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## One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of the Law, Fail to Promote Future Tax Compliance, and Unnecessarily Harm Taxpayers

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### DEFINITION OF PROBLEM

Properly applied, the notice of federal tax lien (NFTL) can be an effective tool in tax collection. It gives the IRS a priority interest in the taxpayer's property, such as a home or a car, and may enable the IRS to collect all or a portion of the tax debt if the taxpayer sells or refinances the property.

If improperly applied, however, tax liens have the potential to cause needless harm to taxpayers and undermine long-term tax collection. Assume, for example, that a taxpayer loses his job during a recession and becomes unable to pay his tax bill. The filing of a tax lien can significantly harm the taxpayer's credit and thus negatively affect his or her ability to obtain financing, find or retain a job, secure affordable housing or insurance, and ultimately pay the outstanding tax debt. Moreover, the government must consider that its role as a creditor is different from that of a private entity creditor. If the filing of a tax lien drives up the taxpayer's costs and renders him or her unemployed or underemployed, the government may be forced to make outlays in the form of unemployment benefits, food stamps, and the like. Thus, the imprudent filing of a tax lien has the potential to badly damage the taxpayer and the taxpayer's family and simultaneously *reduce* federal revenue – a lose-lose proposition.

For this reason, the decision whether to impose a tax lien should be made on a case-by-case basis. Yet, the IRS files many liens systemically, pursuant to “business rules” that require automatic lien filing or a lack of substantive human review.<sup>1</sup>

The National Taxpayer Advocate has been hearing increasing complaints about lien processing in recent years, and this year we conducted a high-level research project on collection activities that, in part, attempted to assess whether liens are being filed effectively to collect revenue. To complete this assessment, TAS reviewed nearly 1.9 million transactions involving about 270,000 individual taxpayers who first incurred new balance-due liabilities during tax year 2002 (and who had no previous unpaid balances due at that time) and

<sup>1</sup> Automated Collection System (ACS), *Customer Service Activity Reports (CSAR), FY 2009 BOD report*. See also E-mail from IRS subject matter expert (Nov. 2, 2009); Internal Revenue Manual (IRM) 5.19.5.3.7 (Dec. 1, 2007); IRM 5.19.5.5.7 (May 29, 2008).

against whom NFTLs were filed in subsequent years.<sup>2</sup> The results of our research suggest that the IRS's use of liens may not be furthering the agency's revenue collection objective and, equally significant, that the IRS has shown very little interest in evaluating the effectiveness of liens for itself. Among our findings:

- There is no discernable causal relationship between the number of lien notices filed and the amount of revenue collected. Over the past decade, the IRS has increased its lien filings by nearly 475 percent – from about 168,000 in fiscal year (FY) 1999 to nearly 966,000 in FY 2009.<sup>3</sup> Yet overall inflation-adjusted (in terms of 2009 dollars) Collection revenue has declined by approximately 7.4 percent during this period.<sup>4</sup>
- IRS procedures require employees to code the source of all payments received on delinquent accounts.<sup>5</sup> Where the IRS received a payment after an NFTL was filed against a taxpayer's property, the IRS coded the source of payments as "miscellaneous" or did not code the payment at all in about 52 percent of the cases.<sup>6</sup> The IRS's failure to accurately code and track the source of payments largely defeats the purpose of having a coding system because it precludes the IRS (including TAS) from drawing useful conclusions about the effectiveness of its lien filings.
- In cases where the IRS did code the source of a payment as something other than "miscellaneous," our analysis found that more than 95 percent of all payments and more than 80 percent of all revenue collected did not result from the lien filings and would have been collected anyway.<sup>7</sup> The largest source of Collection revenue and payments on these accounts was refund offsets (*i.e.*, the taxpayer filed a return in a subsequent tax year showing a refund due and the IRS withheld the refund to satisfy the past-due tax debt), which occur regardless of the existence of an NFTL. Of the \$905 million attributable to payments for which there is a designated payment code, only about \$169 million was unambiguously attributable to lien filings with respect to 2002 delinquent tax liabilities.<sup>8</sup>

<sup>2</sup> TAS reviewed 1,886,683 transactions from 270,399 individual taxpayers. For a more detailed discussion, see *The IRS's Use of Notices of Federal Tax Lien (NFTL)*, vol. 2, *infra*.

<sup>3</sup> IRS, *Statistics of Income (SOI) Data Books, Table 16, Delinquent Collection Activities, 1999-2008*; IRS, Collection Activity Report NO-5000-C23, *Collection Workload Indicators Reports* (Oct. 13, 2009). In FY 2009, the IRS filed 965,618 NFTLs.

<sup>4</sup> *Id.* Small Business/Self-Employed division (SB/SE) response to TAS research request (Nov. 13, 2009). The SOI data is not available for FY 2009. For a more detailed discussion of IRS Collection data, see *Preface: Introductory Comments of the National Taxpayer Advocate, supra*.

<sup>5</sup> See IRM 5.1.2.8.1 (Aug. 15, 2008). These two-digit numeric codes are called Designated Payment Codes (DPCs). The IRS uses DPCs to help identify payments, indicate application of payment to a specific liability, and identify the event that resulted in a payment.

<sup>6</sup> IRS, Compliance Data Warehouse (CDW), Individual Masterfile (IMF) Transaction File Cycle 200913. Of the 1,886,683 total payment transactions, only 629,158 transactions had the DPC code assigned. 1,257,525 transactions were designated "miscellaneous" or "DPC indicator not present." Of the 1,257,525 transactions, 283,091 had a refund offset transaction code; leaving 974,434 payments (or 51.6 percent) as unaccountable. Thus, 912,249 payments (or 48.4 percent) had meaningful DPCs or could be identified as refund offsets. See also Chart 1.2.2, *Dollars Collected Attributable to Liens Filed Against TY 2002 Individual Taxpayer Liability and Subsequent Payments from CY 2002 to CY 2009, infra*. The IRS does not conduct a quality review of the payment information by DPC. IRS response to TAS research request (Oct. 6, 2009).

<sup>7</sup> See *The IRS's Use of Notices of Federal Tax Lien (NFTL)*, vol. 2, *infra*.

<sup>8</sup> IRS, CDW, IMF Transaction File Cycle 200913. The IRS collected \$168.6 million in payments attributable to NFTLs and \$736.7 million in payments not attributable to NFTLs from calendar year (CY) 2002 to CY 2009. See Chart 1.2.2, *Dollars Collected Attributable to Liens Filed Against TY 2002 Individual Taxpayer Liability and Subsequent Payments from CY 2002 to CY 2009, infra*.

The National Taxpayer Advocate has identified the following concerns with the IRS's NFTL policy:

- Lack of managerial review prior to most NFTL filings, which circumvents the provisions of § 3421 of the IRS Restructuring and Reform Act of 1998 (RRA 98);
- Lack of verification of assets prior to filing an NFTL;
- Unnecessary harm to taxpayers whose accounts are reported currently not collectible (CNC); and
- Failure by the IRS to fully utilize its statutory authority to withdraw NFTLs.

Such an approach to NFTL filing harms taxpayers and impairs both the collection of current tax debts as well as future compliance.

## ANALYSIS OF PROBLEM

### Background

*The purpose of the NFTL is to protect the IRS's priority over other creditors.*

A federal tax lien (FTL) arises when the IRS assesses a tax liability, sends the taxpayer notice and demand for payment, and the taxpayer does not fully pay the debt within ten days.<sup>9</sup> An FTL is effective as of the date of assessment and attaches to all of the taxpayer's property and rights to property, whether real or personal, including those acquired by the taxpayer after that date.<sup>10</sup> This lien continues against the taxpayer's property until the liability either has been fully paid or is legally unenforceable.<sup>11</sup> This statutory lien is sometimes called the "secret" lien, because third parties – and usually the taxpayer – have no knowledge of the existence of this lien or the underlying tax debt, and the taxpayer may not understand the significance of this statutory lien.<sup>12</sup> To put third parties on notice and establish the priority of the government's interest in a taxpayer's property against subsequent purchasers, secured creditors, and junior lien holders, the IRS must file an NFTL in the appropriate location, such as a county registrar of deeds.<sup>13</sup> It is IRS policy not to use the NFTL as a negotiating tool.<sup>14</sup> The IRS is required to release a lien not later than 30 days after the underlying liability either is fully satisfied through full payment of tax or is legally unenforceable (typically, by expiration of the statutory period for collecting the tax).<sup>15</sup> Once the certificate of release is issued and filed in the same office as the related NFTL, the tax

<sup>9</sup> Internal Revenue Code (IRC) §§ 6321 and 6322. IRC § 6201 authorizes the IRS to assess all taxes owed. IRC § 6303 provides that within 60 days of the assessment the IRS must provide notice and demand for payment to any taxpayer liable for an unpaid tax.

<sup>10</sup> See IRC § 6321; IRM 5.12.2.2 (May 20, 2005).

<sup>11</sup> IRC § 6322.

<sup>12</sup> IRC § 6321. The IRM refers to this statutory lien as a "silent" lien. See IRM 5.12.2.2 (May 20, 2005).

<sup>13</sup> IRC § 6323(f); Treas. Reg. § 301.6323(f)-1; IRM 5.12.2.8 (Oct. 30, 2009).

<sup>14</sup> IRM 5.12.2.1 (May 20, 2005).

