

# Federal Taxation

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## I. INTRODUCTION

This Article surveys the limited number of significant federal tax cases decided by courts in the Eleventh Circuit in 2009.<sup>1</sup> In *Commissioner v. Neal*,<sup>2</sup> the United States Court of Appeals for the Eleventh Circuit became the first circuit court of appeals to examine whether the United States Tax Court was required to conduct a trial de novo when a taxpayer appealed the Internal Revenue Service's denial of relief under I.R.C. § 6015.<sup>3</sup> In *Nero Trading, LLC v. United States*,<sup>4</sup> the Eleventh Circuit addressed the nature of the hearing a district court must provide to a taxpayer who challenges a summons from the Service before the district court may enforce such a summons.<sup>5</sup> In *United States v. UBS AG*,<sup>6</sup> the United States District Court for the Southern District of Florida denied a motion by the Swiss bank UBS AG in the ongoing controversy surrounding the United States government's efforts to force the bank to release the names of account holders suspected of tax evasion.<sup>7</sup> In *United States v. Klohn*,<sup>8</sup> the United States District Court

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1. For analysis of Eleventh Circuit federal taxation law during the prior survey period, see Dustin M. Covello, Jacquelyn L. Griffin & Svetoslav S. Minkov, *Federal Taxation, 2008 Eleventh Circuit Survey*, 60 MERCER L. REV. 1235 (2009).

2. 557 F.3d 1262 (11th Cir. 2009).

3. I.R.C. § 6015 (2006); see *Neal*, 557 F.3d 1263.

4. 570 F.3d 1244 (11th Cir. 2009).

5. *Id.* at 1245.

6. No. 09-20423-CIV, 2009 WL 2241122 (S.D. Fla. July 7, 2009).

7. *Id.* at \*1-2.

8. No. 3:06-cv-222-J-TEM, 2009 WL 536520 (M.D. Fla. Mar. 3, 2009).

for the Middle District of Florida addressed the period within which a taxpayer may claim a credit or refund of an overpayment of tax.<sup>9</sup> The case of *In re Willis*<sup>10</sup> involved whether an individual's actions with respect to his individual retirement accounts (IRAs) disqualified the IRAs from bankruptcy exemption.<sup>11</sup>

## II. ELEVENTH CIRCUIT COURT CASES

### A. *Commissioner v. Neal*

In *Commissioner v. Neal*,<sup>12</sup> the Eleventh Circuit considered the following question: When a taxpayer appeals a decision by the Service to deny that taxpayer equitable relief under I.R.C. § 6015(f),<sup>13</sup> must the Tax Court conduct a trial de novo, or is it limited to considering only the evidence included in the administrative record developed during the Service's examination?<sup>14</sup> *Neal* involved a spousal conflict between Alimam and Ruth Neal. The Neals kept their finances largely separate; they had separate checking accounts, and they did not often discuss their financial affairs with each other. Ruth and Alimam each paid half of their monthly mortgage payment, Ruth paid most of the family's expenses, and Alimam paid the housekeeper, utility bills, and car payments. Despite Ruth's requests, Alimam refused to answer her questions about the financial aspects of his business or allow her to participate in the filing of the couple's joint federal income tax returns.<sup>15</sup> She gave her W-2 forms to Alimam, and Alimam's accountant prepared the returns. Ruth never looked at the completed tax returns and never spoke to the accountant.<sup>16</sup>

As it turned out, Alimam had not paid taxes attributable to his income. Though income taxes had been withheld from Ruth's own salary, none of the taxes attributable to Alimam's business were paid. Ruth finally learned that the couple owed taxes when she and her husband sought bankruptcy protection in 1989. The bankruptcy hearings revealed that Alimam had secretly purchased a boat, a Colorado villa, at least six cars, and expensive fine art. After an audit

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9. *Id.* at \*5-6.

10. No. 07-11010-BKC-PGH, 2009 WL 2424548 (Bankr. S.D. Fla. Aug. 6, 2009), *aff'd sub nom.* Willis v. Menotte, No. 09-82303-CIV, 2010 WL 1408343 (S.D. Fla. Apr. 6, 2010).

11. *Id.* at \*1.

12. 557 F.3d 1262 (11th Cir. 2009).

13. I.R.C. § 6015(f) (2006).

14. *See Neal*, 557 F.3d at 1263.

15. *Id.* at 1265-66.

16. *Id.* at 1266.

of the couple's 1990, 1991, and 1992 returns, a second declaration of bankruptcy in 1995, and a second garnishment of her wages in 1996, Ruth began to investigate the reasons underlying the couple's financial problems. She eventually discovered that Alimam had been supporting another woman who bore his child and that his share of the tax liability was channeled to his secret life and the support of his second family.<sup>17</sup>

The couple divorced in 1998, and the divorce court ordered Alimam to "pay all past and future tax liabilities incurred by the couple during their marriage."<sup>18</sup> He failed to do so. The Service turned to Ruth, seeking to collect the unpaid tax liabilities from her. The total amount in controversy, exclusive of interest and penalties, was \$278,996.<sup>19</sup>

Since 1938 the tax law has provided that spouses who file joint returns are generally jointly and severally liable for the taxes associated with the returns.<sup>20</sup> In 1961, when the United States Supreme Court held that embezzled funds constitute income,<sup>21</sup> the Service began holding the spouses of insolvent embezzlers jointly and severally liable for the taxes associated with the embezzler's ill-gotten gains.<sup>22</sup> The Service continued to hold this position even in circumstances in which the non-offending spouse was unaware of and did not benefit from the embezzled funds.<sup>23</sup>

In 1971 Congress, dissatisfied with this result, enacted I.R.C. § 6013(e).<sup>24</sup> This exception relieved an innocent spouse from joint and several liability when (1) an understatement was due to the other spouse's fraud, (2) the innocent spouse did not know and had no reason to know of the understatement, and (3) it was inequitable in light of all the facts and circumstances (particularly whether the innocent spouse benefitted from the other spouse's concealed income) to hold the innocent

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17. *Id.* at 1266–67.

18. *Id.* at 1267.

19. *Id.* at 1263.

20. *See* Revenue Act of 1938, Pub. L. No. 75-554, § 51(b), 52 Stat. 447, 476 (codified as amended at I.R.C. § 6013(d)(3) (2006)).

