

Office of Chief Counsel
Internal Revenue Service
memorandum

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subject: **Equitable Tolling of Bankruptcy Code Section 507(a)(8)(A)(i) for period during which an Offer in Compromise is pending**

This memorandum responds to the issue, as set forth below, that has been raised with our office. 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.

ISSUE

Whether, in light of the Supreme Court's recent decision in Young v. United States, 535 U.S. 43 (2002), the principle of equitable tolling operates to suspend the 3-year "lookback" period set forth in Bankruptcy Code section 507(a)(8)(A)(i) for the time period during which a taxpayer's offer in compromise (OIC) is pending with the Service.

CONCLUSION

Notwithstanding the Supreme Court's recent decision in Young, it is our view that the principle of equitable tolling does not operate to suspend the 3-year "lookback" period in section 507(a)(8)(A)(i) for the time period during which a taxpayer's OIC is pending with the Service.

LAW & ANALYSIS

Section 507 of the Bankruptcy Code identifies certain claims that receive a priority status in bankruptcy. One of the claims identified as having priority status is a claim for income tax "for a taxable year ending on or before the date of the filing of the petition for

which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition.” I.R.C. § 507(a)(8)(A)(i). This 3-year period prior to the filing of a bankruptcy petition is often referred to as the 3-year “lookback” period. Priority tax claims, including claims satisfying the 3-year lookback period in section 507(a)(8)(A)(i), are generally excepted from discharge in bankruptcy pursuant to section 523(a)(1)(A) of the Bankruptcy Code.¹ Thus, whether certain tax claims qualify for priority status becomes important in determining the treatment of the tax claims during the bankruptcy and the ability of the Service to pursue collection of the tax liability after bankruptcy.

Outside of the bankruptcy context, section 6331(k) of the Internal Revenue Code provides another example of a statutory provision that affects the Service’s ability to collect a tax liability. More specifically, this provision operates to prohibit the Service from levying “on the property or rights to property of any person with respect to any unpaid tax—during the period that an [OIC] by such person . . . is pending with the [Service].”² We note that an OIC is considered pending when it has been accepted for processing. See I.R.C. § 6331(k); see also Treas. Reg. § 301.7122-1(d)(2) (2002).

Although the facts in Young did not involve a pending OIC, the Supreme Court’s decision did discuss the principle of equitable tolling and its application to the running of the 3-year lookback period. Young involved debtors who filed a Chapter 13 bankruptcy proceeding, moved to dismiss the proceeding, and filed a Chapter 7 proceeding the day before their Chapter 13 case was dismissed. 535 U.S. 43, 45. The Court held that the 3-year lookback period set forth in Bankruptcy Code section 507(a)(8)(A)(i) is equitably tolled “during the pendency of a prior bankruptcy petition,” thus preventing the debtors from using consecutive bankruptcy petitions to render certain tax liabilities dischargeable in their subsequent Chapter 7 proceeding. Id. at 54.

In its analysis, the Court first determined that the 3-year “lookback period is a limitations period because it prescribes a period within which certain rights . . . may be enforced.” Id. at 47. The Court then recognized the well established principle of law that limitations periods are generally subject to the remedy of equitable tolling, “unless tolling would be ‘inconsistent with the text of the relevant statute.’” Id. at 49 (quoting United States v. Beggerly, 524 U.S. 38, 48 (1998)). Also, the court noted the circumstances under which it has permitted equitable tolling, including cases where a party’s misconduct has caused another party to miss a filing deadline and where the party seeking relief has pursued available remedies. See id. at 50. The Court acknowledged, however, “that tolling might be appropriate in other cases” and that Young, as noted above, was such a case. Id.

¹ The exception to discharge provisions under section 523(a) generally apply to an individual debtor receiving a discharge under chapter 7 or 11 of the Bankruptcy Code.

² Levy is also prohibited for 30 days after rejection of an OIC and for any period during which a timely filed appeal is pending. I.R.C. § 6331(k)(1)(B).

For purposes of the issue addressed in this memorandum, Young established some important principles regarding section 507(a)(8)(A)(i) and equitable tolling. First, as stated above, the Court in Young held that the 3-year lookback period is a limitations period generally subject to equitable tolling. In addition, Young held that “nothing in the Bankruptcy Code precludes equitable tolling of the lookback period.” Id. at 47. Finally, Young established that even where it is determined that equitable tolling is not precluded by or inconsistent with applicable statutory provisions, a court must determine whether equitable tolling of the 3-year lookback period is otherwise appropriate under the circumstances of the particular case.

