Office of Chief Counsel
Internal Revenue Service

memorandum

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to: MEMORANDUM FOR ASSOCIATE AREA COUNSEL, SEATTLE

from: Alan C. Levine
Chief, Branch 1 (Collection, Bankruptcy & Summonses)

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subject: Application of Section 6334(e) to Collection from Abusive Trusts

This provides our response to your request for advice dated December 9, 2002. This document may not be cited as precedent. I.R.C. § 6110(k)(3).

ISSUE:

Whether the Internal Revenue Service ("Service") must obtain judicial approval, pursuant to I.R.C. § 6334(e)(1), prior to seizure of residential property titled in the name of a trust created pursuant to an abusive trust scheme, where the Service has made assessments against both the trust and the individual using the property as a principal residence.

CONCLUSION:

While a technical argument may be made that section 6334(e)(1) is inapplicable, we recommend that the Service obtain judicial approval prior to seizure of such property, where a lien foreclosure suit would not otherwise be applicable. In the abusive trust context, it is the Service's position that the trust is a sham. Consistent with this position, the individual should be deemed to be the true "taxpayer", regardless of the additional assessment against the trust. Furthermore, seeking suit for lien foreclosure upon the subject property would be preferable to a section 6334(e)(1) proceeding in most of these cases, as questions regarding the title may create an unfavorable market for administrative sale.

FACTS:

The facts which you have provided are as follows: an individual taxpayer created several trusts as part of an abusive scheme to utilize trusts to evade the assessment and payment of tax. The tax liabilities of the individual taxpayer and the abusive trusts

were examined as part of the abusive trust project. The standard examination procedure is to assess tax against the individual on his or her individual income tax return (Form 1040) and to make an alternative assessment of tax against the trust on its income tax return (Form 1041). This is a "whipsaw" collection approach to protect the Service, where the actual amount of liability is only collected once from the assets of both the individual and the trust.

The individual taxpayer transferred title of his principal residence to the trust. The Revenue Officer is collecting the tax assessment against the trust. The Revenue Officer intends to seize the residential property from the trust. The Revenue Officer has requested advice as to whether the judicial approval requirements of I.R.C. § 6334(e)(1) are applicable in this scenario.

DISCUSSION:

Internal Revenue Code section 6334(a)(13)(B)(i) provides that "[e]xcept to the extent provided in subsection (e)...", the principal residence of the taxpayer (within the meaning of I.R.C. § 121) is exempt from levy. Section 6334(e)(1) modifies this exemption as follows:

> (e) LEVY ALLOWED ON PRINCIPAL RESIDENCES AND CERTAIN BUSINESS ASSETS IN CERTAIN CIRCUMSTANCES.---
>
> (1) PRINCIPAL RESIDENCES.--
>
> (A) APPROVAL REQUIRED.–A principal residence shall not be exempt from levy if a judge or magistrate of a district court of the United States approves (in writing) the levy of such residence.
>
> (B) JURISDICTION.–The district courts of the United States shall have exclusive jurisdiction to approve a levy under subparagraph (A).

I.R.C. § 6334(e)(1). Accordingly, judicial approval is required prior to seizure of a taxpayer's principal residence.

Section 6334 refers to I.R.C. § 121 for the definition of "principal residence of the taxpayer". Section 121 does not provide a specific definition. The regulations enacted under section 121 also do not provide a precise definition of this term. It is inherent in the regulations, however, that the term was meant to indicate the principal residence of an individual taxpayer. For example, there are references to the taxpayer as "he" or "she", as having family members, and as having employment. See, e.g., Temp. Treas. Reg. § 1.121-3T.

This is consistent with a plain meaning understanding of the term "residence" and is further supported by the legislative history underlying section 6334(e)(1). Section 6334(e)(1) was revised by the Internal Revenue Service Restructuring and Reform Act of 1998, P.L. 105-206 ("RRA 98"). The Conference Report for RRA 98 (discussing RRA 3401, Due Process in IRS Collection Actions) provides in part:

> No seizure of a dwelling that is the principal residence of the taxpayer or the taxpayer's spouse, former spouse or minor child would be allowed without prior judicial approval. Notice of the judicial hearing must be provided to the taxpayer and family members residing in the property.

