GL1 - Lesson 3

PROPERTY TO WHICH THE FEDERAL TAX LIEN ATTACHES
(June 2018)

CONTENTS

I. INTRODUCTION

Pursuant to section 6321 of the Code, the federal tax lien (FTL) reaches all of the property and rights to property, both real and personal, belonging to the taxpayer. While there are exemptions from levy under section 6334, there are no federal exemption provisions pertaining to the FTL. Moreover, individual state exemption laws do not limit the scope of the FTL. Finally, while state law determines a taxpayer's interest in property, federal law determines whether the bundle of interests constitutes property under federal law.

II. OBJECTIVES

At the end of this lesson, you will be able to:

- Identify the various categories and specific types of property and rights to property to which the FTL attaches.
- Explain the effect of state law on the attachment of the FTL to property and rights to property.

III. SCOPE OF LIEN

A. Property and Rights to Property.

The FTL provided for by section 6321 attaches to "all property and rights to property" of the person or entity liable for the tax. This very broad statutory language has been interpreted as including all real, personal, tangible, and intangible property of greatly varying natures. See Drye v. United States, 528 U.S. 49 (1999). A future interest that comes into possession upon the passage of time, as well as some types of contingent interests, may be attached, as is discussed later in this lesson.

Note: Any interest in restricted land held in trust by the United States for an individual, noncompetent Indian (not for a tribe) is not deemed to be property, or a right to property, belonging to such Indian. Treas. Reg. § 301.6321-1.

1. After-acquired Property

Once the tax lien has arisen, it continues until the tax liability giving rise to the lien is paid or becomes legally unenforceable. I.R.C. § 6322. The lien attaches immediately to any property acquired by the taxpayer during the existence of the lien. See Glass City Bank v. United States, 326 U.S. 265, 268 (1945).

2. Extent of Service's interest

The Service's interest in the property cannot exceed the taxpayer's interest. See Filicetti v. United States, 2012 WL 602717 (D. Idaho, February 23, 2012). IRM 5.17.2 addresses property to which the tax lien attaches.

B. State Law-created Interests in Property

1. Role of State Law

a) The initial inquiry into whether property is encumbered by a tax lien is: "Does the taxpayer have a property interest in the property in question to which the lien will attach?" In determining the nature and extent of a taxpayer's right in or to property, the law of the state in which the property is located must be evaluated. The Supreme Court stated in Drye, 528 U.S. at 58: "We look initially to state law to determine what rights the taxpayer has in the property the government seeks to reach, then to federal law to determine whether the taxpayer's state-delineated rights qualify as 'property' or 'rights to property' within the compass of the federal tax lien legislation." The Court further explained in United States v. Craft, 535 U.S. 274, 278-9 (2002):

> A common idiom describes property as a 'bundle of sticks' --a collection of individual rights which, in certain combinations, constitute property. . . . State law determines only which sticks are in a person's bundle. Whether those sticks qualify as 'property' for purposes of the federal tax lien statute is a question of federal law.

b) The determination of a property interest by the highest court of a state is binding. Commissioner v. Estate of Bosch, 387 U.S. 456 (1967).

c) The facts of each case will differ, as will the law of each state. Thus, whenever judicial enforcement of liens is necessary, our suit letters to the Department of Justice should discuss in detail the facts, case law precedents and state statutes.

2. Role of Federal Law

a) Once a taxpayer's interest in the property has been defined under the appropriate state law, federal law determines the consequences for the attachment of the FTL. A state law providing that an interest is not property subject to collection for state law purposes has no bearing on determining whether the right is subject to attachment by the federal lien. United States v. Craft, 535 U.S. 274 (2002) (state law protected jointly owned property from the creditors of only one spouse); United States v. Bess, 357 U.S. 51, 56-7 (1958) (state law provided that a beneficiary of an insurance policy was entitled to the cash surrender value of the policy regardless of any creditor's lien). Once a taxpayer acquires an interest, a state-provided right to disclaim the interest will not prevent the lien from attaching to the property. Drye, 528 U.S. at 60.

b) Under certain circumstances, federal law must be resorted to in determining the situs of property for determining which state's law must be looked to in determining the taxpayer's property right. United States v. Webster Record Corp., 208 F. Supp. 412 (D.C.N.Y. 1962).

