

# COLLECTION, BANKRUPTCY AND SUMMONSES BULLETIN

Department of the Treasury

Office of Chief Counsel

Internal Revenue Service

## ***Failure to File and Pay Sufficient to Deny Discharge***

The Eleventh Circuit held that a debtor's failure to file tax returns and pay taxes, without any other affirmative conduct to evade or defeat taxes, was sufficient to deny the debtor a discharge in bankruptcy under B.C. § 523(a)(1)(C).

In **United States v. Fretz**, 2001 U.S. App. LEXIS 4518 (11<sup>th</sup> Cir. Mar. 23, 2001), the debtor, a medical doctor, failed to file returns or pay taxes from 1982 through 1992. Despite alcohol addiction, the debtor continued to work as an emergency-room physician. He made no attempt to conceal assets or actively avoid the payment of taxes, and in 1994 voluntarily signed returns for 1982 - 1992. In 1997, the debtor filed for Chapter 7 bankruptcy, owing in excess of \$1,000,000. The bankruptcy court found that the debtor's conduct did not rise to a level of willfulness that would make the taxes nondischargeable under B.C. § 523(a)(1)(C). The district court affirmed, relying on **In re Haas**, 48 F.3d 1153 (11<sup>th</sup> Cir. 1995). Since the debtor committed no affirmative acts in an attempt to evade or defeat taxes, the district court concluded, there was no willful conduct.

On appeal, the Eleventh Circuit looked to its recent *en banc* decision of **In re Griffith**, 206 F.3d 1389 (11<sup>th</sup> Cir. 2000). The court initially determined that section 523(a)(1)(C) contains a conduct requirement (that the debtor attempt to evade or defeat a tax) and a mental requirement (that such attempt be "willful"). The court reaffirmed that, under **Haas**, a simple failure to pay taxes does not satisfy the conduct requirement. Here, the court found, the debtor's failure to file returns made his case distinguishable from the debtor in **Haas**. The court concluded that section 523(a)(1)(C) does not always require affirmative conduct, but covers both acts of commission and acts of omission. The debtor's failure to file returns, coupled with his failure to pay taxes, satisfied the conduct requirement. As to the mental state requirement, the court reiterated that the Government's burden of proof was met if the Government could show that the debtor (1) had a duty to file returns and pay taxes; (2) knew he had that duty; and (3) voluntarily and intentionally violated that duty. The court found the Government established these requirements by showing the debtor was able to function as a physician despite his alcoholism. This demonstrated the debtor had the ability to timely file his returns.

## **BANKRUPTCY CODE CASES: Exceptions to Discharge (§ 523)**

***Appeal Officer May Refuse Installment Agreement in CDP Hearing***

Disagreeing with the holding of Mesa Oil, Inc. v. United States, 2000 WL 1745280 (D. Colo. Nov. 21, 2000), the court in **Kitchen Cabinets, Inc. v. United States, 2001 U.S. Dist. LEXIS 2388 (N.D. Tex. Mar. 6, 2001)** held that the Service was not obliged to accept a proposed installment agreement that the taxpayer offered during a Collection Due Process hearing.

After receiving a Notice of Intent to Levy, the taxpayer requested, and was granted, a CDP hearing. In its request, the taxpayer offered to make installment payments, but no such request was repeated during or after the CDP hearing. The taxpayer did request time to obtain a loan, to which the Appeals Officer agreed. Following the hearing, the Appeals Officer followed up several times as to the status of the loan, and finally closed the CDP hearing. After receiving the Notice of Determination, the taxpayer filed suit, claiming the Service wrongfully refused to consider its request to pay via installment agreement.

Under the applicable abuse of discretion standard, the court found no evidence that the Appeals Officer acted arbitrarily or capriciously, and so upheld his decision. The court disagreed with the taxpayer that the Service is obligated to accept an installment agreement where there is an indication that a levy may lead to the demise of the taxpayer's business. To the extent that its holding is in conflict with the holding in Mesa Oil, the court stated that it disagreed with Mesa Oil.

**COLLECTION DUE PROCESS**

## CASES

1. **BANKRUPTCY CODE CASES: Exceptions to Discharge  
TRANSFEREES & FRAUDULENT CONVEYANCES: Uniform Fraudulent Conveyance Act**  
**United States v. Westley, 87 AFTR2d ¶ 2001-683 (6<sup>th</sup> Cir. Mar. 21, 2001)(unpublished)**- Taxpayer shareholders received a distribution of corporate assets that liquidated their corporation. The Service tried to collect the corporation's outstanding tax liability by bringing an action under the Uniform Fraudulent Conveyance Action to establish transferee liability. The district court determined the distribution to be constructively fraudulent, which the taxpayers did not contest. However, the Sixth Circuit found that such a determination did not make the taxpayers personally liable for the corporation's tax. The court held that, although a transferee can be required to return fraudulently conveyed property to satisfy an outstanding tax debt, his personal obligation is limited to the amount of the property fraudulently received. Since the Service was on notice that the taxpayers filed for bankruptcy, but did not file a proof of claim or make a request for a determination of dischargeability, B.C. § 523(a)(3)(A) did not except the debt from discharge. As the fraudulently-conveyed property is no longer in the hands of the debtors, and their personal liability was discharged in bankruptcy, the court held that the corporation's taxes no longer are collectible from the debtors.
2. **BANKRUPTCY CODE CASES: Exceptions to Discharge: No, Late or Fraudulent Returns**  
**In re Waugh, 2001 U.S. Dist. LEXIS 2246 (N.D. Tex. Feb. 28, 2001)** - Debtor claimed to have sent his 1986 tax return timely to the Service, which did not receive it. The Service did receive an unsigned copy of the 1986 return in 1989. The Service finally assessed the taxes in 1998, after the debtor's bankruptcy was closed. Since the Bankruptcy Code does not specify what constitutes a "filed" return, the court concluded that Internal Revenue law was controlling, and so that an unsigned return is not a "filed" return. Because of this, the debtor's 1986 taxes were not dischargeable under B.C. § 523(a)(1)(B)(i). The court also found the taxes nondischargeable since they qualified under B.C. § 507(a)(8)(A)(iii) as not assessed before the commencement of the case but assessable after.
3. **BANKRUPTCY CODE CASES: Statute of Limitations: On Collection After Assessment**  
**Lee v. United States, 87 AFTR2d ¶ 2001-627 (Bankr. D. Md. Jan. 31, 2001)** - After converting her bankruptcy case from Chapter 13 to Chapter 7, debtor argued that taxes assessed more than 3 years earlier were dischargeable under B.C. § 523(a)(1), because that would be the result if she had dismissed her Chapter 13 case and filed a new Chapter 7. The court agreed that, had she refiled, the taxes would be dischargeable. But she did not. Conversion from one chapter to another does not affect the date of the filing of the original petition, which is how the three year period is measured under B.C. § 507(a)(8). Thus, conversion has no effect on whether a pre-petition tax obligation is dischargeable.
4. **BANKRUPTCY CODE CASES: Statute of Limitations: On Collection After Assessment**

**In re Hoppe, 87 AFTR2d ¶ 2001-701 (Bankr. E.D. Tex. Mar. 5, 2001)** - Agreeing that the statute of limitations under B.C. § 507(a)(8) was not automatically tolled under B.C. § 108(c), the court still found under Matter of Quenzer, 19 F.3d 163 (5<sup>th</sup> Cir. 1993) that the time period could be equitably tolled under B.C. § 105. Although the debtor took no action to evade the payment of taxes, the Service had less than the 240 days provided by section 507(a)(8)(A)(ii) to collect because of the automatic stay imposed by the debtor's prior bankruptcy. The court found that tolling the statute of limitations promoted public policy and legislative intent by affording the Service a reasonable time to pursue collections.

