

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

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SECURITIES AND EXCHANGE COMMISSION :

Plaintiff, :

vs. :

Case No. 1:10-CV-457
(GLS/CFH)

McGINN, SMITH & CO., INC., :
McGINN, SMITH ADVISORS, LLC :
McGINN, SMITH CAPITAL HOLDINGS CORP., :
FIRST ADVISORY INCOME NOTES, LLC, :
FIRST EXCELSIOR INCOME NOTES, LLC, :
FIRST INDEPENDENT INCOME NOTES, LLC, :
THIRD ALBANY INCOME NOTES, LLC, :
TIMOTHY M. MCGINN, AND :
DAVID L. SMITH, GEOFFREY R. SMITH, :
Individually and as Trustee of the David L. and :
Lynn A. Smith Irrevocable Trust U/A 8/04/04, :
LAUREN T. SMITH, and NANCY MCGINN, :

Defendants, :

LYNN A. SMITH and :
NANCY MCGINN, :

Relief Defendants, :

- and- :

GEOFFREY R. SMITH, Trustee of the :
David L. and Lynn A. Smith Irrevocable :
Trust U/A 8/04/04, :

Intervenor. :

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**MOTION OF WILLIAM J. BROWN, AS RECEIVER, FOR AN
ORDER (I) APPROVING A PROCEDURE FOR THE ADMINISTRATION OF
CLAIMS OF GOVERNMENTAL UNITS; (II) ESTABLISHING A DEADLINE
FOR FILING OF CLAIMS OF GOVERNMENTAL UNITS; (III) APPROVING THE
FORM AND MANNER OF NOTICE THEREOF; (IV) AUTHORIZING THE
APPLICABILITY OF SECTION 505 OF THE BANKRUPTCY CODE TO THIS CASE;
(V) ESTABLISHING THE PRIORITY OF VICTIM INVESTOR CLAIMS
OVER THE IRS; AND (VI) DECLARING THE RECEIVER NOT PERSONALLY
LIABLE FOR TAX LIABILITIES OF THE RECEIVERSHIP, THE
MS ENTITIES, OR OF THE DEFENDANTS ON ACCOUNT OF DISTRIBUTION OF
ASSETS IN ACCORDANCE WITH THIS COURT'S ORDERS**

William J. Brown, as Receiver ("Receiver") for the entity Defendants in this
action and certain other entities, by his counsel, Phillips Lytle LLP, moves (the "Motion") for an

Order: (i) approving a procedure for administration of claims of Governmental Units (as defined below); (ii) establishing a deadline for the filing of government claims against the MS Entities (as defined below); (iii) approving the form and manner of notice thereof; (iv) authorizing the applicability of section 505 of title 11 of the United States Code (the “Bankruptcy Code”) to this case; (v) establishing the priority of victim investor claims over the IRS; and (vi) declaring the Receiver not personally liable for tax liabilities of the Receivership, the MS Entities (as defined below), or of the defendants on account of distribution of assets in accordance with this Court’s Orders, and respectfully represents as follows:

BACKGROUND

1. On April 20, 2010, the Securities and Exchange Commission (“SEC”) filed a Complaint initiating the above-captioned action (Docket No. 1). Also, on April 20, 2010, this Court granted a Temporary Restraining Order (Docket No. 5), which, among other things, froze certain assets of the above-captioned Defendants and Relief Defendants, and appointed the Receiver as temporary receiver with respect to numerous entities controlled or owned by Defendants Timothy M. McGinn and David L. Smith (collectively, the “MS Entities”).

2. On July 26, 2010, the Court entered an order granting SEC’s Motion for a Preliminary Injunction and appointing the Receiver as permanent receiver with the consent of defendants Timothy M. McGinn and David L. Smith (“Preliminary Injunction Order”) (Docket No. 96).

3. On August 3, 2010, the SEC filed an Amended Complaint (Docket No. 100). On June 8, 2011, the SEC filed a Second Amended Complaint (Docket No. 334).

4. The Preliminary Injunction Order authorizes the Receiver to, among other things, “use, lease, sell, and convert into money all assets of the MS Entities, either in public or private sales or other transactions on terms the Receiver reasonably believes based on his own experience and input from his advisors to be most beneficial to the MS Entities and those entitled

to the proceeds...” and to [t]ake such further action as the Court shall deem equitable, just and appropriate under the circumstances upon proper application of the Receiver.” Preliminary Injunction Order, ¶¶ VIII(m), (n).

5. On March 27, 2012, the Court entered an order (i) approving a procedure for the administration of claims of creditors and investors against the MS Entities; (ii) establishing May 28, 2012 as the deadline for the filing of such claims; and (iii) approving the form and manner of notice thereof (“Bar Date Order”) (Docket No. 475).

6. On April 16, 2012, the Court entered an order amending the Bar Date Order setting June 19, 2012 (“Claims Bar Date”) as the deadline for creditors and investors to file claims against the MS Entities (“Amended Bar Date Order”) (Docket No. 481).

7. The vast majority of claims against the MS Entities were determined through the claims procedure approved by the Amended Bar Date Order.

8. The Receiver did not receive any claim forms filed by Governmental Units (as defined below) in response to the notice issued in accordance with the Bar Date Order. For the reasons set forth below, the Receiver respectfully requests that the Court (a) set a deadline for which government claims must be filed and in conjunction with that relief, or, alternatively, (b) enter an Order granting the other forms of relief described in paragraph 9 below.

