No. 11-16276
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re: William M. Hawkins, III aka Trip Hawkins, Debtor,
William M. Hawkins, III aka Trip Hawkins, Appellant, v. United States of America, Internal Revenue Service, and the Franchise Tax Board, a Division of the Government of the State of California, Appellee.

On Appeal from the United States District Court
for Northern California, San Francisco
Case No. 10-CV-02026-JSW

United States Bankruptcy Court, Northern District of California
The Honorable Thomas E. Carlson, Judge
Case No.: 06-30815 TEC, Adversary Proceeding No.: 07-03139

APPELLANT'S BRIEF

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APPELLATE JURISDICTION

Mr. William Hawkins appeals the final judgment of the U.S. District Court for Northern California that affirmed the final judgment of the United States Bankruptcy Court of the Northern District of California in the adversary proceeding of *William M. Hawkins, III, et. al. v. The Franchise Tax Board, a Division of the Government of the State of California, et. al.*, adversary proceeding No. 07-3139 (the "Adversary Proceeding").

Mr. Hawkins, with his wife, Mrs. Lisa Hawkins, brought the Adversary Proceeding in their Chapter 11 bankruptcy case (Case No.: 06-30815-TEC, the "Bankruptcy Case") to have the Bankruptcy Court confirm that certain pre-petition tax obligations to the United States Internal Revenue Service (the "IRS") and the California Franchise Tax Board (the "FTB," together, the "Taxing Agencies") had been included in the discharge of their debts. The Adversary Proceeding was brought under the United States Bankruptcy Code, and the Bankruptcy Court had jurisdiction to enter a final judgment in the matter pursuant to 28 U.S.C. §157(b)(2)(I). *See also*, *Stern v. Marshall*, … U.S. …, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011).

The Bankruptcy Court entered its judgment on April 23, 2010, ruling that Mrs. Hawkins's taxes had been discharged, but that Mr. Hawkins's taxes had not (the "Judgment"). The Bankruptcy Court also issued a Memorandum of Decision

regarding the Judgment (the "Bankruptcy Opinion"). On May 3, 2010, Mr. Hawkins filed a timely Notice of Appeal from the Judgment. The District Court had jurisdiction over the appeal pursuant to 28 U.S.C. §158(a)(1), and by Mr. Hawkins's election under 28 U.S.C. §158(c)(1)(A).

The District Court issued its Order Affirming Judgment of Bankruptcy Court (the "District Court Opinion") on March 22, 2011, and Mr. Hawkins timely filed his Notice of Appeal of the District Court Opinion on May 19, 2011, pursuant to Federal Rule of Appellate Procedure 4(a)(1)(B). This Court has jurisdiction to hear this matter pursuant to 28 U.S.C. §158(d)(1).

QUESTIONS PRESENTED FOR REVIEW

1. The United States Bankruptcy Code Section 523(a)(1)(C)[1] provides that a debtor will be denied the discharge of a tax if he or she "willfully attempted in any manner to evade or defeat such tax." The plain meaning of this section requires that the debtor must have acted or failed to act with the *specific intent to evade or defeat* the tax. The Bankruptcy Court did not require proof of such intent when denying Mr. Hawkins the discharge of the IRS and FTB taxes. The District Court sustained the Bankruptcy Court's holding that: "unnecessary expenditures combined with the non-payment of a known tax constitutes a willful attempt [to

[1] All references to statutes are to the United States Bankruptcy Code unless otherwise identified.

evade or defeat a tax] under Section 523(a)(1)(C)."[2] Did the District Court err when it adopted this legal standard and sustained the Bankruptcy Court's Judgment?

2. To determine whether a debtor acted with the specific intent to evade or defeat a tax under Section 523(a)(1)(C), a bankruptcy court may examine the totality of the circumstances. The Bankruptcy Court here did not find that Mr. Hawkins took any particular action for the purpose of deceiving the Taxing Agencies, concealing assets or by otherwise "evading or defeating" the taxes.[3] Rather, the Court denied the tax discharge based on Mr. Hawkins's pre-petition "earned" income, "unnecessary spending," "business sophistication," knowledge of the tax, and the timing of the bankruptcy petition.[4] Did the District Court err in confirming the Bankruptcy Court's finding that Mr. Hawkins willfully attempted to evade or defeat the taxes of the IRS and the FTB?

3. Did the District Court err in confirming the Bankruptcy Court's finding that Mr. Hawkins spent assets to the detriment of the Taxing Agencies when the Bankruptcy Court had not considered the evidence of Mr. Hawkins's efforts to maximize his assets and reduce spending?

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[2] Excerpt. Pg. 35. Bankruptcy Opinion, Pg. 14, Ln. 9-14; District Court Opinion, Pg. 8, Ln. 21-25.

[3] The Court declined to rule on the Taxing Agencies' claim of fraudulent return and that claim is not before this court.

[4] Excerpt. Pg. 50. Bankruptcy Opinion, Pg. 29.

4. Did the District Court err in finding that the factual errors that were made by the Bankruptcy Court were not material?[5]

STANDARD OF REVIEW AND REVIEWABILITY

The first issue challenges the legal standard that the Bankruptcy Court and the District Court applied when finding that Mr. Hawkins's taxes were not included in his discharge. This is a question of law and must be reviewed by the Court *de novo*. *Cal. Franchise Tax Bd. v. Jackson (In re Jackson)*, 184 F.3d 1046, 1050 (9th Cir. 1999). This issue is subject to review by this Court as it was one of the central elements of the appeal to the District Court; it is discussed in the District Court Opinion on pages 4 through 8.

The second, third and fourth issues challenge the Bankruptcy Court's and the District Court's application of the legal standard to the facts to determine the discharge of the taxes.[6] The second issue, which addresses the question of dischargeability of a debt, is a mixed question of fact and law that is also reviewed *de novo*. *Cal. Franchise Tax Bd. v. Kendall et al. (In re Jones)*, 657 F.3d 921 (9th

[5] The issues have been restated for clarity and brevity.

[6] In the appeal below, the District Court acknowledged that the Bankruptcy Court made several errors in its factual findings. Only the inferences to be drawn from the facts, as corrected, are at issue. Excerpt. Pg. 11-14. District Court Opinion, Pg. 9-12.

Cir. 2011).[7] These issues are subject to review by this Court as they were raised before the Bankruptcy Court and the District Court.

Specifically, the second issue, which challenges the Bankruptcy Court's denial of the tax discharge without finding actions that were taken with the specific intent to evade or defeat the tax, is addressed at pages 12 through 16 of the District Court's Opinion. The third issue, regarding the Bankruptcy Court's error in failing to consider Mr. Hawkins's efforts to preserve assets and reduce spending, was raised below and is discussed at page 12 of the District Court's Opinion. Contrary to the District Court's finding that the issue had not been raised before the Bankruptcy Court, it was a central theme at trial--discussed in the trial brief, in argument, and in testimony. The question was properly before the District Court, and is properly before this Court. The fourth issue, regarding the materiality of the Bankruptcy Court's errors, is discussed at pages 8 through 12 of the District Court's Opinion, and is properly before this Court.

STATEMENT OF THE CASE AND PROCEEDINGS BELOW

Mr. and Mrs. Hawkins filed their bankruptcy petition in September of 2006 because they could not pay the $36 million in additional taxes, interest, and penalties that the IRS and the FTB assessed the year before (collectively, the

[7] Only the WestLaw citation is currently available.

"Additional Taxes").[8] These assessments were made after Mr. and Mrs. Hawkins agreed to the IRS's proposed disallowance of certain losses from two complex investment products that they had purchased in the late 1990's.[9] These are the only taxes at issue.

By filing under Chapter 11 of the Bankruptcy Code, Mr. and Mrs. Hawkins were able to negotiate a consensual plan of reorganization with the Taxing Agencies (the "Plan"). By the time of the trial below, the Taxing Agencies had received approximately $21 million of the taxes, largely through the Hawkins's bankruptcy and Plan. The Bankruptcy Court confirmed the Plan in July 2007, and granted Mr. and Mrs. Hawkins their discharges under Bankruptcy Code Section 1141.

In October of 2007, Mr. and Mrs. Hawkins filed the Adversary Proceeding asking the Bankruptcy Court to confirm that their discharges included the claims for Additional Taxes filed by the Taxing Agencies. After a three-day trial, Bankruptcy Judge Thomas E. Carlson entered the Judgment that Mrs. Hawkins's obligation to pay the Additional Taxes was discharged but that Mr. Hawkins's obligation was not.

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[8] Excerpt. Pg. 79-81. Joint Pre-Trial Conference Statement ("Stipulated Facts"), No's. 48, 50-52, 60-63, 68 and 72.
[9] Excerpt. Pg. 392; Pg. 384; Pg. 80. The Plan. Pg. 16, Ln. 6-14; Pg. 8, Ln. 24; Stipulated Facts #64-66.

The Taxing Agencies accepted the Judgment regarding Mrs. Hawkins. Mr. Hawkins appealed the Judgment that denied the discharge of his taxes to the District Court. The District Court upheld the Bankruptcy Court's Judgment, and Mr. Hawkins now appeals that decision to this Court.

STATEMENT OF FACTS

1. By the end of 2003, Mr. Hawkins had lost $90 Million in the failure of the 3DO Company.

Mr. Hawkins was one of the founders of Electronics Arts ("EA"), which became one of the world's largest video-game publishers.[10] He also helped create The 3DO Company ("3DO"), another computer game company, which went public in 1993.[11] By 1996, Mr. Hawkins had a net worth of over $92 Million.[12] Mr. Hawkins believed he could make 3DO as successful as EA,[13] and by 2001, Mr. Hawkins had sold almost all of his stock in EA to invest the proceeds in 3DO.[14] Even though 3DO had revenue of over $100 million in 2000, and its new game "High Heat Baseball" was forecast to be a great success, it was unable to secure

[10] Excerpt. Pg. 75. Stipulated Facts #4-6.
[11] Excerpt. Pg. 24; Pg. 340. Bankruptcy Opinion, Pg. 3, Ln. 4-5; Second Amended Disclosure Statement, Pg. 4, Ln. 11-13.
[12] Excerpt. Pg. 257. Transcript of January 12, 2004, hearing ("Family Court Transcript"), Pg. 99, Ln. 4-9.
[13] Excerpt. Pg. 340; Pg. 150, Pg. 149. Second Amended Disclosure Statement, Pg. 4, Ln. 14; Trial Transcript ("Hawkins Testimony"), Pg. 482, Ln. 1-24; Pg. 481, Ln. 15-25.
[14] Excerpt. Pg. 261-264; Pg. 340; Pg. 24, Pg. 27. Chart of Hawkins 3DO Investment; Second Amended Disclosure Statement, Pg. 4, Ln. 15-17; Bankruptcy Opinion, Pg. 3, Ln. 4-5; Pg. 6, Ln. 14-16.