#### 5. COLLECTION DUE PROCESS

**Dimartino v. United States, 2001 U.S. Dist. LEXIS 2295 (D. Nev. Jan. 29, 2001)** - Claiming she was denied a Collection Due Process hearing on a determination of unpaid income taxes, taxpayer sued in district court for injunctive relief. The court dismissed the suit for lack of jurisdiction, holding that under I.R.C. § 6320 and § 6330(d)(1), where the underlying matter is income tax liability, only the Tax Court has jurisdiction. Further, even if jurisdiction existed, the court found that it could not grant injunctive relief by virtue of the Anti-Injunction Act, I.R.C. § 7421(a).

#### 6. COLLECTION DUE PROCESS

**Wylie v. Commissioner, T.C. Memo 2001-65 (Mar. 20, 2001)** - By relying on a Form 4340 Certificate of Assessment and Payments to verify the proper assessment of the taxes at issue, the Appeals officer did not abuse his discretion in determining that collection action was appropriate. The court also confirmed that a taxpayer is not entitled to obtain documents or cross-examine witnesses at a CDP hearing.

#### 7. COMPROMISE & SETTLEMENT: Binding Effect

**Inverworld, Ltd. v. United States, 2001 U.S. Dist. LEXIS 3087 (D.D.C. Feb. 9, 2001)** - During appeal of a tax court case, taxpayer sent a settlement letter to the Department of Justice in February. In September, with the settlement offer still under consideration, the taxpayer sent a modified offer to an Associate Area Counsel, with a copy to an IRS revenue officer. In December, Justice accepted the original settlement offer. The taxpayer objected, but the court held that the taxpayer's modification or withdrawal was not effective because it was not sent to the offeree (Justice).

#### 8. COMPROMISE & SETTLEMENT: Refunds

**REFUNDS: Illegally Collected Property**

**SUITS: Jurisdiction**

**Roberts v. United States, 2001 U.S. App. LEXIS 3806 (Fed. Cir. Mar. 13, 2001)** - Taxpayer claimed the Service wrongfully terminated his offer-in-compromise, so he filed a claim for refund which included various contractual claims against the Government. Denied administrative relief, the taxpayer filed suit under 28 U.S.C. § 1346(a)(1) in district court, but the Government removed the suit to the Court of Federal Claims under the Tucker Act, 28 U.S.C. § 1491, as a contractual claim exceeding \$10,000. The Court of Appeals for the Federal Circuit reversed and remanded the case to district court, holding that the true nature of the case was a tax refund suit. Because the taxpayer requested a refund based on wrongfully collected taxes, and has satisfied the jurisdictional prerequisites under section 1346, the district court has jurisdiction, although the taxpayer in that forum would not be entitled to contract remedies.

**9. LIENS: Action to Quiet Title**

**In re Greenwell, Civ. No. 00-00632 SPK (D. Haw. Feb. 13, 2001)** - Court held that an action to quiet title under 28 U.S.C. § 2410 may determine lien priorities, but may not be used to determine the amount or validity of a tax assessment or lien.

**10. LIENS: Priority Over Mechanic's Liens: Residential Property**

**B&D Drywall Supply, Inc. v. I.R.S., 2001 U.S. Dist. LEXIS 2074 (E.D. Mich. Jan. 31, 2001)** - Part owner of a construction company wrongfully used the company's assets to build a personal residence. The company filed a claim against him in 1996, but the Service in 1995 had filed tax liens against the taxpayer's property. The company argued that it had priority under the Michigan Construction Lien Act, but the court disagreed, finding the company failed to establish that a contract existed between the company and the taxpayer. Without a contract, the court found the Lien Act inapplicable.

**11. PAYMENT: Installment Payments**

**McKoin v. Commissioner, T.C. Memo 2001-62 (Mar. 15, 2001)** - Taxpayer's installment agreement (for tax years 1983-1990) provided that 20% of the taxpayer's monthly gross receipts would be "applied to current year's estimated tax." It also provided that any refund would be applied to the tax liability until satisfied. The taxpayer filed a 1997 tax return, claiming an overpayment of \$4,000, which was applied to outstanding 1987 taxes. In 2000, the Service determined a deficiency in the taxpayer's 1997 tax return. The taxpayer claimed that, as the installment agreement required the Service to apply payments to the current years' tax, regardless of when that tax might be determined, the 1997 deficiency was paid by the 1997 overpayment. The court disagreed, finding that the Service was not precluded from subsequently determining a deficiency for a taxable year in respect of which an overpayment was originally claimed and allowed. The Service acted properly under the installment agreement by applying the refund under I.R.C. § 6402 to the 1987 liability.

**12. SUITS: Against United States: Wrongful Levy**

**Pereos v. United States, No. CV-N-99-478 ECR (PHA) (D. Nev. Feb. 13, 2001)** - Taxpayer brought suit claiming refund, based on a wrongful levy, under 28 U.S.C. § 1346(a)(1). The court found the taxpayer could obtain relief in an action for refund on account of a wrongful levy, finding the literal terms of the statute were met. The court further found that the Service's "Fourth Delinquency Notice" was not a notice of intent to levy, and so the Service did not comply with the 30 day requirement of I.R.C. § 6331(d)(2) before it levied against the taxpayer. The court observed that, had the Service properly and timely mailed a notice of intent to levy, the taxpayer's claim that he never received the notice would not make the levy wrongful.

**13. SUMMONSES: Defenses to Compliance**

**United States v. Brunet, 2001 U.S. App. LEXIS 3581 (6<sup>th</sup> Cir. Feb. 28, 2001) (unpublished)** - The Service issued a summons addressed to Karen Brunet and Brunet, Inc., requesting records associated with Brunet, Inc., Karen Brunet and Rickey Brunet. The Sixth Circuit affirmed enforcement of summons, finding no merit to Karen Brunet's contentions, holding: (1) although lack of possession is a defense, lack of ownership is not; (2) since the Service agreed to limit the summons to records it had not already received,

it could not be argued the Service already had the records; and (3) the Government is entitled to information that has only "potential relevance" to its investigation.

14. **SUMMONSES: Defenses to Compliance: Privileges: Attorney-Client**  
Seegerstrom v. United States, 2001 U.S. Dist. LEXIS 2944 (N.D. Cal. Feb. 7, 2001) - Service issued summonses to third-party law firm, seeking records on the formation of limited liability companies formed by the taxpayer. The Service argued that the documents in question were for the purpose of securing business advice, not legal advice, and contained non-privileged factual information from which legal advice could be redacted out. The court disagreed, finding the business advice was incorporated into the legal advice, and the non-privileged information was so interwoven that disclosure would lead to disclosure of privileged information.
15. **SUMMONSES: Defenses to Compliance: Privileges: Attorney-Client**  
Pomerantz v. United States, 2001 U.S. Dist. LEXIS 1232 (S.D. Fla. Jan. 19, 2001) - The Service sought the taxpayer's amended tax returns from her accountant which were prepared at the direction of a divorce attorney to be used by the attorney in litigation. The court found the records protected under the attorney-client and work product privileges because there was no evidence that the accountant prepared the tax returns in question for filing with the Service. Instead, the attorney only intended to use the returns to assist in determining income for the divorce proceeding.
16. **SUMMONSES: Defenses to Compliance: Other**  
United States v. Chai, 2001 U.S. App. LEXIS 2883 (10<sup>th</sup> Cir. Feb. 26, 2001) (*unpublished*) - The district court entered an order enforcing a summons against the taxpayer on January 4. On February 7, the taxpayer filed two motions challenging the court's jurisdiction, which were denied on March 3. The Service then moved to hold the taxpayer in contempt for not obeying the court's January 4 order. The court overruled the taxpayer's objections relative to a hearing on the contempt motion on April 17. The taxpayer then appealed all three orders. The Tenth Circuit, in this unpublished decision, held that the taxpayer's post-judgment motions did not toll the time for appealing the enforcement order. Even though the taxpayer argued for leniency because he acted pro se, the court dismissed his appeal as untimely.

