

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Wyland Analyst: Janet Jennings Bill Number: SB 228
Related Bills: See Legislative History Telephone: 845-3495 Amended Date: April 25, 2011
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Lien Withdrawal

SUMMARY

This bill would authorize the Franchise Tax Board (FTB) to withdraw a Notice of State Tax Lien upon payment of the underlying debt in full.

RECOMMENDATION AND SUPPORTING ARGUMENTS

No position.

Summary of Amendments

The April 25, 2011, amendments removed all of the bill's provisions, which related to legislative intent, and replaced them with the provisions discussed in this analysis. This is the department's first analysis of the bill. This analysis only addresses the provisions of this bill that impact the department's programs and operations.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to allow the department to issue a State Tax Lien Withdrawal upon payment in full to improve the credit history of taxpayers.

EFFECTIVE/OPERATIVE DATE

This bill would become effective January 1, 2012, and would apply to State Tax Lien Withdrawals issued on or after that date, irrespective of the date the State Tax Lien was originally issued.

ANALYSIS

FEDERAL LAW

Under federal law, whenever a person refuses or neglects to pay a tax after notice and demand, a lien in the amount of the tax, applicable penalties, interest, fees, and costs in favor of the United States attaches to all property and rights to property, whether real or personal, belonging to that person. The lien is not valid against any purchaser, holder of a security interest, Mechanic's Lien, or Judgment Lien Creditor until the IRS files a Notice of Federal Tax Lien (Federal Lien) in accordance with applicable state law. In California, the Uniform Federal Lien Registration Act within the Civil Code establishes procedures for the filing of Federal Tax Liens in county recorder offices located in California. A Federal Lien stays in effect for ten years.

Board Position:

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Executive Officer

Date

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A Federal Lien can be released under any of the following circumstances using the corresponding release document:

1. When the federal liability is satisfied, is legally unenforceable, or is covered by a bond for the liability that the Federal Lien represents, the IRS issues a Notice of Release of a Federal Tax Lien (Federal Release).
2. When it is determined that the filing of the Federal Lien was erroneous, the IRS issues a Notice of a Release of a Federal Lien Filed In Error (Federal FIE).
3. When the IRS determines any of the following, a Notice of Withdrawal of a Federal Lien (Federal Withdrawal) may be issued:
 - The filing of the Federal Lien was premature or otherwise not in accordance with administrative procedures.
 - The taxpayer entered into an installment arrangement to satisfy the liability that the Federal Lien represents, unless the agreement provides otherwise.
 - The withdrawal of the Federal Lien would facilitate the collection of the tax liability.
 - The withdrawal of the Federal Lien would be in the best interests of the taxpayer (as determined by the National Taxpayer Advocate¹). This would be determined with the consent of the taxpayer or the National Taxpayer Advocate and the United States.

In February 2011, the IRS announced modified procedures to make it easier for taxpayers to obtain lien withdrawals as follows:

- Taxpayers may request liens to be withdrawn once full payment of taxes is made.
- Taxpayers with unpaid assessments of \$25,000 or less who enter into a direct debit installment agreement will have their lien withdrawn after a probationary period demonstrating that direct debit payments will be honored.
- Taxpayers may request the IRS to withdraw liens on existing direct debit installment agreements.

Recording a Federal Withdrawal is the equivalent of never filing the Federal Lien. The Secretary of the Treasury (Secretary) is required to make reasonable efforts to notify credit reporting agencies (CRAs) and any financial institution or creditor, upon request of the taxpayer, when a Federal Withdrawal is issued.

Under the Fair Credit Reporting Act, a consumer has a right to dispute inaccurate information found in a credit report. A CRA is not required to remove accurate, current, and verifiable information from a credit report unless it is over seven years old or in the case of bankruptcy information, over ten years old.

¹ The Secretary of Treasury, in consultation with the IRS Oversight Board and the IRS Commissioner, appoints the National Taxpayer Advocate.

