No. ______

In the

# Supreme Court of the United States

JAMES W. SMITH,
*Petitioner*,

v.

UNITED STATES OF AMERICA,
*Respondent*.

**On Petition for Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit**

## PETITION FOR WRIT OF CERTIORARI

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## QUESTIONS PRESENTED

1. The Meaning of "Shall" in the Internal Revenue Code.

Sections 6501(a), 6213(a), and 6901(a) of the Internal Revenue Code all provide that the Government "shall" or "shall not" take certain actions in connection with providing notice, making assessments, and collecting unpaid taxes, and § 6502(a) uses an equivalent phrase ("but only if").

**Does the use of the word "shall" in the identified code sections make their provisions mandatory with respect to notice, assessment, payment, and collection in the case of transferees, or can the Government bring proceedings in court to collect taxes without complying with these provisions?**

2. The Overall Statutory Scheme.

The Internal Revenue Code has a very detailed framework of interrelated code sections dealing with a wide range of procedural and administrative issues, including provisions governing notice, assessment, payment, and collection of taxes.

**Can the Government substitute a judicially-created alternative for the very detailed statutory scheme designed by Congress for purposes of enforcing transferee liability?**

3. Due Process and the Failure to Assess.

Section 6901 provides that transferees must be assessed in the same manner as taxpayers except as otherwise provided in that section. The only exception extends the statute of limitations for assessment by at most three years.

**Does the Government's practice of suing transferees without personal assessment frustrate the intent of Congress and deprive transferees of their property without due process of law?**

4. Due Process and the Right to Petition the U.S. Tax Court.

Section 6213(a) provides that a taxpayer "may file a petition with the Tax Court" within 90 days after the Government mails a notice of deficiency to that taxpayer. Section 6901(f) recognizes that a similar process applies for transferees. Section 6902 provides rules that have "special application to transferees" in the Tax Court, including a special burden of proof upon the IRS to show that the petitioner is liable as a transferee and special evidentiary rules to which the petitioner is "entitled."

**Does the Government's practice of suing transferees without issuing a notice of deficiency frustrate the intent of Congress and deny transferees the right to due process by preventing them from filing a petition in the Tax Court?**

5. <u>The Jurisdiction and Independence of the U.S. Tax Court</u>.

Section 7441 establishes the Tax Court "under article I of the Constitution of the United States" and provides that it "shall be independent of . . . the executive branch of the Government." Section 7442 describes the jurisdiction of the Tax Court.

**Does the Executive Branch practice of not sending notices of deficiency to transferees--thereby preventing them from filing a petition in the Tax Court--while suing them without such notice in federal district court, violate the independence of the Tax Court and constitute an unconstitutional infringement upon its jurisdiction?**

6. <u>Sovereign Capacity</u>.

Supreme Court rulings have established that when the Government acts in its sovereign capacity, it is not subject to state statutes of limitations placing time limits upon enforcement. *See, e.g., United States v. California*, 507 U.S. 746, 757 (1993).

**When the Government sues as a third-party beneficiary with respect to a private contract to pay the taxes of another, is it acting in its sovereign capacity such that it is not subject to a state statute of limitations for enforcing the contract?**

7. Suspension of the Collections Statute of Limitations.

Section 6502(a) provides that a tax may be collected from a taxpayer through a proceeding in court if the proceeding begins "within ten years after the assessment of the tax." Section 6503 contains various provisions suspending the running of the limitation period under § 6502.

**Do the provisions of § 6503 suspend the running of the § 6502 collections statute of limitations with respect to both transferees and obligors under a private contract?**

8. Attorneys' Fees and Costs.

Section 7430(a) provides that in a tax case brought by the Government, the prevailing party (other than the Government) may be awarded a judgment for reasonable litigation costs unless the Government position was substantially justified.

**If the Petitioner prevails on this appeal, should the district court's award of attorneys' fees and costs be reinstated (and should additional fees and costs be awarded for the appeal) because Petitioner is the prevailing party and the Government's position was not substantially justified?**

## PARTIES

Petitioner, James W. Smith, was an appellee/cross-appellant in the court below. Mary Carol S. Johnson, an appellee/cross-appellant below, does not participate in this petition. Marian S. Barnwell and Billie Ann S. Devine, defendants in the district court below, are deceased, and their estates were not substituted as parties. Eve H. Smith, defendant in the district court below, was dismissed by the district court.

Respondent, the United States, was the appellant/cross-appellee in the court below.

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## JURISDICTION

The Tenth Circuit Court Judgment was filed on March 29, 2019. (App.1). This Court's jurisdiction is timely invoked under 28 U.S.C. § 1254(1).

## RELEVANT PROVISIONS INVOLVED

Relevant constitutional, statutory, and rule provisions are set forth in the Appendix.

## INTRODUCTION

This case involves the statute of limitations applicable to the Government's claim as a third-party beneficiary of a private contract to pay the taxes of another person. Unlike the statute of limitations issues for transferee liability discussed below, there is very little case law addressing the application of the Code's enforcement provisions to a private contract. In fact, the Code does not appear to address the issue, while circuit courts have split on whether a state or federal statute of limitations should be applied. There is also a circuit court split with respect to whether the suspension provisions of the Code apply to those who are liable to pay the taxes of another.

This case also involves the liability of transferees for federal estate taxes imposed on a decedent's estate. Although both Congress and this Court have determined that such individuals should be treated like taxpayers, the transferees were sued by the Government in federal district court without notice or assessment approximately twenty years after the decedent's death. During the eight-year period since this lawsuit was initiated, two of the transferees have died and only one continues as a Petitioner in this case.

However, the issues involved in this case are far broader than just the federal estate tax. Instead, the assessment, payment, and collection of all types of transferee liability under the Internal Revenue Code (the "Code"), including liability at law or in equity for income, estate, and gift taxes, are at issue. Furthermore, this case involves not only the mandatory enforcement provisions of § 6901, but also the integrity of "the overall statutory scheme" found in Subtitle F of the Code, entitled "Procedure and Administration."