<sup>15</sup> IRC § 6325(a)(1).

lien is conclusively extinguished.<sup>16</sup> Under certain circumstances, the IRS may withdraw an NFTL, in which case the provisions of "this chapter [chapter 64 of subtitle F, relating to collection] shall be applied as if the withdrawn notice had not been filed."<sup>17</sup>

***The NFTL impairs taxpayers' credit reports and unless appropriately applied, may impede taxpayers' financial viability and ability to pay past, current, and future taxes.***

On average, a lien filing reduces a taxpayer's credit score by 100 points.<sup>18</sup> Unpaid tax liens may remain on a taxpayer's credit history, leaving a derogatory mark on the credit history indefinitely.<sup>19</sup> Released liens, including those paid off by the taxpayer, are not generally removed from the credit history until seven years from the date of release.<sup>20</sup> Thus, an NFTL has a significant long-term impact on a taxpayer's credit record.

As a result, some lenders decline to extend credit to a taxpayer if the IRS has filed an NFTL against the taxpayer's property. Others will charge substantially higher rates, even if the lien is subordinated.<sup>21</sup> Impaired credit history can also affect a taxpayer's ability to obtain insurance or rent an apartment on reasonable terms. Moreover, some licensing boards require members to maintain a clean credit history and some employers require employees to do so as a condition of employment.<sup>22</sup> Thus, a lien filing can mean that employees lose their jobs and self-employed individuals cannot maintain the licensing necessary to remain in business. It can also hamper the taxpayer's ability to stay compliant and obtain credit needed to pay preexisting tax debts.<sup>23</sup>

<sup>16</sup> IRC § 6325(f).

<sup>17</sup> IRC 6323(j)(1). An NFTL may be withdrawn if the lien was filed prematurely or not in accordance with IRS procedures, the taxpayer entered into an installment agreement that did not by its terms require the filing of a lien, the withdrawal will facilitate collection, or the withdrawal is in the best interests of both the government and the taxpayer.

<sup>18</sup> Written response from Vantage Score® (Sept. 17, 2009). The impact of the NFTL filing is greatest upon the initial filing and diminishes over time.

<sup>19</sup> As a matter of policy, Experian keeps unpaid tax liens on a credit report for 15 years and Equifax for ten years, while Transunion credit reports reflect them indefinitely. Self-releasing liens are generally reported for ten years after the filing date unless the lien is refiled by the IRS. California requires that all liens, released and open, be removed from credit histories ten years after the filing date. See Cal. Civ. Code, § 1785.13(d).

<sup>20</sup> The Fair Credit Reporting Act (FCRA), § 605(a)(3), 15 USC § 1681c(a)(3). See also Federal Trade Commission, Statement of General Policy or Interpretation; Commentary on the Fair Credit Reporting Act, 55 Fed. Reg. 18804, 18818 (May 4, 1990). The filing of a release will be notated on the credit report but does not necessarily impact the credit score in a significant way.

<sup>21</sup> See, e.g., GMAC Factoring Agreement, available at <http://contracts.onecle.com/abinet/gmac.factor.2003.02.01.shtml> (last visited Oct. 9, 2009). See also CTG Financial, Inc. Factoring Agreement, available at [www.ctgfinancial.com/pdf/Factoring\\_Contract%20\\_3\\_20\\_09.pdf](http://www.ctgfinancial.com/pdf/Factoring_Contract%20_3_20_09.pdf) (last visited Oct. 9, 2009).

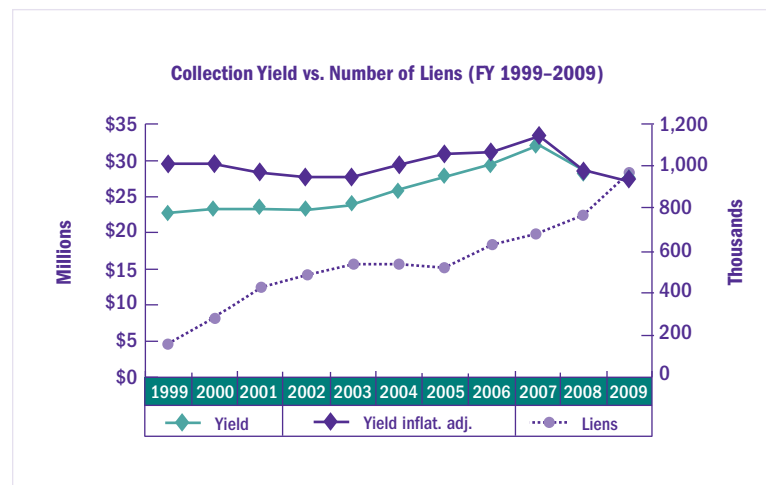
<sup>22</sup> See, e.g., Form U4, *Uniform Application for Broker-Dealer Registration*, Q14M (May 2009), available at <http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/appsupportdocs/p015112.pdf> (last visited Oct. 6, 2009).

<sup>23</sup> See, e.g., IRC § 6323(d) (providing that security protection only extended to the lender for disbursements made within 45 days after the filing of the NFTL, or until the lender is provided actual notice of the NFTL); IRC § 3505(b) (holding a lender providing funds for the ongoing operation of a business potentially liable for unpaid withholding taxes if certain criteria are met).

### The IRS has no means of tracking the effectiveness of NFTL filings in terms of collected tax revenue.

As noted above, IRS NFTL filings increased by about 475 percent from FY 1999 to FY 2009,<sup>24</sup> yet the IRS total collection yield has slightly increased on a slow, relatively consistent and gradual path in FYs 1999-2009.<sup>25</sup> In fact, when adjusted for inflation (in terms of 2009 dollars), the total collection yield declined by approximately 7.4 percent from \$29.4 billion in FY 1999 to \$27.2 billion in FY 2009.<sup>26</sup> Chart 1.2.1 below illustrates this trend from FY 1999 through FY 2009.

**CHART 1.2.1, Absolute Dollar and Inflation-Adjusted Collection Yield and NFTLs Filed, FY 1999 - FY 2009**



A recent TAS analysis of IRS payment data reveals that the IRS does not accurately track the source of tax payments received on past due accounts. In most instances where the payment source is specified, however, the IRS would have received the payment regardless of whether the lien was filed. The IRS assigns a specific numeric code (*i.e.*, a designated payment code or DPC), to each payment it receives to identify the source (*e.g.*, pursuant to an installment agreement (IA), offer in compromise (OIC), levy, seizure, or sale of asset).<sup>27</sup>

<sup>24</sup> IRS, *Statistics of Income (SOI) Data Books, Table 16, Delinquent Collection Activities, 1999-2008*. IRS, *Collection Activity Reports, NO-5000-C23, Collection Workload Indicators Report* (Oct. 13, 2009). See also SB/SE response to TAS research request (Nov. 13, 2009).

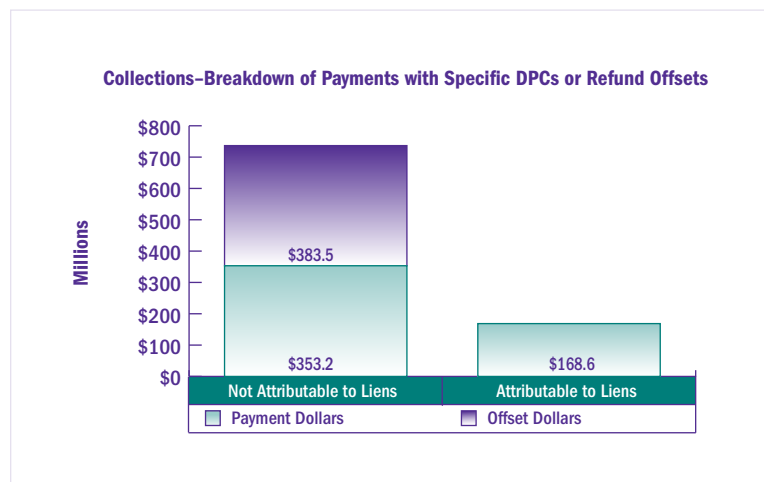
<sup>25</sup> IRS, *SOI Data Books, Table 16, Delinquent Collection Activities, 1999-2008*. SB/SE response to TAS research request (Nov. 13, 2009). Total collection yield as reported in the SOI Data Book is any revenue collected attributable to IRS collection activities, such as levies, liens, and seizures. Total collection yield includes previously unpaid taxes on returns filed plus assessed and accrued penalties and interest. For FY 2008, it includes a total of \$37,254,116 collected by private debt collection agencies. For a more detailed discussion, see *Preface: Introductory Comments of the National Taxpayer Advocate, supra*.

<sup>26</sup> Bureau of Labor Statistics, Dept. of Labor, *Consumer Price Index - All Urban Consumers (CPI-U)*, at <http://www.bls.gov/CPI/> (last visited Oct. 10, 2009).

<sup>27</sup> See IRM 5.1.2.8.1 (Aug. 15, 2008). These two-digit numeric codes are called Designated Payment Codes (DPCs). The IRS uses DPCs to help identify payments, indicate application of payment to a specific liability, and identify the event that resulted in a payment.

As noted above, TAS reviewed nearly 1.9 million transactions involving about 270,000 individual taxpayers who first incurred new balance-due liabilities during tax year 2002 (and who had no previous unpaid balances due at that time), and against whom NFTLs were filed in subsequent years.<sup>28</sup> In approximately 52 percent of all payment transactions attributable to these taxpayers, the IRS coded the payments as “Miscellaneous” or did not code them at all.<sup>29</sup> That is, the IRS does not know what prompted the taxpayer to make a payment in *over half* of the instances. Thus, neither TAS nor the IRS can determine in these cases whether any particular collection action (or none at all) was effective in generating tax payments for the liabilities incurred in TY 2002. Where the payments tracked were designated with a specific payment code, however, the revenue collected and attributable to NFTL filings amounted to less than *one-fifth* of the total revenue collected from these taxpayers, as shown in Chart 1.2.2 below. Chart 1.2.2 shows that of the nearly \$905 million in payments for calendar year 2002 to CY 2009 for which there is a specific DPC, the IRS collected about \$169 million attributable to the NFTL, and nearly \$737 million not attributable to the NFTL.<sup>30</sup>

**CHART 1.2.2, Dollars Collected Attributable to Liens Filed Against TY 2002 Individual Taxpayer Liability and Subsequent Payments from CY 2002 to CY 2009<sup>31</sup>**



<sup>28</sup> TAS reviewed 1,886,683 transactions from 270,399 individual taxpayers. For a more detailed discussion and description of this lien analysis and methodology, including payment allocation, see *The IRS’s Use of Notices of Federal Tax Lien*, vol. 2, *infra*. It should be noted that we reconstructed the 48.4 percent total so that it included offsets. In 51.6 percent of the transactions, neither TAS nor the IRS can identify the source of payment.

