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Federal Taxation

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I. INTRODUCTION

In the year 2011,[1] the courts addressed interesting issues in the areas of constructive receipt, taxpayer standing to pursue non-monetary damages, and lender liability for unpaid payroll taxes. This Article surveys these decisions.

II. *UNITED STATES V. FORT*

In *United States v. Fort*,[2] the United States Court of Appeals for the Eleventh Circuit dealt with the important issue of when assets held in escrow should be treated as income by the beneficiary of the escrow.[3] Though the decision in *Fort* rests on questionable reasoning, courts in several circuits have reached similar decisions, so it represents a significant trend.[4]

Fort was one of a number of tax cases that arose from Ernst & Young's (E&Y) 2000 sale of its consulting business to Cap Gemini.[5] In the sale, a number of E&Y partners involved in the consulting business exchanged their interest in E&Y for shares of Cap Gemini and began working for Cap Gemini.[6] Seventy-five percent of the shares received by each partner were restricted and held in an escrow account. A

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1. For an analysis of federal tax cases decided during the prior survey period, see Augustus N. Makris, *Federal Taxation, Eleventh Circuit Survey*, 62 MERCER L. REV. 1187 (2010).
2. 638 F.3d 1334 (11th Cir. 2011).
3. *Id.* at 1337.
4. *See, e.g.*, United States v. Fletcher, 562 F.3d 839 (7th Cir. 2009).
5. *Fort*, 638 F.3d at 1335; *see Fletcher*, 562 F.3d at 840; United States v. Nackel, 686 F. Supp. 2d 1008, 1010 (C.D. Cal. 2009).
6. *Fort*, 638 F.3d at 1335.

portion of the shares could be sold at specified periods, and all shares left escrow just under five years after the closing date. A portion of the shares were forfeited if the partner resigned or was terminated for cause or for poor performance. As a result of these restrictions, the affected shares were valued at a discount in the sale agreement.[7]

In disclosure documents distributed before the transaction, E&Y partners were informed that the sale would be a taxable transaction and that parties had agreed to consistently treat it as such. The taxpayer, Fort, reported gain from the transaction on this basis on his 2000 tax return.[8]

In 2003, the taxpayer was terminated from his position with Cap Gemini, but because the termination was not for cause or for poor performance, none of his shares were forfeited. After his termination, Fort filed an amended return for 2000, in which he took the position that the restricted receipt of the Cap Gemini shares did not give rise to income in 2000. The Internal Revenue Service (the Service) initially granted the refund but later sued to recover it.[9]

Two important issues were raised in *Fort.* The first issue was whether the taxpayer, pursuant to the rule set forth in *Commissioner v. Danielson,*[10] was barred from attempting to recharacterize the transaction.[11] The second was whether, on the merits, the taxpayer had income in 2000 from the Cap Gemini transaction.[12]

A. *Commissioner v. Danielson*

Substance over form is frequently an issue in tax,[13] and *Commissioner v. Danielson*[14] recognized a significant asymmetry in the doctrine.[15] As noted in *Danielson*, the Service is free to assert that the substance of a transaction is different from its form.[16] Thus, the Service can treat a putative lease as a secured loan or a sale if the facts justify. The taxpayer, on the other hand, is almost always bound by the form of a transaction.[17]

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7. *Id.* at 1335-36.
8. *Id.* at 1336.
9. *Id.* at 1336–37.
10. 378 F.2d 771 (3d Cir. 1967).
11. *Fort*, 638 F.3d at 1337.
12. *Id.* at 1338.
13. *See generally* 1 BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 4.3.3 (3d ed. 2003 & Supp. 3 2011).
14. 378 F.2d 771 (3d Cir. 1967).
15. *Id.* at 774-75.
16. *Id.*
17. *Id.*

