

## Collecting Your Attorney Fees When Your Probate Estate Is Covered in Federal Tax Liens

By Neal Nusholtz

It might happen, one day, that you are representing a deceased estate that has federal tax liabilities exceeding the liquidation value of the estate's assets. The Internal Revenue Service ("IRS") will have a tax lien on the estate that allows it to levy on and auction off the assets to pay the taxes—leaving nothing for anybody else. If you are handling such an estate, you will probably ask yourself, "Will I ever get paid?"

Estates that are unable to pay their tax liabilities are a common enough occurrence for the IRS to address insolvent estates in section 5.5.2.6 (04-05-2012) of the Internal Revenue Manual ("IRM"). The IRM is an operational guide for IRS employees. In regard to the collection of taxes from insolvent estates, this section of the IRM provides that the IRS may allow, if it wants to, for estate administrative expenses to come ahead of the IRS tax lien:

### Administrative Expenses

(1) Expenses related to the decedent's estate are known as "administrative expenses". They include any expenses related to maintenance of the decedent's property incurred after the decedent's death. Expenses are paid from the estate before assets are distributed to the beneficiaries or heirs.

(2) The Service in its discretion may permit reasonable, necessary expenses to be paid before a federal tax lien. Such expenses must be examined to determine if an expense is reasonable and necessary to the administration of the estate. Reasonable and necessary expenses should not be permitted ahead of a tax lien if such expenses are already covered by an insurance policy, trust or other similar benefit that covers such costs.

The IRM is not binding on the IRS and does not have the effect of law.<sup>1</sup> At least one case has held that IRS discretionary refusals to allow certain expenses ahead of the tax lien are not re-

viewable.<sup>2</sup>

This article is an attempt to lay out the legal remedies for collection of attorney fees ahead of an IRS lien when there is a sale of estate property or when there is an attorney's charging lien and there has been an unjustified IRS refusal to permit the payment of your attorney fees.

### Sale of Property

When an estate sells property, the buyer will want a certificate of discharge of the tax lien. A discharge can be obtained under IRC 6325(b)(2)(A) if the IRS receives an amount that is not "less than the value, as determined by the Secretary, of the interest of the United States in the part to be so discharged." In calculating the value of the government's interest, 26 CFR 301.6325-1(b)(3) provides for the payment of costs related to the sale of the property to come ahead of the IRS's lien, "Any reasonable and necessary expenses incurred in connection with the sale of the property and the administration of the sale proceeds shall be paid by the applicant or from the proceeds of the sale before satisfaction of any Federal tax liens or claims of the United States."

Instructions for obtaining a discharge are included in Publication 783.<sup>3</sup> The request for a discharge is made on a Form 14135 "Application for Certificate of Discharge of Property from Federal Tax Lien." A request for a discharge after paying the net proceeds to the IRS can be made by checking the box for IRC 6325(b)(2)(A) in section 7 of the form—"Basis for Discharge".

If the IRS refuses to allow your fee in calculating the net proceeds, under IRC 6325(b)(3) you can (in order not to lose a buyer while arguing with the IRS over your fee) request a discharge to be given after the full proceeds from sale are placed in escrow by agreement with the IRS. ("The Secretary may issue a certificate of discharge of any part of the property subject to the

lien if such part of the property is sold and pursuant to an agreement with the Secretary, the proceeds of such sale are to be held, as a fund subject to the liens and claims of the United States, in the same manner and with the same priority as such liens and claims had with respect to the discharged property.”) Placing the full proceeds in escrow would permit the discharge of the lien to occur with the fee issue to be resolved later. A request for an escrow agreement can be made in section 7 of Form 14135 by checking the box for IRC 6325(b)(3).

After sale proceeds have been placed in escrow, an interested party can sue for their share of the proceeds under IRC 7426(a)(3)—Civil Actions by Persons Other than Taxpayers. That section provides:

(3) If property has been sold pursuant to an agreement described in section 6325(b)(3) (relating to substitution of proceeds of sale), any person who claims to be legally entitled to all or any part of the amount held as a fund pursuant to such agreement may bring a civil action against the United States in a district court of the United States.

