

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

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### RESPONSIBLE OFFICIALS

Peggy Bogadi, Commissioner, Wage and Investment Division

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### DEFINITION OF PROBLEM

Notices of Federal Tax Lien (NFTLs) establish the priority of the government’s interest in a tax debtor’s property against subsequent purchasers, secured creditors, and junior lien holders. TAS studies show that NFTLs can cause unnecessary harm to taxpayers and reduce their ability to become or remain compliant. They also generate significant downstream costs for the government, often without attaching to any tangible or intangible assets.<sup>1</sup>

In 2011, in response to the National Taxpayer Advocate’s continued criticism of NFTL filing and withdrawal policies, the IRS announced a new effort to help financially struggling taxpayers get a “fresh start,” which included several positive changes in how the IRS files and withdraws NFTLs. Notwithstanding this initiative, the IRS still files most NFTLs based on an arbitrary dollar threshold of the unpaid liability, rather than a thorough analysis of the taxpayer’s individual circumstances and financial situation, or reference to NFTL impact on future compliance and collected revenue.

A recent Taxpayer Advocate Service (TAS) study found that by calendar year (CY) 2010, all taxpayers in the study with NFTLs filed against them owed 121 percent of what they owed when the lien was filed.<sup>2</sup> Taxpayers with NFTLs paid \$25,845 on average, which is equivalent to about 69 percent of their liabilities at the time of lien filing. Non-lien taxpayers paid \$38,477, equivalent to about 111 percent of their liabilities at the proxy lien date.<sup>3</sup> More importantly, taxpayers with whom the IRS agreed to settle debts through an offer in compromise (OIC) sometime before 2011 owed only 13 percent of what they owed at the lien or proxy lien date, while taxpayers who did not receive an OIC owed 123 percent of their individual IRS tax debts at the time of lien filing.<sup>4</sup> Further, taxpayers who entered into an installment agreement (IA) during the initial study years (*i.e.*, before 2005) paid

<sup>1</sup> See T. Keith Fogg, *Systemic Problems with Low-Dollar Lien Filing*, 2011 TNT 194-9 (Oct. 6, 2011); National Taxpayer Advocate 2011 Annual Report to Congress 109-128.

<sup>2</sup> The study analyzes the impact of lien notice filing on taxpayer liabilities and payment behavior for a cohort of taxpayers who acquired liens between CYS 2002 and 2004. See TAS Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*, Vol. 2, *infra*.

<sup>3</sup> To compute a proxy lien filing date for our non-lien taxpayers, we first calculated the median days to lien filing from the date our lien taxpayers acquired their tax liability. For our non-lien taxpayers, we then added this number of days to the date they acquired their tax liability to determine the proxy lien filing date.

<sup>4</sup> See TAS Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*, vol. 2, *infra*.

Most Serious Problem

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significantly more on average than taxpayers who did not receive an IA.<sup>5</sup> Those with IAs owed only 57 percent of what they owed at the lien or proxy lien date, while taxpayers who did not receive an installment agreement owed 120 percent of what they owed at the lien or proxy lien date. Thus, NFTL filing produces less revenue and is more harmful to taxpayers than other collection alternatives.

As a result of this and other studies, the National Taxpayer Advocate has identified the following concerns with the IRS’s NFTL policies, some of which have persisted for years:

- Low and inconsistent NFTL filing thresholds established under the “fresh start” initiative;
- The limited use of NFTL withdrawal authority;
- The IRS’s inability to determine the impact of NFTLs on collected revenue due to the inadequate use of Designated Payment Codes (DPCs);
- Unnecessary harm to taxpayers whose accounts are reported currently not collectible (CNC) due to economic hardship; and
- The IRS’s reluctance to develop meaningful NFTL filing and withdrawal criteria or use collection alternatives in lieu of lien filing, based on research on lien impact in terms of collected revenue and effect on tax compliance.

## ANALYSIS OF PROBLEM

### Background

With the IRS Restructuring and Reform Act of 1998 (RRA 98), Congress recognized that federal tax liens may impose a serious hardship on taxpayers, and enacted provisions to preclude the IRS from “abusively us[ing] its liens-and-seizure authority.”<sup>6</sup> Enactment of RRA 98 likely led to reduced NFTL filing activity, as filings for fiscal year (FY) 1999 initially dropped to 168,000 compared to previous year averages of over 750,000.<sup>7</sup> Even though the law requires managerial approval for NFTL filings, “where appropriate,” the IRS concluded that this approval was unnecessary for higher-graded employees.<sup>8</sup> By contrast, the IRS requires all employees to obtain managerial approval if they determine *not* to file or defer the filing of an NFTL when the case meets or exceeds the pre-determined threshold amount.<sup>9</sup>

<sup>5</sup> Taxpayers who receive IAs before 2004 paid \$ 44,989 on average towards their liabilities during the study period. Taxpayers who did not receive IAs paid \$ 31,035 on average. See TAS Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*, Vol. 2, *infra*.

<sup>6</sup> 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, at S12231 (statement of Senator Roth).

<sup>7</sup> IRS, Statistics of Income (SOI), Table 16a, Delinquent Collection Activities, 2002-2009.

<sup>8</sup> See RRA 98, Title III, § 3421; 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). Revenue Officers (ROs) at GS-9 and Automated Collection System (ACS) employees at the GS-6 level are authorized to file an NFTL without managerial approval. IRM 5.12.2.5 (Feb. 1, 2007); IRM 5.19.4.5.1(7) (Apr. 28, 2009).

<sup>9</sup> IRM 5.12.2.4.2.3 (Mar. 8, 2012); IRM 5.19.4.5.2(10) (March 14, 2012).

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The IRS based its NFTL filing model and policy on recommendations (now ten years old) noted in a Treasury Inspector General for Tax Administration (TIGTA) report.<sup>10</sup> The recommendations included filing NFTLs on currently not collectible accounts over \$5,000 and on accounts placed in the Collection Queue.<sup>11</sup> In response to the report, the IRS took the position that in most cases, unless it filed the NFTL it was losing revenue, regardless of a taxpayer’s inability to pay, the absence of assets to which the lien could attach, or the harm to the financial viability of the taxpayer. However, TAS has found that most payments for taxpayers with NFTLs filed against them for which TAS traced the source of the payment were attributable to sources other than the lien notice, *e.g.*, refund offsets.<sup>12</sup>

Despite its inability to measure how effective NFTLs are in collecting revenue, the IRS continued filing an increasing number of them.<sup>13</sup> The volume reached pre-FY 1996 levels again in FY 2008 when the IRS filed 768,000 NFTLs, and peaked at 1.1 million in FY 2010.<sup>14</sup> As a result of the Fresh Start changes in NFTL filing policies (discussed below), the number of NFTLs dropped about 32 percent to approximately 708,000 in FY 2012, as shown on Chart X below. Notably, IRS collection revenue did not decrease despite the significant drop in NFTLs filings.<sup>15</sup>

<sup>10</sup> TIGTA, Ref. No. 2002-30-106, *The Internal Revenue Service Should Modify Its Federal Tax Lien Practices to Treat Taxpayers More Equitably and Better Protect the Government’s Interest* (June 5, 2002).

<sup>11</sup> The TIGTA report stated that the value of taxpayer assets should have no direct impact on a lien filing decision, and if the IRS does not file liens when accounts are closed CNC, the likelihood of any future collection is reduced. The queue is a holding process where cases are placed after the ACS system mails notices to taxpayers and before being assigned for additional collection action by the Collection Field function (CFF). Cases stay in the queue based on business rules and resources available to work them.

<sup>12</sup> See National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18. TAS analysis of IRS payment source data found that the DPC was underutilized on post-assessment tax payments received in 2009. Thus, in most cases, the IRS does not know and cannot determine what event or action prompted the subsequent payment on a past due account.

