

POSTED ON WEBSITE
NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA

In re:) Case No. 09-29162-D-11

SK FOODS, L.P.,

Debtor.

BRADLEY D. SHARP, Chapter 11
Trustee,

Plaintiff,

V.

UNITED STATES OF AMERICA
INTERNAL REVENUE SERVICE,

Defendant .

Adv. Pro. No. 10-2117-D

Docket Control No. USA-1

DATE: July 7, 2010
Time: 10:00 a.m.
Dept: D

This memorandum decision is not approved for publication and may not be cited except when relevant under the doctrine of law of the case or the rules of claim preclusion or issue preclusion.

MEMORANDUM DECISION

On May 5, 2010, the United States, on behalf of named defendant the Internal Revenue Service ("IRS"), filed a motion to dismiss the complaint in this adversary proceeding, pursuant to Fed. R. Civ. P. 12(b)(1), incorporated herein by Fed. R. Bankr. P. 7012. For the reasons set forth below, the court will grant the motion in part.

I. INTRODUCTION

By way of his complaint, the trustee in this chapter 11

1 case, Bradley D. Sharp (the "trustee"),¹ seeks to recover
2 substantial sums allegedly paid by debtors SK Foods, L.P., and
3 RHM Industrial Specialty Foods, Inc., to the Internal Revenue
4 Service at the direction of Scott Salyer on account of Salyer's
5 and his daughters' federal income tax liabilities, for which the
6 debtors had no liability.

7 The trustee alleges that SK Foods paid a total of \$2,328,000
8 and RHM a total of \$393,000 during the two-year reach-back period
9 of 11 U.S.C. § 548 and totals of \$4,828,000 (SK Foods) and
10 \$393,000 (RHM) during the four-year reach-back period of Cal.
11 Civ. Code § 3439.05. Thus, in Counts I and III, the trustee
12 seeks to recover the sums paid during the two-year period (Count
13 I as to the payments made by SK Foods and Count III as to those
14 made by RHM). And in Counts II and IV, the trustee seeks
15 recovery of the total amounts paid during the four-year period
16 (Count II as to SK Foods and Count IV as to RHM).

17 II. ANALYSIS

18 This court has jurisdiction over this proceeding pursuant to
19 28 U.S.C. §§ 1334 and 157(b)(1). This is a core proceeding under
20 28 U.S.C. § 157(b)(2)(H).

21 A. Standards for Dismissal under Rule 12(b)(6)

22 The United States Supreme Court has recently adopted a
23 "plausibility" standard for assessing Rule 12(b)(6) motions,
24 analyzing the complaint before it in terms of whether it
25 contained enough factual allegations, taken as true, to plausibly

26
27 1. Unless otherwise indicated, all Code, chapter, section
28 and Rule references are to the Bankruptcy Code, 11 U.S.C. §§ 101-
1330, and to the Federal Rules of Bankruptcy Procedure, Rules
1001-9036.

1 suggest that the plaintiff was entitled to relief. Bell Atl.
2 Corp. v. Twombly, 127 S. Ct. 1955, 1965, 167 L. Ed. 2d 929, 945
3 (2007). "[W]e do not require heightened fact pleading of
4 specifics, but only enough facts to state a claim to relief that
5 is plausible on its face." 127 S. Ct. at 1974.

6 The Court did not disturb its earlier pronouncement in
7 Scheuer v. Rhodes, 416 U.S. 232, 94 S. Ct. 1683 (1974), that on a
8 motion to dismiss, "[t]he issue is not whether a plaintiff will
9 ultimately prevail but whether the claimant is entitled to offer
10 evidence to support the claims." 416 U.S. at 236. Thus, "a
11 well-pleaded complaint may proceed even if it appears 'that a
12 recovery is very remote and unlikely.'" Bell Atl. Corp., 127 S.
13 Ct. at 1965, quoting and characterizing Scheuer v. Rhodes, 416
14 U.S. at 236.

15 B. Counts II and IV

16 The IRS raises a sovereign immunity defense to the trustee's
17 Counts II and IV.² The IRS contends these counts must be
18 dismissed because the United States has not waived sovereign
19 immunity for claims brought under § 544 and the California
20 Uniform Fraudulent Transfer Act, Cal. Civ. Code § 3439, et seq.
21 ("CUFTA"), seeking a refund of taxes voluntarily paid.

