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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 to subject any of the delinquent taxpayer's property to the payment of tax. We identified 32 opinions issued between June 1, 2015, and May 31, 2016 that involved civil actions to enforce liens under IRC § 7403. The IRS prevailed in 30 of these cases. One case was a split decision. The total number of cases represents approximately a 27 percent decrease from the previous year.<sup>1</sup> This is the second consecutive year that the number of lien enforcement cases decreased. The number of cases dropped by approximately 15 percent in the 2015 reporting period compared to the number of cases in 2014.

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

- *The Right to Appeal the 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**

Internal Revenue Code (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> When the United States files a complaint in the United States District Court to enforce a lien under IRC § 7403, it is required to name all parties having liens on or otherwise claiming interest in the relevant property as 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, once it is determined that the taxpayer has an interest under state law in the property, federal law controls whether the property is exempt from attachment of the lien.<sup>6</sup>

IRC § 7403(c) directs the court to “finally determine the merits of all claims to and liens upon the property,” and if the United States proves a claim or interest, the court may order an officer of the court to sell the property and distribute the proceeds in accordance with the court's findings with respect to the interests of the parties, including the United States' claim for the delinquent tax liability.<sup>7</sup> Ordering

1 National Taxpayer Advocate 2015 Annual Report to Congress 509.

2 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

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, 683 (1983).

7 IRC § 7403(c).

the sale of a taxpayer's property is a powerful collection tool and directly affects any parties who have an interest in the property subject to sale. Based on the Supreme Court case *United States v. Rodgers*, however, the court is not required to authorize a forced sale and may exercise limited equitable discretion. Under *Rogers*, when a forced sale involves the interests of a third party who does not have a federal tax debt, the court should consider the following four factors 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.<sup>8</sup>

In cases where the United States holds a first priority lien, it may offer bids at the sale of the foreclosed property, up to an amount equal to the amount of the lien, plus selling expenses.<sup>9</sup> If a foreclosure action is initiated by another creditor, then IRC § 7403(c) authorizes the United States to intervene in the action to assert any lien on the property that is the subject of such action.<sup>10</sup>

If the case was initiated in a state court, the United States may remove the case to a U.S. District Court.<sup>11</sup> However, if the foreclosure action is adjudicated under state court proceedings, federal tax liens that are junior to other creditors may be effectively removed, even if the United States is not a party to the proceeding.<sup>12</sup> While the action is pending, the court may appoint a receiver empowered in equity to preserve and operate the property prior to the sale, upon the government's certification that it is in the public interest.<sup>13</sup>

For the Department of Justice (DOJ) to file the foreclosure suit, the IRS must first request that DOJ take such action.<sup>14</sup> The Internal Revenue Manual (IRM) provides procedures with respect to what actions the IRS must take before requesting that the DOJ commence a foreclosure proceeding.<sup>15</sup> With respect to a recommendation to foreclose on a taxpayer's principal residence, there are special procedures that the IRS

<sup>8</sup> *Rogers*, 461 U.S. at 709-11.

<sup>9</sup> IRC § 7403(c).

<sup>10</sup> 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.

<sup>11</sup> 28 U.S.C. § 1444.

<sup>12</sup> *U.S. v. Brosnan*, 363 U.S. 237 (1960).

<sup>13</sup> IRC §§ 7403(d) and 7402(a).

<sup>14</sup> IRC § 7401. The IRS prepares a suit recommendation package, and then the IRS Office of Chief Counsel reviews it, and if it agrees sends a letter to the DOJ asking the DOJ to commence the litigation. Chief Counsel Directives Manual, 34.6.1.1.1, *Steps Prior to Litigation*, (Oct. 7, 2015).

