

TAX MANAGEMENT PORTFOLIOS™

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Federal Tax Collection Procedure — Defensive Measures

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TAX MANAGEMENT PORTFOLIOS™

U.S. INCOME

Federal Tax Collection Procedure — Defensive Measures

PORTFOLIO DESCRIPTION

Tax Management Portfolio, *Federal Tax Collection Procedure — Defensive Measures*, No. 638-5th, analyzes in depth the procedures available to defend against IRS collection actions. Beginning with assessment of tax, notice and demand, and nonpayment by a taxpayer, the federal tax lien arises and attaches to all of the taxpayer's property and rights to property. In addition to the federal tax lien, there are other administrative collection devices that the IRS uses to enforce collection of unpaid tax liabilities. These include the federal tax levy and seizure and sale of a taxpayer's property. The IRS also may enforce collection of tax liabilities by instituting judicial proceedings. A further discussion of all of the administrative and judicial collection procedures available to the IRS is contained in 637 T.M., *Federal Tax Collection Procedure — Liens, Levies, Suits, and Third-Party Liability*.

Taxpayers are not without defenses to enforced tax collection by the IRS. Taxpayers (and in some situations third parties) have a variety of administrative and judicial remedies available to resolve, postpone or curtail collection activity by the IRS. This Portfolio analyzes the resolution options and the procedures available to obtain the resolution. The resolutions include challenges to assessments, installment agreements, offers in compromise and bankruptcy. The procedures include collection due process (CDP), collection appeals program (CAP) and other appeals as well as limited litigation alternatives. The available resolutions and procedures are discussed at length in this Portfolio.

This Portfolio may be cited as Mather, and Weisman, 638-5th T.M., *Federal Tax Collection Procedure — Defensive Measures*.

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DETAILED ANALYSIS

I. Introduction

Most of the provisions of the Internal Revenue Code (the Code)¹ relate to the determination of the amount of tax owed by a taxpayer. From the Internal Revenue Service's (IRS) perspective, however, the collection of these tax liabilities is of equal importance. This Portfolio provides a detailed analysis of alternatives and strategies to resolve IRS collection actions. These include challenging the liability, installment agreements, offers in compromise and bankruptcy, and Taxpayer Assistance Orders (TAOs). The procedures available to implement these resolutions also will be analyzed. For further discussion of administrative collection devices — federal tax liens and levies, suits, and other federal tax collection procedures including secondary and derivative liability, see 637 T.M., *Federal Tax Collection Procedure — Liens, Levies, Suits, and Third-Party Liability*.

A. Collection Process: In General

Most federal tax liabilities are collected in a relatively routine manner, through withholding, estimated tax payments, or payments of tax with the filing of tax returns. When the IRS determines that a tax liability is due and has not been paid in a timely manner, however, it may resort to the use of its collection power. The first step in the federal tax collection process is the assessment of tax. Section 6201 and Reg. §301.6201-1 give IRS Area and Campus Directors authority to make assessments of tax. An assessment occurs when an appropriate IRS official schedules the liability and signs the assessment register. In practice, virtually all assessments are performed by campus (Submission Processing Center) personnel. The various types of assessments and the potential ways to challenge a liability are discussed in III., below.

Once the ministerial act of entering the assessment is completed, §6303 directs the IRS to issue a notice and demand for payment of the assessed tax. The standard IRS practice is to issue a notice and demand bearing a Monday date. The notice and demand is usually mailed during the preceding week, however, so that the taxpayer receives it on Monday, the date of assessment. The IRS mails a separate notice to each spouse. The notice and demand is critical because it gives rise to the administrative collection remedies provided in the Code.² Almost all enforced IRS collections are made through use of these administrative collection remedies.

The initial notice and demand typically is followed by two or three computer-generated billing notices issued by an IRS Campus.³ The notice cycle then shifts to the branch of the IRS

that implements collection action for issuance of the formal notice of intent to levy. Most balance due amounts are forwarded to the Automated Collection System (ACS) branch of the IRS.⁴ In certain cases an account may bypass ACS and be forwarded directly to the collection field office.⁵

The federal tax lien is the backbone of the federal tax collection process. Section 6321 provides that a federal tax lien arises upon assessment, notice and demand, and failure to pay. This lien attaches to all of the taxpayer's property and rights to property owned on or acquired after the date of assessment.⁶ Until the notice of federal tax lien is properly filed, however, the lien is not perfected against bona fide purchasers and certain classes of creditors.

A further analysis of the rules concerning the creation, attachment, perfection, priority, duration, and enforcement of the federal tax lien is included in 637 T.M., *Federal Tax Collection Procedure — Liens, Levies, Suits, and Third-Party Liability*.

The federal tax lien is an encumbrance on property. The lien itself, however, does not result in the direct collection of any tax liability. Rather, three devices are available to the IRS to enforce the federal tax lien: (1) administrative levy;⁷ (2) administrative seizure; and (3) judicial collection remedies. The IRS also has a number of remedies by which it may pursue third parties (persons other than the taxpayer) for payment of the taxpayer's liability. The principal targets of these devices are persons responsible for non-payment of withheld taxes; lenders making loans for "net" wages; persons receiving or holding title to the taxpayer's property without adequate consideration; and fiduciaries of estates and receiverships who pay other liabilities before federal taxes.

These liability issues are discussed further in 637 T.M., *Federal Tax Collection Procedure — Liens, Levies, Suits, and Third-Party Liability*.

The taxpayer is not without defenses in the context of federal tax collection procedures. The taxpayer may challenge the assessment, seek an extension of time to pay, seek to enter an installment payment arrangement or submit an offer in compromise with the IRS. If administrative resolution is not possible, relief may be obtained by filing a bankruptcy petition. These alternative resolutions are available in varying degrees at different stages in the collection process. The procedures available to reach a resolution are discussed further below.

Finally, a number of administrative and procedural issues arise in dealing with IRS collection personnel. While the principal purpose of this Portfolio is to discuss the substantive law of federal tax collection, a secondary goal is to provide guidance concerning federal tax collection procedures.

¹Unless otherwise indicated, all references in this Portfolio are to the Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder.

²See §6321, §6331. Note: Absent authority under §7508A, PMTA 2020-007 (May 21, 2020) authorizes the IRS to deem that notice and demand letters that were mailed out late due to the temporary closure of IRS printing services during the COVID-19 pandemic were sent out on a date later than the date shown on the notice in order to grant relief from penalties and interest.

³See the Worksheets for examples of common IRS billing notices.

⁴ACS is a computerized system that maintains balance-due accounts and makes return delinquency investigations. See IRM 5.19.5 (11-23-20).

⁵IRM 5.19.5.4.1 (03-09-18), IRM Exhibit 5.19.5-7 (03-09-18), IRM Exhibit 5.19.5-8 (03-09-18).

⁶§6321; Reg. §301.6321-1; *Aquilino v. United States*, 363 U.S. 509 (1960).

⁷§6331.

B. Role of IRS Branches and Other Agencies

In the typical collection case, the taxpayer deals only with one or two IRS collection employees. In a more complex case, the taxpayer may encounter a number of people both inside and outside the IRS. The most significant participants in the federal tax collection process are discussed below.

1. Revenue Officers

The revenue officer is critical in the IRS collection process. The revenue officer has a broad range of discretion in dealing with the collection of accounts, subject to the guidelines provided by the Internal Revenue Manual (the IRM). A balance due account is assigned to the revenue officer after the initial notice and demand. Upon receiving the account, the revenue officer has the authority to file a notice of federal tax lien and issue a final notice of intention to levy if one has not previously been issued. If the taxpayer does not exercise Collection Due Process (CDP) appeal rights (or after an appeal is resolved), the revenue officer then may serve levies and seize property to collect the unpaid taxes.⁸ The revenue officer also has the authority to withhold enforced collection and to solicit or implement installment payment plans.⁹

The revenue officer's immediate supervisor is the collection group manager. The group manager, typically a senior collection employee with considerable experience as a revenue officer, supervises a group of five to 15 revenue officers in the performance of their collection activities. The IRM provides for review of the revenue officer's actions by the group manager.¹⁰ In the case of liens, levies, defaulted installment agreements, and rejected offers in compromise, an appeal also may be made to the Internal Revenue Service Independent Office of Appeals (referred to below as the IRS Appeals Office or Appeals).

The Territory Manager and Area Director provide other layers of supervision. These senior supervisory personnel are located in the main IRS area office and typically do not become involved with individual collection cases, except those involving substantial dollar amounts or significant legal or procedural issues.

Section 1001 of the Internal Revenue Service Restructuring and Reform Act of 1998 (1998 IRS Reform Act)¹¹ created four taxpayer-centric operating units to replace the regional and district geographic structure that existed before. The four units are (1) individual taxpayers with wage and investment income (W&I), (2) small business and self-employed taxpayers (SB/SE), (3) large business and international taxpayers (LB&I), and (4) the tax-exempt sector (employee plans, exempt organizations, state and local governments) (TE/GE). Most collection personnel are employees of SB/SE.¹²

⁸ See IRM 5.11.1.1 *et seq.* (07-07-20). See also the Worksheets for guidelines to revenue officers in filing notices of federal tax lien.

⁹ See generally IRM 5.10.1 (09-05-24) (actions prior to seizure), IRM 5.11.1 (06-9-23) (levy), IRM 5.12.2 (11-9-15) (filing notice of federal tax lien), IRM 5.14.1 (07-02-24) (installment agreements).

¹⁰ See IRM 1.4.40.3.1 (05-19-10).

¹¹ Pub. L. No. 105-206.

¹² For further discussion of the organization of the IRS, see 623 T.M., *IRS Procedures: Examinations and Appeals*.

2. Technical Services

Technical Services (formerly Special Procedures Function) provides technical assistance to the revenue officers in the field. In most offices, a technical advisor is assigned a specific subject matter. The advisor provides support to all of the revenue officers in the Area for issues arising in that subject matter.

In addition to providing support, the technical advisor also receives certain administrative claims and applications. Technical Services is the focal point for all federal tax claims in bankruptcy, probate, and other court proceedings. Technical Services also is the office for filing applications for release, discharge, or subordination of liens and applications for wrongful levy. Finally, Technical Services serves as a liaison between the revenue officers and Area Counsel with respect to legal issues that arise in collection cases.

3. Office of Chief Counsel

Most Area offices have a representative of the Office of Chief Counsel called Area Counsel. The primary responsibility of Counsel is to represent the IRS in the Tax Court. Certain attorneys within the Counsel office, however, develop specializations in federal tax collection matters. When revenue officers encounter issues which require detailed legal analysis, they request advice from Technical Services which, in turn, requests advice from the Counsel office. In addition, certain administrative collection remedies — such as the filing of a nominee lien — require prior Counsel approval. Finally, in any federal tax collection litigation involving the IRS, Counsel is responsible for gathering the necessary facts and informing the Justice Department of the IRS's position in the litigation.

The Chief Counsel's Office is organized along the same lines as the IRS. The Chief Counsel reviews the legal positions taken in the various Counsel offices and determines the IRS's position with respect to prospective legislation, collection-related regulations, and appeal of cases. Collection issues are handled by Division Counsel for SB/SE.

4. Justice Department

The Justice Department is responsible for handling all federal tax matters in any court other than the Tax Court. The principal courts in which the Justice Department appears are federal bankruptcy courts, U.S. district courts, the Court of Federal Claims, and the Circuit Courts of Appeal.

The attorney representing the Justice Department varies depending on the judicial district in which the particular case is located. Some major cities have Tax Divisions within the U.S. Attorney's office, which handle all federal tax litigation in that district. In other districts, the Civil Trial Division of the U.S. Attorney's office is responsible for federal tax litigation. Finally, the Tax Division of the Justice Department in Washington, D.C., handles federal tax litigation in many districts around the country. Tax Division attorneys maintain their offices in Washington, D.C., and travel to the various districts to conduct the litigation.

Once the case is referred by Counsel, the Justice Department has the authority to settle the case. The Justice Department attorney responsible for the case can entertain settlement discussions and tentatively agree to a proposed settlement, but

the attorney must acquire the approval of the Justice Department before finalizing the settlement. The IRS's concurrence with the settlement proposal is also sought at this time.

5. Overview of Collection Notices and Process

The stages in the tax collection process are as follows:

- an assessment is generated when the return is filed or an audit is concluded;
- the IRS issues notice and demand for payment dated as of the assessment date;
- the IRS issues computer-generated billing notices (CP502, CP503, and/or CP504) about 30 days apart;
- after CP504 is issued, the account is transferred to ACS or a revenue officer in a field office;
- ACS and/or the revenue officer pursues the administrative or judicial collection remedies deemed appropriate within the guidelines provided by the IRM, including issuing collection due process (CDP) notices, filing liens and serving levies;

- the revenue officer receives technical and legal assistance from Technical Services and from the Area Counsel office; and

- if litigation arises, the revenue officer, the technical advisor, the Counsel attorney, and the Justice Department attorney all review the merits of the case and participate in the formulation of the IRS's position in the litigation.

Note: On February 9, 2022, the IRS announced the temporary suspension of certain automated collection notices, including balance due notices (e.g., CP503, CP504) and unfiled tax return notices. The suspension is intended to help avoid taxpayer confusion while the IRS addresses its backlog of unprocessed tax returns.¹³ In Notice 2024-7, the IRS announced it will fully resume issuing automated reminder notices in calendar year 2024 for balances due for tax years 2021 and earlier, thereby resuming the normal notice process for these tax years.¹⁴

¹³ IRS News Release IR-2022-31 (Feb. 9, 2022).

¹⁴ IRS News Release IR-2023-244 (Dec. 19, 2023).

II. Overview of Defensive Measures

A. *Alternative Resolutions*

A taxpayer has a variety of issues and options to consider when faced with collection activity by the IRS. Every taxpayer should carefully consider the following potential resolutions when addressing a collection issue:

- Collection Resolution #1 — Determining whether the tax is lawfully due, including (a) whether the tax was properly assessed; (b) whether payments were properly posted; (c) whether the statute of limitations has expired; (d) whether innocent spouse relief is available; (e) whether the liability can be reduced through a new audit or penalty abatement.
 - Collection Resolution #2 — Obtaining an extension of time to pay the tax.
 - Collection Resolution #3 — Seeking an installment agreement.
 - Collection Resolution #4 — Pursuing an offer in compromise.
 - Collection Resolution #5 — Considering whether a bankruptcy petition would resolve the liability.
- These resolutions are discussed below.

B. *Procedures to Reach Resolution*

After the appropriate options for resolving the balance are examined, it is necessary to determine the appropriate step in the collection process in which the resolution may be implemented. These include:

- Collection Procedure # 1 — Requesting relief during the notice cycle;
 - Collection Procedure # 2 — Dealing with ACS or the Revenue Officer;
 - Collection Procedure # 3 — Requesting a Collection Appeals Program (CAP) appeal;
 - Collection Procedure # 4 — Requesting a Collection Due Process (CDP) appeal;
 - Collection Procedure # 5 — Requesting another type of appeal;
 - Collection Procedure # 6 — Requesting a Taxpayer Assistance Order;
 - Collection Procedure # 7 — Determining whether injunctive relief is available; and
 - Collection Procedure # 8 — Determining whether fair tax collection practices were followed.
- These topics are discussed further below.

III. Determining Whether the Tax Lawfully Is Due (Collection Resolution #1)

The first inquiry in any collection case is to determine if the tax is lawfully due and owing by the taxpayer. There are several potential issues in this determination, including: (1) challenging the assessment; (2) verifying proper application of payments; (3) determining if the statute of limitations has expired; (4) obtaining innocent spouse relief; and (5) seeking a new audit or abatement of penalties.

A. Challenging the Assessment

The first line of defense in a collection case is to determine whether the tax was properly assessed. While it is theoretically possible for the IRS to bring suit to collect tax without first making an assessment, in practice this almost never happens. Therefore, the collection process generally starts with the assessment of the tax.

IRS errors in the assessment process are rare. If an error occurs, however, successfully challenging the error usually means that the collection issue goes away completely. Therefore, one must understand the assessment process to be aware of the potential challenges that might be raised.

Assessments are made pursuant to several different procedures. The typical types of assessment are: (1) summary assessments (usually of tax reported on a return); (2) deficiency assessments; (3) additional assessments of nondeficiency taxes; (4) partnership audit assessments; and (5) jeopardy and termination assessments. It is important to determine the type of assessment that has been made and analyze whether the proper procedures for that type of assessment have been followed.

1. Summary Assessment

Section 6201 sets forth the general assessment authority of the IRS. For an assessment to be valid, the assessment officer must sign a summary record of assessment.¹⁵ The summary record must include the identification of the taxpayer, the character of the liability assessed, the taxable period, and the amount of the assessment. The assessment date is the date that the summary record is signed by the assessment officer.¹⁶ Instead of the manually prepared Form 23C (Summary Record of Assessment), the IRS may use the computer-generated report

¹⁵ See Reg. §301.6203-1. See also *Geiselman v. United States*, 961 F.2d 1 (1st Cir. 1992) (assessment officers make IRS assessments by completing and signing Forms 23-C; the “23(C) date” means the date upon which the assessment officer signed the Form 23-C and therefore is the assessment date); *Lunsford v. Commissioner*, 117 T.C. 183 (2001) (denying request to remand to Appeals to allow taxpayers to question Appeals Officer regarding a matter previously ruled on, i.e., the sufficiency of the record of assessment); *Nicklaus v. Commissioner*, 117 T.C. 117 (2001) (as summary record of assessment used by the IRS to comply with Reg. §301.6203-1 is Form 23-C, not Form 4340, assessment officer does not need to sign and date Form 4340, *Certificate of Assessments and Payments*, to have valid assessment), *aff’d*, 2006-2 USTC ¶50,591 (9th Cir. 2006).

¹⁶ See *Mortenson v. United States*, 74 AFTR 2d 7256 (N.D. Ill. 1994) (assessment is timely provided that Summary Record of Assessment is signed by IRS official before limitations period expires; certificate of assessment serves only as proof of assessment); CCA 201310033 (sufficient supporting documentation for assessment existed where summary record indicated incorrect tax year, but assessment form correctly identified taxpayer, character of liability, and amount; correct tax period was properly provided in supporting documents; and amount matched that self-assessed by taxpayer for correct period).

known as “Revenue Accounting Control System Report 006.”¹⁷ A copy of the summary record may be obtained through a Freedom of Information Act request.

Section 6203 provides that the IRS must provide a taxpayer with a copy of the assessment. Regulations clarify that as long as the IRS furnishes a copy of the pertinent part of the assessment — which provides the taxpayer’s name, date of assessment, the type of liability assessed, the taxable period, and the amounts assessed — the requirement is satisfied.¹⁸ Courts have held that the IRS is *not* required to furnish the taxpayer with a copy of the actual Form 23C (Summary Record of Assessment).¹⁹ The IRS’s production of Forms 4340, *Certificate of Assessments and Payments*, creates a rebuttable presumption that the assessments are valid, which can be rebutted only with evidence that the Forms 4340 suffer from technical irregularities or that the tax assessments are erroneous or lack a rational foundation.²⁰ A taxpayer is not entitled to information regarding the appointment of the assessment officers who signed Forms 4340.²¹

Area and Campus Directors can immediately assess all taxes shown to be due on a tax return.²² The mere act of filing

¹⁷ *March v. IRS*, 335 F.3d 1186 (10th Cir. 2003); *Roberts v. Commissioner*, 118 T.C. 365 (2002), *aff’d*, 329 F.3d 1224 (11th Cir. 2003) (use of RACS 006 does not constitute an irregularity in the IRS’s assessment).

¹⁸ Reg. §301.6203-1.

¹⁹ *March v. IRS*, 335 F.3d 1186 (10th Cir. 2003) (no regulation or statute requires that the “copy of the record of the assessment” be made on Form 23C); *Lunnon v. United States*, No. Civ. No. 16-1152 MV/JFR, 2020 BL 441499 (D.N.M. Nov. 13, 2020) (denying taxpayer’s motion to compel IRS to provide Form 23-C and any supporting records to taxpayer); *Curley v. United States*, 791 F. Supp. 52 (E.D.N.Y. 1992) (*citing United States v. Schroeder*, 900 F.2d 1144 (7th Cir. 1990), IRS’s failure to identify each tax period and to list correct amount of tax on Form 23C does not invalidate presumption of correctness); *Lovelace v. United States*, 91-1 USTC ¶50,144 (W.D. Wash. 1990); *Fulgoni v. United States*, 23 Cl. Ct. 119, 122 (1991) (the probative value of the assessment record, known as Form 23C, that would be signed by an assessment officer, is minimal because it does not contain information on individual taxpayers).

²⁰ See, e.g., *March v. IRS*, 335 F.3d 1186 (10th Cir. 2003) (Form 4340 provided to the taxpayers establishes a presumption that a Form 23C or RACS 006 was validly signed and certified); *Hefli v. IRS*, 8 F.3d 1169 (7th Cir. 1993); *Koff v. United States*, 3 F.3d 1297 (9th Cir. 1993); *Gentry v. United States*, 962 F.2d 555 (6th Cir. 1992); *Lunnon v. United States*, No. Civ. No. 16-1152 MV/JFR, 2020 BL 441499 (D.N.M. Nov. 13, 2020); *Davis v. Commissioner*, 115 T.C. 35 (2000); see also *Best v. Commissioner*, T.C. Memo 2014-72 (Appeals officer did not abuse her discretion in relying on computer transcripts to verify petitioners’ tax had been properly assessed and IRS counsel provided Forms 4340, showing all pertinent parts of the assessment which the IRS must supply upon request, pursuant to Reg. §301.6203-1), *aff’d sub nom. MacPherson v. Commissioner*, 702 Fed. Appx. 615 (9th Cir. 2017), *cert. denied*, 138 S. Ct. 2691 (S. Ct 2018); *Howell v. United States*, 164 F.3d 523 (10th Cir. 1998) (declining to find assessment was rendered invalid by failure to provide information to taxpayer under Reg. §301.6203-1); *Nicklaus v. Commissioner*, 117 T.C. 117 (2001) (where taxpayer can point to no evidence of irregularity in assessment process, presumption of valid assessment remains). *But see Huff v. United States*, 10 F.3d 1440 (9th Cir. 1993) (IRS cannot rely solely on Form 4340, especially if it does not contain requisite information). If the business is identified incorrectly, e.g., the assessment is made to the taxpayer as a partner of a partnership, but the taxpayer’s business is a sole proprietorship, it does not necessarily invalidate the assessment. If the assessment is sent to the correct address, the taxpayer is aware of it, and the incorrect classification did not result in any confusion about which entity was responsible for the tax, the assessment is not invalidated. *Barnes v. IRS*, 116 F. Supp. 2d 1007 (S.D. Ind. 2000).

²¹ *Lunnon v. United States*, No. Civ. No. 16-1152 MV/JFR, 2020 BL 441499 (D.N.M. Nov. 13, 2020).

²² §6201(a)(1); Reg. §301.6201-1(a)(1). See *Perez v. United States*, 312 F.3d 191 (5th Cir. 2002). Included in this category are returns prepared by the IRS under §6020(b) that are executed by the taxpayer.

the return, however, does not constitute an assessment of tax.²³ The IRS must follow the assessment procedures outlined above before the amount of the tax liability shown on the return is considered to be assessed.

Area and Campus Directors also have summary assessment authority for a number of other assessments. First, the IRS may make a supplemental assessment to correct an imperfect or incomplete assessment.²⁴ If the supplemental assessment corrects a tax that is subject to deficiency procedures, the IRS must follow the deficiency procedures before making the assessment.²⁵ Second, the IRS may assess a tax deficiency when the taxpayer has agreed to the assessment by executing a waiver of restrictions on assessment.²⁶ The IRS also may assess a tax resulting from mathematical or clerical errors and from tentative carryback adjustments.²⁷

In cases of mathematical or clerical errors, the taxpayer is entitled to receive a notice of the error and has 60 days to request an abatement of the assessment. If the taxpayer files a timely abatement request, the IRS must abate the assessment and can then assess the tax only after complying with deficiency procedures.²⁸ In some cases, the IRS may abate a portion of the assessment where fraud is involved not due to the taxpayer.²⁹

In addition to assessing amounts of tax due, the IRS also may assess any amount paid as a tax. Moreover, after a notice of deficiency is issued, the IRS can assess any tax payment made with respect to the proposed deficiency, regardless of whether the taxpayer executes a waiver of restrictions on assessment.³⁰ Similarly, the IRS can assess any amount of tax paid before the notice of deficiency is mailed.³¹ However, the IRS

will not assess a remittance that the taxpayer designates as a deposit until the final tax liability is determined.³²

Comment: The distinction between a payment of tax and a cash bond is sometimes difficult to determine. The key consequence of this distinction is that there are different procedures and statutes of limitation for recovery of payments and deposits. A taxpayer should write on the payment whether the taxpayer intends it to be a deposit or advance payment. Otherwise, the IRS will determine the character of the amount pursuant to detailed rules that generally treat the amount as a payment.³³ See III.B.2., below, for further discussion of this issue.

2. Deficiency Procedures

The IRS cannot assess additional amounts of certain types of tax unless a notice of deficiency has been issued, or the taxpayer has signed a waiver of restrictions on assessment.³⁴ The taxes subject to these deficiency procedures include income, estate, gift, and most excise taxes.³⁵ Employment taxes (i.e., withheld income taxes, FICA, and federal unemployment tax) are not subject to these deficiency procedures.³⁶ In addition, exceptions to the deficiency procedures are expressly provided in §6213 for: (1) jeopardy and termination assessments;³⁷ and (2) assessments of claims for income, estate, and gift taxes in receivership and certain bankruptcy cases.³⁸

²³ §6603; Rev. Proc. 2005-18.

³² Rev. Proc. 2005-18.

³⁴ §6213(a), §6213(d). See also *Singleton v. United States*, 128 F.3d 833 (4th Cir. 1997) (IRS supplemental assessment invalid in the absence of issuance of notice of deficiency); *Phila. & Reading Corp. v. United States*, 944 F.2d 1063 (3d Cir. 1991) (assessment of tax that was not preceded by statutorily required notice of deficiency or validly executed waiver was illegal); *Robinson v. United States*, 920 F.2d 1157 (3d Cir. 1990) (IRS issuance of notice of deficiency found to be “pivotal feature of the Code’s assessment procedures”); *Marlow v. Commissioner*, T.C. Memo 2010-113 (IRS was prohibited from assessing deficiency unless either notice of deficiency was mailed to taxpayer at last known address or taxpayer had signed valid waiver of restrictions on assessment); *Manko v. Commissioner*, 126 T.C. 195 (2006) (deficiency notice is generally required before IRS may assess a deficiency); *United States v. Charboneau*, 96 AFTR 2d 2005-6539 (M.D. Fla. 2005) (assessment was invalid where there was no proof IRS sent notice of deficiency and no waiver was executed); *Tavano v. Commissioner*, 986 F.2d 1389 (11th Cir. 1993) (notice of deficiency sent by the IRS need not be signed to be valid); *Spagnoletti v. Commissioner*, No. 21-60135, 2021 BL 464239 (5th Cir. Dec. 6, 2021) (deficiency notice not required where tax liability is self-reported; notice required only when there is a deficiency). For further discussion of what constitutes a valid notice of deficiency, see 630 T.M., *Tax Court Litigation*.

Waivers are usually made on Form 870, *Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment*. However if, in Tax Court, a waiver of restrictions is included in a status report filed by both the taxpayer and the IRS, the IRS waiver form is not necessary and the waiver is valid. *Santana v. Commissioner*, T.C. Memo 2017-14. Note that the taxpayer may withdraw the waiver and opt for the requirement of a notice of deficiency up until the time the IRS takes action on the waiver. Reg. §301.6213-1(d); *Lua v. United States*, 843 F.3d 950 (Fed. Cir. 2016) (absent evidence that taxpayer withdrew waiver before IRS action, waiver remains valid).

Generally, the IRS may not assess tax or collect tax until the taxpayer has had an opportunity to exhaust administrative remedies, including the opportunity to litigate the tax liability. *Commissioner v. Shapiro*, 424 U.S. 614 (1976).

³⁵ See §6213(a); Subtitles A and B and Chapters 41 through 44 of the Code.

³⁶ These employment taxes are imposed by Subtitle C, Chapters 21 through 25. Section 6213(a) applies only to taxes imposed by Subtitles A and B and Chapters 41 through 44.

³⁷ §6851, §6852, §6861.

³⁸ §6871.

²³ *Brafman v. United States*, 384 F.2d 863 (5th Cir. 1967); *Boyd v. United States*, 439 F. Supp. 907 (E.D. Pa. 1977); *In re O’Leary*, 72-1 USTC ¶9287 (W.D. Wis. 1972).

²⁴ §6204; Reg. §301.6204-1. See *Estate of Wilbanks v. Commissioner*, 953 F.2d 651 (11th Cir. 1992) (IRS entitled to make supplemental assessment when earlier assessment failed to include addition to tax for late filing within three years of filing of income tax return); *Brookhurst, Inc. v. United States*, 931 F.2d 554 (9th Cir. 1991) (IRS can collect erroneous refund by supplemental assessment under §6204(a)); *Johnson v. United States*, 927 F. Supp. 36 (D. Conn. 1996) (IRS can make supplemental assessment to correct defect in original assessment if the statute of limitations on assessment is still open), *aff’d*, 123 F.3d 700 (2d Cir. 1997).

²⁵ §6204(b), §6213.

²⁶ §6213(d). The IRS need not formally accept the waiver to be authorized to assess the amount. *Ulrich v. Commissioner*, 585 F.3d 1235 (9th Cir. 2009). See also *Perez v. United States*, 312 F.3d 191 (5th Cir. 2002) (IRS Form CP-2000 evidenced the IRS’s proper assessment and notice of taxpayer’s tax liabilities, including deficiencies). Note that the taxpayer may withdraw the waiver up until the IRS takes action on the waiver. Reg. §301.6213-1(d); *Lua v. United States*, 843 F.3d 950 (Fed. Cir. 2016) (absent evidence that taxpayer withdrew waiver before IRS action, waiver remains valid).

²⁷ §6213(b)(1), §6213(b)(3); Reg. §301.6213-1(b)(1), §301.6213-1(b)(2). See *Estate of Brouman v. Commissioner*, T.C. Memo 2013-99 (no mathematical error where estate return filed with “Estimated” written at top and “Unknown” written as balance due because amount of marital deduction was not yet ascertainable due to pending litigation; error is not obvious on face of return and miscalculation not apparent therefore, IRS not authorized to make summary assessment).

²⁸ §6213(b)(2)(A).

²⁹ CCA 201313029 (portion of assessment due to fraud on part of preparer abated where preparer filed return showing less than actual amount due without taxpayer’s knowledge and collected refund into preparer’s own account).

³⁰ §6213(b)(4); Reg. §301.6213-1(b)(3).

³¹ Reg. §301.6213-1(b)(3).

For taxes subject to the deficiency procedures, an assessment cannot be made until:

- the taxpayer executes a written waiver of the restriction on assessments;³⁹
- the 90-day period expires following the issuance (mailing) of a notice of deficiency (150 days if the taxpayer is outside the United States when the notice of deficiency is mailed); or
- the Tax Court issues a final decision if the taxpayer has timely filed a Tax Court petition.⁴⁰

A decision of the Tax Court becomes final 90 days after the decision is entered unless a timely notice of appeal is filed.⁴¹ Even if a notice of appeal is filed, the IRS may assess the deficiency reflected in the decision unless the taxpayer posts a bond.⁴² There are similar restrictions on the assessment of deficiencies attributable to certain partnership items. See III.A.5., below, for more information regarding partnership assessments.

a. Definition of Deficiency

Section 6211(a) defines a deficiency as the amount by which an income, estate, gift, or certain excise tax exceeds: (1) the amount shown as tax by the taxpayer on the return, (2) plus the amounts previously assessed (or collected without assessment) as a deficiency, (3) minus the amount of rebates, as defined in §6211(b)(2).⁴³ The deficiency is determined without regard to credits for estimated tax payments, taxes withheld from wages, taxes withheld at the source on nonresident aliens and foreign corporations, or collections for termination assessments.⁴⁴ A deficiency thus is determined based not on what payments have been applied to a taxpayer's account, but rather on

what assessments been made with respect to that account. And, a deficiency must exist *before* payments and other remittances for taxes owed can be applied to reduce that deficiency. Thus, for example, a criminal restitution assessment pursuant to 18 U.S.C. §3664 that has been paid before a tax deficiency has been assessed does not reduce or discharge a tax deficiency determination until it has been assessed.⁴⁵

“Return” generally refers to the originally filed return. However, amounts shown as additional tax on an amended return are treated as amounts shown on the “return” for purposes of computing the amount as a deficiency.⁴⁶ If the taxpayer does not file a return, or if the return does not show any tax due, the amount deemed to have been shown on the return is zero.⁴⁷ If the IRS files a substitute for the return (pursuant to §6020(b)) that the taxpayer does not sign, the IRS must follow the deficiency procedures before assessing the tax due.⁴⁸ The IRS nevertheless can follow the deficiency procedures without first filing a return under §6020(b).⁴⁹

b. Notice of Deficiency

(1) Last Known Address

Except in those situations previously noted above, the IRS must issue a notice of deficiency before it can make an assessment of additional tax.⁵⁰ A notice of deficiency is deemed to be validly issued if mailed by certified or registered mail to the taxpayer's “last known address.”⁵¹

What constitutes the taxpayer's last known address is not statutorily defined and has been the subject of much controversy.⁵² Under Reg. §301.6212-2(a),⁵³ a taxpayer's last known address is the address that appears on the taxpayer's most recently filed and properly processed federal tax return, unless the IRS is given clear and concise notification of a different address.

³⁹ The written waiver is usually on IRS Forms 4549 or 870. If the IRS unilaterally changed a material term in a waiver of restrictions on assessments after the taxpayer signed it, the entire agreement is null and void. *Piarulle v. Commissioner*, 80 T.C. 1035 (1983); *Pork v. Goltzbach*, 61-1 USTC ¶9422 (E.D. Va. 1961) (Form 870 altered by IRS but subsequently initialed by taxpayer held invalid).

⁴⁰ §6213(a), §6213(d); Reg. §301.6213-1(a)(2), §301.6213-1(d). See 630 T.M., *Tax Court Litigation*, for further discussion.

⁴¹ §7481, §7483. Neither §7483 nor the Federal Rules of Appellate Procedure provide a mechanism to extend the 90-day timeframe; however, a timely motion for reconsideration may toll the time to appeal. See *Cates v. Commissioner*, 121 AFTR 2d 2018-2050 (11th Cir. 2018).

⁴² §7485(a).

⁴³ When calculating a deficiency, the excess of tax shown over rebates can be a negative number regardless of whether the taxpayer actually received a rebate. *Galloway v. Commissioner*, 149 T.C. 407 (2017) (taxpayer requested a refund equal to the refundable portion of an education credit (\$3,000); IRS subsequently disallowed the credit after making an adjustment to account for the nonrefundable portion of the credit (\$4,500) that taxpayer failed to carry over to their Form 1040; the court accepted the IRS's deficiency calculation expressed as the following equation: \$7,500 deficiency = \$6,984 tax imposed – (\$3,984 tax shown on return – \$4,500 rebate)). See also *Voigt v. Commissioner*, T.C. Memo 2004-62 (deficiency was equal to excess of zero (tax imposed) over negative \$2,396 (amount of disallowed, refundable earned income tax credit)); *Blore v. Commissioner*, T.C. Memo 2000-326 (negative tax liabilities associated with disallowed earned income tax credits generated tax deficiency even though taxpayer's tax liability was zero); *Wilson v. Commissioner*, T.C. Memo 2001-139 (deficiency existed where taxpayer had tax liability of zero but was not entitled to earned income credit that had previously been claimed as overpayment).

⁴⁴ §6211(b)(1). See *Rader v. Commissioner*, 143 T.C. 376 (2014) (tax withheld at source on nonresident aliens under §33 from proceeds of sale of re-

al property not taken into account in determining deficiency under §6211(a)); Reg. §301.6211-1(b).

⁴⁵ See *Rozin v. Commissioner*, T.C. Memo 2017-52.

⁴⁶ Reg. §301.6211-1(a); *Koch v. Alexander*, 561 F.2d 1115 (4th Cir. 1977); *Miskovsky v. United States*, 414 F.2d 954 (3d Cir. 1969); *Rager v. Commissioner*, T.C. Memo 1984-563, *aff'd*, 775 F.2d 1081 (9th Cir. 1985). The IRS is not required to accept an amended return or to treat an amended return as superseding an original return. In calculating a deficiency, where the amended return shows a smaller liability than originally reported, the amount shown as the tax by the taxpayer upon his return, under §6211(a)(1)(A), is the amount shown on the original return. *Fayeghi v. Commissioner*, 211 F.3d 504 (9th Cir. 2000); *Curry v. United States*, 774 F.2d 852, 854 n.1 (7th Cir. 1985); *Koch v. Alexander*, 561 F.2d 1115 (4th Cir. 1977).

⁴⁷ Reg. §301.6211-1(a). See *Spurlock v. Commissioner*, 118 T.C. 155 (2002) (Reg. §301.6211-1(a) held not to be an unreasonable interpretation of §6211).

⁴⁸ GCM 33978 (Nov. 22, 1968); *Spurlock v. Commissioner*, 118 T.C. 155 (2002) (IRS must follow deficiency procedures before assessing income tax liability stated on §6020(b) return unless taxpayer agrees to correctness of liability stated in substitute for return). See also *Millsap v. Commissioner*, 91 T.C. 926 (1988); *Phillips v. Commissioner*, 86 T.C. 433 (1986) (§6020(b) return is not “return” sufficient to foreclose taxpayer's subsequent election of joint filing status).

⁴⁹ *Roat v. Commissioner*, 847 F.2d 1379 (9th Cir. 1988).

⁵⁰ §6213.

⁵¹ §6212(b)(1).

⁵² For further discussion of the last known address rules, see 630 T.M., *Tax Court Litigation*.

⁵³ See generally Reg. §301.6212-2. For guidance on providing notification of a change of address, see Rev. Proc. 2010-16, *superseding* Rev. Proc. 2001-18.

According to Reg. §301.6212-2(b)(1), change of address information that a taxpayer provides to a third party, such as a payor or another governmental agency, does not constitute clear and concise notification of a change of address.⁵⁴ Nevertheless, Reg. §301.6212-2(b)(2) provides that the IRS will update taxpayer addresses maintained in IRS records annually by referring to data maintained by the U.S. Postal Service (USPS). Generally, if the taxpayer's old name and address match the old name and address in USPS's database, the new address in the USPS database will be considered the taxpayer's last known address unless the IRS is given clear and concise notification of another address.⁵⁵

Incarcerated taxpayers present a possible exception to the general rule of Reg. §301.6212-2(a), because courts impose a duty on the IRS to exercise reasonable diligence when ascertaining the taxpayer's last known address. When the IRS possesses specific knowledge regarding the taxpayer's incarceration, and there is a known infirmity in the last known address on which the IRS seeks to rely, the IRS cannot treat that address as the last known address. The specific knowledge typically involves the participation of the IRS in the investigation and/or prosecution of the taxpayer. Examples cited by the Chief Counsel's Office in which the IRS is deemed to have notice of not having the taxpayer's last known address include (1) the IRS having notices returned as undeliverable, or (2) the IRS having attempted delivery to an address different from the address on the most recently filed return.⁵⁶

When the IRS properly mails the statutory notice to the taxpayer's last known address, the taxpayer may not assert the failure to receive the notice as a defense.⁵⁷ The controversy arises when the IRS mails the notice to an obsolete address. If the taxpayer receives the notice despite the incorrect address, most

⁵⁴ See, e.g., *Marks v. Commissioner*, 947 F.2d 983 (D.C. Cir. 1991) (IRS has no duty to send duplicate notices to every single address of which it has knowledge, especially when it has no reason to believe any such address is permanent); *Gyorgy v. Commissioner*, 779 F.3d 466 (7th Cir. 2015) (IRS had no clear and concise notification of newer, good address and thus was entitled to rely on older address on last filed tax return).

⁵⁵ Reg. §301.6212-2(b)(2). See also IRM 1.22.5.13 (01-14-21) (guidance on IRS updating address after receipt of returned mail with USPS yellow label with updated address); PMTA 2012-26 (IRS may update last known address using USPS change of address labels affixed to mail returned to IRS where IRS is reasonably confident individual on change of address label is taxpayer in question); PMTA 2012-28 (IRS may update last known address using USPS Address Correction Service where IRS performs research and is reasonably confident individual is taxpayer in question).

⁵⁶ PMTA 2014-19. See also *Keeton v. Commissioner*, 74 T.C. 377 (1980); *Minemyer v. Commissioner*, T.C. Memo 2012-325.

⁵⁷ *Wilson v. Commissioner*, 564 F.2d 1317 (9th Cir. 1997); *United States v. Ahrens*, 530 F.2d 781 (8th Cir. 1976); *Lurhring v. Glotzbach*, 304 F.2d 556 (4th Cir. 1962); *McKay v. Commissioner*, 89 T.C. 1063 (1987); *Cataldo v. Commissioner*, 60 T.C. 522 (1973), *aff'd per curiam*, 499 F.2d 550 (2d Cir. 1974); *Meyer v. United States*, 86-2 USTC ¶9722 (D. Minn. 1986); *Blair v. Commissioner*, T.C. Memo 1989-454. In *Rivas v. Commissioner*, T.C. Memo 2017-56, a presumption of delivery of a notice of deficiency was established by IRS mailing practices and procedures in light of incomplete IRS records regarding delivery. Once the notice of deficiency was deemed delivered, the court concluded that the taxpayer had failed to accept or refused delivery by the U.S. Postal Service. Deliberate refusal to accept receipt of the notice by the taxpayer was treated as a deemed receipt. See also *Lander v. Commissioner*, 154 T.C. 7 (2020) (copy of certified envelope and notice of deficiency mailed to correct address which was returned to IRS undelivered, along with testimony by IRS technical services office manager of such standard mailing practices evidenced proper mailing).

courts have concluded that the notice is valid.⁵⁸ If, on the other hand, the taxpayer fails to receive the notice because it was improperly addressed, the validity of the notice turns on whether the IRS exercised reasonable diligence in ascertaining the taxpayer's correct address.⁵⁹ Therefore, when the IRS has reason to believe the taxpayer's address as reflected in its files is incorrect, the IRS has a duty to make a reasonable search to ascertain the correct address.

Verbal notification is an insufficient method of providing the IRS with a change of address.⁶⁰ When the taxpayer communicates in writing to the IRS and such correspondence includes the new address, these communications usually provide the IRS with sufficient notice of the proper address.⁶¹

Note: The Tax Court has held that the IRS must be allowed a reasonable period of time for processing a change of address. The Tax Court has held it takes two to three weeks for information input when the return is processed to be transferred to the National Computer System in Martinsburg, West Virginia.⁶² Therefore, a notice of deficiency was valid when it was mailed to the taxpayer's former address after the taxpayer advised the Service Center of a new address but before this information could be entered into the national computer.⁶³

When a deficiency notice is not mailed to the taxpayer's last known address, the taxpayer can file a Tax Court petition and move to dismiss the case for lack of jurisdiction on the ground that the notice of deficiency was invalidly issued. If the court grants the jurisdictional motion, the underlying assessment is invalidated.⁶⁴ In rare cases, the taxpayer may be able to enjoin the collection of taxes by filing suit in federal district

⁵⁸ *Pugsley v. Commissioner*, 749 F.2d 691 (11th Cir. 1985); *Mulvania v. Commissioner*, 769 F.2d 1376 (9th Cir. 1985); *McKay v. Commissioner*, 886 F.2d 1237 (9th Cir. 1989); *Clodfelter v. Commissioner*, 527 F.2d 754 (9th Cir. 1975). See *St. Joseph Lease Capital Corp. v. Commissioner*, 235 F.3d 886 (4th Cir. 2000) (under §6503(a), assessment limitations period is suspended by mailing of technically deficient deficiency notice as taxpayer received actual notice of the deficiency and an opportunity to petition the Tax Court for a redetermination).

⁵⁹ *Wallin v. Commissioner*, 744 F.2d 674 (9th Cir. 1984). In *Wallin*, the taxpayer moved and remarried after filing her 1977 tax return. In 1978 and 1979, she and her new husband filed joint tax returns which reflected her new name, her social security number (on the box marked for the spouse), and her new address. The IRS issued a notice of deficiency to her old name and old address (reflected on the return under audit). The notice of deficiency was returned as undeliverable. The IRS failed to search the computer for a new address under the spousal social security number. The court, finding that the IRS had failed to exercise reasonable diligence in ascertaining the taxpayer's last known address, held that the notice of deficiency was issued invalidly.

⁶⁰ *Mollet v. Commissioner*, 82 T.C. 618 (1984).

⁶¹ *McPartlin v. Commissioner*, 653 F.2d 1185 (7th Cir. 1981); *Abeles v. Commissioner*, 91 T.C. 1019 (1988); *Crum v. Commissioner*, 635 F.2d 895 (D.C. Cir. 1980) (notice mailed to taxpayer's former address not sent to last known address because, before notice was issued, five separate communications bearing new address passed between taxpayer and IRS).

⁶² *Ward v. Commissioner*, 92 T.C. 949 (1989).

⁶³ In response to numerous change of address controversies, the IRS issued Rev. Proc. 2001-18, *superseded by* Rev. Proc. 2010-16, which explains how a taxpayer should inform the IRS of a new address on Form 8822, *Change of Address*.

⁶⁴ *Pyo v. Commissioner*, 83 T.C. 626 (1984); *Shelton v. Commissioner*, 63 T.C. 193 (1974). See CCA 201518016 (IRS has no authority to abate assessment where Appeals Officer cannot verify that deficiency notice was mailed to taxpayer's last known address, taxpayer does not remember receiving notice, and IRS has not yet concluded that assessment is invalid).

court if the taxpayer can show irreparable injury and inadequate remedy at law.⁶⁵

(2) Joint Income Tax Returns

Generally, in the case of a joint income tax return filed by a husband and wife, a notice of deficiency is validly issued if only a single notice addressed to both spouses is mailed.⁶⁶ On the other hand, if either spouse notifies the IRS that separate residences have been established,⁶⁷ the IRS must send a duplicate original of the notice of deficiency by certified or registered mail to each spouse at his or her last known address.⁶⁸ In addition, IRS practice is to mail a separate notice of deficiency to both spouses in all joint return cases.

(3) Erroneous Assessment of a Deficiency

Section 6213 gives the Tax Court jurisdiction to enjoin assessment and collection of any tax by the IRS if the tax is the subject of a timely filed petition pending before the Tax Court. This jurisdiction exists only if the taxpayer timely petitions the Tax Court.⁶⁹ On occasion, the IRS erroneously assesses a deficiency when the taxpayer has filed a timely Tax Court petition. In such cases, the IRS typically places an immediate hold on collection and abates the assessment once the error is brought to its attention.

3. Employment Taxes

In certain cases — e.g., employment taxes imposed under Subtitle C — the IRS may assess a tax without issuing a notice of deficiency.⁷⁰ The taxpayer normally is afforded a pre-assessment administrative appeal. The taxpayer's only judicial remedy is to challenge the assessment by filing a claim for refund and, if the claim is denied, challenging the assessment in federal district court or the U.S. Court of Federal Claims.

4. Penalty Assessments

Most penalties that are not imposed on “deficiency taxes” are not subject to the deficiency procedures. These include penalties under §6694(a) (negligent or intentional disregard of rules and regulations by a tax return preparer causing an understatement of tax), §6695 (failure to sign return, failure to furnish copy to taxpayer, failure to furnish identification number, failure to retain copy or list, failure to file correct information return, or the improper negotiation of refund checks), §6694(b) (willful understatement of liability by a tax return preparer), §6700 (promoting abusive tax shelters), §6701 (aiding and abetting understatements of tax liability), §6702 (frivolous tax submissions), and §6672 (nonpayment of withheld tax-

es).⁷¹ The specific assessment procedures should be analyzed if the assessment at issue involves one of these penalties.

5. Partnership Audit Cases

There are special rules for assessments under the partnership audit procedures for certain partnerships.⁷² These rules are quite complicated and often are not fully understood by the IRS. Particular attention should be paid to the procedures for any assessment purportedly resulting from a partnership audit.

6. Jeopardy and Termination Assessments

As discussed earlier, income, estate, gift, and certain other taxes are subject to pre-assessment deficiency procedures. These procedures can be lengthy, taking months or even years before an assessment is made. Employment and other types of taxes are not subject to the deficiency rules. All types of taxes, however, require a 30-day waiting period after assessment before enforced collection may begin.⁷³

In certain circumstances, the deficiency procedures and the waiting period place the collection of taxes at risk. In recognition of this potential problem, there are special provisions for jeopardy or termination assessments.⁷⁴ These provisions allow for immediate assessment and collection of taxes.

Jeopardy assessments are made when the tax year has passed. Termination assessments are made for the current taxable year or the immediately preceding taxable year when the filing date has not yet passed. To offset the potentially harsh effect of an immediate assessment and collection, there are expedited administrative and judicial review of these assessments and related “jeopardy levies” served within the 30-day waiting period.⁷⁵

a. Elements of Jeopardy

While the respective statutory provisions governing jeopardy and termination assessments indicate that different standards may apply to each,⁷⁶ the regulations make it clear that the determinations for both types of assessments are the same.⁷⁷ Under both the jeopardy and termination assessment procedures, the IRS can assess the tax and immediately commence collection if any one of the following situations exists:

- the taxpayer is or appears to be designing to depart quickly from the United States or to conceal himself;
- the taxpayer is or appears to be planning to place property beyond the reach of the IRS either by removing it from the United States, by concealing it, by dissipating it, or by transferring it to other persons; or

⁶⁵ §7421, §6213(a); *Cool Fuel, Inc. v. Connett*, 685 F.2d 309 (9th Cir. 1982). See *Laing v. United States*, 423 U.S. 161 (1976).

⁶⁶ §6212(b)(2); Reg. §301.6212-1(b)(2).

⁶⁷ Such notification should be provided in accordance with Rev. Proc. 2010-16, §4.02.

⁶⁸ See discussion in 630 T.M., *Tax Court Litigation*.

⁶⁹ §6213(a); see *Allen v. Commissioner*, No. 22-12537, 2022 BL 456105 (11th Cir. Dec. 21, 2022) (unpub. op.) (Tax Court dismissed for lack of jurisdiction where petition was postmarked one day after filing deadline).

⁷⁰ §6212(a), §6213. Withholding taxes reported on a Business Master File (BMF) return may be assessed without following deficiency procedures, however, in certain cases where an examination involves worker classification issues, procedures under §7436 apply. FAA 20102901F.

⁷¹ See discussion in 634 T.M., *Civil Tax Penalties*, and 639 T.M., *Responsible Person and Lender Liability for Trust Fund Taxes — Sections 6672 and 3505*.

⁷² For a further discussion of partnership audit assessments, see 629 T.M., *The Partnership Audit Rules Under the Bipartisan Budget Act*.

⁷³ §6331(d).

⁷⁴ See generally §6851–§6867.

⁷⁵ §7429.

⁷⁶ See §6851, §6861.

⁷⁷ See Reg. §1.6851-1(a)(1), §301.6861-1(a).

• the taxpayer’s financial solvency is or appears to be imperiled.⁷⁸

(1) *Departure from Country*

(a) *In General*

The most general category of jeopardy or termination assessment applies when a person is about to leave the country. In this situation, the Code and the regulations do not require any jeopardy to collection other than the mere fact that the taxpayer is leaving the country.⁷⁹ A taxpayer that already has left the country is not subject to a jeopardy assessment on this ground.⁸⁰ Somewhat different standards apply to U.S. citizens than to resident and nonresident aliens. U.S. citizens leaving the country generally are not subject to jeopardy or termination assessments unless they indicate an intention never to return.⁸¹ Resident and nonresident aliens must obtain a certificate of compliance with internal revenue laws before leaving the country.⁸² Diplomats, employees of foreign governments, students, trainees, and certain aliens temporarily in the United States receive limited exceptions to the certificate of compliance rule.⁸³ Resident aliens intending to depart the country permanently and all nonresident aliens are subject to a jeopardy or termination assessment without any further indicia of jeopardy.⁸⁴ Resident aliens not intending to leave the country permanently are not subjected to a jeopardy or termination assessment without further evidence of jeopardy.⁸⁵

Example: The IRS issued jeopardy assessments against a doctor (Z) and his professional corporation. Each was assessed \$500,000 for four preceding years. The IRS seized property belonging to Z. Also, Z and his wife were indicted for income tax fraud. The jeopardy assessments are reasonable given that: (1) over \$600,000 of the professional corporation’s receipts were directed to Z’s personal account; (2) Z transferred over \$2 million to foreign bank accounts during the years in issue; (3) Z and his wife are foreign born and have relatives in other countries; (4) Z did not report having foreign bank accounts on his federal tax returns; and (5) Z transferred over \$1.2 million to a Swiss bank account after being contacted by IRS special agents.⁸⁶

(b) *Certificate of Compliance*

The regulations provide that aliens (whether resident or nonresident) who depart from the United States or any of its possessions must first procure a certificate that they have complied with all of the obligations imposed upon them by the income tax laws.⁸⁷ This certificate is commonly referred to as a

“sailing permit.” To obtain the certificate, the alien who intends to depart must:

- file any statements or returns required to be filed;
- appear before the IRS (if deemed necessary); and
- pay any taxes required to be paid.⁸⁸

The certificate of compliance must be presented at the point of departure.⁸⁹

When a resident or nonresident alien intends to depart the United States, the IRS determines whether the departure jeopardizes the collection of any income tax for the current or the preceding taxable year.⁹⁰ If the IRS determines that the collection of tax is jeopardized, the alien’s taxable period is terminated.⁹¹ The departure of a resident alien who intends to continue residency generally is not treated as resulting in jeopardy unless circumstances suggest that the alien intends to depart to avoid payment of tax.⁹² In contrast, the departure of a nonresident alien generally does result in a finding of jeopardy unless the alien establishes that he intends to return to the United States and that his departure will not jeopardize the collection of tax.⁹³

(i) *Resident or Nonresident Alien with No Taxable Income*

A resident or nonresident alien with no taxable income for the taxable period up to and including the date of departure (and for the preceding taxable year where the period for filing the income tax return for such year has not expired) must file a statement to that effect on Form 2063, *U.S. Departing Alien Income Tax Statement*, in order to secure a certificate of compliance.⁹⁴ In addition, any alien who is in default in filing a return or paying income tax for any taxable year must file the return and pay the tax to obtain the certificate.⁹⁵

(ii) *Resident Alien Whose Taxable Period Is Not Terminated*

A resident alien with taxable income whose taxable period is not terminated because the IRS finds that his departure does not jeopardize the collection of tax must file a statement to that effect on Form 2063 to secure a certificate of compliance.⁹⁶ In addition, any resident alien who has not filed a return or paid income tax for any taxable year must file the return and pay the tax before procuring the certificate.⁹⁷

⁷⁸ Reg. §1.6851-1(a)(1)(i)–(iii), §301.6861-1(a).

⁷⁹ Reg. §1.6851-1(a)(1)(i) defines a jeopardy situation as simply the taxpayer’s departure from the country.

⁸⁰ *Rogan v. Mertens*, 153 F.2d 737 (9th Cir. 1946).

⁸¹ U.S. citizens are not required to produce evidence of compliance with internal revenue laws before leaving the country. Reg. §1.6851-1(a)(4).

⁸² Reg. §1.6851-2.

⁸³ Reg. §1.6851-2(a)(2).

⁸⁴ Reg. §1.6851-2(b)(1)(ii).

⁸⁵ Reg. §1.6851-2(b)(1)(ii). See, e.g., *Lindholm v. United States*, 808 F. Supp. 3 (D.D.C. 1992).

⁸⁶ *Zamzam v. United States*, 97-1 USTC ¶50,354 (W.D. Va. 1997).

⁸⁷ Reg. §1.6851-2(a)(1). See IRS Publication 519, *U.S. Tax Guide for Aliens*.

⁸⁸ Reg. §1.6851-2(a)(1). Both filing and payment requirements are discussed below.

⁸⁹ Reg. §1.6851-2(a)(1).

⁹⁰ Reg. §1.6851-2(b)(1)(i).

⁹¹ Reg. §1.6851-2(b)(1)(i).

⁹² Reg. §1.6851-2(b)(1)(ii).

⁹³ Reg. §1.6851-2(b)(1)(ii).

⁹⁴ Reg. §1.6851-2(b)(2)(i), §1.6851-2(b)(2)(ii).

⁹⁵ Reg. §1.6851-2(b)(2).

⁹⁶ Reg. §1.6851-2(b)(2)(i).

⁹⁷ Reg. §1.6851-2(b)(2) (flush language).

(iii) *Nonresident Alien Whose Taxable Period Is Not Terminated*

A nonresident alien who has taxable income but whose taxable period is not terminated must file a return, in duplicate, on Form 1040-C for the taxable year of his intended departure to secure a certificate of compliance.⁹⁸ This Form 1040-C must show income received and reasonably expected to be received during the entire taxable year within which the departure occurs. In addition, a nonresident alien must file any delinquent income tax returns and must pay any income tax due.⁹⁹

(iv) *Resident or Nonresident Alien Whose Taxable Period Is Terminated*

In order to secure a certificate of compliance, every alien whose taxable period is terminated upon departure must file with the IRS a return, in duplicate, on Form 1040-C for the short taxable period resulting from such termination showing income received and reasonably expected to be received during the taxable year up to and including the date of departure.¹⁰⁰ In addition, the alien must file the return required under §6012 if the period for filing has not expired as well as any other income tax returns that have not been filed as required.¹⁰¹ The alien must also pay the income tax shown on all returns required to be filed and any income tax due and owing for prior years.¹⁰²

(2) *Concealment of Assets*

Concealment or dissipation of assets is the most frequently litigated basis for a jeopardy or termination assessment.¹⁰³ The courts have cited the following factors as indications of concealment or dissipation of assets:

- possessing and dealing in large amounts of cash,¹⁰⁴
- engaging in an illegal activity,¹⁰⁵
- failing to file returns or underreporting income,¹⁰⁶
- liquidating assets and/or manifesting other behavior which indicates a likelihood of flight;¹⁰⁷

⁹⁸ Reg. §1.6851-2(b)(3)(ii).

⁹⁹ Reg. §1.6851-2(b)(3)(ii).

¹⁰⁰ Reg. §1.6851-2(b)(3)(iii).

¹⁰¹ Reg. §1.6851-2(b)(3)(iii).

¹⁰² Reg. §1.6851-2(b)(3)(iii).

¹⁰³ See Reg. §1.6851-1(a)(1)(ii) (taxpayer appears to be designing quickly to place assets beyond government's reach by removing, concealing, dissipating, or transferring it).

¹⁰⁴ *Dorsey v. United States*, 84-2 USTC ¶9643 (C.D. Cal. 1984); *Howard v. United States*, 84-2 USTC ¶9550 (S.D. Miss. 1984); *Barry v. United States*, 534 F. Supp. 304 (E.D. Pa. 1982); *Erath v. United States*, 79-1 USTC ¶9397 (S.D. Cal. 1979); *Nichols v. United States*, 79-1 USTC ¶9193 (E.D. Cal. 1978), *aff'd*, 633 F.2d 829 (9th Cir. 1980); *Onyeani v. United States*, 2016-1 USTC ¶50,304 (N.D. Ill. 2016) (termination assessment upheld as court found IRS's belief was reasonable that taxpayer was obstructing IRS's ability to collect tax where taxpayer was attempting to conceal income, had attempted to transfer hundreds of thousand of dollars abroad, and, despite having over \$800,000 in bank accounts, had reported no income for several years).

¹⁰⁵ *Erath v. United States*, 79-1 USTC ¶9397 (S.D. Cal. 1979); *Nichols v. United States*, 79-1 USTC ¶9193 (E.D. Cal. 1978), *aff'd*, 633 F.2d 829 (9th Cir. 1980); *Golden ADA, Inc. v. United States*, 934 F. Supp. 341 (N.D. Cal. 1996) (taxpayer continued to liquidate assets after made aware of criminal investigation and civil RICO action).

¹⁰⁶ *Howard v. United States*, 84-2 USTC ¶9550 (S.D. Miss. 1984); *Condon v. United States*, 539 F. Supp. 784 (E.D. Pa. 1981).

• using an alias;¹⁰⁸ and

• planning to use the taxpayer's known assets to defend a criminal proceeding.¹⁰⁹

Comment: While the taxpayer's burden in showing an absence of jeopardy is often quite difficult, the government's determination of jeopardy is not sustained in all cases. The most favorable cases for the taxpayer appear to be those cases in which the jeopardy assessment results from a failed criminal investigation.¹¹⁰ Since criminal investigations are frequent sources of jeopardy assessments, a failed criminal investigation defense may apply in a number of cases.

(3) *Insolvency*

Jeopardy arising from a taxpayer's insolvency generally involves the same analysis as concealment of assets. The IRS rarely makes a jeopardy or termination assessment based merely on its knowledge of the taxpayer's weak financial condition (even though such an interpretation is plausible from the literal language of the Code and the regulations).¹¹¹ Rather, the insolvency indicia of jeopardy is primarily intended for corporations in liquidation.¹¹² There are only a few cases reported involving these situations. Typically some type of affirmative act of dissipating or liquidating assets is required before financial insolvency is considered to be an indication of jeopardy. The proposed jeopardy or termination assessment is not a liability for purposes of the insolvency determination.¹¹³

b. *Administrative Procedures*

(1) *Jeopardy Assessment vs. Termination Assessment*

While jeopardy and termination assessments are the subject of separate provisions of the Code, the only real distinctions between them is the situations in which they apply and the different notice of deficiency provisions. A jeopardy assessment may be made for any tax year for which a tax return is

¹⁰⁷ *Simpson v. United States*, 573 F. Supp. 146 (M.D. Tenn. 1983) (U-Haul at house is sufficient); *Revis v. United States*, 83-1 USTC ¶9223 (D.R.I. 1983) (two-and-a-half-year pattern of disposition sufficient); *Billig v. United States*, 81-2 USTC ¶9792 (N.D. Ga. 1981); *French v. United States*, 79-2 USTC ¶9538 (E.D. Okla. 1979) (taxpayer provided no explanations for transfers or liquidations; court must conclude objective is placing property beyond government's reach); *DeLauri v. United States*, 492 F. Supp. 442 (W.D. Tex. 1980) (three-year pattern of disposition sufficient). *But see Snyder v. United States*, 85-1 USTC ¶9176 (D. Md. 1984), *modified on other issue*, 776 F.2d 187 (4th Cir. 1985) (delay of over two years from jeopardy event not sufficient); *Fumo v. United States*, 2014-1 USTC ¶50,310 (E.D. Pa. 2014) (transfers over period of years for financial and legal reasons to manage affairs during incarceration not jeopardy).

¹⁰⁸ *Erath v. United States*, 79-1 USTC ¶9397 (S.D. Cal. 1979); *Nichols v. United States*, 79-1 USTC ¶9193 (E.D. Cal. 1978), *aff'd*, 633 F.2d 829 (9th Cir. 1980).

¹⁰⁹ *Simpson v. United States*, 573 F. Supp. 146 (M.D. Tenn. 1983); *Randahl v. United States*, 82-1 USTC ¶9356 (D. Minn. 1982); *Nolan v. United States*, 539 F. Supp. 788 (D. Ariz. 1982).

¹¹⁰ See, e.g., *Guerra v. United States*, 645 F. Supp. 775 (C.D. Cal. 1986); *Welch v. United States*, 575 F. Supp. 464 (S.D. Miss. 1983).

¹¹¹ See *Fumo v. United States*, 2014-1 USTC ¶50,310 (E.D. Pa. 2014) (taxpayer's diminishing new worth due to legal bills, criminal restitution, and other financial obligations not indicative of insolvency when still maintaining high net worth).

¹¹² See, e.g., *Fidelity Equipment Leasing Corp. v. United States*, 462 F. Supp. 845 (N.D. Ga. 1978).

¹¹³ Reg. §1.6851-1(a)(1).

due.¹¹⁴ A termination assessment, on the other hand, is applicable only when the tax return for the tax year at issue is not yet due.¹¹⁵ A termination assessment serves to terminate the taxable year for the purpose of computing the amount of tax to be assessed and collected under the termination assessment procedure. Jeopardy and termination assessments are often entered at the same time against the taxpayer as a result of the taxpayer's continuing activity. The difference in the notice of deficiency rules is discussed in III.A.6.b.(5), below.

(2) *Jeopardy Assessment of Non-Deficiency Taxes — §6862*

Section 6861 outlines the jeopardy assessment procedures for taxes that are governed by deficiency procedures. These deficiency taxes are subject to a lengthy administrative and judicial process before assessment. Certain other penalties and taxes (e.g., employment taxes) are not subject to deficiency procedures. There is less need for a jeopardy assessment of these nondeficiency taxes, since the taxes may be immediately assessed in any event without a pre-assessment judicial review. Non-deficiency taxes and penalties may, nonetheless, be the subject of jeopardy assessments pursuant to the procedures set forth in §6862.¹¹⁶ Section 6862 parallels §6861 in that the IRS must make a determination that collection would be jeopardized by delay. No Tax Court review is available for the tax assessed by the jeopardy assessment under §6862, however.¹¹⁷ Section 6862 also requires immediate notice and demand, which is not required under either §6851 or §6861.

(3) *Administrative Approval*

Since a jeopardy or termination assessment is an action with dramatic consequences, IRS Chief Counsel review and approval is required before the IRS can make a jeopardy assessment, a termination assessment, or a jeopardy levy.¹¹⁸ If such prior approval is not obtained, the taxpayer is entitled to an abatement of the assessment or release of the levy.¹¹⁹

This legislative mandate conforms with the IRS practice of making a detailed administrative review of the merits of the case before assessment. All jeopardy and termination assessments must be personally approved by the Area Director for the Area in which the assessment is made¹²⁰ as well as the IRS Area Counsel. In addition to the Area Director's and Counsel's approval, the following IRS officials must review the case: the Examination Group Manager; the Collection Territory Manager; the Chief of the Quality Review Staff; and the Chief of Technical Services.¹²¹

Note: The failure to obtain the personal approval of the Area Director can invalidate the assessment. In one case, an As-

¹¹⁴ Section 6861 applies to deficiencies that only technically arise when a tax is due. See §6211.

¹¹⁵ §6851(a)(4).

¹¹⁶ See *The Butcher Shop, Inc. v. United States*, 88-2 USTC ¶9542 (N.D. Ohio 1988).

¹¹⁷ Taxes under §6862 are, by definition, not taxes subject to deficiency procedures. The Tax Court only has jurisdiction over deficiencies. See §6213(a).

¹¹⁸ §7429(a)(1)(A).

¹¹⁹ See H.R. Conf. Rep. No. 599, 103d Cong., 2d Sess. 56 (1998).

¹²⁰ Rev. Proc. 78-12.

¹²¹ See IRM 5.1.4.3 *et seq.* (03-10-22).

sistant Director, who did not have an official delegation in effect at the time of approval, approved a jeopardy assessment. A district court found the approval to be insufficient and invalidated a subsequent jeopardy assessment aimed at correcting the original defect.¹²² Other courts, however, have held that the use of the Director's signature stamp¹²³ and approval by the acting Director (while the Director was out of town)¹²⁴ did not invalidate the assessment. The required approving signatures are placed on Form 2644 (Recommendation for Jeopardy Assessment/Recommendation for Termination Assessment).¹²⁵ Any taxpayer contesting a jeopardy or termination assessment should obtain Form 2644 to determine the IRS's compliance with the applicable provisions.

(4) *Written Statement of Basis of Assessment*

Within five days after making a jeopardy or termination assessment, the IRS must provide the taxpayer with a written statement setting forth the information that the IRS used in making the assessment.¹²⁶ Typically, the IRS combines this written statement of facts with the letter that notifies the taxpayer of the assessment.

Comment: The written statement frequently contains minimal information concerning the basis of the assessment. Therefore, it may be possible to invalidate the assessment by attacking the adequacy of this written statement.¹²⁷

The importance of the written statement is lessened somewhat by the fact that the IRS can rely on information acquired after the assessment in supporting the reasonableness of the assessment.¹²⁸ The real importance of the written statement is procedural. The statement starts the clock on the 30-day period in which the taxpayer may file an administrative appeal.¹²⁹ Since no judicial review is available if the taxpayer does not file an administrative appeal,¹³⁰ this timing element is critical.

(5) *Notice of Deficiency*

In addition to the written statement setting forth the IRS's position, the IRS also must issue a notice of deficiency after

¹²² *Swegles v. United States*, 87-1 USTC ¶9368 (C.D. Cal. 1987); *Brown v. Commissioner*, T.C. Memo 2016-801, *aff'd*, 697 Fed. Appx. 1 (D.C. Cir. 2017) (unpub.).

¹²³ *Turner v. Turner*, 82-2 USTC ¶9710 (M.D. Fla. 1982).

¹²⁴ *Barry v. United States*, 534 F. Supp. 304 (E.D. Pa. 1982).

¹²⁵ IRM 5.1.4.3 (03-10-22) *et seq.*

¹²⁶ §7429(a)(1)(B). A similar written statement is required after the IRS makes a jeopardy levy.

¹²⁷ *Walker v. United States*, 650 F. Supp. 877 (E.D. Tenn. 1987). *But see Evans v. United States*, 672 F. Supp. 1118 (S.D. Ind. 1987); *Berkery v. United States*, 544 F. Supp. 1 (E.D. Pa. 1982); *Barry v. United States*, 534 F. Supp. 304 (E.D. Pa. 1982); *DeLauri v. United States*, 492 F. Supp. 442 (W.D. Tex. 1980); *Fidelity Equip. Leasing Corp. v. United States*, 462 F. Supp. 845 (N.D. Ga. 1978).

¹²⁸ *Loretto v. United States*, 440 F. Supp. 1168 (E.D. Pa. 1977); *Haskin v. United States*, 444 F. Supp. 299 (C.D. Cal. 1977), *aff'd* (9th Cir. 1978) (unpub.).

¹²⁹ §7429(a)(2). It appears that the time limit for administrative appeal is the earlier of: (1) 30 days from the date of receipt of the written statement; or (2) 35 days from the date of assessment. See Rev. Proc. 78-12; *Snyder v. United States*, 85-1 USTC ¶9176 (D. Md. 1984), *modified on other issue*, 766 F.2d 187 (4th Cir. 1985).

¹³⁰ §7429(b)(1). See *Abrattis v. United States*, 709 F.3d 641 (6th Cir. 2013) (although §7429 requirement for exhaustion of administrative remedies is precondition to judicial review of jeopardy determination, it is not jurisdictional).

making a jeopardy or termination assessment.¹³¹ The notice of deficiency rules for jeopardy assessments differ from the rules for termination assessments.

If a jeopardy assessment is made and a notice of deficiency was not previously sent to the taxpayer for that tax year, the IRS must mail a notice of deficiency to the taxpayer within 60 days after the assessment.¹³² If this notice of deficiency is not issued within the 60-day period, the jeopardy assessment must be abated.¹³³ A jeopardy assessment can also be made after the IRS has issued a notice of deficiency and the taxpayer has filed a Tax Court case.¹³⁴ If a notice of deficiency was previously sent to the taxpayer, no new notice of deficiency is required. The amount of the jeopardy assessment can be either more or less than the notice of deficiency amount.¹³⁵

The notice of deficiency for a termination assessment must be mailed within 60 days after the later of: (1) the due date (including extensions) of the taxpayer's return for the full taxable year; or (2) the date on which the return is actually filed.¹³⁶ If the taxpayer does not file a tax return, however, the notice of deficiency must be issued within 60 days after the due date of the return.¹³⁷ The notice of deficiency issued after a termination assessment may be for a greater or lesser amount than the termination assessment.¹³⁸

Note: As discussed above, a termination assessment only serves to terminate the taxable year for the purpose of computing the amount of tax to be assessed and collected under the termination assessment procedure; it does not terminate the taxable year for all purposes. Therefore, a district court's order enforcing a termination assessment is largely irrelevant with respect to the taxpayer's liability for the tax year, since the termination assessment does not establish the year's total liability.¹³⁹

Even though an untimely notice of deficiency issued after a jeopardy or termination assessment invalidates the assessment, the notice of deficiency is valid, provided that it is issued within the applicable period of limitations for that tax year. The Tax Court will assume jurisdiction over the notice of deficiency to determine the correct tax.¹⁴⁰

c. Administrative Appeal

The taxpayer has 30 days from receipt of the written statement of the IRS's position in which to file an administrative appeal, or 35 days after the assessment if the notice is not time-

ly delivered.¹⁴¹ The taxpayer must file the appeal with the Area Director who issued the notification of jeopardy or termination assessment.¹⁴² The request will be forwarded to the Examination Coordinator, who will in turn forward the request to the Technical Services Manager. The coordinator will keep a copy of the request and will notify Appeals of the request for review. The IRS administrative file is then forwarded to Appeals.¹⁴³ The Appeals Officer has a great deal of discretion in determining the propriety of the assessment. If the Appeals Officer determines that jeopardy to collection does not exist or that the amount assessed is excessive, abatement of all or part of the assessment may be ordered.¹⁴⁴ The Appeals Officer also may entertain negotiations to determine the taxpayer's ultimate tax liability. A conference with the Appeals Officer presents the best opportunity for early administrative settlement of the matters underlying the jeopardy assessment.

If the administrative appeal does not settle the jeopardy assessment issues, the Appeals Officer must issue a letter denying the appeal. This letter is typically brief and merely states that the Appeals Officer found that the determination of jeopardy was reasonable and that the amount assessed was appropriate under the circumstances.¹⁴⁵

d. Judicial Review of Assessment or Levy

Congress enacted an expedited judicial review of jeopardy and termination assessments under §7429 to protect against arbitrary IRS jeopardy determinations. A §7429 summary hearing provides for a review of the reasonableness of the IRS's jeopardy determination but does not determine the ultimate tax liability.

(1) Procedural Issues

The taxpayer must bring an action for judicial review of a jeopardy or termination assessment or a jeopardy levy within 90 days after the earlier of: (1) the day the IRS Appeals Officer notifies the taxpayer of the results of the administrative review; or (2) the 16th day after the taxpayer files the request for the administrative review.¹⁴⁶ A Saturday, Sunday, or legal holiday in the District of Columbia is not counted as the last day of the period.¹⁴⁷

If the administrative review is not requested within the time provided, no judicial review is allowed.¹⁴⁸ Jurisdiction for the action lies exclusively in federal district court unless the assessment or jeopardy levy includes a tax year that already is the subject of a case pending before the Tax Court.¹⁴⁹ In this case,

¹³¹ §6851(b), §6861(b).

¹³² §6861(b); Reg. §301.6861-1(c).

¹³³ See, e.g., *Laing v. United States*, 423 U.S. 161 (1976); *Campbell v. United States*, 592 F.2d 309 (6th Cir. 1979) (termination assessments not followed by notices of deficiency require abatement of assessment and return of all seized property).

¹³⁴ Nevertheless, the jeopardy assessment cannot be made after the Tax Court decision has become final or has been appealed. Reg. §301.6861-1(a).

¹³⁵ §6861(c); Reg. §301.6861-1(b). See CCA 201723019 (court notification in jeopardy assessments is to alert court where amount of assessment differs from deficiency in prior notice of deficiency; no comparable provision for termination assessments).

¹³⁶ §6851(b); Reg. §1.6851-1(b).

¹³⁷ *Perlowin v. Sassi*, 711 F.2d 910 (9th Cir. 1983).

¹³⁸ See Reg. §1.6851-1(b).

¹³⁹ See, e.g., *Romano v. Commissioner*, 101 T.C. 530 (1993).

¹⁴⁰ *Ramirez v. Commissioner*, 87 T.C. 643 (1986) (termination assessments); *Teitelbaum v. Commissioner*, 40 T.C. 223 (1963) (jeopardy assessments).

¹⁴¹ §7429(a)(1)(B), §7429(a)(2); IRM 4.15.1.10.4.1.3 (07-26-21).

¹⁴² Rev. Proc. 78-12; IRM 4.15.1.10.4.1.3 (07-26-21).

¹⁴³ IRM 4.15.1.10.4.1.3 (07-26-21).

¹⁴⁴ Rev. Proc. 78-12. See IRM 4.15.1.10.4.1.4 (07-26-21).

¹⁴⁵ Rev. Proc. 78-12.

¹⁴⁶ §7429(b)(1); *Fernandez v. United States*, 704 F.2d 592 (11th Cir.), cert. denied, 464 U.S. 852 (1983). This expedited post-assessment review apparently resolves any due process questions. See *Abraitis v. United States*, 709 F.3d 641 (6th Cir. 2013) (although §7429 requirement for exhaustion of administrative remedies is precondition to judicial review of jeopardy determination, it is not jurisdictional); *Commissioner v. Shapiro*, 424 U.S. 614 (1976).

¹⁴⁷ §7429(d).

¹⁴⁸ §7429(b) specifies the only two permitted means for obtaining district court review; both contemplate the filing of a request for administrative review. *Friko Corp. v. Commissioner*, 26 F.3d 1139 (D.C. Cir. 1994).

¹⁴⁹ §7429(b)(2)(A).

the Tax Court has jurisdiction to review all of the years at issue.¹⁵⁰ The district court's judicial review of a jeopardy assessment or levy is *de novo*, with no deference to the prior IRS administrative determinations.¹⁵¹

District court venue for a §7429 action lies in the judicial district in which the taxpayer resides.¹⁵² A resident alien can satisfy the venue requirement, but a nonresident alien by definition does not reside in any judicial district in the United States.¹⁵³ While the IRS takes the position that venue for a nonresident alien's §7429 action is not proper in any judicial district, the courts have split on the issue.¹⁵⁴

Within 20 days after the complaint for judicial review is filed, the court must determine whether the IRS was *reasonable* in determining that jeopardy to collection existed and whether the amount of the assessment was *reasonable*. If the government is not properly served within five days after commencement of the proceeding, the 20-day period begins with the date that proper service is made.¹⁵⁵ If the taxpayer establishes a reasonable basis for an extension, the court can extend the 20-day period up to 40 additional days.¹⁵⁶ The failure of the court to review the assessment within the 20-day period does not invalidate the assessment unless the government is the cause of the delay.¹⁵⁷

(2) Discovery

There is no express provision in §7429 for discovery. Without discovery, however, the taxpayer faces a difficult task in trying to overcome the determination of jeopardy by the IRS. As discussed earlier, the written statement of the IRS's position is often summary in nature. Without some form of discovery, the taxpayer may be unable to ascertain the nature of the IRS claim to prepare a response. In recognition of this problem, the courts generally have allowed limited discovery in actions brought under §7429.¹⁵⁸

Note: The extent of discovery allowed is uncertain. The courts are most likely to allow the taxpayer to take the deposition of the IRS revenue agent responsible for the jeopardy assessment.¹⁵⁹ Beyond that, however, additional discovery may be difficult to obtain. Case law suggests that the degree of discov-

¹⁵⁰ §7429(b)(2)(B). If the Tax Court finds that it lacks jurisdiction, but it is in the interest of justice to transfer the action to district court, then it must do so. §7429(e)(2).

¹⁵¹ See *George F. Harding Museum v. United States*, 674 F. Supp. 1323 (N.D. Ill. 1987); *Fumo v. United States*, 2014-1 USTC ¶50,310 (E.D. Pa. 2014).

¹⁵² §7429(e)(1).

¹⁵³ *Williams v. United States*, 704 F.2d 1222 (11th Cir. 1983); *Lemery v. Commissioner*, 54 T.C. 480 (1970).

¹⁵⁴ *Compare Alegria v. United States*, 945 F.2d 1523 (11th Cir. 1991) (while venue for review of jeopardy assessment is proper only where taxpayer resides, thereby barring nonresident aliens from maintaining such review actions, there is no rational basis for distinguishing between nonresident aliens and citizens); *Garzon v. United States*, 605 F. Supp. 738 (S.D. Fla. 1985) (venue found to exist); *First City Nat'l Bank v. United States*, 602 F. Supp. 146 (W.D. Tex. 1984) (ancillary venue found); *Bautista v. United States*, 88-2 USTC ¶9599 (N.D. Cal. 1988) (venue not found).

¹⁵⁵ §7429(b)(3).

¹⁵⁶ §7429(c).

¹⁵⁷ *Meadows v. United States*, 665 F.2d 1009 (11th Cir. 1982); *United States v. Doyle*, 660 F.2d 277 (7th Cir. 1981); *Clarke v. United States*, 587 F. Supp. 674 (E.D. Va. 1984).

¹⁵⁸ See *Hohman v. United States*, 535 F. Supp. 1218 (D.D.C. 1982).

ery allowed depends on the specificity of the written statement of the IRS's position.¹⁶⁰ If the court allows reasonable discovery, however, any defect in the written statement may be considered harmless.¹⁶¹

(3) Burden of Proof

The courts analyze two factors in ruling on the propriety of the jeopardy assessment. First, the IRS has the burden of establishing that it acted reasonably (not correctly) in determining that jeopardy to collection existed.¹⁶² Under this "reasonable" standard, the courts have required that the IRS's position be something more than arbitrary or capricious and something less than supported by substantial evidence.¹⁶³ Moreover, the reasonableness of the IRS's position may be based on inadmissible evidence.¹⁶⁴ Because the standard is reasonableness, it is very difficult for the taxpayer to successfully challenge a determination that collection of the tax is in jeopardy. While taxpayers have prevailed in some instances, the vast majority of reported cases have been in favor of the government.¹⁶⁵

¹⁵⁹ *Hohman v. United States*, 535 F. Supp. 1218 (D.D.C. 1982); *Bremson v. United States*, 459 F. Supp. 121 (W.D. Mo. 1978). *But see Hedrick v. United States*, 88-2 USTC ¶9612 (N.D. Ga. 1988) (no depositions allowed).

¹⁶⁰ *Hohman v. United States*, 535 F. Supp. 1218 (D.D.C. 1982); *Fidelity Equip. Leasing Corp. v. United States*, 462 F. Supp. 845 (N.D. Ga. 1978).

¹⁶¹ *Hohman v. United States*, 535 F. Supp. 1218 (D.D.C. 1982). See *Fidelity Equip. Leasing Corp. v. United States*, 462 F. Supp. 845 (N.D. Ga. 1978).

¹⁶² §7429(g)(1). See, e.g., *McWilliams v. Commissioner*, 103 T.C. 416 (1994) (jeopardy assessment not reasonable since IRS failed to prove taxpayer was planning to flee country; in fact, taxpayer moved to address within United States).

¹⁶³ *Kalkhoven v. United States*, No. 2:21-cv-01440-KJM-JDP, 2021 BL 349694 (E.D. Cal. Sept. 15, 2021) (jeopardy assessment found to be reasonable where taxpayer transferred funds out of United States and transferred funds from real property sale into trust beyond reach of IRS but where trust found to not be independent of taxpayer's control); *Zamzam v. United States*, 97-1 USTC ¶50,354 (W.D. Va. 1997) (government meets the burden of proving that its jeopardy assessment was reasonable — i.e., not arbitrary or capricious and something less than supported by substantial evidence); *Santini v. United States*, 80-2 USTC ¶9586 (N.D. Cal. 1979); *Loretto v. United States*, 440 F. Supp. 1168 (E.D. Pa. 1977); *Revis v. United States*, 558 F. Supp. 1071 (D.R.I. 1983); *Golden ADA, Inc. v. United States*, 934 F. Supp. 341 (N.D. Cal. 1996). *But see George F. Harding Museum v. United States*, 674 F. Supp. 1323 (N.D. Ill. 1987) (citing *United States v. Doyle*, 482 F. Supp. 1227 (E.D. Wis. 1980), court articulates different standard akin to criminal probable cause preliminary hearing).

¹⁶⁴ See *Robinson v. Boyle*, 80-2 USTC ¶9524 (E.D. Va. 1980); *Golden ADA, Inc. v. United States*, 934 F. Supp. 341 (N.D. Cal. 1996); *Hecht v. United States*, 609 F. Supp. 264 (S.D.N.Y. 1985).

¹⁶⁵ *Compare Guerra v. United States*, 645 F. Supp. 775 (C.D. Cal. 1986), *Penner v. United States*, 582 F. Supp. 432 (S.D. Fla. 1984), and *Welch v. United States*, 575 F. Supp. 464 (S.D. Miss. 1983) with *Lopez v. United States*, 614 F. Supp. 1332 (E.D.N.Y. 1985), *Ratzlaff v. United States*, 83-2 USTC ¶9431 (W.D. Wis. 1983), *Simpson v. United States*, 573 F. Supp. 146 (M.D. Tenn. 1983), *Bailey v. United States*, 82-2 USTC ¶9620 (E.D. Mich. 1982), *Randahl v. United States*, 82-1 USTC ¶9356 (D. Minn. 1982), *Amyx v. United States*, 529 F. Supp. 98 (S.D. Ohio 1981), *Hamilton v. United States*, 81-1 USTC ¶9325 (E.D. Va. 1981), *Serpa v. United States*, 81-1 USTC ¶9323 (D. Neb. 1981), *Rogers v. United States*, 511 F. Supp. 82 (D. Minn. 1980), *Ramirez v. United States*, 81-1 USTC ¶9352 (S.D. Fla. 1980), *Fox v. United States*, 81-1 USTC ¶9234 (D. Colo. 1980), *Abercrombie v. United States*, 80-2 USTC ¶9681 (D.S.C. 1980), *Loretto v. United States*, 440 F. Supp. 1168 (E.D. Pa. 1977), and *Friedman v. United States*, 2002-2 USTC ¶50,731 (N.D. Ga. 2002). *But see Fumo v. United States*, 2014-1 USTC ¶50,310 (E.D. Pa. 2014) (jeopardy assessment abated where taxpayer did not attempt to place property out of government's reach or liquidate assets and transfers were for financial planning reasons due to incarceration).

Second, once the IRS establishes jeopardy to collection, the taxpayer then has the burden of establishing that the amount of the computation is unreasonable.¹⁶⁶ The difficulty for the taxpayer in meeting this burden depends on the method of proof that the IRS used in arriving at the amount of the assessment. Because of the expedited nature of jeopardy and termination assessments, the IRS typically has very little time to compile the necessary information to make accurate computations. As a result, the IRS often resorts to estimates and indirect methods of proof in establishing the taxpayer's income. Both of these methods of proof have been upheld by the courts as reasonable in determining the taxpayer's income in the absence of sufficient records.¹⁶⁷ Once the jeopardy assessment is found to be reasonable, some courts do not permit even partial relief for the taxpayer.¹⁶⁸

In spite of their theoretical validity, computations based on indirect methods of proof and computations based on estimates can be successfully attacked on the facts. The typical estimate involves an IRS determination of (1) the profitability of a particular transaction or series of transactions, and (2) an additional estimate of the annual volume of the activity. Both of these determinations may be challenged successfully.¹⁶⁹ The indirect methods of proof analyze the taxpayer's expenditures and increase in net worth and assume that the source of the annual increase in these figures is taxable income.¹⁷⁰ While both estimates and the indirect methods of proof involve projections and assumptions, the indirect methods of proof have an additional weakness, i.e., nontaxable sources of funds reduce or eliminate the taxable income computed. Since the IRS rarely has the opportunity to eliminate potential nontaxable sources of funds in a jeopardy or termination situation, the indirect methods of proof are more easily attacked.¹⁷¹

(4) Judicial Appeal

Section 7429(f) provides that there is no appeal from a district court's determination of the reasonableness of a jeopardy or termination assessment. In certain cases, the courts have interpreted this to preclude appeal on virtually any issue connected with the jeopardy or termination assessment.¹⁷² In other cas-

es, however, the courts seem willing to consider an appeal from trial court proceedings on predominantly procedural issues.¹⁷³

e. Tax Court Review of Deficiency

The Tax Court has limited jurisdiction to review jeopardy and termination assessments or jeopardy levies. This review occurs only when the assessment or levy occurs for a tax year already before the Tax Court. Instead, the Tax Court's primary role in the jeopardy and termination process is to determine the ultimate tax liability after the notice of deficiency has been issued. The summary hearing under §7429 does not establish the taxpayer's ultimate tax liability. Instead, this liability must be determined after the notice of deficiency has been issued in the Tax Court or in a refund litigation proceeding.¹⁷⁴

Comment: By being the subject of a jeopardy or termination assessment before the notice of deficiency is issued, the taxpayer actually may gain some advantages in Tax Court. First, the §7429 procedures provide the taxpayer with an early look at the grounds for the IRS's position. Second, a possible benefit may exist because the expedited nature of the jeopardy or termination assessment often means that the assessment is made with little case development by the IRS. The assessment is followed shortly by the notice of deficiency, which entitles the taxpayer to file a Tax Court petition. If an early Tax Court trial can be obtained, the IRS has a relatively short period in which to develop its case. Since the IRS has the burden of going forward with some evidence on unreported income issues,¹⁷⁵ the taxpayer may be able to force the IRS into an ill-prepared trial by accelerating the date of trial.

f. Collection Issues

Jeopardy and termination assessments are primarily collection devices. The IRS has other methods for investigating and determining a taxpayer's correct liability. Jeopardy and termination assessments are made when the taxpayer's actions indicate that the collection of the liability may be frustrated. Not surprisingly, there are a number of special collection rules that apply after a jeopardy or termination assessment.

(1) Jeopardy Levies

Section 6331(d) requires that the IRS wait 30 days after issuing a notice of intention to levy before enforcing collection. This 30-day waiting period, however, does not apply when the IRS determines that jeopardy to collection exists.¹⁷⁶ Jeopardy levies are not limited to jeopardy and termination assessment

¹⁶⁶ §7429(g)(2). See *Varjabedian v. United States*, 339 F. Supp. 2d 140 (D. Mass. 2004); *Goldberg v. United States*, 95-1 USTC ¶50,071 (C.D. Cal. 1994); *Revis v. United States*, 558 F. Supp. 1071 (D.R.I. 1983).

¹⁶⁷ See, e.g., *Lopez v. United States*, 614 F. Supp. 1332 (E.D.N.Y. 1985) (assessment based on income equal to the wholesale value of cocaine seized held reasonable); *Danneman v. United States*, 84-2 USTC ¶9792 (D. Md. 1984) (extrapolation from 15-day period reasonable).

¹⁶⁸ See *LaRosa v. United States*, 841 F.2d 544 (4th Cir. 1988); *Mrs. Philipines Home for Senior Citizens, Inc. v. United States*, 94-1 USTC ¶50,065 (D. Md. 1993) (where jeopardy assessment is reasonable, court cannot grant limited relief given Fourth Circuit precedent).

¹⁶⁹ See *Pizzarello v. United States*, 408 F.2d 579 (2d Cir.), cert. denied, 396 U.S. 986 (1969) (projection from three-day period invalid); *Breider v. United States*, 614 F. Supp. 1200 (E.D. Wis. 1985) (projection from 16-day period resulted in overstated assessment); *Giles v. United States*, 80-2 USTC ¶9546 (M.D. Fla. 1980) (estimated value of marijuana seized overstated). But see *Danneman v. United States*, 84-2 USTC ¶9792 (D. Md. 1984) (projection from 15-day period adequate).

¹⁷⁰ See 636 T.M., *Tax Crimes*, for a further discussion of indirect methods of proof.

¹⁷¹ See *Noreault v. United States*, 621 F. Supp. 818 (D. Vt. 1985).

¹⁷² See, e.g., *Stites v. United States*, 960 F.2d 864 (9th Cir. 1992) (no appellate review for refusal to award fees and costs in jeopardy assessment abatement); *Morgan v. United States*, 958 F.2d 950 (9th Cir. 1992) (dissenting opin-

ion: §7429 is absolute bar to appellate review); *Stebco Inc. v. United States*, 916 F.2d 556 (9th Cir. 1990) (no appellate review of district court's decision regarding venue for action initiated by nonresident aliens); *Randazzo v. United States*, 751 F.2d 145 (3d Cir. 1984) (appeal of denial of attorneys' fee award is not reviewable); *Nichols v. United States*, 633 F.2d 829 (9th Cir. 1980); *Vicknair v. United States*, 617 F.2d 1129 (5th Cir. 1980).

¹⁷³ *Hiley v. United States*, 807 F.2d 623 (7th Cir. 1986); *Schuster v. United States*, 765 F.2d 1047 (11th Cir. 1985).

¹⁷⁴ *Guerra v. United States*, 645 F. Supp. 775 (C.D. Cal. 1986); *Haskin v. United States*, 444 F. Supp. 299 (C.D. Cal. 1977), *aff'd* (9th Cir. 1978) (unpub.).

¹⁷⁵ *Llorente v. Commissioner*, 649 F.2d 152 (2d Cir. 1981); *Weimerskirch v. Commissioner*, 596 F.2d 358 (9th Cir. 1979); *Carson v. United States*, 560 F.2d 693 (5th Cir. 1977).

¹⁷⁶ §6331(d)(3). Some opportunity to pay or refuse to pay the demand may be required.

cases.¹⁷⁷ There are procedural rules for jeopardy levies served within the 30-day period. These rules generally give the same procedural rights to jeopardy levies as those applicable to jeopardy or termination assessments:

- the right to a written statement of the basis of the IRS's position; and
- administrative and judicial review of the reasonableness of the levy.¹⁷⁸

Comment: As a practical matter, it is unlikely that a taxpayer can challenge the reasonableness of a jeopardy levy without contesting the underlying jeopardy or termination assessment. The procedural rules for jeopardy levies were apparently enacted to ensure that the administrative or judicial reviewer of the assessment also has clear jurisdiction over the related collection actions.

(2) Jeopardy Bond

Section 6863(a) provides that seizure of the taxpayer's property can be stayed after a jeopardy or termination assessment if the taxpayer posts a bond in an amount equal to the amount of the assessed tax liability. Section 6863(b) provides that if a Tax Court petition is not timely filed after the notice of deficiency is issued, the amount stayed by the bond must be paid on notice and demand. If a Tax Court petition is timely filed, payment of the stayed amount need not be made until the Tax Court's decision becomes final.¹⁷⁹

Comment: While posting a jeopardy bond offers some protection against the adverse results of seizure, comparatively few taxpayers are in a position to provide such a bond. Accordingly, the jeopardy bond offers little real protection against seizures following an improper termination or jeopardy assessment.

(3) Stay of Sale

In addition to providing for a bond to stay seizures of the taxpayer's property, §6863 also contains provisions staying the sale of seized property. Section 6863(b)(3) prohibits the IRS from selling property seized pursuant to a jeopardy or termination assessment until after the notice of deficiency has been issued and the period for filing a Tax Court petition has expired. When a petition is filed, no sale can take place until the Tax Court's decision becomes final. The stay of the sale of seized property following a termination assessment is lifted, however, if the taxpayer fails to file a return for the taxable year by the return due date (determined with regard to extensions).¹⁸⁰

A separate stay of the sale of seized property is granted until the procedures under §7429(b) are exhausted.¹⁸¹ This stay usually is irrelevant in deficiency tax cases because it is gen-

erally for a shorter period than the stay based on the notice of deficiency. The stay during the §7429 process is relevant for nondeficiency taxes, however, because no notice of deficiency is issued for a termination or jeopardy assessment under §6862 (relating to amounts assessable without regard to the deficiency procedures). The stay of sale for these assessments lasts only until the administrative and judicial review under §7429 has been exhausted.

The stay of sale provisions are subject to three exceptions. The stay does not apply if:

- the taxpayer consents to the sale;
- the IRS determines that the expenses of conservation and maintenance of the property will greatly reduce the net proceeds; or
- the property is likely to perish¹⁸² or become greatly reduced in value if not sold.¹⁸³

These stay of sale exceptions depend to a large extent on the judgment of the IRS. Once the IRS decides that one of the exceptions applies, §7421 usually bars an action by the taxpayer to review the IRS's judgment and enjoin the sale.¹⁸⁴ The Tax Court, however, can review IRS determinations concerning these exceptions provided that the sale is otherwise stayed during a pending Tax Court case.¹⁸⁵ The burden of proof in this proceeding is on the IRS to establish that conditions supporting a stay of sale exception exist.¹⁸⁶

g. Special Issues

There are two variations on the normal jeopardy or termination assessments situations: the possessor of cash assessment and a civil forfeiture proceeding.

(1) Possessor of Cash — §6867

Section 6867 was enacted in response to a situation where an individual was detained possessing a large amount of cash, but refused to admit ownership.¹⁸⁷ It was difficult for the IRS to sustain jeopardy assessments against this individual, since ownership of the cash was typically difficult to trace.¹⁸⁸ In response to this problem, Congress enacted §6867, which applies when a person possessing cash in excess of \$10,000 denies ownership and fails to identify an owner whose identity the IRS can readily ascertain that admits ownership.

The term "cash" encompasses cash equivalents,¹⁸⁹ including: (1) foreign currency, (2) any bearer obligation (deemed to have a value equal to its face amount), and (3) any medium of

¹⁷⁷ See CCA 201830013 (while jeopardy levies are not limited to jeopardy and termination assessment cases, a jeopardy levy requires a condition that would have allowed a jeopardy assessment to be made).

¹⁷⁸ See §7429. However, not every jeopardy levy made by the IRS is covered by the procedures of §7429. See CCA 200242040 (advising that taxpayer against whom jeopardy levy was made pursuant to IRM 5.11.1.2.1 could obtain review in Collection Appeals Program or CDP equivalent hearing).

¹⁷⁹ This provision has the effect of staying collection during the pending appeal of a Tax Court decision. §6863(b)(3)(A)(iii), §7485(a); Reg. §301.6863-2(a).

¹⁸⁰ §6863(b)(3)(A) (flush language).

¹⁸¹ §6863(c).

¹⁸² See *Galusha v. Commissioner*, 95 T.C. 218 (1990) ("perishable" connotes property that is subject to rapid, short-term decay or deterioration).

¹⁸³ §6863(b)(3)(B).

¹⁸⁴ See *Zion Coptic Church, Inc. v. United States*, 489 F. Supp. 35 (S.D. Fla. 1980), *aff'd* (5th Cir. 1981) (unpub.) (*Williams Packing* standard applied to injunction against sale pursuant to §6863(b) exceptions). See also *Church of Hakeem, Inc. v. United States*, 79-2 USTC ¶9651 (N.D. Cal. 1979).

¹⁸⁵ §6863(b)(3)(C).

¹⁸⁶ *Williams v. Commissioner*, 92 T.C. 920 (1989), *nonacq.*, 1991-2 C.B. 1. ¹⁸⁷ H.R. Conf. Rep. No. 760, 97th Cong., 2d Sess., *reprinted at* 1982-2 C.B. 600, 654.

¹⁸⁸ Mere denial of ownership typically does not overcome the taxpayer's burden of proof. See *Bailey v. United States*, 82-2 USTC ¶9620 (E.D. Mich. 1982).

¹⁸⁹ §6867(d)(1).

exchange which is of a type “frequently used in illegal activities” and is “specified as a cash equivalent.”¹⁹⁰ The regulations further expand the definition of cash equivalents to include: coins, precious metals and stones, jewelry; postage stamps; securities; traveler’s checks; negotiable instruments that are in bearer form, endorsed with no restrictions, made out to a fictitious payee, or otherwise in a form that passes title upon delivery; and incomplete financial instruments (i.e., instruments that are signed but without a payee’s name).¹⁹¹

Section 6867 raises a presumption that the cash possessed represents gross income of a hypothetical single individual for the taxable year in which the possession occurs and that the collection of tax would be jeopardized by delay.¹⁹² The assessment arising from the application of §6867 almost always is a termination assessment. The presumption of income in the year the cash is possessed typically results in an assessment for the current year for which no return is yet due. Since the assessment is effectively against the cash, the possessor has no personal liability for the assessed amount.¹⁹³

Note: When §6867 originally was enacted in 1982, the 50% rate was the maximum tax rate applicable to an individual. Thus, §6867 originally created a presumption that the gross income was taxable at the 50% rate. Subsequently, the maximum applicable tax rate was reduced. This rate reduction created an issue as to whether the rate applicable under §6867 was the 50% rate or the maximum individual income tax rate. The IRS took the position that the 50% rate still applied even after the change in the law. Section 6867(b)(2), however, retroactively clarified this issue by establishing that the rate to be applied under §6867 is the maximum tax rate applicable to individuals under §1.

