



*Coordination and Procedures for
Foreclosures Can Be Improved*

September 21, 2010

Reference Number: 2010-30-119

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Redaction Legend:

1 = Tax Return/Return Information



HIGHLIGHTS

COORDINATION AND PROCEDURES FOR FORECLOSURES CAN BE IMPROVED

Highlights

Final Report issued on September 21, 2010

Highlights of Reference Number: 2010-30-119 to the Internal Revenue Service Deputy Commissioner for Services and Enforcement.

IMPACT ON TAXPAYERS

When property has a Federal Tax Lien attached, the Internal Revenue Service (IRS) may participate in the collection of any proceeds from foreclosure sales. The IRS was inconsistent in how it processed foreclosure cases and coordinated with local United States Attorneys' Offices (USAO). If the IRS does not properly work these cases, taxpayers may miss an opportunity to reduce the amount of taxes owed because any funds collected are applied to the taxpayer's Federal Tax Lien balance.

WHY TIGTA DID THE AUDIT

Because of the increase in home mortgage foreclosures, this audit was initiated to determine whether the IRS Advisory Unit (Advisory) is effectively and efficiently protecting the Federal Government's interest during foreclosure proceedings when there is a Notice of Federal Tax Lien filed.

WHAT TIGTA FOUND

The USAO is the control point for judicial foreclosure proceedings. The Advisory acts in a supporting role by providing necessary information to the USAO to protect the Federal Government's interest. Although the Advisory does not have jurisdiction for judicial foreclosures, coordination between the two offices needs to be improved in some areas. The Advisory did not always follow up to verify whether the USAO was properly and timely filing a claim to collect potential surplus proceeds or to determine if the Advisory's recommendations for releasing the right of redemption were being followed. In addition, the Advisory did not

always have adequate sale information to consider potential redemption of the property after a foreclosure sale.

Unlike judicial foreclosures, the Advisory is the control point for non-judicial foreclosure cases. The information the IRS provides to the public for submitting a timely notice of sale to the Advisory is not consistent with the Internal Revenue Code. Specifically, the Advisory uses the postmark date to determine if the notice is timely. However, information provided to the public states timeliness is established by the receipt date. In addition, the Advisory did not always properly screen the notice of sale or provide sufficient documentation to support why the notices were rejected. Finally, the Advisory was not consistent when making a determination for requests to release the right of redemption.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Director, Collection, Small Business/Self-Employed Division, ensure: 1) the Advisory provides timely information regarding the application of any surplus proceeds and timely recommendations regarding the value of any releases of rights of redemptions; 2) the Advisory has sufficient information to consider potential redemption of foreclosed properties; 3) communications with the public are consistent with the tax law; 4) foreclosure files include evidence supporting rejection of notices of sale; and 5) releases of the rights of redemption are timely and appropriate.

In their response to the report, IRS officials agreed with all of our recommendations and plan to take corrective actions.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 21, 2010

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION

Michael R. Phillips

FROM:

Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Coordination and Procedures for Foreclosures
Can Be Improved (Audit # 200930013)

This report presents the results of our review to determine whether the IRS Advisory Unit is effectively and efficiently protecting the Federal Government's interest during foreclosure proceedings when there is a Notice of Federal Tax Lien filed. This review is included in our Fiscal Year 2010 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations), at (202) 622-8510.



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Abbreviations

CY	Calendar Year
FTL	Federal Tax Lien
I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
NFTL	Notice of Federal Tax Lien
USAO	United States Attorney's Office



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Background

The Internal Revenue Service (IRS) has the authority to attach a claim to a taxpayer's assets when the taxpayer neglects or refuses to pay his or her unpaid taxes.¹ This claim is referred to as a Federal Tax Lien (FTL)² and attaches to different types of property. The IRS files a Notice of Federal Tax Lien (NFTL) (Form 668(Y)), in appropriate local government offices, which notifies interested parties that a lien exists and establishes the IRS' priority among secured creditors for the taxpayers' equity.

Real property with an NFTL attached can also be subject to foreclosure. A mortgage foreclosure happens when a mortgage holder, typically a bank, compels the sale of a property because of nonpayment of the mortgage debt. Home mortgage foreclosures have risen dramatically across the Nation in recent years due to increased subprime mortgage lending³ and interest rate changes on adjustable rate mortgages. Despite recent legislative action and increased levels of loan modification activity, foreclosure activity continues to increase to record levels.

***Home mortgage
foreclosures have
reached record levels.***

RealtyTrac®, an online marketplace for foreclosure properties, showed 3,957,643 foreclosure filings were reported on 2,824,674 United States properties in Calendar Year (CY) 2009. Foreclosure filings include default notices, scheduled foreclosure auctions, and bank repossessions. These filings represent a 21 percent increase in total property foreclosures from CY 2008 and a 120 percent increase from CY 2007. Figure 1 shows that in CY 2009, 1 in 45 (2.22 percent) housing units received at least 1 filing during the year, which is a dramatic rise from 0.58 percent in CY 2006.

¹ Internal Revenue Code (I.R.C.) Section 6321 (1994).

