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An Analysis of Recent Developments & Trends

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An Employer's Guide for Responding to an IRS Wage Levy

by: GJ Stillson MacDonnell and William Hays Weissman

Introduction

Employers routinely receive IRS wage levies, with strict and immediate time constraints for complying. However, with some proper procedures in place, employers should have no problem complying with a wage levy. This Insight provides employers a short guide for dealing with IRS wage levies.

Issuance of a Wage Levy

Under Internal Revenue Code ("Code") section 6331, the IRS may issue a levy for the purpose of seizing a person's property to satisfy unpaid taxes. This is usually done using IRS Form 668-W(c).

A levy may be issued after three prerequisites are satisfied: (1) the IRS issues an assessment for taxes due and sends a Notice of Demand for Payment; (2) the taxpayer fails to respond to the assessment or refuses to pay the assessment; and (3) the IRS issues a Final Notice of Intent to Levy and Notice of Right to a Hearing at least 30 days prior to the levy.¹ A taxpayer has the right to contest the Final Notice if, within 30 days of receipt, he asks the IRS to review the matter. The taxpayer further has a right to appeal the IRS determination, including bringing a suit in federal court.² In order to preserve the right to file a court action the taxpayer must file IRS Form 12153 with the IRS within 30 days of the levy notice.

The statutes, cases, IRS forms and publications all make clear that a taxpayer has the right, and the responsibility, to challenge any levy that he deems erroneous or illegal.³ Recipients of a wage levy, such

as an employer, enjoy no rights to challenge a wage levy because they have no interest in the property subject to it. Thus, the levy process up to the issuance of a wage levy is entirely between the IRS and the taxpayer and does not involve the employer. If an employer receives a wage levy it usually means that the employee has either exhausted his rights or failed to exercise them in a timely manner.

An Employer's Required Compliance

Wages and salaries, including severance and back pay awards, are expressly subject to levy.⁴ Settlement amounts are also subject to levy. As is generally the case with wages, the taxpayer's property interest subject to levy — his wages — is in the hands of the person's employer. Thus, employers are served with wage levies in order to allow the IRS to seize those wages earned by the employee before they are paid.

In order to encourage third party compliance with such levies, Congress enacted Code section 6332. That section provides, in pertinent part, that "any person in possession of (or obligated with respect to) property or rights to property subject to levy upon which a levy has been made shall, upon demand of the Secretary, surrender such property or rights... to the Secretary..."⁵ If the person "fails or refuses to surrender any property or rights to property, subject to levy, upon demand by the Secretary," the person will become personally liable for the taxes, penalties and interest on the levy, plus collection costs.⁶ In addition, a penalty equal to 50 percent of the tax due may also be exacted.⁷

1 IRC § 6331(d); see also *The IRS Collection Process*, IRS Publication 594 (Rev. 02-2004).

2 See *Collection Appeal Rights*, IRS Publication 1660.

3 *United States v. Rogers*, 461 U.S. 677, 682-83 (1983).

4 IRC § 6331(a), (e); *Beltran v. Cohen*, 303 F. Supp. 889, 892 (N.D. Cal. 1969).

5 IRC § 6332(a).

6 *Id.* at § 6332(d)(1).

7 *Id.* at § 6332(d)(2).

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The courts have stated that “clearly, a refusal to honor the levy will be at the third person’s own risk. Even in somewhat doubtful circumstances, the liabilities and penalties may be imposed.”⁸ The Code, however, states that employers who comply with a wage levy order cannot be held liable to an employee for such compliance.⁹

Steps for Complying with an IRS Wage Levy

Because an employer is obligated to start withholding in accordance with the wage levy within 10 days of mailing, it is critical for employers to have in place a system that identifies IRS wage levies immediately upon receipt. Employers should establish mail room procedures so that wage levies are quickly routed to the proper personnel to ensure that the employer meets the time requirements.

Upon receipt of a wage levy, an employer should take the follow steps:

- Immediately give the taxpayer/employee parts 2, 3, 4 and 5 of the wage levy.
- Instruct the employee to sign and return the Statement of Exemptions and Filing Status and return parts 3 and 4 to the employer within 3 work days.
- Based on the Statement of Exemptions and Filing Status executed by the employee, the employer must take the employee’s net pay minus the exemptions and send it to the IRS along with Part 3 of the wage levy for the next payroll period.
- If the amount is not sufficient to satisfy the entire wage levy, the employer must continue to comply with the wage levy until satisfied or until the IRS notifies the employer that it may cease compliance.
- Exemptions must be calculated in accordance with IRS Publication 1494 as discussed below.

