LR #5

Amend IRC § 7403 to Provide Taxpayer Protections Before Lien Foreclosure Suits on Principal Residences

PROBLEM

Taxpayer protections on lien foreclosure suits against principal residences are inadequate. After a taxpayer fails to pay any tax, the federal tax lien arises by operation of law.[1] The IRS may generally commence an administrative seizure when it notifies a taxpayer of the opportunity to be heard in a Collection Due Process (CDP) hearing.[2] After the taxpayer's hearing (or failure to respond), the IRS may seize the taxpayer's property, subject to protections provided by the Internal Revenue Code. A taxpayer's principal residence is generally protected from seizure if:

- The tax liability is $5,000 or less;
- The taxpayer owns insufficient equity in the property;
- The taxpayer will suffer an economic hardship from the seizure;
- An installment agreement (IA) or offer in compromise (OIC) is pending, or if rejected, for 30 days after rejection or during any appeal of the rejection;
- An IA is in effect, or if terminated, for 30 days after the termination or during any appeal of the termination;
- An IRS Area Director does not approve the seizure; or
- A United States District Court judge or magistrate finds the requirements of any applicable law or administrative procedures have not been met, the tax liability is not owed, or the taxpayer's other assets are sufficient for the collection of the debt.[3]

Yet after the IRS files a Notice of Federal Tax Lien (NFTL) in the public records and offers a CDP hearing to the taxpayer, the IRS may request that the U.S. Attorney General (AG) direct the filing of a suit to foreclose the tax lien and sell the taxpayer's principal residence, without reference to the protections applicable to seizures.[4]

IRS procedures recommend that employees request lien foreclosure suits, in lieu of approvals for seizures of principal residences, for taxpayers' residences with "issues related to ownership, nominee situations, collection statute concerns ..., or other items."[5] Ownership

1 Internal Revenue Code (IRC) § 6321.

2 IRC §§ 6330(a)(3) and 6331(a).

3 IRC §§ 6331(k), 6334(a)(13), 6334(e) and 6343(a)(1)(D); Treas. Reg. § 301.6334-1(d)(1). Internal Revenue Manual (IRM) 5.17.3.4.5, *Seizure of a Residence/Principal Residence* (Jan. 7, 2011). IRM 5.10.1.2, *List of Prohibited Seizures* (Dec. 13, 2005).

4 IRC § 7403.

5 IRM 5.10.2.18, *Judicial Approval for Principal Residence Seizures* (July 3, 2009). Collection statute concerns generally develop from collection statutes expiring in one year or less. Collection statute refers to the statutory period for IRS collections (generally ten years) provided by IRC § 6502(a), plus suspensions and extensions provided by law. Nominee situations generally arise when another party owns the property but the taxpayer has the exclusive use and enjoyment of the property. IRM 5.17.2.5.7, Property Held By Third Parties (Mar. 27, 2012); *Oxford Capital Corp. v. United States*, 211 F.3d 280, 284 (5th Cir. 2000).

issues for a principal residence generally arise when another party, such as a non-liable spouse, claims an interest in the property.[6] In these situations, the U.S. District Court may order the sale of the principal residence of a taxpayer, who may be suffering an economic hardship, without regard to the significant taxpayer protections applicable to the IRS's seizure power.

Whether by seizure or foreclosure, the taking of principal residences effectively deprives taxpayers of their homes and the financial resources to acquire new ones. Inadequate taxpayer protections respecting the IRS's ability to request foreclosure may disrupt the taxpayer's livelihood and cause unnecessary harm to his or her family members, the very injuries Congress sought to prevent when the IRS seizes principal residences.

EXAMPLE

A married taxpayer files her tax returns separately from her husband. Both are employed and jointly own a home, which is valued at $300,000. In 2001 and 2002, the taxpayer earns substantial income. In 2003, she files her 2001 return late and her 2002 return timely, showing $20,000 underpayments for each year. The taxpayer miscalculates her estimated taxes; a higher bracket in fact applies. When she discovers the underpayments, she enters into an installment agreement to pay the taxes.

In September 2005, a revenue officer (RO) contacts the taxpayer, because the IRS terminated her IA after she missed two installments. The RO files an NFTL, and sends her Letter 3172, *Notice of Federal Tax Lien Filing and your Rights to a Hearing Under IRC 6320*. The RO also sends the taxpayer Letter 1058, *Notice of Intent to Levy and Notice of Your Right to a Hearing*, notifying her that the IRS proposes to seize her property, and she requests a hearing for the lien and levy action. Because her husband has developed Parkinson's disease, the taxpayer's income is insufficient to pay the couple's basic living expenses. The hearing officer determines that her account should be placed in currently not collectible (CNC) status.

