

National Taxpayer Advocate

2009 Annual Report to Congress

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**THE IRS'S USE OF NOTICES OF
FEDERAL TAX LIEN (NFTL)**

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The IRS’s Use of Notices of Federal Tax Lien (NFTL)

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Executive Summary

A Notice of Federal Tax Lien (NFTL) is a legal tool the IRS uses to facilitate the collection of unpaid tax debts. The NFTL places the public on notice that the IRS has a legal claim to taxpayers' property as security or payment for their tax debt. The IRS frequently files liens using a systematic process that does not take into account the individual circumstances of the taxpayer (*e.g.*, the taxpayer may have an economic hardship, and the filing of the lien may actually be detrimental to the collection of the liability).

The IRS issued nearly one million liens in fiscal year (FY) 2009.¹ This was an increase of 85 percent from the number of liens filed in FY 2005 and about 475 percent from FY 1999.² By comparison, the number of balance due individual returns (Forms 1040) filed from FY 2005 to FY 2009 rose only 24 percent.³ For FY 2009, liens made up over 4,000 of the cases worked by TAS, placing this inventory category in the top one-third of TAS receipts.⁴ The National Taxpayer Advocate is concerned that the IRS's use of the NFTL is harming taxpayers, especially those with economic hardships, while not significantly enhancing the IRS's ability to collect delinquent liabilities.⁵

The TAS Research & Analysis staff analyzed data from taxpayers with liabilities in tax year (TY) 2002.⁶ As part of this study, TAS Research reviewed nearly 1.9 million transactions (payments credited to taxpayers' accounts using transaction codes) involving over 270,000 taxpayers who incurred delinquent TY 2002 liabilities.⁷ The 270,000 taxpayers studied did not have any outstanding tax liabilities at the time their TY 2002 delinquency arose. TAS Research & Analysis examined the subsequent payment history of these taxpayers, along with how the IRS recorded their payments, to explore the relationship between revenue collection and the use of the NFTL. The research objectives for this project included:

- How often is the NFTL effective in securing payment on the tax debt?
- What amounts of the tax payments are not attributable to the NFTL?
- Does increasing the number of tax liens filed increase tax revenue?
- What percentage of NFTLs is filed systemically?

¹ IRS, Collection Activity Report, NO-5000-C23, *Collection Workload Indicators Reports* (Oct. 13, 2009). In FY 2009, the IRS filed 965,618 NFTLs.

² IRS, *IRS Data Books, Table 16, Delinquent Collection Activities, 1999-2008*; IRS, Collection Activity Report, NO-5000-C23, *Collection Workload Indicators Reports* (Oct. 13, 2009). The IRS filed about 168,000 liens in FY 1999 and 522,887 in FY 2005.

³ IRS, *IRS Data Book, Table 16*. Balance due returns (Forms 1040) rose from 22,982,544 in FY 2005 to 28,465,648 in FY 2008.

⁴ Taxpayer Advocate Management Information System (TAMIS) database. Total TAMIS receipts for FY 2009 were 4,232 from all Primary Core Issue Codes (PCICs) associated with liens.

⁵ IRS use of the NFTL damages taxpayers' credit rating, harms their ability to meet future liabilities, and may even have a negative impact on tax collection. See Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of the Law, Fail to Promote Future Tax Compliance, and Unnecessarily Harm Taxpayers*, Vol. I, *supra*.

⁶ We chose tax year 2002 to allow a sufficient time interval to elapse to analyze subsequent payments.

⁷ Specifically, we found 270,399 taxpayers with NFTLs filed on their TY 2002 liability. Please see the methodology section for a more detailed description of the study parameters.

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- How many NFTLs are filed against taxpayers who are incurring a hardship?

The IRS designated payment codes (DPC) for more than half of all the payments made by these taxpayers were insufficient to determine the source of the payment.⁸ Consequently, less than half of the delinquent payments definitively identified the payment source. Ultimately, nearly \$905 million of payments from these taxpayers were traceable.⁹ Given the traceable payment sources, we found:

- Payments associated with liens amount to less than \$1 out of every \$5 of payments.
- Payments that came from sources other than liens accounted for over \$4 out of every \$5 the IRS collected.

