

Legislative Recommendation #26**Provide Collection Due Process Rights to Third Parties Holding Legal Title to Property Subject to IRS Collection Actions****PRESENT LAW**

Current law authorizes the IRS to file Notices of Federal Tax Lien (NFTLs) and levy upon (seize) all property or rights to property of “any person liable to pay any tax” who neglects or refuses to do so, including property owned by certain third parties (individuals or entities). These third parties include nominees, alter egos and persons to whom lien-encumbered property is transferred (collectively, “affected third parties”).¹ In connection with taking these collection actions, the Secretary must provide collection due process (CDP) rights to “the person described in section 6321” (in the case of liens) and to “any person with respect to any unpaid tax” before levying against property (in the case of levies).²

REASONS FOR CHANGE

Congress created the CDP notice and hearing procedures to give taxpayers the right to a meaningful hearing before the IRS levies their property or immediately after the IRS files an NFTL against their property. During a CDP hearing with the IRS Independent Office of Appeals (Appeals), a taxpayer has the right to raise defenses, challenge the appropriateness of collection actions, and propose collection alternatives. If the parties cannot otherwise resolve the issue, Appeals may issue an adverse Notice of Determination that is subject to review in the U.S. Tax Court and that may thereafter be appealed to the U.S. Courts of Appeals.

For purposes of CDP eligibility, the Treasury regulations interpret the statutory term “person” as including only the taxpayer (*i.e.*, the person upon whom the tax was imposed and who refused or neglected to pay following notice and demand). Thus, affected third parties are not afforded CDP rights.³ This interpretation is inconsistent in some respects with the stated congressional intent, and the Treasury Department could have interpreted the statute otherwise. The CDP regime was enacted by the IRS Restructuring and Reform Act of 1998, and in explaining CDP rights, the accompanying conference report referred to “[t]he taxpayer (or affected third party).”⁴ In addition, CDP levy rights are statutorily afforded to “persons,” and are neither limited to taxpayers nor to persons who originally neglected or refused to pay the tax. The term “taxpayer” is defined in IRC § 7701(a)(14) as “any person subject to any internal revenue tax,” which in this context arguably may include affected third parties, given that the IRS is seeking to collect from them.

In some affected third-party circumstances, the IRS seeks to collect from specific property (*e.g.*, encumbered property that has been transferred to a third party, whether or not as a nominee). In other cases, the IRS seeks to collect from all property of the affected third party (*e.g.*, an alter ego).⁵ In both situations, the IRS may file NFTLs that identify the affected third party and levy upon property that, under state law, belongs to the affected third party.

1 See IRC §§ 6323(f) and 6331(a).

2 IRC §§ 6320(a)(1) and 6331(d)(1). See also IRC §§ 6321, 6322, 6323(a), 6323(f), 6323(h)(6), and 6331(a). Section 6321 also refers to “any person liable to pay any tax.” A CDP lien notice will only be given to the person described in IRC § 6321 who is named on the NFTL. Treas. Reg. § 301.6320-1(a)(2) Question and Answer (Q&A)-A1. A CDP levy notice will only be given to the person described in IRC § 6331(a). Treas. Reg. § 301.6330-1(a)(3) Q&A-A1.

3 See Treas. Reg. §§ 301.6320-1(a)(2) Q&A-A7, 301.6330-1(a)(3) Q&A-A2, 301.6320-1(b)(2) Q&A-B5, and 301.6330-1(b)(2) Q&A-B5.

4 H.R. REP. NO. 105-599, at 264 (1998) (Conf. Rep.).

5 See *Oxford Capital Corp. v. U.S.*, 211 F.3d 280, 284 (5th Cir. 2000); Internal Revenue Manual 5.17.2.5.7(2), Property Held by Third Parties (Jan. 8, 2016).

Importantly, the current collection regime, including the available remedies for alleged nominees, alter egos, and persons to whom encumbered property is transferred is costly, unduly burdensome, and inefficient, and it lacks adequate procedural safeguards. First, there is no opportunity for administrative review of the IRS's underlying, and sometimes opaque, determination that a person is a nominee or alter ego of a taxpayer. Second, without CDP rights affected third parties may seek administrative relief, where available, only after the respective collection action has occurred – meaning only after the harm, which may be irreparable, has occurred.⁶ Third, the available judicial remedies are not likely to provide expeditious relief from the effect of the third-party NFTL or levy and are costly for the third parties and the government.⁷ Some third parties who cannot afford the significant expense and burden of litigation may never be able to challenge an inappropriate or unlawful collection action.

In pre-pandemic years, the IRS generally issued over 1.5 million CDP notices to taxpayers, tens of thousands of taxpayers requested CDP hearings, and over a thousand taxpayers filed CDP petitions in the U.S. Tax Court.⁸ By comparison, the IRS filed only about 1,500 nominee and 500 alter ego NFTLs annually when we last obtained data.⁹ Thus, expressly providing CDP rights to affected third parties would not impose an undue administrative burden on the IRS. Rather, it would save resources for both the government and the affected third parties by reducing litigation costs.

For these reasons, the National Taxpayer Advocate believes it is inequitable for taxpayers responsible for tax debts to receive the full protection of IRC §§ 6320 and 6330, while innocent third parties holding legal title to property subject to IRS collection actions do not receive these due process protections.

RECOMMENDATION

- Amend IRC §§ 6320 and 6330 to extend CDP rights to affected third parties who hold legal title to property subject to IRS collection actions.¹⁰

6 The third party may seek reconsideration by the IRS office collecting the tax, by requesting a Collection Appeals Program (CAP) hearing before Appeals, or by requesting assistance from the National Taxpayer Advocate. Because a CAP hearing is not a CDP hearing under IRC § 6330, any determination made as part of the CAP hearing is not subject to judicial review by the U.S. Tax Court under IRC § 6330(d)(1).

7 For example, if the IRS has filed an NFTL, the third party who holds the title is left with the option to bring an action to quiet title under 28 U.S.C. § 2410 in district court. To contest a nominee, alter ego, or transferee levy, the affected third party has to file a wrongful levy action under IRC § 7426 in district court.

8 In addition, we identified 107,359 business taxpayers that requested CDP hearings in FY 2021. IRS Compliance Data Warehouse (CDW), Business Master File Transaction History table (FY 2021); IRS CDW, Individual Master File Transaction History table (FY 2021). The total number of CDP petitions filed in the Tax Court was compiled by the IRS Office of Chief Counsel (Nov. 18, 2021). IRS, Counsel Automated Tracking System, Subtype DU. Inventory pending as of September 30, 2021. This data does not include cases on appeal. The IRS has taken fewer collection actions since the start of the COVID-19 pandemic, and CDP requests have therefore been lower over the last two years.

9 See National Taxpayer Advocate 2012 Annual Report to Congress 545, 550 (Legislative Recommendation: *Amend IRC §§ 6320 and 6330 to Provide Collection Due Process Rights to Third Parties (Known as Nominees, Alter Egos, and Transferees) Holding Legal Title to Property Subject to IRS Collection Actions*).

10 For more detail, see National Taxpayer Advocate 2012 Annual Report to Congress 544 (Legislative Recommendation: *Amend IRC §§ 6320 and 6330 to Provide Collection Due Process Rights to Third Parties (Known as Nominees, Alter Egos, and Transferees) Holding Legal Title to Property Subject to IRS Collection Actions*).