Office of Chief Counsel
Internal Revenue Service

memorandum

CC:SB:4:DET:1:GL-109832-14
LDSledz

date: March 18, 2014

to: Gloria Estrada, Compliance Technical Services Group Manager

from: Associate Area Counsel (Small Business/Self-Employed)

subject: **CP Renewable Energy Marketers, LLC. (EIN: 26-0474375)**
Request for Alter Ego Lien and Levy

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This memorandum is to respond to your request for authority to record and serve an alter ego/nominee lien and levy.

ISSUES

1. Whether the Service may record alter ego/nominee Notices of Federal Tax Lien to secure the unpaid tax liabilities due from CP Renewable Energy Marketers, LLC against property held in the names of C P Recycling, Inc., CP Bio Energy, LLC, CP Recycling of Nebraska, Inc., and Paul D. Knowlson.

2. Whether the Service may proceed with levy and seizure action.

CONCLUSIONS

1. The Service may record Notices of Federal Tax Lien using the following language:

C P Recycling, Inc. as alter ego of CP RENEWABLE ENERGY MARKETERS, LLC.

CP BIO ENERGY, LLC as alter ego of CP RENEWABLE ENERGY MARKETERS, LLC.

CP RECYCLING OF NEBRASKA, INC. as alter ego of CP RENEWABLE ENERGY MARKETERS, LLC.

2. The Service may proceed with levy and seizure activity.

FACTS

CP Renewable Energy Marketers, LLC ("CPREM")was an alternative fuel distributor operated by Paul Knowlson ("Knowlson"). CPREM's business was to provide substrates to third parties who would then combine the substrates in a digester to create fuel. This operation was fully funded by tax credits. CPREM also sold alternative fuel products in addition to providing substrates. Between 2008 and 2011, CPREM provided its product to customers, and gave a portion of the tax credit it received to the customers. CPREM had no assets other than its bank account. The overhead of CPREM was paid by C P Recycling, Inc. ("CPRI"), another entity owned by Knowlson. After receiving tax credits, CPREM would then repay CPRI. In addition to repaying the expenses paid on behalf of CPREM, CPREM transferred significant funds to CPRI. CPREM also guaranteed a line of credit with Comerica Bank for CPRI.

In 2011, a revenue agent informed Knowlson that CPREM was ineligible to receive the credits, and approximately $22 million in credits wrongfully paid to CPREM were assessed. CPREM voluntarily paid $120,000.00 toward this assessment. An additional $481,000.00 was collected through a bank levy.

After the assessment of the wrongfully paid credits, CPREM ceased operations and CP Bio Energy, LLC ("CPBE") was formed by Knowlson to succeed CPREM. There is no evidence of any consideration paid to CPREM for its business. CPBE later spun-off some of its operations to another entity, CP Recycling of Nebraska, Inc. ("CPRN"). CPBE stepped into CPREM's place when CPREM ceased operations. Although CPBE changed some of CPREM's business practices, and lost some customers, the remaining customers viewed CPBE as the same as CPREM. Customers noted that the only change was the name of the company sending invoices. Other customers simply assigned CPREM's vendor number to CPBE. CPBE also retained a majority of the staff of CPREM.

ANALYSIS

A lien arises in favor of the United States upon all property and rights to property of the taxpayer if the taxpayer

is liable to pay any tax and fails or refuses to pay the tax after notice and demand. I.R.C. § 6321. After notice to a taxpayer and demand for payment of his outstanding taxes, and the taxpayer's refusal to pay such taxes, the Service has the power to levy upon "all property and rights to property (except such property as is exempt under I.R.C. § 6334) belonging to such person or on which there is a lien . . . ." I.R.C. § 6331(a).

