No. 11-16276

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re: WILLIAM M. HAWKINS, III, aka TRIP HAWKINS,
and LISA WARNES HAWKINS, aka LISA A. HAWKINS,

Debtors

WILLIAM M. HAWKINS, III, aka TRIP HAWKINS,

Plaintiff-Appellant

and LISA WARNES HAWKINS, aka LISA A. HAWKINS,

Plaintiff

v.

THE FRANCHISE TAX BOARD, A DIVISION OF THE
GOVERNMENT OF THE STATE OF CALIFORNIA and THE
UNITED STATES OF AMERICA, INTERNAL REVENUE SERVICE

Defendants-Appellees

ON APPEAL FROM THE JUDGMENT OF THE
UNITED STATES DISTRICT COURT FOR THE
NORTHERN DISTRICT OF CALIFORNIA

BRIEF FOR THE APPELLEE THE UNITED STATES OF AMERICA, INTERNAL REVENUE SERVICE

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STATEMENT OF JURISDICTION

The statement of jurisdiction set forth in appellant's opening brief is correct.

STATEMENT OF THE ISSUE

Whether the lower courts correctly determined that the income taxes of William M. Hawkins, III ("Trip") for 1997-2000 were nondischargeable in bankruptcy because he "willfully attempted in any manner to evade or defeat such tax[es]" pursuant to 11 U.S.C. § 523(a)(1)(C).

STATEMENT OF THE CASE

Trip and Lisa Hawkins ("debtors") brought this adversary proceeding in their Chapter 11 bankruptcy case against the California Franchise Tax Board (FTB) and the United States. Debtors sought a determination that their state and federal income taxes for 1997-2000 were dischargeable. (ER 29, 33.)[1] The Bankruptcy Court determined that Trip's taxes were excepted from discharge under 11 U.S.C. § 523(a)(1)(C), and that Lisa's taxes were discharged. (ER 51; SER 3.) Trip appealed to the District Court, which affirmed. (SER 1.)

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[1] "ER" and "SER" refer to the page numbers of the Excerpts and Supplemental Excerpts of Record.

STATEMENT OF FACTS

A. Trip's employment with Apple and founding of EA and 3DO

After receiving an M.B.A. from Stanford, Trip joined Apple Computers as its 68th employee. (ER 75.) By 1982, at the age of 28, Trip was Director of Product Marketing. (ER 75.)

In 1982, Trip left Apple to co-found Electronic Arts, Inc. (EA). (ER 75.) Within four years, EA became the world's largest supplier of computer entertainment software. (ER 75.) Trip was CEO and 20% owner of EA. (ER 75; SER 471, 472.)

In 1990, Trip left EA to run 3DO, Inc., which was initially part of EA and later spun off as a separate company. (ER 75, 340.) 3DO was focused on creating a unified electronics standard for computer entertainment. (ER 75; SER 472.) In 1993, an initial public offering was completed for 3DO shares. (ER 172.) In 1994, 3DO was struggling and EA began to withdraw its support. Trip decided to sell his EA stock and invest heavily in 3DO. (ER 340.)

Trip was an experienced and sophisticated investor. Advised principally by his PaineWebber stockbroker, Duncan Naylor, Trip

assembled a sizeable, diversified investment portfolio. (ER 173; SER 5-6, 8-10, 12-28, 30-57, 60-86, 463.)

B. Trip's marriage to and lifestyle with Lisa, sales of EA shares, and participation in FLIP and OPIS tax shelters

In September 1996, Trip divorced Diana Hawkins. (ER 75.) Custody of his two children with Diana was shared equally. (ER 145.) In October 1996, Trip married Lisa. (SER 430.) That year, they purchased a new six-bedroom home in Atherton, California, for $3.5 million. (ER 30; SER 209, 437-38.)

Trip had two children with Lisa, who was not employed outside the home. (ER 75.) Their children, as well as Trip's two children from his marriage with Diana, attended private schools costing between $20,000 and $30,000 per year. (SER 161, 445, 482.) Trip and Lisa employed household staff, including a full-time cook, a full-time nanny, a weekly housekeeper, and gardeners working several hours each week to maintain their substantial property. (SER 492.) Trip also had an assistant who paid bills. (SER 445, 487-88.)

Trip paid $15,000 for a seven-year seat license for San Francisco Giants tickets, covering the 2000-2006 seasons, with a season-ticket

price limited to two-percent increases per year. (SER 364, 485, 489-90, 491.)

In 1996, Trip's net worth was approximately $100 million. (ER 23; SER 145-46, 469.) Much of this wealth was based on his EA stock. (ER 23.) Beginning around 1994, Trip sold large amounts of EA stock, and invested substantial sums in 3DO stock. (ER 24, 261-64; SER 205.) Trip understood that the gains from his sale of EA stock would be subject to capital gains tax. (SER 471.) Trip had gains from sales of EA stock of $24,421,296, $3,760,755, and $38,761,210, in 1996, 1997, and 1998, respectively. (SER 5, 8, 16.)

Trip's principal tax advisor was Harvey Armstrong, with the KPMG accounting firm. (SER 446-48.) David Kenyon was the tax manager for Trip's KPMG account. (SER 458-59.) KPMG prepared debtors' tax returns and quarterly estimated taxes. KPMG also did tax planning work for Trip. (SER 447-48.) Kenyon testified that Trip was a knowledgeable client in terms of financial matters and basic tax issues and "was interested in his tax returns." (SER 459-60, 465, 466.)

Armstrong testified that Trip purchased some "tax products" from KPMG. (SER 448.) In late 1996, Armstrong and another KPMG partner met with Trip to introduce him to the first of these tax products

or strategies, which was subsequently characterized as a Foreign Leveraged Investment Portfolio ("FLIP"). (SER 449-50, 452, 470.) Trip was advised of the risks with regard to attaining the tax objectives of the strategy. (SER 455-56.) Armstrong testified that the desired "tax results" of the FLIP transaction consisted of the generation of capital losses that could be offset against capital gains to create "tax savings." (SER 449, 451.) The losses would be generated as a result of the shifting of basis in stock from a foreign entity to the taxpayer. (SER 300-01, 460-61) KPMG received a fee in connection with the FLIP. (SER 451.)

In September 1996, Trip made a total investment of $3.3 million in a FLIP involving a Cayman Islands corporation, and stock and derivatives in Union Bank of Switzerland ("UBS"). (SER 141-42, 300, 461-62.) On their 1996 and 1997 returns, debtors claimed losses of $6,027,306 and $23,396,798, respectively, relating to this transaction. (SER 5, 8.) These claimed losses were not real economic losses. (SER 408.)

In July 1997, KPMG provided an opinion letter to Trip regarding the income tax consequences of the FLIP. (SER 300.) The opinion letter was intended to protect debtors from tax penalties.

(SER 453-54.) KPMG stated that "it is more likely than not that [Trip] will be allowed to add [the foreign entity's] basis in its redeemed UBS stock to [his] basis" (SER 301), and that the requirements for an opinion letter sufficient to protect Trip from the imposition of a penalty "should be satisfied" by the letter (SER 333).

In 1998, Trip invested in another KPMG basis-shifting tax shelter – an Offshore Portfolio Investment Strategy ("OPIS"). (SER 448.) This transaction involved a Cayman Islands limited partnership, and UBS shares and derivatives. (SER 339-40.)

In September 1998, Armstrong and Trip signed an engagement letter with respect to the OPIS transaction. (SER 335-38.) KPMG stated that "any tax opinion issued by KPMG would not guarantee tax results, but would provide that the tax treatment described in the opinion is 'more likely than not' to occur." (SER 336.) The $500,000 minimum fee for KPMG's "tax consultation services" in connection with the OPIS was not based "on the amount of any tax savings projected or achieved." (SER 336-37.)

In October 1998, Trip made an investment of $ 5.42 million in the OPIS. (SER 143-44.) On December 23, 1998, Kenyon, tax manager for Trip's KPMG account, sent a facsimile to Naylor, Trip's stockbroker.

(SER 12, 149-50, 458, 463.) Kenyon instructed Naylor "to adjust the tax basis" of the UBS shares acquired by Trip to $3,795.98 per share. (SER 149.) The adjustment of basis on the brokerage statement, as well as the spreading of the transaction over more than one year, made it more difficult for IRS auditors to detect the basis shift on debtors' tax returns. (SER 422-23, 428-29.)

On their returns for 1998, 1999, and 2000, debtors claimed losses of $20,570,283.78, $3,566,297.55, and $8,244,602.48, respectively, in connection with the FLIP and OPIS.[2] (SER 12, 57, 82.) These claimed losses were not real economic losses. (SER 408.)

In December 1998, KPMG provided an opinion letter stating that "there is a greater than 50 percent likelihood (i.e., it is 'more likely than not')" that the basis-shifting aspect of the OPIS would be upheld. (SER 350.) KPMG advised Trip that a tax penalty should not be imposed based on satisfaction of the "more likely than not" standard and Trip's receipt of the opinion letter. (SER 351-55.) A similar

[2] The loss claimed for 1998 arose partially from the OPIS and partially from the FLIP, due to a carryover to 1998 for a portion of the FLIP loss that was not used in 1997. (SER 421.)

opinion letter was provided by the law firm Brown & Wood.
(SER 356-59.)

C. The IRS audit of FLIP and OPIS losses

In March 2001, the FTB informed debtors that it was auditing their 1997 and 1998 returns. (ER 75-76.)

On July 27, 2001, the IRS issued Notice 2001-45, 2001-33 I.R.B. 1, in which it notified taxpayers and their representatives that it would disallow losses arising from basis-shifting transactions. The Notice also stated that the IRS may impose penalties on participants in these transactions. (SER 88-91.)

On July 30, 2001, the IRS sent Trip and Lisa a letter notifying them that it was auditing their 1997 return. (ER 76; SER 87.) In the letter, Revenue Agent John Barrett stated that the audit would "focus on the investment loss claimed on UBS stock." (*Id.*) The 1996 tax year was not included in the audit because the statute of limitations had already expired for that year. (SER 420.)