We also found that the IRS has continued to increase the number of NFTLs filed, but that there has not been any real increase in dollars collected (*i.e.*, the total collection yield):¹⁰

- The IRS increased the number of liens filed by 475 percent between FY 1999-2009.¹¹
- During FY 1999-2009, when adjusted for inflation, the total dollars IRS collected actually declined by seven percent from \$29.4 billion to \$27.2 billion (in terms of real dollars valued as of 2009).¹²

The IRS generates a majority of its liens through its Automated Collection System (ACS).¹³ Just under two-thirds of the liens requested by ACS were made systemically (*i.e.*, the IRS generates these liens without determining whether the taxpayers have any assets, or are likely to acquire any assets to which the NFTL would attach).¹⁴ As an example, NFTLs are automatically requested for every taxpayer whose delinquency exceeds \$5,000 when the IRS determines that the liability is Currently Not Collectible (CNC). The CNC designation includes situations where the IRS has determined that the collection of the liability would create a hardship on taxpayers by leaving them unable to meet necessary living expenses. For taxpayers with accounts in CNC status due to economic hardship, we found:

⁸ Of the 1,886,683 total payment transactions, only 629,158 transactions had the Designated Payment Code (DPC) code assigned. 1,257,525 transactions were coded "miscellaneous" or "DPC indicator not present" or had no DPC coding. Of the 1,257,525 transactions, 283,091 had a refund offset transaction code; leaving 974,434 payments (or 51.6 percent) as unaccountable. Thus, 912,249 payments (or 48.4 percent) had meaningful DPCs or could be identified as refund offsets.

⁹ About \$895 million of payments were not traceable.

¹⁰ The total collection yield is any revenue collected attributable to IRS collection activities, such as levies, liens, and seizures. Total collection yield in a fiscal year includes tax, interest, and penalties from multiple tax years.

¹¹ IRS, *IRS Data Books, Table 16, Delinquent Collection Activities, 1999-2008*; IRS, *Collection Activity Report, NO-5000-C23, Collection Workload Indicators Reports* (Oct. 13, 2009). In FY 2009, the IRS filed 965,618 NFTLs.

¹² Bureau of Labor Statistics, Dept. of Labor, *Consumer Price Index - All Urban Consumers (CPI-U)*, at <http://www.bls.gov/CPI/> (last visited Oct. 10, 2009).

¹³ IRS, *Collection Activity Report, NO-5000-C23, Collection Workload Indicators Reports* (Oct. 13, 2009). Of the 965,618 NFTLs filed in FY 2009, 491,822 (50.9 percent) were filed by the ACS.

¹⁴ ACS, *Customer Service Activity Reports (CSAR), FY 2009 BOD report*. See also IRS response to TAS Research & Analysis request (Oct. 30, 2009). ACS systemic programming retrieves cases with expired follow-ups in R7 status (accounts with a 25-day follow-up where the system generated an LT39, *Reminder Notice*), determines if the aggregate assessed balance is greater than \$5,000, and whether there are any modules without a lien. If all three criteria are met, the system requests the lien by inputting history code FM10 on the account. E-mail from IRS subject matter expert (Nov. 2, 2009). See also Internal Revenue Manual (IRM) 5.19.5.3.7, *Reminder Notices* (Dec. 1, 2007); IRM 5.19.5.5.7, *R7 - Lien Determinations (Follow-Up to LT39)* (May 29, 2008).

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- IRS refund offsets were responsible for nearly \$6 out of every \$10 in payments collected from taxpayers.
- NFTLs were responsible for \$2 out of every \$10 in payments collected from taxpayers.

Given the aforementioned findings, we recommend:

- The IRS should discontinue the policy of automatic NFTL filing on CNC hardship accounts with an unpaid balance of \$5,000 or more.
- The IRS should base lien filing determinations for all IRS contact employees on a thorough review of all the taxpayer's circumstances (including the existence and the value of assets, the taxpayer's financial information, the existence and amount of non-tax debt, and the ramifications of the lien on the taxpayer's credit rating).
- The IRS should institute a quality review of payment coding used to track taxpayers' payments for tax liabilities. An accurate method of tracking payments is an essential first step in determining the impact of various collection tools on taxpayers and the efficacy of their use.
- The IRS should study whether lien payments from CNC hardship taxpayers impose an economic hardship on these taxpayers.

Introduction

A Notice of Federal Tax Lien is a legal tool the IRS uses to facilitate the collection of unpaid tax debts. This tool gives IRS priority to assets over other creditors in certain circumstances. In fiscal year 2009, the IRS issued nearly one million liens, an increase of about 475 percent from FY 1999.¹⁵ Given the widespread use of this collection tool, it is important for the IRS to understand the taxpayers' individual circumstances and financial situation prior to filing the NFTL. The National Taxpayer Advocate is concerned that the IRS's use of the NFTL may be harming taxpayers, especially those with economic hardships, while not significantly enhancing the IRS's ability to collect delinquent liabilities. Moreover, taxpayers with damaged credit ratings will have more difficulty meeting future liabilities and might therefore have increased subsequent noncompliance.