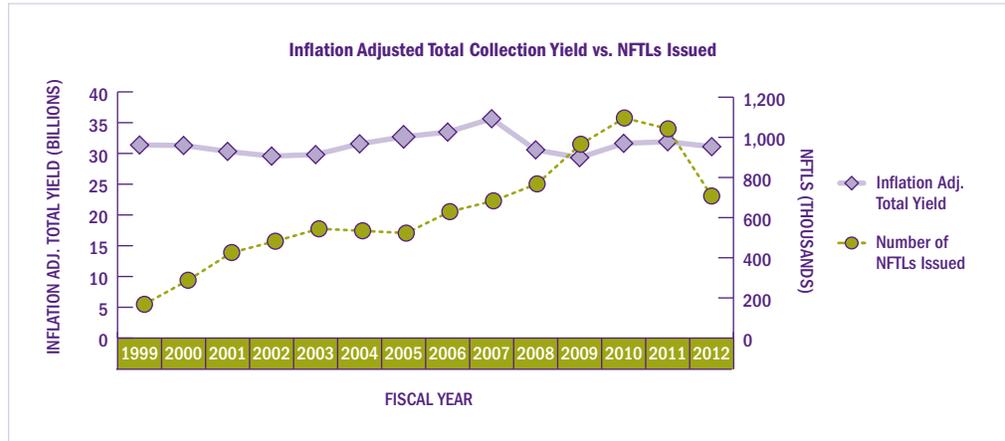
<sup>13</sup> The IRS does not adequately track the source of payments on past due accounts to measure the effectiveness of its collection actions. See National Taxpayer Advocate 2010 Annual Report to Congress 250-266.

<sup>14</sup> IRS, Statistics of Income (SOI), Table 16a, Delinquent Collection Activities, 2002-2009.

<sup>15</sup> IRS Databook, FY 2012, Table 16.

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**FIGURE 1.22.1, Inflation-Adjusted Total Yield vs. NFTLs Issued in FYs 1999–2012<sup>16</sup>**



**Long-Lasting Effect of NFTL on Taxpayers’ Financial Viability**

The NFTL filing and the information contained in the notice are included in consumer (credit) reports<sup>17</sup> and therefore may impair a taxpayer’s ability to obtain financing, find or keep a job, and secure affordable housing or insurance.<sup>18</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 or impede recovery. Ultimately, the lien can undermine tax revenue and future compliance.<sup>19</sup>

TAS interviewed executives at the Experian, Equifax, and TransUnion credit bureaus about the long-lasting, damaging impact of NFTLs on credit reports.<sup>20</sup> While “paid tax liens” appear on credit reports for seven years from the date of payment,<sup>21</sup> unpaid liens may remain on the taxpayer’s credit report indefinitely, even when the underlying lien becomes unenforceable (*e.g.*, because the statute of limitations for collection has expired and the

<sup>16</sup> IRS, *IRS Data Book, Table 16, Delinquent Collection Activities, 1999-2012*; IRS, Collection Activity Report NO-5000-23 and 5000-25, *Collection Workload Indicators (1999-2012)*.

<sup>17</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>18</sup> TAS teleconferences with the major consumer reporting agencies (CRAs) – Experian (Oct. 1, 2009), Equifax (Sept. 1, 2009), and Transunion (Sept. 3, 2009). 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).

<sup>19</sup> 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.

<sup>20</sup> National Taxpayer Advocate 2009 Annual Report to Congress 20.

<sup>21</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 noted on the credit report but does not necessarily impact the credit score in a significant way.

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lien self-released).<sup>22</sup> In addition, the filing of a NFTL reduces a taxpayer’s credit score by an average of 100 points.<sup>23</sup> Thus, the filing may hamper collection and damage the interest that the government intends to protect.

The IRS does not sufficiently consider the impact of an NFTL on credit reports or the resulting harm to the taxpayer. The IRM states that “[t]he filing of a NFTL may affect a taxpayer’s credit rating, and this alone is not sufficient reason to withhold filing the NFTL.”<sup>24</sup> Given changes in credit reporting practices and the use of credit reports, the IRS should routinely consider the impact of NFTLs on taxpayers’ credit before NFTL filing.

### **The Fresh Start Initiative Has Reduced the Number of NFTL Filings and Increased the Number of Withdrawals.**

For several years, the National Taxpayer Advocate has expressed concerns about the adverse impact of IRS lien filing and withdrawal policies on taxpayers and future compliance.<sup>25</sup> TAS also completed several comprehensive studies of the impact of NFTLs on taxpayer compliance behavior, which showed that indiscriminate filings might negatively influence revenue collection.<sup>26</sup> In response, the IRS issued guidance designed to help financially struggling taxpayers, including several positive changes in how it files and withdraws NFTLs.<sup>27</sup> TAS worked very closely with the Collection function in developing and clearing procedural guidance related to the “Fresh Start” initiative,<sup>28</sup> which included:

- Doubling the dollar threshold for filing most NFTLs from \$5,000 to \$10,000, resulting in fewer NFTLs;<sup>29</sup>
- Changing procedures for NFTL withdrawals after lien releases;<sup>30</sup>

<sup>22</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 refilled 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>23</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>24</sup> IRM 5.12.2.4.2(6) (Mar. 8, 2012).

<sup>25</sup> See, e.g., National Taxpayer Advocate 2011 Annual Report to Congress 109-128; National Taxpayer Advocate 2010 Annual Report to Congress 302-310; National Taxpayer Advocate 2009 Annual Report to Congress 17-40. 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>.

<sup>26</sup> See *TAS Research Study: Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*, vol. 2, *infra*. See also National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 91-111 (*TAS 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 (*TAS Research Study: The IRS’s Use of Notices of Federal Tax Lien*).

<sup>27</sup> 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).

<sup>28</sup> 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).

<sup>29</sup> SB/SE, *Interim Guidance Memorandum*, Control No. SBSE-05-0311-039 (Mar. 28, 2011). The Collection Process Study (CPS), in which TAS actively participated, recommended raising the threshold to \$50,000. IRS, CPS 122 (Sept. 30, 2010). NFTLs can still be filed for any amount if appropriate. IRM 5.12.2.4.1 (Mar. 8, 2012).

<sup>30</sup> SB/SE, *Interim Guidance Memorandum*, Control No. SB/SE-05-0611-037 (June 10, 2011).

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- Providing for NFTL withdrawal in most cases where a taxpayer enters into a Direct Debit Installment Agreement (DDIA);<sup>31</sup> and
- Eliminating NFTL filings when the balance to be reflected on the NFTL is less than \$2,500.<sup>32</sup>

Following up on these changes, the IRS reprogrammed its Automated Collection System (ACS),<sup>33</sup> which files NFTLs systemically, as follows:

- On February 24, 2011, ACS’s systemic NFTL filing threshold was increased from \$5,000 to \$10,000;
- On April 15, 2011, the threshold was further increased to \$25,000; and
- On June 25, 2011, ACS established a systemic lien ‘floor’ amount, on subsequent tax periods at \$2,500 or more.<sup>34</sup>

#### *The Effect of the Fresh Start Initiative on the Number of NFTLs Filed*

Because of these changes, in FY 2011 the number of NFTLs decreased by approximately 54,000 or five percent from FY 2010 levels.<sup>35</sup> In FY 2012, the trend continued with NFTL filings down about 32 percent from FY 2011. Automated Collection System filings dropped by 48 percent and filings by Revenue Officers (or non-ACS NFTLs) dropped by 19 percent, as shown on Figure 1.22.2 below.

<sup>31</sup> SB/SE, *Interim Guidance Memorandum*, Control No. SBSE-05-0411-036 (Apr. 7, 2011).

<sup>32</sup> SB/SE, *Interim Guidance Memorandum*, Control No. SBSE-05-0511-050 (May 13, 2011).

<sup>33</sup> IRMs for both Revenue Officers (ROs) and ACS generally state that the NFTL may be filed if the unpaid balance of assessment is \$10,000 or more. IRM 5.12.2.4.1 (Mar. 8, 2012); IRM 5.19.4.5.2 (Mar. 14, 2012).

