

**MSP  
#22****MANAGERIAL APPROVAL FOR LIENS: The IRS's Administrative Approval Process for Notices of Federal Tax Lien Circumvents Key Taxpayer Protections in RRA 98****RESPONSIBLE OFFICIALS**

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**DEFINITION OF PROBLEM**

One of the IRS's most significant powers is its authority to file a Notice of Federal Tax Lien (NFTL) in the public records when a taxpayer owes past due taxes. The NFTL protects the government's interests in a taxpayer's property against subsequent purchasers, secured creditors, and junior lien holders.<sup>1</sup> Unlike most other creditors, the IRS does not need a judgment from a court to file an NFTL.<sup>2</sup> When properly applied, the IRS's lien authority can be an effective tool in tax collection. However, when improperly applied, NFTLs can needlessly harm taxpayers and undermine long-term tax collection.

Specifically, filing an NFTL can significantly harm the taxpayer's creditworthiness and thus impair his or her ability to:

- Obtain financing for a home or other major purchase;
- Find or retain a job;
- Secure affordable housing or insurance;<sup>3</sup> and
- Ultimately pay the tax debt.<sup>4</sup>

Badly damaging the taxpayer's financial circumstances in this way may even require the government to provide welfare benefits to the taxpayer, such as unemployment benefits or food stamps.

Aware of the serious impact and hardship NFTLs can cause in a taxpayer's life,<sup>5</sup> Congress enacted § 3421 of RRA 98 to preclude the IRS from "abusively us[ing] its liens-and-seizure authority."<sup>6</sup> The law requires the IRS to adopt procedures in which an employee's determination to file an NFTL would, "where appropriate," be approved by a supervisor and to set out disciplinary actions when such approval is not obtained.<sup>7</sup>

1 Internal Revenue Code (IRC) §§ 6321, 6322, and 6323(a).

2 IRC §§ 6321, 6322, and 6323(a). IRS collection actions are either taken by the Automated Collection System (ACS) or Revenue Officers (ROs). ROs work in field offices and can send letters, issue liens and levies, and answer calls. ACS is a computerized inventory system that sends taxpayers notices demanding payment, issues liens and levies, and answers telephone calls in an effort to resolve balance due accounts and delinquencies.

3 Heather Struck, *A Bad Credit Score Affects A Lot More Than Credit*, FORBES, Jul. 20, 2011, available at <http://www.forbes.com/sites/heatherstruck/2011/07/20/credit-score-fico-can-hurt-you/>.

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

5 *IRS Restructuring: Hearings on H.R. 2676 Before the S. Comm. on Finance*, 105th Cong., (1998) (see, e.g., statements of Nina E. Olson, Executive Director of the Community Tax Law Project in Richmond, Virginia).

6 RRA 98, Title III, § 3421, Pub. L. No. 105-206, 112 Stat. 758 (1998). See also S. REP. No. 105-174, at 78 (1998); Unanimous Consent Request - H.R. 2676, 143 Cong. Rec. S12230-02 (statement of Sen. Roth).

7 RRA 98, Title III, § 3421(b), Pub. L. No. 105-206, 112 Stat. 758 (1998).

Aware of the serious impact and hardship that lien filings can cause in a taxpayer's life, Congress enacted section 3421 of the IRS Restructuring and Reform Act of 1998 to preclude the IRS from "abusively using its liens-and-seizure authority."

The IRS has deemed that it is rarely "appropriate" to require such approval, because it has made virtually no adjustments to its procedures along the lines of what Congress directed in enacting § 3421 of RRA 98. In fact, the IRS has adopted a collection strategy that often relies on *broad* use of its lien authority.<sup>8</sup> Notably, the IRS has eased previous restrictions on NFTL filings by allowing lower-graded employees to file NFTLs without managerial approval.<sup>9</sup> The IRS also flipped Congress's intent on its head by requiring employees to obtain managerial approval if they determine *not* to file an NFTL or defer filing in many circumstances.<sup>10</sup> Further, the IRS never established appropriate disciplinary actions for employees who fail to secure managerial approval to file an NFTL when such approval is required (*i.e.*, Revenue Officers (RO) below GS-9).<sup>11</sup>

The National Taxpayer Advocate has conducted several significant research studies which show not only that this lien filing approach is ineffective in terms of collecting revenue but that it actually impairs current and future payment compliance and the taxpayer's earnings, and has particularly harmful effects on taxpayers whom the IRS has classified as "currently not collectible" (CNC) because of economic hardship.<sup>12</sup>

A meaningful implementation of Congress's directive would not only better protect the taxpayers' right to a *fair and just tax system*, but would also prevent further harm to taxpayers experiencing economic hardship, while establishing a more effective approach to collecting outstanding liabilities.<sup>13</sup>

## ANALYSIS OF PROBLEM

### Background

#### *A Federal Tax Lien is a Powerful Collection Tool.*

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>14</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>15</sup> This lien continues against the taxpayer's property until the liability either has been fully paid or is legally unenforceable.<sup>16</sup> This

8 Internal Revenue Manual (IRM) 5.12.2.6, *NFTL Filing Criteria* (Oct. 14, 2013).

9 IRM 1.2.44.5, *Delegation Order 5-4* (May 9, 2013); IRM 5.19.4.5.3.4, *When Filing an NFTL Requires Approval* (Aug. 4, 2014).

