IN THE UNITED STATES BANKRUPTCY COURT
FOR THE MIDDLE DISTRICT OF FLORIDA

In re:	)	
	)	
WILLIAM J. KARDASH, SR.,	)	Case No. 8:16-bk-05715-KRM
	)	
Debtor.	)	
	)	Chapter 11
_____	)	

REPLY TO DEBTOR'S RESPONSE AND OPPOSITION TO THE UNITED STATES' MOTION FOR SUMMARY JUDGMENT

In this reply, the United States summarizes its legal positions and then attempts to address the Debtor's arguments in the order in which they were presented in Debtor's Response and Opposition to the IRS's Motion for Summary Judgment (hereafter "Response" or "Debtor's Response"). (ECF No. 76.) For the following reasons, this Court should deny the Debtor's motion for summary judgment and grant summary judgment in favor of the United States.

SUMMARY OF UNITED STATES' ARGUMENTS

I. Courts Must Engage in a Functional Analysis, Which Results in the Conclusion that a 26 U.S.C. § 6901 Transferee Assessment is a Tax

First, and foremost, the United States argues that, in deciding whether its claim is a "tax" entitled to priority status, this Court must engage in the functional analysis prescribed by the Supreme Court. *See, e.g.*, *United States v. Reorganized CF & I Fabricators of Utah, Inc.*, 518 U.S. 213 (1996) (discussing the continued vitality of the "functional analysis" and collecting the long-line of Supreme Court cases demonstrating its application). Because the proper starting point in this case is the Supreme Court's functional analysis (or functional approach), this Court cannot follow the prior opinion of the Bankruptcy Court for the Middle District of Florida in *In re Pert*, 201 B.R. 316 (Bankr. M.D. Fla. 1996), which was not consistent with and did not apply (or even reference) the Supreme Court's controlling case law. Instead, this Court should follow

the Tenth Circuit's opinion in *McKowen v. I.R.S.*, 370 F.3d 1023 (10th Cir. 2004)—which adopts a functional approach and holds that approach dictates that a transferee assessment be treated like a tax. *Id.* at 1027 (quoting *Hamar v. C.I.R.*, 42 T.C. 867, 194 WL 1241 (1964)).[1] The result reached in *McKowen* and *Hamar* is not only consistent with the dictates of *Reorganized CF & I Fabricators*, but also with the Supreme Court's own conclusion in a non-bankruptcy case that 26 U.S.C. § 6901 transferee liabilities—while technically a distinct category of governmental obligation—are in substance tax liabilities and should be treated as such. *United States v. Updike*, 281 U.S. 489, 492–96 (1930).

II. The Text of 26 U.S.C. § 6901 Expressly Commands Transferee Liabilities Be Collectible in the Same Manner as Taxes

Second, the United States also argues that the text of 26 U.S.C. § 6901 expressly commands that the United States' transferee liabilities be collectible in the same manner as tax liabilities—which, in this case, means granting the transferee liability priority status. As is discussed in more detail below, this textual argument is supported by the Tenth Circuit's decision in *McKowen*, 370 F.3d at 1027–28, the legislative history to 11 U.S.C. § 507, H.R. Rep. No. 95-595 at 549 (1978), the interpretation provided by the applicable Treasury Regulation (which is in line with the prior text of the statute), 26 C.F.R. § 301.6901–1(a), and the reasoning of the Supreme Court's opinion in *Updike*, 281 U.S. at 492–96.

[1]Notably, while *McKowen* does not expressly cite *Reorganized CF & I Fabricators*, instead relying on a succinct block quote from *Hamar*, M*cKowen* does cite to *United States v. Sotelo*, 436 U.S. 268, 279 (1978), one of the Supreme Court's preeminent functional analysis cases which is referenced in *Reorganized CF & I Fabricators*.