3. Exempt Property

While there are exemptions from *levy* for certain property belonging to taxpayers provided by section 6334 (see I.R.C. § 6334(a); Treas. Reg. § 301.6334-1(a)), no property or right to property belonging to a taxpayer is exempt from attachment of the FTL. State exemption laws do not affect the reach of the FTL. United States v. Bess, 357 U.S. 51 (1958); Commissioner v. Stern, 357 U.S. 39 (1958).

IV. GENERAL CATEGORIES OF INTERESTS IN PROPERTY

A. Real Property

The question whether certain interests in real property held by or for a taxpayer are subject to the FTL presents, as a general matter, no real problem because of the sweeping language ("all property and rights to property") of the lien statute. Certain legal problems arise, however, when real property, subject to the FTL, is held as a tenancy by the entirety, a joint tenancy, a tenancy in common or as community property, and the tax lien asserted against the property is outstanding against only one of the parties in interest. Of course, where a tax lien is outstanding against all of the tenants or persons who share ownership of the property, the lien may be foreclosed against the entire property regardless of the nature of the estate in the land.

B. Personal Property-Tangible

All of a taxpayer's tangible personal property is clearly subject to the FTL. The Internal Revenue Code provides that the situs of personalty is the residence of the taxpayer at the time a notice of lien is filed. I.R.C. § 6323(f)(2)(B); Treas. Reg. § 301.6323(f)-1(b)(2).

C. Personal Property-Intangible

1. Intangible personal property of a taxpayer is also subject to the FTL. Examples of such intangible personal property are licenses, franchises, debts owed to the taxpayer and any other "choses in action." A chose in action is a personal right not reduced to possession, and recoverable by suit at law. See, e.g., United States v. Stonehill, 83 F.3d 1156 (9th Cir. 1996), cert. denied, 519 U.S. 992 (1996).

2. The difficulty with intangible property occurs when, under state law, what appears to be an interest in property is a mere privilege. Some states have defined licenses as privileges rather than property rights, and for this reason, state law must be examined carefully to determine whether the right is in fact a mere privilege or a property right.

3. With intangible property, problems often arise in collecting from the property to which the lien attaches. For example, a prospective purchaser may be reluctant to bid on a taxpayer’s license if a state regulatory board will not approve the transfer of the license from the taxpayer to the prospective purchaser.

4. A FTL did not attach to the gross proceeds generated from the sale of a commodities exchange membership seat where the rules of the commodities exchange severely restricted the transferability of the seat; the property interest was limited to net proceeds from sale, and the lien attached to that amount only. Chicago Mercantile Exchange v. United States, 840 F.2d 1352 (7th Cir. 1988).

V. FORMS OF JOINT OWNERSHIP RIGHTS AS DEFINED BY STATE LAW

A. Joint Tenancy

1. Generally, under state law a joint tenancy may be created where two or more persons become the owners of property in equal and undivided shares. The interest of each tenant must be created in the same conveyance and at the same time, and the interests must be equal. Generally, where only one of the joint tenants owes taxes, the lien attaches only to the property interest held by that joint tenant.

2. Generally, in joint tenancy there is a right of survivorship benefiting each of the tenants, and the last surviving tenant becomes the owner in fee simple of the entire property. Thus, in almost all states, when an individual against whom a FTL is outstanding predeceases any of the other tenants, the remaining joint tenants take the property unencumbered by the lien. This is because the taxpayer's interest has terminated by operation of law and no property is considered to have passed from the deceased taxpayer to the survivors.

3. If the taxpayer/joint tenant is fortunate enough to be the last survivor of the joint tenancy, the lien will attach to the entire property. This should be compared with the situation in United States v. Bess, 357 U.S. 51 (1958), where a preexisting tax lien on the cash surrender value of a life insurance policy survived the death of the insured taxpayer. In this latter situation, the interest in the cash surrender value did not terminate by operation of law upon the taxpayer's death but became a part of the insurance proceeds which passed to the beneficiaries.

4. State laws may deviate from the general rules outlined above. Therefore, state law must be consulted to determine if these general principles apply. See, e.g., United States v. Librizzi, 108 F.3d 136 (7th Cir. 1997) (because state law provided for the continuation of liens on property after the death of the debtor-joint tenant, the FTL remained on real property after the death of the taxpayer-joint tenant and later attached to one-half of the sales proceeds and not just one–half of the value at the tenant's death).