The Code provides that for purposes of tax enforcement, transferees are subject to the same rules applicable to taxpayers with certain limited exceptions. The Government generally acknowledges the mandatory nature of this statutory framework, but only when it elects to proceed under § 6901. Otherwise, the Government believes that it is free to sue transferees in federal district court without following the requirements of the Code. In fact, the Government has a regular practice of ignoring this statutory scheme, as seen in the provisions of the IRS Internal Revenue Manual: "A suit to impose transferee liability may be necessary when the procedures of IRC § 6901 are not available because the statute of limitations for assessment has expired." (See IRM 5.17.14.4.4, no. 4 (01-24-2012)).

The Government's approach originated with *Leighton v. United States*, 289 U.S. 506, 508 (1933), in which the Government sought to recover income taxes from the unassessed shareholders of an insolvent corporation. Acknowledging that "[t]he meaning of the statute is not free from uncertainty," *Leighton* found that before 1926, the Government could sue such shareholders without assessment based on the equitable trust fund doctrine, and that this "right remained unless taken away by the specific words or clear intendment of the 1926 enactment." Concluding that the right had not been taken away, the Court allowed the Government's claim. A number of courts have expanded the holding in *Leighton*, even as they frequently express concern about their rulings. In the process, a substantial amount of confusion has been created about the law in this area.

After noting the absence of any reported case on the specific issue before it, the Tenth Circuit expanded upon *Leighton* and held "that the collection procedures contained in § 6901 are not exclusive and mandatory, but are cumulative and alternative to the other methods of tax collection recognized and used prior to the enactment of § 6901 and its statutory predecessors." *United States v. Russell*, 461 F.2d 605, 606 (10th Cir. 1972) ("*Russell I*"). As a result, the court excused the Government's failure to assess the transferee within the § 6901 limitation period. Although the transferee argued that the Court in *Leighton* had not been "fully apprised by counsel in that case as to the legislative history of § 6901 and that had that court been more fully informed it would have ruled differently," the court responded: "Such argument should be made to the Supreme Court, and not us. We are not at liberty to go behind the *Leighton* rule." *Russell I* at 608. In *United States v. Russell*, 532 F.2d 175 (10th Cir. 1976) ("*Russell II*"), the court expanded its ruling in *Russell I* by holding that a general tax lien could be used to collect the transferee's unassessed personal liability. However, the court warned: "We deem it advisable to caution the Government that our affirmance in this instance should not be relied upon for a like result in the event of failure by the proper officials to effect the assessment lacking here."

Based on the due process concerns inherent in the *Russell* cases and the fact that the six-year statute of limitations had been expanded to ten years, a district court in the Eight Circuit declined to follow the Tenth Circuit. The court stated that if transferee assessment is not required, "the government could wait at least thirteen years" from the filing of the return "before giving a transferee any notice whatsoever of possible personal liability." *U.S. v. Schneider*, 92-2 USTC ¶60,119 (D.N.D. 1992). The court concluded: "<u>That is patently unfair and unjust, and the court agrees with the defendant that to adopt the government's position denies taxpayers the fundamental due process that the assessment provisions of the Internal Revenue Code were meant to afford</u>." (Emphasis added.)

However, although the Supreme Court has never adopted *Russell I's* "cumulative and alternative" theory, a number of lower courts have done so. In *U.S. v. Geniviva*, 16 F.3d 522 (Third Cir. 1994), the court chose to follow *Russell I*, although it also "express[ed] a certain sorrow that what seems inherently unfair is also quite in accordance with the law, and note[d] a compassion for the equitable position of the appellants." Even as it allowed the Government's claim, in *Estate of Mangiardi v. Comm'r*, the Tax Court quoted *Geniviva* and added: "We also sympathize with the beneficiaries of decedent's estate in that years later they find themselves at risk of forfeiting their inheritance without prior notice, especially after respondent had ample opportunity to make assessments against them." 101 T.C.M. (CCH) 1083, 1086, 2011. In *United States v. Botefuhr*, 309 F.3d 1263, 1277 (10th Cir. 2002), the Tenth Circuit again expanded its transferee liability theory, concluding that if an action for gift taxes can be timely brought against a donor, it can also be timely brought against a donee.

In *United States v. Holmes*, 727 F.3d 1230, 1241 (10th Cir. 2013), another case dealing with a shareholder's transferee liability for corporate income taxes under § 6901, the court again excused the failure to assess the shareholder. *Holmes* relied on *Leighton* and on *United States v. Galletti*, 541 U.S. 114, 115 (2004), which stated: "Once a tax has been properly assessed, nothing in the Code requires the IRS to duplicate its efforts by separately assessing the same tax against individuals or entities who are not the actual taxpayers but are, by reason of state law, liable for the taxpayer's debt." 727 F.3d at 1234. However, *Galletti* involved neither § 6901 nor transferee liability and is therefore inapplicable. Dissenting in *Holmes*, the Chief Judge of the Tenth Circuit wrote: "But in this case, unlike in *Galletti something* in the Tax Code *does require* the IRS to 'duplicate its efforts by separately assessing the same tax'—§ 6901 requires the IRS to separately assess transferees." 727 F.3d at 1245 (Tymkovich, Circuit Judge, dissenting) (emphasis in original). The dissent also distinguished *Leighton*: "To be sure, *before* the statute of limitations for assessing taxes has expired, the IRS may collect unassessed tax liabilities in court, but that is no different than in the case of any other taxpayer ... But the *Leighton* Court did not address what happens when the IRS brings suit against an unassessed transferee *after* the period for assessing the transferee has passed." Id. at 1241 (emphasis in original).

This confusing and constitutionally questionable history has now reached a culmination in this case in which the Tenth Circuit relied on "*Botefuhr's* definitive holding that the limitations period for transferees is the same as the limitations period for the [transferor]." If an estate tax deferral election under § 6166 is involved, the Government now has almost twenty-five years to sue transferees without notice or assessment in federal district court. However, the foregoing line of cases hangs upon an uncertain reading of the 1926 Revenue Act, and a great deal has happened with respect to the tax laws of the United States since that time, including the passage of the 1928 Revenue Act and the enactment of the Internal Revenue Codes of 1939, 1954, and 1986. This case provides the Court with a unique opportunity to reconcile a confused area of law affecting all transferees and to end the inappropriate judicial expansion of a theory that has no support in any Internal Revenue Code, past or present.

## STATEMENT OF THE CASE

### A. BACKGROUND AND FACTS

Anna Smith died in 1991. Following the decedent's death, her four children received distributions from her revocable trust. Two children served as personal representatives and trustees. The four children also received life insurance proceeds totaling about $370,000 as a result of their mother's death.

