OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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MEMORANDUM FOR KENTUCKY-TENNESSEE DISTRICT COUNSEL

FROM: Kathryn A. Zuba
Chief, Branch 2 (General Litigation)

SUBJECT: Installment Agreements in Bankruptcy

This responds to your memorandum dated October 30, 1998. This document is not to be cited as precedent.

LEGEND

Taxpayer X
Taxpayer Y
Date A
Date B
Date C
Date D
Amount A
Amount B

ISSUES

1. Whether the filing of a bankruptcy petition automatically terminates an installment payment agreement between the taxpayer and the Service.

2. Whether the Treasury regulations allow the Service to terminate an installment agreement because the taxpayer has filed bankruptcy.

CONCLUSIONS

1. The filing of a bankruptcy petition does not, in and of itself, act to terminate an installment agreement between the taxpayer and the Service.

2. Under the Treasury regulations, the Service may not terminate the installment agreement of a taxpayer because he or she has filed bankruptcy.

BACKGROUND

Taxpayers X and Y filed a petition under chapter 13 of the Bankruptcy Code on Date A. The Internal Revenue Service filed a proof of claim on Date B, asserting a secured claim in the amount of Amount A, and an unsecured priority claim in the amount of Amount B. At the time of the bankruptcy filing, the taxpayers had an installment agreement with the Service. The debtors' submitted a plan in which they proposed to continue making payments to the Internal Revenue Service through their installment agreement, outside of the plan.

The taxpayers' installment agreement had been in place for nearly six years. During that time the taxpayers missed several payments which were forgiven, they defaulted on their installment agreement at least three times, and paid their installment payments with bad checks twice.

On Date C, the United States Attorney's office for the Western District of Tennessee filed an objection to the debtors' plan because the plan made no provision for payment of the Service's claim.

The debtors filed a Motion to Assume Executory Contract on Date D. Your office requested advice on whether the Government could and should object to the motion. The Chief, Branch 3 (General Litigation), advised that the motion should be opposed. In the course of this advice, he advised that it is our opinion that the filing of a bankruptcy will not automatically terminate an installment agreement between the taxpayer and the Service. Recently, you informed us that the taxpayers have conceded this point and that the Government's claims were allowed in full.

As a follow up to this advice, you have asked how the Service should treat the installment agreements of taxpayers who file for bankruptcy.

DISCUSSION

Section 6159 of the Internal Revenue Code (I.R.C. or "Code") allows the Service to enter into installment agreements to facilitate the payment of a tax. I.R.C. § 6159(a). That section not only authorizes the Service to accept such agreements, but also governs the terms, duration, and conditions under which the Service may alter or terminate them. Installment agreements generally remain in effect from the time the director signs the agreement until the agreement expires by its terms. I.R.C. § 6159(b). Under certain conditions, the Service can alter, modify, or terminate an agreement which would otherwise remain in effect. I.R.C. § 6159(b)(2)-(4). For example, section 6159(b)(3) provides that such agreements may be altered, modified, or terminated by the Service if it determines that the taxpayer's financial situation has "significantly changed."

In your memorandum, you ask whether the filing of the bankruptcy, because of its effect on the ability of the Service to enforce the agreement or collect the liability, acts as a significant change which terminates the agreement. The Code does not provide that a change in financial condition will, in and of itself, act to terminate an agreement. Rather, the Code and regulations require that a determination be made that the change warrants termination of the agreement. Pursuant to the Code, the Internal Revenue Manual (IRM) outlines the factors to be considered and procedures to be followed in reviewing the financial situation of the taxpayer. See IRM 5323. Furthermore, the regulations limit the applicability of this section to situations in which the taxpayer's financial condition has significantly improved. Treas. Reg. § 301.6159-1(c)(2)(i). There are no provisions which would allow the Service to terminate an agreement solely because of worsening financial condition, unless the director determined that collection of the tax was in jeopardy, or another grounds for termination was found to be present.

