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JANUARY 2001 ***BULLETIN NO. 484***

COLLECTION, BANKRUPTCY AND SUMMONSES BULLETIN

Department of the Treasury — Office of Chief Counsel — Internal Revenue Service

Indirect Transferee Liable for Taxes

Holding substance controls over form, the Tenth Circuit found a petitioner who indirectly received assets from a company later assessed with tax liability, but without means to pay, was a fraudulent transferee. **Scott, Transferee v. Commissioner, 2001 U.S. App. LEXIS 75 (10th Cir. Jan. 4, 2001)**.

Petitioner was an officer and director of a corporation that acted as a securities transfer agent. In 1989, the corporation sold substantially all of its assets to a competing corporation. The sale was structured so that the competitor purchased almost all of the assets of the corporation for $300,000. The competitor also entered into a consulting and non-competition agreement with the corporation's primary shareholder (not the petitioner) for $525,000, paid over four years. Simultaneously, the corporation entered into a stock redemption agreement with the shareholder for $300,000.

The petitioner entered into a separate agreement with the competitor. This agreement enabled the petitioner to purchase 21% of the stock of the competitor for a nominal price (10 cents/share, for a total of $1,230). The 21% increased to 33% when the petitioner agreed to forego contributions to a profit-sharing plan and to guarantee a bank loan of the competitor. Although the petitioner reported no liquidating distributions from the corporation, and so paid no capital gains tax, the petitioner did claim a cost basis for the 33% of the competitor's stock. Though this stock was purchased for $1,230, the petitioner claimed a cost basis of $749,760. The corporation signed a closing agreement with the Service, stipulating to a tax liability of $164,981 (which the corporation was unable to pay), and the petitioner joined in the agreement, accepting that $199,652 of the competitor's stock was actually consideration for the purchase of the assets from the corporation.

The petitioner argued that he could not be found liable as a transferee because, under state law, he did not directly receive any assets from the corporation. The petitioner argued that, according to Vendig v. Commissioner, 229 F.2d 93 (2d Cir. 1956), where the competitor issues stock directly to the shareholders, that stock never becomes an asset of the corporation. The Tenth Circuit disagreed. The appeals court found the stock

exchange in this case different from Vendig. In Vendig, the stock exchange was for shares of equal value and the exchange was not connected with the sale of corporate assets. Here, the court found, the stock exchange was contingent on the sale of the corporate assets, and were for nominal, not equal, value.

The court found the parameters of I.R.C. § 6901, which extends liability of a transferee to a distributee of assets, broad enough to include the petitioner. The court further found the State fraudulent transfer statute applicable. The Tenth Circuit rejected the petitioner's contention that he lacked the statutory intent to defraud, finding instead that the multiple opinions which the petitioner solicited on the tax consequences of the transaction, coupled with his own business acumen, was sufficient to support a finding of fraudulent intent. The appellate court thus affirmed the lower court's holding of a fraudulent conveyance by indirect acquisition of assets.

Sale of Restricted Stock

The Service seized closely held stock from a taxpayer. SEC rules prevent the public sale of unregistered securities unless a "no action letter" is obtained from them. The Service wants to sell the stock at a levy sale pursuant to I.R.C. § 6335. The question is whether the Service can sell restricted stock at a levy sale.

In 1997, Counsel wrote to the SEC and requested guidance for their issuing a "no action letter." In our request, we specified that any sale that the Service conducted of restricted stock would be subject to certain conditions. For example, stock of any one issuer would only be sold to one purchaser as a block and that sales would be made only to purchasers who are financially sophisticated and who could afford the risk of the investment. On September 3, 1997, the SEC issued a "no action letter" which provided that if future levy sales were conducted in accordance with the provisions of our request letter dated June 18, 1997 (set out below), the Service would not have to contact the SEC each time it wished to sell restricted stock in the future.

1997 SEC No-Act. LEXIS 849 Securities Act of 1933 - Section 4(1)

CORE TERMS: purchaser, registration, enforcement action, seize, Securities Act, registered, recommend, exemption, facts presented, public sale, own account, belonging, resold, resell, issuer, levy

SEC-REPLY-1: SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

September 3, 1997

RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF CORPORATE FINANCE

Re: Internal Revenue Service ("Service")
Incoming Letter dated June 18, 1997

Based on the facts presented and noting particularly the circumstances, terms and conditions of the sales as described in your letter, the Division will not recommend enforcement action to the Commission if the Service, in reliance on your opinion as counsel that registration is not required, offers and sells the restricted securities acquired pursuant to the Internal Revenue Code (the "Code") in future tax sales conducted in accordance with the sales provisions of the Code as described in your letter without registration under the Securities Act of 1933.

This position is based on the representations made to the Division. Any different facts or conditions might require a different conclusion. Further, this letter expresses the Division's position on enforcement action only and does not express any legal conclusions on the question presented.

Sincerely,

Andrew A. Gerber
Special Counsel

INQUIRY-1: DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

CC:EL:GL:Br2:BJUze
GL-100191343-96

UIC # 64.44.00-00
50.30.00-00

June 18, 1997

The Honorable Martin P. Dunn
Chief Counsel
United States Securities and Exchange Commission
450 5th St., N.W.
Washington, D. C. 20549
Attention: Division of Corporate Finance

Dear Mr. Dunn:

We request that you issue a No-Action Letter, advising the Internal Revenue Service ("Service") that you will not recommend any enforcement action to the Securities and Exchange Commission ("SEC") if the Service sells restricted securities (as that term is defined in Rule 144 under the Securities Act of 1933) at future tax sales conducted in accordance with the sales provisions of *26 U.S.C. § 6335* (hereinafter I.R.C.), under the

circumstances described below, without compliance with the registration requirements of the Securities Act of 1933, as amended ("the Act").

BACKGROUND

If any person fails to pay any federal tax after notice and demand, a lien arises in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person. I.R.C. § 6321. Under I.R.C. § 6331 the Service has the authority to levy, or seize, the property [*3] or property rights of delinquent taxpayers in order to enforce the federal tax lien. On occasion the Service may seize restricted securities belonging to a delinquent taxpayer. Once the Service seizes such property, it must either sell the property at a public sale pursuant to the provisions of I.R.C. § 6335, or return the property to the taxpayer.[1] It is our understanding that the Act imposes restrictions on the public resale of restricted securities. As a result of these restrictions, the Service has in the past been unable to resell restricted securities.

To remedy this situation, we request that you issue the Service a No-Action Letter stating that you will not recommend any enforcement action to the SEC if public tax sales of restricted securities seized by the Service, which are held in accordance with the provisions of I.R.C. § 6335, are conducted without compliance with the registration requirements of the Act.

The Service proposes to resell restricted securities by public sale under the provisions of I.R.C. § 6335, subject to the following conditions: [*4]

1. The restricted securities of any one issuer may be sold to only one purchaser as a block.

2. All publicly available financial and other information concerning any issuer that the Service may by law provide to the purchaser, other than returns or return information made confidential under I.R.C. § 6103, will be made available to any prospective purchaser.

3. Sales will be made only to purchasers who are financially sophisticated, and can afford the risk of the investment.

4. Each purchaser of restricted securities will be required to represent that the restricted securities are being acquired for the purchaser's own account and not with a view to the sale or distribution thereof, and that the restricted securities will not be resold unless pursuant to an effective registration statement under the Act or under a valid exemption from such registration.

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[1] We have enclosed materials that set forth the provisions of I.R.C. §§ 6331 and 6335 and explain their operation.

5. The purchaser of the restricted securities at the tax sale would be required to acknowledge and represent to the Service (or the Service shall certify if it is the purchaser) in writing to the effect that (i) the purchaser (either alone or with such purchaser's attorneys, accountants, or other advisors) possesses the requisite [*5] business and investment knowledge and experience to effectively evaluate the potential risks and merits of the investment, (ii) the purchaser has sufficient financial ability and net worth to bear the economic risk of the investment, (iii) the purchaser is aware of the fact that the restricted securities have not been registered under the Act or applicable state securities law, (iv) the restricted securities are being acquired as an investment for the purchaser's own account and not with a view to the sale or distribution thereof, (v) the restricted securities will not be resold unless they are registered under the Act and applicable state securities laws or there exist valid exemptions from such registration requirements, and (vi) certificates evidencing the restricted securities to be received by the purchaser will bear a legend to the effect that such securities represented thereby are not registered under the Act or under any state securities laws and may not be sold or transferred without registration under the Act and applicable state securities laws or the availability of valid exemptions from such registration requirements.

On the basis of the foregoing, we are of the opinion [*6] that the Service, after it seizes restricted securities pursuant to its levy powers, may resell the restricted securities in the manner described without registration under the Act pursuant to section 4(1) of the Act, and note that the Division of Corporate Finance has previously issued No-Action Letters in similar situations. See e.g. United States Small Business Administration, SEC No-Action Letter, LEXIS 1053 (November 16, 1992).

