2007 LITC Conference

Allowable Living
Expense (ALE) Standards
and Collection Alternatives

December 12, 2007

What We Plan to Discuss Today

First Topic: Allowable Living Expense (ALE) Standards

I. What's ALE All About?

II. How ALE Works

III. What's New with ALE?

IV. Helpful ALE Hints

V. Conclusion

What We Plan to Discuss Today

Second Topic: Collection Alternatives

I. Installment Agreements (IA)
II. Offers in Compromise (OIC)
III. Currently Not Collectible (CNC)

Third Topic: Question and Answer Session

FIRST TOPIC: ALLOWABLE LIVING EXPENSE (ALE) STANDARDS

ALE Section I

What’s ALE All About?

I. What’s ALE All About?

- The IRS began using ALE standards in 1995
- IRS’s goal: Achieve more consistency in its employees’ collection decisions.
- RRA 98 codified the IRS’s use of ALE standards.

I. What’s ALE All About?

- The IRS uses ALE to determine a taxpayer’s current financial condition and ability to pay delinquent taxes.
- ALE serve as “guidelines” for various collection alternatives, such as an Installment Agreement (IA), Offer in Compromise (OIC), and Currently Not Collectible (CNC).

I. What's ALE All About?

- The law requires IRS personnel to determine whether a deviation from the statutory guidelines is appropriate based on the particular facts and circumstances of each taxpayer.

I. What's ALE All About?

- IRS personnel must avoid ALE decisions that "would result in the taxpayer not having adequate means to provide for basic living expenses."

  IRC § 7122(d)(2)(B)

I. What's ALE All About?

- The IRS derives the ALE standards from Bureau of Labor Statistics (BLS) measurements.
- The IRS divides the ALE standards into three subgroups:
  - ➢ National Standards
  - ➢ Local Standards
  - ➢ Other Expenses

I. What’s ALE All About?

- The IRS incorporates the “necessary expense test” for determining ALE standards.
- The test allows expenditures that a taxpayer needs to provide for his or her family’s health, welfare, and production of income.

I. What’s ALE All About?

- Expenses must be reasonable.
- IRS collection personnel may deviate from the standards when failure to do so would cause economic hardship.
- National Standards = “hard floor.”
- Local Standards and Other Expenses = “soft ceiling.”

ALE Section II
How ALE Works

II. How ALE Works

A. <u>National Standards</u>

- The IRS allows the same amount nationally, based on family size, for certain necessary living expenses:
  - Food
  - Housekeeping supplies
  - Apparel and services
  - Personal care products and services
  - Miscellaneous

II. How ALE Works

- The IRS usually determines family size by the number of exemptions on the taxpayer’s income tax return.
- Generally, for National Standards, the IRS does not require the taxpayer to substantiate actual costs, provided the taxpayer does not claim more expenses than the allowable amounts.

II. How ALE Works

B. <u>Local Standards</u>

- Rather than one national amount, the IRS uses varying standards based on local living areas to account for basic living expenses such as:
    - Housing and Utilities
    - Transportation

II. How ALE Works

1. Housing and Utilities
    - Amounts come from BLS and have been provided for each county.
    - Housing includes mortgage or rent payments, interest, property taxes, necessary maintenance and repair, and homeowner fees.

II. How ALE Works

1. Housing and Utilities - continued
   - Utilities include: gas, oil, other fuels, electricity, water, trash collection, septic cleaning, telephone, and cell phone.
   - Generally, the total number of persons for determining family size should be the same number as the taxpayer claimed on his or her income tax return.

II. How ALE Works

1. Housing and Utilities - Continued
   - The IRS allows the standard amount for housing and utilities, or the amount actually paid, ***whichever is less***.
   - **Soft cap**: If the taxpayer claims more than the standards allow, the taxpayer must substantiate the expenses are necessary.

II. How ALE Works

2. Transportation
   - Separated into two categories:
     - Ownership = Cost of payments (lease or purchase).
     - Operating = Costs of insurance, registration, license, inspection, maintenance, repairs, fuel, parking, and tolls.

II. How ALE Works

C. Other Expenses

- The IRS may allow additional living expenses if the costs meet the necessary expense test.
  - Examples include childcare, dependent care, accounting and legal fees, etc.