In *Danielson*, the parties to a stock sale agreed to apportion the consideration between the stock (which was a capital asset) and the shareholders' covenant not to compete (which produced ordinary income).[18] However, in their returns, the shareholders took the position that none of the consideration was allocable to the covenants not to compete.[19] The United States Court of Appeals for the Second Circuit held that the taxpayer was not permitted to challenge the form of his own transaction absent a showing of fraud, duress, or undue influence.[20] The court noted that permitting such challenges would severely burden tax enforcement because the Service would be unable to rely on the form of taxpayer transactions and would instead have to factually investigate every relevant transaction.[21]

In *Fort*, the government argued that the taxpayer's agreement to the transaction, described in the disclosure documents, which included an agreement that the transaction would be treated as a taxable sale, estopped the taxpayer from later asserting that the transaction was not taxable in 2000. The United States Court of Appeals for the Eleventh Circuit disagreed.[22] The court held that *Danielson* only forbids the taxpayer from challenging the agreed *form* of a transaction, not its tax consequences.[23] The *Danielson* rule did not apply because Fort accepted that the transaction was a sale; he only disputed its tax consequences.[24]

B. *Constructive Receipt*

The second issue in *Fort* was whether the taxpayer had constructive receipt of the Cap Gemini shares when they were deposited in escrow in 2000.[25] A cash-method taxpayer generally recognizes income when money or property is actually or constructively received.[26] The court based its decision on constructive receipt.[27] Treasury Regulation section 1.451-2(a)[28] provides that a taxpayer has constructive receipt of property if it is "credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time," but property

18. *Id.* at 772-73.
19. *Id.* at 773-74.
20. *Id.* at 778-79.
21. *Id.* at 775.
22. *Fort*, 638 F.3d at 1337.
23. *Id.* at 1337-38.
24. *Id.* at 1338.
25. *Id.*
26. Treas. Reg. § 1.451-1(a) (2011).
27. *Fort*, 638 F.3d at 1338.
28. Treas. Reg. § 1.451-2(a) (2011).

is not constructively received if it is subject to "substantial limitations or restrictions."[29]

The Eleventh Circuit ruled that Fort did have constructive receipt of the escrow shares because he had sufficient control over the shares and the conditions of forfeiture were largely under his control.[30] The court identified three specific factors that established Fort's control over the shares: (1) the shares were deposited in an escrow account for Fort's benefit; (2) Fort had dividend and voting rights; and (3) the shares were used as a guarantee for Fort's performance of future services.[31] The court also noted the fact that only about ten percent of the E&Y partners had forfeited their shares and that avoiding termination for cause or for poor performance was largely within Fort's control.[32]

The Eleventh Circuit's reliance on a constructive receipt theory was misplaced. The regulations and case law provide that an item is not constructively received if there are substantial limitations on the taxpayer's ability to take possession of the item.[33] Thus, to hold that Fort was in constructive receipt of the Cap Gemini shares, the court was forced to come to the implausible conclusion that performance of nearly five years of service (without termination for cause or poor performance) is not a substantial restriction. Another district court considering the same transaction made the same observation as follows:

> Here, however, the restrictions involved concern matters exclusively within the ex-consulting partner's hands to control. The only person standing in the way of [the taxpayer] actually exercising dominion over the shares themselves was himself. So long as he did not engage in conduct amounting to cause to fire him, or did not quit his position at the firm, or did not breach non-disclosure provisions, the shares in the restricted escrow account were his.[34]

The proposition that a restriction is not substantial merely because it is within the taxpayer's capability to fulfill is unprecedented and unsupported. Indeed, performance of future services is the epitome of a substantial restriction in other contexts. For example, in determining whether property received for services is subject to a "substantial risk of forfeiture" under section 83 of the Internal Revenue Code (I.R.C.),[35] the

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29. *Id.*
30. *Fort*, 638 F.3d at 1340.
31. *Id.* at 1340-41.
32. *Id.* at 1341.
33. *Id.* at 1339.
34. *Nackel*, 686 F. Supp. 2d at 1021.
35. I.R.C. § 83 (2006).

regulations provide that a requirement to provide substantial future services is always such a risk.[36]

Counterintuitively, the proper approach to the case would have been to consider whether Fort had *actual* receipt of the shares. Though the district court rejected this theory and the Service did not dispute the finding,[37] an actual receipt theory fits the facts far better than a constructive receipt analysis. The shares were titled to a brokerage account in Fort's name.[38] Fort had dividend and voting rights over the shares, and he was subject to the rise and fall of the value of the shares. Fort's employment agreement stated that the shares would be forfeited as damages in certain circumstances, which indicates that he was using the shares as security for his performance.[39] The simple fact that the taxpayer had agreed not to sell the shares is not inconsistent with actual possession of the shares.