B. Tenancy in Common

A tenancy in common, similar to a joint tenancy, is an undivided interest in property, but there is no right of survivorship and, once the tax lien attaches to one tenant's interest, it will survive his/her death and continue to encumber the property in the hands of his/her heirs or legatees.

C. Tenancy by the Entirety

1. A tenancy by the entirety is very similar to a joint tenancy except (1) it can exist only between husband and wife and (2) one spouse cannot transfer his or her interest without the consent of the other. In the majority of the jurisdictions recognizing tenancy by the entirety, creditors cannot attach entireties property to satisfy the debts of only one spouse. (The other entireties jurisdictions permit creditors to attach one spouse's interest in entireties property for the debts of only that spouse, subject to the rights of the non-liable spouse.) However, state law on attachment of liens against entireties property is not effective against the FTL. In United States v. Craft, 535 U.S. 274 (2002), the Supreme Court held that a FTL attached to a taxpayer's right to property in a tenancy by the entirety for the tax liability of only one spouse, even though local law (Michigan's) insulates such property from the claims of the creditors of only one spouse. The Court reasoned that, under Michigan law, a tenant by the entirety has numerous rights, including the right to use the property, the right to exclude third parties from it, the right to a share of income produced from it, the right of survivorship, the right to become a tenant in common with equal shares upon divorce, the right to sell the property with the other tenant's consent and to receive half the proceeds from such a sale, the right to place an encumbrance on the property with the other tenant's consent, and the right to block the other tenant from selling or encumbering the property unilaterally. These state law-defined rights, the Court found, are sufficient to constitute "property or rights to property" for federal tax purposes. Notice 2003-60, 2003-2 C.B. 643 addresses issues regarding application of the Craft decision.

2. Although the concept of tenancy by the entireties is normally associated with real property, it is also possible to hold personal property this way.

3. Although there are a number of principles generally applicable to entireties jurisdictions, state laws governing entireties property vary; therefore, always refer to the particular jurisdiction's laws. A jurisdiction's failure to label an ownership

arrangement “tenancy by the entirety” will not, in itself, prevent Craft from applying. See Paternoster v. United States, 640 F.Supp.2d 983 (S.D. Ohio 2009).

4. Craft declined to address the valuation of each spouse's individual interest in the property. 535 U.S. at 289. Notice 2003-60 provides the value of the taxpayer's interest in entireties property will generally be deemed to be one-half. Accord, United States v. Barr, 617 F.3d 370, 374 (6th Cir. 2010), cert. denied, 131 S.Ct. 1678 (2011); Popky v. United States, 419 F.3d 242, 245 (3d Cir. 2005). But see United States v. Cardaci, 2014 WL 7524981 (D.N.J. Aug. 21, 2014) (court declined to order the sale of property, based on its valuation determination which took into consideration the life expectancy of the non-liable spouse), aff’d in part, vac’d in part, rem’d, 856 F.3d 267 (3rd Cir. 2017) (court rejects both the government’s valuation and the taxpayer/taxpayer spouse valuation, orders reconsideration of the forced sale of the property); Pletz v. United States., 221 F.3d 1114, 1117-18 (9th Cir. 2000) (pre-Craft decision using actuarial tables).

D. Homestead Rights

1. Homestead laws that protect a principal residence from general creditors and state laws that actually define property rights must be distinguished. Most states have characterized the homestead right as an exemption from creditors. Such exemptions do not prevent the FTL from attaching to property.

2. In Texas, the homestead right was created by the state constitution to be an interest in property. In United States v. Rodgers, 461 U.S. 677 (1983), the question was raised whether a tax lien attaches to property where a nondelinquent third party has a homestead right in such property under Texas law. The Supreme Court held that where a nondelinquent third party has an interest in property that is subject to a FTL, such as a nondelinquent spouse's homestead right, that interest cannot preclude the sale of the entire property where the Service has requested foreclosure of the FTL under section 7403. The court has discretion under section 7403(c) to order the sale of the entire property. After the sale, the third party must be compensated for the homestead right. It is important to note that if the property was to be sold pursuant to administrative levy under section 6331, only the taxpayer's interest could be sold, not the entire property.

E. Community Property

1. Currently community property states are: Alaska (spouses in Alaska may elect to have statutory community property rules apply to some or all of their property, Alaska. St. § 34.77.010 et seq.), Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin. Puerto Rico is also a community property jurisdiction.

