IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WISCONSIN

IN THE MATTER OF THE REHABILITATION OF SEGREGATED ACCOUNT OF AMBAC ASSURANCE CORPORATION	Case No. 10-cv-778 (Dane County Circuit Court Civil Case No.: 10 CV 1576)
SEAN DILWEG, COMMISSIONER OF INSURANCE OF THE STATE OF WISCONSIN Petitioner v. UNITED STATES OF AMERICA, Respondent.	

UNITED STATES' OPPOSITION TO MOTION TO REMAND

INTRODUCTION

Under federal tax law, when a group of affiliated corporations file a single federal income tax return, the corporations' tax liability is owed by all the corporations, and if not paid is collectible from all their assets. Here a state court has asserted control over a potential tax liability of Ambac Assurance Corporation (Ambac) and its affiliates in its consolidated group and shifted that potential tax liability to a newly created sub-component of Ambac, the so-called "Segregated Account," that is subject to a state insurance rehabilitation proceeding. The Segregated Account was allotted vast insurance policyholder liabilities but no meaningful assets, while substantial assets remain with the other components of the corporate group. (*See* Dkt. # 2, State Court Pleadings, at 29-32.).

Having done all this, the state court enjoined the IRS from collecting the corporate group's potential federal taxes in any manner other than by making a claim in the state rehabilitation proceeding against the assets of the sub-component.

In fact, a state court can do none of those things. No state court can enjoin the United States from exercising its Constitutional prerogative to collect federal taxes. Nor can a state court shift the federal tax liabilities of a consolidated corporate taxpayer to a new entity and force the IRS to collect those liabilities only from that entity, and only in state court proceedings. Yet that is exactly what the state court purported to do when it issued, at the Commissioner's behest, its November 8, 2010 Injunction against the United States Internal Revenue Service.[1]

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[1] Retreating from the extreme breadth of the Injunction as entered by the state court, which by its terms would potentially not permit the IRS to even investigate or assess any unpaid taxes, the Wisconsin Insurance Commissioner now contends that the Injunction "only prevents the IRS from pursuing attachment or levy to collect on a presently disputed tax liability."

(continued...)

The United States is entitled to invoke the federal court's jurisdiction to resolve this dispute over the scope of its sovereign prerogative to collect taxes as provided by the federal tax code. This action was properly removed to federal court, and this Court should deny the Commissioner's Motion for Remand.[2]

ARGUMENT

I. The McCarran-Ferguson Act Does Not Apply To The Internal Revenue Code, And State Statutes Cannot Restrain The Federal Tax Collector.

The Commissioner asserts that because it purports to act under a state insurance insolvency statute, a state court can enjoin the federal government from using the administrative tools that Congress has provided for collecting federal taxes, and further can deprive the United States of a federal forum to litigate a possible tax dispute. The Commissioner is wrong because, unlike a private policyholder or creditor, the United States has a Constitutional mandate to lay and collect taxes and no state law or state court can restrain the exercise of that mandate.

The federal government has a sovereign prerogative and constitutional power to "lay and collect taxes." U.S. Const. art. 1, § 8 cl. 1; *Id*. amend XVI. As the Supreme Court has held, the collection of unpaid taxes "is not the act of an ordinary creditor, but the exercise of a sovereign prerogative, ... ultimately grounded in the constitutional mandate to 'lay and collect taxes.' "

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[1](...continued)
(Remand Motion at 4). The Commissioner has thus waived all objections to any IRS action regarding this potential tax liability short of actually seizing property. Nonetheless, the injunction illegally restrains the United States from exercising its Constitutional mandate to collect federal taxes by administrative levy, as described below.

[2] The facts are set forth in the United States' Motion to Dissolve Injunction, Dkt. #13, and are incorporated here. We also attach as Exhibit A the declaration of Hilarie Snyder to authenticate the exhibits supporting those facts and the exhibits filed with this opposition brief. *See* Ex. A, Declaration of Hilarie Snyder

United States v. Rodgers, 461 U.S. 677, 697 (1983) (footnote and citations omitted). The Internal Revenue Code is the statutory manifestation of the Constitutional taxing power. "It is well established that Congress intended that the revenue laws, in the absence of language evidencing a different purpose, are to be interpreted so as to give a uniform application to a nationwide scheme of taxation." *Modern Life & Acc. Ins. Co. v. Comm'r*, 420 F.2d 36, 37-38 (7th Cir. 1969). State laws are "not controlling unless Congress has made it so, for the subject of federal taxes, including 'remedies for their collection, has always been conceded to be independent of the legislative action of the states.'" *United States v. Union Cent. Life Ins. Co.*, 368 U.S. 291, 293-94 (1961) (quoting *United States v. Snyder*, 149 U.S. 210, 214 (1893)); accord *Mogilka v. Jeka*, 389 N.W.2d 359, 365 (Wis. App. 1986), *review dismissed by*, 131 Wis.2d 594 (Wis. 1986) ("The power of Congress to levy taxes is supreme and is not subject to state legislation")(citation omitted); *see also* 26 U.S.C. § 7421(a) (no court may enjoin federal tax assessment or collection). Thus no state law can restrain the exercise of this sovereign prerogative.

An essential part of the federal tax system is the Anti-Injunction Act, 26 U.S.C. 7421(a). "The object of § 7421(a) is to withdraw jurisdiction from the state and federal courts to entertain suits seeking injunctions prohibiting the collection of federal taxes" in order to "permit the United States to assess and collect taxes alleged to be due without judicial intervention. . . . In this manner the United States is assured of prompt collection of its lawful revenue." *Enochs v. Williams Packing & Nav. Co.*, 370 U.S. 1, 5, 7 (1962). Outside of a few narrow statutory exceptions, no court – federal or state – can enjoin the United States from assessing or collecting

federal taxes.[3] Even "the ruination of the taxpayer's enterprise" cannot overcome this jurisdictional bar. *Id*. at 7 (injunction may not issue even though collection of disputed employment taxes would destroy the taxpayer's business).

