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James Serven

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Taxation Survey

James Serven*

In contrast to the diversified and significant nature of the federal tax cases that came before the Tenth Circuit Court of Appeals in 1991,[1] the court labored through a rather bland and uneventful 1992. While 1992 presented the court with an opportunity to clarify some matters of interest, for the most part the year passed without any major developments. Perhaps as a result of a recessionary economy, or a growing discontent among the taxpaying public, an increasing percentage of the court's time in the tax area seems dedicated to disposing of matters related in one fashion or another to the enforcement of the federal tax laws and the resolution of procedural or administrative disputes between taxpayers and the government, rather than to the interpretation of more substantive tax issues. As more and more citizens encounter difficulties in meeting the tax obligations imposed upon them in a soft economy, the court's opinions increasingly center on challenges — sometimes successful, more often not — to the propriety of the assessment, collection, foreclosure, levy and seizure activities of the Internal Revenue Service. Taxpayers appear more aggressive in attempting to hide their assets, hence an increase in fraudulent conveyance determinations. Tax protestors regularly bring specious constitutional or similar arguments to the court, ultimately claiming that no living human being is subject to federal taxation. These arguments are just as regularly dismissed by the court, occasionally with the imposition of sanctions. Tax issues impacting the distribution of bankruptcy estates occur with more frequency. While the Tenth Circuit addressed many matters meeting these descriptions, virtually no opinion of substantive importance evolved from the court's activities in 1992.

This Survey first examines in detail some of the more noteworthy federal tax cases — noteworthy at least on a relative basis — disposed of by the Tenth Circuit Court of Appeals in 1992.[2] This Survey then concludes by summarizing other opinions handed down by the court in the tax area during the year just past.

* B.S.B.A., Accounting, University of Denver, 1977; Masters in Taxation, University of Denver, 1978; J.D., Stanford University 1981; Lecturer in Law, University of Denver.

1. *See* James Serven, *Eighteenth Annual Tenth Circuit Survey: Taxation*, 69 Denv. U. L. Rev. 1037 (1992).

2. This Survey examines opinions handed down or otherwise first made available by the Tenth Circuit Court of Appeals in 1992, in the area of federal income, estate, and gift taxation.

I. Timely Mailed Notice of Deficiency Is Valid if Received Taxpayer in Manner Not Working Prejudicial Delay, Even Though Improperly Addressed: *Scheidt v. Commissioner*[3]

A. *Background*

The Internal Revenue Code provides that the Commissioner of Internal Revenue must make an assessment of taxes, if at all, within three years after a taxpayer files a return.[4] If the Commissioner determines that there is a deficiency[5] in respect of any tax, the Commissioner is authorized to send a statutory Notice of Deficiency to the taxpayer by certified or registered mail,[6] informing the taxpayer of the deficiency proposed to be assessed by the Commissioner. The mailing of the Notice of Deficiency is a prerequisite to the making of the assessment.[7] The taxpayer to whom the Notice of Deficiency is sent may then file a petition with the United States Tax Court for a redetermination of the deficiency set forth in the Notice.[8] Such a petition must be filed within ninety days after the date of mailing of the Notice of Deficiency.[9] During this ninety day period, the Commissioner is precluded from entering an assessment against the taxpayer in respect of the deficiency proposed in the Notice of Deficiency.[10] However, if the taxpayer fails to timely file a petition for redetermination with the Tax Court within the ninety day statutory period, the Commissioner is directed to assess the deficiency following the expiration of the ninety days.[11] The Commissioner may thereupon commence collection activities against the taxpayer and his assets.

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3. 967 F.2d 1448 (10th Cir. 1992), *cert. denied*, 113 S. Ct. 811 (1992).

4. I.R.C. § 6501(a) (1988). Under certain circumstances, the three-year statute of limitations is extended. For example, if the return omits items of gross income that exceed twenty-five percent of the amount of gross income otherwise reflected in the return, the statutory limitations period is increased to six years. *Id.* § 6501(e)(1). In addition, the statute of limitations is completely open-ended where there has been a false or fraudulent return with the intent to evade tax, where there has been a willful attempt to defeat or evade tax, or where no return has been filed. *Id.* § 6501(c).

5. A "deficiency" is defined in the context of income tax by I.R.C. § 6211(a) to mean, "(1) the excess of the statutorily imposed tax over the total of the amount shown on the taxpayer's return, (2) plus previous assessments, (3) less abatements, credits, refunds, or other prepayments." Keado v. Commissioner, 853 F.2d 1209, 1210 n.1 (5th Cir. 1988).

6. I.R.C. § 6212(a) (1988).

7. *Id.* § 6213(a).

8. *Id.* The Tax Court is the only forum available for the litigation of tax cases which does not require the prepayment of the deficiency. "If the taxpayer fails to timely file a Tax Court petition, but still desires to contest the merits of the deficiency, he must pay the deficiency in full and sue for a refund in a United States District Court or the United States Claims Court." *Keado*, 853 F.2d at 1212, n.10. The Notice of Deficiency, also known as the "90 day letter," has been described as the taxpayer's "ticket to the Tax Court." Delman v. Commissioner, 384 F.2d 929, 934 (3d Cir. 1967), *cert. denied*, 390 U.S. 952 (1968).

9. I.R.C. § 6213(a).

10. *Id.* If the taxpayer does file a timely petition with the Tax Court, the Commissioner is further precluded from assessing the deficiency "until the decision of the Tax Court becomes final." *Id.*

11. *Id.* § 6213(c). An " 'assessment,' essentially a bookkeeping notation, is made when the Secretary or his delegate establishes an account against the taxpayer on the tax rolls." Laing v. United States, 423 U.S. 161, 170 n.13 (1976).

The running of the three-year statute of limitations is tolled during the time that the Commissioner is precluded from assessing a deficiency — that is, for the ninety days following the mailing of the Notice of Deficiency — and for sixty days thereafter.[12] Whether or not a Notice of Deficiency has been validly delivered to the taxpayer so as to be sufficient to toll the statute of limitations can be a question of crucial importance to the Commissioner, particularly where the Notice is sent just prior to the expiration of the three-year period. In the case of an income tax deficiency, the Internal Revenue Code provides the Commissioner with a safe harbor which states that a Notice of Deficiency will be deemed sufficient if it is mailed by certified or registered mail to the taxpayer at his "last known address."[13] Thus, if the Commissioner mails the Notice by certified or registered mail to the taxpayer's last known address,[14] the Notice will operate to suspend the statute of limitations as to the taxpayer, despite the fact that the taxpayer may never receive the Notice and may therefore be unaware of the proposed assessment.[15] Such a Notice provides a form of *deemed* notification to the taxpayer.

If the Notice of Deficiency is *not* sent to the taxpayer's last known address, the safe harbor will not operate to toll the statute of limitations. However, it may happen that the taxpayer, in fact, ultimately receives the Notice, even though it was improperly addressed, such as where the Notice is simply forwarded through the mails to the taxpayer's current, correct address. In such circumstances, the safe harbor will be unavailable to the Commissioner. The courts have generally held, however, that when the Commissioner has been successful in providing the taxpayer with *actual* notice of the proposed assessment, even though the Notice, although timely mailed, was not sent to the taxpayer's last known address, the Notice is sufficient to suspend the statute of limitations as of the date of mailing *if* there has been no delay in the taxpayer's receipt of the Notice that would prejudice the taxpayer's ability to timely file his petition with the Tax Court.[16]

12. I.R.C. § 6503(a)(1). The statute of limitations is further tolled during the pendency of court proceedings, if a Tax Court petition is timely filed. *Id.*

13. *Id.* § 6212(b)(1).

14. The Internal Revenue Service is required to use "reasonable diligence" to ascertain the taxpayer's correct address. Cyclone Drilling, Inc. v. Kelley, 769 F.2d 662, 664 (10th Cir. 1985). *See also* Gullen v. Barnes, 819 F.2d 975, 977 (10th Cir. 1987).

15. In a 1992 decision that was not officially reported, the court of appeals upheld a determination by the district court that a Notice of Deficiency had been timely mailed to the taxpayer's last known address, and thus, the district court had no jurisdiction to hear the taxpayer's action to enjoin the Service from imposing liens and levies against his property. Howell v. United States, No. 92-3016, 1992 U. S. App. LEXIS 32709 (10th Cir. Dec. 11, 1992).

16. *See, e.g.*, Borgman v. Commissioner, 888 F.2d 916, 918 (1st Cir. 1989) (Notice of Deficiency was mailed to the taxpayer in Chicago, then immediately forwarded to him at correct address in Acton, Massachusetts, so as to be received five days after mailing and two days prior to the date the statute of limitations would run. The court stated that: "[a] notice of deficiency that is actually received without delay prejudicial to the taxpayer's ability to petition the Tax Court is sufficient to toll the statute of limitations as of the date of mailing."); McKay v. Commissioner, 886 F.2d 1237, 1239 (9th Cir. 1989) ("[I]f mailing results in actual notice without prejudicial delay . . . it meets the conditions of § 6212(a) no

B. *Facts*

William and Wanda Scheidt filed their 1978 federal income tax return on June 15, 1979. On June 9, 1982, six days before the expiration of the three-year statutory limitation period, the Commissioner of Internal Revenue mailed a Notice of Deficiency to the Scheidts, proposing a deficiency with respect to their 1978 return.[17] The Notice was sent by certified mail, addressed to the Scheidts at Post Office Box 20711, Oklahoma City, Oklahoma. At that time, however, Box 20711 was not the correct mailing address for the Scheidts. Sometime during 1981, the Scheidts had relinquished Box 20711, and had begun renting Box 20748. Both boxes were located at the Village Branch of the Post Office. On December 31, 1981, the forwarding order from Box 20711 to Box 20748 expired.

On May 19, 1981, the Scheidts had informed the Internal Revenue Service[18] that all notices and other correspondence from the Service to the Scheidts should be sent to their home address.[19] Pursuant to a Power of Attorney granted on Form 2848 to their accountant, Robert J. Drewell, and filed with the Commissioner, the Scheidts also directed the Commissioner to send copies of all such correspondence to Mr. Drewell.[20] The Commissioner did not send duplicate originals of the Notice of Deficiency to the Scheidts home address, to Box 20748, or to Mr. Drewell.

On or about June 10, 1982, the Village Branch Post Office received the Notice of Deficiency. Although a notice was placed in Box 20711 informing the Scheidts of the certified letter, it was not picked up. Subsequently, on July 6, 1982, the letter was placed in Box 20748. William Scheidt then picked up the letter and signed for it on that date.[21] Measured from July 6, 1982, the Scheidts, therefore, did not receive the No-

matter to what address the notice successfully was sent.") (quoting Clodfelter v. Commissioner, 527 F.2d 754, 757 (9th Cir. 1975), *cert. denied*, 425 U.S. 979 (1976)). *See also* Lakota v. Commissioner, No. 90-1796, 1991 U.S. App. LEXIS 2833 (1st Cir. Feb. 15, 1991) (misaddressed Notice mailed on February 21, 1989, was actually received by taxpayer sometime in March, well before the May 22 date by which his Tax Court petition would need to be filed; held, the Notice was sufficient to toll the statute of limitations); Pugsley v. Commissioner, 749 F.2d 691 (11th Cir. 1985) (taxpayer not prejudiced when a Notice of Deficiency misaddressed to Tampa, Florida, was immediately forwarded to taxpayer's correct address in St. Mary, Georgia). For an extreme case, see Boccutto v. Commissioner, 277 F.2d 549 (3rd Cir. 1960) (Notice mailed on November 13, 1959, and returned undelivered is nevertheless sufficient when personally handed to the taxpayer at Internal Revenue Service office on January 21, 1960). *Cf.* Sicker v. Commissioner, 815 F.2d 1400 (11th Cir. 1987) (misaddressed notice of deficiency not sufficient to toll statute of limitations where notice not received by taxpayer until eighty-seven days after its mailing and eight days prior to expiration of ninety-day period for filing petition with Tax Court).

17. The Notice also proposed a deficiency arising out of the Scheidts' 1979 federal income tax return.

18. The Internal Revenue Service is sometimes referred to herein as the "Service."

19. Scheidt v. Commissioner, 49 T.C.M. (CCH) 1501 (1985).

20. *Id.* Mr. Drewell began renting Box 20711 after it was relinquished by the Scheidts. Mr. Scheidt and Mr. Drewell had "office shared" since May of 1981. *Id.*

21. The record is unclear as to how the letter found its way to Box 20748. Presumably, personnel at the Village Branch Post Office were aware of the Scheidts' new box and simply placed the letter there.

tice of Deficiency until twenty-one days after the expiration of the three-year statute of limitations, twenty-seven days after the mailing of the Notice, and sixty-three days prior to the date that the Scheidts would be required to file a timely petition with the Tax Court to contest the proposed assessment, assuming the Notice was valid.

On September 4, 1992, the Scheidts timely filed a petition with the Tax Court with respect to the 1978 deficiency. The Scheidts then filed a motion to dismiss the case for lack of jurisdiction and a motion for summary judgment, on the theory that the Notice of Deficiency was not timely mailed to them and that the Notice, therefore, did not toll the three-year statute of limitations. If the statute of limitations had not been tolled, the Notice must then be considered untimely, and there could be no valid assessment of the proposed deficiency relating to 1978.

C. *Result in the Tax Court*

In a 1985 memorandum opinion,[22] the Tax Court denied both motions filed by the Scheidts, holding that, although the Notice of Deficiency had not been mailed to the Scheidts' last known address and the constructive notice safe harbor did not apply, nevertheless, the Scheidts did in fact receive the Notice in time to file a timely petition with the Tax Court. Thus, because the Notice had been timely mailed by the Service and received by the Scheidts with ample time to file their Tax Court petition, the Scheidts were not prejudiced by the delay. Therefore, the Notice served to toll the three-year statute of limitations.

D. *The Tenth Circuit's Opinion*

On appeal, the Tenth Circuit Court of Appeals affirmed the Tax Court.[23] Citing cases decided in the other circuits,[24] the Tenth Circuit Court of Appeals noted the established rule that where the taxpayer receives actual notice of a proposed assessment in the form of a Notice of Deficiency that was timely mailed prior to the expiration of the three-year statute of limitations to an address other than the taxpayer's last known address, the Notice will nevertheless operate to toll the statute of limitations *if* there has been no delay prejudicial to the taxpayer resulting from the fact that the Notice was not sent to his last known address. Here, the court felt — and the taxpayers had in fact stipulated[25] — that the Scheidts were not prejudiced by having sixty-three days to prepare and file their Tax Court petition prior to the expiration of the ninety day statutory period.

On appeal, the Scheidts attempted to convince the Tenth Circuit Court of Appeals that a Notice of Deficiency is not sufficient to toll the statute of limitations unless: (1) the Notice is mailed prior to the expira-

22. Scheidt v. Commissioner, 49 T.C.M. (CCH) 1501 (1985).
23. The three-judge panel consisted of Judge Moore, Judge Engle, and Judge Tacha.
24. *See supra* note 16 for the cited cases and additional cases.
25. *Scheidt*, 967 F.2d. at 1451, n.5.

tion of the three-year statute of limitations, *and* (2) the Notice is received by the taxpayer in "the due course of the mail."[26] The Scheidts fashioned their two-part test in reliance upon language appearing in prior cases that apparently relied in part upon the fact that the misaddressed letter was delivered in "due course."[27] The Scheidts argued that because the Notice was not received by them until twenty-seven days after its mailing, it was not received in the due course of the mail. The Tenth Circuit was not persuaded, noting that the statute only requires the Notice of Deficiency to be *mailed* in a timely fashion, and does not explicitly tie the effectiveness of the Notice to its *receipt* by the taxpayer. The court thus declined to accept the Scheidts' invitation to "graft an additional prerequisite to the tolling of the limitations period based on whether a taxpayer *receives* the notice of deficiency in the due course of the mails."[28]

The Scheidts also argued that a constructive "remailing" of the Notice of Deficiency had occurred through the act of the Notice having been voluntarily placed in the Scheidts' new Post Office box by the Postal Service. If that theory were correct, the date of mailing of the Notice could no longer be considered as June 9, 1982, and would have to be considered as the date the Notice was placed in the new Post Office box. That later date fell outside the three-year statute of limitations. According to the Scheidts, such a "remailing" was, therefore, not timely, and did not operate to toll the statute of limitations. The Tenth Circuit Court of Appeals was not impressed by the Scheidts' argument of "constructive remailing" and simply noted that, in fact, the Commissioner had mailed the Notice only once.[29]

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26. *Id.* at 1451.

27. In the Tax Court, the Scheidts had relied on language in Frieling v. Commissioner, 81 T.C. 42 (1983), to the effect that "[t]he notice [at issue in that case] complied with section 6212(a) because petitioners received it *in due course* through the Postal Service and filed a timely petition in this Court." *Id.* at 60-61 (emphasis added). The Scheidts also relied upon Sicker v. Commissioner, 815 F.2d 1400 (11th Cir. 1987), discussed *supra* note 16, as support for their two-part test. *See also* Zikria v. Williams, 535 F. Supp. 481, 485 (W.D. Pa. 1982) ("[W]here the notice is sent to the wrong address *but delivered to the taxpayer in due course*, there is no prejudice to the taxpayer and the notice is valid.") (emphasis in original).

28. *Scheidt*, 967 F.2d at 1451. The Tax Court, in response to the Scheidts' reliance on *Frieling*, had stated that it did not read the *Frieling* opinion "as requiring a two-step test to be met." Scheidt v. Commissioner, 49 T.C.M. (CCH) 1501, 1504 (1985). The Tax Court concluded that Frieling stands only for the proposition that "petitioners must not be prejudiced by the misaddressing, and must be able to timely file a petition with the Tax Court." *Id.* "The significant factor in the Frieling case, as in the instant case, is that petitioners eventually received the notice and were afforded ample opportunity to file a petition." *Id.* at 1504-05. In response to the Scheidts' reliance upon the *Sicker* case, *supra* note 16, the Tenth Circuit found it easy to distinguish that case (where the taxpayers were afforded only eight days to prepare their Tax Court petition) with the instant case (where the Scheidts had sixty-three days to file such a petition). *Scheidt*, 967 F.2d at 1451.

