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"LAWLESS ACTIONS"
FOURTH CIRCUIT GRANTS MANDAMUS IN ESTATE TAX CASE

Accusing the Service of acting "in complete disregard for the tax code," the Fourth Circuit granted a writ of mandamus, ordering the Service to extend a death tax credit to a decedent's estate. In the **Estate of Mansy Y. Michael v. Lullo.**, **1999 U.S. App. LEXIS 5956 (4th Cir. April 15, 1999)**, the decedent's estate filed an estate tax return which the Service audited, assessing an additional amount due. Following extensive negotiations, the Service sent a closing letter confirming the estate tax of $262,000 negotiated by the parties. The estate then provided proof of payment of taxes to the United Kingdom, and together with a small payment this credit satisfied the estate's tax liability.

However, the Service later discovered it miscalculated the amount of the gross estate by failing to include assets listed on several of the return's schedules. The Service determined the tax should have been $139,000 more. Because the statute of limitations for assessment had expired, the Service reduced the amount of foreign estate tax credit by $139,000, resulting in an unpaid tax liability for the estate. After its administrative appeal was denied, the estate filed for a writ of mandamus. The district court decided that a mandamus action under 28 U.S.C. § 1361 could not be brought to challenge the Service's offset of an otherwise time-barred additional estate tax liability. The court found that the estate did not demonstrate a clear right to relief, or that the Service had a clear duty to credit the full amount claimed. Because the estate had the opportunity to obtain adequate relief through filing a refund suit, the district court refused the writ.

The Fourth Circuit reversed. Initially determining that a issuing a writ of mandamus was a narrow exception to the Anti-Injunction Act, I.R.C. § 7421(a), the court recognized the estate was required to prove two factors:

① Irreparable injury
② Certainty of success on the merits

In Lewis v. Reynolds, 284 U.S. 281 (1932), the Supreme Court permitted the Service to retain payments already received when those payments did not exceed the amount which might have been properly assessed. The Fourth Circuit found Lewis to be a "shield" for the Service to avoid refund suits, but not a "sword" to assess or collect additional taxes in violation of section 6501(a). Where a tax liability had not been assessed, as the Service conceded here, any payment by the estate of an alleged deficiency would be an

overpayment subject to mandatory refund under section 6401. Therefore, the Fourth Circuit concluded, the Service could not collect any additional tax from the estate.

Turning to the second factor, the Fourth Circuit found the availability of a refund suit was an inadequate remedy. In particularly harsh language, the court excoriated the Service for "broken promise[s]," "illegal assessment of taxes," and its "shocking ignorance of the laws it administers, or its utter disregard for the limits of those laws." Unsurprisingly, the court found ample justification for applying the extraordinary equitable remedy of mandamus. It thus ordered the district court to grant the estate's request for reinstatement of the full amount of the foreign estate tax credit.

In dissent, Judge Luttig disagreed with the majority that the Service's right to retain payments under Lewis was limited to refund suits. Instead, the dissent argued the estate was no different from any other taxpayer that is provided an adequate remedy at law by having the right to pay the tax liability and sue for a refund. The dissent also found the Service's disallowance of the taxpayer's attorney's fees deduction and assessment of taxes despite the statute of limitations in Lewis to be factually the same as and so controlling of this case. Lacking "certainty of success on the merits," the dissent disagreed that the estate would have prevailed, much less that it should be granted the unique relief of mandamus. **REFUNDS: Requirement of Claim**

SUPREME COURT GRANTS CERTIORARI IN DRYE

The Supreme Court has agreed to hear the question of "Whether the interest of an heir in an estate constitutes 'property' or a 'right to property' to which the federal tax lien attaches under I.R.C. § 6321 even though the heir thereafter purports retroactively to disclaim the interest under state law." The Eight Circuit's decision in Drye Family 1995 Trust v. United States, 152 F.3d 892 (8th Cir. 1998) was digested in the August, 1998 GL Bulletin.

1. **ASSESSMENTS: Validity**
   Stiles v. United States, 1999 U.S. App. LEXIS 3931(3d Cir. Feb. 24, 1999) (*unpublished*) - Taxpayer argued assessment was invalid because Form 4340, "Certificate of Assessments and Payments" used to support government's motion for summary judgment, was dated after he filed suit. The court found Form 4340 was only a summary, that taxpayer had timely notice of his liability, and so the assessment was presumed correct.