The following material was released previously under I.R.C. § 6110.  
Portions may be redacted from the original advice.

## **CHIEF COUNSEL ADVICE**

### **TRUST FUND RECOVERY PENALTY; CO-OBLIGOR AGREEMENT; OFFER IN COMPROMISE**

CC:PA:CBS:Br2  
GL-705554-00  
November 17, 2000  
UILC: 17.10.02-00

**MEMORANDUM FOR ALBERT B. KERKHOVE**  
**ASSOCIATE AREA COUNSEL (SB/SE)**

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

**SUBJECT:** Co-obligor Agreements in Trust Fund Recovery Penalty Cases

This refers to your transmittal dated October 24, 2000, forwarding for post-review a memorandum dated October 23, 2000, from your office to the Offer in Compromise Manager in your division. This document is not to be cited as precedent.

**ISSUE:**

Whether a co-obligor agreement is required in accepting an offer in compromise of a trust fund recovery penalty from a responsible officer when another responsible officer also has been assessed a trust fund recovery penalty.

**CONCLUSION:**

A co-obligor agreement is not required in accepting an offer in compromise of a trust fund recovery penalty from a responsible officer when another responsible officer also has been assessed a trust fund recovery penalty.

**FACTS:**

The facts as presented indicate that Taxpayers A and B exercised complete control over the finances of Corporation C. Because of the actions of Taxpayers A and B, Corporation C failed

to pay employment tax liabilities. The Internal Revenue Service separately assessed trust fund recovery penalties against Taxpayers A and B pursuant to I.R.C. § 6672. Taxpayer A filed an offer in compromise as to the trust fund recovery penalty. Neither Taxpayer B nor Corporation C filed offers.

The Offer in Compromise Manager requested your advice with regard to whether the Service needs to secure a co-obligor agreement, as discussed in IRM 5.8.6.2(1), from Taxpayer B as a result of Taxpayer A's offer in compromise.

## **DISCUSSION:**

IRM 5.8.6.2(1) provides that, in the case of a joint assessment, a co-obligor agreement should be secured from the maker of the offer in order to preserve the ability to collect from the other parties to the joint assessment. Your advisory memorandum to the Offer in Compromise Manager correctly concluded that a co-obligor agreement is not necessary in this case, since there has been no joint assessment. Taxpayers A and B are each liable in his/her own capacity as responsible officers of Corporation C. See Kelly v. Lethert, 362 F.2d 629 (8<sup>th</sup> Cir. 1966). Acceptance of an offer in compromise from Taxpayer A would have no effect on the Service's ability to collect from Taxpayer B.

# **TRUST FUND RECOVERY PENALTY; REFUNDS**

CC:PA:CBS:Br3  
GL-121095-00  
UIL: 6672.00-00

January 30, 2001

MEMORANDUM FOR WILLARD N. TIMM, ASSOCIATE AREA COUNSEL (SBSE) –  
ATLANTA CC:SB:3:ATL:1

FROM: Lawrence H. Schattner  
Chief, Branch 3 (Collection, Bankruptcy Summons)

SUBJECT: Claims for Refund/Abatement of Trust Fund Recovery Penalty – Handling by Collection Technical Support Groups

This responds to your request of November 30, 2000, for our review of your proposed advice to your local Collection Technical Support Group (CTSG) on a number of issues regarding their future handling of taxpayer claims for refund/abatement of Trust Fund Recovery Penalty (TFRP) assessments, pursuant to I.R.C. § 6672. As a preliminary matter, we note that your proposed advice is directed primarily at the local CTSG's future handling of taxpayer claims for "refunds" of previously paid TFRP amounts, pursuant to the procedures and limitations described in I.R.C. §§ 6511(a), 6532(a)(1), 6672(c), and 7422(a), and of any requests for abatement of uncollected TFRP amounts for periods that are related to these pending claims for refunds, rather than to taxpayer requests for "abatement" of uncollected TFRP amounts that are entirely unrelated to any

pending claim for a refund, under parts of section 6404.<sup>1</sup> Accordingly, we suggest that you revise the subject heading of your proposed memorandum, as we have our own response, to refer to "Claims for Refund/Abatement of Trust Fund Recovery Penalties." Early in the introduction of your proposed memorandum, we also suggest that you highlight for your local CTSO that your discussion is limited to the Service's procedures for handling taxpayer claims for refund of paid TFRP amounts, and that it only addresses taxpayer requests for abatement of unpaid TFRP amounts which are related to the Service's consideration of pending TFRP refund claims. As described below, we also suggest the inclusion of similar, issue limiting clarifications in other part of your proposed advice memorandum. We now consider the issues in your memorandum, slightly out of order.

#### ISSUES 2 & 3 – RESPONDING TO THE LOSS/DESTRUCTION OF THE SERVICE'S ADMINISTRATIVE FILES RECOMMENDING ASSERTION OF TFRP

The bulk of your proposed advice memorandum is devoted to a discussion of the issue described above. With the minor refinements to your discussion listed further below, we agree with your proposed manner of handling this issue locally.

In the past two years, our office has previously opined at some length in two other advice memoranda about how the Service could respond appropriately to the loss/destruction of the Service's administrative files recommending assertion of the TFRP, in procedural contexts that are different from the refund claim circumstances described in your present proposed advice memorandum.

In an advice memorandum dated May 13, 1999, now reproduced at 1999 IRS CCA LEXIS 172, our office previously considered how the Service's Customer Service function should conduct its general project to clean-up the Service's outstanding, aged Non-Master File accounts (including many unpaid TFRP assessments) where the Service knows or has reason to suspect that the Service's original supporting administrative files have now already been destroyed as part of the Service's ordinary document retention policy. In that prior advice memorandum, we suggested that it would not be appropriate for the Service on its own initiative, apart from any particular taxpayer request for relief, and as part of an effort to address the accuracy of the Service's statement of its overall accounts receivable, to (1) investigate whether the Service's administrative file recommending assertion of the TFRP in each case had been destroyed, or (2) abate the unpaid portion of every TFRP assessment on the Service's books where the Service's TFRP file recommending assessment should have or has been destroyed, pursuant to the Service's ordinary

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<sup>1</sup> We understand that the policies and procedures for the Service's handling of taxpayer requests for abatement that are unrelated to a pending claim for refund may be quite different than the procedures for considering a claim for refund. In particular, a taxpayer's opportunity to obtain judicial review of the Service's denial of a request for abatement appears to be more limited and to lie with a different court, pursuant to section 6404(i), than the opportunities for judicial review and the courts which may consider the Service's denial of a claim for refund. If you require advice regarding the Service's procedures and policies with regards to section 6404, you should contact Branch 3 of Assistant Chief Counsel (Administrative Provisions & Judicial Practice).

document retention policy. We gave this advice because many of a taxpayer's potential grounds for or procedural means of challenging a TFRP assessment do not require the Service's original administrative file or a reconstruction thereof in order to assert a proper defense for the Government, and because many taxpayers presumably have no issue with the merits of the Service's aged TFRP assessments, even though they may not have had the means or the desire to pay these outstanding tax liabilities to date. In our second prior advice memorandum described below, we indicated that we stood by the advice memorandum of May 13, 1999, in its context.