STATE LAW

State law provides that whenever a person fails to pay any tax liability, the debt becomes due and payable, and a tax lien automatically arises for that amount. A State Tax Lien attaches to all property and rights to property, including all after acquired property, belonging to the person and located in California. The first billing the FTB sends on a delinquent debt is a Statement of Tax Due. The Statement of Tax Due, among other things, notifies the debtor of the statutory authority to issue the State Lien, the earliest date the State Lien may be filed, and the remedies available to the taxpayer to prevent the filing of a State Lien.

Current law allows the FTB to file a lien, thus making the lien a matter of public record and subject to reporting by the CRAs. A lien may be filed by the FTB only after the FTB first sends a delinquent taxpayer a Statement of Tax Due. For most delinquent taxpayers--before filing the lien--the FTB also issues a second billing notice entitled Final Notice Before Levy, which is a precursor to actual collection action to find assets. The primary collection actions used by the FTB are wage garnishments or notices to withhold or both. For the majority of delinquent taxpayers, only if no payment or collection results after these steps will the FTB actually file a lien. For taxpayers with a history of noncompliance or failure to pay, the FTB will generally file the lien 30 days after issuing the Statement of Tax Due.

Filing the Notice of State Tax lien is necessary for the FTB to give other persons claiming an interest in the delinquent taxpayer's property notice of the State's claim. The Notice of State Tax Lien must be filed in the county where the delinquent taxpayer has property and if the debtor has no property, it is filed in the county of their residence. Under the concept of "first in time, first in right," in the case of liens competing for an interest in the same parcel of real property, the notice of a lien recorded first in time takes priority over later recorded notices of liens.

FTB uses two documents to release a filed State Lien:

1. FTB will issue a "Notice of Release of State Tax Lien" (State Release) when the tax liability is satisfied or has become legally unenforceable. FTB also has the discretion to issue this notice in instances where it determines that releasing a lien would facilitate the collection of the tax liability or the release would be in the best interest of the state and the taxpayer.
2. FTB can issue a "Notice of Release of State Tax Lien Filed in Error" (State FIE) if FTB determines any of the following:
 - A State Lien was filed in error,
 - A State Lien was filed contrary to administrative procedures,
 - A State Lien was filed after a taxpayer enters into an installment payment agreement to satisfy the tax liability for which the State Lien was issued, unless the agreement states otherwise.

Upon request of the taxpayer, FTB is required to mail a copy of the State FIE to the major credit reporting companies in the county where FTB filed the State Lien.

See Appendix 1 for a comparison chart of Federal and California authority for lien releases versus withdrawals.

THIS BILL

This bill would give the FTB the authority to do the following if a liability represented by a State Tax Lien, including penalties and interest has been paid in full:

- Issue a Notice of Withdrawal at the same office in which the Notice of State Tax Lien was filed.
- Provide a copy of the Notice of Withdrawal to the taxpayer.
- Notify credit reporting agencies, financial institutions, and certain other creditors of the Notice of Withdrawal upon written request of the taxpayer.

As a result of the Notice of Withdrawal, the State Tax Lien would be removed from the credit report of the taxpayer as though it never existed.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

The bill would authorize the department to issue a Lien Withdrawal but is silent about when a Lien Withdrawal versus a Lien Release should be issued. It is recommended that the bill be amended to clarify the circumstances under which both may be used.

This bill would allow the FTB to withdraw a lien "paid in full," but fails to include fees in the description of the balance required to be paid. It is recommended that the bill be amended to include fees in describing the liability to be paid.

This bill would make changes to sections of the Revenue and Taxation Code pertaining to state tax liens, but overlooks corresponding changes that need to be made to sections of the Government Code (sections 7171, 7174, 7223, and 7225) pertaining to filing lien documents with the County Recorder's Office and the Secretary of State. Failure to amend the Government Code sections would complicate the administration of this bill.