<sup>15</sup> Internal Revenue Manual (IRM) 5.17.4.8, *Foreclosure of Federal Tax Lien*, (Aug. 1, 2010).

must follow before initiating a referral to DOJ.<sup>16</sup> The IRM instructs the IRS to refer a case to DOJ to pursue a suit to foreclose only when there are no reasonable administrative remedies and hardship issues. Under IRM procedures, the IRS is required to take the following actions and describe the results in a suit recommendation narrative that accompanies the referral:

- 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;
- Attempt to 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), when appropriate;
- Advise the taxpayer about TAS, provide Form 911, *Request for Taxpayer Advocate Assistance (and Application for Taxpayer Assistance Order)*, and explain its provisions;<sup>17</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>18</sup>

## ANALYSIS OF LITIGATED CASES

We reviewed 32 opinions issued between June 1, 2015, and May 31, 2016, that involved civil actions to enforce federal tax liens. Table 7 in Appendix 3 contains a detailed list of those cases. Fifty-six percent of the taxpayers appeared *pro se* and 44 percent were represented. Taxpayers with representation received partial relief in one case. Generally, *pro se* taxpayers did not fare well and only one received full relief.

### Foreclosure of Tax Liens Where Non-Liable Taxpayer Had Interest in Property

In *United States v. Staton*,<sup>19</sup> the United States filed suit to foreclose on a residence located in Hawaii to satisfy in part the delinquent tax liabilities of Ronald Staton. Mr. Staton owned the residence with his wife, Brenda Staton, as tenants by the entirety.

Since Mrs. Staton was a non-liable third party, the court examined the *Rodgers* factors to determine whether foreclosure of the tax liens would unduly harm Mrs. Staton.<sup>20</sup> The court considered all the *Rodgers* factors and found that they favored the United States' foreclosure action, and thus, the court found

16 IRM 5.17.4.8.2.5, *Lien Foreclosure on a Principal Residence* (Jan. 8, 2016). In 2012, TAS issued an Advocacy Proposal to the IRS 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 DOJ 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, TAS worked closely with the IRS to develop an Internal Guidance Memorandum (IGM) to address the issues raised by the National Taxpayer Advocate. Prior to the release of the IGM in 2013, the IRM provisions relating to referring cases under § 6334(e)(1) required the IRS to consider who is living in the residence in determining whether referral to DOJ was appropriate but the procedures under § 7403 did not.

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

18 IRM 5.17.4.8.2.5, *Lien Foreclosure on a Principal Residence* (Jan. 8, 2016).

19 *U.S. v. Staton*, 116 A.F.T.R.2d (RIA) 5947 (D. Haw. 2015).

20 *U.S. v. Staton*, 116 A.F.T.R.2d (RIA) 5947 (D. Haw. 2015). For discussion of the *Rodgers* factors, see Present Law section, *supra*.

the entry of an order of foreclosure appropriate.<sup>21</sup> As part of the *Rodgers* analysis, the court considered Mrs. Staton's one-half interest in the residence.<sup>22</sup> The first factor, economic prejudice to the government, favored the foreclosure sale because a sale of a partial interest in the single-family property located on a single lot "would be impractical." Regarding the second factor, Mrs. Staton failed to present any authority that would shield her ownership interest from the sale. After "guess[ing] at her actual expectations as to her property rights," the court determined that she "could have no legally cognizable expectation that the residence could not be sold" to satisfy her husband's tax liabilities. Considering the third factor, the court concluded that there was no potential for unusual dislocation costs or undercompensation to Mrs. Staton. Finally, in regard to the fourth factor, since the ownership interest between liable and non-liable spouses was equivalent (*e.g.*, tenants by the entirety), the court determined that it weighed in favor of a foreclosure sale. The court acknowledged that the Statons were retired, and Mr. Staton had a health problem and that "the Court does not like to see people lose their homes." The court went on to say, however, that DOJ had been working with the Statons for almost three years to resolve the tax problem without the need for the sale and that if the Statons were successful in raising the funds necessary to pay the United States before the sale occurred, the court would immediately stop the sale.