21. *See* *James v. United States*, 366 U.S. 213, 219 (1961).

22. *See* *Scudder v. United States*, 410 F.2d 686, 688 (6th Cir. 1969); *Davenport v. Comm'r*, 48 T.C. 921, 926–27 (1967).

23. *See, e.g.,* *Huelsman v. Comm'r*, 416 F.2d 477, 478, 481 (6th Cir. 1969) (reversing and remanding the Tax Court's decision that a wife was liable for her husband's income tax deficiencies when the wife was unaware that her husband had embezzled money); *Horn v. Comm'r*, 387 F.2d 621, 622 (5th Cir. 1967) (affirming the Tax Court's holding that a wife who had no knowledge of her husband's embezzlement was nevertheless liable for her husband's tax obligations).

24. *See* Innocent Spouse Act of 1971, Pub. L. No. 91-679, 84 Stat. 2063.

spouse liable for the other spouse's tax liability.<sup>25</sup> In 1998 Congress decided that these requirements were overly technical.<sup>26</sup> Therefore, Congress enacted I.R.C. § 6015(f).<sup>27</sup> Section 6015(f) authorizes the Service to grant equitable relief to a taxpayer if it would be inequitable to hold that taxpayer liable for any unpaid tax and relief would not otherwise be available under § 6015.<sup>28</sup> If the Service denies equitable relief, I.R.C. § 6015(e)<sup>29</sup> allows the taxpayer to petition the Tax Court to determine the appropriate relief.<sup>30</sup>

Ruth followed this course. Pursuant to § 6015(f), Ruth petitioned the Service for equitable relief from joint and several liability for the portion of the couple's tax attributable to Alimam's unpaid income tax. Her petition was denied by an examining agent the following year. An appeal to the IRS Office of Appeals was also unsuccessful. In 2003 the Office echoed the examining agent's conclusions and denied her request for equitable relief.<sup>31</sup>

Ruth then petitioned the Tax Court pursuant to I.R.C. § 6015(e). In her Tax Court case, Ruth sought to introduce new evidence concerning the degree of economic hardship she would suffer if she paid the tax. The Service argued that this evidence was inadmissible because the Tax Court's review was limited to the administrative record.<sup>32</sup> The Tax Court held for Ruth, stating that its "review and determination was not

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25. *Id.* Section 6013(e) was the predecessor to current I.R.C. § 6015(b). *See* I.R.C. § 6015(b) (2006).

26. *See* H.R. REP. NO. 105-599, at 254 (1998) (Conf. Rep.) ("The Committee is concerned that the innocent spouse provisions of present law are inadequate. The Committee believes it is inappropriate to limit innocent spouse relief only to [cases that met section 6015(b) as it then existed].").

27. Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, § 3201(a), 112 Stat. 685, 739 (codified at I.R.C. § 6015(f) (2006)).

28. I.R.C. § 6015(f). Specifically, relief must not be available under either § 6015(b) or § 6015(c). *Id.* The parties in *Neal* agreed that relief was not available to Ruth under either of those sections. 557 F.3d at 1265.

29. I.R.C. § 6015(e) (2006).

30. *Id.*

31. *Neal*, 557 F.3d at 1267. The examining agent had denied relief to Ruth on the grounds that she knew the taxes on her joint returns had been underpaid when she signed the returns, she would not suffer economic hardship if required to pay back taxes, and because Ruth was responsible for a portion of the unpaid taxes. *Id.* The Office of Appeals found that Ruth knew about the underpayment of taxes on her joint returns because the Service had been involved in the couple's prior bankruptcy actions and in Ruth's wage garnishments. *Id.* The Office also found that denying Ruth equitable relief would not cause her to suffer economic hardship because the salary and child support payments she received indicated that she "enjoy[ed] an upper middle income standard of living." *Id.* (alteration in original) (internal quotation marks omitted).

32. *Id.* at 1267-68.

limited to the administrative record but was de novo.”<sup>33</sup> Therefore, the Tax Court allowed the parties to introduce testimony and other evidence from outside of the administrative record. To prevail in a trial de novo, Ruth had to show that the Service had abused its discretion in denying her equitable relief.<sup>34</sup>

Ruth made that showing. After hearing the evidence, the Tax Court found that she did not have knowledge of the unpaid taxes, that the facts were inconclusive as to whether she would suffer economic hardship if she were denied relief, and that, taking into account all the facts and circumstances, it would be inequitable to hold her liable for the tax.<sup>35</sup>

The Service timely appealed to the Eleventh Circuit, arguing that the Tax Court had erred in conducting a trial de novo. The Service contended that the Tax Court was confined to considering only the evidence contained in the administrative record.<sup>36</sup>

The Tax Court had considered this issue twice before. In 2004 in *Ewing v. Commissioner*,<sup>37</sup> the Tax Court held that it could conduct a trial de novo when reviewing a denial of equitable relief.<sup>38</sup> Four years later, the Tax Court reaffirmed that holding in *Porter v. Commissioner*.<sup>39</sup>

The *Neal* case, however, presented this question to a United States court of appeals for the first time. The court began by analyzing the Tax Court’s reasoning in *Ewing* and *Porter*. It noted that in those cases, the Tax Court focused on the statutory language in § 6015(e) and § 6015(f).<sup>40</sup> Section 6015(e) permits the taxpayer to “petition the Tax Court . . . to determine the appropriate relief available to the individual.”<sup>41</sup> The Court reiterated the conclusion in *Ewing* that a de novo review “gives effect to the congressional mandate . . . that we *determine* whether a taxpayer is entitled to relief under section 6015.”<sup>42</sup> The court then turned to the Tax Court’s reasoning in *Porter* that reviews of § 6015(e) petitions should be conducted de novo because § 6015(e) uses language

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33. *Id.* at 1268 (emphasis omitted).

34. *Id.*

35. *Id.*

36. *Id.* at 1268–70.

37. 122 T.C. 32 (2004), *rev’d on other grounds*, 439 F.3d 1009 (9th Cir. 2006).

38. *Id.* at 40–41.

39. 130 T.C. 115, 122–23 (2008).

40. *Neal*, 557 F.3d at 1270.

