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HIGH AND DRYE
Supreme Court Finds Tax Lien Attaches to Estate Property Despite Disclaimer

In a unanimous decision only a month after oral argument, the Supreme Court ruled that an individual's state law disclaimer did not prevent pre-existing tax liens from attaching to an inheritance, in **Drye Family 1995 Trust v. United States, 1999 U.S. LEXIS 8238 (S.Ct. Dec. 7, 1999)**. This significant victory for the Government confirms the primacy of the federal tax lien over state laws designed to protect property from the reach of creditors. It resolves a split among the circuits over whether the federal tax lien under I.R.C. § 6321 attached to the taxpayer's right to inherit, if the taxpayer later disclaimed his inheritance under state law.

The taxpayer's mother died intestate, leaving an estate of about a quarter of a million dollars in real and personal property. At the time of his mother's death, the taxpayer was insolvent and owed over $325,000 in federal taxes. The Service had valid federal tax liens against all of his property or rights to property. Six months after successfully petitioning to be administrator of his mother's estate, the taxpayer validly disclaimed all interest in his mother's estate under Arkansas law. The proceeds of the estate passed to the taxpayer's daughter, who promptly placed them in a spendthrift trust. The taxpayer was one of the beneficiaries of the trust. The Service successfully levied against the trust as the taxpayer's nominee (the trust's assets were held by a third party). The trust responded by filing a wrongful levy action against the Service.

The district court concluded that the Government held valid tax liens against all of the taxpayer's property and rights to property, which included the assets conveyed in the mother's estate. The court further found that the taxpayer's disclaimer was invalid and fraudulent as the trust was merely the taxpayer's alter ego or nominee. On appeal, the Eighth Circuit affirmed.

The Eight Circuit began by reciting the well-established standard that state law controls the nature of an interest in property, but federal law determines whether such a right or interest is subject to a tax lien under I.R.C. § 6321. Disagreeing with Leggett v. United States, 120 F.3d 592 (5^{th} Cir. 1997) (applying Texas law, found an estate's bequest was merely an offer, not a property right), and Mapes v. United States, 15 F.3d 138 (9th Cir. 1994) (applying Arizona law, held timely renunciation prevents taxpayer from acquiring interest in estate property), the court of appeals agreed with United States v. Comparto, 22 F.3d 455 (2d Cir. 1994) (applying New York law, held property interest vests upon decedent's death and so before renunciation). In Drye, the Eighth Circuit held that the pre-existing federal tax liens attached to the taxpayer's state law right to his share of the estate at the time his mother died. The state law "fiction" of disclaimer cannot overcome the federal consequences of the tax liens.

The Eighth Circuit agreed that there were valid policy considerations favoring the disclaimer's precedence. However, the court of appeals noted that Congress clearly intended section 6321 to reach any and all pecuniary interests to which a taxpayer may be entitled to satisfy outstanding tax liability. Nor, the court determined, is any disclaimer included in section 6334, which exempts specified property or rights, and no other, from federal levy.

The Supreme Court affirmed the Eighth Circuit in a unanimous decision by Justice Ginsburg. The Court held for the Government that the "Code's prescriptions are most sensibly read to look to state law for delineation of the taxpayer's rights or interests in the property the Government seeks to reach but to leave to federal law the determination whether those rights or interests constitute 'property' or 'rights to property' under section 6321." Applying that analysis, the Court observed that an expectancy to inherit, under Arkansas law, is assignable (although the Court made clear that it was not deciding whether assignability was a necessary feature of property for federal tax purposes). A right to inherit or to "channel the inheritance to a close family member (the next lineal descendant)" cannot simply be written off as a mere personal right to accept or reject a gift, the Court concluded. According to the Court, that right was "property" or a "right to property" subject to the Government's federal tax lien.

LIENS: State Law, Effect of

1. **BANKRUPTCY CODE CASES: Automatic Stay (§ 362): Tax Court Proceeding**
   Durham Farms v. United States, 1999 Bankr. LEXIS 1514 (D. Or. Nov. 12, 1999) - The bankruptcy court held that the automatic stay does not apply to tax redetermination proceedings brought in Tax Court by TEFRA partners. Because there is no provision in the Bankruptcy Code for payment of federal taxes by a bankrupt partnership, the Tax Court proceedings cannot "concern" the bankrupt partnership within the meaning of B.C. § 362(a)(8).

2. **BANKRUPTCY CODE CASES: Determination of Tax Liability: Assessment of Tax Determined by Bankruptcy Court**
   Klippel v. Internal Revenue Service, 84 AFTR2d ¶ 99-5592 (Bankr. D. N.J. Nov. 18, 1999) - Bankruptcy court abstains from determining the dischargeability of an I.R.C. § 6672 Trust Fund Recovery Penalty liability in a no-asset Chapter 7,

because the determination would have no effect on the administration of the bankruptcy case. The court held the debtor could seek a determination in any other appropriate forum, without involving the bankruptcy court in a determination that would serve no bankruptcy purpose.