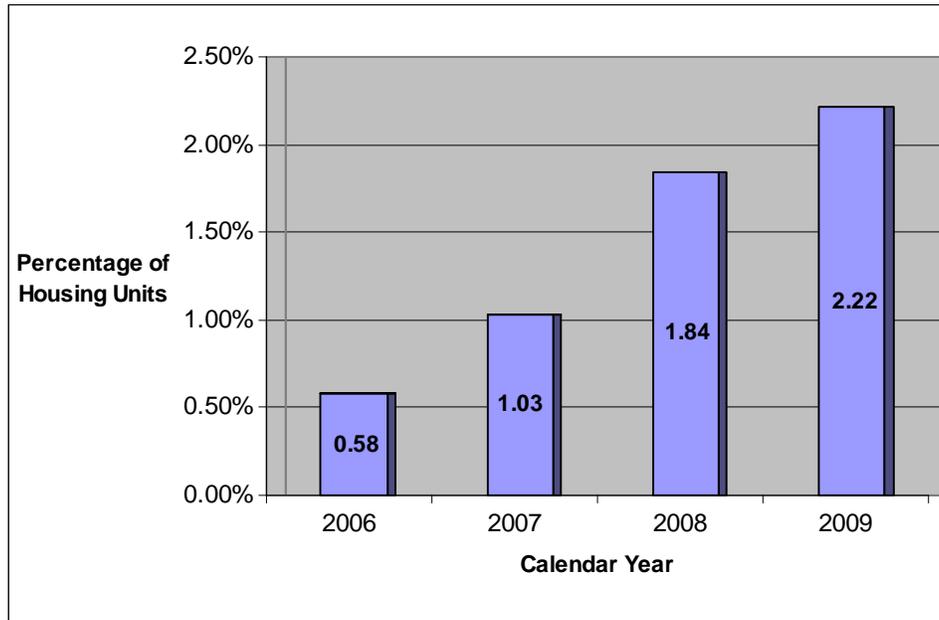
² See Appendix IV for a glossary of terms.

³ The subprime market generally serves borrowers with blemished credit and features higher interest rates and fees than the prime market.



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Figure 1: Percentage of United States Housing Units Receiving at Least One Foreclosure Filing During CYs 2006 through 2009



Source: RealtyTrac® Press Release (dated January 14, 2010).

Each State handles real estate foreclosures differently, as foreclosure proceedings are dependent upon local law. There are two types of foreclosures: judicial and non-judicial.⁴

- Judicial foreclosures occur in States where the sale or disposition is compelled by the authority of the court, beginning with the lender filing a complaint and recording a Notice of Lis Pendens (meaning “action pending”). Once the court declares a foreclosure, the property will then be auctioned to the highest bidder.
- Non-judicial foreclosures occur in States where the sale or disposition can be made without a court proceeding. Generally, to begin the foreclosure process, the mortgage company sends a notice of default or a notice of sale to the homeowner and files a recording in the county recorder’s office. Most States have a requisite time period that must pass before the foreclosure sale can take place. After this time period lapses, a public foreclosure auction is held and the property is sold to the highest bidder.

In judicial foreclosure States, the United States Attorney’s Office (USAO) is the control point for protecting the Federal Government’s interest in the foreclosure proceedings, and the IRS’ Advisory Units (Advisory) act in a supporting role. In non-judicial foreclosure States, the

⁴ States are not entirely judicial or non-judicial. Some states have both types, and the style of foreclosure is dependent on the type of creditor claim.



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Advisory is the central control point for protecting the Federal Government's interest in the foreclosure proceedings. The Advisory is part of the IRS' Collection function within the Small Business/Self-Employed Division.

When a property subject to an FTL is sold in a foreclosure auction, the Federal Government has certain rights it may exercise. Specifically, the Federal Government may collect from the surplus proceeds, exercise its right of redemption, or choose to release the right of redemption as follows:

- Surplus proceeds occur when a foreclosed property is sold for an amount more than sufficient to satisfy the mortgage or other liens that were filed prior to those of the IRS (known as senior liens). If surplus proceeds exist, the Federal Government has a right to collect these funds to apply them to the FTL balance.
- Exercising the right of redemption is the process by which the Advisory may purchase the property from the party who bought the property at the foreclosure sale.⁵ The purpose for redeeming a foreclosure property is to allow the Federal Government an opportunity to resell the property at a higher amount, thereby resulting in greater surplus proceeds to apply to the FTL balance. The redemption time period is 120 days from the date of the foreclosure sale, although certain States grant a longer redemption period.
- The Federal Government may also release its right of redemption. The release of the right of redemption process generally begins with a request from the purchaser. The Advisory then determines whether the release has value by considering if there is equity in the property. For example, there may be cases with equity that is insufficient to cover the expenses associated with redeeming and reselling the property, but the release of the right of redemption would still have value to the purchaser, such as an investor. If the Advisory determines there is no value, it will issue a certificate to the purchaser advising that the Federal Government will not exercise its right of redemption. If the right of redemption is released for value, the Advisory collects the funds, applies them to the FTL balance, and then issues the certificate to the purchaser.

The record number of mortgage foreclosures has caused a significant increase in the number of foreclosure case receipts. Figure 2 shows that from Fiscal Years 2008 to 2009, the Advisory experienced a 7 percent increase in judicial foreclosure receipts and a 63 percent increase in non-judicial foreclosure receipts. During this time period, the Advisory experienced a 44 percent increase in its overall foreclosure inventory.