41. I.R.C. § 6015(e)(1)(A).

42. *Neal*, 557 F.3d at 1270 (emphasis added) (internal quotation marks omitted) (quoting *Ewing*, 122 T.C. at 43).

similar to that in I.R.C. § 6213<sup>43</sup> and I.R.C. § 6214,<sup>44</sup> and the Tax Court has long reviewed petitions under those sections de novo.<sup>45</sup>

The court noted that there are other situations in which de novo determinations are appropriate. For example, under I.R.C. § 7436(a),<sup>46</sup> the Tax Court can “determine” whether the Service correctly determined an individual’s employment status.<sup>47</sup> Section 6404<sup>48</sup> additionally authorizes the Tax Court to “determine” whether the Service has abused its discretion when it has refused to abate interest.<sup>49</sup> In both instances, the Tax Court’s practice has been to make its determination de novo.<sup>50</sup> Accordingly, the court held that when the Tax Court is asked to make a “determination,” as it is under § 6015(f), de novo review is appropriate.<sup>51</sup>

The court then turned its attention to the Service’s argument that the record rule of the Administrative Procedure Act of 1946 (APA)<sup>52</sup> generally limits a court’s review of an agency decision to the administrative record.<sup>53</sup> The court noted, however, that by its own terms the APA does not limit or repeal other requirements imposed by statute or otherwise recognized by law.<sup>54</sup> The predecessors to the Tax Court had a well-established practice of conducting determinations and redeterminations de novo in deficiency determinations prior to the enactment of the APA in 1946.<sup>55</sup> According to the court, the fact that § 6015(e) was enacted in 1998, well after the passage of the APA, was irrelevant because § 6015 is “part and parcel” of the statutory framework that permitted de novo review of deficiency determinations in the pre-APA era.<sup>56</sup> Accordingly, the record rule did not apply.<sup>57</sup>

Moreover, the court endorsed the Tax Court’s argument in *Ewing* and *Porter* that confining appeals in equitable relief cases to a review of the administrative record would result in inconsistent levels of review for

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43. I.R.C. § 6213 (2006).

44. I.R.C. § 6214 (2006).

45. *Neal*, 557 F.3d at 1271 (citing *Porter*, 130 T.C. at 119).

46. I.R.C. § 7436(a) (2006).

47. *Neal*, 557 F.3d at 1270–71 (citing I.R.C. § 7436(a)).

48. I.R.C. § 6404 (2006).

49. *Neal*, 557 F.3d at 1271 (citing I.R.C. § 6404).

50. *Id.*

51. *Id.*

52. 5 U.S.C. §§ 551–559, 701–706 (2006).

53. *Neal*, 557 F.3d at 1273; see also 5 U.S.C. § 706(2).

54. *Neal*, 557 F.3d at 1273.

55. *Id.* (citing *Porter*, 130 T.C. at 121–22; *Ewing*, 122 T.C. at 52 (Thornton, J., concurring)).

56. *Id.* at 1273.

57. *Id.* at 1273–74.

similar cases.<sup>58</sup> The Tax Court provided three examples of equitable relief cases in which a trial de novo is held.<sup>59</sup> First, if the Service fails to consider an equitable relief petition under section 6015(f) within six months, a taxpayer may petition the Tax Court, in which case the Tax Court conducts a trial de novo.<sup>60</sup> Likewise, in deficiency cases, the Tax Court holds a trial de novo if a taxpayer raises equitable spouse relief as an affirmative defense.<sup>61</sup> In both of these cases, the Tax Court necessarily conducts a trial de novo because there is no administrative record.<sup>62</sup> Similarly, after a taxpayer petitions the Tax Court for equitable relief, § 6015(e) explicitly gives that taxpayer's spouse the right to intervene and become a party to the case.<sup>63</sup> The Eleventh Circuit noted the Tax Court's reasoning in *Ewing* and *Porter* that such a right to intervene suggests that Congress intended the Tax Court to conduct trials de novo to allow intervening spouses to offer evidence to challenge the taxpayer's entitlement to equitable relief.<sup>64</sup> The court indicated that it would be inconsistent to conduct de novo trials in these situations but not to do so in Ruth's case.<sup>65</sup>

Finally, the court addressed the Service's argument that *Robinette v. Commissioner*<sup>66</sup> limited the Tax Court's review to the evidence in the administrative record.<sup>67</sup> Before the Service can levy a taxpayer's property to satisfy unpaid taxes, I.R.C. § 6330<sup>68</sup> provides the taxpayer with the right to a hearing with the IRS Office of Appeals and the right to appeal the outcome of that hearing to the Tax Court.<sup>69</sup> In *Robinette* the United States Court of Appeals for the Eighth Circuit held that the Tax Court's review in such cases was limited to the evidence in the administrative record.<sup>70</sup> But the court in *Neal* reasoned that § 6330 provides the right to an "appeal," while § 6015 authorizes the Tax Court to "determine" the appropriate relief.<sup>71</sup> According to the court, "this

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58. *Id.* at 1272.

59. *See id.*

60. *Id.* (citing I.R.C. § 6015(e)(1)(A)(i)(II)).

61. *Id.*

62. *Id.*

63. *Id.* at 1273 (citing I.R.C. § 6015(e)(4); *Porter*, 130 T.C. at 125; *Ewing*, 122 T.C. at 42–43).

64. *Id.* (citing *Porter*, 130 T.C. at 125; *Ewing*, 122 T.C. at 43).

65. *See id.* (noting that identical issues should be treated similarly when heard by a single tribunal).

66. 439 F.3d 455 (8th Cir. 2006).

67. *Neal*, 557 F.3d at 1275–76 (citing *Robinette*, 439 F.3d at 461).

68. I.R.C. § 6330 (2006).

69. *Id.*

70. 439 F.3d at 460, 464.

