

Transferee Liability: Taxpayers Win a MidCoast Case, Part I.

The government's MidCoast transferee liability cases have been fairly successful: following a loss in *Starnes v. Commissioner*, 680 F.3d 417 (4th Cir. 2012), the government rallied for wins in *Frank Sawyer Trust of May 1992 v. Commissioner*, 712 F.3d 519 (1st Cir. 2013) (decision on remand, *Frank Sawyer Trust of May 1992 v. Commissioner*, T.C. Memo 2014-56 (April 3, 2014)) and in *Diebold Foundation v. Commissioner*, 736 F.3d 132 (2d Cir. 2013); the government then leveraged its *Diebold* victory for a second win in a related case, *Salus Mundi Foundation v. Commissioner*, 2014 U.S. App. LEXIS 24240 (9th Cir. Dec. 22, 2014).

A recent opinion from the Middle District of North Carolina came out on the taxpayers' side. *Andrew v. United States*, 2015 U.S. Dist. LEXIS 17193 (M.D.N.C. Feb. 12, 2015). *Andrew* involved an investment club, GNC Investors Club, Inc., that had been formed as a C Corporation; it decided to liquidate due to the double taxation associated with that form. *Andrew*, slip op. at *3. Ultimately, a local attorney put one of the shareholders in touch with MidCoast Credit Corporation. *Id.*, slip op. at *4. Following background and reference checks, a transaction closed on November 28, 2000, with the investment club shareholders selling their GNC shares to Battery Street, a MidCoast affiliate. *Id.*, slip op. at *8.

That day, Battery Street wired the purchase price of \$3,818,000 to the escrow account of the club's lawyer. *Id.*, slip op. at *11. The investment club's assets had previously been reduced to cash, and GNC wired most of its cash to a new bank account that Battery Street had established in GNC's name, while writing a check to Battery Street for less than \$4000 to close out a brokerage account. *Id.*

GNC later filed tax returns that reflected no tax liability, but the IRS assessed a deficiency of over \$1.2 million and an accuracy-related penalty of over \$500,000 in 2004. *Id.*, slip op. at *12. When the government was unable to collect the deficiency, it turned to the former GNC shareholders, issuing transferee assessments in September 2008. *Id.* The former shareholders ultimately elected to pay the disputed amounts and seek a refund, giving rise to the district court case.

Applying North Carolina's Uniform Fraudulent Transfer Act, the district court promptly concluded that the initial transfers involving the sale of the GNC shares were not subject to attack. *Id.*, slip op. at *16-*19. The court reasoned that when the investment club transferred the bulk of its cash from its existing bank account to a new one it retained control of its cash and therefore received reasonably equivalent value. *Id.*, slip op. at *16-*17. The company was also not rendered insolvent, as it had ample cash to pay its tax liabilities. *Id.*, slip op. at *17. Finally, the court concluded that a variety of factors demonstrated that the initial transfers were not made with the intent to hinder or defraud creditors, including the fact that the investment club retained ample assets to pay its liabilities. *Id.*, slip op. at *18-*19.

The court's focus then shifted to a variety of transactions that the Government contended occurred later, at the direction of Battery Street, after the alleged transferees no longer controlled GNC. The government alleged that on November 29, 2000 the investment club transferred roughly \$3.8 million to a lender that had financed Battery Street's acquisition of the shares. *Id.*, slip op. at *20. The government also contended that GNC made two other transfers to pay fees that Battery Street incurred in the transaction. *Id.*, slip op. at *20-*21. This is where the government's case basically fell apart. I will drill into the problems it faced in another post.

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