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# COLLECTION, BANKRUPTCY AND SUMMONSES BULLETIN

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Department of the Treasury

Office of Chief Counsel

Internal Revenue Service

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## THERE'S A NEW LIEN IN TOWN

CBS Branch 1 has approved a modification to **Form 668-H, Notice of Federal Estate Tax Lien**, to permit that form to be used for the consensual lien created and recorded in connection with an election under I.R.C. § 2057, in addition to the consensual lien created and recorded in connection with a section 2032A election. Until the existing form is reprinted, the phrase "and/or section 2057" will be added by pen and ink to the Notice paragraph of Form 668-H.

The change arises because estates meeting certain requirements may elect, under I.R.C. section 2057, to deduct the value of a qualified family-owned business interest (QFOBI) from the gross estate. Estates making a section 2057 election, which results in a lower estate tax liability, must consent to the imposition and recording of a lien on QFOBI assets.

The revised Form 668-H when used in connection with a section 2057 election applies to both real and personal property, unlike the section 2032A election which applies only to real property. If the property subject to the lien consists of both real and personal property or only personal property, contact Area Counsel, SBSE for guidance.

## LAW OF THE CASE

### ***Tax Lien Against Husband Does Not Attach to Entireties Property***

Refusing to "rehear the claims we have already rejected," the Sixth Circuit denied the Government's second appeal in **Craft v. United States, 2000 U.S. App. LEXIS 29586 (6<sup>th</sup> Cir. Nov. 22, 2000)**. In the first appeal, Craft v. United States, 140 F.3d 638 (6<sup>th</sup> Cir. 1998), the appellate court held that a federal tax lien against a husband did not attach to property held by the husband and his wife as tenants by the entireties. Under Michigan law, the court found that the husband did not possess a separate future interest in the real estate, and therefore the federal tax lien could not attach to an interest which did not exist. On remand, the district court found that the husband, while insolvent, had used funds to enhance the property by making mortgage payments, and that these payments (but not

the interest component) was a fraudulent conveyance, entitling the Service to the amount conveyed. The wife appealed the fraudulent conveyance holding and the Government appealed on the basis that the Sixth Circuit's first decision misconstrued the law.

The Sixth Circuit considered the appeal to be "about the extent to which a prior decision of this court binds a subsequent panel when neither the facts, the parties, nor the law has changed." Under the law of the case doctrine, the Sixth Circuit would not reopen issues previously decided unless (1) substantially different evidence was subsequently introduced; (2) a subsequent contrary view of the law is decided by controlling authority; or (3) a decision is clearly erroneous and would work manifest injustice.

Considering the last ground first, the appellate court found no Supreme Court case directly overruled either the first Craft decision, or its predecessor, Cole v. Cardoza, 441 F.2d 1337 (6<sup>th</sup> Cir. 1971). Although the Supreme Court has addressed the reach of the federal tax lien against joint bank accounts (United States v. National Bank of Commerce, 472 U.S. 713 (1985)) and homestead property (United States v. Rodgers, 461 U.S. 677 (1983)), the court found these narrowly tailored to address specific state law situations. Since the Supreme Court has not addressed the issue raised by Craft, the Sixth Circuit would not consider Craft "clearly erroneous."

Nor, the appellate court found, was the recent decision of Drye v. United States, 526 U.S. 1063 (1999) fundamentally inconsistent with Craft. Although Drye dealt with the ability of the federal tax lien to reach behind state law fictions to attach to property, the court found that, unlike the taxpayer in Drye, the husband here had no individual interest in the entirety property, so there was no property or rights to property that the tax lien could attach to under I.R.C. § 6321. Plus, the Sixth Circuit in the first Craft decision considered the effect of state law fictions on the tax lien, and rejected the Government's position. Judge Gilman, although concurring with the majority that the law of the case doctrine precluded a decision in favor of the Service, disagreed with the majority's interpretation of Drye. Judge Gilman believed the majority failed to look behind the characterization of an individual's interest in entirety property under state law, and see the substantive rights actually held by the husband in this case. Because the husband had at least a future contingent interest in the entirety property, an interest that had undeniable value, Judge Gilman believed the federal tax lien should reach the husband's interest in the property.

On the appeal of the fraudulent conveyance issue, the appellate court also upheld the trial court's decision that the husband fraudulently used his own funds to enhance the property. The wife argued that the Government was precluded from raising a fraudulent enhancement argument on remand, but the Sixth Circuit felt its instructions in the first Craft decision were broad enough to allow the trial court to consider that issue, and that the issue was not barred by the statute of limitations. The appellate court also denied the wife's request for interest and attorney's fees, finding that there was no express provision in I.R.C. § 2411 for payment of interest under the facts of this case, and that the Government raised at least colorable arguments on appeal.

**LIENS: State Law, Effect of**

**TRANSFEREES & FRAUDULENT CONVEYANCES: Liability for Interest**

**WATCH THE CLOCK**

***Bankruptcy Trustee Relies on Wrong Statute of Limitations for Refund***

The Ninth Circuit, reversing the lower court, held in **United States v. Shaltry, 2000 U.S. App. LEXIS 28969 (9<sup>th</sup> Cir. Nov. 15, 2000)** that a bankruptcy trustee's claim for refund was barred because she failed to timely exercise her avoidance powers under B.C. § 549.

