No. 17-630

In the Supreme Court of the United States

ROBERT KARBAN, JR.,

Petitioner,

v.

UNITED STATES OF AMERICA,
Department of Treasury and
Internal Revenue Service,

Respondent.

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

REPLY BRIEF OF PETITIONER

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INTRODUCTION

The hallmark of any successful petition for writ of certiorari is whether it raises legal issues that are sufficiently "compelling" to justify Supreme Court review. Sup. Ct. Rule 10. The Court is more likely to grant certiorari where the ruling of a federal appellate court (1) conflicts with the decision of another federal appellate tribunal "on the same important matter," (2) decides an "important question of federal law" that the Supreme Court should settle, and/or (3) decides "an important federal question" in a manner that conflicts with Supreme Court precedent. Sup. Ct. Rule 10(a), (c).

Karban's petition satisfies all these criteria. The Sixth Circuit's decision below conflicts with three other circuits that have adopted a "reasonable cause" exception, as well as another panel of the Sixth Circuit itself. *See Byrne v. United States*, 857 F.3d 319, 329 (6th Cir. 2017); *Conway v. United States*, 647 F.3d 228, 234 (5th Cir. 2011); *Winter v. United States*, 196 F.3d 339, 345-46 (2d Cir. 1999); *Finley v. United States*, 123 F.3d 1342, 1343 (10th Cir. 1997) (en banc). Trust-fund recovery penalties are also among the top ten most litigated tax issues in the federal court system. Taxpayer Advocate Service, National Taxpayer Advocate 2016 Annual Report to Congress, Executive Summary, 84-85 (2016). Consequently, a decision from this Court adopting reasonable cause as an exception to section 6672(a)'s willfulness requirement—and defining the contours of that exception—will significantly alter the landscape of federal tax litigation nationwide. Moreover, the decision below violates this Court's ruling in *Slodov v. United States*, 436 U.S. 238 (1978). That case held that “[s]ection 6672 cannot be read as imposing upon the responsible person an absolute duty to ‘pay over’ amounts which should have been collected and withheld” because the statute “was not intended to impose liability without personal fault.” *Id.* at 254.

Opposing certiorari, the government disregards nearly all these considerations. The ensuing discussion illuminates why the government’s position is unconvincing.

I. THE GOVERNMENT’S OPPOSITION PAYS SCANT ATTENTION TO THE COMPELLING LEGAL QUESTIONS KARBAN RAISES IN HIS PETITION

The government employs two basic tactics in opposition to Karban’s petition: (1) advance arguments that overlook important legal questions, and (2) misconstrue (and at times distort) the record to portray Karban as nothing more than a run-of-the-mill delinquent taxpayer. This reply highlights where the government’s brief departs from both the law and the facts. Set forth below is a delineation of each of the government’s inaccurate or incorrect statements of law or fact, followed by citations to the record, or relevant caselaw, rebutting each of these faulty assertions.

A. Misstatements of Law

The government argues that (1) failure to pay trust-fund taxes, coupled with knowledge of the delinquency, alone supports a finding of willfulness, (2) the courts of appeals uniformly adopt to this view, (3) the Sixth Circuit’s decision follows this approach, (4) the Sixth Circuit’s decision is consistent with courts of appeals decisions recognizing a reasonable cause exception, and (5) the Sixth Circuit's decision adheres to *Slodov*'s "personal fault" requirement. Neither the law nor the record support these contentions.

MISSTATEMENT OF LAW #1:

- "The courts of appeals have uniformly held that a responsible party's decision to pay other creditors with knowledge that taxes owed to the United States remain unpaid constitutes a willful breach of duty for purposes of Section 6672." (Opp.10) (emphasis added).

REBUTTAL:

- This statement is inaccurate because the government exclusively relies on (1) courts of appeals decisions from circuits that do not recognize a reasonable cause exception to section 6672(a)'s willfulness requirement, or (2) courts of appeals decisions issued before that particular circuit subsequently adopted such an exception. (Opp.10).
- The government acknowledges that the courts of appeals are divided over whether to recognize a reasonable cause exception to section 6672(a)'s willfulness requirement. (Opp.7-8).
- A three-way circuit split exists over how to frame a reasonable cause exception. *See Finley v. United States*, 123 F.3d 1342, 1348 (10th Cir. 1997) (en banc); *Winter v. United States*, 196 F.3d 339, 345 (2d Cir. 1999); *Byrne v. United States*, 857 F.3d 319, 329 (6th Cir. 2017).

- *Finley* and *Byrne* excuse unpaid trust-fund taxes for reasonable cause <u>even where the taxpayer knows</u> about the unpaid trust-fund taxes. *Winter* does not. (Pet.13-16).

MISSTATEMENT OF LAW #2:

- "[A] person acts 'willfully' when he pays other creditors with corporate funds <u>while knowing</u> that the trust-fund taxes owed to the United States remain unpaid." (Opp.6) (emphasis added).

