***Dalton v. Commissioner, T. C. Memo. 2008-165 (2008)***

In Dalton v. Commissioner, the Tax Court ruled that the IRS abused its discretion in levying on property held by a trust, as the taxpayers had no nominee interest in it. The case clarified the application of nominee theory in tax collection, emphasizing the need for a beneficial interest under state law before federal tax levies can attach. This decision impacts how the IRS can pursue assets held in trusts by taxpayers' relatives.

**Parties**

Plaintiffs: Arthur Dalton, Jr. and Beverly Dalton, husband and wife, petitioners at the trial level and appellants at the Tax Court level.
Defendant: Commissioner of Internal Revenue, respondent at the trial level and appellee at the Tax Court level.

**Facts**

Arthur Dalton, Jr. and Beverly Dalton purchased three parcels of real property near Johnson Hill Road in Poland, Maine. In 1983, they transferred two parcels to Arthur Dalton, Sr. , Arthur Dalton, Jr. 's father, for $1 and subject to an existing mortgage. In 1984, Arthur Dalton, Sr. purchased the third parcel. In 1985, Arthur Dalton, Sr. created the J & J Trust, naming himself trustee and his grandsons (Arthur and Beverly's sons) as beneficiaries. He then transferred all three parcels to the trust. The Daltons lived in the property from 1997, paying rent to the trust. The IRS assessed trust fund recovery penalties against the Daltons in 1997 for unpaid employment taxes from their corporations. The IRS later sought to levy on the trust's property, asserting a nominee interest of the Daltons in the trust's assets.

**Procedural History**

The IRS issued notices of intent to levy to Arthur and Beverly Dalton in 2004, which they contested through a Collection Due Process (CDP) hearing. The IRS Appeals Office sustained the levy, and the Daltons filed a petition in the Tax Court. The IRS moved for summary judgment, which was denied, and the case was remanded to the Appeals Office to consider both Maine law and federal factors regarding nominee ownership. After a supplemental hearing, the Appeals Office again sustained the levy, leading to a second round of summary judgment motions before the Tax Court.

**Issue(s)**

Whether the Tax Court had jurisdiction to decide the instant matter?
Whether the Daltons had an interest in the Poland property under Maine law that could be reached by the IRS levy under section 6331?
Whether the Daltons had an interest in the Poland property under a Federal nominee factors analysis that could be reached by the IRS levy under section 6331?

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## Rule(s) of Law

Section 6331 of the Internal Revenue Code authorizes the IRS to levy on "all property and rights to property" of a delinquent taxpayer. A nominee theory allows the IRS to reach property held by a third party if the taxpayer has a beneficial interest in it. Under federal law, nominee principles require a two-part inquiry: whether the taxpayer has a state-law interest in the property, and whether that interest is reachable under federal tax law. Maine law recognizes the doctrines of resulting trust, constructive trust, and fraudulent conveyance, which may establish a state-law interest.

## Holding

The Tax Court had jurisdiction to decide whether the IRS abused its discretion in rejecting the Daltons' offer-in-compromise based on their alleged nominee interest in the trust property. The Daltons did not have an interest in the Poland property under Maine law or federal nominee factors that could be reached by the IRS levy under section 6331. The IRS's determination to proceed with the levy was an abuse of discretion.

## Reasoning

The court first established its jurisdiction to review the IRS's determination under section 6330(d), as the Daltons timely filed their petition after receiving notices of determination. On the merits, the court analyzed whether the Daltons had an interest in the Poland property under Maine law that could be reached by the IRS levy. The court concluded that the transfers of the property to Arthur Dalton, Sr. and the trust were gifts, not resulting in a beneficial interest for the Daltons. The court also found no evidence of fraudulent conveyance, as the transfers occurred well before the tax liability arose and were not made with intent to hinder, delay, or defraud creditors. Under federal nominee factors, the court considered eight criteria, including consideration paid, anticipation of liabilities, family relationships, recording of conveyances, possession and use of the property, payment of maintenance costs, internal trust controls, and use of trust assets for personal expenses. The court found that the Daltons' treatment of the property was neutral and did not establish a nominee interest, especially given the timing of the transfers and the existence of a valid trust with a third-party trustee. The court distinguished this case from others cited by the IRS, where taxpayers used trusts to evade tax liabilities. Ultimately, the court held that the IRS abused its discretion in rejecting the Daltons' offer-in-compromise based on a non-existent nominee interest.

## Disposition

The Tax Court granted summary judgment in favor of the petitioners, Arthur and Beverly Dalton, and entered an order and decision for them.

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**Significance/Impact**

Dalton v. Commissioner clarifies the application of nominee theory in the context of federal tax collection. The decision emphasizes that for the IRS to levy on property held by a trust, the taxpayer must have a beneficial interest under state law. This ruling may limit the IRS's ability to reach assets held in trusts by taxpayers' relatives, particularly when the transfers to the trust occurred before the tax liability arose. The case also highlights the importance of considering both state law and federal factors in nominee analysis, and it may encourage taxpayers to structure their affairs to avoid nominee liability by respecting trust formalities and ensuring that transfers are not made in anticipation of tax liabilities.

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