

MLI
#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. Therefore, lien enforcement cases are different from cases described in other Most Litigated Issues because it is always the government, rather than the taxpayer, initiating the litigation. We identified 60 opinions issued between June 1, 2016, and May 31, 2017 that involved civil actions to enforce liens under IRC § 7403.¹ The IRS prevailed in 58 of these cases, a taxpayer prevailed in one case, and one case resulted in a split decision.

TAXPAYER RIGHTS IMPACTED²

- *The Right to Privacy*
- *The Right to Finality*
- *The Right to Appeal the IRS Decision in an Independent Forum*
- *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.³ 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.⁴ The law of the state where the property is located determines the nature of a taxpayer's legal interest in the property.⁵ 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.⁶

1 In our 2016 Annual Report to Congress, we identified 32 cases involving civil actions to enforce tax liens under Internal Revenue Code (IRC) § 7403. See National Taxpayer Advocate 2016 Annual Report to Congress 491. As we identified more lien enforcement cases this year than in the 2016 Annual Report, we revisited our case search criteria used to identify cases for this Most Litigated Issue and employed a more expansive search methodology using broader search terms to account for the fact that United States District Courts, which under IRC § 7403(a) have exclusive jurisdiction over lien enforcement actions, often do not cite to IRC § 7403 in case opinions. As a result, we identified a total of 50 lien enforcement cases for the 2016 reporting period. However, this increase in cases would not have materially changed the ranking of that Most Litigated Issue in the 2016 Annual Report to Congress.

2 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are now listed in the 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).

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.⁷ Ordering 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 *Rodgers*, 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.⁸

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.⁹ 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.¹⁰

If the case was initiated in a state court, the United States may remove the case to a U.S. District Court.¹¹ 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.¹² 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.¹³

For the Department of Justice (DOJ) to file the foreclosure suit, the IRS must first request that DOJ take such action.¹⁴ 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.¹⁵ With respect to a recommendation to foreclose on a taxpayer’s principal residence, there are special procedures

7 IRC § 7403(c).

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

9 IRC § 7403(c).

10 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.

11 28 U.S.C. § 1444.

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

13 IRC §§ 7403(d) and 7402(a).

14 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 Department of Justice (DOJ) asking the DOJ to commence the litigation. Chief Counsel Directives Manual, 34.6.1.1.1, *Steps Prior to Litigation* (Oct. 7, 2015).

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

that the IRS must follow before initiating a referral to DOJ.¹⁶ 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;¹⁷ 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.¹⁸

ANALYSIS OF LITIGATED CASES

We reviewed 60 opinions issued between June 1, 2016, and May 31, 2017, that involved civil actions to enforce federal tax liens. Table 7 in Appendix 3 contains a detailed list of those cases. Half of taxpayers (30 out of 60) in these cases appeared *pro se* while the other half were represented. Taxpayers with representation received relief in one case while another case resulted in a split decision. No *pro se* taxpayers obtained relief.

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

In *United States v. Cardaci*, the United States Court of Appeals for the Third Circuit considered an appeal by both the government and the taxpayers of a decision from the United States District Court for the District of New Jersey.¹⁹ The district court, in a decision discussed in our 2015 Annual Report to Congress, considered the *Rodgers* factors and concluded that because she possessed an 86 percent property interest, it would be inequitable to Mrs. Cardaci (the non-liable spouse) for the government

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 IRC § 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 IRC § 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. Cardaci*, 856 F.3d 267 (3d Cir. 2017) *aff'g in part, vacating in part, and remanding* 114 A.F.T.R.2d (RIA) 6744 (D.N.J. 2014).

to force a sale of Mr. and Mrs. Cardaci's jointly-owned marital home.²⁰ Instead, the court calculated a monthly rental value of the home and ordered Mr. Cardaci (the liable taxpayer) to make monthly rent payments of half the rental value to the government.

