OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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MEMORANDUM FOR DISTRICT COUNSEL,

FROM: Kathryn A. Zuba
Chief, Branch 2 (General Litigation)

SUBJECT:

This memorandum responds to your request for advice dated November 23, 1999. This document is not to be cited as precedent.

LEGEND

X
Y
Year 1
Year 6
Year 9
Date A
Date B
Amount 1
Amount 2
Amount 3
Amount 4
Amount 5

ISSUE

Whether the Service can, in lieu of taking enforced collection action, accept a promissory note and deed of trust in satisfaction of the taxpayers' tax liabilities, and whether the debts secured by such instruments can be collected notwithstanding the statute of limitations for collection in section 6502 of the Internal Revenue Code.

CONCLUSION

The Service can accept a promissory note and deed of trust and can take judicial action to collect on those instruments even after the expiration of the statute of limitations for collection of the taxes at issue. However, the Service's current collection procedures do not contemplate this kind of agreement. We recommend that a Service-wide policy be promulgated prior to utilizing this approach in individual cases.

BACKGROUND

The taxpayers are a married couple, ages X and Y years old, respectively. They have a history of timely filing all returns and of paying all taxes when due. However, in Year 1, taxpayers netted approximately $Amount 1 from the sale of a piece of real property. The proceeds of the sale were used to pay other debts, and an income tax liability of $Amount 2 went unpaid that year. With penalties and interest, that liability now exceeds $Amount 3.

In June of Year 6, the taxpayers were granted an installment agreement for payments of $Amount 4 per month. In February of Year 9, the case was referred back to Field Collection to obtain updated financial information. Since then, the Collection Division has concluded that an installment agreement is no longer an appropriate resolution of the case because full payment of the liability cannot be achieved. In the mean time, the taxpayers have continued to make timely payments under the existing installment agreement.

The taxpayers have twice submitted offers in compromise based on doubt as to collectibility.[1] Both offers were withdrawn because the taxpayers have been unable

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[1] Both offers in compromise contained the standard language waiving and suspending the statute of limitations on collection for the period the offer was pending with the Service and for one additional year. See Form 656, (Rev. 2-1999), Item 8(e) & (n). The effect of these waivers was to extend the collection statute until Date A. However, the amendment of section 6502(a) by the IRS Restructuring and Reform Act of 1998 (RRA) limited the Service's authority to secure such waivers to situations in which the waiver is obtained at the same time as an installment agreement. RRA

to raise the necessary funds to offer an amount equal to the equity in their home, approximately $Amount 5. According to the district, the taxpayers have been unable to borrow against that equity due to their age.

To avoid seizing the taxpayers' residence, the revenue officer proposed to the taxpayers an arrangement whereby the taxpayers would submit to the Service a promissory note secured by a deed of trust, essentially a mortgage, in favor of the United States. In the promissory note, the taxpayers promise to pay $Amount 4 per month until their liability is satisfied. The deed of trust conveys to the United States a security interest in the taxpayers' residence. As it is unlikely that the taxpayers would be able to pay their liability in full given the size of the liability and the age of the taxpayers, the practical effect of this arrangement would be monthly payments by the taxpayers until their deaths, followed by foreclosure and sale of the residence.

DISCUSSION

As you have you have previously advised the district, courts have long recognized that the Service may accept bonds, letters of credit, or mortgages as a means of securing the payment of taxes, and have upheld the Service's right to collect on such instruments as separate debts not subject to the administrative collection procedures set forth in the Internal Revenue Code. See Royal Indemnity Co. v. United States, 313 U.S. 289 (1941); Gulf States Steel Co. v. United States, 287 U.S. 32 (1932); United States v. John Barth Co., 268 U.S. 370 (1929). In these cases, the taxpayers submitted bonds to protect the Government's interests while requests for the abatement of taxes were considered. Each bond gave the United States the unilateral right to demand payment following a determination by the Commissioner of the correct tax due.

In each of these cases, the taxpayers unsuccessfully argued that the statute of limitations for taking administrative collection action, now codified at section 6502 of the Internal Revenue Code, was a defense to collection by the Government pursuant to the bonds issued by the taxpayers. The Court ruled that the bond created a new cause of action, one not subject to the period of limitations for taking administrative collection or bringing suit. See Royal Indemnity, 313 U.S. at 283; Gulf States, 287 U.S. at 39; Barth, 279 U.S. at 374.

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section 3461 also provided that waivers obtained prior to the enactment of RRA, but not in connection with an installment agreement, will expire on the later of the end of original ten year collection statute or December 31, 2002. Since the original collection statute in this case would have expired on Date B, the December 31, 2002, cut-off date applies in this case.

The reasoning of these cases has been expanded to include the collection of debt instruments other than bonds. In Julicher v. Internal Revenue Service, 95-2 U.S.T.C. ¶ 50,379 (USDC, E.D. Pa. 1995), the taxpayer's bank issued an irrevocable letter of credit in favor of the Service. When the Service attempted to collect, the taxpayer sought to enjoin payment because of the expiration of the ten year period provided by section 6502. The court, relying on Barth and Gulf States, held that the letter constituted a new debt in favor of the Government and not subject to the collection restraints of the Code.

