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Subject: Alan S. Gassman, Martin M. Shenkman & Joe Cuffel on *Campbell v. Commissioner* - Tax Court Concludes that the IRS Cannot Reach Assets in an Old and Cold Self-Settled Offshore Trust

"In Campbell v. Comm'r of Internal Revenue, the IRS sought to classify assets that the taxpayer had placed in an offshore trust before the income tax problems arose as being accessible for the purpose of determining his ability to pay a tax judgment in an Offer in Compromise review proceeding. The taxpayer appealed the reasonableness of this determination to the U.S. Tax Court, and Tax Court Judge Kathleen Kerrigan presided over the proceedings and concluded that the IRS abused its discretion in concluding that the assets under the trust would be considered as an available source of payment in an Offer in Compromise."

Alan S. Gassman, **Martin M. Shenkman** and **Joe Cuffel** provide members with commentary on *Campbell v. Commissioner*.

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Here is their commentary:

EXECUTIVE SUMMARY:

In *Campbell v. Comm'r of Internal Revenue*, the IRS sought to classify assets that the taxpayer had placed in an offshore trust before the income tax problems arose as being accessible for the purpose of determining his ability to pay a tax judgment in an Offer in Compromise review proceeding. The taxpayer appealed the reasonableness of this determination to the U.S. Tax Court, and Tax Court Judge Kathleen Kerrigan presided over the proceedings and concluded that the IRS abused its discretion in concluding that the assets under the trust would be considered as an available source of payment in an Offer in Compromise.

FACTS:

John F. Campbell filed personal income taxes in 2001, reporting income of $201,519, and paid the taxes due thereon. In 2002, Campbell and his family moved to St. Thomas in the U.S. Virgin Islands. At that time, he also began the process of setting up a family trust. In April, 2004, Campbell established the First Aeolian Islands Trust (the Trust), and funded it with $5,000,000 (20% of his then-applicable net worth). In May of that same year, the IRS notified Campbell that his 2001 personal income tax form was going to be audited.

In 2006, Campbell moved back to the U.S. to take advantage of real estate opportunities in the Gulf Coast Region after the series of devastating hurricanes in that area prompted law makers to establish the "Go-Zone Initiative".[i] Those investments failed due to economic and Chinese drywall problems that were beyond Mr. Campbell's control.

In 2007, the IRS issued a "statutory notice of deficiency" seeking to collect Campbell's 2001 unpaid tax liability – a "$1,135,192 deficiency and a Section 6662(a) accuracy-related penalty of $113,519."[ii]

In an attempt to settle the tax liability, Campbell filed for an Offer in Compromise ("OIC"). The IRS Offer in Compromise program enables taxpayers to reduce the amount of tax they would otherwise owe based upon the taxpayer's ability to pay, or "doubt as to collectibility," and other factors, which include "doubt as to liability" and "promotion of effective tax administration."[iii]

The IRS rejected Campbell's offer to settle for $12,603, and calculated that his "Reasonable Collection Potential" was millions of dollars.

A taxpayer whose Offer in Compromise application is rejected has the right to appeal the rejection to the Tax Court by filing a petition for judicial review of a determination within 30 days of the date of the rejection letter pursuant to 26 U.S.C. § 6330(d)(1)(B). While the IRS has no duty to negotiate with a taxpayer before rejecting an OIC, under 26 U.S.C. § 6330(c)(2) a taxpayer who has filed an Offer in Compromise may raise any relevant issue relating to the unpaid tax or the proposed levy, including spousal defenses, challenges to the appropriateness of the collection action, and offers of collection alternatives.

Judge Kerrigan found that Mr. Campbell had placed approximately $5,000,000 under a Nevis offshore asset protection trust with Meridian Trust Company in April of 2004.[iv]

> Petitioner funded the Trust with a $5 million contribution. At the time of the contribution petitioner's net worth was approximately $25 million. No contributions to the Trust have been made since petitioner's initial contribution in 2004.
>
> The taxpayer and his family were beneficiaries of the Trust, but did not retain the right to replace the trust company or the Trust Protector. The Trust Protector had the power to suggest a replacement trust company, but also did not have the power to replace the trust company.