Given these concerns and the increasing number of liens filed, the National Taxpayer Advocate tasked TAS Research & Analysis to study NFTLs and their role in tax administration. After careful consideration, we decided that the best way to accomplish this task was to review the payment history of taxpayers who had a lien "attached" to them. We ultimately selected over 270,000 taxpayers newly noncompliant because of their Tax Year (TY) 2002 liabilities and tracked their payment history. We will discuss the selection of these taxpayers in more detail in the methodology section.

Objectives

The objectives for the research project are as follows (the measure(s) accompanying the objectives are in parentheses):

- How often is the NFTL effective in securing payment on the tax debt? (Measure is the tax payments resulting from the NFTL divided by total payments).
- What amounts of the tax payments are not attributable to the NFTL? (Measure is the tax payments from all sources other than the NFTL divided by total payments).
- Does increasing the number of tax liens filed increase tax revenue? (Measure is the increase in filed NFTLs versus the total payments secured from all collection activities (in real 2009 dollars)).
- What percentage of NFTLs are filed systemically? (Measure is total number of NFTLs filed systemically divided by all NFTLs).
- How many NFTLs are filed against taxpayers who are incurring a financial hardship? (Measure is percent of NFTLs filed against taxpayers with financial hardship divided by total number of NFTLs).

¹⁵ IRS, *IRS Data Books, Table 16, Delinquent Collection Activities, 1999-2008*; IRS, *Collection Activity Report, NO-5000-C23, Collection Workload Indicators Reports* (Oct. 13, 2009). In FY 2009, the IRS filed 965,618 NFTLs.

BACKGROUND

What is a Lien?

A federal tax lien (FTL) arises when the IRS assesses a tax liability, sends the taxpayer notice and demand for payment, and the taxpayer does not fully pay the debt within ten days.¹⁶ An FTL is effective as of the date of assessment and attaches to all of the taxpayer's property and rights to property, whether real or personal, including those acquired by the taxpayer after that date.¹⁷ This lien remains until the liability is either fully paid or is legally unenforceable.¹⁸ This statutory lien is sometimes called the "secret" lien, because third parties – and usually the taxpayer – have no knowledge of the existence of this lien or the underlying tax debt. Further, the taxpayer may not understand the significance of this statutory lien.¹⁹ To put third parties on notice and establish the priority of the government's interest in a taxpayer's property against subsequent purchasers, secured creditors, and junior lien holders, the IRS must file an NFTL in the appropriate location, such as a county registrar of deeds.²⁰

Accordingly, an NFTL is a legal tool that enables the IRS to collect tax debts not paid by taxpayers. NFTLs place other creditors on notice of the existence of a tax delinquency and bolster the IRS's claim to an interest in taxpayers' property as security or payment for their tax debt. An NFTL may be filed only after certain requirements are met.²¹ Once these requirements are met, an NFTL is filed for the amount of the tax debt. By filing notice of this lien, the taxpayers' creditors are publicly notified that the IRS has a claim against all of their property, including property they acquire after the lien is filed. This notice is used by courts to establish priority in certain situations, such as bankruptcy proceedings or sales of real estate.

An NFTL "attaches" to all of the taxpayers' property (*e.g.*, their house or car) and to all of their rights to property (such as their accounts receivable if they are running a business). Once a lien is filed, the taxpayer's credit rating may be harmed. For example, 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.²² Therefore, it is very important that the IRS properly evaluates the taxpayer's situation and properly uses the lien as one of its collection tools. The IRS frequently requests NFTLs using a systematic process that does not take into account the taxpayer's individual cir-

¹⁶ IRC §§ 6321 and 6322. IRC § 6201 authorizes the IRS to assess all taxes owed. IRC § 6303 provides that within 60 days of the assessment the IRS must provide notice and demand for payment to any taxpayer liable for an unpaid tax.

¹⁷ See IRC § 6321; IRM 5.12.2.2 (May 20, 2005).

¹⁸ IRC § 6322.

¹⁹ IRC § 6321. The IRM refers to this statutory lien as a "silent" lien. See IRM 5.12.2.2 (May 20, 2005).

²⁰ IRC § 6323(f); Treas. Reg. § 301.6323(f)-1; IRM 5.12.2.8 (Oct. 30, 2009).

²¹ The IRS must first assess the liability. The IRS will then send the taxpayer a Notice and Demand for Payment, which is a bill that tells how much is owed in taxes. Next, the taxpayer must neglect or refuse to fully pay the bill (debt) within 10 days after notification. In addition, the IRS exercises its administrative discretion by only filing a lien if the tax debt exceeds a certain dollar threshold.

²² See Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of the Law, Fail to Promote Future Tax Compliance, and Unnecessarily Harm Taxpayers*, Vol. 1, *supra*.