On August 16, 2001, Kenyon sent Trip an e-mail updating him on the audits. (SER 148.) Kenyon stated that the KPMG Tax Controversy Group was handling "all the clients who have been under audit for this investment," and that there was an IRS "task force assigned to this

issue." (SER 148, 467-68.) On October 5, 2001, Trip signed the 2000 return claiming the increased basis in the UBS shares based on the OPIS. (SER 58-59, 82.)

In October 2001, Trip and Lisa retained Charles Rettig of the law firm Hochman, Salkin, Rettig, Toscher & Perez to represent them in the IRS audit. (ER 76.) On December 18, 2001, Rettig's partner Avram Salkin received from Leslie Daniels, another of Trip's attorneys, a spreadsheet with debtors' "Tax and Interest Exposure Calculations" in connection with the audits. (SER 411, 413, 473, 481.) On February 26, 2002, Salkin prepared a similar spreadsheet of debtors' "Estimated IRS/California Tax Exposure." (SER 412.)

On December 21, 2001, the IRS issued Announcement 2002-2, 2002-1 C.B. 304, regarding "a disclosure initiative to encourage taxpayers to disclose their tax treatment of tax shelters." (SER 92.) The Announcement stated that the IRS would waive certain penalties for qualified taxpayers. Taxpayers were required to make the disclosure before the issue was raised during an examination. (*Id.*) On February 26, 2002, debtors requested that they be allowed to participate in the initiative. (SER 93.)

On March 11, 2002, Barrett sent debtors a letter notifying them that the audit of their 1997 return was being expanded to include 1998 and would "continue to focus on the investment loss claimed on UBS stock." (ER 77; SER 147.)

On July 11, 2002, Barrett sent a letter to Rettig, with a copy to debtors, stating that although the audit was still proceeding, "the Service has concluded that it has a strong case" and that the IRS's position was that the claimed benefits of the transaction were "not allowable." (ER 152.)

On October 11, 2002, the IRS released Announcement 2002-97, 2002-2 C.B. 757, announcing an initiative to resolve cases involving basis-shifting transactions. The principal required term of the settlement initiative was concession by the taxpayer of 80% of the basis shift. One eligibility requirement was that the statute of limitations had not expired for any year in which the taxpayer claimed tax benefits from the transaction. (SER 96.)

On October 17, 2002 and January 29, 2003, Kenyon sent e-mails to Trip, Rettig, and Daniels attaching "draft computations" regarding the "IRS Examination." (SER 414.)

In November 2002, Rettig requested that debtors be allowed to participate in the settlement initiative. In letters dated November 20, 2002 and December 23, 2002, Barrett responded that they were not eligible because the statute of limitations for 1996 had expired. (ER 154, 160, 161, 162.) In the December 23 letter, Barrett requested information pertinent to the imposition of penalties. (ER 162-63.)

In a letter dated March 18, 2003 to Rettig and copied to debtors, Barrett stated that penalties would not be pursued with respect to losses from the OPIS because of debtors' response to the disclosure initiative. Barrett stated that the disclosure did not preclude penalties with respect to losses from the FLIP, which was already under audit at the time of the disclosure and therefore did not qualify for relief from penalties. (SER 94-95; ER 76.) Barrett added that he had not received a response to his December 23, 2002 request for information regarding penalties. (SER 94-95.)

At no point during the audit did debtors contend that the FLIP and OPIS were valid for tax purposes, or otherwise attempt to defend the transactions. (SER 426-27.)

In May and June 2003, respectively, Trip and Rettig sent responses in which they argued that penalties should not be imposed.

(ER 165-74.) Rettig stated that Trip "was specifically advised that there was a greater than 50% chance that the tax treatment reported on their returns would be sustained." (ER 170.)

On July 18, 2003, Barrett issued his audit report proposing deficiencies for 1997-2000 and penalties attributable to the FLIP for 1997 and 1998. (ER 78.) The report was transmitted to debtors on August 25, 2003 (ER 249) and set forth liabilities as follows (ER 176-79):

Year	*Tax*	*Penalty*
1997	$ 2,717,750	$ 1,087,100
1998	$ 8,618,112	$ 1,125,674
1999	$ 262,964	
2000	$ 2,214,673	
Total tax and penalties		$16,026,273

The report included an explanation of the grounds for the determination that the claimed basis shift should not be recognized and the claimed losses disallowed. The IRS also determined that Trip did not have a reasonable-cause defense to the penalties, because the advice upon which he claimed to have relied was provided by the firm (KPMG) that profited from his participation in the FLIP. (SER 98-103.) The IRS advised debtors that they could pay the liabilities owed or

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request a conference with the IRS Appeals Office. (ER 198, 246, 249-50.)

D. Debtors' continued extravagant spending

During the pendency of the IRS audit, which commenced on July 30, 2001, debtors continued to engage in extravagant spending. Trip owned a private jet purchased for $11.8 million in May 2000. (SER 151-52, 474.) The cost of operating the jet was approximately $1 million per year. (SER 409.) The hangar fees were approximately $100,000 per month. (SER 205-06.) In August 2001, debtors took their private jet to Hawaii for a one-week vacation. In December 2001, the jet was used for a personal trip to England. In August 2002, debtors took the jet on a two-week vacation to England, Russia, and Italy. Throughout this period, debtors used the jet for trips to other destinations including Aspen, San Diego, and Long Beach. (SER 366-92, 475-76.)

Debtors continued to purchase Giants season tickets each year commencing with the 2000 season. By the 2003 season, debtors were paying $7,487.76 for their season tickets and $1,415 for their parking pass. (SER 361, 486.)

In November 2002, debtors purchased, as a "vacation home," a newly-built ocean-view condominium in La Jolla, California for $2.6 million. (SER 210-27, 439.)

During the pendency of the audit, Trip contributed millions to a failing 3DO. Trip stated that he relied "on the promised tax benefits [from the FLIP and OPIS] in determining the cash that he had available to invest in 3DO." (ER 341.) In fall 2001, Trip contributed most of a $10 million equity private placement for 3DO. (ER 172.) Between October 2002 and January 2003, Trip lent 3DO $12 million when 3DO was unable to obtain financing. Trip obtained a $4 million mortgage on the Atherton home from Comerica Bank to fund part of these loans. (SER 398-400, 478, 492-93.)

On December 20, 2002, Trip sent an e-mail to 3DO's Board of Directors regarding 3DO's difficulties obtaining financing in order to remain in business. (SER 393-97.) In discussing the terms on which he could provide financing, Trip stated: "I am at the edge financially." (SER 397.)

In May 2003, 3DO filed a Chapter 11 bankruptcy petition. (ER 27, 340.) In a July 2003 e-mail to Kenyon, Trip stated that his 3DO "common stock [was] essentially worthless." (SER 153.) In

September 2003, Trip told his ex-wife Diana that his 3DO stock was "literally worthless." (SER 401.) In November 2003, the 3DO bankruptcy was converted to a Chapter 7 liquidation. (ER 27, 340.) Around the fall of 2003, Trip started a new company, Digital Chocolate, Inc., which produced video games for mobile telephones. (SER 479-80.)

E. Trip's plans to discharge his liabilities in bankruptcy

On October 24, 2003, Rettig sent a letter requesting an administrative appeal of the IRS's audit determination. (ER 198.) This request delayed assessment and collection of the taxes until the conclusion of the appeal. On October 27, 2003, Trip sold his private jet for approximately $5 million. (ER 78.)

In January 2004, Trip filed a brief in support of a motion, which he had filed in San Mateo County Superior Court in July 2003, to reduce child-support payments to his ex-wife Diana. (ER 78, 237.) The brief stated that Trip's debts included $25 million for federal and state taxes, and that Trip "ha[d] more liabilities than assets" and insufficient income to pay his child-support obligation. (ER 239.) In a supporting declaration, Steven Blanc, one of Trip's attorneys, explained that the tax liabilities consisted of $18 million in federal taxes and $7 million in state taxes, including interest. (ER 244-47.)

A hearing was held on Trip's motion on January 12, 2004. (SER 180-81.) Blanc testified that Trip planned to agree to assessment of the taxes proposed in the audit report. (SER 182-83.) Trip was asked whether he planned to accept the IRS's assessment of $18 million, and responded "I will accept it." (SER 200, 207.) When asked whether he believed he owed the taxes, Trip responded "Yes." (SER 207.)

Heinz Binder, Trip's bankruptcy attorney, also testified. When questioned about Trip's statement that he intended to agree to assessment of the taxes, Binder explained that Trip intended to discharge the taxes in bankruptcy (SER 194, 200):

> What we're looking for is the ability to discharge the tax, in other words, to eliminate the tax liability at some point in the future so that Mr. Hawkins can be freed from that tax.

Binder then testified regarding the timing of the planned bankruptcy. He stated that the taxes could not be discharged unless the petition was filed at least three years after the latest return was filed, which would be approximately October 16, 2004, and at least 240 days after the taxes had been assessed, which time had not begun to run because the taxes had not yet been assessed. (SER 201-02.)

Binder provided similar testimony in response to questions by Diana's attorney:

> Q. Mr. Binder, what is the purpose or what would be the purpose of filing a bankruptcy versus the IRS debt and the Franchise Tax Board debt?
>
> A. To receive a discharge.
>
> Q. So he wouldn't have to pay it?
>
> A. Correct.

(SER 203, *see also* SER 204.)

Binder also testified that any liability of KPMG to debtors would be limited to penalties and interest, and would not include the tax, which debtors would have been required to pay whether or not they participated in the transactions. (SER 195-99.)

Following the hearing and issuance of a tentative decision (ER 259-60), the parties exchanged drafts of a proposed order. Trip's attorney removed a provision in an earlier draft referring to his intent to file bankruptcy "to discharge his income tax obligations" because, she explained, such a statement "could well provide a basis for a bankruptcy trustee or creditor in a future case to bring an action claiming that the bankruptcy was filed in bad faith." (SER 154-56, 157.)

