

TYPES NOT MAPPED YET March 26, 2025 | TTR not mapped yet | Joseph Orbach

Supreme Court Limits Ability of Bankruptcy Trustees to Pursue Fraudulent Conveyances Against the Government

In an 8-1 ruling issued March 26, the U.S. Supreme Court reversed the Tenth Circuit and sided with the U.S. government in finding that sovereign immunity bars bankruptcy trustees from pursuing certain state law fraudulent conveyance claims. At issue in this case was the interpretation of Bankruptcy Code Section 106(a), which provides sovereign immunity waivers to 58 distinct bankruptcy code sections, including section 544. Section 544(b), in turn, permits bankruptcy trustees to utilize state law to pursue avoidance and recovery of fraudulent conveyances.

The issue in this case was significant because while the Bankruptcy Code contains a fraudulent conveyance statute (section 548), that statute only has a two-year lookback period, whereas most state fraudulent conveyance statutes (including the Utah statute at issue in this case) have four-year lookback periods. Practically speaking, any alleged fraudulent transfer that occurs between two and four years of a bankruptcy filing can only be recovered utilizing state law pursuant to section 544(b).

The majority held that since section 544(b) only authorizes the avoidance of transfers that can otherwise be “avoided under applicable law” and since outside of bankruptcy a party cannot sue the U.S. government to avoid state law fraudulent conveyances, the sovereign immunity waiver of section 106(a) could not serve to create a substantive right to sue the federal government. Additionally, the Supreme Court reiterated precedent that sovereign immunity waivers are to be narrowly interpreted.

Justice Gorsuch was the sole dissenter in this case, and he believed that the section 106(a) waiver was sufficient to allow the bankruptcy trustee to pursue the state law claims at issue against the IRS.

With this decision, the Supreme Court has resolved a circuit split. The 9th and 10th Circuits had previously held that trustees could pursue the federal government utilizing section 544(b) and relevant state fraudulent conveyance law, where the 7th Circuit had ruled that it could not. As a result of this decision, certain transfers to the government (primarily the IRS) that previously could have been subject to avoidance will no longer be subject to avoidance if they occurred more than two years before the petition date.

The text and structure of §106 and §544 make clear that §106(a)’s waiver of sovereign immunity does not operate to modify §544(b)’s substantive requirements – Justice Jackson

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