⁵ The right to redeem property is provided by Section 2410(c) of Title 28 of the United States Code for judicial foreclosures and Section 7425(d) of the I.R.C. for non-judicial foreclosures.



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Figure 2: Inventory of Judicial/Non-Judicial Foreclosure Cases

Category	Receipts Fiscal Year 2008	Receipts Fiscal Year 2009	Increase/(Decrease)
Redemptions	607	566	(7 percent)
Releases	346	540	56 percent
Judicial	9,632	10,308	7 percent
Non-judicial	20,290	33,116	63 percent
Total	30,875	44,530	44 percent

Source: Fiscal Years 2008 and 2009 Collection Activity Reports.

The Foreclosure Program is one of various programs within the Advisory. Other Advisory programs include discharge and subordination applications, litigation cases, NFTL non-attachments, withdrawal of NFTS requests, IRS seizures, the Trust Fund Recovery Penalty, and aspects of the Taxpayer Advocate. Due to its limited amount of resources, Advisory management has established three levels of priorities to maintain their workload. While the specifics of these priorities may be rearranged and adjusted as needed after management approval, cases from judicial and non-judicial foreclosure programs generally are medium-priority.⁶ The levels of priorities allow the Advisory to dedicate its resources to work cases that are higher profile or generate greater internal revenue.

This review was performed at the local Advisory Units within the Small Business/Self-Employed Division in Laguna Niguel, California; Jacksonville and Plantation, Florida; Chicago, Illinois; and Oklahoma City, Oklahoma, during the period October 2009 through May 2010. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

⁶ Non-judicial foreclosures with “adequate” notice are “low” priority work.



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Results of Review

The Internal Revenue Service Does Not Have Jurisdiction for Judicial Foreclosures, but Coordination With the United States Attorneys' Offices Can Be Improved

Judicial foreclosures require the involvement of the local court system. Because the judicial foreclosure process involves the courts, the USAO is the primary control point for this type of foreclosure, rather than the IRS Advisory. In a judicial foreclosure, the United States should be named party to the suit if an NFTL was filed prior to the commencement of the suit. In such a suit, the USAO acts as a representative for the Federal Government by collecting funds that may result from the foreclosure suit. Although it does not have jurisdiction, the Advisory provides the USAO with information that is necessary to protect the Federal Government's interest, such as lien information and recommendations on collection actions. We reviewed the coordination between local Advisory offices and the USAO and identified some areas that could be improved. Specifically, we identified inconsistencies in how local Advisory offices coordinate information related to surplus proceeds and redemption rights.

The Advisory did not always follow up with the USAO

The USAO must file a motion to participate in a surplus funds hearing and will need a statement of the lien balance due for this hearing. Normally, the USAO sends the Advisory the relevant foreclosure documentation, usually a *Summons and Complaint*, along with a request for the statement of lien balance due. When the Advisory receives this request, it should screen the documents against the NFTL files to determine the outstanding balance on the lien. In cases where records indicate there is no outstanding liability on the lien, the Advisory will advise the USAO, who will file a disclaimer on behalf of the United States. In cases where there is an outstanding liability on the lien, the Advisory will send the appropriate information to the USAO, usually a *Declaration of Balance Due*, which will then be used in court to collect the surplus proceeds.

We judgmentally selected **1** cases with potential surpluses obtained from 2 Advisory locations to determine if the Federal Government's interest was protected. Because the Advisory does not have the jurisdiction to file the claims and collect the surplus proceeds, we determined how information was shared and coordinated between the Advisory and the USAO. In **1** (30 percent) of the cases, the Advisory contacted the USAO, verified the exact amount collected from surplus proceeds, and conducted research to ensure that payment was applied to the taxpayer's account. In **1** (20 percent) cases, the Advisory verified there were no surplus proceeds as a result of the foreclosure sale. However, in **1** (50 percent) cases, no follow up or research was conducted



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before the case was closed. Because the Advisory did not follow up with the USAO on cases with known potential surplus proceeds, the IRS did not know if claims were filed timely or if any surplus proceeds were collected.

In addition, the purchaser of a foreclosure property may request the Federal Government release its right of redemption. The authority to release the right of redemption on judicial foreclosure properties is delegated to the USAO.⁷ In such cases, the purchaser should submit an Application for Release of Right of Redemption in Respect of Federal Tax Liens (Form OBD-225) to the USAO. Upon receipt of Form OBD-225, the USAO should forward the application to the Advisory. The Advisory will determine if the Federal Government has a right to redeem the property and will offer a recommendation as to whether or not to release the right of redemption. The Advisory may also determine if the right of redemption has any value (or a value greater than any minimum value established by the local USAO) by considering if there is equity in the property. The Advisory should then return the completed Form OBD-225 with its recommendation to the USAO. The USAO is then responsible for issuing the certificate to the purchaser if the release is granted, collecting the money for the release, and applying it to the outstanding tax lien balance.

Similarly, our review of 20 cases with requests for releasing of the right of redemption showed the Advisories did not always follow up with the USAO to determine if IRS recommendations were followed. In 11 (55 percent) of the 20 cases, follow up was not necessary because the Advisory made no recommendations to the USAO. In 3 (15 percent) cases, the Advisory followed up to obtain a copy of the response letter submitted to the purchaser from the USAO and a copy of the release of right of redemption certificate. However, in 6 (30 percent) cases, the Advisory did not determine if the purchaser was issued a certificate for the release of right of redemption or if any payments were applied to the taxpayer's account.