In view of Young and these principles, we believe there are two relevant inquiries to be made in determining whether equitable tolling operates to suspend the 3-year lookback period while a taxpayer’s OIC is pending with the Service. First, whether Young’s holding that equitable tolling of the lookback period is not precluded by any provision in the Bankruptcy Code (which holding arose in the context of tolling during the pendency of a prior bankruptcy proceeding) requires an identical result in the context of equitable tolling during the pendency of the taxpayer’s OIC. Second, even if it is determined that equitable tolling of the lookback period while an OIC is pending is not precluded by or inconsistent with any provision of the Bankruptcy Code, whether such equitable tolling is otherwise appropriate when there are options other than levy still available to the Service to protect or collect the tax liability during this period.

1. Preclusion of equitable tolling of the lookback period while an OIC is pending

Just as the lookback provision in section 507(a)(8)(A)(i) provides priority status to tax liabilities falling within the 3-year lookback period, section 507(a)(8)(A)(ii) provides priority status to liabilities assessed within 240 days prior to the filing of the bankruptcy petition. However, unlike the 3-year lookback provision, section 507(a)(8)(A)(ii) contains an express tolling provision. More specifically, section 507(a)(8)(A)(ii) provides priority status to any income tax liability that is “assessed within 240 days, plus any time plus 30 days during which an offer in compromise with respect to such tax that was made within 240 days after such assessment was pending, before the date of the filing of the petition.” Thus, section 507(a)(8)(A)(ii) expressly tolls the 240-day period for the time an OIC is pending, plus 30 days.

We note that one of the arguments asserted by the taxpayers in Young to support the argument that the 3-year lookback period is not equitably tolled during the pendency of a prior bankruptcy was that the presence of an express tolling provision in section 507(a)(8)(A)(ii), coupled with the absence of any such provision in section 507(a)(8)(A)(i), displays an intent by Congress to preclude the tolling of the 3-year lookback period. See id. at 53. As noted above, however, the Supreme Court rejected this argument and held that “nothing in the Bankruptcy Code precludes equitable tolling of the lookback period.” Id. at 47.

More specifically, the Court observed that if the presence of the express tolling provision in section 507(a)(8)(A)(ii) demonstrates anything at all, it “demonstrates that the Bankruptcy Code *incorporates* traditional equitable principles,” rather than demonstrating any intent to preclude equitable tolling of the lookback period. *Id.* at 53. In supporting this position, the Court noted that “[w]hen § 507(a)(8)(A)(ii) was enacted, it was IRS practice – though no statutory provision required it – to stay collection efforts during the pendency of an [OIC].” *Id.* Thus, according to the Court, no court would have applied equitable tolling to suspend the 240-day period during the pendency of an OIC because equitable tolling is not appropriate where the “claimant has voluntarily chosen not to protect his rights within the limitations period.” *Id.* The Court concluded that “the tolling provision in § 507(a)(8)(A)(ii) *supplements* rather than displaces principles of equitable tolling.” *Id.* In other words, the Court appears to have expressed the view that the Service’s prior practice of voluntarily refraining from collection efforts while an OIC was pending rendered necessary the enactment of the express tolling provision, set forth in section 507(a)(8)(A)(ii), as a substitute for equitable tolling.

We believe Young’s analysis regarding the express tolling provision in section 507(a)(8)(A)(ii) lends support to our view that the 3-year lookback period in section 507(a)(8)(A)(i) is not equitably tolled during the pendency of an OIC. If it is true, as Young seems to indicate, that the express tolling provision included in section 507(a)(8)(A)(ii) was intended essentially as a substitute for equitable tolling while an OIC was pending, then we believe the fact that a similar provision was not inserted into the 3-year lookback provision supports the conclusion that the 3-year lookback period is not equitably tolled while an OIC is pending. Clearly, if Congress intended for the 3-year lookback period to also be tolled during the pendency of an OIC, it could have easily provided for such tolling.³ We believe its failure to do so, in light of Congress’ inclusion of the express provision in section 507(a)(8)(A)(ii), arguably manifests an intent to preclude equitable tolling of the 3-year lookback provision while an OIC is pending. Because it is our view that equitable tolling of the 3-year lookback period while an OIC is pending is inconsistent with inclusion of the express tolling provision in section 507(a)(8)(A)(ii), we believe the principle of equitable tolling does not operate to suspend the 3-year lookback period during the pendency of an OIC. See United States v. Beggerly, 524 U.S. 38, 48 (1998)(holding that “[e]quitable tolling is not permissible where it is inconsistent with the text of the relevant statute”).