The most conceptually difficult issue in §6867 cases concerns the respective rights of the “possessor” and the “true owner” to administrative and judicial review of the §6867 assessment. Section 6867(c) provides that if the true owner of the cash (as established by proof satisfactory to the IRS) comes forward, the §6867 assessment must be abated. At this point, the IRS can determine whether collection of tax from the true owner is jeopardized, warranting a jeopardy or termination assessment against that true owner. The true owner then becomes entitled to the normal administrative and judicial review procedures, commencing from the date of that assessment. The priority of the IRS’s claim for the seized funds, however, relates back to the date of the original assessment made against the possessor of the cash under §6867.¹⁹⁴

Since the §6867 assessment is a form of jeopardy or termination assessment, the possessor — as the “taxpayer” — is entitled to receive a notice of deficiency relating to the assessment.¹⁹⁵ The availability of administrative and judicial review for the possessor of the cash has been disputed. Some courts have held that while the possessor of the cash is entitled to receive notice of the assessment under §6867, the possessor is not entitled to administrative or judicial review under §7429 with

respect to the assessment.¹⁹⁶ The Tax Court has allowed judicial review of the notice of deficiency, however.¹⁹⁷

Note: The Tax Court has reasoned that no jurisdiction exists with respect to the possessor in an individual capacity and that a person alleging to be the “true owner” of the cash is not entitled to file a Tax Court petition.¹⁹⁸ Accordingly, the possessor must file the Tax Court petition “as possessor of certain cash” and not in an individual capacity. This allows the possessor to contest whether there is cash in excess of \$10,000, whether the possessor denies ownership and whether the tax computation is correct. The Tax Court can then determine the “true owner” of the cash.¹⁹⁹

Comment: The Tax Court may be the only court open to the possessor of cash. The regulations do not allow the possessor of cash, solely in that capacity, to bring a district court refund suit after a deficiency has been collected.²⁰⁰

To establish the true owner, it must be shown at the time of the assessment that the cash belonged to another person whose identity can be readily ascertained by the IRS and that such person acknowledges ownership. The true owner may raise the ownership issue by intervening in the proceeding commenced by the possessor,²⁰¹ but the true owner cannot separately file a petition with the Tax Court since the true owner has not received a notice of deficiency. It also may be necessary in the ownership determination proceeding to prove that the identified true owner is the only person claiming ownership of the cash so that the IRS can determine whether this true owner has paid tax on the cash.²⁰²

A final question concerns the disposition of the portion of cash that is not used to satisfy the §6867 assessment when no true owner comes forward. Presumably the possessor is not entitled to receive the balance because, by definition, the possessor does not claim ownership. If the possessor is allowed to recover the money, however, the §6867 assessment may prove to be an inexpensive alternative to a claim of ownership by the true owner. For example, when the true owner of cash is known, the IRS frequently makes projections that result in assessments that cover most, or all, of the amount of the seized cash. Under §6867, however, the assessment is equal to the amount of the seized cash multiplied by the maximum tax rate. Therefore, to the extent that the cash exceeds the amount as-

¹⁹⁶ *Morgan v. United States*, 958 F.2d 950 (9th Cir. 1992) (possessor of cash who denies ownership is unable to seek §7429 judicial review of termination assessment); *Lavnikovich v. United States*, 88-2 USTC ¶9409 (D. Mass. 1988); *Robrish v. United States*, 579 F. Supp. 477 (D. Mass. 1983).

¹⁹⁷ *Matut v. Commissioner*, 88 T.C. 1250 (1987), *vacated on other grounds*, 858 F.2d 683 (11th Cir. 1988); *Matut v. Commissioner*, 84 T.C. 803 (1985); *Ono v. Commissioner*, T.C. Memo 1989-555.

¹⁹⁸ *Matut v. Commissioner*, 84 T.C. 803 (1985).

¹⁹⁹ *Matut v. Commissioner*, 86 T.C. 686 (1986), *aff’d*, 858 F.2d 683 (11th Cir. 1988); *Keith v. Commissioner*, T.C. Memo 1989-437; *Scardina v. Commissioner*, T.C. Memo 1988-20.

²⁰⁰ Reg. §301.6867-1(d).

²⁰¹ See *Matut v. Commissioner*, 858 F.2d 683 (11th Cir. 1988) (where true owner fails to sufficiently acknowledge ownership, he cannot be substituted for possessor, and assessment against possessor remains viable), *vacating* 88 T.C. 1250 (1987); §6213. See also *Keith v. Commissioner*, T.C. Memo 1989-437.

²⁰² *Hendrickson v. Commissioner*, 873 F.2d 1018 (7th Cir. 1989), *rev’g Peoples Loan & Tr. Co. v. Commissioner*, 89 T.C. 896 (1987), *on remand*, T.C. Memo 1989-524.

¹⁹⁰ §6867(d)(2).

¹⁹¹ Reg. §301.6867-1(f)(2)(ii).

¹⁹² §6867(a), §6867(b).

¹⁹³ §6867(b)(1); *Whiting v. Lewis*, 86-1 USTC ¶9178 (N.D. Fla. 1985).

¹⁹⁴ §6867(c).

¹⁹⁵ §6851(b), §6861(b).

sessed under §6867, the possessor may recover such cash and conceivably avoid further jeopardy assessments.

(2) Civil Forfeiture

Historically, many jeopardy and termination assessments were related to illegal drug activities. The government can also seek civil forfeiture related to these activities under 18 U.S.C. §981 and 21 U.S.C. §881.²⁰³ These civil forfeiture provisions apply to property that is traceable to narcotics violations or to violations of currency transaction reporting under 31 U.S.C. §5313(a) or §5324. In these circumstances, the Justice Department can bring an action that results in a court order forfeiting the owner's property interest. Since the forfeiture is effective as of the date that the act giving rise to the forfeiture was committed, the forfeiture takes priority over the collection of any subsequent jeopardy or termination assessment.²⁰⁴

Since the same person could be the subject of a successful forfeiture proceeding and a jeopardy or termination assessment, the forfeiture proceeding can take all of the readily collectible amounts, leaving the IRS to collect from other sources. In addition, the fact that the income on which the jeopardy or termination assessment is based may be subject to forfeiture is not a defense to the reasonableness of the amount of the assessment under §7429.²⁰⁵

Note: In practice, it is more frequent for the IRS and the Justice Department or Drug Enforcement Administration (DEA) to agree in advance as to whether forfeiture will be sought and whether any funds seized will be left to satisfy the jeopardy or termination assessment. In other cases, a jeopardy or termination assessment may be made at the request of the Justice Department or DEA after it appears that the attempt to obtain a civil forfeiture will not be successful. The government's burden in sustaining a jeopardy or termination assessment is a lesser burden than that required to sustain a civil forfeiture.²⁰⁶ In spite of this, the increased frequency of drug-related forfeitures has dramatically reduced the use of jeopardy and termination assessments in drug cases.

7. Assessment of Criminal Restitution

When a taxpayer is convicted of a tax crime, there can be three separate overlapping liabilities:

- a “restitution judgment” that is collected by the Department of Justice Financial Litigation Unit (FLU);

- a “restitution-based assessment” by which the IRS can assess and collect the restitution amount; and
- a deficiency determined by the IRS and assessed pursuant to normal deficiency procedures.²⁰⁷

The IRS may summarily assess certain orders of criminal restitution under 18 U.S.C. §3556 pursuant to §6201(a)(4) once all appeals of the order have been exhausted or the right to make such an appeal has expired.²⁰⁸ This is commonly referred to as a “restitution-based assessment” (RBA).

The IRS makes a restitution-based assessment only in cases pertaining to taxes, i.e., Title 26 violations including, but not limited to, those under §7201, §7202, §7203, §7205, §7206(1), §7206(2), §7206(4), §7206(5), §7207, and 18 U.S.C. §286, 18 U.S.C. §287, and 18 U.S.C. §371.²⁰⁹

The amount of ordered restitution payable to the IRS creates two separate debts for the same liability. The first debt is the “restitution judgment” for which the DOJ is responsible for collecting. The second debt is the restitution-based assessment that is assessed and collected by the IRS in the same manner as if it was a tax.²¹⁰ As restitution debts stem from the same underlying tax liability, the full amount can only be collected once. Thus, payments that wholly or in part satisfy the RBA must also be applied against the underlying tax liability for the same type of tax and tax periods (duplicate civil and/or co-defendant assessments), so long as the RBA relates to that underlying tax liability.²¹¹

Example: If the restitution is for tax period 202X but relates to the defendant's business income tax and not his own personal income tax for the same period, the payment would be credited to his RBA and the business's income tax liability, but not credited to his personal income tax liability for 202X.

The tax liabilities that may be assessed include unpaid income and employment tax liabilities of a corresponding busi-

²⁰³ For general rules relating to civil forfeiture proceedings under a civil forfeiture statute that does not include the Internal Revenue Code, see 18 U.S.C. §983, added by the Civil Asset Forfeiture Reform Act of 2000, Pub. L. No. 106-185, §2, effective for any forfeiture proceeding commenced on or after August 23, 2000. In addition to civil forfeiture provisions, 18 U.S.C. §982 authorizes the court, in imposing sentence for a criminal conviction, to order the forfeiture of any property that represents the person's gross receipts obtained as a result of the offense.

²⁰⁴ 18 U.S.C. §981(f); 21 U.S.C. §881. In determining the priority of a local law forfeiture over the jeopardy or termination assessment and resulting federal tax lien, the forfeiture is deemed to relate back to the time of the seizure if the local government's interest is protected against other interests as of that date. §6323(i)(3).

²⁰⁵ *Gonzalez v. United States*, 606 F. Supp. 134 (S.D. Fla. 1985); *Randahl v. United States*, 82-1 USTC ¶9356 (D. Minn. 1982).

²⁰⁶ Compare 18 U.S.C. §981 and 21 U.S.C. §881 with §7429(g).

²⁰⁷ IRM 5.1.5.15.2 (12-16-14); 5.1.5.15.3 (11-04-19); IRM 25.26.1.2 (08-25-21). See also *McElhane v. Commissioner*, 2016-1 USTC ¶50,299 (5th Cir. 2016) (unpub.) (grant of probation does not resolve tax liability).

²⁰⁸ §6213(b)(5), added by Pub. L. No. 111-237, effective for restitutions ordered after August 16, 2010. See CCA 201105037 (assessed amount is limited to losses attributable to Title 26 violations and does not include Title 18 tax-related charges; while general 10-year statute of limitations applies to tax liability assessed under §6201(a)(4), suit may be filed under §6502(a) to reduce assessment to judgment and avail IRS of 20-year judgment lien). See IRM 4.8.6 (08-26-20) for criminal restitution assessment procedures. Note that an appeal by a defendant under 28 U.S.C. §2255 from a criminal sentence that includes restitution does not bar the IRS from making a restitution assessment while an appeal motion is pending. CCA 201616011 (“order” as used in §6201(a)(4) (B) refers to restitution order itself and not to overall criminal sentence). Cf. *Smullen v. United States*, 94 F.3d 20 (1st Cir. 1996) (defendant may not use 28 U.S.C. §2255 to collaterally challenge restitution order).

²⁰⁹ See CC-2011-018, I:Q&A-2, in which the IRS Chief Counsel noted that restitution ordered for a conviction under Title 18 may be assessable if the conviction is based on a failure to pay a tax imposed under Title 26. The IRS also may assess restitution resulting from a plea agreement, supervised release, or as a condition of probation. CC-2011-018 at I:Q&A-3. See also CCA 201105037, in which the IRS Chief Counsel's Office advised that the assessed amount is limited to losses attributable to Title 26 violations and does not include Title 18 tax-related charges. Restitution ordered by a state court is not assessable under §6201(a)(4). CC-2011-018 at I:Q&A-5.

²¹⁰ See IRM 25.26.1.2 (08-25-21).

²¹¹ See IRM 25.26.1.2(3) (08-25-21).

ness entity or employer.²¹² The restitution-based assessment can be made against persons other than the taxpayer, such as a person who aided or abetted the taxpayer's underpayment.²¹³

Because the assessment of restitution under §6201(a)(4) is not itself a determination of the actual civil tax liability for the tax period for which restitution was ordered, and is assessed only "as if such amount were such tax," the IRS does not treat the amount of restitution as either the minimum or the maximum tax liability for the relevant tax period. A restitution-based assessment is independent of the IRS's determination of the civil tax liability for the same period, and does not affect the amount of the "deficiency" the IRS may determine under §6211.²¹⁴ NOL carrybacks, carryovers and other deductions may be applied to reduce the ultimate civil tax liability for that period, regardless of the restitution amount. A taxpayer, may, if permitted, elect not to carry back the NOL due to a lack of financial benefit resulting from the restitution ordered, and to carry the NOL forward only.²¹⁵

Example: Taxpayer (T) is ordered to pay \$100,000 in restitution for tax year 2010 and the IRS subsequently examines T for the same tax period. Pursuant to the examination, the IRS determines a civil tax liability of \$150,000. T timely requests that a NOL deduction from tax year 2011 be carried back to 2010, which would reduce his tax liability by \$100,000. If the IRS allows the NOL carryback, T's civil tax liability would be reduced to \$50,000, and any penalties would be based upon the amount of the remaining civil tax liability. The IRS may allow the NOL carryback, even though it would reduce the tax liability below the restitution-based assessment of \$100,000, because the civil tax liability is separate and independent from the restitution-based assessment. The IRS must collect \$100,000 from T for tax year 2010 to satisfy the restitution-based assessment because the IRS must "assess and collect the amount" ordered as restitution, regardless of whether the civil tax liability is determined to be less. Because the IRS cannot collect twice for the same tax period, the first \$50,000 collected to satisfy the restitution-based assessment of \$100,000 also must be applied to the civil tax liability of \$50,000.²¹⁶

²¹²IRM 25.26.1.2 (08-25-21). The IRS must adjust the unpaid tax liability of the entity or employer to account for payments made through restitution or the assessment against the defendant, as well as adjust the liability of the defendant to account for payments made by or on behalf of the entity or employer. See *United States v. Helmsley*, 941 F.2d 71 (2d Cir. 1991) (amount paid as restitution for taxes must be deducted from any judgment for unpaid taxes in civil proceeding as restitution in tax case is in fact and law payment of unpaid taxes).

²¹³See IRM 25.26.1.2(2) (08-25-21); *Bontrager v. Commissioner*, 151 T.C. No. 12 (Dec. 12, 2018).

²¹⁴*Muncy v. Commissioner*, T.C. Memo 2017-83, *aff'd on other issue*, 890 F.3d 724 (8th Cir. 2018).

²¹⁵However, a taxpayer's ability to apply NOL carrybacks, carryovers and other deductions to reduce civil tax liability is not absolute. Note that because the two assessments are independent, the IRS must send two separate CDP notices and provide for two separate CDP hearings. CCA 201510043.

²¹⁶See CC-2013-012 (July 31, 2013), n. 3; *United States v. Tucker*, 217 F.3d 960 (8th Cir. 2000); *United States v. Helmsley*, 941 F.2d 71, 102 (2d Cir. 1991).

A restitution-based assessment must be for the exact amount of the court order. The defendant may not challenge the existence or the amount of the assessment in any administrative or judicial proceeding.²¹⁷ To the extent that an order identifies several tax periods but only a single, lump-sum restitution amount, the IRS will make an allocation among the periods to most accurately reflect the tax loss.²¹⁸ The IRS may abate a restitution-based assessment that is later determined to be excessive, but only after a court modifies the restitution order.²¹⁹

The IRS may not assess a civil fraud or accuracy-related penalty based on a restitution order. If the IRS determines that a penalty is appropriate for the transaction that gave rise to the restitution order, a standard notice of deficiency must be issued before a penalty may be assessed.²²⁰

With respect to interest, the IRS may not assess interest and §6651(a)(3) penalties on RBAs unless they are included in the restitution amount ordered by a federal district court.²²¹ The Tax Court has held that, because criminal restitution is not a tax, §6201(a)(4) does not authorize the IRS to assess or collect underpayment interest under §6601(a), failure-to-pay penalties under §6651(a)(3), or any other additions to tax based on a restitution award, without first determining the taxpayer's civil tax liability through an examination of tax returns.²²²

If the amount of criminal restitution ordered and the IRS's restitution-based assessment are later determined to be less than the actual tax liabilities, the IRS may not make a supplemental restitution-based assessment under §6201(a)(4).²²³ The IRS may make the additional assessment pursuant to the notice of deficiency procedures under §6201(e), however.

B. Payment Issues

In a number of situations, the application of payments may have favorable or unfavorable consequences for the taxpayer. In addition, the taxpayer may believe payments were made but the IRS has not given proper credit. The following discussion provides the rules for when and how the taxpayer may designate the application of payments and how the application of payments may be determined and challenged.

²¹⁷See §6201(a)(4)(C). Interest may accrue on the assessment under §6601. Interest accruing on a restitution order under Title 18 (i.e., interest accruing on the restitution order under 18 U.S.C. §3612(f)) is not assessable by the IRS, but will be applied against the IRS's assessment (including §6601 interest). §6201(a)(4)(C). When interest is waived in the order of restitution under 18 U.S.C. §3612, interest under §6601 will still accrue on the assessment of the restitution. CCA 201426026. See also IRM 35.2.1.1.5.1 (10-18-16).

²¹⁸CC-2011-018, II:Q&A-9.

²¹⁹CC-2011-018, II:Q&A-10; §6404. A taxpayer should allow the IRS to work with the Justice Department rather than pursue abatement on their own as a court order is needed before the IRS may modify the assessment. CC-2011-018, II:Q&A-10; §6404.

²²⁰CC-2011-018, II:Q&A-14.

²²¹See IRM 25.26.2(6) (08-25-21). Documents such as the judgment and commitment order (J&C) or plea agreement may indicate whether interest and penalties are components of the restitution amount.

²²²*Klein v. Commissioner*, 149 T.C. 341 (2017). See IRM 5.1.5.15.6 (11-04-19), IRM 5.1.5.15.5 (11-04-19); CC-2019-004.

²²³CC-2011-018, II:Q&A-11.

1. Designating Application of Payments

There are detailed rules governing the extent to which a taxpayer may direct (designate) how a payment made to the taxpayer's account will be applied.

a. No Designation for Involuntary Payments

The initial distinction to be made when considering a designation of a payment is whether the payment is "voluntary" or "involuntary." An involuntary payment is a payment made pursuant to judicial action, administrative levy, or IRS offset of a refund against another liability.²²⁴ The taxpayer cannot designate where an involuntary payment is applied. Involuntary payments are applied by the IRS in the best interests of the IRS.²²⁵

b. Designating Voluntary Payments

The application of voluntary payments, on the other hand, may be designated by the taxpayer. A taxpayer making a voluntary partial payment may wish to:

- designate a portion of the payment as interest to maximize any possible interest deduction;
- pay "trust fund" taxes to minimize potential liability for the §6672 trust fund recovery penalty; or
- first pay a liability that cannot be discharged in bankruptcy.

There are no significant limitations on a taxpayer's ability to designate application of a voluntary payment to assessed liabilities.²²⁶ Once the liabilities are assessed, the taxpayer may make designations among liabilities or to any portion of a single liability. This ability also exists before assessment after the taxpayer and the IRS reach agreement on the assessment. If an

²²⁴ See *Stevens v. United States*, 49 F.3d 331 (7th Cir. 1995) (sale to avoid IRS auction is involuntary); *In re Ryan*, 64 F.3d 1516 (11th Cir. 1995) (refund offset involuntary); *Muntwyler v. United States*, 703 F.2d 1030, 1033 (7th Cir. 1983); *Melasky v. Commissioner*, 151 T.C. 93 (2018) (where taxpayers wrote check to IRS and levy emptied bank account before check cleared, causing check to bounce, payment was involuntary; court declined to create equitable exception), *aff'd*, No. 19-60084, 2020 BL 37455 (5th Cir. Feb. 3, 2020) (citing *In re Johnson*, 146 F.3d 252, 261 n. 29 (5th Cir. 1998), court concludes that when funds are seized involuntarily, taxpayer is not afforded privilege of designating to which liability funds are to be applied). *But see Tull v. United States*, 69 F.3d 394 (9th Cir. 1995) (levy on third party before obligation to taxpayer invalid so subsequent payment voluntary). See also 639 T.M., *Responsible Person and Lender Liability for Trust Fund Taxes — Sections 6672 and 3505*.

²²⁵ *Muntwyler v. United States*, 703 F.2d 1030 (7th Cir. 1983); *O'Dell v. United States*, 326 F.2d 451 (10th Cir. 1964); *United States v. DeBeradinis*, 395 F. Supp. 944, 952 (D. Conn. 1975), *aff'd*, 538 F.2d 315 (2d Cir. 1976); *Amos v. Commissioner*, 47 T.C. 65 (1966); IRS Policy Statement 5-14 (formerly P-5-60), printed in IRM 1.2.1.6.3 (6-9-03). See CCA 201347021, where the Chief Counsel's Office advised that the IRS appropriately applied restitution payments, based on Rev. Proc. 2002-26, to personal and corporate liabilities in an order that best served the interests of the government.

²²⁶ See, e.g., *Dixon v. Commissioner*, 141 T.C. 173 (2013), *nonacq.*, AOD 2014-01 (IRS must respect designation where taxpayer designated a voluntary payment toward the income tax liability of a named third party and taxpayer is corporation owned by third party). However see *Melasky v. Commissioner*, 803 Fed. Appx. 732 (5th Cir. 2020), where after taxpayer presented check to IRS but before IRS presented check to bank, the IRS levied on the bank account for a different outstanding liability and the taxpayer was not permitted to designate the levied funds for the liability for which he intended. In AOD 2014-01, the IRS disagreed with the Tax Court that employment tax payments that were not withheld at the source may be designated by an employer to a specific employee's income tax liability.

assessment has been made or an agreement regarding liability has been reached, a partial payment voluntarily tendered by the taxpayer with specific directions as to its application is applied according to the taxpayer's directions.²²⁷

When the taxpayer does not give specific instructions for the application of the partial payment, however, the IRS applies the payment to periods in the order of priority that the IRS determines will serve its best interest. The IRS applies the payment to satisfy the liability for successive periods in descending order of priority until no funds remain. For example, the IRS will typically apply an undesignated payment to the tax period with the shortest collection statute of limitations. If the amount applied to a period is less than the liability for the period, the IRS applies the amount to tax, penalty, and interest, in that order, until the amount is absorbed.²²⁸

When no assessment has been made, the IRS honors the taxpayer's designation of a payment that fully pays the tax.²²⁹ Revenue procedures applicable when individuals could deduct IRS interest as consumer interest provided that if a partial payment of tax was made, and the taxpayer wished to designate a portion of the payment as interest, the allocation was honored only if: (1) the taxpayer agreed to assessment of the liability by executing a waiver of restrictions on assessment; or (2) the taxpayer paid the underlying tax which corresponded to the interest paid, and the amount designated as interest did not exceed the amount of interest that had accrued on the underlying tax.²³⁰ The Tax Court, however, rejected this position.²³¹

The IRS's procedures for applying voluntary partial payments when an assessment has been made or an agreement regarding liability has been reached apply equally to withheld employment taxes and collected excise taxes.²³² Accordingly, the person responsible for nonpayment of an entity's withheld employment taxes (who is subject to a §6672 trust fund recovery penalty assessment) should ensure that the entity designates that all of the payment is to be applied to the "trust fund" portion of the liability to eliminate or reduce the §6672 penalty as-

²²⁷ See Rev. Proc. 2002-26, *superseding* Rev. Rul. 73-305; CCA 202129007 (explaining that to be proper, designation must be specific, in writing, and made at time of payment); see also *Muntwyler v. United States*, 703 F.2d 1030 (7th Cir. 1983); *Liddon v. United States*, 448 F.2d 509 (5th Cir. 1971); *Kurio v. United States*, 429 F. Supp. 42 (S.D. Tex. 1970); *F.P. Baugh, Inc. v. Little Lumber Co.*, 185 F. Supp. 628 (N.D. Cal. 1960), *aff'd in part, rev'd in part on other grounds*, 297 F.2d 692 (9th Cir. 1961); *Amos v. Commissioner*, 47 T.C. 65 (1966); *Stone v. Commissioner*, T.C. Memo 1984-187.

²²⁸ Rev. Proc. 2002-26. See *Valteau, Harris, Koenig & Mayer v. Commissioner*, T.C. Memo 2014-144 (taxpayer failed to provide specific designation instructions to IRS when instructions communicated to depository bank; payments applied according to best interests of IRS). A penalty, for purposes of this guidance, includes any additional amount, addition to tax, or assessable penalty. Rev. Proc. 2002-26. Under former guidance, absent specific instructions, the IRS applied the payment to tax, penalty, and interest, in that order, for the earliest period, then in that order for each succeeding period until the payment was fully applied. See Rev. Rul. 73-305; *White v. United States*, 43 Fed. Cl. 474 (Fed. Cl. 1999) (IRS had full discretion as to application of employment tax payments because taxpayer did not give specific instructions).

²²⁹ Rev. Proc. 2005-18.

²³⁰ Rev. Proc. 84-58.

²³¹ *Perkins v. Commissioner*, 92 T.C. 749 (1989). See also *Preble v. Commissioner*, T.C. Memo 1989-208.

²³² Rev. Proc. 2002-26, *superseding* Rev. Rul. 79-284. The guidance applies to all taxes under the Internal Revenue Code, except alcohol, tobacco, and firearms taxes and the harbor maintenance tax. Rev. Proc. 2002-26.

assessment.²³³ The entity can even designate payment to a specific employee's liability.²³⁴

In making a designation of a voluntary payment, the taxpayer should make the designation on the check itself. All evidence of the designation should be retained. The IRS will accept a designation only if the IRS records reflect the designation or if the taxpayer can prove that the designation was made at the time of payment.

2. Prepayment of Tax Versus Deposit

It is important to distinguish between a deposit and an advance payment of tax. Different rules exist for how they are applied and how they may be returned or refunded.

a. Deposit Procedures

The deposit procedures were changed significantly with the enactment of §6603. Before the enactment of §6603, advance payments essentially were either a deposit in the nature of a "cash bond" or a payment of tax. Section 6603 added a third category of advance payment, a deposit on a disputable tax.

A cash bond is not subject to a claim for credit or refund and can be returned in full to the taxpayer, upon request, provided that the tax has not been assessed. The cash bond stops interest from accruing as of the date of the remittance. If a cash bond is returned to the taxpayer, however, it is returned without interest.²³⁵ In contrast, an advance payment of tax cannot be returned to the taxpayer except through claim for refund procedures. A payment of tax stops interest from accruing as of the date of the payment and also bears interest if the payment of tax is ultimately returned.²³⁶

The enactment of §6603 modified the applicable procedures by creating a new category, a deposit on a disputable tax. Like a cash bond, a deposit on a disputable tax can be returned on written request. Unlike a cash bond, however, if a deposit on a disputable tax is returned, it is returned with interest.²³⁷

The IRS treats a remittance made before a notice of deficiency is mailed that is designated by the taxpayer in writing as a cash bond. Once the assessment is made, the cash bond is applied against the tax liability. The IRS treats a remittance not specifically designated as a cash bond as a payment of tax if: (1) it is made in response to a proposed liability (e.g., a liability proposed in a revenue agent's report); and (2) the proposed liability is paid in full. If a taxpayer makes a partial payment without any designation and the taxpayer's intent regarding the treatment of the payment as a cash bond or payment of tax can-

not be determined, the payment is treated as a deposit in the nature of a cash bond. The IRS treats a remittance made after a notice of deficiency is mailed as a payment of tax, absent contrary instructions from the taxpayer.²³⁸

Specific procedures must be followed to qualify an advance payment as a deposit on a disputable tax. A written statement must be submitted with the deposit explaining the amount and nature of the dispute.²³⁹ This designation generally will not be accepted if the payment is made after the taxpayer signs a waiver accepting an audit report or after a notice of deficiency has been issued and no timely Tax Court petition has been filed.

If an advance payment is not treated as a payment of tax and does not qualify to be treated as a deposit on a disputable tax (e.g., for failure to submit a proper written statement), the payment is still apparently subject to the old cash bond rules. The taxpayer can convert a cash bond to an interest-bearing deposit on a disputable tax effective on the date the IRS receives a written statement satisfying the applicable requirements.²⁴⁰

b. Refund Issues

The classification of a remittance as a payment of tax, a cash bond, or a deposit on a disputable tax has importance beyond the determination of whether interest will be paid upon its return. A payment of tax can be recovered only by filing a claim for refund.²⁴¹ The refund claim procedure is subject to strict statute of limitations rules and can have other undesired consequences. In contrast, a taxpayer may request the return of a cash bond or a deposit on a disputable tax without filing a claim for refund.

Note: Courts have split on the issue of whether an amount submitted with an extension request is a payment or a cash bond.²⁴²

Rev. Rul. 74-580 provides that a tax assessed and paid after the expiration of the period of limitations on assessment can be refunded. For these purposes, the term "overpayment" includes a payment assessed or collected after the expiration of the statute of limitations on assessment.²⁴³ An overpayment also has been defined as any payment in excess of that which properly is due.²⁴⁴ When an overpayment occurs, the taxpayer can receive a refund of the overpayment by filing a claim for refund within three years from the time the return was filed or

²³⁸ §6603(d); Rev. Proc. 2005-18. See also *Fisher v. United States*, 28 Fed. Cl. 88 (1993) (remittance made in amount of deficiency, that does not specifically state that it is a deposit, is a payment).

²³⁹ Rev. Proc. 2005-18.

²⁴⁰ Rev. Proc. 2005-18, §5.01.

²⁴¹ §6401, §6511.

²⁴² See, e.g., *Dantzer v. United States*, 183 F.3d 1247 (11th Cir. 1999); *Ertman v. United States*, 165 F.3d 204 (2d Cir. 1999); *Ott v. United States*, 141 F.3d 1306 (9th Cir. 1998); *Gabelman v. Commissioner*, 86 F.3d 609 (6th Cir. 1996); *Weigand v. United States*, 760 F.2d 1072 (10th Cir. 1985) (amount treated as payment). But see *Moran v. United States*, 63 F.3d 663 (7th Cir. 1995); *Blatt v. United States*, 34 F.3d 252 (4th Cir. 1994); *Cohen v. United States*, 995 F.2d 205 (Fed. Cir. 1993) (whether payment or deposit determined on facts and circumstances basis).

²⁴³ §6401(a).

²⁴⁴ *Jones v. Liberty Glass Co.*, 332 U.S. 524 (1947); *Ott v. United States*, 141 F.3d 1306 (9th Cir. 1998) (payment with extension to file income tax return constitutes a payment of tax).

²³³ See discussion in 639 T.M., *Responsible Person and Lender Liability for Trust Fund Taxes — Sections 6672 and 3505*.

²³⁴ *Dixon v. Commissioner*, 141 T.C. 173 (2014), nonacq. AOD 2014-001.

²³⁵ If the IRS erroneously pays interest on a cash bond, it has at least six years to bring suit to recover the amount paid. See *United States v. Domino Sugar Corp.*, 349 F.3d 84 (2d Cir. 2003) (two-year limitations period for erroneous refund suits under §6532(b) not applicable; action was timely whether six-year limitations period under 28 U.S.C. §2415(a) applied or no statute of limitations applied).

²³⁶ Rev. Proc. 84-58, superseded by Rev. Proc. 2005-18, with respect to remittances made on or after March 28, 2005. See, e.g., *Ford Motor Co. v. United States*, 768 F.3d 580 (6th Cir. 2014) (at time of remittance deposit Rev. Proc. 84-58 governed, not §6603(d), thus overpayment interest did not begin to accrue until date of redesignation of remittance as advance payment of tax).

²³⁷ §6603(d); Rev. Proc. 2005-18.

two years from the time the tax is paid, whichever is later.²⁴⁵ This refund rule applies regardless of whether the payment of tax was voluntary or involuntary.

However, Rev. Rul. 85-67 provides that a tax that is paid but not assessed within the applicable statute of limitations period may be retained by the IRS and is not recoverable by the taxpayer through a claim for refund.²⁴⁶ In other words, a taxpayer who makes a voluntary advance payment of tax in response to an agreed deficiency cannot recover such amount if the payment is made before the statute of limitations on assessment expires and the assessment is later determined to be barred or invalid. If the taxpayer makes no payment, the IRS is precluded from collecting the amount of tax due because the assessment was invalid. On the other hand, if the payment is made as a cash bond or a deposit on a disputable tax and subsequently the assessment is held to be invalid, the taxpayer can request the return of the amount paid.²⁴⁷ The taxpayer apparently would be entitled to return of the cash bond or deposit if it has not been applied in satisfaction of the liability after establishing that the assessment was invalid. The claim for refund procedures do not apply when the taxpayer requests the return of a cash bond or deposit on a disputable tax.²⁴⁸

Comment: A taxpayer should consider the implications of this distinction when making a payment of tax on an un-assessed liability before the statute of limitations on assessment expires.

3. Stray Payments

If the Treasury Department receives a payment from a taxpayer but cannot associate the payment with any liability, the Secretary must make reasonable efforts to notify the taxpayer of its inability to account for the stray payment within 60 days of receipt.²⁴⁹

C. Expiration of the Statute of Limitations

In every tax collection case, the taxpayer should verify that: (1) the statute of limitations on assessment was open when the underlying assessment was made,²⁵⁰ and (2) the statute of limitations on collection is still open.²⁵¹

²⁴⁵ §6511. For further discussion, see 627 T.M., *Limitations Periods, Interest on Underpayments and Overpayments, and Mitigation*, and 631 T.M., *Refund Litigation*.

²⁴⁶ See also *Lewis v. Reynolds*, 284 U.S. 281 (1932); *Crompton and Knowles Loom Works v. White*, 65 F.2d 132 (1st Cir. 1933). Additionally, an overpayment of tax attributable to an advance payment may not be applied to liabilities for other years when the assessment for the other years is barred by the statute of limitations. *McEachern v. Rose*, 302 U.S. 56 (1937); *Am. Light & Tractor Co. v. Harrison*, 142 F.2d 639 (7th Cir. 1944); *Close v. United States*, 79-1 USTC ¶9143 (Ct. Cl. 1978). See also *Morris v. Commissioner*, T.C. Memo 1966-245, where *Lewis v. Reynolds* was held inapplicable when the overpayment resulted from the collection of tax pursuant to an invalid assessment. Rev. Rul. 85-67 does not apply where a credit elect was not applied to the subsequent year with the unassessed liability until after the assessment statute expiration date (ASED). CCA 201550035.

²⁴⁷ *Cohen v. United States*, 995 F.2d 205 (Fed. Cir. 1993); *Stanley v. United States*, 96-1 USTC ¶50,273 (Fed. Cl. 1996).

²⁴⁸ See *Fisher v. United States*, 28 Fed. Cl. 88 (1993); Rev. Proc. 2005-18.

²⁴⁹ Taxpayer Bill of Rights 2 (Pub. L. No. 104-168) §1202.

²⁵⁰ §6501. See discussion in 627 T.M., *Limitations Periods, Interest on Underpayments and Overpayments, and Mitigation*. In certain circumstances an original assessment will be deemed valid after an erroneous abatement. *Becker v. United States*, 2005-1 USTC ¶50,337 (2d Cir. 2005).

1. Assessment Statute of Limitations

a. In General

Section 6501(a) sets forth the general rule that taxes must be assessed within three years after the related return is filed, whether or not the return is timely filed. For purposes of this rule, a return filed early is considered filed on the last day prescribed by law for filing the return.²⁵²

The IRS also must assess employment taxes within three years after the relevant tax return is filed unless fraud is established.²⁵³ While some employment tax returns are filed on a quarterly basis, these returns are considered filed on April 15 of the succeeding year for purposes of computing the statute of limitations on assessment, provided that the returns were actually filed before that date.²⁵⁴

The running of the statute of limitations is suspended by a variety of circumstances that usually correspond to periods during which the IRS is prevented from assessing.²⁵⁵ Any time remaining on the statute of limitations when it is suspended is tacked on to the end of the suspension period for the purpose of ascertaining the expiration date of the statute of limitations on assessment.

One common suspension of the assessment statute occurs when the IRS issues a notice of deficiency. If the taxpayer does not file a petition with the Tax Court, the statute of limitations on assessment for the tax years covered in the notice of deficiency is suspended for 150 days: 90 days following the issuance of the notice of deficiency *plus* 60 days thereafter. If the taxpayer files a timely petition with the Tax Court, the statute of limitations on assessment for the tax years at issue is suspended until 60 days after the Tax Court decision becomes final.²⁵⁶ A Tax Court decision becomes final 90 days after the decision is entered, unless the taxpayer files a timely appeal.²⁵⁷ An appeal extends the suspension of the statute of limitations, but the IRS may assess the tax in an appealed case unless the taxpayer posts a bond.²⁵⁸

²⁵¹ §6502.

²⁵² §6501(b)(1).

²⁵³ §6501(a). The other major exception to the three-year statute of limitations is the six-year period for 25% or greater omissions of income. This six-year statute only applies to taxes under Subtitle A (income taxes). §6501(e)(1). Employment taxes are the subject of Subtitle C.

²⁵⁴ §6501(b)(2). For further discussion, see 627 T.M., *Limitations Periods, Interest on Underpayments and Overpayments, and Mitigation*.

²⁵⁵ §6503(a)(1). See 627 T.M., *Limitations Periods, Interest on Underpayments and Overpayments, and Mitigation*.

²⁵⁶ §6213(a), §6503(a)(1). See *Kirch v. United States*, 99-1 USTC ¶50,452 (S.D. Ohio 1999) (1986 Tax Court petition not filed in respect of deficiency as 30-day letter was not deficiency notice; 1995 assessment was untimely because petition did not suspend limitations period), motion for reconsideration denied, 99-2 USTC ¶50,726 (S.D. Ohio 1999). See also *Hosack v. IRS*, 282 Fed. Appx. (5th Cir. 2008) (filing for redetermination in Tax Court suspends limitations period).

²⁵⁷ §7481, §7483. See discussion in 630 T.M., *Tax Court Litigation*.

²⁵⁸ §6501(a)(1), §7481(a)(2), §7485(a). See *Armstrong v. Commissioner*, 99 T.C. 506 (1992) (taxpayer filed motion for court to accept bond); *Poinier v. Commissioner*, 90 T.C. 63 (1988) (court denied taxpayer's motion to set fixed bond at requested amount and instead fixed bond at higher amount); *Plotkin v. Commissioner*, T.C. Memo 2019-27 (failure of taxpayer to file motion requesting bond allows assessment as it is not court's responsibility to set bond amount *sua sponte*). Tax Ct. R. 192.

Filing a Tax Court petition in response to a notice of deficiency does not automatically suspend the statute of limitations for all aspects of that deficiency. First, a Tax Court petition filed by only one spouse in response to a notice of deficiency issued to both spouses with respect to a joint income tax return will not suspend the statute of limitations as to the non-petitioning spouse. Second, a Tax Court petition that does not contest a deficiency for one of the years covered in the notice of deficiency does not suspend the statute of limitations for the uncontested year.

Several other events cause a suspension of the assessment statute of limitations. These include: (1) signing a consent to extend the assessment statute of limitations (usually on IRS Form 872);²⁵⁹ and (2) a bankruptcy filing, which suspends the period of limitations for the duration of the automatic stay plus 60 days.²⁶⁰ All of the potential suspension events should be examined if the assessment of tax was made more than three years after the return was deemed filed.

b. Pass-Through Entities

In certain instances, the period of limitations for partnership items is different than the period for a partner. This can occur if, for example, a “TEFRA” partnership files its return late but the taxpayer-partner timely files. However, the Supreme Court has held that the statute of limitations for assessment of tax due to S corporation adjustments begins to run on the date that the shareholder’s relevant return is filed.²⁶¹ Thus, even though more than three years may have passed since the filing of the S corporation’s return, the IRS can make an assessment against one of the S corporation’s shareholders based on erroneous items in the S corporation’s return so long as the statute of limitations remains open for the shareholder’s personal return. Similar conclusions have been reached in the context of assessments against partners in “non-TEFRA” partnerships.²⁶²

Assessment of self-employment tax and net investment income tax attributable to a partnership adjustment is subject to a special one-year limitations period. If the adjustment is pursuant to a court order in a “BBA” proceeding, the one-year period begins after the court decision becomes final. In any other case, the one-year period begins 90 days after the date on which the notice of the final partnership adjustment is mailed.²⁶³

2. Collection Statute of Limitations

The §6502 statute of limitations on collection begins to run on the date of assessment.²⁶⁴ From that date, the IRS has

²⁵⁹ §6501(c)(4). See also *Hartland Mgmt. Servs., Inc. v. Commissioner*, T.C. Memo 2015-8 (Tax Court reformed IRS Form 872 to reflect correct tax year in issue, based on its finding of mutual mistake by the parties).

²⁶⁰ §6503(h).

²⁶¹ *Bufferd v. Commissioner*, 506 U.S. 523 (1993), *aff’d* 952 F.2d 675 (2d Cir. 1992). In 1997, Congress *affirmed Bufferd* by amending §6501(a) to provide that the return that starts the running of the statute of limitations is the return of the taxpayer, not the return of another party from whom the taxpayer has received an item of income, gain, loss, deduction, or credit.

²⁶² *Charlton v. Commissioner*, 990 F.2d 1161 (9th Cir. 1993); *Siben v. Commissioner*, 930 F.2d 1034 (2d Cir.), *cert. denied*, 502 U.S. 963 (1991). For a further discussion, see 627 T.M., *Limitations Periods, Interest on Underpayments and Overpayments, and Mitigation*.

²⁶³ §6502(c)(12), as retroactively added by the Tax Technical Corrections Act of 2018, Pub. L. No. 115-141, Div. U, §201(b)(2). For a further discussion, see 624 T.M., *Audit Procedures for Pass-Through Entities*.

10 years to levy or commence a proceeding in court to collect the assessed liability.²⁶⁵ In general, the collection statute is suspended for the period the IRS is prohibited by law from collecting and for the period agreed to by the taxpayer. The collection statute of limitations can be extended by agreement, by filing an offer in compromise, by filing a bankruptcy petition, by filing a collection due process appeal, by being out of the country for a period exceeding six months, and for the period during which an installment agreement proposal is under consideration by the IRS.²⁶⁶

Note: The execution of a substitute for return (SFR) starts the running of the 10-year limitations period on collection under §6502.²⁶⁷

Amendments in the 1998 IRS Reform Act eliminated the provision that allowed the statute of limitations on collections to be extended by agreement between the taxpayer and the IRS, except that the statute may be extended in connection with an installment agreement or release of levy under §6343.²⁶⁸ The extension, however, may only be entered in connection with the original written terms of an installment agreement whose payments extend beyond the end of the otherwise applicable 10-year period. IRS policy is that the statute of limitations will only be extended for five years beyond the normal 10-year statute of limitations expiration date even if the installment agreement will not pay the liability in full by the extended date.²⁶⁹

3. Verifying the Statute of Limitations

Most of the assessment and statute of limitations information may be determined from the taxpayer’s transcript of account. The transcript may be obtained from the IRS by oral re-

²⁶⁴ §6502(a); *Schuster v. Commissioner*, T.C. Memo 2017-15 (10-year limitations period applies from date of assessed unpaid tax liability, regardless of fact that IRS corrected erroneous credit several years after tax liability was due; tax is satisfied only with payment by taxpayer, not by IRS error), *aff’d*, 725 Fed. Appx. 908 (11th Cir. 2018) (unpub.) (IRS’s mistaken application of an extra payment to taxpayer’s liability was not an erroneous refund barred by two-year statute of limitations).

²⁶⁵ §6502(a). *United States v. Estate of Chicorel*, 907 F.3d 896 (6th Cir. 2018) (filing a claim in probate constitutes a proceeding in court); CCA 202044008 (if probate proceeding is independent, unsupervised or informal, then assets of deceased are not under control of court and collection action may be pursued, therefore CSED is not suspended).

²⁶⁶ §6503, §6330(e), §6331(k)(3)(B). *Seagrave v. United States*, 2007-1 USTC ¶50,479 (7th Cir. 2007) (unpub.); *United States v. Giamo*, 854 F.3d 483 (8th Cir. 2017) (even allegedly untimely Tax Court CDP review tolls statute of limitations); *United States v. Holmes*, 693 Fed. Appx. 299 (5th Cir. 2017) (taxpayer stopped from arguing CDP appeal did not suspend statute); *In re Hosack*, 282 Fed. Appx. 309 (5th Cir. 2008) (filing for redetermination in Tax Court suspends limitations period); *Shockley v. Commissioner*, 686 F.3d 1228 (11th Cir. 2012) (where Tax Court petition was filed by former shareholders of corporation being assessed, petition suspended limitations period until after subsequent proceeding in which former shareholders were assessed as transferees of corporation’s assets becomes final), *rev’g* T.C. Memo 2011-96; *United States v. Godley*, 136 F. Supp. 3d 724 (W.D.N.C. 2015) (letter defaulting §6166 estate tax installment agreement re-starts collection statute of limitations). For a discussion of assessments, see 627 T.M., *Limitations Periods, Interest on Underpayments and Overpayments, and Mitigation*.

²⁶⁷ IRM 25.6.1.9.4.5 (10-05-16); SBSE-04-1223-0066 (Dec. 15, 2023) (interim guidance under IRM 4.12.1), to be incorporated as IRM 4.12.1.5.4(2).

²⁶⁸ §6501(c)(4)(A), §6502(a). See Reg. §301.6502-1(b)(1) and §301.6502-1(b)(2).

²⁶⁹ IRM 5.14.2.3 (04-26-19). See Reg. §301.6502-1(b)(1).

quest or by filing Form 4506-T.²⁷⁰ While the transcript includes only the account history, the actual record of assessment may be obtained by making a FOIA request. It is exceptionally rare for any discrepancy to exist between the assessment record and the assessment date reflected on the transcript of account.

In a legal proceeding, the burden of proving that the IRS is barred from assessment or collection rests on the taxpayer. Therefore, the taxpayer must plead the defense and set forth a prima facie case. The burden then shifts to the IRS to prove that its actions are not barred by the statute of limitations (by, for example, proving that a valid extension applies).²⁷¹

D. Innocent Spouse Relief

Another way to challenge the liability in joint return cases is for one spouse to seek “innocent spouse” relief. Generally, if spouses file a joint income tax return, each spouse is jointly and severally liable for the amount of tax due.²⁷² Under §6015, there are three ways for a spouse to be relieved from joint and several liability for a tax.²⁷³

1. “Traditional” Innocent Spouse Relief for Deficiencies

The first type of innocent spouse claim is §6015(b), which allows for innocent spouse relief if:

- a joint return is filed;
- an understatement of tax exists that is attributable to erroneous items of the “nonrequesting” spouse;
- the “requesting” spouse did not know and had no reason to know on signing the return of the understatement of tax;
- taking into account all facts and circumstances, it is inequitable to hold the requesting spouse liable for the tax deficiency for the year attributable to such understatement; and
- the requesting spouse applies for relief no later than two years from the date of the IRS’s first collection activity with respect to the requesting spouse.

If all of the above five conditions are met, an individual may receive innocent spouse relief for the part of a *deficiency* not allocable to the requesting spouse. If all five conditions would be met except that the requesting spouse knew of a *portion* of the erroneous item, the individual can be granted relief to the extent that the liability is not attributable to such portion.²⁷⁴

²⁷⁰ See IR-2020-254 (Nov. 13, 2020), which outlines new procedures undertaken by the IRS to mask sensitive data on business tax transcripts to protect business taxpayers from identity theft, and outlines procedures for taxpayers seeking to verify income for a lender using Form 4506-T. In IRS Tax Tip 2020-164 (Dec. 2, 2020), the IRS announced that beginning in December 2020, the new format of business tax transcripts would conceal certain critical information to help prevent identify theft and would reveal only truncated forms of taxpayer identification numbers, names and addresses with dollar amounts and customer file numbers.

²⁷¹ See *Adler v. Commissioner*, 85 T.C. 535 (1985).

²⁷² §6013(d)(3).

²⁷³ For further discussion of relief from joint and several liability, see 645 T.M., *Innocent Spouse Relief*.

²⁷⁴ §6015(b)(2); Reg. §1.6015-2.

2. Separate Liability Election for Deficiencies

A second type of innocent spouse relief exists for individuals who have filed a joint return and are:

- divorced,
- legally separated, or
- not members of same household during the 12-month period ending on the date of election of relief from joint and several liability.²⁷⁵

Innocent spouse relief can be granted for this “separate liability election” for a *deficiency* arising from an erroneous item attributable to the nonrequesting spouse unless the requesting spouse: (1) had *actual* knowledge when signing the income tax return of the item giving rise to the deficiency or a portion of the deficiency;²⁷⁶ or (2) disqualified assets were transferred to the requesting spouse.²⁷⁷

Disqualified assets are assets transferred to the requesting spouse if the principal purpose for the transfer was avoidance of tax or payment of tax. The assets generally are *not* disqualified assets if the transfer is made pursuant to a divorce decree or agreement of separate maintenance. However, it is presumed to be avoidance of tax if the transfer is made within one year before the date of the first letter of proposed deficiency. The requesting spouse may rebut this presumption by showing that the principal purpose was not the avoidance of tax or payment of tax.²⁷⁸

3. Equitable Relief for All Joint Liabilities

The third ground for relief is §6015(f), which provides that if innocent spouse relief is not available under §6015(b) and §6015(c), the IRS may grant innocent spouse relief if the facts and circumstances make it inequitable to hold the individual liable for the unpaid tax *shown on a return* or for a *deficiency*.

Certain threshold conditions must exist in order for the IRS to consider granting equitable relief:

- the requesting spouse filed a joint return for the year for which relief is sought;
- relief is not available under §6015(b) or §6015(c);
- the claim for relief is timely filed;²⁷⁹
- no assets were transferred between spouses as part of a fraudulent scheme by the spouses;
- the nonrequesting spouse did not transfer disqualified assets to the requesting spouse (this factor may be obviated in certain circumstances, such as abuse or restricted access to information about the family’s finances);
- the requesting spouse did not knowingly participate in filing a fraudulent joint return; and

²⁷⁵ See §6015(c); Reg. §1.6015-3.

²⁷⁶ §6015(c)(3)(C).

²⁷⁷ §6015(c)(4).

²⁷⁸ §6015(c)(4). See Reg. §1.6015-3(c)(3).

²⁷⁹ The IRS considers requests for §6015(f) relief timely filed if the §6502 limitation period on collection of taxes remains open for the years at issue. If the relief sought involves a refund of tax, then the §6511 limitation period on credits or refunds governs whether the IRS will consider the request for §6015(f) relief timely filed. Notice 2011-70.

- the liability from which relief is sought is attributable, in full or in part, to an item of the nonrequesting spouse or an underpayment resulting from the nonrequesting spouse's income (this factor may be obviated in certain circumstances).²⁸⁰

After the initial threshold conditions are established, the IRS will apply a number of factors to determine whether relief should be granted, including:

- marital status;
- economic hardship to the requesting spouse if relief is not granted;
- whether the requesting spouse had knowledge or reason to know about the item giving rise to the deficiency;
- which spouse has a legal obligation to pay the tax;
- whether the requesting spouse significantly benefited from the unpaid liability or understatement;
- whether the requesting spouse made a good faith effort to comply with tax law in the years following the one for which relief is requested; and
- mental or physical health.²⁸¹

No single factor controls whether relief will be granted. In addition, certain factors such as abuse and mental or physical health will be considered. These factors do not weigh in favor of equitable relief if they are not present.²⁸²

4. Innocent Spouse Procedures

An election to claim “traditional” or “separate liability” innocent spouse relief generally must be made on Form 8857 within two years after the date the IRS has begun collection.²⁸³ Collection activity means a collection due process (CDP) notice of intent to levy, an offset of a refund against a liability; the filing of a suit against the requesting spouse for the collection of the joint tax liability, or the filing of a claim in a court proceeding in which the requesting spouse is a party or which involves property of the requesting spouse. Collection activity does not include a notice of deficiency, the filing of a Notice of Federal Tax Lien, or a demand for payment of tax.²⁸⁴

An innocent spouse can recover a refund of tax paid if a claim is made within the refund statute of limitation if traditional relief or equitable relief is allowed, but not if relief is allowed or allowable under the separate liability election.²⁸⁵

Each form of innocent spouse relief may be requested as part of the collection due process (CDP) hearing procedures, unless the requesting spouse previously requested relief and the IRS ruled on that request by issuing a final administrative determination.²⁸⁶

²⁸⁰ See §6015(f); Rev. Proc. 2013-34, §4.01 (effective for requests for equitable relief filed on or after September 13, 2013, and for requests pending on that date), *superseding* Rev. Proc. 2003-61.

²⁸¹ Rev. Proc. 2013-34, §4.03.

²⁸² Rev. Proc. 2013-34, §4.03. See also Reg. §1.6015-4.

²⁸³ §6015(b)(1)(E), §6015(c)(3)(B); Reg. §1.6015-5(b)(1).

²⁸⁴ Reg. §1.6015-5(b)(2).

²⁸⁵ §6015(g); Reg. §1.6015-4(b).

²⁸⁶ Reg. §301.6330-1(e)(2).

The IRS is prohibited from levying while an innocent spouse claim is pending.²⁸⁷ The statute of limitations on collection is suspended during the period collection is stayed.²⁸⁸

If an innocent spouse claim is denied, the requesting spouse will receive a notice of determination and can appeal the IRS's denial of, or refusal to consider, innocent spouse relief to the Tax Court.²⁸⁹ A taxpayer who has a prior Tax Court decision can still raise innocent spouse status if the taxpayer did not meaningfully participate in the prior Tax Court proceeding.²⁹⁰

For a further discussion of innocent spouse relief, see 645 T.M., *Innocent Spouse Relief*.

E. Request for New Audit

A taxpayer may request an audit reconsideration if: (1) the taxpayer filed a tax return; and (2) the assessment remains unpaid, or the IRS has reversed tax credits that the taxpayer is disputing; and (3) the taxpayer identifies which adjustments they are disputing. The taxpayer must also provide new additional information for the audited issues not considered during the original examination or show that there was an IRS computation or processing error in assessing the tax during the exam.²⁹¹

F. Abating Penalties

There are multiple penalties that the IRS can impose on a taxpayer. The principal penalties in the collection area are the penalty for failure to file a return (§6651(a)(1)); the penalty for failure to pay a tax (§6651(a)(2)); and the penalty for failure to deposit taxes (§6656). Each of these penalties may be abated if the taxpayer can show that the failure was due to reasonable cause. A statement under penalty of perjury can be used in support of the taxpayer's reasonable cause claim.²⁹² The IRS also has a program called “First Time Abate” which generally allows abatement of delinquency penalties if the taxpayer meets certain requirements.²⁹³ For further discussion, see 634 T.M., *Civil Tax Penalties*.

The taxpayer can attempt to have the penalty abated by the revenue officer assigned to the case. Alternatively, the taxpayer can file a penalty-only offer in compromise based on doubt as to liability.²⁹⁴ If the taxpayer is unsuccessful with the revenue officer, the taxpayer can file an administrative appeal after the notice of denial of abatement.²⁹⁵ If the administrative appeal is unsuccessful, the taxpayer must pay the amounts due and file a timely claim for refund. If the refund claim is denied, the tax-

²⁸⁷ §6015(e)(1)(B).

²⁸⁸ §6015(e)(2).

²⁸⁹ §6015(e). See Reg. §1.6015-7. For guidance on the time and manner for requesting relief, see Reg. §1.6015-5. The Tax Court's determination in such a dispute, other than one under the small case procedures because it involves \$50,000 or less (as discussed in §7463(f)(1)), constitutes an appealable decision. See §6015(e)(1)(A).

²⁹⁰ §6015(g)(2).

²⁹¹ IRM 4.13.1.2.1 (04-17-24); see IRS Pub. 3598, *What You Should Know About the Audit Reconsideration Process*.

²⁹² Reg. §301.6651-1(c), §301.6656-2(c).

²⁹³ IRM 20.1.1.3.3.2.1 (03-29-23).

²⁹⁴ See VI.A., below, for further discussion of offers in compromise.

²⁹⁵ Reg. §601.106(a)(1)(ii)(c), §601.106(a)(1)(iii). Cf. Prop. Reg. §601.106, IA-85-91, 58 Fed. Reg. 48,802 (Sept. 20, 1993). Before being integrated into Reg. §601.106, this administrative appeals procedure was set forth in Rev. Proc. 78-1.

payer may file a refund suit in federal district court or the Court of Federal Claims.²⁹⁶

²⁹⁶ For further discussion, see 631 T.M., *Refund Litigation*.

IV. Extensions of Time to Pay Taxes (Collection Resolution #2)

A. Short-Term Extensions

The IRS may grant a taxpayer a short-term extension of up to 180 days within which to pay a tax liability if the taxpayer merely needs some extra time to get funds together to pay the tax.²⁹⁷ These extensions are not literally installment agreements. There are, therefore, no forms to be filled out by the taxpayer. The IRS simply informs the taxpayer of these extensions (after a request by the taxpayer) either in person, by telephone, or by letter.²⁹⁸ The letter may refer to the extension as a single payment “installment agreement,” however.

B. Long-Term Extensions

If a taxpayer can establish that timely payment of a tax liability will result in undue hardship, the IRS can grant an extension of time for paying any tax (with the exception of estate taxes) for a reasonable period not to exceed six months from the date payment is due.²⁹⁹ If a taxpayer is abroad, the extension can exceed six months.³⁰⁰ Undue hardship means that a taxpayer will definitely incur substantial financial loss if forced to pay the tax when due.³⁰¹

²⁹⁷ See generally IRS, Additional Information on Payment Plans.

²⁹⁸ IRM 5.19.1.6.3.

²⁹⁹ §6161(a)(1); Reg. §1.6161-1(a), §1.6161-1(b).

³⁰⁰ §6161(a)(1).

³⁰¹ Reg. §1.6161-1(b).

The IRS uses its statutory authority to grant extensions to provide relief to groups of taxpayers in a variety of situations, including:

- taxpayers affected by federally declared disasters.³⁰²
- military spouses seeking relief under the Military Spouse Residency Relief Act (MSRRA).³⁰³
- a “fresh start” initiative for individuals unemployed for at least 30 consecutive days in 2011 (or in 2012 up to the April 17 deadline), and self-employed individuals who experienced a 25% or greater reduction in business income in 2011 from 2010 due to the economy.³⁰⁴
- a three-month extension of time to file and pay for individuals affected by the Boston Marathon explosions.³⁰⁵

³⁰² Additional guidance on disaster relief for specific events is available on the IRS’s website, and additional guidance on federally declared disasters (including affected counties) is available on FEMA’s website.

³⁰³ See, e.g., Notice 2010-30 (transitional guidance provided for military spouses claiming relief under the Military Spouse Residency Relief Act (MSRRA) and extension of time to file granted until October 15, 2010), as extended by Notice 2011-16 (granting an extension of time for military spouses claiming relief under MSRRA to file for calendar year 2010 until October 17, 2011), and Notice 2012-41 (further extending the relief set forth in Notice 2010-30 to taxable years beginning after November 11, 2010, i.e., calendar year 2011 and subsequent calendar years, and instructing civilian spouses to follow the applicable procedures described in Notice 2010-30).

³⁰⁴ See IR-2012-31 (03-07-12).

³⁰⁵ See Notice 2013-30.

V. Installment Agreements (Collection Resolution #3)

After it is determined that the liability is lawfully due, the three primary resolutions of that liability that should be explored are (1) an installment agreement; (2) an offer in compromise; and (3) filing for bankruptcy protection.

A. In General

Under §6159, a taxpayer that cannot timely pay the full amount of taxes due may be allowed to pay the taxes in installments.³⁰⁶ An installment agreement is typically a fallback option for a taxpayer who does not meet the criteria for an offer in compromise (discussed at VI., below). However, before the IRS will enter into an installment agreement with the taxpayer, the IRS will first request that the taxpayer pay as much as possible and borrow the remainder (unless doing so will create an economic hardship for the taxpayer). The IRS will consider an installment agreement only if these attempts fail.³⁰⁷

In determining whether the taxpayer is a good candidate for an installment agreement, the IRS examines the taxpayer's income and expenses. The IRS considers the excess of gross income over the taxpayer's allowable expenses to be available for payment under the installment agreement. The taxpayer should propose to pay a specific amount each month. If the taxpayer does not make such a proposal, the IRS will request that the taxpayer specify how much can be paid each month.³⁰⁸

Note: The mere fact that a taxpayer may be able to demonstrate a *current* ability to pay does not automatically translate into acceptance of an agreement. Other factors such as a taxpayer's past history of pyramiding employment tax liabilities, failure to live up to prior installment agreements, and projected future financial results may suggest that successful completion

is unlikely.³⁰⁹ The IRS will generally not consider an installment agreement for a taxpayer in a pending bankruptcy case.³¹⁰

Proposals to enter into installment agreements may result from letters, phone contacts, voice-mail, e-mail, or other communications between a taxpayer and the IRS.³¹¹ The proposal can be made at any step in the collection process.

The IRS utilizes a variety of forms/methods to secure financial information and/or the installment agreement itself:

- Form 433-A, *Collection Information Statement for Wage Earners and Self-Employed Individuals*.
- Form 433-B, *Collection Information Statement for Businesses*.
- Form 433-D, *Installment Agreement* — Used by taxpayers who are self-employed and/or who operate a business.
- Form 433-F, *Collection Information Statement*.
- Form 433-H, *Installment Agreement Request and Collection Information Statement* — Used by taxpayers who earn wages, are requesting an installment agreement, and the liability is either greater than \$50,000 or cannot be paid within 72 months. The form combines payment and banking information with financial information.

³⁰⁶ §6159; Reg. §301.6159-1. Nevertheless, if, after the IRS files a notice of tax lien, the debtor files for bankruptcy and properly exempts certain property from the bankruptcy estate, and the court discharges the liability on which the lien is based, the IRS may not use an installment agreement under §6159 to collect the value of the exempted property that is subject to the tax lien. This collection device cannot be used because the amount to be paid is based on the property's value, not on the debtor's personal liability, and because the liability cannot be paid in full. CCA 200133044.

³⁰⁷ See IRM 5.14.1.4 (07-02-24); see also IRM 5.14.2.2 (04-26-19) (partial payment installment agreement overview).

³⁰⁸ IRM 5.14.1.3 (07-02-24), IRM 5.14.1.4 (07-02-24). The IRS will also consider varied payment amounts. IRM 5.14.1.4.4 (07-02-24). For guidance on installment agreements involving restitution assessments, see IRM 5.14.4.6 (10-09-20) *et seq.*

³⁰⁹ See, e.g., *Melasky v. Commissioner*, 803 Fed. Appx. 732 (5th Cir. 2020) (no abuse of discretion in rejecting proposed installment agreement where taxpayer failed to comply with previous agreements, had outstanding liabilities for numerous years, and refused to liquidate assets and make discretionary distributions from trust despite numerous extensions granted by settlement officer to do so); *Fifty Below Sales & Mktg., Inc. v. United States*, 497 F.3d 828 (8th Cir. 2007) (IRS appeals officer properly considered taxpayer's current ability to make payments before rejecting proposed installment agreement; officer did not abuse discretion in basing his rejection on conclusion that past history of pyramiding of employment taxes, noncompliance, prior defaults on agreements, and future financial projections showed that taxpayer would not be able to comply with its proposal); *Boulware v. Commissioner*, T.C. Memo 2014-80, *aff'd*, 816 F.3d 133 (D.C. Cir. 2016) (IRS settlement officer rejected taxpayer's proposed installment payment due to noncompliance with current estimated tax payments, unwillingness to liquidate assets to pay tax liability, failure to post bond to minimize asset dissipation, and reflection of ability to pay compared to proposed payment); *First Rock Baptist Church Child Dev. Ctr. v. Commissioner*, 148 T.C. 380 (2017) (IRS settlement officer did not abuse discretion in denying taxpayer's request for installment agreement where taxpayer was not in compliance with ongoing filing obligations).

³¹⁰ IRM 5.9.8.14.1 (02-01-23).

³¹¹ IRM 5.14.1.3(1) (07-02-24). If the IRS receives a proposal to enter into an installment agreement by e-mail, it will not respond by e-mail because such responses violate IRS security policies. *Id.* See *Boulware v. Commissioner*, T.C. Memo 2014-80, *aff'd*, 816 F.3d 133 (D.C. Cir. 2016) (settlement officer did not have to conduct face-to-face meeting with taxpayer under CDP hearing procedures to discuss installment agreement because at time of request taxpayer was noncompliant with tax laws and refused to liquidate assets to satisfy outstanding tax liability).

- Form 9465, *Installment Agreement Request* — Used by taxpayers that owe income tax on Form 1040 or 1040-SR, that are or may be responsible for a Trust Fund Recovery Penalty, that owe employment taxes (for example, as reported on Form 941, Form 943, or Form 940) related to a sole proprietor business that is no longer in operation, or that owe an individual shared responsibility payment under the Affordable Care Act. This is filed together with Form 433-F by taxpayers that owe more than \$50,000. If the taxpayer owes more than \$50,000 then Form 9465 cannot be filed electronically.

- *Online Payment Agreement (OPA)* — A taxpayer can use an OPA through the IRS's website if: (1) they can pay their outstanding combined tax, penalty and interest liability of \$100,000 or less within 180 days (a short-term plan), or (2) owe a combined tax, penalty, and interest liability of \$50,000 or less if the payment period exceeds 180 days (a long-term plan).³¹²

- Form 13844, *Application For Reduced User Fee For Installment Agreements*.

Forms 433 are completed under penalty of perjury. Intentionally false statements can be subject to criminal prosecution.³¹³

A \$5,000 penalty may be imposed for submitting an installment agreement request that is frivolous or designed merely to impede or delay tax administration.³¹⁴

The IRS will notify the taxpayer if the IRS intends to reject an installment agreement proposal. A taxpayer who disagrees with the IRS's proposed action has the right to an independent administrative review. The taxpayer ultimately may request an additional review (i.e., a CAP hearing) before the Appeals Office.³¹⁵

Various methods are available for making monthly installment agreement payments — EFTPS, direct debit, payroll deductions, credit card, payment by check or money order, IRS Direct Pay, Individual Online Account (IOLA)³¹⁶ and cash.³¹⁷

The different types of installment agreements are discussed below. Penalties and interest continue to accrue throughout the duration of the installment agreement.

³¹² Additional information regarding OPAs is available on the IRS's website at <https://www.irs.gov/payments/online-payment-agreement-application>; IRS Pub. 5123, *Online Payment Agreement*. In addition, taxpayers can use the IRS's voicebot feature to request or modify an installment agreement. See IRS Pub. 5658, *Expanded IRS voice bot options help taxpayers set up or modify a payment plan*.

³¹³ See *United States v. Hayes*, 674 Fed. Appx. 507 (6th Cir. 2017).

³¹⁴ See §6702(b). No penalty applies if a taxpayer withdraws a frivolous application within 30 days of being so notified. §6702(b)(3). The penalty also may be reduced at the IRS's discretion. §6702(d). A frivolous application also may be treated as if it never were submitted, thus precluding further administrative or judicial review. §7122(g).

³¹⁵ See §6159(e); Reg. §301.6159-1(e)(5); IRM 5.14.11.7 (03-14-22) (addressing appeals of defaulted or terminated agreements).

³¹⁶ See IRM 5.14.1.2(6) (07-02-24), IRM 21.2.1.48.1 (10-01-23).

³¹⁷ See IRM 21.2.1.48 (10-01-24). VanillaDirect is a new cash payment option available to taxpayers through <https://www.irs.gov/Payments> and participating retail stores. The IRS changed the PayNearMe service to VanillaDirect as the IRS cash payment option. See IRM 21.2.1.60 (10-01-23) *et seq.* (Paying with Cash at a Retail Partner).

1. Guaranteed Installment Agreements

At the taxpayer's request, the IRS must enter into an installment agreement for full payment of the tax liability if:

- the liability is for income tax only and is \$10,000 or less (excluding penalties and interest);
- within the previous five years, the taxpayer has not failed to file or pay, nor entered into another installment agreement,³¹⁸
- the taxpayer demonstrates inability to pay the tax in full;
- the installment agreement provides for full payment of the liability within three years or before the Collection Statute Expiration Date (CSED), whichever is earlier; and
- the taxpayer agrees to remain in full compliance with the tax laws and the terms of the agreement for the period the agreement is in place.³¹⁹

2. Streamlined Installment Agreements (SIA)

If the taxpayer has aggregate unpaid liabilities of \$50,000 or less, the taxpayer may qualify for a "streamlined" installment agreement (SIA). SIA criteria are divided into two tiers: balances due of \$25,000 or less, and balances due of \$25,001 to \$50,000.³²⁰

One key advantage of a streamlined agreement is that it can be processed quickly. No financial disclosure or IRS managerial approval is needed. Streamlined agreements are available even if the taxpayer can fully pay the liability. A taxpayer owing more than \$50,000 still may qualify for a streamlined agreement by paying the assessed balance down to \$50,000.³²¹

To qualify for a streamlined agreement, the taxpayer must be able to fully pay the aggregate unpaid balance of assessments within 72 months or before the expiration of the collection statute of limitations, whichever comes first. Also, streamlined agreements are limited to individual and "in-business" taxpayers owing only income tax, and out of business taxpayers owing any type of tax. Lastly, all tax returns that are due before entering into the agreement must have been filed.³²²

A taxpayer that does not qualify for a streamlined agreement because their balance due exceeds \$50,000 still may qualify for an installment agreement referred to as a "non-streamlined installment agreement" (NSIA), which is discussed further below.

3. In-Business Trust Fund Express Agreements

Businesses owing employment taxes (i.e., trust fund taxes) may qualify for an installment agreement if the entire liability

³¹⁸ If the liability relates to a joint return, this requirement applies to the taxpayer's spouse as well. §6159(c)(2).

³¹⁹ §6159(c); IRM 5.14.5.3 (10-14-21).

³²⁰ IRM 5.14.5.2 (10-14-21).

³²¹ See IRM 5.14.5.2 (10-14-21). The unpaid balance of assessments includes tax, assessed penalty and interest, and all other assessments on the tax modules, but does not include accrued penalty and interest. If pre-assessed taxes are included, the pre-assessed liability plus unpaid balance of assessments must be \$50,000 or less. Examination employees may prepare streamlined agreements for taxpayers with deficiencies of \$50,000 or less that can be paid within 72 months. IRM 5.14.5.2.

³²² IRM 5.14.5.2 (10-14-21).

(including accruals) does not exceed a specified amount (generally \$25,000) and the taxes can be fully paid within 24 months or before the expiration of the statute of limitations on collection, whichever comes first. Generally, no financial statement is required, no §6672 Trust Fund Recovery Penalty determination is made, and a tax lien is not necessarily filed.³²³

4. Partial Pay Installment Agreements (PPIA)

While the goal of an installment agreement is for the IRS to collect the full liability from the taxpayer as quickly as possible (and before the collection statute of limitations expires), the IRS may allow for an installment agreement that does not result in full payment. Such an agreement is known as a Partial Payment Installment Agreement (PPIA).³²⁴

Only necessary expenses (discussed below) are allowed in determining the monthly payment amount. The IRS also will require the taxpayer to make a good faith effort to utilize equity in assets to reduce or fully pay the amount of the outstanding liability, and may request that assets be sold or that equity be borrowed against. However, complete utilization of equity is not always required as a condition of a PPIA (e.g., where the assets have minimal equity or the equity is insufficient to allow a creditor to loan funds).³²⁵

When a PPIA involves trust fund taxes for an out-of-business account, the §6672 Trust Fund Recovery Penalty will be assessed against the responsible person(s) unless there is no collection potential.³²⁶

If a taxpayer qualifies for a PPIA, the IRS will encourage the taxpayer to pay using the direct debit option. A taxpayer that is granted a PPIA is subject to financial review every two years.³²⁷ If, as a result of this review, the IRS determines that the taxpayer's financial condition has improved, the IRS may request an increase in the amount of the installment payments or may terminate the agreement altogether.

5. Non-Streamlined Installment Agreements (NSIA)

Individual taxpayers who do not qualify for other installment agreements due to the amount they owe still may qualify for an installment agreement known as a "non-streamlined installment agreement" (NSIA). Under a NSIA, the IRS will allow an individual taxpayer that has a balance up to \$250,000 to enter into an installment agreement so long as the taxpayer can fully pay before the expiration of the statute of limitations on collection (CSED) expires. In addition, a Notice of Federal Tax Lien (NFTL) determination is required as a condition of the NSIA.³²⁸

³²³ IRM 5.14.5.4 (10-14-21). An express agreement cannot be granted where the first payment on the agreement is a lump sum payment to be made to pay down the balance to meet the \$25,000 criteria, and that taxpayers must meet the dollar criteria at the time the agreement is granted. However, taxpayers with a liability of more than \$25,000 may be considered for an agreement if they pay down the liability to \$25,000 or less before the agreement being granted. In addition, a direct debit installment agreement (DDIA) is required if the unpaid balance of assessment (UBA) is between \$10,000 and \$25,000. IRM 5.14.5.4 (10-14-21).

³²⁴ §6159(a); IRM 5.14.2.1.1.

³²⁵ IRM 5.14.2.1.1, IRM 5.14.2.2.1.

³²⁶ IRM 5.14.2.2.1(8).

³²⁷ §6159(d).

³²⁸ See IRM 5.19.1.6.4.

B. Installment Agreement Fees and Costs

1. Direct Debit Installment Agreements (DDIA)

Under a DDIA, a taxpayer pays through automatic monthly payments that are deducted from the taxpayer's account. The IRS fees for DDIA's are as follows:³²⁹

- \$22 if applying online using the IRS installment payment application.
- \$107 if not using the online IRS installment payment application.
- \$43 for low-income taxpayers (\$0 setup fee for low-income taxpayers applying online using the IRS installment agreement application).

Penalties and interest continue to accrue until the balance is paid in full.

2. Other Installment Agreements

After applying for an installment agreement, payment options for taxpayers not utilizing direct debit include: (1) making monthly payments directly from a checking or savings account (IRS Direct Pay); (2) making monthly payments electronically online or by phone using EFTPS (enrollment required); or (3) making monthly payments by check, money order, or debit/credit card (card processing fees apply).

The IRS fees for installment agreements without the use of direct debit are as follows:³³⁰

- \$69 if using the IRS online installment agreement payment application.
- \$178 if not using the IRS online installment agreement payment application.
- \$43 setup fee for low-income taxpayers (which may be reimbursed if certain conditions are met).

For low income taxpayers, the user fee for entering into an installment agreement (payment plan) may be waived or reimbursed. For installment agreement purposes, low-income taxpayers are individuals with adjusted gross incomes at or below 250% of the criteria established by the poverty guidelines up-

³²⁹ Additional information regarding installment agreements is available on the IRS's website at <https://www.irs.gov/payments/online-payment-agreement-application> and the instructions for Form 9465, *Installment Agreement Request*. See also Reg. §300.1 and §300.2. A qualified low-income taxpayer is an individual that falls at or below 250% of the dollar criteria established by the poverty guidelines updated annually in the Federal Register by the U.S. Department of Health and Human Services. The poverty guidelines for recent years are provided in Tables, Charts and Lists (Federal) > HHS Poverty Guidelines > *Annual Update of the HHS Poverty Guidelines*. Form 13844, *Application for Reduced User Fee for Installment Agreements*, is used to request a reduced fee and to indicate that the taxpayer is unable to make electronic payments through a DDIA.

³³⁰ Additional information regarding installment agreements is available on the IRS's website at <https://www.irs.gov/payments/online-payment-agreement-application> and the instructions for Form 9465, *Installment Agreement Request*. To apply for low-income taxpayer status for installment agreement purposes, see Form 13844, *Application for Reduced User Fee for Installment Agreements*.

dated annually by the U.S. Department of Health and Human Services.³³¹

If the taxpayer is a wage earner, the IRS will likely encourage the taxpayer to enter into a payroll deduction agreement (Form 2159) for the amount of the monthly installment.³³²

Penalties and interest continue to accrue until the balance is paid in full.

3. Changes to an Existing Agreement/Reinstatement

The following IRS fees apply when making changes (including reinstatement) to an existing installment agreement:³³³

- \$10 when revising online (existing DDIA cannot be revised online), \$89 when revising by phone, mail or in-person.
- \$10 for low-income taxpayers when revising online, \$43 when revising by phone, mail, or in-person (but fee may be waived or reimbursed if certain conditions are met).
- \$0 for changes made to a DDIA.

C. Financial Analysis of Income and Expenses

If the taxpayer does not qualify for a guaranteed or streamlined installment agreement, the taxpayer will need to submit to the IRS's financial analysis. The mere fact that a taxpayer may not be able to immediately pay a balance due does not automatically translate into an installment agreement. The IRS analyzes the taxpayer's income and expenses to determine the amount of disposable income (gross income less allowable expenses) available to apply to the tax liability, and also analyzes assets that can be liquidated to resolve any balance due accounts. The IRS's policy is to request immediate payment if the taxpayer has cash equal to the total liability.³³⁴

Note: In the response to COVID-19, the IRS announced the Taxpayer Relief Initiative. As a part of this initiative, certain qualified individual taxpayers who owe less than \$250,000 may set up installment agreements without providing a financial statement or substantiation if their monthly payment proposal is sufficient.³³⁵

To establish a consistent framework for evaluating a taxpayer's ability to pay by means of an installment agreement, the IRS utilizes a series of financial analysis procedures that generally classify a taxpayer's expenses as "necessary" and "conditional."

³³¹ Form 13844, *Application for Reduced User Fee for Installment Agreements*.

³³² IRM 5.14.10.2 (12-14-17).

³³³ Additional information regarding installment agreements is available on the IRS's website at <https://www.irs.gov/payments/online-payment-agreement-application> and the instructions for Form 9465, *Installment Agreement Request*.

³³⁴ IRM 5.15.1.3. See *Am. Limousines, Inc. v. Commissioner*, T.C. Memo 2021-36 (settlement officer did not abuse discretion in rejecting installment agreement offered by taxpayer because taxpayer's own monthly income calculation showed its inability to pay proposed monthly amount); *Kirkley v. Commissioner*, T.C. Memo 2020-57 (settlement officer abused discretion by requiring taxpayers to liquidate their residence before accepting installment agreement; efficient collection of tax liability is to be balanced with concern that collection action be no more intrusive than necessary as required under §6330(c)(3)(C)).

³³⁵ IRS News Release IR-2020-248 (Nov. 2, 2020).

Note: Under certain circumstances, if a taxpayer conceals income to impede collection, a court may order specified installment payments.³³⁶

When a taxpayer is unable to full pay immediately and does not qualify for a streamlined installment agreement, the taxpayer still may qualify for the "six-year rule." Under this option, the IRS generally will allow the taxpayer to enter into an installment agreement and will allow all of the taxpayer's expenses if: (1) the taxpayer establishes an ability to stay current with all payment and filing requirements;³³⁷ (2) the tax liability, including projected accruals, can be fully paid within six years and within the collection statute of limitations (CSED); and (3) the expense amounts are reasonable.³³⁸

Taxpayers who cannot full pay their accounts within six years may be given up to one year to modify or eliminate excessive necessary expenses (i.e., the one-year rule). After the initial year, the monthly payment will increase to the amount allowable considering only necessary expenses.³³⁹

This same financial analysis is applied in offer in compromise determinations (discussed at VI., below). The choice between an installment agreement and an offer in compromise often is dictated by the taxpayer's ability to make monthly payments as determined by the allowable expense analysis and the presence or absence of equity in assets.

1. Income

Income determinations are usually based on current year paystubs or bank deposits and prior year tax returns. The IRS looks at the taxpayer's household income to determine the taxpayer's ability to pay.³⁴⁰ Even though certain kinds of income may be partially exempt from levy, they are nevertheless included in the analysis of the taxpayer's financial condition.³⁴¹

2. Expenses

In general, expenses are analyzed under the "necessary expense test." There are three types of expenses recognized by the IRS: (1) "allowable living expenses" that are based on National and Local Standards; (2) "other allowable expenses" that meet

³³⁶ See, e.g., *Hudak v. IRS*, No. 1:11-cv-012721-MJG, 2018 BL 226269 (D. Md. June 25, 2018) (ordering specified installment agreement and payments pursuant to 28 U.S.C. §3204(a)).

³³⁷ See *Boulware v. Commissioner*, T.C. Memo 2014-80, *aff'd*, 816 F.3d 133 (D.C. Cir. 2016) (taxpayer's proposed installment agreement rejected in part due to noncompliance of current tax year estimated income tax payments); *Strashny v. Commissioner*, T.C. Memo 2020-82 (proposed installment agreement to pay \$1.1 million in six-year agreement rejected where taxpayers refused to liquidate cryptocurrency account from which they withdrew \$19,000 on monthly basis).

³³⁸ IRM 5.15.1.11 (11-22-21). The IRS will not automatically allow agreements based on the six-year maximum if expenses are unreasonable. IRM Exhibit 5.15.1-1 provides additional guidance regarding allowable expenses.

³³⁹ IRM 5.15.1.11 (11-22-21). The one-year rule does not apply to corporations, partnerships, LLCs (where the LLC is identified as the liable taxpayer), or any business expenses. The one-year rule also does not apply for BMF liabilities owed by in-business sole proprietors or LLCs, where the individual owner is identified as the liable taxpayer. IRM 5.14.1.4.1 (03-31-23).

³⁴⁰ IRM 5.15.1.2 (11-22-21).

³⁴¹ See §6334(a)(6), §6331(h). *Ligman v. Commissioner*, T.C. Memo 2015-79 (2015) (railroad retirement benefits includible in determination of household income for purposes of ability to make payments on installment agreement); *Matthews v. Commissioner*, T.C. Memo 2015-225 (monthly veteran disability benefits are includible in financial analysis).

the necessary expense test and normally are allowed; and (3) “other conditional expenses,” which are expenses that may not meet the necessary expense test but may be allowable based on the taxpayer’s individual circumstances.³⁴²

a. Allowable Living Expenses

The Allowable Living Expense (ALE) Standards (also commonly referred to as Collection Financial Standards) provide for a taxpayer’s personal and family health and welfare and production of income. These expenses must be reasonable in amount for the size of the family and the geographic location, as well as any unique circumstances. The total necessary expenses establish the minimum a taxpayer and family needs to live. They are based on national and local standards for food, clothing, health care, transportation, etc. The number of persons counted for purposes of determining the size of a household is the same as the number of individuals personal exemptions and dependents claimed on the tax return.

According to the IRS, the national and local expense standards are guidelines, i.e., if a standard amount is inadequate to provide for a specific taxpayer’s basic living expenses, a deviation should be allowed so long as the taxpayer provides reasonable substantiation. However, the IRS will not deviate merely because it may be inconvenient for the taxpayer to dispose of valued assets or reduce excessive necessary expenses.³⁴³

(1) National Standards for Food, Clothing, and Other Items

Amounts are allowed for five necessary expenses: food, housekeeping supplies, apparel and services, personal care products and services, and miscellaneous. These standards come from the Bureau of Labor Statistics (BLS) Consumer Expenditure Survey. Taxpayers are allowed the total National Standards amount monthly for their family size, without questioning the amounts actually spent.³⁴⁴

(2) National Standards for Out-of-Pocket Health Care Expenses

Amounts are allowed for out-of-pocket health care costs including medical services, prescription drugs, and medical supplies (e.g., eyeglasses, contact lenses). The table for health care allowances is based on Medical Expenditure Panel Survey data. Taxpayers and their dependents are allowed the standard amount monthly on a per person basis, without questioning the amounts actually spent.³⁴⁵

(3) Local Standards for Housing and Utilities

Amounts are allowed for housing based on the county in which the taxpayer resides. The allowable amounts are derived from Census and BLS data. Housing and utilities standards

include mortgage (including interest) or rent, property taxes, insurance, maintenance, repairs, gas, electric, water, heating oil, garbage collection, cable television, internet services, telephone, and cell phone. Taxpayers normally are allowed the local standard or the amount actually paid monthly, whichever is less.³⁴⁶

(4) Local Standards for Transportation

The transportation standards consist of nationwide figures for loan or lease payments (referred to as ownership costs), and additional amounts for operating costs broken down by Census Region and Metropolitan Statistical Area. Operating costs include maintenance, repairs, insurance, fuel, registrations, licenses, inspections, parking and tolls. If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense. If a taxpayer has a car but no car payment, only the operating cost portion of the transportation standard is used to figure the allowable transportation expense. There is a single nationwide allowance for public transportation for taxpayers with no vehicle. Taxpayers are allowed the local standard or the amount actually paid monthly, whichever is less.³⁴⁷

b. Other Allowable Expenses

The IRS may allow “other expenses” if the IRS believes those expenses meet the necessary expense test — i.e., they are necessary for the health and welfare of the taxpayer (and/or family) and/or production of income. Other allowable expenses must be reasonable, and a taxpayer generally must substantiate the amount and justify these expenses as necessary.³⁴⁸ Because there are no national or local standards for determining what is “reasonable,” the IRS has discretion for determining whether an expense is an “other expense” that meets the necessary category and whether the amount is reasonable.³⁴⁹

The types of expenses that may qualify as “other expenses” are:

- Accounting and legal fees for representation before the IRS to resolve the balance(s) due;
- Charitable contributions that are a condition of employment (e.g., a minister that must tithe);
- Child care (baby-sitting, day care, nursery and preschool) to allow employment;
- Court-ordered payments such as alimony, child support, or victim restitution;
- Dependent care for the elderly, invalid or handicapped if there is no alternative to the taxpayer paying the expense;

³⁴² IRM 5.15.1.8 (07-24-19).

³⁴³ See IRM 5.15.1.8 (07-24-19).

³⁴⁴ See IRM 5.15.1.8 (07-24-19). The national and local standards, which are updated periodically, are available on the IRS’s website under Collection Financial Standards at <https://www.irs.gov/businesses/small-businesses-self-employed/collection-financial-standards>.

³⁴⁵ See IRM 5.15.1.8 (07-24-19). The national and local standards, which are updated periodically, are available on the IRS’s website under Collection Financial Standards at <https://www.irs.gov/businesses/small-businesses-self-employed/collection-financial-standards>.

³⁴⁶ See IRM 5.15.1.8 (07-24-19). The national and local standards, which are updated periodically, are available on the IRS’s website under Collection Financial Standards at <https://www.irs.gov/businesses/small-businesses-self-employed/collection-financial-standards>.

³⁴⁷ See IRM 5.15.1.8 (07-24-19). The national and local standards, which are updated periodically, are available on the IRS’s website under Collection Financial Standards at <https://www.irs.gov/businesses/small-businesses-self-employed/collection-financial-standards>.

³⁴⁸ IRM 5.15.1.11 (11-22-21).

³⁴⁹ IRM 5.15.1.5 (11-22-21), IRM 5.15.1.8 (07-24-19), IRM 5.15.1.11 (11-22-21).

- Education that is required as a condition of employment or is for a physically or mentally challenged child and no public services providing similar services is available;
 - Involuntary deductions such as uniforms, work shoes and union dues if it is a job requirement;
 - Term life insurance on the life of the taxpayer only;
 - Secured or legally perfected debts (rarely allowed);
 - Other unsecured debts that meet the necessary expense test of health/welfare and/or production of income (e.g., payments to suppliers or lines of credit needed to continue business);
 - Current year taxes;
 - Delinquent state and local taxes;³⁵⁰
 - Optional telephones and services (e.g., pre-paid long distance phone cards/minutes or prepaid cell cards/minutes);
 - Student loans guaranteed by the federal government for the taxpayer's post-high school education;
 - Repayment of loans made for payment of federal taxes.³⁵¹
- Contributions to voluntary retirement plans are not a necessary expense.³⁵²

c. Conditional Expenses

Conditional expenses generally are all expenses that do not meet the allowable expense tests described above. The IRS may allow conditional expenses so long as the tax liability, including projected accruals, can be fully paid within six years.³⁵³ All conditional expenses must be reasonable. The IRS has discretion in determining whether an amount is reasonable. Although the IRS generally allows six years, agreements are based on the taxpayer's *actual* ability to pay. Thus, if the excess of income over actual expenses would allow the taxpayer to pay more quickly, the IRS will require the shorter time frame.

Conditional expenses generally are not allowed if the taxpayer cannot pay within six years. The IRS will allow the taxpayer's actual, verified expenses for the first year of an installment agreement, however, and generally gives the taxpayer one year in which to eliminate conditional expenses. After the one-year period, the monthly payment will increase to the amount determined by allowing only allowable expenses.³⁵⁴

³⁵⁰ See IRM 5.15.1.11 (11-22-21), which provides detailed information regarding the circumstances under which the IRS will allow payment of delinquent state and local tax liabilities.

³⁵¹ See IRM 5.15.1.11 (11-22-21).

³⁵² See IRM 5.15.1.28(4) (08-29-18).

³⁵³ IRM 5.15.1.8 (07-24-19), IRM 5.14.1.4.1 (03-31-23). See, e.g., *Thompson v. Commissioner*, 140 T.C. 173 (2013) (children's college expenses were not necessary expenses nor were they allowed as conditional expenses where the taxpayer could not fully pay liability within six years). *Boulware v. Commissioner*, T.C. Memo 2014-80, *aff'd*, 816 F.3d 133 (D.C. Cir. 2016) (attorneys' and professional fees and costs incurred in pending litigation for tax deficiency determination not qualified necessary living expenses on Form 433A in determining ability to pay when entering installment agreement).

³⁵⁴ IRM 5.14.1.4.1 (03-31-23).

3. Shared Income and Expenses

One issue that frequently arises when determining ability to pay concerns "shared expenses." When a taxpayer lives with a nonliable person, the IRS may seek to review other income coming into the household and any expenses shared with the nonliable person to determine the taxpayer's allowable portion of the shared household income and expenses. Although the assets and income of a nonliable person may be reviewed to determine the taxpayer's portion of the shared household income and expenses, they generally are not included when calculating the amount that the taxpayer can pay. However, the IRS will seek to obtain sufficient information concerning the nonliable person to determine the taxpayer's proportionate share of total household income and expenses.³⁵⁵

The IRS first determines the total actual household income and expenses and what percentage of the total household income the taxpayer contributes, i.e., the taxpayer's income divided by total household income. The IRS then determines the allowable expenses that are shared, and the expenses that are the sole responsibility of the taxpayer, e.g., child support, allowable educational loan, union dues. The IRS then applies the taxpayer's percentage of income to the shared expenses and adds the taxpayer's sole responsibility expenses and verifies that the taxpayer actually contributes at least this amount to the total household expense.

Example: T's income of \$20,000 plus nonliable person's income of \$5,000 equals household income of \$25,000. T's income of \$20,000 is divided by household income of \$25,000 to determine T's share of household income, i.e., 80%. T's allowable shared expenses are calculated by multiplying the shared expenses by 80%. T also would be allowed 100% of expenses that are T's sole responsibility, unless they are already included under the Allowable Living Expense standards

D. Modification and Termination of Installment Agreements

Once the installment agreement is executed, the IRS may not alter, modify, or terminate the agreement during its term unless:³⁵⁶

- the information that the taxpayer provided to the IRS before entering into the agreement was inaccurate;
- the IRS determines that collection of the tax is in jeopardy;
- the taxpayer fails to pay an installment under the agreement, accrues additional tax liabilities, or fails to provide

³⁵⁵ IRM 5.15.1.5 (11-22-21). The taxpayer is not entitled to any amount paid toward a nonliable person's discretionary expenses. IRM 5.15.1.5 (11-22-21). Shared expense calculations also are used between spouses when the parties live in a separate property state or state law permits the parties to separate their incomes and the nonliable spouse does not agree to use their income to pay the liable spouse's tax debt. Note that the IRS will follow community property laws in community property states to determine what assets and income of the otherwise nonliable spouse are subject to collection.

³⁵⁶ §6159(b)(1)–§6159(b)(4).

the IRS with an updated statement of financial condition when requested to do so;³⁵⁷ or

- the IRS determines that the taxpayer's financial condition has significantly changed and sends notice of termination of the installment agreement at least 30 days before terminating or modifying the agreement.³⁵⁸

The IRS's internal policy is to forward the installment agreement to the Campus for monitoring within three months after execution. After this date, the agreement can be terminated only under the circumstances set forth above. The failure-to-pay penalty continues to accrue but is reduced to one-half of the prior rate if an installment agreement is entered into so long as the taxpayer has filed a timely tax return.³⁵⁹ The IRS must send the taxpayer an annual statement reflecting the amounts paid and amount remaining.³⁶⁰ The IRS usually issues a monthly statement requiring payment and showing the remaining balance due.

A taxpayer may request that the IRS modify or terminate an installment agreement based on a finding that the taxpayer's financial condition has changed significantly.³⁶¹ Such a request does not suspend the collection limitations statute under §6502 during the pendency of the request and the taxpayer must continue to comply with the terms of the existing agreement.³⁶²

Note: Taxpayers can modify installment agreements through a variety of communication methods, including online and by using the IRS's voicebot feature.³⁶³

The IRS generally will notify the taxpayer in writing at least 30 days before modifying or terminating an installment agreement. These notice requirements do not apply in cases where collection of tax is determined to be in jeopardy.³⁶⁴ Once the IRS enters into an installment agreement with a taxpayer for payment of taxes, the IRS cannot terminate the agreement because the taxpayer refuses to agree to an extension of the collection statute.³⁶⁵ The IRS also cannot terminate an installment

agreement during the pendency of a bankruptcy proceeding; instead, the agreement is considered suspended.³⁶⁶ A taxpayer may appeal a proposed modification or termination to Appeals within 30 days after the modification/termination notice.³⁶⁷

E. Effect of Installment Agreement on Collection Activity

The IRS may not levy:

- during the period that a request for an installment agreement is pending;
- during the 30-day period following rejection of the request;
- during the period that an installment agreement is in effect;
- during the 30-day period following termination of an agreement; and
- if a rejection or termination is appealed, during the period the appeal is pending.³⁶⁸

A taxpayer cannot successfully invoke equitable estoppel, however, if the IRS levies because an installment agreement failed to cover all pending liabilities based on an IRS error.³⁶⁹

The collection statute of limitations is suspended by operation of law while the request for installment agreement is pending, for 30 days after rejection of the request, during the 30 days after the termination date, or while the rejection is under consideration by Appeals.³⁷⁰ The statute of limitations is only extended while an installment agreement is actually in effect to the extent the taxpayer and the IRS enter into a separate written waiver of the statute of limitations.³⁷¹

³⁶⁶ See CCA 199920005 (termination of installment agreement may be construed as a violation of automatic stay during the pendency of the bankruptcy).

³⁶⁷ §6159(b)(5); Reg. §301.6159-1(e)(5). A taxpayer's waiver of the right to receive such a termination notice is not valid. CCA 200141012.

³⁶⁸ See §6331(k)(2); IRM 5.14.1.5 (12-23-22). However, the IRS may take certain actions other than levy to protect the government's interest, and is not precluded from filing a claim in a bankruptcy or insolvency proceeding brought against the taxpayer for the full amount of the liabilities owed, regardless of whether the installment agreement provides for full or partial payment of the liabilities at issue. See Reg. §301.6159-1(f)(3). This appeal filing is among the acts that may be postponed under §7508 and §7508A. See Tables, Charts and Lists (Federal) > Postponements Due to Combat Zone or Contingency Operation Service, Federally Declared Disasters, Significant Fires or Terroristic or Military Actions for an updated list of acts, the performance of which may be postponed under §7508 and §7508A; see also *Eichler v. Commissioner*, 143 T.C. 30 (2014) (IRS notice of intent to levy not rescinded while installment agreement pending because notice of intent to levy is different action other than prohibited levy to protect government's interest).

³⁶⁹ *Morgan v. Commissioner*, 345 F.3d 563 (8th Cir. 2003).

³⁷⁰ §6331(k)(3)(B); IRM 5.1.19.3.5 (12-18-23). See also *United States v. Chelsea Brewing Co., LLC*, 2014-2 USTC ¶50,456 (S.D.N.Y. 2014) (government unsuccessfully relied solely on the IRM to argue that defaulting on three installment agreements requires a 30-day extension of the limitations period for each default, resulting in a 90-day extension; IRM is not binding authority and a plain reading does not explicitly allow for the aggregation of extensions).

³⁷¹ §6331(k)(3)(B); Reg. §301.6502-1(b)(1). See CCA 201313022 (waiver of collection statute expiration date (CSED) executed at reinstatement of defaulted installment agreement invalid; waiver must be entered into in connection with original installment agreement).

³⁵⁷ *Pazzo Pazzo, Inc. v. Commissioner*, T.C. Memo 2017-12 (installment plan terminated after taxpayer failed to make payments; IRS entitled to levy).

³⁵⁸ §6159(b)(5).

³⁵⁹ §6651(h). See Reg. §301.6651-1(a)(4) (applying reduced rate if agreement is in effect at any time during the month); CCA 200051038 (treating installment agreement as in effect when approved by authorized IRS employee, and no longer in effect when properly terminated by the IRS).

³⁶⁰ 1998 IRS Reform Act §3506, as amended by the Community Renewal Tax Relief Act of 2000, Pub. L. No. 106-554, §302. For taxpayers in bankruptcy that entered into a pre-petition installment agreement, the IRS Chief Counsel's Office advised that the IRS does not have to send the notice, but if it did, the action would not violate the automatic stay. CCA 200144029.

³⁶¹ Reg. §301.6159-1(e).

³⁶² Reg. §301.6159-1(e)(3).

³⁶³ See <https://www.irs.gov/payments/online-payment-agreement-application> and IRS Publication 5658, *Expanded IRS voice bot options help taxpayers set up or modify a payment plan*.

³⁶⁴ §6159(b)(5). Administrative review of terminations of installment agreements is available for taxpayers who request such a review. §6159(e); IRM 5.14.11.7 (03-14-22).

³⁶⁵ See CCA 199919008; see also CCA 199922051 (although the IRS can condition installment agreement on taxpayer's agreement to timely meet all tax deposits and estimated tax payment requirements, the IRS cannot summarily terminate the agreement if a taxpayer misses a payment deadline).

VI. Offers in Compromise (Collection Resolution #4)

Section 7122 allows the IRS to compromise unpaid civil tax accounts for less than the full amount of the assessed balance due.³⁷² The offer in compromise must cover all taxes, interest, and penalties owed.³⁷³ The IRS may accept an offer in compromise when it is unlikely that the tax liability can be collected in full and the amount offered reasonably reflects the collection potential. Once an offer in compromise is accepted, a contract exists whereby the taxpayer must comply with all the terms of the offer in compromise in exchange for the IRS's agreement to reduce the tax liability owed.³⁷⁴

The objectives of the offer in compromise program are: (1) to effect collection of what could reasonably be collected at the earliest time possible and at the least cost to the government; (2) to achieve a resolution that is in the best interest of both the individual taxpayer and the government; (3) to give taxpayers a "fresh start" to enable them to voluntarily comply with the tax laws; and (4) to collect funds that may not be collectible through any other means.³⁷⁵

The IRS cannot reject an offer in compromise from a low-income taxpayer, or any taxpayer regardless of income level, solely on the basis of the amount offered by such taxpayer.³⁷⁶ A low-income taxpayer is a taxpayer who falls below a set dollar criteria.

The IRS's position is that it will not consider offers in compromise from bankrupt debtors.³⁷⁷ However, some courts have held that this policy is discriminatory and is prohibited by 11 U.S.C. §525(a) when it is based solely on the taxpayer's bankruptcy status and not on the merits of the offer.³⁷⁸ The IRS will also not consider an offer in compromise when a Department of Justice referral is still in effect.³⁷⁹

IRS Form 656, *Offer in Compromise*, sets forth the requirements applicable to the taxpayer and the IRS; in particu-

lar, §7 (Offer Terms) of Form 656 details the terms and conditions a taxpayer must agree to in submitting an offer. Form 656 requires the taxpayer to keep current on the taxpayer's payment and filing requirements for five years from the date of acceptance of the offer in compromise. If the taxpayer fails to timely file and timely pay any tax obligations that become due within the five years after offer acceptance, the IRS may default the taxpayer's offer. If the IRS defaults the offer, the taxpayer will be liable for the original tax debt, less payments made, and all accrued interest and penalties. An offer does not stop the accrual of interest and penalties, and the IRS may default the taxpayer's offer if the taxpayer fails to promptly pay any tax debts assessed after acceptance of the offer for any tax years prior to acceptance that were not included in the original offer.³⁸⁰

In general, the Code requires that a taxpayer's refund (that is, overpayment) be applied first to any outstanding federal tax liability, then to any outstanding federal non-tax debt, child support, Treasury Offset Program debt, state income tax obligation, or unemployment compensation debt, prior to crediting the overpayment to a future tax or issuing a refund.³⁸¹ Offset of overpayments (sometimes referred to as a systemic offset) occurs under §6402(a) prior to the offer in compromise acceptance date, and, after acceptance of an offer, the §6402(a) offset procedures apply to refunds and overpayments for tax periods not included in the offer in compromise. To prevent potential abuse of the change in refund recoupment practices, an exception exists; under this exception, if a taxpayer and the IRS execute the offer in compromise based upon information known at the time of the settlement and the taxpayer subsequently files an amended return requesting a refund for a year not covered by Form 656, the IRS may nevertheless offset that refund.

Taxpayers experiencing financial hardship may request an offset bypass refund ("OBR") while their offer is being considered by the IRS. An OBR occurs when an overpayment that would otherwise be applied to a prior tax liability is instead refunded to a taxpayer. If the taxpayer only has a federal tax liability (and does not owe money to another federal or state agency) and is experiencing economic hardship, the IRS may forego the offset and issue the refund under OBR procedures. There is no specific form used to request an OBR; taxpayers experiencing economic hardship whose offer in compromise is accepted may seek OBRs by contacting the IRS at 800-829-1040.³⁸²

Note: Taxpayers may request assistance from the Taxpayer Advocate Service in seeking an OBR.³⁸³

For further discussion of offsets and OBRs, see 507 T.M., *Income Tax Liability: Concepts and Calculation*.

Before 1998, only two grounds existed for accepting offers in compromise: (1) doubt as to liability; and (2) doubt as

³⁷² H.R. Conf. Rep. No. 599, 105th Cong., 2d Sess. 287 (1998); 1998 IRS Reform Act §3462.

³⁷³ Reg. §301.7122-1(a)(2) The submission of an offer does not interfere with the IRS's ability to credit any overpayments made by the taxpayer against a liability that is the subject of an offer to compromise or to offset such overpayments against other liabilities owed by the taxpayer to the extent authorized by §6402. Reg. §301.7122-1(g)(5).

³⁷⁴ §7122.

³⁷⁵ IRM 5.8.1.1(3).

³⁷⁶ §7122(d)(3)(A); Reg. §301.7122-1(f)(3) (expanding rule to all taxpayers).

