

UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF FLORIDA
Tampa Division
www.flmb.uscourts.gov

In re

Case No. 8:11-bk-12770-CPM

MATTHEW L. FESHBACH and
KATHLEEN MARIE FESHBACH,

Chapter 7

Debtors. /

MATTHEW L. FESHBACH and KATHLEEN
M. FESHBACH,

Adv. Pro. No. 8:11-ap-00803-CPM

Plaintiff,

v.

DEPARTMENT OF TREASURY
INTERNAL REVENUE SERVICE,

Defendant. /

DECLARATION OF MATTHEW L. FESHBACH

I, MATTHEW L. FESHBACH, being duly sworn, state the following under penalty of perjury:

1. My wife and I are the plaintiffs in this lawsuit and I am personally familiar with all the matters set forth below.

Our IRS 2001 Tax Liability

2. My wife and I presently owe the IRS over \$3.8 million in 2001 income taxes. But that is not to say that I made millions in 2001. On the contrary, my massive tax liability from that year arises from “phantom income” triggered by changes in the Tax Code that affected some of the hedge fund positions I was managing. I explain how this liability arose in detail below.

3. We are not millionaires. In fact, the very generous appraisal of our assets recently obtained by the Chapter 7 Trustee in our case showed that all our assets totaled \$138,000.

4. We don't make millions of dollars. In fact, because of the decline in financial markets and chronic health conditions I suffer from, our annual income this year will be about \$240,000. That is not an insubstantial amount, but it is not enough to make any impact on that IRA debt.

5. Further, because of our IRS obligations, my wife and I have been unable to save for retirement, and we have no retirement accounts. In fact, our retirement accounts were liquidated to pay our income taxes. My wife is 62 and I am 58.

6. We no longer own a home because we sold it to pay our tax obligation and paid all the equity to the IRS to pay our 2001 tax liability. In fact, over the years, we reduced our expenses to be able to meet our tax obligation.

7. We have never attempted in any manner to evade or defeat our tax obligations, nor have we ever willfully attempted to evade or defeat our obligation to pay the 2001 IRS tax debt. We have filed all our tax returns and fully paid all our taxes for every year except 2001. And as to 2001, we have paid over \$2.5 million toward that liability.

8. Over the decade we have struggled to pay this liability, we continuously worked to pay the IRS as much as we could afford, and we have complied with every IRS request, including providing mountains of documentation regarding our financial circumstances to the IRS on several occasions.

9. Below I set forth a detailed chronology of our dealings with the IRS.

How I Came to Owe the IRS Millions, or the Impact of the Enactment of IRC §1259 on Selling “Short Against the Box”

10. As an investor, I participated in a common strategy of selling securities “short against the box.” This approach entails the owner of an appreciated security (a taxpayer), borrowing and selling an identical security, while retaining the one he or she already has. By doing this, an investor holds two offsetting positions: one “short” and the other “long.” A “short” position means that an investor owes the asset (or its value) to someone, and thus, is betting that the asset will depreciate so that the liability to the investor will shrink. A “long” position means that an investor owns the asset, and thus, the investor benefits if the value of the asset appreciates and loses if the value of the asset depreciates. Holding the two offsetting positions insulates the investor from fluctuations in the asset’s value.

11. Before the enactment of Internal Revenue Code (IRC) §1259 in 1996, a short sale did not trigger tax on the appreciated long position unless the taxpayer used this long position to cover the short sale.

12. Before 1996, these long-and-short-against-the-box investment strategies allowed taxpayers to obtain financing upon unrecognized gains and, thus, withdraw their equity without recognizing a gain. In other words, I could legally withdraw these unrealized gains through loans.

13. But the enactment of IRC §1259 in 1996 changed that tax treatment. IRC §1259(c)(1) specifically deems a “short sale against the box” to be a constructive sale, requiring the recognition of gain as if the position were sold at its fair market value on the date of the sale and immediately repurchased. Thus, where an investor enters into a short position, he or she would owe tax equal to the fair market value of the stock minus the depreciated basis multiplied by the applicable tax rate. Thus, I was liable for this tax, even though I never actually received proceeds from a sale because, in fact, an actual sale did not occur.