Because of apparent billing issues, the trust company was changed to SouthPac's Nevis office. At the time of the Offer in Compromise appeal, the trust was valued at $1,493,912 by the IRS.[v]

The roughly $3,500,000 of trust assets that were spent for the benefit of Mr. Campbell and his family was determined by the IRS to be dissipated asset funds "used for investments between 2006 and 2010," which brought the IRS's calculation of Mr. Campbell's reasonable collection potential to at least $19,500,000.[vi]

The Tax Court concluded that Mr. Campbell set up and funded the trust well before investing over $27,000,000 in 2006 in GO Zone Properties in Louisiana, Alabama, and Mississippi. Unfortunately, he had a terrible economic result, not only because of plummeting home values, but also because of Chinese drywall issues.

For those who do not recall the calamity of Chinese drywall, up to 100,000 homes in the U.S. were remodeled or built with defective drywall manufactured in China. This drywall, when placed in conditions with high heat and humidity (e.g. the entire Gulf Coast Region that had just been battered by a series of hurricanes), emitted a gas called hydrogen sulfate that smelled like rotten eggs, corroded copper, and caused health issues to the houses' inhabitants. Because the main issue associated with Chinese drywall is the fact that it releases a corrosive gas that can effectively get into every part of a house, reconciling a Chinese drywall situation can sometimes cost more than building a new house.[vii]

The "funds [Campbell] used for the production of income" between the time he invested in GO Zone until 2010, when he had accumulated $3.5 million of negative equity, were sought by the IRS in 2019, as dissipated assets, which contributed to his reasonable collection potential.[viii] The Court found that the investments Campbell made after becoming aware of his 2001 tax liability were not "in an attempt to avoid paying" and were outside the period of time that the Internal Revenue Manual guidelines would permit an appeals officer to look back to in determining whether the taxpayer dissipated assets.[ix]

In this case, because the additional tax and penalty was assessed in April of 2010, the IRS revenue officer could only have looked back six months from that date for assets that Campbell "sold, transferred, encumbered or otherwise disposed of…in an attempt to avoid the payment of the tax

liability."[x] Despite Campbell's awareness of the examination of his 2001 Form 1040 in May 2004, his "ability to pay" was dependent upon the date he was assessed the tax liability at issue.

The Tax Court was not looking at the petitioner's underlying tax liability. The Tax Court reviewed the "administrative determination made by the Appeals Office regarding nonliability issues."[xi] The Standard of Review for these cases is "abuse of discretion."

In assessing whether or not the appeals officer abused her discretion in determining Campbell's appeal, the court looked at the process by which the officer analyzed, chose, and calculated the assets which the IRS believed the taxpayer possessed.

Campbell's ground for the compromise of his tax liability was "doubt as to collectability," which "exists in any case where the taxpayer's assets and income are less than the full amount of the tax liability."[xii] Judge Kerrigan stated that "[g]enerally, under respondent's administrative pronouncements, an OIC based on doubt as to collectability will be acceptable only if the offer reflects the RCP of the case[.]"[xiii]

The RCP is the "Reasonable Collection Potential". To determine a taxpayer's RCP, the appeals officer follows the IRM guidelines. These guidelines are comprised of four categories of assets:

(1) Assets, including dissipated assets;
(2) Future income;
(3) Amounts collectible from third parties; and
(4) Assets available to the taxpayer but beyond the reach of the Government.[xiv]

The appeals officer "calculated petitioner's RCP as $19.5 million, which included dissipated assets, amounts collectible from third parties, and assets beyond the reach of the Government."[xv] Judge Kerrigan assessed the validity of the inclusion of each category of asset included in the calculation and applied the "abuse of discretion" standard to the decision to include these assets in the RCP.

COMMENT:

The petitioner put a large sum of money into an irrevocable grantor trust in Nevis, before knowledge of any pending IRS review. Given that the only contribution was made before the IRS audit, and that no contribution was made thereafter, coupled with the fact that the Trust was not considered to have held assets as "a transferee, nominee, or alter ego of petitioner,"[xvi] the Trust was respected as not being available as a source of payment by the Tax Court.