further independent financing.[15] In an effort to save the company, and his investment, Mr. Hawkins loaned it an additional $12 million, $4 million of which he borrowed against his home (the "3DO Loan").[16]

3DO could not be saved, and it filed bankruptcy in 2003.[17] That filing led to two lawsuits against Mr. Hawkins individually, one by the bankruptcy trustee and one by a group of investors in 3DO.[18] The bankruptcy trustee claimed, among other things, that Mr. Hawkins should not have allowed 3DO to borrow the money; the investors claimed that he should have continued to invest in it.[19] Both suits were intensely litigated, including one appeal.[20] Though Mr. Hawkins settled both actions without having to pay more, the process was expensive and required him to effectively waive all of his claims against the 3DO bankruptcy estate.[21]

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[15] Excerpt. Pg. 150; Pg. 139. Trial Transcript ("Hawkins Testimony"), Pg. 482, Ln. 6-10; Pg. 389, Ln. 9-18.
[16] Excerpt. Pg. 23, 27; Pg. 138, 149. Bankruptcy Opinion, Pg. 2, Pg. 6, Ln. 17-20; Trial Transcript ("Hawkins Testimony"), Pg. 387, Ln. 5-21; Pg. 481, Ln. 19-25; See also Excerpt. Pg. 261-264. Chart for 3DO Investment.
[17] *In re: 3DO*, U.S. Bankruptcy Court Northern District of California, Case No. 03-31581.
[18] Excerpt. Pg. 58. Plaintiff's Trial Brief, Pg. 3, Ln. 14-18.
[19] Excerpt. Pg. 270, 275. Memorandum of Points and Authorities re: 3DO's Trustees Motion to Approve Settlement ("3DO's Settlement") Pg. 2, Ln. 26-27; Pg. 7, Ln. 14-19.
[20] Excerpt. Pg. 58. Plaintiff's Trial Brief, Pg. 3, Ln. 14-18.
[21] The settlement agreement required Hawkins to subordinate his claims, but since the senior claims could not be paid in full, it was effectively a waiver.

2. Mr. and Mrs. Hawkins worked with the IRS to try to resolve the possible taxes, both before and after they were assessed.

While Mr. Hawkins was forming and supporting 3DO, he was also receiving investment advice from KPMG, LLC ("KPMG").[22] KPMG sold Mr. and Mrs. Hawkins's two investments – one called Foreign Leveraged Investment Portfolio ("FLIP") and a second called Offshore Portfolio Investment Strategy ("OPIS").[23] These investments were complicated and resulted in Mr. and Mrs. Hawkins reporting substantial losses for the tax years 1996 through 2000.[24]

In 2001 the IRS began examining transactions that included "basis shifting," similar to FLIP and OPIS.[25] The IRS offered two different programs to taxpayers who had been sold these products and who had underpaid taxes as a result.[26] The first program provided that the IRS would waive certain penalties that resulted from underpayment of taxes because of the investments if the taxpayer disclosed the transaction. The second program allowed the taxpayer to keep the benefit of 20% of the "basis shift" and to claim 20% of the related transaction costs in exchange for conceding the remainder.[27] Mr. and Mrs. Hawkins asked to participate in both of the programs. The IRS accepted Mr. and Mrs. Hawkins's

[22] Excerpt. Pg. 340. Second Amended Disclosure Statement, Pg. 4, Ln. 21-22.
[23] Excerpt. Pg. 24; Pg. 57-58. Bankruptcy Opinion, Pg. 3; Plaintiff's Trial Brief, Pg. 2-3, Ln. 27-28.
[24] Excerpt. Pg. 34; 25. Bankruptcy Opinion, Pg. 13, Ln. 4-5; Pg. 4, Ln. 14-26.
[25] Excerpt. Pg. 76. Stipulated Facts #16.
[26] Excerpt. Pg. 76. Stipulated Facts #21.
[27] Excerpt. Pg. 77. Stipulated Facts #31-34.

disclosure of the "basis-shifting" transactions from 1998, waiving penalties for the years affected, but would not accept the disclosure of the earlier transactions.[28] Mr. and Mrs. Hawkins were not allowed to participate in the second program simply because the statute of limitation for the earliest tax year was closed.[29]

When, in 2003, the IRS agent handling the audit of Mr. and Mrs. Hawkins's taxes issued a proposal regarding his findings, he did not propose any fraud penalty,[30] and included "accuracy related" penalties only for the FLIP transactions.[31] The IRS did not assess the Additional Taxes until March of 2005—three months after Mr. and Mrs. Hawkins accepted the proposed tax, and almost four years after the IRS started its inquiry.[32] The FTB waited to assess its taxes until July of 2005.[33] Neither Taxing Agency imposed fraud penalties on Mr. and Mrs. Hawkins.

Only after the taxes had been assessed were Mr. and Mrs. Hawkins allowed to

[28] Excerpt. Pg. 76. Stipulated Facts #21-23. Mr. and Mrs. Hawkins's extensive communication with the IRS are reflected in the Record. See Excerpt. Pg. 152-198.
[29] Excerpt. Pg. 77; Pg. 123-124. Stipulated Facts #35; Trial Transcript ("Barrett Testimony"), Pg. 71, Ln. 15-18; Pg. 72, Ln. 2-6.
[30] Excerpt. Pg. 78; Pg. 125. Stipulated Facts #40; Trial Transcript ("Barrett Testimony"), Pg. 91, Ln. 24-25.
[31] Excerpt. Pg. 78. Stipulated Facts #40.
[32] Excerpt. Pg. 79. Stipulated Facts #47-52.
[33] Excerpt. Pg. 80. Stipulated Facts #60-63. Mr. and Mrs. Hawkins had to ask the FTB to assess the tax.

make an "offer in compromise" to the IRS to try to settle their liability.[34] In 2006, Mr. and Mrs. Hawkins presented the IRS with an offer,[35] which it rejected.[36] The rejection was apparently based on the IRS's valuation of unvested options in a start-up company called Digital Chocolate at $13 million, when they were actually worth nothing. The IRS also did not acknowledge that Mr. and Mrs. Hawkins already owed over $12 million to the FTB.[37] The IRS's response to Mr. and Mrs. Hawkins's offer contained no counteroffer. It claimed that they were solvent and demanded an immediate $24 million cash payment.[38]

3. Faced with tremendous losses and possible tax liability, Mr. and Mrs. Hawkins reduced costs and preserved assets.

A. Mr. and Mrs. Hawkins Reduce Costs

Faced with the tremendous losses from the 3DO bankruptcy, the expensive resulting litigation, and the threats of the Additional Taxes, Mr. and Mrs. Hawkins began aggressive efforts to reduce their most significant costs and to maximize assets. In 2003, two of Mr. Hawkins's largest expenses were maintaining a private

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[34] Generally the Internal Revenue Service will not consider an offer in compromise for taxes that have not been assessed, *Internal Revenue Manual 5.8.1.4*. http://www.irs.gov/irm/part5/irm_05-008-001.html.
[35] Excerpt. Pg. 80. Stipulated Facts #66. Excerpt. Pg. 224-227. Offer in Compromise ("OIC").
[36] Excerpt. Pg. 224-227. Offer in Compromise.
[37] Excerpt. Pg. 228-231. IRS letter re: OIC. Excerpt. Pg. 293. Bankruptcy Schedules, Pg. 9 showing Digital Chocolate as unvested options.
[38] Excerpt. Pg. 228-231. IRS letter re: OIC plus enclosures/worksheets.

jet he had purchased in 2000[39] and paying court-ordered support obligations to his ex-wife of $194,000 per year.[40] In the summer of 2003, Mr. Hawkins sold the jet and filed a petition with the San Mateo Superior Court to reduce the support payments (the "Family Court Proceeding").[41] The effort was only partly successful.

Diana Hawkins, Mr. Hawkins's ex-wife, refused to acknowledge his changing financial situation and demanded that he continue paying the amount agreed upon when he was worth over $90 million.[42] The Family Court judge in the matter was primarily concerned about the children. He stated: "because of current [financial] uncertainties and . . . [because] the children have become accustomed to a certain lifestyle, this should not change until the picture is clear."[43] The uncertainty existed, in part, because neither Taxing Agency had yet assessed its taxes, though the IRS had suggested a specific amount.[44] There was great doubt about whether Mr. and Mrs. Hawkins would be forced into bankruptcy, and what

[39] Excerpt. Pg. 136, 137. Trial Transcript ("Hawkins Testimony"), Pg. 376, Ln. 4-7; Pg. 378, Ln. 4-9.
[40] Excerpt. Pg. 128. Trial Transcript ("Miller Testimony"), Pg. 294, Ln. 13-15.
[41] Excerpt. Pg. 78; Pg. 142. Stipulated Facts # 41; Trial Transcript ("Hawkins Testimony"), Pg. 424, Ln. 11-15.
[42] Excerpt. Pg. 239; Pg. 60; Pg. 78. Memorandum in Support of Petition to Modify Child Support, Pg. 3, Ln. 2-6; Plaintiff's Trial Brief (Including Steve Blanc Declaration), Pg. 5, Ln. 5-7; Stipulated Facts #41.
[43] Excerpt. Pg. 259-260. Family Court Judge Tentative letter Ruling. This tentative ruling was discussed in detail at the trial. Excerpt. Pg. 129-131. Trial Transcript ("Miller Testimony"), Pg. 307-309.
[44] Excerpt. Pg. 78. Stipulated Facts #41.

would happen if they had to file.[45] Mr. Hawkins believed that he would be able to avoid bankruptcy through negotiation with the Taxing Agencies.[46] In January 2004, the Family Court judge reduced Mr. Hawkins's annual support obligation to $30,000, but ordered Mr. Hawkins to immediately pay $750,000 into a trust for the children.[47]

Mr. and Mrs. Hawkins also reduced their personal spending. They fired the family's full-time domestic staff,[48] reduced the hours of the remaining nanny and an occasional gardener,[49] and stopped taking expensive vacations.[50] In 2006, Mr. and Mrs. Hawkins sold their home, yielding approximately $6.5 million to the IRS.[51] The Hawkins family then moved to a rented house.[52]

B. Mr. and Mrs. Hawkins Preserve Assets.

Throughout this time, Mr. Hawkins worked diligently to preserve their assets. In early 2003, in an effort to save his investment in 3DO, Mr. Hawkins loaned the

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[45] Excerpt. Pg. 258. Family Court Transcript ("Lee Schultz Testimony"), Pg. 142, Ln. 1-6, and Ln. 13-22. The expert for Diana Hawkins claimed that although the tax obligation "looked bleak," "it ain't over 'til it's over," and that "as of December 8, 2004 [Mr. Hawkins] did not owe taxes" because there had been no Notice of Deficiency."