Recognition of Phantom Income

14. Long and short positions against the box existing prior to the change of law in 1996 were “grandfathered” and were not considered taxable events until liquidated. But by this time in 1996, I had borrowed heavily against my locked-in gains and had invested most of the borrowed funds in a home in the Silicon Valley area that we built for \$14 million, a home which later sold for only \$4 million. At that time, we had no delinquent tax liabilities and believed that I would be able to repay the borrowed gains.

15. In 1999, I entered into a short-against-the-box position in the securities of AMRE, Inc., a home improvement and remodeling company (“AMRE”). AMRE, however, filed for bankruptcy and tax laws then required that my trading positions in the securities were liquidated. That triggered huge income recognition for me – so called “phantom income.”

16. As I understand it, phantom income occurs whenever a taxpayer is required to recognize income for tax purposes when there is no actual cash income. Specifically, pursuant to §1259, I was required to pay tax on a gain equal to the fair market value of the liquidated securities minus my depreciated basis from entering into a short-against-the-box position. Thus, I was left with an extremely large tax liability and no liquid resources to pay taxes on the forced gain. In other words, I did not receive cash representing the income I “earned” and, thus, did not have the money to pay the tax incurred on the phantom income. Because of this, we could not pay our 1999 tax liability in a timely manner.

17. In 2001, in an effort to make payments against our 1999 tax obligation, I voluntarily liquidated some of my boxed positions in other securities, which freed up cash to apply towards our 1999 tax liability.

18. Unfortunately, these subsequent liquidation transactions again triggered a taxable gain equal to the fair market value of the liquidated securities minus my depreciated basis from entering into a short-against-the-box position. And once again, the limited amount of cash generated from these transactions was far below the phantom income it generated for the 2001 tax year. In fact, my 2001 tax liability because of these liquidations was \$3,247,239.

19. Of course, any cash these liquidations generated I used to pay our 1999 tax liability and I then had no money to pay our 2001 tax liability as it came due.

Initial Attempts to Resolve Outstanding Tax Liabilities

20. With part of our 1999 and 2001 tax liabilities now outstanding, we turned to the IRS to determine the best method of resolving these liabilities. Because we were without sufficient assets to satisfy either of these obligations, we sought Offers in Compromise (OICs) for both liabilities. But the IRS, which decided to analyze only my previous earnings as an investor instead of our actual financial circumstances at the time of the filing, denied both of these OICs in September 2004.

Installment Agreement and Our Efforts to Pay this Debt

21. While those OICs were pending, the IRS imposed federal tax liens on all our assets due to balances owed. In July 2005, the IRS agreed to permit us to keep our assets in exchange for an immediate satisfaction of the 1999 tax liability and an installment agreement providing for quarterly payments of \$120,000 towards the 2001 tax liability.

22. We promptly paid the IRS \$2,676,395.03 in taxes, interests, and penalties for the 1999 tax year, thus satisfying our obligations for that tax year. We then began making quarterly payments to the IRS in the amount of \$120,000 towards our 2001 tax liability. Notably, by applying these payments this way, the IRS subjected us to much higher interest charges and

penalties. Had the IRS applied the \$2,676,395.03 to pay off the \$1,730,431.04 in taxes owed for 1999 at that time and applied the remaining \$945,963.99 from the 1999 payment towards the 2001 tax liability instead of towards interest and penalties for the 1999 tax liability, we would have owed far less in overall interest and penalties.

23. Despite this unfair allocation, we continued to pay to the IRS our \$120,000 obligation each quarter until January 2008, at which point we were simply overwhelmed with numerous unanticipated financial circumstances which left us unable to pay. First, the disastrous decline in the stock market in 2007 devalued all our assets, as it did all Americans. The decline in the stock market also crippled what remained at that time of my already much-declined investment business. There was likewise few employment opportunities for me in the hedge fund and investment management field, the only field I have worked since 1984.

