



Signed and Filed: April 22, 2010

THOMAS E. CARLSON
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

In re)	Case No. 06-30815 TEC
)	
WILLIAM M. HAWKINS, III, aka)	Chapter 11
TRIP HAWKINS; and LISA WARNES)	
HAWKINS, aka LISA A. HAWKINS,)	
)	
)	
Debtors.)	
)	
_____)	
WILLIAM M. HAWKINS, III, and)	Adv. Proc. No. 07-3139 TC
LISA WARNES HAWKINS,)	
)	
Plaintiffs,)	
)	
vs.)	
)	
THE FRANCHISE TAX BOARD,)	
A DIVISION OF THE GOVERNMENT OF)	
THE STATE OF CALIFORNIA; and the)	
UNITED STATES OF AMERICA, INTERNAL)	
REVENUE SERVICE,)	
)	
Defendants.)	
_____)	

MEMORANDUM DECISION

In this action, the Internal Revenue Service (IRS) and the California Franchise Tax Board (FTB) seek to have unpaid income tax liabilities excepted from the discharge that Debtors Trip and Lisa Hawkins received in their chapter 11 case. The IRS and the

1 FTB (collectively the Government) assert that the tax liabilities
2 should not be discharged, because Debtors filed fraudulent returns,
3 and because Debtors attempted to evade collection of tax. It is
4 unnecessary to determine whether Trip Hawkins filed fraudulent
5 returns, because I determine that he attempted to evade collection
6 of tax by dissipating his assets on unnecessary and unreasonable
7 expenditures while he knew he owed taxes and knew he was insolvent.¹
8 I determine that Lisa Hawkins neither filed fraudulent returns nor
9 attempted in any way to evade tax.

10 BACKGROUND

11 A. The Debtors

12 William M. "Trip" Hawkins (Trip) is a very sophisticated
13 businessman. He received an undergraduate degree in Strategy and
14 Applied Game Theory from Harvard College, and an M.B.A. from
15 Stanford University. He was an early employee of Apple Computer,
16 where he rose to director of marketing. In 1982, he left Apple and
17 became one of the founders of Electronic Arts, Inc. (EA), which
18 became the largest supplier of computer entertainment software in
19 the world. By 1996, Trip had a net worth of approximately \$100
20 million, primarily from his holdings of EA shares.

21 Lisa Hawkins (Lisa) married Trip in 1996. She received a B.A.
22 in communications from Notre Dame de Namur University. Prior to
23 her marriage, she worked as a leasing agent for a car dealership
24 and prepared her own tax returns. After her marriage, she worked
25 in the home and cared for the two children she had with Trip and
26 the two children Trip had from his first marriage.

27

28

¹ This Memorandum Decision shall constitute the court's findings of fact and conclusions of law.

1 B. The Tax Shelters

2 In 1990, EA created a wholly owned subsidiary, 3DO, for the
3 purpose of developing and marketing the devices on which computer
4 games are played. Trip Hawkins left EA to run 3DO. 3DO went
5 public in 1993. In 1994, Trip began to sell large amounts of his
6 EA common stock to invest heavily in 3DO.

7 In 1996, KPMG, the accounting firm that prepared Debtors' tax
8 returns, advised Trip that Debtors would recognize very large
9 capital gains upon the sale of the EA shares, and suggested an
10 investment that would create capital losses that Debtors could use
11 to offset those capital gains. Pursuant to this advice, Debtors
12 invested in a transaction called FLIP (Foreign Leveraged Investment
13 Portfolio) in 1996, and invested in a transaction called OPIS
14 (Offshore Portfolio Investment Strategy) in 1998.

15 FLIP worked in the following way. In September 1996, Trip
16 purchased 1,551 shares of the United Bank of Switzerland (UBS) for
17 \$1.5 million. He also purchased an option to acquire shares of
18 Harbourtowne, Inc. (Harbourtowne), a Cayman Islands corporation.
19 At the same time, Harbourtowne contracted to purchase 30,750 shares
20 of UBS treasury stock from UBS for \$30 million. UBS received an
21 option to repurchase those shares before the sale closed. UBS
22 exercised that option, and the UBS shares were never transferred to
23 Harbourtowne. Trip received an opinion letter from KPMG stating
24 that Trip could add to the tax basis of his UBS shares the \$30
25 million Harbourtowne had contracted to pay for its UBS shares. The
26 KPMG opinion letter stated that it was more likely than not that
27 UBS's repurchase of its shares would be considered a distribution
28 to Harbourtowne (which was not taxable because Harbourtowne is a

1 foreign corporation), and that an appropriate treatment of this
2 transaction would be to transfer Harbourtowne's basis in its UBS
3 shares to Trip's basis in his UBS shares.

4 OPIS worked in a similar way. In October 1998, Trip purchased
5 9,200 shares of UBS for \$1.99 million. He also purchased an option
6 to acquire an interest in Hogue, Investors LP (Hogue), a Cayman
7 Islands limited partnership. Hogue contracted to purchase 145,760
8 shares of UBS treasury stock for \$40 million. Pursuant to a call
9 option, UBS repurchased those shares before the shares were
10 transferred to Hogue. Trip received opinion letters from KPMG and
11 Brown & Wood stating that he could add to the tax basis of his UBS
12 shares the \$40 million Hogue had contracted to pay for its UBS
13 shares.

14 Debtors claimed losses from the FLIP and OPIS shelters on
15 their 1996-2000 tax returns. In December 1996, Trip sold 310
16 shares of UBS stock, and Debtors claimed resulting losses of
17 \$6,027,306. In December 1997, Trip sold the remaining 1,241 UBS
18 shares involved in the FLIP transaction, and Debtors claimed
19 resulting losses of \$23,396,798. In December 1998, Trip sold 5,900
20 of the UBS shares involved in the OPIS transaction, and Debtors
21 claimed resulting losses of \$20,570,283. In December 1999, Trip
22 sold an additional 1,000 UBS shares acquired in the OPIS
23 transaction, and Debtors claimed resulting losses of \$3,566,297.
24 In December 2000, Trip sold the remaining 2,300 UBS shares acquired
25 in the OPIS transaction, and Debtors claimed resulting losses of
26 \$8,244,602.

