A SURVEY OF FEDERAL TAX COLLECTION PROCEDURE: RIGHTS AND REMEDIES OF TAXPAYERS AND THE INTERNAL REVENUE SERVICE

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I. INTRODUCTION

The federal tax collection system is founded on the concept of voluntary compliance.[1] The United States government expects taxpayers voluntarily to compute and timely pay all taxes owed to the federal government. Most taxpayers fulfill this obligation.[2] A minority, however, refuse to comply. Those falling within the latter category are subject to forced collection and various penalties. This article seeks to provide Alaska practitioners with a basic overview of the workings of the federal tax system's forced collection scheme.

The statutory scheme of forced collection set forth in the Internal Revenue Code ("Code") and accompanying Treasury Regulations delegates broad powers to the Internal Revenue Service ("IRS"). Essentially, the scheme empowers the IRS to assess[3] a federal tax, impose a

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1. For administrative and economic reasons, our tax collection system must be based on voluntary compliance. It would prove administratively impossible for the IRS to calculate and extract each citizen's taxes. The financial burden would also prove overwhelming. Our present tax system permits the IRS to focus its resources on those who fail to voluntarily comply. Because the government's ability to function depends upon a constant flow of revenue, basing our tax collection system on voluntary compliance allows the government to function more smoothly and at less cost than relying on a forced collection system.

2. *See* Internal Revenue Service, IRS Measures of Voluntary Compliance, Fact Sheet 86-4 (July 1986).

3. While the terms "assess" or "assessment" are technical terms as used in the Code, the Code does not define them. In practice an assessment is typically regarded

lien for the amount assessed upon all property belonging to the taxpayer, and, if the taxpayer still refuses voluntarily to proffer payment, to sell the property of the taxpayer until the proceeds of the sale satisfy the obligation. To facilitate these procedures, the IRS is given the authority to summons documents and other information, including testimony, from taxpayers and third parties.[4] All of these powers may be exercised without prior judicial approval. The collection scheme also grants taxpayers certain rights and remedies.[5] These rights and remedies, along with the powers of the IRS, vary according to the nature of the case.

This article focuses on the powers and privileges arising in three typical collection situations. First discussed are IRS procedures and taxpayer rights in routine collection cases where the taxpayer merely disputes the amount due or the existence of liability. Second, the article analyzes the powers of the IRS and the remedies available to taxpayers in jeopardy cases — situations where exigent circumstances indicate that the IRS must act quickly in order to effect collection. Finally, the article describes the IRS's power to look to third parties for the collection of taxes, along with the rights of third parties subject to potential liability. Prior to discussing the above, however, this article briefly examines the steps involved in the collection process in order to place the rights and remedies available to a taxpayer into proper perspective.

II. Overview of Collection Procedure

If a tax liability is not paid or settled at the administrative audit level, the IRS issues a notice of deficiency called a "90-day letter."[6] Issuance of the notice of deficiency begins a ninety-day period during which the delinquent taxpayer may file a petition in Tax Court.[7] No assessment of any tax or collection through levy or proceeding in court may begin until after the notice has been mailed and this ninety-day period has expired.[8] When a taxpayer timely files a petition with the

as the first official act of attaching liability for a tax to a particular person. The assessment usually follows a notice of deficiency and demand for payment.

4. I.R.C. § 7602 (1982).

5. A comparison of the rights of the IRS and the taxpayer with respect to forced collection demonstrates that the statutory scheme substantially favors the IRS. One rationale behind this favoritism is that taxpayers' willingness to pay taxes will quickly erode if others are successful in evading taxes. To prevent widespread evasion, the IRS needs substantial powers to swiftly collect unpaid taxes and to impose penalties.

6. I.R.C. § 6212 (1982).

7. *Id.* § 6213(a) (1982). If the notice is addressed to a person outside the United States, the taxpayer has 150 days to file a petition in the Tax Court. *Id.*

8. *Id.* Exceptions are provided for in I.R.C. §§ 6851, 6861 (1982). Section 6851 covers situations in which the IRS believes the taxpayer intends to depart or remove

Tax Court, no assessment or collection is permitted until the Tax Court renders a final decision.[9] The taxpayer may seek appropriate injunctive relief if the IRS attempts collection or assessment before the expiration of this waiting period.[10] If, however, the IRS finds that collection of the tax is in jeopardy and immediate payment on demand is not forthcoming, the taxpayer's injunctive relief may be precluded.[11]

Upon expiration of the stay period, the IRS may assess the federal tax liability.[12] Within sixty days of making the assessment, the IRS must provide notice of the assessment and demand payment from each liable party.[13] A federal tax lien then arises upon all property belonging to the party liable for the tax.[14] If any liable party fails to pay the full amount due within ten days, the IRS possesses the authority to take forced collection action through levy.[15] This collection authority includes the power to seize and sell property belonging to the taxpayer without prior judicial approval.[16]

After the stay period, the IRS can also require production of books and records relating to the existence or location of any property belonging to the taxpayer.[17] The IRS can use its summons authority to obtain information necessary for the collection of any tax.[18] To the extent the taxpayer does not voluntarily comply with the summons, the IRS can seek court enforcement.[19]

If the IRS is unsuccessful in collecting the unpaid taxes through its administrative procedures, it may file a judicial collection proceeding. Through such a proceeding, the IRS can reduce the tax liability to judgment and obtain judicial assistance in collecting any unpaid tax liability.[20]

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his property from the country relatively soon or to conceal his property to impede collection of a tax accrued but not yet due. Section 6861 deals with instances where the IRS believes that delay will jeopardize the assessment or collection of a deficiency. *See infra* notes 143-61 and accompanying text for a more complete discussion of these exceptions.

9. I.R.C. § 6213(a) (1982). *See also id.* § 7481 (1982) (describing when a Tax Court decision becomes final).

10. *Id.* § 6213(a) (1982). This is in spite of the provision in the Code prohibiting suits to restrain assessment or collection ("Anti-Injunction Act"). *Id.* § 7421(a) (1982).

11. Id. § 6331(a) (1982).

12. *Id.* §§ 6201-6207 (Supp. II 1985).

13. *Id.* § 6303(a) (1982).

14. *Id.* § 6321 (1982). Throughout this article, the term property will include rights to property.

15. *Id.* § 6331(a) (1982).

16. *Id.* § 6331(b) (Supp. II 1985).

17. *Id.* § 6333 (1982).

18. *Id.* § 7602 (1982).

19. *Id.* § 7604 (Supp. II 1985).

20. *Id.* § 7402(a) (1982).

In the event that the IRS is unable to collect a tax liability from the primary taxpayer, secondary sources of payment may be examined. Examples of parties who may be liable for at least a portion of the underlying unpaid tax include (1) individuals responsible for unpaid employment withholding taxes,[21] (2) certain lenders or financial institutions either supplying funds for employers' payment of taxes or paying employees directly,[22] (3) individuals who act in a fiduciary capacity for delinquent taxpayers,[23] and (4) transferees who receive property from certain taxpayers who have failed to satisfy fully their tax obligations.[24]

III. Normal Collection Procedure

In the normal collection process,[25] the IRS may utilize both administrative and judicial collection powers. The specific adminstrative methods for collection include the federal lien,[26] summons,[27] and levy authority.[28] The judicial collection process includes the right to file a judicial proceeding to collect taxes.[29] Through these proceedings, the IRS seeks to reduce assessments to judgment and foreclose federal tax liens on specific property. The IRS, like any other creditor, may seek judicial assistance in collection through, for example, an action to set aside a fraudulent conveyance.[30]

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21. *Id.* § 6672 (1982) (any person required to collect, account for, and pay any tax for another, who fails to perform any of these duties, may be personally liable therefor).

22. *Id.* § 3505 (1982) (a lender, surety, or other person not an employer with respect to an employee or group of employees, who pays wages directly to the employees of another, or to an agent on their behalf, is liable for the amounts required to be withheld from their wages).