10 IRM 5.12.2.5.3, *NFTL Do-Not-File and Filing Deferral Determination Approvals* (Oct. 14, 2013); 5.19.4.5.2.1, *Do Not File Approvals* (Aug. 4, 2014).

11 IRS response to TAS information request (July 31, 2014) and IRM 5.12.2.5.2, *NFTL Filing Determination Approvals* (Oct. 14, 2013).

12 See National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 105-29 (Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*); National Taxpayer Advocate 2011 Annual Report to Congress vol. 2 91-111 (Research Study: *Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*); National Taxpayer Advocate 2009 Annual Report to Congress vol. 2 1-18 (Research Study: *The IRS's Use of Notices of Federal Tax Lien*). Taxpayer accounts are reported as currently not collectible when the taxpayer has no assets or income, which by law, are subject to a levy. IRM 1.2.14.1.14, *Policy Statement 5-71* (Nov. 19, 1980).

13 IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>.

14 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.

15 See IRC § 6321; IRM 5.12.1.3, *Creation and Duration* (Oct. 14, 2013).

16 IRC § 6322.

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 debt, and the taxpayer may not understand the significance of this statutory lien.<sup>17</sup>

However, the FTL does not give the IRS priority over other creditors. The IRS must file an NFTL in the county or similar jurisdiction where a taxpayer’s property is located, such as with a register of deeds, to put third parties on notice and establish the priority of the government’s interest in the taxpayer’s property against subsequent purchasers, secured creditors, and junior lien holders.<sup>18</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 becomes legally unenforceable (typically, upon expiration of the statutory period for collecting the tax).<sup>19</sup> Once the certificate of release is issued and filed in the same office as the related NFTL, the tax lien is conclusively extinguished.<sup>20</sup>

### *NFTL Filing Has Significant Consequences for the Taxpayer.*

As mentioned above, the NFTL filing negatively impacts a taxpayer’s credit history,<sup>21</sup> having the potential of reducing a taxpayer’s credit score by 100 points,<sup>22</sup> and has a long-lasting effect on the taxpayer’s financial viability. For example, the existence of the NFTL filing, and the information contained in the notice, are included in the consumer (credit) reports,<sup>23</sup> which can impair a taxpayer’s ability to obtain financing,<sup>24</sup> find or keep a job,<sup>25</sup> and secure affordable housing or insurance.<sup>26</sup> It can also hamper the taxpayer’s ability to stay compliant and obtain credit needed to pay preexisting tax debts.<sup>27</sup>

The taxpayer may experience effects of the NFTL filing long-term, because a NFTL filing will remain on a taxpayer’s credit report for years, or even indefinitely. Specifically, “paid tax liens” appear on credit

17 IRC § 6321. The IRM refers to this statutory lien also as the “assessment” or the “silent” lien. See IRM 5.12.1.2, *Introduction to Liens* (Oct. 14, 2013).

18 IRC § 6323(f); Treas. Reg. § 301.6323(f)-1; IRM 5.12.1.4, *Purpose and Effect of Filing a Notice of Federal Tax Lien (NFTL)* (Oct. 14, 2013).

19 IRC § 6325(a)(1).

20 IRC § 6325(f).

21 It is difficult to speculate as to the degree to which an NFTL will affect a taxpayer’s credit score, because every individual’s situation is different, and there are many different credit scoring systems. Therefore, the impact on one system could be very different from another because the numeric scales are different. See Experian, *A World of Insight*, available at <http://www.experian.com/ask-experian/20080903-tax-liens-and-credit-scores.html> (last visited Dec. 12, 2014). However, a recent IRS study conducted by Experian found that NFTLs have a minimal impact on many consumers’ credit scores. See IRS and Experian Decision Analytics, *Federal Tax Lien Impact Study* (Mar. 31, 2014).

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

23 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.”

24 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. See, e.g., GMAC Factoring Agreement, available at <http://contracts.onecle.com/arbnet/gmac.factor.2003.02.01.shtml> (last visited Dec. 13, 2014).

25 Some licensing boards require members to maintain a clean credit history and some employers require employees to do so as a condition of employment. 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 Dec. 13, 2014).

26 See also IRS Pub. 594, *What You Should Know About the IRS Collection Process* 4 (Apr. 2012) (recognizing the taxpayer may not be able to get a loan to buy a house or a car, get a new credit card, or sign a lease as result of the NFTL filing).

27 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).

reports for seven years from the date of payment,<sup>28</sup> and unpaid liens may remain on the taxpayer's credit report indefinitely, even when the underlying lien becomes legally unenforceable (*e.g.*, because the statute of limitations for collection has expired and the lien self-released or the lien is legally satisfied as a result of an accepted offer in compromise) or the IRS accepts a bond.<sup>29</sup> When a taxpayer has little or no ability to pay and no assets from which to collect, an NFTL filing may further damage his or her financial viability and generate significant downstream costs for the government.<sup>30</sup>

### *Congress Placed Limitations on IRS Lien Filing Authority, Recognizing the Impact of NFTL on Taxpayers.*

As a result of concerns raised by Congress and leaders in the tax community regarding the IRS's use of its NFTL authority,<sup>31</sup> Congress enacted § 3421 in RRA 98.<sup>32</sup> Under this provision, where deemed appropriate, a determination by an employee to file an NFTL would be approved by an IRS supervisor who would:

