PROCEDURE

Home Sweet Home: Protecting the Interest of the Non-Liable Spouse From IRS Seizure and Sale

Author: By Michael L. Cook

MICHAEL L. COOK is a shareholder in the Austin law firm of Winstead PC. ***The author thanks Corby Brooks, an associate with Winstead PC, for assistance in the preparation of this article.***

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No governmental collection action could possibly have a louder ring of unfairness than the threat of losing a home because of the tax liability of another party. The courts are clear, however, that where the survivor's homestead right is a property right under state law, the IRS can take that property right to satisfy the non-owner/taxpayer's debt to the U.S.

In many states a surviving spouse has the right to remain in the homestead occupied by the husband and wife at the time of the first of them to die. If, under state law, the survivor's right is a property right and not merely a statutory entitlement, and the survivor is a delinquent taxpayer, the survivor's right to remain in the home may be subject to the collection powers of the IRS. The Service may file liens against the survivorship right, [1] and it also may attempt to extract the value of the survivorship right by way of an administrative levy [2] or by a judicial foreclosure, [3] thereby forcing a sale of the entire homestead, even though the home is wholly or partially owned by a spouse who is not liable for the tax.

Most taxpayers do not realize that by reason of a marriage they own a survivorship right that is an interest in real property. Furthermore, even if married homeowners are aware of this right, they are quite surprised to learn that the IRS may take the position that it can force a sale of the home owned or partially owned by the non-liable spouse and extract an amount from the sale equal to the value of the liable spouse's right of survivorship.

It is not entirely clear that the broad authority the IRS relies on to enforce its collection policy regarding survivorship rights supports the Service's actions in certain fact patterns. Moreover, in some of those fact patterns, the IRS may be out of bounds with respect to the calculation of the value of the taxpayer's interest it is attempting to extract. When the IRS places a lien on a non-liable spouse's home (known as a "nominee lien") for the purpose of forcing or extracting a payment equal to the value of the non-owner's tax delinquency, it is doing so by extension of case law with distinguishable facts.

The case law discussed in this article arises predominately out of Texas, but the issue is not unique to Texas nor to community property states. Many states extend survivorship rights to spouses who survive the death of the spouse who holds title to all or a part of the homestead or the residence that the parties occupied and declared as their homestead. [4]

The Service's claim for a survivor's homestead right is staked out by the simple act of filing a lien on the home. That act places the ball in the court of the non-liable homeowner, but such homeowner is not required to react until the IRS takes the further step of forcing a sale. In some situations the Service does not take that second step but rather sits on its lien, effectively freezing the claim. The homeowner cannot refinance the mortgage on the

home and the home cannot be sold without a settlement of the Service's claim. Furthermore, if the lien on a taxpayer's survivorship interest is perfected prior to a divorce of the spouses, the Service's position is that its right to foreclose the survivorship interest by way of a forced sale remains intact after the divorce even though the non-owner's right of survivorship automatically terminates by reason of the divorce. [5] In a divorce proceeding, however, a survivorship right is not a property right that is ever negotiated by the parties or awarded by the court. The divorce evaporates the survivorship right as quickly as it was created by the marriage.

EXAMPLE

The focus of this article can be established by a single fact pattern.

Husband (H) is 50 and wife (W) is 40. They live in a community property state that has spousal survivorship rights in a homestead. The home they live in is W's separate property that she acquired by inheritance prior to their marriage. The home is valued at $400,000 and is not subject to any debt.

Unknown to both W and H at the time of their marriage, H had potential exposure for penalties for failure to pay payroll taxes. H and W signed a premarital agreement, which among other things acknowledged that the home was W's separate property. The agreement, however, did not provide for a waiver or abandonment of H's survivorship rights.

After the IRS assessed a Section 6672 penalty against H, the Service filed a nominee lien on the home that, in essence, said W is holding title to property rights (the survivorship right) owned by H. Unless W pays the IRS for a release of the lien, the Service will attempt to foreclose, sell the home, and extract from the proceeds an amount equal to H's survivorship rights and apply it to his liability, with any balance going to W.

Does the IRS have the authority to force a sale of W's home under the existing case law? If so, what value may the Service take from the sale proceeds? These two issues are examined below. The answers, if favorable to the IRS, present significantly negative results to the uninformed, non-liable spouse. Unfortunately, the Service has not issued guidance to the public—and perhaps not even to the various local revenue officers who are filing nominee liens in such circumstances and pursuing levies. It appears that each local IRS office may be applying its own interpretation. [6]

SETTING THE STAGE: *RODGERS*

While homestead survivorship rights may have been a target of IRS collection activity prior to *Rodgers,* 52 AFTR 2d 83-5042 , 461 US 677 , 76 L Ed 2d 236 , 1983-2 CB 253 (1983), [7] it was the *Rodgers* decision that caused the IRS to focus on homestead survivorship rights as a property right.

Lucille Bosco Rodgers lived in Texas in a home that was the community property of Phillip Bosco and Lucille during their marriage. Phillip died in 1974 owing assessed taxes to the IRS. Lucille was not liable for any part of the tax. The IRS filed liens on the residence prior to Phillip's death and, subsequent to his death, the Service attempted to foreclose the lien.

Lucille's position was that under the Texas Constitution [8] she had a right to live in the residence until her death because it was a homestead and the IRS had to wait until she died to foreclose. The Service's position was that not only could the IRS foreclose immediately but Lucille's survivorship right of occupancy could be ignored.

The Supreme Court disagreed with both parties and held that the IRS could foreclose on the residence, and a sale of the residence could be ordered by the district court, but Lucille had to be compensated for her lifetime right to occupy the residence. The Court held that the government's lien under Section 6321 could not extend beyond the property interests held by the delinquent taxpayer and that the government could not collect more than the value of the taxpayer's property interests subject to Lucille's survivorship right to occupy the homestead for her life.

The Court determined the privilege of lifetime occupancy to be a right to property and not merely a statutory entitlement or inchoate personal privilege. The question then became how to calculate the value of such a right. The Supreme Court laid down a practical solution, which was simply to apply a life estate calculation to determine the value of Lucille's survivorship right. [9] The Court did not mandate the form of the life estate calculation; indeed, as an illustration of how a life estate would be calculated the Court discussed the use of a "standard statutory or commercial" table.

