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Who Wins When Uncle Sam Loses? Social Insurance and the Forgiveness of Tax Debts

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Shu-Yi Oei*

Small-scale tax collections decisions have large-scale distributive consequences. The central question addressed in this Article is whether a deliberate government decision to forgive or to not collect a tax owed can be justified, given the distributive consequences that may result. In brief, the government's decision not to pursue full collection of a delinquent tax debt may give rise to two types of distributive outcomes: First, the benefits of non-collection may be captured by the forgiven taxpayer's other creditors. Second, the costs of non-collection may be imposed upon compliant taxpayers and the public through higher taxes, decreased government provision of goods, services, and social assistance, or other macroeconomic impacts. These distributive outcomes may outweigh the potential justifications for tax non-collection. This Article demonstrates, however, that a social insurance framework, which conceptualizes tax non-collection as a transfer of the risk of financial distress from the taxpayer to the government in exchange for payment of an insurance premium, may justify these distributive outcomes and may hence justify the non-collection of tax debts. Further research is required to determine the extent to which tax non-collection procedures should be used to deliver

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social insurance, particularly given the existence of other government-provided social insurance programs.

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INTRODUCTION

Tax collections law is debtor-creditor law.¹ Like other debtors, taxpayers sometimes fail to pay their tax bills.² And, like other creditors, the government will sometimes be unable to collect, or may choose not to collect, the full amount of tax owed.³ Therefore, like other types of debtor-creditor law, federal tax collections law and

¹ MICHAEL I. SALTZMAN & LESLIE BOOK, *IRS PRACTICE AND PROCEDURE*, ¶ 14.01 (2010) (“The Internal Revenue Service . . . is a government creditor, and its claim that a taxpayer owes taxes is a type of debt.”).

² IRS tax gap analysis for the 2006 tax year showed that \$46 billion of taxes reported on time were not paid when due. See INTERNAL REVENUE SERV., *TAX YEAR 2006 TAX GAP ESTIMATE — SUMMARY OF ESTIMATION METHODS 5* (Jan. 2012), available at http://www.irs.gov/pub/newsroom/summary_of_methods_tax_gap_2006.pdf [hereinafter *TAX YEAR 2006 TAX GAP ESTIMATE*]. This \$46 billion “underpayment gap” constituted about 10% of the total gross tax gap. \$36 billion of the \$46 billion underpayment gap was attributable to individual income tax underpayments. See INTERNAL REVENUE SERV., *TAX GAP FOR TAX YEAR 2006: OVERVIEW*, Table 1 (Jan. 6, 2012), available at http://www.irs.gov/pub/newsroom/overview_tax_gap_2006.pdf.

³ See sources cited *supra* note 2. Based on IRS estimates, it is likely that a portion, but not all, of the underpayment gap will eventually be collected using IRS enforcement measures or based on voluntary taxpayer payments. See also *TAX YEAR 2006 TAX GAP ESTIMATE*, *supra* note 2, at 1, 5 (estimating that the amount of enforcement-generated payments and other late payments the IRS will eventually collect is \$65 billion; this number is the enforcement and other late payments total for all three parts of the tax gap analysis — the non-filing gap, the underreporting gap, and the underpayment gap). Exact numbers for the proportion of the 2006 underpayment gap that will eventually be collected via enforcement and voluntary late payments are not currently available. However, IRS estimates for previous years suggest that even after enforcement measures and voluntary late payments, a sizeable portion of the underpayment gap will remain unpaid. INTERNAL REVENUE SERV., *FEDERAL TAX COMPLIANCE RESEARCH: INDIVIDUAL INCOME TAX GAP ESTIMATES FOR 1985, 1988 AND 1992* 10-11, (Apr. 1996), available at <http://www.irs.gov/pub/irs-soi/p141596.pdf> (Showing that for 1985, 1988, and 1992, the estimated amounts collected from enforcement activities and late voluntary payments for individual income taxes were \$4.1 billion, \$6.4 billion, and \$4.8 billion respectively. For those years, the underpayment gap for individual income taxes was \$7.1 billion, \$11.2 billion, and \$8.4 billion respectively. *Id.* at 5. This means that for each year, a substantial portion of the gross underpayment gap with respect to individual income taxes probably does not end up being collected (\$3.0 billion in 1985, \$4.8 billion in 1988, and \$3.6 billion in 1992, based on the estimates).). *Id.* at 5.

policy must deal with issues such as how to collect, when to collect, when to forbear, and when to forgive a tax debt. These policy choices inevitably have important distributive and other impacts.⁴

This Article presents a framework for understanding and analyzing the distributive consequences of tax collections law and policy. Specifically, this Article focuses on instances in which the government decides to forgive a tax owed or to forbear from collecting all or part of such tax, either because it is unable to collect the tax or for other reasons.⁵ Such instances of what I call “tax non-collection” are an important feature of federal tax collections practice and procedure, but the existence and design of such provisions have been underanalyzed in tax scholarship to date.⁶ In previous work, I have argued that non-collection is a justified feature of tax collections law based on revenue raising, equity, and debtor-creditor policy considerations.⁷ More broadly, other scholars have argued that some amount of tax evasion (a set of behaviors that may encompass failure to pay a tax liability) might be desirable on efficiency or cost grounds.⁸ However, yet

⁴ Cf. Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336, 352 (1993) (“Any collection system necessarily has significant distributional implications because it fixes legal rights and creates priorities of repayment that represent the basis for participation in any renegotiation effort.”).

⁵ See sources cited *supra* notes 2 and 3.

⁶ While there is scholarship on IRS administrative collections mechanisms, that literature by and large has not honed in on the policies underlying the processes by which the IRS forgives delinquent tax debts. For a few notable exceptions, see Richard C.E. Beck, *Is Compromise of a Tax Liability Itself Taxable? A Problem of Circularity in the Logic of Taxation*, 14 VA. TAX REV. 153 (1994); I. Jay Katz, *An Offer in Compromise You Can't Confuse: It Is Not the Opening Bid of a Delinquent Taxpayer to Play Let's Make a Tax Deal with the Internal Revenue Service*, 81 MISS. L.J. 1673 (2012); Shu-Yi Oei, *Getting More by Asking Less: Justifying and Reforming Tax Law's Offer-in-Compromise Procedure*, 160 U. PA. L. REV. 1071 (2012). And, while there is scholarship on the priority and dischargeability of tax claims in bankruptcy, that literature has not dealt with the question of how pre-bankruptcy, administrative tax proceedings should interact with the treatment of tax claims in bankruptcy.

⁷ Oei, *supra* note 6, at 1081-100.

⁸ See, e.g., James Andreoni, *The Desirability of a Permanent Tax Amnesty*, 45 J. PUB. ECON. 143, 144-45 (1991) [hereinafter Andreoni, *Permanent Tax Amnesty*] (discussing the advantages of a permanent tax amnesty in increasing the efficiency and equity of the tax system); Luigi A. Franzoni, *Tax Evasion and Tax Compliance*, in *ENCYCLOPEDIA OF LAW & ECONOMICS* ¶ 6020, at 52 (Boudewijn Bouckaert & Gerrit De Geest eds., 2000) (suggesting that “it is not clear whether curbing or eliminating evasion is always a desirable goal”); Louis Kaplow, *Optimal Taxation with Costly Enforcement and Evasion*, 43 J. PUB. ECON. 221, 222-23 (1990) (analyzing the distortionary impacts of raising tax rates versus increasing enforcement activity in determining optimal enforcement policy); Joram Mayshar, *Taxation with Costly Administration*, 93 SCANDINAVIAN J. OF ECON. 75, 77 (1991) (noting the possibility that “the social costs of

unaddressed is the question of how the distributive consequences of tax non-collection should be evaluated given the unique relationship between the sovereign creditor and taxpayer-debtors; the borrowing relationships between taxpayer-debtors and private creditors; and the existence of other mechanisms for the relief of tax and other debts (such as state law insolvency procedures, federal bankruptcy law, and informal negotiations between debtors and creditors that take place in the shadow of formal law).

This Article fills this gap in the literature and builds upon previous work by examining whether the distributive consequences of tax non-collection can ever be justified.⁹ The Article presents two core insights, one descriptive and one normative: The descriptive insight is that tax non-collection likely results in a reallocation of benefits and burdens away from the distributive outcomes dictated by substantive tax law. Such benefits and burdens are not just reallocated between the sovereign creditor and the delinquent tax debtor; rather, they are distributed amongst the sovereign creditor, the delinquent taxpayer, other creditors of the delinquent taxpayer, and other taxpayers. Therefore, two types of distributive outcomes may occur that may undermine justifications for tax non-collection. First, the forgiven taxpayer's other creditors may capture the benefits of tax non-collection. If this occurs, the Internal Revenue Service's (IRS's) forbearance from collection will not benefit the forgiven taxpayer but rather that taxpayer's other creditors. Second, the costs of non-collection may be imposed upon compliant taxpayers and the public in the form of higher taxes; decreased government provision of goods, services, and social assistance; or macroeconomic impacts resulting from increased government borrowing. Thus, it is possible that non-

raising marginal tax revenue by expanding administrative effort may significantly exceed the social cost of raising marginal tax revenue by increasing the tax rate"); see also James Alm, *What is an "Optimal" Tax System?*, 49 NAT'L TAX J. 117, 124 (1996) ("[G]overnment should not expand its enforcement actions to the point where an additional dollar of enforcement costs yields an additional dollar of revenues: the former involves a real resource cost to the economy, while the latter is simply a transfer from the private to the public sector . . . [O]ptimal enforcement should not eliminate all tax evasion . . .") (citations omitted); Frank Cowell, *The Economic Analysis of Tax Evasion*, 37 BULL. OF ECON. RES. 163, 183 (1985) (suggesting that the "utilitarian approach to evasion policy does *not* imply that it is socially beneficial to reduce tax evasion wherever this can be done without resource cost"); A. Mitchell Polinsky & Steven Shavell, *The Optimal Use of Fines and Imprisonment*, 24 J. PUB. ECON. 89, 90 (1984) (noting that under some conditions, underdeterrence may be optimal).

⁹ See generally Oei, *supra* note 6, at 1081-100 (outlining an argument in favor of a robust offer-in-compromise procedure).

collection may result in a situation where compliant taxpayers are funding a welfare gain to the private creditors of non-compliant taxpayers. Whether and to what extent these distributive outcomes occur would need to be empirically determined, and would likely be a result of a number of factors, including tax collections law, non-tax debtor-creditor law, bankruptcy law, informal relationships between taxpayers and their creditors, and politics.

The normative insight presented by this Article is that a social insurance framework can justify both of these seemingly problematic distributive outcomes, and can hence justify tax non-collection in certain instances. A social insurance framework conceptualizes tax non-collection as a transfer of the risk of financial distress from the taxpayer to the government at a cost or premium. That premium may be extracted via higher tax rates on current or future taxpayers, lower levels of government provision of goods and services, or other costs of increased government borrowing. In exchange for the premium, the government agrees to not collect a tax debt owed in certain “covered circumstances.” Under a social insurance framework, both types of distributive outcomes — enjoyment of non-collection’s benefits by private creditors and imposition of non-collection’s costs on compliant taxpayers and the public — are justifiable, even expected. However, there are theoretical challenges and limitations in making a credible social insurance case for tax non-collection.

This Article proceeds in three parts. Part I describes the debtor-creditor relationship that exists between government and taxpayer. It highlights the unique features of this relationship, provides a quick survey of the federal tax collections landscape, and highlights instances in which the IRS either: (1) decides to discontinue efforts to collect a delinquent tax liability; or (2) has adopted procedures that deliberately allow taxpayers to seek relief from payment of their tax debts.

Part II describes the possible distributive consequences of such tax non-collection, showing that an IRS failure to collect a tax owed or decision to forgive all or part of a tax owed will lead to the reallocation of burdens and benefits among the government, the delinquent taxpayer, other creditors of the delinquent taxpayer, and other taxpayers. Part II.A identifies the goals that tax non-collection should reasonably strive to achieve and discusses some of the complexities associated with formulating and implementing non-collection policies. Part II.B describes the seemingly problematic distributive outcomes that may accompany the government’s decision to forgive or forbear from collecting a tax owed. Part II.C discusses the likely factual and legal determinants of these distributive outcomes.

Finally, Part III presents a social insurance framework for understanding and justifying tax non-collection and its distributive consequences. It shows that a social insurance rationale that emphasizes the government's role in bearing debtor default risk can, in certain circumstances, justify tax non-collection despite its potentially problematic distributive outcomes. This Part also considers some of the limitations of a social insurance framework and discusses how any social insurance delivered via tax non-collection should interact with other avenues by which the government provides social insurance and social welfare, most notably, federal bankruptcy law.

The literature on social insurance is extensive; therefore, the task undertaken in this Article is necessarily limited. This Article does not seek to justify a particular level or intensity of tax non-collection, or to support or criticize any particular IRS tax collection or non-collection decision or policy. Nor does it seek to empirically quantify the precise impacts of IRS non-collection policies. That work is in its infancy, though the implications of such research may be enormous.¹⁰ Instead, the Article's goal is twofold. The narrower goal is to show that the distributive outcomes that may result from tax non-collection may not actually be that problematic when viewed from the perspective of social insurance. This is an important insight, because unarticulated worries about distributive justice, equity, and cost effectiveness underlie current debates about the extent to which tax compliance – both with respect to failure to pay and other types of tax evasion – should be enforced. This Article shows that these types of concerns can be allayed, at least in theory. Tax non-collection provisions can play an important role in ensuring economic security, and academics and policymakers should be encouraged to pay more attention to their design and evaluation.

The broader goal of this Article is to expand the boundaries of how tax scholars think about tax collections issues. Far from being a boring technical inquiry, the design of even the most seemingly inconsequential tax collections provisions actually implicates important issues of social justice, social welfare, government provision, and risk transfer. In particular, to the extent that tax collections is a form of non-bankruptcy debtor-creditor law, the design of tax collections policy should be formulated in conversation

¹⁰ See, e.g., Andrew T. Hayashi, *The Legal Salience of Taxation* (Sept. 14, 2012) (unpublished manuscript) available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2151867 (noting, based on study of New York City property taxes, that “tax salience heterogeneity” may lead to differences in appeals and resort to administrative remedies between different groups of taxpayers).

with scholars of debtor-creditor law, so as to facilitate coordination with other debtor-creditor laws and policies, including the consumer bankruptcy system. This Article hopes to jump-start that conversation.

I. THE COLLECTION AND NON-COLLECTION OF TAX DEBTS: AN OVERVIEW

This Part describes the debtor-creditor relationship between the government and the taxpayer, summarizes the main features of the law of tax collections, and outlines the main avenues by which tax non-collection occurs.

A. *Tax Collection as Debtor-Creditor Law*

In the context of tax collections, the government is in effect the creditor of the taxpayer.¹¹ This is true in the simple sense that by virtue of the tax liability determination, taxpayers are adjudged to owe the government creditor a certain amount, which must be paid. It is also true in the more abstract sense that the government extends goods and services on credit to the taxpayer: The taxpayer receives government-provided goods and services in exchange for a price (taxes). The price is determined, in part, by substantive federal tax law and is fixed by the tax assessment. It is then collected under the rules of tax procedure.

There is often a time lag between receipt of the goods or services by the taxpayer, determination of the amount owed by the government, and payment of the tax debt, and this delay sets up the debtor-creditor dynamic. Such time lag exists due to certain distinctive features of the federal tax system, including the largely annual basis of tax filing and assessment,¹² withholding imperfections, and the existence of income streams upon which withholding cannot be accomplished. As is often the case in other debtor-creditor relationships, the taxpayer-debtor must usually compensate the government-creditor for the time value of money between determination of the amount owed and payment, and this occurs in the form of statutory interest and penalties.¹³

Tax collections and enforcement procedures are necessary because of the debtor-creditor relationship between the government and the taxpayer.¹⁴ Because delinquency is a fact of life in the debtor-creditor

¹¹ See SALTZMAN & BOOK, *supra* note 1, ¶ 14.01; Oei, *supra* note 6, at 1093.

¹² See I.R.C. § 441 (2007) (specifying period for computation of taxable income).

¹³ See I.R.C. §§ 6601-03 (2007) (underpayment interest); I.R.C. §§ 6651-6751 (2007) (provisions pertaining to additions to tax and penalties).

¹⁴ See SALTZMAN & BOOK, *supra* note 1, ¶ 14.01.

world, tax collections law must also contain procedures for determining how to enforce and when to cease collection of tax debts. The distinctive characteristics of the sovereign creditor–taxpayer debtor relationship necessitate unique tax collection and non-collection procedures tailored towards managing this relationship. Some of these distinctive characteristics have been explored in the bankruptcy literature that considers whether the sovereign creditor should be accorded priority over other creditors.¹⁵ For example, this relationship is largely involuntary, which creates a large population of tax debtors.¹⁶ The IRS must enforce a congressionally legislated code. Thus, it cannot handpick its debtor and also does not have total control over the exact amount owed, because this will depend on a taxpayer’s personal and business decisions and return reporting position, in addition to federal tax law.¹⁷ Similarly, the tax debtor does not have full control over entering into a debtor-creditor relationship with the government collector.¹⁸ The sovereign creditor–taxpayer debtor relationship is also distinctive by virtue of its mandatory and repeating nature.

In addition, unlike the case of private sector creditors, amounts collected by the IRS do not simply inure to the benefit of the IRS. These collections benefit the public through government spending.¹⁹ Thus, the extractions side and the spending side of the government function are inextricably linked. Finally, a distinctive set of rules will apply to tax debts should the taxpayer file for bankruptcy. The rules for the priority and dischargeability of tax debts in bankruptcy are generally different from those governing various classes of private

¹⁵ See, e.g., Barbara K. Morgan, *Should the Sovereign be Paid First? A Comparative International Analysis of the Priority for Tax Claims in Bankruptcy*, 74 AM. BANKR. L.J. 461, 463-65 (2000) (considering justifications for giving tax claims priority in bankruptcy); Warren, *supra* note 4, at 361-63 (discussing the priority accorded to tax debts in bankruptcy as designed to “restrict externalization of costs” and “minimize losses to the public fisc”).

¹⁶ See Morgan, *supra* note 15, at 464.

¹⁷ See *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 736 (1979) (“The United States is an involuntary creditor of delinquent taxpayers, unable to control the factors that make tax collection likely.”).

¹⁸ See Morgan, *supra* note 15, at 464 (noting that “taxing authorities are involuntary creditors, unable to choose their debtor or obtain security for debt before extending credit”). Of course, there are also voluntary elements to the sovereign creditor–taxpayer debtor relationship. For example, in situations where the IRS grants extensions for filing or payment of tax, it *voluntarily* places itself in the position of being a creditor, or at least voluntarily prolongs creditor status.

¹⁹ See Morgan, *supra* note 15, at 463; see also Warren, *supra* note 4, at 361-63 (discussing “[t]he issue of protecting the public purse”).

debts.²⁰ As further described below, the existence of these distinctive bankruptcy-tax rules should (and to some extent does) affect the ways in which the IRS goes about pre-bankruptcy tax collection.²¹

The large number of involuntary debtors, the repeat elements of the government creditor–taxpayer debtor relationship, the link between the taxing and spending functions of government, and the background bankruptcy rules are all distinctive elements of the debtor-creditor relationship between the tax collector and tax debtors. These elements necessitate a unique set of exceptionally robust mechanisms for managing this relationship, which are contained in existing IRS administrative tax collections policies and procedures.²² The remainder of this Part provides an overview of these procedures. Part I.B discusses the mechanisms by which the IRS enforces and collects tax debts. Part I.C turns to the key avenues by which tax non-collection may occur.

B. Federal Tax Collection

The detailed mechanisms of the tax collections process have been described in detail in various treatises and will not be belabored here.²³ The following discussion merely summarizes the basic elements of the collections process because tax non-collection must be understood against the backdrop of the law of tax collection.

Assessment. Though some aspects of the tax collection process occur before the taxpayer's tax liability is determined, many aspects of federal tax collection essentially begin with assessment of the tax.²⁴ A

²⁰ See *infra* Part II.C.3; see also Morgan, *supra* note 15, at 465 (noting that “if the taxing authorities are not reasonably secure [in bankruptcy] they will be discouraged from negotiating payment terms with debtors, thus forcing premature and possibly unnecessary business failures”).

²¹ See *infra* Part II.C.3.

²² See *Bull v. United States*, 295 U.S. 247, 259-60 (1934) (“[T]axes are the lifeblood of government, and their prompt and certain availability an imperious need. Time out of mind, therefore, the sovereign has resorted to more drastic means of collection [than the usual action at law for the amount due].”); see also SALTZMAN & BOOK, *supra* note 1, ¶ 14.01 (noting that “the Service’s tax collection power [is] an awesome one” and characterizing the effects of a tax assessment as “drastic”).