CASES

1. **BANKRUPTCY CODE CASES: Application of Payment**
Ida v. Department of Treasury, 108 F. Supp. 2d 1181 (D. Kan. 2000) - Debtor owed taxes for 1981, 1987 & 1988. The debtor filed for Chapter 7 bankruptcy in 1990, and during the bankruptcy the Service erroneously filed a Notice of Federal Tax Lien for the 1981 taxes, which was void as a violation of the stay. In 1992 the Service filed a Notice of Federal Tax Lien for the 1987-88 taxes, and in 1995 filed a Notice of Federal Tax Lien for the 1981 taxes. Meanwhile, in 1993 a third party filed a judgment lien against the debtor. When the bankruptcy trustee made a dividend payment of $120,000 to the Service, the third party objected to the Service's application of that dividend to the 1981 tax debt, which admittedly was subordinate to the third party's claim. The district court agreed with the Service that a payment made by a bankruptcy trustee is involuntary, and thus the Service has the right to decide how to apply that payment, absent a contrary order by the court.

2. **BANKRUPTCY CODE CASES: Chapter 13: Effect of Confirmation**
Barbosa v. Soloman, 2000 U.S. App. LEXIS 33448 (1st Cir. Dec. 21, 2000) - Based on a stipulation with the mortgage company that their real estate was worth only $64,000, debtors stripped the secured mortgage claim by $50,000. Their confirmed Chapter 13 bankruptcy plan provided for full payment of the secured amount, plus a 10% distribution on unsecured claims. Then the real estate was sold for $137,500. The Trustee moved to have the debtor's plan amended to provide 100% payment to the unsecured creditors, while the debtors objected, claiming the creditors were bound by the confirmed plan. The appellate court, affirming the lower courts, first found that under B.C. § 1306(a), the appreciated value of the real estate was property of the bankruptcy estate. Noting the apparent inconsistency between property treatment under section 1306 and section 1327, the First Circuit held that although by virtue of section 1327, property at the time of confirmation vests in the debtors free of all claims, the trustee and creditors continue to have an interest in the preservation of those assets. To this end, under section 1329, a plan may be modified in appropriate, rare circumstances (the court refused to adopt as its test that a substantial and unanticipated change in circumstances was a prerequisite for seeking modification). Therefore, the Trustee and creditors were not precluded by the res judicata effect of the confirmed plan from having the plan amended to provide full payment of their claims.

3. **BANKRUPTCY CODE CASES: Chapter 13: Discharge: Debts Provided for by the Plan**
In re White, 87 AFTR2d ¶ 2001- 318 (Bankr. D. Wyo. Dec. 8, 2000) - Debtor filed 1994 income tax return in April, and filed for Chapter 13 bankruptcy in September. The Service filed a secured proof of claim for 1993 taxes, but did

not file a claim or amend the existing claim to include the 1994 taxes (which would have been a priority debt). The debtor's Chapter 13 plan provided for payment in full of all priority claims, as required by B.C. § 1322(a), but the Service was not listed as a priority claimant. The plan was confirmed without objection. After the debtor completed payments and was discharged, the Service began collection of the unpaid 1994 taxes. The bankruptcy court held that the taxes were discharged because the plan referred to all priority claims and so, under B.C. § 1328(a), the 1994 taxes were "provided for" under the plan.

4. **BANKRUPTCY CODE CASES: Determination of Secured Status**
In re Keyes, 255 B.R. 819 (Bankr. E.D.Va. 2000) - Bankruptcy court holds that an ERISA-qualified retirement plan cannot be used to secure the Service's claim because the retirement plan is excluded from the bankruptcy estate under B.C. § 541(c)(2).

5. **BANKRUPTCY CODE CASES: Exceptions to Discharge: No, Late or Fraudulent Returns**
United States v. Summers, 87 AFTR2d ¶ 2001- 430 (Bankr. E.D. Pa. Jan. 11, 2001) - Debtor is collaterally estopped from taking a position inconsistent with a prior guilty plea that he attempted to evade the assessment and payment of his taxes. By virtue of the guilty plea, agreeing to the liabilities in Tax Court, and filing amended returns, the debtor satisfies the standard set out in Fegely, 118 F.3d 979 (3d Cir. 1997), and so his taxes will not be discharged.

6. **BANKRUPTCY CODE CASES: Setoff**
Haizlett v. United States, 87 AFTR2d ¶ 2001- 433 (W.D. Pa. Dec. 28, 2000) - Debtors argue that since they did not file their tax return until after filing their Chapter 7 bankruptcy petition, the associated tax refund is a post-petition debt. The court disagreed, ruling that for the purposes of B.C. § 553 setoff, a tax refund arises at the end of the taxable year to which it relates, and not when the refund is claimed by the debtor. The court also held that a creditor's right of setoff was preserved despite confirmation or discharge, since section 553 takes precedence over any other provision of the Bankruptcy Code.

7. **BANKRUPTCY CODE CASES: Setoff**
In re Martinez, 87 AFTR2d ¶ 2001- 302 (Bankr. W.D. Tex. Dec. 8, 2000) - Debtors right to exempt assets in bankruptcy under B.C. § 522 must yield to Service's right to setoff that property under B.C. § 553(a).

8. **BANKRUPTCY CODE CASES: Subordination (§ 510)**
Freeland, Trustee v. I.R.S. (In Re White Trailer Corp.), 2000 Bankr. LEXIS 1554 (Bankr. N.D. Ind. Nov. 30, 2000) - Payment for debtor's merchandise, including collected excise taxes, was made to bank lockbox. The bank applied all monies to its outstanding loan, instead of forwarding the taxes to the Service,

but the Service filed a claim for the unpaid taxes against the debtor. The trustee argued that as the Service did not pursue collection against the bank, its claim should be equitably subordinated under B.C. § 510(c)(1). The court disagreed, finding the categorical subrogation suggested by the trustee (the claim of every creditor who could look to a codebtor for payment) was prohibited by United States v. Noland, 517 U.S. 535 (1996). The court also disagreed that the Service could collect from the bank under I.R.C. § 7501(a) and § 6672(a), because the excise taxes did not constitute trust fund taxes. Although the bank exercised control over the funds, the debtor's choice to collect the section 4051 excise taxes from the customer did not covert those collected taxes into trust funds, and so the bank was not a responsible party under section 6672.

9. COLLECTION DUE PROCESS
PAYMENT: Installment Payments
AJP Management v. United States, 87 AFTR2d ¶ 2001- 312 (C.D. Cal. Nov. 21, 2000) - Court rejects taxpayer's challenge to Appeal's Office determination to levy. Although the taxpayer claimed the Appeals Officer did not consider his offer in compromise or offer of an installment agreement, the court found the Appeals Officer did consider these alternatives by telephone conference, but that the decision to reject the taxpayer's offer was not an abuse of discretion. Nor was it an abuse of discretion for the Appeals Officer to fail to give the taxpayer additional time to come into compliance. Finally, the court found no basis in law to order the Service to reconsider its Notice of Determination based on "changed circumstances." The companion case is TTK Management v. United States.

10. LEVY: Exempt Property
LIEN: Priority Over Divorced Spouse
McGinness, Receiver v. United States, 2000 U.S. App. LEXIS 34470 (6th Cir. Dec. 22, 2000)*(unpublished)* - Receiver satisfying divorce judgment claimed priority over medicare disbursements. The district court found the Service's levy to have priority, and the Sixth Circuit, in an unpublished decision, affirmed. In an earlier decision, the receiver was found to have standing to sue under I.R.C. § 7426(a)(1) because he had an interest in the medicare funds separate from the taxpayer. In this case, the receiver argued that the disbursements were exempt as satisfaction of child support obligations under section 6334(a)(8) and that his lien was senior to the Service's. The court of appeals found that the taxpayer paid the child support arrearages before the Service's levy, and further the receiver did not factually establish the exemption. The court further found the Service's tax liens predated the receiver's appointment and therefore the Service's levy was upheld.

11. LIENS: Priority Over Mortgages: Refinancing
Contimortage Corp. v. United States, 109 F. Supp. 2d 1038 (D. Minn. 2000) - Taxpayers made substantial home improvements, with part of the refinancing used to pay off their existing mortgage. The new mortgage company used a title

insurance company, which missed a federal tax lien filed during the "gap period" between the last review of the land records on May 2 and the closing on May 9. In determining whether the new mortgage company was entitled to be equitably subrogated to the former company, the court first held that the mortgage company as owner of the property and assignee of the mortgage was a proper party in interest, despite the existence of title insurance. The court then determined that the mortgage company satisfied the elements of equitable subrogation set out in Mort v. United States, 86 F.3d 890 (9th Cir. 1996). Since the Service's tax lien was subordinate to the earlier mortgage, it would be a windfall to the Government to gain priority over the new mortgage. However, because under State law the mortgage company must also show an "excusable mistake of fact" in its failure to learn of the tax lien, the court denied summary judgment to the mortgage company, as there was a dispute whether the mortgage company was given actual notice of the taxes by the taxpayer.

