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TOPICS

Modification of California Unemployment Insurance Code Section 1755(a) to Provide a Minimum Holding Period for Surrender of Property Subject to Levy from Financial Institutions

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The authors would like to thank Robert Schriebman and Patrick McGinnis for their helpful comments.[2]

EXECUTIVE SUMMARY

The current legislation under California Unemployment Insurance Code ("CUIC") § 1755 governs bank levies by the Employment Development Department ("EDD"). CUIC § 1755(a) explains the levy process, applicable statutory periods, and identifies a response time of "within five days of service of the levy." This means that once a levy is served upon a financial institution, the institution must remit the levied funds to the EDD "within five days of service of the levy" to avoid being deemed liable for the tax.

In contrast, Revenue & Taxation Code ("R&TC") § 18670 for the Franchise Tax Board ("FTB"), R&TC § 6703 for the California Department of Tax and Fee Administration ("CDTFA") as explained in Compliance Policy and Procedures Manual (CPPM) Chapter 7, section 753.205, and 26 United States Code ("U.S.C.") § 6332(c) for the Internal Revenue Service ("IRS") provide significant guidance regarding how and when banks must surrender deposits that are subject to levy from other taxing agencies. Pursuant to R&TC § 18670, the bank remits the levied funds "not less than 10 business days from receipt" of the levy notice. Pursuant to CDTFA Collection Publication 54, the bank must hold the funds subject to levy for 10 days prior to releasing the levied funds to the CDTFA. Finally, 26 U.S.C. § 6332(c), provides that the financial institution must turn over levied funds "only after 21 days after service of the levy." Ultimately, the other taxing agencies demonstrate at least a 10-day minimum holding period after receipt of a levy before remitting the designated funds, which is very different from the language found in CUIC § 1755, which requires funds to be remitted to the EDD "within five days."

The limited response time—"within five days"—required under CUIC § 1755 does not provide the taxpayer a sufficient opportunity to determine the validity of the levy, whether funds are exempt from levy, or whether the proposed levy would create undue financial hardship. The authors propose that this law be modified to provide a minimum holding period of 21 days. Modifying the statute would reduce: (1) financial hardship to taxpayers and, (2) administrative costs for the Employment Development Department.

DISCUSSION

I. INTRODUCTION

This proposal addresses the EDD bank levy statute codified in CUIC § 1755. The code section at issue imposes an undue financial hardship and administrative costs on taxpayers and the EDD. This proposal will recommend solutions and amendments to the statute that would allow taxpayers to avoid financial hardship and will allow the EDD to avoid administrative costs.

II. CUIC § 1755 IS FAR MORE STRINGENT THAN THE OTHER AGENCIES' POLICIES

CUIC § 1755 requires banks to remit levied funds to the EDD "within five days of service of the levy." The authors propose that this statute be changed to more closely mirror the required levy hold periods of the FTB, CDTFA, and IRS.

A. Bank Policy When Receiving a Levy Notice

The authors of the proposal researched the internal policies of several major banks regarding accounts served with levies.[3] The bank policies are generally consistent in two respects. First, the account holder must pay a fee for the bank's processing of a levy. This fee applies even

in the event of a wrongful levy action. Second, a bank will generally refuse to remit withdrawals and honor the levy that they believe is valid, even if it leaves the account holder's account with insufficient funds to pay a check that was written from the account. Banks are sure to remit levied funds to avoid incurring liability for failure to comply.[4]

Banks are legally required to comply with a levy notice sent from a taxing agency and will presume its validity unless a taxing agency instructs otherwise. As such, the imposition of fees and restrictions placed on a taxpayer's account are intrusive.

B. FTB Bank Levy Procedures

Per California Revenue and Taxation Code § 18670, the FTB instructs financial institutions to hold taxpayer funds for 10 business days before remitting taxpayer funds in accordance with that bank levy. The minimum holding period the FTB grants to taxpayers is significantly longer than the maximum holding period that the EDD grants. Taxpayers are afforded at least 10 business days to resolve their accounts (essentially at least two full weeks) before levy action is taken. Conversely, the EDD language states that a financial institution must remit a levy "within 5 days." This distinction is significant because, regardless of the "hold period," the bank will withdraw the funds from the taxpayers account on the day the levy is received. The absence of the term "business" days is conspicuous and could effectively reduce the time for taxpayer intervention to 1 or 2 days if a levy is served on a Thursday or if there is a three-day holiday weekend. Thus, mirroring the FTB's holding period would afford taxpayers time to intervene to resolve their liabilities in an alternative manner.