<sup>29</sup> IRS, CDW, IMF Transaction File Cycle 200913. Of the 1,886,683 total payment transactions, only 629,158 transactions had the DPC code assigned. 1,257,525 transactions were designated “miscellaneous” or “DPC indicator not present.” Of the 1,257,525 transactions, 283,091 had a refund offset transaction code; leaving 974,434 payments (or 51.6 percent) as unaccountable. Thus, 912,249 payments (or 48.4 percent) had meaningful DPCs or could be identified as refund offsets. See also Chart 1.2.2, *Dollars Collected Attributable to Liens Filed Against TY 2002 Individual Taxpayer Liability and Subsequent Payments from CY 2002 to CY 2009*, *supra*. The IRS does not conduct a quality review of the payment information by DPC. IRS response to TAS research request (Oct. 6, 2009).

<sup>30</sup> IRS, CDW, IMF Transaction File Cycle 200913.

<sup>31</sup> *Id.* The IRS collected \$168.6 million in payments attributable to NFTLs and \$736.7 million in payments not attributable to NFTLs from CY 2002 to CY 2009.

Moreover, the number of payment transactions (regardless of amount) attributable to NFTLs represented less than five percent of all payments. Table 1.2.3 below breaks down the payments according to type.

**TABLE 1.2.3, Total Payment Transactions from CY 2002 to CY 2009 by Type of Payment (Attributable to Liens Filed Against TY 2002 Individual Taxpayer Liability)<sup>32</sup>**

Designated Payment Code Type	Not Lien Attributable		Offset		Lien Attributable		Total Number	Total Dollars (in thousands)
	Number	Dollars (in thousands)	Number	Dollars (in thousands)	Number	Dollars (in thousands)		
Levies	562,656	\$ (306,763)	15	\$ 17	–	\$ –	562,671	\$ (306,746)
Refund Offsets	–	\$ –	283,091	\$ (384)	–	\$ –	283,091	\$ (383,665)
Bankruptcy and Suits	4,912	\$ (3,072)	6	\$ 16	22,058	\$ (21,391)	26,976	\$ (24,447)
Offers in Compromise	21,157	\$ (27,201)	19	\$ 49	–	\$ –	21,176	\$ (27,152)
Liens	20	\$ (10,158)	2	\$ 0.51	11,016	\$ (147,070)	11,038	\$ (147,080)
Installment Agreements	5,675	\$ (5,679)	15	\$ 22	–	\$ –	5,690	\$ (5,657)
Other DPCs	1,566	\$ (10,497)	21	\$ 39	–	\$ –	1,587	\$ (10,457)
Unrecognized DPCs	1	\$ 0.04	13	\$ 20	6	\$ (106)	20	\$ (86)
<b>Total</b>	<b>595,987</b>	<b>\$ (363,370)</b>	<b>283,182</b>	<b>\$ (220)</b>	<b>33,080</b>	<b>\$ (168,568)</b>	<b>912,249</b>	<b>\$ (905,291)</b>

The TAS analysis demonstrates that when the IRS files an NFTL and records specific payment codes, it collects far more revenue from offsets and payments not attributable to liens (such as levies, OICs, and IAs) than from the NFTLs. If the IRS seeks to understand the effectiveness of its lien and collection policies – and we believe it is critical that the IRS do so – it must first institute a quality review of payment coding.

### **Systemic lien filing circumvents key taxpayer protections enacted by RRA 98.**

One reason the systemic lien filing does not generate a corresponding increase in collection revenue may be that the IRS files NFTLs against taxpayers who have little or no ability to pay or who have no assets from which to collect. In FY 2009, the IRS filed about 51 percent of all liens via its Automated Collection System.<sup>33</sup> Of the NFTL requests that ACS tracks, 61.7 percent were systemic (*i.e.*, IRS systems both made lien filing determinations

<sup>32</sup> IRS, CDW, IMF Transaction File Cycle 200913. The total number of payments is 912,249, of which only 33,080 transactions were attributable to NFTLs. “DPC not present on Posting Voucher, Miscellaneous, or Missing” means valid DPCs with insignificant dollar amounts that cannot be classified in other categories and nonrecognized or invalid DPCs.

<sup>33</sup> IRS, Collection Activity Report NO-5000-C23, *Collection Workload Indicators Reports* (Oct. 13, 2009). Of the 965,618 NFTLs filed in FY 2009, 491,822 were filed by the ACS.



and filed the liens, without the IRS first inquiring whether the taxpayer has any assets, or is likely to acquire assets, to which a lien could attach).<sup>34</sup>

Before the enactment of RRA 98<sup>35</sup> IRS employees had no statutory requirement to obtain managerial approval prior to an NFTL filing.<sup>36</sup> Recognizing that federal tax liens may impose a serious hardship on taxpayers, Congress enacted § 3421 of RRA 98 to provide an extra layer of protection for taxpayers in the form of an administrative approval process.<sup>37</sup> Under this process, a determination by an employee to file a lien would, where appropriate, be approved by an IRS supervisor who, in addition to other analysis, may include a certification that the employee has reviewed the taxpayer's information, verified the balance due, and affirmed that the action proposed is appropriate, considering the amount due and the value of the property.<sup>38</sup> This provision also requires that the failure to follow such procedures should result in appropriate disciplinary action against the supervisor or IRS employee responsible for the failure.<sup>39</sup> In the case of liens or levies issued by ACS, the IRS was given discretion to determine where supervisory review is or is not appropriate.<sup>40</sup>

When the IRS considered implementation of the RRA 98 lien approval requirement, it decided to continue limiting managerial review to only those liens filed by lower-graded revenue officers (ROs), specifically those below the GS-9 level.<sup>41</sup> However, in FY 2009, only about 14 percent of ROs (541 of 3,752) were below that level.<sup>42</sup> In ACS, lower-graded employees (*i.e.*, GS-7 and below) historically required approval from a senior RO or a manager to file a lien,<sup>43</sup> but today, ACS employees at the GS-6 level are authorized to file an NFTL without managerial approval.<sup>44</sup>

<sup>34</sup> ACS *Customer Service Activity Reports (CSAR), FY 2009 BOD report*. See also IRS response to TAS research request (Oct. 30, 2009). ACS systemic programming retrieves cases with expired follow-ups in R7 status (accounts with a 25-day follow-up where the system generated an LT39, *Reminder Notice*), determines whether the aggregate assessed balance is greater than \$5,000, and determines whether there are any modules without a lien. If all three of these criteria are met, the system generates a history code FM10 on the account. The input of the FM10 sends a message to the Automated Lien System to file an NFTL against the taxpayer. When conditions exist that would allow for manual lien filing, the systemic program can also generate a lien. E-mail from IRS subject matter expert (Nov. 2, 2009); IRS response (Nov. 19, 2009). See also IRM 5.19.5.3.7, *Reminder Notices* (Dec. 1, 2007); IRM 5.19.5.5.7, *R7 – Lien Determinations (Follow-Up to LT39)* (May 29, 2008).

<sup>35</sup> RRA 98, Title III, § 3421, Pub. L. No. 105-206, 112 Stat. 758 (1998).

<sup>36</sup> See, *e.g.*, IRM 5350, *Lien for Taxes* (Nov. 15, 1985).

<sup>37</sup> See S. Rep. No. 105-174, at 78 (1998). The provision will preclude the IRS from “abusively us[ing] its liens-and-seizure authority.” Unanimous Consent Request - H.R. 2676, 143 Cong. Rec. S12230-02, at S12231 (statement of Senator Roth).

<sup>38</sup> RRA 98, Title III, § 3421(b), Pub. L. No. 105-206, 112 Stat. 758 (1998).

<sup>39</sup> RRA 98, Title III, § 3421(a)(2), Pub. L. No. 105-206, 112 Stat. 758 (1998).

<sup>40</sup> H.R. Rep. No. 105-599, at 277 (1998) (Conf. Rep.).

<sup>41</sup> Memorandum from Assistant Commissioner (Collection) (July 30, 1998) (concluding section 3421 does not require supervisory review of all collection actions but allows the IRS discretion to determine where such review would be appropriate); Memorandum to Counsel to the National Taxpayer Advocate from Chief, Branch 1, General Litigation Division, Ref. No. GL-122444-98 (Dec. 23, 1998) (same). See also IRM 5.12.2.5 (Feb. 1, 2007); IRM 5.12.2.5.1 (Feb. 1, 2007); IRM 5.12.2.5.2 (Mar. 1, 2004).

<sup>42</sup> IRS, Collection Activity Report NO-5000-C23, *Collection Workload Indicators Reports* (Oct. 13, 2009).

<sup>43</sup> E-mail from former IRS Chief Compliance Officer to the National Taxpayer Advocate (Nov. 2, 2009) (on file with TAS).

<sup>44</sup> Delegation Order 5-4, IRM 1.2.44.4 (Sept. 23, 2005); IRM 5.19.4.5.1(7) (Apr. 28, 2009). All 3,157 ACS employees who had the delegated authority to file NFTLs were GS-6 or higher as of September 30, 2009. IRS response to TAS research request (Oct. 30, 2009).



