Part 5. Collecting Process

Chapter 17. Legal Reference Guide for Revenue Officers

Section 1. General Information

5.17.1 General Information

5.17.1.1 (10-16-2007)
Purpose

1. The Legal Reference Guide for Revenue Officers is intended to make available to revenue officers and other personnel engaged in collection efforts the fundamentals of legal knowledge needed in their daily activities. The results of recent legislation and recent court decisions have been incorporated into the revised text.
2. While the Legal Reference Guide for Revenue Officers has been established as a Handbook keyed to the Internal Revenue Manual, it is not the source of procedural instructions. Revenue officers and other Internal Revenue Service personnel must still look to the basic Internal Revenue Manual (IRM) provisions outside the Handbook for such instructions.
3. Constant study and use of the information contained in the Handbook is needed for it to be most beneficial; however, such study is not intended to make lawyers of the users and it is not a substitute for any required referral of cases through proper channels to Counsel.

5.17.1.2 (04-06-2010)
Local Law Section

1. In order to maintain a comprehensive reference guide, Area Counsel will ordinarily prepare supplementary material discussing the impact of local law on subject matter of the Handbook. See the Chief Counsel Website, SB/SE State Law Guides, at http://ccintranet.prod.irscounsel.treas.gov/OrgStrat/Offices/sbse/Pages/LawGuides.aspx .
2. The choice of subject matter to be included in the local law material is discretionary between the Area Counsel office and the functions of the Service requesting advice on such matters.

5.17.1.3 (10-16-2007)
Functions and Organization of Office of Chief Counsel

1. The functions and organization of the Office of Chief Counsel are set forth below. The roles and responsibilities of the Department of Justice, Tax Division, and United States Attorney are provided in IRM 5.17.1.6 and 5.17.1.7, below.

5.17.1.3.1 (04-06-2010)
Statutory Basis

1. There is established in the Department of the Treasury the Office of General Counsel and the office of an Assistant General Counsel, who serves as Chief Counsel of the Internal Revenue Service. 31 USC § 301(f); IRC § 7803(b)(1). The Chief Counsel is appointed by the President with the advice and consent of the Senate, but the Commissioner recommends to the President a candidate for appointment as Chief Counsel when a vacancy occurs and, if necessary, recommends the removal of the Chief Counsel. IRC § 7803(a)(2)(B) and (b)(1).
2. The Chief Counsel is the chief law officer for the Internal Revenue Service. The Chief Counsel reports directly to the Commissioner except as follows.
   A. The Chief Counsel reports solely to the General Counsel with respect to legal advice or interpretation of the tax law relating solely to tax policy.
   B. The Chief Counsel reports to both the Commissioner and the General Counsel with respect to legal advice or interpretation of the tax law not relating solely to tax policy, and with respect to tax litigation. If there is any disagreement between the Commissioner and the General Counsel on any such matter, it is submitted to the Secretary or Deputy Secretary for resolution. IRC § 7803(b)(3).
3. All personnel in the Office of Chief Counsel report to the Chief Counsel. IRC § 7803(b)(4). The role of the Office of Chief Counsel is to ensure the correct and uniform application of the tax laws. It is, therefore, the responsibility of each component of the Office, individually and collectively, to ensure that all published guidance, documents filed in litigation, and legal advice issued to the Service or to taxpayers accurately reflect the position of the Office. Chief Counsel Directives Manual (CCDM) at IRM 31.1.1.1(1).

5.17.1.3.2 (10-16-2007)
General Statement

1. About one-third of the office of Chief Counsel attorneys work in the vicinity of Washington, D.C., for the most part in connection with the work of the National Office.
2. About two-thirds of the attorneys are assigned to Area Counsel offices or to Operating Division Counsel.

5.17.1.3.3 (10-16-2007)
General Organization

1. The Chief Counsel has an immediate staff consisting of a
   - Deputy Chief Counsel (Operations),

- Deputy Chief Counsel (Technical), and
- a number of Special Counsel, Associate Chief Counsel, and Division Counsel.

5.17.1.3.4 (04-06-2010)
National Office Functions

1. The National Office functions involve planning and directing policies and programs with respect to legislation, regulations, interpretative rulings and opinions, litigation, and advisory services, pertaining to the laws administered by the Internal Revenue Service. The work is handled by the Office of the Special Counsel to the National Taxpayer Advocate and the Offices of Associate Chief Counsel for
   - Income Tax & Accounting
   - Passthroughs & Special Industries
   - Corporate
   - Financial Institutions & Products
   - International
   - Procedure & Administration
   - Tax Exempt & Government Entities
   - Criminal Tax, and
   - General Legal Services.
2. The Office of the Associate Chief Counsel (Procedure & Administration) was realigned with the subsidiary divisions (Administrative Provisions and Judicial Practice; Collection, Bankruptcy and Summonses; and Disclosure and Privacy Law) being eliminated. The office now consists of seven branches which are responsible for the same practice areas previously handled by the subsidiary divisions.

5.17.1.4 (04-06-2010)
Operating Divisions and their Field Offices

1. The function of each operating Division Counsel office is to serve the operating division to which that office is assigned. The Division Counsel reports directly to the Chief Counsel. Additional Division Counsel offices will be managed by Area Counsel or Associate Area Counsel.

5.17.1.4.1 (04-06-2010)
Operating Division Counsel

1. Operating Division Counsel, and their respective field offices, have been created for the operating divisions of: Large & Midsize Business, Tax Exempt & Government Entities, Criminal Tax, Small Business & Self Employed (SB/SE), and Wage & Investment Income (WI). In the field, Operating Division Counsel for SB/SE also serves WI and the Taxpayer Advocate Service (TAS).
2. Division Counsel for SB/SE works closely with the Office of the Associate Chief Counsel (Procedure and Administration) to render legal advice for collection matters.

5.17.1.4.2 (04-06-2010)
SB/SE Operating Division Counsel, and Area and Associate Area Counsel

1. The primary function of the SB/SE Operating Division Counsel, and Area and Associate Area Counsel, is to represent the Internal Revenue Service in cases before the United States Tax Court. They also provide the large variety of legal services which the Office of the Chief Counsel renders in connection with collection of federal taxes (except those involving Alcohol, Tobacco and Firearms matters), summonses, damage suits for failure to release levy or unauthorized collection actions, and defense to or suits to obtain injunctions including promoter injunctions. A prime concern is with the legal problems involved in the collection of delinquent accounts, i.e., those with which revenue officers are directly concerned.
2. Certain matters involving initial action by the field offices are subject to review in the National Office to insure consistency of treatment and uniformity of approach. However, most SB/SE functions have been delegated to Area and Associate Area Counsel for final disposition in order to provide prompt and readily available legal service to the field offices of the Internal Revenue Service handling SB/SE and WI issues and to accomplish the broad responsibilities implicit in the handling of the wide range of legal problems in the collection area. Each such counsel, through his or her staff, handles legal work with respect to:
   A. Collection and protection of the tax claims and liens of the United States in proceedings under 11 USC (the Bankruptcy Code), federal and state receiverships, corporate dissolutions, decedents' estates, and assignments for the benefit of creditors;
   B. Protection of priority rights of federal tax liens in foreclosure actions by mortgagees or other lien holders in partition suits, condemnation suits, interpleader suits and in suits to quiet title;
   C. Applications filed for the discharge of property from the effect of federal tax liens or for the release of such liens and applications for subordination of federal tax liens and for certificates of nonattachment;
   D. Offers in compromise and installment agreements;
   E. Enforcement of summonses, third-party contact issues, and certain disclosure problems;
   F. Taking of affirmative action, whether by way of a separate suit or intervention in a pending proceeding, to collect taxes (with the exception of Alcohol, Tobacco, and Firearms taxes) with a view to reducing tax claims to judgment, enforcing federal tax liens (including the appointment of a receiver), opening safe deposit boxes, enforcing a levy, asserting transferee liability, seeking to collect on bonds, and asserting liability against third parties paying or providing wages;
   G. Recommendations to the United States Attorney with respect to petitions for writ of entry;
   H. Proposals of settlement of pending litigation to be effected through the Department of Justice;
   I. Defense of injunction suits to restrain the assessment or collection of federal taxes (except with respect to Alcohol, Tobacco, and Firearms matters);
   J. Recommendations concerning administrative claims for damages regarding unlawful collection actions, release of liens, and violation of the automatic stay under IRC §§ 7432 and 7433;
   K. Release of the Government's right under 28 USC § 2410 or IRC § 7425(d) to redeem property which has been the subject matter of a foreclosure proceeding in which the United States has been properly named a party, or given adequate notice of nonjudicial sale;
   L. Actions for the perpetuation of testimony;
   M. Handling of legal matters with respect to leases, bonds, contracts and other similar matters;

N. Jeopardy levies, and the administrative and judicial review procedures under IRC § 7429;

O. Determination of trust fund recovery penalty.

3. Field attorneys assigned to SB/SE Area or Associate Area Counsel units will provide legal advice on various matters to Service personnel in the SB/SE and WI Operating Divisions, the offices of the respective commissioner, campus director, and field offices. In connection with this type of activity, which is vital to the success of any organization operating on a decentralized basis, visitation programs have been established so that legal personnel make regular periodic visits to the field offices located throughout the counsel office's service area.

4. The Area or Associate Area Counsel legal staff also maintains day-to-day contacts with the United States Attorneys' offices, and the appropriate Trial Section of the Tax Division, Department of Justice, charged with the ultimate responsibility for the trial of certain proceedings in federal and state courts. Upon request, the Area or Associate Area Counsel and his or her staff furnish appropriate legal services to the United States Attorney and the Department of Justice, which may include

   - preparation of suit or defense letters,
   - authorizing the institution of legal proceedings or the defense of a civil action against the United States, and
   - setting forth the pertinent legal issues and the Internal Revenue Service's position thereon.

5. Area or Associate Area Counsel attorneys may also be appointed as Special Assistant United States Attorneys (SAUSAs) and appear on behalf of the Service in various types of bankruptcy proceedings.

6. Not the least of the services rendered by the Area or Associate Area Counsel and his or her staff is their participation, sometimes in conjunction with the Chief Counsel's National Office staff, in the various training and continuing education programs for revenue officers and other personnel concerned with collection matters, which includes preparation and maintenance of a Local Law Section for the Legal Reference Guide.

5.17.1.5 (04-06-2010)
Associate Chief Counsel (Procedure and Administration)

1. The Associate Chief Counsel (Procedure and Administration) (P&A) serves as principal legal advisor to the Chief Counsel, the Operating Division Counsel, and the operating divisions, on matters such as those concerning assessment, collection, interest, penalties, bankruptcy, summonses, and disclosure.

2. P&A will provide legal interpretations of tax law involving matters, such as collection, bankruptcy, and summonses, that will directly implicate the work of the revenue officer.

3. P&A has a dual responsibility - technical and litigation assistance. In its role of providing technical guidance in order to achieve uniformity in positions and treatment of taxpayers, P&A prepares various guide materials, such as the Chief Counsel Directives Manual Part 34, the texts for various training programs, Chief Counsel Notices, Chief Counsel Advice and Service Center Advice. Additionally, P&A provides formal legal advice to the operating division and other field counsel offices, and P&A's subject matter specialists are available to provide technical advice on an informal basis. P&A also pre-reviews and post-reviews certain documents drafted and decisions made by field counsel. See Chief Counsel Directives Manual (CCDM) IRM Exhibit 35.11.1-1 for a complete listing of matters pre-reviewed by Associate Chief Counsel (P&A). P&A is also responsible for reviewing Internal Revenue Manual revisions and updates for matters involving collection issues.

4. P&A also provides litigation assistance to SB/SE Area Counsel and Associate Area Counsel for certain actions brought by or against the United States. In certain litigation matters, a suit or defense letter must be referred to the Associate Chief Counsel (P&A) for review and approval before referral to the Department of Justice. Those cases or issues include:

   - requests for appointment of a receiver,
   - suits for failure to honor a levy where the 50 percent penalty is sought,
   - suits for judicial approval of service of John Doe summonses,
   - cases raising third-party contact issues under IRC § 7602(c),
   - injunction suits to stop pyramiding in no equity seizure situations,
   - suits for damages under IRC § 7433(e) involving requests for damages for violations of the automatic stay or permanent injunction,
   - suits to assert tort liability for converting property subject to the federal tax lien, or
   - suits involving a bona fide dispute with another Government agency.

5. P&A attorneys often argue motions on behalf of Area Counsel attorneys before the United States Tax Court in Washington, D.C.

6. P&A is responsible for preparing all recommendations regarding appellate and certiorari matters for the Office of Chief Counsel in all cases under its jurisdiction.

7. Even though P&A issues, such as those more particularly described above, will most often concern the SB/SE function, those issues may also concern other operating divisions. In cases where this occurs, the Area Counsel or Associate Area Counsel or Operating Division Counsel of these other functions may request technical advice from the Associate Chief Counsel (P&A).

8. P&A attorneys handle some Tax Court cases just as an SB/SE field office would, from filing answers to handling trials.

5.17.1.6 (10-16-2007)
Department of Justice

1. The Department of Justice generally through its staff of attorneys in the Tax Division, and the United States Attorneys in the field, are the Government's representatives in most courts of the federal and state judicial systems and, as such, represent the Internal Revenue Service. Chief Counsel attorneys represent the Internal Revenue Service before the United States Tax Court.

2. The Chief Counsel's office furnishes such assistance as may be necessary, including recommendations on offers in settlement, suit and defense letters in support of the Service's position on pertinent issues, and recommendations with respect to appeal or certiorari of a court's decision, often conferring with Justice Department attorneys on various matters.

5.17.1.7 (10-16-2007)
United States Attorney

1. In the field there is usually close contact between the United States Attorneys and Area Counsel attorneys. Area Counsel attorneys furnish such assistance to the United States Attorneys as may be necessary, including preparing pleadings, interviewing witnesses, taking depositions, and participating in conferences with taxpayers' representatives.

2. Area Counsel attorneys in SB/SE offices may be designated to act as Special Assistant United States Attorneys (SAUSAs) to represent the Service's interests in bankruptcy proceedings. When so acting, the attorneys are subject to supervision by the United States Attorney or the Tax Division of the Department of Justice, whichever is responsible for the case.

5.17.1.8 (10-16-2007)
Revenue Officer's Role

1. From what has preceded, it is obvious that the collection of the revenue is the result of joint efforts involving many individuals and offices both inside and outside the Internal Revenue Service. In order for a revenue officer to have a proper perspective of his or her role and better understand his or her duties as well as the duties and responsibilities of others, it is important that a revenue officer be familiar with the various interrelationships of the offices involved in tax collection work.
2. While revenue officers are not expected to have the comprehensive knowledge of the law required of attorneys, it is hoped that they will gain a sufficient understanding from the material in the following sections to recognize the legal problems that might call for reference to Counsel for consideration.
3. Whenever litigation involving collection matters is pending or the institution of affirmative legal action to effect collection is being considered, revenue officers will, in the main, be investigators of facts and will be required to prepare reports concerning any facts ascertained. The lawyers charged with the responsibility of handling SB/SE cases must rely upon the administrative personnel of the Internal Revenue Service for investigation of the facts in any case. The importance of the revenue officer as an investigator and fact finder cannot be too strongly emphasized. See IRM 5.17.12 on Investigations and Reports.

More Internal Revenue Manual

Part 5. Collecting Process

Chapter 17. Legal Reference Guide for Revenue Officers

Section 2. Federal Tax Liens

5.17.2 Federal Tax Liens

Manual Transmittal

December 12, 2014

Purpose

(1) This transmits revised IRM 5.17.2, Legal Reference Guide for Revenue Officers, Federal Tax Liens, including transmission of topic based procedural changes incorporated based on the Affordable Care Act.

Background

This section provides procedures for perfecting a federal tax lien and outlines the major issues regarding the types of property subject to the federal tax lien and the status of the federal tax lien versus other competing liens with respect to that property. It also outlines the law and taxpayer rights governing the release of the federal tax lien, discharge of property from the lien, or other types of relief from the lien. This revision also incorporates changes associated with the Affordable Care Act.

Material Changes

(1) Editorial and reference updates made throughout the IRM.

(2) IRM 5.17.2.2.3: Deleted paragraph two the reference pertains to estate tax liens.

(3) IRM 5.17.2.3.2: Added in paragraph three the territories of, Guam, the Commonwealth of the Northern Mariana Islands (CNMI), and the Virgin Islands (VI), as filing personal property lien notices with the district court.

(4) IRM 5.17.2.5.1(3): New paragraph added regarding looking to state law regarding property and civil unions and domestic partnerships.

(5) IRM 5.17.2.5.2.1: Revised to include clarification of community property ownership by same-sex marriages and domestic partnerships.

(6) IRM 5.17.2.5.2.4: Revised to include clarification of tenancy by the entirety ownership by same-sex spouses.

(7) IRM 5.17.2.5.2.5: Revised to include clarification on equitable conversion in light of a recent court decision.

(8) IRM 5.17.2.6.1(5): Adds new paragraph on how equitable conversion can affect the statutory federal tax lien and Notice of Federal Tax Lien (NFTL) status in relation to purchasers.

(9) IRM 5.17.2.6.4(7): Adds new paragraph on how equitable conversion can affect the lien and NFTL status in relation to holders of a security interest.

(10) IRM 5.17.2.6.5.4(1) Editorial Change - Rev. Proc. 2014-61, 2014-47 I.R.B. 860 adjusts yearly amount for calendar year 2015 of *Persons Against Whom a Federal Tax Lien Is Not Valid* regarding personal property purchased in a casual sale to less than $1,520.

(11) IRM 5.17.2.5.4(2): Deleted the Note as it is applicable to levies not liens.

(12) IRM 5.17.2.5.9: New subsection added titled, *Same-sex Marriage and Legally-Recognized Relationships*.

(13) IRM 5.17.2.6.5.7(2) Editorial Change - Rev. Proc. 2014-61, 2014-47 I.R.B. 860 adjusts yearly amount for calendar year 2015 of *Persons Against Whom a Federal Tax Lien Is Not Valid* regarding mechanic's lien for repair or improvement of certain real property to $7,590.

(14) IRM 5.17.2.6.6.1(4)(a): Revise subsection to clarify lien priorities related to the 45-Day Rule.

(15) IRM 5.17.2.7.1.5: Deleted paragraph two as duplicative of content in IRM 5.17.2.6.7 and renumbered the former paragraph three as paragraph two.

(16) IRM 5.17.2.7.1.19: New subsection titled, *Unrecorded Conveyances*, incorporating the content of the reissued Interim Guidance SBSE-05-0914-0057

(17) IRM 5.17.2.8.3: Deleted paragraph five for inaccuracies with content and case cite. Paragraph six renumbered as paragraph five.

(18) IRM 5.17.2.10: New subsection titled, *Federal Tax Lien and the Affordable Care Act's (ACA) Shared Responsibility*, contains information related to the Affordable Care Act encompassing Internal Revenue Code (IRC) § 5000A and § 4980H,

(19) IRM 5.17.2-1: New Exhibit providing a table format visual depiction for the *Commercial Transactions Financing Agreements* example in IRM 5.17.2.6.6.1(4)(a).

Effect on Other Documents

This supersedes IRM 5.17.2 dated December 23, 2013 with an effective date of January 1, 2014 and reissued Interim Guidance Memorandum SBSE-05-0914-0057, titled, *Unrecorded Conveyances and Federal Tax Lien Attachment*, dated September 10, 2014.

Audience

SB/SE Revenue Officers.

Effective Date

(01-01-2015)

Dretha M Barham
Director, Collection Policy
Small Business/Self-Employed

5.17.2.1 (03-27-2012)
Federal Tax Liens Overview

1. This section first explains how the federal tax lien arises, its duration, and the effect of filing a Notice of Federal Tax Lien (NFTL). The text then discusses the priority disputes between the federal tax and competing liens. The text next discusses the different methods for seeking relief from the federal tax lien, including subordination, releases, and certificates of discharge. The section ends with a discussion of the estate tax lien and the gift tax lien.

5.17.2.2 (03-27-2012)
The General Tax Lien

1. The law generally defines a lien as a charge or encumbrance that one person has on the property of another as security for a debt or obligation. Essentially, this concept can be reduced to a simple metaphor — i.e., a special "sticker" similar to what a moving company puts on the furniture, boxes, and other contents of a house when it takes the owner's property from one place to another. The lien (or "sticker") does not change the ownership or other qualities of the property to which it is affixed; it merely identifies the property as having some kind of claim against it.
2. Liens may be divided into three general categories: common-law liens, consensual liens, and statutory liens. This section deals with the statutory liens provided for by the Internal Revenue Code. The principal lien considered in this section is the "general" tax lien, sometimes referred to as the assessment or "secret" lien. The general tax lien is provided for by IRC § 6321 and is a very broad lien; it generally encompasses all of the taxpayer's property or rights to property as security for a tax liability.
3. In addition to the general tax lien, there are two special liens for estate and gift taxes which arise at the date of death or the date of the gift, respectively. These liens are provided for by IRC § 6324. Special estate tax liens applicable to cases involving certain closely held business or farm or qualified family-owned business property are provided for by IRC § 6324A, IRC § 6324B, and IRC § 2057(i)(3)(P), respectively. Questions concerning these liens should be referred to Area Counsel. For more information on the Estate Tax Lien, see IRM 5.5.8.

5.17.2.2.1 (03-27-2012)
When and How the Tax Lien Arises

1. The federal tax lien arises when any "person" liable to pay any federal tax fails to pay the tax after a demand by the Government for payment. IRC § 6321. For federal tax law purposes, a "person" is defined to include individuals, trusts, estates, partnerships, associations, companies, and corporations. IRC § 7701(a)(1). The lien is effective from the date the Government assesses the tax. Thus, if the taxpayer neglects or refuses to pay the assessed tax, then the lien is deemed to relate back to the assessment date. IRC § 6322. The Service is not required to file a NFTL in order for the tax lien to attach. As discussed later in the text, the Service may file a NFTL in order to have priority over the taxpayer's other creditors.

5.17.2.2.2 (03-27-2012)
Duration of the Federal Tax Lien

1. The federal tax lien continues until the liability for the amount assessed is satisfied or becomes unenforceable by reason of lapse of time, i.e., passing of the collection statute expiration date (CSED). IRC § 6322. Generally, after assessment, the Service has ten years to collect the tax liability. IRC § 6502. However, there are some circumstances which may extend or suspend the ten-year collection period.
2. IRC § 6502 provides for an extension of the collection period in two situations:
   A. The statute of limitations was extended at the same time an installment agreement was entered into. In this case, collection action may be taken until the 89th day after expiration of the installment agreement. IRC § 6502(a)(2)(A).

      Note:

      The Service only secures extensions on partial payment installment agreements and only in limited situations. See IRM 5.14.2.1.3.

   B. Release of a levy under IRC § 6343 is accompanied by an agreement to extend the statute of limitations to a specific date and that date has not yet passed. IRC § 6502(a)(2)(B); Treas. Reg. § 301.6343-1(b)(2)(ii)(D).
3. IRC § 6503 provides for the suspension of the collection period in several situations. The more common situations are the following:
   - Issuance of a statutory notice of deficiency, IRC § 6503(a).
   - Assets of the taxpayer in control or custody of a court, IRC § 6503(b).
   - Taxpayer is outside of the United States for a continuous period of at least 6 months, IRC § 6503(c).
   - An extension exists for the payment of an estate tax, IRC § 6503(d).
   - A wrongful seizure of property or a wrongful lien on property, IRC § 6503(f).
   - A taxpayer bankruptcy filing triggering the automatic stay, IRC § 6503(h). Insolvency or Area Counsel can identify whether the automatic stay is in effect for any particular period.

   Note:

   There are other IRC sections whose provisions result in extensions of the Collection Statute Expiration Date (CSED), including, but not limited to, IRC §§ 6015(e)(2), 6330(e)(1), 6331(i)(5), 6331(k)(3)(B) and 6672(c)(4). See also IRM 5.1.19, *Collection Statute Expiration*

   .
4. If the United States files suit and reduces the tax claim to judgment, then the collection period does not expire until the judgment has been satisfied. United States v. Overman, 424 F.2d 1142 (9th Cir. 1970); United States v. Hodes, 355 F.2d 746 (2nd Cir. 1966).
5. State statutes of limitations cannot affect the duration or existence of the federal tax lien. Overman, 424 F.2d at 1147.

5.17.2.2.3 (12-12-2014)
Transfer of Property Subject to Lien

1. After the federal tax lien attaches to property, it remains on that property until the lien has expired, is released, or the property has been discharged from the lien. The transfer of property subsequent to attachment does not affect the lien. United States v. Bess, 357 U.S. 51, 57 (1958). If property is sold by the taxpayer, the lien attaches to

whatever is substituted for it, as it reaches all of the taxpayer's property and rights to property. Phelps v. United States, 421 U.S. 330, 334-35 (1975) (lien attached to the cash proceeds of a sale). However, as a practical matter, it may be difficult to enforce a tax lien against cash sale proceeds.

5.17.2.3 (12-12-2014)
Filing Notice of the Federal Tax Lien

1. The federal tax lien arises when the Service meets the requirements of IRC § 6321, i.e., an assessment and a notice and demand for payment. However, the law provides that in order for the federal tax lien to have priority against certain competing lien interests, the Service must file a NFTL pursuant to IRC § 6323.
2. Prior to filing a NFTL, the Service should verify the outstanding liability and determine that the filing of the notice of lien is appropriate under the circumstances. See IRM 5.12.2.3, *Notice of Federal Tax Lien Filing Determination (Pre-filing Considerations)*.The criteria for filing an NFTL are set forth in IRM 5.12.2.6, *NFTL Filing Criteria*.

5.17.2.3.1 (12-12-2014)
Purpose and Effect of Filing Notice

1. The filing of a NFTL is not a step required to give rise to or to perfect the lien against the taxpayer. The act of filing protects the Government's right of priority as against certain third parties, typically a purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor. IRC § 6323(a). See In re Tracey, 394 B.R. 635 (BAP 1st Cir. 2008) (act of filing NFTL sufficient for section 6323(a) purposes with respect to personal property, under applicable local law, even if clerk fails to record). Generally speaking, unless the Service first properly files a notice of its federal tax lien, the purchaser will take the property free of the federal tax lien. Similarly, unless the Service first files a NFTL, the holder of a security interest, mechanic's lienor, and judgment lien creditor will have priority over the federal tax lien.
2. IRC § 6323(f)(4) requires that in some states a NFTL filed with respect to real property must be indexed in order to be treated as filed. Indexing will be required in a state in which a deed must be indexed in order to be valid against a later bona fide purchaser. See Hanafy v. United States, 991 F. Supp. 794 (N.D. Tex. 1998). If you have any question as to whether IRC § 6323(f)(4) applies to your case, contact Area Counsel.

5.17.2.3.2 (12-12-2014)
Place of Filing

1. IRC § 6323(f) and state law determine the correct place to file a NFTL. If the Service files the NFTL in the wrong office, then the lien will not have priority over a later purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor.
2. Different filing rules apply for real property and personal property. IRC § 6323(f) provides that states may designate one office for filing the NFTL for real and personal property.
   - For real property, the NFTL is filed in the one office designated by the State where the property is physically located. States generally provide that the one office for filing the NFTL for real property is the county recorder or clerk of the county in which the real property is located.
   - As against personal property, the situs of both tangible and intangible property is the residence of the taxpayer at the time the notice of lien is filed. Again, most states generally provide that the one office for filing the NFTL for an individual's personal property is the county clerk's office in the county in which the individual resides.
   - The residence of a corporation or partnership is deemed to be the place at which the principal executive office is located, which is the office at which the major executive decisions are made. S. D'Antoni, Inc. v. Great Atlantic & Pacific Tea Co., Inc., 496 F. 2d 1378 (5th Cir. 1974). For employment tax and certain excise tax purposes, a single-owner unincorporated business entity is classified as a corporation under Treas. Reg. § 301.7701-2T(c)(2)(iv)(B) and (c)(2)(v)(B), subject to the effective date rules in Treas. Reg. § 301.7701-2T(e)(5)-(6).
   - For purposes of filing a notice of federal tax lien, a taxpayer who resides abroad is deemed to reside in Washington, D.C. Thus, a notice of federal tax lien filed against personal property is to be filed with the Recorder of Deeds for the District of Columbia.
3. If a state fails to provide an office or designates more than one office for filing a NFTL, then IRC § 6323(f) provides that the NFTL is to be filed in the office of the clerk of the United States District Court for the judicial district in which the property subject to the lien is situated. Currently, Massachusetts, Puerto Rico, Guam, the Commonwealth of the Northern Mariana Islands (CNMI), and the Virgin Islands (VI) are the only jurisdictions where the Service files a NFTL for personal property in federal district court.
4. IRC § 6323(f)(5) provides that the filing of a NFTL is governed solely by the Internal Revenue Code and is not subject to any other Federal law establishing a place or places for the filing of liens or encumbrances under a national filing system. For purposes of determining whether a state has designated more than one office for filing a NFTL, state law that merely adopts or reenacts a Federal law establishing a national filing system is not counted. IRC § 6323(f)(1)(A)(ii). See also Treas. Reg. § 301.6323(f)-1(a)(2).

   Example: If a state adopts a federal law requiring that liens against airplanes must be filed with a national registry, and state law also provides that liens against personal property must be filed with the county recorder in the county in which the taxpayer resides, the state has designated only one office for the filing of liens against personal property for purposes of IRC § 6323(f). The requirement to file liens against airplanes in a national registry does not constitute a second place of filing. Accordingly, a NFTL against an airplane would be filed with the county recorder's office in the county where the taxpayer resides, and not with the United States District Court. Also, the Service would not file a NFTL with the national registry under IRC § 6323(f). See Treas. Reg. § 301.6323(f)-1(e), Examples 5 & 6.
5. The Revised Uniform Federal Tax Lien Registration Act (1966), which has been adopted by many states, provides, among other things, a clear rule for the personal property of corporations and partnerships: NFTLs should be filed in the Office of the Secretary of State. This rule applies in states that have adopted the Act.

5.17.2.3.3 (12-12-2014)
Refiling of Notice

1. All NFTLs must be refiled within the required refiling period to retain priority as of the initial filing date. If this is not done, most NFTLs filed after December 1982 will self release thirty days after the date ten years after the assessment, regardless of any extension or suspension of the collection statute of limitations.
2. The NFTL may be refiled during the one-year period ending 30 days after the expiration of ten years after the assessment date of the tax. IRC § 6323(g)(3)(A).

   Example: Assume that the Service assessed T's liability on March 1, 1993. On July 1, 1993, the Service filed a NFTL, showing a self-releasing date of March 31, 2003. For all of 1998 and 1999, T's bankruptcy case stayed the running of the collection period. The period for refiling began on April 1, 2002, and continued until March 31, 2003. In this case, the Service timely refiled on January 2, 2003, so the assessment lien and NFTL filed on July 1, 1993, continue to be valid and the lien has priority as of July 1, 1993.
3. If the collection period continues to be suspended or extended after the initial refiling, the Service may have to refile again. This second refiling must be made in the one-year period ending with the expiration of 10 years after the close of the preceding required refiling period. IRC § 6323(g)(3)(B).
4. Frequently, the NFTL is filed in multiple offices. When the Service refiles, it must refile in each of the offices in which the prior NFTLs were filed. See IRC § 6323(g)(2)(A) and Treas. Reg. § 301.6323(g)-1(a)(1). If a taxpayer properly notifies the Service of a change of residence, the Service must not only refile in the original offices, but must also file a NFTL in the recording office covering the new residence.
5. If a self-releasing NFTL is filed in multiple offices with respect to a particular tax assessment, and the Service fails to timely refile in each of those offices, the assessment lien releases and the refiling of any other NFTL is rendered ineffective. Treas. Reg. § 301.6323(g)-1(a)(1). In other words, even if the NFTL is properly refiled in every office except for one, failure to refile in one office causes the underlying assessment lien to be extinguished and the refiled NFTLs to be ineffective.

6. However, neither the failure to refile before the expiration of the refiling period, nor the release of the lien, shall alter or impair any right of the United States to property or its proceeds that is the subject of a levy or judicial proceeding commenced prior to the end of the refiling period or the release of the lien, except to the extent that a person acquires an interest in the property for adequate consideration after the commencement of the proceeding and does not have notice of, and is not bound by, the outcome of the proceeding. Treas. Reg. § 301.6323(g)-1(a)(3). This provision is effective for NFTLs filed on or after April 4, 2011. Contact Area Counsel if you have a case involving a lien that is released that attached property or proceeds that are the subject of a levy or judicial proceeding.

5.17.2.3.4 (03-27-2012)
Contents of Notice of Federal Tax Lien

1. The Secretary of Treasury prescribes the form and content of the NFTL and the NFTL is valid notwithstanding any other provisions of law regarding the form or content. IRC § 6323(f)(3). State law may not require that the NFTL be in any particular form or contain any particular items to be recordable. United States v. Union Central Life Ins., 368 U.S. 291 (1961).

2. The NFTL can be either a paper form (the Service uses Form 668(Y)(c)), or a form transmitted electronically, including by fax or e-mail. Regardless of the method used to file the NFTL, it must identify the taxpayer, the tax liability giving rise to the lien, and the date the assessment arose. Treas. Reg. § 301.6323(f)-1(d)(2).

5.17.2.3.5 (12-12-2014)
Effect of Errors in Notice of Federal Tax Lien

1. Errors appearing on the face of the Service’s filed NFTL often create problems not only in evaluating the validity of the NFTL, but also in determining relative priorities between the Service’s claim and other competing lien claimants.

2. A number of controversies concern errors in the name of the taxpayer as it appears on the NFTL. The general rule is that if the name on the notice is not identical to the correct name of the taxpayer, then the NFTL is still valid if the NFTL is sufficient to put a third party on notice of a lien outstanding against the taxpayer. This is known as the substantial compliance test. United States v. Sirico, 247 F. Supp. 421 (S.D.N.Y. 1965).

3. In applying the substantial compliance test, many courts have upheld NFTLs even when there was an error in the taxpayer's name. See Quist v. Wiesener, 327 F.Supp.2d 890 (E.D. Tenn. 2004) ("Joint Effort" rather than "Joint Effort Productions, Inc."); Whiting-Turner v. P.D.H. Dev. Inc., 184 F.Supp.2d 1368 (M.D.Ga. 2000) ("PDH Development, Inc." rather than PD Hill Development, Inc.”); Kivel v. United States, 878 F.2d 301 (9th Cir. 1989) ("Bobbie Morgan" rather than "Bobbie Morgan Lane"); United States v. Polk, 822 F.2d 871 (9th Cir. 1987) ("Roy Bruce Polk" rather than "Bruce Polk"); Tony Thornton Auction Service, Inc. v. United States, 791 F.2d 635 (8th Cir. 1986) (notice filed against "Davis's Restaurant," a partnership, and one partner, "Joe Davis," was sufficient as notice against the other partner, "Mary Davis"); Richter's Loan Co. v. United States , 235 F.2d 753 (5th Cir. 1956) ("Freidlander" rather than "Friedlander"); Brightwell v. United States, 805 F. Supp. 1464 (S.D. Ind. 1992) ("William S. Van Horn" rather than "William B. Van Horn"); and United States v. Sirico, 247 F. Supp. 421 (S.D.N.Y. 1965) ("Sirico, George" and "Sirico, A." rather than "Assunta Sirico"). But see Fritschler, Pellino, Schrank & Rosen, S.C. v. United States, 716 F. Supp. 1157 (E.D.Wis. 1988) ("Alan G. Casey" rather than "Alan J. Casey"); Haye v. United States, 461 F. Supp. 1168 (C.D.Cal. 1978) ("Castello" rather than "Castillo"); United States v. Ruby Luggage Corp., 142 F. Supp. 701 (S.D.N.Y. 1954) ("Ruby Luggage Corp." rather than "S. Ruby Luggage Corp."); and Continental Invs. v. United States, 142 F. Supp. 542 (W.D. Tenn. 1953) ("W.B. Clark, Sr." rather than "W.B. Clark, Sr.").

4. In re Spearing Tool and Manufacturing Co., Inc., 412 F.3d 653 (6th Cir. 2005), cert. denied sub nom. Crestmark Bank v. United States, 549 U.S. 810 (2006), is the lead case for upholding a NFTL when lien filing records are electronically searched. In Spearing Tool , the Sixth Circuit held that the Service's identification of a taxpayer in a NFTL was sufficient where the name of the corporation appeared in an abbreviated form of the corporate name registered with the Michigan Secretary of State. A lien search by a secured creditor did not disclose the NFTLs that had been filed against "Spearing Tool & Mfg. Company, Inc." The proper name under UCC filing rules was "Spearing Tool and Manufacturing Co."

    - The 6th Circuit found that the secured creditor challenging the validity of the NFTL had failed to conduct a reasonable and diligent electronic search because its search did not take into consideration the following three factors:
      1. The use of the abbreviation "Mfg." and the use of an ampersand are common.
      2. The secured creditor knew that Spearing Tool sometimes used these abbreviations.
      3. The Michigan Secretary of State's office recommended to the secured creditor that it undertake a search using the abbreviations.

    - The 6th Circuit limited its holding to the facts and specifically expressed no opinion about whether creditors have a general obligation to search name variations.

5. In summary, when searching for a NFTL in public records, either in a book format or electronic format, the searcher must act reasonably and diligently. The NFTL identifies the taxpayer when it is sufficient to put a third party on notice of a lien outstanding against the taxpayer. Since this is essentially a factual question, however, it is especially important to pay attention to the "details." Thus, for example, if a person is known or suspected to use any aliases or owns property held for him/her by a nominee, agent or trustee, it is desirable to prepare an individual NFTL for filing in all the necessary names. Area Counsel approval should be obtained before filing a NFTL in the name of a nominee, alter ego, transferee, or successor in interest. IRM 5.12.7.6(8).

5.17.2.4 (12-12-2014)
Collection Due Process

1. IRC § 6320 gives the taxpayer the right to challenge a NFTL filing, request a Collection Due Process (CDP) hearing with Appeals, and seek judicial review of Appeals’ determination with the Tax Court. The Service must generally notify the taxpayer within 5 business days after the date of filing the first NFTL for a tax period. The notice of lien must be given in person, left at the taxpayer’s home or place of business, or sent by certified or registered mail to the person’s last known address. The notice must also inform the taxpayer of the amount of the unpaid tax, the taxpayer’s right to request a hearing, the available administrative appeals procedures, and applicable procedures for releasing the lien. IRC § 6320(a). For more information, see IRM 5.12.6, *Appeals Processes Involving Liens*;IRM 5.1.9, *Collection Appeal Rights*; and IRM 8.22, *Collection Due Process*.

5.17.2.5 (03-27-2012)
Property to Which the Tax Lien Attaches

1. The federal tax lien attaches to all property and rights to property of the taxpayer. This is a very broad concept and includes not only items which are typically thought of as property, e.g., tangible items and "things," but also intangible items and "rights" which a taxpayer may have, but are not necessarily marketable. The only exception is that the lien does not attach to any interest of an Indian in restricted land held by the United States. Treas. Reg. § 301.6321-1.

2. The courts have interpreted this very broad language to include property of greatly varying natures, as well as future interests, contingent interests, and executory contracts.

    - **Future interests**. The fact that a taxpayer’s enjoyment of a "right to property" may be postponed does not prevent attachment. If a taxpayer has an unqualified fixed right, under trust or a contract, to receive periodic payments or distributions of property, a lien attaches to the taxpayer’s entire right regardless of when the payments or distributions will be made. Rev. Rul. 55-210, 1955-1 C.B. 544.

    - **Contingent interests**. These are interests which a party will receive only if certain circumstances or events occur. See Fouts v. United States, 107 F.Supp.2d 815, 817 (W.D. Mich. 2000) (under state law an expectant beneficiary of an inter vivos trust has a present interest in property that is attachable). But see Dominion Trust Co. of Tennessee v. United States, 7 F.3d 233 (unpublished table decision) (6th Cir. 1993) (under state law a contingent remainder person did not have an interest in property). An inter vivos trust is sometimes referred to as a "living trust" .

    - **Executory contracts**. A lien may attach before performance under a contract. See Seaboard Surety Co. v. United States, 306 F.2d 855, 859 (9th Cir.1962) (a lien attached to the taxpayer's rights under an executory contract which the taxpayer had assigned and, when the taxpayer performed under the contract, the government had a lien on the proceeds). See also Randall, Sr. v. H. Nakashima & Co., 542 F.2d 270, 274 (5th Cir. 1976) (contract rights under a partially executed contract constituted a right to property because they had a realizable value).

3. Once the lien has come into existence, it attaches immediately to any property acquired by the taxpayer during the existence of the lien. In other words, unlike a typical mortgage, the federal tax lien attaches to a taxpayer’s after-acquired property.

4. If the Service files a NFTL, the tax lien will generally have priority to a taxpayer's after-acquired property. In United States v. McDermott, 507 U.S. 447 (1993), the Supreme Court held that the federal tax lien had priority over a judgment lien on the taxpayer's after-acquired property, to which the judgment lien and the federal tax lien attached simultaneously, even though the judgment lien was filed ahead of the NFTL.

5.17.2.5.1 (12-12-2014) State Law

1. State law is very significant when considering the property and rights to property to which the federal tax lien attaches. The Government looks to state law to determine a taxpayer's rights in a particular piece of property, but federal law determines whether such interests qualify as property or rights to property. "[One] look[s] to state law to determine what rights the taxpayer has in the property the Government seeks to reach, then to federal law to determine whether the taxpayer's state-delineated rights qualify as 'property' or 'rights to property' within the compass of federal tax lien legislation." United States v. Craft , 535 U.S. 274 (2002); Drye v. United States, 528 U.S. 49, 58 (1999).
2. State law does not determine whether something is property under the Internal Revenue Code. For example, in many states a liquor license is not property. Under the Internal Revenue Code, however, the question is whether the taxpayer has rights under state law. Because the taxpayer does have rights under state law, the liquor license is property under the Internal Revenue Code. See Drye, 528 U.S. at 58-59.
3. The Government must look to state law to determine whether a taxpayer has rights in property by virtue of a civil union, domestic partnership, or similar relationship.

5.17.2.5.2 (03-27-2012) Real Property

1. Federal tax lien questions relating to the joint ownership of property generally arise when other parties claim an interest in real property otherwise subject to the federal tax lien. This issue typically arises when the Service asserts a tax lien against only one of the parties having an interest in real property which, depending on state law, is held in one of the following forms:
   - Community property,
   - Joint tenancy,
   - Tenancy in common , or
   - Tenancy by the entirety.

5.17.2.5.2.1 (12-12-2014) Community Property

1. The community property states are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin. Puerto Rico is also a community property jurisdiction. Spouses in Alaska may elect to have statutory community property rules apply to some or all of their property. Alaska St. § 34.77.010 et. seq. Community property includes both real and personal property.
2. In most community property states, only married couples may own property as part of a community. Community property rules in these states apply to both opposite and same-sex married couples whose marriages are recognized by that state. The community property rules also apply in some states to state-created, formal relationships between opposite and same-sex couples. For example, California, Nevada and Washington permit domestic partnerships to which each states apply its community property laws.
3. Community property law presents special problems concerning the force and effect of the federal tax lien. Questions in that regard should be referred to Area Counsel. Reference may also be made to the State Law Guides on the My SB/SE Counsel website. See http://ccintranet.prod.irscounsel.treas.gov/OrgStrat/Offices/sbse/Pages/LawGuides.aspx and IRM 25.18.1 and IRM 25.18.4.

5.17.2.5.2.2 (03-27-2012) Joint Tenancy

1. A joint tenancy may be created when the following conditions are met:
   - Two or more persons become the owners of property in equal and undivided shares.
   - The interest of each tenant is created in the same conveyance at the same time and the interests must be equal.
2. Joint tenants generally have a right of survivorship. Under the right of survivorship, when a joint tenant dies, the surviving joint tenants automatically own a greater portion of the property.

   Example: Assume A, B, and C own Whiteacre in a joint tenancy. If A dies, B and C automatically own Whiteacre. If B then dies, C automatically is the sole owner.

   Note:

   By statute, some states have abolished the survivorship feature of joint tenancy.
3. Generally, where only one of the joint tenants owes taxes, the lien attaches to the taxpayer's property interest and the entire property may be sold pursuant to judicial sale under IRC § 7403, although the non-liable joint tenant must be compensated from the sale proceeds. If the Service enforces the tax lien against a taxpayer's interest in a joint tenancy and sells it, the purchaser acquires the taxpayer's partial interest in property, but most states then treat the joint tenancy as having been converted to a tenancy in common (discussed below). See generally, United States v. Rodgers, 461 U.S. 677 (1983).
4. In most states, if the individual, against whose property a federal tax lien attaches, dies before any of the other joint tenants, then the lien ceases to attach to the property. However, if the same individual is the last survivor of the joint tenants, the tax lien then attaches to the entire property. In a few states, however, this is not the rule. Wisconsin is an exception to the general rule: if the federal tax lien has attached to the interest of one joint tenant who then dies, the surviving joint tenant takes the property encumbered with the federal tax lien. United States v. Librizzi , 108 F.3d 136 (7th Cir. 1997). Connecticut is also an exception to the general rule. Conn. Gen. Stat. 47-14f. See also Paternoster v. United States, 640 F.Supp.2d 983 (S.D. Ohio 2009). Accordingly, state law should always be consulted to determine whether there is an exception to the general rule.

5.17.2.5.2.3 (03-27-2012) Tenancy in Common

1. A tenancy in common is like a joint tenancy in that it creates an undivided interest in property. However, it is different from a joint tenancy in two important aspects:
   - First, the interest of a tenant in common may be transferred to a third party without destroying the tenancy in common.
   - Second, there is no right of survivorship in a tenancy in common.

   Example: Assume A and B own Blackacre in tenancy in common, and A dies. B and A's estate would then own Blackacre as tenants in common.
2. Applying the above rules to collection, the Service may levy and sell a taxpayer's interest in a tenancy in common. Alternatively, the Service may ask a court to foreclose the federal tax lien and sell the entire property, although the non-liable tenant in common must be compensated from the sale proceeds. Also, if a tax lien attaches to one

tenant's interest, it will survive the taxpayer's death and continue to encumber the property in the hands of heirs or legatees.

5.17.2.5.2.4 (12-12-2014)
Tenancy by the Entirety

1. Only spouses can hold property in a tenancy by the entirety. A tenancy by the entirety is similar to a joint tenancy in having a right of survivorship. But the tenancy by the entirety has a restriction not found with a joint tenancy: one spouse cannot transfer his or her interest without the consent of the other spouse. Same-sex spouses may own property as tenants by the entirety in those states that recognize same-sex marriages and allow property to be held as tenancy by the entirety. Some states permit real and personal property to be held as a tenancy by the entirety while others only permit real property to be held in such manner.
2. For many years there was uncertainty as to whether a federal tax lien could attach to the interest of only one tenant. (If both spouses were liable, the general rule was that a federal tax lien could attach to the tenancy by the entirety.) In United States v. Craft, 535 U.S. 274 (2002), the Supreme Court provided a clear answer, holding that the federal tax lien may attach to the tenancy by the entirety when only one spouse had a federal tax liability. Notice 2003-60, 2003-2 C.B. 643 addressed the application of Craft to different situations. In summary, the Notice stated the following:
   A. The federal tax lien attaches to all the property and rights to property of the taxpayer. The Court's decision confirms that a taxpayer's property and rights to property have always included any rights that the taxpayer may have in entireties property under state law. The Court's decision, therefore, does not represent new law and does not affect other law applicable to federal tax liens and federal tax collection. For example, the Craft decision does not change any limitation on the ability of the Service to rescind an accepted offer in compromise or terminate an accepted installment agreement.

   B. As a matter of administrative policy, the Service will, under certain circumstances, not apply Craft, with respect to certain interests created before Craft, to the detriment of third parties who may have reasonably relied on the belief that state law prevents the attachment of the federal tax lien.

   C. The administrative sale of entireties property subject to the federal tax lien presents practical problems that limit the usefulness of the Service's seizure and sale procedures. Levying on cash and cash equivalents held as entireties property is considerably less problematic and will be used by the Service in appropriate cases.

   D. Because of the potential adverse consequences to the non-liable spouse of the taxpayer, the use of lien foreclosure for entireties property subject to the federal tax lien will be determined on a case-by-case basis. See United States v. Rodgers, 461 U.S. 677 (1983) (IRC § 7403 authorizes foreclosure sale of entire jointly-owned property for separate tax liability of one spouse, but non-liable spouse is entitled to compensation from sale proceeds for loss of her share of the property).

   E. As a general rule, the value of the taxpayer's interest in entireties property will be deemed to be one-half. Accord Popky v. United States, 419 F.3d 242, 245 (3d Cir. 2005); United States v. Barr, 617 F.3d 370, 373 (6th Cir. 2010), cert. denied, 131 S. Ct. 1678 (2011). But see Pletz v. United States, 221 F.3d 1114, 1117-18 (9th Cir. 2000) (using actuarial tables). Craft declined to address the valuation of each spouse's individual interest in the property. 535 U.S. at 289.

   F. Where there has been a sale or other transfer of entireties property subject to the federal tax lien that does not provide for the discharge of the lien, whether the transfer is to the non-liable spouse or a third party, the lien thereafter encumbers a one-half interest in the property held by the transferee.

5.17.2.5.2.5 (12-12-2014)
Equitable Conversion

1. **Some states** recognize the doctrine of equitable conversion, which provides that a purchaser acquires equitable title to property when the unrecorded contract for sale is executed. Although the seller retains bare legal title to the property, the seller's equity interest is in the right to the balance of the purchase money. The seller holds legal title in trust for the purchaser.
2. **Some states** extend the doctrine of equitable conversion to a lender who secures the interest with a mortgage or deed of trust.
3. For a discussion of equitable conversion on the priority of the statutory federal tax lien with respect to purchasers and lenders, see IRM 5.17.2.5.6.1(5), *Purchasers* and IRM 5.17.2.5.6.4(7), *Holder of a Security Interest*, respectively.

5.17.2.5.3 (03-27-2012)
Personal Property

1. Personal property is defined generally as everything that can be owned that is not real property. Tangible property is defined generally as personal property that has physical form and is moveable.
2. The Service takes collection action against a variety of types of personal property, including automobiles, trucks, boats, goods, bank accounts, wages and benefits, interests in trusts, and partnership interests.

5.17.2.5.3.1 (03-27-2012)
Cash and Rights to Cash

1. The federal tax lien attaches to a taxpayer's interest in a bank account, even when the bank account is in the joint names of the taxpayer and others. United States v. National Bank of Commerce, 472 U.S. 713 (1985). This means that the lien reaches a taxpayer's unqualified right to withdraw all of the money in the account without the consent of the other account holder. However, the right of a taxpayer joint depositor to withdraw funds from a joint bank account is provisional and subject to a later claim by a codepositor that the money in fact belongs to him or her.
2. The federal tax lien attaches to a taxpayer's wages as the wages become his property and rights to property. State laws shielding some portion of a debtor's wages from collection do not apply to the Service, as the collection of federal taxes is a matter of federal supremacy. Compare IRC § 6334(a)(9) and IRM 5.17.3.4.7, *Property Exempt from Levy*, regarding exemption of wages and other property from levy.
3. In many situations, the Service loses its federal tax lien on money when a third party acquires the money in exchange for fair value. This occurs under IRC § 6323(b)(1)(A), which provides a superpriority for a purchaser of a security if the purchaser has no actual knowledge of the federal tax lien. Treas. Reg. § 301.6323(h)-1 defines a security to include negotiable instruments and money.

   Example: Taxpayer stops his car at a gasoline station and purchases $25 of gasoline. The federal tax lien has been stripped from the $25 paid to the gasoline station because the station has no actual knowledge of the federal tax lien. The superpriority for purchasers of money allows money to flow in commerce without delays for searching for federal tax liens.

5.17.2.5.3.2 (12-12-2014)
Partnership and Other Joint Interests

1. It is often difficult to determine a partner-taxpayer's interest in a partnership or other joint interest to which a federal tax lien has attached. Generally speaking, a partner-taxpayer's interest in either a partnership or a joint venture is only a share in the equity in the assets; that is, the excess of assets over liabilities. United States v. Kaufman, 267 U.S. 408 (1925). Note that a partnership may own both real and personal property in the name of the partnership. If a federal tax lien exists on the partner-taxpayer's property, the federal tax lien would not attach to the partnership's property. See Rev. Rul. 73-24, 1973-1 C.B. 602 (addressing whether partnership account is subject to levy to satisfy tax liability of individual partner).
2. Frequent and regular partnership "draws" which are advances or loans on annual profits are subject to a lien (and may be levied as salary or wages). United States v. Mokowitz, Passman & Edelman, 603 F.3d 162 (2d Cir 2010).

3. Another issue that arises with respect to partnerships is whether the federal tax lien attaches to a general partner's individual property in connection with an assessment made against the partnership for a partnership tax liability. In United States v. Galletti, 541 U.S. 114 (2004), the Supreme Court held that a timely assessment of a partnership's employment tax liability permits the Service to collect the liability from the individual partners. Because the partners are derivatively liable for the taxes under state law, the assessment and notice and demand upon the partnership gave rise to the federal lien both on partnership and partner property.

5.17.2.5.3.3 (03-27-2012)
Trusts and Beneficial Interests

1. A trust is a state-law created entity where one party holds property for the benefit of another. The following are terms generally used in connection with trusts:
   - The creator of the trust is referred to as the "grantor" or "settlor."
   - The property held by the trust is called the "res," "corpus," "principal" or "remainder." Income generated by the corpus is called income.
   - The person holding the property for the benefit of the other person is called the "trustee" or "fiduciary."
   - The person benefitting from the trust is called the "beneficiary." A beneficiary may only be entitled to income, principal or both, depending on the provisions of the trust.
   - A "revocable" trust is one where under the terms of the trust, the grantor/settlor reserves the right to dissolve the trust and take the property back.
   - An "irrevocable" trust is one that the grantor/settlor cannot dissolve and cannot take the property back.
2. If the taxpayer is the grantor or settlor of a trust, the validity of the trust must be determined under applicable state law. If the grantor reserves a substantial interest or unrestricted control over the management of the operations that is not for the benefit of the purported beneficiary, the grantor remains the owner of the property and the trust will be ignored. For example, property in a family trust that is a sham - the grantors attempt to reduce their taxes by putting the property in trust, while retaining the use and benefits of the property - is subject to collection action to satisfy the grantors' liability. Whitesel Family Estate v. United States, 84-2 U.S. Tax Cas. (CCH) ¶ 9890 (S.D. Ohio 1984); Edwards Family Trust v. United States, 572 F. Supp. 22 (D. N.M. 1983).
3. If the taxpayer is the beneficiary of a trust, a federal tax lien will attach to the taxpayer's beneficial interest in the trust. This determination is made by reference to the trust instrument itself, with the appropriate state law governing construction of the terms of the instrument or the resolution of any ambiguities in the instrument. In some cases the lien will attach to the corpus of the trust and the income payable to the beneficiary. In other cases the lien will attach only to the income as it becomes payable to the beneficiary, and in a few cases it may not attach to either the income or the corpus. The latter situation may arise where the trustee has the unrestricted power of disposition of the trust income; i.e., where he/she may legally refuse to make any further distribution to the taxpayer-beneficiary and instead make the distribution to other beneficiaries or simply accumulate the income.
4. The trust instrument can only determine the property right of the beneficiary (e.g., the taxpayer) in the trust corpus and income; the trust instrument itself cannot determine the effect of the federal tax lien upon that right. Thus, a so-called "spendthrift" trust may by its terms confer certain specific benefits upon a beneficiary and then purport to restrict the rights of creditors to reach those benefits. Such restrictions are not effective to remove those benefits from the reach of the federal tax lien, regardless of whether under the appropriate state law a "spendthrift" trust is regarded as valid in all respects. Bank One Ohio Trust Co. v. United States, 80 F.3d 173 (6th Cir. 1996). In any case where doubt exists as to the rights of a beneficiary of any of the many forms of trusts, the opinion of Area Counsel should be sought.
5. Because the validity of a trust and the taxpayer's rights to trust property are highly dependent upon the particular facts of the case, the terms of the trust agreement, and applicable state law, Area Counsel should be consulted whenever these issues arise. General information regarding the rules relating to trusts and how they impact tax collection may be found in the Tool Box provided on the My SB/SE Counsel website at http://ccintranet.prod.irscounsel.treas.gov/OrgStrat/Offices/sbse/Pages/MySBSECounsel.aspx under "Trusts & Collection Outline." See also IRM 5.17.3.9.24, *Levy and Sale, Trusts*, for information on levying on the corpus or income of a trust.

5.17.2.5.3.4 (12-12-2014)
Intangible Property

1. Intangible property is personal property which lacks a physical existence but is represented by physical evidence. Items in this category include certificates of stock, bonds, promissory notes, licenses, goodwill, debts owed to the taxpayer, patents, copyrights, trademarks, franchises and "choses in action."
2. A chose in action is a personal right not reduced to possession and recoverable by a suit at law. A plaintiff's cause of action in tort or contract against a defendant is an example of a chose in action. United States v. Stonehill, 83 F.3d 1156 (9th Cir. 1996), cert. denied, 519 U.S. 992 (1996).\

5.17.2.5.4 (12-12-2014)
Exempt Property

1. With one exception, no property or rights to property belonging to the taxpayer is exempt from attachment of the federal tax lien. Treas. Reg. § 301.6321-1 provides "... any interest in restricted land held in trust by the United States for an individual noncompetent Indian (and not for a tribe) shall not be deemed to be property, or a right to property, belonging to such Indian."
2. State laws exempting a debtor's property from creditors do not affect the reach of the federal tax lien. United States v. Bess, 357 U.S. 51 (1958); Commissioner v. Stern, 357 U.S. 39 (1958). Similarly, while state law may prevent a beneficiary of a spendthrift trust from transferring his or her interest to third parties, the beneficiary's interest remains property subject to the federal tax lien.

5.17.2.5.5 (03-27-2012)
Terminable Interests

1. Terminable interests are interests a taxpayer may have that, by definition, terminate upon the death of the party holding the interest, such as a life estate in property, or a contract right that will terminate at some time, e.g., an option.
2. The federal tax lien may attach to such an interest before it terminates. However, once the interest terminates, the federal tax lien on that interest also terminates. United States v. Swan, 467 F.3d 655 (7th Cir. 2006); Rev. Rul. 54-154, 1954-1 C.B. 277.

   Example: Assume taxpayer has an option to purchase Whiteacre. The federal tax lien attaches to that option. If the taxpayer, however, never exercises the option, the option will lapse. After the lapse, the federal tax lien no longer attaches to the option.
3. Similarly, in the case of a life estate, the federal tax lien clearly attaches to the life tenant's interest and may be enforced against that interest so long as the life tenant lives. However, upon the death of the life tenant, the lien ceases to attach to the property since the Government's tax lien rights do not exceed the taxpayer's right to the property.

5.17.2.5.6 (03-27-2012)
Property in the Custody of a Court

1. When a taxpayer's property is within the jurisdiction of and under the control of a state or federal court, such property is referred to as being in "custodia legis." This is a judicial doctrine. In most situations, courts recognize that a lien may attach to property held in the court's custody. See Dragstrem v. Obermeyer 549 F.2d 20 (7th Cir. 1977).
2. There may be situations, however, when the federal tax lien will not attach to property held in the court's custody. For example, if an assessment has not been made prior to the transfer of the taxpayer's property to a state court receiver and the taxpayer has no property interest or rights to property after the transfer, then the federal tax lien will not attach to the property held by the receiver.

3. Each state decides whether the taxpayer is divested of his interest upon the transfer.
4. The fact that the Government may not have a lien on property in custodia legis does not prevent the Government from collecting the tax liability in the judicial proceeding that administers the property. The tax lien will attach to any property of the taxpayer not in the custody of the court and will attach to any property returned to the taxpayer upon termination of the court proceedings, such property being in the nature of after-acquired property.

   Note:

   Generally, a levy should not be used to enforce collection of taxes if assets of the taxpayer are in custodia legis. See IRM 5.17.3.4.4, *Custodia Legis*, for more information.
5. In bankruptcy cases, the discharge of the debtor-taxpayer from a tax liability may prevent the tax lien from attaching to after-acquired property. Area Counsel should be contacted with questions concerning the effect of a bankruptcy discharge.

5.17.2.5.7 (12-12-2014)
Property Held By Third Parties

1. Attempting to avoid the imminent attachment of the federal tax lien, taxpayers have transferred their assets to legal entities that they or their friends or relatives control. This maneuver will generally be unsuccessful, because the federal tax lien extends to property held by a third party if that third party is either the alter ego or the nominee of the taxpayer. The factors which are relevant in determining whether such a situation exists are similar to the factors which are used in deciding whether a taxpayer has fraudulently conveyed property to keep it from the reach of creditors.
2. This section outlines some of the most significant elements in determining whether the federal tax lien attaches to property held by a taxpayer’s alter ego or nominee. Note that these two doctrines are legally distinct. Oxford Capital Corp. v. United States, 211 F.3d 280 (5th Cir. 2000).
   - "Alter egos" connote legally distinct entities which are so intermixed that their affairs (and assets) are not readily separable.
   - "Nominees" connote readily separable persons or entities, with one holding certain specific property for the exclusive use and enjoyment of the other.
3. The terms often interchange or overlap, but "alter egos" are usually corporate and business entities controlled by the taxpayer, whereas "nominees" are usually individuals who clearly have a separate physical identity.

5.17.2.5.7.1 (12-12-2014)
Alter Ego

1. Alter ego essentially means a "second self." It is a doctrine that allows the law to disregard an entity’s separate legal identity in order to extend liability and prevent abuse. Using an alter ego theory, if an individual is the alter ego of a corporate taxpayer or other legally distinct entity, then that individual’s assets may be used to satisfy the debts of the corporate taxpayer. This is sometimes called "piercing the corporate veil."
2. Similarly, if a corporation or other legally distinct entity is the alter ego of a taxpayer, then the assets of that entity may be used to satisfy the debts of the individual taxpayer. This is sometimes called "reverse piercing of the corporate veil."
3. An alter ego generally involves a sham corporation used to avoid legal obligations. To establish an alter ego, such that an alter ego Notice of Federal Tax Lien may be filed, it must be shown that the shareholders disregarded the corporate entity and made it an instrumentality for the transactions of their own affairs.

   Note:

   Counsel's position is that federal common law, rather than state law, governs alter ego status. See Chief Counsel Notice CC-2012-002 (Dec. 2, 2011). Contact Area Counsel with questions regarding the applicable law.
4. No one factor determines whether an alter ego situation is present, but a number of factors taken together may. The following list is neither exhaustive nor exclusive, but alter ego situations typically involve one or more of the following:
   A. Commingling of corporate and personal finances and use of corporate funds to pay personal expenses.
   B. Unsecured interest-free loans between the corporation and the shareholder.
   C. The taxpayer is a shareholder, director, or officer of the corporation, or otherwise exerts substantial control over the corporation.
   D. The corporation is undercapitalized relative to its reasonable anticipated risks of business.
   E. A failure to observe corporate formalities, e.g. issuance of stock, payment of dividends, director and shareholder meetings, or the maintenance of corporate records.
   F. A failure to disregard the corporate fiction presents an element of injustice or "fundamental unfairness."
5. In an alter ego case, a special condition NFTL is used, identifying, in the name line of the NFTL before the taxpayer's name, the third party as the alter ego.. For example, if the taxpayer is TP, and ABC Inc. is TP’s alter ego, then the NFTL name line would read "ABC, Inc., as Alter Ego of TP."
6. Area Counsel approval is required prior to filing a Notice of Federal Tax Lien naming an alter ego. See both 5.12.7.6.2*Alter-Ego Lien Notices* and IRM 5.12.7.6.4(6) through (8), *Special Condition NFTL Approval Process: Request, Advisory Review, and Post-Approval*.

   Note:

   Generally, an alter ego should not be asserted in transactions involving only individuals.

5.17.2.5.7.2 (12-12-2014)
Nominee

1. A "nominee" is someone designated to act for another. As used in the federal tax lien context, a nominee is generally a third-party individual who holds legal title to property of a taxpayer while the taxpayer enjoys full use and benefit of that property. In other words, the federal tax lien extends to property "actually" owned by the taxpayer even though a third party holds "legal" title to the property as nominee. Generally speaking, the third party in a nominee situation will be either another individual or a trust.
2. A nominee situation generally involves a fraudulent conveyance or transfer of a taxpayer’s property to avoid legal obligations. To establish a nominee lien situation, it must be shown that while a third party may have legal title to the property, it is really the taxpayer that owns the property and who enjoys its full use and benefit. If state law is undeveloped or underdeveloped as to the issue of nominee ownership, contact Area Counsel for assistance.
3. No one factor determines whether a nominee situation is present, but a number of factors taken together may. The following list is neither exhaustive nor exclusive, but nominee situations typically involve one or more of the following:
   A. The taxpayer previously owned the property.
   B. The nominee paid little or no consideration for the property.
   C. The taxpayer retains possession or control of the property.
   D. The taxpayer continues to use and enjoy the property conveyed just as the taxpayer had before such conveyance.

E. The taxpayer pays all or most of the expenses of the property.

F. The conveyance was for tax avoidance purposes.

4. The Service's NFTL in a nominee situation is identical to the standard NFTL, except that the nominee is identified as the name of the taxpayer. For example, if the taxpayer is TP, and My Brother-In-Law or My Trust is TP's nominee, then the name of the taxpayer on the nominee NFTL would be "My Brother-In-Law or My Trust, Nominee of TP."

5. Unlike the alter ego situation, nominee situations usually involve specific pieces of a taxpayer's property that were conveyed to the nominee. Since the federal tax lien only attaches to property actually "owned" by the taxpayer, it may not reach all property that is, in fact, actually owned by the nominee. Therefore, the NFTL in a nominee situation will usually contain a notation on its face that the lien is filed to attach specifically to certain identified property. This property must be specifically identified and described in the NFTL.

6. Area Counsel approval is required prior to filing a nominee lien. See both IRM 5.12.7.6.1, *Nominee Lien Notices*, and IRM 5.12.7.6.4(6) through (8), *Special Condition NFTL Approval Process: Request, Advisory Review, and Post-Approval* for more information.

5.17.2.5.8 (12-12-2014)
Disclaimers and Renunciations

1. State laws generally provide that a recipient does not have to accept a gift or transfer. Such transfers are generally inheritances, devises, bequests, gifts, and marital interests upon divorce or death of a spouse. To avoid the transfer, state law allows the recipient to "disclaim" or "disavow" or "renounce" such transfers. Typically, the operation of state law can create a legal fiction that the recipient of such transfers never received the property in question by retroactively treating the disclaimer as having occurred prior to the receipt of the property.

2. The issue is whether a taxpayer-recipient's disclaimer will prevent the federal tax lien from attaching to the property. In Drye v. United States, 528 U.S. 49 (1999), the Supreme Court held that such a disclaimer will not prevent a federal tax lien from attaching to the property. Similarly, even though a spouse's renunciation of a marital interest may be treated as retroactive under state law, that state-law disclaimer does not determine the spouse's liability for federal tax on her share of community income realized before the renunciation. United States v. Mitchell, 403 U.S. 190 (1971).

3. "Retroactive" or "relation-back" state laws also do not prevent a federal tax lien from attaching to property. Treas. Reg. § 301.6323(h)-1(a)(2)(B); Brent v. Commissioner, 630 F.2d 356 (5th Cir. 1980); Daine v. Commissioner, 168 F.2d 449 (2nd Cir. 1948); Eisenberg v. Commissioner, 161 F.2d 506 (3d Cir. 1947), cert. denied, 332 U.S. 767 (1947)..

5.17.2.5.9 (12-12-2014)
Same-sex Marriage and Legally-Recognized Relationships

1. The recognition of same-sex marriage and the creation of formal relationships other than marriage may give taxpayers property rights they previously did not have. Federal tax liens will attach to these property rights and the Service will be able to levy on these rights. Many states recognize same-sex marriage. Some states allow opposite and same-sex couples to enter into other formal, legal relationships that confer rights and benefits similar to those provided by marriage. These relationships include civil unions, registered domestic partnerships, reciprocal beneficiaries, and designated beneficiaries. Among the rights conferred on same-sex spouses as well as the opposite and same-sex members of the state-created legal relationships are:

    1. **Inheritance rights.** Upon the death of one spouse or member of a legally-recognized relationship, the survivor may be entitled to inherit certain property under the state's intestacy law. Alternatively, the surviving member may have a right to property as a beneficiary under the decedent's will. Instead of taking under a will, or in the event of unjustifiable disinheritance or omission from the will, the survivor may be entitled to claim an elective share.
    2. **Community property rights.** See IRM 5.17.2.5.2.1.
    3. **Tenancy by the entirety.** See IRM 5.17.2.5.2.4.
    4. **Tort claims.** An opposite or same-sex spouse or member of a legally-recognized relationship may have the right to bring a cause of action in connection with the death or injury of the other member of the legally-recognized relationship. A federal tax lien attaches to tort claims. United States v. Hubbell, 323 F.2d 197 (5th Cir. 1963).
    5. **Insurable interest.** An opposite or same-sex spouse or member of a legally-recognized relationship may have an insurable interest in the life of the other member of the legally-recognized relationship. A delinquent taxpayer in one of these legally-recognized relationships may be the beneficiary under an insurance policy upon the death or disability of the other member.
    6. **Retirement plans.** A liable taxpayer may be entitled to receive survivor benefits or the balance of a retirement account from a retirement plan in which his or her deceased spouse or member of a legally-recognized relationship was a participant. If a liable taxpayer has been divorced, he or she may be entitled to benefits or the account balance from a retirement plan in which his or her divorced spouse or member of a legally-recognized relationship is or was a participant.
        a. **ERISA-qualified plans.** The Employment Retirement Income Security Act (ERISA) governs most retirement plans and if ERISA-qualified, state law rules do not apply. Under ERISA, the term "spouse" includes individuals married to a person of the same sex who were legally married in a state that recognizes such marriages, but who are domiciled in a state that does not. U.S. Dept. of Labor Technical Release No. 2013-04. For a defined benefit plan (plan funded by an employer that pays participants a specific monthly benefit at retirement), the surviving spouse of participant is eligible for a monthly benefit unless the participant and spouse elect against it. For a defined contribution plan (e.g., 401(k), IRA, profit-sharing plan), a spouse is entitled to the balance of the account unless the participant and spouse elect against it. In the absence of a spouse, the named beneficiary may be a registered domestic partner or member of another legally-recognized relationship.
        b. **Non-ERISA plans.** Governmental plans, many church plans and section 403(b) plans are not covered by ERISA. These plans may provide for survivor benefits for a same-sex spouse or member of a legally-recognized relationship upon the death of the participant.

5.17.2.6 (03-27-2012)
Priority of Tax Liens: Specially Protected Competing Interests

1. After notice and demand for payment, the federal tax lien arises and relates back to the assessment date. Congress recognized that it was difficult to conduct business when creditors were unaware of the Service's assessment lien. Consequently, Congress enacted the forerunner of IRC § 6323(a) to provide that a NFTL must be filed in order to have priority over certain creditors. Today, IRC § 6323(a) provides, in part, that "[the] lien imposed by section 6321 shall not be valid as against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until notice thereof ... has been filed ..."

2. IRC § 6323(a) applies to the Service in a variety of situations including interpleaders and lien foreclosures. In lien priority disputes, the Service must determine which claims against the taxpayer's property will be satisfied first, which second, and so on down the order of priority until the value of the property is exhausted. If a purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor with a claim to the taxpayer's property perfects its claim prior to the filing of a NFTL, then that claim is entitled to priority over the tax lien.

3. The parties listed in IRC § 6323(a) are protected against unfiled NFTLs, notwithstanding actual knowledge of the statutory assessment lien. Rev. Rul. 2003-108, 2003-2 C.B. 963.

5.17.2.6.1 (12-12-2014)
Purchasers

1. If a NFTL has not been filed prior to the sale of a taxpayer's property, a purchaser takes the property free of the federal tax lien. IRC § 6323(a).

2. A purchaser is a person who, for adequate and full consideration in money or money's worth, acquires an interest (other than a lien or security interest) in property which is valid under local law as against subsequent purchasers without actual notice. IRC § 6323(h)(6).

3. A purchaser must acquire the property pursuant to a sale. The amount paid must bear some reasonable relationship to the value of the property acquired. However, this requirement of full and adequate consideration does not preclude a bona fide bargain purchase or a purchaser who has not completed performance of his/her obligation, such as the completion of installment payments.

4. A purchaser is also one who has acquired a lease of property, an executory contract to purchase or lease property, one who has an option to purchase or lease property or an interest in it, or one who has an option to renew or extend a lease on property, if the interest acquired is not a lien or security interest.

5. **Some states** recognize the doctrine of equitable conversion, which provides that a purchaser acquires equitable title to property when the unrecorded contract for sale is executed. Equitable conversion is only relevant where the contract for sale is executed before the NFTL is filed but recordation occurs after the NFTL is filed or not at all. Even in states that recognize equitable conversion, the purchaser will not take the property free of the federal tax lien unless they qualify as a "purchaser" under IRC 6323(h)(6). IRC 6323(h)(6) defines a purchaser as a person who acquires an interest in property for adequate consideration that is valid under local law against a subsequent purchaser without notice. In many states, a purchaser's interest is not valid against a subsequent purchaser until it is recorded. Ruggerio v. United States, 2005-2 USTC ¶ 50,645 (4th Cir. 2005), cert. denied, 549 U.S. 811 (2006). In Ruggerio, which is a Maryland case, an assessment lien attached to the taxpayer-seller's real property. Subsequently, the taxpayer-seller contracted to convey the real property to buyer. The Service filed a NFTL before the closing date on the real property. The Fourth Circuit held that buyer took the real property with the federal tax lien attached to it, because the Service filed a NFTL before the buyer qualified as a purchaser under IRC § 6323(a).

   Reminder:

   State Law Guides contain information on equitable conversion and its impact on the priority of the federal tax lien in relation to purchasers.

5.17.2.6.2 (03-27-2012)
Judgment Lien Creditor

1. If a NFTL has not been filed prior to a creditor perfecting a judgment lien, the judgment lien has priority over the federal tax lien. In order to be a judgment lien creditor, the creditor must obtain a valid judgment in a court of record and of competent jurisdiction for the recovery of specifically designated property or for a certain sum of money. Treas. Reg. § 301.6323(h)-1(g).

2. In the case of a judgment for the recovery of a certain sum of money, a claimant must have a perfected lien on the property involved. This requires:
   - the identity of the lienor,
   - the property subject to the lien, and
   - the amount of the lien be established.

3. If state law requires a recording of the judgment before there is a lien on the real property good against third parties, the creditor does not qualify as a judgment lien creditor until that recordation date. If state law requires a levy or seizure of personal property before there is a lien on the personal property that is good against third parties, then there must be a levy or seizure of the personal property before the notice of federal tax lien is filed in order for a judgment lien creditor to have priority.

5.17.2.6.3 (03-27-2012)
Mechanic's Lienor

1. If a NFTL has not been filed prior to a creditor perfecting a mechanic's lien, the mechanic's lien has priority over the federal tax lien.

2. IRC § 6323(h) defines a mechanic's lienor as a person who, under local law, has a lien on real property (or on the proceeds of a contract relating to real property) for services, labor or materials furnished in connection with the construction or improvement of the property. IRC § 6323(h)(2).

3. For priority purposes, the lien arises on the earliest date such lien becomes valid under local law against subsequent purchasers of the property without actual notice of the tax lien but not before the mechanic begins to furnish the services, labor or materials. Thus a mechanic's lienor, who takes all of the requisite action under local law to perfect and enforce such lien, has a mechanic's lien from a date no earlier than the day on which the mechanic began to furnish the services, labor or materials on the job to which the lien relates.

5.17.2.6.4 (12-12-2014)
Holder of a Security Interest

1. If a NFTL has not been filed prior to a creditor perfecting a security interest, the security interest has a priority over the federal tax lien. IRC § 6323(h)(1) defines a security interest as any interest acquired by written contract for the purpose of security (payment, performance, indemnity) in existing property for which the holder paid money or money's worth and which has priority under local law over subsequent judgment liens arising out of unsecured obligations.

2. If a federal tax lien is invalid against an initial holder of a security interest, it is also invalid against another party that acquires the security interest, whether by purchase or otherwise.

3. A security interest must be in existence to prime a federal tax lien. A security interest exists at any time -
   A. if, at such time the property is in existence and the security interest has become protected under local law against a subsequent judgment lien and
   B. to the extent that, at such time, the holder has parted with money or money's worth. See Treas. Reg. § 301.6323(h)-1(a)(3).

4. Thus, where a creditor fails to perfect its security interest as required by the Uniform Commercial Code, the federal tax lien will attach to the property and will be entitled to priority over the creditor. United States v. Trigg, 465 F. 2d 1264 (8th Cir. 1972), cert. denied, 410 U.S. 909 (1973).

5. Local law distinguishes real property from personal property. This is important because the actions required under local law to establish the priority of the security interest against a subsequent judgment lien may differ depending on whether the property involved is real or personal property.

6. State law permitting relation back to perfect a state lien cannot affect the priority of the lien. Treas. Reg. § 301.6323(h)-1(a)(2)(B).

7. In **some states**, equitable conversion provides a lender priority over a NFTL filed before the lender records. Equitable conversion is only relevant where the mortgage instrument or deed of trust is executed before the NFTL is filed, but recordation occurs after the NFTL is filed or not at all. Equitable conversion provides that a lender acquires equitable title when an unrecorded mortgage or deed of trust is executed. In some states, priority is established when the mortgage or deed of trust is executed because the lender's equitable interest is protected under local law against a subsequent judgment lien arising out of an unsecured obligation. IRC 6323(h)(1)(A). Susquehanna Bank v. United States, 2014-2 USTC ¶ 50492 (4th Cir. 2014). In Susquehanna Bank, the NFTL was filed after the deed of trust securing the loan was executed, but before the deed of trust was recorded. The Fourth Circuit found that the lender's unrecorded security interest had priority over the federal tax lien, even though the NFTL had been filed, because an equitable security interest is protected under Maryland law against subsequent judgment-lien creditors.

   Reminder:

   State Law Guides contain information on equitable conversion and its impact on the priority of the federal tax lien in relation to holders of a security interest.

5.17.2.6.5 (03-27-2012)
Superpriorities

1. The Internal Revenue Code provides special protection for limited interests by giving them priority over the federal tax lien even though the interests come into existence after the filing of a NFTL. IRC § 6323(b). These special interests are called "superpriorities."

2. There may be some overlapping among categories of "superpriorities" in which event federal law provides protection if any category applies even though another may also be relevant. Should two categories of "superpriorities" apply to an interest, then the Service should use that category which gives the greatest protection to the private interest.

5.17.2.6.5.1 (03-27-2012)
Securities

1. This "superpriority" protects the purchaser or the holder of a security interest in a "security" who at the time of purchase or at the time the security interest came into existence did not have actual notice or knowledge of the existence of the federal tax lien. IRC § 6323(b)(1). The Code defines securities to include money, stock, bonds, debentures, notes, negotiable instruments, and various other types of interests. IRC § 6323(h)(4) .
2. A subsequent holder of a security interest is also protected if the prior holder did not have actual notice or knowledge at the time the security interest came into existence. An illustration of the intent of this paragraph is the case where "P" , without actual notice or knowledge of the existence of a tax lien, purchases a security from "T" , the taxpayer, after a notice of lien has been filed. "P" is protected under the provisions of this paragraph. If "P" thereafter sells the security to "C" , who at the time of such sale has actual knowledge of the existence of the lien, "C" is also protected against the tax lien. See Treas. Reg. § 301.6323(b)-1(a)(2), Examples (1) and (2).

5.17.2.6.5.2 (03-27-2012)
Motor Vehicles

1. This "superpriority" protects the purchaser of a motor vehicle if, at the time of purchase, —
   A. the purchaser did not have actual notice or knowledge of the existence of the federal tax lien; and
   B. before the purchaser has actual notice or knowledge, the purchaser has actual possession of the motor vehicle and has not thereafter relinquished actual possession to the seller or his/her agent. IRC § 6323(b)(2).

5.17.2.6.5.3 (03-27-2012)
Personal Property Purchased at Retail

1. This "superpriority" protects the purchaser of tangible personal property purchased at a retail sale unless at the time of purchase the purchaser intends the purchase to (or knows the purchase will) hinder, evade or defeat the collection of the federal tax. IRC § 6323(b)(3).
2. "Retail sale" means a sale made in the ordinary course of the seller's trade or business of tangible personal property of which the seller is the owner. It includes a sale in the customary retail quantities by a seller who is going out of business but not a bulk sale or an auction sale in which goods are offered in quantities substantially greater than are customary in the ordinary course of the seller's trade or business or an auction sale where the owner is not in the business of selling such goods. Treas. Reg. § 301.6323(b)-1(c)(2).

5.17.2.6.5.4 (01-01-2015)
Personal Property Purchased in Casual Sale

1. This "superpriority" protects a purchaser of household goods, personal effects or other tangible personal property exempt from levy under IRC § 6334(a). It encompasses items purchased (other than for resale) in a casual sale for less than $1,520. IRC § 6323(b)(4). This amount is adjusted annually for inflation. See Rev. Proc. 2014–61, 2014–47 I.R.B. 860. These sales include "garage sales" or "tag sales."
2. A casual sale is a sale not made in the ordinary course of the seller's trade or business. Protection is afforded only if the purchaser does not have actual notice or knowledge of the existence of the federal tax lien or that the sale is one of a series of sales which means that the seller plans to dispose of, in separate transactions, substantially all of his/her household goods, personal effects and other tangible personal property. This exception applies only to tangible personal property (e.g. household goods, personal effects, wearing apparel, firearms, furniture, etc.) as defined in Treas. Reg. § 301.6323(b)-1(d)(1).

5.17.2.6.5.5 (03-27-2012)
Personal Property Subject to Possessory Lien

1. This "superpriority" protects someone in possession of tangible personal property subject to a lien under local law securing the reasonable price of the repair or improvement of that property. IRC § 6323(b)(5).
2. Thus, for example, if state law gives an automobile mechanic a lien for the repair bill and the right to retain possession of the repaired automobile as security for payment of the repair bill, and the mechanic retains continuous possession of the automobile, a federal tax lien which has attached to the automobile will not be valid to the extent of the repair bill.

5.17.2.6.5.6 (03-27-2012)
Real Property Tax and Special Assessment Liens

1. This "superpriority" protects certain specified state and local tax liens against real property. IRC § 6323(b)(6) applies if state or local law entitles such liens to priority over security interests in such property which are prior in time, and such lien secures payment of one of the following three types of taxes or charges:
   A. A tax of general application levied by any taxing authority based upon the value of such property. For example, real estate tax.
   B. A special assessment imposed directly upon such property by any taxing authority, if such assessment is imposed for the purpose of defraying the cost of any public improvement. For example, sewers, streets, or sidewalks.
   C. A charge for utilities or public services furnished to such property by the United States, a state or political subdivision thereof, or an instrumentality of any one or more of the foregoing.
2. If real estate taxes (whenever they accrue) are ahead of mortgages under local law, they will also be ahead of federal tax liens. The result will be the same if a special assessment lien arises after the federal tax lien is in existence. The same priorities apply in the case of charges for utilities or public services.
3. This superpriority category does not include other state and local tax liens arising for personal property taxes, state or local income taxes, franchise taxes, etc.

5.17.2.6.5.7 (01-01-2015)
Residential Property Subject to a Mechanic's Lien for Certain Repairs and Improvements

1. This "superpriority" protects lienors whose liens arise from the repair or improvement of certain real property. IRC § 6323(b)(7).
2. The property must be a personal residence containing not more than four dwelling units with the owner occupying one of the units and the total contract price being $7,590 or less. This amount is adjusted annually for inflation See Rev. Proc. 2014-61, 2041-47 I.R.B. 860.

5.17.2.6.5.8 (12-12-2014)
Attorney's Liens

1. This "superpriority" protects an attorney who, under local law, holds a lien upon, or a contract enforceable with respect to, a judgment or other amount in settlement of a claim or cause of action, to the extent of reasonable compensation for obtaining the judgment or procuring the settlement, even if the attorney has actual notice or knowledge of the filing of the notice of lien. IRC § 6323(b)(8). There is a limitation upon this absolute priority that arises with respect to a judgment or amount in settlement of a claim or a cause of action against the United States, to the extent that the United States sets off such judgment or amount against any liability of the taxpayer to the United States.

2. Even in those cases where the attorney's lien enjoys the priority over the federal tax lien, it is limited to reasonable compensation. Generally, reasonable compensation means the amount customarily allowed under local law for an attorney's services for litigating or settling a similar case or administrative claim. See North Carolina Joint Underwriting Assn. v. Long, et al., 2008-1 USTC ¶ 50,183 (E.D.N.C. 2008). Nevertheless reasonable compensation shall be determined on the basis of the facts and circumstances of each individual case. The priority does not apply to an attorney's lien which may arise from the defense of a claim or cause of action against a taxpayer, except to the extent such a lien is held upon a judgment or other amount arising from the adjudication or settlement of a counterclaim in favor of the taxpayer.

Next

More Internal Revenue Manual

Part 5. Collecting Process

Chapter 17. Legal Reference Guide for Revenue Officers

Section 3. Levy and Sale

5.17.3 Levy and Sale

Manual Transmittal

November 05, 2014

Purpose

(1) This transmits revised IRM 5.17.3, Legal Reference Guide for Revenue Officers, Levy and Sale.

Background

This section provides guidance for instituting levy and sale to enforce a federal tax lien.

Material Changes

(1) Throughout the section the terms "husband" and "wife" are revised to gender-neutral terms in light of U.S. vs. Windsor.

(2) IRM 5.17.3.3.5.1 is added to explain that levies may not be issued to collect penalties imposed under the Affordable Care Act (ACA) Provision 1501: Requirement to Maintain Minimum Essential Coverage (Individual Shared Responsibility) (IRC § 5000A).

(3)

Effect on Other Documents

This supersedes IRM 5.17.3 dated January 7, 2011.

Audience

SB/SE Revenue Officers

Effective Date

(01-01-2015)

Rocco A. Steco
(Acting) Director, Collection Policy
Small Business/Self-Employed

5.17.3.1 (01-07-2011)
Overview

1. IRM 5.17.2 deals with the federal tax lien in some detail. As that section discussed, the federal tax lien attaches to all of the taxpayer's property and rights to property, both real and personal. This section discusses how the IRS administratively enforces the tax lien using its power to levy on and sell property of the taxpayer or property encumbered with a federal tax lien.

2. A levy is an administrative means of collecting taxes by seizure and sale of property to satisfy delinquent taxes. It enables the government to collect outstanding taxes without first going to court. An exception is the seizure of a principal residence, which requires court approval. See IRM 5.17.3.4.5, below. A levy is a summary self-help extra-judicial remedy used to compel the payment of the tax. United States v. Nat'l Bank of Commerce, 472 U.S. 713 (1985).

3. Collecting taxes by levying upon the taxpayer's property or rights to property warrants serious consideration. This section does not describe the step-by-step actions to be taken by a revenue officer in levying upon and seizing property, because such material is in IRM 5.10, *Seizure and Sale*, and IRM 5.11, *Notice of Levy*. This section addresses legal complications that might arise through use of levy procedures.

5.17.3.2 (01-07-2011)
Authority

1. IRC § 6331(a) authorizes the Secretary to levy upon or seize property to collect delinquent taxes. In this context, Secretary means the Secretary of the Treasury, or any officer, employee, or agency of the Treasury Department authorized to perform the function. See IRC § 7701(a)(11) & (12).

2. The Secretary of the Treasury has delegated the authority to levy to the Area Director to whom the assessment is charged or, upon his request, to any other Area Director. Treas. Reg. § 301.6331-1(a)(1). Revenue officers, while acting in the course of their duties on behalf of the Area Director in levying upon property of the taxpayer, are delegates of the Secretary of the Treasury having power to levy. The revenue officer, however, must obtain the requisite supervisory approval when necessary. See, e.g., IRC § 6334(e).

   Note:

Pursuant to IRC § 6331(g), the Service may not levy on a person's property on the day that person (or that person's officer or employee) is required to appear in response to a summons issued by the Service for the purpose of collecting any tax.

3. IRC § 6331(b) describes levy as including the power of distraint and seizure by any means, thus authorizing the Secretary or his delegate to collect delinquent tax liabilities by distraint against and seizure of particular items of property or rights to property belonging to the person liable to pay the tax or on which there is a tax lien (as on property fraudulently transferred by the taxpayer after the date of an assessment).

4. The revenue officer must take special care to comply with the Internal Revenue Code's levy requirements.

5.17.3.3 (01-07-2011)
Conditions Precedent

1. The Code imposes a number of conditions that must be met before the IRS may levy. In addition, there are certain restrictions that limit the timing of a levy. These include:

   A. the investigation of the status of the property;

   B. notice and demand;

   C. notice of intent to levy;

   D. collection due process (CDP) rights; and

   E. additional restrictions set forth in IRC § 6331.

5.17.3.3.1 (01-07-2011)
Notice and Demand

1. The Service must give the taxpayer a notice stating the amount of the tax liability and demanding payment of it as soon as practicable, but within 60 days after assessment of the tax. IRC § 6303(a).

2. Notice and demand of the assessed tax is necessary prior to levy under IRC § 6331(a), and is also a prerequisite to the creation of the federal tax lien under IRC § 6321. However, pursuant to Treas. Reg. § 301.6303-1(a), the failure to give notice within 60 days does not invalidate the notice. Therefore, a late notice and demand given more than 60 days after assessment is a valid notice and demand for purposes of levy under IRC § 6331(a) and the creation of the federal tax lien under IRC § 6321.

3. An immediate payment of the tax is normally not demanded unless delay would jeopardize collection. Bremson v. United States, 459 F. Supp. 128 (W.D. Mo. 1978). Notice and demand for immediate payment also should be made when the taxpayer's taxable period is terminated pursuant to IRC § 6851 before the expiration of the taxable period.

4. Notice and demand need not personally be served upon the taxpayer to validate such notice. The notice and demand must be left at the dwelling or usual place of business of the taxpayer or mailed to his/her last known address. If doubt exists as to the dwelling, place of business or last known address, the notice should be delivered or mailed to all of the available addresses.

5. Payment of only a portion of the tax after notice and demand represents neglect or refusal to pay. United States v. Wintner, 200 F. Supp. 157 (N.D. Ohio 1961), aff'd per curiam, 312 F.2d 749 (6th Cir. 1963), rev'd on other grounds, 375 U.S. 393 (1964). A levy made before the expiration of the 10-day period after notice and demand, as well as a levy made before notice and demand, is invalid. L.O.C. Indus. Inc. v. United States, 423 F. Supp. 265 (M.D. Tenn. 1976). A levy for a tax liability for which notice and demand was not made is invalid. Notification of a proposed assessment does not eliminate the need for notice and demand for payment of the tax once the assessment is made.

5.17.3.3.2 (01-07-2011)
Notice of Intent to Levy

1. The Service must provide a taxpayer with a 30-day notice of intent to levy. IRC § 6331(d)(2). The notice must be given in person, left at the taxpayer's dwelling or usual place of business, or sent by certified or registered mail to the taxpayer's last known address. Only a single notice is required to be given with respect to a particular liability, regardless of the number of levies made to satisfy the liability. This notice, either L 1058 or LT 11, is usually combined in one notice with the Collection Due Process (CDP) notice required by IRC § 6330. Area Offices use L 1058, and the Automated Collection System (ACS) uses LT 11.

2. A levy made before the expiration of the 30-day period after notice of intent to levy is invalid absent a jeopardy determination or waiver by the taxpayer of the waiting period and right to a hearing. See IRM 5.11.1.2.2.10, *Waiver of Notice of Intent to Levy/Notice of Right to a Hearing*.

5.17.3.3.3 (01-07-2011)
Pre-levy Notice and Collection Due Process (CDP)

1. Prior to levy, the taxpayer is entitled to one (and only one) CDP hearing with respect to the tax and tax period. IRC § 6330; Treas. Reg. § 301.6330-1(b), Q & A-B4.

   Note:

   The taxpayer may receive more than one CDP hearing with respect to a tax period where the type of tax is different (e.g., income tax and employment tax), or the amount of the unpaid tax has changed as a result of an additional assessment of tax. See Treas. Reg. § 301.6330-1(d)(2), Q & A-D1 for examples.

2. The pre-levy notice sets forth in simple and non-technical terms:

   A. the amount of the unpaid tax;

   B. notification of the right to request a hearing;

   C. a statement that the IRS intends to levy; and

   D. the taxpayer's rights with respect to the levy action, including a brief statement that describes:
      (1) the statutory provisions relating to the levy and sale of property;
      (2) the procedures applicable to the levy and sale of property;
      (3) the administrative appeals available to the taxpayer with respect to the proposed levy and the procedures relating to those appeals;
      (4) the alternatives available to taxpayers that could prevent levy on the property (including installment agreements);
      (5) the statutory provisions relating to redemption of property and the release of liens on property; and
      (6) the procedures applicable to the redemption of property and the release of liens on property.

3. The pre-levy notice must be given in person, left at the dwelling or usual place of business of the taxpayer, or sent by certified or registered mail, return receipt requested, to the taxpayer's last known address.

4. The notice under IRC § 6330 must be provided no less than 30 days prior to the date of the first levy with respect to the amount of the unpaid tax for the taxable period for which the levy may be made. Also, as noted in IRM 5.17.3.3.2(1), above, this notice is usually combined with the Notice of Intent to Levy required under IRC § 6331(d).

   Note:

In some situations, the taxpayer may have incentive to waive the waiting period, and the right to a hearing, so the levy can be issued promptly. For example, a taxpayer may want the Service to issue a levy quickly when the taxpayer is expecting another creditor to attach the assets. For more information regarding such waivers, see IRM 5.11.1.2.2.10, *Waiver of Notice of Intent to Levy/Notice of Right to a Hearing*.

5. The Service need not send the taxpayer a CDP notice prior to levy in three circumstances: (1) if the Service has levied on a state tax refund; (2) in a jeopardy levy situation; and (3) if the Service has made a "disqualified employment tax levy." A "disqualified employment tax levy" is a levy made with respect to an employment tax liability for a tax period beginning within 2 years after an employment tax period included in a previous request for a CDP hearing. However, the Service must provide the taxpayer with a notice containing substantially the same information as is contained in the pre-levy notice within a reasonable time after the levy (i.e., post-levy CDP notice). IRC § 6330(f); Treas. Reg. § 301.6330-1(a)(2). See IRM 5.1.9.3.15, *Disqualified Employment Tax Levy*, and IRM 5.11.1.4, *Post-Levy Actions - Disqualified Employment Tax Levy*, for more information regarding this exception.
6. A taxpayer may request a CDP hearing by filing a written request within 30 days following delivery or mailing of the CDP notice. Treas. Reg. § 301.6330-1(b).
7. A CDP hearing will be held by Appeals and, unless waived by the taxpayer, will be conducted by an employee or officer who has had no prior involvement with respect to the taxable period subject to the CDP hearing. IRC § 6330(b); Treas. Reg. § 301.6330-1(d).
8. A taxpayer who fails to timely request a CDP hearing is not entitled to a CDP hearing. Such taxpayer may nevertheless request an administrative hearing with the Appeals Office. Such a hearing is referred to as an "equivalent hearing." The taxpayer must submit a written request for an equivalent hearing within the one-year period commencing the day after the date of the CDP notice issued under IRC § 6330. The equivalent hearing will be held by Appeals and will generally follow the procedures for a CDP hearing. See IRM 5.1.9.3.2.2, *Equivalent Hearing and Timeliness of Equivalent Hearing Requests.*
9. When an equivalent hearing is held, Appeals will issue a Decision Letter rather than a Notice of Determination. In an equivalent hearing, Appeals will consider the same issues that it would have considered at a CDP hearing on the same matter. Because the equivalent hearing is not a CDP hearing, the taxpayer is not entitled to obtain judicial review.
10. The statute of limitations on collection is suspended for the period of the CDP hearing (but not the equivalent hearing) and any judicial appeal. In no event will the period expire before the 90th day after the day on which there is a final determination in a hearing.
11. Levies are generally prohibited during the administrative hearing and during any judicial review and appeals, except where the court has granted a motion to permit levy.

