

INTERNAL REVENUE SERVICE

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MEMORANDUM FOR ASSOCIATE AREA COUNSEL
(SMALL BUSINESS / SELF-EMPLOYED) CC:SB:2:RCH

FROM: JOSEPH W. CLARK
Senior Technician Reviewer, Branch 2
(Collection, Bankruptcy & Summonses)

SUBJECT: Request for Advice on Collection from Exempt or Abandoned
Property: Are Installment Agreements Permitted?

By memorandum dated April 16, 2001, you requested our advice on whether the value of property exempted from a bankruptcy estate and subject to a federal tax lien can, following discharge, be collected by the Service by means of execution of an installment agreement with the taxpayer. ^{1/} As is discussed below, we believe that an installment agreement generally is not an appropriate mechanism for collecting the value of the exempted property.

ISSUES:

- 1) Where a bankruptcy has taken place, do the provisions of the Internal Revenue Code pertaining to installment agreements apply to an agreement to pay the value of property subject to a properly filed federal tax lien, and properly exempted from the bankruptcy estate, where the underlying tax liability has been discharged in the bankruptcy?
- 2) Is there any legal or practical reason why the Service should not allow payment, via periodic installments, equal to the value of the property subject to the lien?

CONCLUSIONS:

^{1/} Your request for advice also refers to abandoned or excluded property to which the federal tax lien attaches. For purposes of simplicity, this memorandum focuses on collection of the value of exempt property. However, we see no reason why our analysis would not also apply to realization of the value of abandoned or excluded property once the underlying tax liability on which the lien is based has been discharged in bankruptcy.

- 1) The provisions of the Code pertaining to installment agreements do not apply since the amount which is expected to be paid is based on the value of the property rather than the personal liability of the debtor, and since the underlying tax liability cannot be paid in full.
- 2) While there is no legal impediment to the Service's allowing payment via periodic installments in this situation, the practice is not encouraged due to the problems caused by the need to monitor such arrangements on a "case-by-case" basis.

LAW AND ANALYSIS:

1) Section 522 of the Bankruptcy Code permits debtors to exempt certain property from the bankruptcy estate. Section 522(c) states, in pertinent part:

Unless the [bankruptcy] case is dismissed, property exempted under this section is not liable during or after the case for any debt of the debtor that arose ... before the commencement of the case, except –

... (2) a debt secured by a lien that is –

... (B) a tax lien, notice of which is properly filed

B.C. § 522(c)(2)(B).

In the situation you present, a federal tax lien attaches to the debtor's property before he or she files a bankruptcy petition. A notice of federal tax lien is, presumably, properly filed at some point prepetition. The debtor goes into bankruptcy, properly exempting certain property from the bankruptcy estate pursuant to B.C. § 522. The tax liability on which the lien is based is discharged. Because of the discharge, the debtor is no longer personally liable for the tax liability. B.C. § 524(a). However, the lien survives the discharge. See, e.g., Johnson v. Home State Bank, 501 U.S. 78, 111 S. Ct. 2150, 115 L. Ed. 2d 266 (1991); In re Isom, 901 F.2d 744 (9th Cir. 1980); In re Dillard, 118 B.R. 89, 91-92 (Bankr. N.D. Ill. 1990)(bankruptcy discharge does not invalidate prepetition federal tax liens). See also United States v. Uria, 180 B.R. 688, 693-694 (S.D. Fla. 1995). Thus, the Service can still collect the value of any property not included in the bankruptcy estate, such as any property properly exempted, to which its lien attached prepetition. See, e.g., In re Verran, 623 F.2d 477, 479 (6th Cir. 1980) (Bankruptcy Act case); In re Leavell, 124 B.R. 535 (Bankr. S. D. Ill. 1991); B.C. § 522(c)(2)(B).

Your question pertains to the methods which the Service may employ to realize the value of the exempted property which is subject to the federal tax lien. The Service clearly has the option of either foreclosing on the lien or of levying on the property once the bankruptcy is over and the automatic stay no longer is in effect. See generally In the Matter of Davis, 170 F.3d 475, 479-480 (5th Cir. 1999)(under B.C. § 522(c)(2),

creditors can utilize collection schemes available to them prebankruptcy in realizing on their security against exempt property following the bankruptcy). You have asked whether the range of collection mechanisms available to the Service includes ensuring payment by installment agreement, such as when the taxpayer prefers to transmit the value of the property at issue in cash rather than losing the property as a result of a lien foreclosure suit or a levy.