29. The Tax Court opinion noted that "[d]uring the period from June 25, 1982, to July 6, 1982, it is unclear what happened to the certified letter." *Scheidt*, 49 T.C.M. (CCH) at 1503. The Scheidts had attempted to fill this gap by contending that the letter *was* in fact returned to the Commissioner, who simply deposited it back in the mail. As to this "proposed scenario," the Tax Court noted that the taxpayers had the burden of proof, but were "unpersuasive on this point." *Id.*

E. *Summary*

The crux of the Scheidts' complaint centers around the fact that employees of the Village Branch of the Postal Office apparently took it upon themselves to locate the Scheidts' correct Post Office box and placed the misaddressed Notice of Deficiency in it, rather than return the Notice to the Commissioner. It would have been true that, had the Postal Service returned the certified letter to the Commissioner following the expiration of the three-year statute of limitations,[30] and had the Commissioner then remailed it to the proper address, the Notice would by that time have been untimely and the statute of limitations for the 1978 tax year would have passed in the Scheidts' favor. The Scheidts thus felt aggrieved that they were placed in a worse position than taxpayers who are mailed misaddressed Notices of Deficiency that are returned to the Commissioner after the limitations period has passed. While conceding that such a distinction among taxpayers does exist, the Tenth Circuit Court of Appeals concluded that the distinction was "reasonable,"[31] noting that:

> Given Congress' decision that the date of *mailing* tolls the limitations period, a clearly rational distinction exists between those taxpayers that receive a notice mailed before the three-year period expires and those who do not.[32]

The opinion of the Tenth Circuit Court of Appeals in *Scheidt* shows the court to be in accord with the views espoused in other circuits, as well as existing precedent in the Tenth Circuit. Where a taxpayer is not prejudiced by a delay in receiving a Notice of Deficiency that has been timely mailed by the Commissioner, the Notice will operate to toll the applicable statute of limitations, despite the fact that the Notice was misaddressed, and regardless of the manner in which the Notice ultimately finds its way into the hands of the taxpayer.[33]

30. The taxpayers argued that the Postal Service, pursuant to Postal Service regulations, should have sent the Notice of Deficiency back to the Commissioner rather than place it in their new box. Normally, the Post Office leaves three notices for the patron, and if the letter remains unclaimed after fifteen days, the letter is returned to the sender. *Scheidt*, 49 T.C.M. (CCH) at 1503.

31. *Scheidt*, 967 F.2d at 1452.

32. *Id.*

33. The Scheidts fared appreciably better in 1992 with the malpractice action they brought against the tax attorney who represented them in connection with their participation in the ill-fated International Monetary Exchange tax shelter litigation. *See* Scheidt v. Klein, 956 F.2d 963 (10th. Cir. 1992).

II. TENTH CIRCUIT CLARIFIES RELIEF AVAILABLE IN QUIET TITLE ACTIONS AND ACTIONS FOR INJUNCTIONS UNDER STATUTORY EXCEPTION TO ANTI-INJUNCTION ACT: *GUTHRIE V. SAWYER*[34] AND *JAMES V. UNITED STATES*[35]

A. *Background*

The statutory provisions of the Internal Revenue Code governing the manner in which a taxpayer is informed of the existence of a proposed assessment against him have been summarized above.[36] The main purposes of a Notice of Deficiency are to apprise the taxpayer of the proposed assessment, and to provide the taxpayer with the opportunity to file a petition with the Tax Court to obtain a redetermination of the deficiency giving rise to the assessment. Such a petition must be filed within ninety days of the date of mailing of the Notice of Deficiency.[37] If the taxpayer does not file a petition with the Tax Court, the Internal Revenue Service may immediately assess the deficiency against that taxpayer upon the expiration of the ninety day statutory period.[38] On the date of assessment, a general tax lien arises in favor of the United States, against all the real and personal property of the taxpayer.[39]

The Internal Revenue Code requires that the Commissioner must provide the taxpayer with a Notice of Assessment and Demand for Payment within sixty days after entering an assessment against the taxpayer.[40] The notice and demand states the amount of the assessment, and makes demand upon the taxpayer for payment. If the deficiency is not paid, the Internal Revenue Service may pursue collection activities against the taxpayer, including asserting the government's rights under its general tax lien, described above. The government is also authorized to levy upon and seize the taxpayer's property to recover the assessment, after mailing a notice of intent to levy to the taxpayer.[41]

Taxpayers often find themselves in the position of desiring to challenge the collection activities of the Internal Revenue Service, although the ninety-day period for filing a petition with the Tax Court may ostensibly have already passed. Among other grounds, the taxpayer may claim (1) that the assessment and collection were invalid because the Notice of Deficiency was defective or never sent; (2) that the tax assess-

34. 970 F.2d 733 (10th Cir. 1992).
35. 970 F.2d 750 (10th Cir. 1992).
36. *See supra* text accompanying notes 4-16.
37. *See supra* text accompanying note 9.
38. *See supra* text accompanying note 11.
39. I.R.C. § 6321 (1988).
40. *Id.* § 6303(a).
41. *Id.* § 6331, which authorizes the Service to "levy upon all property and rights to property . . . belonging to such person . . . ," including salaries and wages. The notice of intent to levy must be provided by the Service thirty days prior to levy. *Id.* § 6331(d)(2). Strict compliance with the statutory requirement that a notice of intent to levy be sent to the taxpayer is a prerequisite to the validity of a levy. *See* United States v. Potemkin, 841 F.2d 97, 101-02 (4th Cir. 1988).

ment was never entered or was otherwise procedurally infirm; (3) that the Service never mailed the Notice of Assessment and Demand for Payment to the taxpayer, or there were other defects in the notification process regarding the assessment; (4) that there were defects or irregularities in the tax lien or the Service's procedures in enforcing the lien; or (5) that the Service never mailed a notice of intention to levy or there were other procedural defects in the levy process. To be able to obtain a forum for litigating such claims, the taxpayer must bring suit under a statute that waives the sovereign immunity of the United States.[42] Generally speaking, the Anti-Injunction Act[43] prohibits suits restraining the assessment or collection of federal taxes.[44]

In the tax area, there are two major exceptions to the general bar of the Anti-Injunction Act. First, the Anti-Injunction Act itself specifically recognizes that suits may be brought under I.R.C. § 6213(a), which authorizes an injunction prohibiting an assessment or levy when the taxpayer has not received a notice of deficiency.[45] Second, 28 U.S.C. § 2410 authorizes civil actions against the United States to, *inter alia*, "quiet title to . . . real or personal property on which the United States has or claims a mortgage or other lien."[46]

Beyond this, there remains some uncertainty as to the nature and scope of the challenges that may be mounted by a taxpayer bringing an action pursuant to these two statutes, and as to the relationship between them. For example, in a quiet title action under section 2410, may a taxpayer challenge the sufficiency of the Notice of Deficiency? The courts are in disagreement. In *Elias v. Connett*,[47] the Ninth Circuit Court of Appeals determined that it did not have jurisdiction under section 2410 to consider the taxpayer's claim that the Commissioner's Notice of Deficiency was defective, as that claim went to "the merits of [the taxpayer's] assessment rather than the procedural validity of the lien."[48] On the other hand, the Third Circuit in *Robinson v. United States*[49] allowed the lack of a Notice of Deficiency to be challenged in a quiet title

42. *See generally* United States v. Dalm, 494 U.S. 596 (1990).

43. I.R.C. § 7421(a) (1988). With certain exceptions, this Act provides that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed." *Id.*

44. In addition, the Declaratory Judgment Act specifically prohibits declaratory judgments in matters relating to federal taxes. 28 U.S.C. § 2201 (1988).

45. I.R.C. § 6213(a) (1988) provides, in part, that "[n]otwithstanding the provisions of section 7421(a), the making of [an assessment of a deficiency] or the beginning of [a levy or proceeding in court for the collection of a deficiency] during the time such prohibition is in force may be enjoined by a proceeding in the proper court."

46. *See* I.R.C. § 6212(c)(1) (1988) for the other statutory exception to the Anti-Injunction Act. In addition, if the evidence shows that the government could not ultimately prevail and if equity jurisdiction otherwise exists because of extraordinary circumstances, injunctive relief may be available to protect a taxpayer from collection activities. *See* Enochs v. Williams Packing & Navigation Co., 370 U.S. 1 (1962). *See also* Overton v. United States, 925 F.2d. 1282, 1284 (10th Cir. 1991); Lonsdale v. United States, 919 F.2d 1440, 1442 (10th Cir. 1990).

47. 908 F.2d 521 (9th Cir. 1990).

48. *Id.* at 527.

49. 920 F.2d 1157 (3d Cir. 1990).

action, apparently concluding that the taxpayer had no other forum in which to raise the issue, and thus a failure to extend jurisdiction would block the taxpayer's access to the courts and "impugn the procedural validity of the assessment."[50]

The *Robinson* opinion indicated that a taxpayer may be required to show the lack of a remedy at law to invoke the statutory exceptions to sovereign immunity, and that injunctive relief will be unavailable if the taxpayer has such a remedy. The *Robinson* court noted that an adequate remedy at law may be provided by the taxpayer's right to pay the deficiency and sue for a refund.[51] Must the taxpayer show the lack of a remedy in order to invoke the statutory exception from the Anti-Injunction Act found in section 6213(a)? The weight of authority answers this question in the affirmative.[52]

The Tenth Circuit's views on these issues are not fully developed. In *Schmidt v. King*,[53] the court considered the scope of relief available to a taxpayer in a section 2410 quiet title actin. In *Schmidt*, the court affirmed that "[w]hen the taxpayer challenges the procedural regularity of the *tax lien* and the procedures used to enforce the *lien*," sovereign immunity is waived under section 2410.[54] On the other hand, the court concluded that, contrary to the *Robinson* case,[55] challenges to a Notice of Deficiency may not be brought in a section 2410 action, as section 2410 is "not to be construed as permitting a collateral attack on the merits of a tax assessment."[56] Finally, as to whether the taxpayer may claim that the tax assessment is procedurally infirm, the court answered in the negative, stating that "[s]ection 2410 does not extend to challenges for procedural irregularities in assessment or collection of taxes" where the validity of a tax lien is not at issue.[57] The *Guthrie v. Sawyer*[58] and *James v. United States*[59] cases provided the Tenth Circuit with an opportunity to reconsider these views.

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50. *Id.* at 1161.
51. *Id.* at 1160. *See supra* note 8.
52. *See* Lovell v. United States, 795 F.2d 976, 977 (11th Cir. 1986); Flynn v. United States, 786 F.2d 586, 591 (3d Cir. 1986); Perlowin v. Sassi, 711 F.2d 910, 912 (9th Cir. 1983); Cool Fuel, Inc. v. Connett, 685 F.2d 309, 313 (9th Cir. 1982); Philadelphia & Reading Corp. v. Beck, 676 F.2d 1159, 1163 (7th Cir. 1982).
53. 913 F.2d 837 (10th Cir. 1990).
54. *Id.* at 839 (emphasis added). *See also* Hughes v. United States, 953 F.2d 531 (9th Cir. 1992); Stoecklin v. United States, 943 F.2d 42, 43 (11th Cir. 1991); Arford v. United States, 934 F.2d 229, 232 (9th Cir. 1991); McCarty v. United States, 929 F.2d 1085 (5th Cir. 1991); Kulawy v. United States, 917 F.2d 729, 733 (2d Cir. 1990).
55. 920 F.2d 1159 (3d Cir. 1990). *See supra* note 49 and accompanying text.
56. *Schmidt*, 913 F.2d at 839. *See also* Pollack v. United States, 819 F.2d 144 (6th Cir. 1987); Egbert v. United States, 752 F. Supp 1010, 1014 (D. Wyo.), *aff'd*, 940 F.2d 1539 (10th Cir. 1990).
57. *Schmidt*, 913 F.2d at 839.
58. 970 F.2d 733 (10th Cir. 1992).
59. 970 F.2d 750 (10th Cir. 1992).

B. Guthrie v. Sawyer[60]

1. Facts

James and Beatrice Guthrie and Wayne and Dorothy Wells had been issued Notices of Deficiency to which they had not responded. Following the expiration of the ninety-day statutory period, the Internal Revenue Service assessed deficiencies against them, and in the context of the Service's collection activities, asserted tax liens against certain property they owned. As to the Wellses, levy and seizure activities were commenced. The taxpayers brought quiet title actions under section 2410 and actions seeking injunctions under section 6213(a), in the course of which they challenged various aspects of the government's actions in assessing the tax and pursuing collection. The cases were ultimately consolidated. While some of the taxpayers' claims were clearly without merit,[61] nevertheless, it was incumbent upon the court to determine whether the court had jurisdiction over the claims under the two statutes.

2. Results in the District Court

The Guthries had first claimed that they had not been mailed a Notice of Deficiency. Contrary to this claim, however, the record indicated that on March 12, 1986, the Commissioner had mailed a Notice of Deficiency by certified mail to James Guthrie, addressed to a Post Office box in Jennings, Oklahoma. Although the Guthries alleged that the Internal Revenue Service had not followed its own procedures in ascertaining their "last known address,"[62] it was essentially uncontroverted that this Post Office box was in fact the Guthries' last known address. After notices left in the Post Office box were ignored, the Notice was returned to the Internal Revenue Service, marked "unclaimed," on March 29, 1986.

In a decision not officially reported,[63] the district court ruled that the section 6213 exception to the Anti-Injunction Act waives sovereign immunity as to this claim. The district court then held on the evidence that a Notice of Deficiency had in fact been sent to the Guthries at their last known address.[64] Thus, the Notice was sufficient to toll the applicable statute of limitations, and the government's assessment was timely. The Guthries also contended that the tax liens asserted by the govern-

60. 970 F.2d 733 (10th Cir. 1992).

61. The taxpayers were apparently "tax protestors." For example, in the district court proceedings, Guthrie raised various constitutional arguments, such as that the assessment was invalid because the federal income tax is a constitutionally proscribed direct tax on income without apportionment, and that Guthrie was not a "person" required to pay income taxes. The district court properly rejected these specious arguments. *See* Guthrie v. Sawyer, 89-1 U.S. Tax Cas. (CCH) ¶9139, at 87,134 (N.D. Okla. 1989). Such "tired arguments are the repertory of the tax protest movement," and have been labelled "sanction-bait." United States v. Buckner, 830 F.2d 102, 103 (7th Cir. 1987) (citations omitted).

62. *See supra* text accompanying note 13.

63. Guthrie v. Sawyer, 1989-1 U.S. Tax Cas. (CCH) ¶ 9139, at 87,134 (N.D. Okla. 1989).

64. *Id.* at 87,136.

ment against certain of their property were invalid because the government had not adhered to its own written procedures in making the assessment that gave rise to the liens.[65] Again, the record showed that this was not the case.[66] The district court ruled that the quiet title statute waives sovereign immunity as to this claim.[67] On the merits, however, the claim was not successful, and the district court held the assessment and the liens to be valid.

Finally, the Wellses asserted various claims in connection with the levy and seizure of their property. The Wellses claimed that the government had failed to record the assessment against them, had failed to issue a Notice of Assessment and Demand for Payment,[68] and had failed to issue a notice of intent to levy. Relying on the above-quoted language in *Schmidt*,[69] the district court held that the quiet title statute does *not* waive sovereign immunity as to these claims, as the validity of a tax lien was not at issue. The district court granted summary judgment for the Commissioner.

3. The Tenth Circuit's Opinion

On appeal, the Tenth Circuit Court of Appeals[70] affirmed the district court as to its disposition of the issues concerning the Guthries, but reversed as to the matters concerning the Wellses. The court of appeals had no difficulty in agreeing with the district court that the section 6213 exception to the Anti-Injunction Act waives sovereign immunity as to the Guthries' claims attacking the validity of a Notice of Deficiency, and that section 2410, the quiet title statute, waives sovereign immunity as to the Guthries' claims contesting the validity of the government's tax lien.[71]

As to the claims raised by the Wellses, however, the Tenth Circuit Court of Appeals reversed the district court's conclusion that no waiver of sovereign immunity is worked by the quiet title statute.[72] The matter was therefore remanded for further proceedings, to allow the Wellses the opportunity to develop their challenge.[73] In reversing the district

65. *Id.*

66. The government submitted Certificates of Assessment and Payments on various Forms 4340, detailing the assessments against the Guthries. *Id.* Such certificates are "routinely used to prove that tax assessment has in fact been made." Geiselman v. United States, 961 F.2d 1, 4 n.1 (1st Cir. 1992) (citation omitted). *See also* Hughes v. United States, 953 F.2d 531, 535 (9th Cir. 1992); Gentry v. United States, 962 F.2d 555, 557 (6th Cir. 1992); United States v. Chila, 871 F.2d 1015, 1017-18 (11th Cir. 1989), *cert. denied*, 493 U.S. 975 (1989); United States v. Miller, 318 F.2d 637, 639 (7th Cir. 1963); United States v. Nuttall, 713 F. Supp. 132, 135 (D. Del. 1988), *aff'd*, 893 F.2d 1332 (3d Cir. 1989); United States v. Dixon, 672 F. Supp. 503, 505-06 (M.D. Ala. 1987), *aff'd*, 849 F.2d 1478 (11th Cir. 1988).

67. *See Geiselman*, 961 F.2d 1.

68. *See supra* text accompanying note 40.

69. *See supra* text accompanying note 56.

70. The three-judge panel consisted of Chief Judge McKay, Judge Seymour, and Judge Ebel.

71. Guthrie v. Sawyer, 970 F.2d 733, 737 (10th Cir. 1992).

72. *Id.* at 739.