23. *Id.* § 6901 (1982).

24. *Id.* (transferees include donees, heirs, legatees, devisees, distributees, and, with respect to estate taxes, persons personally liable for any part of such tax under I.R.C. § 6324(a)(2)).

25. As used here, "normal collection process" refers to those situations in which a taxpayer and the IRS disagree about the amount owed or the existence of liability, but no extraordinary circumstances exist which necessitate immediate collection.

26. I.R.C. §§ 6321-6326 (1982), discussed *infra* notes 31-52 and accompanying text.

27. I.R.C. §§ 7602-7604 (Supp. II 1985), discussed *infra* notes 54-66 and accompanying text.

28. I.R.C. §§ 6331-6344 (Supp. II 1985), discussed *infra* notes 67-118 and accompanying text.

29. I.R.C. § 7403 (1982), discussed *infra* notes 119-141 and accompanying text.

30. I.R.C. § 7402(a) (1982); *see, e.g.,* United States v. Ressler, 433 F. Supp. 459 (S.D. Fla. 1977).

A. Administrative Proceedings

1. *Federal Tax Lien.*

a. IRS Authority. The first collection tool available to the IRS is the federal tax lien.[31] Like other liens, it constitutes legal notice of a claim or interest in property, preserves the status quo among certain creditors, and establishes priority between competing claims to the property.[32]

The federal tax lien attaches to "all property and rights to property, whether real or personal," belonging to the taxpayer.[33] Because the Code does not define "property," the state law definition applies.[34] Any exemption granted by state law will not, however, affect the IRS's right to a lien on the taxpayer's property.[35]

A federal tax lien automatically arises after assessment, issuance of notice of the assessment, demand, and failure of the taxpayer to pay the assessment. The law requires no filing.[36] Until notice of the tax lien is properly filed, however, deficient taxpayers may transfer their property to purchasers and creditors free of the tax lien.[37]

Certain types of property are exempted from the reach of a federal tax lien despite proper filing. Exempted property includes, but is not limited to, certain corporate and other securities, motor vehicles, personal property purchased at retail or casual sale, attorney's liens, insurance contracts, and passbook loans. If, however, the transferee possessed actual knowledge of the lien at the time of the transaction, several of these exemptions are not available.[38] The priority interest of

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31. I.R.C. §§ 6321-6326 (1982).

32. *Id.* § 6323 (1982).

33. *Id.* § 6321 (1982).

34. United States v. Bess, 357 U.S. 51, 55-56 (1958); *see also* Aquilano v. United States, 363 U.S. 509, 512-14 (1960).

35. *Bess,* 357 U.S. at 56-57. The Court held that state exemption statutes have been preempted by the federal tax lien in favor of the United States. Once state law creates a property right in the taxpayer sufficient to satisfy the requirements of section 6323 (decided under former section 3670), state law is inoperative to prevent the attachment of federal tax liens in favor of the United States. The Court observed that Congress had explicitly recognized the superiority of various state laws in bankruptcy and other areas of the tax code. Because Congress had failed to do so here with respect to federal tax liens, the Court reasoned that Congress intended such liens to be superior, notwithstanding contrary state laws. *Id. See also* Treas. Reg. § 301.6334-1(c) (as amended in 1979).

36. I.R.C. § 6321 (1982).

37. *Id.* § 6323(a) (1982). The Code specifies the formal requirements for the proper filing of notice of the tax lien, rules for determining the situs of the property subject to the lien, the form and content of the notice, and, in certain circumstances, the indexing required for the notice. *Id.* § 6323(f) (1982); Treas. Reg. § 301.6323(f)-1 (1976).

38. I.R.C. § 6323(b) (1982); Treas. Reg. § 301.6323(b)-1 (1976).

parties under security interests that arose from certain commercial or real property construction or improvement financing arrangements entered into before the tax lien was filed may also be protected. To be entitled to this protection, the funds must be disbursed within forty-five days after the filing of the lien or before actual knowledge of the lien.[39]

Similarly, the federal tax lien will not attach to property transferred prior to the date of the assessment if the transfer is bona fide and not voidable under various fraudulent conveyance theories.[40] It will attach, however, to all property acquired during the life of the lien, including property acquired after the assessment.[41]

The duration of the federal tax lien is limited. Generally, it continues until the tax or a judgment arising out of such liability is paid or becomes unenforceable due to lapse of time.[42] The period of limitations for collection of a tax liability after assessment is six years.[43] The life of a lien can, however, be extended by agreement or by the timely filing of a judicial proceeding.[44] If extended, the IRS must refile the notice of the lien in order to retain its priority.[45]

b. Taxpayer Rights. A taxpayer is entitled to certain very limited rights and remedies with respect to federal tax liens. First, the IRS must serve the person it believes to be liable with a notice of the assess-

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39. I.R.C. § 6323(c) (1982).

40. United States v. Morgan, 554 F. Supp. 582, 585 (D. Colo. 1982); *see also* Commissioner v. Stern, 357 U.S. 39, 45-47 (1958).

41. Glass City Bank v. United States, 326 U.S. 265 (1945).

42. I.R.C. § 6322 (1982).

43. *Id.* § 6502(a) (1982).

44. United States v. Hodes, 355 F.2d 746, 748-49 (2d Cir. 1966), *cert. dismissed,* 386 U.S. 901 (1967). The life of the lien may be extended by the timely filing of a judicial proceeding because such action tolls the running of the statute of limitations without extinguishing the lien. The lien continues to exist independently of the suit. *Id.* at 748. Indeed, it continues to exist independently of a judgment entered in favor of the United States. Under most state laws, once a judgment is rendered, the underlying lien merges into the judgment, and the creditor must collect on the judgment. The tax lien, however, does not merge with the judgment. Because the IRS can attempt collection through levy or by judicial proceeding, I.R.C. § 6502(a) (1982), the court in *Hodes* reasoned that Congress intended the IRS to have two collection tools. This was significant in *Hodes* because the IRS had properly filed its notice of tax lien in 1955. In 1958, the government brought suit and reduced its assessment to judgment. However, the IRS then failed to comply with the requirements of New York law to obtain a judgment lien. Its judgment lien was not properly perfected until 1963. The government's 1958 judgment was thus subordinate to parties who properly recorded liens in the interim. Having failed to secure its rights by judgment, the IRS brought suit to enforce its 1955 tax lien. The United States Court of Appeals for the Second Circuit held the lien to be valid and superior to all those recorded after the notice of tax lien. *Id.* at 749.

45. *Id.* § 6323(g) (1982); Treas. Reg. § 301.6323 (g)-1 (1976).

ment and a demand for payment before a federal tax lien can arise. To perfect service the notice and demand must be left at the taxpayer's dwelling or usual place of business, or be mailed to the taxpayer's last known address. Notice and demand must be rendered as soon as practicable, but no later than sixty days after the making of the assessment.[46]

Second, the taxpayer can require the IRS to issue a certificate of release of a lien if the liability is paid in full, the taxpayer has posted a bond for the amount due, or the lien has become legally unenforceable.[47] The certificate, which serves as conclusive proof of the extinguishment of the lien,[48] must be issued within thirty days of the occurrence of one of these events.[49]

Finally, the taxpayer may seek relief in a quiet title action in which the taxpayer attempts to remove the lien from the title to the property.[50] This does not, however, constitute a proper procedure for contesting the validity of the underlying tax liability.[51] The quiet title action is limited to situations involving some defect in the collection procedure or full payment of the liability.[52]

2. *Summons.*

a. IRS Authority. The IRS possesses broad authority to "canvass" internal revenue districts in search of tax liabilities[53] and to issue summons to facilitate the obtainment of information pertinent to collection.[54] The summons is an administrative remedy for which the IRS typically need not seek judicial approval.[55] It allows the IRS to examine books, records, and other data belonging to the taxpayer or third parties responsible for the taxpayer's books and records, take testimony of individuals with information regarding collection, and enter premises for the examination of taxable objects.[56] When persons fail to timely or fully comply with the summons, the IRS may seek enforcement of the summons through court order.[57]

