

# **FEDERAL TAX LIENS FOR REAL ESTATE PROFESSIONALS:**

**THE INSIDE SCOOP ON WHAT  
THEY ARE AND HOW YOU  
(AND YOUR CLIENTS) CAN  
DEAL WITH THEM**

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## ABOUT THE AUTHOR

The focus of Attorney Eric L. Green's practice is taxpayer representation before the [Internal Revenue Service](#), [Connecticut Department of Revenue Services](#) and [Massachusetts Department of Revenue](#), as well as handling probate matters and [estate planning](#) for individuals and business owners and [tax planning](#) for closely held businesses. He is a frequent lecturer on tax topics, including criminal and civil tax controversy matters, estate planning, and business planning and has served as adjunct faculty at the *University of Connecticut School of Law*.

Mr. Green is a contributing author for *Advocating for Low Income Taxpayers: A Clinical Studies Casebook, 3<sup>rd</sup> Edition*, and is currently co-authoring *The Guide on the Trust Fund Recovery Penalty* for the American Bar Association, and has also been quoted in *USA Today*, *Consumer Reports* and *CreditCard.com*.

Attorney Green is a 2010 Nolan Fellow of the American Bar Association and currently serves as Chair of the American Bar Association's Closely Held Businesses Tax Committee, and in the past has served as the chairman of the subcommittees on Business Succession Planning and Estate Planning. Attorney Green is the incoming Vice-Chair of the Executive Committee of the Tax Section and is a Member of the Estate & Probate Sections of the Connecticut Bar Association.

Attorney Green is admitted to practice in Connecticut and Massachusetts and is a member of the United States Tax Court Bar. Attorney Green is also a member of the Connecticut and Massachusetts Bar Associations, as well as the American Bar Association. Attorney Green is admitted to practice in Massachusetts and Connecticut Superior Courts, the United States Tax Court, and the Federal District Court for Connecticut. Attorney Green received his Bachelor of Business Administration degree in Accounting from Hofstra University and is an honors graduate from New England School of Law. He earned a Masters of Laws in Taxation (LL.M.) from Boston University School of Law.

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# I. ABOUT TAX LIENS

One of the most common issues that causes real estate professionals to [contact our office](#) is the issuance of a Notice of Federal Tax Lien filed against a taxpayer/client. The lien can cause tremendous impediments to all parties involved: it ruins a taxpayer's credit, it creates difficulty when a home is going to be sold, and it can bring a client's refinancing to a ruinous halt. In 2010 the IRS filed almost 1.1 million notices of Federal Tax Lien against taxpayers and their property.

But it does not have to be this way!

Tax Liens are one of the most powerful tools the IRS has to compel taxpayers to meet tax compliance and pay their back taxes. There are ways that we work with you and your client to remove the lien and get their real estate deal done, and perhaps even resolve the outstanding tax issue at the same time.

## ***About Federal Tax Liens***

A tax lien arises automatically by law: the IRS does not have to take any action for a lien to arise and attach to all of the taxpayer's assets. This often comes to a surprise to clients.

A lien arises by law and attaches to all property or rights to property that the taxpayer owns at the time the tax is assessed, or that they acquire afterward. This means that a lien will attach to property the taxpayer either purchases or

inherits after the lien arises. This is often referred to as the “silent lien” because it is created without any filing on the part of the IRS, and taxpayers often do not realize there is a lien.

The federal tax lien is very powerful. There are a number of United States Supreme Court Decisions that highlight this:

- *United States v. Craft*<sup>1</sup>: A Michigan taxpayer (the husband) had a tax assessed against him that his wife was not responsible for. The couple held property as a “Tenancy by the Entireties” and argued that, under such state law, the husband had no separate interest in the property for the federal tax lien to attach to. The Supreme Court, using the “bundle of sticks” theory for property rights, determined that the taxpayer husband did have rights in the property to which the federal tax lien could attach.
- *Drye et al v. United States*<sup>2</sup>: Petitioner owed the IRS \$325,000 for 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. 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 attempt by the taxpayer to disclaim his interest in it.

These cases highlight the power and reach of the federal tax lien.

Once a taxpayer files his or her return with the IRS (filing date), the IRS will input the information to its system and assess the tax liability (assessment date). Once the tax is assessed a billing notice is generated and sent to the

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<sup>1</sup> 535 U.S. 274 (2002)

<sup>2</sup> 120 S.Ct. 474, (1999)

taxpayer. If the bill is not paid, a lien arises automatically by law and relates back to the original assessment date of the tax return.