12. SUMMONSES: Defenses to Compliance

United States v. Harris, 87 AFTR2d ¶ 2001- 375 (3d Cir. Jan. 12, 2001) - The Third Circuit affirmed the enforcement of a tax summons, and reiterated several basic principles related to the validity of a summons. The court found, under United States v. Powell, 379 U.S. 48 (1964) that the sworn declaration of a revenue agent in compliance with the criteria set out in Powell was sufficient to demonstrate the summons was issued in good faith. The burden of proof then shifts to the taxpayer to set forth an appropriate challenge to the broad investigatory powers of the Service, analogized by the court of appeals to the powers of a grand jury. Since the Powell requirements were met, there is no basis for a challenge under the Fourth Amendment, and the taxpayer cannot make a blanket challenge under the Fifth Amendment. In this case, the taxpayer also failed to allege any other valid basis to challenge enforcement, and the Third Circuit held the Service was not required to issue a notice and demand for taxes not yet determined.

The following material was released previously under I.R.C. § 6110. Portions may be redacted from the original advice.

CHIEF COUNSEL ADVICE

INSTALLMENT AGREEMENTS; FAILURE TO PAY PENALTY

CC:PA:CBS:Br2
GL-703322-00
October 4, 2000
UILN:61.03.00-00
46.00.00-00

MEMORANDUM FOR DISTRICT COUNSEL
MIDWEST DISTRICT, MILWAUKEE

FROM:Kathryn A. Zuba
Chief, Branch 2
(Collection, Bankruptcy & Summonses)

SUBJECT: Failure to Pay Penalty & Defaulted Installment Agreements

This responds to your request for advice, dated June 15, 2000. This opinion is advisory in nature and not to be cited as a precedent.

ISSUES:

1. When is an installment agreement considered in effect for the purpose of a reduction in failure to pay penalty under I.R.C. § 6651(h)?

2. What impact does the issuance of Letter 2975, *Notice of Defaulted Installment Agreement under I.R.C. § 6159(b)*, or Notice CP-523, *Defaulted Installment Agreement, Notice of Intent to Levy*, have on the computation of failure to pay penalty under I.R.C. § 6651(h)?

3. When is an installment agreement considered no longer in effect for the purpose of computing the failure to pay penalty under section 6651?

CONCLUSIONS:

1. An installment agreement is in effect when it is approved by an authorized employee of the Internal Revenue Service.

2. The issuance of the Letter 2975 or Notice CP-523, in and of itself, does not have any impact on the computation of the failure to pay penalty under I.R.C. § 6651(h).

3. An installment agreement is no longer in effect after it has been properly terminated by the Service. According to the Service's current policy and procedures, an installment agreement is considered terminated 30 days after the issuance of the Letter 2975 or Notice CP-523.

LAW & ANALYSIS:

Section 6651(a)(2) of the Internal Revenue Code imposes a penalty for failure to pay an amount shown as tax on a return on or before the due date prescribed for payment of such tax (determined with regard to extensions). Section 6651(a)(3) imposes a penalty for failure to pay any amount in respect of any tax required to be shown, but not shown, on a return, within 21 calendar days from the date of notice and demand.[2] The penalty is not imposed if the taxpayer shows that the failure to pay was due to reasonable cause and not to willful neglect. I.R.C. §§ 6651(a)(2); 6651(a)(3).

Section 6651(h), added to the Code by section 3303 of the Restructuring and Reform Act (RRA) of 1998, provides for a reduced rate of failure to pay penalty under subsection (a)(2) and (a)(3) during any month an installment agreement under section 6159 is in effect for the payment of any tax for which a timely return (including extensions) has been filed. This provision applies for purposes of determining additions to tax beginning after December 31, 2000. The provision does not apply if the penalty has been increased under section 6651(d).[3] Likewise, it does not apply to taxes for which a timely return has not been filed as defined in section 6651.

The first question that you pose with respect to the application of section 6651(h) is when an installment agreement is "in effect." An installment agreement is in effect once it is approved by an authorized official of the Service. See Treas. Reg. § 301.6159-1(b)(3). An offer by a taxpayer to satisfy its tax liability in installments, thus, will not trigger the application of the lower rate of failure to pay penalty under section 6651(h). While an installment agreement is considered pending when the taxpayer submits an

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[2] Taxpayer has 10 business days to pay if the amount for which the notice and demand is issued equals or exceeds $100,000. I.R.C. §§ 6601(e)(3); 6651(a)(3).

[3] Section 6651(d) increases the penalty under subsection (a)(2) and (a)(3) from 0.5 percent to 1 percent for every month or fraction thereof that the taxpayer fails to pay after the day which is 10 days after the date on which notice of intent to levy is given under I.R.C. § 6331(d) or the day on which notice and demand for immediate payment is given under the last sentence of section 6331(a), whichever is earlier.

offer to enter into an installment agreement, see IRM 5.14.1.3, the Service must first determine that the taxpayer's proposal will result in full payment and that the proposed amount and the length of the agreement meet the Service's criteria as set forth in IRM 5.14, *Installment Agreement Handbook*. Consequently, an installment agreement is not considered "in effect" until it is approved by an authorized official within the Service.

The second issue that you pose is whether the issuance of Letter 2975, *Notice of Defaulted Installment Agreement under I.R.C. § 6159(b)*, or Notice CP-523, *Defaulted Installment Agreement, Notice of Intent to Levy*, has any effect on the computation of failure to pay penalty under I.R.C. § 6651(h). We conclude that it does not.

Section 6159(b) requires the Service to provide the taxpayer with a notice of intent to terminate the installment agreement at least 30 days prior to its termination. I.R.C. § 6159(b)(5)(A). Taxpayers with an IDRS monitored installment agreements receive Notice CP 523, while taxpayers with manually monitored installment agreements receive Letter 2957(DO). See IRM 5.14.8.5. These letters serve to notify the taxpayer of the reason for the proposed termination and give the taxpayer 30 days to comply with the terms of the installment agreement. If the taxpayer fails to cure the default within the prescribed time frame, the installment agreement will be considered terminated. While the Letter 2957 and Notice CP-523 set forth the date of termination, they do not, in and of themselves, affect the calculation of the failure to pay penalty under section 6651.

This brings us to the third and last issue which you have raised, that is, when is an installment agreement is no longer "in effect" for purposes of determining the appropriate rate of failure to pay penalty under section 6651(h). An installment agreement is no longer in effect when it is properly terminated by the Service. Currently, the Service does not provide the taxpayer with a termination letter setting forth the date when the taxpayer's installment agreement was terminated. As stated above, however, an installment agreement is considered terminated 30 days after the issuance of Letter 2957 or Notice CP-523 to the taxpayer.[4] See generally IRM 5.14.8.4.

Consequently, if an individual taxpayer enters into an installment agreement for the payment of tax for a timely filed return, prior to the date the increase rate of penalty under section 6651(d) is triggered, the failure to pay penalty under section 6651(a)(2) and (3) will be at the reduced .25% rate for any month or fraction thereof during which an installment agreement is in effect. As indicated above, section 6651(h) provides for a reduced penalty "for any month during which an installment agreement is in effect."

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[4] Please note that the Service has made an administrative decision to grant taxpayers an additional 15 days to appeal the proposed termination. See, e.g., IRM 5.14.8.4(3). In some instances, therefore, a taxpayer may be able to cure a default and, thus, continue with the installment agreement, after the date which is 30 days after the issuance of the Letter 2957 or Notice CP-523.

The purpose of reducing the penalty during the period an individual taxpayer is paying a liability pursuant to an installment agreement is to encourage payment of the outstanding liability. See H.R. Conf. Rep. No. 599, 105th Cong., 2d Sess. 258-59 (1998). To effectuate this purpose, this provision has been interpreted to mean that if an installment agreement is in effect at any time during a month the entire month receives the reduced failure to pay rate. See Prop. Treas. Reg. § 301.6651-1(a)(4).

To illustrate the above principle, consider the following two situations where a taxpayer meets all of the requirements under section 6651(h) and the monthly period for calculating the failure to pay penalty is from the 15th of the month through the 14th of the next month:

1) The taxpayer enters into an installment agreement on May 13th. Although the taxpayer enters into the installment agreement at the end of the monthly period for calculating the failure to pay penalty, the taxpayer receives the benefit of the reduced failure to pay rate for the entire month. Thus, the failure to pay penalty is calculated at the reduced rate under section 6651(h) for the monthly period beginning on April 15th and ending on May 14th.

2) The taxpayer's installment agreement is terminated on August 16th. Although the taxpayer's installment agreement is terminated at the beginning of the monthly period for calculating the failure to pay penalty, the taxpayer receives the benefit of the reduced failure to pay rate for the entire month. Thus, the failure to pay penalty is calculated at the reduced rate for the monthly period beginning on August 15th and ending on September 14th.