REBUTTAL:

- As discussed above, the courts of appeals are divided over the very definition of "willfulness." (Opp.7-8; Pet.8).
- The Sixth and Tenth Circuits certainly do not adhere to the government's proposed definition. *See Byrne*, 857 F.3d at 329 (the reasonable cause exception "limits liability to those who, under the circumstances, failed to take reasonable steps to ensure payment of trust-fund taxes <u>after having received notice</u> that those taxes were not being paid") (emphasis added); *Finley*, 123 F.3d at 1348 (reasonable cause exists where "(1) the taxpayer has made reasonable efforts to protect the trust funds, but (2) those efforts have been frustrated by circumstances outside the taxpayer's control").

MISSTATEMENT OF LAW #3:

- "Petitioner . . . did not comply with *Finley*'s requirement that he take reasonable steps to protect the trust funds." (Opp.11).

REBUTTAL:

- Karban took reasonable steps to protect MasterCasters' trust funds.
- Karban repeatedly urged Foothill to allocate sufficient funds to pay MasterCasters' outstanding trust-fund taxes. (App.37a, 43a-45a, 52a).
- Because of Karban's efforts, Foothill established a daily "reserve account" specifically designated for the payment of MasterCasters' overdue trust-fund taxes. (App.43a, 55a-56a).
- Karban actually observed MasterCasters' weekly line of credit decrease by the amount Foothill reserved for payment of the trust-fund taxes. (App.37a, 43a-44a, 55a-56a).

MISSTATEMENT OF LAW #4:

- Karban could not avail himself of *Finley*'s reasonable cause exception because he "fail[ed] to pay the trust-fund taxes that <u>he knew</u> the company owed." (Opp.11) (emphasis added).

REBUTTAL:

- *Finley*'s reasonable cause exception applies even where, as here, the responsible party <u>is aware of</u> the unpaid trust-fund taxes. *Finley* presumes the responsible party must have known about the tax liabilities since he would otherwise have no reason to "ma[ke] reasonable efforts to protect the trust funds" in the first place, *i.e.*, the first prong in *Finley*'s reasonable cause test. *Finley*, 123 F.3d at 1348.

- Karban also satisfies the second prong in *Finley*'s reasonable cause test because the record shows that his efforts to protect MasterCasters' trust funds "ha[d] been frustrated by circumstances outside [his] control." *Id.*; (App.37-38a, 44-45a, 47a, 51a, 54a-56a).

MISSTATEMENT OF LAW #5:

- "Unlike the corporate president in *Finley*, petitioner knew that the taxes were not being paid during the period that he authorized other uses of corporate funds." (Opp. 11).

REBUTTAL:

- The corporate president in *Finley* also knew about the delinquent taxes during the time when his company "had access to funds that could have been used to make at least partial payment to the government." *Finley*, 123 F.3d at 1344.
- However, the difference between Karban and the corporate president in *Finley* is that Karban took active measures to preserve the trust funds, whereas the corporate president in *Finley* "made no further inquiry" after learning about the delinquent trust-fund taxes and he "took no further action regarding the unpaid withholding taxes even though he had authority to sign company checks . . . " *Id.* at 1343-44.

MISSTATEMENT OF LAW #6:

- The Sixth Circuit's decision below "did not specifically address whether petitioner had 'reasonable cause' for his failure to pay over trust-fund taxes." (Opp.9).

REBUTTAL:

- The Sixth Circuit had the opportunity to fully address whether Karban demonstrated reasonable cause for failing to pay MasterCasters' trust-fund taxes because his petition for panel rehearing exclusively raised this very issue. (Pet.6; Ct. App. Doc. 27).
- Notably, Karban's original Sixth Circuit brief did not discuss reasonable cause as a justification for nonpayment because the Sixth Circuit had yet to recognize this exception to section 6672(a)'s willfulness requirement. A different three-judge panel of the Sixth Circuit first recognized the exception in *Byrne*, which was decided within weeks <u>after</u> the panel's initial decision in this case. (Pet.6). The *Byrne* opinion precipitated Karban's decision to petition for panel rehearing rather than immediately file a petition for writ of certiorari in this Court.

MISSTATEMENT OF LAW #7:

- The Sixth Circuit's decision below is consistent with *Byrne* and other courts of appeals decisions adopting a reasonable cause exception. (Opp.9).

REBUTTAL:

- The Sixth Circuit's decision in this case contravenes *Byrne* and *Finley*.
- According to the panel below, "[w]illfulness is established when a responsible person had knowledge of the tax delinquency and <u>knowingly failed to rectify it</u> when there were available funds to pay the government." (App. 4a-5a) (internal quotation marks omitted) (emphasis added). This stan-

dard leaves no room for excusing the taxpayer's "reasonable steps" to ensure payment. Nonpayment is deemed willful when the taxpayer ultimately "fail[s] to rectify" the delinquency, regardless of his efforts to pay the trust-fund taxes.

