Number: 200148053 **_NOT-152875-01/CC:PA:CBS:B2_**
Release Date: 11/30/2001 **_UIL: 9999.98-00_**

OCTOBER 2001 ***BULLETIN NO. 493***

COLLECTION, BANKRUPTCY AND SUMMONSES BULLETIN

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

Trustee Does Not "Commence Distribution" Until Bankruptcy Court Approves Final Report

In its disposition of a somewhat novel issue, the United States Court of Appeals for the Fifth Circuit decided that a Chapter 7 trustee did not "commence distribution" of assets until the bankruptcy court approved the trustee's final report and accounting, giving the Service's claims priority status. Security State Bank v. IRS (In re Milton Van Gerpen), No. 00-40866 (5th Cir., October 10, 2001).

The taxpayer-debtor filed a Chapter 7 petition in May 1997. The trustee subsequently paid certain administrative expenses incurred by the bankruptcy estate. Thereafter, the bankruptcy court set a claim bar date of June 15, 1998. In January 1999, the taxpayer-debtor filed two claims on the Service's behalf, and the Service submitted a claim of its own. Another creditor, Security State Bank, objected to the claims on the grounds that they were untimely and were not entitled to priority status. The Service argued that because the claims were filed before the trustee "commenced distribution" of estate assets, within the meaning of B.C. § 726(a)(1), the claims were entitled to priority status. Security responded that by making payments to administrative creditors, the trustee "commenced distribution" prior to the time the Service's claims were filed.

Upholding the decisions of the bankruptcy and district courts, the Fifth Circuit held in the Service's favor. Initially, the court noted that Section 726(a)(1) affords first priority in payment to claims entitled to priority pursuant to B.C. § 507 which are filed before the trustee "commences distribution." The court then determined that the term "commences distribution" is a term of art in bankruptcy law, in that the word "distribution," as opposed to "disbursement," applies only to "the final liquidation of the estate." The court noted that a less restrictive definition of "distribution," given that trustees are already permitted to pay some administrative expenses without providing notice to creditors, would result in a situation where creditors, without their knowledge, were barred from filing timely claims. The court concluded that "the appropriate interpretation of 'commences distribution' ... is the date when a bankruptcy court approves the trustee's final report, ... thus allowing the trustee to commence final distribution of the estate."

BANKRUPTCY CODE CASES: Chapter 7 (Liquidation): Distribution of property of the estate: Priority claims

Proofs of claim: Time for filing

CASES

1. **BANKRUPTCY CODE CASES: Chapter 7 (Liquidation)**
Exceptions to discharge
Turnover of property of the estate
In re Carlson, 263 F.2d 748 (7th Cir., August 31, 2001) – Debtor, an attorney, was properly denied a discharge pursuant to B.C. § 727(a)(4)(A) in light of his failure to inform the trustee of his interest in a previously-earned contingency fee, which he improperly transferred to his partner and which constituted property of the bankruptcy estate.

2. **BANKRUPTCY CODE CASES: Exceptions to discharge: No, late, or fraudulent returns – "tainted taxes"**
In re Sgarlat, 2001 Bankr. LEXIS 244 (Bankr. M.D. Fla., September 28, 2001) – Court determined, based on the record as a whole, that taxpayer's filing of documents purporting to be "returns" after Service prepared substitute returns for and assessed the relevant liabilities did not constitute "an honest and reasonable attempt ... to satisfy the requirements of the tax law" sufficient to overcome the exception to discharge provided by B.C. § 523(a)(1)(B)(i).

3. **BANKRUPTCY CODE CASES: Priorities: Income taxes**
In re Pattalochi, 2001 Bankr. LEXIS 1241 (Bankr. D. Wyo., September 17, 2001) – In a case controlled by In re Richards, 994 F.2d 763 (10th Cir. 1993), a bankruptcy court held that B.C. § 105(a) applied, as a matter of law, to suspend the running of the three-year priority period provided by B.C. 507(a)(8)(A)(i) for the duration of a prior bankruptcy, but that B.C. § 108(c) did not apply to afford the Service an additional six-month "tack-on" period as provided by I.R.C. § 6503(h). Thus, the Service's claim for one of the years at issue was not entitled to priority status.

4. **BANKRUPTCY CODE CASES: Property of the estate: Turnover to trustee**
In re Metcalf, 2001 Bankr. LEXIS 1231 (Bankr. N.D. Tex., August 17, 2001) – Under locally controlling case law, taxpayer's prepetition election to have overpayment credited to future tax year was irrevocable. Accordingly, refund was not property of the estate subject to turnover.

5. **BANKRUPTCY CODE CASES: Setoff: Refunds**
In re Ramirez, 266 B.R. 441 (Bankr. D. Minn., September 12, 2001) – Since a taxing authority's obligation to pay a refund arises on the last day of the tax year, state department of revenue properly offset of a refund for 1999 against a liability

for 1994, given that the taxpayer did not file his bankruptcy petition until April 10, 2000, and did not file his state tax return for 1999 until April 17, 2000. Because the taxing authority's right to effect the setoff arose before the bankruptcy commenced, its rights were unaffected by the Bankruptcy Code.

6. **COLLECTION DUE PROCESS**

Sarrell v. Commissioner, 117 T.C. No. 11 (September 25, 2001) – Where petition for Tax Court review of Notice of Determination was not received within 30 days of time Notice was issued, pursuant to I.R.C. § 6330(d)(1), petition was viewed as untimely; accordingly, Tax Court lacked jurisdiction over petition and granted Service's motion to dismiss. Taxpayer could not avail himself of the "timely mailing, timely filing" rule set forth in I.R.C. § 7502(a) since the rule does not apply to documents mailed from post offices outside the United States, as was taxpayer's petition.

7. **COLLECTION DUE PROCESS**

Boyd v. Commissioner, 117 T.C. No. 12 (September 29, 2001) – Pursuant to I.R.C. § 6330(e), statute of limitations for collection was suspended between the time the taxpayer requested a CDP hearing and the time a Notice of Determination was issued, regardless of the fact that the taxpayer did not actively pursue his case or attend the hearing.

8. **COLLECTION DUE PROCESS**

Lindsay v. Commissioner, T.C. Memo 2001-285 (October 15, 2001) – Where taxpayer never raised the issue of whether he actually received a Notice of Deficiency, Tax Court upheld Notice of Determination stating that, pursuant to I.R.C. § 6330(c)(2), taxpayer was precluded from raising issues related to the underlying tax liability since a Notice of Deficiency had been issued, providing the taxpayer with an earlier opportunity to contest the tax liability.