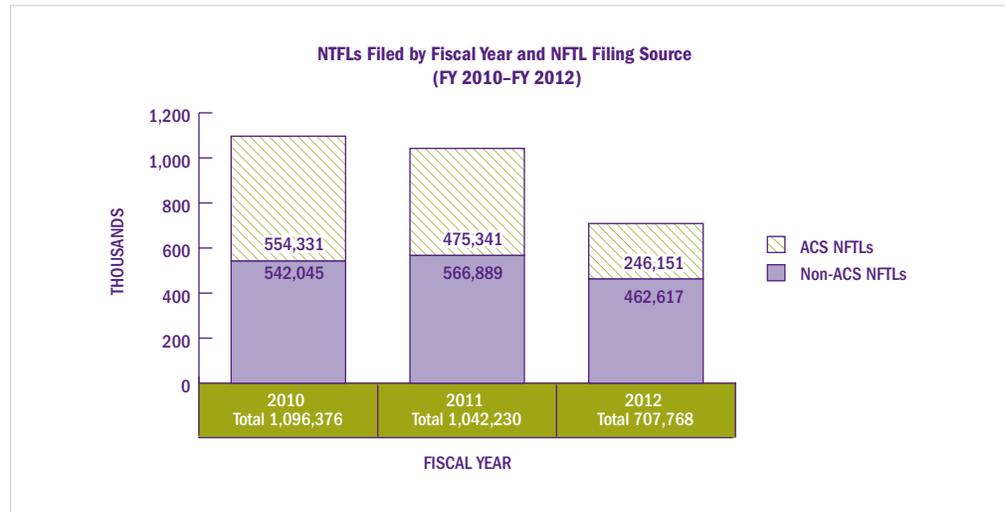
<sup>34</sup> IRS response to TAS information request (Oct. 1, 2012).

<sup>35</sup> IRS, Collection Activity Report NO-5000-23, *Collection Workload Indicators (Oct. 30, 2011)*; IRS, *Fiscal Year 2010 Enforcement Results*, available at [http://www.irs.gov/pub/irs-utl/2010\\_enforcement\\_results.pdf](http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf).

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**FIGURE 1.22.2, NFTLs Filed by Fiscal Year and NFTL Filing Source, FY 2010–2012<sup>36</sup>**



Although it filed fewer NFTLs, the IRS continued to file most NFTLs based on inconsistent dollar thresholds of liability for ACS and ROs, without meaningful human review of the need for the NFTL based on the facts and circumstances of the case.

Fresh Start changes in NFTL filing thresholds provide the IRS an opportunity to measure the change, by sampling accounts to determine the revenue impact of filing NFTLs at the higher thresholds. The earliest IRM guidance made available to TAS (issued around 1978) did not contain a specific dollar threshold requiring an NFTL filing.<sup>37</sup> Instead, the Revenue Officer was to use his or her best judgment in determining whether an NFTL should be filed.<sup>38</sup> The IRM established the \$5,000 threshold for manager’s approval not to file an NFTL, which was tantamount to a filing threshold and equals \$17,667 in today’s dollars.<sup>39</sup> If the IRS wanted to reduce taxpayer burden by doubling the dollar amount, the effective value of that \$10,000 would now be \$35,334, still short of the \$50,000 threshold recommended for a pilot study of applying new NFTL filing criteria by the IRS’s recent Collection Process Study.<sup>40</sup> Thus, the revised lien policies may not deliver the promised “fresh start” for many taxpayers who will grapple with the burden of NFTLs for years.

<sup>36</sup> IRS, Collection Activity Report NO-5000-25 (Oct. 1, 2012). The number of Non-ACS NFTLs includes refiled lien notices.

<sup>37</sup> Archival IRM 5424.11(1), 5424.11(2), 5424.11(3), 5424.12(1), 5424.12(2), 5424.12(3), 5426(1)(a) (Apr. 14, 1978).

<sup>38</sup> *Id.* The IRM referenced a \$2000 amount as the transfer threshold of the account to the field, when no personal or telephone contact was made for an NFTL filing determination.

<sup>39</sup> U.S. Dept. of Labor, Bureau of Labor Statistics, Consumer Price Index (CPI) Inflation Calculator, 1978 vs. 2012. See also IRS response to TAS information request (Oct. 1, 2012) (citing archival IRM 5426(1)(a) (Apr. 14, 1978) as earliest notation of the \$5000 filing threshold).

<sup>40</sup> IRS, *Collection Process Study* (CPS) 122 (Sept. 30, 2010)

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### *The Effect of the Fresh Start Initiative on NFTL Withdrawals*

The “Fresh Start” initiative increased the IRS’s use of NFTL withdrawals, especially in cases where the underlying lien has been released.<sup>41</sup> Form 10916(c), *Withdrawal of Filed Notice of Federal Tax Lien*, is filed in the jurisdiction where the IRS originally filed the NFTL, indicating that the IRS has formally withdrawn the notice, and leading to removal of the NFTL from the public record.<sup>42</sup> This step helps improve taxpayers’ financial viability by repairing their credit ratings.<sup>43</sup>

In FY 2011, the IRS began allowing individual taxpayers to more readily obtain NFTL withdrawals upon entering into direct debit installment agreements (DDIA) to resolve tax debts of \$25,000 or less, when the debt will be paid within 60 months (or prior to the Collection Statute Expiration Date (CSED), whichever comes first).<sup>44</sup> The IRS also agreed that generally it would withdraw NFTLs where tax liabilities have been fully satisfied, even when the NFTLs have already been released.<sup>45</sup>

Through the end of FY 2012, thousands of financially struggling taxpayers have successfully obtained NFTL withdrawals to help regain their financial viability, as shown on Figure 1.22.3 below.<sup>46</sup> Withdrawals increased from about 4,700 in FY 2010 to almost 8,700 in FY 2011 and about 12,000 in FY 2012. Of these, 2,285 in FY 2011 and 4,550 in FY 2012 were NFTL withdrawals after lien releases.<sup>47</sup>

<sup>41</sup> See SB/SE, *Interim Guidance Memorandum*, Control No. SB/SE-05-0312-029 (March 12, 2012) and IRM 5.12.3.29 & 30 (May, 31, 2012); SB/SE, *Interim Guidance Memorandum*, Control No. SB/SE-05-0611-037 (June 10, 2011); SB/SE, *Interim Guidance Memorandum*, Control No. SBSE-05-0411-036 (Apr. 7, 2011). This guidance was issued in response to TADs 2010-1 and 2010-2. See also National Taxpayer Advocate FY 2012 Objectives Report to Congress 12.

<sup>42</sup> For NFTL withdrawal criteria, see IRC § 6323(j)(1)(A)-(D). The underlying statutory lien may remain in effect if the account is not satisfied. See generally IRC §§ 6321; 6322.

<sup>43</sup> Without the NFTL withdrawal, in full paid cases, the fact of NFTL filing will stay on credit reports for seven years. FCRA, § 605(a)(3), 15 USC § 1681c(a)(3). 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 refilled by the IRS. TAS teleconferences with the major CRAs – Experian (Oct. 1, 2009), Equifax (Sept. 1, 2009), and Transunion (Sept. 3, 2009).

<sup>44</sup> IRS, SBSE-05-0411-036, *Withdrawal of Notice of Federal Tax Lien in Direct Debit Installment Agreement Situations* (Apr. 7, 2011).

<sup>45</sup> IRS, SBSE-05-0611-037, *Withdrawal of Notice of Federal Tax Lien after Release* (June 10, 2012).

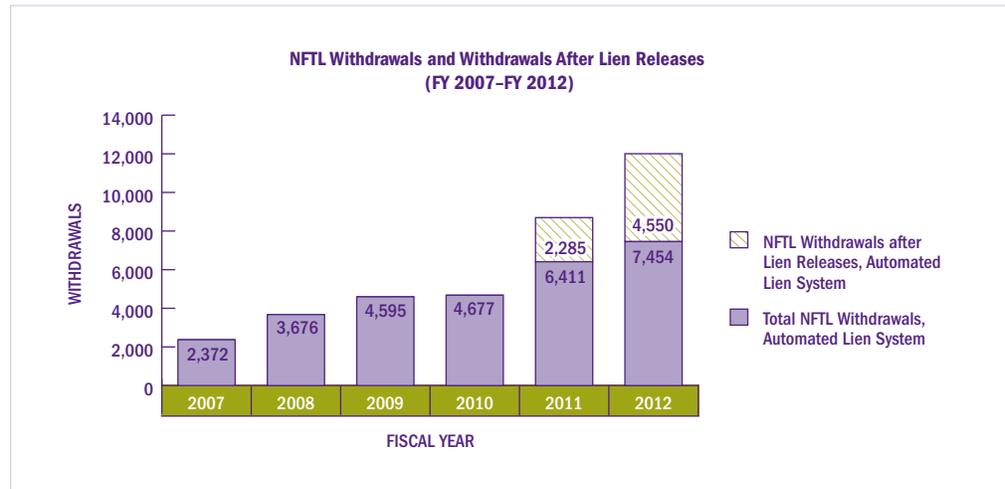
<sup>46</sup> IRS Collection Activity Report, NO 5000-25 (Oct. 22, 2012). See also IRS response to TAS information request (Aug. 15, 2012). After the “fresh start” guidance was released, NFTL withdrawals increased almost twofold in FY 2011, and almost threefold in FY 2012, compared to FY 2010 levels.