In an August 2, 2004 order, the Superior Court reduced the child support and required Trip to place $750,000 in the Hawkins Family Support Trust, which had been established in 2000 for the support of the children. In addition, the court imposed a judicial lien on all the assets of the trust. (ER 313; SER 160-68.)

On October 8, 2004, debtors purchased a new Cadillac Escalade SUV for $69,974. (SER 296, 297-99, 433.) At the time, debtors owned three other cars: a 2000 Lexus SUV, a 2000 Lexus LS 400, and a 1998 Porsche. (SER 432.)

On December 30, 2004, debtors signed a consent to assessment of their federal taxes for 1997-2000 as set forth in the audit report, including penalties. (ER 79, 199.) On March 7 and 14, 2005, the IRS assessed the 1997-2000 taxes and penalties. The total assessment for all four years, including interest, was $21 million. (ER 79; SER 104-39.)

On March 29, 2005, the Superior Court entered a stipulated order providing for the joinder of the support trust in the case so as to bind the trust to the terms of the previous orders entered on Trip's motion. (SER 174-75.) Trip and his divorce attorney signed the stipulated order on December 22, 2004, and Diana, her attorney, and the trust

representative signed it in March 2005. (SER 176.) According to an e-mail sent by Trip's attorney Daniels to the trustee of the support trust, the joinder order was "negotiated by the parties" to the divorce in order "to further protect the trust's assets from a potential bankruptcy by Trip and/or claims by taxing authorities." (SER 179.)

On June 1, 2005, the IRS issued a notice of intent to levy to collect the 1997-2000 liabilities. On June 10, 2005, the IRS filed a notice of federal tax lien. (SER 106, 115, 126, 134.) The IRS granted debtors' request for a stay of collection pending submission and consideration of an offer in compromise. (ER 80.)

On July 15, 2005, Trip filed a state-court complaint against KPMG, alleging fraud and negligence arising out of KPMG's recommendation that he invest in the FLIP and OPIS. Trip alleged that the FLIP and OPIS were "illegal and abusive tax shelters" and were "not legitimate investment strategies." (ER 79-80; SER 403, 406.) Trip alleged that "[d]uring one or more meetings in [his] office . . . in or about 1996, Armstrong recommended to [Trip] that he reduce his tax liability by participating in a certain investment program." (SER 404-05.) Trip later dismissed this action to participate in a federal class action against KPMG. (ER 80.)

On July 22, 2005, the FTB notified debtors that they owed additional state income taxes, penalties, and interest totaling $15.3 million for 1997-2000. (ER 80.)

F. Debtors' submission of an inadequate offer in compromise

In August 2005, debtors obtained a valuation of their furnishings, artwork, and other personal property located in their Atherton home. The property, consisting generally of luxury designer furniture, fine art, decorative accessories, and four cars, was valued initially at $344,735, subsequently increased to $362,135. (SER 228-84, 285-93, 441-42, 442-44.) A separate appraisal was procured in January 2006 for debtors' jewelry, valued at $64,425. (SER 294-95, 434-36.)

In August 2005, debtors submitted to the IRS an offer in compromise, which was returned because it did not include a $150 processing fee. (ER 80.)

On October 12, 2005, debtors submitted an offer in compromise, offering to pay the IRS $8 million over a two-year period. (ER 224.) Debtors' offer was based on "Doubt as to Collectibility," *i.e.*, they stated that they had insufficient assets and income to pay the full amount of their liabilities. (ER 224, 227.) The assets disclosed in the Collection

Information Statement submitted in support of their offer (ER 218-23) included a UBS account in the amount of $8.2 million. The only listed encumbrance on either of their two homes was the Comerica mortgage on the Atherton home. (ER 219-21.)

The income-and-expense portion of the Statement reported monthly wages of $16,667.67, and monthly living expenses of (ER 223):

Food, clothing, misc.	$7,000
Housing and utilities	$33,600
Transportation	$2,700
Health care	$700
Taxes (Income and FICA)	$4,200
Child care	$4,500
Life insurance	$1,650
Other expenses	$40,550
Total Expenses	$94,900

By letter dated March 1, 2006, an IRS Offer Specialist informed debtors that she could not recommend acceptance of debtors' offer, because she had determined that the reasonable collection potential exceeded $36 million. (ER 228.) Attached to the letter were an asset-and-liability table showing the net realizable equity in debtors' assets, and an income-and-expense table showing potential payments over a five-year period computed from income and allowed expenses. (ER 229-30.) Debtors withdrew the offer on March 23, 2006. (ER 81.)

In July 2006, debtors sold their Atherton home for $6,850,000. (ER 81, 312.) The net proceeds of $6,498,241.97 from the sale, after payment of the broker's commission and other costs, were applied to the federal tax lien. (ER 81, 312; SER 107.)

About that time, debtors moved into a home in San Mateo purchased by Trip's father for approximately $2.5 million. Trip's father charged monthly rent of $7,500. (ER 302; SER 483-84.) Debtors' furnishings from the Atherton home were moved into the San Mateo home. (SER 440.)

Trip's Giants seat license was renewed after the expiration of the first license at the end of the 2006 season. (SER 363, 485.) Under the new license, the price for Trip's season tickets "almost doubled" to approximately $14,000. (SER 362, 489.) Trip testified that, under the new license, his father paid for the tickets "for a couple of years," and then Trip resumed paying for them. (SER 487.)

G. Debtors' bankruptcy case

On August 28, 2006, the FTB seized $5,872,679 from debtors' financial accounts. (ER 81.) On September 8, 2006, debtors filed a Chapter 11 bankruptcy petition. (ER 31.)

The only creditors listed on debtors' bankruptcy schedules were Diana and her attorney for claims related to the support trust and Trip's support obligations, GMAC for a $16,906.86 security interest in the Cadillac Escalade, and the IRS and the FTB for secured claims in the estimated amounts of $17 million and $10,828,000, respectively. (ER 297-98, 300-01.) Debtors did not list the Giants seat license on their bankruptcy schedules, although the license was subsequently sold for $19,500. (ER 318-21; SER 490.)

Debtors' schedules of current income and expenditures showed monthly after-tax income of $22,638 and monthly expenses of (ER 305-06):

Housing expense	$7,500
Utilities and home maintenance	$1,615
Food	$3,500
Clothing, laundry and dry cleaning	$450
Medical and dental expenses and health insurance	$700
Recreation, clubs and entertainment, newspapers and magazines	$1,100
Life insurance	$825
Transportation, car payment, auto insurance	$2,328
Child care	$3,800
Education expenses	$150
Storage	$800

On their Statement of Financial Affairs, debtors disclosed, for 2004, 2005, and 2006 (through September 8, 2006), employment income of $213,957, $186,110, and $154,038.51, and income from interest and investment distributions of $1,834,344, $273,618, and $267,766.98, respectively. (ER 308.) They also disclosed $78,274.75 in payments made within the 90-day period preceding the filing of the bankruptcy petition, including $18,593.33 to American Express and $19,246 to Cummings Moving and Storage. (ER 309.)

In October 2006, debtors sold the La Jolla condominium. The net proceeds of approximately $3 million were applied to the federal tax lien. (ER 81; ER 342.)

In their Disclosure Statement filed on March 5, 2007, debtors stated that the IRS filed a proof of claim in the amount of $18.8 million as a secured claim, $91,987.07 as an unsecured priority claim, and $4,804.80 as an unsecured general claim. Debtors stated that the FTB filed a proof of claim in the amount of $10 million as a secured claim (which was junior to the IRS's secured claim) with no priority claim. (ER 347-49.) Debtors stated that "the IRS holds a first-place lien on virtually all of the Estate's assets, except its avoidance claims." (ER 337, 338.)

On July 13, 2007, the Bankruptcy Court confirmed debtor's Chapter 11 plan. Pursuant to the plan, debtors borrowed $350,000 to fund the plan. (ER 81.) Also pursuant to the plan, debtors borrowed an additional $270,565 from Trip's father to discharge the federal tax lien from, and to allow them to retain, their furnishings, art, and other personal property. The proceeds of the class action against KPMG were applied to fund the plan. The IRS received distributions through the plan of about $5.2 million. The plan did not provide for any regular plan payments based on Trip's future employment income. (ER 81-82, 371-98.) On October 4, 2007, debtors received a discharge. (ER 81.) On December 14, 2007, debtors filed the complaint in this proceeding. (SER 498-99.)

H. Bankruptcy Court and District Court opinions

The Bankruptcy Court determined that Trip's liability for the federal and state taxes was nondischargeable under 11 U.S.C. § 523(a)(1)(C), which excepts from discharge a tax "with respect to which the debtor . . . willfully attempted in any manner to evade or defeat such tax." (ER 35.) The court found that Trip "willfully avoided the collection of tax by making unreasonable and unnecessary

discretionary expenditures at a time when he knew he owed taxes and knew he would be unable to pay those taxes." (ER 35.)

The Bankruptcy Court observed that debtors' personal living expenses were "truly exceptional." (ER 41.) The court found that "[d]ebtors altered [their] lifestyle very little after it became apparent in late 2003 that they were insolvent." (ER 30.) The court determined that debtors' *monthly* living expenses, totaling $90,700, exceeded their earned income by $78,000 per month. (ER 42.) The court took particular note of debtors' $33,600 in housing expenses for their Atherton and La Jolla homes, their transportation expenses for four vehicles in a two-driver family, and their $40,550 for "other expenses." (ER 42.) In addition, based on debtors' bankruptcy schedules, the court found that their living expenses "greatly exceeded their after-tax earned income until just before they filed their bankruptcy petition." (ER 43.)

The Bankruptcy Court found that "the most damaging evidence of evasion" were Trip's representations in the child-support proceeding "acknowledg[ing] his tax liability, his resulting insolvency, and his intent to discharge rather than pay his tax liablities." (ER 46.) The court found that the statements by Trip and his attorney at the

January 2004 child-support hearing "indicate[d] that [Trip] *planned* not to pay the tax debt in full." (ER 39-40 (emphasis in original).) The court determined that Trip "willfully evaded payment of [his] tax debt within the meaning of section § 523(a)(1)(C) by causing Debtors to deplete their assets on large unnecessary expenditures for an extended period of time, while knowing that Debtors were insolvent, while knowing that Debtors had a $25 million tax debt that they could not pay and did not intend to pay, and while paying other creditors." (ER 50.)