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46. I.R.C. § 6303(a) (1982).
47. *Id.* § 6325(a) (1982).
48. *Id.* § 6325(f)(1) (1982).
49. *Id.* § 6325(a) (1982).
50. 28 U.S.C. § 2410 (1982).
51. Falik v. United States, 343 F.2d 38 (2d Cir. 1965).
52. *Id.*
53. I.R.C. § 7601 (1982).
54. *Id.* § 7602 (1982).
55. *Id.* The IRS needs prior approval to issue a "John Doe" summons. *See infra* text accompanying note 66.
56. *Id.*; I.R.C. § 7606 (1982).
57. *Id.* § 7604 (Supp. II 1985).

b. Taxpayer Rights. Because the summons may seek information that could result in criminal prosecution, there are limits on the IRS's ability to search for and seize tax information. Unlike in criminal prosecutions, however, the IRS need not establish probable cause prior to a search and seizure. The IRS may issue any summons "necessary" to a tax investigation.[58] In essence, this means that the investigation must be related to a legitimate and proper concern of the IRS, that the inquiry must be relevant to that purpose, and that the IRS must not already possess the information sought.[59]

The taxpayer also enjoys the fifth amendment right not to incriminate himself. Thus, where the IRS has made a criminal investigation referral to the Department of Justice, the summons authority is restricted.[60] If the referral has been made, no civil summons may issue or be enforced.[61] The IRS may, however, continue to use civil summons prior to such referral even when the agents conducting the investigation recognize the possibility of referral for criminal prosecution.[62] In such cases, the IRS must act in good faith in enforcing its civil summons.[63]

Finally, where the IRS serves a summons on a third-party recordkeeper, the taxpayer is entitled to notice of the third-party summons and the opportunity to file a proceeding to quash it.[64] This rule does not apply when the summons is issued to the taxpayer's agent merely to determine whether records have been kept.[65] "John Doe summons," which do not identify the potentially liable person, may issue only after the IRS has established in a court proceeding that (1) the investigation relates to an identifiable person, or ascertainable group,

58. *See id.* § 7605(b) (1982); United States v. Powell, 379 U.S. 48 (1964); United States v. MacKay, 608 F.2d 830 (10th Cir. 1979).

59. *See Powell*, 379 U.S. at 52-59; *MacKay*, 608 F.2d at 833; *see also* United States v. Acker, 325 F. Supp. 857, 862 (S.D.N.Y. 1971) (The IRS summoned a parent corporation to turn over the minutes of all board meetings of it and its affiliated corporations, including the parent's consolidated income tax return. The parent corporation refused to make available all of the minutes, offering instead to make available only those which might have a bearing on the determination of the parent corporation's income tax liability. The court enforced the summons since the request for production was made for a legitimate purpose and the documents *might* have been relevant to that inquiry.).

60. I.R.C. § 7602(c) (1982).

61. *Id.*

62. United States v. Genser, 602 F.2d 69 (3d Cir.), *cert. denied*, 444 U.S. 928 (1979).

63. United States v. LaSalle Nat'l Bank, 437 U.S. 298 (1978). The taxpayer bears the burden of proving that the IRS acted in bad faith. *Id.* at 316.

64. I.R.C. § 7609(a)(1) (1982). Third-party record-keepers include banks, savings and loan associations, consumer reporting agents, attorneys, accountants, brokers, and other persons who may extend credit to the taxpayers. *Id.* § 7609(a)(3) (1982).

65. *Id.* § 7609(a)(4) (1982).

(2) there is a reasonable basis for believing such person may have violated the tax laws, and (3) the information sought is not readily available from other sources.[66]

3. *Levy.*

a. IRS Authority. The third, and likely most potent administrative tool available to the IRS for collection, is its levy authority. Without the need for prior judicial approval, the IRS is authorized to seize and sell property belonging to the taxpayer.[67] The IRS is entitled to levy as often as necessary to collect the amount due plus the expenses of the levy.[68]

A federal tax levy attaches upon service of notice on the person in possession of the property, whether that person is the taxpayer or a third party.[69] Virtually all types of property are subject to a federal tax levy.[70] A levy, however, attaches only to property owned by the taxpayer at the time of service of the levy.[71] Thus, the levy will not attach to property transferred prior to service of the levy,[72] nor to property acquired afterward, excluding wages.[73]

Upon demand of the IRS, any person in possession of property upon which a levy has been effected must surrender the stated property. The only exceptions to this rule apply to persons who have already subjected property to an attachment or judicial execution[74] and to organizations that have issued life insurance or endowment policies to the delinquent taxpayer.[75] When a person fails to surrender the property as required, he becomes personally liable to the United States in a sum equal to the value of the property, up to the amount of the taxes, costs, and interest.[76] In addition, any person who fails to surrender property without reasonable cause is subject to a penalty equal to fifty percent of the amount described above. This penalty is not

66. *Id.* § 7609(f) (1982).

67. *Id.* § 6331 (Supp. II 1985).

68. *Id.* § 6331(c) (1982).

69. Treas. Reg. § 301.6331-1 (as amended in 1983).

70. I.R.C. § 6334 (Supp. II 1985). *See infra* note 79 regarding property exempt from federal tax levy.

71. I.R.C. § 6331(b) (Supp. II 1985).

72. *See, e.g.,* Lapp v. United States, 316 F. Supp. 386, 390 (S.D. Fla. 1970).

73. I.R.C. § 6331(e)(1) (1982); Treas. Reg. § 301.6331-1(a) (as amended in 1983); Treas. Reg. § 301.6331-2(c) (1979).

74. I.R.C. § 6332(a) (1982).

75. *Id.* § 6332(b) (1982). Such a levy is to be regarded as a demand by the IRS for payment of advances the taxpayer could receive on that date plus any amount advanced to the taxpayer while the organization knew of the lien. The amount is payable within 90 days of service of the notice of the levy.

76. *Id.* § 6332(c)(1) (1982).

credited against the amount due.[77] If, on the other hand, a person in possession of a taxpayer's property honors a federal tax levy, he is discharged of any liability to the delinquent taxpayer with respect to such property.[78]

b. Taxpayer Rights.

(1) *Statutory Rights.* The law grants a taxpayer several statutory rights to assure that the levy authority is not abused. First, certain types of property are exempted from the effect of a federal tax levy, although some of these protections are limited to a maximum appraised value.[79] At the time of the levy, an officer seizing property is required to appraise the exempt property and set aside the appropriate amount for the owner.[80] If the taxpayer objects at the time of the seizure to the valuation fixed by the officer, the IRS must summon three disinterested persons to make the valuation.[81]

Second, a taxpayer is entitled to written notice of the intent to levy at least ten days in advance. This notice must be given in person, left at the taxpayer's dwelling place or usual place of business, or sent by certified or registered mail to his last known address. Notice is not required, however, if the Secretary of the Treasury finds that collection of the tax is in jeopardy.[82]

Third, the IRS must provide the taxpayer with notice of any seizure as soon as practicable after taking the property. Notice must be in the form of a written statement of the amount due and a description of the property seized.[83] In addition, the IRS must give notice to

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77. *Id.* § 6332(c)(2) (1982).

78. *Id.* § 6332(d) (1982).

79. *Id.* § 6334(a) (1982). Exempted property includes:

1) wearing apparel and school books necessary for the taxpayer or his family members;

2) if the taxpayer is the head of a family, then so much of the fuel, provisions, furniture, and personal effects in the household, and of the arms for personal use, livestock, and poultry of the taxpayer, as does not exceed $1,500 in value;

3) up to $1000 of books and tools for a trade;

4) unemployment benefits;

5) undelivered mail;

6) certain annuity and pension payments;

7) workmen's compensation;

8) money for the support of minors; and

9) a small amount of wages and salary.