<sup>47</sup> IRS, Automated Lien System, Total NFTL Withdrawals and Withdrawals after Lien Releases, FYs 2007-2012.

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**FIGURE 1.22.3, The Number of NFTL Withdrawals and Withdrawals After Lien Releases in FY 2007–2012<sup>48</sup>**



However, despite the positive impact of the Fresh Start policy changes, only 80 employees in the IRS Office of Advisory and Insolvency (AI) worked NFTL withdrawal requests.<sup>49</sup> This means the number of taxpayers who can benefit from these new policies remains relatively small. The IRS should expand the NFTL withdrawal authority to all ROs and to appropriate ACS employees.

#### **The IRS Still Lacks Tools to Determine the Revenue Effectiveness of NFTLs.**

The National Taxpayer Advocate remains concerned about the IRS’s inability to determine the impact of NFTLs on collected revenue due to the inadequate use of Designated Payment Codes (DPCs) to identify the source of post-assessment tax payments on past due accounts.<sup>50</sup> The IRS enters DPCs for payments attributable to collection actions such as liens, levies, offers in compromise and installment agreements.<sup>51</sup> A TAS analysis of IRS payment source data found the DPC was underutilized on post-assessment payments received in 2009.<sup>52</sup> Thus, in most cases, the IRS does not know and cannot determine what event or action prompted the subsequent payment on a past-due account.

The IRS has not acted on the National Taxpayer Advocate’s recommendation to link each subsequent payment to specific IRS enforcement activities and service initiatives.<sup>53</sup> A recent TIGTA audit also concluded the IRS does not consistently or accurately apply DPCs,

<sup>48</sup> IRS, Automated Lien System, Total NFTL Withdrawals and Withdrawals after Lien Releases, Fys 2007-2012.

<sup>49</sup> IRS response to TAS information request (Aug. 15, 2012).

<sup>50</sup> In prior research, TAS found that most payments for lien taxpayers were attributable to sources other than the lien, e.g., refund offsets. See National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18. See also National Taxpayer Advocate 2010 Annual Report to Congress 250-266.

<sup>51</sup> IRM 3.8.45.9.1 (Feb. 1, 2009).

<sup>52</sup> National Taxpayer Advocate 2010 Annual Report to Congress 250-266. Even with transaction codes that require DPCs, about 75 percent of all entries either had no DPC or defaulted to DPCs of “00” (undesignated payment) or “99” (miscellaneous).

<sup>53</sup> For a detailed discussion of designated payment codes, see National Taxpayer Advocate 2010 Annual Report to Congress 250-266.

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which reduces its ability to assess the effectiveness of collection actions and may lead to inefficient use of resources as well as unnecessary burden on compliant taxpayers.<sup>54</sup> TIGTA recommended that the IRS establish a DPC for all primary payment actions and for all transaction codes (TCs) for payments made in direct response to NFTL filings. The IRS should include TAS in its ongoing review of DPCs, which it agreed to complete by April 15, 2013.<sup>55</sup>

DPCs provide a way to track taxpayer behavior and future compliance, but are ineffective when the IRS does not consistently apply the codes to all subsequent payments. Measuring NFTL effectiveness by using meaningful DPCs and TCs would give the IRS a more accurate and complete picture of whether NFTLs cause the taxpayer to pay on a balance due account. Then the IRS can also factor in costs associated with these filings to complete the cost-benefit analysis.<sup>56</sup> For example, if after attempting to personally contact a taxpayer, the IRS files an NFTL and the taxpayer enters into an installment agreement that permits an NFTL withdrawal under the “fresh start” procedures, it would be logical to attribute the payments to the NFTL filing because the lien has facilitated collection. But if the IRS files the NFTL automatically with no prior personal contact with the taxpayer, and the liability is subsequently paid by a refund offset, it cannot be reasonably associated with the NFTL because there is no direct causal effect between the filing and the payment. The offset would occur with or without an NFTL.

### **IRS Lien Policy Continues to Harm CNC Taxpayers Experiencing a Hardship.**

While NFTL filing is decreasing overall, the IRS retains the requirement of automatic filing on all accounts closed as CNC if the dollar amount of the liability exceeds the \$10,000 threshold.<sup>57</sup> The IRS requires employees to secure managerial approval for the *non-filing* of an NFTL in any situation where the unpaid balance of assessments exceeds \$10,000.<sup>58</sup> The National Taxpayer Advocate continues to disagree with this policy. As noted in a prior report, 59 percent of the total collected on these CNC taxpayer accounts comes from refund offsets, which occur with or without the filing of an NFTL. Only 20 percent of the funds collected on these accounts are attributable to NFTLs.<sup>59</sup> The automatic filing of an NFTL

<sup>54</sup> TIGTA, Ref. No. 2012-30-02, *Designated Payment Codes Are Inaccurate and Ineffective* (Mar. 28, 2012).

<sup>55</sup> This review was initiated in response to the 2010 Annual Report to Congress. See National Taxpayer Advocate 2010 Annual Report to Congress 250-266.

<sup>56</sup> The IRS estimates that an NFTL filing costs between \$25 and \$100 plus labor costs. IRS Collection Process Study (CPS) 122 (Sept. 30, 2010). The IRS may spend up to \$109 million in lien filing costs annually, not including labor costs, based on 1,096,376 NFTLs filed in FY 2010. IRS, Fiscal Year 2010 Enforcement Results, available at [http://www.irs.gov/pub/irs-utl/2010\\_enforcement\\_results.pdf](http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf).

<sup>57</sup> IRM 5.16.1.1 (May 22, 2012). IRS Policy Statement P-5-71 provides the IRS authority to report an account as currently not collectible (CNC) for a variety of reasons (e.g., unable to pay (hardship), unable to contact or locate, and death). “Economic hardship” occurs when an individual taxpayer is unable to pay reasonable basic living expenses. See Treas. Reg. § 301.6343-1(b)(4). The tax is not forgiven, only placed in non-collection status. Penalties and interest continue to accrue, and the accounts may be subject to refund offset.

<sup>58</sup> IRM 5.12.2.4.2.3 (1) (Mar. 8, 2012).

<sup>59</sup> See National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18 (TAS Study: *The IRS’s Use of Notices of Federal Tax Lien*). For those CNC taxpayers who had payment transactions, only 20 percent of the funds collected were attributable to NFTLs. However, this information cannot be inferred to the total population of CNC taxpayers. TAS study notes that 67 percent of the payment transactions had a “miscellaneous” DPC or the DPC was missing. As a result, it is impossible to identify what IRS action resulted in a payment on the delinquent account. In other words, only 33 percent of payment transactions used a DPC that gave a descriptive indication of what IRS action may have triggered the payment.

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on a CNC account can worsen the taxpayer’s already proven hardship without increasing revenue collection.<sup>60</sup>

The IRS could replace the mandatory NFTL filing on CNC taxpayers and taxpayers with no assets with a system of subsequent filing determinations based on periodic monitoring of whether the taxpayers have acquired assets or their financial situations have improved, using information from Accurant and IRS internal databases. This type of analysis is not without precedent. The IRS allows employees to refile an NFTL following extension of the collection statute expiration date using their judgment rather than an arbitrary threshold amount.<sup>61</sup> In fact, the IRS instructs employees *not to automatically* refile the NFTL.<sup>62</sup> The IRS employee must analyze each individual taxpayer’s present and future assets before refiling an NFTL.<sup>63</sup> If the Revenue Officer can make this determination on a refiled NFTL, both ROs and ACS employees should be authorized to use the same procedure for the original determination of NFTL filing.