9. **DAMAGES, SUITS FOR: Against U.S.: Unauthorized Collection**
LEVY: Sale: Suit for damages
SUITS: Against the U.S. or employees

Kabakjian v. United States, 2001 U.S. App. LEXIS 21235 (3d Cir., October 1, 2001) – District court had jurisdiction over quiet title action brought after the subject property was sold, since liens against taxpayers had not yet been released when the lawsuit was filed. Moreover, district court retained jurisdiction even after the liens were released, since jurisdiction under 28 U.S.C. § 2410 is properly determined at the time the suit is filed. However, quiet title claim was properly dismissed since the sale proceedings were "substantially" in accordance with law, as required by I.R.C. § 6339(b)(2). Moreover, since taxpayers failed to demonstrate any actual economic harm sustained as a result of the Service's allegedly improper actions, their claim under I.R.C. § 7433 was without merit.

10. LEVY: Failure to surrender property
Service

United States v. Park Forest Care Center, Inc., 2001 U.S. Dist. LEXIS 16330 (D. Colo., September 13, 2001) – Proper service of Notice of Levy on taxpayer's wages, which was made on taxpayer's employer's bookkeeper, was not undermined by the fact that the bookkeeper allegedly gave the unopened notice to the taxpayer, the employer's financial comptroller, and taxpayer allegedly never informed her employer of the Notice of Levy. This is especially the case since the employer never produced any evidence to rebut the sufficiency of the service or to substantiate the assertion that the bookkeeper forwarded the unopened Notice to the taxpayer.

11. LIENS: After-acquired property
Filing: Place to file: Personal property

In re Eschenbach, 2001 Bankr. LEXIS 1216 (Bankr. N.D. Tex., September 14, 2001) – Federal tax lien against taxpayers' personal property properly filed in the appropriate county in Florida, where the taxpayers were living at the time of filing, attached to personal property acquired after their subsequent move to Texas, regardless of the fact that no lien was filed in Texas, since the liability underlying the lien remained unsatisfied and the statutory time for collection had not elapsed.

12. LIENS: Non-judicial sale: Discharge of property from

Orme v. United States, 2001 U.S. App. LEXIS 22483 (9th Cir., October 18, 2001) – Taxpayers' forfeiture of land sale contract, where federal tax lien attached to the land at issue, constituted a "nonjudicial sale" subject to I.R.C. § 7425. Because the parties did not comply with the notice requirements imposed by Section 7425(b), the federal tax lien was not discharged upon the forfeiture and the owners of the property took back the land subject to the lien.

13. LIENS: Priority over setoff right

Superpumper, Inc. v. Nerland Oil Co., Inc., 2001 U.S. Dist. LEXIS 8073 (D.N.D., June 13, 2001) – Since Service's liens against oil company were choate before any setoff right on the part of another creditor of oil company arose, Service is entitled to funds allegedly subject to setoff. Creditor was not a "purchaser" with priority over the Service since creditor's interest was not that of a purchaser as defined by statute.

14. LIMITATIONS: Assessment and Collection: Waivers
PAYMENT: Application of payment
What constitutes

Malachinski v. Commissioner, 2001 U.S. App. LEXIS 21453 (7th Cir., October 4, 2001) – Tax Court did not err in determining that the relevant evidence failed to support the taxpayer's contention that his consent to extend the statute of limitations on collection was forged by his ex-wife, despite the fact that his ex-wife was serving jail time for participating in a murder-for-hire plot against the taxpayer. Moreover, Tax Court properly determined that an amount the taxpayer sent the Service constituted a deposit on a liability other than the one at issue before the Court, and that the Court accordingly lacked jurisdiction to decide whether the taxpayer was entitled to a credit against the subject liability for that amount.

15. PAYMENT: Installment payments
United States v. Stinson, 2001 U.S. Dist. LEXIS 16401 (W.D. Pa., September 18, 2001) – Service was entitled to reduce an assessment to judgment since I.R.C. § 6331(k)(2), which prohibits the Service from instituting a levy while a valid installment agreement is in effect, does not apply to this case, given that the installment agreement here was signed and payroll deductions pursuant thereto began in April 1998, prior to the effective date of Section 6331(k)(2).

16. PENALTIES: Failure to collect, withhold, or pay over: Responsible officer
United States v. Hankins, No NA 99-0013-C-B/G (S.D. Ind., August 29, 2001) – Where person identified as responsible officer failed to even allege either that he was not responsible for paying or did not willfully fail to pay employment taxes, and where he failed to provide any factual or legal support for his request that the Service refund to him all amounts obtained by levy, Government's motion for summary judgment was granted.

17. PROPERTY SUBJECT TO COLLECTION: Executory contract of sale
United States v. Jepsen, 2001 U.S. App. LEXIS 21628 (8th Cir., October 10, 2001) – Where taxpayer, at the time he conveyed real property to his children, did not intend to make the property a gift, but instead intended to sell them the property with payments to come later, he retained an interest in the property which was subject to a subsequently-filed federal tax lien.

18. SUMMONSES: Defenses to Compliance: Privileges: Accountant-client
Cavallaro v. United States, 153 F. Supp. 2d 52 (D. Mass., July 27, 2001) – In a pre-RRA case, taxpayers did not establish documents prepared by accounting firm were privileged, since they did not demonstrate that the accounting firm was hired to assist their attorneys in providing legal advice. Moreover, the documents were not protected by the "common interest" doctrine since not all parties to the subject litigation were represented by counsel.

19. TRANSFEREES AND FRAUDULENT CONVEYANCES
Eddie Cordes, Inc. v. Commissioner, T.C. Memo. 2001-265 (October 4, 2001) – Corporation was a transferee liable for predecessor corporation's tax debt in its entirety since corporation failed to show whether and to what extent its liability should be limited. Since corporation was a transferee at law, Service was not required to establish the value of the assets corporation received from the taxpayer at the time of merger in order to sustain its burden of proving transferee liability.

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

CHIEF COUNSEL ADVICE

BANKRUPTCY CODE CASES: Refunds: Erroneous

CC:PA:CBS:RCGrosenick
June 5, 2001
GL-100935-01
UIL: 09.35.02-00

MEMORANDUM FOR MARK H. HOWARD
ASSOCIATE AREA COUNSEL - SALT LAKE CITY (CC:SB:5:SLC)

FROM: Joseph W. Clark
Senior Technician Reviewer, Branch 2 (CBS)

SUBJECT:

This Chief Counsel Advice responds to your request for assistance dated March 30, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

LEGEND:

Date A:
Date B:
Date C:
Date D:
Date E:
Date F:
Taxpayer:
Attorney:
Amount Z:
Amount Y:

ISSUES:

1. If an erroneous refund was generated by the abatement of dischargeable liabilities pursuant to a Chapter 7 discharge, but prior to a distribution by the trustee of funds

that should have been applied to those dischargeable liabilities, is a reversal of the abatement permissible?

2. If so, whether a reversal of abatement would violate the discharge injunction?

3. Whether the filing of a suit to collect the erroneous refund violates the discharge injunction of B.C. § 524(a)(2)?

CONCLUSIONS:

- The abatement of dischargeable liabilities may be reversed.
- Reversal of the abatement does not violate the discharge injunction.
- Filing suit to collect an erroneous refund generated from an abatement of dischargeable liabilities may violate the discharge injunction of B.C. § 524(a)(2).