The District Court affirmed, holding that the Bankruptcy Court's findings that Trip "*planned to defeat his taxes* via bankruptcy and [to] continue living the lifestyle to which he had grown accustomed" were sufficient to support its determination that Trip willfully attempted to evade or defeat his taxes. (ER 14-15 (emphasis in original).)

SUMMARY OF ARGUMENT

Bankruptcy Code § 523(a)(1)(C) excepts from discharge taxes that the debtor willfully attempted in any manner to evade or defeat. This exception contains a conduct requirement and a mental-state requirement. A debtor's allocation of funds to unreasonable discretionary spending rather than known tax liabilities is a proper

basis for finding that the conduct requirement has been satisfied. Here, the Bankruptcy Court found that Trip satisfied the conduct requirement by unreasonable discretionary spending, planning to discharge his tax liabilities in bankruptcy rather than to pay them, and submitting an inadequate offer in compromise. The court's finding is further supported by Trip's investment in the FLIP and OPIS shelters and his failure to make any voluntary payments toward his tax liabilities.

The mental-state requirement is satisfied where the debtor's conduct was voluntary and intentional. Fraudulent or specific intent is not required. Here, Trip continued to engage in excessive spending long after he was aware of the tax liabilities. The Bankruptcy Court correctly found that the mental-state element was satisfied.

ARGUMENT

The Bankruptcy Court correctly found that Trip willfully attempted to evade or defeat his tax liabilities

Standard of review

"Whether or not a debtor willfully attempted to evade or defeat a tax is a question of fact reviewable for clear error." *In re Jacobs*, 490

F.3d 913, 921 (11th Cir. 2007); *see In re Zuhone*, 88 F.3d 469, 472 (7th Cir. 1996).

A. The Circuits applying the "in any manner" exception under 11 U.S.C. § 523(a)(1)(C) have articulated a uniform and broad standard consisting of a conduct requirement and mental-state requirement

A Chapter 11 debtor is generally granted a discharge from all debts that arose before confirmation of the plan. 11 U.S.C. § 1141(d). Section 523(a), however, provides exceptions to discharge for various debts, including "a tax * * * with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax." 11 U.S.C. § 523(a)(1)(C). The Circuits that have applied this exception for taxes that a debtor "willfully attempted in any manner to evade or defeat" have given it a generally uniform interpretation, holding that it "contains a conduct requirement (that the debtor 'attempted in any manner to evade or defeat [a] tax'), and a mental state requirement (that the attempt was done 'willfully')." *In re Fretz*, 244 F.3d 1323, 1327 (11th Cir. 2001); *accord United States v. Coney*, 689 F.3d 365, 371 (5th Cir. 2012); *In re Gardner*, 360 F.3d 551, 558 (6th Cir. 2004); *In re Tudisco*, 183 F.3d 133, 136 (2d Cir. 1999); *In*

re Fegeley, 118 F.3d 979, 983 (3d Cir. 1997); *In re Birkenstock*, 87 F.3d 947, 951 (7th Cir. 1996).

"[I]t is evident that Congress did not define or limit the methods by which a willful attempt to defeat and evade might be accomplished and perhaps did not define lest its effort to do so result in some unexpected limitation." *Fegeley*, 118 F.3d at 983 (internal quotation marks and citations omitted); *accord Fretz*, 244 F.3d at 1327; *Dalton v. IRS*, 77 F.3d 1297, 1301 (10th Cir. 1996); *see also Coney*, 689 F.3d at 372. Accordingly, courts have concluded that this discharge exception "is to be expansively defined." *Dalton*, 77 F.3d at 1301; *see Coney*, 689 F.3d at 372 ("broad reading" given to "in any manner" exception in § 523(a)(1)(C)); *see also Gardner*, 360 F.3d at 558 ("in any manner" exception "cast[s] a wide net").

B. The Bankruptcy Court correctly determined that the conduct requirement was satisfied based on debtors' prolonged exorbitant spending, Trip's openly-acknowledged plans to discharge rather than to pay the tax liabilities, and the submission of the inadequate offer in compromise

Congress also expressed the breadth of the § 523(a)(1)(C) discharge exception "[b]y using the unqualified phrase '*in any manner*' to modify a debtor's 'willful attempts' to evade or defeat his taxes."

Coney, 689 F.3d at 372 (emphasis in original); *see Fegeley*, 118 F.3d at 983. The Supreme Court has noted that "[r]ead naturally, the word any has an expansive meaning, that is, one or some indiscriminately of whatever kind." *Ali v. BOP*, 552 U.S. 214, 219 (2008) (internal quotation marks and citation omitted).

Courts have therefore "been reluctant to limit the means by which a taxpayer may 'willfully attempt in any manner to evade or defeat' taxes." *In re Griffith*, 206 F.3d 1389, 1395 (11th Cir. 2000). A court should consider "the totality of conduct to determine whether or not the debtor willfully attempted to evade or defeat taxes." *Fegeley*, 118 F.3d at 983 (quoting *Dalton*, 77 F.3d at 1301); *Coney*, 689 F.3d at 374. Section 523(a)(1)(C) "includes both acts of commission and acts of omission." *In re Toti*, 24 F.3d 806, 809 (6th Cir. 1994); *see Fretz*, 244 F.3d at 1329; *Fegeley*, 118 F.3d at 983; *see also In re Bruner*, 55 F.3d 195, 200 (5th Cir. 1995). Similarly, § 523(a)(1)(C) applies to attempts to defeat the payment or collection of a tax as well as to attempts to evade the assessment of a tax. *Coney*, 689 F.3d at 372; *see Griffith*, 206 F.3d at 1395. Although nonpayment of taxes by itself generally has been held insufficient to satisfy the conduct requirement, it is "relevant evidence." *Fegeley*, 118 F.3d at 983; *Birkenstock*, 87 F.3d at 951.

1. The Bankruptcy Court properly considered debtors' prolonged excessive spending in the face of known tax liabilities

a. Allocation of resources to discretionary expenditures rather than taxes satisfies the conduct requirement

Several circuits have held that a debtor's "large discretionary expenditures" in the face of known tax liabilities are a proper ground for determining that a debtor attempted to evade or defeat a tax. *Jacobs*, 490 F.3d at 926. *See Gardner*, 360 F.3d at 558 (affirming Bankruptcy Court's reliance on its conclusion "that the debtor lived lavishly during the period of time the IRS sought to collect the tax liability" in determining that taxes were nondischargeable); *Bryen v. United States*, 449 Fed. Appx. 165, 168 (3d Cir. 2011) (taxes nondischargeable where debtor "continued to live high on the hog" after learning that he owed substantial tax liabilities); *see also Fegeley*, 118 F.3d at 984 (debtor's "failure to pay taxes when he had the resources to do so" because he lived "lavish[ly] . . . and didn't make good judg[]ments about the allocation of his resources" was a proper basis for determining that conduct requirement was satisfied).

Several lower courts also have held that the "allocation of available income to discretionary expenses and debts other than tax

liabilities constitutes a willful act to evade the payment of taxes" under § 523(a)(1)(C). *In re Lynch*, 299 B.R. 62, 82-83 (Bankr. S.D.N.Y. 2003). *See In re Volpe*, 377 B.R. 579, 589 (Bankr. N.D. Ohio 2007) ("debtor used his disposable income for leisure activities, knowing that he had a significant tax liability"); *In re Hamm*, 356 B.R. 263, 277 (Bankr. S.D. Fla. 2006) ("[a] Debtor's lavish lifestyle is another indicia of attempts to evade or defeat taxes"); *In re Mixon*, 2008 WL 2065895, at *6 (Bankr. N.D. Tex. 2008) ("court may consider a debtor's lavish lifestyle while concurrently failing to pay taxes"); *In re Haesloop*, 2000 WL 1607316, at *5 (Bankr. E.D.N.Y. 2000) ("Plaintiff earned substantial income . . . and chose to apply that income towards expenses other than payment of his federal taxes, and to take on substantial new obligations, even though he had the resources to pay his taxes."); *In re Angel*, 1994 WL 69516, at *3 (Bankr. W.D. Okla. 1994) (debtor "purchased numerous luxury items while he was under a present obligation to pay his taxes"); *see also In re Wright*, 191 B.R. 291, 292-93 (S.D.N.Y. 1995); *In re Hassan*, 301 B.R. 614, 622 (S.D. Fla. 2003). As one court has recognized, "[h]onest taxpayers, the overwhelming majority of Americans, should not be forced to subsidize the excessive spending habits of [such] Debtors." *Hamm*, 356 B.R. at 282. In this case, the

Bankruptcy Court's determination that debtors' "truly exceptional" (ER 41) expenditures were a proper basis for excepting Trip's liabilities from discharge is correct.

Although, as discussed *supra*, nonpayment of taxes by itself generally has been held insufficient to satisfy the conduct requirement, the allocation of resources to unreasonable and excessive expenditures, rather than payment of taxes, is more than mere nonpayment of taxes. It is nonpayment of taxes *in addition to* payment of unreasonable discretionary expenditures. *See In re Bryen*, 433 B.R. 503, 518 (Bankr. E.D. Pa. 2010) ("Debtor had at his disposal a substantial amount of discretionary income" and allocated it to maintaining lavish lifestyle instead of taxes), *aff'd*, 109 A.F.T.R.2d 2012-343 (E.D. Pa.), *aff'd*, 449 Fed. Appx. 165 (3d Cir. 2011). Excepting from discharge taxes based on such conduct recognizes the distinction "between the debtor with the present ability to pay who so refuses and the unfortunate debtor without a present ability to repay." *Lynch*, 299 B.R. at 82.