²³ For a detailed description, see generally STEVEN R. MATHER & PAUL H. WEISMAN, TAX MANAGEMENT PORTFOLIOS: FEDERAL TAX COLLECTION PROCEDURE – DEFENSIVE MEASURES, No. 638-3rd (2009) [hereinafter MATHER & WEISMAN, DEFENSIVE MEASURES]; SALTZMAN & BOOK, *supra* note 1.

²⁴ See I.R.C. § 6201 (2010). Some collections mechanisms such as withholding and estimated tax payments go into effect before the tax return is filed.

tax assessment has the effect of a judgment.²⁵ There are different varieties of assessment, of which summary and deficiency assessments are most common. A summary assessment arises when the taxpayer files a tax return stating her tax liability.²⁶ For a summary assessment, the date of the assessment will be the date the assessment officer schedules the tax liability and signs the summary record of assessment.²⁷ A deficiency assessment arises after the IRS has examined the taxpayer's return and issues a notice of deficiency.²⁸ For deficiency assessments, the assessment cannot be made until 90 days following the mailing of a notice of deficiency.²⁹ If the taxpayer petitions the issuance of the deficiency notice to the tax court within the 90 day allowed time period, collection cannot be made until the tax court decision becomes final.³⁰

Notice and Demand for Payment. Once the tax has been assessed, the IRS must issue a notice and demand for payment of the assessed tax.³¹ The IRS will also normally issue billing notices to the taxpayer.³² At this point, accounts with a balance due are generally forwarded to the IRS Automated Collection System (ACS) branch.³³ ACS collection specialists may then perform an investigation to locate taxpayer assets, including contacting employers, researching records, and using taxpayer identification numbers to match bank accounts and wage payments.³⁴ If ACS cannot collect, the account is forwarded to the IRS collection field office where the taxpayer resides, where the account is assigned to a revenue officer for collection.³⁵

²⁵ SALTZMAN & BOOK, *supra* note 1, ¶ 10.01 (“[T]he assessment has the same force as the judgment an ordinary creditor obtains after the creditor has successfully prosecuted an action on a debt.”).

²⁶ I.R.C. § 6201(a)(1).

²⁷ Treas. Reg. § 301.6203-1 (2012).

²⁸ SALTZMAN & BOOK, *supra* note 1, ¶ 10.01.

²⁹ I.R.C. § 6213(a) (2010). If the taxpayer is outside the United States when the notice of deficiency is mailed, the period is 150 days.

³⁰ *Id.*

³¹ *Id.* § 6303 (1976).

³² MATHER & WEISMAN, DEFENSIVE MEASURES, *supra* note 23, at A-1.

³³ *Id.* In some cases, the account will be directly forwarded to the appropriate IRS field office for collection. *Id.*; see also STEVEN R. MATHER & PAUL H. WEISMAN, FEDERAL TAX COLLECTION PROCEDURE – LIENS, LEVIES, SUITS AND THIRD PARTY LIABILITY, No. 637-1st, at A-5-A-7 (2006) (discussing process of giving notice and demand for payment) [hereinafter, MATHER & WEISMAN, THIRD PARTY LIABILITY].

³⁴ MATHER & WEISMAN, DEFENSIVE MEASURES, *supra* note 23, at A-1; RESEARCH INSTITUTE OF AMERICA, FEDERAL TAX COORDINATOR ¶ V5000.1 (2d ed. 2012).

³⁵ MATHER & WEISMAN, DEFENSIVE MEASURES, *supra* note 23, at A-1.

Federal Tax Lien. The IRS's collections power is buttressed by the federal tax lien. This lien arises in favor of the United States once the IRS has assessed the tax and issued a notice of demand, and if the taxpayer has failed to pay the liability.³⁶ The lien arises against the property and property rights of the taxpayer in the amount owed, including interest, penalties, costs, and additions to tax.³⁷ It generally arises at the time of the tax assessment and continues until the tax liability is satisfied or the statute of limitations has run.³⁸ The lien grants the IRS priority over the taxpayer's own interest in his property;³⁹ however, until the IRS has filed a Notice of Federal Tax Lien (NFTL), the lien will not have priority against bona fide purchasers, security interest holders, and certain other classes of creditors.⁴⁰ Thus, the NFTL essentially constitutes perfection of the IRS's tax lien over such interests.⁴¹ Taxpayers are entitled to notification and a collection due process hearing when an NFTL is filed.⁴²

Federal Tax Levy. The federal tax lien is a security interest that encumbers property of the taxpayer that has not been transferred prior to the tax assessment. However, in order to actually get its hands on the property and collect the tax owed, the IRS must rely on its power to levy. If the taxpayer has not paid the assessed and outstanding tax liability within 10 days after the notice and demand for payment, the IRS may levy upon the property and property rights (other than excepted property rights) of the taxpayer, and upon property on which there is a federal tax lien.⁴³ The IRS must notify the taxpayer in writing of its intention to levy no less than thirty days before the date of levy.⁴⁴

The federal tax levy includes "the power of distraint and seizure by any means," and it allows the IRS to seize and sell the property or

³⁶ I.R.C. § 6321 (2006).

³⁷ *Id.*

³⁸ *Id.* § 6322 (2006).

³⁹ Most perfected security interests of third parties arising before the creation of the federal tax lien will take priority over the federal tax lien.

⁴⁰ I.R.C. § 6323(a), (f) (2006). Certain subsequently occurring interests are accorded a higher priority than the federal tax lien, even where an NFTL has been filed. *Id.* § 6323(b).

⁴¹ See SALTZMAN & BOOK, *supra* note 1, ¶ 16.03.

⁴² I.R.C. § 6330 (2006).

⁴³ I.R.C. § 6331 (2006). The ten-day waiting period is waived if it is determined that collection of the tax is in jeopardy. *Id.*

⁴⁴ *Id.* § 6331(d).

property rights upon which levy is permissible.⁴⁵ Under the levy power, the IRS may seize property held by the taxpayer herself, or it may seize property belonging to the taxpayer that is held by a third party.⁴⁶ For example, if a third party is indebted to the taxpayer, the IRS can levy on the amount owed, and the third party will be required to turn that amount over to the IRS.⁴⁷ The IRS may levy on the salary and wages of a taxpayer by issuing a notice of levy to the taxpayer's employer, in which case the employer must pay the taxpayer's wages (other than exempt wages) over to the IRS.⁴⁸ The IRS may also levy on bank accounts.⁴⁹ Once property has been levied upon, the IRS is required to follow certain procedures in order to sell the property, including fulfilling notice, time and place, and pricing requirements.⁵⁰

The IRS is prohibited from levying in certain circumstances.⁵¹ In addition, the taxpayer has certain defenses against an IRS levy: the IRS must release a levy if: (1) the tax liability for which the levy is made is satisfied or the statute of limitations has run; (2) release of the levy will facilitate collection of the tax liability; (3) the taxpayer has entered into an installment agreement (unless the agreement provides for such levy); (4) the IRS determines that the levy causes economic hardship to the taxpayer; or (5) the fair market value of the property exceeds the tax liability and release of the levy on a part of such property could be made without hindering the collection of such liability.⁵² A taxpayer may also defend (at least temporarily) against an

⁴⁵ *Id.* § 6331(b).

⁴⁶ Treas. Reg. § 301.6331-1(a)(1) (2012).

⁴⁷ *Id.*

⁴⁸ See I.R.C. § 6334(a)(9) (1998); see also INTERNAL REVENUE SERV., TABLES FOR FIGURING AMOUNT EXEMPT FROM LEVY ON WAGES, SALARY, AND OTHER INCOME (Forms 668-W(ACS), 668-W(c)(DO) and 668-W(ICS)) (2012), available at <http://www.irs.gov/pub/irs-pdf/p1494.pdf>.

⁴⁹ See SALTZMAN & Book, *supra* note 1, ¶ 14.15[1][c]; see also I.R.C. § 6332(c) (2006).

⁵⁰ See I.R.C. § 6335(b) (1998); Treas. Reg. § 301.6335-1 (2012).

⁵¹ For example, the IRS may not levy during the pendency of certain federal tax refund proceedings brought by the taxpayer. I.R.C. § 6331(i) (2006). The IRS may also not levy while an OIC is pending and during the thirty days after such offer is rejected (or, if the taxpayer appeals the rejection within such thirty days, during the period that such appeal is pending). *Id.* § 6331(k)(1). Further, the IRS may not levy: (1) for the period a taxpayer's offer to enter into an installment agreement is pending; (2) for the thirty days after such offer is rejected (and during the period the appeal is pending); (3) during the period an installment agreement for payment of the tax liability is in effect; and (4) if the installment agreement is terminated by the IRS, during the thirty days after such termination (and during the period the taxpayer's timely appeal is pending). *Id.* § 6331(k)(2).

⁵² I.R.C. § 6343 (2006).

IRS levy by filing a bankruptcy petition.⁵³ A taxpayer may appeal a notice of levy using the IRS Collection Appeals Program.⁵⁴

Judicial Collection Proceedings. In addition to the administrative procedures described above, the IRS may resort to various judicial proceedings to facilitate tax collection. The IRS may bring suit in federal district court to get a judgment against a taxpayer.⁵⁵ The IRS will usually do this to extend the time for collection of the tax liability.⁵⁶ The IRS can also bring suit against a third party for failing to surrender property in response to an IRS levy.⁵⁷ The government may also bring suit in federal district court to enforce a federal tax lien.⁵⁸ Such suit is usually brought where title is disputed or where there are conflicting claims upon the property on which there is a lien, such that proceeding with a levy action would be inappropriate or would result in a lesser recovery for the government.⁵⁹ In such a proceeding, the government may ask the court to appoint a receiver to enforce the federal tax lien.⁶⁰

The United States may also institute a civil suit to recover an erroneous tax refund.⁶¹ In addition, the government can bring other types of suits or pursue other court orders in furtherance of tax collection.⁶²

⁵³ MATHER & WEISMAN, DEFENSIVE MEASURES, *supra* note 23, at A-62 & n.672 (noting the automatic stay prevents the IRS from seizing the taxpayer's property or issuing a notice of intent to levy); *see also* discussion *infra* Part II.C.3.

⁵⁴ MATHER & WEISMAN, THIRD PARTY LIABILITY, *supra* note 33, at A-67; *see also* *Collection Appeals Program (CAP)*, INTERNAL REVENUE SERV., [http://www.irs.gov/Individuals/Collection-Appeals-Program-\(CAP\)](http://www.irs.gov/Individuals/Collection-Appeals-Program-(CAP)) (last updated Aug. 14, 2012).

⁵⁵ I.R.C. § 7402 (2006).

⁵⁶ MATHER & WEISMAN, THIRD PARTY LIABILITY, *supra* note 33, at A-82; SALTZMAN & BOOK, *supra* note 1, ¶ 14.09[2][a].

⁵⁷ I.R.C. § 6332(d)(1) (2006).

⁵⁸ *Id.* § 7403 (2006). Such lien foreclosure suit is usually requested by the IRS but the action is then brought by the Department of Justice. *Id.* § 7403(a); MATHER & WEISMAN, THIRD PARTY LIABILITY, *supra* note 33, at A-82.

⁵⁹ MATHER & WEISMAN, THIRD PARTY LIABILITY, *supra* note 33, at A-82; SALTZMAN & BOOK, *supra* note 1, ¶ 14.09[2][b].

⁶⁰ I.R.C. § 7403(d).

⁶¹ *Id.* § 7405 (2006).

⁶² *See generally* MATHER & WEISMAN, THIRD PARTY LIABILITY, *supra* note 33, at A-81-A-85.

C. *The Problem of Delinquency, and the Law and Practice of Tax Non-Collection*

Against the backdrop of these administrative and judicial proceedings to enforce collection of a tax liability, tax law contains various avenues via which a delinquent taxpayer may obtain relief from having to pay a tax, interest, or penalty owed. That this family of procedures exists is unsurprising, because it is clearly not efficient for the IRS to eliminate all tax evasion,⁶³ and the question of how to deal with non-payers raises many of the same types of issues.⁶⁴ Furthermore, as already noted, an important feature of laws governing debtor-creditor relations is how such laws deal with the problem of the debtor who cannot or will not pay.⁶⁵

Tax non-collection procedures take the form of reductions in the amount of tax that has to be paid, extensions of time to pay the tax liability, and waivers of penalties. In addition, tax collections law also incorporates a status by which uncollectible tax debts and certain other classes of tax debts may be designated as “currently not collectible” by the IRS, which effectively relieves the taxpayer of her obligation to pay her tax liability, either temporarily or permanently.⁶⁶ Most of these non-collection procedures — such as offers-in-compromise, installment agreements, payment extensions, and currently not collectible designations — apply to both individual and business taxpayers.⁶⁷ As further discussed in Part II.A, however, different policy and design considerations underlie each of these

⁶³ The economics literature on tax evasion has recognized this point. See sources cited *supra* note 8.

⁶⁴ On the other hand, some tax non-collection procedures are arguably different from the tax evasion context, because even when tax evasion is not immediately detected and dealt with, the possibility of future detection is preserved. In contrast, at least some types of tax non-collection can result in permanent write off of a tax debt.

⁶⁵ See *supra* Part I.A.

⁶⁶ This Article does not address non-collection provisions that apply in unique circumstances, such as disaster relief provisions and non-collection provisions applicable to members of the armed forces. See, e.g., I.R.C. § 7508A (2006) (authority to postpone certain deadlines due to disasters); Katrina Emergency Tax Relief Act of 2005, Pub. L. No. 109-73, § 403, 119 Stat. 2016, 2027 (2005) (extending tax return filing and payment deadlines for taxpayers affected by Hurricane Katrina); *Information for Taxpayers Serving in the Armed Forces, FS 2003-11*, INTERNAL REVENUE SERV. (Apr. 3, 2003), <http://www.irs.gov/uac/Information-for-Taxpayers-Serving-in-the-Armed-Forces> (last visited Sept. 5, 2012) (discussing tax exclusions and filing and payment extensions available to certain U.S. Armed Forces personnel serving in combat zones or qualified hazardous duty areas).

⁶⁷ Innocent spouse relief applies to individual taxpayers but may implicate items of business income taken on a joint tax return. See discussion *infra* at Part I.C.5.

procedures. However, they nonetheless can be viewed as a cohesive family because each represents an instance of the IRS exercising less than its full collection right, be it in terms of amount collected or timing of collection.

1. Offers in Compromise

The Offer in Compromise (OIC) procedure is a method by which a taxpayer may settle unpaid tax debts for less than the full sum owed.⁶⁸ Taxpayers may also apply for a penalty-only OIC to obtain abatement of a tax penalty.⁶⁹ A taxpayer making an offer must submit such offer on IRS Form 656.⁷⁰ The submission must include detailed information about the taxpayer's tax liabilities, grounds for the compromise request, the proposed compromise amount, and the payment terms.⁷¹ The taxpayer must also include a required financial statement.⁷²

There are three permissible grounds for compromise of a tax liability: (1) doubt as to collectability; (2) doubt as to liability; and (3) the promotion of effective tax administration.⁷³

Doubt as to Collectability. Doubt as to collectability is the most commonly accepted type of offer and exists "where the taxpayer's assets and income are less than the full amount of the liability."⁷⁴

⁶⁸ See I.R.C. § 7122 (2006).

⁶⁹ MATHER & WEISMAN, DEFENSIVE MEASURES, *supra* note 23, at A-21. The Code imposes several penalties, including penalties for failure to file a return or failure to pay a tax, or for submission of frivolous tax returns. See I.R.C. § 6651(a) (2006); *id.* § 6702 (2006). The I.R.C. § 6651 failure to file and failure to pay penalties may be abated if the failure was due to reasonable cause and not willful neglect. I.R.C. § 6651(a); Treas. Reg. §§ 301.6651-1(a), (c) (2012). The I.R.C. § 6702 frivolity penalty may be reduced "if the Secretary determines that such reduction would promote compliance with and administration of the Federal tax laws." I.R.C. § 6702(d). If the revenue officer denies a penalty-only OIC, a taxpayer may make an administrative appeal to the Office of Appeals. Treas. Reg. § 601.106(a)(1)(ii)(c) (2010). If such appeal is unsuccessful, the taxpayer will have to pay the penalty and file a refund claim, in order to commence judicial refund litigation proceedings.

⁷⁰ See IRS FORM 656 (OFFER IN COMPROMISE), INTERNAL REVENUE SERV., <http://www.irs.gov/pub/irs-pdf/f656.pdf> (last visited Sept. 7, 2012).

⁷¹ MATHER & WEISMAN, DEFENSIVE MEASURES, *supra* note 23, at A-47-A-49; SALTZMAN & BOOK, *supra* note 1, ¶ 15.07[4].

⁷² See, e.g., IRS FORM 433-A, COLLECTION INFORMATION STATEMENT FOR WAGE EARNERS AND SELF-EMPLOYED INDIVIDUALS, INTERNAL REVENUE SERV., *available at* www.irs.gov/pub/irs-pdf/f433a.pdf (last visited Sept. 7, 2012).

⁷³ Treas. Reg. § 301.7122-1(b) (2012).

⁷⁴ Treas. Reg. § 301.7122-1(b)(2); U.S. GOV. ACCOUNTABILITY OFFICE, REPORT TO THE COMMITTEE ON FINANCE, U.S. SENATE, IRS OFFERS IN COMPROMISE: PERFORMANCE HAS BEEN MIXED; BETTER MANAGEMENT INFORMATION AND SIMPLIFICATION COULD IMPROVE THE PROGRAM 1 (2006), *available at* <http://www.gpo.gov/fdsys/pkg/>

Thus, OICs based on doubt as to collectability will require that the Service determine the taxpayer's ability to pay the tax liability through a detailed financial analysis.⁷⁵ In determining ability to pay, taxpayers will be allowed to retain sufficient funds to pay basic living expenses, and although the individual facts and circumstances will be taken into account, guidelines on national and local living standards must be considered.⁷⁶ Whether an OIC based on doubts as to collectability will be accepted depends on whether the offer reflects the account's "reasonable collection potential," defined in the Internal Revenue Manual (IRM) as "the amount that can be collected from all available means, including administrative and judicial collection remedies."⁷⁷

Doubt as to Liability. Doubt as to liability exists where there is a "genuine dispute" about the amount of tax liability.⁷⁸ Such offers usually arise where taxpayers are using the procedure to contest an assessed tax liability that has not been petitioned to the tax court within the applicable time period.⁷⁹ In order for such an OIC to be successful, the taxpayer must show that she would suffer a hardship if the disputed tax had to be paid upfront and a refund suit subsequently filed.⁸⁰

Effective Tax Administration (ETA). An offer based on ETA grounds may be entered into where "although collection in full could be achieved, collection of the full liability would cause the taxpayer economic hardship."⁸¹ In the absence of economic hardship, the IRS may nonetheless compromise a tax liability on ETA grounds "where compelling public policy or equity considerations identified by the taxpayer provide a sufficient basis" for compromise.⁸² Regardless of whether the ETA offer is based on hardship, public policy, or equity, offers based on ETA grounds will only be considered where the

GAOREPORTS-GAO-06-525/pdf/GAOREPORTS-GAO-06-525.pdf.

⁷⁵ Treas. Reg. § 301.7122-1(c)(2).

⁷⁶ *Id.* In 2012, the IRS announced more flexible terms in its OIC procedure financial analysis, pursuant to its "fresh start" initiative, designed to help distressed taxpayers resolve their tax issues more effectively. See IRS News Release 2012-53 (May 21, 2012).

⁷⁷ IRM 5.8.4.3 (June 1, 2010).

⁷⁸ Treas. Reg. § 301.7122-1(b)(1).

⁷⁹ MATHER & WEISMAN, DEFENSIVE MEASURES, *supra* note 23, at A-43-44; SALTZMAN & BOOK, *supra* note 1, ¶ 15.07[1][b][i] (noting the filing period is ninety days).

⁸⁰ SALTZMAN & BOOK, *supra* note 1, ¶ 15.07[1][b][i].

⁸¹ Treas. Reg. § 301.7122-1(b)(3).

⁸² Treas. Reg. § 301.7122-1(b)(3)(ii).

taxpayer does not qualify for compromise under “doubts as to liability” or “doubts as to collectability.”⁸³

In exchange for tax compromise, the taxpayer will be subject to certain requirements and conditions, including a requirement that she remain compliant with the tax laws by filing the required tax returns for the next five years.⁸⁴ The statute of limitations on collection is suspended while the offer is being considered and for the duration of appeals of rejected offers.⁸⁵ The IRS may also credit overpayments of the taxpayer’s other tax liabilities against the liability that is the subject of the taxpayer’s offer to compromise, and may offset such overpayments against the amount sought to be compromised.⁸⁶ On the other hand, the IRS is prohibited from levying on property with respect to the unpaid tax while the offer is pending, for the thirty days following rejection of the offer, and while an appeal is pending.⁸⁷

2. Installment Agreements

A taxpayer who cannot pay the full amount of tax due in a timely manner may enter into an installment agreement with the IRS, which allows her to pay the liability in installments over time.⁸⁸ The IRS may enter into an installment agreement with a taxpayer if it is determined that the agreement “will facilitate full or partial collection” of the tax liability.⁸⁹ In an installment agreement, the taxpayer will generally end up paying the entire assessed tax liability, plus accrued penalties and interest.⁹⁰ However, the taxpayer benefits by not having to make immediate payment of the tax owed, and the IRS arguably takes on an increased risk of default by permitting a delay in payment. In addition, the Code provides for a reduced late-payment penalty for periods during which an installment agreement is in effect.⁹¹

⁸³ See IRM 5.8.11.1(5) (Sept. 23, 2008).