The taxpayer acquired another company which soon was placed into involuntary Chapter 7 bankruptcy. During the gap period, the taxpayer-debtor filed a consolidated tax return, electing to waive the carryback period for net operating losses then in effect under I.R.C. § 172. After the Chapter 7 trustee was appointed, she filed an amended tax return for the debtors, in which she voided the waiver. By so doing, she claimed a refund of \$1.6 million for the bankruptcy estate. Since the non-debtor parent corporation already claimed and exhausted on its own returns the same NOLs which the trustee sought to apply to the debtor subsidiary's returns, the trustee's decision subjected the United States to inconsistent obligations. When the trustee's administrative request for a refund was denied, she timely filed suit under I.R.C. § 7422.

The Government's primary argument was that elections to file consolidated returns and waive carrybacks are not transfers of property interests, and are actions governed by the Internal Revenue Code that cannot be avoided by the trustee as a post-petition "gap period" election under B.C. § 549(a)(2)(A). The court observed that the Government had made a similar argument, unsuccessfully, in **United States v. Sims (In re Feiler), 218 F.3d 948, 956-57 (9<sup>th</sup> Cir. 2000)**. However, because of its holding on the statute of limitations issue, the appellate court did not reach the merits of this issue.

Under section 7422, the taxpayer (or trustee) has three years from the due date for filing the return for the taxable year of the net operating loss. The Government argued that this was the wrong period of limitations. Under its theory, there was no basis for a tax refund until the trustee avoided the debtor's consent to the filing of the consolidated tax return and elected to relinquish the carryback period for the net operating losses. Since the refund was predicated on the avoidance, the true statute of limitations is found under B.C. § 549(d), or within two years of the date of the avoided transfer. The trustee's refund claim was therefore untimely.

The Ninth Circuit found that the debtor filed its consolidated tax return on September 19, 1989. It also found the trustee did not bring an avoidance action until September 21, 1991, more than two years later and so beyond the period of limitations set by B.C. § 549(d). The court refused to consider the trustee's argument that the election should be considered avoided when the return was processed by the Service (rather than the date filed), because the trustee failed to raise that argument below. The court also refused to consider equitable estoppel based on a letter where the Service considered the trustee's

amended return as a claim for refund. The court found no evidence that the trustee relied on the letter in deciding when to file suit.

## **BANKRUPTCY CODE CASES: Trustee's Avoidance of Transfers (§ 549)**

### **DRIVEN INTO THE GROUND**

#### ***Debtor Can't Reduce Secured Claim By Surrendering Collateral After Plan Confirmation***

In ***Chrysler Financial Corporation v. Nolan***, 2000 U.S. App. LEXIS 26642 (6<sup>th</sup> Cir. Oct. 24, 2000), the Sixth Circuit held that a debtor in a Chapter 13 bankruptcy cannot modify a confirmed plan under section 1329(a) by: 1) surrendering the collateral to a creditor; 2) having the creditor sell the collateral and apply the proceeds toward the claim; and 3) having any deficiency classified as an unsecured claim.

In this non-tax case, the debtor owed over \$12,000 on an installment contract for a car. Her Chapter 13 plan provided for payment of \$208 per month on the \$8,200 secured portion of the car contract. Almost a year after confirmation, the debtor filed a motion to surrender the car and reclassify the deficiency (after Chrysler resold the car) as unsecured debt. Finding the debtor was not acting in bad faith, the bankruptcy court granted her motion. The district court agreed that the debtor did not act in bad faith, but reversed under B.C. § 1329(a).

Considering the issue to be one of first impression, the Sixth Circuit found the lower courts split on the issue of whether section 1329 allows a debtor to modify a confirmed plan to surrender collateral for a secured claim (the value of which typically will have been significantly reduced) and then reclassify any deficiency as an allowed, unsecured claim to be paid back at the general pennies-on-the-dollar rate set forth in the plan for unsecured debts. The appellate court considered several arguments presented by the lower courts in support of modification.

First, the court of appeals found that section 1329(a) does not expressly allow the debtor to alter, reduce or reclassify a previously allowed secured claim. Instead, section 1329(a)(1) only affords the debtor a right to request alteration of the amount or timing of specific payments. The court held that a debtor cannot use section 1329(b)(1) to enlarge the modifications permitted by section 1329(a), since section 1329(b)(1) does not apply unless the proposed modification first complies with section 1329(a)(1). Therefore, a modification that reduces the claim of a secured debtor would add a claim to the class of unsecured creditors, a change prohibited by section 1329(a).

Second, the court found that the debtor was attempting to bifurcate a claim that had already been classified as fully secured into a secured claim as measured by the collateral's depreciated value and an unsecured claim as measured by any unpaid deficiency. This, the court found, would negate the requirement of section 1325(a)(5)(B)(ii)

that a plan is not to be confirmed unless the property to be distributed on account of a claim is not less than the allowed amount of the claim.

