Is the Individual Mandate Really Mandatory?

By Jordan M. Barry and Bryan T. Camp

Jordan M. Barry

Bryan T. Camp

Jordan M. Barry is an associate professor at the University of San Diego School of Law, and Bryan T. Camp is the George H. Mahon Professor of Law at Texas Tech University School of Law.

This article examines the tax collection process to see how the IRS might enforce the individual mandate under the healthcare reform law. It concludes that resistant taxpayers can generally be forced to pay the tax penalty only if they are entitled to receive refundable tax credits that exceed their net federal tax liability.

The Patient Protection and Affordable Care Act of 2010 (PPACA)[1] has been the center of a tremendous amount of controversy. The 2,400-page legislation's most controversial provision requires most U.S. citizens to have ''minimum essential coverage'' — that is, a base level of health insurance coverage — for themselves and their dependents.[2] That provision, which has been termed the ''individual mandate,'' is enforced through a penalty administered through the tax system and enforced by the IRS.[3]

Ordinarily, the IRS has broad powers to collect taxes from taxpayers. However, because of the intense hue and cry surrounding the individual mandate, the PPACA's drafters imposed specific limitations on the methods that the IRS can use to collect the tax penalty.[4] Those provisions are not a model of clarity, and they have created considerable uncertainty about what, precisely, will happen to a taxpayer who refuses to pay the tax penalty.

This article addresses that issue. We begin by briefly placing the PPACA, the individual mandate, and the tax penalty into context. We then provide some basic background on the federal tax collection system and the processes through which the IRS collects most federal tax liabilities. Finally, we analyze how the PPACA specifically limits the IRS's ability to collect the tax penalty and, in light of those limitations, the degree to which the individual mandate is truly mandatory in practice. We conclude that, at most, the IRS will generally be able to collect the tax penalty only from a resistant taxpayer if she is entitled to refundable tax credits that exceed her net tax liability.

The Patient Protection and Affordable Care Act

The PPACA strives to increase individuals' access to healthcare in general and health insurance in particular. Some of its more significant provisions include an increase in federal spending on healthcare for lower-income families and individuals, the creation of state-run exchanges intended to increase individuals' access to health insurance, and incentives for employers to offer health insurance to employees.[5]

Another of the PPACA's major provisions generally prohibits insurers from denying insurance coverage, or charging higher rates, to individuals with preexisting conditions.[6] That creates a potential

---

[1]P.L. 111-148. Much of the discussion in this article focuses on section 1501(b) of the PPACA, which adds section 5000A to the IRC.

[2]Section 5000A(a). The individual mandate applies to ''applicable individuals,'' which is defined to include U.S. citizens, U.S. nationals, and aliens lawfully present in the United States. Section 5000A(d)(1), (3). An individual need not maintain health insurance coverage for dependents who do not meet the definition of applicable individual. Section 5000A(a), (d). Some individuals are excluded because of their religious beliefs and practices, as are individuals who are incarcerated. Section 5000A(d)(2), (4). The mandate does not become operative until 2014. Section 5000A(a).

[3]Section 5000A(b) and (g)(1).

[4]It is not clear whether those changes were made in response to the objections of the PPACA's opponents or out of a desire to deprive the PPACA's opponents of specific political arguments.

[5]*See, e.g.*, PPACA sections 1311-1313, 1421, 2001, and 2101; *Seven-Sky v. Holder*, 661 F.3d 1, 24 (D.C. Cir. 2011), *Doc 2011-23522*, *2011 TNT 217-19* (Kavanaugh, J., dissenting).

[6]*See* PPACA section 2704(a) (preventing exclusion based on preexisting condition); PPACA section 2701(a) (limiting the criteria insurers can use to vary rates); PPACA section 2702(a)

(Footnote continued on next page.)

problem: Low-risk individuals will decline insurance. Economists call this phenomenon adverse selection.[7]

To understand this problem, consider a company that sells health insurance policies. Assume that the insurance company cannot deny coverage or adjust the price it charges for insurance based on the health or behavior of the applicant. Thus, the price of insurance is the same for broad classes of purchasers.

But, while the cost of insurance is the same for different purchasers, the benefits that different individuals receive from having insurance can vary a great deal. That is because the monetary benefits of insurance depend on the cost of the medical services that an individual receives. Because people with higher-than-average health risks expect that they will need more medical services than individuals with lower-than-average health risks, the expected benefits of insurance increase with an individual's risk.

Many individuals know whether the health risks they face are higher or lower than average. For example, an individual knows whether she has been diagnosed with a serious disease, how regularly she exercises, her dietary habits, how much alcohol she consumes, etc. Because both high- and low-risk individuals must pay the same price for insurance, but the high-risk individuals get more benefits, insurance is a better deal for a high-risk individual than for a low-risk one. Consequently, the higher an individual's risk level, the more likely she will purchase insurance.[8] For the insurance company to finance medical services for all those high-risk cases, it will have to charge a high premium to all of its customers, which will contribute to making insurance less attractive to low-risk individuals, who are, in theory, less likely to receive large benefits from it.