Although there was coordination between the Advisory and the USAO in some cases, the Internal Revenue Manual does not require the Advisory to conduct followup actions. This condition allows local Advisories flexibility on how to balance resources with workload and other priorities, but also creates inconsistencies. If the Advisory does not follow up, the IRS may not know if information gathered, prepared, and provided to the USAO was useful and protected the interests of both the IRS and the taxpayers.

The Advisory does not always have sufficient information to properly consider redemption rights

In addition to collecting surplus proceeds, the Advisory and the USAO may consider redemption of a property. To do so, the Advisory needs to receive foreclosure sale information from the USAO. The Advisory can examine the foreclosure sale results and determine if a property has

⁷Authority to release any right of redemption is delegated to the Department of Justice by Section 0.70 of Title 28 of the Code of Federal Regulations.



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potential for redemption. If the Advisory chooses to redeem a property that was sold in a judicial foreclosure, it is the Advisory that will execute the redemption process, not the USAO.

In order for the Advisory to make a proper decision about whether to redeem the property, it must receive from the USAO the *Report or Certificate of Sale* and any other information relevant to the sale. However, our review of 10 judicial foreclosure cases with potential surpluses showed that, in 6 (60 percent) cases, the Advisory received only a request for a balance due amount from the USAO, and the *Report or Certificate of Sale* was not provided after the foreclosure sale. As a result, the Advisory could not make a redemption determination.

We were advised that the USAO and the local Advisory offices had mutually agreed the USAO would not send the *Summons and Complaint* and the *Report or Certificate of Sale* to the Advisory for every case. In one location, the USAO did not have sufficient staffing to process the significant number of foreclosures, so information was provided for only those cases that the USAO believed had redemption potential. In addition, we were advised the Advisory did not have sufficient staffing to review and respond timely or the space to store the documentation.

When the Advisory does not have adequate information to make a proper determination about exercising its right of redemption, there is a risk of the taxpayer missing an opportunity to reduce the amount of taxes owed by collecting additional revenue on the FTL.

Recommendations

The Director, Collection, Small Business/Self-Employed Division, should ensure:

Recommendation 1: When solicited by the USAO, the Advisory provides timely information regarding the application of any surplus proceeds and timely recommendations regarding the value of any releases of rights of redemptions.

Management's Response: IRS management agreed with this recommendation. A Director, Advisory, Insolvency, and Quality yearly memorandum will reinforce the Internal Revenue Manual guidance for identifying, entering into the Integrated Collection System, and closing cases. It will also address the need for timely responses to the USAO regarding recommendations for surplus proceeds or release of rights of redemption. In addition, the foreclosure and redemption practices will be submitted for consideration as a topic for the next available revenue officer Continuing Professional Education training program.

Recommendation 2: The Advisory has sufficient information to consider potential redemption of foreclosed properties.

Management's Response: IRS management agreed with this recommendation and will look into the Advisory opening a dialogue with the USAO as appropriate and, as



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resources allow, ensuring receipt of the information needed to consider the recommendation.

Processing of Non-Judicial Foreclosures Was Not Always Consistent or Appropriate

Unlike judicial foreclosures, the Advisory has control over the non-judicial foreclosure cases when the property has an NFTL attached. Before the foreclosure sale, the settlement attorney or other entity conducting the sale should submit a timely and adequate notice of sale to the IRS. A proper notice to the IRS acts to discharge the FTL/NFTL from the property. If a proper notice is not given to the Advisory, the property may be sold with an FTL still attached.⁸ Our review showed the Advisory was not always consistent when processing non-judicial mortgage foreclosure cases. Specifically, we identified inconsistencies related to:

- Information provided to the public for the timeliness of notices of sale.
- Evidence supporting the rejection of notices of sale.
- Decisions about releasing the rights of redemption.

The criteria that establishes the timeliness of the notice of sale is inconsistent

The Internal Revenue Code (I.R.C.) requires the settlement attorney or other entity conducting the sale to submit a notice of sale in writing, by registered or certified mail or by personal service, not less than 25 days prior to the non-judicial foreclosure sale. The notice should be sent to the local Advisory office where the sale is to be held and must include information such as the contact information of the person submitting the notice of sale, legal description of the property, and information from the NFTL. If the notice is not received timely, or if it does not include all of the required information, the lien will still be attached to the property unless corrective actions are taken.

IRS management told us the I.R.C. requires that the postmark date be used to determine if the notice of sale is timely.⁹ If the postmark date is at least 25 days prior to the sale date, the notice is considered timely and the Advisory should review the notice for adequacy. However, information provided to the public states timeliness is established by the receipt date—not the postmark date. Specifically, *Notice of Nonjudicial Sale of Property and Application for Consent to Sale* (Publication 786) states (emphasis added), “*The 25-day period commences upon receipt of an adequate notice of non-judicial sale;*”¹⁰ and *Notice of Inadequacy* (Letter 1840)¹¹ states “...so that we **receive** it at least 25 days before the sale.”

⁸ Section 7425(c) of the I.R.C.