Section 6159 of the Internal Revenue Code governs installment agreements. Section 6159(a) states:

AUTHORIZATION OF AGREEMENTS. – The Secretary is authorized to enter into written agreements with any taxpayer under which such taxpayer is allowed to satisfy liability for payment for any tax in installment payments if the Secretary determines that such agreement will facilitate collection of such liability.

I.R.C. § 6159(a)(emphasis added). Section 6159, in addition to authorizing the execution of installment agreements, includes provisions specifying the extent to which installment agreements remain in effect, the situations in which installment agreements must be entered into, and the Secretary's duty to establish procedures for independent administrative review of termination of installment agreements. See I.R.C. § 6159 (b), (c), (d).

The Treasury regulations promulgated pursuant to Section 6159 provide, in pertinent part:

... A district director, a director of a service center, or a director of a compliance center (the director) is authorized to enter into a written agreement with a taxpayer that allows the taxpayer to satisfy a tax liability by making scheduled periodic payments until the liability is fully paid if the director determines that such an installment agreement will facilitate the collection of the tax liability.

Treas. Reg. § 301.6159-1(a) (emphasis added). Like Section 6159 of the Internal Revenue Code, the regulations contain detailed provisions addressing a variety of issues related to execution and termination of installment agreements. See Treas. Reg. § 301.6159-1(b), (c), (d), (e).

We believe these authorities suggest that an installment agreement is not an appropriate collection device to employ in your situation. As indicated above, Section 6159(a) indicates that installment agreements are executed so that the taxpayer may satisfy his or her "liability for payment of any tax." However, in the situation you present, which involves collection after the tax liability has been discharged, the taxpayer no longer has any liability for the tax. Rather, only the taxpayer's "in personam" liability for the tax at issue has been extinguished by the discharge; an "in

rem” liability survives the bankruptcy. See, e.g., *In re Isom*, *supra*; *In re Dillard*, *supra*. ^{2/} Moreover, the regulations authorize an installment agreement under which the taxpayer makes periodic payments “until the liability is fully paid.” In your situation, not only does no personal liability exist following the discharge, but the liability that once existed will never be “fully paid” via realization of the value of the property exempted in the bankruptcy. In other words, because Section 6159 encompasses installment agreements which are executed to satisfy personal liabilities of taxpayers, and because such agreements generally require that the liabilities be fully paid, we do not think the type of arrangement you contemplate is within the scope of the Code’s detailed provisions pertaining to installment agreements.

2) Your second question is whether any legal or practical reason exists to preclude a taxpayer from paying, via periodic installment payments, the value of exempted property to which the federal tax lien attaches, rather than forcing the taxpayer to have the property liquidated through either a lien foreclosure action or a levy. We see no legal impediment to allowing such an “informal” arrangement in appropriate cases. ^{3/} However, payments made pursuant to this type of arrangement should not be referred to as an installment agreement under I.R.C. § 6159. Moreover, we do not encourage this practice, since taxpayer files kept open post-discharge, based on such informal agreements, would have to be monitored manually, and on a case-by-case basis, which presents a host of practical and logistical problems. Accordingly, we recommend that such arrangements be approved only in compelling situations and where payment appears likely in a relatively short period of time. ^{4/}

^{2/} In *In re Dillard*, the bankruptcy court noted that:

... [R]ights against taxpayers personally are affected by the bankruptcy discharge, but in rem lien rights are not. Because a lien holder retains ability to enforce pre-petition dischargeable obligations against the lien property even after bankruptcy discharge, the debtor’s obligation survives the discharge to the extent it is secured by the lien property.

118 B.R. at 92-93.

^{3/} This type of practice is not addressed anywhere in the Internal Revenue Code, the regulations, or the Internal Revenue Manual. As whether to enter into this type of agreement is a policy determination, we suggest that you consult and obtain the views of the appropriate National Office division of Compliance on this practice.

^{4/} As a potential alternative to an “informal” installment agreement, the Service could enter into an agreement with the taxpayer under I.R.C. § 7506(d). Under this provision, once the Service acquires the property at issue, the taxpayer can agree to pay the Service the value of the property, plus appropriate interest, and can

Thank you for requesting our advice on this matter. If you require further assistance, please contact Debbie Kohn, the attorney assigned to this file, at 202-622-3620.

ultimately have the property released to him or her.