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

OFFICE OF
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MEMORANDUM FOR AREA COUNSEL, SBSE, AREA 3, JACKSONVILLE

FROM: Mitchel S. Hyman
Senior Technician Reviewer, Branch 1
(Collection, Bankruptcy, and Summonses)

SUBJECT: Collection of Partnership Employment Taxes from an Individual Partner in Bankruptcy

This Chief Counsel Advice responds to your e-mail dated September 10, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent. This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney-client privilege. If disclosure becomes necessary, please contact this office for our views.

Your office asked for advice as to treatment of the following facts in light of the United States District Courts' adverse decisions in Briguglio[1] and Galletti[2].

You present this hypothetical: A general partner in a partnership files a bankruptcy petition. The partner holds a 50% interest in the partnership, which has not filed for bankruptcy. An assessment for delinquent employment tax liabilities has been made against the partnership, but not against the partner individually. The limitation period for making an assessment has expired.

In Briguglio and Galletti, the District Court upheld the Bankruptcy Court's decision that an assessment for employment tax liabilities against a partnership is insufficient to assert liability against the individual general partners when the individual partners file Chapter 13 bankruptcy petitions. The court rejected the Service's position that state

[1] United States v. Briguglio, 2001 U.S. Dist. LEXIS 4829, 2001-1 U.S. Tax Cas. (CCH) P50, 360 (C.D. Ca. 2001).

[2] United States v. Galletti, 2001 U.S. Dist. LEXIS 6480, 2001-1 U.S. Tax Cas. (CCH) P50, 434 (C.D. Ca. 2001).

law provides for liabilities of a partnership to flow to the individual general partners, and therefore the employment tax assessment against the partnership is sufficient to establish a valid claim as to the individual partners. For the following reasons, our office's position is that Briguglio and Galletti are incorrect, and that an assessment against the partnership is sufficient to assert liability against a partner in a bankruptcy proceeding and in other collection contexts.

ISSUE:

Whether a separate tax assessment against a general partner is required under I.R.C. § 6203 in order to file a valid proof of claim in bankruptcy against a general partner for employment tax liability incurred by the partnership?

CONCLUSION:

Separate tax assessments against general partners for the employment tax liabilities of the general partnership is not required, if a valid tax assessment has been made against the partnership.

LEGAL ANALYSIS:

Partner Liability for Partnership Assessments

The Service's longstanding position has been that the assessment against a partnership with respect to the partnership's tax liability[3] serves to establish the personal liability of any general partners. The liability is grounded in state law, which universally renders the general partners liable for partnership debts, thus permitting the Service to assert liability directly against the partner. See IRM 5.12.1.18.3; see generally, William D. Elliott, Tax Liens and Levies Involving Partners: Will a Partnership's Assets be Attached?, 14 J. Partnership Tax'n 320 (1998).

[3] We note that this issue does not arise with respect to income taxes, which flow through the partnership entity and are directly assessed against the partners. I.R.C. § 701. Instead, this issue only arises with respect to employment taxes and certain penalties and excise taxes for which the partnership entity can be directly liable with no flow-through consequences for the partners under the Internal Revenue Code.

Numerous court decisions support this position, including cases arising in the Fifth Circuit.[4] In Underwood, the district court relied upon state law to hold partners jointly and severally liable for the partnership's liabilities. Underwood v. United States, 37 F.Supp. 824, 827 (E.D. Tex. 1939), *aff'd* 118 F.2d 760 (5th Cir. 1941).[5]

In Ballard, the court held that the partner in a joint venture was personally liable for the payment of an employment tax assessment made against the partnership, thus permitting the government to levy on the partner's personal property as a method of collection. Ballard v. United States, 17 F.3d 116, 119 (5th Cir. 1994). The most recent Fifth Circuit case addressing this issue, Remington, held that state partnership law was not preempted by federal law, thus the IRS was permitted to assess and collect penalties from the partners of the taxpayer/partnership for the taxpayer's failure to collect trust fund taxes. Remington v. United States, 210 F.3d 281, 282-83 (5th Cir. 2000).

Decisions in many other jurisdictions also support this analysis. In Young v. Riddell, a partner was held liable for various partnership taxes, including excise and employment taxes, and was not named in the assessment documents. The partner paid the taxes and sued for refund. In rejecting his claim, the district court held:

> Where taxes are assessed against a partnership and under state law each member of the partnership is jointly and severally liable for the debts of the partnership, it is unnecessary and superfluous to name the individual partners in the assessment in order to create the liability; their liability arises as a matter of state law.

Young v. Riddell, 60-1 USTC (CCH) ¶ 9,381 (S.D. Cal. 1959) (unpub. op.).