The Notice of Federal Tax Lien is filed in the land records of the town of the taxpayer's home or the home where they reside, even if they own no property in the town. A Notice of Federal Tax Lien will also be filed in the town hall of the town where taxpayers and/or their business is located. A copy of the Notice of Federal Tax Lien is often also filed with the Secretary of the State, though this may vary from state to state, as the filing of the lien is determined by the requirements of each state's law regarding lien filings

The IRS files a Notice of Federal Tax Lien to provide notice to third party creditors of its lien, and therefore its interest, in the taxpayer's property. A sample Notice of Federal Tax Lien is included as an exhibit at the end of this article.

In general, the IRS has 10 years to collect a tax debt. The federal tax lien continues until the liability for the amount assessed is satisfied or becomes unenforceable by reason of lapse of time, i.e., the collection period expires.

For example, Joe and Mary Smith have a tax lien on their home from Joe's failed business for \$100,000 in payroll taxes. They own the home jointly. Their home is worth \$300,000 with a first mortgage for \$150,000, and a home equity line that is maxed out at \$20,000. The IRS seizes the home and sells it at auction for a price of \$250,000. The bank would be paid for its mortgage and the home equity line (\$170,000). The \$80,000 left would be split: \$40,000 to Mary and \$40,000 to the IRS (which represents Joe's equity that the IRS seized). Joe would

still owe \$60,000, so the lien would continue against any remaining assets Joe has or acquires in the future.

For the government to foreclose its tax lien against a personal residence, it must seek a court order in federal district court. This is not an action taken lightly. However, [we have noted](#) an upward trend recently in the number of foreclosure actions by the government.

### ***The IRS Position on Liens***

A Notice of Federal Tax Lien is filed by the IRS whenever the taxpayer owes more than \$10,000. However, as discussed below, there are opportunities for the taxpayer to have the lien either subordinated or withdrawn.

The IRS files the Notice of Federal Tax Lien in an effort to secure its position against third-party creditors. That being said, the IRS does not always want to stop a taxpayer's real estate deal from going through. The IRS will agree to discharge or subordinate its lien to another creditor if the taxpayer can demonstrate to the Technical Advisory Service (TAS) of the IRS that it is in the IRS's best interest to agree to the discharge or subordination.

So [how do we do that?](#)

Read on.

## **2. DISCHARGING TAX LIENS**

How does a taxpayer obtain a discharge of the federal tax lien? There are three ways: specific transactions, an Offer in Compromise (“OIC”) or an installment agreement.

### ***Lien Discharge***

The IRS will agree to discharge property from its tax lien when the taxpayer can demonstrate:

1. The IRS will acquire all of the equity available in the asset upon its sale to a third party; or
2. That there is no equity available for the IRS in the asset.

#### Example 1:

Joe and Mary both owe the IRS \$150,000. They have a buyer for their home for \$300,000. Joe and Mary owe the bank \$220,000 for its mortgage, which is in priority position to the IRS. Joe and Mary provide all of the necessary documentation to the TAS unit of the IRS that support the sale price. In exchange for the IRS receiving a certified check from the closing



for all the available equity (\$80,000), the IRS will agree to discharge the property from its lien so the buyer can take clear title to the property.

Example 2:

The same facts as above except that Joe & Mary owe the bank \$300,000 and can only find a buyer willing to pay \$250,000. The bank agrees to allow the seller to go forward with a short-sale. Here, upon receipt of the documentation necessary to show that the seller will not receive anything from the sale, the IRS will agree to release its lien because there is no equity in the property for it to reach.

The key to seeking a discharge is to show that the taxpayer is not going to walk away with money or a junior creditor will not receive money that could otherwise have gone to pay the IRS tax debt. When [we seek a discharge](#) on behalf of a client [we always make](#) sure to provide a complete package that documents the value of the home, the economics of the deal, and what equity, if any, will be available for the IRS.

***Release Upon Acceptance of an Offer in Compromise***

Taxpayers are allowed to make an offer to settle their IRS tax debt for less than they actually owe. This is referred to as an “Offer in Compromise,” or “OIC.” Every year, [we help](#) many taxpayers to compromise their tax liability.