2. Each state's laws defining community property interests must be consulted before a determination can be made about the property interests to which the lien attaches. The underlying principle of the community property system is that, in general, property acquired during the marriage by the industry and labor of either

spouse, or both spouses, together with the produce and increase thereof, belongs beneficially to both during the marriage. In a strict sense, it is not a legal entity separate from the spouses, but is essentially a business concern. This system is closely analogous to a partnership.

3. The concept of community property does not preclude property acquired during marriage from being held by the spouses as joint tenants or as tenants in common. Since the spouses in general may contract with each other concerning the interest of either in the community so that each may convey his or her interest to the other, there is no reason why they cannot agree that property be conveyed to them in joint tenancy or tenancy in common in the first instance. Because the right of the spouses to hold property as joint tenants is in derogation of the community property rule, however, it must clearly appear that the property was taken as such. Property owned between the spouses as joint tenants or as tenants in common is, to the extent of the interest of each, the separate property of each.

4. It is presumed that any debt incurred during marriage for the benefit of, or protecting the interest of, the community is a community debt and the burden is on the party asserting the contrary to prove it. There is little uniformity among the states with regard to liability for the separate debts of either spouse during marriage or the antenuptial debts of either. State law cannot, however, exempt taxpayers' property from the liability for federal taxes. Therefore, if the taxpayer has an interest in property, the FTL attaches thereto, regardless of a state-created exemption from collection by creditors. United States v. Overman, 424 F.2d 1142 (9th Cir. 1970); In re Ackerman, 424 F.2d 1148 (9th Cir. 1970). Note that the Washington and Arizona community property laws addressed in Overman and In re Ackerman, respectively, limited the spouse to a one-half interest in the property. Under Texas law, a spouse is not so limited. Medaris v. United States, 884 F.2d 832 (5th Cir. 1989).

5. Death or divorce dissolves the community. Neither death nor divorce, however, relieves the surviving spouse or the ex-spouse from the federal tax liability incurred during the existence of the community. Neither the surviving spouse nor the ex-spouse can avoid the FTL by renouncing her interest in the community property upon death or divorce. State law allowing a spouse to exonerate her interest in community property and to exonerate herself from community debts is not effective as to the liability for federal taxes. United States v. Mitchell, 403 U.S. 190 (1971).

VI. SPECIFIC TYPES OF PROPERTY AND RIGHTS TO PROPERTY

A. Partnership Property

1. Often the question will arise whether the FTL attaches to partnership property for the individual liability of a partner. Applicable state law governs the extent of

an individual partner's interest in partnership property. Federal law then determines whether those interests rise to the level of “property” to which the FTL will attach. For example, under state law a partner may not have a recognizable interest in the specific property held by the partnership and therefore the FTL would not attach to such property. Rev. Rul. 73-24, 1973-1 C.B. 602. On the other hand, the partner would have an interest, under state law, in the partnership itself, and the FTL would attach to that interest.

2. Another issue that arises with respect to partnerships is whether the FTL attaches to a general partner’s individual property in connection with an assessment made against the partnership for a partnership tax liability. In United States v. Galletti, 541 U.S. 114 (2004), the Supreme Court held that a timely assessment of a partnership’s employment tax liability permits the Service to collect the liability in a bankruptcy case filed by the general partners who were derivatively liable for the taxes under state law. The Court reasoned that after the Service assessed the employment taxes of the employer-partnership, the Service was not required to separately assess the same tax against the general partners to take advantage of the 10-year collection period of section 6502(a) in the partners’ bankruptcy case. This is in keeping with the long held view of the Service that assessment of the partnership tax and notice and demand to the partnership give rise to the FTL tax lien both on the property of the partnership and on the general partners to the extent that state law makes general partners derivatively liable for the debts of the partnership.

3. Although only a district court opinion, In re Pitts, 515 B.R. 317 (C.D. Ca. 2014) is the first time a court has affirmatively held that an NFTL arising upon the assessment of a partnership’s employment tax liability attaches to the property of the general partners who are liable for the tax under state law.

4. State law generally provides that members of a limited liability company (LLC) are not liable for the debts of the LLC. In such states, an assessment against the LLC does not create a FTL on the property of the member even though the LLC is classified as a partnership under Treas. Reg. 301.7701-2(c). Rev. Rul. 2004-41, 2004-1 C.B. 845.

