



**IT IS ORDERED** as set forth below:

**Date: May 17, 2011**

A handwritten signature in black ink, appearing to read "W. H. Drake", is written over a horizontal line.

**W. H. Drake**  
**U.S. Bankruptcy Court Judge**

**UNITED STATES BANKRUPTCY COURT  
NORTHERN DISTRICT OF GEORGIA  
NEWNAN DIVISION**

<b>IN THE MATTER OF:</b>	:	<b>CASE NUMBERS</b>
	:	
JOHN M. CARSON,	:	BANKRUPTCY CASE
	:	NO. 09-11298-WHD
Debtor.	:	
_____	:	
	:	
JOHN M. CARSON,	:	
	:	
Plaintiff,	:	ADVERSARY PROCEEDING
	:	NO. 09-1069
v.	:	
	:	
UNITED STATES OF AMERICA,	:	
	:	IN PROCEEDINGS UNDER
	:	CHAPTER 7 OF THE
Defendant.	:	BANKRUPTCY CODE

**ORDER**

Currently before the Court is the “Complaint to Determine Dischargeability”

filed by John M. Carson (hereinafter the “Debtor”) against the United States of America (hereinafter the “Defendant”). The Debtor seeks a declaration that his tax obligations for certain tax years have been discharged in his Chapter 7 bankruptcy proceeding. The Defendant contends that these debts are nondischargeable pursuant to section 523(a)(1)(C). Following a trial, the Court took the case under advisement. This issue falls within the subject matter jurisdiction of the Court. *See* 28 U.S.C. §§ 157(b)(2)(I); 1334.

#### **FINDINGS OF FACT**

The Debtor is a college graduate. During the times at issue, he was married, with two children in elementary and middle school. In 1969, the Debtor became a licensed stock broker and began working as a registered investment adviser. Prior to 1994, the Debtor was an employee of various securities firms. From 1994 through 2002, however, he was affiliated with several broker-dealer firms as a self-employed, independent broker-adviser. In this capacity, the Debtor earned well in excess of \$100,000 a year in commissions, which were deposited directly into his money-market account. As a self-employed worker receiving commissions, the Debtor had no taxes deducted from his compensation. He generally failed to make estimated tax payments during the tax years at issue.

In 1995 and 1996, the Debtor earned adjusted gross income of \$154,879 and \$151,564, respectively. The Debtor did not file timely returns for 1995 or 1996, or make any payments toward the tax liabilities assessed for those years, which were \$24,324 and \$38,640.<sup>1</sup> As to the reason behind his failure to file these tax returns timely, the Debtor testified that his accountant, Mr. Brooks, passed away.<sup>2</sup> Upon Mr. Brooks's death, the Debtor retained a new accountant, Peter Tranakos. With Mr. Tranakos' assistance, the Debtor filed his 1995 income tax return on January 21, 1998. When the Internal Revenue Service (IRS) examined the Debtor's 1995 tax return, the IRS determined the return to be inaccurate due to the under reporting of the Debtor's income tax liability by \$14,000, which resulted in the assessment of an accuracy-related penalty. With his 1995 return, the Debtor sent a partial payment of \$18,097, although the return, prior to the additional assessment, reported taxes due of \$24,324. The Debtor filed his 1996 tax return on November 12, 1998.

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<sup>1</sup> The Debtor testified that he believes he made payments during calendar years 1995, 1996, and 1997, but the Internal Revenue Service has no record of such payments, and the Debtor produced no other evidence of having made such payments. This, along with the fact that the Debtor admits he failed to file returns for years 1995 and 1996 until 1998 leads the Court to find that the Debtor made no such payments.

<sup>2</sup> The Debtor was unclear as to when Mr. Brooks passed away, but he testified that he believed that it was in the mid-1990s. Defendant's Exhibit 41, in which the IRS representative assigned to the Debtor's case notes conversations with the Debtor's accountant, suggests that Mr. Brooks passed away some time between January 1998 and September 1999.

Notwithstanding the fact that the return reported an income tax liability of \$38,640, the Debtor sent no payment with his 1996 return.