⁸⁴ SALTZMAN & BOOK, *supra* note 1, ¶ 15.07[8].

⁸⁵ I.R.C. § 6331(k)(3) (2006).

⁸⁶ Treas. Reg. § 301.7122-1(g)(5).

⁸⁷ I.R.C. § 6331(k)(1).

⁸⁸ *Id.* § 6159(a) (2006).

⁸⁹ *Id.*

⁹⁰ Treas. Reg. § 301.6159-1(c)(1)(ii) (2009) (noting that “acceptance of an installment agreement by the IRS does not reduce the amount of taxes, interest, or penalties owed”). *But see infra* notes 103-106 and accompanying text (discussing partial payment installment agreements).

⁹¹ I.R.C. § 6651(h) (2006).

Special rules apply for various types of installment agreements:

Guaranteed Installment Agreements. The IRS is required by statute to accept the proposed installment agreement if the taxpayer is an individual who: (1) owes income tax of \$10,000 or less (determined without regard to interest, penalties, or additions to tax); (2) has not, in the preceding five tax years, failed to file income tax returns or pay the tax shown on such returns; (3) has not, in the preceding five years, entered into an installment agreement with the IRS; (4) is unable to pay the tax owed when due; (5) agrees to pay the tax liability within three years; and (6) agrees to file all tax returns and pay all taxes when due during the period the installment agreement is in effect.⁹²

Streamlined Installment Agreements. Certain taxpayers may qualify for a “streamlined” installment agreement where the taxpayer’s unpaid liabilities are \$50,000 or less.⁹³ Approval by a manager is not required.⁹⁴ Streamlined installment agreements may also be granted by the IRS even if the taxpayer is able to fully pay the liability.⁹⁵ Taxpayers whose liabilities are over \$50,000 may qualify by paying off the tax liabilities in excess of \$50,000.⁹⁶ The taxpayer must pay off the aggregate assessment balance within seventy-two months or before the expiration of the collection statute expiration date, whichever occurs first.⁹⁷ The taxpayer must have filed all tax returns that are due before entering into the agreement.⁹⁸

For streamlined installment agreements where the aggregate unpaid balance is \$25,000 or less, no taxpayer financial information statement is needed.⁹⁹ Only individual taxpayers and business taxpayers who owe only income taxes qualify for such streamlined installment agreements, though out-of-business taxpayers who owe any type of tax

⁹² *Id.* § 6159(c); IRM 5.14.1.2 (Jun. 1, 2010); IRM 5.14.5.3 (Mar. 11, 2011).

⁹³ Memorandum from Scott D. Reisher, Collection Policy Director, to Directors of Collection Area Operations (Jan. 20, 2012), available at http://www.irs.gov/pub/foia/ig/sbse/sbse_05-0112-013.pdf (establishing new criteria for streamlined installment agreements, effective immediately); cf. IRM 5.14.5.2 (Mar. 11, 2011) (stating the previous dollar threshold was \$25,000).

⁹⁴ IRM 5.14.5.2 (5).

⁹⁵ IRM 5.14.5.2 (10).

⁹⁶ See Memorandum from Scott D. Reisher, *supra* note 93, at 2.

⁹⁷ See *id.*; cf. IRM 5.14.5.2(1)(c) (previously, the taxpayer only had sixty months to pay in full).

⁹⁸ IRM 5.14.5.2(7) (“[T]he taxpayer must have filed all tax returns that are due prior to entering into the agreement.”); see also Memorandum from Scott D. Reisher, *supra* note 93, at 1 (“All of the other criteria remain the same”).

⁹⁹ IRM 5.14.5.2(9); Memorandum from Scott D. Reisher, *supra* note 93, at 1.

may also qualify.¹⁰⁰ For those streamlined installment agreements where the aggregate unpaid balance is more than \$25,000 but no more than \$50,000, some financial information may be required and the agreement must be a direct debit installment agreement.¹⁰¹ Only individuals or out-of-business sole proprietors are eligible.¹⁰²

Partial Payment Installment Agreements. While installment agreements generally require taxpayers to pay the full tax liability over time, the IRS may authorize installment agreements that do not yield full payment.¹⁰³ The IRM authorizes such partial payment installment agreements (PPIAs) where the full amount of the liability cannot be collected by the collection statute expiration date, and where the taxpayer has some ability to pay.¹⁰⁴ In order to apply for a PPIA, the taxpayer will have to provide a full collection information statement to the IRS.¹⁰⁵ The IRS will require some utilization of taxpayer equity in assets to make payment of the tax liability.¹⁰⁶

3. Payment Extensions

Another way in which the IRS may provide relief from payment of tax debts is through granting extensions of time for payment. Payment extensions are appropriately classified as a type of tax debt relief because the IRS waives its right to collect the tax when due, and may also waive penalties, thereby giving up some value and taking on the risk that the taxpayer will spend her money elsewhere in the interim. Extensions may be short-term or long-term. The IRS may grant a short-term extension of up to 120 days.¹⁰⁷ Individual taxpayers can

¹⁰⁰ Memorandum from Scott D. Reisher, *supra* note 93, at 1.

¹⁰¹ *Id.* at 2; *see also* <http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Fresh-Start-Installment-Agreements> (last visited Jan. 3, 2013).

¹⁰² *Id.*

¹⁰³ I.R.C. § 6159 (2006). This authority was granted by the 2004 American Jobs Creation Act.

¹⁰⁴ IRM 5.14.2.1 (Mar. 11, 2011).

¹⁰⁵ IRM 5.14.2.1.1.

¹⁰⁶ IRM 5.14.2.1(2).

¹⁰⁷ *See Other Ways to Resolve Tax Debt That Could Save You Money*, INTERNAL REVENUE SERV., available at <http://www.irs.gov/businesses/small/article/0,,id=174267,00.html> (last updated Aug. 3, 2012); *Payment Options Available for Those Who Can't Pay in Full*, INTERNAL REVENUE SERV. (Apr. 7, 2008), available at <http://www.irs.gov/newsroom/article/0,,id=181096,00.html> (last updated Aug. 3, 2012) [hereinafter *Payment Options*].

obtain short-term extensions by applying online.¹⁰⁸ Late payment penalties and interest will apply.¹⁰⁹

In addition, the IRS is authorized by statute to grant longer-term extensions of up to six months, or twelve months in the case of estate taxes.¹¹⁰ In order to obtain such an extension, the taxpayer must show that payment on the due date of the required amount will result in “undue hardship” for the taxpayer.¹¹¹ “Undue hardship” is defined as a “substantial financial loss” to the taxpayer.¹¹² To apply, the taxpayer must file IRS Form 1127 with the IRS with evidence showing that undue hardship would result, a statement of the taxpayer’s assets and liabilities, and a statement showing the taxpayer’s receipts and disbursements for the last three months preceding the due date of the amount owed.¹¹³ The grant of an extension does not stop interest from running, though penalties may not apply.¹¹⁴

4. Taxpayer Assistance Orders

Under I.R.C. § 7811, the National Taxpayer Advocate (NTA or Taxpayer Advocate) has authority to issue a “taxpayer assistance order” (TAO) if it is determined that the taxpayer has suffered or is about to suffer a significant hardship due to the IRS’s collection activities and if certain other requirements are met.¹¹⁵ A TAO can require the IRS to release a levy on taxpayer property or to cease or refrain from taking collection and other actions.¹¹⁶ However, a TAO may not be issued to determine the merits of a tax liability or to bypass the processes for administrative or judicial review of the substantive merits of a tax case.¹¹⁷

¹⁰⁸ See *Payment Options*, *supra* note 107.

¹⁰⁹ See *id.* (noting that “[n]o fee is charged, but the late-payment penalty plus interest will apply”); see also *Three Ways to Pay Your Federal Income Tax*, INTERNAL REVENUE SERV. (Apr. 6, 2011), <http://www.irs.gov/newsroom/article/0,,id=108508,00.html>.

¹¹⁰ I.R.C. § 6161(a)(1) (2006).

¹¹¹ Treas. Reg. § 1.6161-1(b) (2012).

¹¹² *Id.*

¹¹³ Treas. Reg. § 1.6161-1(c).

¹¹⁴ Treas. Reg. § 1.6161-1(d); see also IRS News Release 2012-31 (March 7, 2012) (announcing penalty relief for certain wage earners and self-employed individuals).

¹¹⁵ I.R.C. § 7811 (2004).

¹¹⁶ *Id.*; see also Treas. Reg. § 301.7811-1(a). The IRS may also release a levy on hardship grounds absent a TAO. I.R.C. § 6343(a)(1)(D) (2006); Treas. Reg. § 301.6343-1(b)(4) (2012).

¹¹⁷ IRM 13.1.20.3.1(2) (Dec. 15, 2007).

Treasury Regulations define “significant hardship” for purposes of determining whether a TAO may be issued as a “serious privation caused or about to be caused to the taxpayer as the result of the particular manner in which the revenue laws are being administered by the IRS.”¹¹⁸ Circumstances constituting “significant hardship” include: (1) the existence of an immediate threat of adverse action; (2) a delay of more than thirty days in resolving taxpayer account problems; (3) the incurrence by the taxpayer of significant costs (including professional fees) if relief is not granted; or (4) irreparable injury to, or a long-term adverse impact on, the taxpayer if relief is not granted.¹¹⁹

The IRM provides several examples of “significant hardship.” These include, but are not limited to: (1) the taxpayer’s inability to pay for housing, utilities, food, work transportation, and medical treatment due to levy or refund not being received; (2) the possibility that the taxpayer will become unemployed or lose his income source as a result of IRS’s action; (3) whether the taxpayer will lose out on acquiring real estate; (4) whether the taxpayer’s rights have been abridged; (5) whether the IRS dealt with the taxpayer’s case differently from similarly situated taxpayers and whether that will seriously damage the taxpayer’s ability to earn future income; and (6) whether the taxpayer received a statutory final notice before the IRS took enforcement action.¹²⁰

A taxpayer applies for a TAO by filing IRS Form 911. The IRM specifies steps that the Taxpayer Advocate will take in processing such application.¹²¹ The Taxpayer Advocate will, among other things: (1) determine whether the taxpayer meets the “significant hardship” standard; (2) contact the division or function of the IRS responsible for the taxpayer’s item to establish a reasonable timeline to complete the required action; and (3) take steps to issue the TAO if the taxpayer’s case is not satisfactorily resolved.¹²²

A TAO is binding on the IRS unless modified or rescinded by the NTA, the Commissioner of Internal Revenue, or the Deputy Commissioner.¹²³ If the Commissioner or Deputy Commissioner rescinds the TAO, a written explanation of the rescission must be

¹¹⁸ Treas. Reg. § 301.7811-1(a)(4)(ii) (2012).

¹¹⁹ I.R.C. § 7811(a)(2).

¹²⁰ IRM 13.1.18.7(4) (Feb. 1, 2011).

¹²¹ See IRM 13.1.20 (pertaining to Taxpayer Assistance Orders generally); see also IRM Exhibit 13.1.20-1 (TAO Checklist).

¹²² IRM Exhibit 13.1.20-1.

¹²³ See I.R.C. § 7811(c).

provided to the NTA.¹²⁴ The statute of limitations on collection is suspended for the period starting on the date the taxpayer files a TAO application and ending on the date that the NTA makes a decision with respect to the application and for any period specified by the NTA in a TAO pursuant to such taxpayer application.¹²⁵ The statute is not tolled where the NTA unilaterally issues a TAO absent taxpayer application.¹²⁶

5. Innocent Spouse Relief

Married taxpayers who have filed a joint return are jointly and severally liable for the tax liability assessed on the joint return.¹²⁷ However, such taxpayers may seek relief from a tax payment obligation by requesting innocent spouse relief.¹²⁸ That statute provides three grounds for relief. First, where: (1) a joint return has been filed; (2) the return contained an understatement of tax attributable to the erroneous items of the other spouse; (3) the spouse requesting relief did not know (and had no reason to know) about the understatement in signing the return; (4) taking all of the facts and circumstances into account, it is inequitable to hold the requesting spouse liable for the tax deficiency attributable to the understatement; and (5) the requesting spouse applies for relief no later than two years after the IRS first begins collection activities with respect to the innocent spouse, the requesting spouse may be relieved of tax liability to the extent the liability is attributable to the understatement.¹²⁹

Second, individuals who are divorced or legally separated at the time the request for relief is filed or who are not members of the same household for the past twelve months will generally be eligible to elect innocent spouse relief for the portion of the tax deficiency properly allocable to the non-requesting spouse.¹³⁰ Finally, innocent spouse

¹²⁴ *Id.*; see also Treas. Reg. § 301.7811-1(b) (2012).

¹²⁵ I.R.C. § 7811(d).

¹²⁶ Treas. Reg. § 301.7811-1(e)(4).

¹²⁷ I.R.C. § 6013(d)(3) (2006).

¹²⁸ *Id.* § 6015.

¹²⁹ *Id.* § 6015(b). If, on the other hand, all of the factors are met except that the requesting spouse knew about the understatement but establishes that she did not know the extent of such understatement, then relief may be granted to the extent that the liability is attributable to the portion of the understatement of which the individual did not know and had no reason to know. *Id.* § 6015(b)(2).

¹³⁰ *Id.* § 6015(c), (d). If the requesting spouse had actual knowledge of an item giving rise to the deficiency, or if assets were transferred between jointly filing individuals as part of a fraudulent scheme, then innocent spouse relief will not be granted. *Id.* § 6015(c)(3)(A)(ii), (c)(3)(C).

relief may be granted on equitable grounds on a facts and circumstances basis if relief is not available under the above two grounds.¹³¹

6. “Currently Not Collectible” Status

Once the IRS has taken all the steps in the collections process and it has been determined that a tax liability owed cannot be collected, the IRS may report that taxpayer’s account in “currently not collectible” (CNC) status.¹³² Once an account has been placed in CNC status, collection activity on the balance of that account will be temporarily suspended; however, interest and penalties will continue to accrue until the statute of limitations on collection expires.¹³³ The IRS has historically been unable to collect the vast majority of dollars in accounts that have been designated CNC.¹³⁴

The IRM lists a number of reasons for which an account may be designated CNC.¹³⁵ These include: inability to locate the taxpayer or the taxpayer’s assets, expiration of the statute of limitations for collection or for reducing a tax claim to judgment, inability to collect because the taxpayer lives abroad, death of the taxpayer (where there is no potential for collection from the estate), and inability to contact the taxpayer even if the address is known.¹³⁶

In addition, an account will also be placed in CNC status even if the taxpayer has limited income, where collection would cause the taxpayer hardship by leaving the taxpayer unable to meet “reasonable basic living expenses.”¹³⁷ The determination of what is reasonable

¹³¹ *Id.* § 6015(f).

¹³² See IRM 1.2.14.1.14 (Nov. 19, 1980) (“If, after taking all steps in the collection process, it is determined that an account receivable is currently not collectible, it should be so reported in order to remove it from active inventory. . . . As a general rule, accounts will be reported as currently not collectible when the taxpayer has no assets or income which are, by law, subject to levy.”); see also, generally, IRM 5.16.1 (May 22, 2012).

¹³³ IRM 5.16.1.2.9(12) (May 22, 2012) (“Taxpayers must be advised that interest and penalties will continue to accrue on the account even though the collection action is suspended.”).

¹³⁴ INTERNAL REVENUE SERV., NAT’L TAXPAYER ADVOCATE: 2006 ANNUAL REPORT TO CONGRESS 31 (2006) [hereinafter 2006 NTA ANNUAL REPORT] (finding that from FY 2000 through 2006, the IRS collected annually less than 2% of amounts designated CNC (citing IRS Collection Activity Reports)).

¹³⁵ IRM 5.16.1.1(2) (May 22, 2012) (listing commonly used closing codes under which an account may be designated CNC).

¹³⁶ *Id.*

¹³⁷ *Id.*; see also IRM 5.16.1.2.9 (May 22, 2012) (defining hardship to exist “if a

“will vary according to the unique circumstances of the individual taxpayer.”¹³⁸ The determination will usually be made based on financial information provided by the taxpayer on the relevant forms.¹³⁹ The IRM provides that hardship cases generally involve “no income or assets, no equity in assets or insufficient income to make any payment without causing hardship.”¹⁴⁰

Cases that have been placed in CNC status may subsequently be reactivated. The IRS may systematically reactivate hardship, unable-to-locate, and unable-to-contact cases.¹⁴¹ For instance, unable-to-locate and unable-to-contact cases will be reactivated if a new levy source posts to the IRS’s Integrated Data Retrieval System.¹⁴² Unable-to-locate cases will also be reactivated if a new taxpayer address is located.¹⁴³ Hardship cases may be reactivated if it appears there is a change in the taxpayer’s ability to pay.¹⁴⁴

II. UNDERSTANDING THE DISTRIBUTIVE CONSEQUENCES OF TAX NON-COLLECTION

In theory, tax non-collection procedures should be formulated to achieve positive outcomes for either or both of the taxpayer and the IRS. However, as noted above, less than ideal distributive outcomes may result in actuality, which may cause one to question whether tax non-collection is justified. Part II.A first describes some of the policies

taxpayer is unable to pay reasonable basic living expenses”). Policy Statement 5-71, issued in 1980, provides that in cases where the taxpayer has limited income or assets but it is determined that IRS levy would create a hardship to the taxpayer, that account could also be reported in CNC status. See IRM 1.2.14.1.14 (Nov. 19, 1980) (containing I.R.S. Policy Statement 5-71, which notes that “if there are limited assets or income but it is determined that levy action would create a hardship, the liability may be reported as currently not collectible,” and defining hardship to exist “if the levy action prevents the taxpayer from meeting necessary living expenses”). In making a hardship determination, the IRS must evaluate whether levying on the taxpayer’s property would cause the taxpayer actual hardship, as opposed to “mere inconvenience.” *Id.*

¹³⁸ IRM 5.15.1.1(6) (Oct. 2, 2009).

¹³⁹ IRM 5.16.1.2.9 (May 22, 2012); see IRS FORM 433-A COLLECTION INFORMATION STATEMENTS FOR INDIVIDUALS, INTERNAL REVENUE SERV. (May 2012), <http://www.irs.gov/pub/irs-pdf/f433aai.pdf>; IRS FORM 433-B COLLECTION INFORMATION STATEMENT FOR BUSINESSES, INTERNAL REVENUE SERV. (May 2012), <http://www.irs.gov/pub/irs-pdf/f433boi.pdf>.

¹⁴⁰ IRM 5.16.1.2.9 (May 22, 2012).

¹⁴¹ IRM 5.16.1.1(8) (May 22, 2012).

¹⁴² *Id.*

¹⁴³ *Id.*

¹⁴⁴ *Id.*; see also IRM 5.16.1.2.9(11) (May 22, 2012).

and rationales that may justify the non-collection of taxes and describes the outcomes that non-collection of taxes should strive to achieve. As the discussion in Part II.A shows, this seemingly simple calculus is actually quite complicated and non-static in execution. Part II.B then discusses the seemingly problematic distributive outcomes that may result from the non-collection of taxes. Part II.C shows that whether and which of these distributive outcomes occurs is a function of a number of factual and legal determinants.

A. *The Goals of Tax Non-Collection*

Tax non-collection procedures appear to exist for a number of different underlying reasons rather than being based on one all-encompassing justification. Some of these procedures are targeted towards relief of a taxpayer's liability for equitable reasons. For example, certain types of OICs issued on ETA grounds seem to be based on equitable considerations.¹⁴⁵ In other instances, these non-collection procedures exist to deal with the inevitable situation in which a taxpayer is simply unable to pay the full amount owed. Examples include OICs based on doubt as to collectability, installment agreements, and placing a taxpayer's account in CNC status.¹⁴⁶ In these cases, the policy underlying non-collection is often simply to maximize the amount of revenue that the IRS is able to collect, while not wasting resources chasing an uncollectible debt.¹⁴⁷ In still other cases, non-collection is rationalized on taxpayer hardship grounds. TAOs, for example, are issued on hardship grounds.¹⁴⁸ The IRS may also agree to release a levy if it is creating hardship for the taxpayer.¹⁴⁹ Finally, non-collection may be justified based on impracticability of collection. This is the case, for example, in certain CNC designations, such as where the IRS is simply unable to track down the taxpayer or her assets.¹⁵⁰ Despite these disparate underlying policy rationales, these provisions share an underlying commonality: the government, in applying each of these provisions, refrains from exercising the full extent of its collections power, thereby taking on increased risk

¹⁴⁵ See *supra* Part I.C.1.