In fact, most of the authorities cited by the court's decision deal with actual receipt, not constructive receipt.[40] Specifically, the courts in *Chaplin v. Commissioner*[41] and *Bonham v. Commissioner*[42] both held that the taxpayers had actually received property.[43] General Counsel Memorandum 37,073,[44] which the court in *Fort* cited for the importance of evaluating the taxpayer's "degree of domination and control over the assets in escrow," explicitly makes the point that degree of control is relevant only to actual receipt, not constructive receipt.[45]

An actual receipt analysis emphasizes some points to which the Eleventh Circuit gave little thought. One important factor, dismissed by the court in a footnote, is that the liquidated damages due under Fort's

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36. Treas. Reg. § 1.83-3(c)(1) (2011).
37. *Fort*, 638 F.3d at 1338.
38. *Id.* at 1335.
39. *Id.*
40. *Id.* at 1339.
41. 136 F.2d 298 (9th Cir. 1943).
42. 89 F.2d 725 (8th Cir. 1937).
43. *Chaplin*, 136 F.2d at 302-03; *Bonham*, 89 F.2d at 728 (stating "[s]ince the title to these 750 shares passed in 1929, they were properly included in estimating the gain in that year from this exchange"). Neither opinion ever uses the phrase "constructive receipt."
44. I.R.S. Gen. Couns. Mem. 37,073 (Mar. 31, 1977).
45. *Fort*, 638 F.2d at 1339; I.R.S. Gen. Couns. Mem. 37,073.

> We emphasize that defense should be based on the taxpayer's dominion and control over the funds at issue . . . . Defense should not be based on constructive receipt under Treas. Reg. § 1.451-2 because until exercise of the above elections, taxpayer's control over the funds was subject to substantial limitations; and once either election was exercised, taxpayer's dominion and right to receive control over the funds was the equivalent of actual receipt.

I.R.S. Gen. Couns. Mem. 37,073.

employment agreement were to be calculated as a fixed number of shares, not as a fixed monetary value.[46] If the escrow was genuinely intended to secure Fort's performance under the contract, the forfeiture should be calculated to equal the other party's expected damages. In *Bonham*, one of the cases relied on by the court, the taxpayer's potential forfeiture would have taken the form of the escrow selling whatever number of shares were required to produce sufficient proceeds to make a fixed damages payment.[47] General Counsel Memorandum 37,073 stressed the following point: "The fact that the taxpayer might forfeit its collateral does not present a substantial restriction or limitation on its rights to receive the money *so long as such collateral is forfeited on the basis of its current value*."[48] Fort's forfeiture was based on a fixed number of shares, rather than market value, indicating that Fort did not have all of the benefits and burdens of ownership.

Another important issue that was overlooked by the court was the importance of the dividend and voting rights exercised by the taxpayer. If the stock earned significant dividends and Fort, along with the other former E&Y partners, exercised meaningful voting rights, then the case for finding that Fort actually received the shares is strong. On the other hand, if dividends were minimal and voting rights illusory, then the ability to sell the stock, which Fort did not possess, may have been the only economically significant right associated with the shares. Such a circumstance would support a holding that Fort did not receive the shares.