II. How ALE Works

- Five-Year Rule
  - The IRS may allow additional expenses, called “excessive necessary and conditional expenses,” which do not meet the necessary expense test, if the taxpayer can pay his or her entire tax liability within five years.

  IRM 5.19.1.4.3.5

II. How ALE Works

- One Year Rule
  - The IRS may allow a taxpayer up to one year to modify or eliminate excessive necessary expenses if the taxpayer cannot pay their accounts in full within five years.

ALE Section III

What's New With ALE?

- Overview

III. What's New With ALE?

- Overview
  - On October 1, 2007, the IRS adopted several significant changes to the National and Local standards.
  - These can be accessed at: http://www.irs.gov/businesses/small/article/0,,id=104627,00.html

III. What's New With ALE?

- The IRS worked with TAS to develop the new standards.
- The IRS committed to collaborate with TAS in 2008 to ensure that the standards reflect taxpayers' actual living expenses and self-sufficiency needs.

ALE Section III

What's New With ALE?

A. Changes to National Standards

III. What's New With ALE?

A. Changes to the National Standards

- Added Alaska and Hawaii to the Continental United States (CONUS) National Standards.
- Eliminated income ranges for National Standard allowances.
- Increased the National Standard allowances based on family size.

III. What's New With ALE?

NEW NATIONAL STANDARDS	**One Person**	**Two Persons**	**Three Persons**	**Four Persons**
Food	$270	$511	$615	$737
Housekeeping supplies	$28	$59	$61	$72
Apparel & services	$85	$150	$206	$239
Personal care products & services	$30	$53	$56	$64
Miscellaneous	$81	$152	$185	$219
Total	**$494**	**$925**	**$1,123**	**$1,331**

More than four persons	**Each Additional Person**
For each additional person, add to four-person total allowance:	**$246**

III. What's New With ALE?

- Example:
  - Suppose a taxpayer has a household of three people. The National Standard expense allowance for three persons is $1,123.
  - Suppose further that the taxpayer has actual monthly expenditures totaling $1,000.
  - Therefore, the IRS would automatically allow the National Standard amount of $1,123.

III. What's New With ALE?

- Example - continued
  - Suppose instead that the same taxpayer actually incurred $1,300 per month in necessary living expenses.
  - Conclusion: The IRS would allow only the National Standard amount of $1,123, unless the taxpayer could substantiate a higher amount is reasonable.

III. What's New With ALE?

- Taxpayers must substantiate and justify as necessary ONLY those expenses that exceed the National Standards.
- The IRS will allow the standard amounts for the remaining expense categories.

III. What’s New With ALE?

- Example:
  - Suppose the taxpayer’s actual food expense are $800 due to prescribed or required dietary needs.
  - The National Standards would normally allow the taxpayer only $500.
  - The taxpayer must therefore substantiate the additional $300.

III. What's New With ALE?

- The IRS has created a new National Standard for ***out-of-pocket health care*** expenses.
- Established as a floor on a per person basis, and does not require taxpayer documentation unless the amount claimed exceeds the standard.

III. What's New With ALE?

- Out-of-pocket health care expenses include:
  - Medical services
  - Prescription drugs
  - Medical supplies, including eyeglasses and contact lens

III. What's New With ALE?

- Elective procedures are generally not allowed.
- Out-of-pocket health care standard expense is allowed in addition to the amount taxpayers pay for health insurance.

III. What's New With ALE?

- The IRS developed a new table for out-of-pocket health care expenses based on Medical Expenditure Panel Survey data.
- The table includes a minimum allowance per taxpayer and his or her dependents.
  - ➢ Under age 65: $54
  - ➢ Age 65 and older: $144

III. What’s New With ALE?

- Example:
  - Husband and wife are ages 67 and 61.
  - The IRS would automatically allow \$198 for out-of-pocket health care expenses (\$144 for husband plus \$54 for wife).
  - The couple would need to substantiate any higher costs.

ALE Section III

What’s New With ALE?

B. Changes to Local Standards

III. What's New With ALE?

B. Changes to Local Standards

1. Housing and Utility Changes
   - The categories have been expanded to include households of four, five or more.
   - The IRS also added an allowance for cell phone expense.