DISCUSSION OF AND REPLY TO DEBTOR'S ARGUMENTS IN DEBTOR'S RESPONSE

A. Debtor's Response Concedes That This Court Must Reject Technical Characterizations and Apply the Functional Analysis Articulated in *Reorganized CF & I Fabricators*

In his Response, Debtor concedes that this Court should start its analysis with the functional approach prescribed by the Supreme Court in *Reorganized CF & I Fabricators* and that "'characterizations under the Internal Revenue Code are not dispositive in the bankruptcy context.'" (Kardash Resp. at 5 (quoting *id.* at 224).) He also "agrees that bankruptcy courts should look beyond statutory labels . . . ." (*Id.* at 6.) Debtor, however, fails to then engage in the functional analysis, examine the fundamental purpose of the transferee liability statute, or explain why the functional analysis would not lead to the conclusion that 26 U.S.C. § 6901 transferee liabilities are in substance tax liabilities—and therefore entitled to tax treatment in bankruptcy.[2]

B. Debtor's Attempt to Distinguish the Tax Court's Opinion in *Hamar* as Only Applying to Dischargeability Cases Disregards the Need for Consistent Application of the Functional Approach

Likewise, Debtor's superficial attempts to distinguish the Tax Court's decision in *Hamar* as a case about dischargeability rather than priority status ignore that *Hamar* speaks broadly about whether a transferee liability is in substance a tax and should be treated as such for bankruptcy purposes. There is no reason to believe that the Tax Court's analysis as to what constitutes a tax in bankruptcy would vary based on whether a court is addressing the question of

[2]Instead of doing that analysis, Debtor accuses the United States of attempting to "bootstrap" its claim into a priority claim to the detriment of Debtor's other creditors. (Kardash Resp. at 4-5.) The sincerity of this argument is dubious given that his wife is claiming an interest in Debtor's "marital assets" despite the fact they are still married. (Claim 5-1). Moreover, all of the other claims in the case are secured, so it is difficult to conceive how treating the IRS's claim as a priority unsecured claim could work to the detriment of those creditors.

priority status or dischargeability—both depend on the meaning of the same word: "tax." To the extent the Bankruptcy Code uses the word "tax" in multiple contexts, the case law and commentators suggest there should be a consistent application between § 507 and § 523 and that courts should use the Supreme Court's functional analysis to resolve whether a particular obligation is in substance a tax. *Compare* 4-507 *Collier on Bankruptcy Practice* ¶ 507.11 (Alan N. Resnick & Henry J. Sommers eds., 16th ed. 2016) (functional analysis determines whether an obligation is a "tax" for priority status) *with* 4-523 *Collier on Bankruptcy Practice* ¶ 523.07 (Alan N. Resnick & Henry J. Sommers eds., 16th ed. 2016) (functional analysis determines whether an obligation is a "tax" for dischargeability).

Buttressing the argument that courts should apply a consistent interpretation in priority and dischargeability cases—and engage in the same analysis—are the Supreme Court's prior opinions, which were collected and summarized in *Reorganized CF & I Fabricators*, 518 U.S. at 220–225. In *Reorganized CF & I Fabricators*, itself a priority status case, the Supreme Court did not distinguish between prior cases addressing priority issues, such as C*ity of New York v. Feiring*, 313 U.S. 283 (1941), and cases addressing dischargeability issues, such as *United States v. Sotelo*, 436 U.S. 268 (1978). The Court described all of its past functional analysis cases as being part of the so-called "*Feiring* line" of cases. *Reorganized CF & I Fabricators*, 518 U.S. at 222. Thus, Debtor's attempt to limit the Tax Court's opinion in *Hamar* as being only applicable to the dischargeability context is misplaced; the functional analysis and its result should be the same whether a court is discussing priority status or dischargeability.[3]

Further supporting the argument that a transferee liability is in substance a tax and should be treated as such in bankruptcy is the Supreme Court's opinion in an early non-bankruptcy case

[3] The sincerity of debtor's argument is questionable regardless since the case on which Debtor relies, *Pert*, was a dischargeability case. *See Pert*, 201 B.R. at 317.

on which the *Feiring* court relied: *United States v. Updike*, 281 U.S. 489, 494 (1930). The *Feiring* court held that a governmental obligation is in substance a "tax", and thereby entitled to priority status in bankruptcy, not when it is labeled a tax by the governmental authority but when the obligation has the incidents of a tax—i.e. when it is a nonconsensual financial burden imposed to raise revenues to support the government. *Feiring*, 313 U.S. at 285, 287–288. And it did so while citing *Updike*. *Id.* at 287 (citing Updike, 281 U.S. at 494). While *Updike* is not a bankruptcy case, *Feiring* shows that it is nevertheless strong persuasive authority as to how a functional analysis should be conducted in bankruptcy.

