Lesson 19

TRANSFEREE AND OTHER THIRD-PARTY LIABILITY

(March 2012)

CONTENTS

I. INTRODUCTION

The liability of the third party may stem from federal, state, or common law. Federal law imposes third party liability in situations involving the Trust Fund Recovery Penalty under section 6672 and lender liability under section 3505, which are discussed in detail in Lesson 15. Other situations in which federal law imposes third party liability include fiduciary liability under 31 U.S.C. § 3713(b), the liability of distributees of decedents' estates under section 6324(a), and the liability of donees under section 6324(b).

State transferee liability statutes and state common law doctrines may impose third party liability on transferees who receive property from a taxpayer without fair and adequate consideration. The Federal Debt Collection Procedures Act of 1990 ("FDCPA"), codified at 28 U.S.C. §§ 3001 et. seq., provides uniform federal collection procedures that complement the procedures of the various states. It also preempts any state law that is inconsistent with the Act. The Act provides transferee procedures at 28 U.S.C. §§ 3301-3308. The Service also encounters third-party liability in situations involving state statutes that govern corporate reorganizations, corporate dissolutions, and bulk sales transactions, as well as in situations involving liabilities that resulted from contractual obligations.

In advising Collection on the handling of cases involving third party liabilities, you must determine: (1) the facts giving rise to third-party liability or potential liability; (2) the source of the liability (e.g., a state or federal law); and (3) the procedures for imposing/collecting liability.

II. OBJECTIVES

At the end of this lesson you will know:

- The differences between I.R.C. §§ 6901 and 7402(a) and the procedural aspects of each section
- The requirements of the FDCPA as applied to transferees
- The different forms of fraudulent conveyances governed by the Uniform Fraudulent Conveyance Act (UFCA) and the Uniform Fraudulent Transfer Act (UFTA)
- The legal and factual characteristics of alter ego and nominee liability
- The application of CDP requirements to transferees, alter egos, and nominees
- The broad outlines of certain miscellaneous issues of third-party liability, specifically, collection of a taxpayer's liability from property held in a family trust or by churches or other religious organizations, and the nature of donee liability.

III. TRANSFEREE AND OTHER THIRD-PARTY LIABILITY

A. Examples of Tax and Non-Tax Debts Leading to Transferee and Third-Party Liability

The following is a list of examples of underlying debts for which a proceeding to impose transferee, fiduciary, or other third-party liability may be brought in district court. The list is not exhaustive, but instead illustrates an assortment of different liabilities for which a third-party may be liable.

1. Tax

a) A tax liability for which a deficiency notice was issued to the taxpayer and that is assessed against the taxpayer, or that is set forth in a judgment against the taxpayer

b) A liability for a tax not subject to the deficiency procedures that is assessed against the taxpayer, or that is set forth in a judgment against the taxpayer

c) A section 3505 tax liability set forth in a judgment against the person providing funding, or tax liability under a Miller Act performance bond set forth in a judgment against the surety or guarantor

d) A tax liability for which a notice of liability is issued to a transferee or fiduciary, or a judgment obtained against the transferee or fiduciary, regardless of whether a notice of deficiency was issued to the taxpayer or whether a judgment was obtained against the taxpayer

2. Non-Tax

a) An erroneous refund or credit, if the amount owed is determined in a judgment against the recipient-transferor (e.g., an unassessable erroneous refund or credit)

b) Government property, such as trust funds or an employer's portion of employment tax liabilities that is received by a professional employee organization (PEO) from a common law employer and that is diverted to a person related to the PEO, if the amount is determined in a judgment against the PEO

c) An amount for which restitution is owed (that is not an I.R.C. penalty), such as an amount owed by a preparer or promoter and set forth in an order of restitution entered against the preparer or promoter

d) A False Claims Act award, such as for negotiation of a refund check by a person other than the named payee acting without authority of the named payee

e) Erroneous direct deposit refund obtained by a bogus return (involving theft of identity of named taxpayer) falsely claiming a payment credit not assessable under section 6201(a)(3)

f) A property bond securing a non-tax liability if the property record is not notated with the security arrangement and the property is transferred in defeat of the security arrangement

B. Procedures and Remedies

1. In General

a) With respect to the collection of taxes, if a third-party is liable as a fiduciary under 31 U.S.C. § 3713(b) (which excludes a trustee acting under the Bankruptcy Code, Title 11 U.S.C.) or as a transferee, the liability of the third-party may be litigated either in the Tax Court under section 6901, or by suit in district court under section 7402(a) or 28 U.S.C. §§ 3301-3308 (FDCPA).

b) If the third party's liability does not arise from the transfer of property or the third party's role as a fiduciary under 31 U.S.C. § 3713(b), then the government must bring a suit in district court.

c) To collect non-tax debts (e.g., erroneous refunds), the Service must bring suit in district court.

d) State common law and/or state statutes may provide for successor-in-interest (successor) liability, which generally may be enforced in the district courts, and, in certain circumstances, may be pursued under section 6901.

2. Section 6901 in General

a) Section 6901(a) provides that the liability, at law or in equity, of a transferee of property, or of a fiduciary under 31 U.S.C. § 3713(b), shall be assessed, paid, and collected in the same manner as the underlying tax liability of the taxpayer.

b) The procedures to establish section 6901 transferee/fiduciary liability are similar to the deficiency procedures.

(1) A notice of deficiency (transferee or fiduciary liability) is issued to the transferee or to the fiduciary at the transferee's or fiduciary's last known address. I.R.C. § 6901(g).

(2) The transferee/fiduciary has 90 (or 150 days if this letter is addressed to the transferee/fiduciary located outside of the United States) to petition the Tax Court. Alternatively, the transferee/fiduciary may pay the proposed liability and file a claim/suit for refund.

(3) The Service may assess a liability against a transferee or fiduciary if: (1) the Tax Court enters a decision against the transferee or fiduciary, (2) the transferee or fiduciary defaults on the notice of liability, or (3) the transferee or fiduciary agrees to the assessment.

(4) A lien arises against all property of the transferee/fiduciary upon assessment. The Service may file a notice of federal tax lien (NFTL) against the transferee/fiduciary.

(5) The Service may collect the assessment administratively, e.g., by wage levy or by seizure and sale of property.

3. Other provisions of Section 6901

a) Persons Liable

Section 6901 applies to the following persons and entities:

(1) Transferees, including donees, beneficiaries of decedents' estates, successors to corporate or partnership liquidations or corporate reorganizations, and de facto successors.

(2) Fiduciaries under 31 U.S.C. § 3713(b).

(3) Transferees of transferees.

b) "Transferee" Defined

The term "transferee" includes assignees or donees of an insolvent, heirs, legatees, devisees, all classes of distributees, shareholders of a dissolved corporation, successor of a corporation, a party to a reorganization as defined in section 368, and, for gift tax, a donee (without regard to the donor's solvency), and, for estate tax, any person who, under section 6324(a)(2), is personally liable for any part of such tax. I.R.C. § 6901(h); Treas. Reg. § 301.6901-1(b).

c) Substance Over Form

Courts will look to substance over form to determine whether a party is liable as a transferee. See Scott v Comm'r, T.C. Memo. 1998-426, aff'd, 236 F.3d 1239 (10th Cir. 2001).

d) Type of Taxes

With respect to persons liable as transferees, section 6901 applies to income, estate, and gift taxes incurred by the transferor, and all other taxes incurred by the transferor if the liability for the other taxes arises on the liquidation of a partnership or corporation or a reorganization under section 368(a). I.R.C. § 6901(a)(1)(A), (a)(2).

