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#7**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 44 opinions issued between June 1, 2014, and May 31, 2015, that involved civil actions to enforce liens under IRC § 7403. The IRS prevailed in 40 of these cases. The total number of cases represents an approximate 15 percent decrease from the previous year.<sup>1</sup>

**TAXPAYER RIGHTS IMPACTED<sup>2</sup>**

- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to Finality*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

**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.<sup>3</sup> All parties having liens on or otherwise claiming interest in the relevant property shall be made parties to the action.<sup>4</sup> The law of the state where the property is located determines the nature of a taxpayer's legal interest in the property.<sup>5</sup> 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.<sup>6</sup>

The court may order an officer of the court to sell the property and apply the proceeds to the delinquent tax liability.<sup>7</sup> 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.<sup>8</sup> 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;

1 National Taxpayer Advocate 2014 Annual Report to Congress 503.

2 See Taxpayer Bill of Rights, available at [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights).

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

4 IRC § 7403(b).

5 *U.S. v. Nat'l Bank of Commerce*, 472 U.S. 713, 722 (1985).

6 *U.S. v. Rodgers*, 461 U.S. 677 (1983).

7 IRC § 7403(c).

8 461 U.S. 677 (1983).

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.<sup>9</sup>

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.<sup>10</sup> 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.<sup>11</sup>

The United States may also remove the case to a U.S. District Court if the case was initiated in a state court.<sup>12</sup> 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.<sup>13</sup> The IRC 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, to appoint a receiver with all powers of a receiver in equity to preserve and operate the property prior to the sale.<sup>14</sup>

In 2015, the IRS issued an updated Internal Revenue Manual (IRM) incorporating the interim guidance detailing the procedures the IRS should use when referring cases to the Department of Justice (DOJ) when seeking to recommend a suit to foreclose on a taxpayer's principal residence.<sup>15</sup> 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).<sup>16</sup>

9 461 U.S. 677 (1983) at 709-11.

10 IRC § 7403(c).

11 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. Under 28 U.S.C. § 2410, the United States may be named a party in any civil action or suit in any district court, or in any state court having jurisdiction of the subject matter. IRC § 7424.

12 28 U.S.C. § 1444.

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

14 IRC §§ 7403(d) and 7402(a).

15 IRM 5.17.4.8.2.5, *Lien Foreclosure on a Principal Residence* (Mar. 30, 2015). This updated IRM 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 DOJ. 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 whether 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 537-43 (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 an Internal Guidance Memorandum. See IRS Interim Guidance Memorandum SBSE-0413-035 (Apr. 30, 2013). This guidance was later reissued in IRS Interim Guidance Memorandum SBSE-0414-0032 (Apr. 18, 2014).

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

Prior to the interim guidance, IRM provisions related to referring a case to the DOJ for administrative seizure of a principal residence under IRC § 6334(e)(1) required the IRS to consider who is living in the residence and to verify if economic hardship currently exists (or would be created by the seizure) in determining whether referral was appropriate, but not if the IRS was referring the matter to the DOJ for a foreclosure suit under IRC § 7403.<sup>17</sup> The updated IRM states that the IRS would refer a case to DOJ to pursue a suit to foreclose only when there are no reasonable administrative remedies and hardship issues. The IRM now requires the suit recommendation narrative to contain the results of the following actions:

- Attempt to personally contact the taxpayer and inform them that a suit to foreclose the tax lien on the principal residence is the next planned action;
- Attempt to identify the occupants of the principal residence;
- Discuss administrative remedies with the taxpayer such as an offer in compromise (including Effective Tax Administration offer or an offer with consideration of special circumstances);
- Advise the taxpayer about TAS, provide Form 911, *Request for Taxpayer Advocate Assistance (and Application for Taxpayer Assistance Order)*, and explain its provisions;<sup>18</sup> and
- Include a summary statement in the case history, along with the information on the taxpayer and the occupants of the principal residence including children.<sup>19</sup>

## ANALYSIS OF LITIGATED CASES

We reviewed 44 opinions issued between June 1, 2014, and May 31, 2015 that involved civil actions to enforce federal tax liens. Table 7 in Appendix 3 contains a detailed list of those cases. Forty-one percent of the taxpayers appeared *pro se*, and 59 percent were represented. Taxpayers with representation received full relief in three cases and partial relief in one case. *Pro se* taxpayers did not receive full or partial relief in any cases.