[46] Excerpt. Pg. 132, Pg. 133. Trial Transcript ("Miller Testimony"), Pg. 325, Ln. 8-23; Pg. 326, Ln. 6-11.

[47] Excerpt. Pg. 79. Stipulated Facts #46; Family Court Judge's Tentative letter ruling.

[48] Excerpt. Pg. 149. Trial Transcript ("Hawkins Testimony"), Pg. 481, Ln. 2-14.

[49] *Id.*

[50] Excerpt. Pg. 148. Trial Transcript ("Hawkins Testimony"), Pg. 479, Ln. 14-20.

[51] Excerpt. Pg. 81. Stipulated Facts #70

[52] Excerpt. Pg. 143. Trial Transcript ("Hawkins Testimony"), Pg. 436, Ln. 2-13.

company an additional $9 million secured by a lien on its intellectual property.[53] The IRS asserts in retrospect that this additional loan was irresponsible. At the time, however, Mr. Hawkins felt that it was the only way for him to save the company and his extraordinary investment.[54]

Mr. and Mrs. Hawkins also held interests in various venture-capital partnerships, some of which required significant additional funding in order to maintain the partnership interest.[55] Throughout this time, Mr. Hawkins closely analyzed whether partnership interests should be sold or should be funded.[56] One partnership that he maintained resulted in significant payments from investments in Google and Netflix.[57]

In July of 2005, after the Additional Taxes were assessed, Mr. Hawkins filed a suit against KPMG to recover damages from the FLIP and OPIS transactions,[58] and subsequently joined in a class action lawsuit against KPMG ("KPMG Class Action Lawsuit").[59] Even though that action became property of Mr. and Mrs. Hawkins's

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[53] Excerpt. Pg. 261-264. Chart of Hawkins 3DO Investment.
[54] Excerpt. Pg. 149, Pg. 150. Trial Transcript ("Hawkins Testimony"), Pg. 481, Ln. 19-25; Pg. 482, Ln. 1-3.
[55] Excerpt. Pg. 145, 147; Pg. 391-392. Trial Transcript ("Hawkins Testimony"), Pg. 441, Ln. 7; Pg. 445, Ln. 8; The Plan, Pg. 15-16, List G.
[56] *Id.*
[57] Excerpt. Pg. 145, Pg. 146. Trial Transcript ("Hawkins Testimony"), Pg. 441, Ln. 1-17; Pg. 442, Ln. 1-22.
[58] Excerpt. Pg. 79. Stipulated Facts #56.
[59] Excerpt. Pg. 79-80. Stipulated Facts # 56-59.

bankruptcy estate, and subsequently property of the trust created for the Taxing Agencies, Mr. Hawkins continued to prosecute it.[60]

4. The IRS refused to settle and forced Mr. and Mrs. Hawkins into Bankruptcy.

The hoped-for settlement with the Taxing Agencies never materialized.[61] Mr. and Mrs. Hawkins had no option other than to file for Bankruptcy under Chapter 11, which they did on September 8, 2006. As part of the bankruptcy, Mr. and Mrs. Hawkins filed detailed Schedules and a Statement of Financial Affairs listing all assets and potential assets available.[62]

The IRS and FTB took advantage of the bankruptcy to negotiate the Plan of reorganization between the IRS, the FTB, and Mr. and Mrs. Hawkins, which created an irrevocable trust for the benefit of the Taxing Agencies (the "Tax Trust").[63] With Mr. Hawkins's assistance, the Tax Trust completed the applications needed in the pending KPMG Class Action Lawsuit to expand recovery for the IRS.[64] The Tax Trust also managed assets that were not freely

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[60] Excerpt. Pg. 416-440. Claim letters in KPMG, FLIP and OPIS Class Actions. Under the Plan Mr. Hawkins had no duty to continue to prosecute the case for the Taxing Agencies benefit.
[61] Excerpt. Pg. 134, Pg. 135. Trial Transcript ("Miller Testimony"), Pg. 335, Ln. 8 - Pg. 336, Ln. 10.
[62] Excerpt. Pg. 285-317. Bankruptcy Schedules and Statement of Financial Affairs.
[63] Excerpt. Pg. 385. The Plan, Pg. 9, Ln. 5-22.
[64] Excerpt. Pg. 416-440. Claim letters in KPMG, FLIP, and OPIS Class Actions. The reference in the Bankruptcy Opinion of the $3.4 million payment to the IRS

marketable and could never have been effectively transferred to the Taxing Agencies.[65] Finally, the Plan also required Mr. and Mrs. Hawkins to borrow an additional $500,000 for immediate payment to the Taxing Agencies, plus an additional $270,565 to buy back their personal property.[66] Had the Taxing Agencies thought that more money was available from Mr. and Mrs. Hawkins in the foreseeable future, they could have demanded it through the Plan. Both the IRS and FTB signed the Plan and it was confirmed in 2007. The Court granted Mr. and Mrs. Hawkins their discharges in October 2007.[67]

By the time of the trial, the Taxing Agencies had received over $21 million of the Additional Taxes.[68] Notwithstanding this, the IRS and the FTB refused to accept that the Additional Taxes discharged through the Plan. This forced Mr. and Mrs. Hawkins to bring the Adversary Proceeding in the Bankruptcy Court.

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did not include this, and stated there was "no evidence of the amounts paid. (Excerpt. Pg. 32. Bankruptcy Opinion, Pg. 11, Ln. 12-13). In fact, detailed evidence was submitted in the reports from the trustee for the Tax Trust. Excerpt. Pg. 399. Uecker Report. Pg. 1.

[65] Excerpt. Pg. 318-332; Pg. 391. Schedule B, The Plan, Pg. 15.

[66] Excerpt. Pg. 392, Pg. 384. The Plan, Pg. 16, Ln. 6-14; Pg. 8, Ln. 24.

[67] Excerpt. Pg. 392. The Plan, Pg. 16, Ln. 17-18.

[68] Excerpt. Pg. 81. Stipulated Facts #70: Atherton Home sells for $6.5 Million paid to IRS; Stipulated Facts #83: Plan Payments to IRS $5.23 Million; Stipulated Facts #73: La Jolla Property sells for $3.5 Million, paid to IRS. (The Bankruptcy Court only mentions the payment through the Plan. Excerpt. Pg. 31. Bankruptcy Opinion, Pg. 10, Ln. 14-Pg. 11, Ln. 14.)
The FTB also received $5.8 million through a levy before the bankruptcy Stipulated Facts # 71. No one has ever claimed that Hawkins interfered with any collection efforts or moved assets.

SUMMARY OF ARGUMENT

The Bankruptcy Court denied Mr. Hawkins the discharge of more than $15 million of his obligation to the Taxing Agencies after they had received $21 million, largely through Mr. Hawkins's efforts. The Bankruptcy Court, however, did not find that Mr. Hawkins committed fraud, filed false returns, or failed to file returns. Nor did it find that he intended to conceal assets, deceive the Taxing Agencies, or interfere with collection activity. The judgment is based instead on the Bankruptcy Court's opinion that Mr. Hawkins engaged in "unnecessary" spending when he knew he owed taxes he could not pay.

The decision relies on Bankruptcy Code Section 523(a)(1)(C), which provides that the discharge of a debtor's obligation will not include tax debts "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) (Emphasis added). The initial question for this Court is whether a debtor's "willful attempt to evade or defeat" a known tax occurs when a debtor engages in spending deemed "unnecessary" by a Bankruptcy Court, without regard to the debtor's actual intent in paying the expenses or whether, as is mandated by the language of the statue, a tax cannot be excepted from discharge unless the debtor is shown to have acted with a specific intent to evade or defeat it.

The Ninth Circuit Court of Appeal has ruled that, in order to establish that debtor filed a fraudulent return under the first part of the sentence in the statute, the debtor must be shown to have committed civil fraud. That, in turn, requires proof of specific intent to evade or defeat the tax. *See*, *McKay v. United States*, 957 F.2d 689, 691 (9th Cir. 1992). Though this Circuit has not yet interpreted the second part of the sentence, its plain language similarly describes that the debtor must act with specific intent. Put simply, the word "willfully" is an adverb meaning "intentionally," which *modifies* the verb "attempt," which means to try to do something. Thus, the plain meaning of the section is that the debtor must be shown to have intentionally tried to evade or defeat the tax before it may be excepted from the debtor's discharge.

This interpretation is consistent with the rest of Bankruptcy Code Section 523, which sets out specific debts that are excepted from discharge. Most excepted debts, such as family support obligations, are narrowly described and are not related a debtor's intent at all. The debts that do depend on a debtors intent, however, all require that the debtor have acted with the specific intent to cause the described damage, or expressly refer to reckless acts.

The Bankruptcy Court and District Court ignored the plain meaning of Section 523(a)(1)(C) when they did not require the Taxing Agencies to prove that Mr. Hawkins took some act with the specific intent to evade or defeat the

Additional Taxes. Neither opinion was based on the plain meaning of the statute. Instead, both relied on a series of decisions that read the word "willfully" in the section as requiring only proof that the debtor intentionally did not pay a known tax (called the "willfulness" portion) and took some kind of "culpable action or inaction" to avoid payment or collection of a tax (called the "conduct" portion). Though this interpretation divides the word "willfully" from the phrase it modifies, it still suggests the debtor must have acted with the specific intent to evade or defeat the taxes.

The cases applying this interpretation devolve into a series that states that a debtor's failure to pay a known tax becomes evasion, and thus the tax non-dischargeable, when the court determines he or she made "unnecessary" expenditures, no matter what the debtor's actual intent with respect to the payment of taxes might have been. Neither the decisions below, nor the cases on which they rely, explain why the plain meaning of the statute justifies separating the adverb "willfully" in the statute from the clause it modifies: "attempts. . . to evade or defeat." They provide no authority for replacing a debtor's subjective intent with a judge's assessment of whether a debtor's pre-petition spending is necessary or "appropriate." Nor does anything in the Bankruptcy Code require debtors to reduce spending to some "necessary" level as a condition for discharging their taxes.

If these cases are allowed to stand, no debtor can be assured of discharging a known tax even when there has been no action taken with the intent of evading or defeating them. This is not required by the statute or by the Bankruptcy Code. Because the courts below applied the wrong standard in denying Mr. Hawkins's discharge, their decisions must be reversed.

Finally, the facts presented to the trial court, including the facts showing Mr. Hawkins's efforts to protect his assets and increase the recovery to the Taxing Agencies, cannot support a conclusion that he is guilty of any act or omission with the specific purpose of evading or defeating a tax. The facts themselves are not disputed. The Bankruptcy Court made several substantial errors in its findings, which errors the District Court acknowledged. Because these errors were so large, they must be considered to have been material in the Bankruptcy Court's assessment of Mr. Hawkins's behavior. Even with these errors, however, the Bankruptcy Court did not find that Mr. Hawkins's spending was done for the purpose of evading taxes.