In a second advice memorandum dated October 16, 2000, now reproduced at 2000 IRS CCA LEXIS 134, our office considered how the Appeals function and the Collection function may appropriately respond to the loss/destruction of the Service's original administrative file recommending assessment of the TFRP in the context of a Collection Due Process (CDP) hearing or "equivalent hearing" under the Collection Due Process regulation (Temp. Treas. Reg. § 301.6330-1T). In this second advice memorandum, we indicated that the Appeals function did not need the Service's TFRP assessment file in order to verify the Service's compliance with the requirements of applicable law and administrative procedures, for purposes of I.R.C. § 6330(c)(1) – that an IRS Form 4340 could be relied upon by Appeals for this purpose. We also predicted that many taxpayers would not be eligible to receive a CDP hearing or equivalent hearing regarding the existence or amount of their unpaid TFRP liabilities, because these taxpayers should already have received a prior opportunity for a conference with Appeals to dispute their liability for the TFRP.<sup>2</sup> Issues 4 and 5 of this second advice memorandum consider how the Appeals and Collection functions may respond to the loss/destruction of the Service's original TFRP recommendation files when a taxpayer is eligible to contest and has, in fact, chosen to contest the existence or amount of the taxpayer's unpaid TFRP liabilities in a CDP hearing or equivalent hearing. After considering and relying upon many of the same cases discussed in your present advice memorandum, we concluded that the Service's loss/destruction of its original administrative file recommending the TFRP is not fatal to the Service's case, that the absence of this file may affect the Service's hazards of litigation in defending the merits of its TFRP assessment, and that the Service may nevertheless often successfully reconstruct its lost/destroyed file or an adequate, alternative factual/legal basis for its old TFRP assessment at issue. We further concluded that in a CDP hearing or equivalent hearing context, the initial responsibility for deciding whether to attempt to reconstruct the Service's lost/destroyed TFRP recommendation file and how much time and resources to expend in the effort should lie with the Collection function, and that the affected Service functions, through coordination within the new SBSE structure, could also develop selection tolerances to guide them in making these future resource allocation decisions.

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<sup>2</sup> In footnote 6 to this second memorandum, we acknowledged that going forward with a levy to collect a TFRP liability which a taxpayer hoped to contest as to existence or amount in a CDP or equivalent hearing, but was ineligible to do so because of a prior opportunity for an Appeals hearing, could result in the taxpayer obtaining an opportunity to file a claim for refund and thereby obtain a hearing with regards to the existence or amount of a disputed TFRP liability. Notwithstanding this refund claim possibility, which is the subject covered by your present proposed discussion, we concluded that it would not be appropriate for the Appeals function to consider the merits of the TFRP in these issue preclusion circumstances in a CDP hearing or equivalent hearing context.

We regard your present proposed advice to your local CTSG, in the different context of considering a taxpayer's claim for refund with respect to the TFRP, as fully consistent with our two prior advice memoranda discussed above. In your present context of a taxpayer's claim for refund, a taxpayer who has filed a timely claim will frequently have put the existence and amount of the recently paid (within the last two years) TFRP liabilities at issue. In this context, there are clearly some hazards of litigation to the Service in defending its TFRP assessments when the Service's original TFRP recommendation file has been lost/destroyed. However, as you note, the Service may expend its time and resources in efforts to reconstruct the file or to develop an alternative, adequate factual/legal basis for the TFRP liability and the Service may ordinarily do so without any change in the applicable burden of proof allocation rules for the refund case. It is appropriate, as you have done, for your office to make itself available to advise your local CTSG about the TFRP hazards of litigation and the Collection function's lost file reconstruction efforts on a case by case basis. If your local CTSG considers a system of local selection tolerances to guide them in making future resource allocation decisions about the types of TFRP missing file cases where it is not likely to be cost effective to pursue file reconstruction/development efforts, then we assume your office would also be involved in assisting your local CTSG in that task, as well.

The minor refinements that we suggest you consider with regards to your discussion of issues 2 and 3 in your proposed memorandum are as follows:

- (1) On page 1, at the end of the first line of your restatement of issue 3, we suggest that you add the words "in refund claim situations" so that it is clear that you are only addressing the Service's TFRP file reconstruction efforts that are appropriate in this particular context.
- (2) On page 2, at the end of the last line of your statement of the conclusion with respect to issues 2 and 3, we suggest that you add the words "in connection with refund claims the Service intends to deny."
- (3) On page 4, on line 4 of the first paragraph discussing issues 2 and 3, we believe you intended to cite the discussion at page "15" of the Michaud opinion.
- (4) On page 7, on line 9 of the first full paragraph, we believe you intended to say "burden of proving."
- (5) On page 8, regarding your willingness to defend statement at the end of the second full paragraph, we suggest that you first consult with the Tax Division's Civil Trial Section serving your area, in order to determine whether it distinguishes between "defense" of TFRP cases with lost/destroyed files, on the one hand, and situations where the Service makes an affirmative request to pursue a suit to reduce its tax claims to judgment or to foreclose its tax liens. If the original TFRP recommendation files no longer exist, if the files have not already been reconstructed or alternatively recreated by the Service, and if the taxpayer would not be precluded by *res judicata* from attempting to contest the existence or amount of the TFRP in an affirmative action of this type, then the Civil Trial Section serving your area may believe the Service would be inappropriately shifting the onus of developing the facts to the Tax Division. If the Civil Trial Section serving your area requires the Service to recreate the lost TFRP files before making a request for the Tax

Division to bring an independent suit requesting affirmative relief of this type, then you may wish to add a footnote to this effect, along with an explanation of the Tax Division's reasons for such an approach.

- (6) Also on page 8, on the second line of the final paragraph, we suggest the line end with the words "in the refund/abatement request cases."

#### ISSUE 1 – TIME LIMIT FOR FILING CLAIMS FOR REFUND FOR TFRP

We agree with your answer – that section 6511(a) requires that a claim for refund for a TFRP liability be filed within two years of payment – and the cases you have cited for this principle. Kuznitsky v. United States, 17 F.3d 1029, 1032 (7<sup>th</sup> Cir. 1994); Clark v. United States, 76 A.F.T.R.2d 7831 (11<sup>th</sup> Cir. 1995). As you have indicated, a taxpayer (responsible person) does not file a return that establishes his liability for the TFRP, so any claim for a refund of an overpayment of the TFRP must be filed by the taxpayer within two years from the time the tax was paid, as described at the end of the first sentence of I.R.C. § 6511(a) and in Treas. Reg. § 301-6511(a)-1:(a)(2). However, we do suggest that you consider the minor modifications described below to your discussion of this issue.

In framing the issue initially, you apparently relied upon and repeated the client's wording to describe the issue. However, we find this statement of the issue a little confusing, in light of the wording and structure of section 6511(a). In place of your proposed statement of the issue on page 1 and your statement of the conclusion on page 2, we suggest you consider something along the following lines:

#### ISSUES

**Issue 1.** What is the time limit for a taxpayer (responsible person) to file a claim for refund of the trust fund recovery penalty, pursuant to section 6511(a)?

#### CONCLUSION

**Issue 1.** The trust fund recovery penalty (TFRP) is not a tax for which the taxpayer (responsible person) files a return to establish his liability. Accordingly, under section 6511(a), a claim for refund of an overpayment of the TFRP must be filed by the taxpayer no later than two years from the time the payment was made against the TFRP liability. Taxpayer claims for refund of overpayments of the TFRP are limited to those amounts paid no earlier than two years before the claim for refund is filed. A narrow exception to these limitations may exist when a taxpayer shows he was "financially disabled" during the applicable two year period, within the meaning of section 6511(h). See IRM 8.5.1.2:(2).

In addition to considering the revision described above, we also believe that you were referring to section 6511(a) on page 3, lines 5 and 17, and on page 4, lines 6 and 7.