The arrangement the district has proposed is most nearly analogous to that executed in United States v. Citizens Bank, 50 F. Supp. 2d 107 (D.R.I. 1999). In that case, the taxpayers, brothers whose business was faced with imminent seizure, executed a promissory note secured by a mortgage on their father's residence. In upholding the Government's right to collect on the note and mortgage, the court summed up the reasoning of these cases as follows:

> The principle to be derived from Barth and Julicher is that where the government suspends the collection of a tax at the request of a taxpayer, who in turn provides the government with security for later payment, the government is not thereafter bound by the statute of limitations applicable to the original obligation. Instead, the government may proceed against the security provided to it in consideration of its earlier forbearance.

Citizens Bank, 50 F. Supp. 2d at 111.[2]

The conclusion that these arrangements can be enforced notwithstanding the statute of limitations on collection contained in section 6502 is not changed by the recent amendment of that section. Section 3461 of the IRS Restructuring and Reform Act of 1998 amended section 6502 by narrowing the circumstances under which the Service could extend the collection statute by agreement. Prior to this amendment, taxpayers and the Service could agree to extend the collection period at any time. However, effective January 1, 2000, the Service and the taxpayer may only agree to extend the statute: 1) if the extension is executed by the taxpayer in exchange for the Service's release of a levy made prior to the expiration of the ten-year collection statute, or 2) if the extension is agreed to at the same time as the taxpayer and the Service enter into an installment agreement under section 6159. I.R.C. § 6502(a)(2).

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[2] It is significant that the mortgage in Citizens Bank gave the Service a security interest in property that was not already subject to the lien created by the failure to pay the tax liability. In the present case, the property which will secure the deed of trust is already subject to the Government's lien and is reachable by levy.

While this amendment to section 6502 limited the ability of the Service to obtain waivers of the collection statute, it did nothing to alter the scope of activities to which this period of limitations applies. In the cases cited above, the courts did not find that the bond constituted a de facto waiver of protections of section 6502. Rather, they held that section 6502 was inapplicable to debt instruments submitted by taxpayers in lieu of administrative collection. Given that this limitations period is inapplicable, we conclude that changes to the section do not impact upon the Service's ability to collect on these kinds of instruments.[3]

A decision to accept a debt instrument designed to facilitate collection after the expiration of the collection statute raises significant policy concerns. Over the years, the Service has adopted several policies that limit action taken to extend collection beyond the ten-year statute of limitations. For example, the Code places no limitation on the length of an extension of the collection statute obtained in conjunction with an installment agreement. However, the Service has adopted a policy of limiting such extensions to just one per tax module and for no longer than five years beyond the end of the original ten year collection period. See IRM 5.14, Installment Agreement Handbook, Section 1.7(2). Note also that the Service could preserve the right to proceed against taxpayers in any case by reducing a claim to judgement prior to the expiration of the ten-year collection statute, but does not do so in all cases. Given that the Service does not always take these steps, even when there may be some future collection potential, we recommend that National Office Collection be consulted prior to taking this course of action. Whether the recent amendment of section 6502 can be read as a statement of Congressional intent that the Service normally collect liabilities within ten years, as you have suggested, is one issue to be considered.

As your memorandum noted, the arrangement proposed by the district will not result in full payment of the tax liability at issue. As such, it is essentially a compromise, subject to section 7122 of the Code and regulations issued pursuant to that section. The taxpayers are offering the sum of a stream of payments plus, at some future time, remaining equity in their personal residence. Should the Service determine that the amount offered is adequate to resolve the taxpayers' liability, the resulting compromise should be executed on a Form 656, Offer in Compromise, in accordance with all of the Service's compromise procedures. As currently written, Service procedures do not contemplate the acceptance of a promissory note and mortgage in compromise of tax liabilities. We suggest that this

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[3] In Barth, the Court did describe the taxpayer's actions as a "waiver" of the statutory limitation period that would have otherwise applied. 279 U.S. at 735. However, it was only a waiver in that the taxpayers chose to postpone collection by executing a debt instrument subject to a different period of limitations. Id. The Court clearly stated that the predecessor section to 6502 "ha[d] no application to the situation following a claim of abatement and the giving of a bond." Id.

kind of departure from standard procedures be undertaken only with the approval of the appropriate National Office officials.

LAW, HAZARDS, AND OTHER CONSIDERATIONS

[redacted]

[redacted][4]

[redacted]

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[4] [redacted]

[redacted]

CONCLUSION

The proposed promissory note and deed of trust resolution of this case is permissible under the law, and would create a new debt, enforceable by its terms. However, the proposal represents a significant departure from Service policy with regard to collection in this kind of case. We will bring the issues raised by your request to the attention of Collection and ask that they consider whether agreements such as that proposed here would be helpful in resolving difficult cases.

If you have any questions, please contact the attorney assigned to this case at (202) 622-3620.

cc. Assistant Regional Counsel (GL),