The FTB also provides notice to taxpayers before levying their bank accounts. Before bank levies are enforced, the FTB sends taxpayers the following notices: Formal Demand for Payment[5], Past Due Notice, Final Notice Before Levy ("FNBL"), etc. Initially, the FTB sends a series of collection notices, such as the Formal Demand for Payment and Past Due Notice, to make taxpayers aware that they owe a liability. When the taxpayer does not respond to the notices or resolve their state tax liabilities, the FTB then issues the taxpayer a FNBL. The FNBL advises the taxpayer of its liability and the collection action the FTB could pursue, including bank levies.

Conversely, the EDD does not provide pre-levy notice to a taxpayer. As discussed further below, there are likely underlying due process issues given that the EDD is not required to issue any notices prior to taking levy action.

C. CDTFA Bank Levy Procedures

Similar to the FTB, the CDTFA provides for a 10-day holding period from the date the levy is served before remitting bank funds.[6] During this minimum holding period, taxpayers have an opportunity to contact the CDTFA to discuss alternatives to levy or to file a claim of exemption with the levying officer. The CDTFA also allows additional time when taxpayers exercise good faith and contact the agency. Indeed, "If the tax debtor contacts the responsible office and asserts that they qualify for an exemption from enforcement of the levy, staff will provide the tax debtor with an additional three days to file the claim of exemption."[7] Allowing the minimum holding period gives the taxpayer an opportunity to prove that their funds were wrongfully levied or that they will suffer from a financial hardship if the levy is not released. During the same 10-day window, the CDTFA allows taxpayers to file for a hardship hearing to show that the levy is exempt under state or federal law, or to make other satisfactory arrangements to pay the outstanding tax liability.[8] In conjunction with the hardship hearing, the CDTFA's regulations mandate that the agency release levies in the event the CDTFA determines the levy is creating a significant economic hardship for taxpayers.[9]

Additionally, the CDTFA provides notice to taxpayers regarding any impending levy action. First, the taxpayer is mailed a Notice of Levy from the CDTFA.[10] Second, within 10 calendar days of the taxpayer receiving the levy notice, the CDTFA mails the taxpayer the following: the taxpayer copy of the levy, including the CDTFA-425, *Exemptions from the Enforcement of Judgments*, the CDTFA-425-L3, *Notice of Levy–Information Sheet*, and the CDTFA-403-E *Individual Financial Statement*.[11] In addition to allowing time for the financial institution to receive and process the levy, sufficient notice enables taxpayers to contact the CDTFA and further avoid future levies.

Again, notice of pending levy action is not provided to a taxpayer by the EDD.

D. IRS Bank Levy Procedures

IRS procedures provide that all banks must surrender any deposits only after waiting twenty-one calendar days after service of the levy.[12] Similar to the FTB and CDTFA, the IRS holding period is significantly longer than the EDD's.

The purpose of the IRS holding period is multifaceted. Congress, in passing 26 U.S.C. § 6332(c), wanted to make sure taxpayers had time to challenge a levy prior to the financial institution remitting the levied funds to the IRS. This includes allowing taxpayers time to settle disputes regarding ownership of bank accounts before money is remitted to the IRS, while also allowing time for the taxpayer to contact the IRS and arrange to pay the tax or notify the IRS of errors in the levy.[13] Congress, in passing this section, knew that shorter holding periods would impose hardship on taxpayers, and that longer holding periods alleviate the administrative costs associated

with remedying wrongful levies. Further, the IRS grants additional time to taxpayers to provide a potentially wrongfully levied party a deadline date for providing substantiation of account ownership.[14] The granting of additional time, in addition to the minimum holding requirement, is conducive to the IRS' objective to saving federal resources by avoiding wrongful levy disputes. As the EDD often faces wrongful levy disputes due to the short holding period, implementing a similar policy would benefit the EDD while minimizing financial hardship to taxpayers.

In addition to the longer holding period, the IRS issues two significant notices to taxpayers before the IRS is legally able to seize taxpayer funds. First, taxpayers are sent two billing notices (i.e. Amount Due Notice) that notify them of their liability. Then, taxpayers are issued a Notice of Intent to Levy ("NIL"). The purpose of the NIL is to advise taxpayers of their federal tax liabilities and the IRS's intent to levy, giving them 30 days to address the liability. It also provides the opportunity for the taxpayer to file a Collection Appeals Program ("CAP") appeal within 30 days of the notice if the taxpayer does not agree with the IRS's intent to levy. The second notice, the Final Notice of Intent to Levy ("FNIL"), is the notice that advises taxpayers that the IRS can legally levy 30 days after the FNIL if taxpayers do not timely respond to the notice or resolve their federal tax liability. Significantly, a FNIL provides the taxpayer the opportunity to file a Collection Due Process Appeal, which allows the taxpayer to administratively challenge the right of the IRS to levy the taxpayer. The policy behind these procedures aligns with the FTB and CDTFA by allowing the taxpayer to make good faith attempts to contact the tax agency to find alternative arrangements to pay the liability, while also providing taxpayer's who have been wrongfully levied with time to show the taxing authority that the levy was in fact wrongful. Conversely, the EDD does not have similar notice guidelines in place.