We note that the Bankruptcy Court gave Trip the benefit of a later, shorter time period for considering expenditures than it could have used. Section 523(a)(1)(C) does not define or otherwise limit the time period for determining relevant conduct. But since § 523(a)(1)(C)

applies to conduct seeking to evade both assessment and collection of tax (*Coney*, 689 F.3d at 372), it necessarily applies to conduct occurring both before and after assessment. In determining the nondischargeability of a liability for a particular tax year, the court may consider "acts or omissions of evasion that took place either during that tax year, or during later years." *Hamm*, 356 B.R. at 276.

In *Dalton*, the Tenth Circuit held that a willful attempt to evade taxes was established based on conduct that occurred after the debtor "knew of the tax investigation which was likely to result in a significant assessment," but before the assessment was made. 77 F.3d at 1303; *see also In re Vaughn*, 2013 WL 1324377, at *5 (D. Colo 2013), *appeal pending,* No. 13-1189 (10th Cir.). Other Circuits have determined that a liability was nondischargeable under § 523(a)(1)(C) based on a failure to file returns or other conduct occurring prior to assessment. *Fretz*, 244 F.3d at 1324-25; *Tudisco*, 183 F.3d at 137; *Toti*, 24 F.3d at 806.

Accordingly, the Bankruptcy Court was not required to limit its analysis of debtors' expenditures to the period following January 2004, when Trip admitted, in the child-support proceeding, that he owed $25 million in taxes and that he was insolvent. Under *Dalton*, debtors' expenditures beginning with the commencement of the FTB and IRS

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audits in March and July 2001 (ER 75-76) could also be considered. Similarly, Trip stated that he was "at the edge financially" in December 2002. (SER 393, 397.) Consideration of expenditures in the earlier period, while not necessary, lends further support to the correctness of the Bankruptcy Court's finding that Trip willfully attempted to evade or defeat his tax liabilities through unreasonable expenditures.

In any event, the prolonged nature of either time period further supports the determination that debtors' excessive expenditures satisfied the conduct requirement. In excepting taxes from discharge based on unreasonable expenditures, courts have considered expenditures taken over various time periods. *See, e.g., Gardner*, 360 F.3d at 560 (reviewing expenditures over 33-month period); *Lynch*, 299 B.R. at 77 (considering spending over four-year period).

Trip argues (Br. 46) that unreasonable expenditures do not by themselves satisfy the conduct requirement, and that the cases involving unreasonable expenditures also involved other conduct. Trip has not cited any case holding that unnecessary expenditures are insufficient to satisfy the conduct requirement. *See Lynch*, 299 B.R. at 82-83 ("no court has questioned or noted any exceptions to the principle . . . that the allocation of available income to discretionary expenses

and debts other than tax liabilities constitutes a willful act to evade the payment of taxes") Similarly, Trip has not cited any case holding that more than one instance or type of conduct is required in order satisfy the conduct requirement.

Moreover, in at least one case, a debtor's taxes were excepted from discharge based solely on unreasonable expenditures. *See Angel*, 1994 WL 69516, at *3-4 (debtor who purchased valuable home, luxury cars, and other luxury items willfully attempted to evade or defeat taxes under § 523(a)(1)(C)). Although most of the cases involving unnecessary expenditures also involved some other conduct, "none of these opinions indicate that" finding a willful attempt to evade or defeat tax based on unnecessary expenditures "was dependent on the court's ability to find other taxpayer offenses as well." *Lynch*, 299 B.R. at 83 n.96.

Similarly, the cases do not state that unnecessary expenditures are entitled to any less weight than any other conduct. *Hamm*, 356 B.R. at 276-77 ("[a] Debtor's lavish lifestyle is *another* indicia of attempts to evade or defeat taxes") (emphasis added); *see Landi v. United States*, 316 B.R. 363, 370 (M.D. Fla. 2004) (conduct requirement satisfied based on debtors' use of entity to shield cash from IRS levy,

claiming withholding credits without paying withholding taxes, and lavish lifestyle), *aff'd*, 138 Fed. Appx. 300 (11th Cir. 2005). Indeed, a number of the cases involving unreasonable expenditures focused primarily on the unreasonable expenditures, rather than on other conduct. *Haesloop*, 2000 WL 1607316, at *5-6 (conduct requirement was satisfied based principally on debtor's allocation of substantial income to unnecessary expenditures, although debtor's failure to file timely returns and efforts to limit his collectible assets were also considered); *see also Hassan*, 301 B.R. at 624 (conduct requirement satisfied where debtors "left significant tax liabilities unpaid while they enjoyed the fruits of their labor, vacationing, dining, and tending to other family affairs," although debtors also "conducted their lives in a manner that prevented the attachment of assets by the IRS," including titling property in daughter's name, dealing in cash, and filing late returns).

In *Lynch*, most of the court's opinion was devoted to analysis of the debtor's unreasonable expenditures on housing, credit-card bills, tithing, restaurants, and food. 299 B.R. at 72-76, 84-86. Although the court also concluded that the debtor's cancellation of the direct deposit of her employment income into her bank account was an affirmative act

to evade payment of taxes, the court clearly considered this factor secondary to her excessive spending. Indeed, after making its findings regarding cancellation of the direct deposit (*id*. at 76-77), the court did not even mention this conduct in the remainder of its opinion. *Id*. at 77-86. Similarly, in *Bryen*, the focus of the court's opinion was debtor's "lifestyle," although the court also referred to debtor's practice of "deal[ing] in cash." 449 Fed. Appx. at 167; *see also Bryen*, 433 B.R. at 518 (after discussing debtor's lavish lifestyle, bankruptcy court noted that debtor handled his personal finances in cash or through third parties and that this "conduct, too, contribute[d] to [its] finding" that § 523(a)(1)(C)'s conduct requirement was satisfied); *Fegeley*, 118 F.3d at 984 (because debtor's "failure to file tax returns, together with his failure to pay taxes when he had the resources to do so," due to his lavish lifestyle, "was sufficient to" satisfy conduct requirement, court did not consider other conduct).

Moreover, as the Bankruptcy Court recognized, and as demonstrated below, this case involved a high level of spending over a prolonged period of time "not found in the more typical cases" involving unreasonable expenditures. (ER 50.) The dischargeability determination is based on the totality of conduct, rather than the

presence or absence of any specific factor or factors. In any event, as discussed *infra* pp. 54-61, Trip's conduct in this case was not limited to unnecessary and unreasonable expenditures, but also included planning to discharge rather than to pay his taxes and submitting an inadequate offer in compromise to delay collection of his taxes.[3]

b. Expenditures on multi-million dollar homes were unreasonable

Expenditures on unnecessary housing costs or second homes can satisfy the conduct requirement. *See Bryen*, 449 Fed. Appx. at 167; *Lynch*, 299 B.R. at 72-73, 84-85; *see also Bryen*, 433 B.R. at 518 (debtor "had the luxury of maintaining two residences (one being a vacation home)" and made other unreasonable expenditures). The court in *Lynch* stated that, while "[p]lainly shelter is a necessity" for purposes of determining the reasonableness of the debtor's expenses, "[s]helter on Central Park West in a 3 bed-room apartment [for debtor and her husband] in a doorman building – at a cost of more than $6,000 per

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[3] In *In re Rhodes*, 356 B.R. 229, 235-38 (Bankr. M.D. Fla. 2006), cited by Trip (Br. 46-47), the court found that the debtor, unlike Trip, took adequate measures to reduce his expenses and thus did not satisfy the conduct requirement. In *In re Huber*, 213 B.R. 182, 185 (Bankr. M.D. Fla. 1997), cited by Trip (Br. 47), the court found that the debtor, unlike Trip, was not aware of the extent of his liabilities.

month, or $72,000 per year – is not." 299 B.R. at 84. *See also Hamm*, 356 B.R. at 282 (debtors purchased second home for use of parents); *Haesloop*, 2000 WL 1607316, at *6 (debtor "continue[d] to carry the costs of his country home").

Here, debtors continued to maintain and to reside in their six-bedroom Atherton home (SER 209, 437-38) through the period of the IRS and FTB audits (commencing in March and July 2001), the child-support proceeding, assessment of the taxes at issue, and submission of their offer in compromise in October 2005. (ER 221, 224, 227.) Instead of moving to a smaller, less expensive home for themselves and their four children, two of whom (Trip's children from his marriage with Diana) resided with them only half of the time (SER 431), debtors continued to pay the utilities, maintenance, taxes, insurance, and other costs on this multi-million dollar home until they sold it in July 2006 for $6.8 million, shortly before they filed their Chapter 11 petition. (ER 81, 312.) Moreover, even after selling the Atherton home, debtors moved into another multi-million dollar home – the San Mateo home, which had been purchased by Trip's father for $2.5 million, and which they furnished with luxury items from the Atherton home. (ER 302; SER 440-41, 483-84.)

In addition, on November 8, 2002, debtors purchased their ocean-view second home in La Jolla for $2.6 million. (SER 212, 214, 439.) This was after KPMG, on October 17, 2002, sent Trip and his attorneys an e-mail attaching draft computations regarding the IRS audit. (SER 415-18.) It was also in the same month in which Trip's attorney Rettig, on November 27, 2002, sent a letter to the IRS expressing debtors' intention to settle the liabilities relating to the FLIP and OPIS transactions on the terms set forth in the settlement initiative. (ER 161.) Debtors continued to own and maintain this vacation home (SER 439) even after they filed their Chapter 11 petition on September 6, 2006, until they sold it in October 2006 for approximately $3 million. (ER 81, 342.) Such unreasonable housing and vacation expenses constitute strong evidence of a willful attempt to evade or defeat taxes under § 523(a)(1)(C).

c. Expenditures on luxury automobiles were unreasonable

In *Jacobs*, the Eleventh Circuit, in determining that the debtor willfully attempted to evade or defeat his tax liabilities, considered debtor's expenditure of "between $600 and 700 per month for a leased Mercedes-Benz for his wife, even though [he and his wife] apparently

also drive other luxury vehicles." 490 F.3d at 926. *See also Haesloop*, 2000 WL 1607316, at *6 (debtor "continue[d] to lease a luxury automobile (at a cost of $662.93 per month at the time of trial)").