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cumstances (*e.g.*, the taxpayer might have an economic hardship).²³ The National Taxpayer Advocate is concerned that the systematic application of liens is unnecessarily harming taxpayers, especially those with economic hardships.

Growth in Lien Filings and Impact on Taxpayers Who Require Assistance from TAS

The IRS issued nearly one million liens in FY 2009. This was an increase of about 85 percent from the number of liens filed in FY 2005.²⁴ By comparison, the number of balance due individual returns (Forms 1040) filed during this same period rose 24 percent.²⁵ For FY 2009, lien related issues made up over 4,000 of the cases worked by TAS, in addition to cases where the lien was a secondary issue or where other collection issues were involved including the filing of an NFTL.²⁶

Taxpayers with Tax Debts and Liens Filed by IRS

TAS Research & Analysis staff analyzed data from taxpayers with liabilities in TY 2002.²⁷ As part of this study, TAS Research reviewed nearly 1.9 million transactions (payments credited to taxpayers' accounts using transaction codes) involving over 270,000 taxpayers who incurred delinquent tax liabilities.²⁸ The 270,000 taxpayers studied did not have any outstanding tax liabilities at the time that their TY2002 delinquency arose. TAS Research & Analysis examined the subsequent payment history of these taxpayers, along with how the IRS recorded their payments, to explore the relationship between revenue collection and the use of the NFTL. The findings from this research are discussed below.

METHODOLOGY

Our principal objective was to look at a segment of taxpayers with Notices of Federal Tax Lien, examine their payment transactions, and determine whether the payment was attributable to the lien. We selected TY 2002 modules with NFTLs, so that we could track their subsequent payment history over several years. We selected only modules that became newly delinquent in TY2002. In addition, if there were prior tax modules in collection status, these modules had been satisfied prior to the origination of the TY 2002 liability. This approach ensured that the payments were not associated with prior accounts.

The data set was built in three steps. The first step was to determine new collection accounts in TY 2002. The second step was to eliminate those with prior collection accounts still open. The third step was to determine if there was an NFTL, and if so, to

²³ The IRS ACS files liens systemically in over six out of every ten cases where a lien is filed.

²⁴ IRS, *IRS Data Books, Table 16, FY 2005* (522,887). IRS, *Collection Activity Report, NO-5000-C23, Collection Workload Indicators Reports* (Oct. 13, 2009). The IRS filed 522,887 NFTLs in FY 2005 and 965,618 NFTLs in FY 2009.

²⁵ IRS, *IRS Data Books, Table 16, FY 2005 and FY 2008*. Balance due returns (Forms 1040) rose from 22,982,544 in FY 2005 to 28,465,648 in FY 2008.

²⁶ Taxpayer Advocate Management Information System (TAMIS) database. Total TAMIS receipts for FY 2009 were 4,232 from all PCICs associated with liens.

²⁷ We chose TY 2002 to allow a sufficient time interval to elapse to analyze subsequent payments.

²⁸ Specifically, we found 270,399 taxpayers with NFTLs filed on their TY 2002 liabilities. See the methodology section for a more detailed description of the study parameters.

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attach payment transaction codes, dates, and amounts to the data. Using the Compliance Data Warehouse (CDW) Accounts Receivable Dollar Inventory (ARDI,) and the Individual Master File (IMF) Module file, we extracted TY 2002 modules that became newly delinquent as designated by the record type. Taxpayers that had previous collection accounts still open were removed from the data set. The NFTL date (Transaction Code (TC) 582 date) was added to the file, as were all payment and offset transaction codes, transaction dates, transaction amounts, and DPCs for the corresponding tax year from the CDW IMF Transaction History file. At the time, the latest IMF Transaction History extract cycle was 200913 (13th week of 2009). We added CNC designations with hardship status to the file using TC 530 (CNC), TC 537 (CNC Reversal), and the TC 53X closing codes (to determine hardship) from the CDW IMF Transaction History File. We added other variables such as total positive income (TPI)²⁹ and adjusted gross income from the CDW Individual Returns Transaction File (IRTF).

The resulting file contained 1,886,683 payment transactions associated to 270,399 TY 2002 tax modules or taxpayers (there was a one-to-one correspondence between tax modules and taxpayers). Payment (type) transaction codes along with their associated designated payment codes were used to determine whether a payment was attributable to the lien, not attributable the lien, or attributable to an offset. We used the payment transaction code to identify offsets, and the DPC to determine whether other payments (*i.e.*, payments that were not offsets) were attributable to the lien. The transaction codes used are contained in Appendix 1. Appendix 2 contains a list of the DPCs and associated information including whether the code is associated with payments attributable to liens.