FACTS:

On Date A, Taxpayer and his wife filed a Chapter 7 bankruptcy, receiving a discharge on Date B. On Date C, the Service received a Notice of Assets from the Chapter 7 Trustee, requesting that creditors file proofs of claim in the case. Responding to the discharge order, on Date D, the Service abated the assessments for Taxpayer for the taxable years 1988, 1989 and 1990, plus a frivolous filing penalty under I.R.C. § 6702 for the year 1989.

In response to the Notice of Assets, on Date E, the Service filed a proof of claim, which resulted in a distribution to the Service of $ Amount Z. Because the assessments for some of the periods had already been abated, the application of the $ Amount Z to Taxpayer's account resulted in an erroneous refund of $ Amount Y, which the Service was unable to intercept at the time the mistake was discovered. The refund check was negotiated on Date F, endorsed by "Taxpayer," and stating "Pay to the order of: Attorney." Attorney is thought to be Taxpayer's attorney.

LAW AND ANALYSIS:

- The abatement of dischargeable liabilities may be reversed.

To understand the legal effect of an abatement, it is essential to first understand the legal effect of an assessment. Assessments do not create tax liabilities. Rather, assessments reflect the Service's judgment of what taxes are owed. Cohen v. Mayer, 199 F. Supp. 331, 332 (D.N.J. 1961) affirmed sub nom. Cohen v. Gross, 316 F.2d 521 (3rd Cir. 1963) ("assessment is a prescribed procedure for officially recording the fact and the amount of a taxpayer's administratively determined tax liability, with consequences somewhat similar to the reduction of a claim of judgment"). Taxpayers are liable for taxes, however, whether or not the Service assesses them. I.R.C. § 6501(a) (Service must either assess or bring proceedings in court without assessment within three years after the return is filed). See Ewing v. U.S., 914 F.2d

499, 502-03 (4th Cir. 1990), cert. denied 500 U.S. 905 (1991) (rejecting taxpayer's argument that, prior to assessment, there can be no tax liability and therefore no "payment" of taxes).

Just as assessments do not create a tax liability, neither does the abatement of an assessment extinguish a liability. The authority to abate assessments is contained in section 6404, which provides, in relevant part:

> (a) **GENERAL RULE.**—The Secretary is authorized to abate the unpaid portion of the assessment of any tax or any liability in respect thereof, which---
>
> (1) is excessive in amount, or
> (2) is assessed after the expiration of the period of limitations properly applicable thereto, or
> (3) is erroneously or illegally assessed.
>
> * * *
>
> (c) **SMALL TAX BALANCES.**—The Secretary is authorized to abate the unpaid portion of the assessment of any tax, or any liability in respect thereof, if the Secretary determines under uniform rules prescribed by the Secretary that the administration and collection costs involved would not warrant collection of the amount due.

The plain language of the statute authorizes the abatement of assessments, not liabilities. Section 6404(a) authorizes the Service to abate "the unpaid portion of the assessment of any tax or any liability in respect thereof." Likewise, section 6404(c) begins "The Secretary is authorized to abate the unpaid portion of the assessment of any tax, or any liability in respect thereof." These introductory clauses refer to abating the unpaid portion of the assessment of either "any tax" or any "liability in respect thereof." They do not refer to abating the liability.

Section 6404(c) authorizes the Service to abate the unpaid portion of any assessment when the Service decides "under uniform rules prescribed by the Secretary that the administration and collection costs involved would not warrant collection of the amount due." This abatement has nothing to do with a judgment about whether the assessment reflects the taxpayer's true liability; it only represents the Service's judgment that collecting the account is not cost-effective.[1] In effect the Service excuses its collector's obligation to account for the tax liability, but does not excuse the taxpayer's liability. See Crompton-Richmond v. U.S., 311 F. Supp. 1184, 1186 (S.D.N.Y. 1970) (Service can revive an assessment abated under section 6404(c) because the abatement of an uncollectible tax does not cancel the tax). See also Carlin v. U.S., 100 F. Supp. 451, 454-55 (Ct. Cl. 1951) (IRS cannot relieve a taxpayer of tax liability merely because it is uncollectible, but can only abate it as a bookkeeping entry); Sugar Run Coal Mining v. U.S., 21 F. Supp. 10, 12 (E.D. Pa. 1937) (an

[1] Treas. Reg. 301.6404-1(d) delegates to the Commissioner the authority to prescribe the uniform rules for making a section 6404(c) determination. As discussed infra, the Service has embodied the procedures for bankruptcy discharge determinations in the Bankruptcy Handbook, IRM 5.9.

abatement made because of a collectibility determination does not extinguish the liability).

Because the section 6404(c) abatement is made on the basis of collectibility and not because the liability was improperly assessed, money may still later be collected, so long as the collection limitations period is open. The Service may account for the collection by entering a debit to reverse the prior credit transaction.

- Reversal of the abatement does not violate the discharge injunction.

A debtor who successfully completes the bankruptcy process is discharged from all pre-bankruptcy debts.[2] B.C. §§ 727, 944, 1141, 1228, 1328. The discharge order discharges the debtor from a personal obligation to pay and creates an injunction barring creditors from attempting to collect discharged debts from the debtor personally. B.C. § 524(a)(1), (2). The discharge does not destroy the pre-petition liability, however. Johnson v. Home State Bank, 501 U.S. 78, 84, 111 S. Ct. 2150 (1991) ("a bankruptcy discharge extinguishes only one mode of enforcing a claim -- namely, an action against the debtor in personam"); see also In re Conston, 181 B.R. 769, 773 (D. Del. 1995) (collecting cases). While the Service may continue to collect non-discharged taxes from all of the debtor's property or rights to property, it may collect discharged taxes only from pre-petition property to which a tax lien is still attached.

When the Service learns of a taxpayer's discharge from bankruptcy, the Insolvency function Tax Examiner or Bankruptcy Specialist evaluates the taxpayer's various tax liabilities to decide which have been discharged by the bankruptcy. See generally IRM 5.9.12.5 (describing procedures for evaluating and processing discharge). If the Insolvency employee decides that the costs of working the case do not warrant collection of the amounts involved, then the Insolvency employee must bring the balance due in each discharged tax liability module to zero by inputting adjusting credit Transaction Codes (TCs) to offset whatever debit TCs were used to account for the liabilities. Because the Service's accounting system is designed so that a prior transaction is never erased or extinguished or eliminated from the record, the abatement always takes the form of a credit transaction entered to bring the balance due to zero.[3]

[2] Some debts may be excepted from discharge. B.C. § 523.

[3] Although the Insolvency employee does make a collectibility determination, the freeze code TC 530 cannot be used because (1) that would shut down collection on every tax module of the entire account and (2) the eventual reversal of the TC 530 would cause collection to commence against all of the taxpayer's property. Only by abating specific tax assessments (the ones for discharged taxes) can the Insolvency employee continue to collect the nondischarged taxes and, if the opportunity arises, collect the discharged taxes out of the property to which the lien for those taxes still attaches.