5.17.3.3.3.1 (01-07-2011) Collection Appeals Program

1. A taxpayer or third party may appeal a levy or seizure action that has been or will be taken under the Collection Appeals Program (CAP). See IRM 5.1.9.4, *Collection Appeals Program*. See also Publication 1660, *Collection Appeal Rights*. Except as it relates to installment agreements, CAP is not a program specifically required by statute, and there is no right to judicial review of the decision of Appeals in a CAP case.
2. CAP also may be available to taxpayers or third parties where the CDP or Equivalent Hearing right is not available (due to lapse of time or exercising of the right).
3. Once a seizure action is taken, the taxpayer has 10 business days to appeal under CAP from the date the Notice of Seizure is provided to the taxpayer, or left at his or her usual abode or place of business. Publication 1660, *Collection Appeal Rights*, must be included with the Notice of Seizure. See IRM 5.1.9.4(6).
4. By policy, collection action is suspended while the case is in Appeals for levy and seizure CAP appeals. The Collection function may continue enforcement action, however, if it believes withholding the action would put collection of the tax liability at risk or collection of the tax is in jeopardy. Refer to IRM 5.11.3. A taxpayer may have CAP appeal rights of a jeopardy levy under certain circumstances. See IRM 5.11.3.6, *Appealing the Jeopardy Levy*.

5.17.3.3.4 (01-07-2011) Investigation of Property

1. IRC § 6331(j) requires the Service to investigate the status of property before the levy or seizure of any property that will be sold under IRC § 6335.
2. In the investigation of the status of the property, the Service must:
    A. verify the taxpayer's liability;
    B. analyze whether the amount of estimated sales-related expenses exceeds the fair market value of the property at the time of levy;
    C. determine that the equity in the property is sufficient to yield net proceeds from the sale of the property to apply to the taxpayer’s liability; and
    D. thoroughly consider alternative collection methods.

5.17.3.3.5 (01-07-2011) Additional Requirements

1. IRC § 6331(k) provides that no levy may be made during the time an offer in compromise is pending. If an offer is rejected, no levy may be made during the 30 days after rejection (and, if an appeal of the rejection is filed within the 30 days, while the appeal is pending).
2. IRC § 6331(k) provides that no levy may be made during the time an installment agreement is pending. If the installment agreement is rejected by the Service, no levy may be made during the 30 days after rejection (and, if an appeal is filed within the 30 days, during the time the appeal is pending). In addition, no levy may be made during the time an installment agreement is in effect and, if an agreement is terminated by the Service, during the 30 days after termination (and, if an appeal is filed within the 30 days, during the time the appeal is pending). For criteria identifying "pending" installment agreements, see IRM 5.14.1.3, *Identifying Pending, Approved and Rejected Installment Agreement Proposals on IDRS*.
3. The Code prohibits levy on property if the amount of estimated sale-related expenses exceeds the fair market value of the property at the time of levy. IRC § 6331(f). This is referred to as an "uneconomical levy."
4. Except where there has been a determination that collection is in jeopardy, IRC § 6331(g) prohibits levying on any day on which the taxpayer is required to appear in response to a summons issued by the IRS to collect any underpayment of tax.
5. IRC § 6331(i) prohibits a levy (but not an offset under IRC § 6402) if the taxpayer has filed a refund proceeding to recover a divisible tax, unless jeopardy exists or the taxpayer waives his rights under this subsection.
6. IRC § 6015(e)(1)(B) prohibits levy or proceeding in court with respect to a spouse who has requested innocent spouse relief under IRC § 6015(b) or (c) or who has requested equitable relief under IRC § 6015(f) (if the liability is unpaid as of December 20, 2006, or does not arise until after December 20, 2006),
    A. until the taxpayer signs a waiver of the restrictions (Form 870-IS, *Waiver of Collection Restrictions in Innocent Spouse Cases*),
    B. the 90 day period for petitioning the Tax Court expires, or
    C. if a Tax Court petition is filed, until the Tax Court decision becomes final.

    Note:

    Levy against the non-requesting spouse during this period is not prohibited.

5.17.3.3.5.1 (01-01-2015)
Affordable Care Act Provisions

1. Starting in 2014, the individual shared responsibility payment provision of IRC 5000A requires individuals to have qualifying health care coverage (known as minimum essential coverage or MEC) for each month of the year, qualify for a coverage exemption, or make a shared responsibility payment (SRP) when filing their Federal income tax returns.
2. Per IRC 5000A(g)(2)(B)(ii) and Treas. Reg 1.5000A-5, if a taxpayer fails to pay the shared responsibility payment (SRP) imposed by this section and §§1.5000A-1 through 1.5000A-4, the Secretary will **not** levy on any property of the taxpayer for the failure.

5.17.3.3.6 (01-07-2011)
Jeopardy and Termination Cases

1. If the Area Director determines that collection of the tax is in jeopardy, the Service is not required to wait 10 days after giving the taxpayer notice and demand, 30 days after giving notice of intent to levy, or 30 days after the IRC § 6330 pre-levy notice. See IRM 5.17.15.4, *Jeopardy Collection*, and IRM 5.11.3, *Jeopardy Levy without a Jeopardy Assessment*, for further discussion of jeopardy levies.

5.17.3.4 (01-07-2011)
Scope of Levy

1. The following discussion presumes that all required notices have been provided to the taxpayer and that all conditions for a levy have been met. It addresses the reach of a levy.

5.17.3.4.1 (01-07-2011)
Property and Rights to Property

1. All property and rights to property (except that which is exempt under IRC § 6334) belonging to the person liable to pay the tax, or on which there is a tax lien, may be levied upon for payment of such tax.

   Note:

   Only the taxpayer's interest in property is subject to levy. The interest of a third party is not subject to levy. See, e.g., United States v. Rodgers, 461 U.S. 677 (1983) (in dictum).
2. The property subject to levy may be real property or personal property. In addition, personal property susceptible to levy may be either tangible or intangible. The taxpayer need not have property in his/her possession before it may be levied upon. If it is discovered that property or rights to property are those of the taxpayer, such property is subject to levy no matter who is in possession.
3. In determining a taxpayer's property and rights to property, the Supreme Court has held that one must look initially to state law to determine what rights the taxpayer has in the property the government seeks to reach, then to federal law to determine whether the taxpayer's state delineated rights qualify as property or rights to property within the meaning of the federal tax lien statutes. Drye v. United States, 528 U.S. 49 (1999); Craft v. United States, 535 U.S. 274 (2002).
4. At times an issue will arise regarding whether the taxpayer has a cognizable interest in the property. For example, when a taxpayer has obtained money through the commission of a crime, state law may provide that the taxpayer has no interest in or rights to such money. See, e.g., United States v. Ortiz, 140 F. Supp. 355 (S.D.N.Y. 1956) (illegally obtained money is not the taxpayer's property, therefore the money need not be surrendered by a police property custodian in response to a notice of levy).
5. The *tax lien* attaches to after-acquired property. Glass City Bank v. United States, 326 U.S. 265 (1945). Therefore, use of a levy to collect taxes is not limited to property or rights to property of the taxpayer that exist when the assessment is made. If a federal tax lien has attached to the taxpayer's property and the property is later transferred to a third party in a way that the lien would not be divested, the property remains subject to levy.

   Note:

   Although property acquired post-assessment is subject to the *tax lien*, a *levy* reaches only property and rights to property existing at the time of the levy, or property encumbered with the federal tax lien *as of the time of the levy*. The exception is for continuous levies, discussed in IRM 5.17.3.4.2, below.

   Example: If the tax lien arises on Date A, at which time taxpayer's bank account contains $100, and subsequently on Date B the taxpayer deposits an additional $100, the tax lien then attaches to the full $200 in the account. If the levy is served after Date A but before Date B, the levy only reaches the original $100 because the levy does not reach after-acquired property. A new levy must be served on or after Date B to reach the full $200 in the account.
6. During the time custody of seized property is in the United States, certain benefits may arise that are attributable to the seized property, e.g., rent from a seized building. Although it may be argued that a seizure of the property results in a seizure of the benefits, particularly if the benefit represents a fixed right at the time of the levy and seizure, a notice of levy should be served to remove any doubt as to whether the United States seized the right to benefits. For example, if stocks have been levied upon and before their sale a dividend is declared, a notice of levy should be served on the corporation after the record date but before the dividend is paid out. If real property is seized that is producing rental income, a notice of levy should be immediately served upon the lessee.

5.17.3.4.2 (01-07-2011)
Effect of Levy

1. IRC § 6331(b) provides that except for the continuing levy on salary or wages provided for in IRC § 6331(e) and a levy on certain government payments provided for in IRC § 6331(h), a levy shall extend only to property possessed or obligations existing at the time of the levy. Thus, service of a levy or notice of levy upon the taxpayer or a third person, respectively, results in a seizure of property or rights to property in possession of either party at the time of service of the levy. Should property come into possession of the taxpayer or third party later, another levy must be made to seize the property, regardless of the fact that the federal tax lien attaches automatically to after-acquired property. Rev. Rul. 55-210, 1955-1 C.B. 544. If, for example, a levy is made upon the bank account of a delinquent taxpayer and the bank surrenders the balance in the account at the time the levy is made, this levy has no effect upon subsequent deposits made in the bank by the taxpayer. Subsequent deposits may be reached only by subsequent levies. IRC § 6331(c) provides for successive levies upon property of the taxpayer until the amount due, together with all expenses, is fully paid.
2. Similarly, a levy only reaches obligations that exist when the levy is made. Obligations are in existence when the liability of the obligor is fixed and determinable, even though the right to receive payment is deferred to a later date. Treas. Reg. § 301.6331-1(a)(1). This would include, for example, a right to receive future payments under a trust or contract, provided the right to receive such payments was not contingent upon the performance of future services. Rev. Rul. 55-210, supra. In other words, the right to future income, if it is a fixed or present right to property, is subject to levy, even though the taxpayer cannot receive the property until some future date. In re Orr, 180 F. 3d 656 (5th Cir. 1999).
3. IRC § 6331(e) provides, however, that the effect of a levy on salary or wages payable to or received by a taxpayer is continuous from the date the levy is first made until the levy is released under IRC § 6343.

   Note:

   Treas. Reg. § 301.6343-1(b)(1)(ii) provides that a continuing levy on salary or wages made under IRC § 6331(e) must be released at the end of the period of limitations in IRC § 6502.

4. IRC § 6331(h) provides for a continuous levy on certain federal payments, including Social Security benefits. The levy attaches up to 15% of the payment (and up to 100% in the case of vendors of goods or services sold or leased to the federal government). The power to make an IRC § 6331(h) levy has not been delegated to field personnel. The IRS makes an IRC § 6331(h) levy by sending an electronic transmission to Financial Management Service, another agency within Treasury. These provisions are exceptions to the rule that the levy only reaches obligations that are in existence at the time the levy is made.

5. For purposes of determining the nine-month period under IRC § 6343(b) for the return of property, the "date of such levy" for continuous levies under IRC § 6331(e) and (h) is the date the notice of levy is served. See IRM 5.17.3.5.6, *Release of Levy and Return of Property,* and IRM 5.17.3.5.6.3, *Wrongful Levy*, below, for additional information regarding IRC § 6343.

5.17.3.4.3 (01-07-2011)
Statute of Limitations on Levy

1. In general, any tax may be collected by levy if such levy is made within 10 years after the assessment of the tax, or any extensions of the 10-year period. IRC § 6502(a). If the levy is served within the period of limitations, a suit to enforce the levy may be instituted after the 10-year period. This is true regardless of any state statutes of limitation. See United States v. Summerlin, 310 U.S. 414 (1940). IRC § 6502(a) permits levy after a judgment is secured for the life of the judgment. Therefore, a judgment based on a tax claim can be administratively collected by levy after the 10-year period would have otherwise expired. A judgment does not curtail the use of a levy to collect a liability. See IRM 5.17.4.6.2, *Effect of Judgment on Collection Statute of Limitations*.

2. For personal property that will be sold, IRC § 6502(b) provides that a levy occurs on the date on which the notice of seizure provided in IRC § 6335(a) is given to the owner of the property and not the date the levy is made. In contrast, when the IRS levies on a bank account that will not be administratively sold, the levy occurs when the bank receives the notice of levy. United States v. Donahue Industries, 905 F.2d 1325 (9th Cir. 1990). Thus, it is important that if property is to be seized and sold, the notice of seizure must be given without delay if the statute of limitations on collection is imminent.

3. Prior to the enactment of the Internal Revenue Service Restructuring and Reform Act of 1998 ("RRA 98"), the collection period could be extended by the execution of a written waiver. This authority was curtailed by RRA 98. Currently, the taxpayer and the Service can only enter into an agreement to extend the collection statute in two situations:

   A. if the extension is secured in connection with an installment agreement, or

   B. if a levy was served prior to the expiration of the collection statute and the levy is subsequently released.

4. Additionally, pursuant to a special transitional rule, extensions that were executed on or before December 31, 1999, may expire earlier than their original terms. An extension requested on or before December 31, 1999, expires on the latest of -

   A. the last day of the original 10-year period,

   B. December 31, 2002, or

   C. in the case of an extension in connection with an installment agreement, the 90th day after the extension. RRA 98 § 3461(c)(2).

5. IRC § 6502(a)(2)(A) provides that the statutory period for collection may be extended in connection with granting installment agreements. However, it is the Service's policy that CSED extensions are permitted only in conjunction with Partial Payment Installment Agreements and only in certain situations. See IRM 5.14.2, *Partial Payment Installment Agreements and the Collection Statute Expiration Date (CSED)*.

6. Although an agreement extending the period for collection must normally be executed before the statute of limitations expires, an agreement may be entered into after the 10-year statutory period if the consideration extended by the government is the issuance of a certificate of release of levy. However, the levy itself, for which the certificate of release is issued, must have been made within the statute of limitations and the waiver must have been executed prior to the release. IRC § 6502(a)(2)(B); Treas. Reg. § 301.6502-1(a)(2)(ii).

5.17.3.4.3.1 (01-07-2011)
Suspension of Statute of Limitations on Levy

1. A number of conditions/events will suspend the collection statute of limitations. See IRM 5.1.19.3, *Case Actions That Can Suspend And/Or Extend A CSED*.

2. Under the general rule, the statute of limitations on collection after assessment is suspended during the period in which collection by levy is prohibited. See IRC § 6503(a)(1). For example, collection by levy is prohibited during the period in which an offer in compromise is pending, for 30 days immediately following the rejection of the offer, and for any period in which a timely filed appeal from the rejection is being considered by Appeals. See IRC § 6331(k)(1); Treas. Reg. § 301.7122-1(g)(1). See also IRM 5.8.10.7, *Effect of Previous Offers on Collection Statute*.

3. Other examples of when collection by levy is prohibited include the following:

   - While a CDP hearing, and any appeals thereof, are pending. IRC § 6330(e)(1). See also IRM 5.1.9.3.6, *Collection Appeal Rights, Suspension of Collection Statute of Limitations*.

   - When a taxpayer seeks innocent spouse relief. IRC § 6015(e)(1)(B). See also IRM 25.15.1.8, *Relief from Joint and Several Liability, Statute of Limitations on Collection.*

   - With respect to penalties under IRC §§ 6700, 6701, or 6702, when a taxpayer pays not less than 15 percent of the penalty and files a claim for refund. IRC § 6703(c). See also IRM 5.20.8.7, *Appealing IRC 6700 and IRC 6701 Penalty Assessments*.

4. IRC § 6503 also suspends the collection period of limitations in a number of different situations, including the following:

   - While all or substantially all of the taxpayer's assets are in control or custody of any court in any proceeding and for six months thereafter. IRC § 6503(b). See also Treas. Reg. § 301.6503(b)-1. The rationale of the suspension is that during this time the assets are not subject to administrative collection procedures. The suspension applies to the outstanding amount due on the assessment. Treas. Reg. § 301.6503(b)-1. For more information regarding property in the control of the court, see IRM 5.17.3.4.4, *Custodia Legis*, below.

   - While the taxpayer is outside the United States if the absence is for a continuous period of at least six months. IRC § 6503(c). To make certain that the government has an opportunity to collect the tax after the taxpayer returns, the period does not expire (if the taxpayer has been out of the country for six months or more) until six months after the taxpayer's return to the country. For more information, see IRM 5.1.19.3.7, *Taxpayer Living Outside the U.S*.

   - When there is a wrongful levy. IRC § 6503(f)(1). The collection statute is suspended from the date that the property (including money) of a third person was wrongfully seized or received, to the date that the property is administratively returned pursuant to IRC § 6343(b), or to the date on which a wrongful levy judgment with respect to such property becomes final, and for 30 days thereafter. If the period of limitations is suspended under this provision, it is suspended only for the amount of money or value of specific property that initially has been wrongfully taken from a third party and subsequently has been returned. This amount or value is determined as of the date the property was returned.

   - When there is a wrongful lien. IRC § 6503(f)(2). The collection statute is suspended from the date any person becomes entitled to a certificate of discharge of lien under IRC § 6325(b)(4) until the earlier of the earliest date on which the Service no longer holds any amount as a deposit or bond under IRC § 6325(b)(4) or the date on which a judgment under IRC § 7426(b)(5), concerning the amount deposited or used as bond, becomes final. If the period of limitations is suspended under this provision, it is suspended only for the value of the interest of the United States in the property plus interest, penalties, additions to tax, and additional amounts attributable thereto.

- When a taxpayer files for protection under the Bankruptcy Code. IRC § 6503(h). The collection statute is suspended for the period during which the automatic stay (11 USC § 362) prohibits the IRS from taking any collection action and for six months thereafter. For more information, see IRM 5.9.4.2(3), *Collection Statute Expiration Date (CSED) Suspension Timeframes*.

5.17.3.4.4 (01-07-2011)
Custodia Legis

1. Generally, a levy should not be used to enforce collection of taxes if assets of the taxpayer are in custodia legis (control of the court). However, assets may be seized if a levy would not interfere with the work of the court or the court grants permission to levy. Treas. Reg. 301.6331-1(a)(3). Therefore, upon the filing of a petition in bankruptcy, the death of a taxpayer and the probating of the estate, an assignment for the benefit of creditors, an adjudication of incompetency and appointment of a committee of one's property, and many other types of proceedings or situations if the court has control or custody of the property (actual or constructive) subject to such proceedings, a levy to enforce collection should not be made without prior consideration by Area Counsel.

2. Property is not in custodia legis between the date of the filing of a petition in a state court for the appointment of a receiver and the date of the appointment; therefore, a levy made between those dates is valid. United States v. Allen, 328 F.2d 377 (5th Cir. 1964); Youngstown Sheet & Tube Co. v. Patterson-Emerson-Comstock of Ind., 227 F. Supp. 208 (N.D. Ind. 1963).

3. For a more extended discussion of the effect of bankruptcy, receivership, other insolvencies and decedent estates on levy action, see IRM 5.17.3.5.2.2, *Effect of Insolvency*, and IRM 5.17.3.5.2.3, *Effect of Bankruptcy*, below. See also IRM 5.17.8, *General Provisions of Bankruptcy*; IRM 5.17.9, *Chapter 7 Bankruptcy*; IRM 5.17.10, *Chapter 11 Bankruptcy*; IRM 5.17.11, *Chapter 13 Bankruptcy*, and IRM 5.17.13, *Insolvencies and Decedents' Estates*.

4. Merely because an officer of a court has possession of a taxpayer's property, the property is not necessarily in custodia legis. If a United States Marshal is holding money of a taxpayer for safekeeping as a result of an arrest, to be returned upon posting a bond or acquittal, service of a notice of levy upon the United States Marshal is valid and must be honored, because the property is not in custody of the court. Simpson v. Thomas, 271 F.2d 450 (4th Cir. 1959); United States v. Bourbonnais, 602 F. Supp. 664 (E.D. Va 1985). If the property in possession of the United States Marshal is attached as a result of court process, it is generally in custodia legis and not subject to levy. Averill v. Smith, 84 U.S. (17 Wall) 82, 21 L.Ed. 613 (1872). Property seized in violation of the Fourth Amendment of the Constitution (unlawful search and seizure), although suppressed as evidence in a criminal proceeding, may be levied upon. Field v. United States, 263 F.2d 758 (5th Cir. 1959), cert. denied, 360 U.S. 918 (1959). Although property may be in custodia legis, the federal tax lien attaches to such property, even though the property may not be levied upon. Welsh v. United States, 220 F.2d 200 (D.C. Cir. 1955).

5. Alimony payments made through a clerk of the court under a court order are not in custodia legis and may be levied upon. Property in the hands of an assignee for the benefit of creditors not under court supervision is subject to levy to the extent federal tax liens attached to the property before the assignment date. Notice of levy served upon a bank is ineffective to reach funds of a taxpayer the day following appointment by a court of a receiver of the taxpayer's assets. United States v. Peoples Sav. Bk. & Trust Co. of Wilmington, N.C., 55-2 USTC 55,683 (E.D.N.C. 1955).

6. Where the taxpayer's debtor is in bankruptcy and the taxpayer has filed a claim in the proceeding, there is no prohibition upon serving the bankruptcy trustee to reach the distribution the taxpayer is entitled to in the proceeding. In re Quakertown Shopping Center, Inc., 366 F.2d 95 (3d Cir. 1966); United States v. Ruff, 99 F.3d 1559 (11th Cir. 1996); Laughlin v. United States, 912 F.2d 197 (8th Cir. 1990), cert. denied, 498 U.S. 1120 (1991). However, Area Counsel should be consulted before serving such a levy.

5.17.3.4.5 (01-07-2011)
Seizure of a Residence/Principal Residence

1. IRC § 6334(a)(13)(A) exempts from levy any real property of the taxpayer used as a residence by any individual (except for real property that is rented), if the levy amount does not exceed $5,000.

2. In addition, IRC § 6334(e)(1) requires a court order before administrative seizure of certain principal residences owned by the taxpayer when seizure is otherwise permissible. These include the principal residence of:

    - the taxpayer
    - the taxpayer's spouse
    - the taxpayer's former spouse
    - the taxpayer's minor child

3. Although not legally required, written approval by the Area Director is required administratively before seizure of any property used by any person as a principal residence.

4. After the required approval is obtained, a suit recommendation package should be prepared for Area Counsel. The procedures for preparing a seizure recommendation package for Area Director approval and for preparing the suit recommendation package are set forth in IRM 5.10.2.18.

5. IRC § 6334(e)(1) provides that there will be no levy on a principal residence unless approved by a judge or magistrate (in writing). At this hearing, the Service will be required to demonstrate that (1) the requirements of any applicable law or administrative procedures relevant to the levy have been met, (2) the liability is owed, and (3) no reasonable alternative for the collection of the taxpayer's debt exists.

5.17.3.4.6 (01-07-2011)
Seizure of Business Assets

1. IRC § 6334(a)(13)(B)(ii) and IRC § 6334(e)(2) require the written approval of the Area Director or Assistant Area Director before seizure of certain business assets. "Business assets" is defined as any tangible personal property or real property (except for rental property) used in the trade or business of an individual taxpayer.

2. This approval is not required if there has been a jeopardy determination.

3. Approval may only be given after determining that the taxpayer's other assets subject to collection are insufficient to pay the amount due, together with the expenses of the proceeding.

4. With respect to the seizure of state permits for the harvest of fish or wildlife in the trade or business of an individual taxpayer, the term "other assets" includes future income that may be derived by the taxpayer from the commercial sale of fish or wildlife under the permit.

5. This approval requirement is only for assets used in the trade or business of an individual taxpayer. Thus, this approval is not required before seizure of the business assets of a corporation or partnership.

6. This approval requirement is only for tangible business assets. Tangible property is, in general, property that is physically seized for the purpose of being sold, such as inventory and vehicles. In general, intangible property represents property rights with no separate physical existence that are reached by levy, such as certificates of stock or copyrights. Any questions as to whether a certain business asset is tangible property and therefore, whether Area Director approval is required prior to seizure, should be referred to Area Counsel.

5.17.3.4.7 (01-07-2011)
Property Exempt from Levy

1. IRC § 6334(a) exempts certain property from levy. In addition to residences/principal residences and certain business assets which may be exempt as discussed above, the following property is exempt from levy:

    - wearing apparel and school books necessary for the taxpayer or members of his family

- fuel, provisions, furniture, and personal effects in the taxpayer's household, up to a specified, inflation-adjusted amount
- books and tools of the trade, necessary for the trade, business or profession of the taxpayer, up to a specified, inflation-adjusted amount
- unemployment benefits

  Note:

  The unemployment benefit exemption has been strictly construed and does not encompass retirement and survivors benefits or disability insurance payments under the Social Security Act. Kane v. Burlington Savings Bank, 320 F.2d 545 (2d Cir), cert. denied, 375 U.S. 912 (1963).
- undelivered mail
- certain annuity or pension payments: payments under the Railroad Retirement Act, benefits under the Railroad Unemployment Insurance Act, special pension payments received by Army, Navy, Air Force, and Coast Guard Medal of Honor recipients, and annuities based on retired or retainer pay under chapter 73 of Title 10 of the United States Code

  Note:

  Although as a matter of policy, the Service has placed some administrative restrictions on levying on retirement income and retirement assets, those listed in IRC § 6334(a) are the only ones exempt from levy as a matter of law.
- workmen's compensation (including amounts payable with respect to dependents)
- so much of the salary, wages, or other income as is necessary to comply with a judgment of a court requiring the taxpayer to contribute to the support of his/her minor children, but only if the judgment was entered before the date of the levy
- an amount determined under IRC § 6334(d) as a minimum exempt amount of wages, salary, or other income
- certain service-connected disability payments
- certain public assistance payments
- any amount payable under the Job Training Partnership Act

Note:

With the exception of undelivered mail, unemployment benefits, workmen's compensation, public assistance payments, Job Training Partnership Act payments, specified annuity and pension payments, exempted categories are limited in terms of value, necessity or both.

5.17.3.4.7.1 (01-07-2011)
Effect of State Law on Levy Exemptions

1. Just as state law (including state-defined exemptions) cannot prevent the attachment of the federal tax lien, no state law provision can exempt property or rights to property from levy for the collection of any federal tax. Treas. Reg. 301.6334-1(c).

5.17.3.5 (01-07-2011)
General Procedures -- Levy and Seizure

1. For step-by-step actions to be taken by a revenue officer in levying upon and seizing property, see IRM 5.10, *Seizure and Sale*, and IRM 5.11, *Notice of Levy*. This section addresses legal complications that might arise through use of levy procedures.

5.17.3.5.1 (01-07-2011)
Constitutional Considerations

1. If a levy is not honored or if the taxpayer or a third party interferes with the levy or seizure, it is imperative that constitutional guarantees and individual rights not be violated. Property should not be forcibly removed from the person of a taxpayer. Such conduct may expose a revenue officer to an action in trespass, assault and battery, conversion, etc. Larson v. Domestic and Foreign Commerce Corp., 337 U.S. 682, rehearing denied, 337 U.S. 682 (1949); Maule Industries v. Tomlinson, 244 F.2d 897, (5th Cir. 1957). If there is reason to suspect an interference with a levy, the matter should be referred for proper legal action against the offending party. See IRM 5.17.3.5.4, *Interference With Levy*, below.
2. The Supreme Court in G.M. Leasing Corp. v. United States, 429 U.S. 338 (1977) held that an entry without a warrant by the Service onto private property of a person in which that person has a reasonable expectation of privacy for the purpose of seizing property to satisfy a tax liability is a violation of that person's rights under the Fourth Amendment to the Constitution. Before levies or seizures of property located on such property may be made, permission of the occupant of the premises on which the seizure is to take place must be obtained. If the occupant refuses to permit entry, the matter should be referred to Area Counsel to obtain a court order authorizing entry.
3. The Fourth Amendment to the Constitution, forbidding unreasonable searches and seizures, does not guarantee that illegally seized property, although suppressed as evidence in a criminal proceeding, must be returned to the owner. Accordingly, such property may be levied upon. A similar result occurs if property is illegally seized by state or local authorities for purposes of criminal prosecution and is suppressed as evidence.

5.17.3.5.2 (01-07-2011)
Effecting a Levy or Seizure

1. A levy requires that the property levied upon be brought into legal custody through seizure. There must be actual or constructive physical appropriation of the property levied upon. Mere intent to reduce to possession and control is insufficient. Freeman v. Mayer, 152 F. Supp. 383 (D.N.J. 1957), aff'd, 253 F.2d 295 (3d Cir. 1958). If actual physical appropriation is not possible, i.e., as with a taxpayer's storefront, constructive seizure is effected through posting, tagging, and inventorying the property and by dispossessing the taxpayer of the property (e.g., by padlocking the doors). Physical dispossession might not be necessary depending on the type of property (e.g., a taxpayer's personal residence). Refer the case to Area Counsel if physical dispossession becomes an issue.

5.17.3.5.2.1 (01-07-2011)
Administrative Discretion

1. Whether to levy or take another course of action is within the discretion of the Area Director and his/her collection personnel, subject to the limitations on levy and satisfaction of the requirements for levy. See IRM 5.17.3.3, et seq.

5.17.3.5.2.2 (01-07-2011)
Effect of Insolvency

1. The statute of limitations on collection is suspended during the period in which substantially all of the taxpayer's assets are in control or custody of any court in any proceeding and for six months thereafter. IRC § 6503(b).

2. Although substantially all of the taxpayer's assets may be in custodia legis, property not in custodia legis, because exempt by law, may be levied upon or a suit may be instituted to foreclose a federal tax lien. The suspension provisions of IRC § 6503(b) are applicable with respect to the entire assessment and the taxes can be collected from all the taxpayer's property or rights to property which is not at the time of collection within the jurisdiction of the court.
3. The period of suspension is terminated six months after the date on which the assets are no longer in custodia legis. Generally, in a judicial proceeding, when the court by some act of its own relinquishes its jurisdiction over the property, the property may no longer be considered in custodia legis, notwithstanding the necessity of others to perform certain functions with respect to the property in question.
4. See IRM 5.17.13, *Insolvencies and Decedents' Estates*, for more information regarding insolvencies.

5.17.3.5.2.3 (01-07-2011)
Effect of Bankruptcy

1. Under the Bankruptcy Code, the statute of limitations on collection is suspended for the period during which the Secretary is prohibited by reason of the bankruptcy case from collecting the liability, plus six months thereafter. IRC § 6503(h). The Service may be prevented from collecting the liability for any one of several reasons, including the automatic stay imposed by section 362 of the Bankruptcy Code (11 USC), because it is bound by the terms of a repayment plan pursuant to Chapter 11, 12 or 13 of the Bankruptcy Code or because the court has issued an order prohibiting the Service from exercising its collection powers. Area Counsel's opinion should be obtained in the event of a defaulted Chapter 11 plan to determine what remedies are available to the Service.
2. The Service is automatically stayed from taking any act to perfect or enforce a lien against property of the estate or to collect a claim against the debtor upon the filing of a bankruptcy petition. 11 USC § 362(a).
3. If levied-upon property has not been sold or credited to the taxpayer's account before the taxpayer files for bankruptcy, the trustee can obtain an order directing the Service to turn over property to the trustee if it provides adequate protection for the Service's interest in the seized property. Whiting Pools v. United States, 462 U.S. 198 (1983). The revenue officer should work with Area Counsel to determine whether the government will seek relief from the automatic stay or negotiate for an adequate protection agreement before returning the property. In these cases, time is of the essence because inaction might subject the government to monetary sanctions for violating the automatic stay.
4. For a more complete discussion of the effect of bankruptcy, see IRM 5.17.8, *General Provisions of Bankruptcy*; IRM 5.17.9, *Chapter 7 Bankruptcy*; IRM 5.17.10, *Chapter 11 Bankruptcy*; and IRM 5.17.11, *Chapter 13 Bankruptcy*.

5.17.3.5.3 (01-07-2011)
Notice of Levy

1. The Code does not set forth the manner in which levy is to be made. IRC § 6331(b) merely defines the term "levy" as including the power of distraint and seizure by any means. Treas. Reg. § 301.6331-1(a)(1) states that levy may be made by serving a notice of levy on any person in possession of, or obligated with respect to, property or rights to property subject to levy.
2. The notices of levy used by the Service when levying on cash or cash-like property are the Notice of Levy (Form 668-A(c)(DO)) and the Notice of Levy on Wages, Salary, and Other Income (Form 668-W(c)(DO)). In addition, when a notice of levy is served upon a third party and there is no response or a refusal to comply, it is followed by, though not required by statute or regulation, a Final Demand (Form 668-C).

5.17.3.5.3.1 (01-07-2011)
Seizure

1. The Service must seize tangible property to effect a levy upon the property. That is, the taxpayer's property must be reduced to possession and control (actual or constructive). Freeman v. Mayer, 152 F. Supp. 383 (D.N.J. 1957), aff'd, 253 F.2d 295 (3d Cir. 1958). The Service must take sufficient steps to evidence constructive possession of seized property whose size, bulk or quantity reasonably prevent its removal upon seizure. Property capable of removal, such as an automobile should be removed.
2. Force should never be used in seizing property of a taxpayer. Local or other law enforcement authorities may be contacted to assist the revenue officer in performing his/her duties. Also, the Service may seek a court order to restrain the taxpayer or third party from interfering with such removal or sale.
3. In seizing property to be sold, the Service uses the Levy (Form 668-B) and, post-seizure, the Notice of Seizure (Form 2433).

5.17.3.5.3.2 (01-07-2011)
Tangibles-Intangibles

1. The IRS may levy upon and seize tangible personal property. Such property is generally capable of being viewed and physically seized and, if necessary, removed for safe keeping pending sale. (Real property is, of course, not susceptible of removal. Thus, posting of a notice of levy along with notification to the owner, tenant or occupant amounts to control.)
2. When the IRS levies upon intangible property, such as accounts receivable, contract rights, promissory notes, stock, and debts, problems may arise. The best approach to a levy and seizure of intangibles is to do everything possible to constructively reduce the intangible to possession. Thus, for example, seizure of everything in taxpayer's place of business—padlocking the premises and posting notices of distraint for taxes–did not constitute a levy upon certain accounts receivable of the taxpayer, since no steps were taken to establish possessory dominion over any sums owed the taxpayer. Freeman v. Mayer, supra, (service of notice of levy upon the taxpayer's debtors would have been sufficient in this case).
3. If intangible property is represented by a negotiable document, actual seizure of the document must be made. Service of notice of levy upon the maker of the note, the corporation or the bank is ineffective to reduce the property right to possession. Money on deposit in a bank represented by a nonnegotiable certificate of deposit in the hands of a delinquent taxpayer is subject to the levy. Rev. Rul. 73-12, 1973-1 C.B. 601. The holding in Rev. Rul. 73-12 is not applicable to negotiable certificates. Rev. Rul. 75-355, 1975-2 C.B. 478. A levy by the government on funds represented by a negotiable certificate of deposit must be made by presentation of the negotiable certificate and surrender of such certificate to the maker.
4. There are three essentials to bear in mind when contemplating levying upon intangibles. First, the revenue officer must investigate and determine the taxpayer's property or rights to property. Second, the revenue officer must determine the steps necessary to seize the intangible and reduce it to constructive possession. Third, the revenue officer must resolve whether one levy is adequate, or whether successive levies must be made.

5.17.3.5.3.3 (01-07-2011)
Suits Against Third Party

1. Where a taxpayer has instituted suit against a third party for damages in tort or contract, the right of the taxpayer to satisfaction of any judgment obtained may be levied upon. Service of notice of levy upon the defendant in most cases will amount to constructive seizure of the taxpayer's property rights. However, it is advisable to serve a notice of levy at both the commencement and conclusion of the litigation upon the defendant's attorney and the taxpayer-plaintiff's attorney and upon any insurance company, whether named a party defendant or not, or other party who may be contractually obligated to satisfy, in whole or in part, any judgment obtained in the court proceedings.

5.17.3.5.3.4 (01-07-2011)
Offset

1. A problem frequently encountered when serving a Notice of Levy upon a third party debtor of the taxpayer is the third party's claim that he has a right of setoff against the taxpayer. The claim of setoff is most frequently asserted by banks and, to a lesser degree, by the taxpayer's employer. Generally, if the tax lien arises before a third party acquires the right of setoff, or a levy is made before a setoff is made, a notice of levy reaches all the taxpayer's property in the hands of the third party undiminished by any

setoff. Bank of Nevada v. United States, 251 F.2d 820 (9th Cir. 1957), cert. denied, 356 U.S. 936 (1958); United States v. Sterling National Bank & Trust Co. of New York, 494 F.2d 919 (2d Cir. 1974); and United States v. First National Bank of Arizona, 348 F. Supp. 388 (D. Ariz. 1970), aff'd per curiam, 458 F.2d 513 (9th Cir. 1972).

2. If the federal tax lien attaches to a taxpayer's property prior to setoff, then a bank takes funds encumbered with a federal tax lien. The government may levy on the bank to obtain the encumbered funds. United States v. Donahue Industries, Inc., 905 F.2d 1325 (9th Cir. 1990); Rev. Rul. 2006-42. See also IRM 5.17.3.9.4, *Bank Accounts*, below.
3. If the taxpayer assigns future wages to his employer to secure a debt owed to the employer, a notice of levy will reach only accrued wages due the taxpayer in excess of the amount to be setoff at the time of service of the levy. See Rev. Rul. 73-365, 1973-2 C.B. 407.

5.17.3.5.3.5 (01-07-2011)
Defenses

1. IRC § 6332(a) states that except as otherwise provided in subsection (b), (which contains a special rule for life insurance and endowment contracts) and subsection (c) (which contains a special rule for banks requiring a 21-day delay before payment for the levy is sent, with interest), a person in possession of property or rights to property upon which levy has been made must, upon demand, surrender such property.
2. The Supreme Court held in United States v. National Bank of Commerce, 472 U.S. 713 (1985), that there were only two defenses to a levy: (1) the levied-upon person is not in possession of nor obligated with respect to property or rights to property of the taxpayer, or (2) the property or rights to property are subject to prior judicial attachment or execution.
3. It is important to ensure that the party having actual possession of the taxpayer's property is served with a notice of levy, particularly when dealing with entities rather than individuals. For example, a notice of levy addressed to the Chairman, Board of Supervisors, of a particular county was held to not be a levy on the county because, under state law, only the county treasurer had possession and control of county money. United States v. Brechtel, 90 F.2d 516 (8th Cir. 1937).
4. Courts have rebuffed a number of defenses to levy offered by levy sources. For example, there is no statute of limitations on bringing a suit to enforce a levy. United States v. Weintraub, 613 F.2d 612 (6th Cir. 1979), cert. denied, 447 U.S. 905.
5. Lien foreclosure may be an appropriate alternative to administrative collection where potential defenses would present litigation hazards for the government.

5.17.3.5.3.6 (01-07-2011)
Saved Harmless

1. A person levied upon who honors a levy (or who pays after being held personally liable under IRC § 6332(d)(1) for failure to honor a levy) is discharged from any obligation or liability to the taxpayer and any other person with respect to the property surrendered (or amount paid). IRC § 6332(e). However, any person who mistakenly surrenders property or rights to property in which the delinquent taxpayer has no apparent interest is not relieved of liability to a third party who has an interest in the property. Treas. Reg. § 301.6332-1(c)(2).
2. In addition to any claims against the levy source, the owners of mistakenly surrendered property may also obtain administrative relief for wrongful levy under IRC § 6343(b) or may bring suit to recover their property under IRC § 7426.

5.17.3.5.4 (01-07-2011)
Interference with Levy

1. A revenue officer attempting to levy on property of the taxpayer may experience interference by the taxpayer or a third party. Such interference may take the form of acts committed directly against the revenue officer, attempts to place property beyond the reach of levy through removal or secreting of the property, the institution of judicial proceedings to restrain the collection of a tax, or attempts to rescue or recover the property after its seizure.

5.17.3.5.4.1 (01-07-2011)
Criminal Acts

1. It is a criminal offense to forcibly assault, resist, oppose, impede, intimidate or interfere with any employee or officer of the United States in the performance of his/her official duties. 18 USC § 111. Commission of the act itself is a crime even though the doer of the act had no knowledge that the person assaulted, resisted, etc. was an officer of the Service. Bennett v. United States, 285 F.2d 567 (5th Cir. 1960), cert. denied, 366 U.S. 911 (1961), see also United States v. Alvarez, 755 F.2d 830 (11th Cir.), cert. denied, 474 U.S. 905 (1985) (federal officers generally).
2. Specifically, the Internal Revenue Code provides that it is a criminal offense to endeavor to intimidate or impede, by force or threats of force, any officer or employee of the United States acting in an official capacity under the Code. IRC § 7212.
3. Any person who removes, deposits, or conceals any property subject to levy or who abets in the removal, deposit, or concealment of such property, with intent to defeat the collection of any tax, is guilty of a felony. IRC § 7206(4). For example, the government may consider prosecution where an employer purposely pays a taxpayer in advance to preclude the government from levying upon the accrued salary of the employee. However, under IRC § 7206(4), the burden is upon the government to prove intent, a necessary element of the offense, and a very difficult burden to sustain.
4. Once property has been levied upon and seized, the owner or a third-party may attempt to regain possession improperly. Any person convicted of forcibly rescuing, or causing such rescue of seized property, or attempting or endeavoring to do so, shall be fined not more than $500.00, or not more than double the value of the property rescued, whichever is greater, or be imprisoned not more than two years. IRC § 7212(b). Also, a person may be subject to a fine or imprisonment or both if convicted of forcibly rescuing, dispossessing, or attempting to rescue or dispossess any property taken, detained or seized under the authority of any federal revenue law. 18 USC § 2233. The offense of rescuing property consists of the forcible retaking of the property out of the hands of an officer who has it in legal custody. It is not necessary that violence be committed against the person of the officer (conduct and language may be sufficient). Leaving property in possession of an individual after levy does not justify him/her in taking and disposing of it.

5.17.3.5.4.2 (01-07-2011)
Injunction

1. Taxpayers may also attempt to interfere with levy and seizure of property or rights to property by commencing a court action to enjoin or restrain the collection of a tax. IRC § 7421 prohibits a suit to restrain the collection of any tax except where levy is sought to be made:
   A. during the period a taxpayer may petition the Tax Court; and before the Tax Court's decision becomes final, if a Tax Court petition is filed;
   B. during the pendency of a CDP hearing and any judicial review/appeals unless the court has granted a motion to permit levy;
   C. before the final resolution of a suit for: refund of a divisible tax (but only if a bond is filed); tax return preparer penalties; abusive tax shelter promoter penalties; aiding and abetting understatement penalties and frivolous return penalties;
   D. if a party has brought a wrongful levy action or a suit to review a jeopardy assessment;
   E. during the pendency of notice pursuant to IRC § 6672(b) of proposed liability for the trust fund recovery penalty, and during the pendency of an administrative protest to the asserted liability;
   F. when a deficiency attributable to a partnership item is prematurely assessed, and during the pendency of the Tax Court proceeding (IRC § 6225(b)), after a notice of partnership adjustment is sent and during the pendency of the judicial proceeding resolving the dispute over the proposed partnership adjustment; or
   G. during the pendency of a proceeding for determination of employment status.

2. The courts have further narrowed the parameters of the prohibition against enjoining the collection of the federal tax. For example, the prohibition has been construed not to apply if suit is brought against a purchaser in possession to set aside the government's sale of seized property if conditions precedent to a levy sale have not been substantially complied with. Margiotta v. District Director of Internal Revenue, 214 F.2d 518 (2d Cir. 1954), National Bank & Trust Co. v. United States, 78-1 USTC 9196 (N.D. Ind. 1977), aff'd, 589 F.2d 1298 (7th Cir 1978). Further, where there are special and extraordinary circumstances combined with the illegality of the tax (failure to give notice of the tax and demand for payment), the collection of which is sought to be restrained, the courts, in the exercise of their equitable powers, will restrain collection of such tax by levy, notwithstanding IRC § 7421. L.O.C. Indus. Inc. v. United States, 423 F. Supp. 265 (M.D.Tenn, 1976). The illegality, however, must be clearly apparent and convincingly established. Bob Jones University v. Simon, 416 U.S. 725 (1974); Commissioner v. Americans United, Inc., 416 U.S. 752 (1974); Enochs v. Williams Packing & Navigation Co., 370 U.S. 1, reh'g denied, 370 U.S. 965 (1962).

5.17.3.5.5 (01-07-2011)
Redemption

1. The person whose property has been seized may redeem both real and personal property at any time before its sale by paying the taxes due and any expense incurred in connection with the seizure and contemplated sale. IRC § 6337(a). The amount of the tax due must be paid and not merely an amount equal to the value of the property seized or the value of the government's interest in the property.
2. Once personal property is sold, the taxpayer no longer has any right to redeem the property. Real property, however, may be redeemed within 180 days from the date of sale by the taxpayer, his/her heirs, executors, or administrators, or any person having an interest in or a lien on the property, or any person on their behalf. IRC § 6337(b).
3. When a certificate of sale is tendered after the expiration of the redemption period, the deed should be issued even if there is a contention that a qualified party has offered to redeem and been refused, since that party's remedy is to seek judicial enforcement of the right to redeem.
4. A tenant in common or a wife with an inchoate right of dower has sufficient interest to redeem. See, e.g., Babb v. Frank, 947 F. Supp. 405 (W.D. Wis. 1996), United States v. Lowe, 268 F. Supp. 190 (N.D. Ga. 1966), aff'd sub nom., Lowe v. Monk, 379 F.2d 555 (5th Cir. 1967), cert. denied, 389 U.S. 1039 (1968); Samet v. United States, 242 F. Supp. 214 (M.D.N.C. 1965). Similarly, the husband's right of curtesy entitles him to redeem.
5. The amount to be paid to the purchaser to redeem is the purchase price, together with interest at the rate of twenty percent (20%) per annum. IRC § 6337(b)(2).

   Note:

   IRC § 6622 requires daily compounding interest. See Rosen v. Norton, 970 F.2d 1079 (2d Cir. 1992), cert. denied, 507 U.S. 918 (1993). See also IRM 5.10.6.8(3) and (4) regarding the calculation of interest.
6. If the purchaser cannot be found in the county in which the property to be redeemed is located, payment is to be made to the Secretary or his delegate for use of the purchaser, his/her heirs or assigns. IRC § 6337(b). Redemption cannot be made through a suit attacking the validity of the tax and the sale itself for which the property was seized to satisfy the purported invalid tax. If the terms of the redemption statute are not complied with, there can be no redemption. Babb v. Frank, 947 F. Supp. 405 (W.D. Wis. 1996). If there is an assignment by the purchaser of property purchased at a sale, one entitled to redeem may, as a means of protection, deposit the amount to redeem in court and tender said sum to either the defendant-purchaser or his/her assignee, whoever is entitled to such.
7. On occasion, real and personal property, or a number of tracts of real property may be purchased in the aggregate. Under such circumstances, the purchase price of the realty for purposes of redemption shall be the ratio, as of the time of sale, of the value of the realty to the total value of all property purchased. The minimum price or the highest bid price, whichever is higher, offered for the property separately or in groups shall be treated as the value. Treas. Reg. § 301.6337-1(b)(2).
8. Questions concerning who is entitled to rents, profits and possession of real property during the statutory period of redemption should be referred to Area Counsel.

5.17.3.5.6 (01-07-2011)
Release of Levy and Return of Property

1. The IRS is required to release a levy upon all or part of the property or rights to property levied upon under certain conditions. IRC § 6343(a).
2. The Area Director is authorized to return any property which has been wrongfully levied upon to its rightful owner. In addition to this administrative procedure in IRC § 6343(b) to return wrongfully levied property, a person other than the taxpayer may file suit against the government to recover the property or obtain a judgment. IRC § 7426.
3. In addition, IRC § 6343(d) authorizes the IRS to return levied upon property in certain situations other than wrongful levies:
   - if the levy was premature or otherwise not in accordance with administrative procedures (e.g., the levy was made before the taxpayer was given CDP rights under IRC § 6630),
   - the taxpayer has entered into an installment agreement under IRC § 6159 to satisfy the tax liability (unless the agreement provides otherwise),
   - the return of the property will facilitate the collection of the tax liability, or,
   - with the consent of the taxpayer or the National Taxpayer Advocate, the return of the property would be in the best interests of the taxpayer (as determined by the National Taxpayer Advocate) and the United States.

   Note:

   The provisions of IRC § 6343(b) (as discussed below) apply to IRC § 6343(d) in the same manner as if the property had been wrongfully levied, except that the interest in wrongful levy cases provided under IRC § 6343(c) is not allowed.

5.17.3.5.6.1 (01-07-2011)
Requirements for Release of Levy

1. IRC § 6343(a) requires a release of levy for all or part of the seized property if:
   A. the liability is satisfied or is unenforceable because the statutory period for collection had expired;
   B. release will facilitate collection;
   C. the taxpayer has entered into an installment agreement, unless the agreement provides otherwise;
   D. the Secretary determines that the levy is creating an economic hardship within the meaning of IRC § 6343(a)(1)(B); or
   E. the fair market value of the levied property is more than the amount owed and part of the levied property can be released without hindering collection.
2. In addition, the IRS must, as soon as practicable, release a wage levy upon agreement with the taxpayer that the tax is not collectible. IRC § 6343(e).

5.17.3.5.6.2 (01-07-2011)
Effect of Release

1. Even if a levy is released, IRC § 6343(a) specifically permits a subsequent levy upon the same property. However, the right to levy again is limited by the statute of limitations on collection or any extensions of it. To prevent possible future litigation over the claims of the exempted categories listed in IRC § 6323(a), a release of levy should not be issued unless or until a notice of tax lien is filed to establish the validity of the federal tax lien against such parties.

5.17.3.5.6.3 (01-07-2011)
Wrongful Levy

1. The wrongful levy procedures in IRC § 6343(b) provide for the return of property or sales proceeds to third parties. If the Secretary or his delegate determines that property has been wrongfully levied upon, the Secretary or his delegate pursuant to IRC § 6343(b) may return:

   A. the specific property levied upon;

   B. an amount of money equal to the amount of money levied upon (including interest); or

   C. an amount of money equal to the amount received by the government from the sale of the property.

2. With respect to an amount levied upon or an amount of money equal to the amount received by the government from the sale of such property, interest is allowed and paid at the rate established under IRC § 6621 for the periods described in IRC § 6343(c).

3. If the sale of the property in question has occurred and the property has been declared purchased by the United States, the minimum bid price is to be treated as the amount received from the sale.

4. The United States may return the property at any time it still has possession of it.

   Note:

   If the property is money specifically identifiable, such as a valuable coin collection worth more than its face value, this money is treated as specific property and, where possible, returned.

5. If money is levied upon or received at the sale of property, an amount of money equal to the amount levied upon or received at sale may be returned before expiration of nine months after the date of the levy. When a request for return of property is filed before the expiration of the 9 month period, the funds may be returned after the 9 month period expires if necessary for the investigation and processing of the request.

   Note:

   For purposes of determining the nine-month period under IRC § 6343(b), the "date of such levy" for continuous levies under IRC § 6331(e) and (h) is the date the notice of levy is served.

6. While filing a formal claim for return of property is not a prerequisite of a suit under IRC § 7426, any written request for the return of property under IRC § 6343 must comply with the conditions set forth in Treas. Reg. § 301.6343-2(b). Inadequacies in the request must be noted in writing by the Area Director and mailed within 30 days after receipt of the request or the request is deemed adequate. Treas. Reg. § 301.6343-2(c).

   Note:

   The request must be sent to the office listed in Publication 4528, *Making an Administrative Wrongful Levy Claim Under Internal Revenue Code (IRC) Section 6343(b)*, to be effective. See Treas. Reg. § 301.6343-2(b).

7. A third party challenging a levy by the Service may only seek a remedy in a wrongful levy suit under IRC § 7426. The statute of limitations for bringing a wrongful levy suit is nine months from the date of the levy. However, if an administrative claim has been made for the return of property, the 9 month period is extended by 12 months from the date of the request or 6 months from the date the Service denies the request, whichever is shorter. IRC § 6532(c).

8. The third party cannot bring a quiet title action under 28 USC § 2410 (which has a longer limitations period) because IRC § 7426 is the exclusive remedy for third persons claiming a senior interest in property seized by the Service. Miller v. Tony and Susan Alamo Foundation, 134 F.3d 910 (8th Cir. 1998); Winebrenner v. United States, 924 F.2d 851 (9th Cir. 1991); and United Sand and Gravel Contractors, Inc. v. United States, 624 F.2d 733 (5th Cir. 1980). Similarly, the third party cannot seek redress through a refund claim filed under 28 USC § 1346(a)(1). EC Term of Years Trust v. United States, 550 U.S. 429 (2007).

5.17.3.6 (01-07-2011)
Sale -- Authority

1. Under IRC § 6331(b), the Area Director is authorized to sell the taxpayer's property or rights to property or property encumbered with a federal tax lien.

2. In addition to the authority under IRC § 6331(b) to sell seized property, the Service is authorized to sell personal property acquired by the United States in payment of or for security for federal tax liabilities. IRC § 7505(a). Property is sold under procedures set forth in Treas. Reg. § 301.7505-1(a).

3. The Service is also authorized to sell, at public sale after at least 20 days' notice, real property that has become property of the United States. There are various ways that real property can become property of the United States, including, but not limited to, a judgment of forfeiture under the tax laws, assignment to the United States, or redemption by the United States. IRC § 7506.

4. Sale procedures are set forth in Treas. Reg. § 301.7506-1(b).

5.17.3.6.1 (01-07-2011)
Sale -- Role of Revenue Officer

1. Sales of seized property are conducted by Property Appraisal and Liquidation Specialists (PALS). Revenue officers are generally barred from participating in the actual sale under IRC § 6335.

   Note:

   This prohibition does not bar revenue officers from conducting sales of perishable goods under IRC § 6336.

2. Prohibited acts by revenue officers include:

   - Grouping property prior to sale after the Form 2433 has been completed
   - Registering bidders
   - Tabulating bids
   - Assisting in collecting sales proceeds
   - Issuing certificates of sale
   - Answering sale-related questions
   - Any other sale-related activity involving interaction with anyone attending or conducting the sale

3. Revenue officers have an extremely limited role in post-seizure matters. However, there are limited ministerial acts that the revenue officer may undertake. In addition to the limited use of revenue officers to deliver notices of sale, the revenue officer may, if necessary, record the sealed bid information required on Form 4425, although this is not the preferred practice.

4. Post-seizure the revenue officer continues to be responsible for the collection of the outstanding tax liability and remains in communication with the PALS as necessary. For example, the revenue officer would contact the PALS if the liability were satisfied before the sale or if the taxpayer filed bankruptcy before the sale. In addition, given the continued collection responsibility, the revenue officer may be present at the sale (or otherwise available) to address alternative methods of collection with the taxpayer.

5. As described in IRM 5.10, revenue officers do participate in post–sale procedures. For example, the revenue officer:

   - inputs the transaction code to remove a module from inventory;
   - works with the PALS to ensure that all expenses of seizure and sale are properly debited;
   - maintains the ICS case file; and
   - ensures that documents are forwarded to Advisory for inclusion in the seizure file and the permanent record.

5.17.3.6.1.1 (01-07-2011) Notice of Seizure

1. As soon as practicable after seizure, the revenue officer must give written notice to the owner of the property (or the possessor of personal property) which specifies the amount owed and contains an account of the personal property seized and a reasonably certain description of the real property seized.

2. The notice must be left at the usual place of abode or business of the person to be notified if within the area where the seizure is made, or mailed to his/her last known address if he/she has no abode or business in the area or cannot be readily located. IRC § 6335(a).

3. If the IRS does not comply with the notice requirements, the IRS can still argue that notice was effective because it "substantially complied" with the statute. Grable & Sons Metal Products, Inc. v. Darue, 377 F.3d 592 (6th Cir. 2004), aff'd on other grounds, 545 U.S. 308 (2005).

5.17.3.6.1.2 (01-07-2011) Notice of Sale

1. Preparation for the sale of seized property should be commenced as soon as practicable after seizure.

2. In the same manner as a notice of seizure, and as soon as practicable after the seizure, notice of sale must be given to the owner. A notice specifying the property to be sold and the time, place, manner and conditions of sale must be published in a newspaper published or generally circulated within the county in which the seizure was made. IRC § 6335(b). If a newspaper of general circulation in a county will reach more potential bidders for property to be sold than a newspaper published within the county, or if there is a newspaper of general circulation within the county but not published within the county, the government may publish notice of sale in the newspaper of general circulation. If no newspaper is published or generally circulated in the county, notice of sale shall be posted at the post office nearest the place of seizure and in not less than two other places.

3. The government, by regular mail, also sends a copy of the notice of sale to all interests of record (joint owners, senior and junior lien-holders, nominees, transferees, judgment creditors regardless of whether they have perfected a lien interest, etc.). See IRM 5.10.4.13, *Delivery of Notice of Sale*. See also Verba v. Ohio Cas. Ins., 851 F.2d 811 (6th Cir. 1988) (constructive notice provided by publication and posting pursuant to IRC § 6335(b) held to be constitutionally inadequate). Interests of record are pulled from Form 2434-B which lists all encumbrances/interests of record.

4. A description of real property in a notice of sale is sufficient if the land can be identified, provided that the portion of the description which is left out would add nothing to the certainty of the description. In describing personal property to be sold, it is not necessary that each item be listed and be completely detailed. A general description is sufficient.

5. If notice of sale is posted at public places, the premises of the taxpayer does not constitute a public place, even though the real property was seized for delinquent taxes and the sale was conducted on the premises.

5.17.3.6.1.3 (01-07-2011) Time of Sale and Adjournment

1. The sale must be held not less than 10 days, nor more than 40 days from the date public notice of sale is given, unless it is adjourned for a period not to exceed one month. Pursuant to Anderson v. United States, 44 F.3d 795 (9th Cir. 1995), a sale may be adjourned but not postponed. (Postponed refers to an action taken to delay the sale prior to the commencement of sale; adjourned refers to an action taken to delay the completion of the sale after the bidding has started). The sale may not be delayed beyond the statutory periods provided in IRC § 6335(d).

   Note:

   The Service is subject to another potential time constraint: Under IRC § 6335(f), the owner of any seized property may request that the property be sold within 60 days of the request. The Service must comply unless it determines (and notifies the owner within the 60-day period) that compliance would not be in the best interest of the United States. Failure to do so may have adverse consequences. For example, in Zaparra v. Commissioner, 124 T.C. 223 (2005), reconsideration denied, 126 T.C. 215 (2006), the Tax Court held that where the taxpayers requested that the Service sell the seized property and apply proceeds to their outstanding tax liabilities, but the Service did not sell the property or determine that the sale would not be in the best interests of United States, the taxpayers were entitled to credit for the value of the property as of the date by which it should have been sold under IRC § 6335(f).

2. After the commencement of the sale, it may be adjourned if the interests of either the United States or the taxpayer will best be served by the adjournment. Notice of the adjourned sale should be given to the taxpayer in the same manner as the original notice of sale. It is important that the sale of seized property take place within the time period designated in the Code and regulations because failure to do so will affect the validity of the sale. Powelson v. United States, 963 F.2d 1156 (9th Cir. 1992); Reece v. Scoggins, 506 F.2d 967 (5th Cir. 1975).

3. A sale may be adjourned at any time after the bidding has started but before the property is declared sold or the preestablished minimum bid price has been reached. Adjournments may not be made, however, for the express purpose of adjusting the minimum bid price downward to avoid purchase of the property by the United States. See IRM 5.10.5.4, *Adjournment Procedures*.

5.17.3.6.1.4 (01-07-2011) Jeopardy

1. If the Area Director believes that collection of an unassessed liability is in jeopardy, he/she may make an immediate assessment and pursue collection without need to follow normal assessment and collection procedures. As soon as a jeopardy or termination assessment is made, the tax, penalties, and interest become due and payable, and the Area Director issues a notice and demand for payment in full. If payment is not made, the IRS may immediately proceed to collect by levy without waiting for the usual 10-day period after notice and demand to expire. Collection may be stayed by filing a surety bond.

2. Whenever levy is made without regard to the 10-day period required by IRC § 6331(a)(4), public notice of sale of the property seized will not be made within the 10-day period unless IRC § 6336 (relating to the sale of perishable goods) applies. See IRM 5.17.15, *Termination and Jeopardy Assessments and Jeopardy Collection*, for further discussion.

5.17.3.6.2 (01-07-2011)
Manner of Sale

1. Sales of seized property must strictly adhere to the sale mechanics provided to avoid a charge of impropriety.
2. Seized property may be sold either by public auction or by public sale under sealed bids. The PALS should select the method that will bring the highest price.
3. Prospective bidders should be allowed a reasonable time to inspect the property to be sold insofar as possible. The terms and conditions of the sale, the announcement of a minimum bid price if applicable (announcement of the minimum bid price may be made before the sale begins if advantageous or it may be deferred until after the receipt of the highest bid, and if that bid is greater than the minimum bid price, no announcement will be made), the type of auction sale to be held, the manner of bidding, the conditions under which property is to be offered for sale, etc., should be clearly announced, except as indicated, before entertaining bids.

5.17.3.6.2.1 (01-07-2011)
Minimum Bid Price

1. The IRS cannot sell seized property for less than the minimum bid price. IRC § 6335(e). Such a sale would be an unauthorized collection action, which may lead to an action for civil damages pursuant to IRC § 7433.
2. Before the sale the PALS must establish a minimum bid price below which the property may not be sold. Under the Service's procedures, the minimum bid price is generally computed at 80 percent or more of the forced sale value of the property, less encumbrances having priority over the federal tax lien. The taxpayer is given 10 days to contest the determination of the minimum bid price and may hire an outside appraiser or request a valuation by an IRS Valuation Engineer. The minimum bid price cannot exceed the government's lien interest in the property.
3. IRC § 6335 requires that before sale of seized property the Service must determine if purchase of the property at the minimum bid price is in the best interest of the government. If it is and the minimum bid is not offered at the sale, the IRS must buy the property. IRC § 6335(e)(1)(C). Otherwise, the property must be released back to the owner. IRC § 6335(e)(1)(D). After release, the property would still be subject to the lien and could be reseized. Any expenses of levy and sale are added to the amount of taxes due. If the property is "bid in" by the government at the minimum bid price, it becomes "acquired property" and may subsequently be sold under IRC § 7506.
4. If the property is listed securities, the minimum bid is fixed at no less than 95 percent of the preceding day's closing market price. IRM 5.10.4.8(10) and Policy Statement P-5-35 at IRM 1.2.14.1.9.
5. The PALS may or may not announce the minimum bid at the sale.
6. If the minimum bid price is not offered during the course of a sale, the PALS may do whichever of the following best promotes the interest of the government and the taxpayer:
   A. adjourn the sale for the purpose of re-evaluating the minimum bid price, IRM 5.10.5.4(7);
   B. declare the property purchased by the United States for the minimum bid price; or
   C. release property to the taxpayer pursuant to IRC § 6335(e).
7. The property must be declared sold to the highest bidder if the bids exceed the minimum bid price.
8. No minimum bid price is necessary in a sale of goods determined to be "perishable" under IRC § 6336. The term "perishable goods" means any tangible personal property which is determined to be liable to perish or become greatly reduced in price or value by retaining, or cannot be kept without great expense.

5.17.3.6.2.2 (01-07-2011)
Grouping of Property

1. The property will be sold under the method expected to produce the highest total proceeds. Seized property may be sold as separate items, in lots or as groups of items, or in the aggregate, or all three methods may be employed. If real and personal property are offered for sale, the real property must be offered first as separate items and the personal property as a group, groups, or separate items, before being offered in the aggregate. If several tracts of real estate are to be sold, the costs and expenses of levy and sale should be apportioned to each parcel for purposes of determining the amount to be paid for redemption of any one parcel. Failure to prorate costs and expenses incident to preparation of the sale, or failure to assign a value to each parcel of real property when sold in the aggregate may be held to prejudice the right of redemption before sale or after sale. McAndrews v. Belknap, 141 F.2d 111 (6th Cir. 1944), cert. denied, 323 U.S. 721 (1944).
2. It may be apparent that seized property, if sold, would return an amount far in excess of the tax and expenses of levy and sale. Under such circumstances, if the seized property is divisible and a sale of a part thereof would realize an amount sufficient to pay the entire tax and expenses, only so much of the divisible property should be sold as is necessary to satisfy the liability, including expenses. Johnson v. Gartlan, 470 F.2d 1104 (4th Cir. 1973), cert. denied, 414 U.S. 852 (1973).

5.17.3.6.2.3 (01-07-2011)
Acceptance of Bid--Payment

1. If a purchaser at a cash sale defaults, the IRS must resell the property pursuant to IRC § 6335(e). However, in a deferred payment sale the Service may either sue for the balance or void the sale and resell the property, retaining, as forfeited, any payments made. Treas. Reg. § 301.6335(c)(8). Because the forfeiture provisions of IRC § 6335(e)(3) apply only to deferred payment sales, the PALS should consult Area Counsel regarding whether under state law the United States may sue for damages and retain the deposit. The government must observe all Code provisions governing the sale of seized property even though no time limitations per se are imposed on the resale of property where a purchaser has defaulted.
2. The partial payment of the bid price by the purchaser at a deferred payment sale is forfeited when the Area Director elects to declare the sale null and void. The amount forfeited is not applied to the liability of the taxpayer, but is paid into the Treasury as in the case of other forfeitures. IRC § 7406. The new purchaser will receive the property free of all claims of the defaulting purchaser.

5.17.3.6.2.4 (01-07-2011)
Invalid Sale

1. The Code provisions relating to the sale of seized property are meant to protect the taxpayer. A sale is not void because of noncompliance with the provisions of IRC § 6335, but it is voidable by the owner of the property. Aqua Bar & Lounge, Inc. v. United States, 438 F. Supp. 655 (E.D. Pa. 1977), remanded from 539 F.2d 935 (3rd Cir. 1976). The government cannot of its own accord resell property because it failed to comply with the sale provisions of the Code. Koby v. United States, 47 Fed. Cl. 99 (2000); United States v. Conry, 74-1 USTC 9187 (N.D. Cal. 1973). The government has no statutory authority under section 6335 or under any other section of the Internal Revenue Code to administratively rescind a procedurally defective sale.
2. A taxpayer may institute suit against a purchaser to set aside a sale because the government failed to comply with the pre-sale requirements of the Code. The taxpayer may be able to restrain a sale if she can show the IRS failed to comply with the statutory sale requirements, coupled with a showing of special and extraordinary circumstances (irreparable harm and injury). Transport Mfr. & Equip. Co. of Delaware v. Trainor, 382 F.2d 793 (8th Cir. 1967); Aqua Bar & Lounge, Inc. v. United States, supra; Whalen v. Department of Treasury, 80-2 USTC 13375 (N.D. Ohio 1980). Such a suit does not contravene IRC § 7421, which prohibits suits to restrain the collection of a tax. Powelson v. United States, 963 F.2d 1156 (9th Cir. 1992); Kulawy v. United States, 917 F.2d 729 (2d Cir. 1990); Margiotta v. District Director of Internal Revenue, 214 F.2d 518 (2nd Cir. 1954); Reece v. Scoggins, 506 F.2d 967 (5th Cir. 1975).
3. However, the court may deny the taxpayer equitable relief if the taxpayer waits too long to attack a sale. McAndrews v. Belknap, 141 F.2d 111 (6th Cir. 1944), cert. denied, 323 U.S. 721 (1944); Howard v. Adle, 538 F. Supp. 504 (D. Mich. 1982); Van Skiver v. United States , 751 F. Supp. 1522 (D. Kan.1990), aff'd, 952 F.2d 1241 (10th Cir.), cert. denied, 506 U.S. 828 (1992).

4. Even if the sale is not deemed void, it is imperative to remember that failure to comply with the Code requirements may be deemed unauthorized collection actions subject to damages, if any, pursuant to IRC § 7433.

5.17.3.6.3 (01-07-2011)
Warranties

1. It is important that the PALS emphasize that no warranties are made as to the validity of the title to the property to be sold. The property should be offered for sale "as is" and "where is" and without recourse against the United States.

2. The taxpayer's property and rights to property are sold subject to any prior mortgages, encumbrances or liens in favor of third parties senior to the federal tax lien. Treas. Reg. § 301.6335-1(c)(5)(iii). It is the responsibility of the prospective bidders to investigate title to and encumbrances on the seized property. However, on request the government will provide prospective bidders information it has learned about encumbrances which have priority over the federal tax lien listed on Form 2434-B, Notice of Encumbrances Against Property Offered for Sale.

   Note:

   The number of liens and the uncertainty of their respective priority may depress the sale price. In such cases, rather than administratively seizing and selling the property, the revenue officer (or the PALS if the property has already been seized) should consider recommending suit to foreclose the federal tax lien, provided sufficient money is involved to justify suit.

5.17.3.6.4 (01-07-2011)
Certificate of Sale -- Deed of Property

1. A certificate of sale is given to the purchaser of either personal or real property upon payment of the purchase price. A deed to real property is given to the purchaser or his/her assignees upon surrender of the certificate of sale after the redemption period expires. (If the purchaser cannot produce the certificate of sale, the purchaser must execute an affidavit of lost certificate, drafted by Area Counsel). The certificate of sale of personal property transfers to the purchaser all the delinquent taxpayer's right, title and interest in the property sold, and the certificate is prima facie evidence of the right of the Service to make the sale and is conclusive evidence of the regularity of the sale proceedings. IRC § 6339.

2. The certificate of sale constitutes authority for the transfer of corporate stock and title to motor vehicles. It also constitutes a receipt if the property sold is securities or other evidence of debt. Treas. Reg. § 301.6339-1.

3. A deed to real property is prima facie evidence of the facts stated therein and operates as a conveyance of all the taxpayer's right, title and interest in the premises sold at the time the tax lien attached to the realty, provided the sale has been substantially in compliance with the provisions of the Code and regulations.

4. Some purchasers record the certificate of sale to preclude transfer by the taxpayer to a bona fide purchaser for value.

Next

More Internal Revenue Manual

Part 5. Collecting Process

Chapter 17. Legal Reference Guide for Revenue Officers

Section 4. Suits by the United States

5.17.4 Suits by the United States

Manual Transmittal

March 30, 2015

Purpose

(1) This transmits revised IRM 5.17.4, Legal Reference Guide for Revenue Officers, Suits by the United States.

Background

This section provides procedures for instituting and carrying out a lawsuit. It incorporates outstanding Interim Guidance.

Material Changes

(1) Editorial changes were made and cross references to IRM provisions were updated throughout this section.

(2) IRM 5.17.4.3(2): Revised - Change 20 days to 21 days. See Rule 12, F.R.Civ.P.

(3) IRM 5.17.4.8.2.5: Incorporates SBSE-05-0414-0032.reissued April 18, 2014 which adds requirements related to lien foreclosures related to principal residences.

(4) IRM 5.17.4.10.1(1(b): Changed to Division Counsel (Small Business/Self-Employed) - the delegation for certification of the Secretary, during a proceeding for a collection suit, that a court appointed receiver is in the public interest.

(5) IRM 5.17.4.17.1: Incorporates SBSE-05-1014-0078 reissued October 16, 2014 which deletes the monthly filing and special deposit procedures as a requirement for demonstrating that administrative remedies have been exhausted.

(6) IRM 5.17.4.17.3: New section on IRC § 7402(a) Injunctions regarding monitoring the injunction after it is obtained.

Effect on Other Documents

This IRM supersedes IRM 5.17.4 dated January 1, 2015. This IRM also incorporates the following Interim Guidance number SBSE-05-0414-0032, titled, *Reissuance of Principal Residence Suit Foreclosure Recommendations*, reissued on 4/18/2014 and Interim Guidance number SBSE-05-1014-0078, titled, *Interim Guidance for Monthly Filing and Special Deposit Procedures*, reissued on 10/16/2014.

Audience

SB/SE Revenue Officers.

Effective Date

(03-30-2015)

Kristen Bailey
Acting Director, Collection Policy
Small Business/Self-Employed

5.17.4.1 (08-01-2010)
Overview

1. The purpose of this section is to outline some general characteristics and procedures followed in instituting and carrying out a lawsuit and some common types of lawsuits commenced by the United States for effecting or assisting in the collection of taxes.

2. For information regarding lawsuits that are brought against the United States, see IRM 5.17.5, Suits Against the United States.

3. For procedural guidelines on recommending suits after administrative actions have been exhausted or determined to be unfeasible and/or inappropriate, see IRM 25.3.2, Suits by the United States.

5.17.4.1.1 (08-01-2010)
Distinctions between Judicial and Administrative Collection Processes

1. U.S. Constitution, Article 1, Section 8, provides that "... Congress shall have power to lay and collect taxes..." Congress in enacting the Internal Revenue Code gave the Service broad administrative processes for the collection of taxes. Although such processes are responsible for a majority of the delinquent tax accounts collected, considerable credit for such success lies in the ability of the Internal Revenue Service to utilize, when necessary, the aid of the courts to ensure collection of the tax. This

use of the courts in assisting and effecting collection is commonly referred to as "judicial process."

2. The determination of whether to use administrative or judicial collection processes depends upon the facts of a specific case. However, once the decision is made to proceed by way of a court action, collection personnel should move quickly and thoroughly to ensure its success. Because of the publicity that may accompany a court proceeding, the success of such an action cannot be measured only in the dollar amount of the tax collected. A timely and successful court action can increase the effectiveness and success of the voluntary and prompt payment of taxes.

5.17.4.2 (08-01-2010)
Initiating and Processing Collection Suits

1. A request for institution of a legal proceeding to effect or assist in the collection of a tax is generally initiated in the office of the Area Director by the Field Collection function or Advisory. However, suit recommendations can be initiated by any Collection employee.
2. The authority to approve most suit recommendations is delegated to Collection Territory Managers and Advisory Territory Managers. However, Area Director approval is required if the recommendation is to either

   A. secure judicial approval to seize a principal residence; or

   B. foreclose the federal tax lien against the principal residence of any person.

   See SB/SE Delegation Order 145.2 (Rev. 2).

5.17.4.2.1 (08-01-2010)
General Procedures

1. Prior to recommending the commencement of any legal proceeding for the collection of taxes, the responsible initiating officer should become thoroughly familiar with appropriate provisions of the Internal Revenue Manual and Section 12 of this Legal Reference Guide (IRM 5.17.12), entitled "Investigations and Reports."
2. Area Counsel is always available for the purpose of rendering legal advice in ascertaining the most desirable course of action available and the probability of processing a case through to a successful conclusion. Should the revenue officer uncover information early in the investigation that casts doubt on the success of a contemplated legal proceeding, much time and effort can be saved by requesting timely legal assistance.
3. An examination of the steps taken after a suit recommendation is received by Area Counsel will show the advantage of making a timely recommendation for the institution of a collection suit. After receipt of the suit recommendation, together with supporting documents, Area Counsel examines the case carefully from a legal viewpoint to determine whether or not suit is warranted on the facts presented. If suit is warranted, Area Counsel then prepares a letter to the Assistant Attorney General, Tax Division, Department of Justice, authorizing and requesting the institution of suit. That letter must contain a discussion of the necessary facts and supporting documents, tax information, and applicable statutes and judicial decisions that may be relevant to the case.
4. When the Department of Justice receives the authorization, the case becomes the responsibility of the Department of Justice which makes the final decision whether to institute the suit. The Department of Justice, generally following coordination with Area Counsel, may also determine that a settlement agreement with the taxpayer should be considered. Thus, a significant amount of time may elapse before a suit is filed and a judgment is obtained.
5. When the Department of Justice is given authorization to initiate litigation to collect unpaid federal taxes, it assumes jurisdiction over collection actions. No further administrative collection actions not specifically authorized by the Department of Justice may be taken until jurisdiction for collection is returned to the Internal Revenue Service.

5.17.4.2.2 (08-01-2010)
Statutory Authority

1. The general authority for the United States to commence a court action for the collection or recovery of taxes is provided for by IRC § 7401, as follows:

   > No civil action for the collection or recovery of taxes, or of any fine, penalty, or forfeiture shall be commenced unless the Secretary authorizes or sanctions the proceedings, and the Attorney General or his delegate directs that the action be commenced.

2. The Attorney General has not delegated the authority to direct the institution of such a proceeding to the United States Attorney. The Secretary of the Treasury has delegated his power of authorization to the Chief Counsel of Internal Revenue. Where the commencement of such an action has not been authorized or sanctioned, it is subject to dismissal. Civil actions commenced under this provision must be brought in the name of the United States and not a government official.

5.17.4.2.3 (08-01-2010)
Parties to Suit

1. Generally, the parties or persons who are actively concerned in the prosecution and defense of a lawsuit can be designated as either plaintiffs or defendants.
   - The plaintiff is the usual term applied to the person or persons who initiate the suit.
   - The defendant is the usual term applied to the person or persons against whom relief or recovery is sought in an action or suit.
2. The United States may only be named as a defendant where Congress has enacted a statute specifically authorizing such suit. See IRM 5.17.5, Suits Against the United States.

5.17.4.2.4 (08-01-2010)
Jurisdiction of Courts

1. Generally, jurisdiction can be defined as the power conferred upon a court to hear and determine the subject matter in controversy between parties and to grant the relief asked. Federal courts derive their authority to act either from the United States Constitution or an Act of Congress. State courts derive their authority to act either from the State Constitution or Acts of the Legislature of the particular state. The United States may be a defendant in a state court proceeding, such as a mortgage foreclosure proceeding. The United States, however, has the right to seek removal from the state court to federal district court. However, the United States only has 30 days from receipt of the initial pleading setting forth the claim for relief or 30 days from service of the summons and complaint to file a notice of removal. See 28 USC §§ 1441 and 1446. Where it is the plaintiff, the United States utilizes federal courts to enforce collection of its taxes.
2. The jurisdiction of United States district courts to hear collection suits is established by IRC § 7402(a) which provides as follows:

   > The district courts of the United States at the instance of the United States shall have such jurisdiction to make and issue in civil actions, writs and orders of injunction, and of *ne exeat republica*, orders appointing receivers, and such other orders and processes, and to render such judgments and decrees as may be necessary or appropriate for the enforcement of the internal revenue laws. The remedies hereby provided are in addition to and not exclusive of any and all other remedies of the United States in such courts or otherwise to enforce such laws.

3. The United States Code additionally provides in 28 USC § 1345:

United States as plaintiff. Except as otherwise provided by Act of Congress, the district courts shall have original jurisdiction of all civil actions, suits or proceedings commenced by the United States, or by any agency or officer thereof expressly authorized to sue by Act of Congress.

5.17.4.2.5 (08-01-2010)
Venue of Actions

1. Venue means the place where a suit is tried. A civil action for the collection of internal revenue taxes may be brought in the district where the liability for such tax accrues, in the district of the taxpayer's residence, or in the district where the return was filed. 28 USC § 1396.
2. The United States, therefore, has a choice of forum in the institution of civil suits for the collection of taxes. However, in an *in rem* action (an action against property, rather than against a person, such as a lien foreclosure suit), venue would ordinarily lie in the district where the property in question was located.

5.17.4.3 (03-30-2015)
General Characteristics of a Suit

1. A lawsuit by the United States to collect taxes is generally commenced by the filing of the complaint drafted, in most cases, by someone assigned to the case in the Tax Division of the Department of Justice. When the suit is brought by the United States, the action is commenced in a federal district court.
2. After the filing of the complaint with the court, a copy of the complaint accompanied by a summons is generally served upon all persons named as a party to the action. After service of a summons and complaint, the defendant or defendants are required to file an answer to the complaint within 21 days. See Rule 12, F.R.Civ.P.
3. The purpose of the complaint and answer thereto, which together with all other documents filed in the case are described as pleadings, is to define the issues and apprise the parties of what they must be prepared to argue at the trial.

5.17.4.3.1 (08-01-2010)
Appeal

1. Decisions of a state or district court are generally subject to review by another court. That is, the losing party can usually appeal the lower court’s decision as a matter of right to a higher authority, generally referred to as an appellate court. The method and procedure for effecting an appeal are provided by statute.
2. Issues appealable from a federal district court are usually appealed to the Court of Appeals for the Circuit in which the district court is located. Appeals to the United States Supreme Court may be taken from a decision of a Court of Appeals or the highest state court. The usual time limitation in which an appeal may be taken from a decision of the federal district court in a case in which the United States is a party is 60 days.

5.17.4.4 (08-01-2010)
Periods of Limitation upon Assessment and Collection of Tax under the Internal Revenue Code

1. The statute of limitations for collection is found in IRC § 6502. However, since the statute of limitations for collection generally starts to run on the date of assessment, it is also important to be familiar with the statutory period within which such assessment must be made to be valid. See Exhibit 5.17.4–1 for a summary of some of the more common periods of limitation upon assessment, or commencement of a proceeding in court without assessment, and collection of tax as provided for by the Internal Revenue Code. The failure to timely assess or to commence a suit for the collection of taxes assessed within the period of limitations can defeat a judicial action.
2. The burden of proving that the assessment or collection suit is untimely because the period of limitations has expired generally rests on the taxpayer, unless the United States is acting in reliance on an exception to the normal statute of limitations. See IRC §§ 6502 and 6503 for lists of events which suspend the normal limitation periods.

   Note:

   There are other IRC sections whose provisions may result in extensions of the CSED, including, but not limited to, IRC §§ 6015(e)(2), 6330(e)(1), 6331(i)(5), 6331(k)(3)(B), 6672(c)(4), 7508 and 7508A.
3. If an exception is relied upon for assessing the tax or commencement of the collection suit after the normal period for such action has expired, the burden is upon the Government to show that the exception applies. Failure to carry this burden will generally result in a dismissal of the proceedings.

5.17.4.5 (08-01-2010)
Administrative Procedures for Extending Period of Limitations for Collection by Waiver

1. Prior to the enactment of the Internal Revenue Service Restructuring and Reform Act of 1998 ("RRA 98"), the collection period could commonly be extended by the execution of a written waiver between the taxpayer and the Secretary of the Treasury or his delegate. This authority was severely curtailed by RRA 98.
2. For waiver agreements entered into on or before December 31, 1999, the expiration of the collection period is the latter of:
   A. the 10-year period;
   B. December 31, 2002; or
   C. in the case of an extension in connection with an installment agreement, the 90th day after the end of the period of such extension.
3. For agreements to extend the period of limitations made in conjunction with offers in compromise, the above rules also apply. Thus, in the case of a waiver made in conjunction with an offer entered into on or before December 31, 1999, the expiration of the collection period is the later of the 10-year period or December 31, 2002. No waiver may be made in conjunction with offers entered into after December 31, 1999. In situations involving cumulative offers, or other statute problems involving offers, advice of Area Counsel may be sought.
4. After December 31, 1999, waiver of the statute of limitations for collection may be secured only in the following two situations:
   A. For requests to extend the period of limitations made **after** December 31, 1999, if there is an installment agreement between the taxpayer and the Secretary, a court proceeding must be brought or a levy made prior to the date which is 90 days after the expiration of any period for collection agreed upon in writing by the Secretary and the taxpayer at the time the installment agreement was entered into.
   B. Where release of levy has been made under IRC § 6343 after the 10-year period, a levy must be made or court proceeding begun prior to the expiration of any period for collection agreed upon in writing by the Secretary and the taxpayer before such release.
5. For any waiver, the extension period commences to run on the date the acceptance of the waiver is signed by the Area Director or authorized delegate, not the date of receipt of the waiver.

5.17.4.6 (12-03-2010)
Collection of Judgments

1. The primary responsibility for the collection of judgments rendered in favor of the United States rests with the Department of Justice (DOJ). As a general rule, the DOJ Tax Division Financial Litigation Unit (FLU) will collect judgments for money due, other than payments to be made as part of a bankruptcy case or plan. United States Attorney Offices also have FLUs. The FLU may request advice and assistance from the IRS.
2. After the judgment has been entered, or a settlement is reached, the case is transferred to the Tax Division FLU, which is responsible for attempting to collect the judgment.

When collection efforts are exhausted, the FLU transfers the case back to the DOJ trial section for closing and notification to the IRS. At this point, collection jurisdiction is generally returned to the IRS. However, jurisdiction to compromise taxes that are reduced to judgment is retained by DOJ.

3. If property is located which can be seized in satisfaction of the judgment, this information should be made immediately available to the appropriate DOJ employee. Levy provisions of the Internal Revenue Code are also available to enforce collection of accounts reduced to judgment in litigation begun within the 10-year collection period. See IRM 25.3.5, *Judgment Follow-up*, for procedures relating to the collection of judgments.
4. Under the provisions of IRC § 7406,"[a]ll judgments and moneys recovered or received for taxes, costs, forfeitures, and penalties shall be paid to the Secretary as collections of internal revenue taxes."

5.17.4.6.1 (08-01-2010)
Settlement of Judgments

1. In all cases where the United States has obtained a judgment for tax liabilities, compromise authority thereafter rests with the Department of Justice (DOJ). The IRS cannot compromise under IRC § 7122 taxes that have been reduced to judgment (except Tax Court judgments). See IRM 34.6.1.2.10, Chief Counsel Directives Manual, Settlement Procedures.
2. Although DOJ may have referred a judgment back to the IRS for collection, it continues to retain sole jurisdiction to compromise the judgment.

5.17.4.6.2 (12-03-2010)
Effect of Judgment on Collection Statute of Limitations

1. Under IRC § 6502(a), if a court action is brought against the taxpayer prior to the Collection Statute Expiration Date (CSED), the collection period is extended until the liability for the tax (or the judgment against the taxpayer) is satisfied or becomes unenforceable. Therefore, when a tax assessment is reduced to judgment, thereby extending the collection period, the IRS has two different avenues for collection:
   A. the tax may be collected by levy by the IRS under the Internal Revenue Code, or
   B. the judgment may be enforced by the DOJ Tax Division or U.S. Attorney Office under the Federal Debt Collection Procedures Act (FDCPA). See 28 USC §§ 3001 through 3308.
2. The FDCPA provides alternative ways in which civil judgments entered in favor of the United States may be collected. While the FDCPA applies to judgments entered in civil tax cases, the collection remedies contained in the Internal Revenue Code are still available for assessments that are reduced to judgment.
3. Under the FDCPA, when a judgment is obtained in a suit to reduce assessments to judgment, the Government may file a certified copy of the abstract of judgment in order to create a *judgment lien* against the taxpayer's real property. The certified copy of the abstract of judgment must be filed in the same manner as a Notice of Federal Tax Lien under IRC § 6323(f).
4. The judgment lien created by the filing of the abstract of judgment attaches only to real property. A judgment lien against personal property can be obtained only by seizing the property under judgment enforcement procedures.
5. The judgment lien is effective, unless satisfied, for 20 years. Upon court approval, the judgment lien may be renewed for one additional period of 20 years by filing a notice of renewal. See 28 USC § 3201.

   Note:

   While a suit to reduce assessments to judgment has the effect of extending the collection statute of limitations under IRC § 6502(a), the collection statute expiration date (CSED) is not tied to the duration of the judgment lien. The federal tax lien created under IRC § 6321 does NOT merge into the judgment lien, but continues to exist independently.
6. If the Government does not file the abstract of judgment with a recording office, it may nonetheless enforce the judgment against the taxpayer's property, including real property, by writ of execution. The FDCPA does not provide a time limit within which the Government must enforce the judgment in this manner.
7. Because the federal tax lien does not merge with the judgment lien, the time periods applicable to judgment liens do not apply to the federal tax lien. If a suit is timely filed to reduce tax assessments to judgment, the IRS may pursue administrative collection indefinitely against the taxpayer's real or personal property under IRC § 6502(a).

   Note:

   While a timely suit to reduce assessments to judgment will extend the CSED indefinitely, Notices of Federal Tax Lien must still be timely refiled during the refiling period in order for the IRS to maintain its priority. See IRM 5.12.2.20, *Refiling the NFTL*.
8. Although the collection statute of limitations is extended indefinitely when a tax assessment is reduced to judgment, the IRS has determined that assessments reduced to judgment for which there is no collection potential after 20 years from the date of the judgment will not be maintained on IDRS. However, if collection sources are identified after this 20-year period, the account may be reinstated and collection actions may be resumed. See IRM 25.3.5.6 for procedures for establishing controls for cases in which tax assessments have been reduced to judgment.

5.17.4.6.3 (12-03-2010)
Assessment of Court Sanctions, Penalties and Costs

1. Under IRC § 6673(b)(1), a court may require the taxpayer to pay a penalty not in excess of $10,000 when the taxpayer's position in an IRC § 7433 damages case is frivolous or groundless.
2. Under IRC § 6673(b)(2) & (3), any monetary sanctions, penalties or costs awarded to the government in a civil tax proceeding brought by or against the government in any court (other than the Tax Court), or awarded in connection with an appeal from the Tax Court or other court, may be assessed and, upon notice and demand, collected in the same manner as a tax.
3. See IRM 25.3.5.8 for procedures for requesting assessments under IRC § 6673(b).

5.17.4.7 (08-01-2010)
Suit to Reduce Assessments to Judgment

1. As a general rule the purpose of instituting a suit to reduce assessments to judgment is to prevent the statute of limitations for collection from running where collection cannot be accomplished by administrative methods within the normal statutory period.
2. A suit in aid of collection of taxes will not usually be authorized unless all administrative remedies available have been exhausted or their use would prove ineffective.

5.17.4.7.1 (08-01-2010)
Statutory Authority

1. The statutory authority for bringing a suit to reduce assessments to judgment is found in IRC §§ 7401 and 7402(a). These sections are set forth in IRM 5.17.4.2.2(1) and IRM 5.17.4.2.4(2).

5.17.4.7.2 (08-01-2010)
Amount and Collectibility of Tax Claim

1. Guidelines for determining whether it is feasible to recommend a suit to reduce assessments to judgment are found in IRM 25.3.2.

5.17.4.7.3 (08-01-2010)
Effect of Judgment on Tax Lien and Levy

1. IRC § 6322 (relating to period of lien) provides that where a tax assessment is reduced to judgment, the lien continues until the underlying tax liability is satisfied or becomes unenforceable by reason of lapse of time.
2. With respect to levy proceedings, IRC § 6502(a) (relating to length of period of collection) makes it clear that the Government may continue to levy beyond the normal collection period when a judgment is timely sought until the tax liability or judgment is satisfied or becomes unenforceable.
3. Moreover, the Government's right to foreclosure under the tax lien (as contrasted with the more cumbersome method of foreclosing under the judgment) is still available after the assessment is reduced to judgment.

5.17.4.7.4 (03-30-2015)
Affordable Care Act's (ACA) Shared Responsibility Assessments

1. **Shared Responsibility Payment (SRP):** The IRC § 6321 statutory lien arises normally on the IMF SRP (MFT 35) assessments. However, an IRC § 6323**Notice of Federal Tax Lien cannot be filed** on these assessments. (See IRC § 5000A(g)(2)(B)). Also, IRS policy is that IRS will not take judicial action to reduce the liability to judgment.

   Note:

   MFT 35, tax class 6 is still used on NFM for partnership returns Forms 1065.

2. **Shared Responsibility for Employer**: The IRC § 6321 statutory lien arises normally on these BMF MFT 43 assessments and an IRC § 6323**Notice of Federal Tax Lien may be filed** and included in a recommendation to reduce assessments to judgment.(See IRC § 4980H(d)(1)).

5.17.4.8 (08-01-2010)
Foreclosure of Federal Tax Lien

1. The Government uses a suit to foreclose a tax lien where there is a specific, presently available source of collection. It uses a suit to reduce assessments to judgment to extend the collection period where there is no source of collection currently available. In most other respects the commencement and prosecution of the suits are very similar.
2. In a foreclosure action, the Department of Justice often requests a judgment against the taxpayer. Doing so is appropriate where the property subject to the federal tax lien is not sufficient to satisfy the entire tax liability. In addition, combining a lien foreclosure action with a suit to reduce assessments to judgment avoids potentially duplicative suits.

5.17.4.8.1 (08-01-2010)
Statutory Authority

1. Under IRC § 7403, where there has been a refusal or neglect to pay any tax, the Attorney General, at the request of the Secretary of the Treasury, is authorized to institute a civil action in federal district court to enforce the lien or to subject any property in which the taxpayer has an interest to the payment of the tax liability. IRC § 7403(a). The Secretary of the Treasury has delegated to the Chief Counsel authority to request instituting an action under IRC § 7403.
2. All persons having liens on or claiming any interest in the property involved in the action must be made parties to the action. IRC § 7403(b).
3. In a lien foreclosure action, the court determines the merits of all claims to and liens on the property, and, where the interest of the United States is established, may order the sale of the property. The property is sold free and clear of all liens and encumbrances. The proceeds of the sale are then distributed in accordance with the court's determination of the parties' interests in the property. IRC § 7403(c).

   Note:

   In United States v. Rodgers, 461 U.S. 677 (1983), the Supreme Court held that IRC § 7403 contemplates the sale of the entire property, not just the taxpayer's interest in the property. Nevertheless, the Court found where a nondelinquent third party has an interest in the property (such as homestead property), courts have limited equitable discretion to refuse to order the sale of the entire property. Where the entire property is sold, the nondelinquent third party is entitled to be fully compensated for the value of his or her interest in the property from the proceeds of the sale.

4. If the United States holds the first lien on the property, it may bid at the sale. The amount of the United States' bid cannot exceed the amount of the federal tax lien plus the expenses of sale. IRC § 7403(c).

   Note:

   Whether the Government exercises its right to bid is a matter within the discretion of the appropriate Area Director. It may be appropriate for the Government to bid on the property to prevent its sale at distress prices. This protects the interests of the Government as well as those of the taxpayer.

5. IRC § 7403 also provides that the court may at the request of the Government appoint a receiver to enforce the lien. The court may also appoint a receiver with all of the powers of receivers in equity where the Government has certified that such appointment is in the public interest. IRC § 7403(d). For detailed discussion of receivership, see IRM 5.17.4.10.

5.17.4.8.2 (11-06-2007)
Issues to Consider When Recommending an Action to Foreclose a Tax Lien

1. There are several important factors to consider when determining whether to recommend to Area Counsel that a case be referred to the Department of Justice to institute an action to foreclose a federal tax lien.