E. Conclusion

The holding or waiting periods applicable to the IRS, FTB, and CDTFA provide a taxpayer with a pre-determined amount of time to do a number of things including, but not limited to, determining whether the levy will create a financial hardship, and/or if the levy itself is legally valid.

As the five-day maximum response period is not designated as five "business" days, CUIC § 1755 effectively narrows the levy hold period to 2 to 3 days if there is an intervening weekend, holiday, or holiday weekend. As a result of the "within" language found in CUIC § 1755, the EDD is legally entitled to contact the levy source (banks) and request that they remit the funds immediately to the EDD. Such a request can be made by the EDD as early as the day the levy is processed by the bank. Further, some financial institutions remit funds the day the levy is received to ensure that they comply with the "within" language found in CUIC § 1755. The five calendar-day response period does not provide any procedural safeguard for taxpayers who are levied erroneously, or face a financial hardship, to resolve their EDD account with an alternative to levy.

Furthermore, the taxpayer could learn the funds have been levied and remitted several days later, which is critical for businesses that rely on sufficient funds in their bank accounts to meet their payroll obligations and pay other reoccurring business expenses. While the EDD may agree to reduce the levy amount, it is not common for the EDD to release the levy in full. Therefore, because of the short holding period and lack of notice to the taxpayer, taxpayers are often unable to resolve the levy issue with the EDD, which can result in an employer going out of business, which reduces payroll tax revenue to the EDD and potentially adds new claimants to the unemployment rolls.

Ultimately, the EDD does not have notice procedures to inform taxpayers of pending levy action like the other taxing agencies. Notice procedures are significant because they allow taxpayers and taxing agencies time to determine whether: (1) the funds are exempt from levy; (2) the levy is valid; and, if (3) the account can be resolved in an alternative manner. If the EDD provided notice to taxpayers, it would accomplish several things. First, the EDD would avoid the administrative costs associated with wrongful levies. When funds are exempt from levy and levy action occurs, the EDD exposes itself to wrongful levy suits and must issue refunds back to taxpayers, which is a significant administrative burden and an unnecessary expenditure of state resources. Second, providing notice to taxpayers allows time to contact the agency and resolve their account in alternative ways that preserve the ability to continue in business, and reduces administrative costs for the EDD. Providing taxpayers with alternative methods to resolve their liabilities provides safeguards against erroneous levies and the imposition of financial hardship while protecting the EDD from hindering businesses and spending state resources that otherwise would be not be spent.

Thus, CUIC § 1755(a) should be modified to include a minimum holding period of 21 days to establish safeguards for taxpayers and the EDD.

III. PROBLEMS ADDRESSED

A. Financial Hardship to Taxpayers

Pursuant to the EDD Tax Compliance Guidelines, Collection Management is defined as "a series of actions taken to ensure that the interests of the people

of California are fully protected." It further states that involuntary collection actions should be taken "only" when all other voluntary actions are no longer effective. Additionally, the EDD is to provide accurate information and support to its customers, evaluate and act upon customer concerns or requests in an objective, impartial, and timely manner and utilize staff and technological resources effectively. The five-calendar day (or less) period for banks to respond to a notice of levy contradicts the EDD's own policy guidelines for the following reasons.

First, the people of California include "employees." When the EDD issues a notice of levy ("NOL"), it has the potential to adversely affect employees who may not be paid because of the levy, or worse, may become unemployed. Wage earners who miss even one paycheck can be placed in financial peril. If banks respond in five or fewer calendar days, it is highly unlikely the employer will have an adequate opportunity to successfully resolve the EDD NOL via an alternative method. In such cases, the interests of the people of California are not protected.

Second, as for evaluating or acting upon a taxpayer's concerns or requests in a timely manner, the response time to an NOL does not allow for this (especially if the bank releases the funds on the same day it processes the NOL). If an EDD collector contacts the bank and requests the funds be remitted immediately, then the window of opportunity to address a taxpayer's concerns has been closed unilaterally.