- It is generally a violation of federal and state laws for employers to take adverse action, such as terminating an employee, because of a wage levy (or any other garnishment for indebtedness).¹⁰

Revised Publication 1494 Increases Exemption Amounts for 2006

The IRS recently announced that it had increased the amounts subject to exemption from a wage levy for 2006.¹¹ Thus, for example, the exempt amount for a taxpayer filing as “Married Filing Joint Return” with three exemptions increased \$25 from \$816.67 to \$841.67 for 2006.

Employers should keep in mind the following rules when calculating the amount exempt from a wage levy in accordance with Publication 1494:

- Net or take home pay is the pay that an employee would take home on a regular basis using the W-4 in effect prior to receipt of the wage levy; that is, minus the normal payroll deductions for income and FICA taxes, and other normal deductions, such as 401(k) contributions.
- In certain cases, the IRS will notify the employer not to allow a certain deduction, such as a 401(k) contribution, in which case the employer should follow the IRS’s instructions.
- Employers cannot accept a revised W-4 from an employee following receipt of a wage levy.
- The method of payment, such as direct deposit, has no bearing on a wage levy.
- Only use the 2006 table for levies issued in 2006. If a levy was issued in 2005, continue to use the 2005 table unless the employee provides a new Statement of Exemptions and Filing Status for 2006.

- **Example 1:** On January 3, 2006, Company A receives a wage levy for \$10,000 for Employee X. Company A immediately provides Employee X with Parts 2, 3, 4 and 5 of the wage levy. Employee X returns parts 3 and 4 within 3 work days, and claims that he is married filing jointly with 3 exemptions on his Statement of Exemptions and Filing Status.

Employee X is normally paid \$4,000 semi-monthly, minus \$1500 in payroll deductions for federal and state income taxes, Social Security and Medicare taxes, and a pre-tax health savings account. In accordance with the 2006 table on Publication 1494, Employer A should exempt \$841.67 from each pay check, and send the IRS the remaining \$1,658.33. Since this amount is not enough to satisfy the wage levy, Employer A must continue to send the IRS this amount each pay period until the \$10,000 is satisfied.

- **Example 2:** Same as example 1, except that the wage levy was issued on December 18, 2005. Employer A must use the 2005 table to compute the exemption amount, which is \$816.67. Thus, Employer A should send the IRS \$1,683.33 for each pay period.
- **Example 3:** Same as example 2, except that on January 20, 2006, Employee X executes a new Statement of Exemptions and Filing Status. Employer A should have used the 2005 table for the purposes of calculating the amount subject to exemption from the December 31, 2005, and January 15, 2006, pay periods, but should use the 2006 table for the January 31, 2006, pay periods forward.

Releasing a levy

The IRS must release a wage levy when the taxes, penalties and interest are paid in full. In addition, the IRS must release a wage levy in the following cases:

8 *Farr v. United States*, 990 F.2d 451, 456 (9th Cir. 1993); see also *United States v. National Bank of Commerce*, 472 U.S. 713, 721-26 (1985) (explaining that the party in possession of property subject to a levy has limited defenses and proceeds at its own peril if it refuses to honor the levy).

9 IRC § 6332(e) (“Any person in possession of (or obligated with respect to) property or rights to property subject to levy upon which a levy has been made who, upon demand by the Secretary, surrenders such property or rights to property... shall be discharged

from any obligation or liability to the delinquent taxpayer and any other person with respect to such property or rights to property arising from such surrender or payment.”).

10 See, e.g., 15 U.S.C. § 1674(a).

11 The IRS will provide the employer with a copy of Publication 1494 with the wage levy. It is also available online at the IRS website at <http://www.irs.gov/pub/irs-pdf/p1494.pdf>.

- The statutes of limitations expired before the wage levy was served;
- The taxpayer provides documentation that proves that releasing the wage levy will assist the IRS in collecting the debt;
- The taxpayer enters into an installment agreement, unless the agreement states that the levy is not to be released; or
- The IRS determines that the levy is creating an economic hardship for the taxpayer.