Subsequently, in *Harris,* 56 AFTR 2d 85-5471, 764 F2d 1126 (CA-5, 1985) (discussed in more detail below), the Fifth Circuit mandated very specific tables for the calculation of the life estate there in issue. The government asserted in *Harris* that the appropriate tables to apply in determining the life estate were found in Treasury Publication 723A, Actuarial Values II: *Factors at 6 Percent Involving One and Two Lives* (1971). [10] The taxpayer in *Harris* argued that a question of fact existed as to which actuarial table measured her life expectancy.

The Fifth Circuit adopted the use of the Treasury tables for the purpose of determining the life estate. While acknowledging that the regulatory tables had not attained the force of law, by applying them the court effectively bestowed the force of law on those tables. [11]

It was not difficult to predict the Service's reaction to *Rodgers.* If a homestead survivorship right is a property right that must be respected and immune from IRS collection of tax debt when owned by a non-liable owner, then it is a property right that can be seized when it is owned by a taxpayer who owes delinquent taxes. Apparently, the IRS views *Rodgers* as direct authority for the right to seize a survivorship right no matter what surrounding facts exist. Stated differently, if the Supreme Court determined that a homestead survivorship right is a property right that has to be protected for the non-liable spouse, then it is a property right that may be extracted when it is owned by the taxpayer. But it must be recognized that in doing so the Service will be evicting the non-liable owner from the home in order to satisfy or partially satisfy the tax delinquency with the non-owner's survivorship right—*a property right created by the marriage rather than an asset bought and paid for with the taxpayer's money.*

In *Rodgers,* the valuation of the survivorship right was made easy by the Court. The taxpayer was deceased and Lucille Rodgers's survivorship rights had vested, that is, she was married to Phillip Bosco and was living in the home at the time of his death. Other fact patterns present much more complicated issues. Indeed, the Court in *Rodgers* seemed to be aware that it may have been setting up a rule of law that could be unintentionally extended beyond the facts of *Rodgers* when the Court stated:

"Thus, *although analogy is somewhat hazardous in this area,* it may be said that the homestead laws [referring to the survivorship rights] have the effect of reducing the underlying ownership rights in a homestead property to something akin to remainder interests and vesting in each spouse an interest akin to an undivided life estate in the property." (Emphasis added)

This statement and the interpretation and application of it in *Harris* appears to create a rule that, standing by itself, could apply to facts beyond those that existed in *Rodgers.*

The Impact of *Harris*

In *Harris,* the appellant, a non-liable homeowner, raised many defenses to the IRS levy of her home, [12] none of which impressed the Fifth Circuit. The court, however, attempted to shed light on the approach to the calculation of the valuation of a taxpayer's homestead survivorship rights where the home was held as community property and both spouses were alive, unlike the situation in *Rodgers,* where the taxpayer was deceased at the time of valuation of the survivorship right.

Sarah Harris (the appellant) and John Harris were married in 1973. In 1977 they purchased a home. In 1978, John incurred a payroll tax liability. On 5/17/79, the IRS and John Harris stipulated to the amount of debt in bankruptcy proceedings. On 6/22/79, the IRS filed a lien and on 7/13/79 Sarah was awarded the home by a judgment in a divorce proceeding. Sarah argued that she should be entitled to a life estate equivalent based on the single-life tables, and alternatively one-half of the proceeds of her one-half community property.

The court rejected Sarah's arguments and determined that under Texas law debts incurred during marriage are presumed to be debts of the community and the community is eligible to satisfy the debts of either husband or wife. [13] Therefore, the only interest Sarah was entitled to retain was her homestead survivorship interest determined on the two-life table, not the single-life table as in *Rodgers* where only one party to the marriage was alive at the time of the foreclosure. [14]

In reaching its conclusion, the court in *Harris* made a statement that has proven to be somewhat misleading to the IRS and thus problematic for taxpayers. The Fifth Circuit was trying to show that Sarah's one-life table position had to be erroneous because at the time of the lien John also had a survivor's homestead right and, if they were both valued on a one-life table, the two combined values would exceed 100%. In making its point, the Court said:

"In this case, the following interests existed in the Harrises' residence. First, at the time of assessment notice and attachment of the lien, Sarah and John owned a joint homestead interest in the residence, which is the economic equivalent of a joint life estate. Second, Sarah and John each owned a contingent homestead interest or life estate, which would become a possessory interest in favor of the surviving spouse. Finally, Sarah and John jointly owned the remainder interest in the property."

This language may have made sense in *Harris* where the home at issue was community property, but it should not be applicable where the home is the separate property of the non-liable spouse.

Rodgers involved a situation where the essence of the holding was that the property rights of the survivor had to be protected. The government wanted to disregard Lucille Rodgers's interest; therefore, the *Rodgers* decision—allowing the government to sell the home—was only a partial victory for IRS since Lucille Rodgers was allowed to keep a portion of the sales proceeds. *Rodgers,* however, created a clear path for the IRS to pursue a survivor's rights when the facts are reversed, that is, where the delinquent taxpayer is not the owner of the fee interest in property but merely owns a survivor's right.

In some instances the survivor's right as a property right is inadvertently created by marriage after the assessment of the delinquency occurs. Since the delinquent taxpayer would not have used his or her own funds to acquire the survivorship right but created it merely by marrying the owner of the home, the IRS gets the windfall at the severe expense of the uninformed spouse who owns the home.

In *Harris,* the issues were similar to those in *Rodgers* inasmuch as the fight was about the proper protection allowed to the non-liable spouse, but the facts were different in that there was no community property in *Rodgers* and the only property right owned by the non-liable spouse was her homestead survivorship right, thus making the calculation relatively simple. In *Harris,* the mere facts that the taxpayer was still alive and that the asset targeted for collection (cash proceeds from the sale of the home) was community property caused the court to adopt a much more complex calculation. It appears that the IRS is applying that calculation to all fact patterns, even those with major distinctions from the *Harris* facts.

When to Value the Survivorship Right

The *Rodgers* and *Harris* opinions leave open an important question involved in the administration of the *Rodgers* and *Harris* principles, that being the actual date of computation of the non-liable spouse's rights. Is it the date of the tax assessment of the liable spouse, the date of a lien filing, or the date of foreclosure? *Blakeman,* 70 AFTR 2d 92-5366 , 997 F2d 1084 (CA-5, 1992), provides an answer.

