



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

OFFICE OF
CHIEF COUNSEL

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MEMORANDUM FOR DISTRICT COUNSEL, OHIO DISTRICT
CC:NER:OHI:CIN

FROM: Alan C. Levine, Chief Branch1 (General Litigation)

SUBJECT:

This is in response to your memorandum of November 12, 1999, in which you requested that we post-review the advice you issued to the District Director for the Ohio District concerning the above.

LEGEND:

Taxpayer: X
Surety: Y
Amount: Z

ISSUE(S):

1. Whether the obligation levied upon by the Internal Revenue Service (Service) constituted a "fixed and determinable" property right.
2. Whether attorney's fees as well as fees paid for accounting services and expert witnesses incurred in connection with legal services are entitled to priority over the federal tax lien pursuant to I.R.C. § 6323(b)(8).

CONCLUSION:

We have given thorough consideration to the advisory opinion you provided to the Special Procedures Function and agree with the position you have taken with respect to the first issue, namely, that the failure to honor the Service's levy was not justified. With respect to the second issue, i.e., whether the claim for attorney's fees as well as for accounting services and expert witness fees paid in connection with the legal services are entitled to priority over the federal tax lien, we believe that only the attorney's fees qualify for superpriority status under section 6323(b)(8).

FACTS:

X was assessed employment tax liabilities . Notice of federal tax lien was filed on either or . As of August 31, 1994, the outstanding balance on these liabilities amounted to \$. X contracted with a general contractor, to perform electrical subcontracting services for several public or quasi-public construction projects. More specifically, X separately contracted with on approximately October 26, 1992, March 8, 1993, and June 28, 1993, to provide materials and labor on three construction sites.

As alleged by affidavits subsequently filed by X under Ohio's Mechanic's Lien Law, Ohio Rev. Code. § 1311.01, et seq., and in the complaint thereafter filed in state court, X physically completed work on the three projects on November 24, 1993, November 11, 1993, and approximately December 31, 1993, respectively. X then claimed it was due approximately on the three contracts.

Y was the surety for on the construction projects. X filed separate law suits against Y on . These cases were settled by a single agreement on approximately April 28, 1998.

The terms of the settlement called for payment to X by Y of . Of this amount, some went to X's lawyers for attorney's fees arising from the litigation. The remaining \$ was distributed by or on behalf of X to several third-party creditors, including \$ paid to an accounting firm for services allegedly rendered in association with the litigation and \$ paid for expert witness fees in the litigation. \$ was paid to two creditors for goods or services not directly related to the litigation.

On August 3, 1994, the Service issued a notice of levy to Y for X's tax liabilities. The levy was not honored.

We assume you have determined that the surety does not have priority or that laborers and materialmen have not argued that the taxpayer has no property rights in the proceeds by the failure to complete or failure to pay mechanic's liens. You have not advised what the surety is claiming so we have to assume you are of the view that their position is not well taken.

LAW AND ANALYSIS:

The basic question here is whether, at the time of the levy, Y was in possession of property belonging to X. Pursuant to I.R.C. § 6321, the federal tax lien attaches to

all property and rights to property of a delinquent taxpayer. The question of whether a state law right constitutes property or rights to property under section 6321 is a matter of federal law. United States v. National Bank of Commerce, 472 U.S. 713 (1985). When Congress broadly uses the term "property" as it does in section 6321 and section 6331, it aims to reach every species of right or interest protected by law and having an exchangeable value. Drye v. United States, 120 S.Ct. 474 (1999). According to the Supreme Court, the "Code's prescriptions are most sensibly read to look to state law for delineation of the taxpayer's rights or interests in the property the Government seeks to reach but to leave to federal law the determination of whether those rights or interests constitute 'property' or 'rights to property' under section 6321." id at 477.

Treas. Reg. § 301.6331-1(a)(1) provides in part as follows:

Except as provided in § 301.6331-2(c) with regard to a levy on salary or wages, a levy extends only to property possessed and obligations which exist at the time of the levy. Obligations exist when the liability of the obligor is fixed and determinable although the right to receive payment thereof may be deferred until a later date.

The word "determinable" has been held to mean that the amount of liability is capable of being determined at some later time. Reiling v. United States, 77-1 U.S.T.C. ¶ 9269 (N.D. Ind. 1977). In United States v. Antonio, 91-2 U.S.T.C. ¶ 50,482 (D. Hawaii 1991), the court, in reviewing Treas. Reg. § 301.6331-1(a)(1), stated in footnote two, that it is the liability that must be fixed and determinable, not the amount of the liability. In Antonio, the defendant had done welding and sandblasting work for the taxpayer but there existed a dispute as to how much was owed to the taxpayer at the time of the levies. The court held that the defendant was entitled to set off against the amount owed the taxpayer for payments already made on the debt, for equipment purchased to complete work that was not completed by the taxpayer on a joint project, and for other expenses he incurred in connection with the project.

In United States v. Hemmen, 51 F.3d 883, 890 (9th Cir. 1995), the Service served a notice of levy upon a bankruptcy trustee against whom the taxpayer had filed a claim for administrative expenses. The court there, citing the above Treasury Regulation, held that a "determinable" tax obligation for tax levy purposes requires only that the sum be capable of precise measurement in the future, unlike the requirement that the extent of the obligation be determined. According to the Ninth Circuit, although the sum to be paid to the taxpayer on his claim against the trustee was uncertain at the time the notice of levy was served, "this uncertainty does not defeat the fact that the estate's obligation was 'determinable'. Unlike a requirement that the extent of an obligation be 'determined', the term 'determinable' requires only that the sum be capable of precise measurement in the future." See also, United States v. Murray, 640 F. Supp. 889 (E.D. Tenn. 1989).