³⁷⁷ IRM 5.8.2.4.1(1).

³⁷⁸ *In re Chapman*, 84 AFTR 2d 5068 (Bankr. S.D. W. Va. 1999); *In re Mills*, 240 B.R. 689 (Bankr. S.D. W. Va. 1999). *Cf. In re Peterson*, 317 B.R. 532 (Bankr. D. Neb. 2004); *In re Macher*, 303 B.R. 798 (W.D. Va. 2003) (considering 11 U.S.C. §1129(a)(9)'s flexibility to compromise priority tax claims and fresh start principle, bankruptcy court's equitable power under 11 U.S.C. §105 extends to ordering the IRS to consider reorganization plan as it would a nondebtor's offer in compromise); *In re Holmes*, 298 B.R. 477 (Bankr. M.D. Ga. 2003) (IRS policy not to consider compromise offer while taxpayer is in bankruptcy frustrates basic principles of Bankruptcy Code and §7122; 11 U.S.C. §105 provides authority to issue order). *But see In re 1900 M Rest.*, 319 B.R. 302 (Bankr. D.D.C. 2005) (bankruptcy court cannot compel IRS to consider offer in compromise submitted by debtor during pendency of bankruptcy case); *In re Uzialko*, 339 B.R. 579 (Bankr. E.D. Pa. 2006) (same); FSA 200015037. When a taxpayer with an accepted but uncompleted offer in compromise files a Chapter 13 bankruptcy petition, the IRS asserts a tax claim for the entire underlying liability and IRS personnel are instructed to file a protective claim. FSA 200015037.

³⁷⁹ Reg. §301.7122-1(a)(1). *See Isley v. Commissioner*, T.C. Memo 2013-253 (offer in compromise covering years for which taxpayer was convicted for tax evasion rejected).

³⁸⁰ Form 656 Booklet, *Offer in Compromise*.

³⁸¹ §6402(a), §6402(c), §6402(d), §6402(e), and §6402(f). *See Reg. §301.7122-1(g)(5)*.

³⁸² IRM 5.1.12.20.2 *et seq.*

³⁸³ *See generally* Fred Schindler, How IRS Collection is Helping Taxpayers During the Pandemic (Dec. 9, 2021).

to collectibility.³⁸⁴ The 1998 IRS Reform Act added a possible third basis for acceptance of an offer in compromise — the “promotion of effective tax administration.”³⁸⁵

The acceptance or rejection of an offer in compromise is solely within the discretion of the IRS.³⁸⁶ However, if the IRS does not reject an offer within 24 months after the date of submission, it is deemed to have been accepted.³⁸⁷ Section 7122 prescribes the sole method for compromising a tax liability and strict statutory compliance is required.

Comment: Where the taxpayer and the IRS dispute whether the OIC was accepted, the taxpayer’s options may be limited. The taxpayer cannot sue to enforce the terms of the OIC as such a suit is viewed as a suit to restrain the assessment or collection of tax and thus is barred under §7421. The taxpayer thus may be limited to seeking monetary damages under a breach of contract claim pursuant to the Tucker Act (28 U.S.C. §1491), or the taxpayer can pay the taxes, file an administrative claim for a refund, and then file a district court refund suit. The taxpayer also may wait for the government to sue to collect the taxes and assert the OIC as a defense.³⁸⁸

While the IRS allows an administrative appeal of an offer rejection, no judicial review is available.³⁸⁹ The only exception to this ban on judicial review exists if the rejection of the offer in compromise is part of the IRS determination in a CDP appeal. This rejection can be reviewed for an abuse of discretion.³⁹⁰

A. Offer in Compromise Based on Doubt as to Liability

The taxpayer can submit an offer in compromise to challenge the existence or amount of the IRS assessment. An offer based only on doubt as to liability is submitted on IRS Form 656-L. Doubt as to liability exists when there is a genuine dispute as to the existence or amount of the correct tax liability under the law.³⁹¹ Doubt as to liability does not exist if the liability is correct or it has arisen from a final court decision.³⁹²

The offer package should include a statement explaining why the taxpayer does not owe the liability. The taxpayer should set forth the factual and legal support for the taxpayer’s position and attach pertinent declarations and other documentary evidence supporting that position. The taxpayer is not required to provide a financial statement for an offer based on doubt as to liability.³⁹³

³⁸⁴ T.D. 8829, 64 Fed. Reg. 39,020 (July 21, 1999). The IRS will not simultaneously consider offers in compromise at the same time claiming both that they do not believe the liability is correct (Doubt as to Liability) and that they are unable to pay it (Doubt as to Collectability). See IRM 5.8.10.14; IRM 5.19.17.3, SBSE-05-0321-0336 (interim guidance on processing CNC (currently not collectible) accounts due to hardship and offers in compromise).

³⁸⁵ §7122(d); Reg. §301.7122-1(b)(3).

³⁸⁶ Reg. §301.7122-1(c)(1); *Addington v. United States*, 75 F. Supp. 2d 520 (S.D. W. Va. 1999).

³⁸⁷ §7122(f). For further discussion of §7122(f), see VI.H., below.

³⁸⁸ See, e.g., *RAJMP, Inc. v. United States*, No. 19-cv-876, 2020 BL 69239 (S.D. Cal. 2020).

³⁸⁹ Reg. §301.7122-1(f)(5); *Vivenzo v. Commissioner*, 2008-1 USTC ¶50,395 (3d Cir. 2008).

³⁹⁰ See XI., below, for further discussion of CDP actions.

³⁹¹ IRM 8.23.7.2(1).

³⁹² Reg. §301.7122-1(b)(1); Rev. Proc. 2003-71.

³⁹³ 7122(d)(3)(B)(ii).

Note: If a taxpayer files Form 656-L, *Doubt as to Liability*, and Form 656, *Doubt as to Collectibility*, simultaneously, they will not be considered concurrently. Instead, the IRS will determine processability of the doubt as to liability offer first.³⁹⁴

The IRS is not allowed to reject an offer on doubt as to liability because the IRS is unable to locate the taxpayer’s return or return information.³⁹⁵ Once an offer in compromise based on doubt as to liability has been accepted and the amount paid as required, the remaining balance due in excess of the offer amount is abated and any tax lien filed is released. Even though an accepted offer based on doubt as to liability really only revises the liability to the correct amount, the five-year compliance requirement for all offers still applies.

If the offer in compromise is rejected, the taxpayer has the right to appeal the rejection and meet with an Appeals Officer.³⁹⁶

B. Offer in Compromise Based on Doubt as to Collectibility

1. General Rules

The taxpayer also can submit an offer in compromise based on doubt as to collectibility. In fact, this is by far the most common form of offer. In determining the acceptability of an offer based on doubt as to collectibility, the IRS generally requires that the total amount offered exceeds the total equity value of the taxpayer’s assets plus the value of the taxpayer’s ability to make installment payments, based on future income.³⁹⁷ However, the IRS’s stated policy as to the adequacy of an offer in compromise is not to reject an offer in compromise solely on the basis of asset/income evaluations. Instead, the adequacy of the offer depends on whether the offer reasonably reflects collection potential.³⁹⁸ For business entity taxpayers, the financial analysis to determine the reasonable collection potential (RCP) and the value of the business, either as a going con-

³⁹⁴ IRM 8.23.7.2(12), IRM 5.8.10.14.

³⁹⁵ §7122(d)(3)(B)(i); Reg. §301.7122-1(f)(4).

³⁹⁶ §7122(e); Reg. §301.7122-1(f)(5). See CCA 201421018 (taxpayer has right to appeal rejection of offer-in-compromise or installment agreement, but may not appeal such rejection if due to fraud). See IRM 8.23.7.3 for guidance on rejected doubt as to liability offers.

³⁹⁷ See IRM 5.8.11.3 (04-11-24).

³⁹⁸ IRS Policy Statement P-5-100, at IRM 1.2.1.6.17 (1-30-92); IRM 5.8.4.1 (06-01-10). See *Porro v. Commissioner*, T.C. Memo 2014-81, *aff’d*, 589 Fed. Appx. 502 (11th Cir. 2015) (taxpayer’s offer rejected where collection potential more than double offer, taxpayer’s dissipated asset proceeds not held to pay tax liability, and ownership of taxpayer’s house suspect where records indicated ownership but purportedly transferred to son); *Chandler v. Commissioner*, T.C. Memo 2015-215 (settlement officer did not abuse discretion by treating withdrawals from taxpayer’s retirement accounts used for “a good time” and “anything and everything” as dissipated assets and rejecting offer in compromise for that reason); *McAvey v. Commissioner*, T.C. Memo 2018-142 (appeals officer did not abuse discretion by including real property sale proceeds in taxpayers’ RCP when no proof was provided by taxpayer that the proceeds were spent on necessary living expenses). If there are special circumstances, including facts demonstrating that the taxpayer would suffer “economic hardship” if the IRS were to collect from her an amount equal to the reasonable collection potential and compelling public policy or equity considerations that provide sufficient basis for compromise, the IRS may accept an offer lower than reasonable collection potential. See *Murphy v. Commissioner*, 125 T.C. 301 (2005), *aff’d*, 469 F.3d 27 (1st Cir. 2006); *Lloyd v. Commissioner*, T.C. Memo 2017-60; *McClanahan v. Commissioner*, T.C. Memo 2008-161; IRM 5.8.4.2 (05-10-13).

cern or through forced liquidation, can be quite complex.³⁹⁹ Additionally, the IRS can consider the taxpayer's history of compliance or non-compliance.⁴⁰⁰

Note: If a taxpayer files both Form 656-L, *Doubt as to Liability*, and Form 656, *Doubt as to Collectibility*, simultaneously, they will not be considered concurrently. Instead, the IRS will determine processability of the doubt as to liability offer first.⁴⁰¹

The IRS will not consider an offer in compromise that is solely for a tax period or tax year that has not been assessed unless the IRS has an indication that a return has been received or an assessment is pending.⁴⁰² When spouses are jointly and severally liable for an assessed tax, the taxpayers may submit one joint offer or individual offers.⁴⁰³ When separate offers are submitted and there are jointly held assets, the IRS will carefully review state law to determine each taxpayer's interest in the asset.⁴⁰⁴

2. Formula for an Acceptable Offer

a. Net Realizable Equity of Assets

The first step in the offer in compromise equation is to determine the net realizable equity of the taxpayer's assets. Detailed rules apply in determining the net realizable equity of the assets:

- The taxpayer typically is permitted to utilize "quick sale" value for real property and personal property (normally 80% of fair market value).⁴⁰⁵
- In valuing an Individual Retirement Account or §401(k) plan, the IRS allows the taxes and early withdrawal penalty that would be due on the distribution to be subtracted in determining the net realizable equity if the taxpayers are using the plan funds to pay the offer in compromise.⁴⁰⁶
- A qualified profit-sharing plan, pension plan or defined benefit plan will be treated as having a zero value for purposes of the offer if the taxpayer has no current right to withdraw funds from the plan.⁴⁰⁷
- The cash value of a whole life insurance policy must be considered in the equity calculation.⁴⁰⁸
- In determining the value of property owned in joint tenancy with a non-liable taxpayer, only the taxpayer's interest is included in the value of the taxpayer's net equity.⁴⁰⁹

³⁹⁹ *W. Zintl Constr., Inc. v. Commissioner*, T.C. Memo 2017-119 (the IRS rejection of taxpayer's OIC was based upon an unreasonable calculation of the value of the construction company as a going concern because it failed to account for the trust fund tax liability).

⁴⁰⁰ *Hauptman v. Commissioner*, T.C. Memo 2014-214, *aff'd*, 831 F.3d 950 (8th Cir. 2016); *Bennett v. Commissioner*, T.C. Memo 2008-251; *Oman v. Commissioner*, T.C. Memo 2006-231.

⁴⁰¹ IRM 5.8.10.14 (03-10-22).

⁴⁰² IRM 5.8.1.11.1 (04-20-21). See IRM 35.8.6.2.1 (07-25-12) for Service offers in compromise submitted during a pending Tax Court case (should obtain stipulation of full amount of deficiencies and penalties prior to compromise).

⁴⁰³ IRM 5.8.3.5 (06-18-24).

⁴⁰⁴ IRM 5.8.5.5 (04-08-24).

⁴⁰⁵ IRM 5.8.5.4.1 (04-08-24).

⁴⁰⁶ IRM 5.8.5.10 (04-08-24).

⁴⁰⁷ IRM 5.8.5.10 (04-08-24).

⁴⁰⁸ See IRM 5.8.5.9 (04-08-24).

- The IRS normally averages the ending balance in the taxpayer's bank accounts for three to six months to determine the bank balance amount for equity purposes.⁴¹⁰

- A \$3,450 exclusion may apply to a vehicle used for work, the production of income, or and/or the welfare of the taxpayer's family. A taxpayer who files jointly may claim the exclusion on two vehicles.⁴¹¹

Special rules apply to income-producing assets and dissipated assets.⁴¹² A dissipated asset is "any asset (liquid or non-liquid) that has been sold, transferred, or spent on non-priority items or debts and that is no longer available to pay the tax liability."⁴¹³ If the taxpayer can substantiate claims that the dissipated assets were used for necessary living expenses, those assets are not included in the calculation of the reasonable collection potential (RCP).⁴¹⁴ Generally, a three-year time frame, including the year the offer is submitted, is used to determine whether a dissipated asset will be included in RCP.⁴¹⁵

b. Value of Future Income

The offer in compromise must not only exceed the net realizable equity of assets, but must also take into account collection potential from the taxpayer's income.⁴¹⁶ The starting point for this determination is the hypothetical monthly installment payment amount computed by subtracting the taxpayer's *allowable* expenses from the gross monthly income. The allowable expense determinations are the same as for installment agreements as discussed at V.B., above. Conditional expenses are not allowed for offer purposes.⁴¹⁷

As part of this analysis, the IRS also will consider the effect of allowable expenses that will expire. For example, if the taxpayer has a car payment that will expire in five months, the IRS will compute a monthly payment amount for the first five months allowing the car payment and a greater amount eliminating that payment after that expense ends.

Note: The IRS may deviate from national and local standards if the standard amount is deemed to be inadequate to provide for a specific taxpayer's living expense.⁴¹⁸ A taxpayer's

⁴⁰⁹ IRM 5.8.5.5 (04-08-24).

⁴¹⁰ IRM 5.8.5.7 (04-08-24).

⁴¹¹ IRM 5.8.5.12 (09-24-21).

⁴¹² See IRM 5.8.5.15 (09-24-21), IRM 5.8.5.18 (09-24-21).

⁴¹³ *Johnson v. Commissioner*, 136 T.C. 475, 487 (2011), *aff'd*, 502 Fed. Appx. 1 (D.C. Cir. 2013); IRM 5.8.5.18 (09-24-21).

⁴¹⁴ *Alphson v. Commissioner*, T.C. Memo 2016-84 (offer in compromise rejected when taxpayer was unable to adequately substantiate that assets were used for necessary living expenses); IRM 5.8.5.18(7) (09-24-21); *McAvey v. Commissioner*, T.C. Memo 2018-142 (inclusion into RCP of proceeds from liquidated 401(k) account and sale of partnership interest because taxpayers failed: (1) to report those amounts on their tax return; (2) to substantiate proceeds were used for necessary living expenses; and (3) to apply any of proceeds towards their outstanding tax debt).

⁴¹⁵ IRM 5.8.5.18(2) (09-24-21). For example, if the offer is submitted in 2021, any asset dissipated prior to 2019 should not be included in the determination.

⁴¹⁶ See generally IRM 5.8.5.20 (04-08-24). See also Reg. §301.7122-1(c) (2)(i).

⁴¹⁷ IRM 5.8.5.23 (09-30-13).

⁴¹⁸ IRM 5.8.5.22.1 (10-22-10).

current income generally will be used in the analysis of future ability to pay, but consideration can be given to the taxpayer's overall situation, including such factors as age, health, marital status, number and age of dependents, level of education or occupational training, and work experience.⁴¹⁹ The IRM provides that there are situations that may warrant placing a different value on future income than on current or past income such as when income will increase or decrease, or current necessary expenses will increase or decrease. Other situations may include when a taxpayer:

- is temporarily or recently unemployed or underemployed;
- is unemployed and not expected to return to a previous occupation or previous level of earnings;
- is long-term unemployed;
- is long-term under-employed;
- has an irregular employment history or fluctuating income;
- is in poor health and the ability to continue working is questionable;
- is close to retirement and will be retiring; or
- will file for bankruptcy.⁴²⁰

According to the IRM, judgment should be used in determining income averaging on a case-by-case basis when the taxpayer's income does not appear to meet stated living expenses.⁴²¹ It may be appropriate instead to use the taxpayer's current income and secure a future income collateral agreement, particularly when the future income is uncertain but it is reasonably expected that the income would increase.⁴²²

The computation of an acceptable offer amount depends in part on the way in which the offered amount will be paid. There are two options to pay the offered amount:

- a lump sum offer (paid in five installments or less within five months of acceptance); or
- a periodic payment offer (paid in more than five installments, but no more than 24).⁴²³

The lump sum offer amount must include the net realizable equity in the taxpayer's assets plus the total amount the IRS could collect over 12 months (or if less, the remainder of the statutory period for collection) through monthly payments.

⁴¹⁹ See IRM 5.8.5.20 (04-08-24). See, e.g., *Siebert v. Commissioner*, T.C. Memo 2021-34 (although taxpayer's previous two years of income were substantially less than three years ago, Appeals used all three years to calculate taxpayer's future income because: (1) prior evidence revealed his potential to continue as high income earner, even though he was in his 70s; (2) taxpayer failed to pay taxes for last eight years, despite his high income; and (3) taxpayer coincidentally only claimed that his earning potential permanently decreased when he submitted offer-in-compromise).

⁴²⁰ IRM 5.8.5.20(4) (04-08-24).

⁴²¹ IRM 5.8.5.20 (04-08-24). See *Alphson v. Commissioner*, T.C. Memo 2016-84 (when taxpayer was unemployed on long-term basis, settlement officer erred in averaging past irregular income to arrive at anticipated future income; however, no error existed in including unexplained regular bank deposits in future anticipated income; anticipated future income equals stated expenses when taxpayer's stated income did not meet stated expenses).

⁴²² IRM 5.8.5.21 (09-30-13).

⁴²³ IRM 5.8.1.15.4 (04-20-21).

Such an offer also must include payment of 20% of the amount of the offer.⁴²⁴ The periodic payment offer amount must include the net realizable equity in the taxpayer's assets plus the total amount the IRS could collect over 24 months (or if less, the remainder of the statutory period for collection) through monthly payments.⁴²⁵ Any deferred payment must occur within 24 months.⁴²⁶

Example: If the taxpayer is found to be unable to pay any amount per month and the net realizable equity of the taxpayer's assets is \$10,000, the minimum amount for the offer to be processable is \$10,000. If the taxpayer is able to pay \$100 per month based on the allowable expense standards and the offer amount is to be paid in five months, the offer amount must equal or exceed the \$10,000 net realizable equity of the taxpayer's assets plus \$1,200 ($12 \times \100) or \$11,200. If the offer amount will be paid in more than five months, the minimum amount is \$12,400 [$\$10,000 + (24 \times \$100)$].

c. Special Rules for Third-Party Assets and Income

In reviewing the offer in compromise, the IRS considers amounts that can be collected from other parties (e.g., transferee liability). The IRS also considers assets and income that are available to the taxpayer but beyond the reach of the government (e.g., certain tenancy by the entirety property).⁴²⁷

The IRS also may consider the nonliable spouse's assets and income if the taxpayer transferred property to remove the property from consideration by the IRS, or if state law (e.g., community property law) permits collection of the taxpayer's liability from the nonliable spouse's assets and income.⁴²⁸ Nevertheless, the IRS will not consider the nonliable spouse's assets and income in determining the amount of an adequate offer to the extent that the taxpayer and the nonliable spouse demonstrate that collection of those assets and income would have a material and adverse impact on the standard of living of the taxpayer, the nonliable spouse, and their dependents.⁴²⁹

In determining the taxpayer's income, special rules may apply if the taxpayer is married and the taxpayer and the nonliable spouse have a valid and binding prenuptial agreement or post-nuptial agreement that provides each spouse's earnings are that spouse's separate property. In this instance, the IRS usually will not include the nonliable spouse's earnings in the income and expense analysis of the liable taxpayer.⁴³⁰ Instead, the taxpayer's share of expenses is determined based upon actual sums expended where proven or upon pro rata share of ex-

⁴²⁴ IRM 5.8.5.25 (09-24-21).

⁴²⁵ IRM 5.8.5.25 (09-24-21).

⁴²⁶ IRM 5.8.5.25 (09-24-21).

⁴²⁷ IRM 5.8.5.6 (03-23-18).

⁴²⁸ Reg. §301.7122-1(c)(2)(ii). In CCA 201021049, the IRS Chief Counsel's Office concluded that the IRS may consider the assets of a California registered domestic partner when determining the reasonable collection potential of a taxpayer's OIC as the IRS generally considers the assets of both owners of community property in community property states, and California state law provides that both domestic partners have equal interests and liability in community property.

⁴²⁹ Reg. §301.7122-1(c)(2)(ii)(B).

⁴³⁰ Reg. §301.7122-1(c)(2)(ii).

penses based on the taxpayer's percentage of total household income.⁴³¹

Example: T proves T pays \$1,000 of the \$2,000 of monthly total housing and utilities in a household with a nonliable spouse (S). T's \$1,000 amount can be allowed subject to the allowable standard if a valid property agreement exists under the applicable state law. If no property agreement has been signed or both T and S are liable, the full \$2,000 monthly housing and utilities amounts expended would need to be considered. If the allowable housing standard is \$1,220, the difference of \$780 is considered to be an amount T can afford in monthly payments (absent other excess monthly income). If it is a lump sum offer, this excess expense will cause the minimally acceptable offer amount to be the net realizable equity in T's assets plus \$9,360 (\$780 × 12).

3. Offer in Compromise Not in Government's Interest

Even if an offer in compromise is for an amount greater than the reasonable collection potential, the IRS can reject the offer if acceptance is not in the government's interest.⁴³² Grounds for this rejection include:

- The taxpayer has an egregious history of noncompliance.
- The taxpayer refuses to include dissipated assets in the computation of the offer amount.
- An owner of the taxpayer is not in compliance.
- The amount collectible in a bankruptcy proceeding or with an installment agreement is significantly higher.⁴³³

4. Offer in Compromise Against Public Policy

The IRS can reject an otherwise acceptable offer in compromise if the IRS determines acceptance would be against public policy. Grounds for this rejection include:

- The taxpayer is a tax protestor.
- The taxpayer is involved in continuing criminal activity (other than cultivating or selling marijuana).
- The taxpayer engaged in intentional dissipation of assets.⁴³⁴

⁴³¹ See generally IRM 5.8.5.24 (9-24-21). The IRS will request the nonliable spouse's financial information to determine the actual household income and expenses, verify the percentage of the taxpayer's portion of the shared expenses, and allocate the expenses to the taxpayer based upon the taxpayer's percentage of income. See Reg. §301.7122-1(c)(2)(ii)(A).

⁴³² IRS Policy Statement P-5-100, at IRM 1.2.1.6.17 (1-30-92).

⁴³³ IRM 5.8.7.7.1 (06-23-22). See *Elkins v. Commissioner*, T.C. Memo 2020-110 (no abuse of discretion where OIC was rejected as not in government's interest where settlement officer learned of unreported assets of taxpayer from newspaper search, and taxpayer continued to make subsequent increasing offers, failed to make any payment toward the liability and had negative history of compliance); *Siebert v. Commissioner*, T.C. Memo 2021-34 (OIC was not in government's best interest where taxpayers' egregious history of noncompliance included: 1) eight years of not paying taxes, despite their high incomes and expensive lifestyle; 2) failing to report over \$300,000 in income from sale of partnership interest and liquidated 401(k) account; and 3) repeated failure to make payments in prior IRS agreements).

⁴³⁴ IRM 5.8.7.7.2 (06-23-22); IRS Policy Statement 5-89, at IRM 1.2.1.6.15 (7-26-60). The public policy reasons for rejecting the offer should be discussed in the rejection narrative, and the appropriate IRS official must approve the re-

A criminal conviction, even a tax conviction, is not grounds for a public policy rejection. A public policy rejection requires approval of a SB/SE Territory Manager or SB/SE Compliance Services Operations Manager.⁴³⁵

C. Offer in Compromise That Promotes Effective Tax Administration

In addition to the traditional doubt as to liability and doubt as to collectibility grounds, the IRS also may accept an offer that promotes effective tax administration. However, the IRS will not compromise a liability to promote effective tax administration — whatever the basis — if the compromise would undermine compliance by taxpayers with the tax laws.⁴³⁶

The IRS may enter into a compromise with an individual taxpayer to promote effective tax administration when the IRS determines that, although full collection is possible, collection of the entire liability would cause the taxpayer economic hardship.⁴³⁷ In determining whether economic hardship exists, the IRS considers the following:⁴³⁸

- The same factors exist as those considered under Reg. §301.6343-1 in determining if release of a levy is appropriate due to economic hardship, such as the taxpayer's age, employment status and history, number of dependents, or status as a dependent.
- Whether the taxpayer is incapable of earning a living due to long-term illness, medical condition, or disability and it is reasonably foreseeable that the taxpayer's financial resources will be exhausted providing for care and support during the course of this condition.
- Although the taxpayer has certain assets, the taxpayer cannot borrow against the equity in those assets, liquidation of those assets to pay off outstanding tax liabilities will leave the taxpayer with an inability to meet basic living expenses, and the taxpayer's overall compliance history does not weigh against compromise.
- Although the taxpayer has certain monthly income, that income is exhausted each month in providing for the care of dependents who have no other means of support.

Even if there are no grounds for compromise on the basis of liability, collectibility, or to promote effective tax adminis-

tration. See *Synergy Envtl. Inc. v. Commissioner*, T.C. Memo 2016-99 (a defunct corporation's offer in compromise could be rejected pursuant to IRS Policy Statement 5-89 when a taxpayer had a pattern of moving or eliminating assets).

⁴³⁵ IRM 5.8.7.7.2 (06-23-22).

⁴³⁶ Reg. §301.7122-1(b)(3). See IRM 5.8.5.25.2 (09-24-21) (guidance on calculation of collection potential in offers involving the legal, under state law, cultivation and sale of marijuana).

⁴³⁷ Reg. §301.7122-1(b)(3)(i). See *Lane v. Commissioner*, T.C. Memo 2013-121 (no summary judgment where IRS rejected an offer in compromise based on incomplete data and did not consider economic hardship in calculation of ability to pay).

⁴³⁸ Reg. §301.7122-1(c)(3)(i). The IRS cautions that this is a non-exclusive list of factors. For examples of circumstances in which this ground for compromise may apply, see Reg. §301.7122-1(c)(3)(iii); IRM 5.8.11.3.1 (04-11-24). See also CCA 200126009 (tax code does not authorize IRS to forgive future liability through hardship compromise); CCA 200043006 (advice against compromise notes that facts indicated only potential for financial hardship at indefinite time in future and did not show with any degree of certainty that taxpayer would suffer any reasonably foreseeable financial hardship in near term).

tration based on economic hardship, the IRS may compromise a liability to promote effective tax administration when compelling public policy or equity considerations identified by the taxpayer provide a sufficient basis for compromising the liability.⁴³⁹ The IRS will compromise on these grounds only when, due to exceptional circumstances, collection of the full liability would undermine public confidence that the tax laws are being administered fairly and equitably.⁴⁴⁰ Thus, the IRS expects a taxpayer proposing compromise on these grounds to demonstrate circumstances that justify compromise even though a similarly situated taxpayer may have paid the liability in full.⁴⁴¹

In reviewing an offer to promote effective tax administration, the IRS considers the taxpayer's overall compliance with the tax laws.⁴⁴² Factors that support, but are not conclusive of, a finding that an offer in compromise will undermine compliance with the tax laws include:

- the taxpayer has a history of noncompliance with the filing and payment requirements;⁴⁴³
- the taxpayer has taken deliberate action to avoid paying taxes;⁴⁴⁴ and
- the taxpayer has encouraged others to violate the tax laws.⁴⁴⁵

Before the IRS considers an offer to promote effective tax administration, three conditions must exist. First, the IRS must establish that there is no doubt as to liability and no doubt as to collectibility.⁴⁴⁶ In other words, the IRS must first determine that the taxpayer owes the entire tax and has assets and income sufficient to pay the full amount. Second, the taxpayer must establish an exceptional circumstance and show that requiring payment of the tax in full would create an economic hardship to the individual taxpayer or, if it would not create an econom-

⁴³⁹ Reg. §301.7122-1(b)(3)(ii). See *Bogart v. Commissioner*, T.C. Memo 2014-46 (IRS must consider public policy and equity grounds when evaluating an effective tax administration OIC even though taxpayer's circumstances weren't among the examples listed in Reg. §301.7122-1(c)(1)).

⁴⁴⁰ See *Bogart v. Commissioner*, T.C. Memo 2014-46 (court required IRS to consider whether theft loss constituted exceptional circumstances).

⁴⁴¹ Reg. §301.7122-1(b)(3)(ii). The IRS expects to compromise under this non-hardship effective tax administration standard "only in those rare cases where collection would adversely affect the overall tax system." Preamble to T.D. 9007, 67 Fed. Reg. 48,025 (July 23, 2002). For examples of circumstances in which this ground for compromise may apply, see Reg. §301.7122-1(c)(3)(iv). The IRS may use this basis to compromise interest and penalties where they have accumulated due to delay in determining the taxpayer's liability although the circumstances would have to be extraordinary. These circumstances do not include the excessive accumulation of interest due to protracted litigation and other proceedings. See *Fargo v. Commissioner*, 447 F.3d 706 (9th Cir. 2006).

⁴⁴² Reg. §301.7122-1(b)(3)(iii).

⁴⁴³ Reg. §301.7122-1(c)(3)(ii)(A). See IRM 5.8.11.3.3 (09-23-08). Cf. CCA 200043046 (where corporate officer knew of sale, but not of fraud in filing return, interest due through transferee liability could not be compromised; examples in regulations do not support compromise due to acts of third parties beyond the control of the IRS).

⁴⁴⁴ Reg. §301.7122-1(c)(3)(ii)(B).

⁴⁴⁵ Reg. §301.7122-1(c)(3)(ii)(C).

⁴⁴⁶ IRM 5.8.11.5 (04-11-24). If the taxpayer's assets and collection potential from future income do not exceed the tax liability and special circumstances exist, the IRS must consider the offer under doubt as to collectibility with special circumstances. If the taxpayer submits an offer based on doubt as to collectibility but the IRS determines collection potential exceeds the liability and there are special circumstances, the IRS considers the offer on the basis of effective tax administration. IRM 5.8.11.5 (04-11-24).

ic hardship (or if the taxpayer is not an individual), it would be against public policy or inequitable.⁴⁴⁷ Excessive accrual of interest due to IRS delays in concluding a case will rarely constitute an exceptional circumstance justifying acceptance of an offer in compromise.⁴⁴⁸ Finally, the taxpayer must show that compromising the liability would not have an adverse effect on similarly situated taxpayers that did pay in full.⁴⁴⁹

D. Submitting a Processable Offer in Compromise

1. Preparing Form 656 or 656-L

For an offer in compromise to be "processable," the procedural formalities must be followed, including the requirement to use the forms prescribed by the IRS.⁴⁵⁰

The offer in compromise must be submitted on Form 656 or Form 656-L and may include a detailed statement in support of the offer.⁴⁵¹

Comment: The IRS's website should be consulted to ensure that the most recent version of Form 656 or Form 656-L is used to submit the offer. In addition, the IRS's website contains and Offer In Compromise Pre-Qualifier that can be used as a guide to formulate an offer that will be accepted.⁴⁵²

Note: Offers involving tax periods that include assessed and/or deferred taxes attributable to §965 are processed under special procedures as there may be unique issues involving §965, including the ability of the taxpayer to pay in installments or defer the assessment under certain circumstances that may affect processing and investigation of offers. Consideration of a taxpayer's ability to repatriate the foreign earnings that are the basis for the §965 liabilities may require the assistance of an Abusive Tax Avoidance Transaction (ATAT) Revenue Officer to evaluate the information and assist in conducting research relative to income and assets, including whether the taxpayer is retaining any foreign assets (and, if applicable, valuing the foreign assets). Processing and resolution of such offers will depend on (1) whether the taxpayer made a §965(h) or §965(i) election when filing a tax return (Form 1040/Form 1041/Form 1120), and (2) whether there is a current assessment under §965

⁴⁴⁷ For example, the IRS will give special consideration to an offer from a taxpayer that has been the victim of fraud by a third-party payroll tax preparer. See IRM 5.8.11.3.2.1(6) (04-11-24) for IRS internal guidance on special consideration given to such taxpayers that allows the offer specialist to investigate and process offers submitted by those taxpayers in the most expeditious manner and in a manner that requires the taxpayer to submit the least amount of documentation necessary to complete the investigation and allow for a resolution.

⁴⁴⁸ See *Keller v. Commissioner*, 568 F.3d 710 (9th Cir. 2009); *Fargo v. Commissioner*, 447 F.3d 706 (9th Cir. 2006).

⁴⁴⁹ IRM 5.8.11.3.3 (09-23-08).

⁴⁵⁰ Reg. §301.7122-1(d); *Riederich v. Commissioner*, 985 F.2d 574, (9th Cir. 1993); *Laurins v. Commissioner*, 889 F.2d 910, 912 (9th Cir. 1989); *Nash v. Commissioner*, T.C. Memo 2008-250; *Harbaugh v. Commissioner*, T.C. Memo 2003-316; *Godwin v. Commissioner*, T.C. Memo 2003-289 ("Taxpayers who wish to propose an offer-in-compromise must submit a Form 656, Offer in Compromise"), *aff'd*, 132 Fed. Appx. 785 (11th Cir. 2005); *Ringgold v. Commissioner*, T.C. Memo 2003-199.

⁴⁵¹ Reg. §301.7122-1(d); Rev. Proc. 2003-71.

⁴⁵² See https://irs.treasury.gov/oic_pre_qualifier/ for further guidance. Form 656 is not considered submitted to the IRS until the form is received in one of two COIC locations. If an offer is submitted to the wrong office, it will be forwarded to COIC and not marked received until it arrives. SBSE-05-0424-0020 (Apr. 22, 2024) (interim guidance for IRM 5.8.1, IRM 5.8.2, IRM 5.8.4, and IRM 5.8.8).

and the tax payment is deferred under §965(h), or a §965 assessment will not occur until a triggering event in accordance with §965(i).⁴⁵³

The Tax Court has held repeatedly that there is no abuse of discretion when a settlement officer fails to consider a taxpayer's request for an offer in compromise where a Form 656 was not filed.⁴⁵⁴ However, no provision in the pertinent regulations or revenue procedure requires that an amendment to an offer in compromise take any particular form, and the Tax Court has allowed an amendment to a properly submitted Form 656 to be submitted informally.⁴⁵⁵

An offer based on doubt as to liability is deemed processable once the IRS makes a determination that the offer meets certain minimum requirements. If the requirements are not satisfied, the offer is "returned."⁴⁵⁶ A doubt as to liability offer does not require any payment or fee to be submitted with the offer.⁴⁵⁷

Doubt as to collectibility offers do not require a statement and documentation challenging the liability. The following additional items are required, however:

- completed collection information statements (Forms 433-A and/or 433-B);
- documentation that supports current income and living expenses;
- documentation that details and supports asset values and related encumbrances (e.g., real estate appraisals, dates and amounts of encumbrances, descriptions of vehicles with mileage and accessories listed);
- an optional written statement which explains (1) why the IRS cannot collect more than is being offered; (2) the taxpayer's current and future income prospects, educational background and work experience, health; and/or (3) other factors which may impact on collection potential; and
- a nonrefundable advance payment (commonly referred to as the "TIPRA Payment"). If the offer is a lump-sum offer, a TIPRA Payment of 20% of the total offer amount must be submitted when Form 656 is filed. For deferred payment offers with more than five monthly payments, the proposed TIPRA Payments must begin when Form 656 is

submitted and continue while the offer is being considered. The payments need not be uniform.⁴⁵⁸

Offers that do not comply with the TIPRA Payment requirements may be returned as unprocessable.⁴⁵⁹ The TIPRA Payment will be applied against the offer amount if the offer is accepted, but will not be refunded if the offer is rejected.⁴⁶⁰ The taxpayer can designate that the TIPRA Payment to be applied to a specific portion of the outstanding liability.

Comment: Given that the TIPRA Payment will not be refunded if the offer is rejected, a taxpayer may want to consider structuring the offer in a manner that minimizes the size of the payment.

Specific instructions and examples for preparing an Offer in Compromise are found in the instructions to Form 656. The IRS does not tell the taxpayer what amount to offer. Instead, the taxpayer is responsible for initiating the first specific proposal for compromise. Still, the proposed offer should not be used as a "fishing expedition." It should be a legitimate compromise proposal based on the taxpayer's ability to pay.⁴⁶¹

2. Application Fee and Payment Options

An application fee must be submitted with the offer in order for it to be processed. For offers submitted on or after April 27, 2020, the fee is \$205.⁴⁶²

Note: This fee does not apply to offers based solely on doubt as to liability or to offers made by certain low-income taxpayers.⁴⁶³

If the IRS accepts an offer based on economic hardship or to promote effective tax administration, the user fee is applied against the amount of the offer or, if the taxpayer requests, refunded to the taxpayer.⁴⁶⁴

As noted above, a taxpayer must select a payment option and include the payment with the offer. The amount of the ini-

⁴⁵³ See SBSE-05-0320-0026 (Mar. 23, 2020) (interim guidance under IRM 5.8.1; IRM 5.8.4; IRM 5.19.24); IRM 5.8.2.4.1 (06-14-24); IRM 5.8.4.23.7 (09-24-20); IRM 5.8.10.17 (03-10-22).

⁴⁵⁴ See *Kendricks v. Commissioner*, 124 T.C. 69, 79 (2005); *Bergdale v. Commissioner*, T.C. Memo 2014-152; *Holland v. Commissioner*, T.C. Memo 2013-205; *Gentile v. Commissioner*, T.C. Memo 2013-175, *aff'd*, 592 Fed. Appx. 824 (11th Cir. 2014); *Waring v. Commissioner*, T.C. Memo 2011-270; *Ludzack v. Commissioner*, T.C. Memo 2011-111.

⁴⁵⁵ *Johnson v. Commissioner*, 136 T.C. 475 (2011), *aff'd*, 502 Fed. Appx. 1 (D.C. Cir. 2013) (taxpayer submitted during a CDP hearing three formal offers-in-compromise on Forms 656, before submitting an adjustment to the final Form 656 on a letter from his attorney). Reg. §301.7122-1(d)(2). See IRM 5.8.8.3 (11-06-23) for guidance on when "pen and ink" changes to Form 656 are appropriate in lieu of obtaining an amended Form 656, for example, for transposed taxpayer identification numbers, for removal of a business entity from the form, for filling in a total amount when all other amounts have already been included, or for changing payment dates.

⁴⁵⁶ IRM 5.8.7.2.1 (06-23-22), 5.8.2.4.1 (06-14-24).

⁴⁵⁷ IRM 5.8.1.12 (05-25-23).

⁴⁵⁸ §7122(c)(1)(A)(i); IRM 5.8.2 (06-14-24).

⁴⁵⁹ §7122(d)(3)(C). See, e.g., *Fincourt B Shelton P.C. v. Commissioner*, T.C. Memo 2013-273 (taxpayer submitting \$120,000 payment one month after submitting Form 656 did not enter into a valid offer in compromise).

⁴⁶⁰ See §7122(c); IRM 5.8.2.3 (06-14-24), IRM 5.8.2.4.1 (06-14-24). The Tax Court lacks jurisdiction to consider a taxpayer's request to refund a TIPRA payment. See *Brown v. Commissioner*, T.C. Memo 2019-121 (*Brown I*) (IRS did not abuse discretion by refusing to refund \$80,000 TIPRA payment); *Brown v. Commissioner*, T.C. Memo 2021-112 (*Brown II*) (request for refund denied; Tax Court's jurisdiction to consider refund of TIPRA payment derives from §6320 and §6330 but neither Code section grants court jurisdiction to refund any payment of tax under §6512 or any other Code section), *aff'd*, *Brown v. Commissioner*, No. 22-70001, 2023 BL 21715 (9th Cir. Jan. 24, 2023). The advance payment requirement may be waived for low-income taxpayers or for offers based on doubt as to liability. See Notice 2006-68, for guidance under §7122.

⁴⁶¹ See Rev. Proc. 2003-71, §4.02, §6.03.

⁴⁶² Reg. §300.3. The IRS takes the processing fee into account when considering whether the amount offered is acceptable. Preamble to T.D. 9894.

⁴⁶³ A taxpayer is considered low-income if he/she (1) has income that falls at or below the dollar criteria established by the poverty guidelines that are published annually in the Federal Register by the U.S. Dept. of Health and Human Services or (2) meets the definition of low-income taxpayer as described in §7122(c)(3) (retroactively applies to offers submitted after July 1, 2019). See Reg. §300.3(b)(1)(iii).

⁴⁶⁴ Reg. §300.3(b). Otherwise, the IRS will not refund the fee if the offer is accepted, rejected, withdrawn, or returned as nonprocessable after acceptance for processing. Reg. §300.3(b)(3). Also, the IRS will not charge an additional fee if a taxpayer resubmits an offer that was rejected in error or returned in error after acceptance for processing. Reg. §300.3(b)(4).

tial payment and subsequent payments will depend on the total amount of the offer and which of the following payment options is selected:

- **Lump Sum Cash** — This option requires 20% of the total offer amount to be paid with the offer and the remaining balance paid in 5 or fewer payments within 5 or fewer months of the date the offer is accepted.
- **Periodic Payment** — This option requires the first payment to be paid with the offer and the remaining balance paid in monthly payments within 6 to 24 months, in accordance with the proposed offer terms. Under this option, the taxpayer must continue to make monthly payments while the IRS is evaluating the offer. A failure to make these payments until a final decision letter is received will cause the offer to be returned and cannot be appealed. The total payments must equal the total offer amount.

Practice Tip: A taxpayer may want to consider a payment option that allows for the smallest initial outlay of cash or designating a portion of the payment as a deposit as any payment, once made, is not refundable if the IRS later rejects the OIC.⁴⁶⁵

E. IRS Processing and Returned Offers

On receiving the taxpayer's offer in compromise, the Form 656, *Offer in Compromise*, is date stamped (which establishes the date for calculating the number of days for a processibility determination), and the IRS determines whether the offer is processible. The completion of the initial compliance screening must be conducted within 15 calendar days of the offer assignment date. In situations where a Field Offer Specialist is not in the same location as the Group Manager, an additional five calendar days from the assignment date is allowed.⁴⁶⁶

An offer is deemed to be not processible if one or more of the following criteria are present:

- the taxpayer is in bankruptcy;
- the taxpayer did not submit the application fee or initial payment with the offer;
- the liability was previously referred to the Department of Justice;
- the offer relates to liabilities that have not been assessed;
- the collection statute expiration date has expired for the liabilities the taxpayer seeks to compromise;
- there are outstanding tax returns with regard to the taxpayer; or
- there is no outstanding tax liability.⁴⁶⁷

An OIC that indicates that the total amount of payment is a deposit will not be processible because the taxpayer failed

to properly include the application fee. This does not apply to Low Income Certification OICs.⁴⁶⁸

If the offer is processible, but the offer does not meet certain IRS standards (e.g., the Form 656 was not complete, or the taxpayer has unfiled tax returns) and therefore cannot be processed, the offer must be perfected before the IRS can begin the offer investigation. In such instances, the IRS contacts the taxpayer to indicate and request the information that is missing or needs to be corrected.⁴⁶⁹

An offer in compromise needs perfecting and cannot be processed by the IRS if:

- the Form 656 is missing a signature;
- the Form 656 is obsolete (not the current revision);
- the balance of any TIPRA shortfall is due at the time of submission;
- the offered amount is left blank or is zero (unless there are terms present);
- Form 433-A (OIC) *Collection Information Statement for Wage Earners and Self-Employed Individuals*, and/or Form 433-B (OIC), *Collection Information Statement for Businesses*, is missing, blank, partially completed, or unsigned;
- requested required estimated tax payments from self-employed taxpayers are not received;
- requested federal tax deposits are not received; or
- a signature is missing on a required tax return received with the offer.⁴⁷⁰

If the IRS determines an offer is not processible or cannot be evaluated due to lack of sufficient information to determine whether the offer should be accepted, or if the IRS determines the offer is submitted to delay collection, the offer will be returned. If an offer is "returned" (as opposed to "rejected" on its merits), no appeal rights exist and collection action can be undertaken, including the issuance of levies.⁴⁷¹

⁴⁶⁸ IRM 5.8.2.4.1 (06-14-24). Any amount sent in with the offer to cover the initial payment and application fee must not be designated as a "deposit." Doing so will result in the return of the offer without appeal rights. Such a deposit will be returned to the taxpayer, unless indicated appropriately on Form 656 that it is to be applied to the taxpayer's tax debt. See Form 656, *Offer in Compromise*, and Form 656-B, *Offer in Compromise Booklet*, for further information.

⁴⁶⁹ If the taxpayer fails to respond, the IRS returns the offer as nonprocessible. Reg. §301.7122-1(d)(2). See Rev. Proc. 2003-71, §5.04, §6.02. This return of the offer is not considered a rejection of the offer for purposes of giving the taxpayer the right to an administrative appeal. Reg. §301.7122-1(f)(5)(ii); Rev. Proc. 2003-71, §5.05. See also SBSE-05-1023-0053 (Oct. 4, 2023) (interim guidance on IRM 5.8.1.5.1 to prevent IRS employees from unauthorized disclosures of tax information involving offer in compromise in joint liability situations where the taxpayers are separated or divorced).

⁴⁷⁰ IRM 5.8.3.6 (06-18-24). Guidance on requesting an OIC may be found here on the IRS website, <https://www.irs.gov/payments/offer-in-compromise>. See Rev. Proc. 2003-71, §4, §5.01. See also *Loveland v. Commissioner*, 151 T.C. 78 (2018) (financial information deemed submitted for installment agreement where information was submitted for previously rejected offer in compromise).

⁴⁷¹ Reg. §301.7122-1(f)(5)(ii), §301.7122-1(g)(4). See also *Reed v. Commissioner*, 141 T.C. 248 (2013) (when return of offer in compromise based on doubt as to collectibility occurred years before, IRS not required to reopen offer in collection due process hearing), motion for reconsideration denied, T.C. Memo 2013-273 (2014) (offer was not declined but was returned because tax-

⁴⁶⁵ See CCA 202019002 (IRS may not refund payments made on OIC that is rejected as there has been no overpayment of the tax liability). Note that Part 5 of Form 656 provides for a means to have a portion of a payment treated as a deposit and returned to the taxpayer if the offer is not accepted. If the offer is accepted, any amount designated as a deposit will be applied to the offer amount.

⁴⁶⁶ IRM 5.8.4.6(10) (02-10-23).

⁴⁶⁷ IRM 5.8.2.4.1 (06-14-24).

An offer in compromise can be returned by the Centralized OIC (“COIC”) Unit in the initial review. The offer is returned and the TIPRA Payment is refunded if:

- The taxpayer is in bankruptcy.
- The application fee is not included and the low income certification is not completed.
- The TIPRA Payment is not fully paid.
- A referral is pending with Department of Justice (“DOJ”).
- The offer only covers unassessed liabilities.
- No liabilities exist.
- The offer only covers liabilities for which the collection statute of limitations (“CSED”) has expired.⁴⁷²

The offer is returned and the TIPRA Payment is *not* refunded if:

- Unfiled returns exist for the prior six years (a substitute for return (“SFR”) counts as a filed return for this purpose).⁴⁷³
- Another open offer exists for some of the periods.⁴⁷⁴

An OIC returned as not processable does not suspend the CSED.⁴⁷⁵

An offer that is initially determined to be processable can still be returned later if circumstances exist that preclude a determination. The offer will be returned and the TIPRA Payment will *not* be refunded if:

- The taxpayer files for bankruptcy during the OIC.⁴⁷⁶
- The offer could interfere with a pending DOJ matter.⁴⁷⁷
- Open examinations exist which preclude acceptance of the offer.⁴⁷⁸
- “Other investigations” (including collection or criminal investigations) are pending which preclude acceptance of the offer.⁴⁷⁹
- The taxpayer fails to stay in compliance.⁴⁸⁰

payer was not current in compliance with federal tax obligations at time offer was submitted; neither FAQs on IRS website nor IRM provisions confer enforceable rights on taxpayers for additional time to comply).

⁴⁷² IRM 5.8.2.4.1 (06-14-24).

⁴⁷³ In SBSE-05-1221-0071 (Dec. 22, 2021) (affecting IRM 5.8.2, 5.8.7 and 5.19.7) the IRS issued temporary guidance providing that, due to the backlog and delays in processing 2020 and 2021 (but not 2019) individual and business tax returns, OICs should not be returned for unfiled tax returns. This guidance was extended in SBSE-05-0422-0025 (Apr. 29, 2022) (expired September 30, 2022) and extended in SBSE-05-1222-0087 (Dec. 9, 2022) through April 30, 2023.

⁴⁷⁴ IRM 5.8.2.4.1 (06-14-24).

⁴⁷⁵ IRM 5.8.7.2 (12-20-18).

⁴⁷⁶ IRM 5.8.7.2.2 (06-23-22).

⁴⁷⁷ *Isley v. Commissioner*, 141 T.C. 349 (2013).

⁴⁷⁸ IRM 5.8.4.17.2 (09-24-20).

⁴⁷⁹ IRM 5.8.7.2.2.6 (06-23-22), IRM 5.8.4.19 (05-10-13). See *Brown v. Commissioner*, 826 Fed. Appx. 673 (9th Cir. 2020) (offer returned to taxpayer where other pending matters that could affect taxpayer’s tax liability precluded further consideration of offer).

⁴⁸⁰ IRM 5.8.7.2.2.1 (06-23-22) to 5.8.7.2.2.3 (06-23-22). See SBSE-05-1221-0071 (Dec. 22, 2021) (affecting IRM 5.8.2, 5.8.7 and 5.9.7), the IRS issued temporary guidance providing that, due to the backlog and delays in

- The taxpayer fails to provide requested information.⁴⁸¹
- The taxpayer submits a dishonored application fee or TIPRA payment.⁴⁸²
- The IRS determines the offer is submitted solely for delay.⁴⁸³
- The IRS determines collection is in jeopardy.⁴⁸⁴

There is no appeal for a returned offer. Reconsideration of the return can be requested within 30 days in limited circumstances.⁴⁸⁵ Because it requires full factual development to be eligible for the program, fast-track mediation is probably not available for returned offers.⁴⁸⁶

If the offer was submitted as part of a CDP appeal, IRS Appeals must still make a determination for the CDP case. The Tax Court reviews Appeals determination under an abuse of discretion standard. The IRS contends that no abuse of discretion occurs if Appeals follows the IRM.⁴⁸⁷

A frivolous offer in compromise (i.e., an offer is based on a position that the IRS has identified as frivolous or is designed merely to delay or impede tax administration) is subject to a \$5,000 penalty, applicable to submissions made and issues raised after the date on which the IRS first issues a list identifying frivolous positions.⁴⁸⁸ No penalty applies if a taxpayer withdraws a frivolous submission within 30 days of being so notified.⁴⁸⁹ The penalty also may be reduced at the IRS’s discretion.⁴⁹⁰ A frivolous offer also may be treated as if it never were submitted, thus precluding further administrative or judicial review.⁴⁹¹

F. Levy Prohibited While Offer in Compromise Is Pending

The IRS cannot issue a levy while a taxpayer’s offer in compromise is pending unless the IRS determines that collection of the liability is in jeopardy.⁴⁹² An offer in compromise is pending once the IRS accepts the offer in compromise for processing.⁴⁹³ On this date the IRS will issue an initial processability letter. The issuance of the processability letter does not constitute an acceptance of the offer in compromise. An offer is no longer pending for levy purposes once the offer is rejected. A levy cannot be issued during the 30-day period following

processing 2020 and 2021 (but not 2019) individual and business returns, OICs should not be returned for unfiled tax returns. This guidance was extended in SBSE-05-0422-0025 (Apr. 29, 2022) (expired September 30, 2022) extended in SBSE-05-0922-0072 (Sept. 28, 2022) through December 31, 2022, and by SBSE-05-1222-0087 (Dec. 9, 2022) through April 30, 2023.

⁴⁸¹ IRM 5.8.7.2.2.4 (06-23-22).

⁴⁸² IRM 5.8.7.2.2.5 (06-23-22).

⁴⁸³ IRM 5.8.4.20 (05-10-13).

⁴⁸⁴ §6331(k)(3)(A); Reg. §301.7122-1(g)(3).

⁴⁸⁵ IRM 5.8.7.3.1 (12-20-18).

⁴⁸⁶ IRM 5.8.7.6 (12-20-18); IRM 8.26.3.3 (09-27-17).

⁴⁸⁷ See *Arede v. Commissioner*, T.C. Memo 2014-19.

⁴⁸⁸ §6702.

⁴⁸⁹ §6702(b)(3).

⁴⁹⁰ §6702(d).

⁴⁹¹ §7122(g).

⁴⁹² §6331(k)(1)(A). Reg. §301.7122-1(g)(1), §301.7122-1(g)(3).

⁴⁹³ §6331(k)(1) (flush language).

the rejection of an offer in compromise or, if a timely appeal is filed, while the appeal is pending.⁴⁹⁴

If the IRS is not allowed to levy due to the submission of an offer to compromise, the IRS also will not refer a case to the Justice Department to bring a court proceeding to collect the liability against a person named in a pending offer to compromise.⁴⁹⁵

G. Effect of Offer in Compromise on Collection Statute of Limitations

Submission of an offer in compromise extends the 10-year collection statute of limitations when Form 656 is countersigned by the IRS. This occurrence is actually a suspension of the statute of limitations resulting by operation of law.⁴⁹⁶ The suspension results even if it is later determined that the offer cannot be processed.⁴⁹⁷ For offers filed before March 10, 2002, the effect of the offer on the statute of limitations on collection needs to be analyzed in three steps:⁴⁹⁸

- (1) Compute the original collection statute expiration date (CSED) including the effect of a bankruptcy or events (other than the offer) that extend the CSED.
- (2) Consider the effect of the written waiver contained in an old Form 656 submitted before January 1, 2000:⁴⁹⁹
 - (a) If the CSED (as determined in (1) above) was after December 31, 2002, the waiver has no effect.
 - (b) If the CSED was before December 31, 2002, the new CSED was the shorter of:
 - (i) the CSED as extended by terms of the Form 656 waiver; or

⁴⁹⁴ §6331(k)(1)(B). See Reg. §301.7122-1(g)(2) (time allowed to revise offer after rejection); Rev. Proc. 2003-71, §4.04, §5.01, §9.03.

⁴⁹⁵ Reg. §301.7122-1(g)(6). However, the IRS may authorize the Justice Department to file a counterclaim, or third-party complaint in a refund action or to join the person named in the pending offer to compromise in any other proceeding in which liability for the tax that is the subject of the pending offer may be established or disputed, including a suit against the government under 28 U.S.C. §2410. The government also may file a claim in any bankruptcy proceeding or insolvency action involving that person.

⁴⁹⁶ §6331(k)(3). See *United States v. Clinkscale*, 2014-2 USTC ¶50,387 (N.D. Ohio 2014) (two offers in compromise suspended statute of limitations on collection).

⁴⁹⁷ *United States v. Wilson*, 2016-1 USTC ¶50,308 (E.D. Mich. 2016) (submission of offer in compromise during DOJ referral still suspended statute of limitations).

⁴⁹⁸ Reg. §301.7122-1(g)(1), §301.7122-1(i)(1). See generally *United States v. Ryals*, 480 F.3d 1101 (11th Cir. 2007). For offers submitted before and not pending on or after December 31, 1999 — (1) if the 10-year period specified in §6502(a) expired prior to December 31, 2002, and (2) payments due under the agreement are scheduled to be made after the date upon which the 10-year period specified in §6502(a) expired — unless the taxpayer executed a consent to extend the statutory period of limitations on the collection of the liability involved until the date one year subsequent to the date of the last scheduled payment or until December 31, 2002, whichever is earlier, the IRS would not accept the offer. Former Reg. §301.7122-1T(h)(1). If the waiver was secured with the grant of an installment agreement, the collection period would expire 90 days after the date specified in the waiver. 1998 IRS Reform Act §3461(c)(2). For compromises submitted before December 31, 1999, but pending after that date, the IRS secured revised Forms 656 which did not contain language waiving the collection statute. If a taxpayer submits a revised form before the IRS takes action on the offer, an otherwise valid waiver of the collection statute contained in an older Form 656 is not rescinded. CCA 200142025.

⁴⁹⁹ See RRA 1998 Act §3461(c)(2).

(ii) December 31, 2002.

(3) Consider suspension by operation of law. A CSED suspension occurred for a pending (processable) offer for the following periods:⁵⁰⁰

- (a) January 1, 2000, through December 20, 2000, plus.
- (b) March 9, 2002 through:
 - (i) The offer rejection date plus 30 days (if there is no appeal); or
 - (ii) The termination of an appeal (if applicable).⁵⁰¹

For any offer in compromise, the IRS may continue to require, where appropriate, the extension of the statute of limitations on assessment. However, in any case where the waiver is sought, the taxpayer must be notified of the right to refuse to extend the period of limitations or to limit the extension to particular issues or particular periods of time.⁵⁰²

H. Acceptance of Offer in Compromise

Merely submitting an offer does not constitute acceptance. The offer is not considered accepted until: (1) the appropriate delegation official approves the offer's acceptance; and (2) the IRS notifies the taxpayer by letter that the offer has been accepted.⁵⁰³

Note: The Treasury Secretary is the official vested with the authority to compromise tax liabilities.⁵⁰⁴ This authority has been delegated to various IRS officials as listed in Delegation Order 5-1.⁵⁰⁵

When an offer in compromise is recommended for acceptance, the IRS will prepare a written narrative supporting the acceptance of the offer in compromise and submit it for management approval.⁵⁰⁶ If the offer in compromise involves a to-

⁵⁰⁰ §6331(k)(3).

⁵⁰¹ §6331(k)(3).

⁵⁰² Reg. §301.7122-1(i)(2).

⁵⁰³ Reg. §301.7122-1(e)(1); Rev. Proc. 2003-71, §5.02, §8. See, e.g., *United States v. Roden*, No. 3:19-CV-0723-N, 2020 BL 476180 (N.D. Tex. Dec. 8, 2020) (collateral estoppel does not apply to stop collection action where taxpayer claimed he sold his home as a condition of acceptance of his offer in compromise where revenue agent did not possess authority to enter into such agreement); *Whitesell v. Commissioner*, T.C. Memo 2017-84 (no valid offer in compromise when IRS first deposited taxpayer's check and subsequently sent letter notifying taxpayer of rejection and return of deposit; no valid offer and acceptance due to taxpayer modifying terms and conditions of offer in compromise); *Fincourt B Shelton P.C. v. Commissioner*, T.C. Memo 2013-273 (no valid offer in compromise when IRS did not issue written notice of acceptance). If the taxpayer withdraws the offer, the IRS issues a withdrawal letter. The date of that letter is generally the effective date of the withdrawal; however, if the taxpayer provides written notification of the withdrawal in person or by certified mail, the effective date of the withdrawal is the date the IRS receives the letter. Reg. §301.7122-1(d)(3); Rev. Proc. 2003-71, §7. See *United States v. Donovan*, 348 F.3d 509 (6th Cir. 2003) (offer in compromise suspended statute of limitations on collection until date that offer no longer was pending before IRS, i.e., the date an authorized official acknowledged its withdrawal in writing, not the date the taxpayer withdrew the offer). A taxpayer can withdraw an offer on Form 14773, *Offer in Compromise Withdrawal*, or Form 14773-A, *Offer in Compromise Withdrawal Joint*.

⁵⁰⁴ §7122(a); Reg. §301.7122-1(a)(1), §301.7701-9.

⁵⁰⁵ See IRM 5.8.1.6.1 (offers handled by Justice Department); IRM 5.8.1.6.3 (offers handled by Specialty Collection function); IRM 5.8.1.6.4 (offers handled by Examination function); IRM 5.8.1.6.5 (offers handled by Independent Office of Appeals function).

⁵⁰⁶ IRM 5.8.8.7.

tal tax liability of \$50,000 or more (including interest, additional amounts, additions to tax, and assessable penalties), then the offer must undergo Counsel review to determine whether the offer legally meets the standards of doubt as to liability, doubt as to collectibility or the promotion of effective tax administration, and whether the offer conforms to the IRS's policy and procedures.⁵⁰⁷ If the offer in compromise involves a total tax liability of less than \$50,000, the offer does not need Counsel review.⁵⁰⁸

Where the IRS is accepting an offer with a tax liability greater than or equal to \$50,000 or the offer terms extend past five months, the IRS may file an NFTL. If the tax liability is less than \$50,000 or the offer terms are equal to or less than five months, managerial approval is required to file a NFTL.⁵⁰⁹

Once all required IRS employees have agreed to accept the offer in compromise, an acceptance letter will be sent to the taxpayer.⁵¹⁰ The taxpayer then must make payment pursuant to the terms of the offer.⁵¹¹ A certificate of release of an NFTL must be issued no later than 30 days after the date on which the IRS determines that the taxpayer's outstanding obligation covered by the lien (including any interest, additional amount, addition to the tax, or assessable penalty, together with any additional costs that may have accrued) is fully satisfied by payment or by abatement.⁵¹² If the taxpayer has not fully satisfied payment under the accepted offer in compromise and the taxpayer sells property subject to the lien, the IRS may be entitled to all net sale proceeds that would normally be paid for the taxpayer to obtain a discharge from the lien.⁵¹³

Accepted offers in compromise and copies of Form 7249 *Offer Acceptance Report* under §7122(b) are made public after personally identifiable information is redacted.⁵¹⁴

If the IRS does not reject an offer within 24 months after the date of submission, the offer is deemed to have been accepted.⁵¹⁵ An offer will not be deemed to be accepted if, within the 24-month period, the IRS rejected or returned the offer as

nonprocessable, the taxpayer withdraws the offer, or the offer is deemed withdrawn because of the taxpayer's failure to make the second or later installment due on a periodic payment offer.⁵¹⁶ The period during which Appeals considers a rejected offer in compromise is not included as part of the 24-month period because the offer was rejected by the IRS within the meaning of §7122(f) before consideration of the offer by Appeals.⁵¹⁷

Note: Appeals consideration is not available when the IRS erroneously returns or rejects a taxpayer's submitted offer as nonprocessable.⁵¹⁸

1. Binding Effect

The offer in compromise is binding on the parties after the IRS notifies the taxpayer in writing that the offer has been accepted.⁵¹⁹ Moreover, the liability to which the offer relates cannot be reopened or offer rescinded after acceptance of the offer unless there has been: (1) falsification of information or documents by the taxpayer; (2) concealment of assets by the taxpayer; (3) mutual mistake of a material fact sufficient to cause a contract to be reformed or set aside; or (4) the offer is inconsistent with an existing restitution order.⁵²⁰ Only the court that entered the restitution order can modify the order.⁵²¹ Federal contract law governs the interpretation and effect of an accepted offer.⁵²²

2. Default

An accepted offer in compromise can be defaulted for any number of reasons. The most common are:

- The taxpayer fails to timely pay the offer amount in full.
- The taxpayer failed to fulfill the terms of a related collateral agreement.
- The taxpayer fails to timely file a required return or pay all taxes due in the five years after acceptance of the offer.⁵²³

⁵⁰⁷ §7122(b); Reg. §301.7122-1(e)(6). The ex parte communications rules are not violated when Area Counsel confers with Appeals regarding information used to reject offer. See *Hinerfeld v. Commissioner*, 139 T.C. 277 (2012).

⁵⁰⁸ §7122(b); Reg. §301.7122-1(e)(6). Opposition by Counsel does not preclude the IRS from accepting an offer in compromise provided that grounds for compromise exist under Reg. §301.7122-1. See CCA 200128054.

⁵⁰⁹ IRM 5.8.4.13(6). Under interim guidance, if an offer is being accepted, while there is no requirement to file an NFTL, if the tax liability is greater than or equal to \$10,000 or the offer terms extend past five months, the OE/OS may file a NFTL to protect the government's interest in a taxpayer's real property or other assets. If the tax liability is less than \$10,000 or the terms are equal to or less than five months, managerial approval is required. SBSE-05-0424-0017 (April 11, 2024) (interim guidance for IRM 5.8.4).

⁵¹⁰ Reg. §301.7122-1(e)(1).

⁵¹¹ For a discussion of the application of payments made in accordance with an accepted offer in compromise, see Rev. Proc. 2002-26. Interest is also compromised. IRM 5.8.1.18. For the address on where to send accepted offer in compromise (OIC) payments, see the IRS website, *Offer in Compromise — Frequently Asked Questions*.

⁵¹² §6325.

⁵¹³ See IRM 5.8.10.6(4). See also SBSE-05-1122-0077 (Nov. 22, 2022) (excess funds from sale of property subject to lien applied directly to taxpayer's liability using Designated Payment Codes 53 (discharge) or 55 (subordination)).

⁵¹⁴ See §6103(k)(1).

⁵¹⁵ §7122(f). The date of submission is the date on which the offer is received by the IRS. The postmark date is irrelevant in determining when an offer is submitted. Notice 2006-68, See also IRM 5.8.4.

⁵¹⁶ Notice 2006-68. See, e.g., *Brown v. Commissioner*, 158 T.C. 187 (2022) (collection specialist returned offer as not processable within 24 months).

⁵¹⁷ Notice 2006-68. See, e.g., *Brown v. Commissioner*, 158 T.C. 187 (2022) (offer rejected when returned to taxpayer after six months, not when settlement officer issued notice of determination sustaining initial rejection 27 months later).

⁵¹⁸ Reg. §301.7803-2(c)(9), T.D. 10030, 90 Fed. Reg. 3645 (Jan. 15, 2025), applicable to requests for consideration by Appeals made after February 13, 2025.

⁵¹⁹ See IRM 5.8.3.5(2).

⁵²⁰ Reg. §301.7122-1(e)(5); see *Dutton v. Commissioner*, 122 T.C. 133 (2004) (IRS manager's statement that taxpayer would be entitled to a refund after recommended partial relief under §6015(c) was granted did not result in mutual mistake of material fact or misrepresentation sufficient for offer in compromise to be set aside).

⁵²¹ See IRM 5.8.4.23.1.1.

⁵²² *Trout v. Commissioner*, 131 T.C. 239 (2008); see also *Buesing v. United States*, 47 Fed. Cl. 621 (Fed. Cl. 2000) (no contract with IRS to release tax lien found; if contract had existed, it would be voidable by the IRS because of taxpayer's misrepresentation of material facts and/or for unilateral mistake of fact); *Whitesell v. Commissioner*, T.C. Memo 2017-84 (IRS not bound by state statutes such as UCC); *Haiduk v. Commissioner*, T.C. Memo 1990-506 (absent a showing of misrepresentation or mutual mistake, settlement agreement is binding when IRS makes valid offer, and taxpayer accepts offer).

⁵²³ See, e.g., *Trout v. Commissioner*, 131 T.C. 239 (2008) (IRS did not abuse discretion in refusing to reinstate OIC because taxpayer's repeated failure to file timely returns was material breach of contract terms of OIC).

- The taxpayer fails to return an erroneously issued refund.⁵²⁴

If an event occurs which would cause the offer to default, the IRS will typically notify the taxpayer and provide an opportunity to cure the default.⁵²⁵ If the taxpayer fails to cure the default in the time allotted, the offer is formally defaulted. Once the offer is defaulted or terminated, it cannot be revived and a new offer must be implemented.⁵²⁶

If an offer is formally defaulted, the assessments for the liabilities covered by the offer are revived. No new assessment is made because an abatement made in response to an offer in compromise does not qualify as an abatement under §6404.⁵²⁷ The taxpayer's default simply renders the abatement void *ab initio*.

I. Collateral Agreements

In addition to the amount offered, the IRS may require the execution of a collateral agreement before accepting an offer.⁵²⁸ A collateral agreement provides the government additional benefits in addition to the dollar amount actually secured via the offer, thereby allowing the IRS to recoup part or all of the difference between the amount of the offer and the liability compromised.⁵²⁹ Securing a collateral agreement is the exception, not the rule. The IRS secures such an agreement only when a significant recovery can be anticipated.⁵³⁰ A collateral agreement generally provides for collection from future income or restricts future tax benefits from assets involved in the offer.

The most common types of collateral agreements are:

- future income collateral agreements;
- agreements reducing the basis of specific assets; and
- agreements to waive deductions.⁵³¹

The types of collateral agreements are not mutually exclusive — the IRS may require a taxpayer to execute more than one type of agreement. A taxpayer can offer to pay an additional amount to buy out a collateral agreement.

1. Future Income Collateral Agreement

The most common form of collateral agreement is the future income collateral agreement. These are frequently request-

ed when the taxpayer is relatively young and/or engaged in an occupation where significant increases in future income are possible.

A future income collateral agreement requires the taxpayer to pay over to the IRS certain percentages of the taxpayer's income in each of a specified number of years (usually five, but possibly as many as 10) following acceptance of the offer. The percentage is applied to "annual income" over a certain threshold level. Annual income is generally defined as the taxpayer's taxable income (before NOLs, etc.) plus certain nontaxable sources of income minus federal taxes. In determining the threshold level of income at which to start the collateral agreement, the amount of the taxpayer's ordinary and necessary expenses are considered.

For example, if the IRS and taxpayer agree that the taxpayer's ordinary and necessary expenses total \$20,000 a year, the IRS may require the taxpayer to pay 20% of annual income between \$20,000 and \$30,000, 30% between \$30,000 and \$40,000, and 50% over \$40,000. The IRS requires the taxpayer to submit Form 3439 (*Statement of Annual Income (Individual)*) or Form 3439-A (*Statement of Annual Income (Corporation)*) each year the agreement is in effect to determine compliance with the future income collateral agreement.⁵³² The federal district courts apparently have jurisdiction over refund actions based on disputes over the amount due on a future income collateral agreement.⁵³³

2. Agreement to Reduce Basis

If a taxpayer has real or personal property that may substantially appreciate in value in the near future, the IRS may require the taxpayer to sign a collateral agreement to reduce the basis of such assets.⁵³⁴ The theory behind this agreement is that the taxpayer should not be allowed tax benefits from an asset's basis that is excluded in determining the amount required to pay pursuant to the offer. The basis reduction reduces future depreciation and increases the taxable gain that will be realized in a subsequent sale of the asset. The taxpayer signs Form 2261-B (*Collateral Agreement: Adjusted Basis of Specific Assets*) in order to execute a basis reduction.

3. Agreement to Waive Losses

The IRS can require the taxpayer to waive any carryback or carryover benefits resulting from net operating losses or capital losses.⁵³⁵ The IRS is particularly interested in requiring this agreement when large carryovers are available to be carried forward to years after the offer in compromise is accepted. The taxpayer signs Form 2261-C (*Collateral Agreement: Waiver of Net Operating Losses, Capital Losses, and Unused Business Credits*) to execute this type of agreement.

⁵²⁴ IRM 5.8.9.5. A default by one spouse on a joint offer will not cause a default for the other spouse. CCA 200137018.

⁵²⁵ See IRM 5.8.9.5.

⁵²⁶ CCA 200113031.

⁵²⁷ SCA 200110029.

⁵²⁸ Reg. §301.7122-1(e)(2); see *United States v. Feinberg*, 372 F.2d 352 (3d Cir. 1967); *United States v. Lane*, 303 F.2d 1 (5th Cir. 1962).

⁵²⁹ IRM 5.8.6.1 (10-19-23). The IRS distinguishes a collateral agreement that gives the IRS an alternate means to collect the full amount of overdue taxes, see *United States v. Citizens Bank*, 50 F. Supp. 2d 107 (D.R.I. 1999), from a collateral agreement entered into in the context of an offer in compromise to provide the IRS with consideration beyond what is secured in the offer, discussed herein. See CCA 200133028, CCA 200133040.

⁵³⁰ IRM 5.8.6.2 (06-25-21).

⁵³¹ See IRM 5.8.6.2 (06-25-21). A collateral agreement that clarifies the terms of an offer, Form 2261-D (*Collateral Agreement: Delinquency Penalty Offer — Income Tax*), indicates that the taxpayer understands and agrees that the taxpayer may not claim a refund for any part of the tax, including additions to the tax, previously assessed and collected for the years covered, by reason of carryback of a net operating loss or an investment credit for a later taxable period or year.

⁵³² See IRM 5.8.6.2.1.1 (10-19-23); Forms 2261 (*Collateral Agreement: Future Income — Individual*), 2261-A (*Collateral Agreement: Future Income — Corporation*), and Forms 3439 (*Statement of Annual Income (Individual)*), 3439-A (*Statement of Annual Income (Corporation)*). If a husband and wife compromise a joint income tax liability, one spouse's violation of the future compliance provisions does not affect the other spouse's right to the benefits of the compromise agreement. CCA 200137018.

⁵³³ *Begner v. United States*, 428 F.3d 998 (11th Cir. 2005).

⁵³⁴ IRM 5.8.6.2.2 (10-19-23).

⁵³⁵ IRM 5.8.6.2.3 (10-19-23).

J. Rejection of Offer in Compromise

Section 7122(e)(1) requires an independent administrative review of any rejection of a proposed offer in compromise made by a taxpayer under §7122 before such rejection is communicated to the taxpayer.⁵³⁶ The Internal Revenue Manual provides that a proposed rejection of an offer must be examined by an independent administrative reviewer. The independent administrative reviewer is responsible for reviewing each case to determine if the proposed rejection or return is reasonable based on the taxpayer's facts and circumstances and the offer examiner's analysis of the taxpayer's financial information.⁵³⁷

After the independent administrative review, the IRS issues a written notice to the taxpayer advising of the rejection, the reasons for the rejection of the offer, and the right to an appeal to the Appeals Office. This written notice constitutes rejection of the offer.⁵³⁸ If the taxpayer seeks to have Appeals review the rejection of the offer, the taxpayer must request administrative review within 30 days after the date on the rejection letter.⁵³⁹

If Appeals sustains the rejection, no judicial review is available unless the rejection is part of the determination in a CDP case.

After a loss in administrative review, the taxpayer has the possibility of appeal to Tax Court on an abuse of discretion standard.⁵⁴⁰

K. Sample OIC Scenarios and Analysis

Example 1: Taxpayer B, an individual, owes a total of \$100,000 in income taxes for the tax years 2016 and 2017 and has been assessed a \$20,000 Trust Fund Recovery Penalty which is reflected under the period ending December 31, 2016. B is in currently not collectible status. B has the following assets which are valued as set forth below on the date the financial statement is evaluated for the net equity determination:

	Amount	Forced Sale Value	Encumbrance	Net Equity
Bank Account	\$100	\$100		\$100
IRA	10,000	6,650*		6,650
Furniture/ Personal Property	1,500	1,200		0**
Real Property	200,000	160,000***	150,000	10,000
2014 Mazda 6 150,000 miles	5,000	4,000	800	3,200
Totals	\$216,600	\$171,950	\$150,800	\$19,950

* 66.5% is includible after considering federal and state tax brackets (assuming 15% federal and 6% state brackets) and the early withdrawal penalties (10% federal and 2.5% state).

** Equity exists only if the value exceeds the levy exemption under §6334(a)(2).

*** The forced sale is calculated as $80\% \times \$200,000 = \$160,000$

B earns \$3,000 per month and has to pay an average of \$600 in taxes each month to cover the current estimated tax payment requirement. B's food/miscellaneous allowance is \$583. B has housing and utilities that total \$2,370 in Los Angeles County. B incurs auto operating expenses of \$315 per month and ownership costs of \$200 per month. Finally, B has health care costs of \$200 per month. The IRS reviews the offer for processability. The net realizable equity in B's assets is \$19,950. B's housing and utilities exceed the allowable standard by \$100. This difference of \$100 in the housing and utilities above the standard allowance requires an additional \$1,200 to be added to the net realizable equity.

B has offered \$26,000 as his offer amount. Since this exceeds the net equity in assets of \$19,950 and the \$1,200 from the income analysis, the offer is processable.

⁵³⁶ See Reg. §301.7122-1(f)(2). See also CCA 201421018 (taxpayer has right to appeal rejection of offer-in-compromise or installment agreement, but may not appeal such rejection if due to fraud).

⁵³⁷ IRM 5.8.12.1 (05-17-24), IRM 5.8.12.6.1 (05-17-24).

⁵³⁸ §7122(e)(2); Reg. §301.7122-1(f)(1); Rev. Proc. 2003-71, §9. See *Brown v. Commissioner*, 158 T.C. No. 9 (June 23, 2022), *aff'd* No. 23-70009, 2024 BL 302279 (9th Cir. 2024) (collection specialist returning offer to taxpayer because it was not processable constituted rejection of offer). It may be an abuse of discretion if the offer is rejected and the IRS fails to specify the appropriate acceptable amount. *Samuel v. Commissioner*, T.C. Memo 2007-312.

⁵³⁹ Reg. §301.7122-1(f)(5)(i). The request for administrative review is among the acts that may be postponed under §7508 and §7508A. See Tables, Charts and Lists (Federal) > *Postponements Due to Combat Zone or Contingency Operation Service, Federally Declared Disasters, Significant Fires or Terroristic or Military Actions* for an updated list of acts, the performance of which may be postponed under §7508 and §7508A. However, note that nothing in the current COVID-19 notices (including Notice 2020-23 and its predecessors), nor §7508A itself, extends the 24-month period for the IRS to accept an OIC if the original deadline doesn't fall between April 6, 2020 and July 15, 2020. CCA 202129008.

⁵⁴⁰ See, e.g., *Dietz v. Commissioner*, T.C. Memo 2023-69 (no abuse of discretion where valuation of personal residence was reduced after appraisal and profit-sharing plan included in reasonable collection potential (RCP) calculation as settlement officer's determination that taxpayers' RCPs were greater than submitted OICs was reasonable and supported by factual record); *Ragsdale v. Commissioner*, T.C. Memo 2019-33 (corrected RCP was still greater than proposed OIC amount thus no abuse of discretion); *McAvey v. Commissioner*, T.C. Memo 2018-142 (no abuse of discretion because taxpayer did not provide support for basis of excluding real property sale proceeds from RCP); *W. Zintl Constr., Inc. v. Commissioner*, T.C. Memo 2017-119 (IRS's rejection of taxpayer's offer in compromise, based upon computation of reasonable collection potential (RCP) misapplying going concern valuation of business was abuse of discretion); *Samuel v. Commissioner*, T.C. Memo 2007-312 (IRS's rejection of taxpayer's offer in compromise was abuse of discretion because IRS failed to follow Internal Revenue Manual procedures).

The offer is now referred for investigation. The offer “specialist” reviewing the offer determines that the forced sale value for the car should be \$11,000 and the average bank balance is \$300. Therefore, the offer in compromise must be amended to increase the offer. The offer specialist indicates that the offer will be recommended for acceptance if it is increased to \$28,000 and B agrees to waive the net capital loss carryover claimed on B’s last income tax return. The capital loss carryover reflected on the return is \$18,000.

Example 2: The facts are the same as in *Example 1* above except B’s taxable income in the prior two years is \$50,000 and \$80,000 respectively. The offer specialist can average the income for the three years or require a future income collateral agreement. B convinces the offer spe-

cialist the higher income will not recur. The offer specialist requires a future income collateral agreement with an exclusion figure of \$40,000. The collateral agreement requires 20% of the increment between \$40,000 and \$45,000, 30% between \$45,000 and \$50,000 and 50% over \$50,000 to be paid to the IRS for the next five years. B offers to buy out the collateral agreement for an additional \$7,000. The offer specialist agrees to this buyout resulting in a total offer of \$35,000 with a waiver of the capital losses claimed on the return. No future income collateral agreement will now be required from B. If B did not buy out the collateral agreement, B would calculate the amount due and remit the additional sum required for each of the five years covered by the future income collateral agreement. In no event would B pay more than the total tax, interest, and penalty due.

VII. Bankruptcy (Collection Resolution #5)

If a taxpayer has incurred significant tax debt, it is likely that the taxpayer is experiencing overall financial hardship. In this circumstance, the taxpayer may decide to file a bankruptcy petition. The Bankruptcy Code (11 U.S.C.) governs the collection of all liabilities (including tax liabilities) from the debtor-taxpayer. The Bankruptcy Code stays most collection actions; establishes a mechanism for determining which debts are entitled to payment; and determines the manner and priority in which the competing claims are to be paid. A complete analysis of the Bankruptcy Code is beyond the scope of this Portfolio and is discussed further in 540 T.M., *Bankruptcy and Insolvency Restructurings; Discharge of Indebtedness*, and 1540 T.M., *State Tax Aspects of Bankruptcy* (State Tax Library). However, the general bankruptcy procedures and the impact of the Bankruptcy Code on federal tax collection is discussed to highlight the usefulness of bankruptcy as a defense to IRS collection.

A. Overview

1. Jurisdiction of Bankruptcy Courts

United States district courts have original subject matter jurisdiction over “all cases under title 11”⁵⁴¹ and over civil proceedings “arising under title 11, or arising in or related to cases under title 11.”⁵⁴² In practice, the district courts automatically refer any or all of these cases and civil proceedings to a bankruptcy court for consideration.⁵⁴³

28 U.S.C. §1334 therefore creates jurisdiction for three categories of disputes: (i) those “arising in” bankruptcy litigation; (ii) those “arising under” the Bankruptcy Code; and (iii) those “related to” the resolution of a bankruptcy proceeding.⁵⁴⁴ A dispute “arises in” bankruptcy if it concerns a matter that is exclusive to bankruptcy law and practice.⁵⁴⁵ A dispute “arises under” the Bankruptcy Code when the action is based on a right or remedy explicitly provided in the Bankruptcy Code; that is, when the dispute presents a substantive question of bankruptcy law.⁵⁴⁶ A bankruptcy court may enter final judgments and orders in all cases arising under title 11 and in all civil proceedings arising under title 11 or arising in a case under title 11, which are known as “core proceedings.”⁵⁴⁷ A nonexclusive list of core proceedings is provided in 28 U.S.C. §157(b)(2).

A dispute is “related to” bankruptcy if the outcome of the proceeding could conceivably have any effect on the bankruptcy estate being administered, such as if the outcome would alter the debtor’s rights, liabilities, options or freedom of action (either positively or negatively) and would thus impact the handling and administration of the estate.⁵⁴⁸ As jurisdictional issues

must be resolved *ex ante*, “related to” jurisdiction must be assessed at the outset of the dispute.⁵⁴⁹ And while the “related to” language in 28 U.S.C. §1334(b) must be read to grant jurisdiction over more than simply proceedings involving the debtor’s property or the estate, a bankruptcy court’s “related to” jurisdiction is not limitless.⁵⁵⁰ Thus, courts may decline to exercise jurisdiction if the relationship between the dispute and the bankruptcy case is too remote.⁵⁵¹

A civil proceeding that is “related to” a case under title 11 is deemed a “non-core proceeding,” and the parties must consent before a bankruptcy court may enter a final order in the matter.⁵⁵² If the parties do not consent, the bankruptcy judge may hear the proceeding but must submit a report of proposed findings of fact and conclusions of law to a district court judge for review and entry of an appropriate final order.⁵⁵³

2. Available Bankruptcy Proceedings

The Bankruptcy Code provides five chapters under which debtors can file petitions. For purposes of this Portfolio, the following three chapters⁵⁵⁴ are analyzed:

- Chapter 7 — Liquidation;
- Chapter 11 — Reorganization; and
- Chapter 13 — Adjustment of Debts of an Individual with Regular Income.

Individuals and business taxpayers can file petitions under either Chapter 7 or 11. Only individual taxpayers can file Chapter 13 petitions.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the “2005 Bankruptcy Act”) is notable for creating limitations on the availability of Chapter 7 bankruptcies. The 2005 Bankruptcy Act modified 11 U.S.C. §707(b) by implementing a “means test” formula for determining when a Chapter 7 filing is presumptively abusive and therefore subject to dismissal or (with the consent of the debtor) conversion to a Chapter 13 case. This means test applies if the debtor’s average monthly income for the six-month period before the bankruptcy is filed exceeds the median income for a similarly sized family in the debtor’s state.

⁵⁴⁸ *Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984); see *Gardner v. United States (In re Gardner)*, 913 F.2d 1515, 1518 (10th Cir. 1990); *Miller v. Kemira, Inc. (In re Lemco Gypsum, Inc.)*, 910 F.2d 784, 788 (11th Cir. 1990).

⁵⁴⁹ *Bush v. United States*, 100 F.4th 807, 813 (7th Cir. 2024).

⁵⁵⁰ *Celotex Corp.*, 514 U.S. at 308; see *Board of Governors, FRS v. MCorp Financial, Inc.*, 502 U.S. 32, 40 (1991) (stating that Congress has vested “limited authority” in bankruptcy courts).

⁵⁵¹ *Pacor, Inc.*, 743 F.2d at 994 (holding that the district court had no jurisdiction over action between parties not in bankruptcy although defendant impleaded debtor); *Turner v. Ermiger (In re Turner)*, 724 F.2d 338, 340–41 (2d Cir. 1983) (action awarding damages to the debtor was not related to the bankruptcy when there was no indication that the damages would be part of the bankruptcy estate).

⁵⁵² 28 U.S.C. §157(c)(2).

⁵⁵³ 28 U.S.C. §157(c)(1). Beginning in 2011, the Supreme Court issued a series of opinions regarding the constitutionality of bankruptcy courts issuing final orders in certain designated “core proceedings” that do not “arise under title 11,” because bankruptcy courts are not Article III courts. *Wellness Int’l Network, Ltd. v. Sharif*, 575 U.S. 665 (2015); *Exec. Benefits Ins. Agency v. Arkison*, 573 U.S. 25 (2014); *Stern v. Marshall*, 564 U.S. 462 (2011).

⁵⁵⁴ The other two chapters cover debts of a municipality (Chapter 9) and debts of a family farmer with regular annual income (Chapter 12).

⁵⁴¹ 28 U.S.C. §1334(a).

⁵⁴² 28 U.S.C. §1334(b).

⁵⁴³ 28 U.S.C. §157(a). The district court also may withdraw the reference in whole or in part. 28 U.S.C. §157(d).

⁵⁴⁴ *Celotex Corp. v. Edwards*, 514 U.S. 300 (1995).

⁵⁴⁵ *Nelson v. Welch (In re Repository Techs., Inc.)*, 601 F.3d 710, 719 (7th Cir. 2010); see, e.g., *United States v. Mikhov*, 645 B.R. 609 (S.D. Ind. 2022).

⁵⁴⁶ See, e.g., *Barnett v. Stern*, 909 F.2d 973, 981 (7th Cir. 1990).

⁵⁴⁷ 28 U.S.C. §157(b)(1); *Stern v. Marshall*, 564 U.S. 462, 476 (2011); see *Mich. Emp’t Sec. Comm’n v. Wolverine Radio Co. (In re Wolverine Radio Co.)*, 930 F.2d 1132, 1144 (6th Cir. 1991).

If the means test applies, the U.S. Trustee must: (1) file a statement analyzing whether the debtor's case is presumptively abusive, and (2) file a motion to dismiss or convert the case to a Chapter 13 case or file a statement explaining why such a motion is not appropriate.⁵⁵⁵ Interestingly, the formula incorporates the IRS allowable national and local standard expense criteria discussed above for offers and installment agreements. In general, if the debtor's average monthly income for the six months prior to the bankruptcy filing exceeds the debtor's necessary expenses by a sufficient amount, abuse is presumed.

The debtor's necessary expenses include not only the IRS necessary expenses but also: (1) amounts to care for an elderly, ill, or disabled household member, (2) private-school tuition of up to \$2,575 per year, (3) excess home energy costs, (4) necessary secured debt payments, and (5) a monthly deemed priority claim payment equal to the total priority claims divided by 60.⁵⁵⁶

The abuse threshold is reached if the excess monthly income multiplied by 60 exceeds the lesser of: (1) \$17,150 or (2) the greater of \$10,275 or 25% of the debtor's nonpriority unsecured claims.⁵⁵⁷

Note: The necessary expense categories would appear to include a deemed monthly payment of priority and possibly secured tax claims. If the debtor has these types of tax claims, it may help the debtor qualify for a Chapter 7 bankruptcy to discharge other unsecured nonpriority taxes.

There are also limitations on who is eligible to file Chapter 13 bankruptcy. The most important limitations preclude a Chapter 13 filing if the taxpayer's secured debts exceed \$1,580,125 or the unsecured debts exceed \$526,700.⁵⁵⁸ A debt is secured for this purpose to the extent of the value of assets that are included in the bankruptcy estate.⁵⁵⁹ Assessed but disputed liabilities are included in determining if the debt limits are satisfied.⁵⁶⁰ The combination of the means test and the Chapter 13 debt limits can leave a taxpayer with no ability to qualify for either a Chapter 7 or a Chapter 13 bankruptcy.

In addition to the limitations on filing for bankruptcy discussed above, there are numerous duties imposed on debtors that must be satisfied or the case may be dismissed.

The 2005 Bankruptcy Act added §521(e)(2), which requires a debtor in a Chapter 7 case to provide the trustee with a copy of the tax return (or a transcript thereof) for the most recent tax year ending immediately before the commencement of the case no later than seven (7) days before the first meeting of creditors or risk dismissal of the case (unless the debtor can

demonstrate that the failure was due to circumstances beyond the debtor's control).⁵⁶¹

The 2005 Bankruptcy Act also imposes a similar duty on a debtor in a Chapter 13 case under 11 U.S.C. §1308. This requires the debtor to file all tax returns for all taxable periods ending during the four-year period ending on the date of the filing of the petition at least one day before the first meeting of creditors. A failure to file all returns by the meeting date may result in the trustee holding open the meeting for a reasonable period of time, thus delaying confirmation of the debtor's plan. The filing deadline imposed by 11 U.S.C. §1308 takes precedence over the filing deadline set forth in §6072(a), i.e., the trustee may require the debtor to file the return for the prior year even if the return is not yet delinquent under the tax code.⁵⁶²

3. Creation of Bankruptcy Estate

The filing of a bankruptcy petition creates a bankruptcy "estate."⁵⁶³ The property of the estate includes any property in which the debtor has a legal or equitable interest at the commencement of the bankruptcy case, and any interest in property recovered or recoverable by the estate following the commencement of the case through transfer and lien avoidance provisions.⁵⁶⁴ Thus, the term "estate" refers to the property at a particular point in time rather than the estate in perpetuity.⁵⁶⁵ The debtor is deemed to have an interest in property if the debtor

⁵⁶¹ Despite the seemingly rigid statutory requirements, early cases interpreting this provision appear to favor the debtor. For example, in *In re Houston*, No. 05-15912-SSM, 2006 BL 38790 (Bankr. E.D. Va. May 23, 2006), the bankruptcy court held that a debtor substantially complied with 11 U.S.C. §521(e)(2)(A) (i) by submitting a computer printout summarizing data from a return that had been filed electronically. The bankruptcy court denied the trustee's motion to dismiss the petition after concluding that it believed that the debtor had substantially complied with the statutory requirement, or, if not, that her noncompliance was due to circumstances beyond her control, in that she took reasonable steps to comply and believed in good faith that she had complied. Observing that it was unclear as to exactly what constituted a "copy" of an electronically filed tax return, and that the Bankruptcy Code did not define the term for such purposes, the court explained that it was not prepared on the limited record to rule that a computer-prepared summary of data electronically transmitted to the IRS did not constitute a copy of the return for these purposes. In *In re Grasso*, 341 Bankr. 821 (Bankr. D.N.H. 2006), the court held that a debtor's late delivery of returns to the trustee did not warrant dismissal, as such act was discretionary on the part of the trustee.

⁵⁶² *In re French*, 354 Bankr. 258 (Bankr. E.D. Wis. 2006).

⁵⁶³ For individual taxpayers in a Chapter 7 or Chapter 11 case, a separate legal estate is created for bankruptcy and tax purposes. However, the bankruptcy petition of a corporation or partnership does not create a separate taxpayer. §1398, §1399. See VII.G., below, for a further discussion.

⁵⁶⁴ 11 U.S.C. §541. See *Owen v. Owen*, 500 U.S. 305, 308 (1991). See also, e.g., *Kokoszka v. Belford*, 417 U.S. 642 (1974); *Segal v. Rochelle*, 382 U.S. 375 (1966) (income tax refund can be property of bankruptcy estate); *Sticka v. Lambert*, 283 Bankr. 16 (B.A.P. 9th Cir. 2002) (only portion of advance refund check under former §6428(e) that is attributable to part of 2001 tax year preceding filing of bankruptcy petition is property of estate). Cf. *Christie v. Royal*, 233 Bankr. 110 (B.A.P. 10th Cir. 1999) (post-petition earnings or post-petition loan, clearly not property of the estate in a chapter 7 case, do not become property of the estate simply because debtor uses them to overpay a nondischargeable pre-petition tax claim). But see *Patterson v. Shumate*, 504 U.S. 753 (1992) (debtor's interest in retirement plan qualifying under ERISA not property of bankruptcy estate).

⁵⁶⁵ See *United States v. Warfield (In re Tillman)*, 53 F.4th 1160, 1167 (9th Cir. 2022) (citing *Owen*, 500 U.S. at 308).

⁵⁵⁵ 11 U.S.C. §704(b).

⁵⁵⁶ The dollar amounts under 11 U.S.C. §707(b) are adjusted every three years as prescribed by 11 U.S.C. §104(a). The most recent adjustments are set forth in 90 Fed. Reg. 8941 (Feb. 4, 2025), effective for cases commenced on or after Apr. 1, 2025. The previous private school tuition limit was \$2,275.

⁵⁵⁷ These dollar amounts are adjusted every three years as prescribed by 11 U.S.C. §104(a). The most recent adjustments are set forth in 90 Fed. Reg. 8941 (Feb. 4, 2025), effective for cases commenced on or after Apr. 1, 2025. The previous dollar limits were \$15,150 and \$9,075 respectively.

⁵⁵⁸ The dollar amounts are adjusted every three years as prescribed by 11 U.S.C. §104(a). The most recent adjustments are set forth in 90 Fed. Reg. 8941 (Feb. 4, 2025), effective for cases commenced on or after Apr. 1, 2025. The previous dollar limits were \$1,395,875 and \$465,275.

⁵⁵⁹ *In re Barcal*, 80 AFTR 2d 97-7729 (B.A.P. 8th Cir. 1997); *In re Berena-to*, 226 B.R. 819 (Bankr. E.D. Pa. 1998).

⁵⁶⁰ *In re Persky*, 1998 BL 2972 (E.D. Pa. 1998).

has any right with respect to such property, even if the interest is not a possessory interest.⁵⁶⁶

This definition of property is similar to the definition of property that is subject to the federal tax lien. The most notable distinction is that after the commencement of the bankruptcy case, the debtor can acquire property which is not treated as property of the bankruptcy estate, whereas all after-acquired property of a taxpayer is subject to the federal tax lien. There are a variety of tax-related issues that are presented in determining the property of the bankruptcy estate.

Intangible property. Courts are split as to whether debtors retain any interest in intangible property — such as cash or cash equivalents — that is levied upon by the IRS immediately before the bankruptcy petition is filed.⁵⁶⁷ Generally, if the debtor loses all interest as a result of the levy, the funds do not become property of the estate.

Earned Income Credit. Courts are also split regarding whether the §32 earned income credit constitutes property of the estate. Cases that hold that the earned income credit is not property of the estate are primarily older cases that looked to the policy of the now superseded Bankruptcy Act to construe what constituted property of the estate and emphasized the distinction between the credit and a tax refund.⁵⁶⁸ However, more recent cases decided under the Bankruptcy Code have held that the earned income credit is property of the estate.⁵⁶⁹ Several states have enacted statutes that expressly exempt EITC refunds from the reach of creditors, and thus from the bankruptcy estate, including Colorado, Indiana, Kansas, Louisiana, Mississippi, Nebraska, and Oklahoma. For state-specific information, see 1540 T.M., *State Tax Aspects of Bankruptcy* (State Tax Library).

Similarly, the child tax credit has been included as property of the estate, and not exempt, because the child tax credit was not the type of “public assistance” within the meaning of the relevant state exemption statute.⁵⁷⁰

⁵⁶⁶ *United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983); *In re Prudential Lines, Inc.*, 928 F.2d 565 (2d Cir. 1991) (property of bankruptcy estate includes an inchoate right — i.e., NOL carryovers).

⁵⁶⁷ Compare *In re Boutillier*, 196 Bankr. 323 (Bankr. W.D. Va. 1996) (*Whiting Pools* does not stand for proposition that “cash or cash equivalent” property transforms IRS lien to one which is tantamount to ownership), with *In re Brown*, 126 Bankr. 767 (N.D. Ill. 1991) (debtor has no interest in bank account following levy); *In re Rose*, 112 Bankr. 12 (Bankr. E.D. Tex. 1989) (holding in *Whiting Pools* does not extend to cash; thus, debtor has no interest in bank accounts after levy).

⁵⁶⁸ *Hoffman v. Searles*, 445 F. Supp. 749 (D. Conn. 1978); *In re Hurlles*, 31 Bankr. 179 (Bankr. S.D. Ohio 1983).

⁵⁶⁹ See, e.g., *Williamson v. Jones*, 224 F.3d 1193 (10th Cir. 2000); *In re Johnston*, 209 F.3d 611 (6th Cir. 2000); *Trudeau v. Royal*, 237 Bankr. 803 (B.A.P. 10th Cir. 1999) (debtor’s income tax refund that includes money from earned income credits is property of the bankruptcy estate and is not exempt under state or federal law); *In re Medina*, No. 22-10233-j7, 2022 BL 450825 (Bankr. D.N.M. Dec. 16, 2022) (absent either specific statutory exemption for EITC or broad public assistance exemption, EITC is considered property of bankruptcy estate and is not beyond reach of creditors). *But see In re Longstreet*, 246 Bankr. 611 (Bankr. S.D. Iowa 2000) (EIC excluded from bankruptcy estate under 11 U.S.C. §522 and recently amended Iowa exemption statute); *In re Meza*, 243 Bankr. 538 (Bankr. M.D. Fla. 1999) (EIC refund not part of bankruptcy estate where debtor did not meet all eligibility requirements for EIC at time of filing).

⁵⁷⁰ See *In re Steinmetz*, 261 Bankr. 32 (Bankr. D. Idaho 2001) (EIC refund and child tax credit are contingent interests and thus are considered property of the bankruptcy estate).

Tax Refunds. Courts are also split regarding the treatment of a refund resulting from a jointly filed return where one spouse earns no income and has no withholding and, more generally, in similar cases in which the debtor spouse and the non-debtor spouse have differing property rights in the refund.⁵⁷¹

A majority of courts follow property law principles and hold that the spouse’s interest is limited to that portion of the refund attributable to the spouse’s own withholding, and therefore where one spouse has no withholding, the entire refund is the property of the spouse that has made withholding payments (sometimes referred to as the “Withholding Rule”).⁵⁷²

Other courts, however, have found that a tax refund should be divided equally between a debtor and non-debtor spouse regardless of their respective tax withholding or income (sometimes referred to as the “50/50 Rule”).⁵⁷³

When the non-debtor spouse had income but no withholdings or considerably less in withholdings than the debtor spouse, still other courts have held that the debtor’s portion of the refund from the joint return is calculated using each spouse’s separate tax liability (sometimes referred to as the “Separate Filings Rule”).⁵⁷⁴

Another approach adopted by some courts is the division of joint tax refunds proportionally according to the income generated by each spouse (sometimes referred to as the “Income Rule”).⁵⁷⁵

Another issue concerning allocation of a tax refund involves the allocation of a refund to the period before and after the petition is filed. Generally, only the portion allocable to the pre-petition period is subject to turnover as property of the estate.⁵⁷⁶ If the taxpayer’s income is relatively steady throughout the year, a method of pro rata by days may be used.⁵⁷⁷ Other methods may be applied when the taxpayer’s income is not steady.⁵⁷⁸

The issue is further complicated when the taxpayer applies the refund to pay subsequent year taxes. When a taxpayer makes an irrevocable election under §6513(d) to apply an overpayment from one year against the subsequent year’s taxes, the pre-petition portion of the overpayment is nevertheless considered property of the debtor subject to turnover.⁵⁷⁹ As a practical

⁵⁷¹ See, e.g., *In re McInerney*, 609 B.R. 497, 503–511 (Bankr. N.D. Ill. 2019) (surveying differing judicial approaches to tax refunds of jointly-filing couples where one spouse is debtor and other spouse is non-debtor).

⁵⁷² See, e.g., *Kleinfeldt v. Russell (In re Kleinfeldt)*, 287 B.R. 291 (B.A.P. 10th Cir. 2002); *In re Pirron*, No. 22-B-08555, 2025 BL 51260 (Bankr. N.D. Ill. Feb. 18, 2025); *In re McInerney*, 609 B.R. 497, 505 (Bankr. N.D. Ill. 2019).

⁵⁷³ See, e.g., *In re Hejmowski*, 296 B.R. 645 (Bankr. W.D.N.Y. 2003); *Loevy v. Aldrich (In re Aldrich)*, 250 B.R. 907 (Bankr. W.D. Tenn. 2000).