No other property is exempt from the federal tax levy, regardless of any other federal or state law to the contrary. *Id.* § 6334(c) (Supp. II 1985); Treas. Reg. § 301.6334-1(c) (as amended in 1979).

80. I.R.C. § 6334(b) (1982).

81. *Id.*

82. *Id.* § 6331(a) (1982).

83. *Id.* § 6335(a) (1982).

the owner of its intent to sell the property and publish notice describing the property as well as the time, place, manner, and conditions of its sale in a newspaper circulated in the county in which the seizure is made. If no such paper exists, notice must be posted at the local post office and in at least two other public places in the relevant county.[84]

Fourth, the taxpayer is given statutory rights to contest the manner of sale. The sale must not be less than ten nor more than forty days from the time of public notice and, except under special circumstances, the sale must occur within the county in which the property was seized.[85] Prior to the sale, the IRS must determine the minimum price for which the property will be sold. If no offer is made for the minimum price, the property is declared to be purchased by the United States at the minimum price. The United States will be treated as having received that amount.[86] However, because the IRS has exercised its authority to prescribe through regulations the manner of the seized property's sale,[87] the taxpayer's right to contest the reasonableness of the sale is limited.

Finally, the taxpayer has the right to redeem the seized property from a foreclosure sale pursuant to a federal tax levy. To redeem the property he must pay, prior to the sale, the full amount of the tax liability owed and the expenses of the proceeding.[88] Upon making such a payment, the taxpayer is entitled to the return of the property as well as cessation of all further levy proceedings pursuant to that liability. In the case of real property, the taxpayer has the right to redeem within 180 days after the sale by paying the purchaser the amount paid at the sale, plus interest at the rate of twenty percent.[89]

(2) *Administrative Remedies.* In addition to statutory protections, a taxpayer may contest federal tax levies through a broad range of options at the administrative level.[90] Many of these procedures,

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84. *Id.* § 6335(b) (1982).

85. *Id.* § 6335(d) (1982).

86. *Id.* § 6335(e)(1) (1982).

87. *Id.* § 6335(e)(2) (1982); Treas. Reg. § 301.6335-1(c) (as amended in 1972).

88. I.R.C. § 6337 (1982). In order to redeem, the taxpayer must pay the full amount of the liability, not merely the value of the piece of property. This requirement accords with the power of the IRS to levy upon the taxpayer's property as often as necessary to collect the amount due together with the expenses of levy. *See supra* text accompanying note 68. Requiring the IRS to return the property to the taxpayer upon being paid its value when a deficiency would remain on the liability would only increase administrative expenses. The IRS would simply levy on the property again.

89. I.R.C. § 6337(b) (West Supp. 1986); Treas. Reg. § 301.6337-1(b)(2) (as amended in 1972).

90. While some of the administrative remedies discussed below become available upon imposition of the lien, as a practical matter taxpayers typically invoke these remedies at the levy stage of the proceeding. A lien is merely a defensive tool designed to protect the government's interest in property. A levy is an offensive tool under

however, are available only at the discretion of the IRS, and the taxpayer must establish that such options should be pursued.[91] Normally, this requires showing that there exists a good reason to delay collection action and that such delay is not likely to result in diminished collectibility.

The first such option involves the extension of time for making payment. If the taxpayer determined the tax liability on his return, he may be allowed a reasonable period, not to exceed six months, for payment of the taxes.[92] However, in the case of estate taxes, an extension of up to twelve months is normally allowed, and an extension of up to ten years may be had upon a showing of reasonable cause.[93] If the IRS determined the tax liability, the date fixed for payment may be extended by a period typically not exceeding eighteen months. In exceptional cases, the taxpayer may extend the time for payment for an additional twelve-month period upon a showing that payment by the due date will result in undue hardship to the taxpayer.[94] No such additional extension may be granted when the deficiency is due to negligence, intentional disregard of rules or regulations, or fraud with intent to evade the tax.[95]

Second, the taxpayer may persuade the IRS to agree to release a levy and to return property levied upon. The IRS may only do so if it determines that such action will facilitate collection of the liability,[96] or that the property was levied upon wrongfully.[97]

Third, the taxpayer may petition for a certificate of discharge of specific property from the federal tax lien.[98] This certificate serves as conclusive proof that the IRS has no legal interest in the property, although the federal tax lien remains valid.[99] Before such a certificate will be issued, a taxpayer must show that he has other property worth at least twice the amount of the underlying liability or that the govern-

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which the IRS seeks to affirmatively collect unpaid taxes. Not until the IRS makes an effort to collect through levy is a taxpayer likely to invoke these rights.

91. Treas. Reg. § 301.6343-1 (as amended in 1972).

92. I.R.C. § 6161(a) (1982). The extension can exceed six months if the taxpayer is abroad at the time. *Id.*

93. *Id.* § 6161(a)(2) (1982).

94. *Id.* § 6161(b)(1) (1982).

95. *Id.* § 6161(b)(3) (1982).

96. *Id.* § 6343(a) (1982). To help facilitate collection the IRS may also impose conditions on the release of levy, including requiring financial information, an installment payment agreement, a waiver of the statute of limitations for collection, or a bond. Treas. Reg. § 301.6343-1(a)(2) (as amended in 1972). A release does not operate to prevent any subsequent levy. I.R.C. § 6343(a) (1982).

97. I.R.C. § 6343(b) (1982); Treas. Reg. § 301.6343-1(b) (as amended in 1972).

98. I.R.C. § 6325(b) (as amended in 1972).

99. *Id.* § 6325(f)(1)(B) (1982).

ment's interest in the specific property is worthless.[100]

Fourth, a taxpayer may attempt to convince the IRS to agree to substitute its interest in the levied property for an interest in the proceeds of a private sale of the property.[101] This substitution discharges the property from the federal tax levy and lien, thus facilitating private sale of the property.[102] The taxpayer must agree to hold the sale proceeds in escrow, subject to a claim by the IRS in the amount of the underlying federal tax lien, in order to obtain this discharge.[103] In addition, the sale must divest the taxpayer of all interest in the property sought to be discharged.[104]

Fifth, issuance of a certificate of subordination of a lien is within the power of the IRS.[105] This certificate of subordination conclusively proves that another interest is legally superior to the federal tax lien.[106] In order to obtain a certificate of subordination, the taxpayer must either (1) pay over to the IRS the amount by which the federal tax lien is to be subordinated, or (2) demonstrate that issuance of the certificate will increase the value of the property and the likelihood of collecting the tax.[107] A typical example of the latter occurs when a near insolvent taxpayer who owns a business likely to appreciate if given capital finds a lender who will make the necessary loan, but only on the condition that the lender receive a first priority interest in the property.[108]

Finally, the IRS possesses the authority to compromise any liabilities arising under the Code.[109] Generally, the IRS will agree to compromise only when there is some doubt as to whether (1) the tax deficiency is legally and factually sound, or (2) the IRS will be able to effect complete collection of the liability.[110] Moreover, the IRS will refuse to compromise a criminal liability unless it believes the taxpayer merely violated a regulatory provision of the Code or a related statute without an intent to defraud.[111]

The offer to compromise is submitted on Form 656 (offer of compromise). Submission of an offer of compromise does not automatically defer or stay collection. Deferral of collection is at the discretion

100. *Id.* § 6325(b) (1982).
101. *Id.* § 6325(b)(3) (1982).
102. *Id.* § 6325(f)(1)(B) (1982).
103. *Id.* § 6325(b)(3) (1982).
104. Treas. Reg. § 301.6325-1(b)(3) (as amended in 1982).
105. I.R.C. § 6325(d) (1982).
106. *Id.* § 6325(f)(1)(C) (1982).
107. *Id.* § 6325(d) (1982).
108. Treas. Reg. § 301.6325-1(d)(2)(ii) (as amended in 1982).
109. I.R.C. § 7122(a) (1982).
110. Treas. Reg. § 301.7122-1(a) (1967).
111. *Id.* § 301.7122-1(b) (1967).

of the collection division and will be extended only when the interests of the United States will not be jeopardized by the delay.[112]

The IRS typically requires a statement of financial condition as part of an offer of compromise, particularly where the offer is premised on possible uncollectibility, and may require a collateral agreement as to future income.[113] Under a collateral agreement, taxpayers must generally pay a certain percentage of their income during each year for a ten-year period. The IRS permits most taxpayers to retain a certain minimum allowance for which no taxes will be paid. As the income increases above this minimum level, the percentage payable to the IRS also increases. A collateral agreement always requires annual reporting, including submission of copies of each year's tax returns.