The majority of the estate's value consisted of a closely-held business. The estate paid $5,000,000 in estate taxes in 1992 (about 75% of the total tax). Payment of the remaining balance was deferred pursuant to a § 6166 election. In 1992, the trust assets were distributed to the children, who signed an agreement that they would be equally responsible for paying the deferred tax (the "Distribution Agreement"). At the request of the IRS, the children offered the closely-held stock as collateral to the Government around 1998 in order to obtain a discharge for the fiduciaries from joint and several personal liability, but that offer was rejected. All required tax and interest payments were made until about 2001, shortly before the closely-held business went bankrupt in 2002.

In January 2011, the Government brought an action in Utah federal district court against the four children and one child's wife for approximately $1.6 million in unpaid estate taxes and an unspecified amount of accrued interest. None of these individuals was ever separately assessed by the IRS or provided with a personal notice of deficiency or liability. During the course of the litigation, the two non-fiduciary children died and the Government failed to substitute their estates as parties.

### B. PROCEEDINGS IN THE UNITED STATES DISTRICT COURT

According to the Government's complaint, jurisdiction in the District Court was based on 28 U.S.C. §§ 1340, 1345, 26 U.S.C. §§ 6324(a), 7402 and 7403, and 31 U.S.C. § 3713.

The Government's claims and the District Court's conclusions in resolving them provide important context for the case and are summarized as follows:

(1) With respect to personal liability under § 6324(a)(2):

   a. Because trust beneficiaries are neither "transferees" nor "beneficiaries" for purposes of § 6324(a)(2), the claim was disallowed;
   b. Based on Tenth Circuit precedent, § 6901 is not mandatory and the Government could sue the children as "beneficiaries" of the life insurance policies without assessment;
   c. The daughter-in-law received no transfers and was dismissed from the case; and
   d. Because the trust assets were included in the gross estate under § 2033 rather than any of §§ 2034 through 2042, the

trustees were not jointly and severally liable.

(2) With respect to the joint and several personal liability of fiduciaries under 31 U.S.C. § 3713(b), that liability was discharged under § 2204 because a special lien was created under § 6324A when the children offered the closely-held stock to the IRS as collateral.

(3) The Government could not enforce a § 6321 general tax lien against the Distribution Agreement because it had released its liens against the estate.

(4) The third-party beneficiary claim could not be enforced because Utah's six-year statute of limitations had expired.

Following these rulings, the children sought an award of attorneys' fees and costs pursuant to § 7430 with respect to the following issues: § 2204 discharge, § 2033 inclusion, and the untimely attempts to enforce the Distribution Agreement and a general tax lien. Ruling that the Government's litigation position on these issues was not substantially justified and that the surviving children were the "prevailing party" in the case, the court awarded about $316,000 in attorneys' fees and costs, most of which related to the joint and several liability issues.

### C. PROCEEDINGS IN THE TENTH CIRCUIT COURT OF APPEALS

The Government appealed the award of attorneys' fees and costs and the ruling that the statute of limitations had run on its third-party beneficiary claim. The surviving children cross-appealed the ruling finding them liable under § 6324(a)(2) to the extent of the life insurance proceeds.

The Tenth Circuit ruled as follows:

(1) The Government acted in its sovereign capacity in attempting to collect federal taxes pursuant to the third-party beneficiary claim and could not be bound by a state statute of limitations; § 6502 instead provided the statute of limitations.

(2) A separate assessment of transferee liability under § 6324(a)(2) is not required and the Government is free to sue transferees at any time as long as the limitation period is still open against the transferor.

(3) The Government's position was substantially justified and the award of attorneys' fees and costs was reversed.

## REASONS FOR GRANTING THE PETITION

### I. The Government has a Regular Practice of Ignoring the Mandatory Language of the Code with respect to Enforcing Transferee Liability.

By suing transferees in federal district court without providing either a notice of deficiency or an assessment, the Government regularly violates the mandatory requirements of at least four sections of the Internal Revenue Code, 26 U.S.C. § 1 *et seq*. (the "Code"), three of which expressly provide that the IRS "shall" or "shall not" take certain actions in connection with the collection of taxes, including with respect to the personal liability of transferees. Section 6501(a) provides in part that "the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed ... and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period." In addition, § 6502(a) states in part: "Where the assessment of any tax imposed by this title has been made within the period of limitation properly applicable thereto, such tax may be collected by levy or by a proceeding in court, but only if the levy is made or the proceeding begun—(1) within 10 years after the assessment of the tax." Section 6213(a) generally provides that, with respect to a notice of deficiency issued pursuant to § 6212, "no assessment of a deficiency in respect of any tax imposed by subtitle A [Income Taxes], or B [Estate and Gift Taxes] ... and no levy or proceeding in court for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer ...."

Section 6901(a) provides a general rule stating that, unless provided otherwise in that code section, transferee liability "shall … be assessed, paid, and collected in the same manner and subject to the same provisions and limitations as in the case of the taxes with respect to which the liabilities were incurred." Treas. Reg. § 301.6901-1(a)(1) is even more clear about these requirements, providing that the amount for which the transferee is liable "shall be assessed against such transferee … and paid and collected in the same manner and subject to the same provisions and limitations as in the case of a deficiency in the tax with respect to which such liability is incurred, except as hereinafter provided." Section 6901(c) provides that with respect to an "initial transferee," assessment "shall be ... within 1 year after the expiration of the period of limitation for assessment against the transferor." Section 6901(f) provides suspension for transferees similar to what is provided in § 6503(a)(1) and recognizes that transferees may receive the equivalent of a notice of deficiency: "The running of the period of limitations upon the assessment of the liability of a transferee or fiduciary shall, after the mailing to the transferee or fiduciary of the notice provided for in Section 6212 (relating to income, estate, and gift taxes), be suspended for the period during which the Secretary is prohibited from making the assessment in respect of the liability of the transferee or fiduciary …."