Third, the court held that proposed modification would contravene section 1327(a), because a contrary interpretation postulates an unlikely congressional intent to give debtors the option to shift the burden of depreciation to a secured creditor by reclassifying the claim and surrendering the collateral when the debtor no longer has any use for the devalued asset. Fourth, the Sixth Circuit found it created an inequitable situation where the secured creditor could not seek to reclassify its claim in the event that collateral appreciated, even though the debtor could revalue or reclassify the claim whenever the collateral depreciated. Furthermore, allowing Chapter 13 modifications would permit the debtor to reclassify a secured creditor's claim while simultaneously evading the tradeoff risks and responsibilities attending conversion or dismissal under Chapter 7.

Finally, the court found modification to be at odds with the plain language of section 1329. The court held that when read with the benefit of proper term definitions, section 1329 clearly indicates that modifications after plan confirmation cannot alter a claim (a right to a remedy or payment of a certain total amount), but can extend or compress payments and reduce or increase the amount of the delivery of value planned as an eventual satisfaction for the creditor's claim.

**BANKRUPTCY CODE CASES: Chapter 13: Confirmation of Plan: Secured and General Unsecured Taxes**

## CASES

1. **BANKRUPTCY CODE CASES: Automatic Stay: Enforcement of Judgment**  
**S.E.C. v. Brennan, 2000 U.S. App. LEXIS 26890 (2<sup>d</sup> Cir. Oct. 26, 2000)** - S.E.C. took judgment against debtor for defrauding customers, then, after debtor filed for bankruptcy, sought repatriation of assets from offshore trust. The Second Circuit held the collection action barred by the automatic stay under B.C. § 362(b)(4). The court recognized an exception to the stay where a governmental unit exercises its police or regulatory power, which may include the entry of a judgment. However, when the governmental unit acts to enforce that judgment, the exception no longer applies, and the Government is bound by the stay.
  
2. **BANKRUPTCY CODE CASES: Property of the Estate**  
**United States v. Jones, 86 AFTR2d ¶ 2000-5552 (E.D. Mich. Oct. 23, 2000)** - District court reversed the decision of the bankruptcy court, which reclassified the Service's claim as unsecured. The district court first determined that in a Chapter 7 case where no surplus to return to the debtor existed, either the trustee had to object to the proof of claim, or the debtor had to bring an adversary action to determine dischargeability. As neither of these occurred, the debtor lacked standing to object to the Service's proof of claim. The court next held that there was no statutory provision which gave the bankruptcy court authority to order the removal of the federal tax lien. Since the debtor's property was held as entireties property, which under state law could not be attached for the debtor's sole debts, the property never was part of the debtor's bankruptcy estate. Therefore, the bankruptcy court lacked jurisdiction to reclassify the Service's claim.
  
3. **BANKRUPTCY CODE CASES: Statute of Limitations: On Collection After Assessment**  
**Morgan v. United States, 86 AFTR2d ¶ 2000-5541 (Bankr. N.D. Ga. Oct. 31, 2000)** - On remand, the bankruptcy court in this equitable tolling case found that the Government had a reasonable amount of time to collect 1987 and 1988 taxes before the debtor filed his first bankruptcy in August 1990, but did not have sufficient time for the 1989 taxes, due April 15, 1990. The court also held, based on the Eleventh Circuit's ruling, that although the debtor did not act in bad faith in filing successive bankruptcies, the Government was entitled to have the priority period of B.C. § 507(a)(8)(A)(i) equitably tolled under section 105(a).
  
4. **BANKRUPTCY CODE CASES: Statute of Limitations: On Collection After Assessment**  
**Hamrick v. United States, 86 AFTR2d ¶ 2000-5569 (Bankr. M.D. Ga. Nov. 14, 2000)** - After filing their third bankruptcy petition in two years, Chapter 7 debtors argued for dischargeability of certain taxes. The court, although finding no bad faith in the debtors' filings, concluded under B.C. § 105(a) and Morgan v. United States, 182 F.3d 775 (11<sup>th</sup> Cir. 1999) that the debtors had the burden of proof to show that

equities favored them. The court held the debtors did not meet this burden, either for the taxes or the penalties, and so the three year priority period of B.C. § 507(a)(8)(A)(i) would be equitably tolled and the taxes ruled nondischargeable. The court, however, did not agree with the Government that the three year period should be extended for an additional six months as provided for by I.R.C. § 6503(b) & (h).

**5. COLLECTION DUE PROCESS**

**Boone Trust v. Commissioner, T.C. Memo 2000-350 (Nov. 13, 2000)** - Taxpayer trust received tax refund based on withholding credits. The Service determined the refund was erroneous, and summarily assessed the tax. The taxpayer requested a due process hearing, then appealed the Notice of Determination. The Tax Court, finding that the taxes had been assessed summarily rather than through deficiency proceedings, held that it lacked subject matter jurisdiction to consider the suit. The companion case is Loadholt Trust v. Commissioner, T.C. Memo 2000-349.

**6. COLLECTION DUE PROCESS**

**Diefenbaugh v. Weiss, 2000 U.S. App. LEXIS 28056 (6<sup>th</sup> Cir. Nov. 3, 2000) (*unpublished*)** - Taxpayer, challenging income tax liability, appealed adverse notice of determination to district court. The Sixth Circuit, in an unpublished decision, affirmed that the district court lacked jurisdiction under I.R.C. § 6330(d)(1)(A), and that the taxpayer should have brought his action in Tax Court.

