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Offshore Trustees Beware: No Pre-Levy Notice for You!

By Phyllis C. Taite



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Taite discusses *Greenoak Holdings Ltd. v. Commissioner*, in which the Tax Court addressed whether a third party with an ownership interest in property subject to levy by the commissioner is entitled to rights afforded to “persons” under section 6330. The court also addressed whether it had jurisdiction over an appeal filed by those third parties, and it ultimately dismissed the case for lack of jurisdiction.

Sometimes in the practice of law, procedure is more important than substance. That was the case in *Greenoak Holdings Ltd. v. Commissioner*,¹ in which third parties attempted to protect their property interests in mutually owned property that was subject to a levy against another taxpayer.

Although the law recognizes the legitimacy of third-party rights, the court correctly refused to hear the case because the third parties came in through the proverbial wrong door. The famed sitcom *Seinfeld* once addressed a similar dilemma when patrons were forever barred from indulging in a famous soup for not adhering to proper protocol.

Greenoak Holdings Ltd. involved property owned by James B. Irwin (decedent) who died on September 21, 2009. Howard Crown was appointed as personal representative of the estate. Crown filed Form 706, “United States Estate (and Generation-Skipping Transfer) Tax Return,” reporting all of the

probate and non-probate assets. Karamia Settlement was listed as one of the non-probate assets.²

The estate did not have enough liquid assets to pay the estate tax owed. Crown attributed the inability to pay on the inclusion of the value of Karamia Settlement in the gross estate. The IRS issued a pre-levy notice to Crown.³ The notice indicated the estate owed a balance of \$7,526,038.88.⁴

Crown submitted a timely request for a collection due process hearing and at the hearing argued that the penalties should be abated because the estate had insufficient liquid assets to pay the tax. After the hearing, on May 1, 2013, Crown received a notice of determination sustaining the proposed levy of non-probate assets and denying abatement of penalties.⁵ Crown did not file a petition for review. Instead, he forwarded a copy of the notice to the trustee of Karamia Settlement.

It is important to keep in mind that the trustee was not a party to the CDP hearing. Nevertheless, on May 30, 2013, *Greenoak Holdings Ltd.*, *Southbrook Properties Ltd.*, and *Westlyn Properties Ltd.* (“Petitioners”), all of which were owned by Karamia Settlement, filed a petition with the Tax Court for judicial review. Petitioners asserted that their ownership interests were subject to levy by the commissioner’s actions and that therefore they should have been afforded the CDP rights stated in section 6330.

The IRS filed a motion to dismiss for lack of jurisdiction because Petitioners were not a proper party for filing.⁶ Crown filed a response to the petition for review, essentially supporting the commissioner’s motion to dismiss. Six months later, however, Crown resigned as personal representative and filed a notice of substitution identifying Jill McCrory as the successor personal representative.

²Karamia Settlement is an offshore trust in the Bahamas governed by the law of Jersey in the Channel Islands. The decedent had made transfers to the trust during his lifetime.

³Final notice of intent to levy and notice of your right to a hearing were issued under section 6330.

⁴The record does not indicate the exact amount of estate tax so the balance likely includes penalties and interest.

⁵The notice of deficiency indicates that only property not subject to the probate court’s jurisdiction, non-probate assets, was the subject of the levy.

⁶The court issued the show cause order directing the parties to explain why the estate should not be substituted as petitioner.

¹143 T.C. No. 8 (Sept. 16, 2014).

On May 6, 2014, McCrory filed a supplemental response to the show cause order. McCrory reversed the estate's support of the IRS's motion to dismiss and instead filed a motion and argued (1) that Petitioners did, in fact, have standing to sue in their own right; and (2) that the case should not be dismissed for lack of jurisdiction; or in the alternative (3) that the estate be substituted as the petitioner and that the original petitioners be allowed to intervene.

Addressing the first request, the court had to determine whether Petitioners were entitled to the CDP protections of section 6330. The court reviewed precedent, legislative history,⁷ and statutory language. All the reported cases involving section 6330(d) have been filed by the taxpayer or authorized representatives.⁸ Even so, Petitioners argued that they were proper parties to appeal the notice of deficiency because the word "person" includes any person who might have an interest in the property being levied.

Unfortunately, Petitioners had no case authority for their position. The court noted that the legislative history also strongly suggests that only the taxpayer or an authorized representative is afforded pre-levy notice and the opportunity to petition for judicial review. The House conference report that accompanied the enactment of section 6330 specifically referenced only the taxpayer (on at least five separate occasions) as the person who is afforded pre-levy notice and due process protections. Finally, the statutory provisions specifically state that the person entitled to receive pre-levy notice is the taxpayer.⁹

Petitioners next argued that their property was not property of the estate subject to levy by the commissioner. As the true owners, they, and not the estate, were the proper parties entitled to the notice of intent to levy. The court disagreed. The gross estate is defined as property to which a decedent has a property interest at the time of death.¹⁰

Since there was some evidence that decedent made transfers to the trust before death, the court concluded that the decedent had an interest in the trust. Further, the personal representative included

the offshore trust in the list of non-probate assets, essentially admitting decedent owned or had a property interest in the property.

For all the foregoing reasons, the court found that Petitioners interpreted "person" too broadly. A comprehensive reading of the applicable provisions demonstrates the appropriate person contemplated in the statutory language is the taxpayer and the property subject to levy is property owned by that taxpayer.¹¹ The person whose property is going to be levied is entitled to appeal to the Tax Court, thereby giving the court jurisdiction.