27 In July 2001, the IRS challenged the validity of basis-
28 shifting tax shelters, such as FLIP and OPIS. In Notice 2001-45,

1 the IRS rejected the central concept upon which those tax shelters
2 are based. The IRS Notice states in substance that when a U.S.
3 taxpayer owns shares of a foreign corporation, and also owns an
4 interest in an offshore entity that holds shares of the foreign
5 corporation, the U.S. taxpayer's basis in his shares should not be
6 increased to include the offshore entity's basis in its shares of
7 the foreign corporation when the offshore entity's shares are
8 redeemed by the foreign corporation.

9 In July 2001, the IRS also commenced an audit of Debtors' 1997
10 tax return, focusing its inquiry upon the losses claimed from their
11 transactions in UBS stock.² The audit was later expanded to include
12 Debtors' 1998, 1999, and 2000 tax returns. Debtors immediately
13 retained Hochman, Salkin, Rettig, Toscher & Perez, P.C. (Hochman), a
14 law firm specializing in tax litigation, to represent them in the
15 audit. Hochman responded to several IRS requests for information
16 regarding the FLIP and OPIS transactions.

17 In July 2002, the IRS Revenue Agent performing the audit of
18 Debtors' returns sent Debtors' counsel a letter stating that the
19 losses from the FLIP and OPIS transactions should be disallowed.

20 [T]he Service has concluded that it has a strong case
21 regarding this issue. It is the position of the IRS that
22 the claimed benefits from this transaction are not
23 allowable. The question of application of additions to
24 tax, sometimes called penalties, is also being actively
25 considered.

26 In October 2002, the IRS issued Announcement 2002-97, in which
27 it described the terms upon which it would settle cases involving
28 basis-shifting tax shelters, such as FLIP and OPIS. The
Announcement stated that settling taxpayers would be required to

² The 1996 return was not audited because the limitation period had already expired for that year.

1 concede 80 percent of the claimed losses, would be permitted to
2 claim 20 percent of the claimed losses, and in appropriate cases
3 would be relieved of certain penalties.

4 On November 27, 2002, Debtors' counsel wrote to the IRS,
5 stating Debtors' intention to participate in this settlement
6 program. On December 23, 2002, Debtors received a response from the
7 IRS, stating that Debtors were not eligible for the settlement
8 program, because one of the tax years in which Debtors claimed FLIP
9 losses was no longer open to audit. In October 2003, Debtors'
10 counsel asked that their request for participation in the settlement
11 program be forwarded to the Appeals Division of the IRS.

12 C. Debtors' Investment Losses

13 At the same time Debtors' tax woes were mounting, their
14 investments began to go bad. By late 2002, 3DO, the company in
15 which Debtors had invested almost all of the proceeds from the sale
16 of their EA shares, was experiencing severe financial difficulty.
17 In December 2002, Trip acknowledged that the company needed a large
18 infusion of capital and that he was the only source from which the
19 company could raise that capital. Between October 2002 and January
20 2003, Trip loaned 3DO approximately \$12 million. In May 2003, 3DO
21 filed a chapter 11 petition. In September 2003, Trip told his ex-
22 wife that his 3DO shares were worthless. In November 2003, the 3DO
23 bankruptcy was converted from a chapter 11 reorganization to a
24 chapter 7 liquidation. Debtors never received any significant
25 distribution from that liquidation.

26 D. IRS Audit Report

27 In July 2003, IRS Revenue Agent John Barrett issued his audit
28 report, which disallowed the vast majority of the losses that

1 Debtors had claimed from the sale of their UBS shares. The report
2 stated that Debtors should not be allowed to add to the tax basis of
3 their UBS shares any amounts that Harbourtowne or Hogue contracted
4 to pay for their UBS shares. The claimed basis transfer was
5 inappropriate, the report concluded, because Debtors were never at
6 risk regarding the shares that Harbourtowne and Hogue contracted to
7 purchase, because the transaction lacked economic substance and
8 business purpose apart from tax savings, and because a principal
9 purpose of the transaction was the evasion of federal income tax.
10 As a result of the disallowance of the FLIP and OPIS losses, the
11 audit report indicated that Debtors owed additional taxes and
12 penalties in the amount of \$16 million for the years 1997-2000.³

13 E. The Family Court Proceeding

14 On July 23, 2003, faced with the IRS audit report and
15 investment losses, Trip Hawkins filed a motion in the family court
16 to reduce the child support payments he was required to make to his
17 first wife. He argued that he was entitled to such relief on the
18 basis of reduced income, investment losses, and large tax debts. In
19 the papers submitted in support of this motion, Trip acknowledged
20 that he owed \$25 million to the IRS and the FTB and that he was
21 insolvent as a result. These representations are discussed in more
22 detail below.

23 The family court granted this motion in part, but at the same
24 time required Trip to place additional assets in a trust that had
25 been previously established for the support of the children. The
26 court also imposed a judicial lien on all the assets of that trust,
27 to ensure that those assets could not be seized by taxing

28

³ The additional amount due by year was: \$3,804,850 for 1997;
\$9,743,786 for 1998; \$262,964 for 1999; and \$2,214,673 for 2000.

1 authorities. The genesis and terms of this transfer, which the
2 Government relies upon to show Debtors' attempt to evade collection
3 of tax, is also described in more detail below.

4 F. Assessment of Additional Taxes

5 On December 30, 2004, Debtors consented to the assessment of
6 the additional taxes and penalties shown on the IRS Audit Report.
7 In March 2005, the IRS made an aggregate assessment of taxes,
8 penalties, and interest for tax years 1997-2000 totaling \$21
9 million.

10 On July 22, 2005, the FTB issued a Notice of Proposed
11 Assessment, asserting that Debtors owed additional California state
12 income taxes, penalties, and interest in the amount of \$15.3 million
13 for years 1997-2000. These taxes were assessed shortly thereafter.

14 G. Lawsuit Filed Against KPMG

15 In July 2005, Trip filed suit against KPMG in the San Mateo
16 County Superior Court, alleging claims for fraud and professional
17 negligence arising out of KPMG's recommendation that Debtors invest
18 in the FLIP and OPIS shelters. Trip later dismissed this action to
19 participate in a federal class action suit brought against KPMG in
20 the United States District Court in New Jersey.