At the time C.E. Blakeman died in 1978, he owned as his separate property a rural residence in Texas. In the lower court, Maudine Blakeman prevailed with her position that it was a rural homestead and she was entitled to live there for the remainder of her life. In 1980, the IRS assessed unpaid estate taxes and in 1981 the Service filed liens against the Blakemans' rural homestead.

Following the mandate of *Rodgers,* the district court ordered the homestead to be sold and allowed Maudine to recover the value of her life estate. The date of computation, according to the district court, would be the date of the lower court judgment. Maudine argued that the computation should be made as of the date of the assessment. The IRS argued that the appropriate date of calculation was the date of the foreclosure sale because to do otherwise would be to allow Maudine the free use of the homestead for ten years or so between the date of assessment and the date of foreclosure. The Fifth Circuit held that the date of the foreclosure sale was the appropriate date of calculation.

EXPANDING THE ANALYSIS: *CRAFT*

The Service's position that it can file a lien on a non-liable spouse's home and ultimately foreclose on the lien became a bit more cloudy after the Supreme Court's decision in *Craft,* 89 AFTR 2d 2002-2005 , 535 US 274 , 152 L Ed 2d 437 , 2002-2 CB 548 (2002). *Craft* dealt with the question of whether a tenancy by the entirety created under Michigan law was a property right to which an IRS lien could attach, followed by a forced sale and then a division of the proceeds from a sale of the underlying property between the IRS and the non-liable spouse.

The taxpayer (husband of the respondent in the Supreme Court proceedings) failed to pay federal income tax liabilities assessed against him, and pursuant to Section 6321 a federal tax lien attached to "all [of his] property and rights to property." After the notice of the lien was filed, respondent and her husband jointly executed a quitclaim deed purporting to transfer to her his interest in a piece of real property in Michigan that they owned as tenants by the entirety. Subsequently, the IRS agreed to release the lien and allow respondent to sell the property, with half the net proceeds to be held in escrow pending determination of the Service's interest in the property.

Respondent brought the action to quiet title to the escrowed proceeds. The IRS claimed, among other things, that its lien had attached to the husband's interest in the tenancy by the entirety. The district court had no problem finding that the quitclaim deed would be a fraudulent conveyance if the IRS could seize that which was conveyed, i.e., the husband's

interest in the tenancy by the entireties property. The district court granted the government's motion for summary judgment, but the Sixth Circuit held that no lien attached because the husband had no separate interest in the entireties property under Michigan law, and remanded the case for consideration of an alternative claim (not at issue at the Supreme Court). The Supreme Court held that the husband's interests in the entireties property constituted property or rights to property to which a federal tax lien could attach.

In *Craft,* the Court noted that it looks initially to state law to determine what rights the taxpayer has in the property the government seeks to reach and then to federal law to determine whether such state-delineated rights qualify as property or rights to property under Section 6321 . At the time *Rodgers* was decided, the rule of property or property right determination was primarily a state court function. [15] But post-*Rodgers* the concept was narrowed somewhat by *National Bank of Commerce,* 56 AFTR 2d 85-5210 , 472 US 713 , 86 L Ed 2d 565 , 1985-2 CB 327 (1985), [16] and then further narrowed in *Drye,* 84 AFTR 2d 99-7160 , 528 US 49 , 145 L Ed 2d 466 , 2000-1 CB 863 (1999).

In *Drye,* the Supreme Court extended the federal law control by explaining that state law is initially examined only to find the rights the taxpayer has in the subject property, after which federal law determines whether the taxpayer's rights constitute property or property rights. In *Craft,* the Court further noted that "English common law provided three legal structures for the concurrent ownership of property that have survived into modern times: tenancy in common, joint tenancy, and tenancy by the entirety."

The Court described tenants-in-common as each owning a separate fractional share in undivided property, each tenant having the unilateral right to alienate his or her shares through sale or gift, or to place encumbrances on these shares and transfer such shares at death. [17] They also have many other rights in the property, including the right to use the property, to exclude third parties from it, and to receive a portion of any income produced from it. [18]

Joint tenancies, the Court noted, also have a survivorship component, meaning that on the first to die of the joint tenants the survivor owns all of the underlying property. Tenancy by the entirety is yet distinguishable from both tenancies-in-common and joint tenancies in that tenancy by the entirety is available only to married couples and, like joint tenancies, there is a right of survivorship. The Court noted that a unilateral disposition of one spouse's interest in a tenancy by the entireties is typically not possible without severance, and severance requires the consent of both spouses. Under Michigan law, a spouse could not unilaterally convey an interest in a property held as tenancy by the entireties, and each spouse had a survivorship right.

In coming to its conclusion that one spouse's "bundle of sticks" in a tenancy by the entireties was enough to call it a "property right," the Supreme Court in *Craft* relied heavily on *Rodgers* and rejected the respondent's argument that a property right that could not be alienated could not be seized by the IRS. The court said:

"Excluding property from a federal tax lien simply because the taxpayer does not have the power to unilaterally alienate it would, moreover, exempt a rather large amount of what is commonly thought of as property. It would exempt not only the type of property discussed in *Rodgers,* but also some community property. Community property states often provide that real community property cannot be alienated without the consent of both spouses. See, *e.g.,* Ariz. Rev. Stat. Ann. §25-214(C) (2000); Cal. Fam. Code. Ann. §1102 (West 1994); Idaho Code §32-912 (1996); La. Civ. Code Ann., Art. 2347 (West Supp. 2002); Nev. Rev. Stat. Ann. §123.230(3) (1995); N. M. Stat. Ann. §40-3-13 (1999); Wash. Rev. Code §26.16.030(3) (1994). Accordingly, the fact that respondent's husband could not unilaterally alienate the property does not preclude him from possessing 'property and

rights to property' for the purposes of §6321."

