The Prompt and Certain Collection of Delinquent Taxes

By Neal Nusholtz

If it has not happened yet, one of your clients may one day have an Internal Revenue Code § 7403[1] problem. The National Taxpayer Advocate's annual report has ranked § 7403 in the top 10 tax issues most frequently litigated by the U.S. Department of Justice every year since 2009. Section 7403 permits the forced judicial tax sale of property when an innocent person owns that property with a delinquent taxpayer. Marital homes where only one spouse owes taxes are a common example. The surge in § 7403 cases after 2008 may be attributable to the 2002 *United States v Craft*[2] decision ending the exemption from tax liens for entireties property.[3]

Because IRS administrative levies cannot be used to sell third-party interests in property, the attorney general must apply to federal district courts under § 7403 to force the sale of co-owned property to satisfy the tax debt of only one owner. If the district court orders a forced sale, it will set compensation for the innocent owner. An innocent owner in the Sixth

Circuit will receive the same amount as if he or she had consented to sale of the property by government auction.[4]

United States v Rodgers

Federal court authority to force the sale of your property to pay someone else's taxes was discussed and confirmed in *United States v Rodgers*.[5] In *Rodgers*, a Texas gambler had died, leaving a $900,000 wagering tax debt. His home was owned half by his widow and half by his estate. Under Texas law, his widow had a lifetime right to live in the home. The government wanted the home sold.

The United States Supreme Court in *Rodgers* addressed four issues. The first was statutory authority. The statute provides for the forced sale of any property in which a taxpayer "has any right, title, or interest."[6] The interests of the widow and the deceased gambler extended to the entire home.

The second issue was the constitutional authority to take property from someone who did not owe taxes. That authority was derived from the power of eminent domain: "[T]he use of the power granted by § 7403 is not the power of an ordinary creditor, but the exercise of a sovereign prerogative…."[7] The Court further stated that "§ 7403 makes no further use of third-party property than to facilitate the extraction of value from those concurrent property interests that are properly liable for the taxpayer's debt."[8]

Practical undercompensation

The third issue was compensation for the spouse's interest. That was left to the lower courts, but the *Rodgers* Court used an 8 percent actuarial table as an example: widows aged 30, 50, and 70 would receive 99 percent, 95 percent, and 82 percent of the home's sale price, respectively.[9] The Court also had a concern that "the value of a homestead interest, calculated as some fraction of the total value of a home would be less than the price demanded by the market for a lifetime's interest in an equivalent home."[10] This phrase was later referred to as "practical undercompensation."[11]

The *Rodgers* four-factor balancing test

The fourth issue was when district courts "may decree a sale of such property" under § 7403(c). The *Rodgers* Court listed a "fairly limited set of considerations [that] will almost always be paramount":[12]

- Whether the government will be prejudiced by non-sale
- Whether the spouse has a legally recognized expectation (outside of eminent domain and § 7403) that her homestead would not be sold
- Whether the spouse will suffer prejudice from practical undercompensation and personal dislocation costs
- Who has the greater interest?

The *Rodgers* Court's actuarial calculation and its reference to "a lifetime's interest in an equivalent home" reveal its intentions to compensate the widow for her interest in the entire home. The Sixth Circuit does not compensate a spouse for the entire home under § 7403; rather, the spouse is only entitled to compensation for her one-half interest.[13] That 50 percent compensation rule creates a problem under the third balancing test—practical undercompensation. As one Michigan district court noted when proof was provided that a life estate will cost more than half of the home's selling price, one half of the sale proceeds will never be sufficient

Fast Facts

Is there anything wrong with giving judges judicial discretion over the rights of innocent third parties in tax cases and then telling the judges to defer to the collection of revenue?

Two statutes relating to the enforcement of revenue collection were at issue during the American Revolution.

If the need for revenue affects court decisions, then a greater need for revenue could shift an existing balance and displace our rights.

to purchase a life estate in an equivalent home.[14] The Sixth Circuit affirmed the forced sale in that case, but declined to consider the effect of proof of the cost of a life estate on practical undercompensation.[15]

Limited discretion

Under *Rodgers*, judges have only limited discretion to refuse forced § 7403 sales, and that discretion should be exercised "sparingly, keeping in mind the government's paramount interest in prompt and certain collection of delinquent taxes."[16] That imperative raises a question: is there anything wrong with giving judges judicial discretion over the rights of innocent third parties in tax cases and then telling the judges to defer to the collection of revenue?

The answer depends on your interpretation of the historical role of courts in tax cases. As you might expect, the story of the American Revolution includes a chapter on the role of courts in revenue matters. Colonial revenue enforcement consisted of court-ordered, general search-and-seizure warrants called writs of assistance.

