Client Alert

April 2025

Supreme Court Rules That Bankruptcy Trustees May Not Invoke State Fraudulent Transfer Statutes to Pursue Claims Against Internal Revenue Service

On March 26, 2025, the Supreme Court rendered an important decision in *United States v. Miller*, which examines the interplay between the fraudulent transfer provisions of the U.S. Bankruptcy Code (the "Bankruptcy Code") and the scope of the Bankruptcy Code's waiver of sovereign immunity.

The Bankruptcy Code provides two general avenues for bankruptcy trustees[1] to claw back funds that have been fraudulently transferred.[2] The first avenue is under section 548 of the Bankruptcy Code, which is a standalone fraudulent transfer provision that allows trustees to pursue fraudulent transfer claims that occurred within two years prior to the filing of the bankruptcy petition.

The second avenue is under section 544(b) of the Bankruptcy Code. This statute provides that "the trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is ***voidable under applicable law by a creditor holding an unsecured claim***." (emphasis added). In other words, this clause permits a trustee to claw back a fraudulent transfer that an actual unsecured creditor has standing to unwind under any applicable law (we will refer to this clause as the "actual creditor/applicable law" clause). In practice, section 544(b) allows bankruptcy trustees to bring fraudulent transfer claims that, but for the bankruptcy filing, an unsecured creditor could have brought under state law fraudulent transfer statutes. Notably, other provisions within section

[1] In chapter 11 cases, other parties typically stand in the shoes of a bankruptcy trustee, such as the debtor in possession, or, following confirmation of a plan, a liquidating trust or plan administrator.

[2] A fraudulent transfer clawback claim typically falls under one of two categories. One type is "constructive," where a transferor, while insolvent, transfers money or property without receiving reasonably equivalent value in exchange. The other is "intentional," where a transferor transfers money or property for the purpose of hindering, delaying, or defrauding its creditors.

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544 do allow for certain other clawback claims that do not carry the actual creditor/applicable law clause; however, those provisions are limited in scope and would not apply to garden variety fraudulent transfer claims, such as the claims in *Miller* discussed below.

Why would a trustee prefer to bring a section 544(b) claim under a state law statute over the Bankruptcy Code's own section 548 claim? Because state fraudulent transfer statutes typically carry a four-year statute of limitations, in contrast to the Bankruptcy Code's statute of limitations of only two years. As a result, claims seeking to claw back transfers occurring three to four years prior to the bankruptcy filing are barred under section 548, but not section 544(b).

One other statute in play in the *Miller* decision discussed below is section 106(a) of the Bankruptcy Code. This is a sovereign immunity waiver providing that "[n]otwithstanding an assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit" to the extent set forth therein with respect to dozens of other sections of the Bankruptcy Code, including sections 544 and 548. In other words, section 106(a) when read in a vacuum suggests that governmental entities such as the Internal Revenue Service ("IRS") are not immune from the fraudulent transfer provisions contained in sections 544 and 548.

Turning to the *Miller* decision, the facts are straightforward. Two shareholders of All Resort Group, a Utah-based transportation business, misappropriated All Resort's funds. This included the transfer of $145,000 of All Resort's funds to the IRS to satisfy its shareholders' personal debts. All Resort received nothing in return. Three years later, All Resorts filed for bankruptcy protection.

The payments to the IRS were classical fraudulent transfers. Because the bankruptcy was not filed until three years after the transfers, the trustee was barred from bringing a section 548 claim against the IRS based on its two-year statute of limitations provisions.

The trustee instead brought section 544(b) claims under Utah's fraudulent transfer statutes against the IRS to claw back the funds. The IRS contested the trustee's claims on sovereign immunity grounds—specifically, that as a governmental entity it was immune from Utah's fraudulent transfer statutes. The trustee in turn invoked the sovereign immunity waiver provision under section 106(a) of the Bankruptcy Code (and its cross-reference to section 544), asserting that section 106(a) constituted a blanket waiver of sovereign immunity of claims against the IRS under section 544.

