DISTRICT COURT ORDERED TO RETHINK ITS DECISION NOT TO ORDER SALE OF TAXPAYER'S HOME

The Court of Appeals for the Third Circuit has affirmed a district court's decision that a delinquent taxpayer's home which he owned as tenants by the entirety with his wife was property subject to a federal tax lien. But it vacated and remanded the lower court's decisions to not order a sale of that home but instead have the taxpayer pay "rent" on the property to pay off his tax liability.

Background. A federal tax assessment against a person automatically creates "a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person." The IRS may bring a lien foreclosure suit under an action in federal district court, to reach the funds.

The Supreme Court, in U.S. v. Rodgers held a district court is empowered to enforce a tax lien by decreeing a forced sale of an entire property in which a delinquent taxpayer has an interest, even though a nondelinquent person also has an interest in the same property. The nondelinquent person is entitled to receive an appropriate portion of the sales proceeds. Under certain circumstances, the district court may use its discretion to disallow a request for the forced sale. This discretion should be exercised in the light of the following considerations:

- the extent to which government financial interests would be prejudiced by relegating it to a forced sale of the partial interest;
- whether an innocent/nondelinquent third-party has a legitimate or legal expectation his separate interest would not be subject to a forced sale by the delinquent taxpayer or his creditors;
- the likely prejudice to the third party, both in personal dislocation costs and in practical under compensation; and
- the relative character and value of the nonliable and liable interests held in the property.

Facts. The taxpayers were Mr. & Mrs. Cardaci. Mr. Cardaci was the owner of a business which folded. He owed $80,000 of unpaid taxes, interest and penalty with respect to the business.

Mr. & Mrs. Cardaci owned their residence in New Jersey as tenants by the entirety. It had a market value in the neighborhood of $150,000; there was no mortgage on the property.

The IRS brought an action to reduce to judgment the federal tax assessments against Mr. Cardaci and to force the sale of the Cardaci home. It sought to collect half of the proceeds to pay for Mr. Cardaci's tax liability and to distribute the remainder to Mrs. Cardaci. The district court, recognizing Mr. Cardaci owed $80,000 and the IRS had a valid lien on the Cardaci residence, granted partial summary judgment to that effect.

The district court held a trial with respect to the issue of the forced sale. It issued a judgment, based on its consideration of the equitable factors set out in Rodgers, that "the equities of this case warrant the exercise of the court's very limited discretion not to order a sale." It, therefore, fixed an imputed monthly rental value of $1,500 for the property and ordered Mr. Cardaci to pay half of that value to the IRS each month.

At the time of the district court's order, Mr. Cardaci was age 58, and Mrs. Cardaci was 62.

Mr. Cardaci defaulted on his monthly payment obligations. Both parties filed timely appeals.

Home was subject to federal tax lien. The Circuit Court, affirming the district court, rejected the taxpayers' argument their home was not subject to a foreclosure sale because it was protected by a New Jersey statute.

Besides determining the New Jersey statute didn't apply to the Cardacis because it only affected tenancies by the entirety which were created after the Cardacis' tenancy was created, the Court said, regardless of the applicability of New Jersey statutory or common law, state law must give way to the supremacy of federal law. The Court cited the Supreme Court for the principle that "state law determines only which sticks are in a person's bundle of property rights. Whether those sticks qualify as 'property' for purposes of the federal tax lien statute is a question of federal law." And it said "State-created exemptions are swept aside by the Supremacy Clause of the Constitution."

The Court remands on the issue of whether there should have been a forced sale. The IRS argued the district court abused its discretion in analyzing the Rodgers factors and then erred in concluding the Cardacis' home should not be sold. The Circuit Court agreed the district court erred in its analysis of the Rodgers factors but declined to reweigh the factors itself. Instead, it remanded for the district court to recalculate Mr. & Mrs. Cardacis' relative property interests and again engage in a thorough analysis of the equitable factors set forth in Rodgers.

The Court made the following observations regarding the Rodgers factors:

- The prejudice to the government resulting from a partial sale.

  The district court concluded this factor weighed in the IRS's favor "only slightly" because a sale of Mr. Cardaci's interest would provide little value, while requiring Mr. Cardaci to pay rental payments to the IRS was "likely to produce much greater collection of taxes to the IRS compared with the amount likely to be obtained from a foreclosure sale of the entire property."

The Circuit Court agreed with that evaluation of what might be gained by trying to sell Mr. Cardaci's interest in the home, but taking into account what might be gained from rental payments was not a sound approach in considering this factor. The focus should solely be on determining whether the government would be adequately compensated by a partial sale of the taxpayer's interest or whether a sale of the entire property is necessary to vindicate the government's interest.

