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NOTES

FEDERAL TAX LIENS—I.R.S. MAY LEVY UPON THE ENTIRE BALANCE OF A JOINT BANK ACCOUNT WHEN DELINQUENT CODEPOSITOR HAS RIGHT OF WITHDRAWAL. *United States v. National Bank of Commerce*, 105 S. Ct. 2919 (1985).

In 1980, the Internal Revenue Service (I.R.S.) levied upon two joint bank accounts held by three codepositors, only one of whom owed delinquent taxes. Pursuant to its collection power under the Internal Revenue Code,¹ the I.R.S. demanded that the custodian bank, National Bank of Commerce of Pine Bluff, Arkansas, surrender the levied funds. The bank refused to honor the levy, stating that it did not know the extent of the delinquent taxpayer's interest in the joint accounts. The I.R.S. brought an action against the bank, pursuant to Internal Revenue Code section 6332(c)(1)² for all sums the bank held for the delinquent taxpayer, up to the total delinquent tax due, \$857.00.

The United States District Court for the Eastern District of Arkansas granted the respondent bank's motion to dismiss, holding the case procedurally "premature."³ The United States Court of Appeals for the Eighth Circuit affirmed.⁴ The appellate court noted that under Arkansas garnishment law, a creditor of a bank depositor is not subrogated to the depositor's power to withdraw the entire account balance. Accordingly, the Eighth Circuit reasoned, the I.R.S. is not subrogated to that power either. The court further stated that the delinquent taxpayer did not possess a sufficient property interest in the bank account to support the levy without the I.R.S. first quantifying claims that the taxpayer's codepositors may have in the funds.⁵

1. I.R.C. § 6332(a) (1980) provides that any person in possession of property subject to levy upon which a levy has been made, shall, upon demand of the Secretary, surrender such property.

2. I.R.C. § 6332(c)(1) (1980) provides that any person refusing to surrender property subject to levy shall himself be liable for the sum not so surrendered, but not exceeding the amount of taxes, together with costs and interest.

3. *United States v. National Bank of Commerce*, 554 F. Supp. 110, 117 (E.D. Ark. 1982). The court stated that due process required the I.R.S. to identify the codepositors and to provide them with notice and an opportunity to be heard. *Id.* at 114-15.

4. *United States v. National Bank of Commerce*, 726 F.2d 1292 (8th Cir. 1984).

5. *Id.* at 1300.

In a five-to-four decision, the United States Supreme Court reversed the appellate court and held that the I.R.S. properly utilized the administrative levy power. The Court noted that state law gave the delinquent taxpayer the power to withdraw the entire balance without the consent of the codepositors. The Court held that this power constituted "property or rights" subject to the I.R.S. levy. Because federal law determines whether particular state law property interests are subject to levy, any reference to Arkansas garnishment law was irrelevant. The Supreme Court further noted that the administrative levy is only a "provisional" remedy and is not intended to settle all rights to seized property. Consequently, the taxpayer's codepositors in the joint account may bring an action against the Government to have their property returned. *United States v. National Bank of Commerce*, 105 S. Ct. 2919 (1985).

Levy and distraint⁶ powers have long been used in this country to collect delinquent taxes. As early as 1791, a statute provided for the "distress and sale of goods of the person refusing or neglecting to pay" certain excises imposed by the statute.⁷ In 1924, bank accounts were specifically included in the statutes as property subject to levy for the nonpayment of taxes.⁸ The constitutionality of the levy procedure is well settled. In *Phillips v. Commissioner*,⁹ the United States Supreme Court upheld the I.R.S. levy procedure, stating that summary administrative proceedings have been consistently sustained when adequate opportunity is afforded for a later determination of legal rights.¹⁰

The Internal Revenue Code broadly defines property subject to levy as "all property and rights to property" of the taxpayer.¹¹ The courts have not, however, literally construed the statutory language when determining whether a delinquent taxpayer's property is subject

6. The nonjudicial remedy of distraint is a special summary power of the United States government to enforce collection of taxes, and is analogous to, but in addition to, garnishment and other remedies of the ordinary creditor. *United States v. Manufacturers Trust Co.*, 198 F.2d 366, 368 (2d Cir. 1952).

7. 1 St.L., ch. XV, § 23, p. 204, noted by Circuit Judge Learned Hand in *United States v. Metropolitan Life Ins. Co.*, 130 F.2d 149, 150 (2d Cir. 1942).

8. Revenue Act of 1924 § 1016, 43 St.L. 343 (1924), noted in *United States v. Metropolitan Life Ins. Co.*, 130 F.2d 149, 150 (2d Cir. 1942).