The Bankruptcy Court sided with the trustee and entered a judgment against the IRS holding that the IRS must return the funds to the All

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Resorts bankruptcy estate. The IRS appealed first to the District Court and then to the United States Court of Appeals for the Tenth Circuit. Both courts agreed with the Bankruptcy Court's interpretation that section 106 acted as an express waiver of sovereign immunity.

Ultimately, in an 8-1 decision, the Supreme Court reversed, holding "that §106(a) does not sweep as broadly as [the trustee] maintains." Writing for the majority, Justice Ketanji Brown Jackson opined that section 106 was "jurisdictional" in nature and that "[t]he text and structure of §106 and §544 make clear that §106(a)'s waiver of sovereign immunity does not operate to modify §544(b)'s substantive requirements."

Justice Jackson noted that "§544(b) requires a trustee to identify an ***actual creditor capable of voiding the transfer at issue under 'applicable law.'*** That actual-creditor requirement—which restricts the universe of transactions a trustee can invalidate—is unique to §544(b)." (emphasis added). As section 106 is specific to the Bankruptcy Code, an "actual creditor" suing under Utah's fraudulent transfer statutes outside of bankruptcy would not have the benefit of section 106's sovereign immunity waiver. Because an actual creditor could not bring the claim, neither could a bankruptcy trustee. The fact that section 544 contains certain clawback provisions that are not subject to the actual creditor/applicable law clause further undermined the trustee's assertion that section 106's waiver of sovereign immunity applies as a blanket waiver to all of section 544. Justice Jackson wrote:

> Instead, subsection (a) permits a trustee to invalidate certain transfers that "could have" been voided by a lien creditor, "whether or not such a creditor exists." §§544(a)(1), (2) (emphasis added). That contrast in structure reflects a deliberate congressional choice to tie the trustee's rights under subsection (b) to the rights of an actual creditor under "applicable law." We doubt that Congress meant to supplant that choice when it opted to include §544 on the lengthy list of provisions it inserted into §106(a).

Finally, Justice Jackson stated that "Under long-settled law, Congress must use unmistakable language to abrogate sovereign immunity." Based on this assertion, if the decision to be made in this case were a close call, it would have to be settled in favor of the IRS.

Key Takeaways:

First, *Miller* is the latest in a series of cases where the Supreme Court, and to a growing extent, Circuit Courts, take a strict statutory construction

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analysis to interpret bankruptcy law, in contrast with lower court decisions that often tend to be more policy-driven.

For example, in the June 2024 *Harrington v. Purdue Pharma L.P.* decision, the Supreme Court adopted a strict construction of the applicable provisions of the Bankruptcy Code in reversing a Bankruptcy Court ruling allowing for non-consensual third party releases of the Sackler family, which was a stated condition of their contribution of billions of dollars to resolve tort claims against the bankruptcy estate. This decision came in the face of the policy argument that the Sacklers' proposed contribution would obtain the greatest result for the greatest number of claimants.

More recently, in the March 2025 case of *In re Highland Capital Management, L.P.*, the Court of Appeals for the Fifth Circuit strictly construed the applicable provisions of the Bankruptcy Code in reversing the Bankruptcy and District Court's allowance of a chapter 11 plan containing a "Gatekeeper Clause" that prohibited third parties from bringing suit against estate fiduciaries and their professionals without first obtaining permission from the Bankruptcy Court. Commercial practitioners should take note of this trend toward strict construction by the higher courts.

Second, beyond any bankruptcy law analysis, *Miller* reinforces the principle that waivers of sovereign immunity must be unequivocal. When in doubt, the tie goes to the government.

Third, the holding in *Miller* suggests that a subsequent transferee claim against a recipient of a tax refund flowing from a fraudulent transfer to the IRS would also be barred. Section 550 of the Bankruptcy Code allows in certain circumstances for the clawback of "avoided" transfers from any immediate or mediate transferee of the initial transferee. If a trustee is barred from avoiding a transfer made to the IRS under section 544(b) (and is also barred by the section 548 two-year statute of limitations), it stands to reason that a trustee cannot meet the "avoided" transfer requirement of section 550 that would allow a trustee to claw back a refund from the IRS to a subsequent transferee.

Please contact the Olshan attorney with whom you regularly work or the attorney listed below if you would like to discuss further or have questions.

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