And, this Court should find the *Updike* functional analysis particularly persuasive because the Supreme Court was interpreting the predecessor statute to what is now 26 U.S.C. § 6901, Section 280(a) of the Revenue Act of 1926 (26 U.S.C. § 1069(a)). The Court's functional analysis found that in every meaningful way the transferee liability was a tax:

> It seems plain enough, without stopping to cite authority, that the present suit, though not against the corporation but against its transferees to subject assets in their hands to the payment of the tax, is in every real sense a proceeding in court to collect a tax. The tax imposed upon the corporation is the basis of the liability, whether sought to be enforced directly against the corporation or by suit against its transferees. The aim in the one case, as in the other, is to enforce a tax liability; and the effect of the language above quoted from section 280 is to read into that section, and make applicable to the transferee equally with the original taxpayer, the provision of section 278(d) in relation to the period of limitation for the collection of a tax. Indeed, when used to connote payment of a tax, it puts no undue strain upon the word 'taxpayer' to bring within its meaning that person whose property, being impressed with a trust to that end, is subjected to the burden. Certainly it would be hard to convince such a person that he had not paid a tax.

Updike, 281 U.S. at 493–94.[4] Thus, the Supreme Court held—albeit in a non-bankruptcy case—that 26 U.S.C. § 6901 transferee liabilities were in essence tax liabilities and should be treated as

[4] *Updike* remains good law. *See United States v. Galletti*, 541 U.S. 114, 123 (2004) (citing *Updike*, 281 U.S. at 494–96).

such. And this opinion was a key part of the intellectual foundation for the development of the functional analysis that is now applied in bankruptcy cases. Therefore, *Updike* provides powerful persuasive support for the Court finding, as did the Tax Court in *Hamar* and the Tenth Circuit in *McKowen*, that transferee liabilities under 26 U.S.C. § 6901 are functionally taxes and should be treated as such in bankruptcy.

C. Debtor's Attempt to Distinguish *Hamar* as Relying on Old Authority Ignores the Long Tradition of Applying the Functional Approach to Transferee Liabilities

While Debtor suggests that the Tax Court's reliance on older cases in its 1964 *Hamar* opinion somehow undermines *Hamar*'s persuasive authority (Kardash Resp. at 6), the age of the case law cited is part of the persuasive point the *Hamar* court was making. The *Hamar* court was saying that—in 1964—the legal argument that a transferee liability is not in substance a tax was decided (and thought dead) over three decades earlier. As the *Hamar* court notes: "Contentions such as those advanced by the taxpayers in the above cases have largely or entirely disappeared from the judicial scene since 1931, when the Supreme Court in *Phillips v. Commissioner*, [283 U.S. 589 (1931)], sustained the constitutionality of the summary procedures for enforcing transferee liabilities . . . ." 42 T.C. at 877–78. The *Hamar* court then concludes by finding that the argument once again being advanced must again be rejected and for the same reasons as before:

> The present petitioner's argument—that his liability as a transferee for payment of the estate tax liability of the decedent's estate was discharged in bankruptcy because it was not a liability for 'a tax levied by the United States'—is akin to the arguments presented by the taxpayers in the last-mentioned cases; and we regard it to be here similarly untenable.

Id. at 877–878. Thus, the *Hamar* court didn't see itself as blazing new ground, but instead putting to rest an argument that just would not die.