BANKRUPTCY; Priority Claims; Tolling of Priority Period

CC:EL:GL:Br2
GL-503988-00
UIL # 09.13.00-00

August 15, 2000

MEMORANDUM FOR NEW JERSEY DISTRICT COUNSEL
Attention: Wendy Gardner

FROM: Joseph W. Clark
Acting Chief, Branch 2 (Collection, Bankruptcy & Summonses)

SUBJECT: Request for Technical Advice
Taxpayers:

This constitutes our response to your June 14, 2000, request for an opinion on whether the Service can argue that the running of the three-year "look-back" period for determining priority status of a claim in bankruptcy is tolled during the period of an

earlier bankruptcy when the debtor was making payments pursuant to a confirmed Chapter 11 plan, as an extension of the holding in In re Taylor, 81 F.3d 20 (3d Cir. 1996). We believe that Taylor provides authority for arguing that the look-back period is tolled in this context, but we advocate advancing this position only in circuits where controlling precedent such as Taylor exists.

LEGEND

Taxpayer X
Taxpayer Y
Date A
Date B
Date C
Date D
Date E
Date F

ISSUE: Whether the running of the three-year look-back period for determining that a claim is entitled to priority status, as set forth at B.C. § 507(a)(8)(A)(i), is suspended for the time the debtor was making payments pursuant to the terms of a confirmed Chapter 11 plan.

CONCLUSION: Yes. Based on the reasoning of In re Taylor, 81 F.3d 20 (3d Cir. 1996), the running of the period for determining priority status can be viewed as tolled during any time the Service is precluded from engaging in collection action during bankruptcy, including while the debtor is making payments under a confirmed Chapter 11 plan. However, since the Service no longer advances the reasoning which is the basis of Taylor in circuits which have not addressed the issue, this view is limited to those circuits which have addressed the specific tolling issue addressed in Taylor and which have reached the same conclusion on the same rationale.

BACKGROUND: Your memorandum requesting advice assumes a situation as follows. A married couple owes federal income taxes for various unspecified years which include Date A. On Date B, Taxpayer X files a petition under Chapter 11 of the Bankruptcy Code. The Chapter 11 plan, which fully provides for the couple's income taxes for Date A, a post-petition year, is confirmed on Date C. Taxpayer X makes some payments under the plan in Date D, but then stops making payments until Date E, when Taxpayer X makes several additional payments. On Date F, Taxpayer Y files a petition under Chapter 13. At this point, part of the claim for taxes filed in the second bankruptcy cannot be classified as priority unless the running of the three-year look-back period set forth at B.C. § 507(a)(8)(A)(i) is viewed as suspended during the period between confirmation of the Chapter 11 plan and the time of "substantial default."

LAW AND ANALYSIS: In Taylor, supra, the specific issue presented was whether the period for determining priority status set forth in what is now

B.C. § 507(a)(8)(A)(i) [5] should be viewed as having stopped running during the pendency of the debtor's earlier bankruptcy. In that case, the two bankruptcies involved were both Chapter 13 cases. Since the Service's claim was based on taxes for which a return was filed within three years of the filing of the first bankruptcy petition, but more than three years before the filing of the second bankruptcy petition, its claim would have had to have been classified as unsecured general, rather than unsecured priority, in the second bankruptcy if tolling were not applied.

The Third Circuit Court of Appeals, upholding the determinations of both the bankruptcy and district courts, viewed tolling as warranted in this context. The court essentially reasoned as follows. I.R.C. § 6502(a), a provision of "nonbankruptcy law," sets a ten-year period for collection of taxes following assessment. The running of the section 6502(a) period is suspended during bankruptcy by another "nonbankruptcy" provision, I.R.C. § 6503(h). Therefore, under B.C. §108(c) [6], the running of the period for collection is suspended, as is the running of the period for determining whether a claim is entitled to priority status, during the pendency of any bankruptcy. The Third Circuit

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[5] Section 507(a)(8)(A) of the Bankruptcy Code affords unsecured claims of governmental units an eighth-level "priority" in order of payment where the claims are for prepetition taxable years and are for taxes

> (i) ... for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition; [or]
>
> (ii) assessed within 240 days ... before the date of the filing of the petition ... .

B.C. § 507(a)(8)(A)(1999). Prior to 1995, this provision was numbered B.C. § 507(a)(7)(A).

[6] Section 108(c) of the Bankruptcy Code states, in pertinent part, that

> ... if applicable nonbankruptcy law ... fixes a period for commencing or continuing a civil action in a court other than a bankruptcy court on a claim against the debtor ... and such period has not expired before the date of the filing of the [bankruptcy] petition, then such period does not expire until the later of –
>
> (1) the end of such period, including any suspension of such period occurring on or after the commencement of the case; or
>
> (2) 30 days after notice of the termination or expiration of the stay under section 362 ... with respect to such claim.

B.C. § 108(c).

held that these provisions of the Bankruptcy Code and Internal Revenue Code, taken together, reflect intent on the part of Congress that the Service be afforded additional time to effect tax collection where collection previously could not be pursued due to the pendency of a bankruptcy, relying in part on the fact that the Service cannot collect taxes during the imposition of the automatic stay. See 81 F.3d at 23.

In rendering its decision in Taylor, the Third Circuit did not explicitly address the issue you raise, whether tolling should apply not only when the automatic stay is in effect, but during periods in bankruptcy when the Service is precluded for other reasons from effecting collection. However, the court did make certain comments indicating that its application of tolling might not be limited to periods during which the automatic stay was in effect. For example, the court stated:

> The time limitations within § 507 merely reflect the existing limitation periods in income tax cases under 26 U.S.C. §§ 6501 and 6502, which are suspended during bankruptcy proceedings by § 6503(h).
>
> ...
>
> We deem it obvious that [the relevant Internal Revenue Code and Bankruptcy Code] sections, read together, evidence a congressional concern to preserve the collectability of tax claims. Section 507(a)(7)(A)(i) simply provides priority as to those taxes which fall within the three-year limitation period. The extension of time provided within § 108(c) of the Bankruptcy Code and § 6503(h) of the Internal Revenue Code would be meaningless if debtors could discharge their tax liability by filing successive bankruptcies.

81 F.3d at 24.

Given the Third Circuit's general reasoning in Taylor and the above-cited specific language, we believe that this decision provides authority for arguing that tolling may be warranted for all periods in bankruptcy when the Service is precluded for any reason from taking collection action, including during the type of scenario you present. This makes sense because the Service normally is precluded from collecting taxes while a debtor is adhering to the terms of a confirmed Chapter 11 plan, even though the automatic stay generally is not in effect at this point. See, e.g., B.C. §§ 362(c)(2), 1141 (indicating that automatic stay terminates upon confirmation of plan); United States v. Wright, 57 F.3d 561 (7th Cir. 1995)(in dictum, court summarily agrees that Service was precluded from collecting taxes while payments were being made under reorganization plan). Moreover, this argument, while not squarely addressed by any court, has been at least implicitly approved in several instances. See, e.g., In re Montoya, 965 F.2d 554 (7th Cir. 1992)(finding it unnecessary to address lower court's determination that tolling applies for all periods post-confirmation, but ruling that tolling applies for period Service's claims were initially disallowed); Mouradian v. United States, 1998 U.S. Dist.

LEXIS 13900 (M.D. Fla. 1998)((suggesting that tolling should apply whenever assets are within bankruptcy court's protection); United States v. Colvin, 203 B.R. 930 (N.D. Tex. 1996)(in general discussion of tolling, notes existence of Wright, supra, and Montoya, supra, as supporting application of tolling even while automatic stay is not in effect).

Despite our agreement that this argument is viable, we do not recommend that the argument be advanced in all circuits. We recognize that three circuits in addition to the Third have issued decisions in which tolling was applied based on reasoning similar to that contained in Taylor. See Waugh v. Internal Revenue Service, 109 F.3d 489 (8th Cir. 1997), cert. denied, 118 S. Ct. 80 (1997); In re West, 5 F.3d 423 (9th Cir. 1993), cert. denied, 511 U.S. 1081 (1994); In re Montoya, supra. However, three others have explicitly rejected this reasoning. See In re Palmer, 2000 U.S. App. LEXIS 16115 (6th Cir., July 14, 2000); Morgan v. United States, 182 F.3d 775 (11th Cir. 1999); In re Quenzer, 19 F.3d 163 (5th Cir. 1995). [7] As a result, the Office of Chief Counsel now recognizes the infirmities of the argument that the "look-back" periods contained in the Bankruptcy Code should be deemed tolled pursuant to B.C. § 108(c) and I.R.C. § 6503(h), and the Office no longer advances this argument in circuits where no controlling precedent based on these provisions already exists. [8]

In summary, we believe that Taylor provides authority for arguing, at least in cases arising within the Third Circuit, that the running of the three-year "look-back" period for determining priority status contained in B.C. § 507(a)(8)(A)(i) should be viewed as tolled during not just periods of prior bankruptcies when the automatic stay was in place, but periods when the Service was precluded from effecting collection because the debtor was making payments pursuant to the provisions of a confirmed Chapter 11 plan. Because the Office of Chief Counsel no longer advances the reasoning adopted in Taylor except in circuits where this reasoning has already been adopted, however, we do not urge that the extension of the Taylor holding discussed herein be advocated in all circuits.

