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District Court allows the IRS to reach and attach a rare cello to satisfy an unpaid tax debt from more than a decade ago

U.S. v. Firestone, 131 AFTR 2d 2023 (DC WA), June 12, 2023.

Facts

Executor was the executor of his spouse's estate ("Decedent's Estate") and in 2012 the Internal Revenue Service (IRS) notified Executor that Decedent's Estate was being audited. In April 2013, the IRS informed Executor that the recomputed estate tax liability for Decedent's Estate was $1,869,254.00, including penalty and interest. One month later, Executor created an irrevocable trust (actually called the "Irrevocable Cello Trust"), ostensibly transferring a fine Italian violincello or cello made circa 1816 ("Cello") from Executor as the grantor of the trust to Executor as the Trustee. On April 14, 2014, Decedent's Estate stipulated to additional estate tax liabilities. Executor failed to pay the tax assessment. On January 2, 2019, the IRS commenced an action in US District Court for the Southern District of California against Executor, as a fiduciary and beneficiary of Decedent's Estate, to reduce an unpaid estate tax to judgment and foreclose on certain real property. (This occurred after the IRS made several attempts across many years to collect taxes due on Decedent's Estate.) In March 2021, the Court granted a joint motion, held the transfer of the Cello to be fraudulent/reversible, and entered judgment against Executor in the amount of $2,537,554.16, plus statutory accruals and interest. In September 2021, the US District Court for the Western District of Washington registered that foreign judgment, immediately after which the IRS commenced this action also against Executor as fiduciary and beneficiary of Decedent's Estate. The IRS requested a writ of execution that authorized the seizure of the Cello in order to collect on the foreign judgment. After some corrections, the Court granted the IRS's request and issued the corrected writ. Executor now brings the instant motion to quash the corrected writ of execution. The IRS opposes.

Holding

The Court begins by establishing the standard applied under 28 U.S.C. §3203: "All property in which the judgment debtor has a substantial nonexempt interest shall be subject to levy pursuant to a writ of execution." Under the law, "property" is broadly defined: "any present or future interest, whether legal or equitable, in real, personal..., or mixed property, tangible or intangible, vested or contingent, wherever located and however held (including community property and property held in trust (including spendthrift and pension trusts))," with narrowly defined exceptions. However, a debtor may claim statutory exemptions for their property. The Court observes that Executor here is caught in a "Catch-22" because he claims that the Cello cannot be seized under the writ because it is not his property, but if this were true, then Executor would not have legal standing to move to challenge the writ. Also, Executor contradicts himself by admitting in the same brief that he holds a life estate in the Cello. The Court treats this admission as dispositive of the property issue and moves on to Executor's statute of limitations challenge. The statute cited by the IRS applies to actions to set aside or void a transfer by a debtor that is "fraudulent" and done "with actual intent to hinder, delay, or defraud a creditor." Executor argues that the statute is governed by a six-year statute of limitations, a time which ran before the IRS action commenced. The IRS argues that a different, 10-year statute applies. The Court disagrees and holds that the law imposes "no time limit for the collection of debts by writ of execution." As the grantor of the Trust, as its Trustee, and as its sole beneficiary, Executor holds an interest in the Cello against which the writ of execution may be exercised.

Takeaway

Admittedly, the facts of this case are bizarre, but the principles of law enunciated in it are more broadly applicable. Where the action has been filed on a timely basis and reduced to judgment, the writ of enforcement comes with no expiration date. There is not even any "repose" argument to be made as the debtor is free to satisfy the debt at any time.

US Court of Appeals affirms Bankruptcy Court recall of tax payments to the IRS

David L. Miller v. United States, No. 21-4135 (10th Cir. 2023), June 27, 2023.

Facts

In 2014, Company paid the personal tax debts of two of its principals totaling $145,139 to the IRS. Company filed for bankruptcy in 2017. In assembling the assets of Company, the bankruptcy Trustee also considered §554 of the Bankruptcy Code, which provides that "the trustee may avoid any transfer of an interest of the debtor in property... that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under" the Bankruptcy Code. The Trustee applied §544 seeking to avoid and reclaim for the bankruptcy estate the payments made to the IRS. The Bankruptcy Court allowed the payments to be avoided and ordered the IRS to repay the amounts to be included in the bankruptcy estate for the benefit of the creditors of Company. The IRS appealed this decision to the US District Court for the District of Utah, which affirmed the Bankruptcy Court decision after hearing arguments. The IRS appealed to the US Court of Appeals for the 10th Circuit.

