



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

SMALL BUSINESS/SELF-EMPLOYED DIVISION

January 15, 2015

Control Number: SBSE -05-0115-0007
Expiration Date: January 22, 2016
Impacted: IRM 5.9.4
IRM 5.9.8
IRM 5.9.9
IRM 5.9.10
IRM 5.9.18

MEMORANDUM FOR DIRECTOR, SPECIALTY COLLECTION INSOLVENCY

FROM: Dretha Barham /s/ *Dretha Barham*
Director, Collection Policy

SUBJECT: Procedures for Processing Bankruptcy Cases with Restitution Assessments

The purpose of this memorandum is to reissue interim guidance SBSE-05-0114-005, Procedures for Processing Bankruptcy cases with Restitution Assessments, dated January 22, 2014. Please disseminate this information to all affected personnel within your organizations. These procedures will be incorporated into the Internal Revenue Manual (IRM).

Background

Following the conviction of a defendant for a criminal tax violation or tax-related offense, the court may order the defendant to pay restitution. The requirement that the defendant pay restitution will be contained in a document signed by the judge called a Judgment and Commitment (J&C) Order. In 2010, Congress amended IRC § 6201 to provide that the IRS shall assess and collect tax-related restitution in the same manner as if such amount were tax. This change in section 6201 applies to restitution in all J&C Orders entered after August 16, 2010.

Restitution assessments against individuals will be made on Master File Transaction (MFT) 31 and can be identified by Transaction Code (TC) 971 with action code 102. Restitution ordered in a case of an individual will be assessed with one of the following:

- TC 290 with Reason Code (RC) 141 to 150
- TC 300 with RC 141 to 150
- TC 298 with RC 141 to 150

Restitution assessed against a Business Entity will be made on MFT 02, 06, 05, etc. It is expected that restitution assessments on a Business Master File (BMF) account will be rare.

TC 971 with action codes 180 through 189 will reflect the type of tax and tax periods for which the restitution was ordered. Most restitution assessments will be made against individual taxpayers, even if the restitution assessment relates to a BMF source.

Example: Taxpayer A was convicted of criminal failure to collect or pay over tax under IRC § 7202, and was ordered to pay restitution in the amount of \$30,000. This amount was calculated based on the tax loss resulting from the taxpayer's failure to pay employment taxes in the amount of \$10,000 for each of the last three quarters of 2007. The assessment will be made against Taxpayer A, under his social security number (SSN), even though the assessment relates to the liability of a business.

Restitution-based assessments will be a mirror assessment of (although not necessarily identical to) the tax liability assessed pursuant to a civil exam, creating two separate assessments. Although the restitution-based assessment and civil tax liability assessment are distinct, the IRS generally may not collect both in full for the same period because it would be impermissible double collection. In these cases, any payments made to satisfy the restitution-based assessment must also be applied by the Service to satisfy the civil tax liability for the same tax periods.

However, there are certain circumstances where the restitution is not related to the taxpayer's own civil tax liability for the same period. In such cases, collection in full of both the restitution-based assessment and the criminal defendant's personal tax liability assessment is permissible.

Example: Taxpayer B is an officer of a Corporation B, and was convicted under IRC § 7202 of criminal failure to collect or pay over corporate income tax, for 2007 and ordered to pay restitution. The restitution was calculated based on the tax loss resulting from the taxpayer's failure to collect, account for, and pay over Corporation B's 2007 income tax. In addition to this restitution order that covers corporate income tax liabilities, Taxpayer B is also personally liable for the same tax period (2007) for nonpayment of his personal income tax liability. In this situation, collection of both assessments in full is permissible; the Service will be separately collecting the Taxpayer B's restitution-based assessment as well as the assessment of his personal income tax liability for the same year without cross referencing the two accounts.

Single points of contact are designated in Advisory to serve as liaisons for restitution cases, referred to as Advisory Probation Liaisons (APL). The APL can provide information regarding the terms for payment of the restitution, and are responsible for monitoring whether the taxpayer is in compliance with the J&C Order. APLs are an important resource for Insolvency caseworkers in handling cases with restitution assessments.