A suit under that section must be brought within two years of the date of the agreement setting up the escrow. See IRC 6532(c)(1). Under IRC 7426(h)(1), if the refusal to allow payment of the attorney’s fees is the result of a reckless, intentional, or negligent disregard of the law, damages are available equal to the sum of economic damages up to \$1 million, plus the cost of the action. Injuries such as inconvenience, emotional distress, and loss of reputation are compensable only to the extent that they result in actual pecuniary damages.<sup>4</sup> Under IRC 7426(h)(2), a damage claim requires that administrative remedies are first exhausted as defined by IRC 7433(d). Prior to suit, an administrative claim must be filed with the Area Director, to the attention of the Compliance Technical Support Manager, of the area in which the taxpayer currently resides. See Treas. Reg. 301.7433-1(b). The administrative claim shall include (i) the name, current address,

current home and work telephone numbers and any convenient times to be contacted, and taxpayer identification number of the taxpayer making the claim; and (ii) the grounds, in reasonable detail, for the claim (include copies of any available substantiating documentation or correspondence with the Internal Revenue Service). See Treas. Reg. 301.7433-1(e). Suit cannot be brought until the earlier of six months or the date that the claim is denied. If the claim is filed within the last six months of the two-year period of limitations, then suit can be filed at any time prior to the expiration of the two-year period. See Treas. Reg. 301.7433-1(d)(2).

### Charging Liens

An attorney’s charging lien is explained in *George v Sandor M Gelman, PC*, 201 Mich App 474, 476, 506 NW2d 583(1993):

An attorneys’ lien can be one of two kinds: (1) a general, retaining, or possessory lien, or (2) a special, particular, or charging lien. A general or retaining lien is the right to retain possession of all documents, money, or other property of the client until the fee for services is paid. *Kysor Industrial Corp. v. D.M. Liquidating Co.*, 11 Mich. App. 438, 444, 161 N.W.2d 452 (1968). The special or charging lien is an equitable right to have the fees and costs due for services secured out of the judgment or recovery in a particular suit. 585 *Id.*; 3 Michigan Law & Practice, Attorneys & Counselors, § 161, pp. 486–487. The attorneys’ charging lien creates a lien on a judgment, settlement, or other money recovered as a result of the attorney’s services. *Doxtader v. Sivertsen*, 183 Mich. App. 812, 815, 455 N.W.2d 437 (1990).<sup>5</sup>

Normally, anyone who takes property after a notice of lien is filed takes subject to the lien. IRC 6323(b) provides exceptions to that rule. “Even though notice of a lien imposed by section 6321 has been filed, such lien shall not be valid” and then ten exceptions that have “superpriority”<sup>6</sup> over the IRS lien are listed—item number 8 on the list is an attorney’s charging lien. The attor-

ney's charging lien comes ahead of the IRS lien even if the charging lien is preceded by a recorded lien. IRC 6323(b)(8) describes the eighth superpriority as follows:

(8) Attorneys' liens

With respect to a judgment or other amount in settlement of a claim or of a cause of action, as against an attorney who, under local law, holds a lien upon or a contract enforceable against such judgment or amount, to the extent of his reasonable compensation for obtaining such judgment or procuring such settlement...

IRC 6532(b)(8) grants an argument to an attorney that his or her fees come ahead of the IRS lien<sup>7</sup> but, by itself, it would not grant court access. The IRS would first have to levy on the money belonging to the attorney. An administrative claim asking for the money back would need to be filed, like the one described above under IRC 7433(d) regarding costs of sale. After six months or the denial of the claim, if required, a wrongful levy suit is brought to collect the fees under IRC 7426 (a)(1). Since both the lawsuit for attorney fees pursuant to a sale and a lawsuit for wrongful levy suit are brought under IRC 7426, the damages and timing rules discussed above are the same, except, instead of the two-year statute of limitations period running from the date of the "agreement," it runs from the date of the notice of levy.<sup>8</sup>

One last item about the effect of IRC 6323(b)(8). There is a federal priority statute under 31 USC 3713(a) that provides that the government is always paid first when a taxpayer is insolvent. Section (b) of that statute states, "(b) A representative of a person or an estate (except a trustee acting under title 11) paying any part of a debt of the person or estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims of the Government." The United States Supreme Court has ruled that if an interest has a superpriority under the tax lien statute, it has a superpriority under 31 USC 3713(a). The court reasoned that since the collection of revenue is at the top of government

priorities, it follows that the tax lien statute is the final say on the subject of priorities over IRS tax liens. *United States v Estate of Romani*, 523 US 517 (1998).

In *Romani*, a judgment lien creditor had perfected its interest before the IRS filed a tax lien. After the taxpayer died, the estate's administrator transferred property to the judgment creditor in lieu of execution. The government argued that the administrator was liable under 31 USC 3713(b) for not paying the IRS.