73. *Id.*

court as to the disposition of the Wellses' claims, the court of appeals was forced to reexamine its determination in *Schmidt* that "[s]ection 2410 does not extend to challenges for procedural irregularities in assessment of collection of taxes."[74] Perceiving an "inconsistency" between other statements in *Schmidt* and this latter statement, the court of appeals proceeded to "disapprove the latter statement and specifically hold that [the quiet title] statute *does* waive sovereign immunity with respect to procedural violations arising from assessment, levy, and seizure."[75] Thus, "[u]nder our holding today, procedural deficiencies with respect to recording assessments and issuing notices and demands for payment may now be brought under section 2410."[76] An "alleged failure of the IRS to assess properly or to send valid notices of assessment and demands for payment are procedural defects cognizable in a quiet title suit."[77]

The court also felt inclined to "take this opportunity to discuss the interrelationship of the quiet title statute and the statutory exception to the Anti-Injunction Act, and to clarify those challenges that may properly be brought under each provision."[78] The court first took issue with the holding of *Robinson* and similarly-decided cases which held that a taxpayer must show a lack of remedy at law to invoke the section 6213(a) exception to the Anti-Injunction Act.[79] Noting that "[o]ne leading commentator has stated that '[s]ection 6213 does not require a showing of irreparable injury as a prerequisite to injunctive relief,' "[80] the court adopted this as the "better view:"

> The purpose of the statutory exception is to preserve the taxpayer's right to litigate his tax liability in the Tax Court *before* paying the tax. If the availability of a refund suit after payment prohibits the taxpayer from obtaining an injunction to protect his right to litigate first, that right is virtually meaningless. Under this approach, this right would be available only on a showing that the taxpayer could not pay the tax. We have difficulty believing that Congress intended to give with one hand and take back with the other.[81]

The Tenth Circuit Court of Appeals then noted that, unlike the result in *Robinson*, the court in *Elias*[82] had *not* allowed the taxpayer to raise defects in a Notice of Deficiency in the context of a quiet title action.[83] As seen above, this ultimate holding is consistent with the Tenth Cir-

74. *Id.* at 735.

75. *Guthrie*, 970 F.2d at 735 (emphasis added).

76. *Id.* at 739. A claim that the Service never sent a notice of intent to levy also falls within the jurisdictional scope of section 2410. *See* National Commodity & Barter Ass'n v. Gibbs, 886 F.2d 1240, 1246 n.6 (10th Cir. 1989).

77. *Guthrie*, 970 F.2d at 737.

78. *Id.* at 736.

79. *Id.* at 736-37; *see also supra* note 52 and accompanying text.

80. *Guthrie*, 970 F.2d at 736 (quoting J. MERTENS JR., MERTENS LAW OF FEDERAL INCOME TAXATION § 49E.39 (1991)).

81. *Id.* at 736.

82. *See supra* text accompanying note 47.

83. *Guthrie*, 970 F.2d 736.

cuit's view. Nevertheless, the Tenth Circuit found itself unable to "agree with that court's apparent position that a taxpayer invoking the statutory exception to the Anti-Injunction Act premised on the failure to receive a Notice of Deficiency must also show the lack of an adequate remedy at law."[84] Thus, while in accord with the ultimate holding of *Elias*, the Tenth Circuit was not in agreement with its reasoning: "In sum, we hold that a taxpayer may obtain injunctive relief under section 6213(a) based on the failure to receive a deficiency notice *notwithstanding* the availability of a refund suit."[85] The court reiterated, however, that "a taxpayer is not entitled to raise [the] procedural defect [of lack of receipt of a Notice of Deficiency] in a quiet title action because the purpose of a deficiency notice is to enable a challenge in the Tax Court to determine the amount of the assessment."[86]

C. James v. United States[87]

1. Facts

Ronald James was a self-styled "citizen of the Republic of Wyoming" who therefore believed he was "not a person required to file a return on I.R.S. form 1040."[88] After James ignored Notices of Deficiency mailed to him proposing assessments in respect of tax years 1981 and 1984, the Internal Revenue Service assessed a deficiency against him and proceeded to levy against his wages. James brought suit against the government under section 2410, attempting to quiet title to his wages, and protesting a variety of government actions in connection with the assessment and levy.

2. Results in the District Court

James' *pro se* action raised a host of objections to the Service's assessment and levy activities, including: (1) that no valid Notice of Deficiency had been sent to him; (2) that the Service failed to lawfully assess the deficiency; (3) that the Service failed to serve a Notice of Assessment and Demand for Payment on him; and (4) that no notice of intention to levy was ever sent to him. In an opinion not officially published, the district court concluded that, fairly read, James' various challenges amounted to a suit questioning the propriety of the assessment itself — that is, the validity of the Notice of Deficiency — and in accordance with *Schmidt*, dismissed the action in its entirety.[89]

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84. *Id.* at 736-737.
85. *Id.* at 737.
86. *Id.*
87. 970 F.2d 750 (10th Cir. 1992).
88. *Id.* at 754 n.8.
89. 1991-2 U.S. Tax Cas. (CCH) ¶ 50,347 (D. Wyo. 1991).

3. The Tenth Circuit's Opinion

On appeal, the Tenth Circuit Court of Appeals[90] affirmed all aspects of the district court's opinion, except that portion which dismissed James' claim that he had never been sent a notice of intent to levy for one of the years in question. Citing its very recent opinion in *Guthrie*, the court stated that section 2410 "does not waive sovereign immunity for claims that the taxpayer does not owe the taxes in question"[91] and, therefore, "does not apply to challenges surrounding notices of deficiency."[92] However, the court reiterated its conclusion in *Guthrie* that an alleged failure of the Service to correctly enter the assessment or properly send valid Notices of Assessment and Demands for Payment are procedural defects that may be challenged in a quiet title suit.[93]

The court of appeals agreed with the district court that the bulk of James' claims were not, in fact, addressed to the procedural validity of the assessment and levy process, but to the validity of the assessment itself — that is, the procedural and substantive validity of the Notice of Deficiency. In order to invoke section 2410, James had argued that the alleged invalidity of the Notice of Deficiency rendered all following assessment and levy activities infirm, and thus he was in effect challenging the latter as well as the former.[94] However, the Court of Appeals saw this argument for what it was, a "domino form of logic"[95] that was unavailing. The court stated that "the bulk of plaintiff's action is based on the merits of Mr. James' underlying tax liability, not the procedure used to notify him of the deficiency or the procedure used to collect it."[96]

In order to give James' *pro se* action the benefit of the doubt,[97] the Court of Appeals went on to discuss each of James' claims that could arguably extend to the validity of the Service's assessment and collection activities, and thus fall within the scope of a section 2410 quiet title action.[98] As to allegations that the Service failed to enter the assessment properly and failed to send James a Notice of Assessment and Demand for Payment for each of 1981 and 1984, the court simply noted that the record and evidence amply demonstrated that no such failures occurred.[99] However, the court determined that James' uncontroverted testimony that he was never sent a notice of intent to levy with respect to the levy made to satisfy the 1981 deficiency raised a genuine issue that

90. The three-judge panel was comprised of Judge Logan, Judge Barrett, and Judge Ebel.

91. James v. United States, 970 F.2d 750, 753 (10th Cir. 1992).

92. *Id.* at 755. "In any event, the record establishes that the IRS mailed notices of deficiency for both 1981 and 1984 to Mr. James." *Id.* at 755, n.10.

93. *Id.* at 53.

94. *James*, 970 F.2d at 753.

95. *Id.*

96. *Id.* at 754.

97. *Pro se* complaints are to be interpreted less stringently than those drafted by lawyers. Haines v. Kerner, 404 U.S. 519, 520 (1972).

98. *James*, 970 F.2d at 754-55.

99. *Id.* at 755.

precluded summary judgment.[100] Thus, the district court was reversed on this point and the case was remanded for a determination whether the levy for 1981 was valid.[101]

D. *Summary*

The court of appeals' opinions in *Guthrie* and *James* provide a welcome clarification and expansion of taxpayers' rights in the Tenth Circuit to challenge various phases of the assessment, collection, levy, and seizure activities of the Internal Revenue Service. It is now clear that taxpayers who for one reason or anther may have missed their opportunity to petition the Tax Court for a redetermination of their tax deficiency may nevertheless obtain injunctive relief under certain circumstances from improper government actions without having to pay the deficiency and sue for a refund. Pursuant to the statutory exception to the Anti-Injunction Act provided by section 6213, taxpayers may seek to enjoin assessment and related activities if a defect in the Notice of Deficiency giving rise to the assessment can be proved. Significantly, a taxpayer in the Tenth Circuit may seek injunctive relief under section 6213 without the need to show a lack of an adequate remedy at law. The court of appeals' view on the latter issue places it squarely in the minority, and creates a conflict among the circuits.[102]

Similarly, taxpayers may contest the following items in a quiet title action, pursuant to section 2410, without the need to demonstrate the lack of an adequate remedy at law: (1) the assessment process (including claims that the assessment was never entered or that the Notice of Assessment and Demand for Payment was not properly mailed); (2) the levy and seizure process (including a claim that the notice of intent to levy was not properly mailed, or that the seizure and sale procedures employed by the Service did not comply with statutory and regulatory requirements);[103] and (3) the validity of the government's tax lien (including claims alleging procedural and substantive defects in the lien). However, the taxpayer may not raise issues of defect in connection with the Notice of Deficiency in a quiet title action.

Taxpayers being pursued by the Internal Revenue Service are often among the persons least likely to be able to afford to pursue their rights in a refund suit brought in district court or the Claims Court. The federal government, on the other hand, enjoys virtually unlimited resources. The court's clarification of the right of taxpayers to obtain equitable relief in the described circumstances serves to somewhat level the playing field and ameliorate the significant imbalances in personal and financial resources between taxpayers and the government.

100. *Id.* at 756.

101. *Id.* at 757.

102. *See supra* note 52.

103. *See* Aqua Bar & Lounge, Inc. v. United States, 539 F.2d 935, 939 (3d Cir. 1976). For a description of the Service's internal procedures and guidelines concerning liens, levies, and sales, see IRM (CCH) Part 57(16)0 (Dec. 1992) ("Legal Reference Guide for Revenue Officers").

III. Tenth Circuit Clarifies Redemption Periods Applicable to Internal Revenue Service: *Title Insurance Company of Minnesota v. Internal Revenue Service*[104]

A. *Background*

Under the Internal Revenue Code, the United States is granted 120 days in which to redeem real property sold in foreclosure to satisfy a lien prior to the government's lien.[105] Under Colorado law, the general redemption period is only 75 days.[106] Certain notice provisions must be complied with at both the federal level[107] and at the state level[108] in connection with redemptions out of foreclosure. The interplay of these federal and Colorado redemption provisions was at issue in *Title Insurance Company of Minnesota*.[109]

B. *Facts*

Lynn and Judith Olsen owned certain real property in Adams County, Colorado. Security Industrial Bank held a first deed of trust on this property, which was also subject to several junior tax liens, as well as a junior deed of trust in favor of Dan Savage. On April 26, 1989, Secur-

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104. 963 F.2d 297 (10th Cir. 1992).

105. I.R.C. § 7425(d) (1988) provides that "[i]n the case of a sale of real property . . . to satisfy a lien prior to that of the United States, the Secretary may redeem such property within the period of 120 days from the date of such sale or the period allowable for redemption under local laws, whichever is longer."

106. Colo. Rev. Stat. § 38-38-302(1) (1992 Supp.) provides as follows:

> Except as provided in this section with respect to agricultural real estate, within seventy-five days after the date of the sale of real estate by virtue of any foreclosure of a mortgage, trust deed, or other lien or by virtue of an execution and levy, the owner of the premises or any persons who might be liable upon a deficiency may redeem the premises sold by paying to the public trustee, sheriff, or other proper officer the sum for which the property was sold, with interest from the date of sale at the default rate if specified in the original instrument or if not so specified at the regular rate specified in the original instrument, together with any taxes paid or other proper charges as now provided by law, and a certificate or redemption shall be executed by the proper officer and recorded, and the public trustee, sheriff, or other public officer shall forthwith pay said money to the holder of the certificate of purchase.

Colo. Rev. Stat. § 38-38-303(1) (1992 Supp.) provides in part:

> If no redemption is made within the redemption period provided for in section 38-38-302, the encumbrancer or lienor having the senior lien . . . on the sold premises . . . subsequent to the lien upon which such sale was held may redeem within ten days after the expiration of the above redemption period by paying the amount required by section 38-38-302, and each subsequent encumbrancer and lienor in succession shall have and be allowed a five-day period to redeem, according to the priority of his lien.

107. Treas. Reg. § 301.7425-4(b)(4)(ii) (1976) states as follows:

> Before the expiration of the redemption period applicable under [I.R.C. § 7425], the district director shall, in any case where a redemption is contemplated, send notice to the purchaser (or his successor in interest of record) by certified or registered mail or hand delivery of [the purchaser's] right . . . to request . . . payment in the event the right to redeem under section 7425(d) is exercised . . . for a payment made to a senior lienor.

108. Colo. Rev. Stat. § 38-39-103(2) (1973) provides as follows: "No lienor or encumbrancer is entitled to redeem unless, within the [75-day] redemption period provided for in section 38-19-102, he files a notice of his intention to redeem with the public trustee, sheriff, or other officer making the sale."

109. 963 F.2d 297 (10th Cir. 1992).

ity Industrial Bank caused the property to be sold in a public trustee's sale.[110] The purchasers of the property at the public trustee's sale were Neal and Judy Goldsmith. On July 26, 1989, Savage redeemed the property from the Goldsmiths, and received a public trustee's deed on July 27, 1989.

In mid-August, 1989, Virginia Muwwakkil, a Revenue Officer of the Internal Revenue Service, telephoned Savage to advise him that the Service intended to redeem the property, and inquired about the amount of money Savage had spent in redeeming and repairing the property. Savage did not provide the requested information, nor did he appear on August 24, 1989, at a meeting scheduled by Muwwakkil at the offices of Title Insurance Company of Minnesota for the purpose of delivering a check to Savage to reimburse him for the money he had spent redeeming and repairing the property. On August 24, 1989, the 120th day after the April 26, 1989 foreclosure sale, the Service filed a certificate of redemption on the property with the office of the Adams County Clerk and Recorder. The certificate of redemption stated that the Service had tendered payment to Savage in the amount of $33,645.46 by a check dated August 23, 1989.

On August 30, 1989, the Service notified Savage of its intention to foreclose upon the property. Savage instituted proceedings in district court against the Service on September 25, 1989,[111] and then conveyed his interest in the property to Title Insurance Company of Minnesota.[112] The title company subsequently joined the action through an amended complaint, seeking an adjudication and declaration that it was the owner of the property, free and clear of any lien claimed to exist in favor of the United States. The title company asked that the government be enjoined from asserting any further claim in and to the property. Both the title company and the Service moved for summary judgment. By virtue of the action filed by Savage and joined by the title company, the validity of the certificate of redemption filed by the Service on August 24, 1989, was placed at issue.

C. *Result in the District Court*

In a unreported decision, the district court granted the title company's motion for summary judgment, while denying the Service's motion. In so holding, the district court concluded that the Service's certificate of redemption did not comport with applicable federal and Colorado statutes, and well as applicable federal regulations.[113] As a threshold matter, the district court determined that there was no federal preemption of the Colorado redemption statutes by the federal redemp-

110. *Id.* at 298. Security Industrial Bank first provided the Internal Revenue Service with notice of the foreclosure, as required by I.R.C. § 7425(c) (1989).

111. Presumably pursuant to 28 U.S.C. § 2410 (1978), the "quiet title" statute analyzed in the *Guthrie* case, *supra* notes 60-86.

112. *Title Ins. Co.*, 963 F.2d at 299. Title Insurance Company of Minnesota had insured Savage's title to the property.

113. *Id.*

tion statutes[114] — that is, there was no *express* preemption provision contained in the federal statutes or regulations, and further, there was no *implied* preemption by federal law arising out of an "actual conflict" between state and federal law.[115] The district court went on to conclude that, in filing its certificate of redemption, the Service had not complied either with the Colorado statute that requires the Service to file a notice of intent to redeem within 75 days of the date of sale,[116] or with the Treasury Regulations[117] that require the Service to send notice of a contemplated redemption to the purchaser before the expiration of the redemption period.[118]

D. *The Tenth Circuit's Opinion*

On appeal, the Tenth Circuit Court of Appeals affirmed the district court's grant of summary judgment, but differed with the district court's conclusions of law concerning the interplay of the federal and Colorado redemption statutes. The court of appeals first addressed the conclusions of the district court concerning the question whether the federal redemption statute preempted the Colorado redemption statute. The lower court had concluded that it saw "[n]o conflict [between the respective statutes] which would warrant application of the preemption doctrine to the state [redemption] statute."[119] However, there was some confusion as to whether the district court had actually concluded that, due to the lack of conflict, the 75 day redemption period set forth in the Colorado statute applied to the Service, and that, therefore, the Service's notice given 120 days after the foreclosure sale was untimely.[120] The court of appeals put this question to rest by noting, as the parties were forced to concede, that "it would be error if the district court had in fact held that the 75 day redemption period . . . . somehow applied to the IRS."[121] If the lower court had held that the 75 day redemption period applied to the Service, "then such would conflict with the 120 day provision in 26 U.S.C. § 7425(d) and the latter would prevail."[122] Thus, if the issue were simply "whether the 75 day period to redeem provided by the Colorado statute, or the 120 day period to redeem provided by a federal statute controls, ... under the Supremacy

114. Under the Supremacy Clause of the U.S. CONST. art. VI, cl. 2, federal law preempts and invalidates state law which interferes with or is contrary to federal law. *See, e.g.*, Hillsborough County, Florida v. Automated Medical Laboratories, Inc., 471 U.S. 707, 713 (1985); Gibbons v. Ogden, 9 Wheat. 1 (1824).

115. *Title Ins. Co.*, 963 F.2d at 300.

116. COLO. REV. STAT. § 38-39-203 (1992 Supp.)

117. Treas. Reg. § 301.7425-4(b)(ii) (1976).

118. *Title Ins. Co.*, 963 F.2d at 301.

119. *Id.* at 300.

120. *Id.* at 301. Part of the confusion arose over the fact that COLO. REV. STAT. 38-39-102 (1973) applies on its face to the "owner" of the foreclosed property or to any person who might be liable for a deficiency, and does not apply to a lienor. The Court of Appeals reserved judgment as to whether the Colorado statute was therefore simply not applicable to the Service.