24. Second, in the middle of this financial turmoil, I became seriously ill with chronic pelvic pain syndrome. What that means is that I suffer from crippling pain in my pelvic regions – making it impossible for me to stand or sit for long periods of time, and requiring that I be laying down. This condition severely curtailed my ability to restart an investment business, interview for employment with an investment firm, or otherwise engage in meaningful business opportunities. This ailment also prevented me from working outside our home. Because of these unfortunate events, we were unable to pay our April 2008 installment obligation in a timely manner.

25. But in an effort to continue paying the IRS, we sold our home in June 2008 and used the net proceeds from the sale, \$685,607, to pay our tax obligations. Further, we also tried to sell our furniture from the house in July 2008, but to no avail. We listed various pieces of furniture for approximately three to four months. When that generated little results, we placed

the furniture with with antique dealers and furniture consignment stores to sell our remaining furniture. We applied the proceeds of each of these sales toward our tax obligations.

Offer in Compromise Request and Our Production of Over 6300 Pages of Documents

26. Ultimately, my illness coupled with our struggling financial position left us unable to afford the \$120,000 quarterly payments to the IRS under our installment agreement. Therefore, we sought an additional Offer in Compromise with the IRS in September 2008. The OIC request provided a deferred periodic payment offer for \$2,500 for 48 months starting October 15, 2008.

27. Upon receipt of the OIC request, on September 16, 2008, the IRS requested numerous substantiating documents from us including bank statements, brokerage statements, documents verifying my income, and documents pertaining to our expenses.

28. We promptly responded to this request for information on October 14, 2008. The OIC request was assigned to Revenue Officer Charles Gear, who on January 12, 2009, requested supplemental information from us including documents showing our compliance with all filing and payment requirements with the IRS, medical documentation, bank statements for any business entities affiliated with us, credit card statements, tax returns, and various other documents. We assembled documents responsive to both the September 16, 2008, and January 12, 2009, requests for information and provided an 885-page compilation, including details regarding our assets and earnings, to the IRS on February 26, 2009.

29. On March 13, 2009, Revenue Officer Charles Gear requested even more information pertaining to any entity in which we held an interest. We once again gathered documents responsive to the Revenue Officer's request and provided an additional 1,631 pages of documents to the IRS.

30. After that, during a telephone conference on May 15, 2009 to discuss our OIC, Mr. Gear once again asked for more information before he could make his determination. In response to this telephonic request, we compiled another 124 pages of documents and complied with Mr. Gear's request on May 15, 2009.

31. Despite the immense amount of documentation provided to the IRS clearly reflecting our financial and medical circumstances, Mr. Gear recommended the OIC request for rejection on May 27, 2009. As a proper review of this documentation would have produced a contrary result, our counsel informed Mr. Gear of our intent to appeal this OIC rejection on June 3, 2009. We were very anxious to resolve our tax liability as soon as possible, so we requested a rejection letter from the IRS on three different occasions so we could seek review in the Appeals office. The IRS finally issued a rejection on August 4, 2009.

32. We filed our request for an Appeal with the IRS on August 31, 2009. The Appeal included a detailed account of the circumstances affecting our ability to pay our 2001 tax liability. On October 5, 2009, the IRS acknowledged receipt of our Appeal and assigned the case to Appeals Officer Peter Salinger.

33. We received a letter from Mr. Salinger on December 21, 2009, wherein he requested additional documentation.

34. This request was over and above the nearly 3,000 pages of documents that we previously provided to the IRS that was part of its administrative file.

35. We promptly complied with Mr. Salinger's request on January 23, 2010, providing the IRS with all of our profit and loss and bank statements for the time periods requested. We continued to comply with each subsequent request from the Appeals Office,

including the production of a surgical report after I underwent surgery for my condition on February 16, 2010.