SUMMARY OF MOTION

9. By this Motion, the Receiver requests that the Court (a) enter an order substantially in the form attached as **Exhibit A** (“Government Claims Procedure Order”): (i) approving the procedure for the administration of governmental unit claims against the MS Entities, as summarized below (“Government Claims Procedure”); (ii) establishing a deadline by which governmental units, as such term is defined by section 101(27) of the Bankruptcy Code

(“Governmental Units”),¹ including, but not limited to, all relevant federal, state and local taxing authorities, must file a proof of claim² against the MS Entities if necessary under the Government Claims Procedure (“Government Claims Bar Date”); (iii) approving the proposed form and manner of publication of notice of the Government Claims Bar Date and the Government Claims Procedure; and (b) enter an Order (i) authorizing the applicability of Section 505 the Bankruptcy Code³ to this case; (ii) establishing the priority of victim investor claims over the Internal Revenue Service (“IRS”); and (iii) declaring the Receiver not personally liable for tax liabilities of the Receivership, the MS Entities, or of the defendants on account of distribution of assets in accordance with this Court’s Orders.

10. The Government Claims Procedure is a necessary prerequisite to allow the Receiver to properly make distributions to the defrauded investors and creditors of the MS Entities because of the Receiver’s potential personal liability for the payment of taxes as described below. Both the Receiver and the Securities and Exchange Commission have attempted to identify a method to resolve the Receiver’s concerns including through communications with the IRS and the Department of Justice. Those efforts have been unsuccessful to date because of what the Receiver understands to be a “policy” issue as opposed to any particular issue with the tax returns or tax treatment taken by the Receiver to date. The Receiver believes that the Department of Justice prefers that the Receiver seek judicial intervention in order to bring closure to these issues. In the interim, the Receiver plans to file a

¹ Section 101(27) of the Bankruptcy Code defines the term “governmental unit” broadly to include “United States; State; Commonwealth; District; Territory; municipality; foreign state; department, agency, or instrumentality of the United States (but not a United States trustee while serving as a trustee in a case under this title), a State, a Commonwealth, a District, a Territory, a municipality, or a foreign state; or other foreign or domestic government.”

² For purposes of this Motion, “Claim” is defined to mean the same as in Section 101(5) of the Bankruptcy Code: (5) The term “claim” means – (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

³ A copy of the text of section 505 of the Bankruptcy Code is attached as **Exhibit B**.

separate motion for an order authorizing the Receiver to make distributions to investors and creditors of the MS Entities subject to resolution of any Governmental Unit claims.

11. The SEC supports the Motion.

RELIEF REQUESTED

12. The Receiver is unaware of any material existing claims of Governmental Units against the MS Entities⁴. Since the time for Governmental Units to assert claims has not entirely passed, the Receiver proposes the Government Claims Procedure to be certain that the Receiver is aware of the entire universe of Governmental Unit claims against the MS Entities and to enable the Receiver to appropriately make distributions to defrauded investors and creditors and administer the estates of the MS Entities.

A. Government Claims Procedure

13. The Receiver proposes the following Government Claims Procedure:

I. *Who Must File a Claim Form*

14. Any Governmental Unit that is the holder of a Claim against any of the MS Entities (“Government Claim”) will be required to file a written claim (each, a “Claim Form”), substantially in the form attached as **Exhibit C**, by the Government Claims Bar Date.

II. *Consequences for Failure to File a Claim Form*

15. Unless otherwise ordered by the Court, any Government Unit that is required to file a Claim Form in accordance with the Government Claims Procedure Order, but fails to do so, on or before the Government Claims Bar Date, shall be barred, estopped and enjoined from asserting such claim against the MS Entities or the Receiver, and shall not receive a distribution on account of such claim.

⁴ The Receiver has received notices from the IRS from time to time asserting penalties for late-filed tax returns. The Receiver understands that in all but one instance to date, these asserted penalties have been withdrawn by the IRS.

III. *Method for Filing a Claim Form*

16. In accordance with the Government Claims Procedure Order, all Claim Forms must be delivered by first-class mail, overnight courier, or hand-delivery to Phillips Lytle LLP, Attn: Karen M. Ludlow, One Canalside, 125 Main Street, Buffalo, New York 14203-2887, so as to be **actually** received by 5:00 p.m. (Eastern Time) on the Government Claims Bar Date. Claim Forms **may not** be delivered by facsimile or electronic mail.

B. Government Claims Bar Date

17. Given the procedural status of this case and the need for distributions to be made in order to ensure that the rights of the investors and creditors of the estates are not severely prejudiced, the Receiver proposes that the Government Claims Bar Date be established as sixty (60) days following entry of the Government Claims Procedure Order. The Receiver anticipates that Government Claims Bar Date would be in approximately March 2014.

18. The Receiver believes that the proposed Government Claims Bar Date will provide all Governmental Units with ample opportunity to consult with the Receiver, if they so choose, or to submit a Claim Form in accordance with the Government Claims Procedure Order, if required.

C. Notice of Government Claims Procedure and Government Claims Bar Date

19. The Receiver will post a notice ("Claims Notice") describing the Government Claims Procedure and the Government Claims Bar Date, along with a schedule of the MS Entities, substantially in the form attached as **Exhibit D** on the Receiver's website (www.mcginnsmithreceiver.com).

20. In order to assure that any Governmental Unit that wishes to assert Claims against the MS Entities has an opportunity to participate in the claims administration process, the Receiver proposes to give notice of the Government Claims Procedure and the Government Claims Bar Date as follows:

- i. The Receiver will prominently post to the Receiver's website copies of the Motion, the Government Claims Procedure Order, the Claim Form, and the Claims Notice; and
- ii. The Receiver will provide the Claims Notice describing the material terms of the Government Claims Procedure and the Government Claims Bar Date to (y) all federal, state and local taxing authorities, known by the Receiver, in all jurisdictions where any of the MS Entities was required to file a tax return at any time, and (z) the Attorney General of the United States, the United States Attorney for the Northern District of New York, and the IRS.