(Emphasis added). Internal Revenue Service Restructuring and Reform Act of 1998, Conference Report to Accompany H.R. 2676, H.R. Conf. Rep. No. 105-599, 105th Cong., 2d Sess., at 267.

Consistent with this legislative history and the plain meaning of the term "residence", it is our position that section 6334(e)(1) requires judicial approval prior to seizure of the principal residence of only individual taxpayers (or individual taxpayer's spouses, former spouses or minor children). Section 6334(e)(1) is inapplicable to other taxpayer entities such as corporations, partnerships, or trusts, as these inanimate entities do not have "residences". 1/

The pertinent question, therefore, is whether principal residence property of an individual titled in the name of a trust (for tax avoidance purposes) is the principal residence of an individual taxpayer, where we have assessments against both the individual and the trust. If the individual is the taxpayer, judicial approval would be required prior to seizing the property. If the trust is the taxpayer, judicial approval would not be required.

We recognize that under a technical application of section 6334(e)(1), the argument can be made that judicial approval is not required. We have an assessment against the trust. The property is titled in the name of the trust. On the books, this is a seizure of trust property in satisfaction of trust tax liability, even though we have additionally made an assessment against the individual taxpayer. We further recognize that this result is a direct consequence of the individual's own choice to place the property in the name of a fraudulent trust. We also agree that such an interpretation would be consistent with a policy of aggressive pursuit of collection from abusive trusts.

The problem with this argument, however, is the underlying premise of an abusive trust scheme. If the Service's position is that a trust is a sham, created for tax avoidance purposes, it is inherent in this position that the Service deems the trust to be a nominee of the individual. The Service's position in any abusive trust scenario, therefore, would be that the individual is the true taxpayer and the individual's principal residence would be the true taxpayer's principal residence. This is the case regardless of the actual mechanism used for collection of the liability, such as the "whipsaw" assessment procedure.

1/ As you note, the approval of the Area Director is required prior to the seizure of the principal residence of any individual, regardless of whether or not judicial approval is required. IRM 5.10.2.14(6).

We therefore conclude that the Service should seek judicial approval, pursuant to I.R.C. § 6334(e)(1), prior to seizing principal residence property of an individual titled in the name of an abusive trust. 2/ We further note, however, that seizure of such property even after obtaining judicial approval would not be the optimal course of action in most of these cases. Once a district court has approved seizure of a taxpayer's principal residence, that property must be sold pursuant to the administrative sale procedures in I.R.C. § 6335. The property will be sold by public auction or public sale under sealed bids and the Service makes no warranties as to valid title, but merely conveys by deed all the right, title and interest as provided in I.R.C. § 6339(b)(2). If the property is held in the name of a sham trust, this raises concerns as to the validity of title.

A lien foreclosure action under I.R.C. § 7403 is generally recommended instead of a section 6334(e)(1) action whenever there are clouds on the title, such as a nominee situation, which create an unfavorable market for administrative sale. See IRM 34.7.14.3 and 34.7.5. While there may be cases in which we determine that a section 6334(e)(1) action could be pursued, we generally recommend that you request an action for lien foreclosure on the principal residence property.

If you have any further questions, please contact .

2/ If the subject property is held in the name of a trust or other inanimate entity which the Service does not believe to be abusive or a sham, and the property will be seized in satisfaction of the legitimate tax liability of such entity, judicial approval will not be required prior to seizure. In addition, there are some jurisdictions in which the Service may dispute the validity of a trust to which a residence was transferred where the grantor(s) continued to live in the residence, but courts have upheld the validity of such trusts. In those jurisdictions, a lien foreclosure action would probably be advisable, as further discussed below.