The adverse selection problem may be exacerbated by the PPACA provision that prohibits insurance companies from discriminating based on preexisting conditions. Ordinarily, a low-risk individual might choose to buy insurance to protect against the risk that expensive and unforeseen medical conditions might arise in the future; if such a condition arises, obtaining medical coverage at that point would be much more expensive. For example, if a young, seemingly healthy person declines to purchase insurance, she might later discover that she has cancer, at which point she would have high expected medical costs. In general, insurance companies would try to avoid selling a policy to a new subscriber with cancer or another expensive preexisting condition, because the company would expect to pay more for her medical treatment than it is likely to collect from her in the form of premiums. But because the PPACA prevents insurance companies from discriminating based on preexisting conditions, a person with a preexisting condition must be allowed to purchase health insurance for the same price as everyone else. Thus, a low-risk person might be more tempted to not purchase insurance, knowing that if her expected medical needs change, she will have the opportunity to purchase insurance in the future at the same price.[9]

The individual mandate was designed to solve that adverse selection problem by forcing almost everyone to buy insurance.[10] The premiums collected from the low-risk people who are forced into the insurance pool will help defray the costs of providing medical services to the high-risk people. The individual mandate also prevents the low-risk people from refusing to purchase insurance until they expect to have a lot of medical expenses.

Individuals who fail or refuse to purchase insurance coverage are required to pay the tax penalty. The tax penalty is the only enforcement mechanism that the PPACA provides for the individual mandate, and the federal government has taken the position that the tax penalty is the sole means of enforcement.[11] As others have already pointed out in these pages, the provisions of the PPACA that

(requiring insurers to accept applications for coverage); PPACA section 2705(a) (prohibiting eligibility rules based on health status, medical condition, medical history, genetic information, and disability, among other factors); *see also Seven-Sky*, 661 F.3d at 24 (Kavanaugh, J., dissenting).

[7]*See, e.g.*, Jordan M. Barry, "When Second Comes First: Correcting Patent's Poor Secondary Incentives Through an Optional Patent Purchase System," 2007 *Wis. L. Rev*. 585, 629; Barry and John William Hatfield, "Pills and Partisans: Understanding Takeover Defenses," 160 *U. Pa. L. Rev*. 633, 666 (2012).

[8]From the insurance company's perspective, this is an adverse selection process.

[9]*See* PPACA section 1501(a)(2)(G).

[10]*Id.*

[11]Consider the following exchange at oral argument in *Florida v. HHS*:

> Justice Sotomayor: Could we address, General, the question of whether there are any collateral consequences for the failure to buy — to not buy health insurance? Is the only consequence the payment of the penalty? The private respondents argue that there are other collateral consequences such as for people on probation who are disobeying the law, if they don't buy health insurance they would be disobeying the law and could be subject to having their supervised release revoked.
>
> Solicitor General Verrilli: Yes. That is not a correct reading of the statute, Justice Sotomayor. The only consequence that ensues is the tax penalty. And the — we have made a representation, and it was a carefully made representation, in our brief that it is the interpretation of the

(Footnote continued on next page.)

define the tax penalty are not entirely clear.[12] The exact amount of the tax penalty depends on the taxpayer's particular circumstances, including her family size and the length of time that she went without insurance.[13] Some taxpayers are exempt from the penalty altogether, but in all cases the penalty is subject to a statutory cap.[14] That cap begins at less than $300 per year but rises to $2,250 in 2016, after which point it is indexed to inflation.[15]

The PPACA tasks the IRS with administering the individual mandate and collecting the tax penalty. It provides that the tax penalty will generally "be assessed and collected in the same manner as an assessable penalty."[16] Thus, to understand the operation of the tax penalty, one must understand the federal tax collection process.

Tax Collection Generally

The federal tax laws are designed to ensure that taxes flow smoothly into the federal coffers. The government has a panoply of enforcement mechanisms available to it to ensure taxpayer compliance, including significant criminal penalties for the most severe violators.[17] However, almost all collection actions rely on the IRS's extremely potent civil collection tools: the tax lien, the administrative levy, and the offset power.[18] So it is on those tools that we will focus our attention.

Before examining each of those three collection tools, it is important to understand how the collection process is distinct from the tax determination process. Although the IRS "collects" taxes in the broad sense when it accepts payments that taxpayers voluntarily remit with, or before filing, their returns, the focus of this article is whether and how the IRS compels payment from taxpayers who are not complying with their obligations voluntarily. The three collection tools are tools of compulsion, and the IRS must satisfy several prerequisites before it may use them to collect any tax.

The first prerequisite is a proper assessment.[19] An assessment is simply the recordation of a tax liability on the computerized records of taxpayers' accounts for particular tax periods and types of tax. The default rule is that the IRS may make an assessment immediately after it makes the determination.[20] However, in many situations Congress has modified the immediate assessment rule and requires the IRS to send the taxpayer advance notice of a proposed assessment. One common example is when the IRS believes a taxpayer owes more income tax than the taxpayer has reported on a return. The IRS may not immediately assess the additional tax but must instead send the taxpayer a notice of deficiency, and the taxpayer then has a period of time (generally 90 days) to contest the proposed assessment in the Tax Court.[21] Only after the taxpayer fails to contest the proposed assessment or loses in the Tax Court may the IRS make the assessment. Another example is when the IRS wants to assess the trust fund recovery penalty under section 6672. There, the pre-assessment notice does not give the taxpayer the opportunity for a pre-assessment judicial hearing but does give the taxpayer 60 days to ask for an administrative hearing. Absent a special rule, however, the IRS may immediately assess any other tax. For example, because there is no special rule for the assessment of the employment taxes imposed by section 3111, the IRS may assess those without prior notice. Similarly, assessable penalties other than the trust fund recovery penalty are immediately assessable.

In general the IRS has three years from the due date of a return to assess a liability, although there are many exceptions.[22] Once a liability has been properly assessed, the IRS typically has at least 10 years in which to collect the amount due.[23] Because the tax penalty is assessed like an assessable penalty, and because there are no special rules requiring the IRS to give taxpayers a pre-assessment notice, the IRS may assess the tax penalty without advance notice to the taxpayer.