- On the other hand, *Byrne*'s version of reasonable cause "limits liability to those who, under the circumstances, failed to take reasonable steps to ensure payment of trust-fund taxes after having received notice that those taxes were not being paid." *Byrne*, 857 F.3d at 329 (emphasis added). Under this framework, the taxpayer's "reasonable steps to ensure payment" will insulate him from trust-fund recovery penalties even where those measures prove unsuccessful.

- The same holds true under *Finley*, where reasonable cause exists if "(1) the taxpayer has made reasonable efforts to protect the trust funds, but (2) those efforts have been frustrated by circumstances outside the taxpayer's control." *Finley*, 123 F.3d at 1348 (emphasis added).

MISSTATEMENT OF LAW #8:

- The Sixth Circuit's decision is consistent with *Slodov* "[b]ecause petitioner was responsible for collecting and paying over the trust-fund taxes to the United States during the entire taxable period at issue here." (Opp.14) (emphasis).

REBUTTAL:

- The decision below violates *Slodov* because Karban did not willfully fail to pay MasterCasters' trust-fund taxes.

- *Slodov*'s relevance is limited to its treatment of "personal fault," which speaks to the taxpayer's willfulness, as opposed to responsibility, under section 6672(a). *Slodov*, 436 U.S. at 254 ("The fact that the provision imposes a 'penalty' and is violated only by a 'willful failure' is itself strong evidence that it was not intended to impose liability without personal fault.") (emphasis added).
- In any event, Karban no longer contests his responsibility for paying MasterCasters' trust-fund taxes. The only question he asks this Court to address is whether he willfully failed to pay MasterCasters' trust-fund taxes. (Pet.7) ("[t]his petition exclusively focuses on [section 6672(a)'s] second prong, *i.e.*, the element of willfulness").

MISSTATEMENT OF LAW #9:

- *Slodov*'s "personal fault" requirement "is satisfied where, as here, the responsible person 'presided over the corporation every day during which taxes were [collected] and dissipated to satisfy corporate needs, at the expense of the public fisc.'" (Opp.14) (quoting *Davis v. United States*, 961 F.2d 867, 877 (9th Cir. 1992)).

REBUTTAL:

- The government quotes this statement from *Davis*, not *Slodov*. And, unsurprisingly, *Davis* is yet another decision from a federal circuit court that does not recognize reasonable cause as an exception to section 6672(a)'s willfulness requirement. (Opp.14; Pet.8).
- Instead, *Slodov* actually holds that "[w]hen the same individual or individuals who caused the delin-

quency in any tax quarter are also the 'responsible persons' at the time the Government's efforts to collect from the employer have failed, . . . there is no question that § 6672 is applicable to them." *Slodov*, 436 U.S. at 245-46 (citation and internal quotation marks omitted) (emphasis added).

- Here, Foothill "caused the delinquency." The unrebutted facts demonstrate that (1) Karban timely paid MasterCasters' trust-fund taxes for all the periods preceding Foothill's implementation of the lock-box, (2) Foothill refused to pay the trust-fund taxes for the third quarter of 1998, and (3) Foothill misrepresented to Karban that it had already diverted sufficient funding to a daily "reserve account" specifically designated for the payment of MasterCasters' outstanding trust-fund taxes. (App.37-38a, 44-45a, 47a, 51a, 54a-56a).

B. Misstatements of Fact

The government maintains that Karban willfully failed to pay MasterCasters' trust-fund taxes because, notwithstanding Foothill's lock-box measures, he retained the discretion to allocate payments among the company's creditors. The undisputed facts contradict this narrative, and any disputed facts, when viewed in Karban's favor, could lead a reasonable jury to conclude otherwise.

MISSTATEMENT OF FACT #1:

- "[P]etitioner continued to control payments to creditors" after Foothill exercised its "lock-box" authority over MasterCasters' finances. (Opp. 6).

REBUTTAL:

- While Karban could still <u>recommend</u> which creditors should receive prioritized payments, Foothill made the "final decisions" concerning which creditors would be paid and when. (App.31a-32a, 36a-37a).
- Karban only signed the checks Foothill approved. (App.36a) ("[Foothill] would send me back a list saying this is what you should do. I gave that list to my accounts payable people. They made out the checks. I signed them, and we sent them.").
- Whenever creditors cashed MasterCasters' checks, the money would be drawn from allocated funds on deposit with Foothill, <u>not</u> MasterCasters. (App.49a) ("Our check[s] went out from [Foothill's] account.").

MISSTATEMENT OF FACT #2:

- "Petitioner acknowledged that he 'could really write anything' on a check 'and send it out.'" (Opp.7) (quoting App.49a).