⁹ Section 301.7502-1(c)(2) of the I.R.C.

¹⁰ Publication 786 provides instructions for preparing a Notice of Nonjudicial Sale.



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Without consistent guidance, there is a risk that notices of sale will be improperly rejected or improperly accepted as timely. IRS management advised us Publication 786 and Letter 1840 have not been recently updated and are inaccurate. Management also advised us the Internal Revenue Manual is being revised and they will ensure the criteria are consistent with the I.R.C.

The Advisory is not always providing enough evidence to support the rejection of a notice of sale

When the Advisory receives an adequate notice of sale from a foreclosing party, it needs to be properly reviewed to determine if the Federal Government has an interest in the foreclosure property. For example, the Advisory determines if the FTL on the property is still valid¹² and if the foreclosed property owner is the same taxpayer responsible for the FTL. If the Advisory determines the Federal Government does not have an interest in the foreclosure case, it will file the notice and take no further action on the foreclosure case. These cases are referred to as rejected cases.

We reviewed a judgmental sample of **1** non-judicial rejected notices of sale obtained from 2 Advisory locations to determine if the notices were rejected for proper reasons. Our review showed:

- In**1** (76 percent) cases, the Advisory screened the notices of sale and provided sufficient support for these decisions. For example, the notices had “*FTL has expired*” written at the top of the page, which supported why the Federal Government had no interest in the property and the basis for rejection.
- In**1** (17 percent) cases, there was insufficient documentation to support why the notice had been rejected. We contacted the Advisory office that had processed these notices and were advised that further research had been conducted using external sources to justify why the case was rejected (for example, county property records). However, without the documentation from the external research, we could not verify why these cases were rejected.
- In**1** (7 percent) cases, there was insufficient justification to reject the case. For example, *****1*****.

Although we ultimately agreed with the Advisory decisions for the**1** (17 percent) cases with insufficient documentation, we believe it is important that the cases include an explanation for rejection. It was necessary to perform additional research to identify why these cases were

¹¹ This letter lists any problems with the Notice of Sale and allows the foreclosing entity an opportunity to resubmit the notice.

¹² For example, the FTL would no longer be valid if the FTL liability has been paid in full or it has reached its collection statute expiration date.



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rejected, so it is unclear how management ensured Advisory employees were making the correct decision. We did identify ***1*** cases that were rejected improperly, which supports the need for sufficient evidence in the file. Management needs evidence to be available to provide proper oversight.

IRS management advised us that non-judicial foreclosure work is sometimes set aside due to insufficient staffing and to ensure other high-priority work is completed timely. However, because employees had already taken the time to work the cases, it is important that the file contain the evidence that the research was completed properly so management can ensure the correct decisions were made. When the notices of sale are not properly screened or are incorrectly rejected, the IRS risks losing opportunities for collecting potential revenue, and the taxpayer may lose an opportunity to reduce his or her tax liability.

The Advisory offices are not consistently making a determination when processing release of the right of redemption requests

When a party buys a property with an FTL at a non-judicial foreclosure sale, they may request the IRS release its right of redemption. For example, the purchaser may wish to occupy the property within the 120-day period without fear of losing it to redemption. Similarly, a purchaser who is an investor might want to resell the property to a third party within the 120-day period without the right of redemption attached.

Most actions involved in releasing the right of redemption are taken by the Advisory. The Advisory should determine if the foreclosed property meets any local criteria for redemption, such as equity in the property. If the Advisory determines that it is not in the Federal Government's interest to exercise its redemption right, it may recommend the release of the Federal Government's right for redemption.

The Advisory will also determine if the release has any value. The value is determined by factoring in any equity amount on the foreclosed property after the sale. If there is no equity, the release may have no value. Any payment secured for the release of the right of redemption should be applied to the taxpayer's outstanding liability. From 2 Advisory locations, we reviewed a judgmental sample of 20 cases involving a request for release of the right of redemption to determine if the Advisory was making the proper determinations. Our review showed:

- Inconsistent determination of the value for the release. For example, ****1*****

*****.
- Untimely processing of release requests caused the redemption period to expire before a determination could be made in three cases.



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- Varying degrees of communication between the Advisory and the purchaser. For example, *****1*****

The Internal Revenue Manual does not provide specific guidance regarding value or equity determination when considering a request for the release of the right of redemption. With this flexibility in the process, it creates an opportunity for inconsistent taxpayer treatment. This flexibility also made it difficult to assess whether the Advisory made appropriate decisions for the value for the releases.

IRS management advised us that it is not feasible to implement standard procedures that determine the value of the release at a national level. Geographic location has an impact in determining property values and foreclosure trends, including the release value. In addition, the Advisory has limited resources and its strategy is to put its efforts into the programs that have a greater potential for return. This focus may result in different priorities in different Advisory locations, which may create inconsistencies in how cases are being worked.

In addition, IRS management believes if the need was urgent, the purchaser would follow up with the Advisory, and then the Advisory would be responsive. As a result, the burden is on the purchaser to obtain the release timely.

Recommendations

The Director, Collection, Small Business/Self-Employed Division, should ensure:

Recommendation 3: IRS communications with the public are consistent with the I.R.C. and Internal Revenue Manual. Specifically, Letter 1840 and Publication 786 should be consistent with the I.R.C. and Internal Revenue Manual regarding timeliness for a notice of sale.