21 Debtors never contemplated that their claims against KPMG would
22 enable them to pay in full the tax liabilities arising out of the
23 FLIP and OPIS shelters. At a family court hearing in January 2004,
24 Trip's bankruptcy counsel testified that the damages from such a
25 suit would be limited to the amount of any tax penalties imposed on
26 Debtors, because Debtors would have had to pay the principal amount
27 of the tax due even if they had not been induced to invest in the
28 shelters. In the Disclosure Statement accompanying their chapter 11

1 plan, Debtors estimated that proceeds of the claims against KPMG
2 "may be as much as \$3 million." Although the parties did not
3 introduce evidence as to the exact amount received in settlement of
4 Debtors' claims against KPMG, it appears that the recovery was not
5 materially in excess of the amount Debtors estimated in the
6 Disclosure Statement.

7 H. Offer in Compromise

8 In October 2005, Debtors submitted an Offer in Compromise to
9 the IRS in which Debtors offered to pay the IRS \$8 million over a
10 two-year period. Such an amount would have been equal to
11 approximately 38 percent of the amount that had been assessed by the
12 IRS earlier that year. In March 2006, an IRS official advised
13 Debtors' counsel that she could not recommend acceptance of Debtors'
14 Offer in Compromise. Debtors withdrew the Offer on March 23, 2006.

15 I. Debtors' Lifestyle

16 From the time of their 1996 marriage onward, Debtors maintained
17 a lifestyle that was commensurate with the great wealth they enjoyed
18 at the time they were first married. In 1996, Debtors purchased a
19 home in Atherton, California for \$3.5 million. In 2000, Debtors
20 purchased an \$11.8 million private jet that they used for family
21 vacations as well as for business trips.⁴ In 2002, Debtors
22 purchased an ocean-view condominium in La Jolla, California for \$2.6
23 million. From the date of their marriage to the date of their
24 bankruptcy petition, Debtors employed various gardeners and
25 household attendants.

26 Debtors altered this lifestyle very little after it became
27 apparent in late 2003 that they were insolvent. Although they
28

⁴ The aircraft was held by an entity wholly owned by Debtors.

1 sold the private jet in 2003, they continued to maintain both the
2 Atherton house and the La Jolla condominium until July 2006. In
3 October 2004, Debtors purchased a fourth vehicle costing \$70,000.⁵

4 Debtors' personal living expenses exceeded their earned income
5 long after Trip had acknowledged that Debtors were insolvent. In
6 the Collection Information Statement accompanying their October 2005
7 Offer in Compromise, Debtors disclosed annual after-tax earned
8 income of \$150,000 and annual living expenses of more than \$1.0
9 million.⁶ In the schedules filed in their bankruptcy case in
10 September 2006, Debtors disclosed annual after-tax earned income of
11 \$272,000 and annual living expenses of \$277,000. The components of
12 Debtors' living expenses are discussed in more detail below.

13 J. Debtors' Bankruptcy Case

14 On September 8, 2006, Debtors filed a chapter 11 petition,
15 primarily for the purpose of dealing with their tax obligations.
16 Those tax obligations had been paid in part shortly before and after
17 the bankruptcy petition. In July 2006, Debtors had sold their
18 Atherton home, and the entire \$6.5 million net proceeds had been
19 paid to the IRS in partial satisfaction of its lien. In August
20 2006, the FTB had seized \$6 million from Debtors' various financial
21 accounts. Shortly after the petition date, Debtors sold the La
22 Jolla condominium and paid the entire \$3.5 million net proceeds to
23 the IRS. Even with these payments, however, Debtors owed huge
24 liabilities to both the IRS and FTB. The IRS filed a proof of claim
25 in the bankruptcy case asserting that Debtors owed federal taxes in

26
27 ⁵ The family contained only two drivers. None of Debtors'
children were old enough to drive.

28 ⁶ In addition to specific living expense items totaling
\$652,000, Debtors listed "other" living expenses totaling \$487,000
annually.

1 the amount of \$19 million after taking account of the recent \$9.6
2 million payment. The FTB filed a proof of claim asserting that
3 Debtors owed state income taxes in the amount of \$10.4 million after
4 taking account of the FTB's recent seizure of \$6 million.

5 Debtors proposed a plan of reorganization that provided for
6 payment of part of the amount owed the IRS and FTB through: (1) a
7 new-value contribution of \$500,000; (2) Debtors' purchase of art and
8 furnishings from the bankruptcy estate for \$270,000;⁷ (3) proceeds
9 from the class action suit against KPMG; and (4) liquidation of the
10 other assets of the estate. The plan was confirmed on July 13,
11 2007.

12 The IRS acknowledges that it received payment of approximately
13 \$3.4 million through the bankruptcy case, and contends that it holds
14 an unpaid claim of approximately \$12 million afterwards. The FTB,
15 whose lien rights against Debtors' assets were junior to those of
16 the IRS, received much less in the chapter 11 case. It is not
17 necessary to determine the exact amount due to either the IRS or the
18 FTB, as the parties have sought only a determination as to whether
19 the unpaid taxes, whatever their amount, should be excepted from
20 discharge.

21 The discharge provisions of the confirmed plan state "The
22 Hawkinses will be discharged from any debts that arose before the
23 date of confirmation of the Plan to the extent provided by 11 U.S.C.
24 Section 1141(d)," and that the Debtors, IRS, or FTB may bring suit
25 to determine whether the unpaid tax debts were excepted from the
26 discharge Debtors received.

27
28

⁷ The new-value contribution and purchase of personal property were made through a loan obtained from Trip Hawkins' father.

1 K. The Present Action

2 On December 14, 2007, Debtors filed a declaratory relief action
3 against the IRS and the FTB alleging that a dispute existed as to
4 whether the tax liabilities not paid through the chapter 11 case
5 (the Unpaid Taxes) were discharged, and seeking a determination that
6 the Unpaid Taxes were in fact covered by the discharge entered by
7 this court in October 2007. The IRS and the FTB filed answers
8 acknowledging the existence of the dispute, but asking this court to
9 determine that the Unpaid Taxes were excepted from discharge
10 pursuant to section 523(a)(1)(C) of the Bankruptcy Code.⁸

11

12 DISCUSSION

13

I.
Fraudulent Returns

14

15 The Government first contends that the Unpaid Taxes should be
16 excepted from discharge on the basis that Debtors filed fraudulent
17 returns for the years in which those liabilities arise. § 523(a)(1)
18 (C). The Government contends that the 1997-2000 returns were
19 fraudulent, because Debtors knew that they could not properly claim
20 losses from the FLIP and OPIS shelters to offset gains from the sale
21 of their EA shares.

