

Burden of Proof
Tax Claims
FRBP 3001(f)

USA v. Sherwood (In Re Sherwood)

Dist. Ct. # 96-6140
Main Case # 694-60799-aer13

7/10/96

HOGAN (affirming Radcliffe)

Unpublished

In IRS tax claim litigation, the IRS's proof of claim is entitled to a presumption of correctness once the IRS puts on some substantive evidence that the taxpayer has received income. The taxpayer has the burden of going forward with sufficient evidence to overcome this presumption. The taxpayer also has the ultimate burden of proving by a preponderance of the evidence that the IRS's determinations are incorrect. (But see, MacFarlane v. Franchise Tax Bd, of Calif., 83 F.2d 1041 (9th Cir. 1996) (holding state taxing authority has the ultimate burden of proof in the bankruptcy forum). The bankruptcy court did not err in allocating the above burdens.

On the merits, the bankruptcy court's finding that monies contributed to the Debtor for the tax year in question were loans rather than investments and thus not taxable income, was not clearly erroneous.

U.S. BANKRUPTCY COURT
DISTRICT OF OREGON
FILED

JUL 10 1996

TERENCE H. DUNN, CLERK

BY Re DEPUTY

Rec'd 9-16-96

a. Terry Lowe
FILED *7-11-96*

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CLERK, U.S. DISTRICT COURT
DISTRICT OF OREGON
EUGENE, OREGON

BY [Signature]

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF OREGON

In re
EDWARD R. SHERWOOD and
SESUKO SHERWOOD,

Debtors.

UNITED STATES OF AMERICA,

Appellant,

v.

EDWARD R. SHERWOOD and
SESUKO SHERWOOD,

Appellees.

Bank. Case: 94-60799 acx 13

96-6140

Case No. ~~95-22~~ Misc.

ORDER

This is an appeal from the bankruptcy court's order granting Appellees' objection to a claim of the Internal Revenue Service. This court has jurisdiction under 28 U.S.C. § 158(a).

FACTS

Appellee Edward Sherwood is a mineral prospector who received substantial funds from one Robert Chambers during

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tax years 1983 and 1984. An Internal Revenue Service (IRS or Appellants) audit of Mr. Chambers indicated that a portion of this amount was in the form of investments, rather than loans, and, therefore, may be income to Appellees. Accordingly, the IRS audited Appellees.

During the Appellees' audit, Mr. Chambers and Mr. Sherwood alleged that the funds were loans rather than investments. The auditing agent rejected this allegation, treating the amounts as income which Appellees failed to report. The IRS filed a proof of claim in the amount of \$236,906.05 (\$34,717.52 in taxes for 1983 and \$13,061.00 in taxes for 1984, plus interest and penalties). See Proof of Claim, Ex. A to Bankruptcy Court Record (#66).

Appellees objected to the IRS's Proof of Claim, and an adversarial hearing was held before the bankruptcy court. Appellees called Mrs. Sherwood, who testified that she and Mr. Sherwood filed tax returns for 1983 and 1984 and did not owe the government any money for those years. Transcript of Bankruptcy Court Evidentiary Hearing (Tr.), Ex. D to Bankruptcy Court Record (#66) at 15. Appellees' 1983 and 1984 tax returns were accepted into evidence. Id. The IRS cross-examined Mrs. Sherwood, who testified she was a housewife and that their accountant prepared her and her husbands' 1983 and 1984 income tax returns. Id. at 17-18.

Appellees then rested their case, and the IRS moved for a directed verdict. The bankruptcy judge denied the IRS's

motion, stating "I believe the weight of the evidence would be sufficient to overcome the documents before the Court in the form of a proof of claim." Id. at 21.

The IRS proceeded with their case, first calling the auditing agent George Terpack. Mr. Terpack testified that, in his opinion, the funds conveyed from Mr. Chambers to Mr. Sherwood in 1983 and 1984 were investments, not loans, in part because they were referred to as "stocks" on Mr. Chambers's canceled checks. Mr. Terpack testified, however, that the amounts were recorded in the form of notes, which typically evidence loans, Tr. 43, and that Mr. Chambers never received stock certificates. Tr 83. Mr. Terpack also testified that Mr. Sherwood had told him during the audit that he intended to pay the funds back to Mr. Chambers at some time. Tr. 47. Mr. Terpack also testified that he had considered an affidavit and letters by Mr. Chambers stating that the amounts were intended as loans, not investments. Tr. 90-93.

The government next called Mr. Chambers. Mr. Chambers testified that he bought shares of stock from Mr. Sherwood (Tr. 109, 116, 130-31) and provided loans to enable Mr. Sherwood to ~~pay~~ remain solvent in order to pay returns on Mr. Chambers's initial investments. Tr. 118. Mr. Chambers admitted having difficulty remembering which payments were loans and which were investments. Tr. 119, 121. Mr. Chambers also admitted to signing letters and an affidavit

stating that the payments were loans, but Mr. Chambers alleged he signed these documents in 1988 and 1989 only because Mr. Sherwood told him he would receive no return on his investments unless he did so. Tr. 132-33, 214-15. Mr. Chambers stated that he was in conservatorship from 1986 until February of 1989 because of emotional and financial problems and signed the documents despite knowing his signature would be unenforceable in a court of law. Tr. 133-34. Mr. Chambers stated that he placed no conditions on Mr. Sherwood's use of the funds (Tr. 138) and that he was not generally in the business of lending money. Tr. 143.

