Commissioner v. Stern, 357 U. S. 39 (1958)

Transferee liability for unpaid taxes is determined by applying state fraudulent conveyance laws, not federal tax law.

Summary

In Commissioner v. Stern, the U. S. Supreme Court clarified that the IRS must rely on state law to establish transferee liability for unpaid taxes. The case involved a land company that transferred property to its mortgagees in partial satisfaction of a debt. The IRS sought to hold the mortgagees liable as transferees for the company's unpaid taxes. The Court held that the mortgagees gave "fair consideration" for the property under Arizona law, and there was no evidence of intent to defraud creditors. Thus, the mortgagees were not liable as transferees. This decision underscores the importance of state fraudulent conveyance laws in determining transferee liability in tax collection cases.

Facts

Land Co. owed the Sterns $271,437. 81 as of September 30, 1958, secured by a mortgage. In April 1962, the Sterns released their mortgage with the understanding that they would receive an 80-acre parcel as partial payment of the debt. Land Co. conveyed the parcel to the Sterns, who then released their mortgage of record. All of Land Co. 's other known creditors, except the IRS, were paid in full. The IRS sought to hold the Sterns liable as transferees for Land Co. 's unpaid taxes, arguing the transfer was fraudulent under Arizona law.

Procedural History

The Tax Court ruled in favor of the Sterns, finding they gave fair consideration for the property and there was no intent to defraud creditors. The Commissioner appealed directly to the U. S. Supreme Court, which granted certiorari to review the Tax Court's decision.

Issue(s)

1. Whether the Sterns gave "fair consideration" for the property transferred to them under Arizona fraudulent conveyance laws.
2. Whether the transfer to the Sterns was made with actual intent to hinder, delay, or defraud creditors under Arizona law.

Holding

1. Yes, because the Sterns released their mortgage in exchange for the 80-acre parcel, which constituted fair consideration under Arizona law.
2. No, because there was no evidence that the transfer was made with actual intent to defraud creditors.

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Court’s Reasoning

The Court emphasized that Section 6901 of the Internal Revenue Code does not create substantive transferee liability but provides an administrative procedure for collecting unpaid taxes from transferees based on state law. The Court applied Arizona’s fraudulent conveyance statutes, focusing on the definitions of “fair consideration” and the requirement of actual intent to defraud. The Court found that the Sterns’ release of their mortgage in exchange for the parcel constituted fair consideration, as it was in good faith and represented a fair equivalent value. The Court also noted that the Sterns, as secured creditors, did not gain any preference over other creditors by the transfer. Regarding actual intent, the Court held that the Commissioner failed to meet the burden of proof, as there was no evidence of intent to defraud. The Court quoted Arizona Revised Statutes, emphasizing the requirement of “actual intent * * * to hinder, delay, or defraud either present or future creditors. “

Practical Implications

This decision clarifies that the IRS must rely on state fraudulent conveyance laws to establish transferee liability for unpaid taxes. Practitioners should carefully analyze the applicable state law when assessing potential transferee liability in tax collection cases. The ruling emphasizes the importance of fair consideration and the burden on the IRS to prove actual intent to defraud. Businesses and individuals involved in debt restructuring or asset transfers should ensure that such transactions are supported by fair consideration and do not exhibit intent to defraud creditors. Subsequent cases have followed this precedent, requiring the IRS to prove transferee liability under state law standards.

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