22

23 It is a difficult question whether Trip Hawkins acted with
24 intent to defraud in filing the returns in question. An objective,
25 well-trained tax professional would have known that the claimed loss
26 deductions lacked substance and would not be upheld if challenged.
27 Trip Hawkins clearly has the financial acumen to understand why the
28 FLIP and OPIS losses should not be allowed, and once the IRS

28

⁸ All statutory references are to the United States Bankruptcy Code, Title 11 of the United States Code.

1 challenged the deductions, Debtors never contended that the
2 deductions were valid, and immediately tried to opt into a
3 settlement program that would have allowed them only a small portion
4 of the losses they claimed in their returns. At the same time,
5 however, the FLIP and OPIS shelters were extremely complicated, and
6 at the time Trip signed the returns in question, he held opinion
7 letters from tax professionals stating that it was more likely than
8 not that the claimed deductions would be upheld. These opinion
9 letters were themselves so long and complex that they helped to
10 disguise the lack of substance in the FLIP and OPIS transactions.

11 The court need not, and does not, decide whether Trip Hawkins
12 acted with intent to defraud regarding 1997-2000 returns. As
13 explained below, the Unpaid Taxes should be excepted from discharge
14 on the basis that Trip caused Debtors to make unreasonable
15 discretionary expenditures for an extended period of time after he
16 became aware of tax obligations that he knew he could not pay.

17 There is no evidence that Lisa Hawkins signed the 1997-2000
18 returns with fraudulent intent. To establish such intent, the
19 Government would have to show that she knew that Debtors could not
20 properly claim losses from the FLIP and OPIS transactions. The
21 Government introduced no evidence that Lisa had any understanding of
22 those very complex transactions.

23 II.
24 Willful Attempt to Evade Tax

25 A. Introduction

26 The Government next contends that the Unpaid Taxes should be
27 excepted from discharge, because Debtors willfully attempted to
28 evade the collection of those taxes. Section 523(a)(1)(C) excepts

1 from discharge any debt "with respect to which the debtor . . .
2 willfully attempted in any manner to evade or defeat such tax."

3 The Government contends that Debtors attempted to avoid
4 collection of these taxes by maintaining an extravagant lifestyle
5 while not paying a known tax liability, by making fraudulent
6 transfers of assets, by failing to disclose assets on their
7 bankruptcy schedules, by making an inadequate offer in compromise to
8 the IRS, and by concealing their plan to file bankruptcy.

9 For the reasons stated below, the court finds that the Unpaid
10 Taxes should be excepted from discharge with respect to Trip
11 Hawkins, because he willfully avoided the collection of tax by
12 making unreasonable and unnecessary discretionary expenditures at a
13 time when he knew he owed taxes and knew he would be unable to pay
14 those taxes. The court determines that the Unpaid Taxes should not
15 be excepted from discharge with respect to Lisa Hawkins, because the
16 Government failed to show that she understood the Debtors' financial
17 condition or significantly influenced their spending.

18 B. Legal Standard

19 The elements that the Government must establish to show a
20 willful attempt to evade or avoid tax are summarized well in
21 U.S. v. Jacobs:

22 Section 523(a)(1)(C) "contains a conduct requirement (that
23 the debtor 'attempted in any manner to evade or defeat [a]
24 tax'), and a mental state requirement (that the attempt
25 was done 'willfully')." "The government satisfies the
26 conduct requirement when it proves the debtor engaged in
27 affirmative acts to avoid payment or collection of the
28 taxes", either through commission or culpable omission.
The mental state requirement - willfulness - is satisfied
where the government shows that the debtor's attempt to
avoid tax liability was "done voluntarily, consciously or
knowingly, and intentionally." That standard is met where
"(1) the debtor had a duty under the law, (2) the debtor
knew he had that duty, and (3) the debtor voluntarily and
intentionally violated that duty."

1 U.S. v. Jacobs, (In re Jacobs), 490 F.3d 913, 921 (11th Cir. 2007)
2 (citations omitted).

3 The necessary "affirmative act," or "culpable omission" may
4 consist of failure to file returns,⁹ concealment of income,¹⁰
5 fraudulent transfer or concealment of assets,¹¹ or unnecessary
6 expenditures.¹²

7 The requirement that the taxpayer act voluntarily, consciously,
8 and intentionally "prevents the application of the exception [from
9 discharge] to debtors who make inadvertent mistakes," but does not
10 require the government to establish fraudulent intent. Jacobs, 490
11 F.3d at 924.

12 Numerous decisions have held that unnecessary expenditures
13 combined with nonpayment of a known tax can be the basis for
14 excepting that tax from discharge.

15 [T]he caselaw applying section 523(a)(1)(C) has
16 consistently held section 523(a)(1)(C)'s requirements to
17 be satisfied in situations where the debtor-even without
18 fraud or evil motive-has prioritized his or her spending
by choosing to satisfy other obligations and/or pay for
other things (at least for non-essentials) before the
payment of taxes, and taxes knowingly are not paid.

19 Lynch v. U.S. (In re Lynch), 299 B.R. 62, 64 (Bankr. S.D.N.Y. 2003);
20 accord Jacobs 490 F.3d at 925-27; Stamper v. U.S. (In re Gardner),

21

22

23 ⁹ See, e.g., U.S. v. Fretz (In re Fretz), 244 F.3d 1323, 1329-
24 30 (11th Cir. 2001); U.S. v. Fegeley (In re Fegeley), 118 F.3d 979,
984 (3rd Cir. 1997).

25 ¹⁰ See, e.g., Jacobs, 490 F.3d at 926-27; Wright v. IRS (In re
26 Wright), 191 B.R. 291, 293-95 (S.D.N.Y. 1995); U.S. v. Swenson (In
27 re Swenson), 381 B.R. 272, 299-300 (Bankr. E.D. Cal. 2008); Hamm v.
U.S. (In re Hamm), 356 B.R. 263, 285 (Bankr. S.D. Fla. 2006).

28 ¹¹ See, e.g., Jacobs, 490 F.3d at 925-27; Dalton v. IRS, 77
F.3d 1297, 1302-04 (10th Cir. 1996).

¹² Discussed in detail in text below.

1 360 F.3d 551, 560-61 (6th Cir. 2004); Wright, 191 B.R. at 293; Hamm,
2 356 B.R. at 285-86.