Here, debtors purchased a new Cadillac Escalade SUV for $69,974 in October 2004 (SER 296, 297-99, 433), nine months after Trip acknowledged owing $25 million in taxes during the child-support hearing in January 2004, and shortly before debtors consented to assessment of the federal taxes in December 2004 (ER 79, 239; SER 200, 207). The Cadillac was the fourth car (in addition to their 2000 Lexus SUV, 2000 Lexis LS 400, and 1998 Porsche), for debtors' family of two drivers. (SER 432.) The continued ownership, maintenance, and payment of the insurance and other costs of these four vehicles further established a willful attempt to evade or defeat taxes.

d. Expenditures on private school, vacations, and private jet were unreasonable

Private-school tuition is another "non-necessit[y]" supporting a willful attempt to evade taxes. *Volpe*, 377 B.R. at 587; *see also In re Colish*, 289 B.R. 523, (Bankr. E.D.N.Y. 2002) (payment of religious-school expenses instead of taxes supported finding of

nondischargeability); *Hamm*, 356 B.R. at 282 (payment of son's private-college tuition was example of "lavish spending" constituting "conduct by the Debtors to avoid paying their taxes"); *Wright*, 191 B.R. at 292-93 (debtor's "tuition payments for Ivy League educations for his children" supported nondischargeability determination). "Generally, [debtors] 'owe no duty to their children to provide them with nonessential luxuries while'" their creditors go unpaid. *In re Griffieth*, 209 B.R. 823, 828 (Bankr. N.D.N.Y. 1996) (internal citation omitted). Here, debtors spent between $20,000 and $30,000 annually (per child) on private-school tuition. (SER 445, 482.)

Expenditures on personal travel taken with knowledge of tax liabilities support a finding of nondischargeability. *See Gardner*, 360 F.3d at 560-61; *Volpe*, 377 B.R. at 589; *Lynch*, 299 B.R. at 75-76, 84; *Wright*, 191 B.R. at 293. Trip continued to own and maintain his $11 million private jet and to take his family on domestic and overseas vacations (SER 366-92, 475-76) despite the pendency of the FTB and IRS audits, which commenced in March and July of 2001 (ER 75-76). Trip kept the jet for more than two years after the IRS audit commenced, until he sold it for $5 million on October 27, 2003. (ER 78.)

During this period, Trip continued to pay the jet's operating costs of approximately $1 million per year. (SER 409.)

e. Trip's contributions to a failing 3DO were unreasonable

Taxpayers should not be permitted to make the Government "an unwilling investor in their troubled businesses" as a consequence of their allocation of funds to such businesses instead of to payment of their taxes. *Dinino v. Commissioner*, T.C. Memo. 2009-284, 2009 WL 4723652, at *4 (2009); *see also Brown v. United States*, 591 F.2d 1136, 1142 (5th Cir. 1979). Trip contributed millions to a failing 3DO with knowledge of his increasingly certain tax liabilities. In fall 2001, after the commencement of the audits, Trip contributed most of a $10 million equity private placement for 3DO. (ER 172.) Between October 2002 and January 2003, Trip lent 3DO $12 million. (SER 398-400, 478, 492-93.) This was after Revenue Agent Barrett's July 11, 2002 letter stating that the IRS would not allow the claimed FLIP and OPIS losses. (ER 152.) Moreover, most of the $12 million in 3DO loans were made after Trip received draft computations on October 17, 2002 regarding the IRS audit and, therefore, was aware of the expected amount of the liabilities. (*Compare* SER 399 *with* SER 414.) While

Trip was making the 3DO loans, his attorney was requesting that debtors be allowed to participate in the tax-shelter settlement initiative. (ER 161.) The IRS determined that debtors did not qualify for the settlement initiative. (ER 160, 162.) But Trip, while offering to settle his liabilities, nevertheless apparently did not set aside funds for payment of any settlement with the IRS, but instead allocated his funds, at a time when he stated he was "at the edge financially" (SER 397), to continued contributions to 3DO. Trip's continuing contributions to 3DO, with funds that should have been used (or set aside) to pay his taxes, made the Government an unwilling investor in 3DO.[4]

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[4] The Bankruptcy Court chose to "attach little importance to ownership of the jet, because debtors purchased it when they thought they were solvent, and attempted to sell it "soon after they understood they were insolvent." (ER 48.) Similarly, the court found that "evidence of evasion via unnecessary spending is so strong against Trip that the loans to 3DO add little to the Government's case." (ER 49.) Nevertheless, these expenditures lend further support to the court's decision and may be considered. *See Fidelity Fin. Corp. v. Fed. Home Loan Bank*, 792 F.2d 1432, 1437 (9th Cir. 1986) ("We may affirm the district court on a ground not selected by the district judge so long as the record fairly supports such an alternative disposition of the issue."); *see also United States v. Am. Ry. Express Co.*, 265 U.S. 425, 435 (1924).

f. Debtors' total monthly spending of $90,700 was unreasonable

As recognized by the Bankruptcy Court (ER 41-44), debtors' total monthly spending, after Trip acknowledged in January 2004 that he owed taxes of $25 million, was astounding. The October 2005 Collection Information Statement submitted with debtors' Offer in Compromise showed $90,700 in monthly living expenses (exclusive of taxes). (ER 223.) This amount included $33,600 in housing and utility costs for debtors' two homes, and $2,700 in transportation costs for debtors' four cars. In addition, debtors listed $7,000 for expenditures on "Food, Clothing and Misc." (ER 223.) In *Lynch*, the court found that the debtor's expenditure of $29,000 annually (or approximately $2,400 monthly) on food and restaurants for her and her husband was unreasonable. 299 B.R. at 75.

Also listed on the Statement was $4,500 for "Child/dependent care," even though Lisa was not employed outside the home in order to care for debtors' children. (ER 75, 145, 223.) The Statement listed $40,550 in "Other expenses." (ER 223.)

Additional remarkable categories of expenses, which were listed on debtors' bankruptcy schedules, were monthly expenses of $1,100 for

"Recreation, clubs and entertainment, newspapers and magazines," and $800 for "Storage" (ER 305). *See Jacobs*, 490 F.3d at 926 (expenditures such as $1,000 per month for golf-club membership "relevant to § 523(a)(1)(C)'s conduct element"). It is not clear from the record whether or not the monthly $1,100 expense for recreation included the cost of Giants season tickets, which Trip continued to purchase for each of the 2000-2006 seasons. The annual cost of these tickets was approximately $8,000 to $9,000, including the parking pass. (SER 361, 364, 485-86, 489-90, 491.)

Trip's objection to the Bankruptcy Court's finding that debtors' expenses vastly exceeded their earned income on the ground that the court should have considered Trip's substantial unearned income from investments as well as his salary (Br. 49-50) is meritless. As the District Court noted (ER 11), there is no requirement in § 523(a)(1)(C) or the caselaw for the court to consider either earned or unearned income in evaluating debtors' expenses. Indeed, a higher level of income should render a debtor's failure to pay taxes more, not less, culpable. Here, the Bankruptcy Court considered Trip's earned income *for his benefit* based on the premise that a debtor's income level should be considered in evaluating the reasonableness of the debtor's

expenses. (ER 40 ("It may not be appropriate to require a CEO earning hundreds of thousands of dollars per year to live in an apartment suitable for a clerical employee, even if that CEO is insolvent.").) But this is not a basis for requiring the court to consider unearned income from investments, "which [was] not dependent in any way upon Trip['s] personal efforts." (ER 40 n.18.)

Moreover, debtors did not list any amount for unearned investment income in the Collection Information Statement (ER 223) and bankruptcy schedule (ER 304) upon which the Bankruptcy Court based its comparisons of income and expenses. Although the income-and-expense analysis prepared by the IRS in response to the offer in compromise listed $56,242 in income other than wages, even including this amount, debtors' monthly expenses exceeded their income by $17,790 per month. (ER 40-41, 223, 229, 304.) Debtors' expenditures, including their monthly spending of $90,700, were unreasonable regardless of income level. Finally, as the District Court noted, even if, assuming *arguendo*, debtors' total income, including unearned income, exceeded their expenses, "such a fact could not justify extravagant spending in the face of insolvency," because "[t]o hold otherwise 'would

create special rules for the wealthy.'" (ER 11 (quoting *Lynch*, 299 B.R. at 84-85).)

Trip's argument that the monthly $33,600 listed on the Collection Information Statement for "Housing and Utilities," and considered by the Bankruptcy Court as such, was for the $4 million mortgage on his house used to obtain funds that he lent to 3DO (Br. 50-51) also lacks merit. First, neither the Statement (ER 223) nor the record references cited by Trip (Br. 51 n.101) specify how much of the $33,600 was for the loan as opposed to for housing and utilities. Indeed, the income-and-expense table on the Statement did not specify that any portion of the $33,600 was for the 3DO loan. (ER 223.) The court cannot be faulted for concluding that the $33,600 claimed for "Housing and Utilities" was for housing and utilities, and not for the 3DO loan.

Second, a debtor who "take[s] on substantial new obligations" instead of paying tax liabilities engages in the conduct required under § 523(a)(1)(C). *See Haesloop*, 2000 WL 1607316, at *5. Here, Trip took on the $4 million mortgage on January 30, 2003 (SER 399), which was six months after the IRS's July 11, 2002 letter stating that the IRS would not allow the claimed losses (ER 152), three months after receiving draft computations on October 17, 2002 regarding the IRS

audit (SER 414), two months after his attorney's November 2002 letter requesting that debtors be allowed to participate in the tax-shelter settlement initiative (ER 161), and at a time when he was "at the edge financially" (SER 397). The mortgage to finance the failing 3DO was an unnecessary obligation, and therefore cannot justify the $33,600 in claimed "housing" expenses.