D. Application of Section 505 of the Bankruptcy Code to this Case

21. The Receiver also requests that section 505 of the Bankruptcy Code be made applicable to this case to permit the Court to, among other things, determine the unpaid tax liability of any of the MS Entities where such liability has not yet been contested or adjudicated by a judicial or administrative tribunal of competent jurisdiction before the commencement of this case, or, additionally in the case of an *ad valorem* tax on real or personal property of the estates, if the applicable period for contesting or redetermining that amount under applicable nonbankruptcy law has also not yet expired.

E. Establishing the Priority of Victim Investor Claims Over the IRS

22. There is no authority for the IRS to conclude that any federal tax liability enjoys priority vis-à-vis victim investor claims. The investor claims in this case exceed the total value of Receivership assets recovered to date and all expected future recoveries. Establishing priority over such claims will moot the need to expend resources litigating the propriety and amount of any tax claims in connection with the MS Entities.

23. To the Receiver's knowledge, the IRS has not asserted any claims against the MS Entities and has declined the Receiver's requests for confirmation of whether it may do so in the future. The Receiver has no ability to calculate the IRS' potential tax claim against the MS Entities and cannot recommend a final determination of such a claim at this time.

24. Accordingly, the Receiver respectfully requests that the Court authorize the Government Claims Procedure for all Governmental Units. During that time, the Receiver will continue to fully cooperate with the IRS and other Governmental Units and promptly respond to any requests for information that the Governmental Units require in order to assess their respective claims.

25. To the extent this Court approves any IRS claims against Receivership assets in connection with the MS Entities, those claims should be subordinated to the claims of investor victims in order to effectuate the purpose of the Receivership in maximizing recovery for defrauded investors and creditors.

26. This is consistent with the Department of Justice's official policy for dealing with Ponzi Scheme receiverships. See Tax Division Directive 137 "Tax Claims Against Embezzlers, Swindlers, Etc. vs. Recovery by Investors, Dupes and Victims, Etc." (Directive 137), a copy of which is attached as **Exhibit E**. The essence of the Directive 137 is to confirm that it is the policy of the United States Government to subordinate its tax claims to the claims of Ponzi Scheme victims when certain conditions are met.

27. Directive 137 is a response to the inequity when there is a potential for taxes to be levied on wrongfully obtained income, and where such taxes would otherwise take priority - via the Federal Debt Priority Statute - over the restitution of the victims from whom the "income" was stolen. Directive 137 was issued on November 3, 2008 and provides guidance regarding the treatment of federal tax claims in situations such as this. According to Directive 137, the Department of Justice Tax Division should accord victims with priority where both the tax claim and the victim claim arise from the same transaction and the victim can trace his/her property to the fund in issue.

28. Here, the tax claims unquestionably arise out of the same transaction or series of transactions that gave rise to the victims claims: David Smith and Timothy McGinn have been convicted of multiple criminal counts with regard to many of the years in question and

the income derived from the MS Entities, which were purposefully used to perpetrate an adjudicated fraud. Similarly, there could be no dispute that the group of investors that are participating in the Receivership claims process can trace their investment to the Receivership funds. While tracing on an individual investor level is not possible because the MS Entities effectively commingled investor funds in a pooled account, it is beyond dispute that the investor funds as a whole can be traced directly to the fraud, and the majority of the assets that comprise the *res* of the Receivership.

F. **Declaring the Receiver Not Personally Liable for Tax Liabilities of the Receivership, the MS Entities, or of the Defendants on Account of Distribution of Assets in Accordance with this Court's Orders**

29. Under 31 U.S.C. § 3713(b), the Receiver may be personally liable for debts owing to the United States (or other Governmental Units) to the extent the Receiver pays the claims of another person before payment to the United States. *See, e.g., United States vs. Coppola*, 85 F.3d 1015, 1019-21 (2nd Cir. 1996). A determination by the Court that the victims have priority over the United States is necessary to insulate the Receiver from liability. In *King vs. United States*, 379 U.S. 329 (1964), a deceased distributing agent for a debtor in a bankruptcy proceeding was held personally liable for taxes owed to the United States after he made a court-ordered distribution of assets of the estate to creditors other than the United States. The executor of the agent's estate defended against the imposition of liability, claiming that the estate could not be held liable because the distributing agent had simply been executing the bankruptcy court's orders. *Id.* at 338-39. The Supreme Court rejected this argument and held the distributing agent personally liable because he had failed to advise the Court of the potential unpaid government claims before obtaining and executing the distribution order. *Id.* (emphasis added).

30. In contract, where the government participates in the proceedings in which the Section 3713(b) "representative" is distributing the assets of the estate being represented, the government is bound by a judgment of the court limiting its claim. *See, United States vs. Pate*,

47 F. Supp. 965 (W.D. Ark. 1942). In Pate, the United States submitted a claim against the estate of a deceased insolvent. The attorney for the administrator of the estate presented the government's claim to the Probate Court as a "third class" claim and the administrator paid \$497.81 of the \$2,493.93 that the United States claimed. The United States never took an appeal. Id. at 966-67. Later, the United States sought to recover from the executor the difference between the amount the government had been paid and the amount it had claimed, arguing that 31 U.S.C. § 192 (the predecessor statute to 31 U.S.C. § 3713(b)) provided for liability on the part of the administrator. The court rejected this argument, stating:

Had the government seen fit to do so, it could have held aloof from said proceedings and given the administrator notice of its claim, and then he, at his peril, would have been bound to see that the priority rights of the Government were fully protected. But it saw fit to pursue another course, and to submit its claim against the Meadors estate to the Probate Court of Howard County, a court having jurisdiction to administer said estate; and, having done so, it is bound by the judgment of said Court. To hold otherwise would lead to chaos.

Id. at 968.