In September 2012, the RO contacts the taxpayer for collection. She is in current compliance, although her 2001 and 2002 tax liability, including interest and penalties, has grown to approximately $50,000. The RO suggests that the taxpayer mortgage her home to pay her tax debts. She explains that her husband no longer works, and she is unable to pay the additional monthly payments for a mortgage. Further, their home has been specially modified to accommodate her husband's condition. The RO proposes to foreclose the IRS's lien against the taxpayer's residence, because there is less than one year left in the statutory period for collection. He receives Area Director approval of the foreclosure and refers the suit to the AG.

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6 IRM 5.17.2.5.2, *Real Property* (Mar. 27, 2012).

RECOMMENDATION

The National Taxpayer Advocate recommends that Congress amend IRC § 7403 to preclude an IRS employee from requesting that the AG direct the filing of a civil action to foreclose the federal tax lien against a taxpayer's principal residence in U.S. District Court, unless the IRS employee has received executive-level approval after determining that:

- The taxpayer's other property or rights to property, if sold, are insufficient to pay the amount due, including the expenses of the proceedings; and
- The foreclosure and sale of the residence will not create an economic hardship due to the financial condition of the taxpayer.

PRESENT LAW

Upon assessment of a tax liability, notice to the taxpayer, demand for payment, and the taxpayer's neglect or refusal to pay, a lien in favor of the United States attaches to the taxpayer's property or rights to property.[7] The lien attaches to all property, which includes property held by spouses as tenants by the entirety.[8] In the absence of jeopardy, 30 days after the IRS furnishes a notice of intent to levy to the taxpayer and provides an opportunity for a CDP hearing, the IRS may seize the taxpayer's property or rights to property (except property exempt under IRC § 6334).[9] As soon as practicable after seizure, the IRS must provide written notice to the taxpayer specifying the amount owed, a description of the property seized, and the time, place, conditions, and manner of the sale.[10]

The IRS must generally consider the type of property, collection alternatives, and the financial condition of the taxpayer before collecting by seizure. The Taxpayer Bill of Rights I (TBOR I), enacted in 1988, requires the IRS to release any levy, including seizures, upon a taxpayer's property or rights to property if the IRS determines the seizure is creating an economic hardship due to the financial condition of the taxpayer (*i.e.*, he or she cannot

7 IRC § 6321. IRC §§ 6324, 6324A and 6324B provide for special liens in favor of the U.S. to collect certain unpaid estate and gift taxes. For purposes of this legislative recommendation, the discussion is limited to the general statutory tax lien under IRC § 6321.

8 *United States v. Craft*, 535 U.S. 274, 281-288 (2002). Like joint tenants, tenants by the entirety enjoy the right of survivorship. Unlike joint tenancies, tenancies by the entirety cannot easily be severed unilaterally. Typically, severance requires the consent of both spouses, or the ending of the marriage in divorce.

9 IRC § 6331(a). The IRS's power to seize a taxpayer's property is also known as a levy. Most levies involve the taking of money. However, seizures generally involve the taking of property and selling it pursuant to IRC § 6335. Seizure action is usually the last option in the collection process. IRM 1.2.14.1.8, *Policy Statement* 5-34 (May 28, 1999). IRC § 6330 generally provides the right to a CDP hearing before levy if the taxpayer requests the hearing no later than 30 days after receiving the notice of intent to levy, unless the collection of tax is in jeopardy. The IRS does not need to identify any specific property it intends to levy or seize in the CDP notice. *See* IRM 5.11.1.2.2, *Satisfying the Notice Requirements* (Dec. 11, 2009).

10 IRC § 6335. The IRS also places the notice of sale in some newspaper published or generally circulated within the county where the seizure was made, and posts this notice in the local post office and at least two other public places.

meet basic living expenses).[11] Where collection would create an economic hardship, the IRS also may forego seizure to collect a taxpayer's account and place it in CNC status.[12]

TBOR I also provides for district director or assistant district director approval or a finding that the collection of tax is in jeopardy before the IRS may seize a principal residence.[13] A taxpayer's principal residence includes the principal residence of the taxpayer, the taxpayer's spouse, former spouse, or minor child.[14] The IRS Restructuring and Reform Act of 1998 (RRA 98) amended TBOR I to exempt a principal residence (within the meaning of IRC § 121) from seizure, unless a judge or magistrate of a U.S. District Court approves the seizure under IRC § 6334(e).[15] The judge or magistrate may not approve the seizure unless he or she determines the taxpayer's other assets subject to collection are insufficient to pay the amount due, including the expenses of the proceedings.[16] Further, if the tax liability does not exceed $5,000, the IRS may not seize any property used as a residence by the taxpayer or other real property owned by the taxpayer (other than rental property) used by any other individual as a residence.[17]

