March 14, 2025

Federal Tax Enforcement: An Overview

Federal tax enforcement involves a series of adverse actions that the government—primarily the Internal Revenue Service (IRS)—can take against a taxpayer to collect taxes owed and to penalize non-compliance with federal tax laws. Taxpayers are provided notice of and the opportunity to challenge most enforcement actions. This In Focus provides an overview of federal tax enforcement—outlining the types of adverse actions the government can take against a delinquent taxpayer and highlighting relevant caselaw.

Audit

The IRS can audit—or examine—a taxpayer to determine tax liability and ensure information reported on a tax return is correct. Audits can be conducted by correspondence or in person at an IRS office or at a home or business. The IRS selects a certain number of tax returns at random or through computerized screening for audit. It might also select returns for audits if it notices inconsistencies with other reported information. Special procedural rules apply for audits of certain categories of taxpayers—for example, churches. Taxpayers receive a notice of the audit from the IRS, which specifies the items on a tax return it is auditing. At the conclusion of an audit, taxpayers receive a notice if the IRS proposes adjustment to specific items.

Assessment

Assessment is the statutorily required recording of tax liability. An assessment is reflected in a taxpayer's account transcript maintained by the IRS. An assessment can be based on, among other things, a tax liability reported in a tax return or a calculation by the IRS after an audit.

For most types of assessments, taxpayers are required to be provided with notice of and the opportunity to challenge the proposed assessment in Tax Court. An IRS assessment generally has a "presumption of correctness." *Welch v. Helvering*, 290 U.S. 111, 115 (1933). Unless the assessment is "arbitrary and erroneous," the taxpayer has the burden of proof to rebut the presumption. *U.S. v. Janis*, 428 U.S. 433, 440–42. (1976). Under a provision in the Internal Revenue Code (IRC), the taxpayer can shift the burden of proof to the IRS if the taxpayer introduces credible factual evidence and if procedural requirements are met. IRC § 7491. An assessment triggers the IRS's authority to undertake certain collection actions, such as enforcing the federal tax lien.

Civil Tax Penalties

In addition to assessing tax liability, the IRS can assess certain civil tax penalties, which are categorized into two types: additions to tax and assessable penalties. Additions to tax are subject to more procedural requirements and review before assessment than assessable penalties. In contrast to assessments of tax, the IRS has the initial burden to show a taxpayer's liability for a penalty.

Common Civil Tax Penalties

Congress must specifically authorize penalties. *Farhy v. Comm'r of Internal Revenue*, 100 F.4th 223, 225 (D.C. Cir. 2024). Common authorized penalties assessed by the IRS include

- failure to file a tax return, IRC § 6651(a)(1);
- failure to pay tax owed, IRC §§ 6651(a)(2) and (3); and
- substantial understatement of tax, IRC § 6662(b)(2).

Underpayment Interest

The IRS has statutory authority to charge underpayment interest when a taxpayer does not pay a tax or penalty by the due date. In general, interest accrues until the balance is paid in full. The IRS is required by statute to set underpayment interest rates quarterly. Two different rates of interest are set: a general rate applicable to individual and corporate taxpayers and a higher rate for a "large corporate underpayment."

Federal Tax Lien

When a taxpayer fails to pay a tax liability after (1) assessment and (2) notice and demand for payment, the government automatically has rights to the delinquent taxpayer's property through a federal tax lien created by the IRC. The lien attaches to all property—whether real, personal, or financial—of the taxpayer. The lien applies to "property owned by the delinquent at any time during the life of the lien," including property acquired after the lien arises. *Glass City Bank of Jeanette, Pa., v. U.S.*, 326 U.S. 265, 268–69 (1945).

Once a lien is established, the IRS files a public document called a Notice of Federal Tax Lien (NFTL) to alert creditors of the government's legal right to a taxpayer's property. This notice allows the lien to have priority against certain competing lien interests of third parties. Taxpayers are provided with notice of and the opportunity to challenge an NFTL.

The lien continues until the liability is satisfied or becomes unenforceable by expiration of the period to collect the tax. The IRS will "release" the lien after such time. In certain situations, the IRS may "withdraw" an NFTL even when the taxpayer still owes a tax liability, if, for example, the taxpayer enters into an installment agreement or if the IRS determines that withdrawal best serves the interests of both parties. The withdrawal abandons lien priority but does not extinguish the lien or tax liability.

Collection

Once a federal tax lien exists, the IRS can undertake a series of actions to collect an unpaid tax liability. Taxpayers have several options upon notification of a collection action, including the right to appeal. Taxpayers can also voluntarily enter into a payment plan or request a delay in collection. They may also be eligible for a compromise if they cannot pay the full tax liability even through installments.