The repeated use of the word "shall" in the foregoing code sections and the quoted regulation establishes that the notice, assessment, and collection provisions of the Code are not optional and that they apply equally to taxpayers and transferees unless specifically provided otherwise. With respect to the meaning of the word "shall," this Court has stated: "'[S]hall' makes the act of filing a charge within the specified time period mandatory." *Nat'l R.R. Passenger Corp. v. Morgan*, 536 U.S. 101, 109 (2002), citing *Lexecon Inc. v. Milberg Weiss Bershad Hynes & Lerach*, 523 U.S. 26, 35 (1998) ("[T]he mandatory 'shall,' ... normally creates an obligation impervious to judicial discretion"). Furthermore, there is nothing ambiguous about these requirements. In *King v. Burwell*, this Court said the following about another section of the Code: "If the statutory language is plain, we must enforce it according to its terms." 135 S. Ct. 2480, 2489 (2015) (quoting *Hardt v. Reliance Standard Life Ins. Co.*, 560 U.S. 242, 251 (2010)).

In contrast to the plain language of the Code, the official guidance of the IRS in the Internal Revenue Manual and many proceedings in court are evidence of the Government's regular practice of suing transferees without notice or assessment as long as the collections statute of limitations is still open against the transferor. However, this Court should instead enforce the mandatory provisions of the law as plainly written by Congress.

## II. The Government's "Cumulative and Alternative" Theory is Inconsistent with the "Overall Statutory Scheme" and the "Existing Harmony of the Tax Statutes."

The Government's practice of suing transferees without notice or assessment also contradicts a carefully designed statutory framework of interrelated code sections. In *King v. Burwell*, this Court stated: "[W]e 'must do our best, bearing in mind the fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.'" 135 S. Ct. 2480, 2492, quoting *Utility Air Regulatory Group v. EPA*, 134 S. Ct. 2427, 2441 (2014).

In addition to the code sections mentioned above, the "overall statutory scheme" of the Code includes the following provisions relating to transferees:

- Chapter 66, Subchapter A, "Limitations on Assessment and Collection," includes only four code sections: §§ 6501 through 6504. In these provisions, the only references to transferees are in § 6503(k)(3) and § 6504(7), both of which provide that for "Claims against transferees and fiduciaries, see chapter 71."
- Chapter 71 is entitled "Transferees and Fiduciaries" and includes five code sections: §§ 6901 through 6905. Section 6901 is titled "Transferred assets" and includes provisions dealing with "Method of Collection," "Period of limitations," and "Suspension of running of period of limitations." With respect to Tax Court proceedings, § 6902 contains "Provisions of special application to transferees."
- Section 6324(a)(2) imposes personal liability upon transferees but has no limitation period or provisions authorizing the Government to assess or collect that liability.
- Section 6901(h) expressly defines the term "transferee" to include those personally liable

under § 6324(a)(2). Most other types of transferee liability arise under state law rather than federal law but are still covered by § 6901.

- Section 6901(f) provides that after a notice of liability has been mailed to a transferee, "[t]he running of the period of limitations upon the assessment of the liability of a transferee" is suspended while the IRS is prohibited from assessing that liability.

Although the Tenth Circuit acknowledged that "§ 6324 does not contain an explicit statute of limitations," it stated: "Hence, our reasoning that the statute of limitations governing transferees must be the same as that governing the estate" (see footnote 10). However, addressing statutory silence, § 6302(a) states: "If the mode or time for collecting any tax is not provided for by this title, the Secretary may establish the same by regulations." Regs. § 301.6901-1 states that the liability of a transferee shall be assessed, paid, and collected "in the same manner" as for the underlying tax. Sections 6302 and 6324 are both part of Chapter 64.

Similar to the trust fund doctrine that existed before the 1926 Revenue Act, *Flora v. United States*, 362 U.S. 145 (1958), involved a taxpayer's claim that partial payment of an assessed tax was sufficient to allow a refund claim in federal district court because prior law had allowed this under "the common-law count of assumpsit." Because the new law did not indicate "an intent to change the nature of the refund action in any pertinent respect," the taxpayer argued there was no basis for requiring full payment. In denying the taxpayer's argument, this Court stated: "We are not here concerned with a single sentence in an isolated statute, but rather with a jurisdictional provision which is a keystone in a carefully articulated and quite complicated structure of tax laws." Acknowledging that evidence of congressional intent to the contrary would require a different result, the Court concluded that "the evidence pertaining to this intent is extremely weak, and we are convinced that it is entirely too insubstantial to justify destroying the existing harmony of the tax statutes." *Flora*, 362 U.S. 145 at 158.

Similarly, in this case, a practice from the early twentieth century should not be permitted to overthrow the "complicated structure of tax laws" provided in the Code, especially when the statutory evidence against this practice is actually extremely strong. Instead, the Court should require the enforcement of "the overall statutory scheme" as established by Congress for many years.

## III. The Government's "Cumulative and Alternative" Theory Ignores Almost Ninety Years of Supreme Court Precedent and Relevant Legislative History.

The plain language and mandatory nature of § 6901 were confirmed by this Court in *United States v. Updike*, 281 U.S. 489 (1930). Reviewing § 280 of the Revenue Act of 1926, an almost identical predecessor of § 6901, this Court addressed the Government's argument that the six-year limitation period found in § 278(d) of that Act did not apply to equity suits against transferees to recover "trust funds," and stated:

> This view of the statute is not admissible. The plain words of § 280(a) are, that, "except as hereinafter in this section provided," the liability of the transferee shall be "assessed, collected, and paid" subject, among other things, to the same "provisions and limitations as in the case of a deficiency in a tax imposed by this title . . ." 289 U.S. at 494-95 (emphasis added).

This Court also acknowledged that the proceeding against the transferees was "in every real sense a proceeding in court to collect a tax" and explained that "the effect of the language above quoted from § 280 is to read into that section, and make applicable to the transferee equally with the original taxpayer, the provision of § 278(d) in relation to the period of limitation for the collection of a tax." *Id.* at 494 (emphasis added). Because the collection limitation period had expired, the Government suit against the transferees was disallowed. Although the issues of separate notice and assessment were not before this Court, the same reasoning requires that those provisions be read into § 6901 as well. In *Updike*, this Court stated that even when a *timely assessment* has been made, "to allow an indefinite time for proceeding to collect the tax would be out of harmony with the obvious policy of the act to promote repose by fixing a definite period after assessment within which suits and proceedings for the collection of taxes must be brought." *Id.* at 495-96. The Court then discussed the consequences of an *untimely* assessment:

> In the light of that policy, it seems reasonably clear that the saving clause, "within the

> statutory period of limitation properly applicable thereto," was inserted solely for the protection of the taxpayer—that is to say, in order to preclude collection of the tax even within six years after the assessment, if that assessment, when made, was barred by the applicable statutory limitation. *Id.* at 496 (emphasis added).

