

1 UNITED STATES DISTRICT COURT
2 FOR THE EASTERN DISTRICT OF CALIFORNIA
3

4 UNITED STATES OF AMERICA,

5 Plaintiff,

6 v.

7 THOMAS W. SMITH; MBNA AMERICA BANK
8 N.A.; STATE OF CALIFORNIA
9 FRANCHISE TAX BOARD; DAVID K.
10 JACOBS AS TRUSTEE OF THE T & E A
11 TRUST DATED OCTOBER 1, 1993;

12 Defendants.

1:10-cv-01193 OWW JLT

MEMORANDUM DECISION AND ORDER
RE PLAINTIFF'S MOTION FOR
SUMMARY JUDGMENT

(DOC. 21)

13 I. INTRODUCTION

14 Plaintiff the United States of America ("United States")
15 proceeds with this action to reduce federal tax assessments to
16 judgment and foreclose federal tax liens on real property.

17 Before the court is the United States' motion for summary
18 judgment. Doc. 21. No Defendant filed an opposition. The motion
19 was heard July 18, 2011.

20 II. FACTUAL BACKGROUND¹

21 A. The Taxpayer

22 Thomas Wayne Smith worked for over 44 years as a service,
23 repair and installation technician in the heating and cooling
24 industry. Doc. 22, ¶ 1. Mr. Smith worked part-time for a company
25 he formerly owned, "Bell-Aire Heating and Cooling" ("BAHC"). *Id.*
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28 ¹ Facts are undisputed unless where indicated.

1 B. The Subject Property

2 The real property subject to this action is located at
3 5251 West Decatur Avenue, Fresno, California, 93722, in the
4 County of Fresno, State of California ("Property"). The
5 Property is more particularly described as:

6 Lot 94 of Tract No. 4768, McCaffrey Community No. 7, in
7 the City of Fresno, County of Fresno, State of California,
8 according to the map thereof recorded in Book 60, Pages
9 45, 46, & 47 of Plats, Fresno County Records.

9 APN: 502-283-31

10 Doc. 22-2.

11 Mr. Smith purchased the Property on or about October 30,
12 1998. A Grant Deed transferring all right, title, and interest in
13 the Property to Mr. Smith was recorded with the Fresno County
14 Recorder. May 4, 2011 Deposition of Thomas W. Smith ("Smith
15 Depo."), 7; Doc. 22-2. Mr. Smith occupied the property as his
16 primary residence.
17 primary residence.

18 On October 3, 2002, a Trust Grant Deed was recorded with the
19 Fresno County Recorder which transferred title of the Property
20 from Mr. Smith to "TWC. Trustee: David-Keith: Jacobs." Doc. 22-
21 3.² Mr. Smith continued to occupy and control the Property after
22 its transfer to the TWC Trust. Smith Depo. 129.

23 On or about June 16, 2008, a Grant Deed was recorded with
24 the Fresno County Recorder which transferred title of the
25 Property from the Trustee of the TWC Property Trust to "David
26 Property from the Trustee of the TWC Property Trust to "David
27 _____

28 ² The United States asserts, without evidentiary support, that the purported
 transfer from Mr. Smith to the TWC Trust was for no consideration.

1 Keith Jacobs, Trustee of the T & E A Trust," dated October 1,
2 1993. Doc. 22-4. Mr. Smith continued to occupy and control the
3 Property after the transfer to the T & E A Trust. Smith Depo.
4 126, 129.

5 C. Tax Liabilities

6 Revenue Officer Dennis Stiffler was assigned to secure
7 unfiled tax returns and seek payment of Mr. Smith's unpaid tax
8 liabilities. Doc. 21-4, ¶ 2. Revenue Officer Stiffler calculated
9 Mr. Smith's current balance, with accruals of interest and
10 penalties to June 16, 2011, for individual federal income tax for
11 the tax years ending December 31, 1996, through and including
12 2003, as \$318,752.47. Doc. 21-4, ¶ 5.

13 For the tax year ending December 31, 1996, the original
14 assessment was the result of an Internal Revenue Service
15 examination of a filed tax return. *Id.* at ¶ 3. In resolving the
16 tax liabilities for 1996, Mr. Smith signed a Closing Agreement
17 which included, among others, the following terms: "the T & E A
18 Equipment Trust will be disregarded for the 1996 taxable year"
19 and "the T & E A Equipment Trust [is] the alter ego of the
20 taxpayer and the assets ostensibly held in the names of the
21 trusts are the assets of the taxpayer." Doc. 22-5. Mr. Smith's
22 remaining tax liabilities are also based on Mr. Smith's late
23 filed tax returns, which the Internal Revenue Service accepted.
24 Doc. 21-4, ¶ 4.

