William Scott Stuart, Jr. , Transferee, et al. v. Commissioner of Internal Revenue, 144 T. C. 235 (2015) (United States Tax Court, 2015)

In Stuart v. Comm'r, the U. S. Tax Court rejected the IRS's two-step analysis for determining transferee liability under I. R. C. § 6901, opting instead to apply state law directly. The court found shareholders liable as transferees under Nebraska's Uniform Fraudulent Transfer Act for a corporation's unpaid taxes, highlighting the significance of state law in defining transferee liability and the broad interpretation of the term "claim" to include contingent tax liabilities.

Parties

William Scott Stuart, Jr. , Arnold John Walters, Jr. , James Stuart, Jr. , and Robert Edwin Joyce (collectively, Petitioners) were shareholders of Little Salt Development Co. (Little Salt), a Nebraska corporation. They were designated as transferees by the Commissioner of Internal Revenue (Respondent) for the purpose of collecting Little Salt's unpaid 2003 Federal income tax.

Facts

Little Salt owned 160 acres of land, which it sold to the City of Lincoln, Nebraska, for $472,000 on June 11, 2003, realizing a gain of $432,148. After the sale, Little Salt's only asset was cash. On August 7, 2003, the shareholders sold their shares in Little Salt to MidCoast Investments, Inc. (MidCoast) for $358,826, which was calculated by subtracting 64. 92% of Little Salt's estimated 2003 tax liability from its cash balance. Concurrently, Little Salt transferred all its cash ($467,721) to a trust account controlled by MidCoast's attorney. The next day, the cash was transferred to a new Little Salt account at SunTrust Bank and then to a MidCoast account. Little Salt recorded this transfer as a receivable due from shareholders. Little Salt did not pay its 2003 taxes and was placed in inactive status by Nebraska in 2004. The IRS assessed a deficiency in Little Salt's 2003 tax and issued notices of transferee liability to the shareholders.

Procedural History

The IRS sent notices of transferee liability to the shareholders in November 2010, asserting their liability for Little Salt's unpaid 2003 tax based on the shareholders' receipt of cash in a purported liquidation of Little Salt. The shareholders timely petitioned the U. S. Tax Court, contesting the transferee liability and asserting that the statute of limitations had expired. The Tax Court consolidated the cases for trial, briefing, and opinion. The court rejected the shareholders' statute of limitations defense and proceeded to consider the substantive issue of transferee liability under Nebraska law.

Issue(s)

Whether the shareholders are liable as transferees of Little Salt's property for its

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unpaid 2003 Federal income tax under the Nebraska Uniform Fraudulent Transfer Act (UFTA)?

Rule(s) of Law

The liability of a transferee for a transferor's unpaid taxes is governed by I. R. C. § 6901, which allows the Commissioner to collect such taxes using the same procedures as those used against the taxpayer, subject to state law defining transferee liability. Under Nebraska's UFTA, a transfer is fraudulent as to a creditor if it is made without receiving a reasonably equivalent value in exchange and the debtor is insolvent as a result of the transfer. The term "claim" under UFTA includes "a right to payment, whether or not the right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured. "

Holding

The shareholders are liable as transferees under Nebraska's UFTA for Little Salt's unpaid 2003 tax to the extent of the benefit they received from the transfer, which was the difference between the price they received for their shares and the amount they would have received in a liquidation of Little Salt after paying its taxes.

Reasoning

The court rejected the IRS's two-step analysis, which would have involved disregarding the form of the transaction and applying federal tax principles to recast it as a liquidating distribution, followed by an application of state law. Instead, the court applied Nebraska's UFTA directly, finding that Little Salt's transfer of its cash to MidCoast was constructively fraudulent as to the IRS because it did not receive reasonably equivalent value and was rendered insolvent by the transfer. The court found that the shareholders benefited from the transfer, as they received more for their shares than they would have in a liquidation, and thus were liable as persons for whose benefit the transfer was made. The court also determined that the IRS's claim arose before the transfer, as it was an unmatured claim for Little Salt's 2003 tax liability. The court's decision was based on the expansive definition of "claim" under UFTA, which includes contingent and unmatured liabilities, and the application of state law to determine the substantive liability of transferees.

Disposition

The court entered decisions for the Respondent, holding the shareholders liable as transferees for their respective shares of $58,842 of Little Salt's unpaid 2003 tax.

Significance/Impact

The decision underscores the importance of state fraudulent transfer laws in determining transferee liability for unpaid taxes under I. R. C. § 6901. It clarifies

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that the IRS cannot use federal tax principles to recast transactions before applying state law and that the term “claim” under UFTA includes contingent tax liabilities. The case also illustrates the court’s willingness to hold shareholders liable as beneficiaries of fraudulent transfers, even if they did not directly receive the transferred assets. This ruling has implications for tax planning and the structuring of corporate transactions, as it highlights the risks of using intermediaries to avoid tax liabilities and the potential for shareholders to be held liable for corporate tax debts under state fraudulent transfer laws.

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