**7. COLLECTION DUE PROCESS**

**Konkel v. Commissioner, 86 AFTR2d ¶ 2000-5545 (M.D. Fla. Nov. 6, 2000)** - Notified of imminent assessment of trust fund recovery penalty, the taxpayer (through his representative) requested an appeals hearing. After discussing the computation of the penalty with the Service, the representative withdrew the request for a hearing. After assessment, the Service sent the taxpayer a Final Notice, and the taxpayer requested a Collection Due Process hearing. The settlement officer contacted the taxpayer to set up a hearing date, but the taxpayer responded with written questions. The settlement officer answered the questions, but the taxpayer disagreed and propounded new arguments. The settlement officer responded again, then sent a Notice of Determination. The plaintiff, in turn, filed suit. Although the Service offered the taxpayer another CDP hearing during the suit, the taxpayer did not show up. The court first determined that a taxpayer who is given notice of his right to a hearing, but declines that right, is precluded from disputing his tax liability at a subsequent CDP hearing. In this case, the taxpayer's representative had the power to waive that right on the taxpayer's behalf. Although the taxpayer did not meet with the settlement officer in person, he had adequate opportunity to be heard before the Notice of Determination was issued. Finally, the court found no basis in I.R.C. § 6330 or its legislative history that would give the taxpayer the right to subpoena witnesses or documents at a CDP hearing.

**8. COLLECTION DUE PROCESS**

**Lewis v. I.R.S., 86 AFTR2d ¶ 2000-5517 (S.D. Tex. Oct. 31, 2000)** - Taxpayer received Notice of Intent to Levy for unpaid income taxes. Following an unsuccessful attempt to challenge the taxes through a due process hearing, the taxpayer brought suit in district court. The court dismissed for lack of subject matter jurisdiction, holding that a CDP appeal of income taxes can only be brought before the Tax Court.

**9. COLLECTION DUE PROCESS**

**Mesa Oil, Inc. v. United States, No. 00-B-851 (D. Colo. filed Nov. 21, 2000)** - After receiving Notice of Intent to Levy, taxpayer requested Collection Due Process hearing and offered to make an installment agreement if the Service would withdraw its tax lien. The appeals officer wrote back, informing the taxpayer of the hearing date, explaining why the lien would not be withdrawn, and denying the proposed installment agreement. The taxpayer was also unsuccessful at the CDP hearing, and a Notice of Determination was issued, prompting the taxpayer to go to court. The district court found that the appeals officer abused her discretion in not performing a proper analysis balancing the Service's need for efficient tax collection with the taxpayer's concerns that such collection be as unobtrusive as possible. The court decided that the CDP statute, I.R.C. § 6330(c)(3), was ambiguous because it did not specify what factors the appeals officer needed to consider in performing the balancing analysis. The court held that the appeals officer must verify that she thoroughly considered the facts of the case, including the availability of alternative collection methods. Because the Notice of Determination provides nothing other than conclusory language, the court remanded for the appeals officer to consider the appropriate balancing analysis and to provide complete reasons for her conclusion. The court also found that the Service's failure to make an adequate record of the administrative hearing did not provide the taxpayer with an adequate record for judicial review, in violation of I.R.C. § 6330(d)(1)(B).

**10. COLLECTION DUE PROCESS**

**Meyer v. Commissioner, 115 T.C. 31 (Nov. 7, 2000)** - Service sent taxpayers notice of intent to levy relative to frivolous return penalties under I.R.C. § 6702. The taxpayers requested a collection due process hearing, however, because the appeals officer thought the taxpayers were raising only constitutional challenges, no hearing was held. The Service issued a notice of determination, to which the taxpayers protested, and the Service offered to set up a conference. Instead, the taxpayers filed a petition with the Tax Court for review. The Service argued that the Tax Court lacked jurisdiction because it did not have subject matter jurisdiction over the frivolous return penalties. However, the Tax Court chose to dismiss the petition on the grounds that the appeals officer did not provide taxpayers with an opportunity for a hearing, either in person or by telephone, as required by section 6330(b) prior to the issuance of the notice of determination. Scheduling a conference with the taxpayers after the notice of determination was issued was insufficient to cure this defect, the court ruled.

**11. COLLECTION DUE PROCESS**

**Van Es v. Commissioner, 115 T.C. 25 (Oct. 13, 2000)** - Taxpayer, seeking review of collection activities relating to I.R.C. § 6702 frivolous return penalties, is not entitled to Collection Due Process rights relative to amounts collected prior to the effective date of I.R.C. § 6330 (January 19, 1999). The Tax Court also held it was without jurisdiction to redetermine the frivolous return penalties, as those penalties are not listed in sections 6213(a) and 6211. Jurisdiction, therefore, was with the district court.