9. 283 U.S. 589 (1931).

10. *Id.* at 595.

11. I.R.C. § 6321 (1980) provides in pertinent part that the unpaid tax shall be a lien in favor of the United States "upon all property and rights to property, whether real or personal," belonging to the taxpayer, except property specifically exempted under the Code. I.R.C. § 6331(a) authorizes the Secretary to collect unpaid taxes by "levy upon all property and rights to property" belonging to the taxpayer.

to levy. In one early case, *Mansfield v. Excelsior Refining Co.*,¹² the Supreme Court held that the Government could not seize and sell a fee interest in property in which the delinquent taxpayer possessed only a leasehold interest. The Court noted that the Government must elect either to seize and sell only the delinquent's interest, or make all persons having an interest in the property a party to the suit.¹³

Case law has clearly defined some types of "property interests" as subject to levy. The Government, like creditors generally, can compel a partition and enforce a tax lien against a taxpayer's share of joint tenancy property to the exclusion of any survivorship rights other owners may have in the property.¹⁴ However, the Fifth Circuit has held that the I.R.S. may not compel the sale of the entire joint tenancy property under the judicial foreclosure provisions of the Code,¹⁵ but may sell only the taxpayer's fractional interest in the property.¹⁶ Further, the United States Supreme Court recently held that the Code¹⁷ empowers the federal district courts to force the sale of a home of the delinquent taxpayer even though a nondelinquent co-owner claims a homestead interest in the house under state law.¹⁸

Conversely, some types of property interests are not subject to levy. Case law has established that liens for individual taxes generally do not attach to the assets of the delinquent's partnership;¹⁹ only the taxpayer's right to the surplus of partnership assets is subject to attachment.²⁰ Also, in those states which continue to recognize tenancy by the entirety,²¹ courts generally deny the Government the power to levy on property where only one spouse is a delinquent taxpayer.²² In a

12. 135 U.S. 326 (1890).

13. *Id.* at 341.

14. Plumb, *Federal Tax Collection and Lien Problems (First Installment)*, 13 TAX L. REV. 247, 259 (1958) (citing *United States v. Brandenburg*, 106 F. Supp. 82 (S.D. Cal. 1952)).

15. I.R.C. §§ 7402, 7403 (1980).

16. *Folsom v. United States*, 306 F.2d 361, 367 (5th Cir. 1962).

17. I.R.C. § 7403 (1983).

18. *United States v. Rodgers*, 461 U.S. 677 (1983).

19. Only the taxpayer's interest in the partnership is subject to levy, not the partnership property itself, because the latter is not an asset or property of the individual. See *United States v. Worley*, 213 F.2d 509, 512 (6th Cir. 1954), *cert. denied*, 348 U.S. 917, 918 (1955).

20. Plumb, *Federal Tax Collection and Lien Problems (First Installment)*, 13 TAX. L. REV. 247, 263-64 (1958).

21. Tenancy by the entirety is a form of co-ownership limited to spouses whereby each spouse normally has a present right of enjoyment and possession and a right of survivorship in the whole of the entirety property, but neither alone may transfer his present interest. Note, *Property Subject To The Federal Tax Lien*, 77 HARV. L. REV. 1485, 1498 (1964) (citing 2 AMERICAN LAW OF PROPERTY § 6.6(b) (A.J. Casner ed. 1952)).

22. Note, *Property Subject To The Federal Tax Lien*, 77 HARV. L. REV. 1485, 1498 (1964) (citing *United States v. Am. Nat'l Bank*, 255 F.2d 504 (5th Cir.), *cert. denied*, 358 U.S. 835

noted case, *Raffaele v. Granger*,²³ the Third Circuit held that the I.R.S. could not issue a distraint order against bank accounts held by a husband and wife as tenants by the entirety. Even though each spouse had independent authority to withdraw funds from the account, the court denied the distraint, stating that the United States has no power to take property from an innocent spouse to satisfy the obligations of the other.²⁴ In 1954, legislation was defeated that would have specifically declared property held by the entirety subject to lien.²⁵

Courts generally agree that state law, not federal law, determines the nature of the legal interest which a taxpayer possesses in property. In *Aquilino v. United States*,²⁶ the delinquent taxpayer was a general contractor whose right to money due him was subject to a statutory trust for the benefit of unpaid subcontractors. The issue was whether the I.R.S. lien validly attached to the money due the taxpayer. The Supreme Court remanded to the state court for a determination of the nature of his interest in the property under state law. The Court noted that federal courts are bound by such state court determinations in deciding whether a valid federal tax lien attaches to the property in question.²⁷ In *United States v. Bess*,²⁸ the United States Supreme Court held that a delinquent taxpayer did not have "property or rights to property" in the death proceeds of a life insurance policy, but held that he did have such rights in its cash surrender value. The property interest was, therefore, subject to a federal tax lien. The Court noted that the nature of property rights is determined under state law, and that federal law defines the federal tax consequences which attach to those state-defined rights.²⁹