An OIC is based upon what the IRS can expect to recover from the taxpayer, referred to as “Reasonable Collection Potential.” The calculation of an Offer is beyond the scope of this guide, but generally speaking it includes the net equity in the taxpayer’s assets and an evaluation of their future income, with some adjustments. It is in the client’s best interest to make sure the Offer is viable before the Offer is filed. There is no sense in wasting the client’s money and [our time](#) filing Offers with either little or no chance of being accepted.

Once the OIC is accepted, the lien will be released (usually within 30 days) and taxpayers can move on with rebuilding their credit.

### ***New Streamlined Agreement Discharge Rules***

The rule for the IRS had been, if a taxpayer owed more than \$5,000, a Notice of Federal Tax Lien was filed against the taxpayer. A tax lien can create significant difficulty for a taxpayer: it has a significant negative impact on the taxpayer’s credit score, complicates financing or the sale of real estate and makes public the taxpayer’s tax delinquency. After the IRS received feedback how liens for small amounts were causing taxpayers serious hardship without significantly improving the IRS’s ability to collect the tax debt, the IRS agreed to change its procedures.

Effective in 2011, taxpayers who enter into a streamlined installment agreement and agree to make their payments by automatic draft can seek a lien withdrawal after he or she makes their second payment.

A streamlined installment agreement is a payment plan that the taxpayer enters into under the following conditions:

1. The taxpayer owes less than \$25,000,
2. The full tax liability will be paid within 60 months, and
3. The taxpayer has not had another IRS installment agreement within the last 5 years.

The advantages of a streamlined agreement are that the taxpayer does not have to go through the time and expense of submitting all of his or her financial information or find a way to pay one large lump sum. In allowing taxpayers to make payments by automatic draft, [I believe](#) the IRS Commissioner has recognized that it is in both taxpayer's and the IRS's interest to remove the burden of the IRS lien and help taxpayers restore their credit.

### ***New Discharge Rules for Lapsed Liens***

The IRS has ten years to collect a federal income tax debt. After the ten-year statutory period has run, the liability is no longer enforceable and the tax liens are released.

As you will notice on the sample lien notice enclosed in the materials, the Notice of Federal Tax Lien has a column for the date when the lien will be deemed released unless re-filed.

This feature is why Notices of Federal Tax Lien are deemed to be self-releasing: the IRS needs no separate filing to release the lien after the collection statute has expired. Go and explain that to a bank!

For years we had issues when taxpayers sought to refinance a mortgage and were told by their bank to obtain a release from the IRS for an old lien. The IRS would refuse, stating (correctly) the old lien had been released as stated right on the Notice of Federal Tax Lien because it had not been refiled.

The IRS has finally realized the imposition this put on taxpayers and have changed its policy. The IRS Commissioner agreed in 2011 to allow a taxpayer to request and receive a lien release after the lien has already been deemed self-released in specific circumstances. Therefore, if clients have old tax liens on their records and now need to refinance, [we can make a written request to the IRS](#) and may receive a release of these old, expired liens.

### **3. SUBORDINATING TAX LIENS**

A “lien subordination” is where the IRS will allow another creditor to take a higher priority position over the IRS lien. Understandably, the IRS does not agree to subordinate its priority position to another creditor without significant justification.

The two most common instances in which the IRS will agree to subordinate its debt is where either:

1. The new creditor will lend money to help pay down the tax debt; or
2. The refinancing of the taxpayer’s loan will reduce the monthly payment, therefore allowing the taxpayer to increase the monthly payments currently made to the IRS, paying off the tax debt faster.

In these cases [we are often required](#) to build a strong case for why it makes economic sense for the IRS should agree to the subordination. For instance:

Joe and Mary suffered a house fire that destroyed their home. The home, after the fire, is valued at \$200,000. The first mortgage on the property held by the bank is \$250,000, and the IRS tax lien, in second position, is \$150,000. The bank that holds the first mortgage agrees to provide an additional \$300,000 of

funding to rebuild the home. After construction the value of the new home is estimated to be approximately \$750,000. We can show the IRS that currently its lien has no value, as the home is worth less than the first mortgage ahead of the IRS. However, by agreeing to allow the bank to refinance and loan \$550,000 (the original \$250,000 plus the new \$300,000 for construction) to Joe & Mary the IRS would be in a better position to collect because there would be \$200,000 of equity available after the first mortgage that is not available now (the value of \$750,000 less the \$550,000 owed to the first bank). The IRS would probably agree to subordinate its lien to the bank's new loan.