**12. LIENS: Priority Over State and Local Liens**

**United States v. Reid, Jr., 2000 U.S. Dist. LEXIS 13896 (S.D. Ga. Oct. 26, 2000)** - In this follow-up to a case reported in the April 2000 Bulletin, the Government erroneously released tax liens, and the reinstated liens were inferior to County liens. So the Government attempted to debar the County lien interest by arguing that the County's answer to the Government's foreclosure suit did not properly assert their lien interest. Specifically, the Government argued that the County did not assert the liens as an affirmative defense, and incorrectly categorized them as tax liens when it was not certain what the liens were for. The court disagreed, considering the Government's arguments overly technical. Since the Government had notice of the County's superior liens, there was no prejudice because the County failed to use any "magic words" to describe its lien interest.

**13. SUITS: Against the U.S.: Wrongful Levy****TRANSFEREES & FRAUDULENT CONVEYANCES: Nominee**

**Turk v. I.R.S., 86 AFTR2d ¶ 2000-5529 (D. Mont. Oct. 19, 2000)** - Taxpayer, convicted of failing to file income tax returns, transferred property to his son. The Service levied on the property, and the son filed suit. On summary judgment, the Service argued either the son was the taxpayer's nominee, or that the taxpayer fraudulently conveyed the property. Examining the state law factors to determine nominee status, the court found that the Service relied too heavily on the relationship between the taxpayer and his son, ignoring such factors as (1) the son provided consideration for the property, (2) the son paid the taxes on the property and (3) the son exercised exclusive control over the property. Further, because the Service failed to refute the taxpayer's assertions, the Service was barred from raising the nominee theory at trial. As to the fraudulent conveyance theory, the court found factual issues that needed to be developed at trial.

**14. TRANSFEREES & FRAUDULENT CONVEYANCES: Uniform Fraudulent Conveyance Act**

**Sequoia Property & Equipment Ltd. Partnership v. United States, 2000 U.S. Dist. LEXIS 15908 (E.D. Ca. Oct. 4, 2000)** - Following audit and assessments, taxpayers transferred real estate without consideration to limited partnerships. The United States filed nominee liens, and the taxpayers responded with quiet

title actions. The court determined that, under the California Uniform Fraudulent Transfer Act, the Service's claim to set aside the transfers as fraudulent was time-barred. Following Bresson v. Commissioner, 213 F.3d 1173 (9<sup>th</sup> Cir. 2000), the Government moved for reconsideration. The district court found Bresson controlling, holding that the California Uniform Fraudulent Transfer Act cannot extinguish the Government's claim to set aside fraudulent transfers, and so granted the motion for reconsideration.

## CHIEF COUNSEL ADVICE

### Installment Agreements; Application of Payments

July 31, 2000

CC:EL:GL:Br2  
GL-701813-00

UILN: 61.01.00-00  
61.03.00-00

MEMORANDUM FOR DISTRICT COUNSEL, KANSAS-MISSOURI DISTRICT

FROM: Kathryn A. Zuba /s/ Kathryn A. Zuba  
Chief, Branch 2 (Collection, Bankruptcy & Summonses)

SUBJECT:

This responds to your request for advice, dated April 25, 2000, in the above referenced case. This document is not to be cited as precedent.

#### ISSUE:

Can the taxpayer compel the Service to reapply payments made pursuant to an installment agreement to other tax years and/or liabilities.

#### CONCLUSIONS:

The taxpayer cannot compel the Service to reapply payments made pursuant to an installment agreement.

#### BACKGROUND:

The taxpayer is a corporation which has been delinquent in paying its employment taxes since Year A. The taxpayer was warned that if it did not become current on its tax obligations its assets could be seized to satisfy the unpaid taxes. The taxpayer, nonetheless, continued to pyramid the employment taxes.

In March of Year B, the case was transferred to another revenue officer with the recommendation that the taxpayer's assets be seized if the taxpayer did not comply with its tax obligations. The revenue officer, however, determined that the case would best be resolved by allowing the taxpayer to satisfy its liability pursuant to an installment agreement under I.R.C. § 6159.

Financial analysis revealed that the taxpayer should pay Amount A a month over a period of approximately seven years to satisfy its liability. The taxpayer disagreed. The taxpayer contended that its monthly payment should be reduced to allow it to repay an "alleged" unsecured loan to its sole shareholder. The revenue officer declined to consider the loan repayment amount a necessary expense and to give it priority over the unpaid taxes.

The taxpayer ultimately executed an installment agreement agreeing to the Amount A a month payment. This amount was subsequently reduced to Amount B when the taxpayer entered into an installment agreement with the state taxing authority.

The taxpayer defaulted on the installment agreement after making approximately three payments.<sup>1</sup> The revenue office informed the taxpayer that the installment agreement would be terminated unless the taxpayer immediately cured the default. The taxpayer filed a Form 911, *Application for Taxpayer Assistance Order (ATAO)*, with the local Taxpayer Advocate. The relief the taxpayer is seeking is a rescission of the installment agreement and application of the payments made under the agreement to other tax periods.

#### LAW & ANALYSIS:

The taxpayer assumes that by rescinding the installment agreement, the taxpayer can require the Service to reapply payments made under the installment agreement to another taxable period. The taxpayer's assumption is incorrect, however. Even if the taxpayer were entitled to rescind the installment agreement<sup>2</sup>, it would not be able to require the Service to reapply the payment it had made under the agreement.