3 Courts have used the following language to explain the logic
4 and limits of the doctrine under which a tax debt may be rendered
5 nondischargeable because the debtor pays other creditors or
6 purchases luxuries instead of paying taxes.

7 This Court starts with the recognition that as numerous
8 cases have recognized, "nonpayment of tax alone is not
9 sufficient to bar discharge of a tax liability." . . .
10 [I]n nearly every bankruptcy case in which taxes are due,
11 some income came in that was spent somewhere, in some way.
12 Reconciling that with the principle that nonpayment alone
13 does not constitute evasion requires the recognition that
14 at least part of one's income can be spent on living
15 without running afoul of the deemed evasion that results
16 from electing to spend one's money on purchases or
17 obligations other than taxes, *so long as it fairly can be
18 regarded as non-discretionary.*

19 Lynch, 299 B.R. at 84 (footnotes omitted)(emphasis added).

20 [I]t is not necessary to prove that the debtor was
21 inspired by "bad purpose or evil motive" in failing to pay
22 his taxes. It is enough if the debtor "had the
23 wherewithal to file his return and pay his obligation,"
24 but "voluntarily, consciously, and intentionally" decided
25 to pay other creditors instead.

26 Wright, 191 B.R. at 293 (citations omitted).

27 [B]oth Debtors admit to having knowledge of their tax
28 liabilities since at least 1995. In the face of that
29 knowledge, they continued to spend money on various
30 luxuries rather than on their mounting federal income tax
31 liabilities. This spending demonstrated a decision made
32 by the Debtors to favor self-indulgence over their tax
33 debts. That decision was voluntarily and knowingly made
34 by the Debtors.

35 Hamm, 356 B.R. at 285-86.

36 C. Culpability of Trip Hawkins

37 The Government has met the required burden with respect to Trip
38 Hawkins by establishing that for more than two and one-half years
39 before filing for bankruptcy protection, he caused Debtors to make

1 unnecessary expenditures in excess of Debtors' earned income, while
2 he acknowledged that Debtors had a tax liability of \$25 million,
3 while he relied upon that tax liability in seeking a reduction of
4 child support payments, while he knew Debtors were insolvent, while
5 Debtors paid other creditors,¹³ and while Debtors planned to file
6 bankruptcy to discharge their tax obligations.

7 1. Knowledge of tax liability.

8 By January 2004, Trip Hawkins had acknowledged in writing
9 several times that Debtors owed federal and state income taxes in
10 the amount of \$25 million. In November of 2002, with the advice of
11 expert tax counsel, he sought to accept an IRS settlement offer that
12 would fix Debtors' federal and state tax liability at \$25 million.¹⁴
13 In July 2003, he sought a reduction in child support payments to his
14 ex-wife on the basis of that liability. In September 2003, in an e-
15 mail to the ex-wife, he estimated his tax liability at \$25 million.
16 In January 2004, he filed a brief in support of a motion to reduce
17 child support that stated in relevant part: "[Hawkins'] debts
18 include . . . a \$25,000,000.00 bill for Federal and State of
19 California income taxes. The tax bill has been issued after an
20 offer from the Internal Revenue Service was accepted by Mr.
21 Hawkins."

22
23
24 _____
25 ¹³ Debtors' schedules listed no unpaid general unsecured
claims.

26 ¹⁴ Hawkins attempted to opt into a settlement program
27 established by the IRS under which the taxpayer would concede 80
percent of the claimed loss deduction and the government would
28 recognize the remaining 20 percent of the claimed loss. The
calculation of federal and state tax liability at \$25 million was
calculated on the assumption that Hawkins would be permitted to
claim 20 percent of the loss under the settlement program.

1 In January 2004, Trip Hawkins' tax counsel filed a declaration
2 in support of the motion to reduce child support that stated in
3 relevant part:

4 The total amount that we anticipate that the
5 Taxpayers will owe the IRS as of today's date is equal to
6 \$4,375,949.00; \$11,295,412.00; \$305,152.00; and
7 \$2,500,771.00 for the years 1997 through 2000,
8 respectively. Thus, we estimate the Taxpayers' liability
9 to the IRS to exceed \$18,000,000.00.

10 In addition, the FTB continues to seek their share of
11 the liability. For FTB purposes, the Taxpayers are not
12 eligible for the federal settlement initiative. Based
13 upon this information, it is estimated that the Taxpayers
14 may owe the FTB an amount equal to approximately forty
15 percent (40%) of the IRS liability. Thus, it appears that
16 exposure to the FTB liability will exceed \$7,000,000.

17 It is likely that Trip Hawkins understood that he owed millions
18 in taxes well before January 2004. In closing argument, his counsel
19 acknowledged that Trip understood by November 2002 that Debtors
20 would be liable for the taxes claimed by the IRS and FTB. It is
21 worthy of note that at no time since the IRS challenged the FLIP and
22 OPIS shelters in July 2001 has Hawkins asserted that the losses
23 Debtors claimed through those shelters were allowable under law.

24 2. Knowledge of Insolvency.

25 By January 2004, Trip Hawkins also knew his liabilities
26 exceeded his assets, and that any dissipation of his assets would
27 reduce his ability to pay his tax liabilities. In the January 2004
28 brief in support of his motion to reduce child support, Hawkins
29 openly acknowledged that he was insolvent: "At this time, [Hawkins']
30 assets are about \$20,867,000.00 . . . and his debts include a
31 \$4,000,000.00 house loan and a \$25,000,000.00 bill for Federal and
32 State of California income taxes."

33 The testimony of Hawkins and his bankruptcy attorney at the
34 January 2004 family court hearing indicates that Hawkins *planned* not

1 to pay the tax debt in full. Hawkins testified that he had accepted
2 the IRS settlement offer, which would result in a liability of \$18
3 million to the IRS.¹⁵ Immediately after this testimony, Hawkins'
4 bankruptcy attorney testified that Hawkins' intent was not to pay
5 the tax debt, but to discharge it in bankruptcy. "What we're
6 looking for is the ability to discharge the tax, in other words, to
7 eliminate the tax liability at some point in the future so that Mr.
8 Hawkins can be freed from that tax." Hawkins' bankruptcy attorney
9 then testified at length about the timing of the planned bankruptcy
10 filing.¹⁶ Following the hearing, Hawkins' bankruptcy attorney asked
11 that the order issued by the family court not include any reference
12 to the planned bankruptcy petition, to minimize the likelihood that
13 the bankruptcy petition would be found to be filed in bad faith.¹⁷

14 3. Discretionary Expenditures.