Last, once an NOL is issued, the employer may want to resolve the account without levy. However, the process to do so is time-consuming. The EDD will generally consider a partial release of funds to cover current payroll. This requires the employer to submit current payroll registers and bank statements to prove to the EDD that there are no other funds available to cover payroll. Depending on the timing of the NOL, the time required to produce the payroll and bank records, and the bank's need to protect itself from liability, there is often not sufficient time to complete the process.

B. Administrative Costs to the EDD

Consider the following actual case that demonstrates the EDD's failure to adhere to its own collection guidelines:

> Employer A never received any notification from the EDD that an NOL had been issued, but discovered its account was levied when it routinely checked its bank account balance on a Friday morning. Employer A's representative ("Representative") immediately called the EDD general collection number to discuss this matter and to request a release of the NOL. Representative called several times until reaching an EDD agent. This agent insisted the power of attorney ("POA") must be faxed to him before he could work on the account. He then informed Representative it would take 24 hours to process the POA before he could discuss the case. As time was of the essence, Representative called the EDD Collection Chief, and EDD taxpayer advocate ("TPA") to seek assistance. Fortunately, the TPA returned the call and determined who was the appropriate EDD agent to contact. A manager was notified and contacted the representative that same day to discuss the issues on the case. The EDD manager disclosed that banks often remit funds to EDD on the day the levy is processed and Bank of America, in particular, does that via automated clearing house (ACH).
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> The EDD manager requested full financial information including a completed questionnaire, DE 204, all bank statements for 3 months, and payroll records for the payroll period. On Monday, the representative again spoke with the EDD manager to inquire if the bank had released the funds. The representative discussed the voluminous financial documents requested as the taxpayer had multiple bank accounts. The EDD manager would not release the NOL and insisted that the financial documents were necessary to determine if a release was warranted.
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> On Tuesday, Representative drafted a letter explaining the financials and levy issues, compiled all documents including bank statements and a payroll ledger, and faxed the package to the EDD. Again, the Representative spoke with the EDD manager, who indicated she had reviewed the financials, but a release of levy was not granted. The EDD manager instead referred the case to a specific collector to work with the representative on a collection alternative.
>
> Employer A's representative spent over 7 hours over the course of three business days trying to resolve the NOL. The EDD expended resources including the TPA, general collection personnel, and a collection manager, to consider a release of an NOL, which was ultimately not granted. The actual resolution on the account, a long-term installment agreement, occurred after this apparent unnecessary expenditure of resources.

C. Conclusion

This issue is significant because it affects taxpayers, the EDD, and employees of the taxpayers. Taxpayers are

prejudiced by the limited response time on bank levies and could suffer irreparable financial hardship in the process. If an employer is forced to close its business, the potential for additional collection by the EDD is negatively impacted. The EDD could pursue individuals personally pursuant to CUIC § 1735, but this also adds to the administrative burden of the EDD. An employer's inability to meet payroll due to the levy could also mean more unemployed individuals seeking unemployment compensation, placing yet another administrative burden on the EDD and the State of California as a whole.

Therefore, the current legislation unfairly prejudices taxpayers and could result in adverse results on employment, which directly affects the EDD administratively. Additionally, California is already stigmatized by negative business practices driving major employers out of the state. Thus, a minor modification to CUIC § 1755(a) would be mutually beneficial for taxpayers and the state of California.

The authors are unaware of any similar proposal that have been advanced.

IV. POLICY–POTENTIAL VIOLATION OF DUE PROCESS

Congress enacted 26 U.S.C. § 6330 in an effort to protect taxpayers from abusive or arbitrary collection practices by the IRS. 26 U.S.C. § 6330 provides three procedural safeguards to taxpayers facing potential levy action: notice, an administrative hearing, and judicial review. The enactment of § 6330 implemented significant structural changes governing federal collection procedures and established minimum due process rights prior to levy action by a government entity.

Before issuing a levy to collect a delinquent tax, 26 U.S.C. § 6330 requires the IRS to send notice to the taxpayer at least thirty days in advance. This notice notifies the taxpayer of their right to an administrative hearing to challenge the proposed collection action before the IRS Office of Appeals. The IRS Office of Appeals provides an administrative hearing, which would allow the taxpayer to challenge the underlying collection action, which could lead to petitioning the Tax Court for judicial review. In any event, the IRS sends multiple notices indicating its intention to take levy action prior to issuing a levy notice to a bank. This provides the taxpayer and IRS the opportunity to proactively find an alternate solution to pay the delinquent tax. More importantly, these procedures ensure that all taxpayers are afforded a minimum standard of due process prior to depriving a taxpayer of their property.