⁵⁷⁴ See, e.g. *Crowson v. Zubrod (In re Crowson)*, 431 B.R. 484 (B.A.P. 10th Cir. 2010) (portion is calculated using percentage derived from dividing each spouse’s liability if married filing separately by total of spouses’ liabilities if married filing separately multiplied by actual joint liability); *In re Nevins*, 564 B.R. 151 (Bankr. D.N.H. 2016) (citing *Crowson*, “separate filings” rule is most accurate determination of spouse’s rights in joint tax refund).

⁵⁷⁵ See, e.g., *In re McInerney*, 609 B.R. 497, 505 (Bankr. N.D. Ill. 2019).

⁵⁷⁶ See, e.g., *Barowsky v. Serelson (In re Barowsky)*, 946 F.2d 1516, 1517–1518 (10th Cir. 1991).

⁵⁷⁷ *In re Meyers*, 616 F.3d 626 (7th Cir. 2010).

⁵⁷⁸ *In re Donnell*, 357 B.R. 386 (Bankr. W.D. Tex. 2006).

⁵⁷⁹ *Weinman v. Graves (In re Graves)*, 609 F.3d 1153 (10th Cir. 2010) (prepayment constituted contingent reversionary interest that is property of estate that becomes vested right once subsequent year return is filed and to extent refund is attributable to pre-petition earnings). *But see Nichols v. Birdsell*, 491

matter, however, it is not entirely clear when a trustee can obtain possession of the refund or whether the trustee can require the debtor to turn over the “value” of the refund when the refund itself cannot be obtained.

Tax Payments. Tax payments made before the filing of a bankruptcy petition generally are not property of the estate, i.e., they are pre-petition obligations. However, what happens to checks issued and mailed to the IRS but not deposited by the IRS before the petition date? In *In re Floyd*,⁵⁸⁰ for example, the debtors argued that, although such payments were property of the bankruptcy estate, various provisions of the Bankruptcy Code allowed for payment of such pre-petition obligations on a post-petition basis so long as the payments were supported by a sound business purpose or were necessary for a successful reorganization. The debtors asserted that a failure to honor the checks could subject them to potential criminal liability for issuing a worthless check and also could result in additional penalties and interest associated with the unpaid income taxes. The bankruptcy court concluded that the debtors could not rely on 11 U.S.C. §363(b), which allows for a debtor-in-possession to use property of the estate outside of the ordinary course of business, because they failed to articulate a good *business* reason for the use of the estate funds to pay the pre-petition claims of the IRS outside priority and confirmation of the plan. The bankruptcy court further concluded that even if it accepted the debtor’s assertion that 11 U.S.C. §541, 11 U.S.C. §105 or the doctrine of necessity should allow for the tax payments, the Bankruptcy Code generally does not allow for early payment of a pre-petition debt in a Chapter 11 plan outside of a confirmed plan of reorganization, and that, even if the doctrine of necessity existed in the context of bankruptcy, the debtors did not demonstrate a dire, extraordinary, or rare circumstance such as an immediate demise of a viable business or the protection of valuable assets.

4. Exempt Property

Bankruptcy Code §522 allows an individual debtor to exempt certain real and personal property from the bankruptcy estate.⁵⁸¹ The debtor has the option to elect the federal exemption or the exemption provided by the debtor’s state of residence.⁵⁸² A post-petition tax refund can be an exempt asset if allowed under state law.⁵⁸³

Since the exempt property is not part of the bankruptcy estate, it cannot be used to satisfy unsecured debts that arose before the bankruptcy petition is filed.⁵⁸⁴ Exempt property, how-

F.3d 987 (9th Cir. 2007) (estate property does not have to be immediately capable of being liquidated into cash in order to constitute property of the estate and includes a debtor’s interests that cannot be liquidated and transferred by the debtor). See also *IRS v. Pritchard (In re Block)*, 141 B.R. 609 (N.D. Tex. 1992) (monies were not property of the estate once the irrevocable election had been made and thus were not subject to turnover); *Grant v. United States (In re Simmons)*, 124 B.R. 606 (Bankr. M.D. Fla. 1991) (same).

⁵⁸⁰No. 20-02743-5-JNC, 2020 BL 407390 (Bankr. E.D.N.C. Oct. 20, 2020).

⁵⁸¹The debtor may exempt only the debtor’s interest in the property. See *Schwab v. Reilly*, 560 U.S. 770, 775–776 (2010) (bankruptcy estate retained interest in property beyond exempt amount).

⁵⁸²11 U.S.C. §522(d).

⁵⁸³*In re Benn*, 2006-1 USTC ¶50,261 (B.A.P. 8th Cir. 2006). The refund from an earned income credit can also be exempt under the state exemption scheme. *Williamson v. Murray*, 586 Fed. Appx. 577 (10th Cir. 2014) (unpub.).

ever, can be subject to IRS collection following the discharge of the bankruptcy proceedings. Bankruptcy Code §522(c)(2)(A) provides that a federal tax lien that is not perfected by filing an NFTL is avoided by the bankruptcy proceedings. Certain assets never become part of the bankruptcy estate. Bankruptcy Code §522(c)(2)(B) provides that exempted property is not protected from a perfected federal tax lien properly filed by the IRS before the bankruptcy petition, thus allowing the IRS to pursue the property after bankruptcy. The IRS position is that this “excluded” property is not subject to bankruptcy rules and therefore even the unperfected §6321 “secret” lien remains as an encumbrance on the excluded assets.⁵⁸⁵

5. Proof of Claim

a. In General

On filing a bankruptcy petition, the debtor supplies the bankruptcy court with a list of creditors. The bankruptcy court then notifies these creditors of the bankruptcy filing. If the bankruptcy estate appears to have assets, the creditors are instructed that to participate in the distribution of the estate they must file a proof of claim setting forth the amount the debtor owes and the status of this debt (i.e., secured or unsecured) before a date that is established as the bar date. If a creditor has a claim against the debtor which is secured by an interest in property — i.e., the creditor holds a security interest in the debtor’s property — the creditor is not required to file a proof of claim.⁵⁸⁶ If, however, the creditor’s claim is unsecured, a proof of claim must be filed in order for the creditor to participate in the bankruptcy proceedings.⁵⁸⁷

b. IRS Proof of Claim

The IRS’s Insolvency Unit handles the bankruptcy cases in each Area in which a bankruptcy proceeding is filed.⁵⁸⁸ The

⁵⁸⁴After commencement of bankruptcy proceedings, property interests which are exempted by a debtor are technically “withdrawn from the estate” and thus are no longer property of the estate. *Gebhart v. Gaughan (In re Gebhart)*, 621 F.3d 1206, 1210 (9th Cir. 2010) (quoting *Owen*, 500 U.S. at 308). Moreover, “the general rule is that exempt property immediately reverts in the debtor.” *Mwangi v. Wells Fargo Bank, N.A. (In re Mwangi)*, 764 F.3d 1168, 1175 (9th Cir. 2014).

⁵⁸⁵*Wadleigh v. Commissioner*, 134 T.C. 280 (2010) (§6321 lien relating to unpaid tax liability remains attached to taxpayer’s pension plan following bankruptcy where pension was excluded from bankruptcy estate); *In re Isom*, 901 F.2d 744 (9th Cir. 1990) (although tax debt is discharged, federal tax lien remains an encumbrance against debtor’s property which, in this case, was exempt property; therefore, while discharge prevents the IRS from collecting the taxes from debtor, encumbered property remains liable for the tax debt); *In re Hanson*, 91-2 USTC ¶50,485 (Bankr. E.D. Mo. 1991) (tax liens filed pre-petition survive bankruptcy and are enforceable against debtor’s property after bankruptcy court grants discharge). The list of exempt bankruptcy property is not the same as the property exempt from levy under §6334.

⁵⁸⁶*In re Bisch*, 159 Bankr. 546 (B.A.P. 9th Cir. 1993).

⁵⁸⁷Bankruptcy Rule 3002(a). In some cases, debts are not discharged in bankruptcy and must be satisfied in whole or in part with the assets of the estate. The amount of such debt that is not paid by the estate’s assets remains the debtor’s personal liability after bankruptcy. In such cases — i.e., the IRS has an unsecured claim for a nondischargeable tax liability — the debtor benefits from filing a proof of claim on behalf of the IRS. This proof of claim must be timely filed. See *In re Danielson*, 981 F.2d 296 (7th Cir. 1992) (debtor’s claim filed on IRS’s behalf disallowed as late).

⁵⁸⁸Insolvency is a part of the Collection function for the IRS’s Small Business/Self Employed (SB/SE) Operating Division. IRM 5.9.1.1 (11-24-23). It

bankruptcy court notifies the Insolvency Unit of bankruptcy filings in Chapter 11 cases.⁵⁸⁹ In Chapter 7 and 13 cases, the IRS is notified upon receiving notice of the first meeting of creditors.⁵⁹⁰ The Insolvency Unit places “freeze codes” on the taxpayer’s account to preclude any IRS collection action.⁵⁹¹ This is designed to avoid violations of the automatic stay.

When the Insolvency Unit receives the tax liability information, it prepares and files proofs of claim reflecting any tax, penalty, and interest due.⁵⁹² If the taxpayer did not file tax returns for pre-petition periods, the IRS may:

- serve a summons to determine the amount that is owed;
- examine the debtor at the first meeting of creditors;
- prepare Substitutes for Returns (SFR);
- have Area Counsel or the U.S. Attorney file a motion to compel the bankruptcy court to order the debtor to file the returns;⁵⁹³ or
- file an estimated proof of claim.⁵⁹⁴

c. Bar Date

Bankruptcy Rule 3002(a) provides that, except as provided in Rules 1019(3), 3003, 3004, and 3005, an unsecured creditor must file a proof of claim for the claim to be allowed. If the creditor fails to file a proof of claim, the debtor can file one on the creditor’s behalf to ensure that a creditor who has a nondischargeable debt is paid through bankruptcy.⁵⁹⁵ In a Chapter 11 case, Rule 3003 provides that a proof of claim need not be filed unless the debtor schedules the claim as disputed, contingent, or unliquidated as to the amount.

To be valid, a proof of claim should be timely filed. Bankruptcy Code §502(b)(9) causes a claim by a governmental unit to be deemed timely if a proof of claim is filed within 180 days after the order for relief or by the date set in the bankruptcy rules (if later). In a Chapter 7 case a late claim for a priority tax will be allowed if the claim is filed before the date of distribution.⁵⁹⁶ In a Chapter 11 case, the proof of claim must be filed within the time prescribed by the bankruptcy court.⁵⁹⁷

replaces offices formerly staffed by the IRS’s Special Procedures function (SPf).

⁵⁸⁹ Bankruptcy Rule 2002(j).

⁵⁹⁰ Bankruptcy Rule 2002(a); IRM 5.9.6.2.1 (04-12-2024).

⁵⁹¹ IRM 5.9.1.4.1 (06-06-17).

⁵⁹² See Bankruptcy Form B410 (Proof of Claim), available at https://www.uscourts.gov/sites/default/files/2025-04/b_410_0425-form.pdf; IRS Form 6338-A (Request for Payment of Internal Revenue Taxes); IRM 5.9.1.4; IRM 5.9.14 (Automated Proofs of Claim (APOC)).

⁵⁹³ However, the bankruptcy court may decline to exercise its authority under 11 U.S.C. §105 to compel a debtor to file delinquent returns if the government fails to show that the returns were required or appropriate for its case. See *In re Farrell*, 241 Bankr. 348, 99-1 USTC ¶50,499 (Bankr. M.D. Pa. 1999).

⁵⁹⁴ IRM 5.9.14 (Automated Proofs of Claim (APOC)).

⁵⁹⁵ Bankruptcy Rule 3004. In the alternative to filing a proof of claim, a debtor can have personal liability for nondischargeable taxes determined by filing a complaint to determine dischargeability. 124 Cong. Rec. H32,413 (Sept. 28, 1978). *But see, e.g., In re Kaufman*, 115 Bankr. 378 (Bankr. S.D. Fla. 1990), in which the court refused to determine the dischargeability of the debtor’s tax liability in a no-asset case.

⁵⁹⁶ 11 U.S.C. §726(a)(1). See *Security State Bank v. IRS*, 267 F.3d 453 (5th Cir. 2001) (trustee commences distribution on date bankruptcy court approves trustee’s final report).

Note: Although the bankruptcy rules fail to provide relief for creditors who do not receive notice or have knowledge of a bankruptcy case in order to file a timely proof of claim, the IRS cannot be deprived of its right to share in the distribution from the bankruptcy estate. Therefore, when the IRS fails to file a proof of claim because it did not receive notice or have knowledge of the bankruptcy proceedings, the distributions that the IRS receives from the bankruptcy estate may not be subordinated to timely filed non-priority unsecured claims.⁵⁹⁸ Courts applying the pre-1994 version of 11 U.S.C. §726(a) have held that a priority tax claim against a Chapter 7 debtor is not barred despite its untimeliness.⁵⁹⁹ Other courts have held the IRS to a strict time limit for filing proofs of claims in Chapter 13 cases.⁶⁰⁰ The Bankruptcy Reform Act of 1994 settled the matter by providing that unsecured creditors’ claims must be timely filed.⁶⁰¹

If the IRS files a timely proof of claim in the taxpayer’s bankruptcy proceedings, an often-raised issue is whether the IRS can amend the claim after the bar date has lapsed. In determining whether to allow post-bar date amendments to a timely filed proof of claim, the bankruptcy courts follow equitable principles.⁶⁰² These principles require the courts to answer the following questions:

- Did the debtor and creditors rely on the earlier proof of claim or have reason to know that subsequent proofs of claims would be filed?
- Will other creditors receive a windfall if the amendment is disallowed?
- Did the IRS intentionally or negligently delay in filing the proof of claim at issue?

⁵⁹⁷ Bankruptcy Rule 3003(c)(3). See IRM 5.9.13.7.1(6) (09-02-22) for IRS internal guidance on bankruptcy notices received with insufficient time to file a timely proof of claim.

⁵⁹⁸ *United States v. Cardinal Mine Supply, Inc.*, 916 F.2d 1087 (6th Cir. 1990) (establishes a narrow exception for priority creditors who lack notice of the bankruptcy). See *IRS v. Hildebrand*, 2000-1 USTC ¶50,250 (M.D. Tenn. 2000) (IRS not automatically barred from filing claim where Chapter 13 debtors did not list IRS as creditor and IRS did not receive actual or constructive notice until after 180-day period prescribed in 11 U.S.C. §502(b)(9)), *appeal dismissed*, 248 F.3d 484 (6th Cir. 2001). For IRS procedures when a bankruptcy notice is received late or not at all, see IRM 5.9.17.8.9 (09-10-24).

⁵⁹⁹ *Cooper v. IRS*, 167 F.3d 857 (4th Cir. 1999) (claim that was both first-tier/priority and third-tier/untimely was properly categorized as first-tier/priority); *In re Davis*, 81 F.3d 134 (11th Cir. 1996); *In re Pac. Atl. Trading Co.*, 33 F.3d 1064 (9th Cir. 1994); *In re Vecchio*, 20 F.3d 555 (2d Cir. 1994); *Solow v. United States*, 99-1 USTC ¶50,460 (Bankr. N.D. Ill. 1999) (in absence of equitable subordination showing, pre-1994 11 U.S.C. §726(a)(1) accorded priority status to claim filed after bar date).

⁶⁰⁰ *In re Gardenhire*, 209 F.3d 1145 (9th Cir. 2000) (equitable tolling cannot be applied to extend 180-day period within which the IRS must file claim in Chapter 13 proceedings); *In re Osborne*, 76 F.3d 306 (9th Cir. 1996); *In re Chavis*, 47 F.3d 818 (6th Cir. 1995) (tardy IRS claim is disallowed); *In re Tomlan*, 907 F.2d 114 (9th Cir. 1990). See also CCA 200304009 (advising that equitable tolling is unlikely where the IRS had time to file claim or request extension despite lapse of 85 days between case dismissal and reinstatement). *Cf. In re Waindel*, 65 F.3d 1307 (5th Cir. 1995) (disallowing tardy IRS claim under first-tier, reasoning that IRS potentially entitled to only third-tier recovery).

⁶⁰¹ 11 U.S.C. §726(a).

⁶⁰² *In re Miss Glamour Coat*, 80-2 USTC ¶9737 (S.D.N.Y. 1980). *But see In Re Plunkett* 82 F.3d 738 (7th Cir. 1996); *In re Gilley*, 2003-1 USTC ¶50,156 (Bankr. M.D. Fla. 2002) (denial of amendment to IRS proof of claim to add additional tax period, as it did not relate back to originally filed claim); *In re Dietz*, 136 Bankr. 459 (Bankr. E.D. Mich. 1992).

- Was the IRS justified in failing to request an extension of the bar date?
- Does equity require the consideration of other factors?

The bankruptcy courts look to these factors in determining whether to allow the IRS's late-filed amendments to its proof of claim.⁶⁰³

d. Objections to Proof of Claim

Once the proof of claim has been filed, the claim is deemed to be allowed unless a party in interest timely objects.⁶⁰⁴ The two principal reasons for an objection to an IRS proof of claim are: (1) the tax claim has been improperly classified; and (2) the amount of the claim has been overstated.⁶⁰⁵ Classification of claims is discussed in VII.A.5., below.

The burden of proof lies with the debtor objecting to an IRS proof of claim. Even in a bankruptcy setting, the debtor, as taxpayer, must overcome the presumption of correctness that attaches to an IRS tax assessment. In addition, it may be necessary to object to an IRS proof of claim to avoid the possibility that the deemed allowance of the claim is *res judicata* with respect to any subsequent challenge to the amount of the liability set forth in the claim. Objections to the amount of the claim are discussed more fully in VII.F., below.

6. Classification of Tax Claims

Two of the most critical questions that arise in a bankruptcy proceeding are: (1) which taxes ultimately must be paid; and (2) in what priority must the tax and non-tax debts be paid. To answer these questions it is necessary to determine the classification of tax claims.

The first level of classification of tax claims distinguishes between pre-petition and post-petition claims. Pre-petition tax claims then are characterized as either secured or unsecured,

⁶⁰³ Amended claim allowed: *In re Tanaka Bros. Farm, Inc.*, 36 F.3d 996 (10th Cir. 1994) (IRS allowed to amend estimated proof of claim for employment taxes where claim was clearly an estimate and trustee knew that return had not been filed and that amended claim could be expected); *In re Unroe*, 937 F.2d 346 (7th Cir. 1991); *In re Jackson*, 541 Bankr. 887 (B.A.P. 9th Cir. 2015); *IRS v. Bondi's Valu-King, Inc.*, 126 Bankr. 47 (N.D. Ohio 1991); *In re Overly-Hautz Co.*, 57 Bankr. 932 (Bankr. N.D. Ohio 1986), *aff'd*, 81 Bankr. 434 (N.D. Ohio 1987) (amendments allowed if reasonable relationship to original shown).

Amended claim not allowed: *In re Stavriotis*, 977 F.2d 1201 (7th Cir. 1992) (amendment not allowed where original claim was for \$11,000 and amended claim exceeded \$2.4 million; dramatic increase held unfair surprise to other creditors); *In re Nalle*, 125 Bankr. 164 (Bankr. W.D. Tex. 1991) (failure of IRS employees to examine all schedules attached to Chapter 11 petition bars amendment).

⁶⁰⁴ 11 U.S.C. §502(a). The Bankruptcy Code permits bankruptcy courts to determine the amount or legality of taxes assessed against the debtor; however, the courts cannot alter or supplant the substantive law under which the tax claim arises. *Raleigh v. Ill. Dep't of Revenue*, 530 U.S. 15 (2000) (bankruptcy does not alter the burden imposed by the substantive law); *United States v. Charlton*, 2 F.3d 237 (7th Cir. 1993); *In re Landbank Equity Corp.*, 973 F.2d 265 (4th Cir. 1992) (Bankruptcy Code does not shift burden of proving bad debts to IRS); *Resyn Corp. v. United States*, 851 F.2d 660 (3d Cir. 1988) (burden of proof lies with the debtor objecting to the IRS's proof of claim).

⁶⁰⁵ For example, in *In re Thomas*, 246 Bankr. 500 (E.D. Pa. 2000), the Chapter 13 debtor objected that the secured amount of the IRS's claim had to be reduced to the value of the collateral — the liquidation value of the debtor's business. However, the district court upheld the bankruptcy court determination that the value of the IRS's secured claim in the debtor's interest in the business was based on its value as a going concern, including its goodwill that was not so personal to the debtor that it could not be transferred.

with the unsecured claims further divided into priority claims and general unsecured claims. Post-petition tax claims are classified as administrative or non-administrative claims.

Taxes are deemed to be pre-petition claims if the taxable year for the taxes ends before the taxpayer files the bankruptcy petition. Certain taxes, such as employment taxes, are considered to be divisible taxes, since the taxes actually are imposed on each employee. The claim for divisible taxes is a pre-petition claim if the tax is incurred (i.e., the wages are paid) prior to the filing of the bankruptcy petition.⁶⁰⁶ An individual debtor in a Chapter 7 or Chapter 11 case can terminate a tax year under §1398(d)(2) on the day before the bankruptcy petition is filed, so that the tax due for that terminated year is treated as a pre-petition tax claim.⁶⁰⁷

a. Secured Claims

(1) General Rule

Pursuant to 11 U.S.C. §506, the filing of the Notice of Federal Tax Lien (NFTL) gives the IRS a secured claim for the amount of its interest in the value of the taxpayer-debtor's property. To be a secured claim, the creditor must be secured by a lien on property in which the estate has an interest.⁶⁰⁸ A pre-petition levy on property also may create a secured claim up to the value of the IRS's interest in the property as of the date the levy was served.⁶⁰⁹ Even before the NFTL is filed, §6321 creates a lien on property or rights to property of the debtor. This lien constitutes a statutory lien (as described under 11 U.S.C. §101(53)), which technically makes the tax claim a secured claim to the extent of the lien's interest in the value of the debtor's property, regardless of whether the NFTL has been filed. Nevertheless, the trustee of the bankruptcy estate can avoid a lien if no NFTL has been filed pre-petition. Because the unperfected federal tax lien is so easily avoided, the IRS does not usually list an assessed liability for which no NFTL has been filed as a secured claim.

The value of a secured claim is determined by taking into account the valuation's purpose and the proposed disposition or use of the collateral, in conjunction with any hearing on the disposition or use or on a plan affecting the secured creditor's interest.⁶¹⁰ The Supreme Court held that the appropriate standard in valuing collateral intended to be retained by the debtor is the replacement-value standard, which is the "price that a willing buyer in the debtor's trade, business, or situation would pay to obtain like property from a willing seller."⁶¹¹

⁶⁰⁶ *In re Bellus*, 125 F.3d 821 (9th Cir. 1997).

⁶⁰⁷ See VII.G., below.

⁶⁰⁸ *Persky v. United States*, 98-2 USTC ¶50,786 (E.D. Pa. 1998) (lien on spendthrift trust that is excluded from bankruptcy estate is not secured claim for purposes of former 11 U.S.C. §109(e)). See *United States v. Snyder*, 343 F.3d 1171 (9th Cir. 2003) (because debtor's interest in ERISA-qualified plan is not property of bankruptcy estate under 11 U.S.C. §541(c)(2), IRS's lien on that interest is not a secured claim under §506(a)).

⁶⁰⁹ *United States v. Barbier*, 896 F.2d 377 (9th Cir. 1990) (value of IRS's interest secured by NFTL includes any property exempt from levy under §6334). See also CCA 199945042.

⁶¹⁰ 11 U.S.C. §506(a)(1).

⁶¹¹ See *Assocs. Com. Corp. v. Rash*, 520 U.S. 953, 960 (1997); *In re Vallot*, No. 20-12108, 2021 BL 409404 (Bankr. E.D. La. Oct. 25, 2021) (where IRA is to be retained by debtors, IRA should be valued at current value under *Rash*; where IRA is to be liquidated by debtors, IRA should be valued at liquidation value).

The IRS is not entitled to secured status in a bankruptcy case solely by virtue of its secured status in an earlier bankruptcy case, and therefore must file an amended proof of claim reclassifying its claims into priority claims under 11 U.S.C. §507(a)(8).⁶¹²

One issue that may arise in a Chapter 7 case is the interplay of the priority distribution scheme under 11 U.S.C. §506 and the sale provisions of 11 U.S.C. §363. In *Liebowitz v. Kalamata Capital Grp. (In re Gayety Candy Co.)*,⁶¹³ the bankruptcy court was faced with determining the extent to which the Illinois Department of Revenue could assert a right to 11 U.S.C. §363 sale proceeds that was higher in priority than the IRS's secured claims. The IRS had two tax liens totaling \$178,000 against the debtor that had been recorded before the debtor filed for bankruptcy. A few months after the filing, the bankruptcy trustee sold all of the debtor's assets in accordance with 11 U.S.C. §363, netting \$52,000. The state also made a claim for unpaid withholding and income tax incurred before the bankruptcy filing.

As a preliminary matter, the court first addressed the applicability of the Illinois income and retailer's occupation tax acts and the Illinois bulk sales act. Although finding that the various state statutory schemes applied, the right afforded to the state revenue authority under its bulk sales provisions remained subject to the priority scheme of the Bankruptcy Code. Addressing the IRS's claims for unpaid taxes, the court concluded that there was no question that the IRS had both a priority unsecured claim and a secured claim far in excess of the bulk sale proceeds as a whole pursuant to 11 U.S.C. §506(a)(1), and, but for the effect of the sale order, was entitled to judgment in its favor. Addressing the state's claim for unpaid taxes, the court concluded that the state had not established that it was entitled to be treated as a secured creditor in the instant case, and, as such, the court did not need to address whether the state had a lien arising directly out of either the Illinois Income Tax Act or the Retailer's Occupation Tax Act. At most, the state had unsecured claims afforded a priority in bankruptcy under 11 U.S.C. §507(a)(8). Although finding that the state did have a right to assert successor liability under the state's bulk sales act provisions and was entitled to seek adequate protection under 11 U.S.C. §363(e), the state failed to meet the standards set forth in two other relevant cases addressing sale orders under 11 U.S.C. §363(f), and thus was not entitled to adequate protection of equal or higher priority than other creditors with an interest in the assets, including the IRS.⁶¹⁴

(2) Nonpecuniary Loss Penalties

In Chapter 7 cases, the trustee can avoid a nonpecuniary loss penalty set forth in a validly filed NFTL.⁶¹⁵ While the general rule is that a tax lien cannot be avoided, 11 U.S.C. §726(a)

tion value (i.e., funds remaining upon liquidation after paying early-withdrawal penalties)).

⁶¹² See *In re Offshore Diving and Salvaging, Inc.*, 98-2 USTC ¶50,593 (Bankr. E.D. La. 1998).

⁶¹³ 625 B.R. 390 (Bankr. N.D. Ill. 2021).

⁶¹⁴ See *Ill. Dept. of Revenue v. Hanmi Bank*, 894 F.3d 465 (7th Cir. 2018), affirming order in *In re Elk Grove Vill. Petroleum, LLC*, 562 B.R. 708 (Bankr. N.D. Ill. 2016) (unpub. op.).

⁶¹⁵ 11 U.S.C. §724(a), §726(a)(4). See *Holloway v. IRS*, 340 F.3d 705 (8th Cir. 2003).

(4) provides that in Chapter 7 proceedings, a perfected tax lien can be avoided if the lien secures the IRS's claim for: (1) any fine, penalty, or forfeiture; or (2) multiple, exemplary, or punitive damages arising before the earlier of the order for relief or the appointment of the bankruptcy trustee, to the extent that the forfeiture or damages do not compensate the IRS for an actual pecuniary loss and the encumbered property is not exempted by the debtor.⁶¹⁶ Therefore, if the perfected lien secures a pecuniary loss penalty (e.g., the §6672 Trust Fund Recovery Penalty), the lien cannot be avoided under 11 U.S.C. §724(a).⁶¹⁷

Comment: The purpose of 11 U.S.C. §724(a) is to protect unsecured creditors from the debtor's misconduct. By permitting the trustee to avoid a lien that secures a claim for a forfeiture or penalty (to the extent that the claim is not compensation for actual pecuniary loss), creditors are not punished for the debtor's wrongdoing. Therefore, if a lien securing the IRS's claim for a nonpecuniary loss penalty encumbers exempt property (such as the debtor's house which is exempted from the bankruptcy estate under state law homestead provisions), there is no reason to avoid the lien, since the unsecured creditors' claims are not collectible out of exempt property.⁶¹⁸

In *United States v. Hutchinson*,⁶¹⁹ a U.S. district court upheld the bankruptcy court's denial of the government's motion to abandon property of the bankruptcy estate based on the determination that avoided and preserved penalty portions of liens provided value to the estate. The property at issue was encumbered beyond its fair market value. The question presented was whether the tax and interest portions of the IRS's tax liens take a higher priority over the penalty portions of the liens, despite each lien consisting of tax, interest, and penalties at recording. The court concluded that they do not.

The government argued that the tax and interest portions receive distributions first, given their priority order under 11 U.S.C. §724(b). If that argument were accepted, then the potential value to the estate from sale of the property would have to be evaluated in light of each of the five secured tax balances with interest, before looking to the penalty portions. Under this theory of the appropriate distribution, the property would have inconsequential value to the estate because proceeds from the disposition of the property would not be sufficient to satisfy the

⁶¹⁶ Lien avoidance under 11 U.S.C. §724(a) requires that the lien at issue secure a claim specified in 11 U.S.C. §726(a)(4), which itself describes how property of the bankruptcy estate should be distributed to creditors. In other words, 11 U.S.C. §724(a) concerns the trustee's avoidance of qualifying liens attached to the property of the bankruptcy estate at the time of distribution. Lien avoidance is unavailable in situations where the encumbered property interest is exempted (therefore withdrawn) from the bankruptcy estate, and thus from the reach of the trustee for distribution to creditors. See *United States v. Warfield (In re Tillman)*, 53 F.4th 1160 (9th Cir. 2022) (in case of first impression, 9th Circuit concludes that a trustee may not use 11 U.S.C. §724(a) and 11 U.S.C. §551 to avoid and preserve a tax penalty lien on debtor's exempt property for benefit of the bankruptcy estate).

⁶¹⁷ In general, nonpecuniary loss penalties that relate to nondischargeable tax claims are also nondischargeable; therefore, the debtor remains liable for such penalties notwithstanding the avoidance of the lien under 11 U.S.C. §724(a).

⁶¹⁸ *In re Carlton*, 82-1 USTC ¶9400 (D.N.M. 1982). See also *In re Gerulis*, 85-2 USTC ¶9753 (Bankr. D. Minn. 1985) (disagreeing with *Carlton* on the proper interpretation of 11 U.S.C. §724(a), but nevertheless holding that under 11 U.S.C. §522(c)(2)(B), court lacked power to avoid tax lien on exempt property since NFTL had been properly filed).

⁶¹⁹ 615 B.R. 596 (E.D. Cal. 2020).

tax and interest portion of each of the five IRS liens. Thus, with no funds remaining to pay unsecured creditors, the sale of the property would not benefit the estate.

The bankruptcy trustee argued that the distribution order of the IRS liens is determined solely by the liens' recordation dates relative to one another, i.e., which lien is senior and which lien is junior. Because each of the five IRS liens contained both an avoidable portion and a portion that could not be avoided, under the trustee's theory, the first lien's avoidable portion (penalties) is preserved for the benefit of the estate and deducted from any sale proceeds at the time the tax and interest portions of the liens receive distributions. This process is repeated for the remaining liens, or until the time when all property sale funds are exhausted. Therefore, according to the trustee, the sale of the property would result in funds for distribution to unsecured creditors.

The court reasoned that because the trustee's ability to avoid liens for penalties arises by operation of the bankruptcy code (11 U.S.C. §724(a)), the trustee steps into the shoes of the holder of the avoided lien, and the lien's priority remains the same as it was with respect to other liens before avoidance. Thus, the court concluded that preserving the avoided portion of each lien leaves funds available for distribution to unsecured creditors, making the avoided and preserved penalty portions of liens valuable to the estate. Accordingly, court upheld the bankruptcy court's denial of the government's motion to abandon property of the bankruptcy estate based on the determination that avoided and preserved penalty portions of liens provided value to the estate.

There are no provisions similar to 11 U.S.C. §724(a) (i.e., providing for the avoidance of federal tax liens securing penalties or forfeitures) under Chapter 11 or 13 of the Bankruptcy Code. However, most nonpecuniary loss penalties need not be paid under a confirmed Chapter 11 or 13 plan.

(3) Equitable Subordination

Under the doctrine of equitable subordination, innocent unsecured creditors are to be protected from the debtor's misconduct. The doctrine of equitable subordination generally is triggered by a showing that a claimant has engaged in some type of inequitable conduct and that the misconduct causes injury to other creditors or gives the claimant an unfair advantage. Significantly, 11 U.S.C. §510(c) — which adopts the doctrine of equitable subordination — further provides that the doctrine cannot contravene the provisions of the Bankruptcy Code. The Supreme Court has ruled that while bankruptcy courts are courts of equity, they are not free to adjust legally valid claims of an innocent party who asserted a claim in good faith merely because the courts perceive the results to be inequitable.⁶²⁰

(4) Setoff

Setoff allows parties to subtract a receivable from an amount payable to a creditor and pay the balance. Debts cannot be setoff in bankruptcy unless they are mutual. To be mutual, debts do not have to arise from the same transaction, but they

must involve the same two parties. Where there are two federal agencies involved (one of which is the IRS), these agencies are treated as a single entity for setoff purposes.⁶²¹

A secured tax claim can be setoff under 11 U.S.C. §553. This claim constitutes a secured claim up to the amount that can be set off.⁶²²

If the IRS owes the debtor money, the IRS is able to apply amounts owed to the debtor to the debtor's Federal tax debt.⁶²³ The IRS may request relief from the automatic stay to offset such amounts owed.⁶²⁴ As a prerequisite for offset, the debts must be valid, enforceable, mutual, and liquidated.⁶²⁵ A setoff may be performed retroactively if necessary or appropriate to carry out provisions of the Bankruptcy Code.⁶²⁶

⁶²¹ *In re HAL, Inc.*, 122 F.3d 851 (9th Cir. 1997) (federal agencies are single entity for setoff purposes); *In re Lopes*, 211 Bankr. 443 (D.R.I. 1997), rev'd 197 Bankr. 15 (Bankr. D.R.I. 1996).

⁶²² 11 U.S.C. §506.

⁶²³ 11 U.S.C. §553; *Copley v. United States*, 959 F.3d 118 (4th Cir. 2020) (plain language of §6402(a) and 11 U.S.C. §553(a) provide that right of setoff is not affected by debtors' attempt to claim pre-petition refund as exempt property in accordance with state law), *vacating and remanding* 591 B.R. 263 (E.D. Va. 2018); *In re Pigott*, 330 B.R. 797 (S.D. Ala. Aug. 5, 2005) (tax overpayment by debtors does not necessarily amount to refund which can be exempted from liability for discharged debts until after IRS has exercised its right of setoff); CCA 200235024 (refund generated by carryback of net operating loss from year of bankruptcy petition to pre-petition year is pre-petition obligation for purposes of set-off). The IRS is essentially afforded the same status as a secured creditor but is subject to the automatic stay. See 11 U.S.C. §362(a)(7), §506(a). See also *Wood v. HUD (In re Wood)*, 993 F.3d 245 (4th Cir. 2021) (government right to offset debtor's overpayment of tax under §6402(a) is unaffected by the debtor's attempts to claim overpayment as exempt property where obligation to government is non-tax obligation).

⁶²⁴ See, e.g., *United States v. Gordon Sel-Way Inc. (In re Gordon Sel-Way Inc.)*, 270 F.3d 280 (6th Cir. 2001) (IRS may offset post-petition unemployment tax refund owed to debtor against unemployment tax penalties owed to IRS under Chapter 11 plan because debt to IRS became post-petition obligation when it was not discharged in the Chapter 11 plan); *In re Bare*, 284 B.R. 870 (Bankr. N.D. Ill. 2002) (automatic stay lifted to allow set-off of overpayment against pre-petition taxes); *United States v. Offord Fin., Inc. (In re Medina)*, 205 B.R. 216 (B.A.P. 9th Cir. 1996) (tax debt offset against funds payable to debtor pursuant to USDA contract); *Goldman v. United States (In re Schield)*, 242 B.R. 1 (Bankr. C.D. Cal. 1999) (IRS granted relief from automatic stay and approval of set-off of pre-petition tax overpayment against debtor's pre-petition tax debt). But see *United States v. Reynolds*, 764 F.2d 1004 (4th Cir. 1985) (disallowing set-off in Chapter 13 proceeding where adequate protection provided by confirmation plan); *In re Shultz*, 95 A.F.T.R. 2d 2005-2277 (Bankr. N.D. Ohio 2005) (IRS denied relief from automatic stay to set off tax liability in Chapter 13 proceeding where debtor was in compliance with confirmed plan provisions to pay IRS), *aff'd*, *United States v. Schultz (In re Schultz)*, No. 05-8038 (B.A.P. 6th Cir. May 19, 2006).

⁶²⁵ 11 U.S.C. §553. See *Handelsman v. Johnson (In re Handelsman)*, No. 07-15901 (9th Cir. Dec. 5, 2008) (debtor's short-capital loss carryover did not give rise to enforceable claim against government and, thus, could not offset tax debt); *In re Richards*, 616 B.R. 879 (Bankr. S.D. Ind. 2020) (IRS denied set-off for pre-petition taxes owed against refund generated by post-petition refund attributable to sale of farm assets in Chapter 12 bankruptcy as set-off was not among mutual pre-petition obligations as was not provided for in plan); *United States v. Heilig-Meyers Co.*, No. 3:01CV808 (E.D. Va. 2003) (IRS denied relief from automatic stay to offset tax refund against an unassessed tax liability).

⁶²⁶ *United States v. Mackenzie*, No. CV-22-00461-PHX-DWL, 2023 BL 107497 (D. Ariz. Mar. 30, 2023) (11 U.S.C. §105(a) grants bankruptcy court equitable power to issue any order that is necessary or appropriate to carry out Bankruptcy Code provisions, including retroactively correcting a misunderstanding as to a party's request or position). Such retroactive relief under 11 U.S.C. §105(a) is not confined to matters concerning setoffs. See e.g., *Pac. Shores Dev., LLC v. At Home Corp. (In re At Home Corp.)*, 392 F.3d 1064 (9th Cir. 2004) (retroactive lease rejection necessary and appropriate to carry out provisions of Bankruptcy Code).

⁶²⁰ 11 U.S.C. §510(c)(1). See *United States v. Noland*, 517 U.S. 535 (1996) (equitable subordination not allowed for penalty entitled to first priority as administrative expense).

(5) *Interest*

The holder of a secured claim generally is entitled to pre-petition interest on the claim to the extent of the value of the security.⁶²⁷ The IRS also is entitled to post-petition interest on its secured claim to the extent that the claim is oversecured.⁶²⁸ Even if the post-petition interest is not paid through the bankruptcy proceeding, the interest remains the personal liability of the debtor and can be collected from the debtor's non-bankruptcy assets if the underlying tax obligation is nondischargeable.⁶²⁹ The IRS generally is entitled to post-petition interest on the nondischargeable taxes from the date of the debtor's filing, subject to proper crediting of interim payments, and with interest accruing only on the remaining balance.⁶³⁰ The interest rate is generally the IRS statutory rate.⁶³¹

(6) *Undersecured Claim*

If no NFTL has been filed before the bankruptcy petition is filed, the IRS treats the underlying pre-petition tax liability as an unsecured claim. The tax claim also is unsecured to the extent that the amount of a secured tax claim, represented by a filed NFTL, exceeds the equity in the bankruptcy estate's property encumbered by the NFTL.⁶³² The equity determination is based on the property's fair market value.⁶³³ When a secured claim in a Chapter 7 case exceeds the value of the encumbered

⁶²⁷ 11 U.S.C. §506(b). See also *In re Best Repair, Inc.*, 789 F.2d 1080, 1081 n.1 (4th Cir. 1986). Fair market value — not forced sale value — is the proper measure of the value of the IRS's secured claim when a taxpayer/debtor retains possession of a residence. Moreover, the costs of sale should not be deducted when the debtor retains possession of the house. *In re Taffi*, 96 F.3d 1190 (9th Cir. 1996) (en banc). But see *In re Mitchell*, 954 F.2d 557 (9th Cir. 1992) (selling costs subtracted in determining valuation of debtor's automobile).

⁶²⁸ *In re Ron Pair Enters., Inc.*, 489 U.S. 235 (1989), rev'g 828 F.2d 367 (6th Cir. 1987); *In re Lapiana*, 909 F.2d 221 (7th Cir. 1990).

⁶²⁹ *Bruning v. United States*, 376 U.S. 358 (1964). *Bruning*, a pre-1994 Bankruptcy Act case, appears to remain good law under the Bankruptcy Code. *In re Tuttle*, 291 F.3d 1238 (10th Cir. 2002) (after confirmation and completion of Chapter 11 plan, debtor still personally liable for interest accruing between petition filing and plan confirmation dates on unsecured claim deemed nondischargeable tax debt); *In re Hanna*, 872 F.2d 829 (8th Cir. 1989). See *In re Matunas*, 2001-2 USTC ¶50,537 (Bankr. D.N.J. 2001) (characterizing debtor's payment in excess of liability covered by stipulation agreement as an overpayment which could be put toward payment of remaining post-petition interest liability). See also *United States v. Victor*, 121 F.3d 1383 (10th Cir. 1997) (while "interest that accrues on a nondischargeable tax debt is an integral part of an underlying tax claim and is generally treated the same as the original claim," the IRS, which neither asserted a claim for gap interest — interest that accrues post-petition but before confirmation of the reorganization — nor objected to confirmed plan which did not address it, was not entitled to gap interest in Chapter 11 case involving oversecured claim that did not qualify as nondischargeable debt). Collection directly from the debtor is subject to the §6502 statute of limitations on collection as extended by §6503(i).

⁶³⁰ See *In re Johnson*, 146 F.3d 252 (5th Cir. 1998); *In re Stacy*, 249 Bankr. 683 (Bankr. W.D. Va. 2000).

⁶³¹ 11 U.S.C. §511(a). See *United States v. W.R. Grace & Co.*, 122 AFTR 2d 2018-5955 (D. Del. 2018) (lower interest rate in confirmed bankruptcy plan controlled; IRS not entitled to higher statutory rate).

⁶³² *Dewsnup v. Timm*, 502 U.S. 410 (1992) (when secured claim exceeds value of encumbered property, lien cannot be "stripped down" to property's value). See *In re Hoekstra*, 255 B.R. 285 (E.D. Va. 2000) (Chapter 7 debtors may not void a portion of IRS lien where residence, taking into account prior valid liens, has no value but debtors' personal property has value). But cf. *In re Black*, 99-1 USTC ¶50,156 (Bankr. D. Ariz. 1998) (IRS lien could be stripped off or avoided through Chapter 12 confirmed plan provisions).

⁶³³ *In re Taffi*, 68 F.3d 306 (9th Cir. 1995), *aff'd* en banc, 96 F.3d 1190 (9th Cir. 1996).

property, the lien cannot be "stripped down" to the property's value.⁶³⁴ However, it may be possible to strip down the lien in a Chapter 11 or Chapter 13 case.⁶³⁵

b. *Unsecured Priority Claims*(1) *General Rule*

Unsecured claims consist of priority claims and general unsecured claims. Priority tax claims generally are entitled to eighth priority among the priority claims. A limited third priority tax claim applies to withheld taxes on pre-petition wage claims that were earned within 90 days before the earlier of: (1) the filing of the bankruptcy petition; or (2) the date the debtor's business ceased.⁶³⁶

The eighth priority tax claims consist of:

- income or gross receipts taxes for a tax year for which a tax return was due (including extensions) within three years before the filing of the bankruptcy petition,⁶³⁷

⁶³⁴ *Dewsnup v. Timm*, 502 U.S. 410 (1992); *In re Geisler*, 539 Bankr. 253 (W.D. Pa. 2015).

⁶³⁵ *In re Rodriguez*, No. 13-31164-TJC, 2015 BL 131910 (Bankr. D. Md. May 5, 2015) (Individual Chapter 11); *In re Dever*, 164 Bankr. 132 (Bankr. C.D. Cal. 1994) (Chapter 11); *In re Bellamy*, 962 F.2d 176 (2d Cir. 1992) (Ch. 13); *In re Walker*, No. 17-36804 (CGM), 2018 BL 279456 (Bankr. S.D.N.Y. Aug. 6, 2018) (Ch. 13).

⁶³⁶ 11 U.S.C. §507(a)(3), 11 U.S.C. §346(f); *Otte v. United States*, 419 U.S. 43 (1974).

⁶³⁷ See *In re Borck*, 81 Bankr. 142 (Bankr. S.D. Fla. 1987). However, a taxpayer cannot file a Form 4868 request for an automatic extension of the return filing deadline, then, in a Chapter 11 proceeding, attempt to invalidate the extension based on an inaccurate estimate to have the taxes fall outside of the three-year time period. *In re Kimball*, 2002-1 USTC ¶50,307 (D. Mass. 2002). See *In re McDermott*, 286 B.R. 913 (M.D. Fla. 2002) (tax obligation not dischargeable in Chapter 7 bankruptcy filed three years and two weeks after April 15th filing of both extension request and tax return). Taxes due more than three years before the petition date for which the tax return was not filed or was late filed within two years of the filing of the bankruptcy petition, or the tax return was fraudulent, are specifically: (1) excluded from the priority classification; but (2) included in the nondischargeable tax category, discussed in VII.C.1., below. Another issue is whether the shared responsibility payment under the Affordable Care Act is considered to be a penalty rather than a tax and thus not included in this category. Courts have held that the shared responsibility payment is a tax measured by income within the meaning of 11 U.S.C. §507(a)(8)(A), but is not an excise tax on a transaction under 11 U.S.C. §507(a)(8)(E). See, e.g., *IRS v. Juntoff (In re Juntoff)*, 76 F.4th 480 (6th Cir. 2023) (§5000A individual shared responsibility payment is a "tax" for purposes of 11 U.S.C. §507(a)(8)); *United States v. Alicea*, 58 F.4th 155 (4th Cir. 2023) (holding that §5000A shared responsibility payment is a tax measured by income, which entitled the government's claim to priority); *In re Szczyporski*, 34 F.4th 179 (3d Cir. 2022) (disagreeing with district court and bankruptcy court that *National Federation of Independent Business v. Sebelius*, 567 U.S. 519 (2012) is controlling, but agreeing that shared responsibility payments for failure to maintain qualifying health insurance are taxes entitling IRS claims for such payments to priority in bankruptcy), *aff'd* 531 F. Supp. 3d 934 (E.D. Pa. 2021) (§5000A individual shared responsibility payment is a tax for purposes of the Bankruptcy Code; payment is an income tax entitled to priority treatment in bankruptcy); *United States v. Chesteen (In re Chesteen)*, 799 Fed. Appx. 236 (5th Cir. 2020) (individual shared responsibility payment is not entitled to bankruptcy priority as an "excise tax on a transaction" under 11 U.S.C. §507(a)(8)(E)(i)); *IRS v. Huenerberg*, 623 B.R. 841 (E.D. Wis. 2020) ("excise tax on a transaction" under 11 U.S.C. §507(a)(8)(E)(i) is based on affirmative act like purchasing goods or services whereas individual shared responsibility payment is based on failure to act — i.e., failure to buy health insurance; thus, shared responsibility payment is not a "excise tax on a transaction" for purposes of 11 U.S.C. §507(a)(8)(E)(i)); *In re Albracht*, 617 B.R. 851 (Bankr. E.D.N.C. 2020) (§5000A individual shared responsibility payment is a penalty rather than a tax; even if the payment is a tax, it is not an excise tax on a transaction).

- income or gross receipts taxes for which an assessment was made within 240 days before the filing of the bankruptcy petition (plus, if an offer in compromise has been pending during the 240-day period, the time the offer is pending plus 30 days);⁶³⁸
- unassessed income or gross receipts taxes that are assessable, under the applicable statute of limitations on assessment, as of the bankruptcy petition date;⁶³⁹
- all taxes required to be collected or withheld (e.g., trust fund employment taxes) for which debtor is liable in any capacity, including liability under §6672 for the trust fund recovery penalty;⁶⁴⁰
- an employment tax (e.g., the employer's share of employment taxes) on wages earned from the debtor before the filing of the bankruptcy petition and for which the tax return was due (including extensions) within three years before the filing of the bankruptcy petition;
- certain customs duties and property and excise taxes;⁶⁴¹
- a pecuniary loss penalty relating to one of the taxes specified above (such as the trust fund recovery penalty);
- gap claims (i.e., claims arising in the ordinary course of the debtor's business after the filing of an involuntary bankruptcy petition but before the earlier of the appointment of the trustee or the order for relief);⁶⁴²
- an erroneous refund claim if the tax to which it relates would be a priority claim;⁶⁴³ and

- transferee liability for a priority tax in some instances.⁶⁴⁴

The 2005 Bankruptcy Act added a provision that substantially altered the priority tax determination. For bankruptcy cases filed on or after October 17, 2005, a provision tolls *all* of the time periods set forth above for the time that the IRS is prohibited from collection by any applicable nonbankruptcy law or certain prior bankruptcy cases. This includes a collection due process (CDP) or other appeal that bars collection by levy or a prior bankruptcy automatic stay or stay resulting from a confirmed plan for the period of the prohibition plus 90 days.⁶⁴⁵ Before this change, a CDP appeal had no apparent effect on the priority time periods and the effect of a prior bankruptcy case was unclear.⁶⁴⁶

(2) Interest

While the literal language of 11 U.S.C. §507(a)(8) does not provide for interest, the courts generally have treated pre-petition interest on priority taxes as a priority claim.⁶⁴⁷

Post-petition interest on priority tax claims and on other unsecured or undersecured tax claims generally is not considered allowable although payment of an interest component on priority taxes is a condition to obtaining confirmation of a Chapter 11 plan.⁶⁴⁸ Since priority tax claims are typically nondischargeable, the post-petition interest is usually collectable after the bankruptcy.

c. General Unsecured Claims

If an unsecured pre-petition tax claim is not a priority claim, it is classified as a general unsecured claim. General unsecured tax claims receive the same treatment as other creditors' unsecured nonpriority claims. Nonpecuniary loss penalties (e.g., the fraud or late-filing penalty) can be treated as general unsecured claims even if they relate to a priority claim.⁶⁴⁹

⁶³⁸ Before the 2005 Bankruptcy Act, the offer in compromise had to be filed during the 240-day period for the tolling to occur. *In re Aberl*, 78 F.3d 241 (6th Cir. 1996) (where offer in compromise made before IRS makes official assessment, 240-day period is not tolled); *In re Nader*, 99-2 USTC ¶50,824 (Bankr. E.D. Pa. 1999) (taxes assessed during pendency of appeal from rejection of offer in compromise held nondischargeable priority claims); *In re Genung*, 220 B.R. 505 (Bankr. N.D.N.Y. 1998) (period offer is pending includes duration of appeal of rejected offer); *In re Romagnolo*, 195 B.R. 801 (Bankr. M.D. Fla. 1996) (unprocessable offer does not suspend 240-day period). See also *In re Saunders*, 2004-1 USTC ¶50,140 (Bankr. S.D. Fla. 2003) (taxes treated as nondischargeable due to error in stipulation regarding period debtor's offer in compromise was pending). *But cf. In re Tecson*, 2003-1 USTC ¶50,466 (Bankr. M.D. Fla. 2003) (priority period is not tolled while case is pending in Tax Court).

⁶³⁹ *In re Franklin*, 78 Bankr. 118 (Bankr. E.D. Va. 1987) ("assessable" means that statute of limitations on assessment has not expired and includes extensions of statute of limitations from issuance of notice of deficiency).

⁶⁴⁰ *In re Mosbrucker*, 198 F.3d 250 (8th Cir. 1999) (unpub.), *aff'd* 227 B.R. 434 (B.A.P. 8th Cir. 1998). This category also includes liability for backup withholding under §3406. *In re Trypucko*, 96-1 USTC ¶50,268 (Bankr. C.D. Cal. 1995).

⁶⁴¹ See *United States v. Reorganized CF & I Fabricators of Utah, Inc.*, 518 U.S. 213 (1996) (tax imposed under §4971(a) on failure to satisfy minimum funding standards by tax-qualified pension plan is not an "excise tax" entitled to eighth priority, but is a penalty). See also *Workers' Compensation Trust Fund v. Saunders*, 234 Bankr. 555 (D. Mass. 1999) (state agency's worker's compensation recoupment claim not excise tax, because claim was discretionary and not uniformly asserted).

⁶⁴² 11 U.S.C. §507(a)(8), §502(f).

⁶⁴³ Bankruptcy Code §507(c) provides that the government's claim arising from an erroneous tax refund or credit has the same priority as the tax to which the refund or claim relates; therefore, if the debtor receives an erroneous "quickie" refund under §6411, the priority of the refund claim depends upon whether the subject tax (to which the refund relates) is entitled to priority under the provisions of the Bankruptcy Code. *Bleak v. United States*, 817 F.2d 1368 (9th Cir. 1987); *Darr v. United States (In re TelexFree)*, 615 B.R. 362 (Bankr.

D. Mass. 2020) (IRS claim for erroneous post-petition refund related to pre-petition tax claim denied; 11 U.S.C. §507(c) does not distinguish between erroneous tax refund payments made pre-petition and post-petition therefore IRS holds prepetition priority unsecured claim). *But see In re Frontone*, 301 Bankr. 290 (C.D. Ill. 2003) (erroneous refund claim is not the same as a tax claim for purposes of 11 U.S.C. §523(a)(1)(A)).

⁶⁴⁴ *In re McKowen*, 263 B.R. 618 (D. Colo. 2001), *aff'd*, 370 F.3d 1023 (10th Cir. 2004) (unpub.). *But see In re Kardash*, 573 Bankr. 257 (Bankr. M.D. Fla. 2017) (distinguishing *McKowen* based on the fact that the taxpayer in that case was the sole and controlling owner of the corporation and holding that transferee liability under §6901 for unpaid corporate income taxes is not the equivalent of a tax and not entitled to priority in a Chapter 11 bankruptcy proceeding (quoting *Baptiste v. Commissioner*, 29 F.3d 1533 (11th Cir. 1994))); *In re Pert*, 201 Bankr. 316 (Bankr. M.D. Fla. 1996) (holding that the transferee liability is separate and independent from the unpaid taxes and not excepted from discharge in a Chapter 7 bankruptcy proceeding (citing *Baptiste v. Commissioner*, 29 F.3d 1533 (11th Cir. 1994))).

⁶⁴⁵ 11 U.S.C. §507(a)(8).

⁶⁴⁶ See VII.C.1.a.(8), below, for further discussion of this issue under prior law.

⁶⁴⁷ *In re Garcia*, 955 F.2d 16 (5th Cir. 1992); *In re Larson*, 862 F.2d 612 (7th Cir. 1988); *In re Palmer*, 88 Bankr. 101 (N.D. Tex. 1988) (interest allowed as a pecuniary loss penalty); *United States v. H.G.D. & J. Mining Co., Inc.*, 74 Bankr. 122 (S.D. W. Va. 1986), *aff'd*, 836 F.2d 546 (4th Cir. 1987); *In re Brinegar*, 76 Bankr. 176 (Bankr. D. Colo. 1987) (interest allowed as part of the claim). *But see, e.g., Razorback Ready-Mix Concrete Co.*, 45 Bankr. 917 (Bankr. E.D. Ark. 1984) (later effectively overruled by *In re Stonecipher Distrib., Inc.*, 80 Bankr. 949 (Bankr. W.D. Ark. 1987)).

⁶⁴⁸ See *United Savings Ass'n of Texas v. Timbers of Inwood Forest Assoc. Ltd.*, 484 U.S. 911 (1988); 11 U.S.C. §1322(b)(10).

⁶⁴⁹ 11 U.S.C. §507(a)(8).

Nonpecuniary loss penalties on secured claims also can be general unsecured claims since the lien can be avoided with respect to the penalties.⁶⁵⁰

d. Post-Petition Administrative Claims

Under 11 U.S.C. §507(a)(1), administrative claims are entitled to first priority among all priority claims. For post-petition taxes, 11 U.S.C. §503 allows the IRS to file a request for payment of an administrative expense. Administrative expenses are defined to include: (1) a tax incurred by the estate, other than a priority claim under 11 U.S.C. §507(a)(8),⁶⁵¹ and (2) a tax attributable to an excessive allowance of a tentative carryback adjustment that the estate received (regardless of when the taxable year to which it relates ended).

Interest on an administrative tax claim can be recovered as an administrative expense.⁶⁵² In addition, penalties related to the administrative taxes generally have been held to constitute administrative claims.⁶⁵³

An individual debtor is not liable for the taxes incurred by the estate in either Chapter 7 or Chapter 11 cases because the estate is treated as a separate taxable entity by virtue of §1398.⁶⁵⁴ In a Chapter 13 case, however, it is the IRS position that post-petition taxes are not administrative claims because the Chapter 13 estate is not a separate taxpayer. Therefore, the post-petition tax liabilities remain the taxpayer's obligation.⁶⁵⁵

7. Priority for Payment

The priority of federal tax liens against competing creditors and other interests is discussed primarily in 637 T.M., *Federal Tax Collection Procedure — Liens, Levies, Suits, and Third-Party Liability*. However, this general priority scheme is superseded when the taxpayer-debtor files a bankruptcy petition. Chapter 7, Chapter 11, and Chapter 13 proceedings have slightly different priority rules and payment requirements before the confirmation of a plan of reorganization or discharge is allowed.

As a general rule, creditors holding secured claims are entitled to receive the value of their security first; then priority claims are paid in their order of priority under 11 U.S.C. §507;

and finally unsecured claims are paid before the balance — if any — is turned over to the debtor.

a. Chapter 7 Cases

Since Chapter 7 cases are liquidation proceedings, the priority of payment is critical. For a Chapter 7 case, 11 U.S.C. §724(b) provides that the property of the bankruptcy estate is distributed in the following order:

- first, to liens senior to the IRS's lien;
- second, to priority claims under 11 U.S.C. §507(a)(1) through 11 U.S.C. §507(a)(7), up to the amount of the IRS's secured tax liens;⁶⁵⁶
- third, to the IRS for the excess of the IRS's secured tax claims over the amount distributed pursuant to the second paragraph;
- fourth, to any secured claims junior to the secured tax claims;
- fifth, to secured tax claims to the extent these tax claims are not paid because of the payments made under the second paragraph; and
- sixth, to the bankruptcy estate for distribution under 11 U.S.C. §726.

In essence, 11 U.S.C. §724(b) subordinates the secured tax claim in favor of priority claims other than priority tax claims. In this regard, unsecured claimants step into the shoes of the IRS, and tax debts secured by a perfected NFTL are paid in an amount equal to the secured tax claim minus unsecured claims entitled to priority payments. Taxes claimed as administrative expenses, however, enjoy an elevated priority. In this context, the tax lien is a statutory tax lien, not a judicial lien securing the payment of taxes.⁶⁵⁷

After the priority for paying secured claims is determined, 11 U.S.C. §726 provides that the bankruptcy estate must be distributed in the following order:

- first, to priority claims in the order specified under 11 U.S.C. §507;
- second, to timely filed allowed unsecured claims (and late-filed claims) if: (1) the claim is filed late because the creditor lacked notice or knowledge of the bankruptcy proceeding to file a timely proof of claim;⁶⁵⁸ or (2) the claim is filed in time to permit the claim's payment (claims for nonpecuniary loss penalties are excluded from this priority category);
- third, to allowed unsecured claims that are tardily filed;
- fourth, to nonpecuniary loss penalties;
- fifth, to interest on the above claims; and
- sixth, to the debtor.⁶⁵⁹

⁶⁵⁰ 11 U.S.C. §724(a).

⁶⁵¹ 11 U.S.C. §1306; *In re Hillsborough Holdings Corp.*, 116 F.3d 1391 (11th Cir. 1997) (taxes on pre-petition income not entitled to administrative expense priority); *United States v. Redmond*, 36 Bankr. 932 (D. Kan. 1984). While taxes incurred by the bankruptcy estate are administrative expenses, taxes arising post-confirmation are not incurred by the estate and therefore are the personal liability of the debtor. See *In re Fullmer*, 962 F.2d 1463 (10th Cir. 1992).

⁶⁵² *United States v. Yellin*, 272 F.3d 39 (1st Cir. 2001); *In re Flo-Litner, Inc.*, 916 F.2d 363 (6th Cir. 1990); *United States v. Ledlin*, 886 F.2d 1101 (9th Cir. 1989); *United States v. Cranshaw*, 885 F.2d 837 (11th Cir. 1989); *United States v. Friendship Coll., Inc.*, 737 F.2d 430 (4th Cir. 1984). See *In re Preferred Door Co.*, 990 F.2d 547 (10th Cir. 1993). See also *In re Sun Cliffe, Inc.*, 92-2 USTC ¶50,577 (Bankr. D. Colo. 1992) (interest accruing on Chapter 11 administrative tax claim stops upon conversion to Chapter 7).

⁶⁵³ 11 U.S.C. §503(b)(1)(C). See *Nicholas v. United States*, 384 U.S. 678 (1966); *In re Allied Mechanical Services, Inc.*, 885 F.2d 837 (11th Cir. 1989); *In re Servint Corp.*, 298 Bankr. 579 (Bankr. E.D. Va. 2003) (penalties for failure to comply with EFT deposit requirements for payroll taxes due in post-petition tax periods are allowable as administrative expenses). But see §6658 for the rules concerning the relief available from post-petition penalties.

⁶⁵⁴ See VII.G., below, for further discussion.

⁶⁵⁵ CCA 200113027.

⁶⁵⁶ *Stubbs & Perdue, P.A. v. Angell*, 811 F.3d 166 (4th Cir. 2016) (pre-conversion Chapter 11 fees not allowed out of IRS secured claim in Chapter 7); *Barstow v. IRS*, 308 F.3d 1038 (9th Cir. 2002), cert. denied, 123 S. Ct. 2575 (2003).

⁶⁵⁷ *Barstow v. IRS*, 308 F.3d 1038 (9th Cir. 2002), cert. denied, 123 S. Ct. 2575 (2003).

⁶⁵⁸ See further discussion under VII.A.4.c., above.

b. Chapter 11 Cases

In a Chapter 11 case, the priority rules are directed at the amount of the claims and frequency of payments required to obtain confirmation of the plan of reorganization. A Chapter 11 plan usually allows for deferred payments of the allowed tax claims over a period of time, typically for six years after the date of assessment.

Creditors with secured claims are entitled to retain their liens while they receive deferred cash payments that total the allowed amount of their claims. The amount must equal at least the value of the secured claimant's interest in the property. In the alternative, the bankruptcy estate may apply to sell the collateral free and clear of the lien and cause the secured creditor's interest to attach to the sales proceeds in the same priority.⁶⁶⁰ In addition, if the secured claim would have been a priority tax claim but for the fact that it is secured, the secured claim must be paid on the same schedule as a priority claim.⁶⁶¹

Under 11 U.S.C. §1129, priority tax claims must be paid in an amount equal to the allowed claim (valued as of the effective date of the plan), in regular cash payments⁶⁶² over a period not to exceed five years after the date of the order for relief in a manner at least equivalent to the most favored nonpriority unsecured claim provided for by the plan. The priority tax payments must include "interest" so that the payments have a present value, as of the effective date of the plan, equal to the amount of the claim.⁶⁶³ Interest accruing from the petition date to the confirmation date generally need not be paid in full under the Chapter 11 plan.⁶⁶⁴

Note: A number of courts have addressed the issue concerning the appropriate interest or discount rate to be applied in determining the present value of the deferred payments. Historically, the IRS argued that the §6621 rate should be applied automatically, while debtors typically argued for a lower rate. The circuit courts considering this issue have held that while the §6621 rate is relevant in determining the appropriate interest rate, the bankruptcy court has the authority to consider other factors such as the prevailing market rates, the quality of the security, and the risk of default in establishing the proper rate.⁶⁶⁵

⁶⁵⁹ See IRM 5.9.6.19 (04-12-2024). The distribution does not affect the rights of a private secured party. If property in which a secured party has a lien is sold by the trustee, that creditor will be paid first from the sale proceeds after the expenses of the sale. IRM 5.9.6.19(2) (04-12-2024). However, if the NFTL has priority over the interest of a private secured party, the NFTL must be paid before the secured party depending on the calculation under 11 U.S.C. §724.

⁶⁶⁰ 11 U.S.C. §1129(b)(2)(A).

⁶⁶¹ 11 U.S.C. §1129(a)(9)(D).

⁶⁶² The term "deferred cash payments" does not mean equal monthly payments. See *In re Volle Elec., Inc.*, 132 Bankr. 365 (Bankr. C.D. Ill. 1991) (reorganization plan providing for monthly payments to IRS for four years and balloon payment at end of fourth year approved); *In re Snowden's Landscaping Co.*, 110 Bankr. 56 (Bankr. S.D. Ala. 1990).

⁶⁶³ 11 U.S.C. §1129(a)(9)(C); *United States v. Neal Pharmacal Co.*, 789 F.2d 1283 (8th Cir. 1986); *In re Southern States Motor Inns, Inc.*, 709 F.2d 647 (11th Cir. 1983); *In re Burgess Wholesale Mfg. Opticians, Inc.*, 721 F.2d 1146 (7th Cir. 1983).

⁶⁶⁴ 11 U.S.C. §1129(a)(7)(A)(ii). *In re Miller*, 289 Bankr. 121 (N.D. Cal. 2002).

⁶⁶⁵ *In re Camino Real Landscape Maint. Contractors, Inc.*, 818 F.2d 1503 (9th Cir. 1987); *United States v. Neal Pharmacal Co.*, 789 F.2d 1283 (8th Cir. 1986); *In re Southern States Motor Inns, Inc.*, 709 F.2d 647 (11th Cir. 1983). *But see In re Architectural Design, Inc.*, 86-1 USTC ¶9409 (W.D. Va. 1986)

This, however, may be a pyrrhic victory for the taxpayer. The §6621 rate is a floating rate equal to three percentage points above the rate on short-term Treasury obligations.⁶⁶⁶ Since the rate is based on Treasury obligations, minimal risk is factored into the rate. The market rate applicable to a bankrupt debtor actually may be higher than the §6621 rate.

General unsecured claims must receive an amount equal to what would have been received in a Chapter 7 liquidation.⁶⁶⁷ If some claims are impaired (i.e., there are insufficient assets to pay all of the claims in the class), the plan can be confirmed by "cram down" if one of the impaired classes of claims accepts the plan and either of the following are provided: (1) the unsecured claims receive payments with a present value equal to an amount those claims would receive in a Chapter 7 case; or (2) the holder of any claim that is junior to the unsecured claims does not receive or retain any interest under the plan.⁶⁶⁸ Except in the case of cram down, each class must accept the plan or be unimpaired for the plan to be confirmed.

Administrative claims must be paid in full as of the effective date of the Chapter 11 plan.⁶⁶⁹ Trust fund taxes due on priority wage claims under 11 U.S.C. §507(a)(3) must be satisfied with cash equal to the amount of the claim on the effective date of the plan.⁶⁷⁰

c. Chapter 13 Cases

Under the provisions of Chapter 13, a debtor must submit a plan that provides that future income will be paid on existing debts. The debts are then classified into three general categories: secured, priority, and general unsecured. The payment schemes for these categories provide that: (1) the secured debts must be paid to the extent of the property securing the debt; (2) priority debts must be paid in full; and (3) general unsecured debts must be paid only to the extent of the available future income remaining and dedicated to this purpose. A Chapter 13 debtor cannot change the classification of a debt from one category to another.⁶⁷¹

As with Chapter 11 cases, the priority of payment rules in Chapter 13 cases are prerequisites to the confirmation of the Chapter 13 plan. The plan must provide for payments⁶⁷² over a period not longer than three years, unless the court for cause approves a longer period not to exceed five years.⁶⁷³

(priority unsecured tax only); *In re Stafford*, 82-2 USTC ¶9706 (Bankr. C.D. Kan. 1982).

⁶⁶⁶ §6621(a)(2).

⁶⁶⁷ 11 U.S.C. §1129(a)(7)(A)(ii).

⁶⁶⁸ 11 U.S.C. §1129(a)(10), 11 U.S.C. §1129(b)(2)(B). See, e.g., *In re Minkoff*, 85 AFTR 2d 2000-449 (Bankr. D. Kan. 1999).

⁶⁶⁹ 11 U.S.C. §1129(a)(9)(A).

⁶⁷⁰ 11 U.S.C. §1129(a)(9)(B).

⁶⁷¹ See, e.g., *In re Deutchman*, 192 F.3d 457 (4th Cir. 1999) (cannot extinguish NFTL by "providing for" payment of claim as priority tax); *In re Bates*, 974 F.2d 1234 (10th Cir. 1992) (Chapter 13 plan must provide for full payment of priority tax debt; debtor cannot alter the classification from priority to general unsecured).

⁶⁷² Chapter 13 debtors are not required to pay the IRS's priority tax claims in equal monthly installments; the IRS only has a right to full payment during the life of the plan. *In re Ferguson*, 134 Bankr. 689 (Bankr. S.D. Fla. 1991).

⁶⁷³ 11 U.S.C. §1322(d). *In Pierrotti v. United States*, 645 F.3d 277 (5th Cir. 2011), the Fifth Circuit rejected a debtor's attempt to "modify" the IRS's secured claims for long-overdue tax deficiencies into long-term debt payable over a period of 15 years under 11 U.S.C. §1322(b) because the tax deficiencies

Under the Chapter 13 plan, the secured claimants must: (1) retain the lien securing their claim and receive the value, as of the effective date of the plan, of any property distributed in an amount equal to the amount of their claim; or (2) receive the property securing the claim; or (3) accept the plan. Priority tax claims (including administrative claims) must be paid in full in deferred cash payments under the plan unless the claimant agrees to a different treatment.⁶⁷⁴ Unlike with a Chapter 11 plan, however, there is no requirement that an “interest” component be included in a Chapter 13 plan. The holders of general unsecured claims are entitled to receive an amount, valued as of the effective date of the plan, not less than the amount that would be paid if the debtor liquidated under Chapter 7. If an unsecured creditor objects to the plan, the plan must pay the present value of the unsecured creditor’s claim in full or provide that all of the debtor’s disposable income for a three-year period following confirmation is utilized to pay the creditors.

In a Chapter 13 proceeding, the bankruptcy court often issues a standing order to address a variety of issues that may require the parties to seek court permission, including how to handle tax refunds. In the Bankruptcy Court for the Northern District of Texas, for example, the court uses a standing order in all Chapter 13 cases under which a debtor is allowed to retain the first \$,2000 of a tax refund after any allowable IRS Offset or offset under the Treasury Offset program, and any amount remaining is considered an “excess refund” available for the benefit of the allowed general unsecured creditors.⁶⁷⁵

B. Stopping or Reversing IRS Enforcement Actions

One goal in filing a bankruptcy petition may be to stop the IRS from enforcing collection and/or to recover assets recently seized.

1. Automatic Stay

a. Effect of Automatic Stay

The filing of a bankruptcy petition gives rise to an automatic stay. The automatic stay stops enforcement and the turnover order may allow the taxpayer to recover seized assets. Before the Bankruptcy Reform Act of 1994 and the 2005 Bankruptcy Act,⁶⁷⁶ the automatic stay was an effective mechanism to stop virtually all forms of IRS action. The stay prevented the IRS from taking most collection actions. After the 1994 Act took effect, however, the IRS could:

- demand that the taxpayer/debtor file tax returns;
- audit the taxpayer/debtor’s returns;

- issue a notice of deficiency (but the stay prevents the debtor from filing a Tax Court petition);⁶⁷⁷
- make assessments of uncontested liabilities and of pre-petition tax which is reflected on the debtor’s voluntarily filed return;
- assess certain taxes and issue notice and demands for payment of these tax assessments;⁶⁷⁸
- refile a tax lien notice;⁶⁷⁹
- set off a tax refund against another tax liability, if approved by the bankruptcy court;⁶⁸⁰
- issue and enforce summonses to determine the debtor’s tax liability;⁶⁸¹ and
- revoke a church’s tax-exempt status.⁶⁸²

The 2005 Bankruptcy Act further limited the scope of the automatic stay by allowing:

- the commencement or continuation of a Tax Court proceeding with respect to a post-petition tax;⁶⁸³ and
- setoff of pre-petition refunds against pre-petition taxes *without* bankruptcy court approval.⁶⁸⁴

Even after these changes, the automatic stay still precludes the IRS from seizing the taxpayer/debtor’s property, filing an NFTL, making assessments of contested liabilities, issuing a notice of intent to levy or notice of determination in a CDP appeal for pre-petition claims,⁶⁸⁵ or continuing Tax Court or lien-related judicial proceedings for pre-petition taxes.

⁶⁷⁷ *Halpern v. Commissioner*, 96 T.C. 895 (1991) (initiation of a Tax Court proceeding); *Neilson v. Commissioner*, 94 T.C. 1 (1990) (bankruptcy petition stays Tax Court case until automatic stay is terminated or lifted; once stay is terminated, Tax Court case can be restored to general docket); *Ginella v. Commissioner*, T.C. Memo 1990-648. *Cf.* CCA 200110028 (issuance of notice of determination denying spousal relief under §6015 generally not violation of automatic stay).

⁶⁷⁸ See *In re Innovation Instruments Inc.*, 228 Bankr. 313 (Bankr. N.D. Fla. 1998) (under 11 U.S.C. §362(b)(9)(D), IRS’s assessment of employment taxes, interest and penalties after petition was filed is excepted from automatic stay). *But see In re Covington*, 2000-1 USTC ¶50,334 (Bankr. D.S.C. 2000) (notices of intent to levy and pamphlet went beyond making of assessment and demand for payment; they constituted a collection effort). The IRS also maintains that it may act to extend the statute of limitations by obtaining a Tax Collection Waiver, Form 900, while the stay is in effect, it may file a notice of tax lien for post-petition taxes after a Chapter 13 plan is confirmed, and it may conduct a collection due process hearing to review the filing of an NFTL for such post-petition taxes. CCA 200225003, CCA 200221045.

⁶⁷⁹ See *United States v. Sayres*, 43 Bankr. 437 (W.D.N.Y. 1984).

⁶⁸⁰ See *Luongo v. United States*, 2000-1 USTC ¶50,416 (N.D. Tex. 2000).

⁶⁸¹ *United States v. Arthur Andersen & Co.*, 623 F.2d 725 (1st Cir. 1980); *In re Moore*, 131 Bankr. 893 (Bankr. S.D. Fla. 1991); *In re Ungar*, 104 Bankr. 517 (Bankr. N.D. Ga. 1989); *In re Greene*, 50 Bankr. 785 (S.D.N.Y. 1985).

⁶⁸² See *In re Universal Life Church, Inc.*, 128 F.3d 1294 (9th Cir. 1997) (11 U.S.C. §362(b)(4) excepts from automatic stay government actions to enforce regulatory powers).

⁶⁸³ 11 U.S.C. §362(a)(8).

⁶⁸⁴ 11 U.S.C. §362(b).

⁶⁸⁵ CCA 200018005 (explaining that the IRS generally issues a §6330 CDP Notice only when it has identified a levy source and levy is the next planned action). See CCA 200110028 (where notice of determination denying innocent spouse relief is inseparable from CDP determination, notice should not be issued during bankruptcy). See also *Beverly v. Commissioner*, T.C. Memo 2005-41; *Smith v. Commissioner*, 124 T.C. 36 (2005); *Yuska v. Commissioner*, T.C. Memo 2015-77.

were not considered debts whose pre-bankruptcy terms included a final payment date that fell beyond the five-year term of the debtor’s plan.

⁶⁷⁴ 11 U.S.C. §1322(a)(2).

⁶⁷⁵ See, e.g., *In re Young*, No. 19-20386-rj13, 2021 BL 41811 (Bankr. N. D. Tex. Feb. 5, 2021) (court grants debtors’ motion to retain entire \$4,415 refund after showing that they needed funds to pay for unexpected but necessary costs associated with wife’s deteriorating physical condition, namely repair of a vehicle needed to transport her to medical appointments that was already in body shop under a pay-what-you-can monthly arrangement; although debtors spent refund before filing motion, court found that there was no bad faith and that debtors were proactive in bringing motion).

⁶⁷⁶ Pub. L. No. 104-394.

Similarly, if an installment agreement is in effect when the taxpayer-debtor files a bankruptcy petition, the automatic stay precludes the IRS from accepting any payment of a pre-petition tax liability, even a voluntary payment, by the taxpayer-debtor once the stay takes effect.⁶⁸⁶

The automatic stay also acts to preclude attachment of an IRS lien on assets inherited by a debtor after the filing of the bankruptcy petition, even when the IRS previously filed an NFTL.⁶⁸⁷

Note: The Bankruptcy Code allows a setoff if the tax refund relates to a pre-petition period.⁶⁸⁸ While the IRS's position is that post-petition refunds can be setoff against pre-petition liabilities, there is no apparent authority for this position. Setoff has been allowed in Chapter 7 proceedings,⁶⁸⁹ but not in Chapter 13 proceedings.⁶⁹⁰

The automatic stay bars the commencement or continuation of a Tax Court proceeding for pre-petition taxes, and the Tax Court will dismiss any petition filed in violation of the automatic stay.⁶⁹¹ The stay may not extend, however, to an em-

ployment tax action for an entity in which the debtor is an owner.⁶⁹² If only one spouse has filed a bankruptcy petition and the couple subsequently files a Tax Court petition that pertains to a joint return, the Tax Court proceeding is dismissed only with respect to the spouse who is involved in the bankruptcy proceedings.⁶⁹³

If the Tax Court petition is filed before the bankruptcy petition, the Tax Court proceeding is stayed. Any action to conclude the Tax Court case while the automatic stay is still effective is void.⁶⁹⁴

Finally, the automatic stay is imposed only when a bankruptcy petition is filed. Therefore, the stay is not automatically reactivated when a bankruptcy case — having previously been closed — is reopened.⁶⁹⁵ If the bankruptcy court grants a discharge and the discharge subsequently is revoked, however, the stay remains in effect until the case is closed.⁶⁹⁶

Note: 11 U.S.C. §362(d) empowers the bankruptcy court to lift the automatic stay to allow a Tax Court proceeding to continue. Nevertheless, if the bankruptcy court lifts the automatic stay to allow the Tax Court proceedings to continue, the bankruptcy court retains its jurisdiction to determine the subject tax liability until the Tax Court issues a decision.⁶⁹⁷ In addition, §7464 allows the bankruptcy trustee to intervene on behalf of the bankruptcy estate in the Tax Court proceedings.

⁶⁸⁶ CCA 199921042. Thus, the IRS typically will refund payments accepted in violation of the automatic stay or seek relief from the stay in the bankruptcy court. However, where a Chapter 7 taxpayer-debtor continues to make voluntary payments from post-petition earnings for nondischargeable taxes under a pre-existing installment agreement after filing the bankruptcy petition, the IRS generally continues to accept such payments. CCA 199921042. Once the taxpayer stops making payments under the installment agreement after bankruptcy is filed, the IRS considers the agreement to be suspended, not terminated. CCA 199920005. The IRS considers both payments by check and automatic debit payments to be voluntary. See CCA 199935056.

⁶⁸⁷ *In re Avis*, 178 F.3d 718 (4th Cir. 1999). The IRS had a lien on all of the taxpayer's property in existence when a Chapter 7 involuntary bankruptcy petition was filed but an inchoate lien on property that the taxpayer might thereafter acquire, including a contingent interest in an inheritance under a spendthrift trust. The IRS's inchoate lien on the inheritance could not be perfected until the taxpayer actually received the inheritance. Thus, the lien typically would attach to the inheritance when the creator of the trust died. However, when the inheritance came to the taxpayer, it became property of the bankruptcy estate under 11 U.S.C. §541(a)(5)(A) and thus became subject to the automatic stay provisions. Under 11 U.S.C. §362(a)(5), the bankruptcy petition stays "any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose" before the case commenced. The Fourth Circuit, in a case of first impression in the appellate courts, held that 11 U.S.C. §362 stayed the perfection of the IRS's lien when the estate received the inheritance even though the lien would otherwise have become "perfected" as a matter of law. In rejecting the IRS's argument that 11 U.S.C. §362(a)(5) did not apply because the IRS's lien became perfected by operation of law and not by any act by it or on its behalf, the court stated that such a narrow reading of the term "act" overlooks a chief aim of 11 U.S.C. §362(a)(5), which is to prevent the post-petition perfection of interests in a debtor's bankruptcy estate. The court found support for its position in the inclusion of sections such as 11 U.S.C. §362(b)(18), permitting the perfection of liens resulting from state or local property taxes, and 11 U.S.C. §362(b)(9), granting governmental units certain examination and collection powers, as exceptions to the automatic stay. *Cf. Gonzales v. United States*, 303 Bankr. 849 (B.A.P. 10th Cir. 2004) (filing of §6901 post-petition tax liens against nondebtor insiders was an act to collect pre-petition claim against debtor, violating stay under 11 U.S.C. §362(a)(6)).

⁶⁸⁸ 11 U.S.C. §362(a)(7). See *Harbaugh v. United States*, 89-2 USTC ¶9608 (W.D. Pa. 1989); *In re Ferguson*, 83 Bankr. 676 (Bankr. E.D. Mo. 1988).

⁶⁸⁹ *Duguay v. IRS*, 85-2 USTC ¶9616 (Bankr. W.D.N.Y. 1985); *In re Hoffman*, 51 Bankr. 42 (Bankr. W.D. Ark. 1985); *In re Lee*, 40 Bankr. 123 (Bankr. E.D. Mich. 1984). See *Goldman v. United States*, 99-2 USTC ¶50,829 (Bankr. C.D. Cal. 1999) (retroactive relief from automatic stay granted to allow setoff as debtor's attempted designation violated compromise agreement).

⁶⁹⁰ See, e.g., *United States v. Reynolds*, 764 F.2d 1004 (4th Cir. 1985); *United States v. Norton*, 717 F.2d 767 (3d Cir. 1983). *But see In re Glenn*, 207 Bankr. 418 (E.D. Pa. 1997) (taxpayer's interest in tax refund arises at end of year to which it relates).

⁶⁹¹ *Halpern v. Commissioner*, 96 T.C. 895 (1991); *Thompson v. Commissioner*, 84 T.C. 645 (1985); *Perry v. Commissioner*, T.C. Memo 2014-231 (Tax Court petition filed 3.5 hours before bankruptcy petition valid but proceedings stayed). Courts are split on whether 11 U.S.C. §362(a)(1) automatically stays the time for filing a notice of appeal from a Tax Court decision if the petitioner files for bankruptcy after the Tax Court decision is rendered. See *Roberts v. Commissioner*, 175 F.3d 889 (11th Cir. 1999) (appeal untimely; 11 U.S.C. §362(a)(1) did not stay 90-day period for filing, as Tax Court case was neither a proceeding against the debtor nor a proceeding to recover a claim against the debtor; second bankruptcy filing did not automatically stay the continuation of period for filing appeal under 11 U.S.C. §362(a)(8); 11 U.S.C. §108 extension was not sufficient); *Freeman v. Commissioner*, 799 F.2d 1091 (5th Cir. 1986) (11 U.S.C. §362(a)(1) not applicable to stay appeal because neither the Tax Court proceeding nor appeal therefrom was a proceeding against the debtor). *But see Delpit v. Commissioner*, 18 F.3d 768 (9th Cir. 1994) (time for filing appeal stayed because Tax Court proceeding and appeal therefrom were continuations of IRS administrative proceedings against the debtor). *Compare Delpit* (filing of bankruptcy petition also stays appeal from Tax Court's judgment under 11 U.S.C. §362(a)(1)); *with Cheng v. Commissioner*, 938 F.2d 141 (9th Cir. 1991) (11 U.S.C. §362(a)(8) does not stay appeal from Tax Court).

⁶⁹² *People Place Auto Hand Carwash LLC v. Commissioner*, 126 T.C. 359 (2006).

⁶⁹³ *McClamma v. Commissioner*, 76 T.C. 754 (1981). See also *In re Westberry*, 98-2 USTC ¶50,883 (M.D. Tenn. 1998) (husband's Chapter 13 filing did not stay tax collection against wife), *aff'd*, 215 F.3d 589 (6th Cir. 2000).

⁶⁹⁴ *Marcinek v. Commissioner*, 2011-1 USTC ¶50,320 (3d Cir. 2011) (unpub.).

⁶⁹⁵ *Kieu v. Commissioner*, 105 T.C. 387 (1995) (automatic stay not revived once terminated, absent express indication from bankruptcy court); *Allison v. Commissioner*, 97 T.C. 544 (1991) (IRS issued notice of deficiency after termination of Chapter 7 case; automatic stay not invoked, thereby allowing Tax Court proceeding to continue); *Sanford v. Commissioner*, T.C. Memo 1992-182 (no violation of automatic stay where discharge has been granted in bankruptcy proceedings).

⁶⁹⁶ *Thompson v. Commissioner*, 84 T.C. 645 (1985).

⁶⁹⁷ See *United States v. Wilson*, 974 F.2d 514 (4th Cir. 1992) (when automatic stay is lifted, bankruptcy court and Tax Court have concurrent jurisdiction to decide unadjudicated tax claims).

b. Duration of Automatic Stay

There are two aspects of the automatic stay that are relevant in determining the duration of the stay: (1) the stay's effect on acts against the property of the estate; and (2) the stay's effect on acts against the debtor.

The automatic stay on acts against the property of the estate continues until the property no longer is part of the estate. In Chapter 7 cases, property generally remains part of the estate until the case is closed or dismissed. In Chapter 11 or Chapter 13 cases, property ceases to be property of the estate when it is revested in the debtor. The order of discharge in a Chapter 11 case reverts the property in the debtor unless the property is otherwise provided for by the plan of reorganization.⁶⁹⁸ While not as clear, it appears that confirmation of a Chapter 13 plan reverts the property with the debtor, thereby rendering property not specifically required to fulfill the plan subject to collection of post-confirmation tax liabilities.⁶⁹⁹ Accordingly, if certain property is necessary to the success of the plan, the debtors should ensure that the plan clearly provides that such property does not revert upon confirmation of the plan.⁷⁰⁰

The second aspect of the automatic stay prohibits acts against the debtor. The stay against these prohibited acts continues until the earliest of the following events occurs:

- the bankruptcy case is closed;
- the bankruptcy case is dismissed;⁷⁰¹ or
- a discharge is granted or denied in an individual's Chapter 7 case or any case under Chapters 11 or 13.⁷⁰²

Only individuals can obtain a discharge in a Chapter 7 case.⁷⁰³ Discharge typically is granted after the individual debtor's assets have been liquidated and distributed.⁷⁰⁴ In a Chapter 11 case involving corporate or other nonindividual debtors, a discharge is granted upon confirmation of the plan

of reorganization.⁷⁰⁵ In a Chapter 11 case where the debtor is an individual, a discharge is not granted until the completion of all plan payments, or the bankruptcy court grants a discharge before that time after providing notice and a hearing.⁷⁰⁶ In a Chapter 13 case, a discharge usually is granted upon completion of all payments required under the plan.⁷⁰⁷

c. Violation of Automatic Stay

Actions taken by the IRS in violation of the automatic stay are generally void.⁷⁰⁸ Thus, when the IRS files an NFTL in violation of the automatic stay, the IRS's policy is to prepare a Withdrawal of NFTL, issue it to the recording office, and send a copy to the taxpayer.⁷⁰⁹ IRS internal procedures require the IRS to correct actions in violation of the automatic stay within two work days after the IRS receives knowledge of an actual or potential violation of the Bankruptcy Code.⁷¹⁰

Before the Bankruptcy Reform Act of 1994,⁷¹¹ a question existed when the IRS willfully violated the automatic stay as to whether the debtor could recover damages. The Supreme Court ruled that sovereign immunity was not waived to allow monetary damages under the bankruptcy laws unless the IRS had filed a claim against the bankruptcy estate.⁷¹² The 1994 Reform Act settled the issue by expressly providing for a waiver of sovereign immunity for monetary relief where the IRS violates the automatic stay.⁷¹³

Also, before the 1998 IRS Reform Act, a taxpayer generally was not entitled to recover costs under the Internal Revenue Code for violations of the automatic stay in connection with a collection matter. Pursuant to amendments made by the 1998 IRS Reform Act, however, the taxpayer can recover damages and related costs under either §7433(e) or 11 U.S.C. §362(k) if the IRS willfully violates the automatic stay.⁷¹⁴

⁷⁰⁵ 11 U.S.C. §1141(d)(1). See, e.g., *Zamarello v. Commissioner*, T.C. Memo 1991-494 (automatic stay continues until bankruptcy court grants discharge, dismisses case, or confirms plan of reorganization).

⁷⁰⁶ 11 U.S.C. §1141(d)(5). See, e.g., *Cochran*, 159 T.C. No. 4.

⁷⁰⁷ 11 U.S.C. §1328. See, e.g., *Wahlstrom v. Commissioner*, 92 T.C. 703 (1989).

⁷⁰⁸ *In re Schwartz*, 954 F.2d 569 (9th Cir. 1992); *Anglemyer v. United States*, 115 Bankr. 510 (D. Md. 1990). See also *In re Goldston*, 104 F.3d 1198 (10th Cir. 1997) (while assessment made in violation of automatic stay is void, debtor's liability for §6672 penalty arose when employment taxes were withheld but not remitted; liability exists independent of valid assessment). But see *Bronson v. United States*, 46 F.3d 1573 (Fed. Cir. 1995) (IRS's assessment for §6672 penalty is voidable, as policies of automatic stay are not violated by assessment, and valid, because taxpayer did not attempt to have it voided in bankruptcy), *aff'd* 28 Fed. Cl. 756 (1993) (by delaying objection until statute of limitations for making assessment expired, taxpayer is equitably barred from objecting to §6672 assessment that violated stay); *In re Sanderfer*, 2004-1 USTC ¶50,150 (E.D. Tenn. 2004) (lien filed in violation of stay voidable not void); *In re O'Callaghan*, 342 Bankr. 364 (Bankr. M.D. Fla. 2006) (IRS did not violate automatic stay by refiling NFTLs to prevent expiration of its pre-petition liens while debtor's Chapter 7 case was pending).

⁷⁰⁹ IRM 5.9.5.9.1 (11-01-22).

⁷¹⁰ IRM 5.9.5.5 (11-01-22).

⁷¹¹ Pub. L. No. 103-394.

⁷¹² *United States v. Nordic Village, Inc.*, 503 U.S. 30 (1992). Bankruptcy Reform Act of 1994 §701(b)(2)(B), set out as a note under 11 U.S.C. §101, statutorily overruled *Nordic Village* to the extent the court found 11 U.S.C. §106 did not waive sovereign immunity. *Jove Eng'g, Inc. v. IRS*, 92 F.3d 1539 (11th Cir. 1996).

⁷¹³ 11 U.S.C. §362(k).

⁷¹⁴ See Reg. §301.7430-3(a)(4) (definition of administrative proceeding includes any administrative action for damages under §7433(e) and any proce-

⁶⁹⁸ 11 U.S.C. §1141(b).

⁶⁹⁹ 11 U.S.C. §1327(b). See *In re Mason*, 45 Bankr. 498 (Bankr. D. Or. 1984), *aff'd*, 51 Bankr. 548 (D. Or. 1985). But see *In re York*, 13 Bankr. 757 (Bankr. D. Me. 1981).

⁷⁰⁰ 11 U.S.C. §1327(b). Cf. *In re Deutchman*, 192 F.3d 457 (4th Cir. 1999) (completion of payments due under plan does not extinguish liens, as plan, which did not consistently identify any IRS claim as secured, did not "provide for" IRS's allowed secured claim).

⁷⁰¹ If the debtor appeals the dismissal, the automatic stay is lifted unless the bankruptcy court stays the dismissal pending appeal. *In re Weathersfield Farms, Inc.*, 34 Bankr. 435 (Bankr. D. Vt. 1983); *In re Eden Assoc.*, 13 Bankr. 578 (Bankr. S.D.N.Y. 1981). Also, at least one court has concluded that the debtor's act of filing a second Chapter 13 petition before the first one is dismissed does not show bad faith in the filing of the second petition; thus, the IRS cannot claim interest and penalties which might otherwise have accumulated before the filing of the second petition and during the pendency of the first. *In re Kepner*, 2002-2 USTC ¶50,789 (Bankr. M.D. Pa. 2002).

⁷⁰² 11 U.S.C. §362(c). See *Smith v. Commissioner*, 96 T.C. 10 (1991) (waiver of discharge terminates automatic stay); *Moody v. Commissioner*, 95 T.C. 655 (1990) (confirmation of Chapter 11 reorganization plan terminates automatic stay). However, in *Cochran v. Commissioner*, 159 T.C. No. 4 (Oct. 12, 2022), the Tax Court held that 11 U.S.C. §1141(d)(5) limits *Moody* in that confirmation of a reorganization plan does not terminate the automatic stay in Chapter 11 cases where the debtor is an individual. Rather, in these situations, termination of the automatic stay occurs upon discharge due to completion of plan payments or before that time if the Bankruptcy Court so orders after notice and a hearing.

⁷⁰³ 11 U.S.C. §727(a)(1).

⁷⁰⁴ See 11 U.S.C. §727(a).

Under §7433, the taxpayer may bring an action in the bankruptcy court to recover the lesser of actual direct economic damages plus costs or \$1,000,000 for damages resulting from an IRS employee's willful violation of the automatic stay or of the bankruptcy discharge provisions.⁷¹⁵ The taxpayer must exhaust all administrative remedies before petitioning the bankruptcy court for such damages.⁷¹⁶ In spite of the bankruptcy court's equitable power under 11 U.S.C. §105, the petition generally is the exclusive remedy for recovering damages from willful actions.⁷¹⁷

If damages are awarded under the bankruptcy law for willful violations of the automatic stay or of the bankruptcy discharge provisions, administrative and litigation costs may only be awarded as provided by §7430.⁷¹⁸ Administrative cost awards under the Bankruptcy Code are limited to costs incurred in connection with an administrative proceeding on or after the date of the bankruptcy petition that gave rise to the 11 U.S.C. §362 stay or 11 U.S.C. §524 discharge injunction.⁷¹⁹ The taxpayer must first file a claim for administrative costs with the IRS within 90 days after the date the IRS notifies the taxpayer of its decision on the administrative claim for relief from a violation of 11 U.S.C. §362 or §524.⁷²⁰ The action to recover damages must be filed within two years of the specific violation alleged. This two-year period applies separately to each violation.⁷²¹ The taxpayer must be the prevailing party to recover the costs.

Although 11 U.S.C. §362(k) allows individual debtors to recover actual damages from a creditor's willful automatic stay violation, the section is unclear on whether "actual damages" includes claims for emotional distress. Some courts hold there is no waiver of sovereign immunity for emotional distress claims.⁷²² Other courts hold that because the award of emotional distress damages is a form of monetary relief — compensatory damages — but is not punitive, it falls unambiguously within

the scope of the 11 U.S.C. §106(a) waiver of sovereign immunity for claims arising under 11 U.S.C. §362(k).⁷²³

dure or action brought before IRS seeking relief for IRS violation of 11 U.S.C. §362 or §524).

⁷¹⁵ See §7433(e), §7433(b). See also *Torres v. United States*, 309 Bankr. 643 (B.A.P. 1st Cir. 2004) (damages also allowable in bankruptcy for contempt of discharge order).

⁷¹⁶ §7433(d)(1); Reg. §301.7433-2(d). See Reg. §301.7430-1(e). The action for administrative costs must be filed with the IRS within 90 days after the date the IRS mails, or otherwise notifies the taxpayer of, its decision on the taxpayer's administrative claim for damages. Reg. §301.7430-8(e). If the government can show that a taxpayer did not file an administrative claim before petitioning the court, the court will dismiss the claim. See, e.g., *Conforte v. United States*, 979 F.2d 1375 (9th Cir. 1993); *Turner v. United States*, 429 F. Supp. 2d 149 (D.D.C. 2006). Guidance for IRS attorneys for determining whether a taxpayer previously has filed an administrative claim is provided in Chief Counsel Notice CC-2009-004.

⁷¹⁷ §7433(e)(2)(A).

⁷¹⁸ §7433(e)(2)(B). For purposes of §7430(c)(4)(B)(i), "the position of the United States in the proceeding" is judged from the date a bankruptcy petition is filed, not from the date an adversary proceeding is commenced.

⁷¹⁹ Reg. §301.7430-8(d). See Reg. §301.7430-8(c) (administrative proceeding definition).

⁷²⁰ Reg. §301.7430-8(e). Reg. §301.7430-1(e)(2) sets out the exhaustion of administrative remedy requirements for §7433 claims and for 11 U.S.C. §362(k) claims related to actions involving willful violations of the automatic stay.

⁷²¹ *Kovacs v. United States*, 614 F.3d 666 (7th Cir. 2010).

⁷²² *United States v. Rivera Torres*, 432 F.3d 20 (1st Cir. 2005) (finding that Congress did not waive sovereign immunity for emotional distress damages). See also *In re Dawson*, 390 F.3d 1139 (9th Cir. 2004).

the scope of the 11 U.S.C. §106(a) waiver of sovereign immunity for claims arising under 11 U.S.C. §362(k).⁷²³

The prevailing party must establish that the IRS has willfully violated a provision of 11 U.S.C. §362 or §524.⁷²⁴ To establish willfulness, some courts require the plaintiff to prove only that (1) the defendant knew of the automatic stay and (2) the defendant's actions that violated the stay were intentional. The plaintiff does not need to prove that the defendant had a specific intent to violate the stay.⁷²⁵ Thus for example, courts have rejected claims by creditors that stay violations attributable to a computer error are "inadvertent."⁷²⁶ And one district bankruptcy court has rejected the IRS's claim that its violations of an automatic stay were inadvertent in the face of complexities surrounding a world pandemic.⁷²⁷ In *Chavez-Villasenor v. Dept. of Educ. (In re Chavez-Villasenor)*,⁷²⁸ the Department of Education generally communicates to the Treasury Department to prevent the seizure of tax refunds when one of its student loan debtors is in bankruptcy. Due to a malfunction, the plaintiff's name was not transmitted to Treasury in time to prevent a set-off of her refund, which caused a cascading series of financial problems for the plaintiffs, including having to break a lease and borrow from family members. The software was manually updated and the refund was eventually received. The debtors sued for damages pursuant to 11 U.S.C. §362(k). Following other courts that have rejected the "blame the software defense", the court, addressing the issue of intent, explained that if a creditor, having received a notice of the stay, later forgets about it or fails to communicate the notice to the employee responsible for collection — a subsequent intentional act to collect creates liability, even though the creditor acted without the intent to violate the stay. The court observed that the mere fact that collection was carried out by a computer does not change the analysis, i.e., when a creditor designs or installs collection software and the software later performs as expected, the creditor is deemed to have intended the result. Only if the software's collection activity is not part of its expected function — a virus causing it to send out billing statements at random — could the creditor argue that it did not intend the result.

⁷²³ *Hunsaker v. United States*, 902 F.3d 963 (9th Cir. 2018). See also *Hunsaker v. United States*, No. 6:16-cv-00386-MC, 2019 BL 230145 (D. Or. Jun. 20, 2019) (no error and no abuse of discretion in awarding emotional damages after finding that taxpayers experienced credible and significant emotional harm where their physical symptoms resulted from concern over losing their social security income).

⁷²⁴ Reg. §301.7430-8.

⁷²⁵ See, e.g., *Goichman v. Bloom (In re Bloom)*, 875 F.2d 224, (9th Cir. 1989) (quoting *Inslaw Inc. v. United States, (In Re Inslaw, Inc.)* 83 B.R. 89 (Bankr. D.D.C. 1988)).

⁷²⁶ See, e.g., *In re Campion*, 294 B.R. 313 (9th Cir. B.A.P. 2003); *In re Roberts*, 175 B.R. 339 (9th Cir. 1994); *In re Hill*, 523 B.R. 704 (Bankr. D. Mont. 2014).

⁷²⁷ See *Williams-McAuliffe v. United States (In re McAuliffe)*, No. 3:16-bk-00110, 2022 BL 183331 (Bankr. N.D. W.Va. May 26, 2022) (court rejected IRS claims that post-discharge collection efforts were inadvertent, unintentional, and result of internal miscommunications and disruptions in processing resulting from COVID-19 pandemic; damages awarded for penalties and interest charged following IRS failure to record bankruptcy discharge).