In reaching its decision, the court may have focused more on the potential for abuse in the taxpayer's conduct than on the proper technical treatment of the transaction. At the time of the transaction, the taxpayer reported a completed sale, with a capital gain based on the fair market value of Cap Gemini shares at that time.[49] Had Cap Gemini shares increased in value, it is very unlikely that the taxpayer would have amended his return to put forward a deferred receipt theory because then his gain would have been calculated at the new, higher value of Cap Gemini shares at receipt.[50] Only because the value of the shares went down was it advantageous for the taxpayer to amend his reporting. Despite the court's holding that the *Danielson* rule did not bar the taxpayer's refund claim, the potential for abuse in allowing

46. *Fort*, 638 F.3d at 1340 n.2.
47. *Bonham*, 89 F.2d at 727.
48. I.R.S. Gen. Couns. Mem. 37,073 (emphasis added).
49. *Fort*, 638 F.3d at 1336.
50. *See* Treas. Reg. § 15a.453-1(c)(3) (2011).

taxpayers to recharacterize their transactions based on retrospective calculations may have influenced the court.[51]

III. *CHRISTIAN COALITION OF FLORIDA, INC. V. UNITED STATES*

Christian Coalition of Florida, Inc. v. United States[52] tested the limits of the taxpayer's ability to seek nonmonetary relief in court.[53] The Eleventh Circuit held that the scope for such relief is extremely narrow, if it exists at all.[54]

Christian Coalition of Florida (CC-FL) is a Florida non-profit corporation that was organized to "teach[] concern for the sanctity of life, traditional family values, an economic system which fosters individual self-reliance, and faith in God."[55] Lobbying and publishing "scorecards" for legislators were major activities of CC-FL.[56]

Because it engaged in lobbying activities, CC-FL could not qualify as a I.R.C. § 501(c)(3)[57] charitable organization.[58] Instead, it applied for tax exempt status under I.R.C. § 501(c)(4)[59] as an organization "operated exclusively for the promotion of social welfare."[60] According to the regulations, § 501(c)(4) organizations are permitted to engage in lobbying activities but may not support or oppose particular candidates for office.[61]

In 2000, the Service issued a proposed determination letter rejecting CC-FL's application for tax exempt status, finding that its legislative score cards and other activities amounted to electioneering.[62] Issuance of a final determination letter was suspended while an affiliated organization litigated a similar issue against the Service in another case. When the related case was ultimately concluded in 2008, the Service

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51. *Fort*, 638 F.3d at 1337-38.
52. 662 F.3d 1182 (11th Cir. 2011).
53. *Id.* at 1185.
54. *Id.*
55. *Id.*
56. *Id.*
57. I.R.C. § 501(c)(3) (2006).
58. *Christian Coal.*, 662 F.3d at 1185. Section 501(c)(3) only applies to

> [an organization] no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation . . . and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

I.R.C. § 501(c)(3).

59. I.R.C. § 501(c)(4) (2006).
60. *Id.*; *Christian Coal.*, 662 F.3d at 1185-86.
61. Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii) (2011).
62. *Christian Coal.*, 662 F.3d at 1186.

issued a final determination letter finding that CC-FL did not qualify as a § 501(c)(4) organization. CC-FL was instructed to file corporate tax returns for prior years. CC-FL filed returns for 1991, 1994–2000, and 2005–2006.[63] Because it was funded mostly by nontaxable gifts and had no substantial income, CC-FL owed trivial amounts of tax, approximately $250 for all relevant years.[64]

After filing the returns, CC-FL requested a refund of all taxes paid, challenging the Service's determination that it was not tax exempt.[65] The Service granted a refund for the 2005 and 2006 years without explanation but failed to respond to the other requests within the statutory response period. CC-FL sued for a refund of the remaining years' taxes and, more importantly, for declaratory and injunctive relief. Specifically, CC-FL requested declaratory judgments that it was a § 501(c)(4) organization and that the restrictions on electioneering were unconstitutionally vague and overbroad, as well as an injunction against the Service revoking its tax exempt status in future years.[66]

After the litigation commenced, the Service concluded that the statute of limitations had run for 1991 and the 1994–2000 period and, therefore, refunded the taxes paid for those years.[67] With all taxes refunded, the Service claimed that the refund claim was moot and moved to dismiss the case.[68] CC-FL argued that its declaratory and injunctive claims still constituted a live controversy.[69]

