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An Unlimited Reach-Back Period When IRS Is Triggering Creditor?

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Using the Internal Revenue Service (IRS) as the "triggering creditor" under § 544(b) of the Bankruptcy Code provides a powerful tool for bankruptcy trustees to reach back for periods of 10 or more years in the pursuit of fraudulent conveyances that are otherwise outside the applicable state law statutes of limitation. There are few published opinions on this issue.

Recently, Hon. **Robert A. Mark** of the U.S. Bankruptcy Court for the Southern District of Florida opined that this tool went largely unused, perhaps because trustees did not know they had such a weapon in their arsenal, and contemplated that increased use could cause a major change in contemporary bankruptcy practice.[1] This article examines existing case law regarding the ability of the bankruptcy trustee to utilize the longer, and potentially unlimited, limitations period available to the IRS when the IRS holds an unsecured claim, as well as policy and practical concerns for legal practitioners.

11 U.S.C. § 544(b)

Section 544(b)(1) allows a bankruptcy trustee to avoid fraudulent conveyances that would be "voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502." Under § 544(b), the trustee steps into the shoes of an unsecured creditor to pursue the avoidance of fraudulent transfers using the substantive state or federal law applicable to that particular creditor, who is commonly referred to as the "triggering creditor." Transfers avoided by the bankruptcy trustee become property of the estate and are distributed to all creditors on a *pro rata* basis.[2]

Applicable Law?

The IRS can use state fraudulent conveyance laws or the Federal Debt Collections Procedure Act (FDCPA) to collect on amounts owed to it. Under the FDCPA, a federal creditor can generally avoid fraudulent transfers occurring within six years of filing suit.[3] Statutes of limitations for fraudulent transfers under state law vary but are typically within four to six years of the transfer date.[4] These statutes of limitations are referred to as "reach-back periods."

However, the IRS, as a government creditor (acting in its governmental capacity in pursuit of a claim on behalf of the U.S.), is not subject to state statutes of limitations.[5] In *United States v. Summerlin*, a case involving a late-filed claim by the U.S. in a probate proceeding, the U.S. Supreme Court ruled that "[w]hen the United States becomes entitled to a claim, acting in its governmental capacity and asserts its claim in that right, it cannot be deemed to have abdicated its governmental authority so as to become subject to a state statute putting a time limit upon enforcement."[6] Further, the policy behind an unlimited limitations period for the U.S. originates in the doctrine of *nullum tempus occurrit regi*, or "no time runs against the king," and is justified in the modern era in the idea that "public rights, revenues, and property should not be forfeited due to the negligence of public officials."[7] Thus, there is arguably no time limit on when the IRS can present or assess a claim for outstanding amounts owed to it by a taxpayer.

There is, however, a 10-year limitations period on the initiation of an actual called action, set forth in § 6502(a) of the Internal Revenue Code (IRC):

> [w]here the assessment of any tax imposed by this title has been made within the period of limitations properly applicable thereto, such tax may be collected by levy or by a proceeding in court, but only if the levy is made or proceeding begun within 10 years after the assessment of the tax[.][8]

This IRS collection period is different than a state law reach-back period. The language of § 6502(a) does not technically provide the IRS with a 10-year reach-back period in terms of when the claim had to arise; rather, it constrains the IRS with a 10-year period in which to initiate a collections action. Despite the absence of any such language, the majority of bankruptcy courts have interpreted § 6502(a) as providing the IRS, and thus the bankruptcy trustee using § 544(b), with a 10-year reach-back period to pursue fraudulent conveyances.

Diverging Views

While relatively few opinions directly address a bankruptcy trustee's use of the IRS as a triggering

1 *In re Kipnis*, 555 B.R. 877, 883 (Bankr. S.D. Fla. 2016).
2 *Moore v. Bay*, 284 U.S. 4, 5 (1931).
3 28 U.S.C. § 3306(b) (1990).
4 *See, e.g.*, Fla. Stat. § 726.110 (1987) (four years), 740 Ill. Comp. Stat. 160/10 (1986) (four years), Me. Rev. Stat. tit. 14, § 3580 (1985) (six years).
5 *United States v. Summerlin*, 310 U.S. 414, 417 (1940).
6 *Id.*
7 *In re Vaughan*, 498 B.R. 302, 304 (Bankr. D.N.M. 2013).
8 26 U.S.C. § 6502 (1998) (hereinafter, the "IRS collection period").

creditor in order to avoid state law reach-back periods, the majority of courts have concluded that a trustee may indeed do so. In construing § 544(b) and the trustee's right to avoid a transfer that is "voidable under applicable law by a creditor," courts in the majority primarily rely on principles of statutory construction, under which they will not be swayed by policy concerns or legislative intent unless the plain meaning of a statute leads to an absurd result.[9] Therefore, based on the plain meaning of § 544(b), these courts find that whatever law is applicable to the IRS may be used by the trustee.