Management's Response: IRS management agreed with this recommendation and is addressing this change. The IRS is currently revising Letter 1840 and will include Publication 786 and other foreclosure and redemption products in this revision process.

Recommendation 4: Foreclosure files include evidence supporting why notices of sale were rejected.

Management's Response: IRS management agreed with this recommendation. The Director, Advisory, Insolvency, and Quality yearly memorandum establishing work priorities will reinforce the Internal Revenue Manual guidance for identifying, entering into the Integrated Collection System, and closing cases, including the need for appropriate history notations when closing or rejecting cases.



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Recommendation 5: Releases of the rights of redemption are timely and appropriate.

Management's Response: IRS management agreed with this recommendation. The Director, Advisory, Insolvency, and Quality yearly memorandum establishing work priorities will reinforce the Internal Revenue Manual guidance for identifying, entering into the Integrated Collection System, and closing cases, including the need for timely release of rights of redemption when appropriate, along with a history notation on how or why rights of redemption were or were not pursued.



Appendix I

Detailed Objective, Scope, and Methodology

Our overall audit objective was to determine whether the Small Business/Self-Employed Division's Collection function effectively and efficiently protects the Federal Government's interest during foreclosure¹ proceedings when there is an NFTL filed. To accomplish this objective, we:

- I. Identified the IRS' procedures and guidelines when a property subject to an NFTL is going through foreclosure proceedings.
 - A. Reviewed the Internal Revenue Manual guidelines, Law Enforcement Manual guidelines, and Integrated Data Retrieval System queries. We interviewed the Advisory office to identify its role and involvement during foreclosures. We also reviewed all types of cases for both judicial and non-judicial foreclosures including: surplus proceeds, rejected cases, redemptions, and release of rights of redemption.
 - B. Determined if the process between judicial and non-judicial foreclosure is the same in all locations.
 - C. Reviewed the overall foreclosure process by sending a questionnaire to 10 judgmentally selected Advisory locations having the highest number of foreclosure cases. We judgmentally selected these 10 locations to ensure a greater representation of the foreclosure process per territory offices.
- II. Analyzed the data related to judicial and non-judicial foreclosure actions and identified trends and a population from which to select samples. Because local laws affect foreclosure proceedings, we selected a judgmental sample of judicial and non-judicial foreclosure cases. We used judgmental sampling because the population for each type of case was unknown. The locations were selected by identifying the States having the highest numbers of foreclosure filing rates.
 - A. Obtained previous and current key statistics related to judicial and non-judicial foreclosure actions from the Advisory office and identified where the IRS is focusing its resources. In addition, we obtained statistics from external sources such as RealtyTrac®.
 - B. Extracted the inventory of cases assigned to the Advisory office from the Integrated Collection System.

¹ See Appendix IV for a glossary of terms.



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1. Surplus Proceeds 20 cases
 2. Release of Right of Redemption 20 cases
 3. Redemption 10 cases
 4. Rejected Cases ****1**** cases
- B. Determined if the notice of sale was properly reviewed for adequacy and timeliness by the Advisory office.
- C. Determined if the Advisory office took appropriate actions and timely followed up to secure collection of surplus proceeds from non-judicial foreclosure sales.
- D. For rejected cases, identified the reason and criteria used for rejecting a case and determined if correct decision was made. Also, we determined whether there is more the IRS could have done in this process to monitor cases once rejected.
- E. Determined if the Advisory office made the correct decision to exercise or release the right of redemption of the property sold.
- F. Discussed our conclusions with IRS management.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: the policies, procedures, and practices used by the IRS Advisory unit to manage the mortgage foreclosure program as it relates to surplus proceeds, redemption, and release of right of redemption. We evaluated these controls by reviewing applicable manuals and documentation, interviewing management from the Advisory unit, interviewing attorneys from the USAO, and reviewing a judgmental sample of judicial and non-judicial mortgage foreclosure case files.



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Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Director, Collection, Small Business/Self-Employed Division SE:S:C
Director, Collection Policy, Small Business/Self-Employed Division SE:S:C:CP
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaison: Commissioner, Small Business/Self-Employed Division SE:S



*Coordination and Procedures for
Foreclosures Can Be Improved*

Appendix IV

Glossary of Terms

Term	Definition
Adjustable Rate Mortgage	Loan with an interest rate that can vary up or down at certain intervals (periods) and within certain limits (caps); loan is secured by house on which lender will foreclose if loan is not paid.
Automated Lien System	Used to generate Notices and Releases of Federal Tax Liens, as well as to generate levy documents and letters. The purpose of a tax lien is to put the public on notice that a lien has been placed on a taxpayer's property. Once the information is released to the State recording offices and the District of Columbia Recorder of Deeds, it is public information and is not of a confidential nature.
Collection Statute Expiration Date	The expiration of the time period established by law to collect taxes. It is normally 10 years from the date of the assessment.
Equity	Determined by comparing the property value to the foreclosure sale price. If the property was sold for less than its value, the Advisory will determine that there is equity in the property and may recommend releasing the right of redemption for a higher value than compared to a property that has no equity.
Federal Tax Lien	The claim that the IRS has the authority to attach to a taxpayer's assets when the taxpayer neglects or refuses to pay his or her unpaid tax.
Foreclosure	The process that allows a lender to recover the amount owed on a defaulted loan by selling or taking ownership (repossession) of the property securing the loan. State law generally governs foreclosures, and rules may vary between States.
Housing Unit	A house, apartment, mobile home, group of rooms, or single room that is occupied (or if vacant, is intended for occupancy) as separate living quarters.