71. *Neal*, 557 F.3d at 1276.

showed that Congress knew how to use the term ‘appeal’ and that Congress meant something different when it authorized the Tax Court in § 6015(e) ‘to determine the appropriate relief available’ to a taxpayer.<sup>72</sup> Accordingly, the court determined that *Robinette* was in fact consistent with its reading of § 6015.<sup>73</sup> For these reasons, the court held that the Service had not shown that the Tax Court erred by conducting a trial de novo.<sup>74</sup>

The court then addressed the Service’s alternative contention that the Tax Court still erred in finding, even under de novo review, that the Service had abused its discretion when it denied Ruth equitable relief.<sup>75</sup> The court noted that “Section 6015(f) expressly authorizes the Commissioner to prescribe procedures for determining qualification for equitable relief.”<sup>76</sup> Relief is generally granted if (1) the couple is divorced or separated, (2) the spouse seeking relief did not know and had no reason to know of the underpayment of taxes, and (3) the spouse will suffer economic hardship if relief is not granted.<sup>77</sup> Various additional factors can be considered, including whether the spouse seeking relief has suffered abuse at the hands of the non-requesting spouse and whether the liability for taxes is attributable solely to the non-requesting spouse.<sup>78</sup> The court considered these factors as they related to Ruth’s situation and concluded that the Tax Court had not abused its discretion in providing her with equitable relief.<sup>79</sup>

A substantial dissent was offered by Judge Tjoflat.<sup>80</sup> He principally argued that the majority’s decision “supplant[ed] the scope and standard of review set forth in the [APA]” and that the plain language of § 6015(f) and the Tax Court’s past actions relating to the provision did not support the majority’s conclusion.<sup>81</sup> Accordingly, he argued that the Tax Court’s judgment should have been vacated and remanded, and he would have instructed the Tax Court to limit its review to the administrative record.<sup>82</sup>

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72. *Id.* (quoting I.R.C. § 6015(e)).

73. *Id.*

74. *Id.*

75. *Id.*

76. *Id.*

77. *Id.* (citing Rev. Proc. 2000-15, 2000-1 C.B. 447, at § 4.03).

78. *Id.* at 1276 n.19.

79. *Id.* at 1278.

80. *Id.* (Tjoflat, J., dissenting).

81. *Id.*

82. *Id.*

Judge Tjoflat argued that the Code does not exclusively reference de novo review when it uses the word *determine*.<sup>83</sup> For example, according to Congress's explicit limitation, the Tax Court limits its review to the administrative record when declaring retirement benefits despite the prevalence of the word *determination* in that section's legislative history.<sup>84</sup> Further, in sections on personal holding company taxes, deficiency dividends, and mitigation of tax returns, Congress does not specify the use of de novo review and defines the word *determination* as a "decision by the Tax Court . . . which has become final."<sup>85</sup> For these reasons, Judge Tjoflat argued that the taxpayer's right to petition the Tax Court to "determine" appropriate relief pursuant to § 6015(e)(1)(A) does not imply a right to de novo review.<sup>86</sup>

Judge Tjoflat also took issue with the majority's interpretation of the APA and its relation to the historical practices of the Tax Court.<sup>87</sup> He wrote, "It is a fundamental tenet of administrative law that a court is ordinarily limited to consideration of the decision of the agency . . . and of the evidence on which it was based."<sup>88</sup> He recognized that it is true "that the enactment of the APA did not 'limit or repeal additional requirements' of administrative procedure authorized by statute or by common law."<sup>89</sup> He also generally recognized that certain of the Tax Court's trial de novo procedures for reviewing deficiency determinations by the Service were well-established before the enactment of the APA, and therefore, the Tax Court was not subject to the APA in certain respects.<sup>90</sup>

It was not clear to Judge Tjoflat, however, that § 6015 was "part and parcel" of the procedures for reviewing deficiency determinations by the Service in the pre-APA era.<sup>91</sup> Judge Tjoflat argued that because § 6015 was enacted well after the APA, a petitioner is not exempt from the

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83. *Id.* at 1280.

84. *Id.* at 1280–81.

85. *Id.* at 1280 (quoting I.R.C. § 547(c) (2006); I.R.C. § 860(e) (2006); I.R.C. § 1313(a) (2006)).

86. *Id.* at 1281.

87. *See id.*

88. *Id.* at 1278–79 (alteration in original) (quoting *United States v. Vianchi*, 373 U.S. 709, 714–15 (1963)). Judge Tjoflat argued that de novo review of adjudicative decision is permitted only in those situations in which the agency uses inadequate factfinding procedures. *Id.* at 1279. Because Ruth had the opportunity to provide information to the examining agent and discuss her claim with that agent, Judge Tjoflat argued that the procedures provided to her were sufficient. *Id.*

89. *Id.* at 1281 (quoting 5 U.S.C. § 559 (2006); *Dickinson v. Zurko*, 527 U.S. 150, 150 (1999)).

90. *Id.* at 1283.

91. *See id.* at 1285.

APA's requirements unless he or she shows that an exemption exists according to the text of the statute and the statute's legislative history.<sup>92</sup> He did not think Ruth had made that showing.<sup>93</sup> He wrote:

I do not deny the possibility that Congress may have intended that the Tax Court continue reviewing all matters in which it is granted jurisdiction using an abuse of discretion standard and de novo scope of review. But, a mere possibility is not sufficient to overwhelm Congressional interest in preserving uniformity and fairness in administrative procedure.<sup>94</sup>

Judge Tjoflat also said that it was not problematic to apply a different standard of review in different types of equitable relief cases.<sup>95</sup> In cases such as *Neal*, there is a well-developed administrative record, whereas in the other types of equitable relief cases noted by the majority, no sufficient administrative record exists.<sup>96</sup> Last, Judge Tjoflat argued that allowing a trial de novo increases the risk that the Service, no longer the final arbiter of the facts, will not conduct an impartial review and develop an impartial administrative record.<sup>97</sup>

One commentator has argued that the majority's position is consistent with Congress's intent in enacting § 6015(f)—namely, to effectively grant equitable relief, judges must be allowed to consider all the facts in a given case.<sup>98</sup> Nevertheless, the Service has not abandoned its litigating position,<sup>99</sup> and it is therefore likely that appellate courts will continue to examine this issue.

#### B. *Nero Trading, LLC v. United States*

In *Nero Trading, LLC v. United States*,<sup>100</sup> the Eleventh Circuit addressed the nature of the hearing a district court must provide to a taxpayer who challenges a summons from the Service before the district

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92. *Id.* at 1284.

93. *See id.*

94. *Id.* at 1286.

95. *Id.*

96. *Id.*

97. *Id.* at 1286–87.

