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PRESUMPTION OF DISCLOSURE
Service Must Release Redacted FSAs under FOIA

In the latest installment of the ongoing litigation, the district court in **Tax Analysts v. Internal Revenue Service, 1999 U.S. Dist. LEXIS 14950 (D. D.C. Sept. 3, 1999)** found the Service still is applying Freedom Of Information Act guidelines too restrictively, and ordered the release of previously redacted information from Field Service Advisories. The court suggested the Service follow the lead of the Department of Justice, whose policy states, "Justice [will] defend the assertion of a FOIA exemption only in those cases where the agency reasonably foresees that disclosure would be harmful to an interest protected by that exemption."

Applying a presumption of disclosure, the court reviewed *in camera* forty of the nearly 1300 FSAs in question, which had been redacted by the Service prior to their release to Tax Analysts. Observing that the Service was still battling "tooth and nail" to keep as much of each FSA as possible out of the pubic domain, the court concluded that in many cases, the Service was over-reaching in its redaction efforts.

Examining each of the FSA samples, the court discussed several categories of redactions claimed by the Service. The first category, attorney-client privilege deletions, the court found applicable only to those communications from the FSA requester to Chief Counsel which would reveal the "scope, direction of emphasis of audit activity." In the first FSA examined, the court concluded that the deleted material was a recommendation by Chief Counsel to the field with respect to additional documentation that should be sought in connection with a taxpayer's audit. This was not protected, the court said, because the redacted material was not transmitted by field personnel, and was not based on "confidential information obtained from the client." A second FSA, which contained legal advice from Chief Counsel to the field about whether certain information could be used as evidence, was protected.

Turning to the second category, attorney work-product privilege, the FSAs contained recommendations as to the reasonableness of the Service's position and whether a case should continue to be litigated. The court found these issues to be properly privileged. Redaction of a statement of issues, however, was improper.

The third category was deletions of citations and discussions of state statutes and cases. The Service redacted this information because the states in question were those in which the taxpayer resided and, taken together with other information in the FSA or which was publically available, could identify the taxpayer. The court found this argument to be "patently absurd" as to most of the FSAs in question. Merely identifying the state in which a taxpayer resides is insufficient to reveal the identity of the taxpayer. The court also held that the redaction of the identity of a federal circuit was similarly absurd.

Next, the court reviewed miscellaneous deletions under I.R.C. § 6103. Beginning with the premise that legal analyses contained in FSAs are not "return information", the court disagreed with the Service's characterization that certain redactions identify the taxpayer's business or industry, and so combined with other public information could lead to the identification of the taxpayer. The court similarly disagreed with the Service's argument that certain statutes and court decisions, when used as search terms in a commercial legal research data base (together with other terms in the FSA), would result in the identification of the taxpayer. The court found this to be a "vague, unspecific, unsubstantiated explanation," inadequate to support redaction. However, where special legislation was aimed at a small group of specific taxpayers, to which group the FSA is also directed, the court found redaction of the statute and legislative history was proper.

The fifth category was factual deletions. The court agreed with the Service that redaction was proper when the facts describe a unique and well-known business of a taxpayer, where the references were so interspersed throughout the "facts" section of the FSA that no reasonably segregable non-exempt portion of the section was left. However, the court cautioned that merely because the taxpayer is a well-known entity, the FSA is not entitled to greater redaction when the redaction does not identify the taxpayer nor contain return information.

Finally, the court discussed redaction of certain administrative information. The court ruled that the Service could not redact:

- the date of the FSA
- the date of the request
- the name of the requester
- the name and/or telephone number of the author
- the component office of Chief Counsel
- the signer of the FSA
- the subject matter of the FSA (although the taxpayer's name should be redacted)

FREEDOM OF INFORMATION ACT: Exemptions From Disclosure

NO EMPLOYMENT, NO SUMMONS ENFORCEMENT

"COLLECTIVE ENTITY" RULE LIMITED

In **In re Three Grand Jury Subpoenas Duces Tecum Dated January 29, 1999**, **1999 U.S. App. LEXIS 21381 (2d Cir. Sept. 7,1999)**, the Second Circuit limited the scope of the "collective entity" rule, holding that a person no longer employed by a corporation may claim a Fifth Amendment privilege with respect to summonsed documents. Relying on its earlier decision in In re Grand Jury Subpoenas Duces Tecum Dated June 13, 1983 and June 22, 1983 (Saxon Industries), 722 F.2d 981 (2d Cir. 1983), the court found that three employees who left a corporation, taking corporate records with them, just before being served with grand jury criminal subpoenas, may claim a Fifth Amendment act of production privilege with respect to those documents. When an employee is terminated, the majority found, any documents possessed by that employee are then held in a personal, rather than a representational, capacity.