The court further found that while Petitioners might have an ownership interest in the property subject to levy, they are not persons contemplated by section 6330. As a result, they were not entitled to appeal the notice of deficiency issued against the estate and they are not entitled to pre-levy notice.

Next, Petitioners alleged their ownership interest in the levied property gave the court jurisdiction over the appeal. Petitioners used the language from a House conference report that referenced a third party's right to raise issues at the CDP hearing.¹² Based on the language in that report, Petitioner argued Congress intended to provide affected third parties the same due process rights as the liable taxpayer. The court disagreed.

The court indicated the language "affected third parties" refers to raising issues at the CDP hearing and makes no suggestions about having notice or appeal rights. Further, according to the court, the IRS is not required to provide an itemized list of property subject to levy so it would be impossible to provide alleged owners with pre-levy notice.

Finally, the court considered the issue of whether the estate may be substituted as the party for the petitioner. Petitioners filed the original petition on May 30, 2013, at which time Crown, the original personal representative, was opposed to the petition. When McCrory filed the supplemental response on May 6, 2014, it was nearly a year after the deadline to appeal.¹³ As a result, the request by the estate was not timely, so there was no need to address the motion to allow Petitioners to intervene.

The court noted that section 6330 was enacted to provide procedural rights to taxpayers, while section 7426 was enacted to provide persons other than taxpayers with procedural rights if their property

⁷*Greenoak* at *7, citing the Internal Revenue Service Restructuring and Reform Act of 1998, section 3401(b), 112 Stat., at 747, in order to establish "formal procedures designed to insure due process where the IRS seeks to collect taxes by levy." H.R. Conf. Rept. No. 105-599, at 263 (1998), 1998-3 C.B. 747, 1017.

⁸*Greenoak* at *4, citing *Lunsford v. Commissioner*, 117 T.C. 159 (2001); *Offiler v. Commissioner*, 114 T.C. at 492 (2000); *Thompson v. Commissioner*, T.C. Memo. 2013-260; *Estate of Deese v. Commissioner*, T.C. Memo. 2007-362.

⁹Sections 6212 and 6213.

¹⁰*Id.*

¹¹Sections 6330 and 6331(a).

¹²The House conference report states, in relevant part, "The taxpayer (or affected third party) is allowed to raise any relevant issue at the hearing."

¹³Section 6330(d). The deadline for submitting a petition for review is 30 days from the date the notice of deficiency was issued.

was wrongfully levied.¹⁴ The district court has jurisdiction and is the proper court to hear wrongful levy actions.¹⁵

In the end, the court held that the person entitled to pre-levy notice and due process protections under section 6330 was the taxpayer liable for the unpaid tax. The court further held the court lacked jurisdiction over the petition filed by a party who is neither the taxpayer nor an authorized representative of the taxpayer.

Analysis and Conclusion

As I mentioned earlier, this case brings to mind *Seinfeld's* well-known "Soup Nazi,"¹⁶ who demanded protocol be strictly followed before serving his delicious soup. If the patrons did not adhere, he denied their order with his famous line, "No soup for you!"

Here, the offshore trustee did not have proper protocols in place to protect the trust assets. Therefore, the Tax Court denied access to the third-party petitioners and held that they did not have a right to pre-levy notice. I can almost hear the judge proclaiming "no pre-levy for you!" to the third-party petitioners.

Humor aside, it is tempting to dismiss this case as harmless in light of section 7426. As a practical matter, preventing a levy, as the petitioners sought to do in this case, is always easier than challenging an already executed levy and undoing the consequences from that levy.

¹⁴Section 7426(a)(1); see also *Greenoak* at *10, citing *EC Term of Years Trust v. United States*, 550 U.S. 429, 435 (2007); *Elias v. Commissioner*, 100 T.C. 510, 519, n.10 (1993); *Cutler v. Commissioner*, T.C. Memo. 2013-119.

¹⁵*Greenoak* at *10, citing *Cutler v. Commissioner*, T.C. Memo. 2013-119.

¹⁶See http://en.wikipedia.org/wiki/The_Soup_Nazi: "The term 'Nazi' is used as an exaggeration of the excessively strict regimentation [the Soup Nazi] constantly demands of his patrons."

Maybe the commissioner should consider accommodating third-party interests if the alternative is more litigation under section 7426. Indeed, in the interest of saving time and avoiding unintended consequences, Congress might amend section 6330 to allow third parties to intervene (although not to be entitled to notice because this might create an administrative burden for the government) in CDP hearings when the affected party can prove a property interest at stake.

From a more substantive standpoint, this was the first case in which a third party petitioned the Tax Court for rights under section 6330. It was most interesting because the main focus of the case was statutory construction and interpretation, yet there were several issues and implications in the practice of estates, trusts, and estate tax.

First, any property in which a decedent has an ownership interest is subject to inclusion in the gross estate when determining their estate tax liability.¹⁷ In this instance, it was easily anticipated that the inclusion of the decedent's offshore property interests would increase the estate liability.

Second, for estates that anticipate insufficient liquid assets to cover estate tax, proper planning would include an irrevocable life insurance trust (ILIT) to pay the tax without sacrificing other assets.

Finally, in the event an ILIT does not exist, as in this case, the decedent and foreign trustee should have a predetermined protocol for dealing with estates that may have insufficient liquid assets to pay their taxes. That provides an efficient, cohesive position that has the best option for preserving rights and timely filings. With proper planning and establishing contingencies with proper protocols, maybe taxpayers can avoid the levy action altogether and then third parties won't have to worry about the pre-levy notice at all.

¹⁷Section 2033.