UA-27080615-1

IRS Collection Actions Against Nominees and Alter Egos Lack Due Process, Practitioners Assert

Posted on 08/09/2012 by CCH

Two practitioners asserted on August 8 that the IRS actions aimed at collecting tax debts from third parties are abusive and lack due process. The practitioners spoke at an American Bar Association program on the collection of taxes from nominees, transferees and alter egos.

If a taxpayer (such as a corporation or other entity) that owes taxes has insufficient assets to pay the liability, the IRS may attempt to collect the liability from a third party, using various theories, including:

The third party is a nominee who merely holds title to property on behalf of the taxpayer, who in effect still owns the property;

The third party is the alter ego of the taxpayer and can be held responsible for the taxpayer's debts; or

The third party is a transferee of the taxpayer's property and should have to give up the property.

The IRS's primary collection tools are liens filed against property and levies to obtain property. Under the Taxpayer Bill of Rights, taxpayers have rights to notice and to Collection Due Process (CDP) administrative hearings for liens and levies, stated David Rice, an attorney from Torrance, Calif., who moderated the program. But the 1998 legislation overlooked third-party collection doctrines, such as nominee/alter ego claims, and failed to provide for notice and CDP hearings, Rice said.

Robert McKenzie of Arnstein & Lehr LLP, Chicago, asserted that the biggest problem is the absence of due process rights, if the IRS asserts these third-party doctrines. "The process is done in secret," McKenzie said. Notice is not provided to a third party treated as a nominee or alter ego, he explained. Instead, an IRS revenue officer obtains the approval of IRS Chief Counsel to assert third-party liability and simply files a lien or levy, without giving notice. In McKenzie's experience, neither the IRS collection agent nor the Office of Chief Counsel will discuss the matter with the taxpayer's representative. "The IRS won't talk," he said, making it difficult to resolve the matter informally.

Moreover, there is no right to go to the Tax Court to contest the matter, according to McKenzie. The lien leaves a cloud on the third-party's property, so the client must file a lawsuit to quiet title or a wrongful levy suit, he said. McKenzie added that he has been successful in obtaining temporary restraining orders and preliminary injunctions against the IRS to stop collection actions against third parties, but these can be costly and burdensome to clients.

Glenn Thomas, with the office of the IRS's Taxpayer Advocate Service (TAS), Washington, D.C., agreed that the procedures are not fair and that they violate the rights of third parties. "There is no reason that Chief Counsel shouldn't have discussions" with the taxpayer, Thomas said. Moreover, if the IRS does hold a Collection Appeals (CAP) hearing, it rubber stamps the IRS's actions, simply checking that the Service followed

the proper procedures, and never overturns the action, Thomas noted.

Thomas suggested that taxpayers contact the TAS, which is authorized to intervene in IRS actions that are burdensome or that require substantial taxpayer expenses. The TAS has attorneys that are part of Chief Counsel and can negotiate the matter with other Chief Counsel attorneys. But he said there is no easy administrative approach for taxpayers to follow, and he does not anticipate that Collections' behavior will cease anytime soon. He added that the TAS has had some success in obtaining the return of property to third parties, and that taxpayers will have more success if they get TAS involved, rather than IRS Appeals.

Rice complained that IRS Collections uses a "shotgun" approach, asserting all potential theories without specifying why it is acting against a third party. Thomas said this was not fair and that the TAS was talking to Collections about its approach. McKenzie added that there are some procedural safeguards under Code Sec. 6901 if the IRS claims transferee liability, but the IRS avoids triggering these safeguards when it incorrectly asserts other theories.

Another problem, according to Thomas, is that the IRS places a lien on property without listing the specific property for which it claims transferee liability or nominee status. This can make it more difficult for the third party to obtain withdrawal of the lien.

McKenzie said he has taken an aggressive approach in some cases by making a "qualified offer" of settlement, which the IRS usually rejects. If the taxpayer eventually prevails in court, the IRS will have the duty to pay the taxpayer's expenses and attorneys' fees under Code Sec. 7430 . Another approach he sometimes pursues is to file a bankruptcy proceeding, because a bankruptcy court has authority to stop IRS actions and to hold immediate hearings. But this can be expensive, too, McKenzie said.

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