Gould v. Commissioner of Internal Revenue, 139 T. C. 418 (U. S. Tax Court 2012)

In Gould v. Comm'r, the U. S. Tax Court ruled that Theodore B. Gould's tax returns for 1995-2002 were not fraudulent, despite significant overstatements of net operating loss (NOL) and capital loss deductions. The court found that the Miami Center Liquidating Trust (MCLT) was not a grantor trust, and thus, Gould could not claim NOL deductions from the trust or his bankruptcy estate. The ruling clarifies the tax treatment of liquidating trusts in bankruptcy and the standards for proving fraudulent intent in tax evasion cases.

Parties

Theodore B. Gould and the Estate of Helen C. Gould, deceased, with Theodore B. Gould as executor (Petitioners), filed petitions against the Commissioner of Internal Revenue (Respondent) in the U. S. Tax Court. The cases were consolidated for the purpose of opinion. Petitioners were represented by counsel in docket Nos. 5887-07L and 4592-08, and Mr. Gould represented himself pro se in docket No. 11606-10L.

Facts

Theodore B. Gould and several entities in which he held interests filed voluntary petitions for Chapter 11 bankruptcy in 1984. A liquidating trust, the Miami Center Liquidating Trust (MCLT), was established to manage the debtors' assets, including the Miami Center and proceeds from Washington properties. The MCLT's trustee, Fred Stanton Smith, remitted payments to the IRS for tax liabilities of the debtors, including Gould's bankruptcy estate, for tax years before those at issue in this case. On their individual joint 1995, amended 1995, and 1996-2002 Federal income tax returns, petitioners claimed NOL deductions and estimated tax payments attributed to the MCLT and one of the debtor entities, arguing that Gould was the grantor of the MCLT. They also claimed capital loss deductions for those years. Respondent determined deficiencies in petitioners' 1995-2002 income tax and imposed fraud penalties under I. R. C. sec. 6663(a), asserting that the returns were fraudulent. The three-year period of limitations on assessment under I. R. C. sec. 6501(a) had expired for 1995-2001 before the notice of deficiency was issued, but Respondent argued that the period remained open under I. R. C. sec. 6501(c) due to alleged fraudulent filings.

Procedural History

The Tax Court consolidated the cases for opinion. Respondent issued a notice of deficiency for 1995-2002, determining tax deficiencies and fraud penalties. Petitioners filed petitions challenging the notice of deficiency. Respondent also issued notices of intent to levy and notices of Federal tax lien for petitioners' unpaid self-employment taxes for 1995, 1996, 1999-2003, and 2005-07. Petitioners filed

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petitions for review of the determination pursuant to I. R. C. sec. 6330. The court dismissed the levy action for 1996 as moot. The parties presented arguments regarding the fraudulent nature of the returns, the applicability of the MCLT as a grantor trust, and the entitlement to NOL and capital loss deductions.

Issue(s)

Whether the periods of limitations for assessing and collecting the proposed deficiencies and penalties for 1995-2001 remain open due to fraudulent filings?
Whether petitioners are entitled to NOL deductions for 1995-2002 attributable to Gould's bankruptcy estate or the MCLT?
Whether petitioners are entitled to capital loss deductions for 1995-2002?
Whether petitioners are entitled to a credit or refund of alleged overpayments for 1995-2002?
Whether Respondent properly abated assessments of income tax against the MCLT for tax years 1997 and 1998?
Whether Gould is liable for the civil fraud penalty under I. R. C. sec. 6663(a) for 1995-2002?
Whether petitioners are liable for the accuracy-related penalty under I. R. C. sec. 6662(a) for 2002?
Whether Respondent may proceed by levy to collect petitioners' 1995, 1999-2003, and 2005-07 self-employment tax liabilities?
Whether Respondent's Appeals Office abused its discretion in denying petitioners a face-to-face collection due process hearing for 2000-2003 and 2005-07?