Generally, a taxpayer making a voluntary payment of tax has the right to direct its application to whatever tax liability he chooses. Muntwyler v. United States, 703 F.2d 1030, 1032 (7<sup>th</sup> Cir. 1983); O'Dell v. United States, 326 F.2d 451, 456 (10<sup>th</sup> Cir. 1964).

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<sup>1</sup> Two of the payments were subsequently reversed because the taxpayer's checks were dishonored due to insufficient funds.

<sup>2</sup> Rescission takes place when a contract is undone from the beginning, placing both parties in the same position they would occupy had they never entered into the contract. Dairyland Power Coop. v. United States, 27 Fed. Cl. 805, 813 (1993); 17A Am.Jur.2d Contracts § 539. Since an installment agreement is not a contract, it is not subject to rescission.

To be effective, a designation must accompany the payment, contain the taxpayer's Employer Identification Number (EIN), the period and type of tax for which the payment is intended and, if desired, a detailed description of how the payment is to be allocated between the tax, interest, and penalty. Kinnie v. United States, 994 F.2d 279, (6th Cir. 1993) (oral designation not binding upon Internal Revenue Service); Teets v. United States, 29 Fed. Cl. 697, 703 (1993) (allocation must be in writing). Thus, in a case of a voluntary payment sent directly to the Service, the designation should be made on the check itself.

In the instant case, the taxpayer did not seek to designate the application of the payments made under the installment agreement until he had failed to comply with the terms of the installment agreement.<sup>3</sup> The Service, therefore, is under no obligation to reapply the payment made by the taxpayer.

Although the taxpayer does not have a right to compel the Service to reapply the payment to another taxable period, the Service may, nonetheless, honor the taxpayer's request as long as the reapplication of the payment is not contrary to the Service's policy and procedures and does not enable the taxpayer to avoid the payment of tax. Thus, the Service should not reapply the payment if the Service would be prohibited from collecting the liability to which the payment was originally applied. Similarly, the Service should not reapply payments made by a corporation under an installment agreement to the trust fund portion of the liability, particularly where the Service has made an assessment under section 6672.

#### OFFER IN COMPROMISE; COLLECTION STATUTE OF LIMITATIONS

September 20, 2000

CC:PA:CBS:Br2  
GL-804186-00  
UILC: 17.44.00-00

#### MEMORANDUM FOR DISTRICT COUNSEL, ROCKY MOUNTAIN DISTRICT

FROM: Kathryn A. Zuba  
Chief, Branch 2 (Collection, Bankruptcy & Summonses)

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<sup>3</sup> Indeed, the taxpayer had no right to designate how the payments made under the installment agreement were to be applied. See Bierhaelder v. Commissioner, 70 T.C. Memo (CCH) 43 (1995); Treas. Reg. § 301.6159-1(b)(1)(i). By signing the installment agreement, the taxpayer agreed that all payments made under the agreement would be applied "in the best interest of the United States." See Form 433-D, Installment Agreement (Rev. May 1996).

**SUBJECT:** Collection Statute of Limitations - Offer in Compromise Pending as of December 31, 1999.

This memorandum responds to your request for advice dated June 22, 2000. This document may not be cited as precedent by taxpayers.

**ISSUE:**

How is the statute of limitations for collection under section 6502(a) of the Internal Revenue Code determined for liabilities named on offers in compromise accepted for processing on or before December 31, 1999, and still pending with the Service after that date?

**CONCLUSION:**

If an offer in compromise was accepted for processing on or before December 31, 1999, but remained pending after that date, the statute of limitations for collection is determined by giving effect to both the waiver provision contained in the Form 656 and the suspension of the collection statute provided by section 6331(k)(3) and Treas. Reg. § 301.7122-1T.

**BACKGROUND:**

It has long been the policy of the Internal Revenue Service to suspend enforced collection efforts when a taxpayer submits an offer in compromise, unless collection of the tax would be jeopardized or the offer was made merely as a delay tactic. See Policy Statement P-5-97 (Approved July 10, 1959); Treas. Reg. § 301.7122-1(d)(2) (1960). To insure that the Government's eventual ability to collect was not harmed by withholding collection efforts, consideration of an offer was conditioned upon the execution by the taxpayer of a waiver of the statute of limitations for collection for the period the offer was being considered, while any term of an accepted offer was not completed, and for one additional year. See Treas. Reg. § 301.7122-1(f) (1960); Form 656, Offer in Compromise, Item 8(e) & (n) (Rev. 1-97).

The IRS Restructuring and Reform Act of 1998 (RRA) required several changes to this scheme. First, RRA section 3462 codified the practice of withholding collection while an offer to compromise is being considered by adding section 6331(k) to the Code. See P.L. 105-206, 112 Stat. 685, 764 (1998). Effective January 1, 2000, that section prohibits levy while an offer is pending, for thirty days after an offer is rejected, and while a timely filed appeal of that rejection is pending with the IRS Office of Appeals. See I.R.C. § 6331(k)(1); Temp. Treas. Reg. § 301.7122-1T(f)(2). The section further provides that "rules similar to" those contained in paragraphs (3), (4), and (5) of section 6331(i), which prohibits levy during court proceedings for refund of a divisible tax, will apply. See I.R.C. § 6331(k)(3). Paragraph (5) of section 6331(i) provides that the statutory period for collection is suspended while levy is prohibited. Temporary

Treasury Regulations section 301.7122-1T(h)(2) applies this rule to the period that levy is prohibited due to the pendency of an offer in compromise.