2. **BANKRUPTCY CODE CASES: Chapter 11 (Reorganization): Effect of Confirmation (§ 1141): Provisions of Plan**
   In re Burford, 1999 Bankr. LEXIS 323 (Bankr. N.D. Tex. March 24, 1999) - Court confirmed debtor's chapter 11 plan, which provided for payment of federal taxes for 1988, and that "Payments shall be in an amount sufficient to amortize and fully retire the debt within the six-year period by making payments on a monthly basis ...

." The debtor subsequently amended his 1988 return, prompting the Service to provide an amortization schedule which did not include post-petition interest. The court ruled the debtor did not have to pay the post-petition interest, rejecting the government's claim that it could not include post-petition interest on its proof of claim (although the court admitted that, if a party had objected to such a claim, the allowed claim would not include unmatured interest). Further, the court ruled that the confirmed plan prevented the government from holding the individual debtor personally liable for the unpaid post-petition interest. Because the government provided the amortization schedule, it would be estopped from claiming a greater amount.

3. **BANKRUPTCY CODE CASES: Determination of Secured Status (§ 506): Amount Secured by Lien**

In re Leedy, 230 B.R. 678 (Bankr. E.D. Va. 1999) - In this Chapter 13 bankruptcy, the court ruled that, for the purpose of bifurcating a partially-secured claim into its secured and unsecured components, the "value" of a tax-deferred retirement account should not be discounted to reflect the tax consequences that would flow from the withdrawal of the funds. Thus, the Service's secured claim would not be reduced by amounts such as an early withdrawal penalty.

4. **BANKRUPTCY CODE CASES: Preference (§ 547): Criteria**

Dakmak v. United States (In re Lutz), 1999 U.S. Dist. LEXIS 4527 (E.D. Mich. March 15, 1999) - Trustee moved to set aside debtor's tax payment to United States, made one week before filing chapter 7 bankruptcy, as a preference. The court ruled that the bankruptcy court had a obligation to construct a hypothetical liquidation to analyze whether the payment was preferential, that the preference analysis be conducted separately for the tax, interest, and penalty portions of the payment, and that the "hindsight" (actual) rather than the "estimation" approach be used to calculate administrative expenses.

5. **BANKRUPTCY CODE CASES: Returns by Trustee, Debtor in Possession or Debtor: Bankruptcy Estate of Individual: Computation of Tax Liability**

In re Kerr, 1999 U.S. Dist. LEXIS 2310 (W.D. Wash. Feb. 9, 1999) - Chapter 7 trustee is permitted to exclude from the estate's gross income any gain from the sale of the debtor's residence, under I.R.C. § 1398.

6. **BANKRUPTCY CODE CASES: Setoff (§ 553): Sums Due from Other Federal Entities**

United States v. Cherry Street Partners L.P. (In re Alliance Health of Forth Worth, Inc.) 83 AFTR2d ¶ 99-694 (N.D. Tex. Jan 7, 1999) - Debtor assigned Medicare receivables to Cherry Street, then filed bankruptcy owing federal taxes. Cherry Street argued that its interest in the receivables was superior to the government's right of setoff. However, the court ruled that a right to setoff, as a defense to payment, prevails over a perfected security interest unless the government had actual notice of the security interest before the setoff accrued. The

court further determined that the secured creditor had the burden to prove notice, and that a UCC financing statement was not sufficient notice.

7. **DAMAGES, SUITS FOR: Against U.S.: Unauthorized Collection (§ 7433)**
Bright v. United States, 1999 U.S. Dist. LEXIS 2438 (E.D. Penn. Feb. 24, 1999) - Service levied on taxpayer's wages on September 27, 1994, but released the levy on hardship grounds December 16, 1994. Because the taxpayer failed to file tax returns, the Service levied again starting January 24, 1995, which again was released on hardship grounds March 2, 1995. Taxpayer brought a wrongful levy claim on January 3, 1997, and Service moved to dismiss under the two-year statute of limitations of I.R.C. § 7433(d)(3). However, the court disapproved of the Service's limited reading of taxpayer's pro se complaint to apply only to the first levy, and held that the statute of limitations had not expired as to the second levy.