A list of the APLs is located at

<http://mysbse.web.irs.gov/AboutSBSE/Collection/fieldcoll/aig/aigorg/contacts/19176.aspx>. In the event that the list does not contain the current APL, caseworkers should contact the Advisory group for the state listed in Pub. 4235.

Procedures

Classifying a Case as Restitution

When a revenue officer or an APL learns that a taxpayer against whom a restitution assessment has been made has filed bankruptcy, the revenue officer or APL will contact the Centralized Insolvency Operation (CIO) and inform them that the bankruptcy involves a restitution assessment. The revenue officer or APL should call the CIO and provide this information even if the IRS has otherwise received notice of the bankruptcy case and the case has been opened on the Automated Insolvency System (AIS). The CIO caseworker should input "CRIMREST" on the case classification screen and note the information provided by the revenue officer or APL in the history.

Case Assignment

Field Insolvency will work all cases with Criminal Restitution assessments. These cases will not be assigned to CIO. These are considered complex issues. IRM 5.9.1.4, The Role of Insolvency, will be updated to show Criminal Restitution as a complex issue.

Proofs of Claim

For purposes of a bankruptcy case, a restitution assessment is classified in the same manner as the tax module to which it relates. The Automated Proof of Claim system (APOC) will recognize the assessment and classify it based on the tax module. No flag will be raised solely due to the fact that the assessment is for restitution.

Example: The J&C Order directs the taxpayer to pay restitution for income tax the taxpayer evaded for the tax year 2005. The amount of restitution is assessed on September 12, 2011. On September 12, 2012, the taxpayer files a Chapter 13 bankruptcy case. The restitution assessment is not classified as priority, as the return was due more than three years prior to the filing of the bankruptcy petition, and the restitution assessment was more than 240 days prior to the bankruptcy petition. Because the restitution assessment does not fall within any of the reasons for classifying it as priority, APOC will classify the restitution assessment and the related interest as general unsecured on the proof of claim.

A flag will be raised if a Notice of Federal Tax Lien (NFTL) was filed for the period. If the NFTL was filed with respect to the restitution assessment, the NFTL will carry an "R" and the form number of the underlying tax source, such as "R1040." The flag should be cleared in accordance with the instructions in IRM 5.9.14.2.9(5) (j).

If it is necessary for a caseworker to create a proof of claim manually, caseworkers should follow the regular classification rules for the type of tax for which restitution is to be made. Interest on the restitution assessment will have the same classification as the tax assessment. If the failure to pay penalty accrued on the restitution assessment, it will either be secured or general unsecured.

The mirror assessment of the restitution-based assessment for the same type of tax is created based on a return filed, an assessment made after an audit, or the creation of a 6020(b) return.

Example: The taxpayer is convicted of income tax evasion for the 2006 tax year. In the J&C Order, the court directs the taxpayer to pay restitution of the evaded income tax in the amount of \$10,000. The IRS conducts a civil exam of the taxpayer after his conviction and determines that the deficiency for the 2006 tax year was \$15,000. There will be two assessments made: the first one for \$10,000 based on the restitution order and a second, separate assessment will be made pursuant to a civil exam in the amount of \$15,000. Any payments made towards the restitution-based assessment shall be applied towards the tax liability assessed pursuant to the civil exam to avoid double collection of the assessment.

The same duplicate assessment shall be made for restitution arising from taxes other than income taxes, for example employment taxes. If restitution is ordered against an individual defendant for failure to pay business employment taxes, the restitution is actually based on the employment tax liability of the business, not the individual's personal liability. Nonetheless, business tax liability ordered as restitution can be assessed against the individual. However, the IRS cannot collect in full both the restitution-based assessment and the business employment tax liabilities of that separate business. The prohibition against double collection will come into play here as well. The case worker must adjust the unpaid tax liability of the corresponding business entity to account for any payments made through restitution or the restitution-based assessment against the individual defendant. The prohibition against double collection would not apply, however with respect to the collection of both the individual taxpayer's restitution-based assessment based on the employment tax and his personal civil tax liabilities for the same periods.