- Review the taxpayer's information;
- Verify that a balance is due; and
- Affirm that the action proposed is appropriate given the taxpayer's circumstances, the amount due, and the value of the property or right to property.<sup>33</sup>

Failure to follow these procedures should result in appropriate disciplinary action against the responsible supervisor or employee.<sup>34</sup> Congress delayed the application of RRA 98 § 3421 of RRA 98 until January 1, 2001 for IRS collection actions taken under the IRS Automated Collection System (ACS).<sup>35</sup>

The recently adopted Taxpayer Bill Of Rights supports Congress' analysis and its concern that collection actions be fair, balanced, and taken after carefully considering the taxpayer's facts and circumstances. The congressional directive of RRA 98 § 3421 relates directly to the *right to a fair and just tax system*, which

28 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 noted on the credit report but does not necessarily impact the credit score in a significant way.

29 As a matter of policy, Experian keeps unpaid tax liens on a credit report for 15 years while Equifax and Transunion credit reports reflect them indefinitely. See <http://www.transunion.com/personal-credit/credit-issues-bad-credit/what-affects-your-credit-score.page>; <http://www.experian.com/blogs/ask-experian/2007/05/16/how-long-public-records-stay-on-your-credit-report/>; <http://blog.equifax.com/credit/faq-how-long-does-information-stay-on-my-credit-report/> (last visited on Dec. 13, 2014). For example, most NFTLs are self-releasing, *i.e.*, the notice indicates that unless the IRS refiles it by the listed date, the notice operates as a certificate of release under IRC § 6325(a). IRC § 6325(a) also provides for a release of liens because the underlying liability became legally unenforceable or the IRS accepted a bond.

30 See T. Keith Fogg, *Systemic Problems With Low-Dollar Lien Filing*, 2011 TNT 194-9 (2011); National Taxpayer Advocate 2011 Annual Report to Congress 109-128 (Most Serious Problem: *Changes to IRS Lien Filing Practices are Needed to Improve Future Compliance, Increase Revenue Collection, and Minimize Economic Harm Inflicted on Financially Struggling Taxpayers*). A further consequence of a lien's damage to a taxpayer's financial viability may be a need for unemployment benefits, food stamps, and the like, thus increasing societal cost.

31 The Joint Committee on Taxation observed that "the imposition of liens, levies, and seizures may impose significant hardships on taxpayers" and "that extra protection in the form of an administrative approval process is appropriate." J. Comm. on Tax'n, *General Explanation of Tax Legislation Enacted in 1998*, (1998). See also *IRS Restructuring: Hearings on H.R. 2676 Before the S. Comm. on Finance at 408*, 105th Cong., 375 (1998) (written statement of Bruce Strauss, Enrolled Agent) (suggesting among other things that tax liens filings "must all be reviewed by an independent IRS quality review function prior to implementation of the decision"); *Exploring the Development of Taxpayer Bill of Rights Legislation: Hearing Before the H. Comm. On Ways and Means*, 104th Cong. (1995) (statement of Joseph F. Lane, Enrolled Agent).

32 RRA 98, Title III, § 3421(b), Pub. L. No. 105-206, 112 Stat. 758 (1998).

33 RRA 98, Title III, § 3421(a)(2), Pub. L. No. 105-206, 112 Stat. 758 (1998).

34 RRA 98, Title III, § 3421(b), Pub. L. No. 105-206, 112 Stat. 758 (1998).

35 RRA 98, Title III, § 3421(a)(2), Pub. L. No. 105-206, 112 Stat. 758 (1998).

means taxpayers have the right to expect that the tax system will consider facts and circumstances that might affect their ability to pay.<sup>36</sup>

**The IRS has not implemented Congress' directive, and has embraced a broad NFTL filing policy with little managerial review.**

Since Congress enacted § 3421 in RRA 98, the IRS has:

1. Restated its policy that only ROs below the GS-9<sup>37</sup> level must receive managerial approval prior to filing an NFTL.<sup>38</sup> The IRS stated the costs and administrative burden of expanding the § 3421 protection to other situations outweighed the taxpayer's interest.<sup>39</sup> This approval requirement for ROs below the GS-9 level applies to only less than one percent of ROs.<sup>40</sup>
2. Eased managerial approval requirements for NFTL filings. Specifically, despite the fact that Congress gave the IRS more than two years to determine how to implement § 3421 of RRA 98 for ACS,<sup>41</sup> the only change the IRS made was to grant ACS employees in grades as low as GS-6 the authority to file NFTLs without managerial review.<sup>42</sup> This change was contrary to Congress's directive and more lax than prior ACS guidance, which required GS-7 employees and below to obtain approval from either a senior RO or a manager to file an NFTL.<sup>43</sup> Presently, ACS files about one third of NFTLs, and very few require managerial approval<sup>44</sup> (*i.e.*, only about 6.2 percent of ACS employees are below GS-6, so more than 90 percent of ACS employees can file NFTLs without any managerial review).<sup>45</sup>
3. Required all ACS employees and ROs, regardless of grade level, to obtain managerial approval if they determine *not* to file an NFTL in cases that meet specified criteria.<sup>46</sup>
4. Never established disciplinary action for employees who fail to secure managerial approval where required.<sup>47</sup>

36 See IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights> (last visited Aug. 20, 2014) and Publication 1, *Your Rights as a Taxpayer* (June 2014).