15 Before examining Hawkins' expenditures, it is appropriate to
16 examine Hawkins' earned income. For the purpose of this decision,
17 this court assumes that it should take some account of a debtor's
18 earned income in determining what expenditures are culpable under
19 section 523(a)(1)(C) as unduly lavish. It may not be appropriate to
20 require a CEO earning hundreds of thousands of dollars per year to
21 live in an apartment suitable for a clerical employee, even if that
22 CEO is insolvent. The effort and skill required to earn such sums

23
24 ¹⁵ As noted above, Debtors' tax counsel assumed that a
25 liability to the IRS of \$18 million would result in an additional
26 liability to the FTB of \$7 million.

26 ¹⁶ The bankruptcy attorney explained that the taxes could not
27 be discharged unless the petition was filed at least three years
28 after the latest return was filed and at least 240 days after the
taxes had been assessed. See §§ 507(a)(8) and 523(a)(1)(A).

¹⁷ The attorney may have been concerned that the bankruptcy
court might refuse to confirm Debtors' chapter 11 plan on the basis
that its primary purpose was the avoidance of tax. See § 1129(d).

1 require a nuanced approach in determining what living expenses are
2 necessary.¹⁸ Even the most nuanced approach, however, does not
3 excuse living expenses greatly in excess of earned income over an
4 extended period of time.¹⁹

5 Debtors provided two snapshots of their income and expenses
6 between January 2004 and September 2006. In October 2005, Debtors
7 submitted a Collection Information Statement, signed under penalty
8 of perjury, in support of their Office in Compromise. In September
9 2006, Debtors filed schedules in their chapter 11 case, also signed
10 under penalty of perjury. The October 2005 Collection Information
11 Statement indicated monthly after-tax earned income of \$12,500.
12 Bankruptcy Schedule I indicated monthly after-tax earned income of
13 \$22,180. All of this income was earned by Trip; Lisa was not
14 employed outside the home at any time during this period.

15 Against this backdrop, the Debtors' personal living expenses
16 from January 2004 to September 2006 are truly exceptional. After
17 Trip represented to the family court that he was liable for \$25
18 million in federal and state taxes and that he was insolvent as a
19 result, Debtors spent between \$16,750 and \$78,000 more than their
20 after-tax earned income each month.

21

22

23 ¹⁸ The court should not afford similar weight to unearned
24 income in evaluating the culpability of expenditures by a taxpayer
25 who knows he is insolvent. Such a taxpayer is not "working for his
26 creditors," as the unearned income would be available to those
27 creditors in any event. Although at one time the value of Debtors'
28 stock holdings were inextricably intertwined with Trip Hawkins'
active occupation, the evidence suggests that by 2004, his unearned
income consisted primarily of dividends from UBS stock, which were
not dependent in any way upon Trip Hawkins' current personal
efforts.

¹⁹ A taxpayer who suffers a sudden decline in income may, of
course, need some time to adjust his or her expenditures.

1 In the Collection Information Statement submitted in October
2 2005, Debtors stated that their personal living expenses were more
3 than seven times their after-tax earned income, and exceeded that
4 income by more than \$78,000 per month.

5		
6	After-tax earned income ²⁰	\$12,468
7	Food, clothing, misc.	(\$7,000)
8	Housing and utilities	(\$33,600)
9	Transportation	(\$2,700)
10	Health care	(\$700)
11	Child care	(\$4,500)
12	Life insurance	(\$1,650)
13	Other expenses	(\$40,550)
14	Total Expenses	(\$90,700)
15	Income less expenses	(\$78,232)
16		

17 Several aspects of this Statement are worthy of note. The
18 \$33,600 housing expense included expenses for a 5-bedroom, 5.5 bath
19 house in Atherton (later sold for \$10.5 million), and a 4-bedroom,
20 3.5 bath condominium in La Jolla (later sold for \$3.5 million). The
21 transportation expense covers four vehicles for a family with only
22 two drivers, and includes a \$70,000 Cadillac SUV purchased ten
23 months after Trip Hawkins had acknowledged Debtors' tax liability
24 and insolvency in the family court proceeding. The \$40,550 for
25 "other expenses" is not broken down. If that figure is exaggerated,
26 the exaggeration may itself represent an effort to prevent the
27 collection of tax.

28

²⁰ Wages of \$16,668 less income and FICA taxes of \$4,200.

1 The schedules filed in Debtors' bankruptcy case indicate that
2 Debtors' personal living expenses greatly exceeded their after-tax
3 earned income until just before they filed their bankruptcy petition
4 in September 2006. Debtors sold the Atherton house just before the
5 bankruptcy petition was filed. Debtors sold the La Jolla
6 condominium after the bankruptcy petition was filed. If one adds
7 the minimum amount they could have been spending for housing before
8 the July 2006 sale of the Atherton house, together with the income
9 and living expenses that Debtors reported in their bankruptcy
10 schedules, Debtors' living expenses greatly exceeded their after-tax
11 earned income through July 2006.

12

13	After-tax earned income ²¹	\$22,638
14	Housing expense ²²	(\$24,583)
15	Utilities & maintenance	(\$1,615)
16	Food	(\$3,500)
17	Clothing, laundry & cleaning	(\$450)
18	Medical	(\$700)
19	Recreation & entertainment	(\$1,100)
20	Life insurance	(\$825)
21	Transportation ²³	(\$2,328)

22

23 ²¹ Salary and consulting fees of \$24,567 less payroll and
24 Social Security taxes of \$2,029.

25 ²² Monthly mortgage payment on Atherton house of \$19,500, plus
26 minimum possible real estate taxes on Atherton house of \$2,917 per
27 month, plus minimum monthly real estate taxes on La Jolla
28 condominium of \$2,166 per month (monthly property tax calculated at
1/12 of 1 percent of original purchase price). This figure does
not include any amount for fire insurance, and undoubtedly
underestimates property taxes.

²³ Includes auto insurance, loan payments on the SUV, and
operating expenses.

