

Exemptions: Watch Out for the IRS

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Earlier this year, we published an article setting forth a synopsis of bankruptcy exemptions that a debtor in Florida is entitled to claim, taking into account the changes in the law following the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”). However, not surprisingly, these exemptions are not necessarily applicable when it comes to federal tax liability owed to the Internal Revenue Service (“IRS”), including but not limited to certain spendthrift trusts and IRAs.

Generally speaking, if a trust contains language that expressly forbids alienation of the trust beneficiary’s interest in the trust, then it is deemed a spendthrift trust. Typically, the IRS can levy on a spendthrift trust if it is deemed a “support trust,” but not if it contains “discretionary language.” The Court in Tex. Commerce Bank Nat’l Assoc. v. U.S., 908 F.Supp. 453, 458 (S.D. Tex. 1995) stated that with a true discretionary spendthrift trust, containing discretionary language, the beneficiary of the trust has no right to receive the trust income or principal because the trustee has sole and absolute discretion to distribute to the beneficiary the trust income or principal. On the other hand, with respect to a support trust, the beneficiary has the right to receive as much of the trust income or principal from the trustee as is necessary for the beneficiary’s support. Id. at 458. The spendthrift trust at issue in Tex. Commerce was a discretionary spendthrift trust; thus, the Court held that there was no interest to which the IRS’s levy could attach since the beneficiary of the trust was only entitled to wholly discretionary distributions from the trust. The Court also held that the IRS could not levy on future mandatory income disbursements to the beneficiary because the beneficiary lacked a fixed and determinable right to the payments at the time of the levy. Id. a 458-9. Therefore, if the spendthrift trust at issue is a discretionary spendthrift trust, then the IRS probably cannot levy on it to satisfy a federal tax liability. However, if the spendthrift trust at issue does not contain discretionary language, then the IRS likely can levy on it to satisfy a federal tax liability.

It is also important to note that even before distributions are made to the trust beneficiary, income from a spendthrift trust can be levied on by the IRS to satisfy a federal tax liability. According to the applicable case law, a federal tax lien attaches to future income distributions to a beneficiary from a spendthrift trust when the federal tax lien is first created and not when the distributions are made. The rationale for this is that when the federal tax lien is first created, the beneficiary of the trust possesses, at that time, equitable and legal rights to future income distributions from the trust. *See, In re Orr*, 180 F.3d 656 (Fla. 5th DCA 1999). Thus, income from a spendthrift trust can likely be levied on by the IRS even before distributions are made because the beneficiary of the trust has an equitable and legal right to those distributions. However, as previously mentioned, this is not the case if the trust contains “discretionary spendthrift” language.

Pursuant to 18 U.S.C. § 3613(a), only certain enumerated items set forth in 26 U.S.C. § 6334 are exempt from levy for payments of federal tax liabilities. *See*, 26 U.S.C. § 6334(a)(1)-(8) and (10) and (12). As a result, an IRA or Roth IRA is not exempt from levy for payments of federal tax liabilities, as these items are not included in the enumerated list of exempt property set forth in 18 U.S.C. § 3613(a). Furthermore, according to the applicable case law, the IRS can

levy on an IRA to satisfy a federal tax liability. *See, In re Deppisch*, 227 B.R. 806 (Bankr. S.D. Ohio 1998); *In re Quillard*, 150 B.R. 291 (Bankr. D. R.I. 1993); and *Lawlee v. Suntrust Securities, Inc.*, 740 So.2d 592 (Fla. 5th DCA 1999).

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