# What to Do if You Can't Pay Your Taxes

Anticipate difficulty paying your taxes? IRS repayment plans, personal loans, home equity, offer and compromise and other solutions to pay back taxes.

By Gina Pogol Posted: February 27, 2021

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Uh oh. You completed your 2020 tax return, and you owe more than you can afford to pay. Don't panic! While the IRS has a well-deserved reputation as a harsh creditor, the agency does offer payment plans and other relief. Alternatively, you can borrow money from a financial institution to pay off your tax debt. For many consumers, private-sector loans are more affordable than an IRS plan. Here's what you need to know if you get caught with an unexpected tax bill this year.

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## File on Time, Even If You Can't Pay Your Taxes

The most important tip you will read here is to file your taxes no matter what. Get past your angst and file the return even if you can't send in the full amount due. If your tax return is not ready to file by April 15, 2021, fill out Form 4768, Application for Extension of Time to File, and send it in before the deadline. That form gives you until Oct. 15 to get your return in.

Failure to file your tax return on time can be extremely expensive. The failure-to-file penalty is 5% of the unpaid balance per month until you file. The maximum penalty is 25% of the taxes owed. If you owe $4,000 and file five or more months late, your tax bill grows to $5,000.

You can avoid this charge by simply filing your tax return on time, even if you can't pay your tax bill.

## What Happens if You Can't Pay Your Taxes?

Personal finance experts tell you that ignoring your back taxes is a terrible idea. They won't go away on their own, and the IRS won't magically forget your existence after tax season.

The IRS first sends a notice of taxes owed and demand for payment. If you don't contact them within ten days and make arrangements to pay, the agency accelerates its collection process.

The IRS may seize your assets -- including wages, bank accounts, social security benefits and retirement income. And your car, boat or real estate is up for grabs as well -- the agency can take these things and sell them to pay your back taxes. In addition, the IRS can seize future federal or state tax refunds and apply them to your federal tax bill.

The sooner you address your tax bill, the less painful and less expensive the payment process should be.

But what if you really can't pay your taxes? The IRS is tough, but not entirely unforgiving. If you are so financially drained that you have little or no money after paying your essential living expenses (reasonable costs for household items such as food and clothing, healthcare, housing and utilities, and transportation), you can request Currently Not Collectible (CNC) status. You do this by completing a Collection Information Statement (Form 433-F, Form 433-A, or Form 433-B) and providing proof of your financial situation (information about your assets and your monthly income and expenses).

CNC status doesn't make your tax debt go away. Your debt continues to accrue penalties and interest until it's paid in full. The IRS evaluates your financial position every year for ten years. If your financial condition fails to improve, your tax bill is then written off.

What about bankruptcy? Tax bills, like government-backed student loans, are extremely difficult to discharge in bankruptcy unless you filed on time at least three years ago. Even paying a non-dischargeable debt with an unsecured loan won't make it dischargeable, according to Nolo.com.

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## How to Pay Your IRS Bill: Explore Your Options

The IRS offers several repayment options, including full payment (with a credit or debit card), a short-term payment plan (120 days or fewer), or a long-term payment plan (installment agreement).

You may be able to apply online for an installment agreement if:

- You owe $50,000 or less in combined tax, penalties and interest, and filed all required returns (for long-term repayment); or
- You owe less than $100,000 in combined tax, penalties, and interest (for short-term repayment)

Repayment plans require automatic debits from your checking account or via a credit or debit card. Card payments are subject to additional fees. You can start a short-term plan for a $31 set-up fee online ($107 by phone) or a long-term plan for $149 ($225 by phone). You will continue to accrue penalties at an interest rate of .5% per month, about 6.2% per year. Your minimum monthly payment must be high enough to clear your entire balance, including interest and penalties, in 72 months.

Ineligible taxpayers can still request a plan by filing Form 9465 or calling 800-829-1040.

Other options for paying off the IRS include private loans:

- Home equity loan or line of credit
- Credit card
- 401(k) loan
- Personal loan

Next, you'll compare all alternatives and decide which is best for you.

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## How to Decide Which Way to Pay Your Taxes

Should you apply for an IRS payment plan? Or borrow elsewhere? The answer depends on your circumstances -- the amount you owe, your credit rating, and your income.

If the amount you owe is relatively small and your credit is good, apply for a credit card with a zero percent introductory interest rate. These cards give you six months to 24 months with no interest. Pay as much as you can every month during this interest-free period. If there will be a balance at the end of that time, pay it off before the 0% period ends -- perhaps with a personal loan or balance transfer card.

If the amount is very large, an IRS plan may not work for you. That's because the agency charges about 6.2% interest, and they set your payment at an amount to clear the debt in seven years max. If you owe a lot, this payment may be too high for you. Even if your credit is just okay, a home equity loan will often have lower payments. You can extend the repayment to 15 or 20 years if you like, keeping the loan affordable even for higher loan amounts.

If you have a 401(k) that's eligible for loans, you might be able to borrow up to 50% of your balance or $50,000, whichever is less. You actually lend to yourself and repayment can be flexible. However, if you leave your employer before repaying the loan, the remaining balance becomes -- you guessed it -- taxable income. Which could get you right back into trouble again.

If you have good-to-excellent credit, you may be able to get a better interest rate from a personal loan provider than you'd obtain from the IRS. Companies such as LightStream and Sofi offer unsecured loans at a cost that competes with home equity interest rates.

## Paying Back-Taxes with a Personal Loan

Personal loans are offered by banks, credit unions, and lending companies to clear your tax debt with no prepayment penalty in one to ten years. The shorter the term, the lower your interest rate will be. Choosing a longer term, however, gets you a lower payment. You can always pay more when you can afford it, and that's probably a better solution if your income is sporadic because you're on commission or self-employed.

Another way to use personal loans to minimize what you pay is by combining a personal loan and a credit card. You'll have to pay the IRS "convenience fee" of 1.87% to use a credit card, but it's probably worth doing if you get zero interest for 12 or more months. Another fun option is using a rewards card to pay the IRS, getting all of those nice points or travel miles, and then paying off the credit card with a lower-interest personal loan.

Make sure that you compare several personal loan offers because interest rates vary widely, and you want the best deal for which you qualify.

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## Advantages of Personal Loans for Paying Taxes

There are a few advantages associated with using a personal loan for back taxes.

- If you are late with a payment, you won't get into trouble with the IRS.
- The interest rate is fixed (usually), and if your credit is good, it's lower than the penalty interest rate, which is about 6.2% as of this writing.
- You control your payment by choosing the loan term (one to ten years) instead of letting the IRS do it for you.
- You may be able to take advantage of favorable credit card offers such as rewards or zero interest and then pay those balances before the high credit card interest kicks in.
- Getting approved for an IRS plan takes longer than applying for a personal loan.

Whether a personal loan is right for you depends mostly on your credit rating. If your credit is poor, the IRS plan may be the best you can do. But if you have good or excellent credit, a personal loan could cost you less and bring fewer hassles. You can often find, apply for and receive money from a personal loan in just a day or two.

One final bit of advice? Consult a tax professional to make sure that you stay out of trouble next year. Make sure you withhold enough tax to avoid triggering under-withholding penalties and huge tax bills.

Compare personal loan offers now

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