By contrast, all ACS employees, regardless of grade level, are required to obtain managerial approval if they determine *not* to file a lien.<sup>45</sup> Any such decision must be supported by a case history entry clearly stating the reason why filing a lien will hamper collection or is not proper (*e.g.*, because of doubt as to liability).<sup>46</sup> Similarly, the IRS recently issued interim guidance requiring *all* ROs to obtain managerial approval to *defer* filing a lien for certain employment tax cases in which the unpaid balance is \$5,000 or more.<sup>47</sup> Thus, the IRS requires employees to take extra steps and offer additional justification to avoid filing a lien but does not require employees to verify whether the lien attaches to assets or undertake a review of the taxpayer's financial or personal circumstances to determine whether the lien will be productive.

In essence, IRS procedures have flipped Congress's explicit presumptions. Whereas Congress generally directed that IRS employees should obtain managerial approval when they intend to file an NFTL, the IRS now imposes more rigorous managerial approval requirements when an employee determines not to file an NFTL. The IRS should revise its managerial approval procedures to substantively comply with the intent of RRA 98.<sup>48</sup>

### *The IRS does not verify the existence of assets prior to filing an NFTL.*

As noted above, an NFTL protects the government's interests in a taxpayer's property against subsequent purchasers, secured creditors, and junior lien holders when past due taxes are owed.<sup>49</sup> However, the IRS generally does not verify the existence or the value of the taxpayer's property before filing an NFTL, nor does it determine whether the taxpayer is likely to acquire assets in the future. The IRS could easily ascertain whether taxpayers have assets before filing a lien. Most assets, such as real estate, business property, and motor vehicles are reflected on Accurint, a service provided by Lexis-Nexis, with which the IRS has an unlimited annually renewable contract.<sup>50</sup> Simply checking this database would not

<sup>45</sup> IRM 5.19.4.5.2 (10) (Apr. 26, 2006).

<sup>46</sup> *Id.*

<sup>47</sup> SB/SE, *Interim Guidance Memorandum*, Control No. SBSE-05-1208-069 (Dec. 22, 2008). The IRS issued this guidance in an attempt to implement a Government Accountability Office (GAO) recommendation to timely file NFTLs in federal employment tax cases based on an assumption that filing the NFTL will increase the likelihood of collection. See GAO, GAO-08-617, *Tax Compliance, Businesses Owe Billions in Federal Payroll Taxes 31* (July 2008). See also TAS analysis of collection yields compared to the number of liens filed in Chart 1.2.1, *Inflation Adjusted Collection Yield and NFTLs Filed, FY 1999 - FY 2009*, *supra*.

<sup>48</sup> Section 3421(a) of RRA 98, *Approval Process for Liens, Levies, and Seizures*, specifically states:

- (a) IN GENERAL-The Commissioner of Internal Revenue shall develop and implement procedures under which
  - (1) a determination by an employee to file a notice of lien or levy with respect to, or to levy or seize, any property or right to property would, where appropriate, be required to be reviewed by a supervisor of the employee before the action was taken, and
  - (2) appropriate disciplinary action would be taken against the employee or supervisor where the procedures under paragraph (1) were not followed.
- (b) REVIEW PROCESS-The review process under subsection (a)(1) may include a certification that the employee has-
  - (1) reviewed the taxpayer's information,
  - (2) verified that a balance is due, and
  - (3) affirmed that the action proposed to be taken is appropriate given the taxpayer's circumstances, considering the amount due and the value of the property or right to property.

<sup>49</sup> IRC §§ 6321 and 6323.

<sup>50</sup> See Accurint, <http://www accurint.com> (last visited Oct. 12, 2009).

only increase the effectiveness of liens without unnecessary damage to the taxpayer's credit but could also save on NFTL mailing expenses and court filing fees. Alternatively, the IRS should develop an algorithm to identify whether a taxpayer has assets by using internal sources, such as its own Information Returns Program (IRP) data, which provides verifiable payee/payer documentation.<sup>51</sup>

***IRS lien policy unnecessarily harms taxpayers who are currently unable to pay and does not generate increased collection revenue.***

If the taxpayer owes over \$5,000 and the account is reported as currently not collectible, the IRS will file an NFTL, in many cases systemically, without any determination about whether the taxpayer has or is likely to acquire any assets to which a lien could attach.<sup>52</sup> The IRM requires NFTL filing for CNC accounts both when the IRS cannot locate or contact the taxpayer and when the taxpayer is experiencing an economic hardship.<sup>53</sup> Even though in many cases an IRS employee may have talked to the taxpayer and evaluated his or her financial information or other evidence of financial difficulty (including a medical hardship) prior to reporting the taxpayer's account as CNC (*i.e.*, unable to pay), the IRS has replaced its employees' judgment and discretion with a business rule that requires NFTL filing.<sup>54</sup>

A TAS analysis of collection payment data from a subset of taxpayers in CNC (hardship) status also shows that only about five percent of all payment transactions and approximately 20 percent of the total dollars collected from these taxpayers are attributable to NFTLs, as shown in Chart 1.2.4 below.<sup>55</sup> At the same time, refund offsets — which do not require an NFTL — comprise about 59 percent of the total dollars collected and about half of all payment transactions for this taxpayer population.<sup>56</sup>

<sup>51</sup> IRM 2.3.35.1 (Aug. 1, 2003). The IRP allows IRS employees to request either online or hardcopy Information Returns Processing transcripts from the Information Returns Master File (IRMF), *e.g.*, from such information returns as Form 1098, *Mortgage Interest Statement* (demonstrating home ownership) or Form 1099-INT, *Interest Statement*, and its progeny (demonstrating assets).

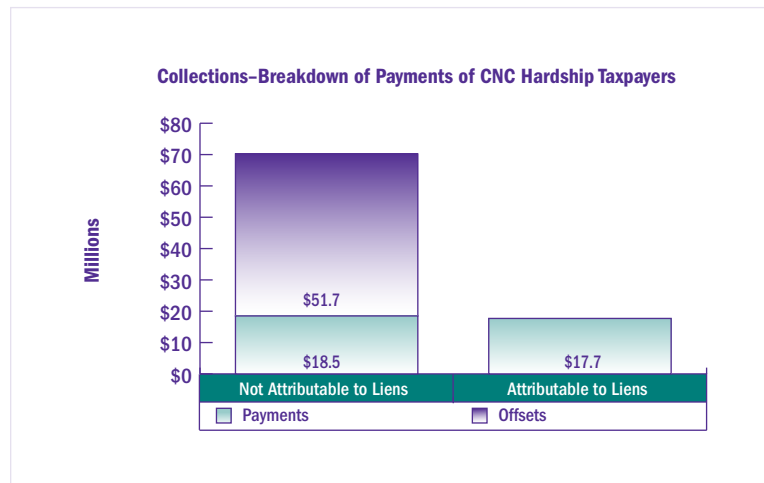
<sup>52</sup> IRM 5.12.2.4.1 (1) (May 20, 2005). IRS Policy Statement P-5-71 provides the IRS authority to report an account as currently not collectible for a variety of reasons (*e.g.*, unable to pay (hardship), unable to contact or locate, and death). This generally suspends collection actions but the liability is still due and owing; thus, penalties and interest continue to accrue until the statutory period of collection expires. "Economic hardship" occurs when an individual taxpayer is unable to pay reasonable basic living expenses. See Treas. Reg. § 301.6343-1(b)(4).

<sup>53</sup> IRM 5.19.4.5.2 (Aug. 4, 2009).

<sup>54</sup> Policy Statement P-5-71, IRM 1.2.14.1.14 (Nov. 19, 1980). See also IRM 5.16.1.1, *Currently Not Collectible Policy and Procedure Overview* (May 5, 2009); IRM 5.16.1.2.9, *Hardship* (May 5, 2009). The basis for a hardship determination is from information about the taxpayer's financial condition provided on Form 433-A, *Collection Information Statement for Wage Earners and Self-Employed Individuals*, or Form 433-B, *Collection Information Statement for Businesses*. See also IRM 5.15.1, *Financial Analysis Handbook* (Oct. 2, 2009).

<sup>55</sup> TAS pulled a subset of CNC Hardship taxpayers from the 270,399 individual taxpayers who first incurred new balance due delinquencies in TY 2002, had no previous unpaid tax liabilities at that time, and against whom NFTLs were filed in subsequent years (discussed above). This analysis is based on the subset of payments that were refund offsets or had specific DPC coding. It does not include those payments that were coded as "Miscellaneous" or had no DPC coding. IRS, CDW, IMF Transaction File Cycle 200913.

<sup>56</sup> Pursuant to IRC § 6402(a), the IRS may credit a taxpayer's overpayment to any federal tax liability prior to making a refund. This application of a tax overpayment is called a refund offset.

**CHART 1.2.4, Total Dollars Collected – Breakdown of Payments of CNC Hardship Individual Taxpayers<sup>57</sup>**

As noted above, automatic NFTL filing on CNC (hardship) taxpayers exacerbates their financial difficulties. Thus, the IRS should eliminate automatic NFTL filing in these cases, and instead require its employees to base filing determinations on a thorough review of the taxpayer's circumstances (including the existence and the value of assets, the taxpayer's financial information, and the effect of the lien on the taxpayer's credit rating).<sup>58</sup> This determination should be made after personal contact with the taxpayer and a substantive consideration of the facts, which may include consultation with a manager.<sup>59</sup> Moreover, this expectation should be applicable to all IRS contact employees, ACS and revenue officers alike. Human intervention, *i.e.*, the application of employee discretion and judgment prior to making a lien determination, is paramount.

IRS failure to fully utilize its statutory authority to withdraw NFTLs harms taxpayers and impairs collection of debts and future compliance.