This taxpayer "saving clause" language is essentially identical to what is found in current § 6502(a), which provides that if an assessment has been made "within the period of limitation properly applicable thereto," the tax may be collected within 10 years after the assessment.

The Government's position also ignores this Court's opinion in *United States v. Continental National Bank & Tr. Co.*, 305 U.S. 398 (1939). In *Continental*, timely assessments were made against the taxpayer and the initial transferee, but not against the subsequent transferees. The Government argued that the assessment of the *initial transferee* caused that transferee to be treated as a transferor taxpayer under § 280, thereby allowing a six-year collection period under § 278(d) with respect to the unassessed *subsequent transferees. Continental Nat'l,* 305 U.S. at 403-404. This is essentially the same argument that the Government has made in the present case—that the assessment of a transferor allows the Government to collect from unassessed transferees within the ten-year collection limitation period under § 6502(a).

In response, this Court stated: "But no assessment was made against any of the defendants" (i.e., the subsequent transferees). (emphasis added). In other words, the Government could not rely on the collections limitation period triggered by the assessment of the immediately preceding transferor in order to bring a suit against unassessed subsequent transferees after the time for assessing those transferees had passed. *Id.* at 404-05. This is exactly the ruling that should apply in this case and to transferee liability in general. If assessment has not been made within the assessment limitation period of § 6501(a), both § 6501(a) and the § 6502(a) saving clause prohibit collection from the unassessed transferee. The dissent in *Holmes* reached the same conclusion: "And according to *Continental*, once the assessment period has expired, the IRS cannot collect in court from an unassessed transferee — just as it cannot collect in court from any other unassessed taxpayer." *Holmes*, 727 F.3d at 1241.

Although the issue in *Continental* arose under the 1926 Revenue Act, the Court's opinion also addressed the 1928 Revenue Act which replaced it. The difference between the two Acts as they relate to § 6901 is extremely important. Section 280(b)(1) of the 1926 Act authorized assessment against all transferees within one year after the expiration of the period of limitation for assessing the taxpayer. In contrast, § 311(b)(1) of the 1928 Act maintained the same one-year period for initial transferees, but then in (b)(2) added an additional year for each subsequent transferee in the chain beginning with the initial transferee, subject to the following limitation: "[B]ut only if within three years after the expiration of the period of limitation for assessment against the taxpayer." The three-year limitation was added by the Senate, as explained in the Senate Finance Committee report quoted by the Court:

> Section 311 (b) (2) of the House bill provides, with specific exceptions, that the period for assessment in such case shall be one year after the expiration of the period of limitation for assessment against the preceding transferee. It seemed to the [Senate] committee that this would unduly prolong litigation and that there should be a time when the transferee may know that he is no longer liable to be proceeded against. A committee amendment therefore provides that in all cases the tax must be assessed within three years after the expiration of the period of limitation for assessment against the taxpayer. Senate Report No. 960, 70th Congress, 1st Session, p. 32. *Continental Nat'l*, 305 U.S. at 404 fn 3 (emphasis added).

This is a clear statement of legislative intent with respect to a law that continues in force today in the form of § 6901(c)(2). The *Continental* opinion did not cite *Leighton*, which was decided six years earlier and did not consider the impact of the 1928 law. Given the overall three-year limitation on assessment and the desire not to "unduly prolong litigation," it seems certain that the 70th Congress would have looked unfavorably upon the ruling of the Tenth Circuit in this case.

## IV. Suing Transferees Without a Notice of Liability and Without Assessment after the Expiration of the Assessment Limitation Period Denies Them Due Process of Law.

The Fifth Amendment to the Constitution of the United States provides that no person may be "deprived of life, liberty, or property, without due process of law." In the similar context of state taxation under the Fourteenth Amendment Due Process clause, this Court recently stated that the "legitimacy" of the power to tax "requires drawing a line between taxation and mere unjustified 'confiscation.'" *North Carolina Dept. of Revenue v. Kimberley Rice Kaestner 1992 Family Trust*, No. 18-457 (U.S. Jun. 21, 2019), at 8. Furthermore, due process "'centrally concerns the fundamental fairness of governmental activity.'" *Id.*

Section 6213(a) generally provides taxpayers with 90 days to file a petition in the Tax Court after receiving a notice of deficiency, and § 6901(a) and (f) make clear that transferees are entitled to the same notice (when sent to transferees, it is called a "notice of liability"). In Tax Court proceedings, § 6902 provides transferees with the benefit of a special burden of proof and special evidentiary rules. However, if the Government fails to provide transferees with a notice of liability, their right to file a petition in the Tax Court is never triggered. Therefore, suing transferees without such notice not only violates § 6213(a), but also prevents them from accessing a forum designed by Congress to resolve tax controversies where they have the benefit of special rules. This practice is fundamentally unfair and deprives transferees of their property without due process of law.

In *Phillips v. Commissioner*, 283 U.S. 589 (1931), this Court addressed a claim that the provisions of the 1926 Revenue Act which treated transferees like taxpayers constituted a violation of due process. This Court stated "[t]he procedure provided in § 280(a)(1) satisfies the requirements of due process because two alternative methods of eventual judicial review are available to the transferee." *Id.* at 597. First, the transferee could pay the tax after personal assessment and then bring an action to recover the amount paid. Second, "the transferee may avail himself of the provisions for immediate redetermination of the liability by the Board of Tax Appeals [now the Tax Court], since all provisions governing this mode of review are made applicable by § 280." *Id.* at 597-98. After reciting the statutory protections of a deficiency notice, the right to appeal to the Board without making payment, and the special evidentiary rules and burden of proof, this Court stated: "These provisions amply protect the transferee against improper administrative action." *Id.* at 598-99. In contrast, the Government's practice of suing transferees without notice or timely assessment essentially rejects the due process analysis in *Phillips* by denying transferees *both* of the "alternative methods of eventual judicial review." Instead, transferees are forced into a forum which was not designed by Congress to resolve tax controversies.