³ While we express uncertainty regarding the precise intent of Congress in enacting the priority provision currently set forth in section 507(a)(8)(A)(ii), we note the following excerpt from the legislative history:

This rule closes a loophole under present law under which, following an assessment of tax, some taxpayers have submitted a formal offer in compromise, dragged out negotiations with the taxing authority until the tax liability would lose priority under the three-year priority period of present law, and then filed in bankruptcy before the governmental unit could take collection steps.

S. REP. NO. 95-989, at 71 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5857.

Moreover, we do not believe our view conflicts with the Court's general holding in Young, as referenced above, that nothing in the Bankruptcy Code precludes equitable tolling of the 3-year lookback period. This general holding in Young arose in the context of whether equitable tolling operates to suspend the 3-year lookback period "during the pendency of a prior bankruptcy petition." Id. at 44. In contrast, the relevant issue discussed herein is whether equitable tolling operates to suspend the 3-year lookback period for the period during which the taxpayer's OIC is pending with the Service. Obviously, the issue discussed herein does not mirror the issue considered in Young. In our view, the Court's conclusion, provided in the context of prior bankruptcy proceedings, that nothing in the Bankruptcy Code precludes the equitable tolling of the lookback period may be distinguished from the issue herein and arguably does not mandate the same conclusion in the context of pending OICs.

2. Equitable tolling while OIC is pending is inappropriate

Even if it is determined that equitable tolling of the 3-year lookback period is not inconsistent with or precluded by the language of section 507(a)(8)(A)(ii), it is our view that equitable tolling may not be applied to suspend the running of the 3-year lookback period while an OIC is pending in light of options other than levy still available to the Service to protect or collect the tax liability during this period. We note that in holding that the 3-year lookback period is tolled by prior bankruptcy proceedings, the Court in Young relied, at least in part, on the fact that the automatic stay in bankruptcy prevents virtually all collection action. See id. at 50-51. For example, according to the Court,

The Youngs' Chapter 13 petition erected an automatic stay under [Bankruptcy Code] § 362, which prevented the IRS from taking steps to protect its claim. . . .

Tolling is in our view appropriate regardless of petitioners' intentions when filing back-to-back Chapter 13 and Chapter 7 petitions – whether the Chapter 13 petition was filed in good faith or solely to run down the lookback period. In either case, the IRS was *disabled* from protecting its claim during the pendency of the Chapter 13 petition, and this period of disability tolled the three-year lookback period when the Youngs filed their Chapter 7 petition.

Id. (emphasis added). The Court recognized that the automatic stay operated to "disable" the Service from any ability to protect or collect the liability.

In contrast to the disabling effect of the automatic stay, a pending OIC does not disable the Service from protecting or collecting its claim. Rather, as discussed above, the Service is merely prohibited from levying on the taxpayer's property to collect a tax liability while an OIC with respect to such tax liability is pending. See I.R.C. § 6331(k); see also Treas. Reg. 301.7122-1(g)(1). Notwithstanding section 6331(k)'s prohibition

on levy while an OIC is pending, the Service still has alternative methods available to protect or collect the tax liability. For example, the Service could file a notice of federal tax lien under I.R.C. § 6323 to perfect its secured interest in the taxpayer's property and to ensure that the Service would have a secured claim with respect to such tax liability in the event the taxpayer ultimately files a bankruptcy petition. See B.C. § 506. In addition, notwithstanding the pending OIC, the Service could levy to collect the tax liability if it determined that collection of the liability was in jeopardy or the Service could setoff an overpayment against the tax liability.⁴ See Treas. Reg. § 301.7122-1(g) (2002).

Unlike the bankruptcy automatic stay, section 6331(k), despite its prohibition on levy, does not operate to disable the Service from protecting its interest or from collecting the tax liability while an OIC is pending. As such, notwithstanding the Court's decision in Young, we believe a court would be very reluctant to apply the principle of equitable tolling to suspend the running of the 3-year lookback period while an OIC is pending. In our view, equitable tolling of the 3-year lookback period is simply not appropriate where the Service has other remedies it may exercise to protect or collect the tax liability.

If you have any questions, please contact the attorney assigned to this case at [REDACTED].

⁴We note that even if the Service, for policy reasons or any other purpose, elects to refrain from such collection options while the OIC is pending, equitable tolling of the 3-year lookback period is not appropriate in our view. As referenced earlier, the Supreme Court in Young observed that "tolling is inappropriate when a claimant has voluntarily chosen not to protect his rights within the limitations period." 535 U.S. 43, 53.