The conclusion that an agreement will not automatically terminate raises the question of whether the Service, if it complies with the requirements of Treas. Reg. § 301.6159-1, can terminate the installment agreement of a taxpayer who is in bankruptcy. In addition to requiring that a determination be made that the agreement should be terminated, the Code and regulation require that certain procedures be followed to protect the taxpayer. The taxpayer must be notified of the decision to terminate thirty days before the termination is to take effect. I.R.C. § 6159(b)(5). During this time, the taxpayer can appeal the decision or can reach an agreement with the Service which will keep the agreement in effect. See I.R.C. § 6159(d) (providing for appeal of termination); IRM 5339(1) (allowing taxpayer thirty days to come into compliance with agreement and avoid enforced collection action).

Your memorandum raises the possibility that, because this notice of termination contains a demand for payment, the termination process may violate the automatic stay provisions of the Bankruptcy Code. Section 362(a) of the Bankruptcy Code (B.C.) provides that the filing of a bankruptcy petition operates as a stay of all pre-bankruptcy legal or enforcement activity against a debtor and his assets. This includes any act to collect, assess, or recover a claim which arose against the debtor prior to the filing of the bankruptcy. B.C. § 362(a)(6). Section 362(a)(6) is intended to prevent creditors from harassing the debtor in attempts to collect on prepetition debts. See 124 Cong. Rec. H11092 (daily ed. Sept. 28, 1978); S17409 (daily ed. Oct. 6, 1978) (remarks of Rep. Edwards and Sen. DeConcini). Congress specifically referred to phoning debtors as an example of activity prohibited by section 362(a)(6). See H.R. Rep. No. 95-595, at 342, reprinted in 1978 U.S.C.C.A.N. 6298. However, a wide range of activities has been found to violate that section, such as contacting the debtor's employer, see In re Smith, 185 B.R. 871, 872-73 (Bankr. M.D. Fla. 1994), or “innocent” acts such as the continued acceptance of automatic payroll deductions which were authorized prior to the filing. See In re Hellums, 772 F.2d 37, 381 (7th Cir. 1985).

Courts have held that not all contact between creditor and debtor will violate the stay. Several circuits have held that creditors may send letters to debtors seeking reaffirmation of an otherwise dischargeable debt without violating the stay. See In re Duke, 79 F.3d 43, 46 (7th Cir. 1996); In re Brown, 851 F.2d 81, 85 (3d Cir. 1988). However, both of these courts recognized that the Bankruptcy Code embodies, in section 524, a competing policy that the debtor be free to reaffrim an otherwise dischargeable debt in exchange for the continued use of a creditor’s services. See B.C. § 524(c). No such policy is at issue in contacting a debtor regarding payment of prepetition taxes. Any contact by the Service would carry with it the threat of the Government’s considerable power to take enforced collection action and could be seen as an attempt to harass a debtor. Unlike a provider of financial services, the Government can provide no direct benefit to the debtor in exchange for his payment. Such contact, no matter how mildly worded, could reasonable be construed as an attempt to take advantage of the fact that the debtor may not be aware that collection action is stayed. See H.R. Rep. No. 95-595, supra, at 342 (expressing Congress’s concern that “[i]nexperienced, frightened, or ill-counseled debtors may succumb to suggestions to repay, notwithstanding their bankruptcy”).

The fact that the automatic stay may prevent the Service from following the procedures necessary to terminate an installment agreement will not allow the Service to dispense with the formalities and regard the agreement as terminated. One of the purposes of the automatic stay is to preserve the status quo so that all creditors can be treated fairly and equally according to the priorities of their respective claims under the Bankruptcy Code. In a chapter 13 case such as this, the Service, like any other creditor, must accept payment under the plan approved by the bankruptcy court. Because action to terminate the agreement may violate

the stay, we advise that the installment agreement be regarded as suspended during the pendency of the bankruptcy.

CONCLUSION

This office has long advised that violations of the automatic stay are to be scrupulously avoided. Because terminating an agreement could be held to violate the stay, we advise that such an agreement should be regarded as “suspended” during the pendency of the bankruptcy case.

If you have any questions or need further assistance, please contact the General Litigation attorney assigned to this case at (202) 622-3620.