B. Bank Accounts

The FTL attaches to bank accounts held for or by the taxpayer. Where bank accounts are held in joint tenancy, the unqualified right to withdraw all of the funds in the account without the consent of the other account holders constitutes a right to property. United States v. National Bank of Commerce, 472 U.S. 713 (1985).

C. Wages

The FTL attaches to the wages of a taxpayer. Certain state laws may exempt some portion of wages from the reach of creditors; such exemptions, however, are not effective against the FTL. Frequent and regular partnership “draws,” which are advances or loans on annual profits, are subject to a lien (and may be levied as salary or wages). United States v. Moskowitz, Passman & Edelman, 603 F.3d 162 (2d Cir. 2010).

D. Trusts

If a taxpayer is the beneficiary of a trust, a FTL against the taxpayer attaches to his/her beneficial interest in the trust. The trust instrument only determines the property right of the beneficiary in the trust corpus and income and not the effect of the FTL upon those rights. In some cases, the lien will attach to the corpus of the trust and the income payable to the beneficiary. In other cases, the lien will attach only to the income as it becomes payable, or it may not attach to either the income or the corpus. The common types of trusts are discretionary trusts and spendthrift trusts. A discretionary trust gives the trustee unrestricted power of disposition of the trust income, i.e., the trustee may legally refuse to make any distributions to the taxpayer-beneficiary and, instead, make a distribution to other beneficiaries or simply accumulate the income. A spendthrift trust may, by its terms, confer certain specific benefits upon a beneficiary and then purport to restrict the rights of creditors to reach those benefits. Such restrictions are not effective to remove those benefits from the reach of the FTL regardless of whether, under the appropriate state law, a spendthrift trust is regarded as valid in all respects. Bank One Ohio Trust Co. v. United States, 80 F.3d 173 (6th Cir. 1996).

E. Retirement Plans

Often questions arise regarding whether the FTL attaches to interests in retirement assets generally protected by anti-alienation provisions. Both ERISA and FERSA generally prohibit the assignment or alienation of plan benefits to any person or entity other than the plan participant (and his beneficiaries). Nevertheless, the FTL attaches to a participant's interest in a plan if the participant has any vested benefit under the plan (see Future Interests, below). (A participant is vested when he has acquired a nonforfeitable right to part or all of his accrued benefits.) The lien then attaches to all present rights the taxpayer has under the plan, including the participant's present right to payment, the present right to payment in the future, and the present right to elect a form of distribution even though the taxpayer has not yet exercised that right.

F. Expectancy to Inherit

Where state law deems a taxpayer's inheritance an assignable right, the FTL can attach to that right even if the heir chooses to disclaim the inheritance. Drye v. United States, 528 U.S. 49 (1999). Despite the legality of the disclaimer under state law, the Supreme Court ruled that the FTL continued to attach to the inheritance. But see United States v. Murray, 217 F.3d 59, 63 (1st Cir. 2000) addressing FN 7 of Drye, 528 U.S. at 60. ("For example, the lien would likely not attach to land owned by a still-living relative of Michael, or to Michael's expected inheritance of it, even if the relative had provided in his will that the land would go to Michael on the relative's death.")

G. Terminable Interests

Terminable interests are property interests that, by definition, terminate upon the occurrence or failure of a specified condition, or after a certain time period. For example, a life estate, an interest that ends upon the death of the party possessing the interest, is a terminable interest. Similarly, an option created under a contract may be a terminable interest. The FTL may attach to such interests before they terminate. However, once the interest terminates, the federal tax lien on the interest also terminates. See United States v. Swan, 467 F.3d 655 (7th Cir. 2006); Rev. Rul. 54-154, 1954-1 C.B. 277. For example, assume taxpayer has an option to purchase real property. The FTL attaches to that option. If the taxpayer, however, never exercises the option, the option will lapse. After the lapse, the FTL attaching to the option is also extinguished.   Similarly, in the case of a life estate, the FTL attaches to the taxpayer's life tenancy and may be enforced against that interest, administratively or judicially, so long as the taxpayer lives. Upon the death of the taxpayer, the lien ceases to attach to the property because the government's lien does not exceed the taxpayer's rights in the property. Note, however, that specific state law must always be researched to determine if a lien in a terminable interest is extinguished.

