No. 11-718

In the Supreme Court of the United States

MICHAEL J. CONWAY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether petitioner, a person responsible for paying over to the United States excise taxes collected from airline passengers, "willfully" failed to pay over the taxes within the meaning of 26 U.S.C. 6672.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-15a) is reported at 647 F.3d 228. The opinion of the district court (Pet. App. 17a-18a) is unpublished but is available at 2010 WL 1056494. The report and recommendation of the magistrate judge (Pet. App. 19a-50a) is unpublished but is available at 2010 WL 1056468.

JURISDICTION

The judgment of the court of appeals was entered on July 19, 2011. A petition for rehearing was denied on September 9, 2011 (Pet. App. 51a). The petition for a writ of certiorari was filed on December 8, 2011. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Under 26 U.S.C. 4261 (2006 & Supp. IV 2010), airlines must collect a transportation excise tax from passengers each time they sell a plane ticket, and they are required to pay over those taxes to the United States. The airlines hold the excise taxes collected from passengers as "a special fund in trust for the United States." 26 U.S.C. 7501(a).

If a company fails to pay over the excise taxes, the company officers and agents responsible for the default are personally liable for the full amount of the unpaid taxes. Section 6672(a) of Title 26 provides:

> Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax * * * shall * * * be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over.

26 U.S.C. 6672(a).

2. a. Petitioner is the founder of National Airlines, Inc. (National). He served as National's president, Chief Executive Officer, and chairman of the board from its founding in April 1995 until National was liquidated through a Chapter 7 bankruptcy in May 2003. Pet. App. 2a. Petitioner had the power to determine which creditors would be paid in what order, and he had the power to sign checks on National's bank account. *Id.* at 6a.

During the third quarter of 2000, after several years of struggling to make a profit, petitioner and National's other directors began to discuss the possibility of entering bankruptcy. Pet. App. 2a. On November 30, 2000, National filed its third-quarter quarterly excise tax re-

turn with the IRS, with a check for $1,832,501.01 to pay taxes due for that quarter. *Ibid.* After the IRS deposited the check, but before the IRS received the funds, National filed for Chapter 11 bankruptcy and closed the bank account on which the check was to be drawn. *Ibid.* As a result, payment to the IRS on that check was refused, *ibid.*, and certain "pre-petition taxes" went unpaid, *id.* at 2a n.2. When National was liquidated in 2003, $148,325.00 of the pre-petition taxes remained unpaid. *Id.* at 4a. After the bankruptcy filing, National made biweekly deposits of the excise taxes that it was required to pay over from its customers. *Id.* at 3a.

b. After the September 11, 2001, terrorist attacks, Congress passed the Air Transportation Safety & System Stabilization Act, Pub. L. No. 107-42, 115 Stat. 230 (Stabilization Act). Pet. App. 3a. The Stabilization Act included a provision that postponed until November 15, 2001, the due date for payment of excise taxes collected by airlines. *Ibid.*; 49 U.S.C. 40101. Pursuant to authority granted in the Stabilization Act, the IRS further extended the due date to January 15, 2002. Pet. App. 3a; I.R.S. Notice 2001-77, 2001-2 C.B. 576.

National invoked the extensions provided under the Stabilization Act to delay paying over taxes collected from passengers for the third and fourth quarters of 2001. Pet. App. 3a. On January 15, 2002, National filed an excise tax return for the third quarter of 2001, but paid no taxes for that quarter. *Ibid.* Instead it filed a request, signed by petitioner, for an extension of time to pay the taxes. *Id.* at 3a, 9a. On January 30, 2002, National filed its excise tax return for the fourth quarter of 2001, again without paying any taxes. *Id.* at 3a. National never paid the third- and fourth-quarter 2001 taxes ("post-petition taxes"), which amounted to

$3,497,448.32 for third-quarter 2001 and $4,803,626.85 for fourth-quarter 2001. *Id.* at 3a-4a.

c. On November 6, 2002, National shut down all operations, and on May 7, 2003, National's bankruptcy was converted to Chapter 7. Pet. App. 3a. From February 2002 through the November 2002 shutdown, National made payments in excess of $220 million to creditors, without paying over the unpaid pre-petition or post-petition excise taxes. *Id.* at 9a. Petitioner admitted that he had personally authorized the payments to other creditors. *Id.* at 37a.

d. Pursuant to 26 U.S.C. 6672(a), the IRS assessed trust-fund recovery penalties against petitioner for the unpaid excise taxes. Pet. App. 4a. After making partial payments toward the assessed penalties, petitioner filed an administrative claim for a refund. *Ibid.* The IRS denied the refund request, and petitioner filed a refund suit in federal district court. *Id.* at 4a, 19a. The government filed a counterclaim for $8.5 million, the balance of petitioner's unpaid taxes. *Id.* at 20a. The United States moved for summary judgment. *Id.* at 4a.