22 Section 544(b)(1) authorizes a trustee to avoid any transfer
23 of an interest of the debtor in property that is voidable under
24 applicable law by an unsecured creditor of the debtor. The IRS
25 acknowledges that Congress has abrogated sovereign immunity with

26
27 2. The IRS makes no similar argument with respect to Counts
28 I and III because those counts are brought solely under § 548, as
to which Congress has expressly abrogated sovereign immunity.
§ 106(a)(1).

1 respect to § 544 (§ 106(a)(1)), but contends that California law
2 does not permit an unsecured creditor to bring a fraudulent
3 transfer action against a taxing authority to recover tax
4 payments voluntarily made, and therefore, that the transfers in
5 question here are not voidable by the trustee under § 544(b)(1).
6 The IRS emphasizes that § 106(a)(1) does not create any
7 substantive claim for relief or cause of action not otherwise
8 existing under the Code, the Rules, or nonbankruptcy law.
9 § 106(a)(5).

10 1. Sovereign Immunity

11 The IRS frames the sovereign immunity question as follows:

12 There is no waiver of sovereign immunity allowing
13 creditors to bring CUFTA actions against the United
14 States. Accordingly, there is no unsecured creditor
15 who could have brought a CUFTA action against the
United States to avoid the transfers to the IRS, and
thus, the Trustee has no cause of action under §
544(b)(1) to avoid the transfers.

16 United States' Motion to Dismiss, filed May 5, 2010 ("Motion"),
17 7:14-18.

18 In other words, Congress' abrogation of sovereign immunity
19 as to § 544 is only one part of the equation; according to the
20 IRS, there must also be a waiver or abrogation of sovereign
21 immunity with respect to the particular "applicable law" under
22 which a bankruptcy trustee is asserting the rights of an
23 unsecured creditor, under § 544(b)(1). However, neither the
24 California legislature nor any state would have authority to
25 abrogate the sovereign immunity of the United States as a defense
26 to a creditor claim under the state's version of the Uniform
27 Fraudulent Transfer Act or otherwise. Thus, the IRS' argument
28 would apparently render meaningless Congress' abrogation of

1 sovereign immunity as to § 544.

2 The court agrees with Liebersohn v. IRS (In re C.F. Foods,
3 L.P.), 265 B.R. 71 (Bankr. E.D. Pa. 2001), that by way of
4 § 106(a)(1), Congress intended to abrogate sovereign immunity
5 with respect to fraudulent transfer actions, both federal and
6 state. Otherwise, there would have been no reason to include
7 § 544 in § 106(a)(1).

8 In C.F. Foods, the court allowed a bankruptcy trustee's
9 claim to avoid pre-petition payments to the IRS under § 544(b)
10 and the Pennsylvania Uniform Fraudulent Transfer Act.

11 By including § 544 in the list of Bankruptcy Code
12 sections set forth in § 106(a), Congress knowingly
13 included state law causes of action within the category
14 of suits to which a sovereign immunity defense could no
15 longer be asserted. Section 544, together with its
16 predecessor section in the Bankruptcy Act (§ 70e), have
17 long had the primary effect of granting the trustee the
18 power to avoid transfers under state law provisions
19 concerning fraudulent transfers. See 3 NORTON BANKR.
20 L. & PRAC. 2d § 54:6 (1997).

21 265 B.R. at 85.

22 Accordingly, in light of the unambiguous language of §
23 106, as supported by the legislative history; the
24 specific inclusion of § 544 in § 106(a); the precedent
25 for Congress providing a trustee with rights that are
26 greater than those possessed by the unsecured creditor
27 upon whom a § 544(b) claim is based; and the policy
28 reasons favoring recovery for the benefit of all
creditors, the IRS's sovereign immunity argument must
fail.

Id. at 86.

24 2. The Voluntary Payment Doctrine

25 The court agrees with the trustee that the voluntary payment
26 argument misses the mark. First, the cases cited by the IRS
27 concern the voluntary payment of taxes collected erroneously or
28 illegally by the taxing agency, not the voluntary payment of

1 legitimately owed income taxes. In Southern Service Co. v.
2 County of Los Angeles, 15 Cal. 2d 1 (1940), the court stated:

3 It is the settled law of this state that illegal taxes
4 voluntarily paid may not be recovered by the taxpayer
5 in the absence of a statute permitting a refund
6 thereof; and in the absence of such statute only
illegal taxes paid under duress, coercion or compulsion
are considered to have been involuntarily paid and
therefore recoverable.

7 15 Cal. 2d at 7 (emphasis added).

