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EVERYTHING IS NOT ENOUGH
AUTOMATIC STAY PREVENTS TAX LIEN ATTACHING TO INHERITANCE

Acknowledging that the Service had, before the debtor filed bankruptcy, done all that was necessary to obtain a tax lien against the debtor's after-acquired property, the Fourth Circuit in **United States v. Gold (In re Avis), 1999 U.S. App. LEXIS 14217 (4th Cir. June 28, 1999)** held that the automatic stay prevented the Service's lien from attaching to an inheritance acquired by the debtor during the bankruptcy.

In 1994, the Service properly filed notices of federal tax lien against the debtor. The debtor apparently had no property, but was the beneficiary of a 3% interest in a discretionary trust, with his interest valued at $1,000 by the Service. On May 10, 1995, the debtor went into involuntary chapter 7 bankruptcy, and on September 3, 1995, the owner of the trust died. The Service filed a proof of claim for $127,000, with $110,000 secured by the liens, against the $150,000 inheritance. Both the bankruptcy court and the district court held that the automatic stay prevented the Service's lien from attaching to property which was received by the bankruptcy estate after the petition was filed. The Fourth Circuit affirmed.

The appellate court began by observing an inherent conflict. The Bankruptcy Code provides that all legal and equitable interests of the debtor become part of the bankruptcy estate, including inheritances (B.C. § 541). On the other hand, the Internal Revenue Code provides that a tax lien under I.R.C. § 6321 attaches to all property and rights to property of a taxpayer. Because the Bankruptcy Code does not address whether a tax lien is permitted to attach to property acquired by the estate post-petition, the Fourth Circuit looked to the nature of the Service's lien and the reach of the automatic stay.

The court concluded that the Service had, at best, an inchoate lien on any after-acquired property of the debtor, including an inheritance. Because the court viewed a chief aim of the automatic stay as preventing post-petition perfection of interests in a debtor's bankruptcy estate, the court saw the attachment of the tax lien to property acquired during the bankruptcy proceedings to be an "act" stayed by the operation of the automatic stay. Supporting this position, the court found that Congress had specifically granted an exemption from the stay for state or local real property tax liens, in B.C. § 362(b)(18). Also,

the exceptions in B.C. § 362(a)(9) for audits, notices and assessment appears to preclude an exception for liens. The conclusion to be drawn from these statutory provisions, according to the Fourth Circuit, is that the automatic stay was intended to bar the perfection of federal tax liens.

In a dissenting opinion, Judge Hamilton observed that the majority's reliance on the automatic stay was a red herring. What really was at issue, according to the judge, was the "claw-back" provision of B.C. § 541(a)(5)(a), which treats an after-acquired inheritance as though the debtor received it prior to the petition date. Because treating the inheritance in this fashion would have allowed the tax lien to be perfected, the inheritance would have come into the bankruptcy estate encumbered by the lien. This, the judge felt, was in accord with the intent of the "claw-back" provision, to prevent debtors from unfairly manipulating the bankruptcy petition date so as to deprive creditors of certain assets.

BANKRUPTCY CODE CASES: Automatic Stay: Creation, Perfection or Enforcement of Liens Against Property of the Debtor or Estate

A DAY LATE AND $675,000 SHORT
GOVERNMENT RELIES ON ERRONEOUS DATE IN COURT ORDER

Twelve and a half years after assessment, the Government filed suit to reduce the taxpayer's assessments to judgment. The Second Circuit determined the suit was one day too late, and dismissed the Government's action. **United States v. Hussein, 1999 U.S. App. LEXIS 11131 (2d Circuit May 28, 1999)**.

On May 28, 1984, the Service assessed the taxpayer's 1983 taxes. The taxpayer then submitted an Offer in Compromise on May 6, 1985. The Service rejected the Offer on September 4, 1986, thus tolling the limitations period on the 1983 taxes for two years, three months and twenty-nine days (the pendency of the Offer plus one year). In January, 1994, the Service levied on the taxpayer's bank accounts, prompting the taxpayer to file for injunctive relief. Denying the taxpayer's plea for injunctive relief, the district court noted that the Government was entitled to collect from the taxpayer until September 27, 1996, because I.R.C. 6502(a), effective November 5, 1990, extended the limitations period from six to ten years (based on adding four years to an affidavit filed by the taxpayer).