We found, however, that about 1.3 million of the nearly 1.9 million payment transactions, about 67 percent, had a DPC of either a 00 (*i.e.*, “unspecified”), or a 99 (*i.e.*, “miscellaneous”), or that the DPC was missing.³⁰ Since these payments were the majority of the payment transactions and we could not exactly determine if these payments were attributable or not attributable to the lien, we removed them from the data analysis. Payments associated with offset transactions remained in the data set.

There were 20 payments with unrecognized designated payment codes, of which six payments were considered attributable to the lien, 13 payments were considered attributable to an offset, and one payment was considered not attributable to the lien. Our final payment data set had 912,249 payment transactions associated to 159,161 taxpayers.

²⁹ TPI is calculated by summing the positive values from the following income fields from a taxpayer's most recently filed individual tax return: wages; interest; dividends; distributions from partnerships, small business corporations, estates, or trusts; Schedule C net profits; Schedule F net profits; and other income such as Schedule D profits and capital gains distributions. Losses reported for any of these values are treated as zero.

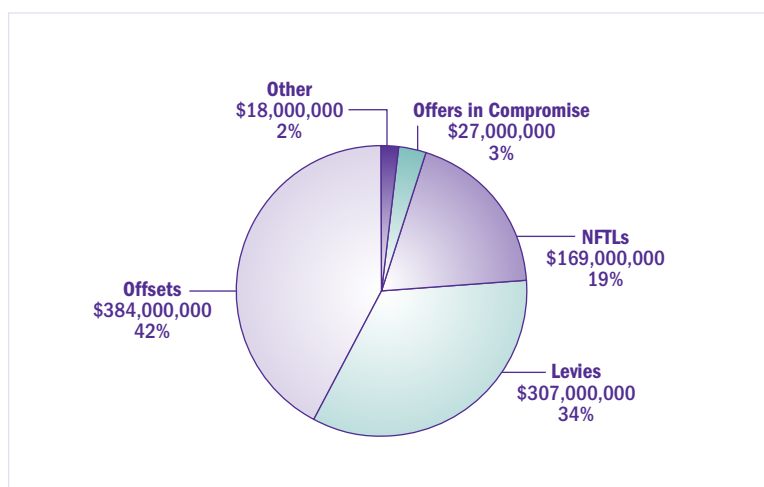
³⁰ 1,257,525 of the 1,886,683 payment transactions had either a DPC of 00 or 99, or no DPC.

FINDINGS

Sources of Payments on Tax Debts

We tracked the payments the 270,000 taxpayers made from 2002-2009, and discovered the IRS coded payments in a way that limited our ability to discern the source of slightly over half of all the payments made by these taxpayers. We limited our analysis to the payments we could track, and determined the sources for nearly \$905 million in payments. The sources of the \$905 million in payments are broken out in Figure 1.

FIGURE 1: Tax Payments by Source



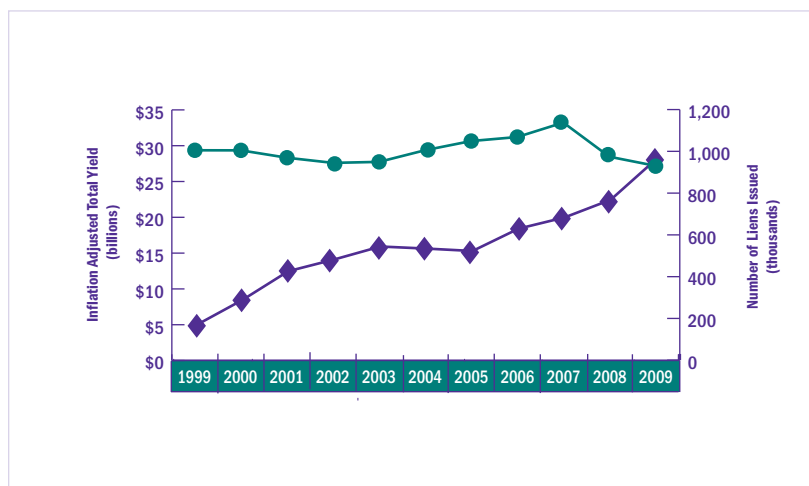
The payments associated with NFTLs amount to less than one dollar out of every five dollars of payments of the traceable payment sources. Conversely, we found that payment sources not attributable to NFTLs were responsible for over four out of every five dollars the IRS collected. The largest source of payments came from the refund offsets (*i.e.*, the source of 42 percent of all payments), whereby the IRS collects tax debts by taking subsequent taxpayer refunds.