John Adams and unreasonable seizures of property

Two statutes relating to the enforcement of revenue collection were at issue during the American Revolution. The earlier one, a 1660 statute, permitted searches for tax cheats by singular warrants preceded by oath and affirmation. It was replaced in 1662 by a statute that removed the specific warrant requirement and permitted unlimited searches by a writ of assistance that was carried in the vest pockets of revenue officers and lasted for the lifetime of the king.[17]

The colonists claimed that the expired 1660 statute still applied and specific warrants were required for tax searches.[18] The British attorney general, William DeGrey, responded to the colonists by circulating a memorandum:

> But it must be observed, that if such a General Writ of Assistants [sic] is not granted to the Officer, the true Intent of the Act may in almost every Case be evaded, for if he is obliged, every Time he knows, or has received information of prohibited or uncustomed Goods being concealed, to apply to the Supreme Court of Judicature for a Writ of Assistants, such concealed Goods may be conveyed away before the Writ can be obtained….The inconvenience of that was experienced upon the Act of 12 CHA. 2d. C. 19 [the 1660 Act] and the present Method of proceeding [the 1662 Act] adopted in lieu of what that Statute had prescribed.[19]

Boston became the colonial epicenter of revenue enforcement by writs of assistance. After King George died in 1760, an application was made to the Massachusetts Superior Court for issuance of new writs of assistance. Colonial attorney James Otis argued against the writ on behalf of 63 Massachusetts Bay merchants, contending that the 1660 statute applied and specific warrants should be required. He also argued that the law permitting general seizures was unreasonable, and that based on a 150-year-old case, an unreasonable law should be struck down. An excited 26-year-old named John Adams sat in and took notes.[20] Otis lost, and the writ was granted.

Section 7403 permits the forced judicial tax sale of property when an innocent person owns that property with a delinquent taxpayer. Marital homes where only one spouse owes taxes are a common example.

Eight years later, searches and seizures in Boston Harbor were rampant and reviled. A series of Boston newspaper columns regularly reporting the repressive search and seizure of ships in the harbor (and elsewhere) were published in New York, Philadelphia, and in other American newspapers and some publications in England. Those widespread reports were noticed by a historian in the early twentieth century, and he later reproduced them in a book.[21] The example below is typical:

> By the number of vessels, brought into this, and other American harbours, by our little guarda costas, we might be ready to conclude, there had been a formal declaration of war against the trade and navigation of this continent, and that in the manner of pursuing it, the G—r [Governor] and C—m—rs [Revenue Commissioners] were determined to make it as distressing as possible.—A vessel owned in the colony of Connecticut, having received on board, several hogsheads of rum at the island of St. Christophers, for which a clearance could not be produced, was taken possession of by an English guarda costa, near the Vineyard, and is now brought into this harbour,—another vessel belonging to a gentleman in this town, returning from the West-Indies, being met with by a guarda costa at no great distance from this place, she was stopp'd and searched; and a trifle of coffee being found on board, she was seized.[22]

After the American Revolution, the states wrote their constitutions and included prohibitions against general warrants. John Adams wrote the 1780 Massachusetts Constitution in which he associated the word "unreasonable" with searches and seizures for the first time:

> Art. XIV. Every subject has a right to be secure from all unreasonable searches, and seizures, of his person, his houses, his papers, and all his possessions. All warrants, therefore, are contrary to this right, if the cause or foundation of them be not previously supported by oath or affirmation, and if the order in the warrant to a civil officer, to make search in suspected places, or to arrest one or more suspected persons, or to seize their property, be not accompanied with a special designation of the persons or objects of search, arrest, or seizure; and no warrant ought to be issued but in cases, and with the formalities, prescribed by the laws.[23]

Adams's reference to unreasonable searches and seizures was picked up by subsequent state constitutions and restated in the Fourth Amendment of the U.S. Constitution.

Adams had adopted the reasonableness standard for search and seizure argued in front of him by James Otis in 1761. After Otis made that unreasonableness argument, jurist William Blackstone wrote this in his *Commentaries*:

> I know it is generally laid down more largely, that acts of parliament contrary to reason are void. But if parliament will positively enact a thing to be done which is unreasonable, I know of no power that can control it…to set the judicial power above the legislature would be subversive of all government.[24]

After John Adams wrote the 1780 Massachusetts Constitution, Blackstone revised his *Commentaries* by adding the italicized language below in his 1783 edition:

> But if Parliament will positively enact a thing to be done which is unreasonable, I know of no power *in the ordinary forms of the Constitution* that is vested with authority to control it.[25]

No constitution existed to which Blackstone could have referred other than the one written in 1780 by John Adams. The next state constitution after Massachusetts was New Hampshire in 1784.