5.17.4.8.2.1 (08-01-2010)
Administrative Collection Devices Are Not Feasible or Adequate

1. As a general rule the administrative collection remedies available to the Government are adequate. However, there are situations in which such remedies have been exhausted or where administrative collection would not be feasible because, for example, a distraint sale would result in a lower price paid for the property. In such cases, consider recommending to Area Counsel that the matter be referred to the Department of Justice for court action. Below are several examples of situations in which lien foreclosure may be appropriate:
   - There are encumbrances on the property in addition to the federal tax lien which make it difficult to determine the relative interests in the property, thereby, in all likelihood, driving down the price purchasers would be willing to pay at a distraint sale.
   - There is a cloud on title, or title is contested by a third party or parties.
   - There are unpaid federal tax liens against only one of several co-owners of real property in an area where the sale of undivided partial interests is unfeasible.

- A business is to be sold as a going concern (e.g., suit may be appropriate when also seeking the appointment of a receiver to operate the business pending the sale to prevent waste or fraud by the taxpayer, see IRM 5.17.4.10, below).
- The Government wishes to reach the cash surrender value of a taxpayer's insurance policy.

5.17.4.8.2.2 (08-01-2010)
Redemption Rights

1. Unlike the sale of real property at a distraint sale, the taxpayer has no right to redeem the property after court ordered foreclosure of the federal tax lien. This makes the property generally more desirable to purchasers and would normally result in a higher selling price than at a distraint sale.

5.17.4.8.2.3 (08-01-2010)
Statute of Limitations

1. See IRM 5.17.4.4 and Exhibit 5.17.4–1 for a general discussion of the statute of limitations on collection actions.
2. Where the Government has reduced assessments to judgment, it may bring a lien foreclosure action after the statutory period provided in IRC § 6502(a) expires.

   Note:

   While obtaining a judgment extends the life of the lien for the purposes of bringing a lien foreclosure action, in order to maintain the priority of the lien in relation to other creditors, the Government must refile the Notice of Federal Tax Lien as provided in IRC § 6323(g).
3. A lien foreclosure action initiated before expiration of the statute of limitations on collection is sufficient to enforce the interest of the United States against the named property even if reduction of the assessments to judgment is not sought concurrently. The refiling of the Notice of Federal Tax Lien under IRC § 6323(g) is needed in this situation as well.

5.17.4.8.2.4 (08-01-2010)
Economic Feasibility of Lien Foreclosure

1. The tax liability and the amount expected to be recovered should be substantial enough to warrant bringing a foreclosure action. Guidelines for determining whether it is feasible to recommend a suit are found in IRM 25.3.2.3.

5.17.4.8.2.5 (03-30-2015)
Lien Foreclosure on a Principal Residence

1. This section discusses the additional elements needed when the residence is defined as the **taxpayer's principal residence**. However, lien foreclosure, on the **personal residence** of any person (defined in IRM 5.10.2-1 Real Property, Row 2), or on the taxpayer's **principal residence** (defined in IRM 5.10.2-1 Real Property, Row 1), requires the written approval of the Area Director.
2. **Taxpayer's Principal Residence** suit recommendations to foreclose the tax lien, while not explicitly stated, carry the same considerations as IRM 5.10.2.19, *Judicial Approval for Principal Residence Seizures*. The suit to foreclose is the secondary alternative used only when the seizure remedy is not the optimal solution. Additionally, a suit to foreclose should only be pursued when there are no reasonable administrative remedies and hardship issues, as described in (3 c) below, to consider.
3. **Taxpayer's Principal Residence** suit to foreclose case action requirements are completed prior to submitting the suit recommendation to Advisory and with the results of the actions included in the suit recommendation narrative. They include:
   A. Attempt to personally contact the taxpayer and inform them that a suit to foreclose the tax lien on the principal residence is the next planned action (follow IRM 5.10.1.7.2, *Personal Contact to Advise the Taxpayer of Proposed Seizure Action*, and IRM 5.1.10.7.2, *Right to Representation*);
   B. Attempt to identify the occupants of the principal residence (see IRM 5.10.2.19(7));
   C. Attempt to discuss administrative remedies with the taxpayer (see discussion in IRM 5.10.1.3.2 regarding alternative methods of collection and risk analysis). This discussion should include the taxpayer's potential to submit an Offer in Compromise (including an Effective Tax Administrative offer or, an offer with consideration of special circumstances) as an administrative remedy, when appropriate (follow IRM 5.8.11);
   D. Advise the taxpayer about the Taxpayer Advocate Service (TAS), provide Form 911, *Request for Taxpayer Advocate Assistance (And Application for Taxpayer Assistance Order)*; and explain its provisions; if the taxpayer indicates that the planned foreclosure of the principal residence would create a hardship, the RO will assist the taxpayer with the preparation of Form 911 and should forward the form to the local Taxpayer Advocate Service office if the revenue officer cannot or will not provide the requested relief (see IRM 13.1.7, *Taxpayer Advocate Service Case Criteria,* for other situations that qualify for Taxpayer Advocate referral and the appropriate procedures to follow);
   E. Include a summary statement in the case history (see IRM 5.10.2.18(5)).
4. **Taxpayer's Principal Residence:** suit narrative body should contain, along with the information on the taxpayer, information on the occupants of the principal residence including children. Provide the name(s), relationship(s) to the taxpayer, brief history (age, health, etc.), and current mailing address of the occupant(s) if it differs from the address of the property being foreclosed and a summary of the administrative remedies considered. If the information is unavailable explain the circumstances why the information was not able to be obtained. (See the section IRM 5.17.12.20.2, *Format of the Narrative Report* and in particular IRM 5.17.12.20.2.2.4, *Additional Items for Lien Foreclosure of Taxpayer's Principal Residence*).
5. **ENTITY REPORT:** A manager, management assistant, or IQA may input "Principal Residence" as a program name in ICS as an identifier in creating a sort query of cases. Instructions can be found in the *ICS User Guide - Chapter 9 Program Names*.

5.17.4.8.3 (08-01-2010)
Preparing Recommendation to Institute an Action to Foreclose Tax Liens

1. A suit to foreclose a tax lien is initiated and processed in much the same manner as a suit to reduce assessments to judgment.
2. In preparing a suit letter to the Department of Justice, Area Counsel relies on information provided in the recommendation. The Department of Justice, in turn, relies on the suit letter from Area Counsel in drafting its complaint should it decide to bring suit. Therefore, it is imperative that complete, accurate information be provided in the recommendation.

   Note:

   If the recommendation is to foreclose the lien on a principal residence, the written approval of the Area Director must be provided along with the recommendation.

Part 5. Collecting Process

Chapter 17. Legal Reference Guide for Revenue Officers

Section 5. Suits Against the United States

5.17.5 Suits Against the United States

5.17.5.1 (08-01-2010)
Overview

1. This section reviews the principal types of judicial actions against the United States which revenue officers may encounter.
2. For information regarding some of the general characteristics and procedures followed in instituting and carrying out a lawsuit for effecting or assisting in the collection of taxes, and some of the most common types of lawsuits commenced by the United States, see IRM 5.17.4, *Suits by the United States*.
3. For procedural guidelines on responding to suits and claims for damages brought against the United States, see IRM 25.3.3, *Suits against the United States and claims for damages under IRC § 7433*.

5.17.5.2 (12-14-2007)
Doctrine of Sovereign Immunity

1. The traditional rule is that the government or sovereign cannot be sued without its consent. This doctrine prevented citizens from bringing actions against the government to redress wrongs allegedly committed against them by the government.
2. The government retains sovereign immunity in order to protect the Treasury and its discretionary governmental functions.
3. Waiver of sovereign immunity and consent to be sued can only be granted by an act of Congress. In giving its consent, Congress may impose such conditions and restrictions as it deems proper. Schillinger v. United States, 155 U.S. 163 (1894).
4. The discussion that follows will review principal statutory exceptions to the doctrine of sovereign immunity and the principal types of judicial actions involving the United States which revenue officers may encounter.

5.17.5.3 (08-01-2010)
Government Consent to be Sued in Actions Affecting Property on which United States Claims a Lien - 28 USC § 2410

1. With respect to real or personal property on which the United States claims a lien, the United States has consented to be sued in federal or state courts in suits to: quiet title; foreclose a mortgage or other lien; partition; or condemn. Also sovereign immunity has been waived as to interpleader suits or actions in the nature of interpleader with respect to real or personal property on which the United States has or claims a lien. 28 USC § 2410(a).
2. The complaint must set forth with particularity the lien or interest of the United States. 28 USC § 2410(b). In actions to foreclose a mortgage or other lien against property in which the United States has an interest, a judicial sale must be sought. 28 USC § 2410(c).
3. When the United States files a claim in a state court proceeding, counterclaims will not lie against the United States in that proceeding. See United States v. Shaw, 309 U.S. 495 (1940).
4. As discussed in IRM 5.17.4, the United States may intervene in any civil action or suit to assert a federal tax lien on property which is the subject of such action or suit.

5.17.5.4 (08-01-2010)
Jurisdiction for Civil Actions Against United States

1. Jurisdiction is the authority of a court over the subject matter of the action, the parties to the action, and the kind and limits of the judgment rendered. Numerous statutes govern jurisdiction in civil, federal tax cases. Jurisdiction must be established under one of the following statutes in order for the court to entertain suit. In addition, IRC § 7421 deprives the court of jurisdiction regardless of these statutes.
2. IRC § 7421(a) prohibits any suit to restrain the assessment or collection of any tax except as provided in subsection (a). The Supreme Court has determined that IRC § 7421(a) applies unless the United States is incapable of winning under the most favorable view of the facts, the taxpayer does not have an adequate remedy at law, and Congress has not provided the aggrieved party with an alternative legal venue by which to contest the legality of a particular tax. Enochs v. Williams, 370 U.S. 1 (1962); South Carolina v. Regan, 465 U.S. 367 (1984).

3. 28 USC § 1331 - District courts have jurisdiction over federal question cases.
4. 28 USC § 1340 - District courts have original jurisdiction of any civil action arising under the internal revenue laws.
5. 28 USC § 1345 - District courts have original jurisdiction of all civil actions commenced by the United States, or by an authorized agency or officer.
6. 28 USC § 1346 - District courts, concurrent with the U.S. Court of Federal Claims, have original jurisdiction over the following actions commenced against the United States:
   A. tax refund suits;
   B. any other civil action against the United States not exceeding $10,000, founded on federal law or regulations, or upon any express, or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort;
   C. an action involving the right of setoff and counterclaim against the plaintiff; and
   D. civil actions under:
   - IRC § 7426 (wrongful levies and erroneous liens, etc.);
   - IRC § 7429 (review of jeopardy levy or assessment procedures) [The United States Tax Court also has jurisdiction over these actions];
   - 28 USC § 2409(a) (action to quiet title where U.S. claims other than lien interest); and
   - tort suits for money damages.
7. 28 USC § 1361 - District courts have original jurisdiction over actions to compel an officer or an employee of the United States or any agency to perform a duty owed the plaintiff.
8. 28 USC § 1491 - Defines the jurisdiction of the U.S. Court of Federal Claims. In the U.S. Court of Federal Claims, there is no dollar limitation on any action.
9. 28 USC § 1503 - The U.S. Court of Federal Claims has jurisdiction over setoffs or counterclaims against the plaintiff.
10. 28 USC § 2463 - All property taken or detained under any revenue law shall not be repleviable [recoverable], but is deemed to be in the custody of the law and subject to the orders and decrees of the United States Courts having jurisdiction thereof.
11. 28 USC § 2409a - Applies where the United States claims an interest in property that is not a security interest. The provision is a consent to suit in a quiet title action.
12. 28 USC § 2410 - Applies to foreclosure, quiet title, partition, condemnation, and interpleader actions where the United States claims a lien interest. If the plaintiff complies with the specific requirements of section 2410, sovereign immunity of the United States is waived and jurisdiction over the United States is obtained. However, subject matter jurisdiction of the state or federal court must exist independently. See Wells v. Long, 162 F.2d 842 (9th Cir. 1947).
13. IRC § 7402 - Internal Revenue Code section 7402 is a general jurisdictional statute relating to the enforcement of internal revenue laws.

5.17.5.5 (08-01-2010)
Procedures Governing Civil Actions Against United States

1. The Federal Rules of Civil Procedure establish procedures for civil actions against the United States in federal district courts. Fed. R. Civ. P. 1. The action is commenced by filing a complaint with the court. Then, the clerk of court will issue a summons to the plaintiff or the plaintiff's attorney, who is responsible for prompt service of the summons and a copy of the complaint upon the United States. Fed. R. Civ. P. 3, 4.
   A. Service must be made upon the United States by delivering a copy of the summons and the complaint to the U.S. Attorney for the district in which the action is brought, or to an Assistant United States Attorney or designated employee, and by sending a copy of the summons and the complaint by registered or certified mail to the Attorney General of the United States in Washington, D.C. Fed. R. Civ. P. 4(i)(1).
   B. Service must be made upon an officer or agency of the United States by serving the United States, as above, and by sending a copy of the summons and complaint to such officer or agency by registered or certified mail. Fed. R. Civ. P. 4(i)(2).
2. A civil action against the United States in the United States Court of Federal Claims is commenced by filing a complaint with the clerk of that court. Service of the summons and complaint on the United States must be made in accordance with Rule 4(i). See paragraph (1)(a), above.
3. 28 USC § 2410(b) establishes procedures for service of process on the United States in suits against the United States in state courts. These procedures are identical to those provided by the Federal Rules of Civil Procedure, cited above. Where the United States is not a party to a suit, and intervenes in such suit pursuant to IRC § 7424, 28 USC § 2410(b) is inapplicable.

5.17.5.6 (12-14-2007)
Removal to Federal Court

1. A civil action or criminal prosecution commenced in a state court against the United States or any agency thereof or any officer of the United States acting within the scope of his/her authority (e.g., the collection of the revenue) may be removed to the United States district court. 28 USC § 1442(a)(1).
2. A state law tort action against a federal officer or employee acting within the scope of his or her employment may be removed to the United States district court upon certification of the U.S. Attorney for the district in which the state action was brought that the officer or employee acted within the scope of his or her employment. 28 USC § 2679(d); see IRM 5.17.5.12, below, for a discussion of tort suits.
3. The United States has consented to be named a party in certain state court actions affecting property in which it has a lien or interest. 28 USC § 2410. But this waiver of immunity is granted on condition that the United States has an unqualified option to remove the action to a federal district court. 28 USC § 1444.
4. Where the United States intervenes in a state court action to assert a federal tax lien on property which is the subject of such action, the removal provision of 28 USC § 1444 is also available. IRC § 7424.

5.17.5.7 (08-01-2010)
Nature of Injunctive Relief

1. An injunction is a court order prohibiting the defendant from doing an act or compelling the defendant to perform an act. See Fed. R. Civ. P. 65. An injunction suit against the Service typically seeks to prevent collection activity.
2. An injunction under Fed.R.Civ.P. 65 is an equitable remedy which may be granted only where the plaintiff establishes that he or she is entitled to equitable relief, i.e. that:
   A. what the defendant is doing or is about to do, is causing, or will cause, irreparable injury to the plaintiff;
   B. money damages will not compensate for the invasion of plaintiff's rights, i.e., there is no adequate remedy in a court of law; and
   C. the plaintiff has an indisputable right which has been clearly invaded by the defendant.

5.17.5.8 (12-14-2007)
Prohibition of Suits to Restrain Assessment or Collection of Taxes

1. Outside of a few limited and narrow exceptions, a suit brought to restrain the assessment or collection of taxes is strictly prohibited by law.

5.17.5.8.1 (08-01-2010)
Anti-Injunction Act - IRC § 7421

1. The Anti-Injunction Act contains a broad prohibition on suits to restrain the assessment or collection of taxes. IRC § 7421(a) provides as a general rule that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom the tax was assessed." This rule also applies to the liability of transferees or fiduciaries. IRC § 7421(b).
2. IRC § 7421 is based on the general rule of equity that where a person has an adequate remedy at law, he or she may not seek equitable relief by way of injunction against the assessment or collection of taxes. The remedy is to pay the tax assessed (or a divisible portion thereof for the Trust Fund Recovery Penalty) and file a refund suit in federal district court or the United States Court of Federal Claims, or, in the case of income, estate or gift tax, to litigate the merits of the tax in the United States Tax Court.
3. See IRM 5.17.5.9 for a discussion of statutory exceptions to the prohibition against suits to restrain assessment or collection of tax.

5.17.5.8.2 (12-14-2007)
Declaratory Judgments

1. A declaratory judgment is a request for a court to declare the rights of parties, without ordering anything to be done.
2. Under the Declaratory Judgment Act, 28 USC § 2201, federal tax questions are exempt from the jurisdiction of the district courts to render declaratory judgments. In Eastern Kentucky Welfare Rights Organization v. Simon, 506 F.2d 1278 (D.C. Cir. 1974), rev'd on other grounds, 426 U.S. 26 (1976), the court held that a party whose tax liability was not directly in dispute could maintain a declaratory judgment action where there was no adequate remedy at law and where a judgment would not have the effect of restraining assessment or collection of taxes. In In re Frey, 98-2 USTC ¶ 50,638 (M.D. Fla. 1998), the court dismissed plaintiff's wife's request for a judgment under section 2201, declaring that the wife was not a nominee of her husband. The court cited the exemption of tax disputes from section 2201. See also Rodriguez v. United States, 629 F. Supp. 333 (N.D. Ill. 1986).

5.17.5.8.3 (12-14-2007)
Mandamus

1. District courts have original jurisdiction to compel an officer or employee of the United States or any of its agencies to perform a duty owed the plaintiff. However, relief in the nature of mandamus is not available:
   - to compel the performance of a discretionary (as opposed to a ministerial) act or the manner in which a discretionary act is to be performed. Stern v. South Chester Tube Co., 390 U.S. 606 (1968); McQueary v. Laird, 449 F.2d 608 (10th Cir. 1971); or
   - when the plaintiff has an adequate remedy at law. United States, ex rel. Girard Trust Co. v. Helvering, 301 U.S. 540 (1937).
2. In In re 1900 M Restaurant Assoc., Inc., 319 B.R. 302 (D.D.C. 2005), the debtor sought a court order compelling the Service to consider an administrative offer in compromise. The court determined that the Service's decision not to process the debtor's offer-in-compromise, pursuant to Service policy of returning as nonprocessable any offer-in-compromise submitted by bankrupt taxpayer, and of requiring tax repayment issues to be resolved as part of plan confirmation process, was one committed to the discretion of the Secretary of the Treasury, and was not reviewable on prayer for relief in the nature of mandamus.

5.17.5.9 (12-14-2007)
Statutory Exceptions

1. Exceptions to the prohibition of suits to restrain assessment or collection of tax.
   - A. IRC § 6015(e) prescribes restrictions applicable to the collection of an assessment where the taxpayer has filed a petition to the Tax Court for relief from joint and several liability on a joint return.
   - B. IRC § 6213(a) prescribes restrictions on the assessment of a deficiency. Assessment and collection may be enjoined if attempted prior to the issuance of a notice of deficiency or prior to 90 days after the issuance of a notice of deficiency, including any time that a case is pending in the Tax Court or on appeal. See Philadelphia & Reading Co. v. Beck, 676 F.2d 1159 (7th Cir. 1982). In addition, the Secretary shall have no right to determine any additional deficiency of certain taxes for the same taxable year if the taxpayer filed a petition with the Tax Court within the time prescribed in IRC § 6213(a).
   - C. IRC § 6225(b) provides that any action which violates the restriction on assessment and collection of partnership level items prior to the completion of the partnership level proceedings may be enjoined in the proper court, including the Tax Court.
   - D. IRC § 6246(b) provides that any action which violates the restriction on making adjustments to partnership items prior to the close of the 90th day after the day on which a notice of a partnership adjustment was mailed to the partnership may be enjoined in the proper court, including the Tax Court.
   - E. IRC § 6330(e)(1) provides that the Tax Court has jurisdiction to enjoin a levy or a proceeding if a taxpayer has filed an appeal of a collection due process notice of determination with regard to the unpaid tax or the levy to which the determination relates.
   - F. IRC § 6331(i) provides that generally there shall be no levy during the pendency of proceedings for refund of divisible tax.
   - G. IRC § 6672(c) provides that injunctions can be issued against collection activity where the taxpayer pays a portion of the tax, files a claim for refund, and furnishes a suitable bond.
   - H. IRC § 6694(c) provides that injunctions can be issued against collection activity where an income tax return preparer pays 15% of the IRC § 6694(a) penalty and files a claim for refund within 30 days of notice and demand of such penalty.
   - I. IRC § 7426(a) and (b)(1) provide that a wrongful levy or sale may be enjoined.
   - J. IRC § 7429(b) provides that, where appropriate, injunctions may be issued against jeopardy and termination assessments.
   - K. IRC § 7436 provides restrictions on assessment and collection during proceedings for determination of employment status.

   Note:

   Under the statutory exceptions, generally the taxpayer must still show entitlement to equitable relief, i.e., irreparable harm and lack of an adequate remedy at law, in addition to a violation of the Internal Revenue Code, in order to obtain an injunction. However, under the IRC § 6213 exception discussed above, the Service no longer insists that taxpayers show irreparable injury as long as they establish that the Service violated the statute. See Robinson v. United States , 920 F.2d 1157 (3rd Cir. 1990); but see Cool Fuel, Inc. v. Connett, 685 F.2d 309 (9th Cir. 1982).
2. Exceptions to the prohibition of suits for declaratory judgments:
   - A. IRC § 7428 provides that the district court of the United States for the District of Columbia, the United States Court of Federal Claims, and the Tax Court may render declaratory judgments concerning charitable organizations seeking an exemption under IRC § 501(c)(3) and/or seeking to avoid private foundation status.

B. IRC §§ 7476 and 7478 authorize the Tax Court to render declaratory judgments on the qualification of retirement plans and the status of certain governmental obligations, respectively. Declaratory judgment suits under IRC §§ 7428, 7476, and 7478 may only be brought by persons affected by the Service's decision and not by third parties.

C. IRC § 7479 authorizes the Tax Court to render a declaratory judgment on an actual controversy involving a determination by the IRS or failure to make a determination that an estate may make an IRC § 6166 election or whether the extension of time for payment under an IRC § 6166 payment extension has ceased to apply.

D. Probate Proceedings - when the government has a claim against the estate.
• The IRS may file claims in state court probate and insolvency cases instituted by other parties. Counsel becomes involved if a dispute arises.
• Consider priority of the federal tax lien vis-a-vis competing creditors. See IRM 5.17.13, *Insolvencies and Decedents' Estates*, for further discussion.

5.17.5.10 (12-14-2007) Judicial Exceptions - Enochs and South Carolina Rules

1. In addition to the statutory exceptions contained in IRC § 7421, the courts have added certain exceptions to the Anti-Injunction Act. In Enochs v. Williams Packing and Navigation Co., 370 U.S. 1, rehearing denied, 370 U.S. 965 (1962), the Supreme Court established a two-pronged test for the issuance of an injunction:

   A. the United States must be incapable of prevailing under the most favorable view of the facts, i.e. the illegality of the tax must be absolutely clear on its face; and

   B. special circumstances must exist indicating that the taxpayer does not have an adequate remedy at law, with the result that the taxpayer will suffer irreparable injury; a showing of mere hardship is insufficient.

   > See also Bob Jones University v. Simon , 416 U.S. 725 (1974); Alexander v. "Americans United" Inc., 416 U.S. 752 (1974). Mere allegations that the tax is arbitrary, excessive, capricious, or without a factual foundation question the merits of the tax and must be determined in a suit for refund or in the Tax Court.

2. In South Carolina v. Regan, 465 U.S. 367 (1984), the Supreme Court reaffirmed the strict judicial exception to the Anti-Injunction Act enunciated in Enochs and the principle that, for a taxpayer, a refund action is generally an adequate remedy to challenge a disputed tax liability. However, the Court set forth another exception to the Act: "the Act ... bar[s] a suit only in situations in which Congress ha[s] provided the aggrieved party with an alternative legal avenue by which to contest the legality of a particular tax." Id. at 373.

5.17.5.11 (12-14-2007) Claims Founded on Contract

1. 28 USC §1491 confers jurisdiction on the United States Court of Federal Claims to render judgment against the United States on claims founded, among others, on an express or implied contract with the United States.

2. Similarly, 28 USC § 1346 grants federal district courts concurrent jurisdiction over such actions provided the amount of the claim does not exceed $10,000.00.

3. Suits on claims not based on contract, or based on unauthorized contracts, are not within the consent statutes. If the action in fact is based on tort, the prohibition against suit cannot be avoided by framing the action as one in contract.

5.17.5.12 (12-14-2007) Claims Founded on Tort - Federal Tort Claims Act

1. A tort, broadly speaking, is a civil wrong, other than breach of contract, for which the law provides a remedy in the form of an action for damages.

2. In 1946, Congress passed what is popularly known as the Federal Tort Claims Act (28 USC § 2671, et seq.) and simultaneously amended 28 USC § 1346 giving district courts (not the Court of Federal Claims) jurisdiction over civil actions against the United States "for money damages ... for injury or loss of property, or personal injury or death caused by the negligent or wrongful act or omission of any employee of the Government while acting within the scope of his office or employment, under circumstances where the United States, if a private person, would be liable to the claimant in accordance with the law of the place where the act or omission occurred." 28 USC § 1346(b)(1).

3. The Act provides that any judgment obtained against the United States shall constitute a complete bar to any action by the claimant against the employee by reason of the subject matter. 28 USC § 2676.

4. The Government cannot, by way of indemnity, recover from the employee any amount for which the Government is held liable under the Act. United States v. Gilman, 347 U.S. 507 (1954).

5.17.5.12.1 (12-14-2007) Exception for Tax Related Claims

1. The Federal Tort Claims Act does not apply to "[a]ny claim arising in respect of the assessment or collection of any tax or customs duty, or the detention of any goods or merchandise by any officer of customs or excise or any other law-enforcement officer." 28 USC § 2680(c).

5.17.5.12.2 (08-01-2010) Exclusiveness of Remedy

1. 28 USC § 2679 provides that the remedy against the United States under the Federal Tort Claims Act for injury or loss of property, or personal injury or death arising from the negligent or wrongful act or omission of any employee of the Government while acting within the scope of his or her office or employment is exclusive. Thus, any other action for money damages arising out of or relating to the same subject matter against the employee is precluded with the exception of claims based on constitutional violations discussed in IRM 5.17.5.14, below. This rule does not apply to negligent or wrongful acts during the collection of any tax. 28 USC § 2680(c). The exclusive remedy for wrongful acts by IRS employees during the collection of federal taxes is IRC § 7433, discussed in IRM 5.17.5.16, below.

2. Filing an administrative claim with the appropriate agency is a prerequisite to the institution of a suit against the United States for damages for injury or loss of property or personal injury or death caused by the negligent or wrongful act or omission of any employee of the Government while acting within the scope of his or her office or employment. 28 USC § 2675. Heads of administrative agencies or their delegates may settle any claim for money damages not in excess of $25,000. 28 USC § 2672.

3. The Attorney General is authorized to defend any civil action or proceeding brought in any court against any employee of the Government, or his or her estate, for any such damage or injury. 28 USC § 2679(c). Any Internal Revenue Service employee against whom such an action or proceeding is brought must immediately advise the General Legal Services function in the field, if a field employee, or the General Legal Services Division of the Office of Chief Counsel, if a National Office employee, of the details by telephone or facsimile transmission. In addition, he or she must immediately forward all process and pleadings served upon him or her, or a true copy thereof, to Area Counsel or, in the case of National Office Employees, to the Associate Chief Counsel, General Legal Services, CC:GLS. The employee sued must thereafter render any assistance and give any additional information requested by the United States Attorney.

5.17.5.13 (12-14-2007) Acting Within Scope of Office or Employment

1. Officers of the United States Government are afforded, in most cases, immunity from liability in civil suits arising from actions taken in the performance of official duties. See Barr v. Matteo, 360 U.S. 564 (1959). The doctrine of official immunity extends to the executive branch of Government, including heads of departments as well as lower ranking executive officers or employees, including Assistant United States Attorneys, agents of the Federal Bureau of Investigation, and agents of the Internal Revenue Service. See, e.g., Scherer v. Brennan, 379 F.2d 609 (7th Cir.), cert. denied, 389 U.S. 1021 (1967); O'Campo v. Hardisty, 262 F.2d 621 (9th Cir. 1958).
2. Official immunity is grounded on principles of public policy that persons occupying important positions should speak and act freely and fearlessly in the discharge of their official functions.
3. Official immunity applies only when the officer or employee of the Government is acting within the scope of his or her authority. In order for one to be acting "within the scope of authority," it is not necessary that the acts be prescribed by statute, or even that they be specifically directed or requested by a superior officer. It is sufficient if the acts are done by an officer in relation to matters committed by law to his or her control or supervision, that the acts are connected with general matters committed by law to his or her control or supervision, or that the officer is operating within the outer perimeter of his or her line of authority. See Clifton v. Cox, 549 F.2d 722 (9th Cir. 1977).
4. Officials and employees of the United States are liable in their own right, in criminal and civil actions instituted in federal or state courts, for their actions done outside of the scope of the duties of their office or employment.

5.17.5.14 (08-01-2010)
Violations of Constitutional Rights - Bivens Actions

1. Under the Supreme Court's holding in Bivens v. Six Unknown Agents of Federal Bureau of Narcotics, 403 U.S. 388 (1971), federal officials acting in the performance of their official duties are subject to personal liability for any violations of constitutional rights of which a reasonable official in a similar situation would be aware.
2. Bivens remedies are available only where there is a constitutional violation and the victim has no other remedy. Davis v. Passman, 442 U.S. 228 (1979). Moreover, where Congress has created specific remedies or when a court-created remedy would interfere with the effective function of government, courts are reluctant to create damages remedies for violations of constitutional rights. Schweicker v. Chilicky, 487 U.S. 412 (1988). The Internal Revenue Code, including IRC § 7433, provides an extensive scheme to challenge the assessment and collection of taxes, and this statutory scheme adequately protects a taxpayer's rights to due process. See Stonecipher v. Bray, 653 F.2d 398, 401 (9th Cir. 1981), cert. denied, 454 U.S. 1145 (1982). See IRM 5.17.5.16, below, for a discussion of IRC § 7433.
3. When Bivens suits are filed against Internal Revenue Service or other government employees, the Department of Justice provides representation of employees who were acting within the scope of their employment if it is in the interest of the United States to do so. 28 CFR § 50.15(a). The Service may pay judgments rendered against IRS employees by reason of anything done in the due performance of their duties. IRC § 7423(2).

5.17.5.15 (12-14-2007)
Civil Damages for Failure to Release Lien

1. IRC § 7432 provides that taxpayers may sue the United States for damages if any officer or employee of the Service knowingly or by reason of negligence fails to release a lien under IRC § 6325 on property of the taxpayer.
2. The taxpayer must exhaust administrative remedies before recovering damages under IRC § 7432.
3. The amount of damages recoverable is limited to the actual, direct economic damages sustained by the taxpayer that the taxpayer would not have sustained but for the actions of the Service, plus the costs of the taxpayer's action.
4. The taxpayer has a duty to mitigate damages, and any award will be reduced by the amount of damages that the taxpayer reasonably could have mitigated.
5. An action under IRC § 7432 may be brought without regard to the amount in controversy, but must be brought within two years after the action accrues, i.e., within two years of when the taxpayer has had a reasonable opportunity to discover all the elements of a possible cause of action.

5.17.5.16 (12-14-2007)
Civil Damages for Certain Unauthorized Collection Actions

1. IRC § 7433(a) provides that taxpayers may sue the United States if, in connection with the collection of any federal tax, a Service officer or employee recklessly or intentionally, or by reason of negligence, disregards any provision of the Internal Revenue Code or implementing regulations.
2. The amount of damages that may be awarded is limited to the lesser of
   - A. $1,000,000 if the damages were caused by reckless or intentional disregard (or $100,000 in the case of negligence), or
   - B. the sum of the actual, direct economic damages sustained by the taxpayer as a proximate result of the actions of the Service officer or employee and the costs of the action.
3. Prior to filing a complaint under IRC § 7433, the taxpayer must have exhausted all administrative remedies provided by the IRS. Treas. Reg. § 301.7433-1 provides that a taxpayer's administrative remedies are deemed to be exhausted on the earlier of the date that a decision is rendered by the IRS on an administrative claim for damages filed in accordance with the manner and form set forth in the regulations, or the date six months after the date that an administrative claim is filed in accordance with the manner and form set forth in the regulations.
4. Under IRC § 7433(e), taxpayers may recover up to $1 million in civil damages arising from actions taken by IRS employees or officers that are deemed to be willful violations of Bankruptcy Code § 362 (relating to the bankruptcy automatic stay) or Bankruptcy Code § 524 (relating to the effect of bankruptcy discharges).
5. Actions under IRC § 7433 must be brought within two years after the date the right of action accrues. The right of action accrues when the taxpayer knows or should have known sufficient facts to be apprised that he has a claims.

5.17.5.16.1 (12-14-2007)
IRC § 7433 as Exclusive Remedy; Limitations

1. IRC § 7433(a) states explicitly that, except as provided in IRC § 7432 (see IRM 5.17.5.15, Civil Damages for Failure to Release Lien, above), it is the "exclusive remedy" for damages for alleged improper actions in connection with the collection of any federal tax.
2. Despite the exclusivity provision in IRC § 7433, the United States has been sued for civil damages under IRC § 7431(a) (providing cause of action for unauthorized disclosure of return information) for unauthorized disclosures of return information occurring in the context of collection activities. See Rorex v. Traynor, 771 F.2d 383 (8th Cir. 1985); cf. Flippo v. United States, 670 F. Supp. 638 (W.D.N.C. 1987). The Service's position is that IRC § 7431 was never intended to redress defective collection activities, and that IRC § 7433 provides the exclusive remedy for alleged damages resulting from alleged improper collection activities. See Shwarz v. United States, 234 F.3d 428, 432-433 (9th Cir. 2000).
3. IRC § 7433 applies to wrongful collection activity; it does not apply to activity stemming from the assessment or determination of taxes. See Ivory v. United States, 96-1 USTC ¶ 50,078 (S.D. Ohio 1996); see also Morse v. United States, 96-1 USTC ¶ 50,216 (E.D.N.Y. 1996).

5.17.5.17 (08-01-2010)
IRC § 7426 Suits against United States - General

1. IRC § 7426 permits four types of suits against the United States:
   - A. for wrongful levy;

B. for surplus proceeds resulting from distraint sales;

C. for substituted sale proceeds where property has been sold pursuant to an agreement described in IRC § 6325(b)(3); and

D. for a determination of whether the value of the interest of the United States (if any) is less than the value determined by the IRS, provided that a certificate of discharge has been previously issued pursuant to IRC § 6325(b)(4).

2. 28 USC § 1346(e) confers original jurisdiction in the federal district courts over any civil action against the United States provided for in IRC § 7426. These actions can be brought only in the judicial district where the property levied upon is situated at the time of levy. 28 USC § 1402(c). Where no levy has been made (such as in agreements for the substitution of sale proceeds or for valuation of the United States' lien interest), the action must be brought where the event giving rise to the lawsuit occurred.

3. The only actions under IRC § 7426 that a person against whom tax is assessed can bring are actions for substituted sale proceeds and for a valuation of the United States' interest in property for which a certificate of discharge has been issued. The other actions authorized by IRC § 7426 can be brought only by a person other than a taxpayer.

4. No action may be maintained against any revenue officer or any other officer or employee of the United States (or former officer or employee) or his or her personal representative with respect to any acts for which an action could be maintained under IRC § 7426. IRC § 7426(d). If an IRC § 7426 action is brought against a revenue officer (or one of the aforementioned individuals), then the pleadings may be amended to substitute the United States as a party-defendant for such individual, as of the time such action was commenced, upon proper service of process on the United States. IRC § 7426(e).

5. The remedies provided by IRC § 7426 are the exclusive means of redress for actions which may be brought under this section. Accordingly, an action that may be brought under IRC § 7426 cannot be maintained under 28 USC § 2410(a)(1) (described in IRM 5.17.5.18.1, below). See Winebrenner v. United States, 924 F.2d 851 (9th Cir. 1991), overruled on other grounds by United States v. Williams, 514 U.S. 527 (1995).

5.17.5.17.1 (12-14-2007)
Wrongful Levy

1. A person other than the taxpayer who claims the Service wrongfully levied upon property he or she has an interest in or lien on, to satisfy the tax liability of another, may bring suit against the United States in federal district court. IRC § 7426(a)(1). See Rev. Rul. 2005-49 and Rev. Rul. 2005-50.

2. In EC Term of Years Trust v. United States, 550 U.S. 429 (2007), the Supreme Court in an unanimous opinion held that IRC § 7426(a)(1) provides the exclusive remedy for third-party wrongful levy claims. Third parties with such claims cannot bring refund actions under 28 USC § 1346(a)(1).

3. For the purposes of IRC § 7426, a levy is considered wrongful against a third person if:

A. the levy is made upon property exempt from levy under IRC § 6334;

B. the levy is upon property in which the taxpayer had no interest at the time the lien arose or thereafter;

C. the levy is upon property with respect to which the third party is a purchaser against whom the lien is invalid under IRC § 6323 or IRC § 6324(a)(2) or (b); or

D. the levy or sale pursuant to levy will or does effectively destroy, or otherwise irreparably injure, the third party's interest in the property which is senior to the federal tax lien.

Treas. Reg. § 301.7426-1(b).

4. A levy may irreparably injure or destroy a senior lien even though legal rights to enforce the senior lien interest survive the levy. Such irreparable injury may occur, for example, where the Service seizes money in accounts subject to the senior lien and nothing is left for the senior lienholder to pursue. Another example is where the Service sells seized personal property to numerous purchasers, which the senior lienholder cannot realistically pursue to satisfy its claim. Treas. Reg. § 301.7426-1(b).

5. A person against whom the tax is assessed for which the levy was made cannot bring a wrongful levy suit under IRC § 7426 .

6. A wrongful levy action may be brought without regard to whether the property has been surrendered to or sold by the Government. However, it may not be brought prior to the time the Government has in fact levied upon the property.

7. There is no requirement that administrative claim remedies be exhausted before a wrongful levy suit can be brought unless recovery of damages is sought as well.

5.17.5.17.2 (12-14-2007)
Injunction

1. The granting of injunctive relief is available only in wrongful levy actions brought under IRC § 7426(a)(1), and then only after the property has in fact been levied upon by the United States. Thus, a court may enjoin the Government from proceeding with enforcement of the levy if the court determines that:

A. the levy or a sale of property pursuant to the levy would irreparably injure the rights of a third party in such property; and

B. the rights of such third party in the property are superior to the rights of the United States.

2. A third party is considered to have a superior interest if:

A. the taxpayer had no interest in the property at the time the lien arose or thereafter (such as where the third party is held not to be a nominee of the taxpayer or the taxpayer does not have a current vested right in a retirement plan);

B. the third party purchaser has priority under IRC § 6323 or IRC § 6324(a)(2) or (b) ; or

C. the third party is a senior lienholder (such as a mortgagor).

3. If the court's determination is in favor of the third party, usually the injunction is either made permanent where the Government does not have possession of the property, or is continued until the levy is released and the specific property is returned to the person.

5.17.5.17.3 (12-14-2007)
Recovery of Property

1. In addition to injunctive relief, there are three alternative types of relief which a court may grant to a third party if the court determines the levy is wrongful. IRC § 7426(b)(2). The court may:

A. order the return of specific property levied upon;

B. grant a judgment for the amount of money levied upon; or

C. grant a judgment for an amount not exceeding the greater of the amount received by the Service from the sale (which, in the case of property purchased by the Service, is the greater of the minimum bid or the amount received upon resale) or the fair market value of the property immediately before the levy.

IRC § 7426(b)(2).

2. The court can order the property wrongfully levied upon to be returned only where the property is identifiable and still in the Government's possession. Such property includes money, where identifiable, such as a coin collection. Otherwise, the relief granted is limited to the amount of the money.

3. If a third party recovers a money judgment, then the United States must pay interest, at the overpayment rate established under IRC § 6621, from the date the Government received the money wrongfully levied upon to the date of payment of such judgment. Money wrongfully levied upon is "received" at the time the Government acquired possession of such money. Similarly, where the property has been sold, the United States must pay interest, at the overpayment rate established under IRC § 6621, from the date of the sale of the property wrongfully levied upon to the date of payment of such judgment. IRC § 7426(g).

5.17.5.17.4 (12-14-2007)
Surplus Proceeds

1. If surplus proceeds have been realized from the sale of property by the United States pursuant to a levy, any person (other than the taxpayer) may bring an action against the United States in district court based on his claim that he:

   A. has an interest in or lien upon such property junior to the lien or interest of the United States; and

   B. is legally entitled to all or part of such surplus proceeds.

IRC § 7426(a)(2).

2. "Surplus proceeds" are those in excess of the amount necessary to satisfy the tax liability giving rise to the levy plus the expenses of the levy sale.

3. If the district court determines that the interest or lien of any party (other than the taxpayer) to an action under IRC § 7426 was transferred to the proceeds of a sale of such property, the court may grant a judgment against the United States in an amount equal to all or any part of the amount of the surplus proceeds of such sale. IRC § 7426(b)(3). A third party whose rights are junior to those of the United States in property sold pursuant to levy may recover all or any part of the surplus sale proceeds to which he or she is legally entitled if the third party's interest or lien was transferred to the proceeds of sale.

5.17.5.17.5 (12-14-2007)
Substituted Sale Proceeds - Certificate of Discharge

1. A certificate of discharge may be issued where property subject to a tax lien is sold and, under an agreement with the Service, the proceeds from the sale are held as a fund subject to the liens and claims of the United States in the same manner, and with the same priority, as the liens and claims on the discharged property. IRC § 6325(b)(3).

2. Claimants to the property may bring an action against the United States in a district court where they are unable to resolve a dispute among competing lienholders, including the United States, concerning their rights to specific property sold pursuant to the agreement with the Service. IRC § 7426(a)(3). Unlike wrongful levy actions and actions for surplus proceeds which may be instituted by any person other than the taxpayer, any person including the taxpayer may bring an action under this provision whether or not such person is a party to the agreement described in IRC § 6325(b)(3). Treas. Reg. 301.7426-1(a)(3). A voluntary payment, however, by a third party to clear a tax lien from property is not an agreement sufficient to invoke district court jurisdiction under IRC § 7426(a)(3). See Denham v. United States, 811 F. Supp. 497 (C.D. Cal. 1992); Ticor Title Insurance Co. v. United States, 1988 WL 383576 (C.D. Cal.1988).

3. If the court determines that a party has an interest in or a lien on an amount held as a fund pursuant to an agreement providing for the proceeds of sale of property to be substituted for the property, the court may grant a judgment in an amount not in excess of the substituted sale proceeds. IRC § 7426(b)(4). The court may enter such judgments as are appropriate to distribute the fund to the parties legally entitled thereto.

5.17.5.17.6 (08-01-2010)
Substitution of Value - Certificate of Discharge

1. At the request of the owner (including the taxpayer) of any property subject to any lien, the Service must issue a certificate of discharge of such property if such owner:

   A. deposits with the Service an amount of money equal to the value of the interest of the United States in the property; or

   B. furnishes a bond acceptable to the Service in a like amount.

IRC § 6325(b)(4).

2. If the property owner believes the Service has overvalued the United States' interest in the property, he or she may, within 120 days after the certificate is issued, bring a civil action against the United States in a district court to have the court determine whether the value of the United States' interest in the property is less than the value determined by the Service. IRC § 7426(a)(4).

3. If the court finds that the Service's valuation of the interest of the United States in the property exceeds the actual value of such interest, the court must grant a judgment ordering a refund of the amount deposited, and a release of the bond, to the extent that the aggregate of the amounts thereof exceeds the value determined by the court. IRC § 7426(b)(5). The plaintiff is entitled to interest at the overpayment rate established under IRC § 6621 from the date the Service received the deposited amount to the date the judgment is paid. IRC § 7426(g).

5.17.5.17.7 (12-14-2007)
Damages in Actions for Wrongful Collection Brought by Persons Other Than Taxpayers

1. Persons other than taxpayers who are harmed by the reckless, intentional or negligent actions of IRS officers or employees in disregard of the Internal Revenue Code may collect damages against the United States in connection with any of the four causes of action authorized by IRC § 7426. (Taxpayers, themselves, may recover such damages under IRC § 7433). These persons are bound, in all respects, to all requirements of IRC § 7433, discussed in IRM 5.17.5.16, above, including the requirement that they first exhaust their administrative remedies.

2. The amount of damages recoverable by persons other than taxpayers is an amount equal to the lesser of $1 million ($100,000 in the case of negligent disregard) or the sum of the actual direct economic damages sustained by the plaintiff as a proximate result of the reckless or intentional or negligent actions of the Service officer or employee, plus the costs of the action. IRC § 7426(h).

5.17.5.17.8 (12-14-2007)
Validity of Assessment

1. For purposes of adjudication under IRC § 7426 , the assessment of tax upon which the interest or lien of the United States is based is conclusively presumed to be valid. IRC § 7426(c). The merits of the tax liability cannot be contested unless the United States requests the foreclosure of its tax lien in such action pursuant to IRC § 7403.

5.17.5.17.9 (08-01-2010)
Period of Limitation on Suit

1. A suit under IRC § 7426 must be commenced within 9 months from the date of the levy or the agreement giving rise to the suit. IRC § 6532(c). However, if a written request for the return of property is made under IRC § 6343(b) within the 9-month period, the 9-month period is extended for 12 months from the date of filing the request or 6 months from the date of disallowance, whichever is shorter. A written request for the return of property which is considered inadequate under Treas. Reg. § 301.6343-2(c) does not extend the 9-month period. To be considered adequate, a written request must include:
   A. the name and address of the person submitting the request;
   B. a detailed description of the property levied upon;
   C. a description of the claimant's basis for claiming an interest in the property levied upon;
   D. the name and address of the taxpayer, the originating Internal Revenue district, and the date of the levy, as shown on the notice of levy form, or, in lieu thereof, a statement of reasons why such information cannot be furnished. Treas. Reg. § 301.6343-2(b).
2. A suit under IRC § 7426(a)(4), with respect to the determination of value of the United States' tax lien interest in real or personal property, must be commenced within 120 days after the day on which the certificate of discharge is issued.

5.17.5.17.10 (08-01-2010)
Administrative Claims

1. The provisions of IRC § 7422(a) (relating to prohibition of suit prior to filing claim for refund) do not apply to actions under IRC § 7426. IRC § 7426(f). Therefore, it is unnecessary for a person to file an administrative claim for refund before instituting an action under IRC § 7426. An administrative claim, in the form of a written request, may be filed seeking the recovery of property wrongfully levied upon, under IRC § 6343(b) (relating to return of property), although the filing of such claim is not a prerequisite to the commencement of an action under IRC § 7426(a)(1). (The request, however, will extend the limitations period for filing an action to 12 months from the date of filing the request or six months after the disallowance of the request, whichever is shorter. IRC § 6532(c)(2).) Similarly, the filing of an administrative application under IRC § 6342(b) (relating to surplus proceeds), seeking a distribution of surplus proceeds resulting from the sale of property pursuant to levy, is not a prerequisite to the commencement of an action under IRC § 7426(a)(2).
2. As discussed in IRM 5.17.5.17.7 above, an administrative claim must be made with the Service before civil damages may be awarded under IRC § 7426(h).

5.17.5.18 (08-01-2010)
Actions Affecting Property

1. 2409a Actions.
   A. Under 28 USC § 2409a, the United States may be named a party defendant in a civil action to adjudicate a disputed title to real property in which the United States claims an interest, other than a security interest or water rights.
   B. Section 2409a is a consent statute.
   C. Section 2409a requires that the United States have a present interest in the property. The statute does not apply if the Government bid in the property at a tax sale and resold it prior to the suit. See Curtis v. United States, 77-1 USTC ¶ 9138 (M.D. Tenn. 1976).

5.17.5.18.1 (08-01-2010)
28 USC § 2410 Actions— Background

1. Under 28 USC § 2410(a), the United States may be named as a party in any civil action or suit in any federal district court, or in any State court having jurisdiction of the subject matter, in the following actions with respect to real or personal property on which the United States claims a mortgage or other lien, including a federal tax lien:
   A. to quiet title;
   B. to foreclose a mortgage or lien;
   C. to partition;
   D. to condemn; and
   E. of interpleader or in the nature of interpleader.
2. 28 USC § 2410 is a consent statute only; it does not confer authority upon any court to foreclose a lien, quiet title to property, partition or condemn property, or to entertain an interpleader suit. There must be a basis for jurisdiction independent of 28 USC § 2410. See Wells v. Long, 162 F.2d 842 (9th Cir. 1947); Shaw v. United States, 331 F.2d 493 (9th Cir. 1964); Simmons v. United States, 280 S.E.2d 463 (N.A. App. 1981). In other words, the court in which the suit is brought must have authority to conduct the type of proceeding instituted. If, for example, a court does not have authority to foreclose a mortgage, 28 USC § 2410 cannot be cited as a basis for jurisdiction over the United States, even though the property is encumbered by a tax lien.
3. If the United States no longer has a lien or mortgage on the subject property, then it cannot be joined as a party under 28 USC § 2410. See United Sand and Gravel Contractors, Inc. v. United States, 624 F.2d 733 (5th Cir. 1980).

5.17.5.18.2 (08-01-2010)
Actions to Quiet Title

1. The United States may be named a party to a suit to quiet title to real or personal property on which the United States has a mortgage or other lien, including a federal tax lien. 28 USC § 2410(a)(1). An action to quiet title is a proceeding instituted by persons claiming some interest or title in the property and seeking to remove a cloud from their title.
2. A judgment or decree in quiet title actions discharges a federal tax lien from the subject property to the extent provided by the local law applicable to similar matters. 28 USC § 2410(c). It is not necessary for the person bringing a quiet title action to request a judicial sale to discharge the Government's interest from the property. See IRM 5.17.4.15 for a discussion of the Government's right to bring an action to quiet title to property that it has acquired through the enforcement of a federal tax lien.
3. A taxpayer may bring a quiet title action under 28 USC § 2410(a)(1) against the United States to challenge the procedural validity of a federal tax lien and sale, but may not contest the merits of the underlying tax assessment in the proceeding. See James v. United States, 970 F.2d 750 (10th Cir. 1992); Hughes v. United States, 953 F.2d 531 (9th Cir. 1992); McCarty v. United States, 929 F.2d 1085 (5th Cir. 1991); Pollack v. United States, 819 F.2d 144 (6th Cir. 1987); Aqua Bar & Lounge, Inc. v. United States, 539 F.2d 935 (3d Cir. 1976). In other words, section 2410 waives sovereign immunity with respect to procedural violations arising from assessment, levy, seizure, or sale, but not with respect to the amount of tax liability assessed.

5.17.5.18.3 (12-14-2007)
Foreclosure Actions

1. If the United States has a mortgage or other lien on real or personal property, it may be joined as a party in a proceeding to foreclose that interest, but only if a judicial sale is being sought. 28 USC § 2410(c).
2. When the foreclosure action involves an encumbrance senior to a federal tax lien, the judicial sale discharges the federal tax lien to the extent it would discharge any other junior lien under the local law of the place where the court is situated. 28 USC § 2410(c). If the foreclosure involves real property, the rights of the United States in such instances are protected by providing a period of time in which the United States may redeem the property. If the foreclosure action involves an encumbrance junior to the federal tax lien, the sale will not disturb the federal tax lien, unless the United States agrees to the sale of the property free and clear of its liens. In that event, the proceeds are distributed according to the priorities of the parties' interests.
3. The effect on a federal tax lien of judicial proceedings to which the United States is not a party and in cases involving nonjudicial sales of property, is discussed below in IRM 5.17.5.19.

5.17.5.18.4 (12-14-2007)
Partition Suits

1. The United States may be named a party to a partition suit where it has a mortgage or lien on the subject property. 28 USC § 2410(a)(3).
2. A partition suit is a judicial proceeding:
   A. brought by a person owning real or personal property with another as joint heirs, joint tenants or tenants in common, without regard to the wishes of the other co-owners;
   B. to have the co-owners' undivided interests in the whole divided into separate interests in portions of the property; and
   C. to which all persons having an interest in the property, including the United States by virtue of its federal tax lien, must be joined as necessary parties and given notice of the proceeding (under most statutes). After a hearing, the court will determine the interests of the co-owners and will enter an order determining the mode of partition.
3. As a general rule, a partition purchaser takes subject to liens and outstanding interests unless the decree of court provides for the sale free and clear of such encumbrances. The issue whether the interests of third parties, including the United States, may be satisfied out of the property partitioned, or must be satisfied from the proceeds of sale of the property, is governed by local law. Since the law varies according to jurisdiction, the question should be referred to Area Counsel for determination.
4. A voluntary partition may be accomplished by any method which the parties deem best, such as by deed, written agreement or sale of the property and division of the proceeds, unless there is a statute to the contrary.

5.17.5.18.5 (12-14-2007)
Condemnation Suits

1. The United States, pursuant to 28 USC § 2410(a)(4), may be added as a party to a condemnation suit, where it has a mortgage or lien on the property being condemned.
2. A condemnation suit is:
   A. a judicial proceeding brought by the United States Government, or the individual states and territories;
   B. to take real or personal private property for public use through the exercise of the power of eminent domain;
   C. for which the owner of the condemned property is entitled to just compensation; and
   D. to which all persons having an interest in the property, including the United States, must be joined as parties and given notice of the proceeding. While condemnation procedures vary from state to state, most statutes require an administrative declaration of taking before a condemnation proceeding may be instituted.
3. A condemnation action is an appropriation of land or personal property for public purposes. The condemnation award stands in the place of the land or personal property, and the rights of all persons, including the United States, may be treated as though transferred to the award.

5.17.5.18.6 (08-01-2010)
Interpleader Suits

1. The United States may be joined as a party to interpleader suits and suits in the nature of interpleader. 28 USC § 2410(a)(5).
2. A person may bring an interpleader suit if:
   A. the person is in possession of (or obligated with respect to) property or rights to property of a delinquent taxpayer in which the person has no interest;
   B. a number of claims are asserted against the property; and
   C. the person cannot determine to whom the property or rights to property should be distributed.
3. A person in these circumstances institutes an interpleader suit to avoid subjecting himself or herself to possible multiple liability by mistakenly surrendering the property to one other than the claimant legally entitled to the property. The person institutes the suit by naming all such claimants as defendants, and surrenders the property to the court for distribution in accordance with its determination of the rights of the various claimants. Such person is referred to as the interpleader.
4. A person cannot join the United States under 28 USC § 2410(a)(5) if the only claimants to the property are the taxpayer and the United States. Rosenheck v. United States, 79 A.F.T.R.2d ¶ 97-2715 (N.D. Okla. 1997); Queen City Savings & Loan Assoc. v. Sanders , 46 A.F.T.R.2d ¶ 80-5715 (W.D. Wash. 1980). In that instance, there is only one claimant to the property because the United States stands in the shoes of the taxpayer.
5. "Suits in the nature of interpleader" are actions where the plaintiff is claiming some interest in the fund deposited as contrasted to a pure interpleader action where the plaintiff asserts no claim to the fund deposited.

5.17.5.18.7 (08-01-2010)
Removal of 28 USC § 2410 Proceeding to Federal Court

1. Most cases in which the United States is named a party under 28 USC § 2410 are brought in state courts.
2. 28 USC § 1444 authorizes removal of actions covered by section 2410 to a federal district court. The Chief Counsel Directives Manual (CCDM) provides that, in general, Area Counsel attorneys should recommend to the Department of Justice to have cases removed to a federal district court. See IRM 34.5.6.6. Immediately consult with Area Counsel whenever any questions arise as to whether the Government's interests will be best protected by having the case removed from state court.

5.17.5.18.8 (08-01-2010)
Procedure and Responsibility

1. The Department of Justice has primary responsibility for protecting the Government's interest in cases in which the United States is joined as a party, regardless of the court involved. In tax cases, it cannot adequately protect the Government's interest without the aid and assistance of the Service. This requires both the assistance of the Area Counsel's office in certain cases and the Area Director's office in all cases.

2. Any pleading (whether or not designated as a complaint) that seeks to join the United States because of a federal tax lien must include the name and address of the delinquent taxpayer, and if a notice of federal tax lien has been filed, the date and place such notice was filed as well as the Service office that filed it. 28 USC § 2410(b). These requirements must be met with respect to each filed notice of tax lien. The pleading must be served personally on the office of the U.S. Attorney for the district in which the suit is pending and on the Attorney General, in Washington, D.C., by registered or certified mail. An answer or other pleading must be filed by the United States within 60 days after service. 28 USC § 2410(b).

3. The U.S. Attorney should contact the office of the Area Director responsible for collection of the account under which the lien arose and forward a copy of the summons and complaint to that office. Depending upon local procedures, the U.S. Attorney may also send a copy of the summons and complaint to Area Counsel. The U.S. Attorney will request information concerning the assessment, the property involved, and the claims of all lienholders.

   A. This information is necessary for the United States to prepare and file an answer or other pleading within 60 days after service or other further time as the court may allow.

   B. The answer must contain the Government's position, including any defenses, and in some cases may request foreclosure of the tax lien.

   C. A copy of the Service's reply to the U.S. Attorney, together with copies of all information furnished to him or her, may be sent to Area Counsel for purposes of review in cases involving disputed issues, so Area Counsel can advise the U.S. Attorney of the Service's litigating position on the issues involved.

   D. In cases where the records of the Service disclose no outstanding tax lien, the Service will advise the U.S. Attorney to file a disclaimer on behalf of the United States.

4. A copy of a complaint involving an interpleader action must be forwarded to Area Counsel. The Area Director's office should immediately investigate the claims of all competing claimants and provide this information to Area Counsel. The information should be specific and include tax data in addition to claimant information. In interpleader cases, Area Counsel is required to prepare a defense letter to the Department of Justice, Tax Division. See Chief Counsel Directives Manual (CCDM), IRM 34.5.6.2 for a general discussion of Counsel procedures in section 2410 actions, and IRM 34.5.6.7.1 for specific procedures relating to interpleader suits.

5.17.5.18.9 (12-14-2007)
Administrative Discharge of Property from Tax Lien During Pendency of Proceeding

1. If the United States receives an application for administrative discharge of the property from the federal tax lien during the pendency of a proceeding to which the United States has been joined as a party, it will be submitted to the Area Director by the U.S. Attorney. The U.S. Attorney will be consulted and provide instructions if such application is received directly by the Internal Revenue Service.

2. As a general rule, applications for discharge of property from the tax lien made without consideration after the commencement of a proceeding in which the United States has been named will be rejected. This is because the Service has established procedures whereby a mortgage holder bringing a foreclosure action can be assured an administrative discharge of a federal tax lien after the completion of the action, if:

   A. there is no value to the tax lien interest; and

   B. the action does not name the United States as a party to the foreclosure proceeding.

5.17.5.18.10 (12-14-2007)
Purchase of Property by the United States

1. In any suit where a debt owing the United States is due (and when a federal tax lien is involved the amount is always due), the United States may sue to foreclose its own lien and seek a judicial sale of the real or personal property. 28 USC § 2410(c); IRC § 7403. When the federal tax lien is the primary lien, the United States is authorized to bid at the sale an amount equal to its claim plus the expense of sale. 28 USC § 2410(c); IRC § 7403.

5.17.5.18.11 (12-14-2007)
Surplus Proceeds

1. If real or personal property is sold in a 28 USC § 2410 action to satisfy a lien senior to a federal tax lien, and surplus proceeds are available, the United States may seek its share of the proceeds. The United States will receive proceeds according to the tax lien's priority with respect to the property sold, for application to the taxpayer's liabilities.

2. The redemption period gives the Service time to investigate and determine whether it would be to the advantage of the United States to redeem the property. The principal consideration in such an investigation is whether the value of the property sold in the foreclosure proceeding is substantially in excess of the amount required to effect the redemption.

3. When the United States redeems real property from a judicial sale pursuant to 28 USC § 2410(c), a junior lienholder may redeem the property from the United States if permitted under the local law where the property is situated.

5.17.5.18.12 (08-01-2010)
The Redemption Price

1. 28 USC § 2410(d) provides a uniform method for determining the amount to be paid by the United States when it redeems real property, whether the redemption is made under the authority of 28 USC § 2410(c) or IRC § 7425(d)(1) (relating to real property sold at nonjudicial sales).

2. The redemption price cannot be greater than the amount paid by the purchaser at the judicial or nonjudicial sale, plus interest at the statutory rate of 6% from the date of sale to the redemption date, plus the excess, if any, of any expenses incurred after the foreclosure sale in maintaining the property over the income from the property during this period. Where the property is not rented out, but is used by the purchaser, the income includes the reasonable rental value of the property. 28 USC § 2410(d).

3. IRC § 7810 established a revolving fund not to exceed $10,000,000 under the control of the Treasury Department which is available without fiscal year limitation for all expenses necessary for the redemption by the Government of real property as provided in IRC § 7425(d) and 28 USC § 2410(c). The revolving fund generally has less than this amount on hand at any given time. Contact Collection Advisory, Insolvency & Quality (AIQ) to determine the exact amount available for redemption.

4. The revolving fund is reimbursed from proceeds of subsequent sales of redeemed real property in an amount equal to the amount expended to make such redemption. See IRM 5.12.5.2.5, *Revolving Fund for Property Redemption* and IRM 5.12.5.2.6, *Advances from the Revolving Fund*, for procedures relating to the revolving fund.

5. By exercising its power of redemption, the United States can purchase property sold at distress prices and resell the property at a profit. Any profit from the sale of redeemed property subject to a tax lien is applied to reduce the liability of the taxpayer whose assessment gave rise to the lien. Surplus proceeds (within the meaning of IRC § 6342(b)) resulting from any sale under IRC § 7506 of real property redeemed by the United States, are not paid into the general Treasury but are placed in a deposit fund account provided for by IRC § 7809, so that they may be paid to parties legally entitled to them.

5.17.5.18.13 (12-14-2007)
Release of Right of Redemption

1. In cases where a federal tax lien is discharged and the Government does not exercise its right to redeem under 28 USC § 2410(c), the right will cloud the title to the property for 120 days or, if greater, the period allowable for redemption under applicable local law. When title is clouded, resale by the purchaser is difficult, if not almost impossible, and also usually deters a purchaser from making any improvements until he or she is sure that his or her right to the property is complete. For this reason, purchasers frequently ask the Government to release its redemption right.

2. A person desiring a release of the Government's right of redemption after a foreclosure suit should submit his or her application to the U.S. Attorney in the jurisdiction where the foreclosure action was held. The U.S. Attorneys have been delegated limited authority to accept or reject applications.

3. Upon receipt of an application, the U.S. Attorney will forward it to the Area Director for valuation of the redemption right. The valuation will usually require a determination of the fair market value of the property, the value of senior encumbrances, the amount required to redeem, etc. The Area Director will forward his or her valuation to the Area Counsel, who analyzes the entire case in the light of the legal factors involved. Area Counsel will transmit its recommendation to the U.S. Attorney or to the Tax Division in Washington, whichever is appropriate.
4. The Department of Justice generally will not release a right of redemption, even where the right is valueless, without some consideration being paid.

5.17.5.19 (12-14-2007)
Proceedings in which United States is not a Party - Background

1. The preceding section dealt with judicial proceedings in which the United States is joined as a party, and discussed the rules for the discharge of federal tax liens on real and personal property involved in such proceedings. IRC § 7425 supplements 28 USC § 2410(a) by providing uniform federal rules for determining the effect on a federal tax lien of judicial proceedings to which the United States is not a party, and in cases of nonjudicial sales of property.

5.17.5.19.1 (12-14-2007)
Judicial Foreclosures

1. If the United States is not a party under 28 USC § 2410 to formal judicial proceedings, the effect of a judgment, or a judicial sale pursuant to such a judgment, depends upon whether a notice of federal tax lien was filed before the action was commenced.
   A. If a notice of federal tax lien is on file in the place provided by law for such filing at the time the action or suit is commenced, the tax lien, and its priority relative to other liens, is not disturbed by the judgment or judicial sale.
   B. If a notice of federal tax lien is not on file before such action is commenced, or (as in the case of special federal estate and gift tax liens) the law makes no provision for such filing, a judgment or judicial sale discharges a federal tax lien to the extent provided by the local law where the property subject to the lien is situated. Treas. Reg. § 301.7425-1(c).
2. For example, if a notice of federal tax lien is not on file on the date a foreclosure action of a first mortgage is brought, and if local law provides that junior liens on real property will be discharged by a judicial sale pursuant to a judgment in a foreclosure action, then a federal tax lien on the property will be discharged by the judicial sale. The result is the same whether the lien arose before or after the date of commencement of the foreclosure action or whether notice of lien was filed at any time after the commencement of the foreclosure action.
3. If the United States has not been joined in a judicial proceeding in which the judicial sale discharges the federal tax lien from the subject property, then the United States may intervene in the suit pursuant to IRC § 7424, and:
   A. make a claim against the surplus proceeds of the sale, prior to their distribution by the court, according to the tax lien's priority with respect to the property sold, for application to the taxpayer's liabilities (Treas. Reg. § 301.7425-1(c)(4)); or
   B. exercise its right to redeem the real property under 28 USC § 2410(c) within 120 days after the sale or, if longer, the redemption period under local law. If the United States' application to intervene is denied, then the judicial sale does not discharge the tax lien. IRC § 7424.
4. The United States has no right of redemption (except as provided by local law) where real property is sold in a judicial proceeding to which it has not been named as a party and it has not intervened pursuant to IRC § 7424.

5.17.5.19.2 (08-01-2010)
Nonjudicial Foreclosures of Non-Perishable Goods

1. A nonjudicial foreclosure on real or personal property is a sale made pursuant to:
   A. an instrument creating a lien on the property sold;
   B. a confession of judgment on the obligation secured by an instrument creating a lien on the property sold; or
   C. a statutory lien on the property sold. IRC § 7425(b). This includes, for example, the divestment of the taxpayer's interest in the real or personal property by operation of law, by public or private sale, or by termination under provisions in a land sales contract or a conditional sales contract. IRC § 7425(c)(4); Treas. Reg. § 301.7425-2(a).
2. A nonjudicial sale, pursuant to a lien senior to a federal tax lien or title derived from the enforcement of a tax lien, will discharge the tax lien or divest the title to the extent provided by local law with respect to junior liens if the notice of lien was filed, or the title was recorded, in the place dictated by local law, more than 30 days before the sale, and the Area Director was given timely and adequate notice of the sale.
3. In situations where a notice of federal tax lien has not been filed or has been filed less than 31 days before the sale, a notice of sale is not required. In these situations, the sale shall have the same effect with respect to the discharge of the federal tax lien/NFTL as provided by local law with respect to junior liens. This is the same result as where the United States does not have a tax lien on file and it is not joined as a party to a 28 USC § 2410 proceeding.
4. The notice of sale must be given in writing, by registered or certified mail or by personal service, not less than 25 days prior to the sale, to the IRS official, office and address specified in IRS Publication 786, "Instructions for Preparing a Notice of Nonjudicial Sale of Property and Application for Consent to Sale." See Treas. Reg. § 301.7425-3. According to Publication 786, the notice should be addressed to the Advisory Group Manager for the area in which the notice of federal tax lien was filed. The requirements for the adequacy of such notice are set forth in Treas. Reg. § 301.7425-3(d), and these requirements must be satisfied with respect to each notice of tax lien filed, and with respect to each recorded title. This notice requirement gives the Government an opportunity to review its position and determine the appropriate action, such as purchasing the property, without placing an undue burden on a foreclosing creditor since he or she need only check the record for federal tax liens or title on the date the action is commenced. See IRM 5.17.5.19.3 regarding nonjudicial sales of perishable goods.
5. Where the United States is not given proper notice of the sale, although notice of lien was duly filed, or the title was duly recorded, more than 30 days before the sale, the sale does not disturb the lien or title of the United States. Treas. Reg. § 301.7425-2(a). This rule does not apply in any case in which, prior to the date of sale, the Area Director consents to the sale of the property free of the lien or title, even though the United States did not receive proper notice of the sale. IRC § 7425(c)(2).
6. If the nonjudicial sale is pursuant to a lien junior to the federal tax lien or the United States' title, then the sale does not discharge the tax lien or divest the title, regardless of whether notice is given to the Area Director. In such instances, the United States may enforce the lien against the real or personal property by administrative or judicial proceedings or may take any appropriate action with respect to its title.

5.17.5.19.3 (08-01-2010)
Nonjudicial Sales of Perishable Goods

1. If the property is perishable, or is liable to become greatly reduced in value by retaining, or cannot be kept without great expense, the 25-day notice rule is not applicable and the property may be sold free of the tax lien or title as long as notice is given at any time prior to the sale. IRC § 7425(c)(3); Treas. Reg. § 301-7425-3(c)(1). The proceeds of the sale (exclusive of costs) must be held at least 30 days after the sale date as a fund subject to the claim of the United States with the same priority as the claim had with respect to the property sold. IRC § 7425(c)(3); Treas. Reg. § 301.7425-3(c)(1).
2. A seller becomes personally liable to the United States for the value of its claim in the proceeds if:
   A. he or she fails to hold the proceeds for the 30-day period; and
   B. the IRS asserts a claim to the proceeds within the 30-day period. Treas. Reg. § 301.7425-3(c)(1).

3. In any event, even if the proceeds of such sale are not so held by the seller, but all the other provisions relating to the sale of perishable goods are satisfied, the buyer of the property at the sale takes the property free of the federal tax lien or title. Treas. Reg. § 301.7425-3(c)(1).

4. The term "perishable goods" is defined as tangible personal property which, in the reasonable view of the seller, is liable to perish or become greatly reduced in price or value by retaining or cannot be kept without great expense. Treas. Reg. § 301.7425-3(c)(2). These goods are the same as those the Internal Revenue Service is authorized to sell pursuant to IRC § 6336 (relating to sale of perishable goods) and IRC § 6863(b)(3)(B)(ii) (relating to exceptions to stay of sale of seized property pending Tax Court decision).

5.17.5.19.4 (12-14-2007)
Right of Redemption after Nonjudicial Foreclosures

1. The United States may redeem real (not personal) property sold in nonjudicial proceedings where the sales were to satisfy a lien senior to a federal tax lien or to a title obtained as a result of the enforcement of a tax lien. IRC § 7425(d)(1). This right of redemption exists even where the Area Director has given his or her consent prior to the sale. Treas. Reg. § 301.7425-4(a)(1). The period of time for redemption in these cases is 120 days from the date of sale or the period allowable for redemption under local law, whichever is longer. IRC § 7425(d)(1). Thus, the United States will always have the right to redeem real property sold at such sales, whether or not other lienors have similar rights under local law.

   Note:

   The date the property is considered sold and the date the redemption period begins under local law varies among jurisdictions. Consult Area Counsel to determine factors applicable in specific locations.

2. The amount to be paid by the United States where it exercises its right of redemption is the amount prescribed in 28 USC § 2410(d) (discussed in IRM 5.17.5.18.12 above). IRC § 7425(d)(2); Treas. Reg. § 301.7425-4(b). As a result, the amount to be paid by the United States is uniform in all cases, regardless of whether the United States redeems the real property from a purchaser at a judicial sale to which the United States was a party or a purchaser at a nonjudicial sale.

5.17.5.19.5 (12-14-2007)
Certificate of Redemption

1. After the United States has exercised its right of redemption under IRC § 7425(d), the Service will apply to the officer designated by local law, if any, for the documents necessary to provide evidence of redemption. If no such officer has been designated by local law, or if the officer so designated fails to issue the necessary documents, the Service is authorized to issue a certificate of redemption for the property redeemed by the United States.

2. The documents issued by the local officer or the certificate of redemption executed by the Service must be recorded in the proper registry of deeds in order to record title to the redeemed property. If the state in which the real property redeemed is situated has not by law designated an office in which the Service-issued certificate of redemption may be recorded, the certificate must be filed in the office of the clerk of the federal district court for the judicial district in which the redeemed property is situated.

3. A certificate of redemption properly executed constitutes prima facie evidence of the regularity of the redemption. When the certificate is recorded, it transfers to the United States all the rights, title, and interest in and to the redeemed property acquired by the purchaser from whom the United States redeems the property. IRC § 7425(d)(3); Treas. Reg. § 301.7425-4(c).

5.17.5.19.6 (12-14-2007)
Release of Right of Redemption

1. If a federal tax lien is discharged or title divested by a nonjudicial sale under IRC § 7425 and the Service does not exercise its right to redeem, the right to redeem clouds title to the property. In many cases the Service is asked to release its right of redemption. The information required in an application for the release of the right of redemption is set forth in Rev. Proc. 68-10, 1968-1 C.B. 758. The Area Director will review the application to determine if the release has any value, and if so, how much the applicant should pay for the release. No processing charge is made for the release of a valueless right of redemption regardless of the fact that the value of a release has an intangible value to the applicant. Treas. Reg. § 301.7425-4(c)(4).

5.17.5.20 (08-01-2010)
Award of Court Costs and Attorney's Fees Under IRC § 7430

1. With respect to any administrative or court proceeding involving the determination, collection, or refund of any tax, interest or penalty, brought by or against the United States, a court of the United States (including the Tax Court) generally may award reasonable litigation and administrative costs to the prevailing party. IRC § 7430(a). The court may not award administrative costs with respect to collection actions, except for damage actions under IRC § 7433 for the willful violation of section 362 or section 524 of the Bankruptcy Code.

   Note:

   Claims for administrative cost awards under IRC § 7430 are considered by Appeals if the substantive issues or IRC § 7430 cost issues are not and have never been before any court of the United States with jurisdiction over these issues. See IRM 8.7.1.10.2, *Claim Cases Involving IRC 7430*. For information regarding other types of administrative claims that may be brought by taxpayers, such as claims for damages for unauthorized collection under IRC § 7433, see applicable IRM provisions, above, and IRM 25.3.3.8, *Pre-Litigation Claim Requirements*.

2. Prevailing Party

   - In order to be a prevailing party, the party must substantially prevail with respect to the amount in controversy or the most significant issue or set of issues presented. IRC § 7430(c)(4)(A).
   - Exception to prevailing party—A party shall not be considered a prevailing party if the United States establishes that its position is substantially justified.
   - The position of the United States shall be presumed to be not substantially justified if the IRS did not follow its applicable published guidance in the administrative proceeding. Published guidance means regulations, revenue rulings, revenue procedures, information releases, notices and announcements, as well as any private letter ruling, technical advice memorandum, and determination letter that is issued to a taxpayer.
   - For purposes of determining whether the United States' position is substantially justified, the court shall take into account whether the United States has lost in courts of appeal for other circuits on substantially similar issues.
   - Qualified Offers. An award of fees and costs may be available if, after a taxpayer has a right to administrative review in the IRS Appeals Office, the taxpayer makes a "qualified" offer that the IRS rejects and, then, the IRS obtains a judgment in the case that is equal to or less than the taxpayer's offer, without regard to interest. In this instance, the taxpayer is treated as the prevailing party. The provisions, however, do not apply to judgments issued pursuant to a settlement or in a proceeding in which the amount of the tax liability is not at issue, such as a declaratory judgment or summons enforcement proceeding. See IRC § 7430(g) .

3. Position of the United States

   - "Position of the United States" means the position taken by the United States in the underlying judicial proceeding, and
   - the position taken in administrative proceedings as of the earlier of the date of the receipt by the taxpayer of the notice of the decision of the Internal Revenue Service or the date of the notice of deficiency.

4. Exhaustion of Administrative Remedies

- Reasonable litigation costs shall not be awarded unless the prevailing party has exhausted the administrative remedies available to it within the Internal Revenue Service.

5. Net Worth Requirements

    - Only individuals whose net worth does not exceed $2,000,000 and corporations whose net worth does not exceed $7,000,000 are eligible for an award of fees and costs.

6. Cap on Hourly Fee

    - In 1998, Congress capped the hourly fees recoverable under this section at $125 per hour and indexed the cap to the rate of inflation.
    - The difficulty of the issues raised and the lack of available tax attorneys may justify raising the cap on the hourly rate.
    - Reasonable attorney's fees may be awarded to persons who represent a prevailing party on a pro bono basis or for a nominal fee.

More Internal Revenue Manual

Part 5. Collecting Process

Chapter 17. Legal Reference Guide for Revenue Officers

Section 6. Summonses

5.17.6 Summonses

Manual Transmittal

September 26, 2014

Purpose

(1) This transmits revised IRM 5.17.6, Legal Reference Guide for Revenue Officers, Summonses.

Background

This section provides basic legal concepts governing the use and enforcement of administrative summonses.

Material Changes

(1) *IRM 5.17.6.1*(3) clarifies when a taxpayer may be required to appear by a summons.

(2) *IRM 5.17.6.2* updated IRM references.

(3) *IRM 5.17.6.4* updated reference to Delegation Order 25-1 for activities concerning summonses.

(4) *IRM 5.17.6.5*(4) added clarifying language on summons notice exemption.

(5) *IRM 5.17.6.5.1* moved clarification of service of a corporate summons from IRM 5.17.6.5.1(6) to IRM 5.17.6.5.1(1).

(6) *IRM 5.17.6.5.1*(7) updated to reflect proper completion and service of a summons to a corporate officer.

(7) *IRM 5.17.6.5.1*(10) adds statement of when a summons should be re-served if the Service will be seeking summons enforcement.

(8) *IRM 5.17.6.5.2*(2) explains no levy can be made on property of summoned person on date that person is to appear in response to a collection summons unless collection of the tax is in jeopardy.

(9) *IRM 5.17.6.5.2*(2) clarified no levy can be made on property of summoned person on date that person is to appear in response to a collection summons unless collection of the tax is in jeopardy.

(10) *IRM 5.17.6.5.2*(3) statement added regarding action needed to formally extend date of summons appearance.

(11) *IRM 5.17.6.6*(1)(a) Adds definition to the term "identified" to clarify when notice is required.

(12) *IRM 5.17.6.6*(2) explains numbered bank accounts exception is very limited in its present scope.

(13) *IRM 5.17.6.6.1* clarifies delivery of a third-party recordkeeper summons.

(14) *IRM 5.17.6.6.3*(7) clarified the need to secure summoned records until 23-day period following the date of giving notice has expired.

(15) *IRM 5.17.6.6.4*(3) statement added that authorized Service officers may complete the summons certification on page two of the summons form.

(16) *IRM 5.17.6.7*(3) expanded the example for Trust Fund Recovery Penalty summonses.

(17) *IRM 5.17.6.8* added statement that a summons generated through the Integrated Collection System (ICS) will automatically generate a third-party notice indicator.

(18) *IRM 5.17.6.10*(4) and (5) deleted. Information from these two paragraphs incorporated and updated into the renumbered paragraphs (4) and (5).

(19) New *IRM 5.17.6.10*(4) renumbered from 5.17.6.10(6). The reference for authority to obtain a full credit report was updated to 31 USC 3711(h)(2).

(20) New *IRM 5.17.6.10*(5) renumbered from 5.17.6.10(7) and information incorporated that the Service can receive a full credit report on tax delinquency investigations by obtaining the consumer's written permission or issuing a summons.

(21) *IRM 5.17.6.10*(6) renumbered from 5.17.6.10(8).

(22) *IRM 5.17.6.18*(4) new paragraph added discussing need to obtain a search warrant when the Service requests content of email communications stored by an internet service provider (ISP).

(23) *IRM 5.17.6.18*(5) renumbered from 5.17.6.18(4).

(24) *IRM 5.17.6.19.2* updated IRM reference regarding audio recording procedures.

(25) *IRM 5.17.6.25* section added to reference unique relationship between Indian tribal governments and the United States government.

(26) Editorial changes were made throughout this section to add clarity and update/correct citations.

Effect on Other Documents

IRM 5.17.6, Summonses, dated October 15, 2010, is superseded.

Audience

SBSE Revenue Officers

Effective Date

(09-26-2014)

Rocco A. Steco
Acting Director, Collection Policy
Small Business/Self-Employed

5.17.6.1 (09-26-2014)
General

1. The purpose of this section is to acquaint revenue officers with the basic legal concepts governing the use and enforcement of administrative summonses. For more detailed guidance, refer to the Summons Handbook at IRM 25.5.
2. In general, the Service should issue summonses only when the taxpayer (or other witness) will not produce the desired records or other information voluntarily. When a taxpayer or third person is willing to testify and produce documents voluntarily, a summons may not be required. In such cases, revenue officers may only need to produce their credentials. Refer to IRM 5.17.6.6.2(3), *Notice and Waiting Period Requirements,* regarding the requirement to serve a summons on a bank in the Tenth Circuit. Before issuing any summons, the Service should consider:
    A. The possibility that judicial enforcement will be required, and
    B. The adverse effect on future voluntary compliance if enforcement is abandoned.

    Note:

    The Service should only issue a summons when it is prepared to seek judicial enforcement if the summoned party fails to fully comply.
3. The summons should not require the witness to do anything other than appear on a given date to give testimony or produce existing books, papers and records or both. A summons cannot require a witness to prepare or create documents, including tax returns, that do not currently exist. However, a taxpayer may be required by a summons to appear and give testimony that would allow a revenue officer to obtain answers to all the questions or blanks on a Collection Information Statement for that taxpayer or produce records to complete a tax return for that taxpayer.

    Note:

    Pursuant to IRC 6331(g), the Service may not levy on a person's property on the day that person (or that person's officer or employee) is required to appear in response to a summons issued by the Service for the purpose of collecting any tax.

5.17.6.2 (09-26-2014)
Legal Authority

1. IRC 7602 provides the Service with summons authority. See IRM 5.17.6.2.1, *Statutory Authority,* below. Additionally, case law provides standards that the Service must meet to have its summons enforced. See IRM 5.17.6.2.2, *Case Law.*

5.17.6.2.1 (09-26-2014)
Statutory Authority

1. IRC 7601 authorizes the Service to inquire about any person who may be liable to pay any internal revenue tax without a summons.
2. IRC 7602 authorizes the Service to summon a witness to testify and to produce books, papers, records, or other data that may be relevant or material to an investigation. *United States v. Powell,* 379 U.S. 48 (1964).
3. IRC 7602 and the corresponding regulations, Treas. Reg. 301.7602-1, also identify the purposes for which the Service may issue summonses. The purposes are:
    - To ascertain the correctness of any return;
    - To prepare a return where none has been made;
    - To determine the liability of a person for internal revenue tax;
    - To determine the liability at law or in equity of a transferee or fiduciary of a person in respect of any internal revenue tax;
    - To collect any internal revenue tax liability; or
    - To inquire into any offense (civil or criminal) connected with the administration or enforcement of the internal revenue laws.

Note:

The Service’s right to examine records provided by IRC 7602 includes the right to photocopy such records.

4. The following persons may be summoned under the authority of IRC 7602(a)(2):
   - The person liable for the tax or required to perform the act (prepare a return);
   - Any officer or employee of such person who has information that may be relevant to the investigation;
   - Any person having possession, custody, or care of books, papers, records, or other data that may be relevant to the investigation; and
   - Any other person the Secretary deems proper.
5. IRC 7602(d)(1) prohibits a summons from being issued or enforced with respect to any person if a Justice Department referral is in effect with respect to such person. A "referral" is in effect, as defined by IRC 7602(d)(2), when either:
   - The Service has recommended to the Justice Department a grand jury investigation of, or the criminal prosecution of, such person for any offense connected with the administration or enforcement of internal revenue laws; or
   - The Justice Department requests, pursuant to IRC 6103(h)(3)(B), the disclosure of return or return information relating to such person, as when the Justice Department requests the Service’s criminal investigators to join an ongoing federal grand jury investigation of the person for non-tax crimes, such as narcotic trafficking or racketeering, to investigate potential tax charges.

   Note:

   The limitation of IRC 7602(d)(1) applies only when the Service has referred to the Justice Department the taxpayer whose liabilities are at issue. The Service is not barred from summoning a third-party witness when the Service has referred the third-party witness to the Justice Department. *Khan v. United States,* 548 F.3d 549 (7th Cir. 2008); Treas. Reg. 301.7602-1(c)(1).
6. Other IRC sections concerning the proper use and enforcement of a summons are:
   - Section 7603 — Service of Summons
   - Section 7604 — Enforcement of Summons
   - Section 7605 — Time and Place of Examination
   - Section 7609 — Special Procedures for Third-Party Summonses
   - Section 7610 — Fees and Costs for Witnesses
   - Section 7611 — Restrictions on Church Tax Inquiries and Examinations
   - Section 7612 — Special Procedures For Summonses For Computer Software
   - Section 7402 — Jurisdiction of District Courts
   - Section 7210 — Failure to Obey Summons

5.17.6.2.2 (12-11-2007)
Case Law

1. In *United States v. Powell,* 379 U.S. 48, 57-58 (1964), the Supreme Court set forth the standards that the Service must meet to have its summons enforced. The Service must show that:
   - The investigation will be conducted pursuant to a legitimate purpose;
   - The inquiry may be relevant to the purpose;
   - The information sought is not already within the Service's possession; and
   - All administrative steps required by the Code have been followed.
2. *Powell* also held that a summons cannot be issued for an "improper purpose." This includes using a summons:
   - To harass the taxpayer;
   - To pressure the taxpayer into settling a collateral dispute; or
   - For any other purpose adversely reflecting on the "good faith" of the investigation.

5.17.6.3 (12-11-2007)
Relevance and Materiality

1. IRC 7602 authorizes the Service to issue a summons to any person to produce for examination books, papers, records or other data, and to require such person to give such testimony, under oath, as may be relevant or material to the determination or collection of any internal revenue tax.
2. The question of what "may be relevant or material" depends on the facts and circumstances of each case. In general, courts reject the use of a summons as a "fishing expedition" and have held that there must be a "realistic expectation" rather than an "idle hope" that something may be discovered to satisfy the relevance and materiality requirements of IRC 7602, particularly where third-party documents are sought. *United States v. Arthur Young & Co.,* 465 U.S. 805, 814, n.11 (1984), citing *United States v. Harrington,* 388 F.2d 520, 524 (2d Cir. 1968).
3. Courts recognize that not all documents summoned will prove relevant or material, emphasizing the test is whether the summoned documents "might throw light upon subjects under legitimate inquiry." *Arthur Young,* 465 U.S. at 813–814.
4. When documents or information are sought from the taxpayer, all records of financial transactions, all books and records showing the receipt or expenditure of money by the taxpayer, all financial transactions of the taxpayer with other persons and the names of such other persons to verify such transactions satisfy the relevance test of IRC 7602.
5. Where documents or information are requested from third persons, all records or information of the taxpayer’s financial transactions with such third persons or other persons satisfy the relevance test of IRC 7602.

5.17.6.4 (09-26-2014)
Summons Authority of Collection Personnel

1. Delegation Order 25-1 (as revised) provides detailed instructions concerning the levels of authority delegated to various Service officials to approve and perform activities concerning summonses. See IRM 1.2.52.2, *Delegation Order 25-1 (formerly DO-4, Rev. 23),* Revenue officers should refer directly to the most current revision of Delegation Order 25-1 whenever an issue arises about their authority to take any of these actions:

   - Authorize, issue and serve summonses;
   - Set the time and place for examination;
   - Administer oaths to witnesses;
   - Take testimony under oath;
   - Take and certify papers; and
   - Receive and examine summoned materials.

5.17.6.5 (09-26-2014)
Proper Description of Documents

1. IRC 7603 provides that books and records sought must be described with reasonable certainty or particularity, including the periods for which the records are sought. In general, the meaning of the phrase "reasonable certainty" is a factual matter that will depend on all the circumstances involved.
2. A demand for documents required to be produced for examination cannot be so general and vague that it would be unreasonable to expect the summoned party to comply. The rule established by the courts is that the Service employee or officer issuing the summons need not describe in minute detail every document and paper to be produced, but must describe them with "such reasonable certainty" that the person summoned will have sufficient information to enable him to produce such documents. *Adamowicz v. United States,* 531 F.3d 151, 157-8 (2d Cir. 2008); *United States v. Medlin,* 986 F.2d 463, 467 (11th Cir. 1993).
3. In *United States v. Calhoun County Hospital, Inc.,* 35 AFTR2d 75-1097 (N.D. Miss. 1974), the typed-in body of the summons did not specify for what years the records were sought. The court rejected the taxpayer's argument that the summons was facially invalid by looking at the "four corners" of the summons, thereby incorporating into the body of the summons the years listed in the caption. *Accord United States v. Duke,* 379 F. Supp. 545 (N.D. Ill. 1974).
4. If it is not known what records are in the summoned party's possession, a summons can be served identifying only the taxpayer, the tax period under investigation, and the type of tax involved.

   - Upon appearance, the witness can be asked whether or not certain records exist.
   - Then a second summons can be issued describing the particular records with reasonable certainty.
   - Such a "preliminary" summons is specifically exempt from the notice provisions of IRC 7609, but the notice exemption applies only to inquiries about whether or not records of the taxpayer's business transactions or affairs have been made or kept. IRC 7609(c)(2)(B) .

5.17.6.5.1 (09-26-2014)
Proper Service - IRC 7603

1. IRC § 7603 provides that service of the summons will be made by delivery in hand of an attested copy to the person to whom it is directed or by leaving it at his last and usual place of abode. Third-party recordkeepers may also be served by certified or registered mail. Corporations do not have a "last and usual place of abode" within the meaning of IRC 7603(a); therefore a summons may not be served by fixing it to the door of the corporate building or by leaving the summons with the secretary of any individual (named or unnamed) on whom the summons is to be served or with another employee.
2. The Summons Handbook at IRM 25.5.3.2, *Service of Summons,* outlines the procedures for serving summonses. This section identifies three options for serving a summons upon an individual who is not a third-party recordkeeper:

   A. Hand the summons to the person to whom it is directed;

   B. At the individual's last and usual place of abode, leave the summons with a person of suitable age and discretion with instructions that the summons be given to the summoned individual; or

   C. By affixing the summons to the front door of the individual's last and usual place of abode by a means that will not mar the finish.

3. In *United States v. Bichara,* 826 F.2d 1037 (11th Cir. 1987), the Eleventh Circuit held that section 7603 allows service by merely leaving the summons at the last and usual place of abode. The Circuit decision reversed the district court, which had denied enforcement on the grounds that merely leaving the summons was insufficient, and that due process required the summons be left with some person of suitable age and discretion. See also *United States v. Gilleran,* 992 F.2d 232 (9th Cir. 1993) (the appellate court reversed the district court that had required the Service to mail the summons in addition to leaving the summons at the last and usual place of abode). Leaving the summons with a person of appropriate age and discretion may be a good practice in certain circumstances, but it is not required by law, and a summons is validly served by being affixed to the door.
4. A summons should be issued only to one summoned party, i.e., only one party's name should appear on the "To" line of a summons. For a summons to a corporation or to an officer of a corporation, see IRM 5.17.6.5.1(6)-(7), below.
5. A summons can be personally served on a person at his business address, but if the person being summoned is not present, the summons may not be left at that address. See *United States v. Myslajek,* 568 F.2d 55 (8th Cir. 1977), cert. denied, 438 U.S. 905 (1978) (summons left with taxpayer's adult son at taxpayer's place of business held defective for purposes of service, although the summons was ordered enforced because the defect in service was not timely raised). The Code authorizes leaving the summons only at the last and usual abode of the person. The fact that an improperly served summons is actually received by the summoned party will not cure the defective service.
6. A summons served on a corporation without identifying a specific person may be served on any officer or employee of the corporation authorized to receive process by either state law or the corporate by-laws. For example, the summons may describe the witness as "X Corporation." The summons should be served only on a person authorized to receive process; it cannot be simply left at the corporate offices. For example, a summons cannot be left with the corporate officer’s secretary. The summons should also not be left at a last and usual place of abode of the person (or persons) authorized to receive process. Therefore, the summons must be served in person to an authorized person, unless the witness is summoned in the capacity of a third-party recordkeeper described in IRC 7603(b).
7. When the summons seeks records or testimony from a specific corporate officer (John Smith, President), the summons should be issued to that officer by name and with his official designation. For example the "In the matter of" line should read "Corporation X" and the "To" line should read "John Smith, President" with John Smith's last known address on the "At" line. Because this summons is issued to an individual, John Smith, the summons may be served either personally upon John Smith or left at his "last and usual place of abode." That John Smith is being summoned to provide testimony/records in his capacity as President of Corporation X does not affect treatment as an individual for purposes of service of the summons.
8. The Certificate of Service is found on the second page of the original Form 2039. Once executed, the certificate is evidence of the facts it states at the hearing for enforcement. IRC 7603(a).
9. In accordance with IRC 7603(a), the copy of the summons given to the summoned person must contain a signed certification or affirmation that it is a true and correct copy of the original. On the current pre-printed summons forms, the attestation clause reads as follows: "I hereby certify that I have examined and compared this copy of the summons with the original and that it is a true and correct copy of the original."

10. Improperly served summonses cannot be cured. But as noted above, the taxpayer may waive defective service of a summons by failing to object to the defective service in a timely fashion. *United States v. Myslajek,* 568 F.2d 55 (8th Cir., 1977) (although summonses were served on taxpayer's adult son at accountant's business office, taxpayer waived strict compliance with requirement that summons be served on the person to whom it is directed or left at his last and usual place of abode where accountant received actual notice of the summonses on date they were served but did not object to defective service until almost three months later); *United States v. Payne,* 648 F.2d 361 (5th Cir. 1981) (taxpayer waived strict compliance with statute governing service of IRS summons where taxpayer appeared at time and place set forth in summons but failed to object to improper service at such time). If the Service improperly served a summons, but acted in "good faith" in doing so and there also was no prejudice to the taxpayer (for example, the taxpayer filed a timely petition to quash the summons), then some courts may find that the Service's error in serving the summons was "harmless." *United States v. Richey*, 632 F.3d559, 564-5 (9th Cir. 2011). However, "harmless error" findings may not be reliably forecast, so the Service should ordinarily re-serve a new summons properly in place of an improperly served summons if the Service will be seeking summons enforcement.

5.17.6.5.2 (09-26-2014)
Time and Place of Appearance - IRC 7605

1. In the case of all first-party summonses (those served on the taxpayer or upon any officer or employee of an entity taxpayer or of a taxpayer with a sole proprietorship) subject to IRC 7605, the following notice and waiting periods requirements apply:

   A. The time and place for appearance and examination must be reasonable. IRC 7605(a).

   B. Date for appearance shall not:
   • be on a Saturday, Sunday, or legal holiday; and
   • be less than 10 full days from service with the date of service excluded from the 10-day waiting period. It is legally sufficient to require the summoned person to appear on the 10th day. However, it may be preferable to set the date of appearance on a later date, such as the 11th day, to avoid any question regarding timeliness.

   Note:

   For a discussion of notice and waiting period requirements in the case of all third-party summonses that are not exempt from the notice requirements of IRC 7609, see IRM 5.17.6.6.2, below.

2. Unless collection of the tax is in jeopardy, no levy can be made on the property of a summoned person on the date the person is required to appear in response to a summons issued for the purpose of collecting an underpayment of tax. IRC 6331(g).

3. Any agreement with a summoned party that alters the party's circumstances of appearance may result in a waiver of the Service's summons rights. In *United States v. Malnik,* 489 F.2d 682 (5th Cir. 1974), the summoned taxpayer entered into an agreement with the Service not to appear based in part on his claim of constitutional privileges. Even though the privileges were infirm, the court held that the Service waived its right to have the taxpayer appear. If a valid reason exists (such as illness) that a witness cannot appear on the date fixed in the summons, the date may be continued by mutual agreement. Review IRM 25.5.3.4, *Time and Place of Examination Set by Summons,* for actions needed to formally extend the date of appearance.