121. *Title Ins. Co.*, 963 F.2d at 301.

122. *Id.*

Clause the federal statute would control."[123] The 120 day federal redemption period, and not the 75 day Colorado redemption period, was therefore held to apply to the Service.

The court of appeals next addressed the conclusion of the district court that the Service had not complied with the requirements of the Colorado statute stating that the redeeming party must file a notice of intent to redeem within 75 days of the foreclosure sale,[124] and having failed to file that notice, its later certificate of redemption was defective. The lower court "apparently concluded that although the IRS may have 120 days under federal law to file its certificate of redemption, under [the Colorado statute] it nonetheless had to file within 75 days" a notice of intent to redeem.[125] The court of appeals disagreed, noting that:

> [One hundred twenty] means, to us, 120 days, and a state statute . . . requiring IRS to file within 75 days a 'notice of intention' to redeem conflicts with, and impinges upon, the 120 days provided by federal statute. Under the Supremacy Clause, the federal statute preempts the state statute.[126]

The court of appeals did agree with the district court, however, in its determination that the Service had not complied with applicable Treasury Regulations[127] requiring the Service to send notice of a contemplated redemption to the purchaser before the expiration of the redemption period. On this point, the Service argued that the verbal notice given by Muwwakkil to Savage in August of 1989 satisfied the requirements of the Regulation, despite the fact that the Regulation expressly calls for notice to be given by registered or certified mail. The court of appeals disagreed, as had the district court. In view of the Service's failure to comply with the Regulation, the court of appeals held the certificate of redemption filed by the Service on August 24, 1989, to be invalid.[128]

E. *Summary*

The opinion in *Title Insurance Company of Minnesota* lays to rest any question as to the proper redemption period applicable to the Internal Revenue Service when it seeks to redeem property which has been sold in a foreclosure sale in Colorado. The Service may rely on the 120 day redemption period provided in the Internal Revenue Code, which

123. *Id.*
124. COLO. REV. STAT. § 38-39-203 (1992 Supp.)
125. *Title Ins. Co.*, 963 F.2d at 301.
126. *Id.*
127. Treas. Reg. § 301.7425-4(b)(4)(ii) (1976).
128. *Cf.* Colorado Proprieties Acquisitions, Inc. v. United States, 894 F.2d 1173, 1174 (10th Cir. 1990), where the foreclosing lending institution gave the Service notice under I.R.C. § 7425(c)(1) by *regular* mail, not certified or registered mail as required by the statute. Despite the fact that the Service conceded it timely received the notice, the notice was held not to comply with the statute, and was, therefore, invalid. *Id.* at 1175. Comparing these facts to the situation faced in *Title Insurance Company of Minnesota* the Court of Appeals viewed *Colorado Properties Acquisitions* as a case where the "shoe was on the other foot." *Title Ins. Co.*, 963 F.2d at 302.

preempts Colorado's 75 day period. The Service also need not provide a "notice of intent to redeem," otherwise required under Colorado law to be given within 75 days of the foreclosure sale, any earlier than the 120 day period. However, *Title Insurance Company of Minnesota* points out that the courts will strictly apply the statutory and regulatory requirements imposed upon the Service in the context of redemptions. Persons seeking to challenge a redemption by the Service should carefully consider whether the Service has fully and timely complied with the regulations' requirements.[129]

IV. Deferral of Particiaption Interest Income Did Not Clearly Reflect Income: *Resale Mobile Homes, Inc. v. Commissioner*[130]

A. *Background*

The Internal Revenue Code provides that a taxpayer must include and report items of gross income in the taxable year in which the item is received by the taxpayer, unless under the method of accounting used by the taxpayer in computing taxable income, such item is to be properly included in some other tax year.[131] A principal method of accounting employed by many taxpayers which causes items of income to be reported in a tax year other than the year of receipt is the accrual method of accounting.[132] Under the accrual method of accounting, "income is to be included for the taxable year when all the events have occurred which fix the right to receive such income *and* the amount thereof can be determined with reasonable accuracy."[133] The foregoing is commonly known as the "all events" test. Under this two-part test, income is accrued and must be reported when (1) the taxpayer has a fixed right to receive the income and (2) the amount of the income can be determined with reasonable accuracy.[134]

With certain exceptions,[135] the taxpayer is free to choose the method of accounting that he will utilize in computing taxable income. However, if the method selected by the taxpayer does not "clearly reflect income" in application, the Internal Revenue Service is authorized to require the taxpayer to compute taxable income using a method that,

129. *See generally* Treas. Regs. § 301.7425-4 (1976).

130. 965 F.2d 818 (10th Cir. 1992).

131. I.R.C. § 451(a) (1989).

132. Treas. Reg. § 1.446-1(c)(1)(ii) (1992 amendment). The other principal method of accounting, which does generally tax items of gross income in the taxable year of receipt, is the cash receipts and disbursements method. Under the cash receipts and disbursements method of accounting, "all items which constitute gross income (whether in the form of cash, property, or services) are to be included for the taxable year in which actually or constructively received. Expenditures are to be deducted for the taxable year in which actually made." *Id.* § 1.446-1(c)(1)(i). *See also id.* §§ 1.451-1(a), 1.461-1(a)(2).

133. *Id.* § 1.446-1(c)(1)(ii) (emphasis added); *see also id.* § 1.451-1(a).

134. *See* Kent Homes, Inc. v. United States, 512 F.2d 395, 397 (10th Cir. 1975); Spring City Foundry Co. v. Commissioner, 292 U.S. 182, 184-185 (1934).

135. For example, the accrual method of accounting is *required* for all taxpayers for whom the production, purchase, or sale of merchandise is a material income-producing factor. Treas. Reg. § 1.471-1 (1989).

in the opinion of the Service, *does* clearly reflect income.[136] The foregoing principles apply not only to the overall method of accounting of the taxpayer, but also to the accounting treatment of any particular item.[137] It is well settled that the Commissioner has broad discretionary powers in determining whether the accounting method used by a taxpayer clearly reflects income, and in requiring taxpayers to switch to another method of accounting that, in the Commissioner's opinion, does clearly reflect income.[138]

In *Commissioner v. Hansen*,[139] the Supreme Court held that participation interest, held back in reserve accounts to guarantee payment of contingent liabilities, must be reported by accrual basis taxpayers in the year the paper is sold. In *Hansen*, three retail automobile and trailer dealers — accrual basis taxpayers — sold installment paper on a discounted basis to various finance companies. The finance companies held back a portion of the face value of the paper in a reserve account, as security for the payment of contingent liabilities arising out of guarantees given to the finance companies. The reserve account was credited as payments were actually made on the paper. When the balance in the reserve exceeded certain amounts, additional payments were made to the dealers. The dealers argued that the presence of the reserve arrangement prevented a conclusion that they had a present and enforceable right to the future payments, thus failing the first half of the "all events" test. The Supreme Court disagreed, holding that the taxpayers had in fact acquired a fixed right to receive the payments in the future. The fact that the taxpayer did not have a right to *presently* recover the reserve was of no consequence. All the events had occurred to fix the right to receive the payment, and only the passage of time was necessary in order for the payments to be received. Focussing on the second half of the two-part "all events" test, the dealers also argued that the amount of income could not be ascertained with reasonable accuracy. Again, the Supreme Court disagreed, stating that because the amounts in the reserve would either be paid over to the taxpayers or applied to their guarantees, the dealers would under any circumstance receive the benefit of the amounts held back. *Hansen* has been widely followed.[140]

In *Resale Mobile Homes, Inc. v. Commissioner*,[141] the Tenth Circuit was called upon to review the Commissioner's determination that the taxpayer's method of accounting for certain "participation interest" earned in the sale of consumer paper generated by its mobile home sales clearly reflected income.

136. I.R.C. § 446(b) (1988).

137. Treas. Regs. § 1.446-1(a)(1) (1992).

138. *See* Commissioner v. Hansen, 360 U.S. 446, 467 (1959); United States v. Hughes Properties, 476 U.S. 593, 603 (1986).

139. 360 U.S. 446 (1959).

140. *See, e.g.*, Shapiro v. Commissioner, 295 F.2d 306 (9th Cir. 1961), *cert. denied*, 369 U.S. 829 (1962); General Gas Corp. v. Commissioner, 293 F.2d 35 (5th Cir. 1961), *cert. denied*, 369 U.S. 816 (1962); Morgan v. Commissioner, 277 F.2d 152 (9th Cir. 1960); Klimate Master, Inc. v. Commissioner, 42 T.C.M. (CCH) 85 (1981).

141. 965 F.2d 818 (10th Cir. 1992).

B. *Facts*

Resale Mobile Homes[142] was engaged in the sale of mobile homes in Denver, Colorado, under the name "Mobile World," and reported its income under the accrual method of accounting. Its customers often purchased mobile homes on credit, signing consumer paper that called for the payment of the amount financed over a stated period of time, in installments, with interest. The practice of Resale Mobile Homes was to immediately sell the paper to one of two finance companies, either Midland Federal Savings and Loan Association of Denver or Advance Mortgage Co., who became the servicers of the paper. Under its agreements with the finance companies, Resale Mobile Homes received the full principal amount of the consumer paper sold, and also became entitled to receive the excess of the total amount of interest scheduled to be collected from the mobile home purchaser during the life of the paper, over the total amount of interest the finance company charged the taxpayer based on a "buy rate." This excess was known as Resale Mobile Homes' "participation."

Each payment received by the finance companies was applied first to interest, based upon the actual number of days elapsed since the last payment, on a simple interest basis.[143] The reminder of the payment was applied to principal reduction. Under this method, the amount of interest accrued with respect to each payment depended solely on the date the payment was actually received by the finance company, and not on the date the payment was due. Thus, unless one were to assume that each payment would be made exactly on its due date, the amount of interest accruing under the consumer paper and the amount of Resale Mobile Homes' participation interest therein could not be exactly determined in advance.

The finance companies paid participation interest to the taxpayer over time, as they actually received the payments giving rise to the participation interest. Thus, each time a payment was received, the finance company would calculate the amount of the payment allocable to inter-

142. The company is referred to as the taxpayer throughout this discussion.

143. This method of applying payments received from the mobile home buyers was fashioned to conform to COLO. REV. STAT. § 5-2-210 (1973), as amended by the Colorado legislature on October 28, 1975, to eliminate the use of the so-called "Rule of 78's" in the event of the prepayment of a consumer loan. Under the Rule of 78's, the amount of interest allocable to each time period during the term of a loan is determined by multiplying the total interest payable over the loan term by a fraction, the numerator of which is the number of periods remaining on the loan at the time the calculation is made, and the denominator of which is the sum of all time periods during the loan term. Resale Mobile Homes, Inc. v. Commissioner, 91 T.C. 1085, 1088 n.1 (1988). The effect of this method is to cause a greater amount of interest to be allocated to the initial periods of a loan than would be the case if interest were economically accrued based on the number of days elapsed applying the stated interest rate to the then-outstanding principal balance of the loan. Because the Rule of 78's effectively and artificially retards the rate at which the principal amount of the loan is reduced, it works to the disadvantage of a consumer who desires to pay the loan off early. The 1975 amendment to COLO. REV. STAT. § 5-2-210 precludes the use of the Rule of 78's in calculating the balance due upon the prepayment of a consumer loan.

est. After then applying the buy rate to determine how much of that interest was to be retained by the fiance company, it remitted the remainder of the interest to Resale Mobile Homes.[144] On its tax returns for the years in question, Resale Mobile Homes reported the participation interest as it was actually paid over to it by the finance companies, and not as a lump sum amount at the time the paper was sold. On audit, the Commissioner determined that Resale Mobile Homes should have accrued all the participation interest in the year the consumer paper was sold, on the theory that its right to receive the interest was fixed and the amount was reasonably determinable. Resale Mobile Homes timely filed a petition for redetermination with the United States Tax Court.[145]

C. *Result in the Tax Court*

The Tax Court agreed with the Commissioner,[146] holding that the participation interest in respect of a particular piece of consumer paper should have been accrued and reported by the taxpayer in the year that the paper was sold to the finance company. As to the first prong of the two-part "all events" test, the court held that the taxpayer "acquired a fixed right to receive the participation interest when it sold the consumer paper to the finance companies. While [the taxpayer] could not compel the finance companies to immediately pay over the participation interest, such is not the key to the accrual of income."[147] The taxpayer also contended that the second half of the "all events" test was likewise not satisfied, because the amount of participation interest that would be paid by the finance companies on any particular piece of consumer paper could not be determined with reasonable accuracy. The Tax Court responded by noting that "while the word 'accuracy' means exactness or precision, when modified by the word 'reasonable' it implies something less than an exact or completely accurate amount."[148] All that is necessary is that the amount be accrued "on the basis of a reasonable estimate,"[149] and when the exact amount is determined later upon receipt,

144. The taxpayer's agreement with Advance Mortgage Co. provided that Advance had the right to maintain a "reserve account" to which the participation interest would be credited. Once the reserve account reached certain specified levels, the held-back participation interest would be paid out to the taxpayer over the life of the paper. The purpose of the "reserve account" was to provide Advance with security for the taxpayer's undertaking to repurchase any paper as to which certain warranties proved to be untrue. *Resale Mobile Homes*, 91 T.C. at 1087. The warranties included that the paper complied with federal, state, and local law; that the paper was free of set-offs, defenses, and counterclaims; and that the paper was secured by a valid first lien on the mobile home. The arrangement with Advance provided that once the amount of participation credited to the reserve account exceeded five percent of the outstanding principal amount of the paper, the excess would be payable to the taxpayer. *Id.* at 1089. The record indicated, however, that Advance never exercised its right to maintain a reserve account. *Id.* at 1087-89. No breach of warranty ever occurred. *Id.*

145. *See supra* note 9 and accompanying text.

146. *Resale Mobile Homes*, 91 T.C. at 1093.

147. *Id.* at 1094.

148. *Id.* at 1095.

149. *Id.* In fact, Resale Mobile Homes prepared estimates of the amount of participation income due under the contracts and reflected the accrued amount in income for finan-

"any difference may be included in income or deducted, as appropriate, in the year in which the correct amount is determined."[150] The Tax Court concluded that:

> [T]he amount of deferred finance income payable to [the taxpayer] was capable of *reasonable* estimation at the time of sale of the new consumer paper. The amount of such income could be calculated through amortization tables. . . . We recognize that there my be some variation in the final amounts received by [taxpayer] due to the default of purchasers or other prepayment of the paper. However, this factor alone does not prevent [taxpayer] from accruing the amount estimated. . . . We do not believe that any variance in amount, due to periodic or late payments, would be of such significance as to prevent [taxpayer] from making a reasonable estimate of the amount to be received or that any errors in such estimation would stand incapable of correction in a later year.[151]

D. *The Tenth Circuit's Opinion*

On appeal, the Tenth Circuit Court of Appeals affirmed the determination of the Tax Court.[152] In addressing the first half of the "all events" test, Resale Mobile Homes attempted to distinguish its arrangements with Midland Federal Savings and Loan Association of Denver and Advance Mortgage Co. from the arrangements present in *Hansen* and its progeny. Specifically, the taxpayer argued that in those cases, funds were actually paid into reserve accounts, and the dealers were assured of receiving the money in the reserve funds once they reached a certain level. Resale Mobile Homes contrasted that arrangement with the one employed in the present case, where no payments were made into a reserve account, and the taxpayer would not be contractually entitled to receive any participation interest until the mobile home purchasers actually made payments on the consumer paper. The purchasers' monthly payments were thus argued to be conditions precedent to any right on the part of Resale Mobile Homes to receive any participation interest.

The Tax Court had disposed of this argument by noting that the present arrangement, which reflected a "holding back" of the participation interest until it was actually received by the finance companies, was simply an economic equivalent of the reserve fund approach, and served the same purpose of ensuring that no interest was paid back to the dealer until the finance company was assured of payment.[153] The Tenth Circuit agreed with this analysis, concluding that the presence or absence of reserve accounts made no difference to the outcome.[154] While

cial accounting purposes. The estimates were based upon amortization schedules that assumed all required monthly payments would be made as scheduled. *Id.*

150. *Id.*

151. *Id.*

152. Resale Mobile Homes, Inc. v. Commissioner, 965 F.2d 818 (10th Cir. 1992).

153. *Resale Mobile Homes*, 91 T.C. at 1094.

154. The taxpayer had argued that, although the documents gave Advance Mortgage

the court acknowledged that the taxpayer was required to wait for payment until the finance companies received payment from the mobile home purchasers, this merely created a technical "condition precedent," and in substance the arrangement "is no different from . . . agreements with reserve accounts; [the taxpayer] still will receive participation interest less any amount of interest not actually paid due to prepayment or default."[155] This delay "in reality is an issue of timing and does not make the payment of participation interest less certain or genuinely conditional."[156]

The Tenth Circuit noted that although the exact amounts ultimately paid over to Resale Mobile Homes might vary based upon the timing of receipts by the finance companies, as well as prepayments and defaults, this was no different from the economic effect of the arrangement in *Hansen*. The Court of Appeals thus agreed with the Tax Court that the first half of the "all events" test was satisfied, because:

> [The taxpayer's] right to receive participation interest was firmly established upon sale of the consumer paper to a finance company. The finance company was legally obligated to pay the participation interest to [taxpayer] when it bought the consumer paper. Although the duty of the finance company to make payment was deferred until it received payment from the purchasers, both the mobile home purchasers and the finance companies were obligated to make their respective payments. [The taxpayer] was not required to take any additional action in order to receive the participation interest.[157]

Turning to the second prong of the "all events" test, the Tenth Circuit again agreed with the Tax Court, concluding that the participation interest was susceptible of determination with reasonable accuracy. The court acknowledged that the amount of participation interest on each contract might "vary based on whether mobile home purchasers make their monthly payments on time, early, or late" and that "[c]ertainly

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Co. the option of establishing reserve accounts, Advance never did so, thus taking this case outside the scope of *Hansen*. The Tenth Circuit noted that the presence or absence of reserve accounts "is of no moment" because the "reserve accounts are simply bookkeeping entries, and '[o]n questions concerning the taxability of income, we are to be guided by facts and not by bookkeeping entries.' " *Resale Mobile Homes*, 965 F.2d at 823 (quoting Commissioner v. North Jersey Title Ins. Co., 79 F.2d 492, 493 (3d Cir. 1935)). In any event, the fact that Advance never exercised the right to require the reserve account was "evidence that operation without reserve accounts was in substance no different from operating with reserve accounts from [the taxpayer's] point of view." *Id.*

155. *Id.* at 824. Prior to the tax years in question, the taxpayer and the finance companies had operated under agreements that called for the establishment of reserve accounts, but did not contain any provision for the monthly calculation of participation interest in the manner called for under the current agreements. The prior agreements had been replaced by the current versions in response to the new restrictions placed on the use of the Rule of 78's under Colorado law, see *supra* note 140. During the years that the prior versions of the agreements were in place, Resale Mobile Homes had accrued the participation interest and reported it in its entirely in the year the consumer paper was sold to a finance company, in accordance with *Hansen*.

