

Hidden Assets and Fraudulent Transfers: What Accountants Need To Watch For!

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Agenda

- ▶ Overview of Fraudulent Transfers
- ▶ Sources of Law
 - ❑ Federal Debt Collection Procedures Act (FDCPA)
 - ❑ Common law/Uniform Fraudulent Transfer ACT (UFTA)
 - ❑ Bankruptcy Code
- ▶ IRS Procedures for Recovering Fraudulent Transfers
- ▶ Nominee Liability
- ▶ Alter-ego Liability
- ▶ Q&A

Overview of Fraudulent Transfers

▶ Two Types:

- ❑ **Intentional:** A transfer of something valuable to hinder, avoid, or delay collection of a valid debt.
 - **Example:** Shortly after A becomes aware that he cannot pay his tax debts and will owe the \$1 million, he gives his business partner \$250,000 of crypto.
- ❑ **Constructive:** A transfer of something valuable: (a) when the transferor [debtor] is *insolvent* and (b) the transferee pays less than fair value for the property received.
 - **Example:** Husband, who owes the IRS \$1 million, quit-claims his ½ interest in House to Wife. House has \$500,000 of equity. Husband has made a constructive fraudulent transfer of \$250,000.

Overview of Fraudulent Transfers

Definitions

- ▶ **“Transfer”** means “every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset or an interest in an asset, and includes payment of money, release, lease and creation of a lien or other encumbrance.” Conn. Gen. Stat. § 52-552b(12) (emphasis added); *Mirlis v. Greer*, 80 F.4th 377, 384 (2d Cir. 2023) (holding a spouses withdrawal of funds from a joint account constitutes a transfer under the UFTA).
 - ❑ Both the Bankruptcy Code and FDCPA provide similar definitions of *transfer*.
- ▶ **“Insolvent”** means:
 - ❑ Balance sheet insolvency [including exempt assets]
 - ❑ Inability to pay debts as they become dueConn. Gen. Stat. § 52-552c; 11 U.S.C. § 548(a)(1)(B); 28 U.S.C. § 3302 (FDCPA)

Fraudulent Transfers Under the FDCPA

- ▶ 28 U.S.C. § 3301 *et seq.*
- ▶ Governs collection by the IRS in court
- ▶ Generally follows the same rules as UFTA and Bankruptcy Code
- ▶ State law exemptions *do not* apply to the IRS, due to the Supremacy Clause of the Constitution
- ▶ 6 year SOL; or 2 years after the transfer could reasonably have been discovered
 - ❑ The 2 year discovery rule only applies for intentional fraudulent transfers
- ▶ However, the IRS can use the 10 year CSED to extend the SOL under the FDCPA

UFTA

- ▶ Most states have adopted a version of the UFTA. New York continues to operate under the older, but similar, Uniform Fraudulent Conveyances Act.
- ▶ Generally, UFTA has a 4 year SOL, with a 1 year discovery period (so shorter time frames than the FDCPA)

Bankruptcy Code §§ 546(b), 548, 550

- ▶ Incorporates UFTA
- ▶ Bankruptcy Code § 548 sets a 2-year SOL on recovery of fraudulent transfers
- ▶ Bankruptcy Code § 546 allows a trustee (or DIP) to bring claims under the UFTA
- ▶ Bankruptcy Code § 548 allows *avoidance* of fraudulent transfers.
- ▶ Bankruptcy Code § 550 sets forth how the transfers are recovered.
- ▶ Bankruptcy Code § 550(b) identifies defense to fraudulent transfers.

IRS Procedures for Pursuing Fraudulent Transfers

- ▶ If no NFTL was filed *prior* to the transfer, the IRS must proceed through litigation. IRM 5.17.14.2.1
- ▶ Litigation will be handled by DOJ Tax and the local U.S. Attorneys Office
- ▶ Will require approval of IRS counsel and DOJ Tax
- ▶ IRM 5.14.14.3.2: “Before pursuing a transferee, the IRS must generally exhaust all legal remedies it may have against the transferor for collection of the tax. **The general rule is that the IRS must show that collection remedies against the transferor have been exhausted or would be futile.** *See, Gumm v. Commissioner*, 93 T.C. 475, 480 (1989). The extent to which the IRS must proceed against the transferor depends on the facts and circumstances. For example, the IRS need not pursue a corporate taxpayer that has been stripped of its assets or a trust that has distributed its property to a beneficiary and terminated.” (Emphasis added.)

IRS Procedures for Pursuing Fraudulent Transfers

- ▶ IRM 5.17.14 - *Fraudulent Transfers and Transferee and Other Third Party Liability*
- ▶ IRM 5.17.14.1.6 – Terms and Acronyms

Terms	Definition
Alter Ego	A second self or lacking a separate identity
Fiduciary	Person or group legally responsible for controlling and managing assets or other interests of another
Fiduciary Responsibility	Legal obligation to act in the best interests of another person or organization
Nominee	A party having title but not the actual owner
Successor in Interest	Successor in ownership where business controlled substantially as it was before the transfer
Transferee	Party to whom a transfer is made
Transferee Liability	Method of collecting an unpaid liability (tax or non-tax) from the transferee / property recipient
Transferee Liability at law	Transferee liability directly imposed by federal or state law or agreed to as part of a contract
Transferee Liability in equity	Transferee liability imposed by a court based on equity or fairness principles
Transferor	Party transferring property to another