#### ISSUE 4 – AN APPROPRIATE CTSG FORM LETTER TO ADVISE TAXPAYERS THE IRS HAS DENIED THEIR REFUND/ABATEMENT CLAIMS FOR THE TFRP

First, consistent with our introductory comments, we suggest that you revise the proposed statement of issue 4 on page 1 of your memorandum to indicate that the form letter being considered is to notify a taxpayer that the taxpayer's claim for "refund/abatement" has been disallowed.

Second, thank you again for calling to our attention several of the mistakes you found in IRM 5.7.7.7:(4) and for also providing us with an opportunity to review your proposed form letter from CTS to advise taxpayers that the Service has denied their refund/abatement claims with respect to the TFRP. Coincidentally, it happens that the Service is now in the process of updating/revising chapters 3 through 7 of IRM 5.7 and our office has been asked by the Service to comment on the new proposed drafts of these chapters of the manual. In the course of our review, we will try to correct the errors you have pointed out in the manual and we intend to suggest that the Service include a form letter (as a new exhibit to Chapter 7 of IRM 5.7.) along the lines of that you provided to us for review, with the revisions discussed further below.

Third, you make a good point on the last lines of page 9 of your memorandum that the Service should send its letters disallowing a taxpayer's claim for refund via certified or registered mail to the taxpayer. As authority for this advice, you may want to add a citation at the end of the sentence to I.R.C. § 6532(a)(1).

Fourth, we have made a few changes to the revised form letter described in the body of your proposed memorandum to provide taxpayers with notice that the Service has denied their claims for refund/abatement of the TFRP. Our revised proposed form letter for this purpose is attached hereto at the end of this memorandum as Exhibit 1. In keeping with the instruction in IRM 5.7.7.7:(4) that the Service should modify its usual Letter 1875(P) in TFRP refund disallowance cases in order to explain taxpayer rights related to section 6672 tax liabilities, our two offices have added to the typical Letter 1875(P) some further paragraphs which are intended to provide the taxpayer with a plain English notice of the taxpayer's rights and obligations to: (1) request a conference with the local office of Appeals; (2) continue the protections of section 6672(c)(1) after claim disallowance, by filing suit within 30 days of the letter disallowing the claim; and (3) cause the Service, pursuant to new I.R.C. § 6331(i), to suspend most of its otherwise allowable collection activities with respect to unpaid TFRP liabilities for periods beginning or transaction occurring after December 31, 1998, by filing a proper lawsuit seeking a refund of the TFRP paid for such periods.

You will note that our proposed Exhibit 1 strikes the following sentence that was suggested by your local CTS for this new letter to describe the information a taxpayer should submit in order to obtain a conference with the office of Appeals: "Your request must contain new or additional facts that were not previously considered, and a statement explaining why you believe the claim should be reconsidered." We believe that this proposed description of what is required of a taxpayer to obtain an Appeals conference with respect to a disallowed TFRP refund claim is not consistent with the independent review role the office of Appeals serves in these cases. See IRM 8.5.1.6.1-4; IRS Policy Statement P-8-50; Prop. Proc. Rule 601.106:(b)(4)(ii). The third paragraph of our attached Exhibit 1 contains a revised description of what we understand the taxpayer should provide to request a conference with the office of Appeals to discuss a disallowed TFRP refund claim.

We hope that the reasons for the remainder of our suggested revisions to this proposed letter will be self-explanatory from our earlier comments. This revised proposed letter should be suitable

for your local CTSG to use for its TFRP refund cases where claims for refund are denied, until the Service prescribes a national form letter for this purpose (e.g., as an exhibit to revised chapter 7 of IRM 5.7).

**EXHIBIT 1**

Person to Contact: <Name>  
Contact Telephone Number: <Number>

**CERTIFIED MAIL**

<Salutation>

We have considered your request for a refund of \$<amount> and abatement of \$<amount> assessed against you for the tax period(s) ended <date(s)>.

We assessed this amount under Internal Revenue Code section 6672 because <taxpayer name primarily responsible for the tax (e.g., the employer)> did not pay the federal <type of tax (e.g., employment, excise)> tax(es) due for the tax period(s) ended <dates>. This is your legal notice that your claim for refund and abatement is disallowed.

If you do not accept our conclusion, you may request reconsideration with the Internal Revenue Service's local office of Appeals. You should make the request for an Appeals conference within 30 days of the date of this letter. A request for an Appeals conference should describe the reasons why you do not agree with our determination and should contain identifying information regarding the tax liability you wish to discuss, along the lines contained in this letter. You should provide a statement containing your view of the facts. Please mail your request for an Appeals conference to:

<the appropriate address>

If you wish to bring suit or proceedings for the recovery of any tax, penalties, or other moneys that were paid and for which this notice of disallowance is issued, you may do so by filing such a suit with the United States District Court having jurisdiction, or the United States Court of Federal Claims. The law permits you to do this within two years of the mailing date of this letter.

Please note, however, that even if you have previously complied with the requirements of Internal Revenue Code section 6672(c)(1) up to this point, the Internal Revenue Service may initiate collection action for the remaining unpaid portion of this liability if you now fail to file suit in the appropriate court within 30 days from the date of this letter.

For any part of your unpaid section 6672 liability that arises from periods beginning or transactions occurring after December 31, 1998, the Internal Revenue Service is also required to suspend most of its otherwise allowable collection activities if you file a proper lawsuit seeking a refund with respect to your disallowed refund claim for the 6672 liability.

While the Internal Revenue Service is prohibited from collecting the unpaid portion of your liability by levy, the limitation period for the Internal Revenue Service to collect this liability is also suspended, pursuant to sections 6331(i)(5) and 6672(c)(4).

If you have any questions, please contact the person whose name and telephone number are shown above.

<Appropriate Signature Block>

**THIRD PARTY CONTACTS; PARTNERSHIPS; S CORPORATIONS**

CC:PA:CBS:Br3  
TL-N-5617-00  
UIL:57.02.00-00

January 25, 2001

MEMORANDUM FOR ASSOCIATE AREA COUNSEL (SB/SE),  
AREA 4, LOUISVILLE

FROM: Lawrence Schattner, Chief, Branch 3  
(Collection, Bankruptcy & Summons)

SUBJECT: Application of I.R.C. § 7602(c) to Flow-Through Entities

This memorandum is in response to your September 27, 2000 request for field service advice regarding the application of I.R.C. § 7602(c) to flow-through entities, such as TEFRA partnerships, non-TEFRA partnerships, and S corporations. We have coordinated this advice within the office of the Associate Chief Counsel (Procedure and Administration) and the office of the Associate Chief Counsel (Passthroughs and Special Industries). Since section 7602(c) is relevant to all audits involving flow-through entities, we agree that uniform guidance must be provided to examining agents.

**ISSUES**

1. With respect to a TEFRA partnership, how should reasonable notice in advance be provided to the taxpayer under section 7602(c)(1)?
2. With respect to a TEFRA partnership, what contacts must be reported under section 7602(c)(2).
3. With respect to a non-TEFRA partnership or an S corporation, how should reasonable notice in advance be provided to the taxpayer under section 7602(c)(1)?
4. With respect to a non-TEFRA partnership or an S corporation, what contacts must be reported under section 7602(c)(2).

**CONCLUSIONS**

1. With respect to a TEFRA partnership, reasonable notice in advance that contacts with third parties may be made should be provided by sending the appropriate Letter 3164 to the tax matters partner. If the Service is looking at transactions between the partnership and specific, identified, partners, or transactions with third parties for the benefit of specific, identified, partners, which will affect only the separate tax liability of these partners, rather than the tax liability of all of the partners, then those specific partners should also be provided advance notice of any third party contacts relating to such transactions.