A. *Legal Background*

To promote efficient collection of taxes, judicial review of tax matters is limited. By design, taxes are assessed and disputed primarily through administrative processes. Thus, there are two main paths by which tax disputes can come to court. First, after the Service issues a statutory notice of deficiency, which follows the administrative audit process and an optional administrative appeal, the taxpayer may challenge the deficiency in the Tax Court.[70] Second, a taxpayer may administratively

63. *Id.*
64. *Id.* at 1186 n.2.
65. *Id.* at 1187.
66. *Id.*
67. *Id.* I.R.C. § 6501(g)(2) provides that if an organization files a return as a tax exempt organization in good faith, the return is sufficient to begin the statute of limitations period even if the organization is later determined to be taxable. I.R.C. § 6501(g)(2) (2006). The statute of limitations is three years from either the filing of the return or the due date for the return, whichever is later. I.R.C. § 6501(a) (2006).
68. *Christian Coal.*, 662 F.3d at 1187-88.
69. *Id.* at 1190.
70. I.R.C. § 6213(a) (2006).

request a refund of any tax that has been paid, whether through self-assessment or as a result of an audit.[71] If the Service does not grant the refund, the taxpayer may file a refund suit before the appropriate District Court or the Court of Federal Claims.[72] The Internal Revenue Code provides for judicial review of various other limited matters as well.[73] Outside of these channels, judicial review of tax matters is prohibited by the Anti-Injunction Act (the AIA),[74] which provides that, unless specifically provided in listed Internal Revenue Code sections, "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained."[75] The Declaratory Judgment Act (the DJA)[76] includes a corresponding provision prohibiting any declaratory relief for tax matters except as allowed by I.R.C. § 7428.[77]

The United States Supreme Court has enforced the terms of the AIA, even in a situation where it did considerable harm to the taxpayer.[78] In *Bob Jones University v. Simon*,[79] the taxpayer, which was a § 501(c)-(3) charitable organization, sought an injunction to prevent the Service from revoking its tax exempt status under a new policy that denied tax exemption to racially discriminatory schools.[80] The Court held that the AIA barred the claim for injunctive relief.[81] The Court reached this holding even though the taxpayer's § 501(c)(3) status had important collateral consequences.[82] Since the taxpayer was a charitable organization, donations were deductible.[83] If the Service revoked the taxpayer's determination letter, potential donors would have to risk audit to challenge the Service's determination.[84] As a practical matter, the taxpayer would probably lose a substantial portion of its donations in the absence of a favorable determination letter.

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71. *Id.*
72. I.R.C. § 7422 (2006).
73. *E.g.*, I.R.C. § 6330 (2006) (noting collections due process hearings); I.R.C. § 7428 (2006) (noting review of denial of § 501(c)(3) status); I.R.C. § 7429 (2006) (noting review of jeopardy assessments).
74. I.R.C. § 7421(a) (2006).
75. *Id.*
76. 28 U.S.C. § 2201 (2006).
77. *Id.* § 2201(a); I.R.C. § 7428 (2006).
78. *See, e.g.*, Bob Jones Univ. v. Simon, 416 U.S. 725, 727 (1974).
79. 416 U.S. 725 (1974).
80. *Id.* at 726-27.
81. *Id.* at 727.
82. *Id.* at 727-28.
83. *Id.*
84. *Id.* at 730-31.

Despite this real risk of injury to the taxpayer, the Court held that the AIA did not allow an injunction.[85] Under the law as it then stood, Bob Jones University's (BJU) only remedy was to wait for a revocation of the determination letter and then either contest a notice of deficiency in the Tax Court or pursue a refund claim for taxes paid.[86] The Court affirmed an earlier decision, *Enochs v. Williams Packing & Navigation Co.*,[87] which required a taxpayer to make a two-part showing to avoid the AIA: first, the taxpayer must show that it would suffer irreparable injury; and second, the government's action must be "plainly without a legal basis."[88] BJU clearly failed to establish the second prong, and the Court held that, however injurious the proposed Service action might be, the AIA did not allow an injunction against it.[89]

