

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

UNITED STATES OF AMERICA	:	CIVIL ACTION
	:	
v.	:	
	:	
DAVID A. KOSS	:	NO. 99-61

MEMORANDUM AND ORDER

YOHN, J. September , 1999

The United States filed this action to obtain a judgment against David A. Koss (“Koss”), in the amount of \$427,914.33, the sum of his outstanding tax liability for tax year 1974, interest and penalties. Koss does not contest the government’s computation of this amount, but resists the United States’ attempt to reduce his tax liability to judgment by asserting that the affirmative defenses of equitable recoupment and setoff prevent the government from collecting his tax deficiency. Before the court are the parties’ cross-motions for summary judgment which seek to resolve whether Koss’s affirmative defenses prevent the government from collecting his tax deficiency for 1974. The parties have agreed that there are no disputed issues of material fact. After considering the parties’ cross-motions for summary judgment, and the government’s response to Koss’s Motion, I conclude that the government’s motion must be granted, and Koss’s motion will be denied.

FACTUAL BACKGROUND

The facts underlying the current dispute are not contested.¹ As the relevant facts have

¹ As required by the court’s scheduling order, the United States filed a motion for summary judgment by July 1, 1999. See Scheduling Order dated April 16, 1999, ¶ 6. Also, as

already been explained by the United States Court of Appeals for the Third Circuit, I will rely on that court's description of the factual background of the parties' dispute. See Koss v. United States, 69 F.3d 705, 706-07 (3d Cir. 1995), cert. denied, 519 U.S. 809 (1996). As the Third Circuit explained:

David A. Koss, a member of the Pennsylvania bar since 1957, agreed with a client in 1971 to perform legal services in exchange for stock in Video Systems Corp. In 1973, a dispute between Koss and his client over the number of shares to be paid Koss escalated into a court action. In January 1974, the parties reached a settlement in which Koss would receive 22,000 shares on February 1, 1974, as well as the proceeds from the intended sale of an additional 20,000 shares. . . .

In their 1974 federal income tax return, Koss and his wife . . . reported the value of the 22,000 shares as \$4,000 of gross ordinary income. In 1977, the Internal Revenue Service started examining the Kosses' 1974 return. However, in 1977 the shares became worthless. While this examination was pending, the Kosses filed a federal income tax return for 1977 which did not claim a loss sustained on the 22,000 shares of Video Systems stock received in 1974.

On December 5, 1980, the IRS asserted an income tax deficiency of \$48,788.05 against the Kosses for 1974. The deficiency was attributable to the IRS placing the fair market value of the 22,000 shares of Video Systems stock at \$110,000 rather than \$4,000. On February 28, 1981, the Kosses timely petitioned the United States Tax Court for a redetermination of this asserted deficiency. Ultimately, the Tax Court upheld the IRS and determined that the Kosses owed \$48,788.05. We affirmed the decision of the Tax Court. Koss v. Commissioner, 57 T.C.M. (CCH) 882, 1989 WL 74749 (1989), aff'd, 908 F.2d 962 (3d Cir. 1990). The Tax Court decision became final on September 23, 1990, when the time for petitioning for certiorari expired.

On August 3, 1991, the Kosses filed an amended tax return for 1977 indicating that the 22,000 shares of Video Systems stock had become worthless.

the order required, the United States filed a "separate, short and concise statement, in numbered paragraphs, of the material facts as to which the party contends there is no genuine issue to be tried." Id. ¶ 7. Koss failed to comply with either of these paragraphs of the scheduling order. His motion for summary judgment was untimely, as it was filed on July 14, 1999. Moreover, his motion failed to contain a separate, numbered list of undisputed facts, which, as the scheduling order states, is sufficient grounds to deny his motion for summary judgment. See id. ¶ 7. Given Koss's agreement that there are no factual issues in dispute and his apparent intention to oppose the United States' motion for summary judgment, Koss's motion will not be stricken from the record as the United States requests, and the court will exercise its discretion to consider the arguments it raises.

Accordingly, they requested an adjustment of their income tax liability and a refund of the \$899.07 in tax they paid for that year. On that same date, the Kosses also filed an amended tax return for 1974 that requested an adjustment based on the carryback of the net operating loss incurred in 1977 due to the worthlessness of the 22,000 shares. At that time, they paid a tax of \$2,148.41 for 1974, which they computed was the amount due after application of the carryback loss. The IRS disallowed the requested adjustments on November 21, 1993.