COLLECTION DUE PROCESS; OFFER IN COMPROMISE; LEVY

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[7] Of the three decisions in which the analysis based on sections 108(c) and 6503(h) was rejected, all except Palmer left the door open for tolling to potentially apply on a different basis. Another decision, In re Richards, 994 F.2d 763 (10th Cir. 1993), applied tolling based on the bankruptcy court's equitable authority afforded by B.C. § 105(a), without addressing the analysis based on sections 108(c) and 6503(h).

[8] Instead, the Office now argues that tolling applies based on the legislative intent underlying the look-back periods themselves. In addition, we argue that the bankruptcy court is authorized to apply tolling if the court believes equitable factors so warrant, pursuant to B.C. § 105(a).

October 5, 2000

CC:EL:GL:Br2
GL-806538-00
UILC: 17.03.0-00

MEMORANDUM FOR NORTHERN CALIFORNIA DISTRICT COUNSEL (SACRAMENTO)

FROM: Kathryn A. Zuba
Chief, Branch 2 (Collection, Bankruptcy & Summonses)

SUBJECT: Waiver of Levy While Offer is Pending

This responds to your request dated July 25, 1999, that we prereview your proposed advice on the below issues. This document is not to be cited as precedent.

LEGEND:

Age A:
Amount A:
Amount B:
Amount C:

ISSUES: (1) Can the Service levy on a taxpayer's pension plan to fund an offer in compromise?

(2) If so, what language should be used for the taxpayer's waiver of the prohibition of levy under I.R.C. § 6331(k)(1)?

(3) Can the Service accept from a taxpayer a waiver of the right to receive a notice of intent to levy and the right to a Collection Due Process hearing?

(4) Does the taxpayer have equity in the pension plan for purposes of determining the proper amount of an offer if the Service can immediately obtain the funds in the plan by levy?

CONCLUSIONS: (1) A levy on a pension plan can only reach funds which the taxpayer can withdraw from the plan. If the taxpayer is not entitled to immediately withdraw the funds, then the Service similarly cannot obtain immediate payment by levy.

(2) Any waiver obtained should specifically enumerate the property to be levied upon.

(3) A taxpayer may not waive the right to the notice of intent to levy, but may waive the right to a Collection Due Process hearing.

(4) If the Service can obtain immediate payment by levy on the plan, the taxpayer has equity in the plan for purposes of the offer.

BACKGROUND: The taxpayer, who is Age A, owes a tax liability of approximately Amount A. The collection period of limitation will expire on most of the tax liability within two years. He has approximately Amount B in a forced-contribution retirement plan, which pursuant to the manual governing the plan cannot be withdrawn until he reaches age 55 and he is retired. However, the plan administrator will honor Internal Revenue Service levies for payment of the delinquent taxes. The taxpayer has submitted an offer in compromise in which he offers to pay Amount C in full satisfaction of the tax liability. The funds would be obtained by a Service levy on the pension plan. The revenue officer has valued the equity in the pension plan as zero for purposes of determining the proper offer amount. The revenue officer wants to accept the offer in conjunction with levying on the pension plan to fund the offer. To accomplish this, the revenue officer would like to obtain a taxpayer waiver of the prohibition on levy while the offer is pending, and a waiver of the right to a collection due process (CDP) hearing. The levy would then be issued and the funds in the taxpayer's pension fund account would be turned over to the Service. We presume that it is intended that the Service would hold these funds as a deposit until the offer is accepted. See IRM 5.8.2.5.

In your proposed advice, you conclude that the prohibition on levy while an offer is pending can be waived in writing, and that once a notice of intent to levy informing the taxpayer of the right to a CDP hearing is issued, the taxpayer can waive in writing the prohibition of levy during the 30 day period following the issuance of the CDP notice. Finally, you conclude that if the Service can levy on the plan, then the taxpayer should have access to the funds and the taxpayer accordingly has equity in his pension plan.

LAW AND ANALYSIS:

I. Levy on Pension Plan

I.R.C. § 6331(a) authorizes the Service to levy upon "all property or rights to property" of a taxpayer to collect delinquent taxes. A levy extends only to property rights and obligations that exist at the time of levy. Treas. Reg. § 301.6331-1(a). Thus, funds in a retirement plan that are currently being paid out to the taxpayer, or which the taxpayer has a right to withdraw, are reachable by levy. Additionally, obligations exist for purposes of a levy when the liability of the obligor is fixed and determinable although the right to receive payment thereof may be deferred until a later date. Id. If the taxpayer has a present right to payment at some time in the future, the levy reaches that right. Rev. Rul. 55-210, 1955-1 C.B. 544. However, the Service can only demand payment in the future when the taxpayer's right to payment ripens. See IRM 5.11.6.1, 5.11.6.2.

The Service's right to payment as a result of a levy on a pension plan is only as extensive as the taxpayer's right to payment. If the taxpayer is currently entitled to

monthly payments, the Service is entitled to receive those monthly payments by levy. See, e.g., Shanbaum v. United States, 32 F.3d 180 (5th Cir. 1994). If the taxpayer only has the right to receive payments at some future date (e.g., upon retirement and/or a specific age), then the Service is not entitled to receive any payments as a result of its levy until such future date.

In this case, you have informed us that the taxpayer has no right to make an early withdrawal from his account. [9] There is, therefore, no current right to payment which the Service's levy can reach. The levy can only reach the taxpayer's right to distributions in the future upon his retirement.

In such circumstances, the Service should not levy on the pension plan to obtain the funds which are to be used for a lump sum payment under the proposed offer. If the taxpayer cannot withdraw the funds himself, then he has no right to immediate payment which the Service can obtain by levy. If the plan administrator is willing to honor an IRS levy, but is not willing to provide the same funds to the taxpayer, then the administrator is mistaken as to the Service's levy authority. We, accordingly, recommend that you revise your advice to indicate that the Service should not levy unless the funds are available to the taxpayer.

II. Waiver of Levy Prohibition during Pendency of Offer

However, since a case may arise where the Service will be able to obtain pension plan funds by levy, we have some general comments regarding the waiver of the section 6331(k) prohibition.

For offers pending on or made after December 31, 1999, section 6331(k) prohibits a levy with respect to any unpaid tax during the period that an offer-in-compromise by such person with respect to that tax is pending, during the thirty days after a rejection of the offer by the Service, and if an appeal is filed within 30 days of the rejection, while the appeal is pending. I.R.C. § 6331(k)(1). An offer becomes pending when it is accepted by the Service for processing, and is no longer pending after it is withdrawn by the taxpayer, or it is accepted or rejected by the Service. Treas. Reg. § 301.7122-1T(c), (f). Thus, generally levies are prohibited while the Service is evaluating whether the offer will be accepted or rejected. Treas. Reg. 301.7122-1T(f)(2). [10]

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[9] You have not, however, provided us with any specific information as to the plan rules and why the administrator will honor a levy but not a taxpayer withdrawal.

[10] We note that there is no statutory prohibition on levy after the offer is accepted, since the offer is no longer pending with the Service. Section 6331(k) would not prohibit a levy on the taxpayer's pension plan after the offer is accepted, and no waiver of the section 6331(k) prohibition would be necessary to permit a levy after acceptance of the offer.

Section 6331(k)(3) states that rules similar to the rules of subsection 6331(i)(3)-(5) shall apply to subsection 6331(k). Section 6331(i)(3)(A)(i) permits a taxpayer to waive in writing the restrictions on levy while a refund proceeding is pending. Thus, section 6331(i)(3)(A)(i), as incorporated by section 6331(k)(3), permits the taxpayer to waive in writing the restrictions on levy while an offer is pending. [11]

You have proposed a waiver which states "I [we] hereby state that I [we] agree to waive the prohibition under I.R.C. § 6331(k) against the IRS's levying on my [our] property or rights to property." This is a broad waiver which permits the Service to levy on all assets of the taxpayer for the full amount of the tax liability. Consistent with the purpose of the prohibition on levy to protect the taxpayer, we believe that the waiver should be narrowly drafted to reference the particular entity and/or asset to be levied upon (e.g., the taxpayer's pension plan account), and to specify the dollar amount that the levy will be limited to (e.g., the offer amount). Such a narrowly drafted waiver will prevent any possible misunderstandings on the part of the taxpayer or the Service as to the intended scope of a waiver. We believe that the draft waiver form you recommend is unnecessarily overbroad.

III. Waiver of Collection Due Process Hearing

We also have some comments concerning the waiver of the right to a Collection Due Process (CDP) hearing. Your proposed advice correctly concludes that a taxpayer may not waive the right to receive a section 6330 notice but that a taxpayer may waive the 30-day period following the issuance of a CDP notice during which the Service is precluded from levying on a taxpayer's property. The reason given for this conclusion, however, is incorrect. The proposed advice states that such a waiver is permitted by Q&A C-9 of Treas. Reg. §301.6330-1T(c)(2); specifically, the last sentence which permits taxpayers to waive some or all of the requirements regarding the contents of a notice of determination. A notice of determination is not issued by Appeals until after the requested CDP hearing is held. The waiver discussed in your advice is one which waives the taxpayer's right to receive a CDP hearing. The waiver would be given by a taxpayer upon receipt of a CDP notice. This waiver occurs before any CDP hearing request is made and is not a waiver of the type being discussed in Q&A C-9.