¹⁴⁶ See *supra* Parts I.C.1, I.C.2, and I.C.6.

¹⁴⁷ See IRM 1.2.14.1.17 (Jan. 30, 1992) (containing I.R.S. Policy Statement 5-100, which notes that the goal of accepting an offer-in-compromise is "to achieve collection of what is potentially collectible at the earliest possible time and at the least cost to the Government").

¹⁴⁸ See *supra* Part I.C.4.

¹⁴⁹ I.R.C. § 6343(a)(1)(D) (2006); see also Treas. Reg. § 301.6343-1(b)(4) (2012).

¹⁵⁰ See *supra* Part I.C.6.

(perhaps even complete certainty) that the tax debt will not be paid. Thus, it makes sense that this family of provisions should be thought about and analyzed in concert.

What are the desired policy outcomes that should underlie the government's forgiveness of tax debts or forbearance from tax collection? In terms of the benefits of non-collection, it makes sense that situations in which the government has decided to forgive all or part of a tax debt, or to refrain from collection of the debt, should generally yield benefits for the delinquent taxpayer, the government, or both.¹⁵¹ In fact, policy discourse in favor of IRS procedures that promote non-collection of certain tax debts generally speak in some way in terms of this calculus. For example, in arguing in favor of strengthening the OIC procedure, the NTA has argued that the IRS is able to collect more through OICs than it ultimately collects from rejected offers, but also as compared to the general tax collections baseline for debts over two years old.¹⁵² The argument, in short, is that forgiving a portion of a tax debt may have revenue benefits for the government.¹⁵³ Similarly, the policy underlying the existence of a CNC designation is that at some point, the cost to the IRS of continued but futile collections efforts outweighs the expected value of the revenue benefits that can be gained from continued collection.¹⁵⁴ On the side of benefits to taxpayers, the NTA has argued that in cases of taxpayers

¹⁵¹ This broad statement of goals incorporates the question of whether non-collection will lead to greater or lesser degrees of behavioral distortion than full collection, an efficiency question that has been taken up in the literature. See sources cited *supra* note 8.

¹⁵² See 2006 NTA ANNUAL REPORT, *supra* note 134, at 89 (reporting that "over 40 percent of tax modules associated with rejected and withdrawn OICs are ultimately reported as not collectible, with many more remaining unresolved for years in 'active' collection status"; and that from 1998 to 2003, the IRS collected less than 50% of what individual taxpayers offered to pay in 44% of cases involving rejected OICs, that it collected less than 10% of taxpayer-offered amounts in 31% of these cases, and it collected nothing in 21% of these cases) (footnotes omitted); see also INTERNAL REVENUE SERV., NAT'L TAXPAYER ADVOCATE: 2007 ANNUAL REPORT TO CONGRESS 375 (2007) (noting that in 2007, IRS collected seventeen cents on the dollar from accepted OICs, but only collected thirteen cents on the dollar on two-year-old debts and collected almost nothing on debts three or more years old).

¹⁵³ See *supra* note 152 and accompanying text.

¹⁵⁴ See I.R.C. § 6404(c) (2007) (giving IRS the authority to abate small tax balances owed if it is determined "that the administration and collection costs involved would not warrant collection of the amount due"). See generally MATHER & WEISMAN, DEFENSIVE MEASURES, *supra* note 23, at A-82 (noting that "[w]hen the revenue officer becomes convinced that the taxpayer has no collectible assets and no future source of collection, the revenue officer closes the case by completing Form 53 (Report of Currently Not Collectible Taxes)").

who are experiencing financial hardship, continued and aggressive collections activities that force taxpayers into dire economic circumstances creates additional costs to society and may not be in the best interests of such taxpayers.¹⁵⁵

It also makes sense that these benefits of non-collection should be weighed against the revenue losses and other costs of non-collection. However, while simple to articulate, such an analysis of costs and benefits of non-collection to the government and taxpayers is actually tremendously complicated. For example, the intended revenue benefits to the government could be erased by the impacts of eroding taxpayer morale and compliance norms over time. Thus, a considered weighing of the costs and benefits of non-collection for a single taxpayer must consider seriously the impacts of potential changes in the behaviors of other taxpayers. The analysis of the benefits to a taxpayer of non-collection is also not a static inquiry — a taxpayer unable to pay a tax debt now may have additional resources at a later time, at which point it may become more justifiable to resume collection. This would raise the question of whether it is in fact good policy to forgive a tax debt in the present. Conversely, a taxpayer who is currently able to pay may encounter changing circumstances that justify forbearance at a later time. In short, articulating and implementing a soundly designed policy of non-collection is a matter of some complexity. As a result, while policymakers have put forth discrete justifications for and against non-collection, an overarching and theoretically consistent approach to non-collection that weighs all possible considerations has not yet been formulated.

B. Possible Problematic Outcomes of Tax Non-Collection

Unfortunately, it will not always be the case that the IRS's decision not to collect the full amount of a tax liability will have the positive outcomes intended. Problematic distributive outcomes may instead result. The specter of these outcomes, together with other concerns — such as moral hazard worries or the perception that non-collection

¹⁵⁵ See INTERNAL REVENUE SERV., NAT'L TAXPAYER ADVOCATE: 2008 ANNUAL REPORT TO CONGRESS 15-38 (2008) (opining that the IRS needs to consider taxpayer economic hardship in undertaking collection enforcement and advocating “[a]n approach that balances the need for enforcement with an equal concern for customer service and taxpayer rights”); INTERNAL REVENUE SERV., NAT'L TAXPAYER ADVOCATE: 2010 ANNUAL REPORT TO CONGRESS 85 (2010) [hereinafter 2010 NTA ANNUAL REPORT] (listing as one of the most serious problems encountered by taxpayers the fact that “IRS collection policies and procedures fail to adequately protect taxpayers suffering an economic hardship”).

would violate horizontal equity — may raise questions about whether tax non-collection is justifiable.¹⁵⁶

1. Capture by the Taxpayer's Other Creditors

The case in which the IRS is the debtor's only creditor presents the greatest potential for a positive outcome. If the IRS is the debtor's only creditor, then it is more likely that the taxpayer herself will in fact benefit from tax non-collection. Funds that would otherwise have to be paid to the IRS would no longer have to be paid. The taxpayer will be able to use those funds for other consumption. By forgiving or forbearing from collection of all or part of a tax debt owed by a distressed taxpayer, the sovereign may truly be able to smooth consumption for that taxpayer. Similarly, in situations in which the IRS is not collecting because the debt appears uncollectible, the IRS also does not have to worry that other private creditors with superior information or better means of enforcing collection will be able to extract from taxpayers amounts that the IRS has not collected. However, some of the complexities associated with determining whether the long and short-term costs of non-collection outweigh the benefits will persist.¹⁵⁷

If the taxpayer is indebted to other creditors in addition to the IRS, which is probably more likely, the analysis is more complicated. Such creditors may capture any funds freed up as a result of the sovereign's willingness to forgive tax debts. This may turn what is supposed to be a welfare gain to the taxpayer into a subsidy of the lending risks of private creditors.¹⁵⁸ As discussed in Part II.C, the extent to which this will happen will depend on the nature of the relationship between such creditors and the taxpayer, the background rules governing that relationship, and the number of such other creditors.¹⁵⁹ For example, an arm's-length credit card lender using a collection agency may be able and willing to coerce a taxpayer to hand over funds that the IRS may have designated as exempt in an OIC, or that the IRS has released from levy under hardship grounds.¹⁶⁰ An informal or non-arm's length

¹⁵⁶ See Oei, *supra* note 6, at Part I.B.2 (arguing in the context of OICs that tax non-collection does not necessarily violate horizontal equity).

¹⁵⁷ See *supra* Part II.A.

¹⁵⁸ The counterargument is that relief of other debts of the taxpayer constitutes an economic and welfare gain for the taxpayer in the terms of the taxpayer's balance sheet picture and in terms of other unquantifiable costs of indebtedness that are relieved. See also *infra* notes 231-233 and accompanying text.

¹⁵⁹ See *infra* Part II.C.

¹⁶⁰ See IRM 5.8.5.20 (Oct. 22, 2010) (describing allowable expenses in considering

lender — such as perhaps a family member — may have less ability or inclination to benefit from the IRS's forgiveness of a tax debt, though it is possible that the taxpayer may feel more compelled to repay such a lender.¹⁶¹ Whether third-party creditors will benefit from forbearance will also depend on whether *any* excess funds are freed up as a result of non-collection: in other words, if the taxpayer is hopelessly insolvent to begin with, there may be nothing for other creditors to capture.¹⁶²

Of course, the situation will not always be quite that binary. A taxpayer who is recently freed of her tax debts — even one for whom the IRS is the only creditor at the time non-collection is exercised — may be able to leverage her improved situation to incur more indebtedness to a private creditor. In this event, what initially appeared to be a single-creditor situation will have, in effect, demanded a multiple-creditor analysis. For example, a taxpayer whose tax debts have been released to the tune of \$100 may be able to use her improved financial position to incur additional consumer debt. The new creditor (i.e., the credit card lender) might then capture the benefits of IRS forbearance.

Even if this were to happen, the debtor may in fact be better off than before the tax debts were forgiven. In that sense, her additional consumption is not necessarily bad, even if funded by credit. Furthermore, the taxpayer's private creditors are likely taxpayers themselves. The extent to which the benefits of non-collection that are captured by such private creditors are subsequently recaptured by the government through additional taxes on those creditors is difficult to quantify, but needs to be taken into account.¹⁶³

Despite these qualifications, the central concern remains: the worry is that the primary beneficiary of IRS forbearance will be neither the government nor the taxpayer but rather other creditors of the taxpayer. The possibility of such a result raises serious concerns about whether the IRS should be in the business of forgiving tax debts at all.

an OIC); IRM 5.8.5.20.1 (Oct. 22, 2010) (describing necessary expenses for OIC purposes); IRM 5.8.5.20.2 (Oct. 22, 2010) (describing how to decide the taxpayer's housing and utilities expense for OIC purposes); *see also* IRM 5.15.1.7 (Oct. 2, 2012) (describing allowable expenses in analysis of taxpayer financial situation).

¹⁶¹ ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, *THE LAW OF DEBTORS AND CREDITORS: TEXT, CASES, AND PROBLEMS* 5 (6th ed. 2009) (noting the existence of such "leverage factors" that "are almost entirely outside the scope of legal regulation").

¹⁶² *See infra* Part II.C.1.

¹⁶³ Conversely, forgiven taxpayers may themselves be creditors and may themselves reap the benefits of government forbearance.

2. Imposition of Non-Collection's Costs on Compliant Taxpayers and the Public

Because a government needs revenue to finance itself, the costs of tax non-collection are likely to be borne by other taxpayers and the public. An IRS decision to forgive or not collect some taxes owed may impact compliant taxpayers in the form of higher taxes.¹⁶⁴ Even if the present generation of taxpayers is not subject to higher tax rates, increased tax burdens may be imposed on future generations. If the government chooses instead to finance its activities by borrowing, the cost of such borrowing will have to be borne at some point by present or future generations of compliant taxpayers in the form of higher extractions or other macroeconomic impacts.¹⁶⁵ IRS non-collection may also place burdens on taxpayers and citizens in the form of decreased government provision of goods, services, and welfare.

Quantifying the magnitude of these costs is complicated, particularly because the data show that in some circumstances, the IRS can actually *increase* revenue collections by being willing to partially forgive a tax debt.¹⁶⁶ In these instances, it is unclear whether such partial forgiveness actually costs the government or the public anything. The answer depends, in part, on whether the baseline is full collection or zero. Furthermore, the exact avenue through which these costs will be imposed will depend on whether the government is able

¹⁶⁴ This point has been recognized in the context of tax evasion more broadly. See Alm, *supra* note 8, at 122 (“[T]ax evasion affects the tax rates that compliant taxpayers face and the public services that all citizens receive.”); Stuart P. Green, *What is Wrong with Tax Evasion?*, 9 HOUS. BUS. & TAX L.J. 220 (2009) (providing a moral account of tax evasion as “cheating,” which “reflect[s] the fact that evading tax causes harm not just to the government but also to one’s fellow citizens, who are forced to bear a heavier burden as a result of one’s conduct”); Joel Slemrod, *Cheating Ourselves: The Economics of Tax Evasion*, 21 J. ECON. PERSPECTIVES 25, 41 (2007) (“Tax evasion affects the distribution of the tax burden as well as the resource cost of raising taxes — bread-and-butter concerns of public economics”); see also Frances R. Hill, *Toward a Theory of Bankruptcy Tax: A Statutory Coordination Approach*, 50 TAX LAW. 103, 106-07 (1996) (noting that where the IRS is unable to collect a tax owed from a taxpayer, this results in a “value shift” to other taxpayers who have to make up the revenue shortfall).

¹⁶⁵ See *infra* notes 217 and 218 and accompanying text. But see Neil H. Buchanan, *Good Deficits: Protecting the Public Interest from Deficit Hysteria*, 31 VA. TAX REV. 75, 99-100 (2011).

¹⁶⁶ See 2006 NTA ANNUAL REPORT, *supra* note 134, at 89 (noting that “the majority of delinquent tax dollars in cases involving rejected OICs tend *not* to be collected”); Oei, *supra* note 6, at Part I.B.1 (discussing revenue benefits of OICs); Nina E. Olson, *Minding the Gap: A Ten-Step Program for Better Tax Compliance*, 20 STAN. L. & POL’Y REV. 7, 26 (2009).

to impose higher taxes on compliant taxpayers or whether it instead responds by reducing spending or by borrowing. In sum, the subject of quantifying the costs of non-collection and their distributive impacts is a complicated business, and is an interesting avenue for further analysis.

C. *The Factual and Legal Determinants of Tax Non-Collection's Distributive Outcomes*

What determines whether the distributive outcomes discussed in Part II.B will occur? The actual distribution of the costs and benefits of tax non-collection will depend on a number of factors, including the relationship between the delinquent taxpayer and her creditors, the number and types of such creditors, the ability of the government to shift the costs of non-collection to compliant taxpayers, and the behavioral impacts on compliance by other taxpayers. It will also depend on federal tax collection procedures themselves and the interaction of such procedures with non-tax debtor-creditor law and federal bankruptcy law.

1. IRS Collections Practice

The distributive consequences of non-collection will obviously be determined first and foremost by IRS collections policies and procedures themselves. How aggressive or effective the IRS is in collections enforcement determines how much surplus will be available to be captured by private creditors and how much burden will be imposed on other taxpayers and the public.¹⁶⁷

Similarly, the extent to which the IRS considers the debts owed by the taxpayer to other creditors in making collections decisions will determine how much those other creditors will benefit. This point is not merely theoretical: in her 2010 Annual Report to Congress, the Taxpayer Advocate identified as one of the most serious problems confronting taxpayers the fact that the IRS ignores the taxpayer's debts owed to other creditors and does not know the impact of doing so when determining the appropriate collections decision.¹⁶⁸ Specifically,

¹⁶⁷ For example, the robustness of IRS systems for evaluating what assets or properties a taxpayer holds and how much a taxpayer can actually reasonably pay will determine how likely it is that there remains surplus for private creditors to capture, as will the IRS's effectiveness at actually collecting the debt. *See generally* IRM 5.15.1 (Oct. 2, 2012), (Financial Analysis Handbook containing procedures for analyzing taxpayer financial situations).

¹⁶⁸ *See* 2010 NTA ANNUAL REPORT, *supra* note 155, at 98-99.

the NTA noted that the IRS sometimes ignores debts like past-due medical expenses and credit card debts, student loans the taxpayer is not currently paying, and home mortgage payments exceeding an estimate of average housing expenditures.¹⁶⁹ The NTA expressed concern that other creditors would continue to collect from taxpayers even outside of bankruptcy proceedings and even if the taxpayers also owe money to the IRS and that current IRS policies would prolong delinquencies, create hardship, lead to unrealistic installment agreements, and promote future delinquencies.¹⁷⁰ The NTA suggested that the IRS should study the effects of more realistic financial analysis policies on taxpayers.¹⁷¹ The IRS, in response, has disagreed with the NTA, stating that “[w]e do not agree that giving priority to other debts in [the] manner [suggested by the NTA] is sound tax administration.”¹⁷²

This back-and-forth between the IRS and the Taxpayer Advocate illustrates some of the distributive issues at stake in designing IRS collections policies. It illustrates that the question of whether and to what extent the IRS should consider and allow debt payments to other creditors in determining a taxpayer’s ability to pay is a live issue. The Taxpayer Advocate’s position is that even if the taxpayer’s private creditors capture some of the benefits of tax non-collection, non-collection is nonetheless justified with respect to certain tax debts.¹⁷³ The IRS takes the opposite position.¹⁷⁴

2. The Federal Tax Priority System and State Debtor-Creditor Law

Another determinant of the distributive consequences of tax non-collection is the laws that govern the priority of the federal tax lien in relation to other debts.¹⁷⁵ Chief among these is I.R.C. § 6323, which controls whether the federal tax lien has priority over the interests of

¹⁶⁹ *Id.* at 99. Such expenses are usually only allowed if the taxpayer enters into an installment agreement to repay the tax debt within five years. *Id.* (citing former Internal Revenue Manual provisions IRM 5.15.1.10 (Oct. 2, 2009) and IRM 5.8.5.6.4 (Sept. 23, 2008)). See also IRM 5.8.5.21 (Oct. 22, 2010).

¹⁷⁰ 2010 NTA ANNUAL REPORT, *supra* note 155, at 103.

¹⁷¹ *Id.*

¹⁷² *Id.* at 106.

¹⁷³ See *supra* notes 168-171 and accompanying text.

¹⁷⁴ See *supra* note 172 and accompanying text.

¹⁷⁵ See, e.g., I.R.C. § 6323 (2006) (governing validity and priority of federal tax lien in relation to other debts); see also I.R.C. § 6321 (1986) (establishing the lien for federal taxes).

other creditors.¹⁷⁶ That statute states that provided the federal tax lien has been perfected by filing an NFTL, the tax lien will take priority over subsequent purchasers, holders of a security interest, mechanic's lienors, and judgment lien creditors.¹⁷⁷ Certain subsequently occurring interests are accorded a higher priority status than the federal tax lien, even where an NFTL has been filed.¹⁷⁸ In order for a competing creditor's lien to take priority over the federal tax lien, courts generally agree that the competing creditor's lien must meet a "choateness" requirement, that is, the identity of the lienor, the property, and the amount of the lien must have been established.¹⁷⁹

How does the federal tax lien priority statute determine the distributive consequences of tax collections decisions? The lien priority statute determines whether the IRS would have been able to levy ahead of other creditors had it wielded the full extent of its collections power. To take a simple example, suppose the taxpayer has \$1,000 of assets and no income. If the taxpayer owes the IRS \$2,000 and a private creditor \$1,000, and the tax debt has lien priority, then if the IRS forbears from collection (perhaps under hardship grounds), the possibility arises that the \$1,000 of assets may be captured by the competing creditor. In this circumstance, the goal of preventing taxpayer hardship may be thwarted. On the other hand, if the IRS does not have priority over the private creditor, then it is less clear that the IRS gives up anything by

¹⁷⁶ For another statutory regime that governs certain non-bankruptcy insolvency proceedings, see 31 U.S.C. § 3713 (2006) (indicating that federal priority statute generally requires that claims of the United States be paid first when a debtor is insolvent, subject to certain other conditions). The Supreme Court has held that 31 U.S.C. § 3713 does not apply to accord priority of the federal tax lien over the perfected liens of judgment creditors. *United States v. Estate of Romani*, 523 U.S. 517, 522-25 (1998).

¹⁷⁷ See I.R.C. § 6323(a); see also *id.* § 6321.

¹⁷⁸ *Id.* § 6323(b). These "superpriorities" generally include, for example, certain purchasers of tangible personal property sold at retail in the ordinary course of the seller's trade or business, purchasers of household goods, personal effects or tangible personal property exempt from levy purchased in casual sales if certain other conditions are met, certain holders of possessory liens securing the reasonable price of repair or improvement to the property, and certain holders of attorney's liens. *Id.* § 6323(b)(3)-(6).

¹⁷⁹ *United States v. Sec. Trust & Savings Bank of San Diego*, 340 U.S. 47, 51 (1950). A lien on all of the debtor's after-acquired property is not choate until the debtor actually acquires the property. *United States v. McDermott*, 507 U.S. 447, 452 (1993) (holding that federal tax lien filed before judgment debtors acquired real property had to be given priority in that after-acquired property over judgment creditor's previously recorded state lien); see SALTZMAN & BOOK, *supra* note 1, ¶ 16.01[3] (noting that choate lien doctrine probably still applies even after revision of I.R.C. § 6323).

forbearing,¹⁸⁰ because the private creditor has the first right to payment out of the \$1,000 of assets. While there may be other impacts on the credit status of the forgiven tax debtor in this latter situation, it cannot accurately be described as “capture” by the private creditor because such creditor was ahead of the IRS to begin with.