Second, RRA section 3461 amended section 6502 of the Code, also effective as of January 1, 2000, to limit the Service's ability to secure from taxpayers agreements to extend the statutory period for collection. See P.L. 105-206, 112 Stat. 685, 763-64 (1998). The Service and taxpayers can now only agree to an extension of the statute of limitations for collection under 6502(a) in two circumstances: 1) the extension is agreed to at the same time as an installment agreement between the taxpayer and the Service, or 2) the extension is agreed to prior to a release of levy under section 6343 which occurs after the expiration of the statutory ten year period for collection. See I.R.C. § 6502(a)(2). Thus, effective January 1, 2000, the Service can no longer secure a waiver of the collection statute as a condition for consideration of the offer, but can rely on the suspension of the statute provided by regulations section 301.7122-1T(h)(2) to keep the collection statute from expiring while the offer is being considered. Further, the Service can no longer extend the collection statute to allow a taxpayer more time to pay any compromise reached. Compromise agreements must now be structured so that all payments are received prior to the expiration of the collection period. See I.R.C. § 6401(a) (amounts collected after expiration of applicable period for collection to be treated as overpayments).

Finally, RRA contained a non-Code "sunset" provision which governs the continued effect of waivers of the collection statute executed prior to January 1, 2000. If a waiver was secured in conjunction with the granting of an installment agreement, the period for collection will expire ninety days after the date specified in the waiver. If the waiver was not obtained at the same time as an installment agreement, the period for collection will expire not later than December 31, 2002, or the end of the original collection statute if it would have occurred after that date. See RRA § 3461(c)(2).

The Service's policies and procedures for the consideration and disposition of offers in compromise have been revised to reflect these changes in the law. However, some confusion exists with respect to the effect these changes in the law will have on offers that were accepted for processing prior to December 31, 1999, but remained pending after that date. Because the Service was authorized to secure waivers of the statute of limitations at the time the Forms 656 in such cases were submitted, and the statute of limitations for collection was suspended as a matter of law beginning on January 1, 2000, it would appear that the Service receives the benefit of both a waiver of the collection statute by agreement and an automatic suspension of the collection statute under the Code. You have been asked by your district how the collection statute is determined in such cases.

#### DISCUSSION:

As is discussed above, prior to the enactment of RRA, the Service could extend the statute of limitations under section 6502 of the Code by agreement with the taxpayer at

any time prior to the expiration of the ten-year statutory period. The statutory period, once extended, could be further extended by agreement at any time prior to the expiration date specified in the previous agreement. These agreements took the form of a waiver of the collection statute by the taxpayer, most often accomplished through a Form 900, Tax Collection Waiver. Although the statute refers to an extension by agreement, the courts have uniformly held that, since the statute of limitations is a defense available to the taxpayer in the event the Service attempts to collect beyond the statutory time period, extension of the time to collect is accomplished via a unilateral waiver of that defense by the taxpayer, and that a tax collection waiver is not a contract. See *Strange v. United States*, 282 U.S. 270, 276 (1931); *Florsheim Bros. Drygoods Co. v. United States*, 280 U.S. 453, 468 (1930).

The Code also contains various provisions that operate to toll the period for collection upon the occurrence of certain events. For example, section 6503 suspends the running of the statute of limitations for collection when the assets of the taxpayer are in the control or custody of a court, when the taxpayer is outside of the United States for more than six months, or when the Service is prohibited from collection because the taxpayer has filed bankruptcy. See I.R.C. § 6503(b) (control or custody of court); I.R.C. § 6503(c) (taxpayer outside of United States); I.R.C. § 6503(h) (bankruptcy). Such suspensions act to toll the collection statute even where it has been previously extended by agreement to a date certain. See, e.g., *Klingshirn v. United States*, 147 F.3d 526, 528 (6th Cir. 1998) (applying I.R.C. § 6503(h)). Cf. *Meridian Wood Products Co., Inc. v. United States*, 725 F.2d 1183, 1188 (9th Cir. 1984) (applying 6503 to suspend previously extended statute of limitations for assessment). In such cases, the statute of limitations is established by the tax collection waiver and the suspension of the statute acts to further extend the period for collection from that date forward. See *Kaggen v. IRS*, 57 F.3d 163, 165 (2d Cir. 1995). If the collection period with respect to a particular liability has been waived or suspended on multiple occasions, the collection period is determined by giving effect to each suspension or waiver in the order in which they occurred, counting periods during which suspensions overlapped only once. See, e.g., *United States v. First Midwest Bank*, 1997 U.S. Dist. LEXIS 16913 (N.D. Ill. October 28, 1997).