The Court in *Bess* reasoned that because the taxpayer had the right to compel the payment of the cash surrender value of the property, he had a property interest subject to levy.³⁰ Other courts, however, have not been uniform in applying this theory to interests in bank accounts. The Sixth Circuit, in *United States v. Stock Yards Bank*,³¹

(1958).

23. 196 F.2d 620 (3d Cir. 1952).

24. *Id.* at 623.

25. See S. REP. NO. 1622, 83d Cong., 2d Sess. 575 (1954), noted in Plumb, *supra* note 20, at 261.

26. 363 U.S. 509 (1960).

27. *Id.* at 513.

28. 357 U.S. 51 (1958).

29. *Id.* at 55-56.

30. *Id.* at 56.

31. 231 F.2d 628 (6th Cir. 1956).

held that the delinquent taxpayer's interest in a co-owned savings bond was not subject to lien, even though the taxpayer could redeem and receive the full amount of the bond. The court noted that the Government had failed to meet its burden of proving the actual value of the taxpayer's interest in the property.³² Other courts have recognized the taxpayer's right to withdraw funds as a "property interest" subject to I.R.S. lien and levy. Thus, a wife's portion of a bank account in a community property state was subject to levy for her spouse's premarital tax debts.³³ Additionally, the I.R.S. was held to have a valid lien against a joint account even though the bank had a "set-off" interest in the account.³⁴

The Arkansas statutes³⁵ provide that codepositors have an unqualified right to withdraw the entire balance of a joint account³⁶ absent a written agreement to the contrary. However, Arkansas case law suggests the statute does not determine title among codepositors; it is merely designed for the protection of banks.³⁷ The federal regulation concerning levy and distraint of joint banking accounts states that the account is subject to levy only to the extent of the taxpayer's interest, and that the factors which determine that interest include the source of the funds and the intent and control of the person who opened the account.³⁸

The Supreme Court in *National Bank of Commerce* broadly construed the levy power of the I.R.S. The Court noted that the statutory language of Internal Revenue Code section 6321, "all property and rights to property," revealed Congress' intent to reach every interest

32. *Id.* at 631.

33. *Babb v. Schmidt*, 496 F.2d 957 (9th Cir. 1974).

34. *United States v. Sterling Nat'l. Bank and Trust Co.*, 494 F.2d 919 (2d Cir. 1974).

35. ARK. STAT. ANN. §§ 67-521 to -522 (1980).

36. A joint account is one that is in two or more names. *Harbour v. Harbour*, 207 Ark. 551, 181 S.W.2d 805 (1944).

37. *See, e.g., Black v. Black*, 199 Ark. 609, 617, 135 S.W.2d 837, 841 (1940); *see also Note, Joint Tenancy—Creation of a Joint Bank Account with the Right of Survivorship*, 24 ARK. L. REV. 361, 364-65 (1970).

38. TREAS. REG. § 301.6331-1(a) (1955) states in full:

A joint checking account is subject to levy only to the extent of a taxpayer's interest therein, which will be determined from the facts in each case. Where one of the persons in whose name a joint account has been established can prove that the funds deposited therein are his sole property, no levy can be made on such funds to satisfy an outstanding tax liability of the other. Factors bearing on the question of the extent of a taxpayer's interest in such an account include the nature of the tenancy created under State law; the source of the funds deposited; the intent of the person opening the joint account; and whether in actual practice the account was under the control of one party even though the other had authority to withdraw funds from the account.

possible to collect delinquent taxes.³⁹ To accomplish the collection task, the I.R.S. may use the lien-foreclosure power⁴⁰ or the administrative levy.⁴¹ The I.R.S. utilized the latter power in *National Bank of Commerce*.⁴² Under section 6331(b), the term "levy" includes the power of distraint and seizure by any means but does not refer to warrantless intrusions into privacy.⁴³

