

MLI #9 Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax Under IRC § 7403

SUMMARY

Internal Revenue Code (IRC) § 7403 authorizes the United States to file a civil action in U.S. District Court against a taxpayer who has refused or neglected to pay any tax, to enforce a federal tax lien, or subject any of the delinquent taxpayer's property to the payment of tax. We identified 33 opinions issued between June 1, 2012, and May 31, 2013, that involved civil actions to enforce liens under IRC § 7403. The IRS prevailed in 30 of these cases. The number of cases represents a 31 percent decrease from the previous year.¹

PRESENT LAW

IRC § 7403 authorizes the United States to enforce a federal tax lien with respect to a taxpayer's delinquent tax liability, or to subject any property, right, title or interest in property of the delinquent taxpayer to the payment of a liability, by initiating a civil action against the taxpayer in the appropriate United States District Court.² All parties having liens on or otherwise claiming interest in the relevant property shall be made parties to the action.³ The law of the state where the property is located determines the nature of a taxpayer's legal interest in the property.⁴ However, if it is determined that the taxpayer has an interest in the property, federal law controls whether the property is exempt from attachment of the lien.⁵

The court may order that the property be sold by an officer of the court and the proceeds applied to the delinquent tax liability.⁶ However, based on the Supreme Court case *United States v. Rodgers*, the court is not required to authorize a forced sale and may exercise limited equitable discretion.⁷ When a forced sale involves the interests of a non-delinquent third party, the court should consider four factors from *Rodgers* when determining whether the property should be sold:

1. The extent to which the government's financial interests would be prejudiced if they were relegated to a forced sale of the partial interest of the delinquent taxpayer;
2. Whether the innocent third party with a separate interest in the property, in the normal course of events, has a legally recognized expectation that the property would not be subject to a forced sale by the delinquent taxpayer or taxpayer's creditors;
3. The likely prejudice to the third party in personal dislocation costs and inadequate compensation; and
4. The relative character and value of the non-liable and liable interests held in the property.⁸

1 National Taxpayer Advocate 2012 Annual Report to Congress 634-639.

2 IRC § 7403(a); Treas. Reg. § 301.7403-1(a).

3 IRC § 7403(b).

4 *U.S. v. National Bank of Commerce*, 472 U.S. 713, 722 (1985).

5 *U.S. v. Rodgers*, 466 U.S. 677 (1983).

6 IRC § 7403(c).

7 466 U.S. 677 (1983).

8 *Rodgers*, 461 U.S. at 709-11.

At the sale of the property in which it holds a first lien, the United States may bid an amount equal to or less than the amount of the lien, plus selling expenses.⁹ Additionally, the United States may intervene in foreclosure actions initiated by other creditors, to assert any lien on the property that is the subject of such action.¹⁰ The United States may also remove the case to a U.S. District Court if the case was initiated in a state court.¹¹ However, junior federal tax liens may be effectively extinguished in a foreclosure and sale under state law, even if the United States is not a party to the proceeding.¹² The IRC also specifically authorizes the court to appoint a receiver to enforce the lien and, upon the government's certification that it is in the public interest, may appoint a receiver with all powers of a receiver in equity to preserve and operate the property prior to the sale.¹³

Recently, the IRS clarified its procedures for referring cases to the Department of Justice (DOJ) when seeking to recommend a suit to foreclose on a taxpayer's principal residence.¹⁴ When a tax lien attaches to the principal residence of a taxpayer or a residence owned by the taxpayer but occupied by the taxpayer's spouse, former spouse, or minor child, the IRS can use two methods to enforce the tax lien. The IRS can request that the DOJ:

- File suit to foreclose the federal tax lien against the principal residence under IRC § 7403; or
- Commence a proceeding to obtain a court order allowing administrative seizure of a principal residence under IRC § 6334(e)(1).¹⁵

In explaining what steps the IRS must take prior to requesting that the DOJ obtain a court order allowing administrative seizure of a principal residence under IRC § 6334(e)(1), the Treasury Regulations clearly state that among other things, the IRS must consider who is living in the residence.¹⁶ The Treasury Regulation on requesting the commencement of a foreclosure action of a principal residence under § 7403 is not as clear about the considerations the IRS should make prior to referring a case to the DOJ for potential foreclosure on a principal residence.¹⁷ Thus, the IRS recently issued interim guidance to employees to explain that the procedures for developing suit referral recommendations under IRC § 6334(e) apply to such recommendations under IRC § 7403 as well.¹⁸ The guidance also emphasizes that the IRS

⁹ IRC § 7403(c).