On cross examination, Mr. Chambers testified that he had invested in several closely held corporations and limited partnerships in the 1980's. Tr. 146-153. Mr. Chambers testified that he had signed checks, letters, and an affidavit during the time he was in conservatorship. Tr. 172-73, 215-225. The court accepted into evidence an affidavit and letters signed by Mr. Chambers indicating that the amounts transferred to Mr. Sherwood were loans. Tr. 185.

After resting its case, the IRS moved for a directed verdict. Tr. 236. The bankruptcy judge denied the motion, noting that "the evidence is in dispute." Tr. 240.

The bankruptcy judge allowed Appellees to call two rebuttal witnesses for the purpose of refuting the IRS's case. Fred Guerin testified that Mr. Chambers's reputation

in the community is that he "sometimes lies." Id. Mr. Sherwood took the witness stand and verified his signature on several exhibits. Tr. 253.

On March 17, 1995, the bankruptcy judge issued his ruling granting Appellees' objection to the IRS's proof of claim on the ground that the amount claimed as a deficiency was for loans rather than investment income. Ex. E to Bankruptcy Court Record (#66).

DISCUSSION

A bankruptcy court's findings of fact are reviewed for clear error, and its conclusions of law are reviewed *de novo*. In re DAK Indus., Inc., 66 F.3d 1091, 1094 (9th Cir. 1995).

Appellant contends the bankruptcy court "incorrectly allocated the burden of proving that the debtors had unreported income for 1983 and 1984." Appellant's Brief (#65) at 9. The IRS's Proof of Claim is entitled to a presumption of correctness once the IRS puts on "some substantive evidence that the taxpayer received income" Weimerskirch v. Comm., 596 F.2d 358, 360 (1979). The taxpayer has the burden of going forward with sufficient evidence to overcome this presumption. The taxpayer also has the ultimate burden of proving by a preponderance of the evidence that the IRS's determinations are incorrect. Baxter v. Comm., 816 F.2d 493, 495 (9th Cir. 1987). But see MacFarlane v. Franchise Tax Bd. of Calif., 83 F.2d 1041,

1045 (9th Cir. 1996) (holding that "[state] taxing authority has the ultimate burden of proof in the bankruptcy forum").

Here, the bankruptcy court denied Appellant's motion for a directed verdict after Appellees rested their case. The court noted

As to the 1983 and 1984 taxes, the debtors have introduced their returns for those years, and one of the debtors has testified that there's no tax owing for those years. I believe many of Counsel's comments may have go [sic] to the weight of the evidence, but I believe the weight of the evidence would be sufficient to overcome the documents before the Court in the form of a proof of claim.

Tr. 21.

The substantive evidence put on by Appellees was sufficient to meet Appellees' burden of going forward with the evidence to overcome the presumptive validity of the proof of claim. The bankruptcy court's finding that Appellees had put on sufficient evidence to overcome the presumptive validity of the IRS's claim is not clearly erroneous and does not constitute an error of law.

The record does not support Appellant's contention that the bankruptcy court improperly shifted the burden of proof to Appellants. Although the bankruptcy judge stated at the outset of the hearings that "the burden is on the . . . debtors to go forward with some evidence to show the claim is not valid [and at] that point the burden may shift back to the creditor to establish the amount of the claim[,] " the record indicates that the bankruptcy judge ultimately

imposed the burden of proof on Appellees. The bankruptcy judge stated "I believe the . . . debtor [Appellee] has the burden of proof. . . ." Tr. 144. In their closing argument, Appellees' attorney stated "I believe debtors have met their burden of proof, which as the Court knows is a preponderance of the evidence." Tr. 256. In the subsequent telephonic hearing of February 17, 1995, the bankruptcy judge found as follows:

Weighing the evidence, that is, weighing Mr. Chamber's [sic] oral testimony as against the documents, this court concludes that the documents are the more credible evidence, and I find that the monies contributed to Mr. Sherwood by Mr. Chambers during 1983 and 1984 were loans and not investments and hence should not be added to taxable income.

Ex. F to Bankruptcy Record (#66) at 11.

The bankruptcy court's finding that the sums paid by Mr. Chambers to Mr. Sherwood were loans rather than investments is not clearly erroneous. Because this finding was based on the preponderant evidence rather than on a finding that Appellant failed to meet its burden of proof, the bankruptcy court did not err as a matter of law.

CONCLUSION

The order of the bankruptcy court is affirmed.

DATED this 10th day of July, 1996



UNITED STATES DISTRICT JUDGE

H,
c-Taub, Rowe
FILED 7-12-96

Entered

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CLERK, U.S. DISTRICT COURT
DISTRICT OF OREGON
EUGENE, OREGON

BY 

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF OREGON

UNITED STATES OF AMERICA

Appellant,

v.

Civil No. 96-6140-HO

EDWARD R SHERWOOD, and
SESUKO SHERWOOD

Appellees.

JUDGMENT

The order of the bankruptcy court is affirmed.

Dated: July 12, 1996.

Donald M. Cinnamond, Clerk

by 

Lea Force, Deputy

U.S. DISTRICT COURT
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LODGED
FBI

JUDGMENT

DOCUMENT NO: _____