As this case illustrates, when [we seek](#) lien subordinations, the key factor in obtaining IRS approval is being able to show how IRS Collection is improved when the IRS agrees to subordinate its lien.

## 4. CONCLUSION

There are a number of ways that taxpayers can deal with the IRS tax lien as well as their tax issue overall. The biggest step is to start dealing with it:

1. Get into tax compliance, meaning file any missing returns and start paying current federal taxes properly;
2. Provide the necessary information to the IRS;
3. Document why the removal or subordination of the lien is in the IRS's best interest; and
4. Work on resolving the overall tax issue so clients can move forward with their lives financially.

Taxpayers may have made one or more bad decisions regarding meeting their tax obligations, but these tax consequences can be corrected and dealt with if taxpayers are willing to [work with us](#) and the IRS to resolve the matter.

Taxpayer Identification Number:

Contact Person:

Employee Identification Number:

Contact Telephone Number:

Date:

**Notice of Federal Tax Lien Filing and Your Right to a Hearing Under IRC 6320**

We filed a Notice of Federal Tax Lien on

Type of Tax

Tax Period

Amount Owed

The lien attaches to all the property you currently own and to all property you may acquire in the future. It also may damage your credit rating and hinder your ability to obtain additional credit.

You have a right to a hearing with us to appeal this collection action and to discuss your payment method options. To explain the different collection appeal procedures available to you, we've enclosed Publication 1660, *Collection Appeal Rights*.

If you want to request a hearing, please complete the enclosed Form 12153, *Request for a Collection Due Process Hearing*, and mail it to  
You must request your hearing by

We'll issue a Certificate of Release of the Federal Tax Lien within 30 days after you pay the full amount owed. To get the current amount owed, contact the person whose name and telephone number appear at the top of this letter.

We'll also release the lien within 30 days after we accept a bond guaranteeing payment of the amount owed or after we adjust your account based on the decision of your requested hearing. We enclosed Publication 1450, *Instructions on how to Request a Certificate of Release of Federal Tax Lien*.



If you have any questions, please contact the person whose name and telephone number appear at the top of this letter.

Sincerely yours,

Director, Collection Policy

Enclosures:

Publication 594, *The Collection Process*

Publication 1450, *Instructions on How to Request a Certificate of Release of Federal Tax Lien*

Publication 1660, *Collection Appeal Rights*

Form 668-Y(C), *Notice of Federal Tax Lien*

Form 12153, *Request for a Collection Due Process Hearing*

**Notice of Federal Tax Lien**

Area:  
SMALL BUSINESS/SELF EMPLOYED AREA

Serial Number

For Optional Use by Recording Office

As provided by section 6321, 6322, and 6323 of the Internal Revenue Code, we are giving a notice that taxes (including interest and penalties) have been assessed against the following-named taxpayer. We have made a demand for payment of this liability, but it remains unpaid. Therefore, there is a lien in favor of the United States on all property and rights to property belonging to this taxpayer for the amount of these taxes, and additional penalties, interest, and costs that may accrue.

- This Notice of Federal Tax Lien has been filed as a matter of public record.
- IRS will continue to charge penalty and interest until you satisfy the amount you owe.
- Contact the Area Office Collection Function for information on the amount you must pay before we can release this lien.
- See the back of this page for an explanation of your Administrative Appeal rights.

Name of Taxpayer \_\_\_\_\_

Residence \_\_\_\_\_

**IMPORTANT RELEASE INFORMATION:** For each assessment listed below, unless notice of the lien is refiled by the date given in column (e), this notice shall, on the day following such date, operate as a certificate of release as defined in IRC 6325(a).

Kind of Tax (a)	Tax Period Ending (b)	Identifying Number (c)	Date of Assessment (d)	Last Day for Refiling (e)	Unpaid Balance of Assessment (f)
1040	12/31/	X	05/30/	06/29/	

Place of Filing \_\_\_\_\_

Total

This notice was prepared and signed at \_\_\_\_\_, on this,

the 27th day of June, 2011.

Signature \_\_\_\_\_  
for \_\_\_\_\_

Title  
REVENUE OFFICER

(NOTE: Certificate of officer authorized by law to take acknowledgment is not essential to the validity of Notice of Federal Tax Lien  
Rev. Rul. 71-466, 1971 - 2 C.B. 409)

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