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Term	Definition
Integrated Collection System	An information management system designed to improve revenue collections by providing revenue officers access to the most current taxpayer information while in the field, using laptop computers for quicker case resolution and improved customer service.
Internal Revenue Code (I.R.C.)	Federal tax law begins with the I.R.C., enacted by Congress in Title 26 of the United States Code. It is the main body of domestic statutory tax law of the United States organized topically, including laws covering the income tax, payroll taxes, gift taxes, estate taxes, and statutory excise taxes. Its implementing agency is the IRS.
Judicial Foreclosure	Foreclosure action executed by the court.
Mortgage	A conveyance of an interest in real property, given as security for the payment of a debt. An agreement between two parties: borrower and lender.
Non-Judicial Foreclosure	Foreclosure on a mortgage without filing a lawsuit or obtaining a court order; generally occurs because a borrower has signed a document such as a deed of trust that gives the trustee the right to sell the property to pay off the debt.
Notice of Default	The initial document (non-judicial) filed by a trustee that starts the foreclosure process, usually after the occurrence of a default under the deed of trust or mortgage.
Notice of Federal Tax Lien	Public notification of creditors that the United States Government has a claim against all property, and any rights to property, of a taxpayer who received a Federal Tax Lien. This includes property owned at the time the notice of lien is filed and any property acquired thereafter. This notice is used by courts to establish priority in many situations, including bankruptcy proceedings or sales of real estate.
Notice of Lis Pendens	Notification of pending lawsuit (Lis Pendens). The initial document (judicial) filed by an attorney or trustee that starts the foreclosure process after the occurrence of default under the deed of trust or mortgage.



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Term	Definition
Notice of Sale	If a homeowner does not make up the mortgage payments, a Notice of Sale will be mailed to the homeowner, posted in public places, recorded at the county recorder's office, and published in area legal publications. This notice will include the time, place, and date the home will be sold at a foreclosure sale.
Redemption	Allows the IRS to acquire title to real estate by buying the property from the purchaser who acquired title at the foreclosure sale. By redeeming the property, the Government secures the equity and once sold, applies it to the taxpayer's liabilities.
Release of Right of Redemption	The United States may release its right of redemption in exchange for the value of this right. In exchange for the value of this right, the United States will issue a certificate stating that it will not exercise the right of redemption. Certificates of Release of Right of Redemption can be issued in both judicial and non-judicial foreclosures.
Surplus	Upon the completion of the foreclosure, generally the clerk of the court sells the property to satisfy the mortgagee's judgment. If the sale nets more money than the amount owed to the first mortgagee, this excess is called a "surplus."



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Appendix V

Management's Response to the Draft Report



COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D. C. 20224

September 8, 2010

RECEIVED
SEP - 8 2010
BY: *DAY*

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Christopher Weener
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Coordination and Procedures for
Foreclosures Can Be Improved (Audit # 200930013)

We have reviewed your draft report, "Coordination and Procedures for Foreclosures Can Be Improved."

We agree with the findings of the report and the recommendations. We appreciate that TIGTA has taken the time to recognize that foreclosures and redemptions are a very complicated segment of the law. For example, TIGTA recognizes that judicial foreclosures involving federal tax liens are the responsibility of the United States Attorney (USAO) and that Advisory in IRS Collection's Advisory, Insolvency, and Quality (Advisory) assists the USAO when requested and responds to the USAO based on the practices of the local USAO.

The TIGTA also recognizes that non-judicial foreclosure sale notices are often sent to the IRS in bulk by companies trying to cover all bases even if there is no public Notice of Federal Tax Lien (NFTL) or even a tax liability. These bulk packages contain 50 to 75 notices each and must be checked first to see if there is even a tax liability involved. We appreciate that TIGTA recognizes we cannot and do not enter all receipts into our Integrated Collection System (ICS). We enter into ICS only those cases where action is appropriate after checking that a taxpayer can be identified, a current public NFTL is on file, and the lien attaches to the property being foreclosed. We agree with TIGTA that clearer definitions that follow the Internal Revenue Code (IRC) and Treasury Regulations are needed in the Internal Revenue Manual (IRM) and IRS published documents of: what an effective notice is; what an adequate notice is; and the type of notice it takes to discharge or remove a federal tax lien through a foreclosure sale.

We agree that our foreclosure and redemption programs are important. We recognize that the economy and, in particular, the current state of the real estate market have dramatically increased receipt of these cases. We also recognize that, as property



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values drop, many properties going through foreclosure have lost equity. Since the federal tax lien attaches to equity, ultimately less funds are available for the IRS to apply to the tax lien debt.

The IRS recognizes the need to improve collection actions on foreclosure and redemption cases. We previously identified some of the issues included in this report and have already taken steps to implement several corrective actions to improve performance in this area.