Holding

We begin with the two sections of the Bankruptcy Code with primary importance to this case, viz., §§106 and 544. Section 106 provides in pertinent part that "Notwithstanding an assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section with respect to [inter alia] ... §544 ..." So, despite the sovereign immunity of the US government and its agencies, the IRS is subject to §544 the same as nongovernmental parties. Section 544(b), in particular, allows a Trustee in a chapter 7 bankruptcy to step into a creditor's shoes and avoid transfers that such a creditor would be able to avoid under applicable law. "Applicable law" for these purposes includes state law outside of bankruptcy. The question before the Court was whether Congress intended to abrogate sovereign immunity as to the underlying state law, particularly in this case, the Utah Uniform Fraudulent Transfer Act. The Court points out that in the bankruptcy process, the Trustee has a duty to recover and assemble assets so that entitled creditors may share in them. In that process (established in the US Constitution as bankruptcy courts are), the United States and its agencies are as vulnerable to disgorge any inappropriate payment received as any other creditor so that all entitled creditors may share appropriately as Congress has directed. (In this case, virtually the sole creditor in the bankruptcy was an individual holding an enforceable employment-discrimination judgment.) The Court, like the Bankruptcy Court and the US District Court below, found that the clear language of the cited statutes provides that the payments by the Company to the IRS were voidable in bankruptcy if under Utah law the creditor here could have avoided a similar payment to any recipient. In examining the Utah Uniform Fraudulent Transfer Act, the Court found the transfers voidable. The Court also cites similar outcomes in other US circuits as compelling.

Takeaway

This is a rare loss by the IRS on its claim of priority over other claimants where outstanding taxes are due. Readers should be careful not to read this outcome too broadly, however. This decision was helped by the fact that the outstanding tax debt was not that of the Company, but of its principals and also that, as a fraudulent conveyance, the payment was made either when the Company was already insolvent or was itself the transfer that made the Company insolvent. Change any one of these facts and you may have a different outcome.

Taxpayer conviction of income tax evasion due to filing fraudulent income statement upheld

United States v. Kevin L. Crandell, No. 22-60350 (5th Cir. 2023), June 29, 2023.

Facts

In our pages there are occasional reminders that some perennial tax scams or ideas never work, and this is another such reminder. Doctor is a medical doctor who contracted to work with two hospitals, one in Mississippi and the other in Alabama. From these contracts, Doctor ordinarily earned $30,000–40,000 per month, but because Doctor worked as a contractor, the hospitals were not required, of course, to withhold any amounts to pay income tax liabilities, and they did not. From 2006 through 2012, Doctor did not pay any income taxes or file any timely tax returns. Ultimately, Doctor owed $943,493 in unpaid taxes, interest, and penalties. Although Doctor briefly visited a certified public accountant in 2008, he took no substantive steps towards addressing his tax debt until 2010, when the IRS began garnishing his bank accounts. Doctor then created two corporations to which the hospitals began to pay his earnings, one in Mississippi and the other in Wyoming, both wholly owned by Doctor. Doctor occasionally paid himself amounts from the corporations. Doctor prepared and filed an IRS Form 433-A, a Collection Information Statement used to work out payment plans with the IRS. However, Doctor grossly understated the amount of his monthly income and did not report all his valuable assets, including his sole ownership of the corporations. Doctor was tried in US District Court and convicted of income tax evasion for filing the fraudulent IRS Form 433-A. Doctor was sentenced to 33 months' imprisonment and $972,493.86 of restitution. Doctor timely appealed.

Holding

Doctor raised two claims on appeal: (1) that the evidence at trial was insufficient to support a conviction for tax evasion (under 26 U.S.C. §7201); and (2) that the court below abused its discretion by denying his motion for a mistrial. On the first issue, the Court noted that the cited statute penalizes "[a]ny person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof." Courts have long held that §7201 has three elements: "(1) willfulness, (2) existence of a tax deficiency; and (3) an affirmative act constituting an evasion or attempted evasion of the tax." Doctor argues that submitting a fraudulent Form 433-A is per se insufficient evidence that a defendant has violated the statute. He argues that these forms are sent to the IRS to solicit a payment plan, a schedule of payments that reflects the amount owed as well as the taxpayer's capacity to pay. A payment plan does not change the amount owed but only the timing of its payment. The Court disagreed, pointing out that the statute proscribes evading "any tax imposed by this title or the payment thereof." Doctor also argued that the amounts reported on Form 433-A were not incorrect but merely adjusted to reflect the garnishing of his wages by the IRS. Again, the Court disagreed, stating that the math did not support Doctor's argument, and pointing to the many omissions of very valuable assets from the form. Finally, the Court found no abuse of discretion by the court below in denying Doctor's motion for a mistrial, finding no significant possibility of prejudice in the proceedings.