The Debtor did make a \$20,000 payment in April 1998, which the IRS applied to the Debtor's 1997 tax liability. On October 16, 1998, the Debtor filed a timely return for 1997. He reported adjusted gross income for 1997 of \$162,191. Although the assessed amount due for 1997 was \$44,680, the Debtor sent a payment of only \$2,000 with his 1997 return, which was credited along with the earlier \$20,000 payment, leaving a 1997 tax liability of \$22,680. On October 30, 1998, the Debtor made the first of four estimated tax payments of \$11,170 for tax year 1998. Subsequent estimated 1998 tax payments were made by the Debtor in November 1998 and January 1999. These payments totaled \$44,680, but the Debtor's actual tax liability for 1998 was \$100,012. The Debtor filed a timely return for 1998 on October 14, 1999, which included a payment of \$20,000, and reported adjusted gross income of \$297,627 for 1998.

In calendar year 1999, the Debtor earned substantially more as an investment adviser than in previous tax years. For tax year 1999, the Debtor reported adjusted gross income of \$315,199. Although his accountant prepared estimated tax payment vouchers for his use during 1999, the Debtor failed to use the vouchers and made no estimated tax payments during calendar years 1999. In addition to the \$20,000

payment sent with the Debtor's 1998 return in October 1999, however, the Debtor made a series of four \$5,000 monthly payments, July through October, which the IRS credited toward his 1995 tax liability, and a \$20,000 payment on November 17, 1999, which the IRS applied toward his 1997 tax liability.

When the Debtor filed timely his 1999 tax return in October 2000, the return reported an income tax liability for 1999 of \$90,463. The Debtor sent a payment of \$5,000 with his 1999 return. Throughout calendar year 2000, the Debtor also earned an exceptionally higher income than in previous years. He reported adjusted gross income for 2000 in the amount of \$645,322, \$514,453 of which was received as commission income. The statements for the Debtor's money-market account (ending in 9294) confirm that \$506,151 was deposited into the Debtor's money-market account during the year 2000. *See* Defendant's Exhibit 11. During calendar year 2000, however, the Debtor made payments to the IRS that totaled only \$110,000, including the payment sent with his 1999 tax return. These payments were applied largely to the Debtor's outstanding liabilities for 1995 through 1998 and were not considered by the IRS to be estimated tax payments for tax year 2000. Although his accountant prepared estimated tax payment vouchers for his use during calendar year 2000, the Debtor failed to use the vouchers and designated none of his tax payments during calendar year 2000 as estimated payments toward his anticipated 2000 income

tax liability.

The Debtor filed his 2000 tax return in October 2001. The 2000 tax return indicated that the Debtor owed \$196,729 for tax year 2000. The Debtor sent no payment with his 2000 tax return. In 2001, the Debtor's adjusted gross income decreased to \$178,384. Although his accountant prepared estimated tax payment vouchers for his use during calendar year 2001, the Debtor failed to use the vouchers and made no estimated tax payments during calendar year 2001. The Debtor made only small payments on his outstanding tax liabilities from prior years. These included five payments of \$3,000 each, which were made in February, June, September, November, and December of 2001. The Debtor timely filed his 2001 tax return in April 2002, indicating an assessed income tax liability for 2001 of \$55,928.

The Debtor lost his job in March of either 2002 or 2003,<sup>3</sup> and has remained unemployed since that time. As a consequence of his loss of employment, the Debtor's 2002 adjusted gross income was just \$35,803. The Debtor's 2002 tax return, filed in October 2003, indicated assessed income taxes of \$10,437. The Debtor sent no payment with his 2002 tax return, but did make one \$3,000 payment in February

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<sup>3</sup> The Debtor testified that he could not remember if he lost his job in 2002 or 2003. The Debtor's account statements indicate continued direct deposits throughout 2002 from National Planning Corporation. This evidence leads the Court to believe that the Debtor most likely lost his job in March 2003.

2002 and one \$1,700 payment in March 2002 toward his outstanding liabilities.

By at least April 1999, the Debtor became aware of the IRS' assertions that he owed unpaid income taxes. The Debtor sent a facsimile to Mr. Tranakos on April 29, 1999, in which the Debtor stated that he had received three separate notices by certified mail from the IRS. In July 1999, the Debtor received a notice of intent to levy from the IRS which prompted him to contact his accountant again for assistance with his tax situation. The Debtor stated that his knowledge of the fact that the IRS claimed he owed unpaid taxes caused him stress and worry.