The dissent found the majority squarely in conflict with the "collective entity" rule, espoused by Braswell v. United States, 487 U.S. 99 (1988), in which the Supreme Court rejected a Fifth Amendment act of production privilege claim by a current employee and held that the custodian's act of production is not a personal act, but rather an act of the corporation, which cannot claim a Fifth Amendment privilege. The dissent found unpersuasive the fact that this case dealt with former employees, finding that the employees left or were terminated after the corporation had been served with the subpoenas. Also, the dissent argued, two of the three signed severance agreements to assist the corporation in any investigation. The dissent pointed out the obvious incentive for corporate employees to abscond with subpoenaed records to avoid judicial process.

SUMMONSES: Defenses to Compliance: Fifth Amendment: Corporate Records

EQUITABLE TOLLING CLARIFICATION

Last month's GL Bulletin discussed equitable tolling in bankruptcy in light of the Eleventh Circuit's decision in **United States v. Morgan, 1999 U.S. App. LEXIS 10741 (11th Cir. July 26, 1999)**. A parenthetical comment, not from the court's decision, stated that the Government no longer argues B.C. § 108(c) as a basis for equitable tolling. This comment should not be taken as a prohibition from relying on controlling precedent in those jurisdictions where the circuit court of appeals has favorably decided for the Service on section 108(c) grounds. [1]

[1] The circuit decisions relying on section 108(c) are: In re Montoya, 965 F.2d 554 (7th Cir. 1992); In re West, 5 F.3d 423 (9th Cir. 1993), cert. denied 511 U.S. 1081 (1994); In re Taylor, 81 F.3d 20 (3d Cir. 1996); and Waugh v. Internal Revenue Service, 109 F.3d 489, 493 (8th Cir. 1997), cert. denied 522 U.S. 823 (1997).

1. BANKRUPTCY CODE CASES: Chapter 7: Distribution of Property of the Estate: Priority Claims

Aggeler v. United States, 1999 U.S. Dist. LEXIS 10781 (W.D. Mich. June 29, 1999) - Chapter 7 debtor objected to untimely filed priority tax claim. The court held the debtor lacked standing in a liquidating chapter 7 as failing to meet the definition of "party in interest" under B.C. § 502(a). The court explained that a "party in interest" must have a pecuniary interest in the distribution of the estate, which an insolvent debtor lacks. Further, the court found that the Service's claim, though tardy, was filed before distribution, and so the Service was entitled to payment.

2. BANKRUPTCY CODE CASES: Chapter 13: Confirmation of Plan

In re Campbell, 1999 U.S. Dist. LEXIS 13611 (W.D. W.Va. August 17, 1999) - Failure of the Service to attend the confirmation hearing, where the Service previously provided a written objection to debtor's Chapter 13 plan (which attempted to discharge an I.R.C. § 6672 Trust Fund Recovery Penalty claim), does not constitute waiver of the Service's objection. The court has an independent duty to verify that a Chapter 13 plan complies with the law.

3. BANKRUPTCY CODE CASES: Chapter 13: Discharge (§ 1328): Debts Provided for by Plan

In re Holway, 237 B.R. 217 (Bankr. M.D. Fla. 1999) - Debtor completed payments under Chapter 13 plan on allowed priority tax claim, but before completing all payments, the debtor converted the case to Chapter 7. The court held that the debtor was liable for unpaid penalties and interest. Reasoning that a confirmed Chapter 13 plan suspends, rather than extinguishes, penalties and interest during the pendency of the plan, the court concluded that those penalties and interest became nondischargeable when the debtor received his Chapter 7 discharge.