---

agencies charged with interpreting this statute, the Treasury Department and the Department of Health and Human Services, that there is no other consequence apart from the tax penalty.

Transcript of Oral Argument in *Dep't of Health and Human Services v. Florida*, No. 11-398, Mar. 26, 2012, at 44-45, *available at* http://www.supremecourt.gov/oral_arguments/argument_transcripts/11-398-Monday.pdf.

[12]*See* Jeffrey H. Kahn, "The Operation of the Individual Mandate," *Tax Notes*, Aug. 1, 2011, p. 521, *Doc 2011-14545*, or *2011 TNT 148-4*.

[13]Section 5000A(c), (c)(1) (insurance), and (c)(4)(A) (family size).

[14]Section 5000A(c)(2) and (e).

[15]Section 5000A(c)(2) and (3)(A)-(D).

[16]Section 5000A(g)(1).

[17]*See* sections 7201 and 7202.

[18]For example, in 2010 the IRS initiated approximately 4,700 criminal investigations. By comparison, it filed roughly 1.1 million notices of federal tax lien and 3.6 million notices of levy on third parties that same year. IRS, 2010 Data Book, tbl. 16b, *Doc 2011-5320*, *2011 TNT 50-18*.

[19]*See* section 6203.

[20]Section 6201(a).

[21]Section 6212 et seq.

[22]*See* section 6501(a) (providing general rule), (c)-(f), and (h)-(m) (providing exceptions).

[23]*See* sections 6502 (providing 10-year statute of limitations on collection as general rule) and 6503 (providing for numerous events that suspend the running of the statute of limitations).

Once assessed, the tax penalty is payable ''upon notice and demand'' by the IRS.[24] Thus, the IRS's next step is to issue the taxpayer a formal demand for the amount due. Because of the way the tax penalty is structured, the taxpayer has no opportunity to contest the liability before making payment. If the taxpayer does not pay, the IRS may commence using its various tools of compulsion.

The first main collection tool is the federal tax lien. It arises automatically once the IRS makes a proper assessment and gives proper notice and demand for payment, and the taxpayer fails to pay in full.[25] This lien is very effective at securing the government's place in line among creditors. When the lien first arises, there is no public record that documents it, making it essentially invisible to the world at large. Nonetheless, the lien is considered perfected as of the date that the IRS assessed the tax, and once it is brought to light, it is enforceable and gives the government priority against nearly all creditors.[26] Because of the potential unfairness that might arise from this automatic, invisible government lien upsetting other creditors' expectations, Congress gives four specific types of creditors special treatment.[27] To enforce its lien against a creditor in one of those four classes, the IRS must file a notice of federal tax lien (NFTL), a public record that makes the lien visible, thereby putting other creditors on notice.[28]

The scope of the automatic federal tax lien stretches expansively across both space and time. All the taxpayer's property, as well as all her rights to property, are subject to it, as is any property that the taxpayer receives during the existence of the lien.[29] The lien is also quite long-lived; by default, the lien lasts at least 10 years.[30] And because the lien is retroactive to the date of the assessment, the taxpayer cannot easily defeat the lien by transferring assets. If the taxpayer fails to pay after proper notice and demand, the lien attaches backwards in time to all the taxpayer's assets at the date of the assessment.[31] Thus, any asset transfers made after that point are simply too late to avoid the lien's touch.

The tax lien works closely with the second collection tool: the tax levy. Section 6331 empowers the IRS to seize and sell any of the taxpayer's property, or rights to property, that is subject to the federal tax lien.[32] Thus, once the IRS makes an assessment and formally demands payment, it can seize and sell any property that the taxpayer owns at that time, as well as any property that the taxpayer later acquires during the next decade or later. The taxpayer need not even be in possession of the property in question; the IRS can levy against property of the taxpayer, or rights to receive property (including bank accounts and future wages), that are in others' possession.[33] The code strongly encourages third parties to comply with IRS levies: Third parties are liable to the IRS if they fail to surrender property that the IRS demands, but they are explicitly relieved of any liability to the delinquent taxpayer or anyone else that might result from honoring the levy.[34] In practice, nearly all the levies the IRS imposes are against bank accounts and other taxpayer property held by third parties.[35]

The code also makes it relatively easy for the IRS to levy. The IRS must provide the taxpayer with written notice of its intention to levy, as well as information about the levy process and actions a taxpayer can take in response.[36] If the taxpayer does not challenge the planned levy within 30 days, the IRS may seize the taxpayer's property and, after giving appropriate notices, may sell the seized property to satisfy the taxpayer's tax liability.[37] The IRS must clear some additional procedural hurdles if it wishes to levy against a taxpayer's principal residence or property used in the taxpayer's trade or business, but even those items remain generally available to the IRS to satisfy a substantial tax

[24]More precisely, demand by the secretary of the Treasury or his delegate. Sections 5000A(g)(1), 6303, 7701(a)(11), and (12).

[25]Sections 6303 and 6321; *Flora v. United States*, 357 U.S. 63 (1958), *aff'd on rehearing*, 362 U.S. 145 (1960).

[26]*See, e.g.*, *Middlesex Savings Bank v. Johnson*, 777 F. Supp. 1024 (1991) (providing a good comparison of tax lien priority with various third parties and discussion of the limits of lien priority disputes).

[27]These four types of creditors, known as the ''Four Horsemen,'' include purchasers for value, mechanics lien holders, holders of security interests, and judgment lien creditors. Section 6323(a); Bryan Camp, ''Protecting Trust Assets From the Federal Tax Lien,'' 1 *Est. Plan. & Cmty. Prop. L.J.* 295, 298 (2009).