IRS Procedures for Pursuing Fraudulent Transfers

- ▶ IRM 5.17.14.3.3.2.3 – Subsequent Transferees
- ▶ Generally. Fraudulent transfers can be recovered from the transferees of the initial transferee
- ▶ However, the subsequent transferee has a defense: if the subsequent transferee was a good-faith purchaser, who paid fair value, and did not have notice of the fraudulent nature of the transfer.
- ▶ “A good-faith purchaser from a transferee of the transferred property generally takes the property free of the initial transferor’s fraud. The same holds true for a creditor who in good faith extends a loan to the transferee and takes a security interest in the transferred property.”
- ▶ No defense if you know about the fraudulent nature of the transfer.

IRS Procedures for Pursuing Fraudulent Transfers

- ▶ Remedies for Fraudulent Transfer
 - ❑ Recovery of the money/property plus interest/appreciation
 - ❑ Liability of the transferee is limited to the value of the property (or appreciation thereof)
- ▶ If a NFTL was filed prior to the transfer the IRS may use administrative remedies, i.e. seizure or levy. IRM 5.17.14.5(3).

IRS Procedures for Pursuing Fraudulent Transfers

- ▶ Special proceedings under IRC § 6901
- ▶ Grants Tax Court jurisdiction to adjudicate certain transferee cases
- ▶ Requires liability to be assessed against the transferee for the transferor's tax. IRM 5.17.14.5.1(2).
- ▶ Then transferee has tax court rights based on the assessment.
- ▶ Typically, the IRS does not assess the transferee and will bring suit under the FDCPA or UFTA.

IRS Procedures for Pursuing Fraudulent Transfers

▶ 5.17.14.5.7 (09-25-2020)

The advantages of using IRC 6901 procedures are:

- a. Following the assessment, the IRS may use all administrative collection procedures and may file NFTLs against the transferee or fiduciary. The federal tax lien attaches to all the property of the transferee or fiduciary.
- b. Use of IRC 6901 procedures is consistent with the general preference to attempt all administrative collection before pursuing judicial collection action.

IRS Procedures for Pursuing Fraudulent Transfers

➤ 5.17.14.5.7 (09-25-2020) (cont.)

The advantages of a district court suit are:

- a. The limitations period for bringing suit to assert transferee or fiduciary liability is generally longer than the limitations period for administratively asserting transferee liability.
- b. Transferee liability can be asserted for any type of tax. The IRC 6901(a) limitations do not apply.
- c. In one action, the IRS may reduce a liability to judgment, establish transferee or fiduciary liability (or, alternatively, set aside a fraudulent transfer) and foreclose a lien. If the court orders a sale, it will be able to give clear title, thereby increasing what a purchaser is willing to pay over what a purchaser would pay at an administrative sale of seized property.
- d. If the property has increased in value, a suit to set aside a fraudulent transfer allows for recovery of the increased property value.

Note: If the property has decreased in value, both the IRC 6901 procedure and a suit to impose transferee liability are preferable to a suit to set aside a fraudulent transfer.

Nominee Liability

- ▶ “[A] nominee is like a dummy, holding mere title to the property without any beneficial interest; it is an arrangement of convenience.” In re First Connecticut Consulting Grp., Inc., 2004 WL 1676211 (Bankr. D. Vt. July 27, 2004) aff'd, 340 B.R. 210 (D. Vt. 2006) aff'd, 254 F. App'x 64 (2d Cir. 2007)
- ▶ The IRS does not have specific statutory authority to file nominee liens.
- ▶ The IRS asserts IRC § 6321 as providing authority: “If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.”

- ▶ Whether nominee ownership exists is a state-law question
- ▶ Connecticut has not recognized the concept of nominee ownership
- ▶ “The government presents no case law wherein a Connecticut court has applied the nominee theory, nor is this court aware of any, and this court declines to make the nominee theory Connecticut state law. However, because it will not affect the results of the decision, this Court will assume, *arguendo*, that federal law applies to the nominee analysis.” *McMahon v. United States*, 2010 U.S. Dist. LEXIS 115197, 106 A.F.T.R.2d (RIA) 2010-6994 (D. Conn. Oct. 29, 2010).

Alter-Ego Liability

- ▶ “Corporate entity can be pierced where the entity is being used to evade the payment of taxes.” CCM 199930013 (Apr. 18, 1999), *citing, Wolfe v. US*, 798 F.2d 1241 (9th Cir. 1986).
- ▶ Whether an entity is an alter-ego is a matter of state law. *US v. National Bank of Commerce*, 472 U.S. 713 (1985)
- ▶ Thus, the IRS must look to state law when imposing alter-ego liability: “We, thus, conclude, that the mere fact that an LLC entity is disregarded as an entity separate from the taxpayer for federal tax purposes does not entitle the Service to collect from the property of the LLC entity as if it does not exist. State law still controls for purposes of determining the taxpayer’s interest in property.” CCM 199930013 (holding SMLLC not disregarded for collection purposes).

Alter-Ego Liability

- ▶ Every state has slightly different law for veil piercing
- ▶ For example, Connecticut, by statute, no longer recognizes reverse veil piercing (holding a business liable for an individual's debts)