In September 2002, the Debtor made an offer in compromise to settle his tax obligations by paying \$348,000. The IRS accepted the offer in compromise in May 2003, but the Debtor failed to make the payment agreed to in the settlement. At the time the Debtor made the offer in compromise, he intended to obtain a home equity line of credit and use the proceeds from the loan to pay the settlement amount. Although the Debtor applied for several loans, the Debtor was unable to obtain any loan.

From 1999 to 2002, the Debtor engaged in lavish spending and investing. The Debtor spent at least \$54,540 on clothing, jewelry, computers and electronics, and items from mail order and specialty stores. Also during the years 1999 through 2002, the Debtor took an annual family vacation to St. Augustine, Florida. With vacation

rental, dining out, groceries, shopping, and activities, these vacations cost the Debtor, on average, between \$4,000 and \$5,000.<sup>4</sup> The bulk of the Debtor's income appears to have been invested heavily in securities purchased with the assistance of margin (in excess of \$1.3 million in 2000), for which he incurred \$100,564 in investment expenses, including margin interest. Even with the excessive use of margin and high investment expenses, according to Defendant's Exhibits 6 and 7, from April 1999 through August 2000, the net value of the Debtor's securities (securities value less negative cash balance) climbed as high as \$1,057,316 and never fell below \$242,521.

From 1999 to 2002, the Debtor also paid \$28,327 in tuition for private primary school for his children, paid \$30,000 for a Dodge Durango vehicle, which he testified he gave to his wife's father, and made charitable contributions of \$53,489. The Debtor's account statements further indicate that, during 1999, 2000, and 2001, the Debtor routinely wrote checks to himself for between \$3,000 and \$6,000. *See* Defendant's Exhibits 6, 8, 10, 11, 12, and 33. In 1999, the Debtor wrote \$60,000 worth of checks to himself. In 2000 and 2001, the Debtor wrote \$63,500 and \$32,900 worth of checks to himself. While the Debtor could not recall why he wrote checks to himself or how he used the funds, it appears clear from the account

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<sup>4</sup> While the Debtor testified that he stopped taking his annual vacation after the summer of 2000, Defendant's Exhibits 9, 12, and 13 confirm that the Debtor vacationed in St. Augustine in the summers of 2001 and 2002.



statements for the Debtor's brokerage account, money market account, and credit card that these funds were not used for basic living expenses, as the account statements for these years include regular charges and debits directly from the money market and brokerage accounts for items such as groceries, drug store purchases, hardware store purchases, home security, pest control, dining out, clothing and shoes, medical bills, dental bills, veterinarian bills, car repair, telecommunications, gasoline, recreation, electricity, satellite television, private school tuition, books, magazine subscriptions, photography, gifts, flowers, jewelry, entertainment, travel, office supplies, insurance, professional fees and dues, accountant's fees, mortgage payments, property taxes, state taxes, tithing, and credit card bills and fees. *See id.*; Defendant's Exhibit 14. Given the regularity of the checks, the fact that they were always made out to the Debtor by way of a round figure, such as \$3,000, \$4,000, or \$5,000, and the fact that the Debtor's regular living expenses appear to have been more than provided for by the funds expended from the Debtor's brokerage and money market accounts, the Court finds that the Debtor cashed the checks and spent the funds on something other than living expenses.

The Debtor filed a voluntary petition under Chapter 7 of the Code on April 9, 2009. At that time, the amounts owed by the Debtor for 1995, 1998, 1999, 2000, 2001, and 2002, including interest and penalties, totaled \$85,561.44, \$17,828.35,

\$145,158.17, \$394,317.61, \$106,086.86, and \$9,334.37, respectively. On August 2, 2009, the Debtor filed the instant complaint seeking a determination as to the dischargeability of his tax liabilities arising from tax years 1995 and 1998-2002.

### CONCLUSIONS OF LAW

Section 727 of the Bankruptcy Code provides for the discharge of an individual debtor's prepetition debts unless such debts are nondischargeable under section 523. *See* 11 U.S.C. § 727(b). Section 523(a)(1)(C) excepts from discharge "any debt (1) for a tax . . . with respect to which the debtor . . . willfully attempted in any manner to evade or defeat such tax." 11 U.S.C. § 523(a)(1)(C). Section 523(a)(1)(C) applies when the debtor has evaded either the assessment or the payment or collection of taxes. *See In re Griffith*, 206 F.3d 1389, 1396-97 (11th Cir. 2000) (en banc).