3. a. A magistrate judge recommended that the government's motion for summary judgment be granted. Pet. App. 19a-50a. As an initial matter, the magistrate judge concluded that petitioner was a "responsible person" within the meaning of Section 6672, and that he could therefore be liable for a penalty equal to the total amount of the excise taxes collected from passengers and not paid over to the government. *Id.* at 34a-37a.

The magistrate judge further concluded that petitioner had willfully failed to pay over the excise taxes. Pet. App. 37a-38a. The magistrate judge explained that "[a] responsible person acts willfully if he knows the taxes are due but uses corporate funds to pay other

creditors, or if he recklessly disregards the risk that the taxes may not be remitted to the government." *Id.* at 37a (citations omitted). The magistrate judge concluded that when National filed for bankruptcy on December 6, 2000, the bankruptcy schedules listed the IRS as a priority claimant for unpaid excise taxes for the third quarter of 2000, and that petitioner therefore knew at that time that excise taxes were not being timely paid. *Ibid.* Petitioner nevertheless authorized the payment of corporate funds to other creditors in connection with National's Chapter 11 bankruptcy proceedings. *Ibid.*

The magistrate judge rejected petitioner's argument that he should not be responsible for the excise taxes because he had relied on the advice of counsel. Pet. App. 38a-39a. The magistrate judge explained that there was "nothing in [petitioner's] deposition that states he was advised by counsel not to pay or that he believed that he did not have to pay excise taxes." *Id.* at 39a.

The magistrate judge also rejected petitioner's argument that National's bankruptcy prevented petitioner from paying over the excise taxes. Pet. App. 40a. The magistrate judge noted that "[t]here are no bankruptcy orders or findings preventing payment," and that the local bankruptcy rules governing National's bankruptcy authorized the timely payment of taxes. *Ibid.*

Finally, the magistrate judge found "no support for [petitioner's] assertion that National was excused from payment of excise taxes" by the Stabilization Act. Pet. App. 28a. The magistrate judge explained that "[t]he Act merely allows an extension of due date for excise tax deposits," *ibid.*, and that "[n]owhere in the law, or anywhere else, is it even intimated that this deferral is tan-

tamount to outright forgiveness of tax liability," *id.* at 43a.

b. The district court adopted the magistrate judge's report and recommendation and granted summary judgment in favor of the United States. Pet. App. 17a-18a.

4. The court of appeals affirmed. Pet. App. 1a-15a. The court agreed with the district court's conclusion that petitioner is a responsible person who could be held liable under Section 6672 for excise taxes that National collected from passengers and did not pay over to the government. *Id.* at 5a-8a.

The court of appeals further held that petitioner's failure to pay over the excise taxes was willful. Pet. App. 9a-14a. The court explained that petitioner "knew no later than January 19, 2001," that the pre-petition taxes had not been paid, and that petitioner "knew that [the post-petition taxes] had not been paid no later than January 15, 2002, when he signed a request for an extension of time to pay over the taxes." *Id.* at 9a. The court further noted that National had "made payments in excess of $220 million to creditors between February 2002 and November 2002." *Ibid.* The court concluded that petitioner's failure to pay over the excise taxes was willful because "[w]here there is undisputed evidence that the responsible person directed payments to other creditors while knowing of the tax deficiency, willfulness is established as a matter of law." *Id.* at 8a-9a (citing *Barnett* v. *IRS*, 988 F.2d 1449, 1457 (5th Cir.), cert. denied, 510 U.S. 990 (1993)).