Takeaway

The primary point here may be lost in the outrageous facts — yes, the taxpayer here could have been convicted (and may yet be) for brazenly ignoring his duty to report his income and pay his fair share as determined by his representatives in the federal legislature. But, in fact, this conviction was founded on misrepresenting his assets and actual income on an information statement used to work out a payment plan with the IRS.

IRS issues guidance on income and FICA withholding for deferred employee benefits that vest when the employee works for a foreign affiliate

Chief Counsel Advice 202327014, April 4, 2023.

Facts

A Chief Counsel Advice (CCA) was requested concerning the exercise of restricted stock units to US citizens employed by a controlled foreign corporation if the restricted stock units were granted when the employees were employed by a US corporation. The facts are as follows. Corporation is a US-based corporation that has foreign affiliates around the globe, incorporated under the laws of their own respective countries ("Controlled Foreign Corporations" or "CFCs"), which are separate taxpayers from Corporation. Corporation grants Restricted Stock Units ("RSUs") to its common-law employees. These RSUs are payable in Corporation stock. For background, RSUs are a form of compensation in which an employer grants a right to receive a specified amount of company stock and/or cash after the grantee/employee has satisfied specified vesting conditions (typically remaining employed with employer through a specified date). RSUs ordinarily generate taxable income when the stock, or its cash equivalence, is transferred to the employees after vesting. This requested CCA seeks to address whether the usual requirements for payroll taxes for Medicare and Social Security under the Federal Insurance Contributions Act ("FICA") and federal income tax withholding ("FITW") apply for a US citizen employee after being transferred to the CFC with respect to the exercise of an RSU granted when the employee was employed by the US-based parent.

Holding

In this CCA, the IRS concluded that the taxable income generated by the exercise of RSUs (for stock or its value in cash) are wages for FITW purposes, and the US parent is responsible for withholding and reporting with respect to the entire taxable compensation. These reporting requirements also apply to any portion of the RSU-exercise income related to the services performed during the vesting period while the employees were employed by the CFC entirely outside of the US. Significantly, the IRS noted in this CCA that under Treas. Reg. §31.3401(a)-1(b)(7) any employee of a foreign corporation who is a US citizen or resident would be subject to FITW on income from services regardless of whether the foreign corporation has a US-based parent. The CCA also cautions taxpayers that the amounts withheld may be affected by the existence of tax treaties or other agreements between the US and the jurisdiction of the CFC.

Takeaway

As the affairs of many of our clients and their businesses grow more complicated and extend into other states and countries, it is incumbent on us all to remain vigilant of any new rules that apply. As always, planning with competent counsel is important at all stages.

Court grants petition compelling disclosure of cryptocurrency exchange's member information and transactions

United States v. Payward Ventures Inc. et al., No. 3:23-mc-80029 (US Dist. Ct., ND Calif.), June 30, 2023.

Facts

As part of the expansion of an ongoing investigation (begun in 2005) into possible tax code violations by the owners of virtual currency digital assets known as cryptocurrencies, the IRS sent a summons to Ventures, the world's third largest cryptocurrency exchange, and its subsidiaries, to produce customer and transaction information of exchange members who met certain criteria. When Ventures and its subsidiaries failed to comply with the summons, the IRS opened this action by filing a petition in US District Court for the Northern District of California to compel compliance with the summons. It has been established by the investigation that some US taxpayers use cryptocurrencies freely to expatriate and repatriate funds to and from offshore accounts. In February, Ventures' US subsidiary settled charges by the Securities Exchange Commission (SEC) that it was engaged in offering and selling unregistered securities in the US by paying a fine of $30 million and agreeing to cease operations in the US. The IRS summons cast a wide net and demanded a range of information on a broad swath of exchange members, arguably to preserve judicial resources by avoiding future additional requests that would likely have to be enforced by the courts.