State debtor-creditor law also plays some part in determining the distributive consequences of tax non-collection. The reason is that whether the interests of other creditors arise before or after the filing of the NFTL depends on the specifics of state and other statutory and judge-made law.¹⁸¹ In other words, state law will govern the question of when, whether, and how certain interests of other creditors are perfected.¹⁸²

3. Bankruptcy and Its Threat

Bankruptcy is a coordinated federal proceeding through which a debtor can pay off some debts in a certain order while obtaining relief from having to pay other debts. There are different types of bankruptcies. In a Chapter 7 bankruptcy, a debtor’s non-exempt assets are liquidated and the proceeds distributed to her creditors, after which the debtor receives a discharge from those debts.¹⁸³ In a Chapter 13 bankruptcy, the debtor retains her pre-bankruptcy assets in exchange for entering into a repayment plan under which certain of her pre-petition creditors are repaid over time out of her post-petition income.¹⁸⁴ Businesses may also restructure their debts and their equity structure via a Chapter 11 reorganization bankruptcy, in order to continue operations in a less encumbered form.¹⁸⁵

Two of the most important concepts in determining the treatment of claims in bankruptcy are priority (the order in which a debtor’s creditors will be paid) and dischargeability (the question of which unpaid debts will be relieved at the conclusion of the bankruptcy proceeding). Tax debts are subject to special rules that govern their priority and dischargeability in bankruptcy, and these rules have

¹⁸⁰ This example ignores the taxpayer’s future earnings capacity.

¹⁸¹ See, e.g., MASS. GEN. LAWS ANN., ch. 254, §§ 1-33 (2012) (Massachusetts lien law); N.Y. LIEN LAW Arts. 1-11 (McKinney 2012) (New York lien law); see also MASS. GEN. LAWS ANN., ch. 106, Art. 9 (Massachusetts law provisions governing secured transactions).

¹⁸² See sources cited *supra* note 181.

¹⁸³ See generally 11 U.S.C. ch. 7 (2006).

¹⁸⁴ See generally *id.* ch. 13 (2006).

¹⁸⁵ See generally *id.* ch. 11 (2006). Chapter 11 bankruptcy is also available to individuals, though less common. *Id.* § 109 (2006).

impacts on the pre-bankruptcy behaviors of tax debtors and the government creditor. The following is a very general summary of these rules.

Secured Tax Claims. If, prior to the bankruptcy filing, the IRS has filed an NFTL on a taxpayer's property with respect to an allowed tax claim, then the IRS will have a secured tax claim to the extent of the equity in the debtor's assets.¹⁸⁶ In a Chapter 7 bankruptcy, the property encumbered by the perfected tax lien (or proceeds from such property) must be distributed to claimholders in a certain order.¹⁸⁷ Generally speaking, the federal tax claim will be subordinated to allowed claims that are senior to the tax lien and certain non-tax priority claims.¹⁸⁸ If an NFTL has been filed, the encumbered property will remain subject to the tax lien even after the bankruptcy is concluded.¹⁸⁹ Thus, even though the underlying tax liability has been discharged, the IRS may seize the lien property after the bankruptcy to pay the discharged tax claim.¹⁹⁰ In a Chapter 13 bankruptcy, unless the secured tax creditor has agreed otherwise, the debtor must either surrender the property securing the claim to the secured creditor, or the plan must generally pay the full value of the secured claim and meet certain other requirements, in order for the plan to be confirmed.¹⁹¹

Priority Tax Claims. Tax claims that are not secured are classified as either priority tax claims or general tax claims.¹⁹² Most priority taxes

¹⁸⁶ See *id.* § 506 (2006); I.R.C. § 6323 (2006); see also INTERNAL REVENUE SERV., BANKRUPTCY TAX GUIDE 24 (2012), available at <http://www.irs.gov/pub/irs-pdf/p908.pdf> (last visited Nov. 6, 2012).

¹⁸⁷ 11 U.S.C. § 724(b) (2006).

¹⁸⁸ *Id.*; see also § 522(c)(2)(B) (2006). For a detailed description, see Hon. Joseph Lee, Bankruptcy Service, Lawyers Ed. § 38:67, 4 BANKR. SERV. L. ED. § 38:67 (Oct. 2011) and Keith Fogg, *Effectively Representing Your Client Before the IRS*, § 21.1.4 (ABA 2011) (discussing the treatment of secured tax claims in bankruptcy).

¹⁸⁹ 11 U.S.C. § 523(a)(1) (2006); see also *In re Quillard*, 150 B.R. 291, 294-95 (Bankr. D.R.I. 1993); INTERNAL REVENUE SERV., BANKRUPTCY TAX GUIDE, *supra* note 186, at 25.

¹⁹⁰ See, e.g., *In re Davenport*, 136 B.R. 125 (W.D. Ky. 1991) (holding that state created homestead exemption is ineffective against properly filed federal tax lien); *In re Rouse*, 141 B.R. 218 (Bankr. W.D. Okla. 1992) (ruling that Chapter 7 debtor's exempt property remains liable for prepetition tax debts for which an NFTL had been properly filed, even though the underlying tax debts were dischargeable). Thus, unlike the claims of other creditors, a perfected federal tax lien may impinge on the property of a debtor (such as homestead of IRAs) that is exempted in the bankruptcy. 11 U.S.C. § 522(c)(2)(B).

¹⁹¹ 11 U.S.C. § 1325(a)(5) (2006); see also C. RICHARD MCQUEEN & JACK F. WILLIAMS, TAX ASPECTS OF BANKRUPTCY LAW AND PRACTICE § 1:61 (3d ed. 2012).

¹⁹² See generally BANKRUPTCY TAX GUIDE, *supra* note 186, at 24-25 (describing the

are “eighth priority” claims.¹⁹³ Very generally, eighth priority taxes include more recent income or gross receipts taxes, more recent employment taxes, withholding taxes for which the debtor is liable, and certain excise taxes.¹⁹⁴

What does it mean to be a priority tax claim? In a Chapter 7 case, priority tax claims are paid out of assets of the bankruptcy estate after paying the secured creditors and the other priority claims that rank ahead of the priority tax claim.¹⁹⁵ Priority tax claims are paid ahead of general unsecured tax claims.¹⁹⁶ Furthermore, eighth priority tax claims are not dischargeable in a Chapter 7 bankruptcy or in an individual’s Chapter 11 bankruptcy.¹⁹⁷ Priority taxes must also be paid in full in a Chapter 13 repayment plan, unless the IRS agrees otherwise.¹⁹⁸

Other Exceptions from Dischargeability. As mentioned, filing for bankruptcy protection may be beneficial to a distressed debtor because she may be able to obtain a discharge of pre-bankruptcy debts. However, not all tax debts are dischargeable in bankruptcy. In

classification of priority unsecured tax claims in bankruptcy).

¹⁹³ 11 U.S.C. § 507(a)(8) (2006). Eighth priority claims mean that they rank behind seven other types of priority claims. However, certain taxes are accorded higher priority. For example, taxes incurred during the administration of the bankruptcy estate are second priority taxes. *Id.* § 507(a)(2). *See also id.* § 507(a)(3) (explaining that certain post-petition taxes arising in an involuntary bankruptcy case accorded third priority).

¹⁹⁴ 11 U.S.C. § 507(a)(8). Such eighth priority taxes include: (1) income or gross receipts taxes for tax years ending on or before the date of the bankruptcy petition, for which a tax return is due to be filed (including extensions) after three years before the date of the bankruptcy filing; (2) income or gross receipts taxes for tax years ending on or before the date of the bankruptcy petition that were assessed within 240 days before the date of the bankruptcy filing; (3) certain income or gross receipts taxes for tax years ending on or before the date of the bankruptcy petition that were not assessed before the bankruptcy filing but were assessable as of that date; (4) withholding taxes for which the debtor is liable; (5) employment taxes earned from the debtor before the bankruptcy filing, for which a return is last due (including extensions), after three years before the date of the bankruptcy filing, whether or not such taxes were actually paid prior to bankruptcy; (6) certain excise taxes on pre-bankruptcy transactions; and (7) certain other taxes. The 240-day window in (2) is calculated exclusive of (1) any period during which an OIC is pending or in effect plus thirty days, and (2) any period during which a stay against collections was in effect in a prior case during the 240-day period plus ninety days. *Id.* § 507(a)(8)(A)(ii).

¹⁹⁵ 11 U.S.C. §§ 507(a), 726(a) (2006).

¹⁹⁶ *Id.* §§ 507(a), 726(a).

¹⁹⁷ *Id.* § 523(a)(1) (2010). *See also infra* notes 199-202 and accompanying text (discussing dischargeability of claims in bankruptcy).

¹⁹⁸ 11 U.S.C. § 1322(a)(2) (2010).

addition to eighth priority tax debts, certain other tax debts are exempt from discharge. In an individual Chapter 7 bankruptcy, taxes for which no return was filed, taxes for which a return was filed late after two years before the bankruptcy petition, taxes for which a fraudulent return was filed, and taxes that the debtor willfully attempted to evade will not be discharged and will survive the bankruptcy.¹⁹⁹ These exceptions to discharge also apply to individual Chapter 11 cases.²⁰⁰ In individual Chapter 13 cases in which the debtor has completed payments under the plan, withholding taxes for which the taxpayer is liable, taxes for which a return was not filed, taxes for which a return was filed late after two years before the bankruptcy filing, taxes for which the debtor filed a fraudulent return, and taxes that the debtor willfully attempted to evade are nondischargeable.²⁰¹ Even if a tax debt has been discharged in bankruptcy, the IRS may still collect the tax against the debtor's pre-bankruptcy property if an NFTL has been filed.²⁰²

Impact of Bankruptcy Rules on Distributive Outcomes of Tax Non-Collection. These bankruptcy rules pertaining to the priority and dischargeability of tax debts will affect the distributive outcomes resulting from government tax collections decisions. Take, for example, a debtor with a large amount of unsecured credit card debt, which is dischargeable in bankruptcy. Assume that this debtor also owes money to the IRS and that the tax debt is not dischargeable. Assume further that the debtor has no lienable assets and insufficient income to pay the tax debt in full while meeting basic living expenses and that that the IRS, after financial analysis, places the taxpayer's account in CNC status on hardship grounds.²⁰³ If the taxpayer files for a Chapter 7 bankruptcy, presumably he would obtain a discharge of the unsecured credit card debt. The nondischargeable tax debt would survive the bankruptcy and in this instance, there would be no capture by other creditors by virtue of the IRS placing the debt in CNC prior to the bankruptcy filing. Rather, the IRS could subsequently reactivate

¹⁹⁹ See *id.* § 523(a)(1). Corporations and non-individuals do not receive a discharge in a Chapter 7 case. *Id.* § 727(a)(1).

²⁰⁰ 11 U.S.C. § 523(a)(1).

²⁰¹ *Id.* § 1328(a)(2) (2006). For a Chapter 13 debtor that fails to complete payments under the Chapter 13 plan but who is nonetheless granted discharge under 11 U.S.C. § 1328(b), the usual exceptions to discharge for individuals under Chapter 7 would apply. *Id.* § 1328(b), (c)(2); see also *id.* § 523(a). See generally BANKRUPTCY TAX GUIDE, *supra* note 186, at 25 (describing dischargeability of unpaid taxes in Chapter 13 cases).

²⁰² See *supra* notes 189-190 and accompanying text.

²⁰³ IRM 5.16.1.2.9 (May 22, 2012).

collection on the taxpayer's account.²⁰⁴ It is likely, in fact, that the IRS would ultimately be made better off by the bankruptcy filing because the taxpayer would presumably be in a better position to pay the tax going forward after the bankruptcy, particularly if income increases.²⁰⁵

If, on the other hand, the facts were the same except that the debtor also had other *nondischargeable* debts (in addition to unsecured credit card debts), it is less clear who the beneficiaries of the IRS's pre-bankruptcy forbearance will be. If the creditors holding those nondischargeable debts are more aggressive than the IRS in collecting from the post-bankruptcy debtor, the beneficiaries of the IRS's pre-bankruptcy largess may well turn out to be those other creditors.

While an actual bankruptcy filing will determine the distributive outcomes of the government's failure to collect a tax debt by virtue of the rules governing the priority and dischargeability of various debts, so will the mere threat of a bankruptcy filing. The specter of a possible bankruptcy filing has multidimensional impacts on the behaviors, motivations, and decisions of debtors and creditors who bargain in the shadow of the bankruptcy law.²⁰⁶ No less so for the government creditor and the tax debtor. For example, if the tax liability owed is not dischargeable in bankruptcy, the IRS might have less incentive to compromise the amount of the liability, particularly if it is known that the taxpayer's other debts are dischargeable.²⁰⁷ On the other hand, the IRS might well be more willing to delay the timing of collection ahead of bankruptcy because this will not destroy its ability to collect the debt if the taxpayer does file for bankruptcy.

Conversely, if the tax debt is dischargeable in bankruptcy, the IRS may be more willing to compromise the amount of the debt because of

²⁰⁴ IRM 5.16.1.1 (May 22, 2012); IRM 5.16.1.6 (May 22, 2012) (describing systemic follow-up process for hardship cases).

²⁰⁵ Of course, if the taxpayer does not file for bankruptcy, it is possible that the private creditor will be able to capture the benefits of IRS forbearance.

²⁰⁶ WARREN & WESTBROOK, *supra* note 161, at 6 (“[F]ormal debtor-creditor laws are important because of the impact they have on the informal, negotiated debt collection process . . .”).

²⁰⁷ The IRS will not consider an OIC where a bankruptcy case has been filed. IRM 5.8.10.2.1 (Sept. 27, 2011); *see also* SALTZMAN & BOOK, *supra* note 1, ¶¶ 15.07[5]-15.07[6][a] & n.280; Memorandum from Gary D. Gray, Assistant Chief Counsel, Internal Revenue Serv., Dep't of the Treasury, to Assistant Regional Counsels (Jan. 4, 2000), available at <http://www.unclefed.com/ForTaxProfs/irs-wd/2000/0011046.pdf>. However, where a taxpayer threatens to file for bankruptcy if the offer is not accepted, the IRS will determine whether the potential for a bankruptcy filing actually exists and the impact such filing would have on collection of outstanding tax liabilities. IRM 5.8.10.2.2 (Sept. 27, 2011).

the threat of zero collections if a taxpayer becomes bankrupt.²⁰⁸ On the other hand, the IRS may respond to this threat by collecting more aggressively before the taxpayer actually files for bankruptcy.

4. Informal Relationships and Actions Between Taxpayers and Their Creditors

Irrespective of the legal limits on a creditor's ability to collect an unpaid debt, the informal relationships between that creditor and the debtor will affect the extent to which the creditor will enforce her collections rights, and will thus affect the distributive outcomes of non-collection.²⁰⁹ Conversely, a debtor may make more attempts to pay certain of her creditors based on the informal relationships between them, and this may occur at the expense of other creditors.

Returning to the example of the IRS placing the taxpayer's tax debt in CNC status on hardship grounds, where the taxpayer also owes unsecured credit card debts,²¹⁰ assume now that, after the IRS's non-collection action, the taxpayer does not in fact end up filing for bankruptcy. If the taxpayer's credit card lenders take aggressive or even illegal action in pursuing non-bankruptcy collection action against the taxpayer (for example, by sending a collection agency after the taxpayer in order to obtain payment), they may be able to extract from the debtor some of the expenses that were allowed by the IRS. In this case, the IRS's forbearance on the ground that taxpayer should be allowed to meet basic living expenses may benefit the private creditor instead of the taxpayer.

²⁰⁸ I.R.M. 5.8.5.18 (Oct. 22, 2010) (noting that where a taxpayer is going to file a Chapter 7 bankruptcy petition, the IRS will "[c]onsider reducing the value of future income" and will "also consider the intangible value to the taxpayer of avoiding bankruptcy"); *see also* IRM 5.8.10.2 (Sept. 27, 2011) ("Bankruptcy may affect the Service's consideration of an OIC. The taxpayer may file bankruptcy and an OIC simultaneously, or file an OIC in an attempt to avoid bankruptcy, or file an OIC after a bankruptcy has been concluded."); IRM 5.8.10.2.2(2), (3) (Sept. 27, 2011) (noting that if the IRS accepts an OIC and the taxpayer does not file for bankruptcy, the IRS "can negotiate for amounts collectible from future income and from assets beyond the reach of the government, that may not be collectible if the taxpayer files for bankruptcy" and the "[t]erms for payment of an offer may result in funds being collected in a shorter time than through bankruptcy"; also noting that the taxpayer benefits because bankruptcy "carries certain negative repercussions").

²⁰⁹ *See supra* notes 159-161 and accompanying text.

²¹⁰ *See supra* notes 203-204 and accompanying text.

5. Political and Other Factors

Finally, political and other factors will affect the distributive outcomes of tax non-collection. In particular, whether the costs of non-collection are felt by compliant taxpayers in the form of higher tax extractions will depend, in part, on whether it is politically feasible to raise tax rates or broaden the tax base. Alternatively, the government may instead need to absorb the costs of non-collection through lower levels of government provision or borrowing. Depending on government policy choice, the distributive consequences are likely to be felt by one or another group of citizens or taxpayers. A complete account of the political, economic and other factors that dictate the distributive consequences of tax non-collection is beyond the scope of this Article. However, the potential impact of these factors cannot be ignored.²¹¹

III. THEORIZING TAX NON-COLLECTION: RISK, SOCIAL INSURANCE, AND THE FUNCTIONS OF GOVERNMENT

Just how problematic are the distributive consequences described in Part II? Are capture of tax non-collection's benefits by private creditors, higher taxes on compliant taxpayers, or diminished provision of government goods and services necessarily bad outcomes? While some degree of tax non-collection may be desirable on administrability, cost, and efficiency grounds,²¹² non-collection's problematic distributive outcomes still need to be justified. The

²¹¹ For a few examples of commentary on tax reform, tax policy choice and its consequences, see Michael Beller, *Obama's Budget Would Raise \$1.5 Trillion in New Revenue*, 134 TAX NOTES 917 (2012) (describing key features of President Obama's fiscal 2013 budget); Karen C. Burke & Grayson M.P. McCouch, *Turning Slogans into Tax Policy*, 27 VA. TAX REV. 747 (2008) (analyzing the consequences of the Bush Administration's tax cuts agenda); William G. Gale & Peter R. Orszag, *An Economic Assessment of Tax Policy in the Bush Administration: 2001-2004*, 45 B.C. L. REV. 1157 (2004) (analyzing the economic effects of the George W. Bush administration's tax policies); Thomas L. Hungerford, *The Redistributive Effect of Selected Federal Transfer and Tax Provisions*, 38 PUB. FIN. REV. 450, 452 (2010) (studying the redistributive effects of certain tax provisions and government transfer programs); David Kamin, Note, *What is a Progressive Tax Change?: Unmasking Hidden Values in Distributional Debates*, 83 N.Y.U. L. REV. 241 (2008) (discussing relationship between theories of redistributive justice and how progressivity is measured); Daniel N. Shaviro, *Reckless Disregard: The Bush Administration's Policy of Cutting Taxes in the Face of an Enormous Fiscal Gap*, 45 B.C. L. REV. 1285 (2004) (discussing the adverse consequences of the Bush Administration's policies of cutting taxes while increasing government spending).

²¹² See sources cited *supra* note 8.

existence of these problematic distributive outcomes may suggest that non-collection should not be pursued despite potential efficiency gains, or should be pursued to a lesser degree.

This Part argues that a framework that conceptualizes tax non-collection as government-provided social insurance can justify both the capture of non-collection's benefits by private creditors and the imposition of non-collection's costs on compliant taxpayers and the public. A social insurance framework can therefore justify tax non-collection.

Part III.A first sets forth a descriptive framework analyzing tax non-collection as potentially performing a social insurance function. Tax non-collection functions as insurance in cases where the government, in exchange for a price or premium, absorbs the risk of taxpayer consumption shocks by forbearing from collection of the tax owed in certain covered circumstances. A social insurance framework can justify the seemingly troubling distributive consequences that may result from tax non-collection.

Part III.B then discusses whether it is justified for the government to provide social insurance against taxpayer financial distress through the mechanism of tax non-collection. This discussion turns on how we answer foundational questions such as whether social insurance should exist at all, and how social insurance provided via tax non-collection should interact with other social insurance or assurance programs that the government provides.

Part III.C turns to a more specific question: how should social insurance provided through tax non-collection interact with social insurance provided through the bankruptcy debt discharge? Consumer bankruptcy scholars have long recognized that the bankruptcy debt discharge itself serves a social insurance function.²¹³ Thus, the question of whether the government should provide social insurance via tax non-collection also implicates the question of whether and to what extent the government should subsidize the private-creditor risk transfer that is already mandated under bankruptcy law.