### Impact of Lien Filing and Indexing on Validity of Federal Tax Liens

In *TPF Deeds, LLC v. United States*,<sup>23</sup> the IRS properly assessed taxes against the taxpayer, Ernest Hewlett, in 2004, and then from 2005 to 2009 recorded seven Notices of Federal Tax Liens in Wasatch County, Utah with respect to the outstanding tax liability. In 2006, Ernest Hewlett, along with his wife Colleen Hewlett and their son Michael, purchased real property in Wasatch County. Ernest Hewlett was a one-third owner of the property. When they purchased the property, the federal tax lien attached to Ernest Hewlett's interest. On the same day the property was purchased, it was conveyed to his daughter, Celeste Hewlett. In 2009, Celeste Hewlett financed the property through SourceOne Financial, Inc., which ordered a title report that identified no tax liens or any other exceptions. In less than a month, SourceOne assigned majority interest in the deed to TPF Deeds, LLC. When Celeste Hewlett defaulted on the loan, a nonjudicial foreclosure proceeding was instituted, and a Trustee's Deed was recorded in favor of SourceOne and TPF Deeds for their respective interests. The IRS was not given notice of the nonjudicial foreclosure action. SourceOne discovered there was a tax lien on the property when it tried to sell its interest to a potential buyer and that party's title report showed a Notice of Federal Tax Lien (NFTL) having been filed for the tax liabilities of Ernest Hewlett.

The court found (upon a stipulation by the United States) that six of the seven liens were ineffective against the property.<sup>24</sup> However, the Court held that the lien relating to Ernest Hewlett's tax year 1997 liabilities, for which an NFTL had been filed with the county's Recorder's Office on August 26, 2005, attached to the property and was superior to the plaintiffs' interest in the property. The court found that the lien attached to the property because it was created before Mr. Hewlett acquired a one-third interest in the property.

The court also found the IRS's NFTL filed on August 26, 2005, established a lien superior to the plaintiffs' because the IRS followed the two main requirements of IRC § 6323(f): (1) the filing of the lien in the proper place, and (2) in a proper manner so that a reasonable inspection will reveal it.

21 *U.S. v. Staton*, 116 A.F.T.R.2d (RIA) 5947 (D. Haw. 2015).

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

23 *TPF Deeds, LLC v. U. S.*, 138 F. Supp. 3d 1268 (D. Utah 2015).

24 The government conceded that only one lien, Lien No. 2, or the lien for unpaid federal income taxes for the 1997 tax year, had priority over lenders' interests in the subject property.

The plaintiffs argued that the filing of the NFTL did not satisfy the second prong because when they conducted their search, they did not locate the notice of tax lien filing; hence, it was not filed in a manner so a reasonable inspection would reveal it.<sup>25</sup> The plaintiffs argued that it was not filed in the proper manner because when the plaintiffs searched the taxpayer's full name "Ernest Hewlett" and "Hewlett, Ernest" in the county records, they came up with no results. However, the court pointed out that merely searching Hewlett, or not using commas and quotation marks when searching the taxpayer's full name, yielded results that show that the IRS had filed a NFTL. The court found that the lien was properly recorded so that a reasonable inspection would reveal it and thus had priority over lenders' interests in the subject property.<sup>26</sup>

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

The number of opinions that involved foreclosure of federal tax liens against property titled in the name of a taxpayer's nominee or alter ego showed a slight increase over last year, with 14 in 2016, compared to 13 in 2015. A nominee is one "who holds bare legal title to property for the benefit of another."<sup>27</sup> Courts typically look at the following factors to assess whether an entity is a nominee of a taxpayer:

- 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 while the transferor retained control;
- There is a close relationship between the transferor and the nominee;
- The parties to the transfer failed to record the conveyance;
- The transferor retained possession (or control); and
- The transferor continues to enjoy the benefits of property.<sup>28</sup>