According to a 1798 statute signed by John Adams as president, unreasonableness was not confined to the absences of probable cause or a properly executed warrant. On May 16, 1797, President Adams gave a speech to Congress which began "the quasi war" with France. Adams complained about

the threat to American commerce from French piracy and called for action: a 1798 statute included provisions for commissioned private armed vessels that could seize French ships for piracy and allow the owner to pay to get the ship back. The statute included this section for damages from improper seizure:

> And the same court, who shall have final jurisdiction of any libel or complaint of any capture, as aforesaid, shall and may decree restitution, in whole or in part, when the capture and restraint shall have been made without just cause, as aforesaid; and if made without probable cause, *or otherwise unreasonably*, may order and decree damages and costs to the party injured.[26]

There were no warrants at sea, and under the statute, the word "unreasonably" applied to seizures even if there was probable cause. As used in the statute signed by Adams, "unreasonable" had its broader natural meaning.

The judicial concern for revenue

When Adams wrote it in 1780, he expected federal courts to review and strike down revenue enforcement based on the nebulous standard of unreasonableness. That expectation is contradicted by this warning from the Supreme Court in *Cheatham v United States*:[27]

> If there existed in the courts, State or National, any general power of impeding or controlling the collection of taxes, or relieving the hardship incident to taxation, the very existence of the government might be placed in the power of a hostile judiciary.[28]

If relief from an unpaid tax liability was an existential threat to government, what would the *Cheatham* Court have said about a $19 trillion federal debt?

Conclusion

In our tax system, revenue enforcement requires forced sales of property. Sometimes our rights are an obstacle to that enforcement. If the need for revenue affects court decisions, then a greater need for revenue could shift an existing balance and displace our rights. The *Craft* case, which took away spousal homestead protections when one spouse did not owe taxes, was decided after the Bush top-rate tax cuts. The *Rodgers* case, which extended eminent domain to tax collection, was preceded by the Reagan top-rate tax cuts. Both cases traded individual rights for a new source of revenue. That could be the cost of having federal courts worry about revenue collection. ■

Neal Nusholtz is a tax attorney practicing in Troy. He was selected in 1999 by Corp! *magazine as one of the top 10 business attorneys in southeastern Michigan and selected for inclusion in The Best Lawyers in America® 2013 and 2014 in the field of trusts and estates.*

ENDNOTES

1. 26 USC 7403.
2. *United States v Craft*, 535 US 274; 122 S Ct 1414; 152 L Ed 2d 437 (2002).
3. *Id.*
4. *United States v Davis*, 815 F3d 253 (CA 6, 2016).
5. *United States v Rodgers*, 461 US 677; 103 S Ct 2132; 76 L Ed 2d 236 (1983).
6. *Id.* at 692.
7. *Id.* at 697.
8. *Id.* at 697.
9. *Id.* at 698–699.
10. *Id.* at 704.
11. *Id.* at 711.
12. *Id.* at 710.
13. *United States v Barr*, 617 F3d 370 (CA 6, 2010); contra *United States v Cardaci*, unpublished opinion of the US District Court for the District of New Jersey, issued August 21, 2014 (No. 12-5402); *United States v Hipolito*, unpublished opinion of the US District Court for the Middle District of Pennsylvania, issued March 6, 2015 (No. 3:13-CV-338).
14. *United States v Davis*, unpublished opinion of the US District Court for the Eastern District of Michigan, issued April 29, 2015 (No. 13-11245).
15. *Rodgers*, 461 US 677.
16. *Id.* at 711.
17. Frese, *Early Parliamentary Legislation on Writs of Assistance*, 38 Col Soc Mass 318 (1959).
18. Kennedy, *Journals of the House of Burgesses of Virginia 1772–1776* (1905), pp 135–137.
19. Quincy Jr., *Reports of Cases Argued and Adjudged in the Superior Court of Judicature of the Providence of Massachusetts Bay Between 1761 and 1772* (Boston: Little, Brown and Company, 1865), pp 452–454.
20. See *id.* at pp 414, 471–476, 486.
21. Dickerson, *Boston under Military Rule 1768–1769* (New York: Da Capo Press, 1970).
22. *Id.* at 85.
23. Thorpe, *The Federal and State Constitutions, Colonial Charters, and Organic Laws of the State Territories and Colonies Now or Heretofore Forming the United States of America* (Washington: Government Printing Office, 1909), vol VI, p 3,088.
24. 1 Blackstone, *Commentaries on the Laws of England*, p 91.
25. See Plucknett, *Bonham's Case and Judicial Review*, 40 Harvard L Rev 30 (1926), p 60.
26. *The Public Statutes at Large of the United States of America from the Organization of the Government in 1789 to March 3, 1845* (Boston: Charles C. Little and James Brown, 1848), pp 578, 580.
27. *Cheatham v United States*, 92 US 85; 23 L Ed 561 (1875).
28. *Id.* at 89.