III. What's New With ALE?

- Example
  - ➢ Assume the local standard for housing and utilities for a single taxpayer is $720.
  - ➢ Suppose a taxpayer incurs $670 for housing and utilities and $40 for a cell phone.
  - ➢ The IRS would allow only $710, because it is the actual amount paid, and it is less than the local standard.

III. What's New With ALE?

- Example – continued:
  - Suppose instead that the same taxpayer incurred $1,000 for housing and utilities.
  - The IRS would allow only the local standard amount of $720, unless the taxpayer documented and justified a higher amount.

III. What’s New With ALE?

- The cost of Internet service still is not allowable, unless the expenditure meets the necessary expense test for the production of income.
- The cost of cable television also continues as not allowable.

III. What's New With ALE?

2. Transportation Changes

- The IRS created a separate nationwide allowance for public transportation (previously included in the vehicle operating cost).
- The IRS now automatically allows the public transportation cost for all taxpayers without a vehicle.

III. What's New With ALE?

- Likewise, the IRS reduced the vehicle operating cost since this previously included an allowance for public transportation.
- The IRS has now set the ownership and operating cost allowances for a second vehicle at the same amount as those for a first vehicle.

III. What's New With ALE?

- If a taxpayer has a car, but no car payment, the taxpayer is only allowed operating costs.
- Transportation allowances include an annual adjustment for fuel cost increases.

III. What's New With ALE?

- Additionally, taxpayers in Milwaukee, Cincinnati, Kansas City, and Tampa will now use the applicable regional numbers since local data was no longer available.
- Generally, if a husband and wife own two vehicles, they are allowed the amount claimed for each vehicle, up to the maximum allowances for ownership and operating expenses.

III. What's New With ALE?

Public Transportation	
National	$163

Ownership Costs		
	One Car	**Two Cars**
National	$478	$956

III. What’s New With ALE?

- Example:
  - A couple, with two cars, resides in Jacksonville, FL.
  - The maximum allowable amount for ownership expenses of each car is $478.
  - The maximum allowable operating expenses of two cars is $362.

III. What's New With ALE?

- If a taxpayer owns a vehicle and uses public transportation, expenses may be allowed for both, provided they are needed for the health and welfare of the individual or family, or the production of income.

III. What's New With ALE?

- However, the expenses allowed would be actual expenses incurred.
- Documentation would not be required unless the amount claimed exceeded the standard.

III. What's New With ALE?

- Example:
  - Suppose a taxpayer takes a train to work, but drives a vehicle from home to the train station.
  - The IRS would allow the actual expenses incurred for vehicle ownership, operating costs, and public transportation (the train fare), unless they exceeded the standard.

ALE Section III

What's New With ALE?

C. Changes to Other Expenses

III. What’s New With ALE?

C. Change to Other Expenses

- While there some was discussion regarding standardizing childcare and dependent care expenses, the IRS adopted no changes for the other expenses.

ALE Section IV
Helpful ALE Hints

IV. Helpful ALE Hints

- Interested parties may find detail on the Allowable Living Expense standards on the IRS website at:

http://www.irs.gov/individuals/article/0,,id=96543,00.html.

IV. Helpful ALE Hints

- The IRS is currently revising its Collection Information Statements (Forms 433-A, 433-B and 433-F) to include updated instructions and to incorporate these changes.

IV. Helpful ALE Hints

- Ensure that the IRS has correctly applied ALE standards.
- If a taxpayer’s necessary living expenses exceed the IRS allowance, assist taxpayers in gathering the required verification to substantiate a higher amount.

IV. Helpful ALE Hints

- Some examples to advocate for higher expenses:
  - ➢ Cost of food and clothing is higher because of the geographical area in which the taxpayer lives.
  - ➢ Taxpayer has necessary medical prescriptions but is unable to fill them because of lack of income.

IV. Helpful ALE Hints

- Examples – continued:
  - Cable and Internet Service
  - Families with two cars and two car notes but only one of the spouses is employed.

ALE Section V
Conclusion

V. Conclusion

- The IRS's use of ALE is in many ways an imperfect science.
- NTA cited ALE as a Most Serious Problem in the 2005 and 2006 Annual Reports to Congress.
- Concerns focused on the IRS's application of standards, which often leads to wrong conclusions.

V. Conclusion

- The new standards appear to be a significant improvement, particularly for low-income taxpayers.
- Remember, the law intends for the standards to be **guidelines.** Be alert to instances where the standards do not provide for adequate basic living expenses and ***advocate*** accordingly.