With respect to a fiduciary, the liability applies to any income, estate, or gift tax from the estate of the taxpayer, decedent, or donor. I.R.C. § 6901(a)(1)(B).

e) Applicable Law

Section 6901 is a procedural statute. It does not define the substantive elements that establish liability. See Commissioner v. Stern, 357 U.S. 39 (1958) (applying section 311(a) of the 1939 Code, predecessor to section 6901). The court in which litigation is commenced should apply applicable state or federal substantive law in determining transferee liability. Id.

If relying on state law, the law of the state in which the transfer occurred generally governs. Fibel v. Commissioner, 44 T.C. 647, 657 (1965); Hicks v. Commissioner, T.C. Memo. 1970-267, aff'd, 73-2 U.S. Tax Cas. (CCH) ¶ 9526 (9th Cir. 1973) (per curiam).

When determining the liability of a third party under section 6901, the IRS has traditionally relied upon state law theories of liability (e.g., in situations involving alleged nominees, alter egos, successors, and fraudulent conveyances, as well as transferees). Federal common law has developed in some of these areas and the government may relay on federal common law in some third party liability cases. This area of law is evolving and is beyond the scope of this lesson. For example, see Notice 2012-002, which sets forth Counsel's position that a federal common law analysis to prove alter ego status is legally correct and consistent with the important principle of uniformity of federal tax enforcement (further explained in the alter ego section).

Contact P&A Branches 3 and 4 for assistance at (202) 622-3600 or (202) 622-3630, respectively.

f) Statutes of Limitation

(1) Assessment

i. Transferees. The Service may assess within one year after the expiration of the period of limitation (including suspensions or extensions) on assessment against the transferor. I.R.C. § 6901(c)(1).

ii. Transferee of a transferee. The Service may assess within one year after the expiration of the limitations period for assessment against the preceding transferee, but not more than three years after the expiration of the period for assessment against the initial transferor. I.R.C. § 6901(c)(2).

iii. If assessment is made against the taxpayer before the expiration of the normal three-year period for assessment, the Service still has one year from the end of the three-year period to assess the transferee, not one year from the assessment of the taxpayer. Commissioner v. Gerard, 78 F.2d 485 (9th Cir. 1935). If, for example, the Service assessed a deficiency against a taxpayer for unpaid 2001 income taxes on January 1, 2004, the Service has one year from April 15, 2005, to make an assessment against a transferee of the taxpayer.

iv. If a collection action is brought against the transferor (or the preceding transferee, in the case of successive transfers) before the expiration of the period for assessment against the transferee, the assessment period for the liability of the transferee expires one year after the return of execution in the court proceeding. I.R.C. § 6901(c).

v. Fiduciary. The liability must be assessed not later than one year after the liability arises, or not later than the expiration of the period for collection of the tax in respect of which the liability arises, whichever is later. I.R.C. § 6901(c)(3).

(2) Federal or State Law

(1) In bringing suit to collect (including imposing transferee liability) under sections 7402(a) and 6502, or in bringing suit under 28 U.S.C. §§ 3301-3308 (the FDCPA), the United States is not bound by state statutes of limitation unless Congress provides otherwise. Phillips v. Commissioner, 283 U.S. 589 (1931).

(2) The United States may pursue a fraudulent conveyance/transfer action under state law and not be bound by the state's statute of limitation. United States v. Summerlin, 310 U.S. 414 (1940); United States v. Fernon, 640 F.2d 609 (5th Cir. 1981).

(3) The Commentary to the UFTA indicates that the four-year limitation period of the Act places a substantive condition on the accrual of a fraudulent transfer action. UFTA § 9 cmt. 8. Some courts have held otherwise and found that the section 6901(c) limitations period is controlling in federal tax cases. See Bresson v. Commissioner, 111 T.C. 172, 182 et seq. (1998), aff'd, 213 F.3d 1173 (9th Cir. 2000); United States v. Nemecek, 79 F. Supp. 2d 821, 824 et seq. (N.D. Ohio 1999).

(3) Extension of Period for Assessment

Because the period of limitation to assess a transferee or fiduciary is based upon the transferor's/taxpayer's period of limitation (whether for assessment or collection), any extension of the transferor's/taxpayer's period of limitation is applicable to the transferee/fiduciary. Additionally, under certain circumstances, the time for assessment may further be extended.

i. The transferee or the fiduciary may extend the time for assessment by written agreement with the Service, so long as the agreement is entered into before the original time for assessing the transferee or fiduciary expires. I.R.C. § 6901(d)(1).

ii. If a notice of transferee or fiduciary liability has been issued for income, estate, or gift taxes, then the running of the period of limitation on assessment is suspended during the period in which the Service is prohibited from assessing the transferee or fiduciary liability, plus 60 days thereafter. I.R.C. § 6901(f).

iii. If a notice of deficiency is issued to the taxpayer and the taxpayer petitions the Tax Court, the extension of the taxpayer's period of limitations on assessment under section 6503 will result in a corresponding extension of the period in which the Service may assess a transferee or fiduciary. California Iron Yards Corp. v. Commissioner, 82 F.2d 776 (9th Cir. 1936); LeBeau v. Commissioner, T.C. Memo. 1992-359; see I.R.C. § 6901(f). The limitations period is suspended until 60 days after a final decision by the Tax Court against the taxpayer. After the 60-day suspension has run, whatever time is left on the limitations period is available to the Service to make the assessment against the transferee or fiduciary. Brooks v. Driscoll, 114 F.2d 426, 431 (3d Cir. 1940). For example, suppose the Service issued a notice of deficiency to the taxpayer on April 13, 2012, for the taxpayer's 2008 income taxes and that the taxpayer filed a petition with the

Tax Court for a redetermination of the taxpayer's liability. If the court entered a decision against the taxpayer that became final on January 2, 2013, then the Service would have one year after January 2, 2013 plus 60 days to issue a notice of transferee or fiduciary liability to an initial transferee or fiduciary of the taxpayer.

g) Exhaustion of Remedies

A condition of transferee liability is that the Service has exhausted its remedies against the taxpayer. J. Mertens, 14A Law of Federal Income Taxation § 53.33 (2012); Healy v. Commissioner, 345 U.S. 278, 284 n.16 (1953). The Service is not, however, required to pursue all causes of action it may have or to take futile actions before pursuing transferee liability. See Wilcox v. Commissioner, 16 T. C. 572, 577 (1951). Assessment against the taxpayer is not a requirement. California Iron Yards Corp. v. Commissioner, 82 F.2d 776 (9th Cir. 1936); Flynn v. Commissioner, 77 F.2d 180 (5th Cir. 1935).

h) Extent of Liability

The transferee or fiduciary may be liable for any tax shown on a return or for any deficiency or underpayment of tax. I.R.C. § 6901(b).