The bill would create a document that is to be filed with County Recorder's Offices, but leaves out whether the County Recorder's Offices will charge or waive the filing fees on a Notice of Lien Withdrawal. The department's automated collection systems are designed to issue a State Release to the County Recorder when the account is paid in full. To collect the recording fee for the State Lien and the State Release, the FTB debits the taxpayer's account at the time the State Lien is filed. The State Lien and the State Release recording fees vary from \$11 to \$18 depending upon the county where the lien was filed. If the State files a State FIE, the filing fee for both the State Lien and the State Release is waived and the debit is reversed from the taxpayer's account. It is suggested that the author amend Government Code section 7227 to add the Notice of Withdrawal to the filing fee charged to the taxpayer for recording of a lien release.

The bill would require the department to notify CRAs, financial institutions, and certain creditors of the Notice of Lien Withdrawal at the written request of the taxpayer. Without a limitation, frivolous activity nonfilers could request the department to notify every financial institution or creditor for which they could find an address. This would create a significant impact on the department's resources and postage costs. It is recommended that the bill be amended to restrict notification to the CRAs and any financial institution or creditors with a demonstrated affiliation to the taxpayer.

The bill could be interpreted to allow a taxpayer to request a Lien Withdrawal on a previous State Release to clear the State Lien from the taxpayer's record. If conversion of a previous release into a withdrawal is not the intent of the author, it is recommended that the bill be amended to state that a Notice of Lien Withdrawal will not be issued on previously released State Liens.

The FTB is in process of implementing the Enterprise Data to Revenue (EDR) Project. The EDR project will allow FTB to use technology to leverage the data that the department has to more effectively administer the tax system. The EDR Project will generate approximately \$2.8 billion of additional revenue for the State by fiscal year 2016/2017. EDR is a benefit based procurement, which means the vendor only gets paid if revenues exceed a determined baseline. The Withdrawal of Lien proposed by this bill would impact receivables that are included in the baseline, which may violate terms of the procurement agreement.

LEGISLATIVE HISTORY

AB 713 (Caldera, Stats.1997, Ch. 600) conformed state law to most of the federal Taxpayers' Bill of Rights by revising provisions of California's Katz-Harris Taxpayer Bill of Rights, Personal Income, and Corporation Tax Laws. The bill conformed California law--with substantive modifications--to the federal provisions on liens. (See Appendix 1.)

PROGRAM BACKGROUND

For fiscal year 2009/2010, FTB issued approximately 295,000 State Liens on debts totaling over \$3.3 billion. FTB issued approximately 84,000 State Releases and approximately 19,000 State FIEs.

Abatement of an underlying tax liability is the most common reason the FTB issues a State FIE. For example, the FTB contacts a taxpayer with an occupational license asking them to explain why a return is not required, and the taxpayer fails to respond. Based on the failure to respond, the department issues a tax assessment and if the taxpayer fails to respond to collection notices, begins collection, including the filing of a State Lien. If the taxpayer subsequently demonstrates they were not required to file a tax return, the assessment is abated and the State Lien is released as State FIE.

A State Tax Lien, and any State Release that later releases that State Tax Lien, remains part of the permanent record available to the public in the County Recorder's Office. Generally, a CRA will identify lien-related documents on file in the County Recorder's Office and use that information in the individual credit profiles it maintains.

When a Federal Release or a State Release is issued, the CRA will maintain a record of the Federal Lien or State Lien and the subsequent releases on the taxpayer's credit profile for up to seven years. When a Federal FIE, Federal Withdrawal, or State FIE is issued, CRAs will remove all record of the Lien and its Release or Withdrawal from the taxpayer's credit profile upon notification.

OTHER STATES' INFORMATION

Laws from the state of *Minnesota, Michigan, Illinois, New York, Florida, and Massachusetts* were reviewed.

Minnesota issues a State Release when the liability is satisfied. If the State Lien has expired, Minnesota does not issue a release. If it is determined that a State Lien was filed in error, a State FIE is issued. A State Withdrawal of the Lien is issued if it is determined that it is in the best interest of the state to do so.