Third, the mortgage payments were also unnecessary because debtors could have sold the multi-million dollar Atherton home, satisfied the mortgage, and moved into a smaller home several years earlier, or at the very least before submitting the offer in compromise in October 2005. (ER 227.) Instead, Trip chose to continue to pay the expenses of residing in, maintaining, and carrying the mortgage on the Atherton home until it was finally sold in July 2006, after debtors were informed that their offer was unacceptable on March 1, 2006. (ER 81.) The Bankruptcy Court did not err in relying on Trip's failure to make any effort to reduce debtors' housing expenses until this late date.

Trip takes issue with (Br. 51) the Bankruptcy Court's statement that the $40,550 listed on the Statement as "Other expenses" was not broken down. Trip argues (*id.*) that the IRS income-and-expense table (ER 229) indicated that this amount was for legal expenses.

Nevertheless, the court correctly stated that this information was not set forth in the income-and-expense table in the Statement. Furthermore, Trip does not provide any details regarding these purported legal expenses, including when, to whom, and for what purpose they were incurred, other than to assert generally (Br. 51) that he "was litigating during that time with both his ex-wife over child support and with KPMG" and "had also retained counsel to represent him in his dealings with the IRS." The child-support-modification order was entered on August 2, 2004, and Trip and his attorney signed a stipulated order providing for joinder of the support trust on December 22, 2004. (SER 160, 176.) The tax liabilities were assessed in March 2005. (ER 79.) Therefore, it is unclear how Trip could have been reasonably paying $40,555 *each month* in legal fees when he submitted the Statement in October 2005. In any event, even without this item, debtors' expenses substantially exceeded their income.

Trip argues that the lower courts (Br. 56-59) improperly failed to consider his efforts to maximize assets and reduce expenses, including living expenses and child support. Trip contends (Br. 56) that the District Court incorrectly concluded (ER 14) that Trip waived this argument by not making it in his Bankruptcy Court brief. The District

Court correctly recognized that Trip did not specify in his Bankruptcy Court trial brief (ER 68-69) any reductions in living expenses or amounts by which he increased his assets. Trip's brief in this Court is vague and insubstantial in this regard. Trip contends only that debtors "fired the family's full-time domestic staff, reduced the hours of the remaining nanny and an occasional gardener, and stopped taking expensive vacations" (Br. 18) without providing any details regarding when these limited measures were taken and the amount of money saved by them. Trip adds (Br. 18) that debtors sold their home in 2006 and "moved to a rented house," without mentioning that the rented house, like the previous home, was a multi-million dollar home. Similarly, Trip claims (Br. 58) that he "preserv[ed] interests in VC funds by meeting contributions requirements," without specifying the date of, amount of, and return on specific contributions made, and whether any return exceeded the amount of interest that was accruing on his tax liabilities. (*See* SER 104-39.)

Trip makes much of his efforts to reduce his child-support obligations (Br. 17-18, 57), but admits (Br. 17-18) that these efforts resulted in him being required to pay a lump sum of $750,000 into the child-support trust. Moreover, the reduction in child support was based

on the standard "DissoMaster" calculation, to which the Superior Court determined Trip was entitled. (SER 162.) The reduction in child support benefitted debtors, was not used to make any tax payments, and in no way offset or mitigated debtors' excessive spending.

2. The Bankruptcy Court properly considered Trip's stated plans to discharge his taxes in bankruptcy rather than to pay them

"A finding under section 523(a)(1)(C) may encompass various schemes." *May v. Missouri Dept. of Revenue*, 251 B.R. 714, 718 (B.A.P. 8th Cir. 2000), *aff'd*, 2 Fed. Appx. 681 (8th Cir. 2001); *Colish*, 289 B.R. at 536. In *In re Acker*, 2010 WL 3813243, at *7 (Bankr. E.D. Tex. 2010), a bankruptcy court held that the conduct requirement was satisfied based in part on the debtor "deliberately us[ing] bankruptcy filings . . . to delay the collection efforts of the IRS."[5]

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[5] In *United States v. Doyle*, 276 F. Supp.2d 415, 427 n.4 (W.D. Pa. 2003), the court found that "to the extent the Taxpayers, in making their financial decisions, took into account" the effect of the timing of the bankruptcy on the dischargeability of the tax liabilities, "this mind set is not evidence of attempted tax evasion." In this case, however, Trip did not simply time a bankruptcy that he planned to file in any event so as to take advantage of the discharge provisions. Rather, as found by the Bankruptcy Court (ER 37-38), he dissipated his assets on unreasonable expenses instead of paying tax liabilities, while planning to file bankruptcy for the sole purpose of discharging the liabilities.

The District Court here held that the Bankruptcy Court correctly concluded that Trip "*planned to defeat his taxes* via bankruptcy and [to] continue living the lifestyle to which he had grown accustomed." (ER 14-15 (emphasis in original); *see* ER 37-40.) The January 2004 child-support hearing demonstrates the strategy by Trip and his attorneys to discharge debtors' taxes in bankruptcy instead of to pay them. Trip's attorney discussed the timing of the bankruptcy as it related to the three-year and 240-day periods for determining dischargeability of income taxes. (SER 201-02.) Trip then followed through on these plans by filing debtors' Chapter 11 petition within a few months of the expiration of the 240-day period (including the period of the pendency of the offer in compromise plus 30 days). (ER 79-81; *see* 11 U.S.C. §§ 507(a)(8)(A), 523(a)(1)(A).)[6] Trip admits (Br. 55) that debtors "had to wait another eight months [after assessment] before filing their bankruptcy petition" (citing 11 U.S.C §§ 507(a)(8),

[6] Section 523(a)(1)(A) excepts from discharge the priority taxes listed in § 507(a)(8). Section 507(a)(8)(A)(i) applies to income taxes for which a return was due, including extensions, within the 3-year period preceding the petition date. Section 507(a)(8)(A)(ii) applies to income taxes assessed within 240 days before the petition date, exclusive of any time during which an offer in compromise was pending, plus 30 days.

523(a)(1)(A)). Debtors' schedules disclosed that prior to filing for bankruptcy, debtors had paid all of their debt except for their taxes and their loan on the Cadillac. (ER 297-300, 323-24.)

Moreover, debtors' bankruptcy plan did not provide for any payments to the IRS other than from the liquidation of or income arising from prepetition property and the borrowed funds.[7] Debtors' plan contained no provision for unconditional regular plan payments, which could be funded by Trip's future employment income. (ER 333-63.)

3. The Bankruptcy Court properly considered the submission of the inadequate offer in compromise

Although the Bankruptcy Court stated that Trip's bankruptcy plans and the inadequate offer in compromise were not by themselves sufficient to satisfy the conduct requirement, it based its § 523(a)(1)(C) determination on these factors and its finding that "Trip caused [debtors] to waste assets through unnecessary personal spending after

[7] Even as to prepetition property, debtors failed to disclose in their bankruptcy schedules and include in their bankruptcy plan their Giants seat license, which Trip eventually sold for $19,500. Although the Bankruptcy Court chose not to rely on this conduct (ER 49), it further indicates that the purpose of the bankruptcy was to discharge the taxes rather than to pay them.

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they decided to discharge their tax liabilities." (ER 48.) Submission of an inadequate offer in compromise is a proper basis for a finding of nondischargeability. *See In re Peterson*, 317 B.R. 556, 565 (Bankr. N.D. Ga. 2004); *Acker*, 2010 WL 3813243, at *7; *see also In re Klayman*, 333 B.R. 695, 704-05 (Bankr. E.D. Pa. 2005). In *Mixon*, the court found that § 523(a)(1)(C) was satisfied based in part on the debtors' submission of an offer to settle $500,000 in taxes for $165,000, when they could have paid substantially more. 2008 WL 2065895, at *14.

Here, debtors requested a stay of collection pending consideration of an offer in compromise. (ER 80.) Although the taxes were assessed in March 2005, debtors did not submit an offer in compromise with the required processing fee until October 2005. (ER 79-80, 224.) As the IRS informed them, this offer was grossly inadequate. Debtors' offer, which was purportedly based on their ability to pay, was for only $8 million, the approximate amount of one of their investment accounts, and did not include any amounts reflecting other assets listed on their Collection Information Statement, including their two homes, their four cars, and other accounts. (ER 219-23, 224-27.) The IRS determined that debtors had $36 million in available assets with which to pay fully their liabilities, which totaled $21 million in taxes, plus interest

accrued from March 2005 (SER 104-39). Moreover, the offer did not provide for any payments from future income, or any other payments beyond the two-year period of the offer, which, as the IRS informed debtors, could have been paid over a five-year period. (ER 224-30.)

Trip asserts that the IRS's rejection of the offer did not account for debtor's state taxes (Br. 59) and that "it was apparently based on the IRS's valuation of unvested options in . . . Digital Chocolate at $13 million, when they were actually worth nothing" (Br. 16). Because the IRS determined that debtors had $36 million in assets and future income value (based on reductions of their excessive expense to allowable levels) debtors could have paid the $21 million in federal liabilities, as well as the approximately $15 million in state taxes, which in any event were junior to the federal tax lien. (ER 228-30, 347-349.) Trip's citation to his bankruptcy schedules (Br. 16) in support of his assertion that the IRS incorrectly valued his interests in Digital Chocolate, even if sufficient to establish the value of the interests, does not establish that Trip explained this to the IRS. In any case, even including a compromised portion of the state taxes, and excluding the Digital Chocolate interests, debtors, at the very least, could have paid

substantially more than the $8 million – approximately 38% of the amount owed – that they offered.

4. Trip's failure voluntarily to pay or to set aside funds for his taxes lends further support to the Bankruptcy Court's determination that the conduct requirement was satisfied

Although nonpayment of taxes by itself generally has been held insufficient to satisfy the conduct requirement, it is "relevant evidence." *Fegeley*, 118 F.3d at 983. A debtor's failure to make voluntary payments of his tax liabilities, other than in response to forced IRS collection measures, is significant. *See In re Carnes*, 244 B.R. 435, 447 (Bankr. W.D. Mo. 2000). Even if a tax liability has not been assessed, a debtor's failure "to attempt to save in anticipation of the tax debt" is conduct supporting a § 523(a)(1)(C) determination. *See Bryen*, 449 Fed. Appx. at 168. Here, Trip failed to make *any* payments, or to set aside funds for the payment, of his tax liabilities, prior to the filing of a notice of federal tax lien against his property and the filing of debtors' bankruptcy case.

