

Failure to Pay Your Federal Taxes May Expose Your Assets

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In the spirit of tax season (not quite the same as the holiday season), we decided it might be thought provoking to write an article addressing the rights of the Internal Revenue Service as a creditor compared with the rights of other judgment creditors. For example, you meet with a client and they advise you that they have an IRA, a 401K, an annuity, a life insurance policy and a homestead property, all of which have been created and maintained by their financial advisor. The client then states to you that it is their understanding that no creditors can levy on these assets even if judgments are obtained against the client. Further into your discussion with the client you learn that the client owes federal taxes to the IRS. Can the IRS levy on these assets?

Before we address the rights of the IRS as a creditor, first, it may be helpful to provide a brief discussion of Florida's exemption laws as they relate to other judgment creditors, typically.

Generally speaking, under Fla. Stat. § 222.21, IRAs and 401Ks are exempt from levy by judgment creditors if they are the type specifically enumerated under s. 401(a), s. 403(a), s. 403(b), s. 408, s. 408A, s. 409, s. 414, s. 457(b), or s. 501(a) of the Internal Revenue Code. *See*, Fla. Stat. § 222.21. Thus, an IRA or 401K must be created and maintained in compliance with the applicable Internal Revenue Code provisions in order for it to be deemed exempt under Florida law. Determining whether a specific IRA or 401K is in compliance with the Internal Revenue Code provisions is an issue for a tax attorney, accountant, or attorney versed in analyzing whether specific retirement accounts fall under the applicable Internal Revenue Code provisions and Florida Statutes.

With respect to annuities, Fla. Stat. § 222.14 provides that "the proceeds of annuity contracts issued to citizens or residents of the state, upon whatever form, shall not in any case be liable to attachment, garnishment or legal process in favor of any creditor of the person who is the beneficiary of such annuity contract." Therefore, under Florida law, annuities may be exempt from levy by judgment creditors. However, simply because an annuity is called an "annuity" does not make it exempt. In order for an annuity to be deemed exempt, it must meet the required characteristics of which, generally speaking, there are four: 1) it must be identified as an annuity, pursuant to Fla. Stat. § 222.14 and the applicable case law, *see In re Solomon*, 95 F.3d 1076, 1078 (11th Cir. 1996); 2) the individual claiming the exemption must be the beneficiary of the annuity, pursuant to Fla. Stat. § 222.14 and the applicable case law, *see In re Belue*, 238 B.R. 218, 222 (Bankr. S.D. Fla. 1999); 3) a court will consider whether the annuity issuer, such as an insurance company for example, is responsible for distributing the funds in accordance with the annuity contract, *see, Belue*, 238 B.R. at 222; and 4) a court will consider whether the payments received by the beneficiary are a payment stream upon maturity, for a term of years or for the lifetime of the beneficiary, *see, Belue*, 238 B.R. at 219, *see also, Goldenberg v. Sawczak*, 791 So.2d 1078, 1083 (Fla. 2001).

Regarding life insurance policies, presuming that your client is the insured under the policy and another individual is the beneficiary under the policy, then the proceeds of the policy would be exempt and a judgment creditor would not be able to levy on the policy to satisfy the judgment. *See*, Fla. Stat. § 222.13.

According to the applicable Florida homestead law, if one's home is located outside a municipality, then the homestead property is exempt to the extent of 160 acres of contiguous land. If one's home is located within a municipality, then the homestead property exemption is limited to one-half acre. *See*, Fla. Const. Art. 10 § 4(a)(1).

Thus, it is clear from the above summary that, generally speaking, in Florida, IRAs, 401Ks, annuities, life insurance policies and homestead property are exempt from judgment creditor levy provided that they were created and maintained in accordance with the applicable laws. However, the same rules do not apply to the IRS with respect to collecting federal taxes.

Pursuant to 18 U.S.C. § 3613(a), only certain enumerated items set forth in 26 U.S.C. § 6334 are exempt from levy by the IRS for the payment of federal taxes. These enumerated items include but are not limited to: wearing apparel, unemployment benefits, certain pension payments, workmen's compensation, a minimum exemption for wages, and the principal residence of the taxpayer in certain instances. Any assets owned by the taxpayer not specifically listed in 26 U.S.C. § 6334 may be levied on by the IRS. Therefore, because IRAs, 401Ks, most annuities and life insurance policies are not included in the list of exempt property set forth in 26 U.S.C. § 6334, these assets are not exempt from levy by the IRS for the payment of federal taxes.

With respect to one's homestead property, the IRS may not levy on a homestead in order to satisfy a federal tax liability of \$5,000 or less. *See*, 26 U.S.C. § 6334(a)(13)(A). However, presuming that the federal tax liability is in excess of \$5,000, the IRS may levy on one's homestead provided that the IRS obtains written approval of the levy from a U.S. district court. Typically, for the IRS to obtain the necessary approval, the IRS would file a petition for judicial approval of levy upon one's primary residence, pursuant to section 6334(e)(1), for the purposes of collecting unpaid federal taxes. The IRS may attach to the petition an IRS officer's declaration, stating that (1) the officer reviewed the applicable IRS records and determined the federal tax amount owed by the taxpayer; (2) the IRS gave the taxpayer notice and demanded payment of the liability, but the taxpayer failed to pay; (3) the IRS attempted to satisfy the liability from assets other than the taxpayer's private residence, but found that no reasonable alternative existed; and (4) the IRS generally followed the requirements of applicable law and administrative procedures. *See*, U.S. v. Gentile, 2009 WL 840601 (11th Cir. 2009).

This article only briefly addresses these issues and is not intended to be an exhaustive discussion of all issues relating to or concerning exemption laws, the rights of the IRS as a creditor, or the rights of other judgment creditors.

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