On appeal, the Third Circuit first considered the Cardaci's argument that the district court lacked the authority to consider the sale of the couple's home owned as tenants by the entirety. The appellate court dismissed this argument for two reasons. First, it found that the New Jersey statute which the Cardaci's claimed protected their home from a foreclosure sale did not apply to them as they had purchased their home ten years before it took effect. Second, and more fundamentally, the court noted that regardless of the New Jersey statute, federal law controlled the enforcement of federal tax liens. The court cited the *Rodgers* case and pointed out that state law exemptions are "swept aside" by the Supremacy Clause of the Constitution. Therefore, the court found that the district court had properly held that the Cardaci's home was considered property subject to the federal tax lien statute.²¹

The appellate court then addressed the government's claim that the district court abused its discretion by not ordering the sale of the Cardaci's home. The court found that the district court had indeed erred in its *Rodgers* analysis but declined the government's request to reweigh the *Rodgers* factors and make a final decision. Instead, the Third Circuit vacated and remanded the case to the district court to recalculate the Cardaci's property interests and to reconsider the *Rodgers* factors. The court also provided "observations" regarding the *Rodgers* factors to assist the district court.²²

With respect to the first *Rodgers* factor, the prejudice to the government resulting from a partial sale, the court noted that the district court was mistaken in determining that the government would collect more taxes from receiving rental payments from Mr. Cardaci than it would from a foreclosure sale of the couple's property. Instead, the district court needed to focus on determining whether the government would be adequately compensated by a partial sale of Mr. Cardaci's interest in the property or whether a sale of the couple's entire property was necessary. The court noted that because there is no real market for partial interest in marital property held as tenants by the entirety due to a buyer of this interest becoming a tenant in common with the remaining spouse, this factor weighed in favor of a forced sale of the Cardaci's home.²³

With respect to the second *Rodgers* factor, the non-liable party's legally recognized expectation that the property would not be subject to a forced sale by the delinquent taxpayer or taxpayer's creditors, the court stated that this factor requires examination of state law property protections. The court stated, as mentioned above, that the New Jersey statute upon which the district court relied did not apply to the Cardaci's property because they purchased it ten years before the law took effect. The court noted that it was unclear whether New Jersey law favored a forced sale of the property and ordered the district court to consider applicable New Jersey law to determine Mrs. Cardaci's legally recognized expectations.²⁴

With respect to the third *Rodgers* factor, the likely prejudice to the third party in personal dislocation costs and inadequate compensation, the court agreed with the district court that Mrs. Cardaci did not face any special dislocation costs. However, it criticized the district court for failing to consider under

20 See National Taxpayer Advocate 2015 Annual Report to Congress 511.

21 *U.S. v. Cardaci*, 856 F.3d 267, 273-4 (3d Cir. 2017) *aff'g in part, vacating in part, and remanding* 114 A.F.T.R.2d (RIA) 6744 (D.N.J. 2014).

22 *Id.* at 274.

23 *Id.* at 275.

24 *Id.* at 275-6.

compensation that a forced sale might cause to Mrs. Cardaci. In particular, the court took issue with the district court's method of calculation of the Cardaci's respective interests in their home. The court stated that the district court needed to use joint-life actuarial tables to calculate both Mr. and Mrs. Cardaci's various interests (including their concurrent interest in the present value and varying interests in life estate and survivorship rights) in their property. The court also stated that if the district court employs this calculation method and finds that Mrs. Cardaci would be undercompensated, then that is an important fact to consider.²⁵

With respect to the fourth *Rodgers* factor, the relative character and value of the non-liable and liable interests in the property, the court noted that because the Cardaci's own approximately equivalent interests in the property, this factor appeared neutral. However, it stated that the district court would be in a better position to consider this fourth factor once it recalculated the Cardaci's respective interests in the property using the joint-life actuarial tables.²⁶

Finally, the court noted that the Supreme Court cautioned in *Rodgers* that the four equitable factors are not an exclusive list and there may be other equitable factors present. The court brushed aside the government's claim that the district court improperly considered whether a forced sale of the property would adversely impact the Cardaci's son, daughter-in-law, and their three children, who lived with them. The court left it to the district court to decide how these interests should be considered.²⁷

Preservation of Federal Tax Lien Against Subsequent Purchasers of Property

Under IRC § 7425, if the government has properly filed a notice of federal tax lien against a taxpayer and is not joined as a party to, or given notice of, a judicial sale of property to which the lien attached, then the federal tax lien remains attached to the property even after subsequent sales. In *United States v. Aikens*, the government sought to enforce federal tax liens on property formerly owned by the taxpayer.²⁸ The taxpayer had incurred tax liabilities for several years and the IRS had properly recorded notice of its tax liens for these liabilities in 2007, 2008, and 2010. The taxpayer had acquired title to the real property in question in 1998, and thus, the liens attached to the real property.²⁹

