

**IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA**

GERALD BROKER and	:	CIVIL ACTION
HOPE BROKER,	:	
Plaintiffs	:	
	:	
v.	:	
	:	
UNITED STATES OF AMERICA,	:	
Defendant	:	00-1930
Newcomer, S.J.		October , 2000

This action pending before the Court is brought by Gerald Broker and Hope Broker, formerly husband and wife and now divorced individuals, against the United States of America for refund of a late payment penalty and interest thereon for income taxes paid for the tax year 1996.

In accordance with Federal Rule of Civil Procedure 52, after a bench trial and upon consideration of the testimony of Mr. Broker, admitted exhibits, and arguments of counsel, as well as the parties' pre-trial submissions, the Court makes the following findings of fact and conclusions of law.

FINDINGS OF FACT

I. PLAINTIFF GERALD BROKER'S RELIANCE ON HIS ACCOUNTANT

1. In 1996, Plaintiff Gerald Broker ("Mr. Broker") was a limited partner in CG Mac Associates, L.P. ("CG Mac") and BL & C Associates, L.P. ("BL&C"), both of which redeemed his partnership interest in 1996.

2. CG Mac filed its partnership income tax return (Form 1065-U.S. Partnership Return of Income) with the Internal

Revenue Service's Philadelphia Service Center on April 15, 1997. The K-1 schedules issued to the individual partners were not attached to the return.

3. BL&C filed its partnership income tax return (Form 1065-U.S. Partnership Return of Income) with the Internal Revenue Service's Philadelphia Service Center on July 10, 1997. The K-1 schedules issued to the individual partners were not attached to the return.

4. Mr. Broker filed extensions with the IRS to file plaintiffs' 1996 income tax return on or before October 15, 1997, because he had not received his Schedules K-1s from various partnerships, including CG Mac and BL&C, until sometime in late September or October 1997.

5. In the years leading up to 1996, BL&C and CG Mac each generated substantial losses from depreciation which flowed-thru to its limited partners (including Mr. Broker), who then deducted the losses on their personal income tax returns.

6. In 1996, Mr. Broker was required to recapture earlier losses from BL&C and CG Mac, which resulted in a taxable long-term capital gain.

7. Plaintiffs realized a long-term capital gain of \$4,386,670 from BL&C Associates in 1996. Similarly, plaintiffs realized a long-term capital gain of \$1,330,955 from CG Mac. Their income tax liability for 1996 is directly attributable to

these gains.

8. Mr. Broker learned from BL&C's Schedule K-1 that BL&C's redemption resulted in recapture income of \$4,386,670, taxable as long term capital gain. Mr. Broker learned that he would incur the gain from BL&C around the end of 1996.

9. Mr. Broker learned for the first time, when he received CG Mac's Schedule K-1, that CG Mac had also taken or suffered an action, probably foreclosure of its real estate, which resulted in recapture income of \$1,330,955, taxable as long term capital gain. Mr. Broker first learned that he would incur the gain from CG Mac sometime immediately prior to the October 15, 1997, due date of his 1996 tax return.

10. The general partner of CG Mac was Mr. Broker's friend and Mr. Broker expected he would have been advised of an event which would trigger recapture income.

11. Mr. Broker had assumed that CG Mac, as in prior years, would generate a loss that plaintiffs could deduct on their 1996 tax return.

12. Shortly after BL&C redeemed Mr. Broker's partnership interest in December 1996, and after learning that he would incur a gain from BL&C, Mr. Broker asked his accountant, Norman S. Wizer, CPA, to estimate his income tax liability and advise as to whether he needed to pay estimated income taxes to the IRS for 1996.

13. Mr. Broker telephoned Mr. Wizer to ask him to calculate the tax on the BL&C recapture sometime prior to the original April 15, 1996 date for the filing of the tax return.

14. Wizer advised Mr. Broker that his credit carry forwards and loss carry forwards would offset the recapture income.

15. Mr. Broker relied on Wizer's advice and did not think he had to pay estimated taxes.

16. In 1996, before learning of the BL&C and CG Mac's recapture events, Mr. Broker sold all of his securities which were marketable and withdrew \$234,000 from his Individual Retirement Account ("IRA") to pay for living expenses and obligations.

17. Plaintiffs were legally separated in 1996, divorced in 1997 and Mr. Broker remarried in 1997.

18. Prior to learning of the BL&C and CG Mac recapture events, Mr. Broker and his soon-to-be wife purchased a new home in 1996 for \$585,000 and committed to refurbishing and furnishing their new home.