After the lien arises but before the IRS forecloses, the IRS generally files an NFTL to protect its interests from any purchaser, security interest holder, mechanic's lienor, or judgment lien creditor.[18] After the filing, the IRS must provide the taxpayer an opportunity to be heard by requesting a CDP hearing within 30 days of the period ending five business days after the filing.[19] Whether or not the IRS has seized property, the IRS may request that the AG or his delegate direct a civil action to be filed in a U.S. District Court to enforce the federal tax lien to collect the liability, or to subject any property in which the taxpayer has any right, title, or interest, to the payment of such liability.[20] When requesting lien foreclosure, the IRS also may request that the AG seek a judgment against the taxpayer for any unpaid

11 This section of the Taxpayer Bill of Rights I was enacted as part of the Technical and Miscellaneous Revenue Act of 1988 (TAMRA), Pub. L. No. 100-647, § 6236(f), 102 Stat. 3740 (codified as IRC § 6343(a)). Treas. Reg. § 301.6343-1(b)(4) defines economic hardship.

12 IRM 5.16.1.1 (May 22, 2012). *See* IRM 5.10.3.5, *Seizing the Property* (Jan. 22, 2008), if the taxpayer claims a hardship situation, the revenue officer should determine, based on the particular circumstances if the actual seizure action should be discontinued.

13 TAMRA, Pub. L. No. 100-647, § 6236(c)(4), 102 Stat. 3740 (codified as IRC §§ 6334(a)(13) and 6334(e)).

14 Treas. Reg. § 301.6334-1(d).

15 Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, § 3445, 112 Stat. 685 (1998) (amending IRC §§ 6334(a)(13) and 6334(e)).

16 IRC § 6334(e).

17 RRA 98, Pub. L. No. 105-206, § 3445(a), 112 Stat. 685 (1998) (codified as IRC § 6334(a)(13)(A)).

18 IRC § 6323(a). *See Fairchild v. IRS*, 450 F.Supp.2d 654, 657-658 (M.D.La. 2006). The NFTL does not protect the priority of the federal tax lien against other creditors, if it is filed after the conclusion of the foreclosure action.

19 IRC § 6320 requires the IRS to provide an opportunity for the taxpayer to request a CDP hearing within 30 days after the five-business-day period following the filing of the NFTL. The IRS is not required to identify if the taxpayer owns any property before it files the NFTL. *See* IRM 5.12.2.4.1, *Criteria for Filing a NFTL* (Mar. 8, 2012).

20 IRC § 7403. The courts cannot refuse to authorize the sale to protect the interests of the taxpayer. *United States v. Rodgers*, 461 U.S. 677, 709 (1983).

amounts following foreclosure.[21] The federal tax lien and the judgment lien obtained by the IRS will survive for at least 20 years and may be extended an additional 20 years.[22]

REASONS FOR CHANGE

Taxpayers face similar economic harm whether they lose their homes through seizure or lien foreclosure. In enacting RRA 98, Congress stated its belief that seizure of a taxpayer's principal residence is particularly disruptive to the taxpayer and his or her family, and should be a last resort.[23] Yet the IRS may request that the AG seek foreclosure of the federal tax lien against a taxpayer's principal residence after the IRS files the NFTL and provides CDP hearing rights to the taxpayer.[24] The IRS increased its seizures by 21 percent and foreclosure suit referrals by 26 percent from fiscal year (FY) 2010 to FY 2012.[25] Although the administrative seizure process is generally adequate, IRS procedures suggest that ROs consider referral to the AG for a lien foreclosure suit where:

- Seizure and sale would result in a lower price paid for the property;
- Encumbrances on the property, other than the federal tax lien, make it difficult for the RO to determine the relative interests in the property;
- The taxpayer's title to the property is contested by a third party; or
- Unpaid federal tax liens are filed against only one of several co-owners and a sale of undivided partial interests is not feasible.[26]

Once the AG directs the filing of a foreclosure suit, the courts have limited equitable discretion to order the sale of the taxpayer's residence in cases where another party claims an