### Foreclosure of Tax Liens Against Property With Non-Liable Spouse

In *Cardaci v. United States*,<sup>20</sup> a husband and wife purchased a residence as joint tenants by the entirety in 1978. The home was the only real property owned by the taxpayers (Mr. and Mrs. Cardaci) and had been their marital residence since the purchase. The United States filed suit to foreclose the tax lien on the taxpayers' residence to satisfy, in whole or in part, the taxes assessed against Mr. Cardaci for unpaid employment taxes his business owed. Mr. Cardaci's business had failed to remit withheld payroll taxes to the IRS for tax year 2000 and one-quarter of tax year 2001 while simultaneously paying its employees and suppliers.

The court held a bench trial to determine if it should exercise its discretion and declined to order the foreclosure sale of the residence. Since the wife was a non-liable third party, the court applied the *Rodgers* factors to determine whether foreclosure of the tax lien on the residence was appropriate.<sup>21</sup> The court

17 Cf. IRM 5.10.2.18(5) (Aug. 4, 2015), IRM 5.10.2.19(1) 5.10.2.19(1) (Aug. 4, 2014) and IRM 5.17.4.8.2.5, *Lien Foreclosure on a Principal Residence* (Mar. 30, 2015).

18 If the taxpayer indicates that the planned foreclosure of the principal residence would create a hardship, the Revenue Officer (RO) is instructed to assist the taxpayer with the preparation of Form 911 and should forward the form to the local TAS office if the RO cannot or will not provide the requested relief.

19 IRM 5.17.4.8.2.5, *Lien Foreclosure on a Principal Residence* (Mar. 30, 2015).

20 114 A.F.T.R.2d (RIA) 6744 (D.N.J. 2014), *appeal docketed*, No. 14-4237 (3d Cir. Oct. 27, 2014).

21 *Id.* For discussion of the *Rodgers* factors, see Present Law section, *supra*.

considered all factors and found that the factor concerning the value of liable and non-liable interests weighed substantially in favor of not forcing a sale of the property.

The government argued Mr. and Mrs. Cardaci's interests in the property were equal (50/50) because they both were roughly the same in age and owned a half interest. The court rejected that argument and instead found the valuation was more complicated as it had to take into account the value of Mrs. Cardaci's right to survivorship. The court reasoned that the Cardacis owned the property as tenants by the entirety, and as such, each spouse was a tenant in common with the other spouse during the joint lives of the couple. A forced sale would sever the tenancy much like a divorce decree or voluntary sale. However, in such situations, the division of the proceeds would occur after the spouses freely surrendered their survivorship interest. In this case the tenancy had not yet been severed, and Mrs. Cardaci had not surrendered the equivalent of a life estate nor her right to withhold consent of the sale. Thus, the valuation of her interest was deemed more complicated than in a divorce case because it had to account for the value of her survivorship interest. Accordingly, the court agreed that Mrs. Cardaci's right of survivorship had value and determined that the government would only be entitled to 14 percent of the sale price of the home, amounting to only a little over \$14,000 for the government after expenses.<sup>22</sup> The court further determined that this result would be nominal compared to Mr. Cardaci's tax debt of over \$80,000. It ordered the Cardacis to pay one-half of the fair market rental value of their home every month until the tax debt was satisfied. In the event that Mr. Cardaci survives Mrs. Cardaci, the court held that the government could then seek the forced sale of the residence to satisfy any remaining portion of the tax debt.<sup>23</sup>

In *United States v. Baker*,<sup>24</sup> the United States filed suit to foreclose tax liens on two parcels of land located in New Hampshire to satisfy in part the delinquent tax liabilities of the taxpayer, Scott Baker. The taxpayer married Robin Baker in 1998. In 2000, the taxpayer and his wife purchased the property the government sought to foreclose as joint tenants with the rights of survivorship. In 2008, the couple divorced. Pursuant to the divorce judgment, the taxpayer's wife was awarded the properties in question. The divorce judgment required the judgment and deed transferring the properties be recorded. However, neither the taxpayer nor the taxpayer's wife ever recorded the deeds or the judgment. In 2009, the IRS made assessments against the taxpayer and filed a Notice of Federal Tax Lien.