The Court's opinion was delivered by Justice O'Connor. Justices Thomas, Scalia, and Stevens dissented strongly, primarily arguing that a property right that cannot be alienated and may be lost on termination of the marriage should not be a property right eligible to be lost to the IRS. The dissent analogized a marriage to a partnership or a corporation, that is, a fiction of law, making the point that if the Service files a lien that attaches to a partnership interest the IRS does not have the ability to dissolve the partnership and take its share. [19]

It is possible that in future litigation dealing with the question posed here, that is, whether a non-owner's contingent homestead survivor's right is a property right subject to levy, *Craft* will play a larger role than *Rodgers.* In *Rodgers,* the Court acknowledged the age-old rule that state law determined when property rights existed and federal law controlled with respect to the government's right to take it. [20] Even though the issue was whether a single element of the homestead bundle of rights (the right to remain in the home after the death of the first spouse to die) was a property right that the government could not take from Mrs. Rodgers, the Court did not break it down and analyze that single piece of the bundle as the Court later did in *Craft.*

In *Craft,* significant debate over the elements of a property right ensued between the majority and the dissent, principally over the absence of a unilateral right to convey the economic benefit of a tenancy by the entireties. The focus here is on the right of survivorship as a separate property right and whether the government can force the sale of a non-liable spouse's home to extract solely the value of that right. The right of survivorship under homestead law does not include all those elements of a property right that were debated in *Craft.* It is not assignable and the owner of it can do nothing with it except possess it. More important, it is contingent and may never be of any value since it can be lost by divorce.

The Court in *Craft* broke apart the bundle of sticks and analyzed the individual elements of ownership by the entireties, that is, the separate rights that comprise the bundle of rights. In contrast, *Rodgers* applied the then-simplistic rule that state law defines property and federal law determines what the IRS can do with it. *Rodgers* did not dissect homestead rights, and it must be remembered that the single right at issue in *Rodgers* was the right of survivorship and not any of the other homestead rights such as the right of creditor protection and the right precluding unilateral alienation by a single spouse during the marriage. And to add further complexity, that single right of survivorship must be applied to different sets of fact patterns since the survivorship at issue in *Rodgers* was the unconditional right to possess the homestead for life, but such rights in other cases are distinguishable because the right is conditional.

What "sticks" then exist for owners of a survivorship right? In *Rodgers* it was simply one, the right of possession, with no right of sale or even transfer by gift. If, however, the two spouses still occupy the homestead at the time of an attempted seizure and sale by the IRS, there is no vested right of occupancy since that right is subject to staying married and subject to one spouse's surviving the other spouse, and there is no right of assignment. That is not a large bundle of sticks, and one can only speculate what the *Craft* court in 2002—and, more important, the Supreme Court as it is constituted today—would do with the question presented here. A tenancy by the entireties is a consensual contractual arrangement that two spouses enter into presumably with full knowledge of their respective rights. A homestead survivorship right is a property right created by marriage with the couple usually having very little knowledge of the risks the non-liable spouse is taking. [21]

Subsequent to *Craft,* the IRS published guidance in Notice 2003-60, 2003-2 CB 643 , on

collection from property held in a tenancy by the entirety, where only one spouse is liable for the tax deficiency. Though the Service's position is that *Craft* is not new law, the IRS has offered some comfort to non-liable spouses. As a matter of policy, the Service will not apply *Craft* for certain interests created before *Craft* to the detriment of third parties who reasonably may have relied on the belief that state law prevents the attachment of the federal tax lien. The sale of entireties property subject to the federal tax lien presents practical problems and because of the potential adverse consequences to the non-liable spouse, the IRS will use lien foreclosure for entireties property on a case-by-case basis.

Notice 2003-60 further provides that the value of the taxpayer's interest in entireties property generally is deemed to be one-half. If there has been a sale or other transfer of entireties property subject to the lien that does not provide for the lien's discharge, the lien thereafter encumbers a one-half interest in the property held by the non-liable spouse or third-party transferee.

APPLYING *RODGERS* AND *HARRIS* TO FACTS

The facts in the hypothetical example above present a completely different analysis from that of *Rodgers* and *Harris.* Since the home is owned by W (the non-liable spouse), are H's survivorship rights characterized as property rights? If so, what is the value of a homestead survivorship right that is subject to two contingencies that probably may terminate the survivorship right?

First, if H and W divorce prior to W's death, H gets nothing not only because of the premarital agreement but also because in most states the law does not allow H any share of the home since it is W's sole and separate property. The second, and more calculable contingency, is that H must outlive W for any property right (if indeed it is) to become a value. What then, would a willing buyer pay for H's contingent property rights if such rights were assignable?

The answer is "nothing." A hypothetical willing buyer most likely does not exist and, if it did exist, the true valuation would be no more than a nominal amount. The Supreme Court in *Rodgers,* however, bypassed the willing-seller/willing-buyer test [22] for the simplicity of the regulatory tables, perhaps only because there was no contingency in that Philip Bosco had predeceased Lucille Rodgers, thus leaving the contingency element of the valuation open for other, more complex fact patterns.

If the very concept of the Service's having the right to force a sale of an innocent party's home to extract value for the taxpayer's survivorship right is surprising, the Service's position that the value is calculated without taking into account these contingencies will be beyond surprising. If the notion that the survivor's homestead right is a property right (even though not vested and still contingent) and therefore a *Rodgers*-type of foreclosure and sale can be enforced as a matter of law, the contingency of the property right should be taken into account in determining H's value that the IRS is attempting to extract.

Applying the mandate of the Supreme Court in *Rodgers* and using the regulatory tables, the valuation of H's homestead survivorship right in the above example should be only slightly more complicated than was the valuation in *Rodgers.* The second contingency, however, is taken into account by using the double life table for the first life age 40 and the second life age 50.

There are no cases or any other published authority that explain exactly how to approach the calculation issue presented with respect to the facts of the example. If it is assumed that the goal is to determine the value of H's right to stay in W's home after W's death, then Example B.4 of IRS Publication 1457 [23] sets out a simple calculation that produces an $18,616 value of H's survivorship right (see Exhibit 1).