4. BANKRUPTCY CODE CASES: Chapter 13: Effect of Confirmation

Deutchman v. Internal Revenue, 1999 U.S. App. LEXIS 22830 (4th Cir. September 21, 1999) - Debtor's chapter 13 plan reduced and reclassified Service's secured claim, but did not object to the Service's proof of claim. The Service did not object to the debtor's plan, and when the Service refused to release its tax liens after the debtor paid the amount specified by his plan, the debtor brought suit. The Fourth Circuit affirmed the district court, holding that in order to "provide for" a creditor under B.C. § 1327(c), a plan must clearly and accurately characterize the creditor's claim throughout the plan. Because the debtor failed to take sufficient affirmative steps to modify or extinguish the Government's liens, those liens passed through bankruptcy unaffected.

5. BANKRUPTCY CODE CASES: Chapter 13: Effect of Confirmation
BANKRUPTCY CODE CASES: Refunds: Setoff

In re Munson, 1999 Bankr. LEXIS 1123 (Bankr. C.D. Ill. August 20, 1999) - The debtor's Chapter 13 plan was confirmed the day before the Service filed a motion to lift the automatic stay to permit setoff of the debtor's income tax refund. Recognizing a split in the Circuits that have decided this issue (cf. In re DeLaurentiis Entertainment Group, Inc., 963 F.2d 1269 (9th Cir. 1992) with In re Continental Airlines, 134 F.3d 536 (3d Cir. 1998), the court chose to go with the Third Circuit's holding that failure to exercise a right of setoff prior to plan confirmation extinguishes that claim.

6. BANKRUPTCY CODE CASES: Chapter 13: Filing and Allowance of Post-Petition Claims (§ 1305)

In re Jagours, 236 B.R. 616 (Bankr. E.D. Tex. 1999) - Service filed proof of claim for 1991 income taxes in debtor's Chapter 13 bankruptcy. After debtor's plan was confirmed, the Service filed an amended claim for 1994-96 taxes. The trustee argued that the amended claim made the debtor's plan infeasible, but the court disagreed. First, the court held that because the Service's claim contained entirely separate tax years, it was a new claim rather than an amended claim. The court then found this new claim was an allowed claim under B.C. § 1305, though not a priority claim under section § 507(a)(8). Such post-petition claims are not impaired by the Chapter 13 plan, although the debtors may provide for payment of such a post-petition claim under section 1322(b)(6). However, the debtors are not required to modify their confirmed plan to make payment of the Service's new claim (which then would be collectible outside bankruptcy), and their failure to address the claim in their plan does not make it infeasible.

7. BANKRUPTCY CODE CASES: Exceptions to Discharge (§ 523): No, Late or Fraudulent Returns

BANKRUPTCY CODE CASES: Returns by Trustee, Debtor-in-Possession or Debtor: Individual

In re Johnson, 236 B.R. 456 (Bankr. M.D. Fla. 1999) - Debtor did not file an individual income tax return in 1989. Claiming he cooperated with the Government in determining his tax liability for that year, debtor sought a discharge of his taxes in Chapter 7 bankruptcy. The court instead found the taxes nondischargeable under B.C. § 523(a)(1)(B) because the debtor failed to sign or submit any document which disclosed all the information from which his tax liability could be computed. Further, the debtor provided the tax information only after litigation in Tax Court, and could not reasonably argue that the stipulation reached in court was intended to be a tax return.

8. BANKRUPTCY CODE CASES: Exceptions to Discharge (§ 523): Pre-petition Priority Taxes

COMPROMISE & SETTLEMENT: Bankruptcy

In re Nader, 1999 Bankr. LEXIS 1001 (Bankr. E.D. Pa. August 16, 1999) - Debtor submitted an Offer in Compromise, which was deemed processable by the Service

on September 12, 1995. The Service rejected the offer on July 23, 1996, but the debtor appealed the rejection. The appeal was pending when the debtor filed Chapter 7 bankruptcy on August 27, 1997. The court found the federal tax liability nondischargeable as a priority debt under B.C. § 507(a)(8)(A)(ii) and § 523(a)(1)(A), reasoning that by signing the OIC Form 656, the debtor agreed with the Service's determination that the OIC was "pending" during the debtor's appeal of the OIC. The pending OIC suspended the statute of limitations as provided by section 507(a)(8)(A)(ii).