On December 27, 1993, the Kosses brought this action for recovery of the \$899.07 and for allowance of the requested adjustments on their 1974 return. The district court entered summary judgment in favor of the government on December 21, 1994. It reasoned that the complaint was barred by the statute of limitations of 26 U.S.C. § 6511 and could not be salvaged by the mitigation sections at 26 U.S.C. § 1311-14.

Koss, 69 F.3d at 706-07 (footnote omitted). The Third Circuit then affirmed the district court's decision, concluding that the statute of limitations, in combination with their failure to pay the assessed tax for 1974, deprived the district court of jurisdiction over the claims of the Kosses for a refund, and that neither the mitigation sections of the Internal Revenue Code nor the doctrine of equitable recoupment provided the relief they sought. See id. at 712.

Following the decision of the Third Circuit, Koss did not pay the balance of the assessed taxes for 1974. See Complaint, ¶ 10; Answer, ¶ 10. The United States thus filed the instant case to reduce Koss's unpaid tax liability to judgment.² The IRS seeks a judgment against Koss in the amount of \$427,914.33, representing the original tax deficiency, interest and penalties, and any interest and statutory additions accruing after May 31, 1999. See Affidavit of Patrick A. Wilson, ¶ 4. It does not appear that the IRS has given Koss credit for the \$2,148.41 he paid to the IRS on August 3, 1991 and the government does not dispute that. See id.; Affidavit of David A. Koss, ¶

² Though the prior court decisions concerning Koss's outstanding tax liability for 1974 indicate that his wife, Freya Koss, was also involved in seeking an adjustment of her 1974 joint tax liability, there is no mention of Freya Koss in this action. The court will assume, therefore, that the IRS seeks a judgment only against David Koss.

14. In the parties' cross-motions for summary judgment, they seek to resolve the issue of whether the doctrines of equitable recoupment and setoff allow Koss to "offset the time barred carryback of the net operating loss from the 1977 year to the 1974 year, thereby extinguishing the deficiency for that year that is the subject of this suit." Memorandum of Law in Support of the United States' Motion for Summ. Judg. ("Government's Mem."), at 2-3.

STANDARD OF REVIEW

The parties have filed cross-motions for summary judgment and have agreed that there are no disputed material facts. See Government's Mem. at 5; Memorandum of Law in Support of the Defendant's Cross-Motion for Summ. Judg. ("Koss's Mem."), at 1. Summary judgment is to be granted "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56 (c). The court should not resolve disputed factual issues, but rather, should determine whether there are factual issues which require a trial. See Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 247-48 (1986). Where, as here, the parties have filed cross-motions for summary judgment, "Rule 56 © does not mean that the case will necessarily be resolved at the summary judgment stage Each party must still establish that no genuine issue of material fact exists and that it is entitled to judgment as a matter of law." Atlantic Used Auto Parts v. City of Philadelphia, 957 F. Supp. 622, 626 (E.D. Pa. 1997). If no factual issues exist and the only issues before the court are legal, then summary judgment is appropriate. See Sempier v. Johnson & Higgins, 45 F.3d 724, 727 (3d Cir.), cert. denied, 515 U.S. 1159 (1995).

The record before the court reveals no contested factual issues that are material to the

current dispute, and the only remaining issues, whether the doctrines of equitable recoupment and setoff relieve Koss of his tax liability for 1974, are legal issues for the court to decide.

Summary judgment is, therefore, appropriate.

DISCUSSION

A. Equitable Recoupment

The doctrine of equitable recoupment was first recognized by the Supreme Court in Bull v. United States, 295 U.S. 247, 262 (1935), a case in which the Supreme Court held that when the same partnership income was subjected to both estate tax and income tax, the estate was entitled to recoup the estate tax it had erroneously paid against the government's assertion of its income tax deficiency, even though the statute of limitations governing the refund of estate taxes had expired. The Court focused on the fact that the government had subjected "[t]he identical money" to two inconsistent assessments, and found that the statute did not bar the taxpayer's claim for recoupment because "recoupment is in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action is grounded. Such a defense is never barred by the statute of limitations so long as the main action itself is timely." Id. at 256, 262. Similarly, when a trust paid tax that should have been paid by the trust's sole beneficiary, the Court allowed the government to equitably recoup the amount of income tax that the beneficiary should have paid against the erroneously paid estate tax, for which the trust claimed a refund. See Stone v. White, 301 U.S. 532, 537-38 (1937). The Court found that even though the trust and its sole beneficiary were distinct legal entities, their equitable interests were identical, and thus, the tax refund due to one could be offset against the payment owed by the other. See id.

