

**THOMAS M. GILL & COMPANY**  
CERTIFIED PUBLIC ACCOUNTANTS  
838 SHOEMAKER AVENUE  
WEST WYOMING, PA. 18644

Thomas M. Gill, C.P.A.  
Robert J. Gill, C.P.A.  
William T. Gill, C.P.A.

Telephone 570.693.2460  
Facsimile 570.693.2615  
Website: [www.gillcpas.com](http://www.gillcpas.com)

## **WHEN A TAXPAYER CAN'T PAY HIS TAX LIABILITY**

First and most importantly, don't let your inability to pay your tax liability in full keep you from filing your tax return properly and on time. Include as large a partial payment as you can. As discussed below, just filing without full payment can save you substantial amounts in filing penalties. More importantly, procedures exist for payment extension and installment payment arrangements which will keep the IRS from instituting its collection process (liens, property seizures, etc.).

### **OVERVIEW OF THE MOST COMMON PENALTIES.**

The "failure to file" penalty accrues at the rate of 5% per month or part of a month (to a maximum of 25%) on the amount of tax your return should show you owe. The "failure to pay" penalty is gentler, accruing at the rate of only ½ % per month or part of a month (to a maximum of 25%) on the amount actually shown as due on the return. (If both apply, the failure to file penalty drops to 4.5% per month (or part) so the total combined penalty remains 5%). The maximum combined penalty for the first five months is 25%. Thereafter the failure to pay penalty can continue at ½ % per month for 45 more months (an additional 22.5%). Thus, the combined penalties can reach a total of 47.5% over time. Both of these penalties are in addition to interest you will be charged for late payment. If you also missed estimated tax payments, an additional penalty is tacked on for the period running from each payment's due date until the tax return due date, normally April 15<sup>th</sup> (or earlier, if the payment is made before the due date). This penalty is computed at 3% above the fluctuating federal short-term interest rate for the period.

### **UNDUE HARDSHIP EXTENSIONS.**

It's important to remember that an extension of time to *file* your return does not mean you have an extension of time to *pay* your tax bill. An extension of time for payment may be available; however, if you can show payment would cause "undue hardship", as discussed below. You will avoid the failure to pay penalty if an extension is granted, but you will still be charged interest. If the IRS determines a "deficiency", i.e., that you owe taxes in excess of the amount shown on your return, the undue hardship extension can be as long as 18 months and in exceptional cases another 12 months can be tacked on. However, no extension will be granted if the deficiency was the result of negligence, intentional disregard of the tax rules or fraud.

To establish undue hardship it is not enough to show that it would just be inconvenient to pay your tax when due. For example, if you would have to sell property at a "sacrifice" price you may qualify. But if a market exists, having to sell property at the current market price is not viewed as resulting in undue hardship.

You would have to show that you do not have enough cash and assets convertible into cash in excess of current working capital to meet your tax obligations. You would also have to show you cannot borrow the amount needed except on terms that would inflict serious loss and hardship.

To qualify for an extension, you have to provide security for the tax debt. The determination of the kind of security – such as bond, filing a notice of lien, mortgage, pledge, deed of trust, personal surety or other form of security – will depend on the particular circumstances involved. When your application for an extension is granted you must deposit any collateral agreed upon with the IRS. No collateral will be required if you have no assets.

Form 1127 is used to apply for an extension. A statement of assets and liabilities must be attached as well as an itemized list of receipts and disbursements for the 3 months preceding the tax due date.

### **INSTALLMENT AGREEMENT REQUEST**

Another way to defer your tax payments is to request the IRS to enter into an installment payment agreement with you. This request is made on Form 9465. The IRS charges a small fee for installment agreements, which will be deducted from your first payment after your request is approved. Form 9465 requires less information than the hardship extension application. IF the liability is under \$25,000, you will not be required to submit financial statements. Even if your request to pay in installments is granted you will be charged interest on any tax not paid by its due date. But the late payment penalty will be half the usual rate ( $\frac{1}{4}\%$  instead of  $\frac{1}{2}\%$ ), if you file your return by the due date (including extensions).

Note that an installment agreement request can be made after your hardship extension period expires.

The installment agreement may terminate and all your taxes become due immediately if any of the following occur:

- The information you provided to the IRS in applying for the agreement proves inaccurate or incomplete.
- You missed an installment.
- You fail to pay another tax liability when it's due.
- The IRS believes collection of the tax involved is in jeopardy.
- You fail to provide an update of your financial condition where the IRS makes a reasonable request for you to do so.

The IRS must give you 30 days notice before altering, modifying or terminating the installment agreement and it must explain its reasons for the action. This notice requirement does not apply when collection of the tax is in jeopardy.

The IRS is required to enter into an installment agreement (at your request) if the following apply:

- the tax liability is \$10,000 or less (not counting interest and penalties)
- within the prior 5 years you (1) have not failed to file returns or pay taxes and (2) have not entered into a previous installment agreement,
- you submit financial statements (at IRS request) and the IRS determines the tax liability cannot be paid in full
- the installment agreement provides for full payment within 3 years, and
- you agree to comply with the tax laws during the agreement period.

## **AVOIDING MORE SERIOUS CONSEQUENCES**

Too many taxpayers hide their heads in the sand when they run into financial difficulties, for example, by failing to file their tax returns. But tax liabilities do not go away if left unaddressed. It is very important that you file a properly prepared return even if full payment cannot be made. Include as large a partial payment as you can with the return and start working with the IRS for a hardship extension or installment agreement as soon as possible. The alternative will include escalating penalties, plus the risk of having liens assessed against your assets and income. Down the road the collection process will also include seizure and sale of your property. In many cases these tax nightmares can be avoided by taking advantage of arrangements readily offered by the IRS.