In 2013, J.P. Morgan Chase initiated a sheriff's foreclosure sale on the property without giving notice to the IRS. Pursuant to the sale, the property was conveyed to Citi Investments, LLC, which then sold it to an unrelated individual a year later.³⁰

The court noted that under IRC § 6321, the government has a lien against all property, whether real or personal, of a delinquent taxpayer. In addition, under IRC § 6322, the tax lien begins at the time of assessment and continues until the liability is satisfied or becomes unenforceable due to the lapse of time. Finally, and critical to this case, the court pointed out that under IRC § 7425, the government's tax lien is not extinguished by a property sale unless the government is joined as a party to the sale or given proper notice.³¹

25 *U.S. v. Cardaci*, 856 F.3d 267, 276-9 (3d Cir. 2017) *aff'g in part, vacating in part, and remanding* 114 A.F.T.R.2d (RIA) 6744 (D.N.J. 2014).

26 *Id.* at 279-80.

27 *Id.* at 280.

28 *U.S. v. Aikens*, 118 A.F.T.R.2d (RIA) 6369 (E.D. Mich. 2016).

29 *Id.*

30 *Id.*

31 *Id.*

The court reviewed the chronology of the case and found that the taxpayer held title to the property while he incurred the tax liabilities and when the IRS recorded its tax liens. The court also found that the IRS had not received notice of the 2013 foreclosure sale, thereby triggering the statutory protection of tax liens against all subsequent purchasers under IRC § 7425. Therefore, the court held that the government's tax lien was not extinguished by the sale of the property, and the government was entitled to enforce the lien against the property even though it was sold to a third party who may not have been aware of the lien.³²

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 15 cases in 2017, compared to 13 in 2016. A nominee is one "who holds bare legal title to property for the benefit of another."³³ 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.³⁴

In *United States v. Wilson*, the government sought to collect tax liabilities from the taxpayer by enforcing tax liens against two pieces of property, one in Holly, Michigan and the other in Carleton, Michigan.³⁵ Both properties were held by partnerships,³⁶ and the government, seeking summary judgment, argued that these partnerships were mere nominees of the taxpayer.

With respect to the Holly, Michigan property, the court analyzed the six factors described above to determine whether it was held by a nominee of the taxpayer. First, the court noted that the taxpayer testified that he quit claimed the property to a family limited partnership for no consideration. Second, the taxpayer transferred the property less than six months after the IRS raided his home and businesses and would have known that he would face litigation or liability for his unpaid taxes. Third, the court found that there was a close relationship between the taxpayer and the nominee as both he and his mother owned a partnership interest in the nominee entity. Upon his mother's passing, a trust bearing her name became owner of her partnership interest. The taxpayer and his wife served as trustees, and the taxpayer was designated as beneficiary of the trust.³⁷ The court found that these first three factors weighed in favor of the government.

32 *U.S. v. Aikens*, 118 A.F.T.R.2d (RIA) 6369 (E.D. Mich. 2016).

33 *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).

34 See, e.g., *U.S. v. Sanders*, 118 A.F.T.R.2d (RIA) 6219 (S.D. Ill. 2016), *aff'd* 676 F. App'x 599 (7th Cir. 2017). See also *Nassar Family Irrevocable Trust v. U.S.*, 118 A.F.T.R.2d (RIA) 6007 (S.D.N.Y. 2016), *aff'd*, 2017 WL 4708170 (2d Cir. 2017).

35 *U.S. v. Wilson*, 117 A.F.T.R.2d (RIA) 2002 (E.D. Mich. 2016).