On September 27, 1996, the Government filed suit to reduce the taxpayer's 1983 and 1984 assessments to judgment, under I.R.C. § 7403. The taxpayer countered with a motion to dismiss, based on the Government's untimely filing. The taxpayer, adding ten years plus the time tolled by the offer in compromise to the assessment date, determined the last day the Government could have filed its action was September **26**, 1996. The Government did not dispute this calculation, but argued that under principles of collateral estoppel, the law of the case doctrine, and principles of equity and fairness, the taxpayer should be precluded from challenging the timeliness of the Government's suit. The district court agreed with the Government, and the taxpayer appealed.

The Second Circuit agreed with the taxpayer. The court found collateral estoppel inapplicable because the district court's finding that the limitations period would expire on September 27, 1996 was dicta, not necessary to the denial of the taxpayer's motion for injunctive relief. Further, the court found the law of the case doctrine also did not apply, as the taxpayer could not have appealed only the wrongful date in the court's decision. Judicial estoppel would not apply because the erroneous date was the result of a good faith mistake or unintentional error. Finally, because the Government could (and should) have calculated the proper date, the appeals court would not reverse on the basis of fairness or equity.

SUITS: By the U.S.: Reduce Tax to Judgment

"DEVIL" GETS HIS DUE
GOVERNMENT CLOSES BARN DOOR ON HALF A HORSE

In **LiButti v. United States, 1999 U.S. App. LEXIS 11130 (2d Cir. May 28, 1999)**, an expensive racehorse, "Devil His Due," was ostensibly owned by taxpayer's daughter's business. The Service filed suit to determine that the daughter was merely the father's nominee, but the district court ruled against the Government on August 3, 1995.[1] While on appeal, the daughter syndicated the horse, selling roughly a half-interest to an unrelated Kentucky corporation. The United States won the appeal, where the Second Circuit agreed that the daughter would be shown to be her father's nominee if the Government could establish he effectively owned and controlled her business.[2] The daughter then sold additional shares in the horse to third parties.

On remand, the district court found the father did in fact control the daughter's business, but refused to grant restitution for any time prior to its latest order on July 2, 1997 (which was well after the daughter had sold most of the interest in the horse to others).[3] Both parties appealed. In the present case, the Second Circuit again ruled favorably for the Government, but effectively awarded the Service only half a horse.

The appellate court easily disposed of the daughter's appeal. The father previously claimed a Fifth Amendment privilege and refused to testify as to his ownership interest in the horse. However, after the district court's July 2, 1997 decision in favor of the government, the father submitted an affidavit indicating he would be willing to testify. The Second Circuit agreed with the trial court that his neglect illustrated the truth of the saying "it is too late to close the barn door after the horse has bolted." In this case, his failure to testify led to an adverse inference that he was the true owner of the horse. However, his affidavit did not indicate specifically what his testimony would be, and so the trial court did

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[1] Libutti v. United States, 894 F. Supp. 589 (N.D.N.Y. 1995).

[2] LiButti v. United States, 107 F.3d 110 (2d Cir. 1997).

[3] LiButti v. United States, 968 F. Supp. 71 (N.D.N.Y. 1998) (reported in the May, 1998, GL Bulletin).

not abuse its discretion in finding no proof that such testimony would change the outcome of the case.

Regarding the issues raised by the Government, the appeals court reversed the trial court's holding on the issue of restitution. As part of its initial decision on August 3, 1995, the trial court enjoined the Service from enforcing its levy against the horse. The Second Circuit found the equities of this case, considering the taxpayer's continual efforts at evasion and the lengths the Service had to go in response, weighed heavily in favor of extending restitution back to the date of that first order, before the daughter syndicated the horse.

However, the Government also forgot to timely close the barn door. A half interest in the horse was sold to a third-party corporation located in Kentucky. Despite the Government's arguments, neither the trial court nor the appellate court found jurisdiction existed over that corporation. Further, the appeals court noted that the Government could have sought a stay pending appeal after the August 3, 1995 decision, but chose not to do so. By its omission, the Government effectively allowed half the horse to bolt.

LEVY: Wrongful Suits: Jurisdiction

SAUSA ALERT

JUSTICE AUTHORIZING PARTICIPATION IN ELECTRONIC BANKRUPTCY FILING PROGRAMS

Local bankruptcy courts are beginning to insist on electronic noticing and filing of documents through the Internet. As a large volume filer, District Counsel will be one of the first required by the court to become involved. To participate, however, SAUSAs need authorization from the Department of Justice. Justice has agreed to issue an authorizing letter to District Counsel to permit SAUSAs to take part.