In August 2008, we initiated revisions to the IRM to clarify instructions and add follow-up deadlines for case actions. The revised IRM 5.12.4, *Judicial/Nonjudicial Foreclosures*, and IRM 5.12.5, *Redemptions*, were published in June 2010 after completing negotiations with the National Treasury Employees Union. We will continue to look for ways to clarify these instructions. Letter 1840, *Notification of Inadequacy of Nonjudicial Sale Notice*, has been revised and is undergoing review by the notice clarity group. Publication 786, *Notice of Nonjudicial Sale of Property and Application for Consent to Sale*, is being revised and will be sent out for clearance as soon as the draft is complete.

Attached is a detailed response outlining our corrective actions. If you have any questions, please contact me, or a member of your staff may contact Frederick W. Schindler, Director, Collection Policy at (202) 283-7650.

Attachment



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Attachment

The Director, Collection, Small Business/Self-Employed Division, should ensure:

RECOMMENDATION 1:

When solicited by the USAO, the Advisory provides timely information regarding the application of any surplus proceeds and timely recommendations regarding the value of any releases of rights of redemptions.

CORRECTIVE ACTION:

We agree with this recommendation: 1) A Director, Advisory, Insolvency, and Quality yearly memorandum establishing work priorities will reinforce the IRM guidance for identifying, entering into ICS, and closing cases. This memo will address the need for timely responses to the USAO regarding recommendations for surplus proceeds or release of rights of redemption, along with an appropriate history notation. 2) Foreclosure and redemption practices will be submitted to Training for consideration as a topic for the next available Revenue Officer Continuing Professional Education (CPE) training program.

IMPLEMENTATION DATE:

- 1) November 15, 2010
- 2) May 15, 2011

RESPONSIBLE OFFICIAL:

- 1) Director, Collection, Advisory, Insolvency, and Quality, Small Business/Self-Employed Division
- 2) Director, Collection Policy, Small Business/Self-Employed Division

CORRECTIVE ACTION(S) MONITORING PLAN:

- 1) The Director, Advisory, Insolvency, and Quality SB/SE will advise the Director, Collection SB/SE of any delays in implementing this corrective action.
- 2) The Director, Collection Policy SB/SE will advise the Director, Collection SB/SE of any delays in implementing this corrective action

The Director, Collection, Small Business/Self-Employed Division, should ensure:

RECOMMENDATION 2:

The Advisory has sufficient information to consider potential redemption of foreclosed properties.

CORRECTIVE ACTION:

We agree with TIGTA that certain information must be provided by the USAO before the Advisory can consider redemption of foreclosed property. We will look into the Advisory opening a dialogue with the USAO as appropriate and as resources allow to ensure receipt of the information needed to consider the recommendation.



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IMPLEMENTATION DATE:

November 15, 2010

RESPONSIBLE OFFICIAL:

Director, Collection, Advisory, Insolvency, and Quality, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN:

The Director, Advisory, Insolvency, and Quality SB/SE will advise the Director, Collection SB/SE of any delays in implementing this corrective action.

The Director, Collection, Small Business/Self-Employed Division, should ensure:

RECOMMENDATION 3:

The IRS communications with the public are consistent with the Internal Revenue Code (IRC) and Internal Revenue Manual. Specifically, Letter 1840 and Publication 786 should be consistent with the IRC and Internal Revenue Manual regarding timeliness for a notice of sale.

CORRECTIVE ACTION:

We agree with this recommendation and this change is being addressed. We are currently revising Letter 1840 and will include Publication 786 and other foreclosure and redemption products in the revision process.

IMPLEMENTATION DATE:

July 15, 2011

RESPONSIBLE OFFICIAL:

The Director, Collection Policy, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN:

The Director, Collection Policy SB/SE will advise the Director, Collection SB/SE of any delays in implementing this corrective action.

The Director, Collection, Small Business/Self-Employed Division, should ensure:

RECOMMENDATION 4:

Foreclosure files include evidence supporting why notices of sale were rejected.

CORRECTIVE ACTION:

We agree with this recommendation. A Director, Advisory, Insolvency, and Quality yearly memorandum establishing work priorities will reinforce the IRM guidance for



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identifying, entering into ICS, and closing cases, including the need for appropriate history notations when closing or rejecting cases.

IMPLEMENTATION DATE:

November 15, 2010

RESPONSIBLE OFFICIAL:

Director, Collection, Advisory, Insolvency, and Quality, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN:

The Director, Advisory, Insolvency, and Quality SB/SE will advise the Director, Collection SB/SE of any delays in implementing this corrective action.

The Director, Collection, Small Business/Self-Employed Division, should ensure:

RECOMMENDATION 6:

Releases of Rights of Redemption are timely and appropriate.

CORRECTIVE ACTION:

We agree with this recommendation. A Director, Advisory, Insolvency, and Quality yearly memorandum establishing work priorities will reinforce the IRM guidance for identifying, entering into ICS, and closing cases, including the need for timely release of rights of redemption (RRR) when appropriate, along with a history notation on how or why RRR was or was not pursued.

IMPLEMENTATION DATE:

November 15, 2010

RESPONSIBLE OFFICIAL:

Director, Collection, Advisory, Insolvency, and Quality, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN:

The Director, Advisory, Insolvency, and Quality SB/SE will advise the Director, Collection SB/SE of any delays in implementing this corrective action.