1	Child care	(\$3,800)
2	Education	(\$150)
3	Storage	(\$800)
4	Total Expenses	(\$39,851)
5	Income less expenses	(\$17,213)

6

7 Debtors made expenditures in excess of earned income for more

8 than two-and-one-half years after Trip Hawkins acknowledged in

9 January 2004 that Debtors were insolvent and would not pay their tax

10 debt in full. Debtors did not sell the Atherton home until July

11 2006. They did not sell the La Jolla condominium until after filing

12 for bankruptcy protection in September 2006.²⁴ They reported in

13 their bankruptcy schedules that on the petition date they were still

14 making the expenditures for the Cadillac SUV, child care, and

15 recreation noted above. Debtors' high level of expenditure also

16 continued well after they consented to assessment of tax by the IRS

17 in the amount of \$21 million in December of 2004, and well after the

18 assessments were recorded in March 2005. The Collection Information

19 Statement indicates that Debtors' monthly living expenses were seven

20 times their earned income ten months after they consented to

21 assessment and seven months after the IRS formally assessed the

22 additional tax. This is not a case where the taxpayers acted

23 appropriately once the tax was formally assessed, perhaps suggesting

24 that their earlier failure to pay was based on some innocent

25 misconception of their duty.

26

27

28

²⁴ Neither Debtor testified that they tried to sell either house promptly after January 2004 but were unable to do so.

1 D. Culpability of Lisa Hawkins

2 The actions, knowledge, and intent of Trip Hawkins do not by
3 themselves require that the Unpaid Taxes be excepted from the
4 discharge granted Lisa Hawkins. Bad acts by one spouse are not
5 automatically attributed to the other spouse for the purpose of
6 determining whether a debt should be excepted from discharge.
7 Allison v. Roberts, (In re Allison), 960 F.2d 481, 485-86 (5th Cir.
8 1992); La Trattoria, Inc. v. Lansford (In re Lansford), 882 F.2d
9 902, 904-05 (9th Cir. 1987); Synod of South Atlantic Presbyterian
10 Church v. Magpusao (In re Magpusao), 265 B.R. 492, 498-99 (Bankr.
11 M.D. Fla. 2001). Bad acts by one spouse may be considered in
12 determining the responsibility of the other spouse, where the other
13 spouse knowingly participates in the bad acts and accepts the
14 benefits derived from those bad acts.²⁵ Lansford, 822 F.2d at 905;
15 Magpusao, 265 B.R. at 500-01; Rainier Title Co. v. Demarest (In re
16 Demarest), 176 B.R. 917, 922-23 (Bankr. W.D. Wash. 1995).

17 The Government has not met its burden of showing that Lisa
18 Hawkins willfully made unnecessary expenditures while not paying a
19 known tax liability. The evidence indicates instead that Lisa
20 reasonably deferred to Trip regarding all significant financial
21 decisions, and that it was he who is responsible for all of Debtors'
22 actions with respect to the tax liabilities in question. In so
23 finding, I note the following.

24 First, Trip and Lisa had very different levels of financial
25 expertise and experience, and played very different roles in the

26
27 ²⁵ One spouse can be vicariously liable for bad acts of the
28 other spouse committed in furtherance of a business partnership
including both spouses. Tsurukawa v. Nikon Precision, Inc. (In re
Tsurukawa), 287 B.R. 515, 523-27 (9th Cir. BAP 2002). That
principle is inapplicable in this case, as there is no evidence of
a business partnership including Trip and Lisa Hawkins.

1 family. Trip had a Stanford M.B.A., worked full time as the CEO of
2 a publicly traded company, and had at one time accumulated \$100
3 million through his own efforts and investments. Lisa had only an
4 undergraduate degree in communications, had very limited business
5 experience, and during the entire period of her marriage to Trip had
6 been a full-time, stay-at-home mother and wife. These facts and
7 circumstances indicate that it was Trip who managed all significant
8 aspects of the family finances, that it was Trip who decided what
9 the family could afford to spend, and that Lisa deferred to Trip's
10 expertise and experience on all financial matters. Trip and Lisa's
11 testimony at trial reinforced this picture.

12 Second, the most damaging evidence of evasion, Trip's
13 representations in his motion to reduce child support payments to
14 his ex-wife, do not implicate Lisa. It was in that motion that Trip
15 acknowledged his tax liability, his resulting insolvency, and his
16 intent to discharge rather than pay his tax liabilities. There is
17 no evidence that Lisa participated in that motion or was otherwise
18 aware of the representations Trip made in that motion.

19 Third, the Government did not examine Lisa in detail regarding
20 her role in decision making regarding family finances, her knowledge
21 of the family's financial condition, or her knowledge of Trip's
22 decision not to pay taxes while maintaining the family's previous
23 standard of living. The Government established through its
24 questioning of Lisa only that she knew of the tax audit, that she
25 participated in some undefined way in the preparation of the
26 Collection Information Statement, and that it was she who purchased
27 the \$70,000 SUV in October 2004. Lisa testified that she paid no
28 attention to financial issues not directly concerned with the
immediate operation of the household, and that even the household

1 bills were generally paid by Trip's personal assistant. I find this
2 testimony credible.

3 The evidence taken as a whole indicates that it was Trip who
4 was in every meaningful sense responsible for Debtors' failure to
5 pay tax while making unnecessary personal expenditures.

6 E. Other Alleged Acts of Evasion

7 In support of its contention that Debtors willfully attempted
8 to avoid collection of tax, the Government relies upon other alleged
9 acts of avoidance that are more problematic. I give little or no
10 weight to the evidence of other acts of willful avoidance discussed
11 below.

12 The Government contends that Trip Hawkins intentionally used
13 the family court proceedings to transfer property to the Hawkins
14 Family Support Trust (the Trust) for the purpose of shielding those
15 assets from taxing authorities. The record of those proceedings
16 does not support this claim. Trip brought a motion to reduce his
17 child support payments on the basis of his investment losses and tax
18 liability. In the course of opposing that motion, the attorney for
19 Trip's ex-wife urged that Trip be required to place additional funds
20 in the Trust, and that the assets of the Trust be shielded from
21 Debtors' tax liabilities by requiring Trip to make the Trust
22 irrevocable and by placing a judicial lien on Trust assets. Trip's
23 counsel opposed this request. It is true that after the family
24 court judge granted the ex-wife's request, Hawkins' counsel
25 cooperated fully in drafting an order implementing that ruling.
26 This record does not show, however, that Hawkins willfully
27 transferred property to the Trust with the intent of frustrating the
28 collection of tax.

