

Fraudulent Conveyances, Alter Egos, Nominees and Other IRS Remedies

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IRC § 3505

- **Lender liability**
- **A third party who pays wages directly for a company which does not also pay the withheld taxes plus interest for that company can be held liable for the taxes due on the payroll. Section 3505(b) imposes liability upon a lender which lends net payroll not the gross amount due for the payroll which would include taxes and interest accrued thereon. [IRC § 3505(b)] A lender cannot be held liable for more than 25% of funds lent to the employer.**

FRAUDULENT CONVEYANCES

- TP attempt to avoid IRS collection measures by conveying their property to a third party or
- “Encumbering” it with purported liens or mortgages

FRAUDULENT CONVEYANCES

- A conveyance is deemed fraudulent when real or personal property is transferred with the object, intent, or result of such transfer being to place it beyond the reach of the transferor's creditors and which operates to prejudice the rights of such creditors. IRM 57(16)0.8211

IRC § 6901

- IRS may assess and collect income, estate and gift taxes from the recipient of a transfer for less than adequate consideration.
- Assessed and collected in the same manner as the taxes that generated the transferee assessment.
- Jeopardy available

Proposal of Liability

- IRS proposes an assessment equal to the lesser of the value of the property received or the amount of taxes due against a transferee by merely sending the party a notice similar to an audit deficiency notice.

State Law

- Liability of the transferee "at law and in equity"
- First, state law may not answer all questions relating to a transferee's liability,
- Second, where a question is not definitively answered by state law, federal law is consulted.
- Third, certain transferee liability issues are not controlled by state law because the supremacy of the federal government prevents the application of state law.
- Federal SOL governs

Example In Equity Liability

- IN 2006 gifts most of his property to his son. In 2007 after the gift the IRS opens an audit TP's 2005 tax return. That audit results in a large deficiency. TP now lacks the funds to pay the taxes.
- IRS may pursue the son if:
 - Transfer takes place after the accrual of tax
 - Transfer left the TP substantially insolvent when the tax obligation is placed on his balance sheet
 - No need for the IRS to show intent.

Other Approaches

- IRC § 6324: estate tax lien
- Bankruptcy fraudulent conveyance actions

Judicial

- A suit to set aside a fraudulent conveyance; or
- A suit to establish transferee liability.

FRAUD IN LAW OR IN EQUITY

- Where the terms of any agreement or the nature of the transaction itself evidence a conclusive presumption in law then the conveyance is fraudulent.
- If there is insufficient consideration for the Debtor's transfer of property (which exists in any transfer to a beneficiary from an estate), even though there is no proof of intent to defraud, it is presumed "fraud in law or in equity," which is fraud that is presumed from the circumstances.

Fraud in Law

- (a) Gift or sale for less than fair market value,
- (b) Then-existing or contemplated indebtedness against the transferor (i.e., accrual of a liability not assessment), and
- (c) Retention of insufficient property by the transferor to pay his indebtedness (insolvency).
- There is no need for the Service to establish an evil motive to assert fraud in law.

EXAMPLE 1

- An example would be a father who transfers most of his assets to a trust for his children and is later audited and assessed with a large deficiency for taxes which had accrued prior to transfer. In such an instance the IRS could attack the trust because the transfer meets the three tests, even though the father had no intent to defraud the IRS.

FRAUD IN FACT

- The IRS must prove an actual intent to defraud when relying upon fraud in fact to set aside a conveyance. Courts will look for "badges of fraud" in making a determination with respect to fraud in fact. Although the badges may amount to little more than suspicious circumstances, they may be used by a court to infer a fraudulent conveyance

Badges of fraud

- **Inadequacy of Consideration**
- **Insolvency of Transferor**
- **Transfer of All or Nearly All of Debtor's Property**
- **Close Relationship Between Parties to the Transfer**
- **Transfer Made in Anticipation of a Tax or During Investigation of a Deficiency**
- **Transaction Not in the Usual Course of Business**
- **Reservation of Any Interest in the Property Transferred**
- **Retention of Possession**
- **Other factors**

TIME OF CONVEYANCE

- In order for the IRS to pursue either a judicial or administrative transferee based on fraud in law, the conveyance must have occurred subsequent to the accrual of a tax liability. If the taxpayer has conveyed property prior to the accrual of the tax, the IRS has no cause of action against the transferee unless it can prove fraud in fact.

Example: Fraud in Fact

- TP is in the middle of an audit and is informed by his EA that he faces a very large deficiency. He arranges for a friend to place a very large mortgage on his home in effort to thwart IRS collection. He has substantial other assets which are not easily seized by the IRS because they are located in Canada. He takes this step of granting a mortgage with the intent to hinder IRS collection.
- IRS may pursue his friend

NOMINEES

- facts show that the taxpayer treats the property as his or her own, a nominee NFTL may be filed. Area Counsel May advise in following circumstances:
 - the taxpayer is paying maintenance expenses,
 - using the property as collateral for loans,
 - paying state and local taxes on the property.