The reason why such waivers of the right to a hearing are permitted is because the Service recognizes that taxpayers may waive any rights granted to them under the Internal Revenue Code. In this regard, taxpayers were administratively permitted to waive their right to receive a notice of intent to levy under I.R.C. § 6331(d) prior to the enactment of I.R.C. § 6330. The notice of intent to levy required to be given under section 6330 is similar to the notice of intent to levy required to be given under section

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[11] However, neither the regulations concerning offers in compromise, nor the Internal Revenue Manual provisions governing offers in compromise, address waivers of the prohibition on levy. See section 301.7122-1T(f)(2); IRM 5.8.3.5.

6331(d). However, the major difference between these provisions is that the section 6330 notice also advises taxpayers of their right to a CDP hearing and, if the section 6330 notice is mailed, the 6330 notice is required to be sent certified mail with a return receipt requested.

Thus, conceptually a taxpayer could waive a notice of intent to levy under section 6330. However, a waiver of a taxpayer's CDP rights do implicate, at least tangentially, the provisions of section 3468 of the Internal Revenue Service Restructuring and Reform Act of 1998. That section prohibits Service employees from requesting a taxpayer to waive the taxpayer's right to bring a civil action against the United States or any Service employee for any action taken in connection with the internal revenue laws unless the taxpayer waives that right knowingly and voluntarily, or that request is made in person and the taxpayer's attorney or representative is present, or the request is made in writing to the taxpayer's attorney or representative. Taxpayers who waive their right to a CDP hearing do not receive a CDP hearing or a notice of determination by Appeals from which they could otherwise seek court review. Accordingly, the consequences of a waiver of the taxpayer's right to a CDP hearing should be discussed with the taxpayer or the taxpayer's representative, if the taxpayer is represented. In order to prevent any misunderstandings, it is the Service's current practice to provide a taxpayer with a section 6330 notice of intent to levy before accepting any waiver from that taxpayer of his right to obtain a CDP hearing. [12]

IV. Valuation of Pension Plan

Finally, we agree with your conclusion that if the plan administrator will honor a Service levy, the pension plan should not be valued as zero for purposes of the offer. Pursuant to the manual guidelines the taxpayer has equity in his forced-participation plan for purposes of determining the amount of the offer only if he has current access to the funds. IRM 5.8.5.3.5. As discussed above, the Service can only obtain the funds by levy to fund the offer if the taxpayer has current access to the funds. Therefore,

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[12] We note that in contrast to the waiver of the prohibition of levy during the pendency of the offer, the waiver of the taxpayer's rights to a CDP hearing cannot be limited to specific property. As a general matter, under section 6330, no levy may be made upon any property of a taxpayer for a particular tax and tax period until notice has been given to the taxpayer of both the Service's intention to levy and of the taxpayer's right to a hearing with Appeals. The taxpayer's rights under section 6330 are with respect to the first levy that is proposed to be made for a particular tax and tax period. The taxpayer is not entitled to either notification of intent to levy or to a hearing for any subsequent levy actions that may be necessary with respect to that particular tax and tax period. More importantly for the purposes of this memorandum, taxpayers are not entitled to separate CDP notification with respect to each asset or type of asset that they may possess. Accordingly, any waiver of the right to a CDP hearing should be broadly worded so as to encompass all of the taxpayer's assets.

pursuant to the manual guidelines it is inconsistent to value the plan as zero for purposes of the offer, while at the same time agreeing to fund the offer by obtaining immediate payment of the pension plan assets by levy.

LIEN FORECLOSURE; PENSION PLANS

October 17, 2000

CC:PA:CBS:Br1
GL-706113-98

UIC 50.29.00-00
UIC 52.00.00-00
UIC 49.02.00-00
UIC 63.38.00-00

MEMORANDUM FOR KANSAS-MISSOURI DISTRICT COUNSEL
CC:MSR:KSM:STL

FROM: Michael R. Arner
Chief, Branch 1 CC:PA:CBS:B01

SUBJECT: Reduce Tax Claim to Judgment

You requested our views on the viability of referring cases to the Department of Justice for lien foreclosure against a taxpayer's interest in a 401(k) plan in the following situation: The taxpayer has received a discharge in bankruptcy, but has an interest in a 401(k) plan that was treated as exempt property in the bankruptcy. Although certain taxes were discharged against the taxpayer personally, the tax lien, filed pre-petition, is enforceable against the plan. In re Isom, 901 F.2d 744 (9th Cir. 1990). In your memorandum, you mentioned that, in addition to the foregoing situation, Special Procedures function (SPf) is interested in referrals to reduce tax liabilities to judgment in non-bankruptcy cases where the collection statute of limitations is close to expiration.

This document is advisory only and is not to be relied upon or otherwise cited as precedent.

Conclusion

(1) Referral for lien foreclosure would be appropriate under the circumstances you set forth, and we believe that the Department of Justice would not be averse to such referrals.

(2) An action to reduce tax liabilities to judgment would be appropriate, as it usually is, where the collection statute of limitations is about to expire.

Discussion

Currently in bankruptcy situations, Collection serves notices of levy on 401(K) plans post-discharge. In your memorandum you indicated that the levies are often returned without remittances because the taxpayer "does not have any distrainable rights or interest in the funds at the time the levy is served" and that "the taxpayer's rights do not vest, for levy purposes," until after the collection statute expiration date (CSED). In light of this, you believe that SPf intends to forward these cases to your office for suit referral. Before addressing the advisability of lien foreclosure, we wish to clarify what you mean when you state that the taxpayer has no distrainable rights and has not yet vested. If that were the case, there would be no property to which the federal tax lien initially attached. [13]Therefore, we believe that you mean that the taxpayer is vested, but is not eligible for an immediate distribution and will not be eligible until after the CSED. In such cases the taxpayer does have a distrainable right–the present right to future distribution. However, the plan is not obligated to turn over the proceeds until the taxpayer has the present right to an immediate distribution. It appears that SPf's rationale for seeking referral of such cases is concern over the CSED occurring before the taxpayer is entitled to distribution. However, we note that the Internal Revenue Code requires only that a proceeding be brought or a levy be made within the period of limitations. I.R.C. § 6502 (a). It does not require the completion of administrative collection within ten years. See, e.g., In re Girard, 57 B.R. 66 (Bankr. E.D. Mich. 1985). Therefore, in cases where the Service has levied on the taxpayer's interest in a plan, the Service's position is protected by virtue of that levy. [14]

Where the Service has not levied, an even in those cases where the Service has and is therefore protected, lien foreclosure is appropriate, and we believe that the Department of Justice would be amenable to such referrals. [15]In bringing lien foreclosure actions, the government could obtain a judicial determination of the taxpayer's interest in the plan. While property is often ordered sold in foreclosure actions, the sale of the property is not required by I.R.C. § 7403. See United State v. Rodgers, 461 U.S. 677 (1983) (court concludes that "§ 7403 does not require a district court to authorize a

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[13]A plan participant has no right at all to receive accrued plan benefits until he is vested in the plan. Vesting occurs when the participant acquires a nonforfeitable right to part or all of his accrued benefits. In other words, it is vesting that creates his ownership of plan benefits. In 401(k) plans, the participant is always vested in his own contributions, while vesting in employer contributions requires satisfaction of service or other requirements specified under the terms of the plan.

[14]

[15]We know of one live case, currently in the Northern Trial Section.

forced sale under absolutely all circumstances, and that some limited room is left in the statute for the exercise of reasoned discretion"). [16]In addition, although the government's position is protected by its ability to bring a failure to honor levy suit should a plan not comply with the levy at the appropriate time, we note that protection rests solely on an outstanding levy on the plan. Thus, we believe that a prudent course of action would be to seek judicial enforcement of the lien. If the levy were mistakenly released (or found to be defective) beyond the CSED, the Service would have no opportunity to levy again or to bring suit. Thus, there would be no means to collect from the plan.

In your memorandum, you also indicated that in non-bankruptcy cases, SPf is interested in referrals to reduce tax liabilities to judgment where the statute of limitations is close to expiration. This scenario is very similar to the typical case where the government would seek to obtain a judgment against the taxpayer. One distinction is that here there would be an administrative remedy available to the Service – it could levy on the plan. However, a levy would be ineffective (until such time as the taxpayer had a right to immediate payment).

In addition, we note that the same rationale for bringing a lien foreclosure action despite the presence of a levy in the bankruptcy context applies in the non-bankruptcy context.