This letter sets out requirements for participation. One requirement applies if support staff file pleadings. Since most courts consider an electronically filed document's User ID to constitute the signature of the attorney for purposes of federal law, the courts provide User ID and passwords to attorneys only. However, for support staff to be able to access the system, the letter recommends that the bankruptcy court, by local rule, allow for authorized agents and employees of the registered attorney to use the attorney's ID and password. In addition, Justice asks that participating District Counsel establish a written procedure to ensure that the correct version document is ready to be filed and to maintain a record of the person filing the document. The letter also sets out records retention requirements, detailing which documents to keep and which document retention format to use.

To get an authorization letter, please call or e-mail Richard Charles Grosenick, (202) 622-4208.

1. **BANKRUPTCY CODE CASES: Chapter 11 (Reorganization): Effect of Confirmation (§ 1141): Provisions of Plan**

In re Scott Cable Communications, Inc., 232 B.R. 558 (Bankr. D. Conn. 1999) - Chapter 11 debtor's plan was confirmed, resulting in a reorganized debtor. The lengthy plan provided for a number of contingencies, including the potential bankruptcy of the reorganized debtor, which in fact occurred. The reorganized debtor's first liquidating plan was determined by the court to be a tax avoidance scheme, and confirmation was denied. In re Scott Cable Communications, Inc., 227 B.R. 596 (Bankr. D. Conn. 1998). Despite this, the debtor obtained court approval for a sale of substantially all of its assets, without payment of capital gains taxes to the Government. Overruling the Service's objections, the court found the asset sale had been anticipated in the original plan of reorganization, and that plan's confirmation was res judicata as to the Service's interests. The court held the Service should have protected itself by objecting to confirmation of the original plan, despite the speculative nature of its objection.

2. **BANKRUPTCY CODE CASES: Chapter 13 (Regular Income Plans): Confirmation of Plan (§ 1325): Priority Taxes**

In re LaForgia, 1999 Bankr. LEXIS 563 (Bankr. M.D. Penn. April 19, 1999) - Debtor's chapter 13 plan was confirmed without objection, although proposing to pay less than the amount of the Service's priority claim. The court denied the debtor's objection to the Service's proof of claim, but then denied the Service's Motion to modify the debtor's plan to provide full payment of the Service's claim. The court found compliance with B.C. § 1325 (a)(6) (debtor will be able to make all payments under the plan) was optional, and, in harsh language, found the consequences of the Service's failure to object to the plan to be that the Service was bound by the plan and so less than full payment.

3. **BANKRUPTCY CODE CASES: Determination of Tax Liability (§ 505): Jurisdiction of Bankruptcy Court**

United States v. Kearns, 1999 U.S. App. LEXIS 11241 (8th Cir. June 1, 1999) - Taxpayer/embezzler filed bankruptcy, claiming offset against Service's proof of claim based on restitution payments. The Service argued that the restitution deduction was inappropriate because the debtor failed to timely file for a refund, thus barring the bankruptcy court from considering the offset under B.C. § 505(a)(2). The Eight Circuit disagreed. It found section 505 granted courts jurisdiction to determine tax liability beyond the year stated in the proof of claim when that liability involves deductions resulting from the repayment of embezzled funds. Further, the appellate court found case law and congressional intent did not require the debtor to submit a formal claim for a refund. As the Service already filed a proof of claim, the court found there would be no additional burden to require the Service to defend its claim. Further (and perhaps primarily driving the court's decision), the Eighth Circuit found the Service asking for too much in trying to again tax money (by denying the offset) that it had already taxed when the debtor reported it on his tax return.

4. **BANKRUPTCY CODE CASES: Exceptions to Discharge (§ 523):**
In re Fretz, 1999 Bankr. LEXIS 676 (Bankr. N.D. Ala. April 12, 1999) - Debtor, a recovering alcoholic, filed chapter 7 bankruptcy, seeking to discharge over a million dollars in tax liability. The court, citing In re Haas, 48 F.3d 1153 (11th Cir. 1995), found the debtor's failure to file and pay taxes was not evasion under B.C. § 523(a)(1)(C), due to his alcholism.