The U.S. Supreme Court's opinion in *Romani* traced the 200-year history of the federal priority statute, including references to hearings and committee reports of the Federal Tax Lien Act of 1966 (over the protests of Justice Scalia). The court called the federal priority statute a "secret lien" and held, "In sum, nothing in the text or the long history of interpreting the federal priority statute justifies the conclusion that it authorizes the equivalent of a secret lien as a substitute for the expressly authorized tax lien that Congress has said "shall not be valid" in a case of this kind." *United States v Estate of Romani*, 523 US 517, 534 (1998).

### A Word or Two About Tax Liens

First, nothing being said here about IRS liens and attorney fees has anything to do with estate tax liens under IRC 6324. That's because under IRC 6324(a)(1) an estate tax lien does not extend to expenses of administration allowed by a court:

Unless the estate tax imposed by chapter 11 is sooner paid in full, or becomes unenforceable by reason of lapse of time, it shall be a lien upon the gross estate of the decedent for 10 years from the date of death, except that such part of the gross estate as is used for the payment of charges against the estate and expenses of its administration, allowed by any court having jurisdiction thereof, shall be divested of such lien.

Second, on the issue of what is covered by a tax lien, whether a tax lien extends to a particular asset may depend upon whether the tax as-



assessment was made against the decedent before death or whether it was made against the estate after death. If the Notice of Federal Tax Lien is recorded on a post-death assessment, it would not reach any property that passed to heirs automatically at the time of death (non-probate property), but it would reach any probate property in the taxpayer’s “estate” at the time of the assessment. The following table is included in IRM 5.5.3.6 (9-17-2020).

If assessment is made:	Then the assessment lien attaches to:
Before Death	property owned by the taxpayer and follows property into probate or to the transferee
After Death	any probate property in the taxpayer's estate at the time of assessment

**Conclusion**

The good news is that when you represent a probate estate that is covered in federal tax liens, the heirs, who will likely get nothing, won’t complain about your fees. The bad news is that the United States government might tell you that you are worth less than you claim. Hopefully, you will be able to find an opportunity to prove otherwise.

**Notes**

1. *United States v Caceres*, 440 US 741 (1979); *United States v Will*, 671 F2d 963, 967 (6th Cir 1982).
2. As the court said in *Matter of Carlson*, 126 F3d 915, 922 (7th Cir 1997), “The Court recognizes that pursuant

to the Internal Revenue Manual (“IRM”), the IRS “may in its discretion not assert priority over reasonable administrative expenses of the estate.” IRM 5.5.2.4(3). This is “limited to expenses for preserving and marshalling estate assets Consideration should be given to how does allowance of this expense benefit the Government giving up its lien position.” IRM 5.5.2.6.1(2). This subordination is in the discretion of the United States and is not subject to judicial review. (“Procedures in the Internal Revenue Manual are intended to aid in the internal administration of the IRS; they do not confer rights on taxpayers.”). *Simmons Estate of*, No 115CV01097TWPMPB, 2017 WL 2800194 at \*4 (SD Ind May 22, 2017), report and recommendation adopted sub nom. *Matter of Estate of Simmons*, No 115CV01097TWPMPB, 2017 WL 3261781 (SD Ind July 31, 2017).

3. See also Revenue Procedure 68-9, 1968-1 CB 756, Jan 1, 1968.

4. Treas. Reg. 301.7433-1(b).

5. Charging liens on probate assets were imposed in *In re Estate of Morrish*, No 351739, 2020 WL 6231970 (Mich Ct App Oct 22, 2020). *Payne Broder & Fossee PC v Shefman*, No 312659 (Mich Ct App July 22, 2014) (unpublished); and *AIG Annuity Ins Co v Law Offices of Theodore Coates, PC*, 478 F App’x 484 (10th Cir 2012).

6. The term “superpriority” is used in IRM 5.17.2.6.5 (Mar 27, 2012).

7. In the bankruptcy context, attorneys with charging liens have been treated as secured creditors whose security interest relates back to the date of the fee agreement. *In re Daddy’s Money of Clearwater, Inc*, 155 BR 788, 790 (Bankr MD Fla 1993). See also *In re McInerney*, 499 BR 574, 580 (Bankr ED Mich 2013).

8. *State Bank of Fraser v United States*, 861 F2d 954 (6th Cir 1988).



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