UNAUTHORIZED COLLECTION SUIT; REGIONAL COMPLIANCE PROGRAM

UIL # 20.02.03-00
CC:EL:GL:Br3
GL-611399-99

MEMORANDUM FOR ASSISTANT REGIONAL COUNSEL (GL),
SOUTHEAST REGION

FROM: Lawrence H. Schattner
Chief, Branch 3 (General Litigation)

SUBJECT:
Potential Application of I.R.C. § 7433

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[16] Rather, we assume that SPf is seeking to ensure payment at such time that the taxpayer becomes presently entitled to distribution from the Plan. Bringing a lien enforcement action will not accelerate the taxpayer's distribution from a Plan; nor will it entitle the Service to a form of distribution not available to the taxpayer.

This constitutes our response to your December 22, 1999, request for an opinion on whether I.R.C. § 7433 applies to certain actions taken by Service employees involved in a Regional Compliance Program (RCP) project in the district. We believe that section 7433 would not provide a means of redress for the affected taxpayers.

ISSUE: Does the Service's failure to treat all which were the subjects of an RCP project alike in the course of determining that some were liable for additional taxes, which may have resulted in some incorrect determinations, provide a cause of action for the affected taxpayers pursuant to I.R.C. § 7433?

CONCLUSION: It is our position, based on the general description of the RCP project contained in your memorandum, that section 7433 does not apply to the actions of the Service in this instance. The violations of the Internal Revenue Code, Revenue Ruling 87-41, and Section 530 of the Revenue Act of 1978 alleged by would have occurred in the determination of tax liabilities. Neither nor the TIGTA report alleges violations of any Code provision even remotely connected to the collection of taxes. Even though revenue officers conducted this program and their motives may have been influenced by collection, these considerations do not change the conclusion that any alleged violations occurred during the determination process, before assessments were made.

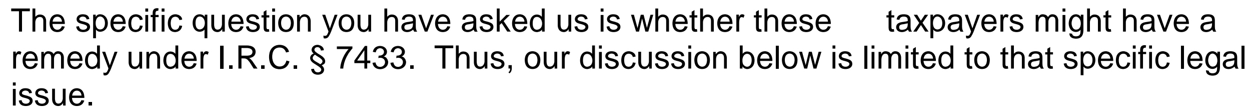
BACKGROUND: The facts relevant to your request for advice are fully documented in your memorandum requesting our advice and in a memorandum dated November 30, 1999, to your Regional Counsel from the Chief Compliance Officer, .[17] The specific RCP project at issue involved taxpayers who were .

Subsequently, , the former Collection Division Chief for the office, alleged that certain irregularities had occurred in the conduct of the RCP project.

[17] The facts are also well documented in the report ultimately issued by TIGTA, discussed infra.

The RCP project took place during
, at which time the project was terminated because of changes in National Office policy directives. In , the district requested that the Region review the RCP project to assess the district's compliance with the Internal Revenue Code and the Internal Revenue Manual. The Region did not issue a written report of its review of the project.

The allegations were ultimately investigated by the Treasury Inspector General for Tax Administration (TIGTA). The TIGTA investigated 267 closed cases and issued its formal report on the subject in . The TIGTA report contained the following observations:



The specific question you have asked us is whether these taxpayers might have a remedy under I.R.C. § 7433. Thus, our discussion below is limited to that specific legal issue.

LAW AND ANALYSIS: Section 7433 was added to the Internal Revenue Code in 1988. The version of this provision which was effective from 1988 until mid-1996, while the events relevant to the RCP project occurred, states, in pertinent part:

> If, in connection with any collection of Federal tax with respect to a taxpayer, any officer or employee of the Internal Revenue Service recklessly or intentionally disregards any provision of this title, or any regulation promulgated under this title, such taxpayer may bring a civil action for damages against the United States in a district court of the United States. Except as provided in section 7432 [providing a damage remedy for failure to release lien], such civil action shall be the exclusive remedy for recovering damages resulting from such actions.

I.R.C. § 7433(a)(1995). [18]

The legislative history of section 7433 reflects that this provision was intended to provide redress for only actions taken with respect to the collection of, rather than also actions taken with respect to the determination of, taxes. Although the Senate version of the provision would have afforded a damage remedy for both types of actions, the conference report explicitly provides that "[a]n action under this provision may not be based on alleged reckless or intentional disregard in connection with the determination of tax." H. R. Conf. Rep. No. 100-1104, 100th Cong., 2d Sess. 228 (1988), reprinted in 1988 U.S.C.C.A.N. 4515, 5289. This means that section 7433 affords no remedy for any act which is related solely to the assessment of a tax. See, e.g., Shaw v. United States, 20 F.3d 182 (5th Cir. 1994), cert. denied, 513 U.S. 1041 (1994); Gonsalves v. Internal Revenue Service, 975 F.2d 13 (1st Cir. 1992), cert. denied, 510 U.S. 851 (1993); Photographic Assistance Corp. v. United States of America, 1999 U.S. Dist. LEXIS 12738 (N.D. Ga. 1999). The case law has defined an assessment in this context

[18] The version of section 7433 which currently is applicable allows a cause of action based on reckless, intentional, or negligent conduct. See I.R.C. § 7433(a) (1999). Negligent disregard of Code or regulatory provisions is not actionable under the version of section 7433 which applies to the RCP project.

as "the decision to impose liability for" a tax, which is not actionable, as opposed to "improper conduct of an agent trying to collect the taxes owed," which is. Shaw, supra.

In the RCP project situation, it appears that any errors committed occurred in the course of discerning whether the subject taxpayers in other words, the errors all appear to have been committed during the assessment stage of the project. According to your memorandum, the only Code sections alleged by to have been violated are sections 3509 and 3402(d). Furthermore, the only Code provisions cited as inconsistently applied in the TIGTA report are sections 3509 and 6020(b). These provisions all pertain to the determination, rather than the collection, of taxes. Thus, any conduct violative of these provisions would not be actionable under section 7433. See, e.g., V-1 Oil Co. v. United States of America, 813 F. Supp. 730, 731 (D. Idaho 1992)(where payment was made voluntarily, no enforced collection occurred and, therefore, no potential violation of I.R.C. § 7433 occurred); Crowd Management Services, Inc. v. United States of America, 792 F. Supp. 87 (D. Ore. 1992), aff'd. in relevant part in unpublished opinion, 1994 U.S. App. LEXIS 24476 (9th Cir. 1994)(even if Service employed wrong test for determination of taxpayer liability, error is not actionable under section 7433 since application of test occurred during determination, rather than collection, of tax). Moreover, section 7433 applies to violations of only the Internal Revenue Code or its regulations. See 1988 U.S.C.C.A.N. at 5289, supra. In this instance, it appears that some of the allegations of Service misconduct focus on the presumed failure to follow procedures established by the Internal Revenue Manual, rather than the Internal Revenue Code or regulations. Such violations of internal procedure are not actionable under section 7433. See Kachougian v. United States of America, 1998 U.S. Dist. LEXIS 2059 (D. R.I. 1998). See also Ludtke v. United States of America, 1999 U.S. Dist. LEXIS 20297 (D. Conn. 1999). For the same reason, any violations of Section 530 of the Revenue Act of 1978 would also not be actionable under section 7433.

Of note is that your memorandum indicates that hearing testimony alleges that [redacted] We do not find any factual support for these allegations in the TIGTA report. However, even if these allegations were valid and the assessments had no appropriate foundation, section 7433 still would not apply since, as noted previously, an improper determination of tax, without more, will not support an action under section 7433. [redacted]

Finally, we note that section 7433 contains its own statute of limitations, in that the provision requires any action to be initiated within two years of the date the right of action accrues. I.R.C. § 7433(d)(3)(1995). In this case, the relevant events clearly

occurred more than two years ago. However, the regulations and case law indicate that, unlike the statute of limitations for a refund action, the limitations period provided by section 7433 does not begin to run until "the taxpayer has had a reasonable opportunity to discover all essential elements of a possible cause of action." Treas. Reg. 301.7433-1(g)(2)(1992); Photographic Assistance Corp., supra. We believe that even if unlawful collection action occurred in this case, the taxpayers involved in the RCP project should have known at the time any questionable assessments were made that the additional taxes were being improperly collected; at the very least, the taxpayers should have inquired as to the Service's basis for making the assessments. Even if [redacted] the taxpayers should have been aware of a potential irregularity at the time the amounts were obtained from them. As a result, even if section 7433 did apply to this situation on substantive grounds, we believe it is arguable that actions under this provision would be procedurally barred because the limitations period would have already run.

In summary, we believe that section 7433 does not apply to the taxpayers affected by the RCP project, primarily because any alleged "irregularities" appear to have occurred in the course of determining, rather than collecting, additional taxes from the subcontractors involved in the project. Our conclusions are based on the descriptions contained in your memorandum of allegations and of the general facts attendant to the group of taxpayers involved in the project.

OFFER IN COMPROMISE; DEFAULT; NOTICE & DEMAND

July 20, 2000

CC:PA:CBS:Br2
GL-501780-00
UILC: 17.15.00-00

MEMORANDUM FOR DISTRICT COUNSEL, MANHATTAN DISTRICT

FROM: Kathryn A. Zuba
Chief, Branch 2 (Collection, Bankruptcy & Summonses)

SUBJECT: Offer in Compromise -

This memorandum responds to your request for advice dated April 28, 2000. This document may not be cited as precedent by taxpayers.