In a significant footnote, the Court softened this harsh ruling slightly.[90] First, it noted that, in the specific context of § 501(c)(3) organizations, the AIA might be unreasonable if an organization could never obtain prospective recognition of its tax exempt status, because of the effect on potential donors.[91] Congress added § 7428 to address this concern.[92] Second, the Court noted that BJU was seeking a pre-enforcement injunction and noted that its approach might be different in a refund case.[93] CC-FL relied heavily on this footnote.[94]

B. *Opinion*

In *Christian Coalition*, CC-FL took the position that, having filed a valid refund suit, the AIA was satisfied and all forms of relief, including injunctive relief, were available.[95] First, CC-FL argued, the case was not moot merely because the Service had issued the requested refund because the injunctive and declaratory questions were still open.[96] Second, CC-FL argued that the refund claim itself was not moot because the Service's determination had state tax consequences and because its refund claim satisfied judicial exceptions to the mootness doctrine.[97]

85. *Id.* at 727.
86. *Id.* at 730.
87. 370 U.S. 1 (1962).
88. *Simon*, 416 U.S. at 745 (citing *Enochs*, 370 U.S. at 6-7).
89. *Id.* at 736-37.
90. *Id.* at 748 n.22.
91. *Id.*
92. *Christian Coal.*, 662 F.3d at 1192.
93. *Simon*, 416 U.S. at 748 n.22.
94. *Christian Coal.*, 662 F.3d at 1192.
95. *Id.* at 1190.
96. *Id.*
97. *Id.* at 1193.

Circuit Judge Marcus delivered the opinion in *Christian Coalition*.[98] The court rejected CC-FL's argument that declaratory and injunctive claims could continue in the absence of a continuing refund claim.[99] The court held that the congressional response to the decision in *Bob Jones* reflected no intent to allow such claims to proceed.[100] In particular, the court noted that Congress added § 7428 to address the Supreme Court's concern about the harmful impacts of the AIA and the DJA on § 501(c)(3) organizations.[101] The fact that no further amendments were made to the AIA and the DJA to address other situations implied that Congress did not intend to allow such suits to proceed.

The court also rejected CC-FL's argument that the collateral consequences of the Service's determination should allow its claims to continue.[102] The court held that these consequences were not sufficient to permit the court to carve out a judicial exception to its interpretation of the DJA and the AIA.[103] The court also noted that, if such claims were sufficient to give courts jurisdiction over declaratory claims, then any would-be tax exempt organization could seek declaratory relief, effectively vitiating the tax exception to the DJA.[104] The court also noted that a judicial exception to the AIA already existed under *Enochs v. Williams Packing & Navigation Co.*[105] and that CC-FL simply failed to meet this standard.[106]

Finally, CC-FL claimed that its refund claim was not moot, even though the Service had repaid the tax money.[107] CC-FL asserted that two judicial exceptions to the mootness doctrine applied.[108] First, it cited the "capable of repetition" doctrine, which holds that a challenge to an action is not moot if the action is too short in duration to be litigated before it becomes moot and if there is a reasonable expectation that the plaintiff will be subject to the same action again.[109] The court rejected this doctrine, holding that nothing about the tax collection made it too short in duration to allow for full litigation of the claim.[110] The

98. *Id.* at 1185.
99. *Id.* at 1190.
100. *Id.* at 1192.
101. *Id.*
102. *Id.* at 1193.
103. *Id.*
104. *Id.* at 1193-94.
105. 370 U.S. 1 (1962).
106. *Christian Coal.*, 662 F.3d at 1194.
107. *Id.* at 1194-95.
108. *Id.* at 1195.
109. *Id.* at 1194-95.
110. *Id.* at 1195-96.

court also held that the taxpayer's tax liability for each taxable year was an independent cause of action, which meant that the taxpayer could not be subject to the "same action" in the future, but only a similar one.[111]

CC-FL's second claim was that the Service's decision to refund the taxes was a voluntary cessation of unlawful conduct, which does not render a claim moot unless the defendant can demonstrate that the unlawful conduct is unlikely to recur.[112] The court rejected this claim because the Service had not conceded that CC-FL was exempt from taxes in the years at issue.[113] Rather, the Eleventh Circuit did not consider the substantive issue and the taxes were barred by the statute of limitations.[114]