⁷²⁸ No. 18-133538-dwh13, 2020 BL 133547 (Bankr. D. Or. Apr. 9, 2020).

d. Relief from Automatic Stay

The IRS can seek relief from the automatic stay by filing a motion with the bankruptcy court.⁷²⁹ The bankruptcy court will grant relief from the stay (by terminating, annulling, modifying, or conditioning the stay) if the IRS's interest in property is not adequately protected (relief "for cause") or if the debtor has no equity interest in the subject property and the property is not essential to the reorganization.⁷³⁰ The IRS has the burden of proving that the debtor has no equity in the subject property.⁷³¹

Instances where the IRS's motion to lift the automatic stay has been granted include:

- The IRS was allowed to reinstate collection by levying on the debtor's pension and applying those funds to the couple's delinquent taxes because the couple had discretionary income and neither offered to provide adequate protection to the IRS nor used their discretionary income to make payments during the stay.⁷³²

e. Limitations Period Tolloed

The filing of a bankruptcy petition also tolls the running of the statutes of limitations for assessment and collection. Under §6503(h), the limitations periods during which the IRS may assess or collect taxes is suspended for the time that the automatic stay is pending and for an additional 60 days (for assessment) and an additional six months (for collection).⁷³³ However, given that the automatic stay does not prevent assessments of tax reported on a voluntarily filed return in cases filed after October 22, 1994,⁷³⁴ §6503(h)(1) no longer suspends the running of the assessment period for this category of tax.⁷³⁵

According to the IRS, the assessment statute of limitations for deficiencies is suspended by operation of §6213(f)(1), §6213(a), and §6503(a)(1). Section 6213(f)(1) suspends the period in which to file a Tax Court petition for the duration of the automatic stay plus 60 days. Section 6213(a) and §6503(a)(1) effectively prohibit the assessment of the deficiency and suspend the statute of limitations for that assessment until the time has expired to file the Tax Court petition and for 60 days thereafter. As a result, the timing of the issuance of a notice of deficiency and the filing of a bankruptcy petition determine whether and how the running of the assessment limitations period is affected by the bankruptcy. When the IRS issues the notice of deficiency on the same day as or after the day the bankruptcy commences and before the automatic stay terminates (or

less than 90 days before the bankruptcy commences), the bankruptcy has an effect on the running of the assessment limitations period. However, when the IRS issues the notice of deficiency 90 or more days before the bankruptcy commences, the bankruptcy does not affect the running of the assessment limitations period.⁷³⁶

Example: D files a bankruptcy petition on January 10, 2019. The IRS issues a notice of deficiency, which is addressed to D within the United States, on the same day. The automatic stay terminates 100 days later on April 19, 2019. The period in which D may file a Tax Court petition for redetermination of the deficiency ends on September 16, 2019, 150 (60 + 90) days after April 19, 2019. D does not file a Tax Court petition. Under §6213(a), the IRS is prohibited from making an assessment during the period from January 10, 2019, through September 16, 2019. Under §6503(a)(1), the running of the assessment limitations period is also suspended during this period. In addition, because D did not file a Tax Court petition, the running of this limitations period is further suspended until November 15, 2019, an additional 60 days after September 16, 2019. On November 16, 2019, any portion of the assessment period that had not run when the notice of deficiency was issued begins to run.⁷³⁷

The limitations period may remain suspended until the IRS is actually notified of the action lifting the automatic stay.⁷³⁸ The IRS has the right to receive all notices provided for under the Bankruptcy Code and corresponding rules before its rights as a creditor can be impaired.

As noted above, §6503(h) tolls the running of the statute of limitations on collection for the time that the automatic stay is pending plus six months. However, because §6503(b) provides that the collection period of limitations is suspended for the period of time in which a taxpayer's assets are in the custody and control of any court plus six months, it is not entirely clear as to which subsection controls with regard to collection.⁷³⁹

⁷³⁶ Rev. Rul. 2003-80.

⁷³⁷ See Rev. Rul. 2003-80 (Situation A).

⁷³⁸ *Richmond v. United States*, 172 F.3d 1099 (9th Cir. 1999). In *Richmond*, after the IRS assessed tax deficiencies, the taxpayer instituted bankruptcy proceedings during which the IRS issued a notice of deficiency identifying additional taxes owed. The bankruptcy court denied the discharge but, despite repeated status inquiries by the IRS, did not enter its order on the case docket or notify the IRS. The IRS learned of the denial 15 months later. After the taxpayer received a discharge in a later bankruptcy, the IRS assessed the additional deficiencies. In upholding the assessment, the court found that, because suspension continued until the IRS received notice that the stay had been lifted, the tax years remained assessable until well after the taxpayer filed the second petition.

⁷³⁹ In *Richmond v. United States*, 172 F.3d 1099 (9th Cir. 1999), the Ninth Circuit, interpreting the predecessor to §6503(h) (i.e., former §6503(i), which contained language virtually identical to that of §6503(h)), indicated that the collection period of limitations did not end until issuance by the bankruptcy court of a discharge order, plus six months. In *McAuley v. United States*, 525 F.2d 1114 (9th Cir. 1975), the Ninth Circuit had held that where §6503(b) and former §6503(i) both may have applied, §6503(b) controlled, and thus the collection period of limitations was suspended from the date a bankruptcy petition was filed until six months after the first creditors' meeting and for an additional six months. However, in *Severo v. Commissioner*, 129 T.C. 160 (2007), the Tax Court, following *Richmond*, held that §6503(h) rather than §6503(b) controls and suspends the running of the collection period from the date the bankruptcy petition is filed to the date that is six months after the bankruptcy court

⁷²⁹ 11 U.S.C. §362(d); Bankruptcy Rule 4001(a)(1); *Staton v. United States*, 123 AFTR 2d 2019-950 (B.A.P. 9th Cir. 2019) (relief from stay granted retroactively).

⁷³⁰ See 11 U.S.C. §362(d). An order granting relief from the automatic stay does not constitute a de facto abandonment under 11 U.S.C. §554(d) by the bankruptcy estate of the property at issue. *Catalano v. Commissioner*, 279 F.3d 682 (9th Cir. 2002), *rev'g* T.C. Memo 2000-82. See VII.G.8., below, for discussion of a bankruptcy estate's abandonment of property.

⁷³¹ 11 U.S.C. §362(g).

⁷³² *Pansier v. United States*, No. 19-C-537 (E.D. Wis., December 30, 2019).

⁷³³ See *United States v. Joel*, 122 AFTR 2d 2018-6371 (W.D. Ky. 2018) (collection period was still tolled under §6503(h) where bankruptcy discharge was revoked for perjury and fraud).

⁷³⁴ See 11 U.S.C. §362(b)(9)(D).

⁷³⁵ Rev. Rul. 2003-80. See *In re Gore*, 96-1 USTC ¶50,069 (Bankr. N.D. Ala. 1995) (questioning continued utility of §6503(h) in deciding the time limits for tax assessments).

2. Recovery of Property by the Bankruptcy Estate

The filing of a bankruptcy petition provides devices that may allow the bankruptcy estate to recover assets and payments that were obtained by the IRS before the bankruptcy petition filing date. The principal devices used to recover these amounts are the turnover order, avoidance of preferential transfers, avoidance of fraudulent transfers, and the assumption or rejection of contracts. The estate may also recover refunds of taxes if the taxpayer-debtor has paid more tax than is actually due.⁷⁴⁰

The estate's ability to recover property, however, may be limited by a prior right of setoff.⁷⁴¹ The estate's ability to recover property also may be limited by the §6511 statute of limitations for filing a tax refund claim.⁷⁴²

a. Turnover

The bankruptcy trustee often can obtain the turnover of assets seized by the IRS if it will assist the rehabilitation of the debtor. The turnover order most frequently is sought by a debtor-in-possession in a Chapter 11 case.

The bankruptcy estate includes all property in which the debtor has a legal or equitable interest at the time the petition is filed.⁷⁴³ Therefore, property of the debtor held by a third party is subject to turnover to the bankruptcy estate. The Supreme Court, in *United States v. Whiting Pools, Inc.*,⁷⁴⁴ adopted an expansive interpretation of the bankruptcy estate's interest in property seized (but not yet sold) by the IRS. The Court, citing strong congressional interest in granting debtors a fresh start and in allowing debtors to recover seized assets which are necessary for a successful rehabilitation, ordered the IRS to turn over the seized assets to the bankruptcy estate.⁷⁴⁵

issues its discharge order. In support of its conclusion, the court noted that the Ninth Circuit had not cited *McAuley* in more recent cases acknowledging that the period of limitations on collection in bankruptcy generally was suspended under §6503(h), and, although it had not previously addressed the issue of which subsection controlled, the Tax Court had repeatedly applied §6503(h) without any limitations imposed by §6503(b).

⁷⁴⁰ See, e.g., *Kokoszka v. Belford*, 417 U.S. 642 (1974); *Segal v. Rochelle*, 382 U.S. 375 (1966) (income tax refund can be property of bankruptcy estate); *Johnston v. Hazlett*, 209 F.3d 611 (6th Cir. 2000) (debtor's earned income credit was property of bankruptcy estate under 11 U.S.C. §541 even though debtor filed bankruptcy petition before end of tax year in which credit was earned); *Trudeau v. Royal*, 237 Bankr. 803 (B.A.P. 10th Cir. 1999) (tax refund and EIC are property of the estate under 11 U.S.C. §541; credit not exempt); *In re Horizon Grp. Mgmt., LLC*, No. 14bk41230, 2020 BL 228252 (Bankr. N.D. Ill. June 19, 2020) (tax payments made to IRS within two-year period before bankruptcy filing subject to recovery by trustee under fraudulent transfer theory as bankrupt entity made payments for related parties' tax liabilities and received no value in exchange; IRS loses summary judgment motion on reverse piercing of corporate veil and affirmative defense as good faith transferee for value). Cf. *In re Meza*, 243 Bankr. 538 (Bankr. M.D. Fla. 1999) (turnover denied where EIC not earned at time Chapter 7 case began). Pursuant to 11 U.S.C. §522(b), state law may permit the debtor to exclude the federal EIC from the bankruptcy estate. See, e.g., *In re Longstreet*, 246 Bankr. 611 (Bankr. S.D. Iowa 2000).

⁷⁴¹ See, e.g., *In re United Marine Shipbuilding, Inc.*, 146 F.3d 739 (9th Cir. 1998) (government agency is entitled to apply its prior court-approved common law right of setoff against tax refund due debtors that was inadvertently released by IRS to bankruptcy trustee).

⁷⁴² See *United States v. Neary*, 206 F.3d 465 (5th Cir. 2000) (11 U.S.C. §362 automatic stay provision does not create implied exception to time limits set out in §6511 to make bankruptcy trustee's refund claim for pre-petition taxes timely even though Chapter 7 debtor's claim would not have been).

⁷⁴³ 11 U.S.C. §541(a).

⁷⁴⁴ 462 U.S. 198 (1983).

⁷⁴⁵ See 11 U.S.C. §542.

Note: The language in *Whiting Pools* seems to allow the turnover of all seized assets (except cash) levied upon and received by the IRS before the commencement of the bankruptcy case.⁷⁴⁶ In the case of cash and other intangible assets, courts disagree as to whether money levied by the IRS is subject to turnover where the money is levied upon but not paid over to the IRS before the petition is filed. The majority of courts have held that the debtor retains rights in the levied money and therefore the property must be turned over to the bankruptcy estate.⁷⁴⁷ When the cash is both levied upon and paid over to the IRS before the petition is filed, however, the debtor's property interest is terminated, and the property is not subject to turnover.⁷⁴⁸

In return for turning over the seized assets, the IRS is entitled to receive "adequate protection."⁷⁴⁹ In general, adequate protection means the IRS is entitled to deferred payments with a value equal to the value of the allowed secured claim under 11 U.S.C. §506(a).⁷⁵⁰ If adequate protection is not offered to the IRS, the turnover of the assets is not ordered.⁷⁵¹

Pre-payment of taxes whereby a taxpayer makes an irrevocable election under §6513(d) to apply an overpayment from one year against the subsequent year's taxes are considered property of the debtor subject to turnover.⁷⁵² As a practical mat-

⁷⁴⁶ See, e.g., *In re Brown*, 126 Bankr. 767 (N.D. Ill. 1991) (levied cash not subject to turnover; debtor's interest in cash — i.e., nonsalable property — terminated when IRS executed pre-petition levy). *But see In re Challenge Air Int'l, Inc.*, 952 F.2d 384 (11th Cir. 1992) (levied funds remain part of bankruptcy estate). The debate over whether levied funds are subject to the turnover provisions of the Bankruptcy Code was apparently settled by the Supreme Court in *United States v. Nordic Village, Inc.*, 503 U.S. 30 (1992). The Court in *Nordic Village* stated that a debtor no longer retains any interest in or title to cash, unlike tangible personal property, that has been levied by the IRS.

⁷⁴⁷ See, e.g., *In re Challenge Air InterNat'l, Inc.*, 952 F.2d 384 (11th Cir. 1992); *In re Giaimo*, 194 Bankr. 210 (E.D. Mo. 1996) (levy procedures under §6331 and §6332 are not complete until bank surrenders money 21 days after levy is served); *In re Hunter*, 201 Bankr. 959 (Bankr. E.D. Ark. 1996) (cash is property of estate where IRS levies before petition is filed, but is not entitled to cash until after petition is filed); *In re Boutilier*, 77 AFTR 2d 96-1536 (Bankr. W.D. Va. 1996) (pre-petition levy on IRA consisting of stocks and mutual funds does not remove IRA from estate's assets, but merely elevates IRS to position as secured creditor); *In re AIC Indus., Inc.*, 83 Bankr. 774 (Bankr. D. Colo. 1988). *But see In re Abercrombie*, 156 Bankr. 782 (Bankr. N.D. Tex. 1993) (pre-petition levy terminates taxpayer's interest in cash); *In re Eisenbarger*, 93-2 USTC ¶50,538 (Bankr. E.D. Va. 1993); *In re Brown*, 126 Bankr. 767 (N.D. Ill. 1991); *DiFlorio v. United States*, 30 Bankr. 815 (N.D.N.Y. 1983).

⁷⁴⁸ See *In re Coghlan*, 98-2 USTC ¶50,585 (D. Ariz. 1998) (where money is levied upon and paid over to IRS before petition is filed, debtor retains no legal or equitable interest in property, and IRS cannot be compelled to return money to bankruptcy estate; court distinguishes instant case from *Whiting Pools* since debtor had no legal or equitable interest in property at time petition was filed); *In re Debmar Corp.*, 21 Bankr. 858 (Bankr. S.D. Fla. 1982) (once cash is turned over to IRS, debtor's interest in such property terminates).

⁷⁴⁹ 11 U.S.C. §363(e); *United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983).

⁷⁵⁰ *United Savings Ass'n of Texas v. Timbers of Inwood Forest Assoc., Ltd.*, 484 U.S. 911 (1988).

⁷⁵¹ *In re AIC Indus., Inc.*, 83 Bankr. 774 (Bankr. D. Colo. 1988).

⁷⁵² *Weinman v. Graves*, 609 F.3d 1153 (10th Cir. 2010) (citing *Whiting Pools* and noting that 11 U.S.C. §541 is deliberately broad in scope, court concludes that pre-payment constitutes a contingent reversionary interest that is property of the estate); *Nichols v. Birdsell*, 491 F.3d 987 (9th Cir. 2007) (estate property does not have to be immediately capable of being liquidated into cash in order to constitute property of the estate and includes a debtor's interests that cannot be liquidated and transferred by the debtor). *But see United States v. Pritchard*, 141 Bankr. 609 (N.D. Tex. 1992) (monies were not property of the estate once the irrevocable election had been made and thus were not subject

ter, however, it is not entirely clear as to whether and when a trustee can obtain possession of the refund or whether the trustee can require the debtor to turn over the “value” of the refund when the refund itself cannot be obtained.⁷⁵³

b. Preferential Transfers

A second method for recovering property from the IRS is through the avoidance of preferential transfers.⁷⁵⁴ Bankruptcy Code §547 sets forth the rules concerning when a transfer of property constitutes a preference that can be avoided. Generally, a trustee can avoid a transfer of property as “preferential” if:

- the property was transferred to or for the benefit of a creditor;
- the transfer was made to satisfy an antecedent debt;
- the transfer was made while the debtor was insolvent;
- the transfer was made during the 90-day period immediately preceding the filing of the bankruptcy petition (this time period is extended to one year when applied to transfers to insiders); and
- as a result of the transfer, the creditor is receiving a greater percentage of its claim than would have been received in a Chapter 7 proceeding.⁷⁵⁵

Since preferential transfers can be avoided only if the transfer occurs within 90 days before the filing date of the bankruptcy petition, the date of the transfer to the IRS is important. The filing of the NFTL, the service of a levy, and the payment pursuant to levy are all considered transfers for determining whether the transfer occurs within the 90-day period prior to the petition.⁷⁵⁶ Payment by check is usually considered to be a transfer on the date of delivery if the check is honored within a normal processing time.⁷⁵⁷ Similarly, a wage garnishment or levy is generally deemed to be a transfer on the date the levy

to turnover); *Grant v. United States*, 124 Bankr. 606 (Bankr. M.D. Fla. 1991) (Same).

⁷⁵³ *Weinman v. Graves*, 609 F.3d 1153 (10th Cir. 2010) (because at no time during the case up to the filing of the turnover action did the debtors have the right to obtain their refund or prepayment from the IRS, the trustee could not compel turnover of that amount). See also *In re Middendorf*, 381 Bankr. 774 (Bankr. D. Kan. 2008); *In re Orill*, 226 Bankr. 563 (Bankr. E.D. La. 1997). But see *Nichols v. Birdsell*, 491 F.3d 987 (9th Cir. 2007) (entire refund was property of the estate and implicitly subject to turnover from the debtor).

⁷⁵⁴ See *In re Russell*, 927 F.2d 413 (8th Cir. 1991) (trustee can avoid debtor’s otherwise irrevocable election to carry forward NOL deductions pursuant to §172). An action to avoid a preference must be commenced by the earlier of: (1) two years after the bankruptcy trustee’s appointment; or (2) the time the case is closed or dismissed. 11 U.S.C. §546(a). The trustee has the burden of proof to establish the avoidability of a transfer under the five factors discussed in this section, but the IRS has the burden with respect to the exceptions available under 11 U.S.C. §547(c) (e.g., the statutory lien exception). 11 U.S.C. §547(g).

⁷⁵⁵ 11 U.S.C. §547(b)(1)–11 U.S.C. §547(b)(5). See, e.g., *Menotte v. United States*, 90 AFTR 2d 2002-5824 (Bankr. S.D. Fla. 2002) (trustee failed to meet burden to show that loan amounts paid directly to government allowed it to receive more than it otherwise would have received in Chapter 7 case).

⁷⁵⁶ 11 U.S.C. §101(54). See also *In re R & T Roofing Structures and Commercial Framing, Inc.*, 42 Bankr. 908 (Bankr. D. Nev. 1984), *aff’d*, 79 Bankr. 22 (D. Nev. 1987), *aff’d*, 887 F.2d 981 (9th Cir. 1989); *In re Tabita*, 38 Bankr. 511 (Bankr. E.D. Pa. 1984).

⁷⁵⁷ *In re Walker Indus. Auctioneers, Inc.*, 45 Bankr. 452 (Bankr. D. Or. 1984); *In re Blanton Smith Corp.*, 37 Bankr. 303 (Bankr. M.D. Tenn. 1984). But see *In re Stavaco Elec. Constr., Inc.*, 48 Bankr. 247 (Bankr. D.N.J. 1985) (transfer date is date check is honored).

is served rather than on the date of payment to the IRS or other creditor.⁷⁵⁸ In some cases, the perfection of a security interest (i.e., the filing of the NFTL) constitutes the relevant transfer date, and the subsequent sale enforcing that interest is not considered to be a transfer.⁷⁵⁹

Once it is determined that a transfer has occurred within the 90-day pre-petition period, the IRS may defend the preference action by arguing that:

- the transfer did not allow the IRS to recover more than its share under a Chapter 7 proceeding;
- the tax payment was not made on account of an antecedent debt;
- the payment was made in the ordinary course of business; or
- the withheld portion of employment tax payments was not a transfer of the estate’s property.

It is likely that the debtor will prevail on the issue of whether the IRS has received more than it would recover in a Chapter 7 proceeding if the tax claim is not secured (i.e., no NFTL has been filed). Most unsecured claims and priority claims do not receive full payment in a Chapter 7 case.⁷⁶⁰ Even if the IRS claim is secured, the subordination provision of 11 U.S.C. §724(b) increases the possibility that the IRS’s pre-petition collection action is preferential.⁷⁶¹ For purposes of determining the value of those claims that have priority over the IRS’s claim in a hypothetical Chapter 7 proceeding, the claims are measured as of the petition date, not the date of the preference action.⁷⁶²

The antecedent debt and ordinary course of business arguments are most frequently raised when withholding and employment tax payments are remitted before the bankruptcy petition is filed. The trustee cannot avoid current withholding and employment tax deposits, since these payments are covered by both the ordinary course of business and the antecedent debt exceptions.⁷⁶³ Current year income tax estimated payments are also not considered to be paid on an antecedent debt and therefore are not subject to avoidance as a preference because the

⁷⁵⁸ *In re Coppie*, 728 F.2d 951 (7th Cir. 1984); *In re Riddervold*, 647 F.2d 342 (2d Cir. 1981). But see *In re Carlsen*, 63 Bankr. 706 (Bankr. C.D. Cal. 1986); *In re Tabita*, 38 Bankr. 511 (Bankr. E.D. Pa. 1984) (transfer occurred when wages became payable).

⁷⁵⁹ *In re Madrid*, 725 F.2d 1197 (9th Cir. 1984); *In re Reinboldt*, 39 Bankr. 678 (D. Minn. 1984); *In re Strauser*, 40 Bankr. 868 (Bankr. N.D. Ohio 1984). But see *In re R & T Roofing Structures and Commercial Framing, Inc.*, 42 Bankr. 908 (Bankr. D. Nev. 1984), *aff’d*, 79 Bankr. 22 (D. Nev. 1987), *aff’d*, 887 F.2d 981 (9th Cir. 1989); *In re New Yorktown Ass’n*, 40 Bankr. 701 (Bankr. E.D. Pa. 1984); *In re Lakeview Inv. Grp., Inc.*, 40 Bankr. 449 (Bankr. E.D.N.C. 1984).

⁷⁶⁰ See generally the discussion under VII.A.6., above.

⁷⁶¹ See VII.A.6.a., above, for a further discussion of this issue. See also *In re R & T Roofing Structures and Commercial Framing, Inc.*, 42 Bankr. 908 (Bankr. D. Nev. 1984), *aff’d*, 79 Bankr. 22 (D. Nev. 1987), *aff’d*, 887 F.2d 981 (9th Cir. 1989). But see *In re Rogers Refrigeration, Inc.*, 33 Bankr. 59 (Bankr. D. Or. 1983); *In re Riverfront Food and Beverage Corp.*, 29 Bankr. 846 (Bankr. E.D. Mo. 1983); *In re Debmar Corp.*, 21 Bankr. 858 (Bankr. S.D. Fla. 1982).

⁷⁶² *In re Tenna Corp.*, 801 F.2d 819 (6th Cir. 1986).

⁷⁶³ See H.R. Rep. No. 595, 95th Cong., 2d Sess. 373, reprinted at 1978 U.S. Code Cong. & Admin. News 5787, 6329. See, e.g., *In re Middendorf*, 381 Bankr. 774 (Bankr. D. Kan. 2008) (estimated pre-payment of 2005 taxes to account for stock sales made eight days before petition was filed not considered preferential transfer as transfer was not on account of antecedent debt).

liability does not technically exist until the tax return is due. If the tax is not paid after the return is due, however, subsequent payment of the income tax constitutes payment of an antecedent debt and therefore is subject to avoidance if the other preference elements are satisfied.⁷⁶⁴

The antecedent debt and ordinary course of business defenses are not usually available when the payment relates to an employment tax liability that is not for the current period. However, while the employer's share of the employment tax payment may be recovered by the bankruptcy estate, the withheld or "trust fund" portion of the employment tax payment has been impressed with a trust in favor of the IRS and therefore is not property of the debtor or the bankruptcy estate.⁷⁶⁵

For a further discussion of trust fund tax payments in bankruptcy proceedings, see 639 T.M., *Responsible Person and Lender Liability for Trust Fund Taxes — Sections 6672 and 3505*.

c. Fraudulent Transfers

Under 11 U.S.C. §548(a)(1)(A), the trustee has the authority to avoid any transfer made within the one-year period immediately preceding the filing of the bankruptcy petition if the transfer was made by the debtor in order to hinder, delay, or defraud a past or future creditor. The trustee also can avoid transfers made for less than adequate consideration if: (1) the debtor was insolvent immediately after the transfer; (2) the debtor was conducting a trade or business with less than adequate capital; or (3) the debtor intentionally incurred debts that were beyond his ability to pay.⁷⁶⁶ Post-petition transfers may also be recovered under 11 U.S.C. §549. If the transferee is the IRS, however, sovereign immunity is not automatically waived for such an action.⁷⁶⁷

Under 11 U.S.C. §544(b)(1), a bankruptcy trustee can avoid fraudulent transfers if he can demonstrate that an unsecured creditor could avoid the same transfer under applicable law outside of bankruptcy (such as the state's fraudulent conveyance law) within the time period allowed by the applicable law. The trustee is permitted to step into the shoes of the IRS

⁷⁶⁴ *In re Cleveland Graphic Reprods., Inc.*, 78 Bankr. 819 (Bankr. N.D. Ohio 1987); H.R. Rep. No. 595, 95th Cong., 2d Sess. 373, reprinted at 1978 U.S. Code Cong. & Admin. News 5787, 6329.

⁷⁶⁵ *Begier v. IRS*, 496 U.S. 53 (1990). See *Stevenson v. IRS*, 2003-2 USTC ¶50,534 (Bankr. E.D. Mich. 2003) (simultaneity of transfer to revenue officer of check and tax return showing same amounts was sufficient to prevent set aside of transfer as preferential). See also *Slobodian v. IRS*, 822 F.3d 144 (3d Cir. 2016) and *Wolff v. United States*, 733 F.3d 583 (4th Cir. 2014) (express trust imposed on employee leasing company funds for withheld taxes of clients).

⁷⁶⁶ 11 U.S.C. §548(a)(1)(B). The issue in *IRS v. Lowe*, No. SA-23-cv-00004-XR, 2025 BL 94266 (W.D. Tex. 2025), was whether the debtors received reasonably equivalent value for their estimated tax payments. Noting that "most courts to consider the question have agreed that estimated tax payments are not recoverable as fraudulent transfers because the debtor receives such a dollar-for-dollar credit against future tax liability," the district court reversed the Bankruptcy Court, holding that "the prepetition estimated tax payments made by the Debtors (\$26,000) represented reasonable estimates of their 2021 tax liability (\$23,177), and thus the Debtors received the reasonably equivalent value of their estimated tax payments at the time the payments were made." The court also noted a split-tax-year election in December, resulting in the tax payments being pulled into the post-petition estate, would have been a zero-sum gain because the bankruptcy estate would have had to pay the tax liability.

⁷⁶⁷ *United States v. Nordic Village, Inc.*, 503 U.S. 30 (1992).

and invoke the applicable law — including the 10-year look-back period under §6502 — that the IRS could use outside of bankruptcy to avoid fraudulent transfers.⁷⁶⁸

Note: The U.S. Supreme Court recently ruled that, in the bankruptcy context, Congress's waiver of sovereign immunity under 11 U.S.C. §106(a)(1) with respect to 11 U.S.C. §544(b)(1) applies only to the §544(b) claim itself and does not extend to any underlying state-law causes of action that may be "nested within" the federal claim.⁷⁶⁹

To the extent that a transfer is avoided under 11 U.S.C. §544, §545, §547, §548, §549, §553(b), or §724(a), 11 U.S.C. §550 permits the trustee to recover the property transferred or, if ordered by the court, the value of the property, from (1) the initial transferee or the entity for whose benefit the transfer was made or (2) any immediate or mediate transferee of the initial transferee who did not take for value, in good faith, and without knowledge of the voidability of the transfer avoided.⁷⁷⁰

Whether a putative transferee is an initial transferee or a mere conduit depends on whether the putative transferee was able to use the funds for its own purposes or could exercise dominion and control over the funds.⁷⁷¹ Thus, when a president had his corporation make out a check payable to cash and used the funds to obtain a bank treasurer's check payable to the IRS to pay his personal income tax liabilities, and the corporation then entered into involuntary bankruptcy, a court held the IRS

⁷⁶⁸ *Mitchell v. Zagaroli (In re Zagaroli)*, No. 18-50508, 2020 BL 426515 (Bankr. W.D.N.C. 2020); *Vieira v. Gaither (In re Gaither)*, 595 B.R. 201 (Bankr. D.S.C. 2018); *Hillen v. City of Many Trees, LLC (In re CVAH, Inc.)*, 570 B.R. 816 (Bankr. D. Idaho 2017).

⁷⁶⁹ *United States v. Miller*, No. 23-824, 604 U.S. ____ (2025) (bankruptcy trustee may not use 11 U.S.C. §544(b) to recover tax payments made to IRS by debtor on behalf of two principals prior to bankruptcy filing).

⁷⁷⁰ In *Coleman v. Community Trust Bank*, 2002-2 USTC ¶50,744 (Bankr. W.D. Va. 2002), the taxpayer filed for reorganization of his coal companies to gain time to take business and tax planning actions to resolve tax problems that, if unresolved, would also lead to large personal tax liabilities due to a Subchapter S tax election. He and his joint filing spouse then granted deeds of trust to a bank to hinder IRS collection of unencumbered properties that they owned jointly. The spouse later filed for Chapter 11 bankruptcy. Acting as debtor-in-possession, the debtor spouse sought to avoid the deeds of trust under 11 U.S.C. §544(b). The court held that the deeds of trust should be avoided only to the extent necessary to pay the valid claims of the IRS, other creditors, and the estate's administrative expenses, but that they should otherwise be left in effect for the bank's benefit. The court also indicated its intent to rescind its order confirming the debtor's plan, which would have allowed her to retain the properties free and clear of the deeds of trust.

⁷⁷¹ *Bonded Fin. Servs, Inc. v. European Am. Bank*, 838 F.2d 890 (7th Cir. 1988). See *Luria v. ADP*, No. 3:09-bk-07047-JAF (Bankr. M.D. Fla. 2018) (when payroll service provider paid funds to third parties and was contractually obligated to withhold, company was mere conduit and was not required to return client's fraudulently transferred funds to trustee of client's bankruptcy estate); *In re C.F. Foods LP*, 265 Bankr. 71 (Bankr. E.D. Pa. 2001) (when IRS exercised dominion and control over pre-petition payments received from bankruptcy debtor by withholding penalty paid for the underpayment of estimated tax from its refund to limited partner of debtor, IRS was not a mere conduit through which funds passed to an initial transferee). But see *In re Abatement Environmental Resources, Inc.*, 301 Bankr. 824 (Bankr. D. Md. 2002) (when trustee's claim arose under state law, fraudulent conveyance action to recover taxes paid to the IRS rejected, as state law restricts refunds of voluntary tax payments); *United States v. Menotte*, 484 Bankr. 835 (S.D. Fla. 2012) (when debtor obtained refund of estimated tax, IRS exercised no discretion and mere fact that §6402 allowed for offset did not preclude determination that IRS was acting as mere conduit when receiving and refunding payment at direction of debtor).

was not an initial transferee from whom the bankruptcy trustee could recover the funds.⁷⁷²

d. Assumption/Rejection of Contracts

Subject to the bankruptcy court's approval, the trustee can assume or reject any executory contracts entered into by the debtor before the bankruptcy petition is filed. This appears to include any offer in compromise that the IRS accepted before the filing of the bankruptcy petition and any future income collateral agreements between the IRS and the debtor.⁷⁷³

e. Claim for Refund by Bankruptcy Estate

Bankruptcy Code §505(a)(2)(B) governs the right of the bankruptcy estate to a refund.⁷⁷⁴ As a procedural matter, the bankruptcy trustee must file a claim for refund with the IRS to raise the refund issue. The bankruptcy court can then determine the right of the estate to the refund after the earlier of: (1) 120 days after the trustee files the claim for refund; or (2) the date of notice of the IRS refund claim determination. The estate's ability to recover property also may be limited by the §6511 statute of limitations for filing a tax refund claim. The automatic stay does not create an implied exception to the time limits set out in §6511.⁷⁷⁵

Under §541(a)(1) of the Bankruptcy Code, the estate's property includes all property in which the debtor has a legal or equitable interest at the commencement of the bankruptcy case. Under §541(a)(7) of the Bankruptcy Code the estate's property includes any interest in property that the estate acquires after the commencement of the case.⁷⁷⁶ A refund attributable to the pre-petition portion of the taxable year when bankruptcy commenced for which the debtor does not elect to bifurcate the taxable year at the commencement of bankruptcy under §1398(d)(2) is property of the bankruptcy estate.⁷⁷⁷ The refundable por-

tion of the earned income credits attributable to the pre-petition portion of the taxable year when bankruptcy occurred are not property of the bankruptcy estate if an exemption is claimed even if the debtor does not elect to close the taxable year at the commencement of bankruptcy under §1398(d)(2).⁷⁷⁸

Some cases have held that the trustee could not set aside an election by the debtor to apply a tax refund for the taxable year preceding bankruptcy to the debtor's tax liability for the next taxable year even though the tax liability for that year was not a liability of the bankruptcy estate.⁷⁷⁹ In one of these cases, the amount of liability for the next year to which the refund could be applied was limited to the liability attributable to the pre-petition portion of the taxable year.⁷⁸⁰

For discussion of the inclusion of a portion of a tax refund from a jointly filed return in the bankruptcy estate, see VII.A.3., above.

C. Discharging or Reducing Tax, Interest, and Penalties

The goal of the Bankruptcy Code is to provide debtors with a fresh start. To this end, 11 U.S.C. §524 provides for a permanent injunction against the collection of debts that are discharged in a bankruptcy proceeding. This discharge injunction applies to all creditors, including the IRS.

The question of which taxes, interest, and penalties ultimately must be paid therefore depends on whether the taxes are considered to be dischargeable under the Bankruptcy Code. If taxes are dischargeable, IRS collection is limited to the payments received through the bankruptcy proceeding (plus possible collection from exempt and excluded property if the lien is not avoided). On the other hand, if the taxes are nondischargeable, the IRS can collect the amount due through the bankruptcy proceeding and/or collect directly from the debtor-taxpayer once the automatic stay is lifted. See the Worksheets for a Dischargeability Summary.

A discharge in bankruptcy operates as an injunction against collection of any discharged debts.⁷⁸¹ If the IRS attempts to collect a discharged tax liability from property that is not subject to an NFTL, sovereign immunity is waived to allow the injured debtor to recover damages, provided the IRS collection

⁷⁷² *Richardson v. United States*, 277 Bankr. 875 (B.A.P. 1st Cir. 2002).

⁷⁷³ 11 U.S.C. §365(a).

⁷⁷⁴ See Rev. Proc. 2010-27, which provides procedures for trustees to follow to request a tax refund from the IRS (other than for applications for tentative carrybacks or refund adjustments under §6411). Announcement 2011-77, modified Rev. Proc. 2010-27 to provide a new address for the IRS's Centralized Insolvency Operation and links to additional information for trustees on the IRS website.

⁷⁷⁵ *In re Armstrong*, 206 F.3d 465 (5th Cir. 2000).

⁷⁷⁶ See *Segal v. Rochelle*, 382 U.S. 375 (1966). See also *Kokoszka v. Belford*, 417 U.S. 642 (1974); *In re Hooper*, 2011-1 USTC ¶50,113 (Bankr. D. Ariz. 2010) (net operating loss refund generated by post-petition change in legislation); *In re Flying J Inc.*, 2010-1 USTC ¶50,155 (Bankr. D. Del. 2009) (debtor's carryback refund claim filed after initiation of bankruptcy proceedings was pre-bankruptcy-petition filing against which IRS could set off its claims for excise and employment taxes and penalties incurred before bankruptcy proceedings; quoting *Segal* to effect that "the loss-carryback refund claim in this case ... is sufficiently rooted in the pre-bankruptcy past" to qualify as pre-petition claim). But see FSA 200039007 (debtors required to carryback post-bankruptcy NOL to tax year that was discharged in bankruptcy because IRS may make adjustments to discharged year in order to determine correct tax liability for nondischarged year).

⁷⁷⁷ *Barowsky v. Serelson*, 946 F.2d 1516 (10th Cir. 1991). See *Law v. Stove*, 97 AFTR 2d 705 (B.A.P. 8th Cir. 2006) (refund resulting from child tax credit for pre-petition year is property of bankruptcy estate). See also *In re Meyers*, 616 F.3d 626 (7th Cir. 2010) (noting that several other methods are available for calculating pre-petition share of tax refund; holding that trustee presented prima facie case for use of "pro-rata-by-days" method); *Shields v. Adams*, 453 Bankr. 774 (Bankr. N.D. Ala. 2011). See also *Hebert v. Royal*, 463 Bankr. 142 (B.A.P. 10th Cir. 2011) (state law at issue does not recognize tracing of exempt funds, so exempt character of debtor's tax refund could not be

established); *EDP Medical Computer Sys., Inc. v. United States*, 480 F.3d 621 (2d Cir. 2007) (while debtor had standing to pursue tax refund claim under Article III of U.S. Constitution, under bankruptcy process debtor may not invoke district court's jurisdiction to assert claim because refund belongs to bankruptcy estate). Cf. *Smith v. Mosier*, 2009-1 USTC ¶50,247 (B.A.P. 10th Cir. 2009) (followed conclusion reached by Utah Supreme Court in interpreting its state exemption statute). For further discussion, see 1540 T.M., *State Tax Aspects of Bankruptcy* (State Tax Library).

⁷⁷⁸ *Baer v. Jones*, 224 F.3d 1193 (10th Cir. 2000); *Accord In re Annis*, 232 F.3d 749 (10th Cir. 2000); *In re Jorge Haedo*, 211 Bankr. 149 (Bankr. S.D.N.Y. 1997). See *Law v. Stove*, 97 AFTR 2d 705 (B.A.P. 8th Cir. 2006) (child tax credit not distinguished from earned income credits); *Cohen v. Borgman*, 698 F.3d 1255 (10th Cir. 2012) (nonrefundable portion of the child tax credit cannot give rise to a refund because it is not treated as a payment and, therefore, it is outside the scope of the state exemption statute).

⁷⁷⁹ *Traina v. Orrill*, 226 Bankr. 563 (Bankr. E.D. La. 1997), and *Carey v. United States*, Doc. Adv. No. 1-90-0254 (Bankr. N.D. Cal. 1991).

⁷⁸⁰ *Carey v. United States*, Doc. Adv. No. 1-90-0254 (Bankr. N.D. Cal. 1991) (unrep. op.)

⁷⁸¹ 11 U.S.C. §524(a)(2). The injunction operates against action to collect, recover or offset debt, such as letters, phone calls, or threats of criminal proceedings.

actions are shown to be willful.⁷⁸² A taxpayer/debtor may bring an action under §7433 for the IRS's willful violation of the discharge provisions, but only after first exhausting administrative remedies.⁷⁸³ A violation is considered to be willful if the IRS knows of the discharge and intentionally acts in violation of the discharge injunction.⁷⁸⁴ The IRS can attack the validity of the discharge if the discharge was obtained by fraud.⁷⁸⁵

1. Discharge and Exceptions to Discharge for Individuals

Bankruptcy Code §727(b), §1141(d)(2), and §1328 govern discharges for individuals. Each chapter has its own rules governing dischargeability of taxes. An individual debtor may be discharged from all debts that arise before the filing of the bankruptcy petition that are not excepted from discharge. There is an extensive list of exceptions, however.⁷⁸⁶ These exceptions are the nondischargeable liabilities. Though characterized as nondischargeable taxes, even these taxes can be discharged without full payment in an entity's Chapter 11 case or in an individual's Chapter 13 case filed under the law before the 2005 Bankruptcy Act under certain circumstances. It is therefore important to understand the general rules governing the nondischargeable taxes and the specific rules for Chapter 7, 11, and 13 cases.

a. General Rules for Nondischargeable Taxes

The major categories of nondischargeable taxes are: (1) priority taxes; (2) taxes on returns either not filed or filed late within two years before the bankruptcy petition; (3) fraudulent tax liabilities; and (4) taxes where the taxpayer has willfully avoided payment. In addition, specific rules apply to the discharge of interest and penalties.

Note: In some cases, the threshold question that must be answered is whether a credit repayment provision is a "debt" or a "tax."⁷⁸⁷

⁷⁸² 11 U.S.C. §105, §524. See *Jove Eng'g, Inc. v. IRS*, 92 F.3d 1539 (11th Cir. 1996); *Hardy v. United States*, 97 F.3d 1384 (11th Cir. 1996) (IRS is liable for damages if post-discharge levy was willful); *In re Cohen*, 2000-1 USTC ¶50,161 (Bankr. S.D. Fla. 1999) (IRS in civil contempt for violating automatic stay five times and discharge injunction, and fined \$10 million); *In re Murphy*, 554 Bankr. 535 (Bankr. D. Me. 2015) (IRS liable for damages related to post-bankruptcy discharge collection attempt; court rejected IRS defense that assigned attorney had dementia).

⁷⁸³ §7433(e). See, e.g., *In re Abate*, 2008-1 USTC ¶50,264 (D.N.J. 2008) (bankruptcy court does not have jurisdiction to compel IRS to return seized tax refund to debtor who alleges IRS violated discharge provisions where debtor has not first exhausted administrative remedies as required by §7433(d)).

⁷⁸⁴ *IRS v. Murphy*, 892 F.3d 29 (1st Cir. 2018).

⁷⁸⁵ *Bussell v. Commissioner*, 130 T.C. 222 (2008).

⁷⁸⁶ See, PMTA 2012-19 addressing the general effect of late and/or notice to the IRS of the beginning of a Chapter 13 case on the dischargeability of the debtor's pre-petition tax liabilities. See IRM 5.9 and IRM 5.17 for guidance on discharging the individual shared-responsibility payment.

⁷⁸⁷ *Compare, e.g., Betancourt v. United States (In re Betancourt)*, 582 B.R. 480, 2018 BL 34883 (Bank. W.D. Mo. Feb. 1, 2018) (debtor's recapture of §36(f)(1) payments owed to IRS were dischargeable because repayment obligations were considered "debt" within meaning of Bankruptcy Code) with *In re Shin*, No. 17-13509-BFK, 2021 BL 52549 (Bankr. E.D. Va. Feb. 16, 2021) (using functional approach, court reasons that recapture obligation is tax because such obligation arose from credit against debtor's tax obligation) and *In re Bryan*, No. 10-10175, 2014 BL 53678 (Bankr. N.D. Cal. Feb. 27, 2014) (court characterized obligation to repay §36 new homebuyer tax credit as nondischargeable tax rather than dischargeable general obligation).

(1) Priority Taxes

All priority taxes are nondischargeable.⁷⁸⁸ These priority tax claims are set forth in VII.A.5.b., above. The major categories of priority taxes are: (1) taxes due within three years before the bankruptcy petition; and (2) all collected (trust fund) taxes due at any time.

With regard to the three-year look-back window for priority tax claims set forth in 11 U.S.C. §507(a)(8)(A)(i), one issue that may arise is what effect, if any, does the filing of a request for a collection due process (CDP) hearing under §6330(e) have on the look-back period? Several courts that have addressed the issue have held that the so-called "flush language" found at the end of 11 U.S.C. §507(a)(8) tolls (i.e., extends) the look-back period for the number of days the CDP matter remains pending, plus another 90 days.⁷⁸⁹

(2) Unfiled or Late-Filed Returns

A discharge is not available for any tax for which the related return is not filed and for any tax for which the related return is filed late (after considering extensions granted) and is filed within two years before the bankruptcy petition date.⁷⁹⁰

It is important for this test to qualify as a "return" to start the two-year period. The 2005 Bankruptcy Act attempted to add some clarity to the issue of what constitutes a return for this dischargeability test.⁷⁹¹ Under the 2005 Act, the following documents constitute a return:

- any return that satisfies the requirements of a return under nonbankruptcy laws;
- a return prepared by the IRS and signed by the taxpayer under §6020(a);

⁷⁸⁸ See *In re Gust*, 197 F.3d 1112 (11th Cir. 1999) (priority tax nondischargeable even though claim was secured claim).

⁷⁸⁹ See, e.g., *Console v. Commissioner*, 291 Fed. Appx. 234 (11th Cir. 2008) (§6330(e) is tolling event under 11 U.S.C. §507(a)(8)'s flush paragraph); *Alexander v. IRS (In re Alexander)*, No. 19-51433 (JAM), 2020 BL 453538 (Bankr. D. Conn. Nov. 20, 2020) (collection due process activity tolled the three-year look-back period creating a priority non-dischargeable claim); *In re Lastra*, No. 12-1188 (Bankr. D.N.M. Dec. 21, 2012) (Congress intended to toll three-year look-back period if taxpayer filed CDP hearing request and later filed for bankruptcy relief); *Tenholder v. United States*, No. 17-cv-1310-DRH (S.D. Ill. Sept. 17, 2018) (agreeing with *Lastra* court that flush language was intended to apply to CDP matters, and therefore, IRS's inability to collect tax by levy during pendency of CDP hearing was sufficient to toll three-year look-back period of §507(a)(8)).

⁷⁹⁰ 11 U.S.C. §523(a)(1)(B). See *In re Smith*, 96 F.3d 800 (6th Cir. 1996) (income taxes not discharged where tax return is filed late and such filing is made within two years of bankruptcy petition's filing date); *In re Mulcahy*, 260 Bankr. 612 (Bankr. D. Mass. 2001) (where first purported returns were insufficient to allow calculation of taxes due, operative return filing date was later date on which taxpayer filed adequate returns from which the IRS made assessments); *Washington v. Commissioner*, 120 T.C. 114 (2003); *Nilsen v. Mass. Dep't of Revenue*, 557 Bankr. 1 (D. Mass. 2016) (late filed returns were not "equivalent reports" for discharge purposes); *Iverson v. IRS (In re Iverson)*, No. 13-37732, 2020 BL 152391 (Bankr. S.D. Tex. Apr. 23, 2020) (tax liability on debtors' late-filed returns filed within two years of bankruptcy petition is not dischargeable; Form 4340, *Certificate of Assessments and Payments*, constitutes valid evidence of a taxpayers' assessed liabilities).

⁷⁹¹ 11 U.S.C. §523(a). See, e.g., *Maryland v. Ciotti*, 638 F.3d 276 (4th Cir. 2011) (report was "equivalent" to a return for purposes of 11 U.S.C. §523(a)(1)(B) because, despite the fact that it need not be signed, to provide false or misleading information with intent to evade payment or collection of tax was criminal offense and complete copy of the federal audit including an explanation of adjustments as well as disagreements was required).

- a report (presumably an audit report) that is equivalent to a return;
- a stipulated judgment or final order entered by a non-bankruptcy tribunal.

A return prepared by the IRS under §6020(b) that is *not* signed by the taxpayer still is not a return.

Note: This 2005 change failed to end the disputes. Uncertainty remains as to what constitutes “a return under nonbankruptcy laws.” According to the IRS, when a debtor submits a Form 1040 after assessment under §6020(b), only the portion of the tax that was not previously assessed would be subject to discharge. If the Form 1040 filed after the assessment reports no additional tax, or a tax decrease, no portion of the tax is dischargeable. Thus, a specific tax year may have a portion of the liability that is subject to discharge and a portion that is excepted from discharge under 11 U.S.C. §523(a)(1)(B)(i).⁷⁹²

Courts disagree on whether 11 U.S.C. §523(a) includes the timeliness requirements of the Code. Some courts have concluded that the applicable nonbankruptcy law necessarily includes the timeliness requirement of §6072(a).⁷⁹³ Other courts have concluded that “applicable filing requirements” address the form and content of a filing rather than its timeliness.⁷⁹⁴

Courts also disagree as to whether “applicable nonbankruptcy law” includes pre-BAPCPA case law, such as the *Beard* test. Some courts interpret the addition of 11 U.S.C. §523(a) as providing a clear definition of return, eliminating the need for analysis under pre-BAPCPA case law.⁷⁹⁵ Other courts include the *Beard* analysis in the law applicable to defining a “return” for dischargeability purposes.⁷⁹⁶ Still others engage in analysis

under the *Beard* test without explicitly adopting it as the test for what constitutes a “return,” and look to whether the filing represents “an honest and reasonable attempt to satisfy the tax law.”⁷⁹⁷

The Eighth Circuit has adopted an objective version of the “honest and reasonable” requirement where the honesty and genuineness of the taxpayer’s attempt to satisfy the tax law is determined based on the information provided on Form 1040.⁷⁹⁸ In contrast, the First Circuit has adopted the subjective version of the “honest and reasonable” requirement used by other Circuit Courts⁷⁹⁹ to review the taxpayer’s conduct for failing to file a timely return.⁸⁰⁰ Under the subjective version, tax liabilities are non-dischargeable where the taxpayer has no legitimate explanation for the late returns.⁸⁰¹

(3) Fraudulent Return

A discharge cannot be obtained for any tax for which the related return is fraudulent.⁸⁰² The settlement of a Tax Court case by agreeing to the §6663 fraud penalty does not establish fraud for purposes of determining dischargeability in bankruptcy. To be collaterally estopped from raising the fraud issue, the issue must actually have been litigated in another forum.⁸⁰³ A

due to taxpayer’s “belated acceptance of responsibility” which was not reasonable attempt to comply with tax code; court deferred judgment on whether any post-assessment filing could be “honest and reasonable”); *In re Starling*, No. 13-36564, 2020 BL 230251 (Bankr. S.D.N.Y. June 19, 2020) (debtor’s tax debt was discharged because the late filed return was an honest and reasonable attempt to satisfy the tax law requirements); *In re Van Arsdale*, No. 14-04035 (Bankr. N.D. Cal. May 18, 2017.) (return filed over four years after due date and IRS preparation of substitute return was not honest and reasonable attempt to satisfy tax obligation); *Biggers v. IRS*, 557 Bankr. 589 (M.D. Tenn. 2016) (determination of fourth prong of *Beard* analysis is subjective and allows for circumstances in which there can be honest and reasonable attempt to comply with tax law even after assessment by IRS and even when untimely forms do not report additional tax liability; court found taxpayer’s filings could have aided IRS in determining both amount and collectability of tax debts); *Rhodes v. United States*, 498 Bankr. 357 (Bankr. N.D. Ga. 2013); *In re Mallo*, 498 Bankr. 268 (D. Colo. 2013), *aff’d*, 774 F.3d 1313 (10th Cir. 2014), *cert. denied sub nom.*, *Mallo v. IRS*, 135 S. Ct. 2889 (2015).

⁷⁹⁷ See *Wogoman v. IRS*, 475 Bankr. 239 (B.A.P. 10th Cir. 2012) (concluding that tax debt was non-dischargeable whether using *Beard* test or other tests); *Perry v. United States*, 500 Bankr. 796 (Bankr. M.D. Ala. 2013); *Smythe v. United States*, 109 AFTR 2d 2012-1392 (Bankr. W.D. Wash. 2012) (return filed after assessment represented debtor’s honest and reasonable attempt to disclose relevant financial data).

⁷⁹⁸ See *Colsen v. United States*, 446 F.3d 836 (8th Cir. 2006) (taxpayer’s subjective intent irrelevant).

⁷⁹⁹ See, e.g., *Giacchi v. United States*, 856 F.3d 244 (3d Cir. 2017); *Justice v. United States*, 817 F.3d 738 (11th Cir. 2016); *Smith v. IRS*, 828 F.3d 1094 (9th Cir. 2016).

⁸⁰⁰ See *Kriss v. United States*, 53 F.4th 726 (1st Cir. 2022).

⁸⁰¹ See *Kriss*, 53 F.4th 726 (taxpayer’s only excuse was false assurance from spouse); see also *Justice*, 817 F.3d 738 (“Failure to file a timely return, at least without a legitimate excuse or explanation, evinces the lack of a reasonable effort to comply with the law.”).

⁸⁰² 11 U.S.C. §523(a)(1)(C). Where a taxpayer includes another person’s income on their tax return along with their income, this does not constitute the filing of a fraudulent return as a matter of law for purposes of dischargeability. *In re Rouley*, 2004-1 USTC ¶50,144 (Bankr. M.D. Fla. 2003). Even if the bankruptcy court initially determines that the taxes are dischargeable, the Tax Court may later assert jurisdiction and declare the taxes nondischargeable, as which may occur, for example, where the taxpayer is later convicted in part of having fraudulently caused the bankruptcy court to discharge the tax debts in the first instance. See *Estate of Bussell v. Commissioner*, 130 T.C. 222 (2008).

⁸⁰³ See *In re Palmer*, 207 F.3d 566 (9th Cir. 2000) (collateral estoppel did not apply to issue of whether debtor made fraudulent return where issue was not actually litigated in prior Tax Court proceeding); *In re Graham*, 973 F.2d

⁷⁹² CC-2010-016; IRM 5.9.2.10.1.2 (01-13-23).

⁷⁹³ See *In re Briggs*, 511 Bankr. 707 (Bankr. N.D. Ga. 2014); *McCoy v. Miss. State Tax Comm.*, 666 F.3d 924 (5th Cir. 2012) *cert. denied*, 133 S. Ct. 192 (2012); *Cannon v. United States*, 451 Bankr. 204 (Bankr. N.D. Ga. 2011); *Creekmore v. IRS*, 401 Bankr. 748 (Bankr. N.D. Miss. 2008); *Mallo v. IRS*, 774 F.3d 1313 (10th Cir. 2014), *cert. denied*, 135 S. Ct. 2889 (2015) (late filed returns are not “returns” under 11 U.S.C. §523 and therefore tax debts reflected in late-filed Forms 1040 are not dischargeable). See also *In re Fahey*, 779 F.3d 1 (1st Cir. 2015).

⁷⁹⁴ See *In re Davis*, 116 AFTR 2d 2015-6318 (Bankr. D.N.J. 2015) (late-filed returns were returns and earlier tax obligations were discharged in earlier bankruptcy filing); *Colsen v. United States*, 446 F.3d 836 (8th Cir. 2006). See also *Brown v. Mass. Dep’t of Revenue*, 489 Bankr. 1 (Bankr. D. Mass. 2013) *aff’d sub nom.*, *Gonzalez v. Mass. Dep’t of Rev.*, 506 Bankr. 317 (B.A.P. 1st Cir. 2014).

⁷⁹⁵ See, e.g., *McCoy v. Miss. State Tax Comm.*, 666 F.3d 924, 929 (5th Cir. 2012), *cert denied* 133 S. Ct. 192 (2012); *Shinn v. IRS*, 2012-1 USTC ¶50,266 (Bankr. C.D. Ill. 2012); *Hernandez v. IRS*, 2012-1 USTC ¶50,152 (Bankr. W.D. Tex. 2012); *Links v. United States*, 2009-2 USTC ¶50,631 (Bankr. N.D. Ohio 2009).

⁷⁹⁶ Under *Beard v. Commissioner*, 82 T.C. 766 (1984), *aff’d per curiam*, 793 F.2d 139 (6th Cir. 1986), a return must: (1) purport to be a return; (2) be executed under penalty of perjury; (3) contain data sufficient to allow calculation of tax; and (4) be an honest and reasonable attempt to satisfy the requirements of the tax law. See also *Mass. Dep’t of Revenue v. Shek (In re Shek)*, 947 F.3d 770, 781 (11th Cir. 2020) (late-filed return does not automatically cease status as a “return” merely because of late filing); *Fremont v. United States*, 748 Fed. Appx. 137 (9th Cir. 2019) (unpub.) (tax debts not discharged because the filing of information three to five years after IRS assessment was not “an honest and reasonable attempt to comply with the tax code”); *Giacchi v. United States*, 856 F.3d 244 (3d Cir. 2017) (Third Circuit adopts *Beard* factors; discharge denied because late filed returns were not honest and reasonable attempt to comply with law); *Justice v. United States*, 817 F.3d 738 (11th Cir. 2016); *Smith v. IRS*, 828 F.3d 1094 (9th Cir. 2016) (Ninth Circuit adopts *Hatton* and *Beard* factors of what constitutes return; denies discharge

criminal conviction after a trial or by plea typically establishes the requisite fraud.⁸⁰⁴ The fraud of one spouse on a joint return does not preclude discharge for the nonfraudulent spouse.⁸⁰⁵

(4) Willful Avoidance of Payment

Even if the applicable return was not fraudulent, a taxpayer cannot obtain a discharge for any tax for which the taxpayer willfully attempts to evade or defeat the tax. There has been extensive litigation over the meaning of willfulness in this context. Most courts hold that willfulness requires a mental state (knowledge of the liability) and conduct (affirmative acts to divert or conceal assets).⁸⁰⁶ It may also be that a specific intent to avoid payment notwithstanding the ability to pay but without affirmative conduct constitutes willfulness.⁸⁰⁷ On the other hand, knowledge of the tax without the ability to pay does not preclude discharge.⁸⁰⁸ It is less clear whether knowledge of the tax and excessive expenditures without more meets the willfulness requirement.⁸⁰⁹

1089 (3d Cir. 1992); *In re Krumhorn*, 249 Bankr. 295 (Bankr. N.D. Ill. 2000) (collateral estoppel precludes relitigation of willful evasion issue litigated in and essential to Tax Court judgment that transactions lacked economic substance); *Bova v. United States*, 98-2 USTC ¶50,803 (Bankr. M.D. Fla. 1998) (Tax Court stipulations of additions to tax under §6663 do not preclude debtor from asserting that tax liabilities are dischargeable in subsequent bankruptcy proceeding).

⁸⁰⁴ *In re Simone*, 252 Bankr. 302 (Bankr. E.D. Pa. 2000) (collateral estoppel barred litigation of dischargeability of taxes in bankruptcy court after debtor pled guilty to criminal tax evasion). See also *Terrell v. IRS*, 119 AFTR 2d 2017-810 (B.A.P. 10th Cir. 2017) (taxpayer collaterally estopped from seeking discharge where taxpayer was convicted of filing false return); *Wilcoxson v. United States*, 2002-1 USTC ¶50,190 (Bankr. S.D. Ala. 2002) (tax liabilities not dischargeable, as debtor doctor was convicted of tax evasion, conspiracy, mail fraud, wire fraud, and currency transaction reporting violations during years in issue).

⁸⁰⁵ *In re Birkenstock*, 87 F.3d 947 (9th Cir. 1996).

⁸⁰⁶ *United States v. Vaughn*, 765 F.3d 1174 (10th Cir. 2014) (discharge of federal tax liability denied where taxpayer entered tax shelter transaction aware of risks and spent assets frivolously although aware of impending assessment); *United States v. Coney*, 689 F.3d 365 (5th Cir. 2012) (large cash transactions without reporting while deferring tax payments constitutes willfulness); *United States v. Mitchell*, 633 F.3d 1319 (11th Cir. 2011) (titling homes in wife's name, depositing business income in wife's accounts to avoid IRS garnishments, and excessive spending showed willfulness); See *In re Jacobs*, 490 F.3d 913 (11th Cir. 2007) (government must show that debtor has engaged in (1) evasive conduct, with (2) a mental state consistent with willfulness); See *In re Gardner*, 360 F.3d 551 (6th Cir. 2004) (lavish personal expenses and diverting funds to nominee accounts constituted willful attempt to evade or defeat); *United States v. Griffith*, 206 F.3d 1389 (11th Cir. 2000) (affirmative acts designed to evade or defeat payment of taxes render tax nondischargeable in bankruptcy); *United States v. Tudisco*, 183 F.3d 133 (2d Cir. 1999) (knowing failure to pay, failure to file, and submission of false withholding statements was more than mere nonpayment); *In re Birkenstock*, 87 F.3d 947 (7th Cir. 1996); *Dalton v. IRS*, 77 F.3d 1297 (10th Cir. 1996) (concealment of ownership assets sufficient act to establish willfulness); *Bruner v. United States*, 55 F.3d 195 (5th Cir. 1995) (use of nominee entities and cash transactions constituted affirmative acts).

⁸⁰⁷ *United States v. Fretz*, 244 F.3d 1323 (11th Cir. 2001) (medical doctor's failure to file returns and pay taxes due to alcoholism constituted willful attempt to defeat or evade tax obligations; "in any manner" language covers attempts to evade or defeat a tax whether accomplished by acts of culpable omission or acts of commission), rev'g 2000-1 USTC ¶50,470 (N.D. Ala. 2000).

⁸⁰⁸ *In re Haas*, 48 F.3d 1153 (11th Cir. 1995).

⁸⁰⁹ *Hawkins v. Franchise Tax Bd.*, 769 F.3d 662 (9th Cir. 2014) (willfulness requires showing of specific intent to evade the tax, and thus, the mere showing of spending in excess of income is not sufficient to establish the required intent). But see *United States v. Stanley*, 595 Fed. Appx.314 (5th Cir. 2014) (unpub.), cert. denied, 135 S. Ct 2891 (2015) (complicated real estate transactions, withdrawing cash from corporation and funneling the same to wife, maintain-

(5) Nonpecuniary Loss Penalties

There is a split of opinion as to the treatment of nonpecuniary loss tax penalties. Some courts have held that tax penalties are treated the same as the related tax. Therefore, if the tax is nondischargeable, the penalty is similarly nondischargeable.⁸¹⁰ More courts have held, however, that if the transaction that gave rise to the penalty occurred more than three years before the bankruptcy petition was filed, the penalty is dischargeable regardless of the status of the related tax.⁸¹¹

Labels are not controlling. In some instances, what is called a "tax" is in fact a penalty for dischargeability purposes and vice versa. For example:

- The 10% tax on a pension plan's accumulated fund deficiency under §4971 is a penalty, not an excise tax.⁸¹²
- The 10% penalty imposed under §72(t) for early distribution from pension plan is a nonpecuniary loss penalty.⁸¹³
- The flat 20% assessment for reversion of pension funds to the employer is an excise tax entitled to priority status, not a nonpecuniary loss penalty.⁸¹⁴

It also appears that the increased interest for tax-motivated transactions under former §6621(c) is considered interest, not a penalty, and therefore is nondischargeable if the tax is nondischargeable.⁸¹⁵

(6) Unscheduled Liability

Discharge will not be granted for a tax debt that is not scheduled on the current income and expense summary if the IRS is not notified within sufficient time to allow the IRS to file a timely proof of claim (unless the IRS has actual knowledge of the bankruptcy case).⁸¹⁶

ing a lavish lifestyle and putting his unopened mail in a box yet simultaneously and timely servicing other debts constituted willfulness); *United States v. Fegeley*, 118 F.3d 979 (3d Cir. 1997) (failure to file returns and pay taxes met definition of willful attempt under civil willfulness test); *Toti v. United States*, 24 F.3d 806 (6th Cir. 1994) (standard for determining willfulness for dischargeability purposes is found in civil cases, which equate "willful" with voluntary, conscious, and intentional evasion); *United States v. Eaton*, No. 2:17-cv-01220, 2020 BL 199306 (S.D. W.Va. May 28, 2020) (despite purchase by taxpayer couple of multiple homes and boats, wife that was president in title of company yet did not participate in management of company funds nor household funds not deemed to willfully evade payment where she was aware tax return was filed late but had no reason to think tax liability would not be paid).

⁸¹⁰ See, e.g., *Cassidy v. Commissioner*, 814 F.2d 477 (7th Cir. 1987).

⁸¹¹ See *McKay v. United States*, 957 F.2d 689 (9th Cir. 1992); *Roberts v. United States*, 906 F.2d 1440 (10th Cir. 1990); *In re Burns*, 887 F.2d 1541 (11th Cir. 1989); *United States v. Wilson*, 2016-1 USTC ¶50,200 (N.D. Cal. 2016) (extended due date must be more than three years before bankruptcy petition); *In re Kuchar*, 2003-2 USTC ¶50,527 (Bankr. D.N.D. 2003). Some courts have found that the interest that attaches to dischargeable penalties that are attributed to nondischargeable underlying tax liabilities is dischargeable. E.g., *In re Miller*, 2003-2 USTC ¶50,598 (Bankr. N.D. Ohio 2003); *In re Fortney*, 76 AFTR 2d 95-5319 (Bankr. S.D. Ga. 1995).

⁸¹² See *United States v. Reorganized CF & I Fabricators of Utah, Inc.*, 518 U.S. 213 (1996).

⁸¹³ *In re Cassidy*, 983 F.2d 161 (10th Cir. 1992).

⁸¹⁴ *United States v. Juvenile Shoe Corp. of Am.*, 99 F.3d 898 (8th Cir. 1996) (relying on *Reorganized CF & I Fabricators*, court notes that labels do not define whether an assessment is a penalty or tax — a tax is a burden for the purpose of supporting the government, whereas a penalty is an exaction imposed as punishment for an unlawful act).

⁸¹⁵ *In re Hardee*, 137 F.3d 337 (5th Cir. 1998).

⁸¹⁶ 11 U.S.C. §523(a)(3).

(7) *Interest and Penalties on Nondischargeable Tax*

Pre-petition interest on nondischargeable tax claims is nondischargeable.⁸¹⁷ As indicated above, nonpecuniary loss penalties relating to nondischargeable taxes also are nondischargeable if the event giving rise to the penalty occurs within three years of the bankruptcy petition date.⁸¹⁸ Post-petition interest is also considered to be nondischargeable if the underlying tax is nondischargeable.⁸¹⁹ Calculation of the interest begins on the date of assessment.⁸²⁰ Nondischargeable post-petition interest and penalties are generally collected directly from the debtor after the automatic stay is lifted.⁸²¹ The IRS, however, may not collect post-petition interest and penalties in a Chapter 11 case if payment of these amounts is provided for in the plan of reorganization except to the extent that the plan fails to provide for interest from the petition date to the confirmation date.⁸²²

Note: After a discharge is granted, the IRS cannot reallocate payments from nondischargeable taxes to dischargeable penalties. Such a reallocation scheme would violate the discharge injunction.⁸²³

(8) *Effect of Earlier Bankruptcy*

Ordinarily, determining the dischargeability of non-trust fund taxes in a bankruptcy case is fairly simple: 11 U.S.C. §523(a)(1)(A), by reference to §507(a)(8)(A)(i), provides that the non-trust fund taxes are generally dischargeable if they are: (1) due more than three years, (2) filed more than two years, and (3) assessed more than 240 days, before the bankruptcy petition. In some cases, however, debtors have made prior bank-

ruptcy filings. These earlier bankruptcies complicate the general rule because the automatic stay prevented the IRS from collecting the taxes while the earlier case was pending. Accordingly, the priority periods of §507(a)(8)(A)(i) may be suspended during the first bankruptcy proceeding. Prior to the 2005 Bankruptcy Act, the majority of courts that decided this issue held that §6503(b), §6503(h), and 11 U.S.C. §108(c) operate to suspend the priority periods of 11 U.S.C. §507(a)(8)(A)(i).⁸²⁴ Other courts held that the authority is a discretionary authority that derives from Bankruptcy Code §105, not §108(c).⁸²⁵

The U.S. Supreme Court ruled that the three-year lookback period under 11 U.S.C. §507(a)(8)(A)(i) is tolled by the length of time that the taxpayers were debtors in a prior bankruptcy, notwithstanding the absence of any language in the provision that would allow such tolling.⁸²⁶ The Court explained that the lookback period is a procedural limitations period subject to traditional equitable tolling principles, and nothing in the Bankruptcy Code precludes equitable tolling of the lookback period. The Court also decided that tolling was appropriate regardless of the debtors' intentions when filing back-to-back Chapter 13 and Chapter 7 petitions (i.e., whether the debtors filed the Chapter 13 petition in good faith or solely to run down the lookback period) because the IRS was prevented from protecting its claim during the pendency of the Chapter 13 petition. Declining to resolve whether 11 U.S.C. §108(c)(1) contains a tolling provision, the Court determined that it would draw no negative inference from the presence of an express tolling provision in 11 U.S.C. §108(c)(1) and the absence of one in 11 U.S.C. §507, indicating that it would be reasonable for Congress to instruct nonbankruptcy courts to toll nonbankruptcy limitations periods while assuming that bankruptcy courts will use their inherent equitable powers to toll the federal limitations periods within the Code. Finally, the Court stated that the explicit provision of tolling in the 240-day lookback period under 11 U.S.C. §507(a)(8)(A)(ii) but not in the lookback period under 11 U.S.C. §507(a)(8)(A)(i), instead of demonstrating a statutory intent not to toll the three-year lookback period,

⁸¹⁷ *In re Larson*, 862 F.2d 112 (7th Cir. 1988); *Leathley v. Commissioner*, T.C. Memo 2010-194; *In re Treister*, 52 Bankr. 735 (Bankr. S.D.N.Y. 1985).

⁸¹⁸ 11 U.S.C. §523(a)(7). Pecuniary loss penalties are presumably considered to be part of the tax, although there is no express statutory authority for this characterization. See e.g., *United States v. Wilson*, 2016-1 USTC ¶50,200 (N.D. Cal. 2016).

⁸¹⁹ See *Bruning v. United States*, 376 U.S. 358 (1964); *Burns v. United States*, 887 F.2d 1541 (11th Cir. 1989); *In re Hanna*, 872 F.2d 829 (8th Cir. 1989); *United States v. River Coal Co.*, 748 F.2d 1103 (6th Cir. 1984); *In re Thaxton*, 119 AFTR 2d 2017-2011 (Bankr. S.D. W. Va. 2017) (while Chapter 13 plan must provide for full payment of allowed priority tax claim, debtor is not relieved from liability for interest; trust fund recovery penalty taxes are not dischargeable and therefore post-petition interest thereon is not dischargeable); *In re Turner*, 37 Bankr. 376 (Bankr. D.N.D. 1984). Similarly, the IRS may collect post-petition interest in a pre-filing priority tax obligation in a Chapter 12 (family farmer) case even if the court confirmed the plan and the debtor made all required payments and received a discharge. See *IRS v. Cousins*, 209 F.3d 38 (1st Cir. 2000) (following *Bruning*); *Ward v. Calif. Bd. of Equalization*, 204 F.3d 888 (9th Cir. 2000) (post-petition interest on tax debt that was excepted from discharge is "integral part" of debt, and, thus, is nondischargeable under 11 U.S.C. §523(a)(1)(A) and is recoverable against debtor), *rev'g In re Bossert*, 230 Bankr. 172 (E.D. Wash. 1999).

⁸²⁰ *Ivison v. IRS (In re Ivison)*, No. 13-37732, 2020 BL 200976 (Bankr. S.D. Tex. May 29, 2020) (post-petition interest is governed by §6621 and begins upon date of assessment).

⁸²¹ *United States v. River Coal Co.*, 748 F.2d 1103 (6th Cir. 1984); *In re Jaylaw Drug*, 621 F.2d 524 (2d Cir. 1980).

⁸²² 11 U.S.C. §1141(a). See *In re Johnson*, 146 F.3d 252 (5th Cir. 1998); *In re Heisson*, 98-1 USTC ¶50,121 (D. Mass. 1997); *Miller v. United States*, 2005-1 USTC ¶50,252 (9th Cir. 2004) (post-petition, preconfirmation gap interest on employment taxes nondischargeable).

⁸²³ See *Langlois v. United States*, 155 Bankr. 818, 93-2 USTC ¶50,364 (N.D.N.Y. 1993). See also *Ivison v. IRS (In re Ivison)*, No. 13-37732, 2020 BL 200976 (Bankr. S.D. Tex. May 29, 2020) (post-petition interest begins upon date of assessment).

⁸²⁴ See, e.g., *Young v. United States*, 233 F.3d 56 (1st Cir. 2000), *aff'd*, 535 U.S. 43 (2002); *In re Waugh*, 109 F.3d 489 (8th Cir. 1997); *In re Taylor*, 81 F.3d 20 (3d Cir. 1996); *In re West*, 5 F.3d 423 (9th Cir. 1993); *Montoya v. United States*, 965 F.2d 554 (7th Cir. 1992); *In re Brustman*, 99-1 USTC ¶50,348 (B.A.P. 9th Cir. 1998). *But see In re Palmer*, 219 F.3d 580 (6th Cir. 2000); *Quenzer v. United States*, 19 F.3d 163 (5th Cir. 1993) (holding that 11 U.S.C. §108(c) does not suspend priority period of 11 U.S.C. §507(a)(8)); *In re Offshore Diving & Salvaging, Inc.*, 99-2 USTC ¶50,944 (E.D. La. 1999) (tolling not authorized by 11 U.S.C. §108(c); not abuse of discretion to refuse to exercise equitable power under 11 U.S.C. §105(a) to toll priority period); *In re Avila*, 228 Bankr. 63 (Bankr. D. Mass. 1999) (three-year lookback period tolled during earlier bankruptcies, but not additional six months; §6503(h) and 11 U.S.C. §108(c) not applicable); *In re Weidner*, 99-1 USTC ¶50,327 (Bankr. N.D. Ohio 1998).

⁸²⁵ *In re Morgan*, 182 F.3d 775 (11th Cir. 1999); *In re Richards*, 994 F.2d 763 (10th Cir. 1993); *In re Messer*, 2000-2 USTC ¶50,609 (S.D.N.Y. 2000); *In re Fiels*, 260 Bankr. 362 (Bankr. D. Md. 2001) (finding authority in 11 U.S.C. §105(a) for automatic, not case-by-case, extension of bankruptcy priority period). *But see In re Palmer*, 219 F.3d 580 (6th Cir. 2000) (bankruptcy court may invoke 11 U.S.C. §105(a) to toll lookback period during time debtor was in prior bankruptcy, but period is not tolled as a matter of law).

⁸²⁶ *Young v. United States*, 535 U.S. 43, 122 S. Ct. 1036 (2002). According to the Chief Counsel's office, the *Young* decision does not mandate the same conclusion in the context of an offer in compromise, i.e., equitable tolling does not operate to suspend the three-year lookback period in 11 U.S.C. §507(a)(8)(A)(i) for the period during which a taxpayer's OIC is pending with the IRS. CCA 200404049.

shows that the Bankruptcy Code incorporates traditional equitable principles.

Therefore, under prior law, a taxpayer could not achieve a discharge of what would otherwise be nondischargeable taxes by first filing a bankruptcy petition, having that case dismissed after the three-year and 240-day periods expire, and then filing a second bankruptcy petition, unless the second petition was filed outside the three-year and 240-day periods (as suspended) plus six months.⁸²⁷

The 2005 Bankruptcy Act effectively codified a version of the *Young* decision. Under the 2005 Act, a prior bankruptcy tolls the three-year period from the return's due date and the 240-day period from assessment for the duration of the automatic stay plus 90 days.⁸²⁸ Since this rule is implemented as part of the priority tax determination under 11 U.S.C. §507(a)(8), the question remained whether equitable tolling would apply to the two-year-from-filing period set forth in 11 U.S.C. §523(a)(1).

Subsequent Bankruptcy Court decisions have applied the *Young* tolling rationale to the two-year lookback period in 11 U.S.C. §523(a)(1)(B)(ii) governing late returns.⁸²⁹ The court in *Rader* noted that, like the three-year lookback period discussed in *Young*, 11 U.S.C. §523(a)(1)(B)(ii) establishes a two-year lookback period in which nondischargeability rights may be enforced. If the IRS does not have the full two years to collect taxes or perfect liens because the debtor files a late return within the two-year period, the debt is nondischargeable.⁸³⁰

The court rejected the debtor's argument that, because Congress did not amend 11 U.S.C. §523(a)(1)(B)(ii) to add tolling language as part of the 2005 Bankruptcy Act, Congress meant to exclude tolling from that section. Instead, the *Rader* court agreed with the rationale of the court in *Putnam* that codification of the decision in *Young* shows that Congress approves of the tolling of the lookback periods to enable the IRS to collect taxes and that the presence of express tolling language in 11 U.S.C. §507(a)(8) "supplements rather than displaces principles of equitable tolling."⁸³¹

⁸²⁷ *In re Brooks*, 78 AFTR 2d 6874 (Bankr. N.D. Okla. 1996) (240-day period for determining priority status of tax assessments is suspended during pendency of first bankruptcy case; thus, IRS's claim still entitled to priority status in second bankruptcy case). See *In re Taylor*, 81 F.3d 20 (3d Cir. 1996) (three-year period is suspended during prior bankruptcy); *In re Richards*, 994 F.2d 763 (10th Cir. 1993); *In re West*, 5 F.3d 423 (9th Cir. 1993); *In re Brickley*, 70 Bankr. 113 (B.A.P. 9th Cir. 1986); *In re Savini*, 260 Bankr. 689 (D.N.J. 2001) ("the periods specified" in 11 U.S.C. §507(a)(8) incorporates tolling periods of §6503(h), including the six-month extension); *In re Deitz*, 116 Bankr. 792 (Bankr. D. Colo. 1990). But see *In re Turner*, 195 Bankr. 476 (Bankr. N.D. Ala. 1996) (§6503(h) does not apply to suspend three-year dischargeability period while prior successive bankruptcy cases are pending). Still, the fact that the taxpayer/debtor waits 241 days after the IRS makes a tax assessment before filing a bankruptcy petition is not per se bad faith. See *In re Devine*, 131 Bankr. 952 (Bankr. S.D. Tex. 1991).

⁸²⁸ 11 U.S.C. §507(a)(8); *Clothier v. IRS (In re Clothier)*, No. 13-29432-K, 2018 BL 351525 (Bankr. W. D. Tenn. Sept. 26, 2018).

⁸²⁹ See *Rader v. IRS (In re Rader)*, No. 3:14-bk-01974, 2023 BL 132483 (Bankr. M.D. Tenn. April 19, 2023); *Ollie-Barnes v. IRS (In re Ollie-Barnes)*, No. 09-82198, 2014 BL 314385 (Bankr. M.D.N.C. Nov. 6, 2014); *Putnam v. IRS (In re Putnam)*, 503 B.R. 656 (Bankr. E.D.N.C. 2014), *aff'd*, No. 5:14-CV-118-D, 2014 BL 449253 (E.D.N.C. Sept. 24, 2014).

⁸³⁰ *Rader v. IRS*, 2023 BL 132483, at 4.

⁸³¹ *Rader v. IRS*, 2023 BL 132483, at 5, quoting *In re Putnam*, 503 B.R. at 665-66.

The *Putnam* court also noted that excluding tolling from 11 U.S.C. §523(a)(1)(B)(ii) would create a loophole in the event a debtor attempts to avoid tax liability by filing a late return and then shielding assets in bankruptcy until the two-year period has expired. In contrast, if a debtor timely files a return due within the lookback period or never files a return, any tax liability is nondischargeable. Therefore, tolling the two-year period in 11 U.S.C. §523(a)(1)(B)(ii) furthers the principles adopted by Congress in 2005.⁸³²

(9) IRS Burden of Proof

If the IRS seeks to establish an exception to discharge on any of the grounds discussed above (including fraud), the IRS must only establish the reason for nondischargeability by a preponderance of the evidence.⁸³³

b. Chapter 7 Cases

In individuals' Chapter 7 cases, taxes arising before the filing of the bankruptcy petition are dischargeable according to the general rules set forth above.

c. Chapter 11 Cases

In individuals' Chapter 11 cases, the discharge is granted for all *dischargeable* taxes arising before confirmation of the plan of reorganization.⁸³⁴ Generally, payment of all priority tax claims is required as a prerequisite to confirmation of the plan. If the Chapter 11 plan does not provide for full payment of the priority taxes, the IRS can collect the unpaid taxes from all exempt and post-confirmation property once the automatic stay is lifted.⁸³⁵ If the bankruptcy court determines the amount of the priority tax liability, however, that is binding on the IRS outside the bankruptcy proceeding.⁸³⁶

If the case is a liquidating Chapter 11 case, an individual only receives a discharge if one would be granted under Chapter 7.⁸³⁷

⁸³² *In re Putnam*, 503 B.R. at 665-66.

⁸³³ *Grogan v. Garner*, 498 U.S. 279 (1991); *In re Zuhone*, 88 F.3d 469 (7th Cir. 1996); *In re Graham*, 973 F.2d 1089 (3d Cir. 1992); *In re Harasymiw*, 895 F.2d 1170 (7th Cir. 1990).

⁸³⁴ 11 U.S.C. §1141(d)(2). *In re Fein*, 22 F.3d 631 (5th Cir. 1994); *In re Grynberg*, 986 F.2d 367 (10th Cir. 1993). For purposes of the automatic stay provisions of 11 U.S.C. §362, the date the plan is confirmed by the court controls, not the plan's effective date (which generally allows a period of time for appeals). Thus, where the IRS makes an assessment after the plan's confirmation date but before the effective date, the assessment is valid. See *United States v. White*, 466 F.3d 1241 (11th Cir. 2006) (once confirmation had been entered and discharge granted, holders of nondischargeable debts can seek repayment for original amount, and Chapter 11 plan's identification of post-confirmation effective date is not sufficient to delay grant of discharge).

⁸³⁵ See *In re Gurwitch*, 794 F.2d 584 (11th Cir. 1986). See also *Grogan v. Garner*, 498 U.S. 279 (1991). But cf. *In re Burford*, 99-1 USTC ¶50,423 (Bankr. N.D. Tex. 1999) (IRS not entitled to collect interest and penalties on underlying taxes where it agreed to and provided amortization schedule for confirmed plan to fully retire debt).

⁸³⁶ *In re Taylor*, 132 F.3d 256 (5th Cir. 1998) (application of res judicata requires actual determination by bankruptcy court). See *Hambrick v. Commissioner*, 118 T.C. 348 (2002) (the IRS may determine deficiencies for years covered by bankruptcy reorganization plan in amounts greater than claimed in plan, as res judicata not applicable).

⁸³⁷ 11 U.S.C. §1141(d)(3), §727(a).

d. Chapter 13 Cases

Bankruptcy Code §1327 provides that a Chapter 13 plan binds the debtor and each creditor whether the plan provides for the claim of the creditor and whether such creditor objects to, accepts, or rejects the plan. In addition, the IRS can be bound by a confirmed Chapter 13 plan even though it originally misclassified its unsecured claims as general unsecured claims as opposed to unsecured priority claims.⁸³⁸ The confirmation of a Chapter 13 plan also eliminates the IRS's right of setoff because the IRS is bound by the terms of the plan under 11 U.S.C. §1327(a).⁸³⁹

The debtor also generally is bound by the confirmed plan. Hence, debtors may not amend a Chapter 13 plan to include unpaid post-petition tax liabilities to protect their re-vested assets from tax collection if the IRS has not filed a proof of claim for these liabilities.⁸⁴⁰

In Chapter 13 cases, most discharges are ordered under 11 U.S.C. §1328(a). Prior to the 2005 Bankruptcy Act the discharge rules in Chapter 13 cases were considerably more expansive than the rules in Chapter 7 cases. Under the former law, all tax debts provided for by the Chapter 13 plan or disallowed under 11 U.S.C. §502 were discharged after completion of all of the plan payments.⁸⁴¹ Under this "super-discharge" provision, both dischargeable taxes and taxes that usually are nondischargeable were discharged, since 11 U.S.C. §1328(a) did not except 11 U.S.C. §523(a)(1) claims⁸⁴² from discharge. Accordingly, there were two critical concepts in Chapter 13 cases: (1) "providing for" tax debts; and (2) disallowance under 11 U.S.C. §502.

For a tax debt to be "provided for," the debtor had to refer to or otherwise deal with the tax debt in the plan. Bankruptcy Code §1322(a)(2) requires all Chapter 13 plans to provide for the full payment of all unsecured priority tax claims. Nevertheless, it did not appear that the debtor was required to provide for payment of the full amount of the priority tax debt if the IRS failed to object to the plan.⁸⁴³ Discharge could be denied,

however, if the debtor failed to provide adequate notice for the IRS to timely identify their claim.⁸⁴⁴

A second ground for avoiding payment in full of a priority tax claim was if the IRS filed its proof of claim late. Arguments were made that a late-filed or non-filed proof of claim could not be a priority tax claim, and therefore need not be paid in full, since the claim had not been "allowed." Although the issue was somewhat unclear, it appeared that these taxes could be discharged if the claims were disallowed or the IRS otherwise failed to object to the treatment of their claim under the plan.⁸⁴⁵

The 2005 Bankruptcy Act effectively eliminated most of these special Chapter 13 super-discharge rules by adding to the category of taxes exempted from discharge under 11 U.S.C. §1328(a)(2): (1) trust fund taxes (11 U.S.C. §507(a)(8)(C)), (2) taxes for unfiled returns or returns filed within two years of the bankruptcy petition (11 U.S.C. §523(a)(1)(B)), (3) taxes due on a fraudulent return (11 U.S.C. §523(a)(1)(C)), and (4) taxes where there was a willful attempt to evade or defeat payment (11 U.S.C. §523(a)(1)(C)). Therefore, even if the debtor can confirm a Chapter 13 plan without paying in full the claims for these excepted taxes, the taxes are not discharged and can be collected from the taxpayer-debtor after the automatic stay terminates.

Note: The exceptions to discharge in 11 U.S.C. §1328(a) do not include all priority taxes, just trust fund taxes in 11 U.S.C. §501(a)(8)(C). Therefore, it appears that the old super-discharge rules remain for other priority taxes (such as taxes due within three years) if the plan "provides for" less than full payment of the priority claim and the IRS fails to object or if the claim is disallowed because it is filed late.

Under 11 U.S.C. §1328(b) hardship discharges, the debtor is discharged from all unsecured debts provided for by the plan or disallowed under 11 U.S.C. §502, except traditional nondischargeable tax debts.⁸⁴⁶ Accordingly, the super-discharge of "nondischargeable" tax claims available under 11 U.S.C. §1328(a) is not available under the hardship discharge of 11 U.S.C. §1328(b).

If the bankruptcy court declines to confirm a proposed reorganization plan, and the debtor withdraws his petition, 11 U.S.C. §1326(a)(2) provides that the trustee must return any deposited funds to the debtor. If the IRS levies, however, the bankruptcy trustee must honor the IRS levy on the funds.⁸⁴⁷

⁸³⁸ *In re Jones*, No. 89-00547-C Bankr. (N.D. Okla. 1993) (unrep. op.). *But see In re Luarks*, 301 Bankr. 352 (Bankr. D. Kan. 2003) (taxing authorities who did not object to plan's confirmation may request full payment of priority claims when trustee objects to their claims).

⁸³⁹ *In re Norton*, 717 F.2d 767 (3d Cir. 1983). *See In re Verdunn*, 89 F.3d 799 (11th Cir. 1996) (IRS's claim for taxes in Chapter 13 proceeding is non-contingent, liquidated unsecured debt that cannot exceed statutory limit under 11 U.S.C. §109(e)). *But see United States v. Munson*, 2000-1 USTC ¶50,456 (C.D. Ill. 2000) (Chapter 13 plan confirmation does not alter or extinguish the IRS's right to setoff pre-petition tax overpayment against debtor's pre-petition tax liability, despite the IRS's failure to timely object to plan); *In re Bare*, 284 Bankr. 870 (Bankr. N.D. Ill. 2002); *In re Sedlock*, 219 Bankr. 207 (Bankr. N.D. Ohio 1998); *In re Whitaker*, 173 Bankr. 359 (Bankr. S.D. Ohio 1994); *In re Or-linski*, 140 Bankr. 600 (Bankr. S.D. Ga. 1991).

⁸⁴⁰ *In re Lilley*, 91 F.3d 491 (3d Cir. 1996) (debtor's pre-petition efforts to defraud IRS not "cause" for dismissing Chapter 13 case); *In re Dickey*, 64 Bankr. 3 (Bankr. E.D. Va. 1985).

⁸⁴¹ 11 U.S.C. §1328(a). *See In re Parffrey*, 264 Bankr. 409 (Bankr. S.D. Tex. 2001) (where debtor finished plan payments the day before hearing on the IRS's motion to dismiss for failure to file post-petition tax returns, motion denied due to court's lack of discretion under 11 U.S.C. §1305).

⁸⁴² Alimony, child support, property settlement, certain long-term debts, student loans, personal injury obligations from drunk driving, and criminal fines and restitution are excepted from discharge.

⁸⁴³ *See In re Gregory*, 705 F.2d 1118 (9th Cir. 1983); *In re Vlavianos*, 71 Bankr. 789 (Bankr. W.D. Va. 1986); *In re Goodwin*, 58 Bankr. 75 (Bankr.

D. Me. 1986); *In re Richards*, 50 Bankr. 339 (E.D. Tenn. 1985). *See also* 11 U.S.C. §1329; *In re Newcomb*, 60 Bankr. 520 (Bankr. W.D. Va. 1986); *In re Hunt*, 59 Bankr. 718 (Bankr. D. Me. 1986) (IRS's ability to amend Chapter 13 plan to provide for full payment of tax claims).

⁸⁴⁴ *In re Trembath*, 97-2 USTC ¶50,738 (Bankr. N.D. Ill. 1997).

⁸⁴⁵ *In re Osborne*, 76 F.3d 306 (9th Cir. 1996) (IRS held to a strict time limit for filing proofs of claims in Chapter 13 cases); *In re Tomlan*, 907 F.2d 114 (9th Cir. 1990); *In re Junes*, 99 Bankr. 978, 89-2 USTC ¶9383 (B.A.P. 9th Cir. 1989); *In re Jones*, 2000-2 USTC ¶50,622 (W.D. Mich. 2000); *In re Goodwin*, 58 Bankr. 75 (Bankr. D. Me. 1986). *But see In re Luarks*, 301 Bankr. 352 (Bankr. D. Kan. 2003) (late IRS claim allowed for priority tax since res judicata did not bar claim). Note that, while personal liability may be discharged, the tax lien remains an encumbrance against the debtor's property, unless the lien is avoided in the bankruptcy proceeding, until the statute of limitations for collection expires.

⁸⁴⁶ 11 U.S.C. §1328(c)(2).

⁸⁴⁷ *In re Beam*, 192 F.3d 941 (9th Cir. 1999) (§6331 and §6334 permit the IRS to collect unpaid taxes by levy unless there is a specific exemption from levy, and §6334 provides no specific exemption for funds returned from a bankruptcy estate).

2. Discharge and Exceptions to Discharge for Partnerships and Corporations

Bankruptcy Code §727(a)(1) provides that a partnership or corporation cannot receive a discharge in a Chapter 7 case. Similarly, if a corporation or a partnership initiates a liquidating Chapter 11 proceeding and, following consummation of the plan, ceases to engage in any business, 11 U.S.C. §1141(d)(3) does not provide a discharge. Bankruptcy Code §1141(d)(1) provides, however, that a partnership or corporation can receive a full discharge upon confirmation of a reorganizing Chapter 11 plan. Partnerships and corporations cannot file a Chapter 13 petition.

Unlike an individual's Chapter 11 case where the debtor cannot obtain a discharge of nondischargeable tax claims, discharge is available in a corporate or partnership Chapter 11 case for both dischargeable and most "nondischargeable" tax claims.⁸⁴⁸ This super-discharge is designed to provide a fixed list of the reorganizing debtor's liabilities to ensure greater certainty for creditors and third parties.⁸⁴⁹ Accordingly, if the plan of reorganization provides for less than full payment of nondischargeable tax claims and the IRS fails to object to confirmation, these "nondischargeable" tax claims are discharged and are not paid unless the IRS can reopen the plan to provide for full payment.⁸⁵⁰ In addition, under certain circumstances, a plan providing for full payment of taxes may include taxes determined after the plan is confirmed that were disputed at confirmation.⁸⁵¹

Note: Certain corporations and partnerships can file bankruptcy petitions under Chapter 12 (Adjustment of Debts of a Family Farmer with Regular Annual Income). Generally, 11 U.S.C. §1228(a)(2) requires the reorganization plan to provide for full payment in deferred cash payments of all priority tax claims unless the IRS agrees to different treatment. Furthermore, 11 U.S.C. §1228(a) provides for a discharge after all payments are made under the plan. The bankruptcy court may, nevertheless, grant a discharge even if the debtor fails to make all payments as required under the plan. Bankruptcy Code §1228(b) provides that: (1) if the debtor is unable to complete the payments because of circumstances beyond the debtor's control; (2) the unsecured creditors have received an amount that they would have received if the case had been a Chapter 7 proceeding; and (3) it is impractical to modify the reorganization plan, the court may grant a discharge even though all payments as provided for under the plan have not been made. These provisions are similar to those for Chapter 13 hardship discharges.

⁸⁴⁸ 11 U.S.C. §1141(d)(1). The 2005 Bankruptcy Act clarified that a corporate debtor cannot receive a discharge for fraudulent tax. 11 U.S.C. §1141(d)(6). A Chapter 11 discharge does not necessarily strip a priority claim of its priority status in a later Chapter 11 filing. *In re R.J. Reynolds-Patrick Cnty. Mem'l Hosp., Inc.*, 92 AFTR 2d 2003-7303 (Bankr. W.D. Va. 2003). See *In re Official Comm. of Unsecured Creditors of White Farm Equip. Co.*, 943 F.2d 752 (7th Cir. 1991) (serial Chapter 11 filing does not divest trust fund taxes of their priority).

⁸⁴⁹ 124 Cong. Rec. H11105, H11114, and H11115 (Sept. 28, 1978).

⁸⁵⁰ See *Virgin Islands Bureau of Internal Revenue v. St. Croix Hotel Corp.*, 60 Bankr. 412 (D.V.I. 1986) (government's motion to reopen plan denied).

⁸⁵¹ *Pettibone Corp. v. United States*, 34 F.3d 536 (7th Cir. 1994).

D. Deferring and Designating Payment

One goal that may be accomplished by filing a bankruptcy petition is to defer payment of a tax that is otherwise nondischargeable and will have to be paid. Since payments are not part of a Chapter 7 bankruptcy scheme, the taxpayer can best accomplish a deferral of payments by filing a Chapter 11 or (if the taxpayer is an individual) a Chapter 13 petition.

Under former 11 U.S.C. §1129(a)(9)(C), to obtain confirmation of a Chapter 11 plan the plan had to provide for payment of priority tax claims within six years after the date of assessment of the tax. If there were multiple assessment dates, the payments usually could last until six years after the last date of assessment. In addition, the IRS would often work with the debtor if it was necessary to allow payments over a somewhat longer period of time. The payments had to contain an interest component so that the payments had a present value as of the effective date of the plan equal to the amount of the allowed claim. (See VII.A.6.b., above, for further discussion of this issue.) The requirements of 11 U.S.C. §1129 did not compel that the plan make equal payments to fully amortize the debt over the allowable period, however. A balloon payment could be permitted.⁸⁵²

The 2005 Bankruptcy Act modified the payment requirements for a Chapter 11 plan. The payments must be completed in regular cash payments within five years of the order for relief, and secured claims for what otherwise would be priority taxes must be paid on the same schedule as priority taxes. (See VII.A.6.b., above, for further discussion of these issues.)

Under either version of the law, a Chapter 11 can be a good way to get a favorable payment plan. Particularly in situations in which the liability at issue is employment taxes for which the IRS is sometimes reluctant to allow an extended payment plan, the Chapter 11 bankruptcy proceeding can be a means of essentially forcing the IRS to accept a five-year installment payment plan. In addition, in a typical installment payment plan, failure to pay and other nonpecuniary loss penalties may continue to accumulate and otherwise extend and increase the payments that are due. This is not required in a Chapter 11 bankruptcy proceeding. Finally, since the amount of the priority tax claim is determined as of the date of the bankruptcy petition and the plan must pay the allowed claim in deferred payments effective as of the date the plan is confirmed, there can be an "interest free" period between the bankruptcy petition date and the plan confirmation date under a Chapter 11 case. The IRS may be able to collect this "gap interest" from the debtor after confirmation of the plan, however.⁸⁵³

A qualifying taxpayer may similarly try to utilize a Chapter 13 plan to provide an extended payment arrangement with the IRS for priority tax claims. This may be particularly desirable if the tax liabilities will either never become nonpriority taxes or the taxpayer cannot wait for the entire time period to avoid priority classification. A Chapter 13 plan must generally provide for payment of the priority claim. Unlike with the Chapter 11 plan, however, the interest component need not be

⁸⁵² See *In re Volle Elec., Inc.*, 132 Bankr. 365 (Bankr. C.D. Ill. 1991), *aff'd*, 139 Bankr. 451 (C.D. Ill. 1992).

⁸⁵³ *In re Heisson*, 98-1 USTC ¶50,121 (D. Mass. 1997).

included in the Chapter 13 plan. Therefore, the amount of the allowed priority tax claim (including pre-petition interest) must be provided for by payment in full over the life of the Chapter 13 plan, i.e., over three to five years. Therefore, the Chapter 13 plan can be a means to force the IRS into installment payments that may be extended over a longer period with no additional accrual of interest and penalties.

The taxpayer also may be able to allocate payments, at least in a Chapter 11 case. The Supreme Court has held that a Chapter 11 plan can designate payments to the trust fund portion of an employment tax liability if the bankruptcy court determines this designation is necessary to the success of the plan.⁸⁵⁴ The IRS typically will not allow this in a normal installment agreement. This ability to designate may extend to a liquidating Chapter 11 plan⁸⁵⁵ but probably not to a Chapter 7 case.⁸⁵⁶ The bankruptcy court cannot reallocate payments applied by the IRS before the bankruptcy petition.⁸⁵⁷

E. Obtaining Relief from Federal Tax Lien

1. Avoiding Lien

Under 11 U.S.C. §101, federal tax liens are included within the definition of statutory liens. One common defensive tactic by debtors is to attempt to avoid liens pursuant to 11 U.S.C. §522(f). For a debtor to avoid a lien under §522(f)(1), the debtor must show that: (1) the lien is a *judicial* lien; (2) the lien is fixed against an interest of the debtor in the property; and (3) the lien impairs an exemption to which the debtor is otherwise entitled.⁸⁵⁸ A federal tax lien is a *statutory* lien and thus may not be avoided under 11 U.S.C. §522(f)(1).⁸⁵⁹

Generally, once the IRS files an NFTL, the tax lien is considered perfected and cannot be avoided by the trustee in a bankruptcy proceeding.⁸⁶⁰ Thus, the IRS can enforce the lien on pre-petition assets after the bankruptcy case is closed even if the debtor's tax debt is discharged.⁸⁶¹ Under 11 U.S.C. §545(2), the trustee may, however, "avoid the fixing of a statutory lien on property" if the lien is not perfected or enforceable as against a bona fide purchaser at the time the bankruptcy case is opened. Therefore, unfiled federal tax liens generally may be avoided on property of the estate by the trustee.⁸⁶² It appears,

however, that the lien avoiding provisions of the Bankruptcy Code do not avoid liens on "excluded" assets that never become part of the estate.⁸⁶³

An issue exists as to whether the trustee can avoid a filed federal tax lien if a "superpriority" situation exists (i.e., subsequent purchaser's interest would prevail over a previously filed NFTL). Courts generally have held that a trustee, although a bona fide purchaser for purposes of the Bankruptcy Code, is not a bona fide purchaser for purposes of §6323(b). Accordingly, the trustee cannot use 11 U.S.C. §545(2) in conjunction with §6323(b) to avoid a filed federal tax lien.⁸⁶⁴ In addition, most cases hold that only the trustee, not the debtor, may exercise the lien avoidance powers under 11 U.S.C. §545(2).⁸⁶⁵ The debtor's limited power to exempt property under 11 U.S.C. §522(h) does not mean that the lien itself can be avoided.⁸⁶⁶ Similarly, a debtor cannot use 11 U.S.C. §522(h) or 11 U.S.C. §522(i)(2) to avoid the penalty portion of a tax lien.⁸⁶⁷

2. Effect of Discharge on Perfected Tax Lien

The discharge of the tax does not render the corresponding NFTL invalid. Accordingly, a tax lien for which the NFTL is properly filed remains as an encumbrance on any exempt property of the debtor following discharge even though the underlying

⁸⁶²Note, however, that the IRS's position is that an NFTL does not need to be filed before the bankruptcy case is commenced to allow it to pursue collection of discharged liabilities against the debtor's "excluded" pre-petition assets (e.g., ERISA-qualified plans), as such assets never become property of the bankruptcy estate. According to the IRS Chief Counsel, since excluded property is not property of the bankruptcy estate subject to creditors' claims, the excluded property should not be subject to a bankruptcy trustee's avoidance powers. CCA 200634012.

⁸⁶³*Wadleigh v. Commissioner*, 134 T.C. 280 (2010); *Gross v. Commissioner*, T.C. Memo 2010-176. See also CCA 200634012.

⁸⁶⁴See *In re Berg*, 121 F.3d 535 (9th Cir. 1997); *In re Walter*, 45 F.3d 1023 (6th Cir. 1995); *In re Janssen*, 97-2 USTC ¶50,860 (B.A.P. 8th Cir. 1997) (while bankruptcy trustee may be a bona fide purchaser for purposes of lien avoidance provisions under 11 U.S.C. §545(2), §6323 requires higher standard for determining who is purchaser entitled to super priority status). Cf. *Gonzales v. United States*, 303 Bankr. 849 (B.A.P. 10th Cir. 2004) (trustee cannot use 11 U.S.C. §544(a)(1) with §6323(b) to avoid a filed tax lien). But see *In re Guyana Dev. Corp.*, 96-1 USTC ¶50,061 (Bankr. S.D. Tex. 1995).

⁸⁶⁵See *In re Stangel*, 219 F.3d 498 (5th Cir. 2000) (debtor lacked standing to avoid tax liens); *In re Aikens*, 94 Bankr. 869, 872 (Bankr. E.D. Pa.) ("While [11 U.S.C.] §545(2) vests avoidance powers solely in the trustee, ... the Debtor is empowered to stand in the shoes of the trustee if he satisfies the criteria of 11 U.S.C. §§522(h), 522(g)(1), and (g)(2)") (internal citations omitted), *aff'd*, 100 Bankr. 729 (E.D. Pa.), *aff'd sub nom.*, *McLean v. Phila. Water Revenue Bureau*, 891 F.2d 474 (3d Cir. 1989); *In re Wethington*, 219 Bankr. 529, 98-1 USTC ¶50,180 (Bankr. D. Minn. 1997).

⁸⁶⁶*In re DeMarah*, 62 F.3d 1248 (9th Cir. 1995); *In re Walter*, 45 F.3d 1023 (6th Cir. 1995).