In addition, the Government's practice of suing transferees without assessment after expiration of the assessment limitation period "denies taxpayers the fundamental due process that the assessment provisions of the Internal Revenue Code were meant to afford." *See United States v. Schneider*, 92-2 U.S.T.C. ¶60,119, 1992 WL 472024 (D.N.D. 1992). In particular, this practice violates § 6501(a) and the saving clause of § 6502(a). This Court has explained the importance of such limitation periods on a number of occasions. For example, the Court has stated: "The theory is that even if one has a just claim it is unjust not to put the adversary on notice to defend within the period of limitation and that the right to be free of stale claims in time comes to prevail over the right to prosecute them." *Railroad Telegraphers v. Railway Express Agency, Inc.*, 321 U.S. 342, 349 (1944).

In *Gabelli v. SEC*, 568 U.S. 442, 448-49 (2013), the Court elaborated:

> Statutes of limitations are intended to "promote justice by preventing surprises through the revival of claims that have been allowed to slumber until evidence has been lost, memories have faded, and witnesses have disappeared." *Railroad Telegraphers v. Railway Express Agency, Inc.*, 321 U.S. 342, 348-349 (1944). They provide "security and stability to human affairs." *Wood v. Carpenter*, 101 U.S. 135, 139 (1879). We have deemed them "vital to the welfare of society," *ibid.*, and concluded that "even wrongdoers are entitled to assume that their sins may be forgotten," *Wilson v. Garcia*, 471 U.S. 261, 271 (1985).

There is neither justice nor due process in allowing the Government to sue transferees without notice of liability or assessment up to twenty-five years after the transfer was made. Not even "wrong-doers" should be subject to such "slumbering" claims.

## V. The Executive Branch Practice of Bringing Suits Against Transferees in the Absence of a Notice of Liability Violates the Independence of the U.S. Tax Court and is an Unconstitutional Infringement upon Tax Court Jurisdiction.

Section 7441 provides in part: "There is hereby established, under article I of the Constitution of the United States, a court of record to be known as the United States Tax Court." The establishment of the Tax Court as an Article I court occurred as part of the Tax Reform Act of 1969, Pub. L. 91-172, 83 Stat. 487. In *Freytag v. Commissioner*, 501 U.S. 868, 887 (1991), this Court noted "the intent of Congress, which enacted legislation in 1969 with the express purpose of 'making the Tax Court an Article I court rather than an executive agency.' S. Rep. No. 91-552, p. 303 (1969)." *Freytag,* 501 U.S. at 887. *Freytag* examined "the Tax Court's functions to define its constitutional status and its role in the constitutional scheme," concluding that the court was "established by Congress to interpret and apply the Internal Revenue Code in disputes between taxpayers and the Government." This Court also stated: "The Tax Court remains independent of the Executive and Legislative Branches. Its decisions are not subject to review by either the Congress or the President." Id. at 890-91. Although an appeals court later held that the Tax Court "exercises Executive authority as part of the Executive Branch" (*see*

*Kuretski v. Commissioner*, 755 F.3d 929, 932 (D.C. Cir. 2014)), Congress quickly responded by adding the following sentence at the end of § 7441: "The Tax Court is not an agency of, and shall be independent of, the executive branch of the Government."

In addition, § 7442 provides: "The Tax Court and its divisions shall have such jurisdiction as is conferred on them by this title." According to the Tax Court, "[t]he question of the Court's jurisdiction is fundamental and must be addressed when raised by a party or on the Court's own motion." *Estate of Forgey v. Commissioner*, 115 T.C. 142, 145 (2000). In *Phillips Petroleum Co. v. Commissioner*, 92 T.C. 885, 888 (1989), the court explained that it had "repeatedly stated that its jurisdiction is strictly limited by statute and that it is without authority to enlarge upon that statutory grant of jurisdiction," and then added: "Sections 7442 and 6213 confer jurisdiction on the Tax Court to redetermine deficiencies in income, estate and gift, and certain excise taxes. <u>Our jurisdiction is dependent upon the issuance of a notice of deficiency</u>." (Emphasis added). *Phillips Petroleum* continued: "<u>The Court also has jurisdiction in cases commenced by a notice of liability as a transferee or fiduciary</u> and disclosure actions." 92 T.C. at 888 (emphasis added). United States Tax Court Rule 13(a) confirms that the "jurisdiction of the Court depends" upon: (1) the issuance of a notice of deficiency; "and (2) in a case commenced in the Court by a transferee or fiduciary, upon the issuance by the Commissioner of a notice of liability to the transferee or fiduciary." Based on the foregoing, a notice of liability issued to a transferee is clearly required in order to create jurisdiction in the Tax Court.

As noted, this Court addressed the jurisdiction of federal district courts to hear cases involving partial payments of an assessed tax in *Flora v. United States*, 362 U.S. 145 (1958). The Court looked to the purposes for establishing the Board of Tax Appeals (the predecessor to the Tax Court), finding that one of those purposes "was to furnish a forum where full payment of the assessment would not be a condition precedent to suit. The result is a system in which there is one tribunal for prepayment litigation and another for post-payment litigation, with no room contemplated for a hybrid of the type proposed by petitioner." *Id.* at 163. This Court also warned that allowing partial payments "could be expected to throw a great portion of the Tax Court litigation into the District Courts" because it could eliminate one of the incentives for choosing the Tax Court as a forum. *Id.* at 175-76.

The Government's position on transferee liability contradicts *Flora* because <u>it creates the very type of hybrid system this Court said should not exist</u>. Furthermore, suing transferees in district court without issuing the required notice of deficiency changes the dynamics between the two systems by expanding the jurisdiction of the "post-payment tribunal" at the expense of the "prepayment tribunal." The *Flora* opinion concludes: "In sum, if we were to accept petitioner's argument, we would sacrifice the harmony of our carefully structured twentieth century system of tax litigation, and all that would be achieved would be a supposed harmony of § 1346(a)(1) with what might have been the nineteenth century law had the issue ever been raised." *Id.* at 176-77. Rejecting this outcome, the Court required full payment in order to "promote the smooth functioning of this system" rather than allowing partial payments which "would work at cross-purposes with it." *Id.* at 176.

Requiring the Government to issue notices of liability to transferees promotes the "smooth functioning" of the Code and protects the Tax Court jurisdiction intended by Congress. In contrast, allowing this requirement to be ignored works at "cross-purposes" with the Code and infringes upon the already "limited jurisdiction" provided by § 7442. Furthermore, the power claimed by the Executive Branch to sue transferees in federal district court without issuing the required notice of liability—thereby preventing them from filing a petition in the "prepayment" tribunal established "under article I of the Constitution" for the purpose of resolving tax controversies—violates the constitutional doctrine of separation of powers in general and the required independence of the Tax Court mandated by § 7441 in particular.