The federal scheme of taxation includes provisions permitting affiliated corporations, including insurance companies, to file consolidated federal tax returns. *See* 26 U.S.C. § 1501 *et seq*. Ambac and its affiliates participated in a consolidated tax group with its parent, Ambac Financial Group, Inc. (AFGI) in the relevant tax periods, and the newly-created Segregated Account also participates in the same group. (Ex. 5, Cooperation Agreement § 3.01, at 6). As a matter of federal tax law, each of the entities participating in a consolidated group is severally liable for the tax liabilities of the entire group. 26 C.F.R. § 1.1502-6(a); *United States v. Williams*, 959 F. Supp. 210, 212 (S.D.N.Y.1997) (IRS can levy against subsidiaries in taxpayer's consolidated group to collect consolidated tax obligations). Even if Ambac is able to allocate, for its own internal accounting purposes, a tax liability to the Segregated Account, neither it nor the state court can bind the United States to such an allocation.[4] "No agreement entered into by one or more members of the group with any other member of such group or with any other

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[3] The exceptions are listed in § 7421(a). In addition, the Supreme Court has held that an injunction may issue if it is clear that "(1) under no circumstances could the government establish its claim to the asserted tax; and (2) irreparable injury would occur for which there is no adequate legal remedy." *Hinderman v. Carpenter*, 72 A.F.T.R.2d 93-5422 (W.D. Wis. 1993) (Crabb, J.), citing, inter alia, *Williams Packing*, 370 U.S. at 6-8 (emphasis added). None of these grounds apply here, and the Commissioner did not even attempt to make such a showing before the state court.

[4] The United States does not dispute that Ambac could create a Segregated Account for "part of its business" on terms permitted by Wisconsin state law. *See* Wis. Stat. § 611.24(2). Making an internal allocation of federal tax liability binding on the United States is another matter.

person shall in any case have the effect of reducing the liability prescribed under this section." 26 C.F.R. § 1.1502-6(c). As with all federal tax regulations, this regulation applies to insurance companies, regardless of state law. *In re First Cent. Fin. Corp.*, 269 B.R. 481, 489-90 (Bankr. E.D.N.Y. 2001), *subsequently aff'd by*, 377 F.3d 209 (2nd Cir. 2004) (dispute between liquidator of subsidiary insurance company and its corporate parent regarding allocation of tax refund; "[a]s a matter of state corporation law, parties are free to allocate among themselves their ultimate tax liability by an express agreement, or by a clearly implied agreement" but such an agreement "does not alter each member's liability to the government for the entire tax") (citations omitted); *accord Home Group, Inc. v. Comm'r*, 92 T.C. 940, 942 (Tax Ct. 1989) ("As a member of the affiliated group of corporations, Home Insurance Company is severally liable for the consolidated tax liability of the entire group. Therefore, such total consolidated tax liability, including deficiencies may be collected from Home notwithstanding the allocation of tax liability or other intercompany agreements") (citations omitted).

The nationwide scheme of taxation embodied in the Internal Revenue Code also necessarily includes provisions for the collection of unpaid taxes. As the Supreme Court has held, "compulsion on the part of the [IRS] occasionally is required in the enforcement of the revenue laws. Indeed, one may readily acknowledge that "the existence of the levy power is an essential part of our self-assessment tax system and that "it enhances voluntary compliance in the collection of taxes that this Court has described as the 'lifeblood of government, and their prompt and certain availability an imperious need.'" *G.M. Leasing Corp. v. United States*, 429 U.S. 338, 350 (1977) (citations omitted). The Internal Revenue Code accordingly gives the IRS administrative tools to collect from delinquent taxpayers. This includes the power to create and

enforce liens on all of a delinquent taxpayer's property. *See* 26 U.S.C. 6321 *et seq.; Mogilka,* 389 N.W.2d at 365 ("The validity and priority of a federal tax lien is governed by federal law").

Also, the IRS may levy assets from a delinquent taxpayer without prior judicial determination of the merits or relative priority to those assets. 26 U.S.C. §§ 6331, 6332. In the special case of a tentative refund paid to a taxpayer pursuant to 26 U.S.C. § 6411 (the subject of Ambac's potential tax liability here), the IRS may recapture a tentative refund summarily and without prior notice or judicial determination. 26 U.S.C. § 6213(b)(3) & 26 C.F.R. § 301.6213-1(b)(2)(I). An IRS levy is designed to be a "provisional remedy" that "does not determine whether the Government's rights to the seized property are superior to those of other claimants" but "does protect the Government against diversion or loss while such claims are being resolved." *United States v. Nat'l Bank of Commerce*, 472 U.S. 713, 721 (1985) (citations and quotations omitted); *cf. United States v. Third Nat.'l Bank of Nashville, Tenn.*, 589 F. Supp. 155, 157 (M.D. Tenn. 1984) ("A claim of lien priority is not a defense to a federal tax levy") (citations omitted). Again, no state law or state court can restrain the IRS from assessing or collecting unpaid federal taxes. 26 U.S.C. § 7421(a) ("no suit for the purpose of restraining the assessment or collection of any tax shall be maintained *in any court* by any person") (emphasis added).[5]

[5] As the Commissioner points out, the United States does not challenge the authority of the federal Bankruptcy Code to impose an "automatic stay" on the collection of pre-petition taxes from Ambac's parent company AFGI, now in Chapter 11. The Commissioner misses the critical difference between AFGI's federal bankruptcy proceeding and the state rehabilitation proceedings: Congress enacted a *federal* statute restraining the collection of pre-petition claims, including federal taxes, in *federal* bankruptcy proceedings. *See* 11 U.S.C. § 362(a)(6). The applicability to taxes cannot be doubted in light of 11 U.S.C. § 362(b)(9). The Wisconsin state legislature has no power to enact any such statute to restrain the federal tax collector.

