Office of Chief Counsel
Internal Revenue Service
Memorandum

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to: Area Counsel (CC:SB:8:LA:3)
Attn: Alan H. Cooper

from: Walter Ryan
Assistant to the Branch Chief, Br 1
Collection, Bankruptcy & Summonses

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subject: Levy on Taxpayer's Property and Rights to Property under Trust

This Chief Counsel Advice responds to your request for assistance dated September 13, 2005. This advice may not be used or cited as precedent.

ISSUES

1. Whether the Service may levy against a spendthrift trust under which the taxpayer is a current income beneficiary and is a vested beneficiary of a future interest in established portions of the trust principal?

2. If the trustee knowingly distributes funds encumbered with the federal tax lien and the funds disappear into the stream of commerce, under state law may the government sue the trustee for the tortious conversion of the federal tax lien?

CONCLUSIONS

1. The Service may levy on certain assets of the trust, despite the existence of spendthrift provisions, as the taxpayer possesses fixed and determinable property rights in the trust. A levy will clearly seize the taxpayer's fixed right to trust income and the taxpayer's fixed right to obtain a future distribution from corpus.

2. When a trustee distributes funds that he knows are encumbered by the federal tax lien and those funds enter the stream of commerce and cannot be traced, the trustee is liable for tortious conversion, i.e., intentionally impairing a lienor's security.

FACTS

On , (hereinafter "settlor") executed a trust agreement referred to as the (hereinafter "trust"). A Certification of Trust was filed with the State of California on the same date. Taxpayer was named Trustee for the Trust. The settlor died on . The trust provides that after the administration of the probate estate, the trust estate shall be divided into as many equal shares as are necessary to establish one share for each of the settlor's children and grandchildren. Taxpayer is a of the settlor and, as such, was allocated one share of the trust estate.

Taxpayer currently receives $ every month from the trust. Taxpayer has tax liabilities for taxable years and totaling $.

LAW AND ANALYSIS

Pursuant to Internal Revenue Code section 6321, the federal tax lien attaches to all property and rights to property of a delinquent taxpayer. The question of whether a state law right constitutes property or rights to property under section 6321 is a matter of federal law. United States v. National Bank of Commerce, 472 U.S. 713 (1985). When Congress broadly uses the term "property" as it does in section 6321 and section 6331, it aims to reach every species of right or interest protected by law and having an exchangeable value. Drye v. United States, 528 U.S. 49, 56 (1999). According to the Supreme Court, the "Code's prescriptions are most sensibly read to look to state law for delineation of the taxpayer's rights or interests in the property the Government seeks to reach but to leave to federal law the determination of whether those rights or interests constitute "property" or "rights to property" under section 6321." Id. at 58.

After the federal tax lien attaches to a taxpayer's property and rights to property, the Service gives notice and demand for payment, and if the taxpayer neglects or refuses to pay, the Service may levy upon the taxpayer's property and rights to property. As Treasury Regulation § 301.6331-1(a)(1) explains, the levy seizes the taxpayer's property and rights to property as of the time of the levy, although it does not accelerate a right to future payment:

> Except as provided in § 301.6331-1(b)(1) with regard to a levy on salary or wages, a levy extends only to property possessed and obligations which exist at the time of the levy. Obligations exist when the liability of the obligor is fixed and determinable although the right to receive payment thereof may be deferred until a later date.

The word "determinable" has been held to mean that the amount of liability is capable of being determined. Reiling v. United States, 77-1 U.S.T.C. ¶ 9269 (N.D. Ind. 1977). Thus, for tax levy purposes, the precise sum of the obligation need only be capable of measurement at some time in the future. See United States v. Hemmen, 51 F.3d 883, 890 (9th Cir. 1995) (construing Treas. Reg. § 301.6331-1(a)(1)).

If a taxpayer has a fixed and determinable right to a stream of payments, the levy will seize not only the payments currently due but also the payments to be made in the future. Rev. Rul. 55-210, 1955-1 C.B. 544. Thus, if a taxpayer has a fixed right under a trust to receive periodic payments or a lump sum distribution from a trust, the levy seizes the rights to such payments or distributions.

Spendthrift Provisions:

Spendthrift provisions, which are state-created exemptions, cannot defeat a federal tax lien. See, e.g., Northwestern Trust Company v. Internal Revenue Service, 622 F.2d 387 (8th Cir. 1980); United States v. Rye, 550 F.2d 682 (1st Cir. 1977). In Leuschner v. First Western Bank and Trust, the Ninth Circuit affirmed that a taxpayer's interest in a trust could be reached by the federal tax lien, observing that "[t]here is no doubt that the paramount right to collect taxes of the federal government overrides a state statute providing for exemptions." 261 F.2d 705, 708 (9th Cir. 1958) (footnotes omitted). Thus the spendthrift provision at of the trust, however effective against certain creditors' claims, is clearly ineffective at insulating assets of the trust from levy by the Service, provided that such assets are first found to constitute the "property" or "right to property" of the taxpayer.

Current Distribution of Trust Income:

The taxpayer has, at a minimum, the right to all current income of the trust. Distribution of current income to the beneficiaries is mandatory and not subject to the exercise of discretion on the part of the trustee.[1] It follows, then, that such mandatory distribution of current income is a property right of the taxpayer that may be levied by the Service and collected as payable. Pursuant to Revenue Rule 55-210, the levy will seize the entire stream of income payments, namely, the income payments currently due and all future income payments.

Future Distributions of Principal:

The taxpayer possesses an additional right to property in the trust in the form of future distributions of a certain proportion of trust corpus. The trust document establishes that the trustee shall distribute to the beneficiaries of the trust's corpus on approximately the anniversary of the settlor's death (approximately) and later shall distribute of the remaining corpus on the anniversary of the settlor's death (approximately). As with distributions of current income, distribution of these proportions of principal are mandatory and not subject to the discretion of the trustee. Furthermore, the beneficiaries' right to such distribution appears fully vested and not subject to divestment. As the only qualification of such right is as to the timing of the beneficiaries' receipt of the distribution, the right is fixed and capable of determination. This payment is essentially the same addressed in Revenue Rule 55-210, so the levy seizes the taxpayer's present right to this future payment, although the levy cannot accelerate the right to payment.

Tortious Conversion of the Federal Tax Lien:

As an alternative or supplement to a suit to enforce a levy, the federal government may sue the holder of the taxpayer's property for tortious conversion of the federal tax lien. United States v. Henshaw, 388 F.3d 738 (10th Cir. 2004). Under California state law, a

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lienor may sue a defendant who intentionally impairs a lienor's security. Nomellini Construction Co. v. United States, 328 F. Supp. 1281 (E.D. Cal. 1971) (imposing liability for the tortious conversion of the federal tax lien under California law). In this situation, if the trustee-taxpayer, who is also the beneficiary-taxpayer, draws a check payable to herself as a trust distribution, then the trustee-taxpayer will have impaired the federal tax lien if the government cannot recover the funds distributed. In other words, the trustee-taxpayer knew that the federal tax lien encumbered her property and rights to property and that funds distributed would disappear into the stream of commerce, thereby damaging the federal tax lien.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

[redacted]

CONCLUSIONS

We find that the taxpayer, as a current income beneficiary and as the vested beneficiary of a future interest in established portions of the trust principal, possesses property rights in the trust that may be levied upon as payable, notwithstanding operation of the trust's spendthrift provisions. As an alternative to the levy, the federal government may also sue the trustee-taxpayer if intentionally makes distributions of funds encumbered with the federal tax lien and the funds disappear into the stream of commerce. If you have any questions with regard to the foregoing analysis, please call us at (202) 622-3610.

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