1 D. The Trusts

2 Mr. Smith became acquainted with David K. Jacobs in 1981 or
3 1982 when they worked on a new church together. Doc. 22, ¶ 2.
4 Some years later, Mr. Jacobs sold Mr. Smith insurance. *Id.* at ¶
5 3.

6 Mr. Jacobs persuaded Mr. Smith to use trusts, which he said
7 would reduce Mr. Smith's income tax liabilities. *Id.* at ¶ 4. Mr.
8 Jacobs invited Mr. Smith and his wife to attend a conference on
9 trusts at which Ronald Chappell, CPA, spoke. Mr. Chappell
10 appeared to be Mr. Jacobs' teacher on trusts. *Id.* at ¶ 5.

11 On or about October 1993, Mr. Smith permitted Mr. Jacobs
12 and his sponsors to create several trusts for Mr. Smith,
13 including the "Comfort Heating Trust," the "T & A A Family
14 Holding Trust," and the "T & E A Equipment Trust." Docs. 22,
15 22-5. Mr. Jacobs also created the "Bell Air Trust," to which
16 Mr. Smith assigned all income and expenses of Mr. Smith's
17 heating and air conditioning business, BAHC.
18

19 The business activities did not change after the transfer
20 of BAHC into trust. Mr. Smith named himself as "manager" of
21 each trust. Mr. Smith was still the boss, and controlled what
22 the business did and did not do, day-to-day operations,
23 collection of income, payment of expenses of the business,
24 bidding, and hiring. Doc. 22, ¶ 8.
25

26 Mr. Smith, his wife, his son, and Mr. Jacobs had authority
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1 to sign on the Bell Air Trust account. Smith Depo., 47-48. Mr.
2 Smith removed Mr. Jacobs from signing authority over several
3 trust checking accounts after he misused the accounts. Smith
4 Depo., 49. Mr. Jacobs advised Mr. Smith to pay from the Bell Aire
5 Trust, and later out of the TWC Trust checking account, all
6 mortgage payments, taxes, insurance and other upkeep expenses for
7 the Property and the expenses of BAHC. *Id.* at ¶ 10.
8

9 Mr. Smith transferred the property where BAHC was located
10 (the 240 North "H" Street shop) ("BAHC Property") to the TWC
11 Trust, and later to the T & E Trust. Doc. 22, ¶ 9. In 2008, Mr.
12 Jacobs as trustee of the T & E Trust sold the BAHC Property and
13 used the proceeds to pay off the mortgage on the Property. *Id.*
14 This transaction involved approximately \$100,000. Smith Depo.,
15 60.
16

17 Mr. Jacobs advised Mr. Smith to transfer the Property into
18 the TWC Trust. On June 16, 2008, Mr. Jacobs as trustee
19 transferred title of the Property to the T & E A Trust. Doc. 22,
20 ¶ 10; Doc. 22-4. Mr. Smith retained control of the Property after
21 the transfer and to the present. Mr. Smith controlled the TWC
22 Property Trust account, and used checks from the TWC Property
23 Trust account to pay the Property's property tax, water, and
24 garbage bills. Smith Depo., 136-138; Doc. 22-6; Doc. 22-7.
25

26 Mr. Jacobs told Mr. Smith that the trusts were "non-
27 reporting trusts." Mr. Jacobs also told Mr. Smith that the trusts
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1 and Mr. Smith did not have to file tax returns. Doc. 22, ¶ 12.
2 Mr. Smith stopped filing tax returns entirely. Smith Depo., 93.

3 After Mr. Smith began receiving letters from the Internal
4 Revenue Service, he signed an "Affidavit of Probable Cause for a
5 Criminal Complaint" against Revenue Officer Dennis Stiffler, at
6 the instigation of Mr. Jacobs. Doc. 22-1.

7
8 Mr. Smith now believes that almost everything Mr. Jacobs
9 told him was false. Doc. 22, ¶ 14. Mr. Smith agreed that the
10 trusts were "baloney." Smith Depo., 133; Doc. 22-5.

11 12 III. LEGAL STANDARD

13 Summary judgment is proper if "the pleadings, the discovery
14 and disclosure materials on file, and any affidavits show that
15 there is no genuine issue as to any material fact and that the
16 movant is entitled to judgment as a matter of law." Fed. R. Civ.
17 P. 56.

18 The moving party bears the initial burden of "informing the
19 district court of the basis for its motion, and identifying those
20 portions of the pleadings, depositions, answers to
21 interrogatories, and admissions on file, together with the
22 affidavits, if any, which it believes demonstrate the absence of
23 a genuine issue of material fact." *Celotex Corp. v. Catrett*, 477
24 U.S. 317, 323, 106 S.Ct. 2548 (1986) (internal quotation marks
25 omitted). A fact is material if it could affect the outcome of
26 the suit under the governing substantive law; "irrelevant" or
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1 "unnecessary" factual disputes are not considered. *Anderson v.*
2 *Liberty Lobby, Inc.*, 477 U.S. 242, 248, 106 S.Ct. 2505 (1986).