The government argued in the foreclosure proceeding that the tax lien for the taxpayer's liabilities attached to the properties that the wife, a non-liable third party, received pursuant to the divorce. The government claimed that its tax liens are "entitled to priority over the divorce judgment because neither the judgment nor any related deed was ever recorded."<sup>25</sup>

The court applied New Hampshire state law which provides that an undivided interest in real estate, apportioned by a divorce judgment, vests in the grantee spouse "by the mere force of the decree."<sup>26</sup> Thus, the court ruled against the government holding that the taxpayer had no rights to the properties to which the tax lien could attach. The court found that the taxpayer lost his right to own, transfer, or encumber the properties when the divorce judgment became final.

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22 *U.S. v. Cardaci*, 114 A.F.T.R.2d (RIA) 6744 (D.N.J. 2014), *appeal docketed*, No. 14-4237 (3d Cir. Oct. 27, 2014).

23 *Id.*

24 *U.S. v. Baker*, 114 A.F.T.R.2d (RIA) 5772 (D.N.H. 2014).

25 *Id.*

26 The *Baker* court cited *Swett v. Swett*, 49 N.H. 264, 264 (1870) (quoting *Whittier v. Whittier*, 31 N.H. 452, 458-59 (1855)).

### Foreclosure of Tax Liens Against Property Held by a Taxpayer's Nominee or Alter Ego

At least 13 opinions identified this year 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.”<sup>27</sup> 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 possession (or control); and
- The transferor continues to enjoy the benefits of property.<sup>28</sup>

For example, in *United States v. Jones*,<sup>29</sup> the court held the trust set up by the taxpayer was the nominee of the taxpayer. The court based this conclusion on the fact that the taxpayer admitted he had “full use, enjoyment, and control over the subject property,” which included residing there, renting out the property and receiving the rents, and paying all utilities and taxes associated with the property.<sup>30</sup> Since Jones’ transfer to the trust was invalid because the trust served as the taxpayer’s nominee, the court found the title to the property was in the name of the taxpayer, and therefore, the United States was entitled to foreclose its lien on the property.

In *United States v. O’Shea*,<sup>31</sup> the court determined that married taxpayers who had dealings with a trust promoter convicted of tax evasion crimes held their properties in sham trusts. The court considered the totality of circumstances, finding that the taxpayers exercised control over the parcels of land when the properties were held by the trusts.

The factors weighing in favor of a determination of control were the inadequate consideration received for the conveyance of the property and the taxpayers continuing to enjoy the benefits of ownership, including using the properties for their residence and their business and paying all the property expenses. As the property was held by nominees or alter egos of the taxpayers, the United States was entitled to foreclose on the four parcels of land. The court ordered the sham trusts be set aside and disregarded for tax purposes. In a subsequent appeal of this case, the U.S. Court of Appeals for the 4th Circuit affirmed the U.S. District Court for the Southern District of West Virginia in favor of the government.<sup>32</sup>

## CONCLUSION

In the 2012 Annual Report to Congress, we anticipated an increase in court opinions involving lien enforcement in the coming years because the number of cases IRS referred to the DOJ spiked from 204

27 BLACK’S LAW DICTIONARY (10th ed. 2014), available at <http://westlaw.com>. See also *U.S. v. Sabby*, 113 A.F.T.R.2d (RIA) 1335 (D. Minn. 2014) (quoting *Scoville v. U.S.*, 250 F.3d 1198, 1202 (8th Cir. 2001)).

28 See, e.g., *U.S. v. Jones*, 114 A.F.T.R.2d (RIA) 6126 (D. Wyo. 2014) (quoting *Holman v. U.S.*, 505 F.3d 1060, 1065 (10th Cir. 2007)); *U.S. v. Sabby*, 113 A.F.T.R.2d (RIA) 1335 (D. Minn. 2014) (quoting *Scoville v. U.S.*, 250 F.3d 1198, 1202 (8th Cir. 2001)).

29 114 A.F.T.R.2d (RIA) 6126 (D. Wyo. 2014).