31. Here, by bringing the United States before this Court through the Claims Resolution Process, and in notifying the Court and the potential claimants of both the possibility of tax liability and of the competing claims of priority over receivership property, the Receiver has discharged his duty under 31 U.S.C. § 3713(b). If the United States objects to the disposition of property pursuant to the approved distribution plan, it has the opportunity now to set forth its objection for determination by the Court. The Receiver, therefore, respectfully requests that upon the final resolution of the IRS tax claims, the Court enter an order declaring that the Receiver shall not be personally liable for tax liabilities incurred by the MS Entities, the Receivership, or the defendants on account of his discharging this Court's Orders.

BASIS FOR RELIEF

A. The Claims Procedures and Bar Date Are Essential To Ensure Appropriate Administration of the Estates of the MS Entities

32. The Receiver has the general power and obligation to ensure that the investors and creditors of the MS Entities receive appropriate and orderly distributions on account of their claims. For the reasons that follow, the Government Claims Procedure and Government Claims Bar Date are necessary to ensure that the Receiver properly discharges this important obligation.

33. *First*, Section 3713 of title 31 of the United States Code (the “Debt Priority Statute”) provides, in pertinent part, that “[a] representative of a person or an estate (except a trustee acting under title 11) paying any part of a debt of the person or estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims of the Government.” 11 U.S.C. § 3713(b). Therefore, if the Receiver seeks to make any distribution to the defrauded investors and the creditors of the MS Entities without ensuring payment of all Government Claims, the Receiver may be subject to personal liability for the payment of such claims.

34. Based on communications with the IRS and the Department of Justice, the IRS is not presently issuing Closing Agreements to Receivers. Consequently, the Receiver has no indication whether the IRS will assert any tax liability for any of the MS Entities.⁵

35. In order to effectively discharge his duties as receiver, the Receiver must be certain that he has complete and accurate information regarding the nature, validity and amount of all Government Claims that may exist. While the Receiver is unaware of any Government Claims and no such claims were filed by the Claims Bar Date, the Receiver requests the proposed Government Claims Procedure be approved to ensure the appropriate

⁵ Interestingly, as described in Section E, the Tax Division of the U.S. Department of Justice recognizes the priority of the claims of defrauded investors over the claims of the IRS. See Department of Justice Directive No. 137 attached as Exhibit E.

administration of the estates for the benefit of creditors and that the Receiver is properly insulated from any personal liability under the Debt Priority Statute or other applicable law.

36. The Receiver has filed over 551 tax returns since his appointment with federal, state and local taxing authorities, covering periods both before and after the commencement of this action from 2004 through 2012, which Governmental Units have not challenged. Those tax returns include periods for which the MS Entities had failed to file tax returns for certain pre-Receivership periods and also for post-Receivership periods.

37. In particular, with respect to federal, state and local taxing authorities, any assessment of taxes would automatically result in the respective Governmental Unit obtaining a lien against property of the taxpayer MS Entity, and potentially implicates the stay imposed in this case by the Court. Therefore, these taxing authorities may have claims that the Receiver is unaware of.

38. *Second*, the failure to set a deadline by which Governmental Units must file proofs of claim would cause the unnecessary delay of distributions to investors and creditors of the MS Entities. This delay will unfairly prejudice those parties. The prejudice to the investors and creditors of the MS Entities caused by delayed distributions outweighs the minimal burden imposed on the Governmental Units in filing proofs of claim in accordance with the Government Claims Procedure or Governmental Units working with the Receiver to resolve any tax liability, especially in light of the streamlined process set forth therein and given the previous claims procedure and Claims Bar Date which afforded Governmental Units the opportunity to file proofs of claim.

39. *Third*, the Government Claims Procedure is necessary to accomplish the purpose of the receivership in avoiding unnecessary costs and maximizing value for investors and creditors. Many courts have held that summary proceedings are within the Court's equitable powers of fashioning relief in an equity receivership and have the beneficial effect of preventing further dissipation of limited receivership assets through costly and unnecessary litigation. *See*,

e.g., *S.E.C. v. Basic Energy & Affiliated Res., Inc.*, 273 F.3d 657, 668 (6th Cir. 2001) (holding that “abbreviated procedures (including the use of a single receivership proceeding to resolve all claims) advance the government’s interest in judicial efficiency by reducing the time needed to resolve disputes, decreasing the costs of litigation, and preventing the dissipation of the receiver’s assets”); *S.E.C. v. Elliot*, 953 F.2d 1560, 1566 (11th Cir. 1992) (holding that the “district court has broad powers and wide discretion to determine relief in an equity receivership” and that a summary proceeding “reduces the time necessary to settle disputes, decreases litigation costs, and prevents further dissipation of receivership assets”).

40. The Government Claims Procedure sets forth an efficient claim resolution process that would enable Governmental Units sufficient time to protect their interests. The Government Units have sixty (60) days to file proofs of claim in this case. In addition, any Governmental Unit that objects to the Government Claims Procedure has the right to file a response to the Motion by the appropriate deadline and seek a determination of the Court.

B. Section 505 of the Bankruptcy Code Should Apply to this Case

41. Section 505 of the Bankruptcy Code, which generally authorizes the court to determine the debtor’s unpaid tax liabilities, should be applicable in this receivership for the following reasons.

42. *First*, it is appropriate for the Court to apply federal bankruptcy rules and principles in the context of a federal equity receivership. Courts in equity receiverships have consulted federal bankruptcy laws for guidance where application of such laws promotes the purpose and goals of the receivership, especially where, as here, there is a dearth of case law in the receivership context. *See, e.g., Bendall v. Laucer Mgmt. Group, LLC*, 523 F. App’x 554, 557 (11th Cir. 2013) (“Given that the primary purpose of both receivership and bankruptcy proceedings is to promote the efficient and orderly administration of estates for the benefit of creditors, we will apply cases from the analogous context of bankruptcy law”); *Fidelity Bank Nat’l Ass’n v. M.M. Group, Inc.*, 77 F.3d 880, 882 (6th Cir. 1996) (applied bankruptcy rules

governing appellate standing in the context of a receivership where no case law existed regarding the rules in a receivership action); *Unisys Fin. Corp. v. Resolution Trust Corp.*, 979 F.2d 609, 611 (7th Cir. 1992) (adopted bankruptcy law principles to determine whether a creditor had an enforceable security interest in property of the receivership estate established under federal banking laws).