The Commissioner cannot rely on the McCarran-Ferguson Act to preempt any part of the Internal Revenue Code, including either the consolidated tax provisions or the administrative collection mechanisms. "[T]he point of McCarran-Ferguson's legislative choice of leaving insurance regulation generally to the States was to limit congressional preemption *under the commerce power*," and the Act "cannot sensibly be construed to address preemption by" the federal tax code, enacted under the Taxing Power. *See American Ins. Ass'n v. Garamendi*, 539 U.S. 396, 428 (2003) (McCarran-Ferguson does not preempt executive agreements with foreign governments that conflict with state insurance statutes) (emphasis added). For that reason, "[t]he courts have rejected all attempts to utilize the [McCarran-Ferguson] Act's preemption exception to invalidate provisions of federal law that exercise the tax power." Raymond A. Guenter, *Rediscovering the McCarran-Ferguson Act's Commerce Clause Limitation*, 6 Conn. Ins. L.J. 253, 316 (2000); *accord Industrial Life Ins. Co. v. United States*, 481 F.2d 609, 610 (4th Cir. 1973)("the power of the federal government to tax was not delegated to the states" by the McCarran-Ferguson Act); *Security Indus. Ins. Co. v. United States*, 702 F.2d 1234, 1251 (5th Cir. 1983) ("insurance companies are subject to the [Internal Revenue] Code's alphabet soup just as other corporate organizations are. Security's juggling acts . . . may not be legitimated with the labels "reorganization" or "liquidation" when those labels do not apply"); *see also Allied Fidelity Corp. v. Comm'r*, 572 F.2d 1190, 1192 (7th Cir. 1978) ("the Insurance Commissioner specifically recognized that the [state] statutory definitions of the types of insurance which Allied was authorized to write included surety bail bonds. While such characterizations may be significant, they are not controlling for the reason that a state classification of a corporation as an insurance company is not necessarily binding on the [IRS] Commissioner for Federal tax

purposes") (citations omitted).

Binding precedent from the Seventh Circuit confirms that the McCarran-Ferguson Act does not constrain the federal government's Constitutional prerogative to assess and collect federal taxes from insurance companies. In *Modern Life*, the Seventh Circuit held that the Internal Revenue Code's definition of "mutual insurance company" controls, even though that definition directly conflicted with the definition provided in the state insurance code. *Modern Life*, 420 F.2d at 37. The court rejected the taxpayer's argument that McCarran-Ferguson reverse-preempted the federal tax code: "'State law may control only when the federal taxing act, by express language or necessary implication, makes its own operation dependent upon state law.' The McCarran-Ferguson Act makes no express reference to the internal revenue laws, nor are we able to discern the implication for which taxpayer contends." *Id.* at 37-38 (footnote omitted).

There is no provision in the Internal Revenue Code permitting a state law to reverse-preempt the Code's scheme for the assessment and collection of federal taxes as to insurance companies. Nor does any provision in the Code imply Congressional intent to permit such a result. To the contrary, the federal tax code clearly reflects Congressional intent to apply federal law uniformly. *Modern Life*, 420 F.2d at 37-38. Thus, the Commissioner cannot rely on McCarran-Ferguson to contend that state laws trump the United States' Constitutional prerogative to assess and collect federal taxes against Ambac.[6]

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[6] Even if this were not so, the Internal Revenue Code would still preempt state insurance laws because the Code "specifically relates to the business of insurance." The McCarran-Ferguson Act states: "No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which (continued...)

II. Removal Of This Action Was Appropriate.

Given that this action involves the serious federal questions set forth above, and given that it seeks to restrain the IRS and thus is against a federal agency, the United States is entitled to a federal forum to vindicate its Constitutional prerogatives from encroachment by a state court. For that reason, upon receiving notice of the November 8 Injunction, the United States promptly removed this action to federal court.[7]

The United States and its agencies have an absolute right to remove any civil action against them, without regard to the reason for the suit or the agreement of other parties. 28 U.S.C. § 1442(a)(1). The Injunction here specifically identifies the "United States Internal Revenue Service," and the order both restrains and relates to the collection of federal tax

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[6](...continued)
imposes a fee or tax upon such business, *unless such Act specifically relates to the business of insurance*." 15 U.S.C. § 1012(b)(emphasis added). The Internal Revenue Code is such a statute, because it explicitly provides for federal taxes on insurance companies. *See* 26 U.S.C. §801-848; 1502; *Hanover Ins. Co. v. Comm'r*, 598 F.2d 1211, 1218 (1st Cir. 1979).

[7] As the Commissioner correctly notes, the IRS has not yet made a determination as to whether the tentative refund to Ambac was erroneous. Nonetheless, prudence dictated that the United States remove when it received notice of the Injunction, which was its first notice that the state court had authorized shifting Ambac's contingent federal tax liabilities to an insolvent segregated account and issued an injunction against the federal government's exercise of its Constitutional prerogative to lay and collect federal taxes against Ambac. *See Accurate Transmission Serv., Inc. v. United States*, 225 F.R.D. 587, 590 (E.D. Wis. 2004) (Government's 30-day removal clock began upon service of a notice of receivership because it then knew that receiver had been appointed and that federal tax lien existed); *accord Vanderwerf v. Planet Eclipse, Ltd.*, 2008 WL 4762047 * 2 (W.D. Wis. 2008) (Crabb, J.) (Removal clock begins when removal is "intelligently ascertainable").

revenue. Additionally, 28 U.S.C. § 1441 gives a defendant the right to remove a case in which the United States District Court has original jurisdiction. *Id*. § 1441. The District Court has original jurisdiction of "all civil actions arising under the Constitution, laws, or treaties of the United States," including those laws providing for the internal revenue. 28 U.S.C. §§ 1331, 1340, 1346 (a)(1), 1346(e). To the extent that jurisdiction exists for any suit against the federal government, it would be pursuant to a law of the United States. The United States' removal of this action was proper pursuant to both §§ 1441 and 1442 of Title 28, and, as a result, this Court has jurisdiction to dissolve the Injunction and resolve the dispute between the parties.[8]

A. An Injunction Restraining The United States From Exercising Its Constitutional Mandate To Lay And Collect Taxes Is A Removable Action, No Matter What Labels Are Attributed To It.