⁸⁶⁷See, e.g., *Hutchinson v. United States*, No. EC-19-1047-GFB, 2019 BL 428931 (9th Cir. Nov. 7, 2019) (unrep. op), *aff'd in unpub. opin.*, No. 19-60065, 2021 BL 400267 (9th Cir. Oct. 19, 2021), *aff'd and reh'g denied*, No. 19-60065, 2021 BL 488984 (9th Cir. Dec. 23, 2021) (addressing whether debtors could use §522(h) to avoid liens that secured tax penalties, the court, citing *In re DeMarah*, concluded that although 11 U.S.C. §522(c)(2)(A) provides that avoided liens that secure non-compensatory penalties do not remain attached to exempt property, Congress carefully added 11 U.S.C. §522(c)(2)(B), which brings back the whole of any tax lien; also, court explained that debtor cannot invoke 11 U.S.C. §522(i)(2), which cites debtor's exemption's authority under 11 U.S.C. §522(g), to circumvent 11 U.S.C. §522(c)(2)'s bright-line-rule that debtor's cannot escape tax liens on otherwise exempt property).

⁸⁵⁴*United States v. Energy Resources*, 495 U.S. 545 (1990).

⁸⁵⁵*In re Deer Park, Inc.*, 10 F.3d 1478 (9th Cir. 1993) (designation allowed in liquidating Chapter 11). But see *In re Kare Kemical, Inc.*, 935 F.2d 243 (11th Cir. 1991) (designation not allowed in liquidating Chapter 11).

⁸⁵⁶*In re Optics of Kansas, Inc.*, 91-2 USTC ¶50,512 (Bankr. D. Kan. 1991) (designation not allowed in Chapter 7).

⁸⁵⁷*In re Kaplan*, 104 F.3d 589 (3d Cir. 1997). For further discussion of allocations, see 639 T.M., *Responsible Person and Lender Liability for Trust Fund Taxes — Sections 6672 and 3505*.

⁸⁵⁸See, e.g., *In re Jordana*, 232 B.R. 469 (10th Cir. BAP 1999); *In re Henderson*, 18 F.3d 1305 (5th Cir. 1994).

⁸⁵⁹See, e.g., *In re Burge*, No. 19-10795-JDL, 2019 BL 394117 (Bankr. W.D. Okla. Oct. 14, 2019) (IRS's tax lien is a statutory lien that may not be avoided under §522(f)); *In re Shick*, 418 F.3d 321 (3d Cir. 2005) (tax lien is a statutory lien); *In re Mills*, 37 B.R. 832 (Bankr. E.D. Tenn. 1984). See also 11 U.S.C. §101(36), which defines a judicial lien, and 11 U.S.C. §101(53), which defines a statutory lien.

⁸⁶⁰11 U.S.C. §547(c)(6). See also *In re Isom*, 901 F.2d 744 (9th Cir. 1990); *United States v. Alfano*, 34 F. Supp. 2d 827 (E.D.N.Y. 1999) (lien against debtors' residence survives Chapter 13 discharge and fraudulent conveyance of residence); *In re Totten*, 82 Bankr. 402 (Bankr. W.D. Pa. 1988).

⁸⁶¹See *In re Isom*, 901 F.2d 744 (9th Cir. 1990).

ing tax debt has been discharged.⁸⁶⁸ A similar result applies for a Chapter 13 plan. The perfected lien continues to attach to retained property unless the lien is stripped.⁸⁶⁹ In addition, the taxpayer will have a difficult time using equitable theories to forestall the IRS's efforts to enforce its lien rights after the bankruptcy.⁸⁷⁰

The NFTL does not continue to be a lien against property that the debtor acquires after the bankruptcy petition is filed, however.⁸⁷¹ Even still, an unqualified right to a future benefit (e.g., a pension interest) will still be subject to the NFTL even if the underlying tax is discharged.⁸⁷² In a Chapter 13 case, the present value of the future payments represents the amount of the secured claim.⁸⁷³

The IRS's position regarding the perfection of its secured interest is the same for a pre-petition levy on property as it is for a lien for which the NFTL has been filed. The IRS maintains that a perfected security interest exists up to the value of the property levied upon as of the date of the filing of the bankruptcy petition.⁸⁷⁴

F. Determining a Tax Liability

Once the IRS files a proof of claim in a bankruptcy proceeding, 11 U.S.C. §106 subjects the IRS to the bankruptcy court's jurisdiction. Even if the IRS does not file a proof of claim, the bankruptcy court still has jurisdiction to determine the amount and dischargeability of the debtor's tax liabilities.⁸⁷⁵ As a general rule, the Bankruptcy Code authorizes the bankruptcy court to determine the amount or legality of the taxpayer's tax liabilities whether or not the tax has been assessed (or a notice of deficiency has been issued) unless the tax has been contested before⁸⁷⁶ and adjudicated by a court of competent ju-

risdiction before the filing of the bankruptcy petition.⁸⁷⁷ The bankruptcy court's statutory authority to determine the amount or legality of a debtor's tax liability extends to situations where the court must make a tax determination, i.e., whether proceeds from an action, omission, or event constitute gross income.⁸⁷⁸ Such determinations are not considered hypothetical advisory opinions when the tax issues presented bear directly on the question of a plan's feasibility.⁸⁷⁹

A prior Tax Court determination of the liability does not preclude a challenge to the interest computed by the IRS in a subsequent bankruptcy proceeding.⁸⁸⁰

The bankruptcy court's ability to adjudicate a taxpayer's liability does not confer on the taxpayer rights that he otherwise would not have if there were no bankruptcy since the Bankruptcy Code was not intended to abrogate all provisions of the Internal Revenue Code in the non-bankruptcy context.

The bankruptcy court has jurisdiction over pre-petition taxes, administrative taxes, and refund claims. The bankruptcy court generally does not have jurisdiction over post-petition taxes, with the exception of administrative taxes.⁸⁸¹

When a bankruptcy case begins, there is an automatic stay on instituting or continuing any Tax Court proceedings related to the determination of a debtor's pre-petition tax liabilities.⁸⁸² However, if a notice of deficiency has been issued and the period for filing a Tax Court petition has not expired, the

(9th Cir. 1996) (proceeding is contested if debtor filed Tax Court petition and IRS filed answer before bankruptcy filing).

⁸⁷⁷ 11 U.S.C. §505(a)(1), 11 U.S.C. §505(a)(2)(A). See *In re Harker*, 2004-1 USTC ¶50,158 (8th Cir. 2004) (bankruptcy court lacked jurisdiction to redetermine liability established in prior Tax Court decision). See also *In re Bunyan*, 2004-1 USTC ¶50,128 (9th Cir. 2004) (prior circuit court dismissal adjudicated whether Tax Court decision was final when the IRS assessed deficiencies, preventing challenge to their validity). Cf. *Neilson v. United States*, 2004-1 USTC ¶50,143 (9th Cir. 2004) (bankruptcy court erred in not giving effect to pretrial stipulation, as determination must rest on all evidence introduced).

⁸⁷⁸ *United States v. LeVandowski (In re LeVandowski)*, No. 4:22-cv-02781-YGR, 2023 BL 82748 (N.D. Cal. Mar. 14, 2023) (plain language of 11 U.S.C. §505 allows bankruptcy court to "determine the amount or legality of any tax ... or any addition to tax" and authorizes it to determine items comprising "bottom-line tax liability") (quoting *Cent. Valley Ag Enters. v. United States*, 531 F.3d 750, 759 (9th Cir. 2008)).

⁸⁷⁹ *United States v. LeVandowski (In re LeVandowski)*, No. 4:22-cv-02781-YGR, 2023 BL 82748 (N.D. Cal. Mar. 14, 2023). See, e.g., *Schwartz v. Gardiner (In re Schwartz)*, 192 B.R. 90 (Bankr. D.N.J. 1996) (finding jurisdiction appropriate where viability of Chapter 11 plan depended upon determination of debtor's tax liability to both IRS and New Jersey Division of Taxation); *Kilen v. United States (In re Kilen)*, 129 B.R. 538 (Bankr. N.D. Ill. 1991) (determining contingent and unliquidated claims appropriate because resulting potential liability "is exactly the kind of [ripe] obligation [that] Congress wanted to have resolved within the bankruptcy process").

⁸⁸⁰ *United States v. Beane*, 841 F.3d 1273 (11th Cir. 2016).

⁸⁸¹ See, e.g., *Moore v. IRS*, 132 Bankr. 533 (Bankr. W.D. Pa. 1991); *In re Mirman*, 98 Bankr. 742 (Bankr. E.D. Va. 1989). While the automatic stay does not apply to post-petition taxes, the prohibition on the commencement of Tax Court proceedings does. See *Halpern v. Commissioner*, 96 T.C. 895 (1991).

⁸⁸² 11 U.S.C. §362(a)(8). See *Perry v. Commissioner*, T.C. Memo 2014-231 (where taxpayer filed petition for redetermination hours before filing bankruptcy petition, Tax Court proceeding suspended while automatic stay is in effect). This contrasts with the treatment of taxes in a receivership. Section 6871(a) provides that the appointment of a receiver in a receivership proceeding allows the IRS to immediately assess a deficiency without regard to the taxpayer's right to petition the Tax Court, as usually provided under §6213. Moreover, since there are no provisions for redetermination of such an assessed deficiency, a Tax Court proceeding is precluded once a receivership proceeding commences.

⁸⁶⁸ 11 U.S.C. §522(c)(2)(B). See *In re Deutchman*, 192 F.3d 457 (4th Cir. 1999); *In re Isom*, 901 F.2d 744 (9th Cir. 1990); *Meyers v. Sassi*, 85-2 USTC ¶9786 (N.D. Cal. 1985); *In re Wessel*, 93-2 USTC ¶50,549 (Bankr. D.S.C. 1993); *In re Gerulis*, 56 Bankr. 283 (Bankr. D. Minn. 1985); *In re Mills*, 37 Bankr. 832 (Bankr. E.D. Tenn. 1984); *Iannone v. Commissioner*, 122 T.C. 287 (2004).

⁸⁶⁹ *In re Brawders*, 503 F.3d 856 (9th Cir. 2007); *Nomellini v. United States*, 757 Fed. Appx. 573 (9th Cir. 2018) (unpub.).

⁸⁷⁰ See *United States v. Burrell*, 2016-1 USTC ¶50,113 (9th Cir. 2015) (unpub.).

⁸⁷¹ *United States v. Sanabria*, 424 F.2d 114 (7th Cir. 1970); *In re Braund*, 423 F.2d 718 (9th Cir. 1970); *In re Fuller*, 92-1 USTC ¶50,119 (B.A.P. 9th Cir. 1992).

⁸⁷² *In re Connor*, 27 F.3d 365 (9th Cir. 1994); *In re Raihl*, 152 Bankr. 615 (B.A.P. 9th Cir. 1993); CCA 200032004.

⁸⁷³ *In re Wesche*, 96-1 USTC ¶50,265 (Bankr. M.D. Fla. 1996).

⁸⁷⁴ See generally VII.A.5.a., above, for further discussion of this issue.

⁸⁷⁵ 11 U.S.C. §505(a), 11 U.S.C. §505(b). See *United States v. Sterling Consulting Corp.*, 261 Bankr. 800 (B.A.P. 1st Cir. 2001) (where matter was not proper for abstention under 28 U.S.C. §1334(c), bankruptcy court could not cede jurisdiction to determine tax liability to district court). See also *Sterling Consulting Corp. v. United States*, 245 F.3d 1161 (10th Cir. 2001), cert. denied, 534 U.S. 1114 (2002); *Perry v. United States*, 113 AFTR 2d 2014-1370 (Bankr. M.D. Ala. 2014) (court abstained from determining extent of liability and extent of lien where court already determined that debt was not dischargeable); *Copley v. United States*, No. 18-2347, 2020 BL 177241 (4th Cir. May 12, 2020) (plain language of §6402(a) and 11 U.S.C. §553(a) provide that right of offset for pre-petition tax liabilities is not affected by debtors' attempt to claim pre-petition refund as exempt property in accordance with state law; language of §6402(a) supersedes 11 U.S.C. §522(c)), *vacating and remanding* 591 B.R. 263 (E.D. Va. 2018).

⁸⁷⁶ See *In re Bunyan*, 2004-1 USTC ¶50,128 (9th Cir. 2004) (issue of finality was contested in prior circuit court proceeding); *In re Baker*, 74 F.3d 906

bankruptcy court can lift the automatic stay and permit the taxpayer/debtor to file a Tax Court petition. The stay also may be lifted in order to continue a pending Tax Court case.⁸⁸³ If the stay is lifted, the Tax Court's decision is binding on the taxpayer/debtor as well as the bankruptcy trustee.⁸⁸⁴ If, for whatever reason, the Tax Court proceeding is delayed, the bankruptcy court can adjudicate the debtor's tax liability regardless of the fact that the claim is pending in the Tax Court.⁸⁸⁵ If the bankruptcy court decides not to lift the stay but instead resolves the tax issues and/or determines the taxpayer/debtor's liability for a nondischargeable tax (at the request of either the debtor or the IRS), the bankruptcy court's decision is binding on the taxpayer/debtor, the IRS, and the estate. In a "no asset" Chapter 7, however, the bankruptcy court may abstain from determining a nondischargeable tax liability because of the lack of any substantial effect on the bankruptcy estate.⁸⁸⁶

Comment: Perhaps the best way to challenge the amount of an IRS liability is by objecting to the IRS proof of claim. As a general rule, the burden of proof lies with the debtor objecting to an IRS proof of claim when the claim is for taxes already assessed. Even in a bankruptcy setting, the debtor — as taxpayer — must overcome the presumption of correctness that attaches to an IRS tax assessment.⁸⁸⁷

The debtor can file a written objection to the allowance of the IRS's claim with the bankruptcy court.⁸⁸⁸ Where the debtor files a motion to determine his tax liability, the debtor bears the burden of proving his entitlement to deductions claimed on the return.⁸⁸⁹ In the case of an objection to a proof of claim, the objecting party has the initial burden of going forward with evidence that the claim should not be allowed.⁸⁹⁰ Previously, some cases suggested that, after the debtor introduced substantial evidence, the ultimate burden of proof shifted to the IRS,⁸⁹¹

particularly with respect to unassessed taxes.⁸⁹² Addressing this dissimilar treatment, the Supreme Court in *Raleigh v. Illinois Dep't of Revenue*⁸⁹³ ruled that when the substantive law creating a tax obligation puts the burden of proof on the taxpayer, the burden of proof on the tax claim in bankruptcy court remains on the taxpayer.

Comment: If the debtor is faced with a large potential liability resulting from an IRS audit, the debtor can challenge the amount of this claim under 11 U.S.C. §502(a) and §502(b). This proceeding may force the IRS to establish its claim before the IRS is ready. To the extent that this estimation proceeding is res judicata as to the amount of the liability, the expedited nature of the proceeding can give the debtor a substantial tactical advantage. A settlement of a dispute over an IRS proof of claim may not bar a later deficiency determination, however.⁸⁹⁴

It may be necessary to object to an IRS proof of claim to avoid having the deemed allowance of the claim constitute a final determination of the underlying liability. Some courts have held that the allowance of an IRS claim *even without objection* bars a subsequent challenge to the underlying liability by res judicata.⁸⁹⁵ This appears to be based on a concern that a debtor could allow an IRS claim to be paid, thereby diminishing the potential distribution to other creditors, and then seek and obtain a refund of the payment after the bankruptcy case is closed. This issue should be watched carefully when the taxpayer/debtor does not agree with the amount of a claim submitted by the IRS.

The debtor can also seek a determination regarding the dischargeability of a tax. If the debtor seeks a discharge of the tax or any other relief specified in Bankruptcy Rule 7001, the matter is treated as an adversary proceeding rather than as a contested matter.⁸⁹⁶ This is significant since more stringent procedural rules must be met for adversary proceedings.⁸⁹⁷

In addition, under 11 U.S.C. §505(a), the bankruptcy court has jurisdiction to order a tax refund. Generally, a taxpayer must file a refund claim with the IRS before a refund can be

⁸⁸³ 11 U.S.C. §362(d).

⁸⁸⁴ See S. Rep. No. 1035, 96th Cong., 2d Sess. 48 (1980), 1980-2 C.B. 620, 644. See also *In re Baker*, 74 F.3d 906 (9th Cir. 1996) (bankruptcy court cannot redetermine tax liability previously established in stipulated Tax Court decision). Note that the Tax Court does not have jurisdiction to determine whether tax deficiencies have been discharged in a prior bankruptcy proceeding or to determine the dischargeability of debts in a bankruptcy proceeding. *Ashmore v. Commissioner*, T.C. Memo 2016-36; *Neilson v. Commissioner*, 94 T.C. 1 (1989).

⁸⁸⁵ See *United States v. Wilson*, 974 F.2d 514 (4th Cir. 1992). If the bankruptcy court does not adjudicate the liability, the Tax Court may adjudicate the issue once the stay is lifted. *Ashmore v. Commissioner*, T.C. Memo 2016-36.

⁸⁸⁶ *In re Shapiro*, 95-2 USTC ¶50,630 (Bankr. E.D. Pa. 1995). But see *In re Macagnone*, 98-1 USTC ¶50,110 (Bankr. M.D. Fla. 1997) (closed no asset Chapter 7 case reopened to determine nondischargeable trust fund recovery penalty liability).

⁸⁸⁷ *Resyn Corp. v. United States*, 851 F.2d 660 (3d Cir. 1988); *United States v. Baskin & Sears, P.C.*, 97-2 USTC ¶50,462 (E.D. Pa. 1997); *In re Greenspan*, 2003-1 USTC ¶50,178 (Bankr. D. Md. 2002).

⁸⁸⁸ Bankruptcy Rule 3007. A copy of the objection and a notice of the related hearing must be mailed or otherwise delivered to the IRS, the debtor, and the trustee in accordance with Rule 7004 at least 30 days before the hearing.

⁸⁸⁹ *In re Carden*, 98-2 USTC ¶50,686 (Bankr. E.D. La. 1998); *In re Quality Beverage Co.*, 170 Bankr. 310 (Bankr. S.D. Tex. 1994).

⁸⁹⁰ Bankruptcy Rule 3001(f). See *Solari Furs v. United States*, 436 F.2d 683 (8th Cir. 1971).

⁸⁹¹ Cases placing the ultimate burden on the claimant: *In re Brown*, 82 F.3d 801, 804-05 (8th Cir. 1996); *In re MacFarlane*, 83 F.3d 1041, 1044-45 (9th Cir. 1996); *In re Placid Oil Co.*, 988 F.2d 554, 557 (5th Cir. 1993); *In re Fullmer*, 962 F.2d 1463, 1466 (10th Cir. 1992); *In re Johnson*, 2000-1 USTC ¶50,415 (N.D. Ga. 2000) (upholding debtor's objection to the IRS's amended proof of claim). But see *In re Stoecker*, 179 F.3d 546, 548 (7th Cir. 1999) (bur-

den of proof remained on trustee, just as it would have been on taxpayer if proceedings taken place outside of bankruptcy), *aff'd*, 530 U.S. 15 (2000); *Resyn Corp. v. United States*, 851 F.2d 660, 663 (3d Cir. 1988); *In re Landbank Equity Corp.*, 973 F.2d 265, 270-71 (4th Cir. 1992).

⁸⁹² See, e.g., *In re Fidelity Holding Co., Ltd.*, 837 F.2d 696 (5th Cir. 1988); *In re Rasbury*, 93-1 USTC ¶50,351 (N.D. Ala. 1993) (burden of proof is shifted to IRS; thus, IRS has to prove that the debtor owes taxes and amount owed), *aff'd*, 24 F.3d 159 (11th Cir. 1994); *United States v. Kontaratos*, 36 Bankr. 928 (D. Me. 1984); *In re Coleman Am. Cos.*, 26 Bankr. 825 (Bankr. D. Kan. 1983). *Compare Placid Oil Co. v. IRS*, 988 F.2d 554 (5th Cir. 1993), *nonacq.*, 1995-1 C.B. 1 (nonacquiescence regarding whether IRS or taxpayer bears ultimate burden of proof in bankruptcy proceeding where taxpayer challenges federal tax claim arising from disallowance of deductions); *In re Landbank Equity Corp.*, 973 F.2d 265 (4th Cir. 1992) (no burden shift on taxpayer's entitlement to deductions). *In re Pac.-Atl. Trading Co.*, 96-1 USTC ¶50,303 (Bankr. N.D. Cal. 1996).

⁸⁹³ 530 U.S. 15 (2000) (bankruptcy trustee challenging the state's imposition of responsible officer penalties on a debtor had to meet burden of proof established by state law regarding the penalty).

⁸⁹⁴ *Breland v. Commissioner*, 152 T.C. No. 9 (2019).

⁸⁹⁵ See *Siegel v. Fed. Home Loan Mortg. Corp.*, 143 F.3d 525 (9th Cir. 1998).

⁸⁹⁶ Bankruptcy Rule 3007.

⁸⁹⁷ Both types of actions require service of a summons and complaint on the IRS, the local U.S. Attorney's Office, and the U.S. Attorney General. Bankruptcy Rules 7004(b)(4), 9014; *United States v. OxyLance Corp.*, 115 Bankr. 380 (N.D. Ga. 1990).

granted.⁸⁹⁸ There is an exception to this rule where the funds are sought as an offset or counterclaim to the IRS's claim or request for payment.⁸⁹⁹ If a Chapter 11 plan is confirmed, confirmation is *res judicata* with respect to pending refund claims relating to the same tax year and bars subsequent litigation on the claim.⁹⁰⁰

Bankruptcy Code §505(b) gives the bankruptcy court the power to determine tax consequences that fall outside the terms of the plan of reorganization. For instance, a plan can affect the amount of carryovers that will pass to the debtor at the completion of the case and will therefore affect the debtor's tax liability for future years.⁹⁰¹ The trustee and the bankruptcy court can reject a Chapter 11 plan whose only purpose is to transfer the debtor's net operating losses to a related party, however.⁹⁰²

G. Income Tax Issues for the Debtor and the Bankruptcy Estate

In general, when an individual files a Chapter 7 or Chapter 11 petition, the bankruptcy estate becomes a taxable entity separate from the debtor. This raises a number of important issues concerning the current income taxation of the debtor and the estate. These include:

- How tax attributes transfer from the debtor to the estate and back.
- How property transfers between the debtor and the estate are taxed.
- How loss or credit carrybacks are applied.
- Whether the debtor should elect to close the debtor's tax year in the year of filing.
- How income and expense is allocated between the debtor and the estate.
- How the estate is taxed.
- How abandoned property is taxed.
- How the discharge of debt is taxed.

1. In General

a. Prior Law

Before the Bankruptcy Tax Act of 1980, there was no Internal Revenue Code section dealing specifically with the tax

treatment of bankrupt individuals and their estates. Outside the Internal Revenue Code, however, there were statutory provisions dealing on a limited basis with the tax aspects of bankruptcy.⁹⁰³ The longstanding position of the IRS under prior law was that the estate of a bankrupt individual was taxable as an estate.⁹⁰⁴ Thus, the IRS ruled that the trustee in bankruptcy was required to file Form 1041 and pay tax on the estate's income.⁹⁰⁵ Decisions of the courts under prior law were in conflict on the question of whether the estate of a bankrupt individual not conducting a business was subject to tax.⁹⁰⁶

b. Bankruptcy Tax Act

Section 1398, a special Internal Revenue Code section dealing with bankrupt individuals and their estates, was enacted as part of the Bankruptcy Tax Act of 1980. Section 1398 applies to any case under Chapter 7 or Chapter 11 commencing on or after March 25, 1981,⁹⁰⁷ in which the debtor is an individual, unless the case is dismissed. Accordingly, §1398 does not apply to the following:

- cases under Chapter 7 or Chapter 11 that are dismissed;
- individuals in bankruptcy under Chapter 12 or Chapter 13;
- individuals who are in receivership, foreclosure, or similar proceedings, whether state or federal, outside the Bankruptcy Code;
- corporations;
- partnerships;
- estates; and
- trusts.

Section 1398 treats an individual and the individual's bankruptcy estate as separate taxable entities. Section 1399 provides that no separate taxable entity is created on commencement of a bankruptcy case, except as provided in §1398. Therefore, in bankruptcy cases involving the entities listed above to which §1398 does not apply, no separate taxable entity is created.

The Committee Reports make it clear that a separate taxable entity is created both in liquidation and in reorganization cases. The reports also draw no distinction between reorganization cases in which a trustee is appointed and cases in which the debtor remains in possession.⁹⁰⁸ Thus, a separate taxable entity is also created in reorganization cases when the debtor remains in possession.

⁸⁹⁸ §7422(a); 11 U.S.C. §505(a)(2)(B).

⁸⁹⁹ *In re Kearns*, 177 F.3d 706 (8th Cir. 1999); *United States v. Henderson*, 2000-2 USTC ¶50,777 (S.D. Miss. 2000); *Michaud v. United States*, 97-1 USTC ¶50,292 (D.N.H. 1997). See also *IRS v. Luongo*, 259 F.3d 323 (5th Cir. 2001) (bankruptcy court had jurisdiction over debtor's action to recover tax overpayment following the IRS's setoff of pre-petition tax overpayment against discharged liability, and debtor's reopening of case to claim overpayment as an exempt asset).

⁹⁰⁰ *Puckett v. Commissioner*, 2000-1 USTC ¶50,439 (5th Cir. 2000) (unpub.), cert. denied, 531 U.S. 1070 (2001). See also *Hambrick v. Commissioner*, 118 T.C. 348 (2002) (absent an indication that bankruptcy court inquired into merits of taxpayer's tax liability during confirmation process or that taxpayer objected to the IRS's proof of claim, creating the need for an 11 U.S.C. §505 hearing, *res judicata* could not apply).

⁹⁰¹ See, e.g., *In re Prudential Lines, Inc.*, 928 F.2d 565 (2d Cir. 1991) (part precluded from claiming worthless stock deduction for debtor's stock, since such deduction would eliminate debtor's ability to carry forward NOLs).

⁹⁰² *In re South Beach Securities, Inc.*, 606 F.3d 366 (7th Cir. 2010).

⁹⁰³ See, e.g., 28 U.S.C. §960, which provides that business conducted under authority of U.S. courts is subject to federal, state, and local taxes.

⁹⁰⁴ Rev. Rul. 72-387; Rev. Rul. 68-48.

⁹⁰⁵ Rev. Rul. 68-48.

⁹⁰⁶ Compare *Williams v. United States*, 667 F.2d 1108 (4th Cir. 1981), and *In re Joplin*, 882 F.2d 1507 (10th Cir. 1989) (estate of bankrupt individual subject to tax), with *In re Kirby*, 62-2 USTC ¶9752 (S.D. Tex. 1962) (estate of bankrupt individual not subject to tax).

⁹⁰⁷ Pub. L. No. 96-589, §7(b), 94 Stat. 3412 (1980).

⁹⁰⁸ H.R. Rep. 96-833, 96th Cong., 2d Sess. at p. 20. Under prior law, the IRS ruled that a separate taxable entity was created in a bankruptcy case involving an individual. Rev. Rul. 72-387; Rev. Rul. 78-134. The Tax Court held that a separate taxable entity was not created in a case involving an S corporation under Chapter 11. *CHM Co. v. Commissioner*, 68 T.C. 31 (1977).

c. State and Local Taxes

Bankruptcy Code §346 aligns state and local tax administration with the Internal Revenue Code's rules creating separate taxable estates in Title 11 cases.⁹⁰⁹ Bankruptcy Code §346 provides that any income is taxed under state or local law to the debtor or to the estate, as provided under federal tax law.⁹¹⁰

2. Transfer of Tax Attributes Between Debtor and Estate

As a general rule, the debtor's tax attributes transfer to the estate when the bankruptcy petition is filed, are used by the estate during its duration, and transfer back when the estate terminates.

a. Federal Taxes

Section 1398(g) provides that the bankruptcy estate succeeds to and takes into account the following attributes of the individual debtor, determined as of the first day of the debtor's taxable year in which the case commences:

- net operating loss carryovers as determined under §172;
- carryover of excess charitable contributions as determined under §170(d)(1);
- any amount to which recovery of tax benefit items under §111 applies;
- carryovers of any credit, and all other items that, but for the commencement of the case, would be required to be taken into account by the debtor with respect to any credit;
- capital loss carryovers determined under §1212;
- in the case of any asset acquired other than by sale or exchange by the estate from the debtor, the basis, holding period, and character the asset had in the hands of the debtor;
- the method of accounting used by the debtor;
- other tax attributes of the debtor, to the extent provided in regulations carrying out the purposes of §1398.⁹¹¹

Pursuant to its regulatory authority, the IRS has added unused passive activity losses and unused passive activity credits under §469, unused at-risk losses under §465, and the §121 exclusion with respect to the property transferred into the bankruptcy estate to the list of attributes to which the estate succeeds at the commencement of the case.⁹¹²

⁹⁰⁹ See §1398 (individuals); §1399 (partnerships and corporations). Pre-2005 Bankruptcy Act 11 U.S.C. §346(b)(1) provided for a separate taxable entity for state and local tax purposes in a Chapter 12 bankruptcy case (unlike §1398). Pre-2005 Bankruptcy Act 11 U.S.C. Chapter 12 is titled "Adjustment of Debts of a Family Farmer with Regular Annual Income." Pre-2005 Bankruptcy Act 11 U.S.C. §346(c) provided that a separate entity is not created in the case of a corporation or partnership (paralleling §1399). For additional discussion, see 1540 T.M., *State Tax Aspects of Bankruptcy* (State Tax Library).

⁹¹⁰ 11 U.S.C. §346(a) and (b). Pre-2005 Bankruptcy Act 11 U.S.C. §346(b) (1) provided that in a case under Chapter 7, 11, or 12 concerning an individual, any income of the estate could be taxed under a state or local law imposing a tax on or measured by income only to the estate, and not taxed to the individual.

⁹¹¹ Absent a regulation adding an attribute to the list of attributes to which the estate succeeds at the commencement of the case, the estate does not succeed to an attribute not listed in §1398(g). See *In re Antonelli*, 92-2 USTC ¶50,619 (Bankr. D. Md. 1992).

The transfer of attributes from the debtor to the estate has the corollary effect that the debtor is denied the use of the tax attributes to which the estate succeeds on the commencement of the case. For example, a debtor cannot use an NOL carryover from the last taxable year preceding the taxable year in which the case commences because the estate succeeds to this attribute.⁹¹³

As noted above, one attribute that carries over to the estate under §1398(g) is the debtor's method of accounting. Although the legislative history does not address what method of accounting the debtor can use post-petition, arguably the debtor should be free to select a new method of accounting for the taxable year in which the case commences and for succeeding years without obtaining the consent of the Secretary under §446(e).

Section 1398(i) provides that, on the termination of an estate, the debtor succeeds to and takes into account the items listed in §1398(g) that the estate succeeded to at the commencement of the case, except for the method of accounting used by the estate. Section 1398(i) also provides that the debtor succeeds to and takes into account the other tax attributes of the estate to the extent provided in regulations. Under the regulations, upon termination of the bankruptcy estate the debtor also succeeds to the estate's unused passive activity loss and passive activity credit disallowed under §469 for the estate's last taxable year and losses not allowed under §465 for the estate's last taxable year, beginning with the debtor's taxable year in which the termination occurs.⁹¹⁴ In addition, the regulations provide that if the estate transfers an interest in a passive activity or former passive activity or an interest in a §465 activity to the debtor other than by sale or exchange before the termination of the estate, the transfer is not treated as a taxable event and the debtor succeeds to the unused passive activity loss and unused passive activity credit allocated to the transferred interest and the transferred interest's share of the unused §465 loss (determined as of the first day of the estate's taxable year in which the transfer occurs).⁹¹⁵

Although §1398(i) does not state when the debtor succeeds to tax attributes on the termination of the estate, it is presumably in the debtor's taxable year in which the termination occurs determined as of the first day of the estate's taxable year in which the transfer occurs.⁹¹⁶ The Tax Court has held that the "termination of the estate" for purposes of §1398(i) occurs at the time of the confirmation of the bankruptcy plan and discharge, rather than upon the final order closing the bankruptcy.⁹¹⁷ Upon the termination of the estate, tax attributes remaining in the bankruptcy estate pass to the debtor after they are re-

⁹¹² Added by Reg. §1.1398-1 and §1.1398-2, effective with respect to bankruptcy cases commencing on or after November 9, 1992, and Reg. §1.1398-3 for sales and exchanges of the taxpayer's principal residence after December 24, 2002.

⁹¹³ See *Banks v. Commissioner*, T.C. Memo 2001-48; *Kahle v. Commissioner*, T.C. Memo 1997-91.

⁹¹⁴ Reg. §1.1398-1(e), §1.1398-2(e).

⁹¹⁵ Reg. §1.1398-1(d), §1.1398-2(d).

⁹¹⁶ See Reg. §1.1398-1(e), §1.1398-2(e).

⁹¹⁷ *Benton v. Commissioner*, 122 T.C. 353 (2004).

duced under §108(b), to the extent of COD income excluded under §108(a).⁹¹⁸

For purposes of determining the number of years during which the debtor can use carryovers to which the debtor succeeds when the case ends, the debtor presumably must count taxable years of the estate to which carryovers have been applied. The statute of limitations on filing a refund claim for federal taxes with respect to a tax attribute to which the debtor succeeds on termination of the bankruptcy case is not tolled during the pendency of the bankruptcy proceeding.⁹¹⁹

Example: The first taxable year of a bankruptcy estate begins November 1, 2016. The estate succeeds under §1398(g) to an NOL carryover of the individual debtor (D) in the amount of \$150,000. The carryover arose out of an NOL for D's taxable year ended October 31, 2016. The estate terminates on February 15, 2018. The estate has NOLs of \$5,000 for its taxable year ended October 31, 2017, and \$3,000 for its short taxable year ended February 15, 2008, after reducing the estate's NOLs by the amount of the estate's discharged indebtedness as required by §108(b). D has income of \$50,000 for the taxable year ended December 31, 2018. Under §1398(i), D succeeds to the estate's NOL carryovers of \$150,000, \$5,000, and \$3,000. For the taxable year ending December 31, 2018, D must apply the \$50,000 of 2018 income against the \$158,000 carryovers from the estate, leaving aggregate carryovers of \$108,000 to taxable years after 2018.⁹²⁰

The death of the debtor does not affect the ability of the surviving spouse to claim attribute carryovers after termination of the estate.⁹²¹ A bankruptcy court order eliminating tax attribute carryovers may be binding, however.⁹²²

b. State and Local Taxes

The Bankruptcy Code contains a provision comparable to §1398(g) with regard to state and local taxes. Under 11 U.S.C. §346(i)(1), in a case under Chapter 7, 11, or 12 concerning an individual, to the extent that any state or local law imposing a tax on income provides for the carryover of any tax attribute from one period to a subsequent period, the estate succeeds to the debtor's tax attributes in any case in which the estate is subject to tax. In addition, under 11 U.S.C. §346(i)(2) after the case is closed or dismissed the debtor succeeds to any attribute to which the estate succeeded to the extent consistent with the Internal Revenue Code.

Also, under 11 U.S.C. §346(f), a transfer of property in bankruptcy from the debtor to the estate or vice versa is not treated as a disposition of such property, except to the extent treated as such under the Internal Revenue Code. The estate must use the same method of accounting that the debtor used immediately before commencement of the bankruptcy case.⁹²³

The following differences exist between the rules applicable in the state and local tax area to the transfer of attributes between the debtor and the estate⁹²⁴ and the rules applicable to federal taxes:

- For state and local taxes, the estate succeeds to all of the debtor's tax attributes for which state or local law provides a carryover.⁹²⁵ Under §1398(g), the estate succeeds only to enumerated federal tax attributes plus such other attributes as may be provided for in regulations.
- Read literally, 11 U.S.C. §346(i)(2)⁹²⁶ provides that at the end of the case, the debtor succeeds only to tax attributes to which the estate succeeded at the commencement of the case, and does not succeed to attributes which arose during the pendency of the case. This is clearly not the result under §1398(i) and was probably not the intended result under Bankruptcy Code §346(i)(2).

3. Taxation of Property Transfers Between Debtor and Estate

A corollary of the transfer of attributes between the debtor and the estate is that transfers of property between the two are generally not taxable.

a. Federal Taxes

Section 1398(f)(1) provides that a transfer other than by sale or exchange of an asset from the debtor to the estate is not treated as a disposition for purposes of any provision of the Internal Revenue Code assigning a tax consequence to a disposition, and that the estate will be treated as the debtor would be treated with respect to such asset. Section 1398(f)(2) provides the corollary rule that a transfer other than by sale or exchange of property from the estate to the debtor at the termination of the estate will likewise not be treated as a disposition for purposes of the Internal Revenue Code. Based on the language of §1398(f)(1) that the estate will be treated as the debtor would be treated with respect to a transferred asset, the estate is liable for the premature withdrawal penalty on amounts distributed from an IRA to the estate.⁹²⁷

Note: Such a situation should be distinguished from a creditor's sale of a claim against the estate, which does not fall within the purview of §1398.⁹²⁸

The "no disposition rule" of §1398(f)(1) and §1398(f)(2) means that gain or loss is not recognized on the transfer of property from the debtor to the estate or on transfers from the estate to the debtor. Moreover, transfers from the debtor to the estate and from the estate to the debtor do not result in the recapture of depreciation, investment credit, or other recapture items, and they do not result in the acceleration of installment obligations under §453B. While the Bankruptcy Tax Act did not amend §1245, §1250, §1254 and other recapture provi-

⁹¹⁸ *Williams v. Commissioner*, 123 T.C. 144 (2004) (taxpayer's post-bankruptcy loss carryforwards disallowed because such losses were reduced to zero under §108(b) prior to passing to taxpayer under §1398(i)).

⁹¹⁹ *Firson v. United States*, 95 F.3d 444 (6th Cir. 1996).

⁹²⁰ See Reg. §1.172-4(a)(3).

⁹²¹ *Lassiter v. Commissioner*, T.C. Memo 2000-25.

⁹²² *Gould v. Commissioner*, 139 T.C. 418 (2012).

⁹²³ 11 U.S.C. §346(e).

⁹²⁴ For further discussion, see 1540 T.M., *State Tax Aspects of Bankruptcy* (State Tax Library).

⁹²⁵ 11 U.S.C. §346(i)(1).

⁹²⁶ 11 U.S.C. §346(i)(2).

⁹²⁷ *In re Kochell*, 804 F.2d 84 (7th Cir. 1986).

⁹²⁸ See, e.g., *Martin v. United States*, 97-2 USTC ¶50,731 (E.D. La. 1997), *aff'd*, 159 F.3d 932 (5th Cir. 1998) (ex-wife of debtor must recognize gain on sale of community property claim against former husband's bankruptcy estate because transfer was from third party rather than bankruptcy estate).

sions, the legislative history behind §1398(f) clearly indicates that Congress intended §1398 to override these recapture provisions.⁹²⁹

The tax consequences of abandonments of property back to an individual debtor by the bankruptcy trustee estate before the termination of the case are discussed at VII.G.8., below.

b. State and Local Taxes

For purposes of state or local law, a transfer of property from the debtor to the estate or from the estate to the debtor is not treated as a disposition for purposes of any provision assigning tax consequences to a disposition, except to the extent that such transfer is treated as a disposition under the Internal Revenue Code.⁹³⁰ This bankruptcy provision parallels §1398(f).⁹³¹

4. Loss and Credit Carrybacks

a. Federal Taxes

In addition to providing for the transfer of tax attributes between an individual debtor and the bankruptcy estate, §1398(j)(2) allows the bankruptcy estate to carry back its net operating losses (NOLs) and certain unused credits to pre-bankruptcy taxable years of the debtor. In a technical advice memoranda, the IRS ruled that a bankruptcy estate could also carry back its alternative minimum tax NOL under §1398(j)(2) to pre-bankruptcy tax years of the debtor.⁹³²

Section 1398(j)(2) helps to eliminate the distinction between cash and accrual basis taxpayers as such distinction existed under prior law, as is illustrated by the following example:

Example: D files for bankruptcy on June 1, 2018, and elects to terminate D's taxable year on May 31, 2018. For the taxable year ended May 31, 2018, D has taxable income of \$10,000, computed without regard to business expenses of \$20,000 accrued but not paid in the taxable year ending May 31, 2018. If D is an accrual basis taxpayer, D can deduct the \$20,000 of accrued expenses in the taxable year ending May 31, 2018. If D is a cash basis taxpayer, D cannot deduct the \$20,000 of accrued expenses in the taxable year ending May 31, 2018. To the extent the estate pays the expenses and such payments generate an NOL, the NOL can be carried back to D's earlier taxable years under §1398(j)(2)(A). The NOL carryback offsets D's taxable income of \$10,000 for the taxable year ending May 31, 2018, to the extent the NOL carryback is not used up in D's earlier taxable years.⁹³³

Section 1398(j)(2)(B) provides that the debtor cannot carry back any carryback from a taxable year ending after the case

commences to any pre-bankruptcy tax year. Thus, the price the debtor pays for the estate's right to carry back its losses to the debtor's pre-bankruptcy tax years is loss of the ability to carry back the debtor's own post-bankruptcy losses to pre-bankruptcy years. The debtor cannot carry back post-bankruptcy tax losses to pre-bankruptcy tax years even after the conclusion of the bankruptcy case.

Example: An individual debtor (D) files for bankruptcy on October 1, 2018. D does not elect to close D's taxable year at the commencement of bankruptcy, so D's last taxable year ending before bankruptcy is the year ending December 31, 2017. In the two taxable years preceding bankruptcy, D had taxable income and tax in the following amounts:

Year Ended	Taxable Income	Tax
12/31/17	\$ 50,000	\$20,000
12/31/16	\$ 65,000	\$28,000
Total	\$115,000	\$48,000

In the estate's first taxable year commencing October 1, 2018, the estate realizes a net operating loss (NOL) of \$113,000 attributable to D's unpaid accounts payable (D is a cash basis taxpayer) paid by the estate. D realizes an NOL of \$50,000 for the taxable year ending December 31, 2018. Under §1398(j)(2), the estate is entitled to carry back its \$113,000 loss to 2016 and 2017, generating a \$46,000 refund. The \$46,000 refund is the estate's property. Under §1398(j)(2)(B), D is precluded from carrying back the \$50,000 NOL for the taxable year ended December 31, 2018, to any taxable years preceding bankruptcy.

Under 11 U.S.C. §548 and §549, the bankruptcy trustee can set aside fraudulent transfers and certain post-petition transfers of the debtor's interest in property. Some courts have held that a pre-petition election by the debtor under §172 to waive the carryback of net operating losses so as to preserve them for future use by the debtor could be set aside to allow the bankruptcy estate to carry the losses back and receive refunds.⁹³⁴

b. State and Local Taxes

For state and local tax purposes, the estate can carry back any loss of the estate to a taxable period of the debtor that ended before the order for relief, to the extent that applicable state or local law allows a carryback and a similar tax attribute may be carried back by the estate under the Internal Revenue Code.⁹³⁵ This bankruptcy provision is comparable to §1398(j)(2), which allows the estate to carry back its losses to pre-bankruptcy tax years of the debtor for federal tax purposes.

⁹²⁹ S. Rep. No. 1035.

⁹³⁰ 11 U.S.C. §346(f).

⁹³¹ See discussion in 1540 T.M., *State Tax Aspects of Bankruptcy* (State Tax Library).

⁹³² TAM 8932002.

⁹³³ See Germain, *Avoiding Phantom Income in Bankruptcy: A Proposal for Reform*, 5 Fla. Tax Rev. 249 (Sept. 2001), for a discussion of the problems cash and accrual taxpayers continue to face even after enactment of the carryback rule of §1398(j)(2).

⁹³⁴ See *United States v. Towers*, 218 F.3d 948 (9th Cir. 2000); *Gibson v. United States*, 927 F.2d 413 (8th Cir. 1991).

⁹³⁵ 11 U.S.C. §346(i)(3).

5. Election to Close Debtor's Taxable Year

As a general rule, only claims that arise before the commencement of the bankruptcy case may be paid from the assets of the bankruptcy estate.⁹³⁶ The question arises as to which tax liabilities of an individual debtor arise before the commencement of the case and thus become claims against the estate, and which tax liabilities of the debtor arise after the commencement of the case and are therefore tax liabilities of the debtor only and are not claims against the estate.

An income tax liability arises when the taxpayer's taxable year closes, even if the tax is not yet payable.⁹³⁷ Thus, if bankruptcy occurs during an individual's taxable year, the individual's tax liabilities for the preceding tax year are claims against the estate, while the individual's tax liability for the taxable year in which bankruptcy takes place (assuming the year does not end until after the commencement of the case) is not a claim against the estate. On the other hand, the liability for employment taxes accrues as wages are paid. Therefore, employment taxes with respect to wages paid pre-petition are a pre-petition liability of the individual, even though the tax is due post-petition. Employment taxes on wages paid post-petition by the bankruptcy estate are a liability of the bankruptcy estate.⁹³⁸

a. Federal Taxes

Section 1398(d)(2)(A) gives an individual debtor an election to close the taxable year on the day before the "commencement date" and to begin a new taxable year on the commencement date. Under §1398(d)(3), the "commencement date" is defined as the day on which the bankruptcy case begins. For purposes of determining the commencement date when an involuntary bankruptcy petition is filed, an involuntary proceeding commences upon the entry of an order for relief, not on the filing date of the involuntary bankruptcy petition.⁹³⁹ Under §1398(d)(2)(C), debtors who have no assets other than property exempt under 11 U.S.C. §522 cannot elect to terminate their taxable years.

An individual debtor who does not elect to close the taxable year under §1398(d)(2)(A) has an unbroken taxable year in the year in which bankruptcy occurs — a part of which includes the period before bankruptcy and a part of which includes the period after the commencement of bankruptcy. When the election is made, however, an individual debtor has two taxable years instead of one. The "pre-petition short tax year" starts January 1 and ends the day before bankruptcy. The "post-petition short tax year" begins the day the bankruptcy commences and continues to December 31.

The significance of the election is that it gives debtors the option to close the taxable year on the day before the commencement of the bankruptcy proceeding. That makes tax lia-

bilities attributable to the pre-petition short tax year liabilities of the bankruptcy estate rather than post-petition liabilities of the debtor.

Example: Individual debtor (D) files a bankruptcy petition on September 23, 2018. Under §1398(d)(3), the commencement date is September 23, 2018. If D does not elect to close the taxable year at the commencement of bankruptcy: (1) D's taxable year does not close when bankruptcy commences; (2) tax liabilities for the taxable year ending December 31, 2017, are claims against the bankruptcy estate; and (3) D's tax liabilities for the taxable year ending December 31, 2018, are claims against D, not claims against the bankruptcy estate. If, however, D elects to close the taxable year at bankruptcy: (1) D has a pre-petition short tax year ending September 22, 2018; (2) D's tax liabilities for the taxable years ending December 31, 2017, and September 22, 2018, are claims against the bankruptcy estate; and (3) D's tax liabilities for the post-petition short tax year commencing September 23, 2018 and ending December 31, 2018, are claims against D, not claims against the bankruptcy estate.⁹⁴⁰

Under §1398(d)(2)(D), a debtor's election to close the taxable year must be made on or before the due date for filing the return for the pre-petition short tax year. The election is irrevocable. There is no provision for extending the time for making the election. The regulations provide that the election is made by filing a return for the pre-petition short tax year on or before the 15th day of the fourth full month following the end of that first short taxable year. To facilitate processing the taxpayer should write "SECTION 1398 ELECTION" at the top of the return. The election may be made by attaching a statement of election to a timely application for an extension of time to file a return for the pre-petition short tax year. Under §1398(d)(2)(B), the spouse of a taxpayer may join in the election, but only if the taxpayer and the spouse file a joint return for the pre-petition short tax year. The spouse joins in the election by filing a joint return with the taxpayer for the pre-petition short tax year or by joining in an application for extension of time to file a return for the pre-petition short tax year and in a statement of election attached to the application for extension.⁹⁴¹

Example: Individual debtor (D) files a bankruptcy petition on June 23. If D elects to close the taxable year on the commencement of the case, D has a pre-petition short tax year ending June 22. D's return for the short year ending June 22 is due on or before October 15, which is the 15th day of the fourth full month following June 22. D makes the election by filing a return for the short taxable year ending June 22 on or before October 15, or by requesting an extension of time to file the return that meets the requirements of §6081, on or before October 15, and attaching a statement or election to the request for extension. If

⁹³⁶ Generally, 11 U.S.C. §101(10) defines "creditor" as an entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor.

⁹³⁷ *Pacific-Atlantic Trading Co. v. United States*, 64 F.3d 1292 (9th Cir. 1995); *Dixon v. IRS*, 218 Bankr. 150 (B.A.P. 10th Cir. 1998); *In re Moore*, 91-2 USTC ¶50,390 (Bankr. W.D. Pa. 1991); *In re Mirman*, 89-1 USTC ¶9297 (Bankr. E.D. Va. 1989) (to extent 11 U.S.C. §502(i) provides to contrary, it is overruled by §1398(d)(2)); *In re Vela*, 88-1 USTC ¶9253 (Bankr. D.P.R. 1988).

⁹³⁸ *Bellus v. United States*, 125 F.3d 821 (9th Cir. 1997).

⁹³⁹ *In re Kreidle*, 91-2 USTC ¶50,371 (Bankr. D. Colo. 1991).

⁹⁴⁰ See, e.g., *In re Johnson*, 95-2 USTC ¶50,611 (Bankr. D. Mass. 1995) (debtors who do not elect to terminate taxable year on filing of bankruptcy petition are liable for all taxes incurred in that year; as such, tax is collectible directly from debtors), and *In re Moore*, 91-2 USTC ¶50,390 (Bankr. W.D. Pa. 1991), to the same effect.

⁹⁴¹ Reg. §301.9100-14T(d).

D is married, D's spouse may join in the election by filing a joint return with D for the short taxable year ending June 22 or by joining in a request for an extension of time to file the return and signing the attached statement of election.

The election to close a taxable year may also be made by a spouse who commences a separate bankruptcy case during the same taxable year.⁹⁴²

Example: Individual debtor (D) and spouse (S) are calendar year taxpayers. A bankruptcy case involving D commences on March 1, a case involving S commences on October 10. If D does not elect to terminate D's taxable year, D has an unbroken taxable year ending December 31. If D makes the election, D has a pre-petition short tax year ending February 28, and a post-petition short tax year commencing March 1. If D elects to terminate D's taxable year on February 28, S can join in the election by filing a joint return with D for the short pre-petition tax year ending February 28 or by joining in a timely application for an extension of time to file the return and filing the required statement.

S's bankruptcy provides S with an opportunity to make an election to terminate S's taxable year on October 9, the day before the commencement of S's bankruptcy case. Unless S joined in the election made by D to terminate D's taxable year on February 28, S will have two short taxable years if S makes the election to terminate S's year on October 9: one for the period January 1–October 9, and the other for the period October 10–December 31. If D has not made the election to terminate D's taxable year on February 28, or if D has made that election and S has joined in the election, D can join in S's election to terminate S's taxable year on October 9 by filing a joint return with S or by joining in a timely application for an extension of time to file the return and filing the required statement. If S joined in D's election to terminate D's taxable year on February 28, and D joins in S's election to terminate S's taxable year on October 9, D and S have taxable years for the period January 1–February 28 (joint return), March 1–October 9, (joint return) and October 10–December 31 (joint return optional). If S did not join in D's election to terminate D's taxable year on February 28, D cannot join in S's election to terminate S's taxable year on October 9, because D and S cannot file a joint return for S's taxable year for the period January 1–October 9.⁹⁴³

Under §1398(d)(2)(F), a return for a short taxable year is treated as a return made under §443(a)(1). Section 443 generally requires a taxpayer with a short taxable year to annualize income by multiplying income for the short period by 12 and dividing the result by the number of months in the short period. The tax is computed on the annualized income, and the tax for the short period is the ratio of the tax computed on the annual basis based on the number of months in the short period. Because the tax is computed on annualized income, the rate of tax

is based on the tax brackets in which the annualized income falls.

Under 11 U.S.C. §505(a), the bankruptcy court is given a broad jurisdictional grant to determine the amount of any type of tax except for taxes already contested and adjudicated before the filing of the bankruptcy petition. This may include jurisdiction to determine the tax liability for the post-petition short tax year of a debtor who elected to terminate the debtor's taxable year at the commencement of bankruptcy.⁹⁴⁴

A major tax-planning question faced by a bankrupt individual is whether to make the election to close the taxable year on the commencement of bankruptcy. As a general rule, a debtor should elect to close the debtor's taxable year when the debtor will have a tax liability for the pre-petition short tax year. If the debtor elects to close the debtor's taxable year, the tax liability for the short taxable year becomes a claim against the estate. Although the liability is nondischargeable in bankruptcy,⁹⁴⁵ the debtor will not have any personal liability for the tax if the property in the bankruptcy estate is sufficient to satisfy the tax claim. If the election is not made, the income for this period is included in the income for the debtor's calendar year ending after the commencement of bankruptcy. Any tax with respect to this income — even though attributable to income collected during the portion of the year before bankruptcy — is not a claim against the estate and therefore must be satisfied in full from the debtor's post-bankruptcy earnings or assets.⁹⁴⁶

Example (1): Individual debtor (D) files a bankruptcy petition on August 18. For taxable year January 1–December 31, D would have income of \$75,000 and tax liability of \$17,132 if D does not elect to terminate the taxable year at the commencement of bankruptcy. If D terminates the taxable year on August 17, D will have income of \$55,000 and a tax liability of \$11,533 for the period January 1–August 17, and income of \$20,000 and a tax liability of \$5,599 for the period August 18–December 31. If D terminates the taxable year at the commencement of bankruptcy, the \$11,533 of tax liability for the period January 1–August 17 becomes a claim against the estate for which D is not personally liable except to the extent the estate's assets are inadequate. Thus, an election by D to terminate the taxable year has the potential for reducing the tax D must pay out of post-bankruptcy assets and earnings from \$17,132 (D's liability for the unbroken calendar year) to \$5,599 (D's liability for the period August 18–December 31).

When the debtor would have no tax liability for the pre-petition short tax year and also would not have unused tax deductions, unused tax credits or an NOL for the short period, there would be no benefit or detriment to making the election. On the other hand, when the debtor has unused deductions, unused credits or an NOL for the pre-petition short tax year and when the debtor can use these tax benefits, it can be to the debtor's benefit not to make the election because the deductions, loss, or

⁹⁴⁴ *In re Schmidt*, 205 Bankr 394 (Bankr. N.D. Ill. 1997) (determination necessary for different administration of Chapter 11 plan).

⁹⁴⁵ 11 U.S.C. §523(a).

⁹⁴⁶ See, e.g., *In re Mirman*, 89-1 USTC ¶9297 (Bankr. E.D. Va. 1989); *In re Vela*, 88-1 USTC ¶9253 (Bankr. D.P.R. 1988).

⁹⁴² Reg. §301.9100-14T(f).

⁹⁴³ See examples under Reg. §301.9100-14T(g).

credit are included in the unbroken taxable year of the debtor. If the debtor has a tax liability for this unbroken year, the deductions, loss, or credit can be used to reduce the amount of tax liability that must be satisfied from the debtor's post-bankruptcy earnings and assets. Because the debtor cannot carry back a post-bankruptcy NOL or unused tax credits to pre-bankruptcy years, any NOL or unused tax credit for the unbroken year in which bankruptcy occurs can be carried forward by the debtor, as an offset to income received or tax liability incurred in later years.

Example (2): Individual debtor (D) files a bankruptcy petition on September 15. If D computes the taxable income and tax on the basis of an unbroken taxable year for 2018, D will have taxable income of \$32,000 and tax of \$5,093 for the year. If, however, D elects to close the taxable year when bankruptcy commences, D will have the following tax and taxable income for D's separate taxable periods:

Period	Taxable Income	Tax
Jan. 1–Sept. 14	(\$40,000)	—
Sept. 15–Dec. 31	\$72,000	\$16,293

There are no unpaid tax liabilities for years before the bankruptcy. It is to D's advantage not to make the election to close the taxable year. If the election is not made, D's loss for the period January 1–September 14 offsets D's income for the period September 15–December 31, thereby reducing D's personal tax liability by \$11,200. If the election is made: (1) D cannot offset the income for the period September 15–December 31 by the loss for the period January 1–September 14; and (2) under §1398(g), the estate (not D) succeeds to any NOL for the period January 1–September 14.

Under some circumstances, it can be advantageous for the debtor to elect to close the taxable year even though there will be an NOL or unused credits for the pre-petition short tax year. This may be the case when: (1) the loss or credits can be used by the estate, as a carryback to earlier years of the debtor or as a carryover as an offset to income or tax of the estate; and (2) the debtor will benefit from the estate's use of the loss or credits. The debtor benefits from the estate's use of a loss or credits when a carryback of a loss or credits to earlier years of the debtor reduces the debtor's nondischargeable liability for unpaid taxes or produces a tax refund which passes to the debtor at the conclusion of the case.

Example (3): Individual debtor (D) files a bankruptcy petition on July 23, 2018. If D files a tax return for the unbroken calendar year 2018, D will have an NOL of \$325,000 for the year. If D elects to close the taxable year when bankruptcy commences, D's taxable income and tax for the separate periods in 2018 will be:

Period	Taxable Income	Tax
1/1/18–7/22/18	(\$345,000)	—
7/23/18–12/31/18	\$ 20,000	\$3,000

D also has nondischargeable tax liabilities for 2017 and 2016 of \$130,000 after all assets of the estate are applied in payment of administration expenses, secured claims, and priority tax claims. A carryback of the \$345,000 loss for the period January 1–July 22, 2018, will, however, reduce D's nondischargeable tax liabilities to \$25,000. In this case, it is to D's advantage to elect to close the taxable year at the commencement of bankruptcy, which will allow a carryback of the loss for the period January 1–July 22, 2018, to earlier taxable years for which D has nondischargeable tax liabilities. If D does not elect to close the taxable year on July 22, 2018, D is precluded by §1398(j)(2)(B) from carrying back the loss for the unbroken 2018 taxable year to the earlier taxable years for which there is a nondischargeable tax liability.

Note that if the estate does not fully use the loss for the period January 1–July 22, 2018, as a carryback or carryover, D succeeds to the carryover under §1398(i) at the conclusion of the case, after reduction of the carryover by the amount of any discharged indebtedness under §108(b)(2)(A). Because the loss for the period January 1–July 22, 2018, is a loss incurred in a pre-bankruptcy tax year, it is not subject to reduction under §108(b)(2)(A) before it is carried back to earlier taxable years of D (see §108(d)(8)). At the close of the bankruptcy case, any NOLs to which debtor succeeds from the bankruptcy estate would have been reduced under §108(b) by the amount of discharged debt that was excluded from the debtor's income under §108(a)(1).⁹⁴⁷

The requirement of §1398(d)(2)(D), that the election to close a taxable year be made on or before the due date for filing the return for the taxable year ending the day before the commencement of the case, can place a serious hardship on debtors. When the return is due before the close of the calendar year, the debtor will have to make an income projection for the full calendar year to determine whether the election will be advantageous. The debtor's returns for past years may also be open and subject to audit. If audits have not taken place, the debtor may not be in a position to know the amount of nondischargeable tax liabilities. Last, because the deadline is a statutory one, the IRS does not have the power to excuse a failure to meet it.

⁹⁴⁷ See, e.g., CCA 200217003 (taxpayer not entitled to use losses after termination of bankruptcy estate to extent losses reduced by cancellation of indebtedness income and extent taxpayer's basis in stock of subchapter S corporations formed by taxpayer was reduced due to bankruptcy estate). See *Firsdon v. United States*, 95-1 USTC ¶50,040 (N.D. Ohio 1994), *aff'd*, 95 F.3d 444 (6th Cir. 1996).

b. State and Local Taxes

For state and local tax purposes, the taxable year of a debtor terminates if and to the extent that the taxable period of the debtor terminates under the Internal Revenue Code.⁹⁴⁸

6. Allocation of Income and Expense Between Debtor and Estate

Because the individual debtor and the estate are separate taxable entities in cases under Chapters 7 and 11 and because the estate will be paying expenses incurred by the debtor and may be receiving income earned by the debtor before bankruptcy, a determination will have to be made whether particular items of income or expense belong to the debtor or to the estate.

a. Federal Taxes

(1) Income

Section 1398(e)(1) provides that the estate's gross income for each taxable year includes the gross income of the debtor to which the estate is entitled under the Bankruptcy Code, excluding any amount received or accrued by the individual debtor before the commencement of the bankruptcy case. Section 1398(e)(2) provides that the individual debtor's gross income does not include any amount included in the gross income of the estate by reason of §1398(e)(1).⁹⁴⁹

Because §1398(e)(1) excludes from the estate's gross income any amount "received or accrued" by the debtor before bankruptcy, accounting principles that apply in determining the timing of the receipt of income should also apply in determining whether an item of income is taxed to the estate or to the debtor. Thus, income that accrued to an accrual basis debtor before bankruptcy occurred is taxed to the debtor rather than the estate even if the estate actually receives the income.

With a cash basis debtor, taxability turns on whether the debtor or the estate receives the income. Although normally the estate is taxed on income of a cash basis debtor paid to the estate, a question arises as to whether a debtor can be taxed on income constructively received before bankruptcy but paid to the estate. Although application of the constructive receipt rules in the bankruptcy context may be unwarranted, the reference in §1398(e)(1) to amounts "received" by the debtor before bankruptcy suggests that constructive receipt rules do apply.

The Committee Reports state that §1398(e)(1) is intended to override otherwise applicable "assignment of income" principles of tax law.⁹⁵⁰ An example is given of a situation where the estate is entitled under bankruptcy law to a salary payment

earned by the debtor before bankruptcy but paid after the petition is filed to the estate because the right to the salary payment becomes property of the estate on the commencement of the case. The Committee Reports state the amount of the salary payment is included in the estate's gross income and is not included in the debtor's gross income. It is not clear, however whether constructive receipt rules could result in the payment being included in the debtor's income even though assignment of income principles would not apply.

The 2005 Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) added 11 U.S.C. §1115, which provides that in Chapter 11 reorganizations the bankruptcy estate, rather than the debtor, must include in gross income both: (1) the debtor's gross earnings from the performance of services after the commencement of the case ("post-petition services"); and (2) the gross income from property acquired by the debtor after the commencement of the case ("post-petition property").⁹⁵¹ As a result, the IRS requires that the debtor attach a statement to the debtor's income tax return stating that the debtor filed a Chapter 11 bankruptcy case, the filing date of the bankruptcy case, the bankruptcy court in which the case is pending, the bankruptcy court case number, the bankruptcy estate's EIN, the allocations of income and withheld income tax, and a description of the method used to allocate income and withheld tax between the debtor and the estate.⁹⁵² See VII.G.7.e., below, for further discussion of requirements for these disclosures.

Note: An individual's self-employment earnings from post-petition services are properly includible in the gross income of the bankruptcy estate under 11 U.S.C. §1115(a)(2) and §1398. However, the individual may still be liable for the self-employment tax related to those earnings because the self-employment tax is not included in §1398(c)(1).⁹⁵³

Example: The individual debtor (D) operates a retail business and files for bankruptcy in 2018. At bankruptcy, D has accounts receivable of \$150,000 that pass to the bankruptcy trustee as property of the estate. If D is an accrual basis taxpayer, the \$150,000 of receivables is taxed to D under §1398(e)(1) and §1398(e)(2) because the income accrued prior to bankruptcy, even though the receivables are collected by the estate. If D is a cash basis taxpayer, the \$150,000 of receivables is income to the estate to the extent collected by the estate, under §1398(e)(1) and §1398(e)(2) unless D has constructive receipt of all or part of the receivables.

Another issue that arises in allocating income between the debtor and the estate concerns the manner of allocating income from the sale of property exempt from inclusion in the bankruptcy estate under 11 U.S.C. §522. Generally, 11 U.S.C.

⁹⁴⁸ 11 U.S.C. §346(d).

⁹⁴⁹ See, e.g., *Sticka v. Lambert*, 283 Bankr. 16 (B.A.P. 9th Cir. 2002) (2001 "Relief Check" was advance refund of anticipated 2001 tax payment and allocated between taxpayer and bankruptcy estate based upon petition date); *Williams v. Commissioner*, 123 T.C. 144 (2004) (S corporation's losses transferred to bankruptcy estate under §1398(e)(1) when determined on last day of S corporation's tax year under §1366(a); taxpayer not entitled to prorated share of S corporation's losses because bankruptcy filed before end of corporation's tax year). See also *French v. Cahill*, 2008 BL 269611, No. 08-3211, 2018 BL 269611 (Bankr. N.D. Ohio 2008) (debtor's 2008 economic stimulus rebate is property of the estate, even though debtor received rebate after filing bankruptcy, because 2008 Economic Stimulus Act was effective before petition was filed).

⁹⁵⁰ H.R. Rep. No. 833, at 26; S. Rep. No. 1035, at 30.

⁹⁵¹ 11 U.S.C. §1115 does not apply to cases under Chapter 7 (liquidations).

⁹⁵² Notice 2006-83.

⁹⁵³ See *Sisson v. Commissioner*, T.C. Memo 2016-143, (holding that an individual's earnings for post-petition services performed for the International Monetary Fund (IMF) were (1) for purposes of 11 U.S.C. §1115(a)(2) and §1398, properly includible in the gross income of the bankruptcy estate; and (2) for purposes of §1402(a)'s self-employment tax liability, properly charged to the individual because §1398(c)(1) does not impose the self-employment tax on the bankruptcy estate).

§541(a) provides that the bankruptcy estate includes all property of the debtor as of the commencement of the case. However, 11 U.S.C. §522(b) provides for the exemption of certain property from the bankruptcy estate. In the following example, based on a private letter ruling, gain from the sale of exempt property is allocable to the debtor, rather than the estate.⁹⁵⁴

Example: Individual debtor (D) resides in California. Under California law, D's residence qualifies for a homestead exemption only if a sale of the house would yield sufficient funds to pay any liens or encumbrances on the house plus \$30,000. Otherwise, the house is not exempt but the debtor is entitled to be paid the amount of the exemption in cash. Under this state statute, D's house was not exempt from inclusion in the bankruptcy estate. Thus, on sale of the house, the tax on the gain becomes an administrative expense that is required to be paid by the estate under 11 U.S.C. §503(b), even though the estate is also required to make a cash payment to D of the exempt amount. Had D's house qualified for the exemption, D would have been taxed on the gain from the sale of the house.

(2) Expense

Section 1398(e)(3) provides that the determination of whether any amount paid or incurred by the estate is allowable as a deduction or credit (or is wages for purposes of subtitle C) is made as if: (1) the amount was paid or incurred by the debtor; and (2) the debtor was still engaged in the same trade, business, and activities as before the commencement of the case. Section 1398(e)(3) has been construed as giving an individual debtor's bankruptcy estate the benefit of the §121 exclusion the debtor would have enjoyed had the debtor sold a principal residence.⁹⁵⁵

Although §1398 is silent on the rules that apply in allocating expenses between the debtor and the estate, it seems reasonable to conclude that the pre-Bankruptcy Tax Act rule that tax accounting principles for determining the period in which expenses are deductible also apply in determining whether an expense is deductible by the estate or the debtor. One reason is that tax accounting principles clearly apply in determining whether income is taxed to the debtor or to the estate. A failure to apply similar rules on the expense side would result in a distortion because an accrual basis debtor would be denied a deduction for accrued but unpaid pre-bankruptcy expenses, but would be forced to recognize accrued but uncollected pre-bankruptcy income.

Application of tax accounting principles to expenses means that an accrual basis debtor can deduct an expense accrued before bankruptcy even if the expense is paid by the estate. Moreover, because the estate succeeds to the debtor's method of accounting, the estate of an accrual basis debtor could not claim a deduction for an expense paid by the estate but accrued by the debtor before bankruptcy.⁹⁵⁶

Example: Individual debtor (D) operates a retail business and files for bankruptcy in 2018. At bankruptcy, D has accounts payable of \$100,000, \$60,000 of which are paid by the estate. If D is an accrual basis taxpayer, the \$100,000 of accounts payable is D's deduction, even though \$60,000 of the accounts payable are paid by the estate. If, on the other hand, D is a cash basis taxpayer, the estate realizes a deduction of \$60,000 on payment of the accounts payable. To the extent the estate's payment of the accounts payable results in an NOL, the NOL can be carried back to earlier taxable years of the debtor.

b. State and Local Taxes

When the Internal Revenue Code provides for a separate taxable estate or entity, a separate taxable estate or entity is created for state and local tax purposes and any income of the estate is taxed to the estate not the debtor.⁹⁵⁷ Presumably tax accounting principles apply in determining whether an item is income of the debtor or the estate. Unlike the Internal Revenue Code, however, the Bankruptcy Code does not purport to override assignment of income principles. Therefore, it is arguable that an item of income that is received by the estate and is income of the debtor under assignment of income principles would be treated as income of the debtor for state and local tax purposes even though it would not be treated as income of the debtor for federal tax purposes.

7. Tax Treatment of the Estate

a. Gross Income

The gross income of the bankruptcy estate consists of income generated by the estate and income of the debtor paid to the estate that was not received or accrued by the debtor before the commencement of the bankruptcy case.⁹⁵⁸

The estate's income is affected by the nature of assets transferred to it from the debtor and sold by the estate. Under §1398(g)(6), the estate succeeds to the basis, holding period, and character of assets of the debtor. Thus, the amount of gain or loss on the sale of an asset, whether gain or loss is ordinary or capital, and whether any capital gain or loss is long-term or short-term is determined with reference to the basis, character, and holding period of the asset in the debtor's hands.

The estate's gross income does not include any income from the discharge of indebtedness of the debtor that is excluded from gross income under §108(a)(1).

b. Administrative Expenses

(1) Federal Taxes

Section 1398(h)(1) provides that administrative expenses allowed under 11 U.S.C. §503 and trustees' fees or charges are allowable as a deduction to the extent not disallowed under any

⁹⁵⁴ See PLR 9122042 revoking PLR 90175075.

⁹⁵⁵ *In re Bradley*, 222 Bankr. 313 (Bankr. M.D. Tenn 1998), *acq.*, AOD 1999-09; *In re Popa*, 218 Bankr. 420 (Bankr. N.D. Ill. 1998). *Cf. In re Mehr*, 153 Bankr. 430 (Bankr. D.N.J. 1993), decided under §121 prior to TRA 1997.

⁹⁵⁶ §1398(g)(7).

⁹⁵⁷ 11 U.S.C. §346(a), as amended by the 2005 Bankruptcy Act, Pub. L. No. 109-8, §719, effective for cases commencing on or after October 17, 2005. Under pre-2005 Bankruptcy Act 11 U.S.C. §346(b)(1), for state and local tax purposes in a case under Chapter 7, 11, or 12 concerning an individual, any income of the estate was taxed only to the estate, and not to the individual.

⁹⁵⁸ §1398(e)(1).

other provision of the Internal Revenue Code. In other words, administrative expenses do not have to satisfy the tests of §162, §212, or some other Internal Revenue Code provision in order to be deductible. Nevertheless, §1398(h)(1) provides that administrative expenses are not deductible to the extent they are not deductible under specific disallowance provisions of the Internal Revenue Code. Thus, federal income taxes are not deductible (disallowed under §275), even though taxes are allowable as administrative expenses. Other examples of administrative expenses that are not deductible are capital expenditures (disallowed under §263) and expenses relating to tax-exempt interest (disallowed under §265).

The estate can deduct its administrative expense carrybacks and carryovers under §1398(h)(2)(A). Generally, the purpose of the deduction for administrative carrybacks and carryovers is to allow the estate a carryback and carryover for deductible administrative expenses that are not trade or business expenses.⁹⁵⁹

The starting point for calculating the administrative expense carryback and carryover is the determination of the administrative expense loss for the taxable year. Under §1398(h)(2)(B), the administrative expense loss for the taxable year is the amount of the NOL as defined in §172(c) that would be increased if the NOL of the estate for the taxable year was computed without the modification contained in §172(d)(4). Section 172(d)(4) limits the amount of allowable deductions not attributable to a taxpayer's trade or business that are includible in the computation of the NOL to the amount of gross income not derived from the taxpayer's trade or business. The administrative expense loss thus consists of unused deductions not includible in the estate's NOL because they: (1) are not attributable to the taxpayer's trade or business; and (2) exceed income not derived from a trade or business. The expenses includible in the administrative expense loss can include administrative expenses and fees not deductible as trade or business expenses under §162 but deductible under §1398(h)(1), as well as any other expenses deductible under other sections of the Internal Revenue Code. For example, interest expense not incurred in a trade or business but deductible under §163 and taxes not incurred in a trade or business but deductible under §164 are includible in the administrative expense loss.

Under §1398(h)(2)(C), the amount of the administrative expense loss that may be carried to a year other than the year in which the loss is incurred is determined under §172(b)(2). Generally, §172(b)(2) requires that a loss be carried first to the earliest taxable year to which it can be carried and then to succeeding taxable years. Under §1398(h)(2)(C), however, the NOL calculation is made before the calculation with respect to the administrative expense loss. Thus, NOL carrybacks and carryovers must be applied against income of the estate (and are reduced) before administrative loss carrybacks and carryovers. Unlike NOLs of the estate, which can be carried back to taxable years of the debtor under §1398(j)(2)(A), administrative expense losses cannot be carried back to taxable years of the debtor under §1398(h)(2)(D), and they are not attributes to which the debtor succeeds at the conclusion of the case under §1398(i).

⁹⁵⁹ Generally, only trade or business expenses can be included in the NOL of an individual. See §172(d)(4).

Example: Individual debtor (D) commences a bankruptcy proceeding on June 1, 2016, and does not elect to close the taxable year when bankruptcy commences. For the taxable year 2015, D had aggregate taxable income of \$32,000. For its first taxable year for the period June 1, 2016–May 31, 2017, the estate has taxable income of \$10,000. For its second taxable year for the period June 1, 2017–May 31, 2018, the estate has an NOL under §172(c) of \$40,000 and an administrative expense loss calculated under §1398(h)(2)(B) of \$12,000.

The \$40,000 NOL can be carried back to D's 2015 taxable year under §1398(j)(2), reducing the NOL to \$8,000. No carryback of the administrative expense loss to taxable years of the debtor is allowed. For the estate's taxable year June 1, 2016–May 31, 2017, the remaining \$8,000 of the NOL carryback is applied to reduce the estate's \$10,000 income for this period, consuming the NOL carryback and reducing the estate's income to \$2,000. Under §1398(h)(2)(C), the NOL carryback is applied to the estate's \$10,000 income before application of the administrative loss carryback. The remaining \$2,000 of income is eliminated by the administrative loss carryback. On the termination of the estate on June 1, 2018, there is no NOL carryover to which the debtor can succeed, and the debtor does not succeed to the unused \$10,000 administrative loss carryover.

(2) State and Local Taxes

For state and local tax purposes, when the Internal Revenue Code creates a separate taxable estate, the items of income and deduction are determined under applicable nonbankruptcy law under 11 U.S.C. §346(k).⁹⁶⁰ The 2005 Bankruptcy Act, significantly amended the Bankruptcy Code to conform state and local income tax administrative issues to the Internal Revenue Code.⁹⁶¹

c. Taxable Income

(1) Federal Taxes

Under §1398(c)(1), the taxable income of an individual's bankruptcy estate is computed in the same manner as taxable income for an individual except as otherwise provided in §1398. Under §1398(c)(2), the tax rates applicable to a bankruptcy estate are those that apply to a married individual filing separately. Under §1398(c)(3), an estate that does not itemize deductions has the basic standard deduction applicable to a married individual filing separately.⁹⁶²

(2) State and Local Taxes

Bankruptcy Code §346(a) provides that whenever the Internal Revenue Code provides that a separate taxable estate or entity is created in a bankruptcy case and the income of the estate is to be taxed to or claimed by the estate, a separate taxable

⁹⁶⁰ See 11 U.S.C. §346(b).

⁹⁶¹ H. Rep. No. 31, 109th Cong., 1st Sess. (2005).

⁹⁶² See *In re Knobel*, 167 Bankr. 436 (Bankr. W.D. Tex. 1994) (joint bankruptcy petition filed by husband and wife creates two bankruptcy estates; both estates are entitled to one personal exemption and one standard deduction).

estate is also created for state and local purposes.⁹⁶³ Generally, state and local income and expense are determined under applicable nonbankruptcy law.⁹⁶⁴

d. Method of Accounting and Taxable Year

(1) Federal Taxes

Under §1398(g)(7), the estate succeeds to the debtor's method of accounting. The estate, however, is not required to use the debtor's taxable year. Thus, as with any new entity, the estate's first taxable year is determined on the basis of the period for which its first tax return is filed.⁹⁶⁵

Under §1398(j)(1), the estate can change its annual accounting period one time without the approval of the Secretary. This allows the trustee to close the estate's taxable year immediately before the expected termination of the estate so the trustee can obtain an expedited determination of tax liability under 11 U.S.C. §505.

Section 443(b)(1) requires a taxpayer to annualize income for purposes of computing tax when the taxpayer's annual accounting period is changed with the approval of the Secretary under §443(a)(1). Because a change in annual accounting period under §1398(j)(1) does not require the Secretary's approval, it appears that such a change is not one under §443(a)(1), so the annualization requirement of §443(b)(1) does not apply.

(2) State and Local Taxes

For state and local tax purposes, the bankruptcy estate uses the same accounting method as the debtor used immediately before the commencement of the bankruptcy case, provided the accounting method complies with the applicable nonbankruptcy tax law.⁹⁶⁶ As is the case for federal tax purposes, there is no express provision in the Bankruptcy Code requiring the estate to use the same taxable year as the debtor. There is no provision for state or local tax purposes comparable to §1398(j)(1) allowing the estate to make a one-time change in accounting period without the approval of the taxing authority.⁹⁶⁷

e. Returns

(1) Federal Taxes

Under §6012(a)(8),⁹⁶⁸ a Chapter 7 or 11 bankruptcy estate must file a return when gross income is equal to or greater than the sum of one personal exemption plus the basic standard deduction for married individuals filing separately. Under §6012(b)(4), the trustee is responsible for filing the returns for the estate. The return is required to be filed on Form 1041.⁹⁶⁹ A return is not required when the case is dismissed, because a separate taxable entity is not created under §1398(b)(1). Under

§6103(e)(5), the trustee is entitled to disclosure of an individual debtor's return for the taxable year in which the case commenced and for prior years, and the debtor is entitled to disclosure of returns of the estate.⁹⁷⁰ On the other hand, §6103(e)(5) also provides that disclosure of the debtor's returns to the trustee in involuntary cases is not required until the order for relief has been entered, unless the court finds that disclosure is appropriate for purposes of determining whether an order for relief should be entered.

Similarly the trustee of a liquidating trust formed to hold assets of bankrupt corporations or individuals is required to file returns and pay tax. The trustee of the liquidating trust of an individual debtor is the fiduciary of a trust and is required to file under §6012(b)(4). The trustee is required to pay tax under §6151(a), which provides that when a return is required the person required to make the return is also required to pay the tax.⁹⁷¹

Bankruptcy Code §1115 requires for individual Chapter 11 cases that the bankruptcy estate, rather than the debtor, must include in its gross income both: (1) the debtor's gross earnings from the performance of services after the commencement of the case ("post-petition services"); and (2) the gross income from property acquired by the debtor after the commencement of the case ("post-petition property"). In October 2006, the IRS issued Notice 2006-83 providing guidance requiring the following:

- The debtor in possession (DIP) or trustee (if one is appointed) must prepare and file the income tax returns of the bankruptcy estate if required under §6012(a)(8);⁹⁷²
- A DIP may be compensated by the estate to manage or operate a trade or business that the debtor conducted before the commencement of the bankruptcy case and such payments are reportable by the debtor as miscellaneous income on the debtor's individual income tax return and may qualify as administrative expenses of the estate;
- Within a reasonable time after the commencement of a Chapter 11 bankruptcy case, the trustee or DIP should provide notification of the bankruptcy estate's employer identification number (EIN) to persons that are required to file information returns with respect to the bankruptcy estate's gross income, gross proceeds, or other types of reportable payments, and such persons should report the gross income, gross proceeds, or other reportable payment on an appropriate information return using the estate's name and EIN in the time and manner required under the Internal Revenue Code;
- The trustee or DIP should not provide the EIN to the debtor's employer or other person filing Form W-2 with respect to the debtor's wages or other compensation, because 11 U.S.C. §1115 does not affect the determination of what constitutes wages for purposes of federal income tax

⁹⁶³ 11 U.S.C. §346(b).

⁹⁶⁴ 11 U.S.C. §346(k)(1).

⁹⁶⁵ See Reg. §1.441-1(b)(2), §1.441-1(c)(1).

⁹⁶⁶ 11 U.S.C. §346(e). See §1398(g)(7) (same rule for federal tax purposes).

⁹⁶⁷ See discussion in 1540 T.M., *State Tax Aspects of Bankruptcy* (State Tax Library).

⁹⁶⁸ As redesignated by the Education Jobs and Medicaid Assistance Act of 2010, Pub. L. No. 111-226, Title II, Subtitle B, §219(b)(1), for taxable years beginning after 2010. The provision is designated as §6012(a)(9) for taxable years beginning before 2011.

⁹⁶⁹ See instructions to Form 1041.

⁹⁷⁰ PMTA 2012-24 (when a trustee is not appointed, the IRS may disclose to the debtor-in-possession's attorney of record return information related to tax matters relevant to the bankruptcy proceeding).

⁹⁷¹ *Holywell Corp. v. Smith*, 112 S. Ct. 1021 (1992).

⁹⁷² As redesignated by the Education Jobs and Medicaid Assistance Act of 2010, Pub. L. No. 111-226, Title II, Subtitle B, §219(b)(1), for taxable years beginning after 2010. The provision is designated as §6012(a)(9) for taxable years beginning before 2011.

withholding or the Federal Insurance Contributions Act (FICA);

- When a Chapter 11 bankruptcy case is closed, dismissed, or converted to a case under Chapter 12 or 13 of the Bankruptcy Code, the debtor should, within a reasonable time, provide notification of the closing, dismissal, or conversion to the persons that were previously notified of the bankruptcy case to the extent notification is necessary to ensure that gross income, gross proceeds, and other types of reportable payments realized after the closing, dismissal, or conversion are reported to the proper person and with the correct taxpayer identification number (TIN);
- If the Chapter 11 case is converted to a Chapter 7 case, gross income (other than post-conversion income from the debtor's services), gross proceeds, or other reportable payments should continue to be reported to the estate if the gross income, gross proceeds, or other reportable payment represents property of the Chapter 7 estate and, therefore, the debtor should notify payors required to report the debtor's nonemployee compensation on Form 1099-NEC that such compensation earned after the conversion to Chapter 7 should be reported using the debtor's name and TIN, rather than the estate's name and TIN;
- While the debtor is not required to file a new Form W-4 with an employer adjusting the debtor's withholding allowances solely because the debtor has filed a Chapter 11 case, a new Form W-4 may be necessary under the applicable regulations when, for instance, the debtor employee is no longer entitled to claim the same number of allowances claimed on the Form W-4 previously provided to the employer, such as for certain deductions or credits that now belong to the estate;
- When the debtor is self-employed, because the debtor continues to derive gross income from the performance of services as a self-employed individual after the commencement of the bankruptcy case, the debtor must continue to report on Schedule SE of the debtor's individual income tax return the self-employment income earned post-petition, which includes the attributable deductions, and must pay the resulting self-employment tax imposed by §1401;
- Because 11 U.S.C. §1115 has no effect on the application of FICA tax, FUTA tax, or federal income tax withholding, with respect to the wages of a Chapter 11 debtor, an employer should continue to reflect such wages and accompanying tax withholdings on a Form W-2 issued to the debtor under the debtor's name and social security number;
- The DIP or the trustee must allocate in a reasonable manner wages, salary, or other compensation reported in Box 1 and the withheld income tax reported in Box 2 of Form W-2 between the debtor and the estate and, if reasonable, may use a simple percentage method for allocating income and withheld income tax;
- In some cases, when persons filing information returns report to the debtor gross income, gross proceeds, or other reportable payments that should have been reported to

the bankruptcy estate using Forms 1099-INT, 1099-DIV, 1099-MISC, 1099-NEC, Schedule K-1, Schedule K-3, or other information returns, the DIP or trustee must allocate the improperly reported income in a reasonable manner between the debtor and the estate to ensure that any income (and income tax withheld) attributable to the post-petition period is reported on the estate's return, and any income (and income tax withheld) attributable to the pre-petition period is reported on the debtor's return; and

- The debtor must attach a statement to the debtor's income tax return stating that the debtor filed a Chapter 11 bankruptcy case, the filing date of the bankruptcy case, the bankruptcy court in which the case is pending, the bankruptcy court case number, the bankruptcy estate's EIN, the foregoing allocations of income and withheld income tax, and a description of the method used to allocate income and withheld tax between the debtor and the estate. The debtor in possession or trustee must attach a similar statement to the income tax return of the estate.

(2) State and Local Taxes

For state and local tax purposes, the time and manner of filing returns is determined under applicable nonbankruptcy law, and the trustee or debtor in possession must file the required income tax returns.⁹⁷³

f. Determination of Tax Liability

The Bankruptcy Code contains a procedure whereby the trustee can request an advance determination of the estate's federal, state, or local tax liability incurred during the administration of the estate.⁹⁷⁴

8. Taxation of Property Abandoned by the Estate

Under 11 U.S.C. §554(a), the trustee is authorized to abandon property of an estate that is burdensome or is of inconsequential value and benefit to the estate. Abandonment under 11 U.S.C. §554(a) can occur when the estate holds property from which the indebtedness plus tax liability that could be incurred may exceed the value of the property.⁹⁷⁵

Abandonment by the estate requires formal notice and a hearing.⁹⁷⁶ The Ninth Circuit, adhering to these requirements, has stated that a court order granting a creditor relief from an automatic stay does not automatically constitute an abandonment of property by the bankrupt estate as a matter of law.⁹⁷⁷

An abandonment of property can take place during the pendency of the case if the trustee abandons the property under 11 U.S.C. §554(a). An abandonment can also occur at the con-

⁹⁷³ 11 U.S.C. §346(a), §346(b), §346(k)(1). See discussion in 1540 T.M., *State Tax Aspects of Bankruptcy* (State Tax Library).

⁹⁷⁴ 11 U.S.C. §505(b).

⁹⁷⁵ For general discussions of the tax consequences of the abandonment of property by the bankruptcy estate of an individual debtor, see Tatlock, *The Bankruptcy Tax Act, the Carryover of Tax Attributes, and Transfer of Property Between an Individual Debtor and His Bankruptcy Estate*, 9 Tax Mgmt. Real Est. J. 19 (1993); Wallace, *Is a Midstream Abandonment of Property by a Bankruptcy Trustee Taxable to the Estate?* 77 J. Tax'n 26 (1992); and Nelson, *Taxation of Abandonments in Bankruptcy*, 10 J. Agri. Tax'n & L. 221 (1988).

⁹⁷⁶ 11 U.S.C. §554.

⁹⁷⁷ *Catalano v. Commissioner*, 279 F.3d 682 (9th Cir. 2002).

clusion of the case under 11 U.S.C. §554(c). Section 554(c) provides generally that, unless the bankruptcy court orders otherwise, any property listed on the schedule of assets provided by the debtor at the commencement of the bankruptcy proceeding and not otherwise administered at the time of the closing of the case is abandoned to the debtor.

Sometimes when property subject to a mortgage in excess of basis is foreclosed upon by the holder of the mortgage, taxable gain (which cannot be excluded from gross income under §108 as discharge of indebtedness income) can be realized. Section 1398(f)(1) and §1398(f)(2) generally provide that the transfer of property between the debtor and the bankruptcy estate at the beginning and at the conclusion of the bankruptcy case, other than by sale or exchange, is not treated as a disposition giving rise to tax consequences.⁹⁷⁸ This general rule, however, does not conclusively establish that the transfer of property subject to indebtedness in excess of basis from the debtor to the bankruptcy estate and from the bankruptcy estate to the debtor will not give rise to taxable gain or loss. Outside the bankruptcy context, such transfers have been held to be taxable sales or exchanges even when the transfer was not for a consideration.⁹⁷⁹ Moreover, §1398(f)(2), which applies to transfers from the estate to the debtor, does not on its face apply to abandonments by the estate during the pendency of the bankruptcy proceeding because §1398(f)(2) states that it applies “[i]n the case of the termination of the estate.”

When property subject to indebtedness in excess of basis is transferred between an individual debtor and the bankruptcy estate, the question is whether the debtor or the bankruptcy estate will bear the burden of any taxable gain resulting from the transfer. If the initial transfer of property subject to indebtedness in excess of basis from the debtor to the estate is a taxable transfer, the debtor will bear the burden of any taxable gain resulting from the transfer. The debtor also bears the tax burden of property subject to indebtedness in excess of basis if both the transfer to the estate and the transfer out of the estate to the debtor are held nontaxable, because the gain resulting from a later foreclosure after the property is abandoned to the debtor is again a post-petition tax liability of the debtor and not the estate.

On the other hand, if the transfer from the debtor to the estate at the commencement of the case is not taxable, but the transfer from the estate to the debtor during the pendency or at the conclusion of the bankruptcy case is taxable, the estate bears the tax burden arising from the gain realized on the transfer. There is a potential logical inconsistency in finding the transfer to the estate by the debtor nontaxable (which presupposes a determination that the transfer is not a sale or exchange for purpose of §1398(f)(1)), and in finding the transfer from the estate to the debtor from the estate to be taxable, presumably based on a determination that such a transfer is a sale or exchange.

⁹⁷⁸ See discussion under VII.G.2., above. See also PLR 9611028 (transfer of partnership interest from bankruptcy estate to debtor during administration of estate is not taxable disposition; there is no difference between transfers made during administration from those made at close of case).

⁹⁷⁹ *Diedrich v. Commissioner*, 457 U.S. 191 (1982) (gift); *Yarbro v. Commissioner*, 737 F.2d 479 (5th Cir. 1984) (abandonment).

Bankruptcy Code §506(a) potentially reduces the tax burden resulting from the transfer of property subject to nonrecourse indebtedness in excess of basis because a secured creditor’s security is reduced to the value of the underlying property and any excess is treated as an unsecured claim. The unsecured portion of the claim will be discharged in the bankruptcy proceeding, and the resulting discharge of indebtedness income is eligible for exclusion under §108(a)(1)(A). Thus, the amount of taxable gain that will be realized on a transfer of the property and that is not excludible under §108 may be limited to the excess of the property’s fair market value over its basis.⁹⁸⁰

The cases have split on the issue of whether taxable gain arises on the midstream abandonment of property subject to indebtedness in excess of basis by the bankruptcy estate of an individual debtor. In *In re Olson*,⁹⁸¹ the Eighth Circuit reasoned that the abandonment of encumbered property by the bankruptcy estate did not confer a benefit on the estate sufficient to constitute a sale or exchange. The Eighth Circuit also stated that the rule of §1398(f)(2), providing that a transfer of an asset other than by sale or exchange on the termination of the bankruptcy estate will not be treated as a disposition for tax purposes, should also be applicable to a midstream termination.⁹⁸²

However, other courts have held that the abandonment of negative basis property by an individual debtor’s bankruptcy estate gives rise to taxable gain.⁹⁸³ This is based on the symmetry that exists for transfers of property and attributes at the commencement and at the conclusion of the case because the transfer of property with basis and potential taxable gain is accompanied by a transfer of any losses that may be available to shelter the gain. Symmetry is lacking, however, if a transfer of encumbered property during the pendency of the case does not give rise to taxable gain, because losses do not pass from the estate to the debtor with the property.⁹⁸⁴

One way a debtor can avoid uncertainty concerning the taxation of an abandonment of property is to trigger a foreclosure before filing for bankruptcy in order to make the resulting tax a pre-petition liability. If the foreclosure occurs in the same calendar year as the commencement of the bankruptcy case, any resulting tax liability is not a pre-petition liability unless the debtor makes the election to terminate the taxable year on commencement of the bankruptcy proceeding.⁹⁸⁵ If the election is made and the pre-bankruptcy foreclosure gives rise to a pre-petition tax liability, the liability is entitled to priority over general creditors under 11 U.S.C. §507(a)(8) and is paid by the

⁹⁸⁰ See PLR 8918016.

⁹⁸¹ 930 F.2d 6 (8th Cir. 1991).

⁹⁸² *Accord In re McGowan*, 95 Bankr. 104 (Bankr. N.D. Iowa 1988). See also *In re Johnston*, 49 F.3d 538 (9th Cir. 1995) (tax consequences to debtor and his bankruptcy estate not relevant for purposes of determining whether abandonment was property under Bankruptcy Code §544(a)).

⁹⁸³ *In re A.J. Lane & Co., Inc.*, 133 Bankr. 264 (Bankr. D. Mass. 1991).

⁹⁸⁴ *In re Rubin*, 154 Bankr. 897 (Bankr. D. Md. 1992) (denying a motion to compel abandonment to the debtor because abandonment to the debtor would be taxable to the bankruptcy estate as would abandonment by the estate directly to a creditor); *In re Laymon* 1989 WL 252447 (D. Minn. 1989) (trustee’s request for permission to abandon encumbered property denied because abandonment would be unfair to the debtor under 11 U.S.C. §704(a)(1) The trustee must administer and close the estate as expeditiously as is compatible with the best interests of parties and would interfere with the debtor’s fresh start. 11 U.S.C. §704(a)(1)).

⁹⁸⁵ See discussion of §1398(d)(2) under VII.G.5., above.

estate to the extent there are assets sufficient to pay claims of this priority.

If the midstream abandonment of property is taxable to the estate, or if the bankruptcy court will not allow midstream abandonment by the estate, there is no advantage to the debtor in triggering a pre-bankruptcy foreclosure. Indeed, in this event, a pre-bankruptcy foreclosure can be disadvantageous to the debtor, because the debtor is personally liable for the nondischargeable tax from the foreclosure to the extent the estate's assets are insufficient to pay the tax liability.

Example: Individual debtor (D), who is contemplating a bankruptcy filing, holds real estate that has a tax basis of \$1 million and that is subject to a nonrecourse mortgage of \$2 million. There are a number of possible results:

If the mortgage is foreclosed before D files for bankruptcy, D realizes taxable gain of \$1 million from the foreclosure. If D subsequently files for bankruptcy, any tax liability attributable to the foreclosure becomes a liability of D's bankruptcy estate, although D will have to pay the liability if the assets of the estate are insufficient because it is nondischargeable.

If the fair market value of the property is less than the amount of the debt, a bankruptcy filing reduces the amount of realized gain not subject to the bankruptcy or insolvency exclusions, because of 11 U.S.C. §506(a). For example, if the fair market value of the property is \$1 million, a foreclosure in bankruptcy would produce \$1 million of cancellation of indebtedness income subject to the bankruptcy exclusion under §108(a)(1)(A) after the application of 11 U.S.C. §506(a), and no gain from the sale or exchange of property. In this event, neither D nor the bankruptcy estate has a tax liability due to the foreclosure because of the §108(a)(1)(A) exclusion, whether or not the estate abandons the property.

If the bankruptcy estate will have no significant assets other than the real estate, D should avoid a pre-bankruptcy foreclosure, because this: (1) would result in a nondischargeable tax liability for D to the extent D does not have NOLs available to shelter the realized gain; and (2) would make 11 U.S.C. §506(a) inapplicable as a possible means of reducing the realized gain on the foreclosure; and (3) would prevent D from arguing that under *A.J. Lane*,⁹⁸⁶ the estate should bear the burden of a foreclosure.

If the bankruptcy estate will have sufficient assets to pay the tax liability resulting from a pre-bankruptcy foreclosure, D should consider triggering a foreclosure. For example, if a pre-bankruptcy foreclosure would result in a pre-petition tax liability of \$400,000 and D has \$500,000 of other assets and \$1,000,000 in general creditor claims there would be sufficient assets in the estate to pay the pre-petition tax liability which would be entitled to priority over general creditors.

9. Income Tax Effect of Debt Discharge

a. Effect on the Estate

Under §108(a)(1)(A), cancellation of debt income is excluded from gross income if the cancellation results from a discharge in bankruptcy. The cost of this exclusion is the reduction of tax attributes.⁹⁸⁷ Since the debtor succeeds to the tax attributes of the estate, these attribute reduction issues are of greater consequence to the debtor than the estate.

b. Effect on the Debtor

The income and deductions of an individual debtor are not directly affected by the discharge of the debtor's indebtedness in a bankruptcy proceeding because the bankruptcy estate is a separate taxable entity. Nevertheless, a debtor can be indirectly affected by the discharge of indebtedness in a bankruptcy proceeding. For example, the reduction of an NOL of the estate under §108(b)(2)(A) reduces the estate's NOL carryback to pre-bankruptcy taxable years of the debtor which can increase the amount of the debtor's nondischargeable tax liabilities that must be satisfied out of post-bankruptcy assets. The reduction of an NOL because of the discharge of indebtedness in bankruptcy can also reduce the NOL carryover to which the debtor succeeds at the conclusion of the bankruptcy proceeding.

Because the debtor is affected by the reduction of tax attributes upon the discharge of indebtedness in bankruptcy, the debtor may have an interest in whether the estate elects under §108(b)(5) to reduce the basis of depreciable property before reducing other attributes. An election to reduce the basis of depreciable property before reducing other attributes may preserve an NOL. Accordingly, a trustee in a bankruptcy proceeding faced with the choice of whether to reduce the basis of depreciable property first should consider whether the debtor should be consulted before the election is made.

c. State and Local Taxes

For state and local tax purposes, debt discharge income is not realized by the estate, the debtor or the successor to the debtor except to the extent such income is subject to tax under the Internal Revenue Code.⁹⁸⁸ When the Internal Revenue Code provides that the amount excluded from gross income with respect to the discharged debt is to be applied to reduce tax attributes of the debtor or the estate, a similar reduction is to be made under state and local law.⁹⁸⁹

10. Cases Under Chapters 12 and 13

Chapter 12 of the Bankruptcy Code provides for the adjustment of the debts of a family farmer or fisherman with regular annual income. Chapter 12 applies to corporations and partnerships as well as to individuals engaged in the business of farming or fishing.⁹⁹⁰

Chapter 13 of the Bankruptcy Code provides for the adjustment of the debts of an individual with regular income.

⁹⁸⁷ §108(b).

⁹⁸⁸ 11 U.S.C. §346(j)(1).

⁹⁸⁹ 11 U.S.C. §346(j)(2). For further discussion, see 1540 T.M., *State Tax Aspects of Bankruptcy* (State Tax Library).

⁹⁹⁰ 11 U.S.C. §101(18), §101(19), §101(19A).

⁹⁸⁶ *In re A.J. Lane & Co. Inc.*, 133 Bankr. 264 (Bankr. D. Mass. 1991).

Chapter 13 applies only to individuals with regular income, defined as income sufficiently stable and regular to enable the individual to make payments under a plan (excluding a stockbroker or commodity broker) and is limited to individuals with indebtedness up to a prescribed amount.⁹⁹¹

Section 1398 does not apply to cases under Chapter 12 or 13. Thus, no separate taxable entity is created in these cases, no federal tax return is filed by the bankruptcy estate and the debtor's federal tax return includes both the debtor's own income and the income of the estate.⁹⁹²

Bankruptcy Code §1208 provides that a case under Chapter 12 may be converted into a case under Chapter 7, and 11 U.S.C. §1307(a) and §1307(d) provide that a case under Chapter 13 may be converted into a case under Chapter 7 or 11. Presumably, if a case under Chapter 12 or 13 involving an individual is converted to a case under Chapter 7 or 11, a separate taxable entity is created pursuant to §1398, effective as of the date of conversion. Thus, §1398 would apply to the debtor and to the estate as if the case commenced on the date of conversion.

Under 11 U.S.C. §706, a case under Chapter 7 can be converted to a case under Chapter 11, 12, or 13, and under 11 U.S.C. §1112, a case under Chapter 11 can be converted to a case under Chapter 7, 12, or 13. When a case under Chapter 7 or 11 is converted into a case under Chapter 12 or 13, the status of the estate as a separate taxable entity ceases, although it is unclear whether it ceases as of the date of conversion or as of the date the case commenced. The better rule would appear to be that the status of the estate as a separate entity ceases as of the date the case commenced to avoid the complexity of having tax attributes pass from the debtor to the bankruptcy estate and then back to the debtor upon conversion. There is no regulation or ruling dealing with this issue.

Section 108 applies to cases under Chapter 12 or 13 to the same extent it applies to cases under Chapter 7 or 11.⁹⁹³ Because there is no separate taxable entity in a case under Chapter 12 or 13, however, the debtor is treated as the taxpayer.

Bankruptcy Code §1231(b) allows bankruptcy courts to authorize the proponents of Chapter 12 plans to request determinations of the federal income tax effects of proposed plans, limited to questions of law. To request such a written determination, the debtor must file a written request with the Centralized Insolvency Operation marked "Request for Determination of Tax Effects of Chapter 12 Plan." A request is processable only if it contains the information specified in the first annual revenue procedure, as updated annually. The request must include a copy of the proposed Chapter 12 plan and a copy of the bankruptcy court order allowing the request. The request must be signed by the proponent with the following declaration:

Under penalties of perjury, I declare that I have examined this request, including the accompanying documents, and, to the best of my knowledge and belief, this request contains all relevant facts relating

to the request, and such facts are true, accurate, and complete.

Within 270 days after receipt of a processable application, the Examination Function will notify the plan proponent of the determination. Unless the court declares otherwise under 11 U.S.C. §1231(b), the IRS will follow the determination if: (1) a copy of the determination is attached to the tax return to which it relates; (2) the determination is properly reflected in the return; (3) the representations upon which the determination was made reflected an accurate statement of the controlling facts; (4) the transactions proposed in the plan were carried out substantially as proposed; and (5) there has been no change in the law that applies to the period during which the transactions were consummated.

