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From:
Sent: Friday, January 13, 2012 11:40 AM
To:
Cc:
Subject: Levy against an ESOP

This email is in response to your questions regarding a tax levy against a taxpayer's interest in an employee stock ownership plan (ESOP). First, you ask whether distributions of dividends from the ESOP are subject to withholding. Plan distributions that are § 404(k) dividends are not subject to withholding under § 3405. See Announcement 2008-56, 2008-26 I.R.B. 1192.

With respect to distributions from the ESOP that are ordinarily subject to withholding, you ask how the withholding rules operate when a distribution is made to honor an IRS tax levy. Section § 6331(a) gives the Secretary permission to collect tax by levy upon all property and property rights belonging to the person who owes the tax. In the case you have asked about, the section 6321 assessment lien encumbers the taxpayer's entire interest in the ESOP account, not just to the amount of tax owed. The levy, in turn, attaches to the account up to the amount necessary to satisfy the stated tax liability that the Service is seeking to collect. Additionally, section 3405(c) requires the payor of an eligible rollover distribution (that is not directly rolled over to another eligible retirement account) to withhold 20% of the distribution. Sections 6331 and 3405(c) are independent requirements that must both be satisfied. This case does not present the question of what to do if the taxpayer's right to a distribution is not great enough to satisfy both requirements. However, in advice that may not be used as precedent, we have previously stated that in the event of a conflict, the withholding requirement of 3405(c) would take priority. See 1997 WL 34649639, www.irs.gov/pub/lanoa/pmta00177_6974.pdf

In this case, the levy attached to the taxpayer's entire interest in the ESOP, and is capped only by the amount listed as the tax liability on the levy. In order to satisfy the levy, the plan administrator should make a large enough distribution to both satisfy the amount of the levy and to withhold 20%. Mathematically, the amount that the plan administrator should withdraw works out to be 1.25 times the amount of the levy (1.25 is the inverse of .8). This will allow the administrator to remit 20% of the withdrawn amount as withholding and the remaining 80% of the withdrawn amount will equal the tax liability listed in the levy.

Please let me know if you have any additional questions.