37 The General Schedule (GS) classification and pay system covers the majority of civilian white-collar Federal employees (about 1.5 million worldwide) in professional, technical, administrative, and clerical positions. U.S. Office of Personnel Management, available at <http://www.opm.gov/policy-data-oversight/pay-leave/pay-systems/general-schedule/> (last visited Dec. 4, 2014). Within the Collection function, a "GS-9" employee is relatively junior.

38 IRM 5.12.2.5.2, *NFTL Filing Determination Approvals* (Oct. 14, 2013).

39 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 from Chief, Branch 1, General Litigation Division to Counsel to the National Taxpayer Advocate, Ref. No. GL-122444-98 (Dec. 23, 1998) (same).

40 IRS Human Resources Reporting Center, Workforce Information by Organization Query on Revenue Officers (Dec. 9, 2013). For instance, as of July 26, 2014, less than one percent of ROs were below the GS-9 level. GS-8 and lower-graded revenue officers totaled two out of 3742 revenue officers. Also, the NFTLs issued by ROs below the GS-9 level may still not be reviewed by a manager. The IRM permits a manager to assign the NFTL review responsibility to another RO at an "appropriate" grade level. (emphasis added). See IRM 5.12.2.7, *Approval of Lien Filing Notice* (Oct. 14, 2013).

41 RRA 98, Title III, § 3421(a)(2), Pub. L. No. 105-206, 112 Stat. 758 (1998).

42 IRM 1.2.44.5, *Delegation Order 5-4* (May 9, 2013); IRM 5.19.4.5.3.4, *When Filing an NFTL Requires Approval* (Aug. 4, 2014).

43 Email from former IRS Chief Compliance Officer to the National Taxpayer Advocate (Nov. 2, 2009) (on file with TAS).

44 IRS No 5000-25, Lien Report, FY 2013 and 2014. ACS filed 204,279 and 198,682 NFTLs out of 602,005 and 535,580 total NFTL filings for FY 2013 and FY 2014, respectively.

45 IRS Human Resources Reporting Center, Position Report Query, ACS employees (no exec), All GSs and GS-5 and less, run date 11/14/2014. As of Nov. 1, 2014, 159 employees out of 2,571 ACS employees were below the GS-6 level.

46 IRM 5.19.4.5.2, *Do Not File Decisions* (Aug. 4, 2014).

47 IRS response to TAS information request (July 31, 2014).

Essentially, the IRS ignored Congress’s directive and elected to adopt an even broader NFTL filing policy, rather than one that emphasizes review of taxpayers’ particular facts and circumstances to ensure the NFTL will attach to assets and not cause hardship.

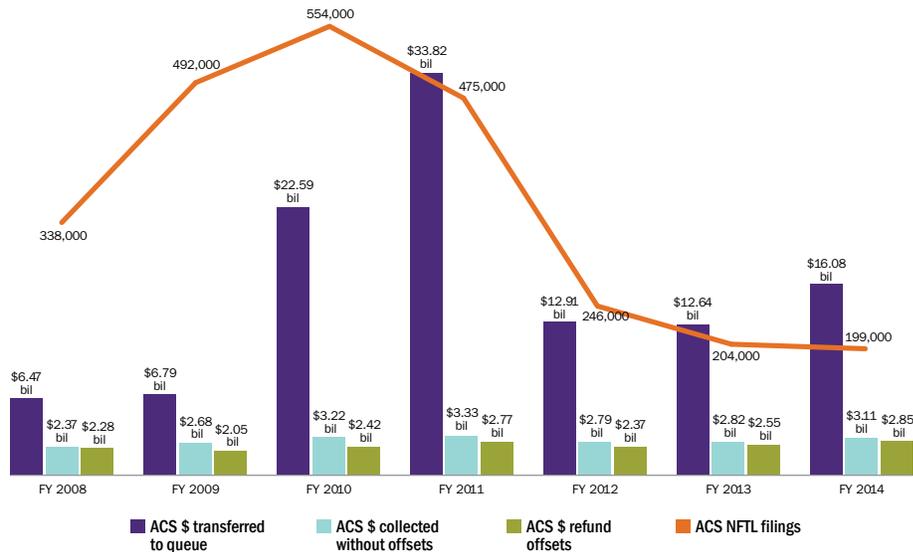
**The current NFTL filing policy has been ineffective in collecting revenue.**

The IRS files many NFTLs, pursuant to “business rules” that require automatic NFTL filing or a lack of substantive human review.<sup>48</sup> The reliance on merely following business rules when filing of NFTLs has contributed to a significant increase in the number of NFTLs filed. For example, NFTL filings rose by about 219 percent from fiscal year (FY) 1999 to 2014,<sup>49</sup> yet the Collection function is collecting only slightly more in real 2014 dollars than in 1999.<sup>50</sup>

The NFTL filing strategy also has been ineffective for the ACS function. ACS systemically takes collection action when “business rules” that require automatic filing of an NFTL are met, rather than reviewing the particular facts and circumstances of each case.<sup>51</sup> As the chart below illustrates, this approach has been ineffective in collecting revenue.