The purpose of the alter ego and nominee lien and levy theories is to prevent a taxpayer from defeating his tax liabilities by placing property in the name of another entity or person which is merely a "front." *See Hill and Company v. United States*, 74-2 U.S.T.C. ¶ 9842 (S.D. Ohio 1974). The government should have sufficient evidence to show a nexus between the taxpayer and the property held by the nominee to meet the burden of persuasion in response to a wrongful levy suit. *Flores v. United States*, 551 F.2d 1169 (9th Cir. 1977).

There is authority for filing alter ego and nominee and executing alter ego and nominee levies where a taxpayer has retained the incidents of actual ownership, while transferring legal title to a third party, or where the government has reasonable cause to believe that the taxpayer's property has been transferred to third-party nominees to avoid creditors. *See Baldassari v. United States*, 78-2 U.S.T.C. ¶ 9560 (Cal. Ct. App. 1978) (*relying upon G.M. Leasing Corp. v. United States*, 429 U.S. 338 (1977)).

Alter Ego Lien[1]

The service ~~my~~ levy on all of the property or rights to property of an alter ego entity (e.g., a trust, corporation, or limited liability company) to collect the liability of a taxpayer, if, for example, "the separate corporate entity is merely a sham, *i.e.*, it does not exist independent of its controlling shareholder and that it was established for no reasonable business purpose or for fraudulent purposes." *Oxford Capital Corp. v. United States*, 211 F.3d 280, 284 (5th Cir. 2000); *see also G.M. Leasing Corp. v. United States*, 429 U.S. 338, 351 (1977). The alter ego doctrine often involves "piercing the corporate veil" to hold an individual or shareholder liable for the debts of a business entity, although "reverse piercing"

[1] With the issuance of Chief Counsel Notice CC-2012-002, Chief Counsel seeks to place additional emphasis on the position that federal common law alone governs the application of the alter ego doctrine, and that state law, or a two-step state/federal alter ego analysis, is improper in the application of that doctrine. We have outlined this position and its supporting arguments and analysis below.

may also be used to recover a taxpayer's delinquent tax liability from his alter ego business entity. *Towe Antique Ford Fund v. Commissioner*, 999 F.2d 1387, 1390 (9th Cir. 1993). The alter ego doctrine is often confused with the nominee doctrine, which goes to whether a person has placed formal ownership of property in the hands of another while in substance retaining all or some of the benefits of the true owner. *See Baum Hydraulics Corp. v. United States*, 280 F.Supp.2d 910, 916-17 (D. Neb. 2003); *In re Richards*, 231 B.R. 571, 578 (E.D. Pa. 1999). In other words, the alter ego doctrine involves the imposition of liability on an entity by treating that entity as the taxpayer for collection purposes, while the nominee doctrine focuses on the taxpayer's relationship to particular property or rights to property.

Federal common law governs the application of the alter ego doctrine in a variety of contexts outside of tax administration. *See, e.g., Board of Locomotive Eng'rs v. Springfield Terminal Ry. Co.*, 210 F.3d 18, 25-26 (1st Cir. 2000) (labor dispute under Railway Labor Act); *NLRB v. West Dixie Enterprises, Inc.*, 190 F.3d 1191, 1194 (11th Cir. 1999) (labor dispute under the National Labor Relations Act); *Thomas v. Peacock*, 39 F.3d 493 (4th Cir. 1994) (breach of fiduciary liability under ERISA), *rev'd on other grounds*, 516 U.S. 349, 353-54 (1994); *NLRB v. Greater Kansas City Roofing*, 2 F.3d 1047 (10th Cir. 1993) (liability for unfair labor practices); *United States v. Pisani*, 646 F.2d 83 (3d Cir. 1981) (liability for Medicare fraud); *EEOC v. MacMillan Bloedel Containers, Inc.*, 503 F.2d 1086, 1089-92 (6th Cir. 1978) (liability under Title VII of the Civil Rights Act); *cf United States v. Golden Acres, Inc.*, 702 F.Supp.1097, 1103 (D. Del. 1988) (default on HUD-held loan); *aff'd without opinion*, 879 F.2d 857 (3d Cir. 1989). These federal decisions are generally rooted in *Clearfield Trust Co. v. United States*, 318 U.S. 363, 367 (1943), in which the Court stated: "The application of state law [governing commercial paper] . . . would lead to great diversity in results by making identical transactions subject to the vagaries of the laws of the several states," and in *United States v. Kimball Foods, Inc.*, 440 U.S. 715, 726 (1979). In *Kimball Foods*, the Court said that "[t]his Court has consistently held that federal law governs questions involving the rights of the United States arising under nationwide federal programs." *Supra* at 726.