Unless the levy has been completely satisfied, an employer should continue to comply with it unless it receives notice from the IRS that the levy has been removed for one of the reasons stated above.

Responding to Employees Arguing Employer Need Not Comply with Levy

An employee will sometimes inform his employer that it does not need to comply with the wage levy order for a variety of reasons, or otherwise threaten action against the company if it complies. However sympathetic an employer might be, as noted above, an employer should comply with wage levies or risk being liable for the levy itself and a 50 percent penalty. Threats of litigation by an employee, however real, should not discourage employers from compliance given the express indemnity set forth in the Code.

Regardless of the reasons an employee provides, it is important for an employer to respond politely but firmly in writing that it is obligated to comply with the IRS wage levy and that it will do so until satisfied or until the IRS informs the employer that it may cease compliance, particularly if the employee threatens litigation. Employers should consult their legal counsel to assist in fashioning an appropriate response.

Below are some of the more common but nevertheless invalid reasons some taxpayers

have used to try to convince employers that they do not need to comply with an IRS wage levy:

- The IRS does not have authority to issue wage levies outside the District of Columbia under section 72 of Title 4 of the United States Code. This section states that the seat of the federal government is at the District of Columbia. The courts have held that section 72 of Title 4 in no way prohibits the IRS from issuing a wage levy outside the District of Columbia.¹²
- The Commissioner of the IRS has not properly delegated authority to inferior IRS officers to issue wage levies under IRC section 6331(a). This argument has been rejected by the courts, which have exhaustively traced the proper delegation of authority for wage levies.¹³
- An IRS wage levy is not valid unless there is a court order. The United States Supreme Court has expressly rejected this argument.¹⁴
- The employer will be liable to the employee for damages if it complies with the wage levy. The Code expressly indemnifies an employer that complies with a wage levy.¹⁵

Dealing with Multiple Federal and State Wage Levies

In addition to IRS wage levies, all states with an income tax have their own procedures for levying state income (and other state taxes). Further, there are state procedures for garnishing wages for child support payments as well as for court judgments. When multiple levy orders exist at any one time, there are specific rules governing the priority of payment for such levies. The various state procedures and priorities are too numerous to set forth here. However, Littler's Employment Taxes Practice Group can assist employers with both federal and state wage levies and garnishment procedures in all of these contexts.

Conclusion

Employers should have procedures in place to quickly respond to an IRS wage levy, including the following:

- Ensure there are proper procedures for identifying and routing an IRS wage levy to the proper personnel immediately upon receipt.
- Timely provide the taxpayer/employer with the appropriate sections of the levy and have him or her return the Statement of Exemptions and Filing Status within 3 working days.
- Properly calculate the amount exempt from levy using the proper table in IRS Publication 1494 (e.g., for levies received in 2005, the 2005 table, unless in 2006 the employee fills out a new Statement of Exemptions and Filing Status).
- Begin withholding within 10 days of receipt for the next pay period and continue until the levy is satisfied or the IRS notifies the employer that it may cease.
- Respond in writing to an employee that insists that the employer ignore the levy or otherwise threatens suit if the employer complies with the levy, however, do not take adverse action against the employee simply because there is a wage levy against his wages.
- Seek legal counsel if there are any concerns about the levy or how to respond to an employee.

GJ Stillson MacDonnell is a shareholder and chair of Littler's Employment Taxes Practice Group and can be reached at gjmacdonnell@littler.com. William Hays Weissman is an associate in Littler's Employment Taxes Practice Group and can be reached at wweissman@littler.com.

¹² *Hughes v. United States*, 953 F.2d 531 (9th Cir. 1992); *In re Myrland*, 209 B.R. 524, 525 (W.D. Wash. 1997).

¹³ *Hughes*, 953 F.2d 531, 536 (9th Cir. 1992).

¹⁴ *Rogers*, 461 U.S. at 682-83 ("Administrative levy, unlike an ordinary lawsuit, and unlike the procedure described in 7403, does not require any judicial intervention,

and it is up to the taxpayer, if he so chooses, to go to court if he claims that the assessed amount was not legally owing.").

¹⁵ See *supra* note 9.