9. BANKRUPTCY CODE CASES: Liens: Determination of Secured Status
BANKRUPTCY CODE CASES: Property of the Estate
In re Schwarzwalder, 1999 Bankr. LEXIS 1158 (Bankr. M.D. Fla. August 19, 1999) - Service had tax lien on debtors' real property at the time they filed Chapter 13 bankruptcy, claiming the property as exempt. The case was converted to Chapter 7, and the trustee entered a report of no distribution, abandoning any non-exempt property. After the Chapter 7 case was closed, a bank with a lien on the property filed to have the case reopened so as to clear title to the property. The court refused to reopen the case, citing a lack of subject matter jurisdiction. Although the bank may have mistakenly believed the debtors paid their tax debt during the bankruptcy, the court found the bank had no rights created by the Bankruptcy Code or related to a bankruptcy case. Whether the real property in question was exempt or abandoned, it is not property of the estate, and so the bankruptcy court lacks jurisdiction under 28 U.S.C. § 1334.

10. BANKRUPTCY CODE CASES: Refunds: Erroneous
United States v. Jackson, 84 AFTR2d ¶ 99-5284 (Bankr. M.D. Ala. August 24, 1999) - In 1996, the debtor received an erroneous refund, then filed Chapter 7 bankruptcy when the Service brought suit. Because the refund also offset a slight balance owed by the debtor for 1988 income taxes, the debtor argued that the liability was discharged. Instead, the court found under B.C. § 507(a) that the refund liability was incurred in 1996, when the debtor received the erroneous refund, and so was entitled to priority status.

11. BANKRUPTCY CODE CASES: Refunds: Setoff
Goldman v. United States (In re Schield), 1999 Bankr. LEXIS 1111 (Bankr. C.D. Cal. August 13, 1999) - Service, with consent of Chapter 7 debtor and pursuant to an Offer in Compromise entered into just prior to the bankruptcy filing, applied his income tax refund to an outstanding liability. The Chapter 7 trustee objected, and the court held that the OIC did not transfer all of the debtor's rights in the overpayment to the Service. Therefore, under B.C. § 549 the Service violated the automatic stay by withholding the refund. However, the Service was entitled to setoff the refund under section 553. Because the Service moved for relief from the stay (in response to the trustee's objection), the court found it judicially convenient to ignore the stay violation and allow the Service to offset the refund.

12. BANKRUPTCY CODE CASES: Setoff (§ 553): Refunds: Taxes

In re Gordon Sel-Way, Inc., 84 AFTR2d ¶ 99-5315 (E.D. Mich. August 31, 1999) - In its liquidating plan, the debtor classified the Service's unsecured claim for employment taxes as a Class 5 claim, to be paid 20%. Although the other Class 5 creditors were paid their 20% share, the debtor disputed the Service's claim for over six years. Though it ultimately lost, the debtor exhausted all of its funds without payment to the United States. The current dispute involved a refund of employment taxes due to the debtor. The United States sought to offset the refund, while the debtor argued that the refund should be used to pay its administrative expenses (namely its lawyers and accountants). The bankruptcy court found for the debtor, holding that the Government's claim lacked mutuality because the Government's claim was for pre-petition taxes while the refund arose post-petition. The district court reversed, finding B.C. § 553(a) merely preserves the common-law right to offset mutual debts.[2] The debtor's plan, providing for the Government's claim, transformed it into a post-petition obligation, and so created the required mutuality. The district court distinguished cases cited by the debtor as cases where the Government attempted to use setoff to better its position. Here, the court pointed out, the Government was using setoff to enforce the debtor's plan and put itself in the same position as other Class 5 creditors, which already had been paid by the debtor. Similarly, the court rejected the debtor's contention that the Service should be required to pursue other Class 5 creditors to disgorge payment. If the debtor had complied with its plan, the court found, there would be no need for the Government to pursue setoff.

