

FEDERAL TAX LIEN BASICS

ABA Tax Section

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I. Creation of the Tax Lien

- [Internal Revenue Code \(IRC\) § 6321](#) creates a lien whenever a taxpayer is assessed a tax and, upon demand for payment, neglects or refuses to pay the tax. This lien is referred to as the “hidden lien” because the IRS is not required to file any notice nor take any further action for this lien to come about.

- The federal tax lien under [IRC § 6321](#) attaches to “all property and rights to property, whether real or personal, belonging to such person.” IN order for a federal tax lien to be valid, there are three requirements that must be met by the government:

1. IRS assessed a tax liability
2. IRS gave the taxpayer notice of the assessment and demanded payment
3. Taxpayer failed to pay the amount assessed 10 days after notice and demand were made

- The IRS is allowed ten years to collect an outstanding tax debt pursuant to [IRC § 6502](#). There are a number of events that may extend this period, including bankruptcy, [\[FN1\]](#) offers-in-compromise [\[FN2\]](#) and Collection Due Process hearings, [\[FN3\]](#) among others. The federal tax lien continues in force until it is either removed by the Service or becomes unenforceable due to the [IRC § 6502](#) collection statute lapsing.

- The Service will file a Notice of Federal Tax Lien to protect its interest against third parties. IRS Letter 3172 will be mailed to the taxpayer informing them of the filing and providing them an opportunity to request a Collection Due Process (CDP) hearing. A copy of this letter is attached in the exhibits.

- The IRS Lien is considered self-releasing, so that when the ten-year collection statute lapses the IRS will not file a release. If the Service does not refile its lien it is deemed released, and states so directly on the lien itself. It is not infrequent that practitioners will need to explain this to third party lenders (such as banks) that the IRS will not provide releases on old tax liens that have lapsed.

II. Taxpayer Rights and Collection Due Process

- Pursuant to [IRC § 6320](#) the Service has 5 days after the filing of a tax lien to notify the taxpayer.

- [IRC § 6326](#) grants an administrative appeal to taxpayers when an IRS lien is filed against them. The taxpayer has 30 days from the date of the letter to file their request for a CDP hearing. The appeal is requested by using IRS Form 12153, which is attached as an exhibit.

- The taxpayer will be provided a hearing with an independent appeals officer, referred to as a Settlement Officer, who will listen to the arguments and evidence presented by the taxpayer or their representative. At the hearing the taxpayer will have the opportunity to challenge either the existence of the tax liability or the amount of the tax liability if they did not have an opportunity to dispute the liability. [\[FN4\]](#)

- The taxpayer will also have the opportunity to request collection alternatives, including the removal of the lien. However, unless the taxpayer can show why collection would be improved by the removal of the lien, these requests will generally be denied.

- The Settlement Officer will issue a Letter of Determination. If the taxpayer disagrees with the decision by the Settlement Officer, they will be allowed 30 days from the date of the Letter of Determination to file a petition in United States Tax Court [\[FN5\]](#) or Federal District Court. [\[FN6\]](#)

III. Scope of the lien

- The Federal Tax Lien is broad and encompassing, attaching to all of the taxpayer's property and rights to property. In addition, once the lien arises, it attached automatically to any after-acquired property. [\[FN7\]](#)
- State law where the property is located will determine the nature and extent of the taxpayer's rights. Despite that, federal law will determine whether the taxpayer's interest constitutes property for purposes of the federal tax lien.
- Community property issues: Community property is a form of co-ownership under state law in 9 states: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, Wisconsin. Alaska has a system of elective community property. An entire review of this is beyond the scope of this outline, however practitioners should be aware that, in these jurisdictions, the issue of who owns the property will determine when the property was purchased and whose funds were used to purchase the property.
- There have been a significant number of cases in this area, including the following notable cases practitioners should be aware of:
 - *United States v. Craft*: [\[FN8\]](#) A Michigan couple held property as a “Tenancy by the Entireties” and argued that, under such state law, there was no separate interest in the property for the federal tax lien to attach to for the taxpayer's federal tax debt. The Supreme Court, using the “bundle of sticks” theory for property rights, determined that the taxpayer did have rights in the property to which the federal tax lien could attach.
 - *Drye et al v. United States*: [\[FN9\]](#) Petitioner owed the IRS \$325,000 on unpaid federal tax assessments, and the IRS had valid tax liens filed against him. The taxpayer's mother passed away, leaving him property worth approximately \$233,000 under Arkansas law. Several months after his mother's death, the Taxpayer filed a written disclaimer of all interests in the estate. Under Arkansas law, such a disclaimer creates the legal fiction that the disclaimant predeceased the decedent; consequently, the disclaimant's share of the estate passes to the person next in line to receive that share. The United States Supreme Court determined that the taxpayer's right to his mother's assets was a property right that the federal tax lien attached to despite the retroactive attempt by the taxpayer to disclaim his interest in it.
 - *United States v. Barczyk*: [\[FN10\]](#) Dealt with the issue of how joint tenant's interest should be valued when the IRS forecloses its lien against the taxpayer's property and only one of the tenants owes the IRS money. The taxpayer pointed to oral argument made by government counsel in the *US v. Craft* [\[FN11\]](#) case where the government argued that the life expectancies should be considered when dividing the joint tenants interest in the property, and cited Revenue Ruling 78-166. The court rejected the taxpayer's argument, noting that Revenue Ruling 78-166 addresses the devolution of jointly-owned real property when a joint tenant murders the other, and went on to point out that even if Revenue Ruling 78-166 were in any way relevant, its