H. Contract for Deed

Generally, state courts have recognized that payments of the taxpayer as purchaser in a contract for deed create a right to realty to which liens may attach. If the FTL attaches before the contract is annulled or extinguished due to nonpayment or other cause, the lien remains attached to the taxpayer's calculable equity in the property as of the date the FTL attached.

I. Construction Contracts and Conditions on a Right to Property

1. Construction contracts generally provide for progress payments by the owner to the contractor upon completion of given segments of the work covered by the contract. The contracts generally provide for so-called "retainages" which are a percentage of each progress payment retained by the owner to protect his/her property from the claims of laborers and material suppliers who may not be paid by the contractor as well as to secure performance by the contractor. In larger construction contracts, subcontractors typically are also involved and their laborers' and material suppliers' rights are controlled, to some degree, by the prime contract, their subcontracts, and by applicable state statutes. In addition, any sizable construction contract is usually bonded by a surety whose bond insures the performance of the contract and the payment of all parties performing work and furnishing material under the contract.

2. The terms of contracts between the owner and the contractor, between the prime contractor and the subcontractors and between the surety and the prime contractor or subcontractor vary greatly as do the laws of the various states which affect this area of consideration. As the property or property rights of the laborers, material suppliers, subcontractors, prime contractor or owner may be subject to a FTL arising during the course of construction under a given contract, the facts can present, and generally do present, an unusually complex picture requiring a thorough analysis of applicable state statutes, the contract rights provided for by the prime contract, subcontracts and surety contract, and appropriate state and federal case law.

3. In two landmark cases, the United States Supreme Court announced the now famous "no property" rule. United States v. Durham Lumber Co., 363 U.S. 522 (1960), and Aquilino v. United States, 363 U.S. 509 (1960). In both of these cases, it was held that the respective taxpayers did not have a property interest in the funds against which the tax lien was asserted. In Aquilino, the Court remanded for a determination of whether the taxpayer/prime contractor, by virtue of a New York statute, held funds against which the FTL was asserted in trust for the payment of laborers and material suppliers and, accordingly, did not have a property interest in the funds to which the FTL could attach. In Durham Lumber Co., the prime contractor/taxpayer, by virtue of the law of North Carolina, was held to have no property interest in funds due from the owner except in any surplus that might remain after the payment of the subcontractors and, thus, the subcontractors were entitled to the funds.

4. In United States v. Chapman, 281 F.2d 862, 865-6 (10th Cir. 1960), a tax lien outstanding against the prime contractor was likewise deemed not to attach to retainages, paid into court by the owner, because the contractor's failure to perform the contractual condition precedent of proving payment of all laborer's and material supplier's claims negated his acquiring a property right in the funds.

5. In spite of the foregoing, the facts of each case will differ, as will the law of each state. Therefore, whenever judicial enforcement of liens or levies is necessary, our suit letters to the Department of Justice should discuss in detail the facts, case law precedents and state statutes applicable to the "no property" issue.

J. Property in the Custody of a Court

1. The property of a taxpayer that is within the jurisdiction of and under the control of any court, state or federal, is referred to as being in custodia legis. This includes property held by a receiver or trustee in bankruptcy as well as funds deposited in a court’s registry during civil or criminal proceedings. As discussed in Lesson 3, the FTL arises on assessment. Therefore, in the case of a taxpayer's property passing to a state court receiver or trustee in bankruptcy pre-assessment, the tax lien will not encumber the property. In the case of an assignment for the benefit of creditors, state law determines if the taxpayer is fully divested of his interest by the transfer. Thus, if an assignment is made before an assessment state law must be researched to determine if the lien attaches to the property in the hands of the assignee. Of course, if the transfer occurs after the lien has arisen, the taxpayer's property passes to the receiver, trustee, or assignee encumbered by the lien. Thus, under certain circumstances, property being in custodia legis will mean that the FTL will not attach to it. In most situations, however, it only presents an obstacle with respect to enforcement of the lien (e.g., levy).

2. The fact that the government did not have a lien on property before it entered in custodia legis does not mean that collection of tax owing cannot be effected,

but collection will have to be accomplished through the processes of the court. This is often done by filing a claim in the court proceeding. Whether the property is subject to a lien may determine the Service's priority over other creditors.