Trip argues (Br. 59) that all of the funds that the taxing authorities have received "came from [debtors'] voluntary disposition of properties and the Tax Trust created by the Chapter 11 plan," whose

assets were maximized by his "financial management" (*id.*) and his prosecution of the KPMG suit (Br. 19-20). Here, debtors did not, through their own sale of their properties or their Chapter 11 plan, voluntarily pay the IRS or the FTB, which were paid only because they had liens or levies on the liquidated property.

Moreover, in managing the assets in the tax trust and in prosecuting the KPMG suit, Trip was doing no more than his duty. *See In re Cheng*, 308 B.R. 448, 455 (B.A.P. 9th Cir. 2004) ("The debtor in possession performing the duties of the trustee is the representative of the estate and is saddled with the same fiduciary duty as the trustee to maximize the value of the estate available to pay creditors."), *aff'd*, 160 Fed. Appx. 644 (9th Cir. 2005); *accord Love v. Tyson Foods, Inc.*, 677 F.3d 258, 273 n.11 (5th Cir. 2012) (same); 11 U.S.C. § 1107. If Trip had truly sought to maximize the assets of the estate, rather than to preserve debtors' lavish lifestyle at the expense of the taxing authorities, he would not have incurred the $270,565 loan obligation to his father in order to discharge the tax lien from debtors' luxury furniture, artwork, and jewelry. (ER 81, 392; SER 424-25, 434-35, 440-42.) Instead, he could have sold that property for fair market value, paid the proceeds to the IRS, replaced the luxury items with

inexpensive items, and applied the funds used to repay Trip's father to make additional payments to the IRS and the FTB.

5. Trip's FLIP and OPIS tax shelters further support the Bankruptcy Court's finding of § 523(a)(1)(C) conduct

A debtor who engages in transactions that make no economic sense other than to attempt to evade taxes satisfies the conduct requirement under § 523(a)(1)(C). *Doyle*, 276 F. Supp. 2d at 424-25; *In re Sommers*, 209 B.R. 471, 478-79 (Bankr. N.D. Ill. 1997); *In re Krumhorn*, 2001 WL 1155258, at *2-5 (N.D. Ill. 2001). Participation in an abusive tax shelter can satisfy the conduct requirement. *Vaughn*, 2013 WL 1324377, at *3. Here, Trip invested in the FLIP and OPIS shelters to avoid tax on the sale of his EA stock. He admitted in his KPMG complaint that the FLIP and OPIS were "illegal and abusive tax shelters" and were "not legitimate investment strategies." (ER 79-80; SER 403, 406.) On their face, the investments in the shelters constituted attempts to evade or defeat taxes under § 523(a)(1)(C).

C. The Bankruptcy Court correctly determined that the mental-state requirement was satisfied

In order to satisfy § 523(a)(1)(C)'s mental-state requirement, the relevant conduct must be engaged in "voluntarily, consciously or

knowingly, and intentionally." *Fretz*, 490 F.3d at 921; *see Coney*, 689 F.3d at 374; *Tudisco*, 183 F.3d at 137; *Dalton*, 77 F.3d at 1302. All that is required is that "the debtor (1) had a duty to pay taxes under the law, (2) knew he had that duty, and (3) voluntarily and intentionally violated that duty." *Coney*, 689 F.3d at 374; *accord Gardner*, 360 F.3d at 558; *Fretz*, 490 F.3d at 921; *Fegeley*, 118 F.3d at 984; *Birkenstock*, 87 F.3d at 952.

Fraudulent intent is not required. *In re Mitchell*, 633 F.3d 1319, 1328 (11th Cir. 2011); *Fegeley*, 118 F.3d at 984. Neither is any showing that the debtor had "evil motive or bad purpose." *In re Ryan*, 286 B.R. 141, 148 (Bankr. W.D. Mo. 2002). The mental-state requirement "prevents the application of the exception to the debtors who make inadvertent mistakes." *Birkenstock*, 87 F.3d at 952. A debtor's business experience and sophistication is relevant to evaluating the mental-state requirement. *In re Vaughn*, 463 B.R. 531, 547-48 (Bankr. D. Colo. 2012), *aff'd*, 2013 WL 1324377 (D. Colo. 2013), *appeal pending*, No. 13-1189 (10th Cir.); *Hamm*, 356 B.R. at 283; *Peterson*, 317 B.R. at 562.

Trip argues (Br. 27) that a "specific intent to evade or defeat a tax" is required in order to satisfy the mental-state requirement. Trip's

argument is inconsistent with the above-stated standard that has been uniformly adopted by all circuits interpreting § 523(a)(1)(C). This argument was expressly rejected by the Fifth Circuit in *Coney*. 689 F.3d at 374 (rejecting debtor's assertion that her actions did not satisfy mental-state requirement because they were not taken "with the specific intent to evade or defeat . . . taxes"); *see also In re Geiger*, 408 B.R. 788, 792 (C.D. Ill. 2009) ("bad faith or specific fraudulent intent" not required under mental-state requirement).

The proposed amicus argues (A.Br. 19) that § 523(a)(1)(C) should be construed consistently with 26 U.S.C. § 7201 and, therefore, requires an affirmative act to evade or defeat taxes. Section 7201 makes it a felony for a person to "willfully attempt[] in any manner to evade or defeat any tax." The argument of the amicus has been rejected by those circuits considering it. *Bruner*, 55 F.3d at 200; *Toti*, 24 F.3d at 808; *see Fegeley*, 118 F.3d at 984; *Dalton*, 77 F.3d at 1300; *see also In re Hedgecock*, 160 B.R. 380, 384 (D. Or. 1993). In *Bruner*, the Fifth Circuit was "not convinced that the language of the Internal Revenue Code must be interpreted the same as that of the Bankruptcy Code," because "[b]oth are very complex regulatory schemes with careful balances of different and competing policies." 55 F.3d at 200. The

heightened level of proof implicated in a criminal tax-evasion statute, particularly a felony statute, is simply inapplicable to an exception to discharge in a bankruptcy case for a civil tax liability. *See Hedgecock*, 160 B.R. at 384; *cf. Bryan v. United States*, 524 U.S. 184, 191 (1998) ("The word 'willfully' is sometimes said to be a word of many meanings whose construction is often dependent on the context in which it appears. Most obviously it differentiates between deliberate and unwitting conduct, but in the criminal law it also typically refers to a culpable state of mind.") (citation and quotation marks omitted). And since the meaning of "willfully" is dependent on the context in which it appears (*Bryan*, 524 U.S. at 191), Trip's argument that "willfully" in § 523(a)(1)(C) should have the same meaning as "willful" in the § 523(a)(6) discharge exception for debts for "willful and malicious injury by the debtor" (Br. 29-32) is wide of the mark.

Here, the Bankruptcy Court correctly found that the mental-state requirement, as articulated by every circuit that has interpreted § 523(a)(1)(C), was satisfied with respect to Trip's conduct. Trip was an experienced and sophisticated businessman and investor. He purchased the FLIP and OPIS transactions in order to offset the gains from the sale of his EA stock and thereby avoid the tax on those gains.

His returns reported losses from those transactions vastly in excess of the relatively modest investments he made in them. The KPMG engagement letter signed by Trip and the opinion letters relating to the transactions stated only that the transactions would "more likely than not" be recognized. (SER 300-34, 336, 339-50.)

In March and July 2001, respectively, the FTB and IRS commenced their audits relating to the FLIP transaction. Also in July 2001, the IRS notified taxpayers that it would disallow losses arising from basis-shifting transactions. Nevertheless, on October 5, 2001, Trip signed the 2000 return claiming the loss from the OPIS transactions. (ER 75-76; SER 58-59, 82.)

By February 2002, Trip's attorneys had prepared computations of Trip's liabilities relating to the audits. (SER 411, 413.) In July 2002, Trip received the letter from the IRS stating that it had a "strong case" regarding the claimed losses, which were "not allowable." (ER 152.)

In short, by July 2002, Trip knew of the IRS's plans to disallow the losses and assess the resulting taxes, and the approximate amount of the taxes. With this knowledge, instead of reducing his spending and setting aside funds for payment of the taxes, Trip allowed debtors to

continue to maintain their two homes, their luxury cars and vacations, and their excessive monthly spending.

The evidence of mental state was even stronger during the period considered by the Bankruptcy Court, after the January 2004 child-support hearing when Trip acknowledged that he owed the taxes, the amount of the taxes, and his insolvency, and his attorney expressed Trip's intention to discharge the taxes in bankruptcy. (ER 38-40, 239; SER 200, 203, 204, 207.) This stated intention, however, was intentionally left out of the child-support-modification order (SER 160-68) to avoid any suggestion that the bankruptcy was filed in bad faith solely to discharge the tax liabilities. (SER 154-56, 157.) Moreover, although the Bankruptcy Court found that Trip objected to the requirement that he contribute additional funds to the support trust (ER 47), he consented to the joinder order entered "to further protect the trust's assets from a potential bankruptcy by Trip and/or claims by taxing authorities." (SER 179.) As correctly found by the Bankruptcy Court (ER 37-44), from the January 2004 child-support hearing through the September 2006 bankruptcy filing, Trip continued to exhibit the same excessive spending behavior, failed to reduce

spending, and even purchased a fourth car, thereby establishing his willful attempt to evade or defeat his tax liabilities.

CONCLUSION

For the foregoing reasons, the judgment of the District Court should be affirmed.

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STATEMENT OF RELATED CASES

Pursuant to Ninth Circuit Rule 28-2.6, counsel for the appellee state that they are unaware of any related cases pending in this Court.

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