Against this background, the Supreme Court decided McEachern v. Rose, 302 U.S. 56

(1937); and Rothensies v. Electric Storage Battery Co., 329 U.S. 296 (1946), which disallowed the use of equitable recoupment as a defense to tax deficiencies and emphasized the limited scope of the doctrine. See United States v. Gulf Oil Corp., 485 F.2d 331, 333 (3d Cir. 1973) (explaining that, in Rothensies, “the Court made clear the limited applicability of the doctrine”). In McEachern, the Court refused to allow the government to collect taxes whose assessment was barred by the statute of limitations by recouping the barred taxes from legitimate claims for the refund of overpayments made in subsequent years. See McEachern, 302 U.S. at 62-63. Similarly, in Rothensies, the Court held that a company could not recoup excise tax refunds from previous years, barred by the statute of limitations, from the company’s current income tax deficiency. See Rothensies, 329 U.S. at 303. The Court concluded that the doctrine of equitable recoupment “has never been thought to allow one transaction to be offset against another, but only to permit a transaction which is made subject of a suit by a plaintiff to be examined in all its aspects, and judgment to be rendered that does justice in view of the one transaction as a whole.” Id. at 299. The Court thus restricted the applicability of equitable recoupment, as explained in Bull and Stone, to cases with facts like those, where “a single transaction constituted the taxable event claimed upon and the one considered in recoupment,” and “the single transaction or taxable event had been subjected to two taxes on inconsistent legal theories.” Id. at 299-300. Most recently, in United States v. Dalm, 494 U.S. 596, 607-08 (1990), the Court determined that a taxpayer seeking a tax refund barred by the statute of limitations could not rely on the doctrine of equitable recoupment as a basis of jurisdiction, and commented that “[s]ince Bull, we have emphasized that a claim of equitable recoupment will lie only where the Government has taxed a single transaction, item, or taxable event under two inconsistent theories.” Dalm, 494 U.S. at

605 n.5.

Here, Koss contends that he should be allowed to carry back his 1977 net operating loss to 1974, and thus recoup the resulting credit against the deficiency he now faces for that year. See Koss's Mem. at 3-4. He contends that equitable recoupment can be applied to allow this offset because the operating loss arose from the same item that created the income tax deficiency in 1974, the Video Systems stock. See id. at 4-5. Because he is attempting to recoup a credit against a deficiency arising from the same taxable item and involving the same tax year, Koss therefore argues, he fits within the doctrine of equitable recoupment as explained in Rothensies and Dalm. See id. at 6. The United States contends, to the contrary, that allowing equitable recoupment here would expand the doctrine beyond its intended bounds because the offset Koss seeks involves two transactions and two tax years, and is not a case where the same item of taxable income has been subjected to inconsistent theories of taxation. See Government's Mem. at 10-12. The United States further argues that the Third Circuit's decision in Philadelphia & Reading Corp. v. United States, 944 F.2d 1063, 1075-76 (3d Cir. 1991), compels the conclusion that multiple tax years are involved. See Government's Mem. at 11-12.

The court is persuaded by the government's assertion that the Third Circuit has already determined that the Video Systems stock was not subjected to inconsistent theories of taxation, and therefore, there has been no other tax paid on the stock that can be recouped against the income tax owing on the stock. See Government's Mem. at 10-11. The Third Circuit, in affirming the district court's grant of summary judgment to the United States in Koss's refund suit, rejected Koss's argument that the IRS had taxed the Video Systems stock on inconsistent theories. See Koss, 69 F.3d at 711-12. Koss claimed that "the IRS maintained inconsistent

positions by arguing in its deficiency assertion . . . that the basis of the shares in 1974 was \$110,000 while also accepting the Kosses' 1977 return . . . which did not declare a loss of the \$110,000." Id. at 711. The court found that the IRS had consistently maintained the position that, in 1974, the stock was worth \$110,000 rather than \$4,000, and thus Koss should have paid additional income tax on the stock in the amount of \$48,788.05. See id. The court pointed out that, whether the amount of the loss was actually \$4,000 or \$110,000, the Kosses "did not declare a loss at all in their 1977 return" and therefore "the IRS accepted their 1977 return without notice that the shares were worthless." Id. The Third Circuit concluded that there was nothing inconsistent in the IRS's acceptance of the Kosses' 1977 return and its position that the Video Systems shares were worth \$110,000 in 1974. See id.³