2. With respect to a TEFRA partnership, contacts made with any partner are not section 7602(c) contacts because they are considered the equivalent of contacting the partnership. Contacts made with persons other than the partners, or employees of the partnership who are acting within the scope of their duties, are section 7602(c) contacts, and a record of such contacts must be made. Third-party contacts that relate to adjustments that flow through to all the partners should be recorded as contacts with respect to the partnership. Third-party contacts that relate to transactions that will affect only the separate tax liability of specific partners should be recorded as contacts with respect to those specific partners.
3. With respect to a non-TEFRA partnership or S corporation, the person(s) who should be sent advance notice of third party contacts depends on whether the examination of the entity is being conducted at the entity level or as part of the examination of a particular partner or shareholder's return. If the former, reasonable notice in advance that contacts with third parties may be made should be provided by sending the appropriate Letter 3164 to the partnership or S corporation. If the latter, then a Letter 3164 should be sent to the particular partner or shareholder whose return is being examined in addition to the Letter 3164 being sent to the partnership or S corporation.
4. With respect to a non-TEFRA partnership or S corporation, the contacts that must be reported similarly depends on whether the examination of the entity is being conducted at the entity level or as part of the examination of a particular partner or shareholder's return. If the former, contacts made with any partner or shareholder are not section 7602(c) contacts because they are considered the equivalent of contacting the partnership or S corporation. Contacts made with persons other than the partners or shareholders, or employees of the partnership or S corporation, who are acting within the scope of their employment, are section 7602(c) contacts, and a record of such contacts must be made. If the latter, then contacts with any partner or shareholder other than the particular partner or shareholder whose return is being examined should be treated as section 7602(c) contacts with respect to the particular partner or shareholder whose return is being examined. Such contacts would still be considered the equivalent of contacting the partnership or S corporation and, therefore, would not be considered section 7602(c) contacts with respect to the partnership or S corporation.

#### FACTS

In the course of providing training to Service personnel on the subject of third party contacts under I.R.C. § 7602(c), you have been asked questions about how the statute applies to flow-through entities such as partnerships (TEFRA and non-TEFRA) and S corporations. Currently, these issues are not specifically addressed in the Internal Revenue Manual, the Third Party Contacts Course book that was prepared for Examination CPEs (Catalog Number 85104L), or the Section 7602(c) - Notice of IRS Contact of Third Parties - Revised Procedures, dated November 1, 1999. Because you are seeking general guidance in this area, no specific facts were included in your request.

#### LAW & ANALYSIS

Under I.R.C. § 7602(c)(1), as enacted by RRA section 3417, an officer or employee of the Service may not contact any person other than the taxpayer with respect to the determination or collection of the tax liability of such taxpayer without providing reasonable notice in advance to the taxpayer.

The statute also requires the Service to provide the taxpayer with a record of persons contacted both periodically and upon the taxpayer's request. I.R.C. § 7602(c)(2). The congressional intent behind these requirements is to provide taxpayers with the opportunity to come forward with information before third parties are contacted and the means to address any reputational concerns arising from such contacts without impeding the ability of the Service to make those contacts that are necessary to enforce the internal revenue laws. With this intent in mind, we have adopted an interpretative approach to section 7602(c) that balances taxpayers' business and reputational interests, with third parties' privacy interests, and the Service's responsibility to administer the internal revenue laws effectively.

The first requirement of the statute is to provide "reasonable notice" in advance to the taxpayer that contacts with third parties may be made. Letters 3164 have been developed by the Service in order to comply with this requirement. In most field audit situations, either Letter 3164F or Letter 3164G should be used depending upon whether the Service needs to obtain information from third parties or to verify information that the Service has received. The second requirement, providing the taxpayer with a record of persons contacted, is accomplished in part by completing a Form 12175, Third Party Contact Report Form, and submitting it to the appropriate Third Party Contact Coordinator.

#### 1. Application of section 7602(c)(1) to TEFRA partnerships

The audit of TEFRA partnerships is conducted at the partnership (entity) level pursuant to I.R.C. § 6221 through 6234, but any resulting liability is ultimately assessed against the individual partners. The tax matters partner (TMP) is responsible for certain administrative duties during the course of the examination, including keeping the other partners informed to the extent and in the manner provided by regulations. See I.R.C. § 6223(g). Additionally, under section 6223(a), each partner whose name and address is furnished to the Service is entitled to receive notice of (1) the beginning of an administrative procedure at the partnership level with respect to partnership items, and (2) the final partnership administrative adjustment from any such proceeding.

The issuance of the Letter 3164, the advance notice of potential third party contacts, is not one of the events specified in the regulations that the TMP must provide notice of, or information with respect to, to other partners. See Temp. Treas. Reg. § 301.6223(g)-1T. However, section 7602(c)(1) requires that the Service provide "reasonable notice" in advance to the taxpayer that third party contacts may be made. Thus, the issue with respect to this first requirement under section 7602(c) is what constitutes reasonable notice to the taxpayer.

In a TEFRA partnership proceeding, the tax treatment of partnership items is at issue. Although the respective tax liabilities of the partners may be affected by the results of the partnership-level proceeding, and thus, they are parties to the proceeding, a third party contact relating to the tax treatment of partnership items is not with respect to the determination of the specific tax liability of any of the partners. Hence, the partnership should generally be viewed as the taxpayer for purposes of giving notice under section 7602(c)(1). Notice should be given to the TMP because the TMP is the statutory representative of the partnership and the partners.

Further, when the Service makes third party contacts in connection with a TEFRA partnership proceeding, any section 6103(k)(6) disclosures to third parties will generally be with respect to the partnership or possibly a DBA, e.g., the ABC Partnership or the XYZ Restaurant. It would be

unusual to make third party inquiries using the names of the individual investors/partners. To the extent that this does occur, the partner would probably be an employee of the partnership, *i.e.*, actively involved in the conduct of the partnership's business. Under those circumstances, notice to the partnership should suffice as notice to the partner/employee as well.

Finally, as is true with respect to subchapter K, the TEFRA partnership provisions sometimes adopt an entity approach and other times an aggregate approach. For the reasons set forth above, we believe that an entity approach should be adopted for purposes of applying the notice requirements under section 7602(c) to TEFRA partnerships.

For purposes of providing notice under section 7602(c), differentiating between certain classes of partners would be inappropriate. Regardless of the status or position of the partner, the business and reputational interests arising from the making of third party contacts would be the same for all partners. Hence, the Service should either give notice to all partners or none of the partners (except the TMP). The rules regarding notice partners only apply with respect to the NBAP and the FPAA, neither of which is at issue here. Notifying all partners of third party contacts could be quite burdensome for the Service, particularly if there are a large number of partners, or there are tiers, etc. Additionally, this burden would be exacerbated by the administrative decision to generally provide notice before each separate third party contact, to the extent that different information is being sought or verified. Consequently, this could pose resource problems and would not be an efficient way to administer the internal revenue laws.

In contrast, if the Service is looking at transactions between the partnership and specific partners, or transactions with third parties for the benefit of specific partners that will affect the separate tax liability of those partners and not the tax liability of all of the partners, then the advance notice should also be provided to those specific partners. In this situation, contacts are being made with respect to the determination of the separate tax liabilities of specific, identified, partners. Therefore, the appropriate Letter 3164 should be provided to those partners before any such contacts are made.