**FIGURE 1.22.1**<sup>52</sup>

**Selected ACS collection activities and number of ACS NFTLs filed, FYs 2008-2014**



48 IRM 5.19.4.5.3.2, *Filing Criteria* (Aug. 4, 2014).

49 IRS Data Book, Table 16 (Nov. 19, 2014). NFTL filings were 168,000 and 535,580 for 1999 and 2014, respectively.

50 IRS Data Book, Table 16 (Nov. 19, 2014). When adjusted for inflation (converted to 2014 dollars) the IRS collected about \$32.1 billion in FY 1999 and about \$34.2 billion in FY 2014.

51 *ACS Customer Service Activity Reports (CSAR), FY 2009 BOD report*. See also E-mail from IRS subject matter expert (Nov. 2, 2009); IRM 5.19.4.5.3.2, *Filing Criteria* (Aug. 4, 2014).

52 Collection Report, NO 5000-2, Part 1 - TDAs, ACS/CS TDAs, FY 2008–FY 2014 and Collection Report, NO 5000-256, Lien Report, FY 2010–FY 2014. Note that the chart shows that the number of NFTLs filed by ACS has dropped dramatically since 2010, however, dollars collected have increased slightly.

ACS collected only about 5.9 percent of the dollars placed in its inventory, and this is only about a half percent more than the IRS obtained by refund offsets, which do not require an NFTL.<sup>53</sup> Nevertheless, ACS filed 198,682 liens.<sup>54</sup> Yet, ACS ultimately transfers much of its inventory to the Queue.<sup>55</sup> Thus taxpayers are harmed both by having unnecessary NFTLs filed and by being transferred to the “inactive” status in the Queue.

Despite this performance, ACS continues to automatically file NFTLs, using them to establish contact with delinquent taxpayers. Contrary to this practice, one IRS study showed establishing contact with taxpayers through letters, rather than a collection action, was a more effective approach.<sup>56</sup>

### The current IRS NFTL filing policy harms taxpayers experiencing economic hardship and may undermine future compliance and revenue.

Taxpayer accounts placed in CNC status because the IRS was either unable to contact or locate the taxpayer, or it determined that the taxpayer was in economic hardship, are subject to NFTLs as long as certain requirements are met (*i.e.*, the tax liability is \$10,000 or greater).<sup>57</sup> As a result of these rules, the IRS systemically files NFTLs against CNC (hardship) taxpayers who in most cases have no assets.<sup>58</sup> When a taxpayer has little or no ability to pay and no assets from which to collect, an NFTL filing may further impede the taxpayer’s financial viability and ultimately undermine tax revenue and future compliance. In addition, if the NFTL badly damages the taxpayer’s family by driving up costs or rendering the taxpayer jobless 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, raising everyone’s share of taxes, and eroding the core taxpayer *right to a fair and just tax system*.

### TAS research studies show the IRS’s NFTL filing approach, void of human consideration, is ineffective, harms taxpayers, and damages future compliance.

TAS Research & Analysis has conducted several in-depth studies on the IRS’s use of NFTLs and their impact on the compliance behavior of delinquent taxpayers.<sup>59</sup> One study analyzed taxpayers who had an NFTL filed against them in 2002 and taxpayers who did not have an NFTL filed against them for the same time period. The study analyzed the effects of an NFTL, or no NFTL, from 2002 through 2010

53 In FY 2014, ACS collected \$3,107,887,286 out of \$52,254,945,879 placed in ACS in FY 2014, and this is compared to \$2,850,701,610 in refund offsets. IRS NO 5000-2, Part 1 - TDAs, ACS/CS TDAs.

54 Collection Report, NO 5000-25, Lien Report, FY 2014.

55 The Queue is a holding inventory where collection cases sit, sometimes for years, usually after being in ACS, and before being assigned to the Collection Field function or reassignment to ACS. Cases sit in the Queue based on business rules and available resources.

56 ACS Telephone Response Study, Kansas City Customer Service Site (Mar.–Apr. 2000). In this study conducted in 2000, the response rate for levies was about 13 percent, while the response rate for Letter 16, *Please Call Us About Your Overdue Taxes or Tax Return*, was nearly 37 percent.

57 IRM 5.12.2.6, *NFTL Filing Criteria* (Oct. 14, 2013). The IRM states: Currently Not Collectible—File a NFTL when BOTH of the following conditions exist: Aggregate assessed balance is at or above \$10,000 Account is being closed using unable to locate (cc03), unable to contact (cc12) or hardship (cc24 through 32) provisions.

58 *Id.*

59 See National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 105-29 (Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*); National Taxpayer Advocate 2011 Annual Report to Congress vol. 2 91-111 (Research Study: *Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*); National Taxpayer Advocate 2009 Annual Report to Congress vol. 2 1-18 (Research Study: *The IRS’s Use of Notices of Federal Tax Lien*).