1 The Government next contends that the Unpaid Taxes should be
2 excepted from discharge, because Debtors planned from January 2004
3 onward to discharge those liabilities, and because they submitted an
4 inadequate Offer in Compromise to delay the Government's collection
5 efforts while Debtors waited for their tax liabilities to become old
6 enough to be subject to discharge. This evidence does show that
7 Debtors intended to discharge rather than pay the Unpaid Taxes.
8 That by itself, however, does not justify a finding that Debtors
9 willfully attempted to avoid the collection of tax. The Unpaid
10 Taxes should be excepted from Trip's discharge, not because Debtors
11 made a decision to file bankruptcy long before they actually did so,
12 but because Trip caused them to waste assets through unnecessary
13 personal spending after they decided to discharge their tax
14 liabilities.

15 The Government urges the court to rely upon Debtors' personal
16 use of their private jet as the centerpiece of their lavish personal
17 spending. I attach little importance to ownership of the jet,
18 because Debtors purchased the jet while they thought they were
19 solvent, and they attempted to sell it soon after they understood
20 they were insolvent.

21 I also decline to rely upon the Government's argument that
22 Debtors attempted to evade tax by making high-risk loans to 3DO
23 shortly before that company filed for bankruptcy. I agree that a
24 pattern of high-risk investments can constitute evidence of an
25 attempt to evade payment of tax. A debtor who has \$100 in assets
26 and owes \$100 in debts acts inappropriately towards his creditors by
27 buying \$100 in lottery tickets. While Debtors' loans to 3DO were
28 somewhat like buying lottery tickets, in that they imposed on the

1 Government most of the risk of loss while affording Debtors most of
2 the benefits of success, the evidence of evasion of tax via
3 unnecessary spending is so strong against Trip that the loans to 3DO
4 add little to the Government's case, and there is no evidence that
5 Lisa played any role in the loans to 3DO.

6 Finally, I am unconvinced that Debtors intentionally failed to
7 disclose their San Francisco Giants seat license,²⁶ and I consider it
8 wholly irrelevant that Debtors were able to maintain a high standard
9 of living post-bankruptcy by purchasing furniture and artworks from
10 the bankruptcy estate with money borrowed from Trip Hawkins' father.

11 F. Conclusion

12 The Government introduced no evidence that Lisa Hawkins signed
13 the 1997-2000 returns knowing that Debtors could not properly claim
14 losses from the FLIP and OPIS shelters. The Government did not
15 establish that Lisa attempted to evade tax through excessive
16 personal expenditures, because it failed to show she had any
17 understanding of the extent of the couple's tax liability, that she
18 knew of Trip's plan not to pay that tax liability, or that she
19 exercised significant influence upon the family's expenditures.

20 Trip Hawkins willfully evaded payment of that tax debt within
21 the meaning of section 523(a)(1)(C) by causing Debtors to deplete
22 their assets on large unnecessary expenditures for an extended
23 period of time, while knowing that Debtors were insolvent, while
24

25 ²⁶ Although Debtors did not specify that they held a seat
26 license, they did disclose in their schedules ownership of season
27 tickets. This conduct is not persuasive evidence of intent to
28 deceive, and is very different from that involved in the cases
cited by the Government in which there was a complete failure to
disclose either the seat license or tickets along with failure to
disclose many other assets. See In re Blow, 2007 WL 1858697
(Bankr. S.D. Tex. 2007) and In re Gordon, 2002 WL 925028 (Bankr.
M.D.N.C. 2002).

1 knowing that Debtors had a \$25 million tax debt that they could not
2 pay and did not intend to repay, and while paying other creditors.

3 It is true that the present case does not exhibit all the
4 badges of tax evasion present in the majority of decisions in which
5 courts have found a willful attempt to evade or defeat tax. In the
6 more typical case in which the court relies upon luxury
7 expenditures, there are other indices of evasion not present here:
8 failure to file returns; concealment of income; failure to pay the
9 amount shown on the returns; or transfer of assets without
10 consideration. Lynch, 299 B.R. at 83 n.96. I have considered those
11 decisions carefully and I conclude that no specific type or number
12 of badges of evasion is required. The statute itself does not
13 require the presence of any badges of evasion; their sole function
14 is as evidence of an intentional, culpable act or omission whereby
15 tax is willfully evaded. In the present case, there is ample
16 evidence of both the conduct requirement and mental-state
17 requirement, and there is evidence of willful failure to pay tax not
18 found in the more typical cases noted above: Trip's exceptional
19 business sophistication; Trip's open acknowledgment of his tax debt
20 and insolvency; the length of time over which Trip caused Debtors to
21 expend funds on unnecessary expenditures after he acknowledged the
22 tax debt; the amount of unnecessary expenditures; and the extent to
23 which unnecessary expenditures exceeded Debtors' earned income.

24 Both parties agree that this court may not order that the
25 Unpaid Taxes be excepted from discharge in part. Whether those
26 liabilities are excepted from discharge is an all-or-nothing
27 question. This is so, because section 523(a)(1)(C) does not provide
28 that an unpaid tax debt is excepted from discharge only "to the

1 extent that" such debt results from the willful avoidance of tax.
2 Lynch, 298 B.R. at 87-88. Although the amount lost to the IRS and
3 FTB as a result of Debtors' excessive discretionary spending is less
4 than the amount of the debt excepted from discharge, the amount lost
5 was far from immaterial. Debtors' personal living expenses exceeded
6 their earned income by \$516,000 to \$2.35 million between January
7 2004 and the petition date.²⁷

8 CONCLUSION

9 Trip Hawkins' income tax liabilities to the IRS and FTB for tax
10 years 1997-2000 are excepted from discharge pursuant to section
11 523(a)(1)(C) of the Bankruptcy Code. Lisa Hawkins' liabilities for
12 the Unpaid Taxes are not excepted from discharge.

13 ****END OF MEMORANDUM DECISION****

14
15
16
17
18
19
20
21
22
23
24 ²⁷ Monthly personal living expenditures exceeded earned income
25 by \$17,213 to \$78,232 per month (see pages 21-23, above). Using
26 those monthly figures, Debtors' personal living expenditures
27 exceeded earned income by a total of \$516,390 to \$2.35 million over
28 the 30 months between January 2004 and July 2006 (when they sold
the Atherton house). The \$2.35 million figure uses the income and
expenses shown in the Collection Information Statement signed by
both Debtors and submitted to the IRS in support of Debtors' Offer
in Compromise. In the two months between the date Debtors sold the
Atherton house and the petition date, expenditures exceed earned
income, but by a smaller amount.