Because the court is bound by the Third Circuit's holding that the IRS never took inconsistent positions on the proper taxation of the Video Systems stock, Koss's claim for equitable recoupment does not fall within the range of situations described in Dalm and Rothensies where the doctrine may be applied. See Dalm, 494 U.S. at 605 n.5; Rothensies, 329 U.S. at 299-300; Coohey v. United States, 172 F.3d 1060, 1064 (8th Cir. 1999) (finding that equitable recoupment only applies when "the party against whom that defense was being asserted [] adopted inconsistent positions to the detriment of the opponent"). As in Gulf Oil, two taxes have not been assessed against the same fund, and the doctrine of equitable recoupment does not apply. See Gulf Oil, 485 F.2d at 333.

Koss argues that because the statute of limitations prevents him from obtaining a credit

³Even if I were not bound by the Third Circuit's prior decision, I would easily conclude independently that the IRS has not taken inconsistent positions.

on his 1974 taxes for the \$110,000 loss he suffered in 1977, he has, in effect, been denied a deduction and has, in effect, been taxed twice on the stock. See Koss's Mem. at 4-5 (citing Pond's Extract Co. v. United States, 134 F. Supp. 476, 480 (Ct. Cl. 1955)). Contrary to Koss's claim, he has not been denied a deduction for the Video Systems stock. Koss never attempted to take a deduction for the Video Systems stock. See Government's Reply Mem. at 2-3. The fact that the statute of limitations prevented him from taking a loss, in 1993, that he failed to take at all in the tax year when it occurred is not a reason to find that Koss has been taxed twice. Koss's citation to Pond's does not lend support to his argument. In Pond's, there was a dispute over the proper year in which the proceeds of a settlement should be taxed, and the IRS effectively collected tax on the proceeds in two separate years. See Pond's, 134 F. Supp. at 479-80. The Court of Claims found that it "would be gross injustice" to allow the government to retain the tax paid on the proceeds under two inconsistent theories and thus allowed the taxpayer to recoup the erroneous payment against the properly asserted tax deficiency. Id. at 480. Unlike Pond's, Koss was never taxed twice on his Video Systems stock and his claim for equitable recoupment must fail.⁴

⁴ Even if the court accepted Koss's argument that he was subjected to inconsistent theories of taxation, the court would not accept his contention that the income tax deficiency arising in 1974 and the net operating loss arising in 1977 were related to the "same transaction." See Rothensies, 329 U.S. at 300-01; Philadelphia, 944 F.2d at 1075 ("equitable recoupment is limited to instances in which the taxes or refunds at issue involved the 'same transaction'"). Courts should not "lump together related, but nonetheless separate transactions so that the facts of a case can be viewed as 'one transaction as a whole.'" Parker v. United States, 110 F.3d 678, 684 (9th Cir. 1997) (quoting Rothensies, 329 U.S. at 299). Here, as in Parker, the taxpayer is seeking to lump together two transactions, the receipt of stock in 1974, which created the income tax liability at issue in this case, and the stock's later loss in value in 1977, which generated the time-barred loss Koss seeks to offset against his 1974 liability. Koss's argument conflates these two separate occurrences by asking the court to examine the "taxation of the stock" just as the taxpayer in Parker conflated taxes owed by related estates by asking the court to determine the

B. Setoff

Koss next argues that he is entitled to carry back the net operating loss he suffered in 1977 to eliminate his 1974 tax liability under the setoff doctrine. See Koss’s Mem. at 6-8. The United States argues that setoff only allows the government, in tax refund suits, to avoid granting a refund when the taxpayer did not overpay its taxes. See Government’s Mem. at 15-16.

The doctrine of setoff originated in Lewis v. Reynolds, 284 U.S. 281, modified by, 284 U.S. 599 (1932). In Lewis, the taxpayer sought a refund of income taxes from the IRS, which took the request for a refund as an opportunity to reevaluate the taxpayer’s liability for that year and to determine that the taxpayer’s liability was greater than originally assessed. See id. at 282. Though the statute of limitations barred the assessment of any additional taxes, the IRS claimed that it could setoff the additional taxes against any refund the taxpayer might be entitled to receive. See id. Though the taxpayer objected that the IRS “lacked authority to redetermine and reassess the tax after the statute [of limitations] had run,” the Court found that the IRS had the authority to reevaluate the taxpayer’s liability following his claim for a refund because the “ultimate question . . . is whether the taxpayer has overpaid his tax,” and “[a]n overpayment must appear before refund is authorized.” Id. at 283. The Court thus upheld the government’s right “right to retain payments already received when they do not exceed the amount which might have been properly assessed and demanded.” Id. Later cases interpreting Lewis have applied setoff, also called the “defense of lack of overpayment,” only to refund claims concerning the same taxpayer, the same tax and the same tax year. See Fisher v. United States, 80 F.3d 1576, 1579