**TAS’s Multiyear Comprehensive Study of NFTL Impact on Future Compliance and Revenue Demonstrates the Need for Meaningful NFTL Filing and Withdrawal Criteria Based on Financial Risk Scoring Principles.**

In FYs 2009-2012, TAS Research & Analysis investigated the IRS’s use of NFTLs and their impact on the compliance behavior of delinquent taxpayers.<sup>64</sup> 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 (Unable to Pay - Hardship) status,<sup>65</sup> while nearly \$6 of every \$10 collected from these taxpayers came from refund offsets.<sup>66</sup> Nonetheless, the IRS filed NFTLs against more than 72 percent of CNC taxpayers suffering

<sup>60</sup> The IRS filed nearly 1.1 million NFTLs in FY 2010, an increase of about 550 percent from FY 1999, while the total dollars collected (adjusted for inflation) actually declined by about seven percent from \$29.4 billion to \$27.2 billion (in terms of real dollars valued as of 2009). IRS, Fiscal Year 2010 Enforcement Results, available at [http://www.irs.gov/pub/irs-utl/2010\\_enforcement\\_results.pdf](http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf). IRS, Statistics of Income (SOI) Data Books, Table 16, Delinquent Collection Activities, 1999-2009. See also Bureau of Labor Statistics, Dept. of Labor, Consumer Price Index – All Urban Consumers (CPI-U), available at <http://www.bls.gov/CPI/>.

<sup>61</sup> Upon the collection statute expiration date, the liability secured by lien becomes legally unenforceable. See generally IRC §§ 6325(a)(1); 6502(a). The NFTL contains the self-releasing language that extinguishes the NFTL and underlying statutory lien. See Form 668(Y)(c), *Notice of Federal Tax Lien* (Rev. Feb. 2004). If the collection statute is extended or suspended on the underlying assessment, beyond the ten-year period, the NFTL must be refiled in the original jurisdiction to keep its priority back to the original filing date. See IRC § 6323(g).

<sup>62</sup> IRM 5.12.2.20.1(3) (Oct. 30, 2009).

<sup>63</sup> *Id.*

<sup>64</sup> See TAS Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*, Vol. 2, *infra*; National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 91-111 (TAS Research Study: *Estimating the Impact on Liens on Taxpayer Compliance Behavior and Income*); National Taxpayer Advocate 2010 Annual Report to Congress, Vol. 2, 89-100. See also National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18 (TAS Research Study: *The IRS’s Use of Notices of Federal Tax Lien*).

<sup>65</sup> See IRM 5.19.1.7.1.5 (Sept. 7, 2011); Policy Statement P-5-71, IRM 1.2.14.1.14 (Nov. 19, 1980). See also IRM 5.16.1.1 (May 22, 2012) and IRM 5.16.1.2.9 (May 22, 2012). 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, 2012).

<sup>66</sup> The IRS automatically moves (offsets) refundable overpayment credits from one period to others with liabilities in the taxpayers’ accounts. IRS, Compliance Data Warehouse (CDW), Individual Masterfile (IMF) Transaction File Cycle 200913. See also National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18.

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an economic hardship in tax year (TY) 2009.<sup>67</sup> These practices harm taxpayers who are experiencing economic hardship and do not lead to any ascertainable revenue gains.

The results of the 2012 TAS study show that NFTL filings during the study period (CYs 2002-2010) had a negative effect on the payment behavior and liabilities of affected taxpayers.<sup>68</sup> Taxpayers with NFTLs filed against them generally paid less and ended up owing more than non-lien taxpayers:

- Taxpayers with NFTLs paid an average of \$25,845, or about 69 percent of their total individual liability at the time of lien filing. Non-lien taxpayers paid \$38,477, equivalent to about 111 percent of their total individual liability at the proxy lien date.
- At the end of the study period (CY 2010), taxpayers with NFTLs owed 21 percent more on average than they owed when the lien was filed (they incurred their original liabilities in 2002). Non-lien taxpayers owed 11 percent more than they owed on their total individual liability at the proxy lien date.<sup>69</sup>

Significantly, TAS’s most recent study also found that CNC taxpayers suffering an economic hardship with an NFTL owed more both at the beginning and at the end of the study period than any other category of taxpayers, as shown in table 1.22.1 below.

**TABLE 1.22.4, Taxpayer Liabilities When the Lien Was Filed vs. CY 2010**

	Mean Balance at Lien or Proxy Lien Date	Mean Balance 2010	Ratio 2010/Lien Date
All Lien Taxpayers	\$37,486	\$45,314	1.21
All Taxpayers without Liens	\$34,813	\$38,635	1.11
CNC Hardship Taxpayers with Liens	\$55,475	\$83,263	1.50
CNC Hardship Taxpayers without Liens	\$27,800	\$42,403	1.53

In general, when taxpayers in the study were able to obtain either an offer in compromise (OIC) or an installment agreement (IA), they owed less in CY 2010 than they owed when the lien was filed. As Table XX shows below, taxpayers in the study who had OICs accepted sometime between CY 2002 and CY 2010 owed only 13 percent of what they originally owed at the lien or proxy lien date. On the other hand, taxpayers who did not receive an OIC owed 123 percent of what they originally owed at the lien or proxy lien date. Thus, the OIC plays a crucial role in helping taxpayers escape an endless cycle of growing tax indebtedness.

<sup>67</sup> National Taxpayer Advocate 2009 Annual Report to Congress 17-40.

<sup>68</sup> See TAS Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*, Vol. 2, *infra*.

<sup>69</sup> See *id.*

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**TABLE 1.22.5, OIC/No-OIC Taxpayer Liabilities When the Lien Was Filed vs. CY 2010**

	Mean Balance When the Lien Was Filed	Mean Balance 2010	Ratio 2010/ 2002
OIC	\$68,917	\$8,763	0.13
No OIC	\$35,106	\$43,032	1.23

Based on preliminary results from this new study, the IRS should not only develop NFTL filing determination criteria based on the impact of NFTL filing on taxpayers in general, on those in CNC status, and on potential improved compliance measures for the remaining lien taxpayers, but should also actively promote the use of collection alternatives such as OICs and IAs in lieu of NFTL filings.<sup>70</sup> TAS suggests that the IRS take innovative new approaches to NFTL filing and withdrawals, using the financial risk scoring that has become standard in the banking and financial industries.<sup>71</sup> A risk-scoring algorithm can employ objective factors such as the existence and value of the taxpayer’s equity in assets, compliance history, reasons for noncompliance, effect on credit score and collection potential, possible harm to the taxpayer and his or her ability to comply in the future, willingness to resolve the liability, payment before the collection statute expiration date (CSED), etc. When the score exceeds a set threshold, the algorithm would be supplemented by human review in the final decision about whether to file. This human review would incorporate an analysis of the taxpayer’s potential eligibility for collection alternatives such as OICs and IAs. The IRS needs to train its employees how to make qualitative judgments of the taxpayers’ financial circumstances before determining whether to file an NFTL and proactively offer OICs and IAs as alternatives to NFTL filing. In this way, the IRS will collect more revenue even as it reduces economic harm to taxpayers.

## CONCLUSION

While the National Taxpayer Advocate recognizes the positive impact of the Fresh Start initiative, she remains concerned about the IRS’s reluctance to eliminate automatic NFTL filing based on arbitrarily set thresholds. The IRS should also develop precise payment coding to account for subsequent payments received because of NFTL filings, so it has better data to determine objective criteria for NFTL filing. Without accurate coding, studies of lien effectiveness will not provide empiric results. TAS offers its assistance in studying the impact of NFTL filings on CNC taxpayers and developing a risk-scoring algorithm for

<sup>70</sup> See *Introduction to Collection Issues: The IRS “Fresh Start” Initiative Has Produced Significant Improvements in Some Collection Policies; However, Significantly More Emphasis on Service Delivery Is Necessary to Realize the Full Benefits of These Important Changes*, *supra*. See also *Most Serious Problem: The Automated Collection System Must Emphasize Taxpayer Service Initiatives to More Effectively Resolve Collection Workload*, *infra/supra*; *Most Serious Problem: Early Intervention, Offers-in-Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance*, *infra/supra*.