In the stipulation to facts for trial, the Taxing Agencies acknowledged that they received $21 million of the Additional Taxes. They did not deny that all of the payments, with one exception, were the result of Mr. and Mrs. Hawkins's voluntary actions, including creating the Tax Trust for the benefit of Taxing Agencies. When all of the accepted facts are considered, there is no basis for

finding that Mr. Hawkins intended to evade or defeat the Additional Taxes. The judgment of the Bankruptcy Court should be reversed.

ARGUMENT

1. When a taxing agency challenges the discharge of a tax under Section 523(a)(1)(C) and there is no fraudulent tax return, it must prove that the debtor acted or failed to act with the specific purpose of evading or defeating the tax.

A. This case of statutory interpretation is one of first impression for the 9th Circuit.

Section 523(a)(1)(C) of the Bankruptcy Code provides that certain tax debts are excepted from a debtor's discharge. It states:

> (a) A discharge under section 1141 … of this title does not discharge an individual debtor from any debt –
>
> (1) for a tax or customs duty
> . . .
> (C) with respect to which the debtor made a fraudulent return or *willfully attempted in any manner to evade or defeat such tax*, ...

(Emphasis added.)

The Ninth Circuit has not interpreted the meaning of "willfully attempted in any manner to evade or defeat," in the second half of the phrase, but has held that in order to except taxes from discharge because a debtor filed a "fraudulent return" under the first half of the phrase, the government must prove that the debtor is guilty of civil fraud. *McKay v. U.S.*, *supra*, 957 F.2d 689, 691. A panel in this Circuit held that "fraud" in the context of a tax obligation implies bad faith,

intentional wrongdoing, and a sinister motive, and that to prove a taxpayer guilty of civil fraud requires proof of specific intent to evade the tax. *Hongsermeier v. Comm'r, supra*, 621 F.3d 890, 902. When this Court applies the rules of statutory interpretation to the second half of the phrase in Section 523(a)(1)(C), it should find that a specific intent to evade or defeat a tax also must be found in order to deny the discharge of a debtor's taxes under this provision.

B. The plain meaning of the statute requires that the taxing agency must prove that debtor acted with the specific intent of evading or defeating the tax.

Statutory interpretation begins with the plain meaning of the statute's language. *Bonner Mall Partnership v. U.S. Bancorp Mortgage Co. (In re Bonner Mall Partnership)*, 2 F.3d 899, 908 (9th Cir 1993). When language is clear and is consistent with the statutory scheme at issue, the judicial inquiry is complete. *Id.* This Circuit holds strictly to the cannon of reading words in their ordinary meaning. In *McKay v. U.S., supra*, 957 F.2d 689, 694, the Court held that Bankruptcy Code Section 523(a)(7)(A) preserves discharge for penalties on taxes older than three years even when the underlying tax is excepted, contrary to suggestions in legislative history. Section 523(a)(1)(C) excepts a tax obligation from discharge when the debtor "willfully attempted" in any manner to "evade or defeat the tax." Examining the plain meaning of these words leads only to the

conclusion that a debtor must act for the specific purpose of evading or defeating the tax in order to lose the tax discharge under this statute.

First, the debtor must "willfully attempt" to evade or defeat a tax. "Willful" is an adverb – it modifies "attempt to….". "Willful" means done deliberately or intentionally. (http:www.merriam-webster.com/dictionary/willfully.) "Attempt" means "to make an effort to do, accomplish, solve or effect." (http://www.meriam-webster.com/dictionary/attempt, *(emphasis added.)*) Thus, "willfully attempt" means to intentionally make an effort to achieve a goal--here the goal to evade or defeat a tax. To say that one can make an effort to accomplish a goal without intending that the effort result in the goal defies logic. Yet, that is exactly what the Bankruptcy and District Courts ruled in their interpretation of the statute.[69]

The mandate for finding that the debtor acted with the specific intent to evade or defeat the tax is further reflected in the phrase "evade or defeat." The relevant definition of "evade" is "to elude by dexterity or stratagem" (http://www.meriam-webster.com/dictionary/evade.) The relevant definition of "defeat" is to "nullify or frustrate." (http://www.meriam-webster.com/dictionary/defeat.) Both words incorporate acting with a particular

[69] Excerpt. Pg. 10. See e.g. District Court Opinion, Pg. 8, Ln. 14-24 describing that making unnecessary expenditures "even without fraud or evil motive" – where there is no specific intent to evade or defeat a tax-"constitutes willful attempt" under Section 523(a)(1)(C). (Citing *Lynch v. United States (In re Lynch)*, 299 B.R. 62, 64 (Bankr.S.D.N.Y. 2003)).

goal. Finally, the phrase "evade or defeat a tax" cannot mean non-payment of the tax or the actual bankruptcy filing, for such interpretation would effectively make all known taxes non-dischargeable. *See e.g. Tudisco v. U.S. Dep't of Treasury (In re Tudisco)*, 183 F.3d 133, 136 (2nd Cir. 1999) and cases cited therein.

C. This interpretation is consistent with the rest of the statute.

The Supreme Court's review of another subsection of Section 523 confirms the reading of subsection 523(a)(1)(C) as requiring specific intent to evade or defeat the tax. Bankruptcy Code Section 523(a)(6) excepts debts "for willful and malicious injury from discharge." The U.S. Supreme Court in *Kawaauhau v. Geiger*, 523 U.S. 57, 118 S.Ct. 974, 140 L.Ed.2d 90 (1998), considered whether the exception included debts for injuries caused by intentional acts, no matter what their purpose, or was limited to acts taken with the specific intention of causing the injury. *Id*. at 61-62. The Court notes that the definition of willful is "voluntary or intentional." *Id*. at 61 ln. 3, citing Black Law Dictionary 1434 (5th Ed 1979). The Court notes that the word "willful" *modifies* the word injury, and that:

> [h]ad Congress meant to exempt debts resulting from unintentionally inflicted injuries, it might have described instead "willful acts that cause injury." Or, might have selected . . . "reckless" or "negligent" to modify "injury."

Id.

Though "willfully" modifies a different phrase in Section 523(a)(1)(C), the use of the word is the same. Under the basic cannon of statutory interpretation, a

word is presumed to bear the same meaning throughout a statute, particularly when used in the same section. *Mohasco Corp v. Silver*, 447 U.S. 807, 818, 100 S.Ct. 2486, 65 L.Ed.2d 532 (1980).

Here, "willfully" modifies "attempted to evade or defeat such tax," thus meaning an action taken for the purpose of attempting to evading or defeat the tax. If the statute had been written to exclude all taxes that a debtor intentionally did not pay, it could have said "willfully did not pay," or "willfully refused to pay." Similarly, if it had been written to exclude taxes where the debtors should have known the questioned action would result in non-payment of a tax, even where that was not the intent, it could have excepted from discharge taxes where the debtor's "willful and reckless action resulted in nonpayment of known taxes."

The interpretation is also consistent with the remainder of the statute. There are nineteen specific exceptions to a debtor's discharge set forth in Section 523 of the Bankruptcy Code. Fourteen of these narrowly-defined obligations are not discharged no matter what the debtor's intent might have been.[70] The remaining

[70] The identified obligations are: taxes incurred during the "gap" period of an involuntary bankruptcy or with a particular time before the petition, or for which no return was filed (§523(a)(1)(A) & (B)); debts not scheduled timely (§523(a)(3)); debt for domestic obligations (§523(a)(5)); certain fines, penalties or forfeitures (§523(a)(7)); debts relating to education loans (§523(a)(8)); debts relating to damages for certain personal injuries (§523(a)(9)); certain debts that debtor had previously discharged (§523(a)(10)); criminal restitution (§523(a)(13)); debts incurred to pay non-dischargeable tax (§523(a)(14)(14a)); fines regarding election law (§523(a)(14)(B); family support (§523(a)(15)); condominium fees

five non-dischargeable debts, with one partial exception, require that the debtor have acted with specific intent to deceive or injure another. Subsection (a)(2) relates to debts "to the extent obtained by false representations or actual fraud," and written statements that were materially false and that the debtor used "with the intent to deceive." Subsection (a)(4) relates to "fraud, defalcations while acting in a fiduciary capacity, embezzlement or larceny." Subsection (a)(6) relates to "willful and malicious injury." Subsection (a)(11) relates to a judgment from fraud or defalcation as a fiduciary in connection with a depository institution. Last, Subsection (a)(12) of the statute relates to "malicious or reckless failure" to fulfill specific commitments to the FDIC. The use of the word "reckless" in this last subsection is the only limited statement of intention in the entire section.

Given that the focus of these exceptions to discharge is on the debtor's acting with an intent to deceive or injure another, reading the phrase "willfully attempt in any manner to evade or defeat" as requiring an action taken with the specific intent to evade or defeat the tax is consistent with the overall scheme of the section. Finally, requiring the taxing agency to prove specific intent to evade or defeat a tax is consistent with the Ninth Circuit's policy that "exceptions to dischargeability should be strictly construed in order to preserve the Bankruptcy

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(§523(a)(16)); fines imposed on certain prisoners (§523(a)(17); debts owed to pension funds (§523(a)(18)); and judgments for violating securities laws (§523 (a)(19)).

Act and purpose of giving debtors a fresh start." *In re Jackson*, *supra*, 184 F.3d 1046, 1051, quoting *In the Matter of Kasler*, 611 F.2d 308 (BAP 9th Cir. 1979).

2. The Bankruptcy Court and District Court ignored the plain meaning of the statute when they did not require the Taxing Agencies prove Mr. Hawkins took some action with the specific intent to evade or defeat the Additional Taxes.

Both the Bankruptcy Court and the District Court claim that no specific action needs to be taken with the intent to evade or defeat a tax to deny a tax discharge under Section 523(a)(1)(C), but neither opinion explains how the requirement for specific intent can be read out of the statute. It appears these claims are largely based on the Courts' reading of *United States v. Jacobs (In re Jacobs)*, 490 F.3d 913, 921 (11th Cir. 2007).[71] In that case a panel of the 11th Circuit held that, in order for a taxing agency to except taxes under this section that were not the subject of a fraudulent return, it would have to prove two elements, first that the debtor acted "willfully," and second that there had been some "conduct" where the "debtor engaged in affirmative acts to avoid payment or collection of the taxes through commission or culpable omission." *Id*. at 921. This analysis creates an inherent confusion, seen in both the opinions by the Bankruptcy and District Courts, and in the other decisions that apply it, because the 11th Circuit

[71] Excerpt. Pg. 7; Pg. 35-36. District Court Opinion Pg. 5, Ln. 3-17; Bankruptcy Opinion Pg. 14-15.

bifurcated the adverb "willfully" from the phrase that it modifies, "attempts…to evade or defeat."