A. *Tax Non-Collection as Social Insurance*

Insurance is a mechanism whereby the risks of many are collectively pooled and transferred to another party in exchange for a price, which is imposed on those whose risks have been transferred.²¹⁴ Tax non-

²¹³ See *infra* note 224 and accompanying text.

²¹⁴ See ALLAN HERBERT WILLETT, *THE ECONOMIC THEORY OF RISK AND INSURANCE* 72

collection likely satisfies this basic definition. In the case of tax non-collection, the pool of insureds is the taxpaying public. By deciding not to collect a tax owed in certain circumstances, the government creditor insures these taxpayers against the risks of financial distress. The “covered events” insured against are basically determined by tax collections law and IRS policies governing when to forbear and when to proceed with collection, as well as by what is realistically collectible. They may include: cost of collection, inability to pay, equity, public policy, or taxpayer hardship.

To characterize tax non-collection as insurance, it must also be shown that the pool of insured taxpayers bears the price of such insurance. That such price or premium is borne by taxpayers is likely.²¹⁵ The premium might be imposed through higher extractions, i.e., higher tax rates, higher underpayment interest rates, or higher penalties for late payments or non-payments.²¹⁶ In addition, since taxing and spending are two sides of government function, the insurance premium might also be extracted through reduced government spending on its citizens. Finally, even if the government decides to make up the revenue shortfall through borrowing, taxpayers would still eventually have to bear the costs of such borrowing.

Even if current taxpayers manage to escape the extraction of insurance premiums (for example, if the government operates at a deficit in the short term), the costs of tax non-collection would eventually have to be borne by future generations of taxpayers in the form of higher taxes or lower levels of government spending. This outcome, were it to occur, would not detract from an insurance characterization of tax non-collection. In other government-provided insurance arrangements, such as social security, the premium paid by an insured need not correspond exactly to the degree of risk

(1951) (defining insurance as a “social device for making accumulations to meet uncertain losses of capital which is carried out through the transfer of the risks of many individuals to one person or to a group of persons. Wherever there is accumulation for uncertain losses, or wherever there is a transfer of risk, there is one element of insurance; only where these are joined with the combination of risks in a group is the insurance complete.”); Gillian Lester, *Unemployment Insurance and Wealth Redistribution*, 49 UCLA L. REV. 335, 360 (2001) (noting that risk can be dealt with by assuming it, reducing hazards, or transferring it, and stating that “[w]hen risk transfer is carried out through a social mechanism — by pooling a large number of individuals — we call it insurance”).

²¹⁵ See Alm, *supra* note 8, at 122; see also discussion *supra* Part II.B.2 and accompanying notes.

²¹⁶ See discussion *supra* Part II.B.2.

transferred, nor is intergenerational cross-subsidization of risk impermissible.²¹⁷ In fact, the ability to transfer risk across generations is one of the advantages of having government be the direct provider of social insurance.²¹⁸

In sum, tax non-collection is accurately described as government-provided insurance when taxpayers collectively transfer to the government the risk of inability to pay a tax debt, and such taxpayers pay a price for the risk transfer.²¹⁹ Further, tax non-collection is *social* insurance because participation is mandatory for all taxpayers.²²⁰

The notion that tax non-collection can be conceptualized as government-provided social insurance is plausible. First, the idea that such insurance could be delivered via the tax system is not so unusual, because it is well accepted that welfare programs can be delivered through the tax system.²²¹ For example, some scholars have suggested

²¹⁷ Theodore R. Marmor & Jerry L. Mashaw, *Understanding Social Insurance: Fairness, Affordability, and the “Modernization” of Social Security and Medicare*, 15 ELDER L.J. 123, 127 (2007) (“The financing of most social insurance, unlike commercial insurance premiums, does not vary with individual risk.”); *id.* at 134-35 (“The simple economic logic of retirement finance is just this: either generation X can prefund its own retirement, or it can fund the retirement of X – 1 and have its retirement funded by X + 1.”); *see also* JEFFREY R. BROWN, PUBLIC INSURANCE AND PRIVATE MARKETS 10 (Jeffrey R. Brown, ed., 2010) (“While the government has no advantage over the private sector in diversifying risk within a given generation, it is uniquely situated to contract over generations.”).

²¹⁸ BROWN, *supra* note 217, at 10 (citing Henning Bohn, *Who Bears What Risk? An Intergenerational Perspective*, in RESTRUCTURING RETIREMENT RISKS 10, 11 (David Blitzstein et al. eds., 2006) (“Welfare improvements are possible because a government’s power of taxation gives it a unique ability to make commitments on behalf of future generations.”)).

²¹⁹ *See* sources cited *supra* note 214; *see also* Adam Feibelman, *Defining the Social Insurance Function of Consumer Bankruptcy*, 13 AM. BANKR. INST. L. REV. 129, 138 (2005) (“Where beneficiaries . . . actually bear the cost of any benefits or protections — either directly or indirectly — these benefits or protections are properly described as social insurance. Social insurance programs are conceptually different than social assistance programs, which generally provide needs-based benefits and for which recipients do not pay a premium.”).

²²⁰ There is no universally agreed upon definition of the term “social insurance.” *See, e.g.*, Alan B. Krueger & Bruce D. Meyer, *Labor Supply Effects of Social Insurance*, in HANDBOOK OF PUBLIC ECONOMICS (Alan Auerbach & Martin Feldstein eds., 2002) (“There is no official definition [of social insurance]. For our purposes, social insurance programs are defined as compulsory, contributory government programs that provide benefits to individuals if certain conditions are met.”); *see also* Feibelman, *supra* note 219, at 129-30 (comparing formal theoretical definitions of the term with functional definitions).

²²¹ While scholars disagree as to whether delivery of welfare benefits through the tax system or direct delivery is a better mechanism, the plausibility of delivery via tax expenditures is established. *See* Anne Alstott, *The Earned Income Tax Credit and the*

a negative income tax or demogrant to deliver welfare benefits.²²² While social insurance and social welfare are not identical, they are related in the sense that they are ways in which the government provides security to its citizens. The key point is that such security can be delivered using the tax system, as well as by direct transfer methods.²²³

Limitations of Tax-Based Welfare Reform, 108 HARV. L. REV. 533, 564-89 (1995) (discussing the limitations of tax-based transfer programs such as the Earned Income Tax Credit); Marjorie E. Kornhauser, *Cognitive Theory and the Delivery of Welfare Benefits*, 40 LOY. U. CHI. L.J. 253 (2009) [hereinafter Kornhauser, *Cognitive Theory*] (interrogating the perceived superiority of using the tax system to deliver welfare benefits to the poor from the viewpoint of cognitive theory); Kyle Logue & Ronen Avraham, *Redistributing Optimally: Of Tax Rules, Legal Rules, and Insurance*, 56 TAX L. REV. 157, 161 (2003) (developing “a general framework for choosing the optimal redistributive policy instrument or combination of redistributive policy instruments, whatever one’s vision of distributive justice might be”); David A. Weisbach, *Tax Expenditures, Principal-Agent Problems, and Redundancy*, 84 WASH. U. L. REV. 1823, 1824 (2006); David A. Weisbach & Jacob Nussim, *The Integration of Tax and Spending Programs*, 113 YALE L.J. 955, 958 (2004) (“Welfare is the same regardless of whether the program is formally part of the tax system or is located somewhere else in the government.”); A. Lans Bovenberg & Peter Birch Sørensen, *Optimal Taxation and Social Insurance in a Lifetime Perspective* 3 (Tilburg University Discussion Paper No. 2007-14, Jan. 2006), available at <http://arno.uvt.nl/show.cgi?fid=57352> (finding based on model that optimal tax-and-transfer system is one that offers less than full disability insurance along with some self insurance through saving). For a more general description of the concept of tax expenditures, see STANLEY S. SURREY, *PATHWAYS TO TAX REFORM: THE CONCEPT OF TAX EXPENDITURES* (1974) and STANLEY S. SURREY & PAUL R. MCDANIEL, *TAX EXPENDITURES* (1985).

²²² See, e.g., MILTON FRIEDMAN, *CAPITALISM AND FREEDOM* 191-93 (1962) (explaining the benefits of a negative income tax); William D. Popkin, *Administration of a Negative Income Tax*, 78 YALE L.J. 388 (1969) (analyzing problems that may arise in the administration of a negative income tax); Daniel Shaviro, *The Minimum Wage, the Earned Income Tax Credit, and Optimal Subsidy Policy*, 64 U. CHI. L. REV. 405, 410 (1997) (noting that some scholars have proposed “negative marginal tax rates at low levels of earned or total income”); James Tobin, Joseph A. Pechman & Peter M. Mieszkowski, *Is a Negative Income Tax Practical?* 77 YALE L.J. 1 (1967) (exploring the practical or technical problems that must be resolved if a negative income tax is to be implemented).

²²³ See Bohn, *supra* note 218, at 12 (“[T]axes are a general purpose risk-sharing device: they socialize the tax share of whatever tax base they are imposed on.”); see also Feibelman, *supra* note 219, at 170 (“Social insurance programs inevitably impose a tax, or the equivalent of a tax, on some segment of the economy – federal tax payers, consumers, employers, corporations, etc. – to fund the benefit or relief that the program provides.”); Logue & Avraham, *supra* note 221, at 168 (“Compulsory private insurance . . . begins to resemble various social insurance alternatives, such as Medicare or Social Security, which in turn have some of the characteristics of a tax-and-transfer regime. That is, the distinction between premiums and taxes begins to break down, as does the distinction between benefit pay-outs and in kind transfers.”).

Second, the idea that forgiveness of a debt — just like an actual cash handout — can be conceptualized as insurance is also well recognized. This notion has been recognized in the consumer bankruptcy literature.²²⁴ It has also been touched on in the economics literature on tax evasion.²²⁵ Unlike programs such as worker's compensation, unemployment insurance, or disability insurance, any "payout" resulting from tax non-collection would be received not in the form of a check or in-kind benefit but rather in the form of a discharge of indebtedness. Yet, as has long been recognized under substantive tax law, the discharge of an indebtedness is no less a positive income item

²²⁴ See, e.g., Barry Adler, Ben Polak, & Alan Schwartz, *Regulating Consumer Bankruptcy: A Theoretical Inquiry*, 29 J. LEGAL STUD. 585, 608 (2000) (noting that one of the goals of consumer bankruptcy is "to insure consumers, to the extent possible, against bad income realizations and to reduce moral hazard in connection with lending agreements"); Jean Braucher, *Consumer Bankruptcy as Part of the Social Safety Net: Fresh Start or Treadmill?*, 44 SANTA CLARA L. REV. 1065, 1072-73 (2004) (characterizing consumer credit use and bankruptcy filing volume as stemming from incomplete public and private insurance coverage for the middle class); Feibelman, *supra* note 219, at 129 ("Bankruptcy scholars generally agree that consumer bankruptcy functions, at least in part, as a form of social insurance."); Charles G. Hallinan, *The "Fresh Start" Policy in Consumer Bankruptcy: A Historical Inventory and an Interpretive Theory*, 21 U. RICH. L. REV. 49, 100 (1986) ("[T]he [bankruptcy] discharge provides the debtor with credit insurance coverage in an amount equal to his dischargeable liabilities less his nonexempt assets at bankruptcy."); Richard M. Hynes, *Non-Procrustean Bankruptcy*, 2004 U. ILL. L. REV. 301, 350-59 (2004) [hereinafter Hynes, *Non-Procrustean Bankruptcy*] (comparing debt relief to other forms of social insurance); Richard M. Hynes, *Why (Consumer) Bankruptcy?* 56 ALA. L. REV. 121, 153 (2004) ("[T]he most plausible justification for the bankruptcy discharge is that it provides the consumer with a form of insurance that the consumer failed to purchase due to some form of market failure."); Richard M. Hynes, *Optimal Bankruptcy in a Non-Optimal World*, 44 B.C. L. REV. 1, 2, 17 (2002) (noting that "[b]ecause an ideal bankruptcy system would provide [debt relief] only after the debtor has suffered some misfortune, bankruptcy can be viewed as similar to a public insurance program" and that "[b]ankruptcy effectively makes creditors the insurer of their debtors by transferring wealth from creditors to debtors, through a reduction in debts, after debtors have suffered some misfortune"); Eric A. Posner, *Contract Law in the Welfare State: A Defense of the Unconscionability Doctrine, Usury Laws, and Related Limitations on the Freedom to Contract*, 24 J. LEGAL STUD. 283, 307 (1995) ("[B]ankruptcy law is analogous to the welfare system: it is social insurance for the nonpoor.").

²²⁵ See Andreoni, *Permanent Tax Amnesty*, *supra* note 8, at 144-45 (noting, in making the case for permanent tax amnesty, that since "[c]heaters with uncertain consumption ex ante will exercise their option for the amnesty if ex post they suffer sufficiently bad luck and wish to eliminate some of their risk," "amnesty acts as a partial social insurance"); see also James Andreoni, *IRS as Loan Shark: Tax Compliance with Borrowing Constraints*, 49 J. PUB. ECON. 35 (1992) [hereinafter Andreoni, *IRS as Loan Shark*] (arguing that taxpayers facing "binding borrowing constraints may use tax evasion to transfer resources from the future to the present").

than getting an actual check in the mail.²²⁶ Moreover, since money is fungible, forgiving a tax debt owed to government frees up funds that can be applied to other consumption, investment, or debt repayment activities.²²⁷ Such freeing of assets for other consumption can accomplish one of the key purposes of social insurance: the reduction of costs to society that follow from the financial and other misfortunes of individuals. The economics are identical to the economics that underlie actual cash transfers. In sum, while the notion is less familiar in the tax collections context,²²⁸ debtor-creditor scholarship already recognizes that the transfer of risk to a third-party insurer via debt discharge is properly characterized as social insurance against financial misfortune.

If we accept that the federal government has a role in providing social insurance, and if we think that tax non-collection is an appropriate vehicle for providing such insurance, then we may regard it as acceptable, even expected, that the costs of tax non-collection would fall on compliant taxpayers in the form of higher taxes or lower spending.²²⁹ These costs essentially represent the premiums that all taxpayers should have to pay in exchange for transfer of risk to the government.

A social insurance theory also justifies the capture of tax non-collection's benefits by the delinquent taxpayer's other creditors.²³⁰ A social insurance theory holds that the government is providing, via tax non-collection, mandatory insurance for citizen-taxpayers against financial distress and inability to pay *all kinds of debts*, not just tax debts.²³¹ Under a social insurance theory, situations in which other

²²⁶ I.R.C. § 61(a)(12) (1986).

²²⁷ See Andreoni, *IRS as Loan Shark*, *supra* note 225, at 44-45 (noting that “amnesty turns tax cheating into a loan” and that “the government can increase welfare by playing the role of ‘loan-shark’ to people whose borrowing is constrained on the private market”).

²²⁸ But see Andreoni, *Permanent Tax Amnesty*, *supra* note 8, at 144-45 (suggesting that tax amnesty can function “as a partial social insurance”); Andreoni, *IRS as Loan Shark*, *supra* note 225, at 44 (noting potential “further roles for the IRS in smoothing consumption in the presence of borrowing constraints”).

²²⁹ See discussion *supra* Part II.B.2; cf. Lee Anne Fennell, *Unbundling Risk*, 60 DUKE L.J. 1285, 1338 (2011) (noting that bankruptcy laws “impose spillovers on other parties — not the creditors, who can price in the risk that the law forces them to bear, but the nondefaulting debtors who must pay more for credit (or suffer from reduced credit availability)” and that “[t]he rules surrounding bankruptcy discharge and similar protections must strike a balance between these types of spillovers”).

²³⁰ See discussion *supra* Part II.B.1.

²³¹ See Andreoni, *IRS as Loan Shark*, *supra* note 225, at 36, 44 (arguing that by enforcing less than full compliance, the government essentially makes loans to

creditors of the delinquent taxpayer capture the benefits of government forbearance may be justifiable if the taxpayer's overall financial picture is improved, or level of financial distress lowered. In fact, from a social insurance viewpoint, the government may actually *intend* for private creditors to capture these benefits. Having the government forgive tax debts while another creditor benefits may, for example, save taxpayers from a catastrophic financial meltdown that may precipitate a high-cost bankruptcy filing by easing the repayment pressures being applied on such taxpayers by private creditors.²³² By allowing the taxpayer to pay off her private creditors and effectively obtain a "fresh start" without filing for bankruptcy, the IRS could also be characterized as acting as an insurer or lender of last resort by forbearing from collection.²³³

In summary, viewing tax non-collection through a social insurance lens can justify imposition of costs on compliant taxpayers and the public. Once these extractions are understood as insurance premiums, the possibility that other taxpayers may bear the costs of IRS forbearance seems expected. A social insurance theory can also justify capture of non-collection's benefits by private creditors, on the grounds that the lessening of other debt loads is a form of consumption smoothing.²³⁴ Though not expressly articulated in these theoretical terms, advocates of taxpayer rights already intuitively understand the social insurance function of tax non-collection. For example, the concept underlies the Taxpayer Advocate's frequent calls for greater protection of taxpayers experiencing economic hardship,

borrowing-constrained taxpayers that can increase welfare and smooth consumption shocks, and that the government thus can play a "positive role . . . in partially completing capital markets"). Cf. Kyle D. Logue, *Tax Law Uncertainty and the Role of Tax Insurance*, 25 VA. TAX REV. 339 (2005) (exploring whether private insurance for uncertain treatment of transactions under tax law is desirable).

²³² See Feibelman, *supra* note 219, at 166 (noting the costs to debtors of financial collapse, including fees, penalties, transaction costs, and emotional costs); see also discussion *infra* note 291.

²³³ See Andreoni, *IRS as Loan Shark*, *supra* note 225, at 36, 44. For example, in the case where the IRS extends the time for payment under an installment agreement and charges interest and penalties, the IRS could be characterized as "lending" the amount of tax owed to the taxpayer by delaying payment, in exchange for a borrowing cost.

²³⁴ See discussion *infra* Part III.C (discussing the interaction of tax non-collection with bankruptcy debt discharge); see also Michelle J. White, *Bankruptcy: Past Puzzles, Recent Reforms, and the Mortgage Crisis*, 11 AM. L. & ECON. REV. 1, 3 (2009) ("The economic justification for having a personal bankruptcy procedure is that individuals benefit from borrowing in order to smooth consumption, but they face uncertainty in their ability-to-repay. Bankruptcy reduces the downside risk of borrowing by discharging some or all debt when debtors' ability-to-repay turns out to be low. It therefore provides debtors with partial consumption insurance.").

reform of provisions such as the OIC procedure, and consideration of the impacts of taxpayers' other debts in making collections decisions.²³⁵

Building a social insurance case for tax non-collection presents theoretical challenges and has limitations. For one thing, a social insurance justification is probably most convincing with respect to the risks of individual taxpayers. Insuring against the risks of business and entity taxpayers may strike one as more problematic, or may at least need to be justified on different grounds. Relatedly, the fact that tax non-collection protects against the risks of both business and individual taxpayers may raise issues of whether cross-subsidization of businesses and individuals is acceptable. Along these lines, it should be noted that the portion of the tax gap constituting the "underpayment gap" is attributable mostly to individual income tax underpayments; thus, attempting to justify non-collection primarily with respect to individual taxpayers may make some sense.²³⁶

In addition, more research is needed to analyze who actually bears the costs of non-collection and in what form. For example, one would need to find out whether tax, interest, and penalty rates actually increase in response to non-collection, or whether government spending instead decreases. Moreover, one would presumably need to show that taxpayers are aware of non-collection alternatives and actually utilize such avenues to insure against financial distress.²³⁷ Perhaps most importantly, one would need to show that existing tax non-collection policies are effectively targeting (or are attempting to target) taxpayers who are unable to pay due to financial distress, as opposed to taxpayers who simply will not pay.²³⁸

²³⁵ 2010 NTA ANNUAL REPORT, *supra* note 155, at 85-90 (noting that IRS policies do not adequately protect taxpayers suffering economic hardship); *id.* at 98-103 (noting that IRS policies that ignore debts that taxpayers owe other creditors could have adverse impacts on taxpayers); *id.* at 311 & n.1 (noting that the Taxpayer Advocate has listed problems with the OIC procedure as one of the most serious problems confronting taxpayers in every year between 2001 and 2010).

²³⁶ See sources cited *supra* notes 2 and 3.

²³⁷ Differences in the salience of these avenues to different groups of taxpayers may create problematic distributive results. See generally Hayashi, *supra* note 10 (showing that this may be happening in the context of the New York City property tax and suggesting avenues for further research).

²³⁸ See Bryan Camp, *The Failure of Adversarial Process in the Administrative State*, 84 IND. L.J. 57, 73-77 (2009) (discussing the difficulties and the importance of properly distinguishing between delinquent taxpayers who "can't pay" and those who "won't pay"). Some level of bad behavior would presumably be acceptable because of the moral hazard risk in any insurance scheme.