Courts have also noted that an additional factor to consider is whose funds were used for the purchase of real property.<sup>29</sup> However, the courts have held that no single factor is determinative.<sup>30</sup> In *United States v. Sollenberger*,<sup>31</sup> the court held that several companies set up by members of the Sollenberger family as part of an "asset protection strategy" were merely nominees over which the taxpayers exercised control or alternatively, the entity was a successor of one of the taxpayers.<sup>32</sup> The court also set aside sham mortgage deeds held by the taxpayers over several properties. Since the entities were merely nominees, the court held that the government's liens validly attached to the properties.<sup>33</sup>

25 IRC § 6323(f)(4).

26 The court also rejected the plaintiffs' equitable subordination argument.

27 *Nominee*, BLACK'S LAW DICTIONARY (10th ed. 2014). See also *U.S. v. Beeman*, 108 A.F.T.R.2d (RIA) 5074 (W.D. Penn. 2011).

28 See, e.g., *U.S. v. Sollenberger*, 150 F. Supp.3d 393, 401 - 02 (M.D. Pa. 2015) (citing *U.S. v. Klimek*, 952 F.Supp. 110, 1113 (E.D. PA 1997)); 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)).

29 *U.S. v. Sollenberger*, 150 F. Supp.3d 393, 402 (M.D. Pa. 2015) (citing *Nobel v. Morchesky*, 697 F.2d 97, 103 (3rd Cr. 1982)).

30 *U.S. v. Sollenberger*, 150 F. Supp.3d, 393, 402 (citing *In re: Richards*, 23 B.R.571, 579 (E.D. Pa. 1999)).

31 *U.S. v. Sollenberger*, 150 F. Supp.3d 393 (M.D. Pa. 2015).

32 *U.S. v. Sollenberger*, 150 F. Supp.3d 393 (M.D. Pa. 2015).

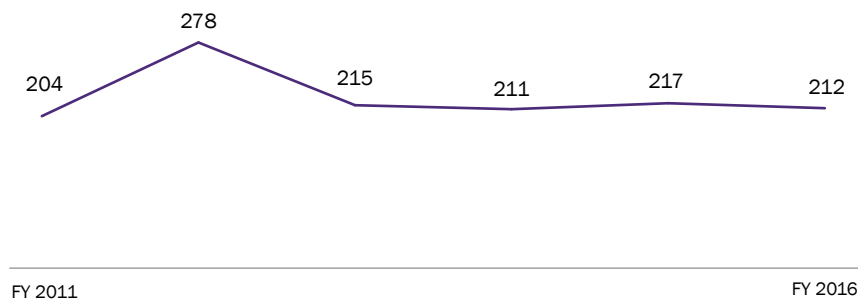
33 *U.S. v. Sollenberger*, 150 F. Supp.3d 393 (M.D. Pa. 2015).

## CONCLUSION

As noted above, this was the second consecutive year that the number of lien enforcement cases decreased. The number of cases dropped by approximately 15 percent from 2014 to 2015 and approximately 27 percent in the past year. It is unclear whether the decrease in the number of litigated cases was directly related to the changes the IRS made in its principal residence referral to DOJ procedures that were instituted in 2013, but with a second consecutive year of decreasing DOJ referrals, the changes seem to have had a positive effect on enforcing taxpayer rights. The number of referrals decreased to 215 in fiscal year (FY) 2013, and slightly fluctuated thereafter, with 211 cases referred in FY 2014, 217 cases referred in FY 2015, and 212 cases referred in FY 2016, as shown in Figure 3.7.1.<sup>34</sup>

**FIGURE 3.7.1**

### Liens Cases Referred to U.S. Department of Justice



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 legislative recommendation to codify the approach used in the IRM so it cannot be reversed administratively.<sup>35</sup>

To address taxpayer burden and enhance the taxpayer *rights to privacy, to a fair and just tax system, and to appeal the 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>36</sup> Nominee cases represented about 42 percent (14 of 33) of lien cases seen in this reporting period.

34 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).

35 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*).

36 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*).