Schad v. Commissioner, 87 T. C. 609 (1986)

A transferee can be held liable for a transferor's tax liabilities if the transfer was fraudulent under state law, and large cash expenditures may be treated as taxable income if the taxpayer cannot prove otherwise.

Summary

Mark Schad received $300,000 from Joseph Collins, who was later killed, under the condition that the money would be Schad's if Collins died. The IRS determined Schad was liable as a transferee for Collins' unpaid taxes since the transfer rendered Collins insolvent. Additionally, Schad was found to have unreported income from $174,679 seized during an attempted marijuana purchase and $14,200 used to buy real estate. The Tax Court upheld the IRS's determinations, emphasizing Schad's failure to prove the money was not income from illegal activities and his liability as a transferee under Florida's fraudulent conveyance law.

Facts

In December 1977, Joseph Collins, fearing for his life, gave Mark Schad $300,000, telling Schad it would be his if anything happened to Collins. Collins was killed in May 1978. Schad kept the money and used it for various expenditures. In 1983, Schad attempted to purchase 600 pounds of marijuana with $174,679, which was seized by Florida law enforcement. Schad also used $14,200 to buy real estate in Marion County. The IRS determined Schad was liable as a transferee for Collins' 1977 tax liabilities and that the seized and spent money was unreported income.

Procedural History

The IRS issued a notice of deficiency to Schad for 1983, alleging unreported income and additions to tax. Schad petitioned the Tax Court, which consolidated two dockets related to his transferee liability and income tax deficiency. The Tax Court upheld the IRS's determinations, finding Schad liable as a transferee and that he failed to prove the seized and spent money was not taxable income.

Issue(s)

1. Whether Schad is liable as a transferee of the assets of Joseph Collins, deceased?
2. Whether $174,679 seized from Schad and $14,200 used to purchase real estate are taxable to him as income for 1983?
3. Whether Schad is liable for additions to tax under sections 6651(a)(1), 6653(a)(1), 6653(a)(2), and 6654 for 1983?

Holding

1. Yes, because the transfer from Collins to Schad was a fraudulent conveyance under Florida law, rendering Collins insolvent.

2. Yes, because Schad failed to prove that the seized and spent money was not income derived from taxable activities in 1983.
3. Yes, because Schad did not provide evidence to refute the IRS's determinations regarding the additions to tax.

Court's Reasoning

The Tax Court applied Florida's fraudulent conveyance law, finding that Collins' transfer to Schad was a gift causa mortis that rendered Collins insolvent. The court noted that a transfer without consideration by an insolvent debtor is presumptively fraudulent under Florida law. Regarding the income tax deficiency, the court rejected Schad's claim that the seized and spent money came from the Collins transfer, citing inconsistencies in Schad's testimony and his lack of corroborating evidence. The court emphasized that Schad's possession of large cash sums and his history of marijuana-related activities supported the IRS's determination that the money was unreported income. The court also upheld the additions to tax, as Schad provided no evidence to challenge these determinations.

Practical Implications

This case underscores the importance of proving the source of large cash expenditures, particularly when linked to illegal activities. It also highlights the potential for transferee liability when a transferor is insolvent at the time of a gift. Legal practitioners should advise clients on the risks of accepting large gifts from potentially insolvent individuals and the need for meticulous record-keeping to substantiate the source of funds. The decision may impact how similar cases are analyzed, especially those involving transfers and income from illegal activities, and it reinforces the IRS's ability to impose transferee liability and tax unreported income based on cash expenditures. Subsequent cases, such as *Delaney v. Commissioner*, have further clarified the burden of proof in similar situations.