(the study period).<sup>60</sup> The research showed that NFTL filing was associated with negative outcomes for payment compliance behavior on the taxpayers' initial liabilities, negative filing compliance behavior, and negative impacts on the amount of income earned by taxpayers in years following the NFTL. Specifically,

- At the end of the study period (calendar year 2010), taxpayers with NFTLs owed 21 percent more on average than they owed when the NFTLs were filed, which was when they incurred their original liabilities in 2002. In contrast, where no NFTL had been filed, taxpayers owed 11 percent more than they owed on their total individual liability at the proxy lien date (2002).<sup>61</sup>
- NFTL taxpayers were less likely to file required returns, with the increased likelihood of non-filing ranging between about one and three percent during the full study period (through 2010).<sup>62</sup>
- NFTL taxpayers were less likely to have an increase in their total positive incomes (TPI) with the increased likelihood of negative outcomes starting at about 7.9 percent and gradually declining to about 5.2 percent by the end of the full study period.<sup>63</sup>

Additionally, these studies showed NFTLs were particularly ineffective when filed against CNC (hardship) taxpayers.

- For tax year (TY) 2009, TAS's analysis of NFTL filing practices showed NFTLs were responsible for only \$2 of every \$10 in payments collected from taxpayers in CNC status, while nearly \$6 of every \$10 collected from these taxpayers came from refund offsets, which occur whether a lien was filed or not.<sup>64</sup> Nonetheless, the IRS filed NFTLs against more than 72 percent of CNC taxpayers suffering economic hardship.<sup>65</sup>
- CNC hardship taxpayers, on average, ended up owing about 50 percent more to the IRS in 2010 than at the time of lien (or proxy lien) filing.<sup>66</sup>

This research also found that taxpayers with an installment agreement (IA) or offer in compromise (OIC) fared much better than others who did not secure such collection alternatives. Over 50 percent of IA

60 This analysis employed a two-phase approach. In phase 1, TAS Research analyzed a cohort of delinquent individual tax return filers (i.e., those who file Forms 1040, U.S. Individual Income Tax Return) who had any unpaid tax liabilities in 2002 and had no other liabilities at the beginning of that year. From these taxpayers, TAS identified taxpayers that the IRS filed NFTLs against and taxpayers it did not file NFTLs against from 2002-2004. TAS compared payment and filing compliance behavior of the two groups from the liabilities inception through 2010, and examined the impact the NFTLs had on taxpayers' incomes during this period. In phase 2, TAS used subsets of the lien and non-lien groups created in Phase 1 to look at the change in total tax liability of the taxpayer groups during the 2002-2010 study periods. TAS also looked at the total dollars the IRS actually collected from these taxpayer groups. National Taxpayer Advocate 2011 Annual Report to Congress vol. 2 91-111 (Research Study: *Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*).

61 See National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 105-29 (Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*).

62 *Id.* The estimation results for the Study for lien coefficients in the current payment, future payment, future filings and future income models reported a high level of statistical significance for all models, at least at the one percent level. The lien coefficient measured the explanatory powers associated with a lien being present for delinquent taxpayers with respect to outcomes for the compliance issues or income. Negative signs indicate reduced compliance for the group, while positive signs imply more. The marginal effects were computed at the means of the sample variables.

63 National Taxpayer Advocate 2011 Annual Report to Congress vol. 2 91-112, (Research Study: *Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*). It should be noted that we did not adjust dollars for inflation. Therefore, the nominal decreases taxpayers experienced in TPI at the end of the study period (i.e., 2010) relative to their 2002 TPI are greater in real terms than equivalent nominal losses experienced earlier in the period.

64 National Taxpayer Advocate 2009 Annual Report to Congress vol. 2 1-18 (Research Study: *The IRS's Use of Notices of Federal Tax Lien*).

65 *Id.*

66 National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 108-30 (Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*).

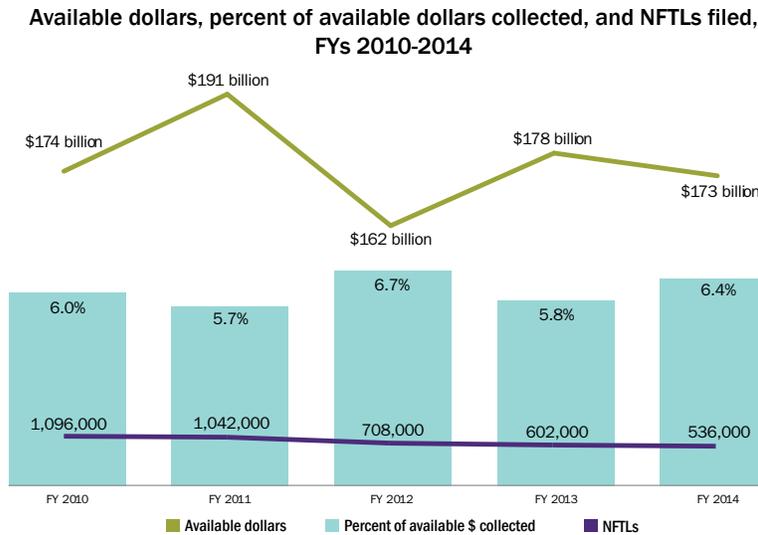
**The IRS systemically files liens against taxpayers in hardship, who in most cases have no assets. When a taxpayer has little or no ability to pay and no assets from which to collect, a lien filing may further impede the taxpayer's financial viability and ultimately undermine tax revenue and future compliance.**

taxpayers and 70 percent of OIC taxpayers were out of debt to the IRS at the end of the study period (2010).<sup>67</sup> The cumulative effect of these studies show that wholesale NFTL filings are ineffective and damage taxpayer compliance, and both the IRS and the taxpayer would be better served by an IA or OIC.