Adjustments made to account for bankruptcy discharges are abatements made pursuant to section 6404(c). A section 6404(c) adjustment is caused by the Service's decision that, despite section 6301's direction to collect taxes, it is not in the public interest to collect a particular liability because of the costs involved. Such abatements do not extinguish an otherwise valid tax liability, regardless of the reason for the abatement. While the bankruptcy discharge affects the Service's ability to collect the discharged liability, it does not extinguish either the underlying liability or those tax liens which have otherwise survived the bankruptcy. Since the underlying tax liability exists after bankruptcy discharge, it also exists after the assessments for the discharged taxes are abated. To account for the later collection, the section 6404(c) abatement may be reversed.

The discharge injunction of B.C. § 524(a)(2) prohibits the commencement or continuation of any act to collect, recover or offset any discharged debt from the debtor personally. Because the reversal of an abatement is, as explained above, not a collection action but merely a bookkeeping function, it is not a violation of the discharge injunction.

- Filing suit to collect an erroneous refund generated from an abatement of dischargeable liabilities may violate the discharge injunction of B.C. § 524(a)(2).

The term "refund" within the phrase "erroneous refund" refers to any erroneous dispersal of money by the Service, whether or not that money has previously been paid in. See, e.g., United States v. Steel Furniture Co., 74 F.2d 744 (6th Cir. 1935) (erroneous payment of interest on a valid refund constitutes an erroneous refund for purposes of I.R.C. § 7405). An "erroneous" refund includes any receipt of money from the Service to which the recipient is not entitled, regardless of whether the recipient is the person whom the Service intended to received the refund or, whether the recipient is a taxpayer, or a third party. See, e.g., deRochemont v. United States, 23 Ct. Cl. 80 (Cl. Ct. 1991).

A "nonrebate" erroneous refund occurs not as a result of a redetermination of the taxpayer's liability, but rather, as a result of a clerical or ministerial error. Nonrebate erroneous refunds can only be recovered through voluntary repayment, civil suit, or right of offset. The Service may not initiate any administrative collection action to recover a nonrebate erroneous refund, because there has been no assessment of that amount. Thus, the Service may not file a Notice of Federal Tax Lien, or issue a levy or notice of seizure for the amount erroneously refunded. The Service may, however, continue to administratively collect any unpaid portion of the original assessment, regardless of whether an erroneous refund was generated on the particular tax module in question. See United States v. Wilkes, 946 F.2d 1143, 1152 (5th Cir. 1991).

As previously noted, the discharge injunction of B.C. § 524(a)(2) prohibits the Service from collecting dischargeable debts from the debtor personally. However, the discharge injunction does not extend to debts which arise after the date of the order for relief. See B.C. § 727(b). The filing of an erroneous refund suit in this instance would be an action to collect a post-petition debt, and so not subject to the discharge injunction. This is because an erroneous refund creates a new debt. See Clark v. United States, 63 F.3d 83 (1st Cir. 1995); O'Bryant v. United States, 49 F.3d 340 (7th Cir. 1995). Thus, an erroneous refund issued and received by the debtors post-petition, like any other tax liability incurred by the debtor post-petition, is nondischargeable. See In re Ryan, 78 B.R. 175 (Bankr. E.D. Tenn. 1987) (debts which became payable by a Chapter 13 debtor post-petition are not discharged by the debtor's completion of plan); Bleak v. United States, 817 F.2d 1368 (9th Cir. 1987) (chapter 7 debtor's liability stemming from an erroneous refund nondischargeable under B.C. § 523(a)(1)(A)).[4] See also In re Campbell, 1990 Bankr. LEXIS 2922 (Bankr. D. Colo. 1990) (Service was entitled to return of an erroneous refund paid to a chapter 7 debtor post-petition).

Nor does the discharge injunction affect the ability of the Service to proceed against the debtor in rem. In re Wrenn, 40 F.3d 1162, 1164 (11th Cir. 1994). In United States v. Buckner, 2001 U.S. Dist. LEXIS 5861 (N.D. Ind. Apr. 10, 2001) adopting magistrate's recommendation 2001 U.S. Dist. LEXIS 5327 (Mar. 14, 2001), the Service levied on a retirement plan, but the debtor filed Chapter 7 bankruptcy before the fundholder replied to the levy. When the debtor's taxes were discharged under B.C. § 507(a)(8) and § 523(a)(1), the Service abated the corresponding assessments. The court held that the section 6404(c) abatements did not extinguish the debtor's liability and that the Service could reverse the abatements. Because the Service never

[4] But cf. In re Jackson, 253 B.R. 570 (M.D. Ala. 2000) (Bleak decided under former version of section 507(c) that read erroneous refund would "be treated the same" as the tax; current version gives the claim the "same priority." Therefore, erroneous pre-petition refund not excepted from discharge under section 523(a)(1)(A)).

released its levy on the retirement plan, which remained outside the bankruptcy estate, the Service could collect the funds.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

The discharge injunction of B.C. § 524(a)(2) prohibits the commencement or continuation of any act to collect, recover or offset any discharged debt. While the bankruptcy discharge affects the Service's ability to collect the discharged liability from the debtor personally, it does not extinguish either the underlying liability or those tax liens which have otherwise survived the bankruptcy. I.R.C. § 6404(c) permits the Service to abate a tax assessment to reflect an administrative determination that collection of a tax is economically unfeasible due to a bankruptcy discharge. Should collection become feasible within the statutory collection period, a section 6404(c) abatement may be reversed without violating the discharge injunction in bankruptcy. The Service then may proceed to collect by the filing of an erroneous refund suit. Because such a suit is an effort to collect a post-petition debt, it does not violate the discharge injunction.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges such as the attorney-client privilege. If disclosure becomes necessary, please contact this office for our views.

If you have any questions, please contact Richard Charles Grosenick at 202/622-3620.

COMPROMISE AND SETTLEMENT: Waiver provisions

September 18, 2001

CC:PA:CBS:Br2
GL-133269-01

UILC: 17.44.00-00

MEMORANDUM FOR ASSOCIATE AREA COUNSEL (SB/SE), AREA 2, NEWARK

FROM: Lawrence H. Schattner
Chief, Branch 2 (Collection, Bankruptcy & Summonses)

SUBJECT: Effect of Offers in Compromise on Collection Statute of Limitations

This Chief Counsel Advice responds to your request dated June 13, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

ISSUE:

Whether the completion of a second Form 656, Offer in Compromise, by a taxpayer prior to the Service having had an opportunity to consider the offer has the effect of rescinding the waiver of the collection statute of limitations contained in the original Form 656.

CONCLUSION:

An agreement on the part of the taxpayer to extend the collection statute is a unilateral waiver of a defense by the taxpayer. Because execution of the waiver was a unilateral act on the part of the taxpayer and not a contract for which consideration is necessary, the Service's failure to act on the compromise has no effect on the validity or effect of the waiver.