Rule(s) of Law

I. R. C. sec. 6501(a) establishes a three-year period of limitations for assessing tax deficiencies, which can be extended under I. R. C. sec. 6501(c)(1) if a return is false or fraudulent with intent to evade tax. I. R. C. sec. 671-677 govern the treatment of grantor trusts, where the grantor or another person is treated as the owner of any portion of the trust for tax purposes. I. R. C. sec. 1398 addresses the tax treatment of bankruptcy estates, including the succession of tax attributes upon termination. I. R. C. sec. 172 allows for NOL deductions, and I. R. C. sec. 1211 and 1212 limit the deductibility of capital losses. I. R. C. sec. 6663(a) imposes a civil fraud penalty for underpayments due to fraud, and I. R. C. sec. 6662(a) imposes an accuracy-related penalty for underpayments due to negligence or substantial understatement of income tax.

Holding

The Tax Court held that the periods of limitations for assessing and collecting the proposed deficiencies and penalties for 1995-2001 were not extended due to fraud, as Respondent failed to prove by clear and convincing evidence that petitioners filed fraudulent returns. The court found that petitioners were not entitled to NOL deductions attributable to Gould's bankruptcy estate or the MCLT, as the MCLT was

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not a grantor trust with respect to Gould, and no tax attributes remained in the bankruptcy estate upon its termination. Petitioners were also not entitled to capital loss deductions for lack of substantiation. The court lacked jurisdiction to determine the propriety of Respondent's abatement of assessments against the MCLT. Gould was not liable for the civil fraud penalty for 1995-2002, but petitioners were liable for the accuracy-related penalty under I. R. C. sec. 6662(a) for 2002 due to a substantial understatement of income tax. Respondent did not abuse its discretion in denying petitioners a face-to-face collection due process hearing for 2000-2003 and 2005-07.

Reasoning

The court analyzed the legal principles and facts to determine whether the MCLT was a grantor trust under I. R. C. sec. 671-677. It rejected petitioners' arguments that Gould was the grantor of the MCLT, as he did not contribute any property to the trust, and the trust was not created and funded gratuitously on his behalf. The court also found that Gould did not acquire an interest in the trust from his bankruptcy estate upon its termination, and the trust income was not used to discharge his debt. The court relied on the U. S. Supreme Court's decision in Holywell Corp. v. Smith, which held that the MCLT was not a grantor trust with respect to Gould. The court further determined that the NOL deductions claimed by petitioners were not available, as the joint motion approved by the bankruptcy court extinguished the tax attributes of Gould's bankruptcy estate upon its termination. The court found that petitioners failed to substantiate their claimed capital loss deductions. In assessing the fraud penalty, the court considered the badges of fraud but concluded that Respondent did not meet the burden of proving fraudulent intent by clear and convincing evidence. The court applied the accuracy-related penalty for 2002 due to a substantial understatement of income tax, rejecting petitioners' reasonable cause defense. The court also addressed the collection issues, finding that petitioners' claims for credits against their self-employment tax liabilities were time-barred, and Respondent did not abuse its discretion in denying a face-to-face hearing.

Disposition

The court sustained Respondent's adjustments disallowing the claimed NOL and capital loss deductions for 2002, imposed the accuracy-related penalty for 2002, and upheld Respondent's determinations regarding the collection of self-employment taxes for 1995, 1999-2003, and 2005-07. The court entered decisions under Rule 155.

Significance/Impact

The Gould decision clarifies the tax treatment of liquidating trusts in bankruptcy and the standards for proving fraudulent intent in tax evasion cases. It reinforces the principle that a liquidating trust is not a grantor trust unless the debtor contributes

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property to the trust or acquires an interest in it upon the bankruptcy estate's termination. The decision also highlights the importance of substantiation for NOL and capital loss deductions and the high burden of proof for the Commissioner to establish fraudulent intent. The ruling has implications for taxpayers and practitioners dealing with bankruptcy-related tax issues and the application of penalties for tax understatements.

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