This Article does not claim that effective delivery of social insurance via tax non-collection currently exists. It does not even claim that current IRS collections policy satisfies all the requisites to meet the theoretical definition of a social insurance program.²³⁹ The point is merely that a properly designed program of tax non-collection can, in theory, effectively perform a social insurance function and can be justified on such basis.

B. *Should the Government Insure Through Tax Non-Collection?*

Assuming that a convincing theoretical case for tax non-collection as social insurance has been made, key normative questions follow. Should insurance against financial distress be provided at all? If so, should it be provided by the government, as opposed to private insurers? Even if one thinks that the government should provide such insurance, is federal tax collections policy the appropriate vehicle? How should tax non-collection interact with other avenues via which the government insures or ensures the security of its citizens?

Part III.B takes a preliminary look at each of these questions in turn. In doing so, it sets out a roadmap for future research about the role that tax non-collection should play in the government's provision of a social safety net.

1. *Should There Be Insurance Against Taxpayer Financial Misfortune?*

Should the risk of taxpayer financial misfortune be pooled and transferred in exchange for a price? The answer to this first question is probably "yes," at least based on current realities. Through a variety of programs, the government already insures citizens against consumption shocks triggered by certain events. Examples include unemployment insurance, disability insurance, and worker's compensation.

Notably, social insurance against financial distress is already provided via our federal bankruptcy system.²⁴⁰ Through consumer bankruptcy, we have a collective proceeding that insures against debtor financial misfortune by transferring risk from debtors to creditors via the bankruptcy discharge, in exchange for higher *ex ante* borrowing costs on all borrowers. A distinctive feature of bankruptcy-provided social insurance is that the debtor does not need to have a

²³⁹ See *supra* Part III.A.

²⁴⁰ See sources cited *supra* note 224.

specific reason for her financial misfortune or to meet an explicit standard of moral deservedness in order to obtain bankruptcy relief.²⁴¹

Tax non-collection shares conceptual similarities with consumer bankruptcy as a system of social insurance. It also has some key differences. Current avenues of tax non-collection are a hybrid between requiring specific reasons for taxpayer distress²⁴² and simply requiring an objective financial analysis.²⁴³ In addition, the risk transfer that is at the heart of consumer bankruptcy takes place between the debtor and all of her creditors, not just the government creditor.²⁴⁴ In fact, the priority enjoyed by secured and priority tax claims in bankruptcy makes it likely that most of the risk is transferred to private unsecured creditors.²⁴⁵ The increased risk to unsecured creditors is reflected in higher interest rates on unsecured debt. The interaction between tax and bankruptcy as social insurance delivery vehicles is discussed further in Part III.C.

In any case, the first question has been asked and answered, at least based on real-world application.²⁴⁶ With respect to tax non-collection,

²⁴¹ See Feibelman, *supra* note 219, at 167 (noting that, “with few exceptions, [bankruptcy] is equally available to the spendthrift as it is to the honest but unfortunate debtor”); Melissa B. Jacoby, *Collecting Debts from the Ill and Injured: The Rhetorical Significance, but Practical Irrelevance, of Culpability and Ability to Pay*, 51 AM. U. L. REV. 229, 270-71 (2001) (arguing against then-proposed bankruptcy reforms because they would not help better distinguish between deserving and undeserving debtors and concluding that “courts will evaluate [such debtors] principally on their balance sheets, not on the details of their financial demise”). *But see* 11 U.S.C. §§ 109(h), 727(a)(11) (2010) (credit counseling and personal financial management instruction required in order to be eligible for bankruptcy discharge). By contrast, unemployment insurance specifically insures against consumption shocks triggered by unemployment and disability insurance specifically insures against the risk of disability.

²⁴² Examples include OICs or TAOs granted on hardship grounds or designations of taxpayer accounts as CNC based on hardship.

²⁴³ Examples include OICs granted based on doubt as to collectability or CNC designations based on inability to locate the taxpayer or the taxpayer’s assets.

²⁴⁴ See *infra* Part III.C for a more extensive discussion.

²⁴⁵ See *supra* Part II.C.3 for a discussion of the bankruptcy priority and dischargeability rules.

²⁴⁶ The economics literature on the extent to which social insurance should be provided takes more varied positions. See, e.g., Bovenberg & Sørensen, *supra* note 221, at 3 (noting that tax-transfer system that offers less than full disability insurance plus some self insurance through precautionary saving is optimal); Nick Netzer & Florian Scheuer, *Taxation, Insurance, and Precautionary Labor*, 91 J. PUB. ECON. 1519, 1529 (2007) (finding that adverse selection and reductions in the supply of “precautionary labor” can cause reductions in tax revenues, negatively affecting social welfare and weakening the case for social insurance); Hal R. Varian, *Redistributive Taxation as Social Insurance*, 14 J. PUB. ECON. 49, 66 (1980) (stating that “[i]f income contains a

the more pertinent question is whether social insurance that the government already provides through various avenues should be supplemented with social insurance administered via tax non-collection.

2. Should the Government Provide Such Insurance, and Should It Do So Through Tax Non-Collection?

This leads to the second question, the answer to which is much less clear. Justifying tax non-collection as social insurance implies an acceptance that the risk of taxpayer misfortune should be transferred to the government creditor (as opposed to private insurers) and that such insurance should be delivered in the form of foregone tax receipts (as opposed to some other mechanism). The question of the appropriate risk-bearing and social insurance function of government has been raised in contexts as varied as when and to what extent government bailouts are appropriate, what part government should play in facilitating high-profile restructurings (for example, the recent restructurings in the automotive industry), and the role of government in providing terrorism insurance, flood insurance, and deposit insurance.²⁴⁷ The characterization of tax non-collection as government-provided insurance raises many of the same issues.

While it may be unrealistic to expect that financial distress insurance can be effectively delivered through private insurance markets,²⁴⁸ it is not clear that the inevitable conclusion is that the

random component then a system of redistributive taxation will contribute to reducing the variance of after-tax income” but noting that the benefits of such “social insurance” must be traded off against efficiency costs).

²⁴⁷ See, e.g., BROWN, *supra* note 217, at 8-12 (discussing justifications for government provision of social insurance); Joseph E. Stiglitz, Jaime Jaramillo Vallejo, & Yung Chal Park, *The Role of the State in Financial Markets*, in PROCEEDINGS OF THE WORLD BANK ECONOMIC REVIEW AND THE WORLD BANK RESEARCH OBSERVER 19, 19-61 (Michael Bruno & Boris Pleskovic, eds., 1994), available at <http://www.uadphilecon.gr/UA/files/1924580762.pdf> [hereinafter Stiglitz, Vallejo, & Park, *Role of the State*] (noting that because of pervasive market failure in financial markets, some forms of government intervention can improve the functioning of financial markets and the economy).

²⁴⁸ A key problem is that adverse selection can cause a private insurance market not to function. By contrast, the government can combat adverse selection by compelling universal participation. BROWN, *supra* note 217, at 8. See also MICHAEL J. GRAETZ & JERRY L. MASHAW, TRUE SECURITY: RETHINKING AMERICAN SOCIAL INSURANCE 42, 42-43 (1999) (noting that social insurance “provides insurance for people who could not otherwise afford it and in markets where moral hazard and adverse selection make private insurance unavailable or of limited value”); Walter Nicholson, *The Evolution of Unemployment Insurance in the United States*, 30 COMP. LAB. L. & POL’Y J.

government creditor should take on a direct and prominent role in its provision. Such insurance could instead be provided by way of government mandate to non-government insurers, or by government creation and regulation of an industry.²⁴⁹ Moreover, even if direct government provision of insurance were chosen, it is not clear that tax non-collection is the best legal vehicle.

Arguments in Favor of Government-Provided Social Insurance Through Tax Non-Collection. On one hand, there are good reasons why it may be appropriate for the government to directly provide social insurance. First, the government may be in a better position to compel universal participation in the insurance scheme by virtue of being able to extract premiums from a broad segment of the public.²⁵⁰ This minimizes the adverse selection problem. Second, the government is at an advantage compared with private insurers in terms of its ability to diversify risk by transferring costs and consequences to future generations.²⁵¹ In the context of tax non-collection, for example, the government could spread the costs of non-collection across past and future generations via higher tax extractions or lower levels of spending.²⁵²

Furthermore, there are good reasons why tax non-collection specifically may be a good vehicle for the delivery of such social insurance. The widespread nature of taxation and tax collection means that a structure already exists that can accommodate the administration of such social insurance to a broad swath of the citizenry. For example, through existing tax filing and collection mechanisms, the government has an advantage in obtaining detailed information about a taxpayer's financial situation, thereby minimizing

123, 132 (2008) (discussing problem of adverse selection in the context of designing voluntary participation wage insurance schemes); Mark C. Weber, *Disability Rights, Welfare Law*, 32 *CARDOZO L. REV.* 2483, 2499 (2011) (noting that SSDI and Workers' Compensation are social insurance programs that make up for market failure because "few private insurers offered disability insurance due to fear of adverse selection").

²⁴⁹ BROWN, *supra* note 217, at 8-9; Allison K. Hoffman, *Oil and Water: Mixing Individual Mandates, Fragmented Markets, and Health Reform*, 36 *AM. J.L. & MED.* 7, 16-17 (2010) (discussing the use of different possible types of government mandates in the context of healthcare reform). The federal bankruptcy system, for example, arguably constitutes social insurance by mandate. See discussion *infra* Part III.C.

²⁵⁰ BROWN, *supra* note 217, at 8; see also Stiglitz, Vallejo, & Park, *Role of the State*, *supra* note 247 (noting that government can avoid adverse selection by "forc[ing] membership in insurance programs").

²⁵¹ BROWN, *supra* note 217, at 10; see also Stiglitz, Vallejo, & Park, *Role of the State*, *supra* note 247 ("[O]nly the government can engage in such intergenerational transfers of risk.").

²⁵² BROWN, *supra* note 217, at 10.

the effects of moral hazard.²⁵³ In addition, the government can seamlessly collect insurance premiums through the tax system by increasing tax rates, reducing tax expenditures, or by choosing another method of absorbing the costs of non-collection.

Progressivity in tax rates may also mean that in addition to being most able to socialize insurance by compelling near-universal participation, the government may also be able to provide the insurance at roughly risk-adjusted premiums.²⁵⁴ Because tax non-collection is likely more expensive to provide for taxpayers in higher marginal tax brackets (because the amount of tax owed is larger so the amount that might need to be forgiven is also larger),²⁵⁵ it is appropriate for the government to charge higher premiums to such taxpayers through the mechanism of progressive tax rates.²⁵⁶ The political considerations that might typically make it unfeasible for the government to differentiate between insureds in setting premiums based on risk are arguably less of a consideration in the context of a society where at least some degree of progressive taxation is generally accepted, or at least tolerated.²⁵⁷ Also, stickiness in tax rates over time

²⁵³ See Stiglitz, Vallejo, & Park, *Role of the State*, *supra* note 247 (“The government has the power to compel the disclosure of information through a range of indirect instruments, including taxes, subsidies, and regulations . . .”).

²⁵⁴ Cf. BROWN, *supra* note 217, at 13 (“[D]ifferent individuals or different firms should face different prices depending on the risk characteristics that they present.”); Varian, *supra* note 246, at 51, 66 (noting that 100% tax plus uniform grant can provide social insurance against the random element of income by “reducing the variance of after-tax income”).

²⁵⁵ The accuracy of this assumption depends on whether taxpayers who are less well-off default more frequently.

²⁵⁶ Cf. Hynes, *Non-Procrustean Bankruptcy*, *supra* note 224, at 360 (arguing that use of bankruptcy by the wealthy to protect a “luxurious lifestyle” and unequal treatment of rich and poor debtors in bankruptcy may be justifiable given bankruptcy’s insurance function, if the wealthy in fact pay higher premiums for the greater protections they enjoy). *But see* Joseph Stiglitz, *Perspectives on the Role of Government Risk-Bearing within the Financial Sector*, in GOVERNMENT RISK-BEARING 109-30 (Mark S. Sniderman ed., 1993) [hereinafter Stiglitz, *Government Risk-Bearing*]; Stiglitz, Vallejo, & Park, *Role of the State*, *supra* note 247 (“[T]he government is at a marked disadvantage in assessing risks and premiums, in part because such assessments are, to a large extent, subjective.”).

²⁵⁷ See, e.g., Marjorie E. Kornhauser, *Equality, Liberty, and a Fair Income Tax*, 23 FORDHAM URB. L.J. 607, 609 (1996) (arguing that “a broad spectrum of the American people endorse particular conceptions of liberty and equality that support a mildly progressive hybrid income-consumption tax”); see also discussion *supra* Part II.C.5. *But see* Lawrence Zelenak, *The Conscientious Legislator and Public Opinion on Taxes*, 40 LOY. U. CHI. L.J. 369, 373 (2009) (noting that “public opinion supports much greater average rate progressivity when questions are framed in percentage terms than when questions are framed in dollar terms”); Michael L. Roberts, Peggy A. Hite & Cassie F.

and the relative invisibility of premiums collected through higher tax rates may mean that there is less pressure on the government to lower tax rates in years in which tax non-collection is less frequent (i.e., when the insurance scheme is more profitable).²⁵⁸ This may help preserve the long-term viability of the insurance scheme. It is also possible that using the tax system to indirectly provide social insurance against certain events would not have some of the distortionary effects associated with traditional forms of social insurance.²⁵⁹

Bradley, *Understanding Attitudes Toward Progressive Taxation*, 58 PUB. OPINION Q. 165, 184-86 (1994) (finding generally that majority of study subjects preferred progressive taxation in abstract questioning but showed lower preference faced with concrete questions). *But cf.* Stiglitz, Vallejo, & Park, *Role of the State*, *supra* note 247 (noting that “political considerations will not allow [the government] to differentiate on bases that the market would almost surely employ.”).

²⁵⁸ BROWN, *supra* note 217, at 12-13 (noting “tremendous disadvantage in pricing systemic risk” experienced by government due to downward rate pressures by insureds in “profitable” years).

²⁵⁹ See, e.g., Krueger & Meyer, *supra* note 220, at 63 (noting that empirical research on unemployment insurance and workers’ compensation programs find that these programs “tend to increase the length of time employees spend out of work”); Netzer & Scheuer, *supra* note 246, at 1529 (showing that under their model, “it may . . . be optimal to completely renounce on social insurance as a policy device and only use income taxation to achieve redistributive objectives”). The scholarly consensus — at least with respect to substantive tax law, seems to favor delivery of welfare benefits using the tax-and-transfer system, as opposed to direct delivery using legal rules, on largely efficiency grounds. See Louis Kaplow & Steve Shavell, *Should Legal Rules Favor the Poor? Clarifying the Role of Legal Rules and the Income Tax in Redistributing Income*, 29 J. LEGAL STUD. 821 (2000) [hereinafter Kaplow & Shavell, *Should Legal Rules Favor the Poor?*] (developing and qualifying argument favoring use of tax rules, rather than legal rules, to redistribute income); Louis Kaplow & Steven Shavell, *Why the Legal System is Less Efficient Than the Income Tax in Redistributing Income*, 23 J. LEGAL STUD. 667, 668 (1994) [hereinafter Kaplow & Shavell, *Why the Legal System is Less Efficient*] (developing a “double-distortion” argument that using tax rules to redistribute income is less inefficient than using legal rules, because legal rules “create[] inefficiencies in the activities regulated by the legal rules,” in addition to distorting work incentives). *But see* Ronen Avraham, David Fortus & Kyle Logue, *Revisiting the Roles of Legal Rules and Tax Rules in Income Redistribution: A Response to Kaplow and Shavell*, 89 IOWA L. REV. 1125, 1128-29 (2004) (questioning the assumptions underlying the Kaplow & Shavell “double distortion” argument); Kornhauser, *Cognitive Theory*, *supra* note 221, at 254-55 (describing political and economic rationales for indirect tax delivery rather than direct welfare delivery, but disagreeing with this view); Chris William Sanchirico, *Taxes Versus Legal Rules As Instruments for Equity: A More Equitable View*, 29 J. LEGAL STUD. 797, 797-800 (2000). Because forgiveness of a tax debt is as much an accession to wealth as a direct cash transfer accomplished through a tax-and-transfer system, the Kaplow and Shavell “double-distortion” rationale for using tax as opposed to legal rules on efficiency grounds may also apply to tax non-collection. See Kaplow & Shavell, *Should Legal Rules Favor the Poor?*, *supra*; Kaplow & Shavell, *Why the Legal*

Arguments Against Government-Provided Social Insurance Through Tax Non-Collection. On the other hand, there are important considerations that may suggest that the government should not take on a direct risk-bearing role. If the insurance characterization is correct, the incidence of the costs to the sovereign in performing a risk-bearing function will be on private citizens.²⁶⁰ Such cost shifting is consistent with the very definition of insurance, but this theoretical framework does not answer the more fundamental question of whether (and, if so, to what extent) it is appropriate for the government to force private individual and entity taxpayers into a common insurance pool in furtherance of financial risk absorption.²⁶¹ Nor does it address the possible distributive impacts of the cost shifting.²⁶²

There are also specific reasons why tax non-collection may not be the best social insurance delivery vehicle. It may be difficult for government to accurately price insurance premiums in a risk-adjusted manner because progressive income taxation is too blunt of a pricing instrument. In addition, tax non-collection will not help to insure taxpayers whose taxable income is so low that they do not owe any tax and will not benefit from non-collection.²⁶³ Also, when combined with other types of government-provided social insurance, the provision of social insurance via non-collection of taxes might obscure the true costs of providing insurance, and may obfuscate the true extent of the benefits to recipients.²⁶⁴

System is Less Efficient, supra.

²⁶⁰ See discussion *supra* Part II.B.2.

²⁶¹ Recent debates regarding taxpayer investment in entities bailed out by the government present the same sorts of questions, and such debates contain an implicit recognition that citizen financial participation will be implicated in any government decision to engage in a risk-bearing role.

²⁶² See discussion *infra* Part III.B.3.

²⁶³ Tax Policy Center numbers show that for FY 2011, 99.4% of individual “taxable units” with a “cash income” level of less than \$10,000 paid no individual income tax. The percentage paying no income tax was 80.8% for taxable units with cash income between \$10,000 and \$20,000, 60.9% for taxable units with cash income between \$20,000 and \$30,000, and 41.4% of taxable units with cash income between \$30,000 and \$40,000. See *Baseline Distribution of Tax Units with No Income Tax Liability by Cash Income Level; Current Law, 2011*, TAX POLICY CENTER: URBAN INSTITUTE AND BROOKINGS INSTITUTION, <http://www.taxpolicycenter.org/numbers/displayatab.cfm?Docid=3056&DocTypeID=1> (last visited Sept. 5, 2012). For a definition of “cash income,” see *The Numbers*, TAX POLICY CENTER: URBAN INSTITUTE AND BROOKINGS INSTITUTION, <http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=574> (last visited Sept. 5, 2012).

²⁶⁴ See discussion *infra* Part III.B.3; see also BROWN, *supra* note 217, at 14; cf. Nancy Staudt, *Redundant Tax and Spending Programs*, 100 NW. U. L. REV. 1197, 1209 (2006)

Furthermore, one might be concerned that the IRS as an agency is not the best qualified to make judgments about which types of financial distress should be insured against. Concerns include: poor or inaccurate targeting of the appropriate recipients; difficulties in distinguishing between those who “can’t pay” and those who “won’t pay”; and difficulties evaluating which “can’t pay” have valid reasons for not being able to pay.²⁶⁵ Finally, it is possible that the slow pace of tax collection proceedings means that the tax collection system is not sufficiently responsive in dealing with acute situations of financial distress.²⁶⁶

In sum, it is not obvious whether the case in favor of administering social insurance through tax non-collection outweighs the case against it. There is no way to answer these questions except by rigorous policy analysis, and further research is needed in order to make a determination. The analysis ultimately should be one of institutional design, and should look at the strengths and weaknesses of the tax collections system itself as well as its efficacy as compared with other delivery mechanisms.²⁶⁷

3. How Should Tax Non-Collection Interact with Other Avenues by Which the Government Provides Social Insurance and a Social Safety Net?

A further question that arises is the question of how social insurance delivered via tax non-collection should interact with other government-provided social insurance programs.²⁶⁸ For example, how

(noting, in the context of social welfare programs, that “the interplay between the programs is so complex that it is nearly impossible to predict the level of benefits to which poor individuals are entitled *ex ante*, which makes it difficult to make good economic decisions or to arrange one’s affairs in a rational manner”).

²⁶⁵ The important conceptual distinction between taxpayers who cannot pay and those who will not pay has been explored in the work of Professor Bryan Camp. See Camp, *supra* note 238, at 73-77 (distinguishing between “can’t pay” and “won’t pay”).