holding contradicts IRS Notice 2003-60, which deals specifically with collections from entireties property, and attributes half of the property's value to each spouse.

IV. Place of filing notice of federal tax liens

- [IRC 6323\(f\)](#) states that state law will determine where a notice of federal tax lien is filed.
- According to the Internal Revenue Manual (“IRM”) liens should be filed as follows: [FN12](#)

Individuals:

A. Real Property - file the NFTL in the recorder's office for the county where the real property is located;

B. Personal Property (tangible or intangible) - In general, file the NFTL at the recorder's office for the county where the taxpayer resides at the time the NFTL is recorded because that is where the property is deemed to be located.

Corporations and Partnerships:

A. Personal Property - file as designated by the state where the principal executive office of the business is located. This may be with the Secretary of State or other designated office. The principal executive office is deemed to be the residence of the corporation or partnership. It is the place where the major management decisions are made. Do not confuse the principal executive office with the principal place of business.

B. Real Property - file in the recorder's office for the county where the real property is physically located.

- Clerk of the United States District Court - File with the office clerk if the state has not designated one office within the state that comports with federal law.
- Recorder of deeds of the District of Columbia - Personal property whether tangible or intangible, is deemed to be located in the District of Columbia if the taxpayer's residence is located there or outside the United States at the time the notice of lien is filed.

V. Priority of Liens

- State law is very significant when considering the property and rights to property to which the federal tax lien attaches. The Government looks to state law to determine a taxpayer's rights in a particular piece of property, but federal law determines whether such interests qualify as property or rights to property.

- After notice and demand for payment, the federal tax lien arises and relates back to the assessment date. Congress recognized that it was difficult to conduct business when creditors were unaware of the Service's assessment lien. Consequently, Congress enacted the forerunner of [IRC § 6323\(a\)](#) to provide that a NFTL must be filed in order to have priority over certain creditors. Today, [IRC § 6323\(a\)](#) provides, in part, that “the lien imposed by [section 6321](#) shall not be valid as against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until notice thereof has been filed.”

- The Internal Revenue Code provides special protection for limited interests by giving them priority over the federal tax lien even though the interests come into existence after the filing of a NFTL. [\[FN13\]](#) These special interests are called “superpriorities.”

- These “superpriority” interests include:

- A. The purchaser or the holder of a security interest in a “security” who at the time of purchase or at the time the security interest came into existence did not have actual notice or knowledge of the existence of the federal tax lien. [\[FN14\]](#)

- B. The purchaser of a motor vehicle if, at the time of purchase, the purchaser did not have actual notice or knowledge of the existence of the federal tax lien and before the purchaser has actual notice or knowledge, the purchaser has actual possession of the motor vehicle and has not thereafter relinquished actual possession to the seller or his/her agent. [\[FN15\]](#)

- C. The purchaser of tangible personal property purchased at a retail sale unless at the time of purchase the purchaser intends the purchase to (or knows the purchase will) hinder, evade or defeat the collection of the federal tax. [\[FN16\]](#) “Retail sale” means a sale made in the ordinary course of the seller's trade or business of tangible personal property of which the seller is the owner.

- D. The purchaser of household goods, personal effects or other tangible personal property exempt from levy under [IRC § 6334](#). It encompasses items purchased (other than for resale) in a casual sale for less than \$1,240. This amount is adjusted annually for inflation. These sales include “garage sales” or “tag sales.” a casual sale is a sale not made in the ordinary course of the seller's trade or business. Protection is afforded only if the purchaser does not have actual notice or knowledge of the existence of the federal tax lien or that the sale is one of a series of sales which means that the seller plans to dispose of, in separate transactions substantially all of his/her household goods, personal effects and other tangible personal property. This exception applies only to tangible personal property (e.g. household goods, personal effects, wearing apparel, firearms, furniture, etc.) as defined in [Treas. Reg. § 301.6323\(b\)-1\(d\)\(1\)](#).