(1) State law may provide for a transferee's liability. Commissioner v. Stern, 357 U.S. 39 (1958). Usually, the transferee's liability is limited to the lesser of the fair market value of the property transferred (less any consideration paid) or the amount of liability of the transferor. If the transferee has assumed all of the transferor's liabilities, such as in a corporate reorganization or pursuant to a contract, then the transferee may be liable for the full amount of the tax, regardless of the value of the property transferred. Eddie Cordes Inc. v. Commissioner, T.C. Memo. 2001-265, aff'd, 58 Fed. Appx. 422 (10th Cir. 2003); Bos Lines v. Commissioner, 354 F.2d 830 (8th Cir. 1965).

(2) The liability of the transferee may include interest and penalties which have accrued against the transferor. If the fair market value of the property exceeds the transferor's tax liability, then the transferee's liability includes interest and penalties. Estate of Stein v. Commissioner, 37 T.C. 945 (1962) (interest); Bowlin v. Commissioner, 31 T.C. 188 (1958) (fraud penalty), aff'd per curiam, 273 F.2d 610 (6th Cir. 1960).

(3) If the fair market value of the property transferred is less than the amount of the unpaid tax liability of the transferor, the transferee may be liable for interest from the date the transferee receives the assets until notice of transferee liability on the use of the property if state law so allows, but not liable for interest or penalties on the tax itself. See Patterson v. Sims, 281 F.2d 577 (5th Cir. 1960); Estate of Stein v. Commissioner, 37 T.C. 945 (1962); see also M. Saltzman, IRS Practice and Procedure ¶ 17.05[1] (2010). Interest under state law does not extend beyond the date of the notice of deficiency (transferee liability or fiduciary liability). Pallister v. United States, 182 F. Supp. 720 (S.D.N.Y. 1960); Merlino v. Commissioner, T.C. Memo. 1995-208.

(4) If a fiduciary pays other creditors instead of paying the government, the fiduciary may be held personally liable to the extent of the payments that he distributed to creditors other than the United States. 31 U.S.C. § 3713(b); United States v. Coppola, 85 F.3d 1015, 1020 (2d Cir. 1996); IRM 5.5.3.9, *Fiduciary or Transferee Liability*. The executor is only liable if he had notice of the claim of the government before making a distribution to another creditor. Little v. Commissioner, 113 T.C. 474, 480 (1999) ("[I]t has long been held that a fiduciary is liable only if it had notice of the claim of the United States before making the distribution." (citing Want v. Commissioner, 280 F.2d 777, 783 (2d Cir. 1960))).

(5) After issuance of a notice of deficiency (transferee liability) the transferee is liable for interest under section 6601. Patterson v. Sims, 281 F.2d 577, 580-81 (5th Cir. 1960).

(6) Transferee liability and interest thereon constitute affirmative matters that the Commissioner, by statute (I.R.C. § 6902(a)) and rule (T.C. Rules 36(b) and 142(d)), must plead affirmatively.

i) Distributees, and Donees

(1) Distributees of property from an estate are personally liable for estate taxes to the extent of the value, measured at the time of the decedent's death, of the property received that was included in the decedent's gross estate for estate tax purposes. I.R.C. § 6324(a)(2).

(2) Donees are liable for gift taxes to the extent of the value of the gift. I.R.C. § 6324(b).

j) Fiduciaries

Section 6901(a)(1)(B) provides for the assessment, payment, and collection of a fiduciary under 31 U.S.C. § 3713(b). A fiduciary that can be assessed against under section 6901 is defined as a representative of a person or an estate (except a bankruptcy trustee acting under title 11) paying any part of a debt of the person or estate before paying a claim of the Government, when the representative is legally obligated to pay the government first based on section 3713 priority of government claims. 31 U.S.C. § 3713.

There are some significant issues concerning fiduciary liability:

(1) The assessment period for a transferee is based on the assessment period of the transferor. The assessment period for a fiduciary, however, is based on the collection period of the transferor.

(2) The Service cannot use section 6901(a)(1)(B) to collect from a trustee of a trust, because that section only applies to the collection of tax from an estate (for income or estate taxes) or for a gift tax. Section 6901(a)(1)(B) makes no provision for collection from a trust. The Service can only collect from a trustee as a transferee ("The liability of

a fiduciary under section 3713(b) of title 31, United States Code in respect of the payment of any tax described in subparagraph (A) from the estate of the taxpayer, the decedent, or the donor, as the case may be.")

(3) The Service can only administratively collect employment and excise taxes from transferees, not fiduciaries, because section 6901(a)(2), referring to "other taxes," only discusses the liability of a transferee if the liability arose on the liquidation of a partnership or corporation, or on a reorganization within the meaning of section 368(a).

(4) Note that despite these limitations on administrative collection through section 6901, the Service may collect in those circumstances by asking DOJ to bring a section 7402 suit in district court.

k) Tax Court Proceedings

In proceedings before the Tax Court, the burden of proof is upon Respondent to show that the petitioner is liable as a transferee of property of a taxpayer. I.R.C. § 6902(a); T.C. Rule 142(d).

The Tax Court has held that the transferee would be liable under section 6901 if the Commissioner establishes: (1) the transferee received the property of the transferor; (2) the transfer was for no consideration or less than adequate consideration; (3) the transfer was made during or after the period for which the tax liability of the transferor accrued; (4) the transferee is liable at law or in equity (if in equity, that the transfer was constructively fraudulent or actually fraudulent); (5) the Commissioner made all reasonable efforts to collect from the transferor, and further collection efforts would be futile; and (6) the value of the transferred property. Gumm v. Commissioner, 93 T.C. 475, 480 (1989), aff'd without opinion, 933 F.2d 1014 (9th Cir. 1991). Later courts have limited this holding as only a generalization of typical state law. See Hagaman v. Commissioner, 100 T.C. 180, 183-84 (1993).

C. Suit Under Section 7402(a)

1. In General

a) Jurisdiction. Section 7402(a) confers jurisdiction upon district courts to render such judgments and decrees as may be necessary or appropriate for the enforcement of the internal revenue laws. This statute, along with 28 U.S.C. §§ 1340 and 1345, grants the district courts jurisdiction over suits brought by the United States to set aside fraudulent conveyances, establish transferee liability and prove other types of third-party liability as to tax and non-tax debts arising under the IRC.

b) The United States may bring an action in district court against a transferee or fiduciary to establish transferee or fiduciary liability. In addition, the United States may file suit against a third party to establish liability in the absence of a transfer under contract or under state law.

c) When recommending a suit to establish third-party liability, generally the Service should ask the Department of Justice to bring a suit against the taxpayer or other transferor to reduce tax or non-tax liabilities to judgment. If the action is to set aside a fraudulent conveyance, the Service should ask the Department of Justice to file suit to impose judgment liens, or foreclose federal tax liens, on the property conveyed.

2. Statute of Limitations

Under section 6502, assessed liabilities may be collected through a judicial proceeding begun within 10 years of the date of assessment (either the assessment against the taxpayer or a section 6901 assessment against a transferee or fiduciary). As to erroneous refunds or credits, such amounts may be recoverable from transferees within the erroneous refund suit period provided in section 6532(b).