The court in *In re Vaughan* took the minority view when the trustee sought to avoid the operation of the four-year state law reach-back period, which would have barred the trustee's claim, by arguing that § 544(b) permitted her to use the 10-year IRS collection period to avoid transfers.[10] The court disagreed, finding that case law, logic and policy only supported the government's right to avoid a state statute of limitations where the action was brought to vindicate a public interest. Where, on the other hand, the trustee was pursuing the avoidance action for the benefit of creditors generally, such an action did not involve public rights or interests, and therefore, the state reach-back period would bar the trustee's claims.[11]

Representative of the majority view is *In re Kaiser*, in which the trustee sought to avoid transfers otherwise outside the applicable state law reach-back period.[12] The court specifically rejected the reasoning in *Vaughan*, finding that the plain meaning of § 544(b) imposed no limitation on the use of the IRS as a triggering creditor, or the "applicable law" that the IRS (and therefore, the trustee) could use in pursuing avoidance actions.[13] Since the statute was clear, the court would not consider any contradicting policy concerns or legislative intent behind § 544(b).[14] The court did not specifically address whether the plain meaning of § 544(b) could lead to absurd results, instead noting that the statute was unambiguous.[15]

Similarly, in *In re Kipnis*, the trustee utilized the IRS as the triggering creditor to set aside a conveyance to the debtor's wife more than nine years prior to the petition date, and thus beyond Florida's reach-back period.[16] Judge Mark agreed with *Kaiser*'s reasoning that the policy concerns raised by the defendant and discussed in *Vaughan* could not justify finding that the trustee's claims were time-barred.[17] Specifically, Judge Mark found that the plain-meaning interpretation of § 544(b) was not absurd but addressed the potentially widespread implications such a finding could have, noting:

> The IRS is a creditor in a significant percentage of bankruptcy cases. The paucity of decisions on the issue may simply be because bankruptcy trustees have not generally realized that this longer reach-back weapon is in their arsenal. If so, widespread use of § 544(b) to avoid state statutes of limitations may occur and this would be a major change in existing practices.[18]

Policy Concerns and Analysis

These opinions highlight some tension between strict statutory construction and broader policy concerns. At issue is the potential assertion of immense power by a bankruptcy trustee on behalf of private creditors, power normally reserved for the federal government in the collection of taxes for the benefit of the public. Through § 544(b), so long as the IRS holds an allowed unsecured claim, the non-sovereign trustee arguably is given exclusive sovereign power of the U.S. to avoid state reach-back periods for the benefit of creditors generally.

What is not addressed in these opinions, at least not in any detail, is the potential for the bankruptcy trustee to reach back even further than 10 years. As previously noted, the unambiguous language of § 6502(a)(1) does not actually restrict the IRS to a 10-year reach-back period. The IRS is not subject to state law reach-back periods; thus, so long as the proceeding is timely initiated under state law and within the IRS collection period, the trustee can potentially reach back much further than 10 years.

While perhaps not an absurd result for the IRS acting in its governmental capacity for the public good as contemplated in *Summerlin*, such a power in the hands of a bankruptcy trustee might lead to absurd results. For the sake of demonstration, consider the following. Suppose that the IRS assesses a tax liability on Jan. 1, 2000. The time in which the IRS could institute a collection proceeding would therefore be Jan. 1, 2000, through Dec. 31, 2009. Suppose the bankruptcy trustee becomes aware of a transfer of valuable property from the debtor to a third party that took place in 1979 — 30 years prior to the petition date. The trustee may initiate a state fraudulent conveyance action on Dec. 31, 2009, to pursue this transfer. Any applicable state reach-back period would have run out long ago. However, the trustee — in using the IRS as the triggering creditor — is not subject to the state statutes of limitations on when claims must arise. Under the IRS collection period, the trustee would appear to be well within its rights to pursue this 30-year-old conveyance.

This is an unquestionably immense power, and based on the majority of courts' conclusions, a power that the bankruptcy trustee can utilize in pursuit of fraudulent transfers for the benefit of all creditors — even if the IRS's claims are minimal, and despite the fact that in *Summerlin*, the Supreme Court did not discuss whether this power was transferrable to a non-sovereign bankruptcy trustee.[19] It might be that Congress never anticipated that such a power would land in the hands of a non-sovereign bankruptcy trustee when enacting § 544(b). However, until Congress takes up the issue, this is a weapon that might be wielded by a trustee to what some may consider absurd results.

9 *See U.S. v. Am. Trucking Ass'ns*, 310 U.S. 534, 543 (1940).
10 *Vaughan*, 498 B.R. at 302.
11 *Id.* at 304-07.
12 525 B.R. 697 (Bankr. N.D. Ill. 2014).
13 *Id.* at 711.
14 *Id.* at 713. *See also Kaiser include Finkel v. Polichuk*, No 10-003ELD, 2010 WL 4878789 (Bankr. E.D. Pa. Nov. 23, 2010); *Alberts v. HCA Inc.*, 365 B.R. 293 (Bankr. D.D.C. 2006); *Shearer v. Tepsic*, 347 B.R. 17 (Bankr. W.D. Pa. 2006); and *Osherow v. Porras*, 312 B.R. 81 (Bankr. W.D. Tex. 2004).
15 *Id.* at 711.
16 555 B.R. at 879.
17 *Id.* at 882-83.
18 *Id.*
19 *Granfinanciera, SA v. Nordberg*, 492 U.S. 33, 34 (1989).

continued on page 69

Practical Considerations

Given this potentially unlimited reach-back period for the IRS, and thus for bankruptcy trustees stepping into the shoes of the IRS under § 544(b), uncertainty arises for bankruptcy practitioners. As noted in *Kipnis*, the IRS is a creditor in a significant number of bankruptcies,[20] giving trustees a clear advantage.

Trustees and their attorneys should look for potentially fraudulent conveyances that would otherwise be beyond the applicable state statutes of limitations. Practitioners representing debtors where the IRS is a creditor must not simply consider the last four to six years in analyzing possibly fraudulent conveyances; they must consider conveyances made during at least the last 10 years. In particular, practitioners representing wealthy or formerly wealthy debtors should investigate any financial planning or asset management that the debtor may have engaged in that could have resulted in conveyances potentially avoidable by the IRS and therefore the bankruptcy trustee. Similarly, nonbankruptcy practitioners assisting clients with estate planning should ensure that a client has no outstanding tax liabilities or IRS disputes at the time that any asset transfers take place (and arguably long after). abi

20 *Kipnis*, 555 B.R. at 883.