The Supreme Court noted that, pursuant to section 6332(a) of the Code, the bank was a custodian whose only defense for not honoring the levy was that the joint accounts did not constitute "property" of the taxpayer.⁴⁴ The Court rejected this defense, noting that state law determines the nature of the legal interest one has in property, but federal law determines the resulting general tax consequences.⁴⁵ The Court stated that under Arkansas law, the bank was legally obligated to allow the taxpayer to withdraw all funds if he so wished—a legal right he could have exercised at any time without notice to his codepositors.⁴⁶ The Court relied heavily on the premise of *Bess*,⁴⁷ which stated that the right to control or compel payment of funds is dispositive in determining whether a taxpayer has a property interest subject to levy.⁴⁸ The I.R.S. steps into the shoes of the taxpayer pursuant to the levy power granted it in the Code, the Court noted. Because under state law the taxpayer could withdraw all of the funds, the I.R.S. possessed the same right.⁴⁹ The Court further noted that a majority of lower courts which have addressed the issue hold that the right to withdraw funds constitutes "property" or "rights to property."⁵⁰

The Supreme Court dismissed the Eighth Circuit's reasoning because it permitted state law to determine which interests in property are subject to federal levy. The Court stated that the appellate court had construed the state's power too broadly, in that the federal tax

39. *United States v. National Bank of Commerce*, 105 S. Ct. 2919, 2924 (1985).

40. I.R.C. § 7403 empowers the Government to institute a civil suit in federal district court to enforce a lien for delinquent taxes, the court having authority to adjudicate and determine all matters and claims of persons having an interest in the property.

41. The administrative levy is a provisional remedy and typically does not require any judicial intervention. The governing statute is § 6331(a), which authorizes collection by levy. *United States v. Rodgers*, 461 U.S. 677, 682 (1983).

42. 105 S. Ct. at 2922.

43. I.R.C. § 6331(b) (1980).

44. *National Bank of Commerce*, 105 S. Ct. at 2925.

45. *Id.* at 2925-26.

46. *Id.* at 2926.

47. *See supra* note 28 and accompanying text.

48. *National Bank of Commerce*, 105 S. Ct. at 2926.

49. *Id.* at 2927.

50. *Id.*

consequences of state-defined property rights are a matter of federal law.⁵¹

The Supreme Court also noted that the administrative levy provision of section 6331 was not intended to settle all rights to seized property.⁵² Instead, it provides a "provisional" remedy, which the government may use as an efficient method to protect its interest in the delinquent taxpayer's property.⁵³ Nondelinquent codepositors who claim that their property has been wrongfully levied upon may apply for its return either through administrative channels or by a civil suit.⁵⁴ The Court also noted that without the administrative levy, the Government would have to resort to costly and time consuming lien-foreclosure suits. This process would encourage taxpayers to hold assets in joint bank accounts to avoid or delay attachment.⁵⁵

A strong dissent, written by Justice Powell, argued that the majority failed to distinguish between a power to withdraw the funds and a right to possession of the funds.⁵⁶ He too cited *Bess*, which stated that a delinquent taxpayer could have no "property" or "right to property" in funds over which he had no right to possession. Moreover, he stated that even if Arkansas law gave the taxpayer a power to withdraw funds, this did not necessarily give him any rights to possession of those funds.⁵⁷

Justice Powell also stated that the majority decision flew in the face of the long-standing decision in *Mansfield v. Excelsior Refining Co.*⁵⁸ He reasoned that, following *Mansfield*, the Court had long interpreted "property and rights to property belonging to the delinquent"⁵⁹ literally, and that the reach of section 6331 extended only to property rights held solely by the delinquent.⁶⁰

Finally, Powell criticized the "provisional" characterization the majority used to describe the I.R.S. administrative levy. He noted that section 6331 provides no notice to third parties that property in which they may have an interest has been seized. Additionally, third parties

51. *Id.* at 2927-28.

52. *Id.* at 2928.

53. *Id.* at 2929-30.

54. *Id.* at 2930.

55. *Id.* at 2931.

56. *National Bank of Commerce*, 105 S. Ct. 2919, 2938 (1985) (Powell, J., dissenting).

57. *Id.* at 2932.

58. 135 U.S. 326 (1890); see *supra* text accompanying note 12.

59. I.R.C. § 6331(a) (1980).

60. *National Bank of Commerce*, 105 S. Ct. at 2935 (Powell, J., dissenting).

have the burden of either seeking an administrative review⁶¹ or filing suit against the Government⁶² to retrieve property wrongfully taken. Because both of these actions must be commenced within nine months of the levy, the innocent parties might not discover their property has been seized to pay someone else's taxes until all remedial possibilities have expired.⁶³