36 The taxpayer, his wife, and his mother-in-law retained life estates in the Carleton property when transferring title to the partnership. *Id.*

37 *Id.*

Fourth, the court stated that the taxpayer recorded the conveyance of the property to the partnership, which would have weighed slightly in favor of the taxpayer. However, the court discounted this factor as it found that the fifth and sixth factors demonstrated that the property was indeed held by a nominee. The court noted that the taxpayer retained possession of the property and continued to enjoy the benefits of it, as the taxpayer and his wife lived there rent-free since 1998. Therefore, based on all these factors, the court found that the partnership holding title to the Holly, Michigan property was the taxpayer's nominee and granted the government's motion for summary judgment to enforce the tax lien against the Holly, Michigan property.³⁸

With respect to the Carleton, Michigan property, the court again analyzed the six factors to determine whether it was held by a nominee of the taxpayer. However, the court noted that these factors did not favor the government as strongly as they did with respect to the Holly, Michigan property. The court pointed out that the Carleton, Michigan property was owned by the taxpayer's in-laws since the 1960s. In 2001, they transferred the property to the taxpayer and his wife by quit claim deed but the taxpayer's mother-in-law retains a life estate in the property.³⁹

The court then discussed the six nominee factors. First, it noted that the taxpayer transferred the property to a family limited partnership for no consideration. Second, he transferred the property in 2005, after the IRS had assessed taxes against him. However, the court noted that the between two and five-year gap between these assessments, which occurred between 2000 and 2003 and the transfer of property to the partnership in 2005, did not support a close connection between the lawsuit or liability and the purpose of the transfer. In addition, the court pointed out that some of the taxpayer's liabilities were assessed in 2000, which is prior to the 2001 transfer of the property from the taxpayer's in-laws to the taxpayer and his wife. The court stated that if there was an intent to shield the property from the tax liabilities then the taxpayer's in-laws could have opted not to transfer it. Therefore, it found this factor neutral.⁴⁰

Third, the court noted that the alleged nominee partnership only had two partners, the taxpayer and his wife. Therefore, the court found that there was a close relationship between the taxpayer and the nominee and this weighed in favor of the government. Fourth, the court noted that the property transfer to the partnership was recorded, which weighed in favor of the taxpayer. Finally, the court found that the fifth and sixth factors also weighed in favor of the taxpayer. The court pointed out that the taxpayer did not live at the property and aside from a one percent interest in the partnership holding the property, there was no evidence that the taxpayer retained possession or exercised control over the property. The court also found no evidence that the taxpayer received a benefit from the property. After considering these factors, the court found that there were genuine issues of fact as to whether the partnership was a nominee of the taxpayer. Therefore, the court denied the government's motion for summary judgment to enforce the lien against the Carleton, Michigan property.⁴¹

38 *U.S. v. Wilson*, 117 A.F.T.R.2d (RIA) 2002 (E.D. Mich. 2016). The court also performed a *Rodgers* analysis and determined that it was not appropriate to exercise its discretion to prevent the sale of the property.

39 *Id.*

40 *Id.*

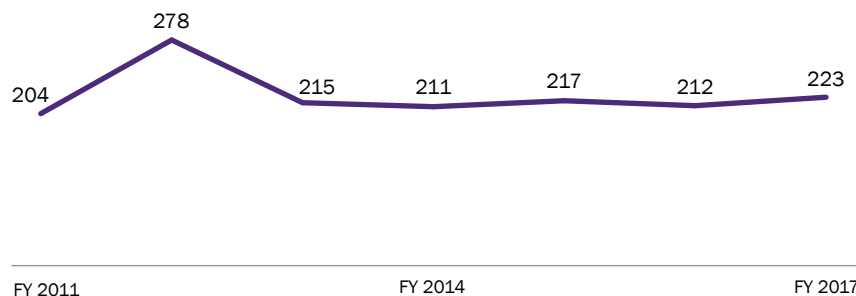
41 *Id.*

CONCLUSION

Lien enforcement cases continue to be a consistent source of litigation between the government and taxpayers. After peaking at 278 cases in 2012, the number of IRS lien enforcement referrals to the DOJ 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 2016.⁴² In FY 2017, this number increased slightly (by approximately five percent) to 223 cases, as shown in Figure 3.7.1.⁴³

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.⁴⁴ The National Taxpayer Advocate continues to urge Congress to adopt her 2012 recommendation to codify the approach used in the IRM so it cannot be reversed administratively.⁴⁵

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.⁴⁶ Nominee cases represented 25 percent (15 out of 60) of lien cases seen in this reporting period.

42 National Taxpayer Advocate 2016 Annual Report to Congress 496 (Fiscal Year (FY) 2010 to FY 2016).

43 DOJ Tax Division, *Suits to Foreclose Tax Lien – Summary by Fiscal Year of Case Receipt* (Oct. 2017).

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

45 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*).

46 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*).