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[4] The opinions predating the Fifth Circuit reorganization should apply equally to the Eleventh Circuit. While Florida had been part of the Fifth Circuit, but is now a part of the Eleventh Circuit, there is precedential value in Fifth Circuit cases decided prior to the close of business on September 30, 1981. See Bonner v. City of Pritchard, 661 F.2d 1206, 1209 (11th Cir. 1981) (en banc), *cited with approval by* King v. St. Vincent's Hospital, 502 U.S. 215, 112 S. Ct. 570, 116 L. Ed. 2d 578 (1991).

[5] In affirming the District Court, the Fifth Circuit did not expressly rely on state law liability but instead focused on the theory prevalent at that time that a partnership is not a separate entity, and therefore the United States is entitled to a lien for unpaid taxes upon all rights of property belonging to the partner as the taxpayer. Underwood, 118 F.2d at 761. A partnership is currently treated as a separate entity for some purposes, including employment tax liability.

The Ninth Circuit affirmed this holding, further stating:

> Having been found a general member of the partnership, appellant is personally liable for the debts and liabilities of the partnership, including its tax liability, even though his status as a partner was not discovered or formally noted in tax records until after termination of the partnership.

283 F.2d 909, 910 (9th Cir. 1960).

In a more recently decided case, United States v. West Production, Ltd., the United States District Court for the Southern District of New York held that the plain meaning of the New York partnership statutes makes the general partners liable for partnership debts to the Service. The court upheld the Service's decision to bring suit to recover employment taxes assessed against the partnership directly from the general partner based on state partnership law. United States v. West Production, Ltd., 2001 U.S. Dist. LEXIS 3665, 2001-1 U.S. Tax. Cas. (CCH) ¶50,358 (S.D.N.Y. 2001).

The United States Bankruptcy Court for the Middle District of Florida, Jacksonville Division decided a case similar to the hypothetical posed. In In re Ross, taxpayer filed a petition for relief under Chapter 7 of the Bankruptcy Code. The plaintiff filed both an objection to the claim and adversary proceeding against defendant United States to determine dischargeability of his partnership interest tax debts for unpaid Federal Insurance Contributions Act (FICA) and Federal Unemployment Tax Act (FUTA) taxes. The court found plaintiff liable for the taxes under the theory that the partners were personally liable for all debts of the partnership, including tax liabilities. In re Ross, 122 B.R. 462 (Bankr. M.D. Fla. 1990).

Other jurisdictions have similarly decided this issue. See e.g., Tony Thornton Auction Service, Inc. v. United States, 791 F. 2d 635 (8th Cir. 1986) (both partners were jointly and severally liable for unpaid employment taxes, even though assessments were only made in the name of the partnership and one partner); Calvey v. United States, 448 F.2d 177 (6th Cir. 1971) (inactive partner remains liable for partnership tax liability for fraud penalties where the inactive partner had no knowledge of the fraud); Livingston v. United States, 793 F. Supp. 251 (D. Id. 1992) (Service has the option of collecting partnership employment taxes by using either federal statutes or by relying on state law to establish joint and several liability); Farrow, Schidhause & Wilson v. Kings Professional Basketball Club, 88-1 USTC ¶ 9333, 1988 U.S. Dist. Lexis 17331 (E.D. Cal. 1988) (general partner need not be separately assessed for taxes in order for a tax lien and levy against partnership property to attach to the property of general partners); see also In re Robby's Pancake House of Florida, Inc., 24 B.R. 989, 997 (Bankr. Tenn. 1982); In the Matter of Crockett, 150 F. Supp. 352 (N.D. Cal. 1957).

Collection of Partnership Employment Taxes in Partner's Bankruptcy

Employers are required to deduct and withhold income and Federal Insurance Contribution Act (FICA) taxes from their employees' wages. See I.R.C. §§ 3402(a) and 3102(a). Employers are also separately liable for their share of FICA taxes as well as for Federal Unemployment Tax Act taxes (FUTA). See I.R.C. §§ 3111 and 3301. These taxes are collectively referred to as employment taxes. The employer is the person liable for payment of these employment taxes. See I.R.C. §§ 3403, 3102(b), 3111, and 3301.

The Bankruptcy Code permits any "creditor" to file a proof of claim. B.C. § 501(a). A "creditor" is an entity that has a claim against the debtor, and a claim is a "right to payment." B.C. § 101(5),(10)(A). Generally, state law provides that partners are liable jointly and severally for the debts of the partnership. See e.g., Fla. Stat. § 620.8306 (2000); Cal. Corp. Code §16306 (2001). The Service's right to payment may only be disallowed if the claim is unenforceable against the debtor and property of the debtor. B.C. § 502(b)(1).

I.R.C. § 6203 authorizes the Service to assess all taxes owed. An assessment is an administrative notation in order to establish tax liability "on the books." The recording of an assessment gives the service administrative remedies in order to collect the tax. See Laing v. United States, 423 U.S. 161, 170 n.13 (1976); United States v. Dixieland Fin'l, Inc., 594 F.2d 1311, 1312 (9th Cir. 1979); see also Michael I. Saltzman, IRS PRACTICE AND PROCEDURE ¶ 10.01 (2d ed. 1991). But the filing of an assessment is not a prerequisite to using other judicial remedies, including those available in bankruptcy actions.

