Federal Tax Liens: Dilatory Government Conduct Bars Foreclosure.

Section 7403 of the Internal Revenue Code authorizes the government to bring a foreclosure action to enforce a federal tax lien, a remedy that the IRS frequently employs in situations in which it has only a partial interest in property. Its power to force a sale is not absolute, however, as courts weigh a variety of factors before authorizing a sale. A recent opinion illustrates this principle in the context of property transferred incident to a divorce.

Smith v. United States, 2014 U.S. Dist. LEXIS 29467 (D. Conn. Mar. 7, 2014) involved a dispute over the validity of a federal tax lien on the former marital home of David and Dyane Smith. David moved out of the house and initiated a divorce proceeding in 2000; he also failed to file his federal tax returns for 2000 and 2001. *Id.*, slip op. at *3. Meanwhile, in August 2001, a *lis pendens* was filed against the marital home by Dyane in August 2001. Subsequently, the IRS issued two tax assessments against David in March 2003.

In July 2003, a divorce decree was entered; among other things, it gave Dyane title to the marital residence, and made her responsible for the mortgage. David was made responsible for his own personal debts; at the time the decree was entered, Dyane was unaware of the tax assessments against David. *Id.*, slip op. at *4-*6. In September 2003, the IRS issued a Notice of Federal Tax Lien to David and recorded it in the local land records. *Id.*, slip op. at *6-*7.

In 2009, Dyane apparently learned of the lien but was advised that she had clear title. In 2011, the IRS, having determined that David was not able to pay his taxes, issued an alter-ego tax lien against Dyane for the balance. After an unsuccessful administrative appeal, Dyane brought an action to quiet title, and the government counterclaimed, requesting foreclosure to enforce its lien.

Although unsuccessful in her challenges to the validity of the government's lien, Dyane found success in opposing foreclosure. The court applied a series of factors developed by the Supreme Court in *United States v. Rogers*, 461 U.S. 677 (1983) to consider the prejudice suffered by someone who has an interest in property subject to a federal tax lien that is not liable for the taxes at issue; these included the likely prejudice to the government in the absence of foreclosure, the non-liable party's expectation that the property would not be subject to forced sale, the likely prejudice to the non-liable party, and the character and value of the non-liable and liable interests in the property. 2014 U.S. Dist. LEXIS 29467, slip op. at *43-*44 (citing *Rogers*, 461 U.S. at 710-11).

In weighing the potential prejudice to the government's interests, the court recognized that a sale of a partial interest in the property was not likely to be feasible, but it also examined the government's dilatory conduct. *Id.*, slip op. at *45-*47. Here, the record was very favorable to Dyane: after issuing the assessments to David in 2003, the IRS had done little to collect. In the interim, David's financial situation had deteriorated. Moreover, internal memoranda from the IRS indicated that it had delayed taking action at the time the property was formally transferred to Dyane under the divorce decree to avoid litigation. *Id.*, slip op. at *47-*48. Given these circumstances, the court concluded that the prejudice to the government was either a neutral factor or only slightly favored a forced sale.

The remaining factors weighed in Dyane's favor: since she was unaware of David's tax liabilities and had been the sole owner of the property for eleven years, she had a reasonable expectation that the property would not be subject to forced sale. *Id.*, slip op. at *49-*50. In considering the prejudice to Dyane from a sale, the court noted that the amount of the debt was small in contrast to the overall value of the property. The government's dilatory tactics again weighed against it here. *Id.*, slip op. at *50-*54. In weighing the final Rogers factor, the court noted that David's lack of any current interest in the property weighed strongly against a forced sale. *Id.*, slip op. at *54-*56. Finding that the weight of the factors was against foreclosure, the court held that the lien remained on the property, but that the government could not foreclose.

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