8 In that case, the court was considering § 3804.1 of the
9 California Political Code which precluded refunds of voluntary
10 payments of taxes "claimed to be erroneous or illegal, by reason
11 of errors, omission or illegalities" in the budgets or tax rates
12 of governmental units. The case does not govern claims for
13 refunds of income taxes voluntarily paid.

14 Citing the voluntary payment rule - that there must be a
15 statute specifically permitting a refund of such payments - the
16 IRS argues that "CUFTA is not such a statute."

17 CUFTA is a general provision for the avoidance of
18 fraudulent conveyances, and it does not purport to
19 establish a cause of action against a governmental
taxing authority for the refund of taxes that were
voluntarily paid.

20 Motion, at 5:9-11.

21 The IRS cites United States v. Field (In re Abatement Envtl.
22 Res., Inc.), 301 B.R. 830 (D. Md. 2003), in which the court, on
23 facts similar to those presented here, concluded that, in
24 enacting Maryland's version of the Uniform Fraudulent Transfer
25 Act, the Maryland legislature did not "creat[e] (or intend[] to
26 create) a statutory exception to the voluntary payment doctrine,
27" 301 B.R. at 834.

28 / / /

1 Of course, the Maryland General Assembly is without
2 power to authorize a refund of federal taxes, but the
3 point here is simply to observe that where it has power
4 to treat a payment of taxes as a fraudulent conveyance
(and thereby vitiate the voluntary payment doctrine),
it has not elected to exercise that power.

5 Id. at 834-35.

6 This court believes, to the contrary, that it was not
7 necessary for the California legislature to designate a
8 particular type of payment as falling within CUFTA in order to
9 make such a payment recoverable as a fraudulent transfer. CUFTA
10 provides in broad terms for the recovery by third parties of
11 transfers made by a debtor, defining "transfer" to include "every
12 mode . . . , voluntary or involuntary, of disposing of or parting
13 with an asset or an interest in an asset," Cal. Civ.
14 Code § 3439(i). The legislature expressly created defenses to a
15 fraudulent transfer claim, Cal. Civ. Code § 3439.08; the
16 voluntary payment rule is not among them. However, among the
17 defenses, "[a] transfer or an obligation is not voidable under
18 paragraph (1) of subdivision (a) of Section 3439.04 [actual
19 fraud] against a person who took in good faith and for a
20 reasonably equivalent value" § 3439.08(a) (emphasis
21 added). "Person" is defined to include a "government or
22 governmental subdivision or agency." § 3439(g).

23 Given these definitions, the court sees no reason to
24 conclude that the legislature did not intend tax payments, even
25 if made voluntarily by the taxpayer, to be recoverable by third
26 party creditors if they meet the requirements of CUFTA. In other
27 words, in pursuing the present claims against the IRS, the
28 trustee is not standing in the shoes of the debtors, as

1 taxpayers, seeking to recover tax refunds, but rather, in the
2 shoes of a creditor seeking to recover property fraudulently
3 transferred, within the meaning of CUFTA, or the value of such
4 property.

5 Suppose that instead of money, one of the debtors had
6 transferred a parcel of real property to the IRS for no
7 consideration. This court would reject any suggestion that an
8 action by a creditor to recover the property would be an action
9 for the recovery of a tax refund, subject to the voluntary
10 payment rule. The court sees no reason to construe an action to
11 recover a transfer of money differently from an action to recover
12 a transfer of real property. Simply put, the trustee's claim
13 under CUFTA is an independent cause of action and not a claim
14 seeking a tax refund.

15 For these reasons, the court will deny the motion as to
16 Counts II and IV.

17 C. Counts I and III

18 The IRS contends that the trustee's Counts I and III allege
19 fraud with insufficient particularity to meet the standards of
20 Bell Atl. Corp., supra, and Ashcroft v. Iqbal, 129 S. Ct. 1937
21 (2009). Although this issue is a close call, in light of the
22 trustee's acknowledgment at the hearing that he will in all
23 likelihood seek to file an amended complaint in any event, the
24 court concludes that the parties and the court would be well
25 served by greater specificity in the complaint. Accordingly, the
26 court will grant the motion as to Counts I and III with leave to
27 amend.

28 / / /

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

III. CONCLUSION

For the reasons set forth above, the motion will be denied insofar as it pertains to Counts II and IV of the complaint and granted insofar as it pertains to Counts I and III, with leave to amend.

The court will issue an appropriate order.

Dated: July __, 2010

ROBERT S. BARDWIL
United States Bankruptcy Judge