The IRS may withdraw an NFTL if:

1. The NFTL was filed prematurely or otherwise not in accordance with IRS procedures;
2. The taxpayer entered into an installment agreement (IA) to satisfy the liability (unless the IA provides otherwise);

<sup>57</sup> TAS pulled a subset of CNC Hardship taxpayers from the 270,399 individual taxpayers who first incurred new balance due delinquencies in TY 2002, had no previous unpaid tax liabilities at that time, and against whom NFTLs were filed in subsequent years (discussed above). This analysis is based on the subset of payments that were refund offsets or had specific DPC coding. It does not include those payments that were coded as "Miscellaneous" or had no DPC coding. IRS, CDW, IMF Transaction File Cycle 200913.

<sup>58</sup> Low Income Taxpayer Clinics (LITCs) report they are dealing with an increasing number of taxpayers who have lost their jobs during the economic downturn and were placed in CNC status. However, the IRS has liens in place for these taxpayers, who want to work but are having difficulty finding employment due to the lien. American Bar Association Section of Taxation LTC listserv submission (Nov. 4, 2009).

<sup>59</sup> IRS Policy Statement 5-47 indicates that notices of lien will generally only be filed after the IRS contacts the taxpayer in person, by telephone, or by notice. IRM 1.2.14.1.13 (Oct. 9, 1996). A personal contact (in person or by telephone) is preferred but not required. IRM 5.12.2.3 (May 20, 2005). The National Taxpayer Advocate notes that the implementation of business rule-driven, systemic lien filing renders these policies meaningless.

3. The withdrawal would facilitate collection; or
4. The withdrawal is in the best interests of the taxpayer (as determined by the National Taxpayer Advocate) and the United States.<sup>60</sup>

However, the withdrawal of an NFTL will not affect the underlying FTL,<sup>61</sup> and thus provides the IRS a discretionary mechanism for withdrawing the notice of lien when release of the lien itself is not an option because the requirements for release have not been met.<sup>62</sup>

The withdrawal provisions of IRC § 6323(j) were enacted as part of the Taxpayer Bill of Rights 2 (TBOR 2) in 1996.<sup>63</sup> Until then, the IRS had no authority to withdraw NFTLs.<sup>64</sup> In proposing lien withdrawal authority, the House Committee Report noted that “[t]he bill allows the IRS to withdraw a public notice of tax lien prior to payment in full by the indebted taxpayer without prejudice, if the Secretary determines that” one of the four listed criteria is met.<sup>65</sup>

The difference between a “lien withdrawal” and a “lien release” is significant and is not well understood. When credit reporting agencies receive notice of a “withdrawal” of an NFTL, they delete any references to the tax lien from the taxpayer’s credit history.<sup>66</sup> In contrast, an NFTL that is “released” typically remains on the taxpayer’s credit report for seven years from the date of the release.<sup>67</sup> As a recent memorandum from the Office of Chief Counsel noted,

[E]ven though a taxpayer has fully paid the tax and a certificate of release has been filed, the fact that the NFTL was filed in the first place can adversely affect the taxpayer’s credit history for years after the tax is paid. In contrast, if the IRS files

<sup>60</sup> IRC § 6323(j); Treas. Reg. § 301.6323(j)(b)(5).

<sup>61</sup> Treas. Reg. § 301.6323(j)-1(a).

<sup>62</sup> IRC §§ 6323(j)(1); 6325(a). A lien can be released if the liability has been satisfied or become unenforceable or the taxpayer has posted a bond.

<sup>63</sup> TBOR 2, Pub. L. No. 104-168, Title V, § 501(a), 110 Stat. 1452 (1996).

<sup>64</sup> H.R. Rep. No. 104-506, 32-33 (1996), reprinted in 1996 USCCAN 1143, 1155-1156.

<sup>65</sup> *Id.* While the legislative history of TBOR 2 does not specifically explain lien withdrawal criteria, a number of congressional hearings preceding TBOR 1 (which initially contained the same lien withdrawal provision) suggest that Congress intended lien withdrawal to be a collection alternative for taxpayers experiencing economic hardship. *Taxpayer Bill of Rights, Hearing Before the Subcomm. on Private Retirement Plans and Oversight of the Internal Revenue Service of the S. Comm. on Finance*, 100th Cong., 1st Sess. (Apr. 10 and 21, 1987)(statement of Jack Warren Wade, National Taxpayers Union). See also statement of Senator Carl Levin (June 22, 1987); *Report on Internal Revenue Service Collection Practices, Impact on Small Businesses, Subcomm. on Oversight of Government Management of the S. Comm. on Governmental Affairs*, 96th Cong., 2d Sess. (Oct. 9, 1980).

<sup>66</sup> TAS teleconferences with the major consumer reporting agencies (CRAs) – Experian (Oct. 1, 2009), Equifax (Sept. 1, 2009), and Transunion (Sept. 3, 2009). IRC § 6323(j)(1) provides “this chapter [chapter 64 of subtitle F, relating to collection] shall be applied as if the withdrawn notice had not been filed.” See also Treas. Reg. § 301.6323(j)-1(a). The IRS should promptly notify credit reporting agencies and financial institutions or creditors identified by the taxpayer of the withdrawal of the notice upon a written request. IRC § 6323(j)(2).

<sup>67</sup> FCRA § 605(3), 15 USC § 1681c(a)(3). The FCRA regulates consumer reporting agencies and provides limitations to the age of particular types of credit information that may be reported. Paid (and therefore released) tax liens are reported for seven years from the date of payment. See also Phillip C. Hong-Barco, *How the Fair Credit Reporting Act Fails to Protect: The Case of IRS Tax Liens on Consumer Credit Reports*, 3 Pitt. Tax. Rev. 181, 191-193 (Spring 2006).

a withdrawal of the NFTL, from a credit rating standpoint it is as if the NFTL was never filed.<sup>68</sup>

In the last several years, the National Taxpayer Advocate has observed a resistance on the part of IRS Collection personnel to withdrawing NFTLs, notwithstanding Congress' express grant of such discretionary authority. She has had conversations with executives at the highest levels of IRS Collection leadership who have indicated a belief that NFTL withdrawal should occur only "where the IRS has made a mistake," that NFTL withdrawal is "an admission of guilt," and that training Collection employees about circumstances under which NFTL withdrawal would be appropriate "will confuse Collection employees and result in [their] not filing liens." Moreover, the IRS has developed an NFTL withdrawal policy that does not allow a taxpayer to obtain a withdrawal after a lien release, and this policy may harm taxpayers. The concept that the IRS could not withdraw an NFTL after filing a release was first introduced in the IRM in 2003, although that provision still specifically authorized withdrawals "if one or more of the four withdrawal provisions is met."<sup>69</sup> Subsequent revisions of the IRM preclude the withdrawal of the NFTL after lien release, even when criteria for lien withdrawal are met.<sup>70</sup> In FY 2009, the National Taxpayer Advocate and Local Taxpayer Advocates (LTAs) issued eight Taxpayer Assistance Orders (TAOs) regarding IRS lien filing policies, five of which specifically ordered the IRS to withdraw NFTLs.<sup>71</sup> The IRS responses to these TAOs demonstrate a lack of understanding of the statutory authority for NFTL withdrawals contemplated by Congress in TBOR 2.<sup>72</sup>

At the request of the National Taxpayer Advocate, the IRS Office of Chief Counsel has recently reevaluated its legal position and now concludes "that as a legal matter, the IRS may file a certificate of withdrawal after a lien release."<sup>73</sup> Since the IRS can only withdraw an NFTL if one of the four criteria in IRC § 6323(j) is met, the taxpayer must persuade the IRS that withdrawal is both in the taxpayer's and the government's best interests. Given the long-term effects of the NFTL release on the taxpayer's credit report – the likelihood that the taxpayer could face higher interest rates, denial of credit or employment, or even job loss – it will often facilitate tax compliance and be in the government's best interests to withdraw an NFTL post-release. Indeed, it will be a rare instance in which post-release NFTL withdrawal would *not* be in the government's best interests. Thus, the IRS should issue interim guidance which allows, upon the request of a taxpayer, for the IRS to withdraw

<sup>68</sup> Memorandum from Branch 3 (Procedure and Administration) to Special Counsel (National Taxpayer Advocate), Ref. No. POSTN-133674-09 (Oct. 8, 2009). TAS teleconferences with the major CRAs – Experian (Oct. 1, 2009), Equifax (Sept. 1, 2009), and Transunion (Sept. 3, 2009).

<sup>69</sup> IRM 5.12.3.26.1 (2) (July 15, 2003).

<sup>70</sup> IRM 5.12.3.26.1(2) and (3) (July 15, 2003). In a 2006 revision of the IRM, the IRS revised its NFTL withdrawal procedures to specifically reject requests for the withdrawal of the NFTL after lien release, even when criteria for lien withdrawal are met. IRM 5.12.3.37 (1) (Sept. 7, 2006).

<sup>71</sup> In FY 2009, the National Taxpayer Advocate and Local Taxpayer Advocates (LTAs) issued a total of 45 Taxpayer Assistance Orders (TAOs).

<sup>72</sup> In one recent case, the TAO was returned to the LTA for reconsideration because the manager believed that to withdraw an NFTL, the taxpayer had to meet all four of the provisions under IRC § 6323(j) instead of meeting only one. The taxpayer signed a written consent allowing TAS to release this tax return information.