Note: If the action is a suit to set aside a fraudulent conveyance, as opposed to establishing personal liability, the United States may have more than 10 years from the date of assessment to bring suit if it has reduced its tax claim to judgment against the taxpayer. United States v. Weintraub, 613 F.2d 612, 619-20 (6th Cir. 1979); United States v. Brickman, 906 F. Supp. 1164 (N.D. Ill. 1995).

3. Burden of Proof

The United States has the burden to prove transferee liability in district court and the Tax Court. I.R.C. § 6902(a); T.C. Rule 142(d).

D. Which Procedure to Employ: 6901 or Suit in District Court

1. The advantages of section 6901 are:

    a) Following assessment, the Service may use all administrative collection procedures against the transferee or fiduciary, such as a wage levy or the seizure and sale of property.

    b) Following assessment, the Service may file notices of federal tax lien, which will attach to the property of the transferee or fiduciary.

2. The advantages of a suit in district court are:

a) If an assessment has been made against the taxpayer, the limitation period in which a suit may be brought to assert transferee or fiduciary liability generally is longer.

b) The United States has more control over the timing of the suit.

c) The Federal Rules of Civil Procedures give the United States broader powers of discovery than the Tax Court rules.

d) The district courts have jurisdiction in cases where the liability does not arise from a transfer or under 31 U.S.C. § 3713(b).

e) Through one court action, the United States can reduce a tax claim to judgment, establish transferee or fiduciary liability, and foreclose a tax lien. Additionally, the United States may set aside the transfer.

E. Enforcing Liens on Transferred Property and Levying Against Property Without a Judgment Against the Transferee

Transferred property to which a federal tax lien has attached at the time of transfer is subject to collection action in the hands of the transferee without regard to the transferor's liability. See United States v. Bess, 357 U.S. 51 (1958); United States v. American Caramel, 172 F. Supp. 95 (E.D. Pa. 1959).

If a federal tax lien arises after property is fraudulently transferred, the Service may still levy on the property without a judgment against the transferee or the property if the transferor has retained an equitable interest in the property. Roland v. United States, 838 F.2d 1400 (5th Cir. 1988).

Note: The government may bring an action to clear title before it sells seized real property.

F. Jeopardy Assessments Against Transferees

The Service may make jeopardy assessments against transferees if it can establish that jeopardy exists under section 6861. Harper v. United States, 769 F. Supp. 362 (M.D. Fla. 1991); Klotzman v. United States, 618 F. Supp. 112 (D. Md. 1985).

The procedures followed are the same as those for making a jeopardy assessment against a taxpayer. The transferee has the same rights as a taxpayer, such as requesting judicial review under section 7429, filing a petition for redetermination with the Tax Court, or suing for a refund. A transferee may not challenge a jeopardy assessment by bringing a wrongful levy action. Shannon v. United States, 521 F.2d 56 (9th Cir. 1975).
Note: Section 7429(a)(1)(A) requires written Counsel approval of jeopardy levies and jeopardy and termination assessments. Specifically, Associate Area Counsel or above must approve

jeopardy levies, IRM 5.11.3.3(3), and Area Counsel or above must approve jeopardy and termination assessments, IRM 4.4.17.2(2), 4.4.17.3. Failure to do so will result in the abatement of the assessment or release of the levy. S. REP. NO. 174, 105th CONG., 2d SESS. 81 (1998), 1998-3 C.B. 537, 617; IRM 4.4.17.2.

G. Sources of Liability

1. Statutes

a) Federal Statutes

Examples of federal statutes imposing liability on a third party include:

- I.R.C. § 6324: A surviving spouse, surviving tenant, trustee, transferee, or beneficiary of a decedent's estate, or donee of a gift, is liable for the estate or gift tax to the extent he or she received property included in the gross estate or to the extent of the gift's value.

- I.R.C. § 6672: A person required to collect, truthfully account for, and pay over any tax imposed by the Code who willfully fails to do so, or willfully attempts in any manner to evade or defeat such tax or its payment, shall be liable for a penalty equal to the total amount of the tax evaded or not collected.

- I.R.C. § 3505: A lender, surety or other person who pays wages directly, or knowingly furnishes funds for the payment of wages, is liable in his own person or estate for an amount equal to the amount which should have been but was not deducted, withheld and paid over.

- 31 U.S.C. § 3713(b): A representative of a decedent's estate or a fiduciary (including receivers; excluding bankruptcy trustees, whose liability is provided under the Bankruptcy Code) who pays any part of a debt before paying an existing claim of the United States is personally liable for the amount not paid to the United States.

- The Federal Debt Collection Procedures Act (FDCPA), 28 U.S.C. §§ 3001 et. seq., provides a federal cause of action for fraudulent transfer. 28 U.S.C. §§ 3301-3308. Prior to the enactment of the FDCPA, only state fraudulent transfer causes of action were available, such as the U.F.T.A. and U.F.C.A.

(1) Transfers fraudulent as to debts to the United States

i. Debt arising before transfer. A transfer or obligation incurred by a debtor is fraudulent as to a debt to the United States which arises before the transfer is made or the obligation incurred, if either (a) the debtor makes the transfer or incurs the obligation without receiving reasonable equivalent value in exchange for the transfer or obligation, and the debtor is insolvent at that time or becomes insolvent as a result of the transfer or obligation; or (b) the transfer was made to an insider for an antecedent debt, the debtor was insolvent at the time, and the insider had reasonable cause to believe that the debtor was insolvent. 28 U.S.C. § 3304(a).

ii. Transfers without regard to date of judgment. A transfer made or obligation incurred by a debtor is fraudulent as to a debt to the United States, whether such debt arises before or after the transfer is made or the obligation incurred, if the debtor makes the transfer or incurs the obligation either (a) with actual intent to hinder, delay, or defraud a creditor, or (b) without receiving a reasonably equivalent value in exchange for the transfer or obligation if the debtor (i) was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction, or (ii) the debtor intended to incur, or believed or reasonably should have believed that he or she would incur, debts beyond his or her ability to pay as they became due. 28 U.S.C. § 3304(b)(1).

iii. In determining actual intent to hinder, delay, or defraud, consideration may be given, among other factors, to whether:

- the transfer or obligation was to an insider;
- the debtor retained possession or control of the property after the transfer;
- the transfer or obligation was disclosed or concealed;
- before the transfer was made or the obligation incurred, the debtor had been sued or threatened with suit;
- the transfer was of substantially all the debtor's assets;
- the debtor absconded;
- the debtor removed or concealed assets;
- the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;
- the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;
- the transfer occurred shortly before or shortly after a substantial debt was incurred; and

- the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor. 28 U.S.C. § 3304(b)(2).

(2) Remedies of the United States. In an action or proceeding under the FDCPA for relief against a transfer or obligation, the United States may obtain:

i. Avoidance of the transfer or obligation to the extent necessary to satisfy the debt due the United States.

ii. Satisfaction of the debt out of the property transferred or other property of the transferee.

iii. Any other relief the circumstances may require. 28 U.S.C. § 3306(a).

b) State Statutes

All states and D.C. have adopted the Uniform Commercial Code in some form. Article 6, Bulk Sales, and former Article 6, Bulk Transfers, are relevant. Under former Article 6, prior to a merchant's sale of stock in trade, the buyer was required to give notice of the sale to the merchant's creditors. Failure to do so rendered the transfer ineffective as to the creditors. Under current Article 6, failure to provide notice renders the buyer liable for resulting damages (i.e., the buyer may effectively be liable for the debts of the seller), but the transfer is not affected.

