



OFFICE OF  
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
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MEMORANDUM FOR ROCKY MOUNTAIN ASSOCIATE DISTRICT COUNSEL  
Attn: Mark H. Howard

FROM: Alan C. Levine  
Chief, Branch 1, General Litigation

SUBJECT:

ISSUE: Whether the Internal Revenue Service ("Service") should interplead the surplus proceeds from the redemption and sale of property or should the Service accept an assignment of the purported interest of the decedent's legitimate children in the surplus proceeds and pay the money to the surviving spouse?

CONCLUSION: The Service should interplead the money. The Service cannot rely on the assignment of the legitimate children's interest in the surplus proceeds because the decedent may have an illegitimate child. Although we have no reason to believe that an illegitimate child exists, state law provides that an illegitimate child has a property right in an intestate estate. To avoid the potential problem of injuring an illegitimate child's intestate interest, the money should be interplead with the state court, which will then resolve any claims to the money.

FACTS: At the time of the taxpayer's death, a junior federal tax lien encumbered the decedent's real property. In a will, the decedent left the real property to his former spouse, who never probated the will. <sup>1/</sup> Subsequently, a senior commercial lienor gave notice to the Service of a nonjudicial sale of the property, thereby extinguishing the tax lien but leaving the Service with the right of redemption.

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<sup>1/</sup> In your memorandum dated April 14, 1999, you explain that the ownership rights to the surplus proceeds are confusing because of conflicting state statutes.

I.R.C. § 7425(b) and (d). The Service then exercised its right of redemption, sold the property, and applied the sale proceeds to the decedent's tax liability, leaving surplus proceeds.

To resolve the ambiguity as to the ownership of the surplus proceeds, private counsel for the former spouse suggests that the legitimate children would be willing to assign any interest they may have to the former spouse. Thus, the Service could pay the former spouse under the theory either that the money has been assigned to her or that she is entitled to the surplus proceeds as the owner of the property.

#### LAW AND ANALYSIS:

I.R.C. § 6342(b) provides that surplus proceeds remaining after the Service's redemption shall be credited or refunded to the person or persons legally entitled to the money.

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Thus, under the  
common law, an illegitimate child had no claim against an intestate estate.  
The State however, has  
rejected this common law treatment of illegitimate children and has provided,  
instead, that all children—legitimate as well as illegitimate—have the right to inherit  
via intestacy.

Accordingly, even if the legitimate children assign whatever interest they have to the former spouse, we do not recommend that the Service remit the surplus proceeds to the former spouse because there may be an illegitimate child who has an intestate claim against the funds. The Service cannot determine with certainty that there is no illegitimate child. We recommend that the Service interplead the funds and let the court resolve the competing interests to the funds.

#### CASE DEVELOPMENT, HAZARDS, AND OTHER CONSIDERATIONS:

We can identify no other litigating hazards that would change or qualify the conclusions reached in this memorandum.

If you have any further questions, please call the branch at 202-622-3610.