43. Here, applicability of section 505 of the Bankruptcy Code to this receivership will allow for the prompt determination and resolution of tax claims in the interest of facilitating efficient administration of the estates for the benefit of creditors. Without the application of section 505, tax claims would be resolved by a judicial or administrative proceeding which (i) will likely result in excessive costs and ultimately delay the distribution process; and/or (ii) may be subject to, and barred by, the stay in effect in this case.

44. *Second*, courts in receivership cases often defer to bankruptcy laws and principles when dealing with issues regarding the valuation, presentment and priority of claims. *See, e.g., Gaff v. FDIC*, 919 F.2d 384, 394 (6th Cir. 1990) (applied principles of the Bankruptcy Code's treatment of equitable subordination and rescission claims in a federal bank insolvency); *Bendall v. Laucer Mgmt. Group, LLC*, 523 F. App'x at 557 (adopted Bankruptcy Code definition of "claim" for purposes of interpreting and enforcing a case management order); *S.E.C. v. One Equity Corp.*, No. 2:08-cv-667, 2010 WL 4878993 at *5-6 (S.D. Ohio Nov. 23, 2010) (applied bankruptcy principle of an informal proof of claim in an equity receivership); *S.E.C. v. Elmas Trading Corp.*, 85 B.R. 116, 118019 (D. Nev. 1987) (applied bankruptcy laws to the distribution of receivership funds and determined the amount of a property lessor's claim in accordance with the Bankruptcy Code).

45. *Third*, applicability of a provision of the Bankruptcy Code in the receivership context is appropriate where, as here, the purpose of the Bankruptcy Code provision serves an important purpose of the receivership process. *See S.E.C. v. First Sec. Co. of Chicago*,

507 F.2d 417, 420 (7th Cir. 1974) (analyzing the purpose and history of a particular bankruptcy provision in the context of distributing assets in a receivership).

46. Section 505 of the Bankruptcy Code derives from a provision of the Bankruptcy Act of 1898, whose purpose was to afford a forum for the ready determination of the legality or amount of tax claims, which determination, if left to other proceedings, would delay conclusion of administration of the estate. *In re Kranitz*, 198 F. Supp. 315, 317 (E.D. Pa. 1961); *see also Cohen v. United States*, 115 F.2d 505, 506 (1st Cir. 1940) (analyzing purpose of the predecessor provision).

47. The interest in the efficient and orderly administration of the estates for the benefit of investors and creditors applies with the same force in the receivership context as in a case under the Bankruptcy Code. The application of section 505 of the Bankruptcy Code would help further such important interest and would benefit all parties in interest in this case.

48. *Fourth*, the application of section 505 of the Bankruptcy Code in this case would facilitate the Receiver in the discharge of his obligations.

49. Providing a forum for prompt resolution of all tax claims will ensure that the Receiver makes appropriate distributions to investors and creditors without the Receiver incurring personal liability under the Debt Priority Statute or other applicable law. Where the government participates in the proceedings in which the receiver is distributing the assets of the estates being represented, the government is bound by the judgment of the court limiting its claim. *See U.S. v. Vibradamp Corp.*, 257 F. Supp 931, 937 (S.D. Cal. 1966); *United States v. Pate*, 47 F. Supp. 965, 968 (W.D. Ark. 1942).

50. Thus, by allowing the Court to determine unpaid tax liabilities and inviting the respective taxing authorities to participate in the claim determination and resolution process, the Receiver will be granted the ability to properly discharge his duties under the Debt Priority Statute.

MEMORANDUM OF LAW

51. Since the basis for the relief requested herein under the Permanent Injunction Order and applicable law is set forth herein, the Receiver requests that any requirement for a separate memorandum of law be waived.

NOTICE OF HEARING

52. The Receiver will give notice of the Motion by posting the Motion on the Receiver's website (www.mcginnsmithreceiver.com) as well as posting at the top of the Receiver's website an explanation of the Motion with the hearing date established by the Court. Notice will also be given to (a) federal, state and local taxing authorities, known by the Receiver, in all jurisdictions, where any of the MS Entities was required to file a tax return at any time, (b) by ECF to counsel of record including counsel to Messrs. McGinn and Smith, (c) the Attorney General of the United States, and the United States Attorney for the Northern District of New York, (d) the IRS, and (e) by ECF to all parties who have filed notices of appearance. The Notice of Government Claims Procedure and Government Claims Bar Date will be provided as stated above.

CONCLUSION

53. The Receiver believes that the simplified Claims Procedure proposed in this Motion will permit efficient administration of the claims against the MS Entities, while at the same time avoiding complex procedures which might impede Governmental Units from meaningfully participating in the claims administration process.

54. Based upon the foregoing, the Receiver respectfully requests that the Court find that the proposed Claims Procedure and Claims Bar Date serve the best interests of the receivership estates, the creditors of the estates, and the Governmental Units, and that the proposed notice of the Claims Procedure and Claims Bar Date is adequate.

55. The Receiver also requests that the Court authorize application of section 505 of the Bankruptcy Code to this case to provide a forum for prompt determination and

resolution of tax claims in the interest of facilitating efficient administration of the estates for the benefit of creditors.

56. Finally, the Receiver seeks entry of an Order establishing the priority of victim investor claims over any claims of the IRS and declaring the Receiver not personally liable for any tax liabilities of the MS Entities, the Receivership or the defendants on account of distribution of assets in accordance with this Court's Orders.