The decision in *National Bank of Commerce* is significant in that it expands the I.R.S. power to levy upon joint bank accounts without a determination of third parties' interests in the account. The Court's rationale appears unfounded. The majority used unsound logic when it reasoned that the taxpayer had a "state-law right" subject to levy simply because the taxpayer may compel payment of the entire balance under the state statutes.⁶⁴ This focuses on a power which the taxpayer may exert over the property, not on a right or interest which the taxpayer possesses in the property. The Court misapplied the *Aquilino*⁶⁵ principle, which it cited in its opinion.⁶⁶ That principle holds that state law controls in determining the nature of the legal interest in the property. The Court never actually determined the state-defined interest, if any, the taxpayer had in the property. In reality, the Court held that the bank's contractual and statutory obligations to honor the taxpayer's withdrawal requests are determinative in establishing "property or right to property" subject to levy.⁶⁷ Further, even though the Court conceded that state law determines the interest one has in property, the majority set forth no Arkansas holdings or dicta in support of its argument that the power to withdraw funds constitutes a "property interest" under Arkansas law. In effect, the Court held that because several courts outside Arkansas have decided that the power to compel is synonymous with the right of possession,⁶⁸ this is also the law in Arkansas.

The Court also failed to consider any possible agreements between the codepositors as to ownership rights or their intentions,⁶⁹ or statutes

61. I.R.C. § 6343 provides that the Secretary may review and return property wrongfully levied upon at any time before the expiration of nine months from the date of levy.

62. I.R.C. § 7426 provides that a taxpayer may bring an action against the United States in a district court for the return of property he claims has been wrongfully levied upon.

63. *National Bank of Commerce*, 105 S. Ct. at 2939 (Powell, J., dissenting).

64. *Id.* at 2926.

65. *Aquilino v. United States*, 363 U.S. 509, 513 (1960).

66. *National Bank of Commerce*, 105 S. Ct. at 2925.

67. *Id.* at 2926.

68. See, e.g., *Babb v. Schmidt*, 496 F.2d 957, 958-60 (9th Cir. 1974); *United States v. Sterling Nat'l. Bank and Trust Co.*, 494 F.2d 919, 921-22 (2d Cir. 1974).

69. The court of appeals noted that the rights of the co-owners are not determined by the Arkansas statutes granting the power to withdraw and stated, "Those rights depend on the inten-

which provide that written instructions be submitted to the bank by codepositors wishing to designate investiture of title.⁷⁰ Additionally, the statutes on which the majority relied were enacted for the benefit of the banking industry, and not to determine any property interest of the codepositors.⁷¹

By extending the I.R.S. levy power in this case, the Supreme Court has placed yet another restriction on the property rights of depositors. The decision may discourage many depositors from utilizing the convenience of joint bank accounts. Because the costs of litigation are high, the value of section 7426, which allows a taxpayer to institute a civil suit against the Government to recover property wrongfully levied upon, is diminished.

One effect of *National Bank of Commerce* may be to influence state legislatures to require financial institutions to disclose the ramifications of a joint bank account.⁷² Most depositors probably do not understand the risks of holding funds in a joint account. As a matter of public policy, the depositors should be aware that his funds deposited in a joint account are at risk if his codepositor owes delinquent taxes to the Government. Additionally, legislatures may enact statutes which redefine codepositors "property interests" in joint bank accounts.

Finally, even though the majority specifically restricts the holding of this case to joint bank accounts,⁷³ one wonders about the possible implications the holding may have on other state-law created forms of joint ownership and property control. As an extreme hypothetical, could the rationale of this case be extended to allow the I.R.S. to levy upon all property which a delinquent taxpayer has power to control or dispose of? Obviously, the ramifications to clients of trustees, attorneys, stockbrokers, and many others who control property for another would be far reaching. Because *National Bank of Commerce* requires no determination of property interests prior to I.R.S. seizure, this situation

tion of whoever deposited the money, or on whatever agreement, if any, might have been made among the co-owners, or on some other applicable rule of state law." *United States v. National Bank of Commerce*, 726 F.2d 1292, 1295 (8th Cir. 1984).

70. ARK. STAT. ANN. § 67-552(e) (1980). Arguably though, this statute was intended by the legislature to settle survivorship disputes in joint accounts and not to effect property rights among the living codepositors. See, e.g., Note, *Joint Tenancy—Creation of a Joint Bank Account with the Right of Survivorship*, 24 ARK. L. REV. 361 (1970).

71. See *supra* note 37 and accompanying text.

72. Cf. Note, *Banking—Joint Account and Set-off*, 9 CAP. U.L. REV. 413, 417 (1979) (banks may be required to disclose risks of joint account due to bank set-off rights against the account).

73. *National Bank of Commerce*, 105 S. Ct. at 2927 n.10.

could occur. The nondelinquent taxpayer would then bear the burden of proof and expense in recovering his property.

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