The second largest source of payments came from levies. The payments received from levies accounted for \$1 out of every \$3 in payments collected by the IRS. A levy is a legal tool the IRS uses to seize taxpayers' property to satisfy a tax debt, and is different from a lien. A lien is a claim used as security for the tax debt, while a levy actually takes the property to satisfy the debt. If taxpayers do not pay their taxes (or make arrangements to settle their debt), the IRS may acquire funds in the taxpayers' possession or monies due to the taxpayers, such as wages or Social Security payments. For instance, the IRS could levy property that belongs to taxpayers but is held by someone else (such as their wages, retirement accounts, or bank accounts).

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The third largest source of payments came from NFTLs. A little less than one dollar out of every five dollars in payments was attributable to NFTLs. The IRS increased the number of liens filed by 475 percent between FY 1999 and FY 2009.³¹ Figure 2 below shows the number of liens issued by the IRS each year, and illustrates that the number of liens issued by the IRS rose almost every year over the past 11 years. During this same period, however, IRS total dollars collected actually declined by seven percent from \$29.4 billion to \$27.2 billion, when adjusted for inflation (in terms of real dollars valued as of 2009).

FIGURE 2: Inflation Adjusted Total Yield vs. Liens Issued



NFTLs Created Systemically

The IRS generates a majority of its liens through its Automated Collection System.³² Of the liens generated by ACS, we determined that just under two-thirds were created systemically.³³ The result is that nearly one-third of *all* NFTLs filed by the IRS are done so systemically and without significant employee involvement. The IRS generates these liens without reviewing the financial circumstances of these taxpayers and does not determine whether these taxpayers have any assets, or are likely to acquire assets to which the lien would attach.³⁴

³¹ IRS, *IRS Data Books, Table 16, Delinquent Collection Activities, 1999-2008*; IRS, *Collection Activity Report, NO-5000-C23, Collection Workload Indicators Reports* (Oct. 13, 2009). In FY 2009, the IRS filed 965,618 NFTLs.

³² IRS, *Collection Activity Report, NO-5000-C23, Collection Workload Indicators Reports* (Oct. 13, 2009). Of the 965,618 NFTLs filed in FY 2009, 491,822 (50.9 percent) were filed by ACS.

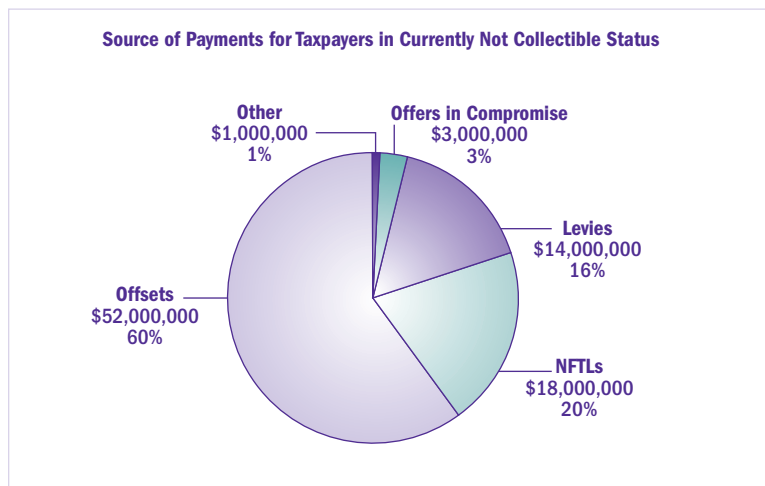
³³ ACS, *Customer Service Activity Reports (CSAR), FY 2009 BOD report*.

³⁴ ACS, *Customer Service Activity Reports (CSAR), FY 2009 BOD report*. See also IRS response to TAS Research & Analysis request (Oct. 30, 2009). ACS systemic programming retrieves cases with expired follow-ups in R7 status (accounts with a 25-day follow-up where the system generated an LT39, Reminder Notice), determines if the aggregate assessed balance is greater than \$5,000, and whether there are any modules without a lien. If all three criteria are met, the system requests the lien by inputting history code FM10 on the account. E-mail from IRS subject matter expert (Nov. 2, 2009). See also IRM 5.19.5.3.7, *Reminder Notices* (Dec. 1, 2007); IRM 5.19.5.5.7, *R7 - Lien Determinations (Follow-Up to LT39)* (May 29, 2008).

Sources of Payments for Taxpayers with Currently Not Collectible Accounts

We looked at the subset of the 270,000 taxpayers who were reported as CNC by the IRS.³⁵ For our analysis, we only included cases that the IRS placed in CNC status because the collection of the liability would create an economic hardship for the taxpayers and would leave them unable to meet necessary living expenses. Cases can also be reported CNC because the taxpayer could not be contacted or located; however, these cases were not included in our CNC analysis. The IRS reported about 13 percent of the taxpayers in our study as CNC due to economic hardship.³⁶ We examined the payment history for these taxpayers. The results are shown in Figure 3.