156. *Resale Mobile Homes*, 965 F.2d at 824.

157. *Id.* at 823.

some payments will be early and others late."[158] However, "on the aggregate [the taxpayer] should be able to reasonably estimate interest amounts in advance."[159]

The Tenth Circuit thus affirmed the Tax Court's conclusion that the "all events" test was satisfied, and that the Commissioner could require Resale Mobile Homes to accrue and currently report all participation interest due over the life of the consumer paper in the year the paper was sold to a finance company. The Commissioner was, therefore, found to be correct it his determination that the procedure used by Resale Mobile Homes to report the participation interest did not "clearly reflect income," and more specifically, that such procedure was an improper application of the accrual method of accounting.

E. *Summary*

The decision in *Resale Mobile Homes* represents yet another example of the courts' willingness to elevate substance over form when attempting to classify transactions for federal income tax purposes. Although there were indeed some differences in the finance company agreements present in *Resale Mobile Homes* and those in *Hansen*, the differences were properly seen to be merely of a technical nature, and not cause for drawing a distinction between the two. *Resale Mobile Homes* is also reflective of the great deference that is paid by the courts to the Commissioner in reviewing determinations by the Commissioner in the tax accounting area. As noted, the Commissioner has broad discretion in determining that an accounting method used by a taxpayer does not "clearly reflect income" or has otherwise been improperly applied,[160] and these determinations are widely honored by the courts.

V. PAYMENTS MADE IN THE CONTEXT OF A CHAPTER 11 REORGANIZATION ARE "INVOLUNTARY" AND CAN BE APPLIED BY THE INTERNAL REVENUE SERVICE AS IT MAY SEE FIT: *IN RE FULLMER*[161]

A. *Background*

It has for some time been the position and practice of the Internal Revenue Service that when a taxpayer makes a "voluntary" payment on a tax liability, the taxpayer may designate how he wants the payment to be applied.[162] The courts agree that a taxpayer can direct how voluntary payments are to be applied.[163] When the payment is "involuntary," however, or if the taxpayer fails to designate how the payment is to be

158. *Id.*
159. *Id.*
160. *See supra* text accompanying note 137.
161. 962 F.2d 1463 (10th Cir. 1992).
162. *See* Rev. Rul. 79-284, 1979-2 C.B. 83.
163. Wood v. United States, 808 F.2d 411, 416 (5th Cir. 1987); O'Dell v. United States, 326 F.2d 451 (10th Cir. 1964).

applied, the Service will allocate the payment as it chooses.[164] In distinguishing between voluntary and involuntary tax payments, the Tax Court, in *Amos v. Commissioner*,[165] described an involuntary payment as "any payment received by agents of the United States as a result of distraint or levy or from a legal proceeding in which the Government is seeking to collect its delinquent taxes or file a claim therefor."[166]

Whether or not payments made by a debtor in the context of a Chapter 11 bankruptcy reorganization are to be considered voluntary or involuntary is a question that has not received a consistent response from the courts. The question usually arises in response to attempts by debtors to designate class seven[167] tax payments, first, to the "trust fund" portion of employment taxes, and then to other taxes, including the "non-trust fund" portion of employment taxes.

Employment taxes generally fall into one of two categories, "trust fund" taxes and "non-trust fund" taxes. Amounts withheld by an employer from an employee's wages, such as the employee's withheld income taxes and the employee's share of social security taxes, are considered to be held by the employer in trust for the government pending their payment over to the Internal Revenue Service.[168] Such taxes are generally referred to as the trust fund portion of employment

164. Muntwyler v. United States, 703 F.2d 1030, 1032 (7th Cir. 1983).

165. 47 T.C. 65 (1966)

166. *Id.* at 69.

167. The priority of certain federal tax liabilities under the Bankruptcy Code may be briefly summarized as follows:

A taxpayer's *prepetition* federal income tax liability is afforded class seven priority in the distribution of the bankruptcy estate if (i) the liability arose in respect of a taxable year that ended on or before the date of the filing of the petition, and the last due date of the return for such year occurred not more that three years immediately before the petition date, (ii) the claim is for a tax assessed within 240 days before the filing date of the petition, with enlargements of that time if an offer in compromise was pending, or (iii) the claim is for certain nondischargeable taxes not assessed prior to the commencement of the case, but still assessable. 11 U.S.C. § 507(a)(7)(A) (1988). Also afforded class seven priority are taxes required to be collected or withheld and paid over, and employment taxes on prepetition compensation earned from the debtor for which a return is last due after three years before the petition filing date. *Id.* §§ 507(a)(7)(C) and (D). Penalties relating to any of the foregoing which compensate for an actual pecuniary loss also receive class seven priority. *Id.* § 507(a)(7)(G).

Claims for *postpetition* federal income taxes incurred by the estate during the period of administration are asserted through a request for payment of administrative expenses. They share the priority afforded to administrative expenses generally, which are entitled to class one priority in the distribution of the estate. *Id.* §§ 503(b)(1) and 507(a)(1). Prepetition taxes, and prepetition taxes only, are excluded from class one priority by virtue of having been relegated to class seven priority. United States v. Redmond, 36 B.R. 932 (Bankr. D. Kan. 1984). Penalties accruing on postpetition debt may also be asserted against the estate as a class one priority. 11 U.S.C. § 503(b)(1)(C). Likewise, interest accruing on such debt receives class one priority. United States v. Cranshaw (*In re* Allied Mechanical Serv., Inc.), 885 F.2d 837, 839 (11th Cir. 1989); United States v. Ledlin (*In re* Mark Anthony Constr., Inc.), 886 F.2d 1101, 1105-06 (9th Cir. 1989); United States v. Friendship College, Inc., 737 F.2d 430, 433 (4th Cir. 1984).

Tax liabilities incurred following confirmation of the plan of reorganization are those of the debtor, not the bankruptcy estate, and generally are not affected by the bankruptcy filing.

168. I.R.C. § 7501(a) (1992).

taxes.[169] The employer's matching share of social security taxes, as well as federal unemployment taxes, constitute the non-trust fund portion.

When a corporation fails to pay its trust fund taxes, the United States Treasury suffers the loss, because the employees from whose wages the amounts were withheld nevertheless are credited in full for the withheld amounts even though they are not paid over to the government. To remedy this situation, section 6672 of the Internal Revenue Code provides that persons who are required to collect, truthfully account for, and pay over any tax — such as the trust fund portion of employment taxes — and who willfully fail to do so, are liable to the government for the full amount of the amounts not collected, accounted for, or paid over.[170] The people determined to be those required to collect, truthfully account for, and pay over the taxes are referred to as "responsible persons." The section 6672 penalty, also known as the "100 percent penalty,"[171] is frequently asserted by the Service when withheld trust fund taxes are left unpaid by a corporation. The penalty is usually assessed against officers, directors, and shareholders of a corporate employer, plus others with check-signing authority.

Voluntary payments made by an employer and designated to be applied to the trust fund portion of employment taxes will be so applied by the Service. However, where the payment is involuntary, or where the taxpayer otherwise fails to request a specific allocation, the Service will allocate employment tax payments to the non-trust fund portion that it would otherwise never collect.[172] This way, the Service maximizes the likelihood that the overall employment tax liability will be satisfied, as the Service remains free to pursue the principals of the corporation for the trust fund portion, in the form of the 100 percent penalty.[173]

As noted, a corporate debtor that is the subject of a Chapter 11 reorganization under the Bankruptcy Code will often attempt to propose a plan of reorganization that, among other things, seeks to apply its class seven tax payments first to the trust fund portion of employment taxes, and then to the non-trust fund portion and other taxes. Its goal in proposing this allocation is to maximize the amount of trust fund taxes

169. Slodov v. United States, 436 U.S. 238, 242-43 (1978).

170. I.R.C. § 6672 (1988).

171. Although these exactions are frequently termed a penalty, such description "does not alter their essential character as taxes." United States v. Sotelo, 436 U.S. 268, 275 (1978).

172. "Once the corporation is out of business, the United States can kiss goodbye any non-trust fund taxes owed it but not paid." United States v. Schroeder, 900 F.2d 1144, 1146 (7th Cir. 1990).

173. It has been held that the pendency of a corporate bankruptcy does not prevent the Service from pursuing the principals of the corporate debtor to collect the 100 percent penalty, as the latter is a "separate and distinct" obligation. United States v. Huckabee Auto Co., 783 F.2d 1546, 1548 (11th Cir. 1986). However, the courts are in disagreement as to whether the Bankruptcy Court has jurisdiction to determine the section 6672 liability of the principals of a corporate debtor, when they themselves are not "debtors" in the bankruptcy. *Compare In re* Brandt-Airflex Corp, 843 F.2d 90 (2d Cir. 1988) *and Huckabee*, 783 F.2d at 1546 *with* Quattrone Accountants, Inc. v. Internal Revenue Service, 895 F.2d 921 (3d Cir. 1990).

that would be paid off in the bankruptcy proceeding for which the debtor's principals might be held personally liable under section 6672 if the reorganization proves unsuccessful.[174]

The questions whether the Bankruptcy Court has equitable jurisdiction to confirm a plan that provides for such an allocation,[175] and whether the debtor otherwise has the right to request such an allocation, have deeply divided the courts. The reported opinions reveal the courts to be in complete disagreement over several important issues bearing on the question, including: (1) whether a Chapter 11 reorganization is "a legal proceeding in which the Government is seeking to collect its delinquent taxes or file a claim therefor;"[176] (2) a proper resolution of the conflicting interests of the "fresh start" policy manifested in the Bankruptcy Code, the tax collection goals reflected in the Internal Revenue Code, and the need to protect innocent creditors; and (3) identifying the "realities of bankruptcy" that impact the question.

Several courts have held tax payments made in the context of a Chapter 11 reorganization to be involuntary. In *In the Matter of Ribs-R-Us, Inc.*,[177] the corporate debtor filed a proposed Chapter 11 plan of reorganization providing that the government's class seven priority tax claims would be paid in full over the statutory maximum six-year period.[178] The plan further provided that all payments in class seven would be applied first to reduce the trust fund portion of the debtor's employment taxes. The Bankruptcy Court confirmed the plan over the government's objection that such payments were involuntary and could be applied by the Service in any manner the Service determined. The Bankruptcy Court disagreed with the government, holding the payments to be voluntary. The district court, relying on the Eleventh Circuit's decision in *In re A & B Heating & Air Conditioning*,[179] affirmed. As discussed

174. The corporate debtor may not obtain a discharge for unpaid trust fund employment taxes. Such taxes are class seven priority obligations, 11 U.S.C. § 507(a)(7)(C) (1988), which are not dischargeable in proceedings under Chapter 11 of the Bankruptcy Code, *id.* § 523(a)(1)(A). The non-trust portion is nondischargeable as well, if the return was last due, including extensions, after three years before the date of the bankruptcy petition. Also nondischargeable are (1) taxes entitled to class two priority (so-called "involuntary gap" claims), *id.*; (2) tax debts with respect to which a return was never filed, *id.* § 523(a)(1)(B)(i); (3) tax debts with respect to which a return was field late, and within two years of the petition, *id.* § 523(a)(1)(B)(ii); and (4) taxes as to which the debtor made a fraudulent return or willfully attempted to evade or defeat the tax, *id.* § 523(a)(1)(C). Penalties that accrue on nondischargeable federal income tax obligations are also nondischargeable. *See id.* § 523(a)(7). Interest on nondischargeable tax obligations is likewise nondischargeable. Bruning v. United States, 376 U.S. 358, 360 (1964); Allen v. Romero, 535 F.2d 618, 623 (10th Cir. 1976).

175. Under the Bankruptcy Code, the Bankruptcy Court is empowered to confirm a plan of reorganization that "include[s] any . . . appropriate provision not inconsistent with the applicable provisions of" the Bankruptcy Code. 11 U.S.C. § 1123(b)(5). *See also id.* § 1129. More generally, the court is empowered to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of" the Bankruptcy Code. *Id.* § 105(a). *See also id.* § 505 (1988 and Supp. III 1992) (granting the Bankruptcy Court the power to determine the validity and amount of taxes).

176. *See supra* text accompanying notes 167-68.

177. 828 F.2d 199 (3d Cir. 1987).

178. 11 U.S.C. § 1129(a)(9)(C) (1988).

179. 823 F.2d 462 (11th Cir. 1987), *vacated and remanded*, 486 U.S. 1002 (1988).

below, the Eleventh Circuit in *A & B Heating & Air Conditioning* held that the allocation question is one best left to judicial determination on a case-by-case basis. On appeal in *Ribs-R-Us*, the Third Circuit reversed the district court, specifically breaking with the Eleventh Circuit and holding that the payments were involuntary. In doing so, the Third Circuit stated its strong preference that the question be determined strictly as "a question of law rather than an issue for the exercise of discretion. A uniform federal rule is preferable so that debtors, creditors, and the Internal Revenue Service will be able to know in advance whether the debtor can make such a designation and guide their decisions accordingly."[180]

The debtor in *Ribs-R-Us* had argued that payments made in the Chapter 11 setting do not fall within the scope of the payments described in the *Amos* definition,[181] in view of the flexibility afforded to reorganizing debtors to propose and implement the amount and timing of payments. The Third Circuit disagreed, holding that, given the broad powers granted to the Bankruptcy Court over the debtor in a Chapter 11 bankruptcy and considering that once a plan of reorganization is confirmed the debtor operates under an express judicial order, the *Amos* standard was met.[182]

The Third Circuit in *Ribs-R-Us* viewed any contrary holding as "inconsistent with the realities of bankruptcy."[183] That reality, according to the Third Circuit, is that:

> [d]ebtors who file under *any* chapter of the bankruptcy code have few, if any, options. As a practical matter, they file bankruptcy because it is a last chance for a relatively ordered financial liquidation or rehabilitation rather that the out-of-control financial debacle facing them on the eve of bankruptcy.[184]

Finally, the debtor in *Ribs-R-Us* argued that certain provisions of the

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180. *Ribs-R-Us*, 828 F.2d at 202. The debtor argued that the success of the reorganization depended on the participation of two of the corporation's principals, who would not be willing to make a proposed cash infusion into the debtor if the trust fund taxes were not extinguished. In response, the Third Circuit pointed out that since the classification of the payment was being determined as a matter of law, the court's decision did not "depend upon whether a particular reorganization could have been effected without permitting the debtor to designate taxes. In any event, the proposed reorganization plan was not contingent upon the court's approval of the designation." *Id.* at 204.

181. Amos v. Commissioner, 47 T.C. 65, 69 (1966). *See supra* text accompanying notes 165-66.

182. *See also In Re* Frost, 47 B.R. 961, 965 (Bankr. D. Kan. 1985):

> In order to determine whether a payment to the IRS is voluntary or involuntary, it must be determined whether or not the payment was received through court or administrative action which resulted in an actual seizure of the property or money. The instant bankruptcy proceeding filed by the debtors is a legal action in which the IRS has filed a claim for delinquent taxes. The payments to be made by the debtors are under the bankruptcy court's jurisdiction and are made pursuant to a plan which must comply with the requirements of the bankruptcy code. Thus, we conclude that payments made by the debtors to the IRS are not voluntary and the IRS has the right to allocate the payments as it sees fit.

183. *Ribs-R-Us*, 828 F.2d at 203.

184. *Id.* at 203 (quoting *In re* Technical Knockout Graphics, Inc., 68 B.R. 463, 469 (Bankr. 9th Cir. 1986) (Volinn, Bankr. J., dissenting)).

Bankruptcy Code evince congressional intent as "essentially subordinat[ing] the federal policy for protection of the revenue [as set forth in 26 U.S.C. § 6672] to the competing federal policy of promoting successful Chapter 11 reorganizations."[185] Discerning no support in the legislative history for this contention, and finding no *specific* authority in the Bankruptcy Code for directing payments in a way that would contravene the policy underlying section 6672, the Third Circuit disagreed.

In *In re Technical Knockout Graphics, Inc.*,[186] prior to filing a Chapter 11 plan of reorganization, the debtor filed a motion seeking permission to make payments to the Service designated to be in reduction of its trust fund liability. The debtor "readily acknowledge[d] that by designating application of the payments first to the trust fund portion of its liability, it [was] attempting to reduce the personal liability of its responsible persons" under section 6672.[187] The government opposed the motion. The Bankruptcy Court granted the motion, and the bankruptcy appellate panel affirmed in a split decision.[188] The government appealed to the Ninth Circuit. In the meantime, the debtor had paid the trust fund portion in full and the plan had been confirmed.

