Learn How to Set Things Right with the IRS if You Have Tax Debt

Description

A large amount of IRS debt might be a heavy burden, but you can ignore the problem, the worst thing you can do. It is not going away.

“It depends on your debt level, but it can be overwhelming,” said Beverly Winstead, a tax attorney in Laurel, Maryland.

“For some folks, $10,000 in IRS debt may appear to be $100,000 for someone in my private business, but you can’t bury your head in the sand,” she explained. “There are solutions to help you get started in the correct direction.”

Resolving the issue by submitting current tax returns and possibly establishing a longer-term strategy to pay off back taxes due is a step in the right direction.

The IRS will continue to assess fines and impose interest on outstanding tax obligations until paid in full. In 2019, the service issued 782,735 notices of levy to third parties garnishing income from delinquent taxpayers. It lodged almost 543,604 tax liens on the property.

The longer you wait to deal with a tax debt situation, the bigger the hole becomes.

“Taxpayers who owe the IRS should deal with it as quickly as possible since it might linger for years,” said Tom Gibson, a CPA at Tax Saving Professionals in Vero Beach, Florida. “Ignoring it will just make it worse.”

Gibson advises taxpayers to prioritize settling tax debt over other responsibilities, even if it means foregoing a home mortgage. “The IRS has the authority to seize your house or your business assets,” he says.

What should you do if you are unable to pay?

The first option, particularly for business owners, is to obtain a bank loan or line of credit to pay off your debts. The interest may not be deductible, but it will likely be lower than the IRS’s effective rate.

Penalties on delinquent tax balances accrue at a monthly rate of 0.5 percent. The IRS also imposes interest on the sum at the federal short-term interest rate, presently 0%, plus 3%. This adds up to a 9% requirement, increasing if interest rates rise.

Another option is to take out a loan from a qualified pension plan, such as a 401(k) or an individual retirement account, which you can repay over time. You will miss out on prospective investment gains, and there will be some interest payable in replacing the funds. Still, it will be substantially less than the carrying cost of debt with the IRS.

Do not simply withdraw funds from your plan. “I think a lot of folks take it out as a taxable distribution, which makes things considerably worse,” Gibson explained.

If paying off the debt right away is not an option, taxpayers can set up an installment payment plan with the IRS for up to 72 months to address the problem. For balances of less than $10,000, you can set it up yourself at irs.gov without disclosing any financial information. If your debt exceeds that amount, you must provide the IRS with details about your monthly income and expenses.

“In many cases, consumers can just do it themselves on the IRS website,” Winstead added. “However, if it’s too much for them, they should consult with a lawyer or a tax representative.”

People who can’t afford guidance can get it for free through organizations such as the University of Maryland’s low-income taxpayer clinic, which Winstead helps manage.

In extremely desperate financial situations, taxpayers who believe they cannot pay a tax bill might make an “offer in compromise” to the IRS. It is essentially a request for the sum owed to be reduced. Be wary of companies who claim to be able to settle tax debt for pennies on the dollar. The IRS will require dire circumstances to agree to a tax debt reduction.

Catastrophic medical bills, a job loss, or unemployed family members relying on you may all qualify. However, if you still have a solid job, your prospects will be minor. “The IRS is unlikely to make a deal with a high-earning doctor or dentist,” Gibson added.

According to IRS data, the IRS received 54,225 compromise proposals from taxpayers in 2019 and accepted 17,890 of them. To make an offer, you must be current on your tax filings and have paid your projected taxes for the current year.

The IRS is not callous, but its decision will determine how recoverable your debt appears to be and how unique your circumstances are. “At the end of the day,” Winstead said, “it will rely on how much disposable income you have and how much equity and assets you own to pay down the debt.”

Because the IRS has been more indulgent with taxpayers throughout the pandemic, she stated that now is the time to address the issue. That could change.

“I suspect they’ll go back to more conventional collecting tactics as we get out of this,” Winstead said. “Now is the moment to take a step in the right path if you have unresolved difficulties with the IRS.”

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