The Commissioner's contention that the Injunction arises from a rehabilitation proceeding not labeled a "civil action," and that the United States was not labeled as a "defendant" has no bearing on the removability of this action. (Remand Motion at 19-26). The United States does not have to be labeled a "defendant" by the state court for removal under § 1442(a), as the word "defendant" appears nowhere in that provision. It is sufficient that the action be "against" the United States or an agency thereof. Further, the court must "look[] to the substance rather than the form of the state proceeding," to facilitate the broad construction to be given to the right of removal under § 1442. *Wisconsin v. Schaffer*, 565 F.2d 961, 963-64 (7th

[8] While the United States bears the burden of demonstrating removability, "the right of removal conferred by § 1442(a)(1) is to be broadly construed." *Kolibash v. Comm'r of Legal Ethics*, 872 F.2d 571, 576 (4th Cir. 1989) (citation omitted). "It should be kept in mind that § 1442(a) creates a jurisdictional right to removal quite separate from that of the general removal statute- § 1441. Generally speaking, the limitations on removal under § 1441 are not applicable to removal under § 1442." *Swan v. Community Relations-Social Dev. Comm.*, 374 F. Supp. 9, 11 (E.D. Wis. 1974).

Cir. 1977). Even for removals under § 1441, which does use the term "defendant," a federal court is not required to defer to the state court's label if the party is, in substance, a defendant. In *Mason City & Ft. Dodge R. Co. v. Boynton*, 204 U.S. 570 (1907) (Holmes, J.), the Supreme Court characterized the plaintiff as a "defendant," for removal purposes, due to a local law requiring that party to commence a defensive action to protect its rights.

Courts routinely remove actions that are not strictly-defined "civil actions" and in which the United States is not named as "defendant." For example, in *Brown & Williamson Tobacco Corp. v. Williams*, 62 F.3d 408 (D.C. Cir. 1995), the court of appeals held that removal under § 1442(a) was proper with respect to state court subpoena enforcement proceedings against members of Congress who were not named as "defendants" in the state court action. The court held that the "statute is not . . . limited to the situation where the federal officer [or a federal agency, under the current version of the statute] asserts a federal excuse in defense of actions that are the focus of the state proceeding." *Id*. at 414.

Courts also remove portions of actions that are not typically defined as "civil actions" when those portions place a federal officer or agency "in jeopardy for his refusal, based on his official duty, to comply with a state court order." *Schaffer*, 565 F.2d at 963-64 (removing contempt proceeding against U.S. Attorney arising out of state grand jury proceeding); *see also Nationwide Investors v. Miller*, 793 F.2d 1044, 1047 (9th Cir. 1986)(post-judgment garnishment proceeding in the form of an order requiring a federal official to testify about the judgment debtor's wages from federal employment could be removed under § 1442, despite the fact that the federal official was not named as a party;"[t]he form of the action is not controlling; it is the state's power to subject federal officers [or agencies] to the state's process that § 1442(a)(1)

curbs") (citations omitted). The Injunction likewise places the IRS in jeopardy for exercising its Constitutionally-mandated duties to collect taxes (in the event that it determines that the tentative refunds should be recaptured by levy), and can be removed notwithstanding "labels" attached to the proceeding under state law).

B. No State Law Can Preempt The Right To Remove.

The Commissioner also claims that removal is improper because Wis. Stat. § 645.04(3) "establishes the exclusive jurisdiction of the State Rehabilitation Court over matters directly pertaining to or incidental to the rehabilitation of an insurer." (Remand Motion at 28). It is far from clear that the Wisconsin statute actually vests the "exclusive" jurisdiction in the state court that the Commissioner would have the Court believe.[9] Even if Wisconsin law did provide for exclusive jurisdiction in the state court, however, "[i]t is now well settled that a state may not restrict a defendant's federal right to remove, either judicially or legislatively." Wright & Miller, 14B *Fed. Prac. & Proc. Juris.* § 3721 (4th ed.). While Wisconsin "is free to establish such rules of practice for her own courts as she chooses, the removal statutes and decisions of this Court are intended to have uniform nationwide application. 'Hence the Act of Congress must be construed

[9] The provision on which the Commissioner relies only precludes other Wisconsin state courts from issuing orders under general equity receivership law, as opposed to the insurance statutes, and says nothing about foreclosing federal courts from jurisdiction. Wis. Stat. § 645.04(3); *see* Exhibit 6, Chapter 89, Laws of 1967, 645.04, Comment on Subsection (3). Further, Wis. Stat. § 645.45 explicitly contemplates that insurance rehabilitation proceedings may proceed in federal court, ousting the state court from jurisdiction, and authorizes the Commissioner to request appointment as federal receiver in such an action. *See* Exhibit 7, Chapter 89, Laws of 1967, Wis. Stat. § 645.45 Introductory Comment, *citing Inland Empire Ins. Co. v. Freed*, 239 F.2d 289 (10th Cir. 1956) (affirming appointment of federal receiver for insolvent insurance company appointed on motion of contract creditor after liquidation proceedings had commenced in state court); *see also* Wis. Stat. § 645.82(4) (appointment of federal receiver for liquidation of assets of foreign insurer).

as setting up its own criteria, irrespective of local law, for determining in what instances suits are to be removed from the state to the federal courts.'" *Grubbs v. Gen. Elec. Credit Corp*., 405 U.S. 699, 705 (1972) (quoting *Shamrock Oil Corp. v. Sheets*, 313 U.S. 100, 104 (1941)).

The Commissioner cannot rely on McCarran-Ferguson to reverse-preempt the federal right to remove. While some parts of Wisconsin's insurance insolvency statutes may relate to the business of insurance, the "parochial purpose of regulating . . . choice of forum" does not. *International Ins. Co. v. Duryee*, 96 F.3d 837, 840 (6th Cir. 1996), *cf. United States Dept. Of Treasury v. Fabe*, 508 U.S. 491, 510 n.8 (1993) ("[A] state statute regulating the liquidation of insolvent insurance companies need not be treated as a package which stands or falls in its entirety"); *Appleton Papers, Inc. v. Home Indem. Co.*, 612 N.W.2d 760, 771 (Wis. App. 2000) ("We hold that the circuit court may not enjoin Home from presenting to a federal court the question of the application of a federal remedy. Wisconsin courts have no power to limit, modify, or control the power of federal courts, including enjoining a litigant from pursuing remedies in that court"). "[T]he McCarran-Ferguson Act . . . is not relevant to the issue of the Court's jurisdiction. . . . [T]hat Act is relevant, if at all, only to the merits of any priority-of-claims dispute that may arise from a clash between the federal priority statute, 31 U.S.C. § 3713, and the Pennsylvania priority scheme." *Koken v. Pension Benefit Guar. Corp*., 383 F. Supp. 2d 712, 718 (E.D. Pa. 2005) (citations and footnotes omitted) (rejecting insurance commissioner's motion to remand action filed in connection with insurance liquidation proceeding).