On appeal, the Ninth Circuit acknowledged that "[f]ederal courts have struggled with the voluntary/involuntary distinction in the bankruptcy context and have come to different conclusions."[189] The court went on to reverse the bankruptcy appellate panel, holding that "payments made by a debtor-in-possession after filing a petition for reorganization under Chapter 11, but prior to confirmation of a reorganization plan, are involuntary and the bankruptcy court does not have equitable jurisdiction to order otherwise."[190] The debtor first argued that a bankruptcy proceeding is not the kind of "legal proceeding" contemplated by the *Amos* standard, in that the payments were not due to any enforced collection procedures or the participation of the government in the bankruptcy proceedings. The Ninth Circuit disagreed. After reviewing various provisions of the Bankruptcy Code highlighting the extent of the court's involvement and the nature of the protections afforded to the debtor in a Chapter 11 reorganization, the court concluded that:

> by filing a bankruptcy petition under Chapter 11, TKO used the authority of the court to keep its creditors at bay while it reorganized and regained financial stability. TKO is not free to abuse this system by designating its payments in a way that benefits only its responsible persons, and possibly harms other creditors, including the IRS, without the scrutiny of the court or other creditors.[191]

The debtor also argued that the equity jurisdiction of the Bank-

185. *Id.* at 203.
186. 833 F.2d 797 (9th Cir. 1987).
187. *Id.* at 801.
188. *In re* Technical Knockout Graphics, Inc., 68 B.R. 463 (Bankr. 9th Cir. 1986). *See Ribs-R-Us*, 828 F.2d at 203.
189. *Technical Knockout*, 68 B.R. at 801-02 (footnote omitted).
190. *Id.* at 802.
191. *Id.* at 803.

ruptcy Court authorized it to order that payments be applied first to the trust fund taxes.[192] Again, the Ninth Circuit disagreed, noting that, to the extent that the Bankruptcy Court's order rested on its equitable jurisdiction, "[s]uch a decision is not within the bankruptcy court's equitable jurisdiction" and to allow the bankruptcy court to designate how payments are to be applied as between trust fund and non-trust fund taxes without notice to creditors or court approval "would subvert the Bankruptcy Code."[193] The court thus held that "the IRS is entitled to apply TKO's payments as the IRS sees fit" to preserve the right of the IRS to pursue the responsible persons under section 6672.[194]

Under facts similar to those present in *Ribs-R-Us*, the Bankruptcy Court in *DuCharmes & Co. v. Michigan (In re DuCharmes & Co.)*,[195] confirmed the debtor's Chapter 11 plan of reorganization only after striking out provisions that would have allocated payments first to trust fund taxes. The district court reversed, holding that such payments were voluntary and could be allocated any way the debtor preferred. On appeal, the Sixth Circuit reversed the district court, stating in a brief opinion that "we agree with the Third and Ninth Circuits that payments made to the IRS on pre-petition tax liabilities by a Chapter 11 debtor ought to be considered 'involuntary payments' that may not be allocated to pay the debtor's trust fund liabilities first."[196]

Other courts have held tax payments made in the context of a Chapter 11 proceeding to be voluntary. In *In re A & B Heating & Air Conditioning*,[197] the corporate debtor had proposed a Chapter 11 plan of reorganization that provided for payment of the debtor's federal tax liability over the statutory six-year period, with payments to be first applied to trust fund taxes. It was recognized that "[b]y paying off the trust fund taxes, the corporate president and sole shareholder would be relieved of his separate liability under [section 6672] for these trust fund taxes."[198] The plan was confirmed by the Bankruptcy Court, over the government's objection.[199] The district court affirmed. On appeal, the Elev-

192. The Ninth Circuit pointed out that, in fact, the bankruptcy court had not specifically ordered the Service to apply the payments to the trust fund liability, but rather to apply the payments as the debtor requested. *Id.*

193. *Id.*

194. *Id.*

195. 852 F.2d 194 (6th Cir. 1988).

196. *Id.* at 196.

197. 823 F.2d 462 (11th Cir. 1987), *vacated and remanded for consideration of mootness question*, 486 U.S. 1002 (1988).

198. *Id.* at 463.

199. *In re* A & B Heating & Air Conditioning, 53 B.R. 54 (Bankr. S.D. Fla. 1985). The bankruptcy court stated:

> Court involvement in the context of a Chapter 11 reorganization case is not the type which results in seizure of property or money as in a levy. Unlike a taxpayer faced with a government instituted collection proceeding which may lead ultimately to levy upon the taxpayer's assets, a Chapter 11 debtor enjoys a great latitude in how and if a plan is proposed and thus how and when the IRS will be paid.... The debtor propounding a plan has a number of options with respect to treatment of a claim by the IRS and it is the freedom afforded by theses options which dictates the conclusion that payments to the IRS pursuant to a confirmed Chapter 11 plan of reorganization are voluntary.

enth Circuit Court of Appeals affirmed in turn, holding that "the allocation question in a Chapter 11 case . . . should be left to judicial discretion to be decided on a case-by-case basis."[200]

The Eleventh Circuit acknowledged the conflicting results of prior decisions, describing them as:

> [A] direct result of the conflicting policies behind the Bankruptcy Code and the Internal Revenue Code. On the one hand, Congress, by enacting [section 6672,] intended to impose liability upon corporate officers who allow trust fund taxes to be used for any purpose other that the payment of withheld taxes.
>
> . . . .
>
> On the other hand, Congress has enacted a detailed Bankruptcy Code which sets forth an orderly process by which creditors of a bankrupt entity are entitled to be repaid. In doing so, Congress "has provided bankrupts with extensive protection from their creditors and a reasonable opportunity for rehabilitation not only for their benefit but for that of the public as well." . . . The Code expresses a preference toward reorganization rather then liquidation; a viable reorganization plan typically provides greater payment to creditors while preserving the economic life of the entity.[201]

The Eleventh Circuit found the policy of the Bankruptcy Code to outweigh that of the Internal Revenue Code. That policy, in turn, was undermined by classifying the tax payments as involuntary, which in many cases would be "detrimental to the reorganization plan" because the incentive of the corporate officers to support the plan would be reduced, and "[f]requently, the efforts put forth by these officers during the reorganization is the corporation's only hope for future viability."[202] The Eleventh Circuit concluded that "[p]ermitting the Internal Revenue Service to allocate tax payments in *all* Chapter 11 proceedings runs contrary to" the policies underlying the Bankruptcy Code, and "decline[d] to accept that argument of the IRS that *all* payments made under a Chapter 11 reorganization are involuntary and thus property allocated by the IRS."[203]

Rather than hold the tax payments to be voluntary as a matter of

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Id. at 57.

200. *In re A & B Heating & Air Conditioning*, 823 F.2d at 465, (quoting *In re* B & P Enterprises, Inc., 67 B.R. 179, 183 (Bankr. W.D. Tenn. 1986)).

201. *Id.* at 464-65 (citation omitted).

202. *Id.* at 465. Citing to a law review article, the court noted that:

> If corporate officers are pressured to pay the taxes out of their own pockets, the incentive to continue successful reorganization is reduced, and it becomes more likely that the responsible officers will convert to Chapter 7 liquidation. Under Chapter 7, as in Chapter 11, taxes have priority; the government will be paid in full whether sufficient funds remain for other unsecured creditors or not. The responsible officers are guaranteed that no tax penalty will be assessed against them personally.

Id. (quoting Note, *Bankruptcy Court Jurisdiction and the Power to Enjoin the IRS*, 70 MINN. L. REV. 1279, 1299-1300 (1986)).

203. *Id.* (emphasis added).

law, however, the Eleventh Circuit relied on the equitable jurisdiction of the Bankruptcy Court and held that the allocation question "should be left to judicial discretion to be decided on a case-by-case basis."[204] The court of appeals remanded to the district court "with directions that the bankruptcy court weigh the impact the proposed allocation would have upon the debtor, Internal Revenue Service, and other creditors."[205]

In *In re Lifescape, Inc.*,[206] the Bankruptcy Court for the District of Colorado held employment tax payments made in a Chapter 11 reorganization to be voluntary, concluding that "[t]he fact that payments are made pursuant to a plan which must comply with the requirements of the Bankruptcy Code does not rise to the level of court action equivalent to a levy, judicial order, execution or judicial sale" implicating the *Amos* definition.[207]

In *United States v. Energy Resources Co.*,[208] the question of whether the Bankruptcy Court has the equitable power and jurisdiction to order that payments made under a proposed Chapter 11 plan of reorganization be allocated against the trust fund portion came before the Supreme Court. The case actually consisted of two separate debtors whose appeals were consolidated by the court of appeals. In one of the cases, a plan of reorganization was confirmed by the Bankruptcy Court over the government's objection, providing that tax payments would be applied to extinguish all trust fund taxes prior to the commencement of payment of the non-trust fund portion. The district court affirmed. In the other case, the Service refused to comply with the debtor's request to apply a post-confirmation payment to the trust fund portion. In response, the debtor obtained an order from the Bankruptcy Court directing the Service to so apply the payment. The district court reversed, holding that the Bankruptcy Court did not have the power to do so.

On appeal, the First Circuit Court of Appeals consolidated the cases and accepted the government's contention that the tax payments were involuntary.[209] However, the Court of Appeals went on to hold that, *notwithstanding* the classification of the payments as involuntary, the

204. *Id.* (quoting *In re* B & P Enterprises, Inc., 67 B.R. 179, 183 (Bankr. W.D. Tenn. 1986)). Relying in large part on factors set out in *B & P Enterprises*, the Eleventh Circuit stated that the Bankruptcy Court is to consider the "equitable reasons warranting such allocations" and should look to the history of the debtor; the absence or existence of prebankruptcy collection or enforced collection measures of the Service against the corporation and "responsible persons;" the nature and contents of the Chapter 11 plan (e.g., whether it is a reorganization or a last resort liquidation); the presence, extent, and nature of administrative and/or court action; the presence of pre- or post-bankruptcy agreements between the debtor and the Service; and the existence of exceptional or special circumstances or equitable reasons warranting the allocation. *See B & P Enterprises, Inc.*, 67 B.R. at 184. "Most importantly, the bankruptcy judge should consider whether the proposed plan is merely a stop gap scheme to hold the taxing authorities at bay with little chance that the debtor will fulfill its obligation under the plan." *A & B Heating & Air Conditioning*, 823 F.2d at 466.

205. *A & B Heating & Air Conditioning*, 823 F.2d at 466.

206. 54 B.R. 526 (Bankr. D. Colo. 1985).

207. *Id.* at 529.

208. 495 U.S. 545 (1990).

209. *In re* Energy Resources Co., Inc., 871 F.2d 223 (1st Cir. 1989).

Bankruptcy Court had the authority to order the Service to apply such payments to the trust fund portion of employment taxes if the Bankruptcy Court concluded that this designation was necessary to ensure the success of the reorganization.[210] The First Circuit thus struck a position consistent with that of the Eleventh Circuit, but opposed to that of the Third, Sixth, and Ninth Circuits. Noting this conflict, the Supreme Court granted certiori. The Supreme Court then affirmed the First Circuit Court of Appeals in a brief opinion authored by Mr. Justice White.

After observing that several provisions of the Bankruptcy Code[211] "are consistent with the traditional understanding that bankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships,"[212] the Supreme Court addressed the government's contention that other provisions of the Bankruptcy Code reflect a policy that the Service be paid in full as to the debtor's tax liabilities, and thus impose limitations on the Bankruptcy Court's equity power that had been exceeded in these cases.[213] The government argued that if payments can be allocated first to the trust fund portion, it would be "at risk" for the non-trust fund portions, which cannot be recovered from the responsible persons.[214] On the other hand, if the Service is allowed to apply tax payments to the non-trust fund portion first, it stands a better chance of collecting the entire amount owed because the debt that is not "guaranteed" by responsible persons in the form of the section 6672 penalty will be paid off before the guaranteed portion. The Supreme Court responded by stating that:

> [w]hile this result might be desirable from the Government's standpoint, it is an added protection not specified in the [Bankruptcy] Code itself: whereas the Code gives it the right to be assured that its taxes will be paid in six years, the Government wants an assurance that its taxes will be paid even if the reorganization fails — *i.e.*, even if the bankruptcy court is incorrect in its judgment that the reorganization plan will succeed.[215]

The Supreme Court further noted that the order of the Bankruptcy Court causing payments to be first applied to the trust fund portion does not remove section 6672 from the field of play: "As the Government concedes, § 6672 remains both during and after the corporate Chapter 11 filing as an alternative collection source for trust fund taxes."[216] The Supreme Court thus held that the Bankruptcy Court "may order the IRS to apply tax payments to offset trust fund obligations where it concludes

210. *Id.* at 234.

211. *See supra* note 174.

212. *Energy Resources Co.*, 495 U.S. at 551.

213. The government noted that the Bankruptcy Code affords class seven priority status to the tax claims at issue, see *supra* note 167, and makes them nondischargeable, see *supra* note 173. Moreover, the Bankruptcy Court is required to assure itself that the reorganization plan will succeed, 11 U.S.C. § 1129(a)(11), and therefore, that the Service will in all likelihood collect the tax debt owned. *Energy Resources Co.*, 495 U. S. at 551.

214. *Energy Resources Co.*, 495 U.S. at 551.

215. *Id.* at 549.

216. *Id.* at 551.

that this action is necessary for a reorganization's success."[217]

B. *Facts*

In *In re Fullmer*,[218] the Internal Revenue Service had filed a proof of claim in the taxpayer's Chapter 11 reorganization proceeding. After confirmation of the plan of reorganization, the taxpayer paid the Service the amount of the claim, apparently designating the payment to be applied to his postpetition tax obligations rather than his prepetition tax debt. The Service refused to honor this designation, and applied the payments to the prepetition debt. The Bankruptcy Court sided with the Service, and the district court affirmed.

C. *The Tenth Circuit's Opinion*

On appeal, the Tenth Circuit opted to join the Third,[219] Sixth,[220] and Ninth Circuits[221] and held that payments made by a debtor pursuant to a Chapter 11 proceeding are involuntary. In its brief discussion of the issue, the Tenth Circuit concluded that "[t]o interpret such payments otherwise would be inconsistent with the realities of bankruptcy where a debtor is required to make such payments pursuant to an express judicial order. Thus, we conclude that Mr. Fullmer was not entitled to direct the application of his payments to any particular tax liability."[222] The Service was, therefore, free to apply the payment as it saw fit.

D. *Summary*

Although not arising in the context of a dispute over employment taxes, the *Fullmer* decision would seem to have equal applicability to a debtor's attempts to designate payments against the trust fund portion of employment taxes to which the "100 percent penalty" imposed under section 6672 applies, particularly since the Tenth Circuit, in reaching its decision, relied entirely on the previously discussed cases arising under section 6672 that were decided by the Third, Sixth, and Ninth Circuits. However, the decision of the Supreme Court in *Energy Resources Co.*[223] seems clearly to cast doubt on the rationales expressed by the Third, Sixth, and Ninth Circuits in support of their respective conclusions, and renders those opinions somewhat doubtful authority.

It is to be kept in mind, however, that the Supreme Court in *United States v. Energy Resources Co.* never reached the question of whether a Chapter 11 debtor's tax payments are properly characterized as voluntary or involuntary. There remains a split among the circuits on this

217. *Id.*
218. 962 F.2d 1463 (10th Cir. 1992).
219. *See supra* note 177.
220. *See supra* note 195.
221. *See supra* note 186.
222. *In re Fullmer*, 962 F.2d at 1468.
223. 495 U.S. 545 (1990).

question, with the Third, Sixth, Ninth, and Tenth Circuits viewing such payments as involuntary, and the First and Eleventh Circuits viewing them as voluntary. The Supreme Court *did* hold that the Bankruptcy Court has the power in the exercise of its equitable jurisdiction under the Bankruptcy Code to order that tax payments are to first be applied to the trust fund portion of employment taxes, and to confirm a plan of reorganization that so provides, even if the payments are properly considered involuntary. To the extent that a Chapter 11 debtor in the Tenth Circuit attempts to designate the application of tax payments without the aid of a court order or an express provision in the plan of reorganization supporting such an application, *Fullmer* indicates that the debtor will not be successful. Given the decision of the Tenth Circuit in *Fullmer*, Chapter 11 debtors are well advised to propose plans of reorganization that provide specifically for the allocation of class seven tax payments, first, to the trust fund portion of the debtor's employment tax liability, so as to maximize the possibility that the debtor's "responsible persons" will not find themselves personally liable for the trust fund portion. Payments made outside the context of a confirmed plan of reorganization should be supported by a court order specifying this allocation, if the debtor is still under the jurisdiction of the Bankruptcy Court.

In light of the fact that the Bankruptcy Court will issue orders or confirm plans of reorganizations calling for such a designation of tax payments only in the discretionary exercise of its equitable powers, Chapter 11 debtors in the Tenth Circuit must be prepared to demonstrate that such exercise of equitable jurisdiction is justified under this circumstances. It is likely that factors such as those discussed by the Eleventh Circuit in *In re A & B Heating & Air Conditioning* will influence the Bankruptcy Court's determination.[224] It remains to be seen how much flexibility will be afforded debtors in the Tenth Circuit in proposing allocations of their tax payments.

VI. Summary of Other Cases Decided by the Tenth Circuit in 1992

A. *Some Decisions of Note*

In *Hall v. United States*,[225] the Tenth Circuit ruled that the mitigation provisions of I.R.C. §§ 1311-1314 apply only in the context of the federal income tax, and therefore do not apply to the windfall profit tax.[226] The taxpayers owned a five percent overriding royalty interest in a federal oil and gas lease in Wyoming being operated by Amoco Production Company. In 1986, the Bureau of Land Management of the Department of the Interior reduced the number of the participating acres in the area,

224. *See supra* note 204.
225. 975 F.2d 722 (10th Cir. 1992).
226. The windfall profit tax was set out in I.R.C. §§ 4986 to 4990 prior to its repeal in 1988. *See* § 1941 of the Omnibus Trade and Competition Act of 1988, Pub. L. No. 100-418, 102 Stat. 1107, 1322 (1988).

the effect of which was to reduce the Hall's net revenue interest to 1.923 percent. The reduction of participating acres was made retroactive to 1976. Amoco unilaterally recouped from the Halls the amount of excess royalty payments made to the Halls prior to 1986 based upon the reduction in participating acres, and issued "corrected" Forms 6248, Annual Information Return of Windfall Profit Tax, to the Halls for 1980 thorough 1985. These forms, of course, indicated that as a result of the reduction of participating acres and the Halls' interest therein, the Halls had overpaid their windfall profit tax for each of those years. The taxpayers successfully filed tax refund claims with the Service for each of the years 1983 through 1985. However, as to the years 1980 through 1982, the Service disallowed the Halls' refund claim on the ground that they were barred by the applicable statute of limitations.[227] The Halls, understandably aggrieved at the resulting "whip-saw" being worked upon them by two branches of the federal government, brought suit in district court seeking to invoke the mitigation provisions of sections 1311-1314.[228] The district court allowed the claim, and entered judgment for the Halls in the amount of $72,300. On appeal, however, the Tenth Circuit reversed, concluding that the mitigation provisions do not apply to the windfall profit tax. The court noted that sections 1311-1314, the mitigation provisions, are found in *Subtitle A* of Title 26, U.S.C., which relates solely to *income* taxes. On the other hand, prior to their repeal the windfall profit tax provisions were found in *Subtitle D* of Title 26, U.S.C., which relates to "Miscellaneous Excise Taxes." After reviewing the legislative history of the mitigation provisions, the Tenth Circuit agreed with the government that these relief provisions could not be invoked by the Halls. The *Hall* decision thus puts the Tenth Circuit on record as limiting the mitigation provisions of sections 1311-1314 to the income tax sphere.[229]

In *Pottorf v. United States*,[230] the plaintiffs were shareholders in Pot-

227. I.R.C. § 6511(a) (1988) requires tax refund claims to be filed within two years of the payment of the tax or within three years from the filing of the relevant return, whichever is later.