Many states impose liability upon surviving corporations in reorganizations such as mergers and consolidations (successor liability). A discussion of successor liability can be found in 19 C.J.S. Corporations (2007 ed.), §§ 747, 911. See also Eddie Cordes v. Commissioner, 58 Fed. Appx. 422 (10th Cir. 2003) (transferee liability not limited to value of assets received by successor from predecessor); Alexander Shokai Inc. v. Commissioner, 34 F.3d 1480 (9th Cir. 1994) (successor liability imposed where sole shareholder owned both predecessor and successor); Self Heating & Cooling v. Commissioner, T.C. Memo. 2004-85 (successor liability imposed where sole shareholder owned both predecessor and successor); Southern Pacific Transportation v. Commissioner, 84 T.C. 387 (1985) (successor, primarily liable under state law, was also liable as transferee by assumption of contracts). Although assessments, liens, or levies in the name of the predecessor may be enforceable against the successor, in many cases it may be necessary to take action against the successor to protect the interests of the government.

Nearly all jurisdictions have adopted either the U.F.T.A. or its predecessor, the U.F.C.A.[1] Both acts and some of their differences will be briefly described in this outline. See also Alces &

---

1 Forty-four jurisdictions have adopted the U.F.T.A.: Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, District of Columbia, Florida, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Maine, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, Texas, Utah, Vermont, the Virgin Islands, Washington, West Virginia, Wisconsin, and Wyoming.

Dorr, A Critical Analysis of the New Uniform Fraudulent Transfer Act, 1985 U. Ill. L. Rev. 527 (1985), for a comparison of the two acts.

2. Contracts (under which liability is imposed on third parties)

By agreement, a purchaser may agree to assume the debts of the taxpayer/seller. Taxes are debts and the government can assert its rights as a third-party beneficiary under the contract. An example of contractual transferee liability is when a business or individual agrees to purchase the assets and assume the liabilities of a going concern. Because taxes are a debt, the purchasing party obligates itself for the transferor's taxes.

Under section 3504, by agreement, a person who is not the common law employer with respect to employees can agree to become liable for employment taxes to the same extent as the common law employer.

3. Common Law

Historically, common law has recognized two types of fraudulent transfers: those effected through actual fraud or constructive fraud. Depending upon the facts and the law, the remedy may be the set aside of a transfer or a personal judgment against the transferee.

a) Constructive Fraud

(1) General Definitions

General definitions of constructive fraud are found under the UFCA and the UFTA as follows:

UFCA § 4: "Every conveyance made and every obligation incurred by a person who is or will be thereby rendered insolvent is fraudulent as to creditors without regard to his actual intent if the conveyance is made or the obligation is incurred without a fair consideration."

UFTA § 4(a): "A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation:

Without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor:

i. was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or

---

Two jurisdictions have adopted the U.F.C.A.: Maryland and New York..

ii. intended to incur, or believed or reasonably should have believed that he would incur, debts beyond his ability to pay as they became due."

Note: A federal tax liability arises at the closing of the tax year, regardless of any return due date.

(2) Elements of Constructive Fraud:

(1) A conveyance (UFCA), a transfer (UFTA), or an obligation incurred. A transfer or conveyance may include the creation of any lien or encumbrance or the release of an enforceable debt.

(2) Insufficient consideration (UFCA) or less than reasonably equivalent value (UFTA). Payment of an antecedent debt is fair consideration if the antecedent debt is a legally enforceable obligation of the transferor.

UFCA § 3: "Fair consideration is given for property or obligation:

i. When in exchange for such property, or obligation, as a fair equivalent therefor, and in good faith, property is conveyed or an antecedent debt is satisfied, or

ii. when such property, or obligation is received in good faith to secure a present or antecedent debt in amount not disproportionately small as compared with the value of the property, or obligation obtained."

UFTA § 3(a): "Value is given for a transfer or an obligation if, in exchange for the transfer or obligation, property is transferred or an antecedent debt is secured or satisfied . . . ."

UFTA § 3(b): "a person gives a reasonably equivalent value if the person acquires an interest of the debtor in an asset pursuant to regularly conducted, noncollusive foreclosure sale or execution of a power of sale for the acquisition or disposition of the interest of the debtor upon default under a mortgage, deed of trust, or security agreement." Beyond this, the UFTA does not define "reasonably equivalent value," but adopts the Bankruptcy Code's approach to the concept (11 U.S.C. § 548(a)(2)). UFTA § 3 cmt. 3, 7A pt. II U.L.A. 296 (1999).

(3) The conveyance or transfer occurred after the taxpayer's liability accrued. Sharp v. Commissioner, 35 T.C. 1168, 1175 (1961).

(4) The transferor must be indebted to the creditor at the time the creditor seeks to have the conveyance or transfer set aside.

(5) The transferor was insolvent at the time of the transfer or is rendered insolvent by the transfer. UFCA § 4. Insolvency is defined in UFTA § 2 and UFCA § 2. Subsequent insolvency (e.g., one year after the transfer) is insufficient.

(6) The government may be required to exhaust avenues of collection against the transferor, unless to do so would be impossible or futile. M. Saltzman, IRS Practice and Procedure ¶ 17.04[3][b] (2d Ed. 2010).

b) Actual Fraud

(1) Both the UFCA and the UFTA proscribe transactions executed with an actual, subjective intent to hinder, delay, or defraud creditors. UFCA § 7; UFTA § 4(a)(1). Actual fraud is determined by state law and is based on the facts involved. M. Saltzman, IRS Practice and Procedure ¶ 17.04[3][a] (2d Ed. 2010). The UFTA lists objective factors that courts may use as criteria in assessing intent. UFTA § 4(b).

(2) The elements of actual fraud are:

(1) A conveyance (UFCA), transfer (UFTA), or an obligation incurred.

(2) A debt from the transferor to the creditor at the time the creditor seeks to have the conveyance set aside.

(3) An actual intent by the transferor to defraud, delay, or hinder creditors.

(3) The creditor can prove intent through circumstantial evidence known as "badges of fraud," such as:

- A lack of fair consideration.
- A close relationship between the transferor and transferee, e.g., corporation–sole shareholder or parent-child.
- Retention by the transferor of the use, enjoyment, possession, or control of the property subsequent to the transfer.
- The transferor is rendered insolvent by the transfer or disposes of most of his or her assets in the transfer.
- The transferor makes efforts to conceal the fraudulent nature of the transfer.
- The transfer was made in haste and in apparent anticipation of action by creditors.
- The transferor was heavily indebted at the time of the transfer.
- The transferee fails to record the transfer.
- The transferor continues to pay expenses with respect to the transferred property.

(4) Section 4(b) of the UFTA lists objective criteria to be used in assessing intent to hinder, delay, or defraud creditors. The criteria correspond closely to the common law badges of fraud.

- The transfer or obligation was to an insider.
- The transferor retained possession or control of the property after the transfer.