The court of appeals acknowledged that "evidence that the taxpayer acted with reasonable cause can sometimes defeat a finding of willfulness." Pet. App. 8a. The court concluded, however, that petitioner had not demonstrated reasonable cause for his failure to pay over

the taxes. *Id.* at 9a-14a. While recognizing that reliance on the advice of counsel "may constitute reasonable cause under some circumstances," *id.* at 10a, the court concluded that petitioner had not "raised a material fact issue supporting a finding that his reliance on counsel's advice provided reasonable cause so as to negate willfulness," *id.* at 11a. With respect to the pre-petition taxes, the court explained that counsel's advice that National should close its bank accounts and open new ones, which resulted in the government's inability to cash a check that National had written to pay over excise taxes, was "not the equivalent of advice that the taxes were not owed." *Ibid.* The court further concluded that "there is no evidence in the record that National's failure to pay its post-petition taxes was due to reliance on the advice of counsel." *Ibid.*

The court of appeals rejected petitioner's argument that the Stabilization Act authorized National to use the excise taxes as working capital. Pet. App. 13a-14a. The court explained that the Act only permitted the airlines to defer payment of certain excise taxes to January 15, 2002, and that "more than a mere statutory deferral of payment would be required to evince an intent to allow the collected taxes to be used for operational purposes." *Ibid.* The court also rejected petitioner's contention that the Stabilization Act precluded National from paying over post-petition excise taxes after the company was in bankruptcy. *Id.* at 7a n.5. The court noted that the local rules governing National's bankruptcy specifically stated that a debtor operating a business in bankruptcy "shall pay all taxes, fees, and other required payments to governmental entities on a timely basis, except where otherwise ordered for good cause shown." *Ibid.* (quoting Bankr. D. Nev. Local R. 960(a) (1992), subse-

quently amended, Bankr. D. Nev. Local R. 2015 (2009)). The court further observed that, even if bankruptcy court approval were required to pay the deferred post-petition taxes, petitioner "had the authority and duty to seek approval from the bankruptcy court for payment of the post-petition taxes, a step that he has not shown that he ever pursued." *Ibid.*

ARGUMENT

Petitioner contends (Pet. 11-30) that he should not have been held liable under 26 U.S.C. 6672 because he did not "willfully" fail to pay over transportation excise taxes that National had collected from its passengers. The court of appeals correctly rejected that argument, and its decision does not conflict with any decision of this Court or another court of appeals. Further review is unwarranted.

1. a. In *Slodov* v. *United States*, 436 U.S. 238 (1978), this Court explained that Section 6672 imposes civil liability on an individual for failure to pay over excise taxes if two requirements are met: (1) the party assessed must be a person responsible for collecting, truthfully accounting for, or paying over the tax (*i.e.*, a "responsible person"); and (2) the party must "willfully" have failed to ensure that the trust fund taxes were paid. *Id.* at 245.

In this case, the court of appeals applied a well-established test for willfulness. Under that test, a responsible person willfully fails to pay taxes when he either (1) pays other creditors with actual knowledge that excise taxes remain unpaid or (2) recklessly disregards the risk that the taxes will not be paid. Pet. App. 8a. Based on undisputed evidence, the court below concluded that petitioner's willfulness had been established as a matter

of law because petitioner knew of the unpaid excise taxes but consciously chose to pay hundreds of millions of dollars to other creditors instead. *Id.* at 9a.

The courts of appeals have uniformly held that paying other creditors with knowledge that taxes remain unpaid constitutes a willful breach of duty for purposes of Section 6672. See, *e.g.*, *Caterino* v. *United States*, 794 F.2d 1, 6 (1st Cir. 1986), cert. denied, 480 U.S. 905 (1987); *Hochstein* v. *United States*, 900 F.2d 543, 548 (2d Cir. 1990); *Greenberg* v. *United States*, 46 F.3d 239, 244 (3d Cir. 1994); *Erwin* v. *United States*, 591 F.3d 313, 325 (4th Cir. 2010); *Logal* v. *United States*, 195 F.3d 229, 232 (5th Cir. 1999); *Gephart* v. *United States*, 818 F.2d 469, 475 (6th Cir. 1987); *Garsky* v. *United States*, 600 F.2d 86, 91 (7th Cir. 1979); *Colosimo* v. *United States*, 630 F.3d 749, 753 (8th Cir. 2011); *Phillips* v. *United States I.R.S.*, 73 F.3d 939, 942-943 (9th Cir. 1996); *Denbo* v. *United States*, 988 F.2d 1029, 1033 (10th Cir. 1993); *Thibodeau* v. *United States*, 828 F.2d 1499, 1505 (11th Cir. 1987). The court of appeals' decision in this case is consistent with those opinions.[1]

b. Petitioner contends (Pet. 11-17) that the court of appeals' willfulness test "effectively imposes a strict liability standard under Section 6672" (Pet. 11), and therefore conflicts with this Court's statement in *Slodov* that Section 6672 "was not intended to impose liability without personal fault." Pet. 13 (quoting *Slodov*, 436

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[1] In *Safeco Insurance Co.* v. *Burr*, 551 U.S. 47 (2007), which involved the civil penalty provision of the Fair Credit Reporting Act, 15 U.S.C. 1681n(a), the Court interpreted the term "willfully" to encompass both "knowing violations of a standard" and "reckless disregard." 551 U.S. at 57. Contrary to petitioner's suggestion (Pet. 18), the court of appeals' understanding of the term "willfully" in Section 6672 is fully consistent with that standard.