[28]Section 6323(a).

[29]Section 6321; *United States v. McDermott*, 507 U.S. 447 (1993), *Doc 93-3795*, *93 TNT 67-14*.

[30]Many actions that taxpayers take during the collection process — such as submitting an offer in compromise, seeking spousal relief under section 6015, or asking the Taxpayer Advocate Service for help — may extend the collection limitations period. *See generally* Ann Murphy et al. (ed.), *Federal Tax Practice and Procedure*, section 8.04 (limitations periods for collection) and section 8.05 (modifications to limitations periods).

[31]Section 6322.

[32]Sections 6331 and 6335.

[33]Section 6332.

[34]Section 6332(d) and (e).

[35]For example, in 2010 the IRS filed roughly 3.6 million notices of levy on third parties but conducted only 605 levies against property held by taxpayers directly. IRS, 2010 Data Book, *supra* note 18, at tbl. 16b.

[36]*See* section 6331(d).

[37]*Id.*; section 6335.

liability.[38] Similarly, while some types of property, such as unemployment benefits and workers' compensation, are specially exempted from the levy authority, the broader rule is that all property is fair game.[39] The net effect of the code's levy provisions is to give the IRS sweeping authority to seize and sell almost all of the delinquent taxpayer's property, subject to procedural safeguards designed to prevent unfair surprise to the taxpayer and small substantive limitations intended to protect the taxpayer and any minor children from extreme poverty.[40]

As an alternative to its administrative collections powers, the IRS may also attempt to collect through court action, most commonly under sections 7401 and 7403. Those statutes allow the IRS to reduce assessments to judgments and to foreclose tax liens. However, there are two major reasons this strategy is much more unwieldy for the IRS than proceeding under its administrative powers. First, it replaces an IRS internal administrative process with a potentially long and drawn-out adversarial judicial process.[41] Second, the IRS cannot itself bring suit to collect the liability.[42] Instead, it must persuade the Department of Justice to sue on behalf of the United States.[43] Because of those logistical issues, the IRS relies on its administrative enforcement tools to a far greater extent than federal lawsuits.[44] In fact, the IRS has propagated a policy among its agents that generally requires them to fully pursue administrative remedies before turning to judicial action.[45]

Nonetheless, lawsuits under sections 7401 or 7403 are useful in some circumstances. The statute of limitations for collections requires that a levy be made within the 10-year limitations period, but a section 7401 action is timely as long as it *starts* within the limitations period.[46] Thus, if it would be difficult to collect an outstanding tax liability through a levy within the limitations period, the IRS can give itself more time by having the DOJ file suit.[47] And once the liability is reduced to judgment, the government's attempts to enforce that judgment are not restricted by the statute of limitations for collecting assessed tax liabilities.[48]

Another advantage of a section 7403 action is that it allows the government to seize and sell property in which the taxpayer owns an interest, even if the taxpayer cannot sell the property without the consent of the other co-owners. The IRS cannot do that by levy. For example, if the taxpayer is one of several co-owners of a piece of real property, the IRS could administratively seize and sell the taxpayer's interest. However, any buyer of the taxpayer's interest would then be a co-owner with the existing owners. That prospect might significantly reduce the sale price of the taxpayer's interest — especially if the other owners are living on the property. In a suit under section 7403, the government can seize and sell the entire property, then apply the portion of the proceeds attributable to the taxpayer's interest against the taxpayer's outstanding liability.[49]

The final major weapon in the IRS's collection arsenal is its offset power, which is rooted in both the common law and in section 6402. Conceptually, offsets are very straightforward: The IRS can offset amounts that it owes to a taxpayer against amounts that that taxpayer owes to the fisc. So, for example, suppose that a taxpayer has a $1,000 outstanding income tax liability for 2010 that she refuses to pay, and that she also is entitled to a net refundable tax credit of $3,000 for 2011. Section 6402 allows the IRS

---

[38]*See* section 6334(a)(13) and (e).

[39]Section 6334(c).

[40]Section 6334(a).

[41]Technically, taxpayers can seek judicial review by the Tax Court of their pre-levy administrative hearing. Section 6330(d)(1). However, that rarely happens. For example, the Government Accountability Office estimated that approximately 2 percent of all taxpayers who requested administrative appeals in 2004 sought judicial review. GAO, ''Tax Administration: Little Evidence of Procedural Errors in Collection Due Process Appeal Cases, but Opportunities Exist to Improve the Program,'' GAO-07-112, at 15 (2006), *Doc 2006-22635*, *2006 TNT 215-24* [hereinafter GAO 2006 Study]. *See generally* Bryan T. Camp, ''The Failure of Adversarial Process in the Administrative State,'' 84 *Ind. L.J.* 57, 99 (2009) (noting that 2.2 million collection due process notices in fiscal 2004 resulted in only 28,000 requests for CDP hearings). It is also worth noting that the code gives the IRS the authority to curtail the legal processes, including judicial review, available to taxpayers whose arguments are frivolous. Section 6330(g)(1). That is significant for two reasons. First, frivolous claims are more common than one might expect. Camp's study of 976 court decisions issued through the end of 2006 found that more than a third were declared frivolous by the courts. 84 *Ind. L.J.* at 116. The GAO estimated that approximately 5 percent of taxpayers requesting appeals presented frivolous arguments, two and a half times the number that sought judicial review. GAO 2006 Study, *supra*, at 17. Second, as the GAO concluded, ''frivolous issues consume a disproportionately large amount of time.'' *Id.*

[42]Section 7401.