LEGEND:

Year 1
Year 2
Year 3
Year 4

Date A
Date B
Date C
Date D
X
Y
Partnership

ISSUE:

Is the failure to pay a deficiency resulting from a tax year prior to acceptance of an offer in compromise, but for which a notice and demand was issued after acceptance the offer, a violation of the compliance provision of the compromise agreement?

CONCLUSION:

In the compromise agreement, the taxpayer promised to comply with all payment provisions of the Internal Revenue Code for a period of five years after acceptance of the offer. The Code requires that taxes be paid upon notice and demand by the Secretary. The failure to pay violated a payment provision of the Code and, thus, constituted default of the compliance term of the compromise agreement.

BACKGROUND:

On Date A, the Service accepted the taxpayers' offer to compromise their Year 1, Year 2, and Year 4 tax liabilities. At the time the offer was accepted, there was no assessed liability outstanding for the Year 3 tax year. The taxpayers made all payments required under the compromise shortly after acceptance as agreed. The offer in compromise contained the standard term requiring compliance with the tax laws for five years following acceptance of the offer. See Form 656, Offer in Compromise, Item 8(d) (Rev. 1-2000).

In Year 3 and Year 4, the taxpayers were limited partners in Partnership, a TEFRA partnership. The partnership filed a petition with the Tax Court with respect to its Year 3 and Year 4 tax years on Date B. The Tax Court dismissed the case on Date C, and assessments against the taxpayers were made in Date D. The taxpayers claim to have been unaware of the Tax Court proceeding involving Partnership when they reached a compromise with the Service.

When the taxpayers were notified of their tax liability for Year 3, they submitted an offer in compromise for that year. That offer was rejected because the Service believed that the liability could be collected in full. The taxpayers then proposed to make an immediate $X payment and pay the remaining liability through an installment agreement of $Y per month. The district apparently rejected the agreement because it believed that the unpaid assessment for Year 3 placed the taxpayers in default of the prior

compromise. It is unclear from your memorandum what course of action the district proposed pursuing with respect to either the compromise or the Year 3 assessment.

An offer in compromise conclusively settles the tax liability specified in the offer. Temp. Treas. Reg. § 301.7122-1T(d)(5). As the Year 4 income tax liabilities were settled by the prior compromise, the taxpayers are not liable for the assessment relating to that year which resulted from the TEFRA partnership audit. However, the compromise did not cover the tax year Year 3. The taxpayers remain liable for the partnership assessment for that year. The question referred to your office by the district is whether that liability has placed the taxpayers in default of the future compliance provisions of the compromise agreement.

Your office has advised the district that the failure to pay the subsequent assessment may or may not constitute default of the compromise agreement. The question turns on the interpretation of the compliance provision quoted above. You reasoned that the compliance provision is ambiguous. It could be read as a promise: 1) to comply with any filing or payment requirement of the Code which arises during the five years following acceptance of the offer, regardless of the tax period to which the obligation relates, or 2) to comply with any filing or payment requirement relating to the five taxable years following acceptance of the offer. Given this uncertainty, you advised the district to leave the prior offer undisturbed and reach some arrangement with the taxpayer for payment of the subsequent assessment of income taxes for Year 3.

LAW & ANALYSIS:

A compromise under section 7122 of the Internal Revenue Code is recognized as a contract. See United States v. Feinberg, 372 F.2d 352 (3d Cir. 1967); United States v. Lane, 303 F.2d 1 (5th Cir. 1962). As such, the compromise agreement is subject to interpretation using generally accepted contract principles.

The purpose of interpretation is to give the contract the meaning intended by the parties at the time the contract was formed. Corbin on Contracts VII (Rev. ed. 1998). The oldest and most frequently relied upon rule of interpretation is the Plain Meaning Rule. The rule states: "[I]f a writing, or the term in question, appears to be plain and unambiguous on its face, its meaning must be determined from the four corners of the instrument without resort to extrinsic evidence of any nature." John D. Calamari & Joseph M. Perillo, The Law of Contracts 166-67 (3rd ed. 1987).

The provision at issue states, in relevant part:

> I/we will comply with all provisions of the Internal Revenue Code relating to filing my/our returns and paying my/our required taxes for 5 years or until the offered amount is paid in full, whichever is longer.

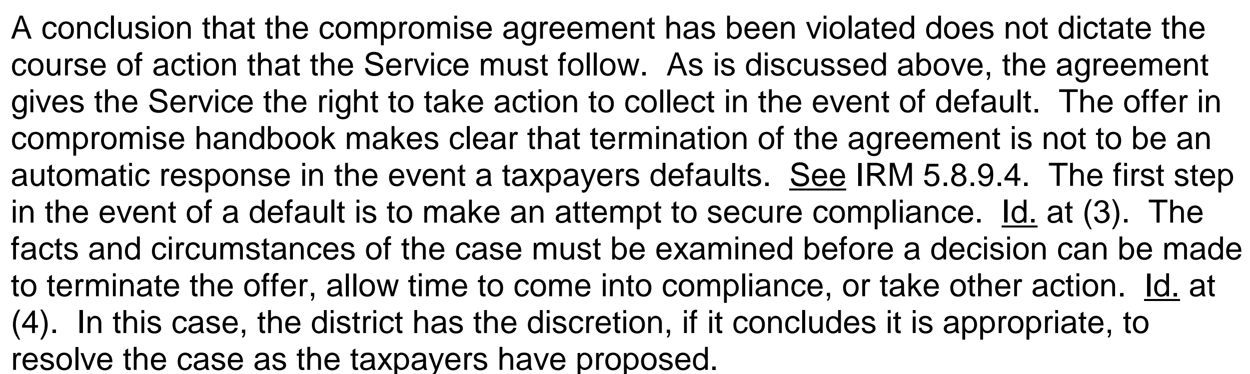
Form 656, Offer in Compromise, Item 8(d) (Rev. 1-2000). Should the taxpayer fail to keep this promise, the Service may terminate the compromise and take action to collect the full balance of the unpaid tax liabilities covered by the compromise. See id. at Item 8(o). The compliance requirement is in keeping with the Service's expectation that a compromising taxpayer will make a fresh start toward future compliance with the tax laws. See Policy Statement P-5-100.

Taking the quoted language at its face, the taxpayer has made a promise to comply with all the filing and payment provisions of the Code. See Restatement (Second) Contracts § 202(3)(a) ("[W]here language has a generally prevailing meaning, it is interpreted in accordance with that meaning."). The promise is not qualified to apply only to particular tax periods, or to exclude obligations relating to past years. The five year time frame is the length of the obligation to comply, and imposes no further limit on the promise. For instance, the term could have expressly stated that the taxpayer will comply with filing and payment obligations "relating to the next 5 tax years." Giving "5 years" the meaning it is commonly understood to have, it expresses a length of time that the promise will be kept.

In this case, a tax liability was determined and assessed against the taxpayers. As the Code requires, the Service sent a notice and demand for payment. See I.R.C. § 6303(a). Upon receipt of the notice and demand, the taxpayers were required to pay the tax shown therein. I.R.C. § 6155(a). The failure to do so violated a payment provision of the Code and constituted default of the compromise agreement.

HAZARDS AND OTHER CONSIDERATIONS

We do not believe that the compliance provision can reasonably be read to be limited only to the five tax years immediately following acceptance of the offer. However, the Plain Meaning Rule has been increasingly criticized in favor of more liberal approached to contract interpretation. See Calamari, supra, at 167. The weight of modern authority would require a court to go beyond an analysis of the plain meaning of the words employed. Commentators and courts have come to realize that no language can be so clear that it is not subject to some dispute regarding its meaning. Id. at 166; Towne v. Eisner, 245 U.S. 418, 425 (1918). The trend in contract interpretation is to focus not solely on the language employed, but to determine the intended meaning by taking into account all relevant extrinsic evidence, regardless of whether a contract term can be said to be ambiguous. See, e.g., Pacific Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co., 442 P.2d 641, 644 (Ca. 1968).



A conclusion that the compromise agreement has been violated does not dictate the course of action that the Service must follow. As is discussed above, the agreement gives the Service the right to take action to collect in the event of default. The offer in compromise handbook makes clear that termination of the agreement is not to be an automatic response in the event a taxpayers defaults. See IRM 5.8.9.4. The first step in the event of a default is to make an attempt to secure compliance. Id. at (3). The facts and circumstances of the case must be examined before a decision can be made to terminate the offer, allow time to come into compliance, or take other action. Id. at (4). In this case, the district has the discretion, if it concludes it is appropriate, to resolve the case as the taxpayers have proposed.

CONCLUSION:

We conclude that the failure to pay a deficiency upon notice and demand is a violation of the Code which constitutes default of the compromise agreement. However, that interpretation of the contract could be subject to dispute. Further, the Service has the discretion to resolve that deficiency through an installment agreement and to leave the compromise undisturbed.