5.17.6.6 (09-26-2014)
Third-Party Summonses Subject to IRC 7609

1. IRC 7609 contains notice and waiting period requirements which apply to all third-party summonses, except for certain limited categories discussed herein. See IRM 5.17.6.6.2, *Notice and Waiting Period Requirements,* for a discussion of these notice and waiting periods

   Note:

   A third-party summons is a summons directed to a person other than the person with respect to whose liability or return the summons is issued, or any officer or employee of such person. A third-party summons is a summons not excepted from notice by IRC 7609(c)(2)(A).

   .

   A. When a third-party summons is issued, section 7609(a) requires notice be given to the taxpayer identified in the heading of the summons and any other person (whether an individual or an entity) identified in the description of summoned records. The term "identified" means identified by proper name (including an acronym derived from the proper name).

   B. The notice and waiting period requirements of IRC 7609(a) apply to third-party summonses that seek the production of any type of records or giving of testimony regarding the person(s) identified in the summons.

   C. Any noticee may intervene in any proceeding brought by the Government to enforce the summons. The summoned third-party has the right to intervene in any proceeding brought by a noticee to quash the summons. IRC 7609(b).

   D. The notice procedures apply to almost all third-party summonses issued for examination purposes. Therefore, the Service must accurately distinguish between third-party summonses and summonses served on the taxpayer under investigation. The Service must also determine if the summons is excepted from notice under IRC 7609(c). IRM 5.17.6.6(2) discusses the exceptions to notice requirements.

   E. In most situations, the distinction between third-party summonses and summonses served on the taxpayer under investigation is obvious. However, it is less obvious in at least two scenarios.
   i) The first scenario involves a married couple who filed joint returns and who are jointly and severally liable for payment.
   • If a summons is served in aid of the collection of an assessment, two separate summonses, one issued to the husband and one issued to the wife should be served. "In the matter of" should list both the husband and wife. This summons is excepted from notice under IRC 7609(c)(2)(D).
   • If a summons is issued in connection with an examination of a return, this is not a collection summons and notice requirements apply. If only one spouse is summoned, the other spouse is entitled to notice under IRC 7609(a) as a person identified in the summons. Even when both spouses are summoned (by issuing and serving separate summonses), each spouse is entitled to notice of the other spouse's summons. This procedure preserves each spouse's opportunity to move to quash the summons served on his or her spouse.
   • If a summons is issued for a period where a married couple has failed to file a return, the spouses should be treated as having separate liabilities regardless of their past filing status. These summonses should be issued for each person and should be captioned "In the matter of Taxpayer-Husband" and "In the matter of Taxpayer-Wife" respectively. No notice is required, except where one spouse is summoned "in the matter of" the other spouse.
   ii) The second scenario involves officers or employees of taxpayer businesses, e.g., corporations and sole proprietorships. When these persons are summoned in their capacity as officers or employees, the summons is a first-party summons that is excepted by IRC 7609(c)(2)(A) from the notice requirements of IRC 7609(a).

   F. When a third party indicates that she will voluntarily provide information but requests the service of a summons as evidence of her legal duty to testify or produce records, revenue officers should follow the notice and waiting period requirements of IRC § 7609 when issuing the summons unless the summons is a collection summons and therefore excepted from these requirements by IRC 7609(c)(2). Revenue officers should not accept the voluntary production of records before the waiting period expires.

2. The notice and waiting period requirements of IRC 7609 apply to all summonses except:

   - A summons served on a person with respect to whose liability the summons is issued, or any officer, or employee of that person (i.e., first-party summonses). IRC 7609(c)(2)(A).

   - A summons served to determine whether or not records of the business transactions or affairs of an identified person have been made or kept. IRC 7609(c)(2)(B).

- A summons served to determine the identity of holders of numbered bank accounts. (That is, accounts which are identified by a number or code rather than by name.) IRC 7609(c)(2)(C). In general "numbered bank accounts" should no longer exist with legitimate U.S. financial institutions, so this exception is very limited in its present scope. *Charles v. United States,* 112 AFTR2d 6652 (W.D. Mich. 2013).
- A summons served in aid of the collection of an assessment made or judgment rendered against the person with respect to whose liability the summons is issued, or the liability at law or in equity of any transferee or fiduciary of that person. IRC 7609(c)(2)(D).
- A summons issued by a criminal investigator of the Service to a third party who is not a third-party recordkeeper. IRC 7609(c)(2)(E) .
- A "John Doe" summons (one that does not identify the person with respect to whose liability the summons is issued). IRC 7609(c)(3), see also IRC 7609(f).
- A summons issued under the provisions of IRC 7609(g) where a court determines there is reasonable cause to believe that giving notice may lead to attempts to conceal, destroy, or alter records relevant to the examination, to prevent the communication of information from other persons through intimidation, bribery, or collusion, or to flee to avoid prosecution, testifying, or production of records. IRC 7609(c)(3).

5.17.6.6.1 (09-26-2014)
Third-Party Recordkeepers

1. A summons to a third-party recordkeeper may be served by certified or registered mail to the last known address of such recordkeeper. IRC 7603(b). The summons may also be served in the traditional means of hand delivery per IRC 7603(a).
2. Third-party recordkeepers are defined in IRC 7603(b)(2) as:
   A. Any mutual savings bank, cooperative bank, domestic building and loan association, or other savings institutions chartered and supervised as a savings and loan or similar association under federal or state law, and any bank or credit union;
   B. Any consumer reporting agency;
   C. Any persons extending credit by credit cards or similar devices. See Treas. Reg. 301.7603-2(a)(3). In *United States v. New York Telephone,* 682 F.2d 313 (2d Cir. 1982), the court held where a telephone company extends credit cards and, additionally, extends credit by other means to both its credit card holders and non-credit card holders, the telephone company is a third-party recordkeeper with respect to all records relating to those credit transactions. These similar means were third-party billings (billing a call to your own phone) and arranging billing relating to those transactions;
   D. Any broker;
   E. Any attorney;
   F. Any accountant;
   G. Any barter exchange (as defined in IRC 6045(c)(3));
   H. Any regulated investment company;
   I. Any enrolled agent; and
   J. Pursuant to IRC 7603(b)(2)(J), any owner or developer of a computer software source code (as defined in section 7612(d)(2)), but only when the summons seeks the production of the source code or the program and data to which the source code relates.
3. The first nine categories of third-party recordkeepers (a through i above) are only considered to be third-party recordkeepers when they are summoned to produce records that they made or kept (or give testimony about such records) of another person's business transactions or affairs. Owners or developers of computer software source codes are third-party recordkeepers even though they may not make or keep records of another person’s business transactions or affairs.

5.17.6.6.2 (10-15-2010)
Notice and Waiting Period Requirements

1. In the case of all third-party summonses subject to IRC 7609(a), the following notice and waiting period requirements apply:
   A. Time - notice, along with a copy of the summons and an explanation of the noticee's right to bring a proceeding to quash, has to be given within three days of the date on which the summons was served, but no later than the 23rd day before the appearance date fixed in the summons as the date of production. IRC 7609(a)(1).
   B. Service of Notice - same manner as provided in IRC 7603 (relating to service of summons) or by certified or registered mail to the last known address of the noticee, or in the absence of a last known address, is left with the person summoned. IRC 7609(a)(2).
2. Noticee Defined - Any person (other than the summoned third party) who is identified in a summons served on a third-party witness for the production of records or testimony relating to the person so identified. The taxpayer identified in the caption of the summons is always a noticee, even though his or her name may not appear in the description of summoned records. A noticee under IRC 7609(a) has the right to be given notice of the summons, to intervene in a summons enforcement proceeding, and to bring a proceeding to quash the summons.
   A. In the case of bank records concerning a corporation solely owned by the taxpayer named in the summons, the corporation is a separate noticee from the taxpayer.
   B. A summons may involve the records of multiple noticees. Where there are multiple noticees who reside at the same address, separate notices are required to be sent to each individual at that address. In situations involving a husband and wife, each spouse is sent a separate notice.
   C. If the Service fails to give notice and receives the summoned information, it is possible for a court to suppress the summoned evidence. *United States v. Kersting,* 891 F.2d 1407 (9th Cir. 1989). See also *United States v. Powell,* 379 U.S. 48, 52-53 (requiring that in order to judicially enforce a summons, the Service must demonstrate that it followed all administrative steps regarding said summons imposed under the Internal Revenue Code).
3. IRC 7609(j) – This section provides that nothing in IRC 7609 shall be construed to limit the Service’s ability to obtain information, other than by summons, through formal or informal procedures authorized by IRC 7601 and 7602. This section indicates that the Service’s ability to seek informally the voluntary production of records, i.e., without a summons, constitutes a procedure authorized by the Code.
   A. The Service is permitted to seek financial records from financial institutions informally except in the Tenth Circuit because of its interpretation of a portion of the Right to Financial Privacy Act (RFPA), 12 USC 3413(c). However, the RFPA only applies to a financial institution’s records for customers who are individuals or are partnerships of five or fewer individuals, so financial records of customers who are corporations, partnerships with non-individual partners, or partnerships with six or more partners are not covered by the RFPA, 12 USC 3401(4) & (5), and may be sought informally within the Tenth Circuit.
   B. In general, the RFPA requires that covered account owners be given notice of (and an opportunity to challenge) a government agency’s intent to obtain records of their finances from a financial institution. However, the RFPA also provides a long-standing exception to these requirements as they apply to the Service. Section 3413(c) states: "Nothing in [the RFPA] prohibits the disclosure of financial records in accordance with procedures authorized by the [IRC]." See 12 USC 3413(c). A more recent exception to RFPA requirements also now exists for the IRS and other Government agencies which have disbursed payments (such as tax refunds) and then need to investigate or recover (through collection efforts) an improper Federal payment (such as an erroneous refund). See 12 USC 3413(k)(2).
   C. In *Neece v. Internal Revenue Service,* 922 F.2d 573 (10th Cir. 1990), the Tenth Circuit ruled that a bank’s voluntary disclosure of a customer’s financial records to the Service, without prior notice to the customer, violated the RFPA. The court reasoned that IRC 7609, not IRC 7602, contained the procedures for obtaining records concerning a taxpayer from a financial institution.

Note:

In all circuits other than the Tenth, the Service takes the position that an informal request for records is a procedure authorized under IRC § 7601. Within the Tenth Circuit, *Neece* should not constrain the Service from informally requesting financial records of customers who are not at all covered by the RFPA (e.g., corporations and some partnerships) or of any customers who received improper Federal payments from the Government (such as an erroneous tax refund).

4. Given the Tenth Circuit's holding in *Neece,* revenue officers should follow IRC 7609 procedures when seeking covered financial information from financial institutions governed by the Tenth Circuit's precedents. (The Tenth Circuit encompasses Kansas, Oklahoma, Wyoming, Utah, Colorado, and New Mexico). Covered information from financial institutions should not be sought by informal means, such as by producing credentials, letters of circularization, or by any other nonsummons method if any of the following conditions exist:
   - The financial institution branch from which the information is sought is located in the Tenth Circuit;
   - The information concerns taxpayers residing in the Tenth Circuit, regardless of the location of the financial institution, or
   - The requesting IRS office is located in the Tenth Circuit, regardless of the location of the financial institution or the residence of the taxpayer.

Note:

Revenue officers should not attempt to obtain financial information voluntarily from financial institutions if the above conditions exist. To do otherwise could result in damages awarded against the Service and the expenditure of valuable resources in defending such damage suits. Revenue officers should seek Area Counsel's advice if there is any doubt regarding whether *Neece* applies.

5.17.6.6.3 (09-26-2014)
Petition to Quash the Summons

1. A noticee who wishes to prevent compliance with the summons by the party summoned must begin a civil action in the appropriate U.S. district court to quash the summons no later than twenty days after the day notice of the summons is given. IRC 7609(b)(2).
2. The noticee must mail (by registered or certified mail) a copy of the petition to quash the summons to the summoned person and a copy to the IRS officer who issued the summons. This must be done within the twenty-day period, and is a jurisdictional prerequisite to the court hearing the complaint. *Yocum v. United States,* 586 F.Supp. 317 (N.D. Ind. 1984); *Franklin v. United States,* 581 F.Supp. 38 (E.D. Mich. 1984).
3. The summoned party has the right to intervene in this proceeding and is bound by the decision in the quash proceeding whether he intervenes or not.
4. If the noticee files a petition to quash the summons, then the Service cannot examine the records until the court issues an appropriate order. The Service may only examine the records prior to the issuance of a court order if the person bringing the petition consents to the examination.
5. The date set for appearance cannot be sooner than the 23rd day after notice is given (as a rule of thumb, the 26th day is used). IRC 7609(d).
6. IRC 7609(d)(1) prohibits premature examination of the records at issue, not physical acceptance. In *Conner v. United States,* 434 F.3d 676 (4th Cir. 2006), the taxpayer appealed the district court's finding with respect to *Powell's* fourth prong, asserting that by accepting the records from a third party prior to expiration of the twenty-three days in which he, the affected taxpayer, could seek to quash the third-party summonses, the revenue agent did not follow IRC 7609(d)(1) nor the IRM. The Fourth Circuit held the taxpayer's argument was without merit. Although the IRM directed the revenue agent not to physically accept records in response to a third-party summons prior to expiration of the twenty-three day period in which the affected taxpayer could seek to quash the summons, such violation, while relevant to the bad faith inquiry presented in this case, did not constitute proof by itself of the IRS's bad faith in issuing the challenged summonses.
7. If the Service receives records from a third party before the expiration of the twenty-third day after notice is given:
   - Immediately seal the records in an appropriate container;
   - Mark the container with the date and time sealed; and
   - Secure the records until (a) the 23-day period following the date of giving notice has expired and no noticee filed a petition to quash, or (b) any court proceeding (including appeals periods) brought to quash toe summons has concluded.
8. A petition to quash brought by the taxpayer suspends the period of limitations for assessment under IRC 6501. IRC 7609(e)(1) only tolls the statute of limitations for a taxpayer who petitions to quash the summons. If only one of the potentially responsible persons (regarding whose liabilities the Service issued separate summonses) files a petition to quash the summons, only that petitioner's assessment statute is suspended. The statute is suspended for the period in which the proceeding and any appeals are pending.
9. If a summoned party's response to a third-party exam summons (such as to determine TFRP liability) has not been resolved, the period of limitations for assessment under IRC 6501, with respect to the taxpayer whose liability the summons is issued, is suspended beginning on the date which is 6 months after the service of the third-party summons. IRC 7609(e)(2). The suspension ends upon final resolution of the summoned party's response. Final resolution occurs when (a) the summons or any order enforcing all or part of the summons is fully complied with and (b) all appeals or requests for further review are disposed of or the period in which appeal can be taken or further review can be requested has expired. Treas. Reg. 301.7609-5(e)(3).

5.17.6.6.4 (09-26-2014)
Duty of Third Party on Receipt of the Summons

1. The third party is required to assemble the records and prepare to produce them on the date specified in the summons, whether or not a petition to quash has been or will be filed. IRC 7609(i)(1).
2. The third party or his agent or employee who makes a disclosure pursuant to a court order or upon reliance of an IRS certificate, where no proceeding to quash the summons has been commenced, or the noticee has consented to the examination, will not be liable to any customer or other person for such disclosure. IRC 7609(i)(3).
3. Certificate - On the second page of the original summons is an unexecuted certification stating that the period for beginning a proceeding to quash a summons has expired and no such proceeding was begun within such period, or that the noticee consented to the examination. If the noticee consents to the examination or the period to quash has expired, the authorized Service officer may complete the certification on the second page of the summons. Upon request of the summoned third party, the issuing officer should furnish a photocopy of the certificate to the third party. IRC 7609(i)(2).

5.17.6.7 (09-26-2014)
The Collection Summons Exception of IRC 7609(c)(2)(D)

1. The procedural rules applicable to third-party recordkeeper summonses issued under IRC § 7609(a) do not apply to collection summonses that pertain to an assessed liability, transferee liability, or a liability reduced to judgment. IRC 7609(c)(2)(D); *Ginsburg v. United States,* 90 AFTR 2d 2002-6555 (D. Conn. 2002).
2. Third-party summonses issued as part of tax delinquency investigations for trust fund recovery penalties (i.e., pre-assessment investigations) or any other investigation where no liability has been assessed are not considered collection summonses under IRC 7609(c)(2). Accordingly, the Service must follow the notice and waiting period requirements of IRC 7609(a) for these summonses. A collection summons that pertains to an assessed liability cannot be combined with a summons to obtain information related to a Trust Fund Recovery Penalty investigation without giving notice under IRC 7609(a).
3. The Service must issue a summons for each person potentially liable for a Trust Fund Recovery Penalty. The Service should not issue a summons that lists the names of all potentially responsible persons for the Trust Fund Recovery Penalty in the heading of one summons and provide redacted notice copies to the noticees.

Example:

Two potentially responsible persons, an officer and an employee, have been identified for potential Trust Fund Recovery Penalty assessments. Two summonses would be issued. A summons concerning the liability of John Smith, President of Corporation X, Inc., would be issued for records and time periods that may be relevant to the liability of "John Smith, President of Corporation X." If the summons is directed to a third party, noticee copies (Parts C and D of the summons form) would be addressed and sent to John Smith at his last known address and noticee copies (Parts C and D) would be addressed and sent to Corporation X at the corporation's last known address. A separate summons concerning the liability of employee, Mary Smith, would be issued for records and time periods at issue that may be relevant to the liability of "Mary Smith, Employee of Corporation X, Inc." Again, if the summons is directed to a third party, noticee copies (Parts C and D of the summons form) would be addressed and sent to Mary Smith at her last known address and noticee copies (Parts C and D) would be addressed and sent to Corporation X at the corporation's last known address. (A Letter for Limiting a Response for Records for Multiple Potentially Responsible Persons as shown in Exhibit 25.5.6-2, *Sample Language for a Letter for Limiting a Response for Records for Multiple Potentially-Responsible Persons,* can be used to notify the bank or other summoned party that the information need only be produced once.)

4. Notification is not required for third-party summonses issued for taxpayer delinquency accounts (TDAs) or any other investigation where an assessed liability exists for each of the periods at issue and the summons is issued in aid of collection of those assessments.

5. Notice is required for third-party summonses for taxpayer delinquency investigations (TDI) where no liability has been assessed.

5.17.6.8 (09-26-2014)
Third-Party Contact Requirements of IRC 7602(c)

1. IRC 7602(c), Notice of Contact of Third Parties, requires that before Service employees initiate contact with third parties for the determination or collection of a taxpayer's tax liability, the taxpayer must be given reasonable notice in advance that third parties may be contacted. IRC 7602(c) also requires the Service to make a record of persons contacted and provide that record to the taxpayer upon the taxpayer's request.

2. Absent jeopardy circumstances, a revenue officer may not contact any third party without first providing reasonable notice to the taxpayer that contact with persons other than the taxpayer may be made. See IRM 25.27.1.3.2, *Exceptions to IRC 7602(c) Notification Requirements*. A third-party contact notice letter is one way to advise a taxpayer that contacts may be made by the Service with other persons.

   Note:

   In most cases, advance third-party contact notice is now accomplished by sending Pub. 1 to the taxpayer. See IRM 25.27.1.3.1, *TPC Notification Procedures*. However, for TFRP or transferee investigations initiated by a revenue officer, the potentially responsible person or transferee may not have been provided with an earlier advance notice that third-party contacts may be made by the Service. In this situation, send the appropriate third-party contact notice letter to the potentially responsible officer or transferee before making any third-party contacts. See IRM 5.7.4.2.2, *Third-Party Interviews and Third-Party Contact Considerations,* and 25.27.1, *Third Party Contact Program*

   .

3. Refer to IRM 25.27.1, *Third-Party Contact Program*, for detailed guidance on third-party contacts.

   Note:

   Service of a summons is contact with a third party. Under Treas. Reg. 301.7602-2(e)(4), Example 4, service of a copy of the summons to the taxpayer satisfies the post-contact recording and reporting requirements of IRC 7602(c) for this contact. The taxpayer should have been provided, however, with the advance general notice prior to the issuance of the summons. Before serving the summons, the Service should verify that the advance general notice has been provided to the taxpayer. Additionally, after making the contact when notice of the summons was not provided to the taxpayer (e.g. for a collection purpose summons), the Service must record the contact on Form 12175, *Third Party Contact Report Form,* and forward the form to the IRC 7602(c) Third-Party Contact Coordinator. Summonses generated through the Integrated Collection System (ICS) case will automatically record the third-party contact and completion of a Form 12175 will not be required.

5.17.6.9 (10-15-2010)
Unnecessary Examinations and Barred Years

1. IRC 7605(b) prohibits unnecessary examinations or investigations of a taxpayer and limits the Service to one inspection of a taxpayer's books of account for each taxable year unless the taxpayer requests otherwise or unless the Secretary or his delegate after investigation, determines that further inspection is necessary and notifies the taxpayer in writing of this determination.

2. An examination of the taxpayer's books for the purpose of collecting the tax after an examination to determine the liability is considered to be an original examination not subject to the restrictions of IRC 7605(b).

5.17.6.10 (09-26-2014)
Fair Credit Reporting Act

1. Banks and other financial institutions have sometimes argued that producing records of a taxpayer's financial transactions pursuant to a summons would violate the Fair Credit Reporting Act (FCRA), 15 USC 1681 et seq. (1970). To protect consumers' interests, the FCRA restricts the circumstances under which a "consumer reporting agency" may furnish a "consumer report" to third parties, including the Service.

2. A "consumer reporting agency" is defined as ". . . any person which for monetary fees or on a cooperative nonprofit basis, regularly engages in whole or in part in the practice of assembling or evaluating consumer credit information or other information on consumers for the purpose of furnishing consumer reports to third parties, and which uses any means or facility of interstate commerce for the purpose of preparing or furnishing consumer reports." 15 USC 1681a. A bank may be considered a "consumer reporting agency" if it meets the above definition.

3. The FCRA specifically excludes from its definition of a "consumer report" any report containing information solely as to transactions or experiences between the consumer and the person making the report. 15 USC 1681a. Thus, information relating only to the bank and its customer (which is generally what the Service seeks) is not covered by the Act, and the bank can produce this summoned information without violating the FCRA. *United States v. Lake County National Bank,* 35 AFTR2d 75-1428 (N.D. Ohio 1975); *United States v. Bremicker,* 365 F. Supp. 701 (D. Minn. 1973).

4. Where the Service has an assessment lien against the taxpayer, has reduced a taxpayer's liability to judgement, or has entered into an offer in compromise or settlement agreement with the taxpayer, the Service can obtain a full credit report pursuant to 31 USC 3711(h)(2) without issuing a summons.

5. Some cases handled by revenue officers begin as tax delinquency investigations, i.e., the investigation begins before there is an assessed tax liability, usually because the taxpayer failed to file a tax return. In these cases, the Service must issue a summons to obtain a credit report; the Service cannot lawfully request a credit report informally. See 31 USC 3711(h) and the FCRA 15 USC 1681b. The Service can receive a full credit report by obtaining the consumer's written permission or by issuing a summons. A summons satisfies the permissible circumstance requirement of 15 USC 1681b(a)(1), which provides that a consumer reporting agency may furnish a full credit report "in response to the order of a court having jurisdiction to issue such an order ...." The Service takes the position that a third-party recordkeeper summons satisfies the court order requirement in 15 USC 1681b(a)(1) because IRC 7603(b)(2)(B) specifically contemplates the IRS issuing a third-party summons to a consumer reporting agency under the FCRA.IRC 7609(i) protects a third party that responds to a summons if the person entitled to notice of the summons does not file a timely motion to quash with the district court. Title 15 1681b(a)(1) does not require the Service to be a creditor of the taxpayer before acquiring a full credit report by summons.

6. Any questions concerning the scope of the Fair Credit Reporting Act or its application to specific situations should be referred to Area Counsel. See also IRM 5.1.18.18, *Consumer Credit Reports,* for additional information on obtaining credit reports.

5.17.6.11 (12-11-2007)
Constitutional Defenses

1. The First Amendment to the Constitution guarantees the right of free expression; this includes the right to assemble freely; freedom of the press; freedom of religion; and freedom of speech.

2. The Fourth Amendment protects against unreasonable searches and seizures. Unlike the Fifth Amendment, discussed below, corporations and other organizations are entitled to the protection afforded by the Fourth Amendment.

3. The Fifth Amendment affords a person a privilege against self-incrimination. It applies to both documentary requests and requests for oral testimony. There are different analyses for each type of request.

4. Area Counsel should be contacted in any case in which the taxpayer raises a constitutional defense to summons enforcement, or for any questions concerning the application of a constitutional argument to a specific situation.

5.17.6.12 (12-11-2007)
Notification to Witness of Constitutional Rights

1. The type of information sought by a revenue officer through the issuance of a summons generally does not tend to develop criminal potential of a case. Therefore, it is not mandatory that the person summoned be informed of his constitutional privilege against self-incrimination. In any case in which the revenue officer believes the criminal potential is so manifest that a warning may be appropriate, Area Counsel should be contacted.

5.17.6.13 (12-11-2007)
Privileges Based on Confidential Relationships

1. Certain confidential relationships between a taxpayer and a witness or another person may give rise to a claim of a privilege from testifying or providing information pursuant to a summons. In the context of IRS summonses, the determination of whether a particular matter is privileged is governed by federal law. Questions concerning the validity of a privilege or its applicability to a particular situation should be referred to Area Counsel.

2. A person cannot successfully refuse to testify or provide information solely on the basis that she stands in a confidential relationship with another person. The burden is on the witness first to establish the facts on which the asserted privilege is based and then to demonstrate how, and the extent to which, the requested information is covered by the privilege. *United States v. Kovel,* 296 F.2d 918 (2d Cir. 1961).

3. A person may forfeit a privilege either by expressly waiving it or failing to assert it. Fed.R.Civ.P. 12(b); see *Hunt v Blackburn,* 128 U.S. 464 (1888); *Cotton v. United States,* 306 F.2d 633, 637 (2d Cir. 1962), citing *United States v. United Shoe Mach. Corp.,* 89 F.Supp. 357, 358-59 (D. Mass. 1950).

5.17.6.14 (10-15-2010)
Attorney-Client Privilege

1. In general, communications from a taxpayer to an attorney made in confidence for the purpose of obtaining legal advice are privileged, and the attorney cannot be compelled to disclose that information to the Service. 8 Wigmore, Evidence 2291 (McNaughton rev. 1961); *United States v. United Shoe Mach. Corp.,* 89 F.Supp. 357, 358-59 (D. Mass.1950). Also, if the taxpayer creates records to facilitate the exchange of privileged communications with the attorney, those records are privileged. *United States v. Davis,* 636 F.2d 1028, 1041 (5th Cir. 1981); *United States v. Bartlett,* 449 F.2d 700, 703 (8th Cir. 1971). However, if a taxpayer turns over pre-existing records to an attorney, the Service can obtain those records by summons, unless the records were otherwise privileged from production while in the taxpayer's possession. Id.

2. As the foregoing information suggests, the attorney-client privilege is not all-inclusive and does not protect everything an attorney may do for a client. The privilege is confined to communications made in confidence by the client for the purpose of obtaining legal advice from an attorney. *United States v. Rockwell International,* 897 F.2d 1255 (3d Cir. 1990). The client in a corporate setting may be any officer or employee of the corporation. *Upjohn v. United States,* 449 U.S. 383 (1981). Also, underlying factual information can be obtained from the employees whether or not this same information has been communicated to the corporation's attorney. Books and records of a taxpayer are not privileged merely because they are in the hands of his attorney. If the records were compellable from the taxpayer, the taxpayer cannot cloak them with the privilege by transferring them to an attorney. *Fisher v. United States,* 425 U.S. 391 (1976).

3. Ministerial or clerical services are not within the attorney-client privilege. Records of financial transactions involving monies paid by or on behalf of a client to an attorney are not covered by the privilege. When an attorney acts as the client's business advisor, or agent for the receipt or disbursement of money or property to or from third parties, the attorney is not acting in a legal capacity and records of such transactions are not privileged. *United States v. Davis,* 636 F.2d 1028 (5th Cir.), cert. denied, 454 U.S. 862 (1981). The identity of a client or the fact that a given individual has become a client are matters which are not usually within the privilege in the absence of special circumstances. *United States v. BDO Seidman,* 337 F.3d 802 (7th Cir. 2003); *United States v. Sidley Austin Brown & Wood LLP,* 2004-2 USTC 50,289 (N.D. Ill. 2004).

4. The preparation of a tax return is primarily an accounting service. When an attorney prepares his or her client's tax returns, the workpapers produced by the attorney while preparing the returns and the tax records on which they are based are not shielded by the attorney-client privilege. *United States v. Under Seal,* 748 F.2d 871, 877 (4th Cir. 1984); *United States v. Lawless*, 709 F.2d 485, 487 (7th Cir. 1983) ("When information is transmitted to an attorney with the intent that the information will be transmitted to a third party (in this case on a tax return), such information is not confidential."); *United States v. Frederick,* 182 F.3d 496 (7th Cir. 1999); *United States v. Pipkins,* 528 F.2d 559, 563 (5th Cir. 1976) ("Courts have refused to apply the privilege to information that the client intends his attorney to impart to others."). The same is true of the communications between the client and the attorney about the return being prepared. Id.

5.17.6.15 (10-15-2010)
Attorney Work-Product Doctrine

1. The work-product doctrine protects documents prepared by an attorney acting for his client in anticipation of or for use in litigation. *Hickman v. Taylor,* 329 U.S. 495 (1947); *United States v. Textron, Inc.*,, 577 F.3d 21 (1st Cir. 2009); *United States v. Davis,* 636 F.2d 1028 (5th Cir. 1981); *Hodges, Grant & Kaufmann v. United States*, 768 F.2d 719 (5th Cir. 1985); Fed.R.Civ.P. 26(b)(3) (protecting against disclosure of the mental impressions, conclusions, opinions or legal theories of an attorney or other representative of a party concerning the litigation).

2. This doctrine applies to IRS summonses. *Upjohn Co. v. United States*, 449 U.S. 383 (1981); *Borstein v. United States*, 977 F.2d 112 (4th Cir 1992).

3. The obligation imposed by a tax summons remains subject to traditional privileges and limitations, *United States v. Euge,* 444 U.S. 707 (1980), and nothing in the language or legislative history of the IRS summons provisions suggests an intent on the part of Congress to preclude application of the doctrine to tangible things constituting attorney work product, absent a showing by the IRS of substantial need and inability to obtain the equivalent without undue hardship.

4. In *United States v. Adlman*, 134 F.3d 1194 (2d Cir. 1998), the Second Circuit held that the work product protection should be granted if the document could fairly be said to have been prepared "because of" the prospect of litigation. In order to determine whether a document was prepared because of anticipated litigation, a court should look to the purpose or function for which a document was prepared, rather than to the content of the document. *United States v. Textron, Inc.,* 577 F.3d 21 (1st Cir. 2009); *United States v. Roxworthy*, 457 F.3d 590 (6th Cir. 2006).

5.17.6.16 (10-15-2010)
Federally Authorized Tax Practitioner-Taxpayer Privilege

1. Prior to the IRS Restructuring and Reform Act of 1998 ("RRA 1998"), the accountant-client privilege was only provided by law in some states; it was not recognized in Federal law. *Couch v. United States,* 409 U.S. 322 (1973); *United States v. Arthur Young,* 465 U.S. 805 (1984). With the enactment of IRC 7525 by RRA 1998, the attorney-client privilege was extended to include communications between a taxpayer and a tax practitioner, including accountants, to the extent that such communications would be considered privileged communications if they were between a taxpayer and an attorney.

   A. IRC 7525 extends the application of the attorney-client privilege to communications between a taxpayer and any "federally authorized tax practitioner" with respect to "tax advice" to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney. The law merely extends the application of the attorney-client privilege to other individuals, it does not modify the attorney-client privilege of confidentiality. Thus, as with the attorney-client privilege, information disclosed to an authorized practitioner acting beyond the capacity of providing confidential federal tax law advice will not be privileged. *United States v. KPMG, LLP,* 316 F.Supp.2d 30 (D.D.C. 2004).

B. The American Jobs Creation Act of 2004 amended IRC 7525(b) by providing that the tax practitioner privilege does not apply to written communications in connection with the promotion of the direct or indirect participation of any person in any tax shelter. Prior to this amendment, the exception to the privilege was limited to written communications of this type regarding **corporate** tax shelters. The Government has the burden to prove preliminary facts in support of the IRC 7525(b) exception to the privilege. *United States v. BDO Seidman, LLP*, 492 F.3d 806 (7th Cir. 2007). "Promotion" of a taxpayer's participation in a tax shelter means simply "furtherance" or "encouragement" , and is not limited to the marketing of a pre-packaged, one-size-fits-all tax shelter product. *Valero Energy Corp. v. United States,* 569 F.3d 626 (7th Cir. 2009). However, there is no necessary "written communication" when a participant in an oral conversation merely prepares personal notes of the conversation. *Countryside Limited Partnership v. Commissioner,* 132 T.C. 347 (2009).

C. The privilege may be waived by any disclosure of the privileged information to a third party not sharing a common legal interest with the client or not necessary to the tax practitioner-client consultation.

D. "Federally authorized tax practitioner" means any individual who is authorized under federal law to practice before the IRS. See Circular 230. The term includes attorneys, certified public accountants, enrolled agents and enrolled actuaries. The term "tax advice" means advice given by an individual with respect to matters within the scope of that individual's authority to practice before the Service. IRC 7525(a)(3).

E. The privilege may only be asserted in:
(1) any noncriminal tax matter before IRS (IRC 7525(a)(2)(A)), and
(2) any noncriminal tax proceeding in federal court brought by or against the United States. (IRC 7525(a)(2)(B)).

F. The privilege may not be asserted to prevent the disclosure of information to any regulatory body other than the IRS, such as the Securities and Exchange Commission (SEC), including in an administrative or a court proceeding.

5.17.6.17 (12-11-2007)
Physician-Patient Privilege

1. In general, there is no federally recognized privilege as to communications between a taxpayer and a physician. *United States v. Moore*, 970 F.2d 48, 50 (5th Cir. 1992).

2. The Health Insurance Portability and Accountability Act, (Pub. L. 104-191, enacted August 21, 1996), now provides privacy rights for individuals whose health care records are maintained by "covered entities." When seeking documents from health care providers, consult with Area Counsel.

   Note:

   In *Jaffee v. Redmond,* 518 U.S. 1 (1996), the Supreme Court ruled that communications between a psychotherapist and a patient are protected from compelled disclosure under Rule 501 of the Federal Rules of Evidence. This privilege includes communications made by patients to psychiatrists, psychologists, and licensed social workers.

5.17.6.18 (09-26-2014)
Non-IRC Limitations on IRS Summons Authority

1. The authority of the Service to issue and enforce summonses is governed by IRC 7602 et seq., which gives the Service broad powers to summon any information that may be relevant to the investigation of a person's tax liability. The Service's summons powers should not be limited except by clearly expressed Congressional intent or clearly recognized privileges and immunities. In *United States v. Arthur Young & Co*., 465 U.S. 805, 816 (1984), citing, *United States v. Bisceglia,* 420 U.S. 141 (1975), the Supreme Court stated that except for traditional privileges and limitations, "other restrictions upon the [Service's] summons power should be avoided absent unambiguous directions from Congress."

2. Although courts have been reluctant to circumscribe the Service's summons power as granted to it by Congress, privacy rights have developed in the form of a patchwork of industry and sector-specific statutes that can be found in statutes other than the Code. When Congress has intended to exclude the Service from general restrictions placed on government investigatory powers contained in statutes other than the Code, it has done so explicitly. For example, Congress provided an exception for the Service from the strictures contained in the Right to Financial Privacy Act, 12 USC 3401 et seq., so long as the Service followed Code procedures. See 12 USC 3413; *Neece v. United States,* 922 F.2d 573 (10th Cir. 1990).

3. Certain federal privacy statutes were designed to protect the right to privacy from private and government sector infringement by imposing limitations on the Service's summons authority. These limitations must be complied with before a party may disclose information to the Service pursuant to a summons. Examples of these statutes include the following:

   - The Health Insurance Portability and Accountability Act, (Pub. L. 104-191, enacted August 21, 1996);
   - The Family Educational Rights and Privacy Act, 20 USC 1232g (FERPA);
   - The Employee Polygraph Protection Act, 29 USC 2001–2009 (EPPA);
   - The Cable Communications Policy Act, 47 USC 551 et seq. (CCPA);
   - The Video Privacy Protection Act, 18 USC 2710 (VPPA);
   - The Communications Assistance for Law Enforcement Act, Pub. L. 103-414, Oct. 25, 1994 (CALEA);
   - The Stored Communications Act (SCA), 18 USC 2701-2712, enacted as Title II of the Electronic Communications Privacy Act of 1986 (ECPA), 18 USC 2510 et seq.; and
   - Part D of the Social Security Act, 42 USC 651-669.

4. With respect to the SCA, the Service has adopted a policy that it will obtain a search warrant (not use a summons) in all cases when it seeks from an internet service provider (ISP) the content of email communications stored by the ISP. Accordingly, the Service will not seek the content of email communications from an ISP in any civil administrative proceeding. See Policy Statement 4-120 (May 3, 2013).

5. When these statutes or others emerge in your cases, contact Area Counsel for advice as to their impact.

5.17.6.19 (10-15-2010)
Rights Claimed by Summoned Persons

1. A witness appearing in response to an administrative summons will frequently claim other rights. Two frequently encountered are the rights to be represented by counsel and to make an audio recording of the summoned interview.

5.17.6.19.1 (12-11-2007)
Right to Counsel

1. A witness appearing in response to a summons is clearly entitled to be represented by counsel of his or her choice. 5 USC 555(b).

2. Whether the witness may be entitled to *any* counsel of her choice has been the subject of some controversy. If a taxpayer's counsel appears to represent persons with conflicting interests, such as representing both the taxpayer and a summoned third-party witness, consult the Summons Handbook at IRM 25.5.5.5, *Dual Representation*, and Area Counsel.

5.17.6.19.2 (09-26-2014)
Right to Make Audio Recording of the Proceeding

1. Taxpayers or their representatives may ask to make audio-tape recordings of the proceedings as long as 10 calendar days advance notice of intent to record is provided to the Service. If the taxpayer asks to record the interview, the Service employee must also record the meeting.
2. Cameras or videotape equipment are not permitted. At no time should employees try to physically confiscate this equipment. Revenue officers should follow the requirements of IRC 7521 and the procedures set forth in IRM 5.1.12.4.4,*Audio Recording Procedures,* concerning audio-taped interviews.

5.17.6.20 (12-11-2007)
Witness Fees

1. IRC 7610(a)(1) provides that persons who are summoned are entitled to receive witness fees and travel expenses. Such persons may be taxpayers or third parties, and they may obtain payment upon request. It should be noted that the conditions under which a summoned person may obtain payment for witness fees and travel expenses are separate and distinct from those under which payment for other costs associated with summons compliance may be authorized.
2. IRC 7610(a)(2) provides that the Service will pay certain third parties for the direct costs incurred in locating, reproducing or transporting records in compliance with a summons.
3. The costs for which such third parties may claim payment are in addition to, and not a substitute for, witness fees and travel expenses.
4. Refer to Treas. Reg. 301.7610-1(c)(2) for specific payment rates for search, reproduction, and transportation costs.

5.17.6.21 (12-11-2007)
Injunctive Relief

1. In general, neither the witness, nor a third party, including the taxpayer, is entitled to declaratory or injunctive relief through a suit brought to quash a summons. Such persons have an adequate remedy at law by a challenge to the summons before the examining agent and before the district court at the summons enforcement proceeding. *Reisman v. Caplin,* 375 U.S. 440 (1964).

5.17.6.22 (12-11-2007)
Criminal Proceedings

1. IRC 7210 makes it a crime for a person to refuse or fail to testify or appear when summoned. That section provides for a fine of not more than a thousand dollars or imprisonment for not more than one year, or both, together with costs of prosecution, upon conviction.
2. The possibility of criminal prosecution under this section is, of course, a powerful tool at the disposal of the Service to compel compliance with the administrative summons. However, a conviction under IRC § 7210 does not accomplish the primary purpose of the summons, namely, obtaining the needed information, because any proceedings to enforce the summons would be held in abeyance pending the outcome of the criminal proceedings.
3. Criminal proceedings may be effective when, for example, the person summoned falsely claims the documents have been destroyed.

5.17.6.23 (12-11-2007)
Civil Enforcement

1. The judicial device for enforcing the administrative summons is provided by IRC 7402(b) and 7604. These sections provide a means of requiring the person summoned to comply.
2. IRC 7604(a) and 7402(b) provide that jurisdiction to compel summons compliance is in the United States District Court for the district in which the summoned person resides or is found. The effect of a proceeding under IRC 7604 is to obtain the assistance of the court in forcing the summoned person to give the desired information to the Service by having the court issue an order to that effect. Disobedience of such an order would be a civil contempt punishable by the court.
3. Disobeying a court’s summons enforcement order can be addressed by both civil and criminal contempt proceedings.
   - Civil contempt is designed to coerce compliance.
   - Criminal contempt is designed to punish disobedience.

5.17.6.24 (09-26-2014)
Summonses Issued to Debtors in Bankruptcy

1. The automatic stay provisions of 11 USC 362(a)(6) prohibit "any act to collect, assess or recover a claim against the debtor that arose before the commencement of the case under this title."
2. The Office of Chief Counsel has determined that service of a collection summons is an "act to collect" and should not be issued while the automatic stay is in effect. IRM 5.17.8.10(2), *Automatic Stay - 11 USC 362*.
3. Summonses issued as part of Delinquent Return Investigation (DEL RET), or any other investigation where the liability at issue has not been assessed or determined through a court judgment, are not considered collection summonses. Accordingly, these summonses would not violate the automatic stay provision of 11 USC 362(a).
4. The automatic stay provisions of 11 USC 362(a) do not bar the issuance of exam purpose summonses.

5.17.6.25 (09-26-2014)
Indian Tribal Government

1. Indian Tribal Governments shall be treated as states for certain purposes per IRC 7871. Therefore, a unique relationship exists between Indian tribal governments and the United States government. This relationship requires a heightened level of sensitivity with respect to compliance efforts.
2. Do not serve a summons on a tribal government or a third party for information concerning a tribal government without coordinating with the Service's Indian Tribal Government (ITG) office in TE/GE. This coordination includes any summons issued by the Service, including those summonses issued to investigate the Trust Fund Recovery Penalty (TFRP) of a tribal entity. A summons initiated by Criminal Investigation is excepted from this requirement. See IRM 25.5.6.6.7.2, *Indian Tribal Government,* for additional information.

Part 5. Collecting Process

Chapter 17. Legal Reference Guide for Revenue Officers

Section 7. Liability of Third Parties for Unpaid Employment Taxes

5.17.7 Liability of Third Parties for Unpaid Employment Taxes

Manual Transmittal

July 18, 2012

Purpose

(1) This transmits revised IRM 5.17.7, Legal Reference Guide for Revenue Officers, Liability of Third Parties for Unpaid Employment Taxes.

Background

This section provides legal guidance on the use of the Trust Fund Recovery Penalty as defined under IRC § 6672. The liability of third parties paying or providing for wages under IRC § 3505 is also addressed.

Material Changes

(1) IRM 5.17.7.1.1 - incorporated additional potentially responsible parties from SB-SE-05-0711-044, Interim Guidance for Conducting Trust Fund Recovery Penalty Investigations in Cases Involving a Third-Party Payer.

(2) Minor editorial changes were made throughout the text.

Effect on Other Documents

This supersedes IRM 5.17.7 dated August 1, 2010. This IRM incorporates Interim Guidance Memorandum SB-SE-05-0711-044, Interim Guidance for Conducting Trust Fund Recovery Penalty Investigations in Cases Involving a Third-Party Payer, 7/1/2011.

Audience

Small Business/Self-Employed Collection Employees

Effective Date

(07-18-2012)

Scott Reisher
Director, Collection Policy
Small Business/Self-Employed

5.17.7.1 (08-01-2010)
Trust Fund Recovery Penalty: Overview

1. IRC § 7501 provides that whenever any person is required to collect or withhold any internal revenue taxes from any other person and to pay over such tax to the United States, the amount of the tax shall be held in a special trust fund for the United States. Trust fund taxes include employment taxes and certain types of excise taxes.
2. The Trust Fund Recovery Penalty (TFRP) is based on IRC § 6672(a), which provides as follows:

   > "Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax on the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 or part II of subchapter A of chapter 68 for any offense to which this section is applicable."

3. The TFRP serves three purposes:
   - It encourages prompt payment of income and employment taxes withheld from employees and other collected taxes;
   - It makes the responsible person liable for 100% of the unpaid trust fund taxes; and
   - It facilitates collection of trust fund taxes from secondary sources.
4. A person is liable for the TFRP if two statutory requirements are met:
   - The person is "responsible" — had the duty to account for, collect, and pay over the trust fund taxes to the government; and
   - The person "willfully" failed to collect or pay over trust fund taxes to the government.
5. The Service may collect trust fund taxes only once, whether from the business, from one or more of its responsible persons, or from the business and one or more responsible persons.

6. Refer to Policy Statement 5-14 (formerly P–5–60), at IRM 1.2.14.1.3, and IRM 5.7, Trust Fund Compliance Handbook.

5.17.7.1.1 (07-18-2012) Persons Subject to the Trust Fund Recovery Penalty

1. The term "person" in Section 6672 includes, but is not limited to, the following:
   - Officer or employee of a corporation;
   - Partner or employee of a partnership;
   - Member or employee of an LLC;
   - Corporate director or shareholder;
   - Another corporation; and
   - Surety or lender.
   - Payroll Service Provider (PSP)
   - Responsible parties within a PSP
   - Professional Employer Organization (PEO)
   - Responsible parties within a PEO
   - Responsible parties within the common law employer (client of PSP/PEO)

   Note:

   The TFRP is not needed to assert liability against the owner of a sole proprietorship because the individual owner is personally liable for employment taxes under IRC §§ 3101, 3402, and 3403. However, the TFRP may be needed to assert liability against an employee or other non-owner who exercises control over the finances.
2. Regardless of a person's corporate title, a person will not be held liable for the TFRP unless he or she has the duty to account for, collect, and pay over the trust fund taxes to the government. Even an officer of the business will not be a responsible person if he or she is an officer in title only and has no substantive duties with the business. O'Connor v. United States, 956 F.2d 48 (4th Cir. 1992). On the other hand, a person who has no corporate title but has control of financial affairs or controls payment of funds by the business, may be held responsible for the TFRP.
3. A determination of liability must take into account all facts and circumstances.

5.17.7.1.1.1 (11-02-2007) Corporate Officers

1. Most TFRP cases involve corporate officers.

5.17.7.1.1.2 (08-01-2010) Corporate Directors

1. A director who is not an officer or employee of the corporation may be responsible for the TFRP if he or she was responsible for the corporation's failure to pay taxes that were due and owing. Commonwealth Nat'l Bank of Dallas v. United States, 665 F.2d 743 (5th Cir. 1982).

5.17.7.1.1.3 (08-01-2010) Partners/Members

1. In accordance with IRC § 6671(b), a member of a partnership, Limited Liability Company (LLC), or Limited Liability Partnership (LLP) may be liable for the TFRP.
2. As a general rule, general partners are individually liable under state law for the debts of a partnership; therefore, assessments are made in the name of the partnership and the names of the general partners. Accordingly, there is usually no reason to make a separate TFRP assessment against the various partners. United States v. Galletti, 541 U.S. 114 (2004). In a limited liability partnership, however, general partners may not be individually liable for the debts of the partnership, depending on the jurisdiction. If you determine that the general partners are not individually liable for the debts of the partnership under state law, then a TFRP assessment against one or more partners may be appropriate. Contact Advisory or Area Counsel with any questions.

5.17.7.1.1.4 (08-01-2010) Employees

1. An employee may be liable for the TFRP if he or she made the decision not to pay the taxes due. Gephart v. United States, 818 F.2d 469 (6th Cir. 1987).
2. Employees are generally under the dominion and control of an employer; however, instructions from a supervisor not to pay taxes do not relieve an employee who is an otherwise "responsible person" from IRC § 6672 liability. Brounstein v. United States, 979 F.2d 952 (3d Cir. 1992).
3. Allegations that an employee is a responsible person should be thoroughly investigated.

5.17.7.1.1.5 (08-01-2010) Professional Employer Organizations (PEOs)

1. Professional Employer Organizations (PEOs), sometimes also referred to as employee leasing companies, and their owners, officers, and/or employees may be responsible persons with respect to client organizations in certain limited circumstances. If you have a case in which you believe that a PEO or an owner, officer, and/or employee of a PEO may be a responsible person, contact Area Counsel.

5.17.7.1.2 (08-01-2010) Responsibility

1. A responsible person may be held liable for the TFRP if such person willfully fails to perform any one of the three duties listed in the statute: collecting, truthfully accounting for, and paying over the taxes. Slodov v. United States, 436 U.S. 238 (1978).
2. The statute does not impose upon the responsible person an absolute duty to pay over amounts that should have been collected and withheld by prior responsible persons. Slodov v. United States, 436 U.S. 238 (1978).
   A. A person who becomes a "responsible person" when the business does not have the funds to pay an employment tax liability that arose under previous management and who uses funds acquired after he became a "responsible person" to pay the operating expenses of the business rather than to pay the prior withholding tax delinquency is not personally liable for the delinquency under Section 6672. Slodov, Id. at 254.

B. If funds are available to pay delinquent trust fund taxes at the time a responsible person assumes control of the business and the responsible person fails to use those funds to pay the delinquent taxes, that person will be liable for the delinquent taxes to the extent of the funds available to pay the trust fund taxes. Id. at 255.

3. One or more persons may be responsible persons within the meaning of IRC § 6672 for the same quarter. Thomas v. United States , 41 F.3d 1109 (7th Cir. 1994).

Note:

If the determination is made that more than one person is liable under IRC § 6672, the revenue officer may recommend that individual assessments of the penalty be made against each person.

4. A determination of "responsibility" depends upon the facts and circumstances of each case. Common factors considered by the court include the following:

- Identification of the person as an officer, director, or principal shareholder of the corporation, a partner in a partnership, or a member of an LLC;
- Duties of the officer as set forth in the by-laws;
- Authority to sign checks;
- Identification of the person as the one in control of the financial affairs of the business;
- Identification of the person as the one who had authority to determine which creditors would be paid and those who exercised that authority;
- Identification of the person as the one who controlled payroll disbursements;
- Identification of the person as the one who had control of the voting stock of the corporation; and
- Identification of the person as the one who signed the employment tax returns.
  See Cook v. United States , 52 Fed. Cl. 62, 89 AFTR2d 2002-1541, 2002-1 USTC ¶ 50,328 (Fed. Cl. 2002); Datloff v. United States, 252 F. Supp. 11, aff'd, 370 F.2d 655 (3d Cir. 1966).

5. The crucial test is whether the person has the "effective power to pay the taxes owed." Purcell v. United States , 1 F.3d 932, 937 (9th Cir. 1993). A person is deemed to have such power if he or she possesses the authority to exercise significant control over the company's financial affairs whether or not such control is in fact exercised. Purcell at 937. Significant control generally relates to the person's status, duty, and authority in the business that failed to carry out one of the three statutory duties. Davis v. United States, 961 F.2d 867 (9th Cir. 1992).

6. Those performing ministerial duties without exercising independent judgment will not be deemed responsible. See Policy Statement 5-14 (formerly P-5-60), at IRM 1.2.14.1.3.

7. An unpaid, voluntary board member of a tax-exempt organization will not be considered a responsible person if the board member is solely serving in an honorary capacity, does not participate in the day-to-day or financial operations of the business, and does not have actual knowledge of the failure on which the penalty is based. IRC § 6672(e). This exception, however, does not apply if it results in no person being liable for the TFRP. Also, a voluntary board member of a tax-exempt organization who is intimately involved in the financial decisions of the company may be a responsible person. See Jefferson v. United States, 459 F.Supp.2d 685 (N.D. Ill. 2006) (twenty year voluntary board president of a non-profit organization who was unpaid but did not serve solely in an honorary capacity, who had check signing authority and control of financial affairs, and who was aware that trust fund taxes had not been paid, was a responsible officer who willfully failed to pay the tax).

5.17.7.1.3 (08-01-2010)
Willfulness

1. Under IRC § 6672(a), the failure to collect or pay over trust fund taxes must be willful.

2. Definition of willful — intentional, deliberate, voluntary, reckless, knowing (not accidental). No evil intent or bad motive is required. Domanus v. United States, 961 F.2d 1323 (7th Cir. 1992).

3. To show "willfulness," the government must show that the responsible party was aware of the outstanding taxes and either deliberately chose not to pay the taxes or recklessly disregarded an obvious risk that the taxes would not be paid. Phillips v. United States, 73 F.3d 939, 942 (9th Cir. 1996).

4. A responsible person's failure to investigate or correct mismanagement after being notified that withholding taxes have not been paid satisfies the IRC § 6672 "willfulness" requirement. Finley v. United States, 123 F.3d 1342 (10th Cir. 1997).

5. The payment of net wages (wages minus trust fund taxes) to employees when funds are not available to pay withholding taxes is a willful failure to collect and pay over under IRC § 6672. If funds are not available to cover both wages and withholding taxes, a responsible person has a duty to prorate the available funds between the United States and the employees so that the taxes are fully paid on the amount of wages paid. For purposes of determining willfulness, an employee owed wages is merely another creditor of the business, and preferences to employees over the government constitute willfulness. Hochstein v. United States, 900 F.2d 543, 548 (2d Cir. 1990).

6. The circuits that have decided the issue have split on whether "reasonable cause" negates a responsible person's willfulness and is a defense to TFRP liability.

   A. The Eighth and First Circuits have determined that reasonable cause is not a defense. Olsen v. United States, 952 F.2d 236 (8th Cir. 1991); Harrington v. United States, 504 F.2d 1306 (1st Cir. 1974).

   B. The Ninth Circuit has not stated specifically that the reasonable cause defense does not apply; however, it has determined that "conduct motivated by a reasonable cause may, nonetheless, be willful." Phillips v. United States, 73 F.3d 939, 942 (9th Cir. 1996).

   C. The Tenth, Eleventh, Second, and Fifth Circuits have determined that the reasonable cause defense applies, at least conceptually, to willfulness determinations under Section 6672. Even these circuits, however, apply the defense narrowly. Smith v. United States, 555 F.3d 1158, 1170 (10th Cir. 2009) (reasonable cause defense must be narrowly construed with respect to Section 6672); Thosteson v. United States, 331 F.3d 1294, 1301 (11th Cir. 2003) (court does not decide whether reasonable cause applies, but notes that this defense is exceedingly limited); United States v. Winter, 196 F.3d 339, 345 (2d Cir. 1999) (reasonable cause defense negated willfulness only if the responsible person reasonably believed that taxes were being paid); Logal v. United States, 195 F.3d 229, 233 (5th Cir. 1999) (reasonable cause defense is exceedingly limited.).

7. A mistaken belief that payments to other creditors were required to be made in preference to trust fund taxes does not make the failure to pay non-willful. Thomsen v. United States, 887 F.2d 12, 17-18 (1st Cir. 1989).

5.17.7.1.4 (08-01-2010)
Examination of Records

1. The revenue officer has the initial duty to determine the identity of officers, partners, members, or employees who had the duty to collect or pay over the taxes.

2. Records to be examined may include the following:

- Articles of incorporation or articles of organization
- By-laws of the corporation or operating agreements
- Minute books

- Payroll records
- Canceled checks and bank records and
- Tax returns

3. The articles of incorporation should contain the names and duties of all officers and directors of the corporation.
4. Corporate by-laws and minute books may disclose the names of persons responsible for the filing of returns and payment of taxes. They may show who has the authority to sign checks, deposit money, and make loans on behalf of the corporation.
5. Bank records and canceled checks should be examined for payment of other financial obligations after the taxes became due.
   A. Signature cards should identify the persons authorized to sign corporate checks.
   B. Bank records may disclose possible diversion of corporate funds.
   C. Financial statements provided to the bank in connection with a bank loan may provide additional information regarding responsibility and financial solvency of the corporation.
6. Tax returns, if filed, may provide the name of the person responsible for filing.

5.17.7.1.5 (08-01-2010)
Interview of Witnesses

1. Interviewing witnesses is an important factor in TFRP investigations.
2. The revenue officer should prepare for the interview prior to meeting with the witness. This will increase the chances that the interview will be successful.
3. When conducting an interview with a potentially responsible person, the revenue officer should determine the following:
   - Whether the person had a duty to account for, collect, and pay over trust fund taxes; and
   - Whether he or she willfully failed to perform any of these duties.
4. If a potentially responsible person asserts a defense for failure to comply with the statutory requirements, all of the details surrounding the defense should be thoroughly questioned and subsequently verified.
5. The interview of non-responsible employees who have knowledge of the business and its decision making process may be extremely helpful in determining who is both a responsible and willful individual.

5.17.7.1.6 (08-01-2010)
Extent of Liability

1. IRC § 6672 is limited to the trust fund portion of the tax; that is, to the tax that the "responsible person" is required to collect or withhold from the wages of employees.
   A. To determine the application of payments and other credits for purposes of determining the TFRP, follow the guidelines in IRM 5.7.7, *Payment Application and Refund Claims*.
   B. After the application of payments has been made, the TFRP is based on the remaining outstanding amount of withheld income tax and employee's FICA tax. Refer to Policy Statement 5-14 (formerly P-5-60), at IRM 1.2.14.1.3.
2. The TFRP does not apply to direct taxes such as the employer's portion of FICA or FUTA. Neither does it apply to non-collected excise taxes.
3. If during the investigation, the revenue officer becomes aware of facts that indicate that a lender, surety, or third party may have indirectly or directly provided funds for the payment of employee wages, the revenue officer should consider assertion of liability under IRC § 3505(a) or (b). See IRM 5.17.7.2, below.

5.17.7.1.7 (08-01-2010)
Limitation Period on Assessment

1. Withholding and FICA Taxes
   A. IRC § 6671 provides that the TFRP is required to be assessed and collected in the same manner as taxes.
   B. IRC § 6501(a) states that, except as otherwise provided in IRC § 6501, any tax imposed by the Code shall be assessed within three years after the return was filed.
   C. Generally, the TFRP must be assessed within three years after the return to which it relates was filed. Lauckner v. United States, 68 F.3d 69 (3d Cir. 1995).
   D. A return of withholding and FICA taxes filed on or before the prescribed due date is deemed to have been filed on the due date. Thus, with respect to any taxable period within a calendar year, the period of limitations is three years from the succeeding April 15 (the due date of the return) or the date the return was filed, whichever is later.
   E. A return executed by the revenue officer is not considered the taxpayer's and, therefore, does not start the assessment statute.
   F. If the return is fraudulent, the tax may be assessed at any time.
2. The assessment period may be extended prior to its expiration by the consent of the person against whom the penalty is to be assessed. This extension, however, applies only to the consenting officer.
3. For further discussion of the statutory assessment period and extensions of such period, see IRM 5.7.3.5, *Statutory Assessment Period*, and IRM 5.7.3.6, *Extension of the Statutory Assessment Period*.
4. Under IRC § 6672(b)(3), the assessment statute may be extended when the IRS mails or hand delivers the L-1153, Notice of Proposed Trust Fund Recovery Penalty, to the taxpayer. Specifically, IRC § 6672(b)(3) provides that if the assessment statute is open when the Service mails or delivers in person the L-1153 to a responsible person, the assessment statute shall not expire before the later of the following dates:
   - The date 90 days after the L-1153 and supporting documents were mailed or hand delivered to the responsible person, or
   - If the person files a timely protest of the proposed TFRP, the date 30 days after Appeals makes a "final administrative determination " regarding the proposed penalty.

EXAMPLE: The limitations period for assessing the TFRP against the taxpayer will expire on April 15, 2010. The revenue officer hand delivers the L-1153 to the taxpayer on April 1, 2010. Because the assessment statute was open when the L-1153 was delivered to the taxpayer, the statute is extended to the date that is 90 days after April 1, 2010 (which is June 30, 2010), unless the taxpayer files a timely protest. If the taxpayer files a timely protest, then the assessment statute will not expire until the date that is 30 days after Appeals makes a final determination regarding the proposed penalty, assuming that date is after June 30, 2010.

5. See also IRM 5.7.3.6.2, *Impact of Letter 1153(DO) on Assessment Statute*.
6. The date of Appeals final determination is the earlier of the date of the Appeals Team Manager's (ATM's) signature on:
   - Form 5402, Appeals Transmittal and Case Memo, or
   - Form 866 or Form 906, Closing Agreements.

5.17.7.1.8 (08-01-2010)
Assessment Procedure and Appellate Rights

1. Refer to IRM 5.7, Trust Fund Compliance Handbook, and IRM 8.25, Trust Fund Recovery Penalty (TFRP).

5.17.7.1.9 (08-01-2010)
Collection of the TFRP

1. It is the Service's policy to collect the unpaid trust fund taxes only once.
2. If, after the assertion of the TFRP, the corporation pays the delinquent tax, the TFRP assessment will be abated. See Policy Statement 5-14 (formerly P-5-60), at IRM 1.2.14.1.3.
3. Similarly, if an amount that has been collected from the responsible person(s) exceeds the amount that the corporation failed to pay, the excess may be refunded within the applicable statutory period to the person(s) that caused the excess payment. Refer to IRM 5.7.7, *Payment Application and Refund Claims*.

5.17.7.1.10 (08-01-2010)
Limitation Period for Collection

1. The TFRP may be collected by levy or by a proceeding in court, but only if begun within ten years after the assessment was made. IRC § 6502(a).
2. The Service may no longer obtain waivers of the collection period except for those waivers secured in conjunction with an installment agreement. IRC § 6502. Current policy limits the use of this authority to partial-payment installment agreements. Refer to IRM 5.14 for guidance.

5.17.7.1.11 (11-02-2007)
Collection of TFRP in Bankruptcy

1. Section 507(a)(8)(C) of the Bankruptcy Code (11 USC § 507(a)(8)(C)) grants eighth priority to all taxes "required to be collected or withheld and for which the debtor is liable in whatever capacity." This includes the TFRP under IRC § 6672.
2. Except for a superdischarge under 11 USC § 1328(a) in a Chapter 13 bankruptcy case, an individual debtor is not discharged from liability for the TFRP. See 11 USC § 523(a)(1)(A). Thus, the Service may collect any unpaid TFRP after the automatic stay terminates.

   Note:

   For bankruptcy cases filed on or after October 17, 2005, there is no longer a superdischarge from the TFRP for responsible persons. See 11 USC § 1328(a)(2).

5.17.7.1.12 (08-01-2010)
Collection of TFRP when Corporation is in Bankruptcy

1. The automatic stay provisions of the Bankruptcy Code do not prevent the Service from assessing and collecting the TFRP from responsible persons who are not themselves in bankruptcy. 11 USC § 362.
2. Responsible persons, therefore, may not enjoin assessment and collection of the TFRP against them when only the corporation is in bankruptcy. In re Prescription Home Health Care, 316 F.3d 542 (5th Cir. 2002) (holding that the bankruptcy court does not have jurisdiction over a nondebtor responsible officer).

   Note:

   As a policy matter, the IRS does not assess the IRC § 6672 penalty against a responsible officer as long as the debtor corporation is current on bankruptcy plan payments. See IRM 5.9.8.10, *Trust Fund Considerations in Chapter 11*.

5.17.7.2 (08-01-2010)
Liability of Third Parties Paying or Providing for Wages

1. In some cases, lenders, sureties, or other persons who are not employers may be personally liable for withheld taxes due. While employers are primarily liable for paying withheld taxes, in some cases they may be without sufficient resources to pay. As a result, recourse against them may be fruitless. IRC § 3505 may provide an alternative means of collecting the withheld taxes.

5.17.7.2.1 (08-01-2010)
Liability for Direct Payment of Wages – IRC § 3505(a)

1. IRC § 3505(a) makes third parties personally liable for the payment of withholding taxes where they pay wages directly to employees of another.
2. IRC § 3505(a) applies to lenders, sureties, or other persons.
   A. "Other persons" includes anyone similar to a lender or surety who pays the wages of employees of another out of its own funds. The most common situation in which a person other than a lender or surety (a statutory "other person") may be found liable under IRC § 3505(a) is where a prime or general contractor, out of necessity (to keep the employees of the subcontractor on the job) or by contract, pays net wages directly to employees of a subcontractor that is having financial problems. See United States v. Kennedy Construction Co. of NSB, Inc., 572 F.2d 492 (5th Cir. 1978) (IRC § 3505(a) liability imposed on a general contractor who co-signed payroll checks for a subcontractor's employees).
   B. IRC § 3505(a) does not apply to a person who is acting only as agent of the employer or as agent of the employees (such as a union agent). See Treas. Reg. § 31.3505-1(c) examples.
3. Liability under IRC § 3505(a) extends to withholding under:
   - IRC § 3402, withheld income taxes;

- IRC § 3102, withheld FICA taxes; and
- IRC § 3202, withheld railroad retirement taxes.

4. Liability does not extend to the employer's share of employment taxes; nor does liability extend to penalties that the Service may impose on the employer.
5. IRC § 3505(a) does not relieve an employer from responsibilities with respect to withholding taxes. The responsibilities continue even though a lender may be paying the employees' wages. The liability of the lender in such a case is to pay the taxes only where the employer does not do so.
   A. The employer is obligated to file an employer's tax return (Form 941) and comply with other requirements generally imposed on employers.
   B. The lender's liability is a sum equal to the taxes (together with interest) required to be deducted and withheld from the wages by the employer.
6. When evaluating whether wages are being paid directly, the Service and the courts look to the "substance" of the transaction and may find the direct payment of net wages present even though a " subterfuge" is used to disguise the substance of the arrangement. See United States v. Kennedy Construction Co. of NSB, Inc., 572 F.2d 492 (11th Cir. 1978) (subcontractor opened special payroll account out of which it issued payroll checks; however, the contractor provided the funds in the account after verifying the net wages owed each pay period and countersigned the pay checks).

5.17.7.2.2 (08-01-2010)
Liability When Funds are Supplied — IRC § 3505(b)

1. IRC § 3505(b) provides that a lender, surety, or other person who supplies funds to or for the account of an employer for the specific purpose of paying wages of the employees of such employer may be personally liable for any unpaid withholding taxes even though this person does not directly pay the employees' wages.
2. A person within the meaning of Section 3505(b) includes the following:
   - A prime or general contractor who supplies funds directly to a subcontractor to meet its net payroll with knowledge of the subcontractor's inability to pay its withholding taxes. United States. Algernon Blair, Inc., 441 F.2d 1379 (5th Cir. 1971).
   - A shareholder, including a parent company of a subsidiary, who makes a capital contribution or a direct loan, or who puts up collateral for a loan from a third party to a corporation if the loan is to be used by the corporation to pay net wages. United States v. Intercontinental Industries, Inc., 635 F.2d 1215 (6th Cir. 1980).
   - A bank that honors a customer's/employer's overdrafts for payroll checks. Fidelity Bank, N.A. v. United States, 616 F.2d 1181 (10th Cir. 1980).
3. Before a person can be liable under Section 3505(b), the following two conditions must exist.
   A. The person must know that the advanced funds are to be used for the payment of wages; this does not include an "ordinary working capital loan." "Ordinary working capital loans" are ones that are made to enable the borrower to meet current obligations as they arise; they are not earmarked for any particular purpose.

   Note:

   If the maker of an "ordinary capital loan" has actual notice or knowledge at the time of the advancement of funds that the funds or a portion of the funds are to be used to pay net wages, IRC § 3505(b) will apply regardless of whether the written agreement states that the funds were advanced for another purpose. Treas. Reg. § 3505-1(b)(3); United States v. Intercontinental Industries, Inc., 635 F.2d 1215 (6th Cir. 1980).

   B. The supplier of funds must have "actual notice or knowledge " at the time such funds are advanced that the employer does not intend to, or will not be able to make timely payment or deposit of taxes required to be withheld. The lender has actual notice or knowledge of any fact from the time such fact is brought to its attention or would have been brought to its attention if the organization had exercised due diligence. See United States v. Park Cities Bank and Trust Co. , 481 F.2d 738 (5th Cir. 1973).

   Note:

   The burden of establishing actual notice or knowledge in such cases is on the government.
4. It is the Service's position that notice to, or knowledge by, any agent of a third-party supplier of funds is imputed to the third party. This is true even if the agent conceals the facts from the supplier. United States v. Park Cities Bank and Trust Co., 481 F.2d 738 (5th Cir. 1973).
5. Under IRC § 3505(b), the liability of the third party may not exceed 25 percent of the amount supplied to the employer for the specific purpose of paying wages.
   A. The 25% limitation applies to accrued interest. O'Hare v. United States, 878 F.2d 953 (6th Cir. 1989).
   B. Example: A lender advances $100,000 to Employer A for the purpose of paying net wages. The employer fails to pay withholding taxes, and is assessed a liability of $25,000 plus an additional $10,000 in accrued interest. The Service may file suit against the lender for $25,000, which is 25% of the amount supplied to the lender. If the assessment had been $20,000 plus an additional $10,000 in interest, the Service still could have brought suit for $25,000 ($20,000 in tax and $5,000 in accrued interest).
   C. The lender's liability does not include penalties that the Service may impose on the employer.
6. The employer remains responsible for filing returns (Form 941).
7. Payments by the lender of withholding taxes reduces the liability of the employer. Similarly, payments by an employer of the withholding taxes reduces the liability of the lender.

5.17.7.2.3 (08-01-2010)
Collection of Liabilities under IRC §§ 3505(a) and (b)

1. Under both IRC §§ 3505(a) and (b), if the person liable does not voluntarily satisfy the liability, the government may collect such liability by a court proceeding only.
   A. The suit must be instituted within 10 years after the assessment against the employer.
   B. In Jersey Shore State Bank v. United States, 479 U.S. 442 (1987), the Supreme Court held that IRC § 6303(a) does not require the government to provide notice and demand for payment to a lender before bringing a civil suit against the lender to collect sums for which it is liable under IRC § 3505. In so holding, the court drew a distinction between the employer, who is liable for the unpaid taxes, and the lender, who has a separate liability under IRC § 3505 but is not liable for the taxes.
2. Do not overlook the possibility that alternative remedies exist, particularly the assertion of the Trust Fund Recovery Penalty. See United States v. Security Pacific Business Credit, Inc., 956 F.2d 703 (7th Cir. 1992); Muller v. Nixon, 470 F.2d 1348 (6th Cir. 1972), cert. denied, 412 U.S. 949 (1973); Turner v. United States, 423 F.2d 448 (9th Cir. 1970).
   A. Section 6672 has advantages over Section 3505, such as
      • The ability to assess the liability, and
      • The ability to administratively collect.

5.17.7.3 (11-02-2007)
Liability of Sureties — Bond on Public Works Contracts

1. The Miller Act, 40 USC § 3131, provides that every performance bond on federal construction projects shall specifically guarantee payment of federal payroll taxes. The obligation of the surety on the performance bond must guarantee the payment of taxes that are required to be collected, deducted, or withheld from wages by the contractor, whether or not the contractor does in fact collect, deduct, or withhold such taxes.

2. Notice of Unpaid Taxes

   A. The government must notify the surety of any unpaid taxes attributable to any period within 90 days after the date when the contractor in fact files a return for such period.

   B. If the contractor fails to file a timely return, the Service must give notice to the surety no later than 180 days from the date when such return was required to be filed, whether or not such return was ever filed.

   C. The notice requirements apply to each calendar quarter or other taxable period. The following examples illustrate the notice requirement periods:
   1) The contractor on a federal construction project files a Form 941 for the third quarter 2002 on October 15, 2002. While the return was not due until October 31, 2002, the contractor did in fact file on October 15, 2002. Thus, the 90-day period would commence on October 16, 2002, and the notice must be given on or before January 13, 2003.
   2) The same contractor files a Form 941 for the third quarter 2002 on January 29, 2003. The government has until April 30, 2003, to notify the surety of the unpaid taxes. If the contractor had failed to file a return, April 30, 2003, would still be the last date of notification to the surety because the 180-day period begins to run from the date the return was required to be filed (October 31, 2002).

3. The government may offset any funds still due the prime contractor. In this case, because of the limited time in which notice can be given to the surety, the revenue officer should still consider notifying the surety for the purpose of holding the surety liable under the provisions of the Miller Act.

4. The only way other than offset to collect is by bringing suit against the surety within one year after the day on which timely notice of the unpaid tax liability was given to the surety.

   Example:

   If the surety is given timely notice on July 1, 2001, that the contractor failed to pay over the taxes applicable to a taxable period, the government must commence suit on or before July 1, 2002, to enforce the obligation under the performance bond. Because of this short statute of limitations, the revenue officer should be alert for the necessity of prompt action.

5. The government will continue to assert its rights under a surety bond on other than federal construction projects, but only where the available evidence clearly and convincingly shows the bond was intended for the direct benefit of the United States.

More Internal Revenue Manual

IRS

Part 5. Collecting Process

Chapter 17. Legal Reference Guide for Revenue Officers

Section 8. General Provisions of Bankruptcy

5.17.8 General Provisions of Bankruptcy

Manual Transmittal

April 24, 2015

Purpose

(1) This transmits revised IRM 5.17.8, *Legal Reference Guide for Revenue Officers, General Provisions of Bankruptcy*.

Background

This section contains information, instructions, and references concerning bankruptcy cases and proceedings. It also explains the provisions and concepts of bankruptcy law that generally apply to all bankruptcy cases.

Material Changes

(1) IRM 5.17.8, *General Provisions of Bankruptcy*, has been updated to provide clarity and expansion of existing material. The following table illustrates changes within this IRM revision.

IRM	Change
5.17.8.1(2)	A new paragraph has been added to discuss the audience of this IRM chapter.
5.17.8.2(1)	Insolvency may request assistance from, or refer a case to, Associate Area Counsel or the Assistant U.S. Attorney.
5.17.8.5(4)	New content has been added to clarify that the Chapter 12 plan is generally paid over a period of three to five years.
5.17.8.7(2)	IRS must be noticed in all Chapter 11 cases.
5.17.8.7(3)	IRS has designated the Centralized Insolvency Operation (CIO) as the official address for noticing IRS on the mailing matrix in Chapter 7, 12, and 13 cases.
5.18.8.8(2)	The United States Trustee monitors Chapter 7, 11,12,13, and 15 trustees.
5.17.8.10(2)(b)	Sending the original assessment notice is not a violation of the stay when assessment is allowed under the Bankruptcy Code.
5.17.8.10(5)	Additional content has been added to clarify that the stay may terminate or not go into place when prior dismissals were not for failure to pass the means test.
5.17.8.13(4)	If IRS does not receive notice in sufficient time to file a claim before the bar date in an individual bankruptcy case, the debt is not discharged.
5.17.8.13(8)	The court may extend the time within which a claim may be timely filed.
5.17.8.15(2)	Employment taxes are treated as pre-petition liabilities when the wages were earned pre-petition.
5.17.8.15(6)	Liabilities incurred for the individual shared responsibility provision (SRP) of the Affordable Care Act (ACA), and assessed on IDRS under MFT 35, are treated as an excise tax in bankruptcy.
5.17.8.17(2)	Post-petition SRP (MFT 35) liabilities incurred by a Chapter 11 or Chapter 7 debtor are not claimable in the bankruptcy case.
5.17.8.17(5)	IRS may file a § 1305 claim for a post-petition SRP (MFT 35) liability in a Chapter 13 case.
5.17.8.19(2)	Pre-petition penalties on an unsecured tax claim are treated as unsecured general unless the penalty is compensation for actual pecuniary loss.
5.17.8.20(6)	Pub 5082 provides information about tax return filing requirements and Chapter 13

5.17.8.20(6)	Pub 5082 provides information about tax return filing requirements and Chapter 13.
5.17.8.21(5)(e)	Announcement 2011-77 updated the address for trustees to file prompt determination request with the CIO.
5.17.8.22(2)	Generally, but not always, debts for the SRP (MFT 35) liability under the ACA are excepted from discharge when the liability on the debtor's Form 1040 is non-dischargeable and the taxpayer received a discharge in a Chapter 7, 11, or 12 case or a Chapter 13 hardship discharge.
5.17.8.22(4)	IRS can collect non-dischargeable liabilities from all the debtor's property after a bankruptcy discharge. IRS can only collect dischargeable liabilities from exempt, abandoned, or excluded property.
5.17.8.22(6)	When the liability on the debtor's Form 1040 is non-dischargeable, the tax assessed for the SRP (MFT 35) liability under the ACA is generally, but not always, excepted from discharge when the debtor received a discharge upon completion of a Chapter 13 plan.
5.17.8.24(4)	Referrals to Counsel for adequate protection are subject to the tolerances in IRM 5.9.4.14.4, *Referral Tolerances*.
5.17.18.26(4)	Content has been revised to clarity that there is no antecedent debt as long as a payment is made *without a penalty* by the due date or extended due date of a return.
5.17.8.27(1)	In addition to BAPCPA allowing offsets of pre-petition income tax refunds to pre-petition income tax debts, BAPCPA allows offsets of income tax refunds to domestic support obligations.
5.17.8.28(1)	The automatic stay and collection statute may be impacted when the debtor is a serial filer.
Exhibit 5.17.8-1, ***Asset Case***	The definition of asset case has been expanded to include all Chapter 9, 11, 12, and 13 cases.
Exhibit 5.17.8-1, ***Chapter 11***	Chapter 11 plans may also provide for liquidation of the debtor. Individual debtors may receive a discharge upon completion of the plan or a hardship discharge.
Exhibit 5.17.8-1, ***Chapter 12***	Individual debtors may receive a discharge upon completion of the plan or a hardship discharge.
Exhibit 5.17.8-1, ***Chapter 13***	The debtor may receive a discharge upon completion of the plan or a hardship discharge.
Exhibit 5.17.8-1, ***Co-Debtor Stay***	The co-debtor stay applies in Chapters 12 and 13 cases.
Exhibit 5.17.8-1, ***Discharge***	The definition has been revised to include hardship discharges in Chapter 11, 12, and 13 cases.
Exhibit 5.17.8-1, ***Excluded Assets***	A NFTL is not required to collect from excluded assets after the discharge.
Exhibit 5.17.8-1, ***Hardship Discharge***	Content has been added that clarifies that individual debtors in Chapter 11 may receive a hardship discharge.
Exhibit 5.17.8-1, ***Joint Return/Single Debtor (Debtor and Non-Debtor Spouse)***	When only one taxpayer on a joint tax return files bankruptcy, the terms "Debtor" and "Non-Debtor Spouse" are now used instead of "Petitioning" and "Non-Petitioning Spouse."
Exhibit 5.17.8-1, ***Lien***	A lien is a claim attaching to property or rights to property as collateral for payment on a debt or obligation. Prior content about NFTLs has been moved to the definition of NFTL.
Exhibit 5.17.8-1, ***Notice of Federal Tax Lien (NFTL)***	There is a prohibition on filing a new NFTL on pre-petition tax debts until after lifting of the stay. Refiling of an existing NFTL is allowed.
Exhibit 5.17.8-1, ***Small Business Case***	The definition of small business case has been updated to reflect the most current debt limit under 11 USC § 104.
Exhibit 5.17.8-1, ***Super Discharge***	The definition clarifies that the term "super discharge" is only applicable to cases filed prior to October 17, 2005.
Exhibit 5.17.8-1, ***Violation of Stay***	In addition to prohibiting acts to collect pre-petition liabilities, the automatic stay prohibits any enforcement actions against property of the bankruptcy estate.

(2) Editorial changes were made throughout this section, including Exhibit 5.17.8-1, *Glossary of Common Bankruptcy Terms*, to add clarity and update or correct citations.

Effect on Other Documents

This supersedes IRM 5.17.8, *General Provisions of Bankruptcy*, dated August 1, 2010. This revision incorporates content from interim guidance SBSE 05-1214-0083, *Processing the Individual Shared Responsibility Payment (SRP) in Bankruptcy Cases*, dated December 15, 2014.

Audience

SB/SE Revenue Officers

Effective Date

(04-24-2015)

Kristen Bailey
Acting Director, Collection Policy
Small Business/Self-Employed

5.17.8.1 (04-24-2015) Overview

1. This section contains information, instructions, and references concerning bankruptcy cases and proceedings. It explains the provisions and concepts of bankruptcy law that generally apply to all bankruptcy cases.

2. This section is used primarily by Revenue Officers (ROs) and Advisors in SBSE. However, employees in functions other than SBSE may refer to the section when dealing with a taxpayer that has filed bankruptcy. Insolvency caseworkers in Field Insolvency (FI) and the Centralized Insolvency Operation (CIO) may refer to this section in addition to IRM 5.9, *Bankruptcy and Other Insolvencies*, when working bankruptcy cases.

3. A glossary of common bankruptcy terms used in this section and IRM 5.17.9, *Chapter 7 Bankruptcy (Liquidation)*; IRM 5.17.10, *Chapter 11 Bankruptcy (Reorganization)*; and IRM 5.17.11, *Chapter 13 Bankruptcy (Individuals with Regular Income) and Chapter 12 (Family Farmers or Fishermen with Regular Income)*, is found in *Exhibit 5.17.8-1*.

5.17.8.2 (04-24-2015) The Insolvency Program's Role

1. The Insolvency program maintains records and files concerning the investigation, preparation, and filing of claims in all bankruptcy proceedings and is the point of contact for revenue officers. The case file is maintained by Insolvency. Insolvency has the responsibility of protecting the government’s interests in all bankruptcy cases. However, Insolvency may request assistance from, or refer a case to, the appropriate Associate Area Counsel (SB/SE) or Assistant U.S. Attorney (AUSA) office.

5.17.8.3 (08-01-2010) The Bankruptcy Code

1. The purpose of federal bankruptcy law is:

   - To provide a uniform, fair, and equitable method of distribution of the debtor’s assets to his creditors; or,
   - To formulate a plan by which the debtor pays creditors from future earnings; and,
   - At the same time, give the deserving debtor an opportunity to start over with a clean slate.

2. Initially, there were state insolvency laws but no federal bankruptcy laws. Bankruptcy law is now contained in a federal statutory scheme called the "Bankruptcy Code." The Bankruptcy Rules contain procedures for implementation of most Bankruptcy Code provisions.

3. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") made major revisions to the Bankruptcy Code. BAPCPA changes generally apply to cases filed on or after October 17, 2005.

4. The Bankruptcy Code is divided into several chapters. Chapters 1, 3, and 5 contain general provisions applicable to all types of bankruptcies. Important sections include:

   A. 101: Definitions (including debt, claim, creditor, family farmer, and small business debtor)

   B. 109: Who may be a debtor

   C. 362: Automatic stay

   D. 502: Allowance of claims or interests

   E. 521: Debtor’s duties, including filing returns and providing copies to the trustee

   F. 522: Exemptions

   G. 541: Property of the estate

   H. 544-549: Trustee’s powers to avoid pre-petition and post-petition transfers of property

5. Chapter 7 deals with liquidating bankruptcies, which are called "Chapter 7 cases," in which the debtor’s non-exempt assets are used to pay creditors. See IRM 5.17.9, *Chapter 7 Bankruptcy (Liquidation)*.

6. Chapter 11 deals with reorganizations of individuals and non-individual debtors which are called "Chapter 11 cases." The non-individual debtor may be a corporation, partnership, or Limited Liability Company (LLC). See IRM 5.17.10, *Chapter 11 Bankruptcy (Reorganization)*. In these cases, plans to pay creditors over a period of time are proposed, with the plan to be funded from future earnings or from liquidation of the debtor’s assets.

7. Chapter 12 deals with family farmer and family fisherman reorganizations, which are called "Chapter 12 cases" and are similar to Chapter 11 and 13 cases. See IRM 5.17.11.19, *Chapter 12*.

8. Chapter 13 deals with reorganizations of individuals with regular income, which are called "Chapter 13 cases," in which payments are made from the debtor’s future earnings pursuant to a plan. See IRM 5.17.11.1, *Overview,* through IRM 5.17.11.18, *Discharge*, for additional information on Chapter 13 cases.

5.17.8.4 (08-01-2010)
Jurisdiction of the Bankruptcy Court

1. Bankruptcy courts generally have jurisdiction over all matters concerning payment of a debtor’s debts under the Bankruptcy Code and administration of the bankruptcy estate. Bankruptcy courts are under the district courts and receive their jurisdiction from the district court.

2. Bankruptcy court jurisdiction includes the authority to determine the amount of tax due by the debtor or estate and what taxes will be discharged (i.e., the taxes for which the debtor will no longer be personally liable). The bankruptcy court also has jurisdiction over any matters concerning payment of any tax debts claimed against the estate, validity of liens, turnover of property to the estate, exemptions of property from the estate, and confirmation of plans. See 28 USC § 157.

   Note:

   The Bankruptcy Code provides a means for balancing the interests of the taxpayer and the Service, as does the administrative offer in compromise (OIC). An administrative offer in compromise is one submitted in accordance with the guidelines and procedures set forth in Rev. Proc. 2003-71 and IRM 5.8, *Offer in Compromise*. Administrative and legal problems would be created if a tax liability were simultaneously the subject of a court supervised bankruptcy case and the administrative offer in compromise process. Accordingly, when a taxpayer has filed for bankruptcy protection, the IRS’s policy is not to consider administrative offers in compromise from a taxpayer in bankruptcy. This issue is more specifically addressed in IRM 5.9.4.10, *Bankruptcy and Other Insolvencies, Common Bankruptcy Issues, Offers in Compromise and Bankruptcy*. See also IRM 5.8.10.2, *Offer in Compromise, Special Case Processing, Bankruptcy*.

3. When a taxpayer files a bankruptcy petition, the automatic stay (discussed below) begins in most cases. Although audit activity can continue and assessments can be made, the automatic stay generally stops all of the IRS’s normal collection procedures.

5.17.8.5 (04-24-2015)
Types of Bankruptcies

1. Under the Bankruptcy Code, a debtor has the choice of:

   - Liquidating assets to pay debts (Chapter 7 and liquidating Chapter 11) or
   - Reorganizing their financial situation to pay creditors over a period of time (Chapters 11, 12, and 13).

   However, the debtor must meet the qualifications of the desired bankruptcy chapter.

2. A Chapter 7 liquidation case is administered by a trustee who:

   - Collects all the debtor’s non-exempt assets,
   - Reduces the assets to cash, and
   - Distributes the funds to creditors in the priority set forth in 11 USC § 726.

   In collecting the debtor’s assets, the trustee may use his powers to avoid certain pre-petition and post-petition transfers.

3. In a Chapter 11, the debtor as a debtor-in-possession ("DIP") typically continues to operate its business while formulating a plan to pay the claims of creditors. BAPCPA made Chapter 11 for individuals very similar to Chapter 13.

4. In a Chapter 12, a debtor continues to operate while formulating and paying a bankruptcy plan. The debtor must be a family farmer or family fisherman with regular annual income. Chapter 12 bankruptcy plans are generally paid over a period of three to five years.

5. In a Chapter 13, the debtor, who must be an individual with regular income, formulates a plan to pay his creditors over a period of three to five years from future earnings.

6. The debtor must meet the requirements in 11 USC § 109 to be a debtor in a particular chapter.

5.17.8.6 (08-01-2010)
Voluntary and Involuntary Bankruptcies

1. Bankruptcy cases may be voluntary or involuntary. A voluntary proceeding is one in which the debtor files a petition for relief in bankruptcy. The filing of the voluntary petition is the "order for relief" in the case. Along with the petition, the debtor must file certain schedules or statements. See 11 USC § 521 and Bankruptcy Rule 1007.

2. An involuntary bankruptcy is one instituted by creditors filing a petition for relief against a debtor. See 11 USC § 303. In contrast to the voluntary case, the "order for relief" is entered at some point after the petition is filed, when the court determines that the criteria for an involuntary bankruptcy are met. An involuntary case may only be commenced under Chapter 7 or Chapter 11. The debtor must be eligible to be a debtor under the chapter for which the petition was filed.
3. Instead of joining with other creditors to file an involuntary petition, the IRS should explore other options to collect tax debts. In the event an involuntary petition is filed by other creditors, however, the IRS should file a proof of claim in order to protect its interests.
4. Under 11 USC § 302, a joint case is commenced by the filing of a single petition by an individual qualified to be a debtor under Chapter 7, 11, 12, or 13, and the individual's spouse. The court may determine that the assets and liabilities of the two debtors will be combined in a single pool to pay creditors. Bankruptcy Rule 1015 provides for joint administration of the estates.

5.17.8.7 (04-24-2015)
Notice to Government of Commencement of Bankruptcy Proceeding

1. Notice of Chapter 7, 12, and 13 cases must be given to the IRS when it is listed as a creditor in the debtor's schedules. See Bankruptcy Rule 2002(g).
2. Bankruptcy Rule 2002(j) provides that, in a Chapter 11 case, notice must be given to the IRS at the address set out in a register maintained under Bankruptcy Rule 5003(e) for the district in which the case is pending. Notice may either be mailed or given through the electronic noticing system. IRS must be noticed in all Chapter 11 cases. It does not matter if IRS was listed as a creditor in the debtor's schedules.
3. The Bankruptcy Rules do not prescribe the place of notice to the IRS in Chapter 7, 12, or 13 cases. 11 USC § 342(e) and (f) authorize creditors to designate addresses to receive notices in Chapter 7 and 13 cases. The IRS has designated one national address for the court's mailing matrix for all Chapter 7, 12, or 13 notices. That address is the Centralized Insolvency Operation in Philadelphia. See IRM 5.9.5.2.2, *Mailing Matrix*, and IRM 5.9.11.1, *Insolvency Mail*, for additional information.

5.17.8.8 (08-01-2010)
Trustees

1. Various types of "trustees" participate in particular bankruptcy cases:
   - The United States Trustee
   - A panel trustee or case trustee
   - A Chapter 13 trustee
   - A Chapter 12 trustee
   - A trustee of a Chapter 11 liquidating trust
2. The United States Trustee (employed by the U.S. Department of Justice) is a supervisory agency that monitors Chapters 7, 11, 12,13, and 15 trustees. (See 28 USC § 586(a)(3))
3. A trustee is appointed in every Chapter 7 case. A trustee may also be appointed in a Chapter 11 case for cause.
4. Prior to confirmation, the Chapter 13 trustee (also called a standing trustee) frequently assists the court in evaluating proposed plans for confirmation. After confirmation, the Chapter 13 trustee functions largely as a disbursing agent. The Chapter 13 trustee receives the debtor's monthly plan payments and disburses funds to the creditors according to the plan.
5. The trustee in a Chapter 7 or 11 bankruptcy case is the representative of the estate. The trustee has the capacity to sue and the trustee can be sued.
6. In some Chapter 11 cases, the plan provides for the creation of a liquidating trust. In these cases, a trustee is designated to oversee the trust. The liquidating trustee is not a trustee under the Bankruptcy Code. The trustee's duties can only be determined by reference to the plan or court orders.
7. The United States Trustee for the district in which the case is pending may serve as trustee, if necessary. A person who has served as an examiner in the case may not serve as the trustee.
8. A bankruptcy trustee qualifies by posting an adequate bond (11 USC § 322). The amount of the bond and sufficiency of the surety on the bond are determined by the United States Trustee. A proceeding on a trustee's bond may not be commenced more than two years after the date of the trustee's discharge. The selection and qualification of an individual as trustee does not prevent a subsequent replacement. The court may remove a trustee, other than the United States Trustee or an examiner, for cause after notice and a hearing.

5.17.8.9 (08-01-2010)
First Meeting of Creditors and the Creditors' Committee

1. 11 USC § 341 provides that within a reasonable time after the order for relief in a case, the United States Trustee shall convene and preside at a meeting of creditors (often referred to as the § 341 meeting).
   A. The debtor is required to attend the meeting and to submit to examination under oath. The purpose of the meeting is to give creditors and the trustee an opportunity to examine the debtor regarding the debtor's acts and property, and in respect to any other matter that may affect the debtor's right to a discharge or the administration of the bankruptcy estate.
   B. The § 341 meeting can be a valuable tool for the IRS to obtain information about the debtor's financial status.
   C. Bankruptcy Rule 2003 governs the procedural aspects of the creditors' meeting (date, place, who presides, minutes, report).
   D. Additionally, under Bankruptcy Rule 2004, the court may order the examination of the debtor or any entity upon motion of any party in interest, separate from the § 341 meeting.
2. In a Chapter 7 case, another purpose of the § 341 meeting is the election of a case trustee and, where appropriate, of a creditors' committee. A creditors' committee may:
   - Consult with the trustee or the United States Trustee in connection with the administration of the estate,
   - Make recommendations to the trustee or United States Trustee respecting the performance of the trustee's duties, and
   - Submit questions to the court or the United States Trustee concerning the administration of the estate.

   Note:

   Only creditors with undisputed general unsecured claims can join Chapter 7 creditors' committees (11 USC § 705(a)). Although the IRS can participate on a creditors' committee when the IRS holds a general unsecured claim, the IRS ordinarily does not participate.
3. In Chapter 11 cases, creditors' committees often play a prominent role. The members are selected by the United States Trustee. The committee functions as the representative of creditors who hold allowable, unsecured, non-priority claims. Governmental entities such as the IRS, are generally excluded from participation on Chapter 11 creditors' committees. (11 USC §§ 1102, 101(41))

4. Not later than the day before the § 341 meeting, Chapter 13 debtors are required to submit tax returns for the taxable periods ending within the four years before the petition date, although this deadline may be extended under certain circumstances. (11 USC § 1308)

5.17.8.10 (04-24-2015)
Automatic Stay - 11 USC § 362

1. Under 11 USC § 362(a), an automatic stay arises by operation of law as soon as the bankruptcy petition, whether voluntary or involuntary, is filed. The stay prohibits most collection activity. Specifically, it prohibits:
   A. Commencement or continuation of a judicial or administrative proceeding against the debtor to recover a pre-petition claim;
   B. Enforcement of a judgment that was obtained pre-petition against the debtor or the property of the estate;
   C. Any act to obtain possession of property of the estate or from the estate, or to exercise control over property of the estate;
   D. Any act to create, perfect, or enforce a lien against property of the estate;
   E. Any act to create, perfect, or enforce a lien against the debtor's property securing a pre-petition debt;
   F. Any act to collect, assess, or recover a pre-petition claim against the debtor;
   G. Setoff of any pre-petition debt owing to the debtor against any claim against the debtor (but see the exception for cases filed under the BAPCPA, below);
   H. Commencement or continuation of a proceeding before the Tax Court concerning a corporate debtor's tax liability for any taxable period the bankruptcy court may determine; or,
   I. Commencement or continuation of a proceeding before the Tax Court concerning the tax liability of a debtor who is an individual for a taxable period ending before the date of the bankruptcy petition.
2. Some actions the IRS must avoid after bankruptcy has been filed because of the automatic stay are:
   A. Verbally requesting payment of pre-petition taxes;
   B. Sending balance due notices on pre-petition taxes other than the "first" or new assessment notice, assuming the assessment is allowable under the Bankruptcy Code;
   C. Issuing Form 668-A (c)(DO) , *Notice of Levy*, or Form 668-(c)(DO), *Notice of Levy on Wages, Salary, and Other Income*, for pre-petition tax periods;
   D. All seizure and levy action directed at property of the estate;
   E. Issuing or continuing to enforce a collection summons or filing any collection suit;
   F. Making certain refund offsets, other than offsets allowed in BAPCPA cases; and
   G. Filing a new NFTL post-petition.