Treatment of Restitution Assessments in Plans

The J&C Order will usually contain a payment schedule specifying the manner in which the restitution amount must be paid, and will normally specify that restitution payments are to be made to the office of the clerk of the district court in the district in which the J&C Order was entered. The clerk of the court office disburses the payments to the appropriate victims of the criminal action. In the case of the IRS as a victim, the payments are mailed to the Kansas City Submission Processing Center (KCSPC), which applies the payments to the restitution assessment. If the person ordered to make restitution payments fails to make the

required payments, the court may revoke or modify a term of supervised release, or may resentence the individual. In the case of the IRS, the assigned APL will also monitor the payments and will report if the taxpayer fails to make the required payments. Insolvency caseworkers can obtain the restitution payment schedule contained in the J&C Order from the appropriate APL.

Because restitution payments are monitored by the office of the clerk of the court, the taxpayer may provide in a bankruptcy plan for the restitution payments to be made to the office of the clerk of court outside the terms of the plan. If the taxpayer provides for the restitution payments outside the plan, caseworkers should not object to the plan solely for this reason. After confirmation, the caseworker should notify the APL that the taxpayer will continue to make payments to the office of the clerk of the court. The APL will monitor that payment of the restitution is being made.

If payments are to be made outside the plan, the caseworker will need to remove the assessment amount from the Claim Screen and the Plan Screen. This will ensure that the trustee does not duplicate the payment made directly to the office of the clerk of the court by the debtor. It will also ensure that none of the payments made pursuant to the plan are applied to the restitution assessment.

If the taxpayer provides in the plan for the restitution assessment to be paid according to the payment scheduled in the J&C Order, caseworkers should verify that the plan complies with the terms of the J&C Order in terms of the amount of the payments and the schedule on which the payments are to be made. If the plan mirrors the provisions of the J&C Order, no objection should be raised to the plan unless some other reason for objection exists.

If the plan provides for the restitution assessment to be paid according to the J&C Order, upon plan confirmation the caseworker should notify the APL that the restitution payments are being made to the IRS pursuant to a bankruptcy plan, and that Insolvency will monitor that the payments are being made. In Chapters 11 and 12 cases, the caseworker should detail in the history the amounts paid under the plan for restitution that are to be applied to the restitution assessment. In Chapter 13 cases, the Field Insolvency caseworker should note the provisions for the restitution payments in an AIS history Summary, pursuant to IRM 5.9.10.6, *Field Insolvency AIS Actions*, IRM 5.9.5.4.2, *Summary Histories*, and IRM 5.9.5.4.3, *Chapter 13 Summary Histories*.

If the plan provides for the restitution assessment to be paid through the plan, but in amounts less than the payments ordered in the J&C Order or on a less frequent schedule than the J&C Order requires, the case should be referred to Counsel to object to confirmation of the plan as it contradicts a court order. In the event that the bankruptcy court confirms a plan in which the restitution payments do not mirror the J&C Order but are in accordance with the provisions of the Bankruptcy Code, the caseworker should apply the payments in accordance with the provisions of the plan and the order confirming the plan. The AIS history should contain the details regarding the appropriate payment application. The caseworker should notify the APL of the details of the confirmed plan and that the plan does not comply with the provisions of the J&C Order.

In all cases, plans should be reviewed for language providing for a discharge of the restitution assessment, and if the plan contains such language, the case should be referred to Counsel for objection.

Application of Payments

Payments made pursuant to a plan for restitution must be applied to the restitution assessment. In the event it is necessary to determine how any payment(s) received in bankruptcy and designated for restitution should be applied, the Insolvency caseworker should contact the APL for guidance.

Default

The Insolvency caseworker should immediately contact the APL in the event that the debtor defaults on a confirmed plan and:

- The restitution is being paid through the plan and
- The restitution assessment(s) have not been fully paid.

The Insolvency caseworker should also contact Area Counsel for guidance on whether a motion should be filed to dismiss the case. The caseworker should inform Counsel that there is an unpaid restitution assessment, and provide the contact information for the assigned APL.

General Discharge Procedures

Pursuant to Bankruptcy Code §§ 523(a)(13) and 1328(a)(3), restitution amounts ordered in the J&C Order are not subject to discharge in an individual debtor's case filed under any chapter of the Bankruptcy Code. If restitution is ordered against an entity, i.e., a non-individual, who later files a Chapter 11 case, the restitution assessment will not be discharged to the extent the Chapter 11 plan provides for payment of the liability. See 11 U.S.C. § 1141(d) (1) (A). Further, the tax loss ordered to be paid as restitution would probably qualify as a tax for which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat (contact Counsel). See 11 U.S.C. § 1141(d) (6) (B).