D. Debtor Attempts to Distinguish the Tenth Circuit's Opinion in *McKowen* on Irrelevant Grounds

Debtor continues his failure to appreciate and apply the functional analysis test when he argues that *McKowen* erred by failing to give the text of § 507(a)(8) its plain meaning. (Kardash Resp. at 8.)[5] In fact, *McKowen* did give the text its plain meaning—the *McKowen* court was simply persuaded that the obligation owed to the government was for a tax. The Bankruptcy Code does not define the meaning of the word "tax." *Reorganized CF & I Fabricators*, 518 U.S. at 220. Instead, courts must engage in a functional analysis to decide whether a particular obligation is one for a tax. *Id.* The *McKowen* court simply found that a § 6901 transferee liability was in substance a tax, stating: "'[W]hile the liability of a transferee may not be a tax liability in the ordinary sense; nevertheless, it is a liability for a tax.'" 370 F.3d at 1027 (quoting *Hamar*, 42 T.C. at 877). Thus, the *McKowen* opinion did give § 507(a)(8) its plain meaning—the court found the debt was for a "tax" related to income and therefore declared the debt to non-dischargeable.

E. Debtor's Interpretation of 26 U.S.C. § 6901 Creates an Unnecessary Conflict Between 26 U.S.C. § 6901 and the Bankruptcy Code

Similarly, the *McKowen* court did not ignore the plain meaning of the text of 26 U.S.C. § 6901; rather, the *McKowen* court recognized that the plain text of 26 U.S.C. § 6901 commands that transferee liabilities be collectible in the same manner as taxes. Under the Debtor's interpretation of transferee liabilities, a conflict is created between the text of the Internal Revenue Code and the Bankruptcy Code. The Bankruptcy Code gives priority only to a claim for a "tax," 11 U.S.C. § 507(a)(8), while the transferee liability statute provides that a transferee

[5]Debtor also points to some factual differences between *McKowen* and the present case but fails to say why these factual distinctions are legally significant.

liability—though not technically a tax under the Internal Revenue Code—must be collectible in the same manner as a tax. 26 U.S.C. § 6901(a).

The *McKowen* court recognized the possible conflict between the statutes and indicated it was bound to construe the statutes in a way to harmonize the two. 370 F.3d at 1027–28. Therefore, the *McKowen* court found that transferee liabilities should be treated as a tax in bankruptcy. *Id.* The *McKowen* court further reasoned that failing to do so "would impermissibly override the specific policy judgment made by Congress in enacting Section 6901." *Id.* at 1028 (citing *Sotelo*, 436 U.S. at 279); *cf. In re Gurwtich*, 794 F.2d 584, 586 (11th Cir. 1986) (citing *Sotelo*, 436 U.S. at 279) (refusing to overrule a policy judgment made by Congress). Thus, even if a transferee liability were found not to be a tax under the functional analysis, the express language of 26 U.S.C. § 6901 would nevertheless command equality of treatment.

Both the legislative history from the enactment of 11 U.S.C. § 507 and the administrative regulation interpreting 26 U.S.C § 6901 also support the conclusion that unassessed transferee liabilities are entitled to the same treatment as any other unassessed tax. In fact, the legislative history for 11 U.S.C. § 507 is unequivocal on this point. Congress believed unassessed transferee liabilities would be entitled to priority status in bankruptcy:

> [T]ax liability of the debtor (under the Internal Revenue Code or state or local law) as a transferee of property from another person will receive sixth priority without the limitations contained in the Senate amendment so long as the transferee liability had not been assessed by the tax authority by the petition date but could still have been assessed by that date under the applicable tax statute of limitations . . . .

See H.R. Rep. No. 95-595 at 549 (1978), reprinted in 1978 U.S.C.C.A.N. 5963, 6496 (same). The applicable Treasury Regulation also supports treating an unassessed transferee liability as though it were an unassessed tax deficiency. *See* 26 C.F.R. § 301.6901–1(a) (transferee liability to be "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") (emphasis added). And, of course, a claim for a tax deficiency which is unassessed but is assessable on the petition date is entitled to priority treatment.[6] 11 U.S.C. § 507(a)(8)(A)(iii).