98. *See* A. Lavar Taylor, *New Administrative Procedures Affecting Section 6015(f) Innocent Spouse Claimants: A Safety Valve to Protect the Rights of Claimants in the Event the Tax Court's Holding in Porter v. Commissioner Is Overruled*, CAL. TAX LAW., Summer 2009, at 43, 47, available at [http://www.taylorlaw.com/pdf/6015\\_article.pdf](http://www.taylorlaw.com/pdf/6015_article.pdf).

99. *See* I.R.S. Chief Couns. Notice CC-2009-021 (June 30, 2009) (advising Chief Counsel attorneys to continue to assert the Service's position from *Ewing and Porter*), available at <http://www.irs.gov/pub/irs-ccdm/cc-2009-021.pdf>.

100. 570 F.3d 1244 (11th Cir. 2009).

court may enforce such a summons.<sup>101</sup> The *Nero* case involved a consolidated appeal brought by two taxpayers—Nero Trading, LLC and Ironwood Trading, LLC. The Service issued Nero and Ironwood administrative summonses requesting information regarding the legal and tax advice obtained by each taxpayer in relation to distressed asset and debt (DAD) transactions in which each taxpayer had participated. The Service was concerned that each taxpayer had benefitted from a DAD transaction involving the use of distressed assets to acquire economic losses from tax-indifferent parties. Both taxpayers filed motions to quash the summonses. The United States District Court for the Northern District of Georgia denied Nero’s motion without a hearing. The United States District Court for the Middle District of Florida denied Ironwood’s motion after a limited evidentiary hearing in which it was able to question the Service agent that issued the summons.<sup>102</sup>

Section 7602 of the Internal Revenue Code<sup>103</sup> grants the Service broad authority to issue a summons to ascertain the correctness of any return, determine a taxpayer’s tax liability, or collect tax, among other things.<sup>104</sup> A Service summons is not self-executing, however, so the summons can only be enforced if the Service applies to the appropriate district court.<sup>105</sup> To enforce such a summons, the Service must make a prima facie showing that (1) the Service will conduct its investigation for a legitimate purpose, (2) the Service’s inquiry may be relevant to that purpose, (3) the Service does not already possess the information sought, and (4) the Service has followed the administrative steps necessary under the Code.<sup>106</sup> If the Service makes this prima facie case, “the burden shifts to the party contesting the summons to disprove one of the four elements of the government’s prima facie showing or convince the court that enforcement of the summons would constitute an abuse of the court’s process.”<sup>107</sup> In *Nero* the Eleventh Circuit decided what types of procedures a taxpayer is entitled to use to meet that burden.<sup>108</sup>

In the Eleventh Circuit, a taxpayer is allowed a limited adversarial hearing at which he can learn whether the Service issued a summons for

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101. *Id.* at 1245.

102. *Id.* at 1245–46.

103. I.R.C. § 7602 (2006).

104. *Id.*

105. *Nero*, 570 F.3d at 1248 (citing I.R.C. § 7604(b) (2006)).

106. *Id.*

107. *Id.* at 1249 (emphasis omitted) (quoting *United States v. Morse*, 532 F.3d 1130, 1132 (11th Cir. 2008)).

108. *See id.*

an improper purpose.<sup>109</sup> To obtain the hearing, the taxpayer need only allege improper purpose.<sup>110</sup> A hearing is necessary to provide the taxpayer the chance to learn the facts necessary to quash an improperly issued summons.<sup>111</sup> The district court may generally use its discretion in determining the scope of the hearing, but an allegation of improper purpose alone does not enable the parties to use discovery devices such as depositions and interrogatories.<sup>112</sup>

The district court denied Nero's motion to quash the summons without granting Nero a limited adversarial hearing and without articulating its reasons for forgoing such a hearing.<sup>113</sup> Therefore, the Eleventh Circuit held that the district court abused its discretion and reversed and remanded accordingly.<sup>114</sup> In Ironwood's case, however, the district court granted a limited adversarial hearing in which it permitted Ironwood to subpoena and question the agent who issued the summons.<sup>115</sup> The Eleventh Circuit held that this procedure constituted a sufficient hearing.<sup>116</sup>

### III. DISTRICT COURT CASES

#### A. *United States v. UBS AG*

The tax case in the Eleventh Circuit that received more media attention than any other did not actually involve any significant United States federal tax law issue. The case of *United States v. UBS AG*<sup>117</sup> arose from the efforts of the United States government to force Swiss bank UBS to release the names of foreign accounts tied to United States citizens suspected of tax evasion.<sup>118</sup>

The Service petitioned the United States District Court for the Southern District of Florida to compel UBS to produce records relating to United States taxpayers who from 2002 to 2007 had accounts maintained, monitored, or managed by UBS. UBS did not have W-9

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109. *Id.* Other circuit courts require a taxpayer to develop facts sufficient to allow an inference of wrongful conduct by the Service before granting an adversarial hearing. *See, e.g., United States v. Tiffany Fine Arts, Inc.*, 718 F.2d 7, 14 (2d Cir. 1983); *United States v. Kis*, 658 F.2d 526, 544 (7th Cir. 1981).

110. *Nero*, 570 F.3d at 1249.

111. *Id.*

112. *Id.*

113. *Id.* at 1250.

114. *See id.* at 1250–51.

115. *Id.* at 1248.

116. *See id.* at 1250.

117. No. 09-20423-CIV, 2009 WL 2241122 (S.D. Fla. July 7, 2009).

118. *Id.* at \*1.

Forms executed by such taxpayers and did not file accurate and timely 1099 Forms naming and reporting all payments made to such taxpayers. UBS contended that its obligation, if any, to disclose such records did not extend to records already obtained by the Service through voluntary disclosures and other filings. Accordingly, UBS filed a motion seeking an order requiring the Service to disclose the accounts already identified through alternate means by the Service.<sup>119</sup>

The district court denied that motion.<sup>120</sup> The court wrote that controlling caselaw in the Eleventh Circuit rejected the proposition that a summons from the Service should not be enforced simply because the Service is in possession of some of the records sought.<sup>121</sup> The court noted that “actual possession of or access to information by the IRS is not an absolute bar to enforcement of a summons for that information.”<sup>122</sup> In any case, the court held that the Service should not be deemed to be in possession of information contained in voluminous corporate records.<sup>123</sup> Because there was no alternative means of securing the information sought by the Service’s summons, the court denied UBS’s motion.<sup>124</sup> The ongoing dispute involves many other facts and legal and political issues beyond the scope of this Article.<sup>125</sup>

#### B. *United States v. Klohn*

In *United States v. Klohn*,<sup>126</sup> the Service collected \$27,218.68 in trust fund recovery penalties from Dieter Klohn in violation of the automatic stay in Klohn’s bankruptcy case.<sup>127</sup> Klohn sought a refund.<sup>128</sup> Sec-

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119. *Id.*

120. *Id.* at \*2.