BACKGROUND:

It has long been the policy of the Internal Revenue Service to suspend enforced collection efforts when a taxpayer submits an offer in compromise, unless collection of the tax would be jeopardized or the offer was made merely as a delay tactic. See Policy Statement P-5-97 (Approved July 10, 1959); Treas. Reg. § 301.7122-1(d)(2) (1960). To insure that the Government's eventual ability to collect was not harmed by withholding collection efforts, consideration of an offer was conditioned upon the execution by the taxpayer of a waiver of the statute of limitations for collection for the period the offer was being considered, while any term of an accepted offer was not completed, and for one additional year. See Treas. Reg. § 301.7122-1(f) (1960); Form 656, Offer in Compromise, Item 8(e) & (n) (Rev. 1-97).

The IRS Restructuring and Reform Act of 1998 (RRA) required several changes to this scheme. First, RRA section 3462 codified the practice of withholding collection while an offer to compromise is being considered by adding section 6331(k) to the Code. See P.L. 105-206, 112 Stat. 685, 764 (1998). Effective January 1, 2000, that section prohibits levy while an offer is pending, for thirty days after an offer is rejected, and while a timely filed appeal of that rejection is pending with the IRS Office of Appeals. See I.R.C. § 6331(k)(1); Temp. Treas. Reg. § 301.7122-1T(f)(2).

Second, RRA section 3461 amended section 6502 of the Code, also effective as of January 1, 2000, to limit the Service's ability to secure from taxpayers agreements to extend the statutory period for collection. See P.L. 105-206, 112 Stat. 685, 763-64 (1998). The Service and taxpayers can now only agree to an extension of the statute of limitations for collection under 6502(a) in two circumstances: 1) the extension is agreed to at the same time as an installment agreement between the taxpayer and the Service, or 2) the extension is agreed to prior to a release of levy under section 6343 which occurs after the expiration of the statutory ten year period for collection. See I.R.C. § 6502(a)(2).

Finally, RRA contained a non-Code "sunset" provision which governs the continued effect of waivers of the collection statute executed prior to January 1, 2000. If a waiver was secured in conjunction with the granting of an installment agreement, the period for collection will expire ninety days after the date specified in the waiver. If the waiver was not obtained at the same time as an installment agreement, the period for collection will expire not later than December 31, 2002, or the end of the original collection statute if it would have occurred after that date. See RRA § 3461(c)(2).

The Service's policies and procedures for the consideration and disposition of offers in compromise have been revised to reflect these changes in the law. However, some confusion exists with respect to the effect these changes in the law will have on offers that were accepted for processing prior to December 31, 1999, but remained pending after that date. Because the Service was authorized to secure waivers of the statute of limitations at the time the Forms 656 in such cases were submitted, those waivers had the effect of extending the time during which the Service can collect, subject to the "sunset" provision described above. For compromises submitted prior to December 31, 1999, but pending after that date, the Service's practice is to secure new forms. Forms 656 with revision dates of January 2000 or later include several changes to the terms of the offer. The securing of new forms insures that all offers accepted after these policy changes are subject to the revised terms and conditions. Consistent with the changes made by RRA, the revised forms do not contain language waiving the collection statute.

Your office has asked whether the submission of the new form prior to the Service's taking action on the offer has the effect of rescinding the previously executed waiver of the collection statute. For the reasons stated below, we conclude that the subsequent submission of a revised Form 656 has no effect on an otherwise valid waiver of the collection statute contained in the original Form 656.

DISCUSSION:

As is discussed above, prior to the enactment of RRA, the Service could extend the statute of limitations under section 6502 of the Code by agreement with the taxpayer at any time prior to the expiration of the ten-year statutory period. The statutory period, once extended, could be further extended by agreement at any time prior to the expiration date specified in the previous agreement. These agreements took the form of a waiver of the collection statute by the taxpayer, most often accomplished through a Form 900, Tax Collection Waiver. Although the statute refers to an extension by agreement, the courts have uniformly held that, since the statute of limitations is a defense available to the taxpayer in the event the Service attempts to collect beyond the statutory time period, extension of the time to collect is accomplished via a unilateral waiver of that defense by the taxpayer, and that a tax collection waiver is not a contract. See Strange v. United States, 282 U.S. 270, 276 (1931); Florsheim Bros. Drygoods Co. v. United States, 280 U.S. 453, 468 (1930).

Your request acknowledges this principle, but focuses on language in several lower court opinions stating that waiver of the collection statute is a "quid pro quo" for consideration of the offer. See United States v. Harris Trust & Sav. Bank, 390 F.2d 285, 288 (7th Cir. 1968); United States v. Havner, 101 F.2d 161, 163 (8th Cir. 1939). You conclude that since the waiver was in exchange for consideration of the offer, failure to consider the offer prior to a new form being submitted changed the effect of the previously signed waiver.

We cannot agree with this conclusion. The Seventh Circuit faced this precise argument in a later case than that cited above. The taxpayer submitted an offer in compromise based on doubt as to liability, which included the waiver language. The Service eventually rejected the offer because liability has been established in a prior court judgment.[1] The taxpayer argued that since rejection was preordained, the Service's agreement to consider the offer was illusory and that the waiver executed in exchange for such consideration was therefore unenforceable. In revisiting its opinion in Harris Trust, the court stated that the "quid pro quo" language should not be read in contractual terms: "Harris Trust does not state that contract principles govern the validity of a waiver and, of course, it could not do so without directly contradicting the Supreme Court's decisions in Florsheim Bros. and Stange." United States v. McGaughey, 977 F.2d 1067, 1073 (7th Cir 1992).

The court's conclusion was perhaps made less clear by what it went on to say. The court concluded that the waiver was valid "because contract principles do not apply and because the IRS did consider the offer, even if rejection was preordained." Id. (emphasis added). While this could be read to indicate that the failure to consider the offer would have had some effect on the validity of the waiver, we believe, reading the statement in context, it was more of a signal from the court that the waiver would have been found valid even if some quid pro quo on the part of the Service was needed.

We think the same can be said of the scenario you have presented. When the offer was countersigned by a Service official with authority to acknowledge the waiver, the offer became "pending." Although not required by law prior to January 1, 2000, the Service suspended collection by levy so that the offer could be processed and considered. Even if the Service had not yet begun to weigh the merits of the offer, this stay of collection by the Service was a benefit to the taxpayer. No such benefit flowing from the Service to the taxpayer would be needed for the waiver to be valid. The existence of such a benefit, however, undercuts any suggestion that the taxpayer would not have signed the waiver had he known that the offer would not immediately be considered on its merits.

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

LIMITATIONS: Assessment and collection

July 10, 2001

[1] See Treas. Reg. § 301.7122-1T(b)(2) ("Doubt as to liability does not exist where the liability has been established by a final court decision or judgment concerning the existence or amount of the liability.")