¹⁰ 28 U.S.C. § 1444. However, if the application of the United States to intervene is denied, the adjudication will have no effect upon the federal tax lien on the property. IRC § 7424.

¹¹ 28 U.S.C. § 1444.

¹² *U.S. v. Brosnan*, 363 U.S. 237 (1960).

¹³ IRC §§ 7403(d) and 7402(a).

¹⁴ Interim Guidance Memorandum (IGM), *Principal Residence Suit Foreclosure Recommendations*, SBSE-05-0413-035 (Apr. 30, 2013). This guidance is the result of action by TAS leadership. In 2012, TAS Systemic Advocacy developed and issued to the IRS an Advocacy Proposal recommending that the IRS consider the negative impact on the taxpayer of a suit to foreclose on a principal residence prior to forwarding the case to the Department of Justice. TAS, *Memorandum for Director, Collection Policy*, Aug. 20, 2012. The National Taxpayer Advocate followed this advocacy proposal with a legislative recommendation that Congress amend IRC § 7403 to require that the IRS, before recommending that the Attorney General file a suit to foreclose, first determine that the taxpayer's other property or rights to property, if sold, are insufficient to pay the amount due, and that the foreclosure and sale of the residence will not create an economic hardship due to the financial condition of the taxpayer. National Taxpayer Advocate 2012 Annual Report to Congress 537-543 (Legislative Recommendation: *Amend IRC § 7403 to Provide Taxpayer Protections Before Lien Foreclosure Suits on Principal Residences*). Following this recommendation, Systemic Advocacy consulted extensively with the IRS to develop the IGM, which adopted the recommendations set forth by the National Taxpayer Advocate.

¹⁵ IRC § 6334(e)(1) requires that the IRS obtain court approval prior to administratively seizing a principal residence.

¹⁶ Treas. Reg. § 301.6334-1(d)(1).

¹⁷ Treas. Reg. § 301-7403-1.

¹⁸ The IGM follows the legislative recommendation made by the National Taxpayer Advocate in 2012. National Taxpayer Advocate 2012 Annual Report to Congress, 537-543 (Legislative Recommendation: *Amend IRC § 7403 to Provide Taxpayer Protections Before Lien Foreclosure Suits on Principal Residences*).

should pursue a suit to foreclose a lien on a residence only when it has considered hardship issues and there are no reasonable administrative remedies.

ANALYSIS OF LITIGATED CASES

We reviewed 33 opinions issued between June 1, 2012 and May 31, 2013 that involved civil actions to enforce federal tax liens. Table 9 in Appendix III contains a detailed list of those cases. Fifty-five percent of the taxpayers appeared *pro se* and 45 percent were represented. Taxpayers with representation received full relief in two cases and partial relief in one case. No *pro se* taxpayer received relief in any of the opinions reviewed.

In *United States v. Marciello*, the IRS had referred the suit to foreclose to the DOJ under IRC § 7403. The court applied the *Rodgers* factors to deny the government's motion for summary judgment with respect to property owned by the taxpayer and his estranged wife.¹⁹ The court noted that the forced sale of the taxpayer's marital home could foreseeably cause the taxpayer's 65-year-old wife significant emotional distress and detriment stemming from dislocation. Although the court felt some of the factors might weigh in favor of the government, it concluded the taxpayer's wife raised a genuine factual issue regarding the proper evaluation of the remaining *Rodgers* factors, and denied the government's motion for summary judgment with respect to the marital home.