8. **DAMAGES, SUITS FOR: Against U.S.: Unauthorized Collection (§ 7433)**
Hart v. United States, 1999 U.S. App. LEXIS 6513 (3d Cir. March 25, 1999) (*Unpublished*) - Taxpayer brought a shotgun complaint alleging the Service coerced him into filing returns and paying taxes. In an unpublished opinion, the Third Circuit rejected the taxpayer's claims under I.R.C. § 7433 because the acts complained of were in connection with the assessment, and not the collection, of taxes. This case is a good, short summary of defenses to common protest-style causes of action.

9. **LEVY: Failure to Surrender Property**
United States v. Smyers, 1999 U.S. Dist. LEXIS 3052 (C.D. Ca. Feb. 26, 1999) - Third party creditor with knowledge of federal tax liens auctioned taxpayer's property but refused to remit proceeds to the Service. The court ordered the creditor to turn over the proceeds to the government, finding that the only proper course of action for the creditor was to file a wrongful levy suit under I.R.C. § 7624. The court also denied the creditor's request for an offset to the expenses of conducting the auction, finding no provision in the law for reimbursement of expenses to a junior claimant in foreclosing on a taxpayer's personal property.

10. **LEVY: Wrongful**
SUITS: Against the U.S. or Employees: Wrongful Levy
Morrison v. United States, 1998 U.S. Dist. LEXIS 21118 (W.D. Penn. Dec. 28, 1998) - Taxpayer, a convicted embezzler, had power of attorney over substantial retirement assets acquried by his mother, but kept in accounts jointly owned by mother, taxpayer, siblings and grandchildren. Under state law, a multi-party account is jointly owned by all parties. Thus, the court determined, taxpayer did not have an unrestricted interest in the funds which the Service could levy upon. Nor was the evidence sufficient to show the other beneficiaries were the alter ego of the taxpayer, under LuButti v. United States, 107 F.3d 110 (2d Cir. 1997).

11. **LIENS: Foreclosure**

United States v. Hawkins, 1999 U.S. Dist. LEXIS 3063 (W.D. Wash. March 2, 1999) - Court denied third party bank's Rule 12(b)6 Motion to Dismiss, finding that even if the Service's tax lien is subordinate to the bank's lien, the government has the right to bring a foreclosure action under I.R.C. § 7403. The court held that the question of whether the court should equitably halt the government's foreclosure should not be determined from a Motion to Dismiss.

12. **LIENS: Priority Over Attorneys**
In re McGaughey, Jr., 1999 U.S. Dist. LEXIS 4600 (S.D. Ill. March 24, 1999) - Attorney of decedent bankrupt debtor claimed priority of his fees over federal tax lien. Although the attorney perfected his lien under state law, the court found he did not satisfy the statutory priority of I.R.C. § 6323(b)(8) because he did not procure or obtain a final judgment or settlement. The only fund available was created by an interim compensation order, which even if credited to the attorney, was not a final judgment.

13. **LIENS: Priority over Judgment Lien Creditor**
Money Store v. Internal Revenue Service, 1999 U.S. Dist. LEXIS 3546 (D. Colo. March 8, 1999) - Service and judgment lien creditor claimed interpled funds. The court upheld the Service's claim, based on a prior NFTL, over the judgment creditor under Colorado law, which provides that a judgment creditor becomes a lien creditor only upon service of a writ of garnishment on a garnishee, an act which occurred after the NFTL was filed. Further, the judgment creditor's recording of the judgment perfected only a lien against real estate, not the funds interpled here.

14. **PAYMENT: Application of Payment**
White v. United States, 1999 U.S. Claims LEXIS 81 (Ct. Fed. Cl. April 19, 1999) - Taxpayer, as responsible person, owed employment taxes for 1st & 2nd quarters of 1990, 2nd, 3rd & 4th quarters of 1991, and 1st, 2nd & 3rd quarters of 1992. He sent in a payment for the amount of the 1992 taxes with the notation "FED. DEPOSIT THRU 11/16/92" which the Service applied primarily to 1991 taxes. A second payment was noted "PREV. STORE TAX" and was applied by the Service to the 1990 taxes. The court found the notations ambiguous, and so did not constitute "specific, written instructions" for allocation of payment. Nor was payment of the exact amount of the 1992 taxes sufficient, because the court found requiring the Service to match such payment, without proper designation and where taxpayer had other delinquencies, to one of multiple different possible tax totals owed was unreasonable. Finally, the taxpayer's citation of a similar, unpublished 6th Circuit case was rejected as non-precedential under 6th Circuit rules.