<sup>73</sup> Memorandum from Branch 3 (Procedure and Administration) to Special Counsel (National Taxpayer Advocate), Ref. No. POSTN-133674-09 (Oct. 8, 2009).

an NFTL where one of the statutory criteria is satisfied, even if the underlying lien has been released.<sup>74</sup>

The IRS should also include the potential for NFTL withdrawal as part of the collection analysis for a taxpayer. If the taxpayer cannot find a good job, or his or her credit is destroyed, that taxpayer may never return to compliance. We also recommend that SB/SE and the Wage and Investment (W&I) division partner with TAS to develop guidance and conduct training for IRS Collection personnel in both the Collection Field function and the ACS about lien withdrawals.<sup>75</sup>

## CONCLUSION

The IRS measures the number of liens filed each year but does not measure whether public filing of liens makes a difference in a taxpayer's compliance behavior over time. By measuring and reporting on the number of liens filed and by not measuring or reporting on their long-term compliance effect, the IRS overstates the effectiveness of liens and sends a message to its employees that the quantity, not the quality, of liens is what matters.

The National Taxpayer Advocate offers these preliminary recommendations:

1. Immediately implement quality review of Designated Payment Codes.
2. Adopt two long-term effectiveness measures to ensure that employees file appropriate and productive NFTLs. First, the IRS should measure the total and average revenue (dollars collected) attributable to NFTL filings. Second, it should measure the long-term impact of the NFTL on the taxpayer's compliance behavior.<sup>76</sup>
3. Abandon the policy of automatic NFTL filing on CNC hardship accounts with an unpaid balance of \$5,000 or more.
4. Implement the provisions of RRA 98 § 3421 by basing lien filing determinations for all IRS contact employees on a thorough review of all the taxpayer's circumstances (including the existence and the value of assets, the taxpayer's financial information, and the ramifications of the lien on the taxpayer's credit rating), after an in-person or telephone interview with the taxpayer and substantive consideration of the facts, which may include consultation with a manager.
5. Require managerial approval for NFTL filings in all cases where the taxpayer has no assets, regardless of the employee's grade level.

<sup>74</sup> See *Legislative Recommendation: Strengthen Taxpayer Protections in the Filing and Reporting of Federal Tax Liens, infra*.

<sup>75</sup> TAS has already developed a training video on taxpayer rights and collection with five case studies, including one on lien withdrawal. We have offered to distribute this video to Revenue Officer groups throughout the IRS and to assist in facilitating the training sessions. TAS training video, *Taxpayer Rights: Collection Case Studies*.

<sup>76</sup> See Nina E. Olson, *Minding the Gap: A Ten-Step Program for Better Tax Compliance*, 20 *Stan. L. & Pol'y Rev.* 7, 23 (2009).

6. Revise the IRM to allow, upon the request of a taxpayer, the withdrawal of an NFTL where the statutory withdrawal criteria are satisfied, even if the underlying lien has been released.
7. Conduct annual training for collection employees and managers in exercising judgment and discretion before and after NFTL filing, and include the TAS training video, *Taxpayer Rights: Collection Case Studies*, as part of the training.

### IRS COMMENTS

As the National Taxpayer Advocate has acknowledged, the NFTL can be an effective tool in tax collection. The purpose of the NFTL is to protect the government's priority over other creditors. In filing an NFTL, the IRS is perfecting an existing lien interest, relative to other creditors, for unpaid federal tax liabilities. Establishing and preserving our priority over other creditors is especially critical when a taxpayer's liabilities exceed their assets and not all debts can be satisfied.

The presence of an NFTL when a taxpayer files bankruptcy can significantly impact the amount of revenue the government receives in a bankruptcy proceeding. The presence of an NFTL gives the IRS a secured claim and a greater potential to collect on its proof of claim. This improves the government's position in competing with other creditors for payment from limited income and assets.

The National Taxpayer Advocate conducted an internal research study on the effectiveness of the NFTL. The IRS believes the methodology used to conduct this study limits the ability to draw meaningful conclusions.<sup>77</sup> The National Taxpayer Advocate's methodology examined trends in lien filing and dollars collected without regard to other variables that may occur over the life of the study. Changes to economic conditions, the inventory mix, and collection business practices and structure all can influence dollars collected. Further, the National Taxpayer Advocate assesses the value of the NFTL based only on those transactions that can be identified by a DPC.<sup>78</sup> To credit the influence of the NFTL only to those payments with transactions specifically made to acquire a release, discharge, withdrawal, or subordination of the lien does not provide a complete picture of the impact of the NFTL. In the sample used by the National Taxpayer Advocate, 56 percent of the transactions received were excluded due to lack of a DPC; this exclusion can have a significant impact on the results and the related analysis. Taxpayer actions such as making installment payments, filing an offer in compromise, or paying the liability in full may be motivated by the anticipation of the filing of or an already filed NFTL. Given the above limitations, the National Taxpayer Advocate study on the effectiveness of the NFTL provides a very

<sup>77</sup> TAS reviewed 2,065,303 transactions from 270,399 individual taxpayers. For a more detailed discussion, see *The IRS's Use of Notices of Federal Tax Lien (NFTL)*, vol. 2, *infra*.

<sup>78</sup> See IRM 5.1.2.8.1 (Aug. 15, 2008). These two-digit numeric codes are called Designated Payment Codes. The DPCs are used to help identify payments, indicate application of payment to a specific liability, and identify the event that resulted in a payment.



conservative estimate for the amount collected as a result of some very specific lien related transactions.

The IRS has conducted and is conducting several research efforts on the impact and effectiveness of tax liens. Our research efforts attempt to control for variables and include all transactions. While not conclusive, the results illustrate the efficacy of liens in various circumstances. Since 2002, IRS Research has completed four independent, statistically valid studies on this topic.<sup>79</sup>

In 2006, Research found that filing a lien on systemically shelved cases had little effect *unless the balance was over \$5,000*. This is one of the same criteria used by IRS Collection in mandatory consideration of lien filing. The study found that:

**“Based on the results from the regression model: for cases with balances between \$5,000 and \$25,000 and having a lien filed, the balance due one year after the lien was filed would be, on average, 28 percent lower than if no lien was filed.”** (Emphasis in original.)<sup>80</sup>

In another study completed in 2002, Research determined that a ten percent increase in lien filing would result in an increase in collections of \$3.99 billion. Research also found that “Liens should generally be filed even when assets have not been identified.”<sup>81</sup>

The IRS maintains, as supported by the 2002 Research study, filing an NFTL, even in situations when assets have not been identified, is a prudent case decision because the NFTL attaches to a taxpayer’s right, title, and interest in current and future property. Thus, even though an account may be placed in currently not collectible status without any current assets from which to collect the tax liability, there remains solid evidence that filing the NFTL is the most responsible and appropriate action the IRS can take in its effort to ensure sound tax administration. There are multiple situations in which the IRS may designate a taxpayer’s account currently not collectible, including an inability to make payments based on current income and expenses; or the IRS’s inability to locate or contact the taxpayer. However, a taxpayer’s situation can, and often does, change. A filed NFTL provides the government a claim in any future income or assets that would allow for payment of the outstanding tax liability. When a lien is filed in these situations, the taxpayer may contact the IRS to resolve the liability when trying to sell or liquidate the asset—an asset that the IRS may not have known about or was acquired after the filing of the lien.

<sup>79</sup> SB/SE Research – St. Paul, Project 13.14, *Estimating the Impact of Federal Tax Lien Filing on Accounts Receivable Resolution* (Dec. 2002) (hereinafter 2002 study); SB/SE Research – St. Paul, Project STP0001, *Impact of the Federal Tax Lien on Cases Shelved by the Currently Not Collectible Filter* (June 2006) (hereinafter 2006 study); SB/SE Research – St. Paul, Project STP0007, *Optimizing the Revenue Collection Impact of Lien Refiling* (Mar. 2007) (hereinafter 2007 study); Turk, Alex and Terry Ashley, 2002, “Accounts Receivable Resolution and The Impact of Lien Filing Policy on Sole Proprietor Businesses,” *Federal Forecasters Conference 2002 – Papers and Proceedings*, 323-332; SB/SE Research – Denver, Project DEN0113.

<sup>80</sup> SB/SE Research – St. Paul, 2006 study.

<sup>81</sup> SB/SE Research – St. Paul, 2002 study.

The IRS does not report tax debts or the filing of NFTLs to credit reporting agencies. Those agencies receive notification of public lien filing through third party vendors and report that information on consumer credit reports. IRS decisions regarding the filing, release, and withdrawal of liens must be based on the need to protect the priority of the government and to secure payment.

The IRS recognizes the need to ensure liens are filed based on the most accurate information known at the time of filing. The amount owed and all other pertinent information available at the time are considered as part of the determination to file an NFTL. Additionally, in those situations when it is appropriate, managerial approval is required prior to filing a lien. In the Restructuring and Reform Act of 1998 (RRA 98), Congress directed the IRS to develop and implement procedures for supervisory review and approval, where appropriate, of liens, levies, and seizures. The Conference Agreement from RRA 98 § 3421 states as follows:

“The conference agreement follows the Senate amendment. The conferees *intend that the Commissioner have discretion* in promulgating the procedures required by this provision to determine the circumstances under which supervisory review of liens or levies issued by the automated collection system is or is not appropriate.”  
(Emphasis added.)<sup>82</sup>

In accordance with § 3421, the IRS has used discretion to ensure that authorities are based on the training and experience of the employee and the type of case at issue; not the pay grade of the employee. For example, grade 6 employees in ACS have completed their initial training and have attained the full working level of their position. At the grade 7 level, revenue officers are still in training status and require oversight from a coach or manager. The cases worked in these two different work streams differ in complexity and risk, which drives whether managerial oversight of certain decisions, including lien filing determinations, is required.

The IRS has a responsibility to review each application for lien withdrawal and, using discretion, weigh appropriate tax administration considerations in determining whether or not to withdraw a filed NFTL. Section 6323(j) authorizes withdrawal when one of four conditions is met; however, the decision to withdraw an NFTL is discretionary. The IRS will consult with the Office of Chief Counsel and revise the IRM to provide guidance on when withdrawal of an NFTL is appropriate in cases in which the lien has already been released.