3. In general the tax lien will attach to any property returned to the taxpayer upon termination of the court proceedings. In bankruptcy cases, however, the discharge of a debtor/taxpayer from a tax liability may prevent the tax lien from attaching to after-acquired property.

K. Embezzled, Stolen or Fraudulently Obtained Property

Until such time as the victim has established ownership rights in the property, the government will assert that the FTL attaches to embezzled, stolen or fraudulently obtained property in the hands of the taxpayer. In the case of embezzled or stolen funds, if the victims are able to establish judicially, by tracing the property, that it belongs to them, a court may find that a constructive trust exists in their favor. The imposition of a constructive trust by judgment before the FTL arises would establish ownership rights to the property and would be conclusive evidence that the FTL could not attach thereto. See Blachy v. Butcher, 221 F.3d 896 (6th Cir. 2000), cert. denied, 532 U.S. 994 (2001).

L. Future Interests; Contingent Interests; Executory Contracts

1. Future interests

The fact that a taxpayer's enjoyment of a "right to property" may be postponed does not prevent attachment. If a taxpayer has an unqualified fixed right under a trust or a contract to receive periodic payments or distributions of property, a lien attaches to the taxpayer's entire right regardless of when the payments or distributions will be made. Rev. Rul. 55-210, 1955-1 C.B. 544. See In re Orr, 180 F.3d 656, 664 (5th Cir. 1999), cert. denied, 529 U.S. 1099 (2000)(under state law, the expectant beneficiary of a spendthrift trust had equitable and legal rights to future income distributions from the trust).

2. Contingent interests

The broad reach of section 6321 may reach contingent interests that constitute a property interest under state law. See Fouts v. United States, 107 F.Supp.2d 815, 817 (W.D. Mich. 2000) (under state law an expectant beneficiary of an inter vivos trust has a present interest in property that is attachable). But see Dominion Trust Co. of Tennessee v. United States, 7 F.3d 233 (unpublished table decision) (6th Cir. 1993) (under state law a contingent remainder person did not have an interest in property); U.S. v. Puyallup Tribe of Indians, 2014 WL 1386553 (W.D. Wash. April 9, 2014) (future per capita payments to tribal members were contingent on approval by tribal council and therefore not "fixed and determinable" or subject to the lien).

3. Executory contracts

A lien may attach before performance under a contract. See Seaboard Surety Co. v. United States, 306 F.2d 855, 859 (9th Cir. 1962) (a lien attached to the taxpayer's rights under an executory contract which the taxpayer had assigned and when the taxpayer performed under the contract the government had a lien on the proceeds). See also Randall v. H. Nakashima & Co., 542 F.2d 270, 274 (5th Cir. 1976) (contract rights under a partially executed contract constituted a right to property because they had a realizable value).

M. Miscellaneous

Other examples of personal property to which the lien attaches are accounts receivable, letters of credit, pensions, Social Security benefits, and securities.

VII. TRANSFERS OF PROPERTY

A. Transfer Subject to Lien, Substituted Property and Lien Tracing

1. Transfers

After the FTL attaches to property, it generally remains on that property until the lien has expired, is released, or the property has been discharged from the lien. The transfer of property subsequent to attachment does not affect the lien. United States v. Bess, 357 U.S. at 57; United States v. Donahue Indus., Inc., 905 F.2d 1325, 1331 (9th Cir. 1990); United States v. Bank of Celina, 721 F.2d 163, 169 (6th Cir. 1983). The lien is not limited to the value of the property at the time of the sale to a third party but may share in any appreciation of the property. United States v. Avila, 88 F.3d 229, 233 (3d Cir. 1996); Han v. United States, 944 F.2d 526, 528-29 (9th Cir. 1991). A tax lien is not valid against a purchaser unless a NFTL has been properly filed prior to purchase. See I.R.C. § 6323(a). Even if no NFTL has been filed, the lien remains valid if the transferee is not a purchaser. Id. A purchaser of marketable securities is protected even if the NFTL lien is filed before the purchase but loses that protection if the purchaser had actual knowledge of the tax lien. See I.R.C. § 6323(b)(1). A tax lien will also continue to attach to property transferred as a gift. See, e.g., United States v. Tempelman, 111 F. Supp.2d 85, 93 (D. N.H. 2000); Lapp v. United States, 316 F. Supp. 386, 391 (S.D. Fla. 1970). A tax lien continues to attach to property transferred as a bequest, devise or inheritance. See, e.g., United States v. Bess, 357 U.S. at 57; Miller v. Conte, 72 F. Supp.2d 952, 959 (N.D. Ind. 1999).