Nominee Liens

- May not file NFTL without the written approval of Area Counsel and RO must.
 - Focus on the conveyance of the title.
 - Requests should be for advice as to the need for a supplemental assessment, a new notice and demand and the language to be incorporated in the NFTL or levy.
 - Prepare a report containing all of the facts of the case to accompany the request.
 - Subsequent enforcement action is at the district's discretion once District Counsel has approved application of the nominee or transferee theory in a case.
 - In determining what additional enforcement action should be taken, consideration much given to the confusion in the chain of title and redemption rights by the taxpayer. These circumstances may depress the sale of the property.
 - A judicial lien foreclosure or seizure followed by suit to foreclose the NFTL will generally bring a greater sale price particularly for real property.
 - The administrative seizure and sale process may be used if prompt action is needed to protect the government's interest. If there is any doubt, request an opinion from District Counsel.

Alter Ego

- IRS might also file a lien alleging that one entity was the alter ego of the other. This can occur in cases when the taxpayer fails to follow corporate formalities with her corporation. For example, if the taxpayer pays personal expenses with corporation assets, she might be found to be the alter ego of the corporation, or visa versa.

Wrongful Levy

- IRS levies person's property to pay taxes of another
- May sue IRS w/I 9 months of levy

Erroneous Seizure

- IRS has occasionally erroneously seized property belonging to others because its employees have failed to accurately check public records to determine legal ownership of the property. Clients of the author have been forced to initiate litigation to prevent sale of their assets to pay liabilities of another taxpayer. The mere threat of such a suit is sufficient, in many instances, to convince the Internal Revenue Service to release an erroneous seizure without the necessity of actually initiating suit. This action is also appropriate if the complaining party holds a partial interest with the taxpayer, i.e. a joint tenant or security interest holder.

- ## Third-party Recovery for Wrongful Seizures
- Prior law, a party could only bring a wrongful levy action pursuant to IRC § 7426(b) which did not provide the same statutory damages and relief as Section 7433.
 - Therefore, the third-party with property wrongfully seized by the Internal Revenue Service had fewer remedies available than the taxpayer who was subject to reckless or intentional disregard of the IRC by an IRS employee. Under the 1998 Act, if in third-party action against the IRS for wrongful levy there is a finding that any officer or employee of the IRS recklessly or intentionally or by reason of negligence disregarded any provision of the IRC,
 - IRS can be held liable for an amount equal to the lesser of one million dollars (\$100,000 in the case of negligence) or the sum of money due under IRC § 7426(h). M
 - ay receive actual, direct economic damages sustained as a proximate result of reckless, or intentional or negligent disregard of any provision of the IRC by an IRS officer, reduced by any amount of damages which would be awarded by IRC § 7426(b), IRC § 7426(h)(1)(A) and the cost of the action.
 - Action must be brought within two years of the occurrence as opposed to the nine months required by the IRC § 7426.

Wrongful Collection Action

- 1998 Act revised IRC § 7433 to allow suits for negligent violation of the Internal Revenue Code in the collection of tax. Prior to this amendment, it had been very difficult for taxpayers to prove that an IRS employee had intentionally or recklessly disregarded the Code.
- **EXAMPLE.** A Revenue Officer seizes a business premises without the prior consent of the owner or a writ of entry issued by a Federal court. The Revenue Officer may be guilty of reckless conduct for failing to follow proper procedures in seizing taxpayer's business premises.

FIDUCIARY LIABILITY

- IRS has the right to personally pursue trustees, executors and other fiduciaries who fail to pay taxes due from a trust or estate. [31 U.S.C.A. § 3713]
- IRS may pursue such fiduciaries administratively if the unpaid liability is for income, estate or gift taxes. [IRC § 6901] The Internal Revenue Code broadly defines fiduciary as follows:
- **Fiduciary**— The term 'fiduciary' means a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any person. [IRC §7701(a)(6)]

Class of Fiduciaries

- Liability of not only executors and personal representatives of a debtor but
- Also court-appointed agents such as liquidating receivers or distributing agents.
- All of these, if in fact given possession and control of the debtor's assets, are charged with the payment of the debtor's obligations, and if there is sufficient notice of the government's claim, they are bound in distributing the assets of any insolvent."

Knowledge of Tax Liability

- A fiduciary may be held liable even though she did not receive any benefit from the estate that she was administering.
- Liability is limited to the extent of the payments of debts which were preferred over those of the United States, or to the amount of taxes remaining due the United States, whichever is lesser.

LIABILITY OF SURETIES

- Performance bonds must guarantee payment of federal payroll taxes if they are entered into pursuant to invitations to bid after June 30, 1967. [40 U.S.C.A. § 270a(d)]
- In order to impose this liability IRS must initiate a civil suit to enforce the obligations under the performance bond.
- SOL for commencing the suit is one year after notice of the unpaid tax liability is given to the surety.
- Normally, prior to initiating such a lawsuit, the IRS will send a demand letter to the bonding company.
- Even though the bonding company may later sue your client, an obligation to a bonding company is dischargeable, and the Trust Fund Recovery Penalty is not dischargeable, in bankruptcy.