13. DAMAGES, SUITS FOR: Against United States: Unauthorized Collection (§7433)

Claitor v. United States, 1999 U.S. Dist. LEXIS 12666 (N.D. Cal. July 29, 1999) - Government agreed to release levy in 1994, but actually did not release the levy until 1998. The Government argued that the taxpayer was barred by the two-year statute of limitations in I.R.C. § 7433(d)(3) because he should have known of the non-release of the levy in 1994. The court, however, found the failure to release levy is a "continuing violation" which continued to accrue until the Government actually released the levy in 1998.

14. LEVY: Failure to Surrender Property

United States v. Tarnove, 84 AFTR2d ¶ 99-5242 (11th Cir. August 20, 1999) (*unpublished*) - Attorney holding personal injury award refused to honor a tax levy against her client. In an unpublished opinion, the Eleventh Circuit upheld the district court's imposition of the 50% penalty under I.R.C. § 6332(d) against the attorney.

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[2] The Government initially argued that the court lacked jurisdiction to consider the setoff, because the bankruptcy estate closed upon confirmation of the debtor's plan. The court found any assessment or collection of a tax liability affects the validity of the plan's confirmation, and so is a core proceeding under B.C. § 157(b)(2).

The attorney argued that the money held was exempt as wages, and further that by filing numerous lawsuits against the Service, she had reasonable cause for refusing to honor the levy. The court observed that the attorney met neither of the two defenses for failing to honor a levy: that she was not in possession of the taxpayer's property, nor was the property subject to a prior judicial attachment or levy. Further, the court found Treas. Reg. § 301.63342(a) provides no exemption where, as in this case, the levy was served after the taxpayer received the award. As to the reasonable cause defense, the court observed that all of her lawsuits had been dismissed, and her stated fear of exposure to liability from a suit by her client was not a defense to the levy.

15. LIENS: Priority Over State & Local Taxes

United States v. R&E Corp., 1999 U.S. Dist. LEXIS 13317 (E.D. Pa. August 1, 1999) - Service and State both claimed proceeds from sale of liquor license. The court first held that the Service's claim did not violate the Tax Injunction Act, 28 U.S.C. § 1341, because it was not seeking to enjoin the State's collection, but rather to determine the priority of their respective liens. Next, the court found the State was not a "judgment lien creditor" because its liens arose by operation of law, not by judicial determination. Consequently, the federal tax liens had priority over all State liens recorded after the Service's assessments. Finally, the court found a state statute which granted superpriority to the State's tax claim in conflict with, and so preempted by, the I.R.C.

16. PENALTIES: Failure to Collect, Withhold or Pay over: Responsible Officer

In re Stoecker 179 F.3d 546 (7th Cir. 1999) - In this state tax case, the Seventh Circuit ruled that the burden of proof in establishing whether a debtor in bankruptcy is the responsible officer liable for a trust fund penalty remains the same in bankruptcy as without (that is, the burden of proof is on the debtor to show that he is not a responsible officer).

17. PENALTIES: Failure to Collect, Withhold or Pay over: Responsible Officer

Unger v. United States, 1999 U.S. Dist. LEXIS 13758 (S.D.N.Y. September 9, 1999); 1999 U.S. Dist. LEXIS 14551 (S.D.N.Y. September 21, 1999) - Plaintiff paid the bills for a corporation which failed to remit payroll taxes. When the corporation filed bankruptcy and the owner proved judgment-proof, the Service assessed plaintiff under I.R.C. § 6672 for a trust fund recovery penalty in excess of $1,000,000.00. Despite the district court's belief that the plaintiff was "a cabin boy on a sinking ship" and that he had been instructed by the owner of the corporation not to pay the taxes, it upheld the imposition of the penalty. However, when the Second Circuit decided United States v. Rem, 38 F.3d 634 (2d Cir. 1994), a concurring opinion suggested the district court may have misinterpreted precedent. With this encouragement, the court urged the plaintiff to file a motion for reconsideration. At trial, a jury again found in favor of the Service, but the court *sua sponte* set aside the verdict as a "gross miscarriage of justice." The court of appeals reversed the district court, United States v. Landau, 155 F.3d 93 (2d Cir.