WHEREFORE, the Receiver respectfully requests entry of an Order (i) granting the Motion, (ii) approving the Government Claims Procedure and the Government Claims Bar Date; (iii) approving the proposed form and manner of notice of the Government Claims Procedure and Government Claims Bar Date as set forth in the Motion, (iv) authorizing the applicability of section 505 of title 11 of the Bankruptcy Code to this case, (v) establishing the priority of victim investor claims over the IRS, (vi) declaring the Receiver not personally liable for tax liabilities of the Receivership, the MS Entities, or the defendants in accordance with this Court's Orders, and (vii) for such other relief as may be appropriate.

Dated: December 30, 2013

PHILLIPS LYTLE LLP

By /s/ William J. Brown
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Exhibit A

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

-----X
SECURITIES AND EXCHANGE COMMISSION :

Plaintiff,

vs.

Case No. 1:10-CV-457
(GLS/CFH)

McGINN, SMITH & CO., INC., :
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FIRST INDEPENDENT INCOME NOTES, LLC, :
THIRD ALBANY INCOME NOTES, LLC, :
TIMOTHY M. MCGINN, AND :
DAVID L. SMITH, GEOFFREY R. SMITH, :
Individually and as Trustee of the David L. and :
Lynn A. Smith Irrevocable Trust U/A 8/04/04, :
LAUREN T. SMITH, and NANCY MCGINN, :

Defendants,

LYNN A. SMITH and
NANCY MCGINN,

Relief Defendants,

- and-

GEOFFREY R. SMITH, Trustee of the
David L. and Lynn A. Smith Irrevocable
Trust U/A 8/04/04,

Intervenor.

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**ORDER (I) APPROVING A PROCEDURE FOR THE ADMINISTRATION OF
CLAIMS OF GOVERNMENTAL UNITS; (II) ESTABLISHING A DEADLINE
FOR FILING OF CLAIMS OF GOVERNMENTAL UNITS; (III) APPROVING THE
FORM AND MANNER OF NOTICE THEREOF; (IV) AUTHORIZING THE
APPLICABILITY OF SECTION 505 OF THE BANKRUPTCY CODE TO THIS CASE;
(V) ESTABLISHING THE PRIORITY OF VICTIM INVESTOR CLAIMS
OVER THE IRS; AND (VI) DECLARING THE RECEIVER NOT PERSONALLY
LIABLE FOR TAX LIABILITIES OF THE RECEIVERSHIP, THE
MS ENTITIES, OR OF THE DEFENDANTS ON ACCOUNT OF DISTRIBUTION OF
ASSETS IN ACCORDANCE WITH THIS COURT'S ORDERS**

Upon the Motion of William J. Brown, as Receiver, for an Order (I) Approving a
Procedure for the Administration of Claims of Governmental Units;¹ (II) Establishing a Deadline

¹ Capitalized terms used but not defined herein shall have the meanings ascribed to such terms in the
Motion.

for Filing of Government Claims; (III) Approving the Form and Manner of Notice Thereof; (IV) Authorizing the Application of Section 505 of the Bankruptcy Code to this Case; (V) Establishing the Priority of Victim Investor Claims Over the IRS; and (VI) Declaring the Receiver Not Personally Liable for Tax Liabilities of the Receivership, the MS Entities, or of the Defendants on Account of Distribution of Assets in Accordance with this Court's Orders dated December 30, 2013 ("Motion") (Docket No. ____), the Court having held a hearing thereon and no objections being sustained thereto, and good cause appearing therefor, it is hereby

ORDERED, that the Motion is granted, and it is further

ORDERED, that all claims of Governmental Units against the MS Entities shall be asserted in accordance with the Government Claims Procedure; and it is further;

ORDERED, to the extent required by the Government Claims Procedure, claims against the MS Entities shall be filed in writing with Phillips Lytle LLP, Attn: Karen M. Ludlow, One Canalside, 125 Main Street, Buffalo, NY 14203-2887, substantially in the form of the Claim Form attached as Exhibit C to the Motion, and it is further

ORDERED, that the last day for Governmental Units to file a claim against the MS Entities is fixed as March __, 2014 ("Government Claims Bar Date"). Unless otherwise ordered by the Court, any Governmental Unit who is required to file a Claim Form in accordance with this Order, but fails to do so, on or before the Government Claims Bar Date, shall be barred, estopped and enjoined from asserting such claim against the MS Entities or the Receiver and shall not receive a distribution on account of such claim, and it is further

ORDERED, that the form and substance of the Claims Notice attached to the Motion as Exhibit D and the manner of publication of the Claims Notice and other notice of the

Government Claims Procedure and Government Claims Bar Date as set forth in the Motion is appropriate, and it is further

ORDERED, that section 505 of the Bankruptcy Code, a copy of which is attached to the Motion as Exhibit B, shall be made applicable to this case in its entirety, and it is further

ORDERED, that the right of the Receiver to file appropriate proceedings in this Court to object to claims and/or establish a procedure for resolution of claims disputes is reserved.

Dated: January ___, 2014

Hon. Christian F. Hummel
United States Magistrate Judge

Doc #05-442743.2

Exhibit B

11 U.S.C. § 505

Determination of tax liability

(a) (1) Except as provided in paragraph (2) of this subsection, the court may determine the amount or legality of any tax, any fine or penalty relating to a tax, or any addition to tax, whether or not previously assessed, whether or not paid, and whether or not contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction.

(2) The court may not so determine—

(A) the amount or legality of a tax, fine, penalty, or addition to tax if such amount or legality was contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction before the commencement of the case under this title;

(B) any right of the estate to a tax refund, before the earlier of—

(i) 120 days after the trustee properly requests such refund from the governmental unit from which such refund is claimed; or

(ii) a determination by such governmental unit of such request; or

(C) the amount or legality of any amount arising in connection with an ad valorem tax on real or personal property of the estate, if the applicable period for contesting or redetermining that amount under applicable nonbankruptcy law has expired.