Exhibit 1. Calculating the Value of H's Survivorship Right

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Table R(2) of IRS Publication 1457
shows the remainder interest after
the life estate of two lives with
ages 50 (H) and 40 (W) using a 4.2%
interest factor to be:                           .19792
Therefore the life estate is (1.0 - .19792):     .80208
The single life estate of W is computed
as the remainder interest after a
40-year-old's life estate as:                    .24446
Therefore the life estate is (1.0 - .24446):     .75554
Accordingly, the valuation of the life
estate of H is:
     Joint life estate                           .80208
     Less: life estate valuation factor of W     .75554
                                                 ------
                                                 .04654
                                                 ======
Therefore, under the facts of the example,
the dollar value of H's contingent life
estate is (.04654 × $400,000):                  $18,616
```

The IRS might not be inspired to initiate the procedure necessary to cause a foreclosure and obtain an order for the sale of a $400,000 house to produce as little as $18,616 of collection. But our hypothetical was set up to illustrate how little the valuation would be.

What would be the result if the example was modified to reverse the ages: W, the owner/non-taxpayer is 50, and H, the non-owner/taxpayer is 40. W's life estate (Table S 2.4) remainder factor is .34166. Therefore, the life estate factor is .65834 and the excess of the two-life factor over H's single-life factor is .14374 (.80208 − .65834). H's share of the house proceeds would be $57,496. Now the IRS will be a bit more interested.

As noted, there are no cases or other authority dealing with the fact pattern set up by the example, i.e., where (1) the ownership of the home is by a non-liable party and not as the spouses' community property or as some other form of joint ownership, and (2) both spouses are alive at the critical date of valuation determination. There is, of course, very specific guidance where either or both of those factors are different: either the home is community property or jointly owned property, or both spouses are alive at the date of valuation determination.

Harris involved both such factors—community property with both spouses being alive at the date of calculation. In *Harris,* the court, attempting to find a workable solution, outlined the critical holding to the effect that the spouses owned the following interests:

(1) H and W owned a joint homestead interest.
(2) H and W each owned a contingent life estate that would begin on the death of the other.
(3) H and W jointly owned a remainder interest in the home.

Unfortunately, it appears that the Service, without mandate or authority, erroneously applies the *Harris* language where the home is the sole separate property of the non-liable spouse, not community property or jointly owned property of the non-taxpayer. Applying the *Harris* calculation to the first example where W, the non-liable owner, is 40 and H, the taxpayer/non-owner, is 50, the results would be that the IRS could extract $220,144 from the $400,000 sale proceeds; W, the owner whose home was lost in the process, would get $179,856 (see Exhibit 2).

Exhibit 2. The IRS Re-Calculation of H's Survivorship Right Using *Harris*

The mechanics of the calculation, according to an IRS worksheet, are as follows:

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Required factors from Publication 1457 (4.2%)
---------------------------------------------
 A. Taxpayer (Age 50) remainder factor          .34166
 B. Taxpayer life estate factor                 .65834
 C. Spouse (age 40) remainder factor            .24446
 D. Spouse life estate factor                   .75554
 E. Two-life remainder interest                 .19792
Computation of first to die
---------------------------------------------
 F. First to die remainder factor (A + C - E)   .38820
 G. First to die income factor (1.0 - F)        .61180
Taxpayer's share
---------------------------------------------
 H. One-half of joint life estate (G ÷ 2)       .30590
 I. Deferred contingent life estate (B - G)     .04654
 J. Remainder (E)                               .19792
 K. Total (H + I + J)                           .55036
Spouse's share
--------------------------------------------
 L. One-half of joint income interest (G ÷ 2)   .30590
 M. Deferred contingent life estate (D - G)     .14374
 N. Total (L + M)                               .44964
Check
--------------------------------------------
 Total of Taxpayer and
    Spouse's interests (K + N)                 1.00000
```

In our example, if the Service's calculation developed from *Harris* could be correct, W—the party who owns the $400,000 home as her separate property and does not owe the tax—will be forced from the home and will lose over 50% of its value. It is doubtful, however, that when there is a challenge to the application of the *Harris* formula in a case where the home is clearly the sole or separate property of the non-liable spouse, the IRS will attempt to use the formula. It is patently wrong for two rather obvious reasons:

(1) H does not own a remainder interest. A remainder interest to H could exist only if H predeceased W and H's heirs took the home back after W's death. If H predeceases W, however, H's rights are terminated; there is nothing for his estate to take after W's so-called life estate.
(2) The *Harris* formula actually values H's ability to live in the home during the time H and W are married until H's death (the contingent life estate begins thereafter). The failure to take into account the probability of divorce is the first fallacy, but the divorce contingency is difficult, if not impossible, to quantify. More important, H's right to live in W's home during H's marriage to W has never been determined to be a right that can be alienated or subjected to creditor's liens. Simply put, it should not be a property right.

The *Rodgers* and *Harris* decisions are now firmly woven into the tax law fabric. What does that mean for W in our example? *Rodgers* and the cases decided thereafter are dealing with fact patterns where the delinquent taxpayer owned an interest in the real property. In the example, H did not own anything but a pure survivor's homestead right, and a non-liable spouse's immediate reaction is how can the IRS force a sale of the non-liable spouse's *separate homestead property* for the collection of H's taxes?

In *Rodgers,* there was nothing contingent about the survivor rights because the taxpayer was already deceased. But in our example, H's right—which can translate into a value—is conditional. H must stay married to W until W dies, a condition that can be terminated by W and H divorcing or H's predeceasing W. *Harris* did not involve contingent rights because the home was sold. [24]

No governmental collection action could possibly have a louder ring of unfairness than the threat of losing a home because of the tax liability of another party. In their broadest sense, however, the opinions of the courts are clear: Where the survivor's homestead right is a property right under state law, the IRS can take that property right to satisfy the non-owner/taxpayer's debt to the U.S.

As noted, for H to "vest" in his right he must be married to W when W dies, meaning that H and W must stay married and H must outlive W for there to be a value to extract. Why should this obvious contingency not be taken into account (1) in determining whether there truly is a property right that could have value, and more important (2) to determine the value of that right? The Supreme Court in *Rodgers,* a case where the survivor's homestead right was not contingent, simply said that it made sense to use a life estate valuation scheme. It was a simple single-life determination on Lucille Rodgers's life. There is not much argument about that because Lucille's right was unconditional and the method answered the simple question of how many years will Lucille have to live in the home.