According to *In re Jacobs*, all that must be shown to meet the "willfully" portion of the phrase (which it calls the "mental state" portion) is that the debtor 1) had a duty under the law to pay a tax, 2) knew he had that duty, and 3) voluntarily and intentionally violated that duty. *Id*. at 921. In other words, a debtor decided not to pay a tax he or she knew was owed. [72] The opinion does not explain why it does not use "willfully" to modify "attempt . . . to evade or defeat," as it appears in the statute. Under *Jacobs*, in order to meet the second, or "conduct," requirement, the taxing agency must prove "the debtor engaged in affirmative acts to avoid payment or collection of the taxes, either commission or culpable omission." *Id*. at 921-924. Although, as read in *Jacobs*, this 'conduct' requirement mandates that the debtor act with specific intent to avoid or defeat a tax, this requirement quickly got lost in the later opinions; the opinions split the "mental prong" and the "conduct prong" of the *Jacobs* analysis.

These opinions are generally summarized in the Sixth Circuit case, *In re Gardner*, which, in describing the scope of intent required, states "knowing and deliberate nonpayment [of a tax] provides the basis for determining that the tax is nondischargeable." *Stamper v. United States (In re Gardner)*, 360 F.3d 551, 557

[72] The cases that could be found applying this analysis did not opine whether taxes that are not yet assessed, and thus cannot be directly paid, are "due."

(6th Cir. 2004), citing *In the Matter of Birkenstock*, 87 F.3d 947, 952 (7th Cir. 1996). *See also*, *In re Tudisco, supra*, 183 F.3d 133, 137; *United States v. Coney*, 689 F.3d 365, 374 (5th Cir. 2012). The cases from various bankruptcy courts that are cited in the Bankruptcy Court Opinion and the District Court Opinion hold that a discharge of taxes can be denied even where no action was taken specifically for the purpose of evading or defeating them. *See e.g. In re Lynch*, *supra*, 299 B.R. 62, 84 (noting that payment of creditors other than the taxing agencies could be a basis to deny tax-discharge). Having stated that the intentional non-payment of a known tax is the only intent needed, however, the opinions relied on by the Bankruptcy and District Courts concede that such a reading would make virtually all taxes non-dischargeable, as any decision not to pay a known tax, no matter what the intent, would be included. *Haas v. IRS (In re Haas)*, 48 F.3d 1153, 1155 (11th Cir 1995) (ruling limited on other grounds in *Griffith v. United States (In re Griffith)*, 206 F.3d 1389, 1394 (11th Cir 2000).

Rather than acknowledging that this interpretation of the statute is unworkable, many of the opinions replace the statutory requirement that a debtor acted with the specific intent to evade or defeat a tax with a judge's subjective view as to whether a debtor's actions were appropriate. *See e.g. In re Lynch*, *supra*, 299 B.R. 62, 85-86 (spending money on expenses other than those that can "fairly can be regarded as non-discretionary" is a basis to except taxes from

discharge); *Hamm v. United States (In re Hamm)*, 356 B.R. 263, 285-286 (stating the debtor "favor[ed] self-indulgence over tax-debts,"). This shift from requiring the debtor to act with the specific intent to evade or defeat the tax to one imposing the judge's assessment of appropriate behavior or necessary spending is reflected in the Bankruptcy Court Opinion.[73]

Notwithstanding this distorted reading of the statute, in all of the cases that Appellant's counsel could locate that held that the debtor need not act with the specific intent to evade or defeat the tax to except them from discharge, the courts found the debtor *did* take some specific action such as concealing or moving assets, failing to file tax returns, or lying to the government.[74] In those cases, the unworkable interpretation that a tax discharge may be denied under 523(a)(1)(C) without specific intent to evade or defeat the tax was unnecessary to the ruling made and essentially dicta.

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[73] Excerpt. Pg. 40-41, Pg. 44. Bankruptcy Opinion, Pg. 19, Ln. 18; Pg. 20, Ln. 2, referencing the Court's determination of "unduly" lavish expenditures, and whether expenditures are "appropriate," Pg. 23, referencing "appropriate" reduction in spending.

[74] *In re Gardner*, *supra*, 360 F.3d 551, 559 (debtor used several nominee accounts and failed to disclose the use of those accounts to agency officials); *In re Birkenstock*, *supra*, 87 F.3d 947, 950-52 [debtor failed to file tax returns and transferred assets to a trust in the children's name without consideration]. *See also*: *In re Lynch*, *supra*, 299 B.R. 62, 76 (debtor stopped direct-deposit of paycheck after IRS threats to levy); *Wright v. IRS, (In re Wright)*, 191 B.R. 291, 293-294 (Bankr.S.D.N.Y. 1995) (debtor stopped using billing service after levy by IRS); *In re Hamm*, *supra*, 356 B.R. 263, 279-281 (debtors used nominee bank accounts and concealed property transfers).

The Bankruptcy Court here did not find that Mr. Hawkins took any such action with the specific intent to evade or defeat the tax, and the effect of its opinion is to vastly expand the scope of the statute. Indeed, the Bankruptcy Court acknowledges:

> The present case does not exhibit all the badges of tax evasion present in the majority of decisions in which courts have found a willful attempt to evade or defeat a tax. In the more typical case . . . there are other indices of evasion not present here: failure to file returns; concealment of income; failure to pay the amount shown on the returns; or transfer of assets without consideration.[75]

Instead, the primary action that the Bankruptcy Court cited as the basis for its opinion was Mr. Hawkins's spending money on "unnecessary expenditures" after he acknowledged that the Additional Taxes might be owed.[76] There was no finding that Mr. Hawkins had engaged in any effort to deceive the Taxing Agencies, conceal assets or income, or otherwise impede any action by the Taxing Agencies to collect the taxes. Because the Bankruptcy Court applied the wrong legal standard and did not find the facts necessary to support its judgment, as a matter of law, the judgment should be reversed.

[75] Excerpt. Pg. 50. Bankruptcy Opinion, Pg. 29, Ln. 3-10,
[76] Excerpt. Pg. 35. Bankruptcy Opinion, Pg. 14, Ln. 9-14.

3. The lower Courts' opinions are inconsistent with the Bankruptcy Code.

A. The practical effect of the lower Courts' rulings is to raise the priority of taxes in a bankruptcy case.

Tax claims in bankruptcy are subject to a detailed scheme for discharge and priority under the Bankruptcy Code. In general, taxes will be discharged unless: 1) they are priority taxes as described at Section 507(a)(8); 2) a return was not filed as described in Section 523(a)(1)(B); 3) a fraudulent return was filed; or 4) there was an "attempt to . . . evade or defeat such tax," as described at 523(a)(1)(C). Except for tax claims granted specific priority, taxes are not paid before other claims under the Bankruptcy Code. They are simply treated as secured or unsecured claims or as a penalty, depending on their character. Indeed, tax liens are often subordinated to both the claims of junior lienholders and to certain other priority claims. 11 U.S.C. §724. Taxing agencies and the liens they assert are also subject to preference claims under Section 547, as is any other creditor. 11 U.S.C. §547.

The effect of the lower Courts' decisions, however, would be to mandate that, upon learning that a tax *might* be owed, a debtor would have to apply all available resources to pay the tax in order to be sure the remaining obligation would be discharged. This could lead to absurd results. Debtors seeking to protect their discharges would be forced to pay taxes within 90 days before filing a bankruptcy petition, only to then have to sue to recover the payments as a

preferential transfer and pay the money to the tax claims in the proper priority. 11 U.S.C. §547. Debtors would be forced to default on loan payments to use the funds to pay taxes, even where maintaining the loans might avoid foreclosure and preserve equity for the bankruptcy estate. Finally, debtors would be forced to forego paying family-support obligations in favor of taxes if the tax obligation were large and there was a risk the support payments would be seen as excessive.

There is nothing in the Bankruptcy Code to suggest that including a tax obligation in the debtor's discharge is conditioned on a debtor granting tax debts such priority pre-petition when they are not entitled to it post-petition. Nor is there a requirement that a debtor make some showing of attempting to pay taxes or being unable to pay them in order to have the tax discharged. Yet, this is exactly the effect of the opinions below in mandating that a potential debtor pay all money not needed for basic living requirements to satisfy outstanding taxes. The Taxing Agencies, in effect, argue that because a debtor may have an obligation under the Internal Revenue Code to pay taxes before obligations owing to other creditors, the Taxing Agencies are entitled to an uncodified priority in bankruptcy contrary to the terms of the Bankruptcy Code.

B. A clear standard for applying Section 523(a)(1)(C) is needed to avoid arbitrary results and to provide guidelines for insolvent tax-payers.

This Court's decision will have tremendous impact beyond this bankruptcy case. The District Court Opinion has been published and already serves as authority in this District that a governmental agency no longer need prove that a debtor acted with the specific intent to evade or defeat a tax in order to except that tax debt from discharge. That Opinion holds that "unnecessary expenses combined with non-payment of a known tax" is enough to deny discharge of taxes.[77] The District Court's decision does not explain what exactly constitutes "unnecessary expenditures," or how, or when, the debtor should make such determination.[78] The Bankruptcy Court decision similarly provides no explanation of this essential prerequisite for its denial of discharge of a tax.

In justifying its reliance on its review of Mr. Hawkins's earned income and expenses to except the Additional Taxes from discharge, the Bankruptcy Court relied on *In re Lynch*, *supra*, 299 B.R. 62, 62 and *In re Hamm*, *supra*, 356 B.R. 263, 263. Both of these opinions struggle to describe "unnecessary expenditures." The opinion in *Lynch* stated: "plainly basic food, shelter, utilities, medical services, daycare and perhaps other things fairly should be regarded for these purposes as non-discretionary . . . if not in excessive amount." *Supra*, 299 B.R. 62, 84. What

[77] Excerpt. Pg. 10. District Court Opinion, Pg. 8, Ln. 19-22.
[78] Excerpt. Pg. 13. At one point, the District Court even states that, at least as to some expenses, "the identity or purpose of the [expense] was irrelevant to the Bankruptcy Court's analysis…." This suggests that even the necessity of the expenses is irrelevant – and that the only measure is whether expenses exceeded "earned" income, District Court Opinion, Pg. 11, Ln. 11-13.

measure is a debtor to use to anticipate what is "basic" and "not excessive"? What are the "other things" that might be regarded as non-discretionary? Neither the court in *Lynch* nor the courts below identify any source articulating a standard.

The court in *In re Hamm* states that the debtor's spending on "various luxuries rather than on their mounting federal income tax liabilities . . . demonstrated a decision by the debtors to favor self-indulgence over their tax debts." *In re Hamm*, *supra*, 356 B.R. 263, 285-286. But "self-indulgence" does not constitute an attempt to evade or defeat a tax, nor is it included in any usual list of "badges of evasion" as evidence of such an attempt.