- E. Someone in possession of tangible personal property subject to a lien under local law securing the reasonable price of the repair or improvement of that property. [\[FN17\]](#) Thus, for example, if state law gives an automobile mechanic a lien for the repair bill and the right to retain possession of an automobile he/she has repaired as security for payment of the repair bill, and the mechanic retains continuous possession of the automobile, a federal tax lien which has attached to the automobile will not be valid to the extent of the repair bill.

F. Certain specified state and local tax liens against real property. [\[FN18\]](#) This applies if state or local law entitles such liens to priority over security interests in such property which are prior in time, and such lien secures payment of one of the following three types of taxes or charges: A tax of general application levied by any taxing authority based upon the value of such property (real estate tax); a special assessment imposed directly upon such property by any taxing authority, if such assessment is imposed for the purpose of defraying the cost of any public improvement (for example, sewers, streets, or sidewalks); and a charge for utilities or public services furnished to such property by the United States, a state or political subdivision thereof, or an instrumentality of any one or more of the foregoing.

VI. Release, Discharge and Subordination

- [IRC § 6325](#) authorizes the Secretary to remove, discharge or subordinate a federal tax lien.
- Removal of a Federal Tax Lien. The Service will agree to remove its lien where a taxpayer can make a showing that collection of the federal tax debt will be improved by the removal of the lien. An example is a taxpayer who is unable to gain employment in their specific field due to the presence of the tax lien, and that if the lien were removed their probable salary would enable them to earn a living sufficient that, after allowable expenses, they would be able to make payments against their outstanding debt.
 - Practitioners involved in a request for removal should consider whether the federal tax lien is actually protecting the federal government. If the taxpayer has no assets of any real value, the government is not giving up much protection in agreeing to remove its lien and assist the taxpayer to obtain financing or employment (which will allow them to pay down their debt).
- Discharge of a Federal Tax Lien. The Secretary is authorized to discharge property from a federal tax lien in the following circumstances:
 - A. Where the federal tax debt will be fully paid by the sale of the property;
 - B. Where the IRS will obtain whatever equity is available in the property to help pay down the federal tax debt; or
 - C. Where the Commissioner determines that there is no equity available for the IRS.
- Example: Taxpayer A owns a home that is valued at \$300,000 and has a first mortgage balance of \$325,000. Taxpayer A also owes \$50,000 in federal taxes, and a Notice of Federal Tax Lien has been filed against his home. If Taxpayer A can arrange for a short sale for \$300,000, the IRS would discharge its lien so that the third party buyer can take clear title, as there is no equity for the IRS in the home.
- In August 2010 the IRS released a new Form 14135 for requesting a Lien Discharge.

- Subordination of a Federal Tax Lien. The secretary is authorized to subordinate its tax lien to another creditor where it can be demonstrated that collection of the tax debt will be enhanced by agreeing to the subordination.

- Example: Taxpayer's home burns down. The destroyed property is valued at \$200,000 in its current condition. There is a mortgage for \$250,000 and a federal tax lien on the property for \$100,000. The bank holding the first mortgage of \$250,000 is willing to loan an additional \$250,000 to rebuild the property, which is estimated to be worth \$700,000 when completed, if the IRS will subordinate its federal tax lien to its new consolidated mortgage of \$500,000. The IRS may subordinate its lien if it is shown that collection will be improved because their lien, while now behind a \$500,000 mortgage is on a \$700,000 property, leaving \$200,000 of equity available for the IRS. In its current condition the value of the property has no equity available for the government.

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[\[FN1\]](#). [IRC § 6503\(h\)](#)

[\[FN2\]](#). Regulation [§ 301.7122-1\(i\)](#).

[\[FN3\]](#). Regulation [§ 301.6330-1\(g\)](#).

[\[FN4\]](#). Regulations [§ 301.6320-1\(e\)\(3\)](#), Q-E2

[\[FN5\]](#). Regulations [§ 301.6320-1\(e\)\(3\)](#), Q-E10

[\[FN6\]](#). [IRC § 6320\(c\)](#), referring to § 6330(d)(1)

[\[FN7\]](#). [IRC § 6321](#).

[\[FN8\]](#). [535 U.S. 274 \(2002\)](#)

[\[FN9\]](#). [120 S.Ct. 474, \(12/07/1999\)](#)

[\[FN10\]](#). [105 AFTR 2d 2010 \(4/6/2010\)](#)

[\[FN11\]](#). [535 U.S. 274 \(2002\)](#)

[\[FN12\]. IRM 5.12.2.8](#)

[\[FN13\]. IRC § 6323\(b\)](#)

[\[FN14\]. IRC § 6323\(b\)\(1\)](#)

[\[FN15\]. IRC § 6323\(b\)\(2\)](#)

[\[FN16\]. IRC § 6323\(b\)\(3\)](#)

[\[FN17\]. IRC § 6323\(b\)\(5\)](#)

[\[FN18\]. IRC § 6323\(b\)\(6\)](#)

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