As with any compromise, the terms and conditions of an offer of compromise are negotiable and turn upon the likelihood that the liability exists and that the tax will be collected. One fixed condition, however, is that the taxpayer must agree to a limited waiver of the statute of limitations on the assessment and/or collection of the tax liability.[114]

As a practical matter, discussions regarding a compromise usually begin informally between the revenue officer assigned to collect the delinquent account and the taxpayer. After these initial discussions, the taxpayer must submit the formal offer of compromise along with the amount offered in compromise.[115] If the formal offer is rejected or withdrawn, the IRS must return the money tendered without interest unless the taxpayer has agreed to apply the amount tendered to the liability.[116] If the IRS accepts the formal offer, all liabilities encompassed by it are conclusively settled, unless either the taxpayer or the government can prove that it was procured by fraud, or under mutual mistake or duress.[117] Acceptance occurs when the taxpayer receives written notification from the IRS.[118]

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112. *Id.* § 301.7122-1(d) (1967).

113. *Id.* § 301.7122-1(d)(3) (1967).

114. *Id.* § 301.7122-1(f) (1967). The waiver must last "for the period during which the offer is pending, or the period during which any installment remains unpaid, and for one year thereafter." *Id.*

115. Treas. Reg. § 301.7122-1(d)(1) (1967).

116. *Id.* § 301.7122-1(d)(4) (1967).

117. *Id.* § 301.7122-1(b) (1967); *see, e.g.,* Cooper Agency v. United States, 301 F. Supp. 871, 875 (D.S.C. 1969) (compromise settlements of tax liabilities conforming to requirements of the Internal Revenue Code are contracts governed by the rules generally applicable to contracts), *aff'd per curiam* 422 F.2d 1331 (4th Cir.), *cert. denied,* 400 U.S. 904 (1970).

118. Treas. Reg. § 301.7122-1(d)(3) (1967).

B. Judicial Proceedings

1. *IRS Authority.* The IRS may, of course, seek judicial assistance in collecting tax liabilities.[119] As a practical matter, the IRS usually seeks judicial assistance only when it finds its administrative procedures for collecting taxes ineffective.

In the typical collection action, the IRS seeks to reduce the federal tax assessment to judgment and to foreclose the tax liens on specific property.[120] But the IRS can also request more unusual relief. For example, the IRS may obtain certain relief on an ex parte basis, including the authority to open, or at least be present at the opening of, a safety deposit box, and to obtain a warrant to enter property without the consent of the owner.[121] The IRS also may attempt to set aside a conveyance as fraudulent when it believes the taxpayer transferred the property prior to the federal tax lien or levy in order to avoid payment.[122] State laws regarding fraudulent conveyances determine whether the transaction will be set aside for the benefit of the United States.[123] Such laws typically require a showing that the property was transferred by an insolvent debtor, or a debtor rendered insolvent by the transfer, to a third party for legally insufficient consideration with an intent to defraud or evade creditors.[124]

If a creditor of a taxpayer whose property is subject to a federal tax lien initiates a legal action against that taxpayer and fails to name the United States as a party to the action, the IRS may intervene in order to assert the federal tax lien against the property in question.[125] If the United States is not joined as a party, and notice of the tax lien was properly filed prior to the suit, the action will not affect the lien.[126] Moreover, if the United States is denied the right to intervene in any such action, the adjudication will have no effect upon the federal tax lien.[127]

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119. I.R.C. §§ 7402(a), 7403(a) (1982).

120. In an action to foreclose a federal tax lien, "all persons having liens upon or claiming any interest in the property involved [must] be made parties thereto." *Id.* § 7403(b) (1982). However, the taxpayer would not be able to assert the omission of this requirement to his benefit because this provision is intended to benefit the party having the lien or claiming the interest.

121. *See, e.g., In re* Gerwig, 461 F. Supp. 449, 451 (C.D. Cal. 1978).

122. I.R.C. § 6901 (1982). Generally, when a conveyance is found under the applicable state law to have been fraudulent, it is deemed void and thus the creditor can reach the property.

123. *See* John Owenbey Co. v. Commissioner, 645 F.2d 540 (6th Cir. 1981); *see also* Commissioner v. Stern, 357 U.S. 39 (1958).

124. Alaska's fraudulent conveyance statute, which resembles that of most other states, is ALASKA STAT. § 34.40.010 (1985).

125. I.R.C. § 7424 (1982).

126. *Id.* § 7425(a)(1) (1982).

127. *Id.* § 7424 (1982).

2. *Taxpayer and Third-Party Rights.* The taxpayer or a potentially liable third party may also invoke judicial powers. Within ninety days of the mailing of the notice of deficiency, the taxpayer has the right to file a petition in the Tax Court contesting the alleged deficiency.[128] The filing of a petition stays further assessment or collection until the Tax Court's final decision, unless the IRS finds the collection of the tax in jeopardy.[129] The taxpayer need not prepay the assessed liability in order to file such a petition.

Under limited circumstances, a taxpayer or third party is entitled to injunctive relief. The Anti-Injunction Act represents the primary obstacle to obtaining such relief. The Act provides that, subject to certain statutory and judicial exceptions, "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed."[130] The noted statutory exceptions to the Act are as follows. Temporary injunctions may issue when the IRS attempts (1) to assess or collect taxes through levy or court proceeding during the ninety- or 150-day period following the mailing of the deficiency notice,[131] or (2) to collect the remainder of a 100% penalty through levy or court proceeding prior to the final resolution of a proceeding timely filed by a taxpayer who is contesting liability and has posted the appropriate bond.[132] Permanent injunctions may issue when the IRS attempts (1) to determine an additional deficiency for the same calendar year relating to the basis of a petition already filed in Tax Court by a taxpayer challenging a prior notice of deficiency sent by the IRS,[133] or (2) to sell property when a third party has filed a wrongful levy suit, has demonstrated the superiority of his rights to the property, and has shown that he would be irreparably injured by levy or sale of the property.[134]

128. *See supra* notes 6-7 and accompanying text.

129. I.R.C. § 6213(a) (1982). Jeopardy assessments, specifically excepted from section 6213(a) and provided for in sections 6851 and 6861, are discussed *infra* notes 142-61 and accompanying text.

130. I.R.C. § 7421 (1982). Penalties are to be regarded as taxes for purposes of this statute. *Id.* § 6671(a) (1982); Herring v. Moore, 735 F.2d 797 (5th Cir. 1984). *But see* LeBlanc v. Shirey, 598 F. Supp. 747, 749-50 (E.D. Tex. 1984) (criticizing the result reached in *Herring,* though the court was bound to follow it), *aff'd sub nom.* Capp v. Eggars, 782 F.2d 1341 (5th Cir. 1986).

131. I.R.C. § 6213(a) (1982).

132. *Id.* § 6672(b) (1982). This exception is more fully discussed *infra* text accompanying notes 187-90.