Administrative Levy

The IRS can collect on a liability using a seizure—or "levy"—of the taxpayer's property that is subject to the federal tax lien. The IRS may seize assets such as wages, bank accounts, a percentage of Social Security benefits and other federal payments, and retirement income. A taxpayer's future federal and state tax refunds are also subject to seizure. The IRS may also levy tangible or real property, such as cars and homes, and sell the property to apply the proceeds toward the tax debt.

The IRS will usually provide notice and demand for payment before levying a taxpayer's property. In addition to the notice and demand for payment, the IRS generally must notify the taxpayer of its intention to levy. Prior to levying tangible or real property, the IRS must provide an additional notice of seizure and must deliver the public notice of sale to the taxpayer. Before or after the sale of real property, the taxpayer is allowed to repurchase—or "redeem"—the property.

Certain types of property, such as child support payments, are statutorily exempt from levy. Levies on other types of property, such as principal residences, involve additional procedural requirements, such as court approval. While generally only property that the taxpayer owns at the time of the levy can be levied, the IRS can continuously levy salary or wages. If the IRS determines a levy will cause the taxpayer "economic hardship," the levy must be released.

Judicial Foreclosure

As an alternative to administrative levies, the federal government can seize and sell a taxpayer's property through judicial foreclosure. Judicial foreclosures are typically brought in federal court by the Department of Justice (DOJ) Tax Division, on referral from the IRS.

The judicial foreclosure statute permits the government to seize property with competing third-party ownership interests, whereas the administrative levy statute only permits seizure of a taxpayer's interest in an asset. *U.S. v. Rodgers*, 461 U.S. 677, 690–94 (1983). The government primarily utilizes judicial foreclosure when selling principal residences, which more commonly involve competing ownership interests.

All parties to the civil proceeding, including taxpayers and third parties, are provided notice of and an opportunity to contest the foreclosure action. Unlike the administrative levy, the taxpayer has no right to redeem real property after court-ordered foreclosure of the federal tax lien.

Criminal Prosecution

Information discovered during an audit or collection action can lead to criminal tax prosecutions, which can proceed in parallel to the enforcement described above. The DOJ Tax Division typically prosecutes these crimes with investigative assistance from the IRS and other components of the Department of the Treasury.

Selected Tax Crimes

The IRC delineates specific tax crimes, including

- tax evasion, IRC § 7201;
- fraud and false statements, IRC § 7206(1);
- aiding and abetting fraudulent or false statements, IRC § 7206(2); and
- fraudulent returns, IRC § 7207.

In addition to criminal liability in the IRC, taxpayers can be liable for related crimes, for example, currency crimes and false statements. Tax crime convictions are punishable by fines and imprisonment.

Typical criminal defenses are available to tax crime defendants, including proof beyond a reasonable doubt and the Fifth Amendment protection against self-incrimination. Questions about the application of the Fifth Amendment to production of documents can arise in criminal tax investigations. The self-incrimination privilege can apply to personal papers if they are "testimonial." *Boyd v. U.S.*, 116 U.S. 616, 638 (1886); *Fisher v. U.S.*, 425 U.S. 391, 411 (1976). The privilege, however, does not prevent production of records required by law to be kept. *Shapiro v. U.S.*, 335 U.S. 1, 33 (1948). Further, the privilege does not extend to corporate persons, and corporate records can be compelled. *Braswell v. U.S.*, 487 U.S. 99, 107–08 (1988).

Other Adverse Consequences of Tax Enforcement

- **Credit:** An NFTL may affect a taxpayer's ability to obtain credit, although major credit reports no longer include NFTLs.
- **Employment:** Employers—including federal agencies—can discover that an NFTL has been filed against an employee or applicant through a background check and take adverse employment actions. IRS employees are subject to a mandatory audit to ensure their compliance with tax laws.
- **Passports:** A person's passport can be subject to revocation and denial of application or renewal, if the IRS certifies that they have a seriously delinquent tax debt.
- **Private debt collection:** The IRS assigns certain outstanding, inactive tax debts to private debt collection agencies.

Considerations for Congress

Most federal tax enforcement mechanisms, including the due process procedures afforded to taxpayers, are defined by Congress in the IRC. Congress may consider further facilitating or constraining these mechanisms within the bounds of the Constitution. Congress may also consider providing for specific treatment of certain categories of taxpayers or assets subject to particular enforcement mechanisms to advance policy goals.

Justin C. Chung, Legislative Attorney

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