121. *Id.* at \*1.

122. *Id.* (quoting *United States v. Davis*, 636 F.2d 1028, 1038 (5th Cir. 1981)).

123. *Id.*

124. *Id.*

125. As of the writing of this Article, the Swiss Federal Administrative Court held that UBS could not disclose to the Service the names of its clients because their actions did not constitute “tax fraud and the like” under Swiss law. See *Swiss Court Says Government Cannot Disclose UBS Data on U.S. Clients*, Tax Notes Today (Tax Analysts) 15-H (Jan. 25, 2010), available at LEXIS, 2010 TNT 15-H.

126. No. 3:06-cv-222-J-TEM, 2009 WL 536520 (M.D. Fla. Mar. 3, 2009).

127. *Id.* at \*3. The income and social security taxes an employer withholds from employees are called “trust fund” taxes on the theory that those taxes are held in trust for the government. M. Robyn Cotrona, *The Price of Employees: Employment Tax Withholding and the Trust Fund Penalty*, 69 FLA. B.J. 27, 27 (1995). Under I.R.C. § 6672(a) (2006), a “trust fund recovery penalty” is assessed against business owners who fail to timely pay over these withheld taxes to the government. See *id.*

128. *Klohn*, 2009 WL 536520, at \*2.

tion 6511(a) of the Internal Revenue Code<sup>129</sup> provides that a claim for a credit or refund of an overpayment of tax must be filed within the later of three years from the time the relevant return was filed or two years from the time the tax was paid, or if no return is filed, within two years from the time the tax was paid.<sup>130</sup> The two-year statute of limitations period applied to Klohn's refund claim because no return was filed with respect to the invalid tax liabilities at issue.<sup>131</sup>

Klohn failed to claim a refund within the two-year period beginning on the date of the overpayment. He argued, however, that the statute of limitations did not start on the date of the overpayment, as the Service contended, but the date on which the district court determined the tax assessments were invalid.<sup>132</sup>

The district court dismissed Klohn's argument as "imaginative."<sup>133</sup> Section 6511(a) plainly states that the statute of limitations begins running from the time the tax is "paid."<sup>134</sup> No reference is made to the time at which the tax is deemed to be invalidly assessed.<sup>135</sup> Further, reasoned the court, its holding was supported by 28 U.S.C. § 1346(a) (1),<sup>136</sup> which confers original jurisdiction upon federal district courts to hear claims for taxes alleged to have been erroneously assessed or collected.<sup>137</sup> That statute does not require that a disputed tax liability first be adjudicated as illegally assessed before a refund action may be commenced.<sup>138</sup> For these reasons, the district court ruled against Klohn and granted summary judgment in favor of the government.<sup>139</sup>

### C. *Steffen v. United States*

In *Steffen v. United States*,<sup>140</sup> Terri Steffen and her husband, Paul Bilzerian, were two of seven limited partners in a limited partnership that owned all the stock of Bicoastal Acquisition Corporation. Bilzerian and his company, Bicoastal Acquisition Corporation, were the general

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129. I.R.C. § 6511(a) (2006).

130. *Id.*

131. *Klohn*, 2009 WL 536520, at \*4.

132. *Id.*

133. *Id.* at \*5.

134. *Id.* (citing I.R.C. § 6511(a)).

135. *Id.*

136. 28 U.S.C. § 1346(a)(1) (2006); *Klohn*, 2009 WL 536520, at \*5.

137. 28 U.S.C. § 1346(a)(1) (2006).

138. *See id.*

139. *Klohn*, 2009 WL 536520, at \*6.

140. No. 8:08-CV-2337-T-24 (M.D. Fla. Apr. 30, 2009) (amended order affirming in part and reversing in part bankruptcy court's decisions).

partners of the partnership.<sup>141</sup> The case came before the United States District Court for the Middle District of Florida on an appeal of certain orders from the bankruptcy court. The issues on appeal pertained to Steffen's objection to the Service's \$5856 claim in her personal bankruptcy case. Steffen objected to the Service's claim based on the Service's treatment of three taxable events: (1) the worthlessness of Steffen's Bicoastal stock, (2) the alleged theft of Steffen's money, and (3) the vitality of a debt owed to her by Bicoastal.<sup>142</sup>

The main issue on appeal was which year Steffen's Bicoastal stock became worthless. In 1991 Steffen amended her 1989 tax return to reflect her determination that the Bicoastal stock became worthless in 1989. In 1989 more than \$500 million worth of claims had been filed against Bicoastal, and Bicoastal was unable to pay some of those debts. As a result, Bicoastal filed a voluntary petition seeking Chapter 11 bankruptcy relief.<sup>143</sup>

The Service denied the deduction.<sup>144</sup> "A stock is worthless if it has no present value and no reasonable prospect of future value."<sup>145</sup> The Service contended that Steffen should have taken a deduction in 1993 because various events indicated that Steffen and Bilzerian believed that the Bicoastal stock had potential future value until 1993. In 1990 Bilzerian indirectly transferred interests in Bicoastal to fully satisfy \$7.5 million of debt. In 1991 he caused an indirect interest in Bicoastal to be pledged as collateral to obtain a \$9.5 million loan. Bilzerian also told his Chapter 7 bankruptcy trustee that the partnership, whose main asset was the Bicoastal stock, had substantial value. In 1993 Steffen and Bilzerian attempted to settle Bilzerian's bankruptcy claims by trying to transfer a twenty-five percent interest in the partnership to the Chapter 7 trustee. Further, Bilzerian also refused to support Bicoastal's \$92 million settlement of claims against a third party. Bilzerian objected to the settlement because he believed the value of Bicoastal's claim was significantly higher. Lastly, Steffen listed the Loving Spirit Foundation's interest in the partnership as an asset worth \$595,830 on the foundation's 1993 tax return.<sup>146</sup> For these reasons, the bankruptcy court found that the Bicoastal stock had not become worthless until

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141. *Id.* at 2.