However, the government has not always been successful in its attempt to argue that its notice of levy attached to a “fixed and determinable” right of the taxpayer. Case law exists for that proposition. For example, in Tull v. United States, 69 F.3d 394, 398 (9th Cir. 1995) the government argued that the rights in question were fixed and determinable because the taxpayer’s obligor had an “obligation to attempt to sell some as yet undetermined amount of property for an as yet undetermined price to as yet undetermined buyers.” There, in ruling against the government, the court of appeals stated that it “did not see how the words ‘fixed and determinable’ could be given so unfixed and undetermined a meaning.”

Other courts have reached similar conclusions. In In re Hawn, 149 B.R. 450 (Bankr. S.D.Tex. 1993), the court determined that the Service’s levy would not reach amounts to be received in the future for sales of property that have not yet occurred. In Morey v. United States, 821 F. Supp.1438 (W.D. Okla. 1993), the court held that “for purposes of enforcing a levy, one must be able to fix and determine the value of the taxpayer’s property interest on the date of levy in order for there to be property subject to levy in the hands of the obligor.” Id., at 1442.

Although the issue is not completely free from doubt, we believe that the obligation of Y to X appears to have been “fixed and determinable” at the time of the Service’s levy notwithstanding that the settlement of X’s lawsuit did not take place until _____, some four years after the notice of levy was served upon Y in _____. In essence, when X physically completed the three work projects in the fall of _____, we assume that it was entitled, pursuant to its contract with _____, to payment. What the Service’s levy attached to was X’s contract right to payment, i.e., an account receivable. As stated in Antonio, supra, when the court in footnote two was interpreting Treas. Reg. 301.6331-1(a)(1), “As long as the events which gave rise to the obligation have occurred and the amount of the obligation is capable of being determined in the future, the obligation is fixed and determinable.” In the instant situation, X’s work had been completed prior to the service of the notice of levy although the amount of the liability was not determined until years later when the lawsuit against Y was settled. See, United States v. Long Island Drug Company, et al., 115 F.2d 983 (2d Cir. 1940) where the court stated that an indebtedness of a third party to a taxpayer is subject to levy, but not an indebtedness that is contingent upon the performance of future services. Although not entirely applicable to the situation confronting us here, we, nevertheless, also call your attention to Rev. Rul. 55-210, 1955-1 C.B.544. That ruling holds that where a taxpayer has an unqualified fixed right, under a trust or a contract, or through a chose in action, to receive periodic payments or distributions of property, a federal tax lien attaches to the taxpayer’s entire right, and a notice of levy based on such a lien is effective to reach, in addition to payments or deductions then due, any subsequent payments or distributions that will become due thereunder. The ruling also states that a notice of levy does not attach to a taxpayer’s right to money that is contingent upon the performance of future services. See also, 1999 TNT 181-79,

which discusses TAM 199924060 and Rev. Rul. 80-230, 1980-2 C.B. 169, (When liability becomes fixed and determinable for income tax purposes).

The second question presented by your memorandum is whether in addition to the \$ fee that X's attorneys claim is entitled to priority over the federal tax lien, priority over the tax lien should also be awarded to the claim for accounting services and expert witness fees in the amounts of \$ and \$ respectively. The only basis for awarding priority to these two items would be if they could qualify for superpriority status pursuant to section 6323(b)(8).

I.R.C. § 6323(b)(8) provides a superpriority to certain attorneys' liens. (A superpriority means that the claimant primes the federal tax lien even when the federal tax lien was filed first. A superpriority is an exception to the rule that first in time is first in right.) Specifically, subsection (b)(8) provides a superpriority over the federal tax lien as follows:

With respect to a judgment or other amount in settlement of a claim or of a cause of action, as against an attorney who, under local law, holds a lien upon or a contract enforceable against such judgment or amount, to the extent of his reasonable compensation for obtaining such judgment or procuring such settlement, except that this paragraph shall not apply to any judgment or amount in settlement of a claim or a cause of action against the United States to the extent that the United States offsets such judgment or amount against any liability of the taxpayer to the United States.

After a levy, an attorney who holds a valid lien under local law may file an administrative request under section 6343(b) with the Service for his reasonable compensation in creating a fund of money through judgment or settlement. The attorney qualifies as a wrongful levy claimant because he has a senior lien, as provided for in section 6323(b)(8), on the judgment or settlement fund of money.

The words of the statute, section 6323(b)(8), are clear. They specifically refer to the attorney's reasonable compensation for obtaining the judgment or procuring the settlement. There is no reference in section 6323(b)(8) to a superpriority for expert witness fees or costs for accounting services. Were this a case where Y were a "prevailing party" who requested an award for expert witness fees and costs for accounting services pursuant to section 7430(c)1(B)i and ii, a court might be inclined to grant its request but such is not the situation here.

In summary, based upon the foregoing discussion, we are of the opinion that the levy in question captured the settlement proceeds except to the extent

of the \$ paid to X's attorneys for bringing about the settlement. That amount is entitled to superpriority status over the federal tax lien pursuant to section 6323(b) (8). As previously stated, the lawsuit settlement proceeds have already been distributed to X's attorneys as well as to several third party creditors.

We trust the above will be helpful. If you have any questions, please do not hesitate to contact us at 202-622-3610.

cc: Assistant Regional Counsel (GL) NER.