

Legislative Recommendation #24**Provide Collection Due Process Rights to Third Parties Holding Legal Title to Property Subject to IRS Collection Actions****SUMMARY**

- *Problem:* When the IRS takes collection action against a taxpayer, the taxpayer is entitled to a collection due process (CDP) hearing at which he or she may raise defenses, challenge the appropriateness of the collection action, and propose collection alternatives. In some cases, the IRS may take collection action against third parties who are liable to pay the tax. These third parties are not entitled to a CDP hearing, giving them less procedural protection than the taxpayer who owes the tax.
- *Solution:* Clarify that affected third parties who hold legal title to property subject to IRS collection actions are entitled to CDP protections to the same extent as the taxpayers who owe the tax.

PRESENT LAW

Current law authorizes the IRS to file a Notice of Federal Tax Lien (NFTL) against 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 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 opportunity and 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

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

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). IRC § 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) 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. 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).” 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. H.R. REP. NO. 105-599, at 264 (1998) (CONF. REP.).

to collect from all property of the affected third party (e.g., an alter ego).⁴ 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.

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, inefficient, and lacks adequate procedural safeguards. A third party may seek administrative review of the nominee/alter ego/lien determination by requesting a Collection Appeal Program (CAP) hearing through Appeals. However, a CAP hearing only provides a summary review, since Appeals' goal is to decide CAP cases within five days.⁵ While Appeals' goal of quickly resolving CAP cases is laudable, the rights of the third party utilizing a CAP appeal can be adversely affected. In addition, no judicial appeal from an adverse Appeals decision is permitted in a CAP case. All CAP decisions are final.⁶

The available judicial remedies require filing in federal district court, which is difficult to navigate without legal representation and is therefore costly for both 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 generally filed fewer than 1,000 nominee and alter ego NFTLs annually when TAS 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 incongruous and inequitable for taxpayers who originally were responsible for tax debts to receive the full protection of IRC §§ 6320 and 6330, while third parties holding legal title to property that makes them currently 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

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

5 IRM 8.24.1.3.8, Case Procedures under CAP (Sept. 28, 2021).

6 *Hughes v. Comm'r*, T.C. Memo. 2012-42; IRM 8.24.1.2, Distinctions Between CAP and Collection Due Process (CDP) Hearings (Sept. 28, 2021).

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 must file a wrongful levy action under IRC § 7426 in district court.

8 In addition, we identified 70,481 business taxpayers that requested CDP hearings in FY 2022. IRS Compliance Data Warehouse (CDW), Business Master File Transaction History table (FY 2022); IRS CDW, Individual Master File Transaction History table (FY 2022). The total number of CDP petitions filed in the Tax Court was compiled by the IRS Office of Chief Counsel and totaled 1,181 (Nov. 4, 2022). 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 IRS response to TAS information request (Oct. 7, 2022).

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), <https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/Legislative-Recommendations-The-IRS-Should-Provide-Collection-Due-Process-Rights-to-Third-Parties-Holding-Property.pdf>.