In *Harris,* the IRS tried to use a single-life table and the Fifth Circuit rejected that proposal and said a two-life table had to be used. As applied to the facts of our example, why should any table be used other than to tell the IRS (and a court) what it already knows: W, a 40-year-old is going to outlive H, a 50-year-old? If W is going to outlive H (according to the tables) there should be no value to H's right to live in the home after W's death. Indeed, if according to *Rodgers* the tables that assume normal lifetimes are to control, then they should control the question of whether there truly is a property right.

The Service's position is that taxpayers do not get to use the presumption that W may predecease H for the question of whether H has anything, but must use the tables solely for a value calculation. No court has addressed this very simple straight-forward proposition because no fact pattern as presented in our example has been litigated. The authority that the IRS applies is the conclusion in *Harris* that when both husband and wife are alive at the time, the joint life table should be applied. The opinion, however, does not make the calculation and thus leaves open the single most important issue in the fact pattern presented here.

Even though there is a naturally strong reaction to the possibility of a non-liable spouse losing a home that is separate property because of the tax liability of the other spouse, one must be mindful that the cure for the non-liable homeowner's problem may have an offsetting negative impact on taxpayers in other fact patterns. If the cure is to somehow declassify the survivorship right from its status as a property right, a non-liable spouse could have a home foreclosed with no *Rodgers*-type compensation if the home is the liable party's separate property or the community or otherwise joint property of the two spouses.

CHALLENGING THE SEIZURE AND SALE OF A PRINCIPAL RESIDENCE

A non-liable homeowner is not without equitable defenses to the seizure and sale of the non-liable spouse's home. The direction the homeowner will take depends on the steps the IRS invokes.

Administrative Seizure

Before the Service can administratively seize a principal residence, the IRS must present the proposed seizure to the U.S. district court pursuant to Section 6334(e)(1) . That section does not give the court any guidance as to the standards to consider before giving the IRS the green light to force the sale of a home.

The Regulations under Section 6334 [25] allow taxpayers to contest a foreclosure of the taxpayer's [26] principal residence, but only to raise minimal defenses which are:

(1) The tax liability has been satisfied.
(2) Other assets are owned by the taxpayer that can satisfy the liability.
(3) The IRS did not follow applicable laws or procedures.

The congressional history of Section 6334(e)(1) , however, is not so restrictive and it is doubtful that in a properly presented case the Regulations would be found to reasonably set forth the intent of Congress. The Senate Report states as follows:

"The provision [Sections 6334(a)(13) and 6334(e)(1)] *requires the IRS to exhaust all other payment options before seizing the taxpayer's business or principal residence.* The provision does not prohibit the seizure of a business or a principal residence, but would treat such seizure as a payment option of last resort. The provision does not apply in cases of jeopardy. *It is anticipated that the IRS would consider installment agreements, offer-in-compromise, and seizure of other assets of the taxpayer before taking collection action against the taxpayer's business or principal residence.*" [27]

Judicial Seizure

The government may choose not to proceed administratively and may attempt to seize and sell the home through a judicial proceeding pursuant to Section 7403 .

Rodgers provides the non-liable spouse with potential protection in such judicial proceedings, although in application the district courts have not been very generous to taxpayers. The Supreme Court basically read the word "may" in Section 7403 [28] to imply some degree of discretion in the district courts to refuse to allow a seizure and sale but the Court made clear that district courts should not have unbridled discretion. The Supreme Court then proceeded to outline a four-factor test. [29] The district courts have succinctly summarized the four factors as follows:

(1) Whether the government's financial interests would be prejudiced by the sale of only the debtor's interest.
(2) Whether a non-liable third-party has a recognized expectation the property would not be subject to forced sale.
(3) The likely prejudice to a third party resulting from dislocation costs and possible undercompensation.
(4) The relative character of liable and non-liable interests in the property. [30]

While the various district courts that have applied the *Rodgers* four-factor test have discussed the factors only in the broadest manner, common sense would suggest that when the non-liable spouse is a mother with minor children or is handicapped in some manner, the third factor (prejudice to the non-liable spouse) will weigh heavily in the court's deliberations. Also, if the home is the separate property of the non-liable spouse (as in our example) the second factor (absence of an expectation of sale) will be closely considered.

The *Rodgers* four-factor test is a product of a proceeding initiated pursuant to Section 7403

and the test was not adopted by Congress in 1998 when it amended Section 6334(e)(1) to require district courts to approve administrative seizures of principal residences. When dealing with an administrative seizure, however, the district courts may not feel constrained by the committee reports or the Regulations under Section 6334(e)(1) since they are not reconcilable. Accordingly, a district court might find it advisable to look to the *Rodgers* four-factors test when third-party (the non-liable owner in our example) claims are present.

How valuable is the district court protection of non-liable third parties in judicial seizures sought by the government under Section 7403 ? Based solely on the wins vs. losses of the non-liable spouse, the conclusion is "not very." [31] Merely analyzing the number of wins and losses, however, is not a good test. While some courts have not allowed the forced sale, in those cases that did allow the forced sale the non-liable spouse has been given an equitable interest in the sales proceeds even where the spouse has participated in some manner in an attempted fraudulent sale of property. The facts and circumstances will have to show a very strong equitable interest in the non-liable spouse, such as illness or minor children in the home where a sale of the home would cause a hardship that outweighs the government's collection ability.

The non-liable homeowner need not play defense and wait on the IRS to take action by filing a lien and then seeking an administrative seizure or by filing a judicial foreclosure suit under Section 7403 . Once a lien has been filed, the non-liable owner is permitted to file a suit in federal district court or in any state court having jurisdiction of the subject matter to quiet title with respect to the home (or any other property for that matter) on which the lien has been filed. [32]

Once a levy or seizure has commenced and the administrative review under Section 6334 (e)(1) has begun, the non-liable party may file a wrongful levy suit in federal district court. [33] The time for filing a wrongful levy suit is relatively short—nine months from the date of the levy. [34] The date of the levy is the date the notice of levy is served. [35] Once a notice of levy is served, the taxpayer no longer has the ability to file a suit to quiet title and a wrongful levy suit is the only remedy. [36]

PROTECTIVE STEPS

In states that allow property rights between spouses to be modified or waived by contract, it should go without saying that where either husband or wife is coming into the marriage with an existing potential tax delinquency, that party's rights to the homestead, including a survivor's rights, should be waived and abandoned. It makes no sense to unnecessarily create a property right that will allow the IRS to take property from a non-liable person to pay the delinquent tax of another.