The Commissioner cites several cases in which a private party tried and failed to effect removal of an action connected to an insurance insolvency proceeding under § 1441. The

Commissioner has not cited a single case in which a federal court remanded an action concerning a federal question - much less a federal tax issue - that was removed by the federal government, under either § 1441 or § 1442(a)(1). The Commissioner cannot rely on *Sheda v. United States Dep't of the Treasury*, 196 F. Supp. 2d 743 (N.D. Ill. 2002). In that case, the United States Treasury was a party, not as a federal agency engaged in federal responsibilities, but because the decedent had amended her will to leave her entire estate to the Bureau of Public Debt, causing the previous beneficiaries of her will to question whether she had been of sound mind at the time.[10] The court held that as a mere beneficiary, the United States was not named as a party "for actions arising from [its] federal responsibilities" so §1442(a)(1) did not apply. Further, the *Sheda* court relied exclusively on cases interpreting a now-repealed version of § 1442(a)(1) that gave the removal right only to federal officers acting "under color of such office," not federal agencies. *Id.* at 745-746. Section 1442(a)(1), as amended in 1996 and currently in force, provides for removal when there is any action against the United States or an agency, and is not limited to officers or acts "under color of office." *Sheda*, therefore, is inapposite.[11]

Nor has the Commissioner produced any authority suggesting that McCarran-Ferguson forbids the removal of an action against a federal agency involving a claim presenting federal questions (although it cites several district court opinions regarding private parties without such

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[10] The Bureau of Public Debt accepts "gifts donated to the United States Government to reduce debt held by the public." See the Bureau's website, at http://www.treasurydirect.gov/govt/reports/pd/gift/gift.htm.

[11] For the same reason, the Commissioner cannot rely on the other pre-1996 cases he cites involving federal agency parties, *In re 73rd Precinct Station House*, 329 F. Supp. 1175 (E.D.N.Y. 1971), and *Fountain Park Coop., Inc. v. Bank of Am. Nat'l Trust & Sav. Ass'n*, 289 F. Supp. 150 (C.D. Cal. 1968).

federal claims). A recent insurance liquidation proceeding in Nebraska illustrates the point. *Granite Reinsurance Co., Ltd. v. Frohman*, 2009 WL 2601105 (D. Neb. 2009). In that proceeding, a creditor filed an action against the Federal Crop Insurance Corporation and the liquidated insurance company seeking to collect unpaid premiums on reinsurance policies. The FCIC removed to federal court pursuant to § 1442(a), just as the United States did here. The liquidator moved to remand, making the very same arguments about exclusive state jurisdiction and alleged harm to the liquidation proceedings that the Commissioner makes here. The district court rejected those arguments because FCIC was a federal agency and the claim arose under federal legislation that (like the Internal Revenue Code) both directly regulated insurance and gave jurisdiction to the federal courts. The court contrasted this situation with that presented in *In re Amwest, Ins. Co.*, 245 F. Supp. 2d 1038 (D. Neb. 2002), on which the Commissioner heavily relies for the proposition that a state insolvency proceeding forecloses removal. As the *Granite* court noted, the outcome of *In re Amwest* would have been different had the removal been filed by a federal agency invoking federal jurisdiction as to a federal question.

C. Because Only The Segregated Account is in Rehabilitation, the State Court Has No In Rem Jurisdiction over the General Account or Ambac's other Affiliates.

The Commissioner also contends that the case must be remanded because the United States is, it claims, merely "one of a number of claimants with a potential interest" in property - namely the assets of the Segregated Account as to which the state court has "*in rem*" jurisdiction by virtue of the rehabilitation proceeding. (Remand Motion at 25-26). This argument simply does not apply to the General Account, or any part of Ambac that is not within the Segregated Account, because the only entity even arguably within the *in rem* jurisdiction of the state court is

the Segregated Account. The state court has never asserted *in rem* jurisdiction over the rest of Ambac, much less its corporate affiliates, and indeed has explicitly rejected any jurisdiction beyond the Segregated Account. "This proceeding pertains solely to the Segregated Account . . ., and does not pertain to the policies, contracts, rights, assets, equity ownership interests, and liabilities remaining in Ambac's General Account." (Exhibit 8, Order For Rehabilitation ¶ 2). Indeed, when the state court issued its first-day injunction order, it explicitly stated that "the injunctive relief granted below does not apply to policies or other contracts which remain in the Ambac General Account." (Ex. D to the Insurance Commissioner's Brief, Dkt. # 14-4, Order on First Day Injunction at 1). The Commissioner emphatically claims that the General Account could *not* be placed in the state court's custody in this rehabilitation proceeding, lest an alleged parade of horribles arise. (Motion at 7-8).

Nor has the Commissioner assumed the mantle of "rehabilitator" for the General Account. As he stated in his Verified Petition for Order of Rehabilitation: "The Commissioner is not asking the Court to exercise jurisdiction over Ambac Assurance Corporation ('Ambac' or its 'General Account') or the policies, contracts, assets, equity ownership interest, and rights or liabilities remaining in Ambac's General Account." (Ex. A to the Insurance Commissioner's Brief, Dkt. # 14-4, Verified Petition, at 1.) This is consistent with the Wisconsin segregated account statute, which provides that "assets attributable to a segregated account shall not be chargeable with any liabilities arising out of any other business of the corporation, nor shall any assets not attributable to the account be chargeable with any liabilities arising out of it. . ." Wis. Stat. § 611.24(3)(c).