<sup>71</sup> See generally Experian, *Financial Stability Risk Score*, at <http://www.experian.com/business-information/financial-stability-risk-score.html>; Rosella, *Credit Risk Analysis and Modeling*, at <http://www.roselladb.com/credit-risk-analysis.htm>.

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meaningful NFTL filing and withdrawal determinations, and in the development of guidance to employees for considering collection alternatives other than NFTL filing.

## RECOMMENDATIONS

The National Taxpayer Advocate preliminarily recommends that the IRS:

1. Include TAS in the ongoing review of DPCs initiated in response to the National Taxpayer Advocate and TIGTA reports.
2. In consultation with TAS and IRS Research functions, revise current DPCs and TCs to categorize each subsequent payment to a filed NFTL.
3. Collaborate with the National Taxpayer Advocate and TAS Research on the ongoing SB/SE lien study of the effectiveness of NFTLs in CNC situations and in the next phase of the TAS lien study on using NFTLs to best improve future compliance.
4. In collaboration with the National Taxpayer Advocate, develop a risk-scoring algorithm based on thorough review of objective factors, discussed above.
5. Replace the current IRS policy of automatically filing NFTLs based on a dollar threshold of the unpaid tax liability with NFTL filing determinations based on the risk-scoring algorithm and develop training for all Collection employees on the new qualitative determination procedures, including the use of collection alternatives such as OICs and IAs in lieu of NFTL filings.
6. Immediately increase the NFTL filing threshold to \$50,000, both for ACS and ROs, as recommended by the IRS Collection Process Study.
7. Immediately replace the mandatory NFTL filing on CNC-hardship taxpayers and taxpayers with no assets with a system of subsequent filing determinations based on periodic monitoring of whether the taxpayers have acquired assets or their financial situations have improved.
8. Require managerial approval for NFTL filing in cases involving CNC (Unable to Pay-Hardship) taxpayers.
9. Expand NFTL withdrawal authority to all ROs and ACS employees who are authorized to file NFTLs.

## IRS COMMENTS

The IRS is committed to assisting taxpayers with their voluntary filing and payment responsibilities. In setting policy, we are charged with balancing the interests of taxpayers with our responsibility to protect both the government and the American taxpaying public’s interests when those taxes are not paid. The Federal Tax Lien is critical for the IRS to protect these interests. The FTL exists by operation of law after an assessment has been made, a demand for payment of the debt has been made, and the taxpayer has neglected or

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refused to pay. The lien attaches to the current and future assets owned by the taxpayer. It remains in effect until the tax debt is paid or becomes unenforceable.

A Notice of Federal Tax Lien must be publicly filed to put the taxpayer’s current and future creditors on notice of the debt owed by the taxpayer and to establish the priority of the NFTL among other secured creditors. The decision to file an NFTL does not mean the IRS is taking possession of any assets or depriving the taxpayer of the use of the assets. The filing of the NFTL does not eliminate any avenues available for the taxpayer to resolve their debt, but it protects the government’s interest in collection processes. Since the lien itself attaches to current and future assets, an NFTL may be filed even though the taxpayer has no current assets, or specific assets have not been identified. The IRS recognizes that filing an NFTL can impact the taxpayer’s credit rating so the taxpayer is first afforded the opportunity to resolve the debt. Then, before determining whether to file an NFTL, other factors are considered including the taxpayer’s willingness and ability to pay the debt and the amount owed. IRS employees also have discretion to not file an NFTL if it would hamper collection of the taxes owed, there is doubt as to the liability, or forthcoming information could lead to either of the above. The collection process is constructed so that a cooperating taxpayer can resolve their debt without an NFTL being filed.

As noted by the National Taxpayer Advocate, the IRS has made several changes within the last two years to its NFTL filing policies, specifically with regard to the NFTL filing thresholds and NFTL withdrawals including:

- Doubling the dollar threshold for filing most NFTLs from \$5,000 to \$10,000, resulting in fewer NFTLs;
- Changing procedures for NFTL withdrawals after lien releases;
- Providing for NFTL withdrawal in most cases where a taxpayer enters into a Direct Debit Installment Agreement; and
- Setting the minimum NFTL filing threshold at \$2,500.

The National Taxpayer Advocate was provided the opportunity to review all of these changes prior to implementation, and their participation was a significant part of the review process. We appreciate that the National Taxpayer Advocate values the changes we have made to update our NFTL program. We believe that these changes have significantly benefited taxpayers.

The Most Serious Problem includes views on the NFTL program and questions aspects such as the NFTL filing criteria and the general effectiveness of the NFTL. Much of the discussion relies on a new 2012 research study conducted by the TAS Research & Analysis function that the IRS has not had sufficient time to thoroughly review. However, based on our initial review of the study’s methodology, we believe that to properly consider the usefulness of the study conclusions, additional information or a better understanding on the

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population size and the propensity score model would be necessary. We look forward to analyzing this issue in more detail.

After reviewing a 2011 TAS study, we expressed concerns that the underlying data, formulas, and methodologies did not support the findings without additional research. Because of questions about the data, we cannot comment on the conclusions that taxpayers against whom the IRS has filed an NFTL tend to be less compliant in tax filing and payment in subsequent tax years. In addition, we also note that the practitioner article cited in the MSP appears not to be an additional study, but an article which is partially based on the results of the 2011 TAS research study.

The IRS has also conducted NFTL research studies which have been shared with TAS. One study concluded that NFTL filing has a direct impact on resolution; has the potential to increase full and partial resolution for both Individual Master File (IMF) and Business Master File (BMF) cases in the queue; and, for BMF entities with one to five employment tax modules, has the most likelihood to pay the greatest proportion of their balance. Both TAS and IRS research found that filing NFTLs on currently not collectable hardship taxpayers appears beneficial to the government as the IRS collected more dollars from CNC hardship taxpayers with an NFTL filed rather than when one has not been filed.

The IRS does acknowledge that NFTL filings do have inherent costs associated with them, and those costs are monitored. The recent IRS decision to raise the NFTL threshold and set a minimum NFTL filing criteria of \$2,500 was due in part to IRS trying to balance the administrative costs of collecting. The IRS is unlike a private sector creditor who can extend or deny credit to a person based on a risk analysis. The private sector practice to secure debts is the routine filing of a note or judgment against the debtor. In the case of the IRS, filing lien notices to establish creditor standing is the only legal means the IRS has to protect the interest of the United States.

The National Taxpayer Advocate further suggests that the dollar threshold used for filing NFTLs should be higher and/or not utilized at all proposing a risk-based algorithm be employed instead. The use of filing thresholds initially came into use to address a concern about consistent treatment of taxpayers. Even so, the amount a taxpayer may owe is not the only determining factor for filing an NFTL. In certain IA situations, a filing determination is not required. Also, instructions to staff allow flexibility to not file or defer filing the NFTL based on the case facts. Risk-based algorithms are utilized by financial institutions to determine to whom money should be loaned. Their algorithms may be based on the person’s credit rating, their previous loan history, income, and other factors to determine the risk of the person defaulting on the loan. Once a person owes a tax liability, the government’s interest is already at risk. Because the government does not select its customers, the required analysis is necessarily different.

Generally speaking, a taxpayer is given several opportunities to resolve his or her debt before an NFTL is filed. The amount the taxpayer owes is but one factor in determining

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whether to file an NFTL. Prior to the recent increase in the dollar amount threshold, much consideration was given to the appropriate amount, including an inflationary adjustment from the enactment of the prior threshold. Although the basic threshold of \$10,000 was established for all collection functions, programming for NFTLs routinely filed by the Automated Collection System was set at a higher amount. The National Taxpayer Advocate refers to the difference in programming as an inconsistent policy. However, this programming was implemented to provide additional relief to taxpayers during the current economic crisis. Since the majority of cases flow through ACS before being assigned to Field Collection, the heightened ACS programming level provides additional time for taxpayers to resolve their liability and additional flexibility for field officers to work with taxpayers before filing an NFTL.