Holding

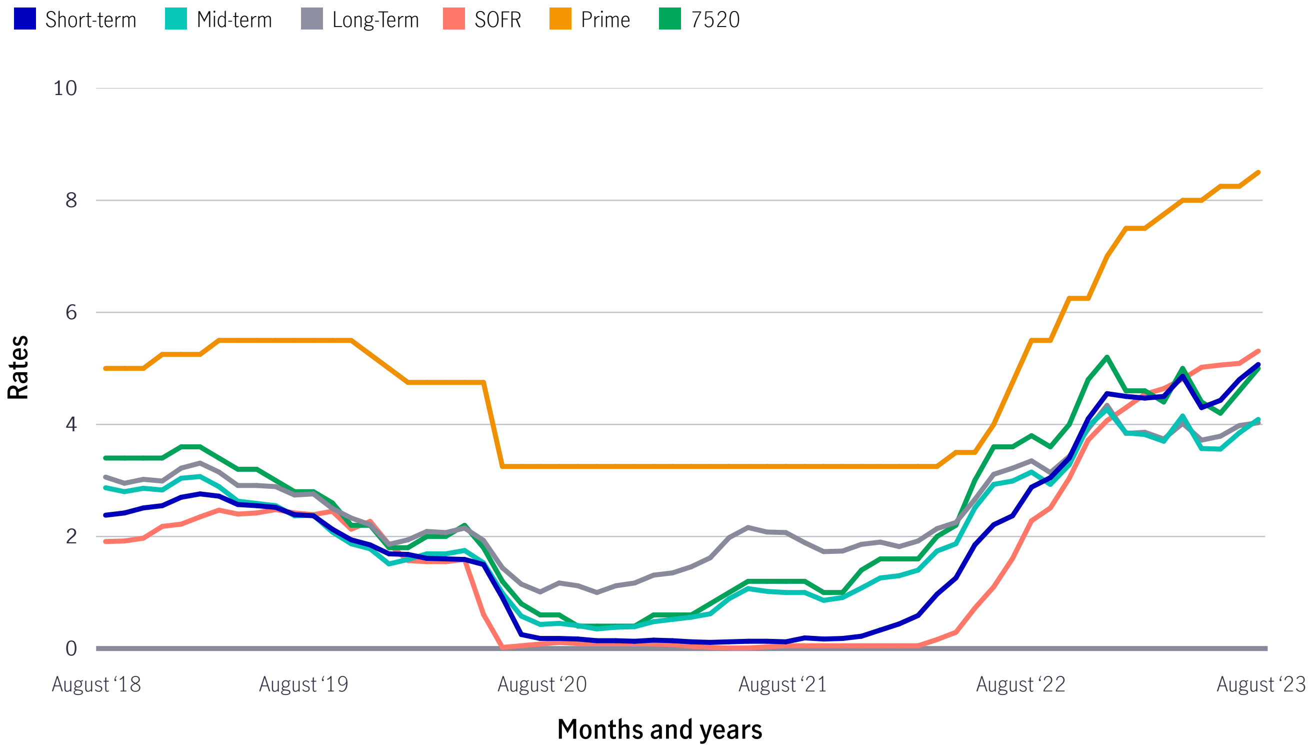
The Court granted the petition in part (and in spirit) and denied it in part. The Court upheld the demand that Ventures and subsidiaries provide members' names, birthdates, taxpayer identification numbers, physical addresses, phone numbers, email addresses, and certain supporting documents for designated members. Designated members comprise those who had conducted transactions of more than $20,000 between 2016 and 2020, inclusive. However, the Court denied the IRS demand for other member information, such as employment, net worth, source of wealth, records of anti-money laundering investigations, etc. This action is part of a much larger investigation by the IRS, SEC, and other US agencies into the cryptocurrency industry to determine general compliance with existing laws and the need for new laws and regulations to protect US citizens and prevent or detect criminal activity.

Takeaway

For many, the anonymity and privacy of the cryptocurrency world is attractive, which is understandable so long as those features are not used to hide crimes or evade taxes. Innovation often brings with it the need for new rules. The transition period can be temporarily bumpy and seem ungraceful, but it is sometimes necessary.

The following are historical graphs of various rates that are commonly used by the Advanced Markets group

Short, Mid, Long Term Applicable Federal Rate (AFR), 7520, SOFR, Prime Rates from August 2018 – August 2023



Take a look at how rates compare this month to last month*

	Short-term AFR	Mid-term AFR	Long-term AFR	7520	SOFR	Prime
August 2023	5.07%	4.09%	4.03%	5.00%	5.31%	8.50%
July 2023	4.80%	3.85%	3.98%	4.60%	5.06%	8.25%

*For more information on these rates, please visit https://www.irs.gov/applicable-federal-rates.

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