19. Mr. Broker withdrew another \$244,288 from his IRA prior to October 1997, to pay living expenses and obligations.

II. PLAINTIFFS' FILING OF THEIR 1996 TAX RETURN

20. Gerald and Hope Broker filed their 1996 federal income tax return on October 15, 1997.

21. Prior to filing their 1996 tax return, the IRS granted plaintiffs an extension of time (until October 15, 1997) to file their return for that year.

22. Plaintiffs did not remit any estimated tax payments with their extension request.

23. Plaintiffs' 1996 federal income tax return showed a total tax liability of \$1,150,883, and an unpaid tax liability (after withholding credits of \$64,756) of \$1,086,127.

24. Plaintiffs did not remit any payment with their 1996 tax return.

25. On December 1, 1997, the IRS assessed against plaintiffs, the tax shown due on their 1996 tax return (i.e., \$1,086,127), plus interest of \$63,368.90. The IRS made an additional interest assessment, in the amount of \$60,398.92, with respect to plaintiffs' unpaid tax liability on August 17, 1998. Plaintiffs do not contest the propriety of these assessments.

26. Plaintiffs paid their 1996 tax liability on June 26, 1998.

27. Plaintiffs made a designated interest payment in the amount of \$123,353.62 to the IRS on July 10, 1998.

28. Between December 1, 1997 and May 3, 1999, the IRS assessed late payment penalties of \$103,176.03, plus interest in the amount of \$3,061.22, against plaintiffs pursuant to Section 6651(a)(2) of the Internal Revenue Code.

29. On April 12, 1999, plaintiffs paid \$106,493.45 to the IRS on account of the assessments referenced above.

30. On or about April 19, 1999, plaintiffs filed a claim for refund (Form 843) of the payment referenced above with the IRS's Philadelphia Service Center.

31. The IRS denied plaintiffs' claim for refund on May 4, 1999.

III. MR. BROKER'S EFFORTS TO PAY HIS TAX LIABILITY

32. Mr. Broker had no liquid assets left in October 1997, other than the balance of money in his IRA, and was unable to pay the tax due for the tax year 1996.

33. The balance in Mr. Broker's IRA after the distribution in 1997 was \$345,000.

34. Mr. Broker planned to borrow \$1,000,000 from a bank and, if he had no other source, he planned to liquidate his IRA to pay the balance of the tax liability and interest.

35. Mr. Broker applied for a loan from FirstTrust Bank (the "Bank") immediately after learning of the tax liability.

36. Mr. Broker had only two assets to secure the loan: (1) approximately 60 thousand shares, or partnership units, in the Pennsylvania Real Estate Investment Trust (PREIT Associates, L.P.), and (2) a second mortgage on his home.

37. Mr. Broker was to receive the Units as part of a severance package from his former employer, the Rubin

Organization, in or around September 1997.

38. Mr. Broker thought he would obtain the loan from the Bank very quickly. However, the Bank required the following: (1) issuance of the stock itself; (2) registration of the PREIT Units; (3) consent from the General Partner of PREIT permitting the Bank's admission as a limited partner if Mr. Broker were to default on the loan; and (3) a legal opinion from PREIT Associates' counsel that a pledge of the Units was permissible.

39. Despite repeated requests of Mr. Broker to the Rubin Organization, the certificates for the Units were not issued to the investors, including Mr. Broker, until April 1998.

40. PREIT Associates, L.P. did not register the Units with the Securities Exchange Commission until sometime in May 1998.

41. On June 24, 1998, counsel to PREIT Associates, L.P. delivered the opinion requested by the Bank.

42. On June 25, 1998, Mr. Broker closed on the loan from the Bank in the amount of \$1,000,000.

43. The following day, on June 26, 1998, Mr. Broker paid the tax due of \$1,086,127.

CONCLUSIONS OF LAW

44. This Court has jurisdiction over this action under 28 U.S.C. § 1346(a)(1).

45. In general, income taxes must be paid at the time

fixed for filing a tax return (determined without regard to any extension of time to file). 26 U.S.C. § 6151(a).

46. The Internal Revenue Code imposes a mandatory penalty for the failure to pay taxes when due unless the taxpayer can show that such failure was due to "reasonable cause" and not due to "willful neglect." 26 U.S.C. § 6651(a)(2). Plaintiffs bear the "heavy burden" of establishing that these elements are present in this case. East Wind Industries, Inc. v. United States, 196 F.3d 499, 504 (3d Cir. 1999) (citing United States v. Boyle, 469 U.S. 241, 245 (1985)).