133. I.R.C. § 6212(a), (c) (1982); *Id.* § 7421 (1982).

134. I.R.C. § 7426(a)(1), (b)(1) (1982). In a wrongful levy proceeding, courts can enjoin the sale of the property levied upon and (1) order its return if the United States still possesses the property, (2) grant a money judgment for the amount levied upon, or (3) order a monetary judgment against the United States and in favor of the third party entitled to the property in an amount equal to either the amount received by the

Despite the broad preclusive language of the Anti-Injunction Act, the Supreme Court in *Enochs v. Williams Packing and Navigation Co.*[135] recognized a limited judicial exception to the Act. For this exception to apply, the taxpayer must prove that (1) the government cannot succeed on the merits of the case, and (2) irreparable harm will occur to the taxpayer if injunctive relief is denied.[136] Courts take a restrictive view of this judicial exception. They require a showing that the government could not possibly succeed under any interpretation of the facts and that more than mere economic hardship will occur.[137] Injunctive relief under this judicial exception has, therefore, seldom been granted.

In 1984, the United States Supreme Court apparently created a new judicial exception to the Anti-Injunction Act. In *South Carolina v. Regan,*[138] the Court held that the Anti-Injunction Act was not intended to bar an action where Congress has not provided the taxpayer "with an alternative legal way in which to challenge the validity of a tax."[139] The plurality opinion specifically declined to decide whether the case fell within the *Williams Packing* exception.[140] Because of the peculiar fact situation in *Regan,* the viability of this new exception remains unclear.[141]

IRS from its sale or the fair market value of the property just prior to the sale, whichever is greater, if the property has been sold. *Id.* § 7426(b) (1982).

135. 370 U.S. 1 (1962).

136. *Id. See also* Bob Jones Univ. v. Simon, 416 U.S. 725 (1974).

137. *See Williams Packing,* 370 U.S. at 5-8; *see also Bob Jones Univ.,* 416 U.S. at 736-37; Pipola v. Chicco, 274 F.2d 909, 914 (2d Cir. 1960) (judicial exception is based on extraordinary and exceptional circumstances and must be maintained as a narrow exception); Westgate-California Corp. v. United States, 496 F.2d 839 (9th Cir. 1974) (probable corporate bankruptcy because of inability to obtain credit due to tax liens insufficient to justify injunction where taxpayer failed to show that government had no possibility of prevailing on the merits); Smaldone v. Kurtz, 450 F. Supp. 1138, 1141 (D.D.C. 1978) (due process violation by IRS might suffice if other essentials of equitable jurisdiction are present); Detwiler v. United States, 406 F. Supp. 695, 699 (E.D. Pa. 1975) (economic hardship was insufficient even where plaintiff found himself "mired in quicksands of unmanageable debts"), *aff'd,* 544 F.2d 512 (3d Cir. 1976), *cert. denied,* 429 U.S. 1105 (1977); Center on Corporate Responsibility, Inc. v. Shultz, 368 F. Supp. 863 (D.D.C. 1973) (non-profit organization was granted injunctive relief against the IRS because it failed to rule that the corporation was a charitable and educational organization exempt from federal taxes and there was no possibility that government would prevail on the merits of the exemption question, the corporation would suffer irreparable harm of probable extinction in the absence of injunction, and the corporation had been subjected to selective treatment for political and ideological reasons).

138. 465 U.S. 367 (1984).

139. *Id.* at 373.

140. *Id.* at 372-73.

141. *Regan* resulted when I.R.C. § 103(a), which exempts from a taxpayer's gross income the interest earned on the obligations of any state, was amended by Congress

When available, injunctive relief may provide the taxpayer with several practical benefits. First, when considering an application for injunctive relief, a district court typically requires the attendance of an Assistant United States Attorney or a trial attorney from the Department of Justice Tax Division. This provides the taxpayer with a separate administrative review of the IRS's action. Because the Department of Justice considers litigation hazards and costs, it may be more amenable to a reasonable resolution of the dispute. Second, district courts prefer compromise resolutions, particularly when taxpayers allege egregious or unfair conduct by IRS agents. To that end, district courts may exert pressure on the government to seek an amicable resolution of the controversy, especially where the controversy is limited to the particular taxpayer. For these reasons, an action for injunctive relief in an onerous levy situation may lead to a compromise or favorable resolution of the problem.

IV. JEOPARDY AND TERMINATION ASSESSMENTS

A. IRS Authority

The preceding discussion centered on the normal collection situation. The IRS possesses greater collection authority where exigent circumstances indicate that the collection of taxes may be jeopardized if collection efforts are not immediately set in motion. In these emergency collection situations, referred to as jeopardy or termination assessments, the law permits the IRS to expedite the assessment and collection process.[142]

The two types of emergency assessments, jeopardy and termination, are fairly similar. To make either assessment, the IRS must determine that the taxpayer is (1) planning to depart from the United States or to conceal himself, (2) designing to immediately place his

in 1982. The amendment added a new provision, § 103(j)(1), which required that state obligations be issued in registered, as opposed to bearer, form in order to qualify for the § 103(a) exemption. Otherwise, the interest earned on them would be taxable income. Because bearer form bonds would carry a lower price than comparably registered form bonds, the new provisions effectively forced states to issue only registered form bonds. South Carolina filed a complaint with the Supreme Court against the then Secretary of the Treasury, Donald Regan, seeking, *inter alia,* injunctive relief on the ground that § 103(j)(1) violated the tenth amendment and the doctrine of intergovernmental tax immunity. The Secretary, never responding to the merits of the claim, argued that the action was barred by the Anti-Injunction Act. If the action were barred, South Carolina effectively had no remedy. If no bearer bonds were issued, there would be no injury and no challenge could be made to the new provision. If South Carolina issued bearer bonds, the purchasers, not South Carolina, would incur the tax liability. Under these circumstances, the state would have no statutory procedure by which to contest the constitutionality of § 103(j)(1).

142. I.R.C. §§ 6851, 6861 (1982).

property beyond the reach of the government, or (3) dangerously near financial insolvency.[143] The only difference between the two assessments is that a jeopardy assessment is made after the due date of a taxpayer's tax return, including extensions, while a termination assessment is made before the end of a tax year and is inapplicable after the due date of the tax return.[144]

If the IRS determines that delay may jeopardize collection because of the existence of one or more of the prescribed situations, it may immediately make an assessment of the tax deficiency.[145] Within five days of such assessment, the IRS must provide the taxpayer with a written statement setting forth the information upon which it bases the assessment.[146] Next, the IRS must issue a notice of deficiency. As in the normal collection process, this marks the beginning of the period for filing a petition in the Tax Court.[147] The IRS must also give the taxpayer notice of the assessment and a demand for payment.[148] Unlike the normal collection process, however, the IRS need not wait ten days after fulfilling the notice requirements before taking collection action through levy.[149]

Although the IRS may immediately levy upon the taxpayer's property pursuant to a jeopardy or termination assessment, it cannot sell the property prior to the expiration of the taxpayer's time to seek administrative review or file a petition in Tax Court.[150] When the taxpayer timely requests administrative review, the IRS cannot sell levied property until the expiration of the filing date for district court review. If an appeal follows, the IRS cannot sell the property until the district court's decision becomes final.[151] If, instead of seeking administrative review, the taxpayer timely petitions the Tax Court and files the appropriate bond, a final decision by the Tax Court is a prerequisite to the sale of the property.[152] These limitations do not apply, however,

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143. *Id.* § 6851 (1982); Treas. Reg. § 1.6851-1(a)(1) (as amended in 1978).

144. I.R.C. § 6851(a)(4) (1982).

145. *Id.* §§ 6851(a), 6861(a) (1982). By contrast, in the normal collection process, the IRS must issue a "90-day letter" and then wait the 90 days for the taxpayer to file a petition in Tax Court. If such petition is filed, the Tax Court's decision must become final before the IRS can make an assessment. *See supra* text accompanying notes 6-11.

146. I.R.C. § 7429(a)(1) (1982). Receipt of this notice begins the running of the period for the assessment. *Id.* § 7429(a)(2) (1982).

147. *Id.* §§ 6851(b), 6861(b) (1982).