If, however, neither husband nor wife is coming into the marriage with the probability of delinquent taxes, the parties usually want the non-owner surviving spouse to have the right to remain in the home subsequent to the death of the first spouse to die. In this situation, protection possibly could be accomplished with a modification to the survivor's rights by a conditional right of survivorship whereby the spouses agree to allow the statutory right (or state constitutional right) to stay intact so long as neither party is liable for delinquent federal taxes that otherwise could be collected from a seizure of the home. Thus, if an assessment of federal taxes is made against one spouse, the right of possession after the death of the other spouse would be abandoned automatically.

This contingent form of waiver and abandonment has not been tested. The IRS may contend that the waiver and abandonment is done without consideration since the action took place at a time when no forbearance being made by the non-liable spouse would be

apparent, [37] but the question of adequacy of consideration should be made when the conditional agreement to waive the abandonment of the homestead right was made, not when the action of the actual waiver takes place. In any event, it would be prudent for the non-liable spouse to pay some amount of actual consideration to the liable spouse in exchange for the waiver and abandonment.

CONCLUSION

The state of the law with respect to the Service's right to force a sale of a home owned by a non-liable party to pay delinquent taxes of a taxpayer begs for guidance. The policy question presented is whether the government can cause a sale of property owned by a person other than the taxpayer in order to carve out a value computed by regulatory tables of a property created solely by the act of marriage, and subject to contingencies, when no consideration was paid by the taxpayer to the non-liable owner.

As demonstrated by the examples in this article, it makes no sense that the IRS should be able to force a sale and take anything. Until the Service concedes the point the question will have to be decided by the courts, most likely in a circuit other than the Fifth, where the opinion in *Harris* has created a very confusing situation. Better yet, Congress should adopt statutory protection for the owner who is not liable for the tax. At a minimum, the IRS should publish its position so that the public will know what to expect.

Practice Notes

In states that allow property rights between spouses to be modified or waived by contract:

- Where either party is coming into the marriage with an existing potential tax delinquency, that party's rights to the homestead, including a survivor's rights, should be waived and abandoned.
- If neither party is coming into the marriage with the probability of delinquent taxes, protection possibly could be accomplished with a modification to the survivor's rights by a conditional right of survivorship whereby the spouses agree that the right of possession after the death of the other spouse would be abandoned automatically if an assessment of federal taxes is made against one spouse.

1

Section 6321 states as follows: "If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount ... shall be a lien in favor of the United States upon all property and *rights to property*...." (emphasis added).

2

Section 6331(a) states in part as follows: "If any person liable to pay any tax ... it shall be lawful for the Secretary to collect such tax ... by levy upon all property and *rights to property* ... belonging to such person...." (emphasis added).

3

Section 7403 .

4

States that have some form of spousal homestead survivorship rights are California, Kansas, Kentucky, Massachusetts, Minnesota, Nevada, New Hampshire, North Carolina, Oklahoma, Tennessee, Vermont, Wisconsin, and Wyoming. Rights vary from state to state and the state law is important. It may create a conditional type of right that does not rise to the level of a property right or the conditions could materially affect the value. Homestead laws normally consist of three distinct features. First, the homestead is exempted from the reach of creditors. Second, limitations are placed on the conveyance of the homestead, in that the homestead cannot be sold by one spouse without the consent of the other spouse, regardless of whether the homestead property is community property or the separate property of either spouse. Third, on the death of either spouse, the homestead is subject to occupancy by the surviving spouse to use it as a homestead. See Estate of Johnson 52 AFTR 2d 83-6465 , 718 F2d 1303 (CA-5, 1983).

5

The IRS position is in effect an extension of the rule that if at the time of the lien filing the lien attaches to a property, the lien cannot be defeated by merely agreeing that the non-taxpayer spouse is awarded the property in the divorce negotiation.

6

With respect to the collection procedures applicable to homestead property, the Internal Revenue Manual gives very little guidance to the revenue officers. See, e.g., IRM section 25.18.4.5., "Collecting Premarital Liabilities" (revised 2/15/05): "If Property subject to a lien is a homestead, collection is subject to other limitations and Counsel should be contacted." See also IRM section 5.17.3.8.1.7, "Homestead" (revised 12/7/07), recognizing that state law varies with respect to homestead rights, that is, whether any element of the homestead creates a property right or is a mere expectancy.

7

See, e.g., St. Clair, 45 AFTR 2d 80-1528 (DC Tex., 1980). There the court allowed the foreclosure of a community property homestead for the husband's separate tax liability and the wife received none of the proceeds representing her survivorship right.

8

Tex. Const. Art. 16, section 52.

9

The Supreme Court remanded the case for the calculation. The Court left another issue open, that is, whether Lucille Rodgers was entitled to a life estate in 100% of the property or to 50% of the value of the property (because it was community property prior to Phillip Bosco's death) *and* a life estate in Phillip's 50%. The Court ignored the issue only because the Court of Appeals failed to dispose of the issue. The IRS can seize the entire community property for the tax liability of one of the members of the community. See the discussion in the text below of Harris, 56 AFTR 2d 85-5471 , 764 F2d 1126 (CA-5, 1985).

10

The determining value of life estate and remainder interests is now controlled by the tables in the Section 7520 Regulations; see note 23, *infra*.

11

The Fifth Circuit stated: "Although these tables have never attained the force of law, see Bowden [49 AFTR 1675 , 234 F2d 937 (CA-5, 1956), *cert. den.*], their use in determining the present value of future interests in property has been long recognized and approved by the Supreme Court, see Simpson [4 AFTR 4735 , 252 US 547 , 64 L Ed 709 (1920)]."

12

The appellant had sold her home (which had been community property) and by agreement with the IRS a portion of the sales proceeds were escrowed. The fight was over the split of the proceeds.

13

Citing Cockherham v. Cockerham, 527 SW2d 162 (Tex., 1975).

14

The same panel applied the Harris reasoning in a companion case and ordered the calculation be determined on a two-life basis. Molina, 56 AFTR 2d 85-5475 , 764 F2d 1132 (CA-5, 1985).