To be sure, the state court issued an *in personam* injunction against the United States to

prevent it from pursuing tax collection actions against the General Account (as well as the Segregated Account) and all other subsidiaries of Ambac. Whatever jurisdictional basis the state court may have for such injunction - and the United States has demonstrated there is none - it cannot be in the nature of *in rem* jurisdiction that would preclude this Court from adjudicating the merits of the injunction. As a district court held in a recent insurance liquidation proceeding in Pennsylvania, a liquidation proceeding over an insurance company did not give the state court *in rem* jurisdiction over that company's subsidiaries *not* in liquidation, even though the court had issued orders regarding those subsidiaries. *Koken*, 383 F. Supp. 2d. at 719-20. Thus, the rehabilitation proceeding is no bar to removal of any action, whether characterized as *in personam* or *in rem*, related to the General Account.

Moreover, even if the state court's injunction were based on *in rem* jurisdiction, that would not counter the applicability of 28 U.S.C. § 1441 or § 1442. State court receiverships are not uncommonly removed to federal court if they raise a federal question or involve claims against the United States. *See* Exhibit 9, Order of Partial Remand, *Novello v. Manor Oak Skilled Nursing Facilities, Inc.*,Civil No. 1:04 cv-415-JTE, Dkt. #3, (W.D.N.Y. Jun. 3, 2004) (in state receivership proceeding removed to federal court because of state court injunction against IRS levies, federal court retains jurisdiction over all issues related to "the adjudication of the propriety of the IRS's tax liens, claims or levies," enjoins the state court from disbursing any funds until federal court determines the IRS's rights to funds, and remands remainder of proceeding to state court).[12]

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[12] This *Manor Oak* opinion resulted from the second of three attempted removals by the United States. The first attempt to remove was remanded before any briefs were filed. The (continued...)

D. The State Court's Jurisdiction Over The Segregated Account Does Not Preclude This Court's Exercise Of Its Federal Jurisdiction

As to the Segregated Account, the United States acknowledges that the rehabilitation proceeding constitutes an action *in rem*. The IRS will not levy on those assets within the Segregated Account that are *in custodia legis* with the state rehabilitation court. It will not do so by operation of *federal* law pursuant to Treasury Regulations, so a state court injunction is unnecessary as well as improper. *See* 26 C.F.R. 301.6331-1(a)(3).[13] Thus, the United States does not ask this Court to assert *in rem* jurisdiction over any assets actually in the state court's custody. The United States does invoke this Court's jurisdiction to resolve any disputes regarding the assessment or collection (including priority) of any federal tax liability.

At any rate, the existence of a state rehabilitation proceeding does not preclude this Court from exercising federal jurisdiction over this federal tax issue. This Court's retention of federal jurisdiction over the Injunction against the United States, over the concomitant binding of the IRS to the allocation of the potential tax liabilities of Ambac to the Segregated Account, and

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[12](...continued)
second attempt to remand was made pursuant to 28 U.S.C. § 1442 in response to an injunction against IRS levies on recipients of distributions from the state court receivership based on the IRS's contention that the distributions did not discharge the federal tax liens. Exhibit 9 reflects the Court's order in which it remanded the matter except for any issues in respect to the IRS levies, state court injunction, and other issues involving the IRS. The third removal attempt was made pursuant to 26 U.S.C. § 7424 after the state court granted the government's motion to intervene in the receivership proceeding, and is not immediately applicable here. *Novello v. Manor Oak Skilled Nursing Facilities, Inc*., 2004 WL 2039800 (W.D.N.Y. 2004). We have suggested an approach similar to that used by the *Manor Oak* court in the second removal attempt – reserving jurisdiction over any issues regarding the assessment, collection, or priority of federal tax and remanding the rest of the proceeding.

[13] Of course, the IRS may still assess taxes that can be charged against the Segregated Account and record notices of federal tax liens against Segregated Account assets. *Appleton v. Comm'r*, T.C. Mem. 2010-255.

over any further disputes regarding the amount of federal tax or its priority or collection will not "interfere with the state court's possession save to the extent that the state court is bound by the judgment to recognize the right adjudicated by the federal court." *Markham v. Allen*, 326 U.S. 490, 494 (1946). It is not necessary for the Court to exercise jurisdiction over the entire rehabilitation proceeding in order to resolve disputes between the Commissioner and the IRS, and the United States urges the Court to remand the remainder of the rehabilitation proceeding.[14]

III. This Action Should Not Be Remanded Based On *Burford* Abstention.

The Insurance Commissioner argues that this case should be remanded based on the Supreme Court's decision in *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943). *Burford* marks an "extraordinary and narrow exception to the duty of the District Court to adjudicate a controversy properly before it." *Quackenbush v. Allstate Ins. Co.*, 517 U.S. 706, 728 (1996). As this Court has held, a "federal court must be mindful of its 'virtually unflagging obligation' to exercise the jurisdiction given it.'" *Teed v. JT Packard & Assoc., Inc.*, 2010 WL 446468 (W.D. Wis. 2010) (Crabb, J.) (quoting *Tyrer v. City of Beloit, Ill.*, 456 F.3d 744, 750-51 (7th Cir. 2006)). "Because of this obligation , abstention is rarely appropriate . . . and a court should abstain only when

[14] Any claim the IRS may assert as to the Segregated Account would have first priority over all other claimants despite the Wisconsin insurance liquidation priority statute. (As to the General Account, which is not in rehabilitation, the Wisconsin statute does not apply, because it applies on its face only to insurance liquidation proceedings.) Wis. Stat. § 645.68. The Supreme Court's holding in *Fabe* does not preclude such a result. In *Fabe*, the United States' claim was predicated on its holding surety bonds, so the United States was in the same position as a private creditor but for operation of the federal priority statute. As to a claim for unpaid federal taxes, however, the United States would be enforcing its Constitutional prerogative to lay and collect taxes. As explained above, the United States' power to collect taxes is untrammeled by the McCarran-Ferguson Act, so the Wisconsin priority statute could not reverse-preempt the operation of § 3713 for the collection of taxes. For now, the United States is content to leave that potential dispute for another day; however, this Court should retain jurisdiction over any such future dispute.

presented with the clearest of justifications." *Id.* * 1 (internal quotations and citations omitted). Abstention under *Burford* is only appropriate when (1) federal courts are asked to decide difficult questions of state law bearing on policy problems of substantial public import whose result transcends the result in the case then at bar and (2) the exercise of federal review would be disruptive of state efforts to establish a coherent policy with respect to a matter of substantial public concern. *International College of Surgeons v. City of Chicago*, 153 F.3d 356, 362 (7th Cir. 1998).

