

Legislative Recommendation #25**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 the IRS determines 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 action 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).¹ These third parties include nominees, alter egos, and persons to whom lien-encumbered property is transferred (collectively, “affected third parties”). 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 to raise defenses, challenge the appropriateness of collection actions, and propose collection alternatives.³ If the parties cannot otherwise resolve the issues, Appeals issues a notice of determination that is subject to judicial review in the U.S. Tax Court.⁴

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).⁵ Thus, affected third parties are not afforded CDP rights.⁶

1 See IRC §§ 6323(f), 6331(a).

2 IRC §§ 6320(a)(1), 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 IRC §§ 6320(c), 6330(c)(2).

4 IRC §§ 6320(c), 6330(d)(1).

5 Treas. Reg. § 301.6320-1(a)(2) Q&A-A1; Treas. Reg. § 301.6330-1(a)(3) Q&A-A1.

6 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).” H.R. REP. NO. 105-599, at 264 (1998) (Conf. Rep.). 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.*, property that has been transferred to a third party subject to a tax lien, 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).⁷ 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 property subject to a tax lien is transferred, is unduly burdensome, inefficient, and lacking adequate procedural safeguards. A third party may seek administrative review of a nominee/alter ego lien or levy determination by requesting a Collection Appeals Program (CAP) hearing through Appeals.⁸ However, a CAP hearing only provides a summary review, since Appeals' goal is to decide CAP cases within five days.⁹ While the goal of quickly resolving CAP cases is laudable, the rights of the third party utilizing a CAP appeal can be adversely affected.

In addition, all CAP decisions are final and not subject to judicial review.¹⁰ The only judicial remedies require filing suit in a U.S. district court,¹¹ which is difficult to navigate without legal representation and can be costly for both affected third parties and the government. Some affected 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 fiscal year (FY) 2023, the IRS issued 125,800 CDP notices to taxpayers; 9,376 taxpayers requested CDP hearings; and 1,110 taxpayers filed CDP petitions in the U.S. Tax Court.¹² By comparison, the IRS only filed 1,532 nominee and alter ego NFTLs during FY 2023.¹³ Thus, expressly providing CDP rights to affected third parties would not impose an undue administrative burden on the IRS and would reduce litigation costs for both the government and the affected third parties.

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 affected third parties holding legal title to property subject to IRS collection actions do not receive these same due process protections.

7 See *Oxford Capital Corp. v. United States*, 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), https://www.irs.gov/irm/part5/irm_05-017-002.

8 Treas. Reg. § 301.6330-1(b)(2) Q&A-B5; Treas. Reg. § 301.6330-1(b)(2) Q&A-B5.

9 IRM 8.24.1.3.8, Case Procedures under CAP (Sept. 28, 2021), https://www.irs.gov/irm/part8/irm_08-024-001.

10 *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), https://www.irs.gov/irm/part8/irm_08-024-001.

11 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 a U.S. 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 a U.S. district court.

12 Of the total hearing requests, 5,768 involved individuals and 3,608 involved business taxpayers. IRS Compliance Data Warehouse (CDW), Individual Master File (FY 2023) (through Sept. 28, 2023); IRS CDW, Business Master File (FY 2023) (through Sept. 28, 2023). This data includes FY 2023 CDP notices mailed and CDP hearings requested as indicated on the taxpayers' accounts by Sept. 28, 2023. Actual numbers may be higher because some may not have been posted to taxpayer accounts until FY 2024. The total number of CDP petitions filed in the Tax Court was compiled by the IRS Office of Chief Counsel. IRS, Counsel Automated Tracking System, Subtype DU. This data does not include cases on appeal.

13 IRS response to TAS information request (Oct. 30, 2023).

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.¹⁴

¹⁴ 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>.