



The Notice of Federal Tax Lien is a Historical Artifact

If you've ever purchased a home, you may remember that in the middle of that long, tedious closing one momentous and yet concise document was suddenly pushed before you. There it was—the Truth in Lending Disclosure Statement, the confession from your mortgage broker about the true costs and risks of borrowing.

For many underwriters, there is an assumption that the Notice of Federal Tax Lien (NFTL) functions in a similar fashion relative to federal tax liabilities. Here it is—a document formally identifying your client as a delinquent taxpayer, detailing the total liability to the IRS, establishing an encumbrance on that client's assets (i.e. your collateral), establishing lien priority for the IRS's claim to that debt, and establishing, most ominously, a legal and procedural posture to take levy action. Right?

The two pieces of information on the NFTL that can be relied upon is that on the date and place indicated, a lien was recorded. The rest, as they say, is history. The day after the lien is processed by the IRS (not even the date of filing), the information is already obsolete.

Wrong.

Setting aside the issues of erroneous lien filings and the procedural implications of a lien (i.e., a lien creates a security interest and establishes priority; the NFTL does not have to be filed for the IRS to levy receivables), which we have and will continue to address in other posts, this article will hone in on one particular dilemma—the NFTL as historical artifact.

One of the chief problems with the NFTL is that it is a past-tense document that affects our work, underwriting, risk assessment, and decision-making in the present. The language of the NFTL is actually written in a confusing hybrid of present and past tense – “taxes have been assessed,” “we have made a demand,” “there is a lien,” “we are giving notice.” It is significant that the statements regarding the debt and collection efforts are in past tense, while the present tense activity is the recording of the lien.

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Does the lien record the correct amount of tax liability and/or the current total of any balances due? The answer is always no. It can't. In the simplest of interpretations, the NFTL cannot account for the per diem accrual of interest or the subsequent assessment of penalties to the accounts. Unlike a GPS map, the IRS does not regularly recalibrate or recalculate on a daily basis and send a courier scrambling down to the courthouse to update the lien. The NFTL simply states that once upon a time, a balance was due.

Similarly, the recorded lien will not be updated to reflect any payments to the account or reductions to the balance due. Imagine, for example, that a \$1 million tax lien is filed the day a taxpayer drops a check for full payment in the mail. How long will the lien show up on a public records search or a credit report? And what happens when, a week later, the IRS applies the payment and it leaves a minuscule balance of interest that accrued during the snail mail hang time? Nothing happens. Crickets. The \$1 million tax lien remains in place until the amount is paid in full and the lien is released.

Real-time information to reduce risk

At Tax Guard, we've seen this problematic issue first hand. After providing a Tax Guard report to a factor prior to funding, we received a phone call from the factor indicating that we must have made a mistake. Our report indicated the liability was less than \$1. The factor asked, "But the federal tax lien shows a liability of \$200,000, so your report is incorrect, right?" Wrong. The taxpayer had recently made a payment of \$200,000, which was verified by the IRS transcripts. The amount of the federal tax lien was, of course, not updated. The factor's relationship with the prospective client was jeopardized because initially the decision was made to not fund the prospect. However, once the factor had the actual, real-time information, the decision was made to fund the client since there was minimal exposure (less than \$1) to the IRS.

Conversely (and hypothetically), it might have been discovered that the balance due secured by the NFTL was actually \$400,000. A lien, after all, is seldom a total of all balances, even on the day it was filed. As every period of tax liability has its own timeline, it is most common to see liens filed on random groups of balances, but seldom all balances due by the taxpayer. The result is actually a series of liens over time, each recording different totals. And which one is the correct one? None of them.

The broader point here is that each lien is simply a snapshot of selected tax liabilities tucked into a Secretary of State or county clerk's time capsule at a particular moment in time. It is not a living document. It doesn't get updated. It does not operate in real time. But lending decisions, like the rest of the world, should and do operate in real time. Tax Guard's information is real time and direct from the IRS.

Considering these circumstances, the NFTL should not be used to make decisions. It should raise questions. The first question should be this—is there any tax liability at all? If so, what is the correct, current, total amount of tax liability? What happens next? What's my exposure to risk here? These are questions requiring further investigation, which the NFTL itself does not and cannot answer.

Tax Guard is asking those questions in real time to produce a report that will always be a more current and more reliable tool for assessing risk than an NFTL identified in a public records search. So the next time you think about a Notice of Federal Tax Lien, try this—conjure an image of archaeological treasure, because this historical artifact is ultimately a relic of the past with little reliability in terms of making a real-time lending decision.

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