15

Bess, 1 AFTR 2d 1904 , 357 US 51 , 2 L Ed 2d 1135 , 1958-2 CB 934 (1958): "... §3670 [of the 1939 Code] creates no property rights but merely attaches consequences, federally defined, to rights created under state law...."

16

Where the Supreme Court said: "State law defined the nature of the taxpayer's interest in the property, but the state law consequences of that definition are of no concern to the operation of the federal tax law."

17

Citing 7 Powell and Rohan, *Real Property* (M. Wolf ed., 2001), §51.01[3].

18

Id. at §§50.03-50.06.

19

Similarly, a property right that is created by a marriage and subject to being lost by dissolution of the marriage should not be eligible for foreclosure even if the other spouse—the non-taxpayer—is compensated. *Query,* with Justices Roberts and Alito now on the Court in place of Justices O'Connor and Rehnquist, whether this decision would be the same if reviewed today, or would the forceful voice of the dissent get two more votes? In U.S. v. Parcel of Real Property Known as 1500 Lincoln Avenue, 949 F2d 73 (CA-3, 1991), then-Judge Alito wrote the opinion for a three-judge panel in a civil forfeiture case involving real property used in the illegal diversion of pharmaceutical drugs. The Third Circuit in that case refused to allow a forced sale of the property and required the government to wait until the death of the innocent co-owner. The property was owned by the convicted party and the innocent party as a tenancy by the entireties. The result of this

decision was exactly the result requested by Lucille Rodgers but rejected by the Supreme Court, and subsequently rejected again by the Court in Craft, where a forced sale and a split of the proceeds was ordered.

20

See notes 15 and 16, *supra,* and the accompanying text.

21

For a particularly insightful analysis of Craft, 89 AFTR 2d 2002-2005 , 535 US 274 , 152 L Ed 2d 437 , 2002-2 CB 548 (2002), see Dagan, "The Craft of Property," 91 Cal. L. Rev. 1517 (2004).

22

See Reg. 20.2031-1(b) , which defines FMV (for estate tax purposes) as the "price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts."

23

IRS Publication 1457 (July 1999), page iv. The Section 7520 regulatory tables (Book Aleph) control (see Harris, *supra* note 9). Reg. 7520-1(c)(1) refers to Reg. 1.642(c)-6(e)(6) .

24

See also Molina, *supra* note 14.

25

Reg. 301.6334-1(d)(2) .

26

The Regulations do not address the question of whether a non-liable owner has standing. They do note that the taxpayer's family members have no standing to contest the levy, although the premise set forth in the Regulations is that the taxpayer owns all of the interests in the home. See Reg. 301.6334-1(d)(3) .

27

S. Rep't No. 105-174, 105th Cong., 2d Sess. 87 (1998), 1998-3 CB 623 (emphasis added).

28

The court in a Section 7403 proceeding "shall ... proceed to adjudicate all matters involved therein ... and, in all cases where a claim or interest of the United States is established, *may* decree a sale of such property...." Section 7403(c) (emphasis added).

29

The Court made it clear that the four factors were not an exhaustive list.

30

For a variety of reasons the courts in the following decisions held for the non-liable spouse and denied a forced sale: Kingman, 83 AFTR 2d 99-1964 , 74 F Supp 2d 753 (DC Ohio, 1999) (government procedure was flawed and failed to prove exact ownership of the taxpayer); Johnson, 78 AFTR 2d 96-7395 , 943 F Supp 1331 (DC Kan., 1996) (government denied summary judgment because it failed to show as a matter of law that government equities outweighed those of the non-liable spouse; fact issue existed); Monticelli, 71A AFTR 2d 93-3003 (DC Nev., 1989) (government denied summary judgment because genuine fact issue existed).

In the following decisions, the courts have denied the non-liable spouse's challenge to a forced sale but pursuant to Rodgers allowed a portion of the sale proceeds to go to the non-liable spouse: Bierbrauer, 68 AFTR 2d 91-5050 , 936 F2d 373 (CA-8, 1991); Persaud, 97 AFTR 2d 2006-1084 , 420 F Supp 2d 1263 (DC Fla., 2006); Hanson, 96 AFTR 2d 2005-7174 (DC Minn., 2005); Kroblin, 94 AFTR 2d 2004-5180 (DC Okla., 2004); Munger, 92 AFTR 2d 2003-6983 (DC Minn., 2003); Casey, 86 AFTR 2d 2000-6754 (DC Calif., 2000); Campbell, 84 AFTR 2d 99-6964 (DC Okla., 1999); Bolton, 85 AFTR 2d 2000-498 (DC Okla., 1999); Sanders, 98 AFTR 2d 2006-5530 (DC Mont., 2005); Pottorf, 76 AFTR 2d 95-6375 , 898 F Supp 792 (DC Kan., 1995); Hopkins, 73 AFTR 2d 94-1338 , 859 F Supp 208 (DC W.Va., 1994); Garcia, 71A AFTR 2d 93-4246 , 789 F Supp 1089 (DC Wash., 1991); Anderson, 71A AFTR 2d 93-4567 (DC S.Dak., 1991); Sellner, 71A AFTR 2d 93-3866 (DC Mont., 1990).

31

No case could be found where the non-liable spouse owns the home as his or her separate property or a similar characterization applies in a non-community-property state.

32

28 U.S.C. section 2410.

33

Section 7426 .

34

Section 6532(c)(1) .

35

Section 6335(b) .

36

Fidelity and Deposit Co. of Maryland v. City of Adelanto, 78 AFTR 2d 96-5069 , 87 F3d 334 (CA-9, 1996); Winebrenner, 67 AFTR 2d 91-465 , 924 F2d 851 (CA-9, 1991); United Sand & Gravel Contractors, Inc., 46 AFTR 2d 80-5597 , 624 F2d 733 (CA-5, 1980).

37

See Calmes, 78 AFTR 2d 96-5952 , 926 F Supp 582 (DC Tex., 1996), where the IRS challenged the efficacy of a premarital agreement (earned income was separate property in a community property state) on the basis of the agreement's being a fraudulent conveyance (inadequate consideration). The court held that the non-liable spouse was not a related party at the time of the agreement and even if she were, she paid adequate consideration to the liable taxpayer by giving up equal claims to his future earned income.

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