[43]*Id.* The IRS does retain veto power over the commencement of that litigation, however.

[44]In 2010, for example, the IRS filed roughly 1.1 million NFTLs and 3.6 million notices of levy on third parties. IRS, 2010 IRS Data Book, *supra* note 18, at tbl. 16b. By comparison, civil actions under section 7403 produced only 46 judicial opinions that year. National Taxpayer Advocate, ''2010 Annual Report to Congress,'' at 43 (Dec. 31, 2010), *Doc 2011-220*, *2011 TNT 4-23*.

[45]Internal Revenue Manual sections 5.17.4.7 and 25.3.2.3.

[46]Section 6502.

[47]IRM section 5.17.4.7.

[48]*United States v. Overman*, 424 F.2d 1142 (9th Cir. 1970). Moreover, reducing the liability to judgment also creates a judgment lien and extends the life of the federal tax lien. *Id.*

[49]*See, e.g., United States v. Rodgers*, 461 U.S. 677 (1983).

to offset the $1,000 outstanding liability against the $3,000 tax credit and simply send the taxpayer a $2,000 check. Without offset, the IRS would have to send the taxpayer a $3,000 check for the refundable tax credit while undertaking unrelated enforcement actions to collect the outstanding $1,000 liability.

Section 6402 authorizes the IRS to credit any overpayments against the taxpayer's existing tax liabilities, including those being paid in installments.[50] Any remaining overpayment is then credited against the taxpayer's past-due child support obligations[51]; debts owed to federal agencies[52]; past-due, enforceable state income tax obligations[53]; fraud-related liabilities arising from the unemployment insurance system[54]; and, in some instances, the taxpayer's estimated federal tax payments.[55] If any overpayment remains after those offsets have been executed, section 6402 requires the IRS to refund that amount to the taxpayer.[56]

The code makes it very easy for the IRS to offset. Generally, all the IRS must do is inform the taxpayer of the offset after the fact.[57] The IRS need not give the taxpayer any advance notice. Even if the taxpayer knows about the pending offset, typically she can prevent or reverse the offset only if she successfully challenges the liability against which the overpayment will be credited. If the liability is a federal tax liability, in most cases the taxpayer must pay it and sue for a refund.[58] If the liability is one of the other debts subject to IRS offset, the code explicitly prohibits any administrative review of the offset and strips all U.S. courts of jurisdiction to restrain or review the offset.[59] Instead, the taxpayer must take action against the agency or state asserting the liability — an action that the code explicitly distinguishes from a suit for refund of tax.[60] The administrative and logistical ease with which the IRS can conduct offsets greatly increases offsets' value as a collection method.

Collecting the Tax Penalty

At first glance, it would seem that the tax penalty is to be collected like any federal tax liability. The PPACA provides that the tax penalty, like any tax liability, is payable ''upon notice and demand'' by the IRS and that it shall generally ''be assessed and collected in the same manner'' as an assessable tax penalty.[61] However, the PPACA then goes on to provide for special rules that limit the tools the IRS may use to collect the tax penalty.

First, the PPACA makes clear that a taxpayer's failure or refusal to pay the tax penalty cannot lead to prosecution or criminal penalties of any sort.[62] Enforcement is thus limited to civil collection methods.

Second, the PPACA imposes limitations on the IRS's ability to use liens and levies. The PPACA prohibits the IRS from levying on any property to enforce the tax penalty.[63] Thus, the administrative tax levy, like criminal penalties, would seem to be taken completely off the table, although it is not entirely clear that the language used fully accomplishes that goal.[64]

Unlike criminal penalties and levies, the PPACA does not attempt to eliminate the tax lien. The PPACA does nothing to prevent the federal tax lien from arising, and thus the lien should still come into being automatically on the taxpayer's refusal or failure to pay the tax penalty. Still, as a practical matter, the PPACA renders the tax lien largely irrelevant to the enforcement of the tax penalty.

Recall that liens and levies work closely together: The IRS can levy any property subject to the federal tax lien, and that threat of IRS levy adds bite to the lien. In fact, the chief way that the IRS enforces the federal tax lien is through levy.[65] Thus, even though

[50]Sections 6402(a) and 6403.
[51]Section 6402(c).
[52]Section 6402(d).
[53]Section 6402(e).
[54]Section 6402(f).
[55]Section 6402(b).
[56]Section 6402(a).
[57]Section 6402(c), (d)(1)(C), (e)(1)(C), and (f)(1)(C).
[58]Section 6406.
[59]Section 6402(g).
[60]*Id.*

[61]Section 5000A(g)(1).
[62]Section 5000A(g)(2)(A).
[63]Section 5000A(g)(2)(B)(ii).
[64]The PPACA prohibits the IRS from levying on the taxpayer's ''property,'' while section 6331 allows the IRS to levy on the taxpayer's ''property and rights to property'' (such as wages the taxpayer has yet to earn or receive). Sections 5000A(g)(2)(B)(ii) and 6331(a). Thus, it is possible to read the PPACA as eliminating the IRS's power to levy on the taxpayer's property while preserving the IRS's authority to levy on the taxpayer's rights to property. However, while that construction is compatible with the literal text of the PPACA, it is hard to imagine how the drafters could have intended that result. It seems far more likely that the use of ''property'' instead of ''property or rights to property'' was merely an oversight and that the PPACA should be construed accordingly. Nonetheless, this is precisely the sort of issue that would best be resolved with certainty through a technical corrections statute. Unfortunately, the controversial nature of the PPACA and of the individual mandate in particular makes the prospect of such an enactment seem unlikely, at least for the immediate future.
[65]For example, in 2010 the number of notices of levy that the IRS served on third parties was more than triple the number of NFTLs that it filed. IRS, 2010 Data Book, *supra* note 18, at tbl. 16b. In 2006 the ratio was nearly 6 to 1. *Id.* Civil actions under section 7403 led to a comparatively minuscule number of judicial opinions that year.

the PPACA allows the tax lien to arise, its prohibition on administrative levy strikes a serious blow to the lien's efficacy.