Michigan issues a State Release when the liability is satisfied and will issue a Certificate Of Withdrawal Of State Tax Lien if a lien has been placed improperly to remove the lien from the records of the Register of Deeds and/or Department of State, Uniform Commercial Code Section.

Illinois issues a State Release when the liability is satisfied, and if it is determined that a Lien was issued in error, will release it with a State FIE. No information on a State Withdrawal of Lien was found.

New York issues a tax warrant instead of a State Lien, and requires the tax warrant to be issued before issuing a bank levy. *New York* will issue a State Release when the liability is satisfied or when filed in error. No information on a State Withdrawal of Lien was found.

Florida issues a Satisfaction of Lien when the liability is satisfied. If it is determined that a State Lien was filed in error a Cancellation of Tax Lien is filed. The taxpayer may request the department to send a copy of the Cancellation of Tax Lien to the CRAs.

Massachusetts issues a Certificate of Release of Tax Lien when the liability is satisfied liability or is unenforceable as a matter of law. No information on a State Withdrawal of Lien was found

FISCAL IMPACT

Department staff is unable to determine the costs to administer this bill until the implementation concerns have been resolved, but anticipate the costs to be significant due to necessary system modifications, notice development efforts of 103 Personal Income Tax and 348 Business Entity and Partnership forms, and additional postage.

ECONOMIC IMPACT

The revenue impact of this bill would be dependent upon the amount of delayed payments by taxpayers that would otherwise pay their taxes timely to avoid the filing of a lien. The withdrawal of the tax lien would benefit a taxpayer that is subject to the lien; an unintended consequence of this bill is the potential that some taxpayers will delay payment knowing they can get a "fresh start" later on when they satisfy their tax liabilities.

The revenue loss from the delayed payments is unknown and would depend upon taxpayer behavior. For FY2009/2010 FTB issued \$3.3 billion in liens. If taxpayer behavior changes, for every one-tenth of a percent in delayed payments for a year, the state would lose \$3.3 million in revenue for that year.

A very small percentage of taxpayers who were issued a lien would accelerate payments to expunge the record of their lien and improve their credit to obtain financing for the purchase of property. It is assumed that these accelerated payments would have insignificant impact on revenues since very few taxpayers with state tax liens have the ability to pay the balance in full or they have liens issued by other agencies making the withdrawal of notice of a state tax lien of no consequence.

SUPPORT/OPPOSITION

Support: State Board of Equalization Member, George Runner.

Opposition: None provided.

ARGUMENTS

Pro: Proponents would argue that this bill would eliminate the adverse effect of a record of lien on a taxpayer's credit report.

Con: Opponents would argue that expunging the record of a validly-filed lien creates an inaccurate credit report that lenders and employers may use when making business decisions.

POLICY CONCERNS

Avoidance of a State Lien is a strong motivator for many taxpayers to address their outstanding tax liabilities. The State Withdrawal may adversely affect the use of the lien as a collection tool.

Expanding the circumstances under which liens could be withdrawn without record could erode the effectiveness of the State Lien as a collection tool.

Because the reasons for issuing a State Withdrawal are not defined, taxpayers may not be treated equitably if one taxpayer can obtain a State Withdrawal, while another taxpayer cannot.

LEGISLATIVE STAFF CONTACT

Janet Jennings

Legislative Analyst, FTB

(916) 845-3495

janet.jennings@ftb.ca.gov

Brian Putler

Legislative Director, FTB

(916) 845-6333

brian.putler@ftb.ca.gov

Appendix 1

	Federal Lien Release	Federal Lien Withdrawal	Federal Lien Release FIE	State Lien Release	State Lien Release FIE
Liability Satisfied	X			X	
Liability Legally Unenforceable	X			X	
Bond Securing Liability Filed	X				
Facilitates Collection of Tax		X		X	
Best Interest of TP		X		X	
Filed in Error (FIE)			X		X
Issued Contrary to Procedures		X			X
Enters into IA		X			