   Note:

   In addition, it is the policy of the IRS not to continue most collection due process proceedings during bankruptcy.
3. The automatic stay does not prohibit the following:
   A. Commencing or continuing a criminal action or proceeding against the debtor;
   B. Commencing or continuing an action or proceeding by a governmental unit to enforce police or regulatory power;
   C. An audit to determine tax liability;
   D. The issuance of a notice of deficiency;
   E. Demand for a tax return;
   F. Refiling a Notice of Federal Tax Lien. United States v. Sayres, 43 B.R. 437 (W.D. N.Y. 1984); In re O'Callaghan , 342 B.R. 364 (Bankr. M.D. Fla. 2006);
   G. Intercepting certain tax refunds for the purpose of setting them off against past-due support obligations; and,
   H. For cases filed on or after October 17, 2005, the effective date of BAPCPA, setting off pre-petition income tax refunds against pre-petition income tax liabilities.

   Note:

   Even if a setoff is not permitted under BAPCPA, temporary retention of refunds, rather than actual offsets, is permitted. Citizens Bank v. Strumpf, 516 U.S. 16 (1995).

   Note:

   Local standing orders or bankruptcy rules in some court jurisdictions may permit certain refund offsets. In such jurisdictions, the permitted refund offsets will not violate the automatic stay.
4. The stay of an act against property of the estate continues until the property is no longer part of the estate. The stay of any other act continues until the earliest of the time:
   A. The case is closed;
   B. The case is dismissed; or
   C. A discharge is granted or denied.
5. For cases filed on or after October 17, 2005, the effective date of BAPCPA, the stay may terminate 30 days after the bankruptcy petition is filed, or may not go into effect at all, if the debtor had one or more bankruptcies dismissed within one year before the latest bankruptcy and dismissal was not for failure to pass the means test. Insolvency should contact Associate Area Counsel (SB/SE) if it is believed that the automatic stay has terminated or not gone into effect in a case. (See IRM 5.9.5.7, *Serial Filers*, and related subsections and exhibits for additional information.)
6. Upon request of a party in interest, such as a creditor, and after notice and a hearing, the bankruptcy court shall grant relief from the stay by terminating, annulling, modifying, or conditioning the stay:
   A. For cause, including the lack of adequate protection for property in which the moving party has an interest, or
   B. Regarding the stay of an act against property if the debtor has no equity in the property, and the property is not necessary to an effective reorganization.

7. The party requesting relief from the stay has the burden of proof with respect to whether the debtor has equity in the property. The party opposing the motion has the burden of proof with respect to all other issues.

8. Section 7433(e) of the Internal Revenue Code creates a cause of action for taxpayers who suffer damages when the IRS willfully violates the automatic stay or discharge provisions. Treasury Regulations under IRC § 7433(e) describe the administrative procedures the taxpayer must follow before filing a judicial action. (See Treas. Reg. § 301.7433-2(e)) Additionally, 11 USC § 362(k) allows for damages to be recovered by an individual who is injured by a willful stay violation.

9. Actions in violation of the automatic stay must be corrected expeditiously. Corrective actions may include, for example, prompt release of pre-petition continuous wage levies and prompt reversal of post-petition setoffs.

5.17.8.11 (08-01-2010)
Adequate Protection

1. Creditors who have a secured interest in any property of the debtor are entitled to adequate protection under the Bankruptcy Code. "Adequate protection" means preservation of the value of the property or collateral securing a creditor’s claim, thereby maintaining the status quo. Adequate protection may be required for the continuation of the automatic stay under 11 USC § 362(d) for the debtor’s use, sale, or lease of estate property under 11 USC § 363(e), and for the granting of a senior lien on collateral to obtain credit under 11 USC § 364(d). The Service is entitled to adequate protection for its secured claim in both real and personal property.

2. Adequate protection only applies to claims of secured creditors. The IRS is entitled to adequate protection only if its claim is secured by a filed Notice of Federal Tax Lien.

3. 11 USC § 361 sets forth three examples of adequate protection:

   A. Single cash payment or periodic cash payments to compensate for a decrease in value of the secured creditor’s interest in the property (e.g., commencing periodic payments to the secured creditor before plan confirmation);

   B. Additional or replacement liens; or

   C. The indubitable equivalent of the creditor’s interest in the property; e.g., something equal to the value of the secured creditor’s interest, other than administrative priority under 11 USC § 503(b)(1). See In re Swedeland Dev. Group, Inc., 16 F.3d 552 (3d Cir. 1994); In re Martin, 761 F.2d 472 (8th Cir. 1985).

   Note:

   These examples are not exclusive. Adequate protection may include other means, such as a requirement that the debtor maintain insurance on the collateral.

5.17.8.12 (08-01-2010)
Use, Sale, or Lease of Property

1. 11 USC § 363 governs the use, sale, or lease of property of the estate. Under 11 USC § 363(b), the trustee or debtor-in-possession may use, sell, or lease the estate property other than in the ordinary course of business only after notice and a hearing. Bankruptcy Rule 6004 governs the procedural requirements for filing a motion for use, sale, or lease of property not in the ordinary course of business. If the business of the debtor is authorized to be operated under Chapter 7 (11 USC § 721), Chapter 11 (11 USC § 1108), Chapter 12 (11 USC §§ 1203, 1204), or Chapter 13 (11 USC § 1304), the trustee or debtor-in-possession may, without notice or hearing, use, sell, or lease property of the estate in the ordinary course of business.

2. Under 11 USC § 363(c)(2), cash collateral may not be used, sold, or leased by the trustee or debtor-in-possession without the consent of each entity that has an interest in the cash collateral or the court’s authorization after notice and a hearing. Bankruptcy Rule 4001 sets forth the procedural requirements for cash collateral motions.

   A. Under 11 USC § 363(a), "cash collateral" is defined as cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest.

   B. Cash collateral also includes the proceeds, products, offspring, rents, or profits of property subject to a security interest as provided in 11 USC § 552(b), whether existing before or after the commencement of a bankruptcy case. This includes accounts receivable of the debtor.

3. Under 11 USC § 363(e), on request of an entity that has an interest in property to be used, sold, or leased, the court may provide adequate protection of such interest.

4. Under 11 USC § 363(f), a trustee may sell property free and clear of liens where certain conditions are met. Most often, however, adequate protection requires that the tax lien and all other liens attach to the sale proceeds with the same priority that they had in the property prior to the sale.

5.17.8.13 (04-24-2015)
Proofs of Claim

1. 11 USC § 501 provides that a creditor may file a proof of claim. A properly filed proof of claim is deemed allowed unless objected to by a party in interest (11 USC § 502(a)). A proof of claim is filed for claims (taxes) that arose pre-petition. See 11 USC § 101(10)(A).

2. Governmental entities have 180 days from the date of the order for relief, or such later time as the bankruptcy rules may provide, in which to file proofs of claim (11 USC § 502(b)(9)). The general bar date for other creditors in Chapter 7 and 13 cases is 90 days from the first meeting of creditors. A tax claim is timely if filed by the later of either of these two deadlines.

   Note:

   Under BAPCPA for Chapter 13 cases, a claim of a governmental unit for a tax with respect to a return required to be filed under 11 USC § 1308 is also timely if it is filed on or before 60 days after the return is filed.

3. An untimely tax claim can be disallowed solely on the basis that it was filed late (11 USC § 502). This may mean no payment in a Chapter 11 or 13 plan. However, in a Chapter 7 case, a late-filed priority claim is entitled to share in a distribution with timely-filed priority claims, so long as it is filed before the trustee takes certain actions relating to the distribution (11 USC § 726(a)).

4. When IRS does not receive notice in an individual asset case in sufficient time prior to the bar date to file a timely proof of claim, the debt owed to IRS is not discharged. See IRM 5.9.13.7.1(6), *Manual Proofs of Claim and Common Claim Issues, Late Filed Claims, Notice Received with Insufficient Time to File A Timely Proof of Claim*. Also, see IRM 5.9.17.7.9, *Closing a Bankruptcy Case, Discharge and Exceptions to Discharge, Procedures for Processing Bankruptcy Discharges when the IRS Received No Notice or Late Notice in the Asset Case*, for additional information.

5. If a creditor does not timely file a proof of claim, the debtor, a co-obligor, or the trustee may file a proof of such claim (11 USC § 501, Bankruptcy Rule 3004). The court is to mail notice of the filing to the creditor, debtor, and the trustee. The creditor may file a proof of claim which supersedes the proof of claim filed by the debtor. See IRM 5.9.13.3, *Manual Proofs of Claim and Common Claim Issues, Filing Entities*.

6. The payment of claims differs depending on how the claim is classified. The three types of pre-petition claims are (a) secured, (b) unsecured priority, and (c) unsecured general. Post-petition claims may also be provided for in bankruptcy as discussed further in *IRM 5.17.8.17*, *Post-petition Claims/Administrative Expenses*.

7. A proof of claim listing an unassessed liability can be filed to protect the Government’s interest before the exact liability of the taxpayer is determined. The claim serves to meet the bar date and notify parties of the claim. The Government should be in a position to show the court that the liability is reasonable. As soon as the correct or complete amount due can be determined, an amended proof of claim should be filed.

8. 11 USC § 502 allows any party in interest to object to a claim. Pursuant to Bankruptcy Rules 3002 and 3003, the court may extend the time within which a claim may be timely filed. Section 502(b) lists several grounds for disallowing a claim, including tardiness. (See 11 USC § 502(b)(9)) If more time is needed to complete an audit or conduct research, advise Associate Area Counsel as soon as possible. Associate Area Counsel will need the case in sufficient time to permit filing of a timely motion for extension. The court may also establish the limitation period for requesting an extension pursuant to Bankruptcy Rule 3003(c)(3). When the case is referred to Associate Area Counsel, ensure the reasons an extension is needed are included in the referral. The court will only grant an extension for cause. Associate Area Counsel will ensure proper action is taken to secure an extension of the period for filing the claim. Insolvency should be prepared to file a timely proof of claim in an estimated amount if the extension is denied.

5.17.8.14 (04-24-2015)
Secured Claims

1. Under 11 USC § 506(a), the IRS has a secured claim when:

   A. It has properly filed a pre-petition Notice of Federal Tax Lien (NFTL), and there is equity in the debtor's property to which the lien attaches; or

   B. It has a tax claim that is subject to setoff under 11 USC § 553.

2. The allowed amount of a secured claim will be determined after a valuation of the property.

   A. The balance, if any, of the IRS's claim will be allowed as an unsecured claim and will be classified as either priority or general unsecured. All property of the debtor must be valued in order to ascertain the value of the federal tax lien.

   B. For purposes of determining the IRS's secured claim, the federal tax lien attaches to the debtor's property that became estate property as of the commencement of the case, including property exempted under 11 USC § 522. (See 11 USC § 522(c)(2)(B)) The federal tax lien also attaches to property exempt from federal tax levy. American Trust v. American Cmty. Mut. Ins. Co., 142 F.3d 920 (6th Cir. 1998); Matter of Voelker, 42 F.3d 1050 (7th Cir. 1994).

   C. Some of the debtor's property never becomes property of the estate and is excluded. ERISA-qualified pension plans and other plans listed under 11 USC § 541 are examples. The value of excluded property is not used to calculate the amount of the IRS's secured claim.

3. Under 11 USC § 506(b), a creditor is oversecured when the value of secured collateral exceeds the amount of the debt owed to the creditor. An oversecured creditor is entitled to post-petition interest on the secured claim. The creditor is also allowed any reasonable fees, costs, or charges provided by an agreement or by state statute under which the claim arose. When IRS is oversecured, IRS is entitled to receive post-petition interest on an allowed and oversecured claim. (United States v. Ron Pair Enterprises, Inc., 489 U.S. 235 (1989))

4. It is not necessary to file a claim in bankruptcy to preserve a lien on the debtor's pre-petition assets that are not sold and distributed during the bankruptcy case. While receiving a discharge will prevent a creditor from enforcing a dischargeable debt against the debtor personally, the IRS may enforce its lien for dischargeable taxes against the debtor's exempt property if a NFTL was filed before the bankruptcy petition was filed. (In re Isom, 901 F.2d 744 (9th Cir. 1990)) However, a lien for dischargeable taxes cannot be enforced against after-acquired property of the debtor. See IRM 5.9.17.4 , *Bankruptcy and Other Insolvencies, Closing a Bankruptcy Case, Exempt, Abandoned or Excluded Property (EAEP)*, and subsections for additional information.

5. Excluded property never becomes property of the bankruptcy estate. The statutory lien remains a claim against pre-petition property even after the bankruptcy discharge. This allows IRS to levy on abandoned or excluded property to collect dischargeable liabilities after the discharge. See IRM 5.9.17.4 and subsections for additional information.

6. Under 11 USC § 544, the trustee has the rights and powers of a judgment lien creditor. Accordingly, if a NFTL has not been filed prior to the institution of the bankruptcy case, the tax claims will be unsecured. The date the NFTL was filed should be clearly shown on the proof of claim. The trustee may not use 11 USC § 544 or 11 USC § 545(2) to prevail over NFTLs filed pre-petition for the types of property described in IRC § 6323(b), since the trustee is not a "purchaser." (11 USC § 545(2); In re Walter, 45 F.3d 1023 (6th Cir. 1995); In re Berg, 121 F.3d 535 (9th Cir. 1997))

5.17.8.15 (04-24-2015)
Unsecured Priority Claims

1. Bankruptcy Code § 507 sets forth the expenses and unsecured claims that have priority and the order of their priority. This will affect the claim's treatment in bankruptcy.

2. Whether the tax was incurred before or after the date of the petition for relief will affect its priority. To determine whether a tax is incurred before or after the petition, a tax on income for a particular period is considered incurred on the last day of the period. Taxes on an event, or measured by an event, are considered as being incurred on the date of the transaction or the event. For example:

   - Taxes due on the transfer of assets by reason of death are incurred on the date of death.
   - Taxes due on a gift are incurred on the date that the gift is given.
   - Excise taxes due to the sale of gasoline are incurred at the time the gasoline is sold.

   While employment taxes are incurred when wages are paid, they are treated as pre-petition liabilities when the wages were earned pre-petition.

3. In a Chapter 7 case, claimants within a priority category as set forth in the subsections of 11 USC § 507 are paid pro-rata when the bankruptcy estate is not sufficient to provide full payment.

4. 11 USC § 507(a)(2), as amended by BAPCPA, gives second priority to administrative expenses as defined under 11 USC § 503(b). Any tax incurred by the estate is an administrative expense under 11 USC § 503(b)(1)(B)(i). These taxes include:

   A. Income and excise taxes;

   B. Employees' and employers' shares of employment taxes on wages earned and paid after the petition date;

   C. Taxes attributable to an excessive allowance of a tentative net operating loss carry back adjustment received by the estate as a "quickie" refund under IRC § 6411;

   D. Any fine, penalty, or reduction in credit relating to a tax which is an administrative tax also constitutes an administrative expense under 11 USC § 503(b)(1)(C); and

   E. Administrative expenses include the actual, necessary costs of preserving the estate. Thus, IRC § 4971 penalties for underfunding pension plans may be administrative expenses if the underfunding obligation occurred during the administration of the bankruptcy estate.

5. Under 11 USC § 507(a)(8), as amended by BAPCPA, eighth priority is given to the following taxes:

   A. Taxes on income or gross receipts for a taxable year ending on or before the date the bankruptcy petition was filed for which a return was due, including extensions, within three years before the bankruptcy;

   B. Taxes on income or gross receipts assessed within 240 days before the bankruptcy petition was filed, exclusive of any time that an offer in compromise related to that tax was pending or in effect during the 240-day period, plus 30 days, and exclusive of any time during which a stay of proceedings against collection was in effect in a prior bankruptcy case during the 240-day period plus 90 days;

   C. Taxes on income or gross receipts not assessed before, but assessable after, the commencement of the case, unless the tax is of a kind specified in the discharge exceptions of 11 USC § 523(a)(1)(B) or (C) for fraud, unfiled returns, or late filed returns within two years of the petition date;

D. A tax required to be collected or withheld and for which the debtor is liable in whatever capacity (11 USC § 507(a)(8)(C)). This includes the trust fund recovery penalty under IRC § 6672.

E. Employer's share of employment tax on wages earned from the debtor before the petition date for which a return was last due, including any extensions, within three years before the petition date (11 USC § 507(a)(8)(D)); or

F. A penalty related to a claim of a kind specified in section 507(a)(8) and in compensation for actual pecuniary loss (11 USC § 507(a)(8)(G)). The trust fund recovery penalty also falls within this category.

6. Certain excise taxes are also entitled to eighth priority under 11 USC § 507(a)(8)(E). They are excise taxes on:

   A. A pre-petition transaction for which a return is last due, including extensions, within three years before the petition date, or

   B. A transaction occurring within three years before the petition date for which no return is required.

   Note:

   Under BAPCPA, all the time periods for determining priority under 11 USC § 507(a)(8) are suspended for any period during which the IRS is prohibited from collecting the tax as a result of a collection due process hearing, the stay of a prior bankruptcy case, or a confirmed plan, plus 90 days.

   Liabilities incurred by individuals under the individual shared responsibility provision (SRP) of the Affordable Care Act (ACA), and assessed on MFT 35 on IDRS, are treated as an excise tax under 11 USC § 507(a)(8)(E) in a bankruptcy case.

7. A claim for an erroneous refund or credit has the same priority as a claim for the tax to which such refund or credit relates.

5.17.8.16 (08-01-2010)
Unsecured General Claims

1. Any portion of the IRS's pre-petition claim that cannot be classified as either secured or unsecured priority is a general unsecured claim.

5.17.8.17 (04-24-2015)
Post-petition Claims/Administrative Expenses

1. Section 503(b)(1)(A) provides generally that administrative expenses include "the actual, necessary costs and expenses of preserving the estate." Taxes incurred by the estate are specifically given administrative expense claim status by 11 USC § 503(b)(1)(B)(i). Generally, administrative tax claims are claims for tax liabilities (including estate income and employment taxes) incurred post-petition by the bankruptcy estate.

2. A post-petition liability incurred by an individual debtor (rather than the estate) in a Chapter 7 or 11 case cannot be claimed in the bankruptcy case. This includes any post-petition liability owed by an individual debtor for tax incurred under the Shared Responsibility Provision (SRP) of the Affordable Care Act (ACA), which is assessed on IDRS under MFT 35. Under IRC § 1398, the individual debtor and the debtor's bankruptcy estate in a Chapter 7 or 11 case are separate taxable entities. Taxes on the individual debtor's post-petition wages in a Chapter 7 cases are incurred by the individual debtor, while taxes on income arising from assets which are property of the estate are incurred by the estate.

   Note:

   Under BAPCPA, 11 USC § 1115 provides that for individuals in a Chapter 11, post-petition wages are included as property of the estate. IRB Notice 2006-83, 2006-2 C.B. 596, provides detailed guidance on tax reporting requirements for individuals filing Chapter 11 bankruptcy on or after October 17, 2005. See Publication 908, *Bankruptcy Tax Guide*, and IRM 5.9.8.13 , *Processing Chapter 11 Bankruptcy Cases, Internal Revenue Code § 1398 Issues*, for additional information.

3. Taxes collectible as expenses of administration shall be assessed against the estate following normal assessment procedures. The notice and payment demand should be sent to the trustee or debtor in possession. If payment is not received, a request for payment of administrative expenses may be filed with the court.

   Note:

   Under BAPCPA, the IRS is not required to file a request for payment of administrative expenses in order for the expenses to be allowed. However, an administrative claim should nevertheless be filed because it puts the debtor and creditors on notice of the tax liability and the amount due. It also assists in the referral of the case to Counsel for dismissal or conversion and helps ensure that the claim will be treated as an allowed administrative claim. (See IRM 5.9.8.16.4.2, *Processing Chapter 11 Bankruptcy Cases, Post-Confirmation Tax Liabilities of the Individual Debtor (Post-BAPCPA)*, for additional information.)

4. Administrative expenses accrue interest and penalties to the date of payment.

5. In Chapter 13 cases, the IRS may file a proof of claim for taxes that become payable while the case is pending (11 USC § 1305(a)(1)). This includes post-petition 1040 liabilities and post-petition SRP (MFT 35) liabilities. If the Form 1040 is post-petition (see IRM 5.9.10.9(1), *Processing Chapter 13 Cases, Post-petition Tax Liabilities*), the SRP (MFT 35) liability is also post-petition. The debtor may not file such a claim on behalf of the IRS.

5.17.8.18 (08-01-2010)
Interest

1. Pre-petition interest has the same status as a claim for the underlying tax: secured, priority or general unsecured. (11 USC §§ 101(5) and 502(b); In re Garcia, 955 F.2d 16 (5th Cir. 1992); In re Larson, 862 F.2d 112 (7th Cir. 1988))

2. The IRS generally is not entitled to claim post-petition interest on its pre-petition claims since a creditor cannot claim interest which has not matured as of the petition date (11 USC § 502(b)(2)). If the underlying tax is non-dischargeable, however, the post-petition interest on such tax is also non-dischargeable. The non-dischargeable tax and interest may be collected from the debtor after the discharge is granted.

3. Section 506(b) provides that post-petition interest will be paid on claims that are "oversecured" (i.e., the value of the collateral securing the claim exceeds the amount of the claim).

4. Administrative expense tax claims accrue interest to the date of payment.

5.17.8.19 (04-24-2015)
Penalties

1. Pre-petition penalties on a secured claim are treated as secured. They are payable as part of the secured claim except in a Chapter 7 case. In Chapter 7, 11 USC § 726(a)(4) provides a low distribution priority for secured tax penalties, unless the penalty is compensation for actual pecuniary loss (as with the trust fund recovery penalty).

2. Pre-petition penalties on an unsecured tax claim are treated as general unsecured unless the penalty is compensation for actual pecuniary loss. It does not matter if the tax claim itself is entitled to priority or general unsecured status.

3. Post-petition penalties are not allowable on pre-petition tax claims, but may sometimes be collectible from the debtor after the discharge. Non-pecuniary loss penalties are non-dischargeable if they relate to a non-dischargeable tax and the transaction or event giving rise to the penalty occurred within three years of the petition date. Also, IRC § 6658 prohibits the accrual of certain penalties during the pendency of the bankruptcy case – from the date the petition is filed until the date the case is closed or dismissed.

4. The Trust Fund Recovery Penalty is a pecuniary loss penalty. If not secured, it is an unsecured priority claim (11 USC § 507(a)(8)(C) and (G)). It is not dischargeable except in Chapter 13 cases filed prior to October 17, 2005, where it has been provided for in the plan. Under BAPCPA, it is no longer dischargeable in Chapter 13 cases (11 USC § 1328(a)(2)).

5.17.8.20 (04-24-2015)
Return Filing Requirements

1. IRC § 1398 contains special tax provisions for an individual filing under Chapter 7 or 11. Individual debtors in those chapters have the right to terminate their tax year when the petition is filed.
2. The bankruptcy estate in an individual Chapter 7 or 11 case is an entity separately taxable from the individual and must file its own tax returns. The Chapter 7 trustee has the duty to file the estate's tax returns, as does the Chapter 11 trustee or Debtor-in-Possession (DIP).
3. In corporate and partnership Chapter 7 and 11 cases, no separate taxable entity is created (IRC § 1399). The trustee, the officers, or managers of the DIP are responsible for filing any required returns.
4. Trustees can apply to be relieved of the filing requirements in corporate cases when the corporation has neither assets nor income. The procedures are contained in Revenue Procedure 84-59.
5. In Chapters 12 and 13, the debtor's bankruptcy estate is not a separate taxable entity for federal income tax purposes. The individual debtor is responsible for filing the returns for all income earned while in bankruptcy.
6. Under BAPCPA, a Chapter 13 debtor must file all required tax returns for all periods ending within four years of the bankruptcy petition date (11 USC § 1308). Failure to do so by the first scheduled 341 meeting date, or by the date to which the meeting is held open by the trustee, is a basis for conversion or dismissal of the case (11 USC § 1307(e)). See In re Perry, 389 B.R. 62 (Bankr. N.D. Ohio 2008). Pub 5082, *What You Should Know About Chapter 13 Bankruptcy and Delinquent Tax Returns*, also provides information about tax filing requirements for Chapter 13 debtors.
7. Ordinarily, disregarded limited liability companies (LLCs), partnerships, and Subchapter S corporations are not themselves liable for a federal income tax. The bankruptcy estates of these pass-through entities are not separate taxable entities pursuant to IRC § 1399.
   A. Nevertheless, when a pass-through debtor is liquidating or engaged in other potentially significant income-producing activity during a Chapter 11 case, the IRS may want to consider the status and the tax effect upon the partners or shareholders of the pass-through debtor, where possible.
   B. It may be difficult for the IRS to obtain timely Form 1065 or 1120S returns from the fiduciaries of liquidating pass-through debtors for post-petition tax years. However, the IRS may need the information on these returns in order to file proper claims in the bankruptcy cases of the partners or of the shareholders that may also be pending or that may be filed soon after the pass-through debtor engages in its income-producing activity.

5.17.8.21 (04-24-2015)
Determination of Tax Liability

1. The bankruptcy court may determine the liability of the debtor or the bankruptcy estate. It does not matter if the liability was previously assessed or paid and whether or not a proof of claim is filed. This includes:
   - Any tax,
   - Any fine or penalty relating to a tax, and
   - Any addition to tax.

   The bankruptcy court may not re-determine a tax liability that was adjudicated before a court of competent jurisdiction before the bankruptcy petition was filed (11 USC § 505(a)).
2. Bankruptcy courts do not have authority to determine the tax liabilities of parties other than the debtor or the debtor's bankruptcy estate. See the following cases for additional information:
   - In re Prescription Home Health Care, Inc., 316 F.3d 542 (5th Cir. 2002)
   - In re Brandt-Airflex Corp., 843 F.2d 90 (2nd Cir. 1988)
   - United States v. Huckabee Auto Co., 783 F.2d 1546 (11th Cir. 1986)
   - American Principals Leasing Corp. v. United States, 904 F.2d 477 (9th Cir. 1990)
   - In re Kaplan, 104 F.3D 589 (3d Cir.1997)
   - In re Wolverine Radio Co., 930 F.2d 1132 (6th Cir. 1991)
3. A bankruptcy court should not determine tax liabilities of debtors or of bankruptcy estates that may not be claimed or paid through the bankruptcy case. For instance, in a no-asset Chapter 7 case, a bankruptcy court should abstain from deciding the debtor's pre-petition tax liabilities. Similarly, a bankruptcy court should refrain from determining taxes:
   - When an individual debtor's post-petition tax liabilities cannot be claimed in a bankruptcy case, or
   - When an individual debtor's post-petition tax liabilities have not been claimed in a bankruptcy case.

   Under the same reasoning, a bankruptcy court should not determine the tax liability of a reorganized Chapter 11 non-individual debtor for any post-confirmation taxes.
4. The trustee must file an administrative claim for refund for the bankruptcy court to determine the right of a bankruptcy estate to a tax refund. The claim must either be denied or not acted upon for 120 days (rather than the six months provided in IRC § 6532). 11 USC § 505(a)(2)(B); see also Rev. Proc. 2010-27 , Rev. Proc. 2010-31IRB 183
5. A trustee may request a prompt determination for administrative period taxes by filing the appropriate tax return (11 USC § 505(b)(2)).
   A. The IRS has 60 calendar days from the date of the request to decide whether to audit the return. The IRS has a total of 180 calendar days from the date of the trustee's request to complete the audit. A longer period may be granted for cause with the court's permission.
   B. The trustee, the debtor, and any successor to the debtor are discharged upon payment of the tax shown on the return when:
   •The IRS does not notify the trustee within 60 calendar days that the return has been selected for audit, or
   •The IRS does not complete the audit and notify the trustee of any tax due within 180 calendar days.

   Note:

   This date may be extended by order of the court. See 11 USC § 505(b)(2)(ii).

C. After the IRS completes the audit, the trustee, debtor, and any successor to the debtor are discharged upon payment of the tax determined by the court. The trustee, debtor, and any successor to the debtor are also discharged upon payment of the tax determined by the IRS.

D. These discharge provisions do not apply if the return is fraudulent or contains a material misrepresentation.

E. Rev. Proc. 2006-24 (May 30, 2006) made Rev. Proc. 81-17 obsolete. Rev. Proc. 2006-24 established the procedures for trustees to file a prompt determination request with the Centralized Insolvency Operation (CIO) in Philadelphia. Announcement 2011-77 then updated the address to file requests with the CIO.

F. Under BAPCPA, the bankruptcy estate, the trustee, and the debtor are discharged upon payment of the tax.

6. Trustees and Debtors-in-Possession (DIPs) may file requests with Insolvency for prompt audit determinations under 11 USC § 505(b) in bankruptcy cases filed by partnership debtors. Trustees and DIPs may also file requests for prompt audit determinations in bankruptcy cases filed by Subchapter S corporations. The prompt audit determination request may be filed with the partnership's post-petition Form 1065. The prompt audit determination request may also be filed with the Subchapter S corporation's Form 1120-S.

   A. The IRS does not treat a Form 1065, *U.S. Partnership Return of Income*, as a return eligible for a prompt determination under 11 USC § 505(b). This is because the Form 1065 is an information return. A prompt audit of the information return could not report or uncover any unpaid liability of the partnership debtor's bankruptcy estate for any federal income tax.

   B. It is unusual for a corporation filing Form 1120-S, *U.S. Small Business Corporation Income Tax Return*, to be liable for a federal income tax in the year a Form 1120-S is filed. Yet, it is not inconceivable that the corporation could be liable for a federal income tax. Accordingly, IRS does now honor requests made pursuant to 11 USC § 505(b) for post-petition Forms 1120-S, even when the Form 1120-S reflects no federal income tax liability. However, a request for a prompt determination by a debtor Subchapter S corporation will discharge only the parties specifically included in section 505(b). The non-debtor shareholders are not included in section 505(b) and will not be discharged.

   C. In a partnership’s bankruptcy case, the bankruptcy court does not have proper jurisdiction to determine the federal tax liabilities of any of the non-debtor partners. In a Subchapter S corporation’s bankruptcy case, the bankruptcy court does not have proper jurisdiction to determine the federal tax liabilities of any of the non-debtor shareholders. (American Principals Leasing Corp. v. U.S., 904 F.2d 477 (9th Cir. 1990))

5.17.8.22 (04-24-2015)
Exceptions to Discharge

1. From a debtor’s viewpoint, the primary purpose of bankruptcy is to obtain relief from indebtedness. Creditors are barred from collecting discharged debts from the debtor personally (11 USC § 524). However, tax liens may be enforceable against property owned by the debtor before bankruptcy even though the tax debt was discharged. See IRM 5.9.17.4, *Bankruptcy and Other Insolvencies, Closing a Bankruptcy Case, Exempt, Abandoned or Excluded Property (EAEP)*, and subsections for additional information about collection of tax debts discharged in bankruptcy after the discharge.

2. Section 523 provides that certain debts of an individual debtor are excepted from discharge. The following taxes are non-dischargeable under 11 USC § 523(a)(1) for individuals who receive a discharge in Chapter 7, 11, or 12. They are also non-dischargeable for an individual who receives a hardship discharge in Chapter 13:

   A. "Gap" period taxes which arise only in involuntary cases which are entitled to priority under 11 USC § 507(a)(3);

   B. Pre-petition taxes entitled to priority status under 11 USC § 507(a)(8);

   C. Taxes with respect to which a return was not filed or was filed late within two years before the petition date; and

   D. Taxes for which the debtor filed a fraudulent return or that the debtor willfully attempted in any manner to evade or defeat.

   Caution:

   Liabilities assessed on IDRS under MFT 35 for the Shared Responsibility Provision (SRP) of the Affordable Care Act (ACA) are taken from Line 61 of the debtor's Form 1040. When the tax on the debtor's Form 1040 is non-dischargeable, the tax assessed for the SRP (MFT 35) of the ACA is often, but not always, excepted from discharge.

3. Pursuant to 11 USC § 523(a)(7), a non-pecuniary loss penalty is non-dischargeable if it relates to a tax that is non-dischargeable under 11 USC § 523(a)(1). The transaction or event that gave rise to the penalty must have occurred within three years before the petition date. Thus, a penalty relating to a non-dischargeable income tax is only non-dischargeable if the tax accrued within three years before the bankruptcy petition. In re Roberts, 906 F.2d 1440 (10th Cir. 1990); In re Burns, 887 F.2d 1541 (11th Cir. 1989); McKay v. United States, 957 F.2d 689 (9th Cir. 1992); In re Miller, 300 B.R. 422 (Bankr. N.D. Ohio 2003).

4. Liabilities excepted from discharge by section 523 survive the bankruptcy and may be collected from any property of the debtor after the discharge. After discharge, dischargeable liabilities may be collected from exempt property secured by a pre-petition Notice of Federal Tax Lien (NFTL). Dischargeable liabilities may also be collected from abandoned or excluded property due to the Service's statutory lien. A NFTL is not required to collect discharged taxes from abandoned or excluded property.

5. Pre-petition and post-petition interest on non-dischargeable taxes is also non-dischargeable, as are any post-petition penalties on these taxes. Bruning v. United States, 376 U.S. 358 (1964); Hanna v. United States, 872 F.2d 829 (8th Cir. 1989).

6. Under BAPCPA, the following taxes claimed in a Chapter 13 are now non-dischargeable when the debtor receives a discharge upon completion of the Chapter 13 plan (11 USC § 1328(a)(2)) :

   - Trust fund taxes
   - Taxes with respect to unfiled returns
   - Late returns filed within two years of the petition date
   - Fraudulent returns
   - Those taxes that the debtor made a willful attempt to evade or defeat.

   Caution:

   Liabilities for the SRP (MFT 35) of the ACA are taken from Line 61 of the debtor's Form 1040. When the tax on the debtor's Form 1040 is non-dischargeable, the tax assessed for the SRP (MFT 35) of the ACA is often, but not always, excepted from discharge.

5.17.8.23 (08-01-2010)
Property of the Estate

1. The bankruptcy estate is created by operation of law as soon as a voluntary or involuntary petition is filed commencing a case (11 USC § 541). In general, only property of the estate is administered in the bankruptcy case. See IRM 5.9.8.13(5), *Internal Revenue Code § 1398 Issues, Determining if Income is Property of the Estate or Property of the Debtor*, for additional information on estate or individual property in Chapter 11 bankruptcy cases.

2. Generally, the estate is comprised of all the debtor’s legal and equitable property interests as of the commencement of the case.

3. Proceeds, rents, or profits of estate property are also estate property.

4. Property that an individual debtor acquires by inheritance or through a divorce settlement within 180 days after the petition date is treated as estate property.

5. In Chapters 12 and 13, the estate of an individual debtor may include after-acquired property such as wages and income (11 USC §§ 1207, 1306). In general, wages earned by an individual debtor in a Chapter 7 case are not property of the estate(11 USC § 541(a)(6)). In cases filed on or after October 17, 2005, post-petition wages and after-acquired property of an individual Chapter 11 debtor are property of the estate (11 USC § 1115(a)).

6. Community property is included in the estate to the extent it is under the sole or joint management and control of the debtor or to the extent it is liable for an allowable claim.

7. Property held by nominees or alter egos, or which the debtor transferred as a fraudulent conveyance, is property of the estate. The trustee may avoid certain pre-petition and post-petition transfers of property and bring such property into the estate for distribution.

8. Generally, property cannot be excluded from the estate by agreement between parties that the debtor's interest will terminate upon financial insolvency or bankruptcy. However, under 11 USC § 541(c)(2), the debtor's interest in a trust that is subject to a restriction on transferability enforceable under non-bankruptcy law is excluded. Under this provision interests in ERISA-qualified pension plans are excluded from the estate. Under 11 USC § 541(b), as amended by BAPCPA, interests in other types of pension plans may also be excluded.

5.17.8.24 (04-24-2015)
Turnover to the Trustee — Assets Seized Pre-petition

1. 11 USC § 542(a) requires an entity in possession, custody, or control of property of the estate (including exempt property) to deliver that property to the trustee, unless the property is of inconsequential value to the estate.

2. Under 11 USC § 542(b), with certain limited exceptions, an entity that owes a debt (e.g. a tax refund) to the debtor that is property of the estate and that is matured, payable on demand, or payable on order must pay such debt to or on the order of the trustee, subject to any setoff rights under 11 USC § 553.

3. Pursuant to United States v. Whiting Pools, Inc., 462 U.S. 198 (1983), property, whether tangible or intangible, levied upon pre-petition, but not transferred before the bankruptcy is filed, is property of the bankruptcy estate subject to turnover. See IRM 5.9.5.8, *Levies and Bankruptcy*, for additional information.

   A. Accordingly, if an IRS levy on accounts receivable, bank accounts, wages, insurance proceeds, and other intangibles has not resulted in the receipt of those funds by the IRS at the time the bankruptcy is filed, they are property of the bankruptcy estate. Any tangible property seized pre-petition, but not sold pre-petition, is property of the bankruptcy estate subject to turnover (however, see below, regarding IRS rights to adequate protection before turnover).

   B. In any case where the IRS has received a pre-petition payment, ownership has transferred to the IRS and the property is not property of the estate. However, the payment may be subject to recovery by the estate as a preference. See *IRM 5.17.8.26*, *Trustee's Power to Avoid Preferences*, for additional information.

4. The courts generally recognize IRS rights to adequate protection where a levy is served pre-petition because the levy provides the IRS with an interest in the levied-upon property. In any case where the IRS is entitled to adequate protection, the IRS should immediately contact the debtor-in-possession or trustee to reach an adequate protection agreement, notify the court, and request relief from the automatic stay. Adequate protection arguments are usually made in Chapter 11 cases, but may occasionally be made in Chapter 7 and 13 cases. A referral should be made to the Associate Area Counsel (SB/SE) for the necessary legal action to be taken. Referrals are subject to the tolerances in IRM 5.9.4.14.4, *Referral Tolerances*. For additional information about adequate protection and cash collateral in Chapter 11 cases, see IRM 5.9.8.5, *Adequate Protection*, and IRM 5.9.8.7, *Cash Collateral/Property Depreciation of the Estate*.

5.17.8.25 (10-16-2007)
Exempt Property

1. Exempt property is property that an individual debtor may elect to place outside of the estate. The exempt property cannot be liquidated by the trustee. Section 522 of the Bankruptcy Code governs the types and amounts of property that the debtor can exempt from the bankruptcy estate. Section 522(b) provides that the debtor may choose to utilize the Bankruptcy Code exemptions listed in § 522(d) or elect the exemptions provided by other Federal or applicable state law. States may legislatively opt out of the Bankruptcy Code exemption scheme and allow the debtors in their state only those exemptions provided by state law. Joint debtors must make the same exemption election.

2. Exempt property is not liable for any debts of the debtor except alimony, security interests, non-dischargeable tax debts, and tax debts secured by a Notice of Federal Tax Lien (NFTL).

3. Only individuals can claim exempt property.

4. Taxes that are discharged with a NFTL properly filed pre-petition may still be collectible from exempt property (11 USC § 522(c)(2)(B)). See IRM 5.9.17.4, *Exempt, Abandoned or Excluded Property*, and subsections for additional information.

5.17.8.26 (04-24-2015)
Trustee's Power to Avoid Preferences

1. Pursuant to 11 USC § 547(b), the trustee may avoid certain pre-petition transfers of the debtor's interests in property to bring that property back into the bankruptcy estate. Such transfers benefit one creditor at the expense of others and are known as preferences.

2. To qualify as a preference, a tax payment must:

   A. Be made while the taxpayer was insolvent;

   B. Be made on or within 90 days before the petition date;

   C. Be a payment outside the normal course of business and not made according to ordinary business terms;

   D. Be for an amount that is more than the creditor would have received in a Chapter 7 liquidation; and

   E. Be a payment on account of an antecedent debt (e.g., a late payment of tax).

3. Pursuant to 11 USC § 547(b), a trustee may avoid a transfer of an "interest of the debtor in property." An interest of the debtor in property does not include property that the debtor holds in trust for another (11 USC § 541(d)). In Begier v. IRS, 496 U.S. 53 (1990), the Supreme Court held that a voluntary pre-petition payment of trust fund taxes (withheld employment taxes and excise taxes collected from purchasers) cannot be avoided under 11 USC § 547(b) because the funds paid were not property of the debtor. The funds were held in trust for the United States under IRC § 7501(a).

4. Although "antecedent debt" is not defined by the Bankruptcy Code, it is clear that the term "antecedent debt" refers to a debt incurred before the date of the transfer. As long as the payment is made by the due date of the return (or by the due date of an extension) without a penalty, there is no antecedent debt. Timely payments of tax cannot be avoided under 11 USC § 547.

5. A tax payment must be made on or within 90 days before the filing of the bankruptcy petition to be avoidable (11 USC § 547(b)(4)). For payments by check, the relevant date is the date the check is honored by the drawee bank.

5.17.8.27 (04-24-2015)
Setoff

1. Outside of bankruptcy, the IRS has the right to set off tax overpayments against tax debts (IRC § 6402). 11 USC § 553 preserves the IRS's right to offset pre-petition claims against pre-petition refunds except as prohibited by the automatic stay. Under BAPCPA, the automatic stay no longer prohibits offsets of pre-petition income tax claims against pre-petition income tax refunds. BAPCPA also allows offsets of income tax refunds to domestic support obligations. (See IRM 5.9.4.4, *Credits, Refunds, and Offsets*, and subsections for additional information.)

2. Pre-petition tax refunds are property of the estate under 11 USC § 541(a). The IRS may be required to turn over the refund to the trustee unless the refund is protected under 11 USC § 553.
3. If the automatic stay prohibits the IRS from setting off, but the IRS's right of setoff is protected under 11 USC § 553, the IRS is not required to turn over the refund. The IRS may temporarily freeze the refund until it has the authority to exercise its setoff rights (Citizens Bank of Md. v. Strumpf, 516 U.S. 16 (1995)).
4. In many jurisdictions, bankruptcy courts have issued standing court orders that modify the automatic stay to permit setoff in some or all circumstances and dispense with the requirement to turn over pre-petition refunds to the bankruptcy trustee.
5. Generally, in Chapter 7, 11, and 13 cases, post-petition overpayments can be offset directly to post-petition tax periods.

5.17.8.28 (04-24-2015)
Effect of Bankruptcy on the Limitation Period for Assessment and Collection

1. IRC § 6503(h) suspends the running of the period of limitation on collection (IRC § 6502) in a case under the Bankruptcy Code during the period in which the IRS is prohibited by reason of such case from collecting, plus six months thereafter. The collection period is suspended while the automatic stay is in effect, and in a Chapter 11 case, while the plan is in effect and not in default. Under BAPCPA, an individual in a Chapter 11 case does not receive a discharge until all payments under the plan have been completed. Thus, the automatic stay remains in effect until the court grants a discharge at the end of the plan as in Chapter 13 cases. When the taxpayer is a "serial filer" the automatic stay and collection period suspension may be impacted. For additional information on the automatic stay, collection statute suspension, and assessment statute in a bankruptcy case, see:
   - IRM 5.9.3.6, *Automatic Stay*
   - IRM 5.9.4.2, *ASED/CSED*
   - IRM 5.9.4.2.1, *BRA 94 and BAPCPA's Effect on Assessments*
   - IRM 5.9.4.3, *Examination and Insolvency*
   - IRM 5.9.5.7, *Serial Filers*
   - IRM 5.9.5.7.1, *Systemic Identification in Serial Filer Cases*
   - IRM 5.9.8.9, *Collection Statute of Limitations and Chapter 11 Plans*
   - IRM 5.9.17.18, *ASED/CSED Considerations*
2. The limitation period for assessments is not suspended by IRC § 6503(h) because assessments are not prohibited by the automatic stay.
3. However, where a notice of deficiency has been issued, the debtor may be prohibited from commencing a Tax Court case by the automatic stay, which indirectly tolls the assessment statute. See Rev. Rul. 2003-80, 2003-29 I.R.B. 83 (July 21, 2003).
   A. The filing of a Tax Court petition, as well as the continuation of a Tax Court proceeding, are precluded by the automatic stay (11 USC § 362(a)(8)). Regardless of whether the IRS issues a Notice of Deficiency before or after the taxpayer files bankruptcy, the taxpayer may be prohibited by 11 USC § 362(a)(8) from filing a Tax Court petition. Under BAPCPA, the automatic stay prohibits an individual from filing a Tax Court petition or continuing a Tax Court case only for taxable periods ending before the date of the order for relief (generally, the date the bankruptcy petition was filed). For corporate debtors, BAPCPA prohibits the commencement or continuation of a Tax Court case for any taxable period for which the bankruptcy court may determine the liability. Generally, this will include all pre-confirmation taxes.
   B. IRC § 6213(f) suspends the running of time for filing a Tax Court petition while the automatic stay is in effect and for 60 days thereafter.
   C. IRC § 6213(a) prohibits the making of an assessment until the period for filing a Tax Court petition (generally 90 days under § 6213(a)) has run. If a Tax Court petition has been filed, the assessment is prohibited until the Tax Court decision is final.
   D. Thus, the IRS is prohibited from assessing an unagreed deficiency on a pre-petition period while the automatic stay is in effect. The prohibition is in effect when a notice of deficiency is issued within 90 days of bankruptcy. The prohibition is also in effect when a notice of deficiency is issued post-petition and the automatic stay is still in effect.
   E. IRC § 6503(a)(1) suspends the running of the assessment period for the period during which the IRS is prohibited from making the assessment and for 60 days thereafter. If the deficiency is placed on the docket of the Tax Court, the assessment period is suspended until the decision of the Tax Court becomes final and for 60 days thereafter.

Exhibit 5.17.8-1
Glossary of Common Bankruptcy Terms

The list below contains terms commonly used in insolvency cases. Additional terms may be found in IRM Exhibit 5.9.1-1, *Overview of Bankruptcy, Glossary of Common Insolvency Terms*.

Abandonment	The process of severing a bankruptcy estate's interest in property. The bankruptcy court may permit the trustee to abandon any property of the estate that is burdensome or of inconsequential value to the estate. Abandonment to avoid adverse tax consequences when the property is sold is an issue when the debtor is an individual in Chapter 7 or Chapter 11. *Affirmative Act:* The trustee may actively abandon or a party in interest may request abandonment. Notice and a hearing is required, although notice can be general, and a hearing is not always held. *Administrative Abandonment:* If the property is listed in the schedules, but it is not administered by the trustee (i.e., sold), then it is abandoned to the debtor upon closing of the estate.
Adequate Protection	A secured creditor is allowed to have its secured interest "adequately protected" while the automatic stay is in effect. This arises when the property is depreciating or, in some cases, when the accrued interest on a defaulted loan is diminishing the equity in the property. The court may award the creditor some protection against the loss of value rather than modifying the automatic stay. Adequate protection most commonly consists of periodic cash payments and replacement liens in post-petition assets. Other provisions can also be included to protect the collateral; such as, a requirement that the debtor maintain insurance on the property.
Adequate Protection Agreement	An agreement between a debtor and a secured creditor to protect the creditor's secured portion until a plan of reorganization is confirmed.
Administrative Expense	The actual, necessary expenses of preserving the estate, including any tax incurred by the estate. This includes tax liabilities for periods ending post-petition and before discharge or dismissal for which the estate is liable. Administrative expenses are entitled to priority under 11 USC § 507(a)(2). 11 USC § 503 defines allowable administrative expenses. IRC § 1398(h) explains the proper handling of these expenses on the bankruptcy estate's tax return.
Adversary Proceeding	A lawsuit within the bankruptcy case in which one party files a complaint to seek relief (for example, to recover money or property, to determine the validity of a lien, to determine dischargeability of a debt, or to obtain an injunction). Adversary proceedings involve more legal formalities than contested matters. Rule 7001 of the Federal Rules of Bankruptcy Procedure determines when an adversary proceeding must be filed.
AMDIS	The Audit Management Display Information System (AMDIS) is one of Examination's command codes used on the Integrated Data Retrieval System (IDRS) to show any return that is being audited by the Examination function.
AMDISA	Same as AMDIS, except it displays specific information on an open tax period.
	The Audit Information Management System (AIMS) is the Examination computer system used by Exam. AIMS is researched by Insolvency when tax accounts

AIMS	have audit indicators, such as a Transaction Code (TC) 420 on IDRS.
AIS	Automated Insolvency System (AIS). The bankruptcy database maintained by Insolvency. Its many functions work together to allow Insolvency to manage all of the bankruptcy cases in Insolvency's inventory.
ASED	The Assessment Statute Expiration Date (ASED) marks the date the statutory period of time for assessing a tax ends. The timeframe for assessing a tax is normally three years from the due date or three years from the date the return is filed, whichever is later (IRC § 6501).
Asset Case	All Chapter 9, 11, 12, and 13 cases are considered asset cases. A Chapter 7 case may be an asset case or a no asset case. A Chapter 7 case in which the debtor has assets which are non-exempt (i.e., available for use in satisfying creditors' claims) is considered an asset case. If the debtor in a Chapter 7 case has only exempt or excluded assets, such as a personal home or a retirement plan, which are not available to pay claims, the case is considered a no asset case.
Automatic Stay	An injunction that arises when a bankruptcy is filed (11 USC § 362). It is a prohibition on the commencement or continuation of any legal or enforcement activities against the debtor, the debtor's property, and property of the estate (subject to certain exceptions). • Generally, the stay terminates when the discharge is granted or denied or the case is closed or dismissed, whichever event occurs earliest. • Any willful violation of the stay may give the debtor the right to claim actual damages and attorney's fees (but not punitive damages). ***Note:*** Creditors may ask the court for relief from the automatic stay to permit them to pursue collection remedies, such as a foreclosure action on real property or to offset a tax refund.
Bankruptcy	A judicial process to resolve a debtor's problems in paying debts incurred by the debtor. The term bankruptcy is usually used in connection with the federal bankruptcy laws enacted by Congress. While "bankruptcy" generally refers to a proceeding brought in the federal bankruptcy courts governed by the Bankruptcy Code, the terms insolvency proceeding and receivership usually refer to proceedings brought under state laws and supervised by the state courts. A bankruptcy can either be voluntary or involuntary. 11 USC § 303 provides the requirements allowing creditors to file an involuntary petition.
Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA)	Most of the provisions of BAPCPA are effective for cases filed on or after October 17, 2005. However, some BAPCPA provisions, such as certain provisions relating to Chapter 12 debtors, took effect on April 20, 2005, the date of enactment. Many provisions of BAPCPA are intended to keep debtors from abusing the bankruptcy system. Such provisions severely limit the imposition of the automatic stay in cases of serial filings, require tax compliance from individual debtors, and establish a means test for Chapter 7 debtors. BAPCPA also added a new Chapter 15 to deal with cross-border bankruptcies.
Bankruptcy Code	The laws of bankruptcy codified under Title 11, United States Code, §§ 101 through 1532.
Bankruptcy Court	A division of a United States District Court. All District Courts have standing orders referring bankruptcy cases to bankruptcy judges. See 28 USC §§ 157, 1334.
Bankruptcy Estate	See *Estate.*
Bankruptcy Petition	The form filed by the debtor (or against the debtor by creditors in an involuntary bankruptcy) with the bankruptcy court requesting relief from creditors. It is filed to commence a case under any chapter of the Bankruptcy Code.
Bankruptcy Reform Act of 1994 (BRA 94)	Signed into law and effective for all bankruptcy cases filed on or after October 22, 1994. It made changes to the bankruptcy law such as permitting assessments and the issuance of notice and demand without violating the automatic stay and the filing of late proofs of claim for priority taxes in Chapter 7 cases.
Bankruptcy Rules	Rules of procedure that govern the practice and procedure in bankruptcy cases. The official name for these rules is the "Federal Rules of Bankruptcy Procedure."
Bar Date	The date fixed by the court or by statute as the date by which a creditor must file a proof of claim. The Service is allowed a minimum of 180 days after the order of relief in which to file a proof of claim. The court may grant extensions for cause.
Case Docket	The official record of the bankruptcy case. It shows every event occurring in and every document filed in the case. The docket is maintained by the bankruptcy clerk's office.
Cash Collateral	11 USC § 363(a) defines cash collateral as "cash, negotiable instruments, documents of title, securities, deposit accounts or other cash equivalents." It simply means cash or cash equivalents which are property of the estate and in which the IRS or other creditors have a secured interest. Cash collateral includes accounts receivable. The trustee or the debtor-in-possession may not use cash collateral without the court's approval or the consent of interested parties.
Change of Venue	Change of location of the bankruptcy filing; usually due to the debtor relocating from one part of the country to another. The bankruptcy jurisdiction is changed to a court in the debtor's new location.
Chapter 7	A liquidation proceeding filed under Chapter 7 of the Bankruptcy Code by an individual, business, or other entity, where creditors are paid by liquidation and distribution of the debtor's non-exempt assets, if any, are available.
Chapter 9	A bankruptcy proceeding for a governmental unit. In order to qualify as a debtor under Chapter 9, an entity must, among other things, be a municipality, be authorized to be a debtor by state law, be insolvent or unable to meet its debts as they mature, and desire to effect a plan to adjust such debts.
Chapter 11	A reorganization proceeding filed under Chapter 11 of the Bankruptcy Code by an individual, business, or other entity where creditors are paid under a plan. A plan can last several years; however, a large percentage eventually fail. Chapter 11 plans may also provide for the liquidation of the debtor. Individual debtors may receive a discharge upon completion of the Chapter 11 plan or a hardship discharge.
Chapter 12	This chapter applies to family farmers and fishermen. It closely resembles a Chapter 13, but without a super discharge. Creditors are paid under a plan. Payments may be paid seasonally. Debtors may receive a discharge upon completion of the Chapter 12 plan or a hardship discharge.
Chapter 13	This chapter applies to individuals with regular income, sole proprietors, and other self-employed individuals. Chapter 13 is a reorganization proceeding for individuals with regular income, including wage earners, where creditors are paid under a plan. Plan payments are paid through a trustee who handles all disbursements. There are debt limitations to qualify for a Chapter 13. See 11 USC § 109(e). The super discharge has been limited by BAPCPA. The debtor may receive a discharge upon completion of the Chapter 13 plan or a hardship discharge.
Chapter 15	This chapter applies when: (1) A foreign court or a foreign representative seeks assistance in the United States in connection with a foreign proceeding; (2) Assistance is requested in a foreign country in connection with a case under 11 USC; (3) A foreign proceeding and a domestic bankruptcy for the same debtor are pending concurrently; or (4) Creditors or other interested persons in a foreign country have an interest in requesting the commencement of, or participating in, a case or proceeding under 11 USC.
Claim	A right to payment even if unliquidated, contingent, or disputed. Proofs of claim may include tax liabilities which have not been assessed. See also *Proof of Claim.*
Co-Debtor Stay	Under the Bankruptcy Code, the co-debtor stay applies only to consumer debts in Chapters 12 and 13 cases. *It does not apply to taxes.* See *Consumer Debt.*
Commencement Date	The day on which a bankruptcy petition is filed.
Complaint	A pleading filed by a party to the bankruptcy case to initiate an adversary proceeding. The complaint must be served with a summons.
Confirmation	The time when the court grants final approval to the debtor's plan of reorganization. Applicable only in bankruptcies under Chapters 11, 12, and 13.
Consumer Debt	A debt incurred by an individual primarily for personal, family, or household purposes. *Does not include taxes*. See *Co-Debtor Stay*.
Conversion	When a debtor voluntarily or involuntarily changes from one chapter of bankruptcy to another chapter with the approval of the bankruptcy court.
Cram Down	In the event any class of claims or interests is impaired under a plan of reorganization in Chapter 11 and does not garner the minimum percentage of votes to accept the plan, the plan's proponent may request the court to confirm the plan by the alternative cram down method. As long as at least one class of creditors approves the plan, the plan does not discriminate unfairly and meets the fair and equitable treatment of creditors test as well as other requirements for confirmation under the Bankruptcy Code, the court may confirm the plan.
Creditor	Person or entity with a claim for a debt against the debtor and/or property of the debtor at the time the bankruptcy petition is filed.
CSED	The date on which the collection statute expires is called the Collection Statute Expiration Date (CSED). The statutory period for collecting a tax is normally ten years from the date of assessment (IRC § 6502). IRC § 6503(h) suspends the CSED while the automatic stay is in effect and for six months thereafter.
Debtor	The person or entity (corporation, partnership, municipality, etc.) that: (1) files a voluntary petition, or (2) has an order of relief entered against it when an involuntary petition is filed by creditors meeting certain requirements with the bankruptcy court.
Debtor-in-Possession (DIP)	The debtor in a Chapter 11 reorganization is known as a debtor-in-possession (DIP) when the debtor remains in full control of all of the assets. The DIP is charged with the duties and responsibilities of a fiduciary to maximize the assets of the estate for the benefit of all creditors and has many of the rights and authority of a trustee.

Discharge	A court order which extinguishes the debtor's personal liability on many pre-petition debts. It is the event triggering a permanent injunction on collecting a debt in a bankruptcy case. Generally, a discharge is granted: (a) In an individual debtor's Chapter 7 case no earlier than 60 days after the date set for the first meeting of creditors (11 USC § 341 Meeting). Only individuals receive a discharge in a Chapter 7 case; (b) In a Chapter 11 non-individual case when the plan is confirmed; (c) In a Chapter 11 individual case when the plan is completed or when the court grants a hardship discharge; and (d) In Chapter 12 and 13 cases, when the plan is completed (three to five years) or when the court grants a hardship discharge. Individual Chapter 11 debtors whose bankruptcies were filed prior to October 17, 2005 were discharged at confirmation of the plan.
Discharge Date	The date the court records the discharge.
Discharge, Denial of	The situation in which a debtor goes through the bankruptcy proceeding and is determined to remain responsible (usually for cause) for all of the pre-petition liabilities. There is no income from the forgiveness of debt because none was given. A denial of discharge has the same effect with respect to the debtor's liability for pre-petition debts as a dismissal. A denial of discharge is the result of an adversary proceeding filed against the debtor.
Discharge Injunction	Under 11 USC § 524, a discharge operates as an injunction against any collection action to recover discharged tax liabilities from the debtor. Damages against the IRS could result if the injunction is violated. Also, see *Violation of Stay*. The discharge injunction may not prevent the IRS from collecting on any lien it may have on exempt, abandoned, or excluded property.
Disclosure Statement	In a Chapter 11 case, an approved disclosure statement must generally accompany the proposed plan of reorganization before the plan is confirmed. The disclosure statement must contain adequate information concerning the affairs of the debtor to allow the creditors to make an informed judgment about the plan. However, for cases under BAPCPA, small businesses may be subject to less stringent disclosure statement requirements. See 11 USC § 1125(f).
Dismissal	The term used when a bankruptcy proceeding is terminated prematurely. Debts are not forgiven. The debtor does not receive a discharge. If a bankruptcy case involving an individual is dismissed by the court, the estate is not treated as a separate entity for federal tax purposes (IRC § 1398(b)(1)). The debtor's tax status is treated as if a bankruptcy case had not been filed. When a bankruptcy case is dismissed, the debtor is restored to the debtor's pre-petition position. Upon dismissal, the debtor is no longer protected by the automatic stay. IRS can resume administrative collection.
Distribution Order	A Distribution Order authorizes the case trustee to pay creditors the amounts listed in the order. It is usually prepared by the Chapter 7 case trustee and entered by the court.
Estate	A bankruptcy estate is created upon the filing of the bankruptcy case. It generally consists of all of the debtor's interests in any property at the time the case is filed. The estate includes property acquired by the estate after the petition is filed. However, certain property is excluded from the estate. Excluded property is usually certain types of retirement accounts. ***Note:*** The estate may also include a non-debtor spouse's community property interests. In an individual Chapter 7 or 11 case, the bankruptcy estate is a separate taxable entity. In Chapter 13 cases, certain assets acquired by the debtor post-petition are also included in the estate (11 USC § 1306). In individual Chapter 11 cases filed on or after October 17, 2005, property of the estate also includes post-petition earnings from services performed by the debtor (11 USC § 1115).
Examiner	An examiner may be appointed in a Chapter 11 case to investigate the financial affairs of the debtor. An examiner does not replace the debtor-in-possession as does a Chapter 11 trustee.
Excluded Assets	A property interest that does not become property of the bankruptcy estate upon the petition date. A NFTL is not required for collection from excluded assets on either dischargeable or non-dischargeable periods.
Exempt Property	Property intended to assist the debtor in making a fresh start and that cannot be liquidated by the trustee. Exempt property is not liable for any debts of the debtor except alimony, security interests, non-dischargeable tax debts, and dischargeable taxes secured by a Notice of Federal Tax Lien (NFTL). Depending upon state law, a debtor may choose between state and federal exemptions. Only individuals can exempt property (e.g., a homestead, vehicles, personal furnishings).
53 Account - CNC	A balance due account that is considered Currently Not Collectible (CNC). Frequently used in Chapter 7 corporate accounts and Chapter 11 liquidating bankruptcies at close of bankruptcy. Processed by use of Form 53.
First Meeting of Creditors (section 341 meeting)	The meeting at which the debtor is required to testify under oath about financial affairs and to respond to questions from creditors and the trustee. Usually held within 20 to 50 days after a case is commenced under any chapter of the Bankruptcy Code. It is also referred to as the § 341 Meeting, 341 Meeting, or 341 Hearing (11 USC § 341).
Fraudulent Conveyance	A transfer of any property by the debtor within one year before the bankruptcy petition with the intent to hinder, defraud, or delay a creditor. When brought to light, the trustee can successfully challenge the transfer and request turnover of the property to the estate (11 USC § 548). For cases filed on or after October 17, 2005, the look back period is two years.
Fresh Start	Refers to the goal of bankruptcy to give the debtor a new financial life free from many past debts. The discharge gives a debtor a fresh start, but some debts are excepted from discharge. See 11 USC § 523.
Gap Period Taxes	Tax liabilities and penalties which accrue during the interim period after an involuntary bankruptcy case is filed and before an order for relief is entered.
General Unsecured Claim	See *Unsecured General Claim*.
Hardship Discharge	When circumstances beyond the debtor's control prevent the Chapter 13 debtor from modifying or completing the plan, the debtor can receive the same type of discharge that would have been received had the debtor been discharged in a Chapter 7 case if certain requirements are met (11 USC § 1328(b)). Chapter 12 affords a similar discharge but under more limited circumstances (11 USC § 1228(b)). Similar to the Chapter 13 case, the court may grant an individual in Chapter 11 case a hardship discharge in appropriate circumstances (11 USC § 1141(d)(5)).
Impaired Class	A class of claim or interest holders is generally "impaired" by a Chapter 11 plan unless the plan leaves the claim or interest holders' non-bankruptcy legal, equitable, and contractual rights unaltered (11 USC § 1124(1)).
Individual Debtor	A person who files bankruptcy as an individual rather than as a partnership, Limited Liability Company (LLC), or corporation. The individual debtor may file singly or jointly with a spouse.
Insider	If the debtor is an individual, an "insider" includes a relative or partner of the debtor, a partnership in which the debtor is a general partner, a general partner of the debtor, or a corporation of which the debtor is a director, officer, or person in control. If the debtor is a corporation, an "insider" includes a director or officer of the debtor or a person in control of the debtor (11 USC § 101(31)). An insider may be subject to different treatment under the Bankruptcy Code. For example, the time period for recovering preferential transfers to an insider is one year as opposed to 90 days for transfers made to non-insiders.
Insolvency	Generally, understood to mean an inability to pay debts as they become due. However, the Bankruptcy Code refers to an insolvent entity as one whose debts are greater than the fair market value of its assets (11 USC § 101(32)). A debtor need not be insolvent to file bankruptcy. See *Bankruptcy.*
Involuntary Bankruptcy Petition	The situation in which creditors meeting certain criteria file a bankruptcy petition, forcing a debtor into bankruptcy involuntarily. See *Bankruptcy* and *Order for Relief.*
IRC § 6020(b)	IRC § 6020(b) allows the IRS to prepare and execute a return when a taxpayer fails to make a required return or makes a false or fraudulent return. A section 6020(b) return is not a return for purposes of the exceptions to discharge under section 523(a) of the Bankruptcy Code.
Joint Return/Separate Bankruptcy Petitions Filed by Each Spouse	The situation in which spouses file a joint income tax return and file separate bankruptcy petitions either on the same date or on different dates. The cases may or may not be "consolidated" into a single case.
Joint Return/Single Debtor (Debtor and Non-Debtor Spouse)	The situation in which spouses file a joint income tax return but only one spouse declares bankruptcy. The person who files for bankruptcy protection is known as the debtor. The other spouse, who did not file bankruptcy, is known as the non-debtor spouse.
Levy	An IRS enforcement tool used to seize tangible and intangible assets. The IRS must turn over to the estate property subject to levy but may seek adequate protection.
Lien	A claim attaching property or rights to property as collateral for payment on a debt or obligation. See *Notice of Federal Tax Lien (NFTL)* for additional information.

Lifting the Automatic Stay	Relief obtained by a specific creditor from the bankruptcy court that lifts the injunction under 11 USC § 362 allowing the creditor to take a certain action. The automatic stay terminates as to all creditors when the discharge is granted or the case is closed or dismissed, whichever event occurs earliest. For cases filed on or after October 17, 2005, the stay may also terminate 30 days after the petition date if the debtor is an individual in a Chapter 7, 11, or 13 case and the individual was dismissed from an individual Chapter 7, 11, or 13 bankruptcy within the previous 12 months.
Liquidation	The act of reducing tangible and intangible assets to cash. This applies to Chapter 7 cases in which the business ceases to exist and its assets are sold. For individuals the liquidation is limited to non-exempt assets. Some debtors liquidate through a Chapter 11 plan.
Local Rules	Each bankruptcy court may make and amend its own local rules governing its practice and procedures in that specific jurisdiction. However, the local rules cannot be inconsistent with the Federal Rules of Bankruptcy Procedure.
Monthly Operating Reports	The reports required to be filed in all Chapter 11 cases by debtors-in-possession or trustees. Generally, the reports include a cash receipts and disbursements journal, income statement, and balance sheet analysis.
No Asset Case	A no asset case is one where no equity in the debtor's assets is available to pay unsecured creditors because all of the debtor's assets are exempt, excluded, fully encumbered by secured liens, or have little value (Chapter 7). Generally, the IRS and other creditors do not file claims in no asset cases, unless or until the bankruptcy trustee provides further notice that assets have been found (Bankruptcy Rule 2002(e) and 3002(c)(5)).
Non-Exempt Assets	Assets which are part of the bankruptcy estate (i.e., the property available to satisfy creditors' claims). See also *Asset Case*.
Non-Pecuniary Loss Penalty	A non-pecuniary loss penalty is a punitive penalty, or "fine." Examples are failure to file, failure to pay, frivolous, fraud, and willful misconduct penalties. Generally, the Service receives only minimal payments on these types of penalties. These penalties may not accrue while the bankruptcy is pending and they may be non-dischargeable if they relate to a non-dischargeable tax.
Notice of Federal Tax Lien (NFTL)	For tax purposes, a properly filed NFTL secures the tax liability up to the value of the equity in the debtor's assets. There is a prohibition on filing a new NFTL on a pre-petition tax debt until after the lifting of the stay. Refiling of an existing NFTL is allowed as this is a continuation of a pre-petition filed NFTL. See also *Secured Claim*.
Objection to Claim	A motion filed with the bankruptcy court by a debtor, creditor, or trustee to object to all or part of a claim. If necessary, a hearing will be held to resolve the dispute. Most bankruptcy court litigation, including objections to claim, are brought by motion pursuant to the less formal contested matter procedures.
180–Day Reports	Each Chapter 7 trustee must submit to the United States Trustee an interim report on each asset case that was open at the beginning of the reporting period. The interim report consists of an Estate Property Record and Report and a Cash Receipts and Disbursements Record.
Order for Relief	The filing of a bankruptcy petition constitutes an order for relief in a voluntary bankruptcy case. In an involuntary case, the court orders relief after notice and hearing on the merits of the involuntary case (Bankruptcy Rule 1013).
PACER (Public Access to Court Electronic Records)	An electronic court notification/information system providing ready information to the public on court records. PACER maintains records and provides a current status on the majority of bankruptcy cases.
Pecuniary Loss Penalty	Assessed to reimburse and compensate the government for an actual loss of taxes. Always treated as a priority classification on the Service's proof of claim, unless entitled to a secured position if a valid lien was filed prior to the commencement of the bankruptcy case.
Person	As used for bankruptcy purposes, "person" includes an individual, business entity (partnership, corporation, etc.), but not a governmental unit (11 USC § 101(41)).
Petition Date	The date the bankruptcy petition was filed in the bankruptcy court.
Plan of Reorganization	A proposed method of payment submitted by the debtor and/or other interested parties in a bankruptcy case to the bankruptcy court and creditors for review and approval. Creditors have the right to vote to accept or reject the plan and/or object to it. Plans are filed in Chapters 11, 12, and 13 bankruptcy cases. Only the debtor can propose a plan in Chapter 12 and 13 cases.
Post-Confirmation	The period that occurs after the plan is confirmed.
Post-Petition	The period after the bankruptcy petition is filed.
Post-Petition Pre-Confirmation	The period from the petition date to the confirmation date.
Post-Petition Taxes	Taxes incurred after the filing of the bankruptcy petition for tax periods ending after the petition date.
Preference	A pre-petition transfer of the debtor's property to a creditor made on or within 90 days before the filing of bankruptcy (or one year if the transfer is to an insider), which enables the creditor to receive more than in a Chapter 7 liquidation. The trustee may avoid the transfer and recover the property for the estate unless one of several exceptions apply, including the exception for payments of debts made in the ordinary course of business (11 USC § 547). The voluntary pre-petition payment by the debtor of trust fund taxes to the Service is not a payment of property of the debtor, and thus cannot be recovered as a preference.
Pre-Packaged Bankruptcies	A bankruptcy which includes a plan of reorganization that the creditors negotiate and accept prior to the filing of the bankruptcy petition.
Pre-Petition	The period of time before the bankruptcy petition was filed.
Pre-Petition Taxes	Taxes incurred, whether or not assessed, prior to the filing of the bankruptcy petition. An income tax accrues on the last day of the tax year.
Priority	The concept relating to the order and the extent to which the various creditors' unsecured claims are satisfied out of the available assets of the bankruptcy estate (11 USC § 507).
Priority Claim	A claim with priority over other unsecured claims. 11 USC § 507 sets forth the prerequisites and order of payment for priority claims, including taxes with return due dates less than three years prior to the petition date, income tax assessments made within 240 days before the petition date, income tax deficiencies that are unassessed but are assessable prior to the petition date unless the taxes are excepted from discharge under 11 USC § 523(a)(1)(B) or (C), and trust fund taxes.
Proof of Claim	A document a creditor files with the bankruptcy court to assert a right of payment from the bankruptcy estate for pre-petition debts. A claim can also be filed for post-petition debts in some instances (e.g.,11 USC § 1305 claims in Chapter 13).
Property of the Estate	All legal or equitable interests of the debtor at the time the bankruptcy is filed. This includes potential claims and lawsuits the debtor may yet file against a third party. It is from this estate the trustee will liquidate assets to pay creditors in a Chapter 7 case and affects the amount creditors must be paid in plans under Chapters 11, 12, and 13 (11 USC § 541).
Pro rata	According to a calculated share; distributed proportionately.
Receivership	See under term *Bankruptcy*.
Reorganization	The process through which a Chapter 11, 12, or 13 debtor promises to resolve or pay creditors' claims.
Res Judicata	The principle that an existing final judgment rendered on the merits by a court of competent jurisdiction is conclusive. It bars the parties from re-litigating the same claims in another proceeding.
Rule 2004 Examination	Similar to a deposition but broader in scope. It permits any party in interest to examine any entity about the acts, conduct, or property of the debtor, the liabilities and financial condition of the debtor, or about any matter which may affect the administration of the debtor's estate, or the debtor's right to a discharge.
Schedules	After a bankruptcy is filed, all debtors must timely file: (1) A schedule of assets and liabilities, (2) A schedule of current income and current expenditures, and (3) A statement of financial affairs.
§ 341 First Meeting of Creditors	See *First Meeting of Creditors*.
Secured Creditor	A creditor having a lien, security interest, or other encumbrance which has been properly perfected as required by law with respect to property owned by the debtor. The creditor has a secured claim to the extent of the value of the collateral or to the extent of the creditor's right to offset a mutual debt owed to the debtor against the creditor's claim against the debtor (11 USC § 506(a)). For tax purposes, a properly filed Notice of Federal Tax Lien secures the tax liability up to the value of the equity in the assets. A federal tax liability may sometimes be secured because the Service has a setoff right against a debtor's right to federal tax refunds or overpayment of tax, or by amounts other federal agencies may owe the debtor.

Short Year Election	An individual debtor (and spouse) have the option of filing short year income tax returns for the pre-petition and post-petition portions of the tax year, if certain requirements are met. This election applies to individual taxpayers who have filed a Chapter 7 or 11 bankruptcy case (IRC § 1398(d)).
Small Business Case	A Chapter 11 case where the debtor's liabilities are less than $2,490,925 and no active creditor's committee exists. Many, if not most, Chapter 11 cases will fall within this definition. The debt limitation must be adjusted every three years under 11 USC § 104 to reflect the Consumer Price Index.
Sovereign Immunity	The doctrine that the United States is immune from suit for damages or other monetary recovery unless the United States waives its immunity from suit (e.g., by a statute permitting a damages suit against the United States). Immunity for damages has been waived under IRC § 7433(e) and immunity has been waived for other actions under the Bankruptcy Code set forth in 11 USC § 106(a).
Substitute for Return (SFR)	A procedure by which the Examination function of the IRS establishes an account and examines the records of taxpayer when the taxpayer/debtor refuses or is unable to file a return, and information received by the Service indicates a return should be filed. The Substitute for Returns (SFR) program under IRC § 6212 uses Statutory Notice of Deficiency (S/N) procedures (i.e., 30-day Letter and 90-day Letter).
Super Discharge	For cases filed prior to October 17, 2005, the discharge granted to an individual debtor upon the successful completion of a Chapter 13 plan or to a corporation or a partnership upon the effective date of a confirmed Chapter 11 plan. All pre-petition tax debts provided for in a Chapter 13 plan are discharged. In the case of a corporation or partnership in Chapter 11 that is not liquidating, all pre-confirmation debts, including administrative period taxes, are generally discharged. For Chapter 13 cases filed on or after October 17, 2005, certain exceptions to the super discharge apply, including certain tax debts.
Trustee	In a case under Chapters 7, 12, or 13, the trustee is the person appointed by the United States Trustee to administer the processing of a bankruptcy case. The trustee is the representative of the bankruptcy estate and owes fiduciary duties to unsecured creditors. In a case under Chapter 11, the debtor-in-possession (DIP) generally serves as the trustee unless the court orders a trustee be appointed and is under the same fiduciary obligation. Listed are several definitions of a trustee and the corresponding chapter(s) of bankruptcy: • *Chapter 7 Trustee:* A disinterested person appointed by the United States Trustee or elected by creditors to administer the Chapter 7 case. Referred to as a panel trustee or case trustee. The Chapter 7 trustee is responsible for a particular Chapter 7 case. • *Chapter 11 Trustee:* A Chapter 11 trustee is responsible for a particular Chapter 11 case. The trustee is appointed by the court or has been elected by the creditors to replace the debtor-in-possession, after the court makes a determination that the DIP should be replaced. The DIP, or the Chapter 11 trustee, is a fiduciary responsible for administering the Chapter 11 case. The United States Trustee or a party in interest may request the court appoint a Chapter 11 trustee for cause. • *Chapter 12 Trustee:* An individual appointed to serve by the United States Trustee in every Chapter 12 case. Referred to as a Chapter 12 standing trustee. • *Chapter 13 Trustee:* An individual appointed to serve by the United States Trustee in a Chapter 13 case. Every Chapter 13 case has a trustee. Referred to as a Chapter 13 standing trustee. ***Note:*** The Chapter 12 and 13 standing trustees are responsible for disbursement of payments under the plans for the respective bankruptcy chapters and do not have the same rights and obligations as a Chapter 7 or 11 trustee.
United States Trustee	An employee of the Department of Justice charged with supervision of the administration of all bankruptcy cases (28 USC § 586). The United States Trustee has a statutory right to appear and be heard on any issue in any bankruptcy case (11 USC § 307).
Unsecured Creditor	A creditor who has no perfected security interest in property of the estate to secure its claim, or no right of setoff, or whose debt exceeds the value of the creditor's collateral or right of setoff (11 USC § 506(a)). Unsecured creditors may be either priority or general unsecured creditors.
Unsecured Creditors Committee	Appointed in Chapter 11 cases by the United States Trustee. The committee is comprised of creditors willing to serve, who generally hold the largest unsecured claims, and whose claims are representative of the type of unsecured debt in the case.
Unsecured General Claim	A claim that is not entitled to either secured or priority status. General unsecured creditors may recover a low percentage on their claims or may recover nothing at all.
Violation of Stay	An improper collection action made during the period in which the automatic stay is in effect. In addition to prohibiting acts to collect pre-petition liabilities, the automatic stay also prohibits any enforcement actions against property of the bankruptcy estate. Examples of collection actions prohibited during the automatic stay (on pre-petition tax liabilities) include the solicitation of an installment agreement, making demand for payment, or the serving of a levy. The Service can be liable for damages and attorneys fees for violations of the automatic stay, but punitive damages cannot be awarded. See also *Discharge Injunction.*

More Internal Revenue Manual

Part 5. Collecting Process

Chapter 17. Legal Reference Guide for Revenue Officers

Section 9. Chapter 7 Bankruptcy (Liquidation)

5.17.9 Chapter 7 Bankruptcy (Liquidation)

Manual Transmittal

April 21, 2015

Purpose

(1) This transmits revised IRM 5.17.9, *Legal Reference Guide for Revenue Officers*, *Chapter 7 Bankruptcy (Liquidation)*.

Background

This section provides legal guidance on Chapter 7 bankruptcies and explains the provisions and concepts of bankruptcy law that are unique to Chapter 7.

Material Changes

(1) IRM 5.17.9, *Chapter 7 Bankruptcy (Liquidation)*, has been updated to provide clarity and expansion of existing material. The following table shows changes within this IRM revision.

IRM	Change
5.17.9.1(3)	A new paragraph has been added to discuss the users of this IRM section.
5.17.9.2(1)(c)	The trustee takes possession of all the debtor's non-exempts assets included as property of the estate.
5.17.9.2(3)(a)	While a business entity is not eligible to receive a discharge in Chapter 7, few or no assets may be available to pay tax liabilities that are not paid by the bankruptcy estate.
5.17.9.2(3)(b)	Discharge prevents collection from the debtor as a personal liability for most debts owed at the time the petition is filed.
5.17.9.2(3)(c)	Non-dischargeable tax liabilities have been further clarified. Interest on non-dischargeable taxes is also non-dischargeable.
5.17.9.3(1)	The automatic stay in an individual case may terminate or not go into place at all when the debtor is a serial filer.
5.17.9.3(4)	The list of actions that do not violate the automatic stay has been expanded.
5.17.9.4(2)	A Limited Liability Company (LLC) has been added to the entities eligible to file Chapter 7.
5.17.9.5(3)	The debtor may chose to provide the trustee with a transcript of the return filed for the most recent tax year ending before the filing of the bankruptcy case instead of a copy of the return.
5.17.9.8(5)	When IRS is not notified in sufficient time to file a timely proof of claim prior to the governmental bar date in an individual case, the liability may be excepted from discharge.
5.17.9.12(3)	The Chapter 7 trustee may continue to operate a debtor's business to sell it at a higher price.
5.17.9.13(2)(i)	Discharge may be denied when the debtor executed and the court approved a written waiver of discharge after an order for relief.
5.17.9.13.1	A new subsection has been added to discuss dischargeability of Individual Shared Responsibility Payment (SRP) liabilities assessed on IDRS under MFT 35 in Chapter 7 cases.
5.17.9.14(2)	The IRS can collect discharged liabilities from exempt property secured by a Notice of Federal Tax Lien (NFTL) after the discharge.
5.17.9.14(3)	The IRS can collect discharged liabilities from abandoned or excluded property after discharge due to its statutory lien. A NFTL is not required.

(2) Editorial changes were made throughout this section to add clarity and to update or correct citations.

Effect on Other Documents

This supersedes IRM 5.17.9, *Chapter 7 Bankruptcy (Liquidation)*, dated August 1, 2010. This revision incorporates interim guidance SBSE 05-1214-0083, *Processing the Individual Shared Responsibility Payment (SRP) in Bankruptcy Cases*, dated December 15, 2014.

Audience

SB/SE Revenue Officers.

Effective Date

(04-21-2015)

Kristen Bailey
Acting Director, Collection Policy
Small Business/Self-Employed

5.17.9.1 (04-21-2015)
Overview

1. This section discusses Chapter 7 bankruptcies. It explains the provisions and concepts of bankruptcy law that are unique to Chapter 7.
2. A glossary of the bankruptcy terms used in this section is found in IRM Exhibit 5.17.8-1.
3. This section is used primarily by Revenue Officers (ROs) and Advisors in SBSE. However, employees in functions other than SBSE may refer to this section when dealing with a taxpayer that has filed Chapter 7 bankruptcy. Insolvency caseworkers in Field Insolvency (FI) and at the Centralized Insolvency Operation (CIO) may refer to this section in addition to IRM 5.9, *Bankruptcy and Other Insolvencies*, when working bankruptcy cases.

5.17.9.2 (04-21-2015)
Purpose

1. The most common form of relief sought by debtors under the Bankruptcy Code is liquidation under Chapter 7.
   A. A Chapter 7 case may be started by a voluntary or involuntary petition.
   B. A Chapter 7 case involves three major participants: the debtor, the trustee, and the creditors.
   C. The trustee’s job is to administer a Chapter 7 liquidation. The trustee takes possession of all the debtor's non-exempt assets included as property of the estate. These assets are reduced to cash. The trustee then distributes the proceeds to the creditors in accordance with their legal priorities established in 11 USC § 726.
2. The primary purpose of Chapter 7 from the creditors’ standpoint is fair and equal treatment of creditors in accordance with their relative priorities.
3. One of the primary purposes of Chapter 7 from the debtor’s viewpoint is to obtain a discharge of debts, thereby giving an individual debtor a "fresh start."
   A. A discharge in a Chapter 7 case is given to individuals only. Partnerships, Limited Liability Companies (LLCs), and corporations do not receive a discharge in Chapter 7. However, few or no assets may be available for the collection of the tax liabilities of these business entities when not paid by the bankruptcy estate.
   B. The right of an individual to a discharge is not absolute, as grounds may exist to oppose a discharge. Generally, if a debtor is honest and follows the rules of the Bankruptcy Code and the court, the debtor will obtain a discharge. A discharge prevents collection from the debtor as a personal liability for most of the debts owed at the time of the filing of the petition.
   C. Even if a discharge is obtained, certain debts of an individual debtor may be non-dischargeable and survive bankruptcy. Many tax liabilities and interest on those taxes are non-dischargeable. In particular, priority tax debts are non-dischargeable. Non-priority tax liabilities may be non-dischargeable when the taxes are on unfiled returns or on returns filed late and within the date that is within two years of the bankruptcy petition date. Taxes related to fraudulent returns are non-dischargeable. Additionally, taxes are non-dischargeable when the debtor willfully attempted to evade or defeat the tax in any manner.
4. In general, in a Chapter 7 case, the debtor's non-exempt assets are collected, reduced to cash, and funds distributed to the creditors. To accomplish this, the court must determine:
   A. The debtor’s pre-petition rights and interests;
   B. The pre-petition rights and interests of some or all of the creditors against other creditors or transferees;
   C. The rights of the debtor or trustee to recover property held by third parties;
   D. The rights of the debtor to retain existing or future (after-acquired) property, including rights to retain certain property as exempt from the bankruptcy process; and
   E. The relief granted to the debtor by the Bankruptcy Code from unpaid creditors.

5.17.9.3 (04-21-2015)
Automatic Stay

1. The automatic stay is triggered by the filing of a bankruptcy petition. The automatic stay of an act against property of the estate remains until it is no longer estate property. In the case of a non-individual, the automatic stay of any other prohibited act remains in place until the earlier of dismissal or closure of the case by the court. Unless the debtor is a serial filer, the stay of any other prohibited act in the case of an individual remains in effect until the earliest of:
   - Closure of the case by the court,
   - Dismissal of the case by the court,
   - Granting of a discharge, or
   - Denial of a discharge.

   If the individual debtor is a "serial filer" , the automatic stay may terminate 30 days after the current petition date or may not go into effect at all. See IRM 5.9.6.5, *Bankruptcy and Other Insolvencies, Processing Chapter 7 Cases, Automatic Stay*, and IRM 5.9.5.7, *Bankruptcy and Other Insolvencies, Opening a Bankruptcy Case, Serial Filers*, for additional information.
2. The automatic stay prohibits:
   - Any act to collect a pre-petition debt;
   - Any act to create, enforce, or perfect a lien against property of the estate or property of the debtor to collect a pre-petition debt; or,
   - The commencement of any proceeding against the debtor to collect a pre-petition debt.
3. For a complete listing of acts prohibited by the automatic stay, see 11 USC § 362(a).
4. The following list contains some common actions taken by the Service that do not violate the automatic stay. For additional actions that do not violate the stay, see IRM 5.9.3.6(10), *Bankruptcy and Other Insolvencies, Debtors' Delinquent Accounts, Automatic Stay, Certain Activities Allowed*.
   - Refiling a valid pre-petition Notice of Federal Tax Lien (NFTL),
   - Making an assessment for certain taxes and issuance of one informational notice,

Caution:

Debtors receive one notice of assessment of a pre-petition tax return balance due. Subsequent notices may not be issued. If they are, Insolvency must be contacted immediately.

- An audit to determine a tax liability,
- Conducting, continuing, and completing a Trust Fund Recovery Penalty (TFRP) investigation,
- Demanding tax returns,
- Sending a statutory notice of deficiency, or
- Setting off pre-petition income tax refunds against pre-petition income tax liabilities (11 USC §§ 362(b)(9) and (26)).

5. If the Service willfully violates the automatic stay, the Service may be subject to damages and attorney's fees under 11 USC § 362(k) and IRC § 7433(e). See the following cases for additional information:
   - In re Chesnut, 422 F.3d 298, 300 (5th Cir. 2005) (determining that creditor violated stay when it foreclosed on an asset to which the debtor had only an arguable claim of right);
   - In re Price, 42 F.3d 1068 (7th Cir. 1994) (IRS willfully violated stay by sending post-petition notice of intent to levy to Chapter 13 debtors, with knowledge of the bankruptcy proceedings, and declining to stop collection action); and,
   - In re Bulson, 117 B.R. 537 (B.A.P. 9th Cir. 1990) (IRS initiation of automated collection proceedings, based on mistaken belief that the bankruptcy case was closed, constituted a willful violation of the stay).

5.17.9.4 (04-21-2015)
Who May Be a Chapter 7 Debtor

1. Generally, any entity may be a debtor under Chapter 7 except:
   - Governmental units,
   - Railroads,
   - Insurance companies, and
   - Banks and other financial institutions.
2. Eligible entities include individuals, partnerships, Limited Liability Companies (LLCs), and corporations.
3. As a result of changes made to the Bankruptcy Code by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), for bankruptcy petitions filed on or after October 17, 2005, an individual may not file a Chapter 7 petition unless such person received a briefing from an approved non-profit credit counseling agency, including a budget analysis, within 180 days before the petition date. (11 USC § 109(h))

   Exception:

   Individual debtors are excepted from this requirement if (1) the United States Trustee determines that the approved non-profit credit counseling agency for the district in which the debtor resides is not reasonably able to provide services to additional debtors, or (2) the bankruptcy court excuses the debtor from the required credit counseling.

5.17.9.5 (04-21-2015)
Initiating a Chapter 7 Case

1. A Chapter 7 case is commenced by the filing of a bankruptcy petition. The petition may be a voluntary or an involuntary petition. A voluntary petition is filed by the debtor. An involuntary petition may be filed by creditors on behalf of the debtor. However, at least three creditors must join together to file an involuntary Chapter 7 petition for the debtor. A husband and wife can file a joint petition. (11 USC § 302)
2. Bankruptcy Rule 1007 requires the Chapter 7 debtor to file certain supporting documents within a fixed time after filing the petition. These documents include a mailing matrix, statement of financial affairs, and schedules. As part of the schedules, the debtor must also include Form B22A, or a means test calculation statement, which is required by 11 USC § 707(b)(2)(C).
3. For cases filed post-BAPCPA, the debtor must provide the trustee with a copy of the federal income tax return required under applicable law for the most recent tax year ending immediately before the commencement of the bankruptcy case and for which a federal income tax return was filed. However, the debtor may elect to provide the trustee with a transcript instead of a copy of such return. In either case, the copy of the return or transcript must be provided to the trustee no later than seven days before the date first set for the first meeting of creditors. (11 USC § 521(e)(2))
4. For cases filed post-BAPCPA, 11 USC § 521(j) requires the debtor to file all post-petition returns as they become due. If the debtor fails to do so, the Service may request the court to convert or dismiss the case.

5.17.9.6 (08-01-2010)
The Trustee

1. In a Chapter 7 case, the United States Trustee must appoint a member of the panel of private trustees as interim trustee promptly after the order for relief (11 USC § 701). The interim trustee serves until a trustee is elected by eligible creditors. This election is held at the first meeting of creditors which must be held within a reasonable time after the order for relief (11 USC § 341). If no trustee is elected, the interim trustee serves as trustee. The interim trustee has all the rights and powers of a bankruptcy trustee.
2. A Chapter 7 trustee is a fiduciary and is accountable to the court for the trustee's actions. The trustee represents the estate and, in particular, the unsecured creditors.
   A. The Chapter 7 trustee's duties under 11 USC § 704 include collecting the assets of the estate. This may include converting property to money, examining claims of creditors, and objecting where appropriate.
   B. In addition, the trustee must investigate the finances of the debtor, file tax returns where required, and pay taxes when due.
   C. If the debtor served as the administrator of an employee benefit plan at the time that the bankruptcy petition was filed, the trustee must continue to perform the debtor's duties as administrator.
   D. At the end of the bankruptcy proceedings, the trustee is required to file a final report with the court and the United States Trustee. Any creditor, including the IRS, may object to this report or account.
   E. If the debtor is an individual and has mostly consumer debts, the trustee must also file a statement indicating whether the debtor's case would be presumed to be an abuse of the Bankruptcy Code under 11 USC § 707(b)(2). The statement must be filed within 10 days after the first meeting of creditors.

5.17.9.7 (08-01-2010)

Conversion or Dismissal

1. Under 11 USC § 706(a), the debtor may convert a Chapter 7 case to Chapter 11, 12, or 13 at any time, as long as the case was not originally converted from a Chapter 11, 12, or 13. Also, the court may, upon request of a party in interest and after notice and hearing, convert a Chapter 7 case to Chapter 11 at any time. The court may not convert a Chapter 7 case to Chapter 12 or 13 unless the debtor requests or consents to such conversion (11 USC § 706(b) & (c)).

2. Under 11 USC § 707(a), the court may dismiss a Chapter 7 case only after notice and a hearing and only for cause, including:

   A. Unreasonable delay by the debtor that is prejudicial to creditors;

   B. Non-payment of any required fees or charges; or

   C. Failure of the debtor in a voluntary case to file the schedules required by 11 USC § 521(a)(1) within 15 days of the commencement of the case. However, dismissal is only on a motion by the United States Trustee.

3. The court can dismiss a case on other grounds, including bad faith in filing the petition.

4. When an individual's debts are primarily consumer debts, 11 USC § 707(b) provides that the court, on its own motion or on a motion by the United States Trustee, trustee, or any party in interest (e.g., panel trustee or a creditor), may dismiss a Chapter 7 case filed by an individual debtor, or convert the case to Chapter 11 or 13 (with the debtor's consent). In this situation, the court must first find that granting Chapter 7 relief would be an abuse under 11 USC § 707(b)(2). There is a presumption of abuse if the debtor fails to meet a means test calculation based on income, expenses, and certain debts. In a joint case, the means test calculation would be based on the financial information of both spouses.

5. A Chapter 7 case cannot be dismissed or converted based on any form of means testing if the debtor is a disabled veteran and the indebtedness occurred primarily during a period of active duty or while the debtor was performing a homeland defense activity (11 USC § 707(b)(2)(D)(i)).

6. A Chapter 7 case cannot be dismissed or converted based on any form of means testing with respect to the debtor while the debtor is on, and during the 540-day period beginning immediately after the debtor is released from, a period of active duty of not less than 90 days or performing a homeland defense activity of not less than 90 days (11 USC § 707(b)(2)(D)(ii)).

5.17.9.8 (04-21-2015)
Proofs of Claim

1. Generally, in Chapter 7 cases, a proof of claim must be filed in order to share in the distribution of the estate. The procedure for filing claims in Chapter 7 are set forth in Bankruptcy Rules 3001 and 3002.

2. In a Chapter 7 case, if it appears from the schedules that there are no assets from which a dividend can be paid, the court may include in the notice of first meeting of creditors a statement that it is unnecessary to file proofs of claim (Bankruptcy Rule 2002(e)). If the payment of a dividend subsequently becomes possible, further notice will be given for the filing of claims.

3. In Chapter 7 cases, to be timely, an IRS claim must be filed within 180 days after the order for relief (Bankruptcy Rule 3002(c)). In Chapter 7 cases, a tardily filed priority claim may still receive priority treatment, as discussed in *IRM 5.17.9.11*(2)(a) below. See 11 USC § 726(a)(1) for additional information.

4. As a result of BAPCPA's amendments to 11 USC § 503(b)(1), for cases commencing on or after October 17, 2005, the IRS may file, but is not required to file, a proof of claim for its administrative expenses as a condition to being allowed a claim for such expenses.

5. When IRS is timely noticed in a case, Insolvency caseworkers must file claims prior to the governmental bar date. If IRS was not notified in sufficient time to file a proof of claim prior to the governmental bar date, the liability in the individual Chapter 7 Asset case may be excepted from discharge. See IRM 5.9.6.12(7), *Bankruptcy and Other Insolvencies, Processing Chapter 7 Bankruptcy Cases, Proof of Claim - Asset Cases, Expired Bar Dates*, for additional information.

5.17.9.9 (08-01-2010)
Bankruptcy Estate Income Taxes

1. The bankruptcy estate in an individual Chapter 7 case is a separate taxable entity that must file its own tax return. The Chapter 7 trustee has the duty to file the estate tax return.

2. In corporate and partnership Chapter 7 cases, no separate taxable entity is created. The trustee is responsible for filing required tax returns.

3. If certain requirements are met, individuals in Chapter 7 have the right to terminate their tax year when the petition is filed (IRC § 1398). This creates two short taxable periods in the year in which the bankruptcy petition is filed. One taxable period is the pre-petition liability for which the estate is liable. The other taxable period is the post-petition liability which is the debtor's responsibility. See IRM 5.9.6.13, *Bankruptcy and Other Insolvencies, Processing Chapter 7 Bankruptcy Cases, Post-petition Liabilities — Individuals*, and IRM 5.9.6.14, *Bankruptcy and Other Insolvencies, Processing Chapter 7 Bankruptcy Cases, Bankruptcy Estate Income Taxes - Separate Taxable Entity*, for further discussion on the separate taxation of an individual Chapter 7 debtor and the bankruptcy estate.