Also, the PPACA prohibits the IRS from filing a notice of lien because of any failure to pay the tax penalty.[66] This approach — leaving the code provisions that bring the lien to life untouched but preventing the IRS from bringing the lien to light — has somewhat strange consequences. No one besides the IRS and the taxpayer will know that the lien has come into being. To the extent that the lien affects third parties when it comes into existence, this raises potential problems.[67] Moreover, bankruptcy law disfavors hidden liens.[68] Because the IRS cannot file a notice of lien, it will rarely be able to assert tax penalty claims as secured claims in bankruptcy, and it is unclear whether the tax penalty is a "tax on or measured by income or gross receipts" such as to entitle it to priority status under 11 U.S.C. section 507(a)(8).[69]

The IRS could still potentially use the tax lien to secure its right to priority repayment against the taxpayer herself.[70] But to do that on its own, the federal government would need to be in possession of proceeds from the sale of the taxpayer's assets. Because the IRS cannot levy on property to enforce the tax penalty, it would seem that there would be few instances in which that might happen.

However, one such scenario deserves mention. Suppose that a taxpayer has both an outstanding federal income tax liability of $10,000 and a tax penalty liability of $1,000, but refuses to pay either. Suppose also that the taxpayer owns a piece of investment property valued at $15,000. The IRS could use its levy powers to seize the property and sell it at auction to satisfy the taxpayer's $10,000 federal income tax liability. Assuming that there are no expenses from the levy proceeding and that the property sells for its full fair market value of $15,000, there would be $5,000 remaining after the $10,000 tax liability is satisfied. The IRS is statutorily obligated to credit or refund those extra proceeds to the person or persons who are legally entitled to them.[71] Treasury regulations presume that the taxpayer is entitled to the remaining proceeds unless someone else establishes a superior claim.[72] It would seem that the federal tax lien against the taxpayer would establish the IRS's superior claim, thereby allowing it to keep $1,000 in satisfaction of the tax penalty liability. The IRS could presumably accomplish the same goal through offset instead of through the federal tax lien.

It is not entirely clear that this analysis is correct; the PPACA uses broad language to prohibit levying on property to enforce the tax penalty, and it is possible that language prevents this outcome. However, the preceding analysis seems to be a more natural reading of the statutory language. Assuming that analysis is correct, it highlights a gap in the PPACA's direct prohibition on enforcing the tax penalty through levy. The PPACA would still seem to prevent the IRS from intentionally levying property with a value that exceeds a taxpayer's outstanding federal tax liability in order to have surplus proceeds that the IRS could then apply to the tax penalty. It might be difficult to tell when the IRS was taking that approach when the item being levied is a piece of real estate, a boat, or some other piece of property that may not be easy to divide or for which the whole is worth more than the sum of its parts. But nearly all IRS levies are conducted against bank accounts and similar types of property, and the person levied on is only obligated to remit funds to satisfy the amounts listed in the notice of levy. Because the PPACA would prohibit the notice of levy from including the tax penalty amount, the IRS would not often be able to collect excess funds.

---

[66]The PPACA forbids the filing of a notice of lien "with respect to any property of a taxpayer." Section 5000A(g)(2)(B)(i). Section 6321 provides for a lien on the taxpayer's property and rights to property. Thus, the same question of interpretation arises concerning the use of the phrase "property" instead of "property and rights to property," discussed in the context of administrative tax levies.

[67]For example, some contracts give a party specific rights if someone obtains a lien against the counterparty (for instance, the right to accelerate the counterparty's obligations under the contract). If a taxpayer has entered into such a contract, the federal tax lien that arises from failure to pay the tax penalty might have meaningful consequences for her counterparty (and, presumably, negative consequences for the taxpayer). But in that circumstance, the counterparty would have no way of knowing that a lien had arisen, since the PPACA prohibits the IRS from filing a public notice of lien. PPACA, ch. 48; section 5000A (g)(2)(B)(i). The taxpayer's counterparty could give himself some protection against that eventuality by requiring the taxpayer to inform him that the federal tax lien has arisen, but the counterparty would generally have no way of knowing if the taxpayer was complying with her notice obligations.

[68]*See* 11 U.S.C. sections 544 and 545 (giving the bankruptcy trustee powers to avoid statutory and nonstatutory liens).

[69]There might be times, however, when the IRS could assert a tax penalty claim as a secured claim; 11 U.S.C. section 506 provides that an allowed claim of a creditor that is subject to setoff under section 553 is also a secured claim to the extent of the amount subject to setoff, with any amount of the claim in excess of the setoff amount remaining an unsecured claim. Thus, if the taxpayer has made a pre-petition overpayment, the IRS might be able to assert a secured claim based on a right to setoff.

[70]The secret tax lien always beats the taxpayer. *See United States v. Bess*, 357 U.S. 51 (1958).

[71]Section 6342.

[72]Reg. section 301.6342-1(b).

Thus, in almost all cases, this would not help the IRS enforce the tax penalty.

The final way the federal tax lien might have some effect is that it could be a basis for filing a lien foreclosure action under section 7403. As noted above, that lawsuit would adjudicate the rights of all parties regarding particular taxpayer assets and would allow the IRS to seize and sell taxpayer assets to satisfy the federal tax lien securing the tax penalty.