47. Neither "willful neglect" nor "reasonable cause" is defined in the Code; however, the Supreme Court has defined "willful neglect" (as that term is used in current context) as a "conscious, intentional failure or reckless indifference." United States v. Boyle, 469 U.S. at 246 n.4.

48. The definition of "reasonable cause" (as it relates to a taxpayer's failure to pay) is found in Treasury Regulation § 301.6651-1(c)(1), which provides:

A failure to pay will be considered to be due to reasonable cause to the extent that the taxpayer has made a satisfactory showing that he exercised ordinary business care and prudence in providing for payment of his tax liability and was nevertheless either unable to pay the tax or would suffer an undue hardship (as described in §§ 1.6161-1(b) of this chapter) if he paid on the due date. In determining whether the taxpayer was unable to pay the tax in spite of the exercise of ordinary business care and prudence in providing for payment of his tax liability, consideration will be given to all the facts and circumstances of the

taxpayer's financial situation, including the amount and nature of the taxpayer's expenditures in light of the income (or other amounts) he could, at the time of such expenditures, reasonably expect to receive prior to the date prescribed for the payment of the tax. Thus, for example, a taxpayer who incurs lavish or extravagant living expenses in an amount such that the remainder of his assets and anticipated income will be insufficient to pay his tax, has not exercised ordinary business care and prudence in providing for the payment of his tax liability. Further, a taxpayer who invests funds in speculative or illiquid assets has not exercised ordinary business care and prudence in providing for the payment of his tax liability unless, at the time of the investment, the remainder of the taxpayer's assets and estimated income will be sufficient to pay his tax or it can be reasonably foreseen that the speculative or illiquid investment made by the taxpayer can be utilized (by sale or as security for a loan) to realize sufficient funds to satisfy the tax liability. A taxpayer will be considered to have exercised ordinary business care and prudence if he made reasonable efforts to conserve sufficient assets in marketable form to satisfy his tax liability and nevertheless was unable to pay all or a portion of the tax when it became due.

49. The Court finds that plaintiffs' failure to pay their taxes for the tax year 1996 was due to reasonable cause and not due to willful neglect.

50. Mr. Broker's actions with respect to the payment of the tax due was not conscious, and did not constitute intentional failure or reckless indifference; rather, the evidence shows that once he discovered he owed the tax, Mr. Broker made great efforts to procure sufficient funds to pay the tax.

51. The Court determines that the following constituted reasonable cause for Mr. Broker's failure to pay the

tax due in 1996: (1) Mr. Broker's reliance on the advice of his accountant, Norman S. Wizer, CPA that Mr. Broker would owe no federal income tax for 1996; (2) Mr. Broker's subsequent decision not to pay any estimated taxes based on Wizer's advice; (3) in light of Wizer's advice and Mr. Broker's understanding that he would not would not owe any federal income tax with the filing of plaintiffs' 1996 income tax return, Mr. Broker's sale of his marketable securities and withdrawal from his IRA for living expenses and to purchase and refurbish a new home with his soon-to-be wife before his learning of his tax liability.

52. The Court concludes that Plaintiff Gerald Broker has made a satisfactory showing that he exercised ordinary business care and prudence in providing for payment of his tax liability and was nevertheless unable to pay the tax or would suffer an undue hardship.

53. Mr. Broker demonstrated at trial that he promptly sought to secure a \$1,000,000 loan from the Bank upon discovering his tax liability, and then subsequently made diligent efforts to satisfy the requirements set forth by the Bank in obtaining that loan.

54. The Court determines that the circumstances which led to the delay in obtaining the loan were beyond Mr. Broker's control and that his efforts to procure sufficient assets and monies to satisfy his tax liability were reasonable.

55. For the reasons stated above, the IRS's assessment of a penalty (under Section 6651(a)(2) of the Internal Revenue Code) against plaintiffs due to their failure to timely pay the tax shown due on their 1996 income tax return was improper. Accordingly, the Court shall order the IRS to refund plaintiffs said penalty in the amount of 106,493.45 plus interest thereon.

AN APPROPRIATE ORDER FOLLOWS.

Clarence C. Newcomer, S.J.

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	:	
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O R D E R

AND NOW, this day of October, 2000, upon
consideration of this Court's Findings of Fact and Conclusions of
Law based on a bench trial in this action, it is hereby ORDERED
as follows:

(1) JUDGMENT is ENTERED in favor of plaintiffs and
against defendant.

(2) Defendant shall refund plaintiffs the late payment
penalty assessed for the tax year 1996 in the amount of
\$106,493.45 plus interest thereon.

AND IT IS SO ORDERED.

Clarence C. Newcomer, S.J.