## 2. Application of section 7602(c)(2) to TEFRA partnerships

Contacts made with the partners of a TEFRA partnership are not treated as contacts with persons other than the taxpayer. Since a partnership is not a natural person, it can only speak or act through authorized agents or representatives. Similarly, contacts with a partnership generally must be through a natural person, *i.e.*, an individual. By virtue of their owning a partnership interest, the partners are afforded certain rights and charged with certain responsibilities relating to the partnership by state laws such as the Uniform Partnership Act and the Uniform Limited Partnership Act, as well as under the partnership agreement that they entered into with respect to the specific partnership of which they are a partner. In addition, in TEFRA partnerships, each partner has the right to participate in any administrative proceeding relating to the determination of the proper tax treatment of partnership items at the partnership level. I.R.C. § 6224(a). Hence, the partners may be viewed as being in privity with the partnership, at least for purposes of the administrative tax proceeding. Consequently, a contact made with any partner of a TEFRA partnership should be treated as a contact of the partnership, rather than as a third party contact. Therefore, Service employees need not complete a Form 12175 with respect to contacts made with partners. However, in the situation where the contact relates solely to a particular partner's separate tax liability and not to flow-through items that affect all of the partners, a Form 12175

should be completed concerning that contact even if that contact is made with another partner. For these purposes, the particular partner whose tax liability is at issue should be treated as the taxpayer.

In this regard, contacts made with current officers, employees, or fiduciaries of the taxpayer, who are acting within the scope of their employment or relationship with the taxpayer, are not considered contacts with persons other than the taxpayer. See Prop. Treas. Reg. § 301.7602-2. Thus, it is only necessary to prepare a record of contacts on Form 12175 regarding contacts made with persons other than the partners, or employees of the partnership who are acting within the scope of their employment. Such record must be provided to partners upon their request. The periodic record of contacts may be sent to the TMP, as the statutory representative of the partnership and the partners.

### 3. Application of section 7602(c)(1) to non-TEFRA partnerships and S corporations

While non-TEFRA partnerships and S corporations file information returns at the entity level, there is no statutorily mandated unified examination at the entity level as prescribed under section 6221 for TEFRA partnerships and under former section 6241 for S corporations. Nonetheless, as a practical matter, both prior to the effective date of TEFRA, as well as with respect to non-TEFRA entities currently, the Service often conducts an examination at the entity level and then applies the results as part of the audit of the tax returns of the partners or shareholders. Other times, however, the Service may examine the entity's return in connection with its examination of the tax return of a particular partner or shareholder. Under either approach there generally is only one examination conducted of the entity's return; a separate examination of the entity's return is not normally conducted with respect to each partner or shareholder whose return is being audited. Notwithstanding the above, unlike a TEFRA partnership proceeding, the partners or shareholders in a non-TEFRA partnership or S corporation do not have the right to participate in any administrative proceedings conducted at the entity level. Moreover, separate proceedings must ultimately be conducted with respect to each partner or shareholder in order for the Service to make any adjustments relating to a non-TEFRA partnership or S corporation. Thus, if the contact is made in the context of an entity-level examination, then the entity should be considered the taxpayer for purposes of section 7602(c)(1). On the other hand, if the contact is made in the context of an examination of a particular partner or shareholder's return, then both that partner or shareholder and the partnership or S corporation should be considered taxpayers for purposes of section 7602(c)(1).

With respect to satisfying the advance notice requirement, there is no TMP to serve as a representative of a non-TEFRA partnership or S corporation, as well as the partners or shareholders. Nonetheless, under state law, the entity generally has an affirmative obligation to keep its partners or shareholders informed about matters regarding the business or affairs of the entity. The Revised Uniform Partnership Act of 1994 provides that each partner and the partnership shall furnish to a partner, and to the legal representative of a deceased partner or partner under legal disability, without demand, any information concerning the partnership's business and affairs reasonably required for the proper exercise of the partner's rights and duties under the partnership agreement. With respect to S corporations and their shareholders, the corporation has a fiduciary duty to keep shareholders informed concerning matters involving the corporation. Because the entities in question are obligated to inform their beneficial owners as to information that they would reasonably require to carry out their obligations as either partners or shareholders, notice to the entity will be deemed notice to the partners and shareholders for

purposes of section 7602(c). Consequently, if an entity-level examination is being conducted, reasonable notice in advance to the partners or shareholders may be provided by sending the appropriate Letter 3164 to the partnership at the partnership address or to the S corporation at the corporation's address. However, if the examination of the entity is being done as part of the examination of a particular partner or shareholder's return, then the Letter 3164 should be sent to that particular partner or shareholder in addition to sending the Letter 3164 to the partnership or S corporation.

#### 4. Application of section 7602(c)(2) to non-TEFRA partnerships and S corporations

Under section 7602(c)(2), the issue is whether a contact with a “person other than the taxpayer” is made when a partner or shareholder is contacted with respect to adjustments to the partnership or S corporation’s return that may be flowed through to all of the partners or shareholders. Once again, the answer will depend upon whether the examination of the entity is being conducted at the entity level or as part of the examination of a particular partner or shareholder’s return. If an entity-level examination is being conducted, for the reasons discussed in connection with TEFRA partnerships, *e.g.*, entities may only speak or act through natural persons, a contact made with any partner or shareholder should be considered as a contact of the partnership or S corporation, rather than as a contact of a person other than the taxpayer. Contacts with persons other than the partners or shareholders, however, are section 7602(c) contacts, and a record of such contacts must be made and provided to the partners or shareholders upon their request. The periodic reporting requirement under section 7602(c)(2) may be met by sending the record of contacts to the partnership or the S corporation.

On the other hand, if the examination of the entity is being done as part of the examination of a particular partner or shareholder's return, then contacts with any other partner or shareholder should be treated as third party contacts, which must be recorded on a Form 12175 and reported to the partner or shareholder under examination in accordance with the periodic reporting requirement of section 7602(c)(2). In this situation, the record of contacts should be sent to the partner or shareholder whose return is being audited.

## **BANKRUPTCY; AUTOMATIC STAY; INNOCENT SPOUSE**

CC:EL:GL:Br2  
GL-705872-00

December 21, 2000

**MEMORANDUM FOR**

## ASSOCIATE AREA COUNSEL – ST. LOUIS (SMALL BUSINESS / SELF-EMPLOYED)

FROM:Joseph W. Clark

## Senior Technical Reviewer, Branch 2 (Collection, Bankruptcy & Summonses)

SUBJECT: Automatic Stay Violation: Notice of Final Determination of Denial of "Innocent Spouse" Relief

This constitutes our response to your September 15, 2000, request for advice on whether a notice of final determination denying innocent spouse relief to a taxpayer in bankruptcy constitutes a potential violation of the automatic stay. We believe that the issuance of this type of determination generally does not violate the stay.

ISSUE: Whether the issuance of a notice of final determination denying relief from joint and several liability on a joint income tax return, pursuant to I.R.C.

§ 6015, constitutes a potential violation of the stay on various actions imposed upon the filing of a bankruptcy petition, pursuant to B.C. § 362.

CONCLUSION: No. Since the issuance of a notice of final determination denying innocent spouse relief generally does not fall within any of the categories of activities proscribed by B.C. § 362(a), it generally does not constitute a stay violation.

STATUTORY BACKGROUND: The Internal Revenue Service Restructuring and Reform Act of 1998 eased the requirements for obtaining relief from joint and several liability on a tax return jointly filed by a husband and wife. The new provisions are set forth in the current version of I.R.C. § 6015.

Section 6015(b) provides that, with respect to a jointly-filed return, an individual may be partially or fully relieved of liability for an understatement of tax, if: 1) the understatement is attributable to erroneous items of the individual's spouse; 2) the spouse seeking relief establishes that in signing the return he or she did not know, and had no reason to know, that the understatement existed; 3) taking into account all the facts and circumstances, it would be inequitable to hold the spouse seeking relief liable for the deficiency in tax attributable to such understatement; and 4) relief is sought within two years of the date the Service has commenced collection activities with respect to the spouse seeking the relief. Alternative avenues of relief available to spouses filing jointly are afforded by Section 6015(c) and Section 6015(f). These provisions, respectively, limit liability for taxpayers no longer married, legally separated, or no longer living together (Section 6015(c)) and allow for potential relief on an equitable basis where subsections (b) and (c) do not afford relief (Section 6015(f)).