CC:PA:CBS:BO1
TL-N-3430-01
UIL: 52.00.00-00

MEMORANDUM FOR ASSOCIATE AREA COUNSEL BROOKLYN CC:SB:1:BRK
ATTN: Patricia A. Rieger

FROM: Michael A. Arner
Senior Technician Reviewer, Branch 1
Collection, Bankruptcy & Summonses CC:PA:CBS:BO1

SUBJECT: IRM Procedural Update 00230

This responds to your memorandum dated June 28, 2001. In accordance with I.R.C. § 6110(k)(3), it should not be cited as precedent.

ISSUE

Whether I.R.C. § 6502(a)(1) overrides the plain wording of I.R.C. § 6501(b)(3), which provides that the Service's execution of a return under I.R.C. § 6020(b) shall not start the running of the period for assessment and collection?

CONCLUSION

Section 6502(a)(1) neither conflicts with nor changes the plain wording of section 6501(b)(3).

BACKGROUND

IRM Procedural Update 00230 provides that the CSED shall be calculated from the date of the taxpayer's late-filed return showing a smaller tax liability than the amount assessed under the deficiency procedures.

DISCUSSION

Section 6020(b)(2) provides that "[a]ny return so made [the section 6020(b) return] and subscribed by the Secretary shall be prima facie good and sufficient for all legal purposes.

Section 6501(b)(3) provides that "[n]otwithstanding the provisions of paragraph (2) of section 6020(b), the execution of a return by the Secretary pursuant to the authority conferred by such section shall not start the running of the period of limitations on assessment and collection."

Section 6502(a)(1) provides that "[w]here the assessment of any tax imposed by this title has been made within the period of limitation properly applicable thereto, such may be collected by levy or by a proceeding in court, but only if the levy is made or proceeding begun–within 10 years after the assessment of the tax, ..."

Because we interpret section 6502(a)(1), the question has been raised as to whether section 6502(a)(1) changes the clear rule in section 6501(b)(3) that the Service's execution of a section 6020(b) return does not start the running of the collection period. We conclude that section 6502(a)(1) does not change the rule in section 6501(b)(3). Indeed, courts have explicitly rejected taxpayers' arguments that the execution of section 6020(b) returns trigger the running of the assessment and collection period under section 6502(a)(1) and have held that section 6501(b)(3) prevents the running of these periods. E.g., Jensen v. I.R.S., 1998 U.S. App. LEXIS 30069 (9th Cir. 1998); Taylor v. I.R.S., 1994 U.S. App. LEXIS 35983 (10th Cir. 1994). (The determination of assessment date(s) is not a matter within our jurisdiction, so we have coordinated related assessment questions with Branch 2 of APJP, and we will issuing further guidance on the actual calculation of the CSED.)

Please call if you have any further questions.

PAYMENT: Installment payments

CC:PA:CBS:Br2
GL-118271-01
UILC: 61.00.00-00

June 14, 2001

MEMORANDUM FOR AREA COUNSEL, AREA 5 (SMALL BUSINESS/SELF-EMPLOYED), DENVER GROUP 2

FROM: Lawrence Schattner
Chief, Branch 2 (Collection, Bankruptcy & Summonses)

SUBJECT: Waiver of Notice of Termination of Installment Agreement

This responds to your request for advice dated April 9, 2001. This document is not to be cited as precedent.

ISSUE: Whether the Service can obtain a waiver of a taxpayer's right to receive the notice of termination of an installment agreement required by I.R.C. § 6159(b)(5)?

CONCLUSION: Section 6159 does not authorize a waiver of the taxpayer's right to receive notice of termination of an installment agreement.

BACKGROUND: You have brought to our attention two cases where, as part of Collection Appeals Proceedings before Appeals Settlement Officers, installment agreements were entered into with the taxpayer in which the taxpayer waived the right to notice of termination if any term or condition in the installment agreements were not met, thus permitting the Service to commence immediate collection action upon default. One of those cases involved a prior default in an installment agreement. You have been asked by the revenue officer to whom the accounts are assigned whether the waivers are valid, thus permitting the Service to levy on the taxpayers' assets without notice of termination should the taxpayers default on the agreements. You conclude that a waiver of the right to notice of termination is legally valid, but that as a matter of policy such waivers should only be solicited in egregious cases such as where the taxpayer has had prior defaulted installment agreements.

LAW AND ANALYSIS: For the following reasons, we conclude that waivers of the right to receive notice of termination of installment agreements are invalid. A notice of proposed termination should be sent after default even if such a waiver was executed.

Section 6159 authorizes the Service to enter into agreements for the payment of taxes in installments. I.R.C. § 6159. Section 6159(b) provides: "Except as otherwise provided in this subsection, any agreement entered into by the Secretary under subsection (a) shall remain in effect for the term of the agreement." Section 6159(b) further enumerates the grounds for which the Service may alter, modify and terminate installment agreements: providing inaccurate or incomplete information before the agreement was executed; collection of the tax is in jeopardy; the financial condition of the taxpayer has significantly changed; the taxpayer fails to pay an installment, or any other tax liability, when due; and the taxpayer fails to provide financial information requested by the Secretary. Section 6159(b)(5) specifies that unless collection of the tax is in jeopardy, the Secretary may not alter, modify or terminate an installment agreement for the enumerated reasons unless the taxpayer is given 30 days notice of such termination with an explanation of why the Secretary intends to take the action. Treas. Reg. § 301.6159-1(c)(4) further provides that upon receiving the notice of termination, the taxpayer may provide information showing that the reason for the intended alteration, modification or termination is incorrect.

Levies with respect to the tax which is the subject of an installment agreement are prohibited during the period that an installment agreement is in effect, and in the case of a default, during the 30 day period (plus the period of any appeals) after notice of termination is sent. I.R.C. § 6331(k)(2)(C),(D). The taxpayer can, however, waive the restriction on levy. I.R.C. § 6331(i)(3)(A), (k)(3).

We conclude that a waiver of the right to receive a notice of termination is not permitted under the current statutory scheme. The purpose of the notice of termination is to give the taxpayer the right and opportunity to contest a proposed termination, and there is no statutory basis for forcing the taxpayer to relinquish that right as a condition of entering an installment agreement. The receipt of the notice of termination is a fundamental right which cannot be withdrawn absent specific statutory authorization.

The Secretary has the discretion to require terms that protect the interests of the Government as a condition to entering into an installment agreement, such as a requirement that the taxpayer authorize direct debit bank transfers. Treas. Reg. § 301.6159-1(b). However the Secretary cannot impose conditions inconsistent with section 6159. Because the statute and regulations contain restrictions on the ability of the Service to terminate agreements, the Service can only insert additional terms in installment agreements which are consistent with these restrictions. A waiver of the notice of termination entered into as a condition of acceptance of the installment agreement is invalid because it is inconsistent with section 6159(b). [1]

We finally note that it would be legally permissible under the statute to require the taxpayer to waive the restriction on levy for the 30 day period (and during any appeal period) after the notice of termination, as a condition for entering into the installment agreement. However, the published procedures involving installment agreements do not contemplate such waivers. See IRM 5.14.1.5 (10/18/99). While it might be appropriate to require such waivers in cases involving past defaults, this is a matter of policy which should be approved within the National Office of the SB/SE Division.