However, there are several problems with relying on section 7403 to enforce the tax penalty. First, there are internal constraints on the IRS's ability to proceed with judicial collection actions. The IRS has taken the position that the purpose of judicial enforcement proceedings is to prevent the statute of limitations from lapsing before the liability can be collected.[73] IRS policy generally requires it to fully pursue its administrative remedies before turning to judicial action.[74] Second, there are constraints on actions that are external to the IRS. The IRS cannot itself file a lawsuit under section 7403; instead, it must persuade the DOJ, which has its own priorities and obligations, to do so.[75] The DOJ generally will not commence an action against a taxpayer unless there is a sufficiently large federal tax liability at issue.[76] While the exact threshold is not public knowledge, observers agree that it exceeds a taxpayer's potential annual liability under the tax penalty. The amount of the tax penalty that a taxpayer faces depends on her individual circumstances, but even a taxpayer who is subject to the largest liability that the PPACA allows each year would not exceed, say, $10,000 for several years. And even if the DOJ does bring suit, the United States would still find itself behind all other creditors in line for payment if, as discussed above, it cannot file a notice of its lien.

Lastly, it is not entirely clear that a lawsuit under section 7403 is available at all. One could argue that the PPACA's prohibition on the filing of a notice of lien bars a lawsuit under section 7403, because it would constitute a public filing announcing the federal tax lien. However, that argument is suspect in two respects. First, the phrase "filing notice of lien" is best seen as a term of art with a specific meaning that does not include a lawsuit under section 7403.[77] Second, the PPACA prohibits the Treasury secretary from filing a notice of lien, but it is not clear that this provision should be construed as applying to the DOJ, which is the government actor that must file a section 7403 action. That a similar provision of the PPACA specifically restricts both the secretary and the attorney general from filing a notice of lien, but that this provision does not, lends this argument additional force.[78]

A similar argument against the possibility of proceeding under section 7403 could be crafted around the PPACA's prohibition on levying on any of the taxpayer's property to satisfy the tax penalty.[79] The code defines "levy" as including the "power of distraint and seizure by any means."[80] If the United States succeeds in establishing its claim to property in an action under section 7403, the district court is authorized to sell the property and distribute the proceeds among the interested parties in accordance with their interests.[81] Thus, a section 7403 action might constitute a levy action under the code's definition, in which case the PPACA's prohibition on the IRS's levy power could be construed as barring a lawsuit under section 7403. However, the PPACA's prohibition is directed at the secretary of the Treasury, so it is not clear that it imposes any constraints on the DOJ's ability to file lawsuits or collect the resulting judgment. Thus, the validity of this argument is highly uncertain.

The combined effects of the PPACA's collection restrictions severely curtail the IRS's ability to enforce the tax penalty. Although refusal or failure to pay the tax penalty will still give rise to a federal tax lien, it seems unlikely to be of much value to the IRS as an enforcement tool for convincing taxpayers to pay the tax penalty.

That leaves the IRS to rely on its final major collection tool: offset. In stark contrast to liens and levies, the PPACA places no restrictions whatsoever on offsets. However, unlike liens and levies, which the IRS generally can apply whenever any taxpayer fails or refuses to pay an assessed tax liability, the IRS can offset only when a taxpayer happens to have made an overpayment of tax. Currently, most

---

[73]IRM section 5.17.4.7.

[74]IRM sections 5.17.4.7 and 25.3.2.3.

[75]Sections 7401 and 7403(a).

[76]To our knowledge, the policy is not described in any publicly available document. *See also* IRM section 25.3.2.3 (setting forth IRS guidelines on the minimum amount of federal tax liability that must be involved before the IRS will recommend a judicial action but redacting the exact amounts from the public version).

[77]*See* section 6323.

[78]*See* section 1411(h)(3).

[79]Section 5000A(g)(2)(B)(ii).

[80]Section 6331(b).

[81]Section 7403(c).

individual taxpayers regularly overpay their income taxes through overwithholding, so as a practical matter, this may not be a significant constraint.[82]

However, taxpayers have a significant amount of control over the payments they make to the IRS. Thus, it would seem that a conscientious taxpayer has the ability to avoid this enforcement tool altogether through careful tax planning. The chief group of taxpayers for whom this would not be the case are those who are entitled to receive refundable credits in excess of their federal tax liability.[83] However, those taxpayers tend to have low incomes and are thus likely to fall within the tax penalty's exemptions for low-income taxpayers.[84]

The Tax Penalty and Tax Administration

The interplay of the tax penalty with offsets also merits comment in one additional respect. Offsets are used to help enforce a variety of obligations that are not related to federal tax, such as obligations involving child support, other federal agencies, state income taxes, and fraud on the unemployment insurance system.[85] The code includes detailed provisions on how the tax system intertwines with those other legal obligations. It provides a priority system for allocating the amount of any overpayment among each class of liabilities, and it allows any taxpayer who wishes to challenge the IRS's conduct to take action against the federal or state agency that asserts the existence of the obligation.[86]

Thus, there is a preexisting statutory and administrative infrastructure that allows the IRS to aid in the collection of nonfederal tax liabilities. That structure automatically integrates IRS offsets into the collection process for debts owed to other federal agencies. Accordingly, the PPACA's architects could easily have drafted the PPACA to make those who fail to secure minimum essential coverage liable to the Department of Health and Human Services or some other federal agency. Doing so would still have secured the use of the IRS's offset power to help collect the penalty for violating the individual mandate but would otherwise have left the IRS out of the mandate's enforcement and administration.