U.S. at 254). Petitioner's argument misapprehends both the decision in *Slodov* and the common understanding of "strict liability."

In *Slodov*, the taxpayer had purchased the stock and assumed the management of three food-vending corporations that were indebted at the time of purchase for approximately $250,000 of taxes, including taxes withheld from employees' wages. 436 U.S. at 240. Those funds had not been paid over to the United States when due, and they had also been dissipated before Slodov acquired the business. *Ibid.* After Slodov assumed control, the corporations acquired funds sufficient to pay the taxes, but they used the money to pay wages, rent, suppliers, and other creditors. *Ibid.*

The Court held that a "responsible person" may be held responsible under Section 6672 for "willfully failing to pay over trust funds collected prior to his accession to control when at the time he assumed control the corporation has funds impressed with a trust." *Slodov*, 436 U.S. at 259-260. The Court also stated, however, that a responsible party would not violate Section 6672 "by willfully using employer funds for purposes other than satisfaction of the trust-fund tax claims of the United States when at the time he assumed control there were no funds with which to satisfy the tax obligation." *Ibid.* The Court concluded that, because the collected trust funds had already been dissipated when Slodov assumed control of the corporations, Slodov did not willfully fail to pay over the taxes that had previously been collected. *Ibid.*

In so holding, the Court specifically stated that "[w]hen the same individual or individuals who caused the delinquency in any tax quarter are also the 'responsible persons' at the time the Government's efforts to col-

lect from the employer have failed, * * * there is no question that [Section] 6672 is applicable to them." *Slodov*, 436 U.S. at 245-246; see *Davis* v. *United States*, 961 F.2d 867, 874 (9th Cir. 1992) ("personal fault" analysis in *Slodov* is satisfied when responsible person "presided over the corporation every day during which taxes were [collected] and dissipated to satisfy corporate needs, at the expense of the public fisc"), cert. denied, 506 U.S. 1050 (1993); *Mazo* v. *United States*, 591 F.2d 1151, 1155 (5th Cir.) ("Where there has been no change in control, * * * responsible persons are subject to a duty to apply any available unencumbered funds to reduction of accrued withholding tax liability."), cert. denied, 444 U.S. 842 (1979). Because petitioner was responsible for collecting and paying over the excise taxes to the United States during the entire relevant period, the court of appeals' decision holding him liable under Section 6672 does not conflict with this Court's decision in *Slodov*. And because the court of appeals' decision was premised on petitioner's deliberate choice to pay substantial sums to other creditors, with knowledge that National's excise taxes remained unpaid, the decision did not subject petitioner to "strict liability" or "liability without personal fault."

c. Petitioner further contends (Pet. 18-20, 23-24), that the court of appeals should have applied the criminal willfulness standard set forth in *Cheek* v. *United States*, 498 U.S. 192 (1991). Under that standard, a defendant may negate the willfulness required for criminal tax liability by showing "that because of a misunderstanding of the law, he had a good-faith belief that he was not violating any of the provisions of the tax laws." Pet. 19 (quoting *Cheek*, 498 U.S. at 201-202). Petitioner's argument lacks merit.

In the context of criminal tax penalties, this Court has required a higher level of proof of willfulness than in other contexts. See, *e.g.*, *Cheek*, 498 U.S. at 200 (requiring proof of a "voluntary, intentional violation of a known legal duty") (internal quotation marks removed). As the Court in *Cheek* made clear, this higher level of proof is limited to *criminal* tax statutes. *Id.* at 199-200.