5.17.9.10 (08-01-2010)
Treatment of Tax Liens

1. Under 11 USC § 724(b), tax lien claims are subordinated to claims entitled to priority under 11 USC §§ 507(a)(1) through 507(a)(7), including administrative expenses and certain other priority claims. If a case was converted from Chapter 11 to 7, administrative expenses, other than wages, salaries, or commissions arising after the date of the petition, only include the expenses incurred during the Chapter 7 case (11 USC § 724(b)(2)).

2. Thus, property of the estate that is subject to a tax lien or proceeds of such property is distributed in the following order:

   A. To the holders of liens senior to the tax lien;

   B. To priority claims specified in 11 USC §§ 507(a)(1) – (7), up to the amount of the allowed tax claim that is secured by the tax lien;

   C. To the holder of the tax lien, in the amount equal to the difference between the amount of the priority claims above and the actual amount of the tax lien;

   D. To the holders of liens junior to the tax lien;

   E. To the holder of the tax lien in the amount of the allowed tax claim that is not paid under c above; and

   F. To the estate.

3. Before subordinating a tax lien claim to the priority claims described above, the trustee must first use all unencumbered assets of the estate to satisfy those claims (11 USC § 724(e)).

5.17.9.11 (08-01-2010)
Distribution of Property of the Estate

1. The trustee's main goal is to produce an estate for the debtor's unsecured creditors by liquidating the debtor's non-exempt and unsecured assets and pursuing causes of action to recover money or property.

2. Under 11 USC § 726, the property of the estate is to be distributed as follows:
   A. Priority claims (timely filed, or if tardily filed, on or before the earlier of 10 days after the date that the summary of the trustee's final report is mailed to creditors, or the date of final distribution) in the order specified in 11 USC § 507;
   B. General unsecured claims, including claims filed late due to the claimant's lack of notice or actual knowledge of the case;
   C. Other tardily filed general unsecured claims;
   D. Claims (secured or unsecured) for a fine, penalty, or forfeiture, or for multiple, exemplary, or punitive damages to the extent such claims are not for actual pecuniary loss;
   E. Interest at the legal rate from the date of the petition on any claim paid under the above; and
   F. The debtor.
3. Upon conversion to a Chapter 7, administrative claims of the previous chapter retain their administrative status, but are paid after the administrative claims of the Chapter 7 (11 USC § 726(b)).
4. If funds are insufficient to pay all the creditors in a certain class, the creditors within that class will share pro-rata (11 USC § 726(b)).

5.17.9.12 (04-21-2015)
Adequate Protection and Turnover

1. The concepts of adequate protection and turnover in bankruptcy are explained in IRM 5.17.8.11, *General Provisions of Bankruptcy, Adequate Protection*, and IRM 5.17.8.24, *General Provisions of Bankruptcy, Turnover to the Trustee — Assets Seized Pre-petition*, respectively.
2. In Chapter 7 cases, adequate protection should rarely be the basis for the IRS to resist turning over property of the estate to the trustee. In most instances, adequate protection arguments are not warranted or reasonable. A secured tax claim in a Chapter 7 case is subordinated to unsecured priority claims pursuant to 11 USC § 724. The IRS is only entitled to amounts determined by the distribution scheme established in 11 USC § 726.
3. 11 USC § 721 allows the court to authorize the Chapter 7 trustee to operate the debtor's business for a limited period. The operation must be in the best interest of the estate and consistent with the orderly liquidation of the estate. For example, the trustee may continue operating the debtor's business to sell it at a higher price as a going concern. It may be more reasonable for IRS to make an argument for adequate protection of the Service's secured interests in these limited cases.

5.17.9.13 (04-21-2015)
Discharge

1. Under 11 USC § 727, discharge is available to individuals in Chapter 7 cases unless there are grounds for denial of discharge. When the debtor is eligible for discharge, the individual is discharged from most debts that arose prior to the filing of the Chapter 7. Debts that are excepted from discharge and which are non-dischargeable are listed in 11 USC § 523.
2. Under 11 USC § 727, the grounds for denial of discharge include:
   A. With the intent to defraud or delay, debtor has transferred, destroyed, or concealed property of the debtor within one year before the bankruptcy or property of the estate during bankruptcy;
   B. Debtor has concealed, falsified, destroyed, or failed to preserve financial records, unless justified under the circumstances;
   C. In connection with the bankruptcy case, debtor knowingly and fraudulently:
      (1) Made a false oath or account;
      (2) Presented or used a false claim;
      (3) Gave, offered, or received money, property, or advantage for acting or forbearing to act; or
      (4) Withheld from an officer of the estate any recorded information relating to the debtor's property or financial affairs;
   D. Debtor has failed to satisfactorily explain any deficiency in assets available to meet liabilities;
   E. Debtor has refused to obey a lawful order of the court or to testify, unless the order was to respond to a material question or to testify to a matter on which the debtor has asserted the privilege against self-incrimination and not been granted immunity;
   F. Debtor has committed an act specified in a) through e) above on or within one year before the date the bankruptcy was filed, or during the case, in connection with the bankruptcy of an insider;
   G. Debtor has received a discharge in a Chapter 7 or Chapter 11 case commenced within eight years of the filing of the petition;
   H. Debtor has received a discharge in a Chapter 12 or Chapter 13 case commenced within six years of the filing of the petition unless the unsecured debts provided for in the plan were entirely satisfied, or at least 70 percent of the claims were satisfied and the plan was proposed in good faith and was the debtor's best effort;
   I. Debtor executed and the court approved a written waiver of discharge after the order for relief;
   J. After filing the bankruptcy petition, debtor has failed to complete the required personal financial management course (unless the court or trustee determines that the debtor is not required to complete such a course); or
   K. The court finds that there is reasonable cause to believe that 11 USC § 522(q)(1) applies to the debtor, and there is a proceeding pending in which debtor may be found guilty of a felony as described in 11 USC § 522(q)(1)(A) or liable for a debt as described in 11 USC § 522(q)(1)(B) (includes certain debts arising from violations of securities laws and criminal acts or willful misconduct that causes serious physical injury or death to another individual in the preceding 5 years).
3. A discharge may be revoked by the court upon the request of the trustee, a creditor, or the United States Trustee under 11 USC § 727(d) if:
   A. The discharge was obtained through fraud of the debtor which the requesting party did not know of until after the discharge was granted;
   B. The debtor knowingly and fraudulently failed to report the acquisition of or entitlement to property of the estate;
   C. The debtor has refused to obey a lawful order of the court or to testify; or
   D. The debtor has failed to explain a material misstatement in an audit or failed to make documents related to the audit available for inspection.
4. The request for revocation must be made:
   A. Within one year of the discharge in the case of a discharge obtained through fraud; or,
   B. Before the later of one year after the discharge or the date the case is closed, in the case of failure to report property or failure to obey an order of the court.
5. While a Chapter 7 debtor may be granted a general discharge, any debt that is non-dischargeable under 11 USC § 523 will not be barred from further collection activity. Additionally, post-petition interest on non-dischargeable taxes is non-dischargeable.

6. If a debt is discharged, the discharge injunction under 11 USC § 524 prohibits any act to collect the debt against the debtor personally. If the IRS willfully violates the discharge injunction, it may be subject to damages and attorney's fees under IRC §§ 7430 and 7433(e).

5.17.9.13.1 (04-21-2015)
Discharge and the Individual Shared Responsibility Payment (SRP) Liability Assessed under MFT 35 on IDRS

1. Liabilities assessed under the Individual Shared Responsibility Payment (SRP) of the Affordable Care Act (ACA) are assessed on the Individual Master File (IMF) under Master File Tax (MFT) Code 35. The SRP liability is treated as an excise tax under 11 USC § 507(a)(8)(E). However, since the liability on the SRP MFT 35 module is derived from the debtor's Form 1040, *U.S. Individual Income Tax Return*, certain information from the debtor's Form 1040 is used in determining dischargeability of the SRP.

2. An individual or joint debtor may not be eligible for discharge in the current Chapter 7 case if they received a discharge in a prior bankruptcy case. Eligibility is determined by the type of bankruptcies filed by the debtor and the petition date of the prior bankruptcies. See IRM Exhibit 5.9.5-3, *Allowable Elapsed Time Between Bankruptcy Filings and Discharges*, for additional information.

3. Discharge may depend upon whether IRS was properly noticed of the bankruptcy filing. See IRM 5.9.17.7.9, *Procedures for Processing Bankruptcy Discharges when the IRS Received No Notice or Late Notice in the Asset Case*, and IRM 5.9.17.9(4), *Chapter 7 Discharge Actions, Lack of Notice in Chapter 7 No Asset Cases*, for determining if taxes may be excepted from discharge due to improper notice.

4. The list below contains the exceptions to discharge for the SRP MFT 35 module when the individual or joint debtor receives a discharge in a Chapter 7 case and IRS was properly noticed in the case:

   - The SRP is non-dischargeable if the Form 1040 was due, with extensions, within the three-years prior to the bankruptcy petition date.
   - The SRP may be non-dischargeable if the tax on the Form 1040 is non-dischargeable due to willful evasion or fraud. When the SRP may be non-dischargeable due to willful evasion or fraud, refer the case to Area Counsel for guidance. See IRM 5.9.17.7.2(1).
   - The SRP is non-dischargeable if the income tax on the Form 1040 is non-dischargeable because the Form 1040 was filed after assessment. See IRM 5.9.17.7.1, *Determining Dischargeability of Late Filed Returns in Which a SFR was Prepared*, for additional information on SFRs and discharge.
   - The SRP is non-dischargeable if the Form 1040 was filed late and after the date that is two-years before the date of the bankruptcy petition.

   Note:

   The three-year "look- back" provision

   in 11 USC § 507(a)(8) and two-year period with regard to late returns are automatically tolled during a prior bankruptcy while the automatic stay is in effect. See IRM 5.9.13.19.3(4), *BAPCPA Tolling*, for additional information.

5. 11 USC § 507(a)(8)(E) governs excise taxes. Because SRP liabilities are a tax for which a return is required, IRS employs the same dischargeability analysis as 11 USC § 507(a)(8)(A)(i). If the tax on the Form 1040 is non-dischargeable, the tax on the SRP MFT 35 module is generally non-dischargeable. The interest is always non-dischargeable when the tax is non-dischargeable. No penalty is assessed or accrued on the SRP.

   Example:

   John Doe timely files his 201412 income tax return on 04/15/2015. There is no tax due on the Form 1040. John Doe listed $350 as the SRP amount on Line 61 of his Form 1040. IRS assesses a MFT 35 module for the SRP for 201412 in the amount of $350. On 02/15/2018, IRS assesses an Examination deficiency (TC 300) for $1500 on the 30-201412 income tax module. John Doe files Chapter 7 on 05/18/2018.
   ‣ *The tax and interest due on the Form 1040 are not dischargeable.* The TC 300 was assessed 89-days prior to the bankruptcy petition date. The TC 300 is a priority debt under 11 USC § 507(a)(8)(A)(ii). It is excepted from discharge under 11 USC § 523(a)(1)(A).
   ‣ *The tax and interest on the SRP MFT 35 module are dischargeable.* The 30-201412 module was due on 04/15/2015. The return due date was more than three-years prior to the bankruptcy petition date. The SRP MFT 35 module is an excise tax. There is nothing in 11 USC § 507(a)(8)(E) that makes assessments within the 240-days prior to the petition date a priority debt for excise tax. The tax and interest on the excise tax on the MFT 35 module are not excepted from discharge under 11 USC § 523(a).

   Example:

   John Doe files his 1040 for 201412 late and on 05/01/2016. He had no approved extension (TC 460) for filing the 201412 income tax return. He has no tax due on the Form 1040. John Doe listed $350 as the SRP amount on Line 61 of his Form 1040. IRS assesses a MFT 35 module for the SRP for 201412 in the amount of $350. On 02/15/2018, IRS assesses an Examination deficiency (TC 300) for $1500 on the 30-201412 income tax module. John Doe files Chapter 7 on 05/15/2018.
   ‣ *The tax and interest due on the Form 1040 are not dischargeable.* The TC 300 was assessed 89-days prior to the bankruptcy petition date. It does not matter that the return due date was more than three-years prior to the petition date. It does not matter that the return was filed late and more than two-years prior to the petition date. The determining factor is that the TC 300 is a priority tax under 11 USC § 507(a)(8)(A)(ii). It is excepted from discharge under 11 USC § 523(a).
   ‣ *The tax and interest on the SRP MFT 35 module are dischargeable.* The 30-201412 module was due more than three-years prior to the bankruptcy petition date. The 30-201412 return was filed more than two-years prior to the bankruptcy petition date. There is nothing in 11 USC § 507(a)(8)(E) that makes assessments within the 240-days prior to the petition date a priority debt for excise tax. The tax and interest on the excise tax on the MFT 35 module are not excepted from discharge under 11 USC § 523(a).

5.17.9.14 (04-21-2015)
Collection Outside Bankruptcy

1. The IRS can collect non-dischargeable liabilities from all assets of the debtor after the automatic stay is lifted. These assets include the exempt, abandoned, non-administered, and after-acquired property of an individual debtor.

2. With a properly filed pre-petition NFTL, the IRS may collect dischargeable liabilities from property exempted from the bankruptcy estate after the automatic stay lifts.

3. The IRS may collect dischargeable liabilities from property excluded from the estate or abandoned by the trustee after the stay lifts due to the statutory lien. A NFTL is not required prior to levy on excluded or abandoned assets. Excluded property includes ERISA-qualified pension plans and other plans described in 11 USC § 541(b).

   Note:

   See IRM 5.9.17.4, *Bankruptcy and Other Insolvencies, Closing a Bankruptcy Case, Exempt, Abandoned or Excluded Property (EAEP)*, for additional information on collecting dischargeable liabilities after the discharge.

More Internal Revenue Manual

Part 5. Collecting Process

Chapter 17. Legal Reference Guide for Revenue Officers

Section 10. Chapter 11 Bankruptcy (Reorganization)

5.17.10 Chapter 11 Bankruptcy (Reorganization)

5.17.10.1 (08-01-2010)
Overview

1. This section of the handbook discusses the basic purpose and procedural workings of a Chapter 11 bankruptcy case, explains the ways in which a Chapter 11 bankruptcy case is different from a bankruptcy case brought under other chapters of the Bankruptcy Code, and highlights issues of particular significance to the IRS in Chapter 11 bankruptcy cases.
2. For further information, see IRM 5.9.8, *Processing Chapter 11 Bankruptcy Cases*.

5.17.10.2 (08-01-2010)
Purpose of Chapter 11 Bankruptcy

1. Chapter 11 is the primary reorganization chapter of the Bankruptcy Code for business debtors.
2. Individuals are also eligible to file Chapter 11. See IRM 5.17.10.11 for further discussion on individuals in Chapter 11.
   A. An Individual who wishes to pay creditors over time through a plan and not liquidate in a Chapter 7 case generally files a Chapter 13 case rather than a Chapter 11 case.
   B. For individuals, Chapter 13 has the following advantages over Chapter 11: proceedings are less expensive for a debtor, and more of an individual debtor's debts (including tax debts) may be discharged in Chapter 13 without payment.
   C. To be eligible for Chapter 13, an individual must have regular income and meet certain debt limitations. Currently, an individual must have less than $360,475 of unsecured debts and less than $1,081,000 of secured debts to file a Chapter 13 case. These debt amounts are adjusted every three years based upon the Consumer Price Index. The next adjustment will be effective April 1, 2013.
   D. Also, changes to the Bankruptcy Code made by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) have made Chapter 11 cases filed by individuals similar to Chapter 13 cases. As in Chapter 13, individual Chapter 11 debtors must now complete payments under the plan before they can receive a discharge. 11 USC § 1141(d)(5).
3. The general goal of a Chapter 11 case is for the financially distressed business debtor to restructure and negotiate its debts and ownership interests with its creditors and owners and then obtain court approval (confirmation) of a plan of reorganization that allows the debtor to continue operating its business after the commencement of the bankruptcy case.
   A. Ideally, a Chapter 11 plan of reorganization is acceptable to most of the debtor's creditors because creditors are more likely (over time) to receive a greater distribution from the plan as payment of the debtor's pre-bankruptcy debts than through liquidation of the debtor's business.
   B. In addition, a Chapter 11 plan often gives the debtor's creditors some form of new ownership interest in the debtor.
4. However, a large percentage of Chapter 11 debtors actually fail to reorganize their businesses successfully, either before or after confirming a plan.
   A. In these circumstances, the Chapter 11 case may still enable a business debtor to sell its business assets for a higher price (e.g., as a going concern) than a Chapter 7 trustee would be able to obtain for the assets in a Chapter 7 liquidation, resulting in a greater return for creditors.
   B. On the other hand, while a Chapter 11 debtor is in the process of deciding whether to sell its assets, the debtor may incur new significant debts, or it may dissipate its assets trying to keep the business going. As a result, Chapter 11 cases are ordinarily much more labor intensive for the IRS and other creditors to monitor and evaluate than bankruptcies filed under other chapters of the Bankruptcy Code.

5.17.10.3 (08-01-2010)
Initiating a Chapter 11 Case

1. A Chapter 11 case is commenced with the filing of a voluntary bankruptcy petition by a debtor or with the filing of an involuntary bankruptcy petition by creditors.
2. A debtor need not be insolvent or even unable to pay its debts when due in order to file a voluntary Chapter 11 case. A debtor's inability to pay debts as they become due may be relevant if a debtor contests an involuntary petition filed against it. 11 USC § 303(h).
3. In a Chapter 11 case, whether or not the IRS is listed on the debtor's schedules as a creditor, the IRS should be served with copies of all voluntary Chapter 11 petitions, notices of any cases converted from another chapter to Chapter 11, and orders for relief entered for any involuntary Chapter 11 cases. Bankruptcy Rule 2002(f) and (j)(3). Bankruptcy Rule 2002(j)(3) provides that copies of notices that are required to be mailed to all creditors must be mailed, in a Chapter 11 case, to the IRS at the address set

out in the register maintained by the clerk of the bankruptcy court under Rule 5003(e). Thus, for the duration of the Chapter 11 case, the IRS should continue to be served with bankruptcy pleadings, orders, and other documents in the Chapter 11 case that are required to be served on "all creditors," whether or not the IRS has filed a claim in the case. Bankruptcy Rule 2002(a), (b), (f), and (j)(3).

5.17.10.3.1 (08-01-2010)
Documents Required When Chapter 11 Case Is Initiated

1. Within 15 days of filing a voluntary petition or the entry of an order for relief (in an involuntary case), a Chapter 11 debtor must file a number of standardized schedules, statements, and other specified documents with the court. Bankruptcy Rule 1007(b) and (c). These documents tend to be more voluminous and more widely available to creditors (including the IRS) in Chapter 11 cases than in bankruptcy cases under other chapters.
2. In a voluntary case involving an individual Chapter 11 debtor, the debtor must file the following documents with the petition:
   A. a certificate indicating that the debtor has received credit counseling during the 180-day period before the filing of the petition, as required by 11 USC § 109(h);
   B. the debt repayment plan developed during that credit counseling, if any; or
   C. a court determination excusing the debtor from the required credit counseling.

      Note:

      See Bankruptcy Rule 1007(b)(3) and (c). Failure to file these documents can be grounds for dismissing the debtor's bankruptcy case.
3. With a voluntary petition, a Chapter 11 debtor should file a mailing matrix indicating the names and addresses of each of its creditors, plus a list of creditors holding the 20 largest unsecured claims against the debtor. Bankruptcy Rule 1007(a)(1) and (d). In the case of an involuntary petition, the debtor must file the mailing matrix within 15 days after the entry of the order for relief and file the list of creditors holding the 20 largest unsecured claims within two days after the order for relief. Bankruptcy Rule 1007(a)(2) and (d). This list of creditors may assist the United States Trustee in appointing members of the Unsecured Creditors' Committee for the debtor's case.
4. The debtor's required schedules and Statement of Financial Affairs may help the IRS identify some of its potential tax claims against the debtor, as well as the IRS's setoff rights, and evaluate its security for Notices of Federal Tax Liens (NFTLs) filed against the debtor.

5.17.10.3.2 (08-01-2010)
Prepackaged Chapter 11 Cases

1. In recent years many large Chapter 11 debtors have been able to file their proposed disclosure statements and plans on or immediately following the date they file for bankruptcy. Before even filing for bankruptcy, these large debtors may negotiate a restructuring of their debt and ownership structures with their major secured and general unsecured creditors and stockholders. They hope to obtain enough votes for confirmation of their plans before going into bankruptcy and to remain under bankruptcy court supervision for the shortest possible time. Cases of this type are called "prepackaged" and are now commonly filed in Delaware and the Southern District of New York pursuant to 11 USC 1126(b) and Bankruptcy Rule 3018(b).
2. In a prepackaged Chapter 11 case, the debtor may seek consideration of its proposed disclosure statement and confirmation of its proposed plan at the same time, and request that hearings on these matters be held in a very short time frame — sometimes as little as 45 days after filing the petition. Prepackaged cases can be a problem for the IRS because the IRS is ordinarily one of the debtor's few major creditors that is not aware of the debtor's plans to file a prepackaged bankruptcy. Because the IRS may have ongoing audits of the debtor, confirmation of the proposed plan may occur before the bar date for the IRS and other governmental units to evaluate and file their claims.
3. Prepackaged plans that propose a sale or transfer of substantially all of the debtor's assets are a particular problem for the IRS because the principal purpose of the transaction may be tax avoidance. See In re Scott Cable Communications. Inc., 227 B.R.596 (Bankr. D. Conn. 1998). Refer to the Chief Counsel Directives Manual (CCDM) at IRM 34.3.1.3 for procedures regarding the referral to Counsel of Chapter 11 cases involving major tax liabilities or significant or sensitive issues for the IRS.

5.17.10.4 (08-01-2010)
The Debtor in Possession (DIP)

1. In a Chapter 11 case, the debtor (i.e., the debtor's management team) usually remains in control of its business and assets as the "debtor in possession" (DIP), unless the court orders the appointment of a trustee to replace the DIP. 11 USC §§ 1101, 1104(a).
2. A DIP is given the rights and powers of a bankruptcy trustee. 11 USC § 1107(a).

5.17.10.4.1 (08-01-2010)
Appointing a Chapter 11 Trustee

1. At any time from the petition date until the confirmation of a Chapter 11 plan, any interested party in the case (e.g., the Creditors' Committee or individual creditors) or the United States Trustee (UST) may make a motion with the bankruptcy court for the appointment of a trustee to replace the debtor in possession in the management of the debtor's business and assets. 11 USC § 1104(a); Bankruptcy Rule 2007.1(a).
2. The appointment of a trustee is rare because the change in management disrupts the debtor's business. A trustee is usually appointed in cases where there is fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by its current management. 11 USC §§ 1104(a) and (e).
3. If the bankruptcy court does not order the appointment of a Chapter 11 trustee, then at any time before a plan is confirmed, an interested party or the UST may make a motion for the appointment of an examiner to investigate the debtor for matters such as allegations of fraud, dishonesty, misconduct, or irregularity in managing the affairs of the debtor either by current or former management of the debtor. 11 USC § 1104(c); Bankruptcy Rule 2007.1(a) and (c). The examiner does not replace the debtor in possession in the management of the debtor's affairs or deprive the debtor in possession of its rights to propose a plan for the debtor.
4. If grounds exist for the dismissal or conversion of the case, the court may instead appoint a trustee or examiner if it determines that doing so is in the best interests of creditors and the bankruptcy estate. 11 USC § 1104(a)(3).

5.17.10.4.2 (08-01-2010)
Chapter 11 Committees

1. The Bankruptcy Code provides a mechanism that allows unsecured creditors to oversee the debtor's operations and voice their concerns throughout the Chapter 11 case. As soon as practicable after a voluntary Chapter 11 petition is filed, or an order for relief is entered in an involuntary case, the UST appoints a committee of unsecured creditors.
2. The powers of the Unsecured Creditors' Committee in a Chapter 11 case are very significant and extensive. 11 USC §§ 1102 and 1103. Its views are also important to the bankruptcy court.
3. The Unsecured Creditors' Committee ordinarily consists of the creditors, willing to serve, that hold the seven largest unsecured claims against the debtor. 11 USC § 1102(b).
4. With the court's approval, the Unsecured Creditors' Committee may hire one or more attorneys, accountants, or other agents to represent or perform services for the committee. 11 USC § 1103.
5. The IRS and most governmental units are not eligible to serve as members of the Unsecured Creditors' Committee. 11 USC § 101(41).

5.17.10.5 (08-01-2010)
Early Events in a Chapter 11 Case

1. In a typical Chapter 11 case, the debtor seeks bankruptcy court approval for a number of "first day" orders, including an order allowing the debtor to continue using its cash collateral. The court will grant the debtor the use of its cash only if the debtor can show that a creditor that has a security interest in the cash is adequately protected, i.e., the creditor will not lose the value of its security.
   A. When the IRS has filed NFTLs which attach to such cash collateral, the IRS should become involved in the case as soon as possible to protect its interests.
   B. Early in a Chapter 11 case, a debtor may also seek to compel turnover to it of property which the IRS levied upon or seized before the petition date.
2. The IRS and other creditors may take advantage of their opportunity to question a debtor at the first meeting of creditors under 11 USC § 341.

5.17.10.5.1 (08-01-2010)
Mandatory Referrals to Counsel

1. Soon after a Chapter 11 case is filed, IRS employees in SB/SE, LMSB, Appeals, and TEGE should identify and refer cases meeting certain criteria to Field Insolvency. Field Insolvency will then refer the case to the appropriate SB/SE Area Counsel office for handling. See IRM 5.9.4.13.3 . These include cases in which the debtor has major tax liabilities, there is significant audit impact to items claimed on returns, or which may involve significant or sensitive issues for the IRS. If certain other criteria are met, these cases may also be referred by Area Counsel to the Associate Chief Counsel, Procedure and Administration, as part of the Significant Bankruptcy Case Program.

5.17.10.5.2 (08-01-2010)
Limitations on a Debtor's Right to Use Cash Collateral

1. In a Chapter 11 case, the debtor in possession (DIP) typically wants to continue running the business until the business can either be reorganized or sold as a going concern.
   A. The DIP may automatically continue its routine ("ordinary course") use, sale, or lease of most of its prepetition property (other than cash collateral) without obtaining the approval of the court. 11 USC § 363(c)(1). However, the DIP must obtain court approval to use, sale, or lease property of the estate other than in the ordinary course of business. 11 USC § 363(b).
   B. Whether the DIP's proposed use of its cash collateral is routine or otherwise, the DIP must obtain the consent of each creditor with an interest in such cash collateral, or bankruptcy court authorization, prior to the use of the cash collateral. In evaluating the DIP's request for authorization to use cash collateral, the court may authorize such use only if the creditor's interest in the property is adequately protected against loss. 11 USC §§ 363(a), (c)(2), and (e).
   C. The DIP's unauthorized use of cash collateral which causes substantial harm to one or more creditors is grounds for dismissal or conversion of the bankruptcy case. 11 USC § 1112(b)(4)(D).
2. A DIP often negotiates agreed first day orders for the use of its cash collateral with its significant prepetition lenders before entering bankruptcy. However, the DIP may neglect to consider the secured position of the IRS in cash collateral after the IRS has filed NFTLs against the debtor.
   A. Accordingly, when the IRS is a secured creditor, the IRS must frequently take the initiative of seeking relief from the DIP or from the court by pointing out that the DIP is using cash collateral that is subject to an IRS lien.
   B. As soon as possible after a Chapter 11 bankruptcy filing, the IRS should identify any secured claims it has against the debtor, contact the debtor's counsel, and begin negotiations for adequate protection for the IRS as a condition for the debtor's continued use of cash collateral.
3. Adequate protection to the IRS for a DIP's use of its cash collateral usually includes periodic cash payments (beginning immediately) on the secured claim or the provision of replacement liens to the IRS on property the DIP acquires after the petition date. 11 USC § 361. See also the discussion on adequate protection in IRM 5.17.10.5.3, below, and IRM 5.9.8.5, *Adequate Protection*.

5.17.10.5.3 (08-01-2010)
Turnover and Adequate Protection

1. A voluntary Chapter 11 filing by a debtor is often preceded by the IRS levying upon or seizing certain assets of the debtor. After filing bankruptcy the debtor may then immediately file a motion with the bankruptcy court requesting an order for the IRS to turn over the seized property to the debtor or to release the levy. 11 USC § 542.
2. In U.S. v. Whiting Pools, Inc., 462 U.S. 198 (1983), the Supreme Court affirmed a debtor's right under 11 USC § 542 to the return of tangible property seized by the IRS, subject to the requirement of 11 USC § 363(e) that the debtor provide the IRS with adequate protection for the use of property to be turned over in which the IRS has a secured interest.
3. The protection that is adequate to a creditor for turnover of property to the debtor depends on the factual circumstances of the case, including the type of property involved.
   A. The IRS seldom expects to receive periodic cash payments as adequate protection for its turnover of the debtor's seized real property because such property does not usually depreciate rapidly.
   B. However, the IRS does want the DIP to be required to maintain adequate insurance coverage for its buildings and other improvements to real property.
   C. On the other hand, levied upon cash, accounts receivable, and inventory may quickly be dissipated by a DIP if turned over to the DIP by the IRS. In these situations the IRS is interested in adequate protection along the lines of retaining a portion of the cash received, receiving future periodic payments (with post-petition interest) before a plan is devised or confirmed, obtaining replacement liens on after-acquired assets such as the DIP's inventory and accounts receivable, and providing for the DIP's post-petition compliance with its continuing federal tax obligations.

5.17.10.5.4 (08-01-2010)
The First Meeting of Creditors

1. The section 341 meeting in a Chapter 11 case is an opportunity for creditors (including the IRS) to question the debtor under oath about a wide range of relevant matters concerning the debtor's past behavior, its present finances, and the likely future of the bankruptcy case. 11 USC § 341; Bankruptcy Rule 2003.
2. In some areas Insolvency asks selected revenue officers for their assistance and expertise in listening to and questioning the debtor's witnesses at section 341 meetings.
3. If the debtor provides inadequate information or documentation for IRS purposes at the section 341 meeting, Insolvency may ask Area Counsel to arrange a more thorough examination of the debtor or other witnesses under Bankruptcy Rule 2004.

5.17.10.6 (08-01-2010)
Claim Bar Dates in Chapter 11

1. The time for filing claims in a Chapter 11 case is not determined by statute or rule. The bankruptcy court fixes (by an order) the date by which creditors are to file their prepetition claims in a Chapter 11 case. Bankruptcy Rule 3003(c)(3).
2. The IRS and other governmental units are allowed no fewer than 180 days after the order for relief (e.g., the petition date in a voluntary case) to file a timely claim for a prepetition period. 11 USC § 502(b)(9). In "prepackaged cases," however, it may be in the IRS's interest to file a claim as soon as possible where confirmation of the plan will occur before the 180-day filing period expires.

3. A proof of claim is deemed to have been filed on behalf of the IRS if a Chapter 11 debtor lists, on the debtor's bankruptcy schedules, a prepetition tax debt owed to the IRS which is liquidated, undisputed, and not contingent. 11 USC § 1111(a); Bankruptcy Rule 3003(b)(1) and (c)(2).

4. As a result of BAPCPA's amendments to 11 USC § 503(b)(1)(D), for cases commencing on or after October 17, 2005, the IRS may file, but is not required to file a request for payment of its administrative claim. Nevertheless, the IRS should file an administrative claim to put the debtor and creditors on notice of the liability and of the amount due. See IRM 5.9.8.11(8).

5.17.10.6.1 (08-01-2010)
Setoffs

1. In the course of many Chapter 11 cases, the IRS discovers that its prepetition tax debts are secured, even though it did not file an NFTL, due to setoff rights the IRS holds against carryback tax refunds for prepetition years or against amounts owed the debtor by other federal agencies. All federal agencies are generally considered one creditor (the United States) for setoff purposes under the Bankruptcy Code. See In re HAL, 122 F.3d 851 (9th Cir. 1997); Turner v. SBA, 84 F.3d 1294 (10th Cir. 1996).

2. Be aware that corporate Chapter 11 debtors often request carryback tax refunds from the IRS immediately through tentative carryback (quickie refund) procedures, rather than through ordinary refund procedures.

3. The IRS has the right to offset the quickie refund against federal tax liabilities of the taxpayer. This right of setoff becomes particularly important when the taxpayer is in bankruptcy because dollar amounts of quickie refunds can be large, and setoff may be the only assured way of collecting liabilities owing from the taxpayer. Difficult mutuality issues are raised, however, when losses from post-petition periods are carried back to prepetition years; consult Area Counsel in such cases. See IRM 5.9.8.8 for further discussion.

4. The automatic stay, 11 USC § 362(a)(7), prevents the actual making of a setoff, but prepetition setoff rights are nevertheless preserved in bankruptcy. 11 USC § 553. If a refund is owed to the debtor that could be credited against a liability owed by the debtor, the Service should freeze the refund until the stay can be lifted. See Citizens Bank of Maryland v. Strumpf, 516 U.S. 16 (1995) (temporary freeze of a debt owed to the debtor and request for relief from stay to allow setoff did not violate the automatic stay against setoffs). The Service's setoff rights extend to unassessed liabilities identified on a proof of claim. Rev. Rul. 2007-52.

   Note:

   For cases filed on or after October 17, 2005, the effective date of BAPCPA, the automatic stay does not prohibit setting off prepetition income tax refunds against prepetition income tax liabilities.

5. When the FDIC has taken over a bank, the bank's parent holding company often files for bankruptcy protection. The FDIC as well as the parent holding company may file a claim for refund if proper procedures are followed. Treas. Reg. § 301.6402-7. The FDIC's claim for refund does not affect the Service's setoff rights.

5.17.10.6.2 (08-01-2010)
Straddle-Year Claims

1. Because Chapter 11 debtors ordinarily continue to operate their businesses after filing for bankruptcy and seldom file bankruptcy on the first day of a new tax reporting period, there are frequently federal tax liabilities owed by Chapter 11 debtors for taxes arising in the year in which the bankruptcy petition was filed.

   A. For divisible/transactional taxes (e.g., employment and most excise taxes), the IRS splits the taxes due for the straddle period between priority tax debts incurred prepetition and administrative period tax debts incurred post-petition.

   B. However, income taxes are incurred on the last day of the income tax year. 11 USC § 507(a)(8)(A), as amended by BAPCPA, clarifies that only income taxes for tax years ending on or before the petition date will receive priority treatment in the bankruptcy case. Thus, income taxes that accrue in the year for which the bankruptcy petition is filed are entirely administrative expense taxes.

      Note:

      Section 507(a)(8)(A) was clarified by BAPCPA to provide that income taxes will be considered prepetition (priority) claims only when the tax year ended before the bankruptcy petition was filed, overturning pre-BAPCPA case law that relied on that section to hold that the petition-year liability should be split into prepetition and postpetition portions. See In re Pacific-Atlantic Trading Co., 64 F.3d 1292 (9th Cir. 1995).

5.17.10.6.3 (08-01-2010)
Pensions and Penalties

1. Although pension underfunding taxes arising under IRC § 4971 are considered a "tax" under the Internal Revenue Code, the Supreme Court has determined that the tax under IRC § 4971 is a penalty (hence a general unsecured claim) for Bankruptcy Code claim classification purposes. See U.S. v. Reorganized CF&I Fabricators of Utah, Inc., 518 U.S. 213 (1996).

2. However, in appropriate cases where the Chapter 11 debtor has incurred IRC § 4971 underfunding taxes post-petition, the IRS may assert before the bankruptcy court that these taxes are entitled to administrative expense priority as part of the actual and necessary costs and expenses of preserving the bankruptcy estate under 11 USC § 503(b)(1)(A). Contact Area Counsel in cases where the debtor owes IRC § 4971 liabilities.

5.17.10.6.4 (08-01-2010)
Post-Petition Tax Compliance

1. Debtors in possession (DIPs) are required to file periodic reports with the bankruptcy court, the U.S. Trustee, and the IRS describing payments made to employees, the amount of taxes required to be withheld or paid for and on behalf of employees, and the place where these amounts are deposited. 11 USC §§ 704(8) and 1106(a)(1); Bankruptcy Rule 2015(a).

2. Chapter 11 cases require monitoring by Insolvency even if the IRS has not found any prepetition taxes owed by the debtor because the DIP often becomes delinquent in paying withholding tax, FICA, and other taxes while operating the business after the petition date. Large dollar or chronically noncompliant taxpayers may merit manual monitoring by Insolvency, including putting the DIP on monthly filing and deposit verification regimes.

3. On request of an interested party, the court is required to convert a Chapter 11 case to a Chapter 7 case or dismiss the bankruptcy case entirely under 11 USC § 1112(b) if the debtor fails to file the required periodic reports or comply with its post-petition tax obligations.

4. Corporate Chapter 11 debtors frequently report net operating losses (NOLs) for their recent prepetition income tax years or their post-petition income tax years and then carryback these NOLs to earlier income tax years in order to obtain refunds of the taxes they paid in the earlier tax years.

   A. Corporate Chapter 11 debtors, which often need large cash infusions to keep their businesses operating, also frequently request carryback tax refunds from the IRS immediately (usually within 45 days of filing a Form 1139, Corporation Application for Tentative Refund) through tentative carryback (quickie refund) procedures, rather than through ordinary refund procedures.

   B. If the IRS pays a quickie refund to the DIP after the petition date and the quickie refund turns out to be excessive after the loss year return is audited, then the IRS is entitled to file an administrative expense claim in the Chapter 11 case for the excessive amount of the quickie refund. 11 USC § 503(b)(1)(B)(ii).

   C. For cases commencing on or after October 17, 2005, the IRS may file, but is not required to file, a request for payment of its administrative expenses. Nevertheless, the IRS should file an administrative claim to put the debtor and creditors on notice of the liability and of the amount due.

5. Corporate Chapter 11 debtors sometimes use a Chapter 11 case to liquidate substantially all of their assets, either through mid-stream asset sales that are approved by the bankruptcy court under 11 USC § 363 or by seeking confirmation of a liquidating plan which may provide either for the sale of the debtor's assets to a third party or for the transfer of substantially all of the debtor's assets to a Liquidating Trust. In liquidating cases of this type, the sale or taxable transfer of the debtor's property to a third party may sometimes cause the debtor's bankruptcy estate to realize substantial capital gains income (after considering the debtor's adjusted basis in the property sold) and a federal income tax liability (after considering the debtor's other taxable events in the year and the debtor's available NOL carryovers from prior tax years).

5.17.10.7 (08-01-2010)
The Plan Process

1. The plan process begins with the debtor's filing of a plan of reorganization and disclosure statement. The disclosure statement should contain information about the debtor and the proposed plan which would enable creditors to make an informed decision on whether or not to vote for the plan. The bankruptcy court must approve the disclosure statement before the debtor may solicit creditors' votes on the plan. As discussed below, the bankruptcy court may determine that the plan itself provides sufficient information in small business cases.
2. For purposes of determining how creditors are to be treated under the plan and voting, the Bankruptcy Code requires that a plan group claims into classes. Generally, claims may only be put in the same class if they are similar. Creditors within a class vote together. Claims within a particular class are treated the same under the plan.
3. Once the necessary votes for acceptance of the plan are obtained and the court determines that it meets the requirements of the Bankruptcy Code, the plan will be confirmed. A plan can be confirmed through the cram down process over the dissension of classes of creditors as long as one impaired class votes to accept the plan. 11 USC § 1129(b). For a definition of an "impaired class" , see IRM 5.17.10.9.2 , *Impairment of Claims in a Chapter 11 Plan*, below. The debtor and all creditors are bound by the terms of a confirmed plan.

5.17.10.7.1 (08-01-2010)
The Debtor's Control of Plan Development (Exclusivity)

1. Ordinarily, Chapter 11 debtors enjoy the exclusive right to propose their Chapter 11 plans for the first 120 days after the petition date. On the request of any interested party (e.g., the debtor, creditors, or U.S. Trustee), the bankruptcy court may extend or reduce the debtor's 120-day exclusivity period if cause is shown. 11 USC § 1121(d)(1). The court may not extend the debtor's exclusivity period to a date that is more than 18 months after the petition date.
2. "Small business" Chapter 11 debtors, discussed in IRM 5.17.10.7.2, below, have the exclusive right to file a Chapter 11 plan during the first 180 days following the date of the petition. 11 USC § 1121(e)(1).

5.17.10.7.2 (08-01-2010)
Mandatory Small Business Debtor Treatment

1. Prior to BAPCPA, the small business provisions and their shorter timeframes regarding the plan were optional. For cases commencing on or after October 17, 2005, small business treatment is now mandatory for all debtors that fall within the small business debtor definition in 11 USC §§ 101(51C) and (51D). See Bankruptcy Rule 1020 (requires debtor in voluntary Chapter 11 case to state in the petition whether the debtor is a small business debtor). Under BAPCPA, the small business provisions are designed to prevent abuses of the bankruptcy system in small business cases, as well as make these cases less costly and move more quickly toward confirmation.
2. A small business debtor is defined as one that engages in business activities with total, noncontingent debts of less than $2,343,300, but only in a case where the U.S. Trustee has not appointed a committee of unsecured creditors or the court has determined that the committee is not sufficiently active and representative to provide effective oversight of the debtor.
3. The small business debtor has the exclusive right to file a plan during the 180 days after the petition date, while other Chapter 11 debtors are only guaranteed a 120-day exclusivity period. 11 USC § 1121(e).
   A. However, the small business debtor must file its plan and disclosure statement within 300 days after the petition date. 11 USC § 1121(e).
   B. The 180-day and 300-day periods may only be extended if the debtor demonstrates that it is more likely than not that the court will confirm a plan within a reasonable period of time. Failure to timely file or confirm a plan or file a disclosure statement is a basis for conversion or dismissal of a Chapter 11 case under 11 USC § 1112.
   C. In a small business case, the court must confirm a plan that complies with the Bankruptcy Code no later than 45 days after the plan was filed. 11 USC § 1129(e).
4. IRS employees should be aware that the automatic stay will not apply in a small business case in the following situations:
   A. the debtor already has a small business case pending at the time the current petition is filed;
   B. the debtor was in a prior small business case that was dismissed for any reason, by a court order, within the two-year period ending on the petition date;
   C. the debtor was in a prior small business case in which a plan was confirmed in the two-year period ending on the date of petition; or
   D. the debtor is an entity that has acquired substantially all of the assets or business of a small business debtor described in a), b), and c) above, unless the debtor demonstrates that it acquired the assets or business of such small business debtor in good faith and not for the purpose of avoiding the application of 11 USC § 362(n).
5. Section 1116, 11 USC, lists a number of duties required of small business debtors, including the duty to file a copy of the most recent Federal tax return with a voluntary petition or seven days after the order for relief in an involuntary case. Small business debtors must also timely file and pay post-petition taxes. Failure to comply with any of these requirements is a basis for conversion or dismissal of the case. 11 USC § 1112(b)(4)(I).

5.17.10.8 (08-01-2010)
The Disclosure Statement

1. Chapter 11 requires a debtor to file a disclosure statement along with a proposed plan of reorganization. Bankruptcy Rule 3016(b).
2. The disclosure statement must be provided to all creditors, and the bankruptcy court must approve it before the debtor may solicit the creditors' votes for the acceptance or rejection of the proposed plan.
3. The disclosure statement should generally provide creditors and other interested parties with "adequate information" about the debtor and the proposed plan so that they may decide whether to vote for or against the plan.
4. The bankruptcy court determines, during a hearing, whether the disclosure statement contains adequate information and should be approved. In determining whether there is adequate information, the court is required to consider the cost and benefit of additional information and the complexity of the case. 11 USC § 1125(a)(1). Once the disclosure statement is approved, a proposed plan may move to confirmation in a relatively short time frame.
5. In small business debtor cases, the court may determine that the plan itself provides adequate information and that a separate disclosure statement is not necessary. The court may also approve a disclosure statement submitted on standard forms. 11 USC § 1125(f)

5.17.10.8.1 (08-01-2010)
The Content of a Disclosure Statement

1. The Bankruptcy Code does not specify all of the information that needs to be included in the disclosure statement, but does provide that it must discuss the potential, significant federal tax consequences of the plan to the debtor, any successor of the debtor, and creditors. 11 USC § 1125(a).

2. Generally, the disclosure statement will set forth the recent history of the debtor, the reasons why the debtor filed a bankruptcy petition, and the measures the debtor has undertaken to reverse financial setbacks. The disclosure statement should also provide a summary of the plan and the treatment given to the various creditors.

3. Bankruptcy courts have required that a disclosure statement contain a discussion of the following matters:

   A. the debtor's available assets and their value;

   B. claims made against the estate;

   C. a liquidation analysis, setting forth the estimated return that creditors would receive if the debtor was in a Chapter 7 case;

   D. the future management of the debtor;

   E. the risks being taken by creditors and interest holders under the proposed plan; and

   F. the existence, likelihood, and possible success of litigation involving the debtor.

   Note:

   For Chapter 11 cases filed on or after October 17, 2005, the Code clarifies that the disclosure statement should discuss the tax consequences of the plan. 11 USC § 1125(a)(1).

4. A careful review of the proposed disclosure statement may lead Insolvency to conclude that a referral to Area Counsel for assistance is appropriate under Significant Bankruptcy Case handling procedures. See Chief Counsel Directives Manual (CCDM) at IRM 34.3.1.3. For instance, the proposed disclosure statement may indicate that the plan will create a Liquidating Trust to pay creditors' claims or that the plan will effect a sale of substantially all of the debtor's assets to a third party. Insolvency may conclude that Area Counsel's assistance is required to evaluate the potential tax consequences of the plan and to devise appropriate procedures to protect IRS interests under the proposed plan.

5.17.10.8.2 (08-01-2010)
The Disclosure Statement Approval Process

1. After a plan proponent files a proposed disclosure statement with the bankruptcy court, the court typically enters an order giving notice to the debtor, all creditors, and other interested parties that a hearing will be held. Bankruptcy Rule 3017(a).

2. When the disclosure statement notice order is served on the IRS, Insolvency uses the event as an opportunity to fine tune and amend the amount of any IRS claims, to reevaluate the security for any claims the IRS has filed as secured and amend the characterization of its secured claim (to priority or general unsecured status) if appropriate, and to conduct updated post-petition tax compliance reviews for the debtor to see if any further administrative expense claims should be filed.

3. Ultimately because the purpose of the disclosure statement approval process is informational and because the Government has limited resources for litigating in bankruptcy court, the IRS usually objects to a proposed disclosure statement only if it is grossly deficient, and the IRS is also considering significant objections to the proposed plan. However, an objection to a proposed disclosure statement should be filed if it incorrectly describes the Service's claim, since this will affect other creditors.

5.17.10.9 (08-01-2010)
Plans in Chapter 11

1. The ultimate form of a Chapter 11 plan in a particular case is ordinarily a matter for intense negotiations between a debtor, its significant creditors, and other interested parties (e.g., the debtor's stockholders).

5.17.10.9.1 (08-01-2010)
Classification In Chapter 11 Plans

1. For the purpose of determining the treatment of creditors in a Chapter 11 plan, the Bankruptcy Code generally requires that claims be "classified" (placed in Class 1, Class 2, etc.) based on the nature of the claims. 11 USC § 1123(a)(1). Claims or interests may be included in a particular class only if such claims or interests are substantially similar to the others in that class. 11 USC § 1122(a).

2. In practice, each secured claim is commonly placed in its own class or subclass, due to a secured creditor's often unique interest in certain property of the debtor's bankruptcy estate, based upon the extent and priority of the creditor's lien or the specific mutual debt subject to offset.

3. Administrative expense claims, gap period claims, and priority tax claims should not be classified by a Chapter 11 plan.

5.17.10.9.2 (08-01-2010)
Impairment of Claims in a Chapter 11 Plan

1. A Chapter 11 plan must specify any class of claims or interests that is not impaired under the plan. 11 USC § 1123(a)(2).

   A. A class of claim or interest holders is impaired by a Chapter 11 plan unless the plan leaves the claim or interest holders' non-bankruptcy legal, equitable, and contractual rights unaltered. 11 USC § 1124(1).

   B. In general the IRS's secured claims and general unsecured claims are almost always impaired by a Chapter 11 plan.

2. A Chapter 11 plan must provide the same treatment for each claim or interest in a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of the holder's particular claim or interest. 11 USC § 1123(a)(4). This is one reason why general unsecured creditors may be placed in several different classes in a complex Chapter 11 case.

3. It is improper for a debtor or other plan proponent to attempt to limit or reduce the amount of a disputed IRS tax claim by providing in the plan that the IRS claim is for a specific amount that the IRS does not agree with; the amount and classification of disputed tax claims should be challenged in a contested proceeding apart from the plan confirmation process. See In re Taylor, 132 F.3d 256 (5th Cir. 1998).

5.17.10.9.3 (08-01-2010)
Acceptance and Voting on a Chapter 11 Plan

1. In Chapter 11 cases, most of a debtor's creditors and interest holders may "vote" to accept or reject a proposed plan, as well as file an objection to the proposed plan. In the Bankruptcy Code, voting on acceptance or rejection of a plan only occurs in Chapter 11 cases.

2. Classes of creditors and interest holders who are unimpaired are deemed to have accepted the plan. 11 USC § 1126(f). A class is deemed not to accept if it receives no property under the plan. 11 USC § 1126(g).

3. An impaired class of creditors is considered to have accepted the plan if it is accepted by creditors holding at least two-thirds of the amount of the combined claims and more than one-half in number of the allowed claims of those in the class who vote. 11 USC § 1126(c).

4. Because administrative expense claims, gap period claims, and priority tax claims should not be classified by a Chapter 11 plan, the IRS ordinarily may not vote with respect to these types of claims.

5. However, IRS claims that are secured or general unsecured should be classified and are almost always impaired by the plan, so the IRS should have an opportunity to vote to accept or reject a plan with respect to these types of claims.

   A. When the IRS or other agencies of the United States are creditors, 11 USC § 1126(a) provides the Secretary of the Treasury with authority to accept or reject a Chapter 11 plan on behalf of the United States.

   B. Pursuant to General Counsel Order No. 4 (Jan. 19, 2001), the authority to accept or reject plans where the United States is a creditor has been delegated to the Chief Counsel. See CCDM 30.2.2, Exhibit 30.2.2-6. This delegation covers proceedings where the United States possesses only a tax claim, as well as proceedings in which there are other claims of the United States in addition to the claim of the IRS.

6. When there are claims of the United States for taxes owed to the IRS and for debts owed to other agencies, the different agencies must coordinate their votes; disagreements on how to vote may be referred to the General Counsel of the Treasury Department for resolution. See Chief Counsel Directives Manual (CCDM) at IRM 30.2.2, Exhibit 30.2.2-6 at ¶10.

5.17.10.9.4 (08-01-2010)
Chapter 11 Plan Confirmation Process

1. Once eligible creditors have voted on the plan, and any modifications are made to it, a confirmation hearing is held to finalize the plan. 11 USC § 1128.

2. Under the "cram down" procedures, a plan can be confirmed over the dissenting vote of an impaired class as long as the plan does not "discriminate unfairly," and is "fair and equitable," with respect to each impaired, dissenting class. 11 USC § 1129(b). Thus, a plan can be "crammed down" over the vote of a dissenting class of creditors as long as one impaired class has voted to accept the plan.

3. However, the Bankruptcy Code describes how each type of claim the IRS may have against a Chapter 11 bankruptcy estate should be treated under a plan in order for the plan to be confirmed. The IRS should ensure that its various claims are properly treated under a plan and object to confirmation of the plan if it fails to provide for such treatment. Failure to object to a plan's proposed treatment of a claim may be interpreted as consent to that treatment.

4. Also, the IRS should attempt to include specific default provisions in a Chapter 11 plan. These default provisions specify the manner for the IRS to give the debtor notice of a default and an opportunity to cure the default. The default provisions may also clarify that the IRS may use its administrative collection powers to collect the tax due by the debtor if it fails to timely cure its defaulted plan payments.

5. Once a plan is confirmed, it is binding on the debtor and all interested parties.

5.17.10.9.4.1 (08-01-2010)
Objection to a Chapter 11 Plan

1. *Objecting* to a proposed Chapter 11 plan is a separate process from *voting* to accept or reject a plan. The IRS votes (accepts or rejects) only when it holds a secured claim or a general unsecured claim and it does not believe confirmation of the plan would be in its best interest. It objects to confirmation when the plan does not meet the legal requirements for confirmation under the Code, as when it holds unsecured priority tax claims that are not provided for as required under section 11 USC § 1129(a)(9). In most cases the IRS holds all three types of claims, so it votes and objects.

5.17.10.9.4.2 (08-01-2010)
Plan Treatment Of Administrative Expense and Gap Period Claims

1. All administrative expense claims (11 USC § 507(a)(2)) and gap period claims (11 USC § 507(a)(3)), including those of the IRS, must be fully paid in cash on the "effective date" of the plan, except to the extent that a particular claimant agrees otherwise. 11 USC § 1129(a)(9)(A).

   A. The IRS should rarely agree to any different treatment. But see paragraph 4, (IRM 5.17.10.9.4.2(4)), below.

   B. In some Chapter 11 cases, the IRS may even request that the bankruptcy court order the debtor in possession or trustee to deposit the money required to pay these administrative expense and gap period claims on the plan effective date in a special account before the court enters an order confirming the plan. Bankruptcy Rule 3020(a).

2. The effective date of the plan is ordinarily defined in the plan.

   A. If not, the effective date may be considered to be the date that the plan confirmation order becomes final and plan distributions should begin, ordinarily no sooner than 10 days after the confirmation order is entered.

   B. If the IRS holds significant administrative expense claims against a debtor's bankruptcy estate and if the proposed plan suggests an effective date for the plan that is too vague or too long after the plan is confirmed, then the IRS should object to the plan. See In re Potomac Iron Works, Inc., 217 B.R. 170 (Bankr. D. Md. 1997).

3. Administrative expense tax liabilities include penalties and interest on taxes incurred by the bankruptcy estate. See United States v. Friendship College, Inc., 737 F.2d 430 (4th Cir. 1984); In re Preferred Door Company, Inc., 990 F.2d 547 (10th Cir. 1993).

   Note:

   Administrative claims for penalties may not be equitably subordinated (paid less or differently from other administrative expense claims) under 11 USC § 510. See United States v. Noland, 517 U.S. 535 (1996).

4. If the bankruptcy estate is incurring administrative period taxes, but the administrative expense claim bar date proposed in the plan falls before or shortly after the tax return for the relevant tax year is due, the IRS should seek to extend the proposed administrative expense claim bar date to a specified reasonable period of time after the tax return is due.

   A. In this circumstance the IRS may agree for some of its potential administrative expense claims to be paid in full sometime after the plan effective date, since the bankruptcy estate's tax return for the administrative tax period will not be due until after the plan becomes effective.

   B. The IRS may also want to be sure that the reorganized debtor or other entity responsible for paying the administrative period taxes later determined to be due has maintained a cash reserve that will be available for paying the potential administrative period taxes.

      Note:

      While 11 USC § 503(b)(1)(D) provides that for cases commencing on or after October 17, 2005, the Service's request for payment of administrative liabilities does not have to be filed with the court for the expenses to be allowed, an administrative expense claim should nevertheless be filed. The filing of an administrative claim puts the debtor and creditors on notice of the liability and of the amount due. It also assists in the referral of the case to Counsel for dismissal or conversion, and helps ensure that the claim will be treated as an allowed administrative claim.

5.17.10.9.4.3 (08-01-2010)
Plan Treatment of Priority Tax Claims in Chapter 11

1. In order to be confirmed, a Chapter 11 plan must provide for unsecured priority tax claims (11 USC § 507(a)(8)) of the IRS to be paid in full, in cash, either on the plan effective date or in regular installment payments within five years of the date of the petition, including interest on any unpaid claim amounts after the plan becomes effective. 11 USC § 1129(a)(9)(C). The IRS may consent (knowingly or by not objecting) to other treatment of its priority tax claims by a Chapter 11 plan.

2. While irregular or fluctuating payments may be acceptable to the IRS when the reorganized debtor operates a seasonal business, the IRS should object to any Chapter 11 plan which promises a large balloon payment of IRS priority taxes at the end of a five-year payment period.

3. The interest rate required for installment payments of priority taxes under a Chapter 11 plan is determined pursuant to IRC § 6621 as of the calendar month in which the plan is confirmed, compounded daily pursuant to IRC § 6622. 11 USC § 511.

5.17.10.9.4.4 (08-01-2010)
Plan Treatment of Secured Tax Claims in Chapter 11

1. If a confirmed Chapter 11 plan and confirmation order provide for incomplete payment of or fail to address an IRS secured claim, property of the debtor's estate (except exempt and abandoned property) may be treated as free and clear of the IRS liens that previously secured the IRS claim. 11 USC § 1141(c).

   A. Thus, it is very important for the IRS to ensure that its secured claims are properly classified as "secured" by a proposed Chapter 11 plan, that the plan accurately defines the amount of the IRS secured claims, and that the IRS's liens will attach to the proceeds arising from the sale of any property to which the liens attached.

   B. Also, the plan should provide for the retention of the IRS's liens and the provision of deferred cash payments to the IRS for at least the total value of the IRS secured claim, plus interest calculated from the plan's effective date. 11 USC §§ 1129(b)(2)(A)(i)-(ii).

2. In addition to security arising from properly filed NFTLs, IRS claims are often secured by IRS rights to set off against prepetition federal tax refunds owed to the debtor and against other amounts payable to the debtor from another agency of the United States.

   A. The case law is split on whether a creditor loses its setoff rights by failing to provide specifically for preservation of these rights in a confirmed Chapter 11 plan or in the confirmation order. Compare In re De Laurentis Entertainment Group, Inc., 963 F.2d 1269 (9th Cir. 1992) (no loss of setoff rights) and In re Deutchman, 192 F.3d 457 (4th Cir. 1999), with In re Continental Airlines, 134 F.3d 536 (3d Cir. 1998) (setoff rights arguably lost, if not preserved in the plan).

   B. Accordingly, when the IRS knows it has setoff rights or is uncertain at plan confirmation whether it has setoff rights (as in a prepackaged plan situation), the IRS should request that the Chapter 11 plan specifically provide that the setoff rights of the IRS, if any, are not impaired by the plan.

3. Generally, when a reorganized Chapter 11 debtor retains property encumbered by an IRS lien after plan confirmation, the Bankruptcy Code requires that the reorganized debtor make deferred cash payments to the IRS for at least the allowed amount of the IRS secured claim with interest. Interest is determined pursuant to IRC § 6621 as of the calendar month in which the plan is confirmed. 11 USC § 511. However, 11 USC § 1129(b)(2)(A)(i)(II) does not specify the time period by which full payment of a secured tax claim must be completed.

   A. For cases commencing on or after October 17, 2005, 11 USC § 1129(a)(9)(D) provides that if a secured tax claim would otherwise have had priority tax status under section 507(a)(8), it will be paid in the same manner as unsecured priority tax claims, i.e., by regular installment payments to be made within five years of the date of the petition, including interest on any unpaid claim amounts after the plan becomes effective. See IRM 5.17.10.9.4.3(3) .

   B. For other secured tax claims, the IRS generally opposes long payout periods in a Chapter 11 case. The IRS has defeated some Chapter 11 plans which have proposed long payout periods for IRS secured claims on grounds of feasibility. See In re Haas, 162 F.3d 1087 (11th Cir. 1998).

4. When the IRS holds an oversecured claim in a Chapter 11 case, the IRS is entitled to be paid post-petition, pre-effective date interest with respect to its oversecured claim. 11 USC § 506(b).

   Note:

   When the IRS has not been paid this administrative period interest on its oversecured claim before confirmation, the IRS should ensure that the plan specifically recognizes the oversecured status of the IRS claim and provides for the full payment of this administrative period interest under the plan.

5. Whether an IRS secured claim is oversecured or undersecured, the IRS is also ordinarily entitled to be paid post-effective date interest under the plan on its secured claim if the property encumbered by the tax lien was not sold. The interest is determined pursuant to IRC § 6621 as of the month in which the plan is confirmed. 11 USC § 511.

6. Some bankruptcy courts allow a Chapter 11 debtor in possession to strip down the value of liens (prohibited in Chapter 7 cases by Dewsnup v. Timm, 502 U.S. 410 (1992)) before confirmation, in a proceeding to challenge the secured claim or to determine the extent of a lien. Courts have no authority, however, to modify secured claims other than through the plan. Section 1123(b)(5) allows the court to confirm a plan that modifies the rights of holders of secured claims, so any lien stripping in Chapter 11 must happen through a provision in a confirmed Chapter 11 plan.

7. While a Chapter 11 plan may modify the rights of holders of secured claims against property of the estate, individual debtors often have prepetition property which is

   - excluded from their bankruptcy estates (such as ERISA qualified pension interests, as in Patterson v. Shumate, 504 U.S. 753 (1992));
   - exempted from their bankruptcy estates (see 11 USC § 522, Bankruptcy Rule 4003, and Taylor v. Freeland, 503 U.S. 638 (1992)); or
   - abandoned by their bankruptcy estates prior to plan confirmation (11 USC §§ 554(a)-(b)).

8. An individual debtor's non-estate property of this type is not generally dealt with by a Chapter 11 plan, so this property is ordinarily not at risk of being stripped of prepetition tax liens by the plan. 11 USC § 1141(c); In re Isom, 901 F.2d 744 (9th Cir. 1990).

5.17.10.9.4.5 (08-01-2010)
Plan Treatment of General Unsecured Tax Claims in Chapter 11

1. If the IRS has general unsecured claims, it may vote to reject a plan and subsequently file an objection to confirmation of a plan based on the plan's proposed treatment of those claims.

2. In general, a Chapter 11 plan may be confirmed despite a vote to reject the plan by a class of creditors holding impaired, general unsecured claims. However, the plan cannot improperly discriminate between general unsecured claims. It must be "fair and equitable" in its treatment of the dissenting class of impaired, general unsecured claims holders in order to be confirmed by the bankruptcy court under "cram down" procedures. 11 USC § 1129(b)(1).

3. A plan is "fair and equitable" if it provides full payment, with interest, to the holders of claims in a dissenting class of general unsecured creditors or provides that the claims or interests of any "junior" claim or interest holder will not receive or retain any property or interest under the plan. 11 USC § 1129(b)(2)(B)(ii). This latter requirement is commonly referred to as the "absolute priority rule."

   A. The classes of claims or interests that are "junior" to a class of general unsecured creditors under the Bankruptcy Code include any class of subordinated holders of debt (subordinated bondholders, for instance) and the debtor's owners (e.g., the stockholders or partners).

   B. Thus, if a proposed Chapter 11 plan provides for the stockholders or the parent company of the debtor to retain any part of their ownership interest in the reorganized debtor, then a dissenting class of general unsecured creditors may object to confirmation of the plan by raising the absolute priority rule.

   C. However, some courts recognize a "new value exception" to the absolute priority rule. Under this exception, the owners of the debtor may retain some part of their ownership interests in the debtor in a cram down situation if the owners will be making a new contribution in money (or other capital) to the reorganized debtor.

   D. The Government has argued that there is no new value exception to the absolute priority rule. The Supreme Court has not addressed whether such an exception to the absolute priority rule should be recognized. See Bank of America NT & SA v. 203 North LaSalle Street Partnership, 119 S.Ct. 1411 (1999); U.S. Bancorp Mortgage Co. v. Bonner Mall Partnership, 115 S.Ct. 386 (1994); Norwest Bank Worthington v. Ahlers, 485 U.S. 197 (1988).

4. In addition to an objection based on the absolute priority argument, the IRS may file an objection to confirmation of a Chapter 11 plan in the following situations:

A. The plan improperly classifies the IRS's general unsecured claims apart from other similar, general unsecured claims and then provides for better (earlier or closer to full) payment of these other classes of general unsecured claims. 11 USC §§ 1129(a)(1) and (3), 1123(a)(1), and 1122(a).

B. The plan attempts to subordinate IRS penalty claims (including taxes for the debtor's underfunding of a pension plan under IRC § 4971) or other IRS general unsecured claims to the claims of all other classes of general unsecured creditors. See U.S. v. Reorganized CF&I Fabricators of Utah, Inc., 518 U.S. 213 (1996).

C. The plan provides smaller payments, overall, for the general unsecured claims of the IRS than the IRS would receive for those claims if the debtor was liquidated in a Chapter 7 case. 11 USC § 1129(a)(7)(A)(ii). This is commonly referred to as the "best interests of creditors" test. However, it is usually very difficult for a general unsecured creditor to make a successful argument that the plan fails the best interests of creditors test as to its own claim.

5.17.10.9.5 (08-01-2010)
IRS Feasibility Concerns with Chapter 11 Plans

1. A Chapter 11 plan should not be confirmed if the plan is likely to be followed by liquidation or the need for further reorganization (in another bankruptcy case, for instance), of the debtor or of any successor to the debtor under the plan, unless the plan proposes such liquidation or further reorganization. 11 USC § 1129(a)(11). This is commonly referred to as the "feasibility" test.

2. Common Chapter 11 feasibility concerns and objections of the IRS have included the following types of plan proposals:

   A. Balloon payments of IRS priority tax claims.

   B. Delays of the plan effective date (the date to pay IRS administrative expense or gap period claims) for an unreasonable period of time after plan confirmation, while the debtor remains in possession and control of the business.

   C. Extended deferred payment periods for IRS secured claims.

3. Identifying other IRS feasibility concerns with a proposed Chapter 11 plan may require a closer review of the entire structure of the proposed plan.

   A. A proposed Chapter 11 plan may provide that the reorganized debtor will pay the entire allowed priority tax claims of the IRS in regular even installments within five years of the petition date, but a careful review of other provisions of the plan may show that this promise is empty.

   B. For instance other parts of the proposed plan may provide that the debtor will transfer substantially all of its assets to a new entity (separate from the reorganized debtor), that the debtor's pre-confirmation debts to be assumed by the new entity will be limited to certain categories (secured debts and unsecured trade creditor debts perhaps) that would not include the tax debts to the IRS, and that the debtor will not be retaining or receiving sufficient cash or other property from the transfer of substantially all of its property to the new entity to ever pay the outstanding IRS tax claims.

5.17.10.9.5.1 (08-01-2010)
IRS Tax Avoidance Concerns with Chapter 11 Plans

1. If a proposed Chapter 11 plan is otherwise qualified to be confirmed, the bankruptcy court should nevertheless deny confirmation if the principal purpose of the plan is the avoidance of taxes. 11 USC § 1129(d). If the IRS objects on this ground, it has the burden of proof on the issue of showing that tax avoidance is the principal purpose of the proposed Chapter 11 plan. 11 USC § 1129(d).

2. One situation where it may be appropriate for the IRS to object that the principal purpose of a Chapter 11 plan is tax avoidance is when a sale or transfer or substantially all of the debtor's assets after confirmation is expected to produce a sizeable federal income tax liability for the debtor's bankruptcy estate, and the plan does not provide a mechanism for paying this federal tax liability to the IRS. See In re Scott Cable Communications, Inc., 227 B.R. 596 (Bankr. D. Conn. 1998).

3. If the taxpayer suspected of attempting to avoid a future federal income tax liability is not liquidating under a proposed Chapter 11 plan, the IRS may still be able to conduct a meaningful review of the facts and legal implications of the transactions after the plan is confirmed through a regular audit pursuant to IRC § 269. In a post-confirmation year audit of a taxpayer with a confirmed Chapter 11 plan, the IRS takes the position that confirmation of the bankruptcy plan does not stop the IRS from challenging the transactions effected by the plan for purposes of IRC § 269. See Treas. Reg. § 1.269-3(e); In re Hartman Material Handling Systems, Inc., 141 B.R. 802 (Bankr. S.D. N.Y. 1992).

5.17.10.9.5.2 (08-01-2010)
Designation of Payments in Chapter 11 Plans

1. In Chapter 11 cases where a corporate debtor is liable to the IRS for a significant amount of unpaid prepetition trust fund taxes, the debtor in possession often seeks in its plan to designate IRS application of the earliest payments required under the plan to satisfy the corporation's outstanding trust fund taxes first.

   A. The debtor in possession is often still controlled by the managers whom the IRS has already found or may still find liable as responsible persons for the debtor's previously unpaid trust fund taxes under IRC § 6672.

   B. The IRS generally views the corporate debtor's request to designate plan payments to trust fund taxes first as a means of shifting the risk of a Chapter 11 plan failing before completion from the debtor's managers to the IRS, while the debtor in possession typically argues that it is attempting to relieve its managers of the potential distraction of worrying about whether the IRS will collect the taxes owed from them before the debtor's plan is completed.

2. In U.S. v. Energy Resources, 495 U.S. 545 (1990), the Supreme Court decided that bankruptcy courts do have the authority to approve Chapter 11 plans which order the IRS to apply a Chapter 11 debtor's plan payments to trust fund taxes first if the court concludes that the designation of payments in this manner is necessary for the success of the reorganization plan.

3. The courts are split on whether a bankruptcy court may designate the application of payments made under a Chapter 11 plan to trust fund taxes when the plan provides for the debtor's liquidation rather than the debtor's continuation as a reorganized business. In re Kare Kemical, Inc., 935 F.2d 243 (11th Cir. 1991) (no designation allowed); In re Deer Park, Inc., 10 F.3d 1478 (9th Cir. 1993) (designation allowable).

4. Energy Resources does not provide that bankruptcy courts have the jurisdiction to determine the tax liability of non-debtors. See In re Prescription Home Health Care, Inc., 316 F.3d 542, 549 (5th Cir. 2002). For this reason, the IRS maintains that a bankruptcy court lacks the proper authority or jurisdiction to enjoin the IRS from investigating a corporate debtor's potentially responsible persons for their liability for the trust fund recovery penalty (TFRP), from assessing the TFRP against the debtor's responsible persons, and from attempting to collect the TFRP from the debtor's responsible persons while the debtor's trust fund tax liabilities remain unpaid. See generally In re Prescription Home Health Care, Inc., 316 F.3d 542 (5th Cir. 2002); U.S. v. Huckabee Auto Co., 783 F.2d 1546 (11th Cir. 1986); In re LaSalle Rolling Mills, Inc., 832 F.2d 390 (7th Cir. 1987); A to Z Welding & Mfg. Co., Inc. v. U.S., 803 F.2d 932 (8th Cir. 1986); In re American Bicycle Assoc., 895 F.2d 1277 (9th Cir. 1990).

5. However, absent statute of limitation period considerations, it is the general policy of the IRS to refrain from asserting the TFRP against non-debtor responsible persons in cases where the corporate debtor has already approved a Chapter 11 plan that provides for full payment of priority taxes for so long as the plan is not in default. See IRS Policy Statement 5-14 (formerly P-5-60), at IRM 1.2.14.1.3.

5.17.10.10 (08-01-2010)
The Effects of Confirmed Chapter 11 Plans

1. When a confirmed Chapter 11 plan becomes effective, the extent to which tax liabilities (whether or not a proof of claim was actually filed) are discharged depends on a number of factors. These factors include whether the debtor is an individual or a non-individual (e.g., corporations, partnerships, limited liability companies, etc.), whether a non-individual debtor is liquidating or reorganizing, and what the specific terms of the plan provide.

2. Once a confirmed Chapter 11 plan becomes effective, the automatic stay (11 USC § 362), which went into effect on the petition date, is generally lifted. However, the discharge injunction that arises upon confirmation of the plan generally continues to prohibit the IRS from collecting a tax debt that is either discharged or fully provided for by the plan (unless and until the plan falls into substantial default).

3. For Chapter 11 cases of individuals filed on or after October 17, 2005, the debtor generally does not receive a discharge until after completion of payments under the plan. Under section 362(c), the automatic stay generally terminates upon the earlier of three events, the grant or denial of discharge, the closing of the case, or the dismissal of the case. However, the automatic stay prohibiting acts against property of the estate remains in effect until the property is no longer property of the estate. A Chapter 11 plan typically provides for the revesting of property of the estate in the debtor or some other entity, but it may not. 11 USC § 1141(b). Further, for Chapter 11 cases of individuals filed on or after October 17, 2005, the estate includes post-petition wages and property, as in Chapter 13 cases. 11 USC § 1115.

4. To the extent a tax debt is fully provided for by an effective Chapter 11 plan that is not in substantial default, the IRS collection limitation period with respect to that tax debt is automatically suspended pursuant to IRC § 6503(h).

5.17.10.10.1 (08-01-2010)
The Chapter 11 Discharge

1. The overwhelming majority of debtors with confirmed and effective Chapter 11 plans are non-individual debtors (e.g., corporations, partnerships, limited liability companies, etc.). The discharge granted a non-individual debtor in a Chapter 11 case is substantially different from the discharge granted an individual debtor. See IRM 5.17.10.11 for a discussion on the Chapter 11 discharge for individual debtors. When the Chapter 11 debtor is an individual, the exceptions to discharge in 11 USC § 523(a) apply. The provisions of a confirmed plan cannot affect the dischargeability of tax liabilities of individuals when the liabilities are excepted from discharge under 11 USC § 523(a)(1).

   Note:

   For bankruptcy cases filed on or after October 17, 2005, Chapter 11 debtors who are individuals are generally not entitled to receive a discharge until after completion of all payments under the plan, as in Chapter 13 cases. 11 USC § 1141(d)(5). However, a debtor who cannot complete all payments under the plan, but has paid more to creditors than they would have received in a Chapter 7 case, may be entitled to a hardship discharge.

2. Unless otherwise provided for in the plan or confirmation order, non-individual Chapter 11 debtors generally receive a "superdischarge" of all of their pre-confirmation debts. 11 USC § 1141(d)(1)(A). However, for Chapter 11 cases filed on or after October 17, 2005, tax debts for which the debtor filed a fraudulent return or willfully attempted to evade are not discharged even if the debtor is not an individual. 11 USC § 1141(d)(6)(B).

3. A debtor's Chapter 11 plan is required to provide for full payment in cash of the allowed claims the IRS has filed for administrative expense and gap period taxes, priority taxes, and secured taxes. Therefore, a Chapter 11 plan for a non-individual debtor is required to "provide otherwise" for discharge of these types of taxes, as long as the IRS has filed proofs of claim for these taxes, and the IRS claims are allowed. If the IRS does not file proofs of claims for pre-confirmation taxes owed by a non-individual Chapter 11 debtor, the plan generally will provide for discharge of these tax debts.

4. With respect to the IRS's secured claims, the IRS should ensure that a plan provides for the retention of tax liens on the debtor's property which secures the IRS's claim. Otherwise, the tax liens may be stripped from all of the debtor's property when the plan becomes effective. 11 USC § 1141(c).

5. Prepackaged Chapter 11 plans sometimes provide for most of a debtor's unsecured debts (including some or all of its potential tax debts) to pass through confirmation of the prepackaged plan with no alteration. A prepackaged Chapter 11 plan may provide this passthrough treatment for most types of unsecured debts because the debtor may be primarily concerned with restructuring only its most significant debts and stock ownership in a pre-agreed manner, and involving all of its creditors in the bankruptcy proceeding could slow down approval of its narrowly drawn prepackaged plan. Nevertheless, the IRS should carefully review the proposed terms of a prepackaged plan that provides for passthrough treatment of some unsecured debts to be sure that the passthrough terms of the proposed plan actually cover all of the potential claims of the IRS against the debtor.

6. If the confirmed plan of a non-individual Chapter 11 debtor provides for the liquidation of all or substantially all of the property of the debtor's bankruptcy estate and if the debtor does not engage in business after the plan is confirmed, then the debtor does not receive a discharge of its pre-confirmation debts automatically pursuant to 11 USC § 1141(d)(3).

   A. In many liquidating Chapter 11 cases of this type, the terms of the debtor's Chapter 11 plan itself frequently provide for the non-individual debtor's pre-confirmation debts to be discharged or released under the plan.

   B. The debtor's creditors may choose not to object to this treatment of their debts because there may be no collection source for their debts apart from distributions under the liquidating Chapter 11 plan anyway.

5.17.10.10.2 (08-01-2010)
The Binding Effect of Chapter 11 Plans

1. The provisions of a confirmed Chapter 11 plan generally bind the debtor, any entity acquiring property under the plan, and any creditor (including the IRS), whether or not the claim of such creditor is impaired under the plan and whether or not the creditor has accepted the plan. 11 USC § 1141(a). While is it always the better practice to object to a plan that contains inappropriate provisions, there are specific statutory exceptions to the general rule that a plan's terms are binding upon creditors. Statutory exceptions are made for:

   A. debts excepted from discharge by 11 USC § 523(a)(1), in the case of individuals;

   B. the denial of discharge by 11 USC § 1141(d)(3), which denies a discharge to liquidating non-individual debtors;

   C. the withholding of an individual Chapter 11 debtor's discharge until the completion of payments under the plan; and

   D. debts excepted from discharge by 11 USC § 1141(d)(6), including non-dischargeable tax debts relating to a fraudulent return or the willful attempt to evade such taxes in the case of corporate debtors.

2. If the terms of a confirmed Chapter 11 plan purport to limit or reduce IRS priority tax claims to an amount less than what the IRS is entitled to under the Bankruptcy Code, and if there was no tax determination proceeding in the bankruptcy, the IRS may also argue that the debtor misused the plan confirmation process to produce an adjustment of rights that the debtor should have pursued through a contested bankruptcy proceeding, apart from the plan confirmation process. In such cases the United States has persuaded several courts that terms of this type in a confirmed Chapter 11 plan are not binding on the IRS. See In re DePaolo, 45 F.3d 373 (10th Cir. 1995); In re Taylor, 132 F.3d 256 (5th Cir. 1998).

5.17.10.10.3 (08-01-2010)
Status of the Automatic Stay and Collection SOL after Plan Confirmation for Non-Individuals

1. When a Chapter 11 plan becomes effective, the non-individual debtor generally receives a discharge of at least some of its debts. Pursuant to 11 USC § 362(c), the stay of acts against property of the estate ends only when the property is no longer in the estate, and property of the estate typically revests in the debtor upon confirmation of a plan. Section 362(c) provides that the stay remains in effect until the earliest of three events: grant or denial of discharge, closing of the case, or dismissal.

2. In a Chapter 11 case of a non-individual, the discharge is typically granted or denied when the plan is confirmed.

3. When the automatic stay is lifted upon confirmation of the plan, the IRS is not generally free to resume its normal collection activity for the debtor's pre-confirmation tax debts. The plan is binding upon the debtor and all creditors. 11 USC § 1141(a). Also, the discharge injunction typically takes effect when the plan is confirmed and the discharge is granted. 11 USC § 524(a). However, the discharge injunction does not prohibit:

   A. the commencement or continuation of proceedings concerning the debtor before the U.S. Tax Court, or

B. the setoff of discharged tax liabilities against prepetition refunds.

4. To the extent that a Chapter 11 plan provides for full payment of the IRS's pre-confirmation tax claims, in particular its administrative, priority, and secured tax claims, the plan precludes the IRS from attempting to collect these taxes (outside of receiving payments under the plan and making setoffs). If the debtor substantially defaults on making the payments on the taxes provided by the plan, the IRS may pursue administrative action to collect any unpaid portion of the amount which the confirmed plan originally provided for payment to the IRS, though default provisions in the plan should generally be followed. See IRM 5.17.10.12.1,*Chapter 11 Plan Default Procedures*.

5. After a Chapter 11 plan becomes effective and the automatic stay is lifted, the statute of limitations for the IRS to collect a pre-confirmation tax, that is to be fully paid under a Chapter 11 plan, remains suspended pursuant to IRC § 6503(h)(2), unless the debtor substantially defaults on making plan payments of the tax at issue. See United States v. Wright, 57 F.3d 561 (7th Cir. 1995); United States v. McCarthy, 21 F. Supp. 888 (S.D. Ind. 1998).

5.17.10.11 (08-01-2010)
Individuals in Chapter 11

1. BAPCPA made several changes to Chapter 11 to make cases of individuals similar to Chapter 13 cases, often adopting language from relevant Chapter 13 provisions.

2. Under new 11 USC § 1115, an individual Chapter 11 debtor's bankruptcy estate now includes post-petition property and earnings of the debtor. New 11 USC § 1129(a)(15) provides that individuals must apply their projected disposable income to the plan for a minimum of five years, although Chapter 11 plans can be longer. These changes impact how the individual debtor and the debtor's bankruptcy estate are each taxed under IRC § 1398.

   A. For an individual debtor filing a Chapter 11 case (as in individual Chapter 7 cases), the individual and the individual debtor's bankruptcy estate are treated as separate taxpayers by IRC § 1398. See IRM 5.9.8.13 for further discussion on the separate taxation of an individual Chapter 11 debtor and the bankruptcy estate.

   B. Given the broader definition of property of the estate under 11 USC § 1115, income that would otherwise have been taxable to the Chapter 11 debtor had section 1115 not been enacted is arguably taxable to the Chapter 11 estate. Such income may include (1) all wages and other income from the performance of services earned after the bankruptcy filing and (2) all rents, dividends, and other income from property acquired after the filing.

   C. This approach was, however, not likely intended by Congress at least insofar as post-petition income from the performance of services is concerned. Notice 2006-83 provides further guidance on the effects of 11 USC § 1115 on the taxation of Chapter 11 bankruptcy estates and individuals.

3. The bankruptcy estates of individuals in Chapter 11 often need to be closely monitored for compliance with their administrative period income tax obligations pursuant to IRC § 1398.

   A. The IRS has generally made the Chapter 7 panel trustees aware of their federal income tax obligation to file Form 1041 returns for an individual debtor's bankruptcy estate through circulation of IRS Publication 908 (Tax Information on Bankruptcy) and through various meetings with the trustees.

   B. In some cases, it may be appropriate for the IRS to ask the debtor in possession to abandon, or the bankruptcy court to order abandonment, of estate property to the individual debtor (11 USC § 554) before the taxable transfer of that property occurs. See In re Olson, 930 F.2d 6 (8th Cir. 1991); In re Nevin, 135 B.R. 652 (Bankr. D. Haw. 1991).

4. Under new 11 USC § 1127(e), upon the request of a party in interest, the amount or timing of plan payments can be modified any time before completion of the plan.

5. The changes made by BAPCPA have also made the Chapter 11 discharge for individuals similar to the discharge for individuals in Chapter 13 cases.

   A. Under new 11 USC § 1141(d)(5), Chapter 11 debtors who are individuals will not receive a discharge upon confirmation of the plan. As in Chapter 13, the discharge occurs after completion of payments under the plan. The court may, however, grant the debtor a hardship discharge before the completion of plan payments.

   B. The types of tax debts excepted from discharge have not changed — many prepetition secured and unsecured tax debts survive plan confirmation whether or not the IRS files a claim for the tax in the bankruptcy case. See Matter of Fein, 22 F.3d 631 (5th Cir. 1994); In re DePaolo, 45 F.3d 373 (10th Cir. 1995); In re Gurwitch , 794 F.2d 584 (11th Cir. 1986). In particular, tax debts that are excepted from discharge under 11 USC §§ 523(a)(1)(A)-(C), such as priority taxes, are not discharged when an individual completes payments under the Chapter 11 plan. 11 USC § 1141(d)(2).

6. Claims for post-petition administrative period interest that is due on non-dischargeable taxes against an individual in Chapter 11 are not allowed and cannot be paid under the Chapter 11 plan. However, the individual debtor remains personally liable for paying this post-petition interest, after confirmation, outside of the plan. See In re Tuttle, 291 F.3d 1238 (10th Cir. 2002).

7. In Chapter 11 cases, a claim for an individual debtor's own (as opposed to the estate's) post-petition federal tax liabilities may not be filed in the bankruptcy case, but these post-petition pre-confirmation debts of the individual survive confirmation and may be collected from the individual. See In re Johnson, 190 B.R. 724 (Bankr. D. Mass. 1995); In re Wood, 240 B.R. 609 (C.D. Cal. 1999).

5.17.10.12 (08-01-2010)
Monitoring Compliance with Chapter 11 Plans

1. In a Chapter 11 case where a plan confirmation order is procured by fraud, an interested party may file an adversary complaint to revoke the confirmation order and the discharge received by the debtor at any time before the 180th day after the confirmation order was entered. 11 USC § 1144; Bankruptcy Rule 7001. The circumstances constituting procurement by fraud must be plead with particularity and proven by a preponderance of the evidence. Bankruptcy Rule 7009; Federal Rule of Civil Procedure 9(b). It is relatively rare for the IRS to seek revocation of a Chapter 11 plan.

5.17.10.12.1 (08-01-2010)
Chapter 11 Plan Default Procedures

1. Many Chapter 11 plans specify the procedures applicable to all creditors or to the IRS when the reorganized debtor defaults on its required payments under the plan.

2. In the case of a default, Insolvency may refer the case to a revenue officer to resume administrative collection activity.

3. Insolvency may also refer the case to Area Counsel to file a motion to dismiss or convert the debtor's Chapter 11 case to a Chapter 7 case. However, dismissal or conversion would only be appropriate if the bankruptcy estate retained property after confirmation. There is no provision that reinstates the automatic stay upon conversion.

   Note:

   Dismissal of a Chapter 11 case due to a default by a debtor with respect to a confirmed plan does not revoke any discharge which has been granted in the case. This is an issue in a Chapter 11 case of a non-individual debtor who receives a discharge on confirmation of a plan.

More Internal Revenue Manual

Part 5. Collecting Process

Chapter 17. Legal Reference Guide for Revenue Officers

Section 11. Chapter 13 Bankruptcy (Individuals with Regular Income) and Chapter 12 Bankruptcy (Family Farmers or Fishermen with Regular Income)

5.17.11 Chapter 13 Bankruptcy (Individuals with Regular Income) and Chapter 12 Bankruptcy (Family Farmers or Fishermen with Regular Income)

5.17.11.1 (10-01-2010)
Overview

1. This section primarily concerns Chapter 13 bankruptcies. It explains the provisions and concepts of bankruptcy law that are unique to Chapter 13. It also briefly discusses Chapter 12 bankruptcies.
2. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) significantly revised the Bankruptcy Code. These changes generally apply to bankruptcies filed on or after October 17, 2005.
3. Exhibit 5.17.8-1 contains a glossary of the bankruptcy terms used in this section.

5.17.11.2 (10-01-2010)
Purpose of Chapter 13 Cases

1. Chapter 13 provides a procedure for an eligible individual with regular income to pay all or a portion of his or her debts through plan payments over an extended period. Only those portions of regular income that are not necessary to pay living expenses are used to pay claims.
2. Before the effective date of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), a debtor received a superdischarge if he or she completed all payments required under the plan. Any tax debts provided for under the plan would be discharged. BAPCPA modified this discharge so that certain tax debts excepted from discharge under 11 USC § 523 are no longer discharged. For example, trust fund recovery penalties are no longer discharged and must be paid in full.
3. After filing the Chapter 13 petition, the debtor files a Chapter 13 plan which proposes to pay creditors, including the IRS, over a period of up to five years, typically in monthly installments.

5.17.11.3 (10-01-2010)
Who May Be a Chapter 13 Debtor

1. Chapter 13 is for individual debtors. 11 USC § 109(e).
   A. It is not available to corporations, partnerships, or other business entities.
   B. An individual owning a business as a sole proprietorship may file as an individual, and the schedules may include business debts of the individual.
   C. Chapter 13 cases are commonly known as wage-earner cases, but the Bankruptcy Code does not require that the individual be a wage earner as long as the individual has regular income with which to fund the plan.
   D. An "individual with regular income" is defined in 11 USC § 101(30) as an individual whose income is sufficiently stable and regular to enable such individual to make payments under a Chapter 13 plan. A stockbroker or commodity broker is excluded from filing bankruptcy under this chapter.
2. To be a Chapter 13 debtor, the individual must have a regular source of income, and total outstanding liabilities at the time of the petition cannot exceed certain dollar limits.
   A. For cases commenced on or after April 1, 2010, the dollar limits were increased to $360,475 for unsecured debts and $1,081,400 for secured debts. 11 USC § 109(e).
   B. These dollar limits are increased every three years based upon the Consumer Price Index.
   C. The debts must be noncontingent and liquidated.
3. Liabilities set forth in a statutory notice of deficiency are noncontingent, liquidated debts even if contested in Tax Court at the time the bankruptcy petition is filed. United States v. Verdunn, 89 F.3d 799 (11th Cir. 1996); In re Brooks, 216 B.R. 838 (Bankr. N.D. Okla. 1998). A debt is noncontingent when all of the events giving rise to liability for the debt occurred prior to the debtor's filing for bankruptcy. See, e.g., In re Knight, 55 F.3d 231, 236 (7th Cir. 1995); In re Nicholes, 184 B.R. 82, 88 (9th Cir. BAP 1995).

Note:

As long as the liabilities can be calculated through mathematical computations, a debt may be liquidated without issuance of a notice of deficiency. See Hounsom v. United States, 325 B.R. 319 (M.D. Fla. 2005).

5.17.11.4 (10-01-2010)
Initiating a Chapter 13 Case

1. A Chapter 13 case must be voluntary. Procedures for filing a Chapter 13 are otherwise essentially the same as in Chapter 7 cases. A Chapter 13 debtor is required to file schedules of assets and liabilities, a schedule of current income and expenditures, a schedule of executory contracts, and a statement of financial affairs. Bankr. Rule 1007.
2. A first meeting of creditors (11 USC § 341) is held as in a Chapter 7 case. The business of the meeting includes the examination of the debtor concerning the debtor's statement of financial affairs and the feasibility of the debtor's plan. Under BAPCPA, before the first meeting of creditors, the debtor is required to file tax returns for the four-year period ending before the petition date and provide to the trustee a copy of the return for the tax year ending immediately before the petition date. 11 USC §§ 521(e)(2), 1308(a); In re Perry, 389 B.R. 62 (Bankr. N.D. Ohio 2008).
   A. Unlike Chapters 7 and 11, Chapter 13 makes no provision for creditors' committees.
   B. Appointment of a trustee in a Chapter 13 does not displace a business debtor from management, unlike Chapter 11.

5.17.11.5 (10-01-2010)
The Trustee

1. There is a trustee in every Chapter 13 case. The trustee is almost always a standing trustee who is appointed by the United States Trustee. 11 USC § 1302.
   A. The Chapter 13 trustee's duties include many of those of the Chapter 7 trustee, such as being accountable for all property received, investigating the financial affairs of the debtor, opposing the discharge if advisable, and making a final report and accounting.
   B. Under BAPCPA, the trustee must ensure payment of the debtor's domestic support obligations.
   C. The trustee is to appear and be heard at hearings concerning the valuation of property subject to a lien, confirmation of a plan, or modification of the plan after confirmation.
   D. The trustee must also ensure that the debtor commences making timely plan payments.
2. If the debtor is engaged in business, the trustee has some of the duties of a Chapter 11 trustee under 11 USC § 1106(a)(3) and (4), including investigating the financial condition of the debtor and the desirability of continuing the business, and filing a statement regarding such investigation.

5.17.11.6 (10-01-2010)
Rights and Duties of the Debtor

1. The debtor has the exclusive right to seek court approval for the use, sale, or lease of property outside the ordinary course of business. These rights are essentially the same as those given to a Chapter 7 trustee. 11 USC § 1303.
2. Unless the court orders otherwise, a debtor engaged in business is authorized to operate the business. 11 USC § 1304.
   A. In this capacity the debtor is subject to the same rights, powers, and limitations of a debtor in possession (or trustee) in a Chapter 11 case with respect to the use, sale or lease of property and the obtaining of credit.
   B. A debtor engaged in business must also perform the duties of a Chapter 7 trustee under 11 USC § 704(8), including filing with the court and the United States Trustee periodic reports and summaries concerning the operation of the business. 11 USC § 1304(c).
3. Unlike individual Chapter 7 and Chapter 11 estates, a Chapter 13 estate is not a separate taxable entity. IRC § 1399. The debtor is therefore responsible for filing tax returns for all postpetition income.

   Note:

   Under 11 USC § 521(j), added by BAPCPA, the IRS may request that the court convert or dismiss the case if the debtor fails to file postpetition returns. The IRS need not be a party in interest to make this request.

5.17.11.7 (10-01-2010)
Proofs of Claim

1. To receive payment, a proof of claim must be timely filed. The procedures for filing a claim are set forth in Bankruptcy Rules 3001 and 3002.
2. The time for filing a proof of claim for nongovernmental creditors in a Chapter 13 case is 90 days after the date first set for the first meeting of creditors. However, under 11 USC § 502(b)(9) as amended by BAPCPA, a governmental unit also has 180 days after the date of the bankruptcy petition to file a claim and has 60 days after a required return is filed to file a claim for a tax to which the return relates. A claim filed within any of these periods is timely. A governmental unit may seek to have these time frames extended by filing a motion for extension prior to the expiration of the initial time period. Bankr. Rule 3002(c)(1).

5.17.11.8 (10-01-2010)
Automatic Stay

1. A Chapter 13 debtor is protected by the automatic stay provisions found in 11 USC § 362.
2. The stay operates until the Chapter 13 case is dismissed or closed, or a discharge is granted or denied. 11 USC § 362(c)(2). Because the discharge is not granted until all payments have been made under the plan, the stay remains in effect throughout the entire period of the plan.

   Note:

   The IRS may request relief from the automatic stay in certain circumstances (e.g., lack of adequate protection). 11 USC § 362(d). Consult Area Counsel to determine whether seeking relief from the stay is appropriate.
3. Under BAPCPA, if the debtor had one or more bankruptcies pending within a year before the current bankruptcy, the stay may terminate early or may never go into effect. The stay may terminate 30 days after the petition date where one prior bankruptcy was filed, and it may never go into effect where there were two or more prior bankruptcies. The debtor may be able to proceed to confirmation even if the automatic stay is deemed to not be in effect. Consult Area Counsel for advice on how to determine the duration of the automatic stay in these situations.
4. The duration of the automatic stay affects the running of the collection statute of limitations and how long it is suspended under IRC § 6503(h). Serial bankruptcy cases make it difficult to calculate the statute of limitations. Consult with Area Counsel to make these calculations.
5. Additionally, creditors are stayed from collecting from co-debtors on consumer debts. 11 USC § 1301. Consumer debt is defined in 11 USC § 101(8) as debt incurred primarily for a personal family or household purpose. Tax liabilities are not included in the definition.

5.17.11.9 (10-01-2010)
Adequate Protection and Turnover

1. Lack of adequate protection can be a basis for the IRS to resist turning over property of the estate to the trustee. See In re Hooper, 152 B.R. 309 (Bankr. D. Colo. 1993). Adequate protection typically means periodic cash payments. In a Chapter 13, the debtor is required to initiate payments within 30 days of the filing of the plan. 11 USC § 1326(a). Confirmation is achieved fairly quickly in most Chapter 13 cases, binding the Government to the terms of the confirmed plan. Thus, adequate protection has been determined by some courts to be provided by the periodic payments required by the confirmed plan. United States v. Reynolds, 764 F.2d 1004 (4th Cir. 1985); United States v. Norton, 717 F.2d 767 (3d Cir. 1983).