Contrary to the Commissioner's suggestion, the mere existence of an insurance rehabilitation proceeding does not justify *Burford* abstention. *New Orleans Public Serv., Inc. v. Council of City of New Orleans*, 491 U.S. 350, 362 (1989) (*Burford* "does not require abstention whenever there exists" a state administrative process, or "even in all cases where there is a potential for conflict with state regulatory law or policy). Rather, the Court must review completely the facts of the case to determine if it is one of the rare instances in which *Burford* abstention is appropriate. *Teed*, 2010 WL 446468 * 2. Courts frequently decline to abstain from asserting federal jurisdiction in the face of an insurance insolvency proceeding. *See Quackenbush.*, 517 U.S at 706; *Gross v.Weingarten*, 217 F.3d 208, 222-24 (4th Cir. 2000); *Riley v. Simmons*, 45 F.3d 764 (3rd Cir. 1995); *Webb v. B.C. Rogers Poultry, Inc*., 174 F.3d 697 (2nd Cir. 1999). More to the point, neither Ambac's General Account nor its affiliates are in rehabilitation, and are not under the *in rem* jurisdiction of the state court, so any applicability of *Burford* to an insurance company in rehabilitation is irrelevant.

This case involves the United States' Constitutional prerogative to collect federal taxes and its right to remove such cases. The issues in dispute between the United States and the

Commissioner are issues of federal tax law, specifically whether a state court can shift and isolate federal tax liability away from members of a corporate group of taxpayers that are not within the court's *in rem* jurisdiction and enjoin the United States from collecting federal taxes from those taxpayers. These federal claims here are not "entangled in a skein of state-law that must be untangled before the federal case can proceed" as is appropriate for a Court to abstain in accordance with *Burford*. *Quackenbush*, 517 U.S. at 727; *New Orleans Public Serv*., 491 U.S. at 362. Instead, by issuing the Injunction, the state court has gratuitously and unnecessarily entangled itself into federal law. The Commissioner cites no case in which a district court abstained from asserting jurisdiction over a federal tax dispute. Moreover, *Burford* abstention is only available where a federal court is asked to provide some form of equitable or discretionary relief. *Quackenbush*, 517 U.S. at 730. The United States has not invoked this Court's original jurisdiction seeking discretionary relief but rather has invoked its removal jurisdiction because it is entitled to be free of the state court's injunction that violates the Anti-Injunction Act set forth in the Internal Revenue Code, and sovereign immunity more generally. No exercise of discretion is involved.

Thus, the Commissioner cannot rely on *Metropolitan Life Ins. Co. v. Board of Directors of Wisconsin Ins. Sec. Fund*, 572 F. Supp. 460, 473 (W.D. Wis. 1983) (Crabb, J.). In that case, several insurance companies brought a federal lawsuit seeking declaratory and injunctive relief against the Board of Directors (including the Commissioner of Insurance) of the Wisconsin Security Fund. Generally, the Wisconsin statutes permitted the state to assess charges against insurance companies and use the money raised to assist with the liquidation of other insolvent insurance companies. The State provided a procedure for the insurance companies to object to

their assessment. The Plaintiff insurance companies challenged the constitutionality of certain of the Wisconsin statutes governing the operation of the insurance security fund and the manner in which they had been assessed for the liquidation of another insurance company. This Court recognized that it had jurisdiction over the plaintiffs' objections because the plaintiffs' citizenship was diverse from that of the defendants' and because the plaintiffs raised a federal question. 572 F. Supp. at 467. However, the Court concluded that *Burford* abstention was appropriate because the case involved unsettled questions of state law and presented decisions bearing on state policy. Further, the Court held that the potential for conflict in the results of federal and state court adjudication could bring a halt to the state's efforts to effect its policy respecting the liquidation and rehabilitation of Wisconsin insurance companies. 572 F. Supp. at 473.

But, unlike the plaintiffs in *Metropolitan Life*, the United States here is not seeking to enjoin the Commissioner from collecting state-assessed fees for a state-created fund. This action raises no state law questions, unsettled or otherwise, because the only relevant issue is the extent of the federal government's right under the federal Constitution and Internal Revenue Code to collect federal taxes. The Commissioner does not suggest that the facts of this case (an insurance company, part of which is in rehabilitation, being potentially liable for $700 million in erroneous tentative refunds) is at all typical; it may well be unique. As a result, it is unlikely that this Court's decision will disrupt the Wisconsin insurance regulatory scheme.

The federal issues here - the circumstances under which the IRS can be enjoined and a taxpayer can manipulate its affairs to avoid federal tax - are compelling federal concerns. Federal tax law requires a uniform application over a nationwide scheme of taxation and affects

matters of national public concern. *Modern Life*, 420 F.2d at 37-38. That application is carried out through the Internal Revenue Code and, when necessary, the federal courts. *Id.* The tax issues before the Court do not involve unsettled claims of state law or questions bearing on state policy, as required for *Burford* abstention. Having this Court decide these federal issues, therefore, will not be "disruptive" to the state's efforts to establish a coherent policy with respect to a matter of substantial public concern.[15] *See Metropolitan Life Ins.*, 572 F. Supp. at 473.