Please contact the attorney assigned to the case at (202) 622-3620 if you have any questions or comments concerning this memorandum.

PAYMENT: Installment payments

July 18, 2001

CC:PA:CBS:RCGrosenick
TL-N-2166-01
UIL 09.17.00-00

MEMORANDUM FOR PAUL J. SUDE
ASSOCIATE AREA COUNSEL/PHILADELPHIA
(CC:SB:2:PHI:2)

FROM: Joseph W. Clark
Senior Technician Reviewer, Branch 2 (CBS)

SUBJECT: Installment Agreement Default Processing

[1] One of the installment agreements at issue requires the taxpayer to timely file returns and make federal tax deposits. We note in this regard that an installment agreement can only be terminated for the reasons stated in section 6159(b). Failure to make federal tax deposits, failure to file returns, and failure to do any other act not specified in section 6159(b), are not valid grounds for terminating an installment agreement. See IRM 5.14.8.3 (10/18/99).

This Chief Counsel Advice responds to your memorandum dated April 19, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

ISSUES:

1. May the Internal Revenue Service require that a taxpayer become current as to his estimated tax payments as a condition for reinstatement of a defaulted installment agreement?

2. May the Service require that a taxpayer enter into a direct deposit installment agreement as a condition for reinstatement of a defaulted installment agreement?

3. May the Service require that a taxpayer pay federal tax liabilities or make future tax payments by credit card as a condition for reinstatement of a defaulted installment agreement?

CONCLUSIONS:

1. Yes, the Service may require as a condition of reinstatement that the taxpayer become current with his estimated tax payments.

2. Yes, the Service may require as a condition of reinstatement that the taxpayer enter into a direct deposit installment agreement.

3. No, the Service may not require as a condition of reinstatement that the taxpayer pay by credit card.

FACTS:

The Philadelphia Service Center, in the course of a project on defaulted installment agreements, has suggested the Service consider using the foregoing conditions as mandatory prerequisites to reinstatement. In your proposed Significant Service Center Advice, you agree that the Service may require a taxpayer to become current on estimated tax payments and enter into a direct deposit arrangement as preconditions for reinstatement. You do not believe the Service may require the taxpayer to pay by credit card. So that the Service and the public are aware of these new conditions, you further recommend that these procedures be incorporated into the Internal Revenue Manual.

LAW AND ANALYSIS:

Section 6159 of the Internal Revenue Code governs installment agreements.

> AUTHORIZATION OF AGREEMENTS. – The Secretary is authorized to enter into written agreements with any taxpayer under which such taxpayer is allowed to satisfy liability for payment for any tax

> in installment payments if the Secretary determines that such agreement will facilitate collection of such liability.

I.R.C. § 6159(a). Section 6159, in addition to authorizing the execution of installment agreements, includes provisions specifying the extent to which installment agreements remain in effect, the situations in which installment agreements must be entered into, the specific conditions under which an installment agreement may be terminated by the Service, and the Secretary's duty to establish procedures for independent administrative review of termination of installment agreements. See I.R.C. § 6159 (b), (c), (d).

The Service is not required to enter into an installment agreement with a taxpayer.[1] "The director has the discretion to accept or reject any proposed installment agreement." Treas. Reg. § 301.6159-1(b)(1)(i). See, e.g., AJP Management v. United States, 87 AFTR2d ¶ 2001-312 (C.D. Cal. Nov. 21, 2000) (appeals officer did not abuse his discretion by rejecting proposed installment agreement); Kitchen Cabinets, Inc. v. United States, 2001 U.S. Dist. LEXIS 2388 (N.D. Tex. Mar. 6, 2001) (Service not obliged to accept a proposed installment agreement offered during a Collection Due Process hearing). In addition, prior to entering into an installment agreement, the Service may impose terms and conditions to protect the interests of the government. Treas. Reg. § 301.6159-1(b)(1)(B). The law does not prohibit the Service from establishing conditions, such as the use of direct deposit, before a proposed installment agreement will be accepted. In fact, the example provided under this Regulation is that the director may require that a taxpayer authorize direct debit bank transfers as a method of making installment payments under the agreement. As the Service may require a taxpayer to enter into a direct deposit agreement as a precondition to an initial installment agreement, the Service likewise may require a taxpayer to enter into a direct deposit agreement as a precondition to reinstatement of a defaulted agreement.

Although the Service has wide discretion whether or not to accept a proposed installment agreement, the Service's ability to terminate an existing installment agreement is limited by statute. The Service may propose termination of, or place in default, an installment agreement if the taxpayer:

- fails to pay an installment payment when due under the terms of the agreement;
- fails to pay another tax liability at the time such liability is due;

[1] There is an exception to this rule for proposed installment agreements which satisfy specific criteria, as set forth in I.R.C. § 6159(c). If a proposed installment agreement meets these criteria, the Service must accept the "guaranteed" agreement. See IRM 5.17.2.2.3 However, one of the criteria is that the taxpayer not have entered into an installment agreement with the Service during the past five years. I.R.C. § 6159(c)(2)(C). This prevents a taxpayer who has defaulted from proposing a "guaranteed" installment agreement as a means of bypassing preconditions the Service sets on reinstatement, and so the exception for "guaranteed" installment agreements is not applicable here.

- fails to provide a financial condition update upon request;
- provides information prior to the date such agreement was entered into that was inaccurate or incomplete; or
- if the director determines the collection of any tax liability to which the installment agreement applies is in jeopardy.

I.R.C. § 6159(b)(4); Treas. Reg. § 301.6159-1(c). An installment agreement may not be defaulted or terminated for the taxpayer's failure to make estimated tax payments, failure to make federal tax deposits or failure to file another return at the time such return is due. IRM 5.14.8.3(1).

However, just because the Service is limited in how it may terminate an agreement does not mean that the Service is also limited in its ability to reinstate (or refuse reinstatement) to a taxpayer who has defaulted. The bases on which the Service may terminate or default an installment agreement are set out by statute. The bases for reinstatement are not. Though Congress intends the Service to be flexible in working with taxpayers to resolve their tax liabilities via installment agreements,[2] the law does not require the Service to automatically reinstate a defaulted taxpayer. See Lilley v. United States, 1991 U.S. Dist. LEXIS 913 (N.D. Ohio Jan. 7,1991) (acceptance of payments does not require IRS to reinstate installment agreement). When Congress amended section 6159 in the Restructuring and Reform Act of 1998, it did not limit the Service's ability to impose terms and conditions prior to entering into (or reinstating) installment agreements. Instead, the Service retains the discretion to refuse to accept a new installment agreement proposed by a taxpayer who previously defaulted. See MRCA Info. Servs. v. United States, 2000 U.S. Dist. LEXIS 12550 (D. Conn. Aug. 1, 2000) (Court upholds Service's rejection, in Collection Due Process hearing, of proposed installment agreement by taxpayer who previously defaulted on two agreements).