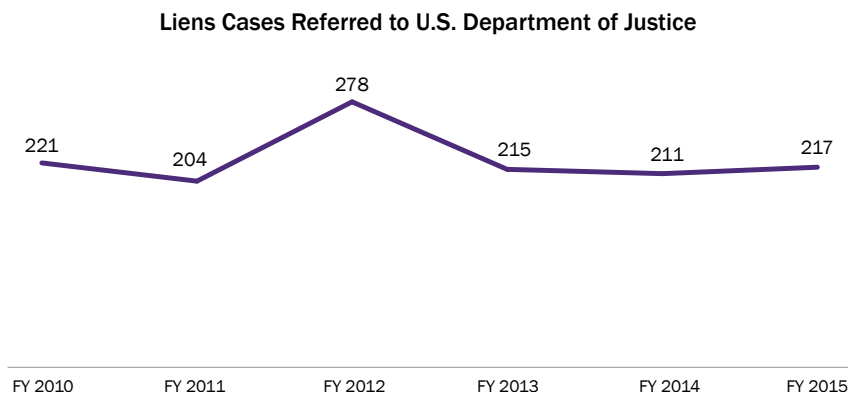
30 *Id.*

31 *U.S. v. O’Shea*, 115 A.F.T.R.2d (RIA) 887 (S.D.W. Va. 2015), *aff’d* by 116 A.F.T.R.2d (RIA) 5389 (4th Cir. 2015).

32 *U.S. v. O’Shea*, 116 A.F.T.R.2d (RIA) 5389 (4th Cir. 2015).

in fiscal year (FY) 2011 to 278 in FY 2012.<sup>33</sup> While there was a marked increase in lien enforcement opinions issued in reporting year 2014, from 33 in 2013 to 52 in 2014, the number of opinions issued this year fell to 44.<sup>34</sup> It is unclear whether the 2014 increase in the number of litigated cases was directly related to a greater number of cases referred to DOJ in FY 2012. The number of referrals decreased to 215 in FY 2013, and slightly fluctuated thereafter, with 211 cases referred in FY 2014 and 217 in FY 2015, as shown on Figure 3.7.1 below.<sup>35</sup>

**FIGURE 3.7.1, The Number of Cases Referred to the DOJ by Fiscal Year.**<sup>36</sup>



The National Taxpayer Advocate anticipates the updated IRM will have a positive effect on taxpayer rights in future years, as the IRS refers fewer suits to foreclose tax liens on taxpayers undergoing a hardship or in situations where there are reasonable alternatives. The National Taxpayer Advocate continues to recommend that Congress adopt the previous legislative recommendation to codify the approach used in the IRM.<sup>37</sup>

To address taxpayer burden and enhance the taxpayer *rights to privacy, to a fair and just tax system, and to appeal an IRS's decision in an independent forum*, the National Taxpayer Advocate has also recommended that Congress amend IRC §§ 6320 and 6330 to extend Collection Due Process rights to “affected third parties,” known as nominees, alter egos, and transferees, who hold legal title to property subject to IRS collection actions.<sup>38</sup> Such cases represented about 30 percent (13 of 44) of lien cases seen in this reporting period.

<sup>33</sup> National Taxpayer Advocate 2012 Annual Report to Congress 639.

<sup>34</sup> There were 48 opinions issues in 2012. National Taxpayer Advocate 2012 Annual Report to Congress 634.

<sup>35</sup> National Taxpayer Advocate 2014 Annual Report to Congress 508 (FY 2010 to FY 2013). DOJ Tax Division, *Suits to Foreclose Tax Lien – Summary by Fiscal Year of Case Receipt* (Oct. 2014), and DOJ Tax Division, *Suits to Foreclose Tax Lien – Summary by Fiscal Year of Case Receipt* (Oct. 2015).

<sup>36</sup> *Id.*

<sup>37</sup> The National Taxpayer Advocate recommended 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 537-43 (Legislative Recommendation: *Amend IRC § 7403 to Provide Taxpayer Protections Before Lien Foreclosure Suits on Principal Residences*).

<sup>38</sup> National Taxpayer Advocate 2012 Annual Report to Congress 544-52 (Legislative Recommendation: *Amend IRC §§ 6320 and 6330 to Provide Collection Due Process Rights to Third Parties (Known as Nominees, Alter Egos, and Transferees) Holding Legal Title to Property Subject to IRS Collection Actions*).