The FTB and CDTFA largely adhere to the minimum due process requirements by providing notice to a taxpayer prior to initiating levy action. This affords taxpayers the opportunity to work with the FTB or CDTFA to ensure that the proposed levy action is valid. It also provides ample opportunity to proactively find a repayment solution on the delinquent debt with the FTB or CDTFA. Both agencies provide multiple rounds of notice to a taxpayer prior to initiating levy action.

In contrast, the EDD does not provide taxpayers with notice prior to initiating levy action. The only mailing provided by the EDD prior to levy action occurring is a "Statement of Account," which details a taxpayer's outstanding tax liabilities. Importantly, this mailing does not indicate that any form of collection action is pending. As a result, there are likely underlying due process issues surrounding EDD collection procedures. Those issues, however, may be alleviated if the EDD adopts additional time under CUIC § 1755(a), similar to the procedures implemented by the FTB and CDTFA.

V. PROPOSED EDD SAFEGUARD

The authors propose the EDD implement a 21-day holding period on notices of levy to prevent potential financial hardship, reduce the occurrence of wrongful levy action, and afford taxpayers the opportunity to resolve their accounts in a less intrusive manner. In turn, the EDD will conserve resources while supporting taxpayers in paying outstanding liabilities. Taxpayers who stay in business can work towards compliance and continue to provide employment opportunities. To alleviate any concerns that a minimum holding period would ultimately decrease tax revenue, the authors also propose an additional (and contemporaneous) safeguard.

A. Notice Procedures

If the EDD is unwilling to implement a minimum holding period, it would behoove the EDD to provide more notice to taxpayers before a bank levy is served. Similar to the IRS, FTB, and CDTFA, implementing notice procedures prior to initiating levy action protects both the EDD and taxpayer. It provides a safeguard to the EDD by ensuring it provides sufficient due process to taxpayers prior to initiating levy action. Notice procedures protect taxpayers from unknowingly having their bank accounts levied, which causes potentially irreparable harm to the taxpayer and, collaterally, its innocent employees. Implementing formal notice procedures prior to levy action would also allow taxpayers to cooperate with the EDD to proactively find payment options for their delinquent tax debts.

Thus, the EDD, at a minimum, should adopt notice procedures to ensure that all taxpayers have adequate and fair notice prior to enforced collection action by levy.

VI. CONCLUSION

In sum, the extremely limited response time for banks to remit levied funds, "within five days," does not provide a sufficient opportunity for taxpayers to determine the validity of the levy, whether funds are exempt from levy, or whether the proposed levy would otherwise create undue financial hardship. While the limited response time may appear to be an effective and near immediate method to collect delinquent taxes, it also leaves the EDD vulnerable to increased administrative costs, unnecessary expenditure of resources, and potential loss of revenue for taxpayers who go out of business. The authors propose that CUIC § 1755(a) be modified by replacing "within five days of service of the levy" with "no earlier than 21 days of service of the levy."

ENDNOTES

1. The comments contained in this paper are the individual views of the author(s) who prepared them, and do not represent the position of the California Lawyers Association or of the Taxation Section.

2. Although the authors and/or presenters of this paper might have clients affected by the rules applicable to the subject matter of this paper and have advised such clients on applicable law, no such participant has been engaged by a client to participate on this paper. No author has a direct personal or financial interest in the issue addressed in this paper.

3. The authors researched the internal policies for these banks: Wells Fargo, Bank of America, JPMorgan Chase, Capital One, PNC, and TD Bank.

4. CUIC § 1757 (Any "person" notified, including banks and financial institutions, shall be liable in its own person in the amount of the debt if it fails or refuses to surrender the personal property requested).

5. *In the Matter of the Appeal of: J. CHU-HSIANG CHI, M.D. INC.*; OTA Case No. 18011005 (The pertinent notice included the following language: "Failure to pay the liability may result in collection actions, including bank levy, and imposition of collection fees.").

6. CPPM Chapter 7, section 753.205.

7. *Id.*

8. California Department of Tax and Fee Administration Publication 54 (August 2017).

9. *Id.*

10. CCP § 703.520.

11. *Id.*

12. 26 U.S.C. § 6332(c).

13. I.R.M. 5.11.4.1 Purpose of process and procedures for serving notices of levy on bank accounts; 26 U.S.C. § 6332 Legislative History; https://www.irs.gov/businesses/small-businesses-selfemployed/information-about-bank-levies.

14. I.R.M. 5.11.4.3 Multiple Signature Authority for a Bank Account.