The National Taxpayer Advocate makes seven preliminary recommendations. In response, the IRS has taken, or is taking, the following actions with respect to these recommendations:

<sup>82</sup> IRS Restructuring and Reform Act of 1998, Pub. L. 105-206, Conf. Report, H.R. 2676, 105th Congress 2d Sess. 278.

The IRS recognizes the need to ensure the consistent and appropriate use of Designated Payment Codes by employees. We will review our guidance in this context for clarity to ensure employees understand the need to properly code payments received.

The IRS has initiated several research studies to determine the effectiveness of lien filing. We will continue to utilize the findings from these and future studies when considering IRM and policy changes to ensure employees are filing appropriate and productive NFTLs.

The IRS does not have an automatic NFTL filing policy on CNC hardship accounts. A lien determination is required when closing an account CNC hardship with an unpaid balance of \$5,000 or more. As part of the lien determination, an employee may decide that a lien should not be filed due to individual taxpayer circumstances.<sup>83</sup>

The IRS believes we provide adequate guidance and training to our employees to allow them to make appropriate lien determinations.<sup>84</sup> Employees are expected to ensure liens are filed based on the most accurate information known at the time of filing. The amount owed and all other pertinent information available at the time are considered as part of the determination to file an NFTL.

Given that the NFTL attaches to a taxpayer's right, title, and interest in current and future property, we do not believe it is appropriate to require managerial approval for NFTL filings on all cases where the taxpayer has no current assets.

A taxpayer's situation can, and often does, change and a filed NFTL provides the government a claim in any future income or assets that would allow for payment of the outstanding tax liability.

The IRS will consult with the Office of Chief Counsel on their interpretation of IRC § 6323(j) and, consistent with their advice, revise the IRM to provide guidance on when withdrawal of an NFTL is appropriate in cases in which the lien has already been released.

The IRS believes current training efforts and updates are sufficient to convey IRS policy with regard to lien determinations.<sup>85</sup> The collection function frequently revisits this topic in Continuing Professional Education sessions.

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<sup>83</sup> See IRM 5.12.2.4, *Notice of Federal Tax Lien Determination* (Oct. 30, 2009); IRM 5.19.4.5.2, *Lien Filing Determinations* (Apr. 28, 2009).

<sup>84</sup> *Id.*

<sup>85</sup> ROs receive training on lien filing determinations as part of revenue officer Unit 1 training - Course 15829; ACS employees receive training on lien filing determinations in ACS Basic Training - Liens Course 18753.

## Taxpayer Advocate Service Comments

The National Taxpayer Advocate agrees that the notice of federal tax lien can be an effective tool in tax collection, when used appropriately. Congress conveyed federal tax lien powers onto the IRS to protect the government's interest in the taxpayer's property and afford it priority status over other creditors. In a recent collection training video, the IRS Collection function director recognizes that "no other country appears to have a tool similar to the Notice of Federal Tax Lien. In other countries, tax administration agencies have to initiate some type of lengthy litigation in order to document the debt."<sup>86</sup> However, with great powers comes great responsibility. The NFTL filing and the information contained on the notice are available on consumer (credit) reports<sup>87</sup> and therefore may impair a taxpayer's ability to obtain financing, find or keep a job, and secure affordable housing or insurance. When a taxpayer has little or no ability to pay and has no assets from which to collect, an NFTL filing may significantly impede the taxpayer's financial viability and ultimately undermine long-term tax revenue and future compliance.

In addition, the government has a secondary interest at stake. If the NFTL damages the taxpayer and the taxpayer's family by driving up the taxpayer's costs or rendering him or her unemployed or underemployed, the government may be forced to provide a social safety net in the form of unemployment benefits, food stamps, and the like, thus increasing societal cost and raising everyone's share of taxes. For these reasons, the IRS should only employ this powerful tool after attempting to contact the taxpayer personally and considering *all* of the taxpayer's specific facts and circumstances. This analysis should include the existence and the value of and equity in assets, the taxpayer's financial information including other debts, and the ramifications of the lien on the taxpayer's credit rating, including the taxpayer's ability to comply with current and future tax obligations.

The National Taxpayer Advocate is disappointed by the IRS's insistence that filing an NFTL is a necessity on all cases and that this act will increase compliance and yield more revenue. This is troubling because the IRS's own data suggest otherwise. Although the IRS proudly boasts that in one of its 2002 research studies "a ten percent increase in lien filing would result in an increase in collections of \$3.99 billion," the actual numbers tell a much different story. As we stated earlier, over the past decade, the IRS has increased its lien filings by nearly 475 percent – from about 168,000 in FY 1999 to nearly 966,000 in FY 2009.<sup>88</sup> Yet

<sup>86</sup> David Alito, Director, Collection, SB/SE, Training Video, *Focusing on the Basics*, <http://sbse.web.irs.gov/cl2/sl/ivt/cksk/Collection/0358/default.htm> (last visited Dec. 16, 2009)(referring to Australia, Canada, New Zealand, and Great Britain).

<sup>87</sup> The term "consumer report" is defined in the FCRA, § 603(d), 15 USC § 1681a(d). Hereinafter, we will use the more commonly used term "credit report." On average, the filing of an NFTL reduces a taxpayer's credit score by 100 points. Written response from Vantage Score® (Sept. 17, 2009). The impact of the NFTL filing is greatest upon the initial filing and diminishes over time.

<sup>88</sup> IRS, *SOI Data Books, Table 16, Delinquent Collection Activities, 1999-2008*; IRS, Collection Activity Report NO-5000-C23, *Collection Workload Indicators Reports* (Oct. 13, 2009). In FY 2009, the IRS filed 965,618 NFTLs.

overall inflation-adjusted Collection revenue has declined by approximately 7.4 percent during this period.<sup>89</sup>

The IRS 2006 lien study covered only about 8,000 CNC “shelved” cases out of over a half million Forms 1040 reported as CNC by the IRS in 2003.<sup>90</sup> While the study report suggests that filing liens on CNC cases in the \$5,000 to \$25,000 balance due range could be beneficial, particularly if the threshold for shelving cases is lowered, the average difference in payment amounts between those study cases with and without a lien was only \$130. Moreover, the study considered all payments to a tax module even though some payments may have been offsets of a taxpayer’s subsequent refund and in no way attributable to the lien. In addition, the National Taxpayer Advocate is concerned that the study does not analyze lien filings on many other types of cases. Clearly, the lien study recommendations cited by the IRS missed the mark.<sup>91</sup>

Moreover, the IRS has failed to acknowledge these inaccuracies and instead continues to rest its lien filing policies and procedures on similarly misguided or outdated data.<sup>92</sup> The initial models in the studies show that NFTLs actually decrease resolution.<sup>93</sup> The studies attribute this decline to a substantial variation in the way IRS uses NFTLs. Further the models account for this variation and show that NFTLs increase resolution (in certain scenarios) as they expected. *On the contrary, TAS’s study made no assumptions on the effect of NFTLs on resolution and just observed the data that show that NFTLs could not be proven to be effective in our study population.*

TAS’s analysis indicated that in approximately 52 percent of all payment transactions, the IRS coded the payments as “Miscellaneous” or did not code them at all.<sup>94</sup> The remaining 48.4 percent had meaningful DPCs or could be identified as refund offsets.<sup>95</sup> Although the IRS is correct in stating that a portion of the “Miscellaneous” or uncoded payments may

<sup>89</sup> IRS, *SOI Data Books, Table 16, Delinquent Collection Activities, 1999-2008*. SB/SE response to TAS research request (Nov. 13, 2009). The SOI data is not available for FY 2009. For a more detailed discussion of IRS Collection data, see *Preface: Introductory Comments of the National Taxpayer Advocate, supra*.

<sup>90</sup> In 2003, IRS Collection function implemented computer filters that classified certain cases as being in CNC status. Cases selected by the filters are placed in the shelved status and are not worked.

<sup>91</sup> SB/SE Research – St. Paul, 2002 study; SB/SE Research – St. Paul, 2006 study; SB/SE Research – St. Paul, 2007 study.

<sup>92</sup> For example, the 2002 study is based on 1999 data.

<sup>93</sup> For example, the 2002 study states: “[o]ne should keep in mind that, since other factors are not being controlled, we cannot conclude that any difference is because of the lien.” SB/SE Research – St. Paul, 2002 study, 12. We note that this is the very same “flaw” that the IRS uses to criticize the 2009 TAS research study discussed herein.

<sup>94</sup> IRS, CDW, IMF Transaction File Cycle 200913. Of the 1,886,683 total payment transactions, only 629,158 transactions had the DPC code assigned. 1,257,525 transactions were designated “miscellaneous” or “DPC indicator not present.” Of the 1,257,525 transactions, 283,091 had a refund offset transaction code, leaving 974,434 payments (or 51.6 percent) as unaccountable. Thus, 912,249 payments (or 48.4 percent) had meaningful DPCs or could be identified as refund offsets. See also Chart 1.2.2, *Dollars Collected Attributable to Liens Filed Against TY 2002 Individual Taxpayer Liability and Subsequent Payments from CY 2002 to CY 2009, supra*. The IRS does not conduct a quality review of the payment information by DPC. IRS response to TAS research request (Oct. 6, 2009).