228. Briefly summarized, the provisions of I.R.C. §§ 1311-1314 are aimed at mitigating the harsh effect of applicable statutes of limitation by recognizing that certain determinations relating to a tax year, such as court determinations or final dispositions of refund claims, may create "errors" such as the double inclusion or exclusion of income or the double allowance or disallowance of deductions or credits in time-barred years. For example, a Tax Court determination that a particular item of income is includable in a given "open" year may create an accounting "error" if the taxpayer had actually included it in a prior "closed" year and paid tax on it. The mitigation provisions of I.R.C. §§ 1311-1314 allow for a correction of the error through certain prescribed adjustments, despite the fact that the prior year is closed by the statute of limitations.

229. *But see* Chertkof v. United States, 676 F.2d 984 (4th Cir. 1982). In *Chertkof*, the Fourth Circuit invoked the mitigation provisions of § 1311-1314 to avoid a taxpayer whipsaw that had both income tax and estate tax implications. *See also* the dissent filed in *Hall* by Judge Garnett Thomas Eisele, Senior District Judge for the District of Arkansas sitting by designation, voicing agreement with the "well-reasoned opinion of the district court in this case" and the reasoning in *Chertkof*. *Hall*, 975 F.2d at 727.

230. Nos. 91-3365, 91-3366, 1992 U.S. App. LEXIS 32797 (10th Cir. Dec. 2, 1992). The decision is reflected in an unpublished Order and Judgement. Such Order has no precedential value and may not be cited or used by any court within the Tenth Circuit,

torf Farms, Inc., a Kansas corporation that forfeited its Articles of Incorporation when it failed to pay applicable state franchise taxes. Following the forfeiture, the Internal Revenue Service filed notices of tax liens against the corporation's real property in the local real property records. When the real property was subsequently condemned, the IRS successfully claimed the condemnation proceeds in a state court proceeding. In this appeal, the shareholders of Pottorf Farms, Inc., argued that once the corporation had lost its charter, title to the corporation's property passed by operation of law to the shareholders, and thus, the IRS's later-filed lien was invalid. The Tenth Circuit Court of Appeals pointed out, however, that under Kansas state law[231] a corporation may continue to act for three years following its dissolution for the purpose of winding up its affairs. Although the corporation had forfeited its Articles of Incorporation, it continued to exist as an entity for the purposes of paying its debts and disposing of its assets. The condemnation proceeds were therefore determined to be the property of the corporation, not the shareholders, and the IRS's lien was held valid.

B. *Bankruptcy*

In *In re Bates*,[232] the debtor filed a Chapter 13 bankruptcy petition. The debtor had owned and operated a Wyoming lumber business as a sole proprietorship. It was determined that the debtor owed the government $61,212.89 in federal employment taxes. Of this amount, $39,714.72 were "trust fund" taxes and $21,498.17 were "non-trust fund" taxes.[233] The IRS perfected its general tax lien[234] for these amounts by filing prepetition notices of lien. The value of debtor's assets available to satisfy this lien amounted to $21,950, leaving the government unsecured as to most of the debt.[235] The debtor presented a Chapter 13 plan that proposed to classify the unpaid trust fund portion as a class two priority claim that would be paid in full, and to classify the remaining, non-trust fund portion as an unsecured claim that would be paid pennies on the dollar. The debtor's presumed goal in proposing this classification was to obtain a discharge for most of the non-trust fund portion. On appeal, the Tenth Circuit affirmed the district court's determination that the trust fund portion was to be classified as a secured claim, and that the non-trust fund portion was to be classified as a class seven priority claim.[236] Due to the fact that priority tax claims in bankruptcy are not dischargeable,[237] the effect of the court's classifica-

except for purposes of establishing the doctrines of law of the case, res judicata, or collateral estoppel. 10th CIR. R. 36.3.

231. KAN. STAT. ANN. § 17-6807 (1988).

232. 974 F.2d 1234 (10th Cir. 1992).

233. *See generally* the discussion of the *Fullmer* case which appears *supra* notes 218-22.

234. *See supra* note 39 and accompanying text.

235. 11 U.S.C. § 506(a) (1988) provides that a claim secured by a lien on property is considered "secured" to the extent of the value of the property, and "unsecured" to the extent the amount of the creditor's interest exceeds the value of the property.

236. *See supra* note 168.

237. *See supra* note 174.

tion was to deny debtor a discharge for any portion of the employment taxes.

In *In re Cassidy, Jr.*,[238] the Tenth Circuit held that the ten percent penalty imposed under I.R.C. § 72(t) on premature withdrawals from pension plans, profit sharing plans, and IRA's[239] is not to be afforded priority under the Bankruptcy Code.[240] The first question addressed by the court was whether the ten percent exaction was a "tax" that could be afforded class seven priority.[241] The court acknowledged that the ten percent exaction is in fact labelled a "tax" under the Internal Revenue Code, but concluded that "Congress' labelling of the section 72(t) exaction as a tax is not determinative of its status for priority in bankruptcy."[242] The court then went on to hold that, in view of the ambiguous legislative history of section 72(t)[243] and the acknowledged purpose of the Bankruptcy Code provisions relating to priorities,[244] the ten percent exaction is properly characterized as a penalty and not a tax, and is not to be afforded priority.[245] The court further concluded that the penalty was not entitled to class seven priority as "compensation for actual pecuniary loss."[246]

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238. 983 F.2d 161 (10th Cir. 1992).

239. I.R.C. § 72(t) (1988).

240. The question whether the 10 percent penalty is dischargeable in bankruptcy is left open. If the penalty is not determined to be imposed in connection with a tax that is nondischargeable, or if the withdrawal occurred more than three years prior to the date of the bankruptcy petition, the penalty would be dischargeable. *See* 11 U.S.C. § 523(a)(7) (1988).

241. 11 U.S.C. § 507(a)(7) (1988) states as follows:

> (a) The following expenses and claims have priority in the following order:
>
> . . . .
>
> (7) Seventh, allowed unsecured claims of governmental units, only to the extent that such claims are for —
>
> (A) a tax on or measure by income or gross receipts.

242. *Cassidy, Jr.*, 983 F.2d at 163. This conclusion places the Tenth Circuit in apparent conflict with the Sixth Circuit, which has indicated its inclination to defer to Congress' designation of a "tax" as such under the Internal Revenue Code. *Id*; *see also* United States v. Mansfield Tire & Rubber Co., 942 F.2d 1055 (6th Cir. 1991).

243. A "tax" has been judicially defined to mean (1) an involuntary pecuniary burden, regardless of name, laid upon individual or property; (2) imposed by, or under authority of the legislature; (3) for public purposes, including the purposes of defraying expenses of government or undertakings authorized by it; (4) under the police or taxing power of the state." *In re* Lorber Industries of California, Inc., 675 F.2d 1062, 1066 (9th Cir. 1982). The Tenth Circuit viewed the application of the third test as problematic. On the one hand, it is possible to divine a "public purpose" underlying section 72(t), in that the exaction could be argued to recapture a measure of tax benefits afforded under the qualified retirement plan rules, and to promote savings. However, the legislative history of section 72(t) was equally susceptible of being read to indicate that the purpose of section 72(t) was simply to penalize early withdrawals. *Cassdy, Jr.*, 983 F.2d at 164.

244. This purpose of allowing priority claims is to compensate for a pecuniary loss actually suffered, and not to afford priority to claims not reflecting a pecuniary loss, as the latter would have the effect of depleting rather than conserving the bankruptcy estate and punish innocent creditors. *See* Matter of Unified Control Systems, Inc., 586 F.2d 1036, 1038 (5th Cir. 1979).

245. *Cassidy, Jr.*, 983 F.2d at 165.

246. *Id.* 11 U.S.C § 507(a)(7)(G) provides class seven priority for any "penalty related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss."

C. *Tax Shelters*

In *Jackson v. Commissioner*,[247] *Nickeson v. Commissioner*,[248] and *Cannon v. Commissioner*,[249] taxpayers were denied deductions for losses incurred in tax shelter transactions found by the Tax Court[250] to have been entered into without a profit motive.[251] In *Jackson*, the taxpayer purchased "territorial distributorships" from U.S. Distributors, Inc., entitling them to distribute the jewelry products of American Gold & Diamond Corporation within designated territories. Based upon their initial investment of $15,000, and the fact that the Jacksons had executed documents obligating them to pay $720,000 on a nonrecourse basis for territorial distribution rights, the Jacksons were encouraged by the tax shelter promoter to deduct $60,000 on their 1982 federal income tax return. Believing the arrangement to be an abusive tax shelter, the Jackson's accountant refused to file the return on this basis, and instead deducted only the Jackson's 1982 out-of-pocket expenditures incurred in acquiring the distribution rights. Relying heavily upon its 1985 opinion in *Moore v. Commissioner*[252] involving the identical tax shelter arrangement, the Tax Court concluded that the arrangement was so lacking in economic substance as to be a sham, and disallowed this deduction.[253] On appeal, the Tenth Circuit agreed with the Tax Court "that the transaction was a sham and that the Jacksons are not entitled to their claimed deductions."[254] Noting that either lack of a profit motive or lack of economic substance can render a transaction a sham,[255] the Tenth Circuit found that various factors supported this conclusion, such as the lack of operating history of the promoting entities and their lack of goodwill, the emphasis placed by the operative documents on the tax benefits represented to be available, the unrealistic financing arrangement, and the fact that there was no demonstrated source of product. As to the profit motive of the taxpayers, the Tenth Circuit determined that the Tax Court was justified in finding that the taxpayers had no genuine expectation of profit, particularly considering the fact that the contract assigned unspecified territories to them[256] and the fact that the Jacksons made no

247. 966 F.2d 598 (10th Cir. 1992).

248. 962 F.2d 973 (10th Cir. 1992).

249. 949 F.2d 345 (10th Cir. 1991).

250. Jackson v. Commissioner, 61 T.C.M. (CCH) 2806 (1991); Cannon v. Commissioner, 59 T.C.M. (CCH) 164 (1990); Brock v. Commissioner, 58 T.C.M. (CCH) 826 (1989), *aff'd sub nom.* Nickeson v. Commissioner, 962 F.2d 973 (10th Cir. 1992).

251. Whether a taxpayer enters into a transaction in pursuit of economic profit is a question of fact. The trial court's findings on that issue are not to be disturbed on appeal unless they are "clearly erroneous." FED. R. CIV. P. 52(a). The Supreme Court has instructed that: "[a] finding is "clearly erroneous" when although there is evidence to support it, the reviewing court on the entire evidence is left with a definite and firm conviction that the mistake has been committed." United States v. United States Gypsum Co., 333 U.S. 364, 395 (1948).

252. 85 T.C. 72 (1985).

253. *Jackson*, 161 T.C.M. (CCH) at 2810.

254. *Jackson*, 966 F.2d at 601.

255. *See* Bohrer v. Commissioner, 945 F.2d 344, 348 n.5 (10th Cir. 1991); Casebeer v. Commissioner, 909 F.2d 1360, 1363 (9th Cir. 1990).

256. *Jackson*, 966 F.2d at 601. The territories were assigned on a lottery basis after the

attempt to research the industry or the companies.

The *Jackson* court cited *Nickeson* as support for its conclusions.[257] In *Nickeson*, the Tax Court had disallowed the taxpayers' deductions under I.R.C. § 174(a) (1988) for research and development expenses incurred in developing an automatic meter reading device.[258] The taxpayers had deducted the amount of money and the face amount of certain promissory notes delivered to George Risk, the promoter of the arrangement and a principal of George Risk Industries, Inc, of Kimball, Nebraska. The offering documents stressed the tax benefits of participating in the arrangement, which included a touted 4-to-1 write-off based on the initial cash investment, but gave no particulars concerning the manner in which the technology was to be developed or any other economic aspects of the project. Recognizing that a taxpayer's entitlement to deductions under section 174 depends upon whether the taxpayer is engaged in a "trade or business,"[259] the Tenth Circuit acknowledged that this required an "initial inquiry into whether the 'activity was undertaken or continued' in good faith, with the dominant hope and intent of realizing a profit, *i.e.*, taxable income, therefrom."[260] Applying various tests, including the nine factors listed in the "hobby loss" regulations under I.R.C. § 183[261] and the so-called *Rose* test,[262] and after reviewing past decisions evaluating the presence or absence of profit motive in research and development programs and related activities,[263] the Tenth Circuit concluded that the taxpayers "did not meet their burden to show they entered the . . . program with a good faith intent to profit; rather, the [arrangement] was 'the naked sale of tax benefits.' "[264]

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investment was made, and the taxpayers seemed unconcerned about which territories were assigned to them. *Id.*

257. *Id.* See also Kubler v. Commissioner, No 90-9019, 1992 U.S. App. LEXIS (10th. Cir. April 24, 1992) (*Nickeson* reasoning applied to deny deductions under I.R.C. § 174 for development of components of variable opacity glass.) The Order and Judgment in *Kubler* was unpublished, *see supra* note 219.

258. Nickeson v. Commissioner, 962 F.2d 973 (10th Cir. 1992).

259. I.R.C. § 174 (1988) allows the taxpayer to deduct "research or experimental expenditures which are paid or incurred by him during the taxable year *in connection with his trade or business as expenses.*" *Id.* (emphasis added).

260. *Nickeson*, 962 F.2d at 976 (citations omitted).

261. I.R.C. § 183 (1988) precludes the deduction of so-called "hobby losses," that is, activities "not engaged in for profit." Treas. Reg. § 1.183-2(b) (1972) outlines nine factors indicative of a good faith intent on the part of the taxpayer to recognize a profit. Paraphrased, the factors are (1) the extent to which the taxpayer carries on the activity in a businesslike manner, (2) the taxpayer's expertise or his reliance on the advice of experts, (3) the time and effort the taxpayer expends in carrying on the activity, (4) the expectation that assets used in the activity may appreciate in value, (5) the taxpayer's success in similar activities, (6) the taxpayer's history of income or loss in the activity, (7) the amount of occasional profits, if any, (8) the taxpayer's financial status, and (9) the elements of personal pleasure or recreation. *Id.*

262. In Rose v. Commissioner, 88 T.C. 386 (1987), *aff'd*, 868 F.2d 851 (6th Cir. 1989), the Tax Court developed a two-step "generic tax shelter" and "economic substance" test to determine the validity of deductions and credits derived from activities where the tax benefit requires that the taxpayer's activities constitute either a trade or business or be undertaken for the production of income, as required by I.R.C. § 162 & 212 (1988).

263. *Nickeson*, 962 F.2d at 977.

264. *Id.* at 977-978 (quoting Brock v. Commissioner, 58 T.C.M. (CCH) 836 (1989)).

Finally, in *Cannon v. Commissioner*,[265] the taxpayer had invested over $800,000 in a Mexican gold and silver mining venture that never turned a profit. The Tax Court agreed with the Commissioner[266] that the expenditures were nondeductible under section 183.[267] On appeal, the Tenth Circuit Court of Appeals[268] reviewed the application of the nine hobby loss factors[269] to the taxpayer's investment activities in Mexico. While it concluded that some of the factors supported the taxpayer and others supported the government, "[t]aking all facts and circumstances into account, we cannot say that the Tax Court's application of the [factors listed in the] Treasury Regulations accompanying section 183 was clearly erroneous."[270]

D. *Enforcement*

In *Long v. United States*,[271] the Tenth Circuit held that the Service did not unlawfully disclose tax information concerning the taxpayers by sending notices of liens and levies to various financial institutions, county recorders, the Colorado Department of Revenue, and the Social Security Administration in an effort to collect a $138,961 jeopardy assessment[272] against the taxpayers. The taxpayer had filed this action against the Service claiming damages arising from the disclosures.[273] The Tenth Circuit held that disclosures made to the Colorado Department of Revenue were statutorily authorized[274] under the Service's written Agreement on Coordination of Tax Administration.[275] Despite the

265. 59 T.C.M. (CCH) 164 (1990), *aff'd*, 949 F.2d 345 (10th Cir. 1991), *cert. denied*, 112 S. Ct. 3030 (1992).

266. *Id.*

267. *Id.* at 170. On appeal, the taxpayer objected to the invocation of I.R.C. § 183 by the Tax Court, because that section had not been explicitly raised or considered by the Service or the taxpayer. According to the taxpayer, only sections 162, 212 and 616 were at issue and had been raised by the parties. The Tenth Circuit disagreed, concluding that section 183 "is interrelated to sections 162 and 212, profit motive being the common underlying theme." Cannon v. Commissioner, 949 F.2d 345, 348 (10th Cir. 1991). "In determining whether the mining activity met the requirements of sections 162 or 212, the court naturally applied section 183. Section 183 is often used in analyzing 'for profit' issues, both in the context of hobby losses and in the context of trade or business expenses." *Id.* Thus, "the Tax Court's application of section 183 was routine and predictable, not extraordinary." *Id.* at 349.

