagrant conduct" as an action intended to evade or defeat any tax imposed by Title 26 or the collection or payment of any such tax.[6]

4 We recognize that adopting these recommendations would impact taxpayers who might want to dip into their retirement savings to pay their tax debts and request a levy to avoid the ten percent tax that applies to early distributions from retirement accounts. On balance, however, we believe the greater protections afforded to retirement savings by our recommendations outweigh this impact.

5 In rare cases, a taxpayer with vast retirement savings may be delinquent in paying his or her tax debts without having engaged in flagrant conduct. To avoid providing an unlimited exemption from levy in these cases, Congress could make the levy exemption subject to a cap, such as $1 million in qualified retirement savings, and index it for inflation to maintain its value in future years.

6 For legislative language generally consistent with these recommendations, see, *e.g.*, John Lewis Taxpayer Protection Act, H.R. 3738, 117th Cong. § 203 (2021); and Taxpayer Protection Act, H.R. 2171, 115th Cong. § 203 (2017).