Interestingly, the court specifically declined to address the issue of whether injunctive or declaratory relief would be appropriate in the context of a live refund claim.[115] Instead, the court adopted a narrower holding: the AIA and the DJA prohibit suits consisting solely of claims for declarative or injunctive relief.[116] However, the court's opinion was hostile to CC-FL's attempts to avoid the AIA and the DJA, suggesting that, even if the refund claim were live, the court would have been reluctant to allow the injunctive and declaratory claims to proceed.[117] More importantly, nothing in the text or policy of the AIA or the DJA suggests that prohibited injunctive and declaratory claims are acceptable in the context of a refund claim.[118] Accordingly, *Christian Coalition* suggests that, even in a refund case, declaratory and injunctive relief are not available.

IV. *UNITED STATES V. GE HFS HOLDINGS, INC.*

In *United States v. GE HFS Holdings, Inc.*,[119] the United States District Court for the Middle District of Florida resolved a technical question regarding the statute of limitations for lender liability actions for unpaid employment taxes.[120] Because employment taxes are withheld from the wages of employees, there is a special concern that financially troubled employers might use the withheld sums as a

111. *Id.*
112. *Id.* at 1196.
113. *Id.*
114. *Id.*
115. *Id.* at 1192.
116. *Id.* at 1185.
117. *See id.* at 1190-96.
118. *See* I.R.C. § 7421(a); 28 U.S.C. § 2201.
119. No. 8:10-cv-231-T-33TBM, 2011 WL 5525360 (M.D. Fla. Nov. 14, 2011).
120. *Id.* at *7-8.

convenient source of illicit financing for their businesses. To protect the Treasury and employees from unscrupulous expropriation, the Code gives the Service several additional remedies to collect unpaid employment taxes.[121] Though the most significant of these remedies is the trust fund recovery penalty, which allows the Service to collect the unpaid taxes from responsible executives or directors of the employer, I.R.C. § 3505(b)[122] allows unpaid employment taxes to be collected from "[a] lender, surety, or other person" who finances a wage payment knowing that no employment taxes would be withheld.[123]

The controversy in *GE HFS Holdings* arose from a 1997 loan agreement between Heller Healthcare Finance, Inc. (Heller) and NuMed Home Health Care, Inc. (NuMed).[124] In 2000, NuMed went into Chapter 11 bankruptcy. During the proceedings, the government filed an adversary proceeding against Heller to determine the priority of their liens, Heller's under the loan agreement and the government's for unpaid taxes. The government also added a § 3505(b) lender liability claim, but it was ultimately dismissed because the bankruptcy court lacked jurisdiction to adjudicate the tax liability of a non-debtor.[125]

In 2010, the government reasserted its lender liability claim against Heller (now GE HFS Holdings, Inc.). Heller contended that the claim was outside the applicable statute of limitations.[126] Treasury Regulation § 31.3505-1(d)(1)[127] (after optimistically setting out procedures for voluntary payment of the tax) provides that the government may collect on the lender's liability within ten years of the assessment of the tax on the employer.[128] Treasury Regulation § 31.3505-1(d)(3)[129] provides that the limitations period can be extended by agreement.[130]

Since more than ten years had passed since the majority of the employment taxes at issue had been assessed against NuMed, the government needed to argue that the statute of limitations had been tolled or extended. Since the taxpayer had not agreed to an extension, as allowed by Treasury Regulation § 31.3505-1(d)(3), the government instead analogized to the general tax collection statute, I.R.C. § 6502-

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121. I.R.C. § 6672 (2006).
122. I.R.C. § 3505(b) (2006).
123. *Id.*; Treas. Reg. § 31-3505-1(b)(1) (2011).
124. 2011 WL 5525360, at *1.
125. *Id.* at *2-3.
126. *Id.*
127. Treas. Reg. § 31.3505-1(d)(1) (2011).
128. *Id.*
129. Treas. Reg. § 31.3505-1(d)(3) (2011).
130. *Id.*