3 If the moving party would bear the burden of proof on an
4 issue at trial, it must "affirmatively demonstrate that no
5 reasonable trier of fact could find other than for the moving
6 party." *Soremekun v. Thrifty Payless, Inc.*, 509 F.3d 978, 984 (9th
7 Cir. 2007). In contrast, if the non-moving party bears the burden
8 of proof on an issue, the moving party can prevail by "merely
9 pointing out that there is an absence of evidence" to support the
10 non-moving party's case. *Id.*

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12 If the moving party meets its burden, the "adverse party may
13 not rest upon the mere allegations or denials of the adverse
14 party's pleadings, but the adverse party's response, by
15 affidavits or as otherwise provided in this rule, must set forth
16 specific facts showing that there is a genuine issue for trial."
17 Fed. R. Civ. P. 56(e). If the moving party does not meet its
18 burden, "[s]ummary judgment may be resisted and must be denied on
19 no other grounds than that the movant has failed to meet its
20 burden of demonstrating the absence of triable issues." *Henry v.*
21 *Gill Indus.*, 983 F.2d 943, 950 (9th Cir. 1993).

22
23 In ruling on a motion for summary judgment, a court does not
24 make credibility determinations or weigh evidence. See *Anderson*,
25 477 U.S. at 255. Rather, "[t]he evidence of the non-movant is to
26 be believed, and all justifiable inferences are to be drawn in
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1 his favor." *Id.* Only admissible evidence is considered in
2 deciding a motion for summary judgment. *Soremekun*, 509 F.3d at
3 984. "Conclusory, speculative testimony in affidavits and moving
4 papers is insufficient to raise genuine issues of fact and defeat
5 summary judgment." *Id.*

7 IV. DISCUSSION

8 A. Tax Liabilities

9 The United States moves for summary judgment on Mr. Smith's
10 tax liabilities.

11 1. Trusts

12 The United States contends that Mr. Smith attempted to use
13 trusts to reduce his tax liabilities, and there is no question
14 that the trust scheme was illegitimate. The United States
15 contends that they obtained an injunction shutting down the sale
16 of the trust scheme, and prosecuted the Certified Public
17 Accountant who promoted the scheme to Mr. Smith. *See United*
18 *States v. Estate Pres. Servs., Inc.*, 202 F.3d 1093 (9th Cir.
19 2000) ; *see also United States v. Chappell, et al.*, 2:97-cr-216-
20 WBS-DAD (E.D. Cal. 1999) (conviction of CPA who promoted scheme
21 to Mr. Smith for tax evasion scheme involving use of trusts).
22 The Court of Appeals found the tax shelter to be "plainly
23 illegitimate." *Estate Pres. Servs., Inc.*, 202 F.3d at 1106.

24 A trust without economic substance is a sham and is not
25 recognized for federal tax law purposes. *Sparkman v. Comm'r*, 509
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1 F.3d 1149, 1154-1155 (9th Cir. 2007) ("It has long been the law
2 that a transaction with no economic effects, in which the
3 underlying documents are a device to conceal its true purpose,
4 does not control the incidence of taxes."); see also *Zmuda v.*
5 *Comm'r*, 731 F.2d 1417, 1421 (9th Cir. 1984) (holding that the
6 trusts at issue were "shams" and thus disregarded for federal tax
7 purposes); *Hanson v. Commis's'r*, 696 F.2d 1232, 1234-35 (9th Cir.
8 1983) (disregarding a trust that had no economic substance). In
9 evaluating whether a trust has economic substance, the court
10 employs a four-factor test:
11

12 (1) whether the taxpayer's relationship to the transferred
13 property differed materially before and after the trust's
14 creation; (2) whether the trust had an independent trustee;
15 (3) whether an economic interest passed to other trust
16 beneficiaries; and (4) whether the taxpayer respected the
restrictions placed on the trust's operation as set forth in
the trust documents.

17 *Sparkman*, 509 F.3d at 1155.

18 There is no issue that Mr. Smith's trusts lacked economic
19 substance. Mr. Smith's relationship to his transferred property
20 did not differ before and after they were transferred to the
21 trusts. Mr. Smith continued living in the Property after its
22 transfer without paying rent and paid all Property expenses.
23 Although Mr. Jacobs was named as an independent trustee, Mr.
24 Smith removed Mr. Jacobs from signing authority over trust
25 accounts after Mr. Jacobs misused the accounts. Mr. Smith was
26 named "manager" of the trusts and controlled their day-to-day
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1 operations. There is no evidence that an economic interest passed
2 to other trust beneficiaries. In resolving the tax liabilities
3 for 1996, Mr. Smith signed a Closing Agreement which included,
4 among others, the following terms: "the T & E A Equipment Trust
5 will be disregarded for the 1996 taxable year;" and "the T & E A
6 Equipment Trust [is] the alter ego of the taxpayer and the assets
7 ostensibly held in the names of the trusts are the assets of the
8 taxpayer." Doc. 22-5. Mr. Smith admitted that the trusts were
9 "baloney." Smith Depo., 133.