However, that was not the approach the PPACA's architects selected. Instead, they enacted the tax penalty. In doing so, they tasked the IRS with enforcing and administering the individual mandate's penalty provision and, as a practical matter, placed that penalty provision squarely within the tax system.[87]

Yet, at the same time, the PPACA creates special collection rules that apply only to the tax penalty. Thus, the IRS must now keep track of a new type of liability that cannot be addressed through the usual set of collection procedures. The IRS's systems were designed to enable its approximately 100,000 employees to process hundreds of millions of returns and collect trillions of dollars each year. The IRS accomplishes that impressive feat through a tremendous amount of automation and standardization. Creating a special class of liability for which only specified collection tools are available creates significant administrative challenges for the IRS. In light of those administrative challenges and the significant limitations that the PPACA places on all of the IRS's major collection tools except for offsets — which would automatically be available to aid in collection if the individual mandate's penalty provision were owed to any another federal agency — one might fairly question the wisdom of the tax penalty's current structure.

Conclusion

While the collection process for the tax penalty has many similarities to the collection process for

[82]In fiscal 2010 the federal government issued more than $358 billion in individual income tax refunds. IRS, 2010 Data Book, *supra* note 18, at tbl. 8. The average individual income tax refund was $3,048. *Id.* at n.3.

[83]Section 6401(b).

[84]For example, the earned income tax credit is the largest refundable tax credit in the code. Designed to provide cash aid to low-income families without discouraging work, it provided $60.4 billion to 27.4 million filers in 2009. IRS, Statistics of Income Bulletin, tbl. 1, *available at* http://www.irs.gov/individuals/article/0,,id=177571,00.html. The PPACA exempts from the tax penalty those individuals who cannot afford coverage, those with income below the poverty line, and those whose ability to obtain coverage has been affected by hardship. Section 5000A(e)(1), (2), and (5). Because the EITC and those exemptions both target taxpayers with low incomes, it seems likely that there would be a large overlap between the individuals who qualify for each provision.

[85]Section 6402(c), (d), (e), and (f).

[86]Section 6402(c), (d)(2), (e)(3), (f)(2), and (g).

[87]This article takes no position on whether the individual mandate as implemented is constitutionally supported by Congress's power to spend money or impose taxes. Nor does this analysis assume that the tax penalty is a ''liability in respect of an internal revenue tax'' under section 6402(a). While the IRS's statutory power to offset is limited to taxes, its common-law rights to offset are not. *See United States v. Munsey Trust Co.*, 332 U.S. 234, 239 (1947) (''The government has the same right which belongs to every creditor, to apply the unappropriated moneys of his debtor, in his hands, in extinguishment of the debts due to him.'') (internal quotes omitted). However, it does seem likely that the tax penalty is a ''liability in respect of an internal revenue tax'' under section 6402(a), given that the PPACA both provides for the tax penalty to be administered like the assessable penalties of chapter 68, subchapter B, and contemplates that the tax penalty would be enforceable through liens and levies but for the special limitations that the PPACA imposes on those powers. *See* section 5000A(g)(1).

existing federal tax liabilities, there are also significant differences. The restrictions placed on the IRS's ability to collect the tax penalty make it unlikely the IRS can effectively enforce the individual mandate. The only major collection tool that remains unaffected is the offset, which, by its nature, applies only if the taxpayer happens to overpay her federal income tax obligations or is entitled to a net refund in a given year. Thus, many taxpayers who neglect or refuse to pay the tax penalty could structure their affairs in such a way as to avoid being subject to legal consequences of any sort for years to come, if ever. For those taxpayers, the individual mandate may not actually be mandatory after all.

The Backlog of Tax Debts: A Billion Reasons to Address It

By Jeff Trinca

Jeff Trinca

Jeff Trinca is a vice president of Van Scoyoc Associates. He worked on the Tax Reform Act of 1986 as tax counsel to former Sen. David Pryor and was chief of staff to the National Commission on Restructuring the Internal Revenue Service.

As Congress once again considers funding levels for the IRS, the author suggests that perennial underfunding results in significant loss of revenue to the federal government. Those debts are now sitting in IRS accounts receivable and could be collected with help from Treasury's Financial Management Service.

Underfunding the IRS costs taxpayers nearly $1 billion a year. Let's be clear: This is not one of those wistful estimates based on the current tax gap of $385 billion a year. This number is based on real dollars already sitting in an IRS accounts receivable.

Every year the Treasury Inspector General for Tax Administration publishes a report read by only a few tax administration junkies. "Trends in Compliance Activities" paints a stark picture for anyone who might be bothered to take 30 minutes to read it. It shows that assessed taxes waiting for IRS action have ballooned over the last 14 years. (Why 14 years? That is apparently how long TIGTA has been collecting data.)

Figure 1 shows us amounts owed in the queue. For those of us who don't speak IRS, TIGTA is kind enough to provide a definition for the word "queue": "An automated holding file for unassigned inventory of delinquent cases for which the Collection function does not have enough resources to immediately assign the cases for contact."

In other words, the queue is the tax administration's version of the old Soviet bread lines. Except that in this situation, if you wait 10 years, the statute of limitations actually gives you the bread for free.

Figure 1 shows that the dollars stuck in the queue have risen tenfold. Not impressed? Would it help if I said there is another secret queue behind the queue? Logic would tell you there are only two ways to escape the queue: Pay your tax bill, or wait 10 years and win the tax compliance lottery. But this is the government, so things can never be that simple. Figure 2 shows accounts that have been removed and placed in the secret queue.