In determining the appropriateness of foreclosure, the courts frequently consider whether a transfer of the property to another party extinguished the federal tax lien. For example, in *United States v. Dickert*, the taxpayer failed to file an income tax return for the 1999 tax year.²⁰ Based on information provided by third parties, the IRS computed the taxpayer's tax liability and sent the taxpayer a statutory notice of deficiency (SNOD) proposing an assessment. The taxpayer did not file a Tax Court petition or otherwise respond to the SNOD; thus, the liabilities proposed in the SNOD were assessed. After the assessment, but before a notice of federal tax lien (NFTL) was filed, the taxpayer transferred real property to a third party who did not pay full or give adequate consideration. Based on these facts, the court determined that the government had demonstrated it properly assessed the liabilities after notice and demand for payment, these liabilities remained unpaid, and a federal lien tax arose upon assessment that attached to all the taxpayer's property, including the property transferred to the third party.²¹ The court found that because the third party did not qualify as a "purchaser" under 26 U.S.C. § 6323(h)(6), the tax lien remained on the property and thus was subject to foreclosure.²²

In *United States v. Aiello*,²³ the court considered whether it was appropriate to foreclose on property transferred to the taxpayer's wife after the IRC § 6321 tax lien arose and the IRS filed an NFTL. The court looked at whether the tax liabilities were assessed prior to or after transfer of title. Once it determined the

19 2013 U.S. Dist. LEXIS 43582 (D. Mass. 2013) *adopting* 2013 U.S. Dist. LEXIS 43589 (D. Mass. 2013). For an explanation of the *Rodgers* factors, see footnote 8, *supra*.

20 2012 U.S. Dist. LEXIS 187223 (N.D. Fla. 2012).

21 IRC § 6321. This lien that arises upon assessment and notice and demand for payment is known as the "secret lien" because its existence is generally known only by the IRS and the taxpayer.

22 If a taxpayer transfers property subject to a federal tax lien to a purchaser before the government files an NFTL, the lien no longer attaches and the purchaser acquires the property free of the lien. IRC § 6323(a). A purchaser is defined in the Code as a person who for adequate consideration acquires an interest (other than a lien or security interest) in property which is valid under local law against subsequent purchasers without actual notice. IRC § 6323(h)(6).

23 2013 U.S. Dist. LEXIS 77854 (E.D.N.Y. 2013).

liabilities were assessed prior to the transfer of property to the wife, the court found the tax lien remained on the property, notwithstanding the transfer.²⁴ Applying similar reasoning, the court in *United States v. Johnson* found that because the taxpayer transferred properties to his daughter after the IRC § 6321 lien arose and an NFTL was filed, the federal tax liens remained on the properties.²⁵

A number of the opinions involved foreclosure of federal tax liens against property titled in the name of a taxpayer's nominee or alter ego. A nominee is "one who holds bare legal title to property for the benefit of another."²⁶ Courts typically look at a number of factors to determine whether an entity is a nominee of a taxpayer, such as whether:

- The nominee paid no or inadequate consideration;
- The property was placed in the name of the nominee in anticipation of the tax debt or litigation;
- There is a close relationship between the transferor and the nominee;
- The parties to the transfer never recorded the conveyance;
- The transferor retained control; and
- The transferor continues to enjoy the benefits of property.²⁷

In *United States v. Smith*, the court held the revocable living trust set up by the taxpayer was the alter-ego/nominee of the taxpayer.²⁸ The court based this conclusion on the fact that the taxpayer admitted he owned the property held by the trust, had exclusive use of the subject properties, and personally paid the property expenses.

In *United States v. Zaccardi*, the taxpayer transferred title of his house to Grace Christian Fellowship, an entity that the government argued was not functionally a church but was simply the taxpayer's nominee.²⁹ The court agreed with the government, noting that the transfers of the home were made without exchange of money or other items of value.³⁰

The court in *United States v. Hopkins* reached a similar decision.³¹ The taxpayers established two trusts and a corporation and the husband, an emergency room physician, instructed his employers to send his compensation to one of these entities. After the taxes were assessed, the taxpayers transferred their residence and adjoining real property to one of these entities and acquired new properties in the name of one of these entities. After noting that the taxpayers themselves were the chief officers of these entities, the court held that these trusts and corporations were the nominees of the taxpayers and thus ordered the foreclosure of the tax liens on the properties held by the nominee entities.³²

24 2013 U.S. Dist. LEXIS 77854 (E.D.N.Y. 2013).