FIGURE 3: Payments from Taxpayers in CNC Status Due to Hardship



The largest source of payments for taxpayers whose accounts were designated as CNC was offsets. IRS refund offsets were responsible for nearly \$6 out of every \$10 in payments collected from taxpayers (see Figure 3). The significantly higher percentage of payments from refund offsets for hardship taxpayers when compared to all taxpayers suggests that these taxpayers have little ability to make voluntary subsequent payments. The next largest source of payments is liens, followed by levies. The use of liens by the IRS was responsible for \$2 out of every \$10 in payments collected from taxpayers.

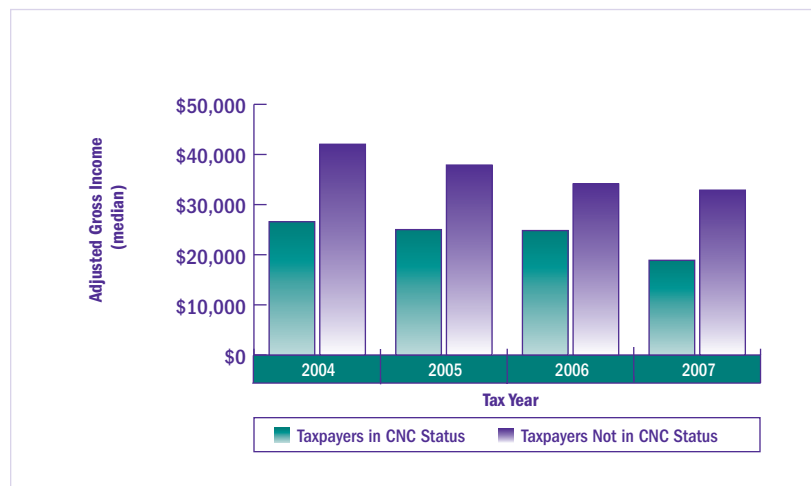
³⁵ CNC status means the IRS has determined it is currently unlikely to collect the tax liability from the taxpayer. TAS Research & Analysis pulled the subset of CNC Hardship taxpayers from the 270,399 individual taxpayers who first incurred new balance due delinquencies in TY 2002, had no previous unpaid tax liabilities at that time, and against whom NFTLs were filed in subsequent years. This analysis is based on the subset of payments that were refund offsets or had specific DPC coding. It does not include those payments that were coded as “Miscellaneous” or had no DPC coding. IRS, CDW, IMF Transaction File Cycle 200913.

³⁶ The IRS reported 35,919 of the taxpayers in this study as CNC due to economic hardship.

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Taxpayers with CNC Accounts by Income Level

We looked at the income level of taxpayers who were in the CNC status when the lien was attached. We wanted to know if their income differed substantially from taxpayers not in CNC status. The results are shown in Figure 4.

FIGURE 4: Taxpayers with NFTLs and Income Level³⁷

The median adjusted gross income of taxpayers in the CNC status was roughly two thirds of the income of taxpayers not in the CNC status.

Dollars attributable to the filing of an NFTL are paid without regard to whether the taxpayer can afford to pay the monies extracted through the NFTL. For example, taxpayers whose liabilities the IRS reported CNC actually had a slightly higher percentage of their payments come from the filing of the NFTL. Given the CNC status of these taxpayers and their relatively low income levels, it is likely that the IRS is using its NFTL interest to secure payments that these taxpayers cannot afford to pay.

³⁷ Data is shown for TY 2004 -2007 due to incomplete income data for TYs 2003 & 2008. Income data was available for 21,500 of the 35,919 CNC taxpayers.

CONCLUSION

Overall, NFTLs can only be shown to generate a small portion of delinquent payments collected from taxpayers. Nevertheless, the IRS continues to increase the number of NFTLs filed on a yearly basis. The filing of a NFTL may have serious consequences for taxpayers, and this tool should only be used by the IRS when warranted by individual case circumstances.

Improved payment coding and additional research are needed to enable the IRS to better understand how effective the NFTL is as a collection tool, and to determine in what circumstances the filing of NFTLs is an effective collection action. Specific recommendations are contained hereafter.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that:

- The IRS should discontinue the policy of automatic NFTL filing on CNC hardship accounts with an unpaid balance of \$5,000 or more.
- The IRS should base lien filing determinations for all IRS contact employees on a thorough review of all the taxpayer's circumstances (including the existence and the value of assets, the taxpayer's financial information, the existence and amount of non-tax debt, and the ramifications of the lien on the taxpayer's credit rating).
- The IRS should institute a quality review of payment coding used to track taxpayers' payments for tax liabilities. An accurate method of tracking payments is an essential first step in determining the impact of various collection tools on taxpayers and the efficacy of their use.
- The IRS should study whether lien payments from CNC hardship taxpayers impose an economic hardship on these taxpayers.