In addition, 11 U.S.C. §1222(a) and §1232 address the requirement that a Chapter 12 plan must provide for full payment of 11 U.S.C. §507 priority claims, but carve out an exception for claims owed to a governmental unit that arose as a result of the sale, transfer, exchange, or other disposition of any farm asset used in the debtor's farming operation. If such a claim otherwise would be entitled to 11 U.S.C. §507 priority, 11 U.S.C. §1222(a) and §1232 provide instead that it is treated as a general unsecured claim subject to discharge.⁹⁹⁴

One issue that may arise is whether 11 U.S.C. §1232 allows a Chapter 12 plan to compel a tax authority to disgorge pre-petition withholdings. The Eighth Circuit has held that the plain language of 11 U.S.C. §1232 does not allow such a result. The court explained that 11 U.S.C. §1232 is merely a priority-stripping provision that only addresses the priority of the claim of a governmental unit, i.e., it does not change the way the amount of a claim of a governmental unit is calculated for the underlying tax liability nor does it establish the right to or amount of a refund. Accordingly, nothing in 11 U.S.C. §1232 authorizes a debtor's Chapter 12 plan to require a tax authority to disgorge, refund, or turn over pre-petition tax withholdings for the benefit of the estate.⁹⁹⁵

11. Dismissed Cases

Section 1398 does not apply to cases under Chapter 7 or 11 that are dismissed.⁹⁹⁶ Because §1398 does not apply, no separate taxable entity is created in a dismissed case. The Committee Reports indicate that the debtor reports all income of the estate in a dismissed case.⁹⁹⁷ When tax returns have been filed by the debtor and the estate and income of the estate has not been reported by the debtor, the debtor presumably must file an amended return to include the estate's income and deductions and the estate's return is presumably void and of no effect. Likewise, an election by the debtor to terminate the taxable year also presumably becomes void.

The cancellation of debt rules of §108 do not apply to a dismissed case because no discharge is granted by the court

⁹⁹⁴ See *In re Richards*, 616 B.R. 879 (Bankr. S.D. Ind. 2020) (IRS denied right of setoff for pre-petition taxes owed against refund generated by post-petition refund attributable to sale of farm assets in Chapter 12 bankruptcy; setoff was not among mutual pre-petition obligations and was not provided for in confirmation plan).

⁹⁹⁵ See *Iowa Dep't of Revenue v. DeVries (In re DeVries)*, 621 B.R. 445 (B.A.P. 8th Cir. 2020).

⁹⁹⁶ §1398(b)(1).

⁹⁹⁷ H.R. Rep. No. 833, at 20; S. Rep. No. 1035, at 25.

⁹⁹¹ 11 U.S.C. §109(e).

⁹⁹² §1399. See, e.g., *Hall v. United States*, 132 S. Ct. 1882 (2012), *aff'd* 617 F.3d 1161 (9th Cir. 2011) (holding post-petition income taxes were not "incurred by the estate" and not dischargeable where debtors realized taxable gain on sale of farm assets after filing under Chapter 12).

⁹⁹³ §108(d)(2).

or pursuant to a plan approved by the court as is required by §108(d)(2).

12. Receivership, Foreclosure, and Similar Proceedings

Because it applies only to cases under title 11, §1398 does not apply to state or federal receivership, foreclosure, or similar proceedings outside title 11. Nevertheless, the IRS asserts that a separate taxable entity is created in a state insolvency proceeding.⁹⁹⁸

The regulations require a receiver who stands in the place of an individual to file the income tax return for the individual. When the receiver controls only part of the individual's property, however, the receiver need not file a return and the individual must report the income and deductions of the insolvency estate.⁹⁹⁹

The bankruptcy discharge rules of §108 do not apply to receivership, foreclosure or similar proceedings outside title 11.¹⁰⁰⁰ Individuals involved in such proceedings, however, may be entitled to exclude cancellation of debt income under the §108(a)(1)(B) insolvency exception, the exception for qualified farm indebtedness in §108(a)(1)(C), or the exception for qualified real property business indebtedness in §108(a)(1)(D).

H. IRS Motions to Convert or Dismiss

The IRS has relatively few defenses available to combat the taxpayer-debtor's bankruptcy case. There are two attacks which the IRS can mount when the debtor has not followed the rules prescribed by either the bankruptcy court or the plan of reorganization: (1) a motion to dismiss the bankruptcy case; and (2) a motion to convert the case to a Chapter 7 case. After the 2005 Bankruptcy Act, another dismissal or conversion is commonplace. Debtors attempting to qualify for a Chapter 7 are forced to dismiss their case or agree to convert to a Chapter 13 case if they fail the "means test." (See VII.A.1., above, for further discussion of the means test.)

Chapter 7 cases may be dismissed only for cause, including delay prejudicial to creditors and failure to pay fees.¹⁰⁰¹ While the IRS apparently has the authority to move to convert a Chapter 7 case into a Chapter 11 case, this is rarely done in practice.¹⁰⁰²

The criteria used by the IRS in deciding to request a conversion or dismissal of a case are based on the same factors that the taxpayer considers in filing a Chapter 11 or a Chapter 13 case.¹⁰⁰³ The IRS prefers a Chapter 7 proceeding to one under Chapter 11 or Chapter 13 because the debtor's ability to control the administration of the bankruptcy estate is greatly limited under Chapter 7. The three grounds most commonly used by the IRS to convert or dismiss a Chapter 11 or Chapter 13 case are: (1) pyramiding of employment tax liabilities (i.e., the debtor makes payments under the plan, in part, by failing to pay

current employment tax obligations); (2) failing to file a timely plan of reorganization;¹⁰⁰⁴ and (3) failing to make payments in accordance with the plan. The most common of these grounds for conversion or dismissal is failure by the debtor to make the payments required under the plan. This failure constitutes a material default with respect to the plan.¹⁰⁰⁵

Note: There is no set rule concerning the number of payments that may be missed before the debtor's case is subject to conversion or dismissal. At least one court has held that two missed payments can result in conversion or dismissal when the debtor fails to adequately explain the reason for the default.¹⁰⁰⁶

The IRS also may seek dismissal if the bankruptcy is filed in bad faith.¹⁰⁰⁷ This is particularly common in Chapter 13 cases under the authority of 11 U.S.C. §1307(c).¹⁰⁰⁸

I. Miscellaneous Tax Issues in Bankruptcy

The Internal Revenue Code provides special rules for tax issues in bankruptcy proceedings. For instance, §6658 provides relief from penalties under §6651, §6654, or §6655, which are otherwise imposed for failing to make timely payments of tax. To obtain relief under §6658, the bankruptcy court must issue an order prohibiting such payments, and the tax liability must be one that was incurred by the estate.¹⁰⁰⁹ Moreover, the bankruptcy court must find that there are insufficient funds to pay the administrative expenses of the estate. If the debtor incurred the tax liability, the tax must have been incurred before the earlier of: (1) the order for relief; or (2) the appointment of the trustee. In addition, the bankruptcy petition must have been filed before the due date of the return, including extensions, or the date for making the addition to tax must have occurred on or after the date on which the petition was filed.

Under §3302, a credit is allowed against an employer's federal unemployment tax (FUTA) if the employer makes pay-

¹⁰⁰⁴ The failure to file a timely plan of reorganization or Chapter 13 plan does not typically cause the conversion or dismissal of a Chapter 11 or Chapter 13 case. The case is not converted or dismissed unless the IRS establishes that the delay is unreasonable and prejudicial. See *Theatre Holding Corp. v. Mauro*, 681 F.2d 102 (2d Cir. 1982); *In re Powell Bros. Ice Co.*, 37 Bankr. 104 (Bankr. D. Kan. 1984).

¹⁰⁰⁵ 11 U.S.C. §1112(b)(8), 11 U.S.C. §1307(c)(6). See also *In re Greatwood*, 194 Bankr. 637 (B.A.P. 9th Cir. 1996) (failure to file returns is sufficient basis for Chapter 13 case dismissal for bad faith), *aff'd*, 120 F.3d 268 (9th Cir. 1997) (unpub.). Also, the Chief Counsel's Office advised that, upon a substantial default, where the debtor has stopped making plan payments, the IRS is entitled to use administrative mechanisms to collect the entire amount still due under the plan, regardless of state law that limits the IRS to collecting only the amount for which the debtor is in default. CCA 200146058.

¹⁰⁰⁶ *In re Sando*, 30 Bankr. 474 (Bankr. E.D. Pa. 1983). But see *In re Faaland*, 37 Bankr. 407 (Bankr. D.N.D. 1984) (debtor's explanation sufficient to avoid conversion or dismissal).

¹⁰⁰⁷ But see *In re Padilla*, 222 F.3d 1184 (9th Cir. 2000) (bad faith provides cause to dismiss Chapter 11 and 13 cases, but not Chapter 7 case).

¹⁰⁰⁸ *In re Lilley*, 91 F.3d 491 (3d Cir. 1996); *In re Eisen*, 14 F.3d 469 (9th Cir. 1994); *In re Gier*, 986 F.2d 1326 (10th Cir. 1993); *In re Love*, 957 F.2d 1350 (7th Cir. 1992). But cf. *In re Parffrey*, 264 Bankr. 409 (Bankr. S.D. Tex. 2001) (where debtor used post-petition debt to finish plan payments before hearing on the IRS's motion to dismiss for failure to file post-petition tax returns, court would have dismissed for bad faith, but found 11 U.S.C. §1305 did not grant it discretion to do so).

¹⁰⁰⁹ See, e.g., *In re Am. Elec. Constr., Inc.*, No. 2-86-01133 (Bankr. S.D. Ohio Oct. 5, 1990) (unpub.) (§6658 not applied; bankruptcy court did not issue order directing debtor not to make timely tax payments).

⁹⁹⁸ Rev. Rul. 73-94. In Rev. Rul. 73-94, the IRS relied on Rev. Rul. 68-48, which set forth the IRS's pre-Bankruptcy Tax Act position that a separate taxable entity was created in a federal bankruptcy proceeding involving a partnership.

⁹⁹⁹ Reg. §1.6012-3(b)(5).

¹⁰⁰⁰ §108(d)(2).

¹⁰⁰¹ 11 U.S.C. §707(a).

¹⁰⁰² 11 U.S.C. §706(b).

¹⁰⁰³ 11 U.S.C. §1112, 11 U.S.C. §1307.

ments to a state unemployment compensation fund. The amount of the credit is reduced for late payments, however. The provisions of §3302(a)(5) eliminate the reduction in credit if bankruptcy trustees, through no fault of their own, make late payments.

Under 11 U.S.C. §108(a), a party can extend a limitations period for two years following a bankruptcy order for relief. The extension applies if nonbankruptcy law fixes a period in which the debtor may “commence an action” and such period has not expired before the date of the filing of the bankruptcy petition. Bankruptcy Code §108(a), however, does not extend the limitations period for filing administrative tax refund claims, only the period for filing actual tax litigation.¹⁰¹⁰

J. Examples: Bankruptcy as Defense to IRS Collection

The following fact situation and related examples illustrate the usefulness of filing a bankruptcy petition as a defense to IRS collection.

Factual Situation: By September 2019, X Corp. has been in business for six years. X Corp. has not managed to generate significant profit since its inception and, therefore, has reported little taxable income. In September 2018, the IRS concluded an audit of X Corp.’s 2015 tax year and asserted an income tax deficiency of \$20,000 and a negligence penalty of \$4,000. X Corp. did not petition the Tax Court, and the IRS assessed the deficiency and penalty in January 2019. Moreover, in 2017, X Corp. began to fall behind in paying its employment tax liabilities. The IRS contacted X Corp. in 2018, and assessed the employment tax and late payment penalty in January 2018. The IRS filed a Notice of Federal Tax Lien (NFTL) for the 2017 employment taxes and late payment penalty in July 2018. X Corp. negotiated to postpone collection by paying \$1,000 per month and by making timely deposits of its current employment tax liabilities. X Corp. later decided that the only way to improve its financial condition was to purchase more efficient equipment. In order to pay for the equipment, X Corp. used funds needed to pay for last month’s employment tax deposits. X Corp. now owes \$5,000 for September 2019 for which the IRS assessed the employment taxes and failure to deposit penalty in November 2019. It still owes \$35,000 on the 2017 employment tax liabilities.

T is X Corp.’s principal officer and shareholder. T was a tax protester in 2009 and 2010. The IRS discovered T’s activities in 2013. The IRS issued a notice of deficiency in 2014 and assessed income deficiencies of \$10,000 for each year in October 2018. In addition, the IRS assessed a \$7,500 fraud penalty under §6663 for 2009 and a negligence penalty under §6662 and a late-filing penalty under §6651 for 2010. The IRS filed an NFTL for the 2010 liability in May 2019 but forgot to include the 2009 liability. T has been paying \$1,000 per month on the liabilities since August 2018. After being contacted by the IRS, T began to report all of his income but claimed his personal expenses as deductible business expenses in 2015 and 2016 to eliminate his taxable income. T’s Tax Court case involving these deductions is still pending. Finally, the revenue

officer handling X Corp.’s case informed T that he is subject to the trust fund recovery penalty for X Corp.’s unpaid 2017 and 2019 trust fund taxes. Other than his X Corp. stock, T’s only significant asset is his \$200,000 house, which is encumbered by a \$180,000 secured debt.

When the revenue officer learned of X Corp.’s failure to make timely deposits of employment taxes, the revenue officer asked X Corp. to cure the delinquency immediately. X Corp. was unable to make the deposit, so the revenue officer obtained a writ of entry and padlocked X Corp.’s rented business premises.

Example 1: Bankruptcy Estate and Exempt Property. X Corp. files a Chapter 11 bankruptcy petition because it can still be profitable and, therefore, does not want to liquidate. T, in his individual capacity, is considering filing a Chapter 13 petition because the Chapter 13 proceeding is less complex. As of the date of the petition, X Corp.’s assets become part of the bankruptcy estate. Almost none of X Corp.’s assets fit within the categories of exempt assets. Equity of \$7,500 in T’s residence (or the applicable amount, under state law, if T elects to have the state exemptions apply) is an exempt asset not subject to the claims of T’s creditors. Since the NFTL was filed for T’s 2010 liability and (as discussed below) T’s 2009 liability is nondischargeable, the exempt equity is, nevertheless, subject to the 2009 and 2010 tax liens.

Example 2: Automatic Stay. The automatic stay often affects the timing of the bankruptcy petition filing. Since the IRS has seized the business premises, X Corp. should file its Chapter 11 petition immediately. Filing the petition stops the IRS from selling X Corp.’s assets. Nevertheless, the IRS is not obligated to return the seized assets unless the bankruptcy estate obtains a turnover order. X Corp.’s bankruptcy petition does not allow it to enjoin the assessment of the trust fund recovery penalty against T. Such an injunction is beyond the bankruptcy court’s jurisdiction. Since T does not face imminent enforced IRS collection, there is no advantage for T to file a bankruptcy petition before the assessment of the §6672 penalty or the Tax Court determination. T does not need the automatic stay and should delay filing a bankruptcy petition.

Example 3: Turnover. If the bankruptcy estate can show that the going-concern value of the business assets substantially exceeds the liquidation value, the estate should be able to obtain the release of the IRS seizure and the turnover of the seized assets to the bankruptcy estate, pursuant to *Whiting Pools*. In exchange, the IRS is entitled to deferred cash payments with a value equal to the IRS’s interest in the seized property. The IRS may try to extract an immediate monthly payment schedule in exchange for a stipulated turnover of the assets. The bankruptcy court typically allows this arrangement if other secured creditors do not object.

¹⁰¹⁰ *TLI, Inc. v. United States*, 100 F.3d 424 (5th Cir. 1996).

Example 4: Avoiding Preferences. Assume that in the 90-day period before the bankruptcy petition date, X Corp. paid its current employment tax deposits and made three \$1,000 trust fund tax designated payments on the 2019 liabilities. The bankruptcy trustee is unable to recover the current employment tax deposits as avoidable preferences because these payments were made in the ordinary course of business and were not on account of an antecedent debt. Under *Begier*, the three \$1,000 payments made within the 90-day period are not subject to avoidance, since the payments are not from the debtor's funds but are made from funds deemed to be held in trust for the IRS.

Example 5: Classification. On the bankruptcy petition date, X Corp. has the following tax liabilities:

Tax	Year	Assessed	Penalties	NFTL Filed
Income	2015	1/19	Negligence	—
Employment	2017	1/18	Late payment	7/18
Employment	2019	11/19	Failure to deposit	—

The 2015 income tax liability is a general unsecured claim because: (1) no NFTL was filed; (2) the related return was due more than three years before the bankruptcy petition date; and (3) the liability was assessed more than 240 days before the bankruptcy petition date.

The 2017 employment tax liability is a secured tax claim to the extent that X Corp. has equity in its assets that are not encumbered by liens senior to the NFTL. The late payment penalty, however, can be converted to a general unsecured claim if X Corp. files a Chapter 7 petition because it is a nonpecuniary loss penalty. The bankruptcy trustee must avoid the NFTL to the extent of the penalties to obtain this result. Pre-petition interest and post-petition interest on the secured claim are also secured to the extent that the IRS's tax claim is oversecured. All of the 2018 employment tax liability and the 2017 penalty claim are unsecured. The employer's portion is a priority claim because the related return is due within three years before the bankruptcy petition date. The employee's (or trust fund) portion of the employment tax is a priority tax regardless of when the return is due. Pre-petition interest on these priority claims is also a priority claim. The bankruptcy estate has to provide an interest factor (i.e., post-petition interest) on the priority tax claims to obtain confirmation of the Chapter 11 plan. Finally, the failure to deposit penalty on the 2019 liability is a nonpecuniary loss penalty for which no NFTL was filed and, accordingly, is a general unsecured claim.

Example 6: Classification. If T were to file a bankruptcy petition, T would have the following tax liabilities:

Tax	Year	Assessed	Penalties	NFTL Filed
Income	2009	10/18	Fraud	—
Income	2010	10/18	Negligence	5/19
Income	2015/16	—	—	—
\$6672	2017/18	—	—	—

The 2009 tax liability is not a priority claim because the return was due more than three years the filing and the tax was assessed more than 240 days before the prospective bankruptcy petition date. However, this liability is nondischargeable because the liability is due to fraud. The fraud penalty itself can be discharged.

The 2010 income tax liability (plus interest) is a secured claim to the extent T has equity in his house, which is not subject to liens senior to the NFTL (i.e., \$20,000). In addition, post-petition interest on the 2010 liability is a secured claim to the extent that the \$20,000 equity is not consumed by the 2010 tax liability and pre-petition interest. The negligence and late-filing penalties for 2010 are nonpecuniary loss penalties. As such, they can be discharged (see Example 10, below) and can be subordinated to the claims of general unsecured creditors. In a Chapter 7 case, the bankruptcy trustee can avoid the lien for these penalties, leaving them with only general unsecured status. In a Chapter 11 or 13 case, however, these penalties, since they are secured by the NFTL, are general unsecured claims only if there is an insufficient interest in T's property to cover the full amount of the tax, interest, and penalty for 2010.

T's 2015 and 2016 income tax liabilities are currently priority tax claims because they are assessable as of the prospective bankruptcy petition date. To remove these liabilities from the priority tax category, T must: (1) settle the Tax Court case to cause the assessment of the tax; and (2) wait 240 days after assessment. In addition, T has to wait until at least three years after the tax return due date (including extensions) to ensure that the 2016 liability is not a priority tax.

The Trust Fund Recovery Penalty liability is a priority tax under any circumstance. No planning opportunities are presented for this \$6672 penalty in a Chapter 7 case.

Example 7: Chapter 11 Priority. X Corp.'s Chapter 11 plan of reorganization must provide for the following in order to be confirmed:

- the NFTL must be retained for the 2017 employment taxes, and the IRS must receive regular cash payments equal to the secured amount of tax, interest, and penalty. Alternatively, X Corp.'s property can be sold with the IRS's secured claim attaching in the same priority to the sales proceeds;
- the 2019 employment taxes and any undersecured portion of the 2017 employment taxes must be pro-

vided for in regular cash payments with a present value equal to the total tax plus pre-petition interest; and

- the 2015 income tax liability and the penalties on all of X Corp.'s 2019 employment tax liabilities need only be paid in the amount that those claims would have been entitled to in a hypothetical Chapter 7.

Example 8: Chapter 13 Priority. T's prospective Chapter 13 plan must provide for the following in order to be confirmed:

- the NFTL for the 2010 income tax liability must be retained, and the non-exempt portion of the \$20,000 value of the secured claim (i.e., T's equity in the house) must be paid to the IRS. Alternatively, the plan could be confirmed pursuant to a different payment arrangement if the IRS accepts the alternative arrangement;
- the unassessed 2015 and 2016 income tax liabilities and the §6672 penalty liability (plus pre-petition interest) are priority tax claims which must be paid in deferred payments over a term not exceeding three years (or five years with the bankruptcy court's approval); and
- the 2009 income tax liability and penalty, any undersecured portion of the 2010 income tax liability and penalty, and any penalties on the 2015 and 2016 income tax liabilities are general unsecured claims and must be satisfied by the amount which would be paid in a hypothetical Chapter 7 liquidation. If the IRS objects to the plan: (1) the IRS must receive payments with a present value equal to the full amount of the unsecured claim; or (2) all of T's disposable income for the next three years must be utilized to pay his creditors. If T is required to pay less than all of the 2009 tax liability, the tax would not be dischargeable because the tax results from fraud and the Chapter 13 super-discharge provision no longer provides a discharge. The 2010 liability is dischargeable.

T may wish to delay filing the bankruptcy petition. If T can delay filing the petition until after the later of: (1) three years from the return due date; or (2) 240 days after assessment, T could move the 2015 and 2016 income tax liabilities (but not the §6672 penalty liability) to the general unsecured category.

Example 9: Chapter 11 Dischargeability. X Corp.'s 2015 income tax deficiency is dischargeable, since the liability is not a priority tax claim and is not due to fraud or a late-filed return. The employment tax liabilities are nondischargeable. The trust fund portion of the employment tax

liabilities is nondischargeable regardless of the due date of the respective employment tax return. The employer's share of the employment tax liability is a nondischargeable priority tax because the related returns were due within three years before the bankruptcy petition date. The 2015 income tax liability will be discharged when X Corp.'s Chapter 11 plan of reorganization is confirmed. If X Corp. schedules the nondischargeable tax claims without providing for full payment and the IRS fails to object to confirmation of the plan, the nondischargeable tax claims can also be discharged.¹⁰¹¹

Example 10: Chapter 13 Dischargeability. Under the former law, T's 2009 liability would be dischargeable because, even though the liability is attributable to fraud, the super-discharge provision would apply. This super-discharge provision was eliminated by the 2005 Bankruptcy Act. The fraud penalty itself is dischargeable under either version of the law because the events giving rise to the penalty occurred more than three years before the bankruptcy petition date. The 2010 liability is dischargeable because the liability relates to a tax return due more than three years before T's potential bankruptcy petition date and has been assessed for more than 240 days. The NFTL filed for the 2010 liability does not render the tax liability nondischargeable, but the perfected lien survives T's discharge and continues to encumber T's pre-petition exempt property. Since the 2010 tax liability is dischargeable, and the events occurred more than three years before the bankruptcy petition date, the related negligence and late-filing penalties are dischargeable. The 2015 and 2016 liabilities are nondischargeable because they are assessable as of the prospective bankruptcy petition date. T has to resolve the Tax Court case and wait the longer of three years from the return due date or 240 days after the assessment before filing the bankruptcy petition to render these liabilities dischargeable. The penalties for the 2015 liability are dischargeable even though the underlying tax is nondischargeable because the events giving rise to the penalties occurred more than three years before the bankruptcy petition date. Since this is not true for the 2016 penalties, those penalties are nondischargeable. The proposed §6672 penalty liability is nondischargeable without regard to the time of assessment. The interest on the respective taxes is dischargeable only if the underlying tax is also dischargeable.

¹⁰¹¹ However, the IRS may audit and make additional claims for the same years covered by the bankruptcy proceeding without running afoul of res judicata principals. *In re DePaolo*, 45 F.3d 373 (10th Cir. 1995) (citing 11 U.S.C. §523 and §1141); *Hambrick v. Commissioner*, 118 T.C. 348 (2002).

VIII. The IRS Collection Notice Cycle (Collection Procedure #1)

As set forth above, the principal means to resolve a tax collection matter are contesting the liability, negotiating an installment agreement or offer in compromise, or bankruptcy. A bankruptcy is an independent judicial proceeding that does not require IRS participation in the resolution. A liability challenge, installment agreement, and an offer in compromise, however, can only be obtained by an agreement with the IRS. These resolutions can be attempted at various stages of the IRS collection process. The following sets forth the various collection procedures and the options for resolution at that stage.

The notice cycle commences with the initial bill and continues through the final notice (Notice CP 504). During the notice cycle, efforts can be made to resolve the case by contacting

the number on the notice. A representative with an IRS Form 2848, *Power of Attorney and Declaration of Representative*, on file can also deal with the IRS Practitioners' Hotline during the notice cycle.

Contact should certainly be made during the notice cycle when the taxpayer is challenging whether the tax liability really is due. It is usually best to challenge the liability at the earliest opportunity. A request for an installment agreement or filing an offer in compromise also can be done at the notice stage. Filing a bankruptcy petition will often not be appropriate during the notice cycle, however, since taxes are typically not dischargeable shortly after assessment.

IX. Dealing with the IRS Automated Collection System (ACS) or Revenue Officer (Collection Procedure #2)

After the notice cycle, the IRS collection case will be sent to ACS or a field revenue officer. ACS is a centralized unit where there is usually a different IRS representative for each contact. A case that goes to a field revenue officer will be assigned to one person who is responsible for all aspects of the case.

Once it is determined that a tax liability is enforceable and that the taxpayer has no statutory basis for relief, the taxpayer is left with little leverage in the collection area. A taxpayer is in the strongest bargaining position if the taxpayer can convince the revenue officer or ACS that ultimate collection will be enhanced if the IRS delays enforced collection. This argument is persuasive if, for example, the taxpayer has little equity in existing assets but has good future income potential. By delaying enforced collection, the IRS may realize greater collection from future payments.

If a taxpayer plans on negotiating in this manner, the taxpayer must make sure that all tax returns for all periods subsequent to the years of the unpaid liabilities are filed. The IRS does not negotiate with a taxpayer whose current filing and payment obligations are not being satisfied. The taxpayer should also make sure that all financial information submitted is truthfully completed and that assets are not concealed. These actions afford the taxpayer the best opportunity to negotiate a successful offer in compromise or installment agreement.

Comment: The taxpayer should make every attempt to resolve the collection issues administratively with the revenue officer or ACS. Administrative resolution — including installment payment agreements and offers in compromise — is much less expensive, from a professional fees standpoint, than any form of judicial relief. Only when the administrative avenues for resolution have been exhausted should the taxpayer begin to consider filing a bankruptcy petition. The effects of bankruptcy on the collection of tax are well known to the IRS and, in some circumstances, may provide additional leverage in the negotiation of an administrative resolution.

When the IRS becomes convinced that the taxpayer has no collectible assets and no future source of collection, the IRS can close the case by completing Form 53 (Report of Currently Not Collectible Taxes).¹⁰¹² This action (commonly referred to as “53-ing the account” or putting the account in “CNC” status) removes the case from the revenue officer’s or ACS’s inventory. Thereafter, the case remains closed as long as the taxpayer’s income stays below certain limits.¹⁰¹³ Certain large ac-

counts, though, are subject to mandatory follow-up to ensure protection of the revenue potential.¹⁰¹⁴

The revenue officer or ACS representative has authority (with managerial approval) to accept or reject an installment agreement. An offer in compromise can also be submitted to the revenue officer or ACS, but it will be forwarded to the centralized offer in compromise unit for consideration and acceptance or rejection.

When the IRS becomes convinced that the costs of administration and collection of an unpaid tax balance outweigh the benefit of collection, the IRS also may choose to abate a small tax balance. Under §6404(c), the IRS has the authority to abate the unpaid portion of the assessment of any tax, or any liability in respect of the tax, when the IRS determines under uniform rules that the costs of administration and collection would not warrant collection of the amount due. The IRS may use such an abatement in a case in which a notice of federal tax lien is filed, the underlying tax liability is discharged in bankruptcy, and the IRS consents to release its lien for the discharged period upon payment of less than the full value of its interest in property subject to the lien.¹⁰¹⁵ Unless the tax is abated by agreement, the IRS can later reverse the §6404(c) abatement and collect the liability if, within the collection limitations period, the taxpayer becomes able to pay.¹⁰¹⁶

If the revenue officer or ACS appears to be taking an overly aggressive position, the taxpayer should consider requesting a review by the group manager or exercising appeal rights.¹⁰¹⁷ There is a certain amount of risk in making a request for review because the group manager generally supports the revenue officer or ACS representative and the request for review may not be welcomed. However, in light of the liability that exists for negligent collection actions, the IRS has been more careful in the collection action it is undertaking.

¹⁰¹³ When a taxpayer’s account is placed in CNC status, the debt is not forgiven or extinguished; collection action is merely deferred. *Shenk v. Commissioner*, T.C. Memo 2015-193. Although CNC status defers collection action with respect to any future state tax refunds, the IRS may continue to apply federal tax overpayments against an assessed, unpaid liability. See §6402(a); see also *Greene-Thapedi v. Commissioner*, 126 T.C. 1, 7–8 (2006); *Bullock v. Commissioner*, T.C. Memo 2003-5 (“An offset under section 6402 is distinguishable from, and does not constitute, a levy action.”). Thus, even if a taxpayer’s account is in CNC status, the Tax Court lacks authority to prevent the IRS from applying the taxpayer’s future federal tax refunds against the taxpayer’s unpaid federal tax liability. *Etoty v. Commissioner*, T.C. Memo 2020-49 (citing *Greene-Thapedi*, 126 T.C. 1, 13 (2006)).

¹⁰¹⁴ See IRM 5.16.1.6 (11-14-23).

¹⁰¹⁵ CCA 200130044.

¹⁰¹⁶ Chief Counsel’s Notice CC-2001-014.

¹⁰¹⁷ See X., below (Collection Appeals Program). See also XIII., below (Taxpayer Assistance Orders).

¹⁰¹² See IRS Policy Statement P-5-71, printed in IRM 1.2.1.6.14 (11-19-80).

X. Collection Appeals Program (CAP) (Collection Procedure #3)

A. When Available

Under the Collection Appeals Program (CAP), a taxpayer facing a notice of lien, levy, seizure, or denial or termination of an installment agreement can briefly forestall the collection action to challenge procedural errors. Taxpayers cannot use CAP to challenge the underlying tax assessment.¹⁰¹⁸

Section 7123(a) statutorily binds the IRS to follow its procedures with respect to CAP. The scope of collection actions subject to review under this program is broader than the range of issues which can be addressed in a collection due process (CDP) appeal.¹⁰¹⁹

In the case of a federal tax lien (NFTL), CAP may be utilized either before or after the filing of the notice. A CDP hearing is only available after the lien is filed. The taxpayer also may appeal a denied request to withdraw, discharge, subordinate or acknowledge non-attachment of an NFTL.¹⁰²⁰

In the case of a levy notice, the taxpayer may appeal before or after the IRS places a levy on the taxpayer's wages, bank account, or other property.¹⁰²¹ However, once the levied proceeds are applied toward the taxpayer's liability, the taxpayer must make an administrative claim under the procedures described in Publication 5149, *Making an Administrative Return of Property Claim Under Internal Revenue Code (IRC) Section 6343(d)*, and if the administrative claim is denied, the taxpayer can request a CAP appeal.¹⁰²² In the case of seizure of property, the taxpayer may appeal before or after the IRS seizes the property, however, the taxpayer must make a post-seizure appeal request to the collection manager within 10 business days after the notice of seizure is given to the taxpayer or left at the taxpayer's home or business.¹⁰²³

In the case of an installment agreement (IA), the taxpayer may appeal a proposed denial or termination of the agreement or a default of an installment agreement.¹⁰²⁴

B. Appeal Procedures

CAP also is more expansive than the CDP appeal in that a CAP appeal can be filed by persons other than the taxpayer. Third-party nominees or other persons holding property subject to a levy are not entitled to a CDP hearing. However, these third parties may seek a hearing before the Appeals office under CAP.¹⁰²⁵ Similarly, if the IRS files a nominee lien the nominee

or person allegedly holding property of the taxpayer may seek a hearing before the Appeals Office under CAP.¹⁰²⁶

Under CAP, taxpayers and IRS officials have limited time periods in which to act or respond. If the initial collection contact was through a notice, the taxpayer should contact the Collection manager by telephone. Collection managers have 24 hours in which to return telephone requests for review.¹⁰²⁷

If the taxpayer and the Collection manager do not resolve the disagreement, the taxpayer should mail Form 9423, *Collection Appeal Request*, within three business days following the conference with the Collection manager to request a CAP appeal or collection action may resume.¹⁰²⁸ In addition to requiring that the taxpayer state the reasons for disagreeing with the IRS collection action, Form 9423 requires the taxpayer to include solutions for resolving the tax problems. The appeal typically occurs in less than one month. The taxpayer may request a reasonable conference delay, usually not more than five business days. The Appeals Office tries to decide the case within five business days.¹⁰²⁹ The decision is binding on both the taxpayer and the IRS unless there is fraud, malfeasance, concealment, misrepresentation of material fact, an important mistake in mathematical calculation, or other circumstances that indicates that failure to reopen the CAP decision would be a serious administrative omission.¹⁰³⁰

Note: Unlike an appeal under the collection due process (CDP) procedures, if the taxpayer disagrees with the determination made by the Appeals Office, the taxpayer may not contest the determination in Tax Court.

Because CAP is available before a lien is filed or a levy is issued, CAP can be used before the CDP notices are issued. Filing a CAP should not be done without consideration of the consequences on a potential CDP hearing, however. If a CAP appeal is filed and a determination is made, the taxpayer will lose the right to contest that determination in a subsequent CDP hearing.¹⁰³¹ If the underlying liability is not considered in the CAP appeal, however, the taxpayer still may challenge the liability in a subsequent CDP hearing.¹⁰³² Therefore, while CAP may be a preferable remedy in certain cases (especially for liens) because it allows an appeal before the IRS collection ac-

¹⁰²⁶ Reg. §301.6320-1(b), Q&A-B5.

¹⁰²⁷ IRS Pub. 1660, *Collection Appeal Rights*.

¹⁰²⁸ IRM 5.1.9.4.2 (08-30-18). A taxpayer is still entitled to a CAP appeal if the Form 9423 is received a reasonable time after the Collection manager conference.

¹⁰²⁹ See IRM 5.1.9.4.4 (10-23-19), IRM 5.19.8.4.16.8 (02-03-14), Form 9423, *Collection Appeal Request*.

¹⁰³⁰ IRM 5.1.9.5.4 (08-30-18).

¹⁰³¹ §6330(c)(4). In PMTA 2012-14, the IRS Chief Counsel's Office addressed the issue of whether §6330(c)(4) precluded consideration during a CDP hearing of an issue that was raised and considered in a CAP hearing, in which the taxpayer meaningfully participated, when the CAP and CDP hearings were requested simultaneously. The IRS Chief Counsel concluded that, if a CAP proceeding is concluded before the date the CDP hearing request is made and the taxpayer meaningfully participated, the issue raised and considered at the CAP hearing is precluded from consideration in the CDP hearing because the completed CAP hearing was a "previous administrative proceeding" under §6330(c)(4). However, if the taxpayer simultaneously requests a CAP and CDP hearing, or requests the CDP hearing before the conclusion of the CAP hearing, the CAP hearing cannot be a "previous" administrative proceeding. Any issue raised considered in the CAP hearing is not precluded from being raised in the CDP hearing under §6330(c)(4).

¹⁰³² *Mason v. Commissioner*, 132 T.C. 301 (2009).

¹⁰¹⁸ IRM 8.24.1.3.3(2) (9-28-21).

¹⁰¹⁹ See Rev. Proc. 99-28, §5; see also IRS Pub. 1660, *Collection Appeal Rights*.

¹⁰²⁰ IRM 8.24.1.2 (9-28-21).

¹⁰²¹ IRM 8.24.1.3(2) (9-28-21).

¹⁰²² IRM 8.24.1.3(5) (9-28-21). For third parties, once the levied proceeds are applied toward the taxpayer's liability, the third party may submit an administrative claim under the procedures described in Pub. 4528, *Making an Administrative Wrongful Levy Claim Under Internal Revenue Code (IRC) Section 6343(b)*, and if denied, the third party can request a CAP hearing. IRM 8.24.1.3(4) (9-28-21).

¹⁰²³ IRM 8.24.1.3.5(10) (9-3-19).

¹⁰²⁴ See IRM 8.24.1.3(2) (9-28-21).

¹⁰²⁵ Reg. §301.6330-1(b), Q&A-B5.

tion is taken, it may cause the loss of the right to judicial review that is available only with a CDP appeal.

Note: If a taxpayer requests both a CDP hearing and a CAP about the proposed levy or the NFTL filing, the taxpayer must choose between the two. If the taxpayer will not sign a withdrawal of the CDP request or cannot decide between CAP and CDP, the IRS will give the taxpayer the CDP hearing.¹⁰³³

¹⁰³³ IRM 8.24.1.2(4) (9-28-21). A taxpayer has no legal right to a CAP hearing where a CAP hearing and CDP hearing are requested simultaneously. IRM 8.24.1.2(4) (note) (9-28-21).

A CAP appeal generally cannot be used to challenge the taxpayer's liability.¹⁰³⁴ CAP is an excellent forum to contest the denial of an installment agreement, but there is no right under CAP to review adverse determinations for offers in compromise.¹⁰³⁵ Filing a CAP appeal can also affect the timing for discharging taxes in bankruptcy.¹⁰³⁶

¹⁰³⁴ IRM 5.1.9.4.1(2) (08-27-21), IRM 8.24.1.3.3(2) (9-28-21).

¹⁰³⁵ IRM 5.1.9.4(1) (02-07-14), IRM 5.1.9.4.1(1) (08-27-21).

¹⁰³⁶ 11 U.S.C. §507(a)(8)(A)(ii)(II) (240-day period suspended while collection stayed).

XI. Collection Due Process (CDP) Appeals (Collection Procedure #4)

A. Purpose of CDP Procedures

Congress held hearings in the summer of 1998 and received voluminous evidence concerning apparent abuses by the IRS's collection function. Congress responded to the information received at these hearings by enacting the collection due process (CDP) procedures.¹⁰³⁷ The goal was stated as "taxpayers are entitled to protections in dealing with the IRS that are similar to those they would have in dealing with any other creditor." The CDP procedures were enacted to promote fairness to taxpayers by affording due process by means of a notice and hearing process.¹⁰³⁸

Scholarly debate ensued over the usefulness of the CDP procedures in the mid-2000s. Some felt CDP went too far and imposed too much of a restraint on the IRS in the tax collection process.¹⁰³⁹ Others felt the CDP procedures were an important (if flawed) protection against overreaching by the IRS Collection Division.¹⁰⁴⁰

Whatever the debate a decade ago, the CDP procedures have not changed materially since their original enactment. Congress did not amend or restrict the CDP procedures. The procedures still exist as originally intended, i.e., to provide administrative and judicial review for potential abuse by the IRS Collection Division.

The CDP procedures provide possibly the most important avenues of relief to the taxpayer from federal tax lien and levy actions.¹⁰⁴¹ These procedures require notice and an opportunity for a hearing *after* the filing of a notice of federal tax lien (NFTL) and *before* the IRS can levy. In general, the taxpayer may challenge the underlying liability if there has been no prior opportunity. In addition, many proposed resolutions of collection action may be raised at the CDP hearing (e.g., requesting innocent spouse status, submitting an offer in compromise, seeking an installment agreement).

The principal steps in the CDP process are:

- CDP Notice after the NFTL is filed or before levy;
- CDP hearing request filed by the taxpayer;
- CDP hearing with the Appeals Office;
- Notice of Determination following CDP hearing; and
- Tax Court review.

Comment: Filing a timely CDP appeal should be considered *mandatory* if the taxpayer is seeking an administrative resolution of a complicated collection matter. The CDP pro-

¹⁰³⁷ S. Rep. No. 105-174, p. 67, *reprinted at* 1998-3 C.B. 537, 603.

¹⁰³⁸ S. Rep. No. 105-174, p. 64.

¹⁰³⁹ See Camp, *Tax Administration as Inquisitorial Process and Paradigm Shift in the IRS Restructuring and Reform Act of 1998*, 56 Fla. L. Rev. 1 (2004).

¹⁰⁴⁰ See Cords, *How Much Process Is Due? I.R.C. Sections 6320 and 6330 Collection Due Process Hearings*, 29 Vt. L. Rev. 51 (2005); Book, *The Collection Due Process Rights: A Misstep or a Step in the Right Direction?* 41 Hous. L. Rev. 1147 (2004).

¹⁰⁴¹ See §6320, §6330. Reg. §301.6320-1 and §301.6330-1 address the notice provisions, procedural requirements, and rules governing the conduct of CDP hearings before Appeals.

visions have effectively shifted most sophisticated collection work from the IRS Collection function to IRS Appeals.

B. Time for Issuing CDP Notices

1. Issuance After NFTL Filing

A Collection Due Process hearing notice must be provided *after* the NFTL has been filed (a CDP Lien Notice).¹⁰⁴² The notice is typically provided in IRS Letter 3172. The CDP Lien Notice must be provided within five days of the filing of the NFTL and must be provided 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.¹⁰⁴³ The failure of the taxpayer to accept the CDP notice does not render it invalid.¹⁰⁴⁴

The IRS must give notification to the taxpayer for each tax period listed on the first NFTL filed.¹⁰⁴⁵ The IRS also gives notice of subsequent NFTLs for the same periods and for NFTLs filed at separate recording offices.¹⁰⁴⁶ However, the IRS will not give a CDP Lien Notice to the taxpayer on a refiled NFTL.¹⁰⁴⁷ Instead, the taxpayer can seek reconsideration by the IRS collection office that is refiled the tax lien, a CAP appeal, or assistance from the Taxpayer Advocate's office.

The CDP Lien Notice must contain the following information:

- the amount of unpaid tax;
- a statement that sets forth the taxpayer's right to request a CDP hearing within 30 days after the end of the five-day period that expired after the filing of the NFTL;
- the provisions of §7345 relating to the certification of seriously delinquent tax debts and the denial, revocation, or limitation of passports of individuals with seriously delinquent tax debts;
- the administrative appeals that the taxpayer can utilize;¹⁰⁴⁸ and

¹⁰⁴² §6320(a)(1).

¹⁰⁴³ §6320(a)(2); Reg. §301.6320-1(a). *Schake v. Commissioner*, T.C. Memo 2002-262. Reg. §301.6320-1(a)(1) references Reg. §301.6212-2 to define last known address generally as the address that appears on the taxpayer's most recently filed and properly processed federal tax return, unless the IRS is given clear and concise notification of a different address. For a further discussion of last known address, see 630 T.M., *Tax Court Litigation*.

¹⁰⁴⁴ *Smith v. United States*, 2003-1 USTC ¶50,281 (D. Or. 2003); *Raft v. United States*, 2003-1 USTC ¶50,435 (D. Ohio 2003).

¹⁰⁴⁵ Reg. §301.6320-1(a)(2), Q&A-A3. See CCA 201531020 (as agent for all members of consolidated group, parent company receives notification for any member of consolidated group).

¹⁰⁴⁶ Reg. §301.6320-1(a)(2), Q&A-A5, -A6.

¹⁰⁴⁷ Reg. §301.6320-1(a)(2), Q&A-A5, -A6. Where a lien erroneously self-releases after a collection suit is begun, and the IRS revokes the release, the IRS should file a new notice of tax lien to have priority over subsequent purchasers and, based on the filing, must give the taxpayer the opportunity to have a CDP hearing. CCA 200123003 (advising that CDP notice was required because of the IRS's position, based on Reg. §301.6325-1(f)(2), that revocation reinstates lien but not NFTL).

¹⁰⁴⁸ An IRS failure to give the taxpayer information on appeals procedures does not affect the appeal rights. *Lindsay v. Commissioner*, T.C. Memo 2001-285, *aff'd*, 2003-1 USTC ¶50,307 (9th Cir. 2003).

- the statutory provisions and procedures the IRS utilizes to release federal tax liens.¹⁰⁴⁹

A failure to provide the CDP Lien Notice does not invalidate the NFTL. The NFTL remains valid, but the IRS must give the taxpayer a substitute CDP notice and an opportunity for an Appeals hearing.¹⁰⁵⁰ Similarly, the IRS's position is that the failure to provide the taxpayer's representative with a copy of the CDP notice may violate the Administrative Procedures Act but does not invalidate the underlying collection action.¹⁰⁵¹

A person against whom a nominee lien has been filed is not entitled to receive a CDP Lien Notice or a right to an Appeals hearing because CDP rights are only available to the taxpayer.¹⁰⁵²

2. Issuance Before Levy

The taxpayer also is entitled to a CDP notice *before* the IRS levies on the taxpayer's property (the CDP Levy Notice). The notice is provided on Letter 1058 or Letter LT11, which is issued by the revenue officer or by Automated Collection System (ACS). A refund offset is not a levy for this purpose and no CDP notice is given or required.¹⁰⁵³ The IRS can issue Letter 1058 notwithstanding other provisions that prevent the IRS from levying.¹⁰⁵⁴

The CDP Levy 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 not less than 30 days before the day of the first levy.¹⁰⁵⁵ The notice must state: (1) the amount of unpaid tax; (2) the person's right to request a hearing during the 30-day period after the notice;¹⁰⁵⁶ (3) the proposed IRS action and the rights of the person regarding that action, including a brief statement containing the applicable Code provisions and procedures on levy and sale of property; and, (4) the administrative appeals available and the

¹⁰⁴⁹ §6320(a)(3). Reg. §301.6320-1(a)(2), Q&A-A10. For IRS Chief Counsel Advice regarding CDP notice procedures, see CCA 199932047 (addressing deceased taxpayers, LLCs, partnerships, notices containing errors, notices to representatives, and third-party investigations). See *Miccosukee Tribe of Indians of Fla. v. Commissioner*, T.C. Memo 2015-216 (notice that omitted amount of §6721(e) penalties met requirements of 6320(a)(3) and was valid where it correctly identified amount of unpaid tax, informed taxpayer of right to hearing and available administrative appeals, and identified provisions relating to release of liens).

¹⁰⁵⁰ Reg. §301.6320-1(a)(2), Q&A-A12.

¹⁰⁵¹ CCA 200113004.

¹⁰⁵² Reg. §301.6320-1(a)(2), Q&A-A7. *Pragasam v. Commissioner*, 2007-2 USTC ¶50,704 (9th Cir. 2007) (unpub.); *S&M Tr. No. 1 v. Commissioner*, T.C. Memo 2008-72. The nominee may otherwise seek reconsideration by the IRS office collecting the tax or filing the NFTL, an administrative hearing before Appeals under its Collection Appeals Program (CAP), or assistance from the National Taxpayer Advocate. However, such reconsideration would not be subject to judicial review. Reg. §301.6320-1(b), Q&A-B5.

¹⁰⁵³ *Boyd v. Commissioner*, 451 F.3d 8 (1st Cir. 2006).

¹⁰⁵⁴ *Eichler v. Commissioner*, 143 T.C. 30 (2014) (restriction on levy under §6331(k)(2) when an installment agreement request is pending does not preclude Letter 1058).

¹⁰⁵⁵ §6330(a)(2); Reg. §301.6330-1(a). Reg. §301.6330-1(a)(1) references Reg. §301.6212-2 to define last known address generally as the address that appears on the taxpayer's most recently filed and properly processed federal tax return, unless the IRS is given clear and concise notification of a different address. *Berkun v. Commissioner*, 890 F.3d 1260 (11th Cir. 2018). For further discussion of last known address, see 630 T.M., *Tax Court Litigation*. There is no statutory requirement that a final notice of intent to levy be signed. *Everman v. Commissioner*, T.C. Memo 2003-137.

¹⁰⁵⁶ §6330(a)(3)(B); Reg. §301.6330-1(c).

related procedures, alternatives to levy (including installment agreements under §6159), and the applicable Code sections and procedures for redemption of property and release of liens on property.¹⁰⁵⁷ In the case of joint filers, nothing in §6330 bars the IRS from issuing separate notices to the spouses.¹⁰⁵⁸

In *Ramey v. Commissioner*,¹⁰⁵⁹ the IRS sent the notice by certified mail, return receipt requested, to the taxpayer's last known address. The Tax Court held that the notice was sufficient to start the 30-day period for purposes of requesting a CDP hearing, regardless that the taxpayer's address, which he provided to the IRS, was shared by several businesses and the postal service delivered the notice to an unauthorized individual at that address. Furthermore, whether or when the taxpayer received the notice was irrelevant because the notice was properly served under §6330(a)(2) and §6330(a)(3).

Levies made in connection with jeopardy collection proceedings, levies to collect a federal tax liability from a state tax refund, disqualified employment tax levies (DETL), and levies on federal contractors pursuant to the IRS's Federal Payment Levy Program, are not eligible for the §6330 pre-levy hearing procedures, but are eligible for a post-levy hearing.¹⁰⁶⁰

If the taxpayer timely complies with the procedures to request a CDP hearing, any proposed IRS collection action is stayed until the IRS Appeals office has issued a determination and, in certain cases, any judicial appeal becomes final.¹⁰⁶¹

C. CDP Hearing Request

A timely CDP hearing request entitles the taxpayer to a "full hearing" with the opportunity for judicial review. If the request is not timely, the taxpayer may only seek an "equivalent hearing" with no judicial review. A taxpayer who seeks an equivalent hearing must wait until the 30-day period for requesting a full CDP hearing has expired, otherwise the request will be timely and result in a full hearing.¹⁰⁶²

Taxpayers should state all grounds in the hearing request. The most common grounds for a hearing request are: (1) IRS failed to follow required procedures; (2) underlying liability overstated or not lawfully due; (3) taxpayer entitled to innocent

¹⁰⁵⁷ §6330(a)(3); Reg. §301.6330-1(a)(3), Q&A-A6. For IRS Chief Counsel Advice regarding CDP notice procedures, see CCA 199932047 (addressing deceased taxpayers, LLCs, partnerships, notices containing errors, notices to representatives, and third-party investigations). In CCA 200816023, the IRS Chief Counsel concluded that a CDP notice issued with respect to liabilities from a disregarded single-owner LLC that lists the owner's name but omits his SSN is legally sufficient as an SSN is not required; however, the owner must list his SSN rather than the LLC's EIN when making a request for a CDP hearing.

¹⁰⁵⁸ *Moorhous v. Commissioner*, 116 T.C. 263 (2001).

¹⁰⁵⁹ 156 T.C. 1 (Jan. 14, 2021).

¹⁰⁶⁰ See §6330(f), §6330(h); Reg. §301.6330-1(a)(2), §301.6330-1(a)(3), Q&A-A7; *Clark v. Commissioner*, 125 T.C. 108 (2005); *Dorn v. Commissioner*, 119 T.C. 356 (2002). See also PMTA 2013-16 (guidance on implementing the federal contractor exception to §6330(f)).

¹⁰⁶¹ §6330(e); Reg. §301.6330-1(g). In joint liability situations, where only one spouse has requested a CDP hearing, levy action can continue with respect to the spouse who has not requested a CDP hearing. This may occur in situations where the spouses are separated or divorced. Otherwise, levy action will generally be suspended for both spouses. See IRM 5.1.9.3.5.1(5) (08-30-18); CCA 199935059.

¹⁰⁶² See *Ruhaak v. Commissioner*, 157 T.C. 103 (2021) (equivalent hearing request made before 30-day expiration period triggered full CDP hearing even though box on Form 12153 requesting equivalent hearing was checked).

spouse relief; and (4) IRS failed to consider collection alternatives.

Note: Appeals may not consider any issue that is statutorily prohibited from being considered during a CDP hearing (or an equivalent hearing) in accordance with §6320, §6330, Reg. §301.6320-1, Reg. §301.6330-1, or related administrative guidance.¹⁰⁶³

1. “Full” CDP Hearing

The taxpayer must request a CDP hearing within 30 days after the issuance of the CDP notice, to receive full CDP rights (including the opportunity for court review).¹⁰⁶⁴ A taxpayer is entitled to only one hearing with respect to the CDP Lien Notice and one hearing in response to the first CDP Levy Notice filing for any period to which the unpaid tax relates.¹⁰⁶⁵ If the request is not filed in response to the first notice, the taxpayer is entitled only to an equivalent hearing (as discussed further below).¹⁰⁶⁶ The request also cannot be filed prematurely. If the request is filed before a CDP notice is issued, the request cannot be considered.¹⁰⁶⁷

The 30-day period in which a taxpayer may timely request a CDP hearing begins on the day after the date of mailing of the CDP notice.¹⁰⁶⁸ The CDP hearing request must be in writing and must state the reasons as to why a hearing is sought.¹⁰⁶⁹ The request must include the taxpayer’s name, address, daytime telephone number, social security number, and tax period and must be signed by the taxpayer or the taxpayer’s authorized representative.¹⁰⁷⁰ Form 12153, *Request for a Collection Due Process or Equivalent Hearing*, should be used.¹⁰⁷¹

¹⁰⁶³ Reg. §301.7803-2(c)(13), T.D. 10030, 90 Fed. Reg. 3645 (Jan. 15, 2025), applicable to requests for consideration by Appeals made after February 13, 2025.

¹⁰⁶⁴ Reg. §301.6320-1(b)(1); Reg. §301.6330-1(c)(1); Reg. §301.6330-1(c)(2), Q&A-C3.

¹⁰⁶⁵ §6320(b)(2); Reg. §301.6320-1(b)(1). See *Jewell v. Commissioner*, T.C. Memo 2016-239 (regardless that several NFTLs were filed in different counties pertaining to the same unpaid tax, taxpayer only entitled to one hearing arising from first NFTL filed).

¹⁰⁶⁶ Reg. §301.6320-1(b)(2), Q&A-B1 (if taxpayer does not timely request CDP hearing with respect to first filing of NFTL, taxpayer forgoes right to CDP hearing with Appeals and judicial review of Appeals determination with respect to NFTL). See *Inv. Rsch. Assocs., Inc. v. Commissioner*, 126 T.C. 183 (2006) (full CDP hearing only available in response to first lien notice); *Orum v. Commissioner*, 123 T.C. 1 (2004) (no judicial review based on intent to levy issued after installment agreement defaulted because prior notice of intent to levy not appealed).

¹⁰⁶⁷ *Andre v. Commissioner*, 127 T.C. 68 (2006).

¹⁰⁶⁸ See, e.g., *Newsome v. Commissioner*, T.C. Memo 2007-111; *Lopez v. Commissioner*, T.C. Memo 2001-228.

¹⁰⁶⁹ §6320(b)(1). Section 6702(b) subjects frivolous §6320 CDP submissions or those designed merely to delay or impede tax administration to a \$5,000 penalty. No penalty applies if a taxpayer withdraws a frivolous submission within 30 days of being so notified. §6702(b)(3). The penalty also may be reduced at the IRS’s discretion. §6702(d). A frivolous submission also may be treated as if it never were submitted, thus precluding further administrative or judicial review. §6330(g). For discussion of the judicial review of designations of frivolous positions, see 630 T.M., *Tax Court Litigation*.

¹⁰⁷⁰ Reg. §301.6320-1(c)(2), Q&A-C1. In addition, IRS submission processing (service) centers have been directed to treat as a request for a CDP hearing frivolous correspondence that is submitted in a timely fashion if it contains language that can be reasonably construed as a request for a hearing. SCA 200233001.

¹⁰⁷¹ Reg. §301.6320-1(c)(2), Q&A-C1; Reg. §301.6330-1(c)(2), Q&A-C1.

The taxpayer must send or hand deliver the request to an IRS office and address listed in the CDP notice.¹⁰⁷² The timeliness of the request is determined in accordance with the rules of §7502 and §7503.¹⁰⁷³

If the hearing request is delivered by mail to any of the addresses shown on the CDP notice, is postmarked timely for delivery to an IRS address listed in the CDP notice, and:

- is timely received, then the received date is the date of the hearing request.
- is not timely received, then the postmark date is the date of the hearing request.¹⁰⁷⁴

Moreover, when a taxpayer has a collection case assigned to a revenue officer and the taxpayer submits a CDP or equivalent hearing request to the revenue officer rather than the address on the CDP notice, timeliness is measured from the postmark date of the request mailed to the revenue officer, or the date received by the revenue officer if the request is faxed or hand-delivered.¹⁰⁷⁵ Timeliness may also be measured by the date a request is received via DUT.¹⁰⁷⁶

There is no special provision for taxpayers residing outside of the United States.¹⁰⁷⁷ If the request is timely made on the taxpayer’s behalf by the taxpayer’s spouse or other personal representative and meets the requirements for requesting a CDP hearing (other than the requirement that it be made by the taxpayer), the taxpayer may perfect the request by filing, within a reasonable time after a request from Appeals, a signed written affirmation that the request was submitted on the taxpayer’s behalf.¹⁰⁷⁸ If the request being made is with respect to a substitute CDP notice, the taxpayer must make the request before the end of the 30-day period that begins on the day after the date of the substitute CDP notice.¹⁰⁷⁹ When the date appearing on a CDP notice is *earlier* than the mailing date, the 30-day period prescribed by §6330(a)(2) and §6330(a)(3)(B) is calculated by the date of mailing.¹⁰⁸⁰

¹⁰⁷² Reg. §301.6320-1(c)(2), Q&A-C6; Reg. §301.6330-1(c)(2), Q&A-6. The taxpayer can also fax the hearing request to the fax number listed on the notice, if one is provided. If not, the taxpayer can call the toll-free number on the notice or 1-800-829-1040 to obtain the appropriate fax number. The taxpayer can also hand-deliver the request to the local taxpayer assistance center within the 30-day period. See IRM 5.1.9.3.2(8) (10-19-23). As an alternative, the taxpayer can submit the request via DUT — which is a new Document Upload Tool available at IRS.gov. IRM 5.1.9 (10-19-23) (incorporating SB-SE-05-1222-0085 (Dec. 2, 2022)).

¹⁰⁷³ Reg. §301.6320-1(c)(2), Q&A-C4; Reg. §301.6330-1(c)(2), Q&A-1.

¹⁰⁷⁴ IRM 5.1.9.3.2(8). *Note:* The Internal Revenue Manual was revised in response to PMTA 2020-02, in which the Chief Counsel acknowledged taxpayer confusion caused by multiple addresses on CDP notices and advised that PMTA 2013-11 should no longer be followed.

¹⁰⁷⁵ IRM 5.1.9.3.2.1(7).

¹⁰⁷⁶ Collection employees may now accept correspondence through the IRS Document Upload Tool (DUT), and allow taxpayers to upload documentation using a one-time use only Unique Access Code. Correspondence received through DUT, like correspondence received through fax, is labeled with the date and time. IRM 5.1.9.

¹⁰⁷⁷ Reg. §301.6320-1(c)(2), Q&A-C5. *Cf. Sarrell v. Commissioner*, 117 T.C. 122 (2001) (addressing timeliness of petition mailed from outside the United States for review of Notice of Determination).

¹⁰⁷⁸ Reg. §301.6320-1(c)(2), Q&A-C1.

¹⁰⁷⁹ Reg. §301.6320-1(c)(2), Q&A-C8.

¹⁰⁸⁰ *Weiss v. Commissioner*, 147 T.C. 179 (2016), *aff’d*, 2018 BL 182800 (D.C. Cir. 2018) (unpub.), *cert. denied* 139 S. Ct. 612 (U.S. 2018).

An offset of a credit against the liability before the CDP Levy Notice cannot be contested in the CDP hearing.¹⁰⁸¹ The IRS cannot levy, however, while a CDP hearing request is pending in response to a CDP Levy Notice.¹⁰⁸² The IRS retains its NFTL while a CDP hearing request is pending in response to a CDP Lien Notice. If the IRS begins a levy or proceeding during the time the suspension is in force, the IRS's action may be enjoined by a proceeding in the proper court.¹⁰⁸³

Pending CDP hearing requests do not prevent all collection-related actions. The IRS can take the following actions:

- The IRS may levy for tax periods and taxes covered by the CDP Lien Notice hearing if the CDP Levy Notice requirements have previously been met.
- The IRS may file NFTLs for the same tax and tax period stated on the CDP notice at another recording office.
- The IRS may take other non-levy collection actions such as starting judicial proceedings or offsetting overpayments from other periods against the tax shown on the CDP notice.
- The IRS may levy for the tax and tax period shown on the CDP notice to collect a state tax refund due the taxpayer, or if it determines that tax collection is in jeopardy.¹⁰⁸⁴

Filing a request for a full CDP hearing in response to a CDP Lien Notice or CDP Levy Notice causes a corresponding suspension of statutes of limitations. The statutes of limitations on collection under §6502 and on criminal prosecution under §6532 are suspended during the CDP hearing and judicial process, if any.¹⁰⁸⁵ The date the request is received is the date on which the suspension of the statutes of limitations begins.¹⁰⁸⁶ The suspension continues until the time for filing a petition for judicial review expires even if no petition is filed.¹⁰⁸⁷ The suspension also continues until a subsequent court action becomes final even if the petition for review is untimely.¹⁰⁸⁸

2. Equivalent Hearing

A taxpayer who fails to timely request a full CDP hearing may still seek an “equivalent hearing” before Appeals. A request for such a hearing is made using Form 12153. A taxpayer

must wait until the expiration of the 30-day period for requesting a full CDP hearing before submitting a request for an equivalent hearing as a request submitted before the expiration of the timeframe for requesting a full hearing will be considered as a request for a full CDP hearing.¹⁰⁸⁹

Appeals will generally follow the same procedures and will consider the same issues during an equivalent hearing as it would for a “full” CDP hearing.¹⁰⁹⁰

The statute of limitations and collection actions are not suspended during an equivalent hearing.¹⁰⁹¹ Suspension of collection action is not required, but Appeals may ask the IRS office to suspend collection activities or take other appropriate action.

There is no Tax Court review of an equivalent hearing decision. Tax Court review may be independently available, however, for denials regarding innocent spouse status under §6015(b), §6015(c), or §6015(f).¹⁰⁹²

D. Mandatory Hearing Issues

There are two issues for which a determination is required whether or not the issue is raised by the taxpayer in the CDP hearing. These “mandatory” hearing issues are the “verification of procedures” and the “balancing” of the efficiency and the intrusiveness of the collection action.¹⁰⁹³

1. Verification of Procedures

When a CDP hearing request is received, the Settlement Officer in the IRS Appeals Office reviews the case to see if applicable law and administrative procedures were met.¹⁰⁹⁴ The

¹⁰⁸⁹ Reg. §301.6330-1(i). See *Ruhaak v. Commissioner*, 157 T.C. No. 9 (2021) (taxpayer's request for equivalent hearing made before expiration of 30-day period following mailing date of levy notice triggers a full CDP hearing rather than an equivalent hearing, even if the box on Form 12153 requesting an equivalent hearing is checked).

If the taxpayer makes an untimely request for a CDP hearing and the IRS decides to grant an equivalent hearing, thereby providing the taxpayer with a final opportunity for administrative review before proceeding with enforced collection, the IRS's decision to conduct an equivalent hearing does not constitute a waiver of the time restrictions within which a taxpayer is required to request such a hearing. *Kennedy v. Commissioner*, 116 T.C. 255 (2001) (dismissing petition for review pursuant to §6330(d) for lack of jurisdiction on ground that the IRS did not make a determination because petitioner failed to file a timely request for Appeals office hearing pursuant to §6330(a)(2), §6330(a)(3)(B), and §6330(b)). See *Everman v. Commissioner*, T.C. Memo 2003-137. Submission processing centers should treat frivolous correspondence that contains language that can be reasonably construed as a request for an equivalent hearing as such a request. However, if the document contains vague language, the IRS will exercise discretion to require the taxpayer to verify that such a request is being made. SCA 200233001.

¹⁰⁹⁰ Reg. §301.6330-1(i)(2), Q&A-I1.

¹⁰⁹¹ Reg. §301.6320-1(i)(2), Q&A-I4; Reg. §301.6330-1(i)(2), Q&A-I3. In an unusual case, a taxpayer attempted to argue that his CDP request was intentionally filed *untimely*, and, therefore he was only entitled to an equivalent hearing, the purpose of which was to prevent the collection statute from extending, and thus rendering the IRS's levy untimely. See *Weiss v. Commissioner*, 147 T.C. 179 (2016), where the court held that the CDP request was timely, thus extending the collection statute.

¹⁰⁹² Reg. §301.6330-1(i)(2), Q&A-I6. *Moorhous v. Commissioner*, 116 T.C. 263 (2001).

¹⁰⁹³ §6330(c)(3)(A), §6330(c)(3)(C).

¹⁰⁹⁴ §6330(c)(1) (as referenced by §6320(c)). See, e.g., *Cropper v. Commissioner*, 826 F. 3d 1280 (10th Cir. 2016) (Appeals Officer did not abuse discretion in determining that IRS properly mailed deficiency notices to taxpayer's last known address and that IRS met all applicable requirements to proceed

¹⁰⁸¹ *ATL & Sons Holding, Inc. v. Commissioner*, 152 T.C. 138 (2019).

¹⁰⁸² §6330(e)(1), §6330(e)(2) (incorporated by reference in §6320(c)); Reg. §301.6330-1(g).

¹⁰⁸³ §6330(e)(1). However, the Tax Court does not have jurisdiction to enjoin the action or proceeding unless a timely appeal has been filed under §6330(d)(1). Even then, the Tax Court's jurisdiction is only in respect of the unpaid tax or proposed levy to which the determination being appealed relates.

¹⁰⁸⁴ Reg. §301.6320-1(g)(2), Q&A-G3.

¹⁰⁸⁵ §6320(c), §6330(e)(1); Reg. §301.6320-1(g)(1). See *United States v. Gillian*, 737 Fed. App'x 660 (4th Cir. 2018) (unpub.). The IRS will continue to accept voluntary payments made for the tax and tax period stated on the CDP notice. Reg. §301.6320-1(g)(2), Q&A-G3.

¹⁰⁸⁶ Reg. §301.6320-1(g)(2), Q&A-G1; *Boyd v. Commissioner*, 117 T.C. 127 (2001).

¹⁰⁸⁷ Reg. §301.6330-1(g)(1); *United States v. Kollman*, 774 F.3d 592 (9th Cir. 2014); *United States v. Weiss*, 461 F. Supp. 3d 183 (E.D. Pa. 2020) (suspension period includes time where taxpayer filed petition for writ of certiorari), *aff'd*, 52 F.4th 546 (3d Cir. 2022).

¹⁰⁸⁸ §6330(e)(1). See CCA 200215050 (if petition to Tax Court is untimely, the IRS should treat collection statute expiration date as suspended until court's dismissal is final; if petition is imperfect, CSED is suspended until 90th day after court's entry of decision to dismiss).

verification generally requires confirmation that the taxes were actually assessed and all legally required notices were issued. This includes determining whether:

- The tax was properly assessed.¹⁰⁹⁵
- The assessment was made before the expiration of the assessment statute of limitations.¹⁰⁹⁶
- The assessment was not barred by a prior closing agreement.¹⁰⁹⁷
- Notice and demand for payment was issued.¹⁰⁹⁸
- The deficiency notice underlying an audit assessment was sent to the taxpayer's last known address.¹⁰⁹⁹
- Letter 1153 proposing a Trust Fund Recovery Penalty was properly issued.¹¹⁰⁰
- The IRS properly mailed TEFRA notices under former §6223 and assessed the tax attributable to partnership items within the one-year suspension period in former §6229(d).¹¹⁰¹
- The assessment of a penalty was approved by a supervisor as required by §6751(b).¹¹⁰²
- An IRS jeopardy assessment was properly authorized.¹¹⁰³

with levy action). The officer is not required to rely on any particular document to satisfy the verification requirement. *Best v. Commissioner*, T.C. Memo 2014-72, *aff'd*, 702 Fed. Appx. 615 (9th Cir. 2017). The Tax Court has jurisdiction to consider verification issues (e.g., whether a deficiency notice was issued before assessment/regardless of whether the issues were raised at the CDP hearing). *Hoyle v. Commissioner*, 131 T.C. 197 (2008); *Talbot v. Commissioner*, T.C. Memo 2016-191, *aff'd*, 708 Fed. Appx. 421 (9th Cir. 2017); *Kearse v. Commissioner*, T.C. Memo 2019-53 (abuse of discretion where officer relied solely on IDRS to verify notice of deficiency was duly mailed despite taxpayer alleging irregularity).

¹⁰⁹⁵ *Ron Lykins, Inc. v. Commissioner*, 133 T.C. 87 (2009).

¹⁰⁹⁶ *Conway v. Commissioner*, 137 T.C. 209 (2011), *aff'd sub nom. Nakono v. Commissioner*, 552 Fed. Appx. 724 (9th Cir. 2014) (unpub.).

¹⁰⁹⁷ *Estate of Duran v. Commissioner*, 890 F.3d 192 (5th Cir. 2018).

¹⁰⁹⁸ *Conway v. Commissioner*, 137 T.C. 209 (2011), *aff'd sub nom. Nakono v. Commissioner*, 552 Fed. Appx. 724 (9th Cir. 2014) (unpub. op.).

¹⁰⁹⁹ *Cropper v. Commissioner*, 826 F.3d 1280 (10th Cir. 2016) (in determining that IRS properly mailed deficiency notices to taxpayer's last known address and met all applicable requirements to proceed with levy action); *Alamo v. Commissioner*, 751 Fed. Appx. 583 (4th Cir. 2019) (unpub.) (same). For a further discussion of last known address, see 630 T.M., *Tax Court Litigation*. In *Talbot v. Commissioner*, T.C. Memo 2016-191, *aff'd*, 708 Fed. Appx. 421 (9th Cir. 2017), the Tax Court determined that Appeals failed to verify the applicable procedures were met for deficiencies related to certain tax years (2007 to 2009), and consequently, the filed NFTL and proposed levy on the taxpayer's property for those tax years were rejected. The court explained the procedures included the settlement officer verifying that a deficiency notice was mailed to the taxpayer's correct address before the tax assessment. For tax years 2007 to 2009, the IRS's certified mailing list provided an incorrect address for the taxpayer and no other evidence was submitted to prove the officer verified a notice of deficiency was duly mailed. Accordingly, the court held the officer's determination to proceed with collection against the taxpayer for those tax years was an abuse of discretion. *Gurule v. Commissioner*, T.C. Memo 2015-61.

¹¹⁰⁰ *Lee v. Commissioner*, 144 T.C. 40 (2015).

¹¹⁰¹ See Notice CC-2016-007.

¹¹⁰² *Blackburn v. Commissioner*, 150 T.C. 218 (2018). *But see Laidlaws Harley Davidson Sales, Inc. v. Commissioner*, T.C. Memo 2023-90 (settlement officer did not abuse his discretion in failing to verify §6751(b) compliance because he would have been bound by the court's prior decision to impose the penalty; verification would have served no purpose). For a discussion of the §6751(b) supervisory approval requirements, see 634 T.M., *Civil Tax Penalties*.

The required verification is a simple verification, not a substantive review.¹¹⁰⁴

The Settlement Officer can typically verify most of the required procedures by reviewing an account transcript.¹¹⁰⁵ If irregularities are alleged or it is necessary to verify proper issuance of notices to the last known address, examining IRS computer records and other documents may be required.¹¹⁰⁶

2. Balancing Efficiency Versus Intrusiveness

The other mandatory issue that must be included in the IRS determination is balancing "the need for efficient collection of taxes" against "the legitimate concern ... that any collection action be no more intrusive than necessary."¹¹⁰⁷ The IRS notice of determination issued after the conclusion of the CDP hearing typically contains a boilerplate statement that the Settlement Officer performed this balancing. This is usually sufficient. Taxes must be collected. Collection without liens or levies is always "inefficient." Liens and levies are always "intrusive." Since liens and levies are almost required to collect the tax, however, they are rarely more intrusive "than necessary." Unless liens and levies create a hardship with little or no effect on collection, it is unlikely the IRS will fail to satisfy the balancing requirement if a balancing analysis is conducted.¹¹⁰⁸

Similarly, it is unlikely that the taxpayer can use the balancing requirement to force certain IRS collection action. The

¹¹⁰³ *Brown v. Commissioner*, T.C. Memo 2016-82, *aff'd*, 697 Fed. Appx. 1 (D.C. Cir. 2017) (unpub.).

¹¹⁰⁴ See *Laidlaws Harley Davidson Sales, Inc. v. Commissioner*, T.C. Memo 2023-90 (settlement officer did not abuse his discretion in failing to verify that IRS notice identifying reportable transaction was issued in accordance with the Administrative Procedure Act (APA), which was a substantive review not required by §6330(c)(1)).

¹¹⁰⁵ *Burke v. Commissioner*, 124 T.C. 189 (2005); *Davis v. Commissioner*, 115 T.C. 35 (2000).

¹¹⁰⁶ *Hoyle v. Commissioner*, 131 T.C. 197 (2008); *Peterson v. Commissioner*, T.C. Memo 2016-17; *Marlow v. Commissioner*, T.C. Memo 2010-113.

¹¹⁰⁷ §6330(c)(3)(C). See, e.g., *Living Care Alternatives of Utica, Inc. v. United States*, 411 F.3d 621 (6th Cir. 2005) (Appeals did not abuse discretion in performing balancing analysis required by §6330(c)(3)(C)). See also *Silvercrest Manor Nursing Home, Inc. v. Commissioner*, T.C. Memo 2017-96 (given value of taxpayer's assets exceeded underlying liability and taxpayer provided no proof of how it could comply with proposed installment agreement while claiming negative monthly revenue of over \$20,000, government's interest in efficiently collecting amounts taxpayer owed via levy simply tipped scale in government's favor); *Seminole Nursing Home, Inc. v. Commissioner*, T.C. Memo 2017-102 (case remanded to Appeals for reconsideration of §6330(c)(3)(C) balancing analysis where substantial mathematical error by Appeals may have affected Appeals' decision); *Kraft v. Commissioner*, 142 T.C. 259 (2014) (IRS settlement officer properly considered §6330(c)(3) factors and did not abuse his discretion by proceeding with proposed levy and declining taxpayer's request to levy against different source; IRS settlement officer also did not abuse his discretion by deciding not to address taxpayer's 2010 and 2011 liabilities at time when written notice for taxpayer's 2010 and 2011 tax years advising taxpayer of his right to §6330 hearing had not yet been sent); *Fincourt B Shelton P.C. v. Commissioner*, T.C. Memo 2013-273 (no abuse of discretion in reversing status as currently not collectible defunct corporation where taxpayer-corporation filed tax returns and paid taxes for multiple periods after informing IRS of intention to close).

¹¹⁰⁸ See *Budish v. Commissioner*, T.C. Memo 2014-239 (Appeals officer failed to properly balance need for efficient collection with taxpayer's concern that collection action be no more intrusive than necessary where officer decided notice of lien should be filed due to mistaken belief that officer lacked discretion to do otherwise under IRM and in disregard of taxpayer's presentation of evidence of potential financial hardship). See also IRM 8.22.9.6.7 (11-13-13).

taxpayer will have a difficult time proving that a particular collection action should be mandated under the balancing test.¹¹⁰⁹

E. *Optional Issues Raised by Taxpayer*

As set forth in §6330(c)(3)(B), the IRS must make a third determination. The Settlement Officer must determine whether issues *actually raised* in the hearing by the taxpayer have merit. These issues are “optional” in the sense that the issues need not be included in the CDP determination if the issues were not actually raised in the CDP hearing.¹¹¹⁰

These optional issues that must be affirmatively raised by the taxpayer include:

- challenges to the underlying liability;
- spousal defenses;
- challenges to the appropriateness of collection actions; and
- proposed collection alternatives, including a bond, substitution of assets, an installment agreement, or an offer in compromise.¹¹¹¹

1. *Challenge to “Underlying Liability”*

a. *Scope of Underlying Liability*

The heading to §6330(c)(2)(B) references “underlying liability,” but the text references “underlying tax liability.” “Underlying tax liability” refers to any amounts that the IRS assessed for a particular tax period. The term is not limited literally to “tax.” Interest and penalties may also be challenged in a CDP hearing.¹¹¹²

The underlying liability is also not limited to traditional “deficiency” taxes set forth in §6211. This derives from the literal language of §6330(c)(2)(B) which allows the taxpayer to challenge “the existence or amount of the underlying liability ... if the [taxpayer] ... did not otherwise have an opportunity to dispute such tax liability.”

It is unclear if payment issues constitute a challenge to the “liability.” The Tax Court seems to limit “liability” to the amount of tax or penalty for the applicable period, while payments, credits, or carrybacks are considered under an abuse of discretion standard.¹¹¹³ The Tax Court further limits consideration of amounts and credits from other periods to situations in which the credits or carrybacks have already been determined for those other periods.¹¹¹⁴ The refund statute of limitations for the credit year must also be considered to see if the credit is available.¹¹¹⁵

¹¹⁰⁹ *Kraft v. Commissioner*, 142 T.C. 259 (2014).

¹¹¹⁰ *Gentile v. Commissioner*, 592 Fed. Appx. 824 (11th Cir. 2014) (unpub.), *aff’d* T.C. Memo 2013-175; *Magana v. Commissioner*, 118 T.C. 488 (2002).

¹¹¹¹ §6330(c)(2).

¹¹¹² *ATL & Sons Holdings, Inc. v. Commissioner*, 152 T.C. 138 (2019).

¹¹¹³ Note: It is not entirely clear whether the application of credits or net operating losses constitute a challenge to the underlying liability. See *Dixon v. Commissioner*, 141 T.C. 173 (2014); *Frieje v. Commissioner*, 125 T.C. 14 (2005) (application of credits among years considered under abuse of discretion standard); *Rivah v. Commissioner*, 584 Fed. Appx. 811 (9th Cir. 2014) (unpub.) (equitable recoupment of NOLs considered). But see *Landry v. Commissioner*, 116 T.C. 60 (2001) (accuracy of credit application in prior years considered under *de novo* standard as challenge to liability).

The following additional liability challenges can be made in a CDP hearing if there was no prior opportunity to dispute the issue:

- Employment taxes;¹¹¹⁶
- Trust fund recovery penalties;¹¹¹⁷
- Other assessable penalties;¹¹¹⁸
- An interest abatement claim;¹¹¹⁹
- Whether the underlying tax was discharged in a bankruptcy proceeding;¹¹²⁰
- Whether the collection statute of limitations had expired.¹¹²¹

b. *No Prior Opportunity to Dispute*

The taxpayer may challenge the underlying liability only if the taxpayer “did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability.”¹¹²² This statutory preclusion is triggered by the opportunity to contest the underlying liability, even if the opportunity is not pursued.¹¹²³

One issue that may arise in TEFRA cases concerns the interplay of NOL carryforwards arising from a year for which a deficiency is assessed for the NOL year but the taxpayer does not receive a CDP hearing with regard to any carryforward years. In *Amanda Iris Gluck Irrevocable Tr. v. Commissioner*,¹¹²⁴ the taxpayer was a direct and indirect partner in several TEFRA partnerships. In 2012, one of the partnerships sold a property and allegedly failed to report its entire distributive share of the gain. The IRS adjusted the taxpayer’s 2012–2015

¹¹¹⁴ *Weber v. Commissioner*, 138 T.C. 348 (2012); *Shuman v. Commissioner*, T.C. Memo 2018-135; *Morgan v. Commissioner*, T.C. Memo 2018-98; *Del-Co Western v. Commissioner*, T.C. Memo 2015-142.

¹¹¹⁵ *Linton v. Commissioner*, 123 AFTR 2d 2019-787 (10th Cir. 2019).

¹¹¹⁶ *Blue Lake Rancheria Econ. Dev. Corp. v. Commissioner*, 152 T.C. 90 (2019).

¹¹¹⁷ *Mason v. Commissioner*, 132 T.C. 301 (2009).

¹¹¹⁸ *Gardener v. Commissioner*, 145 T.C. 161 (2015), *aff’d*, 704 Fed. Appx. 720 (9th Cir. 2017) (unpub.) (§6700 penalties); *Yari v. Commissioner*, 143 T.C. 157 (2014), *aff’d*, 669 Fed. Appx. 489 (9th Cir. 2016) (unpub.) (§6707A penalty); *Callahan v. Commissioner*, 130 T.C. 44 (2008) (frivolous return penalty); *Shaw v. Commissioner*, T.C. Memo 2010-210.

¹¹¹⁹ *Hoffman v. Commissioner*, 119 T.C. 140 (2002); *Wright v. Commissioner*, T.C. Memo 2002-312; *Merriweather v. Commissioner*, T.C. Memo 2002-226.

¹¹²⁰ *Washington v. Commissioner*, 120 T.C. 114 (2003); *Colvin v. Commissioner*, T.C. Memo 2010-235. See also *Ferguson v. Commissioner*, 568 F.3d 498 (5th Cir. 2009) (Tax Court does not have similar jurisdiction to consider whether taxes were discharged in a §6213 deficiency case).

¹¹²¹ *Jordan v. Commissioner*, 134 T.C. 1 (2010); *Boyd v. Commissioner*, 117 T.C. 127 (2001).

¹¹²² §6330(c)(2)(B) (as referenced by §6320(c)); Reg. §301.6320-1(e)(1). See, e.g., *Lepore v. Commissioner*, T.C. Memo 2013-135 (taxpayer did not have prior opportunity to contest underlying §6672 trust fund recovery penalty where he did not personally receive Letter 1153; court found receipt of letter by son who then misplaced it and never informed taxpayer was insufficient notice for purposes of §6330(c)(2)(B)); *Cropper v. Commissioner*, 826 F.3d 1280 (10th Cir. 2016).

¹¹²³ *Goza v. Commissioner*, 114 T.C. 176 (2000); *Bell v. Commissioner*, 126 T.C. 356 (2006) (taxpayer had opportunity to contest liability by virtue of receiving notice even though IRS erroneously informed him that he could not contest the liability). See *Nestor v. Commissioner*, 118 T.C. 162 (2002); *Sego v. Commissioner*, 114 T.C. 604 (2000).

¹¹²⁴ 154 T.C. 259 (2020).

returns via a computational adjustment pursuant to §6231(a) (6) resulting in the elimination of an NOL claimed by the taxpayer for 2012 and disallowing NOL carryforward deductions claimed by the partnership for tax years 2013–2015, creating balances due for those years. The IRS immediately assessed the resulting tax and eventually sought to levy to collect the taxes due for 2013–2015. The taxpayer ultimately petitioned the Tax Court seeking to challenge the CDP determinations regarding its underlying tax liabilities for 2012–2015. The IRS moved to dismiss as to 2012 and 2013, noting that 2012 was never before the court and that the 2013 liability had been fully satisfied by the application of credits from other years. The IRS also moved for summary judgment as to 2014 and 2015.

The Tax Court ultimately determined that the partnership was entitled to challenge its underlying liabilities for 2014 and 2015 because it had no prior opportunity to do so as required by §6330(c)(2)(B). Citing prior decisions, the court explained that the “prior opportunity” language in §6330(c)(2)(B) means an opportunity to dispute the liability in a *prepayment* posture,¹¹²⁵ and the taxpayer did not have such an opportunity as the liabilities arose from computational adjustments. The court noted that while it generally lacks jurisdiction to review computational adjustments in deficiency proceedings under §6330(a)(1), its review in CDP cases is not so limited, i.e., it can review underlying liabilities from such adjustments in a CDP setting.¹¹²⁶

However, a TEFRA partner that has received a Notice of Beginning of Administrative Proceeding (NBAP) or Notice of Final Partnership Administrative Adjustment (FPAA) and who fails to make a §6223(e)(2) or §6223(e)(3) election cannot later contest their partnership tax liability in a Collection Due Process (CDP) hearing because the TEFRA proceeding is the proper and only venue to challenge partnership tax liabilities.¹¹²⁷

Another unresolved question is whether a prior “opportunity” to challenge an underlying liability under §6330(c)(2) (B) refers to an administrative review, judicial proceeding, or both. Reg. §301.6320-1(e)(3) interprets a prior “opportunity” to mean an administrative review or litigation. The courts have generally agreed that a prior opportunity to contest a liability in Appeals is sufficient to preclude another opportunity in a CDP hearing. This is based on (1) the reasonableness of the interpretation in the regulation, (2) the plain language of §6330(c)(2)(B) on its face; (3) the statute’s surrounding text; and (4) §6330(c)(4)(A) and the purpose of the 1998 IRS Restructuring and Reform Act, which intended to provide taxpayers oppor-

tunities to seek meaningful liability review through informal means short of litigation.¹¹²⁸

The IRS historically has made a concerted effort to narrow the challenges to the underlying liability in a CDP hearing. The following events constitute a prior opportunity to dispute the tax liability, thereby eliminating the ability to challenge the liability in a CDP hearing:

- The taxpayer received a notice of deficiency in sufficient time to file a Tax Court petition but did not do so.¹¹²⁹
- The IRS issued a notice of deficiency or other proposed assessment but the taxpayer did not actually receive it because the taxpayer refused delivery.¹¹³⁰
- The taxpayer received Letter 1153 proposing the §6672 Trust Fund Recovery Penalty and did not file an administrative appeal.¹¹³¹

¹¹²⁸ *Keller Tank Services II, Inc. v. Commissioner*, 854 F.3d 1178 (10th Cir. 2017) (referencing *Chevron, U.S.A., Inc. v. Nat’l Res. Def. Council, Inc.*, 467 U.S. 837 (1984)). The Fourth and Seventh Circuits have reached the same conclusion. See *Our Country Home Enters., Inc. v. Commissioner*, 855 F.3d 773 (7th Cir. 2017); *Iames v. Commissioner*, 850 F.3d 160 (4th Cir. 2017).

¹¹²⁹ Reg. §301.6330-1(e)(3), Q&A, E-2; *Haminski v. Commissioner*, 679 Fed. Appx. 926 (11th Cir. 2017) (unpub.); *Lewis v. Commissioner*, 128 T.C. 48 (2007) (upholding validity of Reg. §301.6330-1(e)(3), Q&A, E-2); *Behling v. Commissioner*, 118 T.C. 572 (2000) (taxpayer barred from challenging underlying liability if taxpayer received notice of deficiency even if it is considered by Appeals Officer); *Lacy-Thompson v. Commissioner*, T.C. Memo 2014-137 (petitioners may not dispute remaining balance of accuracy-related penalty under §6330(c)(2)(B) because they had opportunity to, and they did, dispute entire accuracy-related penalty at hearing with Appeals Office representative and, as a result of that hearing, petitioners and Appeals Office representative executed Form 870-AD). See also *Kuykendall v. Commissioner*, 129 T.C. 77 (2007) (for purposes of Reg. §301.6330-1(e)(3), 12 days was insufficient time to allow taxpayers to petition the Tax Court); *Looper v. Commissioner*, 73 T.C. 690 (1980) (17 days was insufficient); *Sicker v. Commissioner*, 815 F.2d 1400 (11th Cir. 1987) (receipt of notice of deficiency with only 8 days remaining was insufficient to permit timely filing of petition).

¹¹³⁰ *Sego v. Commissioner*, 114 T.C. 604 (2000) (taxpayer’s refusal to accept delivery still constitutes receipt); *Onyango v. Commissioner*, 142 T.C. 425 (2014), *aff’d*, 638 Fed. Appx. 5 (D.C. Cir. 2016) (failure to check for mail precludes claim of nonreceipt); *Giaquinto v. Commissioner*, T.C. Memo 2013-150 (taxpayer was deemed to have refused delivery when he failed to respond to two delivery notices left at his residence and could not offer a plausible explanation for such failure); *Rivas v. Commissioner*, T.C. Memo 2017-56 (evidence of placing notice in custody of U.S. Postal Service established presumption of delivery, so notice of deficiency marked “Undelivered” indicated taxpayer failed to accept or refused delivery, thus it is deemed received).

¹¹³¹ See *Totten v. United States*, 2007-1 USTC ¶50,502 (W.D. Wash. 2007) (prior appeal precludes review of liability in CDP case); *Pelliccio v. United States*, 253 F. Supp. 2d 258 (D. Conn. 2003) (taxpayer, who received Form Letter 1153 before each assessment of §6672 penalty but did not avail himself of alternatives provided in letter, could not challenge liability in a CDP hearing); *Walker v. United States*, 2003-1 USTC ¶50,157 (S.D. Cal. 2002) (due to chance to dispute §6672 penalty before effective date of §6330, taxpayer was not entitled to dispute liability in CDP hearing); *Solucorp Ltd. v. Commissioner*, T.C. Memo 2013-118 (petitioner precluded from challenging underlying liabilities because it did not respond to or contest proposed assessment of TFRPs set forth in Letter 1153). But see *Barnhill v. Commissioner*, 155 T.C. 1 (2020) (taxpayer received Letter 1153, timely submitted protest, but did not receive subsequent Letter 5157 to schedule conference; summary judgment denied); *Lepore v. Commissioner*, T.C. Memo 2013-135 (taxpayer did not have prior opportunity to contest underlying §6672 trust fund recovery penalty where he did not personally receive Letter 1153; court found receipt of letter by son who then misplaced it and never informed taxpayer was insufficient notice for purposes of §6330(c)(2)(B)).

¹¹²⁵ See, e.g., *Credit-Guard of Am., Inc. v. Commissioner*, 149 T.C. 370 (2017); *Sugarloaf Fund LLC v. Commissioner*, 141 T.C. 214 (2013).

¹¹²⁶ See *Yari v. Commissioner*, 143 T.C. 157 (2014) (§6330(d)(1) expanded Tax Court’s review to include penalties not otherwise reviewable in a deficiency action), *aff’d*, 669 Fed. Appx. 489 (9th Cir. 2016); *Callahan v. Commissioner*, 130 T.C. 44 (2008).

¹¹²⁷ See §6330(c)(4)(C). See also, e.g., *Goldberg v. Commissioner*, T.C. Memo 2021-119, *aff’d* Nos. 22-1084 & 22-1085 (7th Cir. July 14, 2023) (when an NBAP or FPAA is properly furnished to the partner, the only venue for the partner to challenge their partnership tax liability is a TEFRA proceeding unless a timely §6223(e)(2) or §6223(e)(3) election is made; the partners’ attempted TEFRA statute of limitations challenge in a CDP hearing in the case at bar was an improper attempt to appeal their underlying partnership tax liability, which had been decided in an earlier TEFRA partnership proceeding). TEFRA audit procedures are discussed further in 624 T.M., *Audit Procedures for Pass-Through Entities*, and BBA audit procedures are discussed further in 629 T.M., *The Partnership Audit Rules Under the Bipartisan Budget Act*.

- The taxpayer or the taxpayer's representative signed IRS Form 4549, IRS Form 2751, or a similar document consenting to the assessment of an increased liability.¹¹³²
- The taxpayer participated in a prior administrative or judicial proceeding in which the issue could have been raised.¹¹³³
- The taxpayer received a prior CDP notice for the same liability and did not file a CDP request.¹¹³⁴
- The taxpayer filed a prior bankruptcy case in which the liability *could have been* contested.¹¹³⁵

On the other hand, challenges have been allowed in the following situations:

- The tax reported by the taxpayer in the original return was allegedly too high.¹¹³⁶

¹¹³² *Deutsch v. Commissioner*, 478 F.3d 450 (2d Cir. 2007), (representative signature on Form 4549 constituted prior opportunity to challenge merits); *Aguire v. Commissioner*, 117 T.C. 324 (2001) (execution of Form 4549 is waiver of administrative and judicial rights to review of underlying tax liability); *Pough v. Commissioner*, 135 T.C. 344 (2010) (signing Form 2751 precluded challenge to TFRP); *Potts v. Commissioner*, T.C. Memo 2017-228 (Appeals settlement on Form 870-AD precludes challenge to liability).

¹¹³³ §6330(c)(4) (as referenced by §6320(c)); Reg. §301.6320-1(e)(1). See *James v. Commissioner*, 850 F.3d 160 (4th Cir. 2017) (where taxpayer protested civil penalty with Appeals before tax was assessed, pre-assessment hearing before Appeals is opportunity to dispute tax liability and taxpayer is barred from disputing underlying liability in CDP proceeding); *Hassel Family Chiropractic, DC, PC v. Commissioner*, 368 Fed. Appx. 695 (8th Cir. 2010) (unpub.) (prior appeal on employee classification issue constitutes prior opportunity); *Golden v. Commissioner*, 548 F.3d 487 (6th Cir. 2008) (challenge to assessment statute of limitations barred by prior opportunity); *Gardener v. Commissioner*, 704 Fed. Appx. 729 (9th Cir. 2017) (unpub.) (prior litigation triggers collateral estoppel); *Lander v. Commissioner*, 154 T.C. 7 (2020) (prior opportunity to dispute liability occurred when Appeals Officer took fresh look at record, conceded some issues, significantly reduced portion of tax previously assessed against taxpayers, and even invited them to contact him if they had additional questions); *Stroube v. Commissioner*, 130 T.C. 257 (2008) (fraud on court must be raised in prior case); *Lewis v. Commissioner*, 128 T.C. 48 (2007) (prior penalty appeal precluded challenge to penalty in CDP); *Magana v. Commissioner*, 118 T.C. 488 (2002) (based on statute and on collateral estoppel, taxpayer may not assert that no effective extension of limitations period was executed where contention was adjudicated in prior district court proceeding); *Rodriguez v. Commissioner*, T.C. Memo 2003-153 (untimeliness of notice of deficiency had to be raised in deficiency proceeding); *West v. Commissioner*, T.C. Memo 2010-250; *Galloway v. Commissioner*, T.C. Memo 2021-24 (taxpayer could not raise prior rejection of OIC by appeals in new CDP hearing as prior consideration by Appeals constituted administrative proceeding within meaning of §6330(c)(4)(A); mere fact that settlement officer addressed prior OIC did not revive the issue), *aff'd*, No. 21-2269, 2022 BL 44513 (7th Cir. Feb. 9, 2022).

¹¹³⁴ Reg. §301.6330-1(e)(3), Q&A-E7; *Jeffers v. Commissioner*, 992 F.3d 649 (7th Cir. 2021) (previous CDP notice qualified as prior opportunity to challenge underlying tax liability even though taxpayer did not file CDP request); *Smith v. Commissioner*, T.C. Memo 2016-186.

¹¹³⁵ *Silverman v. Commissioner*, 2010-1 USTC ¶50,348 (9th Cir. 2010); *Kendricks v. Commissioner*, 124 T.C. 69 (2005) (failure to object to proof of claim precludes later challenge to the underlying liability); *PCT Servs., Inc. v. United States*, 2003-2 USTC ¶50,536 (N.D. Ga. 2003) (earlier bankruptcy proceeding gave chance to challenge underlying liability).

¹¹³⁶ Reg. §301.6320-1(e)(1). See *Montgomery v. Commissioner*, 122 T.C. 1 (2004) (§6330(c)(2)(B) extends protections of CDP process to taxpayer who may have erred in preparing and filing original income tax return if taxpayer did not receive deficiency notice and did not otherwise have chance to dispute liability). The IRS is not required to accept an amended return if paper support is not provided. *Cantrell v. Commissioner*, 576 Fed. Appx. 439 (5th Cir. 2014) (unpub.).

- The notice of deficiency was mailed to the taxpayer's last known address but was not actually received.¹¹³⁷
- The notice of deficiency was received too late to file a timely petition.¹¹³⁸
- The taxpayer did not actually receive Letter 1153 proposing the Trust Fund Recovery Penalty or was not allowed a preassessment appeal when a protest was filed.¹¹³⁹
- The taxpayer did not actually receive a notice of determination of worker classification.¹¹⁴⁰
- An appeal of the liability was filed but did not conclude before the CDP notice was issued.¹¹⁴¹
- The taxpayer asserted that the collection statute of limitations had expired.¹¹⁴²
- A notice of tax lien was sent for late filing penalties, and it was not clear whether a penalty abatement proceeding had been offered or occurred before the taxpayer's request for a CDP hearing.¹¹⁴³

¹¹³⁷ *Yasgur v. Commissioner*, T.C. Memo 2016-77 (mailing to wife not received by separated spouse); *Garrett v. Commissioner*, T.C. Memo 2015-228 & T.C. Memo 2016-179 (presumption of delivery resulted so summary judgment denied but delivery untimely found at trial).

¹¹³⁸ *Kuykendall v. Commissioner*, 129 T.C. 77 (2007) (receipt 12 days before petition due date insufficient); *Conn v. Commissioner*, T.C. Memo 2008-186 (no receipt shown while husband in prison); *Shrere v. Commissioner*, T.C. Memo 2006-29 (no receipt if no evidence of deliberate refusal of delivery); *Yasgur v. Commissioner*, T.C. Memo 2016-77 (married taxpayer living apart from wife neither received nor deliberately refused receipt of levy notice mailed to him at last known address and thus could challenge his underlying tax liability). See CCA 201518016 (IRS has no authority to abate assessment where Appeals Officer cannot verify that deficiency notice was mailed to taxpayer's last known address, taxpayer does not remember receiving notice, and IRS has not yet concluded that assessment is invalid).

¹¹³⁹ *Mason v. Commissioner*, 132 T.C. 301 (2009); *Fitzpatrick v. Commissioner*, T.C. Memo 2016-179; *Barry v. Commissioner*, T.C. Memo 2010-57; *Lee v. Commissioner*, 144 T.C. 40 (2015); *Obiakor v. Commissioner*, T.C. Memo 2015-112 (Tax Court can review when taxpayer denies that personal service of notice occurred). *But cf. Giaquinto v. Commissioner*, T.C. Memo 2013-150 (taxpayer cannot challenge the Trust Fund Recovery Penalty assessed in a Letter 1153 when taxpayer deliberately refused to accept the letter's delivery). *Romano-Murphy v. Commissioner*, 816 F.3d 707 (11th Cir. 2016) (IRS failure to allow appeal after protest allows CDP review).

¹¹⁴⁰ *Hampton Software Dev., LLC v. Commissioner*, T.C. Memo 2016-38.

¹¹⁴¹ In *Perkins v. Commissioner*, 129 T.C. 58 (2007), the Tax Court held that a taxpayer had not had an opportunity to dispute his underlying tax liability where the IRS had issued a notice of intent to levy but did not allow him to challenge the assessment at the CDP hearing. Before the CDP hearing was scheduled, Appeals had responded to a letter that the taxpayer had previously forwarded to Appeals by treating it as an abatement request and denying it despite the fact that it had been sent after the period for requesting an abatement had expired. The Appeals employee conducting the later CDP hearing then denied the taxpayer the opportunity to challenge the underlying tax liability on the grounds that his prior letter to Appeals regarding the assessment constituted a prior opportunity to dispute the liability. Likewise, in *Barnhill v. Commissioner*, 155 T.C. 1 (2020), the court distinguished between a vehicle that gives rise to an opportunity to challenge an underlying liability, and the actual "opportunity" itself. In *Barnhill*, the taxpayer timely submitted a protest in response to a Letter 1153, but did not receive the subsequent Letter 5157 to schedule a conference. The court stated that if a taxpayer takes all the steps necessary to avail himself of an opportunity to challenge an underlying liability, then §6330(c)(2)(B) requires that the taxpayer realize that opportunity and thus, denied summary judgment to the IRS.

¹¹⁴² *Jordan v. Commissioner*, 134 T.C. 1 (2010); *Graur v. Commissioner*, T.C. Memo 2016-52; *Reinhart v. Commissioner*, T.C. Memo 2014-218.

¹¹⁴³ *VICA Technologies, LLC v. Commissioner*, T.C. Summ. Op. 2019-7.