36. Despite our responsiveness, the OIC request ultimately was denied by the Appeals Office in May 2010. It is significant to note that we continued to make monthly payments of \$2,500 while our OIC and Appeal were pending, and for several months after our deferred periodic payment offer had lapsed.

Return of the Case to IRS Collections

37. After the denial of our OIC request, our case returned to the Collections Division of the IRS and was assigned to Revenue Officer Kerry Clancey. Once again, we attempted to work with the IRS to resolve our 2001 tax liability. On September 15, 2010, Ms. Clancey requested that we provide, among other things, additional documentation regarding our income as well as our assets.

38. On October 14, 2010, we provided Ms. Clancey with the documents responsive to her request along with six (6) four-inch binders of documents that were previously provided to Revenue Officer Charles Gear.

39. On December 3, 2010, Ms. Clancey requested additional information from us which we once again promptly provided on December 23, 2010. Ultimately, despite our repeated efforts, we were unable to afford the payments the IRS demanded to satisfy our 2001 tax liability.

40. Our declining financial circumstances along with my declining health ultimately forced us into bankruptcy in early 2011.

“Totality of the Circumstances” Factors

41. I understand that bankruptcy courts looks at several factors to determine whether a person filing bankruptcy has sought to evade or defeat payment of an IRS tax debt. I will address each of the factors below.

42. **Understatement of income for more than one year.** We have never understated our income in any year. We have always filed and paid my taxes, other than this 2001 liability.

43. **Implausible or inconsistent behavior.** We have never offered any implausible explanation or been inconsistent in our behavior. We have disclosed extensively our financial condition to the IRS.

44. **Extensive dealings in cash.** We have no dealings in cash.

45. **Failure to cooperate with the IRS.** We have completely cooperated with the IRS and have provided responsive documents to every request it has made, totaling over 6300 pages at this point.

46. **Inadequate record keeping.** We have extensive records and have provided them to the IRS – over 6300 pages.

47. **Transfer of assets to a family member.** We have transferred no assets to family members, other than what we use to raise our kids.

48. **Transfers of assets for inadequate consideration.** We have not transferred assets, much less transferred them for inadequate consideration. Most recently, when we sold our home and our furniture, we turned over the proceeds to the IRS.

49. **Transfers that greatly reduce assets subject to IRS execution.** We have transferred no assets. To the contrary, to the extent that we had assets, we used them to pay the IRS.

50. **Transfers made in the face of serious financial difficulties.** We have made no such transfers.

51. **Failure to acquire significant assets relative to a debtor's earnings.** As noted, we are not millionaires and we have used what income we have had to pay the IRS. We sold any significant asset we have to pay the IRS.

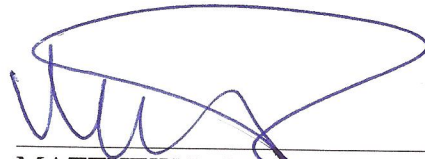
52. **Any other conduct that is likely to mislead or conceal.** We have undertaken no conduct to mislead or conceal, nor have we ever been accused by anyone, including the IRS, of doing so.

53. We have paid 100% of our tax liabilities for all tax years other than 2001. In doing so, we continuously worked to be compliant with the IRS. Our failure to pay our 2001 tax liability was due solely to the unfortunate events that began with my ill-fated transaction in 2001 undertaken specifically to pay my 1999 taxes.

54. We have never sought to evade, avoid, or defeat paying this liability. Completely to the contrary, we working diligently for nearly over nine years to resolve pay and resolve our 2001 tax liability with the IRS, including providing full disclosures of our income and assets to every layer of the IRS and liquidating our assets to make payments.

Pursuant to 28 U.S.C. § 1746, I declare under penalty of perjury that the foregoing is true and correct.

Executed on December 11, 2011.



MATTHEW L. FESHBACH