



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

SMALL BUSINESS/SELF-EMPLOYED DIVISION

October 4, 2011

Control Number: SBSE-05-1011-084  
Expiration Date: October 5, 2012  
Impacted: IRM 5.12.3

MEMORANDUM FOR DIRECTORS, COLLECTION AREA OPERATIONS  
DIRECTOR, ADVISORY AND INSOLVENCY

FROM: Scott D. Reisher /s/ **Scott D. Reisher**  
Director, Collection Policy

SUBJECT: Reissuance of Interim Guidance for Certificates of  
Discharge in Short Sale Situations

The purpose of this memorandum is to reissue Interim Guidance SBSE-05-1010-054, dated October 4, 2010, regarding the processing and approving of requests for certificates of discharge in short sale situations and to clarify the impact of certain provisions of the Home Affordable Foreclosure Alternatives Program (HAFA)<sup>1</sup>. The applicable sections of IRM 5.12.3, Certificates Relating to Liens, will be revised to include the information in this memorandum. Please ensure that this information is distributed to all affected employees in your organization.

The authority of the Internal Revenue Service (IRS) to issue a certificate of discharge of property subject to the federal tax lien is found in Internal Revenue Code (IRC) section 6325(b). Among other conditions, the IRS may issue a certificate of discharge when the interest of the United States in the such property is determined to have no value (section 6325(b)(2)(B)).

A short sale occurs when the senior lien holder agrees to accept less than the total amount owed as satisfaction for its lien claim. For example, a bank has a priority mortgage claim for \$600,000, but, due to the significant decline in the real property market, the bank agrees to a sale of the mortgaged property for \$300,000. Because the senior lien attaches to all the equity in the property, generally the lien interest of the United States in short sale properties is valueless. Therefore, applications for discharge for properties subject to short sales should be considered under IRC 6325(b)(2)(B).

---

<sup>1</sup> HAFA is part of Home Affordable Modification Program (HAMP) enacted by Treasury Department Supplemental Directive 09-01 on April 5, 2010.

To facilitate the sale of the property in these situations, the senior lien holder might negotiate the payment of expenses to be taken from its settlement amount. In certain situations, these expenses might be greater than normal closing costs allowed by the IRS and might include creditors that would otherwise be junior to the IRS. This action by the senior lien holder to carve proceeds out of its priority claim to pay these expenses does not create an equity interest on the part of the taxpayer which may be reached by the IRS lien. Provided there is no fraudulent aspect to the payment distribution and the lien interests of the IRS in other properties of the taxpayer is not being harmed, the IRS has no authority to require payment of the sum that otherwise would have gone to the senior lien holder.

Following the previous example, the bank determines that out of the \$300,000 sales price, it will allow \$15,000 of expenses to be paid. Most of the \$15,000 is for normal closing costs, but \$5,000 of it is for a homeowner's association fee, which is junior in priority to the IRS, and \$2,000 is for state transfer taxes. Because the payments made for the homeowner's association fee and the state transfer taxes are made from proceeds attributable to the bank's priority lien interest and the interest of the IRS in the property to be discharged is valueless, the IRS cannot condition discharge upon payment of any part of the amount going to these expenses.

In conjunction with the above guidance, if a sale is being conducted under the provisions of HAFA, there are certain restrictions that may need considered. For example, payments to junior creditors under HAFA cannot exceed \$6,000 in aggregate. Also, the payments are: limited to 6% of the amount due the junior creditor; should be paid in the order of priority; and must be reflected on the HUD-1 Settlement Statement.

Other provisions of HAFA provide that an investor (purchaser) can be reimbursed, on a three (3) to one (1) matching basis, up to \$2,000, for facilitating the release of subordinate lien holders. In other words, for each three dollars an investor pays to secure release of a subordinate lien, the investor will be entitled one dollar of reimbursement up to a maximum \$2,000. For junior lien holders to qualify for payment and investors to qualify for reimbursement, the junior lien holders must agree to release their liens with respect to the property.

Another provision of HAFA is that the seller is entitled to an incentive payment of \$3,000 to assist with relocation expenses. To qualify, the property must be the seller's principal residence and the amount must be shown on the HUD-1 Settlement Statement. This payment has no bearing on the taxpayer's equity in the property and therefore the IRS cannot require payment of the sum as a condition of discharge; however, it is a payment that could be levied. As a matter of policy, the IRS will not levy this payment unless flagrant conduct circumstances exist. A levy on this relocation allowance must be approved by the Territory Manager. If a taxpayer receives a relocation payment through this

provision, they are not eligible to request the relocation expense allowance described in IRM 5.12.3.14.4.

Payments to the seller/taxpayer outside of this provision of HAFA may also be income that can be attached by levy. If additional payments are to be made to the taxpayer, investigate the nature of the payment to determine if it can be reached by levy. Consult with management and Area Counsel as needed. If it is an asset that can be levied, you must exercise discretion in determining whether to proceed with levy action.

The limitations of HAFA as described above have no effect upon the discharge authority in regular short sale situations. In other words, if the sale is not being conducted under the provisions of HAFA, the IRS has no authority to require payment of amounts paid to junior creditors from the senior lien holder's proceeds as a condition of discharge of the subject property. If the sale is subject to the provisions of HAFA, the IRS can ensure that the terms are being properly followed, but still cannot require payment of any sum to which we are not entitled.

When a discharge application involving a short sale is received, process the application as if HAFA is not involved. Should the information indicate that proceeds are being provided to a junior creditor, the purchaser, or the taxpayer, contact the mortgage company to determine if they are a loan service provider operating under the provisions of HAFA. If they are, evaluate the distribution according to the HAFA terms described above and notify the mortgage company of any discrepancies found. If they are not under the provisions of HAFA, process the request following standard procedures outlined in IRM 5.12.3 and in this interim guidance. Presuming no issues are identified, the discharge application can be approved following existing IRM procedures.

In normal (non-short) sale situations, where the lien claim of the bank is fully paid and the federal tax lien attaches to surplus proceeds, the IRS's lien interest must be satisfied in accordance with IRC 6325(b) before the property can be discharged from the lien. Creditors junior to the IRS interest are not entitled to payment from the proceeds before the IRS lien interest is fully paid.

If you have any questions, please contact me, or a member of your staff may contact Kyle Romick, Senior Program Analyst.

cc: [www.irs.gov](http://www.irs.gov)