3. BANKRUPTCY CODE CASES: Exceptions to Discharge (§ 523)
BANKRUPTCY CODE CASES: Priorities (§ 507)

In re Gust, 1999 U.S. App. LEXIS 32154 (11th Cir. Dec. 9, 1999) - The 11th Circuit summarily upheld the district court's decision in this case. The debtor argued that under B.C. § 523(a)(1)(A) the Government's secured tax claim was dischargeable, relying on United States v. Victor, 121 F.3d 1383 (10th Cir. 1997). Victor held that by referencing section 507(a)(8), B.C. § 523(a)(1)(A) addresses only unsecured taxes for dischargeability purposes. The district court disagreed with this contention, finding section 523(a)(1)(A) focuses on the kind of tax described by section 507(a)(8) rather than the type of claim that may be filed. Therefore, a secured federal claim is not dischargeable under section 507(a)(8) in a chapter 7 bankruptcy.

4. BANKRUPTCY CODE CASES: Priorities (§ 507)

In re Bennett, 237 B.R. 918 (Bankr. N.D. Tex. 1999) - Court held that a criminal restitution judgment was not entitled to priority treatment under B.C. § 507(a)(8). Debtor pled guilty to mail fraud and tax evasion charges, and was ordered to pay restitution. Subsequently, the debtor filed for bankruptcy. The United States neither filed a proof of claim nor objected to the debtor's Chapter 7 discharge. The court found despite the language of 18 U.S.C. § 3613(c) (restitution is a lien "as if the liability of the person fined were a liability for a tax assessed under the Internal Revenue Code.") that there is no specific reference to criminal restitution in the list of priorities under B.C. § 507. Further, the court held, the twin purposes of restitution - deterring and punishing the wrongdoer - are undermined when innocent creditors are required to help pay for a debtor's criminal sanctions. Since the United States still retains a nondischargeable restitution judgment, it is not harmed.

5. LIENS: Filing: Misnomer

Villard v. United States, 176 F.3d 479 (5th Cir. 1999) (*unpublished*) - In an unpublished opinion, the Fifth Circuit affirmed that a federal tax lien filed against "White-Hall Windermere Company, Inc." was effective against the taxpayer, Whitehall-Windermere Company, Inc., so as to defeat a subsequent judgment creditor's lien.

6. LIENS: Priority Over Attorneys

Reed & Steven v. HIP Health Plan of Florida, Inc., 1999 U.S. Dist. LEXIS 17940 (S.D. Fla. Oct. 7, 1999) - The district court adopted the magistrate judge's report of September 7, 1999. In this case, an advertising agency sued a health care plan, then switched attorneys. The second counsel obtaining a favorable settlement which was subject to both attorneys' liens. The Service, which had a lien against the health care plan, agreed that the second counsel was entitled to priority under I.R.C. § 6323(b)(8), but disputed payment to the advertising agency's first set of attorneys. The court found that the first attorney's charging lien was entitled to superpriority status under section 6323(b)(8) because Florida law provides that an attorney's charging lien relates back to the time the attorney first began representing the client. The court also disagreed with the Service that the total attorneys' compensation was limited to the 40% standard adopted by Florida Bar Rules. The court found that since the advertising agency had two sets of attorneys, both were entitled to reasonable compensation.

7. SUMMONSES:

United States v. Nixon, 1999 U.S. Dist. LEXIS 17921 (S.D. Fla. Oct. 28, 1999) - Service issued summons to corporate officers regarding the corporation's tax liability. The court quashed the summonses, finding the Service failed to comply with newly-enacted I.R.C. § 7602(c), which requires notice to the taxpayer prior to any contact with a third party. The Service, which did not send the required notice, argued that because of the close relationship of the officers to the taxpayer corporation, the officers were not third parties and section 7602 did not apply. The court disagreed, and further found no "good faith" exception to the requirements of the statute.

8. SUMMONSES: Third Party Summonses: Notice to Person Identified

Barmes v. United States, 1999 U.S. App. LEXIS 31401 (7th Cir. Dec. 2, 1999) - Seventh Circuit dismissed taxpayers' petition to quash third-party summons. The Service issued a summons to the taxpayer's bank, but did not provide them a copy. The taxpayers argued that since the summons was not issued solely in aid of collection, as required by I.R.C. § 7609(c)(2)(D), the summons was invalid. The court of appeals disagreed, holding that the statute did not contain the word "solely" and therefore, a summons issued for more than one purpose qualified for the section 7609 notification exception if one purpose of that summons was to aid in collection (as the revenue officer testified it did). The court also disagreed with the taxpayer's argument that the Service qualifies for the exception to notification only if the subject of the third-party summons is also the taxpayer named in the assessment.

9. SUMMONSES: Third Party Summonses: Right to Intervene or Proceeding to Quash

Clay IV v. United States, 1999 U.S. App. LEXIS 32832 (6th Cir. Dec. 20, 1999) - Taxpayer's suit to quash third-party recordkeeper summons was properly dismissed, the Sixth Circuit affirmed, because the taxpayer failed to file within the 20 days allowed under I.R.C. § 7609(b)(2)(A). A proceeding to quash, as with any suit against the United States, requires waiver of the Government's sovereign immunity. In this case, the Government's waiver, and also the court's jurisdiction, ends when the twenty-day limitation has run. The court of appeals found unpersuasive the taxpayer's argument that Fed. R. Civ. P. 6(e) added three days to this period because notice of the summons was mailed to them. First, section 7609(b)(2)(A) specifically mandates filing within 20 days notwithstanding any other law or rule of law. Second, Rule 6(e) provides additional time only for a “party,” and as no suit yet had been filed, the taxpayer could not be considered a “party.”