142. *Id.* at 1-2.

143. *Id.* at 2.

144. *Id.*

145. *Id.* at 3 n.3.

146. *Id.* at 3.

1993.<sup>147</sup> On appeal, the district court held that the factual findings of the bankruptcy court were not clearly erroneous.<sup>148</sup>

The next issue the court addressed was whether Steffen was entitled to take a theft loss deduction in 1991.<sup>149</sup> Steffen claimed the deduction because an interior designer was paid for services that the designer never provided. The Service argued that Steffen did not show that the loss occurred, and, if the loss had occurred, it belonged to Bicoastal.<sup>150</sup>

After an examination of the evidence, the bankruptcy court held that Steffen had not proved that the loss occurred and, if it had, the loss belonged to Bicoastal, not Steffen.<sup>151</sup> To take a theft loss deduction, a taxpayer must prove that there is no reasonable prospect of recovery.<sup>152</sup> In 1991, however, Steffen pursued recovery from her interior designer in a bankruptcy action. The bankruptcy court found that Steffen, therefore, believed that she had a reasonable prospect of recovery against her interior designer in 1991. There was little other evidence presented on the issue.<sup>153</sup>

In any case, the bankruptcy court found that the loss, if any, belonged to Bicoastal because Bicoastal paid the vast majority of the interior designer's fee. Further, the interior designer invoiced Bicoastal, not Steffen. Thus, the bankruptcy court disallowed Steffen's theft loss deduction.<sup>154</sup>

Upon a motion to reconsider submitted by Steffen, however, the bankruptcy court reversed its initial holding based on factual findings in a different case to which the Service was not a party. It was not clear what factual findings were presented in that other case.<sup>155</sup> The district court was "troubled" by the bankruptcy court's reversal "based only on findings it made in a different case to which the [Service] was not a party."<sup>156</sup> Accordingly, the district court reversed and held that the bankruptcy court's initial decision disallowing the theft loss must stand based on the reasons contained in the initial decision.<sup>157</sup>

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147. *Id.*

148. *Id.* at 6.

149. *Id.* at 4.

150. *Id.* at 10–11.

151. *Id.* at 11.

152. Treas. Reg. § 1.165-1(d)(3) (as amended in 1977).

153. *Steffen*, No. 8:08-CV-02337-T-24, slip op. at 13–14.

154. *Id.* at 12–14.

155. *Id.* at 12.

156. *Id.*

157. *Id.* at 14.

The final issue was whether Steffen was entitled to take a bad debt deduction in 1993.<sup>158</sup> Steffen based the deduction on money she allegedly loaned to Bicoastal that was never repaid. The Service asserted that Steffen did not prove that a business debt actually existed. Steffen disagreed, noting that an earlier decision of the bankruptcy court had found Steffen's claim against Bicoastal to be valid. The bankruptcy court agreed with Steffen.<sup>159</sup>

Section 166(a)<sup>160</sup> of the Internal Revenue Code provides "[t]here shall be allowed as a deduction any debt which becomes worthless within the taxable year."<sup>161</sup> It was undisputed that in 1993 the entire amount of the alleged debt was set off against amounts owed to Bicoastal. Thus, the Service asserted that the debt was not worthless.<sup>162</sup> The district court agreed and reversed accordingly.<sup>163</sup>

#### D. *In re Willis*

In *In re Willis*,<sup>164</sup> the United States Bankruptcy Court for the Southern District of Florida addressed whether funds held in Ernest W. Willis's IRAs were exempt from his bankruptcy estate.<sup>165</sup> Willis and his wife owned fifty percent of a corporation whose sole tangible asset was an improved parcel of real estate in Boca Raton, Florida. By 1993 the corporation was delinquent on its mortgage payments. Willis and the bank holding the mortgage entered into a settlement agreement under which the bank would assign the mortgage to Willis for \$792,500. To finance the purchase of the assignment, Willis authorized a \$700,000 wire transfer from an IRA that he held with Merrill Lynch.<sup>166</sup> In December 1993 the money was transferred to the bank's escrow agent, and the bank "executed an assignment of mortgage naming Willis as the assignee."<sup>167</sup> Willis borrowed funds from others so he could repay \$700,000 to his Merrill Lynch IRA. In February 1994 Willis deposited \$700,000 into the Merrill Lynch IRA.<sup>168</sup>

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158. *Id.* at 4.

159. *Id.* at 15.

160. I.R.C. § 166(a) (2006).

161. *Id.*

162. *Steffen*, No. 8:08-CV-02337-T-24, slip op. at 16.

163. *Id.*

164. *In re Willis*, No. 07-11010-BKC-PGH, 2009 WL 2424548 (Bankr. S.D. Fla. Aug. 9, 2009), *aff'd sub nom.* *Willis v. Menotte*, No. 09-82303-CIV, 2010 WL 1408343 (S.D. Fla. Apr. 6, 2010).

165. *See id.* at \*1.

166. *Id.* at \*1-2.

167. *Id.* at \*2.

168. *Id.*

Willis also had a brokerage account with Mercury Finance Securities. In January 1997 the balance in that brokerage account was negative \$112,395. To cover the losses, Willis engaged in a check-swapping process between the brokerage account and the Merrill Lynch IRA.<sup>169</sup> The check-swapping process resulted in total deposits of \$2,022,000 into the brokerage account and total deposits of \$1,835,500 into the Merrill Lynch IRA during 1997 and 1998. These transactions created a positive balance of \$186,500 in the brokerage account.<sup>170</sup>

Willis also transferred funds from the Merrill Lynch IRA to two other IRAs. Between August and November of 2002, Willis transferred \$60,000 from the Merrill Lynch IRA to an IRA with Fidelity bank.<sup>171</sup> In addition, in June of 2002, Willis withdrew \$90,000 from the Merrill Lynch IRA. Those funds were deposited to and withdrawn from various accounts over the course of the ensuing four-and-a-half years until they landed in an IRA handled by AmTrust bank, along with some other funds. In December 2006 Willis contributed \$108,433.60 to the AmTrust IRA.<sup>172</sup>