The Insurance Commissioner also quotes from the portion of this Court's decision in *Metropolitan Life*, which in turn analyzes *Colorado River* abstention. *Colorado River* abstention requires simultaneously pending federal and state suits. *Tyrer*, 456 F.3d at 751. The *Metropolitan Life* plaintiffs had just such competing lawsuits. *Metropolitan Life*, 572 F. Supp. at 465, 471 (noting that the plaintiffs had concurrently pending appeals of their assessments in the state court liquidation proceeding and administratively with the defendant). Against that background, this Court concluded that the *Metropolitan Life* plaintiffs' claims, whether viewed as in rem or in personam, were disruptive to and duplicative of then pending state court insolvency proceedings. Thus, *Colorado River* abstention was appropriate. *Metropolitan Life*, 572 F. Supp. at 471. Because the United States removed this action, there is no competing

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[15] As discussed at note 8 above, Wisconsin's insurance insolvency statute indicates that rehabilitation proceedings may proceed in federal court, so the Commissioner's insistence on exclusive state jurisdiction is questionable at best *See* Wis. Stat. § 645.45 & Wis. Stat. § 645.82(4); *see also Inland Empire*, 239 F.2d at 289. Additionally, the Insurance Commissioner has not presented any evidence that the Circuit Court of Dane County stands in any specialized relationship of technical oversight or concentrated review to the evaluation of what is at issue here - the government's tax claims. *See Teed*, 2010 WL 446468 *3. *Burford* abstention is appropriate only when there exists a state court that has a specialized relationship of technical oversight or concentrated review. *Property & Casualty Ins. Ltd. v. Central Nat'l Ins. Corp.*, 936 F.2d 319, 323 (7th Cir. 1991); *New Orleans*, 491 U.S. at 360; *Colorado River Water Conservation v. United States*, 424 U.S. 800, 814 (1976).

currently pending state court case against the government.

Finally, the concerns raised by the Insurance Commissioner and this Court in *Metropolitan Life* are not present here. As we have said, the United States is not asking this Court to decide the propriety of the first-day injunction as to the policyholders and creditors of the Segregated Account. The arguments the United States has raised here apply to no other litigant. As a result, this case will not set a precedent for other litigants or encourage them to remove a claim to federal court. *See id*. *Burford* does not support abstention in these circumstances.

The Insurance Commissioner also relies on *Blackhawk Heating & Plumbing Co. Inc. v. Geeslin*, 530 F.2d 154 (7th Cir. 1976). In *Blackhawk Heating*, two state court appointed liquidators appealed a federal district court decision in a diversity of citizenship case. 530 F.2d 154, 156 n.2 (7th Cir. 1976). The case involved the rightful owner of escrow securities and required the district court to address state preference law and whose rights to the securities enjoyed priority. *Id*. at 157. The liquidators were parties to the district court action because state liquidation proceedings against two insurance companies with potential claims to the escrow securities were pending in Illinois and Indiana during the federal litigation. Nonetheless, Blackhawk Heating chose to file its petition in federal court to determine its rights in the escrow securities. As the Seventh Circuit noted, "[t]wo courts, one state and one federal, s[ought] to exercise power over the same piece of property and order its final disposition." *Id*. at 157.

The Seventh Circuit, in deciding that the District Court did not have jurisdiction, noted that the liquidation proceeding - which had jurisdiction over the property of the insurance company - was initiated before the Federal Court proceeding. Also, the Seventh Circuit noted

that the federal court proceeding was an "*in rem*" action because Blackhawk sought the turnover of assets. The Seventh Circuit concluded that the district court could not exercise jurisdiction over the "property" of the insurance company because the property had been removed from its "*in rem*" jurisdiction. *Id*. at 159. This diversity action did not involve federal tax law or *Burford* and the United States has not yet asserted any rights to the property in the Segregated Account or for that matter the General Account of Ambac.

The Insurance Commissioner argues that the IRS's "desire to jump ahead of policyholders in direct violation of the priority structure of Wis. Stat. § 645.68 supports *Burford* Abstention." (Brief at 41-44). That concern is irrelevant to the focus of the United States' removal. By removing the federal tax issues implicated in this action to federal court, the United States is not seeking to usurp the Insurance Commissioner's powers to rehabilitate the Segregated Account or seize any Segregated Account assets actually *in custodia legis* with the state court. Instead, we removed this case simply because it involves the collection of tax and, in particular, it involves the collection of tax from a taxpayer that is neither in rehabilitation nor liquidation. The United States' intent is to vindicate the supreme federal interest in collecting federal tax against intrusion by a state court. This Court should not abstain from adjudicating those federal issues.

CONCLUSION

For the reasons described above and in our opening brief, the United States respectfully requests that this Court deny the Insurance Commissioner's motion to remand and grant the United States' motion to dissolve.

Respectfully submitted,

December 30, 2010

JOHN WILLIAM VAUDREUIL
United States Attorney

ROBERT KOVACEV
Senior Litigation Counsel, Tax Division

/s/ Hilarie Snyder

HILARIE SNYDER
Trial Attorney, Tax Division
U.S. Department of Justice
Post Office Box 7238
Washington, D.C. 20044
Telephone: (202) 307-2708 (Snyder)
Telephone: (202) 307-6541 (Kovacev)
Fax: (202) 514-6770
hilarie.e.snyder@usdoj.gov
robert.j.kovacev@usdoj.gov

CERTIFICATE OF SERVICE

IT IS HEREBY CERTIFIED that service of the foregoing OPPOSITION BRIEF and Declaration of Hilarie Snyder has been made by First Class Mail, postage prepaid, upon the following this 30th day of December, 2010:

Ambac Financial Group, Inc.
Peter A. Ivanick
Dewey & LeBoeuf LLP
1301 Avenue of the Americas
New York, NY 10019
Attorney for Ambac Financial Group, Inc.

And on this 30th day of December, 2010 filed in the Court's electronic filing system which sends notice to all parties of record, including:

Michael B. Van Sicklen
Matthew R. Lynch
Foley & Lardner LLP
150 East Gilman Street
Post Office Box 1497
Madison, Wisconsin 53701
Attorney for Sean Dilweg,
Commissioner of Insurance of the State of Wisconsin

Daniel Stolper
Stafford Rosenbaum LLP
222 West Washington Avenue, Suite # 900
P.O. Box 1784
Madison, Wisconsin 53701-1784
Attorney for Ambac Assurance Corporation

/s/ Hilarie Snyder
HILARIE SNYDER
Trial Attorney, Tax Division
U.S. Department of Justice
Post Office Box 7238
Ben Franklin Station
Washington, D.C. 20044
Telephone: (202) 307-2708
hilarie.e.snyder@usdoj.gov