<sup>95</sup> TAS reviewed 1,886,683 transactions from 270,399 individual taxpayers. For a more detailed discussion and description of this lien analysis and methodology, including payment allocation, see *The IRS’s Use of Notices of Federal Tax Lien (NFTL)*, vol. 2, *infra*. It should be noted that we reconstructed the 48.4 percent total so that it included offsets. In 51.6 percent of the transactions, neither TAS nor the IRS can identify the source of payment.

have been associated with an NFTL filing, in the absence of mechanisms to account for the source of payment neither TAS nor the IRS can speculate to what extent such payments are attributable to NFTL filings. We partially agree with the IRS's assertion that TAS findings provide a conservative estimate for the amount collected as a result of lien-related transactions. However, the conservatism in our analysis works both ways – *i.e.*, it is just as if not more likely that our findings also significantly understate the amount collected as a result of actions *other than* lien-related transactions. ***Moreover, the conservatism in our analysis is solely attributable to the IRS's failure to accurately and properly code payment transactions. Therefore, we believe that our approach provides the most accurate results.*** In addition, the IRS largely overstates the impact of an NFTL in bankruptcy proceedings on the amount of revenue the IRS receives. FY 2008 data clearly show that the IRS collected more on unsecured priority claims than on secured claims in bankruptcy proceedings.<sup>96</sup>

In its response, the IRS also suggests the decline in dollars collected could be attributable to “changes in economic conditions, the inventory mix, and collection business practices and structure.” However, the IRS has not initiated a new study of a statistically valid sample of taxpayers to determine the extent to which the recession may have contributed to the decline in dollars collected, and more importantly, how NFTL filing may affect the taxpayer's ability to pay the tax liability and his or her future tax compliance. Nor has the IRS committed to immediately implement a quality review of Designated Payment Codes as recommended by the National Taxpayer Advocate. The National Taxpayer Advocate insists that the IRS implement quality review of employees' consistent and proper use of DPCs. She also strongly believes that the IRS should conduct a full scale, statistically valid study of NFTL effectiveness, including the total and average revenue (dollars collected) attributable to NFTL filings as well as other sources, and the long-term impact of the NFTL on the taxpayer's compliance behavior.<sup>97</sup> When conducting studies about taxpayer compliance and the effectiveness of liens, the IRS should partner with TAS research function in the design of the studies to ensure that they are framed appropriately to consider the impact on taxpayers' economic viability and long-term tax compliance, not just short-term gains or justifications of current practices.

The National Taxpayer Advocate rejects the IRS's rationale for current lien filing procedures that ensure an NFTL will be filed on most CNC accounts with an unpaid balance of assessment of \$5,000 or more.<sup>98</sup> The National Taxpayer Advocate disagrees that “filing the NFTL [in cases reported as CNC] is the most responsible and appropriate action the IRS can take in its effort to ensure sound tax administration.” Sound tax administration requires making a careful, case-by-case analysis of a taxpayer's specific facts and circumstances.

<sup>96</sup> IRS, Collection Activity Report NO-5000-31, *IMF Report of Bankruptcies* (Sept. 30, 2008). In FY 2008, the total collection for all chapters showed \$181,328,355 collected from unsecured priority claims and \$57,858,628 collected from secured claims.

<sup>97</sup> This study should also analyze the impact of lien filing on individual taxpayers and small businesses by income levels, since there is some evidence that the NFTL is particularly damaging to low income taxpayers and small businesses that already have limited access to credit.

<sup>98</sup> IRM 5.12.2.4.1 (Oct. 30, 2009). In general, the IRM requires NFTL filing when “an open account with an aggregate UBA [Unpaid Balance of Assessment] of \$5,000 or more is being reported as currently not collectible.”

It does not mean an arbitrary, automatic decision, per the IRM, to file an NFTL without consideration of the existence of assets and the likelihood that the taxpayer will acquire assets during the remaining statute of limitations period.

Emphasizing the IRS's discretion in promulgating the language in RRA 98 § 3421, the IRS fails to address the reasons why Congress enacted this provision in the first place. Congress recognized that federal tax liens may impose a serious hardship on taxpayers and wanted to provide an extra layer of protection for these taxpayers.<sup>99</sup> The Senate Report (where this provision was initially introduced) specifically stated:

*“The Committee believes that the imposition of liens, levies, and seizures may impose significant hardships on taxpayers. Accordingly, the Committee believes that extra protection in the form of an administrative approval process is appropriate.”* (Emphasis added).<sup>100</sup>

RRA 98 § 3421 introduced an administrative approval process that requires a supervisor to verify that the filing of a lien was appropriate, considering the amount due and the value of the taxpayer's assets. However, the IRS has interpreted this provision as not requiring managerial review of all liens prior to filing in most cases. Further, the current lien filing policies negate the usefulness of any managerial review because the only verification the IRS does before filing a lien is to verify that the amount due is correct.<sup>101</sup>

The National Taxpayer Advocate strongly believes that the IRS should implement meaningful managerial review of lien filing determinations. The determination process should follow the letter and the spirit of law and include a serious effort to make an in-person or telephone interview with the taxpayer, and a substantive consideration of all facts and circumstances, including the existence and the value of assets, the taxpayer's financial information, and the ramifications of the lien on the taxpayer's credit rating and its long-term impact on taxpayer compliance. This process may include a consultation with a manager, “where appropriate.” Additionally, since Congress specifically envisioned the managerial review to include the consideration of “value of the property or right to property,”<sup>102</sup> the IRS should require managerial approval for NFTL filings in all cases where the taxpayer has no assets, regardless of the employee's grade level.

The National Taxpayer Advocate is pleased with the IRS's plans to consult with the IRS Office of Chief Counsel on the interpretation of IRC § 6323(j) with respect to withdrawal

<sup>99</sup> RRA 98, Title III, § 3421, Pub. L. No. 105-206, 112 Stat. 758 (1998). See S. Rep. No. 105-174, 78 (1998). The provision will preclude the IRS from “abusively us[ing] its liens-and-seizure authority.” Unanimous Consent Request - H.R. 2676, 143 Cong. Rec. S12230-02, S12231 (statement of Senator Roth).

<sup>100</sup> See S. Rep. No. 105-174, at 78 (1998).

<sup>101</sup> IRM 5.19.4.6.4(1) (Oct. 26, 2007); IRM 5.19.4.5.2 (Apr. 26, 2006); IRM 5.19.4.5.1(7) & (8) (Dec. 22, 2005); IRM 5.19.5.5.7 (3) (May 29, 2009). For example, when the account is in CNC status, the lien should be filed for any unpaid balance of \$5,000 or more and the IRS is unable to locate or contact the taxpayer, or the taxpayer is experiencing an economic hardship. IRM 5.12.2.4.1(1) (May 20, 2005); IRM 5.19.4.5.2 (Aug. 4, 2009).

<sup>102</sup> RRA 98, Title III, § 3421, Pub. L. No. 105-206, 112 Stat. 758 (1998).



of NFTLs. However, given the significant financial hardship that NFTLs may impose on affected taxpayers, and the recent Chief Counsel conclusion “that as a legal matter, the IRS may file a certificate of withdrawal after a lien release,”<sup>103</sup> the IRS should immediately issue interim guidance to its employees regarding NFTL withdrawals after releases. Moreover, the IRS should work with the National Taxpayer Advocate, in addition to Chief Counsel, with respect to this guidance, in order to ensure that the taxpayer’s perspective is considered.

Finally, the National Taxpayer Advocate disagrees that current training efforts and updates are sufficient to convey IRS lien determination policy to all employees involved in NFTL filing. As stated above, the IRS responses to NFTL-related TAOs demonstrate IRS employees’ lack of understanding of statutory authority.<sup>104</sup> It is also surprising that the IRS rejects TAS’s offer of assistance in training Collection employees. The National Taxpayer Advocate believes these employees will benefit from the TAS training video, *Taxpayer Rights: Collection Case Studies*, which illustrates the NFTL process from a taxpayer’s perspective.

## Recommendations

The National Taxpayer Advocate recommends that the IRS take the following specific actions:

1. Immediately implement a quality review of Designated Payment Codes.
2. Adopt two long-term effectiveness measures to ensure that employees file appropriate and productive NFTLs.
  - a. First, the IRS should measure the total and average revenue (dollars collected) attributable to NFTL filings.
  - b. Second, it should measure the long-term impact of the NFTL on the taxpayer’s compliance behavior.<sup>105</sup>
3. Abandon the policy of automatic NFTL filing on CNC hardship accounts with an unpaid balance of \$5,000 or more.
4. Implement the provisions of RRA 98 § 3421 by basing lien filing determinations for all IRS contact employees on a thorough review of all the taxpayer’s circumstances (including the existence and the value of assets, the taxpayer’s financial information, and the ramifications of the lien on the taxpayer’s credit rating), after an in-person

<sup>103</sup> Memorandum from Branch 3 (Procedure and Administration) to Special Counsel (National Taxpayer Advocate), Ref. No. POSTN-133674-09 (Oct. 8, 2009).

<sup>104</sup> For example, in one recent case, the TAO was returned to the LTA for reconsideration because the manager believed that to withdraw an NFTL, the taxpayer had to meet all four of the provisions under IRC § 6323(j) instead of meeting only one. The taxpayer signed a written consent allowing TAS to release this tax return information.

<sup>105</sup> See Nina E. Olson, *Minding the Gap: A Ten-Step Program for Better Tax Compliance*, 20 Stan. L. & Pol’y Rev. 7, 23 (2009).

or telephone interview with the taxpayer and substantive consideration of the facts, which may include consultation with a manager.

5. Require managerial approval for NFTL filings in all cases where the taxpayer has no assets, regardless of the employee's grade level.
6. Immediately issue interim guidance to allow, upon the request of a taxpayer, the withdrawal of an NFTL where the statutory withdrawal criteria are satisfied, even if the underlying lien has been released. After consulting with the IRS Office of Chief Counsel on the interpretation of IRC § 6323(j) and, consistent with the counsel advice, revise the IRM to provide guidance on when withdrawal of an NFTL is appropriate in cases in which the lien has already been released.
7. Conduct annual training for collection employees and managers in exercising judgment and discretion before and after NFTL filing, and include the TAS training video, *Taxpayer Rights: Collection Case Studies*, as part of the training.