## VI. There is a Split of Authority Among Four Circuit Courts with respect to the Statute of Limitations Governing the Enforcement of a Contract to Pay the Taxes of Another Person.

The Government has asserted a third-party beneficiary claim with respect to a private contract to pay the unpaid estate tax entered into in 1992 by the decedent's children. Although payments were made for many years pursuant to the § 6166 election, those payments stopped around 2002 when the closely-held business went bankrupt and the deferral election was terminated. The district court held that the period for enforcing the contract was governed by Utah's six-year statute of limitations for breach of contract. Utah Code Ann. § 78B-2-309(2). However, the Government argued for the application of the ten-year statute of limitations under § 6502(a) and the Tenth Circuit upheld this position on appeal.

Whether a federal statute of limitations can allow the Government to enforce an otherwise unenforceable third-party beneficiary claim arising under a private contract to pay the taxes of another person is an important question of federal law that has never been addressed by this Court. However, there is now a split of authority on this issue involving at least four Circuit Courts of Appeals, including the Fifth, Sixth, Eighth, and Tenth Circuits. With the exception of the Eighth Circuit, the rulings of these courts are inconsistent with this Court's opinions in at least three cases: *Cooke v. United States*, 91 U.S. 389, 398 (1875), *Guaranty Trust Co. v. United States*, 304 U.S. 126, 141 (1938), and *United States v. California*, 507 U.S. 746, 758 (1993).

"Whether in general a state law action brought by the United States is subject to a federal or state statute of limitations is a difficult question." *California*, 507 U.S. at 758. "When the United States becomes entitled to a claim, acting in its governmental capacity, and asserts its claim in that right, it cannot be deemed to have abdicated its governmental authority so as to become subject to a state statute putting a time limit upon enforcement." *United States v. Summerlin*, 310 U.S. 414, 417 (1940). The question is whether or not the Government is acting in a governmental capacity. Because *Summerlin* distinguished *Cooke*, 91 U.S. 389, the earlier case is helpful in understanding the scope of the later. In *Cooke*, this Court stated that if the Government "comes down from its position of sovereignty, and enters the domain of commerce, it submits itself to the same laws that govern individuals there." 91 U.S. at 398.

In *California*, the Government cited *Summerlin* and two other cases in support of the proposition that "state statutes of limitations do not bind it," but this Court found that in each case the Government's right was either based on a federal statute or such a statute provided the statute of limitations. 507 U.S. at 757. Because the Government's claim in *California* was based on "a private contractor's state-law debt," this Court concluded: "*Summerlin* is clearly distinguishable." *Id.* at 758. Instead, the Court relied on *Guaranty Trust Co. v. United States*, 304 U.S. 126 (1938), wherein the United States took an assignment of a Russian deposit in a New York bank. In *Guaranty Trust*, this Court stated that if the Russian claim was barred by New York's statute of limitations, "the United States as its assignee can be in no better position." Furthermore, barring the claim "deprive[d] the United States of no right, for the proof demonstrates that the United States never acquired a right free of a preexisting infirmity, the running of limitations against its assignor, which public policy does not forbid." Id. at 141-42. Citing *Guaranty Trust*, *California* held that "the Government did not assert

[its] right until it filed the federal judicial proceeding . . . Because the Government waited until after the state statute of limitations had run . . . to bring suit, the Government was not subrogated to a right free of a pre-existing infirmity." *California*, 507 U.S. at 758-59.

In this case, the district court closely followed the analysis in *California*, ruling that the Government did not obtain its third-party beneficiary claim pursuant to federal law and concluding that "the government acquired a right with a 'pre-existing infirmity,' i.e. the state statute of limitations." *United States v. Johnson*, 224 F.Supp.3d 1220, 1247 (D. Utah 2016), *rev'd*, 920 F.3d 639 ($10^{th}$ Cir. 2019). In contrast, the Tenth Circuit has created a new rule derived from its opinion in *Holmes*, stating that "the Government is always acting in its sovereign capacity when it seeks to collect unpaid federal taxes," and determining that "[i]t is immaterial whether its claim to payment arises under federal or state statutory or common law." *Johnson*, 920 F.3d at 644. Instead, "[t]he only relevant question is whether the Government's suit, if successful, will result in the defendant's liability to pay federal taxes the Government has assessed against a taxpayer." *Id.*[1]

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[1] In two cases decided before *California*, the Fifth and Sixth Circuits relied on *Summerlin* in ruling that the Government was not bound by state statutes of limitations when seeking to enforce a private contract. *See U.S. v. Parker House Sausage*, 344 F.2d 787 (6th Cir. 1965); *United States v. West Texas State Bank*, 357 F.2d 198, 201 (5th Cir. 1966). Neither opinion cites *Cooke* or *Guaranty Trust*.

It is important to note that the Code gives the Government the right to collect taxes from taxpayers and transferees, but does not authorize it to collect from obligors under a private contract. In reality, the Government is not collecting federal taxes pursuant to the Code, but is simply pursuing a state law claim for damages that are measured by another person's tax liability. The Eighth Circuit reached a similar conclusion in *United States v. Scott*, 167 F.2d 301 (8th Cir. 1948), stating:

> We think the six-year limitation, . . . on collecting income taxes after assessment, has reference only to such liabilities for payment as are imposed upon a party by law and not to any liability which a party may voluntarily impose upon himself by contract so as to give the United States an additional and special right of action.
> 167 F.2d at 303.

Holding that state law should govern, *Scott* stated: "In technical concept, appellee's liability here was not for taxes as such but for damages from breaching his obligation to satisfy a debt of the taxpayer. The provisions of the Internal Revenue Code do not make such an obligor a 'taxpayer.' Indeed, the Revenue Code does not even make mention of such a contractual liability …" *Id.*

This Court should resolve the conflict among the four circuit courts with respect to the enforcement of a private contract by upholding its opinions in *Cooke*, *Guaranty Trust*, and *California,* and adopting the Eighth Circuit's approach in *Scott*.

## VII. There is a Split of Authority Among Three Circuit Courts on Suspension of the Statute of Limitations Under Section 6503 with respect to Liability to Pay the Taxes of Another Person.