²⁶⁶ See Weisbach & Nussim, *supra* note 221, at 961, 1016 (arguing that due to lack of responsiveness, the food stamp program might not work well if integrated into the tax system); cf. Alstott, *supra* note 221, at 580 (arguing that the Earned Income Tax Credit, “as a tax-based program, is thus inherently unresponsive relative to traditional transfer programs” and that “[u]nresponsiveness may impose real hardship on those for whom unemployment is involuntary”).

²⁶⁷ See, e.g., Weisbach & Nussim, *supra* note 221, at 981-82 (arguing that from the point of view of “government policy as a whole,” integrating welfare programs into the tax system may facilitate simplification).

²⁶⁸ Scholars in a variety of legal fields have explored the question of how various social insurance or social welfare programs should interact or be coordinated. See, e.g.,

should tax non-collection interact with programs such as unemployment insurance, workers compensation, and disability insurance?²⁶⁹ These programs also come within the definition of social insurance because beneficiaries pay in premiums to compensate for the risk undertaken by the government-insurer.²⁷⁰ Furthermore, how should social insurance administered via tax non-collection interact with other social welfare and social safety net programs administered by the government? These are two separate, though related, questions and the following discussion addresses each of them in turn.

Relationship with Other Social Insurance Programs. Tax non-collection and other social insurance programs may overlap in the kinds of risks they cover.²⁷¹ For example, if inability to pay a tax debt occurs as a result of workplace injury or disability, tax non-collection may be insuring against the same risk as workers' compensation and disability insurance, respectively. If tax non-collection and another social insurance program provide overlapping coverage upon the occurrence of certain events, this would raise a number of program design issues.

As a threshold matter, does it make sense to have the same risk covered by more than one program? The existence of duplicative and overlapping programs may present problems of excessive costliness, coordination, and the undermining by one program of the goals of another.²⁷² Existing literature on delivery of social welfare benefits has

Feibelman, *supra* note 219, at 161-72 (exploring relative efficiencies of and relationship between consumer bankruptcy and unemployment insurance as social insurance programs); Shaviro, *supra* note 222, at 433-73 (discussing problems with the minimum wage and exploring alternative approaches to low-wage subsidization such as the EITC and a negative income tax); Staudt, *supra* note 264 (exploring the merits of having redundant and overlapping social welfare programs); Weisbach, *supra* note 221 at 1843-49 (considering, and rejecting, redundancy as a solution to moral hazard and adverse selection problems in the context of choosing to use tax expenditures).

²⁶⁹ See sources cited *supra* note 268.

²⁷⁰ See sources cited *supra* notes 214, 219-220 and accompanying text.

²⁷¹ Consumer bankruptcy scholars have explored the question of how social insurance programs may function as substitutes. See, e.g., Alena Allen, *State-Mandated Disability Insurance as Salve to the Consumer Bankruptcy Imbroglia*, 2011 B.Y.U. L. REV. 1327 (arguing for state-mandated disability insurance to combat rise in consumer bankruptcies); Feibelman, *supra* note 219, at 155-61 (discussing whether bankruptcy and other social insurance programs function as substitutes).

²⁷² Arguments have been made in the scholarship both in favor of and against duplication and redundancy in program design. See, e.g., Alstott, *supra* note 221, at 535 (challenging the case for integration); Jason Marisam, *Duplicative Delegations*, 63 ADMIN. L. REV. 181, 183-84 (2011) (arguing that allowing some duplication in administrative delegation may be efficient); Shaviro, *supra* note 222, at 466 (in order

noted the problem of cost duplication and poor coordination, and many have recommended integration.²⁷³ However, other scholars have noted that duplication may be beneficial for other reasons. Nancy Staudt, for example, has argued in the context of social welfare programs that the dynamics of government and politics may make integration unfeasible, that having multiple overlapping programs can diversify political costs and promote competition, and that redundancy can promote “reliability in the face of uncertainty.”²⁷⁴

In order to properly evaluate the extent of these cost, coordination, and duplication concerns in the social insurance context, one would need to measure at least roughly the costs to government of administering social insurance through the tax collection function relative to other delivery mechanisms. One would also need to have a better idea of whether, in practice, distressed taxpayers actually use tax non-collection and other social insurance programs to perform the same consumption smoothing functions in order to figure out whether the programs really overlap in coverage. In addition, one would need to evaluate whether there are political or other benefits to be gained from some amount of program duplication. Assuming that duplication is found to be devoid of any benefits, one would need some basis for favoring one delivery method over the other. Such a judgment could be based on efficiency concerns, simplicity, responsiveness, or institutional design, among other factors.²⁷⁵

The empirical data on these questions in the context of tax collections is thin, which is unsurprising because conceptualizing tax

to avoid perverse incentives, focus should be on adopting optimal rate structure rather than on discrete programs); Staudt, *supra* note 264, at 1208 (noting arguments that “the extensive and uncoordinated network of social welfare programs leads to severe coordination problems, program incompatibility, and costly duplication and overlap”); *id.* at 1211 (noting the “strong consensus in the scholarly literature [that] [i]t is time for Congress to replace the multitude of specialized social welfare programs with a single integrated plan”); Weisbach & Nussim, *supra* note 221; see also JONATHAN B. BENDOR, PARALLEL SYSTEMS: REDUNDANCY IN GOVERNMENT 15-23 (1985) (discussing redundancy in the context of welfare policy); Feibelman, *supra* note 219, at 161-72 (comparing the administrative costs, self-insurance costs, moral hazard costs, and macroeconomic costs of the consumer bankruptcy system and unemployment insurance).

²⁷³ See sources cited *supra* note 272.

²⁷⁴ Staudt, *supra* note 264, at 1222-24.

²⁷⁵ See, e.g., Alstott, *supra* note 221, at 564-89 (discussing disadvantages of using tax system to deliver EITC, based on accuracy, responsiveness, and noncompliance concerns); Weisbach & Nussim, *supra* note 221, at 1022-23 (arguing that food stamps should not be integrated into tax system because tax system may not deal well with short term problems).

non-collection as partial social insurance is a largely unexplored concept. Because of the important role that tax non-collection could play in insuring against various shocks, more research is needed to better understand these program design issues.

Relationship to Social Welfare and Public Goods Provision. Related to the question of tax non-collection's interaction with other social insurance programs is its interaction with social welfare and social safety net programs. As discussed here and elsewhere, social welfare and social safety net programs are conceptually different from social insurance programs because they are programs for which the recipients do not pay in premiums that reflect the transferred risk.²⁷⁶ Examples of such programs are Medicaid, Temporary Assistance for Needy Families (TANF), and food stamps.

At its core, the question of how tax non-collection interacts with and affects other social welfare programs is a distributive question. The social insurance characterization of tax non-collection is predicated on the assumption that insured taxpayers pay the price for such insurance in the form of either higher extractions, lower levels of government provision of goods, services, or welfare, or other financing costs.²⁷⁷ However, as noted, the tax collection system does not reach every person eligible for welfare benefits. In fact, those who do not owe any tax would not derive any benefit from a social insurance scheme administered through tax non-collection.²⁷⁸ This raises the following distributive question: if the price of insurance via tax non-collection is in fact extracted in the form of lower levels of government provision for *all* citizens (as opposed to higher tax rates on just those with positive tax liability), will this have adverse distributive impacts on the social safety net available to those of low income? In other words, because social insurance through tax non-collection costs something, there is a risk that such cost will be borne by low-income citizens (because they will receive lower levels of government provision through other mechanisms) who will be shut out from the benefits of non-collection (because they owe no tax).²⁷⁹ This outcome

²⁷⁶ See discussion *supra* notes 214-220 and accompanying text. Of course, this conceptual distinction breaks down at the edges in the sense that the costs of such programs are ultimately experienced by the recipients and others in the form of reduced government spending elsewhere.

²⁷⁷ See discussion *supra* notes 215-218 and accompanying text.

²⁷⁸ See *supra* note 263 and accompanying text.

²⁷⁹ The literature has raised analogous design-related concerns in evaluating the mechanisms by which welfare benefits should be delivered. See generally Alstott, *supra* note 221, at 585 (noting that "the traditional tax policy goal of exempting the poor from income taxation tends to undermine automatic EITC participation");

may be distributively unjust. It is also possible that lower levels of public goods provision may cause tax evasion to increase.²⁸⁰

That tax non-collection might raise distributive concerns is unsurprising. Like consumer bankruptcy, tax non-collection often necessitates application, documentation, and provision of certain information to the IRS.²⁸¹ Like filing for bankruptcy protection, these activities have costs, including administrative costs, fees, down payments, and costs of legal advice and representation. Thus, it makes sense that taxpayers with the resources to absorb those costs will be most likely to be the primary beneficiaries.²⁸² The distributive concern arises if these benefits are obtained at the cost of those unable to absorb these costs. Just like the relationship between tax non-collection and other social insurance programs, the interaction between tax non-collection and non-insurance social welfare programs needs to be further studied.

Kornhauser, *Cognitive Theory*, *supra* note 221, at 277-78 (citing study suggesting that there is higher EITC participation “only for those who already have an obligation to file a return” and that “those who have no such obligation actually may have higher participation rates in traditional direct expenditure welfare programs”); Weisbach & Nussim, *supra* note 221, at 1007-27.

²⁸⁰ See Winfried Becker, Heinz -Jürgen Büchner & Simon Sleeking, *The Impact of Public Transfer Expenditures on Tax Evasion: An Experimental Approach*, 34 J. PUB. ECON. 243, 248-49, 251 (1987) (finding, based on experiment, that propensity to evade tax decreases with rising transfer payments and concluding that “a politician, who wants to use transfer payments as an instrument of economic policy, may need to consider carefully the impact of the transfer payments’ distribution on tax-evasion behavior”); see generally, Frank A. Cowell & James P.F. Gordon, *Unwillingness to Pay: Tax Evasion and Public Good Provision*, 36 J. PUB. ECON. 305 (1988) (studying the effects of public good provision on tax evasion behavior in large and small economies).

²⁸¹ For example, certain OICs and installment agreement require taxpayers to provide detailed financial information.

²⁸² Analogous insights have been made in the bankruptcy scholarship, where scholars sometimes characterize consumer bankruptcy as a “middle-class” protection. See, e.g., TERESA A. SULLIVAN, ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, *THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT* 6 (2000) (“[B]ankruptcy is a largely middle-class phenomenon.”); Melissa B. Jacoby et al., *Rethinking the Debates Over Health Care Financing: Evidence from the Bankruptcy Courts*, 76 N.Y.U. L. REV. 375, 377 (2001) (considering “the extent to which middle-class families have used bankruptcy as a safety net, or as insurance of last resort, in the financial aftermath of medical problems.”); Elizabeth Warren, *The Economics of Race: When Making It to the Middle is Not Enough*, 61 WASH. & LEE L. REV. 1777, 1779 (2004) (“Bankruptcy is a middle class phenomenon . . .”).

C. *Tax Non-Collection and Bankruptcy Discharge: Social Insurance Programs in Conflict?*

The characterization of tax non-collection as social insurance presents a further interesting question: how should tax non-collection interact with consumer bankruptcy? Consumer bankruptcy is of particular interest because it is another major system in which debt relief may play a social insurance role.²⁸³ Bankruptcy scholars have recognized that consumer bankruptcy provides partial social insurance against debtor financial misfortune.²⁸⁴ In bankruptcy, risk is transferred from the debtor to her creditors via the bankruptcy debt discharge in exchange for higher *ex ante* borrowing costs for all borrowers.²⁸⁵ Thus, the extent to which tax non-collection, as a system of debt relief by the government creditor, should also play a social insurance function needs to be evaluated in light of the partial social insurance function performed by consumer bankruptcy.²⁸⁶ The potential overlap between tax non-collection and bankruptcy-delivered social insurance raises distinctive issues that are in addition to the usual questions of program administration and efficiency costs of duplicative programs.²⁸⁷

Impacts of an Enhanced Risk-Bearing Role for Government. A key feature of bankruptcy-delivered social insurance is that the providers of such insurance are not solely the government but the general pool of creditors. Delivery of social insurance via the bankruptcy system is essentially done through constitutional and government mandate: by legislating the constitutionally required bankruptcy scheme, the government has, in essence, forced private creditors into the role of insuring against debtor misfortune, and private creditors in turn extract premiums from debtors in the form of higher interest rates. This system of placing the risks of default on private creditors may make sense to the extent that the government has an interest in

²⁸³ In fact, the interplay between IRS collections policies and the backdrop of bankruptcy relief can be observed throughout IRS collections policies and practice. See sources cited *supra* notes 207 and 235 and accompanying text.

²⁸⁴ See sources cited *supra* note 224 and accompanying text.

²⁸⁵ See sources cited *supra* note 224 and accompanying text.

²⁸⁶ While the IRS has paid some attention to the administrability, compliance, and coordination problems of exercising tax non-collection while the taxpayer is in bankruptcy, the broader questions of how the pre-bankruptcy role of the sovereign in risk bearing through tax collections policy should interact with risk bearing in the bankruptcy context have not been broached. See *supra* note 207.

²⁸⁷ See *supra* Part III.B.3.

forcing the contracting parties to internalize and bear the costs of debtor financial collapse.²⁸⁸

Thus, the case for pre-bankruptcy government insurance via tax non-collection basically amounts to an argument that the risk transfer between distressed debtors and their creditors (including the government creditor) that takes place via consumer bankruptcy should be preceded by a risk transfer directly to the *government creditor in advance of a potential taxpayer bankruptcy*.

There may be some merit to having the government perform an enhanced, pre-bankruptcy, risk-bearing function. The delinquent tax owed by the bankrupt debtor to the government is likely to be a small percentage of the government's total receivables, while being a larger percentage of the receivables of a private creditor.²⁸⁹ Thus, it is possible that the government will be the least-cost bearer of the risk of debtor default, as compared with other creditors.²⁹⁰ In addition, having the government intervene as a risk bearer ahead of a potential bankruptcy filing might save some taxpayers from the high costs of catastrophic financial collapse.²⁹¹ At least with respect to priority tax debts, by forbearing ahead of bankruptcy, the government effectively waives its rights to priority repayment in bankruptcy, thereby converting itself into a non-priority, unsecured financier of last resort that can prevent a bankruptcy filing.

On the other hand, there may be negative impacts. One obvious concern is that an enhanced risk-bearing role for the sovereign may cause private creditors to engage in more risky lending behaviors because the government will assume part of the risk. For example, private creditors may engage in more aggressive lending to debtors with marginal credit given the assurance that the government will step

²⁸⁸ See Warren, *supra* note 4, at 361-63 (characterizing the priority given to tax debts as an instance of how bankruptcy law "restricts externalization of costs" in the context of business bankruptcy). Of course, it is questionable whether such internalization is successful, since creditors may be able to pass the costs of debtor collapse on to compliant debtors. See, e.g., Ronald J. Mann, *Optimizing Consumer Credit Markets and Bankruptcy Policy*, 7 THEORETICAL INQUIRIES L. 395, 423-29 (2006) (describing present day consumer lending as "a world in which lenders are optimizing default rates and externalizing losses to other parties" and arguing that more risk should be placed on lenders, who are in the best position to minimize costs of financial distress).

²⁸⁹ Similar arguments have been articulated in making the case that the government should not be entitled to repayment priority in bankruptcy. See Morgan, *supra* note 15, at 466, n.14 (making this point in the context of recent criticisms of the priority granted to sovereigns under various countries' bankruptcy laws).

²⁹⁰ See *supra* note 289.

²⁹¹ See *supra* note 232 and accompanying text.

in to rescue such debtors by forbearing from tax collection. This dynamic is exacerbated by the fact that, unlike a consolidated bankruptcy proceeding, it may be difficult for the government to obtain complete information about the delinquent taxpayer's other creditors in making pre-bankruptcy non-collection decisions. The government might therefore subsidize (or fail to subsidize) the wrong risk. It might prove impossible for the government to appropriately target the sorts of creditors whose risks it wants to subsidize.

Credit Pricing Consequences. Tax non-collection may undermine the system of priority and dischargeability of tax debts that is established by the federal bankruptcy procedure. As described in Part II.C.3 above, the government tax creditor is generally granted more favorable treatment than general unsecured creditors in bankruptcy, in terms of both priority and dischargeability of tax debts.²⁹² In granting priority to certain tax debts, the Bankruptcy Code has articulated a policy that the sovereign should be paid ahead of other creditors.²⁹³ The favored treatment accorded to the sovereign through the bankruptcy priority and discharge rules should presumably be reflected in lower "borrowing costs" to debtors for tax debts than that charged by unsecured creditors to reflect the higher risk to unsecured creditors, though it is questionable whether this is really the case.²⁹⁴

This may lead to problems if the government creditor decides to assume more risk by engaging in pre-bankruptcy tax non-collection. An increased risk-bearing role for the tax creditor through non-collection may lower the cost of private borrowing because private creditors are exposed to less risk. However, because the existence and extent of tax non-collection may not be salient to private creditors, because private creditors may lack information about a debtor's tax position, because creditors cannot be certain when government will

²⁹² This order reflects the bankruptcy policy of internalizing the losses of financial distress to those private parties who contract with the debtor. *See supra* Part II.C.3; *see also* Warren, *supra* note 4, at 361-63.

²⁹³ *See* Warren, *supra* note 4, at 361-63; *see also* Morgan, *supra* note 15, at 463-65 (discussing the rationales for this policy choice).

²⁹⁴ *See, e.g.,* Hill, *supra* note 164, at 111-12 (discussing problems associated with the notion that the government creditor can effectively take its level of priority into account in calculating and implementing tax rates). *Contra* Morgan, *supra* note 15, at 466-67 (noting that government has access to powers not available to private creditors, such as recouping losses through additional taxes, imposing penalties and high underpayment interest rates, imposing third party liability, and tax lien and levy powers). This argument also assumes that the underpayment interest rates and penalty amounts charged to delinquent taxpayers may be lower than interest rates charged by those (unsecured) creditors who expect to get a smaller slice of the pie in bankruptcy.

act, and because the pricing of credit may be sticky, the expected price impacts may not occur and private borrowing costs might instead remain high.²⁹⁵ On the other hand, increased risk bearing by the tax creditor through non-collection may raise tax rates and interest and penalties on tax underpayments and non-payments.²⁹⁶ If tax rates rise in relation to private borrowing costs, this may improve the position of some while worsening that of others, depending on factors such as tax brackets, the extent of personal leverage, and ability to borrow. These distributive consequences associated with the pricing of credit would need to be further studied.

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In short, from the point of view of risk allocation, tax non-collection may obfuscate the allocation of risk between the government and private creditors because it puts government in a position of subsidizing the risk of default previously allocated to private creditors by federal bankruptcy. This may obfuscate the actual location of the debtor default risk. It may also have impacts on the costs of private borrowing in relation to tax rate costs. While the question of how tax non-collection should interact with other social insurance programs is not specific to the intersection of bankruptcy and tax non-collection law, bankruptcy-delivered social insurance does raise some distinctive issues. This Article has merely sketched out some of the issues that should be considered in designing tax non-collection policies and procedures. It leaves the complex normative task of delineating the precise ways in which tax non-collection and bankruptcy discharge should interact for future work.

CONCLUSION

Small-scale tax collections decisions have large-scale distributive consequences. This Article has discussed the possible distributive consequences of the government's non-collection of a delinquent tax debt, namely, enjoyment of non-collection's benefits by private creditors and imposition of non-collection's costs on compliant taxpayers and the public. These outcomes may seem problematic; however, they are justifiable under a social insurance rubric.

²⁹⁵ This situation would thwart the potential role that the government creditor might play in completing credit markets. See Andreoni, *IRS as Loan Shark*, *supra* note 225, at 36, 44.

²⁹⁶ See discussion *supra* Part II.B.2.

There are theoretical challenges involved in making a credible case that tax non-collection functions as partial social insurance. In addition, further research is needed in order to understand how the partial social insurance function played by tax non-collection interacts with other social insurance and social welfare delivery mechanisms, and how they should interact. In particular, the interplay between the government's risk bearing that takes place through tax non-collection and the private creditor risk bearing that occurs through consumer bankruptcy needs to be more thoroughly studied.

This Article is not advocating a specific design or level of tax non-collection, nor does it claim that current tax non-collection procedures are effectively fulfilling a social insurance function. Rather, its goal is to show that if properly designed, the forgiveness of tax debts may perform an important function in ensuring security and may be justified, even if done at some cost to compliant taxpayers and the public or at the benefit of private creditors. The design and implementation of IRS non-collection policies such as OICs, installment agreements, TAOs, and other such programs requires further study by academics and policymakers. This family of programs cannot be dismissed out of hand, nor should they be uncritically accepted and adopted.

More broadly, this Article reframes how we should think about tax collections policy. It shows that our evaluation of how the IRS should formulate technical tax collections policies is inextricably linked to the way we conceptualize the role of government with respect to risk, insurance, and the social safety net. In sum, theoretical notions about the role of government in ensuring security should inform the design and evaluation of even the most seemingly mundane tax collection provisions.