An analysis of this factor boils down to the idea, "the higher the expected market price of a partial interest, the less the prejudice, and the less weighty the government's interest in going

ahead with a sale of the entire property." Because there is no real market for one spouse's interest in a marital home held in a tenancy by the entirety (the sale of which would leave the purchaser as a tenant in common with the remaining spouse), the Circuit Court said this factor weighed in favor of a forced sale of the Cardaci home.

- The non-liable party's legally recognized expectation in the property.

  The Court here said consideration of that expectation requires reference to the protections afforded by state law. The district court found, because New Jersey law provides special protection for a spouse's interest in marital property, Mrs. Cardaci would have expected her property would be free from foreclosure based on her husband's tax obligations. According to the IRS, however, when the district court looked to New Jersey state law, it relied upon a statute which was "facially inapplicable."

The Circuit Court agreed with the IRS. In determining the effect of New Jersey law on Mrs. Cardaci's expectations, the district court relied, in part, as noted above, on a section of New Jersey's statutory code which only applied to tenancies by the entirety created after the Cardacis' tenancy was created. Therefore, the Circuit Court said, the IRS was correct that that statute was inapplicable and, on remand, the district court should consider the issue under common-law principles without reference to the statute.

- The likely prejudice to the third party.

  The district court concluded this factor was neutral because, while Mrs. Cardaci would face dislocation costs, the costs were no greater than in any other foreclosure sale.

The Circuit Court agreed there were no special dislocation costs to consider here. But it found problematic in that the district court did not then address the "practical undercompensation" Mrs. Cardaci might suffer in the event of a forced sale.

In order to determine whether an innocent spouse will be adequately compensated by a fair distribution of the proceeds from a forced sale, a court must first determine the amount the spouse would receive from such a sale. The district court here said Mrs. Cardaci's interest in the property was worth 86% of the property's market value, determined as follows: The Cardacis' survivorship rights were of equal value: 50% of the property. It then found Mrs. Cardaci's life estate to be worth 72% of the value of her interest in the property. Because Mrs. Cardaci had only a one-half interest in the property, that 72% was divided by two to get to 36% of the value of the whole property. Since Mrs. Cardaci also had a 50% interest in survivorship, the Court added that 50% to the 36% value of the life estate to find she had an 86% total interest in the value of the property. The district court did not include Mr. Cardaci's interest in a life estate in its calculations; the Circuit Court noted that, had the district court done so, the sum of both spouses' interests would have exceeded 100%.

The IRS argued, based on the decision in Popky v. United States, the district court should have determined each spouse had a 50% interest in the home, without any consideration of their respective life expectancies and future interests in the home.

The Circuit Court said neither position was correct. Popky was not controlling. In that case, the marital property at issue had already been liquidated. The Popky Court concluded the

interest of each spouse in the resulting cash was an equal 50%. Even though the cash itself was still held by the spouses as tenants by the entireties under the controlling state law, there can be no life estate in cash as there can in real property. As a result, there was no need in Popky to turn to actuarial tables.

As to the district court's calculation of the Cardacis' respective interests in the marital home, the Circuit Court said, in a tenancy by the entirety, each spouse has a concurrent interest in the present value of the property, in a life estate, and in a right of survivorship. But because both the probability of obtaining the property upon the death of one's spouse and the value of the life estate depend on life expectancy, any calculation of the cash value of those interests must be based on actuarial statistics. To give one admittedly extreme example, the Court said, it stands to reason that a healthy 26-year-old wife would have a greater interest in a life estate than would her ailing 89-year-old husband. While each spouse would have the same rights to the home, the measurable property value they would be likely to receive from the property is not the same. Therefore, a method of calculation was needed that took into account each spouse's concurrent interest in the present value and their varying interests in life estate and survivorship rights.

A fair approach must therefore rely on joint-life actuarial tables to reflect the interests of both spouses. And, such an approach avoids the dilemma created by the district court's methodology, which resulted in a sum of the various interests that exceeded 100% of the value of the property.

- The relative character and value of the non-liable and liable interests in the property.

  The Circuit Court said the Cardacis owned approximately equivalent interests in the property, both in terms of the character and value of their interests. Therefore, the fourth factor seemed neutral. Once the district court calculated the relative interests in the property using a joint-life actuarial table, it would be in a position to determine more precisely how this fourth factor weighs in the balance.

Cardaci, (CA 3 5/8/2017) 119 AFTR 2d ¶ 2017-736

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