

Tax Research Using IRS.GOV

Securing Discharges of Property from Federal Tax Liens

As I began my research for this article, I searched www.irs.gov and discovered newly-revised Publication 4235. It is amazing how helpful irs.gov can be. I urge readers not to overlook the irs.gov website when researching basic IRS procedures.

Publication 4235 provides the addresses and phone numbers of the “Collection Advisory Group” offices throughout the country. In the past, the title “Special Procedures” or “Technical Services” has been used to identify this group which determines when an IRS lien can be discharged or subordinated prior to an IRS debt being paid in full. Publication 4235 also refers to seven other publications relating to the Notice of Federal Tax Lien, including Publication 783 entitled “Instructions on how to apply for a Certificate of Discharge of Property From a Federal Tax Lien”.

The relevant law for tax liens can be found in Internal Revenue Code (“IRC”) Sections 6321 through 6327. The IRS procedures can be found in the regulations thereunder as well as Section 5.17.2 of the Internal Revenue Manual (“IRM”). When one wishes to transfer property free of the federal tax lien, one requests of the IRS a “Certificate of Discharge” pursuant to IRC §6325(b) and IRM 5.17.2.8.1. The process that the IRS would like taxpayers to follow to request such a discharge is set forth in Publication 783.

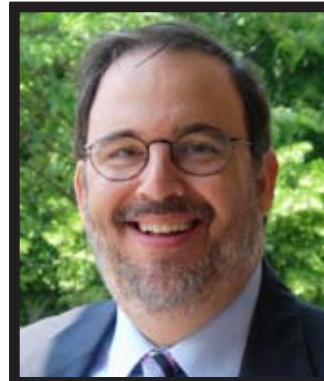
The discharge process is used by taxpayers to transfer property to others. Here are some examples:

Debtor taxpayers wish to sell their home, using the proceeds to reduce their IRS debt.

Debtor taxpayers wish to sell their business to a third party to maximize proceeds, yet amounts are not sufficient to pay off all of the entire IRS debt.

Debtor taxpayer corporation wishes to sell its inventory to an LLC owned by a minority of its shareholders, thus allowing the underlying business to be continued by the next generation.

In each of the above cases, the buyer will acquire the assets free and clear from the IRS lien because the IRS has agreed to discharge its lien against the assets being sold. It should be noted that the IRS lien against the taxpayer and any of his/her/its other assets will continue. In most cases, the IRS will receive the sales price, less payments to senior secured creditors, less agreed transactional expenses of the assets being sold. There are cases in which the IRS will discharge property even when the IRS receives no money from the transaction. This will occur, for example, in the case of a residence which has a fair market value less than the mortgage balance. Such action is specifically envisioned



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by IRC §6325(b)(2)(B) which provides that the Secretary (of the Treasury) may issue a certificate of discharge of property subject to the federal tax lien if the Secretary determines that the interest of the United States has no value.

Often, the IRS will negotiate to reduce professional fees related to the transaction. In New Jersey, they do not even allow the 1 percent reality transfer tax in spite of the fact that no real estate transfer can take place without paying the tax, citing that it is technically a fee rather than a tax.

If the collection matter is currently being handled by a Revenue Officer in the field, it is important to get support for the discharge from the Revenue Officer and his/her manager. Although this is not required, nor is it a final determination, such consensus-building provides a solid foundation for the ultimate decision being made by the Collection Advisory Group. Once one has secured support from the Revenue Officer, then one should move quickly to put together the request (made by a letter, not a form) and the accompanying materials. Publication 783 provides a listing of the materials which, ideally, the IRS would like to have. As you gather those materials, it is important to anticipate questions and provide as much documentation and backup as possible.

Here are some additional pointers for putting together your letter: Be sure to include a comprehensive list of property to be discharged from the lien. If you are discharging inventory, attach the actual inventory listing. If you are, in essence, selling a company through an asset sale, you must list all of the assets, including intangible assets. Keep in mind that the goal is to discharge all property being transferred from the lien to complete the planned transaction. If you do not accurately or thoroughly describe the property, the IRS cannot provide you the discharge or the discharge provided may be ineffective.

Include a “Summary of Transaction” section to lay out the entire transaction to the IRS and disclose all of the transaction’s intricacies. It is important that they fully understand what is

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If there are secured creditors ahead of the IRS, be sure to provide promissory notes, security instruments, and statements of balance due. You want to paint a clear picture of the transaction and how the funds will be distributed. For more complex transactions, provide a supplemental spreadsheet which clearly shows how and when the proceeds are being distributed among creditors.

The IRS will not allow a junior creditor (that is one that has an unsecured position or a secured position established after the IRS gave notice of its lien) to receive funds if the IRS debt is not fully paid.

When dealing with real estate, provide a listing of anticipated costs of closing (i.e. mortgage payoff, real estate commissions, attorney fees) with the initial letter. As soon as possible thereafter, provide a draft of the HUD-1 closing statement.

Do not hold up the submission of the Request for Discharge while waiting for the HUD-1 or any other document. It is more important to provide a substantially complete document as early as possible and then supplement it as additional documentation is secured.

In a normal economic environment, I find the IRS request for appraisals with respect to arms-length transactions to be unnecessary. Consider substituting an online valuation and negotiate the sufficiency of such a document. The IRS uses such valuation services in its Offer in Compromise units. However, in turbulent economic times, one may need appraisals to convince the IRS of a

significant diminution in value.

The Collection Advisory Group will insist on at least 30 days to consider the request. The 30 days run from the time they receive a complete package. If there is a Revenue Officer on the case, the package must be provided to the Revenue Officer who will then turn the package around. If you have not received a decision within 30 days, I have found the Taxpayer Advocate Service helpful in bringing a matter to

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fruition.

The practicality of making deals happens, without any advance assurance by the IRS, makes the entire process risky. Insofar as possible, your client should include contingencies in their sales contracts for securing IRS approval of the lien discharge. For businesses, securing contingent language is usually not a problem. However, for residential real estate, such contingencies can make the property unmarketable. The IRS will not approve hypothetical transactions. They prefer to have actual contracts and a pro-forma closing/HUD-1 statement in order to provide a decision.

Securing a Certificate of Discharge on property can be the ideal solution to an IRS problem. However, being successful requires the practitioner to put together a complete package and to be tenacious in moving the case along. The Collection Advisory Group appears to reject most requests at first blush. Accordingly, I push hard to secure a "wet reading" on the case as quickly as possible and move to address their concerns. With documentation and persuasion, one can succeed in securing discharges.

If your request for discharge is rejected, you may appeal such rejection by filing a form 9423, Collection Appeal Request. The matter is then considered by the Office of Appeals. In some cases, the Office of appeals merely reviews the procedural aspects of the underlying decision and does not get into the substance. In others, they will exercise independent judgment and/or attempt to negotiate a resolution among the parties. Even if an appeal could be viable, by the time we get to an Appeals hearing, the buyer has often moved on. ☺

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