Finally, the Supreme Court's decision in *Updike*, 281 U.S. at 492–96, also makes clear that the equality of treatment envisioned by Congress is such that while there may be a technical distinction between "taxes *qua* taxes" and transferee liabilities, transferee liabilities are nevertheless entitled to equal treatment.

F. Debtor's Suggestion That *Baptiste* and *Pert* Are Binding Authority Ignores That Neither Performs the Relevant Functional Analysis to Determine the Treatment of a Transferee Liability in Bankruptcy

Finally, Debtor mistakenly argues that he relies on binding authority and must prevail.[7] Debtor cites to *Baptiste v. C.I.R.*, 29 F.3d 1533 (11th Cir. 1994) and *In re Pert*, 201 B.R. 316, 318 (Bankr. M.D. Fla. 1996) as binding authority on which the Court should rely. However, the United States has previously distinguished these cases at length, and shown that these cases do not present any relevant authority that would require the Court to rule for the Debtor. For sake of brevity, those arguments are not repeated here in full. Rather, in summary, *Baptiste* is not a bankruptcy case, and the Eleventh Circuit there held only that a transferee liability is not a tax

[6] This clarifying interpretation of the statute by the agency which administers it should be given deference. *See Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 844 (1984). Notably, this interpretation is also in line with the text of the statute as it appeared prior to being restyled and renumbered. *Compare* Section 280(a) of the Revenue Act of 1926 (prior 26 U.S.C. § 1069(a)) *and* Section 311(a) of the Revenue Act of 1939 (prior 26 U.S.C. § 311(a)) *with* 26 U.S.C § 6901(a). The Eleventh Circuit has stated that Congress did not intend the minor textual revisions between the prior statutory versions and 26 U.S.C. 6901(a) to change the meaning of the statute; rather, Congress was simply "removing superfluous language." *Baptiste v. C.I.R*, 29 F.3d 1533, 1542 n.7 (11th Cir. 1994).

[7] As part of this final section, Debtor confusingly suggests that it is somehow relevant that transferee liability is considered an *in rem* remedy. That distinction is only relevant to the amount for which Debtor can be held liable, i.e. the transferee liability represents the amount the transferee received (plus interest) and not the full amount the transferor might otherwise owe.

under the Internal Revenue Code but is instead a "nontax liability" that is nevertheless entitled to be treated "as if it were a tax liability." *Baptiste*, 29 F.3d at 1541–42 (citing 26 U.S.C. § 6901(a)). This ruling, while informative as to the proper technical characterization under the Internal Revenue Code, does nothing to answer the legal question as to whether a transferee liability should be treated as a tax for bankruptcy purposes. And *Pert*, which is not in fact binding on this Court, misapplies *Baptiste*. The *Pert* opinion relies on the holding of *Baptiste*—that transferee liabilities are not taxes—and applies it in the bankruptcy context without acknowledging or engaging in the functional analysis prescribed by the Supreme Court.[8] Put simply, neither *Baptiste* nor *Pert* engages in the correct analysis; therefore, neither can be considered even persuasive authority for the Court's decision here.

CONCLUSION

Under the functional approach articulated by the Supreme Court, the United States' transferee liability claim is entitled to priority treatment. Providing for priority treatment in this bankruptcy will give full effect to the remedy provided by section 6901 of the IRC, which demands such claim be treated in the same manner as a tax claim. Thus, the Court should deny Debtor's motion for summary judgment and instead grant summary judgment in favor of the United States.

[8] It is surprising that the *Pert* court does not even acknowledge the Supreme Court's case law given that *Reorganized CF & I Fabricators* was decided only months earlier. *Compare Reorganized CF & I Fabricators*, 518 U.S. at 213 (decided June 20, 1996) *with Pert*, 201 B.R. at 316 (decided Sept. 27, 1996).

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on February 21, 2017, the foregoing Reply to Debtor's Response and Opposition to the United States' Motion for Summary Judgment was filed and served via the Court's CM/ECF filing system on the following:

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General Information

Court	United States Bankruptcy Court for the Middle District of Florida; United States Bankruptcy Court for the Middle District of Florida
Docket Number	8:16-bk-05715