- The transfer or obligation was disclosed or concealed.
- Before the transfer was made or the obligation was incurred, the transferor had been sued or threatened with suit.
- The transfer was of substantially all the transferor's assets.
- The transferor absconded.
- The transferor moved or concealed assets.
- The value of the consideration received by the transferor was or was not reasonably equivalent to the value of the property transferred or the amount of the obligation incurred.
- The transferor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred.
- The transfer occurred shortly before or shortly after a substantial debt was incurred.
- The transferor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the transferor.

H. Retransfer of Property

1. The Tax Court has held that a transferee is not liable if he or she retransfers the property to the transferor. Mendelson v. Commissioner, 52 T.C. 727 (1969). The rationale is that the return of the property by the transferee leaves the transferor's creditors in the same position they were in prior to the original transfer. Id. at 735; Gobins v. Commissioner, 18 T.C. 1159 (1952), aff'd per curiam, 217 F.2d 952 (9th Cir. 1954).

2. Transferee liability will, however, be imposed if the retransfer does not occur until after the issuance of the notice of deficiency (transferee liability). Ginsberg v. Commissioner, 35 T.C. 1148 (1961), acq., 1961-2 C.B. 3, aff'd, 305 F.2d 664 (2d Cir. 1962); Noell v. Commissioner 24 T.C. 329 (1955), acq., 1955-2 C.B. 3.

I. Defenses

Some defenses to fraudulent conveyance actions are:

1. The transferee paid adequate consideration (UFCA) or reasonably equivalent value (UFTA).

2. The transferor was solvent.

3. The property was transferred to a legitimate creditor.

4. The transferor did not owe tax.

5. The tax debt had been satisfied.

6. The statute of limitation has expired.

7. A transfer or obligation is not voidable against a person who took the property in good faith and for a reasonably equivalent value, or against any subsequent transferee or oblige who also took the property in good faith and for a reasonably equivalent value. UFTA § 8(b).

8. The government has not exhausted all reasonable means of collecting from the transferor.

J. Trust Fund Doctrine

1. Under the trust fund doctrine, certain property transferred out of a corporation is treated as held in trust for the benefit of creditors. See, e.g., Leighton v. United States, 289 U.S. 506 (1933) (cited in 14A Mertens Law of Fed. Income Tax'n § 53:4). A creditor must prove: (1) the transfer of assets, (2) the value of the assets, (3) the transferor's insolvency at the time of the transfer or as a result of the transfer or a series of transfers, and (4) the exhaustion of collection action against the transferor or the futility of pursuing such collection. Creditors may recover in equity on their claims (including claims by the United States for unpaid federal taxes and non-tax debts) from the stockholders who receive distributed assets. See generally 14A Mertens Law of Fed. Income Tax'n § 53:5. The purpose of the doctrine is to prevent fraud upon creditors through removal of assets that creditors reasonably believed to be in the corporation when they entered into business with the corporation. Whisenhunt v. Park Lane Corp., 418 F. Supp. 1096, 1098 (N.D. Tex. 1976).

2. Creditors may not recover against bona fide purchasers of corporate assets for valuable consideration who are without notice. Sanger v. Upton, 91 U.S. 56, 60 (1875).

K. "At Law" vs. "In Equity"

Historically, the underlying sources of third-party liabilities were divided into two categories, liabilities "at law" and liabilities "in equity." See, e.g., section 311 of the Internal Revenue Code of 1939 (1953) (providing that the "liability, at law or in equity, of a transferee of property of a taxpayer, in respect of the tax … imposed upon the taxpayer" generally may assessed, collected, and paid in the same manner as a deficiency); Leach v. C.I.R., 21 T.C. 70 (1953). This distinction has become less relevant since the adoption of the UFCA and UFTA as positive law in most jurisdictions and the enactment of the FDCPA.

IV. ALTER EGO DOCTRINE

A. Tax Liabilities

1. Sometimes there is such a unity of interest and ownership between a corporation and an individual or shareholder that their separateness has ceased to exist, and failure to disregard the corporate form would result in injustice. In such cases, the corporation is deemed the "alter ego" of the individual, and the government may look to the individual to collect unpaid taxes and non-tax debts of the corporation. See Oxford Capital Corp. v. United States, 211 F.3d 280 (5th Cir. 2000).

2. Although a corporation is generally treated as an entity separate from and independent of its owner(s), courts will ignore the fiction of separateness and approve a piercing of the corporate veil when the device of incorporation frustrates the intent of the law, such as impairing the government's ability to satisfy a legitimate tax debt. Valley Finance v. United States, 629 F.2d 162, 172 (D.C. Cir. 1980). Thus, a shareholder, including an individual shareholder, may be required to pay the taxes or non-tax debts of the disregarded corporation. Wolfe v. United States, 798 F.2d 1241 (9th Cir. 1986). A corporation may be treated as viable for the purpose of assessing a tax against it, while disregarded for purposes of satisfying the assessment. United States v. Walton, 909 F.2d 915 (6th Cir. 1990); Wolfe, supra; see also Avco Delta v. United States, 540 F.2d 258 (7th Cir. 1976).

3. As well as imposing liability on a shareholder for the tax debts of an alter ego corporation, the doctrine may also work the other way, imposing liability on an alter ego corporation for a tax or non-tax liability of a shareholder. Shades Ridge Holding v. United States, 888 F.2d 725 (11th Cir. 1989).

B. Indicia of Alter Ego

1. Use of corporate assets or employees for personal rather than corporate business.

2. Commingling of corporate funds with shareholders' funds.

3. Inadequate capitalization.

4. Incomplete corporate organization, e.g., failure to issue stock, to pay state taxes, to file articles of incorporation, etc.

5. Failure to follow corporate formalities, such as holding regular meetings of the directors or maintaining minutes of meetings.

6. The corporation has only one shareholder or is closely held by members of a family.

7. Incorporation is used for a fraudulent purpose or to mask illegal activities.

Note: Courts are reluctant to disregard the corporate form. Therefore, the government should not assert the alter ego doctrine unless the government can prove several of the above indicia. Inadequate capitalization of a solely owned corporation may well be insufficient, on its own, to show alter ego. More convincing is the commingling of funds or use of corporate assets for personal purposes.

Note: If a shareholder has been skimming funds from a corporation, or the corporation is paying dividends when it is insolvent, you should also consider a transferee theory. In addition, states may have laws holding officers and directors liable to creditors under certain circumstances, such as if the directors declared and paid dividends to themselves while the corporation was insolvent.

When working an alter ego case, refer to Notice 2012-002, which explains Counsel's position that a federal common law alter ego analysis is the appropriate and best way for courts to resolve alter ego claims in federal tax collection cases. The reason for this policy is that the use of state law as the alter ego rule of decision in federal tax collection cases frustrates the important federal policy of uniform imposition of federal tax liability. Attorneys should still undertake the two-step state/federal alter ego analysis as an alternative argument. Suit letters, defense letters, and any Tax Court briefs addressing an alter ego analysis in the collection context should be submitted to Branch 3 or 4 of Procedure and Administration prior to referral to the Department of Justice or filing with the Tax Court.

Please direct all questions concerning this Notice and how to proceed with an alter ego case to Branch 3 or 4 of Procedure and Administration at (202) 622-3600 or (202) 622-3630, respectively.