(b) (1) (A) The clerk shall maintain a list under which a Federal, State, or local governmental unit responsible for the collection of taxes within the district may—

(i) designate an address for service of requests under this subsection; and

(ii) describe where further information concerning additional requirements for filing such requests may be found.

(B) If such governmental unit does not designate an address and provide such address to the clerk under subparagraph (A), any request made under this subsection may be served at the address for the filing of a tax return or protest with the appropriate taxing authority of such governmental unit.

(2) A trustee may request a determination of any unpaid liability of the estate for any tax incurred during the administration of the case by submitting a tax return for such tax and a request for such a determination to the governmental unit charged with responsibility for collection or determination of such tax at the address and in the manner designated in paragraph (1). Unless such return is fraudulent, or contains a material misrepresentation, the estate, the trustee, the debtor, and any successor to the debtor are discharged from any liability for such tax—

(A) upon payment of the tax shown on such return, if—

(i) such governmental unit does not notify the trustee, within 60 days after such request, that such return has been selected for examination; or

(ii) such governmental unit does not complete such an examination and notify the trustee of any tax due, within 180 days after such request or within such additional time as the court, for cause, permits;

(B) upon payment of the tax determined by the court, after notice and a hearing, after completion by such governmental unit of such examination; or

(C) upon payment of the tax determined by such governmental unit to be due.

(c) Notwithstanding section 362 of this title, after determination by the court of a tax under this section, the governmental unit charged with responsibility for collection of such tax may assess such tax against the estate, the debtor, or a successor to the debtor, as the case may be, subject to any otherwise applicable law.

Exhibit C

Exhibit D

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

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SECURITIES AND EXCHANGE COMMISSION :

Plaintiff, :

vs. :

Case No. 1:10-CV-457
(GLS/CFH)

McGINN, SMITH & CO., INC., :
McGINN, SMITH ADVISORS, LLC :
McGINN, SMITH CAPITAL HOLDINGS CORP., :
FIRST ADVISORY INCOME NOTES, LLC, :
FIRST EXCELSIOR INCOME NOTES, LLC, :
FIRST INDEPENDENT INCOME NOTES, LLC, :
THIRD ALBANY INCOME NOTES, LLC, :
TIMOTHY M. MCGINN, AND :
DAVID L. SMITH, GEOFFREY R. SMITH, :
Individually and as Trustee of the David L. and :
Lynn A. Smith Irrevocable Trust U/A 8/04/04, :
LAUREN T. SMITH, and NANCY MCGINN, :

Defendants, :

LYNN A. SMITH and :
NANCY MCGINN, :

Relief Defendants, :

- and- :

GEOFFREY R. SMITH, Trustee of the :
David L. and Lynn A. Smith Irrevocable :
Trust U/A 8/04/04, :

Intervenor. :
-----X

**NOTICE OF GOVERNMENT CLAIMS BAR
DATE AND PROCEDURE**

NOTICE IS HEREBY GIVEN that William J. Brown, as Receiver (“Receiver”) in this action, with approval of the Court, has established a procedure for asserting claims of governmental units (as such term is defined in section 101(27) of the Bankruptcy Code)

("Governmental Units") against McGinn, Smith & Co., Inc. and the other entities listed on the attached schedule (collectively, the "MS Entities") to this Notice. This procedure does not involve non-government creditors or investors who hold claims against the MS Entities since those claims were part of a prior process which had a June 19, 2012 bar date.

1. Filing Deadline

The deadline for filing claims of Governmental Units against any of the MS Entities is **March __, 2014** ("Government Claims Bar Date").

2. Who Must File a Claim Form

Each Governmental Unit with a claim against any of the MS Entities **MUST** submit a properly completed claim form to the Receiver.

4. When and Where to File a Claim Form

All claim forms must be delivered by first-class mail, overnight courier, or hand-delivery to Phillips Lytle LLP, Attn: Karen M. Ludlow, One Canalside, 125 Main Street, Buffalo, New York 14203-2887, *so as to be actually received* by 5:00 p.m. (Eastern Time) on the Government Claims Bar Date. Claim forms **may not** be delivered by facsimile or electronic mail.

5. What to File

The form for submitting any such claim is available on the Receiver's website (www.mcginnsmithreceiver.com) in the 'Government Claims' section at the top of the first page.

A copy of the form may also be requested in writing addressed to:

Phillips Lytle LLP
Attn: Karen M. Ludlow
One Canalside
125 Main Street
Buffalo, NY 14203-2887

If you require a receipt for your claim, please enclose an extra copy of the claim form (without exhibits) and a stamped, self-addressed envelope.

Dated: December 30, 2013

PHILLIPS LYTTLE LLP

By _____
William J. Brown (Bar Roll #601330)
Attorneys for Receiver
Omni Plaza
30 South Pearl Street
Albany, New York 12207
Telephone No. (518) 472-1224

and

One Canalside
125 Main Street
Buffalo, New York 14203-2887
Telephone No.: (716) 847-8400