Federal common law, as opposed to state law, should govern the question of alter ego liability because (1) there is a need for a nationally uniform body of law to apply in situations like the one presented, and (2) the application of state law would

frustrate important federal policy. *Id.* at 728-29. We are aware, however, that the application of federal law may impact existing relationships under state law. *Id.* (priority of liens stemming from federal lending programs must be determined with reference to federal law). The use of federal common law is not precluded by *Commissioner v. Stern*, 357 U.S. 39 (1958). *Stern*, which was decided before *Kimball Foods*, held that transferee liability under the precursor to section 6901 is to be determined under state law rather than federal common law. *Id.* at 44-45. The Court leaned heavily in *Stern* on legislative history reflecting the strictly procedural role of the federal transferee liability statute coupled with reliance on the substantive role of state laws concerning fraudulent transfers--state laws which do not vary extensively from state to state. In contrast, state variations on alter ego doctrine will often lead to disparate results on the same set of facts. Moreover, unlike section 6901, the alter ego doctrine does not impose a defaulting taxpayer's liability on another person, but treats an entity as the taxpayer for tax collection purposes.

Using state law rather than federal common law in this instance would frustrate the important federal policy of uniform imposition of federal tax liability. In analogous circumstances, federal courts apply federal law to federally created claims. *See Anderson v. Abbott*, 321 U.S. 349, 365 (1944) ("the question of liability for these [non-tax, federal] assessments is a federal question. The policy underlying a federal statute may not be defeated by such an assertion of state power."); *Pisani*, 646 F.2d at 87 (adopting a federal standard where state law "might be more restrictive" than federal law because "we believe it is undesirable to let the rights of the United States in the area change whenever state courts issue new decisions"); *Golden Acres*, 702 F. Supp. At 1103 ("[i]f Delaware courts are indeed as reluctant to pierce the corporate veil as defendants allege . . . then application of Delaware law in cases such as this one would frustrate the national housing policy behind the HUD program which insured Golden Acres' mortgage").

Use of federal common law for alter ego determinations in federal tax collection matters is also supported by section 7402(a), which grants the district courts authority to issue "such judgments or decrees as may be necessary or appropriate for the enforcement of the internal revenue laws." That statute may be analogized to section 10(c) of the Labor Management Relations Act ("LMRA"), 29 U.S.C. § 160(c), which authorized quasi-judicial proceedings in which the NLRB could take such actions as would

effectuate the policies of the LMRA. On the basis of this provision, and beginning with *Textile Workers Union of America v. Lincoln Mills of Alabama*, 353 U.S. 448, 456 (1957), the Court gradually expanded the application of federal common law in enforcing the LMRA. The Court later held that a successor could be compelled to arbitrate, *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543, 549 (1964), then held that federal law controlled whether a successor was liable to remit back wages to an employee who won that relief against its predecessor, when the successor (who had notice of the claim) had acquired all of the predecessor's assets but had not assumed its liabilities. *Golden State Bottling Co., Inc. v. NLRB*, 414 U.S. 168, 171-74 (1973). In upholding the use of federal law, the Court held that "the Board's remedial powers under § 10(c) include broad discretion to fashion and issue the order before us as relief adequate to achieve the ends, and effectuate the policies, of the Act." *Id.* at 176. Under I.R.C. § 7402(a), the courts may be said to have similar powers in the area of federal tax collection. Indeed, given that withholding taxes "are part of the wages of the employee," *Gephart v. United States*, 818 F.2d 469, 472 (6th Cir. 1987), and that private employees may recover back wages using federal common law, it stands to reason that the United States may rely on federal common law to collect the tax.