The suspension of the collection statute provided by regulations section 301.7122-1T(h)(2) operates in the same manner as the suspension provisions of section 6503. The statute of limitations for collection is first determined by giving effect to any prior waivers that extended the collection period, and that period is then regarded as suspended for any time an offer in compromise was pending after December 31, 1999.

EXAMPLE 1: The taxpayer executed, and the Service accepted, a waiver of the collection statute prior to December 31, 1999. The waiver extended the collection statute until March 31, 2001. On June 1, 2000, the taxpayer submits an offer to compromise, which the Service recognizes as processable that same day. The offer is rejected on July 30, 2000, sixty days later. The collection statute will have been suspended for the sixty days the offer was pending with the Service and for thirty days

thereafter, for a total of ninety days. Assuming that the taxpayer does not appeal the rejection, the period for collection will now expire on June 29, 2001.

The same analysis would apply in the case of an offer submitted on or before December 31, 1999, but which remains pending after that date. Section 301.7122-1T(h)(2) suspended the statute of limitations, as previously extended by the parties, effective January 1, 2000. The first step in the analysis would be to interpret and give effect to the waiver in the Form 656. Courts have held that a tax collection waiver should be interpreted in a manner consistent with the intent of the taxpayer and the Government. See United States v. Havner, 101 F.2d 161, 163-64 (8th Cir. 1939) and cases cited therein. The language of the waiver provision indicates an intent to extend the statute for the length of time necessary to evaluate the offer, for performance to be completed, and for one additional year.

In this situation, the intent of the parties is given effect by construing the waiver as being measured only with reference to periods during which the collection period is not otherwise suspended by the pendency of the offer, *i.e.*, by ignoring periods named in the waiver to which section 301.7122-1T(h)(2) applies. This is accomplished by starting with the collection period as it existed at the time the offer was submitted and adding to that period any time that the offer remained pending prior to January 1, 2000, plus one year.

EXAMPLE 2: An offer in compromise was submitted on September 1, 1999, and deemed processable by the Service that same day. The ten-year collection period for the liability named on the offer was set to expire on February 1, 2000. If the offer remains pending until December 31, 1999, the waiver provision will extend the collection statute for a period equal to the four months the offer was pending in 1999, plus one year. The new collection statute expiration date, as extended by the waiver, is June 1, 2001.<sup>4</sup>

The next step in the analysis is to give effect to the suspension provided as a matter of law by section 301.7122-1T(h)(2). The collection statute, having been extended to a date certain by the waiver, is then suspended, beginning on January 1, 2000, for the time the offer is pending, and, if the offer is rejected, for an additional thirty days or until an appeal of that rejection has been resolved.

EXAMPLE 3: The offer in EXAMPLE 2, above, was rejected on June 1, 2000. Section 301.7122-1T(h)(2) acted to suspend the statute from January 1 to June 1, 2000, plus

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<sup>4</sup> If this first step leads to the conclusion that the statute of limitations for collection was extended beyond December 31, 2002, the waiver acted to extend the statute until that date only. If the waiver would extend the statute beyond December 31, 2002, but the original collection statute expiration date was, itself, beyond that date, the waiver essentially had no effect. See RRA § 3461(c)(2).

an additional thirty days. Assuming that the taxpayer does not appeal the rejection, the collection period resumed running on July 2, 2000, and will expire on December 1, 2001.

Arguably, the period for collection in these cases should be further extended, pursuant to the waiver executed prior to January 1, 2000, by the period of time after acceptance of the offer but before completion of its terms or default by the taxpayer. See United States v. Feinberg, 372 F.2d 352, 356 (3d Cir. 1967). However, interpreting the waiver as including periods after December 31, 1999, would be inconsistent with the intent of Congress in limiting the Service's authority to solicit and accept waivers of the collection statute. Under the revised statutory scheme, the interests of the Government are protected by suspending the statute of limitations for collection for the period that an offer is pending, plus thirty days after a rejection and during an appeal of that rejection. Congress implicitly determined that this was sufficient protection to warrant withholding collection while an offer was being considered. Further, if the waiver is interpreted as including the period after acceptance of the offer, the waiver itself would continue to grow in length even after the Service no longer had the authority to extend the collection statute in this manner.

Finally, interpreting the waiver as referring only to periods prior to January 1, 2000, provides a rule of construction which can be applied in all cases and will allow both the Service and the taxpayer to know, with certainty, how much time remains on the collection statute at any given point in time. Because the waiver provision can be interpreted as of January 1, 2000, the amount of time remaining on the collection statute for all pending offers in compromise can be determined without the uncertainty that would surround post-acceptance actions by the taxpayer or the Service.

EXAMPLE 4: The offer in EXAMPLE 2, above, was accepted on June 1, 2000. Section 301.7122-1T(h)(2) acted to suspend the statute from January 1 to June 1, 2000. The collection period resumed running on June 2, 2000, and will expire on November 1, 2001.

If an offer in compromise was submitted prior to December 31, 1999, and remains pending after that date, the statute of limitation for collection under section 6502 is determined by giving effect to both the waiver of the statute of limitations for collection contained on the Form 656 and the suspension of the collection statute under section 301.7122-1T(h)(2) of the Treasury Regulations.