REBUTTAL:

- This statement reflects highly selective editing on the government's part, bordering on intentional distortion. The entire quoted passage supports the exact opposite conclusion; that Karban, in fact, exercised no control over the funds dispensed to MasterCasters' creditors. Karban actually said:

> So I would write the check. The customer would get it and cash it. It would come back, I guess, to [Foothill's] bank. <u>And they would look to see if, in fact, those were the ones they approved, and the amounts</u>. Because I

> could really write anything, you know what I'm saying, and send it out. <u>So they double-checked and reconciled that I did what they told me to do</u>.

(App.49a) (emphasis added).

MISSTATEMENT OF FACT #3:

- "Petitioner also admitted that he had considered paying the taxes but had chosen not to do so." (Opp.7) (citing App.51a).
- Petitioner exercised a "deliberate choice to pay substantial sums to other creditors with the knowledge that the trust-fund taxes remained unpaid." (Opp.14).

REBUTTAL:

- The following is the unedited version of Karban's deposition testimony:

> Q: Did you ever consider instead of paying some of the other creditors that Foothill approved, pay the payroll taxes with the money that they had authorized?
>
> A: Well, I considered that, <u>but the bank told me not to. They told me not to change any of the lists. And they specifically said for payroll taxes that they would take care of them</u>.

(App.51a) (emphasis added).

MISSTATEMENT OF FACT #4:

- "[P]etitioner simply acceded to Foothill's pressure to pay only the creditors that it had approved." (Opp.11).

REBUTTAL:

- Karban repeatedly urged Foothill to allocate sufficient funds to pay MasterCasters' outstanding trust-fund taxes. (App.37a, 43a-45a, 52a).
- Because of Karban's efforts, Foothill established a daily "reserve account" specifically designated for the payment of MasterCasters' overdue trust-fund taxes. (App.43a, 55a-56a).
- Karban actually observed MasterCasters' weekly line of credit decrease by the amount Foothill reserved for payment of the trust-fund taxes. (App.37a, 43a-44a, 55a-56a).

MISSTATEMENT OF FACT #5:

- "[P]etitioner asserts that Foothill <u>promised to pay</u> the trust-fund taxes at some unspecified future time." (Opp.12) (emphasis added).
- Karban asserts that "Foothill assured him that <u>it would establish</u> a reserve account for the trust-fund taxes and would pay them later." (*Id.*) (emphasis added).

REBUTTAL:

- Foothill did establish a reserve account for the trust-fund taxes. (App.43a, 55a-56a).
- Again, Karban actually observed MasterCasters' weekly line of credit decrease by the amount Foothill reserved for payment of the trust-fund taxes. (App.37a, 43a-44a, 55a-56a).

- Foothill lied to Karban and pocketed the money in the reserve account without ever paying the trust-fund taxes. (App.47a, 52a).

MISSTATEMENT OF FACT #6:

- Petitioner "yielded to pressure from certain suppliers and had paid an insistent creditor more than the amount approved by Foothill, taking the difference from another creditor on the approved list." (Opp.3, 7) (citing App.49a).

REBUTTAL:

- Karban only recalled one specific instance where he paid a demanding supplier more than the amount Foothill approved. (App.49a).
- Although Karban increased the amount of money allocated to this Foothill-approved creditor, the government acknowledges that (1) he was unable to exceed the overall amount of Foothill's weekly disbursement to MasterCasters' creditors, and (2) Foothill threatened to withdraw MasterCasters' line of credit "if he continued to change the pre-approved amounts." (Opp.3) (citing App.49a-50a).
- Karban certainly could not have replaced an approved creditor with an unapproved creditor, such as the IRS, as indicated by his testimony that, although he considered such an option, "the bank told me not to. They told me not to change any of the lists." (App.51a).
- Furthermore, the record is unclear about whether Karban exercised this one-time act of discretion (1) before MasterCasters incurred the trust-fund tax liabilities, (2) before he became aware of these

liabilities, or (3) after he already knew about Foothill's establishment of the reserve account. (App. 49a, 51a-52a).

- A reasonable jury could conclude that Karban did not willfully fail to pay MasterCasters' trust-fund taxes based on any one of these timelines.

C. Summary

The government's strategy is a simple one—convince this Court that section 6672(a)'s willfulness requirement is "uniformly" applied throughout the circuits; that each circuit's approach is consistent with *Slodov*; and that Karban is no different than any other corporate officer seeking to shirk his liability for unpaid trust-fund taxes. Nothing could be further from the truth. Rather, the reality is that Karban's petition raises significant legal questions that, each in their own right, are "compelling" enough to warrant certiorari. Sup. Ct. Rule 10.

CONCLUSION

For the above reasons, Karban respectfully requests that the Court grant his petition for a writ of certiorari.

Respectfully submitted,

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