V. NOMINEE LIABILITY

A. In General

1. In some cases the government will be able to prove that a third party is a nominee of the taxpayer. In other words, the taxpayer is the true owner of, or holds the equitable interest in, the property; the third party owns the property in name only for the benefit of the taxpayer. See Holman v. United States, 505 F.3d 1060 (10th Cir. 2007). The government may look to property held in the name of a nominee to satisfy the tax liabilities of the true owner. United States v. Schaeffer, 245 B.R. 407 (D. Colo. 1999). Establishing that the title holder is merely a nominee is particularly useful where a taxpayer has placed all of his assets in a family trust. See, e.g., Allen Family Trust v. United States, 558 F. Supp. 152 (D. Kan. 1982).

2. The Service may file liens against property held by a nominee and take other administrative actions against such property, based on the assessment against the taxpayer. To protect priority, the administrative actions, particularly filing of notice of lien, should be made in the name of the nominee, as nominee of the taxpayer. Since title is clouded, the government may wish to pursue a quiet title action and a suit to foreclose a tax lien before attempting to sell the property.

B. Indicia of Nominee Liability

1. There are no particular facts that must be proven to establish that property held in one name is property of another. All that must be proven is that the property is, in fact, being held in one name while beneficially owned by another.

2. Many of the facts that are used to establish transferee liability may also indicate that one party is a nominee for another. Therefore, in most cases the government should assert that the third party is the transferee or, in the alternative, the nominee of the taxpayer.

3. Some factors that may be relevant are:

a) The taxpayer provided the funds or guaranteed the financing for the purchase of the property.

b) The taxpayer pays all of the expenses of the property, e.g., utility bills, property taxes, and mortgage payments.

c) The nominee paid no consideration or inadequate consideration for the property.

d) There is a close relationship between the taxpayer and the nominee.

e) The conveyance was not recorded.

f) The taxpayer retains possession of or control over the property.

g) The property is placed in the name of the nominee in anticipation of liability on the part of the taxpayer or a lawsuit against the taxpayer.

h) The taxpayer takes deductions relating to the property.

i) The taxpayer receives income such as rent or dividends from the property.

j) The taxpayer is listed as the owner on financial documents relating to the property, e.g., the taxpayer lists the property as his or her own on a loan application.

k) In the case of a trust, the taxpayer used trust assets to pay taxpayer's personal expenses.

l) In the case of a trust, there were insufficient internal controls in place with respect to the management of the trust.

Courts use a two-step analysis to identify property to which a tax lien attaches and that is subject to levy. Drye v. United States, 528 U.S. 49, 52 (1999). The first step is to determine what interest or rights the taxpayer has under state law. Id. The second step is to determine whether these state interests or rights are "property" under section 6321 or 6331. Id. The law is unsettled with regard to the application of the two-step test for nominee theory. Some courts have approved the use of the federal nominee factors to determine whether the taxpayers have a beneficial interest in property – the first step in the Drye analysis – when the state nominee law is substantially the same as the federal nominee factors. See United States v. Swan, 467 F.3d 655, 656 (7th Cir. 2006); Shades Ridge v. United States, 888 F.2d 726, 728 (11th Cir. 1989). Similarly, courts have approved the use of federal nominee factors to amplify underdeveloped state nominee law. See United States v. Northern States Investments, Inc., 670 F. Supp. 2d 778 (N.D.Ill. 2009) ("Because Illinois law does not adequately articulate the nominee test, this court follows federal common law to the extent that federal law adds flesh to the state law bones."). In the absence of identifiable state nominee law, some courts have approved the use of federal factors if the existence of state-law principles similar to nominee theory indicates that state courts would adopt the federal nominee factors. See Scoville v. United States, 250 F.3d 1198, 1202 (8th Cir. 2001); May v. A Parcel of Land, 458 F.Supp. 2d 1324, 1337-38 (S.D. Ala. 2006). Other courts, however, in the absence of an identifiable state nominee law, have required the application of analogous state law instead of the federal nominee factors. See Spotts v. United States, 429 F.3d 248, 251 (6th Cir. 2005) (constructive trust doctrine). In the Tenth Circuit, once the court finds a state interest, the inquiry ends because the second step will automatically be met. See In re Krause, 637 F.3d 1160, 1167 (10th Cir. 2011) (holding that Kansas fraudulent conveyance doctrine established the state property interest sufficient to hold that the debtor retained an interest in property held by certain trusts as nominees).

Chief Counsel's position is that the federal nominee factors may be applied in the first step of the Drye analysis when they are substantially the same as or are used to amplify state nominee law, or when analogous concepts indicate that the state courts would adopt the federal nominee factors.

In addition, courts often misapply nominee principles or refuse to apply them in federal tax cases, substituting instead other state law creditor remedies, such as fraudulent conveyance and resulting trust, that do not adequately assess a taxpayer's rights and interests in property. Please direct all questions concerning nominee to Branch 3 or 4 of Procedure and Administration at (202) 622-3600 or (202) 622-3630, respectively.

VI. COLLECTION DUE PROCESS

A. Notice of Federal Tax Lien

1. In General

Section 6321 creates a federal tax lien on all property and rights to property of any taxpayer who neglects or refuses to pay the tax for which the taxpayer is liable. Section 6320 provides that the Service must notify the taxpayer in writing that a NFTL has been filed. The taxpayer is entitled to one collection due process (CDP) hearing per tax period before an Appeals officer who has had no prior involvement with respect to that tax period. The taxpayer may appeal the determination of the Appeals officer to the Tax Court.

2. Liable Third Parties

1. The Service does not give notice under section 6320 to a nominee, alter ego, or transferee of the taxpayer, because the third party is not the person described in section 6321 and, therefore, is not entitled to such notice. <u>See</u> Treas. Reg. § 301.6320-1(a)(2), Q&A-A7 (concerning nominees); IRM 5.12.2.6.4(3) (nominees and alter egos). The third party is not entitled to a CDP hearing. Treas. Reg. § 301.6320-1(b)(2), Q&A-B5.

2. The Service does, however, send Letter 3177(DO), Notice of Federal Tax Lien Filing - Nominee or Alter-Ego, to nominees and alter egos notifying them that the lien has been filed, and that they also have collection appeal rights, IRM 5.12.2.6.4(4); specifically, an administrative hearing before Appeals under its Collection Appeals Program (CAP), Treas. Reg. § 301.6320-1(b)(2), Q&A-B5. (A CAP hearing is not collection due process, and any determination or decision resulting from the hearing is not subject to judicial review.) They may also seek reconsideration by the Service office collecting the tax or filing the lien, as well as assistance from the National Taxpayer Advocate. Treas. Reg. § 301.6320-1(b)(2), Q&A-B5. Additionally, the third party may seek a certificate of discharge under section 6325(b)(4) and pursue any other procedures to which a third party may be entitled. <u>Id.</u>

B. Levies

1. In General

Section 6331 authorizes the Service to levy upon all property and rights to property of any taxpayer who neglects or refuses to pay his or her tax liability after notice and demand for payment has been made on the taxpayer. Section 6330 provides that no levy may be made on any property or right to property of any taxpayer unless the Service notifies the taxpayer of their right to a CDP hearing before the levy is made. The taxpayer is entitled to one hearing per tax period before an Appeals officer who has had no prior involvement with respect to that tax period. The taxpayer may appeal the Appeals officer's determination to the Tax Court. The Service may not take any levy action pursuant to the determination during the 30 days in which the taxpayer may seek judicial review or while judicial review is pending.