In February 2007 Willis filed for Chapter 7 bankruptcy protection. He claimed exemptions for the Merrill Lynch IRA, the AmTrust Bank IRA, and the Fidelity IRA. The IRAs were valued at \$1,247,000, \$109,000, and \$143,000, respectively. The bankruptcy trustee and Willis's creditors (the movants) objected to Willis's claimed exemptions, and a lawsuit ensued.<sup>173</sup>

Section 522(b)(4)(A) of the Bankruptcy Code<sup>174</sup> provides that when the IRS issues a "favorable determination" with respect to an IRA's structure and form, the retirement funds held in the IRA are presumed to be exempt from the bankruptcy estate.<sup>175</sup> It was undisputed that the IRS had issued a favorable determination with respect to each IRA at issue, so the movants had the burden of proving that funds held by the IRAs were not exempt from the bankruptcy estate.<sup>176</sup>

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169. *Id.* Willis deposited funds to his brokerage account that he borrowed from the Merrill Lynch IRA. *Id.* Within sixty days, Willis borrowed additional funds from the Merrill Lynch IRA, deposited those funds in his brokerage account, then withdrew funds on the same day from his brokerage account to pay off the prior loan from the Merrill Lynch IRA. *Id.* at \*14 n.2. He repeated this process every sixty days. *Id.*

170. *Id.* at \*3.

171. *Id.* at \*3-4.

172. *Id.* at \*11.

173. *Id.* at \*1.

174. 11 U.S.C. § 522(b)(4)(A) (2006).

175. *Id.*

176. *See In re Willis*, 2009 WL 2424548, at \*7, \*11. Willis argued that section 522(b)(4)(A) created an irrebuttable presumption. *Id.* at \*6. The court held that the

The movants pointed to 11 U.S.C. § 522(b)(3)(C).<sup>177</sup> That statute provides that an individual debtor may exempt from property of the bankruptcy estate “retirement funds to the extent those funds are” held in an IRA that is exempt from tax under I.R.C. § 408.<sup>178</sup> Section 408(e) of the Internal Revenue Code states that an IRA will not be exempt from tax as of the first day of the taxable year in which the “individual for whose benefit [the IRA] is established . . . engages in any ‘transaction prohibited’ under section 4975 with respect to [the IRA].”<sup>179</sup> Section 4975 of the Internal Revenue Code,<sup>180</sup> in relevant part, defines *prohibited transaction* as any direct or indirect (1) “lending of money or other extension of credit between [an account] and a disqualified person” or (2) “transfer to, or use by or for the benefit of, a disqualified person of the income or assets of [the account].”<sup>181</sup>

Generally, a “disqualified person” is any person who exercises discretionary authority or control over the assets of the account.<sup>182</sup> The court concluded that Willis exercised discretionary authority and control over the IRAs and that he was therefore a disqualified person with respect to each account.<sup>183</sup>

Willis transferred \$700,000 from the Merrill Lynch IRA to purchase the mortgage on real estate in Boca Raton.<sup>184</sup> It was for the benefit of Willis because he subsequently sold the property for \$1.2 million.<sup>185</sup> The fact that Willis had repaid the \$700,000 made no difference because extensions of credit are also prohibited transactions.<sup>186</sup> Accordingly, the court held that the transactions constituted prohibited transactions.<sup>187</sup> As a result, the Merrill Lynch IRA ceased to be qualified under § 408 as of January 1, 1993.<sup>188</sup> Thus, the court held that the

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presumption was rebuttable because bankruptcy courts generally interpreted the word “presumed” to create a rebuttable presumption under the Bankruptcy Code and because Congress would have omitted the words “presumed to be” from the statute if the presumption was not intended to be rebuttable. *Id.* at \*6–7.

177. 11 U.S.C. § 522(b)(3)(C) (2006); see *In re Willis*, 2009 WL 2424548, at \*8.

178. 11 U.S.C. § 522(b)(3)(C); I.R.C. § 408 (2006).

179. I.R.C. § 408(e).

180. I.R.C. § 4975 (2006).

181. *Id.* § (c)(1).

182. *In re Willis*, 2009 WL 2424548, at \*9 (citing I.R.C. § 4975(e)(3)(A)).

183. *Id.*

184. *Id.* at \*9.

185. *Id.*

186. See *id.* at \*9–10.

187. *Id.* at \*9.

188. *Id.* The court also found that the check-swapping process constituted a prohibited transaction. *Id.* at \*10–11. The series of transactions had the effect of providing an extension of credit between the Merrill Lynch IRA and Willis. *Id.* at \*10. Consequently,

funds in the Merrill Lynch IRA were not exempt from the bankruptcy estate.<sup>189</sup>

The court also held that the funds in the AmTrust IRA and the Fidelity IRA were not exempt from the bankruptcy estate.<sup>190</sup> “IRA funds rolled over from a non-qualified account retain their non-qualified status.”<sup>191</sup> However, the funds in the AmTrust IRA and the Fidelity IRA were rolled over from the Merrill Lynch IRA after it ceased to be exempt as a result of Willis’s prohibited transactions.<sup>192</sup> Accordingly, the court concluded that the funds in the AmTrust IRA and the Fidelity IRA were not exempt from the bankruptcy estate.<sup>193</sup> The court likewise held that distributions from the Merrill Lynch IRA were not exempt from Willis’s bankruptcy estate.<sup>194</sup> Although distributions from an IRA that are deposited to another IRA within sixty days are generally exempt from a debtor’s bankruptcy estate, Willis’s distributions from the Merrill Lynch IRA were not exempt at the time that he took such distributions because the Merrill Lynch IRA was disqualified at that time.<sup>195</sup>

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the court held that had the Merrill Lynch IRA not already ceased to be exempt in 1993, these prohibited transactions would have destroyed its tax-exempt status as of January 1, 1997. *Id.*

189. *Id.* at \*9–11.

190. *Id.* at \*11–12.

191. *Id.* at \*11.

192. *Id.* at \*11–12.

193. *Id.* The funds in the Fidelity IRA were included in the bankruptcy estate only to the extent of the \$60,000 that could be traced to the Merrill Lynch IRA. *Id.* at \*12. The Fidelity IRA contained funds from other sources, and the source of those other funds was not clear. *Id.* at \*14 n.6. Thus, the court held that the movants failed to present rebuttal evidence to establish that those other funds did not qualify for exemption from the bankruptcy estate. *Id.*

194. *Id.* at \*13.

195. *Id.*