However, in Briguglio and Galletti, the Bankruptcy Court held and the District Court affirmed that assessments of tax deficiencies for a partnership must be made individually against each partner as a prerequisite to collection against the general partners in bankruptcy.

The District Court affirmed the reasoning of the Bankruptcy Court, which it summarized as follows:

> [U]nder the Internal Revenue Code ("Code"), to be held liable for tax obligations, a taxpayer must be validly assessed. [Sept. 12, 2000 Order at 8 (citing IRS Code § 6203).] Under the Code, a valid assessment is made by recording the liability of the "taxpayer" in the office of the Secretary. [Id.; See § 6203.] A "taxpayer" is defined as "any person subject to any internal revenue tax." [Id.; See § 7701(a)(14).] A "person" includes "an individual, a trust, estate, partnership, association, company, or corporation." [Id.] The definitions of "taxpayer" or "person" do not include

> "partner" or "general partner." [Sept. 12, 2000 Order at 9.] The court found, however, that a general partner may be an "individual" subject to taxation. Under these definitions a partner "must be assessed individually under § 6203 before he can be liable." [Id.] The court concluded, "therefore, contrary to the IRS's argument, a partner must be assessed individually under § 6203 before he can be held liable." [Id.]

Briguglio, 2001 U.S. Dist LEXIS 4829 at *3-4.

The court asserted that several other opinions had already directly addressed this issue and had squarely decided that "a valid assessment is a prerequisite to tax collection." Briguglio, 2001 U.S. Dist. LEXIS 4829 at *15-16, *citing* El Paso Refining Inc. v. I.R.S., 205 B.R. 497 (W.D. Texas 1996); Coson v. United States, 169 F. Supp. 671 (S.D. Ca. C. Div.1958), *modified and aff'd on other grounds*, United States v. Coson, 286 F. 2d 453 (9th Cir. 1961); In re Fingers, 170 B.R. 419 (S.D. Cal. 1994). The court additionally held that the statute of limitations had run regarding the time in which the Service could separately assess the individual taxpayers, using the 3-year statute of limitations under I.R.C. § 6501(a).

Our office disagrees with both the Bankruptcy Court and the District Court's rationale. First, In re Fingers addresses an improper assessment made while the automatic stay was in effect. The facts in Fingers are not analogous to those in Briguglio and Galletti because in those cases there was nothing deficient in the partnership assessment.

Second, the courts' reliance on El Paso was misplaced. El Paso involved the issue whether a partner/debtor could avoid liens on the partner's property for partnership tax debts because the assessment against the partnership alone was insufficient to establish a tax lien as to the separate property of the partner. The issue in Briguglio and Galletti is whether a valid proof of claim may be made in a bankruptcy action based upon the partners' liability for the partnership debts under state law; the IRS is not relying on the validity of the tax lien.

Moreover, our office's position is that the courts' reliance on Coson was misplaced. In Coson, the courts rejected the proposition that an assessment made against a partnership could be effective against a limited partner for the purposes of collecting taxes from the limited partner's individual property. "[O]n the facts of this case, it is concluded that the plaintiff herein never was assessed for these taxes." Coson, 169 F.Supp. at 676. It was clear that the courts limited their holdings to the specific facts presented by Coson: the person against whom the Service sought to collect the partnership tax liability from was a *limited* partner rather than a general partner. In Briguglio and Galletti, however, the claims in bankruptcy were all made against general partners only. Therefore, Coson is distinguishable.

Finally, the courts' rejection of Young v. Riddell as controlling law is puzzling. The courts attempted to distinguish this case based upon the fact that Young addressed petitioners' demand for a refund of taxes, not collection of taxes from a partner. Briguglio at *11-12. However, Young v. Riddell specifically held that assessments against individual partners were not necessary to hold the individual partners liable for the partnership debts.

Thus, the debtors remained liable for the unpaid employment taxes under state law. The IRS properly had a "claim" against each of the debtors within the meaning of the Bankruptcy Code. See B.C. § 101(5)(A). Since the claims were not "unenforceable," they should have been allowed. See B.C. § 502(b)(1).

The decisions in Briguglio and Galletti have recently been appealed by the Department of Justice Tax Division to the Ninth Circuit Court of Appeals. The issue briefed is "whether the district court erred as a matter of law in holding that the IRS does not have an allowable claim in bankruptcy against a partner for unpaid employment taxes assessed against his partnership unless the IRS makes a separate assessment of the same tax liabilities against the partner." Final brief at 3. We are confident that the Ninth Circuit will reverse the lower courts' decisions in both Briguglio and Galletti.

Litigating Hazards

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If you have further questions, please call the attorney assigned to this case at (202) 622-3620.

[6] [redacted]