SECOND TOPIC:
COLLECTION ALTERNATIVES

Overview of IRS Collection Alternatives

I. Installment Agreements
II. Offers in Compromise (OIC)
III. Currently Not Collectible (CNC)

Collection Alternatives

Section I

Installment Agreements

I. Installment Agreements

- Arrangements whereby the IRS allows taxpayers to pay their tax liabilities over time.
- During the duration of agreements, penalty and interest continue to accrue.
- The IRS may not levy while an installment agreement remains in active status.

I. Installment Agreements

- Guaranteed IA
  - Under IRC 6159(c), IRS must accept an IA when a taxpayer owes less than $10,000, has filed and paid all tax returns during the 5 years prior to the year of the liability, has not had a prior IA during those 5 years, and can full pay the tax liabilities within 3 years.

I. Installment Agreements

- Streamlined IA
  - Taxpayer owes $25,000 or less and can full pay the liabilities within 60 months or prior to the collection statute expiration date, whichever comes first.
  - Does not require detailed financial analysis or managerial approval.

I. Installment Agreements

- Streamlined IA
  - Can be set up with the Online Payment Agreement (OPA), by calling the number on the bill or notice, or by completing Form 9465, Request for Installment Agreement.

I. Installment Agreements

- Routine IA
  - Taxpayer does not qualify for a guaranteed or streamlined IA but can pay the liabilities prior to the expiration of the collection statute.
  - Financial analysis required
  - Allowable living expenses (ALE) apply.

I. Installment Agreements

- Partial Payment IA (PPIA)
  - Taxpayer cannot full pay the liabilities prior to expiration of the collection statute but has ability to make some regular payments.
  - Equity in assets must be considered.
  - Similar to, but different from an Offer in Compromise.

I. Installment Agreements

- User Fees
  - The IRS charges a user fee of $105 for all Routine IAs.
  - Taxpayers whose income falls at or below 250 percent of low income poverty guidelines may qualify for a reduced fee of $43.

Collection Alternatives

Section II

Offers in Compromise

II. Offers in Compromise

- Policy Statement P-5-100 provides:
  - The Service will accept an Offer when it is unlikely that the IRS can collect the full tax liability and the Offer reasonably reflects collection potential.
  - An Offer in Compromise is a legitimate alternative to declaring a case currently not collectible or to a protracted installment agreement.

II. Offers in Compromise

- The IRS's goals:
  - Maximize what the Service can collect at the earliest possible time and at the least cost to the government.
  - Rehabilitate the taxpayer and provide a fresh start toward future voluntary compliance.

II. Offers in Compromise

- Taxpayers may submit an Offer on the following grounds:
    - Doubt as to Collectibility
    - Doubt as to Liability
    - Effective Tax Administration

II. Offers in Compromise

1. Lump sum (cash)
   - Requires the Offer to be paid in ***five*** or fewer installments.
   - The taxpayer must provide a twenty percent down payment.
   - Low income taxpayers are exempt from the partial payment requirement.

II. Offers in Compromise

2. Short-Term Periodic Payment Offer
   - Requires completion within 24 months.
   - Taxpayer must submit the first installment with the Offer.
   - Taxpayer must make regular payments during the investigation.
   - Low income taxpayers are exempt from the initial down payment.

II. Offers in Compromise

3. Deferred Periodic Payment Offer
   - Requires payment of the offer amount over the remaining statutory collection period.
   - Offer must include the first payment.
   - Taxpayer must make regular payments during the investigation.
   - Low income taxpayers are exempt from the initial partial payment.

II. Offers in Compromise

- User Fees
  - Offers require a $150 application fee.
  - Fee waived for Doubt as to Liability, and for low income taxpayers.
  - Low income at or below 250 percent of federal poverty guidelines.
  - Low income taxpayers must complete Form 656-A.

Collection Alternatives

Section III

Currently Not Collectible

III. Currently Not Collectible

- Policy Statement P-5-15 (formerly P–5–71)
  - Provides the authority for reporting accounts as currently not collectible (CNC).
  - Most common reasons for CNC: taxpayer’s hardship or a taxpayer’s inability to pay.

THIRD TOPIC:

QUESTION AND ANSWER SESSION

Questions?

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