As with all exceptions to discharge, section 523(a)(1)(C) must be construed strictly in favor of the debtor. *United States v. Fretz (In re Fretz)*, 244 F.3d 1323, 1327 (11th Cir. 2001). The Defendant "bears the burden to prove, by a preponderance of the evidence, that a particular claim is nondischargeable under [section 523(a)(1)(C)]." *Id.* (citing *Griffith v. United States (In re Griffith)*, 206 F.3d 1389, 1396 (11th Cir. 2000)); *see also In re Jacobs*, 490 F.3d 913, 921 (11th Cir.

2007); *Wilbert v. Internal Revenue Service, et al. (In re Wilbert)*, 262 B.R. 571 (Bankr. N.D. Ga. 2001) (Drake, J.). Whether a debtor willfully intended to evade or defeat a tax is a question of fact to be determined from the totality of the evidence. *In re Peterson*, 317 B.R. 556 (Bankr. N.D. Ga. 2004) (Diehl, J.); *Teeslink v. United States (In re Teeslink)*, 165 B.R. 708, 716 (Bankr. S.D. Ga. 1994) (citation omitted).

Section 523(a)(1)(C) requires the satisfaction of "a conduct requirement (that the debtor "attempted in any manner to evade or defeat [a] tax"), and a mental state requirement (that the attempt was done "willfully")." *Id.* The simple failure to pay taxes, without more, does not meet the "conduct requirement." *In re Haas*, 48 F.3d 1153, 1158 (11th Cir.1995), *abrogated in part, In re Griffith*, 206 F.3d 1389, 1395-96 (11th Cir. 2000) (en banc); *see also Jacobs*, 490 F.3d at 922 (noting that, in *Haas*, the court rejected the government's argument that it need only prove the debtor knew of the duty to pay and had the means to do so, but failed to pay). Accordingly, the conduct requirement is not satisfied solely by establishing that the debtor, who has filed accurate returns, simply failed to pay the taxes while continuing to pay other debts. *See Haas*, 48 F.3d at 1158. "The government satisfied the conduct requirement when it proves the debtor engaged in affirmative acts to avoid payment or collection of taxes, either through commission or culpable omission." *United States of America v. Mitchell*, \_\_\_ F.3d \_\_\_, 2011 WL 652517, \*6

(11th Cir. Feb. 24, 2011) (quoting *Jacobs*, 490 F.3d at 921).

Such affirmative acts may include: failing to file tax returns; purchasing "significant assets" that are titled "in the names of family members;" dealing solely in cash in an effort to prevent the attachment of bank account funds; causing income to be characterized as non-wage income to avoid withholding and failing to pay estimated tax payments on such income; and making large discretionary expenditures when the debtor knows of his tax liabilities and has the means to pay the liabilities, but chooses not to do so. *Jacobs*, 490 F.3d at 925-26; *see also In re Hassan*, 301 B.R. 614, 623-624 (S.D. Fla. 2003) (affirming bankruptcy court's decision that tax debt was nondischargeable when debtors failed to file timely returns until contacted by the IRS, failed to perform under an arranged payment plan, purchased property in their daughter's name, and maintained a lavish lifestyle instead of paying their taxes). In the *Mitchell* case, the court found the conduct requirement satisfied by the debtor's failure to file tax returns or to pay any amount towards his taxes for five years. *Mitchell*, 2011 WL 652517, \*6.

The mental state requirement does not require a showing of fraudulent intent, but rather a demonstration that the attempt to avoid a tax liability was done "willfully" -- "done voluntarily, consciously or knowingly, and intentionally." *Jacobs*, 490 F.3d at 921. To establish the required mental state, the defendant must

prove that the debtor: "(1) had a duty under the law, (2) knew he had that duty, and (3) voluntarily and intentionally violated the duty." *Mitchell*, 2011 WL 652517 at \*6.