Once an individual or entity files a bankruptcy petition, the Bankruptcy Code imposes a stay, "applicable to all entities," against various actions. B.C.

§ 362(a). These actions are enumerated in subsections (1) through (8) of Section 362(a), and include, inter alia:

- (1) the commencement or continuation ... of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title.
  - .
  - .
  - .
- (4) any act to create, perfect, or enforce any lien against property of the estate;

- (5) 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 commencement of the case under this title;
- (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;
- .
- .
- .
- (8) the commencement or continuation of a proceeding before the United States Tax Court concerning the debtor.

B.C. § 362(a).

Section 362 also renders the stay inapplicable to certain specific activities. These include, *inter alia*, conducting audits, issuing Notices of Deficiency, and making assessments, if such activities are undertaken by “governmental units.” B.C. § 362(b)(9).

**LAW AND ANALYSIS:** Your request for advice presents the novel issue of whether a notice of final determination denying innocent spouse relief to an individual in bankruptcy violates the automatic stay.<sup>3</sup> For purposes of this memorandum, we assume that the determination is of an administrative nature, issued by the Service.

In general, the issuance of this type of administrative determination does not constitute a stay violation. Spouses who file joint tax returns are jointly and severally liable for any deficiency of tax for the period encompassed by that return, pursuant to I.R.C. § 6013(d)(3). Thus, in the innocent spouse context, a determination adverse to the individual seeking relief, while denying the relief sought, fails to have the effect of imposing any additional liability upon him or her, since the individual is already liable for the full amount of the deficiency. Thus, the determination issued by the Service arguably does not violate the automatic stay because it does not constitute action taken “against the debtor” or his or her property as is generally required under section 362(a).

Moreover, the issuance of a determination denying innocent spouse relief would not, for other reasons, violate any of the individual subsections of B.C. § 362(a). The issuance of the determination would not violate the automatic stay under section 362(a)(1) as it would not constitute a proceeding “against the debtor that was or could have been commenced before the commencement of” the bankruptcy case, or “to recover a claim against the debtor that arose before the commencement of the case.” Even if we were to agree that an administrative proceeding determining innocent spouse relief constituted a proceeding “against the debtor,” the ultimate denial of relief would not violate the stay because the proceeding which culminated in the determination would have been initiated by the debtor, rather than by someone else. The majority view in this regard is that where a given proceeding is initiated by the debtor himself or herself, the ultimate outcome of the proceeding -- regardless of whether it is favorable or unfavorable to the debtor -- does not violate the automatic stay. See, e.g., Roberts v. Commissioner, 175 F.3d

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<sup>3</sup> We are aware of no case law addressing this issue.

889 (11th Cir. 1999); Freeman v. Commissioner, 799 F.2d 1091 (5th Cir. 1986) (cases involving appeals of Tax Court cases -- since the Tax Court case was determined to have been initiated by the debtor, the appeal of the Tax Court decision was not stayed).<sup>4</sup> See also Parker v. Bain, 68 F.3d 1131 (9th Cir. 1995); Maritime Electric Co., Inc. v. United Jersey Bank, 959 F.2d 1194 (3d Cir. 1991); Jefferson Ward Stores, Inc. v. The Doody Co., 48 B.R. 276, 278 (E.D. Pa. 1985)(nontax cases in which denials of actions requested by debtors were found not to violate the stay).

Issuance of a determination denying innocent spouse liability also would not violate subsections (a)(3) or (a)(4) of Section 362, since the determination would not address or attempt to affect property of the bankruptcy estate. Nor would the determination even indirectly affect estate property since, as has previously been noted, both the spouse seeking relief and the other spouse are already jointly and severally liable for the tax at issue. By denying innocent spouse relief, the Service essentially reaffirms that liability and maintains the status quo, resulting in no impact on either the estate's assets or its liabilities.

Similarly, the determination denying innocent spouse relief would not violate the stay under subsections (a)(5) and (a)(6). The determination would have no impact on any lien against the debtor-spouse's property, rendering subsection (a)(5) inapplicable. It also would not be tantamount, in itself, to "an act to collect, assess, or recover" a claim against the individual seeking innocent spouse relief, as it would be only embody a decision, not purport to lead to imminent collection action. One possible exception to the conclusion that these subsections do not stay issuance of a determination denying innocent spouse relief might exist if the determination were issued as part of a Letter 3193, Notice of Determination Concerning Collection Actions Under Section 6320 and/or 6330, otherwise known as a Collection Due Process (CDP) determination. Innocent spouse liability may be determined as part of a CDP proceeding undertaken pursuant to I.R.C. §§ 6320 or 6330. The position of this office is that the Service should not institute any aspect of a CDP proceeding during bankruptcy, as doing so could be characterized as an act to collect a liability on the debtor's part and, thus, as a stay violation under section 362(a)(6).<sup>5</sup>

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<sup>4</sup> Under the minority view on this issue, an appeal of a Tax Court decision is stayed on the rationale that an investigation into an individual's tax liability is inherently an action taken "against" that individual, and thus a "continuation" of that proceeding, including an appeal of a Tax Court decision ruling on the individual's liability, is prohibited by section 362(a)(1). See Delpit v. Commissioner, 18 F.3d 768 (9th Cir. 1994). We think it is possible, although unlikely, that courts adopting this rationale might view the issuance of a determination of innocent spouse liability as a "continuation" of an investigation into a couple's tax liability and, analogous to the Delpit situation, as an action accordingly prohibited by the stay under section 362(a)(1). Because this appears to be an attenuated extension of what is already a minority view, however, we recommend assuming that innocent spouse determinations may be issued in bankruptcy even in districts where Delpit would apply.

<sup>5</sup> We have been told that, in many instances, the innocent spouse determination is reported on a form separate from the CDP determination and may even be sent to the taxpayer at a different time from the time the CDP determination is sent. In that

Accordingly, where the notice of final determination denying innocent spouse relief is inseparable from a CDP determination, the notice should not be issued during bankruptcy.

The legislative history relevant to the Bankruptcy Code reflects that the automatic stay was never intended to prohibit the type of action at issue here. The House Report accompanying the Bankruptcy Reform Act of 1978, through which the Bankruptcy Code was added to the United States Code, states, in pertinent part:

The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan or simply to be relieved of the financial pressures that drove him into bankruptcy.

H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 340 (1977), reprinted in 1978 U.S. Code Cong. & Ad. News 5963, 6296-97.

The type of action at issue here, issuance of a determination on innocent spouse relief, constitutes one which was precipitated by a taxpayer, and which – even if the determination is adverse and the spouse seeking relief is in bankruptcy -- has no impact on the debtor-spouse's creditors, property, or rights in bankruptcy. In this respect, it is analogous to issuance of a Notice of Deficiency, which is specifically rendered not subject to the automatic stay pursuant to B.C. § 362(b)(9)(B). A notice of final determination denying innocent spouse relief is not the type of action which was contemplated by Congress when the automatic stay provisions were included in the Bankruptcy Code. For this reason and for the other reasons discussed herein, the issuance of a determination denying innocent spouse relief would not generally constitute a violation of the automatic stay.

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event, issuance of the innocent spouse determination, in itself, clearly would not be a violation of section 362(a)(6). Of note, however, is that this division has issued Chief Counsel Advice reflecting the position that issuance of a CDP Notice, in which the taxpayer is notified of the Service's proposed action (for example, the Service's intention to levy on the taxpayer's property), and the taxpayer's right to be heard on the proposed action, is violative of the automatic stay under section 362(a)(6). See General Litigation Bulletin 476 (May 2000) at 10. Therefore, we believe that the final CDP determination may also violate the stay, as would the determination as to innocent spouse relief if it is issued within the CDP determination.