In response to these studies<sup>68</sup> and other advocacy efforts,<sup>69</sup> the IRS in early 2011 announced an effort to help financially struggling taxpayers get a “fresh start.”<sup>70</sup> This initiative included several positive changes in how the IRS files and withdraws NFTLs.<sup>71</sup> As a result, NFTL filings have declined from about 1,096,376 in FY 2010 to 535,580 in FY 2014, a decrease of 51 percent.<sup>72</sup>

If the filing of NFTLs were a significant driver of revenue collection, one would expect this dramatic decline in NFTL filings to produce a similarly dramatic decline in the amount of revenue the IRS Collection function collected on delinquent accounts. Yet the percent of dollars collected on delinquent accounts by the IRS Collection function has not shown a similar decrease, even though the dollars available for collection decreased slightly from FY 2010 to FY 2014, as depicted below.<sup>73</sup>

- 67 National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 108-30 (Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*).
- 68 See *id.* at 105-29; see also National Taxpayer Advocate 2011 Annual Report to Congress vol. 2 91-111 (*Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*); National Taxpayer Advocate 2009 Annual Report to Congress vol. 2 1-18 (*The IRS's Use of Notices of Federal Tax Lien*).
- 69 See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress 124-33 (Most Serious Problem: *Collection Strategy: The Automated Collection System's Case Selection and Processes Result in Low Collection Yields and Poor Case Resolution, Thereby Harming Taxpayers*); National Taxpayer Advocate 2012 Annual Report to Congress 403-25 (Most Serious Problem: *Although the IRS "Fresh Start" Initiative Has Reduced the Number of Lien Notices Filed, the IRS Has Failed to Determine Whether Its Lien Policies are Clearly Supported by Either Increased Taxpayer Compliance or Revenue*); National Taxpayer Advocate 2011 Annual Report to Congress 109-28 (Most Serious Problem: *Changes to IRS Lien Filing Practices are Needed to Improve Future Compliance, Increase Revenue Collection, and Minimize Economic Harm Inflicted on Financially Struggling Taxpayers*); National Taxpayer Advocate 2010 Annual Report to Congress 302-10 (Most Serious Problem: *The IRS Has Been Slow to Address the Adverse Impact of its Lien-Filing Policies on Taxpayers and Future Tax Compliance*); National Taxpayer Advocate 2009 Annual Report to Congress 17-40 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of the Law, Fail to Promote Future Tax Compliance, and Unnecessarily Harm Taxpayers*). See also TADs 2010-1 and 2010-2 (Jan. 20, 2010). For copies of the TADs, see National Taxpayer Advocate Fiscal Year 2011 Objectives Report to Congress, Appendix VIII, available at <http://www.irs.gov/pub/irs-utl/nta2011objectivesfinal.pdf>.
- 70 IRS, Media Relations Office, *IRS Announces New Effort to Help Struggling Taxpayers Get a Fresh Start; Major Changes to Lien Process*, IR-2011-20 (Feb. 24, 2011). TAS worked very closely with the Collection function in developing and clearing procedural guidance related to the “Fresh Start” initiative.
- 71 ACS's systemic NFTL filing threshold was increased from \$5,000 to \$10,000, then to \$25,000 a few months later; and ACS established a systemic NFTL ‘floor’ amount on subsequent tax periods at \$2,500 or more. IRM 5.12.2.4.1, *Integrated Collection System (ICS) Documentation When Deferring the Filing of an NFTL or Choosing Do Not File* (Mar. 8, 2012); IRM 5.19.4.5.2, *Do Not File Decisions* (Mar. 14, 2012).
- 72 IRS Data Book, 2014, Table 16.
- 73 IRS Collection Reports, No 5000-2, Taxpayer Delinquent Accounts Report (Sept. 2014); No 5000-108, Monthly Report of Offer In Compromise Activity (Sept. 2014); No 5000-6, Installment Agreement Cumulative Report (Sept. 2014); and No 5000-25, Lien Report (Sept. 2014).

FIGURE 1.22.2<sup>74</sup>

These results are fully consistent with what the TAS studies have found. Ultimately, the IRS maximizes revenue collection by filing NFTLs in the right cases—not by filing NFTLs in large numbers of cases, triggered solely by arbitrary dollar amounts.

### The IRS should require managerial approval before filing an NFTL in specific situations.

As illustrated above, the IRS's current NFTL filing policy negatively affects collection results, taxpayers' income, and future compliance. The IRS's implementation of § 3421 of RRA 98 would better ensure that NFTLs are effective and do not create hardship. The National Taxpayer Advocate understands that requiring managerial approval prior to filing all NFTLs is not feasible or practicable. However, the IRS can identify specific situations in which requiring managerial approval would be appropriate and help to prevent useless and harmful NFTLs. These would include cases where it is likely that the lien will cause a hardship, will do little to protect the government's interest in the taxpayer's property or rights to property, or will impair the taxpayer's ability to pay the tax. The following three categories are situations where the lien could have such an effect.