Those federal appellate decisions that have applied state law to determine the alter ego question for purposes of federal tax collection have done so without analysis concerning the identity of the taxpayer and the alter ego entity. *See, e.g., Old West Annuity and Life Insurance Co. v. Appollo Group*, 605 F.3d 856, 861 (11th Cir. 2010); *United States v. Scherping*, 187 F.3d 796, 802 (8th Cir. 1999); *Floyd v. IRS*, 151 F.3d 1295, 1298 (10th Cir. 1998); *Zahra Spiritual Trust v. United States*, 910 F.2d 240, 242 (5th Cir. 1990); *Wolfe v. United States*, 798 F.2d 1241, 1244 n.3 (9th Cir. 1986). In the majority of cases, the courts never address this choice-of-law question because the answer would be the same under both state and federal law. *See, e.g., Shades Ridge Holding Co. v. United States*, 888 F.2d 725, 728 (11th Cir. 1989) ("the standards are so similar that the distinction is of little moment"); *United States v. Jon-T Chemicals, Inc.*, 768 F.2d 686, 690 n.6 (5th Cir. 1985) ("we find no need to determine whether a uniform federal alter ego rule is required, since the federal and state alter ego tests are essentially the same"). Some courts, such as the Eleventh Circuit in *Old West Annuity*, have relied mistakenly upon the Supreme Court's decision in *Aquilino v. United States*, 363 U.S. 509, 512-13 (1960) and subsequent decisions applying *Aquilino* that did not present an

alter ego issue. Few courts cite arguments based on *Kimball Foods* or *Clearfield Trust*, and if they do so, the fail to substantively address the merits of such arguments. *See, e.g., Old West Annuity*, 605 F.3d at 861.

The issue in *Aquilino* was whether a taxpayer's legal interest in the proceeds from a building contract was a "property" interest to which the federal tax lien could attach, when the proceeds were subject to a statutory trust for unpaid laborers, subcontractors, and materialmen. The Court clarified its *Aquilino* holding in its later decision in *Drye v. United States*, 528 U.S. 49 (1999). According to *Drye*, 528 U.S. at 59 n.6, *Aquilino* set forth the rule that when the government seeks to enforce a federal tax lien, the courts are to look first to state law to determine the nature of the legal interest a taxpayer has in property the government seeks to reach, but that federal law determines whether the taxpayer's interests are sufficient to constitute property or rights to property subject to the lien.

Unlike the lien attachment issue in *Aquilino* or *Drye*, the alter ego question does not concern property rights. The alter ego doctrine goes to the identity of the taxpayer who is liable for the tax. As the Fifth Circuit has observed, once it has been determined that one corporation is the alter ego of another, all of the assets of either corporation may be levied upon for the debts of the other because the law does not recognize the two corporations as having an independent existence for purposes of debt collection. *Oxford Capital Corp.*, 211 F.3d. at 284; *see also Scherping*, 187 F.3d at 801-02 ("Alter ego means 'other self' – where one person or entity acts like, or for, another to the extent that they may be considered identical."). A proper alter ego analysis, therefore, does not focus on what property is liable for a debt or who holds what rights to that property under state law, but rather the focus is on which entities are liable for the debt and whether two entities formally separate should be regarded as one. That is, the proper analysis should focus on whether the alleged alter ego entity should be regarded as the taxpayer for tax collection purposes, and not on whether the taxpayer had a state-law enforceable property right in property.