The Bankruptcy Court's opinion also reveals the uncertainty in using "necessity" or "luxury" as a measure of whether taxes are to be discharged. When discussing "discretionary spending" the Bankruptcy Court states:

> 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. The effort and skill required to earn such sums require a *nuanced approach* in determining what living expenses are necessary.[79]

(Emphasis added.)

[79] Excerpt. Pg. 40-41. Bankruptcy Opinion, Pg. 19, Ln. 19-Pg. 20, Ln. 2 (emphasis added).

It is based on this consideration that the Court decides to compare "necessary" expenses to "earned" income.[80] But there is no authority to justify denying the discharge of a known tax based on the fact a debtor spent more than he earned. (Indeed, this is why most debtors are in bankruptcy in the first place.) Nor does Section 523(a)(1)(C) except from discharge taxes that were not paid because of a debtors' self-indulgence, unnecessary expenditures or "inappropriate" behavior.

If the lower Courts' opinions are allowed to stand, they will create uncertainty for every potential debtor in this District who lives above some unstated standard.[81] This includes failed entrepreneurs, commercial real estate developers, and individuals who were once wealthy who personally guaranteed the debts of a failed company. If a debtor's discharge may be attacked for no reason other than his choice of what creditors he pays or his lifestyle, at what point must he stop negotiating with creditors in an effort to resolve conflicts or to recover a failing business? When, and how fast, must a potential debtor liquidate his assets to pay his taxes, and how far must he reduce his lifestyle to avoid attack?

Before the Bankruptcy Court Opinion was issued, these were not questions that a potential debtor needed to ask, for, as the section was applied, taxes were

[80] Excerpt. Pg. 41. Bankruptcy Opinion, Pg. 20. Ln. 2-20, Footnote 18.
[81] There is, of course, a measures of income and expense (more properly called "maximum standard"), in the Bankruptcy Code under the "means test" in 11 U.S.C. §707(b). The means test is extremely detailed and is not incorporated into 523(a)(1)(C).

only excepted from discharge when there was actually some specific action taken to evade or defeat the tax by concealing or transferring assets, concealing income by failing to file returns, changing financial practices in response to levy, or otherwise deceiving taxing agencies. A standard that is consistent with the statute's language and requires that a taxing authority prove that the debtor acted with the specific goal of evading or defeating taxes in order to except the tax from discharge is proper. Such a standard will preserve the discharge to which an honest debtor is entitled, and eliminate the confusion that would be created if the lower Courts' decisions are allowed to stand.

4. The Bankruptcy Court's analysis of the "totality of the circumstances" does not support a conclusion that Mr. Hawkins committed any act with the purpose of "evading or defeating a tax" under Section 523(a)(1)(C).

A. The Bankruptcy Court's primary basis for excepting the Additional Taxes from Mr. Hawkins's discharge was his "unnecessary expenditures."

Courts may look to "the totality of the circumstances" to determine whether a debtor attempted to evade or defeat a tax under Section 523(a)(1)(C). *See e.g*. *United States v. Doyle*, 276 F. Supp.2d 415, 423 (W.D.Pa. 2003). A multitude of possible circumstances can reflect the requisite intent, including: failing to disclose income, failing to file tax returns, transferring assets without consideration, or concealing them from collection.[82] See, *Rhodes v. United States (In re Rhodes)*,

[82] Excerpt. Pg. 50. Bankruptcy Opinion, Pg. 29, Ln. 3-23.

356 B.R. 229, 236 (Bankr.M.D.Fl. 2006)*; see also, Rowen v. United States (In re Rowen)*, 298 B.R. 641, 651-652 (Bankr.D.Alaska 2003) [describing complex trust arrangements created to avoid tax levy].

The Bankruptcy Court here acknowledged that the well-known "badges of evasion" did not exist in this case. It based its decision instead on Mr. Hawkins's "exceptional expenditures," his knowledge of the tax obligations, his business sophistication, and the timing of his bankruptcy filing.[83] The Court held that these circumstances were sufficient to except the tax from discharge.[84] The Court made no finding that Mr. Hawkins took any particular action in "an attempt…to evade or defeat [the] tax" as is required by Section 523(a)(1)(C).

The Bankruptcy Court repeats the "unnecessary expenditures" element in several forms, seemingly to make the list longer. The Court stated:

> [T]here is evidence of willful failure to pay tax not found in the more typical cases noted above: [Mr. Hawkins's] exceptional business sophistication; [his] open acknowledgment of his tax debt and insolvency, the length of time over which [he] caused the Debtors to expend funds on unnecessary expenditures; the amount of unnecessary expenditures; and the extent to which unnecessary expenditures exceeded earned income.[85]

[83] Excerpt. Pg. 50. Bankruptcy Opinion, Pg. 29, Ln. 5-10.
[84] Excerpt. Pg. 50. Bankruptcy Opinion, Pg. 29, Ln. 5-10.
[85] Excerpt. Pg. 50. Bankruptcy Opinion, Pg. 29, Ln. 17-23.

The Bankruptcy Court did not explain what role Mr. Hawkins's "sophistication" played in its analysis, or why his "open" acknowledgment of the tax obligation has any weight.

The Bankruptcy Opinion accepts that planning to file a bankruptcy and delaying the filing to discharge taxes alone is not evidence of an attempt to evade or defeat the tax under the statute. The Bankruptcy Court stated:

> The Government . . . contends that the Unpaid Taxes should be excepted from discharge because the Debtors planned from January 2004 onward to discharge those liabilities, and because they submitted an inadequate offer in compromise to delay the Government's collection efforts while Debtor's waited for their tax liabilities to become old enough to be subject to discharge. This evidence . . . by itself, however, does not justify a finding that Debtor's willfully attempted to avoid the collection of a tax.[86]

See also, United States v. Doyle, *supra*, 276 F. Supp.2d 415, 427, fn.4. [delay in filing bankruptcy to allow tax claims to age and thereby to be discharged are not attempts to evade or defeat a known tax under this section].[87]

Finally, the Bankruptcy Court carefully dismissed all of the other allegations by the Taxing Agencies that Mr. and Mrs. Hawkins attempted to evade or defeat the Additional Taxes. The Bankruptcy Opinion states "I give little or no weight" to the evidence offered regarding the Family Court order to pay $750,000 into the support trust, the jet Mr. Hawkins sold in 2003, Mr. Hawkins's loan to 3DO, and

[86] Excerpt. Pg. 48. Bankruptcy Opinion, Pg. 27, Ln. 1-9.
[87] 11 U.S.C. 507(a)(8).

the purchase of assets from their own bankruptcy estate with money borrowed from Mr. Hawkins's father.[88] That leaves Mr. Hawkins's "extraordinary expenses," as the primary justification for the Bankruptcy Court excepting the Additional Taxes from Mr. Hawkins's discharge.

B. "Unnecessary expenditures," without evidence of increase, is not evidence of specific intent to evade or defeat Additional Taxes.

i. "Unnecessary" or "non-essential" spending does not on its face establish an intent to evade or defeat a known tax.

It is difficult to see how "unnecessary spending," however that is calculated, could be done for the purpose of evading taxes unless it reflected a rapid, intentional *increase* in spending, or was part of a scheme to transfer all transactions to cash and thereby avoid levy. *See e.g. United States v. Doyle*, *supra*, 276 F. Supp.2d 415, 421 [after checking accounts were levied, taxpayers stopped using accounts and used cash and money orders to pay bills]; *In re Lynch*, *supra*, 299 B.R. 62, 76-77 [debtor stopped direct-deposit of paycheck after IRS threats to levy]. That is not the circumstance here. Neither the Taxing Agencies nor the Courts below suggest that Mr. and Mrs. Hawkins increased their spending, or that the *reason* they didn't reduce food costs, mow their own yard, or buy a cheaper

[88] Excerpt. Pg. 47-50. Bankruptcy Opinion, Pg. 26, Ln. 7 - Pg. 29, Ln. 10. The Bankruptcy Opinion does include a passing reference to the "high risk" nature of Mr. Hawkins's loans to save 3DO, but Judge Carlson also commented at the end of trial, "You know, he's putting his own money into the business. This just doesn't look like abusive conduct. Okay? This isn't the kind of social conduct we really want to discourage." Excerpt. Pg. 151. Trial Transcript Pg. 503, Ln. 13-16.

car, was to evade or defeat taxes. Nor was there ever an allegation that Mr. and Mrs. Hawkins converted transactions to cash or ever attempted to interfere with a levy.[89] Neither of the lower Courts' opinions explain why a debtor's failure to reduce living costs quickly enough following some event signaling the finalization of tax liability proves intent to evade or defeat a tax.

ii. No cases support the lower Courts' holdings that, without more, "unnecessary expenditures" combined with nonpayment of a known tax constitute a requisite willful attempt to evade or defeat a tax under Section 523(a)(1)(C).

In all cases that Counsel for the Appellant could find in which a debtor's luxurious or unnecessary spending was found to be a contributing factor for denial of discharge under 11 U.S.C. section 523(a)(1)(C), there was some additional showing of an effort to conceal income by not filing returns, conceal assets, interfere with levies, or deceive the taxing agency. The Courts below relied on no case without such an additional showing.

Rather, in the two cases where the taxing authority sought to have the court except the tax from discharge on the basis of "luxurious spending" where there was no such intentional effort to undermine tax collection, the court ruled in favor of

[89] Excerpt. Pg. 343. The only levies were done by the Franchise Tax Board. One was a preference (Stipulated Facts #81) and the other was done post-petition, allegedly violating of the automatic stay. Plan and Disclosure Statement Pg. 7, Ln. 2-11.

the debtor. In *In re Rhodes*, *supra*, 356 B.R. 229, the court refused to find that payments of college tuition and maintaining an expensive car after learning of the tax obligation were enough to except the taxes from discharge. *Id*. at 237. In *Huber v. IRS (In re Huber)*, 213 B.R. 182, 185 (Bankr.M.D.Fla. 1997), the court found that the debtor's spending money to save a failing business and transferring property to maintain "minority," status, though voluntary acts, were not made to defeat a tax.

The District Court distinguishes these cases stating they were decided on the basis that the debtors in the cases did not know that they owed the tax when the questioned activity occurred.[90] In fact, in *Rhodes* the debtor knew they owed taxes when at least some of the questioned expenses were incurred. *In re Rhodes*, *supra*, 356 B.R. 229, 236. While the Court in *In re Huber* considered that the debtor did not appreciate the *size* of the tax debt, it also stated:

> Even if the debtor is aware of the taxes due and owning and allocates his or her money to something else other than the payment of taxes, the taxes… are not excepted from discharge…without a showing of circumstantial factors of fraudulent activity.