268. *Cannon*, 949 F.2d at 352.

269. *See supra* note 261.

270. *Cannon*, 949 F.2d at 352.

271. 972 F.2d 1174 (10th Cir. 1992).

272. *See* I.R.C. § 6861(a) (1988).

273. I.R.C. § 7431(a)(1) (1988) provides that "[i]f any officer or employee of the United States knowingly, or by reason of negligence, discloses any return or return information with respect to a taxpayer . . . such taxpayer may bring a civil action for damages against the Untied States in a district court of the United States." The confidentiality of return information is protected by I.R.C § 6103(a) (1988).

274. I.R.C. § 6103(d)(1) (1988) authorizes disclosures by the Service to state agencies if certain conditions are satisfied, including that the disclosure be made "only upon written request" of the agency, and only "to the representatives of such agency . . . designated in such written request." *Id.*

275. The IRS has entered into Agreements on Coordination of Tax Administration with each of the fifty states and the District of Columbia. The Agreement is in standard form, and prides, *inter alia*, that "[t]his agreement constitutes the requisite authorization

taxpayer's arguments to the contrary,[276] the court further held that disclosures to financial institutions, county recorders, and the Social Security Administration were clearly authorized under the Internal Revenue Code[277] and the Income Tax Regulations.[278]

In *Diandre v. United States*,[279] the district court held that a Special Agent of the Criminal Investigation Division of the Internal Revenue Service improperly disclosed tax return information concerning the taxpayer and his business. The agent had sent a "circular letter" to the business' banks and customers requesting information concerning transactions between the business and the recipients of the letter. The letter informed the banks and customers that the Service was investigating the taxpayer and the business, and disclosed certain information about the taxpayer, such as his name, address, and status as a director of the company.[280] As a result of the information obtained, summons were subsequently issued to all the banks. The district court held that the information was disclosed in violation of I.R.C. § 6103.[281] On appeal, the Tenth Circuit Court of Appeals reversed the determination of the district court. The major area of disagreement between the parties was

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pursuant to § 6103(d)(1) of the Code for IRS to disclose to, and permit inspection by, an agency representative of Federal returns and Federal return information." *Long*, 972 F.2d at 1178.

276. The taxpayer's arguments essentially amounted to a challenge to the sufficiency of the assessment, and not to the disclosure procedures. The Service produced a certified copy of Form 4340, "Certificate of Assessment and Payments," which was acknowledged by the Tenth Circuit to be "sufficient evidence that an assessment was made in the manner prescribed by § 6203 and Treas. Reg. 301.6203-1," which establish the applicable statutory and regulatory requirements. *Long*, 972 F.2d at 1181. *See supra* note 65.

277. Under I.R.C. § 6103(k)(6) (1988), tax return information may be disclosed in the course of an investigation if three requirements are met: (1) the information sought is "with respect to the correct determination of tax, liability for tax or the amount to be collected, or with respect to the enforcement of another provision" of the Internal Revenue Code, (2) the information sought is "not otherwise reasonably available," and (3) it is necessary to make disclosures of return information in order to obtain the additional information sought.

278. Treas. Reg. § 301.6103(k)(6)-(1)(b)(6) (1980) authorizes disclosures of tax return information when necessary to "establish or verify the financial status or condition and location of the taxpayer whom collection is or may be directed, [and] to locate assets in which the taxpayer has an interest" in connection with "the establishment of liens against . . . assets [in which the taxpayer has an interest], or levy on, or seizure, or sale of, the assets to satisfy [the taxpayer's tax] liability."

279. 968 F.2d 1049 (10th Cir. 1992).

280. The letter stated:

> The Internal Revenue Service is conducting an investigation of Metro Denver Maintenance, Inc., Lakewood, Colorado, for the years 1983 through 1985. Mr. DiAndrea is an officer of Metro Denver Maintenance whose address is 6800 West 6th Avenue, Lakewood, Colorado, 80215.
>
> During the course of our investigation, we noted transactions between you and Metro Denver Maintenance, Inc. and/or Mr. DiAndrea for [the] previously mentioned period. As part of our investigation, we need to verify the purpose of these transactions. Your assistance is needed in determining all payments made to or on behalf of Metro Denver Maintenance, Inc. and/or Mr. DiAndrea for the previously mentioned period. We would appreciate you furnishing the information indicated on Attachment 1, for use in a Federal tax matter.

Id. at 1051. The Attachment referred to "the date, check number, amount and form of all payment(s) . . . made in cash, money order, etc." The Attachment specifically referred to "payments made in the form of cash." *Id.*

281. *See supra* notes 273-78.

whether the requirement of section 6103 that the information be "not otherwise reasonably available" had been satisfied. The court of appeals held that, because the letter requested information about possible cash payments made by the recipients to the taxpayer or his business, and because this information could not reasonably be obtained from any other source, the statutory requirement was met. The court of appeals also admonished that "[t]he district court strayed beyond the parameters of section 6103 when it sought to determine [the agent's] subjective intent and when it concluded that insufficient justification was shown to warrant delving into whether cash payments were made."[282] The court of appeals noted that:

> section 6103 does not provide a vehicle to test the probable cause or any other level of justification to investigate. . . . The plain language of section 6103 does not limit in any way what information the IRS may seek in the course of an investigation. Section 6103 merely imposes certain restriction on the IRS's ability to make disclosures in seeking that information.[283]

In *United States v. Dawes,*[284] the Tenth Circuit joined the Sixth[285] and Ninth[286] Circuits, as well as several district courts,[287] in holding that a taxpayer's conviction for failure to file federal income tax returns is not precluded by the fact that the Treasury Regulations and the instructions accompanying the tax forms do not carry an Office of Management and Budget[288] control number.[289] Donald and Phyllis Dawes had each pled guilty to three counts of willful failure to file federal income tax returns[290] for 1981, 1982, and 1983, but preserved for appeal the question whether the lack of OMB control numbers excused their failure to file. Relying on the reasoning of the other courts that previ-

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282. *DiAndrea*, 968 F.2d at 1053.

283. *Id.*; *see* Barrett v. United States, 795 F.2d 446, 451 (5th Cir. 1986) ("the court does *not* inquire whether the information sought is necessary"); United States v. MacKay, 608 F.2d 830, 832 (10th Cir. 1979) (stating that the Service is not required to have probable cause to issue a summons). On the other hand, the Service must use its summons authority in good faith, and the courts may refuse to enforce a summons if it was issued to harass the taxpayer or if it is unclear or overly broad. United States v. LaSalle National Bank, 437 U.S. 298, 313 (1978); United States v. Powell, 379 U.S. 48, 57 (1964); United States v. Malnik, 489 F.2d 682, 686 n.4 (5th Cir.), *cert. denied*, 419 U.S. 826 (1974).

284. 951 F.2d 1189 (10th Cir. 1991).

285. United States v. Wunder, 919 F.2d 34, 38 (6th Cir. 1990).

286. United States v. Hicks, 947 F.2d 1356, 1358-60 (9th Cir. 1991).

287. *See* United States v. Stiner, 765 F. Supp. 663 (D. Kan. 1991); United States v. Burdett, 768 F. Supp. 409 (E.D.N.Y. 1991); Brewer v. United States, 764 F. Supp. 309 (S.D.N.Y. 1991); United States v. Crocker, 753 F. Supp. 1209, 1214-16 (D. Del. 1991).

288. Hereinafter referred to as the "OMB."

289. Under the Paperwork Reduction Act of 1980, Pub. L. No. 96-511, 94 Stat. 2812 (1980), the OMB is assigned the task to review all federal forms constituting "information collection requests," 44 U.S.C. § 3507 (1988), and assignment of a control number to all forms approved by the OMB. Under the Paperwork Reduction Act, 44 U.S.C. § 3512, "no person shall be subject to any penalty for failing to maintain or provide information to any agency if the information collection request . . . does not display a current control number assigned" by the OMB. The taxpayers had argued that because the Income Tax Regulations and the instructions do not contain OMB control numbers, they could not be penalized for failing to file their income tax returns.

290. *See* I.R.C. § 7203 (1988).

ously addressed the issue,[291] the Tenth Circuit concluded that this argument was without merit.[292]

In *United States v. Gosnell*,[293] the taxpayer transferred all his assets to a purported business trust. The Tenth Circuit determined that "the District Court properly ordered the foreclosure on the government's lien after it determined that the transfer was fraudulent,"[294] and rejected various tax protest claims.[295]

E. *Annual Round-up of Tax Protestors, and Other Matters*

During 1992, the Tenth Circuit Court of Appeals disposed of various tax protestor cases and other matters in a similar vein. These are summarized in the following paragraphs.

In *Fox v. Commissioner*,[296] the court affirmed the dismissal of a Tax Court petition filed by a tax protestor who claimed "that she was 'brainwashed' by one Sy Prog, apparently a tax protestor, into proceeding before the Tax Court in the manner she did,"[297] and now wanted a "second chance to produce evidence in the Tax Court."[298]

In *Pleasant v. Lovell*,[299] members of the National Commodity and Barter Association, a national tax protest organization,[300] sued certain

291. The analysis of each of the courts that has previously addressed the issue has varied, but all the courts have come to the same conclusion. The reasoning has included that the requirement to file a tax return is mandated by statute, not regulation, so the taxpayer was not convicted of violating the regulations, *see* United States v. Wunder, 919 F.2d 34, 38 (6th Cir. 1990); that the explicit statutory requirement to file a tax return places the regulations and instructions beyond the scope of the Paperwork Reduction Act of 1980, United Sates v. Hicks, 947 F.2d 1359 (9th Cir. 1991); and that the regulations and instructions cannot be viewed independently and classified as "information collection requests" as defined by the statute — they are merely subsidiary to the income tax forms, and assist taxpayers in completing the return, *Crocker*, 753 F. Supp. at 1216. The Tenth Circuit was most persuaded by the latter analysis. Form 1040, the personal income tax return form, and its associated forms do carry OMB control numbers.

292. *Dawes*, 951 F.2d 1189. Subsequent 1992 Tenth Circuit cases following *Dawes* include United States v. Jump, No. 91-5183, 1992 U.S. App. LEXIS 27779 (10th Cir. Oct. 19, 1992) and Gassei v. Dep't of Justice, No. 91-6400, 1992 U.S. App. LEXIS 15381 (10th Cir. June 25, 1992).

293. 961 F.2d 1518 (10th Cir. 1992). For other 1992 decisions by the Tenth Circuit relating to fraudulent conveyances, both decided to the same effect, *see* United States v. Jensen, No. 91-4224, 1992 U.S. App. LEXIS 34732 (10th Cir. Dec. 29, 1992) and United States v. Neilson, No. 91-4175, 1992 U.S. App. LEXIS 34823 (10th Cir. Dec. 23, 1992).

294. *Gosnell*, 961 F.2d at 1520.

295. Gosnell's appeal was determined to be frivolous, and sanctions in the amount of $1,500 were awarded to the government. *Gosnell*, 961 F.2d at 1521. *See* Casper v. Commissioner, 805 F.2d 902 (10th Cir. 1986).

296. 969 F.2d 951 (10th Cir. 1992).

297. *Id.* at 952. Fox's petition asserted various claims that the Tenth Circuit acknowledged to be "blatantly frivolous and groundless." *Id.*

298. *Id.*

299. 974 F.2d 1222 (10th Cir. 1992).

300. The National Commodity and Barter Association "is an organization formed in 1979 which 'espouses dissident views on the federal tax system and advocates a return to currency backed by gold and silver.'" United States v. National Commodity & Barter Ass'n, 1990-1 U. S. Tax Cas. (CCH) ¶ 50,284 (quoting Voss v. Bergsgaard, 774 F.2d 402, 405 (10th Cir. 1985)). The NCBA is especially active in the Tenth Circuit. The NCBA has been described as an organization whose members "advocate dissident political views concerning the tax and monetary policy of the United States Government," Kroll v. United

government agents alleging violations of the group members' First Amendment rights to free speech and freedom of association, and Fourth Amendment rights against unreasonable search and seizure.[301] The Tenth Circuit affirmed the district court's dismissal of these claims.[302]

In *Fostvedt v. United States*,[303] the Tenth Circuit affirmed the district court's reliance on the Anti-Injunction Act and the tax exception provision of the Declaratory Judgment Act[304] to dismiss a taxpayer's suit seeking to "declare the actions of the [Service] to be arbitrary, capricious, an abuse of discretion and unconstitutional, and [to] enjoin the agency from further action against"[305] him until the Service complied with his request to submit his grievances to the National Office for technical advice, abate the Notice of Deficiency, and hold an appeals conference. The taxpayer also sought a declaration that the Service violated his constitutional rights by keeping records classifying him as a tax protestor. The court viewed the taxpayer's action as "an attempt to delay and/or prevent the IRS from assessing and collecting the income tax deficiencies and penalties due because of [taxpayer's] failure to file income tax returns for the years in question."[306]

In *United States v. Parsons*,[307] an individual[308] filed false Form 1099's with the Service, reflecting that he had paid taxable compensation to various public and private officials with whom he had disagreements, in an attempt to trigger tax audits or investigations of those individuals.[309]

States, 573 F. Supp. 982, 984 (N.D. Ind. 1983), in response to what the organization "perceives to be an unconstitutional and oppressive monetary and taxation system. The leadership of the NCBA advocates and promotes opposition to federal income tax laws." United States v. Stelten, 867 F.2d 446, 448 (8th Cir. 1989). Among other services, the National Commodity Exchange, which has been described as the "service wing" of the NCBA, is "operated by NCBA members as a private or warehouse bank" which the Service views as a vehicle designed, among other things, to obscure the paper trail surrounding the financial affairs of its members. Aspinall v. United States, 984 F.2d 355 (10th Cir. 1993) (quoting National Commodity & Barter Ass'n v. United States, 951 F.2d 1172, 1173 (10th Cir. 1991)); Heinold Hog Mkt., Inc. v. McCoy, 700 F.2d 611, 612 (10th Cir. 1983). Reported opinions involving the NCBA and its members are legion, numbering in the dozens.

301. In an earlier decision, Pleasant v. Lovell, 876 F.2d 787, 792 (10th Cir. 1989), the Tenth Circuit had reversed in part a grant of summary judgment against the plaintiffs, holding that material issues of fact existed concerning the availability of a qualified immunity defense. On remand, the district court ruled that no constitutional violations had occurred, and alternatively, that qualified immunity protected the government agents. This determination was at issue in the current appeal.

302. Parallel litigation was pursued by the NCBA. *See* National Commodity & Barter Ass'n v. Gibbs, 886 F.2d 1240 (10th Cir. 1989) (remanding to the district court on First and Fourth Amendment claims); National Commodity & Barter Ass'n v. Gibbs, 1992-2 U.S. Tax Cas. (CCH) ¶ 50,334 (D. Colo. 1991) (on remand, dismissing the action).

303. 978 F.2d 1201 (10th Cir. 1992).

304. *See supra* notes 43-44.

305. *Fostvedt*, 978 F.2d at 1202.

306. *Id.* at 1203.

307. 967 F.2d 452 (10th Cir. 1992).

308. Among other things, Parsons was a member of the National Commodity and Barter Association. *See supra* note 300.

309. For other examples of the use of this "strategy," *see* United States v. Olson, No. 91-2109, 1992 U. S. App. LEXIS 7244 (10th Cir. Apr. 14, 1992) (following her conviction

The Tenth Circuit affirmed Parson's conviction on thirteen counts of willfully making a false statement to a United States agency[310] and one count of knowingly making and presenting a false claim.[311]

In *United States v. Cutler,*[312] the taxpayer opened various stock brokerage accounts and undertook substantial trading activity using false names, phone numbers, and social security numbers. Based on the false account information, the brokerage firm prepared and filed Forms 1099-B reflecting the stock transaction information. The Tenth Circuit affirmed Cutler's felony conviction that was based on six counts of aiding and assisting in the preparation or presentation of false documents arising under the internal revenue laws.[313] In *United States v. Payne,*[314] under facts similar to those present in *Cutler*, the taxpayer's conviction for tax evasion[315] and false representation of social security numbers[316] was upheld.

In *Van Skiver v. United States,*[317] a tax protester[318] brought an action alleging wrongful levy and unauthorized disclosure of tax return information, and seeking to quiet title to personal property. After the district court dismissed the action, the Van Skivers filed a self-styled "Motion to Reconsider." Finding no support in the Federal Rules of Evidence to authorize such a motion, and finding various other defects in the motion and the taxpayers' claims, the Tenth Circuit affirmed the dismissal of the action.

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on a minor traffic matter, New Mexico resident filed false 1099's reflecting she had paid over $400,000 in taxable compensation to the municipal judge who presided at her trial and to various jail and police personnel; conviction affirmed); United States v. Hildebrandt, 961 F.2d 116 (8th Cir. 1992) (farmer filed false Form 1099's on various individuals that were connected with the bank seizure of his farm; conviction affirmed); United States v. Citrowske, 951 F.2d 899 (8th Cir. 1991) (farmer filed false Form 1099's on 36 individuals; conviction affirmed).

310. *See* 18 U.S.C. § 1001 (1988).

311. *See id.* § 287.

312. 948 F.2d 691 (10th Cir. 1991).

313. I.R.C. § 7206(2) (1988) makes it a felony to willfully aid or assist in, or procure, counsel, or advise "the preparation or presentation under, or in connection with any matter arising under, the internal revenue laws, of a return, affidavit, claim, or other document, which is fraudulent or is false as to any material matter."

314. 978 F.2d 1177 (10th Cir. 1992).

315. *See* I.R.C. § 7201 (1988).

316. *See* 42 U.S.C. § 408(a)(7)(B) (1991 Supp.).

317. 952 F.2d 1241 (10th Cir. 1991).

318. Raymond and Alma Van Skiver are no strangers to the federal courts. For an example of the bizarre tenor of the Van Skivers' views on the internal revenue laws, see United States v. Van Skiver, 1991-1 U.S. Tax Cas. (CCH) ¶ 50,017 (D. Kan. 1990).