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Bankruptcy trustees may have special card to play after *Kipnis* decision

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If the analysis of a Florida bankruptcy court is correct, transfers of property may be vulnerable to avoidance by bankruptcy trustees for more than twice as long as is commonly assumed — for 10 years after the transfer took place.

Under federal bankruptcy law, a trustee may claw back from the recipient assets — or their equivalent dollar value — obtained in a "fraudulent transfer" — i.e., one made by the transferor (a) with the actual intent of hindering, preventing or delaying creditors from being paid, or (b) for less than reasonably equivalent value in return, at a time when the transferor was insolvent or was made so by the transfer. The trustee distributes those recovered assets to the transferor's creditors.

While the U.S. Bankruptcy Code contains its own fraudulent transfer section — permitting recovery of transfers made within two years before the bankruptcy filing — it also allows trustees to avoid transfers that would have been avoidable under other "applicable law"; commonly, "applicable law" is state fraudulent transfer law (generally, the Uniform Fraudulent Transfer Act), which has a longer reach-back period.

The trustee need only identify an actual unsecured creditor with a valid claim who, at the time of the bankruptcy filing, could have timely brought an action targeting a particular transfer under state law. Using Illinois law, such an action could seek to undo transfers made within four years prior to the bankruptcy, but generally would be untimely as to older transactions.

However, that four-year limitation may be significantly enlarged if the unsecured creditor identified by the trustee is one of the most common in bankruptcy cases: the Internal Revenue Service (IRS).

In *In re Kipnis*, 555 B.R. 877 (Bankr. S.D. Fla. 2016), the bankruptcy court held that if the IRS holds an allowable claim against the debtor, a trustee may exercise the right the IRS would have outside bankruptcy to recover fraudulently transferred assets to pay that claim.

Because the IRS has 10 years to collect taxes after they are assessed and is not bound by state law limitations periods, a bankruptcy trustee may also undo transactions consummated as far back as 10 years before the bankruptcy case was filed.

Moreover, the Bankruptcy Code magnifies the avoidance power provided to the IRS. Outside of bankruptcy, the IRS could recover only the amount needed to pay the outstanding tax claim; in bankruptcy, a trustee may recover the entire amount of the transfer for the benefit of all creditors, no matter how small the IRS claim might actually be.

The debtor may owe the IRS only $100, but the trustee can unwind a million-dollar transaction in full and distribute the recovery to all unsecured creditors.

Donald Kipnis invested in an invalid tax shelter, and the IRS assessed a tax deficiency against Kipnis of more than $1 million. Less than five months later, Kipnis transferred substantial real estate and cash to his wife, arguably to protect those assets from the IRS' collection efforts. More than eight years after that, Kipnis filed for bankruptcy relief, listing the IRS as an unsecured creditor.

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The bankruptcy trustee filed suit against Kipnis' wife to avoid the transfers under Florida's fraudulent transfer statute. The wife moved to dismiss on the basis that Florida's fraudulent transfer law contained a four-year reach-back limitation, while the challenged transfers had occurred over eight years earlier.

The court ruled against the wife and allowed the suits to proceed. The court reasoned that "applicable law" includes, not just state law, but also Sections 6502(a)(1) and 6901(a)(1)(A)(i) of the Internal Revenue Code (IRC), which allow the IRS to collect taxes up to 10 years after assessment and, in that effort, to use state fraudulent transfer laws to pursue third-party transferees of the taxpayer's property.

The court noted that while the IRS would have had to establish that the transfer was indeed fraudulent under Florida's Uniform Fraudulent Transfer Act — as the bankruptcy trustee must also do — the limitations period for the IRS — and for a trustee asserting the IRS' rights — is governed by the Revenue Code: "[bankruptcy law] is clear and allows the [t]rustee ... to step into the shoes of the IRS to take advantage of the 10-year collection period in [IRC] [Section] 6502."

While most courts that have considered this issue agree with *Kipnis* (including an Illinois bankruptcy court in *In re Kaiser*, 525 B.R. 697 (Bankr. N.D. Ill. 2014)), one decision offers hope on long-completed transactions. In *In re Vaughan Co.*, 498 B.R. 297 (Bankr. D. N.M. 2013), the court refused to allow a trustee to use the IRS' longer reach-back period.

While it acknowledged the majority view, the court stressed the importance of looking at "the whole law, and to its object and policy." Finding the IRS' immunity from state statutes of limitations to be a "sovereign power" designed to advance public interests, the court denied that power to bankruptcy trustees, who represent the private interests of creditors.

The court in *Vaughan* also worried about effecting a "dramatic change in the law": "If a bankruptcy trustee ... could recover transfers made within [10] years before the petition date, it would eviscerate the UFTA's four-year look back period in most bankruptcy cases."

The *Kipnis* court acknowledged that its ruling might put many more transactions at risk, noting that the small number of such attacks so far may "simply be because bankruptcy trustees have not generally realized that this longer reach-back weapon is in their arsenal." But the court was determined to enforce its view of the plain meaning of the Bankruptcy Code.

Given how common IRS claims are in bankruptcy cases, more trustees may now start challenging transactions from beyond four years prior to the bankruptcy filing. Targets of such challenges should examine *Vaughan* for ammunition to thwart a trustee's 10-year reach-back efforts and persons engaging in transfers intended to protect assets from creditors should consider the impact on those efforts of liabilities they may owe to the IRS.