[90] Excerpt. Pg. 8. The District Court's reading of *Rhodes* is incomplete. The Court states that the *Rhodes* Court based its decision on finding that the debtor was not aware of his liability. District Court Opinion, Pg. 6, Ln. 21-28. The *Rhodes* opinion states that the debtor continued to pay for an expensive car and support an adult child after learning of the tax obligation. The court noted that, at least as to the daughter's tuition, "the evidence fails to demonstrate the decision [to spend the money] was made with the intent to evade taxes." *Rhodes v. U.S.*, *supra*, 356 B.R. 229, 237.

In re Huber, *supra*, 213 B.R. 182, 184.

5. The facts established at trial did not support the Bankruptcy Court's inference that Mr. Hawkins was guilty of a willful attempt to evade or defeat a tax.

A. Mr. Hawkins's pre-petition spending, without some evidence that his purpose was to waste assets, is not evidence of an intent to evade or defeat the Additional Taxes.

The Bankruptcy Court never found that Mr. Hawkins had the specific intent to spend money for the purpose of wasting his assets and thereby evading his taxes. There was no scheme to shed assets in the face of impending tax levies. Rather, the Bankruptcy Court found that Mr. and Mrs. Hawkins's spending was "discretionary" and "inappropriate"[91] in the face of a known tax. This conclusion, in turn, is based on the Bankruptcy Court's unsupported assumption that everything the Hawkins family spent above Mr. Hawkins's earned income was spent for "personal living." [92]

The Bankruptcy Court's opinion that Mr. and Mrs. Hawkins lived a lavish lifestyle is taken from its review of Mr. and Mrs. Hawkins's income and expenses. It looked at what it calls two "snap shots" of Mr. and Mrs. Hawkins's finances. One is the Collection Information Statement that they provided with its Offer in

[91] Excerpt. Pg. 35, Pg. 44. Bankruptcy Opinion, Pg. 14, Ln. 9-14, Pg. 23, Ln. 22-25.
[92] Excerpt. Pg. 41. Bankruptcy Opinion, Pg. 20, Ln. 15-20.

Compromise to the IRS in October 2005.[93] The other is in the Bankruptcy Schedules filed with the Bankruptcy Court in September 2006.[94] The Bankruptcy Court's discussion of these documents is fraught with errors and unsupported conclusions. These errors were largely acknowledged by the District Court.

The Bankruptcy Court's first error was that in looking at Mr. Hawkins's income, it only looked at his wages, not all of his income. The Bankruptcy Court justifies this in a footnote stating, "The unearned income would be available to those creditors in any event," and it assumes that this income was generated by UBS stock.[95] The statement is not supported, and the "Income/Expense Table" provided by the IRS in response to the Offer in Compromise shows that most of the $50,000 per month "non-earned" income came from "partnerships," and not from stock dividends.[96] Mr. and Mrs. Hawkins's bankruptcy schedules show that these partnerships were venture capital funds (the "VC Funds") that required

[93] Excerpt. Pg. 41; Pg. 218-223. Bankruptcy Opinion, Pg. 20, Ln. 5-14; Collection Information Statement for OIC.
[94] Excerpt. Pg. 41; Pg. 285-317. Bankruptcy Opinion, Pg. 20, Ln. 5-14; Bankruptcy Schedules and Statement of Financial Affairs.
[95] Excerpt. Pg. 41. Bankruptcy Opinion, Pg. 20, Ln. 18.
[96] Excerpt. Pg. 228-231. IRS letter re: OIC plus enclosures/worksheets, Pg. 2 identified as Income & Expense Table #40.

ongoing capital contributions and were not freely marketable.[97] Mr. Hawkins testified at length to his efforts to preserve the funds before bankruptcy.[98]

The Taxing Agencies never argued they could have levied the VC Funds. The fact that the Chapter 11 Plan creates the Tax Trust to manage assets for the benefit of the Taxing Agencies rather than just handing them over further evidences that the assets were not "available to creditors in any event," as was assumed by the Bankruptcy Court. [99] The District Court dismisses this $50,000 per month error by stating that the Court need not consider income at all when considering alleged extravagant spending.[100] The District Court thereby suggests, without stating, that "extravagance" is some measure unrelated to a person's means, yet no standard is offered.

The Bankruptcy Court's second error was to substantially mischaracterize Mr. Hawkins's expenses as "unnecessary." The Bankruptcy Opinion describes the $33,000 listed for housing in the Collection Information Statement as

[97] Excerpt. Pg. 285-317. Bankruptcy Schedules and Statement of Financial Affairs, Schedule B, Pg. 2-3, #14 "Interests in partnerships or joint ventures".
[98] Excerpt. Pg. 144-146__. Trial Transcript ("Hawkins Testimony"), Pg. 440, Ln. 10 - Pg. 442, Ln. 25.
[99] Excerpt. Pg. 41; 385. Bankruptcy Opinion, Pg. 20, Ln. 18; Second Amended Plan of Reorganization, Pg. 9, Ln. 6-22.
[100] Excerpt. Pg. 11-12. District Court Opinion, Pg. 9, Ln. 24 - Pg. 10, Ln. 2.

"unnecessary," even though the debt on the property was not a personal debt to purchase it, but rather a business debt to pay the 3DO loan.[101]

The Bankruptcy Court's Opinion also states that approximately $40,000 on the Collection Information Statement for "other expenses" is not broken down.[102] Yet, the next exhibit provided to the Bankruptcy Court, the "IRS's income/expense table," reflects the explanation that this was for legal expenses.[103] Mr. Hawkins was litigating during that time with both his ex-wife over child support and with KPMG.[104] He had also retained counsel to represent him in his dealings with the IRS.[105] Though it should be evident that legal expenses are not "living expenses" and are not discretionary, the Bankruptcy Court characterizes all of Mr. Hawkins's expenses as "living expenses."[106]

The District Court dismissed the Bankruptcy Court's mischaracterization of Mr. Hawkins's expenses, holding that the Bankruptcy Court's conclusion that Hawkins's "housing expenses" were unnecessarily high was not a material error,

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[101] Excerpt. Pg. 42-44; Pg. 138, Pg. 149. Bankruptcy Opinion, Pg. 21-23; Trial Transcript ("Hawkins Testimony"), Pg. 387, Ln. 5-21; Pg. 481, Ln. 19-25.
[102] Excerpt. Pg. 42. Bankruptcy Opinion, Pg. 21, Ln. 24-25.
[103] Excerpt. Pg. 223. Collection Information Statement for OIC, Pg. 6 showing "other" expenses as $40,550; Excerpt. Pg. 229. IRS letter re: OIC plus enclosures/worksheets, Pg. 2 identified as Income & Expense Table, No. 51 "Other – Legal fees "$40,550".
[104] Excerpt. Pg. 78, Pg. 79. Stipulated Facts #41 and #56.
[105] Excerpt. Pg. 76. Stipulated Facts #18.
[106] Excerpt. Pg. 44. Bankruptcy Opinion, Pg. 23, Ln. 15-25.

even though it includes servicing the $4 million 3DO loan.[107] The District Court also dismissed the Bankruptcy Court's failure to acknowledge the $40,000 per month legal fees, stating the purpose of the expenses was irrelevant.[108] The District Court's comments suggest that the only fact to consider is the amount of a debtor's pre-petition spending – the amount of income or purpose of the spending is irrelevant. This view reduces determining whether a debtor attempted to evade or defeat a tax to a straight calculation of expenses. That is clearly not the meaning of the statute. If it were, the statute would simply except from discharge the taxes of any debtor who spends more a set amount per month for a set period of time before the petition.

Once one considers all of Mr. and Mrs. Hawkins's actions, and acknowledges that substantial portions of their expenses were not discretionary living expenses, such as VC Fund capital calls, the 3DO loan, and extensive legal fees, the only alleged extravagances remaining are the debt incurred to buy a car, the $3,800 per month for childcare, and $1,100 per month for the entertainment for a family of six.[109] There is no evidence or even allegations that the purpose of the choices made about child care, entertainment, buying the SUV, or any other expense was to evade or defeat a tax.

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[107] Excerpt. Pg. 12. District Court Opinion, Pg. 10, Ln. 3-23.
[108] Excerpt. Pg. 13. District Court Opinion, Pg. 11, Ln. 6-15.
[109] Excerpt. Pg. 287, Pg. 305-306. The La Jolla house carried no debt but did accrue property taxes. Bankruptcy Schedules A, and J.

B. Mr. Hawkins's intelligence and former business success are not evidence of an intent to evade or defeat the Additional Taxes.

The Bankruptcy Opinion notes at the outset that Mr. Hawkins graduated from Harvard, and states that "[Mr. Hawkins's] exceptional business sophistication" is a factor in its holding.[110] The Opinion does not, however, state that Mr. Hawkins used this sophistication to create a scheme with the purpose of evading taxes by spending his money.

Without such an explanation, the Bankruptcy Court's consideration of Mr. Hawkins's intelligence suggests that it is imposing a different standard of conduct on Mr. Hawkins than it would on another debtor. The possible double standard is also reflected in the Bankruptcy Court's opinion regarding allowing the discharge of Mrs. Hawkins's tax obligation. While the Bankruptcy Court could simply have stated that she didn't know of the debt or the decision not to pay it, it describes her as "having only an undergraduate degree in communications, . . . and during the entire period of her marriage [having been] a full-time, stay-at-home mother and wife."[111]

[110] Excerpt. Pg. 23; Pg. 50. Bankruptcy Opinion, Pg. 2, Ln. 12-15; Bankruptcy Opinion, Pg. 29, Ln. 15-23.
[111] Excerpt. Pg. 46. Bankruptcy Opinion, Pg. 25, Ln. 3-6.

In the 7th Circuit Court of Appeals decision of *Payne v. United States (In re Payne)*, 431 F.3d 1055 (7th Cir. 2005), the dissent complains of such an overbroad use of Section 523(a)(1)(C). In a slightly different context it stated:

> Section 523(a)(1)(C) does *not* say that willful tax evasion precludes discharge, and any other purpose may do so too if the Judge thinks the taxpayer crafty. We should not allow overly open-ended discretion on a concrete text.

Id. at 1062 (emphasis in original). Unless a debtor is accused of some complex plan, which is not the case here, his or her intelligence or sophistication should not be relevant to determining whether there was an attempt to evade or defeat a tax.

C. The date that Mr. and Mrs. Hawkins filed their Bankruptcy Petition was largely dictated by the Taxing Agencies in assessing the Additional Taxes, and is not evidence of an attempt to or defeat evade Additional Taxes.