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Appendix 1

Transaction Code	Brief Description
640	Advanced payment of determined deficiency
641	Dishonored advanced payment
670	Subsequent payment
671	Dishonored subsequent payment
672	Correction of 670 processed in error
673	Input of a 672 changes existing 670 to 673
680	Designated payment of interest
681	Dishonored designated payment
682	Correction of 680 processed in error
690	Designated payment of penalty
691	Dishonored designated payment
692	Correction of 690 processed in error
694	Designated payment of fees and collection costs
695	Reverse designated payment of fees and collection costs
700	Credit applied
701	Reverse generated credit applied
702	Correction of erroneously applied credit
706	Generated overpayment applied from another tax module
710	Overpayment credit applied from a prior tax period
712	Correction of 710 or 716 processed in error
716	Generated overpayment credit applied from prior tax period
760	Substantiated credit payment allowance
762	Correction of 760 processed in error

The IRS's Use of Notices of Federal Tax Lien (NFTL)

Appendix 2

Designated Payment Code Description	Attributable to Lien or Not
00 - Designated payment indicator is not present on posting voucher	
01 - Non-trust fund (BMF MFT 01, 03, 09, 11 and 12)	Not NFTL
02 - Payment is applied first to the trust fund portion of the tax (BMF MFT 01, 03, 09, 11, and 12)	Not NFTL
03 - Bankruptcy, undesignated payment	NFTL
04 - Levied on state income tax refund (State Income Tax Levy Program (SITLP)) (prior to 07/22/1998)	Not NFTL
05 - Notice of levy (Other levy proceeds)	Not NFTL
06 - Seizure and sale	NFTL
07 - Federal tax lien	NFTL
08 - Suits (Non-Bankruptcy)	NFTL
09 - Offer in compromise	Not NFTL
10 - Installment agreement (Manually Monitored Installment Agreements)	Not NFTL
11 - Bankruptcy, designated to trust fund	NFTL
12 - Cash bond credit (allowed with TC 640 only)	Not NFTL
14 - Authorization given by taxpayer to apply payment to expired CSED account	Not NFTL
15 - Payments caused by Form 8519	Not NFTL
16 - Federal EFT levy payment	Not NFTL
17 - EFT payroll deduction installment agreement payment	Not NFTL
18 - FPLP payment for the Primary Taxpayer Identification Number (TIN). Payments are received electronically from Financial Management Service (FMS)	Not NFTL
19 - FPLP payment for the Secondary TIN. Payments are received electronically from FMS	Not NFTL
20 - State Income Tax Levy Program	Not NFTL
21 - Manual Posting of State Income Tax Levy Payments	Not NFTL
22 - Alaska Permanent Fund Dividend Levy Program	Not NFTL
23 - Alaska Permanent Fund Dividend Levy Program (AKPFD) receipt (used exclusively for manually applied payments)	Not NFTL
24 - Payment received with an amended return	Not NFTL
27 - Unknown	
28 - Unknown	
29 - Unknown	
31 - Exclude payment from systemic cross-reference processing to allow treatment of each spouse differently on a joint return	Not NFTL
33 - OIC \$150 application fee for offers submitted under TIPRA legislation	Not NFTL
34 - OIC 20 percent lump sum or initial periodic payment under TIPRA legislation	Not NFTL
35 - OIC subsequent payments made during the offer investigation under TIPRA legislation	Not NFTL
36 - Unknown	
38 - Unknown	
43 - Unknown	
47 - Installment Agreement User Fee, reduced initial fee, IMF only	Not NFTL
49 - Direct Debit Installment Agreement (DDIA) User Fee, initial fee	Not NFTL

The IRS's Use of Notices of Federal Tax Lien (NFTL)

Designated Payment Code Description	Attributable to Lien or Not
50 - Installment Agreement User Fee (IAUF). (Valid with MFT 13 (BMF) for tax period XXXX12 and with MFT 55 (IMF) for tax period XXXX01.)	Not NFTL
51 - Installment Agreement User Fee, Reinstatement fee	Not NFTL
53 - Discharges	NFTL
54 - Subordinations - Gov. agrees for NFTL to have lower priority in exchange for compensation from new superior lien holder	NFTL
55 - Subordinations	NFTL
56 - Withdrawals	NFTL
57 - Judicial and Non- Judicial Foreclosures	NFTL
58 - Redemptions; Release of Right of Redemptions	NFTL
59 - CID cases (182-Probation)	Not NFTL
80 - Unknown	
86 - Unknown	
89 - Unknown	
90 - Unknown	
99 - Miscellaneous payment other than above	