148. Treas. Reg. §§ 1.6851-1(c) (as amended in 1978), 301.6861-1(d) (as amended in 1982).

149. I.R.C. § 6331(a) (1982).

150. *Id.* § 6863(b)(3)(A)(i) (1982).

151. *Id.* § 6863(c)(1)(A) (1982).

152. *Id.* § 6863(b)(3)-(c) (1982); Treas. Reg. § 301.6863-2(a) (as amended in 1978). District court determinations regarding adminstrative decisions on the making of as-

when the taxpayer consents to the sale, the IRS determines that the expense of maintaining the property will greatly reduce the net proceeds from its sale, or the property is of a perishable nature.[153]

B. Taxpayer Rights

The taxpayer has two procedures by which to challenge jeopardy or termination assessments.[154] First, a taxpayer may obtain a stay of collection by filing a bond with the Secretary of Treasury in an amount equal to the assessment.[155] If the assessment relates to a deficiency over which the Tax Court has jurisdiction, the stay is subject to the condition that the taxpayer file a petition with the Tax Court. Absent the timely filing of such a petition, the bond, together with interest from the date of the jeopardy notice, will be paid over to the IRS upon notice and demand.[156]

Second, the taxpayer may petition the district court for an expedited review of the jeopardy or termination assessment.[157] In order to obtain such review, however, the taxpayer must first seek an administrative review of the assessment within thirty days of receipt of the written statement of information detailing the grounds for the assessment.[158] After seeking administrative review, the taxpayer must file suit for review in district court within thirty days after the earlier of the day the IRS gives notice of its administrative review decision, or the sixteenth day after the taxpayer requests such administrative review.[159] Within twenty days after the filing of the taxpayer's request for review, the district court must decide whether the IRS reasonably made the assessment in an appropriate amount.[160] The IRS bears the burden of proving the reasonableness of the assessment, while the burden of proving the reasonableness of the amount rests with the taxpayer.[161]

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sessments are final and conclusive; they cannot be appealed. I.R.C. § 7429(f) (1982). Consequently, when the taxpayer opts for administrative review, the property levied upon may be sold by the IRS, at the latest, after the district court renders its decision. In contrast, Tax Court decisions may be appealed and thus may not become final for a much longer period.

153. I.R.C. § 6863(b)(3)(B), (c)(2) (1982).

154. The taxpayer may also challenge the substance of the assessment through Tax Court or through refund litigation.

155. I.R.C. § 6863(a) (1982).

156. *Id.* § 6863(b)(1) (1982).

157. *Id.* § 7429 (1982).

158. *Id.* § 7429(a) (1982).

159. *Id.* § 7429(b)(1) (1982).

160. *Id.* § 7429(b)(2) (Supp. II 1985).

161. *Id.* § 7429(g) (1982).

V. Collection From Secondary Sources

Circumstances exist in which the IRS may assess federal tax liabilities against secondary sources and seek collection from these sources in addition to the primary taxpayer. One such situation occurs when an entity has failed to pay the employment and social security taxes withheld from the wages of its employees.[162] A fiduciary or transferee may also be held liable in certain contexts.[163]

A. Liability for Withholding Taxes

Employers have an obligation to withhold certain social security and income taxes from the wages of their employees and to keep such funds in accounts separate from their general cash accounts.[164] Taxes withheld by employers are typically called trust fund taxes.[165] Financially troubled employers often use trust fund taxes to pay creditors, expecting to be able to replenish the fund by the time their obligation comes due. Many such entities become insolvent and unable to satisfy the obligation.[166] When faced with this situation, the United States may seek collection of the entity's unpaid trust fund taxes from other sources, particularly those controlling persons who decided which creditors to pay.[167] Under certain circumstances, financial institutions or other lenders who provided funds to the entity may also be liable for its trust fund taxes.[168]

1. *100% Penalty.* Under the so-called "100% Penalty" provision, the IRS may assess and collect a penalty in the amount equal to the unpaid corporate trust fund taxes from any person who was required, but failed, "to collect, truthfully account for, and pay over the tax."[169] In order to assert the 100% penalty assessment, the IRS must establish two elements. First, the person subject to penalty must be "responsible" for seeing that the corporation's withheld trust fund taxes were paid to the government.[170] Generally, a finding of responsi-

162. *Id.* § 6672 (1982).

163. *Id.* § 6901 (1982).

164. *Id.* §§ 3101, 3102, 3402 (Supp. II 1985).

165. *Id.* § 7501 (1982).

166. *See, e.g.,* Barnett v. United States, 594 F.2d 219 (9th Cir. 1979); *see also* United States v. Sotelo, 436 U.S. 268, 277-78 n.10 (1978).

167. *See* I.R.C. §§ 6671(b), 6672 (1982); *see also Barnett,* 594 F.2d at 221 (IRS sought unpaid withholding taxes from Barnett who had founded the corporation, was its president and administrator, and consequently was a "responsible officer" of it with respect to which creditors it paid).

168. I.R.C. § 3505 (1982).

169. *Id.* § 6672 (1982).

170. *See* Slodov v. United States, 436 U.S. 238, 244-45 (1978); Turner v. United States, 423 F.2d 448, 449 (9th Cir. 1970); Monday v. United States, 421 F.2d 1210, 1214-15 (7th Cir.), *cert. denied,* 400 U.S. 821 (1970).

bility will attach to persons charged with "control over the corporation's business affairs [and] who participate in decisions concerning payment of creditors,"[171] or those who have "the final word as to what bills should or should not be paid, and when."[172] Second, the IRS must prove that the person "willfully" failed to pay over the taxes.[173] In this context, willfulness means a voluntary, conscious, and intentional choice to pay other creditors instead of the government at the time the wages were paid and the withholding taxes were due for deposit.[174] Mere negligence is insufficient to establish willfulness under this provision.[175] A reckless disregard of the risk that the taxes may not be paid over to the government may, however, constitute willfulness.[176]

A third party assessed the 100% penalty should be aware of three of the provision's unusual features. First, a 100% penalty assessment is presumed correct. The burden of proving the impropriety of the assessment rests on the individual charged.[177] Second, liability may attach to more than one person.[178] Finally, the IRS need not seek collection from the underlying entity prior to asserting the 100% penalty against controlling persons.[179]

2. *Lender Liability.* The IRS may also file an assessment against certain financial institutions or other lenders and collect unpaid corporate withholding taxes directly from them.[180] A lender, when it pays wages directly to the employees on behalf of the employer, may assume personal liability for the taxes that should have been deducted and withheld from the employees' wages.[181] Moreover, if a lender

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171. *Monday,* 421 F.2d at 1214-15.

172. Dudley v. United States, 428 F.2d 1196, 1201-02 (9th Cir. 1970) (quoting Wilson v. United States, 250 F.2d 312, 316 (9th Cir. 1957)); *see also* Griswold v. United States, 209 F. Supp. 98 (S.D. Cal. 1962) (controlling stockholder who controlled corporation's "purse strings" and decided the priority in which creditors were to be paid was held liable for the 100% penalty).

173. *See Monday,* 421 F.2d at 1216.

174. *See Dudley,* 428 F.2d at 1200; Kalb v. United States, 505 F.2d 506 (2d Cir. 1974), *cert. denied,* 421 U.S. 979 (1975).

175. *See* Mazo v. United States, 591 F.2d 1151, 1154 (5th Cir.), *cert. denied,* 444 U.S. 842 (1979); Brown v. United States, 591 F.2d 1136, 1140 (5th Cir. 1979).

176. *See* Sinder v. United States, 655 F.2d. 729 (6th Cir. 1981); United States v. Pomponio, 635 F.2d 293, 296 (4th Cir. 1980); Anderson v. United States, 561 F.2d 162, 165 (8th Cir. 1977).

177. *See* Hartman v. United States, 538 F.2d 1336 (8th Cir. 1976); *Monday,* 421 F.2d at 1214-15.