25 111 A.F.T.R.2d (RIA) 1551 (S.D. Tex. 2013).

26 *U.S. v. Smith*, 109 A.F.T.R.2d (RIA) 2359 (W.D. Wash. 2012) quoting *Scoville v. U.S.*, 250 F.3d 1198, 1202 (8th Cir. 2001).

27 *Id.*

28 *Id.*

29 110 A.F.T.R.2d (RIA) 6679 (D. Utah 2012).

30 *Id.*

31 2013-1 U.S.T.C. (CCH) ¶ 50,218 (D.N.M. 2013).

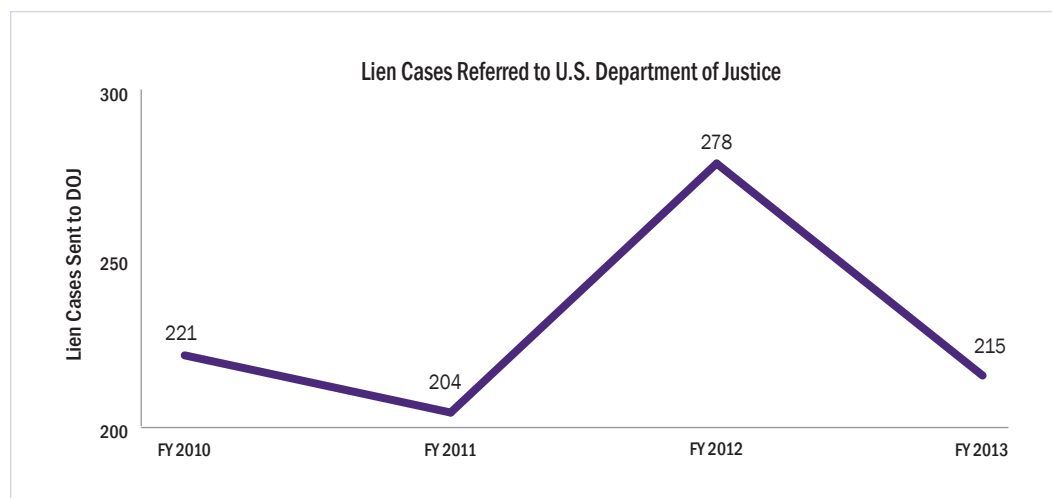
32 2013-1 U.S.T.C. (CCH) ¶ 50,218 (D.N.M. 2013).

CONCLUSION

In the 2012 Annual Report to Congress, we predicted that we might see more court opinions involving lien enforcement in the coming years due to an increase of cases referred to the Department of Justice by the IRS.³³ While we did not find that outcome this year, factors such as delays in litigation or settlement prior to trial may have contributed to the smaller number of court opinions this year and a spike in cases may be seen in coming years.

Figure 3.9.1 below shows the number of cases referred to the DOJ by fiscal year.³⁴

FIGURE 3.9.1, Lien Cases Referred to U.S. Department of Justice by Year, FY 2010–2013



More importantly, the National Taxpayer Advocate and her staff raised concerns about inadequate protections for taxpayers in lien enforcement mechanisms, as evidenced in specific cases open in the Taxpayer Advocate Service. With the issuance of interim guidance clarifying when the IRS should seek to refer a foreclosure case to the Department of Justice, referrals of cases may decrease in coming years and we may then see a further decline in court opinions on lien enforcement.

³³ National Taxpayer Advocate 2012 Annual Report to Congress 639.

³⁴ Department of Justice (DOJ), Tax Division, *Suits to Foreclose Tax Lien - Summary by Fiscal Year of Case Receipt* (Oct. 3, 2012) and Department of Justice (DOJ), Tax Division, *Suits to Foreclose Tax Lien - Summary by Fiscal Year of Case Receipt* (Oct. 18, 2013).