taxation of a trust involved with both estates. See Parker, 110 F.3d at 683-84; see also Philadelphia, 944 F.2d at 1076 (refusing to allow taxpayer to lump together deficiencies and overpayments arising over separate years).

(Fed. Cir. 1996) (allowing IRS to offset unassessed interest against taxpayer's refund claim); Dysart v. United States, 340 F.2d 624, 627 (Ct. Cl. 1965) (discussing the difference between equitable recoupment and setoff).

Though Dysart does comment that “both the government and the individual taxpayer have the legal right to raise a setoff without having to appeal to the court’s discretion or to its evaluation of the particular equities,” that court did not find that the doctrine was applicable outside of refund suits. Id. at 628. Koss does not present, and the court has not located, cases applying the doctrine of setoff other than in refund suits. See Estate of Michael v. Lullo, 173 F.3d 503, 508-09 n.8 (4th Cir. 1999) (finding that the setoff doctrine described in Lewis “encompasses tax refund litigation only” and noting that, of the eighty citations to Lewis by the Supreme Court and by Courts of Appeal, “[n]early all of these decisions have arisen from refund disputes” and “the rest have merely string-cited Lewis in general discussions of standards of proof applicable in tax cases”); Bachner v. Commissioner of Internal Revenue Serv., 81 F.3d 1274, 1277-78 (3d Cir. 1996) (following Lewis and explaining significant difference between deficiency and refund claims); Fisher, 80 F.3d at 1579; cf. Estate of Bender v. Commissioner of Internal Revenue, 827 F.2d 884, 888 (3d Cir. 1987) (explaining that “before an individual may claim that he has an income tax refund asset he must demonstrate that he does not owe more money to the IRS than the IRS owes him”). The case on which Koss relies, Union Pacific R.R. Co. v. United States, 389 F.2d 437, 447 (Ct. Cl. 1968), is also a refund suit where the court ruled that if the government attempted to setoff amounts against the taxpayer’s refund claim, then the taxpayer could also assert additional refunds “to offset [] the government’s new issues.” Union Pacific does not stand for the proposition urged by Koss, that taxpayers are allowed to setoff

statutorily barred refund claims against deficiency assessments made by the government. See id. at 447; Koss's Mem. at 7.

This suit by the government to obtain a judgment against Koss is not a refund suit which would enable Koss to setoff his 1977 net operating loss against his 1974 tax deficiency. Koss's attempt to extend the setoff doctrine first announced in Lewis beyond the context of refund suits has no foundation in existing case law. Therefore, Koss may not rely on the doctrine of setoff to eliminate his tax deficiency for tax year 1974.

CONCLUSION

Neither the doctrine of equitable recoupment nor the doctrine of setoff applies to allow Koss to avoid his tax deficiency for 1974 in the face of this suit by the United States to reduce his tax deficiency to judgment. Koss's motion for summary judgment will therefore be denied and the United States' motion for summary judgment will be granted. Judgment is entered against Koss in the amount of \$427,914.33, representing the original tax deficiency, interest and penalties, plus and any interest and statutory additions accruing after May 31, 1999. The United States shall however, credit Koss's August 3, 1991, payment, in the amount of \$2,148.41, against this judgment.

An appropriate order follows.

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

UNITED STATES OF AMERICA	:	CIVIL ACTION
	:	
v.	:	
	:	
DAVID A. KOSS	:	NO. 99-61

ORDER

AND NOW, this _____ day of September, 1999, after consideration of the parties' cross motions for summary judgment, and the plaintiff's response to the defendant's motion for summary judgment, IT IS ORDERED that:

- (1) Plaintiff's Motion for Summary Judgment is GRANTED;
- (2) Defendant's Cross-Motion for Summary Judgment is DENIED; and
- (3) Judgment is entered in favor of the United States of America and against David A.

Koss in the amount of \$425,765.92 plus any interest and statutory additions accruing after May 31, 1999.

William H. Yohn, Jr., J.