The Tax Court did not discuss whether state or federal law would enable the Internal Revenue Service to reach the assets of an offshore trust, but Judge Kerrigan, who delivered the Opinion, is a former partner in the law firm of Baker and Hostetler, with a background in tax and legislative processes. She has been sitting on the Tax Court for 7 years of her 15-year term.

Judge Kerrigan must have concluded that the IRS would not be able to reach the assets of a legitimately formed Nevis asset protection trust, even though the trustee of that trust apparently allowed $3,500,000 of assets, plus growth thereon, to benefit the taxpayer.

We believe that Judge Kerrigan made the right call. Even if she had concluded that the questionable Bankruptcy Court decisions that have indicated that U.S. law should apply when a U.S. debtor forms an asset protection trust, the Nevis law does not recognize U.S. judgments. In fact, the recent Belize Supreme Court decision referenced in *In Re Rensin* concluded that the trustee of a Belize asset protection trust should not turn assets over as the result of a U.S. bankruptcy court order. The Belize Supreme Court ordered the trustee in that case "not to comply with any court order to turn over assets in the Joren Trust other than an order from the Supreme Court of Belize."[xvii]

The Court noted a number of positive facts in its evaluation of the case:

> Petitioner created the Trust in 2004 as an irrevocable grantor trust. He and his family are named beneficiaries of the Trust. Under Section 671, petitioner is required to report all tax consequences of the Trust's activities on his personal federal tax return. The Trust document indicates that petitioner has no control over the trustee and [**20] cannot force the trustee to make distributions or investments. Petitioner contends that as a beneficiary of the Trust he does not hold a property interest in the Trust assets.

Specifically, Judge Kerrigan indicated that it was "arbitrary, capricious, and without sound basis in fact or law" for the IRS to determine the Trust was a nominee of Mr. Campbell where the IRS representatives failed to present "any evidence supporting the determination that [Campbell] has a property right in the Trust under State law."[xviii] Beyond failing to characterize Mr. Campbell's 2006 GO Zone investments as deceptive means to "shirk his financial obligation to the public fiscal policy," the Court found that the $19.5 million determination could not be sustained against the proposed levy:[xix]

> The trustee, in its sole discretion, directed a portion of the Trust's assets to be invested in Antilles Offshore Investors, Ltd. Petitioner could not and did not control this decision. For reasons addressed previously, we conclude that the Trust's assets are not considered assets available to petitioner but beyond the reach of the Government. Therefore, we find that the appeals officer abused her discretion in determining that petitioner had control over the Trust's assets.
>
> We have considered all other arguments made and facts presented in reaching our decision, and to the extent not discussed above, we conclude that they are moot, irrelevant, or without merit.[xx]

The Court noted that the taxpayer did not have any control over trust distributions or investments. "Petitioner maintains no control over the trustee to make distributions or investments." It is surprising that investments were noted as control over investments, which is not generally viewed as a tax sensitive power.

Tax Court Memorandum Opinions, such as the one considered here, can be appealed to one of the U.S. Courts of Appeals once a decision is entered by the Tax Court.[xxi] The notice of appeal must be filed with the Tax Court within 90 days after a decision is entered, or 120 days if the IRS appeals first. The taxpayers may also file a motion for reconsideration of an opinion within 30 days after the written opinion was mailed; the motion is considered by the Judge that decided the case, and is rarely granted. However, in a case such as Mr. Campbell's, the matter may be sent back to the IRS to reconsider collection alternatives or other matters.

Conclusion

The taxpayer's foreign asset protection trust ultimately escaped inclusion as an asset to be considered for purposes of the taxpayer's Reasonable Collection Potential. While the IRS wanted to count it among the assets that could be used to pay the tax levy, Judge Kerrigan ruled that the Trust was not includable in the calculations of Campbell's assets. The factors that may have impacted this decision were as follows:

> (1) The taxpayer established the Trust many years before the notice of tax levy occurred, therefore his decision to place assets in the Trust was not viewed as an attempt to hide and protect the money from creditors.
>
> (2) The transfers to the Trust were reasonable relative to the taxpayer's net worth.
>
> (3) The taxpayer was a beneficiary but was not in direct control of the assets. The Tax Court noted that the trustee directed the funds of the Trust in the trustee's sole discretion.
>
> (4) Inherent in the Court's opinion is the fact that the Trust was properly administered. Had the taxpayer in reality controlled the Trust, had Trust formalities been ignored, etc., the results may have been different. For example, in *Wyly*, the Court imputed control over the protectors to the taxpayer and disregarded the trust.[xxii]
>
> (5) The taxpayer's financial issues were not a result of the taxpayer being a bad actor, as in the *Klabacka*[xxiii] or *Rensin* cases.
>
> (6) The Court did not focus on public policy issues.[xxiv]

The Tax Court ruled that the Nevis Trust must be respected in this case, for good reason. Due to the timing of the establishment of the trust, and the way the trust was structured, there is no doubt why Judge Kerrigan ruled that the Appeals Officer abused her discretion in her attempt to include the Trust assets in her RCP calculation.

The difficulty for advisors is how to synthesize the various cases addressing domestic and foreign asset protection trusts. Many of the unfavorable cases have involved bad actors, and there has been almost no discussion in the decisions as to what the basis is for determining that a trust established in a foreign jurisdiction would for some reason be subject to the law of the residence of the settlor. While "bad facts" are often not relevant to the legal analysis of the case involved, one cannot help but wonder what the implications are. Overall, the facts in so many cases have been so egregious that one must wonder whether or how the legal reasoning in those cases may be applied to more reasonable circumstances. Perhaps this *Campbell* case is an illustration of a better fact case, and a Judge who understands how these trusts work and can legitimately be used. This situation may be communicated to clients who have or are considering the use of a self-settled trusts of any type.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

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CITATIONS:

[i] 26 U.S.C.A. § 1400N (West). The Gulf Opportunity Zone Act, also known as the GO Zone Act, was enacted in 2005 and repealed in 2018. The tax benefit encouraged investment in areas affected by Hurricane Katrina.

[ii] *Campbell v. Commr. of Internal Revenue*, 117 T.C.M. (CCH) 1018, 3 (Tax 2019).

[iii] 26 C.F.R. § 301.7122-1(b).

[iv] *Campbell v. Commr. of Internal Revenue*, 117 T.C.M. (CCH) 1018, 1 (Tax 2019).

[v] *Id.* at 3.

[vi] *Id.* at 4.

[vii] Chinese Drywall Woes. The Newsletter for Warranty Management Professionals. December 10, 2009. **https://www.warrantyweek.com/archive/ww20091210.html.** To completely remove and replace defective Chinese drywall, home construction and real estate companies estimate at least $100,000 per home.

[viii] *Campbell v. Commr. of Internal Revenue*, 117 T.C.M. (CCH) 1018, 6 (Tax 2019).

[ix] *Id.* at 15.

[x] *Id.* at 14-15.

[xi] *Id.* at 12.

[xii] *Id.* at 13.

[xiii] *Id.*

[xiv] *Id.* at 14.

[xv] *Id.* at 13.

[xvi] *Id.* at 18.

[xvii] *In re Rensin*, 600 B.R. 870, 876 (Bankr. S.D. Fla. 2019).

[xviii] *Campbell v. Commr. of Internal Revenue*, 117 T.C.M. (CCH) 1018, 6 (Tax 2019).

[xix] *Id.* at 17.

[xx] *Id.* at 22.

[xxi] https://www.ustaxcourt.gov/taxpayer_info_after.htm.

[xxii] SEC v. *Wyly* et al, No. 1:2010cv05760 - Document 622 (S.D.N.Y. 2015).

[xxiii] Blattmachr, Blattmachr, Gassman & Shenkman, "Toni 1 Trust v. Wacker – Reports of the Death of DAPTs for Non-DAPT Residents Is Greatly Exaggerated," LISI Asset Protection Planning Newsletter #362 (March 19, 2018).

[xxiv] Shenkman Rothschild, "Self-Settled Trust Planning in the Aftermath of the Rush University Case," LISI Asset Protection Planning Newsletter #215 (December 6, 2012).