2. Liable Third Parties

The Service does not give notice of the proposed levy to a nominee, alter ego, or transferee of the taxpayer, because the third party is not the person described in section 6331(a) and, therefore, is not entitled to such notice. See Treas. Reg. § 301.6330-1(a)(3), Q&A-A2. Nor is the third party entitled to a pre-levy CDP hearing. Treas. Reg. § 301.6330-1(b)(2), Q&A-B5. The third party may, however, seek reconsideration by the Service office collecting the tax, a CAP hearing before Appeals, or assistance from the National Taxpayer Advocate. Treas. Reg. § 301.6330-1(b)(2), Q&A-B5. (A CAP hearing is not collection due process, and any determination or decision resulting from the hearing is not subject to judicial review. Id.)

VII. LIEN DISCHARGE

In general, section 6325(b)(4)(A) allows the owner of any property subject to a tax lien to obtain discharge of property from the effect of a tax lien by substituting value. The owner must deposit money or give an acceptable bond under section 7101 sufficient to cover what the Service believes to be the value of its interest in the property. Under section 7426(a)(4), the owner may, within 120 days after the discharge certificate is issued, bring a civil action in district court, challenging the Service's determination of the value of its interest in the property.

If the district court finds that the Service's determination of value exceeds the actual value of the government's interest in the property, the court shall order a release of the bond and a refund of the money deposited to the extent they exceed the court's determination of value. I.R.C. § 7426(b)(5). Interest must be paid on any portion of the deposit refunded to the owner, from the date of the deposit to the date of the refund. I.R.C. § 7426(g)(3). If the owner does not bring suit within the 120-day period, the Service shall, within 60 days thereafter, apply the amount deposited, or collect on the bond, to satisfy the taxpayer's liability and refund any excess, with interest, to the owner. I.R.C. § 6325(b)(4)(C). The Service must release the bond or refund the deposit, with interest, to the extent the Service determines that the taxpayer's liability can be satisfied from another source or that the value of the Service's interest in the property is less than the Service previously determined. I.R.C. § 6325(b)(4)(B).

Section 6503(f)(2) suspends the period of limitation on collection against the taxpayer for the value of the Service's interest in the property (plus interest, penalties, and additions to tax) from the time the owner becomes entitled to a certificate of discharge to 30 days after the earlier of the date the Service no longer holds the deposit or bond or the date the judgment in the owner's civil suit against the Service becomes final.

VIII. MISCELLANEOUS ISSUES

A. Churches

The Religious Freedom Restoration Act (RFRA). The RFRA, 42 U.S.C. §§ 2000bb et seq., provides that the government shall not substantially burden a person's exercise of religion unless the government demonstrates that the application of the burden is in furtherance of a compelling governmental interest and is the least restrictive means of furthering that interest. 42 U.S.C. § 2000bb-1(a)-(b). A person whose religious exercise has been burdened in violation of the RFRA may assert that violation as a claim or defense, and obtain relief, in a judicial proceeding. 42 U.S.C. § 2000bb-1(c).

1. Under the RFRA, the nongovernmental party bears the burden of establishing that the government has substantially burdened his or her free exercise of religion. Muslim v. Frame, 897 F. Supp. 215, 216 (E.D. Pa. 1995), aff'd, 107 F.3d 7 (3d Cir. 1997). Once this threshold has been satisfied, the government bears the burden of establishing that its conduct is the least restrictive means of serving a compelling governmental interest. Id.

2. A "substantial burden" under the RFRA is one that significantly inhibits or constrains conduct or expression that manifests some central tenet of the individual's religious beliefs, meaningfully curtails the individual's ability to express adherence to the individual's faith, or denies the individual reasonable opportunities to engage in activities fundamental to his or her religion. Werner v. McCotter, 49 F.3d 1476, 1480 (10th Cir. 1995).

3. The uniform, mandatory participation of taxpayers in the federal income tax system is a compelling governmental interest for purposes of the RFRA. Browne v. United States, 22 F. Supp. 2d 309, 312-13 (D. Vt. 1998) (quoting Adams v. Commissioner, 110 T.C. 137, 139 (1998)), aff'd, 176 F.3d 25 (2d Cir. 1999).

4. As to the least restrictive means prong of the RFRA, the Service generally tries to resolve collection disputes prior to taking administrative action and where enforced collection action is necessary, utilizes the least restrictive action. The Service uses available administrative remedies for collection before referring a case for litigation.

5. All suit authorization, defense, and settlement letters to the Tax Division of the Department of Justice regarding collection of the tax liability of any religious organization, or recommending enforcement action against property belonging to a religious organization or assets located on the property of a religious organization, should

be transmitted through the Associate Chief Counsel (Procedure & Administration, Branches 3 & 4).

B. Fraudulent Conveyances and Alter Egos

Courts have upheld liens and levies on property held by churches where the taxpayers fraudulently conveyed the property to the churches. E.g., Loving Saviour Church v. United States, 728 F.2d 1085 (8th Cir. 1984); United States v. Boos, 85-2 U.S. Tax Cas. (CCH) ¶ 9639 (N.D. Okla. 1985); United States v. Jose, Inc., 81-1 U.S. Tax Cas. (CCH) ¶ 9358 (E.D. Wis. 1981).

Similarly, courts have upheld liens and levies on property held by churches where the churches were alter egos of the taxpayers. Loving Saviour Church, supra; Church of Hakeem, Inc. v. United States, 79-2 U.S. Tax Cas. (CCH) ¶ 9651 (N.D. Cal. 1979).

C. Beneficiary and Donee Liability

Section 6324(a)(2) renders a beneficiary who receives property from a decedent's estate personally liable for unpaid estate tax up to the value of the property at the time of the decedent's death. Similarly, section 6324(b) creates a lien on all gifts made during the tax year if the gift tax is unpaid, and the donee is personally liable for such unpaid tax up to the value of the gift.

A donee or beneficiary liable for gift or estate tax is liable as a transferee, and liability, which is determined by federal, not state, law, does not depend on the taxpayer's solvency or insolvency or whether the Service has assessed the taxpayer. Poinier v. Commissioner, 858 F.2d 917, 920 (3d Cir. 1988); La Fortune v. Commissioner, 263 F.2d 186, 194 (10th Cir. 1958); Mississippi Valley Trust Co. v. Commissioner, 147 F.2d 186, 188 (8th Cir. 1945); Baur v. Commissioner, 145 F.2d 338, 345 (3d Cir. 1944).

D. Family Trusts

Under sections 671 through 677, where the grantor of a trust retains certain powers over, or interests in, the trust (e.g., a reversionary interest in the trust corpus or income exceeding five percent, or the power to revest title in the grantor), the grantor is treated as the owner of the trust and income attributable to the trust is treated as income to the grantor.

Property in a family trust that is a sham-the grantors attempt to reduce their taxes by putting the property in trust, while retaining the use and benefits of the property-is subject to collection action to satisfy the grantors' liability. Whitesel Family Estate v. United States, 84-2 U.S. Tax Cas. (CCH) ¶ 9890 (S.D. Ohio 1984); Edwards Family Trust v. United States, 572 F. Supp. 22 (D. N.M. 1983).