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U.S. v. Balice: IRS Successfully Pierced Trust

Proper formation, funding and formalities of operating are vital for a plan to succeed.

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The Internal Revenue Service successfully pierced the trust created by a taxpayer to satisfy a tax lien on the basis that the trust was a mere nominee for the taxpayer and could be disregarded. In all planning, consider the risk that a court might disregard and pierce a trust as being a mere nominee for the settlor. This issue should be part of the discussion with clients as to why proper formation, funding and formalities of operating are vital for a plan to succeed. The lessons of *Balice*, acknowledging that it's yet another very bad fact case, might still provide some insight to practitioners and clients structuring trusts for asset-protection planning, divorce planning, as well as estate-tax planning.[1] Poor planning and execution can undermine a trust plan.

The court determined that a trust to which the taxpayer transferred his residence was a mere nominee and permitted the IRS to foreclose on the property to satisfy a federal tax lien. A nominee is a person or entity who "holds bare legal title to property for the benefit of another."

Determining Whether Person or Entity Is Nominee

Evaluate the following factors in determining whether the person or entity is a nominee on behalf of another:

1. Did the nominee pay adequate consideration for the property?
2. Did the taxpayer transfer property to the name of the nominee in anticipation of a suit (or, in this case, in anticipation of IRS collection efforts)?
3. Did the transferor continue to use the property?
4. Did the transferor retain enjoyment of the benefits of the transferred property?
5. Was there a close relationship between transferor and the nominee?
6. Was the transfer recorded in the case of real estate?

The reality in *Balice* is that the taxpayers behaved so inappropriately that finding against them may have been the only just result. That, however, may not ensure that future courts won't apply some of the factors cited in the *Balice* analysis in attacking other trusts.

Bad Facts

In *Balice*, the facts concerning the trust were bad. The IRS filed the action to reduce to judgment defendant Michael Balice's tax liability for several years and to foreclose on a residential property at 70 Maple Avenue in Metuchen, N.J., that was held in a trust. The taxpayers had unpaid tax liabilities for many years and brought suit. The court held in favor of the IRS. The taxpayers attended a seminar that taught how to create trusts to obtain tax protection, and they signed a quitclaim deed transferring title of their property to a trust for no consideration. Following deeding the house to the trust, the taxpayers continued to live in and exercise control over that property. The court found that the couple exercised complete control over the trust checking account. The court also noted that the trust bank account statements were sent to the the taxpayers' home. At one of the trials, the taxpayers admitted that the trust was created to protect the property from liabilities. Although the taxpayers didn't fact record a deed transferring the house to the trust, the court found that all the other factors indicating a nominee were met.

In *Balice*, as in so many other bad-fact cases, the background bad facts were ugly and had to have colored the court's view of the situation. The taxpayers didn't file a tax return for several years despite earning income. Their income was earned by marketing products that purported to teach others how to avoid income tax by creating sham trusts. They were convicted of conspiracy to defraud the United States, wire and mail fraud, and attempt to evade income tax. So, while *Balice* might be dismissed as just a case of bad actors, it may still be worthwhile to try to glean some relevant planning lessons.

Comparison to a SLAT

Some of the facts in *Balice* are unclear. It appears from the case that both the husband and wife created the trust and both transferred the house to the trust, but it appears that Marion, the wife, served as trustee. Recognizing the limitations of comparing a really bad-fact case like *Balice* to a reasonably planned trust, it still may nonetheless be worth trying to extract some lessons.

A spousal lifetime access trust (SLAT) is a common planning technique. A wife, for example, may create a trust for her husband and descendants and then gift assets to that trust. The husband can benefit from the assets in that trust, and according to most if not all commentators, the wife might indirectly benefit by virtue of her relationships with her husband. For example, if the wife's SLAT purchased a vacation home, the wife might be able to stay in that property as a result of her being married to her husband. Leaving aside the bad-actor issues in *Balice*, and what was at best unartful and careless planning and trust administration, might a court look at a SLAT in a similar fashion as the court did in *Balice*? Hopefully, perhaps likely not. But what if there's an aggrieved creditor seeking assets in that SLAT? What if the SLAT wasn't carefully operated? What if the husband took distributions from the SLAT, deposited those distributions into a joint checking account with his wife, and his wife thereafter paid both marital and personal bills from that account? A few innocent mistakes a year in administering a trust formed with proper intent might well set a stage for a claimant to argue something sinister was afoot.

While clearly the facts in *Balice* were worse than in most cases practitioners ever confront, where might a court draw the line? Clients are too often reticent to spend the time or incur the professional fees to have their advisors help them administer a trust. While *Balice* is extreme, clients should take it as a warning that the costs and time to have their advisors administer a trust may well prove worthwhile.

Planning Lessons

While practitioners might dismiss *Balice* as just another bad-fact case, which it is, it's worthwhile to instead draw planning lessons from it.

1. If the trust doesn't pay consideration for the property, document that the property was gifted properly to the trust. Prior to any gifts, assemble some due diligence to confirm that the gift transfer isn't a fraudulent conveyance. Have the client/transferor sign a balance sheet reflecting reasonable net worth before and especially after the transfer.
2. Have the client disclose/document any known claims or suits. Consider performing some due diligence to corroborate that statement from the client. The Internet can make this rather cost effective even on a small-dollar transaction.
3. If the transferor will continue to use the property post-transfer, be certain that the trust authorized use of personality and consider the merit of having an

independent trustee or at least someone other than the transferor serve in a fiduciary capacity. Even if the trust can permit the settlor use of property, for example, in a self-settled trust, discuss with the client the merits of paying a fair rent, along with a lease agreement between the client and the trust, instead of using property immediately after a transfer, which would suggest an implied arrangement with the trustee to do so.

4. The court in *Balice* noted a close relationship with the transferor and nominee. With the availability of administrative trust services from so many trust companies, the cost of having a truly independent trustee to infuse more impudence into a trust transaction is not particularly costly but may prove quite helpful.

5. While the *Balice* court considered the recordation of real estate, the generic view of this issue is to be certain to follow all formalities. This will almost always require a collaborative effort of the client's advisors as each of the CPA, trust officer, attorney and insurance consultant will have distinct tasks to fulfill to adhere to formalities.

Endnote

1. *U.S. v. Balice,* Case 2:14-cv-03937-KM-JBC, (D.N.J. Aug. 9, 2017).

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