For purposes of the discharge, interest will be treated in the same manner as the tax to which it relates. Accordingly, interest will not be discharged if the restitution assessment is not discharged. The only penalty that may accrue on a restitution assessment is the failure to pay penalty. The failure to pay penalty on restitution assessments should be treated like other tax penalties in bankruptcy that relate to nondischargeable taxes, and will not be subject to discharge if the failure to pay occurred within three years of the bankruptcy case.

Discharges on IMF Accounts

Criminal restitution assessments will be identified by a new CRIMREST DDR (Discharge Determination Report), which will be present on Individual Master File (IMF) restitution assessments.

The restitution assessment and the interest should not be discharged on an IMF module. If the module contains only the restitution assessment and interest, the DDR should be worked by taking the following actions:

1. Input TC 521 with the appropriate closing code to reverse the open 520.
2. On the AIS Automated Discharge System (ADS) screen, enter **M** (manually processed) in the "DECISION" field next to the corresponding Discharge Determination Report (DDR).
3. Click "Save" in the top right corner of the ADS screen.
4. Document the AIS history screen with all actions taken.

If the penalty and interest on the penalty are dischargeable, caseworkers should work the CRIMREST DDR in these cases by taking the following actions:

1. Input TC 971 action code 033 on all partially dischargeable periods using command code REQ77.
2. Input appropriate abatement transactions on the Integrated Data Retrieval System (IDRS) for the penalties using command code REQ54.
3. At the same time the penalty abatements are input on IDRS using REQ77, input TC 521 with appropriate closing code(s) with a three cycle delay.
4. On the AIS ADS screen, enter **M** (manually processed) in the "DECISION" field next to the corresponding DDR.
5. Click "Save" in the top right corner of the ADS screen.
6. Document the AIS history with all actions taken.

If the penalty and interest on the penalty are not dischargeable, caseworkers should work the CRIMREST flag in these cases by taking the following actions:

1. Input TC 521 with the appropriate closing code to reverse the open 520.
2. On the AIS Automated Discharge System (ADS) screen, enter **M** (manually processed) in the "DECISION" field next to the corresponding Discharge Determination Report (DDR).
3. Click "Save" in the top right corner of the ADS screen.
4. Document the AIS history screen with all actions taken.

Discharges on BMF Accounts

If the restitution assessment was established on a BMF module and the taxpayer:

- Filed a Chapter 7 case or a liquidating Chapter 11 case, close the case using the procedures in IRM 5.9.17.10 and IRM 5.9.17.11, as no discharge is granted.
- Filed a regular, non-liquidating, Chapter 11 case, the restitution assessment will be discharged except to the extent the plan or plan confirmation order provides otherwise, or to the extent that section 1141(d)(6) applies (mentioned above). Follow the instructions contained in IRM 5.9.17.7.8(6) and 5.9.17.12.1 in closing these cases. In the event that any portion of the restitution assessment or related interest may have been discharged, caseworkers should contact the appropriate APL and Counsel.
- Document the AIS history to reflect the actions taken.

The dischargeability of any additional assessments on the module which are not for restitution will be determined based on the guidelines contained in IRM 5.9.17.7, *Discharge and Exceptions to Discharge*, and IRM 5.9.17.7.8, *Discharge and Restitution Assessments and IRM 5.9.2.10.1, Bankruptcy Discharges and Collection*. Caseworkers should pay particular attention to whether the taxes are nondischargeable because the debtor filed a fraudulent return or made a willful attempt to evade or defeat the tax, and should follow the procedures contained in IRM 5.9.17.7.2, *The Fraud or Willful Evasion Exception*.

The impacted IRM sections will be updated in the next revision to include these instructions.

If you have questions, please contact me, or a member of your staff may contact Patricia Murphy, Insolvency Program Analyst, or Rocco Steco, the Program Manager.

cc: Director, Field Collection
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