15. **SUITS: By the U.S.: Reduce Tax to Judgment**
United States v. Szopa, 1999 U.S. Dist. LEXIS 4410 (N.D. Ill. March 19, 1999) - Taxpayers underpaid 1983 & 1986 but overpaid 1984 & 1985 taxes. When the government began suit to foreclose on its tax liens, the taxpayers argued their overpayment should be credited against their liabilities under the doctrine of

equitable recoupment. The court disagreed, holding that because different tax years were at issue, there was no single transaction constituting the taxable event claimed upon, as required under Rothensies v. Electric Storage Battery Co., 329 U.S. 296 (1946).

16. **SUMMONSES: Defenses to Compliance: Improper Purpose: Pending Criminal Case**

Crystal v. United States, 1999 U.S. App. LEXIS 7271 (9th Cir. April 16, 1999) - Taxpayers contacted Southern California CID, asking if the Service had any pending activity (audit, collections, investigations, etc.) against them. When CID said no, taxpayers made voluntary disclosures. At the same time, an informant approached Los Angeles CID, who began an investigation and issued summonses. The taxpayers moved to quash, claiming they had been misled by the Service's representations. The Ninth Circuit determined that although the Service may have been negligent in failing to administratively coordinate the two encounters, this did not rise to the level of fraud or deceit necessary for a finding of bad faith. Further, the court held that voluntary disclosure does not guarantee immunity from prosecution.

17. **SUMMONSES: Defenses to Compliance: Privileges: Accountant-Client**

United States v. Frederick, 1999 U.S. App. LEXIS 7420 (7th Cir. April 19, 1999) - Defendant, an attorney-accountant, claimed privilege in refusing to turn over summonses documents. The Seventh Circuit began by rejecting several of the government's arguments: that there can be no privilege for numerical information, nor for information supplied to a tax preparer with the expectation it will be forwarded to the Service. But the court then refused to extend privilege to the documents at issue. The court found dual purpose documents (prepared both for use in tax return preparation and litigation) are not privileged. Even if an attorney's thinking "infects" the worksheets, the court held, that did not change the character of the worksheets from unprivileged accountant's work product. In dicta, the court examined the new tax practitioner's privilege, I.R.C. § 7525, but concluded the result in this case would be the same. Nothing in the new statute suggests that nonlawyer practitioners are entitled to privilege when they are doing other than lawyer's work, the court said.

18. **TRANSFEREES AND FRAUDULENT CONVEYANCES: Uniform Fraudulent Conveyance Act**

Craft v. United States, 1999 U.S. Dist. LEXIS 5150 (W.D. Mich. March 30, 1999) - Sandra Craft and her husband purchased real estate as tenants by the entireties. In Craft v. United States, 140 F.3d 638 (6th Cir. 1998), the appellate court ruled that a federal tax lien did not attach to the husband's interest in entireties property at the moment the couple transferred that property to the wife (see the April, 1998, GL Bulletin for a summary). On remand, the district court considered whether such a transfer was fraudulent. The court found under Michigan's Fraudulent Conveyance Act, a conveyance of exempt property is not fraudulent, but where an insolvent

debtor enhances the entireties property, such enhancement may be. In this case, the husband had made mortgage and property tax payments. Of that amount, the court held the government entitled to the principal payments, finding tax and interest payments did not enhance the property.

19. **TRUSTS, COLLECTION FROM:**
United States v. Murray, 1999 U.S. Dist. LEXIS 3668 (D. Mass. March 5, 1999) - Taxpayer and his wife placed their residence in an irrevocable trust before the Service filed a tax lien against the property. The court rejected the Service's arguments that (a) the trust was revocable (because the taxpayer did not have a unilateral right to revoke the trust); (b) the trust was a sham (because it was properly recorded instrument); and (c) that the transfer was a fraudulent conveyance (because the wife testified one reason for the trust was to provide an ownership entity for planned real estate investments). Although the court found the tax lien attached to the taxpayer's interest in the trust, despite the wife's arguments that the taxpayer had transferred his interest to her prior to the filing of the tax lien (the court found the lack of supporting documentation fatal to her claim), the court ruled that the Service could not execute on that lien until the trust dissolves in 2001.