One element the Bankruptcy Court relies on for its decision is the length of time between when Mr. Hawkins acknowledged he might owe significant taxes and when he filed bankruptcy, during which he allegedly failed to adequately reduce his spending.[112] The Court, however, does not acknowledge the reason for that delay. Mr. Hawkins acknowledged his likely tax obligation in December 2004. Mr. and Mrs. Hawkins then effectively asked for the taxes to be assessed by signing the waiver of Restrictions on Assessment and Collection of Deficiency

[112] Excerpt. Pg. 50. Bankruptcy Opinion, Pg. 29, Ln. 15-23.

Tax."[113] The IRS took three months to issue the assessment.[114] Mr. and Mrs. Hawkins's attorneys immediately informed the FTB of the federal adjustments to the 1997-2000 tax years and asked the FTB to make corresponding adjustments and assess State taxes.[115] It took the FTB another five months, until July 2005, to issue a proposed statement of tax, which did not become effective until September 2005.[116] Cal. Rev. & Tax. Code §19041(a). Mr. and Mrs. Hawkins then made an Offer in Compromise to the IRS, which was refused.[117]

Mr. and Mrs. Hawkins then had to wait another eight months before filing their bankruptcy petition. 11 U.S.C §§507(a)(8), §523(a)(1)(A). Given that almost all of the delay between when Mr. and Mrs. Hawkins asked to have the tax assessed and when they filed their bankruptcy petition was caused by the Taxing Agencies' delay in assessing the Additional Taxes, and the passing of the statutory waiting period, the Bankruptcy Court improperly considered the delay in filing as evidence of an attempt to evade or defeat a tax.

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[113] Excerpt. Pg. 79. Stipulated Fact #47.
[114] Excerpt. Pg. 79. Stipulated Facts #48, and #50-52.
[115] Excerpt. Pg. 79. Stipulated Fact #49. Excerpt. Pg. 209. Letter from Blanc requesting FTB make assessments.
[116] Excerpt. Pg. 80. Stipulated Facts #60-63.
[117] Excerpt. Pg. 80. Stipulated Facts #64-66, #68. Excerpt. Pg. 224-227. Offer In Compromise.

D. Mr. Hawkins's efforts to reduce his expenses and maximize recovery to the Taxing Agencies defeats any claim that Mr. Hawkins "attempted to evade or defeat" the Additional Taxes.

i. The matter is properly before the Court.

The District Court refused to address that the Bankruptcy Court's failure to consider the "totality of the circumstances," particularly Mr. Hawkins's positive efforts to marshal his assets and the resulting benefit to the Taxing Agencies. The District Court stated that the matter was not raised in the Bankruptcy Court, and referenced sections of the Appellant's trial brief below that "have no references to the record."[118] The referenced sections stated hypothetical scenarios. The necessary references to the record at trial were set forth in a different section of the Appellant's brief below, and are described here.[119]

Mr. Hawkins's efforts to marshall his assets was a central theme during the trial. Appellant's trial brief raises the issue that the court must consider the totality of the circumstances before excepting taxes from discharge. That brief states in a heading, "[A]n analysis of the totality of the circumstances mandates discharging the taxes."[120] It then lists Mr. Hawkins's: 1) cooperating with the IRS and the taxing process, including filing regular tax returns, keeping records, and providing all information requested by the Taxing Agencies; 2) cooperating with the IRS in

[118] Excerpt. Pg. 14. District Court Opinion, Pg. 12, Ln. 7-14.
[119] *Id.*
[120] Excerpt. Pg. 68. Plaintiff's Trial Brief, Pg. 13, Ln. 10-11.

its examination of the subject transaction's; 3) waiving their objection to the IRS's proposed tax; and 4) reducing living expenses.[121]

The Appellant's trial brief also describes Mr. and Mrs. Hawkins's significant efforts to reduce monthly expenses by reducing Mr. Hawkins's obligations to his ex-wife, and to maximize the assets paid to the Taxing Agencies by, among other things, continuing to prosecute the action against KPMG and confirming the Chapter 11 Plan, which implemented the unique vehicle of the Tax Trust.[122] Mr. and Mrs. Hawkins's efforts to maximize the value of their assets and thereby benefiting the Taxing Agencies was raised in the proceeding below and should have been considered as part of the "totality of the circumstances." The Bankruptcy Court's failure to do so was reversible error, and should have been considered by the District Court on Appeal.

The Ninth Circuit has held that in order for a reviewing appellate court to rule on an argument, the argument must have risen sufficiently, "for the trial court to rule on it." *O'Rourke v. Seaboard Surety Co. (In re E.R. Fegert, Inc.)*, 887 F.2d 955, 956 (9th Cir. 1989) (internal citations omitted). The Ninth Circuit in *Fegert* addressed whether it was proper for the Bankruptcy Appellate Panel to consider the applicability of a defense to a bankruptcy-preference action, where the bankruptcy court had not ruled on the defense or discussed it in its decision. The

[121] Excerpt. Pg. 68. Plaintiff's Trial Brief, Pg. 13, Ln. 10-21, Ln. 24-27.
[122] Excerpt. Pg. 68-69. Plaintiff's Trial Brief, Pg. 13, Ln.10 - Pg. 14, Ln. 26.

Ninth Circuit stated: "we have ruled that intermediate appellate courts may consider any issue supported by the record, even if the bankruptcy court did not consider it." *Id*. The District Court committed clear error in refusing to consider whether the Bankruptcy Court committed clear error when it failed to include Mr. Hawkins's efforts to reduce his expenses and maximize his assets when assessing whether he was attempting to evade or defeat the Additional Taxes.

ii. A review of the totality of the circumstances requires that Mr. Hawkins's taxes be included in his discharge.

The Bankruptcy Court's review of "two snapshots" of what it mistakenly described as living expenses failed to consider the totality of Mr. Hawkins's two-year effort to maximize his assets, his efforts to reduce his expenses, or his ongoing cooperation with the Taxing Agencies. Mr. Hawkins's efforts to reduce spending and maximize assets were explained in detail during the trial. Mr. Hawkins testified regarding his successful efforts to reduce his child-support obligation, lowering it from $15,000 a month, to $1,305 per month,[123] and to reduce his living expenses.[124] Mr. Hawkins testified regarding his efforts to maximize assets - preserving interests in VC Funds by meeting contributions

[123] Excerpt. Pg. 130. Trial Transcript ("Miller Testimony"), Pg. 308, Ln. 2-5.
[124] Excerpt. Pg. 149, Pg. 148. Trial Transcript ("Hawkins Testimony"), Pg. 481, Ln. 2-15 and Pg. 479, Ln. 14-20.

requirements,[125] and increasing the distributions that went to the IRS.[126] Finally, the Taxing Agencies acknowledge in the statement of stipulated facts for trial that as of the date of the trial, all of the $21 million that they had received, except for the unopposed levies by the FTB, came from Mr. and Mrs. Hawkins's voluntary disposition of properties and the Tax Trust created by the Chapter 11 Plan. [127] The Taxing Agencies never asserted that they could have recovered anything near this sum without Mr. Hawkins's cooperation, or that they ever tried.

While the Bankruptcy Opinion contains scattered references to some of these events, it does not consider these efforts as part of a "totality-of-circumstances" analysis. Neither the Bankruptcy Opinion nor the District Court Opinion acknowledges that all circumstances, both favorable and unfavorable, surrounding a debtor's failure to pay taxes should be considered when determining whether the debtor took any action with the intent to evade or defeat taxes. The

[125] Excerpt. Pg. 144-146. Trial Transcript ("Hawkins Testimony"), Pg. 440, Ln. 20 - Pg. 441, Ln. 17-Pg. 442, Ln. 22.
[126] Excerpt. Pg. 146. Trial Transcript ("Hawkins Testimony"), Pg. 442, Ln. 23-24. Counsel for the IRS made an offhand remark at this point in the trial that the, "IRS has collected quit a bit more than the . . . offer in compromise." The comment, as well as not being testimony, ignores the facts: 1) the Offer in Compromise was made at a time that Mr. Hawkins also owed $12 million to the FTB and had to reserve funds for that settlement, and 2) that the majority of the payments made to the IRS were made through the unique tools of the Chapter 11 plan, where the IRS was in priority and had to be paid in full before the FTB receives any distribution.
[127] Excerpt. Pg. 81. Stipulated Facts #'s 70, 73, 83.

Bankruptcy Court's failure to consider all of the circumstances of Mr. Hawkins's financial management was clear error.

CONCLUSION

The plain meaning of Bankruptcy Section 523(a)(1)(C) is to except taxes from discharge where the debtor has acted with the specific intent of evading or defeating those taxes. The Bankruptcy Court and District Court in this case have disregarded the requirement that the debtor be shown to have acted with specific intent, but now assert that "unnecessary expenses" combined with non-payment of a known tax is enough to deny a tax discharge under this statute.

If left to stand, these decisions put at risk the ability of every insolvent taxpayer in this Circuit to obtain relief from a known tax obligation in Bankruptcy. The decisions leave current and future taxpayers without any standards to govern their conduct when they discover that taxes may be owed, and unable to predict the risk that ordinary behavior may result in excepting known taxes from discharge depending upon the judge drawn for his or her particular case. The practical result is to give taxes a priority that is inconsistent with the Bankruptcy Code.

There is nothing in the Bankruptcy Code that conditions the discharge of a debtor's taxes on an unspecified measure of a debtor's pre-petition spending. Nor is there any justification for the lower Courts' expansion of this statute. To the

extent that opinions in other districts hold differently, those decisions must be disregarded as inconsistent with the meaning of the statute.

In excepting the Additional Taxes from Mr. Hawkins's discharge, the Bankruptcy Court did not apply the plain language Section 523(a)(1)(C) because it failed to find that Mr. Hawkins took any specific action with the intent to evade or defeat his taxes. The Court rejected the arguments by the IRS and the FTB that Hawkins acted to conceal assets or to try to deceive the government. Instead, the Bankruptcy Court based its decision on its finding that Mr. Hawkins's non-payment of known taxes, and unnecessary personal expenditures.[128] The Bankruptcy Court, however, did not find that Mr. Hawkins's *purpose* in making those expenditures was either to waste assets or to avoid taxes. Rather, an assessment of all the circumstances presented to the Bankruptcy Court establishes Mr. Hawkins's efforts to maximize his assets and increase the recovery to the Taxing Agencies.

The Bankruptcy Court applied the wrong legal standard when it excepted the Additional Taxes from Mr. Hawkins's discharge without finding that Mr. Hawkins took any specific action with the intent to evade or defeat a tax, nor could the undisputed facts presented to the Bankruptcy Court support such a finding. For these reasons the judgment should be reversed.

[128] Excerpt. Pg. 48. Bankruptcy Opinion, Pg. 27, Ln. 11-14.

Statement of Related Cases
Circuit Rule 28-2.6

There are no related cases in this Circuit that pertain to this matter.

Dated: January 9, 2013 BINDER & MALTER, LLP

By: /s/ Wendy W. Smith
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