1998), but remanded with an option for a new trial, which the district court has taken up. The second ruling sets out the court's instructions as to the plaintiff's burden of proof, which will be met if he can show that despite his technical authority to pay bills, in actuality he failed to exercise significant control but instead merely followed the orders of his superior. The ruling also states that the court will instruct the jury not to consider any testimony about non-Service matters, such as the plantiff's authority to sign non-tax checks.

18. PRIORITY: Insolvency (31 U.S.C. § 3713)

Law Offices of Jonathan Stein v. Cadle Co., 1999 U.S. Dist. LEXIS 14180 (C.D. Cal. April 7, 1999); 84 AFTR2d ¶ 99-5306 (June 16, 1999); 1999 U.S. Dist. LEXIS 14162 (August 25, 1999) - These three related decisions deal with priority to interpled funds under the Insolvency Act, 31 U.S.C. § 3713. The plaintiff interpled funds received from a settlement which were claimed by several creditors of a now-defunct corporation. The Service claimed the funds under the priority established by the Insolvency Act. In the first decision, the court found the Insolvency Act applied because the corporation had committed an "act of bankruptcy" by failing to discharge a lien against it within 30 days. The court further determined that the United States had priority under the Insolvency Act because no creditor had achieved actual possession of the interpled funds. Because the United States relied on a judgment rather than a tax lien, the court found the Tax Lien Act, I.R.C. § 6323, did not apply and did not trump the Insolvency Act. However, the court also determined that for the United States to ultimately prevail under the Insolvency Act, it would have to prove that the corporation was in fact insolvent. Following an evidentiary hearing, the court's second decision reached exactly that conclusion, based on evidence that the corporation's liabilities exceeded its assets. Finally, the attorney who interpled the funds claimed a right to fees, but in its third decision the court denied this request, finding the plaintiff offered no reason why he interpled the funds, nor could he show any meaningful service rendered once the action began.

19. REFUNDS: Requirements of Claim

Clement v. United States, 84 AFTR2d ¶ 99-5247 (1st Cir. March 19, 1999) *(unpublished)* - In an unpublished, per curiam decision, the First Circuit affirmed the district court's dismissal of the taxpayer's refund suit. The court held that although a properly executed tax return may constitute a claim for a refund, the return must delineate the grounds upon which entitlement to the refund is premised and present sufficient facts to apprise the Service of the exact basis of the claim. The taxpayer's return, which lacked information needed to judge its substantial correctness and which contained substantially incorrect information, did not satisfy these requirements.

20. SUMMONSES: Defenses to Compliance: Fifth Amendment: Corporate Records

United States v. Insurance Consultants of Knox, Inc., 1999 U.S. App. LEXIS 19662 (7th Cir. August 18, 1999) - Service issued summonses for financial records to corporation and to taxpayer as secretary/treasurer of corporation. Taxpayer

refused to comply. The Seventh Circuit found the Government, by affidavit of the special agent, established the four factors required by United States v. Powell, 379 U.S. 48, 57-58 (1964). The taxpayer argued that enforcement of the summons would violate his Fifth Amendment rights. The court, however, noted that the custodian of records cannot rely on a personal privilege against self-incrimination to avoid producing corporate documents in his possession in a representative capacity, even if those documents might incriminate him (the "collective entity" rule).[3] The court also dismissed the taxpayer's argument that he need not produce records the Service already possesses, finding that the Service does not "possess" information simply because it may have seen the documents at an earlier examination. Finally, the court found the taxpayer was not prejudiced by a notice of nine days, twenty-three hours (rather than the ten days required by statute), holding instead that notice to appear any time during business hours on the tenth day satisfied the requirement of I.R.C. § 7605(a).

21. SUMMONSES: Intervention by Taxpayer

Vanderhoof v. Commissioner, 1999 U.S. Dist. LEXIS 13595 (E.D. Cal. August 18, 1999) - This opinion provides a summary of many of the common defenses raised by a taxpayer in opposition to a third party tax lien, such as relevance, immunity, technical invalidity, and violation of constitutional rights. The court disposes of all of these arguments, although denying the Service's request for summary enforcement because the Service failed to show that any third party had refused to comply with the summons.

[3] See In re Three Grand Jury Subpoenas on p. 3