178. *See* Gray v. United States, 586 F. Supp. 1127, 1131 (D. Kan. 1984); Teel v. United States, 529 F.2d 903, 906 (9th Cir. 1976).

179. I.R.C. § 3505 (1982).

180. *Id.* § 3505(a) (1982).

181. *Id.* § 3505(b) (1982).

supplies funds to an employer for the specific purpose of paying taxes, with actual knowledge that the employer does not intend or will not be able to make timely deposit of the withheld taxes, the lender will be personally liable for the trust fund taxes up to twenty-five percent of the funds so supplied.[182]

3. *Secondary Taxpayer Protections.* Secondary sources can avoid or minimize the impact of the 100% penalty provision and the provision involving lenders' liability. Withholding taxes are comprised of both a "trust fund" portion and a "non-trust fund" portion. The "trust fund" portion of the tax is the income withheld from employees' wages to pay withholding and FICA taxes.[183] The "non-trust fund" portion of the corporation's obligation is the employer's matching FICA contribution.[184] If the corporate taxpayer neglects to designate how partial tax payments should be applied, the IRS will first apply the payments to the non-trust fund portion. By so doing, the IRS maximizes the trust fund portion of the taxes for which it can seek collection from secondary sources.[185] A corporation, however, has the right to designate that voluntary partial tax payments be applied first to the trust fund portion of the taxes.[186] The taxpayer-employer can thereby minimize, or possibly avoid, the unpaid trust fund taxes that the IRS can secure from secondary sources.

In addition, an individual assessed a 100% penalty may petition for a stay of collection.[187] In order to obtain the stay, the person assessed a penalty must (1) pay the minimum amount required to file a refund suit, (2) file a claim for refund of such payment with the IRS, and (3) post a bond in the amount of one and one-half times the amount of the assessment — all within thirty days of the notice and demand.[188] The person must then file a refund suit with a district or claims court within thirty days after the IRS denies the claim for refund.[189] Unless the Secretary of Treasury determines that collection of the penalty is in jeopardy, fulfillment of these requirements permits

182. *Id.*; Treas. Reg. § 301.3505-1(b)(3) (1976); *see also* Fidelity Bank v. United States, 616 F.2d 1181 (10th Cir. 1980) (bank did not have authority to compel payment of withholding taxes such that it would be responsible for 100% penalty even though it was clearly liable for 25% penalty pursuant to section 3505(a)).

183. I.R.C. §§ 7501, 3101, 3102, 3401 et. seq. (1982 & Supp. III 1985).

184. *Id.* § 3111 (Supp. II 1985).

185. *See* Liddon v. United States, 448 F.2d 509, 513 (5th Cir. 1971), *cert. denied,* 406 U.S. 918 (1972); Pacific Nat'l Ins. Co. v. United States, 422 F.2d 26 (9th Cir.), *cert. denied,* 398 U.S. 937 (1970).

186. *Pacific Nat'l,* 422 F.2d at 33.

187. I.R.C. § 6672(b) (1982).

188. *Id.* § 6672(b)(1)-(3) (1982).

189. *Id.* § 6672(b)(2) (1982).

the court to enjoin any collection action by the IRS.[190]

Finally, a 100% penalty assessment, unlike the normal refund suit, may be challenged in district court or claims court by filing an appropriate "divisible assessment" of the liability.[191] The minimum payment necessary to file a refund suit contesting a 100% penalty assessment is the amount of tax that should have been withheld for any one employee.[192]

B. Fiduciary and Transferee Liability

Transferees and fiduciaries also fall within the reach of the IRS's assessment and collection powers.[193] Assessment against such parties normally occurs when a delinquent primary taxpayer has failed to fully pay his taxes and the person assessed has either received property from the primary taxpayer without exchanging something of value for it or exercised some degree of control over a delinquent primary taxpayer. For example, where an estate has failed to pay its taxes, the IRS may seek collection from a beneficiary of the estate who has received property from the estate's representative or administrator. The IRS may assess and collect taxes against such transferees or fiduciaries in the same manner and with the same limitations as apply to the primary taxpayer.[194] The IRS must follow the assessment procedures previously discussed for primary taxpayers.[195]

The elements of transferee liability are (1) that the transferee received assets of value from the transferor without giving something of value in return, (2) that the transferor had primary liability for the tax, (3) that the tax was not paid in full, and (4) that the IRS has complied with the applicable statute of limitations.[196] If these statutory elements are satisfied, the IRS may make a personal assessment against the transferee and attempt to collect from the transferee's assets.[197] If the transferee challenges the assessment in Tax Court, the burden of

190. *Id.* § 6672(b)(1), (5) (1982).

191. *See* Psaty v. United States, 442 F.2d 1154, 1159 (3d Cir. 1971); Steele v. United States, 280 F.2d 89 (8th Cir. 1960).

192. *See* Fidelity Bank v. United States, 616 F.2d 1181, 1182 n.1 (10th Cir. 1980).

193. I.R.C. § 6901 (1982).

194. *Id.*

195. *Id.*; regarding the procedures which must be followed with respect to primary taxpayers, *see supra* text accompanying note 46.

196. *See* I.R.C. § 6901 (1982); Treas. Reg. 301.6901-1 (as amended in 1961); *see also* Healy v. Commissioner, 345 U.S. 278, 284 n.16 (1953). The requirement that the transferee not give value for the assets received results from the definition of "transferee" being limited primarily to donees, heirs, legatees, devisees, and distributees. I.R.C. § 6901(h) (1982); Treas. Reg. § 301.6901-1(b) (as amended in 1961). "Transferee" also includes "any person who, under section 6324(a)(2), is personally liable for any part of such tax." I.R.C. § 6901(h).

197. I.R.C. § 6901(a) (1982).

proof rests on the IRS "to show that a petitioner is liable as a transferee of property of a taxpayer but not to show that the taxpayer was liable for the tax."[198]

A fiduciary who allows distribution of the assets of a delinquent taxpayer may also be found personally liable for any unpaid taxes after distribution.[199] The United States' claim is generally paid first when a person indebted to the government becomes insolvent and either (1) the person makes a voluntary assignment of property, (2) the property of the person, if absent, is attached, or (3) an act of bankruptcy is committed.[200] The claim of the United States also enjoys priority when a deceased debtor's estate is insufficient to pay all of the debts of the decedent.[201] Because unpaid taxes are considered debts owing to the United States,[202] a representative of a delinquent taxpayer's estate who pays other creditors before paying the United States is liable for the unpaid balance claimed by the United States.[203] An executor, however, may make a written application for release from personal liability.[204] Upon payment of the amount owed by the estate to the IRS, the executor will be discharged from further personal liability.[205]

Generally, the rights and remedies available to a transferee or fiduciary are the same as those described for the primary taxpayer. As a practical matter, however, the IRS will make transferee or fiduciary assessments only when it has failed to collect from the primary source or it feels that collection from the primary taxpayer is doubtful. When the IRS finally decides to make an assessment against a transferee or fiduciary, it is not likely to be generous with terms of collection.

VI. CONCLUSION

In order to effectuate voluntary compliance with the federal tax collection system, the IRS is delegated broad authority to summarily enforce collection. The primary collection mechanisms available to the IRS for forced collection include the federal tax lien, summons authority, and the powers of levy and distraint. As to each of these mechanisms, a taxpayer possesses limited rights to contest perceived unfair or unlawful collection action. A taxpayer would be well advised to assert these rights in order to protect his interests.

198. *Id.* § 6902(a) (1982).
199. *Id.* § 6901(a) (1982).
200. 31 U.S.C. § 3713(a)(1)(A) (1982).
201. *Id.* § 3713(a)(1)(B) (1982).
202. *See* Price v. United States, 269 U.S. 492 (1926).
203. 31 U.S.C. § 3713(b) (1983).
204. I.R.C. § 6905 (1982); Treas. Reg. § 301.6905-1 (1972).
205. I.R.C. § 6905 (1982); Treas. Reg. § 301.6905-1 (1972).