(a),[131] which provides for a ten-year collection period for "any tax imposed by this title."[132] Under I.R.C. § 6503(h),[133] the ten-year period of § 6502 is suspended during the pendency of a bankruptcy case.[134] The Government took the position that the period for collecting the lender-liability tax was suspended during the NuMed bankruptcy case and that the collection action against Heller was therefore timely.[135]

The Government's position drew support from the Seventh Circuit in dicta in *United States v. Associates Commercial Corp.*[136] In *Associates Commercial Corp.*, the Government similarly attempted to collect employment taxes from a lender to a bankrupt employer. The lender made two arguments: that the statute of limitations had expired and that the Government had failed to give required notice and demand for payment.[137] The court held that notice to a lender was required but suggested in dicta that the suit would have been timely because the statute of limitations had been tolled by the employer's bankruptcy and that the limitations period for the lender liability tax should be "coterminous" with that of the primary taxpayer.[138] The notice holding of the Seventh Circuit was eventually overruled by the Supreme Court, but the dicta regarding the statute of limitations was not discussed.[139]

In *GE HFS Holdings*, the Middle District of Florida held that the dicta in *Associates* was not controlling over the plain language of § 3505 and the associated regulation.[140] The court was further persuaded by the fact that, since *Associates*, the § 3505 statute of limitations provision had been amended to extend its length and to provide for tolling the limitations period by agreement.[141] The fact that a bankruptcy-tolling provision was not also added strongly suggested that no such provision was intended.[142] This holding accorded with a 1988 decision of the Ninth Circuit addressing the same issue.[143]

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131. I.R.C. § 6502(a) (2006).
132. *Id.*; *GE HFS Holdings, Inc.*, 2011 WL 5525360, at *4.
133. I.R.C. § 6503(h) (2006).
134. *Id.*
135. *GE HFS Holdings, Inc.*, 2011 WL 5525360, at *4.
136. 721 F.2d 1094 (7th Cir. 1983), *overruled by* Jersey Shore State Bank v. United States, 479 U.S. 442 (1987).
137. *Id.* at 1095-96.
138. *Id.* at 1097-98.
139. *GE HFS Holdings*, 2011 WL 5525360, at *6; *Jersey Shore State Bank*, 479 U.S. at 446 & n.5.
140. *GE HFS Holdings*, 2011 WL 5525360, at *6.
141. *Id.*
142. *Id.* at *7.
143. *Id.*; United States v. Harvis Constr. Co., 857 F.2d 1360, 1365 (9th Cir. 1988).

The Government also argued that the relationship between the employer liability and the lender liability should create a unified limitations period.[144] In *United States v. Galletti*,[145] the Supreme Court held that parties that were secondarily liable for a tax under state law should be subject to the same assessment procedures and statute of limitations as the primary taxpayer.[146] The Eleventh Circuit rejected this argument based on significant differences between the employer's liability under I.R.C. § 6673[147] and the lender's § 3505(b) liability.[148] The court noted several such differences: the fact that the lender liability is only 25% of the unpaid tax, the fact that the lender is not subject to penalties, and the fact that collection procedures are different.[149]

The holding of *GE HFS Holdings* is technical and involves an obscure Code section, but its practical application may be broader than it initially seems. Since the lender liability tax only comes into play when a primary taxpayer has misappropriated payroll taxes and the taxes cannot be recovered, tolling of the statute of limitations in bankruptcy will almost always be relevant. Moreover, in such cases a lender may be the only solvent party the Government can hope to recover the lost taxes from. Thus, the question of when exactly lender liability is foreclosed by the statute of limitations is significant for both lenders and the Government.

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144. *GE HFS Holdings*, 2011 WL 5525360, at *6-7.
145. 541 U.S. 114 (2004).
146. *Id.* at 116.
147. I.R.C. § 6673 (2006).
148. *GE HFS Holdings*, 2011 WL 5525360, at *7.
149. *Id.*

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