5.17.11.10 (10-01-2010)
Setoff

1. Under BAPCPA, the automatic stay does not prohibit the IRS from setting off prepetition income tax refunds against prepetition income tax liabilities. 11 USC § 362(b)(26). Where the automatic stay prohibits other types of setoffs, the IRS can temporarily retain a refund to preserve its setoff rights. In those cases, the IRS should seek relief from the stay before permanently offsetting refunds. See Citizens Bank v. Strumpf, 516 U.S. 16 (1995). After confirmation of the Chapter 13 plan, and where the plan fully provides for the IRS claims, retaining the refund indefinitely may be considered a violation of the automatic stay.
2. The IRS may set off postpetition overpayments against postpetition liabilities unless the IRS filed a claim under 11 USC § 1305 for these liabilities. Section 1305 allows creditors to file claims for debts that become payable after the petition date, and these claims may be provided for in the plan.
3. Local bankruptcy court rules and orders may provide specific procedures regarding the offset of refunds. Consult Area Counsel for local rules.

5.17.11.11 (10-01-2010)
The Chapter 13 Plan

1. The debtor has the exclusive responsibility for filing a plan. 11 USC § 1321. Although most plans are filed at the time of the petition, the debtor has up to 15 days from the filing of the petition to file the plan unless the court, for cause, allows otherwise. Bankr. Rule 3015(b). The plan specifies what each creditor will be paid and under what terms.
2. Unlike Chapter 11 creditors, Chapter 13 creditors do not vote on the plan. A creditor should object to confirmation if the plan does not properly treat its claim.
3. Section 1322(a) requires a plan to provide for:
   A. submission of all or such portion of future earnings or other future income to the trustee as is necessary to fund the plan;
   B. the full payment, on a deferred basis, of priority claims (including priority taxes under 11 USC § 507) unless the holder of the claim agrees to different treatment;

      Note:

      Under 11 USC § 1322(a)(4), added by BAPCPA, if the plan provides for less than full payment of a domestic support claim entitled to priority status, all the debtor's disposable income for a five-year period must be applied to plan payments.
   C. the same treatment for each claim within a class; and
   D. the payment of interest on claims for nondischargeable unsecured debts, assuming that the debtor has disposable income remaining after paying all allowed claims in full.
4. Prior to BAPCPA, the plan could not be longer than three years unless the court, for cause, approved a longer payment period, not to exceed five years. Under BAPCPA, the allowable plan length is tied to the debtor's income, but the plan cannot exceed five years under any circumstances. 11 USC § 1322(d).
5. A court must confirm a plan if the holder of each allowed secured claim has accepted the plan; if the plan provides that the claimholder retains its lien and receives the full amount allowed on such claim; or if the debtor surrenders the property securing such claim to the claimholder. 11 USC § 1325(a)(5).
   A. Under BAPCPA, if a secured creditor is to receive periodic payments, the payments must be in equal monthly amounts, and the amount of the payments must provide an amount sufficient to constitute adequate protection if the claim is secured by personal property.
   B. Under BAPCPA, a secured creditor may retain its lien until the debtor pays the underlying debt or the court grants a discharge, whichever is earlier. If the case is dismissed or converted prior to completion of the plan, a secured creditor retains its lien to the extent allowed by nonbankruptcy law.

      Note:

      The value of a secured claim does not include the value of property excluded from the bankruptcy estate. A lien on excluded property passes through bankruptcy unaffected and remains enforceable against this property after the discharge is granted. Excluded property is a property interest that never becomes property of the bankruptcy estate. ERISA-qualified pension plans and other plans listed under 11 USC § 541 are examples.
6. The IRS should object to confirmation if its secured claim is not properly treated under the plan. A confirmed plan is binding on a secured creditor who does not timely object to the plan even if the plan does not comply with 11 USC § 1325(a)(5). In re Szostek, 886 F.2d 1405 (3d Cir. 1989); IRS v. DiPasquale, 2006 WL 1207990, 97 AFTR2d 2006-2233, 2006-1 USTC ¶ 50,318 (D.N.J. 2006).
7. The debtor may deal with a secured claim outside the plan. If the secured claim is held by the IRS and the debtor does not pay its liability, the IRS should ask the court to lift the stay.
8. A plan should not be confirmed unless priority claims are provided for in full, and the IRS should object to a plan that does not provide for full payment of priority taxes. In the event that the IRS does not object and a plan is confirmed without properly providing for priority taxes, the IRS, prior to discharge, can move to have the plan dismissed or modified. This has been successful in some courts. In re Escobedo, 28 F.3d 34 (7th Cir. 1994); In re Puckett, 193 B.R. 842 (Bankr. N.D. Ill. 1996). After discharge, the IRS's options are more limited.
9. Under the "best interests of creditors" test, unsecured general claims must receive under the plan at least the amount they would be entitled to in a Chapter 7 case. 11 USC § 1325(a)(4). To decide whether the plan meets this requirement, the court must determine the value of nonexempt assets and make a hypothetical Chapter 7 distribution. If a claim would be fully paid in a Chapter 7 case, the creditor is entitled to receive interest on its claim until it is fully paid in the Chapter 13 case.
10. If a plan provides for less than full payment of unsecured general claims, the court may not approve the plan over the trustee's or a creditor's objection unless the debtor commits all the debtor's projected disposable income to plan payments. 11 USC § 1325(b)(1)(B).

    Note:

    The court shall confirm a plan if the plan has been proposed in good faith and not by any means forbidden by law. 11 USC 1325(a)(3). In general, the good faith test requires consideration of the totality of the circumstances. See, e.g., In re Alt, 305 F.3d 413 (6th Cir. 2002) (providing a list of possible circumstances courts should consider). For example, a plan may not meet the good faith test if the debtor fails to pay all disposable income into the plan or if the plan provides a minimal payout in relation to large unsecured debts. Consult Area Counsel to determine whether a plan has not been proposed in good faith.
11. If the debtor fails to file the federal tax returns required by 11 USC § 1308 (returns for the four-year period ending on the petition date), the court shall dismiss or convert a case on request of a party in interest or the United States Trustee and after notice and a hearing. 11 USC § 1307(e). The court will decide whether to dismiss or convert the case based upon the best interests of the creditors and the estate. Or the court may extend the filing deadline for a limited time if the debtor demonstrates by a

preponderance of the evidence that the failure to file a return as required is attributable to circumstances beyond the debtor's control. 11 USC § 1308(b)(2). See IRM 5.17.11.17, below, for more information regarding conversion or dismissal of Chapter 13 cases.

5.17.11.12 (10-01-2010) Payments

1. The debtor shall commence making payments proposed by a plan within 30 days after the plan is filed or the order for relief is entered, whichever is earlier. 11 USC § 1326(a)(1).
2. The payments are to be retained by the trustee until confirmation or denial of confirmation.
   A. If a plan is confirmed, the trustee shall distribute such payments in accordance with the plan.
   B. If the plan is not confirmed, the trustee shall return the payments to the debtor after deducting allowed administrative claims under 11 USC § 503(b). The IRS can levy on the trustee to obtain these funds. Beam v. IRS, 192 F.3d 941 (9th Cir. 1999).

5.17.11.13 (10-01-2010) Effect of Confirmation

1. Once confirmed, a plan is binding, whether or not a claim is provided for and whether or not the creditor has objected to, accepted, or rejected the plan. 11 USC § 1327(a).
2. Upon confirmation, property of the estate revests in the debtor except as otherwise provided in the plan or the order confirming the plan. 11 USC § 1327(b). Except as otherwise provided in the plan, the property revesting in the debtor is free and clear of any claim or interest of any creditor provided for in the plan. 11 USC § 1327(c). Postpetition earnings and income used to fund the plan are property of the estate after confirmation until the plan is completed or the case is dismissed. 11 USC § 1306(a)(2).
3. The automatic stay is not lifted upon confirmation in a Chapter 13, but continues until the case is dismissed, closed, or the debtor is discharged. Therefore, additional contact with the debtor, demand for payment, and collection of prepetition liabilities may be prohibited. Contacting the debtor to investigate and determine the amount and existence of a liability does not violate the stay.

5.17.11.14 (10-01-2010) Collection of Postpetition Taxes

1. There are two potential alternatives for collecting postpetition taxes in a Chapter 13:
   A. administrative collection (e.g., levy); or
   B. filing a claim under 11 USC § 1305.
2. The IRS may collect postpetition liabilities from the property of the debtor, but not from property of the estate. Collection of postpetition taxes during the pendency of a Chapter 13 case is complicated because of differing views in the courts as to what is property of the estate after confirmation. Filing a notice of federal tax lien for postpetition taxes does not violate the automatic stay.

   Note:

   To avoid litigation on the issue of whether filing tax liens for postpetition taxes violates the automatic stay, the notice of federal tax lien should include an annotation stating, "This Notice of Federal Tax Lien is not being filed with respect to property while it remains property of the bankruptcy estate of the taxpayer."
3. Most courts hold that although a Chapter 13 bankruptcy estate exists after confirmation, it is limited to the portion of the earnings or other property of the debtor necessary for the funding of the plan. Accordingly, any other assets are available for administrative collection of postpetition taxes. See, e.g., Telfair v. First Union Mortgage Corp., 216 F.3d 1333 (11th Cir. 2000); In re Heath, 115 F.3d 521 (7th Cir. 1997); In re Markowicz, 150 B.R. 461 (Bankr. D. Nev. 1993); In re Thompson, 142 B.R. 961 (Bankr. D. Colo. 1992); In re McKnight, 136 B.R. 891 (Bankr. S.D. Ga. 1992). However, the law in some districts is that all property remains in the estate after confirmation. See In re Aneiro, 72 B.R. 424 (Bankr. S.D. Calif. 1987). Additionally, examining a debtor's plan is important because the plan may specify that all or s ome of the property is to remain property of the estate.
4. As an alternative to pursuing postpetition claims outside bankruptcy, the IRS may file a claim for its postpetition taxes under 11 USC § 1305(a)(1).
   A. Such a claim is allowed or disallowed as though it were a prepetition claim. 11 USC § 1305(b).
   B. However, full payment of section 1305(a) claims and payment of interest and penalties thereon are permissive and not required elements of a Chapter 13 plan. 11 USC § 1322(b)(6). Accordingly the IRS does not file section 1305 claims in most jurisdictions.
   C. There is no bar date for filing a claim under 11 USC § 1305. The debtor cannot file this type of claim on behalf of the IRS; only the IRS can file it.

5.17.11.15 (10-01-2010) Modification of the Plan

1. Any time prior to the completion of payments under a confirmed plan, the plan may be modified upon the request of the debtor, the trustee, or an unsecured creditor, after notice and a hearing. 11 USC § 1329. The plan may be modified to:
   A. increase or reduce the amount of payments on claims in a particular class;
   B. extend or reduce the time for such payments;
   C. alter the amount of the distribution to a creditor whose claim is provided for by the plan to the extent necessary to take into account any payment of that claim other than under the plan; or
   D. under BAPCPA, reduce amounts to be paid under the plan by the amount expended by the debtor to purchase health insurance for himself or his dependents.
2. The requirements of 11 USC §§ 1322 and 1325(a) apply to the modified plan.

5.17.11.16 (10-01-2010) Revocation of Confirmation

1. A party in interest may request revocation within 180 days of confirmation if the confirmation order was procured by fraud. 11 USC § 1330.
2. If the court revokes an order of confirmation, it shall convert or dismiss the case, whichever is in the best interest of the creditors, unless within the time fixed by the court the debtor proposes and the court confirms a modification of the plan under 11 USC § 1329.

5.17.11.17 (10-01-2010) Conversion or Dismissal

1. The Chapter 13 debtor may convert the case to Chapter 7 at any time. 11 USC § 1307(a).

2. On request of the debtor, the case may be dismissed at any time unless the case was previously converted from another chapter. 11 USC § 1307(b).

3. Upon the request of an interested party or the United States Trustee and after notice and a hearing, the court may convert a case to Chapter 7 or dismiss it, whichever is in the best interest of creditors, for cause including:

   - unreasonable delay that is prejudicial to creditors,
   - material default with respect to the terms of a confirmed plan,
   - failure to commence making timely plan payments, and
   - under BAPCPA, failure to fulfill required postpetition domestic support obligations, 11 USC § 1307(c)(11).

4. Although lack of good faith is not enumerated as a specific basis for dismissal, courts have recognized it as sufficient cause under 11 USC § 1307(c). Marrama v. Citizens Bank of Mass., 549 U.S. 365, 373 (2007); In re Alt, 305 F.3d 413 (6th Cir. 2002); In re Love, 957 F.2d 1350, 1354 (7th Cir. 1992); In re Maclean, 200 B.R. 417 (Bankr. M.D. Fla. 1996).

5. Under BAPCPA, the court shall dismiss or convert the case for failure to file tax returns for the four-year period ending on the petition date and for any period after the petition date. 11 USC § 1307(e); In re Cushing, 401 B.R. 528 (1st Cir. BAP 2009); In re Perry, 389 B.R. 62 (Bankr. N.D. Ohio 2008). Dismissal or conversion under this provision is not automatic; consult with Area Counsel to determine whether a motion to dismiss or convert is appropriate.

5.17.11.18 (10-01-2010)
Discharge

1. Under 11 USC § 1328(a)(2), as amended by BAPCPA, the debtor is discharged of all debts provided for by the plan or disallowed under 11 USC § 502 (e.g., late claims filed after the bar date) except:

   A. trust fund taxes; and

   B. taxes for which returns were not filed, or were filed late and within two years of the petition date, or for which the debtor made a fraudulent return or made a willful attempt to evade or defeat the tax.

2. BAPCPA adds new prerequisites to discharge in Chapter 13 cases. For example:

   A. Under 11 USC § 1328(a), the debtor must certify that he has satisfied any domestic support obligations.

   B. Under 11 USC § 1328(f), the debtor cannot receive a discharge if the debtor received a discharge in a Chapter 7, 11, or 12 case during the four-year period before the petition date, or received a discharge in a Chapter 13 case during the two-year period before the petition date.

   C. Under 11 USC § 1328(g), the court cannot grant the debtor a discharge unless the debtor has completed a course in personal financial management since filing the bankruptcy petition.

   D. Under 11 USC § 1328(h), the court cannot grant a discharge unless the court, after notice and a hearing, finds no reasonable cause for believing that the debtor has abused the bankruptcy system.

3. Tax claims, including priority claims, will be discharged if they are provided for in the plan. Courts have held that "provided for" simply means "dealt with," "referred to," or "mentioned." In re Gregory , 705 F.2d 1118 (9th Cir. 1983); IRS v. DiPasquale, 2006 WL 1207990, 97 AFTR2d 2006-2233, 2006-1 USTC ¶ 50,318 (D.N.J. 2006); In re Bryant, 323 B.R. 635 (Bankr. E.D. Pa. 2005).

4. The IRS's claim may be discharged even if it is not paid in full or it is provided for in an amount less than that claimed. However, the plan must provide for the full payment of priority claims. Failure to so provide may render the plan void. The IRS, like other creditors, is bound by the terms of a confirmed plan. If the plan provides less than the amount of the IRS's claim, the IRS should object to confirmation.

   Note:

   The court can vacate an order of discharge where the IRS was not paid as required in the plan, and the court's discharge order was based on the mistaken assumption that the IRS was paid. Cisneros v. United States, 994 F.2d 1462 (9th Cir. 1993); see also In re Midkiff, 342 F.3d 1194 (10th Cir. 2003).

5. If the debtor does not complete plan payments, a hardship discharge may be granted under 11 USC § 1328(b). A hardship discharge is equivalent to the discharge granted under Chapter 7. All priority taxes and other nondischargeable taxes under 11 USC § 523 will not be discharged. The court may grant a hardship discharge, after notice and a hearing, only if:

   A. the failure to complete plan payments is due to circumstances beyond the debtor's control (e.g., loss of job);

   B. the value of the property actually distributed is at least what would have been distributed in a Chapter 7; and

   C. modification of the plan is not feasible.

5.17.11.18.1 (10-01-2010)
Collection Outside of the Bankruptcy Estate

1. The IRS can collect nondischargeable liabilities from the exempt, abandoned, nonadministered and after-acquired property of an individual debtor.

2. Regarding dischargeable liabilities, if a Notice of Federal Tax Lien (NFTL) has been filed prepetition, the IRS may collect on its lien from exempt or excluded property or property that has been abandoned or otherwise not administered by the trustee.

3. Even if an NFTL has not been filed, the IRS may enforce its assessment lien against excluded property after the automatic stay is lifted. Property excluded from the estate includes ERISA-qualified pension plans and other plans described in 11 USC § 541(b).

5.17.11.19 (10-01-2010)
Chapter 12

1. Chapter 12 is similar in many ways to a Chapter 13, but only a "family farmer or fisherman" can be a debtor under Chapter 12. A "family farmer" can be an individual, partnership, or corporation, with regular income, if specified percentages of the income, assets and debts of the debtor are farming-related. See 11 USC § 101(18), (19), (20).

2. The Chapter 12 plan must provide for full payment of the IRS's priority claims. Under BAPCPA, an exception to this rule exists when the claim is owed to a governmental unit and it arises as a result of the sale, transfer, exchange, or other disposition of farm assets used in the debtor's operations, and the debtor receives a discharge. If the exception applies, the claim is treated as a general unsecured claim. 11 USC § 1222(a)(2)(A).

   Note:

The Service continues to litigate the definition of terms in section 1222(a)(2)(A) and the potential application of this exception to postpetition transactions. See Knudsen v. IRS, 581 F.3d 696 (8th Cir. 2009); In re Hall, 393 B.R. 857 (D. Ariz. 2008) (appeal pending in the Ninth Circuit); In re Dawes, 382 B.R. 509 (Bankr. D. Kan. 2008), aff'd, 415 B.R. 815 (D. Kan. Mar. 12, 2009) (appeal pending in the Tenth Circuit).

3. BAPCPA requires that the plan provide for postpetition interest on nondischargeable unsecured claims to the extent that the debtor has disposable income remaining after paying all allowed claims in full. 11 USC § 1222(b)(11).
4. Individual debtors remain liable for debts that are nondischargeable under 11 USC § 523.

More Internal Revenue Manual

Part 5. Collecting Process

Chapter 17. Legal Reference Guide for Revenue Officers

Section 12. Investigations and Reports

5.17.12 Investigations and Reports

Manual Transmittal

March 30, 2015

Purpose

(1) This transmits revised IRM 5.17.12, Legal Reference Guide for Revenue Officers, Investigations and Reports.

Background

This section illustrates the type of investigation to be performed upon receipt of an account for collection which may require a legal proceeding to assist in the collection of the account, and the type of report to be prepared. It is designed to aid the revenue officer in securing all the necessary facts by obtaining testimony and documentary evidence.

Material Changes

(1) Cross references to related resources added throughout this section.

(2) IRM 5.17.12.11 revised by Counsel to include a new paragraph (1) and substantially revising the newly numbered paragraphs (2) and (4).

(3) IRM 5.17.12.12(3) and IRM 5.17.12.20.2.2.4, incorporate SBSE-05-0414-0032 issued April 18, 2014 which adds requirements related to lien foreclosures of a taxpayer's principal residence

(4) IRM 5.17.12.20.2 section reformatted for better organizational structure and clarity.

Effect on Other Documents

This material supersedes IRM 5.17.12 dated April 6, 2010. This IRM also incorporates the following IRM Interim Guidance SBSE-05-0414-0032, *Reissuance of Principal Residence Suit Foreclosure Recommendations* issued April 14, 2014.

Audience

SB/SE Revenue Officers

Effective Date

(03-30-2015)

Related Resources

IRM 25.3.2, *Litigation and Judgments, Suits by the United States*

Training Publication 29957-101, *Suit and Litigation Guide for Revenue Officers (Participant Guide)*

Kristen Bailey
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Small Business/Self Employed

5.17.12.1 (10-16-2007)
Overview

1. This section illustrates the type of investigation to be performed upon receipt of an account for collection which may require a legal proceeding to assist in the collection of the account, and the type of report to be prepared.
2. This section is also designed to aid the revenue officer in securing all the necessary facts by obtaining testimony and documentary evidence.
3. General characteristics and procedures followed in instituting and carrying out a suit and some common types of suits commenced by the United States are discussed in IRM 5.17.4, *Suits by the United States.*
4. The principal types of suits that may be brought against the United States which revenue officers may encounter are discussed in IRM 5.17.5, *Suits Against the United States.*
5. See also IRM 25.3*, Litigation and Judgments.*

5.17.12.2 (04-06-2010)
General

1. A thorough investigation requires the following:
   - Familiarity with applicable sections of IRM 5.17, *Legal Reference Guide for Revenue Officers*, and other applicable IRM provisions,
   - A working familiarity with basic theories and principles of both federal and state law,
   - Some knowledge of the law of evidence,
   - Knowledge of the manner in which business and financial transactions occur and are conducted, and
   - Full development of facts.
2. Be impartial and thorough in conducting the investigation. Thorough development of facts may enable the United States to avoid unnecessary litigation and to anticipate and be prepared for the taxpayer's and third parties' defenses. Full development of facts may enable Area Counsel or the Department of Justice to advance other theories to support a position.

5.17.12.3 (04-06-2010)
Identification, Evaluation and Analysis of Issues and Problems

1. Review existing material in the file to determine the issues in the case and those issues that, though not raised, are implicated by the information in the file. Inquire about the existence of other files not in your possession, such as Examination, Appeals, and Criminal Investigation files. The discovery of other files or material might aid substantially in narrowing or enlarging issues, providing leads and establishing a complete background to the case.
2. Examine the file, or files, to determine the facts that already have been developed, and whether further development is required. Determine the extent to which such facts could be proven in a court of law by evidence contained in the files.
3. Ascertain contentions or defenses of the taxpayer and other parties to the contemplated legal action and make a list of those facts relied upon by such parties.

5.17.12.4 (10-16-2007)
Case Strategy

1. Review the file and determine the facts that still need to be established and the evidence (oral and documentary) that needs to be secured. Develop a case strategy that includes the best sources and methods to obtain the information and the most effective order in which to secure it.
2. Oral evidence consists of testimony that is given by word of mouth. Documentary evidence includes, but is not limited to, the following:
   - papers
   - letters
   - books of account
   - canceled checks
   - official records
   - deeds
   - contracts
   - maps
   - photographs
   - computer disks and computer files
   - e-mail messages

5.17.12.5 (03-30-2015)
Methods of Obtaining Evidence

1. Voluntary
   A. If possible, evidence should be obtained voluntarily. Make no promise that the person you are interviewing (the "witness") will or will not be called to testify as a witness in a court case. If asked, just reply that the witness may or may not be called to testify.

   Note:

   In obtaining evidence, whether testimonial or documentary, from persons other than the taxpayer, follow all statutory requirements and internal guidelines concerning third party contacts to comply with IRC § 7602(c). See IRM 5.20.3*Third-Party Contacts.*
2. Use of Summons
   A. If the witness does not voluntarily give oral testimony or documentary evidence, use the administrative summons to obtain the necessary testimony or documents. If the case is already pending in court, clear the use of the summons with Area Counsel. See IRM 5.17.6, *Summonses*, for a discussion on the proper use of a summons and related problems.

   Note:

In obtaining testimonial evidence from witnesses, it is desirable that the initial conversation be informal so that the witness will feel at ease. In the event of an obviously recalcitrant witness, place the witness under oath to take testimony.

3. Taking Testimony

   A. The witness should respond to the questions in his or her own words.

   B. Let the witness do most of the talking.

   C. Avoid having the witness respond "yes" or "no."

   D. Do not ask leading questions, i.e., questions that suggest an answer in the witness' mind.

   E. Witnesses are sometimes forgetful and not entirely accurate. Accordingly, solicit the testimony of other persons or documentary evidence to corroborate the testimony of the witness.

   F. Establish that the witness has personal knowledge of the facts with respect to which the witness is testifying. Otherwise, the testimony may not be admissible as evidence in a court of law.

   G. Consider the credibility of the witness:

- How logical is the testimony?
- What is the witness' reputation for truth and veracity?
- Is the witness in any way involved in the case?
- Is the witness biased for or against or related to the taxpayer?

5.17.12.6 (10-16-2007)
Admissions and Hearsay

1. Record any statement by a party against the party's own interest, because the admission of an unfavorable fact will be of value in proving the truth of the fact.

2. Hearsay is evidence that does not come from the personal knowledge of the witness, but from the mere repetition of what the witness has heard said by others, or what others have told the witness. Exercise care to insure that the witness has actual knowledge of the facts stated. Hearsay generally may not be used as evidence, but hearsay may lead you to the witness with actual knowledge of the facts.

5.17.12.7 (03-30-2015)
Documentation of Testimony

1. Make a written memorandum of an interview immediately thereafter, even though it does not appear that the person will be called as a witness or that the information will be of any immediate value.

2. A formal affidavit (notarized) containing a complete summary of the desired information may be solicited. For example, if there is reason to believe that the witness might change the testimony at a later date, request the witness to give a formal affidavit.

3. If the witness is unwilling to give a formal affidavit, attempt to obtain the signature of the witness on a typed or handwritten summary of the desired information.

4. If the witness is unwilling to sign a statement, consider using an administrative summons and having a stenographer prepare a verbatim transcript of the questioning.

5. The interview may also be recorded.

   Note:

   Consult IRC § 7521, *Procedures involving taxpayer interviews* for procedures to follow involving taxpayer interviews, and IRM 4.10.3.2.6, *Requests to Tape Record Interviews*, and IRM 5.1.12.3, *Taxpayer Recording of Interviews*, for procedures regarding taxpayer requests to make an audio recording of an in-person interview.

5.17.12.8 (04-06-2010)
Documentary Evidence

1. Obtain the originals of documents whenever possible. If not available, make photocopies of the originals. In all cases, show the source from which the document was obtained. Obtain necessary documents at the outset, removing the possibility that they might be later lost or otherwise unavailable.

2. Consider the authenticity of documents. If there are circumstances that raise a doubt as to authenticity, Criminal Investigation may be of assistance.

3. Verify information in documents. When a mortgage, deed, assignment, conditional sales contract, or other security device is a material factor in the case, verify the alleged facts on the face of any such instrument. Do not rely on information provided in a letter, by telephone, or orally. Examine the document itself.

4. Determine whether all filing and recording requirements of state law have been satisfied that are necessary to perfect the document against third parties. Carefully scrutinize family transactions to determine whether consideration actually passed. When the outstanding balance on a mortgage remains unchanged over a period of time, it could mean that it is a sham.

5. Whenever possible, secure certified copies of documentary evidence. Any internal Service transcript or other document can be certified as well. To preserve their value as self-admitting evidence, certified document copies must not be marred, defaced, or altered in any way.

5.17.12.9 (04-06-2010)
Sources for Documentary Evidence

1. Public Records — Public records such as copies of mortgages or assignments, deeds, or conditional sales contracts, may be obtained from the county recorder or other appropriate officer with whom they are required to be filed under state recording statutes. If the taxpayer, or other party, has testified in any court regarding the transaction in question, a certified copy of the relevant portion of the transcript may be desirable. If the taxpayer is a corporation, the files of the state custodian of corporate records may provide valuable information.

2. Within the Service — Special agents' or revenue agents' reports, the taxpayer's income, estate, gift, or employment tax returns for prior years, tax returns of related entities or parties, trust fund recovery penalty files, and other records may be of assistance. The originals of these documents are usually required for litigation unless the underlying liability is not challenged in potential litigation or the liability has been previously judicially determined. If original returns or the administrative file cannot be located or obtained and it is anticipated that these documents may be needed, consider the feasibility of going forward with a suit recommendation without these documents. Consult with Advisory or Area Counsel to resolve any questions.

   Note:

   Discussing the case with special agents or revenue agents who have worked the case may be valuable, as they may have knowledge of information not contained in the written report.

3. Other Federal and State Agencies — State and Federal agencies such as the State Insurance Commissioner, the Small Business Administration, and the State or Federal Securities and Exchange Commission may have information of a non-public nature that may be of assistance.

4. Commercial Institutions — Life insurance companies may provide copies of policies; banks may provide canceled checks in some cases or transcripts of account; and loan companies or loan departments of banks may provide copies of financial statements prepared by the taxpayer.

   Note:

   Evidence of different facts must be obtained for different cases. For example, the facts needed to establish transferee liability would be different from the facts needed to establish liability for failure to honor a levy.

5.17.12.10 (04-06-2010)
Suits to Reduce Tax Claims to Judgment

1. Probability of Litigating the Merits — If suits for judgment are recommended, taxpayers often deny liability for the taxes involved. Anticipate such arguments at an early stage and take steps to obtain the original tax returns, revenue agents' reports, and other assessment related files for the account modules in question to avoid their destruction. Forward the administrative files to Area Counsel when the suit recommendation is made. Discuss the probability of litigation on the merits in the suit recommendation.

2. Previous Court Litigation and Appeals Settlements — Often the liability in question has been determined in the Government's favor by proceedings in the Tax Court, by the allowance of tax claims in bankruptcy and receivership proceedings, or by other court action. In such cases, the taxpayer may not contest the case on the merits again. Similarly, if a case has been settled by mutual concessions in Appeals, the taxpayer may be precluded from raising the merits. Make reference to any court decisions or settlements and include copies of any such decisions or settlement agreements, if possible, in the suit recommendation.

3. Collectibility of the Judgment — Discuss the taxpayer's earning power, age, health, business connections, marital status, dependents, and the possibility of inheriting or acquiring assets from others.

5.17.12.11 (03-30-2015)
Fraudulent Transfers and Transferee and Other Third Party Liability

1. **Fraudulent Conveyance**. The government may bring a fraudulent transfer action to set aside the transfer, or in some instances, to obtain a judgment of liability against the transferee.

   A. **State law.** Fraudulent conveyance laws were initially developed by state courts. That common law is reflected now in state statutes based on the *Uniform Fraudulent Conveyance Act* (UFCA) (proposed in 1918) and the *Uniform Fraudulent Transfer Act*(UFTA) (proposed in 1984). The liability under these laws is termed "in equity" because of the common law origin. Most states have enacted statutes based on the (UFTA. There are two kinds of fraudulent conveyances that may result in liability “in equity”: those effected though constructive fraud and those effected though actual fraud. See IRM 5.17.12.11, at (2) and (3), below, respectively. The elements of an action vary state by state even if a statute is based on a uniform act: e.g., a state may change an element provided in the uniform act or retain an element of the common law in its statute. A state might continue to allow an action based on the common law and if so precedent under that common law may make it a preferred alternative to an action based on a statute.

   B. **Federal law**. The *Federal Debt Collection Procedures Act of 1990* (FDCPA), 28 U.S.C. §§ 3001 et seq., provides a federal cause of action for fraudulent transfers. Provisions regarding fraudulent transfers involving debts are at 28 U.S.C. §§ 3301-3308 (Subchapter D). Section 28 U.S.C. § 3304 provides a remedy similar that provided by the UFTA. For debts arising before a transfer, see 28 U.S.C. § 3304(a) (compare constructive fraud under UFTA), and for transfers without regard to the date the debt arose, see § 3304(b) (compare actual fraud under UFTA). The FDCPA should complement state procedures; but, if not, the Act preempts any state law that is inconsistent with the Act; see 28 U.S.C. § 3003(d).

2. **Constructive Fraud** — Constructive fraud occurs when a taxpayer (or other person liable for the tax) makes a conveyance and such taxpayer or person is or will be thereby rendered insolvent when the conveyance is made without adequate consideration. Discuss in detail the facts pertaining to:

   - The transfer of assets made when the transferor was liable for the tax. While tax liability arises at the end of the tax year, a transfer made during the tax year may give rise to a contingent tax liability at the time of the transfer in some jurisdictions,
   - The insolvency of the taxpayer as of the date of transfer, or immediately thereafter,
   - The absence of reasonably equivalent value or fair consideration (terminology depends on the statute) in exchange for the transfer, and
   - The value of the assets (fair market value) on the date of transfer, which generally determines the limits of the transferee liability.

See IRM 5.17.14.2.3.2.2.1, *Constructive Fraud.*

   Note:

   See IRM 5.10.1.3.3(2), *Equity Determination*, for determining Fair Market Value (FMV). Where an accurate fair market value is not easily determinable, consider contacting the Property Appraisal and Liquidation Specialists (PALS) to discuss how to value the property or to request that the PALS provide an appraisal for the property.

3. **Actual Fraud** - Transfer With Actual Intent To Hinder, Delay or Defraud Creditors —- The proof must be clear and convincing to set aside a conveyance on the ground of actual intent to defraud the Government. Usually it is impossible to prove actual fraudulent intent by direct evidence because the facts relating to the fraudulent transfer are within the knowledge of the taxpayer or other transferor. Proof of the fraud must, therefore, usually come by inference from circumstances surrounding the transaction and the relationship and interest of the parties thereto. To establish actual intent to defraud creditors, thoroughly analyze and discuss the facts and evidence relating to:

   A. Knowledge of the transferor's intent by the transferee, the parties involved, and their relationship,

   B. The property transferred or obligation incurred, the value of the property at the time of the transfer and its current value, and

   C. Competing claims to the property by bona fide lien holders or security holders.

   See IRM 5.17.14.2.3.2.2.2 , *Actual Fraud*.

4. **Transferee and Other Third Party Liability**. State law may provide that in a particular situation the transferor’s tax liability is directly imposed on the transferee. The imposition of liability under these laws is termed "at law."

   A. **Bulk sales**. Most states have adopted some form of the Uniform Commercial Code (UCC). Article 6 of the UCC governs bulk sales and establishes liability of persons who purchase substantial inventory or equipment from a merchant if certain procedures are not followed.

   B. Transfers or distributions leaving the person without enough assets to pay debts.
   See IRM 5.17.14.2.3.3, *Trust Fund Doctrine*;
   IRM 5.17.14.2.3.5, *Transferee Liability of a Shareholder or Distributee of a Corporation*;
   IRM 5.17.14.2.3.1(3), *Transferee Liability Directly Imposed on the Transferee (At Law)* at "d." (distributions upon dissolution of corporation).

C. Corporate merger or consolidation statutes.
See IRM 5.17.14.2.3.4, *Successor Liability of a Corporation as a Transferee*.

D. Transfers made as a part of a scheme to avoid debts; e.g., sale of assets to another corporation that is tantamount to a "de facto merger" or a "mere continuation."
See IRM 5.17.14.2.3.4(4), *Successor Liability of a Corporation as a Transferee*.

E. Transferee entered into a contract in which the transferee expressly or impliedly agreed to assume the transferor's tax liability.

Note:

Consult with Area Counsel for advice in cases involving issues of this type.

5. See IRM 5.17.14, *Fraudulent Transfers and Other Third Party Liability*, for additional information regarding suits to set aside fraudulent transfers.

5.17.12.12 (03-30-2015)
Lien Foreclosure Actions

1. Property Involved - Accurately describe the property. Appraise the property, state the current forced sale and fair market values and how they were derived. Ensure reliable sources and methods are used. Indicate what steps can be taken, if any, to generate interest among prospective buyers.

   Note:

   If the property under consideration for foreclosure consists of assets where an accurate fair market value is not easily determinable, it is highly recommended that the revenue officer contact the Property Appraisal and Liquidation Specialists (PALS) to discuss how to value the property or to request that the PALS provide an appraisal for the property.

2. Competing Claims or Liens

   A. Perform thorough property records checks and secure certified copies of all documents evidencing claims to or liens on the property. Ensure records checks are current and accurate.

   B. **Do not alter** certified documents in any way. This restriction includes any sort of alteration or defacement to the documents, including marking or writing on them, affixing labels or tabs, cutting them, punching holes in them, or stapling or unstapling them.

   C. Identify the owners of competing claims or liens and state their current addresses.

   D. Describe the type of claim or lien (for example, mortgage, trust deed, contract for sale, state tax lien).

   E. State the date of the instrument.

   F. Give recording data (date and place of filing, book and page number, where lien is filed).

   G. State the original amount of the claim.

   H. Determine and provide the outstanding balance, including amount of principal, interest and other charges separately stated.

   I. Discuss the validity of the competing claim or lien or any of its terms or conditions that are questionable.

   J. Discuss whether any action has been taken or is to be taken to enforce the competing claim or lien, the nature of such action, the court in which it is pending, and its current status.

   Reminder:

   Additional information on these types of suits can be found in:
   Training Publication 29957-101 in Section E-12 with the sample narrative in Section E-16.

3. For lien foreclosure on a taxpayer's principal residences, also see IRM 5.17.4.8.2.5, *Lien Foreclosure of a Personal Residence or the Taxpayer's Principal Residence* and *IRM 5.17.12.20.2.2.4*.

5.17.12.13 (03-30-2015)
Suits for Failure to Honor Levy

1. Include the following information in the suit recommendation:

   - Name and address of person failing to honor levy,
   - Dates on which all collection notices were served,
   - Dates of contact for purpose of requesting payment,
   - A full description of the property or rights to property levied upon,
   - A discussion of the facts establishing the taxpayer's interest in the property or right to property,
   - Information as to whether the debt is disputed,
   - Contentions advanced by the person levied upon, and
   - Facts tending to controvert the contentions of the person levied upon.

     Note:

     If there are competing claims to the property or right to property levied upon, it may be necessary for the Government to institute an action to foreclose its liens, rather than to bring an action to enforce the levy, in which case you should provide information necessary for lien foreclosure actions.

   Reminder:

   Additional information on these types of suits can be found in Training Publication 29957-101 in Section E-61 with the sample narrative in Section E-64.

5.17.12.14 (03-30-2015)
Interpleader Suits

1. The complaint of the stakeholder-plaintiff will usually describe the property in question and the parties claiming rights to it. Analyze the complaint to determine what type of action the Government should take to protect its rights.

2. On occasion, you will learn of litigation between the taxpayer and other parties, the result of which may add to or diminish the taxpayer's assets. In such cases, if administrative remedies are not sufficient protection or are impractical, determine whether intervention is desirable or necessary.

   Reminder:

   Additional information on these types of suits can be found in Training Publication 29957-101 in Section E-121 with the sample narrative in Section E-126.

5.17.12.15 (04-06-2010)
Other Suits in Which Government or Employee Is Defendant

1. In some cases, such as injunction proceedings, quiet title actions, or suits for damages in which the Government is the defendant, you may be requested to make reports of events that have culminated in litigation or to investigate and make reports on some feature of the litigation. In such cases, use the same general principles set forth in this section to prepare the report. See also IRM 5.17.5, *Suits Against the United States*.

5.17.12.16 (10-16-2007)
Other Suits in Which Affirmative Action is Sought To Be Taken

1. On occasion, you may recommend the institution of miscellaneous types of proceedings such as:
   - Suits against sureties under the performance bond provisions of the Miller Act (see IRM 5.17.7.3 and IRM 5.1.14.1.1),
   - Suits against third parties paying or supplying funds for payment of wages (see IRM 5.17.7.2 and IRM 5.1.14.3),
   - Suits on bonds (see IRM 5.1.14.1.2),
   - Proceedings to obtain writs of entry (see IRM 5.17.4.13),
   - Suits to recover erroneous refunds (see IRM 5.17.4.14), or
   - Proceedings to obtain permission to seize the principal residence of a taxpayer (see IRM 5.17.4.9).
2. Use the general principles set forth in this section to prepare the report.

5.17.12.17 (04-06-2010)
Preparation of the Report: Initial Steps

1. Consultation with Manager
   - Discuss findings and proposed recommendation.
   - Discuss difficult problems and questions encountered in the investigation.
   - Re-read appropriate earlier sections and other material relevant to the particular case.
   - Advisory and Area Counsel may also be consulted for advice.

5.17.12.18 (04-06-2010)
Follow An Outline

1. Reduce material gathered to an outline before preparing the narrative report.
2. Organize material in a sequential or chronological form.
3. Focus on significant points.
4. Form 4478, Civil Suit Checklist, is helpful, but is not a substitute for a well developed narrative report.

5.17.12.19 (10-16-2007)
General Suit Recommendation Guidelines

1. Ensure all suit recommendation documents are typed and assembled in an organized and professional manner.
2. Include an index of exhibits or table of contents.
3. Use tabbed file dividers and other organizational aids.

5.17.12.20 (10-16-2007)
The Narrative Report

1. Purpose — To present in a logical sequence all pertinent facts so that appropriate legal action may be taken. The report must be written so that the reader understands the significance of its contents and is persuaded to act on it.
2. Qualities of a Good Report:
   - Impartiality
   - Accuracy
   - Completeness
   - Conciseness
   - Logical arrangement of material
   - Each paragraph is limited to one topic sentence or issue
   - Coherence
   - Proper spelling and grammar
   - Important facts are emphasized

   Note:

If the volume of facts or statistics in a paragraph are so voluminous as to hinder readability, consider assembling the data in a table attached as a numbered, referenced exhibit.

3. Avoid using abbreviations in the narrative report. If acronyms are used, ensure that the words are initially spelled out.

5.17.12.20.1 (10-16-2007)
Contents of the Narrative Report

1. A complete narrative report should include the following:
   - A separate narrative statement of the case.
   - Numbered paragraphs to facilitate form and report references.
   - The check list data contained on any applicable form.
   - Exhibits identified by number and referenced in the narrative report. Tables, transcripts and summaries should show the source of the information.
   - A list of witnesses and proposed defendants, together with the complete address of each.

   Note:

   Forms 4477 through 4481 are not a substitute for a complete narrative report in recommending litigation of any type, although they may be referenced in the report. The notation "See Report" should appear in the appropriate blocks on the forms.

5.17.12.20.2 (03-30-2015)
Format of the Narrative Report

1. Use standard U.S. Government memorandum stationery.
2. Divide the narrative report into three sections:
   - Introduction
   - Body
   - Conclusions and Recommendation

5.17.12.20.2.1 (03-30-2015)
Narrative - INTRODUCTION Items Included

1. The type of suit being recommended.
2. The amount of money expected to be recovered.
3. The type of tax and outstanding balance. Details can be incorporated by reference to Form 4477, Civil Suit Recommendation, or accompanying transcript.
4. The date the earliest and/or imminent statute of limitations on collection will expire
5. A statement that administrative remedies are impractical, or that administrative remedies have been exhausted, and the reasons why administrative remedies have not been effective
6. A statement that urgent action is required when necessary, and the reasons for urgent action.

5.17.12.20.2.2 (03-30-2015)
Narrative - BODY - General Items Included

1. **Personal History of Taxpayer:** Brief personal history and description of the taxpayer and other significant parties, including:

   For Individuals:

   A. tax payment history;
   B. age;
   C. occupation or business activity;
   D. marital and family status;
   E. known health issues; and
   F. other pertinent information that may have bearing on the suit.

   For non-individuals summarize:

   A. description of the entity;
   B. business (i.e. past and/or present business operation);
   C. activities;
   D. principals;
   E. state or jurisdiction location of entity;
   F. status; and
   G. other relevant data.

2. **Chronological presentation:** All relevant facts, including actions by the taxpayer, the IRS, and third parties, with references to exhibits where appropriate.
3. **Suit Justification:** Reasons why suit is justified, particularly in a suit to reduce a tax claim to judgment if there is no immediate prospect of recovery on the judgment, and if the anticipated proceeds are below the criteria set forth in IRM 25.3.2.3, *Criteria for Bringing Suit*.

4. **Corporate Information:** If the taxpayer is a corporation, provide the location of the principal executive office, date of incorporation, state of incorporation, and the name, title (if applicable), and physical address of the statutory agent for service.

5. **Basis for Assessment:** Provide the basis for the assessment to the extent that information is available to you, including protest, appeal, and Tax Court data. If administrative files are not available, include additional details concerning the assessment such as whether the assessment is a:

   a) tax liability as shown on the tax return.
   b) deficiency based on Tax Court decision.
   c) deficiency that the taxpayer agreed to.
   d) deficiency not agreed to and petition not filed with Tax Court. Give basis for the deficiency by furnishing a copy of the Revenue Agent's Report.
   e) fraud case. If so, state whether there was criminal prosecution.
   f) jeopardy assessment. If so, state the basis of the tax determination.

6. **Additional Assessment Details** including:

   a) Date of assessment;
   b) Date of Notice and Demand;
   c) **Original (total) Assessed Amount:** Breakdown of assessment, not reduced by any subsequent payments or abatements, showing type and amount of tax (show penalty and interest separately) and describe the penalty using the applicable section of the Code, such as IRC § 6651, IRC § 6654, or IRC § 6656;
      For example
      TC 150, TC 166 (IRC § 6651), TC 196, TC 300, TC 176 (IRC § 6654), TC 196
   ** A Form 4340, *Certificate of Assessments and Payments*, can be attached as an exhibit in lieu of items a - c above
   d) **Current Balance Due:** The tax, penalty and interest currently outstanding (show the tax, penalty and interest separately and provide the rate of daily accrual of interest).

   Note:

   The breakdown above details more fully than does Form 4477, item five, column c.

7. **Timeliness of Assessment:** If the assessment was made after the normal period for assessment had expired, explain why the assessment was nevertheless timely. This may include information that fraud was involved, that a return was not filed, that a waiver extending the time for assessment was secured, or that other appropriate justification exists. See IRM 5.17.4-1, *Suits by the United States, Limitation Upon Assessment*, and IRM 25.6.1.9, *Statute of Limitations Processes and Procedures, Assessments.*

8. **Special Condition Notices of Federal Tax Lien:** Provide any Nominee, alter ego, and other special condition NFTL information.

9. **Jeopardy Information:** if applicable.

10. **Appeals and Collection Due Process:** Information regarding compliance with CDP and notice requirements and other taxpayer rights, including any appeals and results:

IRC § 6320	For suits to foreclose a tax lien, interpleader suits, and other suits in which the filing of a Notice of Federal Tax Lien (NFTL) is significant, provide information regarding compliance with the Collection Due Process (CDP) requirements.
IRC § 6330 and IRC § 6331(d)	If Letter 1058, *Notice of Intent to Levy and Notice of Your Right to a Hearing*, was issued to the taxpayer, provide information regarding compliance with the CDP requirements. **Note:** Whether a levy should be issued to the taxpayer prior to a suit being recommended will depend upon the facts of the case. IRM 5.17.4.7(2) provides that a suit in aid of collection of taxes will not usually be authorized unless all administrative remedies available have been exhausted or their use would prove ineffective. The issuance of a levy to the taxpayer would be an administrative remedy that must be exhausted or determined to be ineffective prior to recommending that a suit be filed against the taxpayer.

To the extent applicable in the particular case, the CDP information provided should include the following:

   a) Date CDP Notice was sent or served. Secure originals, facsimiles, or copies of the notices and attach them as referenced exhibits.
   b) The address to which the notice was sent (if hand delivered, the name of the person served and the address where the notice was served or left).
   c) Method of service of the notice (certified mail, certified mail with return receipt requested, or hand delivery).
   d) If mailed, whether the notice was returned either as unclaimed or as undeliverable.
   e) Date the taxpayer's request, if any, for a CDP Hearing or an equivalent hearing was received.
   f) A copy of any Notice of Determination or Decision Letter issued by Appeals.
   g) Date, if any, taxpayer filed for judicial review of Appeals Notice of Determination and a discussion of the court's disposition of the case.
   h) Computation of the statute of limitations for collection.

Note:

CDP information can be significant even if not required for the action at issue because it demonstrates opportunities the taxpayer had to challenge the liability or the Service's actions and the outcome of any prior challenges. Such opportunities can be significant in countering issues raised by the taxpayer during litigation. However, compliance with CDP requirements is not required before initiating litigation to collect a liability unless required for the specific actions at issue, such as in a suit to enforce a levy.

Reminder:

If CDP information is not available because of the age of certain actions or other extenuating circumstances, the unavailability, the circumstances, and the attempts to gather the information must be fully explained and documented in the narrative.

11. **Related Cases:** If there are any related cases, provide a brief summary.

12. **Trust Fund:** If trust fund taxes are involved, state whether the Service made trust fund recovery penalty (TFRP) assessments and, if not made, indicate reason that assertion of the penalty would not be a suitable means of collecting. If the Service made a TFRP assessment, state the facts and circumstances giving rise to the assessment and the collection status of the assessment. Also, discuss why the revenue officer believes the responsible person is deemed to have willfully failed to pay over the tax.

13. **CSED:** The date the statute of limitations for collection will expire. If the normal period for collection has expired, explain why the filing of the proposed suit will be timely and show how the current Collection Statute Expiration Date (CSED) was derived. See IRM 5.17.4-2, *Suits by the United States, Limitation Upon Collection*, and IRM 5.1.19, *Collection Statute Expiration*. Obtain copies of waivers, offers in compromise, etc., and incorporate them as exhibits when appropriate.

14. **Witnesses:** Give the names of witnesses, present addresses, and titles or other identification, as appropriate. Discuss any evidence the witnesses have already given or may be expected to give.

15. **Case Weaknesses:** Discuss any weaknesses in the evidence or unreliability of witnesses. Discuss any evidence to controvert possible weaknesses, if available, including efforts made to verify assertions of the taxpayer or other party involved. Also discuss contentions of the taxpayer and third parties.

16. **Property Value:** State the forced sale and fair market values of the property if the case will result in the sale of assets subject to a tax lien, and the basis for these values. If you recommend the appointment of a receiver, set forth the factors warranting this action.

    See IRM 5.17.4.10.1(1), *Types of Court Appointed Receivers*, at "b." regarding certification from Division Counsel (SB/SE).

17. **Taxpayer Representative:** Provide the name and address of the taxpayer's representative. Provide the names of representatives of any competing lienors, claimants or other parties when available. When appropriate, this may be done by reference to Form 4479, Lien and Claimant Data - Civil Suit.

18. **Additional Items:** Specific suit types may require additional information. See the following sections for those items.

5.17.12.20.2.2.1 (03-30-2015)
Additional Items for Failure to Honor Levy

1. The Body section of a narrative report, to support the recommendation, should include:

    A. Name and address of person failing to honor notice of levy,

    B. Reason levy not honored (an effort should be made to determine the reason, since the party may be justified in not honoring the levy),

    C. Date Form 668–A, *Notice of Levy*, was served, and proof of service (e.g. by personal service, certified mail, or fax acknowledgement if party has agreed to accept service by fax),

    D. Date Form 668–C, *Final Demand*, was served, and proof of service (i.e. service of the final demand is by certified mail or personal delivery),

    E. Dates the party served was contacted to request payment and the manner of contact,

    F. Description of property or rights to property subject to levy,

    G. Whether collection of tax can be made from other sources (normally, if the tax can be collected by other means, suit should not be recommended), and

    H. Whether the 50-percent penalty is proposed, and the basis for the recommendation.

    Reminder:

    Additional information on these types of suits can be found in Training Publication 29957-101 in Section E-61 with the sample narrative in Section E-64.

5.17.12.20.2.2.2 (03-30-2015)
Additional Items for Setting Fraudulent Transfer Aside Based on Constructive Fraud

1. The Body section of a narrative report, to support a recommendation, should include:

    A. Whether administrative procedures under IRC § 6901 can be used (administrative procedures are less costly and should be used whenever possible instead of recommending suit), see IRM 5.17.14,*Fraudulent Transfers and Transferee and Other Third Party Liability,*

    B. Name and address of transferee,

    C. Description of property (use Form 4480, Property Description - Civil Suit),

    D. Whether transferor was insolvent at time of transfer or immediately thereafter; also furnish financial statement, if possible,

    E. Evidence that transfer was made to hinder, delay, or defeat payment of tax,

    F. Date property acquired by transferee,

    G. How acquired by transferee,

    H. Consideration given by transferee (if none, so state),

    I. Fair market value on date acquired by transferee,

    J. Basis for determining fair market value,

    K. Relationship between transferor and transferee,

    L. Date tax liability of transferor assessed (if the tax was not assessed before the transfer, information should be furnished to show that parties involved were aware that assessments were being proposed or in process of being made), and

    M. Actions taken to collect tax from transferor.

    Reminder:

    Additional information on these types of suits can be found in Training Publication 29957-101 in Section E-31 with the sample narrative in Section E-41.

5.17.12.20.2.2.3 (03-30-2015)
Additional Items for Recovering Erroneous Refunds

1. **Suit to recover an erroneous refund**: The Body section of a narrative report, to support a recommendation, should include:

    A. The type of tax and the period(s) involved,

    B. The amount of the erroneous refund,

    C. Date return was filed and date erroneous refund was made,

    D. Administrative efforts to collect the erroneous refund,

    E. Computation of the statute of limitations for filing suit to collect, and

    F. A description of the events that resulted in the erroneous refund.

    Reminder:

    Additional information on these types of suits can be found in Training Publication 29957-101 in Section E-56 with the sample narrative in Section E-58.

5.17.12.20.2.2.4 (03-30-2015)
Additional Items for Lien Foreclosure of Taxpayer's Principal Residence

1. **Definition:**
   - For the **personal residence** of any person is found in IRM 5.10.2-1 Real Property, Row 2, and
   - For the **taxpayer's principal residence** is found in IRM 5.10.2-1 Real Property, Row 1.
2. The Body section of a narrative report supporting the recommendation to foreclosure on a **taxpayer's principal residence**, must contain:
   A. Information on the taxpayer as well as information on the occupants of the principal residence including children. Provide the name(s), relationship(s) to the taxpayer, brief history (age, health, etc.), and current mailing address of the occupant(s) if it differs from the address of the property being foreclosed. If the information is unavailable explain the circumstances why the information was not able to be obtained.

   B. A summary of the administrative remedies considered or used. If the information is unavailable explain the circumstances why the information was not able to be obtained.

   C. Date and result of contact with or attempted contact of the taxpayer to advise them that foreclosure of the principal residence is next planned action.

   D. Date taxpayer advised about Taxpayer Advocate Service (TAS) and provided Form 911, *Request for Taxpayer Advocate Service Assistance (And Application for Taxpayer Assistance Order)*. Include whether the taxpayer claimed hardship when informed of the plan to foreclosure on the principal residence; whether the taxpayer availed themselves of assistance from the Taxpayer Advocate Service (TAS); and any results of TAS involvement.
3. See also IRM 5.17.4.8.2.5(3), *Lien Foreclosure on a Principal Residence*.
4. For information on seizure of a taxpayer's principal residence see IRM 5.17.4.9, *Proceeding to Seize a Principal Residence*.

   Reminder:

   Additional information on these types of suits can be found in: Training Publication 29957-101 in Section E-12 with the sample narrative in Section E-16.

5.17.12.20.2.3 (03-30-2015)
Narrative - CONCLUSION and RECOMMENDATION

1. Provide a brief analysis of the case, including any theories or principles which support the recommendation in the conclusions and recommendation portion of the report.

5.17.12.21 (04-06-2010)
Suit for Damages for Failure to Release Lien, for Unauthorized Collection Actions, or for Actions in Violation of the Automatic Stay and Discharge Provisions of the Bankruptcy Code, IRC §§ 7432 and 7433

1. These suits are not initiated by the Service. However, it may be necessary to prepare a report to assist with the defense of the Government's position when they are brought by taxpayers. Such reports must address and document the following:
   A. Date administrative claim for damages was filed, and office where claim was filed.

   B. Amount of damages claimed.

   C. Name of taxpayer or third party making claim.

   D. Description of collection activity upon which the claim is based.

   E. Information concerning administrative review of the claim by the Service.

   F. If applicable, date on which request for certificate of release of lien was received, or date on which claimant alleges that lien became fully satisfied or unenforceable.

   G. Description of the damages claimed.

   H. Statement as to whether you believe that suit was commenced within the 2-year statute of limitations period.

   I. Statement as to whether the claimant could have mitigated the damages claimed.
2. See IRM 25.3.3, *Suits against the United States and claims for damages under IRC § 7433* and IRM 5.12.3.10, *Civil Cause for Action Under IRC § 7432 for Failure to Release Lien,* for additional information.

More Internal Revenue Manual

IRS

Part 5. Collecting Process

Chapter 17. Legal Reference Guide for Revenue Officers

Section 13. Insolvencies and Decedents' Estates

5.17.13 Insolvencies and Decedents' Estates

Manual Transmittal

July 09, 2012

Purpose

(1) This transmits revised IRM 5.17.13, Legal Reference Guide for Revenue Officers, Insolvencies and Decedents' Estates.

Background

This section provides guidance on collecting tax liabilities in cases of probate and insolvency proceedings.

Material Changes

(1) IRM 5.17.13.1 - added cross reference to IRM 5.9.20, Non-Bankruptcy Insolvencies, and 5.5, Decedent Estates and Estate Taxes.

(2) IRM 5.17.13.3 - added note discussing case in which the holding in Romani was not applied because the IRS was not relying on a claim for which a tax lien arose.

(3) Material in 5.17.13.5 has been incorporated into 5.17.13.2.

(4) IRM 5.17.13.6 - revised to clarify the IRS may, in its discretion, allow payment of administrative expenses unless the amounts are excessive or unreasonable. References that the IRS should concede expenses have been removed. Also added cross references to applicable provisions in IRM 5.5.2, *Probate Proceedings* and the State Law Guides on the My SB/SE Counsel website.

(5) IRM 5.17.13.7 - added references to IRM procedures for filing proofs of claim in non-bankruptcy insolvency proceedings and probate proceedings; revised discussion of advantages and disadvantages for filing proofs of claim; added note regarding importance of timely removing state court proceedings to federal district court; and added references to newly revised IRM 5.5.4, *Proof of Claim Procedures in Decedent Cases.*

(6) IRM 5.17.13.8(6) - clarified that as a requirement to impose personal liability, the Government must show that the fiduciary had either actual knowledge of the tax liability or knowledge of such facts as would put a reasonably prudent person on notice as to the existence of the tax debt before making the challenged distribution or payment. Added new (7) to address sending notice to successor administrator.

(7) IRM 5.17.13.10.3 - revised to clarify that the Federal Priority Statute, 31 USC § 3713(a), applies when the assets of a decedent's estate in the custody of the executor or administrator are not enough to pay all debts of the decedent; and that the assets of the estate will include any claims the executor has against holders of property that can be used to pay the tax liability.

(8) IRM 5.17.13.12.1 - clarifies that an assignee for the benefit of creditors is subject to the federal tax lien *even though a Notice of Federal Tax Lien has not been filed.*

(9) IM 5.17.13.11.2(2) - changed "must" to "may" because IRC § 6871(a) provides that the IRS "may" make an assessment under this provision.

(10) Editorial changes were made throughout this section to add or update cross-references to applicable IRM provisions, to clarify provisions by revising or removing confusing, redundant or outdated information, and to update or correct citations.

Effect on Other Documents

This supersedes IRM 5.17.13 dated October 16, 2007.

Audience

SB/SE Revenue Officers

Effective Date

(07-09-2012)

Scott D. Reisher
Director, Collection Policy
Small Business/Self-Employed

5.17.13.1 (07-09-2012)
Insolvencies and Decedents' Estates Overview

1. This section discusses how to collect tax liabilities in insolvency proceedings. IRM 5.17.13.1 through IRM 5.17.13.9 discuss general principles, and IRM 5.17.13.10 through IRM 5.17.13.13 discuss specific types of insolvency proceedings.

   A. Examples of insolvency proceedings include:
   • *Receiverships,IRM 5.9.20.2*
   • *Assignments for the Benefit of Creditors,*IRM 5.9.20.3
   • *Corporate Dissolutions* IRM 5.9.20.4
   • Insolvent decedents' estates, in IRM 5.5.2, *Probate Proceedings*

   B. These distinct proceedings have a significant similarity. In each one, a fiduciary acquires property of a debtor or decedent, which becomes "property of the estate." The fiduciary then has the duty of administering and distributing the property of the estate.

   C. The term "insolvency proceedings" does not refer to bankruptcy cases. The Bankruptcy Code (Title 11 of the United States Code (USC)) governs bankruptcy cases, which are addressed in IRM 5.17.8 through IRM 5.17.11 of this Handbook, and also in IRM 5.9*, Bankruptcy and Other Insolvencies*. Bankruptcy cases are under the jurisdiction of the federal courts.

   D. Insolvency proceedings are usually under the jurisdiction of state courts (except for federal receiverships). Insolvent debtors and unsecured creditors usually prefer the bankruptcy procedures. Therefore, bankruptcy cases are more common than insolvency proceedings.

2. In the case of an insolvency, the IRS may be entitled to payment of federal taxes ahead of other creditors under the Federal Priority Statute, 31 USC § 3713(a). If a fiduciary pays other claimants ahead of the IRS in violation of the Federal Priority Statute, then the fiduciary might be personally liable under 31 USC § 3713(b).

   Note:

   The IRS may also be able to assert transferee liability against persons who receive property from insolvent estates. See IRM 5.17.14, *Fraudulent Transfers and Transferee and Other Third Party Liability.*

5.17.13.2 (07-09-2012)
Priority of Government Claims Under 31 USC § 3713(a), the Federal Priority Statute

1. Under 31 USC § 3713(a)(1)(A), the Federal Priority Statute, the Federal Government is entitled to have its claims paid first when a person indebted to the Government is insolvent and:

   A. a debtor without enough property to pay all debts makes a voluntary assignment of property;

   B. property of an absent debtor is attached; or

   C. an "act of bankruptcy is committed."

      Note:

      "Act of bankruptcy" , defined below in 5.17.13.2.3, does not refer to cases brought under Title 11 (the Bankruptcy Code). The Federal Priority Statute does not apply to cases under Title 11. In bankruptcy cases, the priorities in the bankruptcy laws apply rather than the Federal Priority Statute.

2. Section 3713(a)(1)(B) of the Federal Priority Statute covers decedents' estates. The Federal Government is entitled to have its claims paid first if the estate of the deceased debtor, in the custody of the executor or administrator, is not enough to pay all debts of the debtor. This means, among other things, that the Government is entitled to be paid before the heirs receive an inheritance.

3. Pursuant to the Federal Priority Statute, the general rule is that in an insolvency proceeding or a decedent's estate case, the fiduciary must pay a federal claim before other claims.

5.17.13.2.1 (07-09-2012)
Insolvency

1. "Insolvent" under 31 USC § 3713(a) refers to "balance sheet" insolvency. This occurs when the debtor's liabilities exceed the debtor's assets. *Lakeshore Apartments, Inc. v. United States*, 351 F.2d 349 (9th Cir.1965); *United States v. Golden Acres*, 684 F.Supp. 96 (D.Del. 1988); *United States v. Blumenfield*, 128 B.R. 918 (E.D. Pa. 1991).

2. The inability or failure to pay debts as they become due does not, by itself, constitute insolvency under 31 USC § 3713(a). *United States v. Oklahoma*, 261 U.S. 253 (1923). For example, the debtor might have far more assets than liabilities, but may not be able to liquidate the assets to pay off the debts on time.

3. The relevant time for testing insolvency is at the time of distribution of assets. Thus, although an estate might not be insolvent at the commencement of a proceeding, the federal priority will arise if the estate is insolvent when assets are later distributed. *Schwartz v. Commissioner*, 560 F.2d 311 (8th Cir. 1977); *Hatch v. Morosco Holding Co.*, 61 F.2d 944 (2d Cir. 1932).

5.17.13.2.2 (07-09-2012)
Transfer of Assets

1. Section 3713(a)(1)(A)(i) applies where the debtor's property is transferred to a fiduciary in a legal proceeding brought to liquidate the insolvent debtor's property and pay the debtor's debts. *United States v. Oklahoma*, 261 U.S. 253 (1923); *Bramwell v. United States Fidelity and Guaranty Co.*, 269 U.S. 483 (1926). Section 3713(a)(1)(A)(i) applies to the following proceedings:

   - general assignments for the benefit of creditors (a debtor transfers all property to an assignee)
   - general receiverships (a receiver takes control of all of the debtor's assets)
   - liquidations of insolvent corporations, either judicial (fiduciary appointed by a court) or nonjudicial (officers of the corporation act as the fiduciaries)

2. Section 3713(a)(1)(A)(ii) applies when the absent debtor's property is administered for all of his creditors. See *United States v. Clover Spinning Mills Co.*, 373 F.2d 274 (4th Cir. 1966). The term "attachment" in this section "is not the familiar attachment made at the instance of and for the benefit of one creditor, …, but to a form which was in use in some states when the federal statute was enacted in the late 18th century, by which the absconder's property was sequestered and administered for the benefit of all his creditors." William T. Plumb, Federal Tax Liens, 195, n. 23 (1981).

5.17.13.2.3 (07-09-2012)
Act of Bankruptcy

1. Section 3713(a)(1)(A)(iii) applies when an act of bankruptcy is committed. In defining "act of bankruptcy," courts look to the definition in the Bankruptcy Act of 1898, (11 U.S.C. § 21a) (repealed 1978), even though the Bankruptcy Reform Act of 1978 (Bankruptcy Code) generally superseded the Bankruptcy Code and the concept of "acts of bankruptcy" is not used in the Bankruptcy Code. The Bankruptcy Act of 1898 stated that: Acts of bankruptcy by a person shall consist of his having:

   - concealed, removed, or permitted to be concealed or removed any part of his property, with intent to hinder, delay, or defraud his creditors or any of them, or made or suffered a transfer of any of his property, fraudulent under the provisions of section 67 or 70 of this Act; or

- made or suffered a preferential transfer, as defined in subdivision a of section 60 of this Act; or
- suffered or permitted, while insolvent, any creditor to obtain a lien upon any of his property through legal proceedings or distraint and not having vacated or discharged such lien within thirty days from the date thereof or at least five days before the date set for any sale or other disposition of such property; or
- made a general assignment for the benefit of his creditors; or
- while insolvent or unable to pay his debts as they mature, procured, permitted, or suffered voluntarily or involuntarily the appointment of a receiver or trustee to take charge of his property; or
- admitted in writing his inability to pay his debts and his willingness to be adjudged a bankrupt.

2. Under the definition, an act of bankruptcy may arise even when there has been no transfer of property to a fiduciary, and multiple acts of bankruptcy may exist in one transfer. In *United States v. Golden Acres, Inc.*, 684 F.Supp. 96 (D. Del. 1988), an insolvent corporation owing a debt to the United States paid $466,760.54 to its sole officers and directors. In doing so it committed three independent acts of bankruptcy: it made a preferential transfer of assets to its sole officers and directors; it conveyed property with the intent to hinder, delay, or defraud any creditor, which was a fraudulent conveyance; and it conveyed property without receiving fair consideration, which also was a fraudulent conveyance. The district court imposed liability on the payees/officers under section 3713(b) because they were representatives of Golden Acres and were “liable to the extent of the payment for unpaid claims of the government.”
3. In a lawsuit asserting an act of bankruptcy, care must be taken to ensure that all of the elements for a particular act of bankruptcy are proven. For example, in *Jonathan’s Landing, Inc. v. Townsend*, 960 F.2d 1538 (11th Cir. 1992), the district court granted the Government’s motion for summary judgment, which asserted that the third act of bankruptcy applied to the debtor: the debtor suffered or permitted, while insolvent, any creditor to obtain a lien upon any of his property through legal proceedings or distraint. The Eleventh Circuit reversed the district court, reasoning that summary judgment should not have been granted because the Government had failed to prove that the taxpayer-debtor had been insolvent prior to committing an act of bankruptcy.
4. A Section 3713 claim against the debtor-taxpayer does not preclude the Government from also asserting claims under other section of the Internal Revenue Code, such as IRC §§ 7501 and 6672. In *Jonathan's Landing*, 960 F.2d at 1546 n.40, the Eleventh Circuit was "puzzled" as to the Government's failure to assert additional claims against the debtor under IRC §§ 7501 and 6672.

5.17.13.2.4 (07-09-2012)
Debt Due the United States

1. For the purposes of the Federal Insolvency Statute, taxes are "debts" due the United States. *United States v. Estate of Romani*, 523 U.S. 517, 525 n.8 (1998); *Massachusetts v. United States*, 333 U.S. 611, 625-625(1947).
   A. Taxes are "debts" even if they are unassessed. It is sufficient if the tax liability has accrued. *Viles v. Commissioner*, 233 F.2d 376 (6th Cir. 1956); see *Estate of Frost v. Commissioner*, T.C. Memo. 1993-94.
   B. The Federal Priority Statute applies not only to tax liabilities incurred before the proceeding, but also to tax liabilities incurred after the proceeding commences (i.e., taxes incurred by a receiver in operating a business). See IRM 5.17.13.6 (9), below.

5.17.13.3 (07-09-2012)
Exception for Certain Interests That Would Have Priority Under the Federal Tax Lien Act; United States v. Estate of Romani

1. The Federal Priority Statute does not apply if, before the insolvency proceeding begins, another person has obtained an interest in the property that would prevail over the federal tax lien under IRC § 6323. *United States v. Estate of Romani*, 523 U.S. 517 (1998).
   A. If the interest of a creditor prevails over the federal tax lien under IRC § 6323(a), (b), (c), or (d), then the federal claim does not have priority over the creditor’s interest.
   B. Under IRC § 6323(a), the following creditors prevail unless the IRS has filed a Notice of Federal Tax Lien: (a) purchasers, (b) holders of security interests, (c) mechanic's lienors, and (d) judgment lien creditors. Generally, creditors meeting the requirements in IRC § 6323(a), (b), (c), or (d), will have a higher priority claim than the IRS if the creditor’s interest arises prior to the insolvency proceeding and prior to the filing of the Notice of Federal Tax Lien. See Note, below.
   C. In *Estate of Romani*, the Supreme Court held that a judgment lien creditor who recorded its liens on real property before the IRS filed its Notices of Federal Tax Lien prevailed over the IRS’s tax claims in an insolvent decedent’s estate case.
   D. The general rule is that if the creditor would prevail against the IRS under IRC § 6323 outside of an insolvency, it will also prevail against the IRS in the insolvency.
   E. Under *Estate of Romani*, many priority disputes in insolvency proceedings will be resolved by determining lien priorities under IRC § 6323.

   Note:

   The *Romani* case applies only where the Government is relying on a claim for which a lien arose under IRC § 6321 and the competing interest is one identified in § 6323. In *Law Offices of Jonathan A. Stein v. Cadle Company*, 250 F.3d 716 (9th Cir. 2001), the Service levied the compensation of the president and CEO of an insolvent company. The company ignored the levy and continued to pay the president. The Service then sued the company to enforce the levy, and obtained a judgement under IRC § 6332(d). A third party also obtained a judgement against the company. The company then received a damages award to which the Service and the third party both claimed priority. In the ensuing interpleader proceeding, the Government claimed priority under 31 USC § 3713. The third party claimed priority by virtue of a judgement lien under IRC § 6323. The district court held for the Government under 31 USC § 3713, and the appellate court affirmed, finding that under *Romani*, the judgement lien would have priority if the United States were relying on claim for which a tax lien arose under IRC § 6321. However, in this case, the IRS did not have a federal tax lien claim against the company, so section 6323 did not apply. The Government won because section 3713 gave its claim priority over the third party's judgement lien.

2. If a competing interest does not have priority over a tax claim under IRC § 6323, the Romani exception would not apply.
   A. For example, the priority of a federal tax lien against a state tax lien is not governed by IRC § 6323. Instead, the Federal Priority Statute applies and the federal tax claim has priority over a state tax claim for distribution from an insolvent estate. This is true even if outside of insolvency the state claim would prevail because it was choate before the federal lien arose. *Straus v. United States*, 196 F.3d 862 (7th Cir. 1999).
   B. Persons such as heirs and devisees who receive distributions from decedents’ estates generally do not have priority interests under IRC § 6323(a). Therefore, their interests are generally subject to the federal priority.

5.17.13.4 (07-09-2012)
Other Exceptions

1. In *United States v. Fabe*, 508 U.S. 491 (1993), the Supreme Court held that the federal priority yields if it interferes with the McCarran-Ferguson Act (15 USC § 1011 et seq.). The McCarran-Ferguson Act provides that no federal law can supersede any state law regulating the insurance business. In *Fabe*, the Federal Priority Statute did not trump state law that subordinated federal tax claims to insurance claims of policyholders in the liquidation of an insolvent insurance company.
2. The Service may, *in limited circumstances*, cede priority for purposes of funding claims for family allowances, funeral expenses, or administrative expenses, even though debts to the Government technically have priority over these claims.

   Note:

The Federal Priority Statute does not apply in bankruptcy cases (i.e., bankruptcy petitions filed under Title 11.

5.17.13.5 (07-09-2012)
Administrative Expenses and Family Allowances

1. Although the Federal Priority Statute, 31 USC § 3713, does not provide for any exceptions to the Government's priority, courts have held that certain classes of claim can be paid before the tax debt. These excepted classes include administrative expenses, funeral expenses, and homestead or family allowances.
2. Administrative expenses are expenses incurred for the general welfare of creditors. Administrative expenses include:
   - court costs
   - reasonable compensation for the fiduciary and fiduciary's attorney
   - expenses incurred to collect and preserve assets
3. Administrative expenses must be examined to determine if the expense is reasonable and necessary to the administration of the estate. For more information, see IRM 5.5.2.6, *Administrative Expenses.* See also IRM 5.5.2.6.1.1, *Necessary Administrative Expenses* for factors to consider when determining what expenses should be allowed as necessary administrative expenses. For example, reasonable and necessary expenses should not be permitted ahead of a tax lien if such expenses are already covered by an insurance policy, trust or other similar benefit that covers such costs. See IRM 5.5.2.7, *Insurance Policies.*
4. Generally, state statutes provide limits on the amounts allowed for payment of reasonable administrative expenses. Some state law guidelines are based on the size of the estate, other provisions allow a set percentage to be paid as an allowable expense. Some expenses can be negotiated to a certain extent by the estate administrator, others, such as court filing fees, are not negotiable. State standards should be considered, *but are not controlling,* when determining whether administrative expenses are reasonable. See IRM 5.5.2.6.1, *Reasonable Administrative Expenses.* Information regarding a particular state's laws may be found in the State Law Guides on the My SB/SE Counsel website under the link for law guides, http://ccintranet.prod.irscounsel.treas.gov/OrgStrat/Offices/sbse/Pages/LawGuides.aspx.
5. The family allowance is **not** considered an administrative expense of the estate. In limited circumstances, the Service can exercise discretion to allow payment ahead of a tax lien. Consideration needs to be given to circumstances such as whether there are minor children who do not have another parent to support them. For example, if the surviving parent has sufficient income, trust distributions or life insurance proceeds to support minor or incapacitated children, this payment would not be allowed ahead of the tax lien.

   Note:

   A federal tax lien, arising before death, continues in the property to which it attached and therefore is prior to funeral costs, the surviving spouse's exempt property allowance (widow's allowance) and any support allowances (for the surviving spouse and minor children during administration of the estate). Consult with Area Counsel if you have any questions regarding the allowance and payment of such expenses ahead of IRS claims.
6. Fees paid to the fiduciary or the fiduciary's attorney may be deemed unreasonable if:
   - the fees are excessive in amount, or
   - they are incurred in support of unreasonable activity, e.g., positions that are frivolous or without substantial merit,
   - or they have been estimated or not incurred.

   Reasonable attorney fees are those incurred for preserving or marshalling estate assets. See IRM 5.5.2.6.1.1(1), *Necessary Administrative Expenses.* In proceedings other than probate proceedings, such as receiverships or corporate dissolutions, the Government may also argue that "reasonable" fees are limited to fees that benefit the Government as the priority claimant (e.g. fees incurred to sell receivership assets or to pursue claims against third parties).
7. The expenses of a decedent's last illness are a debt of the decedent and not entitled to priority under section 3713. Rev. Rul. 80-112, 1980-1 C.B. 306.
8. Taxes incurred by the estate during its administration should be paid as an administrative expense of the estate. See IRM 5.5.2.6.1.1.1, *Claiming Taxes as an Administrative Expense.* It is less clear whether administrative taxes, taxes incurred during a *receivership,* are entitled to priority by virtue of the Federal Priority Statute or by virtue of being "administrative" expenses. Consult local Area Counsel if a question involving the priority of administrative taxes arises.

5.17.13.6 (07-09-2012)
Filing the Proof of Claim

1. The IRS may file a proof of claim to collect any tax liability from the assets in a judicial insolvency proceeding. See IRM 5.9.20, *Non-Bankruptcy Insolvencies,* for procedures for filing claims in certain types of non-bankruptcy insolvency proceedings. See IRM 5.5.4.6, *Proof of Claim Procedures* for procedures for filing proofs of claim in decedent cases.

   Note:

   To share in distribution from the probate estate, you must file a timely claim against the estate, because most probate courts will not consider payment of a debt unless a timely claim is submitted.
2. The time for filing a claim will generally be specified either by state law or by notice from the court. State statutes of limitation, including those fixing a time for filing proofs of claim in a decedent's estate or other proceeding, do not apply to the United States. *United States v. Summerlin*, 310 U.S. 414 (1940); *United States v. Bushlow*, 832 F. Supp. 574 (E.D.N.Y. 1993); see also *Bresson v. Commissioner*, 213 F.3d 1173 (9th Air. 2000), affirming 111 T.C. 172 (1998).

   Note:

   The IRS should file a proof of claim within the time specified by state law to avoid litigation and ensure that taxes will be considered in distribution of estate assets. See IRM 5.5.4.7, *Comply with Bar Date.*
3. Once the United States files a proof of claim in a judicial proceeding, such as a probate or receivership proceeding, the court arguably has jurisdiction to determine the merits of the tax liability. It is generally not in the IRS's interests for a state court to rule on the merits of a tax liability.

   Note:

   Time is of the essence when seeking to remove any dispute regarding the merits of a federal tax assessment to federal district court. Generally, a notice of removal must be filed within thirty days of receipt by the IRS of the initial pleading raising such an issue. See IRM 5.5.2.10(4)(i), *Referral to Area Counsel for Judicial Action,* and IRM 25.3.3.3, *Removal of Action from State Court.* It is essential that disputes regarding the merits of a tax assessment be litigated in federal district courts whenever possible.
4. There are several advantages to the Service timely filing a proof of claim, including the following:
   A. It provides notice of the tax liability to the fiduciary. Notice is a prerequisite needed to establish personal liability under USC § 3713(b).
   B. It entitles the IRS to payment from the estate.
   C. It avoids the necessity of tracing assets to collect taxes by levy or through transferee liability.

D. The IRS will receive notices of hearings and other matters in the proceeding.

5. The disadvantage of filing a proof of claim is the possibility that the state court may adjudicate the merits of the claim. Where it is determined that filing a proof of claim will be disadvantageous to the Service, the following alternatives to filing a claim may be taken:

   A. The Government can give notice to the fiduciary of the tax liability by sending Form 10492, *Notice of Federal Taxes Due,* and rely on the fiduciary's personal liability under 31 USC § 3713(b) to encourage them to pay the claim. See IRM 5.17.13.8 below.

   B. The United States may bring a suit to reduce the tax assessments to judgement in federal district court. To the extent that the federal court enters a final order before a state court does, the state court will be bound by the federal court's order.

   C. The IRS may be able to assert transferee liability against the recipient of assets from an insolvent estate. See IRM 5.17.14, *Fraudulent Transfers and Transferee and Other Third Party Liability.*

6. Prepetition and post-petition interest and penalties are covered by the federal priority under 31 USC § 3713(a). See Rev. Rul. 87-99,1987-2 C.B. 291 (the IRS maintains that the statute gives priority to post-petition interest if the IRS has a lien and its claim is oversecured. Oversecured means the value of the property securing the IRS's claim exceeds the underlying tax liability).

   Note:

   Some courts, however, have limited interest on debts incurred before the insolvency to the interest that accrued up to the commencement date of the proceeding. *Lapadula & Villani, Inc. v. United States* , 563 F. Supp. 782, 785 n.7 (D. N.Y. 1983) citing *United States v. Sullivan*, 254 F. Supp. 254 (D. R.I. 1966) (analogizing the Federal Priority Statute to a bankruptcy proceeding).

   See also IRM 5.5.4.8, *Claiming Penalty and Interest,* for information on claiming penalties and interest in decedent cases.

5.17.13.7 (07-09-2012)
Personal Liability of the Fiduciary Under 31 USC § 3713(b)

1. 31 USC § 3713(b) imposes personal liability on a fiduciary or representative of an insolvent person or estate if the fiduciary:

   A. has knowledge of the federal tax debt, and

   B. pays other debts before paying the priority tax claims.

2. Personal liability is limited to the value of the assets that the fiduciary distributes in violation of federal priority. Section 3713(b) states: "A representative of a person or an estate (except a trustee under title 11) paying any part of a debt of the person or estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims of the Government."

3. Examples of the types of fiduciaries include executors, administrators, and personal representatives of insolvent estates; receivers; assignees; and officers of insolvent corporations. See IRC § 7701(a)(6). The common characteristic of persons liable under 31 USC § 3713(b) is that *"they are given possession and control of assets of debtors and are charged with the payment of debtors' obligations consistent with the creditors' rights and priorities. " King v. United States*, 379 U.S. 329(1964); *United States v. Whitney* , 654 F.2d 607 (9th Cir. 1981); *United States v. Crocker*, 313 F.2d 946, 949 (9th Cir. 1963) (holding the fact that a receiver is appointed by the court does not make the receiver immune from liability).

4. Fiduciaries generally are charged with:

   A. gathering the debtor's or decedent's assets;

   B. administering the assets, including liquidating the assets as appropriate;

   C. paying creditors; and

   D. distributing any remaining assets back to the debtor, heirs, or beneficiaries.

      Note:

      Section 3713(b), like 31 USC § 3713(a), does not apply to bankruptcy trustees in cases arising under Title 11 (the Bankruptcy Code).

5. Personal liability under 31 USC § 3713(b) only applies if the fiduciary uses estate assets to pay a debt in violation of federal priority under 31 USC § 3713(a).

   A. Personal liability only arises if the estate is insolvent.

   B. There is no personal liability if debts are paid ahead of federal claims if such debts have priority over the United States under IRC § 6323.

6. Knowledge of the federal claim is a requirement of personal liability. *United States v. Coppola*, 85 F.3d 1015 (2d Cir. 1996); *Want v. Commissioner*, 280 F.2d 777 (2d Cir. 1960); *Leigh v. Commissioner*, 72 T.C. 1105 (1979). The Government must show that the fiduciary had either actual knowledge of such facts as would put a reasonably prudent person on notice as to the existence of the tax debt before making the challenged distribution or payment. *United States v. Coppola*, 85 F.3d at 1020 (2d Cir. 1996); *Bank of the West v. Comm'r*, 93 T.C. 462 (1989). Thus, it is important to give notice of the tax debt to the fiduciary before any assets are distributed.

7. If a successor administrator is appointed, notice of taxes due should be sent to the new administrator to make them aware of the outstanding tax liability. If notice was sent to the prior administrator, send a copy of that notice to the successor administrator.

8. Personal liability under 31 USC § 3713(b) is the "muscle" behind the federal priority under 31 USC § 3713(a). Under 31 USC § 3713(b), the fiduciary must first pay known priority debts of the United States or risk personal liability.

5.17.13.8 (07-09-2012)
Asserting Personal Liability Against a Fiduciary

1. The IRS can assert personal liability against a fiduciary by either:

   A. Filing a suit under IRC § 7402(a) against the fiduciary in a federal district court, or

   B. Issuing a notice of fiduciary liability to the fiduciary under IRC § 6901(a)(1)(B). The notice gives the fiduciary the right to challenge the determination in the United States Tax Court.

2. Generally the statute of limitations for filing suit against a fiduciary under 31 USC § 3713(b) is the same as the statute of limitations for collecting the underlying tax assessment *United States v. Motsinger*, 123 F.2d 585 (4th Cir. 1941). Some cases suggest that it may be possible to successfully assert a longer statute of limitations for filing suit under 31 USC § 3713(b) against a fiduciary. See *U.S. v. Moriarty*, 8 F.3d 329 (6th Cir. 1993). Consult Area Counsel if the CSED is close or has expired and a fiduciary may be liable.

3. The statute of limitations for issuing a notice of fiduciary liability to the fiduciary is the later of one year after the fiduciary liability arises or the expiration of the statute of limitations for collecting the underlying tax liability IRC § 6901(c)(3).

4. The Government may be able to bring an action on the bond that fiduciaries are often required to post to serve as a fiduciary. The Government may also seek removal of the fiduciary for misconduct.

5. A fiduciary's defenses to liability under 31 USC § 3713(b) include:

    A. The fiduciary had no knowledge of the federal tax debt.

    B. The estate was solvent when the distribution was made.

    C. The statute of limitations on collection of the underlying tax and for asserting liability under IRC § 6901 has expired.

    D. The distributions made by the fiduciary were for claims over which the United States did not have priority.

5.17.13.9 (10-16-2007)
Decedents' Estates

1. A decedent's estate, or probate proceeding, is governed by state law. The purpose of the proceeding is to gather and distribute the decedent's assets.

    A. The assets administered in the probate proceeding are part of the decedent's estate. These consist of assets that the decedent owned prior to the decedent's death.

    B. A personal representative or administrator is appointed by the probate court to administer the assets of the estate. The personal representative's duties include a) gathering the assets of the deceased; b) paying the administrative expenses, taxes and other debts of the deceased; c) distributing the remaining assets as specified in the will or state law.

    C. The decedent may have executed (signed) a will or died intestate (without a will). If the decedent has executed a will, the executor named in the will is appointed as personal representative. If the named executor is deceased or declines to act (and the will does not name a successor who is willing to serve as executor), or if no will has been executed, then the court will appoint an administrator as personal representative.

    D. Some assets are not subject to probate administration including a) property held jointly with the right of survivorship; b) proceeds from life insurance policies; and c) property transferred to a trust during the decedent's life. Such assets may transfer at death directly to the survivor without going through probate. In such a case, these assets will not be within the custody of the court.

    E. The probate proceeding may be court supervised or may be an informal proceeding not requiring court supervision. If the proceeding is court supervised, the personal representative must obtain court approval to take many actions such as distributing assets.

2. Usually the IRS will assert a tax claim against an estate by filing a proof of claim in any judicially supervised probate proceeding. This is because the decedent's probate estate is under the jurisdiction of the state court. Notice of the tax liability should be given to the personal representative to ensure that the representative will be subject to 31 USC § 3713(b) personal liability.

3. State laws typically direct that the fiduciary must distribute estate assets in the following order of priority:

    A. costs and expenses of administration (including homestead and family allowances)

    B. reasonable funeral expenses

    C. debts and taxes with preference under federal law

    D. expenses of the decedent's last illness

    E. debts and taxes with preference under state law

    F. all other claims

4. However, insofar as state priority laws conflict with the federal priority, the federal priority controls.

5.17.13.9.1 (07-09-2012)
Administrative Collection

1. A statutory lien that arises against property of a taxpayer before a taxpayer's death continues to attach to the property after the taxpayer's death. *United States v. Bess*, 357 U.S. 51 (1958).

2. Collection by levy: As a general rule, when property to which the federal tax lien attaches passes into the control or custody of the court, collection by levy is not used because it would interfere with the court's processes. *United States v. Silverman* , 621 F.2d 961 (9th Cir. 1980) (Collection is prohibited while the assets are in custody of the court.). Where the proceeding has progressed so far that levy would not interfere or where the court grants permission to levy, levy may proceed. Treas. Reg. § 301.6331-1(a)(3). Consult Counsel before taking any enforced collection action after the claim is filed or notice and demand is made if estate assets are under the control of the court. But, if there are non-probate or other assets not subject to the court's jurisdiction or under the control or custody of the court, then the IRS may levy on those assets.

3. Property will not be in the custody of the court if:

    A. There is no judicial probate proceeding (e.g., there is an informal non-judicial proceeding, or no proceeding at all); or

    B. The property is not part of the probate estate (i.e., non-probate/exempt assets).

4. Persons who receive distributions from a decedent's estate, such as heirs and devisees, generally do not fall within any of the priority categories of IRC § 6323. The IRS may collect from such distributed property without the filing of a Notice of Federal Tax Lien (NFTL) if the assets are not under the custody of the court.

5. If a statutory lien arises after the death of the decedent, it may attach to property in the decedent's estate as of the assessment date. Some property may pass outside of the probate estate; for example, life insurance and property held by joint tenancy. Because a determination of rights to property is dependent upon state law, contact Area Counsel to determine if the federal tax lien will attach to probate property.

6. The period of limitations for collection is suspended under IRC § 6503(b) while a decedent's assets are under the control or custody of a court and for 6 months thereafter. Collection from the non-probate assets and the assets of the surviving spouse on joint liabilities with the decedent will have the normal 10-year statute for collection. The probate action will extend the collection statute for the decedent's liabilities only with respect to the probate assets in control of the court and then only if the probate assets are substantial in value relative to the entire estate. *United States v. Silverman*, 621 F.2d 961, 967 (9th Cir. 1980).

5.17.13.9.2 (07-09-2012)
The Probate Court

1. State courts have jurisdiction over a decedents' estate. Usually, state statutes designate a particular court to supervise the administration of estates. These courts are often known as probate courts. A decedent's estate is generally administered in the probate court of the county in which the decedent resided at the time of death.

2. Specific procedures for the probate court vary depending on the law of each state.

    Note:

Many of the State Law Guides on the My SB/SE Counsel website include a discussion of applicable state law regarding probate proceedings. http://ccintranet.prod.irscounsel.treas.gov/OrgStrat/Offices/sbse/Pages/LawGuides.aspx.

3. Generally, the first step in the judicial probate of a will is to file the will with the probate court. After a party proves a will to be genuine, the court will issue letters of administration to an executor. The executor then has the duty of gathering together and inventorying the estate assets, paying the debts of the decedent, and making distributions of the assets.
4. If there is no will, a party may file a petition with the probate court to request that the court appoint an administrator. The court will issue letters of administration and charge an administrator to perform the same tasks as the executor.
5. Both the executor and the administrator are known as personal representatives. The personal representative may be required to post a bond before appointment to act for the estate.
6. Creditors, including the IRS, can file claims against the estate. The personal representative will approve or disapprove each claim. If the fiduciary disapproves the claim, then the creditor may argue the case before the probate court. The creditor may also appeal an adverse decision to a state appellate court. After all disputes are settled, the personal representative distributes the assets. Heirs and devisees get any remaining assets after creditor's claims are satisfied.

5.17.13.9.3 (07-09-2012)
Fiduciary Liability of Personal Representatives

1. Section 3713(a) priority applies to a decedent's estate when the assets of the estate in the custody of the executor or administrator are not enough to pay all debts of the decedent.
2. Assets of the estate do not include certain property passing outside of probate, such as jointly held property. However, the estate does include any claims the executor has against holders of property that can be used to pay the tax liability. For example, under IRC § 2206 and 2207, the executor has the right to compel contributions toward the estate tax from life insurance recipients and property subject to a power of appointment.
3. If the 31 USC § 3713(a) priority applies, then the personal representative can be liable under 31 USC § 3713(b) for distributions that violate federal priority.

5.17.13.10 (07-09-2012)
Receiverships

1. A receivership usually has one of two purposes:
   A. A receivership can be a secondary proceeding brought to protect property until a primary legal proceeding is completed. For example, a mortgagee in a mortgage foreclosure suit may ask for the appointment of a receiver to take custody of the specific property subject to the mortgage, such as a hotel or other commercial property that is producing income. The receiver must collect the rents and operate the property during the foreclosure proceeding. This might preserve the value of the property pending the foreclosure sale.
   B. A receiver can also be appointed to liquidate all of the debtor's assets and to pay the debtor's debts. A receivership is an alternative to an assignment for the benefit of creditors and a bankruptcy proceeding.
2. A receivership can be a:
   A. general receivership in which the receiver takes control of all assets of the debtor, or
   B. a limited receivership in which specific assets are in the custody of the receiver. Ordinarily a limited receivership is for the benefit of specific creditors (e.g., a mortgage foreclosure).
3. A receivership, especially a limited receivership, does not always involve an insolvent debtor.
4. Generally, an interested party may initiate a receivership by filing a motion that seeks to have a receiver appointed by the court. An interested party might want to begin a receivership proceeding to:
   A. conserve, preserve, protect or administer property that is involved in a legal action;
   B. prevent fraud or loss of property from fraud;
   C. prevent mismanagement of property; or
   D. replace an irresponsible or insolvent assignee where claims are jeopardized in an assignment for benefit of creditors.
5. Creditors might want to initiate a receivership if a debtor is on the border between successful business operations and failure. The creditors might hope that a receiver will be able to operate profitably to make the business solvent. In such a case, the receiver will take charge of the property of the debtor and manage it for a period of time. The goal is to earn an amount sufficient to pay the creditors. If this cannot be done, the receiver may, with court permission, liquidate as much of the property as is necessary to pay the debts. The receiver can then distribute the proceeds to the creditors and return the balance, if any, to the debtor.
6. A majority of receivership actions arise in the state courts because the basis for federal district court jurisdiction is limited.
7. The United States can request the federal district court to appoint a receiver as part of a federal tax lien foreclosure action. IRC § 7403(d). The United States should seek such a receivership if it believes that it is necessary for the collection, preservation or orderly liquidation of property it wants to foreclose upon. See Suit and Litigation Guide for Revenue Officers, Training 29957-101, Catalog #55451Z, beginning on page E-95, for additional information and a sample suit narrative for a Suit for Appointment of a Receiver.

5.17.13.10.1 (10-16-2007)
Receiver

1. State statutes generally provide the purposes and conditions necessary to appoint a receiver. The party seeking the receivership must show the court that a receivership is necessary. Generally, there is no absolute right to the appointment of a receiver. Instead, the decision rests in the sound judicial discretion of the court. The court may also appoint a receiver on its own motion.
2. The receiver is usually an independent party without an interest in the case. The receiver must impartially protect the property or interests of the parties to the suit. A party in interest may be appointed receiver because of the nature of the property or special knowledge of the business. Generally, a court will allow a party in interest to serve as a receiver only if all of the parties to the suit agree.
3. The receiver is a fiduciary who can be personally liable under 31 USC § 3713(b) for violating the Federal Priority Statute in 31 USC § 3713(a). However, government claims might not have top priority in many receiverships because:
   A. there is no insolvency;
   B. there was no "act of bankruptcy" (e.g., the receivership is a limited receivership); or
   C. other creditors have priority pursuant to IRC § 6323.

5.17.13.10.2 (07-09-2012)
Assessment and Collection in Receiverships

1. Pursuant to IRC § 6036, a receiver in a receivership proceeding (and similar fiduciaries, including assignees for the benefit of creditors) who is in control of all or substantially all of the assets of a debtor must give notice of the appointment to the Area Director within 10 days of the receiver's appointment. Treas. Reg. § 301.6036-1.
2. Under IRC § 6871(a), assessments for income, estate and gift taxes may be made immediately after the appointment of a receiver in any receivership proceeding before any federal or state court. Treas. Reg. § 301.6871(a)-1. In these instances the IRS does not issue a notice of deficiency, and the taxpayer is deprived of access to Tax Court. Treas. Reg. § 301.6871(b)-1(a).
   A. The IRS may advise the receiver if it makes an immediate assessment pursuant to IRC § 6871(a). Treas. Reg. § 301.6871(b)-1(c).
   B. Even if the IRS has issued a notice of deficiency, the taxpayer is prohibited from filing a Tax Court petition after the appointment of the receiver. IRC § 6871(c)(1); *Levine v. Commissioner*, T.C. Memo. 1987-564 (1987). However, the Tax Court will have jurisdiction if the debtor files the petition before the receivership begins.
   C. Section 6871(a) applies to any judicially supervised liquidation proceeding in which a fiduciary is appointed with the powers of a receiver. *Williams v. Commissioner*, 44 T.C. 673 (1965) (IRC § 6871 applied to assignment for the benefit of creditors under supervision of court).
3. The IRS may file a proof of claim in the receivership proceeding to collect from the assets in the custody of the court. The IRS may not engage in administrative collection from assets in the custody of the court. Accordingly, the period of limitations for collection is suspended under IRC § 6503(b) if all or substantially all of the taxpayer's assets are in the control or custody of the court.