A two-step state/federal alter ego analysis is not consistent with the state courts' approach to choice-of-law issues in alter ego cases. Recognizing that the alter ego doctrine is about whether a shareholder or other entity should be regarded as the taxpayer for tax collection purposes, not about

who owns what property, state courts themselves vary on whether to apply the law of the state of incorporation or the law of the state where the liability arose (and generally do not focus on the situs of property that might become the subject of a judgment lien for the liability). *E.g., compare United States v. Clinical Leasing Serv., Inc.*, 982 F.2d 900, 902 n.5 (5th Cir. 1992) (applying Louisiana law rather that the law of Delaware, the state of incorporation, to decide an alter ego claim, and citing the *Restatement*) *with Fletcher v. Atex, Inc.*, 68 F.3d 1451, 1456-57 (2d Cir. 1995) (relying on New York choice of law principles to decide an alter ego claim under Delaware law as the state of incorporation). Thus, in traditional shareholder liability or "veil piercing" cases, many state courts apply the law of the state of incorporation because that state has the greater interest in determining when the insulation of corporate limited liability will be stripped away. *See Restatement (Second) of Conflicts of Laws ["Restatement"]* § 307 (1971) (and cases cited therein). But other courts recognize that another state may have the greater interest. *See Restatement* § 309 ("[t]he local law of the state of incorporation will be applied . . . except where, with respect to the particular issue, some other state has a more significant relationship . . . to the parties and the transaction").

The controlling issue under federal common law of alter ego is "who has 'active' or 'substantial' control." *Ross Controls, Inc. v. United States, supra; Today's Child Learning Center, Inc. v. United States*, 40 F.Supp.2d 268 (ED Pa. 1998). The Tenth Circuit stated that the factors to determine whether an alter ego exits are:

(1) Whether there is such a unity of interest and lack of respect given to the separate entity of the corporation by its shareholders that the personalities and assets of the corporation and the individual are indistinct; and
(2) Whether adherence to the corporate fiction sanctions a fraud, promotes injustice, or leads to an evasion of the legal obligations.

NLRB v. Greater Kansas City Roofing, 2 F.3d 1047 (10th Cir. 1993). *See also Minnesota Laborers Health and Welfare Fund v. Scanlon*, 360 F.3d 925, 928 (8th Cir. 2004); *InterGen N.V. v. Grina*, 344 F.3d 134, 148-149 (1st Cir. 2003); *NLRB v. West Dixie Enterprises, Inc.*, 190 F.3d at 1194.

There is sufficient evidence in this case to show the necessary nexus in the case of CPRI, CPBE, and CPRN to justify treating each as alter ego of CPREM. CPBE is the successor entity of CPREM. Although some of CPREM's business model was changed, CPBE still engages in essentially the same business, with the same customers, the same staff, fulfills the same contracts, and uses the same vendor number for some customers. CPRN was created merely by diverting some of CPBE's business to a new entity. Therefore, CPRN is also a successor to CPREM's business. These two entities were created to avoid CPREM's significant tax liability. Knowlson operates all of these entities, and it is clear that CPBE and CPRN exist solely because CPREM was assessed the wrongfully paid credits.

CPRI paid all of CPREM's expenses. Although CPREM would later pay back CPRI for this service, CPRI and CPREM were so interconnected that their separate existences should be ignored. Knowlson admitted that this is the case when he allowed CPREM to guarantee a line of credit for CPRI. These companies operate at far less than arms-length. Instead, the two companies operated in such a way that an alter ego lien is warranted.

Finally, at this time there are not sufficient facts to warrant filing a lien as to Knowlson.

If you have any questions, please feel free to call Attorney Lawrence D. Sledz at (313) 628-3101.

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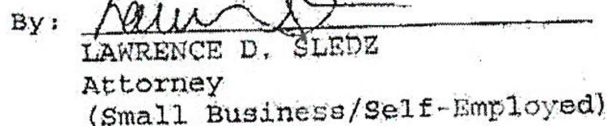
By: 
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