5. **BANKRUPTCY CODE CASES: Exceptions to Discharge (§ 523): No, late or fraudulent returns**
United States v. Binkley, 1999 U.S. Dist. LEXIS 8837 (M.D. Fla. May 25, 1999) - Government argued that innocent spouse's tax liability is nondischargeable in chapter 7 bankruptcy because the debtor's joint tax return was fraudulent. The court disagreed, finding that a fraudulent return does not preclude dischargeability as to a spouse who is not shown to be guilty of complicity or otherwise personally involved in the fraud.

6. **BANKRUPTCY CODE CASES: Exemptions (§ 522): Collection of Secured Dischargeable Taxes**
BANKRUPTCY CODE CASES: Liens: Avoidance by Trustee
In re Mulligan, 1999 Bankr. LEXIS 630 (Bankr. D. N.H. May 14, 1999) - Debtors received chapter 7 discharge, but Service had secured claim against their condominium. Ruling for the Service, the court found that even though the personal debt had been discharged, and there appeared to be no equity in the property, the Service still had a lien against the debtor's real estate. The debtors lacked standing to avoid this lien under B.C. § 545(2), nor could any claimed exemption in the property avoid such liens, under section 522(c)(2)(B).

7. **BANKRUPTCY CODE CASES: Statute of Limitations: On Collection After Assessment: Suspension Under Bankruptcy Code**
In re Barton, 1999 Bankr. LEXIS 646 (Bankr. W.D. Va. May 17, 1999) - Court found the priority time period under B.C. § 507(a)(8)(A) was equitably tolled during the period debtors were in a prior bankruptcy, under the general authority of B.C. § 105(a). The Court reasoned the Bankruptcy Code was not intended to allow debtors to avoid taxes by filing multiple bankruptcy petitions.

8. **BANKRUPTCY CODE CASES: Statute of Limitations: On Collection After Assessment: Suspension Under Bankruptcy Code**
In re Young, 1999 Bankr. LEXIS 557 (Bankr. D. N.H. May 5, 1999) - Court found the priority time period under B.C. § 507(a)(8)(A) was equitably tolled during the periods debtors were in a prior bankruptcy, under B.C. § 108(c). The court found a literal reading of B.C. § 507(a)(8)(A) and § 523(a)(1)(A), allowing discharge after three years even if the debtor was in bankruptcy and the automatic stay was in effect to prevent collections, was an absurd result, as Congress clearly intended the Service to have a full three years to collect.

9. **LIENS: Priority over Security Interests: Commercial Transactions Financing Agreements**
United States v. Talco Contractors, Inc., et al., 1999 U.S. Dist. LEXIS 8006 (W.D. N.Y. May 7, 1999) - Court found the United States had priority to interpled condemnation funds because taxpayer's assignment of condemnation award was a collateral assignment, not an assignment of proceeds, and so subject to U.C.C. Article 9. Because the creditor/assignee failed to perfect its interest in the collateral assignment by filing, the United States had priority over the creditor's unperfected security interest.

10. **SUMMONSES: Defenses to Compliance: Fifth Amendment: Taxpayer's Records in Possession of Third Party**
Streett v. United States, 1999 U.S. Dist. LEXIS 8775 (W.D. Va. May 27, 1999) - Two days after notice of audit, taxpayers granted their accountant status as attorney in fact under Form 2848 (Power of Attorney) to deal with the Service. The magistrate judge held that delivery of documents to their accountant as their attorney-in-fact was not delivery to a third party, and so did not cost taxpayers their Fifth Amendment privilege in a subsequent criminal investigation.

11. **SUMMONSES: Defenses to Compliance: Privileges: Attorney-Client**
United States v. Randall, 1999 U.S. Dist. LEXIS 8862 (D. Mass. May 21, 1999) - Accountant hired by taxpayers during audit to review tax returns originally prepared by the taxpayers' attorney refused to comply with Service summons, claiming attorney-client and work-product privileges. The court ordered the summons enforced, finding the accountant lacked standing to raise the attorney-client privilege on behalf of the taxpayers (who did not raise the privilege themselves). Nor was the accountant acting as the agent for the attorney in providing legal advice. Because the returns were prepared during audit, before any investigation of the taxpayers by the Service, the court ruled that the returns were not prepared in anticipation of litigation and so the work-product privilege would not apply.