In the MSP, the National Taxpayer Advocate suggests the NFTL does not produce revenue and continues to use Designated Payment Codes to evaluate the effectiveness of filed NFTLs while at the same time acknowledging that DPCs are not an accurate source (*See National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18*). The DPCs are intended to identify payments received from a specific collection event (*e.g., levy, seizure*), or for a specific taxpayer-defined action (*e.g., paying trust fund taxes, paying toward an OIC*). A DPC cannot presume the taxpayer’s motivation for making a payment nor can it attribute multiple factors to individual credits on a taxpayer’s account. A taxpayer’s reason for taking any actions regarding a federal tax debt can be based on any number of reasons that are directly or indirectly attributable to the NFTL. To credit the influence of the NFTL only to those payments with DPCs specifically notated as lien-related does not provide a complete picture as the FTL exists whenever a tax debt is owed, and the NFTL, or potential for it, is always present. For example, taxpayer actions such as paying the liability in full, making installment payments, or filing an offer in compromise, may be motivated by the anticipation of, as well as the utilization of, the NFTL. So, while movement can be made with the DPC application to better track the most immediate event leading to the payment, DPCs can never capture the total impact of the NFTL effectiveness as essentially every collection action can be attributed, at least in part, to the NFTL. We are presently analyzing the utilization of DPC codes to determine their usefulness and will involve TAS in any implemented changes to DPCs and their usage. The IRS recognizes the importance of properly determining the effectiveness of the NFTL and value of the appropriate selection of DPCs; however, measuring and reporting on trends in collection activity and dollars collected through DPCs would fail to account for other variables critical to analyzing the effectiveness of collection actions. Additionally using DPCs related to the filing of an NFTL to measure and report trends in collection activity and dollars collected is limited because of the inherent limitations in DPC data.

In making conclusions on the revenue produced by NFTLs and promoting IAs and OICs as alternatives to filing NFTLs, the MSP relies on the TAS 2012 research study. In our preliminary review of the study’s methodology, we noted that it does not provide the number of IA or OIC cases that had NFTLs filed compared to the number that did not. There is also

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no distinction between the IAs where an NFTL filing determination was not required from the higher risk IAs where a filing determination had to be made. Moreover, the findings that taxpayers who have IAs pay more than those who do not and that taxpayers who have accepted OICs owe less than those who do not are conclusions having limited bearing on the effectiveness of NFTL filings.

The National Taxpayer Advocate also makes a conclusion on the effectiveness of the NFTL by drawing comparisons between increased NFTL filings and decreased dollars collected by Collection. We do not believe a direct correlation between the sets has been demonstrated. It should also be noted that the decrease in overall collection revenue is discussed without regard to factors such as the recent economic downturn.

Finally, the National Taxpayer Advocate continues promoting the withdrawal of the NFTL for taxpayers as a way to make them more compliant. The IRS has made changes to the NFTL withdrawal policy allowing more taxpayers to qualify for withdrawals; however, the IRS is not aware of data to determine the immediate or long-term effect of this change on future collection and compliance. The MSP report suggests the number of IRS employees working NFTL withdrawals is a hindrance; however, we are not aware of any data indicating NFTL withdrawal requests have been repressed or not been processed based on our current staffing. The IRS’s recent expansion of positions authorized to approve NFTL withdrawals in certain circumstances will further facilitate the timeliness of working NFTL withdrawals, but this should have no impact on the volume of requests received.

The research of the NFTL CNC situations has been completed and the results previously shared with TAS. Discussions continue on collaborating with continued research in this area. We look forward to TAS affording us the opportunity to participate in the parameters and methodology stage with any future TAS research studies regarding NFTLs.

As discussed, the IRS is unlike a private-sector creditor who can extend or deny credit based on a risk scoring algorithm. Given that the debt has already been incurred (in essence the credit extended), there is limited benefit to using that model as a determinate for a notice of lien filing. Many factors come into play before an NFTL filing decision is made. IRS employees have discretion to not file a NFTL if it will hamper collection of the taxes owed, there is doubt as to the liability, or forthcoming information could lead to either of the above. The taxpayer’s filing and payment compliance, along with their financial viability, are considered when the non-filing or deferring of a notice of Federal Tax Lien is being determined. Additionally an NFTL determination is not required on Guaranteed/Streamlined Installment Agreements or In-Business Trust Fund Express Agreements, but NFTLs may be filed at the discretion of the revenue officer to protect the government’s interest (such as a pending bankruptcy or other exigent circumstances). TAS has been, and continues to be, an integral part of the review process when the IRS sets policy regarding factors impacting NFTL determinations and filing.

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Instructions to staff are updated when NFTL policy changes are made. NFTL issues have been, and remain, a regular part of the yearly Collection training cadre of topics. Collection remedies such as OICs and IAs are an integral part of the collection process, not necessarily an “alternative” to filing an NFTL. Recent changes affording the taxpayer the ability to have the NFTL “withdrawn” provide the taxpayer additional alternatives and incentives to resolving tax liabilities.

As discussed, the IRS recently raised the lien filing threshold. We will continue to monitor whether additional changes are appropriate. Further increasing the thresholds would require a comprehensive risk-based analysis of the impact in order to avoid a negative impact on collection for the government. Both GAO and TIGTA have commented that the IRS needs to adequately protect the government’s interest in regards to delinquent taxes. The IRS is currently developing and implementing statistical analyses to observe the influence of the Fresh Start lien filing threshold increase relative to other factors.

An NFTL filing does not prevent the taxpayer from obtaining financing to acquire assets. Multiple reviews to determine if the taxpayer has acquired assets on which the government has already lost the opportunity of being a secured creditor is not an effective way to protect the government’s interest. Additional reviews revisiting NFTL filing decisions would add significant costs while relying on arbitrary timeframes for performing the subsequent reviews, neither of which is efficient or effective. A taxpayer who has acquired assets may file bankruptcy and the government claim will not be protected. However, a taxpayer can contact the IRS to discuss payment alternatives at any time.

The IRS has determined appropriate levels for managerial approval of NFTL filing and under what conditions approval is needed. The TAS and IRS research both concluded that IRS collected more dollars with CNC hardship taxpayers when an NFTL is filed than when one has not been filed.

The delegated authority to approve an NFTL withdrawal was expanded, with the concurrence of TAS, in May 2012 to certain positions outside Advisory and Insolvency management, based on situational factors. Procedures for the expanded authority should be implemented by spring, 2013.

## Taxpayer Advocate Service Comments

For four consecutive years, the National Taxpayer Advocate has addressed the IRS’s lien-filing practices as one of the most serious problems facing America’s taxpayers.<sup>72</sup> During this time, TAS has also produced several detailed and enlightening research studies to assist the IRS in adjusting these practices in a manner that is beneficial to the government, our taxpayers, and the goal of voluntary compliance.<sup>73</sup> In light of the extensive dialogue that has already taken place regarding this issue, the National Taxpayer Advocate finds the IRS’s response to this report to be disappointing.

The IRS has once again fallen back on a mantra-like position that its current lien-filing practices are “critical” to “protect the interests of the government and the American tax-paying public,” without adequately explaining why and how this is the case. That rote justification can be used to justify any policy, no matter how ineffective or harmful. The response takes the position that “the IRS does not select its customers” in justifying why best practices used by most financial institutions do not apply to delinquent taxpayers. Yet, the response fails to recognize that “voluntary compliance” is a long-term commitment for most taxpayers, and collection treatments that focus only on short-term results can be counterproductive to the long-term objectives of sound tax administration.<sup>74</sup>

The IRS response reveals a continued lack of appreciation and concern by the IRS for the financially devastating impact a Notice of Federal Tax Lien can have on a financially struggling taxpayer. The IRS’s response also implies a general lack of understanding of its own collection policies and procedures. The IRS contends that before determining whether to file an NFTL, it considers other factors, including the taxpayer’s willingness to pay the debt. The IRS further states the collection process is “constructed so that a cooperating taxpayer can resolve their debt without an NFTL.” These statements are misleading and essentially inaccurate.