21 IRC § 7402(a).

22 IRC § 6322 provides that a federal tax lien shall continue until the liability is satisfied or unenforceable by reason of lapse of time. The Federal Debt Collection Procedure, 28 U.S.C.A. 3001 *et seq.*, provides the exclusive means for collection of a debt owed to the government to the extent another federal law does not specify procedures for recovering a claim or judgment that are inconsistent with it. 28 U.S.C.A. § 3002(3)(B) (2012) defines federal debts to include assessments, taxes, penalties, and interest. 28 U.S.C.A. § 3201(c) (2012) provides that a judgment lien is effective, unless satisfied, for a period of 20 years, and may be renewed for additional periods of 20 years if a notice of renewal is filed before the running of the initial 20 year period and the court approves it.

23 S. Rep. No. 105-174, at 86-87 (1998).

24 IRC §§ 6321 (tax lien arises), 6320 (CDP rights), 6323 (priority of tax lien) and 7403 (lien foreclosure suit referral). Although the IRC does not require that the IRS file an NFTL before requesting lien foreclosure, the IRS generally files an NFTL to protect the priority of the government's interest in the property the IRS is foreclosing on. *See* IRC § 6323(a).

25 IRS, Small Business/Self Employed Division (SB/SE), Collection Activity Report NO-5000-24, *Levy and Seizure Report* (Oct. 1, 2012). Department of Justice (DOJ), Tax Division, *Suits to Foreclose Tax Lien – Summary by Fiscal Year of Case Receipt* (Oct. 3, 2012). The IRS conducted 605 seizures and referred 221 lien foreclosure suits to the DOJ in FY 2010, and conducted 733 seizures and referred 278 lien foreclosure suits to the DOJ in FY 2012.

26 IRM 5.17.4.8.2.1, *Administrative Collection Devices Are Not Feasible or Adequate* (Aug. 1, 2010). Property seized and sold by the IRS under IRC § 6335 generally yields less proceeds, because the owners of real property sold, their heirs, executors, administrators, or any other person having an interest, or lien on the property, are permitted to redeem property sold at any time within 180 days after the sale under IRC § 6337(b). These parties do not have the same redemption rights in a lien foreclosure suit, because the court must determine the respective interests of these parties in the suit and issue a final order, which may be appealed by the taxpayer or party under Rule 4 of the Federal Rules of Appellate Procedure, or compromised by the AG under IRC § 7122.

interest in the property.[27] Courts could decline to order a sale of the entire property after deciding whether:

- Forced sale of the taxpayer's partial interests would yield enough proceeds so as to not prejudice the government's financial interest in the entire property.
- A non-liable party with an interest in the property would, in the normal course of events, have a legally recognized expectation that the separate property would not be subject to forced sale by the taxpayer or his or her creditors.
- Inadequate compensation and personal dislocation costs in the sale of the entire property would prejudice the financial interests of the non-liable party with an interest in the property.
- The relative character and value of the non-liable party's interest is much greater than the taxpayer's interest.
- Common sense and consideration of special circumstances support forced sale of the taxpayer's partial interest.[28]

However, the courts have no discretion to refuse to authorize the sale to protect the interests of the taxpayer.[29]

Taxpayers have no protection following IRS referral of lien foreclosure suits against their principal residences. By contrast, before the IRS may request seizure and sale of the principal residence, the IRS must prove to the court that the taxpayer has insufficient assets to pay the full amount due, and the IRS must return the residence if the seizure creates an economic hardship.[30] Taxpayers should be afforded the same rights in lien foreclosure requests against their principal residences as they would receive when the IRS seizes their principal residences.

EXPLANATION OF RECOMMENDATION

Taxpayers should be protected from loss of their principal residences by lien foreclosure because loss of a principal residence causes economic harm, disrupts taxpayers and their families, and should only be used as a last resort. Before requesting that the AG direct the filing of a suit to foreclose the federal tax lien and sell the taxpayer's principal residence, the IRS employee should receive executive-level approval after determining whether the taxpayer's other property or rights to property are insufficient to satisfy the federal tax debt, and whether the foreclosure and sale of the principal residence creates an economic hardship due to the financial condition of the taxpayer. With these protections in place, the U.S. District Court could determine whether the IRS made the appropriate mandatory

27 *United States v. Rodgers*, 461 U.S. 677, 708-709 (1983).

28 *Id*. at 710-711 (1983).

29 *Id*. at 709 (1983).

30 IRC §§ 6334(e), 6343(a)(1)(D), and 6343(d).

findings, and order or deny the foreclosure and sale of the taxpayer's principal residence accordingly.