2. Substituted Property

In certain situations, case law has held that if property is sold to a *bona fide* purchaser, such that the lien is no longer valid as against the purchaser, the lien might reattach to the property substituted for it. Phelps v. United States, 421 U.S. 330, 334-35 (1975) (lien attached to cash proceeds). When property encumbered with a FTL is transferred to a third party and subsequently the third party exchanges the encumbered property for other property (the substituted property) such that the FTL no longer attaches to the original property, the tax lien has been held to attach to the substituted property. United States v. Boardwalk Motor Sports, Ltd., 692 F.3d 378, 386 (5th Cir. 2012), cert. denied, 133 S.Ct. 2854 (2013); Tony Thornton Auction Serv., Inc. v. United States, 791 F.2d 635, 638 (8th Cir. 1986).

3. Lien Tracing

When multiple transfers take place, each displacing the tax lien, the lien is transferred to each property given in exchange. The process of following the tax lien from property to property is called lien tracing: "It was well established long ago that the lien follows any property substituted for what the taxpayer owned, provided that the chain of substitution can be traced." Municipal Trust and Savings Bank v. United States, 114 F.3d 99, 101 (7th Cir. 1997). Lien tracing may be relatively straightforward in some cases; but it is complicated in situations where funds have been commingled. Where funds have been commingled, courts will turn to:

> equitable tracing principles, which are means 'used by courts in many different areas of law to identify and segregate property that has been mingled with other property in such a manner that it has lost its identity.' William Stoddard, Note, Tracing Principles in Revised Article 9 § 9–315(B)(2): A Matter of Careless Drafting, or an Invitation to Creative Lawyering, 3 Nev. L.J. 135, 135 (Fall 2002). '[T]he goal of 'tracing' is not to trace anything at all in many cases, but rather [to] serve[ ] as an equitable substitute for the impossibility of specific identification.' Id. at 142. There are several alternative methods, none of which is optimal for all commingling cases; courts exercise case-specific judgment to select the method best suited to achieve a fair and equitable result on the facts before them. Id. at 139–40, 149.

United States v. Henshaw, 388 F.3d 738, 740-741 (10th Cir. 2004). Tracing methods include, for example, first in-first out, last in-first out, and lowest intermediate balance. As the Tenth Circuit observed in Henshaw, the use of a particular method is determined on a case-by-case basis.

B. Transfer But Taxpayer Remains True Owner

1. Taxpayer's Nominee

A lien will attach to property that had been transferred to the taxpayer's nominee. A nominee lien usually involves a specific piece of property for which the taxpayer is the beneficial owner. Oxford Capital Corp. v. United States, 211 F.3d

280, 284 (5th Cir. 2000). Where state law is undeveloped as to the issue of nominee ownership, the Tax Court has stated that Federal courts have relied on a relatively well-defined body of Federal common law. Dalton v. Commissioner, 135 T.C. 393 (2010), rev'd on other grounds, 682 F.3d 149 (1st Cir. 2012).

a. Recent cases discussing nominee status: Hudgins v. Commissioner, T.C. Memo. 2012-260 (September 10, 2012); United States v. Jones, 2012 WL 569366 (C.D. Cal., February 17, 2012).

2. Taxpayer's Alter Ego

A lien will attach to property that had been transferred to the taxpayer's alter ego. G.M. Leasing Corp. v. United States, 429 U.S. 338, 351 (1977). The alter ego doctrine focuses on the relationship between the taxpayer and the alter ego; i.e., whether the taxpayer is similar to or controls another individual, trust, business or corporation. The alter ego theory requires more factual development than the nominee lien theory. Application of a federal common law standard of alter ego was rejected in Old West Annuity and Life Ins. Co. v. Apollo Group, 605 F3d 856, 861-862 (11th Cir. 2010). The Office of Chief Counsel subsequently issued Chief Counsel Notice CC-2012-002 (December 2, 2011), which urges application of a federal common law standard of alter ego.

2018 GL-1, Lesson Instruction Assigned to Nancy Gilmore

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