1. **Taxpayer's income falls below 250 percent of the federal poverty level:** Prior to filing an NFTL, an employee could review available information and determine if the taxpayer's income falls below 250 percent of the federal poverty level.<sup>75</sup> By identifying these taxpayers, the IRS can presume economic hardship (*i.e.*, inability to pay basic living expenses) and consider whether the

74 IRS Collection Reports, No 5000-2, Taxpayer Delinquent Accounts Report (Sept. 2014); No 5000-108, Monthly Report of Offer In Compromise Activity (Sept. 2014); No 5000-6, Installment Agreement Cumulative Report (Sept. 2014); and No 5000-25, Lien Report (Sept. 2014).

75 To determine taxpayer's income, employees could review taxpayer's most recent tax return, or third-party information it has available, whichever is more recent. See Department of Health and Human Services (DHHS), The 2014 HHS Poverty Guidelines, available at <http://aspe.hhs.gov/poverty/14poverty.cfm> (last visited on Nov. 14, 2014). For Calendar Year (CY) 2014, an individual who makes \$11,670 or less is in poverty. This number is then multiplied by 250 percent to determine the 250 percent federal poverty threshold.

lien will only cause further hardship.<sup>76</sup> The IRS already makes such a presumption when identifying low income taxpayers to filter out of the Federal Payment Levy Program (FPLP).<sup>77</sup>

2. **Taxpayers in CNC (hardship) status:** As shown above, taxpayers in CNC (hardship) status are often crippled by tax debt, and filing NFTLs against them does little to protect the government's interest, while most likely making the taxpayer's situation even worse.<sup>78</sup> The manager can consider whether the NFTL will actually assist in collecting the tax (*i.e.*, there are assets for the lien to attach to) or will only further harm the taxpayer.
3. **Taxpayers in a non-streamlined installment agreement:**<sup>79</sup> Taxpayers in an IA make significant strides toward paying off their tax debt.<sup>80</sup> Filing an NFTL against these taxpayers may jeopardize their ability to pay, because the NFTL can hinder their earning potential by threatening their credit rating and ability to secure financing or maintain professional licenses.

Requiring managerial approval in these situations would allow a supervisor to conduct a quality review of the determination to file an NFTL. This review would ensure that IRS employees have considered whether:

1. The NFTL would attach to property;
2. The benefit to the government of the NFTL filing outweighs the harm to the taxpayer, including consideration of any special circumstances pertaining to the taxpayer; and
3. The NFTL filing will jeopardize the taxpayer's ability to comply with the tax laws in the future.

If employees fail to secure managerial approval prior to filing an NFTL in these situations, the IRS should take disciplinary actions. A first-time violation should result in an admonishment along with the employee having to complete further training regarding when managerial approval is required before filing a NFTL. Subsequent violations should be met with stiffer consequences, including a written reprimand, or suspension.

76 IRC § 6343(a)(1)(D) requires the IRS to release a levy when it would create an economic hardship due to the financial condition of the taxpayer. Treas. Reg. § 301.6343-1(b)(4) specifies that an economic hardship exists if a taxpayer cannot pay his or her basic living expenses.

77 The FPLP is an automated system the IRS uses to match its records against those of the government's Bureau of the Fiscal Service (BFS) to identify taxpayers with unpaid tax liabilities who receive certain payments from the federal government. In 2011, the IRS finalized and implemented a low income filter. This filter's design was largely based on a TAS study, which tested a filter model that identified and removed from FPLP low income taxpayers the model showed would experience economic hardship. Largely accepting the findings from the TAS study, the IRS designed a filter that excluded taxpayers from the FPLP whose income fall below 250 percent of the federal poverty level. National Taxpayer Advocate 2008 Annual Report to Congress Vol. II, 46-72 (Research Study: Building a Better Filter: *Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program*).

78 National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 108-130 (Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*).

79 See IRM 5.14.5.1, *Installment Agreements Overview* (May 23, 2014): 1) Guaranteed agreements: under IRC § 6159(c) taxpayers who meet certain conditions and who have a delinquency \$10,000 or less are entitled to an installment agreement. 2) Streamlined agreement: streamline agreement criteria may be secured where the aggregate unpaid balance of assessments does not exceed \$25,000 and may be paid off within a 72 month period. Taxpayers who meet these criteria do not need to provide a financial information statement to the IRS. 3) Non-streamline agreement: agreements that fall outside the parameters of the guaranteed and streamlined IA.

80 National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 108-130 (Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*).

Requiring managerial approval before filing an NFTL in the above situations would better adhere the IRS's NFTL policy to Congress's directive. It also would protect taxpayers' *right to a fair and just tax system*, by creating an NFTL policy that considers each taxpayer's individual facts and circumstances.<sup>81</sup>

## CONCLUSION

Fifteen years after Congress determined the IRS should implement enhanced taxpayer protections in the form of managerial approval when it files NFTLs, the IRS still has not adequately changed its procedures to require such approval. To the contrary, the IRS has embraced a broader NFTL filing policy. This approach continues to harm taxpayers and yield poor collection results.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. In collaboration with TAS, develop and implement factors to determine situations in which managerial approval of NFTL filings is appropriate and should be required.
2. Develop and implement disciplinary actions to be taken when managerial approval prior to filing a NFTL is not secured in the specified situations.

<sup>81</sup> IRM 5.11.1.3.1, *Pre-Levy Considerations* (Aug. 1, 2014). The IRS has emphasized the need for such judgment in the context of making a levy determination by instructing revenue officers to exercise good judgment when making the determination to levy, which means they are to consider the taxpayer's financial condition.