

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

Continuing the discussion of *Andrew v. United States*, 2015 U.S. Dist. LEXIS 17193 (M.D.N.C. Feb. 12, 2015), after the district court concluded that the initial transfers surrounding the GNC Investment Club sale were not fraudulent, its focus shifted to the government's allegations concerning subsequent transactions that GNC made at the direction of Battery Street, the purchaser, after the transferees no longer controlled GNC. *Andrew*, 2015 U.S. Dist. LEXIS 17193, slip op. at *18-*22.

The three alleged transactions included a transfer of roughly \$3.8 million that GNC made one day after the closing to Battery Street's lender to pay off the loan Battery Street had used to finance the purchase of GNC's shares, along with two other transfers from GNC to pay fees that Battery Street had incurred in acquiring GNC. *Id.*, slip op. at *20-*21. These three transactions left GNC with \$192,758.74, which was well below the amount needed to pay its tax liabilities. *Id.*, slip op. at *21

As in other MidCoast transferee liability cases, the central thrust of the government's case was that the post-closing transactions were part of a single integrated transaction and the alleged transferees were responsible because they had either actual or constructive knowledge of the entire scheme. While this approach was successful in cases such as *Diebold Foundation v. Commissioner*, 736 F.3d 132 (2d Cir. 2013) and *Salus Mundi Foundation v. Commissioner*, 2014 U.S. App. LEXIS 24240 (9th Cir. Dec. 22, 2014), the government failed miserably in *Andrew*.

First, the government was unsuccessful in establishing that the relevant post-closing transaction even occurred because the alleged transferees successfully objected to the various loan documents and bank records relied upon by the government as inadmissible hearsay. The issue here was double hearsay. In the absence of some testimony from either Battery Street or its lender, the district court concluded that it could not admit the purported loan documents to establish that a loan had been made to finance the purchase of GNC shares, particularly since the court had concerns about their authenticity, in light of inconsistent dates. *Id.*, slip op. at *24-*28. Similar problems plagued the government's reliance upon bank records it had obtained by summons: in the absence of testimony from someone from the bank, the fact that the government had obtained the records by summons and maintained them as business records was insufficient to establish the truth of what the records indicated. *Id.*, slip op. at *29-*30.

Second, the court concluded that even if the faulty evidence of these transactions was credited, it was not sufficient to establish that the former GNC shareholders had constructive knowledge of Battery Street's post-closing plans. In the court's view, the circumstances surrounding the transaction were not sufficient to put the former shareholders on inquiry notice: MidCoast was brought to the shareholders attention by a reputable attorney and no one affiliated with the former GNC shareholders raised any questions about the transaction. *Id.*, slip op. at *32-*33. While there was a premium being paid for the GNC shares, it was relatively modest and several plaintiffs had testified that they had experience with transactions where a premium over book value was paid. *Id.*, slip op. at *33. Moreover, the court concluded that it was doubtful that reasonable inquiry would have led the former shareholders to conclude that GNC would be unable to pay its taxes after the sale. In particular, the court noted that this transaction was

concluded before IRS Notice 2001-16 was issued, identifying “intermediary transactions” as potentially abusive. *Id.*, slip op. at *34.

Finally the Court concluded that *Diebold* was distinguishable in light of the far greater sophistication of the parties in that case, among other factors. *Id.*, slip op. at *34-*38.

Jim Malone is a tax attorney in Philadelphia; he focuses his practice on federal, state and local tax controversies. This post is intended to provide background on a relevant issue; it is not intended as legal advice. © 2015, MALONE LLC.