

Consistency, Hobgoblins and Esoterica: A Look at Interpleader in Tax Levy Cases.

A recent case from the Western District of New York highlights a fairly esoteric issue: interpleader of funds subject to an IRS tax levy. The case is also interesting because of a governmental flip-flop on the power of a federal court to entertain an interpleader case involving a fund that has been the subject of a federal tax levy: first the IRS told a state court that only a federal court could address the priority of its lien, but when the entity holding the fund obliged by filing an interpleader action in federal court, the government balked and move to dismiss, arguing that no federal jurisdiction existed. *Woods Oviatt Gilman, LLP v. United States*, 2013 U.S. Dist. LEXIS 55086 (Apr. 16, 2013).

The story started with a married couple, the Sinisgallis, who owned several businesses, including a landfill. New York's Department of Environmental Conservation brought suit against the Sinisgallis, as well as several businesses that they controlled, seeking damages relating to remediation of the landfill. Meanwhile, Mr. Sinisgalli was the subject of a federal criminal investigation, and federal agents searched the Sinisgalli residence, seizing \$827,000 in cash. After applying some of the cash to satisfy outstanding taxes owed by the Sinisgallis, the balance of approximately \$425,000 was turned over to Woods Oviatt Gilman LLP, the law firm representing the Sinisgallis in the environmental action, which escrowed the funds per a court order entered by the state court judge who was hearing the landfill remediation case. *Woods Oviatt Gilman, LLP v. United States*, 2013 U.S. Dist. LEXIS 55086, slip op at *4-*5.

Roughly three years after the government turned over the funds, it filed a Notice of Levy against the fund, seeking an additional \$171,171.93 in back taxes and penalties owed by Mr. Sinisgalli. The law firm, as trustee of the fund, informed the state court judge of the levy and invited the IRS to participate in a conference to address the respective rights of the parties with the state court judge. But the IRS had other plans: it declined the invitation, noting that it was not a party to the state court action, and opining that federal court was the sole forum in which its rights in the fund could be addressed. *Id.* at *6. The law firm obliged, filing an interpleader action, and naming both the federal government and the New York Department of Environmental Conservation as defendants.

The federal government, apparently sharing Emerson's view that consistency is overrated, moved for judgment on the pleadings, arguing that no federal question existed because the underlying issues were issues of state law. *Id.* at *9. The government made this argument despite its prior representations in state court. For good measure, it advised the district judge that any state court action would have been removed. *Id.* at 11 n.6. The district court was not sold: "federal question jurisdiction exists in an interpleader action where the holder of disputed funds is faced with a federal tax lien because federal jurisdiction would have existed in an action brought by the IRS to enforce the lien." *Id.* at *12 (citations omitted). Apparently every federal court that has looked at the issue has reached the same conclusion. *See id.* at *12-*13.

The interpleader action is a little unusual: the Internal Revenue Code explicitly provides that when someone who either possesses property subject to a tax lien complies with a levy he is "discharged from any obligation or liability to the delinquent taxpayer and any other person with respect to such property." I.R.C. § 6332(e). The IRS levy form even reprints this provision on the back. Thus, in the ordinary case, an interpleader should not be necessary.

There are cases, however, where an interpleader action may be prudent, and this case probably highlights one of them: the stakeholder filing the case was a law firm; it represented the taxpayers, and it had been ordered by a state court to hold money in trust for a pending state court case. There are probably other situations in which an interpleader action is appropriate to provide additional protection to a client who is holding property subject to levy.

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