The Internal Revenue Manual requires Collection employees to make a lien-filing determination within ten days from the “initial attempted contact or initial actual contact date, whichever date is earlier.” A determination is still required within ten days even if no contact has been made with the taxpayer.<sup>75</sup> In establishing criteria for making this determination, the IRM clearly specifies that if the taxpayer’s “unpaid balance of assessments is

<sup>72</sup> See National Taxpayer Advocate 2011 Annual Report to Congress 109-128; National Taxpayer Advocate 2010 Annual Report to Congress 302-310; National Taxpayer Advocate 2009 Annual Report to Congress 17-40. See also TADs 2010-1 and 2010-2 (Jan. 20, 2010).

<sup>73</sup> See *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*, vol. 2, *infra*; National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 91-111 (TAS 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 (TAS Research Study: *The IRS’s Use of Notices of Federal Tax Lien*).

<sup>74</sup> For a detailed discussion of this issue, see TAS Research Study: *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*, vol. 2, *infra*.

<sup>75</sup> IRM 5.12.2.4 (Mar. 8, 2012).

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\$10,000 or more,” then the employee is required to file a lien.<sup>76</sup> This guidance is very clear, and creates an environment where collection employees can generally file NFTLs before making any contact with the affected taxpayers.

We appreciate the IRS’s acknowledgement of TAS’s involvement in the development of the changes in lien policies included in the “Fresh Start” initiative. We are pleased that the IRS recognizes TAS as an integral part of the policy review process. However, over the past year, TAS has worked extensively with the IRS to expand its lien-filing criteria to allow more flexibility and judgment by Collection employees in determining when an NFTL is actually necessary. Certainly, the taxpayer’s level of cooperation should be one of these factors. Yet, in far too many cases, it is not. TAS has not been able to clear recent IRM revisions pertaining to IRS lien-filing practices, and we appear to have reached an impasse on this issue. The National Taxpayer Advocate continues to urge the IRS to develop lien-filing criteria that reasonably balance the necessity of an NFTL to collect delinquent taxes against the financial harm the lien creates for many taxpayers.

In January 2010, the National Taxpayer Advocate issued a Taxpayer Advocate Directive regarding the IRS’s lien-filing practices. In response, the IRS committed to conduct a study to specifically determine the utility of filing NFTLs on CNC hardship accounts, and examine the effect of lien filings on cases with no assets. This response, issued in June 2010, specified that this study should include the input of TAS Research and was to be completed as “expeditiously as possible.” Despite IRS comments to the contrary, no such comprehensive study has been completed to date. The IRS response indicates that “research studies” have been completed that confirm the benefits of current lien-filing practices. However, TAS has found these studies to be exceptionally limited in scope, and inconclusive in identifying the impact of the NFTL on revenue collection and the subsequent compliance behavior of the affected taxpayers.

In its response, the IRS states that “TAS and IRS research both concluded that IRS collected more dollars with CNC hardship taxpayers when an NFTL is filed than when one has not been filed.” The IRS bases this statement on findings of a recent research study it conducted that TAS found to be so fundamentally flawed in its analysis and conclusions that the National Taxpayer Advocate secured the agreement of the IRS Director of Research and the Commissioner of SB/SE to not publicize this study and to collaborate with TAS on better-designed research in this area. She sought that agreement because she was concerned

<sup>76</sup> IRM 5.12.4.1 (Mar. 8, 2012). The IRM notes that taxpayers who enter into certain types of installment agreements with the IRS, e.g. “streamlined” agreements, generally will not be subject to a lien. However, if the NFTL is filed prior to making contact with the taxpayer, this opportunity is lost.

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that the IRS would use the unsupported findings of this study to justify taxpayer-harmful policies. The IRS’s response confirms her fears.<sup>77</sup>

After citing a research study that IRS leaders agreed was flawed, the IRS response ironically expresses concerns that TAS’s research studies cannot be considered conclusive without additional research. Moreover, the IRS states that in order to determine the impact of the recent changes to the lien-filing thresholds, “a comprehensive risk-based analysis” must be completed to “avoid a negative impact on collection for the government.”<sup>78</sup> The National Taxpayer Advocate has consistently supported the use of comprehensive, ongoing research to support important business decisions, and has conducted and publicly reported on significant research studies, including one in volume 2 of this report regarding the impact of lien filings on amounts collected and owed by debtor taxpayers. Moreover, TAS Research usually shares not only the final results of our research studies with the appropriate IRS research functions, but also shares our design for the studies before we actually conduct the data runs.

There comes a time when the IRS’s demand for “comprehensive analysis” begins to sound like a stalling tactic to avoid making prudent business decisions. The IRS has had ample time to produce meaningful data to support its lien-filing practices, but has failed to do so. In the meantime, thousands of taxpayers continue to suffer the consequences of indiscriminate filing of NFTLs.

<sup>77</sup> The IRS (SB/SE Research) did not determine whether any revenue was collected from real estate sales or bankruptcy proceedings, whether the taxpayers were still in CNC status at the time of the proceedings, or whether the proceeds (if any) were applied to the CNC modules the IRS filed the liens against. The IRS also did not adequately confirm whether real estate was actually purchased. It could have been inherited or previously owned – a judgmental verification sample in Accurint showed that their methodology for identifying real estate ownership was likely not accurate: of the 20 taxpayers sampled, Accurint confirmed real estate ownership in only 12 cases (60 percent). The IRS also did not determine whether the taxpayer still had a tax liability at the time the real estate was purportedly purchased.

<sup>78</sup> In its response, the IRS states that “the National Taxpayer Advocate suggests the NFTL does not produce revenue and continues to use Designated Payment Codes to evaluate the effectiveness of filed NFTLs while at the same time acknowledging that DPCs are not an accurate source.” The IRS has mischaracterized the results of our 2009 lien study. In that study, we found that the IRS, contrary to its own IRM provisions, had failed to input meaningful DPCs on 67 percent of the 1,886,683 payments made by taxpayers during the study period. Many payments had a null (00) or miscellaneous (99) DPC coding. Thus, because of the IRS’s failure to follow its own procedures, TAS was unable to report on the connection between liens and *all* payments. However, TAS was able to track and report on the connection between liens and *those payments for which the IRS had input a DPC or were coded as refund offsets*. The data on those 912,249 payments conclusively showed that 95 percent of the payments and 80 percent of the dollars paid were not attributable to the filing of a notice of federal tax lien. See National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18 (TAS Research Study: *The IRS’s Use of Notices of Federal Tax Lien*).

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## Recommendations

The National Taxpayer Advocate recommends that the IRS:

1. Include TAS in the ongoing review of DPCs initiated in response to the National Taxpayer Advocate and TIGTA reports.
2. In consultation with TAS and IRS Research functions, revise current DPCs and TCs to categorize each subsequent payment to a filed NFTL, where applicable.
3. Collaborate with the National Taxpayer Advocate and TAS Research on the ongoing SB/SE lien study of the effectiveness of NFTLs in CNC situations and in the next phase of the TAS lien study on using NFTLs to best improve future compliance.
4. In collaboration with the National Taxpayer Advocate, develop a risk-scoring algorithm based on thorough review of objective factors, discussed above.
5. Replace the current IRS policy of automatically filing NFTLs based on a dollar threshold of the unpaid tax liability with NFTL filing determinations based on the risk-scoring algorithm, and develop training for all Collection employees on the new qualitative determination procedures, including the use of collection alternatives such as OICs and IAs in lieu of NFTL filings.
6. Immediately increase the NFTL filing threshold to \$50,000, both for ACS and ROs, as recommended by the IRS Collection Process Study.
7. Immediately replace the mandatory NFTL filing on CNC-hardship taxpayers and taxpayers with no assets with a system of subsequent filing determinations based on periodic monitoring of whether the taxpayers have acquired assets or their financial situations have improved.
8. Require managerial approval for NFTL filing in cases involving CNC (Unable to Pay-Hardship) taxpayers and cases in which no personal contact has been made with the taxpayers.
9. Expand NFTL withdrawal authority to all ROs and ACS employees who are authorized to file NFTLs.