Making an offer-in-compromise based on doubt as to liability is considered a challenge to the underlying tax liability and cannot be made in the context of a CDP hearing if the taxpayer had a prior opportunity to dispute the liability.¹¹⁴⁴

2. Challenges to the Appropriateness of Collection Actions

There may be technical issues concerning the propriety of a lien or proposed levy. These issues must also be considered by the Settlement Officer if the taxpayer raises the issues in the CDP hearing.¹¹⁴⁵

3. Innocent Spouse Relief

The taxpayer can raise appropriate spousal defenses under §66 or §6015 which were not raised in a prior judicial proceeding unless the IRS already has made a final determination as to such defenses in a notice of deficiency or a final determination letter. The existence of a prior deficiency proceeding should only preclude raising the issue in the CDP hearing if the person claiming innocent spouse relief participated meaningfully in the deficiency case.¹¹⁴⁶

4. Collection Alternatives

If the proper procedures were followed and the underlying liability is not challenged or is determined to be due, the final issue is typically whether the IRS considered available collection alternatives. The taxpayer can suggest collection alternatives, including an installment agreement, posting a bond, substitution of assets, or an offer in compromise.¹¹⁴⁷ A CDP hearing often presents the best opportunity to obtain one of these collection alternatives due to the increased involvement of the Settlement Officer and the availability of judicial review. It is therefore critical for the taxpayer to stay in current compliance, comply with all requests for information, and vigorously pursue the proposed collection alternative throughout the CDP hearing process. Failing to comply with these basic require-

ments gives the Settlement Officer an “easy out” for refusing to consider a proposed collection alternative.¹¹⁴⁸

5. TEFRA/BBA Partnership Procedures

Former §6221 requires that the tax treatment of partnership items be determined at the partnership level. The IRS position is that since CDP proceedings are a partner-level proceeding, a taxpayer may not challenge the underlying tax liability regarding the tax treatment of partnership items in a CDP proceeding. This is true even if the taxpayer never receives an FPAA that was otherwise properly addressed and mailed.¹¹⁴⁹ The taxpayer may challenge the penalties related to a TEFRA adjustment, however, if no prior opportunity to contest the liability was available.¹¹⁵⁰

The IRS contends a partner may not raise the statute of limitations in the CDP hearing if the partner failed to raise the issue in a timely filed petition in response to the FPAA.¹¹⁵¹ The same prohibition applies even if there was no action filed in response to the FPAA.¹¹⁵²

When there is at least one TEFRA assessment that has not been resolved, the IRS generally will not consider an OIC and will seek to have the taxpayer withdraw the OIC until the issues have been resolved.¹¹⁵³

One issue that may arise in TEFRA cases concerns the interplay of NOL carryforwards arising from a year for which a deficiency is assessed for the NOL year but the taxpayer does not receive a CDP hearing with regard to any carryforward years. In *Amanda Iris Gluck Irrevocable Tr. v. Commissioner*,¹¹⁵⁴ the taxpayer was a direct and indirect partner in several TEFRA partnerships. In 2012, one of the partnerships sold a property and allegedly failed to report its entire distributive share of the gain. The IRS adjusted the taxpayer’s 2012–2015 returns via a computational adjustment pursuant to §6231(a) (6), resulting in the elimination of an NOL claimed by the taxpayer for 2012 and disallowing NOL carryforward deductions claimed by the partnership for tax years 2013–2015, creating balances due for those years. The IRS immediately assessed the resulting tax and eventually sought to levy to collect the taxes due for 2013–2015. The taxpayer ultimately petitioned the Tax Court seeking to challenge the CDP determinations regarding its underlying tax liabilities for 2012–2015. The IRS moved to dismiss as to 2012 and 2013, noting that 2012 was never before

¹¹⁴⁴ *Baltic v. Commissioner*, 129 T.C. 178 (2007).

¹¹⁴⁵ §6330(c)(2)(A), §6330(c)(3)(C); Reg. §301.6320-1(e)(3), Q&A-E1, §301.6330-1(e). See also *Morgan v. Commissioner*, 345 F.3d 563 (8th Cir. 2003) (IRS levy on certain bankruptcy-exempt assets allowed; in absence of affirmative misconduct by IRS, no estoppel for taxpayer against IRS for statements by agent that no collection would occur); CCA 199939034 (§6330 procedures applied to levy made to collect tax of partner to bilateral income tax treaty containing collection assistance articles, but taxpayer could raise only procedural issues).

¹¹⁴⁶ Reg. §301.6330-1(e)(2); Reg. §301.6330-1(e)(3), Q&A-E3 (spousal defenses not subject to limitations imposed by §6330(c)(2)(B)), Q&A-E4 (situations precluding taxpayer from raising spousal defenses).

¹¹⁴⁷ §6330(c)(2)(A) (as referenced by §6320(c)); Reg. §301.6320-1(e). In *Reed v. Commissioner*, 141 T.C. 248 (2013), *motion for reconsideration denied*, T.C. Memo 2013-273 (2014), a taxpayer in a CDP hearing following a notice of intent to levy requested that an offer in compromise that had been returned to him years earlier be reopened. The Tax Court held that the IRS was not required to reopen an offer in compromise based on doubt as to collectibility in a CDP hearing where the offer was returned to the taxpayer years before commencement of hearing. The court further held that the Settlement Officer did not abuse his discretion in sustaining the proposed levy action in light of the returned offer. In denying the subsequent motion for reconsideration, the Tax Court stated that the offer was not declined but was returned because the taxpayer was not current in compliance with his federal tax obligations at the time the offer was submitted. Further, the court noted that the taxpayer did not request additional time to comply with the current obligations, and neither the FAQs on the IRS website nor IRM provisions confer enforceable rights on taxpayers for additional time to comply.

¹¹⁴⁸ See XI.H.5.d., below, for examples of the Tax Court’s application of the abuse of discretion standard of review.

¹¹⁴⁹ See *Hudspeth v. Commissioner*, T.C. Memo 2005-83, *aff’d*, 177 Fed. Appx. 326 (4th Cir. 2006); *Crowell v. Commissioner*, 102 T.C. 683 (1994); CC-2016-007 (March 21, 2016) (IRS attorneys should argue that former §6221 precludes taxpayer from challenging any deficiency attributable to partnership item that was determined under TEFRA procedures either through final adjudication by court or default of FPAA).

¹¹⁵⁰ *McNeill v. Commissioner*, 148 T.C. 481 (2017).

¹¹⁵¹ See, e.g., *Taurus FX Partners v. Commissioner*, T.C. Memo 2013-168 (statute of limitations on assessment of tax attributable to partnership items (or affected items) is affirmative defense that may only be raised in timely filed petition in response to FPAA).

¹¹⁵² See IRS Chief Counsel Notice CC-2016-007 (Mar. 21, 2016).

¹¹⁵³ See IRM 5.8.4.17.2 (09-24-20), 8.23.3.9.4(1) (10-15-14); *Brown v. Commissioner*, T.C. Memo 2019-121 (Sept. 16, 2019) (Settlement Officer did not abuse her discretion in returning and closing taxpayer’s OIC case given that taxpayer was subject to open TEFRA audit).

¹¹⁵⁴ 154 T.C. 259 (2020).

the court and that the 2013 liability had been fully satisfied by the application of credits from other years. The IRS also moved for summary judgment as to 2014 and 2015.

The Tax Court ultimately determined that the partnership was entitled to challenge its underlying liabilities for 2014 and 2015 because it had no prior opportunity to do so as required by §6330(c)(2)(B). Citing prior decisions, the court explained that the “prior opportunity” language in §6330(c)(2)(B) means an opportunity to dispute the liability in a *prepayment* posture,¹¹⁵⁵ and the taxpayer did not have such an opportunity as the liabilities arose from computational adjustments. The court noted that while it generally lacks jurisdiction to review computational adjustments in deficiency proceedings under §6330(a)(1), its review in CDP cases is not so limited, i.e., it can review underlying liabilities from such adjustments in a CDP setting.¹¹⁵⁶

F. Conduct of CDP Hearing

1. Impartial Settlement Officer

The CDP hearing is typically conducted by an Appeals Settlement Officer, an IRS employee who is not subject to the Appointments Clause restrictions in hiring.¹¹⁵⁷ The CDP hearing must be conducted by an impartial Settlement Officer who had “no prior involvement” with the unpaid taxes.¹¹⁵⁸ The “pri-

¹¹⁵⁵ See, e.g., *Credit-Guard of Am., Inc. v. Commissioner*, 149 T.C. 370 (2017); *Sugarloaf Fund LLC v. Commissioner*, 141 T.C. 214 (2013).

¹¹⁵⁶ See *Yari v. Commissioner*, 143 T.C. 157 (2014) (§6330(d)(1) expanded Tax Court’s review to include penalties not otherwise reviewable in a deficiency action), *aff’d*, 669 Fed. Appx. 489 (9th Cir. 2016); *Callahan v. Commissioner*, 130 T.C. 44 (2008).

¹¹⁵⁷ *Tucker v. Commissioner*, 135 T.C. 114 (2010). See also *Tooke v. Commissioner*, 164 T.C. No. 2, 2025 BL 27956 (2025) (taxpayer lacked standing to challenge Chief of Appeals position under Appointment Clause; Appeals Officers and Appeals Team Managers are not Officers of the United States requiring appointment in accordance with Appointments Clause).

¹¹⁵⁸ §6330(b)(1)–§6330(b)(3); Reg. §301.6330-1(b), §301.6330-1(d)(2), Q&A-D4; *MRCA Info. Servs. v. United States*, 2000-2 USTC ¶50,683 (D. Conn. 2000). See also *Cox v. Commissioner*, 514 F.3d 1119 (10th Cir. 2008), *rev’g* 126 T.C. 367 (2006), where the Tenth Circuit, reversing the Tax Court, held that an Appeals Officer’s CDP hearing for tax year 2000 that considered the taxpayers’ failure to pay for 2001 and 2002 constituted prohibited “prior involvement” under §6330(b)(3) such that he could not later handle a CDP hearing for the 2001 and 2002 taxes. Finding the text of §6330(b)(3) to be a clear expression of congressional intent, the court indicated that its holding would, by implication, invalidate Reg. §301.6330-1(d)(2), which expressly excludes prior CDP hearings from the definition of “prior involvement.” In AOD 2009-01 (June 1, 2009), however, the IRS Chief Counsel announced its nonacquiescence to the Tenth Circuit’s opinion and its intent to continue litigation in cases other than those in the Tenth Circuit. The IRS Chief Counsel concluded that the Tenth Circuit incorrectly determined that the term “involvement” had a plain meaning, noting that the term was not defined in the statute or in legislative history, was inherently ambiguous, and did not give proper deference to the IRS’s construction of “involvement” in the regulations. The IRS Chief Counsel explained that an Appeals officer is not legally precluded under the “no prior involvement” language found in §6330(b)(3) from conducting a taxpayer’s CDP hearing for a given tax year because he considered the taxpayer’s

or involvement” need not be a CDP case. Prior involvement in an offer in compromise appeal precludes a Settlement Officer from handling a CDP appeal.¹¹⁵⁹ A taxpayer may waive the right to have the hearing conducted by a previously uninvolved IRS employee.¹¹⁶⁰

The Settlement Officer conducting the hearing cannot engage in *ex parte* contact with other IRS employees.¹¹⁶¹

2. Conference

The IRS conducts the CDP hearing in an informal manner.¹¹⁶² A CDP hearing may consist of:

- a face-to-face conference,
- a telephone conference,
- written communications with the IRS Settlement Officer, or
- some combination of meetings and communications.

compliance history when evaluating the taxpayer’s eligibility for collection alternatives during a prior CDP hearing.

Consistent with the construction of “prior involvement” reflected in the regulation, no disqualifying involvement arises when the same appeals officer holds consecutive CDP hearings for the same taxpayer who has accrued new, unpaid tax liabilities. Prior involvement refers, instead, to an appeals officer having considered the tax year at issue in a prior non-CDP context, e.g., as when the Appeals Officer worked on the case as a Revenue Officer. *Hardy v. United States*, 2003-2 USTC ¶50,542 (N.D. Ala. 2003) (Appeals Officer who was IRS signatory on notice of tax lien for 1985 liability but had no prior involvement with penalties for years at issue in CDP hearing, held impartial under §6330(b)(3)). See also *Waltner v. Commissioner*, T.C. Memo 2015-146; *Harrell v. Commissioner*, T.C. Memo 2003-271.

¹¹⁵⁹ *Moosally v. Commissioner*, 142 T.C. 183 (2014).

¹¹⁶⁰ §6320(b)(3); Reg. §301.6320-1(d)(1), §301.6320-1(d)(2), Q&A-D4, -D5; *MRCA Information Services v. United States*, 2000-2 USTC ¶50,683 (D. Conn. 2000). The IRS also may allow a taxpayer to waive the right to a CDP hearing before the 30-day period has run, provided that the taxpayer has received the notice of his right to a hearing. CCA 200003021. In addition, if the facts and circumstances indicate that waiver of certain CDP rights may be in the best interest of the taxpayer, for example, to enable the IRS to act quickly in performing an administrative function it could not otherwise take, a revenue officer may advise or suggest such waiver to the taxpayer. CCA 200007001. See Reg. §301.6320-1(c)(2), Q&A-C9. However, taxpayers who waive their right to a CDP hearing do not receive a Notice of Determination from Appeals from which they could otherwise seek court review. Reg. §301.6320-1(f)(1).

¹¹⁶¹ Rev. Proc. 2012-18, *amplifying, modifying, and superseding* Rev. Proc. 2000-43; *Hinerfield v. Commissioner*, 139 T.C. 277 (2012) (communications with Counsel permitted); *Drake v. Commissioner*, 125 T.C. 201 (2005).

¹¹⁶² Reg. §301.6320-1(d)(2), Q&A-D6, §301.6330-1(d)(2), Q&A-D6; *Katz v. Commissioner*, 115 T.C. 329 (2000) (telephone communication deemed adequate for hearing under §6320(b)); FSA 200009007. See *Johnson v. United States*, 2003-1 USTC ¶50,297 (N.D. Fla. 2002) (where taxpayer refused to attend hearing until the IRS produced information that taxpayer had no legal right to receive, making of determination based on written correspondence and case file was not an abuse of discretion); *Konkel v. Commissioner*, 2001-2 USTC ¶50,520 (M.D. Fla. 2000) (taxpayer who submitted questions in lieu of attending hearing had adequate opportunity to be heard before issuance of Notice of Determination). See also *Lunsford v. Commissioner*, 117 T.C. 183 (2001); *Charnas v. Commissioner*, T.C. Memo 2015-153.

A face-to-face conference usually provides the best opportunity for an acceptable resolution. The IRS will not conduct a face-to-face conference if the taxpayer does not intend to discuss relevant issues, or if the taxpayer wishes to use the conference as a forum to espouse only frivolous and groundless arguments.¹¹⁶³ The IRS may also deny a face-to-face conference request if the taxpayer does not provide requested information, is not in current filing or payment compliance, or fails to satisfy other Settlement Officer requests.¹¹⁶⁴ Offering a telephone hearing satisfies all statutory and due process requirements.¹¹⁶⁵

If the taxpayer requests a face-to-face conference and meets the applicable requirements, the IRS will ordinarily offer to conduct the hearing at the Appeals office closest to the taxpayer's residence or principal place of business. If that is not satisfactory to the taxpayer, the IRS will give the taxpayer an opportunity for a hearing by correspondence or by telephone. If that is not satisfactory to the taxpayer, the Settlement Officer will review the taxpayer's CDP hearing request, the case file, any other written communications from the taxpayer (including written communications, if any, submitted in connection with the CDP hearing), and any notes of any oral communications. Under these circumstances, review of those documents constitutes the CDP hearing.¹¹⁶⁶

3. Administrative Record

As is set forth more fully below, most judicial review is based on the "administrative record" of the hearing and the Settlement Officer's actions. It is therefore critical for the taxpayer to raise all potential issues and defenses and keep a good record of the CDP hearing.

While the IRS initially maintained that no transcript or recording of a face-to-face meeting or conversation was re-

quired, if Appeals offers a face-to-face conference and the taxpayer asks to record the conference, the IRS will allow an audio recording of that conference in accordance with §7521.¹¹⁶⁷ The taxpayer is not entitled to record a telephone hearing.¹¹⁶⁸

The taxpayer does not have the right to subpoena and examine witnesses at a CDP hearing.¹¹⁶⁹ The rules of evidence also do not apply at the CDP hearing. It is therefore important to submit supporting documentation in any form to ensure it is included in the administrative record.

4. Time for Conducting Hearing

There is no set period of time within which Appeals must conduct the CDP hearing, but Appeals tries to conduct the hearing as expeditiously as possible under the circumstances.¹¹⁷⁰ To the extent practicable, the IRS will hold the hearing for a CDP Lien Notice in conjunction with a hearing for a CDP Levy Notice.¹¹⁷¹

Some cases qualify for Rapid Response Appeals Process (RRAP) priority collection due process (CDP) hearings.¹¹⁷² These expedited hearings are discussed in 623 T.M., *IRS Procedures: Examinations and Appeals*.

5. Jurisdiction Retained by Appeals Office

The Appeals Office that makes the determination retains jurisdiction over that determination, any subsequent hearings the taxpayer may request regarding the NFTL, and any collection actions taken or proposed due to Appeals' determination. Appeals also may consider changes in a taxpayer's circumstances after the taxpayer exhausts other remedies.¹¹⁷³

Additional Appeals Office consideration does not operate as a continuation of the original CDP hearing. Therefore, it does not suspend the periods of limitation.¹¹⁷⁴ In addition, a decision that results from a retained jurisdiction hearing is not appealable to the Tax Court.¹¹⁷⁵ These restrictions apply because a

¹¹⁶³ Reg. §301.6320-1(d)(2), Q&A-D8; Reg. §301.6330-1(d)(2), Q&A-D8. See *Ludlam v. Commissioner*, 810 Fed. Appx. 845 (11th Cir. 2020) (unpub.) (where taxpayers are barred from challenging the amount of tax deficiency in their CDP hearing because they failed to petition the Tax Court, their argument is deemed frivolous and they are not entitled to face-to-face conference).

¹¹⁶⁴ *Muir v. Commissioner*, 123 AFTR 2d 2019-768 (5th Cir. 2019) (unpub.); *Moses v. Commissioner*, T.C. Memo 2014-220 (failure to provide information); *Anderson v. Commissioner*, T.C. Memo 2014-216 (IRS denial of face-to-face conference proper where taxpayers did not even complete proper forms; therefore IRS could not properly evaluate collection alternatives). See *Boulware v. Commissioner*, T.C. Memo 2014-80, *aff'd*, 816 F.3d 133 (D.C. Cir. 2016) (face-to-face hearing denial not abuse of IRS's discretion because taxpayer: (1) was noncompliant with tax payments; (2) was unwilling to liquidate assets to pay outstanding liability; and (3) failed to post bond to minimize asset dissipation).

¹¹⁶⁵ Reg. §301.6320-1(d)(2), Q&A-D6; *Hoeffner v. Commissioner*, 587 Fed. Appx. 147 (5th Cir. 2014) (unpub.); *McMaster v. Commissioner*, 2009-1 USTC ¶50,321 (9th Cir. 2009) (unpub.); *Katz v. Commissioner*, 115 T.C. 329 (2000).

¹¹⁶⁶ Reg. §301.6320-1(d)(2), Q&A-D7. *Katz v. Commissioner*, 115 T.C. 329 (2000). In CCA 201024057, the IRS Chief Counsel's Office addressed the issue of taxpayers who request a face-to-face hearing and then request a telephone conference once the case is transferred. The IRS Chief Counsel concluded that it was not advisable once a face-to-face hearing was requested to inform a taxpayer that the hearing had to be face-to-face and then consider the taxpayer to have waived the right to a hearing if the taxpayer did not appear at the scheduled time and place. Accordingly, the IRS Chief Counsel recommended that such cases stay with Appeals for a telephone conference, but, if a taxpayer continued to delay by refusing to schedule or not answer the phone at the appointed time, Appeals then could consider the hearing to have been waived as long as such prospect had been made clear to the taxpayer throughout the process.

¹¹⁶⁷ Notice CC-2003-031. This change in the IRS's position followed *Keene v. Commissioner*, 121 T.C. 8 (2003), in which the Tax Court held that a taxpayer who seeks to audio record a §6330 hearing has the right to do so by virtue of §7521(a)(1). Previously, the IRS reasoned that due to the informal nature of the hearing under Reg. §301.6320-1(d)(2), Q&A-D6, taxpayers were not entitled to tape record the hearing. At least one court agreed. See *Hardy v. United States*, 2003-2 USTC ¶50,542 (N.D. Ala. 2003) (taxpayer not entitled to tape record hearing; §7521(a)(1) not applicable, as CDP hearing was not an interview relating to the determination or collection of a tax); *Helvie v. Beach*, 2003-2 USTC ¶50,630 (S.D. Fla. 2003) (mandamus denied as taxpayer could not show that IRS owed unmistakable duty to permit stenographic recording of CDP hearing).

¹¹⁶⁸ *Calafati v. Commissioner*, 127 T.C. 219 (2006).

¹¹⁶⁹ Reg. §301.6320-1(d)(2), Q&A-D6. See *Davis v. Commissioner*, 115 T.C. 35 (2000); *Schrems v. Commissioner*, T.C. Memo 2003-25.

¹¹⁷⁰ Reg. §301.6320-1(e)(3), Q&A-E9. *Brantley v. Dist. Dir.*, 2002-1 USTC ¶50,251 (M.D. Fla. 2001)). According to the Chief Counsel's Office, a CDP hearing should be delayed during the pendency of a criminal investigation and any subsequent criminal proceeding, unless it is determined that the CDP hearing will not imperil the criminal prosecution. CCA 200250001.

¹¹⁷¹ §6320(b)(4); Reg. §301.6320-1(d)(1).

¹¹⁷² IRM 8.22.6.2(1) (09-25-14).

¹¹⁷³ §6330(d)(3) (as referenced by §6320(c)); Reg. §301.6320-1(h), §301.6330-1(h)(1). However, courts have refused to order the Appeals office to review its determination for changed circumstances. See *CompuCel Serv. Corp. v. Commissioner*, 2002-1 USTC ¶50,284 (D. Md. 2002); *AJP Mgmt. v. United States*, 2001-1 USTC ¶50,184 (C.D. Cal. 2000).

¹¹⁷⁴ Reg. §301.6320-1(h)(2), Q&A-H1; Reg. §301.6330(h)(2), Q&A-H1.

¹¹⁷⁵ Reg. §301.6320-1(h)(2), Q&A-H2; Reg. §301.6330(h)(2), Q&A-H2.

taxpayer is entitled to only one CDP hearing with respect to the tax specified in the CDP notice.

G. CDP Hearing Result

1. Agreed Resolution

Many CDP hearings are resolved on an agreed basis. Appeals can refuse or reverse collection action due to a failure to follow procedures, redetermine the amount of the liability or allow innocent spouse relief, and allow a collection alternative such as an installment agreement or offer in compromise. If a resolution is reached, IRS Form 12257 is typically used to memorialize the resolution and terminate the CDP hearing process.

2. Notice of Determination or Decision Letter

If there is no agreement in a full CDP hearing, the Settlement Officer will issue a Notice of Determination by certified or registered mail.¹¹⁷⁶ The notice addresses the taxpayer's arguments and sets forth any agreements the Settlement Officer reached with the taxpayer.¹¹⁷⁷

If the hearing was only an equivalent hearing, the Settlement Officer will issue a Decision Letter. Decision Letters typically have no right to judicial review.

H. Judicial Review

1. Notice of Determination Required

Generally, the taxpayer can only appeal from a Notice of Determination. If no Notice of Determination is issued, the Tax Court lacks jurisdiction to review the IRS action.¹¹⁷⁸ Similarly, an incomplete or deficient Notice of Determination can deprive the Tax Court of jurisdiction.¹¹⁷⁹ The 30-day period is nonjurisdictional and therefore is subject to equitable tolling.¹¹⁸⁰

If the taxpayer does not file a timely CDP hearing request, no Notice of Determination can be issued by Appeals, and no

¹¹⁷⁶ Reg. §301.6320-1(b)(2), Q&A-B3, Q&A-E8; Reg. §301.6330-1(e)(3), Q&A-E8.

¹¹⁷⁷ Reg. §301.6320-1(e)(3), Q&A-E8. The Tax Court may remand to Appeals cases where the notice of determination does not address each of the issues raised by the taxpayer during the hearing. See, e.g., *Synergy Env'tl., Inc. v. Commissioner*, T.C. Memo 2014-140 (remand to Appeals to state findings and decision regarding OIC raised during hearing that was submitted a year earlier and was being considered in a separate appeal).

¹¹⁷⁸ See *Vivenzio v. Commissioner*, 2008-1 USTC ¶50,395 (3d Cir. 2008) (letter denying offer in compromise did not confer jurisdiction on Tax Court).

¹¹⁷⁹ *LG Kendrick, LLC v. United States*, 146 T.C. 17 (2016), *aff'd*, 684 Fed. Appx. 744 (10th Cir. 2017) (unpub.); *Smith v. Commissioner*, 124 T.C. 36 (2005).

¹¹⁸⁰ *Boechler, P.C. v. Commissioner*, 596 U.S. 199 (2022) ("jurisdiction with respect to such matter" language in §6330(d)(1) most likely refers to "petition the Tax Court for review of such determination" clause and does not clearly confer jurisdiction on "within 30 days of a determination" clause therefore 30-day filing period is nonjurisdictional and subject to equitable tolling), *rev'g and rem'g* 967 F.3d 760 (8th Cir. 2020), *aff'g* No. 18578-17 L, 2019 BL 580643 (T.C. Feb. 15, 2019). This 2022 holding contradicts *Duggan v. Commissioner*, 879 F.3d 1029 (9th Cir. 2018) (citing *Maier v. Commissioner*, 360 F.3d 361 (2d Cir. 2004), §6330(d)(1) is "unambiguous" that for Tax Court to have jurisdiction, petition for review must be filed within 30 days of determination). Cf. *Allen v. Commissioner*, No. 22-12537, 2022 BL 456105 (11th Cir. Dec. 21, 2022) (unpub. op.) (Tax Court lacked jurisdiction when petition was postmarked one day past filing deadline). See 630 T.M., *Tax Court Litigation*, for further discussion.

Tax Court case can be filed.¹¹⁸¹ If the taxpayer is entitled only to an equivalent hearing (for missing the 30-day deadline for filing a CDP hearing request, for example), the IRS will issue a Decision Letter rather than a Notice of Determination. No judicial review of a Decision Letter is available.¹¹⁸² A determination reflected in a Decision Letter issued because of Appeals's mistaken belief that the CDP hearing request was not timely, however, serves to invoke the Tax Court's review jurisdiction.¹¹⁸³ Likewise, if a taxpayer's request for a CDP hearing is denied by the IRS, there is no determination under §6320 or §6330 and no jurisdiction¹¹⁸⁴ within the Tax Court.¹¹⁸⁵

2. Tax Court Jurisdiction

When the CDP provisions were first enacted in 1998, jurisdiction for judicial review of a CDP determination was generally in the court that had original jurisdiction over the underlying tax. Accordingly, the Tax Court would exercise jurisdiction only over the "deficiency taxes" for which the Tax Court otherwise had jurisdiction.¹¹⁸⁶ The Tax Court may not have had plenary jurisdiction over "nondeficiency taxes" even when related

¹¹⁸¹ *Adolphson v. Commissioner*, 842 F.3d 478 (7th Cir. 2016) (without a notice of determination Tax Court lacks jurisdiction to even consider if 1058 letter was issued).

¹¹⁸² *Offiler v. Commissioner*, 114 T.C. 492 (2000) (equating notice of determination with notice of deficiency for purposes of jurisdiction).

¹¹⁸³ *Craig v. Commissioner*, 119 T.C. 252 (2002); *Murphy v. Commissioner*, T.C. Memo 2019-72.

¹¹⁸⁴ Consider, however, judicial review of frivolous position determinations, discussed in XI.H.6., below.

¹¹⁸⁵ *Ryckman v. Commissioner*, 163 T.C. No. 3 (Aug. 1, 2024). In *Ryckman*, the IRS sought to collect a Canadian tax debt as required under the Canada-U.S. Income Tax Treaty. The taxpayer in the case sought a CDP hearing, was denied by the IRS, and so petitioned the Tax Court. The court reasoned that under the treaty, the U.S. is obligated to collect an accepted Canadian revenue claim as it would a U.S. tax assessment for which CDP hearing rights have lapsed. The court determined that because the taxpayer had no additional rights under §6320 or §6330 regarding the collection of her Canadian tax liability, and the treaty does not create or provide rights for administrative or judicial review of Canada's finally determined revenue claim by the U.S., the IRS had no obligation to issue a determination. Thus, the court lacked jurisdiction in the case. See also *Jenner v. Commissioner*, 163 T.C. No. 7 (Oct. 22, 2024) (IRS denied CDP hearing request over collection of FBAR penalties because they are not taxes and thus not subject to notice and other §6320 and §6330 requirements; Tax Court lacked jurisdiction to review).

¹¹⁸⁶ §6330(d)(1)(A) (1998). *Serv. Emps. Int'l Union v. Commissioner*, 125 T.C. 63 (2005) (no Tax Court jurisdiction over §6652(c)(1) exempt organization information return delinquency penalties); *Downing v. Commissioner*, 118 T.C. 22 (2002) (Tax Court jurisdiction exists for §6651(a)(2) income tax late payment penalties); *Van Es v. Commissioner*, 115 T.C. 324 (2000) (no Tax Court jurisdiction over §6702 frivolous return penalties); *Moore v. Commissioner*, 114 T.C. 171 (2000) (no Tax Court jurisdiction over §6672 trust fund recovery penalty). *Ginsberg v. Commissioner*, 130 T.C. 88 (2008), (no jurisdiction to review a supplemental determination notice regarding collection of a trust fund recovery penalty because it related back to the original notice and was not a new determination for purposes of amended §6330(d)'s effective date); *Johnson v. Commissioner*, 117 T.C. 204 (2001) (no jurisdiction to review the IRS's determination to collect by levy the frivolous return penalty under §6702). But see *Dorn v. Commissioner*, 119 T.C. 356 (2002) (Tax Court has jurisdiction under §6330(d) to review an IRS determination under §6330(f) that use of jeopardy levy was appropriate); CCA 200213007 (advising that Tax Court has CDP jurisdiction to determine that taxes were exempted from discharge under fraud exception of 11 U.S.C. §523(a)(1)(C)); *Parker v. Commissioner*, 117 T.C. 63 (2001) (IRS's filing of tax liens before effective date of §6320 and §6330 is not start of collection action which precludes Tax Court review of proposed levy determination under §6330(d)).

tax issues were properly pending before the court.¹¹⁸⁷ The Tax Court's jurisdiction over the traditional deficiency taxes was exclusive.¹¹⁸⁸ For the nondeficiency taxes, jurisdiction existed in the federal district courts which otherwise had jurisdiction over those types of taxes. Under the prior version of §6331(d)(1), a taxpayer who filed in the wrong court still could get review in the correct court.

For determinations made after October 17, 2006, the federal district courts lack jurisdiction, leaving the Tax Court as the only court with jurisdiction over CDP cases.¹¹⁸⁹ This 2006 legislative change expanded the Tax Court's jurisdiction to include taxes over which the Tax Court historically had no jurisdiction.¹¹⁹⁰ As there is only one court with jurisdiction, the ability to refile in the correct court has been eliminated.¹¹⁹¹

3. Procedures to Obtain Judicial Review

A judicial appeal can be made only by filing a Tax Court petition within the applicable time after the date of the Notice of Determination.¹¹⁹² The timing of a request for Tax Court review concerning denials of innocent spouse relief is 90 days. The Tax Court petition must be filed within 30 days if relief is requested for other issues raised in the CDP hearing.¹¹⁹³

The 30-day period can be extended when the last day is a Saturday, Sunday or legal holiday in the District of Columbia.¹¹⁹⁴ Similarly, in any case (including by reason of a lapse in appropriations) in which a filing location is inaccessible or otherwise unavailable to the general public on the date a petition is due, the relevant time period for filing such petition is tolled for the number of days within the period of inaccessibility plus an additional 14 days.¹¹⁹⁵

¹¹⁸⁷ *Gorosep v. Commissioner*, 446 F.3d 1014 (9th Cir. 2006). *But see Wagnenknecht v. United States*, 509 F.3d 729 (6th Cir. 2007) (suggesting the Tax Court did have jurisdiction over a penalty case since it had exclusive jurisdiction over the related income tax case).

¹¹⁸⁸ *Wos v. United States*, 2008-2 USTC ¶50,464 (7th Cir. 2008) (unpub.); *Redeker-Barry v. United States*, 476 F.3d 1189 (11th Cir. 2007).

¹¹⁸⁹ §6330(d)(1).

¹¹⁹⁰ See *Callahan v. Commissioner*, 130 T.C. 44 (2008).

¹¹⁹¹ See Chief Counsel Notice CC-2007-1001.

¹¹⁹² §6330(d)(1); Reg. §301.6330-1(f)(1). The filing of this appeal is among the acts that may be postponed under §7508 and §7508A when the IRS publishes guidance providing relief related to a specific combat zone, qualifying deployment in a contingency operation, federally declared disaster, significant fire or terroristic or military action. See Tables, Charts and Lists > *Postponements Due to Combat Zone or Contingency Operation Service, Federally Declared Disasters, Significant Fires or Terroristic or Military Actions*, for an updated list of acts, the performance of which may be postponed under §7508 or §7508A, and 627 T.M., *Limitations Periods, Interest on Underpayments and Overpayments, and Mitigation*.

¹¹⁹³ Reg. §301.6330-1(f)(2), Q&A-F2. See *Boechler, P.C. v. Commissioner*, 596 U.S. 199 (2022) (30-day period is nonjurisdictional and therefore is subject to equitable tolling), *rev'g and rem'g* 967 F.3d 760 (8th Cir. 2020), *aff'g* No. 18578-17 L, 2019 BL 580643 (T.C. Feb. 15, 2019). See also *Raymond v. Commissioner*, 119 T.C. 191 (2002) (citing §6015(e)(1) and Reg. §301.6330-1(f)(2), Q&A-F2 in granting review of CDP determination as to spousal relief where petition was sent to court 34 days after notice of determination was mailed).

¹¹⁹⁴ §7503.

¹¹⁹⁵ See §7451(b)(1). The term "filing location" means the office of the clerk of the Tax Court or any on-line portal made available by the Tax Court for electronic filing of petitions. See §7451(b)(2). Previously, when the Tax Court Clerk's Office was inaccessible due to inclement weather, government closings, or for other reasons, the time for filing was extended to the first accessible day that was not a Saturday, Sunday, or legal holiday. See *Guralnik v. Commissioner*, 146 T.C. 230 (2016) (due date was Sunday, Monday was holi-

The 30-day period cannot be extended by seeking reconsideration of the CDP hearing determination.¹¹⁹⁶ The Tax Court does not have jurisdiction over petitions filed by parties that are neither the taxpayer nor the authorized representative of the taxpayer.¹¹⁹⁷

If a taxpayer has filed a Title 11 bankruptcy case and thus cannot file a Tax Court petition, the period for filing a Tax Court case is suspended during the time the taxpayer cannot file a Tax Court petition, plus 30 days.¹¹⁹⁸

The Notice of Determination must be mailed to the taxpayer's last known address although actual receipt without prejudicial delay makes the notice valid.¹¹⁹⁹ The Notice of Determination also must be facially correct for the Tax Court to have jurisdiction under §6330(d)(1).¹²⁰⁰ If the petition is filed by an entity, the entity must have the capacity under state law to bring litigation.¹²⁰¹

The procedures for judicial review of a Notice of Determination are set forth in Tax Court Rules 330, *et seq.* These rules govern the content of the petition and other procedures that are unique to so-called "lien and levy actions." Tax Court Rule 331(b) directs that the petition include: (1) the taxpayer's name and address; (2) a description (including the date) and a

day, government offices were closed due to winter storm on Tuesday, and petition arrived on 33rd day when offices reopened; utilizing principles of Fed. R. Civ. P. 6(a)(3), because petition was filed on first accessible day after court reopened for business, petition was deemed timely filed). While "inaccessible" does not mean that a place must be impossible to reach, a short delay that does not bar access to a place for the remainder of a day does not establish inaccessibility. *Organic Cannabis Found., LLC, v. Commissioner*, 962 F.3d 1082 (9th Cir. 2020) (FedEx delivery unsuccessful due to construction or police activity did not establish inaccessibility), *cert. denied*, No. 20-1014 (S. Ct. May 3, 2021).

¹¹⁹⁶ See *McCune v. Commissioner*, 115 T.C. 114 (2000).

¹¹⁹⁷ *Greenoak Holdings Ltd. v. Commissioner*, 143 T.C. 170 (2014) ("person" entitled to judicial review under §6330(d)(1) is taxpayer liable for unpaid tax; Tax Court lacks jurisdiction over petition filed by entities owned by off-shore trust that is property of taxpayer estate). *But see Med. Practice Solutions, LLC v. Commissioner*, 132 T.C. 125 (2009), *aff'd sub nom. Britton v. Schulman*, 106 AFTR 2d 2010-6048 (1st Cir. 2010) and *Bergdale v. Commissioner*, T.C. Memo 2014-152 (notice of determination issued to single member LLC provides jurisdiction for owner's petition); *BM Constr. v. Commissioner*, T.C. Memo 2021-13 (notice of determination issued in name of construction company, a sole proprietorship, rather than to its sole owner, was sufficient to confer jurisdiction over the owner; given that sole proprietorship is an entity in which a single individual owns all the assets, is liable for all debts, and operates in an individual capacity, the identity of the named petitioner in a case involving a disregarded entity is of no consequence and does not raise any jurisdictional or proper caption issues).

¹¹⁹⁸ §6330(d)(2).

¹¹⁹⁹ *Bongam v. Commissioner*, 146 T.C. 52 (2016) (determination notice not required to be sent to taxpayer's last known address to be valid; notice valid if taxpayer received it and timely petitioned Tax Court).

¹²⁰⁰ *Lunsford v. Commissioner*, 117 T.C. 183 (2001), *overruling in part Meyer v. Commissioner*, 115 T.C. 417 (2000). In *Meyer*, the IRS issued a notice of intent to levy for frivolous return penalties, the taxpayers requested a CDP hearing, and the IRS issued a Notice of Determination without a hearing because the Appeals Officer thought only constitutional challenges were being raised. The Tax Court dismissed the taxpayers' petition stating that it lacked jurisdiction on the grounds that the determination letter was invalid because the Appeals office issued it before providing the taxpayer with an opportunity for a pre-levy CDP hearing. In *Lunsford*, the court concluded that it should not have addressed the validity of the Notice of Determination, because it lacked subject matter jurisdiction; and it made an incorrect jurisdictional analysis by first looking behind, instead of at, the Notice of Determination to decide whether the IRS offered a proper CDP hearing.

¹²⁰¹ *Urgent Care Nurses Registry, Inc. v. Commissioner*, T.C. Memo 2016-198 (suspended corporation could not file CDP petition).

copy of the Notice of Determination; (3) the tax liabilities at issue; (4) a listing of the IRS errors (such as the failure to verify procedures, redetermine the underlying liability, or consider collection alternatives); (5) the facts on which the taxpayer relies; and (6) a request for relief.

Note: A taxpayer may elect the Tax Court's small case procedures if the total amount due for all periods combined is not more than \$50,000.¹²⁰²

4. Judicial Review of Mandatory Issues

Once the petition is filed, the principal issue becomes the scope of the judicial review available. This varies depending on the determination of the Appeals Office that is challenged. Each principal determination has a different standard concerning the extent to which the issue had to be raised with Appeals in the CDP hearing, the record or evidence that can be considered, and the standard for review of the Appeals Office's determination. In general, the Tax Court can sustain the IRS determination, reverse the determination, or remand the case to Appeals for further consideration.¹²⁰³

a. Verification of Procedures

Appeals normally verifies that the proper procedures were followed by the IRS as a matter of course. The taxpayer nevertheless should raise the issue affirmatively in the CDP hearing. Even if the verification issues are not raised in the CDP hearing, however, the verification issues are mandatory and the Tax Court has jurisdiction over these issues in a subsequent judicial proceeding.¹²⁰⁴

The Tax Court usually relies on Form 4340, *Certificate of Assessments, Payments and Other Specified Matters*, or U.S. Postal Service Form 3877, *Certified Mailing List*, as proof that procedures were followed. The Settlement Officer can rely on these or other internal summaries, but Forms 4340 or 3877 normally should be provided by the IRS if the issue is contested at trial. The Tax Court has clarified, however, that no particular document needs to be provided to a taxpayer at an administrative hearing to satisfy the verification requirements.¹²⁰⁵

If the Tax Court determines that procedures were not verified, then the IRS failed to perform a mandatory review. Failing to perform a mandatory task usually constitutes an abuse of discretion and the Court will typically remand the case to Appeals for further verification unless remand would be pointless.¹²⁰⁶

¹²⁰² §7463(f); *Schwartz v. Commissioner*, 128 T.C. 6 (2007); IRS Chief Counsel Notice CC-2009-03. For a further discussion of CDP litigation before the Tax Court, see 630 T.M., *Tax Court Litigation*.

¹²⁰³ See *Kelly v. Commissioner*, 130 T.C. 79 (2008).

¹²⁰⁴ §6330(c)(1). See *Spagnoletti v. Commissioner*, No. 21-60135, 2021 BL 464239 (5th Cir. Dec. 06, 2021) (Settlement Officer verified procedures even though deficiency notice was not required as taxpayer self-reported tax liabilities and thus underlying tax liability was not at issue); *Lee v. Commissioner*, 144 T.C. 40 (2015); (verification of issuance of Letter 1153 for trust fund recovery penalty); *Hoyle v. Commissioner*, 131 T.C. 197 (2008) (verification of issuance of notice of deficiency). The IRS's position is that following "administrative procedures" in a CDP case includes verifying that the IRS followed the relevant provisions of the Internal Revenue Manual. See CCA 201212018; CC-2009-10 (cancelled May 15, 2009); *Trout v. Commissioner*, 131 T.C. 239 (2008) (concurring opinion); SCA 200112004.

¹²⁰⁵ *Burke v. Commissioner*, 124 T.C. 189 (2005); *Roberts v. Commissioner*, 118 T.C. 365 (2002); *Nestor v. Commissioner*, 118 T.C. 162 (2002); *McNeill v. Commissioner*, T.C. Memo 2017-206. See also *Cropper v. Commissioner*, 826 F.3d 1280 (10th Cir. 2016).

b. Balancing

The Settlement Officer must balance the intrusiveness of the collection action against the need for efficient collection. While this balancing is mandatory, successful challenges to this balancing are rare.¹²⁰⁷

5. Judicial Review of Optional Issues

a. Requirement to Raise in CDP Hearing

Optional issues need be considered by the Tax Court only if they were raised at the CDP hearing.¹²⁰⁸ It is therefore critical for the taxpayer to make a clear record in the hearing of the relief requested. If an optional issue was not raised at the CDP hearing, the Tax Court will not consider the issue in a subsequent judicial appeal.¹²⁰⁹

b. Challenge to Underlying Tax Liability

When the validity of the underlying tax liability properly is at issue, the Tax Court will review the matter on a *de novo* basis and new evidence may be submitted.¹²¹⁰ This is based on the legislative history, which indicates that a *de novo* standard applies if the validity of the tax liability properly is at issue.¹²¹¹

The question of whether there was a prior opportunity to challenge the liability is also subject to *de novo* review in Tax Court. If the Notice of Determination makes reference to the reconsideration of the merits of the taxpayer's liability even though the taxpayer received a statutory deficiency notice or otherwise had a prior opportunity to dispute the liability, these statements are not considered part of the Notice of Determination because these issues are not properly part of the CDP hearing and are not subject to judicial review.¹²¹² Similarly, the Settlement Officer's refusal to consider a challenge to the underlying liability can also be reviewed and reversed in a subsequent Tax Court case.¹²¹³

Because a proper challenge to the underlying liability is subject to *de novo* review, there is no reason to remand the case

¹²⁰⁶ *Hoyle v. Commissioner*, 131 T.C. 197 (2008); *Barnes v. Commissioner*, T.C. Memo 2010-30. *But see Marlow v. Commissioner*, T.C. Memo 2010-113 (assessment invalidated because remand pointless).

¹²⁰⁷ *Blackman v. Commissioner*, T.C. Memo 2013-194.

¹²⁰⁸ §6330(c)(3)(B); *Giamelli v. Commissioner*, 129 T.C. 107 (2007); *Anderson v. Commissioner*, T.C. Memo 2016-211.

¹²⁰⁹ *First Rock Baptist Church Child Dev. Ctr. v. Commissioner*, 148 T.C. 380 (2017); *Giamelli v. Commissioner*, 129 T.C. 107 (2007).

¹²¹⁰ *Jordan v. Commissioner*, 134 T.C. 1 (2010). See FSA 200124005 (new evidence can be introduced at trial because the challenge to the underlying liability is subject to *de novo* review). See also *Lufkin v. Commissioner*, T.C. Memo 2021-71 (taxpayer not relieved of his burden of proof when challenging underlying tax liability merely because IRS unintentionally destroyed taxpayer's financial documents during supposed seizure).

¹²¹¹ H.R. Conf. Rep. No. 599, 105th Cong., 2d Sess. at 266 (1998). See *Tornichio v. United States*, 263 F. Supp. 2d 1090 (N.D. Ohio 2002).

¹²¹² Reg. §301.6330-1(e)(3), Q&A-E11. *Cropper v. Commissioner*, 826 F.3d 1280 (10th Cir. 2016); *Behling v. Commissioner*, 118 T.C. 572 (2000); *Goza v. Commissioner*, 114 T.C. 170 (2000). The Appeals Officer's findings could be used in another context. In FSA 200247018, the Chief Counsel's Office based advice that the IRS could not treat a payment as an undesignated payment on an Appeals Officer's finding in a CDP hearing that the taxpayer provided clear evidence that the payment was a designated payment of estimated tax.

¹²¹³ *McNeil v. Commissioner*, 148 T.C. 481 (2017).

to Appeals. The liability challenge will be considered by the Tax Court similarly to a normal deficiency case.

If the challenge to the liability is heard by the Tax Court, *res judicata* or collateral estoppel may apply to prevent subsequent litigation in a refund suit.¹²¹⁴ Similarly, prior litigation of the underlying issue may cause *res judicata* or collateral estoppel to apply to part of the determination in the CDP case.¹²¹⁵

c. Innocent Spouse Relief

If a request for innocent spouse relief is raised in a CDP hearing, the IRS can either issue a separate Notice of Determination on the innocent spouse claim or include it in the determination in the CDP case. If it is included in the CDP determination, the merits of the claim can be litigated in Tax Court in the same manner as if there was a separate Notice of Determination.

d. Collection Alternatives

The Tax Court will only reverse the IRS determination on collection alternatives if there was an abuse of discretion.¹²¹⁶

Abuse of discretion has been defined as “determinations [that] were arbitrary, capricious or without sound basis in fact or law.”¹²¹⁷

Comment: The settlement officer must give proper and fair consideration to the issues raised by the taxpayer as CDP hearings are designed to be a forum for considering the taxpayer’s legitimate disagreement with collection actions.¹²¹⁸ Thus it is important to examine whether a taxpayer’s concerns have been properly addressed in the CDP hearing.¹²¹⁹

For factual determinations, the abuse of discretion standard typically means reviewing whether the Settlement Officer’s determination was *reasonable*, not whether it was *correct*.¹²²⁰ Erroneous interpretation of law, however, typically constitutes an abuse of discretion.¹²²¹

Even though abuse of discretion is a difficult standard, it allows the Tax Court to review the IRS determination on an installment agreement or offer in compromise in the CDP context

even though no judicial review is otherwise available.¹²²² This is a critical distinction that usually dictates that requests for collection alternatives should be made in a CDP appeal if at all possible.

As an optional review issue, the Tax Court only considers collection alternative issues that were raised at the CDP hearing or otherwise brought to the attention of Appeals.¹²²³ The Tax Court also considers only the reasons for the IRS determination that are stated in the Notice of Determination.¹²²⁴

It is important to recognize the distinction between whether the *issue* was raised and whether the *evidence* in support of the issue was presented in the CDP hearing. The question of the evidence that can be considered in a subsequent Tax Court review caused disagreement between the Tax Court, the IRS, the Eighth Circuit, and other courts. This dispute centered on the scope of the record on which judicial review should be based. The Tax Court has held that it may receive new evidence in the course of reviewing whether the Appeals Office abused its discretion, i.e., the Court’s review is not limited to evidence presented during the hearing so long as the issue was raised.¹²²⁵ The IRS disagrees with the Tax Court’s conclusion.¹²²⁶ Similarly, in reversing the Tax Court, the Eighth Circuit took the position that, consistent with general principles of administrative law and the Administrative Procedures Act, judicial review of the IRS’s decision should be limited to the administrative record developed at the hearing.¹²²⁷ Unless the Tax Court’s decision in a particular case is appealable to a circuit that follows the so-called “record rule”, additional evidence concerning collection alternatives may be submitted to the Tax Court in reviewing collection alternatives.¹²²⁸

Whatever the scope of the record, the taxpayer faces a difficult task in establishing that the IRS abused its discretion in considering collection alternatives. In the vast majority of cases, the Tax Court upholds the IRS determination. *See. e.g.,*

¹²²² *Speltz v. Commissioner*, 454 F.3d 782 (2006).

¹²²³ *Magana v. Commissioner*, 118 T.C. 488 (2002) (longstanding illness and hardship newly raised at review). In *Giamelli v. Commissioner*, 129 T.C. 107 (2007), the Tax Court held that it does not have the authority to consider §6330(c)(2) issues that were not raised before Appeals, thus foreclosing any suggestion that it made in *Magana* that it had such authority. *See Murphy v. Commissioner*, 469 F.3d 27 (1st Cir. 2006) (explanation not offered at hearing excluded at trial).

¹²²⁴ *Leslie v. Commissioner*, T.C. Memo 2016-171, *aff’d on other grounds*, 725 Fed. Appx. 597 (9th Cir. 2018) (unpub.).

¹²²⁵ *Robinette v. Commissioner*, 123 T.C. 85 (2004), *rev’d*, 439 F.3d 445 (8th Cir. 2006) (remains law of Tax Court outside Eighth Circuit). *See Kreit Mech. Ass’n, Inc. v. Commissioner*, 137 T.C. 123 (2011) (expert testimony allowed on business asset valuation).

¹²²⁶ Notice CC-2006-008.

¹²²⁷ *Robinette v. Commissioner*, 439 F.3d 445 (8th Cir. 2006). The court observed that nothing in the statute or legislative history of the IRS Restructuring and Reform Act of 1998, which enacted §6330, clearly indicated an intent by Congress to permit trials de novo in the Tax Court when that court reviews CDP determinations. Further noting that every district court to consider an appeal under §6330 has limited its review to the record created before the IRS, the court opined that it would be anomalous to conclude that Congress intended in §6330(d) to create disparate forms of judicial review depending on which court was reviewing the appeals officer’s determination. *See Murphy v. Commissioner*, 469 F.3d 27 (1st Cir. 2006); *Keller v. Commissioner*, 568 F.3d 710 (9th Cir. 2009) (following Eighth Circuit in *Robinette*).

¹²²⁸ *See Belair v. Commissioner*, 157 T.C. 10 (2021) (given that Tax Court’s decision would be appealable to Ninth Circuit, which has applied record rule, Tax Court decided through summary judgment on basis of administrative record whether IRS’s determination was abuse of discretion).

¹²¹⁴ CCA 201617007 (although bar of §6512(a) does not apply, affirmative defenses of *res judicata* and collateral estoppel should apply).

¹²¹⁵ *Gardner v. Commissioner*, 145 T.C. 161 (2015), *aff’d*, 704 Fed. Appx. 720 (9th Cir. 2017).

¹²¹⁶ *Goza v. Commissioner*, 114 T.C. 176 (2000); *Murphy v. Commissioner*, 469 F.3d 27 (1st Cir. 2006); *Veneziano v. Commissioner*, T.C. Memo 2011-160 (abuse of discretion where IRS never properly allowed taxpayer to challenge underlying liability).

¹²¹⁷ *Giamelli v. Commissioner*, 129 T.C. 107 (2007). *See Belair v. Commissioner*, 157 T.C. 10 (2021) (IRS did not abuse discretion in denying taxpayer’s installment agreement request given that she had not filed her delinquent returns after several opportunities to do so); *Reynolds v. Commissioner*, T.C. Memo 2021-10 (settlement officer did not abuse his discretion in rejecting proposed installment agreement because statute does not require IRS to enter into such agreement with respect to court-ordered criminal restitution).

¹²¹⁸ *See Hamilton v. Commissioner*, T.C. Memo 2022-21. *See also Charnas v. Commissioner*, T.C. Memo 2015-153; §6330(c)(2) (providing that taxpayer may raise “any relevant issue”).

¹²¹⁹ *See Charnas v. Commissioner*, T.C. Memo 2015-153; *Blosser v. Commissioner*, T.C. Memo 2007-323 (“If section 6330(b) [providing a taxpayer’s right to a fair hearing before a levy is made] is to be given any force, the Appeals Office must make its determination . . . after giving adequate consideration to all meritorious issues the taxpayer has raised during the hearing.”).

¹²²⁰ *Dalton v. Commissioner*, 682 F.3d 149 (1st Cir. 2012).

¹²²¹ *Alessio Azzari, Inc. v. Commissioner*, 136 T.C. 178 (2011).

Burklow v. Commissioner, No. 236-24L, 2025 BL 29625 (T.C. Jan. 30, 2025).

Some of the more typical reasons for sustaining the IRS determination include:

- The taxpayer failed to provide IRS Form 433-A or sufficient financial information.¹²²⁹
- Only frivolous arguments were raised.¹²³⁰
- No collection alternatives were raised.¹²³¹
- The taxpayer failed to raise an argument or present evidence supporting the taxpayer's position on a timely basis.¹²³²
- The taxpayer failed to file past-due returns or was not current on taxes.¹²³³
- The taxpayer failed to cooperate with the IRS during the hearing.¹²³⁴
- The Settlement Officer followed the guidelines in the Internal Revenue Manual and/or the taxpayer failed to comply with those guidelines.¹²³⁵
- The Settlement Officer considered relevant facts in sustaining rejection of an offer in compromise as not in the government's interest.¹²³⁶
- The Settlement Officer considered proper factors in rejecting an effective tax administration offer in compromise.¹²³⁷
- The taxpayer failed to propose a specific installment agreement amount or set forth a payment schedule.¹²³⁸
- The Settlement Officer properly rejected the taxpayer's proposed OIC because the taxpayer's reasonable collection potential (RCP) of disposable income and assets far exceeded the amount he offered to pay, and furthermore, the taxpayer failed to show how his age or ineligibility for Social Security benefits would create an economic hardship for him if the IRS collected the amount equal to his RCP.¹²³⁹

¹²²⁹ *Schropp v. Commissioner*, 405 Fed. Appx. 800 (4th Cir. 2010); *Belair v. Commissioner*, 157 T.C. 10 (2021); *Spagnoletti v. Commissioner*, T.C. Memo 2020-140, *aff'd* by *unpub.op.*, No. 21-60135, 2021 BL 464239 (5th Cir. 2021); *Brown v. Commissioner*, T.C. Memo 2016-82.

¹²³⁰ *Oropeza v. Commissioner*, 2010-2 USTC ¶50,695 (9th Cir. 2010); *Kubon v. Commissioner*, T.C. Memo 2011-41.

¹²³¹ *Schropp v. Commissioner*, 2011-1 USTC ¶50,122 (4th Cir. 2010); *Pough v. Commissioner*, 135 T.C. 344 (2010).

¹²³² *Van Camp v. Commissioner*, 2010-2 USTC ¶50,529 (9th Cir. 2010) (unpub.); *Durda v. Commissioner*, T.C. Memo 2017-89.

¹²³³ *Orum v. Commissioner*, 412 F.3d 819 (7th Cir. 2005); *James G. Hood DDS v. Commissioner*, 2009-1 USTC ¶50,404 (9th Cir. 2009) (unpub.); *Belair v. Commissioner*, 157 T.C. 10 (2021); *First Rock Baptist Church Child Dev. Center v. Commissioner*, 148 T.C. 380 (2017); *Pough v. Commissioner*, 135 T.C. 344 (2010).

¹²³⁴ *Pough v. Commissioner*, 135 T.C. 344 (2010).

¹²³⁵ *Rebuck v. Commissioner*, T.C. Memo 2016-3.

¹²³⁶ *Hauptman v. Commissioner*, T.C. Memo 2014-214, *aff'd*, 831 F.3d 950 (8th Cir. 2016).

¹²³⁷ *Gillette v. Commissioner*, T.C. Memo 2018-195, *aff'd*, 801 Fed. Appx. 398 (7th Cir. 2020).

¹²³⁸ *Rebuck v. Commissioner*, T.C. Memo 2016-3.

¹²³⁹ *Abraham v. Commissioner*, T.C. Memo 2021-97.

There are some instances in which the taxpayer has been able to establish an abuse of discretion. These include:

- The IRS failed to fully consider the taxpayer's arguments.¹²⁴⁰
- The IRS failed to allow a reasonable extension of time to submit requested information.¹²⁴¹
- The IRS incorrectly included assets or income or incorrectly determined asset or income values or other components of an offer in compromise determination.¹²⁴²
- The IRS based its refusal to consider an installment agreement on a refusal to subordinate the NFTL which itself was due to an incorrect interpretation of lien priority rules.¹²⁴³
- The taxpayer established that a waiver of the collection statute of limitations was invalid.¹²⁴⁴
- Although the taxpayer did not provide complete information as requested, the Settlement Officer nevertheless was able to evaluate the collection alternative and calculate allowable expenses, yet declined the request for an installment agreement.¹²⁴⁵
- The taxpayer established that a levy would cause economic hardship because it would prevent the taxpayer from paying reasonable basic living expenses.¹²⁴⁶
- The IRS did not treat the taxpayer in a "fair and rational manner" when taxpayer's case was closed one day after a missed document production deadline despite taxpayer's

¹²⁴⁰ *Loveland v. Commissioner*, 151 T.C. 78 (2018); *Emery Celli Cuti Brinckerhoff & Abady v. Commissioner*, T.C. Memo 2018-55; *Charnas v. Commissioner*, T.C. Memo 2015-153; *Estate of Sanfillippo v. Commissioner*, T.C. Memo 2015-15; *Blosser v. Commissioner*, T.C. Memo 2007-323; *Harris v. Commissioner*, T.C. Memo 2006-186; *Hamilton v. Commissioner*, T.C. Memo 2022-21 (settlement officer's plain errors in disregarding fact that taxpayers had filed 2017 return before CDP hearing as requested, failure to include in administrative record 11-page fax from taxpayers containing important and relevant information, and arbitrary denial of extension to provide large amount of financial information despite taxpayer's good faith effort to keep settlement officer apprised as to their progress was abuse of discretion; settlement officer made up her mind after a cursory one-hour review of taxpayers' materials and failed to give proper consideration to issues they raised as required by §6330(c)(3)(B)).

¹²⁴¹ *Judge v. Commissioner*, T.C. Memo 2009-135.

¹²⁴² *Dalton v. Commissioner*, 135 T.C. 393 (2010) (incorrect nominee determination caused asset to be improperly included in offer amount computation); *Campbell v. Commissioner*, T.C. Memo 2019-4 (incorrect application of dissipated asset rule); *W. Zintl Constr., Inc. v. Commissioner*, T.C. Memo 2017-119 (use of going concern value without accounting for payroll tax liability when determining a reasonable collection potential (RCP) of business entity taxpayer was unreasonable); *Fairlamb v. Commissioner*, T.C. Memo 2010-22; *Blair v. Commissioner*, T.C. Memo 2009-232; *Samuel v. Commissioner*, T.C. Memo 2007-312.

¹²⁴³ *Alessio Azarri, Inc. v. Commissioner*, 136 T.C. 178 (2011).

¹²⁴⁴ *Rosenbloom v. Commissioner*, T.C. Memo 2011-140.

¹²⁴⁵ *Leslie v. Commissioner*, T.C. Memo 2016-171 (denial of collection alternative based on missing information not necessary for calculation was irrational determination and abuse of discretion; court will not uphold notice of determination on grounds other than those stated in notice denying collection alternative), *aff'd*, 725 Fed. Appx. 597 (9th Cir. 2018); *Boettcher v. United States*, T.C. Memo 2021-4 (case remanded where IRS rejected installment agreement request outright purportedly on grounds that taxpayers failed to provide requested information but taxpayers had in fact provided sufficient financial information).

¹²⁴⁶ *Vinatieri v. Commissioner*, 133 T.C. 392 (2009).

track record for cooperation and compliance during his dealings with the IRS in that calendar year.¹²⁴⁷

- The IRS did not ask for taxpayers' financial information and, therefore, could not properly evaluate taxpayers' eligibility for an installment agreement.¹²⁴⁸
- The Settlement Officer reviewed and sustained the Centralized Unit's decision to return the taxpayers' offer in compromise without independently reviewing the taxpayers' offer on the merits, despite multiple requests to do so and having all the necessary information for such review.¹²⁴⁹

For purposes of determining whether the underlying tax remains "unpaid" and whether IRS collection actions are necessary, the Tax Court's CDP jurisdiction includes deciding whether an "available credit" from another tax year or other source can reduce or pay in full the underlying tax liability at issue.¹²⁵⁰ The overpayment credit must have been established by the IRS or a court before the CDP hearing review. Pursuant to §6330 the Tax Court lacks jurisdiction to determine an overpayment of an unrelated liability during a CDP hearing review.¹²⁵¹

The Tax Court lacks refund jurisdiction in an appeal of a CDP determination that involves both a collection issue and a challenge to the underlying tax liability after the tax liability has been paid by an offset.¹²⁵²

Because the abuse of discretion standard applies, the typical remedy for an IRS failure to meet the standard is to remand the case to Appeals unless remand would be pointless.¹²⁵³ If the abuse results from an incorrect interpretation of law for which the proper resolution can be determined without remand, the Tax Court will simply order the appropriate resolution.¹²⁵⁴

6. Judicial Review of Frivolous Position Determinations

If the IRS Appeals Office identifies a position as frivolous, or as reflecting a desire to delay or impede the administration of federal tax laws, Appeals may treat the portion of a submission containing the position as if it were never submitted.¹²⁵⁵ The IRS then typically issues a letter disregarding the CDP request. The designation of a position as frivolous, or as reflecting a desire to delay or impede the administration of federal tax laws, is subject to judicial review.¹²⁵⁶

7. Resolution of the Tax Court Case

The Tax Court's jurisdiction must be established by issuance of a Notice of Determination and a proper and timely petition. Once established, there are several ways in which the Tax Court can resolve the case.

a. Dismissal

Tax Court jurisdiction in a CDP case often involves reviewing whether the IRS's proposed collection activity is appropriate.¹²⁵⁷ Even if jurisdiction was properly invoked initially, the Tax Court can lose jurisdiction in certain circumstances (i.e., the matter becomes moot) if the liability at issue is subsequently paid or the IRS concedes that there is no unpaid liability for a disputed year upon which a collection action could be based.¹²⁵⁸ The Tax Court lacks refund jurisdiction in an appeal of a CDP determination that involves both a collection issue and a challenge to the underlying tax liability after the liability is paid.¹²⁵⁹

On the other hand, a revocable concession by the IRS does not render the case moot.¹²⁶⁰ The Tax Court also maintains jurisdiction over a CDP case where an installment agreement was denied even though the IRS withdrew the lien at issue.¹²⁶¹ Dismissal is appropriate, however, when an installment agreement

¹²⁴⁷ *Szekely v. Commissioner*, T.C. Memo 2013-227.

¹²⁴⁸ *Uribe v. Commissioner*, T.C. Memo 2014-116 (Tax Court remanded case to IRS Office of Appeals on issue of collection alternatives because Appeals did not properly evaluate taxpayers' request for installment agreement).

¹²⁴⁹ *Mason v. Commissioner*, T.C. Memo 2021-64.

¹²⁵⁰ *Del-Co W. v. Commissioner*, T.C. Memo 2015-142 (without available credit IRS could proceed with levy); *Credex, Inc. v. Commissioner*, T.C. Memo 2017-241 (failure to allow worker income tax credits abuse of discretion).

¹²⁵¹ *Del-Co W. v. Commissioner*, T.C. Memo 2015-142.

¹²⁵² *Commissioner v. Zuch*, No. 24-416, 2025 BL 202534 (U.S. June 12, 2025), reversing and remanding 97 F.4th 81 (3d. Cir. 2024). See also *Greene-Thapedi v. Commissioner*, 126 T.C. 1 (2006) (if proposed levy was satisfied by overpayment offset, proposed levy becomes moot and taxpayer thus lacks independent basis to challenge existence or amount of underlying tax liability in CDP proceeding before the court); *McLane v. Commissioner*, 24 F.4th 316 (4th Cir. 2022) (following *Greene-Thapedi*, "underlying tax liability" does not confer jurisdiction on Tax Court to determine overpayment and order refund); *Willson v. Commissioner*, 805 F.3d 316 (D.C. Cir. 2015) (Tax Court lacked jurisdiction as there was no underlying tax liability where IRS had entirely abated improperly assessed liability and abandoned levy and returned funds it collected to satisfy improper liability); *Boyd v. Commissioner*, 117 T.C. 127 (2001) (Tax Court lacked jurisdiction where taxpayer had asserted that collection was time barred and that some tax liabilities already had been paid); *Weber v. Commissioner*, 138 T.C. 348 (2012) (on appeal from §6330 hearing, Tax Court determined that it lacked jurisdiction to review claimed overpayment of §6672 penalty).

¹²⁵³ *W. Zintl Constr. Inc. v. Commissioner*, T.C. Memo 2017-119.

¹²⁵⁴ *Zapara v. Commissioner*, 126 T.C. 215 (2016), *aff'd*, 652 F.3d 1042 (9th Cir. 2011).

¹²⁵⁵ §6330(g).

¹²⁵⁶ *Ryskamp v. Commissioner*, 797 F.3d 1142 (D.C. Cir. 2015); *Busek v. Commissioner*, 143 T.C. 301 (2014); *Thornberry v. Commissioner*, 136 T.C. 356 (2011). But see CC-2016-008 (IRS refuses to follow these cases unless binding precedent exists).

¹²⁵⁷ See, e.g., *Greene-Thapedi v. Commissioner*, 126 T.C. 1 (2006); *McLane v. Commissioner*, T.C. Memo 2018-149, *aff'd*, 24 F.4th 316 (4th Cir. 2022).

¹²⁵⁸ *Commissioner v. Zuch*, No. 24-416, 2025 BL 202534 (U.S. June 12, 2025), reversing and remanding 97 F.4th 81 (3d. Cir. 2024) (Tax Court proceeding became moot when basis for levy ended, and IRS ceased pursuit of levy, after IRS applied taxpayer's overpayments in other tax years to eliminate tax liability that was the basis for the levy); *Willson v. Commissioner*, 805 F.3d 316 (D.C. Cir. 2015) (Tax Court lacked jurisdiction when IRS abated improperly assessed liability and abandoned levy); *MacDonald v. Commissioner*, T.C. Memo 2009-240 (jurisdiction of federal judicial system is limited to "cases and controversies" by the U.S. Constitution, Article III, §2), citing *Hefli v. Commissioner*, 97 T.C. 180 (1991), *aff'd*, 983 F.2d 868 (8th Cir. 1993).

¹²⁵⁹ *McLane v. Commissioner*, T.C. Memo 2018-149, *aff'd*, 24 F.4th 316 (4th Cir. 2022).

¹²⁶⁰ *Vigon v. Commissioner*, 149 T.C. 97 (2017) (case was not moot because, while the IRS abated the liability and released the liens for §6702 "frivolous tax submission" penalties, it did not completely and irrevocably eradicate the threat of reassessing the penalties, and expressly reserved the right to reassess the penalties, while claiming there was no statute of limitation on such penalties).

¹²⁶¹ *First Rock Baptist Church Child Dev. Ctr. v. Commissioner*, 148 T.C. 380 (2017).

is the proposed collection alternative and the taxpayer goes out of business.¹²⁶² However, neither the taxpayer nor the Commissioner may “unilaterally oust the Tax Court from jurisdiction” until the court decides the controversy. Once the Tax Court obtains jurisdiction over a liability challenge, it retains that jurisdiction until the matter is resolved.¹²⁶³

b. Motion for Summary Judgment

The preferred IRS method to resolve a CDP case is a motion for summary judgment under Tax Court Rule 121. These motions are typically reserved for issues for which there is an abuse of discretion standard of review. The IRS seeks to establish that the Settlement Officer acted reasonably and not arbitrarily by submitting most or all of the administrative record of the CDP hearing and a declaration of the Settlement Officer.

Motions for summary judgment can be granted only if the motion establishes that there are no genuine issues of material fact in dispute and the IRS is entitled to judgment as a matter of law.¹²⁶⁴ The motion will typically be denied if the taxpayer can establish:

- The Settlement Officer failed to perform a mandatory review.
- Factual disputes exist.
- The Settlement Officer adopted an incorrect interpretation of law.

c. Trial

If no dispositive motion resolves the case, the Tax Court will schedule the CDP case for trial. CDP cases are typically calendared for trial on the same trial sessions as the Tax Court’s deficiency cases.

Cases that involve a proper challenge to the underlying liability are conducted in essentially the same manner as a normal Tax Court deficiency case. Since the review is *de novo*, the administrative record in the CDP hearing is generally not relevant to the Tax Court’s determination.

In cases that do not involve a challenge to the underlying liability, the abuse of discretion standard applies. In these cases the administrative record is critical. Most or all of the administrative record will typically be included in a stipulation of facts. Although it is sometimes opposed by the IRS, the testimony of

¹²⁶² *Lindsay Manor Nursing Home, Inc. v. Commissioner*, 725 Fed. Appx. 713 (10th Cir. 2018) (unpub.).

¹²⁶³ The Tax Court subject-matter jurisdiction is determined at the time it is invoked and remains “unimpaired until the Court has decided the controversy.” *Vigon v. Commissioner*, 149 T.C. 97 (2017), citing *Naftel v. Commissioner*, 85 T.C. 527 (1985) and *Dorl v. Commissioner*, 57 T.C. 720 (1972), *aff’d*, 507 F.2d 406 (2d Cir. 1974). See also *Charlotte’s Office Boutique, Inc. v. Commissioner*, 425 F.3d 1203 (9th Cir. 2005), *aff’g* 121 T.C. 89 (2003).

¹²⁶⁴ *Dahlstrom v. Commissioner*, 85 T.C. 812 (1985); *Allen v. Commissioner*, T.C. Memo 2016-13; *Ding v. Commissioner*, T.C. Memo 2015-20.

the Settlement Officer is also frequently permitted. Even courts that limit review of the administrative record allow testimony of the Settlement Officer to explain the basis of the determination.¹²⁶⁵

The Tax Court will typically order post-trial briefs. After all briefs are filed, the Tax Court judge takes the case under consideration and eventually issues an opinion and decision or order. The order or decision can make any of three determinations:

- The Tax Court can uphold the IRS determination.¹²⁶⁶ This is treated as a decision of the Tax Court in all respects.
- The Court can order the case to be remanded to IRS Appeals for further consideration and a supplemental determination. Remand is appropriate when the administrative record is unclear.¹²⁶⁷ Remand can also be based on a change in circumstances after the CDP hearing.¹²⁶⁸ Additional information can be considered during remand and becomes part of the administrative record.¹²⁶⁹
- The Tax Court can reverse the IRS determination and order an alternate outcome.¹²⁷⁰

The taxpayer can recover attorneys fees as the prevailing party in CDP litigation under §7430 in a similar manner as for a deficiency case.¹²⁷¹

d. Appeal

Decisions of the Tax Court in CDP cases are appealable under the same rules as normal deficiency cases. Under the former-law CDP procedures, confusion existed concerning the venue for appeal in a case that did not involve a challenge to the underlying liability. The D.C. Circuit asserted exclusive venue over Tax Court appeals from CDP cases filed before December 19, 2015, that did not involve liability challenges.¹²⁷² For petitions filed after December 18, 2015, however, §7482(b)(1) provides that venue lies within the circuit in which an individual taxpayer resides or the principal place of business of an entity.¹²⁷³

¹²⁶⁵ *Robinette v. Commissioner*, 439 F.3d 455 (8th Cir. 2006).

¹²⁶⁶ *Lunsford v. Commissioner*, 117 T.C. 183 (2001).

¹²⁶⁷ *Wadleigh v. Commissioner*, 134 T.C. 280 (2010); *Quality Software Systems, Inc. v. Commissioner*, T.C. Memo 2015-107 (remand appropriate when explanation of determination unclear); *Duarte v. Commissioner*, T.C. Memo 2014-176.

¹²⁶⁸ *Gurule v. Commissioner*, T.C. Memo 2016-61; *Churchill v. Commissioner*, T.C. Memo 2011-182.

¹²⁶⁹ *Lunnon v. Commissioner*, 652 Fed. Appx. 623 (10th Cir. 2016) (unpub.).

¹²⁷⁰ See *Marlow v. Commissioner*, T.C. Memo 2010-113; *Zapara v. Commissioner*, 126 T.C. 215 (2006) *aff’d*, 652 F.3d 1042 (9th Cir. 2011); *Hauptman v. Commissioner*, 831 F.3d 950 (8th Cir. 2016); *Lunnon v. Commissioner*, 652 Fed. Appx. 623 (10th Cir. 2016) (unpub.).

¹²⁷¹ *Fitzpatrick v. Commissioner*, T.C. Memo 2017-88.

¹²⁷² *Byers v. Commissioner*, 740 F.3d 668 (D.C. Cir. 2014).

¹²⁷³ §7482(b)(1)(G).

XII. IRS Appeals and Fast Track Mediation (Collection Procedure #5)

A. Collection Appeals

Appeals' focus has historically been on audit disputes. The 1998 IRS Reform Act changed this focus significantly. A number of collection enforcement actions may be appealed, including the CAP and CDP appeals discussed above. Appeals are also permitted regarding the denial of a penalty abatement, the imposition of the trust fund recovery penalty, or denial of an offer in compromise.¹²⁷⁴ These arise in the ordinary course of these particular remedies.

A protest must be filed with pertinent supporting documentation to appeal an IRS action.¹²⁷⁵ Appeals conferences are informal and testimony is not taken under oath.¹²⁷⁶ However, affidavits submitted under penalty of perjury will be considered.

The goal of the IRS Appeals Office is to resolve federal tax controversies without litigation to the extent possible.¹²⁷⁷ The IRS Appeals Office must evaluate each case in a fair and

impartial manner.¹²⁷⁸ Section 1001 of the 1998 IRS Reform Act provides that *ex parte* communications between Appeals Officers and other IRS employees are not allowed to the extent that such discussions appear to affect the independence of Appeals.¹²⁷⁹ Appeals Officers and Settlement Officers must make their decisions based on the hazards of litigation taking into account the facts and law presented.

B. Fast Track Mediation

In addition to the appeals after the Collection Division has acted, the IRS offers a fast track mediation program.¹²⁸⁰ In fast track mediation, the Appeals Office functions as a mediator to try to resolve disputes between the taxpayer and the IRS before the collection action is completed.

Fast track mediation is intended to be used for certain offer in compromise issues involving subjective determinations and most Trust Fund Recovery Penalty issues.¹²⁸¹

The taxpayer and IRS Collection must agree to fast track mediation. Both parties must sign IRS Form 13369, *Agreement to Mediate*.

¹²⁷⁴ See, e.g., IRM 5.7.4 (07-14-23).

¹²⁷⁵ Reg. §601.106(b). For proposed revised protest rules, see Prop. Reg. §601.106(b).

¹²⁷⁶ Reg. §601.106(c). See also Prop. Reg. §601.106(c).

¹²⁷⁷ IRM 8.1.1.1.1 (01-09-24). See Statement of Procedural Rules, Reg. §601.106(a)(1). For further discussion of administrative appeals, see 623 T.M., *IRS Procedures: Examinations and Appeals*.

¹²⁷⁸ IRM 8.1.1.1.1 (01-09-24).

¹²⁷⁹ Rev. Proc. 2012-18, *amplifying, modifying, and superseding* Rev. Proc. 2000-43, which is discussed further in 623 T.M., *IRS Procedures: Examinations and Appeals*.

¹²⁸⁰ Rev. Proc. 2016-57; IRM 8.26.3 (09-27-17).

¹²⁸¹ IRM 8.26.3.4.1 (09-27-17).

XIII. Taxpayer Assistance Orders (TAOs) in Collection Cases (Collection Procedure #6)

If the taxpayer can show the IRS's collection activities have resulted or are about to result in significant hardship, the taxpayer can file Form 911, *Request for Taxpayer Advocate Service Assistance (And Application for Taxpayer Assistance Order)*, with the Taxpayer Advocate in the area where the taxpayer resides and request the issuance of a Taxpayer Assistance Order (TAO).¹²⁸² The order is issued by the Taxpayer Advocate and may require the IRS to release levied property or to cease collection activities.¹²⁸³

A significant hardship is deemed to exist in the following situations:

- There is an immediate threat of adverse action.
- A delay of less than 30 days is needed to resolve taxpayer's account.
- The taxpayer will incur significant costs (including fees for professional services) if relief is not granted.
- Irreparable injury, harm, or an adverse impact will be imposed on the taxpayer if relief is not granted.¹²⁸⁴

¹²⁸² §7811(a). The procedures for filing and processing an Application for Taxpayer Assistance Order are set forth in Reg. §301.7811-1(b) as well as in IRM 13.1.20 (06-14-23). The Taxpayer Advocate Service is administered by the National Taxpayer Advocate. Before TBOR2, Pub. L. No. 104-168, the Problem Resolution Program (the predecessor to TAS) was administered by the IRS Ombudsman. A \$5,000 penalty may be imposed for submitting a TAO request that is frivolous or designed merely to impede or delay tax administration. See §6702(b). No penalty applies if a taxpayer withdraws a frivolous TAO request within 30 days of being so notified. §6702(b)(3). The penalty also may be reduced at the IRS's discretion. §6702(d).

¹²⁸³ §7811(b).

¹²⁸⁴ §7811(a)(2).

The regulations under §7811 further define the term "significant hardship" as a serious privation caused or about to be caused to the taxpayer as a result of the particular manner in which the revenue laws are being administered by the IRS. Mere economic or personal inconvenience to the taxpayer does not constitute significant hardship.¹²⁸⁵ A TAO cannot be issued to contest the merits of a tax liability, as a substitute for an administrative or judicial remedy, or to enjoin an act of the Office of Chief Counsel (other than Appeals).¹²⁸⁶

Once issued, a TAO is subject to modification or rescission only by the National Taxpayer Advocate, the Commissioner, or the Deputy Commissioner.¹²⁸⁷ Once a TAO request is submitted, the running of any applicable statutes of limitations is suspended for the period beginning on the date of the taxpayer's application for the TAO and ending on the date specified in the TAO.¹²⁸⁸

¹²⁸⁵ Reg. §301.7811-1(a)(4)(ii).

¹²⁸⁶ Reg. §301.7811-1(c)(3).

¹²⁸⁷ §7811(c).

¹²⁸⁸ §7811(d). See *Rothkamm v. United States*, 802 F.3d 699 (5th Cir. 2015) (wife who paid husband's tax assessment considered "taxpayer" for purposes of §7811(d), which tolled §6532(c) statute of limitations to file §7426(a) wrongful levy suit), *acq. in result only*, AOD 2020-03 (IRS acquiesces to holding that term "taxpayer" in §7811 can be broadly interpreted to include a wrongful levy claimant but does not acquiesce to holding that §7811(d) suspends running of limitations periods for third parties to file wrongful levy claims/suits); CCA 199910043 (if IRS prohibited by its own procedures from collecting taxes it declared priority or nondischargeable, and made no attempt to collect those taxes, then IRS can rely on §7811(d) and 11 U.S.C. §105(a) to toll bankruptcy priority and dischargeability periods; courts can require evidence of abuse of system by debtor, e.g., that application filed as delaying tactic). For further discussion, see 623 T.M., *IRS Procedures: Examinations and Appeals*.

XIV. Injunctive Relief (Collection Procedure #7)

Once it is determined that the collection of tax is not barred by the statute of limitations and administrative appeal rights are unavailing, other avenues may be explored to restrain the IRS's collection of the tax. However, trying to obtain a judicial injunction will rarely be a viable option due to the "Anti-Injunction Act" in §7421.

With certain limited exceptions, the Anti-Injunction Act (AIA) withdraws all courts' jurisdiction over suits filed to restrain the assessment or collection of any tax.¹²⁸⁹ For example, if

¹²⁸⁹ §7421. Penalties set out in Chapter 68, Subchapters A and B, are treated as taxes for purposes of the AIA. See, e.g., *Fla. Bankers Ass'n v. Dep't of Treasury*, 19 F. Supp. 3d 111 (D.D.C. 2014), *vacated*, 799 F.3d 1065 (D.C. Cir. 2015), *reh'g denied*, No. 14-5036 (D.C. Cir. Nov. 5, 2015), *cert. denied*, 136 S. Ct. 2429 (2016); *Maze v. IRS*, 862 F.3d 1087 (D.C. Cir. 2017), *aff'g* 206 F. Supp. 3d 1 (D.D.C. 2016) (suit by plaintiffs to switch participation in IRS's 2012 OVDP to later Streamlined Procedures with more favorable terms regard-

ing §6662 accuracy-related penalties was barred by AIA as allowing plaintiffs to switch would have had effect of restraining IRS from collecting penalties for which plaintiffs were currently liable). However, the U.S. Supreme Court has held that a suit to enjoin an information reporting requirement was not barred by the AIA, even though a violation of the reporting requirement could result in a tax penalty. See *CIC Servs., LLC v. IRS*, 141 S. Ct. 1582 (U.S. 2021).

For a further discussion of the AIA and §7421, see 637 T.M., *Federal Tax Collection Procedure — Liens, Levies, Suits, and Third-Party Liability*.

ing §6662 accuracy-related penalties was barred by AIA as allowing plaintiffs to switch would have had effect of restraining IRS from collecting penalties for which plaintiffs were currently liable). However, the U.S. Supreme Court has held that a suit to enjoin an information reporting requirement was not barred by the AIA, even though a violation of the reporting requirement could result in a tax penalty. See *CIC Servs., LLC v. IRS*, 141 S. Ct. 1582 (U.S. 2021).

¹²⁹⁰ *Bob Jones Univ. v. Simon*, 416 U.S. 725 (1974), (citing *Enochs v. Williams Packing & Navigation Co.*, 370 U.S. 1 (1962)); *Estate of Michael v. Lullo*, 173 F.3d 503 (4th Cir. 1999).

XV. Violations of Fair Tax Collection Practices (Collection Procedure #8)

Absent permission from the taxpayer or a court, the IRS is limited as to when it may communicate with a taxpayer in connection with the collection of any unpaid tax. The IRS may not communicate with the taxpayer: (1) at an unusual time or place or one which the IRS should know is inconvenient to the taxpayer; (2) when the IRS knows the taxpayer is represented by a person authorized to practice before the IRS with respect to the tax, unless the representative does not respond or consents to direct communication with the taxpayer;¹²⁹¹ and (3) at the taxpayer's place of employment if the IRS knows or has reason to know that the taxpayer's employer prohibits such communication.¹²⁹² The IRS assumes that it is convenient to communi-

cate with the taxpayer after 8 a.m. and before 9 p.m. local time at the taxpayer's location unless the IRS has knowledge of circumstances to the contrary.¹²⁹³ According to the IRS, statutorily required notices, such as the notice of intent to levy, are not within the purview of §6304(a).¹²⁹⁴

The IRS also may not engage in any conduct the natural consequence of which is to harass, oppress, or abuse any person in connection with the collection of any unpaid tax.¹²⁹⁵ Under §6304(c), violation by the IRS of these fair tax collection practices is actionable under §7433.

In collecting a claim, compromising a claim, or terminating collection action on a claim, the IRS is permitted to obtain a consumer report or comparable credit information on any person liable for the claim.¹²⁹⁶

¹²⁹¹ Cf. CCA 200027045 (advising that Last Chance Letter for collection summons could be sent to taxpayer who executed power of attorney form, but should be sent to representative to avoid unethical ex parte contact). For purposes of bringing an unauthorized collection action under §7433 based on a claimed violation of §6304, an allegation that the IRS knew that the taxpayer was represented by counsel is inadequate. *United States v. Grant*, 289 F. Supp. 2d 1361 (S.D. Fla. 2003).

¹²⁹² §6304(a)(1)–§6304(a)(3).

¹²⁹³ §6304(a) (flush language).

¹²⁹⁴ SCA 200032040. See also CCA 200027045 (tax delinquency investigation (TDI) summons issuance is not an act of collection under §6304(a)).

¹²⁹⁵ §6304(b).

¹²⁹⁶ 31 U.S.C. §3711(h). See CCA 201614032 (IRS may obtain credit report in determining whether taxpayer's account should be placed in "Currently Not Collectible" status due to financial hardship); CCA 201502010 (IRS may obtain credit report of non-liable spouse in community property state, as it constitutes consumer report of liable spouse).

XVI. Miscellaneous Collection Issues

A. Passport Revocation or Denial

In addition to collection by lien and levy, the IRS can assert pressure on the taxpayer by causing the taxpayer's passport to be denied or revoked. See 637 T.M. *Federal Tax Collection Procedure — Liens, Levies, Suits, and Third-Party Liability*, for a complete discussion of this issue.

B. Collection of Criminal Restitution Assessments

Because criminal restitution assessments are treated like assessments of tax, most collection defenses are available. The collection defenses cannot interfere with the order of the court, however. Accordingly, there are some restrictions and differences for collection of a restitution-based assessment.

It is common for the IRS to assess the criminal restitution amount and an overlapping civil tax liability. Although criminal restitution and a civil tax liability are distinct, the IRS may not collect both for the same period because that would be impermissible double collection.¹²⁹⁷ Any payments made to satisfy the restitution-based assessment must also be applied by the IRS to satisfy the civil tax liability for the same tax period. The proper application of payments is achieved through the use of a mirrored account for the restitution-based assessment and the ultimate civil liability for the same period. The restitution itself is also a judgment that can be collected by the Department of Justice pursuant to provisions outside the Internal Revenue Code.¹²⁹⁸

Under §6501(c)(11), the IRS may assess restitution under §6201(a)(4) or file a proceeding in court to collect the amount ordered as restitution at any time. Once assessed, the general 10-year statute of limitations for collection under §6502(a) (and any suspensions of such period pursuant to §6503) applies. Under §6322, the date on which the statutory tax lien arises under §6231 is the date of the restitution-based assessment.¹²⁹⁹ The IRS may file a civil suit to reduce the restitution-based assessment to judgment before the 10-year period expires to obtain a 20-year judgment lien under 28 U.S.C. §3201(c).¹³⁰⁰ The IRS should not refer the restitution-based assessment to the Department of Justice for a collection enforcement suit when restitution was ordered solely as a condition of supervised release or probation because reducing the assessment to judgment will not extend collectibility beyond termination of supervised release on probation.¹³⁰¹

¹²⁹⁷ IRM 25.26.1.2.(3). *United States v. Tucker*, 217 F.3d 960, 962 (8th Cir. 2000) (explaining that criminal restitution for a tax crime should be ordered in favor of the IRS and calculated based on the tax owed and that "any amounts paid to the IRS as restitution must be deducted from any civil judgment IRS obtains to collect the same tax deficiency"); *United States v. Helmsley*, 941 F.2d 71, 102 (2d Cir. 1991) ("[W]e believe it is self-evident that any amount paid as restitution for taxes owed must be deducted from any judgment entered for unpaid taxes in such a civil proceeding"). See also IRM 25.26.1.2.

¹²⁹⁸ See *United States v. Poff*, 727 Fed. Appx. 249 (9th Cir. 2018) (unpub.).

¹²⁹⁹ CC-2011-018 at III:Q&A-16.

¹³⁰⁰ CC-2011-018 at II:Q&A-15. CC-2011-018 at III:Q&A-16.

¹³⁰¹ PMTA 2018-19. See also CCA 202118015 (where restitution is imposed solely as condition of supervised release and not under other portion of sentence, IRS is obliged only to assess and collect restitution during period of supervised release).

A taxpayer is entitled to a CDP hearing when the IRS attempts to collect a restitution-based assessment by lien or levy. The IRS must comply with the CDP notice, hearing and verification requirements.¹³⁰² However, the taxpayer may not challenge the amount of restitution in a CDP hearing.¹³⁰³

To the extent that the taxpayer is seeking collection alternatives under §6330(c)(2)(A)(iii), the IRS may not enter into any installment agreement or offer-in-compromise that would result in the taxpayer paying less than the amount of restitution ordered.¹³⁰⁴

C. Private Debt Collection Agencies

In 2004, Congress authorized the IRS to use private debt collection agencies to locate and contact taxpayers owing outstanding tax liabilities and to arrange for payment of those taxes.¹³⁰⁵ In 2009, Congress barred the use of funds for this purpose and the IRS announced that it would not renew its contracts with private tax collectors, effectively abandoning this program.¹³⁰⁶

The program was reinstated by the Fixing America's Surface Transportation (FAST) Act.¹³⁰⁷ Following the FAST Act changes, the IRS is required to enter into qualified tax collection contracts for the collection of inactive tax receivables.¹³⁰⁸ See Pub. 4518, *What You Can Expect When the IRS Assigns Your Account to a Private Collection Agency*, for more information.¹³⁰⁹

A qualified tax collection contract is any contract for the services of locating and contacting any taxpayer to request full payment or an installment agreement from the taxpayer and to obtain the financial information of the taxpayer.¹³¹⁰

An inactive tax receivable is any tax receivable: (1) removed from the active inventory for lack of resources or inability to locate the taxpayer, (2) for which more than 2 years has passed since assessment and no IRS employee has been assigned to collect the receivable, or (3) for which a receivable has been assigned for collection but more than 365 days have passed without interaction with the taxpayer or a third party for

¹³⁰² IRM 5.1.5.15.3(5); CCA 201510043 (CDP procedures apply separately to restitution-based assessment and deficiency assessment). The IRS is not precluded from taking administrative collection action (e.g., levy) based on the §6201(a)(4) assessment while a taxpayer is making payments under a restitution payment plan. CC-2011-018 at II:Q&A-20.

¹³⁰³ Section 6201(a)(4)(C) precludes a taxpayer from challenging the existence or amount of the underlying tax liability on which the restitution is based. See PMTA 2012-27 (Oct. 22, 2012) (challenge to amount of restitution prohibited at CDP hearing because criminal case itself is prior judicial hearing regarding same issue in which taxpayer meaningfully participated). See also IRM 35.3.23.2.4.

¹³⁰⁴ IRM 5.1.5.18.5, IRM 5.1.5.18.6.

¹³⁰⁵ Former §6306.

¹³⁰⁶ Financial Services and General Government Appropriations Act, 2009, Pub. L. No. 111-8, Div. D, §106; IRS News Release IR-2009-19 (Mar. 5, 2009).

¹³⁰⁷ Pub. L. No. 114-94, Div. C, §32102, effective for tax receivables identified after December 4, 2015. See IRM 5.19.1.5.21 *et seq.* for internal IRS guidance on private debt collection programs.

¹³⁰⁸ §6306.

¹³⁰⁹ See also IRS News Release IR-2021-191 (Sept. 22, 2021) (beginning September 23, 2021, taxpayers with overdue tax debts may be contacted by one of the following private collection agencies on behalf of the IRS: CBE Group, Inc., Coast Professional, Inc., ConServe).

¹³¹⁰ §6306(b).

purposes of furthering the collection.¹³¹¹ A tax receivable is any outstanding assessment which the IRS includes in potentially collectible inventory.¹³¹²

Certain tax receivables are not eligible for collection under a qualified tax collections contract. These include:¹³¹³

- pending or active offer in compromise or installment agreements;
- innocent spouse cases;
- cases involving deceased taxpayers, taxpayers under age 18, taxpayers in a designated combat zone or victims of tax-related identity theft;
- cases that are currently under examination, litigation, criminal investigation, or levy;
- cases that are subject to a proper exercise of a right of appeal;
- cases involving taxpayers whose income substantially consists of disability insurance benefits or supplemental security income benefits under the Social Security Act,¹³¹⁴ or
- cases involving taxpayers with adjusted gross income less than 200% of the applicable poverty level.¹³¹⁵

Taxpayers in federally declared disaster areas may request relief from immediate collection measures.¹³¹⁶

The provisions of the Fair Debt Collection Practices Act (15 U.S.C. 1692 *et seq.*) apply to any qualified tax collection contract, except to the extent superseded by §6304, §7602(c), or by any other provision of the Internal Revenue Code.¹³¹⁷ Ad-

¹³¹¹ §6306(c)(2)(A), as amended by the Taxpayer First Act, Pub. L. No. 116-25, §1205, effective for tax receivables identified by the IRS after December 31, 2020. Before the Taxpayer First Act, the second inactive tax receivable was any tax receivable for which more than 1/3 of the applicable limitations period had lapsed and no IRS employee had been assigned to collect the receivable. §6306(c)(2)(A)(ii), before amendment by Pub. L. No. 116-25, §1205. See also IRM 5.1.12 (procedures for case resolution when taxpayer liability has been assigned to private collection agency).

¹³¹² §6306(c)(2)(B).

¹³¹³ §6306(d).

¹³¹⁴ §6306(d)(3)(E), as amended by the Taxpayer First Act, Pub. L. No. 116-25, §1205, effective for tax receivables identified by the IRS after December 31, 2020. See Social Security Act, §223 (42 U.S.C. §423) (disability benefits) and Social Security Act, tit. XVI (supplemental security income for the aged, blind, and disabled). The IRS and SSA initially had difficulty identifying SSI recipients who might be eligible for the exclusion. Starting June 24, 2022, however, the IRS was able to begin systemically excluding from assignment to PCAs SSI recipient accounts and began recalling such accounts. SSI recipients who may be assigned to a PCA should notify the PCA of their status so that their account can be automatically returned to the IRS. See *NTA Blog: Beginning Today, Some of Our Nation's Most Vulnerable Taxpayers Will Automatically Have Their Accounts Excluded From Assignment to Private Collection Agencies* (June 24, 2022).

¹³¹⁵ §6306(d)(3)(F), as amended by the Taxpayer First Act, Pub. L. No. 116-25, §1205, effective for tax receivables identified by the IRS after December 31, 2020.

¹³¹⁶ §6306(i).

¹³¹⁷ §6306(g). The Federal Communications Commission issued a report and order containing final rules on August 11, 2016, which extended some collection protections to those with federal debts with regard to any autodialed, prerecorded-voice, and artificial-voice calls that reasonably relate to the collection of a covered debt; so called “robo-calling.” See FCC 16-99 (Aug. 11, 2016), available at: https://apps.fcc.gov/edocs_public/attachmatch/FCC-16-99A1.pdf, and 47 C.F.R. §64.1200. See XV., above, for a discussion of the Fair Debt Collection Practices Act.

ditionally, §7433A permits civil damages for unauthorized collection actions by those performing services under qualified collection contracts. Section 7433A applies §7433 with modifications.¹³¹⁸ The modifications require that:¹³¹⁹

- the taxpayer bring any §7433 action against the person or company who entered into the qualified collection contract, not the United States;
- the person or company who entered into the contract, not the United States, is liable for costs and damages;
- the action is not an exclusive remedy; and
- §7433(c) (payment authority), §7433(d)(1) (exhaustion of administrative remedies), and §7433(e) (violations of bankruptcy procedures) do not apply.

Taxpayer Advocate Assistance Orders (TAOs) apply to the persons executing under qualified collection contracts.¹³²⁰

D. IRS Summons in Aid of Collection

Revenue officers have broad powers to gather information from taxpayers and third parties. Section 7602 allows revenue officers to issue summonses to examine books, records, and other information relevant to the determination and collection of the tax liability. For further discussion of summons requirements, see 633 T.M., *Compelled Production of Documents and Testimony in Tax Examinations*.

E. Freedom of Information Act (FOIA) Requests by Taxpayers

The taxpayer has administrative avenues available to obtain information within the IRS’s possession. The Freedom of Information Act (FOIA) allows a taxpayer to gain access to documents in the possession of the IRS that are disclosable under §6103 and the FOIA exemptions. A taxpayer can obtain a copy of a transcript of account and a copy of the IRS administrative file through a FOIA request.¹³²¹

F. Damage Actions

A taxpayer may bring a court action for damages in a U.S. district court if an employee of the IRS negligently disregards any provision of the Internal Revenue Code or a regulation promulgated thereunder in tax collection actions.¹³²² The taxpayer must first have exhausted administrative remedies.¹³²³ The taxpayer’s recovery is limited to the lesser of: (a) \$100,000 or (b) the sum of the actual, direct economic damages sustained by

¹³¹⁸ §7433A(a). See XVI.F., below, for a discussion of §7433.

¹³¹⁹ §7433A(b).

¹³²⁰ §7811(g). See 623 T.M., *IRS Procedures: Examinations and Appeals*, for a discussion of TAOs.

¹³²¹ For a further discussion of FOIA and its many exemptions, see 625 T.M., *Obtaining Information from the Government — Disclosure Statutes*.

¹³²² §7433(a); Reg. §301.7433-1. See *Mihalcheon v. United States*, No. 2:24-cv-00749-MCS-JC, 2025 BL 103696 (C.D. Cal. Mar. 26, 2025) (no damages under §7433(a) because IRS did not disregard an I.R.C. provision or regulation).

¹³²³ §7433(d)(1). See, e.g., *Whitsitt v. Cato IRS Agent*, 2018 BL 257644 (E.D. Cal. 2018), *adopted*, 122 AFTR 2d 2018-5735 (E.D. Cal. 2018), *aff’d*, 773 Fed. Appx. 918 (9th Cir. 2019) (taxpayer failed to allege administrative remedies were exhausted; taxpayer’s mere allegation that he called the IRS to complain about levy was insufficient to satisfy the requirement in §7433).

the taxpayer plus the costs of court action.¹³²⁴ If the collection action is intentional or reckless, the \$100,000 limit is increased to \$1,000,000.¹³²⁵ The action must be brought within two years after the right of action accrues.¹³²⁶

A third party may also secure a judgment against the IRS if the IRS employee acts recklessly, intentionally or with negligence. The third party can recover the same amount a taxpayer can recover. The third party must have exhausted the third party's administrative remedies to recover any amount.¹³²⁷ If the collection action is intentional or reckless, the \$100,000 amount is instead \$1,000,000.¹³²⁸

A taxpayer may bring an action for damages in bankruptcy court if, in connection with the collection of a federal tax, an IRS officer or employee willfully violates either the Bankruptcy Code's automatic stay provision, the Bankruptcy Code's discharge provision, or a regulation promulgated under either of these provisions.¹³²⁹

¹³²⁴ §7433(b).

¹³²⁵ §7433(b).

¹³²⁶ §7433(d)(3).

¹³²⁷ §7426(h)(2); Reg. §301.7426-2(a), §301.7426-2(b). As damages in connection with a claim under §7426(h) are subject to the exhaustion of administrative remedies, mitigation of damages, and time for filing limitations imposed by §7433(d), the rules under Reg. §301.7426-2 are similar to those promulgated under §7433, i.e., Reg. §301.7433-1.

¹³²⁸ §7426(h)(1); Reg. §301.7426-2(a).

¹³²⁹ §7433(e), citing 11 U.S.C. §362 and 11 U.S.C. §524; Reg. §301.7433-2. Reg. §301.7433-2 reflects that damages in connection with a claim under §7433(e) are recoverable to the extent allowed by §7433(b) and

The willfulness test has been held to have been met where the IRS knew of a bankruptcy court discharge but nevertheless sought to collect the tax debt (i.e., the IRS had knowledge of a stay or injunction, and intended actions that constituted a violation of the stay or the injunction).¹³³⁰

G. Federally Authorized Tax Practitioner Privilege

Section 7525, added by the 1998 IRS Reform Act, provides that communications between a taxpayer and any federally authorized tax practitioner are privileged as if made to an attorney. This privilege does not apply to a criminal tax matter.¹³³¹ The term "federally authorized tax practitioner" includes attorneys, certified public accountants, enrolled agents, and enrolled actuaries.¹³³² The privilege does not apply to any written correspondence made to a director, shareholder, officer, employee, agent, or representative of a corporation in connection with the promotion of the direct or indirect participation of the corporation in any tax shelter.¹³³³ The privilege can be waived in the same manner as the attorney-client privilege.¹³³⁴

are subject to the exhaustion of administrative remedies, mitigation of damages, and time for filing limitations imposed by §7433(d). Reg. §301.7433-2(b)(1) and §301.7433-2(c) define damages and costs with reference to how those terms are defined in Reg. §301.7433-1 relating to actions under §7433(b).

¹³³⁰ *IRS v. Murphy*, 564 B.R. 96 (D. Me. 2016), *aff'd*, 892 F.3d 29 (1st Cir. 2018).

¹³³¹ §7525(a)(2).

¹³³² §7525(a)(3)(A); 31 U.S.C. §330.

¹³³³ §7525(b).

¹³³⁴ See §7525(a)(1).

TABLE OF WORKSHEETS

PRACTICE AIDS

Worksheet 1	Interplay Between §6320 and §6330 — Collection Due Process (Chart).
Worksheet 2	Dischargeability of Taxes in Bankruptcy (Chart).

Working Papers for this Portfolio can be found online at <https://bloombergtax.com>.

Additional Resources:

The following resources are available on *Bloomberg Law: Tax*. For information on how to obtain this material, call 1-800-372-1033.

- Liability Collection, Campus Collection International Case Processing — IRM 5.19.19:
https://www.irs.gov/irm/part5/irm_05-019-019r.
- Effective Tax Administration Offers in Compromise Under §7122 — IRM 5.8.11:
http://www.irs.gov/irm/part5/irm_05-008-011.html.
- Securing Installment Agreements — IRM 5.14.1:
https://www.irs.gov/irm/part5/irm_05-014-001r.
- Offer in Compromise Pre-Qualifier online tool:
https://irs.treasury.gov/oic_pre_qualifier/.
- Collection Financial Standards:
<https://www.irs.gov/businesses/small-businesses-self-employed/collection-financial-standards>.
- Collection Financial Standards — National Standards for Food, Clothing, Other Items and Transportation Expenses:
<https://www.irs.gov/businesses/small-businesses-self-employed/national-standards-food-clothing-and-other-items>.
- Collection Financial Standards — National Standards for Out-of-Pocket Health Care:
<https://www.irs.gov/businesses/small-businesses-self-employed/national-standards-out-of-pocket-health-care>.
- Collection Financial Standards — Local Standards for Housing and Utility Expenses:
<https://www.irs.gov/businesses/small-businesses-self-employed/local-standards-housing-and-utilities>.
- Collection Financial Standards — Local Standards for Transportation Expenses:
<https://www.irs.gov/businesses/small-businesses-self-employed/local-standards-transportation>.
- Publication 1660, *Collection Appeal Rights*.
- Publication 908, *Bankruptcy Tax Guide*.