The Court concludes the Defendant has established the conduct requirement. The Debtor failed to file tax returns for 1995 or 1996 or to pay any amount towards his tax liability for these years until almost the end of 1998. The Debtor put forth no clear explanation as to why he failed to comply with his obligation to do so. He testified that he always believed he had filed and paid taxes during this period of time because, if his accountant had told him to file something or pay something, he would have done so. Considering the fact that the Debtor is a sophisticated, educated businessman, the Court does not believe the Debtor was simply mistaken about whether his accountant had actually filed his tax returns. Even if the Debtor erroneously believed his accountant had filed the returns for 1995 and 1996, the Court cannot find that the Debtor honestly believed that, after earning commissions of \$150,000 a year, with no withholding for income or self-employment taxes, his tax liability for 1995 or 1996 had been paid. The idea that the Debtor's former accountant was to blame for his failure to file and pay during this time is even more difficult to believe when one considers the fact that the Debtor later failed to pay estimated tax payments, even though his accountant had prepared the necessary

paperwork for him to do so.

The Debtor's tax issues with regard to tax years 1998, 1999, 2000, 2001, and 2002 were a direct result of the Debtor's failure to file returns for 1995 and 1996 until 1998 and his failure to make estimated tax payments for 1997. When the Debtor finally filed his missing returns and began making payments toward the large delinquency, the payments made were applied to these earlier years, rather than the years in which the payments were made. Even at this point, however, the Debtor could have used his substantial income in 1999 or 2000 and liquidated his stock holdings to clean up the delinquent taxes and pay his 2000 tax liability. According to Defendant's Exhibit 41, the amount owed by the Debtor, less the amounts he paid over the course of 2000, 2001, and 2002, for tax years 1995, 1998, and 1999 totaled approximately \$235,295. The Debtor could have paid this amount in full at any time during the months of September 1999 through August 2000 by simply liquidating the securities held in his brokerage account. As noted above, according to Defendant's Exhibits 6 and 7, from April 1999 through August 2000, the net value of his securities (securities value less negative cash balance) climbed as high as \$1,057,316 and never fell below \$242,521. Further, the Debtor received at least \$506,000 in cash in 2000, which he could have used to pay the remaining outstanding liabilities.

The Debtor's decision to invest, spend, and give away a portion of his income

in the form of a \$30,000 vehicle given to a family member, are contrary to the Debtor's position that he paid what he could pay along the way and did not willfully avoid paying the taxes, but simply could not afford to pay the taxes after he lost his employment. The facts of this case belie the Debtor's assertions that this case has more in common with a debtor who has the means to pay his taxes, but makes the decision to use the funds to pay other creditors. The Court is persuaded that the Debtor could easily have paid the full amount, but decided to delay and pay only a portion of his taxes, hoping that he could negotiate away the penalties and interest "at some point in time." *See* Opening Statement of Debtor's Counsel, Transcript of Hearing on Complaint, October 19, 2010 at 11. This conduct satisfies the requirement of the statute that the Debtor "attempted in any manner to evade or defeat" the tax.

As to whether the Debtor's conduct was "willful," the Court concludes that the Defendant has satisfied the burden of proving that Debtor: "(1) had a duty under the law, (2) knew he had that duty, and (3) voluntarily and intentionally violated the duty. The Debtor clearly testified as to his awareness of his outstanding tax liability and of his duty to pay the tax. This was true during the years 1999 and 2000, during which he earned \$315,199 and \$645,322, respectively, and could have used his income to pay his 1995, 1998, 1999, 2000, and 2001 tax liabilities in full. The Court,

however, agrees with the Debtor that, after he lost his job and his securities portfolio was liquidated, due to the falling values of the securities and his use of margin, the Debtor lacked the ability to pay the tax obligations incurred in tax year 2002. Accordingly, the Court cannot conclude that the Debtor voluntarily and intentionally failed to pay these taxes, and these obligations should be discharged.

### **CONCLUSION**

For the reasons stated above, the Court concludes that the tax debts owed by the Debtor, John M. Carson, to the United States of America for tax years 1995, 1998, 1999, 2000, and 2001 are **NONDISCHARGEABLE** pursuant to section 523(a)(1)(C). The tax debt owed for tax year 2002 is dischargeable.

A separate judgment will be entered in favor of the United States of America concurrently with this Order.

**END OF DOCUMENT**