This Court and the courts of appeals have recognized that Section 6672 is a civil liability statute, distinct from the criminal penalties also available to enforce the trust-fund tax laws. See, *e.g.*, *Slodov*, 436 U.S. at 245; *Davis*, 961 F.2d at 869; *McGlothin* v. *United States*, 720 F.2d 6, 8 (6th Cir. 1983). In *Domanus* v. *United States*, 961 F.2d 1323, 1325 (1992), the Seventh Circuit rejected the taxpayer's argument that the *Cheek* standard should apply under Section 6672. The court observed that "every jurisdiction which has reached the issue" had concluded that Section 6672 incorporates a civil willfulness standard, under which the government must prove only that the failure to pay was "voluntary, conscious and intentional." *Id.* at 1325 (quoting *Monday* v. *United States*, 421 F.2d 1210, 1216 (7th Cir.), cert. denied, 400 U.S. 821 (1970)); see *id.* at 1326-1327 ("[T]he definition of 'willfully' used in criminal tax statutes should not be incorporated into the standard for [Section] 6672 liability."). Petitioner cites no case applying the criminal willfulness standard described in *Cheek* to civil-penalty proceedings under Section 6672.

d. Petitioner further contends (Pet. 21-24) that the ruling below conflicts with the Tenth Circuit's decision in *Finley* v. *United States*, 123 F.3d 1342 (1997) (en banc), which recognized a "reasonable cause" defense to Section 6672 liability. The reasonable-cause defense recognized in *Finley* applies in limited circumstances

where: "(1) the taxpayer has made reasonable efforts to protect the trust funds, but (2) those efforts have been frustrated by circumstances outside the taxpayer's control." *Id.* at 1348. The court of appeals' decision does not conflict with *Finley*.[2]

In the present case, the court of appeals specifically acknowledged that "evidence that the taxpayer acted with reasonable cause can sometimes defeat a finding of willfulness." Pet. App. 8a. The court rejected petitioner's reasonable-cause defense on the merits, however, finding no record evidence that petitioner's failure to pay over the excise taxes was based on the advice of counsel, *id.* at 12a-13a; that the Stabilization Act did not excuse National from paying over the excise taxes, *id.* at 13a-14a; and that the commencement of the bankruptcy case did not prevent petitioner from paying over the post-petition excise taxes, *id.* at 7a n.5. Petitioner's fact-bound contention that the court of appeals misapplied the reasonable-cause defense to the facts of his case does not warrant this Court's review. *United States* v. *Johnston*, 268 U.S. 220, 227 (1925) ("We do not grant * * * certiorari to review evidence and discuss specific facts.").

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[2] Petitioner also asserts in passing that the Federal Circuit "ha[s] adopted [a] less restrictive interpretation[] of the willfulness requirement." Pet. 15 (citing *Godfrey* v. *United States*, 748 F.2d 1568 (1984)). The Federal Circuit, however, has held that "[w]hether the failure to pay the overdue taxes [is] willful * * * call[s] for proof of a voluntary, intentional, and conscious decision not to collect and remit taxes thought to be owing—and [does] not * * * requir[e] a special intent to defraud or deprive the Government of monies withheld on its account." *Godfrey*, 748 F.2d at 1576-1577 (internal quotation marks omitted). That standard is wholly consistent with the willfulness standard applied by the court of appeals in this case.

In any event, the court of appeals correctly concluded that petitioner had not demonstrated reasonable cause for failure to pay over the excise taxes. Although petitioner makes numerous assertions about the advice he allegedly received from counsel (Pet. 4, 7, 9, 27, 28), he cites no record evidence supporting those claims. Rather, he simply argues in a footnote that "[t]he advice [he] received during National's bankruptcy was a disputed issue below." Pet 4 n.4. There is likewise no merit to petitioner's argument (Pet. 24-29) that National's bankruptcy, in combination with the Stabilization Act's postponement of the due date for paying excise taxes, prevented National from paying the excise taxes. As the court of appeals explained, even if bankruptcy court approval were required to pay the deferred taxes, petitioner "had the authority and duty to seek approval from the bankruptcy court for payment of the post-petition taxes." Pet. App. 7a n.5.

e. Finally, citing his purported inability to pay thejudgment entered against him, petitioner urges this Court to interpret Section 6672 so as to avoid subjecting him to "harsh results." Pet. 29-30. This Court has observed that "[t]he decision to hold an individual 'liable for a tax owed by a corporation,' even if there is a wide disparity between the corporation's liability and the individual's resources, was made when Internal Revenue Code § 6672 was passed, since it is that section which imposes the liability without regard for the individual's ability to pay." *United States* v. *Sotelo*, 436 U.S. 268, 279 (1978). Petitioner's purported inability to pay the excise taxes does not justify altering the well-settled understanding of civil willfulness under Section 6672. Cf. 26 U.S.C. 6330(c)(2)(iii), 7122 (establishing an offer-

in-compromise procedure for taxpayers who have insufficient resources to pay their obligations).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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