   Note:

   Formal intervention rather than merely filing a claim will give the United States standing as a party to the proceeding to challenge court orders. Usually the United States intervenes only in federal court receiverships.
4. The receiver takes property subject to prior tax liens. The 6321 lien is not valid against the creditors listed in IRC § 6323(a), unless an NFTL was filed before the creditor took an interest in the property. Receivers are not on the IRC § 6323(a) list, so the tax lien encumbers the property in the receiver's hands. One or more of the § 6323(a) creditors may have an interest in the property when the receiver takes it, however, and that interest would have priority over the 6321 lien if the interest predates the filing of the NFTL.
5. Unlike bankruptcy cases, receivership proceedings do not provide a discharge. The IRS may collect any tax claim that remains unpaid once the proceeding ends. IRC § 6873.

5.17.13.11 (10-16-2007)
Assignments for the Benefit of Creditors

1. An assignment for the benefit of creditors is a state law proceeding in which the debtor voluntarily transfers his property to another party (the assignee) in trust. The assignee then uses or sells the property to pay the debtor's debts.
2. The assignment can be a general assignment of all or substantially all of the debtor's property or a partial assignment of only some of the debtor's property.
3. Most assignments are under the jurisdiction of a state court. If the court supervises the assignment, then the proceeding may essentially be a receivership. In this case, the same rules applicable to receiverships may apply. For example, the IRS may immediately assess under IRC § 6871. Also, the IRS may not levy. Accordingly, the statute suspends the collection period of limitations while the property of a general assignment is under the control or custody of the court. IRC § 6503(b).
4. Under most state laws, a valid assignment for creditors vests the legal title of the debtor's property in the assignee. The property is beyond the control of the assignor or the reach of any of the assignor's creditors, other than their rights under the assignment to share in the distribution of the assigned property. Normally, the assignee takes title to the assigned property as a trustee, and in general the assignee's duties, powers, and liabilities are those of a fiduciary.
5. The assignee takes the assigned property subject to all liens and encumbrances.
6. Some states have enacted statutes prohibiting an assignor from preferring one or more creditors over other creditors in making an assignment for the benefit of creditors. Under these statutes, the assignment must be for the equal benefit of all the assignor's creditors.
7. Like a receivership, the assignment differs from a bankruptcy case in that the debtor does not receive a discharge of debts.

5.17.13.11.1 (07-09-2012)
Assessment and Collection

1. Like a receiver, an assignee for the benefit of creditors does not fall within one of the protected categories of IRC § 6323. Therefore, the assignee is subject to the federal tax lien even though a Notice of Federal Tax Lien has not been filed. If the tax liability is assessed before the assignment, a valid tax lien exists against all the assignor's property. The effect of the assignee taking the property is that the Government retains its interest in the property to the extent of its lien and the Government is entitled to enforce its lien against the property.
   A. The priority of competing creditors claiming an interest in the assets will be determined under IRC § 6323.
   B. The IRS cannot take administrative collection action against the assigned assets if the assignment is judicially supervised and the assets are within the control or custody of the court. Instead, the IRS may file a claim in the proceeding to assert a right to the assets. See IRM 5.17.13.7, above, for considerations before filing a proof of claim.
2. If the tax liability is assessed after the assignment, the taxpayer no longer has an interest in the property at the time of assessment, so the tax lien does not attach to the assigned property.
3. The United States can assert a priority claim under 31 USC § 3713(a) for voluntary assignments for the benefit of creditors. *United States v. Cole*, 733 F.2d 651 (9th Cir. 1984). The assignee is a fiduciary who can be personally liable under 31 USC § 3713(b) for using property of the insolvent estate to pay lower priority creditors ahead of known federal tax liabilities. If other creditors have priority over the United States under IRC § 6323 (e.g., mortgages and other consensual security interests), however, the federal priority statute will not provide superior priority.

5.17.13.12 (10-16-2007)
State-law Corporate Dissolutions

1. A corporation is considered a "person." A corporation exists separately from the identity of its stockholders and officers.
   A. This means that the corporation itself can own property, can sue and be sued, and can incur tax liability.
   B. It also means that this separate existence may come to an end. When the corporation's existence does end, the corporate affairs are wound up (the corporation must pay its debts and distribute its remaining assets). This process is a "corporate dissolution."
2. A corporation's existence is artificial, created by state law. State statutes provide for:
   A. the creation of the corporation;

B. the period of its existence; and

C. termination of its life.

3. Stockholders of a corporation may decide to terminate the corporate existence. They may voluntarily dissolve the corporation and forfeit the corporate charter.

4. The state may also initiate a proceeding to forfeit the corporate charter. Usually a state will do this as a method of enforcing some state law requirement. The most common example of this is the state requirement that corporations pay a state franchise tax. If the required payment is not made, the state may bring an action to forfeit the charter, thereby terminating the corporate existence.

5.17.13.12.1 (10-16-2007)
Dissolution Proceedings

1. If difficulties arise in the liquidation of assets, payment of claims, or distribution of assets, or if state law requires, dissolution may be conducted in a court proceeding.

   A. Usually the court appoints a receiver, liquidator, or other fiduciary. The fiduciary must attend to the dissolution under orders of the court and the court will hear and determine all controversies that arise during the course of the dissolution.

   B. The IRS should file a claim in such a proceeding to collect from the assets of the corporation.

   C. The IRS cannot levy on any property within the custody of the court.

   D. A bankruptcy corporate liquidation differs from a non-bankruptcy corporate judicial liquidation in that the bankruptcy proceeding is governed by federal bankruptcy law and is supervised by a federal court, while the non-bankruptcy judicial proceeding is governed by state corporate law and is supervised by a state court.

2. If the parties are able to liquidate the corporation without the help of a court and if all parties and creditors are satisfied that justice is being done, there is no reason for court action. The parties may conduct the liquidation entirely out of court if state law permits.

   A. A nonjudicial liquidation is likely if there is either enough money to pay all corporate creditors or if the value and disposition of the assets and the priority among claimants is not disputed.

   B. A nonjudicial dissolution is usually conducted by the officers of the corporation. Such officers become trustees for creditors and act in a fiduciary capacity.

   C. If at any time during a nonjudicial dissolution the Government determines that the interests of the United States are not protected, then the Government may bring suit to subject corporate properties to payment of tax under IRC § 7403.The Government can seek to appoint a receiver under IRC § 7403(d). Such action converts the nonjudicial dissolution into a judicial dissolution.

   D. The Government may also consider administrative collection action in nonjudicial dissolutions.

5.17.13.12.2 (10-16-2007)
Duties of Fiduciaries

1. The fiduciary who is charged with liquidating the corporation will first collect all corporate assets, inventory the assets, value, liquidate them and make distributions to creditors and stockholders.

2. The fiduciary must ordinarily give notice of the dissolution to all who might hold claims against the corporation. This will usually be a public notice such as newspaper publication in addition to specific notice to each known creditor as required by state law. The notice will give the place where claims are to be filed and the date by which they should be filed.

3. If money or property remains in the hands of the liquidator after satisfaction of claims against the corporation, the balance will be distributed to the stockholders. All valid claims against the corporation must be paid before anything is distributed to stockholders, but after payment of claims all equity remaining in the corporation belongs to the stockholders.

5.17.13.12.3 (10-16-2007)
Priority of Federal Taxes

1. Priority of the United States versus other creditors of the corporation will often be determined by IRC § 6323.

2. However, with respect to persons without priority under IRC § 6323, such as state entities and stockholders, the United States can claim priority pursuant to 31 USC § 3713(a).

3. Where the United States has priority under 31 USC § 3713(a), it can assert personal liability under 31 USC § 3713(b) against fiduciaries who pay claims with lower priority than the federal claim, so long as the fiduciary had knowledge of the tax liability.

5.17.13.12.4 (07-09-2012)
Collection Options

1. If a tax claim against the corporation is not paid, and corporate assets are distributed to stockholders, collection may be effected from such stockholders to the extent of the property received by each. There are three possible grounds for collection from stockholders:

   A. If federal tax liens attached to the corporate property before the distribution, the transfer would not divest the tax liens and, therefore, the property received may be foreclosed in the hands of the stockholders by a suit under IRC § 7403(a).

   B. Transferee liability may be asserted against the stockholders under IRC § 6901. See IRM 5.17.14.2.3.5, *Transferee Liability of a Shareholder or Distributee of a Corporation*.

   C. Where appropriate, a suit could be filed to set aside the transfer as a fraudulent transfer. See IRM 5.17.14.2.3.2,*Transferee Liability Based on Fraudulent Transfers*.

2. In the event of a corporate merger or consolidation, the successor corporation often takes all the assets and assumes all the liabilities of the old corporation. Collection from the successor corporation can be effected by the same means as discussed with respect to stockholders.

   Note:

   Corporate mergers or consolidations can take many forms. Before attempting to collect from a successor corporation, contact the successor corporation to obtain documents describing the transaction and consult with Chief Counsel.

3. Where the tax in question is a withheld employment tax or collected excise tax, the Trust Fund Recovery Penalty under IRC § 6672 provides an effective means to collect the unpaid liability from corporate officers who were responsible for payment of the tax.

4. An offer in compromise may be considered when it is unlikely that the tax liability can be collected in full and the amount offered reasonably reflects collection potential. An offer in compromise may achieve the goal of collecting what is potentially collectible at the earliest possible time and at the least cost to the government. Refer to IRM 5.8. - Offer in Compromise.

Part 5. Collecting Process

Chapter 17. Legal Reference Guide for Revenue Officers

Section 14. Fraudulent Transfers and Transferee and Other Third Party Liability

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5.17.14 Fraudulent Transfers and Transferee and Other Third Party Liability

Manual Transmittal

January 24, 2012

Purpose

(1) This transmits revised IRM 5.17.14, Legal Reference Guide for Revenue Officers, Fraudulent Transfers and Transferee and Other Third Party Liability.

Background

This section provides guidance on the methods the United States can use to collect an unpaid liability where an initially liable person, e.g., a taxpayer (the "transferor"), has transferred property to a third party (the "transferee") prior to or after the liability to the United States is incurred.

Material Changes

(1) This section has been reorganized in its entirety so that topics flow more logically and redundant provisions have been eliminated. Substantive deletions, additions, or revisions are noted in the following paragraphs.

(2) IRM 5.17.14.1 - added a new overview of the various theories under which the government may collect tax liabilities from a person or entity that is not the original taxpayer.

(3) IRM 5.17.14.2(2) - removed subparagraph (c) in examples of Non-Tax liabilities; example determined to be confusing and inaccurate.

(4) IRM 5.17.14.2.2 - added definition of secondary liability.

(5) IRM 5.17.14.2.3 - added general explanations of transferee liability “at law” and “in equity.”

(6) IRM 5.17.14.2.3(3)(a) and (b) - added explanation that the type of transferee liability resulting from a fraudulent transfer is liability in equity.

(7) IRM 5.17.14.2.3(6) - clarified that while the tax liability arises at the end of the tax year, a transfer occurring during the tax year may give rise to a contingent tax liability at the time of the transfer.

(8) IRM 5.17.14.2.3(9) - added paragraph explaining that different terminology may be used for theories of transferee liability under state law. Questions regarding the appropriate theory or theories that will apply in a given case should be directed to Area Counsel.

(9) IRM 5.17.14.2.3.1(3) - added explanations of state laws which impose liability on a transferee in corporate mergers or consolidations, “de facto mergers,” and corporate dissolutions.

(10) IRM 5.17.14.2.3.3 - discussion regarding use of the “trust fund doctrine” as a basis for establishing transferee liability was expanded; added note explaining the difference between the trust fund doctrine and the direct imposition of liability under IRC § 6672.

(11) IRM 5.17.14.2.3.4 - added language specifically addressing successor liability of a corporation as a transferee.

(12) IRM 5.17.14.2.3.6 - substantially revised to add information and case law citations regarding the extent of a transferee's liability depending upon whether transferee liability is based “in equity” or “at law.”

(13) IRM 5.17.14.4 - added overview of the different methods that may be used to collect from a transferee or fiduciary.

(14) IRM 5.17.14.4.6(7) - added paragraph explaining that a suit to set aside a fraudulent conveyance may be combined with a suit to impose personal liability on a transferee in certain situations.

(15) IRM 5.17.14.4.6.1 - clarified discussion of the applicability of the six-year statute of limitations under the FDCPA; added a note that Area Counsel must be consulted whenever the Service plans to rely on the provisions of the FDCPA to set aside a fraudulent conveyance and the six-year statute is imminent or has expired.

(16) IRM 5.17.14.4.7 - added discussion of considerations for determining whether to follow IRC § 6901 procedures or to file suit.

(17) IRM 5.17.14.5 - added provisions discussing "Successor Liability as Primary Liability."

(18) IRM 5.17.14.6 - expanded discussion of nominee and alter ego doctrines, the distinctions between the two, and enforcement actions that may be taken.

Effect on Other Documents

This supersedes IRM 5.17.14 dated October 1, 2007.

Audience

SB/SE Revenue Officers

Effective Date

(01-24-2012)

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Small Business/Self-Employed

5.17.14.1 (01-24-2012) Third Party Liability Overview

1. There are a variety of situations where a third party can be held liable for the tax liability of another. This IRM discusses the different legal theories for third party liability.
   A. Transferee liability
   B. Fiduciary liability
   C. Successor liability
   D. Nominee or alter ego
2. Although these theories require the application of different laws and different methods for collection, common elements exist in any analysis of third party liability. The legal theory that is pursued by the Service will ultimately depend on the specific facts of a case.
3. Because the legal theory applied depends on the specific facts, Field Collection will want to fully develop the factual background for each case. This includes, but is not limited to, any information or facts regarding the transfer and the relationship between the parties.
4. Many of the legal theories for third party liability also involve the assertion of fraud by the Service and, therefore, any evidence or facts suggestive of fraud should also be included when developing the factual background.
5. This IRM section also discusses the different methods available to the Service for collecting tax liability from a third party. See IRM 5.17.14.4, *Methods of Collecting from a Transferee or Fiduciary*.
   A. The Service can use administrative remedies where a Notice of Federal Tax Lien was properly filed before a transfer to the third party. In these cases, the federal tax lien can be enforced by lien or levy without first making an assessment against the transferee under IRC § 6901 or filing suit in district court.
   B. The Service can also use administrative collection procedures to collect from a taxpayer's property that is held by a nominee or alter ego.
   C. Where no federal tax lien attaches to the property before it is transferred to a third party, the Service must generally make an assessment against the transferee using the IRC § 6901 procedures before pursuing administrative collection procedures. In these situations, the Service can also file suit in district court to seek to set aside the fraudulent conveyance.
6. These methods of collection are all discussed in greater detail in the provisions that follow. A determination of the best approach to take will depend upon the particular facts of the case. After the factual background of a case has been fully developed, Area Counsel is available to assist Field Collection in determining such matters as the applicable state law, or the best legal theory to proceed under given the specific facts. See IRM 25.3.2.2.1, *Area Counsel Assistance*.

5.17.14.1.1 (01-24-2012) Transferee Liability

1. The government may seek to collect a taxpayer's unpaid tax, penalty or interest by asserting transferee liability when a taxpayer (transferor) has transferred property to another person or entity (transferee) and a substantive provision of the law provides the ability to assert liability against the recipient based on the transfer.
2. The liability of the transferee is secondary to that of the transferor, meaning it is derived from the transferor's liability. Transferee liability does not create a new liability. Instead, it provides a secondary method to collect the transferor's tax liability.
3. Frequently, collection of the tax is based on a finding that the transfer was fraudulent. An actual transfer occurred but there is a legal basis for collecting the tax liability from the transferee.
4. Transferee liability may also arise under a contract, under federal statutes, or under state law.

5.17.14.1.2 (01-24-2012) Fiduciary Liability

1. A representative of a person or an estate (except a trustee acting under the Bankruptcy Code of Title 11) paying any part of a debt of the person or estate before paying a debt due to the United States is personally liable to the extent of the payment for unpaid claims of the United States.
2. A fiduciary is not liable unless the fiduciary knows of the debt or had information that would put the fiduciary on notice that an obligation was owed to the United States.
3. Fiduciary liability is discussed more fully in IRM 5.17.13.8, *Personal Liability of the Fiduciary.*

5.17.14.1.3 (01-24-2012) Successor Liability

1. Under the successor liability doctrine, the government seeks to impose liability because the taxpayer sold or transferred assets to or merged with another corporation and the recipient or surviving corporation is liable under state law for the debts of the predecessor corporation.
2. The successor corporation may be liable as a transferee, as more fully discussed in IRM 5.17.14.2.3.4, or the successor corporation may be primarily liable, as more fully explained in IRM 5.17.14.5, *Successor Liability as Primary Liability*.

5.17.14.1.4 (01-24-2012) Nominee or Alter Ego Doctrines

1. Nominee or Alter Ego. The government may collect a taxpayer's liability from the assets of a third party if the third party is holding assets as the taxpayer's nominee or alter ego.
   A. The nominee theory is based on the premise that the taxpayer ultimately retains the benefit, use, or control over property that was allegedly transferred to a third party. Thus, the nominee theory focuses on the relationship between the taxpayer and the transferred property. A transfer of legal title may or may not have occurred, but the government does not believe a substantive transfer of control over the property in fact occurred.
   B. The alter ego theory allows collection from the taxpayer's alter ego when the taxpayer and the alter ego are so intermixed that their affairs are not readily separable. Thus, the alter ego theory focuses on the relationship between the taxpayer and the alter ego.

      Note:

As explained in IRM 5.17.14.6, *Nominees and Alter Ego Doctrines*, the nominee and alter ego doctrines are separate theories.

5.17.14.2 (01-24-2012)
Transferee Liability

1. Transferee liability is a method of collecting an unpaid liability (tax or non-tax) from the property recipient where a transferor has transferred property to a third party (the transferee) prior to or after a liability is incurred (such as the assessment of a tax).
2. The following are examples of underlying debt for which a transferee proceeding can be brought. The list is not exhaustive, but is intended to indicate the range of underlying liabilities, particularly non-tax.

Tax

A. A tax liability for which a deficiency notice was issued to the taxpayer and that is assessed against the taxpayer, or that is set forth in a judgment against the taxpayer.

B. A liability for a tax not subject to the deficiency procedures that is assessed against the taxpayer, or that is set forth in a judgment against the taxpayer.

C. A tax liability for which a deficiency notice could have been issued to the taxpayer, or a judgment obtained against the taxpayer, but for which, instead, a notice of deficiency is issued to a transferee or fiduciary, or a judgment obtained against the transferee or fiduciary.

Non-Tax

A. An erroneous refund or credit, where the amount owed is determined in a judgment against the recipient-transferor.

B. Government property (for example, trust funds or the employer's portion of employment tax liabilities received by a professional employee organization (PEO) from a common law employer which is diverted to a person related to the PEO, where the amount is determined in a judgment against the PEO).

5.17.14.2.1 (01-24-2012)
Types of Transfers

1. A transfer can be direct or indirect and includes:
   - The disposition of or parting with an asset or an interest in an asset.
   - The payment of money.
   - The payoff of debt.
   - The release of a debt or claim.
   - The granting of a lease.
   - The creation of a lien or other encumbrance.
   - The compensation, especially when excessive, paid to corporate officers.
   - The distribution of sale proceeds or other corporate assets to shareholders.

5.17.14.2.2 (01-24-2012)
Secondary Liability

1. Courts generally consider a transferee's liability to be secondary to the primary liability of the transferor. Secondary liability means the transferee derives its liability from the transferor's liability based on the receipt of property under circumstances which subjects the transferee to the liabilities of the transferor.
2. Before pursuing a transferee, the Service must generally exhaust all legal remedies it may have against the transferor for collection of the tax. The general rule is that the Service must show that collection remedies against the transferor have been exhausted or would be futile. See Gumm v. Commissioner, 93 T.C. 475, 480 (1989). The extent to which the Service must proceed against the transferor depends on the facts and circumstances. For example, the Service need not pursue a corporate taxpayer that has been stripped of its assets or a trust that has distributed its property to a beneficiary and terminated.

5.17.14.2.3 (01-24-2012)
Establishing Transferee Liability

1. A transferee is liable for a tax either "at law" or "in equity."
2. "At law" liability is where the liability of the transferee is directly imposed by federal or state law or agreed to as part of a contract (either an express or implied agreement).
3. "In equity" liability is where the liability of the transferee is imposed by a court based on equity or fairness principles.

   A. Transferee liability in equity is based on fraudulent conveyance laws that were initially developed by courts based on the principle that debtors may not transfer assets for less than adequate consideration if they are left unable to pay their liabilities.

   B. Although the doctrine was initially based on the common law (case law), both federal and state statutes now address setting aside transfers based on a fraudulent conveyance.
4. To establish a transferee's liability "at law," the Service must prove:

   A. the transferor transferred property to the transferee;

   B. the transferor was liable for the tax at the time of the transfer, or the transfer occurred in the year of liability, and the transferor remains liable for the tax; and one of the following:

   C. the transferor and the transferee entered into a contract in which the transferee expressly or impliedly agreed to assume the transferor's tax liability, or

   D. liability is directly imposed on the transferee (strict liability) under a federal or state statute (e.g., a bulk sales law or a state corporate merger or dissolution statute) or case law.

   Note:

While not a required element for establishing transferee liability at law, information regarding the value of the property at the time of transfer should be provided because applicable law may limit the transferee's liability to this amount. Additionally, information regarding efforts made to collect the tax from the transferor, or why collection actions against the transferor would be futile, should be provided.

5. To establish a transferee's liability "in equity," the Service generally must prove:

   A. the transferor transferred property to the transferee;

   B. the transferor was liable for the tax at the time of the transfer, or the transfer occurred in the year of liability, and the transferor remains liable for the tax;

   C. the value of the transferred property at the time of transfer (which generally determines the limits of the transferee's liability);

   D. the transfer was for less than adequate consideration;

   E. the transferor was insolvent or the transfer made the transferor insolvent; and

   F. all reasonable efforts have been made to collect the liability from the transferor-taxpayer.

6. The tax liability arises at the end of the tax year. However, a transfer occuring during the tax year may give rise to a contingent tax liability at the time of the transfer.

7. For certain kinds of transfers (e.g., fraudulent transfers, gifts and testamentary distributions), the Service must also prove the value of the transferred property at the time of the transfer, which generally determines the limits of the transferee liability. See IRM 5.17.14.2.4, *Extent of Transferee Liability*.

8. The methods of establishing transferee liability, discussed below, are not mutually exclusive. Frequently, the facts in a particular case may support a number of different theories for imposing transferee liability. For example, depending upon applicable state law, the same set of facts could support imposing liability on the transferee under the following theories:

   - fraudulent transfer
   - trust fund doctrine
   - successor liability
   - transfer to shareholder or corporate distributee

9. Additionally, states may use different terminology for these different theories. For example, not all states specifically recognize the doctrine of "successor liability" but instead will impose transferee liability under the same or a similar set of facts and call it something else (e.g., trust fund doctrine, fraudulent conveyance). For Field Collection, fully developing the facts of the case that support varying theories of transferee liability is more important than determining which specific legal theory applies. Consult with Area Counsel to determine the appropriate legal theory or theories under which suit may be brought in your state.

   Note:

   Many of the State Law Guides on the My SB/SE Counsel website include a discussion of applicable state law for fraudulent conveyances or other types of transferee liability. See http://ccintranet.prod.irscounsel.treas.gov/OrgStrat/Offices/sbse/Pages/LawGuides.aspx.

5.17.14.2.3.1 (01-24-2012)
Transferee Liability Directly Imposed on the Transferee ("At Law")

1. A transferee liability is considered "at law" when it is directly imposed by a federal or state law specifying that in a particular situation a transferee will be liable for the debts of the transferor. The transferee liability my be directly imposed by a statute or by judicially created doctrine embodied in case law.

   Note:

   When transferee liability is based on the fraudulent transfer of property, the transferee liability is "in equity" even though a state statute provides the mechanism to set aside the fraudulent conveyance. In these scenarios, the fraudulent transfer statute sets forth criteria to be considered by a court to determine if a fraudulent transfer took place, and authorizes the court (a) to enter a judgment of liability against the transferee, and/or (b) to set aside the fraudulent transfer. See IRM 5.17.14.2.3.2.

2. The Internal Revenue Code has provisions which impose direct liability on a transferee for the transferor's tax.

   A. A distributee/recipient of certain types of property from a decedent's estate is personally liable under IRC § 6324(a)(2) for estate taxes to the extent of the value of the property received. See IRM 5.17.2.9.1(4), *The Estate Tax Lien*.

   B. A donee of a gift is personally liable under IRC § 6324(b) for any gift tax incurred by the donor to the extent of the value of the gift. See IRM 5.17.2.9.2(2), *The Gift Tax Lien*.

      Note:

      In the situations listed above in (a) and (b), no assessment against the transferee or fiduciary is needed to collect during the 10 year lien period provided by IRC § 6324 with respect to the lien that arises automatically without assessment. A judgment or assessment may be needed after expiration of the 10 year lien period.

3. Most states also have statutes which directly impose liability on a transferee in certain circumstances.

   A. Bulk sale provisions found in the Uniform Commercial Code (UCC) or other state laws impose liability for a business' debts on the purchaser of substantially all of the inventory or equipment of the business if notice of the purchase is not given to the business's creditors.

   B. Corporate merger or consolidation - The corporate laws of many states impose liability on the surviving corporation for the debts of the disappearing constituent corporations following a merger or consolidation.

   C. Most states have case law that imposes liability when one corporation sells its assets to another corporation and the asset sale is tantamount to a "de facto merger" or a "mere continuation" of the transferor corporation. See Atlas Tool v. Commissioner, 70 T.C. 86, 113-114 (1978), aff'd, 614 F.2d 860 (3d Cir. 1980).

      Note:

      In these scenarios, the surviving corporation may also have primary liability as a successor in interest. See IRM 5.17.14.2.3.4.

   D. Distributions upon dissolution of corporation: Most states have statutes that authorize creditors to sue shareholders for distributions upon dissolution of the corporate taxpayer. Some states have statutes imposing liability on a director for distributions made upon dissolution of a corporation even if the director is not a shareholder.

4. Transferee liability may also be directly imposed on a transferee "at law" if the transferee expressly or impliedly agreed to assume the transferor's tax liability in a contract.

5.17.14.2.3.2 (01-24-2012)
Transferee Liability Based on Fraudulent Transfers ("In Equity")

1. Transferee liability in equity may also result from a fraudulent transfer. The concept of transferee liability based on a fraudulent transfer is that fairness dictates that the government should be able to collect from the fraudulently transferred property as if the transferor still held the property.

2. Although fraudulent transfers take many forms, their common goal is to put assets out of the reach of creditors. It is important to look for a transaction which diminishes a taxpayer's assets. Any transaction which leaves a taxpayer with something less than what the taxpayer started with can potentially be a fraudulent transfer. For example, the forgiveness by a taxpayer of a debt owed him or the release by a taxpayer of a bona fide claim against a third party constitutes a transfer which may be set aside if the necessary elements of fraud are present.

3. A transfer is in fraud of a debt owed to a creditor when real or personal property is transferred to a third party with the object or the result of placing the property beyond the reach of the creditor or hindering the creditor's ability to collect a valid debt.

4. Many theories of liability require a party seeking to set aside a transfer of property as fraudulent to exhaust all other available remedies against the transferor. See Gumm v. Commissioner, 93 T.C. 475, 480 (1989). The general rule is that the Service must show that collection remedies against the transferor have been exhausted or would be futile. This means that the Service should always make a reasonable and well-documented search for additional assets retained by the transferor, and first attempt to satisfy the debt out of those assets.

5. When fraudulent transfers are identified, it may be advisable to file a specially worded Notice of Federal Tax Lien identifying the transferee and specific property involved to prevent further clouding of title while enforcement actions are being taken. Approval of and guidance as to the styling of such specially worded notices of lien must be secured from Area Counsel before recording. See IRM 5.12.2.6.4.1, *Preparing Special Condition NFTLs (Nominee, Alter-Ego, and Transferee)*.

6. Depending on the facts of the case and the applicable state law, transferee liability based on fraudulent transfer may overlap with liability imposed under the trust fund doctrine (IRM 5.17.14.2.3.3), successor liability (IRM 5.17.14.2.3.4), and the liability of shareholder and corporate distributees (IRM 5.17.14.2.3.5).

5.17.14.2.3.2.1 (01-24-2012)
Fraudulent Transfers Under Federal and State Law

1. The Federal Debt Collection Procedures Act (FDCPA) became effective in 1991. 28 USC § 3001 et seq. Prior to the FDCPA, the United States relied on applicable creditor and debtor law of the various states to attack fraudulent transfers.

   A. The FDCPA gives the United States a uniform federal procedure for setting aside a fraudulent transfer to aid in the collection of federal debts, including tax debts. 28 USC § 3301 et seq. These sections of the FDCPA are based on the Uniform Fraudulent Transfers Act, 7A Pt. II Uniform Laws Annotated (ULA) 2.

   B. The United States is not bound to use the FDCPA to collect its debts. If necessary, it can proceed under any cause of action provided by state or federal law. See United States v. Letscher, 99-2 USTC ¶ 50,947 (S.D.N.Y. 1999).

2. All states recognize a cause of action to set aside a fraudulent transfer. A majority of jurisdictions have adopted either the Uniform Fraudulent Conveyance Act (UFCA), 7A Pt. II ULA 246 (2 states & U.S. Virgin Islands) or its successor, the Uniform Fraudulent Transfer Act (UFTA), 7A Pt. II ULA 2 (43 states and the District of Columbia). The fraudulent transfer provisions found in the UFTA are similar to those in the FDCPA.

   Note:

   It is important to review the law of the state in which the transfer occurred. Many of the State Law Guides on the My SB/SE Counsel website include a discussion of applicable state law for fraudulent conveyances or other types of transferee liability. See http://ccintranet.prod.irscounsel.treas.gov/OrgStrat/Offices/sbse/Pages/LawGuides.aspx.

3. The FDCPA, the UFCA and the UFTA recognize both actual fraud and constructive fraud as grounds for setting aside a transfer.

5.17.14.2.3.2.2 (01-24-2012)
Types of Fraud in a Fraudulent Transfer

1. Constructive fraud and actual fraud are the two principal kinds of fraud. At least one of them must be proven to set aside a transfer.

   A. Proof of constructive fraud is sufficient to set aside a transfer that occurs after the debt arises. FDCPA § 3304(a); UFTA § 5; UFCA §§ 4 and 5.

   B. Proof of actual fraud will defeat a transfer whether the debt arises before or after the transfer. FDCPA § 3304(b); UFTA § 4; UFCA §§ 6 and 7.

2. Constructive fraud exists when property is transferred for inadequate consideration (or for less than the reasonably equivalent value) and the transferor either is insolvent when the transfer occurs or is made insolvent by the transfer. FDCPA § 3304(a); UFTA §§ 4(a)(2) and 5; UFCA §§ 6 and 7. A transferor's intent is immaterial if constructive fraud is proven. See IRM 5.17.14.2.3.2.2.1 .

3. Actual fraud occurs when property is transferred with the actual intent to hinder, delay, or defraud a creditor in the collection of a debt owed it. FDCPA § 3304(b); UFTA § 4(a)(1).

   A. It can be difficult to prove that a transfer was made with the actual intent to defraud a creditor. A fraudulent transfer usually is made without any verbal or written expression of the reason for the transfer.

   B. Because of this, actual fraud is generally proved through circumstantial evidence known as the "indicators of fraud," such as lack of adequate consideration or a transfer to insiders. For other indicators of fraud, see IRM 5.17.14.2.3.2.2.2(3), below.

4. The fact that a taxpayer is in debt does not preclude the taxpayer from transferring property for adequate consideration. A transfer founded on adequate consideration and made with a bona fide intent is valid against the United States. But see the discussions of preferential transfers in IRM 5.17.14.2.3.2.2.1(6) and the trust fund doctrine in IRM 5.17.14.2.3.3, below.

5.17.14.2.3.2.2.1 (01-24-2012)
Constructive Fraud

1. The United States may prove constructive fraud to set aside a transfer that occurs after the debt arises.

2. Constructive fraud exists when a transferor does not receive reasonably equivalent value (FDCPA & UFTA) or fair consideration (UFCA) in exchange for the transfer, and the transferor was insolvent at the time of the transfer or became insolvent as a result of the transfer.

3. Reasonably equivalent value is not defined by the FDCPA or the UFTA except that a purchaser at a regularly conducted non-collusive foreclosure sale is presumed to give reasonably equivalent value. FDCPA § 3303(b); UFTA § 3(b). The concept of reasonably equivalent value does not exist under the UFCA; instead, the concept of fair consideration is used.

4. Fair consideration for purposes of the UFCA is given in exchange for property if:

   A. it is a "fair equivalent" to the property conveyed; and

   B. exchanged in good faith. UFCA § 3.

5. A transferor is insolvent if the sum of the transferor's debts exceeds a fair valuation (FDCPA & UFTA) or the fair salable value (UFCA) of the transferor's assets. FDCPA § 3302; UFTA § 2; UFCA § 2.

A. The FDCPA and the UFTA presume that a transferor who generally is not paying debts as they come due is insolvent.

B. Where insolvency results from a series of related transfers, some of which may have occurred before actual insolvency, all of the transfers can be set aside as fraudulent.

6. The FDCPA and the UFTA contain another category of transfers which are considered fraudulent as to a current creditor. A transfer is fraudulent if:

- the transfer was made to an insider on account of an antecedent (prior) debt;
- the transferor was insolvent at the time; and
- the insider had reason to believe that the transferor was insolvent when the transfer occurred.

This is commonly known as a preferential transfer to an insider. FDCPA § 3304(a)(2); UFTA § 5(b). Examples of insiders include:

- family members, when the transferor is an individual
- directors and officers, when the transferor is a corporation
- general partners and relatives of general partners, when the transferor is a partnership. FDCPA § 3301(5); UFTA § 1(7).

5.17.14.2.3.2.2.2 (01-24-2012)
Actual Fraud

1. Proof of actual fraud as to a debt owed to the United States is sufficient under the FDCPA, the UFCA and the UFTA to set aside a transfer whether the debt arises before or after the transfer. FDCPA § 3301(5); UFCA § 7; UFTA § 4(a)(1).

2. Actual fraud exists when a transferor actually intended to hinder, delay or defraud a creditor. Because it can be difficult to prove that a transfer was made with the actual intent to defraud creditors, use of circumstantial evidence, "indicators of fraud," is often necessary.

3. A transferor's actual intent is generally proved through the indicators of fraud. The commonly recognized indicators of fraud include:

- the transfer lacks fair consideration;
- the transferor and transferee are closely related, such as family members, or a shareholder and the shareholder's closely held corporation;
- the transferor retains the enjoyment, possession and control of the property after its transfer;
- the transfer was concealed;
- before the transfer, the transferor had been sued or was threatened with suit;
- substantially all of the transferor's assets were transferred;
- the transferor left the jurisdiction secretly;
- the transferor removed or concealed assets;
- the transferor was insolvent at the time of transfer or became insolvent shortly after the transfer occurred;
- the transfer occurred shortly before or after a substantial debt was incurred; or
- the transferor transferred the essential assets of a business to the holder of a lien who subsequently transferred the assets to an insider. See FDCPA § 3304(b)(2); UFTA § 4(b).

4. The adequacy of the consideration for the transfer is an important indicator of fraud. United States v. Green, 201 F.3d 251 (3d Cir. 2000); United States v. Denlinger, 982 F.2d 233 (7th Cir. 1992).

   A. A person cannot give property away if it is to the detriment of creditors. If some consideration has changed hands, it may be necessary to determine whether the consideration was merely a "cover" for a fraudulent transfer.

   B. Although the possibility exists of proving that a transfer was fraudulent even if consideration changed hands, the presence of adequate consideration is a strong defense.

5. A transfer of all or nearly all of a taxpayer's property which leaves the taxpayer without any means of paying creditors is highly indicative of fraud. It must be determined, however, whether this property was transferred in an attempt to pay the transferor's debts. If so, there may be no basis to invalidate the transfer without showing that the United States had legal priority over the creditors who were paid.

6. A transfer made shortly before or after the tax is due may be evidence of fraud. United States v. Scherping, 187 F.3d 796 (8th Cir. 1999); United States v. Parks, 91-1 USTC ¶ 50,263 (D. Utah 1991).

7. In attempting to set aside a transfer, it is helpful to show that the transaction was not made in the usual course of business. Examples of this are:

- a sale made outside of usual business hours;
- a failure to record an instrument that would normally be recorded;
- an extension of credit for an unusually long period of time to a purchaser without security; and
- a failure by the transferee to properly inventory goods transferred to him.

8. A reservation of an interest in the transferred property that is inconsistent with a bona fide transfer indicates fraud.

9. The FDCPA, the UFTA and the UFCA also consider a transfer of property without receipt of reasonably equivalent value (FDCPA and UFTA) or fair consideration (UFCA) to be fraudulent, whether the debt arises before or after the transfer, if the transferor:

   A. was engaged in or was about to engage in a business or a transaction for which the remaining assets of the transferor were unreasonably small in relation to the business or transaction, or

   B. intends or believes that he will incur debts beyond his ability to pay as they mature. FDCPA § 3304(b)(1)(B); UFCA §§ 5 & 6; UFTA § 4(a)(2).

5.17.14.2.3.2.3 (01-24-2012)
Subsequent Transfers

1. A good-faith purchaser from a transferee of the transferred property generally takes the property free of the initial transferor's fraud. The same holds true for a creditor who in good faith extends a loan to the transferee and takes a security interest in the transferred property.

2. A subsequent transferee with notice of the fraudulent transfer is subject to the rights of creditors of the initial transferor.

5.17.14.2.3.3 (01-24-2012)
Trust Fund Doctrine

1. Transferee liability may also exist based on the trust fund doctrine, a judicially created equitable doctrine. The theory behind the doctrine is that when a transfer leaves the transferor without enough assets to pay debts, the transferee holds the transferred property in trust for the benefit of the transferor's creditors.

2. Although you should look to the specific requirements under the relevant state case law, the trust fund doctrine generally requires the Service to show that -

   A. the alleged transferee received property of the transferor;

   B. the transfer was made without consideration or for less than adequate consideration;

   C. the transfer was made during or after the period for which the tax liability of the transferor accrued;

   D. the transferor was insolvent prior to or because of the transfer of property or that the transfer of property was one of a series of distributions of property that resulted in the insolvency of the transferor;

   E. all reasonable efforts to collect from the transferor were made and that further collection efforts would be futile; and

   F. the value of the transferred property.

3. The trust fund doctrine is most commonly used to impose transferee liability on a shareholder for taxes incurred by a corporation when the shareholder receives assets from a corporation prior to its dissolution. See, e.g., Benoit v. Commissioner, 238 F.2d 485, 491 (1st Cir. 1956). Recovery under the doctrine is limited to the value of the property transferred. Many states have also enacted statutes to permit creditors of a corporation to sue shareholders. See IRM 5.17.14.2.3.5, *Transferee Liability of a Shareholder or Distributee of a Corporation*.

   Note:

   Application of the "trust fund doctrine" as used here should not be confused with the assertion of the "trust fund recovery penalty" under IRC § 6672. IRC § 6672 directly imposes liability on a third party – the person required to collect, truthfully account for, and pay over any tax imposed who willfully fails to do so.

5.17.14.2.3.4 (01-24-2012)
Successor Liability of a Corporation as a Transferee

1. Successor liability may arise under two different scenarios. A successor corporation may be liable as transferee when it is -

   A. a corporation surviving or resulting from a merger, consolidation or reorganization of one or more corporations; or

   B. a corporation to which all or substantially all of the assets of another corporation has been sold or otherwise transferred.

2. Successor liability may be primary liability if a state statute provides that a corporation surviving or resulting from a merger or consolidation assumes by operation of law all of the liabilities of the constituent corporations. See IRM 5.17.14.5, *Successor Liability as Primary Liability*, for more information.

3. State law governing successor liability generally imposes liability in the following circumstances:

   A. when the successor expressly or impliedly assumes the liabilities;

   B. when a corporation reorganizes, merges or consolidates with another corporation;

   C. when one corporation transfers its assets to another corporation but the corporations do not formally merge, there may nevertheless be a de facto merger or the successor may be considered a mere continuation of the corporation selling or transferring assets; or

   D. the transaction amounts to a fraudulent conveyance.

   In these instances, the government may rely on successor liability doctrine to hold a successor corporation liable for the tax debts of its predecessor. Given the potential for differences in state law, consultation with Area Counsel is important.

4. Because whether the successor assumed the transferor's liabilities will generally be a contract interpretation issue, the more difficult instances for the government to establish successor liability are when there is a de facto merger or the seller is a mere continuation. When determining whether a de facto merger or mere continuation exists, courts may look at whether:

   A. the second corporation continues the business or performs the same functions of the taxpayer;

   B. the taxpayer's employees become the employees of the second corporation;

   C. the taxpayer and the second corporation are owned or controlled by the same individual or individuals;

   D. the successor's business activities are carried out in the same location;

   E. less than full consideration is paid for the transferred assets; and

   F. the business relationships remain relatively static.

5. If the surviving corporation may be held liable for the transferor's debts as a successor under either a statute imposing liability or case law, the transferor's tax liability may be collected from the successor using the IRC § 6901 procedures. See IRM 5.17.14.5, *Successor Liability as Primary Liability*, for additional discussion.

5.17.14.2.3.5 (01-24-2012)
Transferee Liability of a Shareholder or Distributee of a Corporation

1. Shareholders/distributees who receive assets from a corporate liquidation can be subject to transferee liability for the unpaid corporate income taxes, penalties and interest.

2. Shareholders who receive assets of a corporation on its dissolution and who are liable as transferees are jointly and severally liable to the extent of the assets transferred to them. The Service is not obligated to pursue all of the shareholders for collection of the corporation's unpaid income taxes. Since the liability of a shareholder, however, is generally limited to the value of the assets received from the corporation, it may be necessary as a practical matter to pursue all shareholders in order to collect the full liability.

3. Shareholders/distributees may also be liable as transferees when assets are distributed but the corporation is not liquidated or dissolved. The liability in the following examples would most likely be based on a fraudulent transfer:

A. A distribution to a shareholder based on the shareholder's equity interest in a corporation, such as a dividend, or a payment by the corporation of a debt owed to a shareholder, can be a preferential transfer to an insider, thus, resulting in transferee liability. See IRM 5.17.14.2.3.2.2.1 .

B. If a stockholder is also an officer or an employee of the corporation, and receives a bonus or salary which is unreasonable, the stockholder may be treated as a transferee on the theory that the excessive salary is the equivalent of a distribution of corporate assets.

4. A corporation or person who acquired the stock or any asset of a corporation may be liable as a transferee.

   A. If the acquisition of assets is a fraud to the creditors of the transferor corporation, the acquiring corporation is liable as a transferee based on a fraudulent transfer. See IRM 5.17.4.2.3.2, *Transferee Liability Based on Fraudulent Transfers*. A sale or distribution of corporate assets may also result in a trust in favor of creditors under the trust fund doctrine. See IRM 5.17.14.2.3.3, *Trust Fund Doctrine.*

   B. Transferee liability may arise in a stock or asset sale context, where the sale is in economic substance a "sham." This liability is most likely to be based on a fraudulent transfer. See IRM 5.17.14.2.3.2, *Transferee Liability Based on Fraudulent Transfers.*

   C. The purchase of the stock of a corporation, followed by the liquidation of the corporation, may render the purchaser liable as a transferee as a successor. See IRM 5.17.14.2.3.4, *Successor Liability of a Corporation as Transferee.*

5. Transferee liability may also be a consideration in Notice 2001-16 intermediary transaction tax shelters. These listed transactions are basically intended to avoid the payment of taxes on a corporate stock or asset sale. The participants to the transaction — the seller's shareholders, the buyer, the intermediary, and the transaction's facilitators — may all be possible transferees. Their potential liability for unpaid taxes resulting from the transaction will depend on the facts of the case and the proper tax treatment of the transaction. Intermediary transaction tax shelters may also be analyzed under any of the other transferee liability theories listed above, depending on the facts of the case.

5.17.14.2.4 (01-24-2012)
Extent of Transferee Liability

1. The amount of the transferee's liability for the transferor's unpaid tax, penalties, and interest depends on whether transferee liability is based "in equity" or "at law."

2. When transferee liability is based "in equity," the transferee's liability is generally limited to the value of the property transferred.

   A. For example, liability of shareholders under the trust fund or similar doctrine is limited to the value of property received. Phillips-Jones Corporation v. Parmley, 302 U.S. 233, 237 (1937).

   B. Transferee liability in equity is equal to the value of transferred property at the time of transfer. However, if the value has decreased since the transfer, the liability may be equal to the value of the property at the time the transfer is found to be fraudulent by a court. See United States v. Verduchi, 434 F.3d 17 (1st Cir. 2006).

3. Generally, transferee liability "at law" is full liability, regardless of the value of the assets received, unless limited by state or federal law or by agreement.

   A. When transferee liability is "at law" because the transferee has agreed to assume the transferor's liability, the transferee is liable for the full amount of the transferor's liability, regardless of the value of the assets transferred. Bos Lines, Inc. v. Commissioner, 354 F.2d 830, 837 (8th Cir.1965), aff'g T.C. Memo.1965-71.

   B. Where transferee liability is based on state law, state law determines the extent of liability. Commissioner v. Stern, 37 U.S. 39, 44-45 (1940).

   C. Liability is not limited to the value of the assets transferred if there is a reorganization, merger, consolidation, or the successor corporation is the result of a de facto merger or a mere continuation of the taxpayer. See, e.g., Atlas Tool v. Commissioner, 70 T.C. 86, 113-14 (1978), aff'd, 614 F.2d 860 (3d Cir. 1980).

   D. Shareholder liability is limited to the value of the distribution to the shareholder where a state statute imposes liability upon distribution of assets upon dissolution of a corporation if creditors have not been paid. See, e.g., C.D. Const. Corp. v. Commissioner, 451 F.2d 470 (4th Cir. 1971), aff'g T.C. Memo. 1970-297.

   E. Similarly, a transferee's liability for gift taxes and estate taxes, based on the Internal Revenue Code, is limited to the value of the gift or the property distributed from the decedent estate. IRC § 6324(a)(2) and (b).

   See IRM 5.17.14.2.3 , *Establishing Transferee Liability*, for further discussion on the distinction between "at law" liability and "in equity" liability.

4. Each transferee is jointly and severally liable for the transferor's unpaid taxes to the extent of the value of assets received at the time of transfer. The Service therefore is not required to apportion liability among transferees.
   Example: If three transferees each received transfers worth $20,000 and the transferor's liability is $15,000, then each transferee is liable for the entire $15,000 and not a mere pro rata share ($5,000). The Service may collect the liability from one, two, or all three of the transferees, subject to a total collection of $15,000.

5. A transferee is liable for interest under IRC § 6601 from the date that the transferee receives notice of transferee liability. Patterson v. Simms, 281 F.2d 577 (5th Cir. 1960).

6. Generally, a transferee is liable for the transferor's total tax liability, including IRC § 6601 interest that accrues on that tax liability before the transfer, but only to the extent of the value of the assets transferred.

7. If the value of the assets transferred is less than the transferor's total tax liability on the transfer date, the transferee is not liable for IRC § 6601 interest that continues to accrue on the transferor's tax liability after the transfer date. Estate of Stein v. Commissioner, 37 T.C. 945 (1962). Generally, the transferee's liability for the transferor's tax liability, including interest, is limited to the value of the property transferred to the transferee. The total liability imposed on the transferee may exceed the value of the transferred assets, however, if interest accrues under state law with respect to the assets. See Stansbury v. Commissioner, 102 F.3d 1033 (10th Cir. 1996). In this scenario, the existence, starting date, and rate of interest are controlled by state law.

8. If the value of the assets transferred is more than the transferor's total tax liability on the transfer date, the transferee is liable for IRC § 6601 interest that continues to accrue on the transferor's tax liability after the transfer date. Lowy v. Commissioner, 35 T.C. 393 (1960). Generally, the total liability imposed on the transferee, including interest, cannot exceed the value of the assets transferred to the transferee. If the excess value of the assets becomes exhausted by the imposition of IRC § 6601 interest, the transferee may be liable for additional interest under state law with respect to the transferred assets.

9. Regardless of the value of assets transferred, federal law governs the imposition of interest once the notice of transferee liability is issued. A transferee is liable for interest under IRC § 6601 from the date of this notice to the date of payment.

10. A transferee of the initial transferee may be subject to liability for the tax of the transferor. A transferee of an initial transferee is liable if:

    - the initial transferee is liable and
    - there is a basis for transferee liability of the subsequent transferee (such as a fraudulent transfer from the initial transferee).

11. The liability of a subsequent transferee is generally limited to the value of the property received (see (1) – (9) above).

    Note:

    Remember, however, that a good-faith purchaser from a transferee of the transferred property generally takes the property free of the initial transferor's fraud. See IRM 5.17.14.2.3.2.3.

5.17.14.3 (01-24-2012)
Fiduciary Liability

1. Pursuant to 31 USC § 3713(b), a representative of a person or an estate (except a trustee acting under the Bankruptcy Code, Title 11) paying any part of a debt of the person or estate before paying a debt due to the United States is personally liable to the extent of the payment for unpaid claims of the United States. See IRM 5.17.13.5, *Elements of 31 USC § 3713(a)*, for additional discussion.
2. A fiduciary is not liable unless the fiduciary knows of the debt or had information that would put the fiduciary on notice that an obligation was owed to the United States.
3. Personal liability under 31 USC § 3713(b) only applies where the United States has priority under 31 USC § 3713(a), the applicable insolvency statute.
   A. The priority generally applies where the person or estate is insolvent.
   B. The priority is superseded by interests that would have priority over the federal tax lien under IRC § 6323.
4. Personal liability is limited to the value of the assets that the fiduciary distributes in violation of federal priority.
5. Prior to enactment of IRC § 6901, the United States proceeded against a fiduciary by means of a suit filed in a federal district court. This procedure is still available. See IRM 5.17.14.4.4, *Establishing Transferee or Fiduciary Liability by Suit,*.
6. IRC § 6901(a)(1)(B) permits the Service to impose personal liability on a fiduciary under 31 USC § 3713(b) by way of a procedure commenced with the issuance of a notice of fiduciary liability. The fiduciary may then contest the proposed liability in the Tax Court. See IRM 5.17.14.4.2, *Assessing Liability under IRC § 6901*.
7. Fiduciary liability is discussed in IRM 5.17.3.8, *Personal Liability of the Fiduciary Under 31 USC § 3713(b)*.

5.17.14.4 (01-24-2012)
Methods of Collecting from a Transferee or Fiduciary

1. **IRC § 6901 Procedures**. The government may invoke the procedures under IRC § 6901, which provides a mechanism for collecting the unpaid taxes, penalties and interest from a transferee or fiduciary when a separate substantive legal basis provides for the transferee's or fiduciary's liability. An assessment under IRC § 6901 allows for collection against any assets held by the transferee or fiduciary.

   Note:

   IRC § 6901 is strictly a procedural statute that does not by itself create any liability. The existence or extent of a transferee's or fiduciary's liability is determined by applicable state or federal law. The procedures for assessing transferee liability under IRC § 6901 are discussed at IRM 5.17.14.4.1.
2. **District Court Suit**. The government may also use judicial enforcement remedies to pursue collection of the tax liability. The government may bring an action in district court against a transferee or fiduciary to impose transferee or fiduciary liability, discussed at IRM 5.17.14.4.4, or a suit to set aside a fraudulent conveyance, discussed at IRM 5.17.14.4.6.
3. **Administrative Remedies**. If a Notice of Federal Tax Lien was properly filed before the transfer, then the lien will generally take priority over any subsequent transferees, purchasers, or other interests. See IRC § 6323. If this is the case, the federal tax lien can be enforced by levy/seizure without recourse to the IRC § 6901 procedures or filing suit in federal district court. See IRM 5.17.3.4.1(5).
4. If legal title to property has been transferred by the transferor or fiduciary and no lien attached prior to the transfer, the Service generally may not levy or seize the property without first making an assessment against the transferee under IRC § 6901 or filing suit in district court. This general rule is subject to two exceptions:
   A. The filing of a lien and serving of a levy or seizure may be permissible if the transferor has retained an equitable interest in the property by continuing to assert dominion or control over the transferred property. This is the nominee or alter ego situation, described more fully at IRM 5.17.14.6.
   B. If state law permits the creditors of the transferor to immediately levy or execute against a fraudulent transfer even when it is in the hands of the transferee without first obtaining a judgment setting aside the transfer, the Service should be entitled to levy or seize the transferred property, as well as file a notice of lien against such property. Consult with Area Counsel to determine whether state law permits such action in a particular case.

5.17.14.4.1 (01-24-2012)
Assessing Transferee and Fiduciary Liability

1. The following provisions describe how the Service administratively imposes liability for the transferor's tax liability on a transferee or fiduciary. The liability may then be collected from *any* of the transferee's or fiduciary's property. This approach is generally preferable when the value of the property has decreased since the transfer.
2. To hold a transferee or fiduciary liable for another's tax, the Service mails a notice of transferee or fiduciary liability to the transferee or fiduciary's last known address. Then if a Tax Court petition is not filed or if the liability is sustained by the Tax Court, the Service can assess the tax against the transferee under the authority of IRC § 6901. See IRM 5.1.14.2.1, *Report of Investigation of Transferee Liability*, and IRM 4.8.8.13.4, *Statutory Notice of Transferee Liability*, for more information.

5.17.14.4.2 (01-24-2012)
Assessing Liability Under IRC § 6901

1. IRC § 6901 provides a procedure by which the Service may assess and collect the unpaid taxes, penalties, and interest:
   - from a transferee or
   - from a fiduciary liable under 31 USC § 3713.
2. IRC § 6901 is strictly a procedural statute; it does not create the substantive liability of a transferee for the transferor's tax debt. The existence of, or extent of, a transferee's liability is determined by applicable state or federal law. Commissioner v. Stern, 357 U.S. 39 (1958).
3. A transferee's liability may be established at law, e.g., by contract, or under a state or federal law directly imposing liability on the transferee. Liability may also be established in equity, which is based on fraudulent transfer statutes. IRC § 6901(a).
4. The procedures for establishing transferee and fiduciary liability under IRC § 6901 are similar to the deficiency procedures.
   A. A notice of transferee or fiduciary liability must be mailed to the last known address of the transferee or fiduciary.
   B. The transferee or fiduciary may petition the Tax Court within 90 days.
   C. The liability will be assessed against the transferee or fiduciary if:
      • the Tax Court enters a decision against the transferee or fiduciary;
      • the transferee or fiduciary defaults on the notice of liability; or
      • the transferee or fiduciary agrees to an assessment of the liability.
   D. Once the liability is assessed, and after notice and demand and a refusal to pay, a lien is created which attaches to all property of the transferee or fiduciary. A Notice of Federal Tax Lien must be filed to protect the Service's interests under IRC § 6323.
   E. The assessment may be collected administratively from all property and rights to property of the transferee or fiduciary.
   F. The period for collection of the assessment against the transferee is the IRC § 6502 collection statute of limitations (10 years running from the assessment against the transferee).

See IRM 5.1.14.2.1, *Report of Investigation of Transferee Liability*, for procedures for initiating a transferee assessment.

5. A transferee is defined under IRC § 6901(h) to include a donee, heir, legatee, devisee, and distributee, and with respect to estate taxes, any person who, under IRC § 6324(a)(2), is personally liable for such tax.

   A. The regulations add the following examples to the definition of a transferee: a distributee of an estate of a deceased person, a shareholder of a dissolved corporation, the assignee or donee of an insolvent person, the successor of a corporation, a party to a reorganization as defined in IRC § 368, all other classes of distributees, and with respect to the gift tax, a donee. Treas. Reg. § 301.6901-1(b).

   B. These definitions are not all-inclusive, but are merely examples of transferees.

6. Assessments against a transferee can be made under IRC § 6901 for a transferor's:

   - income tax, estate tax or gift tax; or
   - other taxes, such as employment taxes, if the transferee's liability arises out of a liquidation of a partnership or corporation, or a corporate reorganization under IRC § 368(a).

7. Assessments against a fiduciary can be made under IRC § 6901 for the income tax, estate tax or gift tax due from the estate of a taxpayer, decedent or donor. IRC § 6901(a)(1)(B).

8. The transferee or fiduciary may be assessed for any of the above-mentioned taxes shown on a return or for any deficiency or underpayment of these taxes. IRC § 6901(b).

9. The periods of limitations under IRC § 6901(c) for the assessment of the liability of a transferee or fiduciary are:

   A. For an initial transferee, one year after the assessment period against the transferor ends.

   B. For a transferee of a transferee, one year after the period for assessment against the preceding transferee ends, but not more than three years after the period for assessment against the transferor ends.

   C. If, however, before the end of the period for assessment against the transferee, a court proceeding to collect the tax is begun against the transferor or the last preceding transferee, then the period for assessment against the transferee expires one year after the "return of execution" in the court proceeding (when the officer charged with carrying out a judgment returns the order to the court stating the judgment has been executed).

   D. For a fiduciary, one year after the fiduciary liability arises or the period for collection of the tax ends, whichever is the later.

10. Under IRC § 6901(d), the periods mentioned above may be extended, prior to expiration, by agreement. In the case of a transferee of a transferee, however, the execution of an extension agreement by the initial transferee is not effective to extend the overall three-year limitations period discussed above in paragraph (9)(b) of this subsection.

11. If a notice of liability has been mailed to a transferee or fiduciary, the running of the statute of limitations for assessment is suspended for the period during which an assessment is prohibited by IRC § 6213 and for 60 days thereafter. IRC § 6901(f).

12. Where the statute of limitations on assessment with respect to the transferor is open because of the transferor's tax fraud or his failure to file a tax return, then the statute of limitations remains open as to the transferee. See IRC § 6501(c).

13. Statutes of limitations for state fraudulent transfer statutes do not apply to IRC § 6901. Bresson v. Commissioner, 111 T.C. 172 (1998).

5.17.14.4.3 (01-24-2012)
Burden of Proof Under IRC § 6901

1. In a proceeding before the United States Tax Court under IRC § 6901, the burden is on the Service to prove that a transferee or fiduciary is liable for the tax of another. IRC § 6902(a).

2. A transferor's deficiency is presumed correct, but a transferee may prove otherwise. A transferee has the burden of proof on this issue, not the Service. IRC § 6902(a). When a court has already decided a transferor's tax liability, however, a transferee may not relitigate the issue. Jahncke Serv., Inc. v. Commissioner, 20 BTA 837 (1930).

3. To establish fiduciary liability under 31 USC § 3713(b), the Service has the burden to prove that the fiduciary paid a debt of the person or estate for whom the fiduciary is acting before paying the debts due the United States. The fiduciary is not liable unless the fiduciary knew of the tax debt or had information that would put a reasonably prudent person on notice that an obligation was owed to the United States. United States v. Coppola, 85 F.3d 1015 (2d Cir. 1996).

5.17.14.4.4 (01-24-2012)
Establishing Transferee or Fiduciary Liability by Suit

1. The United States may establish transferee or fiduciary liability by filing a suit in district court pursuant to IRC § 7402 and 28 USC §§ 1340 and 1345. This suit is brought against the transferee or fiduciary and results in a judgment against the third party, permitting collection from any of the transferee's or fiduciary's assets.

2. Since a suit to establish transferee or fiduciary liability is a collection suit, the ten-year statute of limitations in IRC § 6502 for suits to collect taxes applies. The ten-year statute of limitations provided for in IRC § 6324 from the date of death or the date of the gift applies for collection of estate and gift taxes if the suit is based on IRC § 6324 transferee liability.

3. A suit to establish transferee or fiduciary liability is not limited to certain types of taxes as are the assessment procedures of IRC § 6901. All types of taxes, including employment and excise taxes, can be collected in a transferee suit.

4. A suit to impose transferee liability may be necessary when the procedures of IRC § 6901 are not available because the statute of limitations for assessment has expired.

5. A suit to impose transferee liability may be preferable to assessment when:

   - the transferred property has depreciated in value;
   - the transferee has concealed, disposed of, or converted the transferred property; or
   - the transferee has commingled the transferred property with other property.

   Note:

   Where the value of the property has decreased following the transfer, the amount of any personal judgment against the transferee ordinarily cannot exceed the value of the property at the time of the transfer.

6. Where liability is sought to be imposed on a third-party for another's tax by way of a suit brought by the United States in a district court, the burden of proof is on the United States as the petitioning party. When a transferee files a refund suit, the burden of proof remains with the transferee.

7. The government may also bring a suit to collect against the transferred property in the hands of the transferee, also called a suit to set aside a fraudulent transfer. See IRM 5.17.14.4.6, *Suit to Set Aside a Fraudulent Transfer.*

5.17.14.4.5 (01-24-2012)
Defenses to Transferee or Fiduciary Liability

1. Proof by the transferee that the transferor's tax liability has been paid is a valid defense to transferee liability. The transferor's liability will be collected only once. A transferee's liability is extinguished once the tax liability is paid by the transferor or other transferee, and either the transferor waives any right to a refund or the period of limitations for seeking a refund has expired. Because a transferee's liability is secondary to the primary liability of the transferor, a compromise of the transferor's liability may either reduce or extinguish the liability of the transferee.
2. Acceptance of an offer to compromise a transferee's liability has no effect on the transferor's primary liability or on the liability of other transferees. Any payment by the transferee, though, reduces the transferor's liability and, thereby, the liability of other transferees.
3. A transferee may contest the liability of the transferor.
   A. No liability is imposed on the transferee if it is proven that the transferor is not liable for any tax.
   B. A prior decision on the merits of a tax liability of a transferor fixes the amount of the tax for purposes of a transferee's liability. The transferee is barred from litigating the transferor's liability, just as the transferor would be barred from relitigating the transferor's liability in another forum.
4. To determine whether there is a prior decision on the merits, specific information regarding the resolution of the litigation must be obtained.
   - A decision on the merits includes a determination by a court following a trial or an agreed stipulation of a tax liability.
   - A voluntary dismissal prior to entry of a decision by a court or a dismissal for lack of jurisdiction is not considered to be a determination on the merits. In such a case, the transferee can later litigate the transferor's tax liability in another forum.
   - A defaulted notice of deficiency is not a decision on the merits.
   - A closing agreement between a transferor and the Service binds the transferee.
5. Other defenses include:
   A. the expiration of the statute of limitations;
   B. return of all or a part of the transferred property;
   C. any other defense that can be used for the type of liability asserted (e.g., that the Service has not exhausted its remedies against the transferor).
6. For defenses of a fiduciary, see IRM 5.17.13.9, *Asserting Personal Liability Against a Fiduciary*.

5.17.14.4.6 (01-24-2012)
Suit to Set Aside a Fraudulent Transfer

1. Rather than a suit to impose liability on the transferee, the United States may commence a civil lawsuit against the transferor and the transferee in a United States district court when the original taxpayer transferred property in fraud of a tax debt owed to the United States. Ordinarily, the suit requests that the court set aside the transfer. If successful, ownership of the property is reinstated in the transferor, and the transferor's tax is collected from the property. This approach is generally preferable when the value of the property has increased since the transfer.
2. The relief requested from the court is:
   - to set aside the transfer,
   - to reinstate the transferor's ownership of the property, and
   - to order the property sold to pay the transferor's debt.
3. The right of the United States to set aside a fraudulent transfer is found in federal law and in state law.
   A. The Federal Debt Collection Procedures Act (FDCPA) provides a federal cause of action for setting aside a fraudulent transfer in a federal district court, other than the United States Tax Court. 28 USC § 3301 et seq.
   B. The United States may also use all of the remedies available to a private creditor under applicable state law to defeat a fraudulent transfer. Generally, the law of the state in which the transfer occurs will govern.
4. In a suit to obtain relief with respect to a fraudulent transfer, the burden is on the United States to prove that the transfer of the property was in fraud of a debt owed the United States. Depending on the circumstances, the United States must prove that the transfer was the result either of the transferor's actual fraud or constructive fraud.
5. Generally, the focus of the cause of action is the transferred property (an "in rem" action). Usually, a personal judgment is not rendered against the transferee. See FDCPA § 3307(b).
6. Generally, a suit to set aside a fraudulent transfer is combined with a suit to foreclose any liens for the transferor's taxes which attach to the transferred property once the transferor's ownership in the property has been reinstated. If a Notice of Federal Tax Lien was properly filed before the transfer, then the lien will encumber the property in the hands of any transferee and normally have priority. See IRC § 6323. Thus, an administrative collection action or a lien foreclosure action can be considered in lieu of a fraudulent transfer suit.
7. A suit to set aside a fraudulent transfer may also be combined with a suit to impose personal liability on a transferee if the transferred property has depreciated in value. See IRM 5.17.14.4.4. The extent of the personal liability would be the difference between the value of the property when transferred and the value of the property when it is sold by order of the district court.

5.17.14.4.6.1 (01-24-2012)
Statute of Limitations for a Fraudulent Transfer Suit

1. A fraudulent transfer suit brought by the United States under IRC § 7402(a) to impose transferee liability on a transferee to collect on an assessment against the transferor is subject to the statute of limitations on collection of a tax imposed by IRC § 6502 (ten years after assessment against the transferor, plus applicable extensions). See also FDCPA, 28 USC § 3003(b)(1) (FDCPA does not impose time limits on actions to collect taxes brought under provisions outside the FDCPA).
2. It is the position of the majority of the courts that the United States is not bound by any state statute of limitations, including the UFTA (generally, four years after transfer). Thus, in a fraudulent transfer suit brought by the United States pursuant to IRC § 7402(a) and a state statute, the limitations period under IRC § 6502 should control.
3. Where the United States brings a suit under the fraudulent transfer provisions of the FDCPA, those provisions generally impose a six-year limitations period. See FDCPA, 28 USC § 3306(b). However, the FDCPA also provides that its provisions shall not be construed to curtail or limit the right of the United States under any other Federal law to collect taxes. See FDCPA, 28 USC § 3003(b)(1). Accordingly, an argument could be made that the United States may rely on whichever limitations period is longer, ten years from assessment against the transferor under IRC § 6502, or six years from the fraudulent transfer to the transferee under the FDCPA, 28 USC § 3306(b).

   Note:

If it is anticipated that the suit will be brought under the fraudulent transfer provisions of the FDCPA and the six year statute of limitations under the FDCPA is imminent or has expired, consult with Area Counsel to determine whether the argument can be made that the ten-year statute of limitations applies in the particular case. To avoid the issue, suits relying upon the FDCPA to set aside a fraudulent transfer should be filed within the six year statute of limitations whenever possible.

5.17.14.4.6.2 (01-24-2012)
Defenses for the Transferee in a Fraudulent Transfer Suit

1. A transferee who takes property in good faith and for a reasonably equivalent value is not affected by a transferor's actual fraud. The transferee's rights in the transferred property are superior to the transferor's creditors, and the transfer will not be set aside. FDCPA § 3307(a); UFTA § 8(a).
2. To be considered a good faith purchaser, the transferee must be without knowledge of the fraudulent purpose of the transferor at the time of the transfer and at the time consideration passes between them.
3. To qualify as a purchaser for reasonably equivalent value, the transferee must have exchanged property for the transfer. A promise to pay or payment with a nonnegotiable note is not sufficient.
4. If the transferee is not a good faith purchaser for reasonably equivalent value, then the transferee will be ordered to surrender the property or an equivalent amount of money. The transferee also is subject to an accounting for any rents or profits generated by the transferred property.
5. Even though a transfer is set aside as fraudulent, a good-faith transferee is allowed a credit for any consideration given to the transferor. The credit may be in the form of a lien on the transferred property or a setoff against any money judgment entered against the transferee. The transferee also will receive a credit for amounts expended to preserve the transferred property.
6. Another defense available to a transferee is a claim that he has paid other creditors of the transferor to the extent of the value of the transferred property.
7. The defense of "laches" (which will bar a lawsuit that is filed so unreasonably late that it is unfair to the party sued) does not apply to an action by the United States to set aside a fraudulent transfer.

5.17.14.4.7 (01-24-2012)
Considerations: Assess Under IRC § 6901 or File Suit

1. The advantages of using IRC § 6901 procedures are:
   A. Following the assessment, the IRS may use all administrative collection procedures and may file lien notices against the transferee or fiduciary. The federal tax lien attaches to all the property of the transferee or fiduciary.
   B. Use of IRC § 6901 procedures is consistent with the general preference for resorting to administrative collection before judicial collection.
2. The advantages of a district court suit are:
   A. The limitations period for bringing suit to assert transferee or fiduciary liability is generally longer than the limitations period for administratively asserting transferee liability.
   B. Transferee liability can be asserted for any type of tax. The IRC § 6901(a) limitations do not apply.
   C. In one action, the government may reduce a liability to judgment, establish transferee or fiduciary liability (or, alternatively, set aside a fraudulent transfer) and foreclose a lien. If the court orders a sale, it will be able to give clear title, thereby increasing what a purchaser is willing to pay over what a purchaser would pay at an administrative sale of seized property.
   D. If the property has increased in value, a suit to set aside a fraudulent transfer allows for recovery of the increased value of the property.

   Note:

   If the property has decreased in value, both the IRC § 6901 procedure and a suit to impose transferee liability are preferable to a suit to set a aside a fraudulent transfer.

5.17.14.5 (01-24-2012)
Successor Liability as Primary Liability

1. Many state corporate merger and consolidation statutes provide that a surviving corporation is liable for the debts of a predecessor corporation when the surviving corporation is the result of a formal merger or consolidation of two corporations. In these cases, the surviving corporation is primarily liable for the tax debts of the predecessor corporation as a successor in interest. The successor in interest becomes the taxpayer and is primarily liable for the predecessor's tax liability. Oswego Falls Corp. v. Commissioner, 26 B.T.A. 60 (1932).
2. The government should generally handle successor liability cases by asserting primary liability against the successor. The government may also seek to hold the successor liable as transferee under the IRC § 6901 procedures. See Southern Pacific Transportation Company v. Commissioner, 84 T.C. 367 (1985). See also IRM 5.17.14.4.2, *Assessing Liability Under IRC § 6901*.

   Note:

   A number of courts have held that a successor corporation cannot be primarily liable and liable as a transferee based on the same legal theory. See, e.g., Commissioner v. Oswego Falls Corp., 71 F.2d 673, 676 (2d Cir. 1934). Although the Service does not agree with this holding, it is advisable to identify a separate legal basis for liability of the successor as transferee before resorting to the IRC § 6901 procedures. Consult Area Counsel before recommending the pursuit of an assessment against the successor under IRC § 6901.
3. Like nominee or alter ego scenarios, a taxpayer's liability may be collected from the successor in interest using administrative collection procedures. This is assuming that a valid assessment exists against the original corporate taxpayer because the successor corporation steps into the shoes of the transferor corporation. Although the government may rely on foreclosure of the secret lien against the successor, a new notice of federal tax lien against the successor naming the successor corporation (corporation X, as successor to taxpayer A) should be filed to preserve the government's priority over other creditors.
4. Successor liability may also be established in federal district court pursuant to IRC § 7402(a) and 28 USC §§ 1340 and 1345. The ten-year statute of limitations under IRC § 6502 for the original corporation's tax liability applies to collect from the successor corporation.
5. If it appears that successor liability may apply, consult Area Counsel for approval before taking any collection action against the successor corporation.

5.17.14.6 (01-24-2012)
Nominee and Alter Ego Doctrines

1. Nominee
   - A tax liability may be collected from the taxpayer's property held by a nominee.
   - In a nominee situation, the taxpayer places the taxpayer's assets(s) in the name of another person or entity, but control of the asset(s) and other incidents of ownership remain with the taxpayer. The transfer is "in name only." In other words, in a nominee situation, a separate person or entity, such as a trust, holds specific property for the exclusive use and enjoyment of the taxpayer.

- Generally, specific property being held by the nominee must be identified and listed on a notice of federal tax lien filed against the nominee.
- The nominee theory focuses on the relationship between the taxpayer and the transferred property. See IRM 5.17.2.5.7.2 for factors used to show the presence of a nominee situation.
- If it is determined that a nominee situation may exist, consult Area Counsel before instituting administrative collection action against the nominee.

2. Alter Ego
   - A tax liability may also be collected from the taxpayer's alter ego.
   - In an alter ego situation, the taxpayer usually establishes an entity (often a corporation) and transfers assets to it, but there is such a unity of ownership and interest between the taxpayer and the entity such that the entity is not considered a genuine separate entity. In other words, an alter ego is an entity that is legally distinct from the taxpayer, but is so intermixed with the taxpayer that their affairs (and assets) are not readily separable. As a result, the entity should be considered the same as the taxpayer for collection purposes.
   - All of the assets owned by the alter ego may be used as a source from which to collect the taxpayer's tax liability.
   - The alter ego theory focuses on the relationship between the taxpayer and alleged alter ego entity. See IRM 5.17.2.5.7.1 for factors used to show the presence of an alter ego.
   - If it is determined that an alter ego may exist, consult Area Counsel before instituting administrative collection against the alter ego.
3. Nominee and alter ego situations are distinguishable from transfers for which transferee liability may be asserted, including fraudulent transfers. Although they often share common facts and one case can involve both concepts, nominee and alter ego situations are different from fraudulent transfers in the following respects:
   A. Transfer of Legal Title Not Required. A transfer of legal title is not necessary to prove a nominee or alter ego relationship exists. Holman v. United States, 505 F.3d 1060, 1064-65 (10th Cir. 2007) (nominee lien against property purchased by nominee with money from the taxpayer is permissible). Nominee or alter ego theories can be used when there has been an indirect transfer by the taxpayer or when there are problems proving a fraudulent transfer occurred. For example, the taxpayer was not insolvent at the time of the transfer or was not rendered insolvent by the transfer, or a transfer may have occurred well before the tax liability accrued. Insolvency or the accrual of taxes near the date of transfer must be shown to prove a transfer was fraudulent.

   B. Simulated Transfer Versus Actual Transfer.
   i) If a transfer has occurred, the nominee and alter ego situations are based on simulated transfers. Often, the simulated transfer may be to a fictitious entity owned and controlled by the taxpayer. See United States v. Klimek, 952 F. Supp. 1100 (E.D. Pa. 1997). The simulated transfer is not intended to divest the transferor of any rights to the property.
   Example: In the nominee scenario, there may be a transfer to a third party while the taxpayer actually retains the benefit and use of the property or with the understanding that the property will be returned to the transferor after the transferor's creditors lose interest in collecting their claims.
   Example: In the alter ego scenario, the taxpayer may transfer property to an entity owned and controlled by the taxpayer to shield assets from creditors.

   Note:

   In both examples, the transfer is a sham and taxpayer remains the true owner.

   ii) In most situations in which transferee liability may be asserted, including fraudulent transfers, the parties intend to effect an actual transfer of property or an interest in property. Between the transferor and the transferee, the transfer is valid under contract law. In contrast to the nominee or alter ego situation, transferee liability is generally only asserted when the taxpayer has transferred both legal title and control over the property to the transferee.

5.17.14.6.1 (01-24-2012)
Enforcement in Nominee and Alter Ego Situations

1. A taxpayer's liability can be collected from the taxpayer's property held by a nominee or alter ego using administrative collection procedures.The purported transfer is ignored and the IRS can rely on an assessment made against the taxpayer and a lien filed in the name of the taxpayer. To protect the priority of the assessment lien against the liens and security interests of third parties, a notice of federal tax lien based on the assessment against the taxpayer should be filed in the name of the nominee or alter ego (as taxpayer's nominee/alter ego), and property seized or levied by a nominee or alter ego levy. Area Counsel approval is required to issue an alter ego or nominee lien or levy. See IRM 5.11.1.2.5, *Approval of Alter-Ego and Nominee Notices of Levy*; IRM 5.12.2.6.4.1, *Preparing Special Condition NFTLs (Nominee, Alter-Ego, and Transferee)*; IRM 5.12.2.6.5, *Preparing Nominee Liens*; and IRM 5.12.2.6.7, *Alter-Ego Liens*.
2. Field Collection should always work to fully develop the factual background of each particular case, but it may not be possible to develop sufficient facts to establish which theory best fits the case, or the available facts may suggest the application of more than one theory. In these cases, the Service may take the position that a taxpayer has transferred the property to a third party by means of a fraudulent transfer or, alternatively, that the taxpayer's property is held by a nominee or alter ego. Area Counsel is also available to assist in determining which legal theories apply given the specific facts of the case.
3. A suit in federal district court pursuant to IRC §§ 7402(a) and 7403 and 28 USC §§ 1340 and 1345 may be advisable under some circumstances as an alternative to levy/seizure to establish that the property is held by the taxpayer's nominee or that the legally separate entity is an alter ego of the taxpayer.
   - For example, a suit is advisable if the Service would like to maximize the sale of nominee or alter ego property, because a court will be able to give clear title to the property and potential buyers will pay more than if the property is seized and sold.
   - Similarly, if the property is encumbered and there is likely to be a dispute about the priority of lien or security interests, a suit would probably be the most prudent approach.
   - If the property to be collected from is a principal residence, a suit should be filed because judicial approval of the seizure of the residence would be required under IRC § 6334.
   - A suit may be in order if the expiration of the collection statute of limitations is near.
   - If there is some uncertainty about whether there was a fraudulent transfer or a nominee situation, a suit should be filed.
4. The ten-year statute of limitations under IRC § 6502 for collecting the taxpayer's liability applies to collect from nominees and alter egos, whether by levy or suit.

More Internal Revenue Manual

Part 5. Collecting Process

Chapter 17. Legal Reference Guide for Revenue Officers

Section 15. Termination and Jeopardy Assessments and Jeopardy Collection

5.17.15 Termination and Jeopardy Assessments and Jeopardy Collection

Manual Transmittal

October 23, 2014

Purpose

(1) This transmits revisions to IRM 5.17.15, Termination and Jeopardy Assessments and Jeopardy Collection.

Material Changes

(1) Reviewed and updated IRM where necessary for IRM references.

Effect on Other Documents

This material supersedes IRM 5.17.15, dated December 29, 2009.

Audience

SB/SE Revenue Officers

Effective Date

(10-23-2014)

Rocco A. Steco
Acting Director, Collection Policy
Small Business/Self-Employed

5.17.15.1 (12-29-2009)
Background

1. If collection of an unassessed liability is in jeopardy, the IRS may make an immediate assessment and pursue collection without the need to follow normal assessment and collection procedures. As soon as a "jeopardy assessment" is made, the tax, penalties, and interest become due and payable. IRC §§ 6851 and 6861. See IRM 5.1.4, *Jeopardy, Termination, Quick and Prompt Assessments*, for procedures for making jeopardy assessments.

2. Generally, if collection of a tax is in jeopardy, a jeopardy assessment has already been made. There may be situations, however, where the tax liability has already been assessed through normal procedures before a jeopardy determination is made. In either situation, when collection of the tax liability is in jeopardy, the IRS may immediately proceed to collect by levy without waiting the usual 10-day period after notice and demand to expire, IRC § 6331(a), or the 30-day period after notice of intent to levy is made, IRC § 6331(d). For procedures for issuing jeopardy levies without a jeopardy assessment, see IRM 5.11.3, *Jeopardy Levy without a Jeopardy Assessment.*

5.17.15.2 (10-23-2014)
Jeopardy Assessments Initiated by Collection

1. The term "jeopardy assessment," generally speaking, may refer to either a termination assessment under IRC § 6851, or a jeopardy assessment under IRC §§ 6861 and 6862. Both types of assessment are premised upon a determination that the collection of the tax is in jeopardy.

   - A termination assessment applies to the current tax year, or the immediately preceding tax year if the due date for the return has not passed. If jeopardy is determined, the taxpayer's tax year is terminated and treated as a complete tax year for assessment purposes. Termination assessments are made for income taxes only.

   - A jeopardy assessment applies to a closed tax year, where the due date for filing a return has expired. For income, estate, gift, and certain excise taxes, assessment is made pursuant to IRC § 6861. For other kinds of taxes (employment and other excise taxes), assessment is made pursuant to IRC § 6862.

   Note:

   Termination and jeopardy assessments should be distinguished from quick and prompt assessments. See IRM 5.1.4.4,*Quick Assessment*, and IRM 5.1.4.5,*Prompt Assessments*, for a discussion of the situations in which a quick or prompt assessment may be made and applicable procedures.

2. Collection personnel should not initiate termination assessments, but rather refer potential termination assessments to Examination for appropriate action. See IRM 5.1.4.3.2, *Termination Pre-Assessment Recommendations*. Jeopardy assessments initiated by Collection personnel are limited to proposed:

   - Trust Fund Recovery Penalty assessments;

   - Employment and excise tax assessments, whether or not the return due date has expired;

- Partnership penalty assessments;
- Income tax assessments when there is no question as to the amount of liability.

3. See IRM 5.1.4.3,*Jeopardy Assessments, Pre-Assessments*. The discussion below is limited to provisions applicable to Collection personnel.

5.17.15.2.1 (12-29-2009)
Grounds for Jeopardy Assessments

1. Treas. Reg. § 301.6861-1(a), by reference to Treas. Reg. § 1.6851-1(a), provides that jeopardy will exist if the IRS finds that the taxpayer:
   - is (or appears to be) planning to leave the United States or to remove his or her property from the United States,
   - is concealing himself or herself or his or her property within the United States, or
   - is doing any other act threatening the collection of tax for the current or the preceding taxable year, such as transferring or dissipating assets, making himself or herself financially insolvent, or, in the case of a corporation, liquidating substantially all of its assets.
2. In determining whether one of the three circumstances stated above is present, there are many factors which the court may consider. The court, for instance, may consider whether the taxpayer is involved in illegal activity. Mueller v. CIR, 882 F.Supp. 1060, 1062 (S.D. Fla. 1995); Harvey v. United States, 730 F.Supp. 1097, at 1106 (S.D. Fla. 1990) (citing Young v. United States, 671 F.Supp. 1340 (S.D. Fla. 1987)). The court also may consider:
   - whether the taxpayer possesses, or deals in, large amounts of cash;
   - whether prior tax returns report little or no income despite taxpayer's possession of large amounts of cash;
   - whether assets have been dissipated, such as through forfeiture, expenditures for attorney's fees, or appearance bonds;
   - whether there is a lack of assets from which potential tax liability can be collected;
   - whether the taxpayer has used aliases which makes it more difficult to locate either the taxpayer or his assets;
   - whether the taxpayer has failed to supply appropriate financial information;
   - whether the taxpayer has used multiple addresses, making it hard to find the taxpayer;
   - whether taxpayer has a history of illegal activity, convictions, or probable cause to believe that the taxpayer was engaged in illegal business activities;
   - whether taxpayer has a history of concealing assets overseas;
   - whether taxpayer recently sold or transferred property;
   - whether taxpayer transferred property to relatives for inadequate consideration; and
   - whether taxpayer transferred property in the wake of an investigation.

   Magluta v. United States, 952 F.Supp. 798 (S.D. Fla. 1996), citing, Mesher v. United States, 736 F.Supp. 233, 235-236 (D. Or. 1990).
3. The financial solvency of the taxpayer must be threatened or appears to be imperiled or there can be no jeopardy. The calculation of solvency does not take into account the proposed assessment of tax, penalty, and interest. Evidence of a pending bankruptcy does not alone establish insolvency, though evidence of a prior adjudication of bankruptcy may be a factor in establishing insolvency.

5.17.15.2.2 (12-29-2009)
Form and Procedure

1. Only the Area Director has the authority to determine that a jeopardy assessment should be made. Written approval by the Chief Counsel or his or her delegate is also required. See IRM 5.1.4, *Jeopardy, Termination, Quick and Prompt Assessments*, for procedures for making jeopardy assessments. See also Form 2644 , *Recommendation for Jeopardy or Termination Assessment* .
2. Sufficient, objective facts must support the reasonableness of the determination that collection is in jeopardy. The amount assessed must be supportable, i.e. there must be a reasonable, factual basis for determining that the taxpayer received income.
3. For income, estate, gift, and certain excise taxes, a statutory notice of deficiency for the jeopardy assessment must be issued within 60 days following assessment. See IRC § 6861(b).
4. A statutory notice of deficiency for the termination assessment of income taxes must be issued within 60 days after the due date of the taxpayer's return, regardless of whether the taxpayer files a return. See IRC § 6851(b); Perlowin v. Sassi , 711 F.2d 910 (9th Cir. 1983).

5.17.15.2.3 (12-29-2009)
Stay of Collection of Jeopardy Assessments

1. After a jeopardy assessment is made, the IRS is required to send notice and demand to the taxpayer for the amount of the jeopardy assessment. Regardless of whether the taxpayer has filed a petition with the Tax Court, the amount of the assessment must be paid within 10 days unless a bond is filed as provided in IRC § 6863. See Treas. Reg. § 301.6861-1(d).
2. The bond must be equal to the amount of the jeopardy assessment the collection of which the taxpayer is seeking to stay, plus interest. Upon the filing of such a bond, collection of the amount covered by the bond is stayed. See Treas. Reg. § 301.6863-1.

5.17.15.3 (11-30-2007)
Presumption Regarding $10,000 in Unclaimed Cash

1. If any person is in possession of cash or a cash equivalent in excess of $10,000.00, and does not claim it as his or as that of a readily identifiable person, IRC § 6867 provides that the IRS may presume that it represents gross income of a single unidentified individual for that taxable year and that, for purposes of IRC § 6861 (Jeopardy Assessments of Income, Estate, Gift, and Certain Excise Taxes), collection of the tax will be jeopardized by delay.
2. The entire amount is taxed at the highest rate in Code section 1 and the possessor is treated as the taxpayer for certain limited purposes.
3. The possessor is sent a statutory notice of deficiency for assessments made under IRC § 6867. The possessor is also entitled to contest the assessment in Tax Court.
4. The possessor is entitled to the information that the "taxpayer" would receive as provided under IRC § 7429(a)(1). This section mandates that the Secretary provide the taxpayer with a written statement indicating the information relied upon in making the assessment within five days after the assessment is made.
5. The possessor is not entitled to the administrative or judicial review provided by IRC § 7429(a). Commissioner v. Hendrickson, 873 F.2d 1018 (7th Cir. 1989); Robrish v. United States, 579 F. Supp. 477 (D. Mass. 1983).

6. Should the true owner come forward, the assessment against the possessor will be abated and replaced by an assessment against the owner. The right to challenge the assessment will vest in the true owner, and he will be entitled to full review rights under IRC §§ 7429(a) and (b). Matut v. Commissioner, 858 F.2d 683 (11th Cir. 1988), vac'g & rem'g 88 T.C. 1250 (1987).
7. Cash equivalents include coins, precious metals, jewelry, precious stones, postage stamps, foreign currency, bearer obligations, and any medium of exchange that has been frequently used in illegal activities. Treas. Reg. § 301.6867-l(f).

5.17.15.4 (10-23-2014)
Jeopardy Collection

1. Generally, before property can be levied, the taxpayer must be given a
   - Notice and demand (taxpayer has 10 days to pay the amount due)
   - Notice of intent to levy (taxpayer has 30 days to pay before property can be levied), and
   - Notice of a right to a Collection Due Process (CDP) hearing under IRC § 6330 (taxpayer has 30 days to request a hearing).

   Note:

   Both the notice of intent to levy and the notice of a right to a CDP hearing are provided by Letter 1058, *Notice of Intent to Levy and Notice of Your Right to a Hearing*.

   See IRM 5.11.1.3.2, *Required Notices*, for a discussion of the required notices and how to calculate the time periods.
2. If collection of the tax is in jeopardy, the IRS is not required to wait 10 days after giving the taxpayer notice and demand, or 30 days after giving notice of intent to levy and notice of a right to a CDP hearing.

   Note:

   In case a taxpayer mails a request for a hearing under IRC § 6330 on the 30th day, an additional 15-day waiting period should be allowed before issuing a levy except in certain situations. See IRM 5.11.1.3.2(4).
3. Delegation Order 5-3 (Rev. 1) provides the delegations of authority for issuing notices of intent to levy and notices of the right to a CDP hearing, including the authority to issue notices of levy when collection is in jeopardy. See IRM 1.2.44.3.
4. The authority to issue notices of levy when collection is in jeopardy (with or without a jeopardy/termination assessment) and the pre-levy notices have not been issued and/or the waiting periods after the notices have not passed has been delegated to, among others, SB/SE Collection Territory Managers, Insolvency Territory Managers, and Advisory Territory Managers. See IRM 1.2.44.3(20) & (21). Additionally, the concurrence of the appropriate Area Counsel or Associate Area Counsel is required.
5. The authority to issue notices of levy during the 15-day waiting period following the end of the 30-day period for notice of intent to levy and notice of a right to a hearing, if collection is in jeopardy, has been delegated to, among others, SB/SE Collection Territory Managers, Insolvency Territory Managers, and Advisory Territory Managers. See IRM 1.2.44.3(17) & (18).
6. Even after all pre-levy notices have been issued and the waiting periods for them have passed, a jeopardy determination **may** be required for a levy because:
   A. It is the appearance date of a summons
   B. There is a pending or active installment agreement
   C. A rejected installment agreement can be appealed or is being appealed
   D. An offer in compromise is pending
   E. A rejected offer in compromise can be appealed or is being appealed

   In these situations, the authority to issue the notice of levy is delegated to, among others, SB/SE Territory Managers, Insolvency Territory Managers, and Advisory Territory Managers. Additionally, concurrence of the appropriate Area Counsel or Associate Area Counsel is required. See IRM 1.2.44.3(14) & (15).

   Note:

   All jeopardy levies must be approved by Counsel even though under IRC § 7429(a)(1)(A) Counsel is only required to approve jeopardy levies issued during the 30 days from notice and demand. See IRM 5.11.3.3(3).
7. See IRM 5.11.1.4.9, *Refund Litigation*, for information regarding the issuance of a levy to collect certain divisible taxes, such as trust fund recovery penalties, that are included in a suit for a refund. Generally, no levy can be issued to collect such taxes unless collection is in jeopardy and Counsel approval has been obtained.
8. While a tax delinquency need not be 10 days old before a jeopardy levy may be issued, there must be a notice and demand for immediate payment of the tax liability and a failure or refusal to pay before the levy is lawful. Thus, in Martinez v. United States, 669 F.2d 568 (9th Cir. 1981), the jeopardy levy was ruled invalid because the taxpayer did not receive notice and demand until after the levy was served. There is no predetermined waiting period for refusal or failure to pay, however, and the levy may be made immediately after failure or refusal to pay. L.O.C. Indus., Inc. v. United States, 423 F.Supp 265, 273 (M.D. Tenn 1976).
9. The IRS must provide the taxpayer with a notice containing the same information as is contained in the pre-levy notice within a reasonable time after the jeopardy levy. Treas. Reg. § 301.6330-1(a)(2)(ii). The notice contains the statement of taxpayer's collection due process rights required by IRC § 6330(f). Dorn v. Commissioner, 119 T.C. 356 (2002).

5.17.15.4.1 (10-23-2014)
Sale of Property Seized by Jeopardy Levy

1. Whenever levy is made without waiting the 10-day period after notice and demand required by IRC § 6331(a), public notice of sale of the property seized shall not be made within such 10-day period unless IRC § 6336 (relating to the sale of perishable goods) applies. See IRC § 6335(b). See also IRM 5.10.1.4, IRM 5.10.1.5, and IRM 5.10.2.17 for more information regarding the seizure and sale of perishable goods.
2. If the Area Director determines that any property seized is liable to perish or become greatly reduced in price or value by keeping, or that such property cannot be kept without great expense, the IRS may return such property to the owner upon his/her payment of the appraised value of the property or the posting of an acceptable bond or if the owner neither pays the appraised value or posts a bond, the IRS shall make public sale as soon as practicable after the seizure. See IRC § 6336; Church of Hakeem, Inc. v. United States, 1979 WL 1475 (N.D. Cal. 1979) (yacht ordered sold where expenses of conservation and maintenance would greatly reduce net proceeds if sale delayed). But see , Galusha v. Commissioner, 95 T.C. 218 (1990) (IRS did not prove expenses would greatly reduce net proceeds if sale delayed).
3. In the case of a jeopardy assessment of income, estate or gift tax under IRC § 6861, property levied upon and seized may not be sold until expiration of the period within which the taxpayer may petition the Tax Court for a redetermination of the assessment, or until the Tax Court decision becomes final. See IRC § 6863(b). The property may still be sold if:
   - the taxpayer consents,

- a determination is made that expenses of conserving and maintaining the property will greatly reduce the net proceeds, or
- the goods are perishable.

  Note:

  Remember that the provisions of IRC § 6863(b), addressing petitions to the Tax Court, are conditions precedent to the sale of seized property that must be complied with to remove any taint of illegality from the sale

  .

4. For jeopardy assessments and seizures made under IRC § 6862, where there is no Tax Court review, a different stay provision applies. IRC § 6863(c) stays the sale of seized property until the district court's determination under IRC § 7429 becomes final.

5.17.15.4.2 (12-29-2009)
Form and Procedure

1. The Territory Manager has the authority to approve a jeopardy levy. Written approval by the Chief Counsel or his or her delegate is also required. See discussion beginning at IRM 5.17.15.4(3), above.
2. See IRM 5.11.3, *Jeopardy Levy without a Jeopardy Assessment*, for procedures for issuing a jeopardy levy without a jeopardy or termination assessment.

5.17.15.5 (12-29-2009)
Administrative Review

1. IRC § 7429(a)(1) requires that within five days after the jeopardy assessment or levy is made, the IRS must send the taxpayer a written statement of the information relied on in making the assessment or levy. The notice must state the specific facts and reasons (not mere conclusions) relied on by the IRS; if the notice states merely conclusions, the assessment or levy may be held invalid.
2. Within 30 days after the written statement is furnished (or 30 days after the five-day period expires), the taxpayer may ask for administrative review. This request requires the IRS to determine whether making the assessment or levy was reasonable and whether the amount assessed was appropriate under the circumstances. The request by the taxpayer for administrative review is a prerequisite to judicial review.

5.17.15.6 (11-30-2007)
Judicial Review

1. The taxpayer may seek judicial review within 90 days after the earlier of the date the IRS notifies the taxpayer of the administrative determination or 90 days following the 16th day after the taxpayer requests administrative review. Normally the proper forum for review is the United States District Court, but the Tax Court has concurrent jurisdiction where a Tax Court petition was filed prior to assessment or levy and one or more of the taxable periods before the Tax Court is covered by the jeopardy assessment. See IRC §§ 7429(b)(1) and (2).
2. The court's review is limited to the reasonableness of the assessment or levy and the appropriateness of the amount. The court has 20 days to make its determination. However, the taxpayer, on reasonable grounds, may request an extension of up to 40 days. See IRC §§ 7429(b)(3) and 7429(c).
3. The court's determination is final and not subject to appeal or review by any court. See IRC § 7429(f). However, it is the IRS position that if the court's decision is based on some ground other than the reasonableness of the assessment or levy and the appropriateness of the amount assessed, it is reviewable by an appellate court. See Thermtron Products, Inc. v. Hermansdorfer, 423 US 336 (1976); see also Meadows v. United States, 665 F.2d 1009 (11th Cir. 1982).

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