Even if the Government is correct that it can bring an action against transferees without notice or assessment, and even if the period for enforcing the contract claim is governed by federal law, it is still necessary to bring a timely collection action under § 6502(a). However, in both cases, the § 6502(a) collection period has run unless suspended by § 6503. Therefore, the issue is whether § 6503 suspension applies to transferees and to obligors under a private contract. These are important questions of federal law that have not been previously addressed by the Supreme Court. Although the Petitioner is not aware of any other case addressing the suspension issue in the context of a private contract, there is a split of authority involving at least three circuit courts with respect to the application of § 6503 to parties liable to pay the tax of another.

The Government relies on two rulings from the Seventh Circuit, *United States v. Associates Commercial Corp.*, 721 F.2d 1094 (7th Cir. 1983), and *United States v. Wright*, 57 F.3d 561 (7th Cir. 1995), for its argument that § 6503 suspension applies to transferees. In *Associates*, the court ruled that the limitations period for third-party lender liability for employment taxes under § 3505 should be "coterminous" with the period for the taxpayer. 721

F.2d at 1097. *Wright* addressed the secondary liability of general partners and reached a similar conclusion.

However, in *United States v. Harvis Construction Co.*, the Ninth Circuit expressly declined to follow the Seventh Circuit, reasoning: "Although § 3505 creates lender liability, it does not provide for the mode or time of collection." 857 F.2d 1360, 1363 (9th Cir. 1988). Because the six-year statute of limitations under Regs. § 31.3505-1(d)(1) had already run, the Government argued that the six-year period under § 6502 applied instead, subject to suspension under § 6503. *Id.* at 1362. The court rejected the Government's argument, stating: "The regulation does not contain a provision for § 6503 suspensions, and we will not create a suspension on the basis that the I.R.S. inadvertently failed to include it." *Id.* at 1364. Stating that Congress could easily have applied § 6503 to lenders but did not, the court observed: "The proper function of a court is to construe and apply statutes, not write them." *Id.* at 1365. The court also noted that it may "be prejudicial to allow a § 6503 suspension created by the actions of the taxpayer to be imposed against the lender in the absence of a clear rule or regulation to the contrary," and gave the example of § 6503(c) suspension if the taxpayer left the country for twenty years. *Id.* at 1364.

Like § 3505, § 6324(a)(2) creates transferee liability but does not address collection issues. Unlike § 3505, the regulations under § 6324(a)(2) do not provide a limitation period, but the matter is statutorily addressed by § 6901. Like the traveling taxpayer example in *Harvis*, § 6503(d) suspension arises from a taxpayer election that can suspend the limitation period for almost fifteen years without the knowledge of the transferees. Furthermore, the only reference in § 6503 to transferees is the direction in subparagraph (k)(3) to see chapter 71. The only suspension provision found in chapter 71 is § 6901(f), which provides for suspension similar to that found in § 6503(a)(1). Therefore, a straightforward reading of these provisions is that § 6503(d) and the other § 6503 suspension provisions do not apply to transferees. Also, even if this Court finds that a separate action under § 6324(a)(2) is permissible, there is no authority for statutory suspension and the failure of the IRS to provide for regulatory suspension should receive the same treatment as in *Harvis*.

With respect to the third-party beneficiary claim, the arguments for not applying § 6503 suspension to transferee liability generally apply to the enforcement of a private contract as well. However, the Tenth Circuit ignored the § 6503 suspension issue in this regard and stated that "[t]he sole question before this court is whether [Utah's] six-year statute of limitations . . . or the ten-year statute of limitations set out in [§ 6502] is applicable …" 920 F.3d at 643. The court also stated: "Because the Government's third-party beneficiary claim seeks to hold Appellees liable for the payment of unpaid estate taxes assessed against the Estate, § 6502(a) supplies the statute of limitations applicable to the Government's claim." *Id.* at 644. However, § 6502(a) provides for collection within "10 years after the assessment of the tax." Because the estate tax was assessed in 1992, the 10-year period ran many years before the action was brought in this case. Although the Tenth Circuit never explained how a ten-year statute could cover an almost twenty-year claim, the unstated assumption must be that § 6503 always applies.

Based on the foregoing reasons, this Court should adopt the approach taken by the Ninth Circuit in *Harvis* and hold that § 6503(d) suspension does not apply to either transferees or obligors under a private contract.

### VIII. Award of Attorneys Fees and Costs.

Section 7430(a) provides that in a tax case brought by the Government, the prevailing party (other than the Government) may be awarded a judgment for reasonable litigation costs unless the Government position was substantially justified. The district court awarded about $316,000 of fees and costs because the Petitioner was the prevailing party and the Government's position was not substantially justified. This award was reversed by the Tenth Circuit on appeal. However, if the Petitioner prevails on this appeal, the district court's award of attorneys' fees and costs should be reinstated because Petitioner would then be the prevailing party and the Government's position would not be substantially justified. In that case, the Court should also award fees and costs attributable to Petitioner's appeals to the Tenth Circuit and to this Court.

## CONCLUSION

This case involves important issues of federal law that should be resolved by this Court in order to end decades of confusion and misapplication of the enforcement provisions of the Internal Revenue Code in connection with transferee liability. In addition to violating the mandatory provisions of numerous code sections and contradicting the "overall statutory scheme" designed by Congress, the Government has ignored or misapplied multiple Supreme Court rulings. Furthermore, the Government's practice of failing to assess and provide notice of liability to transferees deprives them of due process of law. This practice also deprives the Tax Court of its statutory jurisdiction and amounts to an unconstitutional encroachment by the Executive Branch on an Article I Court. Finally, the Government's third-party beneficiary claim raises the issue of state versus federal law with respect to the applicable statute of limitations, and involves a circuit court split on that issue and a circuit court split on the suspension provisions of the Code. The latter split also involves suspension for transferee liability.

If the Tax Code were a country and taxpayers its citizens, then the Government has denied transferees the citizenship benefits to which they are entitled, while imposing the burdens of such status on parties to a private contract who are foreigners to the Code. Neither treatment is in accord with principles of due process under the laws of the United States. Taxpayers are required to follow the Government's detailed tax rules and the Government should be required to follow them as well.

For these reasons, the petition should be granted.

Respectfully submitted,

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