Doc #05-442750.2

Schedule of Receivership Entities

107th Associates LLC Trust 07
107th Associates LLC
74 State Street Capital LP
Acquisition Trust 03
Capital Center Credit Corporation
CMS Financial Services
Cruise Charter Ventures LLC dba YOLO Cruises
Cruise Charter Ventures Trust 08
First Advisory Income Notes LLC
First Commercial Capital Corp.
First Excelsior Income Notes LLC
First Independent Income Notes LLC
FirstLine Junior Trust 07
FirstLine Senior Trust 07
FirstLine Trust 07
Fortress Trust 08
Integrated Excellence Junior Trust
Integrated Excellence Junior Trust 08
Integrated Excellence Senior Trust
Integrated Excellence Senior Trust 08
IP Investors
James J. Carroll Charitable Fund
JGC Trust 00
KC Acquisition Corp.
KMB Cable Holdings LLC
Luxury Cruise Center, Inc.
Luxury Cruise Holdings, LLC
Luxury Cruise Receivables, LLC
M & S Partners
McGinn, Smith & Co.
McGinn, Smith Acceptance Corp.
McGinn, Smith Advisors
McGinn, Smith Alarm Trading
McGinn, Smith Asset Management Corp.
McGinn, Smith Capital Holdings
McGinn, Smith Capital Management LLC
McGinn, Smith Financial Services Corp.
McGinn, Smith FirstLine Funding LLC
McGinn, Smith Funding LLC
McGinn, Smith Group LLC
McGinn, Smith Holdings LLC
McGinn, Smith Independent Services Corp.
McGinn, Smith Licensing Co.
McGinn, Smith Transaction Funding Corp.
Mr. Cranberry LLC
MS Partners
MSFC Security Holdings LLC
NEI Capital LLC

Pacific Trust 02
Point Capital LLC
Prime Vision Communications LLC
Prime Vision Communications Management Keys
Cove LLC
Prime Vision Communications of Cutler Cay LLC
Prime Vision Funding of Cutler Cove LLC
Prime Vision Funding of Key Cove LLC
RTC Trust 02
SAI Trust 00
SAI Trust 03
Security Participation Trust I
Security Participation Trust II
Security Participation Trust III
Security Participation Trust IV
Seton Hall Associates
TDM Cable Funding LLC
TDM Cable Trust 06
TDM Luxury Cruise Trust 07
TDM Verifier Trust 07
TDM Verifier Trust 07R
TDM Verifier Trust 08
TDM Verifier Trust 08R
TDM Verifier Trust 09
TDM Verifier Trust 11
TDMM Benchmark Trust 09
TDMM Cable Funding LLC
TDMM Cable Jr Trust 09
TDMM Cable Sr Trust 09
Third Albany Income Notes LLC
Travel Liquidators, LLC
White Glove Cruises LLC
White Glove LLC

Doc #05-442750.2

Exhibit E

DEPARTMENT OF JUSTICE
TAX DIVISION DIRECTIVE NO. 137

TAX CLAIMS AGAINST EMBEZZLERS, SWINDLERS, ETC.

v.

RECOVERY BY INVESTORS, DUPES, AND VICTIMS, ETC.

Often the Government's tax claim against an embezzler or perpetrator of a swindle can be collected only by reducing possible recovery by the investor, dupe or victim.* Where there is no statutory lien for either the federal tax claim or the claim of the investor or victim, the Tax Division will examine both the origin of the claim and whether the investor or victim can trace the lost property to the fund at issue. When both the tax claim and the claim of the investor or victim arise from the same transaction and the investor or victim can trace its property to the fund in issue, the Tax Division will recognize the priority of the claim of the investor or victim.

When the tax claim and the claim of the investor or victim do not arise from the same transaction, the Tax Division will recognize the priority of the claim of the investor or victim when the investor or victim can trace his claim to the property at issue and either (a) title never passed to the wrongdoer, such as in the case of theft, or (b) when a constructive trust, including all tracing requirements, has been imposed prior to assessment of the tax, or would be imposed and the tax has not been assessed.

If a federal court has ordered restitution as part of a criminal case, the Division will evaluate the priority of the federal tax liens against the claims of investors and victims in accordance with federal law, including the *Mandatory Victims Restitution Act*, 18 U.S.C. § 3613, which creates a federal restitution lien for the benefit of the victims of wrongdoing (which includes both defrauded investors and victims of theft), and the *Federal Tax Lien Act*, 26 U.S.C. §§ 6321-6323. In general, the Tax Division will follow the principle of "first in time is first in right."

Claims for taxes arising from administration of a receivership or from disposition of property in constructive trust should be paid as an expense of

* As used here, Ainvestor@ denotes a willing participant or customer who was misled or defrauded by the perpetrator, and includes Adupes@ (see *Cunningham v. Brown*, 265 U.S. 1, 7 (1924)). AVictim@ denotes a person who did not willingly participate or willingly part with money or property, such as when there is theft, including embezzlement.

administration, "on or before the due date of the tax." 28 U.S.C. § 960; *see also*, 26 U.S.C. § 6012(b)(3). Such administration expenses are generally paid ahead of other claims against the assets of the receivership. When a receivership is insolvent, the administrative tax claims may be entitled to priority pursuant to 31 U.S.C. § 3713.

A mere showing by opposing counsel that allowing the Government's tax claim would prejudice the investor or victim in some way is not sufficient grounds for concession. While there is room for negotiation, the above principles should guide your analysis and negotiation. These cases are particularly susceptible to resolution by compromise. Even when our position is legally correct, a court may nevertheless seek to uphold a constructive trust wherever possible, by relaxing tracing requirements or employing other means to hold in favor of a sympathetic investor or victim. Accordingly, consistent with a realistic evaluation of litigating hazards, we should endeavor to reach reasonable settlement in these cases, rather than presenting unsympathetic claims to the court.

Although Tax Division civil attorneys, paralegals and support staff are not "Employees of the Department of Justice" for purposes of the *Justice For All Act of 2004*, 18 U.S.C. § 3771 and regulations, 45 C.F.R. § 45.10(a), Tax Division civil attorneys, paralegals and support staff act in accordance with and uphold the spirit of the *Justice For All Act of 2004* when they act in accordance with this Directive (including any update or revision), and analyze a case under these principles.

Date: 11/3/2008

/s/ Nathan J. Hochman

NATHAN J. HOCHMAN
Assistant Attorney General