Office of Chief Counsel
Internal Revenue Service
memorandum

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to: Frederick W. Schindler
Director, Collection Policy, SBSE

from: Gary D. Gray
Deputy Associate Chief Counsel (Procedure & Administration)

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subject: Section 3421 of the IRS Restructuring and Reform Act of 1998, Pub. L. No. 105-206

On January 21, 2010, the National Taxpayer Advocate issued Taxpayer Advocate Directive 2010-1, directing the Service to immediately discontinue the policy of automatic Notice of Federal Tax Lien filing on Currently Not Collectible hardship accounts with an unpaid balance of $5,000 or more.

ISSUE

Whether the Service is in compliance with the requirements of section 3421 of the IRS Restructuring and Reform Act of 1998 ("RRA 98").

CONCLUSION

The Service fully adheres to both the letter and the spirit of RRA '98 section 3421 when it complies with the procedures currently set forth in the IRM.

DISCUSSION

Section 3421 of the RRA '98 required the Commissioner to develop and implement procedures under which the determination by a Service employee to file a NFTL or to take levy or seizure action would, "where appropriate," be required to be reviewed by a supervisor before the action was taken.

Before the enactment of section 3421 of the RRA '98, there was no statutory or administrative requirement for managerial or supervisory review or approval of a decision to file a NFTL. Section 3421 left the Commissioner with discretion to determine the circumstances under which such review would be appropriate as well as the extent of such review. The legislative history makes this point explicit for situations involving notices of lien issued by the automated collection system, which would encompass the vast majority of those CNC situations at issue in the TAD. See General Explanation of Tax Legislation Enacted in 1998 ("Bluebook") at 96, 1998-4 C.B. 543 ("The Commissioner is to 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.”). The review process may include a certification that the employee has reviewed the taxpayer's information, verified that there is a balance due, and affirmed that the proposed action is appropriate given the taxpayer's circumstances, considering the amount due and the value of the property. RRA 98 ' 3421(b).

Given the large number of taxpayer accounts that the Service is tasked with managing, several functions inevitably need to be automated. The Commissioner has determined that there are categories of accounts for which it would not be appropriate to engage in the balancing suggested by section 3421, because the administrative costs and burdens of undertaking the balancing in addition to the government’s strong interest in establishing priority vis-à-vis other creditors outweighs the taxpayer’s interests. The hardship CNC situation targeted in the TAD is an example of one of these categories.

Congress was keenly aware of the government’s need to satisfy expeditiously the filing requirements of section 6323. The legislative history acknowledges that "[a] Notice of Lien must be filed in order to inform potential purchasers or creditors of the Federal government's priority interest in the taxpayer's property" (emphasis added). See Bluebook at page 81 (description of Present and Prior Law). Congress recognized this heightened interest in establishing lien priority through the enactment of section 6320, which allows the Service to file a NFTL before the taxpayer is afforded collection due process rights. The adverse result to the government of not filing Notices of Federal Tax Liens would be diminished collection of tax revenues. It would permit a later creditor to obtain priority over the government’s earlier arising assessment lien (e.g., purchasers, judgment lien creditors, and holders of security interests), and it would allow such interests to prime those of the government in any after-acquired property (including gifts and inheritances), on which the general tax lien otherwise would attach. Section 6323(a). Collection would also be diminished in bankruptcy, because the Service’s claims would not be secured without a NFTL, and secured claims generally fare better than unsecured claims. The filing of an NFTL also is critical for *in rem* collection of debts for which a taxpayer has received a discharge, because section 522(c)(2)(B) of the Bankruptcy Code provides that a debtor's exempt property remains liable for a tax lien for which a notice properly has been filed. See In re Isom, 901 F.2d 744 (9th Cir. 1990). These consequences would be in addition to the costs associated with performing the suggested balancing, which would include verifying the taxpayer's property and the taxpayer’s equity in such property as well as assessing the prospects for the taxpayer’s future accumulation of property.

The Commissioner’s decision to give these considerations greater weight than the interests of taxpayers in not being subject to a NFTL is valid. The hardships that may flow from the statutory imposition of the lien must be distinguished from those related to the filing of the NFTL. The stated motive behind the enactment of section 3421 was Congressional concern that the “imposition of liens, levies, and seizures may impose significant hardships on taxpayers.” See Bluebook at 96; S. Rep. 105-174 (Senate Report) at 78, 1998-3 C.B. 537; H.R. Rep. No. 105-599 (Conference Report) at 277,

1998-3 C.B. 747. The general tax lien imposed by section 6321 “upon all property and rights to property” belonging to the taxpayer arises automatically by operation of law at the time the assessment is made and continues "until the liability for the amount so assessed (or a judgment against the taxpayer arising out of such liability) is satisfied or becomes unenforceable by reason of lapse of time." Section 6322. In addition to establishing priority against third parties, the federal tax lien applies pressure on the delinquent taxpayer to pay. Although the imposition of the federal tax lien may mean significant hardships for a taxpayer, the Commissioner has no discretion to delay or mitigate the attachment of the lien. Section 3421 focuses on the hardship associated with the filing of the notice of the lien, not the lien itself.

The National Taxpayer Advocate 2009 Annual Report to Congress addresses this second-order hardship by explaining that a NFTL “impairs taxpayers’ credit reports and unless appropriately applied, may impede taxpayers’ financial viability and ability to pay past, current, and future taxes.” To support this assertion, the report explains: (1) on average, a lien filing reduces a taxpayer’s credit score by 100 points; (2) unpaid tax liens may remain on a taxpayer’s credit history, leaving a derogatory mark on the credit history indefinitely; (3) 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; (4) some lenders decline to extend credit to a taxpayer if the Service has filed an NFTL against the taxpayer’s property; (5) some lenders will charge substantially higher rates; (6) impaired credit history might affect a taxpayer’s ability to obtain insurance or rent an apartment on reasonable terms; and (7) some licensing boards require members to maintain a clean credit history and some employers require employees to do so as a condition of employment. These second-order hardships all involve the taxpayer’s relationships with third parties. As an involuntary creditor not involved in the extension of credit, the Service is not in a position to evaluate these potential hardships and lacks the resources to effectively account for them in the large number of CNC hardship cases.

In addition, section 3421 does not require the Service to ignore basic business realities. Private sector creditors routinely perfect non-de minimis interests in debtors' property by filing notices of lien. The Service’s mission to help taxpayers “understand and meet their tax responsibilities” and to “appl[y] the tax law with integrity and fairness to all” does not dictate a different practice from that of other creditors.

The Commissioner has exercised the statutory discretion to determine when it would be appropriate to file a NFTL as evidenced by Service procedures. Collection Policy has procedures in place that govern lien filing requirements. IRM Part 5.12.2 (current 10-2009). Those procedures have been vetted by both management and Counsel. The Tax Court has upheld the validity of these procedures and implicitly has approved the Commissioner's decision not to apply the balancing suggested by section 3421 when taxpayers have challenged the authority of Service personnel to file NFTLs. See Criner v. Commissioner, T.C. Memo 2003-328 (the court upheld the collection action, finding that compliance with the IRM was enough, even though the IRM did not require a formal “review step”).

If you have any questions regarding this matter, please call Micah Levy at (202) 622-4137 or me at (202) 622-3400.