11 Mr. Smith's sham trusts lacked economic substance and are
12 not recognized for federal tax law purposes.

13 2. Tax Liability

14 In an action to collect tax, the United States bears the
15 burden of proof. *United States v. Stonehill*, 702 F.2d 1288, 1293
16 (9th Cir. 1982).

18 The government can usually carry its initial burden,
19 however, merely by introducing its assessment of tax due.
20 Normally, a presumption of correctness attaches to the
21 assessment, and its introduction establishes a prima facie
22 case.

23 *Id.* The United States submitted Certificates of Assessments and
24 Payments for the tax years at issue. Doc. 23. Revenue Officer
25 Stiffler calculated Mr. Smith's current balance, with accruals of
26 interest and penalties to June 16, 2011, for individual federal
27 income tax for the tax years ending December 31, 1996, through
28 and including 2003, as \$318,752.47. Doc. 21-4, ¶ 5. Mr. Smith has

1 not presented any evidence to rebut the presumption of
2 correctness or create an issue of fact regarding his tax
3 liability.

4 The United States' motion to reduce the tax assessments to
5 judgment against Mr. Smith in the amount of \$318,752.47, plus
6 statutory interest and other statutory additions from June 16,
7 2011, is GRANTED.

9 B. Default Judgment Against Non-Appearing Parties

10 The United States also moves for entry of default judgment
11 against: (1) Mr. Jacobs as trustee of the T & E A Trust and (2)
12 MBNA America Bank N.A. ("MBNA"). Default judgment was entered
13 against Mr. Jacobs and MBNA on July 6, 2011. Doc. 25. The United
14 States' motion for default judgment against Mr. Jacobs and MBNA
15 is DENIED as moot and unnecessary.

17 C. Foreclose Federal Tax Liens

18 The United States moves pursuant to 26 U.S.C. § 7403 for an
19 order of judicial sale of the Property to foreclose on Mr.
20 Smith's federal tax liens.

21 Under 26 U.S.C. § 7403, a court "may decree a sale" of a
22 delinquent taxpayer's property. 26 U.S.C. § 7403. A civil
23 collection action under Section 7403 "is one method in a
24 formidable arsenal of collection tools available to the
25 government to collect taxes." *United States v. Gibson*, 817 F.2d
26 1406, 1407 (9th Cir. 1987). Section 7403 affords the court
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1 "limited equitable discretion" "to take into account both the
2 government's interest in prompt and certain collection of
3 delinquent taxes and the possibility that innocent third parties
4 will be unduly harmed by that effort." *Id.* (quoting *United States*
5 *v. Rodgers*, 461 U.S. 677, 709 (1983)). Discretion is limited to
6 the consideration of four factors when the independent interests
7 of third parties are involved:
8

9 (1) the extent to which the government's financial interests
10 would be prejudiced if it were relegated to a forced sale of
11 the taxpayer's partial interest, (2) whether the third party
12 with a nonliable separate interest in the property has a
13 legally recognized expectation that his or her separate
14 property will not be subject to a forced sale by the
15 taxpayer's creditors, (3) the likely prejudice to the third
16 party, both in personal dislocation costs and practical
17 under compensation, and (4) the relative character and value
18 of the interests held in the property.

15 *Id.* at 1407 - 1408.

16 Here, there is no evidence that a third party has an
17 interest in the Property. The Supreme Court has stated that there
18 are "virtually no circumstances . . . in which it would be
19 permissible to refuse to authorize a sale simply to protect the
20 interests of the delinquent taxpayer . . ." *United States v.*
21 *Rodgers*, 461 U.S. 677, 709 (1983). There are no grounds to
22 exercise discretion under 26 U.S.C. § 7403.
23

24 The United States' motion for an order of judicial sale of
25 the Property to foreclose on Mr. Smith's federal tax liens is
26 GRANTED.
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V. CONCLUSION

For the reasons stated:

1. The United States' motion for summary judgment is GRANTED in part and DENIED in part.
2. The United States shall submit a proposed form of order decreeing its tax liens foreclosed and ordering sale of the subject real Property, consistent with this memorandum decision, within five (5) days following electronic service of this memorandum decision.

SO ORDERED.

DATED: July 18, 2011

/s/ Oliver W. Wanger
Oliver W. Wanger
United States District Judge