As the Service may impose reasonable terms and conditions before accepting a proposed installment agreement, the first two conditions suggested above (payment of estimated taxes and direct deposit) may be set by the Service as preconditions to the reinstatement of a terminated or defaulted installment agreement. In your proposed memorandum, you disagree that the Service may require payment by credit card as a condition of reinstatement. You note that the Internal Revenue Manual presently recommends that the Service consider compliance with estimated tax requirements and payment by direct deposit before considering reinstatement. IRM 5.14.8.6(1)f&g. Although payment by credit card is authorized by law,[3] the use of a credit card requires the taxpayer to incur a fee. The instructions for Form 1040, for example, state that for the use of a credit card, a convenience fee will be charged by the service provider based on the amount the taxpayer is paying. See also Temp.

[2] See Internal Revenue Service Restructuring and Reform Act of 1998 (H.R. 2676) § 3467 (codified at I.R.C. § 6159(c)), reprinted in Joint Committee on Taxation, 106th Congress, General Explanation of Tax Legislation Enacted in 1998 at 113 (1998).

[3] See I.R.C. § 6311(d), Temp. Treas. Reg. § 301.6311-2T.

Treas. Reg. § 301.6311-2T(e). This "convenience" fee is not a tax debt, but is an amount imposed by virtue of the method of payment selected by the taxpayer. It is one thing if a taxpayer voluntarily chooses to pay the credit card fee, but we do not believe the Service can require the taxpayer to incur such a fee as a condition of reinstatement.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

We agree with your recommendation that, should the Service decide to adopt any or all of these proposed conditions to reinstatement, such procedures should be incorporated into the Internal Revenue Manual. This will insure uniformity of application and notify taxpayers of the new conditions. We also share your concerns that some taxpayers may not have the ability to pay by direct deposit and that this may be perceived as unfair. However, a taxpayer who is denied reinstatement of a defaulted installment agreement due to the conditions suggested above (or for any other reason) has a right to appeal such denial. See I.R.C. § 6159(e) (cross-referencing I.R.C. § 7122(d)); IRM 5.14.6.3.[4] We believe the appeal process affords sufficient safeguards to insure a taxpayer is not treated unfairly.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges such as the attorney-client privilege. If disclosure becomes necessary, please contact this office for our views.

If you have any questions, please contact Richard Charles Grosenick at 202/622-3620.

[4] See also IRM 5.14.8.7 (appeal of defaulted/terminated installment agreements).

REDEMPTION: Method for sale

August 17, 2001

CC:PA:CBS:BR1
GL-112355-01

UILC: 68.03.00-00

MEMORANDUM FOR ASSOCIATE AREA COUNSEL RICHMOND
CC:SB:2:RCH
Attn: TBHeavner

FROM: Alan C. Levine,
Chief Branch 1 Collection, Bankruptcy & Summonses

SUBJECT: Liquidated Damages

This Chief Counsel Advice responds to your memorandum dated May 21, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

ISSUE

If the Internal Revenue Service ("Service") sells real property redeemed pursuant to I.R.C. § 7425 and the sales contract does not provide for liquidated damages for a defaulting purchaser, may the Service offset the bidder's deposit to recover its actual damages.

CONCLUSION

When the sales contract does not provide for "liquidated damages," the Service may offset the bidder's deposit against its actual damages arising from a defaulted sale.

FACTS

The Service redeemed real property following a nonjudicial sale and subsequently sold the property at public auction. The notice of sale stated that the property would be sold to the highest bidder, who would be required to pay 15% of the highest bid price at the time of sale and would be required to pay the balance within 30 days after the bid was accepted. The purchaser defaulted on the remainder of the bid price. The notice of sale made no mention of liquidated damages.

LAW AND ANALYSIS

Black's Law Dictionary defines liquidated damages as the sum which a party to a contract agrees to pay if he breaks some promise and, which having been arrived at by a good faith effort to estimate actual damage that will probably ensue from the breach, is recoverable as agreed damages if a breach occurs.

I.R.C. § 7506(a) provides, "The Secretary shall have charge of all real estate which is, or shall become the property of the United States . . . or which has been redeemed by the United States . . . ." Section 7506(b) provides, "The Secretary may, at public sale, and upon not less than 20 days notice, sell and dispose of any real estate owned or held by the United States as aforesaid."

Treas. Reg. § 301.7506-1(b)(5) states, "in the event of the sale of redeemed property . . . [a] notice of sale shall state whether, in the case of a default in payment of the bid price, any amount deposited . . . shall be retained as liquidated damages . . . not to exceed $200." Treas. Reg. § 301.7506-1(b)(6) limits the recovery of liquidated damages to a maximum amount of $200.00, as discussed below:

> The district director may, before giving notice of sale, solicit offers from prospective bidders and enter into agreements with such persons that they will bid at least a specified amount in case the property is offered for sale. In such cases, the district director may also require such persons to make deposits to secure the performance of their agreements. Any such deposit, but not more than $200, shall be retained as liquidated damages in case such person fails to bid the specified amount and the property is not sold for as much as the amount specified in such agreement.

Alternatively, the Service may choose not to insert a clause for liquidated damages. In that situation, we have taken the position that the Service may still recover its actual damages. Nothing in the regulations prohibit the Service from recovering its actual damages, and we see no reason why the Service should not have the same right as any other seller to recover actual damages from a defaulting purchaser. Moreover, it can be inferred from other sections of the Internal Revenue Code and regulations that Congress intended that the Service not bear the economic burden resulting from the defaulted sales of property. [1]

[1] I.R.C. § 6335(e)(3) and the regulations thereunder, which concern the sale of seized property rather than the sale of property that the government has redeemed, provide that if the purchaser fails to pay the balance of the bid price, the Service can either (1) institute suit for the balance of the purchase price or (2) readvertise and resell the property again and consider the deposit forfeited.

Based upon the foregoing discussion, if the Service did not insert a liquidated damages clause, we think that the Service may recover its actual damages in full. Given that the Service has the defaulting purchaser's deposit, the Service may exercise its common law right of offset and recover its damages from the deposit.

In response to your inquiry concerning the discrepancy in pattern letters P-339 and P-637 referenced in IRM 5.10.7.3.5, we contacted the Office of Filing and Payment Compliance to ascertain why the letter used to give notice of sale of redeemed property, P-637, contains a liquidated damages provision but the pattern letter for the sale of other than redeemed property, P-339, does not. Apparently, there is no explanation for the discrepancy, and we were advised that it was probably just an oversight in drafting. However, to clarify matters, that office will revise pattern letter P-637 to delete any reference to liquidated damages. Likewise, they will revise pattern letter P-340, Notice of Sealed Bid Sale, (other than redeemed property) to delete any reference to liquidated damages so that it will comport with pattern letter P-1627 (redeemed property) which does not contain such a provision.

If you have any further questions, please do not hesitate to call us on 202-622-3610.

cc: Jeff Basalla, Director, Filing & Payment Compliance, S:C:CP:FP